S&P Global Ratings

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Research Update:

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

April 24, 2020

Overview

- We estimate that the cost of the COVID-19 pandemic will likely lead to Burgenland posting a significant deficit in 2020.
- However, we expect that the state will be able to cover the losses from the federal tax holiday and the economic recession with funds from the federal treasury.
- We are therefore affirming our 'AA/A-1+' ratings on Burgenland and maintaining the stable outlook.

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Rating Action

On April 24, 2020, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on Austria's State of Burgenland. The outlook is stable.

Outlook

The stable outlook reflects our view that Burgenland is well positioned to cover the one-off hit to its budgetary performance in 2020 stemming from the pandemic. We believe Burgenland's debt will not increase beyond 60% of operating revenue in our forecast horizon through 2022.

Downside scenario

We would consider lowering our ratings on Burgenland in the event of consistent deficits after capital accounts, for example due to a deepening economic crisis or lifted cost-controls. This would result in a pronounced depletion of the state's currently ample liquidity and likely lead us to take a more negative view of the state's financial management.

Upside scenario

Ratings uplift would stem from an improvement of Burgenland's economic profile that aligned it with the national average, or a more supportive and predictable institutional framework for all Austrian states. However, we currently see these developments as unlikely.

Rationale

We expect the COVID-19 pandemic to have a significant impact on the state's budgetary performance, which should be partly offset by an economic rebound in 2021. We have not included any effects from the announced federal tax reform in our base case, because the reform has effectively been put on hold during the evolving health situation. We believe that the state's finances might benefit from the upcoming reform of the interstate equalization system from 2021, with negotiations potentially starting later this year. We believe that Burgenland will be to return to small surpluses after capital accounts from 2021, evidence to management's commitment to consistently reduce its direct debt burden. We also take into account Burgenland's exceptional liquidity situation, with funding provided by the federal treasury (OeBFA), as well as its lower economic wealth levels than other Austrian states'.

The tax holiday the federal government announced will have knock-on effects on states

We generally regard the legal framework in which Austrian states operate as predictable and supportive. Given that the states and the federal government depend on the same bucket of tax revenue, decisions taken at the federal level on tax rates--or most recently on tax holidays--have immediate effects for the states. The federal government has announced a tax holiday of up to three months for taxpayers, which will lead to estimated losses of €10 billion at the federal level in 2020. This leaves commensurately less for the states to take via the tax sharing system. Updates to the tax distribution system are regularly implemented, with negotiations for the next reform likely to start in late 2020 and take effect from 2022.

The federal government coalition announced a tax reform in early 2020 that would have caused tax revenue losses for Burgenland from 2021. We believe that a meaningful reform might be implemented, but the timing and extent of this reform is currently unclear. In addition, with the upcoming revision of the equalization system, we believe that the state might lobby for compensation at the federal level in exchange for its approval of the revision.

The Austrian fiscal system collects taxes nationally and distributes revenue to states according to their population. In this way, Burgenland benefits directly from the wealthy Austrian economy. National GDP per capita is very high at almost €45,000 per capita in 2019. We estimate the COVID-19 pandemic will cause national real GDP to decline in 2020 significantly, followed by a subdued rebound in 2021, with the regional economy to follow national trends. We expect Burgenland's fiscal revenue will mirror these developments, with a more pronounced negative effect in 2020 due to the announced tax holiday.

Austria's extensive tax-sharing regime has sheltered Burgenland from revenue-base volatility, but also limited the state's budgetary flexibility. The state benefits from central government transfers to a greater extent than its Austrian peers, partially owing to its economic profile. Although we view Burgenland's economy as strong in a global comparison, it is weaker than the national average. We estimate the state's GDP per capita at about 70% of the national average, and the proportion of Burgenland's dependent population is slightly higher than in most other Austrian states. With an unemployment rate of 7.5% as of March 2020 (according to the Austrian national definition), at par with national unemployment, unemployment is low by international standards.

However, we note that unemployment will likely see a sharp increase in 2020.

Following elections in early 2020, social democrats are now forming the state government with an absolute majority in the state parliament. All current government members were members of the previous coalition government, therefore we do not expect the state's prudent financial policies to change, given its stated intention to limit guarantees and reduce direct debt constantly. We anticipate that Burgenland will fully comply with the directives of the Austrian Stability Pact, and we assume the federal government will exempt states from the pact in 2020.

Deficit in 2020 will likely be funded by debt increase raised at the federal treasury

According to preliminary results, Burgenland posted a small deficit after capital accounts of 2.2% of adjusted total revenue due to the funding of some operating expense, which would have been expensed in 2020. We expect that final figures, including transfers to and from reserves, will not significantly alter the preliminary results. In 2020, we expect that the delays in tax revenue due to the tax holiday, in addition to the lower economic activity following the lockdown to fight the COVID-19 pandemic, will lead to significantly lower operating revenue. Unlike German and Swiss peers, Burgenland has not announced additional expenditure measures funded by own means; nevertheless, our base case incorporates some additional operating spending in 2020, leading to a significant deficit after capital expenditure.

In our base-case scenario from 2021, we anticipate that the state will return to moderate operating surpluses of 7% of operating revenue and roughly balanced after-capital accounts. That said, we note that Burgenland has kept a tight rein on spending, enabling stringent budget execution. Pensions are paid on a pay-as-you-go basis and are entirely unfunded, which weighs on our assessment of Burgenland's budgetary performance. We estimate the net present value of pensions at about €900 million, and believe that yearly payments of about 3% of operating revenue to retired special status civil servants will continue to burden the state's finances for years to come.

Even though we project an increase in debt in 2020, Burgenland's direct debt burden is low. The state usually follows a moderate net-debt repayment policy of €2 million per year, which we consider very likely to continue over the next few years, thanks to its sound liquidity reserves. All direct debt is in domestic currency at fixed interest rates with the federal treasury, which limits risks considerably. In our calculation of tax-supported debt we include the debt of BELIG, the state's real estate company, and KRAGES, the state's hospital institution. Unlike other Austrian states, Burgenland bears no contingent risk from guarantees or ownership of a public sector bank.

We consider that Burgenland's outsourced companies, including but not limited to the state's holding company LHB, represent the state's largest contingency risk. In addition, we factor into our assessment of contingent liabilities the currently negative market value of derivatives, which the state is trying to negotiate with banks. We assess contingent liability risk overall as limited in size and probability.

We consider the state's liquidity exceptional, based on a coverage ratio of cash, liquid assets, and committed credit lines to debt service over the coming 12 months well in excess of 100%. We also take into account Burgenland's established access to funding from OeBFA and the Austrian capital market. The state has signed two liquidity lines totaling €80 million with banks. The state only rarely utilizes commercial banks for short-term credit in limited amounts, predominately for a few days near the year-end. The state might use some of its liquidity to fund specific investment projects over the next few years.

Key Statistics

Table 1

State of Burgenland Selected Indicators

	--Fiscal year ending Dec. 31--					
(Mil. €)	2017	2018	2019bc	2020bc	2021bc	2022bc
Operating revenues	1,106	1,146	1,210	1,050	1,265	1,258
Operating expenditures	1,023	1,018	1,154	1,153	1,124	1,163
Operating balance	83	128	56	(103)	141	95
Operating balance (% of operating revenues)	7.5	11.2	4.6	(9.8)	11.1	7.6
Capital revenues	24	30	37	84	2	2
Capital expenditures	119	101	121	189	140	80
Balance after capital accounts	(12)	57	(28)	(208)	2	17
Balance after capital accounts (% of total revenues)	(1.0)	4.8	(2.2)	(18.3)	0.2	1.3
Debt repaid	76	31	81	83	88	64
Gross borrowings	74	73	0	290	85	62
Balance after borrowings	(14)	99	(108)	0	0	15
Direct debt (outstanding at year-end)	274	272	269	476	473	471
Direct debt (% of operating revenues)	24.8	23.7	22.2	45.3	37.4	37.4
Tax-supported debt (outstanding at year-end)	400	422	449	686	713	741
Tax-supported debt (% of consolidated operating revenues)	31.6	32.1	32.6	56.3	49.7	51.9
Interest (% of operating revenues)	1.4	1.3	1.3	1.7	1.4	1.4
Local GDP per capita (€)	30,000	30,585	31,170	N.A.	N.A.	N.A.
National GDP per capita (€)	42,209	43,720	44,986	N.A.	N.A.	N.A.

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 available.

Ratings Score Snapshot

Table 2

Burgenland (State of) Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	2
Economy	2
Financial management	2
Budgetary performance	4
Liquidity	1
Debt burden	2
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

- Full Analysis: Austria, March 13, 2020

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

- Economic Research: Europe Braces For A Deeper Recession In 2020, April 20, 2020
- Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 2020
- Economic Research: COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- Economic Research: COVID-19 Macroeconomic Update: The Global Recession Is Here And Now, March 17, 2020
- Full Analysis: Austria, March 13, 2020
- Local Government Debt In Germany, Switzerland, And Austria For 2020, March 2, 2020

- Default, Transition, and Recovery: 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
- Banking Industry Country Risk Assessment: Austria, June 19, 2019
- Ratings History List: Europe, Middle East, And Africa Local And Regional Government Ratings Since 1975, March 8, 2019
- Public Finance System Overview: Austrian States, Sept. 6, 2018

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