FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Region of Nouvelle Aquitaine at 'AA'; Outlook Negative

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Fitch Ratings - Paris - 24 May 2022: Fitch Ratings has assigned the Region of Nouvelle Aquitaine Long-Term Local- and Foreign- Currency Issuer Default Ratings (IDRs) of 'AA' with Negative Outlooks. A full list of rating action is below.

Nouvelle Aquitaine's 'AA' IDRs are derived from its 'aa' Standalone Credit Profile (SCP), which results from the combination of a 'High Midrange' risk profile and a 'aa' debt sustainability assessment. The 'High Midrange' risk profile is the same as other Fitch-rated French metropolitan regions, while the 'aa' debt sustainability assessment reflects a payback ratio that is below 7.5x on a sustained basis under Fitch's rating-case scenario. No other factor affects the ratings.

The Negative Outlook reflects that on the French sovereign (AA/Negative). French local and regional governments (LRG) cannot be rated above the sovereign.

KEY RATING DRIVERS

Risk Profile: 'High Midrange'

Fitch assesses Nouvelle Aquitaine's risk profile at 'High Midrange', reflecting a combination of 'Stronger' and 'Midrange' assessments. The 'High Midrange' risk profile reflects Fitch's view of a lower risk than international peers that Nouvelle Aquitaine's ability to cover debt service by its operating balance may weaken unexpectedly over the forecast horizon (2022-2026) due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt or debt-service requirements.

Revenue Robustness: 'Stronger'

Nouvelle Aquitaine benefits from highly stable revenue sources and solid long-term revenue growth prospects. Operating revenue is mostly made up of growing and predictable tax items and stable resources transferred by the state with low counterparty risk. The latter include transfers from the state and fuel tax proceeds, mostly guaranteed by the state (a total 38% of operating revenue in 2021).

Around half of operating revenue is linked to the economic cycle. In 2021, this included a share of VAT proceeds collected nationally (47%) and vehicle registration fees (9%), which are collected locally and linked to vehicle purchases in the region. In Fitch's view, vehicle registration fees are a less robust revenue source as they are linked to a specific market and the share of electric and hybrid cars exempt from vehicle registration fees will increase in the long term.

Revenue Adjustability: 'Midrange'

Fitch considers Nouvelle Aquitaine's revenue adjustability as 'Midrange' as the region's rate-setting power is limited to the vehicle registration tax. The region's current tax rate is below the French regions' median at EUR41, and is the lowest of the Fitch-rated regions. An increase in the tax rate to EUR60 (maximum rate for French regions) and withdrawing tax exemptions for hybrid cars would have increased total revenue by more than 4% in 2021, which in Fitch's view would cover more than 100% of the reasonably expected revenue decline in case of economic downturn (estimated at 2% of revenue by Fitch).

Fitch views the affordability of additional taxation on this tax item as strong compared with international peers, as an increase in vehicle registration fees would represent only a marginal proportion of the region's median income.

Expenditure Sustainability: 'Stronger'

Nouvelle Aquitaine has a solid record of and good prospects for control over operating expenditure. Over 2017-2021, opex grew by 1.8% a year on average, compared with 1.6% for operating revenue. The higher growth rate for opex is due to Nouvelle Aquitaine being three smaller regions that were merged. Some expenditure items, notably staff costs, which were different among the three regions are being harmonised at the higher level. This is also why Nouvelle Aquitaine has higher staff expenses per capita and more employees per capita than other Fitch-rated regions. Fitch expects this characteristic to gradually disappear.

Nouvelle Aquitaine's responsibilities mainly include non-cyclical expenditure that is unlikely to increase in an economic downturn (planned investments, transportation and secondary education). In 2021, the pandemic impact on opex was not substantial and mainly included transfers to SNCF to cover regional trains operating deficit and subsidies to local associations. Fitch expects the current inflationary environment to drive up transfers to transport operators and high schools, as the energy component is a significant cost item for them. Nouvelle Aquitaine's growing population also leads to high needs for public services, such as high schools.

Expenditure Adjustability: 'Midrange'

Nouvelle Aquitaine's operating expenditure is mainly made up of mandatory transfers, related to transportation, vocational training or secondary education. Staff costs (22% of operating spending in 2021) are also rigid spending item,s as most of the region's employees have the status of civil servants.

The region retains some flexibility to scale down expenditure in case of need given its significant level of capital expenditure (32% of total expenditure in 2021), mostly dedicated to transportation and school renovation. The latter could be postponed or scaled down in case of need.

However, capex flexibility is limited by the region's high investment needs, which are driven by population growth. Overall, we estimate the share of Nouvelle Aquitaine's inflexible expenditure to be between 70% and 90%.

Liabilities & Liquidity Robustness: 'Stronger'

Nouvelle Aquitaine's liabilities carry little risk. At end-2021, 80% of its debt was fixed-rate and 97% was considered risk-free by national regulation (Gissler Charter - 1A). Only 0.6% of outstanding debt (EUR14 million) may be considered risky as it is classified 4E under the national Gissler Charter, but Nouvelle Aquitaine chose to fix the rate on this debt instrument in December 2020. The debt amortisation profile is smooth overall and we expect it to remain well covered by the region's operating balance.

Nouvelle Aquitaine's contingent liabilities (EUR108 million guarantees at end-2021) are low, representing 24% of the operating balance in 2021. Fitch did not identify any material risk.

Liabilities & Liquidity Flexibility: 'Stronger'

Fitch views the framework for emergency liquidity support from the state as strong. This is evident in cash-pooling between French LRGs and the state, with the former's liquidity deposited at the national Treasury. French LRGs may benefit from the transfers of tax proceeds in advance from the French state in case of liquidity shortfalls. The counterparty risk of this mechanism is low due to the sovereign's high rating.

The region has strong access to liquidity under various forms. In 2021, it benefited from EUR200 million of bank lines with commercial banks rated in the 'A' category, which were used as back-up lines for its NeuCP programme (EUR500 million ceiling). Like other French LRGs, the region has access to institutional lenders, such as Caisse des Depots et Consignations (AA/Negative), which can support them in case of borrowing difficulties with commercial banks.

Debt Sustainability: 'aa category'

In Fitch's rating-case scenario, the region's payback ratio remains below 7.5x (2021: 5.9x) on a sustained basis. Debt-service coverage (Fitch's synthetic calculation) remains close to 2x, while the fiscal debt burden edges towards 150%.

In 2021, Nouvelle Aquitaine's operating balance bounced back to a pre-pandemic level at EUR459 million from EUR322 million in 2020 (a comfortable 20% of operating revenue), mainly driven by a higher-than expected rebound in VAT. We expect Nouvelle Aquitaine's operating balance to remain above EUR460 million by 2026, supported by a 2.2% average increase in VAT proceeds (at a constant perimeter), but limited by rising inflation.

Nouvelle Aquitaine's capital expenditure totalled EUR878 million in 2021 (32% of total expenditure), down from EUR843 million in 2020 (31%). We expect the region to continue implementing a large capex programme of around EUR4.4 billion over 2022-2026, mostly allocated to transportation and high schools. In our rating case, net adjusted debt increases to close to EUR3.5 billion by 2026 (2021: EUR2.7 billion).

DERIVATION SUMMARY

The SCP reflects the combination of a 'High Midrange' risk profile and debt sustainability that Fitch assesses in the middle of the 'aa' category under its rating case. No other factor affects the region's ratings.

Debt Ratings

Nouvelle Aquitaine's EUR1 billion EMTN and EUR500 million NeuCP programmes ratings are in line with its IDRs.

KEY ASSUMPTIONS

Issuer-specific qualitative assumptions:

Risk Profile: 'High Midrange'

Revenue Robustness: 'Stronger'

Revenue Adjustability: 'Midrange'

Expenditure Sustainability: 'Stronger'

Expenditure Adjustability: 'Midrange'

Liabilities and Liquidity Robustness: 'Stronger'

Liabilities and Liquidity Flexibility: 'Stronger'

Debt sustainability: 'aa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Sovereign Cap: 'N/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 growth of 0.7% a year on average, closely linked to prudent economic growth, which drives VAT proceeds;

- Operating expenditure growth of 0.9% a year on average; this moderate expected growth considering the current inflation rate is due to some earmarked funds received from the state as part of the pandemic recovery package, which decrease in 2024 in both operating revenue and operating expenditures; excluding this specific item, operating expenditures grow by close to 2% a year in our rating-case scenario;

- Negative net capital balance of EUR582 million a year on average, in line with the issuer's own projections; and

- Average 1.5% cost of debt.

Liquidity and Debt Structure

Fitch's adjusted debt includes the region's long-term direct debt (EUR2.7 billion at end-2021) and other Fitch's classified debt (EUR210 million). Fitch's net-adjusted debt (EUR2.7 billion at end-2021) corresponds to the difference between Fitch's adjusted debt and the cash at the end of the year considered by Fitch as unrestricted (EUR141 million at end-2021).

Issuer Profile

Nouvelle Aquitaine is a region with six million inhabitants covering the south-west of France. It was created in 2016 from the merger of three smaller regions. It is responsible for local transportation infrastructure, vocation training, high schools and economic development.

RATING SENSITIVITIES

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

Nouvelle Aquitaine's Long-Term IDRs could be downgraded if its payback deteriorated to above 7.5x on a sustained basis under our rating case. A downgrade of the sovereign's ratings would lead to a downgrade of Nouvelle Aquitaine's ratings.

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

A revision of the Outlook to Stable could result from a similar sovereign Outlook revision, all other things being equal.

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

Sources of Information

The principal sources of information used in the analysis are described in the Applicable Criteria.

Discussion Note

Committee date: 23 May 2022

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

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

Nouvelle Aquitaine, Region of	LT IDR	AA Rating Outlook Negative	New Rating
	ST IDR	F1+	New Rating
	LC LT IDR	AA Rating Outlook Negative	New Rating
	LC ST IDR	F1+	New Rating
senior unsecured	LT	AA	New Rating
senior unsecured	ST	F1+	New Rating

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

Nouvelle Aquitaine, Region of	EU,UK Endorsed

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