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CREDIT OPINION
10 June 2022

Update

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RATINGS

Ticino, Republic and Canton of

Domicile	Switzerland
Long Term Rating	Aa2
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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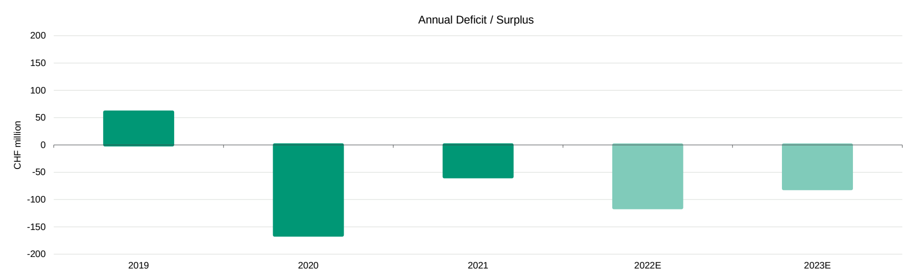
Republic and Canton of Ticino (Switzerland)

Update following affirmation of Aa2 stable

Summary

The credit profile of the Republic and Canton of Ticino (Ticino or the canton, Aa2 stable) is underpinned by its wealthy economy, very strong governance and high degree of fiscal flexibility, which supports solid financial results. Gross operating balance (GOB) has temporarily declined, as the COVID-induced economic shock hit the canton's tax revenues and resulted in additional spending. Ticino's strong stance towards fiscal consolidation and the gradual economic recovery post-pandemic should help the canton to return to solid GOB levels in the coming years. The credit profile also incorporates Ticino's conservative debt management and very good access to financial markets that mitigate risks stemming from moderate debt burden compared to international peers and large contingent liabilities. The ratings also factor in a moderate likelihood of support from the Government of Switzerland (Aaa stable) if the canton were to face acute liquidity stress.

Exhibit 1
Spending review to gradually reduce the annual deficit from 2023 targeting equilibrium by 2025



2022-23E: Moody's estimate
Source: Issuer and Moody's Investors Service

Credit strengths

» Strong stance towards fiscal consolidation, driven by a constitutional requirement in terms of financial equilibrium

» A high degree of fiscal flexibility, combined with sound management practices

» A wealthy economy

Credit challenges

» Increasing debt levels, although manageable

» Sizeable exposure to contingent liabilities

Rating outlook

The stable outlook reflects Ticino's resilience and wealthy economy which will support the canton's financial performance. The objective of a return to a balanced financial performance is further supported by the canton's very strong management and governance practices.

Factors that could lead to an upgrade

A combination of the following could have positive rating implications: a positive GOB, amounting to and stabilizing at a double-digit percentage of operating revenue; and a sustained reduction in leverage.

Factors that could lead to a downgrade

Negative pressures could be exerted on the rating by one or a combination of the following: a significant deterioration of the operating performance sustained over time. A substantially higher-than-expected net direct and indirect debt (NDID) to operating revenue ratio; and significant financial pressure arising from contingent liabilities. Although not likely, a sovereign downgrade could also result in a downgrade of Ticino's rating.

Key indicators

Republic and Canton of Ticino
Year ending 31 December

	2019	2020	2021	2022E	2023E
Net Direct and Indirect Debt as a % of Operating Revenues	84.6	88.1	97.9	91.9	96.0
Financing Surplus (Deficit) as % of Total Revenues	-2.9	-8.8	-5.3	-7.0	-6.9
Gross Operating Balance as a % of Operating Revenues	4.5	-2.0	1.0	-0.3	0.7
Interest Payments as a % of Operating Revenues	0.6	0.6	0.5	0.6	0.6
Intergovernmental Revenues as a % of Operating Revenues	29.1	30.7	32.6	31.0	31.2
Capital Expenses as a % of Total Expenses	10.1	9.2	8.9	9.7	9.9
GDP per capita as a % of national average	105.9	106.0	105.7	105.3	105.9

Source: Issuer, National Statistical Office and Moody's Investors Service

Detailed credit considerations

On 3 June 2022, Moody's has affirmed the Republic and Canton of Ticino's Aa2 issuer and senior unsecured debt ratings, reflecting the canton's wealthy economy, which supports solid financial results, very strong governance, high degree of fiscal flexibility and a moderate debt burden compared to international peers. The Aa2 ratings also reflect large contingent liabilities but which pose limited risks.

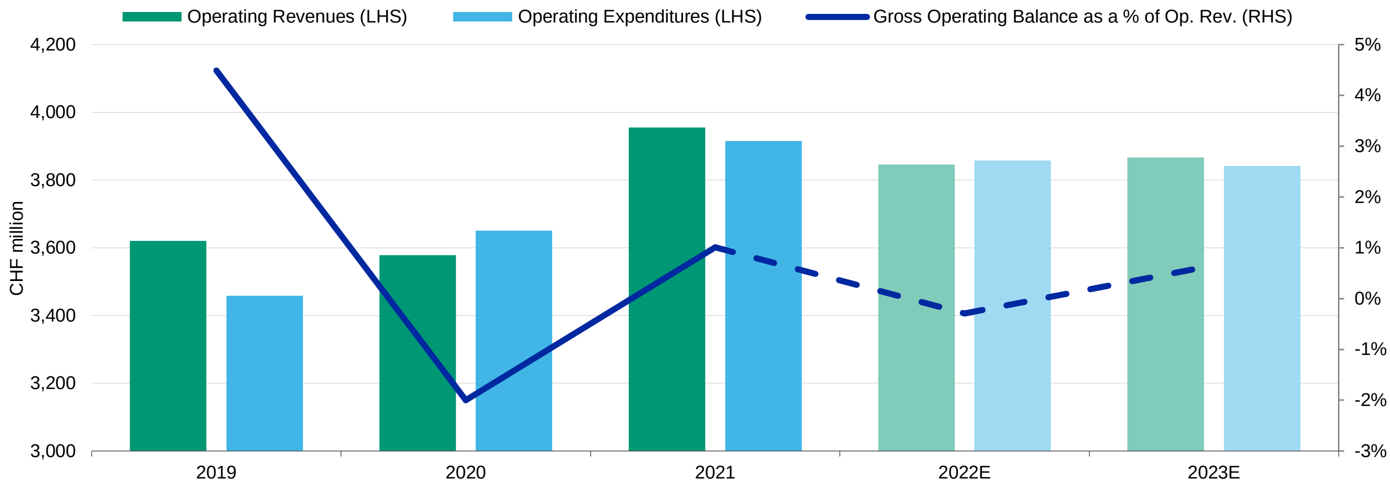
The credit profile of the Republic and Canton of Ticino, as expressed in its Aa2 stable rating, combines a Baseline Credit Assessment (BCA) of aa2 and a moderate likelihood of extraordinary support from the Swiss Confederation in the event the canton faces acute liquidity stress.

Baseline credit assessment

Strong stance towards fiscal consolidation, driven by a constitutional requirement in terms of financial equilibrium

Ticino's gross operating balance (GOB) has declined as the COVID-induced economic shock hit the canton's tax revenues and resulted in additional spending, leading to a GOB-to-operating revenue of -2% in 2020, compared to 4.5% in 2019. The operating performance was positive in 2021 (GOB-to-operating revenue of 1%), supported by resources provided by the Swiss Confederation to cantons to finance pandemic-related expenses. We expect that the GOB should represent -0.3% of operating revenue in 2022. Ticino has recently decided to launch a spending review from 2023, targeting a balanced financial performance by 2025, an objective that is embedded in cantonal constitution and law. The canton will mainly review personnel spending, costs of goods and services, and transfers, in order to reduce the annual financial deficit to CHF-80 million down from CHF-129.8 million budgeted in 2023, and then progressively to CHF-40 million in 2024 and to 0 in 2025 (Exhibit 1). The canton's strong stance towards fiscal consolidation should help Ticino to return to positive GOB levels from 2023 onwards (Exhibit 3). Our expectations are underpinned by Ticino's successful track-record in restoring financial equilibrium, reflected in its positive governance issuer profile score (G-1), which recognizes the canton's very strong management and governance practices.

Exhibit 3
Progressive return to solid GOB levels in the coming years, supported by the strong stance towards fiscal consolidation and the gradual economic recovery post-pandemic



2022-23E: Moody's estimate
Source: Issuer and Moody's Investors Service

A high degree of fiscal flexibility, combined with sound management practices
Ticino benefits from a high degree of fiscal flexibility, which supports solid financial results. The canton, like its national peers, has ample autonomy in setting tax rates and the cantonal law provides for an adjustment of the fiscal coefficient to meet financial targets, if other measures, such as spending review or other revenue increase, are not sufficient. Ticino also benefits from a robust inter-cantonal revenue equalization system, which provides stability to cantons' finances. Tax receipts account for the highest proportion of operating revenues (58% in 2021), followed by intergovernmental transfers (33%) and other revenues (9%). Moreover, the canton has strong flexibility on the expenditure side, even if social spending is a sizeable and a rigid budget item with cost pressures associated with ageing population.

Ticino's financial management is sound. Financial planning is strong with in-year monitoring, fiscal targets are defined and typically met and the degree of transparency is high. Debt and investment management are conservative and based on clear guidelines. The debt structure is simple with long-term debt mainly consisting in bonds at fixed rate. Ticino's debt management targets a smooth amortisation profile, avoiding very long tenor, with a cap of CHF 250 million per year on long-term debt repayment. Ticino takes a proactive approach to treasury management. Treasury budgets are carefully planned and monitored during the year taking into consideration scheduled liquidity inflows and outflows. Cash on hand stood at 1.8% of operating revenue in 2021 down from 2% in 2020 and it is likely to remain at a similar level in 2022, since the canton tries to minimize cash in bank accounts to avoid paying interest rates on cash balances. However, we do not consider the cash position as a challenge because of very good access to financial markets.

A wealthy economy
Ticino is a medium-sized canton, located in the southern part of Switzerland. It shares its border with the Region of Lombardy (Italy) (Baa2 stable), the wealthiest region of Italy. The districts of the City of Lugano (Aa3 stable) and Mendrisio are key international hubs for import and export businesses.

Ticino's GDP per capita is slightly above the national average (around 105%), which is higher than the European average. The cantonal GDP is mainly driven by the service industry (around three quarters), followed by manufacturing. Trade, banking and real estate account for the bulk of Ticino's economic activity, although banking industry growth has slowed since the financial crisis. Industries most affected by the pandemic (restaurants and hospitality) have benefited from economic support, preventing a rise in insolvency rates in 2020 and 2021.

After the economic contraction in 2020 because of the pandemic (Swiss real GDP reduced by -2.5%), Swiss economy started to recover in 2021 (forecasted real GDP growth rate of 3.7%) and we expect a real GDP growth rate of 2.5% in 2022. The gradual economic recovery post-pandemic will further support the canton's fiscal results, while Ticino's exposure to the consequences of Russia-Ukraine military conflict is relatively low.

Increasing debt levels, although manageable

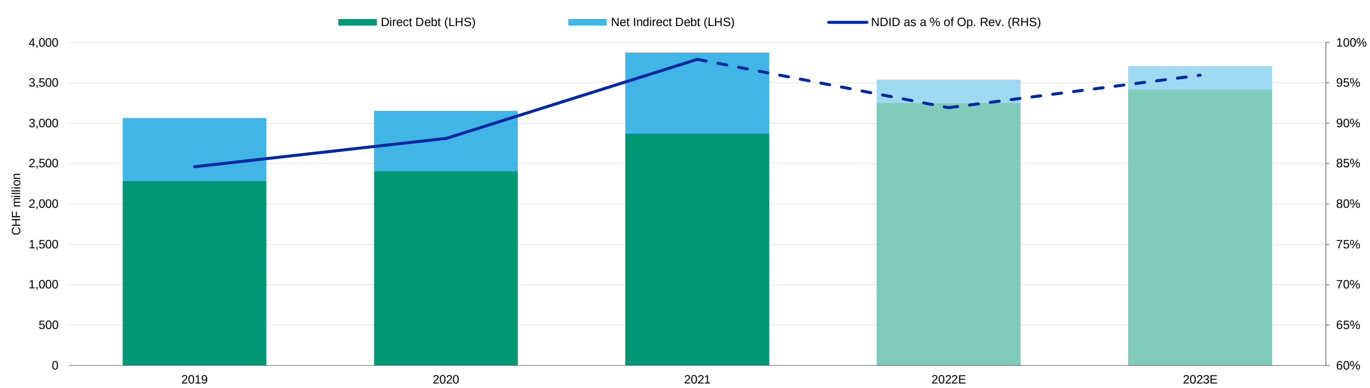
In 2021 Ticino's net direct and indirect debt (NDID) amounted to CHF3.87 billion. As of year-end 2021, long-term direct debt accounted for 50% of Ticino's NDID, short-term direct debt for 24% and indirect debt for 26%. NDID to operating revenue ratio has increased to 98% in 2021 up from 85% in 2019, driven by one-off short-term borrowing needs. The canton has used CHF942 million of short-term debt in 2021 and CHF580 in 2020 – thereby temporarily exceeding the cantonal guideline to keep the share of short-term debt below 20% of total debt – to cover tax deferral granted during the pandemic in 2020, and to pre-finance long term debt repayment and a loan to Banca Stato in 2021.

Indirect debt consists of a financial liability of over CHF700 million to attain 85% pension obligation coverage ratio by 2051. Ticino has decided to give in advance this amount to IPTC (Insituto di Previdenza del Cantone Ticino) in 2022 and 2023, and to finance it by issuing long-term debt. IPTC will invest this contribution in the markets, aiming at achieving 100% coverage ratio with the investment proceeds in the long-term. We also include in the indirect debt the financial debt of the cantonal hospital (Ente Ospedaliero Cantonale [EOC]), which represents around 7% of Ticino's NDID.

We expect Ticino's NDID to remain above 90% of its operating revenue in 2022, and approaching 100% over the next three years (Exhibit 4). With an average interest rate at 0.8% on long-term debt at year-end 2021 and a simple debt profile, the canton's debt burden will remain very manageable.

Exhibit 4

NDID to stay above 90% of operating revenue, but remains manageable



2022-23E: Moody's estimate.
From FY2021 we include in the indirect debt the financial debt of the cantonal hospital (EOC).
Source: Issuer and Moody's Investors Service

Sizeable exposure to contingent liabilities

Ticino's contingent liabilities represent 480% of operating revenue in 2021 and mainly comprise the cantonal bank Banca Stato's obligations. Ticino owns 100% of Banca Stato and provides a full deficiency guarantee on the bank's liabilities (4.3 times of operating revenue). Banca Stato is an autonomous institution under public law, which aims to promote Ticino's economic development through mortgage lending and asset management. Its activities cover all the operations of a universal bank. Ticino's exposure to contingent liabilities has grown to 480% in 2021 up from 426% in 2019, driven by Banca Stato's significant increase of customer deposits, due to pandemic-induced rise in savings. However, we assess the risks associated to these liabilities to be moderate reflecting the bank's solid credit profile and close supervision of the Swiss Financial Market Supervision Authority (FINMA).

Ticino's exposure to contingent liabilities is also derived from its fully owned electricity wholesaler Azienda Elettrica Ticinese (AET). AET's institutional mandate is to guarantee the procurement of electricity for the canton at competitive prices. AET's leverage is currently low compared with that of Ticino and represents around 7% of the cantonal operating revenue.

Finally, we view as a contingent liability Ticino's exposure to the remaining unfunded part of its pension fund (to attain 100% coverage ratio), which corresponds to around 40% of its operating revenue. As Ticino can change the pension levels retroactively with a law, this could lead to a lower disbursement – thereby reducing liabilities – in case of need.

Ticino's very good access to financial markets and conservative debt management largely mitigate risks stemming from its moderate debt levels and large contingent liabilities. Should contingent liabilities expand, the value of cantonal guarantees will grow proportionally, a credit negative.

Extraordinary support considerations

Ticino has a moderate likelihood of receiving extraordinary support from the Swiss Confederation. This reflects Swiss cantons' ample autonomy, and the strongly decentralized relationship between the cantons and the Swiss Confederation.

ESG considerations

REPUBLIC AND CANTON OF TICINO's ESG Credit Impact Score is Positive CIS-1

Exhibit 5
ESG Credit Impact Score

CIS-1
Positive

NEGATIVE IMPACT POSITIVE IMPACT

For an issuer scored CIS-1 (Positive), its ESG attributes are overall considered as having a positive impact on the rating. The overall positive influence from its ESG attributes on the rating is material.

Source: Moody's Investors Service

Ticino's ESG Credit Impact Score is positive (**CIS-1**), reflecting a very strong governance profile and neutral-to-low exposure to environmental and social risks.

Exhibit 6
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-2	G-1
Neutral-to-Low	Neutral-to-Low	Positive

Source: Moody's Investors Service

Environmental

We assess Ticino's environmental issuer profile score as neutral-to-low (**E-2**). Exposure to environmental risks such as carbon transition, water management, natural capital and waste & pollution is neutral-to-low. Ticino has a moderately negative exposure to physical climate risks, due to increasingly volatile weather conditions and rising temperatures. Climate change related environmental trends may cause losses in productivity, weigh on investment and put pressure on cantonal revenue base.

Social

Our overall assessment of Ticino's social issuer profile results in a neutral-to-low score (**S-2**). The canton has a high level of education and overall strong levels of public health & safety. Residents benefit of a good access to basic services. Labor & income indicators are favorable, reflecting a relatively diversified service-based economy and a low unemployment rate. Ticino is moderately negative exposed to demographics challenges, due to population ageing. We foresee a persistently high, although manageable, future demand for healthcare and social services with implications on public spending. Housing is viewed as moderately negative given the elevated housing prices across the territory.

Governance

Ticino's highly transparent and very strong management and governance practices are captured by a positive governance issuer profile score (**G-1**). Strong stance towards fiscal consolidation, driven by a constitutional requirement in terms of financial equilibrium, will perdure and will contribute to Ticino's ability to meet and even exceed its fiscal targets. Sound debt management, based on clear guidelines, combined with very good access to financial markets, support liquidity and mitigate risks stemming from its moderate debt levels and contingent liabilities, which will remain manageable.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of aa2 is close to the scorecard-indicated BCA of aa1. The one-notch differential reflects the potential pressure that might arise from the canton's contingent liabilities.

The matrix-generated BCA of aa1 reflects an Idiosyncratic Risk score of 2 (presented below) on a 1-9 scale, where 1 is the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aaa, as reflected in the Swiss bond rating (Aaa stable).

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

Exhibit 7

Republic and Canton of Ticino

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**2.40**	**20%**	**0.48**
Economic Strength [1]	3	105.78%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**1**	**20%**	**0.20**
Legislative Background	1		50%			
Financial Flexibility	1		50%			
Factor 3: Financial Position				**4.50**	**30%**	**1.35**
Operating Margin [2]	5	0.64%	12.5%			
Interest Burden [3]	1	0.55%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	5	97.91%	25%			
Debt Structure [5]	9	41.49%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**2.33 (2)**
Systemic Risk Assessment						**Aaa**
Scorecard-Indicated BCA Outcome						**aa1**
Assigned BCA						**aa2**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance/operating revenues
[3] Interest payments/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2021.

Ratings

Exhibit 8

Category	Moody's Rating
TICINO, REPUBLIC AND CANTON OF	
Outlook	Stable
Issuer Rating	Aa2
Senior Unsecured -Dom Curr	Aa2

Source: Moody's Investors Service

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