28 May 2020

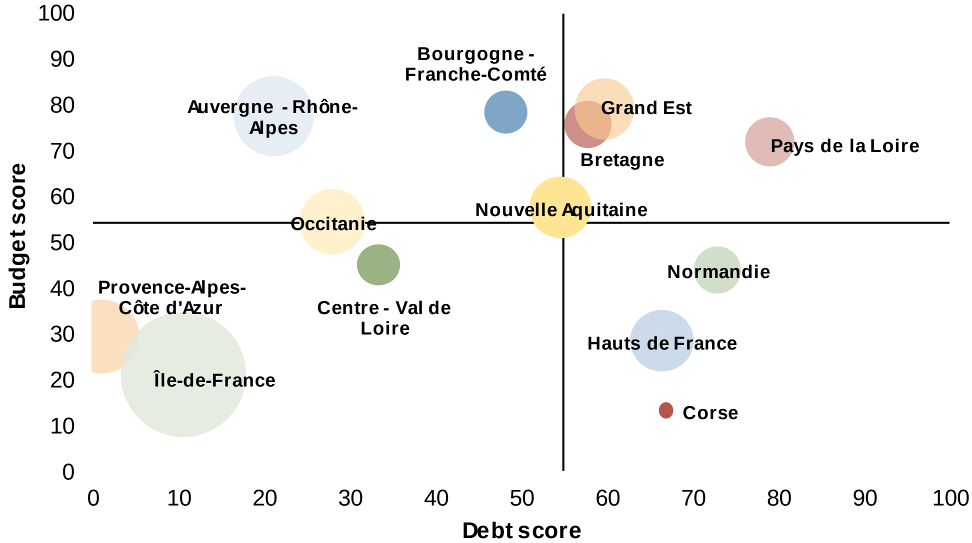
French municipal finances: state of play in the face of the Covid-19 crisis

Covid-19 struck just as French municipal councils are due to be renewed in this year's municipal elections. The crisis will have significant economic costs for the French economy, raising concerns about local government finances. While French municipalities benefit from institutional and budgetary buffers, the health of local government finances will also be key in withstanding the Covid-19 shock and other longer-term budgetary pressures while maintaining crucial investment levels. In this report, we assess the robustness of municipal finances in 13 regions, explore budgetary and institutional buffers and outline longer-term challenges.

The last municipal mandate saw external budgetary pressures, which weighed on finances and spurred cost savings. But it also saw buoyant economic growth, which supported fiscal consolidation. While some budgetary pressures have abated, the economic impact of the Covid-19 crisis as well as the elimination of the residency tax and rising risks of post-crisis consolidation measures present new challenges.

The time is thus opportune to assess the robustness of France's municipal finances. We do so by leveraging a key component of Scope's Sub-Sovereign Methodology: the Core Variable Scorecard (CVS), which allows for a *quantitative* and *comparative* assessment of fiscal fundamentals (i.e. of the debt burden and budgetary performance). Crucially, our analysis focuses on regional differences using aggregate financial data for municipalities.

Figure 1. Regional municipal finance scores & share of French municipal debt
CVS scores (1=weak; 100=strong), % of French municipal debt (bubble size)



N.B. The axes cross at the median debt and budget scores.
Source: Scope Ratings GmbH

Our analysis highlights the following key takeaways:

- French municipal finances improved overall in recent years, with wider operating margins, lower debt burdens and higher investment levels on aggregate. But regional disparities remain as some regions show stronger municipal finances than others.
- The adverse impact of the Covid-19 shock will be mitigated by budgetary and institutional buffers. Longer-term challenges linked to the residency tax reform and rising expenditure pressures persist, however.
- On aggregate, municipalities in Île de France and Provence-Alpes-Côte d'Azur are more exposed to these risks while those in Pays de la Loire, Grand Est, Bretagne, Bourgogne-Franche-Comté and Normandie have more robust aggregate financial positions.

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French municipalities: a fragmented sector and crucial public investor

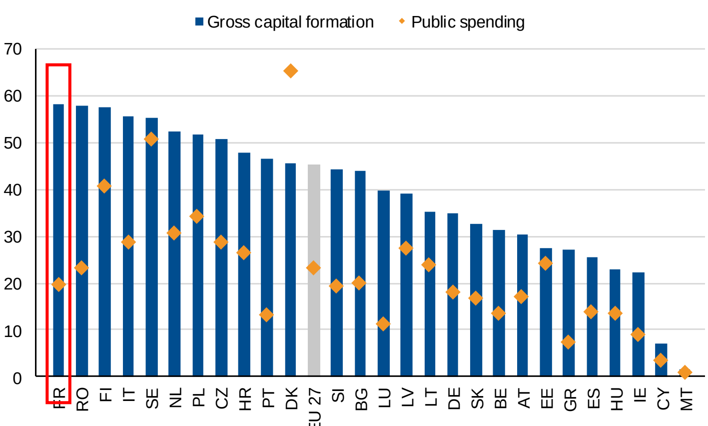
A fragmented local government sector

French local authorities play an important role in several key policy areas. They are responsible for education, social initiatives, road infrastructure and the provision of essential public services, among other things. The French municipal sector is highly fragmented relative to other European countries. Its more than 35 000 *communes* represent over a quarter of all municipalities in the OECD and 40% in the EU[1]. Most French municipalities are small with a national average municipal population of 1,900 inhabitants; well below the OECD average of 9,700. A smaller, more fragmented municipal sector can constrain its ability to streamline administrative and investment capacities. The government has implemented reforms to create and expand intermunicipal groupings to address this issue and achieve synergies between smaller municipalities[2].

Municipalities play a crucial role for France's public investment

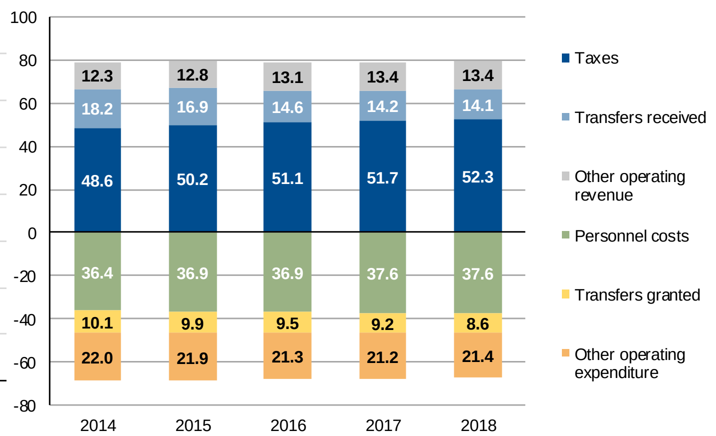
French municipalities play a crucial role as investors in local infrastructure. While French local government spending represents only around 20% of total public expenditure, it accounts for 58% of public investment, the largest share among EU countries (**Figure 2**). Municipalities receive State grants and can issue debt, but own resources (and, by extension, operating margins) play a large part in financing their investments. As such, the robustness of municipal finances is one of the most important drivers of local government investment[3].

Figure 2. Local government spending and investment, 2018
% of general government



Source: Eurostat, Scope Ratings GmbH

Figure 3. French municipal operating revenue & expenditure
EUR bn



N.B. The figures presented above are aggregated for France
Source: DGCL, Scope Ratings GmbH

Some financial autonomy but strong central government influence

French municipalities have medium levels of financial autonomy compared with European peers. Major decision-making powers are centralised and strong regulatory frameworks limit budgetary flexibility. At the same time, municipal councils have authority over local tax rates and are less dependent on State transfers (18% of operating revenue in 2017) than in countries such as Germany (over half of operating revenue). Similarly, they can tap multiple forms of funding without central government interference, although they cannot engage in deficit financing and are required to adopt balanced budgets (i.e. the golden rule). Finally, the central government defines mandatory expenditure items such as debt service, personnel costs as well as all spending required to maintain a *minimal* level of essential public services, which constrains expenditure flexibility.

[1] OECD (2016), Subnational Government Structure and Finance Database.
[2] Today, there are close to 1,258 inter-municipal groupings for an average size of 29 municipalities and 54,187 inhabitants.
[3] Observatoire des finances et de la gestion publique locales (2019), L'investissement des communes et intercommunalités depuis 2014.

External budgetary pressures in recent years

French municipal budgets are highly sensitive to policy changes decided at the central government level. This was evidenced in recent years when local authorities faced considerable external budgetary pressures. Chief among them was the decline in State transfers, which dropped by 22% from EUR 18bn in 2014 to EUR 14bn in 2017 as part of the central government's plan to strengthen public finances (**Figure 3**). On top of this, the State implemented an expenditure norm in 2014, aimed at containing local and regional government expenditure growth to no more than 1.2% per year. The combination of both factors resulted in budgetary pressures and forced local authorities to adjust their budgets: first by reducing investments and then by implementing cost-saving measures. In 2017, State transfers stabilised, providing some relief to municipal budgets.

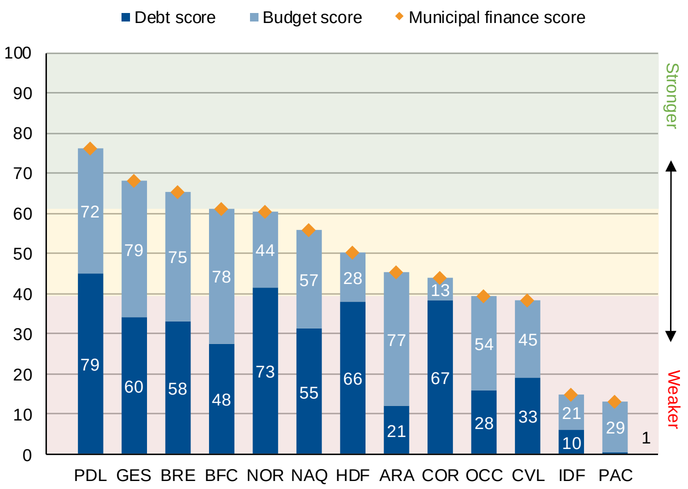
Assessing the health of local government finances

The Covid-19 pandemic emerged just as elections were due to re-elect municipal councils, which will steer local budgets over the next six years. We propose to assess the robustness of local government finances at the turbulent start of this new mandate.

A quantitative and comparative approach using aggregate data

In order to assess the strength of local government finances, we adopt a Core Variable Scorecard approach, a key component of Scope's Sub-sovereign Methodology. We use aggregate financial indicators provided by the *Direction Générale des Collectivités Locales* on a regional basis to conduct a *comparative* analysis along two dimensions: i) debt burden; and ii) budgetary performance. A detailed presentation of the CVS approach can be found in **Annex I**. It is important to note that the use of aggregate data has limitations as it does not account for heterogeneity *within* a region. The following analysis should be interpreted in this context.

Figure 4. Municipal finance scores - aggregated[4]
CVS scores (1 = weakest ; 100 = strongest)



N.B The red and green areas represent the 25th and 75th percentiles respectively
Source: Scope Ratings GmbH

Figure 5. Breakdown of municipal finance scores
CVS scores (1 = weak ; 100 = strongest)

	Debt score (57%)	Budget score (43%)	Municipal finance score
Pays de la Loire	79	72	76
Grand Est	60	79	68
Bretagne	58	75	65
Bourgogne - Franche-Comté	48	78	61
Normandie	73	44	60
Nouvelle Aquitaine	55	57	56
Hauts de France	66	28	50
Auvergne - Rhône-Alpes	21	77	45
Corse	67	13	44
Occitanie	28	54	39
Centre - Val de Loire	33	45	38
Île-de-France	10	21	15
Provence-Alpes-Côte d'Azur	1	29	13

Source: Scope Ratings GmbH

Five 'stronger' regions, two 'weaker' and six 'intermediate'

Figures 4 and **5** present an overview of the results from our CVS analysis (a full overview of the ratios and CVS scores is available in **Annex II**). The following conclusions can be made:

- **Five 'stronger' regions:** On aggregate, municipalities in Pays de la Loire (CVS score of 76), Grand Est (68), Bretagne (65), Bourgogne–Franche-Comté (61) and Normandie (60) have the most robust finances, reflecting relatively low levels of

[4] ARA = Auvergne – Rhône-Alpes; BFC = Bourgogne – Franche-Comté ; BRE = Bretagne ; CVL = Centre – Val de Loire ; COR = Corse ; GES = Grand Est ; HDF = Hauts de France ; NOR = Normandie ; NA = Nouvelle Aquitaine ; OCC = Occitanie ; PDL = Pays de la Loire ; PAC = Provence-Alpes-Côte d'Azur ; IDF = Île de France.

indebtedness and strong budgetary performance. Municipalities in these regions have more comfortable fiscal positions and can better withstand economic and budgetary pressures *on average*.

- **Two 'weaker' regions**: Conversely, municipal finances in Provence-Alpes-Côte d'Azur (CVS score of 13) and Île de France (29) are the weakest on aggregate, reflecting high debt levels, lower operating performance, less flexible budgets and low levels of investment intensity relative to budget size[5]. Risks of rising local fiscal imbalances or subdued local investment are higher for these regions in a stressed scenario.
- **Six 'intermediate' regions:** Local government finances in most French regions (6 out of 13) show moderate levels of financial risks *overall*. Within this category, three risk profiles can be observed:
  - i) Two 'strong' debt and 'weak' budget regions: Hauts de France (CVS score of 50) and Corse (44). Municipalities in these regions have lower debt burdens but less budgetary buffers on average.
  - ii) One 'strong' budget and 'weak' debt region: Auvergne-Rhône-Alpes (45) whose municipalities present strong budgetary performances overall but have relatively high debt burdens.
  - iii) Three 'balanced' regions with moderate levels of debt and budget risks: Nouvelle Aquitaine (56), Occitanie (39) and Centre-Val de Loire (38).
- These results point to regional disparities even though fiscal rules are defined at the central government level and multiple fiscal equalisation mechanisms aimed at reducing regional inequalities. To some extent, this reflects the administrative and financial autonomy granted to French municipalities. More conservative budgeting and investment strategies seem to determine the financial standing of municipalities rather than stronger regional economic fundamentals. As **Figure 6** shows, higher municipal finance scores are not necessarily correlated with stronger regional wealth, growth or labour market performance.

Figure 6. Municipal finance scores and economic performance indicators

	Municipal finance score	Disposable household income (EUR)[1]	Real GDP growth (%)[2]	Unemploy-ment rate (%)[2]
Pays de la Loire	76	18,774	1.9	8.3
Grand Est	68	18,852	0.4	9.6
Bretagne	65	18,785	1.9	8.3
Bourgogne - Franche-Comté	61	19,329	0.3	8.7
Normandie	60	18,952	0.4	9.8
Nouvelle Aquitaine	56	18,850	1.7	9.2
Hauts de France	50	17,319	0.6	12.0
Auvergne - Rhône-Alpes	45	19,821	1.7	8.5
Corse	44	17,090	1.9	10.3
Occitanie	39	18,146	1.8	11.5
Centre - Val de Loire	38	19,370	0.4	9.2
Île-de-France	15	23,023	2.0	8.5
Provence-Alpes-Côte d'Azur	13	19,331	1.0	11.1

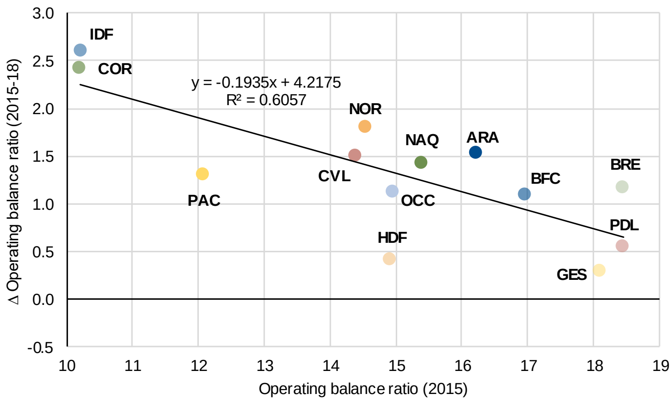
[1] 2017; [2] 2014-18 average
Source: OECD, INSEE, Scope Ratings GmbH

[5] We note that the fiscal fundamentals of Paris, with a relatively high debt burden, are likely to have a large impact on the municipal finance score of Île de France with the city's outstanding debt amounting to EUR 6.4bn in 2017 (over a third of the region's aggregate municipal debt). A large and diversified economy, wealthy fiscal base as well as strong market access and funding options grant Paris more budgetary leeway relative to other French municipalities.

Recent strengthening of municipal finances increases robustness to shocks[6]

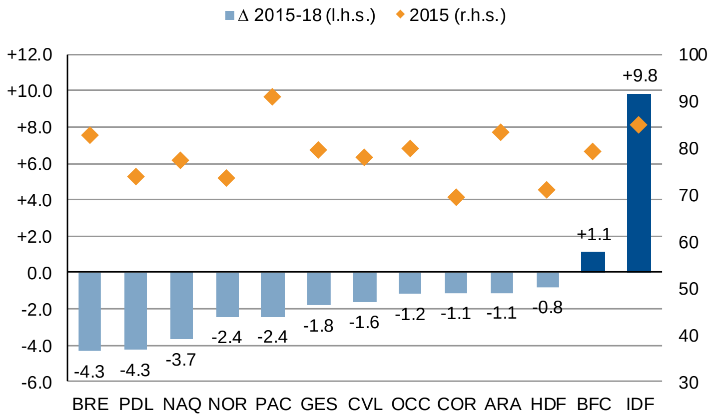
While the municipal finance scores presented above offer a snapshot of the health of municipal finances, they do not account for their evolution over time. Examining the evolution of municipal indebtedness and budgetary performance in recent years provides additional insights.

Figure 7. Operating balance/operating revenue, 2015-18
% (horizontal axis); pps (vertical axis)



Source: DGCL, Scope Ratings GmbH

Figure 8. Debt/operating revenue, 2015-18
pps (l.h.s.); % (r.h.s.)



Source: DGCL, Scope Ratings GmbH

Converging operating performance but diverging debt trajectories

The aggregate operating performance of municipalities improved for all regions between 2015 and 2018. There is also a high level of convergence, as the regions in which municipalities had the lowest initial operating margins tend to show the largest improvements (**Figure 7**). There have also been substantial improvements in terms of debt levels with all regions, except for Île de France and Bourgogne-Franche-Comté, having lower municipal debt levels relative to operating revenue in 2018 than in 2015 although with no clear signs of convergence. Municipal debt in Île de France increased by 9.8pps of operating revenue over 2015-18 while decreased by 4.3pps in Bretagne despite similar initial debt levels of 83%-85% of operating revenue (**Figure 8**).

Local investment declined in 2014-16…

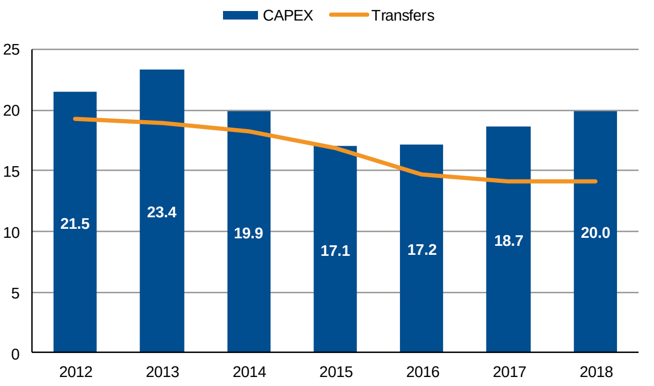
The last electoral cycle was marked by a period of declining local investment between 2014 and 2016 (**Figure 9**). Decreasing State transfers strongly impacted investments in the first half of the mandate via two channels: i) *directly* by weighing on budgetary performance, thereby forcing municipalities to cut back on non-essential spending; and ii) *indirectly* by raising concerns about future revenue, thus increasing municipalities' risk aversion.

…but picked up in 2017-18

Local investment picked up over 2017-18, in line with the electoral cycle, but also thanks to stabilising State transfers, wider operating margins, and favourable financing conditions[7]. All regions saw their aggregate municipal investment levels (in per capita terms) increase over 2016-17 (**Figure 10**). Local capital expenditure per capita increased the most in Provence-Alpes-Côte d'Azur (+14.2%) and Nouvelle Aquitaine (+13.2%) and the least in Normandie (+3.1%) and Bretagne (+4.7%). Corse and Île de France stand out in terms of municipal investment intensity with per capita CAPEX representing EUR 456 and EUR 402 respectively, far above the levels observed in other regions.

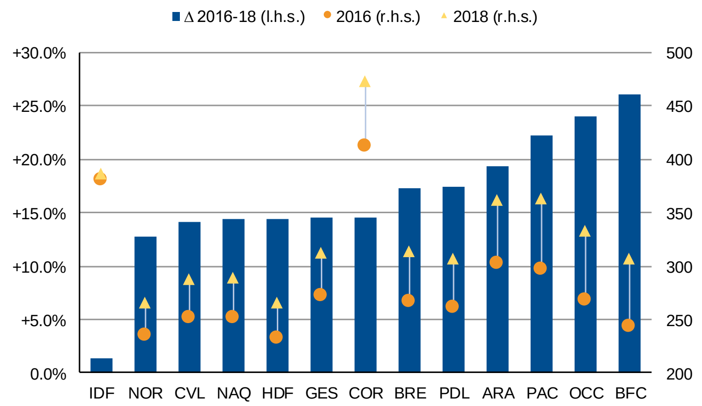
[6] Due to data availability, the analysis presented in this section refers to the 2015-18 period.
[7] Observatoire des finances et de la gestion publique locales (2019), L'investissement des communes et intercommunalités depuis 2014.

Figure 9. Aggregate local CAPEX and incoming transfers
EUR bn



N.B. The figures above are aggregate for all municipalities in France
Source: DGCL, Scope Ratings GmbH

Figure 10. CAPEX per capita – evolution and levels
% (l.h.s.), EUR (r.h.s.)



Source: DGCL, Scope Ratings GmbH

Municipal finances are on a stronger footing

Overall, French municipal finances improved during the last mandate. While the decline in State transfers over 2014-17 strained municipal budgets, it also spurred a wave of consolidation across French local authorities and fostered more cost-efficient municipal budgets. Aggregate growth in local operating expenditure averaged 0% over 2014-18, versus 2.4% in 2012-13. This paved the way for stronger budgetary performance and more effective debt management strategies, which allowed municipalities to widen their operating margins, lower their debt burdens and increase self-financed investments once State transfers stabilised. As a result, municipalities are generally on a stronger financial footing today, though regional disparities remain and not all municipalities are equally equipped to face upcoming challenges.

Budgetary and institutional buffers mitigate the impact of Covid-19

Covid-19 pandemic creates high levels of near-term uncertainty

Incoming municipal councils will have to face significant near-term pressures linked to the Covid-19 pandemic, although implications for their financial performance are manageable thanks to budgetary and institutional buffers.

The containment measures implemented in response to the Covid-19 crisis have led to a significant deterioration in France's near-term economic outlook (see Scope's recent comment), with real GDP potentially shrinking up to 10% in 2020. These forecasts remain subject to downside risk, and economic turmoil could extend beyond 2020 depending on how rapidly the virus is contained and lock-down measures are relaxed.

French municipal finances will be impacted due to both lower revenue (as fewer public services are provided) and higher costs linked to extraordinary measures such as free childcare services for hospital workers or expanded support services for the elderly. Similarly, the deference of payment of certain taxes granted to companies can lead to some liquidity pressures. However, lower costs during the lockdown due to a more limited offering of public services will likely mitigate the final impact on operating margins. French municipalities also have access to external liquidity through committed or revolving lines with private banks, which support their liquidity positions.

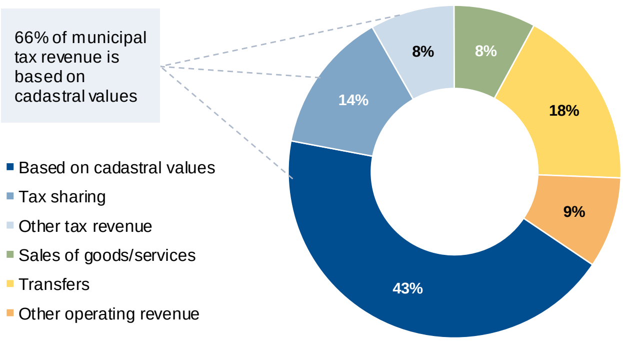
But less cyclically exposed budgets…

We expect a manageable medium-term impact on municipal finances as local budgets are typically less cyclically exposed than that of the central or regional governments. The main sources of tax revenue for French municipalities (66% of tax revenue) are the residency and property taxes whose fiscal base is registry rental values, which are less sensitive to economic shocks (**Figure 11**). Additionally, French municipalities have a large share of capital expenditure which can be postponed, thus absorbing adverse impacts of lower revenue on their margins. This ability to withstand economic shocks was apparent during the global financial crisis, when French municipal finances were far less impacted than those of the central government.

…and a supportive institutional framework provide buffers

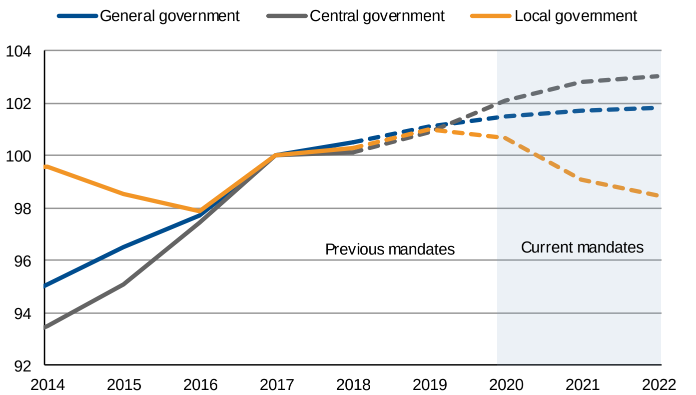
French municipalities also benefit from a supportive institutional framework. The government has already announced increases in State transfers to fund investments while a more substantial financial support package will likely be included in the next budget law. At the same time, liquidity pressures are mitigated by regular and predictable cash inflows, including State transfers and local taxes, which are paid monthly and guaranteed by the government through the centralised Treasury accounts. We also expect the government to provide liquidity support in the form of VAT advances. The government can also provide further exceptional assistance in case of severe cash constraints through the Treasury accounts.

Figure 11. Composition of municipal operating revenue
%



N.B. Tax revenue is represented in shades of blue.
Source: DGCL, Scope Ratings GmbH

Figure 12. Public spending per government level
2017 = 100



N.B. The dotted lines reflect public spending trends as outlined in the 2018-22 budget programme.
Source: Eurostat, Scope Ratings GmbH

Structural developments pose longer-term challenges

Residency tax reform reduces revenue flexibility

Longer term, a key issue facing incoming mayors is the residency tax (*taxe d'habitation*) reform. Emmanuel Macron's government is following through on its campaign promise to eliminate the residency tax for French households (for 80% of households in 2020 and entirely by 2023). The tax, which amounts to around a fifth of municipal operating revenue, represents a key pillar of tax authority for French local authorities (see previous Scope research). The government has committed to compensating municipalities entirely by transferring the *département*'s share of the built property tax (*taxe foncière sur propriété batie*), with additional compensating transfers if necessary. The reform will increase the concentration of municipal tax bases, which could undermine revenue flexibility and increase fiscal pressures for property owners, as highlighted recently by the OECD[8]. This has created additional revenue uncertainty for local authorities, which may hamper local investment.

Rising post-crisis cost containment pressures

Finally, there is a risk of increasing central government pressure to contain local government spending. The government's efforts to reduce the deficit have increasingly focused on local government budgets in recent years. The 2018-22 budget programme projects sizeable local savings of EUR 13bn, while central government spending is set to increase (**Figure 12**). The substantial EUR 110bn support package announced by the government in response to the Covid-19 outbreak will significantly widen the budget deficit

[8] OECD (2019), Economic Surveys: France April 2019.

to at least 8% in 2020. This, on top of political commitments to increase education and healthcare spending will weigh on public finances. The risk is that the State seeks to achieve cost savings once the health and economic crises are over, which may put additional pressure on local governments.

Since 2014, local public expenditure has been steered by non-binding growth ceilings (*Objectif d'Evolution de la Dépense Locale*), currently set at a rate of 1.2% up to horizon 2022. In 2018, the State reinforced this mechanism by signing legally binding contractual agreements with the 322 largest sub-national authorities. Local governments that have not signed an agreement will still be subject to spending controls and may receive penalties if they exceed their targets. The expenditure norm has been suspended to give regional and local governments more budgetary leeway in response to the Covid-19 pandemic. Still, longer term, municipalities that have rigid expenditure structures or which have not effectively implemented cost-saving measures risk facing central government pressure to streamline their spending in years to come.

Concluding remarks

Overall, French municipal finances have improved over 2014-18, with stronger and converging operating performance, lower debt burdens as well as higher investment levels overall. Yet, divergences remain, with some regions showing more robust municipal finances than others. While this aggregate approach does not give a complete picture of the financial standing of individual municipalities, it provides an indication of which regions' local authorities are best equipped to face upcoming challenges.

Municipalities in regions with strong finance scores such as Pays de la Loire, Grand Est, Bretagne, Bourgogne-Franche-Comté and Normandie are better equipped to face upcoming short-term and medium-term challenges, while municipalities in Provence-Alpes-Côte d'Azur and Île de France are more exposed to these risks.

While the Covid-19 crisis will have a significant impact on the French economy and central government finances, inherent budgetary buffers and a supportive institutional framework will mitigate its impact on local government finances. However, more material challenges related to the residency tax reform and potential post-crisis consolidation measures pose longer-term risks.

Annex I. An overview of the CVS approach

To assess the robustness of municipal finances at the regional level, we use a modified version of the CVS approach detailed in Scope's Sub-sovereign Methodology. More specifically, we use the two pillars of the CVS which cover fiscal fundamentals: the *Debt burden* and *Budget performance* pillars. Due to data availability, not all of the indicators presented in the Sub-sovereign methodology have been used here. We also include the payback ratio and CAPEX as a percentage of operating revenue, as both indicators are particularly relevant in the French context. Local authorities often use the payback ratio to steer their budgets, while investment intensity captures the extent which municipalities fulfil their key role as public investors. CVS scores are calculated using the following seven indicators:

Pillar	Weight	Indicator	Purpose	Sub-weight
Debt burden	57%	Interest payments (% of operating revenue)	Indicates the level of debt affordabillity	33%
		Debt (% of operating revenue)	Measures the level of indebtedness	33%
		Payback ratio (years of operating balance)	Measures the capacity to deleverage	33%
Budgetary performance	43%	Operating balance (% of operating revenue)	Indicates the capacity to repay its debt and self-finance investments	50%
		Personnel expenditure (% of operating expenditure)	Indicates level of expenditure flexibility	20%
		Transfers (% of operating revenue)	Indicates the level of revenue flexibility and self sufficiency	20%
		CAPEX (% of operating revenue)	Measures the level of local public investment relative to revenue generating capacity	10%

We use three-year weighted averages of the latest available data (2016-18). After controlling for outliers, we calculate the minimum and the maximum values for each indicator and place the regions within this range. We apply a minimum-maximum algorithm to determine a score ranging from 1 (weakest) to 100 (strongest) for each financial metric: $1 + 99 \times |(\mathrm{X} - \mathrm{MIN})|/(\mathrm{MAX} - \mathrm{MIN})$. We then aggregate the scores using the weights outlined above.

Annex II. Full overview of CVS inputs and scores

	Debt, % operating revenues		Payback ratio, years		Financial expenditure, % operating revenues		Debt score	Operating balance, % operating revenues		Personnel expenditure, % operating expenditures		Transfers/grants, % operating revenues		CAPEX, % operating revenues		Budget score	CVS final score
	Ratio	Weight 33%	Ratio	Weight 33%	Ratio	Weight 33%	Weight 57%	Ratio	Weight 50%	Ratio	Weight 20%	Ratio	Weight 20%	Ratio	Weight 10%	Weight 43%	
Auvergne-Rhône-Alpes	83.2	30.7	4.8	25.8	3.1	6.7	21.0	17.3	75.4	52.8	61.7	16.0	100.0	27.3	73.5	77.4	**45.3**
Bourgogne-Franche-Comté	80.4	44.2	4.6	53.1	2.7	47.5	48.3	17.6	79.1	49.8	100.0	20.8	50.5	28.4	85.9	78.2	**61.2**
Bretagne	79.6	47.6	4.2	100.0	2.9	26.2	57.9	19.2	100.0	54.0	41.9	21.6	42.6	28.3	85.5	75.4	**65.5**
Centre-Val de Loire	76.6	61.9	5.0	2.4	2.8	35.9	33.4	15.3	48.5	55.1	24.8	20.4	54.5	25.2	47.9	44.9	**38.3**
Corse	68.6	100.0	5.7	1.0	2.3	100.0	67.0	12.1	5.5	56.6	1.0	25.7	1.0	36.9	100.0	13.1	**43.8**
Grand Est	78.8	51.6	4.4	75.4	2.7	52.1	59.7	18.0	84.7	50.4	100.0	22.5	33.1	29.5	100.0	79.0	**68.0**
Hauts de France	70.8	89.3	4.7	38.9	2.5	71.3	66.5	15.1	45.6	55.8	13.2	25.4	3.6	23.0	21.5	28.3	**50.1**
Normandie	71.9	84.3	4.6	54.6	2.4	80.0	73.0	15.8	55.0	52.9	59.6	24.8	9.8	23.2	24.6	43.8	**60.4**
Nouvelle Aquitaine	75.1	69.2	4.7	36.2	2.6	58.5	54.6	16.0	57.4	53.3	53.5	19.9	59.4	26.2	60.2	57.3	**55.8**
Occitanie	79.3	49.0	5.0	1.0	2.8	34.1	28.0	15.8	55.0	54.2	39.4	20.0	58.8	27.2	71.6	54.3	**39.3**
Pays de la Loire	71.1	88.1	3.8	100.0	2.7	49.3	79.1	18.8	95.4	53.9	44.5	21.1	47.5	26.0	57.8	71.9	**76.0**
Provence-Alpes-Côte d'Azur	89.5	1.0	6.9	1.0	3.1	1.0	1.0	12.9	16.3	58.8	1.0	13.8	100.0	21.9	8.8	29.2	**13.1**
Île-de-France	93.6	1.0	8.0	1.0	2.9	29.4	10.5	11.8	1.0	58.8	1.0	11.7	100.0	21.3	1.0	20.8	**14.9**

Annex III. Summary of Scope's 'framework-driven' approach

Step 1 - Framework assessment: integration with the sovereign - country/government layer specific

Category	Weight	Sub-weight		Integration	Score	Weighted score
Institutionalised support	50%	25%	Transfer & bailout regime	Medium	50	13
		15%	Borrowing limits	Full	100	15
		10%	Funding support	Medium	50	5
Fiscal interlinkage	35%	20%	Tax authority	Medium	50	10
		15%	Fiscal equalisation	Medium	50	8
Political coherence	15%	10%	Distribution of powers	Medium	50	5
		5%	Common policymaking	Medium	50	3
			Integration with the sovereign		Σ	58

Integration	Indicative range
0-10	0-10
10-20	0-9
20-30	0-8
30-40	0-7
40-50	0-6
50-60	0-5
60-70	0-4
70-80	0-3
80-90	0-2
90-100	0-1

Step 2 - Individual credit profile - issuer specific

Category	Weight	QS	Risk	Score	CVS	Score	Weight	Total (QS-CVS avg)
Debt burden and liquidity profile	40%	Debt profile	Low	100	Interest, % op.rev.	43	50%	79
		Contingent liabilities	Low	100	Debt, % op.rev	51	25%	
		Funding and liquidity mgmnt	Low	100	Balance before debt, % op.rev.	94	25%	
		Debt QS score	Σ	100	*Debt CVS score*	Σ	58	
Budget performance and flexibility	30%				Operating balance, % op.rev.	100	40%	72
		Budget management	Low	100	SD operating balance	90	15%	
		Expenditure flexibility	Medium	50	Personnel exp., % op.exp.	66	15%	
		Revenue flexibility	Medium	50	Capex, % tot exp.	70	15%	
					Transfers, % op.rev.	24	15%	
		Budget QS score	Σ	67	*Budget CVS score*	Σ	78	
Economy and social profile	20%				GDP per capita	15	40%	40
		Growth & diversification	Medium	50	Unemployment rate	51	20%	
		Labour market & demographics	Medium	50	GDP volatility	62	20%	
					Old-age dependency ratio	7	20%	
		Economy QS score	Σ	50	*Economy CVS score*	Σ	30	
Quality of governance	10%	Recent events & policy risk	Low	100	Quality	66	33%	73
		Transparency & accountability	Low	100	Impartiality	36	33%	
					Corruption	34	33%	
		Governance QS score	Σ	100	*Governance CVS score*	Σ	45	
						Individual credit profile	Σ	68

Step 3 - Indicative rating: notch adjustment - *downwards* - from sovereign rating

Individual credit profile: 68

Indicative maximum notch adjustment from sovereign rating:

Indicative sub-sovereign rating			Strong ≥ 75	≥ 65	Medium ≥ 55	≥ 45	≥ 35	Weak ≥ 25	< 25
Institutional framework: Integration with sovereign (58)	Full	0 - 1	0	0	0	-1	-1	-1	-1
		0 - 2	-1	-1	-1	-1	-1	-2	-2
		0 - 3	-1	-1	-1	-2	-2	-2	-3
	Medium	0 - 4	-1	-1	-2	-2	-3	-3	-4
		0 - 5	-1	-2	-2	-3	-3	-4	-5
		0 - 6	-2	-2	-3	-3	-4	-5	-6
		0 - 7	-2	-2	-3	-4	-5	-5	-7
	Low	0 - 8	-2	-3	-4	-4	-5	-6	-8
		0 - 9	-2	-3	-4	-5	-6	-7	-9
		0 - 10	-3	-4	-5	-6	-7	-8	-10

Issuer
Sub-Sovereign A
Country
France
Sovereign rating
AA
Indicative rating adjustment
-2
Additional considerations
-
Final rating
A+

Our approach to rating sub-sovereigns is split into three fundamental steps:

1) We determine the degree of intergovernmental integration between the sovereign and sub-sovereign entity per government tier by assessing the supportiveness of the institutional framework. We determine an indicative rating range vis-à-vis the sovereign rating whereby, the higher (lower) the level of integration, the narrower (wider) the range.
2) Having established the indicative rating range from the sovereign within which the ratings of the respective sub-sovereigns can fall, we assess the individual credit profile by benchmarking core variables and qualitative factors against national peers.
3) We determine the indicative sub-sovereign rating by mapping the indicative maximum rating distance from the sovereign rating, as determined by the institutional framework assessment, to the individual credit profile.

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