FitchRatings

Fitch Affirms Polish Region of Mazowieckie at 'A-'; Outlook Stable

Fitch Ratings-Warsaw/London-19 October 2018: Fitch Ratings has affirmed the Polish Region of Mazowieckie's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'A-' and Long-Term National Rating at 'AA+(pol)'. The Outlooks are Stable. Fitch has also affirmed Mazowieckie's senior unsecured debt long-term foreign currency rating at 'A-'.

The affirmation 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. The ratings also reflect the region's high indirect risk, driven by significant and ongoing financing requirements of the healthcare sector, which we do not expect to decrease in the medium term.

KEY RATING DRIVERS
Fiscal Performance - Strength/Stable: Our projections continue to show that the region will post strong operating performance with operating margins at around 20%-25% in the medium term. This will be supported by control of operating costs (precautionary programme in place) and by the expected growth of corporate income tax (CIT) revenue. CIT is the region's most important revenue source (60%-76% of operating revenue) and dependent on the national economy. In October 2018 Fitch revised its GDP growth forecast for Poland to 4.8% for 2018 from 4.4%. On the back of economic expansion we expect the region to report about 12% higher CIT revenue (PLN2.3 billion).

We forecast the region's operating balance to reach PLN800 million for 2018 (2017: PLN727 million) and cover annual debt service more than 3x. It will also translate into a higher contribution by the region to the equalisation system in 2019-2020 as payments will be calculated based on 2017-2018 tax revenue. From 2019 we expect the operating balance to be lower but to cover debt service by at least 2x.

Debt, Liabilities & Liquidity - Strength/Stable: The region's debt has been declining since 2014. We forecast that it will decline to about PLN900 million at end-2021 from an expected PLN1 billion at end-2018. It will be driven by bond redemptions (PLN239 million outstanding at end-June 2018) and low new debt pressure from planned investments. We project the region's debt payback ratio (debt-to-current balance) to remain at below two years (2018: expected 1.4 years).

The region is exposed to foreign currency risk as over 40% of its debt stock at end-June 2018 was euro-denominated (bonds and loan from Council of Europe Development Bank). We expect the region's foreign currency exposure to fall to 20% of the debt stock by end-2019 due to bond redemptions. Cash in Mazowieckie's accounts was PLN394 million in January-September 2018, compared with PLN417 million in January-September 2017.

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. In contrast, the strong financial health of the region's railway companies, which have the most debt within the region's shareholdings (about 60% of total indirect risk), allows them to service their own debt. This is due to the long-term service contracts signed with the region for the provision of regional passenger railway services.

Economy - Strength/Stable: Mazowieckie's gross regional product per capita (the region has over five million inhabitants) was 160% of the national average and 109% of the EU-28 average in 2016. The unemployment rate was 5.1% at end-July 2018, below Poland's average (5.9%). The region is characterised by strong differences in economic development within its sub-regions. To maintain access of the less developed regions to EU grants under the next budgeting period, the region has been statistically divided into two NUTS 2 units from 2018.

Management & Administration - Neutral/Stable: Mazowieckie's administration has to ensure compliance with the precautionary programme introduced in 2014, limiting spending and indebtedness. The biggest challenge facing the administration is the financially weak healthcare sector as well as acceleration of infrastructure investments that were curbed in 2012-2014.

Institutional Framework - Neutral/Stable: The regulatory regime for Polish local and regional governments (LRGs) is fairly stable. Their activities and financial statements are closely monitored and reviewed by the central administration. LRG's finances are public and LRGs are obliged to disclose their financial accounts on time and in detail. The main revenue sources such as income tax revenue and transfers and subsidies from the central government are centrally distributed according to a legally defined formula, which limits the central government's scope for discretion.

RATING SENSITIVITIES

The ratings could be upgraded if the region's net overall risk falls below 70% of current revenue (2018: 68% on a preliminary basis) and if the region maintains strong operating performance with an operating margin above 20%, provided the sovereign's IDRs are also upgraded.

Mazowieckie's ratings could be downgraded if net overall risk exceeds 120% of current revenue on a sustained basis along with material deterioration in operating performance.

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Applicable Criteria

International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016) (https://www.fitchratings.com/site/re/878660)
National Scale Ratings Criteria (pub. 18 Jul 2018) (https://www.fitchratings.com/site/re/10038626)

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