Research Update:

Swiss City of Zurich Upgraded To 'AAA/A-1+' On Very Strong Overall Financials; Outlook Stable

October 20, 2023

PRIMARY CREDIT ANALYST

Ludwig Heinz
Frankfurt
+ 49 693 399 9246
ludwig.heinz
@spglobal.com

SECONDARY CONTACT

Stefan Keitel
Frankfurt
+ 49 693 399 9254
stefan.keitel
@spglobal.com

RESEARCH CONTRIBUTOR

Sagar Modve
CRISIL Global Analytical Center, an S&P affiliate, Mumbai

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Overview

- We expect that the Swiss City of Zurich (Zurich-City) will continue to post a very strong budgetary performance over 2023-2025, enabling it to maintain sound debt and liquidity metrics.
- The city will be able to remain resilient even in a more subdued macroeconomic environment, due to its exceptionally strong economy and tax base, and its prudent financial management.
- We therefore raised our long-term rating on Zurich-City to 'AAA' from 'AA+', affirmed our 'A-1+' short-term rating, and assigned a stable outlook to the long-term rating.

Rating Action

On Oct. 20, 2023, S&P Global Ratings raised its long-term issuer credit rating on the Swiss City of Zurich (Zurich-City) to 'AAA' from 'AA+'. The outlook is stable. At the same time, we affirmed the 'A-1+' short-term issuer credit rating.

Outlook

The stable outlook reflects our expectation that Zurich-City will preserve strong budgetary performance even amid subdued GDP growth, maintaining prudent financial policies and containing debt at moderate levels.

Downside scenario

We could lower the rating if the city's budgetary performance weakens significantly, due to a more expansionary spending policy or unexpected substantial tax revenue shortfalls. Such developments could also signal a less prudent financial management, if no sufficient countermeasures were to be taken.

Rationale

The upgrade reflects our expectation that Zurich-City continues to benefit from strong tax revenue in 2023-2025, outperforming its budget plans and maintaining a strong budgetary performance even in the current more muted macroeconomic environment in Switzerland. Despite lower economic growth ahead, we think the city's financial performance is set to remain resilient, not least thanks to Zurich-City's prudent financial management. We therefore think that debt increases--largely reflecting the city's ambitious investment agenda--will remain moderate and debt relative to operating revenue will remain broadly stable.

Our rating on Zurich-City continues to benefit from the city's very strong local economy, which is diversified despite the financial sector's significance. In that regard, we maintain our assumption that the city has accumulated buffers to weather a potential impact of the recently completed UBS-Credit Suisse merger on its finances. The rating also reflects the city's strong liquidity, in particular its strong access to capital market funding, and the extremely predictable and supportive institutional framework for municipalities in the Canton of Zurich (AAA/Stable/--). The rating also takes into account the city's relatively high debt level.

Zurich-City's strong local economy and prudent financial management have helped build budgetary buffers that underpin the city's financial resilience

Zurich-City is Switzerland's economic center, with GDP per capita of Swiss franc (CHF) 195,000 in 2022. We now expect the Swiss economy to expand 0.6% in 2023 and 1.2% in 2024, down from 2.6% growth seen in 2022. We expect Zurich-City's GDP will expand broadly in line with national GDP, underpinning continued robust tax revenue growth, despite the slowdown in economic growth. Moreover, we note that Zurich-City's economy is highly diversified, with leading research institutions and national and international companies in various fields, such as information technology and life sciences. Switzerland and Zurich-City consistently place prominently in international rankings regarding competitiveness and quality of life.

Zurich-City is also an international financial center. The financial sector is a pillar of the local economy and important employer, generating a high 27% of gross value added in the city. In June 2023, the merger of the two largest Swiss banks, UBS and Credit Suisse, was completed. We expect that the potential impact on the city's credit profile will be limited. The associated layoffs are unlikely to weigh on the city's finances. Switzerland's tight labor market will prevent a stark increase in unemployment; Zurich-City's unemployment rate was at a very low 1.9% in September 2023. Direct social costs are unlikely to affect the city substantially given that the Swiss unemployment insurance would first step in. The impact on income taxes is also mitigated by the regionally dispersed residency of those affected. We assume that the merger will likely have a temporary impact on corporate taxes, albeit of a manageable magnitude and partially counterbalanced by reduced intra-cantonal equalization payments.

We project tax revenue growth will continue, despite the more muted macroeconomic conditions. This is underpinned by the city's continued attractiveness as an economic center and its continuous population growth and low unemployment. These factors have, for example, contributed to a surge in the city's real estate profit tax revenue in recent years.

Zurich-City could tap its very strong tax base if needed, due to its significant financial autonomy. In the coming years, very strong (accrual) results will likely trigger discussions around tax reductions from time to time. We anticipate that the city's financial management will remain prudent, with very conservative budgeting and a track record of significant overperformance, guided by financial goals limiting, for instance, deficits in accrual terms. 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 rather constant. We think that the city would have leeway to counteract a temporary weakening of its finances, but this could prove politically difficult currently, given the strong 2022 (and expected 2023) results, and in the absence of a more severe weakening in the macroeconomic environment affecting the city.

We view the institutional framework for municipalities in the Canton of Zurich as 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. There is an intra-cantonal equalization scheme based on tax revenue strength to which Zurich-City contributes because its tax base is above the cantonal average. Zurich-City receives compensation for its costs as an urban center. 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, we think the city would have leverage to solve financial difficulties without cantonal involvement. Otherwise, the canton would likely need to pass specific legislation to support Zurich-City in an extraordinary situation.

Budgetary performance should remain solid and debt increases contained while strong funding access underpins the liquidity position

We now expect Zurich-City will continue to achieve sound operating surpluses of 10% on average over 2023-2025, even slightly higher than in our previous review. The city will likely continue to exhibit stronger-than-budgeted results, and we expect the drivers of the strong 2022 results to persist:

- Resilient tax revenue growth;
- Lower operating expenditure, particularly given a share of budgeted-for positions are not filled; and
- Underimplementation of capital expenditure.

We note that any potential economic weakening will likely affect local tax revenue with a delay of one to two years, which implies some uncertainty regarding corporate taxes. Indications for income taxes, withholding taxes of foreign nationals, and real estate profit taxes, however, remain particularly solid in our view. Further risks reflected in our base case are cost inflation, for example in personnel and material expenditure, and rising public service requirements in the growing city. However, we note that a substantial number of positions are unfilled and consumer price index inflation in Switzerland is set to moderate to an average 1.6% in 2024. Over the coming years, the city has an ambitious investment program, peaking in 2024-2025, that targets investing in schools, housing, utilities infrastructure, and net-zero-related projects. In 2022, well over 80% of budgeted capital expenditure was implemented, a high figure from a historical perspective. Incorporating a continued underimplementation, we project an overall deficit after capital accounts of 3.5% on average over 2023-2025. We view this as still moderate, despite a projected widening of deficits due to rising capital expenditure. We think that the city's tight real estate market will likely keep spending pressures for housing investment elevated over the coming years.

In our base-case scenario, debt-financing of the projected deficits will inch up tax-supported debt slightly to a moderate 61% of operating revenue by 2025, up from 57% in 2022. Zurich-City consolidates most utility entities in its balance sheet, equalizing direct and tax-supported debt and considerably reducing contingent liabilities, in our view. Unconsolidated 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 2023, Zurich-City has issued three new bonds at favorable conditions, among them its first green bond. The latest issuance, in September for CHF300 million at an 18-year maturity, carried a 1.75% coupon. This underpins the continuously strong demand for the city's securities, which we think even persists in times of heightened uncertainty and which we think has been underpinned during the pandemic and during financial market uncertainties in the first quarter of 2023. The city relies on short-term borrowing to manage liquidity needs, which we factor in our projection of the city's debt service. With an average maturity of 11.4 years, in combination with the low share of variable-rate debt (4.7%), the city will only gradually face interest rate increases. Nevertheless, we project interest payments will rise when the city refinances CHF500 million of long-term debt each year in 2024-2025. All debt is in local currency.

Debt-service coverage with free cash and contracted facilities over the next 12 months is well above 120%. We expect the city will maintain low average minimum cash holdings over the coming 12 months compared with annual debt service and financing requirements. When including contracted liquidity lines, debt-service coverage increases considerably to more than 120%. The use of cash pooling the city has contracted with municipality-related third parties could potentially add to the city's liquidity needs.

Key Statistics

Table 1

City of Zurich--Selected indicators

Mil. CHF	2020	2021	2022	2023bc	2024bc	2025bc
Operating revenue	7,747.9	8,307.2	8,978.6	9,297.4	10,035.8	9,872.7
Operating expenditure	7,064.1	7,553.4	8,191.0	8,328.0	8,895.7	9,051.3
Operating balance	683.8	753.8	787.6	969.3	1,140.0	821.4
Operating balance (% of operating revenue)	8.8	9.1	8.8	10.4	11.4	8.3
Capital revenue	253.0	41.2	201.5	103.0	103.0	104.7
Capital expenditure	1,160.2	1,070.7	1,417.8	1,334.4	1,482.7	1,451.3
Balance after capital accounts	(223.4)	(275.7)	(428.7)	(262.1)	(239.7)	(525.2)
Balance after capital accounts (% of total revenue)	(2.8)	(3.3)	(4.7)	(2.8)	(2.4)	(5.3)
Debt repaid	690.0	730.0	891.0	1,141.0	1,000.0	800.0
Gross borrowings	760.0	675.0	925.0	1,395.0	1,050.0	1,329.0
Balance after borrowings	(166.9)	(354.3)	(402.6)	6.2	(174.2)	(0.1)
Direct debt (outstanding at year-end)	5,176.5	5,121.7	5,156.3	5,410.0	5,460.0	5,989.0
Direct debt (% of operating revenue)	66.8	61.7	57.4	58.2	54.4	60.7
Tax-supported debt (outstanding at year-end)	5,176.5	5,121.7	5,156.3	5,410.0	5,460.0	5,989.0

Table 1

City of Zurich--Selected indicators (cont.)

Mil. CHF	2020	2021	2022	2023bc	2024bc	2025bc
Tax-supported debt (% of consolidated operating revenue)	66.8	61.7	57.4	58.2	54.4	60.7
Interest (% of operating revenue)	1.2	0.9	0.8	0.8	1.0	1.1
Local GDP per capita (single units)	191,134	205,339	204,087	216,951	216,698	211,516
National GDP per capita (single units)	85,568	93,080	92,869	99,468	100,611	99,187

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	Score
Institutional framework	1
Economy	1
Financial management	1
Budgetary perfomance	2
Liquidity	1
Debt burden	3
Stand-alone credit profile	aaa
Issuer credit rating	AAA

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. 9, 2023. An interactive version is 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

- Credit Conditions Europe Q4 2023: Resilience Under Pressure Amid Tighter Financial Conditions, Sept. 26, 2023
- Switzerland 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 11, 2023
- Global Ratings List: International Public Finance Entities July 2023, July 25, 2023
- Subnational Debt 2023: An Easing Burden In Germany, Austria, And Switzerland, March 2, 2023
- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 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

Upgraded; Ratings Affirmed

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

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.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.