FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms San Pedro Garza García's Ratings

Wed 30 Aug, 2023 - 13:20 ET

Fitch Ratings - Monterrey - 30 Aug 2023: Fitch Ratings has affirmed the municipality of San Pedro Garza García, Nuevo León's Long-Term Local Currency Issuer Default Rating (IDR) at 'BBB-' as well as its National Long-Term Rating (NLTR) at 'AAA(mex)'. Both ratings have Stable Rating Outlooks.

The Municipality's Standalone Credit Profile (SCP) is assessed at 'aa-', and is positioned as the highest SCP among LATAM issuers. In spite of that, its IDR is capped by Mexico's sovereign rating (BBB-/Stable). This highlights Fitch's perspective on which Mexican subnationals cannot be rated above their sovereign.

The ratings highlight Fitch's expectation that San Pedro's payback ratio will remain negative through 2023-2027 due to higher unrestricted cash levels than its forecast financial liabilities. They also incorporate projected actual debt service coverage ratios (ADSCRs) well above 4.0x, as well as negative fiscal debt burden levels. The ratings also factor in a 'Midrange' risk profile and a 'aaa' debt sustainability score under Fitch's rating case scenario. No asymmetric risks were identified.

Fitch classifies San Pedro as a Type B entity due to its requirement to cover debt service from cash flow on an annual basis.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

San Pedro's 'Midrange' risk profile results from the assessment of its six key risk factors (KRF) at 'Midrange'. The aforementioned reflects Fitch's view that there is a moderately low risk of the issuer's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon (2023-2027) due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt-service requirements. Mexican subnationals' risk profiles are limited to a 'Midrange' assessment given Mexico's sovereign rating and their national fiscal framework.

Revenue Robustness: 'Midrange'

The 'Midrange' assessment of revenue robustness is based on San Pedro's revenue structure; although federal transfers were 50.5% of the operating revenue during 2018-2022, among the lowest ratios within national peers, Fitch considers that San Pedro's revenue sources are closely linked to stable and predictable transfers streamed down from a 'BBB-' rated sovereign counterparty. Nonetheless, the aforementioned highlights the municipality's relatively moderate fiscal autonomy.

San Pedro's deflated operating revenue (2.4% five-year 2018-2022 CAGR) showed a higher performance than the national real GDP (-0.22% five-year CAGR) and revenue growth is expected to be positive in forthcoming years due to sound national and local GDP prospects, primarily through corporate, financial and insurance services as well as retail trade.

San Pedro's General Revenue-Sharing Fund (FGP) -- the main federal transfer made to Mexican municipalities -- increased in 2022 and is expected to keep growing in forthcoming years due to further collection efficiency improvements; this variable is used as an input for determining the distribution of FGP, in adherence to Fiscal Coordination Law.

Revenue Adjustability: 'Midrange'

The 'Midrange' assessment of revenue adjustability comes from San Pedro's moderate affordability to raise additional taxation from an international perspective. This is due to its large taxpayer base with strong purchasing power; in 2021, its GDP per capita was USD63,695 positioning it as the highest among Mexican municipalities. The assessment also incorporates that although there is no constitutional ceiling to increase taxes, any additional adjustment proposal must be approved by the State's Congress, mitigating municipal maneuverability.

During 2018-2022, taxes averaged 40.9% of San Pedro's operating revenue. The property tax is the largest revenue tax source and represented 24.1% of the operating revenue in 2022; it's followed by real estate ownership transfer tax, which covered 16.0%. These figures indicate that the municipality could have an adequate independent ability to raise additional taxes or fees in the event of an economic downturn that may pose a revenue decline for subnationals.

Expenditure Sustainability: 'Midrange'

The 'Midrange' assessment of expenditure sustainability is based on San Pedro's favorable track record of prudent budgeting and expenditure execution displayed through robust operating balances in the past five years. During 2018-2022, the deflated operating expenditure CAGR was 2.0%, while the deflated operating revenue was 2.4%. Also, its operating margin in 2022 rebounded to 25.9% from 16.5% due to sound revenue growth and measured expenditure execution; this indicator was well above Fitch's rated entities median average of 12.0%.

Fitch expects moderate control over total expenditure prospects in forthcoming years, which could gradually narrow their gap closer to that of revenues' growth rates. The municipality's main expenditure responsibilities are over moderately counter-cyclical items such as security, public lighting, waste collection, paving, and recarpeting, thus allowing adequate identification and control of future expenditure requirements.

Expenditure Adjustability: 'Midrange'

The 'Midrange' assessment of expenditure adjustability is based on Fitch consideration that San Pedro's affordability to reduce expenditure figures could be made mainly through capex, which averaged 25.5% of total expenditure in the past three years, well above Fitch's 17% benchmark for Mexican municipalities. Also, the operating expenditure to total expenditure ratio was favorable and averaged 74.4% over the same period, also below Fitch's 82% benchmark, showing an adequate maneuvering margin. From 2023 to 2027, Fitch expects San Pedro to successfully cover its capex program mainly through operating balance and unrestricted cash.

Liabilities & Liquidity Robustness: 'Midrange'

The 'Midrange' assessment of liabilities and liquidity robustness is based on Fitch's views on Mexican national framework for debt and moderate liquidity management. Although, as of March 31, 2023, San Pedro did not contract long-term nor short-term debt, it could borrow up to 15% of its disposable revenue as long-term debt, and up to 6% of its total revenue as short-term debt. These prudential borrowing limits are established to all Mexican entities by the Alerts System made by the Ministry of Finance and Public Credit. Also, San Pedro's appetite for risk is considered low and it does not hold off-balance sheet risks nor pension liabilities that pose a risk to its financial performance.

San Pedro's financial debt comprises a public-private partnership project (PPP) with an outstanding balance of MXN33.3 million in year-end 2022. The PPP involves a surveillance camera system project through a financial lease that was contracted in 2018 and is expected to end in 2026. Fitch considers that the monthly payments do not represent a considerable stress to the municipality's cash flow.

Liabilities & Liquidity Flexibility: 'Midrange'

The 'Midrange' assessment of liabilities and liquidity flexibility is based on San Pedro's high liquidity levels available as unrestricted cash, even though the Mexican framework does not provide emergency liquidity support from upper tiers. According to the Ministry of Finance and Public Credit, during 2018-2022, the municipality's liquidity covered up well above the 1.0x benchmark, and even showed an average above 10.0x, indicating a sound short-term liquidity position. These high coverage ratios were due to small amounts of non-banking liabilities. Also, San Pedro has a wide local debt market willing to provide external liquidity when in need.

Debt Sustainability: 'aaa category'

San Pedro's debt sustainability score of 'aaa' combines the results of persistent expected negative payback ratios (net adjusted debt/operating balance) during 2023-2027 due to high unrestricted cash balances (aaa score), as well as ADSCRs above 4.0x (aaa score). Also, the fiscal debt burden has a 'aaa' score due to forecast negative net adjusted debt balances.

Fitch estimates that even under higher interest rates and inflation, San Pedro will maintain low debt metrics and adequate operating balances in 2023-2027, averaging 17.1% of operating revenues. Also, the net adjusted debt (adjusted debt minus unrestricted cash) is negative in Fitch's rating case scenario due to the Municipality's high and growing liquidity levels, resulting in robust debt metrics. Fitch expects this behavior to persist.

In 2021, San Pedro's operating expenditure level raised due to healthcare expenses during the pandemic, but still managed to be lower than operating revenue figures. In 2022, Fitch saw a more robust operating balance due to higher revenue growth and lesser operating expenditure pressures related to health spending.

DERIVATION SUMMARY

San Pedro's SCP of 'aa-' is the product of a 'Midrange' risk profile and 'aaa' debt sustainability score. It also factors in national and international peer analyses for specific positioning;

national peers include Corregidora, Puebla, El Marqués and Saltillo Municipalities, and international peers comprise the Cities of Tallinn (Estonia) and Strasbourg (France). The Municipality's IDR is capped by Mexico's sovereign rating (BBB-/Stable); thus, its IDR is positioned at 'BBB-'. Fitch does not identify any asymmetric risks. Lastly, the NLTR of 'AAA(mex)' is derived from San Pedro's IDR and national peer analysis.

KEY ASSUMPTIONS

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Midrange'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Midrange'

Liabilities and Liquidity Robustness: 'Midrange'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'aaa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Rating Cap (LT IDR): 'N/A'

Rating Cap (LT LC IDR) 'BBB-'

Rating Floor: 'N/A'

Quantitative assumptions - Issuer Specific

Unlike the base case, the rating case assumes a higher operating expenditure growth rate and this results in a lower operating balance. Also, additional long-term debt is included in the rating case, and the interest rates projected for debt service are also increased.

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 2018-2022 figures and 2023-2027 projected ratios. The key assumptions for the scenario include:

--Operating Revenue: CAGR of 8.2% from 2022 to 2027, considering the trend of the local economy and Fitch's economic projections for inflation and GDP growth from the latest Global Economic Outlook (GEO).

--Operating Expenditure: CAGR of 11.4% from 2022 to 2027, considering the historical trend of operating margins and assuming higher growth in operating expenditure in comparison with that of operating revenue;

--Operating Margin: 17.1% average from 2023 to 2027, considering operating revenue and operating expenditure trends;

--Capital Revenue: Nominal growth is adjusted by 1% from Fitch's estimated inflation rate;

--Net negative capital expenditure of MXN1,046.6 million, on average between 2023 and 2027, considering the historical average and cash-flow available for capital expenditure, which in turn is a function of current balance, capital revenue and long-term debt;

--Additional long-term debt is considered for up to MXN534.4 million in 2023, equivalent to 15% of non-earmarked revenues, considering the limit allowed by the federal regulation;

--Additional short-term debt is not considered in 2023 due to consistently high unrestricted cash levels;

--Interest Rate: 12% in 2023, 10.8% in 2024 and increasing between 2025 and 2027 from 9.5% to 10.0%, adding up to 250 basis points to the policy reference rate estimated by Fitch.

Summary of Financial Adjustments

Fitch's net adjusted debt corresponds to the difference between Fitch-adjusted debt and the local and regional governments' (LRGs) unrestricted cash. The latter corresponds to the level of cash at the end of the year, excluding cash that Fitch views as being earmarked for payables or restricted.

Issuer Profile

The municipality of San Pedro Garza García is one among 51 municipalities in the state of Nuevo León and is part of the Monterrey Metropolitan Area. It occupies an area of 70.91 square km and has a total population of 132,169 inhabitants (2020). Specializing in economic sectors such as corporate, financial services and retail trade, it is considered one of the most developed municipalities in Mexico with one of the highest levels of per capita income and average years of schooling in the country.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--A downgrade on Mexico's IDR (BBB-/Stable) would lead to a corresponding rating action on the issuer's IDR;

--A payback higher than 13.0x could lead to a negative action in the IDR; however, this is not expected;

--San Pedro's SCP could be downgraded if the payback ratio weakens to a level higher than 5.0x or if its DSCR were lower than 4.0x.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--The IDR is capped by the sovereign rating. A rating action on Mexico's IDR (BBB-/Stable) would lead to a corresponding rating action on the issuer.

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.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

San Pedro's IDR is capped by Mexico's Sovereign Rating (BBB-/Stable).

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

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
San Pedro Garza Garcia NL, Municipio de	LC LT IDR Affirmed	BBB- Rating Outlook Stable	BBB- Rating Outlook Stable
	Natl LT Affirmed	AAA(mex) Rating Outlook Stable	AAA(mex) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Orel Montemayor
Senior Analyst
Primary Rating Analyst
+52 81 4161 7089
orel.montemayor@fitchratings.com
Fitch Mexico S.A. de C.V.

Prol. Alfonso Reyes No. 2612, Edificio Connexity, Piso 8, Col. Del Paseo Residencial, Monterrey 64920

Alberto Hernandez Villarreal
Associate Director
Secondary Rating Analyst
+52 81 4161 7059
alberto.hernandezvillarreal@fitchratings.com

Guilhem Costes
Senior Director
Committee Chairperson
+34 91 076 1986
guilhem.costes@fitchratings.com

MEDIA CONTACTS

Elizabeth Fogerty
New York
+1 212 908 0526
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Metodología de Calificaciones en Escala Nacional (pub. 22 Dec 2020)

Metodología de Calificación de Gobiernos Locales y Regionales Internacionales (pub. 30 Sep 2021)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

San Pedro Garza Garcia NL, Municipio de	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.