FITCH AFFIRMS POLISH REGION OF MAZOWIECKIE AT 'A-'; OUTLOOK STABLE

Fitch Ratings-Warsaw/London-19 April 2019: Fitch Ratings has affirmed Polish Region of Mazowieckie's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-'. At the same time Fitch has upgraded the National Long-Term Rating to 'AAA(pol)' from 'AA+(pol)'. The Outlooks are Stable.

Fitch has also affirmed Mazowieckie's senior unsecured debt long-term foreign currency rating at 'A-'. The region's standalone credit profile (SCP) is assessed at 'aa+', which reflects a combination of a 'Midrange' risk profile assessment and strong debt metrics leading to a 'aaa' debt sustainability score.

The upgrade of the National Rating reflects Fitch's opinion that the relative strength of Mazowieckie compared with national peers has improved. The affirmation of the remaining ratings reflects our unchanged expectations that the region's budgetary performance and liquidity will remain solid and that regional direct debt will decline over the medium term.

Under our new criteria introduced in April 2019 (Rating Criteria for International Local and Regional Governments) Fitch classifies Mazowieckie - as for all Polish local and regional governments (LRGs) - as type B as it covers debt service from its cash flow on an annual basis.

Mazowieckie is the largest and richest among 16 Polish regions (population 5.3 million). In 2016 the region's gross regional product accounted for 160% of the national average and 109% of the EU28 average. The unemployment rate was 4.9% at end-2018 (national 5.8%). Services dominate the economy around the region's capital, the City of Warsaw, with a wealthy and diversified tax base. Distant sub-regions show weaker economic development and wealth indicators.

KEY RATING DRIVERS

Revenue Robustness assessed as Weaker
Dependence on national fiscal regulation and macroeconomic development leads to our weaker assessment of Mazowieckie's revenue robustness. Mazowieckie's operating revenue is dominated by taxes, which account on average for over 80% of operating revenue. Most of it is CIT (74% of operating revenue in 2018), which is strongly exposed to economic fluctuations. The tax has a greater sensitivity than the economic cycle as the rate of change tends to overshoot the economy in a down- or an up- cycle. Fitch forecasts GDP growth for Poland to slow to 3% by 2020 from a cyclical peak of 5.1% in 2018. We therefore assume in our rating case tax revenue to grow by about 1.5% CAGR in 2019-2023, compared with 13% CAGR in 2014-2018.

Revenue Adjustability assessed as Weaker
We assess Mazowieckie's ability to generate additional revenue in response to possible economic downturns as limited and weaker than other Polish regions'. The region has the highest share of CIT in its revenue compared with other regions and CIT rates are set by the Polish government. Although an equalisation scheme exists for Polish LRGs, Mazowieckie is the highest contributor. In 2018, the region paid PLN376 million into the system, ie about 13% of operating revenue compared with our expectation of 15% in 2019-2020.

Expenditure Sustainability assessed as Stronger
We assess the expenditure sustainability of Mazowieckie as stronger, in line with our assessment for all Polish regions. The regions have mostly non-cyclical responsibilities in public transport

(average of 35% of opex for all Polish regions in 2017), administration (17%), culture (13%) and education (9%) as well as capex (30% of total expenditure). Mazowieckie, however, has equalisation payments, which are cyclical and constituted about 20% of opex in 2018. We assume that this share to grow in the medium term but no more than 30% of opex.

Expenditure Adjustability assessed as Stronger
Mazowieckie's has a proven track record of reducing total expenditure in case of need. Since 2014, the operating costs of the region have been tightly controlled as part of a precautionary programme imposed by a state budget loan to the region. The region may spend on average 26% of total expenditure on capex in 2019-2023 under our rating case. In case of need, Mazowieckie can postpone some of the spending or partially scale back on its investments as they are predominantly large numbers of infrastructure investments.

Liabilities & Liquidity Robustness assessed as Midrange
This assessment is in line with our 'Midrange' assessment of the national framework for debt and liquidity in Poland. Mazowieckie's loan portfolio is dominated by loans from international financial institutions (66% of stock at end-2018) and the state budget loan (22%), with debt maturities until 2038 and a smooth amortisation profile. We forecast debt will decline to about PLN760 million at end-2023 (2018: PLN1 billion) due to full bond redemptions in 2019 (about PLN120 million) and low financing needs.

Mazowieckie is exposed to foreign currency risk (35% of debt in euros at end-2018). We expect the share to fall to about 20% by end-2019. All debt is at floating rate, which exposes the region to interest rate risk. Mazowieckie partially mitigates this risk with its prudent financial management as hedging is not allowed for Polish LRGs. Indirect risk stemming from the region's shareholdings (including healthcare units) remains high, driven by ongoing substantial financial support (capital injections, guarantees and loans) for the financially weak healthcare sector. We project that in the medium term, as in the past, the region's financial support for healthcare units could reach PLN150 million annually.

Liabilities & Liquidity Flexibility assessed as Midrange
Mazowieckie's cash position has been consistently strong since 2014. The region is not reliant on external borrowing for cash flow needs. Our rating case projections foresee a liquidity coverage ratio (operating balance plus unrestricted cash-to-debt service in current year) of 3x on average in 2019-2023, compared with an average of 4x in 2015-2018. The region has no committed credit lines but could easily obtain one with a limit up to PLN300 million in case of need.

Debt sustainability 'aaa'
Under Fitch's rating case the debt payback ratio (net direct risk-to-operating balance) - the primary metric of debt sustainability assessment for type B LRGs - will remain sound over our five-year rating horizon due to the expected deleveraging. Secondary metrics - fiscal debt burden measured as net adjusted debt-to-operating revenue and the debt service coverage ratio (DSCR) measured as operating balance-to-debt servicing - should maintain their 'aaa' assessment, which results in an overall debt sustainability assessment of 'aaa'.

Fitch's rating case forecasts that pressure on debt increase due to new investments will be low and that net debt will decline over 2019-2023. This will lead to strong debt sustainability metrics with a payback ratio remaining below two years (2018: 0.8 years) and a fiscal debt burden below 25% (2018: 27.5%). The DSCR ratio will exceed 5x (2018: about 14x).

RATING DERIVATION

The region's SCP is assessed at 'aa+", which reflects a combination of a 'Midrange' risk profile assessment and strong debt metrics resulting in a 'aaa' debt sustainability score. The SCP also factors in Mazowieckie's comparison with peers. Mazowieckie's IDRs are capped by Poland's IDRs. The region's IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state.

KEY ASSUMPTIONS
Fitch's key assumptions within our rating case (2019-2023) for the issuer include:
-Tax revenue growth at 1.5% CAGR compared with 5% CAGR in base case;
-Operating expenditure growth at 7% CAGR compared with 6% CAGR in base case due to limits on opex growth resulting from the precautionary programme;
-Interest rates to rise 50bp annually from 2020 compared with 25bp in the base case;
-Average capex at 26% of total expenditure in the base and rating cases; and
-The healthcare sector remains financially weak in the long term requiring financial assistance from the region's budget.

RATING SENSITIVITIES

A rating action on Poland will be mirrored in Mazowieckie's IDRs in light of the rating constraint.

Deterioration of the region's debt sustainability with a payback ratio trending towards 5x and a weaker debt service coverage of below 4x under Fitch's rating case could lead to a SCP downgrade.

Contact:

Primary Analyst
Dorota Dziedzic
Senior Director
+48 22 338 62 96
Fitch Polska S.A.
16 Krolewska Street
Warsaw 00-103

Secondary Analyst
Renata Dobrzynska
Director
+48 22 338 62 82

Committee Chairperson
Vladimir Redkin
Senior Director
+7 495 956 9901

Media Relations: Athos Larkou, London, Tel: +44 20 3530 1549, Email: athos.larkou@thefitchgroup.com; Malgorzata Socharska, Warsaw, Tel: +48 22 338 6281, Email: malgorzata.socharska@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
National Scale Ratings Criteria (pub. 18 Jul 2018)
https://www.fitchratings.com/site/re/10038626
Rating Criteria for International Local and Regional Governments (pub. 09 Apr 2019)
https://www.fitchratings.com/site/re/10067640