



RATING ACTION COMMENTARY

Fitch Affirms Italian Autonomous Province of Trento at 'BBB+'; Outlook Stable

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Fitch Ratings - Milan - 06 Nov 2020: Fitch Ratings has affirmed the Autonomous Province of Trento's (PAT) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BBB+' with Stable Outlooks and Short-Term Foreign-Currency IDR at 'F1'.

The affirmation reflects PAT's 'High-Midrange' risk profile and 'aaa' debt sustainability assessment, with Fitch's expectation that the payback ratio will remain below two years in a conservative rating case scenario of a stagnant economy after the pandemic. The IDRs are compressed to 'BBB+' from our assessment of the province's Standalone Credit Profile (SCP) at 'aaa' as PAT's ratings are constrained at two notches above the sovereign IDRs (BBB-/Stable).

Its special autonomous status entitles PAT to collect shares of national taxes, ranging from 90% of personal income tax (PIT) and corporate income tax to 80% of VAT, limiting the dependence on transfers from the state, while its consent is needed to modify its responsibilities and funding. In the aftermath of the first wave of the pandemic, PAT and the national government negotiated a reduction of the province's EUR350 million transfers to the state as a contribution to the consolidation of the national finances, a legacy of the eurozone crisis in 2011/12, as well as an increase in state transfers to fund more than EUR100 million of pandemic-related healthcare and social spending.

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 some form of government restrictions are maintained or broadened. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector for their 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: 'High-Midrange'

Fitch has assessed PAT's risk profile at 'High-Midrange', meaning there is a low risk that PAT's operating balance shrinks below EUR1 billion or its debt servicing requirements for interest and principal increasing above EUR200 million, as outlined in Fitch's rating case scenario. The assessment results from a combination of four 'Stronger' (revenue robustness, revenue adjustability, expenditure adjustability and liabilities and liquidity robustness) and two 'Midrange' (expenditure sustainability and liabilities and liquidity flexibility) attributes on the six key risk factors.

PAT has a comfortable operating margin of 25%, good flexibility of spending that could be exploited if necessary and a low level of debt - in the context of national prudential regulation for borrowing. These ensure a positive and solid performance, even in a prolonged stressed economy.

Revenue Robustness: 'Stronger'

Fitch expects PAT's operating revenue to range between EUR4.5 billion (base case) and EUR4.3 billion (rating case) in the medium term, gradually absorbing the nearly 10% fall in taxes in 2020 and factoring-in slow revenue growth of 0.5% per year in 2023-2024 (rating case). Revenue performance is underpinned by good socio-economic wealth indicators with GDP per capita nearly 25% above the EU average and the employment rate expected to bounce back to the 2019 level of 70% by 2023 from a likely 66% in 2020.

Fitch expects PAT's revenues to rebound to EUR4.5 billion by 2024, but revenue fundamentals are weakening: PAT's demographics are slightly negative as the immigration balance does not fully offset the natural downtrend. Operating revenues have been growing by about 1% in real terms over 2015-2019, but per-capita GDP has

been slowly declining when compared with the EU average as the province's economic fabric is being held back by Italy's GDP underperformance. Fitch's expects Trento's (nominal) GDP to almost return to the 2019 level of EUR21 billion by 2024.

Revenue Adjustability: 'Stronger'

Fitch calculates PAT's potential revenue flexibility at 8% of its tax revenue, when raising the PIT surcharge and regional business tax to the maximum possible levels and removing the tax relief in place. PAT's flexibility is underpinned by its wealthy socio-economic indicators, such as GDP per capita at EUR38,000, median household income at EUR33,600, and a low unemployment rate at 5%.

With its flexibility of around EUR350 million, PAT could cover the maximum revenue decline of EUR140 million experienced in 2015 by 2.5x or nearly 1x the operating revenue decline Fitch expects in its baseline scenario for 2021 compared with 2019. However, it is unlikely PAT will raise taxes in the aftermath of COVID-19 crisis in order to avoid adverse effects on the economic recovery.

Expenditure Sustainability: 'Midrange'

Budgetary flexibility is supported by PAT's set of responsibilities, which is more diversified than Italy's 15 regions with an ordinary statute of autonomy, as well as compared with some other Italian regions with a special status of autonomy. Healthcare accounts for nearly 80% of spending for ordinary regions but is only about one-third for PAT (versus e.g. 50% in Sicily). This increases spending predictability, as functions such as funding of education, local transport and social housing are relatively non-cyclical.

While funds' reallocation and the increase in state transfers will help tackle the adverse effects of the pandemic on households and local firms more hit by the crisis, like those in the tourism sector, Fitch expects PAT to maintain its tight control of spending.

Operating expenditure will therefore continue growing in tandem with revenue, leading to relative stability of the operating balance at around EUR1 billion. Fitch expects this will continue in the medium term when subdued revenue growth in the absence of central state intervention can be counterbalanced by PAT keeping expenditure growth below 1% per year.

Expenditure Adjustability: 'Stronger'

Fitch deems PAT has a moderate share of rigid costs as the latter only account for about 70%, including spending for healthcare (35%), education (25%) and local authorities (15%), and nearly one-third of the EUR1.5 annual billion capex could be delayed if necessary, or up to EUR250 million of social spending could be lowered. Nevertheless,

Fitch does not expect a downward revision of expenditure over the next few years, net of the cancellation of the contribution to the state budget in 2020 and possible reduction in 2021. To tackle the pandemic, PAT will be able to increase its transfers to sustain the local economy and employment.

Higher-than-national average per-capita spending supports potential curtailment. PAT's network of subsidiaries also have the ability to modulate costs and capex thanks to a good level of transport, health and other socio-economic infrastructure in the province, as shown by the aggregate debt, or direct risk, peaking at EUR1.8 billion in 2015. We expect PAT to be able to reabsorb any spending peak due to post-pandemic expansive measures, as support of the local economy in the medium term is also delivered through its network of GREs.

Liabilities and Liquidity Robustness: 'Stronger'

Trento's debt framework largely mirrors the national prudential regulation. Borrowing is allowed only for capex, at amortising structures, with no foreign currency debt exposure and debt service is capped at 20% of free revenue and by a general rule that requires spending to be budgeted only if backed by revenue. This underpins the predictability of due liabilities over the medium term and Fitch's 'Stronger' assessment for this factor.

PAT is formally debt-free as it borrows through its financial arm Cassa del Trentino (CdT, BBB+/Stable), fully backed by the Province's transfers for debt amortisation as well as an unconditional, irrevocable and at first demand guarantee. CdT's debt was around EUR1 billion at end-2019 (21% of PAT's operating revenue) of which 45% is with the European Investment Bank and Cassa Depositi e Prestiti (BBB-/Stable) and Region Trentino Alto Adige, while 55% is in bonds.

CdT's debt is entirely at fixed rates and fully amortising (after an amortising swap on a EUR75 million bullet bond), while PAT's other Fitch classified debt of about EUR270 million at end-2019 includes Patrimonio del Trentino's and Trentino Trasporti's debt backed by PATs' first-demand guarantee, monitored by PAT to remain within debt limits.

Liabilities and Liquidity Flexibility: 'Midrange'

PAT's liquidity at end-2019 was EUR2.5 billion, with Fitch-calculated free cash reserves of EUR300 million while the remaining part is restricted to future spending. PAT's treasury bank Unicredit (BBB-/Stable) is committed to advancing liquidity lines up to EUR0.5 billion (10% of the budget), or 30% for about EUR1.5 billion when provincial companies are also considered, limiting any unexpected refinancing risk.

Debt Sustainability: 'aaa' category

PAT's debt sustainability assessment is resilient to our revised assumptions following the COVID-19 outbreak, as the operating balance remains stable at around EUR1.0 billion. PAT's liabilities rise to around EUR1.5 billion, or 35% of revenue (EUR1.3 billion in 2019), when adjusted to consider the main provincial subsidiaries and leads to a debt-to-operating balance ratio (payback) at 1.5x in 2024, against 1x in 2019.

PAT's 25% operating balance, capital subsidies, and to a minor extent borrowing and depletion of reserves, will fund the EUR6.5 billion capex Fitch expects over 2020-2024. This will include investments in education and school building renovation, road and transport infrastructures, social housing and the support and promotion of tourism activities, as well as sustaining the local economy after the pandemic.

Even if debt service for interest and principal edges towards EUR200 million, the debt service coverage (operating balance to debt service) will remain reasonably good at above 4x.

PAT 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.

DERIVATION SUMMARY

PAT's SCP is assessed at 'aaa', reflecting a combination of a 'High-Midrange' risk profile and debt sustainability metrics also in the 'aaa' category.

PAT's IDRs are constrained at two notches above the sovereign's rating, reflecting its financial autonomy, strong economy and protective constitutional provision requiring consent for change in revenue or responsibilities. The IDRs also reflect the potential interference in PAT's finances by the state in case of sovereign or macroeconomic stress.

PAT's Short-Term IDR is assessed at the higher possible level of 'F1' amid a short-term liquidity coverage ratio (Fitch unrestricted cash and operating balance/debt service) estimated around 5x on average in 2020-2022, debt robustness assessed as Stronger and debt flexibility assessed as Midrange.

KEY ASSUMPTIONS

Qualitative Assumptions and assessments:

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

Debt sustainability: 'aaa' category

Support: n/a

Asymmetric Risk: n/a

Sovereign Cap or Floor: Yes

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 2014-2019 figures and 2020-2024 projected ratios. The key assumptions for the scenario include:

- -1.4% decrease in operating revenue on average in 2020-2024, versus -0.4% in baseline scenario across the same period;

- -0.9% decrease in operating spending on average in 2020-2024, versus -0.5% in baseline scenario across the same period;

- Adjusted debt reaching EUR1.5 billion in rating scenario versus EUR1.2 billion in baseline scenario.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Any negative action on the sovereign's ratings will be mirrored on PAT's IDRs.

PAT's Long-Term IDRs could be downgraded if the payback increased above nine years (plus a fiscal debt burden above 100%) on a sustained basis in our rating case scenario. This would lead to a multiple-notch lowering of PAT's SCP to 'a', and subsequently a smaller leeway of one notch above the sovereign's ratings.

The same output would emerge following a revision of PAT's risk profile to 'Midrange' together with a worsening of the payback close to nine years.

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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure 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, visit [<https://www.fitchratings.com/site/re/10111579>].

SUMMARY OF FINANCIAL ADJUSTMENTS

Direct debt includes the debt incurred via CdT and debt repayment considers that to CdT (followed by an equivalent adjustment of capital transfers).

Other Fitch classified debt includes Patrimonio del Trentino's and Trentino Trasporti's debt backed by PAT's first demand guarantee.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Trento, Autonomous Province of	LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable
●	ST IDR	F1	Affirmed	F1
●	LC LT IDR	BBB+ Rating Outlook Stable	Affirmed	BBB+ Rating Outlook Stable

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APPLICABLE CRITERIA

[International Local and Regional Governments Rating Criteria \(pub. 27 Oct 2020\)](#)
(including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

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