MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
28 June 2019

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RATINGS

**Berne, City of**

| | |
|---|---|
| Domicile | Berne, Switzerland |
| Long Term Rating | Aa1 |
| Type | LT Issuer Rating - Fgn Curr |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*


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# City of Berne (Switzerland)

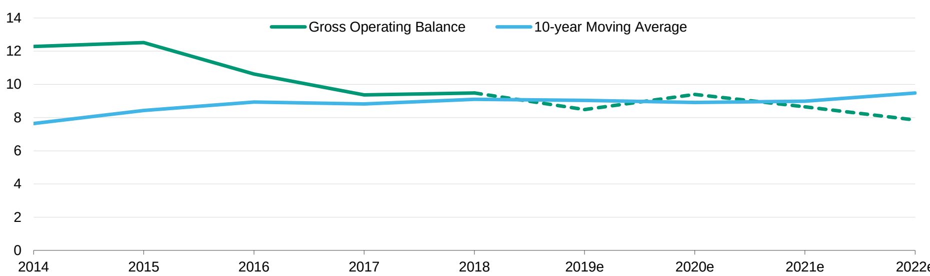
Update to credit analysis

## Summary


The credit profile of the City of Berne (Aa1 stable) reflects the city's sound operating performance, wealthy economy and a moderate likelihood that the Canton of Berne would provide support if the city would face acute liquidity stress. The city has a conservative budgetary management and a strong governance, which should enable it to maintain good operating surpluses over the medium term. We expect the city's moderately high debt level to stabilise by 2022, after a significant increase in 2018, while the city is expanding its infrastructure investment programme in response to its growing population. Furthermore, public service standards are relatively high, which limits financial flexibility.


Exhibit 1

**We expect the City of Berne to maintain sound operating performance**
**Gross Operating Balance as a % of Operating Revenues (2014-2022)**




Figures starting from 2019 reflect our expectations.
*Source: Issuer, Moody's calculations (adjusted for interest payments for self-supporting subsidiaries)*

## Credit strengths

» Sound operating and financial performance expected to remain

» Strong institutional framework underpinning the city's consolidation efforts

» Strong and resilent economic base leading to predictable revenues

## Credit challenges

» Moderately high debt level slightly increased, although expected to stabilise

» Slightly uneven maturity profile, albeit well managed

## Rating outlook

The stable outlook on Berne's rating reflects our expectations that the city will continue to achieve sound operating results, while preserving its debt levels over the medium term.

## Factors that could lead to an upgrade

Upward rating pressure of Berne's Aa1 rating could be triggered by a significant reduction of net direct and indirect debt over the medium term.

## Factors that could lead to a downgrade

Downward rating pressure on Berne's Aa1 rating could arise if the city's net direct and indirect debt would rise significantly and/or if the city were to experience a structural drop in operating margins. Although not expected, a sovereign downgrade could also result in a downgrade of the city's rating.

## Key indicators

Exhibit 2

**City of Berne**

| as reported | 2014 | 2015 | 2016 | 2017 | 2018 | 2019e |
|---|---|---|---|---|---|---|
| Gross Operating Balance as a % of Operating Revenues | 12.3 | 12.5 | 10.6 | 9.4 | 9.5 | 8.5 |
| Capital expenses as a % of Total expenses | 12.2 | 11.5 | 11.4 | 9.1 | 7.2 | 11.7 |
| Self-financing ratio | 1.1 | 1.3 | 1.1 | 1.2 | 1.4 | 0.7 |
| Financing surplus (deficit) as a % of Total Revenues | 0.9 | 3.5 | 0.8 | 1.8 | 2.6 | -3.7 |
| Interest payments as a % of Operating Revenues | 2.5 | 2.5 | 1.8 | 1.3 | 1.1 | 1.1 |
| Intergovernmental revenues as a % of Operating Revenues | 27.9 | 27.2 | 27.4 | 27.3 | 26.6 | 26.6 |
| Net Direct and Indirect Debt as a % of Operating Revenues | 112.2 | 106.7 | 108.2 | 95.7 | 103.8 | 101.6 |

2019 figures reflect our expectations
*Source: Issuer, Moody's Investors Service*

## Detailed credit considerations

The credit profile of the City of Berne, as expressed in the Aa1 stable rating, combines (1) a baseline credit assessment (BCA) of aa1, and (2) the moderate likelihood of extraordinary support coming from the cantonal government of Berne in the event that the city faced acute liquidity stress.

### Baseline credit assessment

**Sound operating and financial performance expected to remain**

Berne's medium-term financial plan envisages increasing tax revenue, which appears slightly optimistic, but still manageable based on the performance in the past years. The plan also suggests stable operating surpluses, which we expect the city's management to outperform by setting savings measures in order to limit negative financial results . We consider this achievable, in the absence of an unexpected economic slowdown.

The city's adjusted operating surplus was sound at 9.5% of operating revenue in 2018, stable compared to 2017. Positive operating results over the past few years (see Exhibit 2) are largely driven by the administration's efforts to limit growth in operating expenditure and reflect the city's conservative and cautious budgetary policy. Tax revenue, which account for about a half of the budget, slightly declined in 2018 but are expected to increase by 2.5% on average during the next 4 years, thus sustaining the budget.

The City of Berne's adjusted (for interest payments for self-supporting subsidiaries) financing surplus improved to a healthy 2.6% of total revenues in 2018, up 0.9% vs 2017. The city's infrastructure investments are aimed at closing the investment and maintenance gap following a prolonged period of financial consolidation. We expect slightly negative financial results in the medium term as a part of these investments will be debt financed.

### Strong institutional framework underpinning the city's consolidation efforts

The city's financial statements are audited by external auditors and its finances benefit from the canton's strong oversight. The canton is the supervisory authority for municipalities in its territory and has the right to intervene in all cases, where the budgetary exercise is deemed not to have been conducted in accordance with cantonal laws. The canton receives the annual reports and has the right to request any financial information from the city for the current fiscal year, with the ability to intervene in case of delays on the budgetary agreement.

The institutional framework – which encompasses the arrangements outlining intergovernmental relations at all levels and jurisdictional powers and responsibilities – is mature and highly developed. Similar to Swiss cantons, Swiss municipalities have fiscal autonomy within the limits fixed by the canton (Article 50 of the Swiss Constitution), which is embedded in a "law for municipalities" that exists in each canton.

### Strong and resilent economic base leading to predictable revenues

The City of Berne is the capital of the Swiss Federation and its administrative centre. The city also houses the headquarters of important national players such as SBB, the national railway company, and Die Post, the national postal company. Telecommunications, health-care and pharmaceutics, food and services are important economic sectors represented in the city.

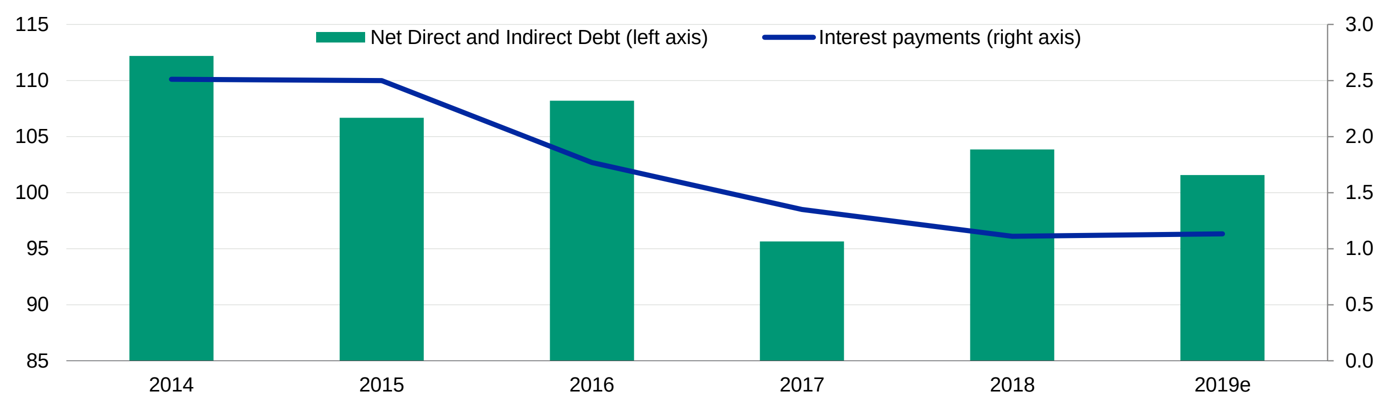
With around 142 thousand inhabitants at the end of 2018, the city is the fourth-largest in Switzerland. The city's population has started to grow, largely as a result of migration inflows, which will continue to drive economic growth. For 2018, we saw a real GDP growth rate of 1.3% for Berne near to that of the Sovereign (1.5%), while private consumption and exports have been expected to pick up. This moderate level of growth is largely due to the public sector's dominance in the local economy (i.e. federal administration and the university), which limits economic volatility and forms a supporting factor for the city, especially during recessions. Unemployment rate has historically been low, reaching 2.1% last year, which was below the national average (2.6%). We expect unemployment to decrease going forward as the economy picks up.

### Moderately high debt level slightly increased, although expected to stabilise

Berne's net direct and indirect debt slightly increased in 2018 reaching high 104% of operating revenues from 96% in 2017, due to increased exposure in the city's pension fund. Going forward we expect the debt to stabilise at least until 2022, given the slight increase due to new investments will be accompanied by a comparable reduction in exposure to the pension fund, based on the convergence towards full coverage. This debt burden still compares well with the significantly higher levels of a decade ago.

Exhibit 3

**Berne's moderately high net direct and indirect debt are expected to stabilise.**
**NDID and interest payments (as % of Operating Revenues)**




2019 figures reflect our expectations
*Source: Issuer, Moody's Investors Service*

The city is exposed to some subsidiaries, none of which we deem a major risk. We consider the debt of majority-owned companies as almost entirely self-supporting.

The city's largest public companies are Energie Wasser Bern (EWB), a multi-utility corporation under public law. The company is profitable and privatisation is currently not under consideration. Another major entity is Bernmobil, a local public transport company. Berne also has shareholdings in six other companies, which we consider as minor risks for the city. The largest of them is the Fonds für Boden & Wohnbaupolitik, which is a conservatively financed public real estate developer. We note that Berne is not involved in any substantial public-private partnerships or leasing activities.

The city also provides some guarantees, mainly for the actuarial gap of its employees' pension fund, which we include as indirect debt. The coverage ratio of the fund sunk back to 91.0% at the end of 2018 from 96.4% in 2017. The city aims to close the gap by injecting capital over the coming years, combined with some measures for which other stakeholders will be responsible.

**Slightly uneven maturity profile, albeit well managed**

Berne has a conservative debt management approach and risks associated with its debt characteristics are low, given that all debt is in Swiss francs and at fixed rates. Typically, the use of derivatives is very limited and is managed carefully.

Debt service is somewhat volatile, but relatively stable in the last 3 years with 28.1% of total revenues in 2018 (after 27.2 and 30.0% in 2017 and 2016 respectively). In the past the volatility was mainly due to a somewhat uneven maturity profile of the city's outstanding bonds. The city is benefiting from the very low interest environment in Switzerland (Swiss national overnight rate standing at -0.75%), but also has some risk if interest rates increase, although not expected. We expect the debt service to stay between 25 and 30% in the medium term. The city has, however, taken measures to smooth out the maturity profile going forward and has excellent access to the well-developed and extremely liquid domestic capital markets.

The city's interest cost are low at 1.1% of operating revenues in 2018, slightly lower than the 1.4% in 2017. The figures for debt service and interest cost are adjusted, as they exclude interest on debt that has been lent on to self-supporting subsidiaries.

### Extraordinary support considerations

We consider Berne to have a moderate likelihood of extraordinary support from the Canton of Berne that reflects our assessment of the canton's stringent supervision, as it receives the city's annual reports and has the right to request any financial information for the current financial year. In case of deficits, the city will have to present an eight-year plan for budgetary consolidation, with final approval resting in the canton's hands. Despite this reliance, there are no implicit or explicit bail-out mechanisms from the canton to the city.

## Rating methodology and scorecard factors

The assigned baseline credit assessment (BCA) of aa1 is in line with the scorecard indicated BCA. The matrix generated BCA of aa1 reflects (i) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest, and (ii) a systemic risk score of Aaa, as reflected in the sovereign bond rating for Switzerland.

For details about our rating approach, please refer to Rating Methodology: Regional and Local Governments, 16 Jan 2018.

Exhibit 4
City of Berne

| Baseline Credit Assessment | Score | Value | Sub-factor Weighting | Sub-factor Total | Factor Weighting | Total |
|---|---|---|---|---|---|---|
| Scorecard | | | | | | |
| **Factor 1: Economic Fundamentals** | | | | | | |
| Economic strength | 1 | 132.43 | 70% | 1 | 20% | 0.20 |
| Economic volatility | 1 | | 30% | | | |
| **Factor 2: Institutional Framework** | | | | | | |
| Legislative background | 1 | | 50% | 3 | 20% | 0.60 |
| Financial flexibility | 5 | | 50% | | | |
| **Factor 3: Financial Performance and Debt Profile** | | | | | | |
| Gross operating balance / operating revenues (%) | 3 | 9.61 | 12.5% | 4 | 30% | 1.20 |
| Interest payments / operating revenues (%) | 3 | 1.27 | 12.5% | | | |
| Liquidity | 1 | | 25% | | | |
| Net direct and indirect debt / operating revenues (%) | 7 | 103.84 | 25% | | | |
| Short-term direct debt / total direct debt (%) | 5 | 27.00 | 25% | | | |
| **Factor 4: Governance and Management - MAX** | | | | | | |
| Risk controls and financial management | 1 | | | 1 | 30% | 0.30 |
| Investment and debt management | 1 | | | | | |
| Transparency and disclosure | 1 | | | | | |
| **Idiosyncratic Risk Assessment** | | | | | | **2.3(2)** |
| **Systemic Risk Assessment** | | | | | | **Aaa** |
| **Suggested BCA** | | | | | | **aa1** |

*Source: Moody's Investors Service*

## Ratings

Exhibit 5

| Category | Moody's Rating |
|---|---|
| **BERNE, CITY OF** | |
| Outlook | Stable |
| Issuer Rating | Aa1 |

*Source: Moody's Investors Service*

REPORT NUMBER 1181724

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