Italy
Credit Analysis

Autonomous Province of Trento

Ratings

	Current Rating	Previous Rating	Rating Action
Foreign Currency			
Long-Term	AA+	-	Nov 2002
Short-Term	F1+	-	Nov 2002
Local Currency			
Long-Term	AA+	-	Jun 2004

Rating Watch ....None
Rating Outlook...Stable

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Summary Data

	31 Dec 2004	31 Dec 2003
Op. Revenue (EURm)	3,548	3,344
Total Debt (EURm)	0.0	0.0
Operating Balance/ Operating Revenue (%)	34.7	32.8
Debt Servicing/Current Revenue (%)	0.0	0.0
Debt/Curr. Balance (Yrs)	0.0	0.0
Capital Expenditure/ Total Expenditure (%)	40.2	41.9
Surplus (Deficit) Before Debt Variation/Total Rev. (Exc. New Debt) (%)	-2.9	-7.4
Current Balance/ Capital Expenditure (%)	79.1	67.9

Profile

Trento, located in the wealthy north-east of Italy, is a small province with a population of about 498,000 (0.9% of Italy's total). Its GDP per capita is 30% higher than the EU25 average. As it has the status of an autonomous province it enjoys a high degree of financial independence in terms of both revenue and expenditure. Trento's autonomy is protected at the Italian constitutional level through an agreement with Austria.

Rating Action and Outlook

Fitch Ratings has affirmed the Long-term rating of the Autonomous Province of Trento (Trento or the Province) at 'AA+', which is above the sovereign rating of the Republic of Italy('AA' with a Negative Outlook). This primarily reflects the unchanged exceptional status and autonomy of the Province within the Italian system of government and its continuing solid budgetary performance. Trento has a higher degree of financial autonomy than ordinary Italian regions, which gives it the flexibility to offset central government's tax rate and tax base decisions, although this does not fully insulate the Province from potential financial pressure stemming from central government decisions on tax and spending. Trento's rating is linked to, but not constrained by, Italy's sovereign rating, in that the Province's finances can offset the negative effects from the sovereign's finances.

Key Rating Factors and Performance

Positive key rating factors include:

- The Province's special status, involving considerable financial autonomy, is not only recognised by the Italian Constitution, but is also protected by an international agreement with Austria;
- Trento has a strong and stable operating performance, reporting ample current margins, at 35% of operating revenue over the last ten years, a fully tax-funded healthcare system and completely self-financed investments. The Province will raise direct financial debt only to fund strategic and profit-generating projects. Even if the Province were to issue the entire amount of EUR500m allowable under its EMTN programme, its debt exposure would remain modest at 15% of its budgeted operating revenue and 0.5 times its current balance.
- A wealthy, diversified and dynamic economy, as evidenced by the Province's GDP per capita, one of the highest in Europe, and its unemployment levels, which are among the lowest – two key strengths that underpin Trento's finances.
- Strong financial flexibility, which is demonstrated by Trento's ability to introduce its own taxes – as has recently occurred – the substantial value of its real estate and financial assets, an expenditure structure that is more diversified than those of ordinary regions and a high share of investments (40% on average for 2000-2004) that could be cut or postponed should the need arise.
- Modest financial commitments pursuant the fully serviced and directly paid debt of provincial companies and public entities. The exposure remains modest, at 4% of the Province's 2005 budgeted operating revenue.
- Efficient management. Daily monitoring of the Province's financial and cash position, prudent budgetary provisions and a proactive approach contribute to management operations' accuracy, avoiding mismatches between revenue and expenditure.

Negative key rating factors include:

- Exposure to central government tax and spending decisions. The Province has only moderate tax flexibility, as the rates and bases for the main taxes are controlled by central government, which is also responsible for tax collection.

24 November 2005

Institutional Framework

Trento: considerable autonomy by comparison with other Italian regions

Trento, located in the north-east of Italy, forms, with the Autonomous Province of Bolzano, the Autonomous Region of Trentino-Alto Adige. It is characterised by extensive legislative and financial powers guaranteed by the Italian constitution on the basis of an international agreement with Austria, which recognises the Province's different cultural, historical and linguistic heritage. The Province has functions and powers similar to those of an Italian Special Status Region. Central government retains exclusive powers over policing, justice, defence, foreign policy and pensions, while shared areas of responsibility – where Trento has a large say in the management and funding – include healthcare, education, roads and transport. All other governmental functions are the exclusive responsibility of the Province. Trento's wide-ranging financial autonomy includes the power to levy its own taxes, the right to retain a share (around 90%) of direct and indirect central government taxes generated in the Province, and the right to receive 90% of the actual tax collected in its area for any new tax introduced by central government. The Province's autonomy is given effect by special laws (*norme di attuazione*) that cannot be unilaterally modified by ordinary national legislation. Central government cannot introduce legislation impinging on the autonomy of the Province without prior negotiation and approval through a special commission (*Commissione Paritetica*). This commission is composed of members nominated both by central government and by the two autonomous provinces. Over the years, Trento has become a skilled negotiator with the Italian central government, often achieving good results. The latest constitutional reform, in 2001 has increased the autonomy of the ordinary regions in theory, although not yet in practice. This has further consolidated Trento's autonomy and given it additional legal safeguards.

Growing responsibilities and a new financing system in sight for ordinary regions

Following the European-wide trend towards decentralisation, spurred by the principle of subsidiarity, Italian regions are in the midst of national constitutional reforms. Before 2001 regions were essentially pass-through agencies for executing central government's policies on healthcare and social care, transport and economic development (note that in this report "central government" means "state", unless otherwise indicated). Since then their responsibilities have expanded to all areas that were non-specifically reserved for central government (foreign policy, defence, the protection of fundamental rights, national taxes and finances and social security, etc) or explicitly shared with it, such as healthcare and education.

Healthcare accounts for almost two-thirds of the regions' budgets, followed by transport with 10%, infrastructure and economic development with 5% and social housing with 3%. The four regions and two provinces with special autonomous status (the regions – Valle d'Aosta, Friuli V.G., Sardinia, Sicily – and the provinces – Trento and Bolzano) have more diversified expenditure structures, as their above-average tax revenues allow them to self-finance local governments, education and a larger share of expenditure on environmental protection and social housing.

The responsibilities of autonomous regions and provinces that predate the current devolution process have not been changed. By contrast, their finances, based on a shared tax system and centred on a percentage of national taxes generated within their boundaries (ranging from 40% to 100%), are being partially replicated in the forthcoming reform of the ordinary regions' financing system. Central government maintains responsibility for the collection of all taxes enacted nationally.

A recent framework of constitutional autonomy for regions is being completed, but is not expected to weaken cohesion principles

After the constitutional changes in 2001, the Constitutional Court issued a series of rulings clarifying the limits of regions and central government legislative powers. The repeal of several central government laws, infringing on regions' legislative prerogatives, has helped raise regions' institutional positions vis-à-vis central government. Additional constitutional changes, currently being discussed, could strengthen regions' visibility by allowing them: a) to be represented in the National Senate, which will more closely reflect local developments; b) to appoint judges in the Constitutional Court, to better protect regions' legislative prerogatives; and c) to benefit from a financing regime based on shared taxes (probably VAT, PIT, corporate tax and the "regional" business tax, IRAP).

If the financing system of ordinary regions is revised to reflect local economic wealth and performance, the creation of an explicit equalisation fund will smooth out discrepancies in regions' fiscal capacities. It will ensure that the provision of services to all residents meets minimum quality standards set at the national level, currently secured in the allocation system based on a standard level of expenditure (in healthcare and other socially sensitive institutional services) throughout the country. The constitutional duty to provide key services, such as healthcare, at a standard agreed between central government and the regions, is one of the few areas that makes it difficult for central government to tighten its finances, as required by the Stability and Growth Pact (SGP).

The Constitutional Court ruling 37 of 2004 clarified that regions' recognised constitutional autonomy prevents any reduction in the legislative and financial autonomy that has already been granted to them. By the time the tax-sharing system is introduced, central government will maintain the option to select how to provide revenue (transfers or taxes) to regions; it is nonetheless bound to make available the resources needed to fully finance the standard of services agreed with regions.

From central government's incentive to transfer unfunded responsibilities, to co-operative behaviour with the regions

Intragovernmental arrangements imply that regions' functions can neither be subordinated to central government's agenda (in terms of the provision of adequate resources), nor can they be changed unilaterally by central government (to accommodate its own financing requirements). Commitments to other EU/euro member states have further reduced central government's incentives to devolve unfunded responsibilities to the regions because the former is accountable for both central and local governments' budgetary performance.

However, sluggish economic growth translates into insufficient central government transfers to the regions and from the regions to healthcare units. The regions' finances continue to be affected by upward pressure on expenditure, mainly as a result of the labour-intensive nature of their responsibilities and strong expenditure growth. Consequently, the healthcare sector has been accumulating off-balance-sheet liabilities since the beginning of the 1990s, when the provision of services was devolved to the regions. Following the Constitutional Court ruling 1993/355, which stated that regions could not be required to finance healthcare deficits without being transferred adequate revenues, central government continues to finance a share of the regions' off-balance-sheet liabilities but with years of delay, which results in liquidity pressures for the healthcare units.

SGP constraints lead to growth in private sector debt

In light of the SGP constraints, central government and regions have agreed to increase tax revenue – which will be pooled to finance healthcare in the regions – up to 6% of national GDP. In return, regions are constitutionally committed to national efforts, which are aimed at reducing Italy's debt to GDP ratio and keeping the Republic's annual budgetary deficit within the limits agreed at the EU level.

Because the social sensitivities of healthcare make cuts in operating expenditure difficult to implement, the pressure to contain growth in public sector debt has encouraged the growth in debt-like structures, which are not recorded as "Eurostat debt". Structured deals repaid via pass-through SPVs aim to spread regions' operating spending in excess of recurrent cash revenues over several years. In the context of the international trend of cutting taxes, the full tax financing of healthcare spending seems difficult to achieve in the medium term, even though this policy could be sustainable when Italian households' low level of debt (15% of the GDP) is taken into account.

Supervision, planning, accounting, investment, debt and liquidity

Central government control has always been relatively lax and is not set to strengthen in light of regions' increasing autonomy. The national audit body, the Corte dei Conti, performs ex post controls, basically to check the legitimacy of the operations.

The regions' accounting is based on a modified accruals concept; the adoption of full accruals is being considered in order to improve transparency and to meet the 2004 requirement that investment spending needs to generate an increase in assets. For the time being, however, regions' balance sheets are relatively incomplete, do not fully record assets and liabilities, the amortisation of fixed assets is not expensed and public sector entities are not consolidated.

In light of SGP constraints, the Constitutional Court in December 2004 (425) backed the principles of national law 350/2003, which aligned the definition of national debt to that of Eurostat, listing the debt-structures that can now be considered as direct financial debt. Borrowing is allowed until debt servicing reaches 25% of a region's operating revenue. Bullet maturities must be accompanied by sinking funds, to avoid moral hazard at the expense of future governments, and non-euro-denominated debt must be hedged with currency swaps.

Although regions started to borrow in the mid-1990s, their levels of debt are lower than both national and local governments. Moreover, the northern regions tend to tap the financial markets more than those in the south, which are still able to benefit from EU structural transfers. As central government usually bears the financial cost of unpredictable events, such as natural disasters, regions' free financial reserves are kept at minimum, even close to zero, which leaves them reliant on cash advances in the event of liquidity mismatches.

The bulk of revenue is provided to regions in monthly instalments, but cash is kept at the national treasury system until it is disbursed. Commercial banks called "treasury banks" are in charge of cashing in revenue and making payments within the limits set by the regions' annual budgets. In performing this public function, the treasury bank is required to follow a region's instructions, as well as national legislation, and, therefore, bears specific responsibility for the use of public money if legal procedures (in terms of procurement, allocation, disbursement, etc) are infringed. In this respect, the Corte dei Conti is helped in detecting any mishandling of public money by regions' treasury banks, which are required to draw up the financial statement of a region's cash inflows and outflows.

Treasury agreements with banks and provisions stated in loan and bond contracts usually commit treasury banks to pay debt instalments when they come due by putting aside regions' resources or by advancing liquidity if necessary. This tries to replicate on a contractual basis what is stated by law for provinces and cities. The treasury bank could be held accountable if it failed to make such payments. However, if a region is suffering from distressed finances, the treasury bank is not deemed to be liable if it refuses to advance liquidity to serve a region's long-term debt.

Protection for the regions' lenders is covered by national legislation

National legislation provides regions with an option to prioritise the payment of annual direct debt instalments, together with expenditure on staff and basic and essential services. For this to happen, the region must segregate the resources needed for these payments by providing the treasury bank with a list detailing the amounts of prioritised expenditure falling due in the following three months. The *dissesto* (financial distress) procedure is not applicable to regions, as it implies supervision by central government. If need be and if deemed appropriate, regions in financial distress can delegate central government to pay their financial lenders directly by tapping into their share of transfers.

■ Administration

Political stability over the years

At the latest elections in October 2003, the ruling coalition won another term. Mr Lorenzo Dellai was directly elected by popular vote to serve a second term as provincial president, winning over 60% of the votes. The new electoral system, involving the direct election of the president, guarantees a comfortable majority in the provincial council and speeds up the legislative activity of the province. Trento has always been governed by coalitions of centre or centre-left autonomist parties, with a co-operative centre-right opposition. Over the years, this has guaranteed the unity and stability of the provincial board, while simultaneously protecting and preserving common interests, such as the province's autonomy.

Together with the president of the Autonomous Province of Bolzano, Trento's provincial president holds the presidency of the Trentino-Alto Adige region. This ensures that administrative and financial interaction between Trento and the region is smoother and more co-ordinated.

Priorities: institutional reform…

The Province has been promoting internationalisation by strengthening links with neighbouring areas – especially the Tyrol – through synergies and partnerships in economic, cultural and political matters. This, and further improvements in the quality of the Province's infrastructure and environment still represent important targets for the administration in its new term. However, it is now focusing on a fresh priority: a broad institutional reform of the provincial system. According to the related proposal, the Province will retain legislative, and programming and control powers, while local governments will be delegated most responsibility for the administrative and service functions. A special council will be created, which will serve as a conduit for the opinions of local governments in the Province's programming/planning activities for public finance and socio-economic issues. New financial resources will be allocated to the local governments, with a neutral impact on provincial accounts: more transfers will go to the municipalities, but the Province will have fewer direct responsibilities and, thus, less expenditure To facilitate the provision of services and a more efficient system, a new intermediary tier of local government (the inter-municipal community) will be created, while minimum levels of services will be guaranteed through an equalisation mechanism. The reform, to be gradually implemented from year-end 2005, will involve the implementation of a common IT system across the different tiers of government and the adoption of a common accounting system. The reform is expected to create an integrated and coordinated public finance structure, leading to the rationalisation of expenditure. It should also prevent overlaps and duplications of work, and increase the monitoring of the provincial system's finances.

...and preservation of strong financial conditions

Financial policy for the coming years is aimed at maintaining high current margins through:

- the rationalisation of operating expenditure (i.e. a freeze on turnover the centralisation of purchases and e-procurement, as well as cuts in discretionary expenditure);
- an increase in charges for certain services to achieve higher cost coverage by tariff (but with high attention on equity issue;
- the introduction of a tax on tourism and a compulsory health contribution paid by all citizens (*contributo previdenziale obbligatorio per l'assistenza agli non autosufficienti*).

This last item has been introduced to help contain the costs of the provincial welfare system and offset potential pressures related to the ageing population. Investments will remain high, as in the past, and will focus on strategic areas such as research, innovation and the communications infrastructure (i.e. roads and railways).

Efficient and proactive management

The Province's budgetary approach is prudent. An efficient internal control system and daily monitoring of cash inflows and outflows ensure a balance between revenue and expenditure, while, at the same time, allowing the Province to minimise discrepancies between cash and accruals. In addition, integrated cash management with the treasurer bank guarantees timely cash advances during payment peaks. The Province maintains an unreserved fund balance equivalent to around 10% of its operating revenue, cushioning it against unforeseen events. Reliable cash flow projections, a unicum in the Italian context, provide long-term visibility on Trento's accounts. The proactive and competent management team is constantly seeking new sources of income, be it from its own, devolved or asset-related revenue, and also maintains tight control over expenditure. Investment programmes are tracked through a timetable of public works, which enables local officials to prioritise projects and schedule the work in progress. A coordinated provincial public finance system and the careful monitoring of wider public sector entities (companies, healthcare units and functional agencies, for example) and municipal governments ensure the efficient, effective and economic management of public resources.

Wider public sector

Trento has stakes in several companies in various sectors – a reflection of the depth of its involvement in the provincial economy. These include: transport services (*Trentino Trasporti, Interbrennero, Autostrada del Brennero*); airports (Verona and Trento); information and communications technology (*Informatica Trentina*); financial services (*Mediocredito, Tecnofin Trentina* and *Cassa Centrale delle Casse Rurali Trentine*); the promotion and marketing of tourism activities (Trentino Spa); and the promotion of economic activity through centres for business innovation (*Agenzia per lo Sviluppo*). Please see the table on page 10 for details of these holdings.

The creation of an asset management company (Patrimonio SpA), the transformation into a joint stock company of the social housing entity (Itea), and the new role assigned to Tecnofin Trentina, for the financing of local provincial entities (in which it will act as a local *Cassa Depositi and Prestiti*), will allow the Province to better pursue its strategy of an integrated provincial system while making the best use, and gaining most value out of public resources.

■ Socio-Economic Performance

Growing population

The Province of Trento has a population of about 498,000 (0.9% of the national total), which has been increasing by 10% in the past 15 years, mainly owing to net migratory inflows, but also, to a lesser extent, to positive natural growth. Foreign residents account for 5% of the provincial population. The proportion of the population over the age of 65, currently at 18% (Italy 19%) is expected to rise, mirroring the national trend. This will, to a limited extent, increase the pressure on healthcare spending.

Province focuses on socio-economic factors

The administration is well aware of the strategic importance of the local economy, given its close correlation with the provincial budget. It has supported the economy through investment over the years, mainly focusing on infrastructure, services and R&D. A comparison of per capita capital expenditure in Trento and Italy provides evidence of this: in the past five years years, the Province has spent three times more than the Italian average.

A diversified and dynamic economy

Trento has a service-based economy, a mature industrial sector that is not concentrated, but is,

Tax Revenue Breakdown

(EURm)	2000	2001	2002	2003	2004
Own Taxes	**361.7**	**379.3**	**388.7**	**400.3**	**466.5**
IRAP-Business Activities Tax	275.3	268.0	276.7	284.6	338.6
PIT Surtax	22.2	40.8	41.1	41.0	49.0
Car Tax	41.2	46.5	47.1	49.8	52.2
Other	23.0	24.0	23.8	24.9	26.7
Devolved Taxes	**2,350.5**	**2,408.4**	**2,609.6**	**2,716.3**	**2,774.0**
PIT	754.0	792.8	795.3	781.0	829.5
CIT	123.9	129.1	130.1	142.0	159.0
VAT	561.9	546.4	597.0	615.0	591.6
Petrol Tax	175.6	165.3	170.4	174.5	n.a.
Capital Gains Tax	60.7	90.4	91.4	103.5	n.a.
Other	674.4	684.4	825.4	900.3	1,193.9
Total Taxes	**2,712.2**	**2,787.7**	**2,998.3**	**3,116.6**	**3,240.5**

Source: Autonomous Province of Trento

rather, characterised by a large number of small and mid-sized companies. Over the last few years, real growth in the local economy has consistently outpaced the national average of 1%. The Province's other economic indicators are also strengthening: its 3% unemployment rate in 2005 is one of the lowest in the EU25, while GDP per capita is 30% above the EU25 average. The diversity of the local economy and its moderate export orientation in comparison with the national average and the high level of public investment (public administration accounts for up 18% of local GDP, versus 12.5% for Italy as a whole) have, to some extent, protected the province from the downturn in the national economy.

Traditional craft industries rooted in the culture and traditions of the area make up the bulk of the economy; these are sustained by an extensive network of supporting facilities such as co-operative banks that lend to local firms, training and research programmes, and vocational schools. The industrial sector contributes 24% of GDP, versus a national average of 27%, and its main activities include metal, paper, lumber and synthetic rubber production, food processing and non-electrical machinery.

Tourism has been among the most dynamic sectors recently, owing to growing inflows of foreign and national tourists, attracted to the Province's ski resorts and high-quality agricultural produce (e.g. wine, apples, cheese and ham).

Growth prospects

An already high level of infrastructure underpins Trento's growth prospects. The construction of new railway lines (Trento-Marilleva) that will interconnect the surrounding tourist destinations, and the upgrading of the transport system along with the EU's Corridor no. 1 (Palermo–Berlin) and Eurotunnel will further support Trento's long-term economic growth potential. The availability of affordable rents will help attract immigrants, offsetting the shortage in the local workforce. The Province's social housing agency, ITEA, is developing new housing and renovating the existing stock, as well as fuelling the construction industry ([which accounted for]7% of GDP in 2004). A fast-developing university, substantial public investments in R&D and the presence of renowned innovation centres (i.e. Microsoft) will positively contribute to the province's skilled workforce and the creation of new valued-added companies.

■ Finances and Performance

Revenue

Provincial revenue has been driven by the high proportion of tax revenue, which accounted for approximately 91% of 2004 operating revenue. The Province has two main sources of tax: (i) locally raised taxes, over which it has discretion; and (ii) devolved taxes, basically via tax-sharing with the central government, where it remains vulnerable to central government tax decisions. Trento is entitled to receive a share of all major taxes imposed by the national parliament and generated/collected on Trento's territory: 100% of the electricity consumption tax; 90% of PIT, CIT, petrol tax and the capital gains tax; 70% of VAT; 40% of VAT on imports; 90% of all other devolved taxes. It may also levy its own taxes on activities and tax bases that are not reserved for and regulated by central government.

Taxes have been buoyant over the last few years, increasing at a compound annual growth rate (CAGR) of 4.5% in the 2000-04 period, fuelled by a wealthy and dynamic economy.

The central government's proposed reduction in PIT (a national tax cut of around EUR12bn) and IRAP could potentially reduce the Province's revenue by an estimated EUR150m-EUR200m, equivalent to 4% of 2004 operating revenue. However, several factors should offset the impact of the announced tax

Operating Expenditure

(EURm)	2000	2001	2002	2003	2004
Staff Costs	467.9	490.6	520.8	569.5	596.4
Goods and Services	95.3	103.0	112.3	113.9	125.0
Transfers	1,250.3	1,367.5	1,454.2	1,540.9	1571.3
Municipalities	197.8	213.5	216.0	227.1	236.0
Healthcare	602.3	695.3	740.3	783.1	805.5
Miscellaneous	450.2	458.7	497.7	530.7	529.8
Others	15.0	20.1	21.1	21.9	22.8
Tot. Op. Exp.	**1,828.5**	**1,981.2**	**2,108.4**	**2,246.2**	**2,315.5**

Source: Autonomous Province of Trento

cuts: agreements with central government, which guarantee invariance of the amount of resources allocated to the Province; the introduction of new tax sources (tourism tax and health contributions); and the Province's active stance on tax evasion, as well as its dynamic management approach of constantly seeking new revenue sources. In addition, any national reduction in taxation could, potentially, boost Trento's economy, and, therefore, its finances.

Trento could gain up to EUR110m in additional tax revenue, about 3% of current revenue for 2004, if it were to use its tax flexibility to the maximum. Additional flexibility also stems from the possibility of introducing medicine and healthcare service co-payments and from its EUR400m worth of real estate and financial assets, which provide a substantial budgetary cushion in case of need.

In addition, Trento has around EUR2bn in revenue, mainly corresponding to the past few years' taxes, that is likely to be recognised, after negotiations with central government. Although this amount has not yet been recorded in provincial financial statements, once recognised by the central government (which Fitch understands to be a highly likely prospect), it will allow Trento to benefit from additional revenue in the coming years.

Expenditure

Trento's operating expenditure, which consists primarily of healthcare (72%), staff costs and transfers to municipalities, grew at a CAGR of 6% over the 2000-2004 period. The region devolved new but minor responsibilities (the chamber of commerce, cadastre) to Trento in 2004, but this had a neutral impact on its accounts as the new revenue matches the new expenditure.

Balanced Healthcare Accounts. Healthcare transfers accounted for about 35% of operating expenditure in 2004 (compared with an average of 70%–80% in the other Italian regions). Trento's healthcare sector is independent and has been self-financing since 1995. The Province is responsible for this sector's wage bargaining, which has replaced the national system, and for the costs of people on welfare (i.e. the elderly and the infirm). Trento has no healthcare deficit and runs a balanced healthcare account. In addition, invoices are paid within the contractual 120 days (the national average is above 300 days), which is indicative of the efficient financial management of the healthcare system and its low pressure on the Province's liquidity.

Staff Costs (26% of operating expenditure). Expenditure in this area grew sharply in the early 1990s owing to a steep rise in the number of public employees (in 1997 the province became financially responsible for about 5,700 elementary school teachers). The upward revision of the Provincial staff bargaining agreement has caused wage costs to increase in the last two to three years, although staff spending as a proportion of operating expenditure has remained in line with previous years' levels. Turnover freeze should maintain stable personnel costs in the medium term.

Transfers to Municipalities (11% of 2004 operating expenditure). The Province has sole responsibility for and exclusive powers over the financing of municipalities' expenditure. For the period 2000-2005, Trento agreed to give the 223 municipalities 22.1% of taxes devolved from central government. This amount is allocated to the municipalities on the basis of objective criteria (i.e. the number of elderly inhabitants and tourists, and geographical characteristics). In addition, to ensure continuing fiscal soundness and stability, the Province has implemented an "internal stability pact" with the municipalities. As a consequence, no municipality has fallen into financial distress (*dissesto*), and, in general, all have low debt levels and solid financial performance.

In the 2000-2004 period, capital expenditure averaged EUR1.5bn per annum or around 40% of total expenditure. The administration is also committed to maintaining investments at similarly high levels in the coming years. Capex is mainly composed of transfers to third parties (i.e. local governments, the private sector and provincial companies) and relates to relatively small projects in a variety of sectors. The high level of investment spending gives the Province substantial financial flexibility in the event of a budgetary shortfall.

Capital revenue, mainly composed of central government and EU transfers, has funded 15% of Trento's investments on average in the last five years. The Province benefits from central government financial support for important infrastructure projects. For example, the so called Asse del Brennero project, a Trans-European rail network connecting Europe from north to south, is expected to be fully funded by the Italian government.

Budgetary performance

Trento's financial performance has been outstanding in recent years, comparing favourably with those of both its Italian peers and its best-performing international peers. Although revenue growth was lower than operating expenditure for the 2000-2004 period, operating margins remained healthy, at 35% of operating revenue on both an accruals and cash accounting basis.

The substantial operating balance, combined with a sizeable capital revenue and fund balance (*avanzo di amministrazione*), allow the Province to fully self-finance its capital expenditure and investment, without recourse to debt.

Owing to its considerable budgetary flexibility and management's prudent and active financial approach, the Province is expected to maintain this exceptional performance over the medium term as well.

■ Debt and Liquidity

Direct debt

Trento has not incurred any new financial debt in the past eight years, and has been debt free since 1997. In June 2005 the Province renewed its EUR500m EMTN programme aimed at funding investments, but it has not yet issued any notes under the programme. It is expected to borrow only if the investment is of strategic importance to the modernisation and economic development of the area, and will provide a substantial return. In this context, the Province's debt position may change following the planned acquisition of some hydroelectric power plants currently owned by Enel, the national electricity energy monopoly. Trento could issue EUR500m in new bonds for this purpose, but even so, its debt exposure would remain very low, at 15% of budgeted operating revenue and with a debt coverage ratio (debt to current balance) of 0.5 years. The purchases are likely to generate profits that will be used to pay off any debt raised to finance them.

Sound liquidity position

The Province's cash flows indicate that it has successfully balanced inflows and outflows over the past few years through the effective management of its liquidity position. Its high cash-generating capacity is supported by high rates of own revenue collection, the daily monitoring of Trento's cash position and its reliable multi-year cash projections. The Province can obtain a cash advance from its treasury bank (Unicredito, 'AA-(AA minus)'), equivalent to 30% of its budgeted tax revenue (about EUR900m), but uses only a small portion of this facility in periods of concentrated payments. Trento benefits from an outstanding treasury position, paying a lower interest rate on cash advances than it receives on cash accounts.

Contingent liabilities

The risk associated with the Provincial administration's wider public sector companies is limited because of their generally healthy financial condition and the Province's strict control and monitoring of the entities concerned. The equity value of Trento's shareholdings, over EUR150m, allows the Province to enjoy additional revenue flexibility in case of need, as financial assets are recorded at cost on its balance sheet. However, the current administration is not planning to sell its shareholdings because of their strategic importance for local economic development.

The Cities' Finances

(EURm)	**2001**	**2002**	**2003**
Operating Revenue	653.9	657.1	677.5
Operating Expenditure	541.2	538.1	557.9
Operating Balance	**112.8**	**118.9**	**119.6**
Interest	21.2	19.8	19.0
Current Balance	**91.6**	**99.2**	**100.6**
Capital Balance	*-94.4*	*-129.1*	*-135.2*
Surplus/Deficit Bef. Debt Var.	**-2.9**	**-29.9**	**-34.6**
Debt Repayments	67.7	60.8	68.6
New Borrowings	45.6	72.2	81.4
Overall Results	**-24.9**	**-18.5**	**-21.8**
Total Debt	**435.1**	**413.0**	**425.8**
Current Bal/Op. Rev. (%)	14.0	15.1	14.9
Def./Surp. Bef. Debt/Tot.Rev. (%)	-0.3	-2.7	-3.0
Debt/Curr.Bal (Years)	4.8	4.2	4.2
Op. Balance/Debt Service/ (%)	1.3	1.5	1.4

Source: Autonomous Province of Trento

Main Provincial Companies 2004

(EURm)	Stake (%)	Turnover	Profit & Loss	Financial Debt
Agenzia Sviluppo (Econ.Develop.)	98.5	130.6	0.1	0.0
Trentino Trasporti (Transport)	87.1	34.3	-1.4	17.0
Aerop. Caproni (Airport)	86.7	0.7	0.1	0.0
Tecnofin Tr (Fin. Services)	82.2	48.0	0.2	0.0
Trentino SpA (Tourism Prom.)	60.0	6.2	0.0	0.0
Informatica Tr (IT)	51.0	37.9	1.5	0.0
Interbrennero (Transport)	47.0	1.3	0.8	0.0
Aerop. Catullo (Airport)	18.4	48.3	0.7	0.0
Mediocredito T.A.A. (Bank)	17.5	1414.4	5.8	-
Aut. Brennero** (Motorway)	5.3	252.9	38.9	0.0
Cassa Centrale delle Casse Rurali Trentine (Fin. Services)	5.0	1551.9	4.1	-

Source: Autonomous Province of Trento

The Province fully and directly services bonds raised by two entities: Trentino Trasporti-TT (‘AA/Stable’) and Itea launched EUR35m and EUR50m in bonds, respectively, at end-2004; both issuances were rated ‘AA’. A third issuance of up to EUR50m by the University of Trento, whose capital projects fall under the responsibility of the Province, is likely to be launched at end-2005 and will enjoy the same features as the TT and Itea bonds. In addition, Trento grants annuities for the capital projects of the municipalities, which, in turn, have contracted debt backed by these provincial subsidies. However, the Province does not guarantee municipal debt. Outstanding total municipal debt was EUR426m at end-2003, with annuities accounting for around 30% of the debt-service requirements.

The Province’s full contributions to its companies’ debt servicing form part of its long-term, fixed and contractual obligations and are therefore considered in the rating analysis as a debt-like exposure, although subordinated to Trento’s senior unsecured debt since they do not share the same legal protection features. However, this exposure remains limited compared to Trento’s overall budget, at 4% of budgeted operating revenue for 2005, when the forthcoming University bond is included in the calculation.

Guarantees on third-party debt amounted to only EUR38m as of June 2005; however, these are not first-demand guarantees and have never requested provincial payments so far. The Province does not report any off-balance-sheet liabilities.

Appendix A

Autonomous Province of Trento

(EURm)	2000 Actual	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2005 Budget	2006 Budget	2007 Budget
Taxes	2,712.2	2,787.7	2,998.3	3,116.6	3,240.5	3,103.6	3,139.7	3,220.0
Transfers Received	67.2	85.4	162.8	143.9	190.5	193.7	165.7	60.9
Fees, Fines and Other Operating Revenues	68.5	69.8	78.5	83.7	117.3	72.5	74.2	74.6
Operating Revenue	**2,847.9**	**2,942.9**	**3,239.6**	**3,344.2**	**3,548.3**	**3,369.9**	**3,379.6**	**3,355.5**
Operating Expenditure	-1,828.5	-1,981.2	-2,108.4	-2,246.2	-2,315.5	-2,389.9	-2,431.9	-2,490.0
Operating Balance	**1,019.4**	**961.7**	**1,131.2**	**1,098.0**	**1,232.8**	**980.0**	**947.7**	**865.5**
Financial Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Balance	**1,019.4**	**961.7**	**1,131.2**	**1,098.0**	**1,232.8**	**980.0**	**947.7**	**865.5**
Capital Revenue	158.2	245.5	292.4	253.6	215.0	236.8	169.1	146.1
Capital Expenditure	-1,166.0	-1,407.3	-1,490.1	-1,616.7	-1,558.5	-1,481.7	-1,366.7	-1,261.6
Capital Balance	-1,007.8	-1,161.8	-1,197.6	-1,363.1	-1,343.5	-1,244.9	-1,197.7	-1,115.5
Surplus (Deficit) before Debt Variation	**11.6**	**-200.1**	**-66.5**	**-265.2**	**-110.7**	**-265.0**	**-250.0**	**-250.0**
Debt Repayment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
New Borrowing	0.0	0.0	0.0	0.0	0.0	0.0	250.0	250.0
Net Debt Movement	0.0	0.0	0.0	0.0	0.0	0.0	250.0	250.0
Overall Results	**11.6**	**-200.1**	**-66.5**	**-265.2**	**-110.7**	**-265.0**	**0.0**	**0.0**
Debt Stock								
Short-Term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-Term	0.0	0.0	0.0	0.0	0.0	0.0	250.0	500.0
Total Direct Debt	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**250.0**	**500.0**
Debt-Like	0.0	0.0	0.0	0.0	0.0	130.6	118.3	106.9
- Cash and Liquid Deposits	211.9	250.2	715.8	509.3	384.7			
Net Commitments	**-211.9**	**-250.2**	**-715.8**	**-509.3**	**-384.7**			
Guarantees	40.4	37.6	25.2	18.0	18.0	38.0		
Debt of PSEs (Municipalities)	448.4	435.1	413.0	425.8	n.a.			

Appendix B

Autonomous Province of Trento

	2000 Actual	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2005 Budget	2006 Budget	2007 Budget
Fiscal Performance Ratios								
Operating Balance/Operating Revenue (%)	35.8	32.7	34.9	32.8	34.7	29.1	28.0	25.8
Current Balance/Current Revenue*** (%)	35.8	32.7	34.9	32.8	34.7	29.1	28.0	25.8
Surplus (Deficit) Before Debt Variation/ Total Revenue* *(%)	0.4	-6.3	-1.9	-7.4	-2.9	-7.3	-7.0	-7.1
Overall Results/Total Revenue (%)	0.4	-6.3	-1.9	-7.4	-2.9	-7.3	0.0	0.0
Operating Revenue Growth (Annual % Change)	5.2	3.3	10.1	3.2	6.1	-5.0	0.3	-0.7
Operating expenditure growth (annual % Change)	3.7	8.4	6.4	6.5	3.1	3.2	1.8	2.4
Current Balance Growth (Annual % Change)	8.1	-5.7	17.6	-2.9	12.3	-20.5	-3.3	-8.7
Debt Ratios								
Debt (Annual % Change)	0.0	0.0	0.0	0.0	0.0	0.0	100.0	100.0
Interest Paid/Operating Revenue (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating Balance/Interest Paid (x)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt servicing/Current Revenue (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt Servicing/Operating Balance (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt*/Current Revenue (%)	0.0	0.0	0.0	0.0	0.0	3.9	10.9	18.1
Debt* and Guarantees Issued/Current revenue (%)	1.4	1.3	0.8	0.5	0.5	5.0	10.9	18.1
Debt*/Current Balance (yrs)	0.0	0.0	0.0	0.0	0.0	0.1	0.4	0.7
Debt*/GDP (%)	0.0	0.0	0.0	0.0	0.0	1.0	2.7	4.4
Liquid Assets Brought Forward/Debt Servicing (%)	0.0	0.0	0.0	0.0	0.0	2,147.6		
Debt* per Capita (Local Currency)	0	0	0	0	0	261	737	1,214
Revenue Ratios								
Operating Revenue/Budget Operating Revenue (%)					105.5			
Tax Revenue/Operating Revenue (%)	95.2	94.7	92.6	93.2	91.3	92.1	92.9	96.0
Modifiable Tax revenue/Total Tax Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Transfers Received/Operating Revenue (%)	2.4	2.9	5.0	4.3	5.4	5.7	4.9	1.8
Operating Revenue/Total Revenue** (%)	94.7	92.3	91.7	93.0	94.3	93.4	95.2	95.8
Total Revenue** per Capita (Local Currency)	6,290	6,643	7,358	7,495	7,557	7,213	7,097	7,003
Expenditure Ratios								
Operating Expenditure/Budget Operating Expenditure (%)					106.3			
Staff Expenditure/Operating Expenditure (%)	25.6	24.8	24.7	25.4	26.4	25.9	25.4	24.7
Current Transfer Made/Operating Expenditure (%)	68.4	69.0	69.0	68.6	67.9	66.6	66.4	65.7
Capital Expenditure/Budget Capital Expenditure (%)					98.3			
Capital Expenditure/Total Expenditure (%)	38.9	41.5	41.4	41.9	40.2	38.3	36.0	33.6
Total Expenditure per Capita (Local Currency)	6,265	7,059	7,497	8,048	7,779	7,743	7,597	7,503
Capital Expenditure Financing								
Current Balance/Capital Expenditure (%)	87.4	68.3	75.9	67.9	79.1	66.1	69.3	68.6
Capital Revenue/Capital Expenditure (%)	13.6	17.4	19.6	15.7	13.8	16.0	12.4	11.6
Net Debt Movement/Capital Expenditure (%)	0.0	0.0	0.0	0.0	0.0	0.0	18.3	19.8
Change in Reserves/Capital Expenditure (%)	26.1	49.1	43.7	47.8	34.7	49.8	61.3	62.8

* Includes debt-like
** Excluding new borrowing
*** Includes financial revenue