S&P Global
Ratings

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Research Update:

Swiss Canton of Solothurn Outlook Revised To Positive On Strong Financials; 'AA+/A-1+' Ratings Affirmed

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Overview

- We expect Solothurn, a midsize Swiss canton, will continue to post strong financial results, having shown greater resilience to the COVID-19 pandemic's negative effects than previously expected.
- The sale of the canton's shares in energy provider Alpiq helped repay long-term maturities in 2021 without the need for refinancing.
- We revised our outlook on Solothurn to positive from stable.
- We also affirmed our long- and short-term ratings on the canton at 'AA+/A-1+'.

Rating Action

On May 6, 2022, S&P Global Ratings revised the outlook on its long-term rating on the Swiss Canton of Solothurn to positive from stable. At the same time, we affirmed our 'AA+/A-1+' long- and short-term issuer credit ratings.

Outlook

The positive outlook on Solothurn indicates that the canton will remain committed to a balanced budget with very limited recourse to debt, if any. As a result, its financial position and debt burden may significantly improve to become commensurate with a 'AAA' rating.

Upside scenario

We could raise the rating on Solothurn if, in the next two years, we were to see a continuation of the strong financial performance similar to pre-pandemic levels, and if we observed a lower likelihood of adverse tax reform measures.

Downside scenario

We could revise the outlook to stable if we were to see changes to the canton's tax revenue that are more significant than currently expected, which could lead to reduced operating surpluses and hamper the debt-repayment strategy.

Rationale

In our view, Solothurn will keep applying its tight financial policy, which helped cushion against the pandemic's financial effects, and thereby strengthen its budgetary performance. We believe that the canton will gradually reduce its leverage and repay debt where possible, as shown by its Swiss franc (CHF) 150 million long-term debt repayment in 2021, which was partly financed by the sale of its share in energy provider Alpiq. The rating on Solothurn benefits from its location in Switzerland, including a supportive institutional framework and a very strong and resilient economic position.

We continue to assess the canton's liquidity position as exceptional, with liquid assets and contracted funding well above 120% of debt service over the next 12 months, while establishing medium-term assets to finance the next upcoming long-term debt maturity in 2023 of CHF100 million. While we see potential changes in the composition of tax revenue, mainly triggered by the public referendum on May 15, 2022, we believe that the strong financial management of the canton will be able to cushion potential tax revenue reductions through savings measures.

Solid financial results despite geopolitical tension

Despite the Russia-Ukraine conflict, which will amplify economic slowdown and higher inflation in Europe, we still expect solid real GDP growth at about 2.4% in Switzerland, albeit down from 3% in our previous review. We do not expect this economic slowdown to have significant adverse effects on Solothurn's financial performance over the next two years. This is based mainly on two effects. Firstly, the exceptionally strong tax revenue inflow during the past two years resulted in a much-lower-than-expected reduction in tax base, which will, in our view, result in tax revenue recovering to about pre-pandemic levels in 2023 at the latest. Secondly, the continuously strong inflow of Swiss National Bank dividends, currently at 6x profit distribution, as well as inter-cantonal equalization payments. Moreover, we believe that these positive developments will provide Solothurn with enough financial flexibility to weather a potential referendum outcome on an intra-cantonal tax reform, which will be held on May 15, 2022.

We are convinced that the prudent management will implement measures to balance Solothurn's budgetary performance, if required. The last considerable savings program was successfully implemented in 2014, highlighting management's commitment to consolidation. We do not see any indication of significant changes to the financial management direction under newly elected finance minister Peter Hodel, who took up office Aug. 1, 2021. The initial referendum proposal aims for a gradual reduction of the income tax burden for individuals in the canton toward the Swiss average tax rate. To our knowledge, this initiative could cost Solothurn up to CHF130 million annually. The cantonal government has therefore put forward a counterproposal to reduce the tax burden for small- and medium-income households, which would cost the canton around CHF30 million annually. In our view, the canton's proposal has a high likelihood of succeeding, and we have therefore incorporated it into our base-case assumptions.

We continue to assess the institutional framework for Swiss cantons as extremely predictable and supportive. While the Swiss institutional system provides Solothurn with a reliable source of revenue through its resource equalization scheme, it also highlights the canton's dependence on developments in Switzerland's economic centers. In our view, this is not an impediment but rather a supporting factor for the canton's financial performance.

Balanced budgets leading to zero deficit and deleveraging

We believe that Solothurn will use its tight financial policy, strong economic performance, and continuously high dividend payouts by the SNB to post balanced budgets after capital accounts over our forecast horizon. Making use of the resilient tax base, which did not suffer significantly from the pandemic, the canton will post operating surpluses at around 4.5%. This financial performance is supported by Solothurn's management's ability to keep expenditure growth at moderate levels.

The sale of the remaining shares in energy provider Alpig at the end of 2020, which generated a one-off capital revenue of about CHF139 million, enabled Solothurn to repay its 2021 long-term debt maturity of CHF150 million without additional debt refinancing. In our debt assessment, the canton will move toward a tax-supported debt to operating revenue ratio of roughly 77% in 2024, compared with 91% in 2020, and a peak of 105% in 2017. The canton is thereby gradually but consistently reducing the one-off full capitalization of the cantonal pension fund, which followed a 2014 public referendum. In our view, it might further reduce its debt burden through already established medium-term assets of CHF50 million, which will come due just before the next long-term debt maturity of CHF100 million in 2023. Since all of Solothurn's debt is denominated in Swiss francs and the management has no intention of amending this policy, the canton's finances do not face foreign exchange rate risk at this time. Unlike other rated Swiss peers, Solothurn does not have a cantonal bank to support. Other contingent financial risks are negligible, stemming from relatively small stakes in private companies, a guarantee for a former waste disposal site, and a small amount of agricultural loans.

We continue to incorporate in our rating a solid liquidity position. The canton benefits from 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. In combination with the canton's strong access to Switzerland's deep and liquid capital markets, we assess the overall liquidity position of the canton as exceptional.

Key Statistics

Table 1

Canton of Solothurn--Selected Indicators

	--Year ended Dec. 31--					
Mil. CHF	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenues	2,238	2,281	2,396	2,362	2,388	2,407
Operating expenditures	2,036	2,126	2,207	2,251	2,283	2,303
Operating balance	203	156	189	111	105	104
Operating balance (% of operating revenues)	9.1	6.8	7.9	4.7	4.4	4.3
Capital revenues	18	153	7	7	7	11

Table 1

Canton of Solothurn--Selected Indicators (cont.)

	--Year ended Dec. 31--					
Mil. CHF	**2019**	**2020**	**2021**	**2022bc**	**2023bc**	**2024bc**
Capital expenditures	157	109	84	115	109	114
Balance after capital accounts	64	200	112	3	3	2
Balance after capital accounts (% of total revenues)	2.8	8.2	4.6	0.1	0.1	0.1
Debt repaid	305	305	385	200	300	300
Gross borrowings	305	230	200	200	280	280
Balance after borrowings	65	126	(72)	4	(17)	(18)
Direct debt (outstanding at year-end)	2,143	2,065	1,880	1,880	1,860	1,840
Direct debt (% of operating revenues)	95.7	90.5	78.5	79.6	77.9	76.5
Tax-supported debt (outstanding at year-end)	2,162	2,081	1,896	1,896	1,876	1,856
Tax-supported debt (% of consolidated operating revenues)	96.6	91.2	79.1	80.3	78.6	77.1
Interest (% of operating revenues)	0.9	0.9	0.8	0.8	0.8	0.8
Local GDP per capita (single units)	68,846	66,354	68,756	71,424	73,481	75,266
National GDP per capita (single units)	84,500	81,455	85,250	87,287	89,299	91,310

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.

Ratings Score Snapshot

Table 2

Canton of Solothurn--Ratings Score Snapshot

Key rating factors	Score
Institutional framework	1
Economy	1
Financial management	2
Budgetary perfomance	2
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 11, 2021. 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

- Global Macro Update: Preliminary Forecasts Reflecting The Russia-Ukraine Conflict, March 8, 2022
- Switzerland, Feb. 14, 2022
- European Economic Snapshots: From Fast-Paced Recovery To Robust Expansion, Dec. 6, 2021
- Default, Transition, and Recovery: 2020 Annual International Public Finance Default And Rating Transition Study, Sept. 14, 2021
- Institutional Framework Assessment: Swiss Cantons, Jan. 14, 2021

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
Solothurn (Canton of)		
Issuer Credit Rating	AA+/Positive/A-1+	AA+/Stable/A-1+
Solothurn (Canton of)		
Senior Unsecured	AA+	