Research:

Return to Regular Format

Industry Report Card: Italian Regional Governments

Publication date: 03-Nov-2004

Primary Credit Analyst(s):
Myriam Fernandez deHeredia, Madrid (34) 91-389-6942; myriam_fernandez@standardandpoors.com
Vittoria Ferraris, Milan (39) 02-72111-214; vittoria_ferraris@standardandpoors.com
Massimo Visconti, Milan (39) 02-72111-206; massimo_visconti@standardandpoors.com
Bertrand de Dianous, Milan (39) 02-72111-266; bertrand_dedianous@standardandpoors.com
Alexandra Dimitrijevic, Paris (33) 1-4420-6663; alexandra_dimitrijevic@standardandpoors.com

Commentary/Key Trends

We currently rate 10 Italian regions, all located in northern and central Italy. The rating spread has reduced in 2004, due to the rating actions that followed the downgrade of the Republic of Italy (AA-/Stable/A-1+) earlier this year. Ratings on Italian regions now range between 'AA-' and 'A', reflecting satisfactory overall credit quality.

The low rating differential, despite the divergence in the financial and economic standing of the 10 rated regions, is mainly a reflection of the Italian regional governments' financing system and expenditure structure. With a budget concentrated mainly on health care (which accounts for 65%-80% of regional revenues), and the funding for health care related expenditures linked primarily to non-economic-driven factors, there is little room for a larger rating differential. As ratings coverage is extended to regions in the south of the country we expect a more diversified credit landscape, although sub-investment-grade ratings are unlikely.

The outlook on all Italian rated regions is stable, reflecting our expectation that there will be no significant changes to the regions' credit profile over the next two years. Debt is still modest, and financing requirements for investment purposes are not likely to increase significantly. For some regions, however, tax-supporting debt is trending upward due to the need to tackle long payment delays from suppliers at the local health care units (Aziende Sanitarie Locali) level. Regions are increasingly using debt-like instruments to finance the health care funding gap. We consider these instruments, ultimately paid for by regional resources, as regional tax-supported debt.

Looking further ahead, decisions on the funding of health care costs over the next few years, together with the progress of the devolution process and its related financing, will largely determine the evolution of the Italian regions' finances, and consequently of their creditworthiness, in the medium term.

A favorable funding mechanism for health care, with increased funding for the overall health care system and a sufficiently generous indexation rate, would probably mean a structural reduction in health care deficits for all Italian regions in the medium term, and the opportunity for the most ailing to tackle liquidity problems at their health care units. Any increase in the regions' financial autonomy would also be key to curtailing the health care funding gap. In all scenarios, however, deficit reduction will be challenged by the structural growth of health care expenditures, driven by pharmaceuticals, the national demographic trend, and wage renegotiations.

We maintain our criteria of not rating any Italian regional or local governments above the sovereign. The recent announcement by the central government of the maintenance of the tax freeze in 2005 reinforces this approach. The regions' financial autonomy and taxing powers remain constrained because the government is still able to take unilateral decisions that affect regional fiscal policy.

Issuer Review

Table 1 Italian Regions		
Comments	**Country**	**Analyst**
Abruzzo (A/Stable/--)		
Abruzzo posted higher-than-expected health care expenditure in 2003, amounting to 7% of its operating revenues, one of the highest of the rated regions. Abruzzo's health care deficit should continue to trend downward in 2004, owing to the rationalization measures implemented by the regions, although it is likely to remain above the average deficit. Regional direct debt is low, forecast at less than 40% of operating revenues for year-end 2004. Tax-supported debt, however, is likely to trend upward over the next few months because of the need to tackle cash strains at the health care units level.	Italy	Bertrand de Dianous
Emilia-Romagna (AA-/Stable/--)		
The rating on Emilia-Romagna is constrained by that on the Republic of Italy, which reflects a framework of intergovernmental relationships that permits the central government to take unilateral measures that can have an impact on the region's fiscal policy and that curtails the region's financial and taxing autonomy. Emilia-Romagna's own credit fundamentals are robust: health care deficits are below €100 million (1.3% of operating revenues), and financing requirements are modest. Debt is low, forecast at	Italy	Vittoria Ferraris

less than 30% of operating revenues for year-end 2004. The region's economy is among Italy's most developed, and the unemployment rate is low.		
Friuli-Venezia Giulia (AA-/Stable/--)		
The rating on Friuli-Venezia Giulia is constrained by that on the Republic of Italy. Friuli's special status provides the region with a more diversified revenue and expenditure structure than its normal-status counterparts. This allows the region to post robust operating margins (more than 20% of operating revenues in 2003) and limits its financing requirements. Health care deficits are under control. The region has a low debt burden, which should remain below 40% of operating revenues over the next few years.	Italy	Massimo Visconti
Lazio (A/Stable/--)		
Lazio shows recurrent high health care deficits. Although these have reduced over the past few years, they remain a burden for the region and have a negative impact on financial flexibility and tax-supported debt. Structural measures taken at both national and regional levels should help to further reduce health care deficits, ease liquidity tensions at the health care units, and stabilize tax-supported debt in the medium term.	Italy	Vittoria Ferraris
Liguria (AA-/Stable/--)		
The region has managed to control health care deficits over the past few years, leading to a low debt burden, forecast at about 36% of operating revenues for year-end 2005 (of which only 12% at the charge of the region, the rest being serviced by the state). Cost-control measures and additional resources expected from the central government to finance health care costs should compensate for the high pressure from Liguria's aging population. Financing needs for investments are low. Capital expenditures are chiefly funded by the state and the EU.	Italy	Vittoria Ferraris
Lombardy (AA-/Stable/--)		
The rating on Lombardy is constrained by that on the Republic of Italy. Lombardy has low tax-supported debt, forecast at less than 20% of revenues for year-end 2004, manageable health care deficits of less than 2% of operating revenues, and a very developed economy. These supportive credit factors are not likely to change over the next few years.	Italy	Alexandra Dimitrijevic
Marches (AA-/Stable/--)		
As a result of an active tax policy prior to the freeze on regional taxes, Marches is progressively curtailing its health care deficit to less than €100 million per year (about 3% of		

operating revenues). The region's direct debt, forecast at less than 40% of operating revenues for year-end 2004, is not likely to gr+A23ow significantly over the next few+A24 years, given that most investments are financed by the state or the EU.	Italy	Bertrand de Dianous
Tuscany (AA-/Stable/--)		
The rating on Tuscany is constrained by that on the Republic of Italy. Tuscany's credit fundamentals are robust, with good health care management (there have been no health care deficits since 2001), low debt, and a robust economy. These fundamentals are unlikely to change over the next few years.	Italy	Massimo Visconti
Umbría (AA-/Stable/--)		
Umbria's credit fundamentals are robust, with low health care deficits, low financing requirements for investments, and a low debt burden (forecast at less than 30% of operating revenues for year-end 2004). With prudent management, the region's financial performance should remain robust, although debt is likely to increase in the medium term. Most of Umbria's investment needs are being funded by the state, through a special program for the reconstruction of damages after the 1997 earthquake that severely hit the region.	Italy	Bertrand de Dianous
Valle d'Aosta (AA-/Stable/--)		
The rating on Valle d'Aosta is constrained by that on the Republic of Italy. The region's financial standing is expected to remain robust over the next few years, with high operating surpluses and modest deficits after capital expenditures. Its budget structure--with no single sector representing more than 30% of the expenditure budget--and its diversified revenue sources provide this small northern region with greater flexibility than that of its normal-status counterparts. Debt is modest and should remain below 50% of operating expenditures over the next few years. Valle d'Aosta's health care sector is relatively strong and does not represent a significant liability for the region.	Italy	Bertrand de Dianous
*Ratings are as of Nov. 3, 2004.		

Recent Rating/Outlook/CreditWatch Actions

Recent rating actions on Italian regions are primarily linked to the downgrade of the Republic of Italy on July 7, 2004. Only two of the negative rating actions taken, the downgrade of Lazio and the outlook revision on Abruzzo to stable from positive, are linked to revenue and expenditure mismatches in health care. The remaining regions, although operating within a constrained environment, continue to manage rapidly growing health care costs and scarce financial resources relatively well, and are controlling costs through a variety of instruments, both structural and one-off.

Table 2 Recent Rating/Outlook/CreditWatch Actions*				
Issuer	**To**	**From**	**Date**	**Reason**
Abruzzo	A/Stable/--	A/Positive/--	Oct. 26, 2004	The outlook revision reflects higher-than-expected health care deficits, slow structural reforms in health care, and increasing tax-supported debt.
Emilia-Romagna	AA-/Stable/--	AA/Negative/--	7-Jul-04	The ratings were lowered following the downgrade of the Republic of Italy.
Friuli-Venezia Giulia	AA-/Stable/--	AA/Negative/--	7-Jul-04	The ratings were lowered following the downgrade of the Republic of Italy.
Lazio	A/Stable/--	A+/Negative/--	Sept. 3, 2004	The downgrade resulted from higher-than-expected health care deficits and increasing tax-supported debt.
Lombardy	AA-/Stable/--	AA/Negative/--	7-Jul-04	The ratings were lowered following the downgrade of the Republic of Italy.
Tuscany	AA-/Stable/--	AA/Negative/--	7-Jul-04	The ratings were lowered following the downgrade of the Republic of Italy.
Valle d'Aosta	AA-/Stable/--	AA/Negative/--	7-Jul-04	The ratings were lowered following the downgrade of the Republic of Italy.
*Actions taken since the last report card dated Jan. 15, 2004.				

Selected Articles

Table 3 Previously Published Related Articles*	
Article title	**Publication date**
Overview of Italian Public Sector Structured Transactions	Oct. 28, 2004
Debt-like Obligations Help Italian Local and Regional Governments Raise Funds	Jul. 26, 2004
Italy Country Report: Fiscal Coordination and Rating Implications	March 22, 2004
New Debt Guidelines for Italian Local and Regional Governments Viewed Positively	Feb. 9, 2004
*Articles are available to subscribers of RatingsDirect, Standard & Poor's Web-based	

credit analysis system, at www.ratingsdirect.com.

Contact Information

Table 4 Contact Information			
Credit analyst	**Location**	**Telephone**	**E-mail***
Bertrand de Dianous, rating analyst	Milan	(39) 02-72111-266	bertrand_de_dianous@standardandpoors.com
Alexandra Dimitrijevic, director	Paris	(33) 1-4420-6663	alexandra_dimitrijevic@standardandpoors.com
Myriam Fernández de Heredia, director	Madrid	(34) 91-389-6942	myriam_fernandez@standardandpoors.com
Vittoria Ferraris, associate director	Milan	(39) 02-72111-214	vittoria_ferraris@standardandpoors.com
Massimo Visconti, rating specialist	Milan	(39) 02-72111-206	massimo_visconti@standardandpoors.com
*Group E-Mail Address: PublicFinanceEurope@standardandpoors.com			