S&P Global
Ratings

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# Styria (State of)

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This report does not constitute a rating action.

## Credit Highlights

### Overview

| Credit context and assumptions | Base-case expectations |
|---|---|
| We anticipate subdued real economic performance, with Austrian real GDP largely stagnating in 2023 and 1.7% growth in 2024. | Following the full acquisition of Energie Steiermark AG, consolidation efforts will likely resume in 2024, leading to narrowing but ongoing deficits after capital expenditure (capex) and a stabilization of the debt burden. |
| Conversely, inflationary pressures will support strong nominal tax collection. | The state has low exposure to rising interest rates because most debt is at fixed rates and its refinancing needs are low. |
| We expect only minor updates to the regular revision of the Austrian tax-sharing system from 2024. | Styria maintains a strong liquidity position due to its well-established access to short-term financing at the national state-financing agency. |

**S&P Global Ratings believe Styria will refocus on controlling rising expenditures and limiting deficits after the acquisition of Energie Steiermark AG and ahead of the upcoming state elections in 2024.** The need to comply with the national stability pact from 2024 will help keep the state's debt burden roughly stable.

**We expect that the currently negotiated update of the Austrian fiscal equalization scheme will not have a significant net impact.** Small adjustments to the tax-sharing formula or an additional allocation of funds for the states' health and long-term care sectors are possible, but we would expect these to fund additional expenditures.

# Outlook

The stable outlook reflects our view that Styria's budgetary performance will recover after 2023 on increasing tax revenue and management's commitment to contain spending increases. This will limit the need for additional debt over the next two years. We assume that access to the Austrian federal debt management agency will continue to ensure the state's liquidity.

## Downside scenario

We could lower our ratings if Styria's management loosens its grip on expenditure, particularly if that leads to deficits after capital accounts approaching 10% of total revenue. In addition, if changes to the institutional framework after the scheduled update on tax equalization led to budgetary pressures for the state, for instance from additional spending responsibilities without corresponding compensation, this could put stress on the ratings.

## Upside scenario

Any ratings upside would require a significant improvement in Styria's financial performance, with consistent surpluses after capital accounts and a pronounced deleveraging to bring the state's debt more in line with national peers.

# Rationale

## Elevated inflation is expanding tax revenue despite a sluggish economy

With sluggish economic prospects in Europe, we expect Austrian real GDP to largely stagnate in 2023, with knock-on effects for Styria, followed by a moderate 1.7% growth in 2024 (see Sovereign Risk Indicators, published July 10, 2023, on RatingsDirect). However, Austria’s national GDP per capita remains very high in an international comparison, and we expect it to reach €52,011 (about $55,899) in 2023.

Fueled by inflation, tax revenue continues to outperform initial expectations, even after recent tax-relief measures. The Austrian fiscal system collects taxes nationally and distributes revenue to the states according to their population. Therefore, the Austrian states shared the burden of the tax shortfalls with the central government during the COVID-19 pandemic but also benefitted enormously from increased tax collection thanks to the post-pandemic recovery and strong inflation in 2022.

We do not expect major shifts in Austrian states' revenue or responsibilities to result from ongoing negotiations around the country’s fiscal equalization mechanism. The central government renegotiates with local and regional governments every four-to-six years on how they will share tax revenue and reallocate roles and responsibilities, with the current round aiming for financial effectiveness from 2024. We do not expect a significant change following the upcoming update, but regard small adjustments to the tax sharing formula or an additional allocation of funds for the states' health and long-term care sectors as possible. That said, since we believe these would only fund additional responsibilities, we expect only minor net effects. Overall, we assess the Austrian intergovernmental system as very predictable and well balanced because its consensus-based operating model usually balances stakeholders’ different interests and prevents sudden policy shifts.

We do not expect that Styria's prudent financial management will deviate from its cost control efforts, despite upcoming local elections in 2024. We view the state's financial management as strong, focusing on expenditure control and improving operating budgetary performance. This was indicated by the relatively weak appetite for additional spending during the COVID-19 pandemic and the recent energy crunch. We also note that Styria is sticking to low-risk financial rules, including the avoidance of foreign exchange debt and derivatives.

## Consolidation efforts should stabilize debt at moderate levels by 2024

Styria's €532.7 million acquisition of the remaining 25% stake in utility company Energie Steiermark AG from Macquarie will lead to a sizeable deficit after capital accounts in 2023. However, based on management's otherwise ongoing consolidation efforts, we expect the state to return to smaller deficits at roughly pre-pandemic levels from 2024. We understand from management that the cost of the additional debt for the transaction is likely to be about equivalent to the additional share in dividends to be distributed to Styria, and we note that the state firmly intends to divest the 25% stake again in the medium term (see Austrian State of Styria's Full Ownership of Energie Steiermark Is Likely Temporary, published Feb. 21, 2023). Our assessment of budgetary performance also reflects ongoing payments for unfunded, pay-as-you-go pension liabilities that, although not excessively large, will continue to weigh on results for the foreseeable future.

Under our base-case scenario, from 2024 the rising budget size from the deficit-neutral inclusion of additional administrative activity will lead to a denominator-driven reduction in the direct debt ratio to slightly above 90% of adjusted operating revenue. We regard this as moderate in an international comparison but high for an Austrian state. Styria predominantly borrows from the federal treasury (Oesterreichische Bundesfinanzierungsagentur [OeBFA]), which allows for fixed-rate, low-cost funding and offers ultra-long tenors of up to 100 years.

We regard Styria's contingent liabilities as low, particularly because the state--contrary to some national peers--no longer owns a financial institution. The remaining grandfathered guaranteed debt for the former state bank (less than €400 million at year-end 2022) and housing loan receivables sold to various banks (also less than €400 million at year-end 2022), which Styria also guarantees, nominally constitute its largest exposures but carry low risks, in our view.

The state's exceptional access to external liquidity is a key rating strength. Cash holdings are usually very low and cover less than half of debt service over the next 12 months. Additionally, Styria maintains €300 million of committed credit lines with four commercial banks, together leading to a low debt service coverage ratio and effectively leaving the state dependent on access to external funds. Like most other Austrian states, Styria's liquidity position is therefore predominantly characterized by its exceptional access to external liquidity via OeBFA and, to a lesser extent, the capital market. In addition to its sizeable credit facility with OeBFA, the state uses funds from its cash pooling with related third parties, like the state hospital company or the state real estate company.

### State of Styria Selected Indicators

| Mil. EUR | 2020 | 2021 | 2022e | 2023bc | 2024bc | 2025bc |
|---|---|---|---|---|---|---|
| Operating revenue | 5,395 | 4,706 | 5,420 | 5,600 | 6,459 | 6,666 |
| Operating expenditure | 5,339 | 4,555 | 4,916 | 5,249 | 6,164 | 6,349 |
| Operating balance | 56 | 150 | 504 | 352 | 295 | 317 |

## State of Styria Selected Indicators

| | | | | | | |
|---|---|---|---|---|---|---|
| Operating balance (% of operating revenue) | 1.0 | 3.2 | 9.3 | 6.3 | 4.6 | 4.8 |
| Capital revenue | 737 | 260 | 233 | 158 | 143 | 163 |
| Capital expenditure | 1,054 | 681 | 754 | 1,329 | 764 | 776 |
| Balance after capital accounts | (261) | (271) | (17) | (820) | (326) | (296) |
| Balance after capital accounts (% of total revenue) | (4.3) | (5.5) | (0.3) | (14.2) | (4.9) | (4.3) |
| Debt repaid | 250 | 255 | 240 | 285 | 289 | 286 |
| Gross borrowings | 485 | 619 | 0 | 1,147 | 603 | 536 |
| Balance after borrowings | (26) | 93 | (257) | 43 | (13) | (46) |
| Direct debt (outstanding at year-end) | 4,626 | 4,981 | 4,723 | 5,585 | 5,899 | 6,152 |
| Direct debt (% of operating revenue) | 85.7 | 105.9 | 87.1 | 99.7 | 91.3 | 92.3 |
| Tax-supported debt (outstanding at year-end) | 4,768 | 5,144 | 4,886 | 5,748 | 6,062 | 6,315 |
| Tax-supported debt (% of consolidated operating revenue) | 88.3 | 109.2 | 90.1 | 102.6 | 93.8 | 94.7 |
| Interest (% of operating revenue) | 1.8 | 2.3 | 1.6 | 2.0 | 1.9 | 2.0 |
| Local GDP per capita ($) | 44,888 | 48,845 | 47,589 | 50,855 | 54,625 | 58,836 |
| National GDP per capita ($) | 48,896 | 53,774 | 52,413 | 55,899 | 60,008 | 64,835 |

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. EUR--euro. $--U.S. dollar.

## State of Styria Ratings Score Snapshot

| Key rating factors | Scores |
|---|---|
| Institutional framework | 2 |
| Economy | 1 |
| Financial management | 2 |
| Budgetary performance | 4 |
| 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, July 10, 2023. 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: Principles Of Credit Ratings, Feb. 16, 2011

# Related Research

- Subnational Debt 2023: An Easing Burden In Germany, Austria, And Switzerland, March 2, 2023
- Subnational Debt 2023: Fiscal Sustainability Rules Are Put To The Test, March 2, 2023
- Austria, Feb. 27, 2023
- Bulletin: Austrian State of Styria's Full Ownership Of Energie Steiermark Is Likely Temporary, Feb. 21, 2023
- Institutional Framework Assessment: Austrian States, Dec. 30, 2022
- Local And Regional Governments Outlook 2023: Rougher Seas Ahead, Nov. 29, 2022
- Bulletin: Graz's Financial Situation Is Unlikely To Burden Styria, Nov. 10, 2022

- Local And Regional Government Risk Indicators: European LRGs Stay Firm Amid Economic Slowdown And High Inflation, Sept. 22, 2022

## Ratings Detail (as of July 26, 2023)*

| | |
|---|---|
| **Styria (State of)** | |
| Issuer Credit Rating | AA/Stable/A-1+ |
| **Issuer Credit Ratings History** | |
| 01-Feb-2019 | AA/Stable/A-1+ |
| 03-Feb-2017 | AA/Negative/A-1+ |
| 11-Aug-2014 | AA/Stable/A-1+ |

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.