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Ratings

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Research Update:

State of Upper Austria 'AA+/A-1+' Ratings Affirmed; Outlook Stable

May 17, 2024

Overview

- We expect the State of Upper Austria will adapt to slower tax revenue growth, balance persisting spending pressures, and maintain a sound budgetary performance.
- Thus, we anticipate that net borrowing needs stemming from the state's elevated capital expenditure will remain contained, increasing the state's tax-supported debt burden only slightly.
- Extraordinary high tax revenue collection, driven by inflation, combined with contained expenditure execution, helped Upper Austria to outperform its budget and balance accounts in recent years.
- We affirmed our 'AA+/A-1+' long-term and short-term ratings on Upper Austria and maintained our stable outlook.

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Rating Action

On May 17, 2024, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the state of Upper Austria. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Upper Austria will make conservative fiscal decisions and maintain moderate deficits after capital accounts in the next few years. The state's ratio of tax-supported debt to operating revenue, while slightly increasing to cover projected deficits, should therefore remain low in an international comparison.

Downside scenario

We could consider a negative rating action on Upper Austria if we were to observe a less cautious financial management stance, potentially indicated by higher expendiutre than anticipated, amid weaker economic developments weighing on the state's tax revenue. In this scenario, Upper Austria's budgetary performance would likely materially deteriorate compared with our base-case scenario and induce a more material increase of the state's debt burden over time.

Upside scenario

A positive rating action would depend on Upper Austria further tightening fiscal policies and continuing to contain contingent liabilities, while maintaining a strong liquidity position. In such a scenario, the state's budgetary performance and debt trajectory would likely exceed our current projections.

Additionally, any positive rating action would be contingent upon a positive change in our rating on Austria (AA+/Stable/A-1+). We believe Upper Austria does not meet the conditions that would allow us to rate it higher than the related sovereign.

Rationale

Our ratings on Upper Austria are underpinned by the well-balanced institutional framework under which it operates, its wealthy local and national economy, and conservative financial management practices. Going forward, the state will benefit from augmented contributions under Austria's recently adjusted fiscal equalization system, helping to finance higher social expenditure and infrastructure investments, while nationally distributed tax revenue is set to slow amid subdued economic growth.

We expect a continued cautious fiscal stance by the state's management, which should contain the state's deficits at low levels and thereby contribute to maintaining a sound budgetary performance and comparatively low debt burden. Unfunded pension obligations are, in our renewed assessment, no longer an elevated performance risk, as net pension costs are limited and the number of unreimbursed, state-funded retirees will soon peak. Upper Austria's exceptional liquidity position, supported by access to the federal debt management agency, additionally supports the ratings.

Upper Austria continues to benefit from a robust economy and additional funding from the revised national fiscal equalization system

Austria's national economy and Upper Austria's local economy continue to provide a structurally supportive backdrop, despite currently stagnant growth due to dampened private investments and international trade. We anticipate a partial rebound of Austrian economic growth this year, after a minor recession in 2023 with -0.8% real GDP growth. While Upper Austria's local economy is more industrialized and export-oriented--having less exposure to the tourism sector--than other Austrian states, we still expect it to perform broadly in line with the national average. Upper Austria has high economic wealth, a low unemployment rate, and innovative businesses in a national comparison. From 2025, we expect growth momentum will pick up in Austria, as a result of resuming private investments and strengthening external demand.

The recent revision of Austria's fiscal equalization system should help Upper Austria--and the other Austrian states--to better cope with social expenditure pressures. Under the system, which collects taxes nationally and then distributes revenue to the regional states according to their relative population, Upper Austria will continue to participate directly in national developments, potentially shielding the state's fiscal intake from local economic issues. Recent adjustments entail additional funds from national revenue streams to the system effective from 2024, equipping Upper Austria with about €200 million of additional funds annually, earmarked for spending on health, long-term care, and education, alongside climate-related investments. We understand that these receipts largely mirror increasing spending in the specified areas, thus preventing a situation of inevitably growing expenditures for these state responsibilities remaining unreimbursed. Additionally, Upper Austria continues to benefit indirectly from national economic support measures paid from the federal budget, for instance a current program stimulating construction activity, therefore limiting the scope for state-specific measures. Upper Austria also occasionally receives support for local projects from the federal government, such a new public transport line in the state's capital Linz--with central government covering 50% of the cost of this project, which is currently the state's largest. We believe that policy changes that could follow the Austrian general elections in fall 2024 will not entail major reforms to the institutional framework for the state's economy and budget.

We expect Upper Austria's financial management to remain committed to conservative fiscal policies, balance existing capital expenditure plans with available fiscal resources, and comply with national debt-brake rules. Certain infrastructure investments authorized under the state's extensive post-pandemic stimulus program have so far not been fully implemented. This leaves Upper Austria with approved but yet unspent and unfunded capital expenditures of around €1.2 billion, equivalent to about 15% of operating revenue. However, we believe this will not be a source of excess spending going forward, as we understand that the state's management carefully monitors--and has the required veto rights to limit--effective annual net borrowing. In our view, conservative fiscal policies are also supported by the state's political landscape. Upper Austria recently enacted a new debt ceiling that limits the permissible amount of direct debt--which currently reaches about 16% of revenues--to a threshold as low as 25% of revenues and sets guidelines for contingencies when approaching this debt ceiling.

Persisting spending pressures and high investments are balanced against slowing tax revenue growth

We expect that Upper Austria's budgetary performance will remain sound over the medium term, with solid operating margins and only very limited deficits after capital accounts. This follows very strong results in 2022--and estimated for 2023--when we understand that tax revenue and contributions from the national equalization system exceeded budgeted amounts, while capital expenditure fell short of the budget. We anticipate tax revenue growth will slow, as nominal growth and inflation are set to moderate. Despite the additional payments from the recent fiscal equalization mechanism reform, expenditure pressure in education, health and long-term care, and affordable housing will remain high, reflecting the state's political priorities and socioeconomic trends. Moreover, we expect inflation-induced cost pressure, in line with national inflation, to moderate only gradually over our forecast horizon through 2026. Capital expenditure for mobility infrastructure, digitalization, and green energy is set to remain high, while these investments will also contribute materially to maintaining the state's economic attractiveness, in our view.

After reviewing the most recent data, we now believe that the risk to budgetary performance from Upper Austria's unfunded, pay-as-you-go, pension obligations toward retiring civil servants will remain limited. Following changes in hiring practices in the early 2000s, most of Upper Austria's current employees are covered by the national pension insurance system rather than the state's budget. For the remaining, state pension-eligible special-status civil servants--predominantly teachers--Upper Austria is heavily reimbursed by the federal level. Deducting all reimbursements, we calculate net pension expenditure of currently only slightly above 2% of Upper Austria's annual operating revenue. From state projections, we infer that the number of pension-eligible retirees is close to its peak. In our view, this limits the potential additional budgetary burden of pension spending, even when allowing for cost-per-capita increases. Still, we note that potentially less ample federal support in the future for other age-related spending pressures, such as long-term care, could weigh on the state's results over the long term.

We anticipate that Upper Austria will maintain its outstanding tax-supported debt at around 30% of total operating revenue over our forecast horizon, which is low in an international comparison. This includes leasing contracts and loans incurred by state-owned enterprises that we consolidate. Upper Austria sources its direct debt exclusively from Austria's national debt management agency, at comparatively low fixed interest rates and denominated in euros.

In our overall debt assessment, we also take into account an anticipated increasing trend of the debt burden and consider the risk from contingent liabilities, partly because Upper Austria is the majority owner of Oberoesterreichische Landesbank AG--a local bank--and Energie AG Oberoesterreich--a local energy producer and utility provider--although neither has required any substantial support from the state in the recent past. In addition, we include housing loan receivables--which are relatively large compared with the state's budget--provided to the Upper Austrian population and sold to banks. However, we view the likelihood of significant risk materialization as very low.

We continue to assess Upper Austria's overall liquidity as exceptional. This reflects only limited debt maturities in 2024-2026, the resulting debt service coverage ratio remaining well above 100% throughout the forecast horizon, and the state's legally defined access to a facility with the national debt management agency. Although Upper Austria does not maintain committed bank credit lines out of cost considerations, we believe it could easily access lending from commercial banks on short notice, for instance via the Landesbank, or borrow directly in the capital markets.

Key Statistics

Table 1

Upper Austria (State of)--Selected indicators

	--Year ending Dec. 31--				
	2022	2023e	2024bc	2025bc	2026bc
Operating revenues	7,934	8,346	8,534	8,865	9,121
Operating expenditures	6,871	7,565	7,927	8,221	8,443
Operating balance	1,063	781	607	644	678
Operating balance (% of operating revenues)	13.4	9.4	7.1	7.3	7.4
Capital revenues	33	24	24	29	32
Capital expenditures	867	800	841	864	885
Balance after capital accounts	229	5	(210)	(191)	(175)
Balance after capital accounts (% of total revenues)	2.9	0.1	(2.5)	(2.1)	(1.9)
Debt repaid	5	134	70	47	52
Gross borrowings	0	134	170	220	220
Balance after borrowings	224	5	(110)	(18)	(7)
Direct debt (outstanding at year-end)	1,325	1,328	1,437	1,625	1,809

Table 1

Upper Austria (State of)--Selected indicators (cont.)

	--Year ending Dec. 31--				
	2022	2023e	2024bc	2025bc	2026bc
Direct debt (% of operating revenues)	16.7	15.9	16.8	18.3	19.8
Tax-supported debt (outstanding at year-end)	1,815	1,835	1,994	2,238	2,483
Tax-supported debt (% of consolidated operating revenues)	22.9	22.0	23.4	25.2	27.2
Interest (% of operating revenues)	0.1	0.1	0.2	0.2	0.3
Local GDP per capita (single units)	50,700	53,443	55,634	57,576	59,361
National GDP per capita (single units)	49,807	52,417	54,568	56,491	58,252

*Adjusted operating revenue and operating expenditure figures revised upward by an equal amount to align with gross presentation of federally reimbursed salary and pension payments to (former) teachers under current Austrian public sector accounting standard VRV 2015. This leads to insignificantly different performance and debt ratios compared with our previous calculations.
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 applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

Upper Austria (State of)--Ratings score snapshot

Key rating factors	
Institutional framework	2
Economy	1
Financial management	1
Budgetary perfomance	2
Liquidity	1
Debt burden	3
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

- Sovereign Risk Indicators, April 8, 2024. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Energie AG Oberoesterreich's Ratings Affirmed At 'A' Ahead Of Capex Increase; Outlook Stable, March 21, 2024
- Subnational Debt 2024: Fiscal Policy Differences Influence Borrowing In Developed Markets, March 4, 2024
- Subnational Debt 2024: Focus on debt sustainability, Feb. 29, 2024
- Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown, Feb. 29, 2024
- Austria, Feb. 26, 2024
- Oberoesterreichische Landesbank AG, March 14, 2023
- Institutional Framework Assessment: Austrian States, Dec. 30, 2022

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.