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RATING ACTION COMMENTARY

Fitch Affirms Italian Autonomous Region of Valle d'Aosta at 'A-'; Outlook Stable

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Fitch Ratings - Milan - 30 Sep 2022: Fitch Ratings has affirmed the Autonomous Region of Valle d'Aosta's (VDA) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-' with Stable Outlooks.

The affirmation reflects VdA's 'Midrange' risk profile and 'aaa' debt sustainability assessment under Fitch's expectation that the debt payback ratio (net debt-to-operating balance) will remain below three years in our rating case scenario featuring prolonged economic stagnation after the pandemic and the Ukraine/Russia war. The 'A-' IDRs are four notches below the region's Standalone Credit Profile (SCP) of 'aa' as VdA's ratings are constrained at two notches above the sovereign's IDRs (BBB/Stable).

KEY RATING DRIVERS

Risk Profile: 'Midrange'

The 'Midrange' risk profile assessment reflects a moderately low risk that VdA's ability to cover debt service with the operating balance may weaken unexpectedly over the scenario horizon (2022-2026) either because of lower-than expected revenue or expenditure above expectations, or because of an unanticipated rise in liabilities or debt-service requirements.

VdA's 'Midrange' risk profile reflects five 'Midrange' key risk factors and one 'Stronger' key risk factor.

Revenue Robustness: 'Midrange'

VdA is a special-statute region that is entitled to receive 100% of the tax revenue generated in its territory. This limits the region's dependence on state transfers, which accounted for 6% of its EUR1.3 billion operating revenue in 2021 (2%-3% on average before the pandemic), despite extraordinary additional transfers that the state provided to all regions to fund pandemic-related healthcare costs.

Around 90% of VdA's operating revenue comes from taxes, which makes the region's revenue base more linked to and directly connected with the local economy and less with government transfers compared with ordinary regions. However, support from the central government granted in 2021 to all regions via current transfers allowed VdA to counterbalance two consecutive years of decline in tax revenues (5.5% in 2020 and 4.5% in 2021) as well as cover pandemic-related extraordinary expenditure.

Further state support, including transfers that will remain above the EUR30 milliion-EUR40 million pre-pandemic average, will help tackle possible second-round effects from the economic slowdown expected amid the energy crisis.

Fitch expects VdA's operating revenue to increase to around EUR1.4 billion on average in 2022-2026, up from its pre-pandemic average of around EUR1.3 billion, as tax revenues are supported by positive GDP growth on average during the five-year forecast period and high inflation rates. Any negative impact of the fiscal reform on personal income tax (PIT) will be covered by state transfers until 2024, while the economic recovery expected after 2023 and VdA's wealthy socio-economic indicators will support PIT's dynamics.

The 'Midrange' assessment also considers the region's small economic size as well as taxpayer concentration on a few names for corporate income tax, including the regional hydro company C.V.A. S.p.A. a s.u. (BBB+/Stable).

Revenue Adjustability: 'Midrange'

Fitch assesses VdA's ability to generate additional revenue in response to an economic downturn as 'Midrange', reflecting the region's high affordability and moderately stable revenues. VdA's leeway to increase revenue is just below EUR70 million, or 5% of revenue, by Fitch's calculation, through increasing the PIT surcharge and business tax to their legal maximums and removing all relevant tax reliefs, as well as raising charges and fees.

VdA's wealthy socio-economic indicators, including GDP per capita at roughly EUR37,000 (or 22% above the EU27 average) and high employment rate of nearly 70%, underpin tax-revenue flexibility. Tax-raising potential would cover the peak-to-trough revenue decline observed over the last 10 years by more than 50%, when adjusted for changes in the funding system. However, it is unlikely that VdA will raise taxes during the current energy crisis and in the aftermath of the pandemic to avoid thwarting its economic recovery.

Expenditure Sustainability: 'Midrange'

VdA has a strong ability to control costs, as evidenced by a balanced budget in the past 10 years, and by reducing its cost structure between 2012 and 2014 to allow for its contribution to the national budget consolidation when it peaked at EUR250 million. As a special statute region, VdA has a more diversified set of responsibilities, with healthcare accounting for about a quarter of total expenditure, versus 80% in ordinary regions, and education covering another 15%. This increases spending predictability, as potentially highly cyclical functions such as social benefits (7%) and support to local governments (9%) only represent around 15% of VdA's expenditure

VdA's operating expenditure reached a 10-year peak in 2021, driven by the reinstatement of a EUR82 million contribution to the state budget (reduced by 80% in 2020), the persistence of pandemic-related extraordinary costs and of measures to counteract the impact of the pandemic. VdA used own resources as well as central government extraordinary transfers to meet increased healthcare costs (up 20% from pre-pandemic levels at over EUR320 million), as well as to support the local economy via transfers to local governments.

Over the medium term, under Fitch's rating case, operating spending is expected to continue growing by around 1% a year on average in 2022-2026 amid an inflationary environment, to peak at EUR1.25 billion. This factors in stable healthcare spending, as reduced pandemic-related extra costs allow an increase in personnel expenditure to attract skilled medical staff, and further support to the local economy.

Expenditure Adjustability: 'Midrange'

VdA's share of inflexible costs is moderate at just below 70% of total expenditure (net of contribution to the state's budget). This includes healthcare, education, staff and transfers to local governments. The region expanded the scope of expenditure to sustain the local economy and employment, as evidenced by the increase in 2020-2021 not only in healthcare expenditure, but also in transfers to local governments and capex (up 40% in two years).

Per capita expenditure is higher than the national average but we do not expect VdA to reduce operating expenditure from the 2020-2021 peaks as the scope for savings is constrained by VdA's role in regional economic development via its material support for local SMEs.

Liabilities & Liquidity Robustness: 'Stronger'

VdA operates under a prudent national and individual debt management framework. Borrowing is allowed only for capex and with amortising structures, solely in local currency, and with debt service capped at 20% of free revenue (not earmarked for healthcare). Medium-term debt service, which will be around EUR40 million in 2026 under Fitch's rating case, will be paid out of recurring revenue. This underpins the predictability of due liabilities over the medium term and Fitch's 'Stronger' assessment of this factor.

VdA's debt profile is conservative and is almost entirely composed of a euro-denominated bond (EUR18.5 million outstanding at end-2021), after the redemption in May 2021 of a EUR543 million bullet bond using provisions in a sinking fund.

VdA's direct debt of around EUR20 million at end-2021 carries little risk and represents less than 2% of operating revenue. Its EUR160 million adjusted debt, including debt of its financial company, Finaosta (EUR141.3 million in 2021, down from EUR153 million in 2020) and guaranteed by the region, is entirely covered by VdA's EUR214 million Fitch-calculated unrestricted cash at end-2021. As of 2022, Fitch includes its estimate of Finaosta's debt in VdA's direct debt, as the region is in the process of taking over the guaranteed part of the company's debt, as required by the national Court of Accounts. Finaosta's debt is entirely composed of loans, of which 80% is with Cassa Depositi e Prestiti (BBB/Stable) and 20% with commercial banks, and its addition to VdA's direct debt does not affect the 'Stronger' assessment of this factor.

Liabilities & Liquidity Flexibility: 'Midrange'

VdA's liquidity at end-2021 was EUR585 million, down from around EUR1.1 billion in 2020 as the region used the proceeds from the sinking fund to repay a bullet bond. Almost 40% of VdA's cash, or EUR214 million, were Fitch-calculated free reserves, which covered nearly

10x debt service requirements (net of the EUR543 million bullet repayment), while the rest is considered restricted for future spending. Fitch prudently estimates around EUR150 million on average of free cash reserves in the coming years and in a more conservative scenario, assumes the region will use all of its free cash reserves. The counterparty ratings of liquidity providers cap this assessment at 'Midrange'.

Debt Sustainability: 'aaa category'

VdA's debt sustainability assessment is resilient to our conservative assumptions featuring low economic growth and higher-than-average inflation in the medium term, as the operating balance declines to EUR130 million from an average EUR230 million in 2017-2021, and liabilities rise to around EUR330 million, or 25% of operating revenue (EUR19 million in 2021 and Fitch-estimated EUR150 million in 2022 after the inclusion of Finaosta's debt). This leads to a debt-to-operating balance ratio (payback) at 2.6x in 2026, 0.1x in 2022.

VdA's 10% operating margin, capital subsidies, borrowing and free cash reserves will fund the EUR1.15 billion capex Fitch expects over 2022-2026. This will include investments in healthcare infrastructure, education and school building renovation, road and transport infrastructures, social housing and the promotion of tourism activities, as well as sustaining the local economy after the pandemic and the Russia/Ukraine war.

Even if debt service for interest and principal edges towards EUR45 million, debt service coverage (synthetic calculation) will remain good at around 4x on average in the medium term.

DERIVATION SUMMARY

The combination of VdA's 'Midrange' risk profile with a debt payback ratio of around 2.5 years on average in the medium term leads to a SCP in the 'aa' category. A high debt-service coverage ratio of on average around 4x, debt-to revenue below 50% and peer comparison with other European regions lead to the 'aa' SCP.

VdA's IDRs are constrained at two notches above the sovereign's ratings, reflecting the region's special autonomous status while also considering potential intervention by the state in case of sovereign stress, such as a 10% increase in VdA's EUR82 million contribution to state's budget.

Short-Term Ratings

VdA's 'F1' Short-Term IDR is the higher of two options mapping to a 'A-' Long-Term IDR. This is based on an estimated short-term liquidity coverage ratio (Fitch-calculated unrestricted cash and operating balance-to-debt service) at 5.6x on average in 2022-2023, 'Stronger' debt robustness, and 'Midrange' debt flexibility.

Debt Ratings

VdA's senior unsecured debt is rated 'A-', in line with its Long-Term IDR.

KEY ASSUMPTIONS

Qualitative assumptions:

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Midrange'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Midrange'

Liabilities and Liquidity Robustness: 'Stronger'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'aaa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Sovereign Cap: 'A-'

Sovereign 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 2017-2021 figures and 2022-2026 projected ratios. The key assumptions for the scenario include:

- Operating revenue to increase on average 0.9% under our rating case as 1.9% increase in tax revenue is partially offset by a 10% decrease in transfers received

- Operating expenditure to increase by 1.3% on average in 2022-2026

- Negative net capital balance on average at EUR130 million

- Cost of debt on average at 6.7%

- Net Fitch-adjusted debt at around EUR330 million by 2026 (debt free at end-2021)

Liquidity and Debt Structure

Fitch-adjusted debt (EUR160 million at end-2021) includes VdA's direct debt (EUR18.5 million), and the guaranteed part of Finaosta's debt (EUR141.5 million).

Net Fitch-adjusted debt (-EUR53 million) corresponds to the difference between Fitch-adjusted debt (EUR160 million) and year-end cash that Fitch deems unrestricted (EUR214 million).

VdA's cash was EUR585 million at end-2021 of which EUR371 million was deemed by Fitch as restricted and not available for debt service, which corresponds to the gap between receivables and non-financial short-term liabilities.

Issuer Profile

VdA is an autonomous region located in the north of Italy, with a diversified set of responsibilities, including healthcare, education and local transport, funded with a fixed share of major national taxes as set in the Italian constitution. VdA has around 1.2 million residents, by far the smallest region in Italy, and wealthy socio-economic indicators in comparison with national and international peers. The local economy is diversified with services as the dominant sector (e.g. tourism and public services). Fitch classifies VdA as a type B local and regional government as it covers debt service from cash flow annually.

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 VdA's IDRs.

Further deterioration in payback ratio towards four years on a sustained basis leading to a downward revision of the SCP would narrow the rating differential between VdA and the sovereign.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

A debt payback ratio sustainably below two years would lead to a reassessment of VdA's SCP, widening the notching differential above the sovereign. This could lead to an upgrade of VdA's IDRs, if the sovereign rating was also upgraded.

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

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

VdA's ratings are linked with Italy's.

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.

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
Valle d'Aosta,Autonomous Region 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
senior unsecured	LT	A-	Affirmed	A-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 03 Sep 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Valle d'Aosta,Autonomous Region of	EU Issued, UK Endorsed

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