Canton of Basel-City

November 6, 2023

This report does not constitute a rating action.

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Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
The strong local presence of the pharmaceutical industry continues to provide the Canton of Basel-City (Basel-City) with an extremely dynamic and robust tax base.	Much better-than-budgeted tax collection should enable the canton to post strong results again in 2023, with broadly balanced accounts after capital expenditure (capex).
Switzerland appears to be navigating the current economic challenges better than most of its neighbors, with relatively resilient economic growth, and far lower inflation.	Basel-City's budget should be well prepared to absorb the tax cuts, which are effective from 2024, and re-invest the anticipated substantial proceeds from the implementation of the Organization for Economic Co-operation and Development (OECD) minimum tax rate into further improving the competitiveness of its local economy from 2025.
Supported by the recent strong operating results, Basel-City's political leadership plans to make significant investments into public infrastructure, climate protection, social cohesion, and the canton's attractiveness as a place for business and residence.	Infrastructure spending and predicted small deficits after capital accounts will likely cause a minor uptick in the canton's debt burden, which nevertheless should remain overall moderate throughout 2023-2026.

Basel-City will continue to benefit from an extraordinarily strong local economy. The dynamic growth of Basel-City's strong pharmaceutical industry has been extraordinary over recent years, and S&P Global Ratings expects this to continue.

We expect strong operating margins to finance a large part, but not all, of the canton's sizable capex projects. Basel-City's list of planned investment projects is long, implying that even with sizable operating margins, the canton will likely require limited net new borrowing over the next few years.

An exceptional liquidity position and a moderate debt burden will remain supporting factors for the ratings on Basel-City. We expect no change to our prediction of minor deficits after capital accounts, and a resulting moderate increase in the canton's debt burden.

Outlook

The stable outlook reflects our view that Basel-City will continue to achieve sound operating performance over the next few years, despite current economic headwinds, and contain the deficits that we anticipate will result from its capex program.

Downside scenario

We could lower the rating if the canton's management fails to exercise budgetary discipline and loosens its grip on financial performance more than we currently assume. This could include significantly elevated capex volumes, for example repeated, sizable (in relation to the canton's overall budget) real estate purchases for the canton's financial account, leading to a deterioration in budgetary performance and eventually a markedly higher debt burden. In addition, pressure on the rating would build if the cantonal bank calls on Basel-City for support.

Rationale

A robust economy and strong institutional framework continue to support Basel-City

With slow but continuing economic growth and relatively benign inflation, Switzerland appears to be navigating the current challenging economic climate better than most neighbors. We forecast national real GDP growth will bottom out at 0.6% in 2023, increasing to 1.2% in 2024, and 1.4% in 2025. In our view, inflation in Switzerland, as measured by the consumer price index, will slow to 2.3% in 2023, 1.6% in 2024, and 1.5% in 2025, after peaking at a comparatively low 2.8% in 2022. The Swiss national unemployment rate of 3.6% at the end of first-half 2023, calculated according to the International Labour Organization's definition, signals a continued tight labor market. With an estimated national GDP per capita slightly above Swiss franc (CHF) 90,000 (almost $100,000) in 2023, Switzerland remains one of the world's strongest economies.

The pharmaceutical industry in Basel-City ensures that the strength of the local economy will continue to exceed the already very strong Swiss economy. Some of the largest corporations in the pharmaceutical and chemical sectors globally, such as Roche, Novartis, and Lonza, are headquartered in Basel-City, and we understand that the industrial cluster continues to expand within the canton. Because of this, local GDP per capita amounts to more than 200% of national GDP per capita. The pharmaceutical companies in Basel-City directly and indirectly drive a significant share of the canton's strong tax base. The comparatively higher tax revenue potential makes Basel-City one of only seven contributor cantons, of a total of 26, in the Swiss national fiscal equalization scheme. Basel-City will pay CHF133 million into the system in 2024, about 2.8% of S&P Global Ratings-adjusted operating revenue.

We currently anticipate only a minor net structural impact on Basel-City's finances from the implementation of the OECD minimum tax rate in Switzerland from 2024, despite the likely substantial gross proceeds and possible temporary cash and performance effects. With Basel-City's corporate tax rate sitting below the new 15% required minimum rate, its largest corporate taxpayers will face significant additional tax-like payments to the Swiss national government to bridge the difference. Of these flows, 75%, estimated by one study to reach CHF270 million per year, will be transferred back into Basel-City. However, we infer from media reports that different measures, for example tax credits for research and development, higher infrastructure spending, or even lower taxes for foreign specialists, are being discussed in the cantons most affected by this effective tax increase to maintain their competitive edge. Therefore, we believe that once all responses are implemented and higher payments into the Swiss national fiscal equalization system are considered, net fiscal gains for Basel-City will remain limited.

Two pending national legislative initiatives, one for greater subsidization of health insurance premiums for low-income households, and one for cost-free child care, could theoretically decrease the supportiveness of the institutional framework for Swiss cantons. However, we trust that the cantons' representation in the second chamber of the national parliament and the possibility of a referendum can avert extremely detrimental legislative changes for Basel-City. The canton's already above-average health insurance premium subsidization should limit unavoidable marginal costs from the first initiative to no more than CHF25 million per year, according to Swiss government calculations. While we have less visibility on the national child care initiative, a similar local project has just been approved by the cantonal parliament. Basel-City estimates a cost of about CHF35 million, of which CHF7 million has already been incorporated into its 2024 budget.

We believe that the key challenge for Basel-City's financial management will be to balance significant planned investments into urban infrastructure (sewage treatment, port area conversion, public transport, etc.), health care facilities, and carbon neutrality against possibly less dynamic revenue growth than in previous years. We note that besides the capex projects reflected in the canton's core budget plan, Basel-City also intends to expand its directly owned portfolio of affordable housing units by 50% (to 3,000 units) by 2035. It also wants to support the refurbishment of the University Hospital Basel with a CHF300 million budget loan over the next 15 years. We currently trust that, if Basel-City's revenue growth slows, its pragmatic financial management will make the required adjustments to keep deficits and debt growth under control. However, this may then involve politically difficult discussions and decisions.

Small deficits after capital accounts, despite strong operating margins, imply a slightly higher debt burden

For 2023, we anticipate Basel-City will significantly outperform its budget by about CHF200 million, mainly due to much better-than-budgeted tax collection from the corporate sector. This would translate into an operating margin above 11% and presumably a minor surplus after capital accounts in our cash-focused calculation approach. While these higher tax collections are partly of a nonrecurring nature (payments in respect of prior years), they also contain a material structural element (company relocations to Basel-City, and business expansion). However, the lack of profit distribution from the Swiss National Bank (SNB) in 2023, and lower revenue from transaction taxes, will reduce the outperformance.

The canton's recent package of various tax cuts, approved by a cantonal referendum in March 2023, will start to weigh on operating margins from 2024, and, in our view, push these to about 8%. Our forecast considers costs of about CHF112 million, or 2.5% of operating revenue, for the tax package, a resumption of the SNB profit distribution at a comparatively low level in 2025, and salary adjustments in line with our inflation forecast, albeit lagging. Minor deficits after capital accounts result from an assumed execution rate of about 80% for budgeted investments, to which we add payments of up to CHF150 million annually for assets such as affordable housing units that the canton designates as, in principle, optional (Finanzvermögen) and hence reports separately.

We expect Basel-City's consolidated debt burden to rise slightly from its current low of about 60%, on account of the predicted small deficits after capital accounts, and expected borrowings by the University Hospital Basel. All Basel-City's direct capital market debt is fixed rate and denominated in Swiss francs. The canton issues green and social bonds. Compared with peers, we note a slightly shorter average tenor in Basel-City's debt portfolio. However, upcoming maturities are relatively small, ranging CHF200 million-CHF380 million per year until 2027. Given Basel-City's strong standing in the capital market and the limited maturity amounts, we believe the canton should have no issues refinancing this.

We understand the planned full remodeling of the University Hospital Basel's entire campus will require CHF900 million of debt funding over the next 15 years. While Basel-City has communicated plans to provide CHF300 million as a loan directly from its budget, reportedly with the option to convert into equity in case this is needed, the remaining CHF600 million is to be borrowed in the market. Given widely reported concerns about the hospital's ability to carry and eventually repay such an amount of debt, we conservatively include the market-sourced borrowing in our tax-supported debt metric and treat the on-lending as capex. With no details on timing yet, we assume additional debt will accrue pro rata over the long construction phase, with therefore only a limited impact on our key indicators during 2024-2026.

We continue to view Basler Kantonalbank (BKB) as the canton's most relevant contingent liability, given the bank's size and the canton's statutory guarantee. While well capitalized, BKB's balance sheet size exceeds the canton's annual operating revenue by a factor of almost 12x. In addition to BKB, we perceive a rising contingent liability risk from the canton's other hospitals. A CHF90 million reduction in the balance sheet value of Basel-City's geriatric hospital at year-end 2022 has not yet required any cash injections from the canton. However, such cash injections have been required elsewhere, in our view signaling increasing sector-wide financial pressure.

Basel-City's exceptional liquidity position is decisively ensured by a committed, CHF900 million credit facility with local lender BKB, which it owns by majority, and access to the deep and liquid Swiss capital market for government borrowers. Cash held in bank accounts supports our liquidity assessment, but, in our calculation, falls short of the outflow for the next 12 months, given elevated capex, in addition to debt service.

Canton of Basel-City Selected Indicators

Mil. CHF	2021	2022	2023bc	2024bc	2025bc	2026bc
Operating revenue	4,510	4,666	4,751	4,702	4,855	4,963
Operating expenditure	4,048	4,067	4,212	4,332	4,475	4,550
Operating balance	463	599	539	370	381	413
Operating balance (% of operating revenue)	10.3	12.8	11.3	7.9	7.8	8.3
Capital revenue	28	11	11	12	20	26
Capital expenditure	380	853	522	474	542	592
Balance after capital accounts	111	(243)	28	(92)	(141)	(154)
Balance after capital accounts (% of total revenue)	2.4	(5.2)	0.6	(2.0)	(2.9)	(3.1)
Debt repaid	408	525	500	350	381	225
Gross borrowings	0	454	450	507	586	441
Balance after borrowings	(283)	(352)	(11)	14	0	0
Direct debt (outstanding at year-end)	2,781	2,710	2,660	2,817	3,022	3,238
Direct debt (% of operating revenue)	61.7	58.1	56.0	59.9	62.2	65.2

Canton of Basel-City Selected Indicators

Tax-supported debt (outstanding at year-end)	2,870	2,855	2,805	3,002	3,247	3,503
Tax-supported debt (% of consolidated operating revenue)	63.6	61.2	59.0	63.8	66.9	70.6
Interest (% of operating revenue)	0.1	0.1	0.2	0.4	0.6	0.8
Local GDP per capita ($)	216,447.9	216,478.8	232,549.3	235,685.5	232,122.6	232,584.1
National GDP per capita ($)	93,080.2	92,869.0	99,467.7	100,611.1	99,187.4	99,394.3

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. $--U.S. dollar.

Canton of Basel-City Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1
Budgetary performance	1
Liquidity	1
Debt burden	4
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
- Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening, Sept. 25, 2023
- Switzerland 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Aug. 11, 2023,
- Institutional Framework Assessments: Swiss Cantons Benefit From Autonomy And Robust Checks And Balances, May 23, 2023
- Basler Kantonalbank, Dec. 13, 2022

Ratings Detail (as of November 01, 2023)*

Basel-City (Canton of)	
Issuer Credit Rating	AAA/Stable/A-1+
Senior Unsecured	AAA
Issuer Credit Ratings History	
09-Nov-2018	AAA/Stable/A-1+
10-Nov-2017	AA+/Positive/A-1+
16-Jun-2009	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.