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RATING ACTION COMMENTARY

Fitch Rates Romanian Cluj County at 'BBB-', Outlook Stable

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Fitch Ratings - Warsaw - 04 Oct 2023: Fitch Ratings has assigned Romanian Cluj County Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) of 'BBB-' with Stable Outlooks. A full list of rating actions is below.

Cluj County's ratings reflect Fitch's view that the county's operating performance and debt ratios will remain in line with peers with 'aa' category debt sustainability over the medium term. This is despite pressures on its budget stemming from increasing prices, continued macroeconomic spill over from the war in Ukraine and the implementation of an ambitious investment plan.

Fitch assesses the county's Standalone Credit Profile (SCP) at 'a', reflecting a combination of 'Midrange' risk profile and 'aa' debt sustainability. The county's IDRs are constrained by the sovereign (Romania; BBB-/Stable) and capped at 'BBB-'.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

The assessment of the six key risk factors reflects Fitch's view that there is a moderately low risk of the issuer's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon (2023-2027), due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt-service requirements.

Revenue Robustness: 'Midrange'

The county has stable revenue sources with revenue growth prospects in line with national GDP growth. Tax and fees revenue accounted for 70% of county's operating revenue in 2022, driven by moderately cyclical economic activities. Personal income tax (PIT) accounts for a high almost 64% of operating revenue (after the central government increased the share to 15% from 13%), while local taxes and fees make up less than 6%, driven by revenue from county property, rents and concessions, and to a lesser extent, tax on vehicles.

Revenue Adjustability: 'Midrange'

We assess Cluj's ability to generate additional revenue in response to possible economic downturns as 'Midrange' in view of the equalisation scheme for Romanian local and regional governments (LRG), which is much more meaningful for counties than municipalities. The county has benefited from the equalisation transfers, especially in 2018-2019 after the PIT tax rate cut, when on average 31% of PIT revenue received by the county was obtained though the equalisation scheme.

Like other Romanian LRGs, the county has limited tax-revenue-raising flexibility, as income tax rates are determined by the state, as are the majority of current transfers. The county has some flexibility on charges and fees and concessions, which together account for less than 6% of operating revenue.

Expenditure Sustainability: 'Midrange'

This assessment is in line with all Fitch-rated Romanian LRGs. The county's main responsibilities are non-cyclical, including social assistance, road infrastructure maintenance and health unit administration. The county has a record of moderate control of operating expenditure growth. Its operating expenditure has generally moved in line with operating revenue, which has resulted in a sound operating balance, accounting on average for over 20% of operating revenue in 2018-2022. The county's capex is linked to the availability of EU or state budget investment grants and has a proven record of postponing investments in case funding is not ensured.

The county is implementing an ambitious investment plan during 2017-2026, with a total RON1,510 million of capital spending, financed via non-reimbursable investment grants in 53% (38% from the EU and 15% from the state budget). The investment plan covers investments in public roads (60%), solid waste (24%), health (8%) and education and heritage (3% each). During further investments under the 2021-2027 EU programming period, the county intends to increase its investment programme by RON3.8 billion, with a focus on building healthcare units (78% of planned capex), and road infrastructure (13%). The timing and scope will depend on the availability of non-reimbursable grants from the EU and state budget.

Expenditure Adjustability: 'Stronger'

The county has high spending flexibility, which is reflected in a low share of staff costs in its budget (on average below 20% of total in 2018-2022) and a high share of capex in total spending (on average 38% in 2018-2022). Cluj could cut its operating expenditure on road maintenance and repairs, as well as on the county's heritage and cultural events, among others. The county could also postpone some of its investments or partially scale them back, especially those not co-financed by the EU.

The share of capex in the total budget has been high, at above 30% of the total expenditure in the past four years and exceeded 50% in 2022. As the majority (76%) of the investments under the county's current plan is co-financed with EU investment grants from the 2017-2020 multiannual framework, final qualifiable payments must be executed by the end of 2023. Consequently, we expect the share of capex to total expenditure to remain high in 2023. In the medium term, Fitch expects the share of capex to remain above 40%, as the county will be rolling out investments under the new EU budget for 2021-2027.

Liabilities & Liquidity Robustness: 'Midrange'

Fitch assesses the county's individual framework for debt, liquidity and off-balance sheet management as 'Midrange (similar to other rated LRGs in Romania). The national framework is supportive of liabilities' robustness and the central government has established prudential borrowing limits (local governments in Romania need to comply with a debt servicing limit). Annual debt service is not allowed to exceed 30% of the last three years' average of own revenues, with Cluj having substantial headroom. There are further restrictions on high-risk loan types and derivatives.

The county has an entirely amortising debt structure, with debt repayments not exceeding 10% of debt outstanding at end-2022, no short-term debt, and high liquidity, which covered about 3x total debt servicing in 2022. However, all of the county's debt has floating interest rates, which exposes it to interest-rate risk. The county currently has no exposure to foreign-exchange risk.

The county's public sector is limited and consists of six majority-owned companies that provide services in regional airport management, water and sewage management, real estate management, conference center and regional agro marketing activities. The county controls the boards and approves the budgets. Its contingent liabilities relate mainly to debt at the airport company and the water company, but the county's risk is limited to the extent of the paid in capital. The county has extended guarantees (2022: RON50 million) to some of the entities' debt. However, as both companies are profitable, they are servicing their own debt.

The county's government-related entity financial plans envisage a debt increase, especially at the airport company. However, the extent will depend on the availability of non-reimbursable grants from the EU and the state budget.

Liabilities & Liquidity Flexibility: 'Midrange'

There is no emergency liquidity support from upper tiers of government but Cluj has access to the state Treasury and had a high amount of liquidity with the monthly account balance averaging RON44 million in 2022, covering debt service scheduled for 2022 by 3x. The county has historically had good liquidity, with liquidity coverage ratio averaging over 9x in the past three years.

Debt Sustainability: 'aa category'

Under our rating-case scenario, we expect the payback ratio to average just above 6x in 2025-2027 ('aa' debt sustainability category), from low 1.4x in 2022. The coverage ratio (synthetic calculation) will be above the 1.7x average ('a' debt sustainability category) and the fiscal debt burden will increase following investments but remain below 100% on average in 2025-2027 (2022: 40%).

The county's 2020-2022 fiscal performance was resilient to the pandemic, as its operating balance strengthened to RON144 million in 2022 from RON28 million in 2020. This was due to an increase in revenue, mainly central government additional transfers (VAT), and the county's share of national PIT.

Under the rating-case scenario, Fitch prudently assumes the operating balance will decline throughout 2023-2027 to around RON89 million on average. Fitch's rating case assumes that the county's debt will peak at RON640 million in 2027 (2022: RON228 million).

DERIVATION SUMMARY

The combination of a 'Midrange' Risk Profile and a debt sustainability assessment in the middle of the 'aa' category, as well as rated peers' positioning leads to the 'a' SCP. The IDRs are capped by Romania's sovereign rating. The county's IDRs are not affected by any other rating factors.

Short-Term Ratings

The 'F3' Short-Term IDR s are derived from the 'BBB-' Long-Term IDR.

KEY ASSUMPTIONS

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Midrange'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Stronger'

Liabilities and Liquidity Robustness: 'Midrange'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'aa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Rating Cap (LT IDR): 'BBB-'

Rating Cap (LT LC IDR) 'BBB-'

Rating 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:

--Annual average 3% increase in operating revenue, including tax revenue CAGR 4.1% and transfers received CAGR 0.5%;

--Annual average 6.5% increase in operating spending;

--Net capex RON146 million on average (above the historical average of RON118 million);

--Average cost of debt 6.2% and long-term maturities of new debt (up to 2033)

Quantitative assumptions - Sovereign Related

Figures as per Fitch's sovereign actual for 2021 and forecast for 2022-2024, respectively (no weights and changes since the last review are included as none of these assumptions was material to the rating action):

Issuer Profile

Cluj County is classified by Fitch as a 'Type B' LRG, as it is required to cover debt service from cash flow on an annual basis. It has almost 680,000 residents and is the fourth largest county in Romania. In GRP terms it is the second fastest growing county in the country (after City of Bucharest). The local economy is well diversified and mainly service oriented. Six industrial parks within its administration limits support its development.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-A downgrade of Romania's IDRs, or a multi-notch revision of the county's SCP below 'bbb-', which could be driven by a material deterioration in its debt metrics, particularly debt payback above 13x on a sustained basis under Fitch's rating case

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of Romania's IDRs

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

DISCUSSION NOTE

Committee date: 18 September 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

Cluj County's IDRs are capped by the Romanian sovereign IDR.

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		
Cluj County	LT IDR	BBB- Rating Outlook Stable	New Rating
	ST IDR	F3	New Rating
	LC LT IDR	BBB- Rating Outlook Stable	New Rating
	LC ST IDR	F3	New Rating

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)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Cluj County	EU Issued, UK Endorsed

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