FitchRatings

Fitch Affirms Italian Autonomous Province of Trento 'A-'; Outlook Negative

Fitch Ratings-Milan/London-24 May 2019: Fitch Ratings has affirmed the Autonomous Province of Trento's (PAT) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-' with Negative Outlooks and Short-Term Foreign-Currency IDR at 'F1'

The affirmation reflects PAT's performance being in line with Fitch's expectations of a debt-to-operating balance contained within two years amid a risk profile, or debt tolerance, assessed as high-midrange. The latter envisages low risk of weaker debt service coverage over the medium term due to a contraction of the operating balance, either because of revenue falling short of expectations or spending rising above expectations, or an unexpected increase in debt service requirements. PAT's IDR reflects a compression of its 'aaa' Standalone Credit Profile (SCP) due to the limited leeway above Italy's sovereign rating.

KEY RATING DRIVERS
Fitch deems the risk that the EUR1.1 billion operating balance (24% of revenue) shrinks over the medium term as relatively low amid 'stronger' assessments for revenue robustness, revenue flexibility and expenditure adjustability, and a 'midrange' assessment for expenditure sustainability.

Revenue Robustness: Stronger
Revenue exhibits low volatility, with the average deflated growth rate at 0.2% 2009-2018, close to Italy's average GDP growth of -0.3% in the period. Fitch expects PAT's revenue to grow by about 1% per year over the medium term (versus 2% in 2014-2018), or about 0.5% in the conservative rating case scenario featuring prolonged economic stagnation in 2020 and 2021 before returning to trend growth of 0.5% in 2022/23.

GDP per capita of EUR36,000 or 125% of the Italy/EU averages and an employment rate close to the EU average of 70% underpins revenue resiliency. Growth of taxes, which represent 92% of revenue, is reliant on personal income tax (PIT), which grew by 20% to EUR1.5 billion over 2012-2018, and was insensitive to the economic slowdown in 2012/2014, offsetting other more sluggish taxes such as corporate income tax and VAT as well as the near halving of the business tax (IRAP) to EUR200 million amid changes in the tax base and rates.

Revenue Flexibility: Stronger
The assessment of revenue flexibility is supported by the province's ability to increase taxes leading to a potential rise of 8%-10% (EUR350 million) in operating revenues, which would twice cover the peak-to-trough revenue fall of EUR140 million in 2015. Fitch consider PAT's affordability to raise taxes as high, due to the low unemployment rate of about 5% and high socio-economic wealth indicators.

Expenditure Sustainability: Mid-range
PAT's control of spending and the administration's priority to maintain the alignment of revenue and spending over the economic cycle translate into a solid operating margin, whose slowdown to 25% from 30% in the mid-2010s was due to accounting changes, including the allocation of the provincial contribution to national budget, and a moderate spending hike after years (2010-2015) of continue cost rationalisation keeping them at EUR2.8 billion.

Pro-growth investment spending is usually pushed through by Cassa del Trentino (CdT; A-/Negative) or other provincial companies as shown by the aggregated debt, or direct risk, spiking at EUR1.8 billion in 2015. Fitch also deems PAT to have a moderate share of rigid costs (around 70%), including spending for healthcare (35%), education (25%) and local authorities (15%), and nearly half of investment, which could be delayed if necessary.

Expenditure adjustability: Stronger
Higher-than-national average spending, in particular on healthcare, supports curtailment potential. Spending in the sector declined in 2012-2015, then rebounding to PAT's more standard level of EUR2,200 per capita (EUR1,900 nationally); PAT's network of GREs' also display propensity to modulate costs and capex thanks to a good level of transport, health and other socio-economic infrastructure in the province.

Fitch believes the risk that PAT's EUR100 million interest and principal (2% of revenue) incurred through CdT to rise unexpectedly is also low, amid "stronger" assessments liabilities and liquidity robustness and "moderate" assessment for Liabilities and Liquidity Flexibility.

Liabilities and Liquidity Robustness: Stronger
National and provincial prudential regulation includes borrowing for capex, debt amortising structure, no foreign currency debt exposure and debt service cap at 20% of free revenue. PAT is formally debt-free as it borrows through its financial arm CdT, whose debt exposure, EUR1 billion in 2018, is included in Other Fitch classified debt as it is fully backed by PAT through an unconditional, irrevocable and at first demand guarantee, as well matched by provincial subsidies for debt repayment. PAT is among the few Italy's LRGs to maintain rather active market access.

PAT has limited off-balance risks with liabilities of subsidiaries such as Patrimonio del Trentino, University of Trento and Trentino Trasporti included in net indirect risk and modest guarantees at EUR116 million at end-2018, excluding CDT whose debt is consolidated into that of PAT. PAT maintains aggregate debt for its subsidiaries below 10% of GDP, and debt and uses derivatives for fair value hedging and at times of interest rate exposure to match floating interest on borrowing with fixed multi-annual subsidies for debt amortisation. Overall borrowing is controlled by PAT with prior authorisation.

Liabilities and liquidity flexibility: Midrange
PAT's treasury bank Unicredit (BBB/Negative) is committed to advancing liquidity lines up to EUR0.5 billion (1/10 of the budget), or 3/10 for about EUR1.5 billion when provincial companies are also considered, covering the debt servicing requirements of about EUR250 million per year over the medium term several times. Fitch expects Trento's cash to edge higher towards EUR2 billion over the medium term - with free fund balance returning to a positive result in 2018 from the nearly EUR200 million deficit posted in 2016 following write-off of receivables -, eventually halving to EUR1 billion in the rating case scenario encompassing higher capital spending.

Debt Sustainability Assessment: 'aaa'
PAT's debt, including borrowing incurred via CdT, accounts for EUR1 billion, of which nearly EUR600 million is from debt capital markets. Fitch expects the debt-to-operating balance to hover around 1x, or 1.8x in the rating case scenario, in which borrowing would edge to EUR2 billion versus EUR1.2 billion in the base case

SCP AND RATING DERIVATION
The 'aaa' SCP stems from 'aaa' debt sustainability combined with a high midrange risk profile

PAT is eligible to be rated above the sovereign by virtue of its institutional strength and high degree of financial autonomy. PAT's special autonomous status entitles it to receive shares of national taxes, ranging from 90% of personal income tax and corporate income tax to 80% of VAT. This underpins the region's tax revenue resilience and limits dependence on state transfers, which account for 1% of revenue.

The maximum two-notch leeway above the 'BBB' sovereign rating captures the risk of possible interferences by the state in case of macroeconomic or financial stress of sovereign finances and subsequent risk of weakening predictability of intergovernmental relations although PAT's diversified set of responsibilities supports budgetary flexibility and contributions to national consolidation efforts are subject to bilateral agreement.

Fitch does not apply any asymmetric risks or extraordinary support from the central government

We assess the region's short-term rating at 'F1', considering PAT's solid liability and liquidity framework amid liquidity that covers more than 1.5x debt servicing needs over the medium term.

RATING SENSITIVITIES
PAT's IDRs are constrained by the Italian sovereign ratings so changes to Italy's IDR would be mirrored on PAT's ratings.

A sharp deterioration of PAT's debt sustainability with a debt-to operating balance, or payback ratio, above nine years (and fiscal debt burden above 100%) would lead to a multiple-notch downgrade of the provincial SCP to 'a', and subsequently a narrowed leeway of one-notch above the sovereign ratings

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