

**Credit Opinion: Naples, City of**

**Naples, City of**

*Italy*

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bonds -Dom Curr	A1

**Contacts**

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**Key Indicators**

**Naples, City of**

	2001	2002	2003	2004	2005
Net direct and guaranteed debt as % of operating revenues	58.2	57.6	69.0	85.0	98.0
Accrual financing surplus (requirement) as % of total revenue	0.9	2.8	-7.1	-12.9	-13.7
Gross operating balance as % of operating revenue	10.3	11.9	12.1	6.8	3.6
Interest payments as % of operating revenue	4.1	4.0	3.9	4.3	5.4
Intergovernmental transfers as a % of operating revenues	57.4	54.6	48.3	46.9	47.5
Capital spending as a % of total expenditures	16.8	23.8	31.6	28.5	22.1
GDP per capita as a % of national average	65.6	64.9	64.6	66.3	-

**Opinion**

**Credit Strengths**

Credit strengths of the City of Naples are:

Commitment to addressing structural issues

Moderate debt level, albeit growing

End of 'dissesto': no material risk from past claims

**Credit Challenges**

Credit challenges of the City of Naples are:

Weak socio-economic environment

Pressurising institutional framework

Continued weak collection ability that drives liquidity pressure

Relevant exposure to risk stemming from municipal companies

Structural budgetary rigidities

## Rating Rationale

The A1 debt rating, with stable outlook, of the City of Naples was affirmed as a result of the application of Moody's Joint-default Analysis (JDA) rating methodology for regional and local governments (RLGs). In accordance with this methodology, the rating on Naples reflects the combination of the following inputs: a) Baseline Credit Assessment (BCA) of 6 (on a scale of 1 to 21, where 1 represents the lowest credit risk); b) Aa2 local currency rating of the Republic of Italy; c) 90% degree of default dependence; and d) 35% likelihood that the central government would act to prevent a default by the city.

Naples' BCA of 6 reflects the following factors:

Italy is characterised by a mature and wealthy operating environment, suggesting a low systemic risk. Italian cities are responsible for providing basic services to citizens in a context of greater local autonomy and accountability, limited tax-raising capacity and a relatively rigid expenditure structure. The reduced support from the central government, coupled with restrained revenue dynamics, is posing new challenges for some local governments. Nevertheless, Moody's acknowledges the central government's interest and strong regulatory framework.

Moody's views pressures arising from the institutional framework as increasingly impacting Naples credit profile, especially in view of the weak and demanding socio-economic environment. Naples faces the reduction in support and ordinary transfers from the central government - a key credit challenge for the city, given its difficulties in counting on its own revenues, its low revenue flexibility and its relatively rigid expenditure. Indeed, the city continues to experience poor collection rates on taxes and charges, impacting negatively on cash flow generation and leading to a high level of accumulated receivables, a proportion of which Moody's understands to be doubtful. The rating agency believes that, going forward, the pressure arising from the collection of the city's own revenues, combined with substantial delays in payments, could weigh on Naples' ability to achieve an adequate operating cash performance. Nonetheless, Moody's positively notes that the administration has recognised the key structural issues and has started to implement measures focused mainly on waste-management tax and fines. However, despite some positive signals, Moody's does not expect significant structural improvements to be achieved over the near term.

The city's direct debt is growing to about 98% of 2005 operating revenues. Although some important capital projects (i.e., the subway) are subsidised by third parties, Naples could build up some additional debt over the medium term.

Naples' credit profile is also affected by risk arising from municipal companies. In this context, the city's finances face potential pressure from recurrent losses, relatively high levels of commercial and financial debt, and difficulties in revenue collection.

On a positive note, the city is emerging from a 10-year situation of 'dissesto', with no material risk from past claims.

Naples shows one of the lowest levels of per capita GVA - 34% below the national average - and a high unemployment rate of 18.9% in 2005 (Italy 7.7%).

Default dependence:

Default dependence of 90% reflects the city's high reliance on central government's transfers.

Extraordinary Support:

A likelihood of extraordinary support for Naples of 35% from the central government reflects Moody's assessment at the jurisdictional level of the central government's promotion of greater accountability for cities coupled with the central government's attitude towards non-intervention to prevent defaults by lower-tier governments, counterbalanced by Naples' presence in the capital market.

## Rating Outlook

The stable rating outlook reflects Moody's expectation that the measures adopted to tackle structural issues will be effective and will produce substantial results.

### What Could Change the Rating - UP

A rating upgrade is regarded as unlikely in the near term.

### What Could Change the Rating - DOWN

Persistent tensions in operating cash performance and excessive reliance on debt could negatively impact Naples' credit fundamentals.

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