Poland
Credit Analysis

Region of Mazowieckie

Ratings

	Current Ratings
Foreign Currency	
Long-Term	A-
Local Currency	
Long-Term	A

Outlook

Foreign Long-Term IDR	Stable
Local Long-Term IDR	Stable

Financial Data

Region of Mazowieckie

	31 Dec 06	31 Dec 05
Operating revenue (PLNm)	2,016.5	1,521.4
Debt (PLNm)	0	0
Operating balance/operating revenue (%)	23.5	29.8
Debt service/current revenue (%)	0	0
Debt/cur balance(yrs)	0	0
Operating balance/interest paid (x)	1,582	4,540
Capital expenditure/total expenditure (%)	34.7	37.1
Surplus (deficit) before debt variation/total rev. (exc. new debt) (%)	-11.3	-6.6
Current balance/capital expenditure (%)	59.6	77.1

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Related Research

- *International Rating Methodology for Local and Regional Government*

Rating Rationale

- The region's operating performance is sound, with an operating balance of PLN475m accounting for 23.5% of operating revenue in 2006, although it has weakened since 2004, when a rise in operating revenue took the operating margin to 40.7% and it had a budgetary surplus of PLN404m. Since 2004 the region's liquidity has been high. In 2006 cash in the region's account averaged about PLN350m, which enabled the region to earn PLN14m of interest revenue.
- Mazowieckie is the wealthiest Polish region. In 2005 its gross regional product (GRP) per capita was 158,4% of the national average. The region ranks first by the number of companies registered (17% of the national total) and companies with foreign capital (36%). It is the most important scientific centre in Poland.
- Operating revenue grew fast in 2004-2006. In 2006 it grew by over 30%, mainly due to growth of revenue from income taxes, which accounted for 80% of operating revenue. The region has the highest income tax revenue per capita among all Polish regions. It expects legislative changes to reduce its corporate income tax (CIT) revenue by PLN150m in 2008, but this may be compensated by a PLN50m increase in targeted grants and a rise in overall tax revenue due to economic growth.
- The region had no direct debt in 2004-2006 and its direct risk was very low (about PLN61m at end-2006). The region's debt is projected to increase to PLN1bn by end-2010, but debt should not exceed 50% of operating revenue and the debt payback ratio should be below five years.
- The financial situation of the region's healthcare sector is difficult. In 2006 the sector posted an aggregated net loss of PLN71m and had PLN150m of long-term debt and PLN114m of overdue liabilities. The sector's financial situation has further deteriorated in 2007 due to strikes and salary increases. Under restructuring in 2005-Q207 the region repaid about PLN58m of the sector's liabilities. Fitch considers that there is a high risk of the region facing payment under the guarantees provided to the sector (valued at PLN167m at end-2006).
- To control quality and costs, the region set up the rail operator Koleje Mazowieckie to provide railway services in the region. The region's expenditure on rail transport services grew by a compound annual growth rate (CAGR) of 74% in 2003-2006 and Fitch expects it to remain high in the medium term.

Key Rating Drivers

- As the rating is capped by Poland's Foreign Currency Issuer Default Rating, an upgrade of the sovereign rating accompanied by continued good budgetary performance could result in a rating upgrade.
- Downside to the ratings would arise from a substantial deterioration in operating performance accompanied by an abrupt rise in indirect risk connected with the rocketing debt and overdue liabilities of the healthcare sector.

Profile

The Region of Mazowieckie accounts for 11% of the national territory and 13.5% of population. Its main responsibilities include: regional railway and bus transport; healthcare; constructing and maintaining regional roads; and regional development.

Institutional Framework

The local government sector in Poland consists of 16 voivodships (regions), 379 powiats (counties), including 65 cities (miasta na prawach powiatu) and 2,478 gminas (municipalities).

Responsibilities

The region's responsibilities include: public education; healthcare (regional hospitals and specialised healthcare services); social care; public order; culture (operas, theatres and museums, regional cultural activities and preserving regional culture); regional public transport; environmental protection; establishing regional development programmes; developing international economic relations at the regional level; and constructing and maintaining regional roads. The region is also responsible for creating a suitable environment for regional development, shaping the regional labour market and developing the regional infrastructure.

Region's Share in PIT and CIT

	1998 Act	2003 Act		
(%)	1998-2003	2004	2005-2007	2008
CIT	0.5	15.9	15.9	14.0
PIT	1.5	1.6	1.6	1.6

Source: Local Governments' Revenue Act, November 1998; Local Governments' Revenue Act, November 2003

Funding

To improve the financial flexibility of the regions in Poland, a new financing system was introduced in 2004 which increased regions' share of revenue from income taxes and decreased transfers from the central government. Regions started to be entitled to receive 15.9% of CIT instead of 0.5% previously and 1.6% of personal income tax (PIT) collected in its administrative area (see table above).

At the same time, some responsibilities performed by regions were reclassified from "central-government-delegated responsibilities" to "the regions' own responsibilities" (eg regional railway and bus transport services). The reclassification has changed the way in which these responsibilities were financed. Previously they were financed through central government transfers but since 2004 started to be financed from the regions' own resources (income taxes).

Further changes will take place in 2008. The Polish Constitutional Tribunal has ruled that the financing of bus transport services is not the regions' own responsibility (and consequently financed from their own sources), falling instead within central-government-delegated responsibilities financed from grants. Due to this the Local Governments' Revenue Act was changed: from 2008 the regions' share in CIT will decrease to 14% from 15.9% and the regions will receive grants from the state to finance bus transport services. This change may have a negative impact on the wealthy region's finances, as the lost revenue due to lower share in CIT may not be compensated by the grants received alone.

EU Financing

With effect from 2007 regions in Poland have been designated managing authorities responsible for implementation of the regional operational programmes (RPOs) financed from the EU in 2007-2013. Every region is responsible for setting the aims to be achieved by its RPO, defining how much money will be spent in different sectors, choosing the projects for financing, monitoring their implementation, and settling all the payments under the programme. Regions will also be intermediate bodies in implementing the regional component of the Operational Programme of Human Resources Development (PO KL), which is financed from the European Social Fund and is aimed at employment, education, social inclusion, human resources in rural areas, and efficient and effective public administration at all levels. All financing from the EU received under the RPO and PO KL will go through the regions' budgets, both when the regions are beneficiaries of the financing and when they only pass the amounts to other beneficiaries. The result will be a significant increase of regions' budgets, influencing both operating and capital revenue and expenditure.

The amounts received for social projects (from the European Social Fund) are recorded as operating revenue and the corresponding expenditure is classified as operating expenditure. The amounts received for infrastructure projects are capital revenue, while the corresponding expenditure is capital expenditure.

Debt Limits

According to the Public Finance Act, local governments must comply with debt and debt-servicing ratios. Debt cannot be higher than 60% of total revenue and debt-servicing expenditure cannot exceed 15% of total revenue. These debt limits have been broadly criticised as they constrain the ability of economically sound local governments to incur debt. New debt regulations are under discussion.

Budgeting and Reporting

From 2008 local and regional governments' budgets will have to split revenue and expenditure into operating and capital headings, which will increase their transparency and should help to improve budgetary management at the operating and capital level.

The scope of budgetary reporting and external control is clearly set out in legislation. Local governments are obliged to report to the regional accounting chambers (regionalna izba obrachunkowa, RIOs). Reports are made on a quarterly, interim and annual basis.

Supervision and Control

Local governments are controlled by the RIOs, which represent the Ministry of Finance at the regional level, and the Supreme Chamber of Control (NIK).

The RIOs supervise local government activity in budgetary matters and carry out training activities. Local governments must provide RIOs with budget resolutions, semi-annual and annual budget completion reports and revisions of budgets for a year so that the RIO can assess their compliance with the relevant statutes. If a local government's council does not approve its annual budget by 31 March, the RIO can impose a provisional budget plan. It also reviews the local government's borrowing decisions and checks whether the local government complies with the debt and debt-servicing limits. Once every four years the RIO is obliged to carry out a complete review of local government finances, covering accounting standards and reporting procedures.

The NIK's role is to control public finances at all levels having a special focus on local governments' use of grants and subsidies from the state budget.

Internal Audits Required by the Public Finance Law Since 2004

All tiers of local government must employ an internal auditor responsible for analysing and defining risks in every area of local government activity. Auditors report directly to the president or marshal.

Administration

Political Stability and Priorities

The region's governing bodies are the regional board (the executive) and a 51-seat sejmik (regional parliament). The marshal is the head of the executive and represents the region. He is appointed by the regional parliament, which is elected by direct vote for a four-year term. The last election was held in November 2006. The Civic Platform (PO, which is also the ruling party at the national level after the parliamentary elections in October 2007) won 16 seats, followed by the Law and Justice Party (PIS) with 13 seats and the Polish Farmers Party (PSL) with 13 seats. The Left and Democrats held only four seats, followed by the populists Polish Families Party with three seats. Two councillors are independent.

After the local elections, the region's marshal, Adam Struzik from the PSL, was reappointed by the regional parliament and he established a coalition with PO, which gives him 29 votes in total.

In May 2006 the region updated its Regional Development Strategy to 2020. The aims of the strategy include improving the professional qualifications of the local workforce, creating a more favourable environment for economic and entrepreneurial activity and R&D, developing the metropolitan functions of the City of Warsaw, developing the region's non-metropolitan areas, and establishing the region's image as a good place for tourism.

The strategy complies with the RPO through which EU structural funds will be distributed to beneficiaries in the region.

Under the RPO in 2007-2013 the region will receive EUR1.8bn, which will be aimed at following targets, decided by the region:

- creation of favourable environment for R&D and entrepreneurial activity (23.5% of all EU financing under RPO);
- development of IT facilities in the region (11.2%);
- development of the regional transport system (29.4%);
- environmental protection (10.8%);
- strengthening the role of cities in development of the region (4.9%);
- making use of natural resources to develop tourist activity (8.2%);
- improving the professional qualifications of the local workforce (9%); and
- technical support (3%).

The amounts received from the EU will require co-financing from the national sources (state government, Region of Mazowieckie and municipalities within its boundaries) of EUR323m. The region expects that in 2007-2013 about EUR255m of financing under RPO will go through its budget annually, but in fact the first amounts will be received in 2008 rather than in 2007. The region defined 27 key investments to be financed under the RPO, of which 13 will be implemented by the region: nine relating to roads (total cost of PLN700m) and one relating to railway transport (PLN420m). One investment — the development of an airport in the City of Modlin (projected total cost of the first stage is over PLN250m) — will be carried out by a minority-owned company.

Budgetary Framework

The region's public sector is limited to seven companies. The companies have been set up by the region or taken over from the state government since 2003.

Mazowieckie's Regional Loan Fund and Mazowieckie's Guarantee Fund are small companies, employing less than 20 people, which were set up to provide loans and guarantees to SMEs and people who want to set up their own businesses.

Mazowiecki Port Lotniczy Warszawa-Modlin Sp. z o.o. will develop the existing Modlin military airfield into an airport. In 2007 the company's equity was increased to PLN60m jointly by all its shareholders (the region injected PLN15.6m). The company will start the construction and modernisation works in Q108. The total cost of the first stage of the project is estimated at over PLN250m and it will be co-financed from the EU financing (precise co-financing not defined yet).

Railway Services Provided by Koleje Mazowieckie

The most important company is Koleje Mazowieckie (KM), which was set up in 2004 by the region and the state-owned regional transport company PKP Przewozy

Regionalne and began operating in January 2005. The company was set up because the region wanted to have more control over the quality and costs of the railway services provided, as organisation and financing of railway services is the region's own responsibility. Until end-2004 PKP Przewozy Regionalne had a monopoly on regional rail services in the country and regions were usually unable to assess the true cost of the services provided.

In 2006 the region increased its stake in KM to 95% from 51%. The region is negotiating to acquire the remaining 5% held by PKP Przewozy Regionalne.

KM employs about 1,800 people. It provides railway services in the region using trains and rolling stock leased from PKP and the region. The region would like to purchase the trains currently leased from PKP in order to contribute them in kind to KM. The region has also started to invest in new trains and efficient rolling stock, which are then leased to KM. The region spent about PLN60m in both 2005 and 2006; about PLN155m will be spent in 2007 and PLN290 in 2008. The region plans to purchase 22 new trains (total cost of PLN420m), a project that is on an indicative list of major projects to be co-financed from EU funds. All this capital expenditure should yield savings on operating expenditure in the medium term.

Key Financial Figures on Corporate Exposure

	City's share (%)	Equity (PLNm)	Assets (PLNm)		Net income (PLNm)		Long-term debt (PLNm)	
	2006	2006	2005	2006	2005	2006	2005	2006
Koleje Mazowieckie (railway company)	95.0	22.2	63.9	112.4	1.1	0.2	0.0	0.0
Mazowiecki Fundusz Poręczeń Kredytowych Sp. z o.o. (guarantee fund)	35.0	8.6	14.2	22.8	5.5	8.3	0.0	0.0
Mazowiecki Regionalny Fundusz Pożyczkowy Sp. z o.o. (regional loan fund)	100.0	10.0	14.8	13.1	-0.3	-0.1	0.0	0.0
Agencja Rozwoju Mazowsza (regional development company)[a]	100.0	60.0	-	61.0	-	0.7	-	0.0
Mazowiecki Port Lotniczy Sochaczew (airport)	34.0	0.5	0.1	0.5	0.0	0.0		0.0
Mazowiecki Port Lotniczy Warszawa-Modlin (airport)	26.0	7.0	4.4	36.3	-0.8	-2.4	0.0	0.0
Instytucja Filmowa Max-Film S.A. (cinemas)	100.0	28.8	45.2	56.2	0.2	7.5	0.3	2.1
Total	-	-	-	-	-	-	**0.3**	**2.1**

[a] created in 2005
Source: Region of Mazowieckie

The KM's operating revenue can be split into own revenue (40%, mainly from tickets sold), grants from the region (38.5%, nominally almost PLN141m in 2006) and other sources (21.5%). The company broke even in 2005-2006 and had no long-term debt, as the calculated grant which will be transferred to the company by the region covers the costs of the services provided and it is the region that purchase the new trains' fleet.

High Risk Stemming from Healthcare Sector due to High Liabilities and Losses

The region is the funding body for 36 healthcare entities (it appoints directors, decides on eg liquidating or disposing of entities, and is liable for their debts): 25 hospitals, six outpatient clinics and five other healthcare entities (eg companies that service ambulances and operate first-aid stations). The sector's financial situation is difficult. The aggregated financial data of the sector are presented in the table below. The sector has been generating losses and accumulating liabilities for a few years.

Until end-2004 the healthcare entities had no long-term debt but posted high overdue liabilities (mainly to suppliers) and an aggregated net loss of PLN63m. Due to the restructuring processes implemented in 2005 the sector's net loss decreased (to PLN47m) and healthcare entities incurred long-term financial debt which was aimed at repayment of overdue liabilities. The long-term financial debt increased to about PLN150m in 2006 from about PLN3m in 2004, while overdue liabilities fell by PLN101m, to PLN114m at end-2006. In 2006 the aggregated loss was about PLN71m in 2006.

Region's Healthcare Sector

	2004	2005	2006
Employees	18,857	18,686	18,309
Net profit/loss	-63.2	-47.2	-71.4
Total debt	3.3	83.2	162.1
Long-term debt	2.1	75.9	150.6
Short-term debt	1.3	7.3	11.5
Overdue liabilities	216.1	185.9	114.1

Source: Region of Mazowieckie

The restructuring of the sector was prompted by the national government's one-off initiative taken in 2005 to provide indebted healthcare entities with restructuring loans, which may be 70% written off when they are serviced on time. The region's healthcare entities have received loans of about PLN75m in total, of which 15.8% has already been written off.

Under the restructuring programme the region took over and repaid about PLN58m of the hospitals' liabilities in 2005-Q207. In addition, the region issued guarantees totalling PLN167m at end-2006, which serve as collateral for bank loans taken by the hospitals aimed at repayment of their overdue liabilities. However, Fitch considers that there is a high risk that the region will face payments under the guarantees provided to the sector. If a healthcare entity defaults on payment and the bank calls the guarantee, the contract requires the region to step in and serve the loan instead of the healthcare entity. This means that the region will not have to repay the whole guaranteed loan at one time. In 2005-2007 the region faced payments of PLN8.6m due to guarantees issued (repayment of one loan taken by a healthcare entity in agreement with the bank and the entity).

Based on a salary increase of over 20% in 2006 and a further increase in 2007 prompted by strikes, it is very likely that the sector's financial results will deteriorate year on year in 2007. Because of strikes, the healthcare entities have not operated normally, which reduced the number of services provided and the revenue for the entities. However, it is too early to give precise data about 2007.

The region supports the sector also by providing it with short-term loans during a year. By 20 September 2007, the region had supported the sector with loans amounting to PLN33m. Should the healthcare entity not be able to repay the loan until the end of the year, the region tends to extend the loan's maturity rather than to write it off.

The region has been implementing an investment programme in the healthcare sector, worth PLN257m in 2006 and about PLN200m budgeted for 2007. It aims to improve the sector's equipment and broaden the range of services provided, and consequently should gain higher financing from the National Healthcare Fund, which is responsible for financing healthcare services in Poland. As a founding body for the healthcare entities, the region becomes liable for their liabilities if they defaulted, which is why it is interested in maintaining their good financial shape. The entire healthcare sector in Poland requires reforms at the national level.

Economy

Mazowieckie, located in the centre of Poland, is the biggest Polish region by area (11% of the national territory) and the most populous one (5.16 million, 13.5% of the national population).

It is also the wealthiest region, but characterised by the widest disparities between its sub-regions. In 2005 its gross regional product (GRP) accounted for 21.4% of Poland's GDP. In 2005 its GRP per capita was 158.4% of the national average, placing the region first among all 16 regions. The regional and national economy grew about 6% in 2006-2007 and similar growth is projected for 2008.

Well-Developed Services Sector

The region's economy is dominated by the services sector, which accounted for 75.1% of gross value added (GVA) in 2005 and 58% of the local workforce, well above national averages. Industry and construction accounted for 21.2% of GVA in 2004 and 22.2% of employment. The GVA derived from agriculture was 3.7%, although it employed 15.8% of the local workforce (agricultural areas make up the majority of the region's territory).

The region's main services sub-sectors are trade, telecommunication, and financial and insurance services. Almost all banks operating in Poland have their headquarters in the region (in particular in Warsaw) and almost all industries are present in the region (except for coalmining and shipbuilding). Agriculture in the region concentrates on market gardens and orchards.

The region has the highest number of companies registered, which account for 17% of all companies registered in Poland. The number of companies has been increasing consistently for the last ten years. At end-2006 they amounted to about 609,600 entities, of which about 72% are sole traders and 11.2% are limited-liability companies.

The region ranks first by the number of companies with foreign capital. At end-2006 there were over 20,000 companies with foreign capital (36% of all in Poland) compared with about 5,700 for the Dolnoslaskie region, which ranks second on this measure. The most important international companies to have invested in Mazowieckie (over USD1m each) are France Telecom, Citibank, Vivendi, UniCredito, Nestle, Mars Incorporated, Lucent Technologies, Fiat, Delhi Automotive Systems and Avon.

Unemployment

Together with the other two Polish regions rated by Fitch, Region of Wielkopolska ('AA+(pol)') and Region of Malopolska ('AA(pol)'), the Region of Mazowieckie had the lowest unemployment rates in 2004-2006. Following the national trend the unemployment rate has been declining since 2003. At end-2006 it was 11.9% compared with the national average of 14.9%. The rate fell to 9.5% in Q307. However, the region is characterised by high disparities among its sub-regions, where the unemployment rate ranges from 3.4% in Warsaw to over 30% in some of the counties in the region.

Most Important Scientific and Business Centre in Poland

The region's economic and human potential is concentrated in Warsaw, which accounts for 33% of the region's population and 50% of all companies registered in the region. It is home to 100 universities and higher-education institutes (24% of the national total), which have over 16,000 academic staff (17% of the national total) and over 346,000 students (18%).

Population

The population of Mazowieckie has been growing for the last 10 years. In 2006 it rose by about 16,000 to about 5,164,000 due to highly positive migratory balance (2.6 per 1,000 in 2006), which is the highest among all Polish regions and made up for the negative birth rate (-0.6 per 1,000 in 2006). This high rate may be attributable to the location of Warsaw in the region, which is an attractive labour market.

Gross Value Added and Employment Composition

	Region of Mazowieckie		Poland	
	GVA 2005	Employment 2005	GVA 2005	Employment 2005
Agriculture, forestry and hunting	3,7	15.8	4,5	21.5
Industry and construction	21,2	22.2	29,5	29.2
Services	75,1	62.0	66,0	49.3
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Statistical Office, Poland

Finances and Performance

Revenue

Soaring Revenue from Income Taxes

Income taxes (CIT and PIT) are the most important source of the region's operating revenue, accounting for 79% in 2006. Revenue from income taxes increased by 22% in 2006 and has continued to grow in 2007, which is due to national economic growth. Mazowieckie is the wealthiest region in Poland, with the highest number of companies, which results in the highest per capita income tax revenue among all Polish regions.

At the beginning of 2007 the region budgeted PLN1,781m of revenue from income taxes and later increased this by PLN150m. The region considers it attainable in light of the good collection of these taxes. As at 30 June 2007 the region had collected about 52% of income taxes budgeted for the whole year.

The region's revenue from income taxes will fall in 2008 due to the lower share of CIT that it is entitled to following a change in financing bus transport services (see *Institutional Framework* above). The loss in income taxes is estimated by the region at PLN150m, but part of it may be offset by the growing national economy improving the financial results of companies.

Rebound in Current Transfers

The current transfers include current grants aimed at central-government-delegated tasks, general subsidy (including educational and regional elements) and financing from the EU on social projects.

Under previous legislation current transfers made up the bulk of the region's operating revenue, accounting for 63% in 2003. After the reform in 2004 (see *Institutional Framework* above) current transfers were halved, but the decline was more than compensated by increased revenue from income taxes.

In 2005-2006 current transfers started to increase again due to increased financing from the EU on social projects (PLN8m in 2005 and PLN5m in 2006) and a regional subsidy received from the state. The subsidy is calculated based on a set formula: the higher the unemployment rate, the higher the number of km of roads per inhabitant and the lower the GRP per inhabitant, the higher the regional element received.

In 2008 the region's current transfers will rise about PLN50m in result of change in financing of the bus transport services (to be financed from a targeted grant from the state budget instead of income taxes).

In the next years, the amount of current transfers will increase further as the region will receive financing from the EU aimed at PO KL (see *EU Financing* above). The region estimates the amounts to be received at EUR900m in 2007-2013.

However, they will generally influence both sides of the budget, as the region will transfer them to ultimate beneficiaries.

Revenue

(PLNm)	2004	2005	2006	2007[a]
Income taxes	1,299	1,312	1,599	1,780
Other local taxes and fees	6	8	4	6
Current transfers	10	80	178	181
Other operating revenue	97	122	235	193
Operating revenue	**1,411**	**1,521**	**2,017**	**2,160**
Interest revenue	15	32	14	9
Capital revenue	56	39	90	32
Total revenue (1)	**1,482**	**1,592**	**2,121**	**2,201**
Expenditure aimed at equalisation mechanism (2)	380	310	638	794
Total revenue excluding amounts spent at equalisation mechanism (1-2)	**1,101**	**1,282**	**1,484**	**1,407**

[a] Budget
Source: Region of Mazowieckie

Expenditure

Expenditure Aimed at the Equalisation Mechanism

As Mazowieckie's tax revenue per capita became over double the national average, the region is obliged by law to transfer some amounts to the state budget, which are then directed to poorer regions (with tax revenue per capita lower than the average). The amounts paid by the region have been growing (see table in *Revenue* section). It rose from PLN311m in 2005 to PLN637m in 2006, when it accounted for about 41% of the region's operating expenditure (27% of total expenditure). In 2007 the amounts should remain at the 2006 level, but the region projects them to increase by PLN100m in 2008.

Public Transport the Most Expensive Item

The most expensive item under the region's responsibility is public transport. In 2006 operating expenditure in this sector amounted to about PLN358m (23% of the region's operating expenditure). About 39% of it related to railway services and about 18% to bus services.

As in other regions, the costs of bus transport services have been increasing, but the pace of the growth is moderate (CAGR of 13% in 2003-2006), which results from high competition among the service providers.

The region's expenditure on rail transport services has been growing much faster than on bus transport services. The CAGR of expenditure on rail transport services was 74% in 2003-2006, and Fitch expects it to remain high in the medium term. However, the region's investments in the new trains and its control over the company's costs should yield savings in the longer term (see *Budgetary Framework* above).

High Healthcare Spending

In 2005 operating expenditure in the healthcare sector was very high (PLN107.2m, ie 11% of operating expenditure). It was due to restructuring processes implemented in the sector, under which the region repaid some of the sector's liabilities (about PLN58m). In 2006 operating expenditure in the sector decreased to about PLN40m and should be maintained at this level in 2007. The region's expenditure may increase in the next years, especially when the region will have to make payments under the guarantees provided to the sector, which at end-2006 were valued at PLN167m.

Capital Revenue and Expenditure

The region's capital revenue is made up solely of the transfers received. Until 2005 most of capital transfers was received under regional contracts signed annually between the region and the state government aimed at financing investments of national importance. The share of capital revenue in total revenue fell to an average of about 5% in 2004-2006 from about 18% in 2002-2003. In 2006 capital transfers were high (PLN90.4m), of which PLN63m was a grant from the state budget aimed at purchase of trains.

In the next years capital revenue will increase as the region will receive increased amounts from the EU. About 20% of all the amounts received under RPO will be spent on the region's own investments, while the rest will be directed to other beneficiaries (eg municipalities) in the form of capital grants included in capital expenditure. The region will also receive additional EU financing from programs managed at the national level, which will be aimed at its own investments.

Capital expenditure rose more than fivefold in 2003-2006 thanks to high rise in the region's revenue. It rose to PLN820m from PLN140m in 2003. In 2006 capital expenditure accounted for 35% of total expenditure. In 2006, 44% of capital expenditure was spent on direct investments and 56% were capital grants.

In 2005-2006 almost 70% of capital expenditure was channelled into three areas under the region's responsibility: public transport, healthcare and agriculture. Transport was the main recipient (about 32%) due to investments in roads, acquiring shares in Koleje Mazowieckie and a purchase of trains. Capital expenditure in the healthcare sector averaged 27% of the total due to investments in hospitals (PLN148m in 2005 and PLN257m in 2006).

The investment plan for 2007-2009 projects the region's capital expenditure at about PLN1.7bn, 83% of which will be financed from the region's own sources, 8% from EU financing and 13% from other sources. The highest capital expenditure will be directed at the region's roads (about 30% of all capex), railways (30%), healthcare (14%), and culture (7%). This investment plan includes only own investments of the region and this plan seems realistic. In fact, capital expenditure shown in the budget will be higher, as the region will act as a pass-through vehicle for part of the grants from the EU (see *Institutional Framework* and *Administration* sections above).

Budgetary Performance

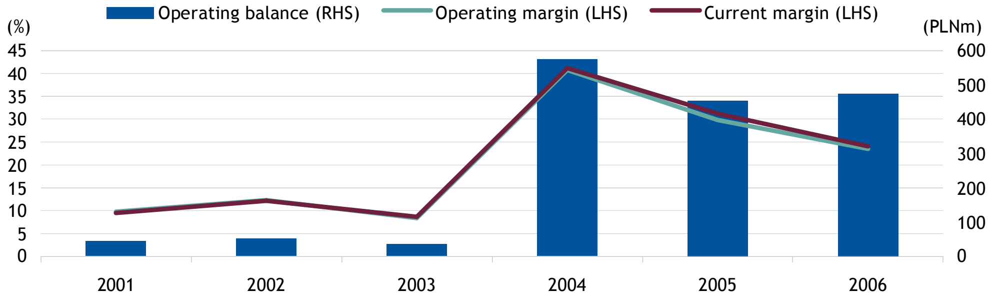
The region's financial position changed completely in 2004 after the introduction of the new financing system (see *Institutional Framework* above). As a result, the region's budgetary performance became exceptionally good, with high operating and current balances, high margins and no debt.

In 2004 Mazowieckie's operating revenue tripled year on year (it grew by 46% in the Region of Malopolska and 75% in the Region of Wielkopolska). As a result, the region's operating balance rocketed to PLN574m from about PLN34m in 2003 and its operating margin jumped to over 40% from about 8% in 2003.

In 2004 Polish regions curbed growth of operating expenditure in case the new financing system would disadvantage them; but when the changes turned out to be very beneficial for them, they posted an exceptionally good operating performance. In 2005-2006 the regions started to use the received revenue more broadly, and as a result their operating performance weakened year on year, though it remained very good, much better than in 2003. In 2006, the operating balance was PLN475m accounting for 23.5% of operating revenue.

As the region was almost debt free in 2004-2006, which resulted in interest paid of less than PLN1m, and it earned substantial interest revenue from high cash deposits in its bank account, its current margin was almost 1pp higher than the operating one.

Budgetary Performance



Source: Own calculations based on Region of Mazowieckie's data

The region's current balance plus capital revenue plus surpluses from previous years were sufficient to finance its capital expenditure in 2004-2006. The budgetary surplus posted by the region in 2004 was exceptionally high at PLN404m.

In the next years Fitch expects the region's budget will grow in size due to the fact that the region will receive EU financing, part of which will be directed to other beneficiaries. It will influence both revenue and expenditure sides of the budget, including operating and capital parts. The region's operating performance should remain good in the medium term, with high operating balances and margins, adequate for projected increase in debt.

Debt and Liquidity

The region had no direct debt in 2004-2006. Its direct risk was very low (PLN66m in 2006) and related to bridge financing of the EU co-financed projects (the loans are repaid using the EU funds after the relevant phases of the projects are completed).

Loan Agreement for EUR50m with EIB

The region signed a loan agreement with EIB for EUR50m (equivalent of about PLN200m) aimed at purchasing trains for Koleje Mazowieckie. The loan will be drawn in two tranches, PLN80m in 2007 and PLN120m in 2008. The loan has a grace period of four years and a final maturity of 25 years. The bank guaranteed that interest will not be higher than WIBOR+0.13 in the whole period of the loan. According to the loan agreements, the region's operating balance (calculated similarly as by Fitch) should be higher than 2x of interest paid and must not fall below 1.5x of interest paid.

The budget for 2007 projects the region's debt to increase to over PLN500m, including PLN80m from EIB. However, the actual amount drawn may be lower, as in 2006, when PLN240m of debt was planned but no debt was drawn. According to the region's recent projections, its debt may amount to PLN300m at year-end.

The region's debt will increase in the coming years, up to PLN1bn by end-2010, which, calculating very conservatively, is about 50% of 2006 operating revenue.

Contingent Liabilities

The region's contingent liabilities relate to debt of the region's companies, debt of

Contingent Liabilities

(PLNm)	2005	2006
Guarantees	62.9	167.3
Total debt of region's hospital	83.2	162.1
- exc. g'teed amount	20.3	0.0
Debt of region's companies	0.3	2.1
Total city's contingent liabilities	**83.5**	**169.4**

Source: Fitch's calculations based on the region's data the region's healthcare sector and guarantees issued to it (see table below). The region's contingent liabilities almost doubled in 2006 year on year and amounted to PLN169.4m. Fitch expects them to increase further in the medium term due to planned investment of the region's companies and worsening situation in the healthcare sector (see *Budgetary Framework* above).

Liquidity

Changes in the financing system introduced in 2004 significantly improved the region's liquidity. As in other regions, in 2001-2003 the region's cash at year-end did not exceed PLN10m. The situation changed in 2004, when the region's cash at year-end rocketed to over PLN360m. Cash averaged to about PLN565m in 2005 and PLN352m in 2006, remaining high at about PLN282m in the first 10 months of 2007. High liquidity enabled the region to earn high interest revenue of PLN14m in 2006. The region has a stand-by liquidity credit line of PLN50m, but it was not used in 2006 and 2007.

Appendix A

Region of Mazowieckie

	Actual				
(PLNm)	2002	2003	2004	2005	2006
Taxes	132.6	134.0	1,298.8	1,311.8	1,599.3
Transfers received	272.5	259.3	96.6	121.9	234.9
Charges, fines and other operating revenue	12.4	17.8	15.8	87.7	182.3
Operating revenue	**417.5**	**411.1**	**1,411.2**	**1,521.4**	**2,016.5**
Operating expenditure	-366.3	-376.7	-837.2	-1,067.4	-1,541.9
Operating balance	**51.2**	**34.4**	**574.0**	**454.0**	**474.6**
Financial revenue	1.2	1.5	14.6	31.5	14.4
Interest paid	-1.3	-0.4	-1.3	-0.1	-0.3
Current balance	**51.1**	**35.5**	**587.3**	**485.4**	**488.7**
Capital revenue	83.6	94.7	56.0	39.1	90.4
Capital expenditure	-126.6	-140.0	-239.4	-629.8	-819.6
Capital balance	**-43.0**	**-45.3**	**-183.4**	**-590.7**	**-729.2**
Surplus (deficit) before debt variation	**8.1**	**-9.8**	**403.9**	**-105.3**	**-240.5**
Debt repayments	-6.0	-6.0	-25.0	0.0	0.0
New borrowing	0.0	25.0	0.0	0.0	0.0
Net debt movement	**-6.0**	**19.0**	**-25.0**	**0.0**	**0.0**
Overall results	**2.1**	**9.2**	**378.9**	**-105.3**	**-240.5**
Debt stock					
Short-term	0.0	0.0	0.0	0.0	0.0
Long-term	0.0	25.0	0.0	0.0	0.0
Direct debt	**0.0**	**25.0**	**0.0**	**0.0**	**0.0**
+ Other Fitch classified debt	0.0	0.0	0.0	22.2	61.0
Direct risk	**0.0**	**25.0**	**0.0**	**22.2**	**61.0**
- Cash, liquid deposits, sinking fund or pre-financing	n.a.	9.4	364.4	214.7	69.9
Net direct risk	**n.a.**	**15.6**	**-364.4**	**-192.5**	**-8.9**
Guarantees and other contingent liabilities	0.8	3.6	59.0	63.9	167.3
Net indirect risk (public-sector entities exc. gteed amount)	n.a.	0.0	0.0	20.6	2.1
Net overall risk	**n.a.**	**19.2**	**-305,4**	**-108.0**	**160.5**
Memo					
% of debt in foreign currency	0.0	0.0	0.0	0.0	0.0
% of issued debt	0.0	0.0	0.0	0.0	0.0
% of fixed interest rate debt	0.0	0.0	0.0	0.0	0.0

Source: Region of Mazowieckie

Appendix B

Region of Mazowieckie

	Actual				
	2002	2003	2004	2005	2006
Fiscal performance ratios					
Operating balance/operating revenue (%)	12.3	8.4	40.7	29.8	23.5
Current balance/current revenue[a] (%)	12.2	8.6	41.2	31.3	24.1
Surplus (deficit) before debt variation/Total revenue[b] (%)	1.6	-1.9	27.3	-6.6	-11.3
Overall results/total revenue (%)	0.4	1.8	25.6	-6.6	-11.3
Operating revenue growth (annual % change)	-6.6	-1.5	243.3	7.8	32.5
Operating expenditure growth (annual % change)	-9.1	2.8	122.2	27.5	44.5
Current balance growth (annual % change)	21.4	-30.6	1,556.2	-17.4	0.7
Debt ratios					
Direct debt growth (annual % change)	n.a.	n.a.	n.a.	n.a.	n.a.
Interest paid/operating revenue (%)	0.3	0.1	0.1	0.0	0.0
Operating balance/interest paid (x)	39.4	78.2	441.5	4,540.0	1,582.0
Direct debt servicing/current revenue (%)	1.7	1.6	1.8	0.0	0.0
Direct debt servicing/operating balance (%)	14.3	18.7	4.6	0.0	0.1
Direct debt/current revenue (%)	0.0	6.1	0.0	0.0	0.0
Direct risk/current revenue (%)	n.a.	6.1	0.0	1.4	3.0
Net overall risk/current revenue (%)	0.2	6.9	4.1	-7.0	7.9
Direct debt/current balance (yrs)	0.0	0.7	0.0	0.0	0.0
Direct risk/current balance (yrs)	0.0	0.7	0.0	0.0	0.1
Direct debt/GDP (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Direct debt per capita (PLN)	0	5	0	0	0
Revenue ratios					
Operating revenue/budget operating revenue (%)	n.a.	n.a.	n.a.	n.a.	118.4
Tax revenue/operating revenue (%)	31.8	32.6	92.0	86.2	79.3
Modifiable tax revenue/total tax revenue (%)	0.0	0.0	0.0	0.0	0.0
Current transfers received/operating revenue (%)	65.3	63.1	6.8	8.0	11.6
Operating revenue/total revenue[a] (%)	83.1	81.0	95.2	95.6	95.1
Total revenue[a] per capita (PLN)	98	99	288	309	411
Expenditure ratios					
Operating expenditure/budget operating expenditure (%)	n.a.	n.a.	n.a.	n.a.	88.2
Staff expenditure/operating expenditure (%)	26.8	28.1	14.7	14.5	11.8
Current transfer made/operating expenditure (%)	45.6	44.3	26.3	16.6	30.4
Capital expenditure/budget capital expenditure (%)	n.a.	n.a.	n.a.	n.a.	111.7
Capital expenditure/total expenditure (%)	25.3	26.8	21.7	37.1	34.7
Capital expenditure/local GDP (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Total expenditure per capita (PLN)	98	102	214	329	458
Capital expenditure financing					
Current balance/capital expenditure (%)	40.4	25.3	245.3	77.1	59.6
Capital revenue/capital expenditure (%)	66.0	67.7	23.4	6.2	11.0
Net debt movement/capital expenditure (%)	-4.7	13.6	-10.4	0.0	0.0

[a] Includes financial revenue
[b] Excluding new borrowing
Source: Region of Mazowieckie