



RATING ACTION COMMENTARY

Fitch Affirms Romanian 5th District of Bucharest at 'BBB-'; Outlook Negative

Fri 15 May, 2020 - 4:13 PM ET

Fitch Ratings - Frankfurt am Main - 15 May 2020: Fitch Ratings has affirmed the Romanian 5th District of Bucharest's (5th District) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BBB-' with Negative Outlooks. A full list of rating actions is detailed below.

The affirmation reflects Fitch's view that the 5th District's operating performance and debt ratios will remain in line with 'BBB-' rated peers' over the medium term, despite an expected economic downturn triggered by the coronavirus pandemic. Fitch assesses the 5th District's Standalone Credit Profile (SCP) at 'bbb'. The Negative Outlook reflects that of Romania (BBB-/Negative/F3).

While the 5th District's most recently available 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 base- and rating-case qualitative and quantitative inputs based on performance expectations and assessment of key risks.

KEY RATING DRIVERS

Risk Profile: 'Low Midrange'

The 'Low Midrange' risk profile reflects a combination of four 'Midrange' key risk factors and two other 'Weaker' key risk factors.

Revenue (Robustness) Assessed as 'Midrange'

Fitch assesses the 5th District's revenue robustness as 'Midrange' in view of stable revenue sources with revenue growth prospects that are in line with domestic nominal and deflated GDP growth. The district's local economy is diversified with no employment concentration.

The 5th District relies on a stable tax base, consisting of personal income and property taxes, which accounted for 60% of the district's operating revenue in 2019. Majority of the district's tax revenue is from personal income tax collected locally but rates are set by the central government, which is common among Romanian LRGs. Despite a difficult operating environment for Romanian LRGs, we assume stable growth prospects for the district's tax revenue.

Property taxes accounted for 15% of operating revenue. Following improvements in property evaluation and collections, property tax revenue has grown consistently in recent years and become less volatile.

Current transfers from the central government accounted for 36% of the 5th District's operating revenue in 2019, making it an important contributor to the city's operating revenue. The transfers are driven by redistributed VAT shares and have increased in recent years. We expect the share of transfers to remain stable for the next four years, in line with the administration's expectations. However, they are difficult to budget for Romanian local governments, as they depend on collections and are subject to distribution from the central government.

Revenue (Adjustability) Assessed as 'Weaker'

This assessment reflects the district's limited ability to generate additional revenue, in line with our assessment for all other rated Romanian LRGs, since tax rates are set by the central government, which significantly limits LRGs' flexibility in adjusting taxes.

The 5th District has some flexibility on local taxes and property charges and fees, which together accounted for 18% of operating revenue in 2019. However, we expect such additional leeway to cover less than 50% of a reasonable decline of revenues in an economic downswing. The 5th District also has a low affordability of additional taxation, which could result in negative public repercussions and political tensions. Financial equalisation is of lower importance in Romania than France or Germany.

Expenditure (Sustainability) Assessed as 'Midrange'

Fitch assesses the district's expenditure sustainability as 'Midrange', in line with the all other Fitch rated Romanian municipalities'. The 5th District's main responsibilities are non-cyclical, including social assistance, public services, sports and culture, public institutions and municipal services.

The 5th District's operating expenditure has grown generally in line with operating revenue growth, which resulted in stable operating margins, although operating revenue for the past four years fell at a faster rate than operating expenses (4Y average: -7% vs. -0.2%).

The 5th District's capex is dependent on availability of feasible funding, such as the local budget, non-reimbursable or reimbursable national and international funds and EU grants. The 5th District has flexibility to postpone investments in case of need.

Expenditure (Adjustability) Assessed as 'Midrange'

Fitch assesses the 5th District's ability to reduce spending in response to shrinking revenue as 'Midrange'. The 5th District can reduce part of its capex, given its high share of total expenditure. Capex is volatile, ranging between 4% and 25% in 2015-2019 of total expenditure. The city has no history of cutting back operating expenditure. The 'Midrange' assessment is also supported by balanced-budget rules in place. LRG's budgets are approved by the central government and are not allowed to run deficits.

We view the spending flexibility of mandatory responsibilities as limited.

Liabilities and Liquidity (Robustness) Assessed as 'Midrange'

The central government has established prudential borrowing limits, including an annual debt service limit at no more than 30% of the last three years' average of own revenues and restrictions on high-risk loan types and derivatives. The 5th

District has remained well below the annual debt service limit at 8% in 2019. It is further supported by an entirely amortising debt structure, the absence of short-term debt and moderate market access. Annual debt repayments for 2020-2033 were under 25% of its total debt at end-2019. Its cash balance covered annual debt service by 0.6x in 2019. The district is not exposed to FX risk. This, together with a lower-risk debt structure than other Romanian LRGs', results in a 'Midrange' assessment.

Liabilities and Liquidity Framework (Flexibility) Assessed as 'Weaker'

Fitch assesses the 5th District's liquidity framework as 'Weaker' since there is no emergency liquidity support from upper tiers of the government. However, the 5th District has ample access to the State Treasury and a moderate amount of liquidity available. The latter has allowed the district to finance its capex without the need for new debt. Our rating case expects the liquidity coverage ratio to remain stable. Investment plans will only be realised based on availability of funding. Fitch assumes no new net debt until 2024.

Debt Sustainability Assessment: 'aa'

Under our Rating Criteria for LRGs Fitch classifies the 5th District - as with all other Romanian LRGs - as type B as it covers debt service from its cash flow on an annual basis.

Fitch has revised its rating-case assumptions to factor in the expected economic downturn triggered by the coronavirus pandemic. Under our revised rating case for 2020-2024, Fitch projects the 5th District's debt payback ratio (net adjusted debt to operating balance), which is the primary metric of debt sustainability for Type B LRGs, to remain little changed at 4.2x in 2024 versus 4.1x in 2019, and below our 5x threshold for a 'aaa' assessment.

Fitch's rating case projects that the district's fiscal debt burden will improve, following a decrease of debt, to 92.2% in 2024 from about 125% in 2019, corresponding to a 'aa' assessment (Fitch assumes redemption payments for 2020-2024). This is supported by a still strong synthetic debt service coverage ratio (SDSCR) of about 2.7x, little changed from 2.8x in 2019, also corresponding to a 'aa' assessment. All three metrics result in an overall 'aa' debt sustainability.

DERIVATION SUMMARY

The district's IDRs are capped by the Romanian sovereign IDRs. The 'bbb' SCP reflects a combination of 'Low Midrange' risk profile and a 'aa' debt sustainability assessment. The SCP also factors in peer comparison. The city's IDRs are not affected by any other rating factors, but are constrained by the sovereign's IDRs.

KEY ASSUMPTIONS

Qualitative assumptions and assessments:

Risk Profile: Low Midrange

Revenue Robustness: Midrange

Revenue Adjustability: Weaker

Expenditure Sustainability: Midrange

Expenditure Adjustability: Midrange

Liabilities and Liquidity Robustness: Midrange

Liabilities and Liquidity Flexibility: Weaker

Debt sustainability: 'aa' category

Support: N/A

Asymmetric Risk: N/A

Quantitative assumptions - issuer-specific

Base-case assumptions (based on 2015-2019 figures and 2020-2024 projected ratios)

- Growth of tax revenue by 2% in 2020 and in line with assumed real GDP growth in 2021-2024

- Operating revenue (excluding tax revenue) to grow in line with expected inflation

- Operating expenditure to grow in line with expected inflation

- Capex of RON100 million annually in 2020-2024, above the last five-year average (RON64 million)

Fitch's rating case is a 'through-the-cycle' scenario, which incorporates a combination of revenue, cost and financial risk stresses.

The key assumptions for the rating case include (compared with the base case):

- Stress of tax revenue by -2pp in 2020 and -1pp annually in 2021-2024
- Operating revenue (excluding tax revenue) additionally stressed by -2pp in 2020 only
- Stress of operating expenditure by an additional 3pp in 2020 and 1pp annually in 2021-2024 to reflect higher operating expenditure growth in the rating case
- Debt to decline at a slower rate than the district's expectations, to remain within balanced budget rules and corresponding increase of interest payments in line with projected debt growth

RATING SENSITIVITIES

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

- A downgrade of Romania's IDRs.
- Downward revision of SCP by three notches, which could occur if the 5th District's debt metrics sustainably weaken with a debt payback ratio exceeding 9x under Fitch's rating case.

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

- An upgrade of Romania's IDRs or Outlook revision to Stable.

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>.

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.

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		
5th District of Bucharest	LT IDR	BBB-	Affirmed
●	ST IDR	F3	Affirmed
●	LC LT IDR	BBB-	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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Additional information is available on www.fitchratings.com**APPLICABLE CRITERIA**[Rating Criteria for International Local and Regional Governments \(pub. 13 Sep 2019\) \(including rating assumption sensitivity\)](#)**ADDITIONAL DISCLOSURES**[Dodd-Frank Rating Information Disclosure Form](#)[Solicitation Status](#)[Endorsement Policy](#)**ENDORSEMENT STATUS**

5th District of Bucharest

EU Issued

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Romania

