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Research Update:

Austrian State Of Vorarlberg Assigned 'AA+/A-1+' Ratings; Outlook Stable

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Overview

- In our view, the Austrian State of Vorarlberg benefits from an excellent individual credit profile and prudent management.
- We include in our assessment the relatively high contingent risks from majority ownership of the state bank.
- We are assigning our 'AA+/A-1+' ratings to Vorarlberg.
- The stable outlook reflects our expectation that Vorarlberg will be able to keep its excellent financial position, with balanced accounts and a very low debt burden over the next two years.

Rating Action

On Oct. 16, 2015, Standard & Poor's Ratings Services assigned its 'AA+/A-1+' long- and short-term issuer credit ratings to the Austrian State of Vorarlberg. The outlook is stable.

Rationale

We base our ratings on Vorarlberg on the very predictable and well-balanced institutional framework for Austrian states. The ratings benefit from our view of the very strong regional economy and very strong management. The state's budgetary performance is very strong, with consistent surpluses after capital accounts on average over five years, including three years of our base-case scenario. We consider the state's liquidity as exceptional, based on an outstandingly high coverage of yearly debt service. Vorarlberg's very low tax-supported debt burden also supports the ratings.

We assess the state's budgetary flexibility as average, as it has considerable assets available for sale if needed. Contingent liabilities are moderate, in our view, given the high capitalization of the state bank.

The long-term issuer credit rating on Vorarlberg is at the same level as our assessment of its stand-alone credit profile.

Vorarlberg has an excellent individual credit profile, in our view. The state's management follows a clearly established budgeting process, with conservative planning assumptions on a worst-case basis. The state consequently usually outperforms its budgets and financial planning, which supports the strong political commitment to achieve balanced accounts with no new debt borrowing. In addition, we regard management as risk-averse, since foreign exchange loans and the use of derivatives and structures are forbidden by state law. The state's liquidity policy focuses on continuing access to banks, which should enable the state to cover its

very low debt service of below 1% of operating revenues. In addition, in case of need, the federal finance minister has the power to grant all states access to funds from the federal treasury. We understand that the access is usually granted after a formal application, which Vorarlberg has not made.

In our base-case scenario until year-end 2017, we expect that Vorarlberg will achieve an average five-year operating surplus of 11% of operating revenues, and a small surplus after capital accounts on average. We therefore regard the state's budgetary performance as excellent. Vorarlberg has a history of very sound budgetary performance, with a surplus after capital accounts on average over 2012-2014, and an outstanding operating surplus of over 10% achieved on average over the past three years. Contrary to the state's official budgeting and financial planning, we expect this development to continue as tax revenues currently outperform the state's expectations and expenditures are on track. In addition, we do not expect that the current refugee crisis in Europe will lead to a significant impact on public accounts in Austria or elsewhere in the eurozone (see "The Surge Of Refugees In The EU: Boon Or Burden For Sovereign Ratings?" published Sept. 15, 2015, on RatingsDirect).

Vorarlberg posts the lowest tax-supported debt ratio of all Austrian states, and we forecast it will remain stable, in the very low single digits when compared to operating revenues, until 2017. Both direct debt and tax-supported debt are also very low in an international comparison. All debt is amortizing and denominated in euros, effectively limiting refinancing risks and eliminating foreign exchange risks. In contrast to most Austrian states, Vorarlberg's pension liabilities are low, in our view, which further supports this credit strength.

We also take into account Vorarlberg's moderate contingent liabilities, stemming mainly from its majority ownership of Vorarlberger Landes- und Hypothekenbank AG. The bank is very large when compared with the state budget size and also in comparison with other Austrian or German state banks or Swiss cantonal banks relative to the budget size of their respective government owner. However, we assess that the bank has adequate capitalization and sound risk management, which somewhat reduces the risk of the state being called to support the bank. In addition, we note positively that the Austrian states reacted quickly following the implementation of a moratorium on debt and interest payments by HETA, the workout unit for failed Hypo-Alpe Adria. This was driving another state-guaranteed bank, Pfandbriefstelle, into a possible liquidity squeeze as HETA is one of the main assets of this bank.

In our opinion, Austrian states benefit from the generally close and consensus-based cooperation between Austria's federal and state governments, which forms an institutional framework we regard as very predictable and well balanced. According to the constitution, the federal government can unilaterally pass a new tax-sharing system. However, usually both the federal and state levels of government work together to agree on the system. The next scheduled revision of the law on taxsharing is in 2016; negotiations between the federal government and the states started in mid-2015. We don't anticipate a major reform of the allocation of responsibilities or resources to Austrian states. If major changes occurred, we believe the states would receive compensation for any potential additional

expenditure. Moreover, we don't believe that the potential upcoming tax reform in Austria will lead to major revenue shortfalls for the states, as Austria's stability pact and its national debt-brake rule set forth financial goals to be achieved by the states. We believe that Vorarlberg is well positioned to meet the nationally set targets.

The vast majority of Vorarlberg's revenues stem from shared taxes and transfers from the federal government. The central government collects taxes and distributes the funds to the states according to a predefined formula, which makes Vorarlberg's revenue base dependent on national economic developments. Vorarlberg's regional economy is very strong, in our opinion, with an estimated GDP per capita of about €39,540 on average over the past three years and a growth rate similar to the national average. Regional unemployment is lower than the national level, and rising at slower rates, which further underlines Vorarlberg's regional economic strength. We understand that the number of employed is increasing, but newly created jobs do not absorb the increasing labor supply.

We regard Vorarlberg's budgetary flexibility as average in an international comparison. The share of Vorarlberg's modifiable revenues is very low as the state cannot influence shared taxes. Contrary to most Austrian states, Vorarlberg has an above-average capability to generate revenues from asset sales, although this is currently not on the political agenda. However, in our view Vorarlberg has the means to increase its generally limited revenue flexibility by one-off measures if needed. In addition, we believe that Vorarlberg has flexibility on its relatively high capital expenditures, which consistently account for more than 15% of total expenditures.

Liquidity

Vorarlberg's liquidity is exceptional, as our criteria define the term, including strong access to external liquidity. In our view, Vorarlberg has a proven track record of sufficient access to a deep and liquid capital market at all times and access to a diversified pool of banks. We classify the banking sector of Austria in group '3' under our Banking Industry Country Risk Assessment (see also "Banking Industry Country Risk Assessment: Austria," published June 25, 2015).

Due to the amortizing debt structure, the state's yearly repayments are very low, at less than 1% of operating revenues. The state's cash flows are fairly predictable, with regular dates for large incoming and outgoing payments. We include the state's practically unused credit line in our calculations of available liquidity, leading to an outstandingly high coverage ratio of yearly debt service.

Outlook

The stable outlook reflects our expectation that Vorarlberg will be able to keep its excellent financial position, with balanced accounts and a very low debt burden over the next two years.

We could lower our ratings on Vorarlberg if material financial distress at the state bank Vorarlberger Landes- und Hypothekenbank AG led to a call on the state to honor its guarantees for the bank.

An upgrade of Vorarlberg is contingent on a positive rating action on Austria (AA+/Stable/A-1+), as we do not rate Austrian states above the sovereign. In such a case, we would consider a positive rating action on Vorarlberg if it managed to reduce its contingent liabilities and if the institutional framework for Austrian states became more supportive and predictable than currently.

However, we currently view both scenarios as unlikely.

Key Statistics

Table 1

State of Vorarlberg Financial Statistics							
	--Fiscal year end Dec. 31--						
(Mil. €)	2012	2013	2014	2015bc	2016bc	2017bc	2018bc
Operating revenues	1,302	1,357	1,428	1,491	1,528	1,573	1,647
Operating expenditures	1,112	1,182	1,269	1,327	1,374	1,418	1,463
Operating balance	190	175	159	164	153	155	185
Operating balance (% of operating revenues)	14.6	12.9	11.1	11.0	10.0	9.9	11.2
Capital revenues	160	172	165	179	194	191	182
Capital expenditures	352	332	313	337	343	337	356
Balance after capital accounts	(1)	15	12	6	4	10	11
Balance after capital accounts (% of total revenues)	(0.1)	1.0	0.7	0.4	0.3	0.5	0.6
Debt repaid	6	9	9	10	9	11	12
Net budget loans	0	0	0	0	0	0	0
Balance after debt repayment and onlending	(7)	6	2	(3)	(4)	(2)	(1)
Balance after debt repayment and onlending (% of total revenues)	(0.5)	0.4	0.1	(0.2)	(0.2)	(0.1)	(0.1)
Gross borrowings	5	0	9	10	9	11	12
Balance after borrowings	(2)	6	11	6	4	10	11
Operating revenue growth (%)	3.9	4.2	5.3	4.4	2.5	3.0	4.7
Operating expenditure growth (%)	3.1	6.3	7.4	4.6	3.5	3.2	3.1
Modifiable revenues (% of operating revenues)	6.1	5.7	5.3	5.2	5.1	5.0	4.8
Capital expenditures (% of total expenditures)	24.0	21.9	19.8	20.2	20.0	19.2	19.6
Direct debt (outstanding at year-end)	112	103	102	102	102	102	102
Direct debt (% of operating revenues)	8.6	7.6	7.1	6.8	6.7	6.5	6.2
Tax-supported debt (% of consolidated operating revenues)	8.6	7.6	7.1	6.8	6.7	6.5	6.2
Interest (% of operating revenues)	0.2	0.2	0.1	0.2	0.1	0.1	0.1
Debt service (% of operating revenues)	0.7	0.8	0.8	0.8	0.7	0.9	0.9

Table 1

State of Vorarlberg Financial Statistics (cont.)

	--Fiscal year end Dec. 31--						
(Mil. €)	2012	2013	2014	2015bc	2016bc	2017bc	2018bc

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. Base case reflects Standard & Poor's expectations of the most likely scenario.

Table 2

State of Vorarlberg Economic Statistics

	--Fiscal year end Dec. 31--						
	2009	2010	2011	2012	2013	2014	
Population	368,868	369,384	370,440	372,555	374,861	377,110	
Population growth (%)	0.4	0.1	0.3	0.6	0.6	0.6	
GDP per capita (euros) (single units)	35,100	36,500	38,200	38,900	39,800	39,919	
Unemployment rate (%)	7.3	6.7	5.6	5.6	5.8	6.0	

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.

Ratings Score Snapshot

Table 3

State of Vorarlberg Ratings Score Snapshot

Key Rating Factors

Institutional Framework	Very predictable and well balanced
Economy	Very strong
Financial Management	Very strong
Budgetary Flexibility	Average
Budgetary Performance	Very strong
Liquidity	Exceptional
Debt Burden	Very low
Contingent Liabilities	Moderate

*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, Oct. 12, 2015. Interactive version available at <http://www.spratings.com/sri>

- Research Update: Republic of Austria 'AA+/A-1+' Ratings Affirmed On Continuing Fiscal Consolidation; Outlook Stable, Sept. 25, 2015

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

- Research Update: Republic of Austria 'AA+/A-1+' Ratings Affirmed On Continuing Fiscal Consolidation; Outlook Stable, Sept. 25, 2015
- The Surge Of Refugees In The EU: Boon Or Burden For Sovereign Ratings?, Sept. 15, 2015
- Banking Industry Country Risk Assessment: Austria, June 25, 2015
- 2014 Annual International Public Finance Default Study And Ratings Transition, June 8, 2015

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

Vorarlberg (State of)

Issuer credit rating

Ratings List Continued...

Foreign and Local Currency

AA+/Stable/A-1+

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