

RATING ACTION COMMENTARY

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

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Fitch Ratings - Milan - 06 Sep 2024: Fitch Ratings has affirmed the Autonomous Province of Trento's (PAT) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-' with Stable Outlooks.

The affirmation reflects Fitch's expectations that debt metrics will remain strong and commensurate with the ratings. PAT's Standalone Credit Profile (SCP) is 'aaa', stemming from a 'aaa' category financial profile combined with a 'High Midrange' risk profile. The 'A-' IDRs are six notches below the SCP as PAT's ratings are constrained at two notches above Italy's sovereign IDRs (BBB/Stable).

KEY RATING DRIVERS

Risk Profile: 'High Midrange'

The assessment reflects Fitch's view of a low risk that PAT's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon (2024-2028) due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt-service requirements.

Revenue Robustness: 'Stronger'

PAT's special autonomous status entitles it to receive shares of national taxes, ranging from 90% of personal income tax (PIT) and corporate income tax to 80% of VAT. This limits the province's dependence on state transfers and underpins its tax revenue resilience, thanks to PAT's good socioeconomic indicators, with GDP per capita at 25% above the EU27 average and an employment rate around 70% in 2022. In 2023, PAT's tax revenues increased by about 5% to reach an all-time high of around EUR4.8 billion, driven in particular by VAT. Fitch expects PAT's operating revenue to remain above EUR5 billion in 2024-2028, up from its pre-pandemic average of approximately EUR4.5 billion, as tax revenues are supported by positive GDP growth and some inflationary dynamics. Any negative impact from PIT fiscal reform will be covered by state transfers until 2024, and good economic fundamentals will support revenues in the longer term.

Revenue Adjustability: 'Stronger'

Fitch calculates PAT's revenue flexibility at 6% of tax revenue, or around EUR350 million, by raising the PIT surcharge and provincial business tax to the maximum possible levels and removing tax reliefs, covering a reasonably expected revenue decline of EUR140 million by 2.5x. Flexibility is underpinned by wealthy socioeconomic indicators, such as GDP per capita at EUR44,200 and a low unemployment rate below 4%. Fitch considers it unlikely that PAT will raise taxes to avoid pressuring households and firms, but it could streamline existing relief and benefits, bringing positive results in the medium term.

Expenditure Sustainability: 'Midrange'

PAT has a long record of maintaining its operating balance above EUR1 billion, or nearly 25% of operating revenue, reflecting its ability to control costs. Budgetary stability is supported by PAT's responsibilities, which are more diversified than Italy's 15 ordinary statute regions, with healthcare representing only about one-third of total spending, versus 80% in ordinary regions, and education and culture covering around one-quarter of PAT's opex. This increases spending predictability, as potentially highly cyclical functions, such as social benefits (7%) and support to local governments (15%), only represent approximately 20% of PAT's opex.

Expenditure Adjustability: 'Stronger'

PAT has a moderate share of rigid costs, accounting for approximately 60% of expenditure, including staff, healthcare, local authorities and education. Nearly one-third of its EUR1.3 billion annual capex could be delayed if necessary, or up to EUR250 million of social spending could be streamlined. Nevertheless, Fitch does not expect a reduction in expenditure over the next five years, as resources from the expected reduction of its annual contribution to the state budget will be channelled toward sustaining the local economy and public employment, and filling the personnel expenditure gap.

Liabilities & Liquidity Robustness: 'Stronger'

PAT's debt framework largely mirrors national prudential regulation. Borrowing is allowed only for capex, with amortising structures, solely in local currency and with debt service capped at 20% of free revenue. It is also governed by a general rule that budgeted spending must be backed by revenue. This underpins the predictability of liabilities due over the medium term and Fitch's 'Stronger' assessment of this factor.

PAT is formally debt free, as it borrows through its financial arm Cassa del Trentino S.p.A. (CdT; A-/Stable), which is fully backed by PAT's transfers for debt amortisation and an unconditional, irrevocable and at first-demand guarantee. PAT's direct debt (including CdT) was approximately EUR845 million at end-2023 (16% of operating revenue), of which 69% is with the European Investment Bank, Cassa Depositi e Prestiti SpA (BBB/Stable) and Region Trentino Alto Adige (TAA), and approximately 31% is in bonds.

PAT's debt also includes one EUR75 million provincial loan with TAA. Fitch reclassifies EUR216 million debt at Patrimonio del Trentino and Trentino Trasporti backed by PAT's first-demand guarantee, which is closely monitored by PAT to remain within debt limits.

Liabilities & Liquidity Flexibility: 'Midrange'

PAT's liquidity was EUR4.2 billion at end-2023, up from EUR3.8 billion in 2022, with Fitch-calculated free cash reserves of around EUR817 million (inclusive of the cash at CdT we consider unrestricted), while the remainder is restricted to future spending. PAT's treasury bank UniCredit S.p.A. (BBB/Stable) is committed to advancing liquidity lines up to EUR0.5 billion (10% of tax revenue), or approximately EUR1.5 billion when provincial companies are also considered, limiting any unexpected refinancing risk. This assessment also reflects the lower counterparty ratings on PAT's committed liquidity lines that can be extended by the treasury bank.

Financial Profile: 'aaa category'

PAT's financial profile is resilient to our conservative assumptions of opex growing alongside some inflationary pressures while tax revenues remain roughly stable, as the operating balance declines below EURO.9 billion, and PAT's liabilities rise to around EUR1.4 billion, or 20% of operating revenue (EUR1.1 billion in 2023), when adjusted to consider the main provincial subsidiaries. This leads to a debt-to-operating balance ratio (payback) at 1.3x in 2028, versus 0.2x in 2023.

PAT's operating margin of around 20%, capital subsidies and to a lesser extent, borrowing and free cash reserves, will fund the EUR6.6 billion capex Fitch expects over 2024-2028. This will include investments in healthcare infrastructure, education and school building renovation, road and transport infrastructures, social housing, the promotion of tourism activities and sport facilities, as well as sustaining the local economy. Even if debt service for interest and principal edges towards EUR200 million, debt service coverage (synthetic calculation) will remain good at around 13x on average in 2026-2028.

DERIVATION SUMMARY

PAT's 'aaa' SCP reflects a combination of a 'High-Midrange' risk profile and a 'aaa' financial profile. PAT's IDRs are constrained at two notches above the sovereign's ratings, reflecting the region's financial autonomy, strong economy and protective constitutional provision requiring consent for change in revenue or responsibilities. The IDRs also reflect potential interference in PAT's finances by the state in case of sovereign or macroeconomic stress.

Short-Term Ratings

PAT's Short-Term 'F1' IDR is the higher of two options mapping to a 'A-' Long-Term IDR. This is backed by a short-term liquidity coverage ratio (Fitch-calculated unrestricted cash and operating balance/debt service) estimated at approximately 11x on average in 2024-2025, 'Stronger' debt robustness and 'Midrange' debt flexibility.

KEY ASSUMPTIONS

Qualitative assumptions:

Risk Profile: 'High Midrange'

Revenue Robustness: 'Stronger'

Revenue Adjustability: 'Stronger'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Stronger'

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 slightly decrease on average -0.6% under our rating case as stable tax revenue is partially offset by a 17% decrease in transfers received
- Opex to increase by 1.7% on average in 2024-2028, factoring in some inflationary pressures and increasing personnel costs
- Negative net capital balance on average at around EUR0.9 billion, broadly in line with management projections
- Apparent cost of debt increasing from 1.8% in 2023 to 2.5% in 2028 as all of PAT's debt is fixed-rate and increasing rates only apply to Fitch-estimated new borrowings
- Net Fitch-adjusted debt at around EUR1 billion by 2028

Summary of Financial Adjustments

CdT's EUR769 million debt stock reclassified as PAT's direct debt.

Transfers made to CdT (EUR14 million interest expense and EUR131 million principal repayment) reclassified from capex to debt service.

Liquidity for CdT of EUR364 million, of which EUR255 million restricted, added to PAT's liquidity.

Fitch considers cash net of the working capital (payables minus receivables) and the amounts earmarked for future expenses as unrestricted.

Issuer Profile

PAT is an autonomous province in northern Italy with 500,000 residents, less than 1% of the Italian population, and wealthy socioeconomic indicators. Its responsibilities include healthcare, education and local transports, funded with a fixed share of major national taxes, as set by its statute of autonomy.

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 PAT's IDRs

PAT's Long-Term IDRs could be downgraded if debt payback deteriorates towards 8x on a sustained basis in our rating case. This would lead to a multiple-notch downward revision of PAT's SCP and subsequently less leeway above the sovereign's ratings.

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

As PAT's IDRs are constrained by the Italian sovereign ratings, changes to Italy's IDRs would be mirrored on PAT's ratings.

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: 4 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

PAT'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 ↕
Trento, Autonomous Province 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

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[International Local and Regional Governments Rating Criteria \(pub. 17 Aug 2024\) \(including rating assumption sensitivity\)](#)

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