



RATING ACTION COMMENTARY

Fitch Revises Outlook on Flemish Community to Negative; Affirms at 'AA'

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Link to Fitch Ratings' Report(s):

[The Flemish Community - Rating Action Report](#)

Fitch Ratings - Paris - 09 Apr 2020: Fitch Ratings has revised the Outlook on the Flemish Community's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) to Negative from Stable and affirmed the IDRs at 'AA'. Fitch has also affirmed the Short-Term Foreign-Currency IDR at 'F1+'. A full list of rating actions is below.

The revision of the Flemish Community's Outlook follows the revision of Belgium's Outlook to Negative from Stable on 3 April 2020.

Under EU credit rating agency (CRA) regulation, the publication of local and regional governments' reviews is subject to restrictions and must take place according to a published schedule, except where it is necessary for CRAs to deviate from this in order to comply with their legal obligations. Fitch interprets this provision as allowing us to publish a rating review in situations where there is a material change

in the creditworthiness of the issuer that we believe makes it inappropriate for us to wait until the next scheduled review date to update the rating or Outlook/Watch status. The next scheduled review date for Fitch's rating on Flemish Community is 10 July 2020, but Fitch believes that developments in the country warrant such a deviation from the calendar and our rationale for this is laid out below.

KEY RATING DRIVERS

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

HIGH

One-notch Leeway Above the Sovereign

Fitch considers that the Flemish Community may not be rated more than one notch above the Belgium state (AA-/Negative). As a result, a downgrade of the sovereign would be reflected in the ratings of the Flemish Community, hence the Negative Outlook.

The Flemish Community's Standalone Credit Profile (SCP) is 'aa+', two notches above the rating of Belgium, and the entity meets the conditions for it to be rated above the sovereign, including institutional strength and large financial and fiscal autonomy. In Fitch's view, the Flemish Community would have the ability in some scenarios to continue servicing its debt, despite a default of the sovereign, which is reflected in the one-notch rating difference with the sovereign.

However, Fitch also believes that a sharp deterioration of sovereign finances would likely have an impact on the Flemish Community, and that a default of the sovereign would have a significant impact on the Flemish Community, including a sharp increase in its cost of borrowing, although not necessarily leading to an immediate default by the Flemish Community itself. Fitch also considers that the Flemish Community has a large incentive to support the federal government due to the importance of the services provided by the latter to the population, including unemployment benefits. This explains why we consider that the Flemish Community may not be rated more than one notch above the sovereign.

LOW

Risk Profile: 'Stronger'

Fitch assesses the Flemish Community's risk profile at 'Stronger'. The key risk factors relative to revenue expenditure sustainability, and liabilities and liquidity are assessed as 'Stronger'. Expenditure adjustability is assessed as 'Midrange'.

Debt sustainability: 'a' category

This assessment reflects a payback ratio (net adjusted debt / operating balance) that Fitch expects at slightly below 9x in the medium term in our rating case scenario, or in the lower end of the 'aa' category (2019: 4.2x estimated), and a coverage ratio (operating balance/debt service; Fitch's synthetic calculation) expected to be at around 1.4x in the medium term in this scenario, or the 'bbb' category. The fiscal debt burden (net adjusted debt / operating revenue) would remain low, at around 40%, or compatible with a 'aaa' category, but has a lower weight in our final assessment. Overall, the combination of debt metrics leads us to 'a' debt sustainability assessment.

Fitch will revise its assumptions to reflect the economic consequences of the coronavirus pandemic and containment measures. This will lead to higher level of debt and weaker debt metrics in our rating case scenario. However, we expect them to remain in line with a debt sustainability in the 'a' category, and with the ratings.

DERIVATION SUMMARY

The Flemish Community's SCP is assessed at 'aa+' reflecting a combination of a 'Stronger' profile and debt sustainability metrics assessed in the upper end of the 'a' category under Fitch's rating case scenario. The SCP also reflects the peer comparison.

The Flemish Community's rating is 'AA' as Fitch considers that it may not be rated more than one notch above the sovereign.

KEY ASSUMPTIONS

Qualitative Assumptions and assessments and their respective weight in the rating decision:

Risk Profile: Stronger; low weight

Revenue Robustness: Stronger; low weight

Revenue Adjustability: Stronger; low weight

Expenditure Sustainability: Stronger; low weight

Expenditure Adjustability: Midrange; low weight

Liabilities and Liquidity Robustness: Stronger; low weight

Liabilities and Liquidity Flexibility: Stronger; low weight

Debt sustainability: 'a' category; low weight

Support: N/A

Asymmetric Risk: N/A

Sovereign Cap Or Floor: No (one notch above the sovereign); high weight

Quantitative assumptions - issuer specific

Fitch's rating case scenario is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on the 2015-2019 figures and 2020-2024 projected ratios. The issuer's quantitative specific assumptions have a low weight in the rating decision.

Quantitative assumptions - sovereign related (note that no weights are included as none of these assumptions was material to the rating action)

Figures as per Fitch's sovereign actual for 2018 and forecast for 2021, respectively:

- GDP per capita (US dollar, market exchange rate): 47,280; 45,672

- Real GDP growth (%): 1.5; 2.8
- Consumer prices (annual average % change): 2.3; 1.7
- General government balance (% of GDP) : -0.7; 1.7
- General government debt (% of GDP) : 100.0; 107.5
- Current account balance plus net FDI (% of GDP) : -3.0; 2.3
- Net external debt (% of GDP): -7.5; 2.3
- IMF Development Classification: DM
- CDS Market Implied Rating: n/a

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating

Action/Upgrade:

The Outlook would be revised back to Stable if the Outlook on the sovereign was revised to Stable, all other things remaining unchanged.

Factors That Could, Individually or Collectively, Lead to Negative Rating

Action/Downgrade:

Negative rating action on Belgium would be reflected on the Flemish Community's Long-Term IDRs as the latter may not be rated at more than one notch above the sovereign.

The Flemish Community's ratings could be downgraded if its payback ratio exceeds 10x on a sustained basis in our rating case scenario. This could happen if the economic downturn that affects operating revenue growth increases the entity's debt metrics significantly above the level projected in our rating case scenario.

BEST/WORST CASE RATING SCENARIO

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

<https://www.fitchratings.com/site/re/10111579>.

SUMMARY OF FINANCIAL ADJUSTMENTS

The analysis is based on the Flemish Community's consolidated operating revenue and expenditure. It includes the Flemish Community's general budget and some public institutions that are largely financed by the Flemish Community, such as universities for instance. These institutions account for less than 10% of total operating revenue and spending of the consolidated accounts.

Fitch's adjusted debt includes the Flemish Community's direct debt (EUR6.738 billion at end-2019) and 'other Fitch-classified debt' items, totalling EUR4.463 billion at end-2019. The latter comprised EUR2.1 billion in public-private partnership debt, EUR1.45 billion of consolidated public institutions' debt, and EUR918 million that the Flemish Community will repay to the federal state over a 16-year period. However, in contrast with European System of Accounts rules, it does not include the guaranteed debt of social housing companies, which we view as self-supporting, nor that of hospital infrastructure.

SOURCES OF INFORMATION

Committee date: 8 April 2020

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.

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.

RATING ACTIONS

ENTITY/DEBT	RATING		
The Flemish Community	LT IDR	AA	Affirmed
●	ST IDR	F1+	Affirmed
●	LC LT IDR	AA	Affirmed
●	LC ST IDR	F1+	Affirmed
● senior unsecured	LT	AA	Affirmed
● senior	ST	F1+	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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

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The Flemish Community

EU Issued

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