FITCH REVISES AUTONOMOUS REGION OF SARDINIA'S OUTLOOK TO STABLE; AFFIRMS AT 'A-'

Link to Fitch Ratings' Report: Autonomous Region of Sardinia - Rating Action Report
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=864140

Fitch Ratings-Milan/Paris/London-27 March 2015: Fitch Ratings has revised the Autonomous Region of Sardinia's Outlook to Stable from Negative and affirmed the Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'A-' and its Short-term foreign currency IDR at 'F2'.

KEY RATING DRIVERS

The revision of the Outlook reflects Fitch's expectations that the region's debt will continue declining with stable operating performance fully covering debt service requirements. The ratings also take into account the region's revenue resilience, which we expect to benefit from the administration's initiatives to support economic recovery.

The rating action reflects the following rating drivers and their relative weights:

High:

Debt: Fitch expects Sardinia to borrow about EUR500m in the medium term to support its investment programme. Due to early redemption of costly loans, however, total debt is expected to keep declining towards EUR1bn in the medium term (from EUR2bn in 2011). We expect the debt burden to remain around 25% of revenue and debt servicing requirements (including early repayments) to remain at 4%-5% of the regional budget. Debt coverage by the current balance, or debt payback, is forecast to stabilise at around three years.

Medium:

Management: Fitch believes that the administration will foster private as well as EU capital investments (the latter expected to amount EUR500m in 2015) by partly funding new projects, and partly through wider involvement of the regional development agency SFIRS. Nevertheless, Fitch believes that this will not translate into higher overall liabilities.

Investments will remain focused on upgrading the region's infrastructure (ports, airports and high-speed roads), on extraordinary maintenance of school facilities as well as on information technology projects and R&D, aimed at supporting tourism and at tackling demographic outflows.

Economy: To spur the region's economic recovery, the administration approved a permanent 25% cut to business tax - IRAP - for corporations, while exempting newly established enterprises from tax for five years. Fitch believes that this should help Sardinia to come out of recession (-1% in 2014; -2.7% in 2013), with an expected 0.5% growth in 2016. The oil refinery, green energy, construction and tourism sectors should contribute to stabilising the employment rate at around 50%, and to reducing unemployment towards 15% while supporting domestic consumption. This in turn should support tax revenue, which Fitch expects to rise above EUR6.5bn over the medium term.

Sardinia's ratings also reflect the following rating drivers:

Institutional Framework: Sardinia is eligible to be rated above the sovereign by virtue of its institutional strength and high degree of financial autonomy. Sardinia's special autonomous status entitles it to receive fixed regional shares of major national taxes, ranging from 90% of VAT to 70% of personal income tax (PIT), while the Italian Constitution shields these features from the risk of unilateral decisions by the state regarding revenue and spending responsibilities. Fitch does not expect this statute of autonomy to change in the foreseeable future.

However, Fitch assesses Italian inter-governmental relations as neutral for Sardinia's ratings as the region remains obliged in its contribution to Italy's fiscal budget consolidation. For example, the region's proceeds from VAT increases in 2012 were reclaimed by the national government for its budget.

Fiscal performance: According to 2014 preliminary figures, the region posted an operating margin of about 6.5%, roughly in line with Fitch's expectation of 7.5%. Due to a more diversified mix of revenue and responsibilities compared with ordinary Italian regions, Sardinia's revenue growth should absorb rising spending for social care/security.

Fitch expects the region's operating performance to remain stable, fully covering debt servicing requirements. Due to active management of EU funds, in tandem with investment commitments cutbacks, the region has managed to post a balanced budget and overcome its traditional fund balance deficit since 2013.

RATING SENSITIVITIES

An upgrade would be contingent on an operating margin consistently above Fitch's projections of about 7%, coupled with a rise in socio-economic indicators towards EU average, supporting budget flexibility.

A downgrade could stem from a prolonged economic downturn or economic shock with unemployment rate rising above 20%, jeopardising tax revenue generation. A structural decline of the operating margin below 5% amid debt rising above Fitch's projections could also lead to a downgrade.

Contact:

Primary Analyst
Sergio Ciaramella
Director
+39 02 87 90 87 216
Fitch Italia - Societa Italiana per il Rating S.p.A.
Via Morigi, 6 - Ingresso Via Privata Maria Teresa, 8
20123 Milan

Secondary Analyst
Raffaele Carnevale
Senior Director
+39 02 87 90 87 203

Committee Chairperson
Christophe Parisot
Managing Director
+33 1 44 29 91 34

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549, Email: athos.larkou@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable criteria 'Tax-Supported Rating Criteria' dated 14 August 2012, 'International Local and Regional Governments Rating Criteria ' dated 23 April 2014 are available at www.fitchratings.com.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
International Local and Regional Governments Rating Criteria - Outside the United States
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=719656