

## **RATING ACTION COMMENTARY**

# **Fitch Affirms Flemish Community at 'AA'; Outlook Negative**

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Fitch Ratings - Paris - 07 Jun 2024: Fitch Ratings has affirmed the Flemish Community's Long-Term Foreign-and-Local Currency Issuer Default Ratings (IDRs) at 'AA' with Negative Outlooks. A full list of rating actions is below.

The affirmation reflects Fitch's unchanged assessment of the Flemish Community's Standalone Credit Profile (SCP) at 'aa+'. This reflects the combination of a 'Stronger' risk profile and debt sustainability assessed at the upper end of the 'a' category under Fitch's rating case. The Long-Term Foreign-Currency IDR is one notch above that of Belgium (AA-/Negative) and reflects Fitch's view that the Flemish Community would have the ability to continue servicing its debt in some scenarios, despite a default of the sovereign. The Negative Outlook reflects that on the sovereign.

## **KEY RATING DRIVERS**

### **Risk Profile: 'Stronger'**

Fitch assesses five out of six key risk factors as 'Stronger'. The 'Stronger' risk profile reflects Fitch's view that there is a negligible risk of the issuer's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon (2024-2028) due to lower-than-expected revenue, higher expenditure or an unexpected rise in liabilities, debt or debt-service requirements.

### **Revenue Robustness: 'Stronger'**

The Flemish Community benefits from robust revenue sources, mainly stable and growing tax items, mostly comprising tax revenue collected nationally and transferred by the federal government (58% of operating revenue in 2023). These are protected by the Special Finance Act. They increase in line with GDP and population growth, which allows the Flemish Community to cover growing spending needs. Own fiscal items (30%), include a surcharge tax on personal income tax (PIT; 17%), and a wide range of

regional taxes (13%). They have shown great resiliency during economic downturns, and we expect them to grow in the coming years.

### **Revenue Adjustability: 'Stronger'**

The Flemish Community benefits from high tax flexibility. Fitch believes that additional revenue stemming from an increase in taxes would cover more than 200% of a reasonable decline in revenue in an economic downturn, which Fitch estimates at about 2%. The entity has autonomy to determine 12 specific taxes, including property, inheritance and transfer duties, like other Belgian regions. In addition, regions have the ability to determine the rate for about one-quarter of PIT through a surcharge system.

### **Expenditure Sustainability: 'Stronger'**

The Flemish Community's responsibilities are mostly non-cyclical, especially education, health or transportation, while unemployment benefits are paid at the federal level. In an economic downturn, we would expect the Flemish Community to tighten spending in light of its record of budgetary discipline. The region's goal is to return to a balanced budget by 2027, from a EUR2.4 billion deficit in 2023, according to European system of account rules, which will require tight control over spending.

### **Expenditure Adjustability: 'Midrange'**

Fitch estimates the Flemish Community's share of inflexible expenditure at 70%-90%, mainly comprising subsidies on education and training, welfare, public health and family. However, we see fewer restrictions on the Flemish Community to alter its spending than for local and regional governments (LRG) in other decentralised countries, such as France. Staff costs are a rigid cost item, especially in the context of high inflation due to the automatic indexation mechanism of wages. However, the overall share of staff costs is moderate (14% of opex in 2023).

The share of capex in total spending remains modest (10%), offering limited flexibility for the Flemish Community to reduce spending in case of need. The investment programme also includes a large committed infrastructure project (Antwerp's ring road).

### **Liabilities & Liquidity Robustness: 'Stronger'**

The Flemish Community operates under a robust individual debt management framework, characterised by high data transparency on debt and off-balance-sheet liabilities. Fitch views its liabilities as low risk. At end-2023, 92% of long-term debt was fixed-rate. The debt amortisation schedule shows large repayment peaks in 2032, 2033

and 2042, mostly of bonds. However, the risk of large bullet repayments is mitigated by the modest amount of maturities in proportion to the Flemish Community's cash flow. The administration is also progressively smoothing its debt amortisation schedule.

### **Liabilities & Liquidity Flexibility: 'Stronger'**

The Flemish Community has good access to liquidity in various forms. Its liquidity is backed by its bonds' eligibility for the European Central Bank's public-sector purchase programme. The entity benefits from EUR3.75 billion committed bank lines contracted with ING Belgium NV/SA (AA-/Stable), which have been extended to 2026.

### **Debt Sustainability: 'a category'**

Fitch classifies the Flemish Community as a Type B LRG. We assess the Flemish Community's debt sustainability at the upper end of the 'a' category. Our rating case expects the debt payback ratio (primary metric used for Type B LRGs) to be 9.0x in 2028 (2023: 8.1x), the coverage ratio (synthetic calculation) close to 1.4x on average over 2024-2028 and a fiscal debt burden of about 57%.

In our rating-case, we expect operating balance to decrease in 2024, based on Fitch's expectation of lower nominal GDP growth and higher inflation, after a high 2023. We then expect it to steadily increase to around EUR4.2 billion in 2028. The pace of recovery will depend on economic growth after 2024, and the cost-cutting measures put in place by Flanders to comply with its fiscal target of a budget balance in 2027.

We expect net-adjusted debt to increase to close to EUR38 billion at end-2028, reflecting a switch in debt management since 2015, with the Flemish Community directly financing some public entities rather than guaranteeing their debt, as well as the financing of large investments, especially the Antwerp ring road (more than EUR3 billion expected in 2024-2028).

### **DERIVATION SUMMARY**

The Flemish Community's 'aa+' SCP reflects a combination of a 'Stronger' risk profile and debt sustainability assessed in the upper end of the 'a' category under Fitch's rating case. The IDR is one notch above Belgium's rating and reflects Fitch's view that in some scenarios, the Flemish Community would have the ability to continue servicing its debt, despite a default of the sovereign.

However, Fitch also believes that a sharp deterioration in 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 it would not necessarily lead 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 is why we consider that the Flemish Community cannot be rated more than one notch above the sovereign.

### **Short-Term Ratings**

Fitch assesses the Flemish Community's Short-Term IDRs at 'F1+', in line with its rating guidance

### **Debt Ratings**

The Flemish Community's senior unsecured debt ratings are in line with its IDRs.

### **KEY ASSUMPTIONS**

**Risk Profile: 'Stronger'**

**Revenue Robustness: 'Stronger'**

**Revenue Adjustability: 'Stronger'**

**Expenditure Sustainability: 'Stronger'**

**Expenditure Adjustability: 'Midrange'**

**Liabilities and Liquidity Robustness: 'Stronger'**

**Liabilities and Liquidity Flexibility: 'Stronger'**

**Debt sustainability: 'a'**

**Support (Budget Loans): 'N/A'**

**Support (Ad Hoc): 'N/A'**

**Asymmetric Risk: 'N/A'**

**Rating Cap (LT IDR): 'AA'**

**Rating Cap (LT LC IDR) 'AA'**

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 2019-2023 figures and 2024-2028 projected ratios. The key assumptions for the scenario include:

- Average 2.4% increase per year in operating revenue, driven mostly by high nominal GDP growth over our forecast horizon.
- Average 2.4% increase per year in opex, driven by a sustained increase in staff costs (+2.8% a year on average) and operating subsidies (+2.4%).
- Capital balance on average at around a negative EUR5 billion per year, in line with issuer's expectation.
- Average cost of debt of 2.6%, factoring in the Flemish Community's high share of fixed-rate debt (92% at end-2023) and a fixed 3.4% rate on new borrowings from 2024.

### **Issuer Profile**

The Flemish Community is a federated entity of the Belgian state, combining the responsibilities of a region, such as the economy, and that of a community, such as welfare and education. It has a population of 6.7 million, representing 58% of the national population.

### **RATING SENSITIVITIES**

#### **Factors that Could, Individually or Collectively, Lead to Negative Rating**

##### **Action/Downgrade**

A downgrade of Belgium would be reflected in the Flemish Community's ratings. The Flemish Community's Long-Term IDRs could also be downgraded if its payback ratio approaches 13x on a sustained basis in our rating case. This could happen if GDP growth in the coming years is lower than that in our rating case.

#### **Factors that Could, Individually or Collectively, Lead to Positive Rating**

##### **Action/Upgrade**

An upgrade of the Flemish Community is unlikely given that the Outlook on Belgium is Negative. We would revise the Outlook to Stable if we revised the Outlook on the sovereign to Stable, all other things unchanged.

### **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: 04 June 2024

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

The Flemish Community's ratings are linked to Belgium's.

## 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 ↕ |                            | PRIOR ↕                    |
|-------------------|----------|----------------------------|----------------------------|
| Flemish Community | LT IDR   | AA Rating Outlook Negative | AA Rating Outlook Negative |
|                   | Affirmed |                            |                            |
|                   | ST IDR   | F1+ Affirmed               | F1+                        |

|                  |           |                            |          |                            |
|------------------|-----------|----------------------------|----------|----------------------------|
|                  | LC LT IDR | AA Rating Outlook Negative |          | AA Rating Outlook Negative |
|                  | Affirmed  |                            |          |                            |
|                  | LC ST IDR | F1+                        | Affirmed | F1+                        |
| senior unsecured | LT        | AA                         | Affirmed | AA                         |
| senior unsecured | ST        | F1+                        | Affirmed | F1+                        |

[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)

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Flemish Community

EU Issued, UK Endorsed

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