Research Update:

Austrian State of Styria 'AA/A-1+' Ratings Affirmed; Outlook Stable

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CreditWire Vendor Headline:

S&PGR Affirms Austrian State Styria At 'AA/A-1+'; Otlk Stable

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Overview

- Tax shortfalls will lead to significant deficits after capital accounts for Styria in 2020 and 2021.
- We assume that the state will return to balanced accounts by 2024, limiting the intake of direct debt.
- We are therefore affirming our 'AA/A-1+' ratings on Styria with a stable outlook.

Rating Action

On Jan. 29, 2021, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on the Austrian state of Styria. The outlook is stable.

Outlook

The stable outlook reflects our view that Styria will return to its consolidation path when the effects of the pandemic fade. We expect that the forecast economic recovery in Austria will lead to increasing tax revenue again by 2022 at latest, limiting the need for additional debt intake. Furthermore, we assume that access to the Austrian federal debt management agency will ensure the state's liquidity at all times.

Downside scenario

We could lower our ratings over the next two years if Styria failed to return to its consolidation path due to a loosening grip on expenditure, which we would regard as a management failure.

In addition, continued adverse macroeconomic conditions or negative changes to the institutional framework occurring from the scheduled update on tax equalization could put pressure on the ratings.

Upside scenario

Any upside scenario would require a significant improvement in Styria's financial performance, which we currently consider highly unlikely.

Rationale

Major tax shortfalls forecast for 2020 and 2021 will drive Styria's budgetary performance into significant deficits. We expect this will lead to an upward shift in debt metrics, which should remain contained due to ongoing consolidation measures and recovering tax revenue from 2022. Styria's debt ratio is still moderate in an international comparison. Our ratings on Styria are supported by the general strength of the Austrian national economy, despite the effects of the COVID-19 pandemic, and our view that the state maintains a certain degree of cost control. Styria further benefits from low contingent liabilities and exceptional access to liquidity via the Austrian federal debt management agency, OeBFA, and commercial banks.

The pandemic will reduce tax revenue considerably in 2021

The current recession in 2020, after lockdown measures to restrict the spread of COVID-19 in Austria, will lead to tax shortfalls in 2021. The shortfalls for Styria--as for other Austrian states--will be increased by the national tax reform implemented from 2021. Although we expect economic growth to rebound in 2021, collection and distribution mechanics imply that next year's tax revenue will be similarly affected as in 2020, effectively delaying the recovery of public finances. We currently anticipate Austria's national GDP will increase by an outstanding 4.5% in 2021. The Austrian fiscal system collects taxes nationally and distributes revenue to the states according to their relative population, therefore the Austrian states share the burden of the tax shortfalls with the central government.

We expect Austria's national GDP per capita to nevertheless remain at €42,300 (equivalent to $51,000) in 2020. Despite a COVID-19-induced drop, this still signals a very strong economy and clearly supports our ratings on Styria.

We continue to regard the institutional framework under which Styria operates as very predictable and supportive, but we anticipate that a pending update to the national tax-sharing formula will likely be delayed. The national fiscal equalization mechanism (Finanzausgleich), which determines the allocation of shared taxes between the federal, state, and local levels, was originally scheduled to be renegotiated by 2022. However, we understand that, given uncertainty about fiscal developments and limited resources for renegotiations, the existing formula might continue for two additional years, potentially with additional support from the federal forthcoming. If the Austrian federal legislators enact further meaningful changes to the tax code, this could be compensated by either additional one-off transfers to the states or systemic improvements in the distribution of tax revenue and expenditure tasks going forward.

In our view, Styria's financial management has so far demonstrated relative restraint in various spending decisions taken to mitigate the effects of COVID-19. These comprise, for example, the acquisition of protective medical equipment, support to individuals and enterprises not sufficiently covered by federal programs, and payments to facilitate capital expenditure by Styrian municipalities. Compared with national and international peers, the appetite for additional spending in Styria seems to be contained. We interpret this as a sign that cost control remains an important target for Styria's financial management.

One-off increase in debt due to deficits in 2020 and 2021

The lockdown measures to contain the pandemic, as well as the impact from the national tax rate reduction, will prevent Styria from fully balancing its accounts until at least 2023. Lower tax revenue in 2020 will lead to significantly lower budgetary performance in 2020 and the following years, with deficits after capital accounts of about 10% of total revenue. Styria had a track record of continuously improving its budgetary performance, peaking in 2019 thanks to a significant premium collected from a debt-refinancing exercise, with an exceptional surplus after capital accounts of 3.5%, according to our cash-focused calculation approach. Going forward, we expect practically balanced operating accounts in 2020-2021, and then recovery to about 5% of operating revenue by 2023. We expect this recovery to be driven by national tax revenue, which should improve to pre-pandemic levels by 2023 only, despite our assumption of economic recovery before then. Potential upside to our forecast could stem from increased consolidation measures or additional funds allotted to states in the upcoming revision of the national tax equalization. We currently see the revision as unlikely to be realized over the next three years, however.

Our assessment of budgetary performance reflects ongoing payments for unfunded, pay-as-you-go pension liabilities that, although not excessively large, will also weigh on results for the foreseeable future.

The forecast deficits in our base-case scenario will lead to an increase in direct debt to levels of about 100% of adjusted operating revenue. We expect debt to stay at this level until year-end 2023. Despite this increase in Styria's debt ratio, we anticipate its debt burden will remain average in an international context. Styria predominantly borrows from OeBFA, which allows for low-cost funding and offers long tenors of up to 100 years at preferential rates. The state's long-term annual debt maturities generally remain below €300 million. We believe that the predicted normalization of performance starting from 2022 will enable Styria to stabilize its debt burden at the current level.

Contingent liabilities are low in our view, since the state sold its minority stake in the former state bank in 2019. The remaining grandfathered guaranteed debt (less than €600 million) and sold housing loan receivables (slightly more than €600 million) that Styria also guarantees nominally constitute its largest exposures, but carry low economic risk in our view. We also include in our assessment of low contingencies the risk of being called to support its various participations such as utility company Energie Steiermark, in which the state holds a majority stake.

Similar to most other Austrian states, Styria's liquidity position is predominantly determined by its exceptional access to external liquidity via OeBFA and, with decreasing importance, the capital market. The state is entitled to borrow from OeBFA for planned drawings of funds and maintains a sizable credit facility with the agency for liquidity management purposes. We assume that OeBFA is ready to provide necessary liquidity support to Styria and its peers during the current slump. Styria also maintains €300 million of committed credit lines with three different commercial banks. Relative to the elevated deficits after capital accounts that we predict for 2020 and 2021, existing liquidity and commercial credit lines alone are insufficient to keep our calculated debt service coverage ratio above the relevant threshold of 40% during this period. But, since we anticipate performance will normalize from 2022, we continue to assess Styria's liquidity position as exceptional.

Key Statistics

Table 1

State of Styria Selected Indicators

	--Year ended Dec. 31--					
Mil. €	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**	**2023bc**
Operating revenues	5,358	5,545	5,292	5,339	5,675	5,902
Operating expenditures	5,018	5,137	5,240	5,387	5,512	5,599
Operating balance	340	407	51	(48)	163	303
Operating balance (% of operating revenues)	6.3	7.3	1.0	(0.9)	2.9	5.1
Capital revenues	255	567	168	168	168	168
Capital expenditures	836	764	752	706	680	671
Balance after capital accounts	(241)	211	(533)	(586)	(349)	(200)
Balance after capital accounts (% of total revenues)	(4.3)	3.5	(9.8)	(10.6)	(6.0)	(3.3)
Debt repaid	468	1,220	250	255	240	285
Gross borrowings	770	1,083	485	841	589	485
Balance after borrowings	31	67	(298)	(0)	0	(0)
Direct debt (outstanding at year-end)	4,547	4,398	4,633	5,219	5,568	5,768
Direct debt (% of operating revenues)	84.9	79.3	87.6	97.7	98.1	97.7
Tax-supported debt (outstanding at year-end)	4,742	4,562	4,797	5,383	5,732	5,932
Tax-supported debt (% of consolidated operating revenues)	88.4	82.2	90.6	100.7	100.9	100.4
Interest (% of operating revenues)	1.9	1.9	2.1	2.0	1.9	1.8
Local GDP per capita (single units)	40,000	41,164	38,768	40,835	41,917	43,069
National GDP per capita (single units)	43,681	44,879	42,339	44,712	45,993	47,264

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. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

State of Styria Ratings Score Snapshot

Key rating factors	**Scores**
Institutional framework	2
Economy	1
Financial management	2

Table 2 (cont.)

State of Styria Ratings Score Snapshot

Key rating factors	Scores
Budgetary perfomance	4
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, Dec. 14, 2020. An 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Jan. 11, 2021
- Local And Regional Governments Outlook 2021: Gradual Recovery Will Test Rating Resilience, Dec. 10, 2020
- Default, Transition, and Recovery: 2019 Annual International Public Finance Default And Rating Transition Study, Dec. 8, 2020
- Energie Steiermark AG, Nov. 25, 2020
- Institutional Framework Assessment: Austrian States, Oct. 13, 2020
- Credit Conditions Europe: Ill-Prepared For Winter, Sept. 29, 2020
- Economic Research: The Eurozone Is Healing From COVID-19, Sept. 24, 2020
- Research Update: Austria Rating Affirmed At 'AA+/A-1+'; Outlook Stable, Sept. 11, 2020
- European Local And Regional Government Risk Indicators, June 30, 2020

- COVID-19 Will Test The Financial Flexibility Of LRGs In Germany, Switzerland, And Austria, April 27, 2020
- Local Government Debt In Germany, Switzerland, And Austria For 2020, March 2, 2020

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	
Styria (State of)	
Issuer Credit Rating	AA/Stable/A-1+