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Research Update:

Austrian State of Burgenland 'AA/A-1+' Ratings Affirmed On Very Strong Budgetary Results; Outlook Stable

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Overview

- We consider that the State of Burgenland's budgetary performance has improved to very strong, contributing to stable and low tax-supported debt.
- In our view, the state operates under a very predictable and well-balanced institutional framework and has excellent access to external liquidity.
- We are affirming our 'AA/A-1+' ratings on Burgenland.
- The stable outlook reflects our view that Burgenland will continue to display very sound budgetary performance, with balanced accounts after capital spending on average over the next two years.

Rating Action

On May 8, 2015, Standard & Poor's Ratings Services affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on the Austrian State of Burgenland. The outlook is stable.

Rationale

The ratings on Burgenland primarily reflect our view of the very predictable and well-balanced institutional framework for Austrian states. We view favorably Burgenland's strong economy, low debt burden (including pension liabilities), low contingent liabilities, and strong financial management. Burgenland's budgetary performance has improved to very strong from strong on the back of exceptional earnings in 2014 and the zero deficit target for all states. We regard Burgenland's liquidity as exceptional, taking into account its exceptional access to external liquidity. Moreover, we factor into our assessment the state's limited budgetary flexibility. The long-term rating on Burgenland is equivalent to our 'aa' assessment of the state's stand-alone credit profile.

We base the ratings on the very predictable and well-balanced institutional framework for Austrian states, which protects Burgenland from volatility in its revenue base. All major taxes are shared between the federal and state governments. Consensus-based decision-making and the national stability pact mandate all levels of government to achieve a zero general government deficit by 2016 at the latest. Although the current system was initially to last until 2012, it has been extended until 2016. The negotiations for the scheduled update to the tax equalization system are ongoing, and we expect it to be implemented in 2016. At this stage, we don't anticipate significant effects on the states' finances.

We believe the political turmoil surrounding the creation of a wind-down unit for Austrian bank Hypo-Alpe Adria shows a shift in the balance of power between the federal government and the states. Reduced predictability of the institutional framework for Austrian states is now reflected in our assessment, as is our view of a weakened revenue and expenditure balance, due to the central government's interim refusal to allow Carinthia access to the federal treasury, which in turn reflects the institutional framework's propensity to support the states.

The rating on Burgenland benefits from the state's prudent financial strategies and clear commitment to balanced accounts after capital expenditures. In recent years, the state's administration has met or even exceeded its target budgets, which we view as another indicator of the state's cautious management. In addition, we don't think the state's constitutional reform will negatively affect our overall view of its strong financial management. Furthermore, we view positively the comprehensive accounting reform that is likely to occur in 2017.

In our base-case scenario through to year-end 2017, we expect Burgenland will show very strong budgetary performance, with an operating surplus of about 10% of operating revenues and balanced after-capital accounts on average. In 2014, the state likely outperformed its budget, closing the year with a surplus after capital accounts, mainly because of exceptional one-time revenues. These stem from an extraordinary €50 million payment to Burgenland following the EU Court of Justice's ruling on Grazer Wechselseitige Versicherung's (GRAWE's) acquisition of Bank Burgenland in 2006. Given the improvement in Burgenland's average budgetary performance compared with our last review, we believe budgetary performance will remain broadly stable, with operating surpluses of about 10% of adjusted operating revenues and balanced accounts after capital spending over the coming three years.

The state's stronger budgetary performance is largely due to solid shared-tax revenue growth, which dominates its revenue base, and a tight grip on operating and capital expenditures. We regard the state's overall budgetary flexibility as weak, however, given its small share of modifiable revenues, which usually stays below 20%. Burgenland has divested most of its assets in the past, securitizing large parts of its housing loans via its special purpose company, Wohnbau Burgenland GmbH, and selling Bank Burgenland in 2006.

All of Burgenland's borrowings come from the federal treasury and are in euros, and it does not use the capital markets at present. Given Austrian states' obligation to incur no net new borrowing by 2016 under the stability pact, we expect that Burgenland's long-term debt ratio will decrease gradually as its revenues increase. Based on our assumptions regarding Burgenland's revenues and spending, and our assessment of the state's prudent management, we expect that Burgenland will cease net new borrowing by 2015. Because the state has no specific debt-reduction program, we expect in our base-case scenario that its tax-supported debt will represent about 25% of operating revenues until 2017, which is very low compared with that of international peers. Including relatively high unfunded pension liabilities, we assess Burgenland's debt burden as low.

The guarantees that Burgenland grants to outsourced companies are a weakness, in our opinion. Although we view these guarantees as low risk and self-supporting, we also factor into our ratings the total amount guaranteed, which is more than twice the state's debt burden. Still, since the associated risk is limited, we assess the state's contingent liabilities as low. However, Burgenland's unconsolidated reporting limits budgetary transparency and completeness, in our view.

We also take into account Burgenland's strong economy in an international comparison. While our assessment is anchored by the national GDP, Burgenland's wealth is relatively low for an Austrian state, with GDP per capita at about two-thirds the national average. Additionally, although the state's economy is diversified, with mainly small and very small enterprises forming its backbone, activity is disparate. Southern parts of the state are very rural, with limited economic activity, whereas the northern areas show slightly more economic activity. Moreover, the state's unemployment rate is low, a benefit of its close proximity to Austria's capital, Vienna.

Liquidity

We view Burgenland's overall liquidity as exceptional, including what we regard as the state's exceptional access to external liquidity. Free cash, liquid assets, and committed facilities cover the state's yearly debt service by about 100%, making cash coverage adequate. Burgenland has agreed liquidity lines totaling €80 million with two banks, which we include in our debt-service coverage ratio. Daily cash holdings are generally very low because the state uses its access to the federal treasury for daily cash management, although the GRAWE payment provides a temporary boost to cash holdings until spent on investment projects. Additionally, cash flows are highly predictable because they follow a regular pattern during the year. Because Burgenland transferred its portfolio of assets in 2012 to the entities it owns, its direct access to liquid assets is now limited. Under our base case, debt service accounts for about 12% of operating revenues, including short-term refinancing via the federal treasury.

Our assessment of liquidity is supported by the state's exceptional access to external liquidity. Like all Austrian states, Burgenland is entitled to timely access to liquidity from the federal financing agency for planned drawings of funds, after yearly approval from the federal ministry of finance. We understand Burgenland has followed all required procedures for access. We view the possibility of financing via the federal treasury as a key credit strength for Austrian states, including Burgenland.

Outlook

The stable outlook reflects our view that Burgenland will maintain its very strong budgetary performance, with balanced accounts after capital spending over the next two years. This should, in turn, lead to stable nominal debt, in our opinion. Furthermore, we think economic conditions in Burgenland will not change markedly over the coming 24 months, keeping the state's economy structurally weaker than the very strong national average.

We currently do not envisage a realistic scenario in which we would upgrade Burgenland. If we saw significant structural surpluses after capital accounts, compared with our base-case scenario of balanced accounts, and structurally improved management, there could be upside rating potential.

We could lower our long-term rating on Burgenland over the next 24 months if we saw a pronounced deterioration of budgetary performance, for example, because increased spending pushed up tax-supported debt. Such a shift in budgetary discipline could also negatively affect our assessment of the state's financial management. However, this scenario would entail a breach of Austria's national debt-brake rule, which we view as highly unlikely to occur.

Key Statistics

Table 1

State of Burgenland Financial Statistics

	--Year end Dec. 31--					
(Mil. €)	**2012**	**2013**	**2014e**	**2015bc**	**2016bc**	**2017bc**
Operating revenues	1,039	1,092	1,151	1,112	1,149	1,181
Operating expenditures	977	995	991	1,000	1,039	1,054
Operating balance	61	98	160	112	111	127
Operating balance (% of operating revenues)	5.9	8.9	13.9	10.1	9.6	10.8
Capital revenues	15	20	20	14	14	14
Capital expenditures	143	111	145	126	126	135
Balance after capital accounts	(67)	7	35	0	(2)	6
Balance after capital accounts (% of total revenues)	(6.3)	0.6	3.0	0.0	(0.1)	0.5
Debt repaid	127	121	135	118	75	90
Balance after debt repayment and onlending	(193)	(114)	(100)	(118)	(77)	(84)
Balance after debt repayment and onlending (% of total revenues)	(18.3)	(10.2)	(8.5)	(10.5)	(6.6)	(7.0)
Gross borrowings	141	130	138	118	75	90
Balance after borrowings	(53)	16	38	0	(2)	6
Operating revenue growth (%)	4.3	5.2	5.4	(3.4)	3.3	2.8
Operating expenditure growth (%)	4.6	1.8	(0.4)	0.9	3.9	1.4
Modifiable revenues (% of operating revenues)	18.8	19.2	21.2	17.1	16.8	16.6
Capital expenditures (% of total expenditures)	12.8	10.1	12.7	11.2	10.8	11.4
Direct debt (outstanding at year-end)	266	275	278	278	278	278
Direct debt (% of operating revenues)	25.6	25.2	24.2	25.0	24.2	23.5
Tax-supported debt (% of consolidated operating revenues)	25.6	25.2	24.2	25.0	24.2	23.5
Interest (% of operating revenues)	1.3	1.3	1.4	1.4	1.1	1.2
Debt service (% of operating revenues)	13.4	12.3	13.1	12.0	7.7	8.8

Table 1

State of Burgenland Financial Statistics (cont.)

	--Year end Dec. 31--					
(Mil. €)	**2012**	**2013**	**2014e**	**2015bc**	**2016bc**	**2017bc**

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's 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 Standard & Poor's expectations of the most likely scenario. e--Expected year end result.

Table 2

State of Burgenland Economic Statistics

	--Year end Dec. 31--					
	2012	**2013**	**2014**	**2015bc**	**2016bc**	**2017bc**
Population	286,143	286,983	288,131	289,283	291,019	292,765
Population growth (%)	0.4	0.3	0.4	0.4	0.6	0.6
GDP per capita (local currency) (single units)	24,610	25,050	25,491	26,001	26,729	27,584
Unemployment rate (%)	7.8	8.5	8.9	N/A	N/A	N/A

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices, Eurostat, and Experian Limited. N/A--Not applicable. bc--Base case, reflects Standard & Poor's expectations of the most likely scenario.

Ratings Score Snapshot

Table 3

State of Burgenland Ratings Score Snapshot

Key rating factors	
Institutional framework	Very predictable and well balanced
Economy	Strong
Financial management	Strong
Budgetary flexibility	Weak
Budgetary performance	Very strong
Liquidity	Exceptional
Debt burden	Low
Contingent liabilities	Low

*Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

Sovereign Risk Indicators, March 31, 2015. An interactive version is available at www.spratings.com/sri

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs - October 15, 2009

Related Research

- Default, Transition, and Recovery: International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Public Finance System Overview: Austrian States, Jan. 12, 2011

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	
	To	From
Burgenland (State of)		
Issuer credit rating		

Ratings List Continued...

Foreign and Local Currency	AA/Stable/A-1+	AA/Stable/A-1+

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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