Research Update:

City of Zurich 'AA+/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- The pandemic will lead to weaker tax revenue in 2021-2023, despite the forecast rebound in economic growth.
- We believe that conservative planning and tight expenditure controls will keep deficits below the city's current financial projections.
- We affirmed our 'AA+' and 'A-1+' issuer credit ratings on the city. The outlook is stable.

Rating Action

On April 23, 2021, S&P Global Ratings affirmed its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on the City of Zurich (Zurich-City). The outlook is stable.

Outlook

The stable outlook is based on our view that the pandemic will have a manageable effect on the city's financials. We expect Zurich-City will maintain debt at current moderate levels of about 70% of operating revenue. We also assume that the city will maintain its sound cash cushion.

Downside scenario

We could lower the ratings if the city substantially deviates 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-pandemic levels. In this scenario, the city would also resume debt accumulation above our current assumptions.

Upside scenario

We could raise the ratings if Zurich-City manages to structurally reduce its debt burden

consistently below 60% of operating revenue, while maintaining high and predictable debt service coverage. In addition, more consistent visibility on financial plans could provide upside potential for the rating.

Rationale

The ratings on Zurich-City are based on the extremely predictable and supportive institutional framework for municipalities in the Canton of Zurich (AAA/Stable/--), as well as the very strong local economy, which is expected to recover quickly from the recession in 2020.

The ratings on the city also benefit from its sound budgetary performance, including moderate deficits in the next two years caused by lower expected tax revenue related to the COVID-19 pandemic. We believe that the city's prudent management will outperform its financial planning, as in previous years, and keep tax-supported debt at moderate levels.

The economic rebound in 2021 will not be followed by similar recovery in tax revenue

We expect that the Swiss economy will rebound quickly in 2021 from the recession caused by the global pandemic in 2020, with real GDP per capita forecast to expand by 3.5% and 3.0% in 2021 and 2022 respectively. This development is contingent on the number of future infections and the success of vaccinations. Zurich-City, as the most important economic center in Switzerland, will benefit from the assumed quick economic rebound, based on its highly diverse and dynamic economic structure. Unemployment stood at about 3.1% in March 2021, which is only marginally higher than the national average but very low in an international context. Despite the effects of COVID-19, Swiss GDP per capita is very high, at about €75,500 in 2021, while the city's GDP is about twice as high, providing it with a comfortable tax base.

Although we expect the economy to rebound quickly, we expect tax revenue to lag. This is primarily due to the Swiss taxation system, with advance tax payments made before final payments the following two years, depending on tax bills. Budgetary deficits will, in our view, lead to only moderate debt increases, while internal liquidity 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 institutional framework for municipalities in the Canton of Zurich is extremely predictable and supportive, in our view. It 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 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.

We assess the city's 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. Furthermore, additional internal guidelines strengthen the predictability of the city's financial policy with clear targets, but also leave room for unforeseen challenges.

Weaker budgetary performance is expected in 2021-2023

The economic effects of the COVID-19 pandemic will lead to lower tax revenue in the years to come, since the Swiss taxation system spreads tax payments--depending on the source--over up to two years. We therefore expect Zurich-City to achieve lower operating surpluses in our base-case years, including 2023, than the 12.6%-13.3% growth surplus seen in 2018 and 2019. In 2020, the city managed to achieve a significantly lower deficit after capital accounts than budgeted, despite the pandemic, reflecting sound expenditure controls and lower capital investments. We expect financial management will continue to achieve savings each budget year, which should outperform the city's very conservative financial planning and--if fully realized--lead to 10%-15% deficits after capital accounts. The multi-year investment program is unlikely to be executed in full as budgeted, which, alongside pandemic-related delays, leads us to assume in our base-case scenario that the city will once again outperform its plans significantly. However, we expect moderate deficits after capital accounts of 1.5%-5.0% per year.

We are convinced that financial management might implement additional savings measures if deemed necessary, since the strict budgetary guidelines include a set of optional actions--such as adjusting the tax multiplier, cutting expenses, and delaying the capital expenditure program--to maintain financial stability. We do not believe that the upcoming municipal elections in first-quarter 2022 will alter these very prudent financial policies.

We expect the city will finance its deficits over 2021-2023 mostly with new borrowings that will stabilize its debt burden at a moderate 70%-75% of operating revenue. In the pre-pandemic years, Zurich-City created financial headroom by repaying some direct debt. We note that all relevant utility entities are consolidated in its balance sheet, equalizing direct and tax-supported debt and considerably reducing contingent liabilities.

Zurich-City enjoys strong access to the deep and liquid Swiss capital market. In 2020, the city managed to place a bullet bond with a maturity of 40 years at no interest cost, reflecting the strong demand for its securities. We expect the city will maintain average minimum cash holdings of Swiss franc (CHF) 200 million-CHF300 million. Zurich-City's own cash reserves are therefore relatively low, with debt-service coverage for the next 12 months below 40%. When including liquidity lines contracted, debt service coverage increases considerably, depending on the use of cash-pooling with third parties. The city uses these arrangements as a precaution to mitigate unforeseen liquidity risk events, but they also introduce potential volatility in the coverage ratio. Our overall assessment of Zurich-City's liquidity as strong considers existing cash, committed undrawn credit lines, and strong access to the Swiss capital market.

Key Statistics

Table 1

Zurich (City of) Selected Indicators

(Mil. CHF)	2017	2018	2019	2020	2021bc	2022bc	2023bc
Operating revenues	7,912	7,901	7,847	7,748	7,920	7,969	8,260
Operating expenditures	6,863	6,847	6,862	7,064	7,388	7,448	7,524
Operating balance	1,049	1,055	985	684	532	521	736
Operating balance (% of operating revenues)	13.3	13.3	12.6	8.8	6.7	6.5	8.9

Table 1

Zurich (City of) Selected Indicators (cont.)

(Mil. CHF)	2017	2018	2019	2020	2021bc	2022bc	2023bc
Capital revenues	45.1	68.4	91.4	253.0	148.0	144.8	155.3
Capital expenditures	860.1	991.7	1,030.9	1,160.2	1,067.1	1,059.2	1,018.7
Balance after capital accounts	233.5	131.2	45.7	-223.4	-387.2	-393.8	-127.1
Balance after capital accounts (% of total revenues)	2.9	1.6	0.6	-2.8	-4.8	-4.9	-1.5
Debt repaid	943	798	505	690	660	600	700
Gross borrowings	709	548	620	760	988	1,014	847
Balance after borrowings	-34.3	-156.6	123.4	-166.9	-84.0	-0.1	-0.4
Direct debt (outstanding at year-end)	5,907	5,597	5,107	5,177	5,505	5,919	6,066
Direct debt (% of operating revenues)	74.7	70.8	65.1	66.8	69.5	74.3	73.4
Tax-supported debt (outstanding at year-end)	5,907	5,597	5,107	5,177	5,505	5,919	6,066
Tax-supported debt (% of consolidated operating revenues)	74.7	70.8	65.1	66.8	69.5	74.3	73.4
Interest (% of operating revenues)	1.7	1.6	1.2	1.2	1.0	1.5	1.5
Local GDP per capita (CHF)	167,029	171,443	169,937	160,820	165,203	167,639	170,010
National GDP per capita (CHF)	81,764	84,219	84,466	81,191	83,655	86,055	87,663

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

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1
Budgetary perfomance	2
Liquidity	2
Debt burden	3
Stand-alone credit profile	aa+

Table 2

Zurich (City of) Ratings Score Snapshot (cont.)

Key rating factors	Scores
Issuer credit rating	AA+

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

- Sovereign Risk Indicators, April 12, 2021. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, April 14, 2021
- Economists Forecast Eurozone Rebound In 2021, Even After Lighter Lockdowns, Dec. 1, 2020
- Economic Research: The Eurozone Is Healing From COVID-19, Sept. 24, 2020
- Switzerland 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 21, 2020
- Comparative Statistics: European Local And Regional Government Risk Indicators, June 30, 2020
- COVID-19 Will Test The Financial Flexibility Of LRGs In Germany, Switzerland, And Austria, April 27, 2020
- Canton of Zurich 'AAA' Ratings Affirmed; Outlook Stable, Nov. 20, 2020
- Local Government Debt In Germany, Switzerland, And Austria For 2020, March 2, 2020
- Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others?, Aug. 29, 2018

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

Ratings Affirmed	
Zurich (City of)	
Issuer Credit Rating	AA+/Stable/A-1+