FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Cassa del Trentino to 'BBB+'; Outlook Stable

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Fitch Ratings - Milan - 26 May 2020: Fitch Ratings has downgraded Cassa del Trentino SpA's (CdT) Long-Term Issuer Default Rating (IDR) to 'BBB+' from 'A-'. The Outlook is Stable. Fitch has affirmed the Short-Term IDR at 'F1'. A full list of rating actions is below

CdT is the Autonomous Province of Trento's (PAT) funding agency. It disburses funds, including capital subsidies, on behalf of PAT to finance the investments of municipalities and not-for-profit organisations within PAT's territory. CdT is a pass-through entity, and so does not retain market, financial or operational risks associated with its lending, which are instead borne by PAT.

While Italian government-related entities' (GREs) most recently available issuer data may not have indicated performance impairment, material changes in revenue and cost profiles are occurring across the sector and likely to worsen in the coming weeks and months as economic activity suffers and some form of government restrictions are maintained or broadened. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector for their severity and duration, and incorporate revised qualitative and quantitative inputs based on performance expectations and assessment of key risks, including extraordinary support.

KEY RATING DRIVERS

Following the recent downgrade of PAT's IDRs (see Fitch Downgrades Autonomous Province of Trento to 'BBB+' on Sovereign Rating Action; Outlook Stable, dated 8 May 2020 on www.fitchratings.com) we have downgraded CdT's IDRs to reflect its rating equalisation with PAT's IDRs.

Overriding Regional Government Guarantees

CdT's IDRs move in tandem with those of PAT due to a share of government guaranteed debt, adjusted by Fitch to exclude pass-through funds being disbursed to PAT's beneficiaries, expected to remain close to 100%, a factor in itself triggering the equalisation by overriding the assessment of the GRE support factors.

The assessment of PAT's support to CdT is as follows:

CdT is credit-linked to PAT through the strength of their links and Fitch's assessment of PAT's willingness to provide extraordinary support if needed. This translates into a high score of 35 using the top-down approach under Fitch's GRE criteria, which would result in a one-notch differential with PAT absent the assessment of the Standalone Credit Profile.

Status, Ownership and Control Assessed as Very Strong

Fitch believes this rating factor very strongly supports the alignment of CdT's IDR with that of PAT through the high likelihood of PAT taking over CdT's liabilities if necessary to prevent its default, as CdT carries out near-governmental functions for PAT. CdT's limited liability status does not imply automatic transfer of liabilities to PAT by legal provisions should the former for any reason be subject to liquidation. The evolving national legislation on local and regional governments' (LRGs) companies subjects them to bankruptcy, despite a non-univocal interpretation by judges.

However, the high likelihood of liability transfer stems from the proximity to government functions as CdT borrows on PAT's behalf, and from April 2019 has been included in the Eurostat perimeter of Italy's and PAT's public sectors. CdT is fully owned, enabling PAT to appoint the board of directors; approve annual budgets, medium-term business plans and financial statements and retain control of strategic decisions and policy design. PAT's direction and control entails routine checks of the adherence of CdT's operations to provincial guidelines. In addition, CdT's creditors can enforce their rights against PAT, as per law provision, leading to ex-post legal transfer of liabilities.

Support Track Record and Expectations Assessed as Very Strong

Fitch believes this rating factor very strongly supports the alignment of CdT's IDR with that of PAT through the high likelihood of support provision to prevent default. PAT's most likely support channel is likely to be an increase in grants, one of the source of funds it receives from PAT for subsequent disbursement to municipalities and public sector entities subject to PAT's surveillance.

The assessment also reflects ongoing annuity transfers matching CdT's needs for interest and principal repayment, as CdT itself is not designed for profit generation. As an in-house provider of financial and consultancy services, Fitch believes PAT's support to CdT would not be hampered by EU state-aid rules while national legislation tends to allow for equity injections for loss-making GREs when part of a recovery plan.

Socio-Political Implications of Default Assessed as Moderate

Fitch assesses this factor as having a moderate contribution to the alignment of CdT's IDR with that of PAT. Fitch's assessment reflects CdT's relatively low visibility outside its strict operating range, which involves about a dozen investors in CdT's nearly EUR1 billion gross debt outstanding, the European Investment Bank (EIB) as a main bank lender and about one hundred borrowers/beneficiaries of PAT's resources.

While municipalities and provincial companies could switch to banks for borrowing, CdT is also an instrument for the implementation of other provincial policies. These range from the monitoring of aggregated public sector debt, to consultancy services, such as PPP implementation, and the disbursement of provincial funds to local cities and companies whose interruption, in case of CdT not functioning, may be somewhat disruptive for munis and PAT's subsidiaries, prompting support.

Financial Implications of Default Assessed as Strong, revised from Very Strong

Fitch assesses this factor as strongly contributing to the alignment of CdT's IDR with that of PAT, revised from "very strong" based on comparative analysis with peers. The assessment balances the perception of CdT as PAT's proxy funding agency, hence high damages to PAT's market borrowing capacity in case of default, with Fitch's expectations that the impact of CdT's default on PAT's borrowing capacity would be tackled by the ongoing policy role of Cassa Depositi and Prestiti (CDP; BBB-/Stable), Italy's government lending arm. CDP is required to fund Italy's local and regional governments uniformly, possibly regardless of CdT's default if not due to PAT's credit quality.

Operations

Fitch expects CdT's assets to rise towards EUR2.5 billion over the medium term, from EUR1.7 billion in 2019 and external/market debt for bonds and loans to rise towards EUR1.7 billion from EUR1.0 billion in 2019 as CDT incurs new borrowing also to fund PAT's spending and alleviate the disruptions of COVID-19 and phasing in spending to counter the fall in GDP.

Despite the alignment of interest rates embedded in PAT's assets/credits with CdT's borrowing market rates to limit net interest margin volatility, Fitch expects the average interest rate differential to be eroded by the likely growing cost of borrowing for Italian public sector entities. The agency factors in a reduction of the average credit spread towards 50bp by 2022 from 77bp in 2019.

Fitch anticipates CdT's net interest income to be around EUR15 million over the medium term and the ROE to decline towards 5% 2020-2022 from an average of 9% in 2016-2019. As CdT is only exposed to PAT, this translates into no provision for impairment loans.

DERIVATION SUMMARY

CdT's IDRs move in tandem with those of PAT amid a share of government guaranteed debt expected to remain close to 100%, a factor in itself triggering the equalisation while overriding the assessment of the GRE support factors.

Fitch also classifies CdT as a GRE of PAT under its GRE criteria and believes that PAT would provide extraordinary support to CdT to avoid its default.

KEY ASSUMPTIONS

Borrowing to continue to be assisted by PAT's guarantees for its large part

RATING SENSITIVITIES

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

An upgrade of PAT's IDR.

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

A downgrade of PAT, or substantial rise in non-guaranteed borrowing if not offset by a stronger assessment of the support rating factors currently yielding 35 points.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance 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.

LIQUIDITY AND DEBT STRUCTURE

Liquidity generated by operations is underpinned by liquid assets of about EUR450 million in 2019, not expected to fall below EUR250 million over the medium term.

Bullet EUR75 million bond due in 2027.

Amortising bonds for about EUR500 million; amortising loans for EUR300 million.

SUMMARY OF FINANCIAL ADJUSTMENTS

None

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

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

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Linked to the PAT.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Cassa del Trentino S.p.A.	LT IDR	BBB+	Downgrade
•	ST IDR	F1	Affirmed

ENTITY/DEBT	RATING		
•	LC LT IDR	BBB+	Downgrade
• senior unsecured	LT	BBB+	Downgrade

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Rating Criteria for International Local and Regional Governments (pub. 13 Sep 2019) (including rating assumption sensitivity)

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Cassa del Trentino S.p.A.	EU Issued

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