Research Update:

Swiss City Of Zurich Outlook Revised To Positive From Stable On Possible Debt Stabilization; 'AA+/A-1+' Ratings Affirmed

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Overview

- We believe that rising local tax revenue will benefit Zurich-City's budgetary performance despite the uncertain economic outlook in Europe.
- We believe the city could stabilize debt levels if financial management continues to significantly outperform budget plans.
- We therefore revised our outlook on Zurich-City to positive from stable and affirmed our 'AA+' long-term and 'A-1+' short-term ratings on the city.

Rating Action

On Oct. 21, 2022, S&P Global Ratings revised its outlook on the Swiss City of Zurich to positive from stable. At the same time, we affirmed our 'AA+/A-1+' issuer credit ratings on the city.

Outlook

The positive outlook reflects our view that Zurich-City might stabilize its debt ratio despite economic uncertainty. Even with subdued economic growth, we anticipate that local tax revenue will continue increasing due to the sound post-pandemic recovery and a growing population. This could enable the city to post stronger budget results, leading to a stabilized or even reduced debt burden.

Upside scenario

We could raise the rating in the next 24 months if Zurich-City stabilizes its debt ratio to levels consistently below 60% of operating revenue, while maintaining high and predicable debt-service coverage.

Downside scenario

We could revise the outlook to stable if budgetary performance did not improve enough to prevent noticeable debt accumulation. This could be the case, for instance, due to lower growth and consequently lower tax revenue. We could also affirm the ratings if management fails to exert fiscal discipline, for example by loosening expenditure controls, leading to debt staying elevated.

Rationale

We expect Zurich-City's budgetary performance to remain sound, despite challenges from reduced economic growth in Europe over the next two years. We believe that the city's financial management will outperform its budgets, reducing debt intake considerably compared with budget plans.

The ratings take into account Zurich-City's relatively large debt burden compared with that of higher-rated peers.

The ratings are also 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, generating increasing tax revenue for the city.

Most taxes stem from stable sources, limiting exposure to economic shocks

Zurich-City is the dominant economic center in Switzerland. The Swiss economy rebounded significantly after the pandemic, and is expected to achieve real GDP growth of 1.6%-2.4% from 2022-2024, despite challenges from rising energy prices and reduced growth in main trading partners. We expect the city to grow at similar rates as the national average as it has a highly diverse and dynamic economic structure. Zurich-City achieves about twice Switzerland's already-very high GDP per capita of $94,600 in 2022, providing a comfortable tax base the city might tap if politically feasible--which is currently not the case, according to our understanding. Unemployment is very low, at 1.6% in August 2022, which benefits the city because income taxes are a dominant and relatively stable revenue source. The population is growing by more than 1% per year, further adding to tax revenue growth.

Municipal elections for city government and city parliament in early 2022 did not materially alter politics, we therefore view a change Zurich-City's prudent approach to financial policies as unlikely. We understand management is committed to financial targets that require a balanced budget after capital accounts (in Swiss accounting terms) on average over a multiyear horizon and related factors. Strict budgetary guidelines include a set of facultative actions--such as adjusting the tax multiplier, cutting expense at the discretion of the government, and delaying the capital expenditure program's implementation if the financial goals are at risk.

Financial management usually achieves significant savings compared to budgeted expenditure because budgets tend to be cautiously planned. The city could, in principle, decide on the tax multiplier for key revenue sources, granting large legal flexibility, but the political goal is to keep the tax rate constant.

The institutional framework for municipalities in the Canton of Zurich is extremely predictable and supportive. It relies on the consensus-based approach of the canton and municipalities for structural and legal changes, avoiding unbalanced burdens for either side. 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 situation.

Solid budgetary performance limits debt intake

We expect Zurich-City to achieve solid operating surpluses from 2022-2024, from 8.7%-10.3%, comparable with results from 2020 and 2021. We believe it will likely outperform 2022 budgets again based on solid tax revenue growth and contained spending. We expect tax revenue to continue increasing, because income tax payments are based on the taxpayer's income in the previous two years. Any decline in economic performance is therefore likely to affect local tax revenue with a delay of one-to-two years. We therefore expect solid revenue growth to continue at least until 2023. The multiyear investment program is unlikely to be executed in full as budgeted, so we therefore expect deficits after capital accounts to remain limited, at 4%-5% of total revenue from 2023.

Zurich-City will finance its deficits expected for 2022-2024 mostly with new borrowings that will keep its direct debt above 60% by 2024. Most utility entities are consolidated in its balance sheet, equalizing direct and tax-supported debt and considerably reducing contingent liabilities in our view. Nonconsolidated participations are either minority holdings (like Flughafen Zurich) or might require only limited support from the city if needed.

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. The city is a regular issuer in domestic capital markets. In early 2022, Zurich-City issued two bonds with maturities of up to 30 years, reflecting the strong demand for its securities, and is likely to issue two bonds in 2023. About half of its debt matures after 2030, limiting the risk from interest rate increases in combination with the low share of variable rate debt (5%). All debt is in local currency.

We expect the city will maintain average minimum cash holdings of Swiss franc 200-300 million, which is low compared with annual debt service and financing requirements; the coverage for the next 12 months is usually well below 40%. When including contracted liquidity lines, debt service coverage increases considerably, depending on the use of cash pooling the city has contracted with municipality-related third parties, which adds potential volatility of the debt service coverage ratio, in our view.

Key Statistics

Table 1

City of Zurich--Selected Indicators

	--Year ended Dec. 31--					
Mil. CHF	**2019**	**2020**	**2021**	**2022bc**	**2023bc**	**2024bc**
Operating revenue	7,847.0	7,747.9	8,307.2	8,920.2	9,191.5	9,321.2
Operating expenditure	6,861.8	7,064.1	7,553.4	8,003.2	8,354.5	8,511.1
Operating balance	985.2	683.8	753.8	917.0	837.0	810.1
Operating balance (% of operating revenue)	12.6	8.8	9.1	10.3	9.1	8.7
Capital revenue	91.4	253.0	41.2	74.4	103.0	106.1

Table 1

City of Zurich--Selected Indicators (cont.)

	--Year ended Dec. 31--					
Mil. CHF	**2019**	**2020**	**2021**	**2022bc**	**2023bc**	**2024bc**
Capital expenditure	1,030.9	1,160.2	1,070.7	1,100.3	1,321.3	1,368.3
Balance after capital accounts	45.7	(223.4)	(275.7)	(108.9)	(381.3)	(452.1)
Balance after capital accounts (% of total revenue)	0.6	(2.8)	(3.3)	(1.2)	(4.1)	(4.8)
Debt repaid	505.0	690.0	730.0	780.0	761.0	500.0
Gross borrowings	620.0	760.0	675.0	631.0	1,128.0	958.0
Balance after borrowings	123.4	(166.9)	(354.3)	(265.0)	(0.0)	(0.1)
Direct debt (outstanding at year-end)	5,107.0	5,176.5	5,121.7	4,973.0	5,340.0	5,798.0
Direct debt (% of operating revenue)	65.1	66.8	61.7	55.7	58.1	62.2
Tax-supported debt (outstanding at year-end)	5,107.0	5,176.5	5,121.7	4,973.0	5,340.0	5,798.0
Tax-supported debt (% of consolidated operating revenue)	65.1	66.8	61.7	55.7	58.1	62.2
Interest (% of operating revenue)	1.2	1.2	0.9	0.8	0.8	0.9
Local GDP per capita (single units)	186,865	178,880	184,325	186,310	187,599	188,804
National GDP per capita (single units)	83,300	80,120	83,726	87,272	89,375	91,166

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. CHF--Swiss franc. N.A.--Not available.

Ratings Score Snapshot

Table 2

City of Zurich--Ratings Score Snapshot

Key rating factors	
Institutional framework	1
Economy	1
Financial management	1
Budgetary perfomance	2
Liquidity	2
Debt burden	3
Stand-alone credit profile	aa+
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, Oct. 10, 2022. Interactive version available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, Oct. 13, 2022
- Economic Research: Global Credit Conditions Downside Scenario: Recession Risks Deepen, Oct. 12, 2022
- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022
- Switzerland, Aug. 15, 2022
- Cyber Risk In A New Era: International Public Finance Is A Target, July 19, 2022
- Updated 2022 Outlook For Local And Regional Governments: Life Without Central Government Crutches, July 13, 2022
- Local Government Debt 2022: Rising Risks Keep Global Borrowing High, April 12, 2022

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; Outlook Action

	To	From
Zurich (City of)		
Issuer Credit Rating	AA+/Positive/A-1+	AA+/Stable/A-1+