MOODY'S
INVESTORS SERVICE

Credit Opinion: Trento, Autonomous Province of

Global Credit Research - 03 Nov 2011

Italy

Ratings

Category	**Moody's Rating**
Outlook	Negative
Issuer Rating	Aa3

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Key Indicators

Trento, Autonomous Province of

	2006	**2007**	**2008**	**2009**	**2010**
Net direct and indirect debt as % of operating revenues	**3.4**	**9.2**	**18.6**	**17.3**	**18.0**
Cash financing surplus (requirement) as % of total revenues	**0.9**	**4.1**	**1.2**	**2.3**	**-1.6**
Gross operating balance as % of operating revenues	**33.9**	**34.1**	**34.6**	**33.1**	**34.7**
Interest payments as % of operating revenues	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Intergovernmental transfers as a % of operating revenues	**4.9**	**5.2**	**2.3**	**2.5**	**1.5**
Capital spending as a % of total expenditures	**37.6**	**36.7**	**37.1**	**37.3**	**38.1**
GDP per capita as a % of national average	**117.4**	**118.5**	**120.2**	**122.2**	**-**

Opinion

SUMMARY RATING RATIONALE

The Autonomous Province of Trento's Aa3 issuer rating incorporates the province's unique legal status, its wealthy economy and solid financial fundamentals, reflected in consistently strong and predictable budgetary performances, even during the recent financial crisis. The rating also factors in the province's revenue sensitivity to economic cycles, the deteriorating economic environment and the modest efforts agreed with the central government to support the national financial equilibrium as well as its rising indirect debt exposure.

Despite the three-notches downgrade to Aa3 from Aaa on 5 October 2011, which followed the downgrade of Italy's sovereign rating to A2 from Aa2, Trento's rating remains firmly anchored two notches above the sovereign, reflecting (i) its unique and protective constitutional status; and (ii) its exceptionally strong fiscal and debt metrics.

National Peer Comparison

The Autonomous Province of Trento (PAT) is rated at the top of Italian RLGs, exceeding the rating range of Italian regions which spans from A1 to Baa2. Its relative position reflects greater legislative and financial autonomy, excellent gross operating balances and low indebtedness.

Credit Strengths

Credit strengths of the Autonomous Province of Trento include:

- Long-established unique status, which ensures greater legislative and financial autonomy and offers protection from interference by the Italian government

- Strong and politically stable management, with sophisticated financial planning capacity

- Excellent operating performance and absence of direct financial debt

- Rich and well-diversified economic base, with wealth levels significantly exceeding national averages

Credit Challenges

Credit challenges of the Autonomous Province of Trento include:

- Rising indirect exposure in the past three years

- Budgetary sensitivity to economic cycles, albeit mitigated by its effective intervention in the local economy

- Preserving its sizable financial flexibility through continued cost rationalisation in a deteriorating operating environment

Rating Outlook

The negative rating outlook mirrors the negative outlook on Italy's sovereign rating.

What Could Change the Rating - Up

An upgrade is regarded as unlikely given the negative rating outlook. Stabilisation of Trento's rating would require the stabilisation or upgrade of Italy's sovereign ratings.

What Could Change the Rating - Down

A downgrade of Italy's sovereign rating would likely lead to a downgrade of Trento's rating. Furthermore, although highly unlikely given the support of the constitutional framework, any alterations in the fundamental structure of the province's unique status could prompt a negative rating change. Significantly growing exposure to indirect debt could also exert downward pressure on the rating, depending on the pace and sustainability of growth.

DETAILED RATING CONSIDERATIONS

The rating assigned to the Autonomous Province of Trento reflects the application of Moody's Joint Default Analysis (JDA) rating methodology for regional and local governments (RLGs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the autonomous province and then considers the likelihood of support coming from the central government to avoid an imminent default by the province should this extreme event ever occur.

Baseline Credit Assessment

PAT's BCA of 4 (on a scale of 1-21 where 1 represents the lowest credit risk) reflects the following factors:

Financial Position and Performance

Trento has displayed very good budgetary performances over the past few years, reflected in solid operating margins and a robust self-financing capacity, as testified by the absence of direct debt on its books. Its operating performances are excellent on both an accrual and cash basis, with gross operating margins averaging 34% of operating revenue in 2006-2010, sustained by a mix of revenue growth and related spending policies. The stimulus package adopted in 2009-2010, together with strict control over expenditure items has offset the slightly negative impact of the global financial crisis on operating results. This combined with the increased revenue flexibility contained within the new federal regime supports Moody's view of the stability of provincial operating surpluses above 30% of operating revenues in 2011-12.

Trento traditionally self-financed its investments by using the large operating surpluses. At an average of 37% of total expenditure, capital spending represents a fundamental component of the provincial budget and has been instrumental in providing an adequate stimulus to the local economy in the last two years. Going forward, the province is expected to maintain its traditionally high investment levels, focusing on key areas such as healthcare, education and road construction. However, the province's robust budgetary flexibility, the high level of predictability of its revenue streams and strict cost controls should ensure that budgetary performances remain sound in the medium term.

Operating revenues have recorded sustained growth rates of around 6% (compound average growth) in 2006-2010 In 2010, the effects of the provincial measures to sustain enterprises and households as well as a moderate increase in local tariffs offset a reduction in operating proceeds due to the economic recession. In addition, the wider revenue-raising capacity granted by the recent fiscal reform increases its untapped flexibility significantly.

On the expenditure side, the province enjoys greater financial autonomy and wider spending flexibility compared with other Italian regions. Trento has a more diversified expenditure structure, with lower weighting of healthcare spending in its budget (37%) than other regions (80% on average). The province has maintained tight controls over expenditure growth in all of its responsibilities, particularly in the healthcare sector, where growth dynamics are difficult to contain due the socially sensitive nature of the sector. Trento has historically run its hospitals efficiently without incurring healthcare deficits. The ongoing streamlining of healthcare network is expected to further strengthen the sector's efficiency.

In 2011, the province will begin to implement fiscal consolidation measures, including some cuts in discretionary items and personnel costs in order to meet the more stringent budgetary requirements agreed with the central government. Trento's contribution to the country's austerity measures is expected to be fairly contained in light of its excellent financials and very high shock-absorption capacity. That said, despite its unique constitutional status, Trento is not completely insulated from the national operating environment and the government's adverse decisions. Therefore Moody's cannot rule out that Trento's agreed contribution to the country's austerity measures might increase in the future.

The province holds stakes in a variety of companies operating in sectors that are deemed strategic for the administration. Amongst those in which the province is the majority shareholder, none represent a relevant risk. The overall profitability of these provincial companies make them an asset for the province, although Moody's notes a progressive increase in financial exposures, particularly in the past three years.

Debt profile

Trento's consistent track record of self-financing and conservative financial management underpin its lack of direct debt, which is unique by national and international standards. Nonetheless, Moody's observes that the province has recently experienced a growth in indirect exposure through its controlled companies.

According to Moody's calculations, the overall net indirect exposure at the end of 2010 amounted to around EUR 790 million or 18% of its operating revenues. The progressive increase from.3.4% in 2006 is mainly attributable to recent issuances by Cassa del Trentino SpA (CdT; Aa3, negative), the provincial company in charge for managing provincial funds to local governments (see analysis on Moodys.com). Going forward, the above ratio could reach up to a maximum of 25%-30% in 2013. In particular, Moody's recognises the intrinsic financial convenience of the use of CdT's debt instruments, but notes that the sustained pace of growth of this quasi-direct debt adds rigidity to the provincial budget. Moody's will closely focus on CdT's debt dynamics as well as the associated burden on the province's finances.

Governance and Management Factors

The province's financial management is highly sophisticated and focused on maintaining the efficiency of the budget. Planning capacity has proved very effective in strongly containing the externalities of the financial crisis. Financial statements are punctual and well documented; budgetary performances have always been accurate and better than previously budgeted, thereby reflecting prudent management. Institutional capacity is also excellent.

In an effort to improve coordination and efficiency in the enlarged public sector, the administration has recently revised its governance structure, developing new managerial roles with respect to key provincial functions that were previously held in-house. Those entities primarily affected by the reform include Cassa del Trentino SpA, for the allocation management of provincial funds; Patrimonio SpA and Itea SpA, for provincial real estate; Riscossioni SpA, for tax collection; and Centrale Acquisti, for procurement.

Economic Fundamentals

Located in North-eastern part of Italy,Trento features a small but dynamic economy. Trento's population has grown slightly over the past few years, thanks to positive growth in both natural births and migration inflows. The province features a demographic profile in line with the national figures, with 19% of the population over the age of 65 (Italy: 20%). The related impact on provincial finances is very limited, given the high wealth level of the provincial population.

Trento enjoys good wealth levels, with GDP per capita significantly exceeding national (+22%) and EU averages. During the financial crisis, the province's economy has outperformed national figures. The provincial stimulus package allowed Trento to contain the GDP contraction in 2009 to -3% (Italy: -5%) and to prevent a significant rise in Trento's traditionally low unemployment rates (around 4.3% in 2010, about half the national figure). The recovery in the local economy that started in 2010 (+1.7%) is expected to continue in 2011, driven by improving performances in manufacturing and an increase in export activities.

The province's economy accounts for around 1% of Italy's GDP and is largely focused on services (70%); also noteworthy are tourism-related and public sector activities, which have represented an element of stabilisation during negative economic cycles.

Operating Environment

The operating environment for Italian RLGs is typical of advanced industrial economies and is reflected in the country's high wealth levels, low GDP volatility and the country's sound government institutions. These characteristics suggest low systemic risk.

Since October 2011, Italy's government is rated A2, with negative outlook. Italy's downgrade from Aa2 prompted the downgrade of all Italian sub-sovereign ratings, reflecting (i) a weakening operating environment, and (ii) the challenges arising from the fiscal tightening measures imposed on regional and local governments by the central government. Italian RLGs are enduringly linked to the central government and remain exposed to the macro-economic risks impacting their sovereign.

After the severe recession experienced in 2009, the Italian economy continues to face structural impediments to growth, namely low productivity and significant labour and product-market rigidities. In addition to the structural weaknesses affecting economic growth, Italy is exposed to fragile market sentiment for European sovereigns with high levels of debt, which adds uncertainties to funding conditions. However, although public debt is very high, Italy's private agents display relatively low indebtedness. Furthermore, the banking sector, which is more traditional and globally less exposed, is unlikely to require direct support from the government.

The fiscal consolidation packages approved in July-August 2011 are designed to stabilise the government's finances and to accelerate debt reduction. RLGs share the pressure on the general government budget and are required to contribute to the nation's fiscal consolidation efforts by enduring lower state transfers and more stringent budgetary requirements. This will result in increased sector-wide budgetary rigidities and generally deteriorating budgetary performances in the near future.

Institutional Framework

The institutional framework, which encompasses the arrangements determining intergovernmental relations and jurisdictional powers and responsibilities, is mature and developed. The constitutionally-recognised special status of the autonomous provinces of Bolzano and Trento allows for a more diversified revenue structure than ordinary regions, retaining nearly all tax revenues generated and collected in their territory. Autonomous provinces can adjust tax rates and levy new taxes, albeit within the limits/principles established by the state, which also retains tax collection authority. Moreover, the central government cannot interfere with provincial powers without the provinces' consent.

Bolzano and Trento are characterised by a well diversified expenditure profile, with limited exposure to the healthcare sector (one third of the provinces' budget), which is a typical source of financial pressure for ordinary regions.

The implementation of the fiscal federalism will bring about limited impact for provincial responsibilities. Although the greater legislative and financial autonomy granted by their special status remains unchanged, the autonomous provinces will contribute to the equalisation system at the national level, mainly through the adoption of previously state-financed responsibilities (university, employment assistance programmes, subsidies tobordering local governments) in their territory.

Extraordinary Support Considerations

Moody's assigns a moderate likelihood of extraordinary support from the central government, reflecting the province's long-established special status of autonomy.

Moody's also assigns a high default dependence between the Autonomous Province of Trento and the Republic of Italy, reflecting the province's low reliance on central government's transfers, its own sources of revenue similar to that of the central government, and a local economic base integrated with the national economy.

Output of the Baseline Credit Assessment Scorecard

The BCA scorecard for the Autonomous Province of Trento (presented below) generates an estimated BCA of 3, close to the BCA of 4 assigned by the rating committee.

The BCA scorecard, which generates estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, is a tool used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by the scorecard provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard-estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in the scorecard cannot fully capture the breadth and depth of our credit analysis.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Implementation Guidance published in August 2010 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings."

The Moody's Global Scale rating for issuers and issues in local currency allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the government's intrinsic credit strength and accounts for ongoing operating subsidies and transfers from the supporting government. In effect, the baseline credit assessment reflects the likelihood that a local government would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a regional or local government (RLG) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), moderate (31% - 50%), high (51% - 70%), very high (71% - 95%) or fully supported (96% - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to RLGs, default dependence reflects the tendency of the RLG and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the higher-tier government to provide extraordinary support and prevent a default by an RLG is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' baseline default risks, the lower the benefits achieved from joint support. In most cases, the close economic links and/or overlapping tax bases and/or close intergovernmental fiscal arrangements between different levels of government result in a moderate to very high degree of default dependence.

Default dependence is described as either low (0% - 30%), moderate (31% - 50%), high (51% - 70%) or very high (71% - 100%).

Rating Factors

Trento, Autonomous Province of

Baseline Credit Assessment Scorecard - 2009	Value	Score	Sub-Factor Weighting	Sub-Factor Total	Factor Weighting	Total
Factor 1: Operating Environment						
National GDP per capita (PPP basis, $US)	29,704	3	50.0%			

National GDP Volatility (%)	2.8	3	25.0%	4.50	50.0%	2.25
National Govt Effectiveness Index (World Bank)	0.52	9	25.0%			
Factor 2: Institutional Framework						
Predictability, Stability, Responsiveness	1	1	50.0%	2.09	10.0%	0.21
Fiscal Flexibility (A): Own-Source Revenues	7.5	7.5	16.7%			
Fiscal Flexibility (B): Spending	1	1	16.7%			
Fiscal Flexibility (C): Extent of Borrowing	1	1	16.6%			
Factor 3: Financial Position & Performance						
Interest Payments/Operating Revenue (%)	0.0	1	25.0%	2.75	10.0%	0.28
Cash Financing Surplus(Req)/Total Revenue (%)	2.2	6	25.0%			
Gross Operating Balance/Operating Revenue (%)	33.6	1	25.0%			
Net Working Capital/Total Expenditures	13.7	3	25.0%			
Factor 4: Debt Profile						
Net Direct and Indirect Debt/Operating Revenue	17.3	1	50.0%	4.50	10.0%	0.45
Short-Term Direct Debt/Direct Debt (%)	0.0	1	25.0%			
Net Debt/Operating Revenue Trend	79.0	15	25.0%			
Factor 5: Governance & Management						
Fiscal Management	1	1	40.0%	1.98	10.0%	0.20
Investment & Debt Management	1	1	20.0%			
Transparency & Disclosure (A)	1	1	15.0%			
Transparency & Disclosure (B)	7.5	7.5	15.0%			
Institutional Capacity	1	1	10.0%			
Factor 6: Economic Fundamentals						
Regional or Local GDP pc PPP - estimated ($US)	35,969	1	100.0%	1.00	10.0%	0.10
Estimated BCA						**3**

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