FitchRatings

# FITCH AFFIRMS REGION OF MAZOWIECKIE AT 'BBB'; OUTLOOK STABLE

Fitch Ratings-Warsaw/London-20 November 2015: Fitch Ratings has affirmed the Polish Region of Mazowieckie (Mazowieckie) Long-term foreign currency IDR at 'BBB', Long-term local currency IDR at 'BBB+' and National Long-term Rating at 'A+(pol)'. The Outlooks are Stable. Fitch has also affirmed Mazowieckie's EUR50m and EUR32m senior unsecured bonds' Long-term foreign currency rating at 'BBB'.

The affirmation is based on our unchanged expectation that the region will balance its budget and reduce direct debt. The precautionary programme and lower equalisation transfers from 2015 should support the region's efforts. The affirmation also takes into account the uncertainty about an equalisation back-payment for 2014, mitigated by the region's currently high liquidity.

KEY RATING DRIVERS

The 'BBB' rating reflects the region's operating balance satisfactory for debt service and the still, high albeit likely to decrease, net overall risk (direct and indirect risk). It also factors in the volatile fiscal performance, which we expect to stabilise in the medium term.

In 2015-2017, we expect the region to post a strong budgetary performance and that the operating balance will fully cover debt service obligations (principal and interest). For 2015, we project the operating margin could improve to high 23%, up from the average 10% reported in 2010-2014.

The main driver of the marked margin increase in 2015 is the stronger than originally expected by the region corporate income tax (CIT) dynamic, combined with lower equalisation payments to be made by the region and the spending provisions imposed by the precautionary programme. Revenue from CIT accounts for more than 50% on average of the region's operating revenue and may increase by 13% yoy in 2015 following the improvement in the national economy, with expected GDP growth of 3.5%.

The region's equalisation payments will decrease substantially from 2015 compared with 2012-2014 due to legal changes. The transfers will no longer be the region's biggest expenditure item (35% of opex in 2013), providing it with higher budgetary flexibility. The equalisation payment in 2016 should not exceed PLN355m or 20% of the region's projected operating expenditure (see '2016 Equalisation Payments for Polish Regions' below).

In 2014, the region entered into a precautionary programme to be able to obtain a state budget loan and settle overdue equalisation payments for 2013-2014. The programme will support the region in maintaining a balanced budget by setting restrictions on spending and stopping new debt. The programme's performance will be strictly monitored by the Finance Ministry on a quarterly basis until end-2039.

We expect the region's liquidity to remain satisfactory in 2015-2017. The month-end balance of the region's accounts was PLN308m on average between January and September 2015 (2014: PLN60m) as it improved significantly due to higher CIT revenues and provided the region with sufficient funds to settle financial liabilities. The region's liquidity may temporarily come under stress if it has to pay back PLN182m of equalisation payments due for 2014. However, this is subject to an outstanding court decision.

We assume that the region's debt will decline in line with scheduled repayments, due to the debt brake imposed by the precautionary programme to about PLN1.24bn at end-2017 from PLN1.57bn at end-2014. The debt stock will fall to a moderate 50%-60% of current revenue by 2017 (2014: 77%). We project the indirect risk from the region's shareholdings to remain high, driven by the ongoing need for financial support (capital injections, sureties and loans) for the financially weak health care sector. This will be despite a decrease in the regional companies' debt, which dominates indirect risk. We project indirect debt to decrease to about PLN700m by 2017 from PLN804m at end-2014 due to scheduled repayments.

RATING SENSITIVITIES
The ratings could be upgraded if the region's net overall risk (direct and indirect risk) falls below 90% of current revenue and the region demonstrates good operating performance on a sustainable basis, with the operating balance around 14% of operating revenue supporting sound liquidity.

Mazowieckie's ratings could be downgraded if the region fails to post an operating balance which fully covers debt service obligations (principal and interest) or if net overall risk significantly exceeds 130% of current revenue (2014: 127.7%).

KEY ASSUMPTIONS
The permanent equalisation mechanism from 2017 will reduce pressure on the region similar to 2015 and 2016 where a transitional law is valid.

The region's precautionary programme will be maintained until end-2039.

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Applicable Criteria
International Local and Regional Governments Rating Criteria (pub. 18 May 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=865254
Tax-Supported Rating Criteria  (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

Related Research
2016 Equalisation Payments for Polish Regions
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=872711