FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Milan - 03 Apr 2020: Fitch Ratings has affirmed the Autonomous Region of Valle d'Aosta's (VdA) Long-Term Local and Foreign Currency Issuer Default Ratings at 'A-' with Negative Outlooks and Short-term Foreign Currency IDR at 'F1'. The long-term ratings on the region's senior unsecured bonds have also been affirmed at 'A-'.

The affirmation reflects VdA's resilient financial profile even under our new assumptions on tax revenue, which we have revised down to -5% in 2020, possibly reaching -10% in a rating scenario of a contracting economy after the coronavirus outbreak. 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'. The Negative Outlook reflects that on Italy.

While Italian LRGs' most recently available issuer data may not have indicated performance impairment, material changes in revenue and cost profiles are occurring across the sector and likely to worsen in the coming weeks and months as economic activity suffers and government restrictions are maintained or broadened. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector for its severity and duration, and incorporate revised base- and rating-case qualitative and quantitative inputs based on performance expectations and assessment of key risks.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

With five key risk factors assessed as 'Midrange' and one as 'Stronger', VdA's risk profile has been maintained at 'Midrange', which points to a relatively low risk that service coverage by the operating balance weakens unexpectedly over the forecast horizon (2020-2024) below 3x, either because of revenue falling short of expectations or spending overshooting above expectations, or an unanticipated rise in liabilities/debt service requirements.

Revenue Robustness: 'Midrange'

VdA is a special statute region that is entitled to receive 100% of the tax revenue generated in its territory. Since 2012-2013, the region's revenue growth has been curtailed by an average 1.3% in real terms due to the contribution to national budget consolidation in the aftermath of the Eurozone crisis. This contribution has been gradually resized, reaching around EUR110 million in 2019 from EUR250 million, with a positive effect on the region's operating balance.

Fitch tests the region's EUR1.3 billion operating revenue resiliency against its revised expectations of a cumulated 7% decline in 2020-2021 base scenario, which doubles in case of a prolonged weak economy following the pandemic. Our conservative assumptions consider the region's small economic size as well as taxpayer concentration on a few names, including the regional hydro company CVA (A-/Negative).

Revenue Adjustability: 'Midrange'

This assessment is supported by Fitch's estimate of VdA's theoretical revenue flexibility of about EUR70 million, or 5% of revenue. Tax-raising potential would cover the peak-to-trough revenue fall in the economic slowdown experienced in 2015 by more than 50%, when adjusted for changes in the funding system and contributions to the national budget. Positively, the region has wealthy socio-economic indicators that underpin its tax-revenue flexibility, such as GDP per capita at roughly EUR39,000 (or 30% above the EU27 average), and a high employment rate of nearly 70%.

Expenditure Sustainability: 'Midrange'

VdA has a solid track record of cost control and balanced budget over the years, while being able to resize its cost structure between 2012 and 2014 to allow for a contribution to the national budget consolidation, which peaked at EUR250 million. As a special statute region, VdA has a more diversified set of responsibilities, with healthcare covering about a quarter of total expenditure, while in ordinary regions it covers 80% of the budget. Other spending items include social services (7%), education and culture (7%), transport (6%) and support to the region's local governments (9%).

Fitch expects a further reduction in the region's contribution to the national budget to cover healthcare cost spikes related to the pandemic, while Fitch continues to factor in EUR20 million-EUR30 million capital expenditure for the region's casino company, which is currently under bankruptcy protection. Despite expectations that the casino company will post a balanced income statement in 2019, its activities in 2020/21 could slow down as a consequence of the lockdown.

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), which comprises healthcare, education, staff, purchase of goods and services. While Fitch does not expect a downward revision of expenditure during the pandemic, we believe that the region will possibly extend the scope of expenditure to sustain the local economy and employment. 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.

Liabilities and Liquidity Robustness: 'Stronger'

VdA's debt profile is conservative and almost entirely composed of two euro-denominated bonds, amortising synthetically thanks to provisions to the sinking fund, with a EUR543 million bullet repayment in May 2021, 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 the region's medium-term debt service around EUR35 million-EUR40 million is paid out of recurring revenue.

Liabilities and Liquidity Flexibility: 'Midrange'

VdA's average EUR200 million liquidity in 2019 (year-end about EUR420 million) comfortably covers debt service requirements by over 5x, cushioning the region's debt service capacity during the pandemic. Fitch estimates the region will post around EUR100 million of free cash reserves, while maintaining access to about EUR200 million of credit lines with its treasury bank, Unicredit (BBB/Negative). Counterparty ratings on liquidity, including the sinking fund held at Deutsche Bank (BBB/RWN), cap this assessment at 'Midrange'.

Debt Sustainability: 'aaa' category

Under its conservative scenario of a contracting economy, Fitch expects that the operating balance will halve to EUR150 million in 2020 compared to 2019. Coupled with debt at EUR600 million by 2024, when including regional financial company Finaosta's debt, this leads to a payback around four years from current 0.5. Even with this sharp deterioration of the payback under stressed circumstances, VdA's debt sustainability remains in the 'aaa' category.

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. As a special statute region, VdA's finances 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 environment to economic fluctuations.

DERIVATION SUMMARY

The combination of VdA's 'Midrange' risk profile with a debt payback ratio of four years leads to its SCP being assessed in the 'aa' category. A high debt-service coverage ratio above 3x, debt-to revenue ratio below 50% and peer comparison with other European regions 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, such as a moderate increase in the contribution to state's budget of around EUR20 million.

KEY ASSUMPTIONS

Qualitative Assumptions and Assessments:

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' category

Support: N/A

Asymmetric Risk: N/A

Sovereign Cap or Floor: Y

Quantitative assumptions - issuer specific

Fitch's rating case scenario is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on the 2015-2018 figures, 2019 preliminary figures and 2020-2024 projected ratios. The key assumptions for the scenario include:

- around 1% decrease in operating revenue on average in 2020-2024 in rating case, while average operating revenue remains substantially flat in the same period;

- about 1% increase in operating spending on average in 2020-2024 in our rating scenario versus roughly 2% in base case;

- Adjusted debt at EUR600 million in rating scenario versus around EUR450 in base scenario.

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

A sovereign downgrade will lead to a similar action on VdA's IDRs.

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 downward revision 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+'.

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

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

BEST/WORST CASE RATING SCENARIO

Ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings https://www.fitchratings.com/site/re/10111579.

SUMMARY OF FINANCIAL ADJUSTMENTS

Adjustments to 2019 preliminary figures

Direct debt reported gross of the sinking fund

Finaosta's estimated debt reclassified as Other Fitch-classified debt

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Valle d'Aosta,Autonomous Region of	LT IDR	A-	Affirmed
•	ST IDR	F1	Affirmed

ENTITY/DEBT	RATING		
•	LC LT IDR	A-	Affirmed
• senior unsecured	LT	A-	Affirmed

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Rating Criteria for International Local and Regional Governments (pub. 13 Sep 2019) (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

ADDITIONAL DISCLOSURES FOR UNSOLICITED CREDIT RATINGS

Valle d'Aosta,Autonomous Region of (Unsolicited)	
With Rated Entity or Related Third Party Participation	Yes
With Access to Internal Documents	Yes
With Access to Management	Yes

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UNSOLICITED ISSUERS

ENTITY/SECURITY	ISIN/CUSIP/COUPON RATE	RATING TYPE	SC ST
Valle d'Aosta,Autonomous Region of	-	Long Term Issuer Default Rating	Ur

ENTITY/SECURITY	ISIN/CUSIP/COUPON RATE	RATING TYPE	SC ST
Valle d'Aosta,Autonomous Region of	-	Short Term Issuer Default Rating	Ur
Valle d'Aosta,Autonomous Region of	-	Local Currency Long Term Issuer Default Rating	Ur

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