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PUBLIC SECTOR EUROPE

CREDIT OPINION
14 December 2021

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RATINGS

Walloon Region

Domicile	Belgium
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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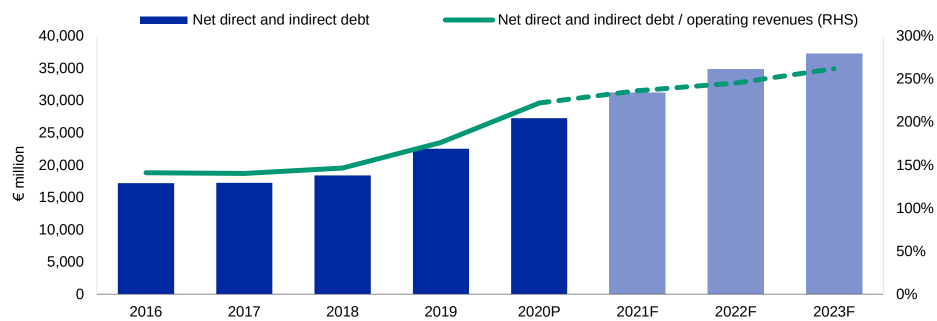
Walloon Region (Belgium)

Update following the downgrade to A3/(P)P-2, stable outlook

Summary

The credit profile of the Walloon Region (A3 stable) reflects the permanent impact that the coronavirus crisis is expected to have on its deficit and debt trajectories, and our expectation that the region's debt burden will be very high for longer. Our assessment of the Walloon Region's creditworthiness also takes into account a mature and robust legislative background, prudent but sophisticated debt management and its unquestioned market access, as well as its tax autonomy. The Walloon Region benefits from a high likelihood of support from the government of Belgium (Aa3 stable) if it were to face acute liquidity stress.

Exhibit 1
Following the coronavirus shock in 2020, the region's debt and debt burden will be permanently very high



P: Preliminary data, F: forecast
Source: Walloon Region, Moody's Investors Service

Credit strengths

» A mature and robust legislative background with well-defined responsibilities amid a complex Belgian institutional system

» Revenue flexibility is high, and the region is committed to increasing its expenditure flexibility and to proceeding with spending cuts

» Sophisticated but prudent debt management underpins unquestioned market access

Credit challenges

» Substantial financing deficits will push the region's debt burden to a very high level for longer

» An economy which compares unfavorably with national and European peers

Rating outlook

The stable outlook reflects our view that strong debt and liquidity management as well as high debt affordability and strong market access are consistent with a A3 rating.

Factors that could lead to an upgrade

An upgrade of the Walloon Region's rating would require consecutive years of balanced budgets or financing surplus, leading to a downward trend in the debt burden ratio towards pre-coronavirus levels. An upgrade of Belgium's sovereign bond rating would also have positive implications for the region.

Factors that could lead to a downgrade

A continuation of the increase in the region's debt burden from already very high levels, due to a failure to implement savings and/ or to a less supportive economic growth than currently expected, would weigh on the ratings. A material increase in the region's interest burden and/ or a material weakening in its market access would also be credit negative. A downgrade of Belgium's sovereign bond rating would have negative implications for the Walloon Region as well.

Key indicators

Exhibit 2

	2015	2016	2017	2018	2019	2020P	2021F	2022F	2023F
Gross operating balance / operating revenues (%)	-1.3%	-2.6%	-4.0%	-2.9%	-6.0%	-23.0%	-28.6%	-8.3%	-8.9%
Interest expenses / operating revenues (%)	2.2%	2.1%	2.2%	2.3%	2.1%	2.3%	2.6%	2.4%	2.7%
Capital spending / total expenditure (%)	2.8%	2.3%	2.6%	2.4%	2.6%	1.6%	4.4%	16.1%	12.7%
Financing surplus (requirement) / of total revenues (%)	-4.2%	-5.0%	-6.7%	-5.5%	-8.9%	-24.9%	-34.4%	-25.4%	-21.2%
Direct debt / operating revenues (%)	70.1%	71.0%	75.9%	89.8%	98.9%	134.1%	151.4%	166.7%	188.5%
Net Direct and Indirect debt / operating revenues (%)	137.3%	140.8%	140.2%	146.4%	176.0%	222.0%	236.3%	245.2%	266.2%

P: Preliminary data, F: forecast
Source: Walloon Region, Moody's Investors Service

Detailed credit considerations

On December 3 2021, we downgraded the Walloon Region's long-term issuer and senior unsecured, and short-term debt ratings to A3/(P)P-2 from A2/(P)P-1 to reflect the long-lasting impacts of the coronavirus crisis and our expectation that the region's debt burden will increase to a very high level as the region will continue to post substantial financing deficits.

The credit profile of the Walloon Region, as expressed in its A3 rating, combines a BCA of baa2 – which has been downgraded from a3 to reflect the long-lasting impacts of the coronavirus crisis on financing deficit and debt trajectories – and the high likelihood of extraordinary support from the federal government if the entity were to face acute liquidity stress.

Baseline Credit Assessment

A mature and robust legislative background with well-defined responsibilities amid a complex Belgian institutional system

The country's federal structure of government has gradually, but significantly, evolved over the past decades towards a greater devolution of decision-making power to the six federated entities – one of which is the Walloon Region. This has included greater tax autonomy for regions, with the implementation in 2015 of the Sixth State Reform. The determining characteristic of a region is its geographical area, while that of a community is its culture and language. The Walloon Region represents 55% of the Belgian territory but 32% of its population. The communities cut across the regions and the French Community (CFB, A2 stable) comprises all the residents of the Walloon Region and Brussels-based French-speaking inhabitants (approximately 4.2 million inhabitants). At the federated level, there are five legislatures (all elected for a five-year term) and five governments (elected by the Parliament, which in turn elects a president): the Walloon Parliament and Government, the Flemish Parliament and Government (which represent both the region and the Community of Flanders [Aa3 stable]), the Brussels Region Parliament and Government, the German-speaking Community Parliament and Government, and the French Community Parliament and Government.

While the country's regional disparities and divisions are associated with governance complexities at the federal level, the legislative background – which encompasses the arrangements determining intergovernmental relations at all levels, as well as jurisdictional powers and responsibilities – is mature and robust. Exclusive responsibilities assigned to the federated entities are stable, and regions are competent in territorial matters (including economic development, transports, environment, housing) as well as employment. The remaining responsibilities are assigned to the federal government (including foreign affairs, national defence and justice). The distribution of responsibilities is subject to judicial control, exercised by the Constitutional Court of Belgium (which can undo legislation that contravenes the division of powers), and by the Council of State. For the Walloon Region, it also means that revenues and spending responsibilities are well-defined, that tax autonomy is ensured and that changes could not occur suddenly. Any change to the legislation that governs Belgian sub-sovereigns must be approved by a majority in both linguistic groups (French and Dutch/German) in the national Parliament, in addition to a two-thirds overall majority.

Sophisticated but prudent debt management underpins unquestioned market access

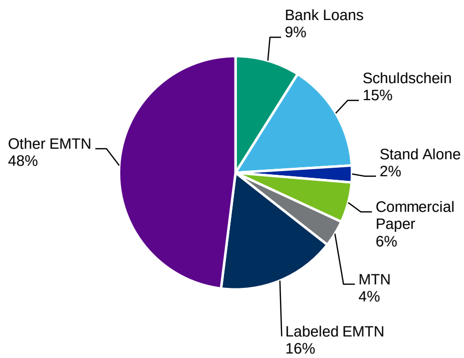
As one of the federated regions and communities in Belgium, the region has always benefitted from a very strong access to diversified funding sources. The region recently created a debt agency in order to optimize its funding and cash management. Debt management is based on prudent rules, including: (i) debt due within one and five year(s) must remain below 15% and 50% of total outstanding debt, respectively; (ii) the target share of variable-rate debt is 15%; (iii) there is no exposure to foreign currency risk; (iv) the use of swaps is non-speculative (the region always holds an underlying asset – outstanding commercial paper is therefore considered as long-term debt based on the maturity of the associated swaps). We also note that in the past few years the region took over the debt of several satellite organizations (*Unités d'Administration Publique*) in order to minimize their funding costs and achieve greater transparency.

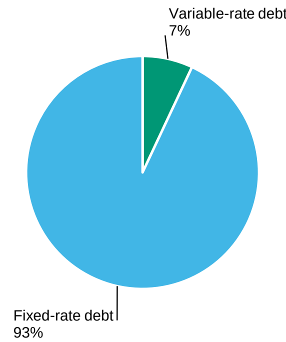
The region benefits from very strong access to external liquidity. Instruments comprise: (i) a €20 billion EMTN (Euro Medium Term Note) programme; (ii) MTN (Medium Term Note) programmes, which can be used for short- (*billets de trésorerie*) and long-term maturities (€1.25 billion with BNP Paribas Fortis SA/NV [A1/A2 stable]; and €2.5 billion with Belfius Bank SA/NV [Belfius, A1/A1 stable]); and (iii) a €3.25 billion overdraft cash facility – including a firm commitment underwriting agreement – with Belfius. In addition, in December 2021, the region signed a financing agreement with the European Investment Bank (EIB, Aaa stable) for a total of €1.1 billion to fund social housing energy efficiency works and flood resilience projects.

The region's long-term funding strategy has evolved to face increasing financing needs. In 2020 and 2021, the region issued five highly demanded benchmark bonds for a total amount of €3.7 billion and €2.2 billion, respectively, two of which labeled bonds (sustainability and social). 2021 issuances include a €500 million 50-year bond which attracted an order book at 1.8 times issuance size – shorter maturity benchmarks issued in 2021 attracted even higher book sizes (2.7x and 3.9x). Since 2019, it has been aiming to regularly issue labeled debt in a benchmark format in order to build a yield curve and increase its investor base. Access to the European Central Bank (ECB)'s monetary policy support programmes further enhances the region's market access.

The Walloon Region's liquidity is also supported by predictable and regular cash flows. In addition, it has centralized the cash balances of some of its satellite organizations to improve cash management and therefore optimize its financing – this allows the region, for example, to smooth out its transfer payments to satellites.

Exhibit 3
The region's debt is diversified and largely immune to interest rate shocks
As a % of direct debt (excluding bank overdraft) as of 31/12/20





EMTN : Euro Medium Term Notes
Source: Walloon Region, Moody's Investors Service

Revenue flexibility is high, and the region is committed to increasing its expenditure flexibility and to proceeding with spending cuts
The Walloon Region benefits from a high degree of tax autonomy. Tax revenues represented 42% of total revenues in 2019. The region has rate-setting powers on regional taxes (approximately 20% of revenues in 2019). In addition, since the implementation of the Sixth State Reform in 2015, the region benefits from increased flexibility to modify a regional surcharge rate on personal income tax (PIT) (21% of revenues in 2019). This flexibility is limited, however, given that regional PIT proceeds are derived by applying the surcharge rate to federal PIT proceeds – the region has no control over marginal tax rates and brackets, which are both set at the federal level. While there is currently no plan for the Walloon Region to use this flexibility, it better positions the region to mitigate any budget shortfall by raising taxes. Without accounting for potential behavioral effects, a 0.1 percentage point increase in the regional surcharge rate (to 33.357% from 33.257%) would have resulted in close to €8 million in additional revenues in 2019. We also note that the region is working on optimizing its tax proceeds, including through an upcoming move towards a greater level of regional collection of taxes which are currently collected by the federal government and then redistributed to the region.

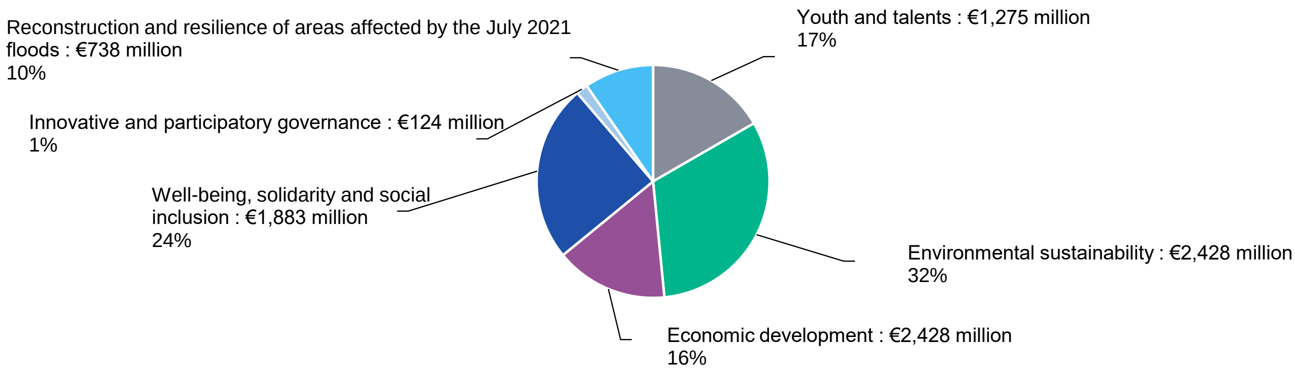
In early 2020, the Walloon Region entered a spending review process and subsequently adopted the implementation of a zero-based budget (ZBB). This large-scale budgeting exercise consists in systematically reviewing expenses in order to optimize spending and should result in a 10% flexibility on expenditures in line with the results obtained by peers. In our view, this gives credibility to the region's commitment to achieve spending cuts amounting €150 million each year from 2022 onwards (or around 1% of total spending), over the coming 10 years . At the same time, we consider that this will not be material enough to prevent the region's debt burden from further increasing. We will therefore continue to monitor the developments surrounding expenditure management, including the effective implementation of the region's savings plan as well as the use of the flexibility highlighted with the ongoing spending review process.

Substantial financing deficits will push the region's debt burden to a very high level for longer
At the end of 2021, we expect the Walloon Region's net direct and indirect debt (NDID) to reach €31.2 billion and thus to already represent a very high 236% of total revenues. According to our forecasts, the region will post financing deficits over €3 billion each year over 2022-24, against €1 billion in 2019. As a result, the NDID will further increase to over €40 billion, pushing the debt burden, as measured by the NDID-to-total revenues ratio, above 275% by the end of 2024, which is the end of the current political mandate. At the same time, we expect the current and forecast low-interest-rate environment to allow the Walloon Region to keep its interest burden low but increasing, from 2.1% of operating revenues in 2019 to 2.7% and 3.0% in 2023 and 2024, respectively.

Even if in 2021 total revenues will represent 103% of 2019 levels – thanks to the recovery of the Belgian economy, supporting regional tax revenues and shared taxes – the region is facing spending pressures resulting from its large recovery plan as well as from the impacts of the July 2021 floods[1]. Amounting to €7.6 billion in total by 2024, the Walloon recovery plan combines the European Union

(EU)'s Recovery and Resilience Facility (RRF) with pre-crisis commitments announced in the 2019 Regional Policy Statement, in addition to new public investment measures[2]. Following the July floods, the Walloon government also decided to reallocate around €800 million of recovery plan spending.

Exhibit 4
The Walloon Region's recovery plan will focus on green and social investments



Source: Walloon Region, Moody's Investors Service

Out of the total recovery plan, only 20% (€1.5 billion) will benefit from budget neutral funding from the EU's RRF and the remainder will have to be financed by the region. While this boost in public investment should generate medium-to-long-term economic, social and environmental benefits, the large size of this plan explains, in our view, why the recovery in revenues and the savings plan to which the government is committed with its 2022 draft budget (see *"Revenue flexibility is high, and the region is committed to increasing its expenditure flexibility and to proceeding with spending cuts"*) will not be enough to reverse the growing debt trajectory. We therefore expect the Walloon Region's debt burden to remain permanently higher than its pre-coronavirus level in the medium-term. In this context, one of the key challenges of the Walloon region will be to stabilize its debt burden over a reasonable time horizon as the government is committed to. In this respect, we will continue to monitor any developments surrounding the implementation of the Walloon Region's recovery plan and the resulting new borrowing needs.

The region's economy compares unfavorably with national and European peers

The region's economic fundamentals compare unfavorably with both national peers and European levels. Regional gross domestic product (GDP) per capita in 2019 represented 73% and 97% of the national and EU averages, respectively. In addition, socio-economic indicators, including labor participation and unemployment rates, are structurally weaker than peers – before the coronavirus crisis the regional unemployment rate reached 7.2% in 2019, compared with national and EU rates of 5.4% and 6.7%, respectively.

However, the Walloon economy is diversified, with the proportion of the workforce employed in services, industry and agriculture aligned with national levels. The high share of public employment compared with the Belgian average is a strength when the economy faces a shock, like the coronavirus-induced recession in 2020 – it acts as a macroeconomic stabilizer, which shields the regional economy from strong (both upwards and downwards) fluctuations.

Extraordinary support considerations

We assign a high likelihood of extraordinary support from the national government, reflecting: (i) our assessment of the reputational risk for the federal government if the Walloon Region were to default; and (ii) indications of support stemming from the federal government's commitment to enabling federated entities to reach sound financials, including Articles 49 and 54 of the 1989 Financial Law – the latter states that regions and communities are entitled to offset insufficient or untimely receipts from the federal government with a guaranteed loan.

ESG considerations

The Walloon Region's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 5
ESG Credit Impact Score

CIS-2
Neutral-to-Low

NEGATIVE IMPACT
POSITIVE IMPACT

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

The Walloon Region's ESG Credit Impact Score is neutral to low (**CIS-2**), driven by moderately negative social risks while governance considerations are neutral and exposure to environmental risks is low.

Exhibit 6
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-3	G-2
Neutral-to-Low	Moderately Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

The Walloon Region's exposure to environmental risks is generally low, even though extreme climate events, such as the July 2021 floods, demonstrate the potential magnitude of the negative impacts. Its overall E issuer profile score is therefore neutral to low (**E-2**).

Social

The Walloon Region faces moderate risks from exposure to social risks (**S-3**). Like Belgium, the Walloon Region faces long-term economic and fiscal pressures from demographic change, marked by a shrinking working age population and a rising dependency ratio. Labor & income, including low participation rates to the labor force, also weigh on the region's social profile. At the same time, Wallonia benefits from widely available high-quality education, good housing availability, high quality healthcare and basic services.

Governance

The influence of governance on Walloon Region's credit profile is neutral to low (**G-2**). The region's financial management is strong as illustrated by prudent but sophisticated debt management. At the same time, the region's track record of unbalanced budget when economic growth was supportive weighs on its G profile.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report "Regional and Local Governments – International: Credit impact of ESG factors limited in advanced economy

RLGs, negative in emerging markets" and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Rating methodology and scorecard factors

The assigned BCA of baa2 is close to the scorecard-indicated BCA. The one-notch difference captures the very high debt ratios relative to peers. The matrix-generated BCA of baa1 reflects an Idiosyncratic Risk score of 5 (presented below) on a 1 to 9 scale, where 1 is the strongest relative credit quality and 9 the weakest; and (2) a Systemic Risk score of Aa3, as reflected by Belgium's Aa3 stable sovereign bond rating.

Exhibit 7

Walloon Region

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**6.60**	**20%**	**1.32**
Economic Strength [1]	9	72.5%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**3**	**20%**	**0.60**
Legislative Background	1		50%			
Financial Flexibility	5		50%			
Factor 3: Financial Position				**4**	**30%**	**1.20**
Operating Margin [2]	7	-4.9%	12.5%			
Interest Burden [3]	3	2.2%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	7	176.0%	25%			
Debt Structure [5]	3	13.9%	25%			
Factor 4: Governance and Management				**5**	**30%**	**1.50**
Risk Controls and Financial Management	5					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**4.62 (5)**
Systemic Risk Assessment						**Aa3**
Suggested BCA						**baa1**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance/operating revenues
[3] Interest payments/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2019.

Ratings

Exhibit 8

Category	Moody's Rating
WALLOON REGION	
Outlook	Stable
Issuer Rating -Dom Curr	A3
Senior Unsecured -Dom Curr	A3
Other Short Term -Dom Curr	(P)P-2

Source: Moody's Investors Service

Endnotes

1 The region estimates it will need to incur costs of €2.3-€3 billion because of the floods. Of these, around €800 million will be redirected from spending planned under its recovery plan, while €1 billion will be pre-financed by insurance companies in the form of interest-free amortising loans repayable over 10 years starting from 2024. The federal government has also voluntarily agreed to provide a €1.2 billion loan, which will be repayable over 15 years starting from 2025. In addition, the region has obtained a €300 million loan from the EIB and is hoping to receive around €100 million in aid from the EU Solidarity Fund.

2 Pre-crisis and new measures are included in the "Walloon Transition Plan" and "Get up Wallonia"

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