



Fitch Affirms Municipality of San Pedro's Local Currency IDR at 'BBB'; Outlook Stable

Fitch Ratings-Monterrey-30 September 2019: Fitch Ratings has affirmed the Municipality of San Pedro's Long-Term Local Currency Issuer Default Rating (IDR) at 'BBB' with a Stable Rating Outlook.

Fitch assesses San Pedro's standalone credit profile (SCP) at 'aa-' considering the municipality's 'aaa' debt sustainability score and its 'Midrange' risk profile. San Pedro's robust fiscal performance and low expected debt result in strong payback and debt service coverage ratios.

The rating is capped by Mexico's sovereign rating of 'BBB'/Stable, reflecting Fitch's view that a subnational in Mexico cannot be rated above the sovereign.

The municipality's 'midrange' risk profile reflects less dependence of transfers from the sovereign compared to the rest of the municipalities in Mexico, adequate capacity to adjust revenues in the case of an economic downturn due to the very high affordability of its population, favorable control over operational expenditure, which grows at a slower pace than operating revenue, and very low debt levels and high liquidity available under various forms, notably unrestricted cash.

KEY RATING DRIVERS

Revenue (Robustness) Assessed as 'Midrange'

The municipality of San Pedro has an operational revenue growth highly above national GDP growth. The three-year historical average growth of San Pedro's taxes was 20% compared to 2.5% of national GDP growth. In addition, the municipality has a stable revenue source mostly based on proprietary revenues since tax collection represents around 43% of operating revenues in 2018. High valued properties in San Pedro and collection efficiency explain the property tax collection. Even though operational transfer dependence is much lower than other sub nationals in Mexico, current capital requirements would need the mix of federal and state contributions, given the high cost of public works. Transfers are received regularly from the Sovereign rated 'BBB'/Outlook Stable. Due to this combination of factors, Fitch proposes the attribute as 'Midrange'.

Revenue (Adjustability) Assessed as 'Midrange'

This attribute evaluated as 'Midrange' is an outlier from the rest of the Mexican entities. The most important reason is the very high affordability of its population. In addition, it has a high proportion of taxes over operating revenue supported with high value properties. The latter implies that the municipality would have an adequate independent ability to increase taxes or fees in the event of an economic downturn that may pose a revenue decline for sub nationals.

Expenditure (Sustainability) Assessed as 'Midrange'

This attribute is considered a 'Midrange' given the entities responsibilities over moderately countercyclical expenditure (maintenance and public services). Moreover, operational expenditure has increased at a much slower pace than operating revenues.

Expenditure (Adjustability) Assessed as 'Midrange'

The municipality has moderate expenditure adjustability as the current level of capex is adequate and above Mexican municipalities average at 22% of total expenditure in 2018, and could be discretionarily adjusted or subject to reductions. In addition, staff expenditure represents a moderate 49% of total expenditure and its growth has been controlled.

Liabilities and Liquidity (Robustness) Assessed as 'Midrange'

Fitch evaluates as moderate the national framework for debt and liquidity management since there are prudential borrowing limits and restrictions on loan types; however, the federal financial discipline law has been in effect since 2016, so it has a very recent track record.

Given its sound tax revenue more than budgeted, the entity has prepaid its debt in full in 2018. The only outstanding financial debt is a financial leasing of MXN58.9 million in 2018, with an unrestricted cash of MXN838.2 million, which derives to a net overall debt of -MXN779.6 million. San Pedro's appetite for risk is evaluated as low.

Liabilities and Liquidity (Flexibility) Assessed as 'Midrange'

The municipality's liquidity is sound. In 2018, San Pedro has even had enough cash to prepay long-term debt in full, which is not a very common practice among sub nationals in Mexico. Currently, they do not have external liquidity sources due to its high amount of unrestricted cash; however, it has a wide external market, which will be willing to provide external liquidity resources if needed.

Debt Sustainability Assessment: 'aaa'

San Pedro's debt sustainability score of 'aaa' is the result of an expected negative payback ratio (net adjusted debt/operating balance under Fitch's rating case) in 2023; this is higher unrestricted cash than financial obligations. The secondary metrics are the debt service coverage ratio (ADSCR), which is favourable and assessed higher than 14x, and the fiscal debt burden, also evaluated to remain negative due its high levels of cash and low expected debt.

Rating Derivation

San Pedro's 'aa-' SCP is derived from a combination of a 'Midrange' risk profile assessment and debt metrics, which resulted in 'aaa' debt sustainability assessment. The municipality's metrics compare favorable among 'aa' peers; however, the SCP assessment factors are weaker than other peers at 'aa' given that the municipality doesn't have any factor assessed as strong, mainly because of the sovereign's rating of 'BBB'. Considering the latter, Fitch evaluates San Pedro's SCP at 'aa-'. Fitch does not apply any asymmetric risk, given neutral assessment of management, governance and pension's liabilities. Fitch neither applied extraordinary support from upper-tier government, non-existent in the Mexican subnational framework.

KEY ASSUMPTIONS

Rating case:

- Operating Revenue increases 4.5% on average for 2019-2023.
- Operating Expenditure increases 5.5% on average for 2019-2023.
- Variable Interest rate of 10.5% (TIE 28).
- Additional long term debt considering past debt policies, total amount of MXN350 million for 2020.

RATING SENSITIVITIES

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

Fitch could downgrade the entity's SCP if material borrowing leads to a debt payback ratio above five years under Fitch's rating case, which has a low probability in the agency's opinion.

Contact:

Primary Analyst
Martha Gonzalez
Associate Director
+52 81 8399 9119
Fitch Ratings Mexico
Prol. Alfonso Reyes 2612 Monterrey, N.L. Mexico

Secondary Analyst
Alfredo Saucedo
Director
+52 81 8399 9163

Committee Chairperson
Christophe Parisot
Managing Director
+33 1 44 29 91 34

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email:
elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com
Applicable Criteria
Rating Criteria for International Local and Regional Governments (pub. 13 Sep 2019)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy

ALL 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](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. 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](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY

10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. 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.

SOLICITATION STATUS

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

Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Fitch Updates Terms of Use & Privacy Policy

We have updated our Terms of Use and Privacy Policies which cover all of Fitch Group's websites. [Learn more.](#)