FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Puy-de-Dome at 'AA-'; Outlook Stable

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Fitch Ratings - Paris - 31 May 2024: Fitch Ratings has affirmed Puy-de-Dome 's Long-Term Foreign-and Local-Currency Issuer Default Ratings (IDRs) at 'AA-' with Stable Outlook. A full list of rating actions is below.

The affirmation reflects Fitch's unchanged assessment of Puy-de-Dome's Standalone Credit Profile (SCP) at 'aa+'. This reflects the combination of a 'High Midrange' risk profile and debt sustainability assessed at the upper end of the 'aa' category. The IDRs are capped by France's sovereign rating (AA-/Stable). The Stable Outlook reflects that on the sovereign.

KEY RATING DRIVERS

Risk Profile: 'High Midrange'

Puy-de-Dome's 'High Midrange' risk profile reflects a combination of 'Stronger' and 'Midrange' assessments of six key risk factors. It also reflects Fitch's view of a low risk that the department's ability to cover debt service by its operating balance may weaken unexpectedly over the rating horizon (2024-2028) due to lower-than-expected revenue, higher-than-expected expenditure, or an unexpected rise in liabilities, debt or debt-service requirements.

Revenue Robustness: 'Stronger'

Puy-de-Dome's revenue sources are robust, comprising growing and predictable tax items, such as insurance contracts (14% of operating revenue in 2023) and a share of VAT (33%). VAT is linked to national consumption; Fitch therefore considers that a sustained decrease in this revenue source is unlikely. The department also receives stable revenue from the state, including transfers (27% of operating revenue in 2023) and fuel tax (7%), the proceeds of which are mostly guaranteed by the state. Counterparty risk is low due to sovereign's high rating.

Property transfer duties (13%) represent the main source of budget volatility as they are linked to real estate transactions, which we take into account in our rating case. In 2023, they fell by 18% due to a lower number of transactions and lower real estate prices, driven by high mortgage rates. We expect them to fall by 11% in 2024 under our rating case before rebounding from 2025.

Revenue Adjustability: 'Midrange'

French departments benefit from the cost pass-through mechanism with the French state as their counterparty. They are responsible for public spending decided nationally, especially social spending, and tend to receive greater financial support from the French state when costs increase. The support mechanisms from the state have not always been sufficient to cover the increase in spending in the past and do not benefit from a constitutional guarantee. As a result, this assessment is 'Midrange' and not 'Stronger'.

Expenditure Sustainability: 'Midrange'

Like other French departments, a large share of Puy-de-Dome's expenditure is social spending (54% of opex in 2023), which depends on national decisions, constraining the department's capacity to control expenditure. This spending includes social benefits (16%), a countercyclical item that tends to grow when unemployment rises. Nevertheless, the department has demonstrated good control over opex, with operating revenue growing faster than opex (2.1% vs. 1.9% in 20217-2022) except in 2023, which we consider exceptional.

Expenditure Adjustability: 'Midrange'

Puy-de-Dome's opex adjustability is limited. Opex mainly comprises mandatory transfers, especially social accommodation fees (25% of opex in 2023), social benefits (16%), and other social subsidies (13%). Staff costs (23%) are a rigid spending item as most of the department's employees are civil servants. However, cost-cutting remains possible, as evidenced by cost control in recent years. The department has more flexibility over capex (14% of total expenditure in 2023). However, this is reduced by the department's high investment needs, especially for secondary school renovation and road maintenance. We estimate inflexible expenditure at 70%-90% of total spending.

Liabilities & Liquidity Robustness: 'Stronger'

At end-2023, the department's liabilities carried little risk as 54% of its debt was fixed-rate (post-swap) and 100% was deemed risk-free under national regulation (Gissler Charter). The department did not have short-term debt. The amortisation profile is smooth with only a few peaks and an average annuity of EUR14 million. The department's off-balance-sheet liabilities (guarantees plus public-sector entities' debt) are sizeable, representing 8.5x of the operating balance in 2023. However, 91% was related to the low-risk social housing sector, with the rest linked to the medical-social sector.

Liabilities & Liquidity Flexibility: 'Stronger'

Fitch assesses the framework for emergency liquidity support from the state as strong. This is evidenced by the cash-pooling between local and regional governments (LRG) and the state, with the former's liquidity deposited at the national Treasury. French LRGs may benefit from advance transfers from the state of tax proceeds in case of a liquidity shortfall. The counterparty risk of this mechanism is low due to the sovereign's high rating.

The department has strong access to various forms of liquidity. Puy-de-Dome, like other French LRGs, has access to some institutional lenders, especially the Caisse des Depots et Consignations (AA-/Stable), which may provide support in case it is denied access to commercial lenders or bond markets.

Debt Sustainability: 'aa category'

We assess Puy-de-Dome's debt sustainability at the upper end of the 'aa' category. In Fitch's rating case, Puy-de-Dome's payback ratio remains in the 4.0x-5.0x range in 2026-2028 (2023: 2.5x). Debt service coverage (Fitch's synthetic calculation) is in the 2x-4x range and the fiscal debt burden remains below 50% in our rating case. Its operating balance declined 25% to EUR87 million in 2023 driven by a decrease in property transfer duties (-18%), and a rise staff costs and goods and services, as well as higher social spending.

In our rating case, we expect the operating balance to decrease to EUR78 million, as the expected dynamism on VAT will be offset by increasing opex, most notably social benefits, social accommodation fees and staff costs. We expect net adjusted debt to rise to close to EUR370 million by 2028 from EUR214 million at end-2023, as we expect the department's self-financing capacity (current balance + capital revenue/capex) to average 74% over the scenario.

DERIVATION SUMMARY

Puy-de-Dome's 'AA-' Long-Term IDR is based on the department's 'aa+' SCP and is capped by France's sovereign ratings. The SCP is driven by a 'High Midrange' risk profile and debt sustainability that Fitch assesses at the higher end of the 'aa' category under its rating case. No additional risk factors affect the ratings.

Short-Term Ratings

Fitch assesses Puy-de-Dome's Short-Term IDRs at 'F1+', in line with its rating guidance.

Debt Ratings

The department's senior unsecured long- and short-term bonds ratings are in line with its Long- and Short-Term IDRs, respectively.

KEY 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: 'aa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Rating Cap (LT IDR): 'AA-'

Rating Cap (LT LC IDR) 'AA-'

Rating 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 2019-2023 figures and 2024-2028 projected ratios. The key assumptions for the scenario include:

- Average 1.6% increase per year in operating revenue, driven mostly by a gradual recovery in property transfer duties from 2025 onwards and VAT proceeds (+2.8% a year on average over 2024-2028), which are expected to remain dynamic

- Average 2.0% increase per year in opex, driven by a sustained increase in social spending, notably social benefits (+2.6% a year on average over 2024-2028), accommodation fees (+3%), as well as staff costs (+2%)

- Capital balance on average at around a negative EUR96 million per year

- Average cost of debt of 2.7%, factoring in the department's high share of floating-rate debt (46% at end-2023) and a fixed 3.4% rate on new borrowings from 2024

Summary of Financial Adjustments

The fire brigade's accounts are consolidated with those of the department as they are mainly financed by the latter, especially through an annual operating subsidy (EUR42 million in 2023).

Issuer Profile

Puy-de-Dome is a French department in the central part of the country, in the Auvergne-Rhône-Alpes region. It has 0.7 million residents and its main responsibilities are social spending, education (middle schools) and road maintenance.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A deterioration of the payback ratio above 9x on a sustained basis in our rating case scenario could lead to a downgrade, although Fitch views this as very unlikely.

A downgrade of the French sovereign would also lead to a downgrade of the department's ratings

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of the French sovereign would lead to an upgrade of the department's ratings, all else remaining equal.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

DISCUSSION NOTE

Committee date: 28 May 2023

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Puy-de-Dome's IDRs are capped by France's IDRs.

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 ⬍

Puy-de-Dome, Department of	LT IDR AA- Rating Outlook Stable Affirmed	AA- Rating Outlook Stable
	ST IDR F1+ Affirmed	F1+
	LC LT IDR AA- Rating Outlook Stable Affirmed	AA- Rating Outlook Stable
senior unsecured	LT AA- Affirmed	AA-
senior unsecured	ST F1+ Affirmed	F1+

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

Puy-de-Dome, Department of	EU Issued, UK Endorsed

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