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Research Update:

Italian Province of Rome Affirmed At 'BBB' On Expected Favorable Institutional Framework Reform; Outlook Still Negative

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Overview

- Contrary to our previous expectations, we believe the Italian Province of Rome (Rome Province) will show a substantial budgetary deterioration in 2014, mainly due to falling tax bases and regional transfers.
- The province will soon change its current legal status to that of a metropolitan city, and it will assume new responsibilities, and possibly, experience a favorable change in its revenue structure.
- We anticipate that, as the Metropolitan City of Rome, the province will preserve its main rating drivers, including very skilled management, a dwindling debt burden, and ample liquidity.
- We are affirming our 'BBB' rating on the province.
- The negative outlook on Rome Province mirrors that on Italy, reflecting the possibility that we could lower the rating on the province if we lower our ratings on Italy.

Rating Action

On Nov. 21, 2014, Standard & Poor's Ratings Services affirmed its 'BBB' long-term issuer credit rating on the Italian Province of Rome (Rome Province). The outlook remains negative.

Rationale

The affirmation incorporates our anticipation that Rome Province will change its legal status to "metropolitan city" from "province" as from Jan. 1, 2015. In our view, the status change to metropolitan city will confer significant new responsibilities on the province and likely will strengthen its revenue structure. We are assuming that the new status will bestow an adequate revenue-expenditure match upon the future metropolitan city, and offset the negative conditions currently menacing Rome Province's creditworthiness. In particular, the province's hitherto sound tax bases have weakened in 2014. But we assume the metropolitan city status will fortify Rome Province's revenues. Furthermore, the central government has designed a very aggressive revenue-cutting plan for provinces, but we believe it will not fully apply to metropolitan cities.

Moreover, we believe the province's very skilled managers will remain after the transformation to metropolitan city; that the Metropolitan City of Rome's liquidity position will remain buoyant; and that its debt burden will continue to decrease.

The rating on Rome Province primarily reflects our long-term sovereign rating on Italy (unsolicited; BBB/Negative/A-2). We consider that Rome Province, like all other Italian local and regional governments (LRGs), does not meet all the criteria under which we could rate an LRG above the sovereign. In particular, we think Rome Province lacks sufficient financial autonomy to oppose negative intervention from the sovereign, such as a change in the local revenue or expenditure structure. In addition, Italian law obliges the province to deposit the majority of its cash holdings at the Italian central bank.

We have revised down our assessment of Rome Province's stand-alone credit profile (SACP) to 'a+' from 'aa-'. 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.

The 'a+' SACP now reflects our view that some additional risks are affecting Rome Province's budgetary performance, which we now see as compatible with our assessment of average instead of very strong. Nevertheless, the province's intrinsic creditworthiness remains robust, in our view. We base this on our view of Rome Province's strong financial management, strong economy, exceptional liquidity, very low contingent liabilities, and our assumption that the upcoming institutional framework for metropolitan cities will boast features compatible with our assessment of evolving-but-balanced institutional framework for metropolitan cities. The province's weak budgetary flexibility and still-high, albeit rapidly declining, tax-supported debt partly offset these positives.

We assume Rome Province will continue to operate in an evolving-but-balanced institutional framework, which is neutral for the rating. Despite the central government's fiscal consolidation measures and dwindling national 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's 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, the central government has strengthened its support to LRGs over recent years, for instance by sponsoring liquidity facilities to pay off LRGs' arrears. As a result, the overall results indicate that the main metrics of all LRG tiers have materially improved since 2010, including debt burden, budgetary performance, and liquidity position.

In a different vein, since 2012 the central government has gradually set the scene for the abolition of the provincial tier, or at least, a substantial reduction of its scope and financial importance. The process has gained momentum recently, and the draft Stability Law for 2015 envisages very strong revenue-cutting measures that we now view as incompatible with the current scope of provincial responsibilities. If revenue cuts were to materialize as announced in the draft stability law, provinces would be underfunded or, alternatively, would have to transfer their responsibilities to upper or lower government layers.

Nevertheless, we believe the measures contained in the Stability Law for 2015 will not fully apply to metropolitan cities, including the future Metropolitan City of Rome. When the law takes effect, we understand that the Metropolitan City of Rome will maintain the responsibilities it holds as Province of Rome and be conferred additional ones, including coordination of municipalities in its jurisdiction. If properly implemented, we believe the role of metropolitan cities could increase the efficiency of the municipal tier and align well with the current objectives of the central government's ongoing structural reforms. Based on these assumptions, we do not believe the central government will undermine the metropolitan cities' revenue-expenditure matches, and therefore we currently maintain our institutional framework assessment for the future Metropolitan City of Rome at the same level as for the Province of Rome.

In our view, Rome Province's budgetary performance is average. We factor into our estimate that, in 2014, Rome Province will post somewhat weaker operating surpluses and surpluses after capital expenditures (at 5.4% and 1.3% on accrual terms) than we previously expected. We think the province's tax bases might be less resilient than we currently expect. We also estimate slight deficits after capital expenditures in cash terms in 2014. This is due to a combination of:

- Falling car-related tax revenues (the province's main tax revenue item), against the backdrop of continuing fiscal competition from the Autonomous Provinces of Trento and Bolzano, and falling premium prices in the car insurance sector;
- Smaller transfers in cash terms from the Region of Lazio; and
- The impact of the central government's fiscal consolidation measures.

We assume the revenue structure of the metropolitan city will improve in 2015-2016. Specifically, we factor in some additional fiscal consolidation measures by the central government (€30 million annually in cumulative terms). However, this represents one-half of the revenue cuts that we estimate would be applicable following a strict interpretation of the 2015 draft Stability Law for Provinces. We assume that metropolitan cities will get the revenues of their structures somewhat reinforced, in order to duly deliver on their responsibilities without revenue-expenditure mismatches. This may happen through a variety of means, including sharing local taxes, greater regional transfers, or stronger support against tax evasion. Despite these future possible boosts, we see that Rome Province's current capacity to further raise taxes is minimal since the 2013 tax increases; hence, we assess its budgetary flexibility as weak.

We believe margins will generally remain positive during our forecast horizon (2015-2016) but structurally below 5%. We envisage limited deficits or slight surpluses after capital expenditures.

Given its expected surpluses, the province is unlikely to take on material new debt. We thus anticipate that the province's debt stock will fall to about 111% of operating revenues by 2016, from 144% at year-end 2013.

A key factor that underpins our budgetary assumptions relates to our assessment of financial management as strong, which mainly reflects our view that the managers exert good control over revenues and expenditures, so as to maintain average budgetary performance.

We believe the province's powerful economy bolsters its tax bases. Rome Province's wealth is about 20% higher than the national average. In addition, the province's 11.3% unemployment rate is lower than Italy's 12.2% average in 2013, partly because the central government has its headquarters and employs a large number of civil servants in the province. The province's economy is feeling the effects of Italy's current slow economic recovery, however. Our forecasts encompass zero growth in Italy's real GDP this year and structurally low growth at about 1% thereafter.

We see very low risk from the province's non-self-supporting fully owned companies--recently merged Provincia Attiva and Capitale Lavoro--which posted an aggregate minor surplus in 2013 and are debt free. We therefore consider that the province does not carry material contingent liabilities.

Our assessment of Rome Province's SACP could weaken to 'a' if the province's financial performance deteriorated beyond our current expectation. If this occurred, it could weaken liquidity such that it would no longer be in line with our current exceptional assessment. The SACP could further deteriorate if we concluded that the institutional framework for metropolitan cities was evolving but unbalanced, owing to a weaker-than-expected revenue structure.

Liquidity

We assess Rome province's liquidity as exceptional based on its structurally high cash holdings and satisfactory access to external funding.

We estimate that the province's average cash (adjusted for the next 12 months' budgetary performance) should cover debt service requirements for the next 12 months by more than 2.8x, which we view as a very comfortable ratio. We also expect debt service to stabilize at 13% of operating revenues in 2015-2016.

We believe the province will maintain its traditionally sound liquidity on the back of an average budgetary performance with very small deficits after capital spending, good revenue and expenditure management, and very little pressure from overdue payables.

We expect the above-mentioned liquidity-supportive factors to remain in place over our forecast horizon; hence we think Rome Province will:

- Maintain high payment rates and low average payment periods for operating payables;

- Maintain its cash holdings consistently above €100 million; and
- Draw very moderately on loans already contracted with Italian financial institution Cassa Depositi e Prestiti SpA.

Outlook

The negative outlook on Rome Province mirrors that on Italy. The outlook reflects the possibility that we could lower the rating on the province if we lowered our ratings on Italy.

Apart from a sovereign downgrade, and in accordance with our criteria, we would lower the rating on the province if its SACP deteriorated to below the 'bbb' level. Given the currently strong 'a+' SACP, however, such a scenario appears very unlikely.

If we revised the outlook on Italy to stable and the province performed in line with our base-case scenario, we would likely take a similar action on the province.

Key Statistics

Table 1

Province of Rome Financial Statistics

	--Fiscal year ending Dec. 31--							
(Mil. €)	**2009**	**2010**	**2011**	**2012**	**2013**	**2014bc**	**2015bc**	**2016bc**
Operating revenues	563	581	472	499	496	491	511	537
Operating expenditures	515	539	412	412	439	465	494	526
Operating balance	48	42	60	87	56	26	17	11
Operating balance (% of operating revenues)	8.5	7.3	12.7	17.4	11.4	5.4	3.3	2.1
Capital revenues	59	42	18	9	264	10	10	10
Capital expenditures	117	121	37	24	335	30	30	30
Balance after capital accounts	(9)	(36)	41	72	(14)	6	(3)	(9)
Balance after capital accounts (% of total revenues)	(1.5)	(5.8)	8.4	14.2	(1.9)	1.3	(0.6)	(1.6)
Debt repaid	55	43	37	69	59	39	40	41
Balance after debt repayment and onlending	(64)	(79)	4	3	(73)	(33)	(43)	(50)
Balance after debt repayment and onlending (% of total revenues)	(10.3)	(12.7)	0.8	0.6	(9.6)	(6.5)	(8.3)	(9.1)
Gross borrowings	19	0	0	0	0	0	0	0
Balance after borrowings	(45)	(79)	4	3	(73)	(33)	(43)	(50)
Operating revenue growth (%)	5.6	3.2	(18.8)	5.7	(0.5)	(0.9)	3.9	5.2
Operating expenditure growth (%)	7.7	4.6	(23.5)	(0.0)	6.7	5.8	6.2	6.5
Modifiable revenues (% of operating revenues)	50.4	48.0	65.6	67.1	73.3	71.6	69.4	66.9
Capital expenditures (% of total expenditures)	18.5	18.4	8.2	5.4	43.2	6.1	5.7	5.4

Table 1

Province of Rome Financial Statistics (cont.)

Direct debt (outstanding at year-end)	922	879	841	773	715	676	636	595
Direct debt (% of operating revenues)	163.7	151.2	178.3	154.9	144.1	137.5	124.5	110.7
Tax-supported debt (% of consolidated operating revenues)	163.7	151.2	178.3	154.9	144.1	137.5	124.5	110.7
Interest (% of operating revenues)	6.6	5.8	7.0	6.2	5.6	5.4	5.1	4.7
Debt service (% of operating revenues)	16.4	13.2	14.9	20.0	17.5	13.4	12.9	12.3

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. 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

Province of Rome Economic Statistics

	--Fiscal year ending Dec. 31--				
	2009	**2010**	**2011**	**2012**	**2013**
Population	4,154,684	4,194,068	3,995,250	4,039,813	4,083,282
Population growth (%)	1.1	0.9	(4.7)	1.1	1.1
Local GDP per capita (€)	31,643	31,689	32,065	31,521	N.A.
National GDP per capita (€)	25,757	26,219	26,614	26,382	26,138
Unemployment rate (%)	8.1	9.1	8.5	10.0	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. N.A.--Not available.

Ratings Score Snapshot

Table 3

Province of Rome Ratings Score Snapshot

Key rating factors	
Institutional framework	Evolving but balanced
Economy	Strong
Financial management	Strong
Budgetary flexibility	Weak
Budgetary performance	Average
Liquidity	Exceptional
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

Sovereign Risk Indicators, Sept. 22, 2014. Interactive version available at http://www.spratings.com/sri

Related Criteria And Research

Related Criteria

- Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013

Related Research

- Public Finance System Overview: Italian Regions, Provinces, And Municipalities, Oct. 5, 2007
- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013

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 Affirmed

Rome (Province of)	
Issuer Credit Rating	BBB/Negative/--
Senior Unsecured	BBB

Additional Contact:

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