FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Paris - 06 Sep 2024: 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 unchanged assessment of VdA's Standalone Credit Profile (SCP) at 'aa+'. This reflects the combination of a 'Midrange' risk profile and a financial profile assessed at the upper end of the 'aaa' category. The 'A-' IDRs are five notches below the region's SCP as VdA's ratings are constrained at two notches above Italy's sovereign IDRs (BBB/Stable).

KEY RATING DRIVERS

Risk Profile: 'Midrange'

This assessment reflects Fitch's view that there is a moderately low risk that VdA's ability to cover debt service with its operating balance may weaken unexpectedly over the forecast horizon (2024-2028) either because of lower-than expected revenue or higher-than-expected expenditure, or because of an unanticipated rise in liabilities or debt-service requirements.

Revenue Robustness: 'Midrange'

As a special statute region, VdA is entitled to receive 100% of national tax revenue collected in its territory, limiting its dependence on state transfers (5% of operating revenue in 2023). Tax revenue represented 86% of operating revenue in 2023, with VAT (25% of operating revenue in 2023) and personal income tax (PIT, 27%) the main items, which make the region's revenue base more linked to the local economy than other regions. The assessment also reflects the region's small economy and concentration on a few entities for corporate income tax, including regional hydro company C.V.A.

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 4% of revenue, by Fitch's calculations, through increasing the PIT surcharge and business tax to their legal maximum and removing the relevant tax relief, as well as raising charges and fees.

VdA's socioeconomic indicators, including GDP per capita at about EUR39,350 in 2023 and low unemployment rate (4.1% in 2023 vs. 7.8% on national level), 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's opex structure is fairly predictable and moderately counter-cyclical, mainly comprising healthcare expenses (29% of opex in 2023). As a special statute region, VdA has more diversified responsibilities, with healthcare accounting for about a third of total expenditure, versus 80% in ordinary regions, and education covering another 15-20%. Around 20% of the region's opex is potentially highly cyclical, most notably social benefits (8%) and transfers to local governments to support their economy (10%).

VdA has demonstrated good control over its costs, with operating revenue growing faster than opex (4.5% per year on average over 2019-2023 vs. 1.9%). Over the medium term, we expect opex to continue growing under the rating case by around 3% a year on average in 2024-2028, with a notable 6% increase in 2024 as a result of increasing non-healthcare staff costs (+11% vs. 2022).

Expenditure Adjustability: 'Midrange'

VdA's cost structure is moderately rigid as inflexible costs account for around 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.

Liabilities & Liquidity Robustness: 'Stronger'

VdA is allowed to borrow only for capex, under national prudential regulation with amortising debt, no foreign-currency debt and debt-servicing capped at 20% of free revenue (not earmarked for healthcare), which limits the risk of unforeseen liabilities coming due. VdA's direct debt of about EUR87 million at end-2023 carries little risk as it is solely fixed-rate bonds (13%) and loans (87%). 60% of loans are with the state lending arm Cassa Depositi e Prestiti SpA (BBB/Stable/F2). The region had no short-term debt at end-2023. The amortisation profile is smooth with only one peak in 2024, which is covered by unrestricted cash (9.2x at end-2024).

Liabilities & Liquidity Flexibility: 'Midrange'

VdA can access various forms of liquidity. It has access to institutional lenders such as Cassa depositi e prestiti SpA, like all Italian local and regional governments (LRG), which ensures long-term financing at lower charges than capital markets. Italian LRGs benefit from central government support, such as transfers, long-term subsidised loans and backing in case of extraordinary events that cause difficulties in tapping the market and paying commercial liabilities. Counterparty ratings limit our assessment of this factor to 'Midrange'.

VdA's cash increased to EUR802 million at end-2023 (EUR642 million at end-2022), of which more than half (EUR426 million) Fitch considered unrestricted and could cover around 7x 2023 debt service requirements.

Financial Profile: 'aaa category'

We assess VdA's financial profile at the upper end of the 'aaa' category, In Fitch's rating case, VdA's payback ratio (net adjusted debt-to-operating balance) remains sustainably below 0x (2023: -0.8x) as net-adjusted debt remains negative due to high level of cash considered unrestricted by Fitch.

In our rating-case, we expect the operating balance to decline to EUR190 million in 2028, from EUR431 million in 2023. We expect transfers received to decrease to pre-pandemic levels and growth of tax revenue to slow (+0.2% yoy on average vs. +5% in 2019-2023) as economic growth and inflation subside, while opex continues to increase (+2.9% yoy), mostly due to personnel increases (+6%). We expect net-adjusted debt to decrease to -EUR433 million, from -EUR340 million, as we expect the region's self-financing capacity (current balance + capital revenue / capex) to average 150% over the scenario, and unrestricted cash to remain high.

DERIVATION SUMMARY

VdA's 'A-' Long-Term IDRs are based on the region's 'aa+' SCP and 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. The SCP is driven by a 'Midrange' risk profile and a financial profile that Fitch assesses at the higher end of the 'aaa' category, factoring a payback ratio sustainably below 0x under our rating case, due to a negative net-adjusted debt. No additional risk factors affect the ratings.

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 48.1x on average in 2024-2025, '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

Qualitative 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'

Financial Profile: 'aaa'

Asymmetric Risk: 'N/A'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): '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 2019-2023 figures and 2024-2028 projected ratios. The key assumptions for the scenario include:

- Operating revenue to decrease on average -0.7% (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 2.9% (CAGR) on average in 2024-2028, factoring in some inflationary pressures and increasing personnel costs

- Negative net capital balance on average at -EUR126 million, broadly in line with management projections

- Apparent cost of debt at 3.4%, factoring the region's reliance on only fixed rate debt and the fact that we do not expect the region to incur new borrowing.

- Net Fitch-adjusted debt at around -EUR433 million by 2028, factoring the region's high level of unrestricted cash (around EUR450 million at end-2028) and as we expect the region to finance its capex programme with operating balance and capital revenue.

Issuer Profile

VdA is an autonomous region in northern Italy with around 123,000 residents, by far the smallest region in Italy, and wealthy socioeconomic indicators. Its responsibilities include healthcare, education and local transportation, funded by a fixed share of 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 the payback ratio above 3x 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: 04 September 2024

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's ratings are linked to Italy's.

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	A- Rating Outlook Stable Affirmed	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

FITCH RATINGS ANALYSTS

Louis Thivent
Senior Analyst
Primary Rating Analyst
+33 1 44 29 91 33
louis.thivent@fitchratings.com
Fitch Ratings Ireland Ltd
28 avenue Victor Hugo Paris 75116

Giulia Gasparini
Associate Director
Secondary Rating Analyst
+39 02 9475 5780
giulia.gasparini@fitchratings.com

Pierre Charpentier
Senior Director
Committee Chairperson
+33 1 44 29 91 45
pierre.charpentier@fitchratings.com

MEDIA CONTACTS

Athos Larkou
London

+44 20 3530 1549
athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

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APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 17 Aug 2024) (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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