MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
21 June 2017

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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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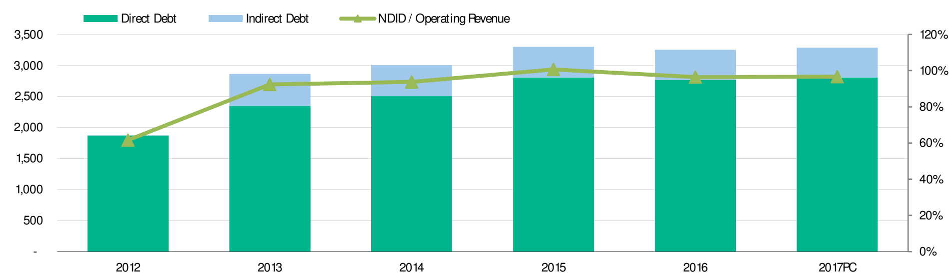
Ticino, Republic and Canton of

Switzerland, Government of

Summary Rating Rationale

The Canton of Ticino's (CT) Aa2 issuer and debt ratings are underpinned by (1) a constitutional requirement to maintain financial equilibrium; (2) a high degree of budgetary and financial flexibility; (3) efficient treasury management, (4) a strong and diversified economy. The canton faces the following credit challenges: (1) its gross operating balance has historically been tight, although it is stabilising towards equilibrium; (2) a high debt exposure; (3) the moderate contingent liabilities in the form of guarantees issued to the canton's fully-owned bank, Banca dello Stato del Canton Ticino ("Banca Stato"), and partly unfunded pension liabilities.

Exhibit 1
Net Direct and Indirect debt (NDID) expected to stabilise
CHF million



Source: Issuer, Moody`s

Credit Strengths

» A constitutional requirement to maintain financial equilibrium

» A very high degree of budgetary and financial flexibility

» Efficient treasury management

» A strong and diversified economy

Credit Challenges

» Tight gross operating balance, although slowly increasing

» High debt levels

» Guarantees issued to wholly-owned bank

Rating Outlook

The rating outlook is stable.

Factors that Could Lead to an Upgrade

» A positive gross operating balance amounting to a double-digit percentage of operating revenues

» A structural deleveraging

Factors that Could Lead to a Downgrade

» A materially higher than expected increase in the Canton's net direct and indirect debt ratio

» Significant financial pressure arising from contingent liabilities triggered by the cantonal bank or cantonal pension fund

Key Indicators

Exhibit 2

Ticino, Republic and Canton of

	2012	2013	2014	2015	2016	2017PC
Net direct and indirect debt as % of operating revenues	61.61	92.41	93.74	100.64	96.40	96.64
Accrual financing surplus (requirement) as % of total revenue	-5.44	-11.55	-7.94	-5.93	-3.46	-4.20
Gross operating balance as % of operating revenue	0.27	-2.82	-1.73	0.13	1.36	2.06
Interest payments as % of operating revenue	1.25	1.33	1.10	1.07	0.97	0.79
Intergovernmental transfers as a % of operating revenues	27.00	29.53	29.10	28.97	28.97	30.20
Capital spending as a % of total expenditures	8.42	10.62	9.11	8.91	7.90	9.20
GDP per capita as a % of national average	102.68	102.43	104.86	-	-	-

*Modified cash figures, net of depreciation and pass-through items, PC = pre-closed figures, last GDP per capita figures available at 2014
Source: Issuer, Moody`s

Detailed Rating Considerations

Baseline Credit Assessment

FINANCIAL EQUILIBRIUM MANDATED BY CONSTITUTION

A recent change in CT's constitutional law requires it to maintain an operating financial equilibrium, a credit positive. The cantonal government has put in place a financial plan, focused on spending reductions, which will allow it to comply by 2018 at the latest. This plan, which we see as realistic, is in line with the cantonal rule which sets deficit limits of 9% of operating revenues.

In 2016 CT implemented a spending review designed to eliminate its annual deficit, which stood at CHF47.4 million, or a modest 1.4% of operating revenues, in 2016. The spending review is designed to achieve savings of CHF141 million in 2017, CHF168 million in 2018 and CHF185 million in 2019. We consider this a credible and effective plan which will help ensure a positive financial performance in the next three years. The sector where the greatest savings will likely be achieved is healthcare and social affairs. In the future we foresee persistently high although manageable demand for healthcare and social services, reflecting CT's ageing population.

A VERY HIGH DEGREE OF BUDGETARY AND FINANCIAL FLEXIBILITY

CT's very low tax rates give it a significant financial buffer. The canton, like its peers, has unlimited autonomy in setting tax rates and exerts full control over its costs, giving it a high degree of fiscal flexibility. CT also has good access to capital markets, including the short-term money market.

CT's operating revenues increased by 10.9% in 2012-16 even though its tax rates remained unchanged. Tax receipts account for 63.9% of the canton's revenues, followed by intergovernmental transfers (29%) and other revenues (7.1%). Under the Swiss fiscal system, the federal government, the cantons and the municipalities all levy separate personal income taxes and corporate taxes. CT has complete freedom to set the rate for cantonal personal income tax and corporate tax, which accounts for the highest proportion of total tax payments.

General purpose grants account for 56.8% of CT's intergovernmental transfers. CT also benefits from a robust inter-cantonal revenue equalization system, which ensures a stable annual gross operating balance. Budgetary flexibility is more limited on the expenditure side due to costs associated with the canton's ageing population.

EFFICIENT TREASURY MANAGEMENT

CT takes a proactive approach to treasury and debt management. Treasury budgets are carefully planned in advance through the fiscal year. As of 2016, Ticino had access to CHF2.9 billion of uncommitted credit lines with 26 banks and supranational organizations. As of YE2016 the canton had used CHF638.5 million of short-term debt. The credit lines are renewable and have a maturity of between 1 week and 12 months.

Cash-on-hand stood at a modest 2% of operating revenues on average in 2012-16, which is low compared to peers. However, we do not consider the low cash position as a challenge due to easy borrowing fostered by Switzerland's current negative interest rates.

Treasury and debt are managed by CT's Department of Finance and Economy (DFE), which is responsible for: (1) Short and long-term funding and (2) Treasury management and short-term financial investments. The DFE can lend besides other public entities, such as its owns participated companies, only to counterparties that have a minimum rating of A3 and are regulated by FINMA, the Swiss financial supervisor.

A STRONG AND DIVERSIFIED ECONOMY

Ticino is a medium sized canton with a population of about 350,000 and a relatively diversified service-based economy. GDP per-capita is slightly above the national average (104.9% in 2014-last reported figure), but significantly above the EU28 average (220%). The unemployment rate was 5.9% in 2017 (first-quarter), slightly higher than the Swiss average of 5.3%. Located in the southern part of Switzerland, CT shares a border with Lombardy (Baa1 - stable), the wealthiest region of Italy. CT's workforce includes about 62,000 skilled cross-border workers, a number that has increased over the last years. Cantonal GDP is mainly driven by the service industry (71%), followed by manufacturing (27%). Trade, banking and real estate account for the bulk of Ticino`s economic activity, even if banking industry growth has slowed since the financial crisis. More than 70% of CT's workforce is employed in the service industry, where trade, banking and tourism are the dominant sectors. The districts of Lugano and Mendrisio are key international hubs for import and export businesses, a strong source of potential growth. CT has particular strengths in raw material trading and fashion industry logistics, which helps attract skilled workers.

TIGHT GROSS OPERATING BALANCE, ALTHOUGH SLOWLY INCREASING

The canton's operating performance has been tight in the last 5 years, as indicated by a gross operating balance (GOB) ranging from +1.4% of operating revenue in 2016 to -2.8% in 2013. The ratio increased to 1.4% in 2016 from 0.1% in 2015 and is expected to improve toward 2.1% in 2017. We expect GOB to become stronger going forward.

In 2016, the canton reported an annual operating deficit of CHF47.4 million (gross of depreciation), down sharply from CHF128 million the previous year and significantly lower than the budgeted CHF87.9 million deficit. The mandatory equilibrium requirement in the cantonal constitution should gradually reduce the deficit, allowing CT to reach breakeven in 2018.

HIGH DEBT LEVELS

In 2016, CT's net direct and indirect debt (NDID) amounted to CHF3.25 billion, or 98.1% of realized operating revenue, which is high compared to national and international peers. This was up from 61.6% in 2012, reflecting mainly a one-off contribution to the cantonal pension fund.

This level of debt is manageable considering current low interest rates, and the canton's significant financial flexibility. We expect the NDID as a percentage of operating revenues to stabilise to 99% in 2017. In 2016 CT issued CHF170 million bullet bond with 0.4% coupon due in 2044 to cover cumulated deficit. NDID as a percentage of operating revenues should stabilise from 2017-18 as the canton reaches budgetary breakeven. As of YE2016 long-term debt accounted for 65% of CT's NDID, followed by short-term (20%) and indirect debt (15%). In 2016 the indirect debt consists of a financial liability of about CHF432 million with a fixed amortizing schedule aimed at funding up to 85% of the canton's pension obligations by 2051. Its pension liabilities are currently 67.3% funded.

GUARANTEE ISSUED TO WHOLLY-OWNED BANK

CT owns 100% of Banca Stato and provides a full deficiency guarantee on the bank`s deposits (3.6x cantonal revenues). However, the potential threat posed by Banca Stato is moderate thanks to its low-risk business profile, and the canton is further protected by its good access to the capital markets. Banca Stato is adequately capitalized with a Tier 1 ratio of 15.7% in 2016, in line with national peers.

Banca Stato is an autonomous institution under public law which aims to promote Ticino's economic development through mortgage lending and asset management. The Bank is headquartered in Bellinzona and has 460 employees in four branches and 14 agencies. Its activities cover all the operations of a universal bank. Seventy percent of Banca Stato's revenues are generated through lending. In 2010 the lender increased its private banking business by acquiring a controlling stake in UniCredit (Suisse) Bank (USB), now called Axion SWISS Bank SA, and today fully owned by Banca Stato. The investment was designed to reduce the bank's lending exposure. Although the bank's risk appetite is low, we see some risk from M&A activity. Should the balance sheet of the bank expand, the value of cantonal guarantee will grow proportionally, a credit negative.

Extraordinary Support Considerations

Moody's assigns a moderate probability of extraordinary support from the Swiss Confederation. This reflects Swiss cantons' ample autonomy, and the strongly decentralized relationship between the cantons and Confederation.

Output of the Baseline Credit Assessment Scorecard

In the case of Ticino, the BCA matrix generates an estimated BCA of aa1, 1 notch higher compared to the BCA assigned by the rating committee.

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

The idiosyncratic risk scorecard and BCA matrix, which generate estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by these tools provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

Rating Methodology and Scorecard Factors

Exhibit 3
Ticino, Republic and Canton of

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub- factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	5	104.86	70%	3.8	20%	0.76
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	1	20%	0.20
Financial flexibility	1		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	5	0.57	12.5%	3.75	30%	1.13
Interest payments / operating revenues (%)	3	1.01	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	5	96.40	25%			
Short-term direct debt / total direct debt (%)	5	22.76	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						2.39(2)
Systemic Risk Assessment						Aaa
Suggested BCA						aa1

Source: Issuer, Moody`s

Ratings

Exhibit 4

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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