City of Milan
Rating Report

STABLE OUTLOOK
BBB+

Credit strengths

- Ample liquidity
- Sound budgetary and financial management
- Wealthy socio-economic profile
- Effective governance
- Supportive framework

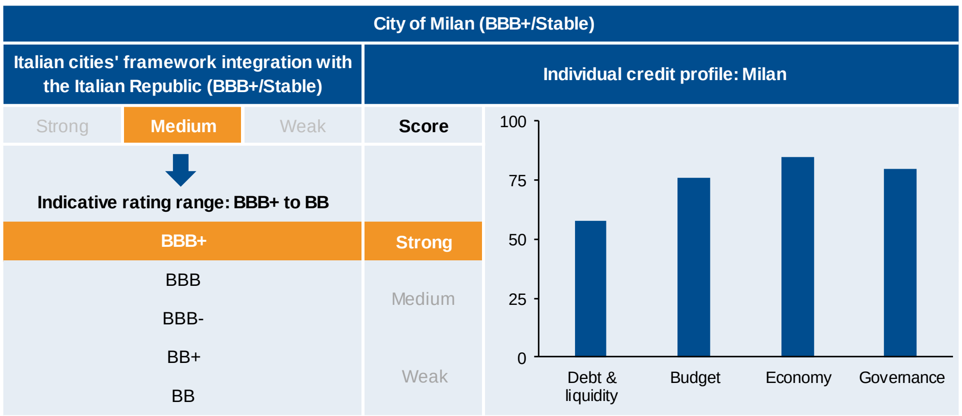
Credit weaknesses

- Large debt stock
- Limited revenue flexibility
- Sizeable, though low-risk, contingent liabilities

Rating rationale and Outlook: The BBB+ rating reflects the City of Milan (Milan)'s sound budgetary and financial management, ample liquidity, wealthy socio-economic profile and effective governance. In addition, the rating is supported by an integrated institutional framework under which Italian cities operate, which ensures fiscal discipline and present a record of budgetary and funding support from the central government. These elements support our view that the city's finances will be able to weather the withdrawal of pandemic-related central government support and resume a path of reduction in debt levels, although the Covid-19 shock and now the economic ramifications of the Russia-Ukraine war reduce the budgetary room for manoeuvre. Credit challenges relate to Milan's high debt stock, limited revenue flexibility, and its sizeable, yet manageable, contingent liabilities.

The Stable Outlook reflects our view that risks to Milan's rating are balanced over the next 12 to 18 months.

Figure 1: Scope's approach to rate the City of Milan



Source: Scope Ratings

Positive rating-change drivers

- Upgrade of Italy's sovereign rating
- Changes in framework resulting in higher budgetary and financial flexibility

Negative rating-change drivers

- Downgrade of Italy's sovereign rating
- Protracted deterioration in operating margins weakening debt affordability
- Notable increase in debt

Ratings & Outlook

Foreign currency

Long-term issuer rating	BBB+/Sta
Senior unsecured debt	BBB+/Sta
Short-term issuer rating	S-2/Sta

Local currency

Long-term issuer rating	BBB+/Sta
Senior unsecured debt	BBB+/Sta
Short-term issuer rating	S-2/Sta

Lead analyst

Giulia Branz
+49 69 6677389 43
g.branz@scoperatings.com

Team leader

Dr Giacomo Barisone
+49 69 6677389 22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Institutional framework

Record of support and prudent restriction of market exposure

Milan benefits from the mature legal and fiscal framework that underpins the intergovernmental integration between cities and the central government in Italy. The fiscal policy defined at the central level has helped maintain fairly low deficit and debt levels in the municipal sector in an international context, with prudent restrictions on debt and liquidity management limiting cities' exposure to market risk. The framework benefits from preventive checks and conditional financial assistance in the 'dissesto' procedure, an extraordinary support mechanism aiming to avoid defaults. Sovereign on-lending plays a dominant role, with state-owned promotional bank Cassa Depositi e Prestiti (CDP, BBB+/Stable[1]) as the main creditor of Italian sub-sovereigns.

Frequent reforms of municipal taxes and need to contribute to national fiscal consolidation

Following the financial and sovereign debt crises, municipal finances have been subject to frequent reforms affecting their tax bases and cuts to the equalisation system, thereby contributing to the national fiscal consolidation process. The main revenue sources include a high share of own taxes – on property, general services and supplements to personal income tax. Cities have limited room to manoeuvre in adjusting tax rates.

Municipalities' finances were protected during Covid-19

In response to the Covid-19 pandemic, system-wide support measures have been made available to municipalities. The central government has earmarked funds to restore revenue losses and support investments, while CDP has allocated liquidity advances to speed up the repayment of commercial debt and reprofiled cities' loan repayments.

Figure 2: Framework assessment

Institutional framework assessment: Italian cities					
Category	Weight		**Assessment:** Integration	Score	Weighted score
Institutionalised support	25%	Transfer & bailout regime	**High**	100	25
	15%	Borrowing limits	**High**	100	15
	10%	Funding support	**Medium**	50	5
Fiscal interlinkage	20%	Tax authority	**Medium**	50	10
	15%	Fiscal equalisation	**Medium**	50	8
Political coherence	10%	Distribution of powers	**Medium**	50	5
	5%	Common policymaking	**Medium**	50	3
			Integration with the sovereign	**Σ**	**70**

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

Source: Scope Ratings

Our assessment of the intergovernmental integration between Italian cities and the central government results in an indicative downward rating distance of a maximum of four notches[2] between the Italian sovereign (BBB+/Stable[1]) and an Italian municipality (**Figure 2**), depending on its individual credit profile strength. This reflects:

'High' institutionalised support: discretionary and rule-based support; credible borrowing limits

- Central government's record of providing discretionary and rule-based support to municipalities, including via the 'dissesto' procedure;
- Credible fiscal rules, which are among the strictest in the EU, including quantitatively specified and legally binding borrowing limits;

'Medium' fiscal interlinkage: government dominance of tax system

- Restricted capital market access with less preferential regulatory treatment of municipal debt versus sovereign debt (different risk weights under Basel) though the sovereign and CDP provide regular funding;
- Central government control over major tax rates and redistribution across municipalities covering mandatory spending; and

'Medium' political coherence: some coordination across government layers

- Lack of legislative autonomy, but political coordination across government layers.

[1] Amended on 23 January 2023, substituting "Negative", which was incorrectly included in the original publication.
[2] With intergovernmental integration at 70% (threshold value), we opted conservatively for the indicative four-notch range.

Individual credit profile

We assess Milan's individual credit profile as strong vis-à-vis national peers in view of: i) its conservative debt and liquidity management supporting a continuous reduction in the debt stock and robust debt profile, coupled with high cash reserves and good access to external liquidity; ii) sound budget management and above-average budgetary flexibility; iii) dynamic local economy as the country's leading commercial, industrial and financial hub, strengthening the city's ability to generate own revenues for the long term; and iv) high-quality governance, with a record of meeting policy objectives. This justifies the positioning of the city's rating at the upper end of the rating range for Italian municipalities as defined by their institutional framework, resulting in Milan's final rating being aligned with that of the sovereign at BBB+. Our qualitative and quantitative assessments are summarised in the scorecards reported in the annex.

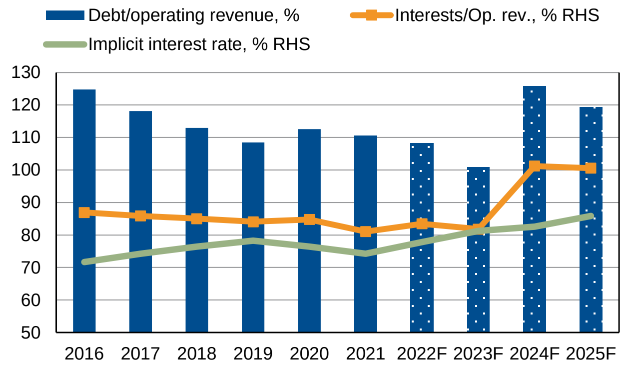
Debt burden and liquidity profile

High but declining debt with a favourable profile

Milan's debt is high, at EUR 3.7bn by end-2021, corresponding to 110.6% of its operating revenue (**Figure 3**). The Covid-19 shock interrupted the significant deleveraging achieved during 2015-19, with a cumulative reduction in its debt stock of over half a billion euros. In 2020 and 2021, Milan issued new debt of EUR 150m and EUR 200, respectively, to support investment in the context of the weakened economic outlook, resulting in an overall debt increase of EUR 120m from 2019 levels. The debt stock includes EUR 560m in flexible loans and credit lines yet to be used, which meaningfully lower funding needs in coming years. Funds for investments under the National Recovery and Resilience Plan will also reduce the need for the debt financing of capex, with Milan expecting to receive more than EUR 4bn in the next five years.

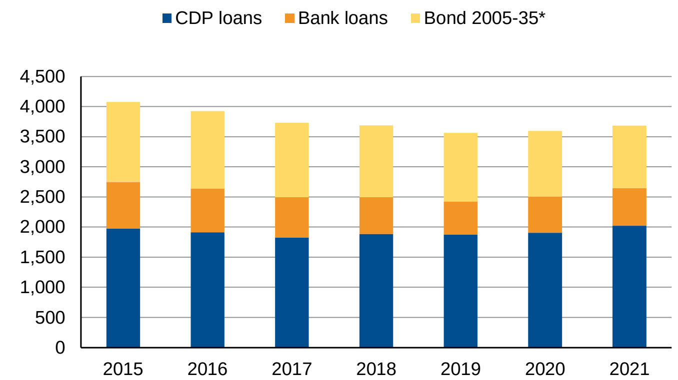
Debt solely comprises euro-denominated borrowings for long-term investment programmes and is naturally or synthetically amortising, substantially reducing refinancing risks, supported by the very long average debt maturity of 18.5 years. The city pays EUR 50m annually into a sinking fund for the repayment of a bullet bond maturing in 2035. The bond constitutes around a third of Milan's debt, while about 70% of outstanding debt is in the form of loans. The main creditor is CDP, with close to 55% of Milan's total debt, which strengthens the long-term nature of the city's creditor base. The high share of debt with fixed interest rates (82% of total) has led to a broadly stable interest-payment burden, at 3.7% of operating revenue in 2017-21, slightly above national peers' average but well within borrowing limits for municipalities set at 10% of current revenue (**Figure 4**).

Figure 3: Debt burden
%



Source: Comune di Milano, Scope Ratings

Figure 4: Debt composition, by creditor
EUR m



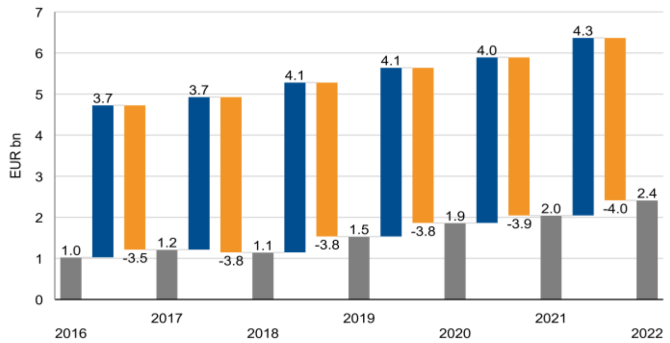
*Net of sinking fund
Source: Comune di Milano, Scope Ratings

We expect debt to resume a downward path this year, in line with the city's expectations. The issuance of about EUR 50m in new debt every year over 2022-25 is below annual repayments, which should lead to a decline in the debt stock to EUR 3.2bn by 2025 (**Figure 3**). In relative terms, debt would decline to about 108% of operating revenue this year, broadly in line with 2019 levels. Despite the decline in the nominal stock, debt should be around 120% of operating revenue by end-2025, which is due to a structural reduction in revenues of about EUR 700m in 2024 resulting from the re-allocation of transport services at the provincial level. Annual debt service would increase, averaging 11% of operating revenues over 2022-25, from just 7% in 2020-21, as the supportive effects of renegotiations of loan repayments come to an end. Still, the city's active debt management measures, including the use of flexible loans to contain interest costs, will keep the debt burden manageable in the coming period.

Contingent liabilities unlikely to materialise

Financial debt related to the main companies owned by Milan is high in an international context, totalling around EUR 6bn in 2020, or 190% of the city's operating revenue. However, associated contingent liabilities have a low risk of materialising in the city's budget as the most indebted entities are self-supporting and have generally reported positive financial results in recent years. 75% of this debt relates to A2A Spa, the largest Italian multi-utility, which has consistently reported net profits and pays regular dividends (EUR 63m last year) to the city. However, other companies in the transport sector, especially Sea Spa and Atm Spa, were significantly exposed to Covid-19-related shocks. They incurred significant losses in 2020-21, which could, however, be fully absorbed by own reserves. We expect this shock to be short-lived. Signs of recovery were already robust last year, with both companies able to halve their losses. We expect further improvements this year given the removal of Covid-19 restrictions and a faster-than-expected recovery in air traffic. Guarantees issued by Milan declined to around EUR 230m in 2021, from EUR 340m in 2015, and primarily relate to Atm Spa in the context of metropolitan equipment renovation co-financed by the EIB.

Figure 5: Cash position at year beginning, EUR bn
Inflows: blue, outflows: orange, deposits: grey



Source: Comune di Milano, Scope Ratings

Figure 6: Cash collection and payment rates, %
2019-2021

		Milan	Peer 1	Peer 2	Peer 3	Peer 4
Current revenue - cash collection						
Budgeting accuracy (final % of budgeted)	Accrual	100	100	88	98	97
	Cash	84	52	76	69	77
Cash collected, % of revenue		77	66	66	75	62
Current expenditure - cash payment						
Budgeting accuracy (final % of budgeted)	Accrual	83	82	65	80	73
	Cash	72	65	57	71	73
Cash paid, % of expenditure		81	78	54	73	77

Source: BDAP, Scope Ratings

Strong liquidity, with substantial cash at hand and good access to external sources

Milan's liquidity is strong in relation to national peers. The city's sound financial management has resulted in high cash holdings, which increased to EUR 2.4bn at end-2021 from EUR 1.2bn in 2016 (**Figure 5**). Cash reserves can cover twice the cumulative debt service expected over the next three years, thus constituting a significant backstop against emergencies. Prudent liquidity assumptions have strengthened Milan's ability to generate cash flow, with realistic estimations of cash collection underpinned by the low cyclicality of its tax base. Milan's cash planning accuracy and collection capacity is better than peers', with cash collection at 77% of current revenue of the same fiscal year, 10pp above the average among the other largest Italian cities (**Figure 6**).

Despite a stronger cash collection capacity than peers, the city is yet to collect large amounts of 'residui attivi', namely, amounts of credits from previous years, of EUR 3.5bn. About half of the amount refers to obligations from more than three years ago, which implies some difficulty in collecting old credits. The city's solid liquidity is reflected in its fast payment timing, with Milan paying suppliers on average before the respective due date. The city has also access to about EUR 815m in advances from its treasurer annually in 2022-24. However, in view of the ample liquidity, it has not resorted to this external cash source in the past. Milan also has a credit line with the EIB to finance the metropolitan train line M4.

Budgetary performance and flexibility

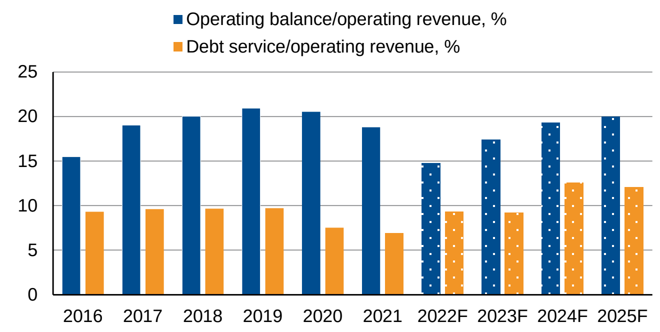
Record of stable operating performance underpinned by sound budgetary planning

Milan's budgetary performance has been strong, with high operating surpluses averaging 19.9% of operating revenues in 2017-21, underpinned by conservative budgetary management, continuous cost controls and moderate tax revenue growth. These factors have also helped Milan to build up cash reserves, self-finance investment and reduce debt (**Figure 7**).

Covid-19 significantly impacted the city's finances and remains a key risk to the outlook

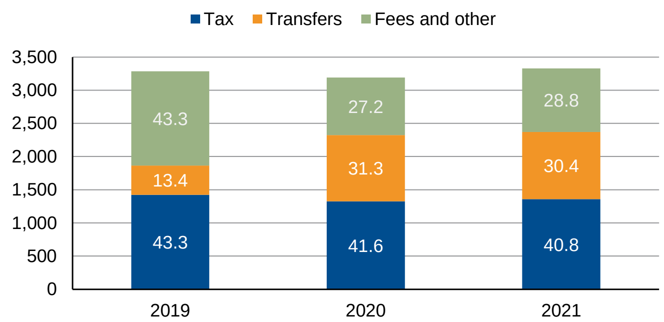
The Covid-19 shock has severely affected Milan's finances. The surrounding region was one of the hardest hit in Italy and consequently subject to a strict regime of containment measures. In 2020 and 2021, the city recorded a decrease in tax and fee revenue of EUR 590m on average (18% of 2019 operating revenue) from 2019. This has been significantly mitigated by an average increase in annual transfers of EUR 560m, incorporating substantial central government extraordinary support. In addition, Milan has maintained a tight grip on spending and made use of accumulated budget surpluses, supporting its ability to maintain a high operating margins and sustain investment without significantly increasing debt (**Figure 8**).

Figure 7: Budgetary performance
%



Source: Comune di Milano, Scope Ratings

Figure 8: Covid-19 impact on operating revenue
EUR m; data labels show share of total in percentage terms



Source: Comune di Milano, Scope Ratings

The key risk to the budgetary outlook relates to the speed of recovery of own revenue, especially fees, after central government transfers decline materially from this year. We expect the city to achieve an operating surplus averaging 18% of operating revenue in 2022-25, although margins are set to be lower in 2022-23. This level would comfortably allow debt service to be covered with current revenue, in line with the legal framework, but falls short of pre-crisis levels. This is based on our expectation of a resilient economic rebound, supporting own revenue recovery, although downside risks have emerged following the Russia-Ukraine war and the related energy price shocks. We also expect a reversal in some of the cost saving during the pandemic with the stop of activities, with high inflationary pressures eroding the margin for cost containment.

On the investment side, Milan should benefit from EU recovery funds, allowing for higher public investment without placing an additional burden on the city's finances. Milan has requested EUR 4.7bn (more than twice the city's cumulative capex in the last five years) to implement 64 projects by 2026. Most of these target environment (EUR 2.4bn) and mobility (EUR 1.3bn). These, together with investments related to the 2026 Olympics Games, support the economic outlook over the medium term.

High revenue autonomy, but limited tax rate manoeuvrability

Milan's operating revenue before the pandemic was dominated by local taxes (45% of operating revenue) and proceeds from services and other activities (45%), which strengthened the link between revenues and economic performance. The high share of property taxes and service charges (65% of operating revenue), in combination with a wealthy socio-economic profile and a growing population, reduces the cyclicality of the local tax base, supporting the city's stable operating performance. The Covid-19 shock temporarily altered structural revenue components, with transfer revenue accounting for double the share in total operating revenue in 2020-21 in relation to the pre-crisis level. As of 2024, the share of transfers should structurally decline to about 10% following the reallocation of transport services at the provincial level. Milan's revenue flexibility is limited despite a growing local tax base because the city has already reached the maximum rates set by the central government. In addition, Milan is a major net contributor to the equalisation fund, with its contribution largely offsetting revenues flowing back to the city.

High expenditure flexibility in national context

Milan benefits from higher expenditure flexibility than peers. This is due to the lower share of rigid spending items, an increasing share of investment expenditure, and a record of keeping current expenditure growth below that of revenue despite frequent reforms affecting municipal taxes and expenditure pressures from a growing population. Operating expenditure relates mainly to the acquisition of goods and services (69%), followed by personnel costs (22%). Over 2017-21, operating expenditure increased on average by 0.4% year-over-year, supported by a flat headcount. At the same time, revenue growth has been 1.2% on average, driving the improving operating performance. Investment expenditure has significantly increased, from 9.2% of total expenditure in 2016, to 16.6% last year. The city was able to finance investment of above EUR 800m per year in 2018-20, with limited recourse to debt financing. Resources allocated to investments declined last year to EUR 560m. The outlook for the next years will, however, benefit from the inflow of EU funding. Considering the Italian Treasury's index on cities' budget structural rigidity, based on personnel costs, deficit rebalancing and debt service relative to current revenue, Milan (25%) compares favourably with an average of 37% in larger cities.

Economy and social profile

Economic and financial hub in national and international context

Milan benefits from a favourable socio-economic profile underpinned by a wealthy, well-diversified and highly competitive economy, resulting in a strong ability to generate own revenues for the long term. Milan is the economic and financial hub of the wealthy region of Lombardy, Italy's core manufacturing and export region, which accounts for one-fifth of Italian GDP. Milan alone accounts for about 9% of Italian GDP and benefits from a wealthy socio-economic profile, with a GDP per capita equivalent to around 185% of the national average (178% of the EU average) (**Figure 9**).

The economy is diversified, with a business-friendly environment attracting international investments and skilled workers, underpinning its high growth potential. The city's appeal to foreign investors is reflected by the fact that 4,700 foreign multinational companies are based in Milan, or around one-third of those active in Italy. The city's multi-sectoral economy ranges from technology-intensive manufacturing and biological sciences to financial services, culture and design. It also benefits from eight prestigious universities, which supports the specialisation in higher-value-added industries.

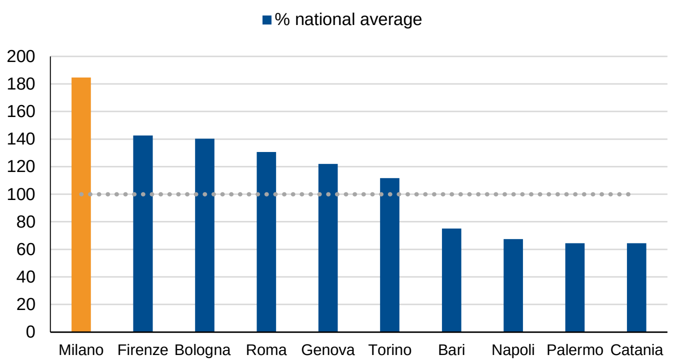
Milan and the surrounding region's economy was severely hit by the Covid-19 pandemic: in 2020, Lombardy's GDP contracted by almost 9%, in line with Italy's decline. This was, however, followed by a strong GDP rebound last year, expected at just below 7%. The recovery has continued into this year, with record production in manufacturing, well above the pre-pandemic trends. Tourism is also recovering much faster than initially anticipated. Still, employment remains below pre-pandemic levels. The uncertainty caused by the

Russia-Ukraine war, especially if the energy crisis worsens, poses substantial risks to the outlook. On the positive side, the large amount of public investment inflow under NGEU and in relation to the Olympic Games are set to support the economy over the coming years.

Positive socio-demographics, driven by attractive labour market

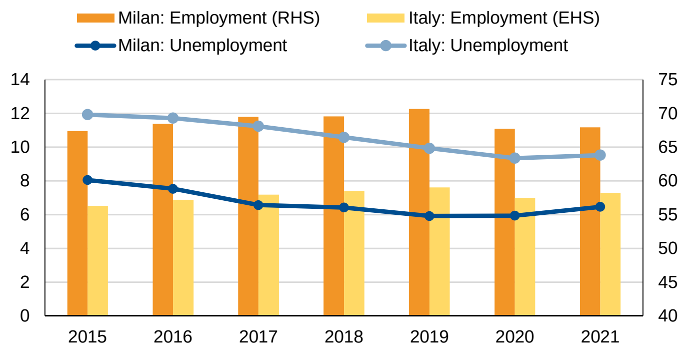
Milan enjoys favourable labour market characteristics and positive demographics, supporting its long-term tax revenue potential. In 2021, the Milan province's employment rate was 68%, well above the national level of 58%, while the unemployment rate was 6.5% compared to Italy's 9.5% (**Figure 10**). Milan's population is expected to increase in the medium term (by around 3.5% by 2030) in view of urbanisation trends, with net migration offsetting the natural decline driven by ageing dynamics.

Figure 9: GDP per capita, % of national average, 2019



NB: data refer to the province level

Figure 10: Employment and unemployment rates, %, 2021



Source: Eurosta, ISTAT, Scope Ratings

Quality of governance

Stable political environment

Milan benefits from a stable political environment, with the centre-left party having led municipal governments since 2006. 2021 elections results confirmed Giuseppe Sala as mayor for a second five-year mandate. We expect continuity in the administration's commitment to fiscal consolidation, signalled by a EUR 500m reduction in the city's debt over 2015-19. The administration's effective governance is reflected in its ability to regularly fulfil policy objectives and present its accounts on time and in compliance with fiscal rules. This has been demonstrated also by the effective management of the city's budget during the Covid-19 pandemic, including preserving compliance with fiscal rules and limiting debt increases while keeping investment high, which has been despite the unprecedent drop in own revenue.

Milan is committed to environmental and social development

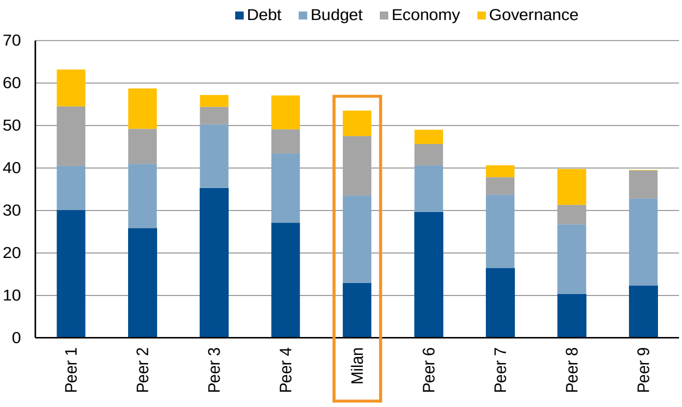
The city has ambitious environmental targets, including carbon-neutrality by 2050 and the recycling of 75% of waste by 2028, as recently outlined in its 'Aria e Clima' plan. In line with those priorities, the administration has confirmed its commitment to foster investment in public transport, by expanding metropolitan lines, supporting bike- and car-sharing, and committing to reconvert all transport operated by ATM to electric by 2030. Milan is one of 100 cities selected by the European Commission for the Cities Mission project and will thus benefit from additional funding and research projects supporting green mobility, energy efficiency and urban greenery. On the social side, Milan aims to increase the supply of social housing by redeveloping existing public property in disuse, identifying new areas in which to realise housing facilities, and offering accessible rents via incentives to private providers. This is on top of leveraging NGEU funds towards projects aimed at improving social services and countering social exclusion.

Annex: scorecards and financial indicators

Figure 11: Qualitative Scorecard (QS)

Individual credit profile - qualitative assessment (QS)					
Category	Weight	Qualitative Scorecard	Risk		
			Low	Medium	High
Debt burden and liquidity profile	40%	Debt profile			
		Contingent liabilities			
		Funding and liquidity			
Budget performance and flexibility	30%	Budget management			
		Expenditure flexibility			
		Revenue flexibility			
Economy and social profile	20%	Growth & diversification			
		Labour & demographics			
Governance	10%	Recent events & policy risk			
		Transparency & accountability			

Figure 12: Quantitative scorecard (CVS)



EUR m	2017	2018	2019	2020	2021
Operating revenue	3,161	3,266	3,285	3,191	3,329
Tax revenue	1,397	1,411	1,423	1,326	1,358
Transfers (incl. equalisation)	439	470	440	998	1,013
Fees and own proceeds	1,325	1,385	1,421	867	958
Interest revenue	17	15	16	16	15
Capital revenue	287	493	591	515	444
Operating expenditure	2,559	2,612	2,598	2,536	2,703
Personnel	590	609	596	582	580
Goods and services	1,758	1,797	1,805	1,734	1,857
Other current expenditure	211	206	197	220	266
Interest payments	120	122	122	119	118
Capital expenditure	371	385	513	607	580
Operating balance	602	654	687	656	626
Capital balance	-84	107	78	-92	-136
Balance before debt movement	411	624	677	262	387
Gross borrowing (incl. flexible loans already in the debt stock)	111	127	117	127	96
Redemption	184	193	198	121	113
Operating balance/operating revenue, %	19.0	20.0	20.9	20.5	18.8
Balance before debt movement/total revenue, %	11.3	15.7	16.9	7.0	10.0
Interest payments/operating revenue, %	3.8	3.8	3.7	3.7	3.6
Transfers/operating revenue, %	13.9	14.4	13.4	31.3	30.4
Personnel expenditure/operating expenditure, %	23.0	23.3	22.9	23.0	21.5
Capex/total expenditure, %	11.5	11.5	15.4	17.4	16.6
Debt (EUR m)	3,734	3,688	3,564	3,594	3,683
Debt/operating revenue, %	118.1	112.9	108.5	112.6	110.6
Debt service/operating revenue, %	9.6	9.7	9.7	7.5	6.9

Source: Comune di Milano, BDAP, Scope Ratings

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR - 75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer