Research Update:

Switzerland's City of Zurich 'AA+' Ratings Affirmed; Outlook Stable

April 24, 2020

Overview
- We expect the City of Zurich will likely stay resilient to the current recession after performing strongly in 2019 and accumulating substantial liquidity reserves due to conservative planning.
- COVID-19-related effects will burden the city’s budget in 2020 and 2021, resulting in weaker tax revenue.
- However, we expect performance to be in line with our previous forecast due to our increased confidence in stringent budget execution, with a slight debt increase and continued strong liquidity.
- We are affirming our 'AA+' long-term issuer credit rating on the city with a stable outlook.

Rating Action
On April 24, 2020, S&P Global Ratings affirmed its 'AA+' long-term issuer credit rating on the City of Zurich (Zurich-City). The outlook is stable.

Outlook
The stable outlook reflects our expectation that Zurich-City will manage the effects of COVID-19 on tax revenue through strict budget management and contain deficits at moderate levels while not substantially increasing debt, which should remain above 60% of operating revenue. We also assume that the city will maintain its cushion of cash and increased access to external liquidity sources, particularly during the COVID-19 pandemic.

Downside scenario
We could lower the ratings if the city substantially deviated from its financial policy, with deficits after capital accounts heading toward 10% of total revenue and mirroring difficulties in implementing consolidation measures to return to pre-crisis levels. In this scenario, the city would
also resume its debt accumulation.

**Upside scenario**

We could raise the ratings if Zurich-City withstood the effects of COVID-19 on its budgets with only moderate deficits after capital accounts, further cut its debt burden, and maintained a strong liquidity position, even if credit and liquidity lines are reduced.

**Rationale**

We expect COVID-19 to affect Zurich-City’s budgetary performance through lower tax revenue, but this will be in part balanced by operating and capital expenditure (capex) savings. The city should be able to manage COVID-19 well but will feel the effects into 2021, despite an expected economic rebound next year. This is primarily due to the Swiss taxation system, with advance tax payments made before down payments the following two years depending on tax bills. However, we do not expect the 2021 corporate tax reform to burden the city’s budget beyond our previous forecasts. Budgetary deficits will, in our view, lead to only moderate debt increases, while internal and access to external liquidity should remain strong. Zurich-City's management remains committed to financial targets that require, on average, a balance of past accounts, budget, and financial planning over a seven-year horizon.

The local economy provides a strong basis for local taxation. However, the constraints of a diverse socioeconomic urban population affect financial performance.

The ratings further reflect an extremely predictable and supportive institutional framework for municipalities in the Canton of Zurich (Zurich-Canton; AAA/Stable/→).

**Very strong economy, with an extremely predictable institutional framework for municipalities in the canton and management's adherence to strict financial policies**

We expect Switzerland’s and Zurich-City’s GDP to contract by 6.5% in 2020 due to the effects of COVID-19-related lockdowns on economic activity. However, we forecast it will rebound substantially to 6.3% growth in 2021, depending on the duration of the lockdown, with our current assumption being a gradual opening of economic activity starting in May 2020. Despite the effects of COVID-19, Swiss GDP per capita should remain at very high levels of about $77,750 (2020), while the city’s GDP is twice as high.

Zurich-City is the most important economic center for Switzerland, reflecting a highly diverse and dynamic economic structure, primarily in the services sector. The city’s economy is largely spurred by the financial industry (28% of value added for the local economy), which consists of different sectors such as commercial and investment banking, asset and wealth management, and insurance and reinsurance. Other important sectors include education, health, and culture. Despite the financial industry’s dominance, we do not see concentration risk because of the sector’s fragmentation and diversification, but understand structural changes in the industry will affect the city’s economy. With that said, we believe the city will need to rely on its adaptability to market and technological challenges.

We assess the institutional framework for municipalities in the Canton of Zurich as extremely predictable and supportive. This framework relies on the consensus-based approach of the canton and municipalities for structural and legal changes, avoiding unbalanced burdens for
either side. However, legally, municipalities cannot oppose changes unless there is a referendum. The latter represents a final backstop to unwanted changes for municipalities, where municipal politicians could influence voters. Due to the strong municipal autonomy, extraordinary support for municipalities might be contained and the canton would likely need to pass specific legislation to support Zurich-City in an extraordinary case, a situation we view as only theoretical. In the wake of the COVID-19 pandemic, Zurich-Canton allocated Swiss franc (CHF) 15 million of its jubilee dividend from Zuercher Kantonalbank to support small and midsize businesses. This will be managed and distributed via its municipalities including Zurich-City, which received CHF4 million for this purpose.

We assess city management as very strong, because it adapted and strengthened some cantonal regulations of the fiscal framework for municipalities and clarified measurements, time frames, and related issues (such as for the medium-term balanced budget). Furthermore, additional internal guidelines strengthen the predictability of the city's financial policy with clear targets, but also leave room for unforeseen challenges. These guidelines include a set of optional measures on budgetary flexibility ranging from adjusting the tax multiplier to cutting expenses, lowering the capex program, and setting guidelines for liquidity and debt management. We expect city management will adapt to the challenges of the COVID-19 pandemic and national corporate tax reform. We also expect the increased capital program to be managed reasonably by applying the defined tools, and further expect management will implement the required measures to maintain financial stability.

Budgetary performance will be impacted amid the COVID-19 pandemic, leading to a slight debt increase, but the city should maintain strong liquidity

We now have more confidence in the city's budget execution and have made positive adjustments to our previous forecast, including higher revenue and lower expenditure. However, this is mitigated by the effects of COVID-19, including expected lower tax revenue. Therefore, we expect budgetary performance to remain in line with our previous 2020 and 2021 forecasts. The burdening effects of the national corporate tax reform had already been factored into our previous forecast and pose no new threats, although this may be counterbalanced by delays to the increased multi-year investment program caused by the COVID-19 pandemic. Admittedly, there is high uncertainty regarding these factors, but generally we expect the city's management will contain deficits after capital accounts and return to pre-crisis targets.

The city closed 2019 with a surplus, albeit slightly weaker than previous years, allowing for full self-financing of capex. Improvements compared with budgets included higher revenues and lower expenses, both on the operating and capital side, amounting to CHF550 million in cash terms. Beyond the increased capex program, budgets and financial plans reflect lower operating margins, while demonstrating commitment to the balanced budget requirement (in accrual terms including depreciation). Financial plans remain unaltered, including a forecast tax revenue increase in 2020, followed by stagnant tax revenue until 2023 due to the effects of the cantonal tax reform, with the corporate tax rate cut to 7% from 8%. We expect tax revenue to decrease about 8% and 4% in 2020 and 2021, respectively, because of the COVID-19–related lockdown of the city's economy and, therefore, lower income and profit taxes. Nontax revenue, stemming primarily from the sale of products and services at utility entities, is expected to moderately increase from 2020-2022. However, it may also be partly affected by the lockdown of the economy and depend on the extent of the recovery process. Transfers are forecast to increase from 2021-2023 related to the canton's compensational payments, which are linked to the corporate tax reform. We forecast moderate deficits after capital accounts at 2.8% of total revenue on
average in 2020-2022, despite our assumption that not all capex will be realized. A major part of
capex is budgeted for industrial services (utility entities), but also for construction and
refurbishment of hospitals, housing, and other buildings. Because of the COVID-19 pandemic,
some of this capex might be delayed, which we have not reflected in our forecasts. In our view,
pension obligations are fully funded and do not constrain Zurich-City's budgetary performance.

We expect the city will finance deficits mostly with new borrowings that will stabilize its debt
burden at a moderate 68%-70% of operating revenue until 2022. In recent years, Zurich-City has
repaid substantial debt. Direct debt and tax-supported debt is the same for the city, because all
relevant utility entities are consolidated in its balance sheet. Zurich-City has always been
welcomed by the Swiss capital market and extended its maturity profile to 2046, consistent with
the lifetime of some of its investment projects. The city has no major contingent liabilities due to
the consolidation of its utility entities in its accounts, and the minimal ones remaining have low
risk of materialization.

Zurich-City's liquidity position has improved since it entered additional credit and liquidity lines as
a precaution to mitigate unforeseen liquidity risk events. We expect the city will maintain average
minimum cash holdings of CHF200 million–CHF300 million, which covers roughly 40% of annual
debt service, excluding contracted credit and liquidity lines. Liquidity should be replenished with
short-term borrowings if it drops below planned levels. We also assess deficits will primarily be
covered by new borrowings, which we expect to remain moderate. For managing liquidity,
Zurich-City has access to contracted and committed liquidity and credit lines in substantial
amounts, which support its debt-service coverage ratio. Slightly lower debt service and
substantially improved liquidity increase debt-service coverage to slightly below 200%. However,
we expect some volatility in the coverage ratio, depending on changes in credit and liquidity lines.
Zurich-City's access to the deep and liquid Swiss franc capital market is strong. Our overall
assessment of Zurich-City's liquidity as strong takes into account existing cash, committed
undrawn credit lines, and strong access to the Swiss capital market.

Key Statistics

Table 1

Zurich (City of) Selected Indicators

<table>
<thead>
<tr>
<th>(MIL. CHF)</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020bc</th>
<th>2021bc</th>
<th>2022bc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenues</td>
<td>7,912</td>
<td>7,901</td>
<td>7,847</td>
<td>7,841</td>
<td>7,969</td>
<td>8,119</td>
</tr>
<tr>
<td>Operating expenditures</td>
<td>6,863</td>
<td>6,847</td>
<td>6,862</td>
<td>7,183</td>
<td>7,241</td>
<td>7,348</td>
</tr>
<tr>
<td>Operating balance</td>
<td>1,049</td>
<td>1,055</td>
<td>985</td>
<td>659</td>
<td>728</td>
<td>772</td>
</tr>
<tr>
<td>Operating balance (% of operating revenues)</td>
<td>13.3</td>
<td>13.3</td>
<td>12.6</td>
<td>8.4</td>
<td>9.1</td>
<td>9.5</td>
</tr>
<tr>
<td>Capital revenues</td>
<td>45</td>
<td>68</td>
<td>91</td>
<td>127</td>
<td>139</td>
<td>145</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>860</td>
<td>992</td>
<td>1,031</td>
<td>1,026</td>
<td>1,059</td>
<td>1,159</td>
</tr>
<tr>
<td>Balance after capital accounts</td>
<td>234</td>
<td>131</td>
<td>46</td>
<td>(240)</td>
<td>(192)</td>
<td>(243)</td>
</tr>
<tr>
<td>Balance after capital accounts (% of total revenues)</td>
<td>2.9</td>
<td>1.6</td>
<td>0.6</td>
<td>(3.0)</td>
<td>(2.4)</td>
<td>(2.9)</td>
</tr>
<tr>
<td>Debt repaid</td>
<td>943</td>
<td>798</td>
<td>505</td>
<td>620</td>
<td>680</td>
<td>680</td>
</tr>
<tr>
<td>Gross borrowings</td>
<td>709</td>
<td>548</td>
<td>620</td>
<td>880</td>
<td>880</td>
<td>830</td>
</tr>
</tbody>
</table>
Table 1

Zurich (City of) Selected Indicators (cont.)

<table>
<thead>
<tr>
<th>(Mil. CHF)</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020bc</th>
<th>2021bc</th>
<th>2022bc</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance after borrowings</td>
<td>(34)</td>
<td>(157)</td>
<td>123</td>
<td>(1)</td>
<td>8</td>
<td>(93)</td>
</tr>
<tr>
<td>Direct debt (outstanding at year-end)</td>
<td>5,907</td>
<td>5,597</td>
<td>5,107</td>
<td>5,367</td>
<td>5,567</td>
<td>5,717</td>
</tr>
<tr>
<td>Direct debt (% of operating revenues)</td>
<td>74.7</td>
<td>70.8</td>
<td>65.1</td>
<td>68.4</td>
<td>69.9</td>
<td>70.4</td>
</tr>
<tr>
<td>Tax-supported debt (outstanding at year-end)</td>
<td>5,907</td>
<td>5,597</td>
<td>5,107</td>
<td>5,367</td>
<td>5,567</td>
<td>5,717</td>
</tr>
<tr>
<td>Tax-supported debt (% of consolidated operating revenues)</td>
<td>74.7</td>
<td>70.8</td>
<td>65.1</td>
<td>68.4</td>
<td>69.9</td>
<td>70.4</td>
</tr>
<tr>
<td>Interest (% of operating revenues)</td>
<td>1.7</td>
<td>1.6</td>
<td>1.2</td>
<td>1.7</td>
<td>1.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Local GDP per capita (single units)</td>
<td>168,616</td>
<td>166,424</td>
<td>168,692</td>
<td>156,796</td>
<td>165,016</td>
<td>167,478</td>
</tr>
<tr>
<td>National GDP per capita (single units)</td>
<td>80,144</td>
<td>82,525</td>
<td>81,717</td>
<td>77,751</td>
<td>81,827</td>
<td>83,048</td>
</tr>
</tbody>
</table>

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful. CHF--Swiss franc.

Ratings Score Snapshot

Table 2

Zurich (City of) Ratings Score Snapshot

<table>
<thead>
<tr>
<th>Key rating factors</th>
<th>Scores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Institutional framework</td>
<td>1</td>
</tr>
<tr>
<td>Economy</td>
<td>1</td>
</tr>
<tr>
<td>Financial management</td>
<td>1</td>
</tr>
<tr>
<td>Budgetary performance</td>
<td>2</td>
</tr>
<tr>
<td>Liquidity</td>
<td>2</td>
</tr>
<tr>
<td>Debt burden</td>
<td>3</td>
</tr>
<tr>
<td>Stand-alone credit profile</td>
<td>aa+</td>
</tr>
<tr>
<td>Issuer credit rating</td>
<td>AA+</td>
</tr>
</tbody>
</table>

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.,” published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Feb 21, 2020
In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee’s assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

### Ratings List

<table>
<thead>
<tr>
<th>Ratings Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zurich (City of)</td>
</tr>
</tbody>
</table>

Issuer Credit Rating: AA+/Stable/--
Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/S04352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.
Research Update: Switzerland's City of Zurich 'AA+' Ratings Affirmed; Outlook Stable

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