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RATING ACTION COMMENTARY

# Fitch Affirms Italian Autonomous Region of Valle d'Aosta at 'A-'; Outlook Stable

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Fitch Ratings - Milan - 22 Sep 2023: Fitch Ratings has affirmed the Autonomous Region of Valle d'Aosta's (VdA) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-' with Stable Outlooks.

The affirmation reflects Fitch's expectations that VdA's debt metrics will remain strong and commensurate with the ratings under its rating case.Fitch has raised VdA's Standalone Credit Profile (SCP) to 'aa+' from 'aa' due to strengthened debt sustainability, which Fitch assesses at the upper-end of the 'aaa' category under its rating case, combined with a 'Midrange' risk profile.

The 'A-' IDRs are four notches below the region's Standalone Credit Profile (SCP) of 'aa+' as VdA's ratings are constrained at two notches above Italy's sovereign IDRs (BBB/Stable).

## KEY RATING DRIVERS

**Risk Profile: 'Midrange'**

VdA's 'Midrange' risk profile reflects five 'Midrange' key risk factors and one 'Stronger' key risk factor.

**Revenue Robustness: 'Midrange'**

VdA is a special-statute region that is entitled to receive 100% of the tax revenue generated in its territory. This limits the region's dependence on state transfers, which accounted for 5% of its EUR1.5 billion operating revenue in 2022, versus 2%-3% on average before the pandemic. The state provided extraordinary additional transfers to all regions to fund pandemic-related healthcare costs.

Around 90% of VdA's operating revenue comes from taxes, which makes the region's revenue base more linked to the local economy and less to government transfers compared with other regions. In 2022 VdA's tax revenue rebounded from the EUR1.1 billion low reached in 2020-2021 to EUR1.3 billion, the maximum level in the past 10 years. The main driver was inflation, which pushed VAT revenues up by almost 30%, as well as an increase of business tax (IRAP, +23%) and corporate income tax, which almost doubled to EUR98 million from its historical average of about EUR50 million.

Fitch considers the 2022 result extraordinary and expects VdA's operating revenue to stabilise around EUR1.4 billion on average in 2023-2027, up from its pre-pandemic average of around EUR1.3 billion, as the inflationary push wears off, while tax revenue is supported by overall GDP growth. Any negative impact from the personal income tax (PIT) revisions will be covered by state transfers until 2024, while the economic recovery expected after 2023 and VdA's sound socioeconomic indicators will support PIT's dynamics.

**Revenue Adjustability: 'Midrange'**

Fitch assesses VdA's ability to generate additional revenue in response to an economic downturn as 'Midrange', reflecting the region's high affordability and moderately stable revenue. VdA's leeway to increase revenue is just below EUR70 million, or 5% of revenue, by Fitch's calculations, through increasing the PIT surcharge and business tax to legal maximums and removing relevant tax relief, as well as raising charges and fees.

VdA's socioeconomic indicators, including GDP per capita at about EUR38,200 in 2022 and high employment rate, underpin tax revenue flexibility. Tax-raising potential would cover the peak-to-trough revenue decline over the last 10 years by more than 50% when adjusted for changes in the funding system.

**Expenditure Sustainability: 'Midrange'**

VdA has a strong ability to control costs, with a balanced budget in the past 10 years and by reducing its healthcare expenditure in 2012-2014 to allow for its contribution to the national budget consolidation when it peaked at EUR250 million. As a special statute region, VdA has more diversified responsibilities, with healthcare accounting for about one-third of total expenditure, versus 80% in ordinary regions, and education covering another 15-20%. This enhances spending predictability, as potentially highly cyclical functions such as social benefits (7%) and support to local governments (9%) represent just over 15% of VdA's expenditures.

Over the medium term, operating spending is expected to continue growing under Fitch's rating case by around 2% a year on average in 2023-2027 due to inflation, peaking at EUR1.3 billion in 2027. This factors in stable healthcare spending, as reduced extra costs from the pandemic allows increased personnel expenditure to attract skilled medical staff, and increased transfers to local governments.

**Expenditure Adjustability: 'Midrange'**

VdA's share of inflexible costs is moderate at just below 70% of total expenditure, net of contributions to the state's budget. This includes healthcare, education, staff and transfers to local governments. The region expanded the scope of expenditure to sustain the local economy and employment, with increased healthcare expenditure, transfers to local governments and firms and capex, up 40% in 2020-2021. The region withdrew some of the 2021 extraordinary measures as the economic recovery strengthened in 2022.

Per capita expenditure is higher than the national average, but we do not expect VdA to further reduce operating expenditure as scope for savings is constrained by VdA's role in regional economic development via its material support for local SMEs.

**Liabilities & Liquidity Robustness: 'Stronger'**

VdA operates under a prudent national and individual debt management framework. Borrowing is only allowed for capex and with amortising structures, solely in local currency, and with debt service capped at 20% of free revenue not earmarked for healthcare. Medium-term debt service, which will be around EUR40 million in 2027 under Fitch's rating case, will be paid from recurring revenue. This underpins the predictability of due liabilities over the medium term and Fitch's 'Stronger' assessment of this factor.

As required by the national Court of Accounts, in 2022 VdA assumed as its own direct debt the guaranteed share of the debt of its financial company, Finaosta S.p.A., which Fitch already considered as regional debt and included it in its adjusted debt. At end-2022 VdA's debt profile remains conservative and consists of one euro-denominated bond (EUR14.8 million outstanding) and EUR43.5 million outstanding loans, most of which (75%) were with Cassa Depositi e Prestiti SpA (CDP, BBB/Stable).

**Liabilities & Liquidity Flexibility: 'Midrange'**

VdA's liquidity at end-2022 was EUR642 million, up from EUR585 million in 2021. More than half (55%) of VdA's cash, or EUR351 million, was Fitch-calculated free reserves, which covered around 17x 2022 debt service requirements, while the rest is considered restricted for future spending.

Fitch prudently estimates EUR200 million on average of free cash reserves in coming years in its rating case, or around 30% of total year-end cash. The counterparty ratings of liquidity providers cap this assessment at 'Midrange'.

**Debt Sustainability: 'aaa category'**

Under Fitch's rating case, which features readjusting operating revenues after the 2022 peak and operating expenditure growing alongside inflation and personnel increases, the primary debt metric (the payback ratio - net adjusted debt-to-operating balance) will be around 0.7x on average in 2025-2027, which is consistent with 'aaa' debt sustainability.

We expect VdA's operating balance to decline to just below EUR140 million in 2027 from an average EUR260 million in 2018-2022, and liabilities rise to around EUR390 million, or 30% of operating revenue (2022: EUR146 million). VdA's 10% operating margin, capital subsidies, borrowing and free cash reserves will fund the EUR1.65 billion capex Fitch expects over 2023-2027. This will include investments in healthcare infrastructure, education and school building renovation, road and transport infrastructures, social housing and the promotion of tourism activities, as well as support to the local economy.

Even if debt service for interest and principal edges toward EUR40 million, debt service coverage (synthetic calculation) will remain good at around 4.1x on average in the medium term.

## DERIVATION SUMMARY

The combination of VdA's 'Midrange' risk profile with a debt payback ratio of around 0.7x on average in 2025-2027 leads to a SCP in the 'aa' category. A high debt-service coverage ratio of on average around 4x, debt-to revenue below 10% and peer comparison with other European regions lead to the 'aa+' SCP.

VdA's IDRs are constrained at two notches above the sovereign's ratings, reflecting the region's special autonomous status while also considering potential intervention by the state in case of sovereign stress, such as a 10% increase in VdA's EUR82 million contribution to state's budget.

**Short-Term Ratings**

VdA's 'F1' Short-Term IDR is the higher of two options mapping to a 'A-' Long-Term IDR. This is based on an estimated short-term liquidity coverage ratio (Fitch-calculated unrestricted cash and operating balance-to-debt service) at 16.4x on average in 2023-2024, 'Stronger' debt robustness, and 'Midrange' debt flexibility.

### Debt Ratings

VdA's senior unsecured debt is rated 'A-', in line with its Long-Term IDR.

## KEY ASSUMPTIONS

**Risk Profile: 'Midrange'**

**Revenue Robustness: 'Midrange'**

**Revenue Adjustability: 'Midrange'**

**Expenditure Sustainability: 'Midrange'**

**Expenditure Adjustability: 'Midrange'**

**Liabilities and Liquidity Robustness: 'Stronger'**

**Liabilities and Liquidity Flexibility: 'Midrange'**

**Debt sustainability: 'aaa'**

**Support (Budget Loans): 'N/A'**

**Support (Ad Hoc): 'N/A'**

**Asymmetric Risk: 'N/A'**

**Rating Cap (LT IDR): 'A-'**

**Rating Cap (LT LC IDR) 'A-'**

**Rating Floor: 'N/A'**

### Quantitative assumptions - Issuer Specific

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2018-2022 figures and 2023-2027 projected ratios. The key assumptions for the scenario include:

- Operating revenue to decrease on average -1.4% (CAGR) under our rating case as tax revenues decrease from their 2022 peak as inflation decreases, and current transfers gradually return closer to pre-pandemic averages

- Operating expenditure to increase by 2.1% (CAGR) on average in 2023-2027, factoring in some inflationary pressures and increasing personnel costs

- Negative net capital balance on average at EUR200 million, broadly in line with management projections

- Apparent cost of debt increasing from 1.6% in 2022 to 1.8% in 2027 as all of VdA's debt is fixed-rate and increasing rates only apply to Fitch-estimated new borrowings

- Net Fitch-adjusted debt at around EUR194 million by 2027 (debt free at end-2022)

### Issuer Profile

VdA is an autonomous region in the north of Italy, with around 1.2 million residents, by far the smallest region in Italy, and wealthy socioeconomic indicators. Its responsibilities include healthcare, education and local transportation, funded with a fixed share of major national taxes as set in the Italian constitution.

## RATING SENSITIVITIES

### Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Negative action on the sovereign's ratings would be mirrored on VdA's IDRs.

Deterioration in payback ratio above 2x on a sustained basis leading to a downward revision of the SCP would narrow the rating differential between VdA and the sovereign.

### Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

As VdA's IDRs are constrained by the Italian sovereign ratings, changes to Italy's IDRs would be mirrored on VdA's ratings, assuming the rating differential between VdA's SCP and the sovereign IDR remains seven notches or more.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

## DISCUSSION NOTE

Committee date: 20 September 2023

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

## PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

VdA is rated two notches above the sovereign.

### References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

## RATING ACTIONS

| ENTITY / DEBT | RATING | | PRIOR |
|---|---|---|---|
| Valle d'Aosta,Autonomous Region of | LT IDR<br>Affirmed | A- Rating Outlook Stable | A- Rating Outlook Stable |

| | | |
|---|---|---|
| | ST IDR F1 Affirmed | F1 |
| | LC LT IDR A- Rating Outlook Stable Affirmed | A- Rating Outlook Stable |
| senior unsecured | LT A- Affirmed | A- |

VIEW ADDITIONAL RATING DETAILS

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## APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 03 Sep 2021) (including rating assumption sensitivity)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| Valle d'Aosta,Autonomous Region of | EU Issued, UK Endorsed |

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