



RATING ACTION COMMENTARY

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

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Fitch Ratings - Paris - 09 Jun 2023: 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.

Puy-de-Dome's 'AA-' Long-Term IDR is based on the department's Standalone Credit Profile (SCP) of 'aa+' and is capped by France's Long-Term IDR (AA-/Stable). The SCP is driven by a 'High Midrange' risk profile and debt sustainability that Fitch assesses at the upper end of the 'aa' category under its rating case. No other rating factors affect the ratings. The Stable Outlook reflects that on the sovereign.

KEY RATING DRIVERS

Risk Profile: 'High Midrange'

Puy-de-Dome's key risk factors are assessed at 'Stronger' or 'Midrange'. The 'High Midrange' risk profile reflects a low risk relative to international peers that the department's ability to cover debt service by its operating balance may weaken unexpectedly over the forecast horizon (2023-2027) either because of lower-than-expected revenue or expenditure overshooting expectations, or because of an unanticipated rise in liabilities or debt-service requirements.

Revenue Robustness: 'Stronger'

Puy-de-Dome benefits from robust revenue, comprising growing predictable tax items, such as the tax on insurance contracts (14% of operating revenue in 2022) and a share of VAT (26%). VAT is linked to national consumption and Fitch considers a sustained decrease to be unlikely.

The department also receives stable revenues transferred by the French state, including transfers (27% of operating revenue in 2022) and the fuel tax (7%), the proceeds of which are mostly guaranteed by the state. Counterparty risk is low due to the high rating of the French state.

Property transfer duties (15% of operating revenue in 2022) are the main source of potential volatility in the medium term, as they are linked to real estate transactions. This volatility is reflected in our rating-case scenario assumptions.

Revenue Adjustability: 'Midrange'

Like other French departments, Puy-de-Dome's has limited fiscal flexibility. However, Fitch believes that French departments benefit from state support given their responsibility for public policies that are decided at the national level, especially social spending, and that they tend to receive greater financial support from the French state when costs increase. As a result, Fitch believes the loss of fiscal flexibility would make support from the state even more likely.

As the support mechanism from the state has been insufficient in the past to cover spending increases and does not benefit from a constitutional guarantee, the overall assessment for revenue adjustability is 'Midrange' and not 'Stronger'.

Expenditure Sustainability: 'Midrange'

Like other departments, a large share of Puy-de-Dome's expenditure is social spending that depends on national decisions, notably social spending, which constrains the department's capacity to control expenditure. This spending includes social benefits (17% of opex in 2022), a countercyclical item that tends to grow when unemployment rises.

Nevertheless, the department has demonstrated good control of opex in recent years, which grew 1.9% per year on average over 2017-2022, but at a lower pace than the operating revenue growth (2.1%).

Expenditure Adjustability: 'Midrange'

Puy-de-Dome's opex adjustability is limited. Opex mainly comprises mandatory transfers, especially social allocations (30% of opex in 2022, including social benefits) and social accommodation fees (25% of opex in 2022). Staff costs (22%) are also a rigid spending item as most of the department's employees have the status of civil servants. However, cost-cutting measures remain possible, as evidenced by good cost control in recent years.

The department has more flexibility over its capex (15% of total expenditure in 2022). 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-2022, the department's liabilities carried little risk as 52% of its debt was fixed-rate (post-swap) and 99.8% was deemed risk-free under national regulation (Gissler Charter). The department did not have short-term debt at end-2022. The amortisation profile is smooth with only a few peaks and an average annuity of EUR38 million over 2023-2027.

The department's off-balance-sheet liabilities (guarantees plus public-sector entities' debt) are sizeable, at 6.4x of the operating balance in 2022. However, 93% was related to the low-risk social housing sector, with the rest linked to the medical-social sector.

Liabilities & Liquidity Flexibility: 'Stronger'

Fitch views the framework for emergency liquidity support from the state as strong. This is evidenced by 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 state transfers of tax proceeds in advance 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 liquidity under various forms. Like other French LRGs, Puy-de-Dome has access to some institutional lenders, especially Caisse des Depots et Consignations (AA-/Stable), which may provide support in case of denied access to commercial banks or bond markets.

Debt Sustainability: 'aa category'

We assess Puy-de-Dome's debt sustainability at the upper end of the 'aa' category. Our rating case forecasts Puy-de-Dome's payback ratio to remain structurally below 6.0x over

2023-2027 (2022: 1.8x), debt service coverage (Fitch's synthetic calculation) in the 2x-4x range in 2025-2027 and a fiscal debt burden below 50%.

The department's operating balance is sound despite a decrease to EUR115 million in 2022 (representing 16% of operating revenue) from EUR120 million in 2021. This was due to an increase in goods and services (+17%), staff costs (+6%) and social accommodation fees (+9%).

Under our rating case, based on stressed assumptions, we expect the operating balance to decrease to EUR67 million by 2027, driven by higher social benefits, an increase in social accommodation fees (4%), rising staff costs (3%) and higher energy bills, as reflected in goods and services costs (3%). The projected decrease in the operating balance is also due to a cumulative 20% decrease in 2023-2024 of property transfer duties, reflecting the volatility of this revenue source.

In the rating case we expect net Fitch-adjusted debt to increase to EUR352 million in 2027, from EUR209 million in 2022, as the department aims to maintain high capex (on average EUR122 million per year), mostly for the renovation of secondary schools and road maintenance.

DERIVATION SUMMARY

Puy-de-Dome's department's 'aa+' SCP is driven by a 'High Midrange' risk profile and debt sustainability that Fitch assesses at the upper end of the 'aa' category under its rating case.

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'

Sovereign Cap (LT IDR): 'AA-'

Sovereign Cap (LT LC IDR) 'AA-'

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 2018-2022 figures and 2023-2027 projected ratios. The key assumptions for the scenario include:

- Operating revenue to increase 0.9% yoy, despite a decrease in property transfer duties in 2023 and 2024, of a cumulated 20%
- Operating expenses to increase 2.6% yoy
- A capital balance on average of -EUR99 million
- Cost of debt on average at 2.9%, which takes into account a 3.7% interest rate assumption on new debt

Liquidity and Debt Structure

Fitch-adjusted debt includes Puy-de-Dome's long-term financial debt (EUR268 million at end-2022, including EUR125 million of bonds and EUR143 million of bank debt), and the debt of the fire brigade (EUR32 million) included in 'other Fitch-classified debt'. The department did not have any short-term debt at end-2022. Net Fitch-adjusted debt (EUR209 million) corresponds to the difference between adjusted debt (EUR300 million)

and the year-end available cash viewed as unrestricted by Fitch (EUR91 million at end-2022).

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 (EUR37 million in 2022).

Issuer Profile

Puy-de-Dome is a French department located 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

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.

Discussion Note

Committee date: 7 June 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.

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 ⇅		PRIOR ⇅
Puy-de-Dome, Department of	LT IDR	AA- Rating Outlook Stable	AA- Rating Outlook Stable
	Affirmed		
	ST IDR	F1+ Affirmed	F1+

	LC LT IDR		AA- Rating Outlook Stable	AA- Rating Outlook Stable
			Affirmed	
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)

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Puy-de-Dome, Department of

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