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## Research Update:

# Italian Metropolitan City of Rome 'BBB-' Rating Affirmed; Outlook Stable

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## Overview

- The rating on the Metropolitan City of Rome (Rome MC, formerly the Province of Rome) continues to primarily reflect our long-term sovereign rating on Italy.
- We anticipate that Rome MC will need to tap its credit line in 2016 as the city's liquidity has deteriorated since our last review in April 2015.
- We are affirming our 'BBB-' rating on Rome MC.
- The stable outlook on Rome MC mirrors that on Italy.

## Rating Action

On Oct. 16, 2015, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term issuer credit rating on the Italian Metropolitan City of Rome (Rome MC). The outlook is stable.

## Rationale

The rating continues to primarily reflect our long-term sovereign rating on Italy (unsolicited; BBB-/Stable/A-3). We consider that Rome MC, like all other Italian local and regional governments (LRGs), does not meet all the criteria under which we would rate an LRG above the sovereign. In particular, we think Rome MC lacks sufficient financial autonomy or political power to oppose negative intervention from the sovereign, such as the application of very harsh revenue cuts. In addition, Italian law obliges metropolitan cities (MCs) to deposit the majority of their cash holdings at the Italian central bank.

Rome MC's stand-alone credit profile (SACP) remains at 'a', despite our assessment of a deterioration of its liquidity since our last review in April 2015.

The SACP is not a rating but a means of assessing the intrinsic creditworthiness of an LRG, assuming there is no sovereign rating cap. The SACP results from the combination of our assessment of an LRG's individual credit profile and the benefits we see from the institutional framework in which it operates.

Rome MC operates in an evolving but balanced institutional framework, in our view. Following the creation of MCs in January 2015, the central government imposed very harsh cuts on this tier of government, through the 2015 Stability Law. This was under the assumption that the reshuffling of responsibilities between MCs, cities, regions, and the central government had already taken place, implying a reduction of personnel-related costs for MCs and provinces. Since the reshuffling has not yet taken place, cuts in 2015 have generated a temporary mismatch between revenues and expenditures that the MC tier has funded with its positive fund balance, now almost depleted. We believe that the central government will adjust this temporary mismatch from 2016, given that the MC tier will no longer benefit from ample fund balances. We assume in our base-case scenario that the central government will reduce the amount of fiscal consolidation originally applied to MCs for 2016 and 2017, or create new taxes for the MC tier, with the aim of redressing this temporary mismatch. In addition, for 2015, the central government has authorized a partial suspension of some debt service payments by MCs, to mitigate the temporarily unsettled framework and the revenue expenditure mismatch.

Following the full implementation of the law officially creating MCs (Law 56/2014), we understand that Rome MC will maintain most of the previous responsibilities of the province with the exception of some nonfundamental functions. It will also be charged with additional responsibilities, including coordination of municipalities in its jurisdiction, although the time frame is likely to be beyond our forecast horizon of 2018. Once fully implemented, we believe MCs may be instrumental in increasing the efficiency of the municipal tier.

Despite the central government's fiscal consolidation measures and dwindling tax bases owing to the recent economic crisis, Italian LRGs have generally not experienced revenue-expenditure mismatches. In our view, this balance stems largely from central government efforts to gradually set up sounder fiscal rules and promote spending austerity. The Italian government--including LRGs--must comply with EU fiscal deficit targets for the general government, and the central government has strong enforcement mechanisms to prompt LRGs to cut spending and raise taxes. On top of that, central government support to LRGs has strengthened over recent years: For instance, it has sponsored liquidity facilities to allow LRGs to pay off arrears (Rome MC didn't require these facilities as it has very good payment rates).

Rome MC's individual credit profile (ICP) continues to be supported by its strong financial management and its very low contingent liabilities. Its liquidity, despite weakening, continues to support the ICP, as does its strong economy. Its very weak budgetary flexibility, its historically high debt burden, and its average budgetary performance weigh negatively on the ICP.

Rome MC's economy is strong. Wealth is about 20% higher than the national average. In addition, its unemployment rate is lower than Italy's average (11.3% compared with a 12.7% national average in 2014), partly because the central government has its headquarters and employs a large number of civil servants in the city. In line with other Italian LRGs and the Republic of Italy, we view that the economy has limited growth prospects, reflecting Italy's current slow economic recovery.

Rome MC's strong financial management has enabled the former province to weather difficult times, such as central government transfer cuts since 2011, weak economic conditions, delayed cash transfers to the province from the Region of Lazio, and declining tax collection rates. However, this has gradually depleted its budgetary flexibility, deteriorated its budgetary performance, and weakened its liquidity position. Nevertheless, debt has continued to fall, Rome MC has not delayed payments, and there are no off-budget liabilities.

Rome MC's budgetary flexibility is very weak. In 2015, it will use its available fund balance to compensate for the harsh consolidation measures applied to MCs. The entity used up its operating expenditure flexibility to mitigate the lower central government transfers as of 2011. From 2012, it increased its automobile-related taxes, which represent about 70% of operating revenues, to the maximum legal ceiling. However, the resulting revenues failed to match Rome MC's expectations because of declining car sales and because two of Italy's autonomous provinces--Trento and Bolzano--are collecting a sizable share of auto-related taxes that Rome MC previously collected, owing to changes in legislation that are favorable to autonomous provinces. Lastly, Rome MC faced delays in cash transfers from the Region of Lazio, leading it to use some of its ample cash holdings to avoid delaying payments.

We assess Rome MC's budgetary performance in cash terms because we consider that cash financial flows are more reflective of Rome MC's financial performances--in line with other Italian cities we rate. Rome MC's budgetary performance in cash terms is average. Operating margins in cash terms over 2015-2017 will stand at 0% of operating revenues, in our base-case forecast, compared with an average of 14% over 2013-2014. We expect the deficit after capital expenditure to be 8% of total revenues over 2015-2017, versus a slight surplus of 0.1% in 2013-2014.

Our 2015 base-case scenario incorporates lower debt service payments for 2015, as fiscal consolidation will be partly offset by a systemwide legally authorized partial suspension of debt service. We also assume a strong reduction of Rome MC's positive unreserved fund balance as it will be used to cover the central government cuts.

Our forecasts for 2016 and 2017 incorporate the following assumptions:

- The central government will revise downward the cuts applied by the 2015 Stability Law, thus alleviating financial pressure on Rome MC; and
- Rome MC will pass on its nonfundamental functions to cities, regions, or the central government, reducing personnel-related costs.

Nevertheless, we forecast that Rome MC's 8% average deficit after capital accounts in cash terms over the coming years will only have a marginal impact on debt. This is in part because some capital expenditures will be funded through revenues accrued and collected in the past, as a result of which the city will use some of its accumulated reserves (with a negative impact on our liquidity assessment--please see the section "Liquidity" below), but will have marginal recourse to long-term borrowing.

According to our base-case scenario, the debt burden will remain high, but will be on a declining trend as the city will be paying down debt. We forecast tax-supported debt--which includes the very low debt of the company ASP Colline Romane, under liquidation--will stand at 126% of consolidated revenues in 2017.

We consider that Rome MC carries very low contingent liabilities. We see very low risk from the city's non-self-supporting fully owned company--Capitale Lavoro SpA--

which posted a minor surplus in 2013 and is debt-free. We also see very low risk arising from potential court rulings. According to the latest available information from Rome MC, pending litigation is under negotiation and is unlikely to generate sudden unfavorable court judgements in the near future.

We could revise down our SACP assessment for Rome MC to 'a-' if its budgetary performance in cash terms weakened and its liquidity deteriorated further.

### Liquidity

We have revised downward our assessment of Rome MC's liquidity to strong from exceptional as we now assess its access to external liquidity as limited.

Rome MC's ratio of free cash and liquid assets over the past 12 months to the following 12 months of debt service continues to be exceptional, although the ratio is markedly lower than our April 2015 calculation.

We now forecast that Rome MC will need to access external liquidity: We expect it will tap its liquidity line in 2016, meaning that we can no longer consider the abovementioned ratio as structurally exceptional. Hence, we now take into account Rome MC's limited access to external liquidity, as defined in our criteria. Our view on liquidity access is derived from Standard & Poor's assessment of Italy's banking system, according to our banking industry and country risk methodology (see "Banking Industry Country Risk Assessment: Italy," published July 30, 2015, on RatingsDirect).

We now estimate that Rome MC's average cash (adjusted for the next 12 months' balance after capital accounts in cash terms) should cover debt service requirements for the next 12 months by more than 1.5x compared with the previous 3.3x. The deterioration of the ratio is linked to both lower average monthly cash holdings between October 2014 and September 2015 (versus April 2014 and March 2015) and higher debt-service requirements for 2016 compared with 2015.

Rome MC can currently access a €50 million liquidity line with its treasury bank, Unicredit, which it has never used in the past. We expect Rome MC to tap its liquidity line in 2016 and 2017, and we also expect the available liquidity line to increase up to 25% of the previous two years' operating revenues (which would mean approximately €120 million in 2016), in accordance with the current national legislation limits.

## Outlook

The stable outlook on Rome MC reflects that on Italy.

If we downgraded Italy, we would also downgrade Rome MC, all else being equal.

Given Rome MC's SACP of 'a', we currently do not envisage a realistic scenario under which Rome would be downgraded based on its own merit to below 'BBB-'.

Conversely, we would upgrade Rome MC if we upgraded Italy, assuming that Rome MC's SACP continued to be above 'bbb' at the time of the sovereign upgrade.

## Key Statistics

**Table 1**

**Rome (Metropolitan City of) Financial Statistics**

| | --Fiscal year end Dec. 31-- | | | | | | |
|---|---|---|---|---|---|---|---|
| **(Mil. €)** | **2011** | **2012** | **2013** | **2014** | **2015bc** | **2016bc** | **2017bc** |
| Operating revenues* | 537 | 480 | 516 | 487 | 528 | 543 | 553 |
| Operating expenditures* | 467 | 425 | 402 | 459 | 523 | 555 | 553 |
| Operating balance* | 70 | 55 | 114 | 28 | 5 | (13) | 1 |
| Operating balance (% of operating revenues)* | 13.0 | 11.5 | 22.1 | 5.8 | 1.0 | (2.3) | 0.1 |
| Capital revenues* | 21 | 8 | 272 | 7 | 10 | 9 | 9 |
| Capital expenditures* | 80 | 37 | 342 | 62 | 55 | 50 | 48 |
| Balance after capital accounts* | 10 | 26 | 44 | (26) | (40) | (53) | (38) |
| Balance after capital accounts (% of total revenues)* | 1.8 | 5.4 | 5.6 | (5.3) | (7.5) | (9.6) | (6.8) |
| Debt repaid*§ | 37 | 59 | 68 | 39 | 27 | 36 | 77 |
| Balance after debt repayment and onlending* | (27) | (33) | (24) | (65) | (67) | (89) | (115) |
| Balance after debt repayment and onlending (% of total revenues)* | (4.9) | (6.7) | (3.0) | (13.2) | (12.4) | (16.1) | (20.5) |
| Gross borrowings*† | 14 | 29 | 18 | 7 | 20 | 70 | 88 |
| Balance after borrowings* | (14) | (4) | (6) | (59) | (47) | (19) | (27) |
| Operating revenue growth (%)* | 8.9 | (10.5) | 7.5 | (5.8) | 8.6 | 2.7 | 2.0 |
| Operating expenditure growth (%)* | (1.9) | (9.0) | (5.4) | 14.1 | 14.0 | 12.5 | 7.5 |
| Modifiable revenues (% of operating revenues) | 65.6 | 67.1 | 73.3 | 69.2 | 66.0 | 66.3 | 66.6 |
| Capital expenditures (% of total expenditures) | 8.2 | 5.4 | 43.2 | 19.0 | 11.6 | 8.1 | 8.2 |
| Direct debt (outstanding at year-end) | 841 | 773 | 715 | 676 | 669 | 703 | 680 |
| Direct debt (% of operating revenues) | 178.3 | 154.9 | 144.1 | 140.4 | 127.8 | 132.3 | 125.7 |
| Tax-supported debt (% of consolidated operating revenues) | 178.6 | 155.2 | 144.5 | 140.8 | 128.1 | 132.5 | 126.0 |
| Interest (% of operating revenues) | 7.0 | 6.2 | 5.6 | 5.4 | 2.3 | 7.2 | 4.7 |
| Debt service (% of operating revenues) | 14.9 | 20.0 | 17.5 | 13.5 | 7.4 | 14.0 | 11.5 |

*Calculated in cash terms. §Also includes the repayment of short term debt in 2017. †Also includes the cash advanced by the treasury bank in 2016 and 2017. Note: The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case, reflects Standard & Poor's expectations of the most likely scenario.

**Table 2**

**Rome (Metropolitan City of) Economic Statistics**

| | --Fiscal year ended Dec. 31-- | | | |
|---|---|---|---|---|
| | **2011** | **2012** | **2013** | **2014** |
| Population | 3,995,250 | 4,039,813 | 4,321,244 | 4,342,046 |
| Population growth (%) | 0.4 | 1.1 | 7.0 | 0.5 |
| GDP per capita (€) | 34,320 | 33,893 | 33,147 | N/A |
| Unemployment rate (%) | 8.4 | 9.9 | 11.0 | 11.3 |

The data and ratios above result in part from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. Sources typically include national statistical offices, Eurostat, and Experian Limited.

## Ratings Score Snapshot

**Table 3**

**Rome (Metropolitan City of) Ratings Score Snapshot**

| **Key rating factors** | |
|---|---|
| Institutional framework | Evolving but balanced |
| Economy | Strong |
| Financial management | Strong |
| Budgetary flexibility | Very weak |
| Budgetary performance | Average |
| Liquidity | Strong |
| Debt burden | High |
| Contingent liabilities | Very low |

*Standard & Poor's ratings on local and regional governments are based on eight main rating factors listed in the table above. Section A of Standard & Poor's "Methodology For Rating Non-U.S. Local And Regional Governments," published on June 30, 2014, summarizes how the eight factors are combined to derive the rating.

## Key Sovereign Statistics

Please see "Sovereign Risk Indicators," Oct. 12, 2015.

## Related Criteria And Research

### Related Criteria

- Criteria - Governments - International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign - December 15, 2014
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments - June 30, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions - November 19, 2013

### Related Research

- Sovereign Risk Indicators - October 12, 2015. An interactive version can be found at www.spratings.com/SRI.
- Banking Industry Country Risk Assessment: Italy - July 30, 2015
- Default, Transition, and Recovery: 2014 Annual International Public Finance Default Study And Rating Transitions - June 8, 2015

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

## Ratings List

| | Ratings | |
|---|---|---|
| | To | From |
| Rome (Metropolitan City of) | | |
| Issuer credit rating | | |
| Foreign and Local Currency | BBB-/Stable/-- | BBB-/Stable/-- |
| Senior Unsecured | | |
| Local Currency | BBB- | BBB- |

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