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Research Update:

Swiss Republic and Canton of Geneva 'AA-' Rating Affirmed; Outlook Remains Negative

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Overview

- The Swiss Canton of Geneva continues to benefit from its very strong economy, favorable institutional framework, and strong financial management.
- Meanwhile, we still expect that implementing the Swiss corporate tax reform is likely to mean that the canton will receive lower corporate tax proceeds from 2020, structurally weakening its budgetary performance.
- We are affirming our 'AA-' long-term rating on the canton.
- The outlook remains negative.

Rating Action

On Nov. 3, 2017, S&P Global Ratings affirmed its 'AA-' long-term issuer credit rating on the Swiss Republic and Canton of Geneva. The outlook remains negative.

Outlook

The negative outlook reflects our view that the likelihood of a sharp increase in the canton's debt remains significant, due to its plans to undertake a large, debt-funded recapitalization of the canton's largest public pension fund, CPEG, which is facing significant unfunded pension liabilities.

We could lower the rating if the decisions taken by the canton's financial management over the next 12 months lead to a significant increase in its debt burden, with tax-supported debt significantly exceeding 180% of consolidated revenues, while unfunded pension liabilities remain well above 50% of the canton's operating revenues post recapitalization.

Upside Scenario

Conversely, we could revise the outlook on the canton to stable if we consider our downside-case scenario as less likely--reflecting a more limited impact of the potential recapitalization of CPEG on the canton's debt burden, and a stronger decrease of unfunded pension liabilities--and if the canton continues to perform in line with our current base case.

Rationale

The rating reflects our view that the Canton of Geneva will continue to benefit from an extremely predictable and supportive institutional framework, strong management, and a very strong economy. At the same time, the planned corporate tax reform will likely lead to a reduction of the canton's revenues, widening of its deficit post 2020, and ultimately a higher debt burden.

The canton's relatively low debt service coverage ratio is somewhat mitigated by its good access to a diversified pool of Swiss financial institutions.

Very strong economy, favorable framework, and strong financial management remain strengths for the canton

We view Swiss cantons' institutional framework as extremely predictable and supportive, notably because major reforms are planned well in advance and widely discussed (including the current corporate tax reform), and transparency and accountability standards are very high. Swiss cantons display a comparatively strong adequacy of revenues and expenditures, supported by equalization mechanisms. The likely compensating transfers from the Swiss Confederation under the corporate tax reform project reflects the supportiveness of the canton's institutional framework.

In addition, Geneva continues to benefit from a wealthy and diversified economy, with real GDP per capita exceeding Swiss franc (CHF) 97,000 (over $99,000) in 2016, which is very high in an international context. The impact of local GDP growth on the canton's finances is significant, since the bulk of its operating revenues is made of locally collected taxes (about 80% as of 2016).

We continue to view Geneva's financial management as strong, since we still positively view the cantonal executive's commitment to address the deterioration in budgetary performance through cost-cutting measures over recent years, and to seek a structural solution for its public pension by recently addressing a draft bill aimed at recapitalization of its largest public pension fund, CPEG. Moreover, in our view, the canton continues to display good long-term financial planning, prudent debt and liquidity management, and maintains sound controls over its government-related entities.

Like all Swiss cantons, Geneva has extensive legal flexibility in setting personal income and corporate profit tax rates, but we regard its revenue-raising flexibility as low in practice, because tax hikes are subject to popular referendum and, given the nature of the corporations it hosts, Geneva is sensitive to tax competition. This, combined with the largely rigid nature of operating expenditures (mostly consisting of personnel, social aid, and allowances and transfers for health care and public transport) and limited capital expenditures (capex) in an international comparison (7.3% of total expenditures on average over 2017-2019 under our base-case scenario) supports our view of the canton's average budgetary flexibility.

Large, unfunded pension liabilities will continue to constrain the canton's debt burden

We expect Geneva will record weak budgetary performance over our rating horizon, reflecting structural reduction in its budgetary performance and our expectation that the canton will implement the corporate tax reform from 2020. Under our base case, the operating balance will decrease to 3.5% of operating revenues in 2017, due to less dynamic tax revenues. We expect the operating margin will stabilize by 2019, above our previous base case due to the time lag in the implementation of the reform of the corporate tax. This also reflects a strong increase in Geneva's contribution to the Swiss cantonal equalization system from 2018, and increasing social aid and health expenses that will be partly mitigated by cost-control and -cutting measures. These pressures on the expenditure side will be offset, in our view, by increasing tax revenues, reflecting higher local GDP growth prospects.

In the context of increasing international pressure to reduce tax advantages granted to companies in Switzerland, the confederation had drafted a project ("Réforme de l'imposition des entreprises III" or RIE III) to reform the Swiss corporate taxation system, and abolish cantonal lump-sum taxation. While this project was rejected by national popular referendum in February 2017, the Swiss Confederation and the cantons are working on a new project ("Project fiscal 17" or PF17), which could be enacted from 2020--and not from 2019 as was initially proposed. These active negotiations are lead with regard to financial compensation from the Swiss Confederation for cantons' corporate tax cuts, and we understand at this stage that PF17 effects could be very close to the previous tax reform project RIE III for Geneva. The canton would face a reduction in tax revenues under a corporate tax cut (Geneva had previously stated its willingness to cut its general corporate tax to 13.49% from 24.2%) but also benefit from partial compensation from the confederation to cantons, with a net negative impact on its operating margin of around 4% of its operating revenues. Despite the time lag in the expected implementation of the corporate tax reform beyond the horizon of our base case (2017-2019), we continue to consider the related tax revenue losses as a pressure element in our assessment of the canton's budgetary performance.

We anticipate that the canton's capex will average CHF630 million over 2017-2019, up from CHF550 million in 2016. This will likely lead to deficits after capital accounts averaging 3.9% of total revenues in 2017-2019, which is higher than the 0.4% in 2016, but stable over the period. The corporate tax reform's implementation in 2020 could lead to deficits after capital accounts of about 8% of revenues.

Given our expectation of increasing deficits after capital accounts, we anticipate that the canton's tax-supported debt will slightly increase to 146% of consolidated operating revenues at year-end 2019, from 142% in 2016. We include in our calculation of tax-supported debt Geneva's direct debt and the debt for non-self-supporting government-related entities (transportation company TPG and public hospital HUG). Meanwhile, interest charges should remain limited at 2.4% of operating revenues by 2019. Despite capital injection in 2012/2013, Geneva continues to record high unfunded pension liabilities, notably through CPEG, representing 108% of the canton's operating revenues at year-end 2016, up from 93% at year-end 2015, due to the lowering of the technical rate to 2.5% at end-2016. We expect these liabilities will remain sizable in the coming years, which negatively affects our assessment of the canton's debt burden.

In September, the cantonal executive adopted measures aimed at implementing a structural solution for CPEG, which faces significant unfunded pension liabilities. The cantonal executive's project targets to reaching a coverage ratio of 80% by recapitalizing CPEG with CHF4.7 billion, of which CHF4.5 billion would be taken over by the canton. The measures would also plan to shift the pension scheme for future pensioners from a defined benefit to a defined contributions scheme. However, such a reform would still require parliamentary approval and most likely be subject to a popular referendum. Regarding the context of upcoming cantonal elections in April-May 2018, we still view the implementation of the recapitalization of the public pension fund as unlikely over the period 2018-2019, and do not factor it into our base-case scenario.

We continue to assess Geneva's liquidity as adequate. We consider that Geneva has a weak debt coverage ratio but strong access to external liquidity. We expect that the canton's average available amounts on its committed bank lines of CHF1.28 billion will cover more than 40% of its debt service over the next 12 months. In our view, the canton continues to benefit from strong access to external liquidity, as reflected by large short-term facilities, comprising CHF1.3 billion of contracted bank lines as well as CHF3.5 billion of liquidity lines that are not formally contracted but generally available and regularly used, with various public sector entities and Swiss and international banks. The canton has also been a frequent issuer of public bond in recent years.

In our view, the canton has moderate risks associated with its contingent liabilities, mainly through the cantonal bank Banque Cantonale de Geneve (A+/Negative/A-1), of which it remains the largest shareholder, and public insurance institution Rentes Genevoises (not rated) that benefits from cantonal guarantee over its liabilities.

Key Statistics

Table 1

Republic and Canton of Geneva Key Statistics

	--Fiscal year end Dec. 31--				
(Mil. CHF)	**2015**	**2016**	**2017bc**	**2018bc**	**2019bc**
Operating revenues	8,166	8,158	8,099	8,292	8,454
Operating expenditures	7,589	7,681	7,820	8,013	8,166
Operating balance	577	477	280	279	288
Operating balance (% of operating revenues)	7.1	5.9	3.5	3.4	3.4
Capital revenues	144	40	20	20	20
Capital expenditures	630	550	596	609	676
Balance after capital accounts	91	(33)	(297)	(310)	(368)
Balance after capital accounts (% of total revenues)	1.1	(0.4)	(3.7)	(3.7)	(4.3)
Debt repaid	1,400	1,123	925	820	525
Gross borrowings	678	915	1,022	1,130	893
Balance after borrowings	(631)	(241)	(200)	(0)	0
Modifiable revenues (% of operating revenues)	76.6	77.7	77.4	77.7	77.6
Capital expenditures (% of total expenditures)	7.7	6.7	7.1	7.1	7.6
Direct debt (outstanding at year-end)	12,670	12,466	12,563	12,872	13,241
Direct debt (% of operating revenues)	155.2	152.8	155.1	155.2	156.6
Tax-supported debt (outstanding at year-end)	13,485	13,237	13,356	13,690	14,083

Table 1

Republic and Canton of Geneva Key Statistics (cont.)					
	--Fiscal year end Dec. 31--				
(Mil. CHF)	2015	2016	2017bc	2018bc	2019bc
Tax-supported debt (% of consolidated operating revenues)	145.4	141.7	144.1	144.4	145.7
Interest (% of operating revenues)	2.6	2.4	2.5	2.4	2.4
Local GDP per capita (nominal, CHF)	98,568	97,528	97,438	98,777	100,436
National GDP per capita (nominal, CHF)	78,507	78,268	78,541	79,717	81,154

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 francs.

Ratings Score Snapshot

Table 2

Republic and Canton of Geneva Ratings Score Snapshot	
Key Rating Factors	
Institutional framework	Extremely predictable and supportive
Economy	Very strong
Financial management	Strong
Budgetary flexibility	Average
Budgetary performance	Weak
Liquidity	Adequate
Debt burden	Very High
Contingent liabilities	Moderate

*S&P Global Ratings' credit ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments" summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

Sovereign Risk Indicators, Oct. 13, 2017. An interactive version is also available at http://www.spratings.com/sri.

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Institutional Framework Assessments For Non-U.S. Local And Regional Governments - September 21, 2017
- Research Update: Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable - May 19, 2017
- Default, Transition, and Recovery: 2016 Annual Non-U.S. Local And Regional Government Default Study And Rating Transitions - May 08, 2017
- Refinancing Needs Continue To Dominate German, Swiss, And Austrian Local And Regional Government Borrowing In 2017 - February 23, 2017
- Public Finance System Overview: Swiss Cantons - November 03, 2016
- Banking Industry Country Risk Assessment: Switzerland - September 02, 2016

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 agreed that all the key rating factors were unchanged.

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

	Rating	
	To	From
Geneva (Republic and Canton of)		
Issuer Credit Rating		
Foreign and Local Currency	AA-/Negative/--	AA-/Negative/--
Senior Unsecured		

Ratings List Continued...

Local Currency	AA-	AA-

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. 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.

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