S&P Global Ratings

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Solothurn (Canton of)

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Solothurn (Canton of)

Key Rating Factors

Issuer Credit Rating
AA+/Stable/A-1+

Credit context and assumptions	Base-case expectations
COVID-19 will be a one-off hit. • The COVID-19 pandemic will hit economic growth and tax revenue in Switzerland. • Cantonal measures to implement the corporate tax reform have finally been approved by a cantonal referendum. • The canton of Solothurn benefits from increased payouts from the Swiss National Bank (SNB) in 2020, mitigating the fall in tax revenue.	An economic rebound in 2021 should help mitigate the financial effects. • We believe that measures to contain the spread of the virus will be lifted in the second quarter of 2020, limiting economic contraction in Switzerland. • We also expect a significant economic rebound in 2021. • We assume the canton's prudent management will continue to implement budgetary measures to limit pressure on debt and liquidity if needed.

Outlook

S&P Global Ratings views the canton as well prepared to weather the financial effects of the pandemic, limiting new debt in 2020 and safeguarding its liquidity situation. We assume that the canton's management will be able to implement measures to limit deficits after capital accounts.

Downside scenario

We could consider a downgrade if Solothurn's budgetary performance worsened beyond our base case through 2023, all other things remaining equal. In addition, pressure on the ratings could build if we observed a deterioration in the canton's liquidity, for example, if Solothurn lost access to favorable funding.

Upside scenario

We could raise our ratings on Solothurn if the canton managed to increase its budgetary flexibility, for example, by limiting its dependence on the national equalization system. In addition, a sustained reduction of its comparably high debt would give upward potential to the ratings.

Rationale

The extremely predictable and supportive institutional framework for Swiss cantons and Solothurn's sound economic fundamentals, with very high GDP per capita, underpin the canton's creditworthiness. We expect that the canton will face budgetary challenges stemming from the COVID-19 pandemic and the corporate tax reform, which will lead Solothurn to post deficits after capital accounts over the next few years. Solothurn has a somewhat weaker financial position than higher-rated Swiss peers, as underscored by its comparably high tax-supported debt burden.

Credit context and assumptions: Solothurn benefits from equalization payments

We assess the institutional framework for Swiss cantons as extremely predictable and supportive. While the Swiss system provides Solothurn with a reliable source of revenue, it also limits the canton's budgetary flexibility and highlights the canton's dependence on economic developments in Switzerland's economic centers. As the amounts are based on tax revenue cashed in a few years ago, the amount Solothurn receives does not depend on current economic conditions. In 2020, Solothurn is entitled to receive Swiss franc (CHF) 372 million from the national equalization system, which translates into about 16.9% of operating revenue.

Following the implementation of economic and social restrictions to counter the COVID-19 pandemic in early 2020, we expect nominal GDP in Switzerland to contract by 6.5% in 2020, followed by a very sound rebound in 2021 assuming that the containment measures are lifted. We expect that Solothurn will follow national trends, given its economic structure and comparable containment measures. Solothurn receives equalization payments since it has a relatively weak economic profile in a national comparison. Although from an international perspective, GDP per capita is very high, it is considerably lower than in other Swiss cantons. Socioeconomic indicators for Solothurn are favorable, with very low unemployment at only 2.6% in March 2020, outperforming even the very low national average at 2.8%. We assume that unemployment will increase slightly following the economic contraction in 2020.

Base-case expectations: Challenges to Solothurn's financial situation are mitigated by SNB payouts and equalization payments

Solothurn closed 2018 and 2019 with small surpluses after capital accounts. This is not repeated in our base-case scenario covering 2020 to 2022. An economic contraction in 2020 following the pandemic and tax rate cuts following the corporate tax reform will put pressure on the canton's budgetary performance, leading to yearly deficits of 4%-5% of adjusted total revenue. The payout from the SNB of 4x the usual rate mitigates the tax shortfalls in 2020 for Solothurn, and is also likely to reduce the deficit in 2021, while sluggish tax revenue is likely to continue. In addition, Solothurn receives equalization payments calculated on tax revenue achieved three to five years earlier.

Solothurn's voters finally approved the canton's revised approach and tax rate changes for corporates in early 2020. The amended approach will lead to tax rate cuts for corporations spread over three years, with the first cut being implemented in 2020. We are convinced that the prudent management will implement balancing measures if necessary; it did so in 2014 by implementing a savings program, highlighting management's commitment to consolidation. Additionally, we note that the canton is bound by the constitutional "debt-brake" rule, which limits deficits at the level of equity available. We therefore view Solothurn's budgetary flexibility as average, based on the canton's adequate leeway to adjust revenue. Solothurn's pension fund is fully funded, with a coverage ratio beyond

100% at year-end 2019. Despite a negative performance in the first quarter of 2020, we do not anticipate that the canton will have to contribute additional funds to cover its pension obligations in the medium term.

We assess Solothurn's liquidity as a key credit strength, with projected cash, liquid assets, and committed facilities covering more than 120% of debt service over the next 12 months. We also factor in the canton's strong access to Switzerland's deep and liquid capital market. Solothurn faces low debt service requirements, with only one bond falling due in 2021 and no long-term debt maturities in 2020 and 2022. The canton has short-term financing available via bank facilities to bridge liquidity gaps in times of low cash inflows, which the canton uses, especially at year-end. The canton's revenue and expenditure follow a predictable pattern, which facilitates liquidity planning.

We anticipate a slightly rising debt burden over the next few years, based on contained deficits, as per our base-case scenario. Tax-supported debt will increase to about 110% of adjusted operating revenue by 2023, which is high compared with national peers' but only moderate in an international comparison. This forecast is contingent on our assumption of no changes in the canton's liquidity policy. Since all of Solothurn's debt is denominated in Swiss franc and the management has no intention of amending the policy, the canton's finances do not face foreign exchange rate risk at this time. Unlike all rated Swiss peers, Solothurn does not have a cantonal bank to support. Other contingent financial risks are negligible, stemming from the relatively low amount of participations in private law companies, a guarantee for a former waste disposal site, and a small amount of agricultural loans.

Key Statistics

Table 1

Canton of Solothurn Selected Indicators

	--Year ended Dec. 31--						
(Mil. CHF)	**2017**	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**	**2023bc**
Operating revenues	2,078	2,138	2,238	2,203	2,206	2,249	2,278
Operating expenditures	1,959	1,974	2,036	2,173	2,185	2,210	2,243
Operating balance	119	164	203	31	21	39	35
Operating balance (% of operating revenues)	5.7	7.7	9.1	1.4	1.0	1.7	1.5
Capital revenues	38	30	18	19	12	14	14
Capital expenditures	158	162	157	115	132	151	166
Balance after capital accounts	(1)	32	64	(65)	(99)	(99)	(117)
Balance after capital accounts (% of total revenues)	(0.1)	1.5	2.8	(2.9)	(4.4)	(4.4)	(5.1)
Debt repaid	200	200	305	200	350	0	100
Gross borrowings	350	200	305	264	448	98	217
Balance after borrowings	150	33	65	(0)	0	0	1
Direct debt (outstanding at year-end)	2,151	2,141	2,143	2,207	2,305	2,403	2,520
Direct debt (% of operating revenues)	103.5	100.1	95.7	100.2	104.5	106.9	110.6
Tax-supported debt (outstanding at year-end)	2,185	2,175	2,162	2,241	2,339	2,437	2,554
Tax-supported debt (% of consolidated operating revenues)	105.1	101.7	96.6	101.7	106.0	108.4	112.1
Interest (% of operating revenues)	1.0	1.0	0.9	0.9	0.9	0.9	0.9

Table 1

Canton of Solothurn Selected Indicators (cont.)

	--Year ended Dec. 31--						
(Mil. CHF)	**2017**	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**	**2023bc**
Local GDP per capita (single units)	65,459	66,932	67,701	61,910	65,979	69,033	70,837
National GDP per capita (single units)	78,917	80,700	81,208	75,500	80,462	84,187	86,386

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. CHF--Swiss francs. 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.

Ratings Score Snapshot

Table 2

Canton of Solothurn Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	2
Budgetary performance	3
Liquidity	1
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, April 24, 2020; a free 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- COVID-19 Will Test The Financial Flexibility Of LRGs In Germany, Switzerland, And Austria, April 27, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 2020
- Bulletin: Swiss Cantons Will Receive Greater Payouts From SNB, But Will It Last?, March 3, 2020
- Local Government Debt 2020: Debt Reduction In Germany, A Swiss Pension Fund Recapitalization, And Small Net Borrowings In Austria, March 2, 2020
- Research Update: Switzerland Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Feb. 21, 2020
- 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Two Popular Votes, Two Approaches To Corporate Tax Reform In Switzerland, May 21, 2019
- Banking Industry Country Risk Assessment: Switzerland, Nov. 20, 2019
- Public Finance System Overview: Swiss Cantons, Nov 20, 2018
- International Public Finance Rating Trends: German, Austrian, And Swiss Local And Regional Governments, Oct. 22, 2018
- Will The Swiss Tax Reform Plan TP 17 Cost Some Cantons More Than Others? Aug. 29, 2018

Ratings Detail (As Of May 15, 2020)*	
Solothurn (Canton of)	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+
Issuer Credit Ratings History	
01-Dec-2010	AA+/Stable/A-1+
20-Sep-2010	AA/Watch Pos/A-1+
21-Jun-2010	AA/Positive/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.

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