

11 Oct 2019 | Affirmation

Fitch Affirms Ile-de-France at 'AA'; Outlook Stable

Fitch Ratings-Paris-11 October 2019:

Fitch Ratings has affirmed the Region of Ile-de-France's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'AA' with Stable Outlooks. Fitch has also affirmed the region's Short-Term Foreign-Currency IDR at 'F1+'. The long-term issues of Ile-de-France have been affirmed at 'AA'. Its EUR7 billion EMTN programme's ratings have been affirmed at 'AA' and 'F1+'. The region's EUR1 billion commercial paper programme (NEU CP) has been affirmed at 'F1+'.

The Stable Outlook reflects Fitch's expectation that Ile-de-France's net payback ratio (net adjusted debt / operating balance) will remain structurally below 7.5x in the medium term.

Ile-de-France is France's main political and economic centre and one of the EU's wealthiest regions. It has a population of 12.2 million, representing 18% of the national population. In 2017, GDP per capita was EUR58,300, or 194% of the EU average. Unemployment is below the French average (7.6% vs. 8.4% in 1Q19), but the poverty rate is higher (15.7% in 2016 vs. 14.7% in metropolitan France).

Key Rating Drivers

Ile-de-France's standalone credit profile (SCP) is assessed at 'aa+', reflecting a combination of a sound risk profile, assessed at 'High Midrange', and strong debt sustainability assessed in the upper end of the 'aa' category under Fitch's rating case scenario. Ile-de-France's ratings are capped by the sovereign (AA/Stable).

High Midrange Risk Profile

Fitch assesses Ile-de-France's risk profile at 'High Midrange', reflecting a favourable mix of Stronger and Midrange Attributes on the six key risk factors.

Revenue Robustness: Stronger

Ile-de-France's operating revenue is mostly made up of predictable and growing tax items. The levy on corporate-value added tax (CVAE; 20% of operating revenue in 2018) and the VAT (14%) are linked to GDP growth, while the fuel tax (31%) is mostly shielded from the economic cycle as a significant proceed level is guaranteed by the French state. Fitch views the region's potential revenue volatility as low in the medium term, and mainly linked to vehicle registration fees (11%) as they are linked to a specific market (vehicle purchases).

Revenue Flexibility: Midrange

Ile-de-France's fiscal flexibility is moderate as it is limited to vehicle registration fees. However, an increase of the tax rate to EUR60 (Fitch's assumed maximum rate for French regions), up from EUR46.15, would have increased operating revenue by 3% in 2018, which in Fitch's view would cover a reasonably expected

revenue decline by more than 100%. Fitch considers the affordability of additional taxation as strong as the additional tax bill would represent a marginal proportion of the region's inhabitants' average income.

Expenditure Sustainability: Stronger

Ile-de-France shows tight control of expenditure, resulting from strict budget planning. This is reflected by the continuous decline in operating expenditure in the last three years. The region also complies with the new prudential rules set by the French state, which cap its current expenditure growth at 1.14% a year in 2018-2020 (excluding some perimeter effects). The region's expenditure is mainly non-cyclical and unlikely to grow in an economic downturn. Vocational training (28% of operating spending in 2018) is probably the main cyclical item as the needs are likely to grow when unemployment rises. However, French regions have autonomy on this public policy, and the costs of large vocational training plans are usually covered by the French state.

Expenditure Flexibility: Midrange

Ile-de-France's operating expenditure is mainly made up of mandatory transfers, relative to transportation (31% of operating spending in 2018), vocational training (28%), or secondary education (11%). Staff costs (17%) are also rigid spending items as most of the region's employees have the status of civil servants. However, the region has a large capex programme (38% of total expenditure in 2018), which could be postponed or scaled down in case of need, although this flexibility is partially offset by the region's high capex needs, especially in terms of transportation and high-school infrastructures. We estimate the share of inflexible expenditure to be between 70% and 90%.

Liabilities and Liquidity Robustness: Stronger

Ile-de-France operates under a robust national and individual debt management framework. Its liabilities carry little risk. At end-2018, debt was 86% fixed rate and 100% was considered risk free by the national framework. Off-balance sheet liabilities are mostly made of Ile-de-France Mobilites, a public-sector entity in charge of public transportation in the region's territory. The region has 51% of the seats on the board of directors. Ile-de-France Mobilites' debt has increased sharply in recent years due to significant capital expenditure needs (end-2018: EUR1.9 billion) and we expect this rising trend to continue in the coming years. However, Fitch assesses Ile-de-France Mobilites' risk profile as sound. It is largely funded by the tax levy on transport and its mandates are not subject to competition.

Liabilities and Liquidity Flexibility: Stronger

The region has strong access to liquidity under various forms. It has access to institutional lenders such as Caisse des Depots et Consignations (AA/Stable) like all French LRGs, and also used credit lines from the European Bank of Investment (AAA/Stable) in 2019. It benefits also from a EUR587 million revolving line with a bank rated 'A+', which is mainly used as back-up line for the commercial paper programme.

Debt Sustainability: 'aa' category

This assessment reflects a net payback ratio expected to remain below 6x in the medium term in our rating case scenario (2018: 5.1x), in the upper end of the 'aa' category, and a synthetic coverage ratio expected to remain above 2x.

Ile-de-France's budgetary performance is strong. Operating balance increased sharply to EUR1.087 billion in 2018, from EUR691 million in 2014, as a result of growing tax revenue and a decline in operating spending. This allowed the region to self-finance a large share of capital expenditure in recent years. The operating balance is likely to increase further to around EUR1.3 billion in 2019, and we expect it remain above EUR1 billion in the coming years in our rating case scenario.

The region's net adjusted debt was EUR5.7 billion at end-2018, but is likely to decrease to around EUR5.3 billion at end-2019, below its 2015 level. In our rating case scenario, we expect it to increase to EUR6.4 billion at end-2023 as the region aims to implement a large capex programme (close to EUR1.9 billion per year expected in the coming years, representing 40% of total expenditure, compared with EUR1.6 billion a year on average in 2014-2018).

Derivation Summary

Based on the risk profile assessment and debt sustainability metrics, Fitch assesses the region of Ile-de-France's SCP at 'aa+'. The region's SCP is above the sovereign rating. As a result, Ile-de-France's Long-Term IDRs are capped by the sovereign. No other rating factor affects the ratings.

Key Assumptions

Fitch's rating case scenario is a "through-the-cycle" scenario, which incorporates a combination of revenue and financial risk stresses. It is based on 2014-2018 figures and 2019-2022 projected ratios. The key assumptions for the scenario include:

- 0.7% annual growth in operating revenue in 2019-2023, which includes the following items: removal of the apprenticeship tax and related revenue as of 2020; 1.7% a year growth of VAT proceeds and 1.4% growth of CVAE proceeds as of 2020;
- 1.1% annual growth in operating expenditure in 2019-2023;
- a capital balance of -EUR1.1 billion on average in 2019-2023;
- close to EUR200 million of sales of assets revenue in 2020;
- a 2.2% cost of debt and 15-year maturity for new debt, significantly above the current market conditions.

RATING SENSITIVITIES

Positive rating action could result from an upgrade of the sovereign, provided that the net payback ratio remains below 6x on a sustained basis in our rating case scenario.

Ile-de-France's long-term ratings could be downgraded if the region's net payback ratio exceeds 7.5x on a sustained basis in our rating case scenario. This could happen if the growth of operating expenditure sustainably exceeds the current plans and is not matched by an equivalent increase in operating revenue. A downgrade of the sovereign would also be reflected in the region's ratings.

Liquidity and Debt Structure

Fitch-adjusted debt includes the region's short-term debt (EUR500 million at end-2018) and long-term debt (EUR5.660 billion at end-2018). Fitch-net adjusted debt corresponds to the difference between Fitch-adjusted debt and the cash at the end of the year considered as unrestricted by Fitch (EUR591 million at end-2018).

Summary of Financial Adjustments

Fitch considers the transfers by the region to offset the amount of CVAE proceeds it received as lower revenue rather than additional expenditure. These transfers include a transfer made to the state for the other regions (fonds national de garantie individuelle des ressources; EUR674.8 million in 2018), the equalisation funds (EUR115.7 million), and the transfer to the Ile-de-France departments to compensate for the doubling of CVAE regional share proceeds as of 2017 (EUR1,372 million).

Fitch believes these restatements allow a meaningful comparison with other LRGs. They are neutral for Ile-de-France's operating balance, and so also for the payback and coverage assessment. However, they reduce the level of operating revenue and are negative on the fiscal debt burden assessment (net adjusted debt/operating revenue).

ESG Considerations

ESG credit relevant is a score of 3, meaning that ESG issued are credit neutral. Given the missions of the issuer and the institutional framework, these issues are minimally relevant to the rating.

Ile-de-France, Region of; Long Term Issuer Default Rating; Affirmed; AA; RO:Sta
 ----; Short Term Issuer Default Rating; Affirmed; F1+
 ----; Local Currency Long Term Issuer Default Rating; Affirmed; AA; RO:Sta
 ----senior unsecured; Long Term Rating; Affirmed; AA
 ----senior unsecured; Short Term Rating; Affirmed; F1+

Contacts:

Primary Rating Analyst

Pierre Charpentier,
Associate Director
+33 1 44 29 91 45
Fitch France S.A.S.
60 rue de Monceau
Paris 75008

Secondary Rating Analyst

Christophe Parisot,
Managing Director
+33 1 44 29 91 34

Committee Chairperson

Vladimir Redkin,
Senior Director
+7 495 956 2405

Media Relations: Athos Larkou, London, Tel: +44 20 3530 1549, Email: athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

[Rating Criteria for International Local and Regional Governments \(pub. 13 Sep 2019\)](#)

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