



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

Fitch Ratings-Warsaw/London-20 April 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 direct debt will reduce over the medium term. The ratings also reflect the region's high indirect risk, driven by the 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 a strong operating performance with operating margins hovering around 20%-25% in the medium term. This will be supported by control of operating costs, which results from the conditions of the precautionary programme that has been in place since 2014. The operating performance will be also fuelled by the expected growth of corporate income tax (CIT) revenue, which is the region's most important revenue source, historically making up between 60%-76% of the region's operating revenue.

The CIT growth dynamic depends on the national economy and shows a stronger dynamic than that of GDP in times of economic growth. Fitch has revised its GDP growth forecast for Poland to 4.4% for 2017 from 3.2%. On the back of economic expansion the region has reported 21% higher CIT revenues (PLN1.8 billion) than planned at the beginning of 2017 (PLN1.48 billion).

High CIT revenue resulted in a high operating balance of PLN727 million in 2017. However, it will also translate into a higher contribution by the region to the equalisation system in 2019 as the payments will be calculated based on the 2017 tax revenue. As a result we expect the operating balance to amount to PLN630 million in 2018 and hover around PLN550 million from 2019. The operating balance

will sufficiently cover debt service, at least by 2x in 2018-2021.

Debt, Liabilities & Liquidity - Strength/Stable: The region's debt has been declining since 2014 as a result of the budgetary surpluses reported and in line with the new debt brake imposed by the precautionary programme. For 2018-2021 we project that the region will report budgetary surpluses allowing a further reduction in debt. We project that the region's direct debt will decline to about PLN900 million (30% of current revenue) at end-2021 from PLN1.2 billion (48%) at end-2017. We expect the region's debt payback ratio to remain safe at below two years in this period (2017: 1.7 years).

Although gradually decreasing since 2015, 40% of the debt stock at end-2017 was euro-denominated, exposing the region to foreign currency risk. Mazowieckie is going to redeem EUR82 million (outstanding at end-2017: PLN228 million) of bonds by end-2019 and we project the region's foreign currency exposure to reduce by half at that time. The region's sound liquidity, which we expect to be maintained in the medium term, builds a cushion for unexpected FX rate changes. The average cash at Mazowieckie's accounts was PLN200 million in 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 the healthcare units could reach up to PLN150 million annually. In contrast, the strong financial health of the region's railway companies, whose debt is the highest of 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 5.6% at end-2017, below Poland's average of 6.6%. The region is characterised by strong differences in wealth parameters between the sub-regions, which resulted in a statistic division into two NUTS 2 units from 2018.

Management & Administration - Neutral/Stable: Mazowieckie's management has to ensure compliance with the precautionary programme introduced in 2014, limiting spending and indebtedness. The biggest challenge facing management is the healthcare sector, which is still reporting weak financial performance and requires significant financial assistance from the region, as well as investments. Management aims also to make up for the backlog in infrastructure investments caused by the region's financial limitations in 2012-2014.

Institutional Framework - Neutral/Stable: The regulatory regime for Polish LRGs is fairly stable. Their activities and financial statements are closely monitored and reviewed by the central administration. LRG 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 (2017: 68% on preliminary basis) and if the region sustains a strong operating performance with an operating margin above 20%, provided the sovereign IDRs were 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. 07 Mar 2017)

(<https://www.fitchratings.com/site/re/895106>)

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