FitchRatings

FITCH DOWNGRADES POLISH REGION OF MAZOWIECKIE TO 'BBB+'; OUTLOOK STABLE

Fitch Ratings-London/Warsaw-12 April 2011: Fitch Ratings has downgraded the Polish Region of Mazowieckie's Long-term foreign currency rating to 'BBB+' from 'A-', Long-term local currency rating to 'A-' from 'A' and National Long-term rating to 'AA(pol)' from 'AAA(pol)'. The Outlook on all ratings is Stable.

The downgrades reflect the deterioration of the region's operating performance in 2009-2010, which is not expected to materially improve in 2011-2012, and its weak debt ratios. The ratings and Stable Outlook reflect the region's weak control over its operating expenditure, which is growing faster than operating revenue, and is also negatively affected by equalisation transfers, as well as high indirect risk from the region's healthcare sector. The ratings are supported by the region's wealthy and developed tax base.

The ratings could be downgraded further if Mazowieckie's operating performance remains weak, indirect risk continues to grow or materialises in significant direct pressure on the region's budget. The ratings could be upgraded if the region's operating performance improves due to better control of operating expenditure, and if debt stabilises, which will conjoined lower indirect risk.

In 2010, the operating balance deteriorated to 5.2% of operating revenue (from average 20.8% in 2007-2009). Fitch expects an operating margin of about 8% in 2011-2013, considerably below the high level achieved before 2010. As a result, the debt repayment ratio will remain weak, above 15 years. Although management intends to limit any increase in debt, Fitch expects that debt may rise, because of implementation of investments, to about 78% of current revenue in 2013 from a moderate 66.5% (PLN1.4bn) at end-2010. Debt service is projected to increase to an average of PLN250m in 2017-2019 from an average of PLN117m in 2011-2016 because of scheduled bond repayments, which may result in a weak debt service ratio.

The high share of operating revenue coming from income tax revenue (2010: 71%) and the complicated and progressive formula of the equalisation transfers leave the region exposed to the economic cycle. Tax revenue was already declining in 2010, but equalisation transfers expenditure grew by 7% to PLN939m (accounting for 63% of actual tax revenue in 2010). In 2011, equalisation transfer expenditure will decline to PLN628m, due to the one-year agreement with the Ministry of Finance, although the system remains disadvantageous.

Mazowieckie is the largest (11% of national territory), most populous (5.2m inhabitants) and wealthiest Polish region.

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Additional information is available at www.fitchratings.com.

Applicable criteria, "Tax-Supported Rating Criteria", dated 16 August 2010, and "International Local and Regional Governments Rating Criteria - Outside the United States", dated 17 March 2010, are available on www.fitchratings.com.

Note to Editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(pol)' for National ratings in Poland. Specific letter grades are not therefore internationally comparable.

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=548605
International Local and Regional Governments Rating Criteria - Outside the United States
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=504770