Fitch Affirms Region of Valle d'Aosta at 'A-': Outlook Negative

Fitch Ratings - Milan - 19 April 2019: Fitch Ratings has affirmed the Autonomous Region of Valle d'Aosta's Long-Term Local and Foreign Currency Issuer Default Ratings at 'A-' and Short-term Foreign Currency IDR at 'F1'. The Outlook is Negative. The long-term ratings on the region's senior unsecured bonds have also been affirmed at 'A-'.

The ratings are constrained at two notches above the Italian sovereign's 'BBB' rating as VdA's standalone credit profile (SCP) is assessed at 'aa'. Its Negative Outlook reflects that on Italy.

The affirmation reflects our expectation of continuing solid performance, with a debt payback ratio stable at below five years, underpinned by the region's constitutional autonomy.

Key Rating Drivers

As a special statute region, the finances of VdA are shielded from central government intervention, which is subject to bilateral agreements. The region funds its diversified set of responsibilities with 100% of all major national taxes collected on its territory, mainly personal and corporate income taxes, VAT and excise duties). Its modest size (127,000 inhabitants) exposes the region's wealthy economic environment to fluctuations due to a cyclical steel industry, which accounts for about 13% of EUR4.4 billion regional GDP.

KEY RISK FACTORS
Revenue Robustness: Midrange
VdA's revenue is fairly resilient, with a EUR35,000 GDP per capita (or 20% above the EU28 average), and a high employment rate of nearly 70% despite deep recessions in 2009 and 2013. However, inter-governmental changes over 2012-2017, including a reduction in the share of regional excise duties as a bid to raise VdA's contribution to the state budget, translated into a revenue decline of about 8%.

Fitch expects VdA's revenue to total around EUR1.3 billion in 2019-2023, as higher tax proceeds on mild GDP growth (0.5% expected) offsets the lack of dividend income from hydro company CVA (A-/Negative) after the receipt of nearly EUR100 million extraordinary dividend from 2016 to 2018. The region's revenue resilience is factored into Fitch's more conservative rating case, which envisages slower GDP growth through 2019-2021, with operating revenue averaging EUR1.25 billion.

Revenue Adjustability: Midrange
The assessment is supported by Fitch's estimate of VdA's revenue flexibility of about EUR70 million, or 5% of revenue, which would roughly cover a peak-to-trough revenue fall in an economic slowdown, after nettting changes in the funding system and contributions to the national budget. The region's affordability to raise tax rates is moderate, partially limited by the small size of the local economy and its limited diversification, notwithstanding solid socio-economic indicators.

Expenditure Sustainability: Midrange
The assessment is driven by VdA's track record of cost control, as reflected by a nearly 10% cut to the region's EUR2,200 per capita spending for health care between 2012 and 2014 to make room for a EUR250 million

contribution to the national budget consolidation. As the latter is gradually reduced to EUR100 million for 2019 VdA will reinstate capex and opex towards historical levels, especially in the healthcare sector. The region's set of responsibilities is wide and diversified, ranging from healthcare (25%), social services (7%), education and culture (7%), transport (6%), support to the region's local governments (9%), economic development, agriculture and vocational training (4%), land development and environment (3%).

Expenditure Adjustability: Midrange
The assessment is driven by VdA's moderate share of inflexible costs at around 70% (net of contribution to the state's budget), in particular for healthcare, education, staff, purchase of goods and services. Per capita expenditure is higher than the national average but the scope for reduction is constrained by the region's role in regional economic development via its material support to local SMEs. Additionally, we expect VdA will start expanding some of its public labour force in 2020, limiting future expenditure flexibility.

Liabilities and Liquidity Robustness: Stronger
Fitch assesses VdA's debt profile as conservative. Debt is almost entirely composed of two euro-denominated bonds, amortising organically or synthetically when provisions to the sinking fund a EUR543 million bullet repayment in May 2021 are taken into account, and includes financial derivatives hedging against interest rate risk. In line with national regulations, VdA's borrowing is limited to 20% of free revenue and debt servicing requirements have to be paid out of recurring revenue.

While the hydro company CVA is profitable and distributes dividends, the region's casino company was placed under bankruptcy protection and VdA has taken over the repayment of the guaranteed part of the outstanding EUR80 million debt.

Liabilities and Liquidity Flexibility: Midrange
Fitch expects VdA to maintain a satisfactory liquidity position at around the 2018 average of EUR200 million, which will cover debt service by almost 5x, and with free reserves of about 3% of its budget. Complementing liquidity options are undrawn liquidity lines with treasury bank Unicredit (BBB/Negative) for EUR200 million.

Debt Sustainability Assessment: 'aaa'
VdA was virtually debt-free in 2018 after about EUR600 million outstanding bonds were netted of provisions into the sinking fund and EUR50 million free cash. Fitch expects the region's debt, including Finaosta's liabilities which were recently reclassified within the Eurostat scope of public administrations , to rise to about EUR350 million over the medium term, or EUR700 million in our conservative rating case to test the resilience of VdA's debt ratios through the economic cycle. Rising borrowings would be driven by higher capex and weaker operating surpluses and the debt payback ratio (debt-to-operating-balance) is expected to peak at just below four years in 2023 (zero in 2018).

Derivation Summary

Ratings Derivation
VdA is classified by Fitch as a type B local and regional government (LRG), as it covers debt service from cash flow on an annual basis. With five key risk factors assessed as 'Midrange' and one as 'Stronger', VdA's risk profle is evaluated as 'Midrange'. The combination of 'Midrange' risk profile and a debt payback ratio of four years leads to VdA's SCP being assessed in the 'aa' category. A high debt-service coverage ratio, low debt-to revenue ratio and peer comparison lead to a 'aa' notch-specific SCP.

VdA's IDR is constrained at two notches above the sovereign's rating, reflecting the region's special autonomous status while also considering potential intervention by the state in case of sovereign stress. The Negative Outlook reflects that on Italy.

Key Assumptions

KEY ASSUMPTIONS
Fitch's assumptions within our rating case for the issuer include:
- Nominal GDP growth at about 1.5% in 2019-2023 with a 1% average GDP deflator;
- Regional tax revenue nominal growth on average at 0.4%;
- Dividends scaling-back in 2019, before increasing in 2020-2023 to compensate for weak tax revenue growth and transfers decline;
- Sharp decline of operating spending in 2019 due to reduction in the contribution to the state budget; and
- Average operating spending growth at 0.6% a year in 2020-2023.

RATING SENSITIVITIES

VdA's IDRs are partly constrained by the Italian sovereign ratings and hence will mirror rating actions on on the sovereign.

Deterioration in the region's debt sustainability with a payback ratio towards five years together with a weaker debt service coverage ratio would lead to a downgrade of the region's SCP.

Further deterioration with a payback ratio above five years leading to a three-notch downgrade of the SCP would narrow the rating differential between VdA and the sovereign to one notch and consequently lead to a downgrade of the region's IDR to 'BBB+'.

Summary of Financial Adjustments

No adjustment to 2018 preliminary financial data.
Main adjustments to 2017 figures relate to the reclassification of annual provisions for the sinking fund from capital expenditure to debt repayment.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Valle d'Aosta,Autonomous Region of	LT IDR A- ⛔ Affirmed		A- ⛔
	ST IDR F1 Affirmed		F1
	LC LT IDR A- ⛔ Affirmed		A- ⛔
	SCP aa New Rating		
senior unsecured	LT A- Affirmed		A-

Additional information is available on www.fitchratings.com

Applicable Criteria

Rating Criteria for International Local and Regional Governments (pub. 09 Apr 2019)

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Entity/Security	ISIN/CUSIP/COUPON RATE	Rating Type	Solicitation Status
Valle d'Aosta,Autonomous Region of	-	Long Term Issuer Default Rating	Unsolicited
Valle d'Aosta,Autonomous Region of	-	Short Term Issuer Default Rating	Unsolicited
Valle d'Aosta,Autonomous Region of	-	Local Currency Long Term Issuer Default Rating	Unsolicited
Valle d'Aosta,Autonomous Region of	-	Stand-Alone Credit Profile	Unsolicited
Valle d'Aosta,Autonomous Region of EUR 543 mln Floating Rate Notes 28 May 2021	XS0129991864	Long Term Rating	Unsolicited
Valle d'Aosta,Autonomous Region of EUR 74 mln 4.197% Notes 31 Dec 2026	IE00B1LD3052	Long Term Rating	Unsolicited
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