Fitch Ratings

RATING ACTION COMMENTARY

Fitch Affirms French Department of Savoie at 'AA'; Outlook Negative

Fri 03 Dec, 2021 - 17:04 ET

Fitch Ratings - Paris - 03 Dec 2021: Fitch Ratings has affirmed the Department of Savoie's Long-Term Foreign-and Local-Currency Issuer Default Ratings (IDRs) at 'AA' with Negative Outlook. Fitch also affirmed Savoie's Short Term Foreign-Currency IDR at 'F1+' and assigned a Local-Currency Short Term IDR of 'F1+'. A full list of rating actions is below.

Fitch assesses Savoie's Standalone Credit Profile (SCP) at 'aaa'. This reflects the combination of a 'High Midrange' risk profile and very strong debt sustainability metrics that Fitch assesses in the 'aaa' category under its rating case scenario. Savoie's IDR is capped by that of the sovereign (AA/Negative) and no other rating factors apply.

KEY RATING DRIVERS

Risk Profile: 'High Midrange'

Fitch assesses Savoie's risk profile at 'High Midrange', reflecting a mix of 'Stronger' and 'Midrange' attributes on the six risk factors. The assessment reflects Fitch's view of a low risk relative to international peers that the department's ability to cover debt with the operating balance may weaken unexpectedly over the forecast horizon (2021-2025) due to lower revenue, expenditure, or an unexpected rise in liabilities or debt or debt-service requirements.

Revenue Robustness: 'Stronger'

Savoie benefits from robust revenue, mainly comprising predictable and growing tax items and stable resources transferred by the French state. The latter include transfers and fuel tax whose proceeds are mostly guaranteed by the French state and have low counterparty risk due to the high sovereign rating.

Property transfer duties (26% of operating revenue in 2020) are the main source of potential volatility as they are linked to real estate transactions. They grew by 66% in 2015-2019, to EUR143 million in 2019 (including about EUR6 million of exceptional proceeds) from EUR86 million in 2015, and remained a high level of EUR135 million in 2020, despite the pandemic and containment measures. In 2021, we expect proceeds to grow by about 15%, due to an exceptional level of real estate transactions and growing real estate prices. We factor the potential volatility of this tax item into our rating case scenario assumptions.

Revenue Adjustability: 'Midrange'

Like other French departments, Savoie's share of property tax has been replaced in 2021 by a share of VAT to be collected nationally. As a result, the department has lost almost all of its fiscal flexibility.

However, Fitch believes that French departments benefit from cost pass-through mechanisms with the state as their counterparty. They are responsible for public policies decided at the national level, especially for social spending, and tend to receive greater financial support from the French state when costs increase. Fitch expects the state to continue supporting the departments if the latter face a sustained increase in social spending, and the full removal of their fiscal flexibility would make support from the state even more likely, in our view.

The support mechanisms from the state were insufficient to cover spending increases in the past and do not benefit from a constitutional guarantee. A 'Stronger' assessment of the rating factor is therefore ruled out. However, the record of financial support and our expectation that such support would continue in case of need justify, in our view, a 'Midrange' assessment of the factor for all French departments.

Expenditure Sustainability: 'Midrange'

Savoie exercises good control over its operating expenditure. Between 2015 and 2020, operating expenditure grew by 0.4% a year on average (including the transfer of transportation competencies to the region in 2017-2018), below the growth in operating revenue (+1.3%). In 2020, opex grew by a high 3.8%, which included exceptional spending linked to the pandemic and the sharp increase in social benefits. We expect it to grow by more than 4% in 2021, especially due to increases in wages in the social sector, which will impact social accommodation fees paid by the department. However, we expect opex growth to return to a slower pace in 2022-2025, between 1% and 2% per year on average.

Like other departments, a large share of Savoie's expenditure depends on national decisions, notably for spending linked to social action, which constrains its capacity to control them. This spending includes social benefits, which is a counter-cyclical item that tends to grow when unemployment rises, and we expect it to increase significantly in 2020-2021 due to the economic recession triggered by the pandemic. However, the weight of this spending item remains moderate in the department's budget in comparison with the average for French departments (9% of operating spending in 2020 versus 17% on average).

Expenditure Adjustability: 'Midrange'

Savoie's operating expenditure is fairly rigid, mainly comprising mandatory current transfers, including social subsidies (23% of operating spending in 2020), social accommodation fees (22%), transfers to middle schools, and transfers to the fire brigade. Staff costs (25%) are also a rigid spending item as most of the department's employees have the status of civil servants. Cost-cutting measures remain possible, as evidenced by the good control exercised by the department over operating spending in recent years.

The department has more flexibility over its capital expenditure programme as a significant share may be postponed in case of need. The share of capex in total expenditure is high for a French department, at 23% in 2020 versus an average of 15% for French departments. This reflects the geographical features of the department, which has a very large road network. Overall, we estimate the share of non-flexible items to be between 70% and 90% of total spending.

Liabilities & Liquidity Robustness: 'Stronger'

Savoie operates under a robust national framework, which includes a transparent risk assessment of different types of debt products and limits the level of guarantees. At end-2020, Savoie carried little risk: 80% of debt was fixed-rate and 98% was considered risk-free under national regulation (Gissler Chater).

Debt service is structurally well-covered by the operating balance (2020: 4.6x). The department's debt amortisation profile is fairly smooth until 2028, with an annual average capital repayment of EUR11 million. It shows peaks in 2029 and 2036 due to some private placements issued. However, the risk of bullet repayments is mitigated, in Fitch's view, by the modest amount of these maturities in absolute terms and as a proportion of Savoie's operating balance.

Off-balance sheet liabilities (guarantees plus public-sector entities' debt) are significant and represented 6.5x the department's operating balance in 2020. However, more than 90% was related to the low-risk social housing sector, especially the public provider controlled by the department (OPAC), which has sound debt ratios. The department is also a shareholder of companies operating ski-resorts in the French Alps. These companies were hit by the pandemic, especially in 2021 as they were closed during winter. This had a negative effect on the department's finances, due to a sharp decline in dividends received and the absence of ski lift tax received this year, which we included in our financial projections.

Liabilities & Liquidity Flexibility: 'Stronger'

Fitch considers that there is a strong framework for emergency liquidity support from the state. There is cash-pooling between French local and regional governments (LRG) and the state because their liquidity is deposited at the national Treasury. French LRGs may benefit from cash advances from the state in case of need as the latter may transfer to some tax items proceeds in advance. This limits the risk of liquidity shortfall. The counterparty risk of this mechanism is low due to the sovereign's high rating.

The department also has abundant access to liquidity under various forms, including EUR38 million from committed lines contracted with counterparties rated in the 'A' category. Like other French LRGs, the department also has access to some institutional lenders, especially the Caisse des Depots et Consignations (CDC;

AA/Negative), which may provide support if the region was denied access to commercial banks.

Debt Sustainability: 'aaa category'

Savoie has exceptionally strong debt sustainability metrics despite the impact of the pandemic, with a payback ratio at below 1x and coverage ratio (Fitch's synthetic calculation) close to 16x in 2020.

In 2020, the operating balance declined to EUR112 million, from EUR134 million in 2019. Operating revenue decreased by 1.5%, driven by a 6% decline in property transfer duties (-2%, adjusted from exceptional items in 2020), while opex grew by 3.8%, driven by social benefits and one-off items. In our rating case scenario, the operating balance would vary between EUR75 million and EUR90 million in 2022-2025, a result of our prudent assumptions. These include a 25% drop in property transfer duties, following an exceptional level expected in 2021.

We expect Savoie to maintain a high capex programme in the coming years, especially relative to middle schools' infrastructure and road maintenance. In our rating-case scenario, we expect the department's capital expenditure be about EUR130 million a year on average in 2021-2025, equivalent to 20%-25% of total expenditure, and the capital balance to be close to -EUR100million a year.

Accordingly, in our rating case scenario, the department's net adjusted debt would grow to around EUR200million at end-2025, from EUR86 million at end-2020. Much will depend on the evolution of operating revenue, and especially that of property transfer duties. However, we expect debt sustainability ratios to remain sound, with a payback at below 3x.

DERIVATION SUMMARY

Fitch assesses Savoie's SCP at 'aaa'. This reflects the combination of a 'High Midrange' risk profile and very strong debt sustainability metrics that Fitch assesses in the 'aaa' category under its rating-case scenario. Savoie's IDR is capped by that of the sovereign (AA/Negative) and no other rating factors apply.

KEY ASSUMPTIONS

Qualitative assumptions:

Risk Profile: 'High Midrange'

Revenue Robustness: 'Stronger'

Revenue Adjustability: 'Midrange'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Midrange'

Liabilities and Liquidity Robustness: 'Stronger'

Liabilities and Liquidity Flexibility: 'Stronger'

Debt sustainability: 'aaa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Sovereign Cap: 'AA'

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 2016-2020 figures and 2021-2025 projected ratios. The key assumptions for the scenario include:

- Operating revenue growth of 0.4% a year on average in 2021-2025;

- Operating expenditure growth of 2.4% a year on average in 2021-2025;

- net capital balance of close to -EUR100 million on average in 2021-2025;

- an average 2.2% apparent cost of debt in 2021-2025.

Liquidity and Debt Structure

Fitch's adjusted debt includes Savoie's short-term and long-term debt (EUR159 million), as well as the "other Fitch-classified debt" items (EUR4.5 million). The latter is made up of the fire brigades' debt covered by the department. Fitch's net adjusted debt corresponds to the difference between Fitch's adjusted debt and the cash at the end of the year that Fitch considers to be unrestricted (EUR77 million).

The department's available cash was EUR87 million at end-2020. Fitch considers that EUR10 million was restricted and not available for debt service, which corresponds to the gap between receivable (EUR18 million) and non-financial short-term liabilities (EUR28 million).

Issuer Profile

Savoie is a French department in the French Alps, close to the border with Italy. It benefits from outstanding ski resorts and has socio-economic indicators that are stronger than the French average.

RATING SENSITIVITIES

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

A downgrade of the sovereign would be reflected in Savoie's ratings. A payback ratio above 7.5x on a sustained basis in our rating case scenario could lead to a downgrade, which Fitch views as very unlikely.

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

Savoie's Outlook would be revised to Stable if the sovereign Outlook was revised to Stable.

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

Savoie's ratings are capped by France'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.

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
Savoie, Department of	LT IDR	AA	Affirmed	AA
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	AA	Affirmed	AA
	LC ST IDR	F1+	New Rating	

PREVIOUS Page 1 of 1 10 rows NEXT

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

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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

Savoie, Department of EU Issued, UK Endorsed

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