FITCH UPGRADES REGION OF MAZOWIECKIE TO 'BBB+'; OUTLOOK STABLE

Link to Fitch Ratings' Report: Region of Mazowieckie - Rating Action Report
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=881897

Fitch Ratings-Warsaw/London-20 May 2016: Fitch Ratings has upgraded the Region of Mazowieckie's Long-term foreign currency Issuer Default Rating (IDR) to 'BBB+' from 'BBB'. The Long-term local currency IDR has been upgraded to 'A-' from 'BBB+' and the Long-term National Rating to 'AA(pol)' from 'A+(pol)'. The Outlooks are Stable. Fitch has also upgraded Mazowieckie's EUR50m and EUR32m bonds' Long-term foreign currency rating to 'BBB+' from 'BBB'.

The upgrade is based on our view that the region has stabilised its fiscal performance and debt service ratios in 2014-2015 at a level that is commensurate with a higher rating. The ratings take into account the direct debt reduction and the early repayment of financial obligations leading to a save debt service.

The Stable Outlook reflects our expectations that the region's budgetary performance and liquidity will remain solid in the medium term, supported by lower equalisation transfers, and the precautionary programme will be maintained. The latter ensures that the region's investments can be debt financed provided the region fulfils strict conditions. The ratings also reflect the region's high indirect risk driven by the ongoing need for high financial support for the health care sector.

KEY RATING DRIVERS
The upgrade reflects the following rating drivers and their relative weights:

HIGH
In 2016-2018, we expect the region to post a strong operating performance, with an operating margin around 25%, significantly higher than the margins posted in 2010-2014 (10% on average). The main drivers will be the lower equalisation payments to be made by the region and the spending provisions imposed by the precautionary programme, combined with an expected strong corporate income tax (CIT) dynamic. The precautionary programme was implemented in 2014 as a precondition to obtaining a state budget loan necessary to repay the overdue equalisation payments for 2013-2014.

In 2015, the region demonstrated improved performance with a strong operating margin of 25%. This was driven by both expenditure decline and growing tax proceeds. Revenue from CIT, which accounts for more than 60% of the region's operating revenue, increased by 12% yoy (PLN150m) in 2015 following an improvement in the national economy, with GDP growth of 3.6%. In addition, following legal changes, from 2015 the region's equalisation payments have decreased substantially compared with 2012-2014. The transfers in 2015 (PLN271m) and expected for 2016 (PLN318m) will no longer be the region's biggest expenditure item and may account for less than 20% of opex (2013: 35%), providing it with higher budgetary flexibility.

Fitch projects that the region's operating balance should be PLN570m on average in 2016-2018 and will exceed the annual debt service at least twice, even though the latter is expected to increase to about PLN250m annually on average in 2017-2018 (PLN89m in 2012-2015) due to the start of redemption of the bonds of PLN349m from 2017.

MEDIUM
As result of the scheduled debt repayment, we project that Mazowieckie's debt will decline to about PLN1.0bn at end-2018 from PLN1.5bn at end-2015. The debt level should be moderate, falling to 40%-45% of current revenue by end-2018 from 71% at end-2015. This is in line with the new debt brake imposed by the precautionary programme, according to which Mazowieckie is allowed to start new debt-financed investment projects provided they fulfil strict conditions (eg. the investments will be EU co-financed).

The region's liquidity improved significantly in 2015. Cash at year-end rose to PLN165m in 2015 from PLN114m in 2014. We expect that in 2016-2018 liquidity remains sound and will ensure safe debt service. A positive rating factor was the settlement of the questioned equalisation back-payment for 2014. In April 2016, the region repaid PLN165.8m of PLN182.1m and we expect that it will settle the rest later this year. Taking into account the repayment of the equalisation payment and the premature repayment of the PLN70m loan taken over from the Brodnowski hospital during its restructuring process, the net overall risk (direct and indirect risk) to current revenue will reduce to 106.5% (2015: 117.7%).

We consider the indirect risk resulting from the region's shareholdings to remain high, driven by the ongoing need for substantial financial support (capital injections, guarantees and loans) for the financially weak healthcare sector. We project that in the medium term the region's financial support for those entities could amount to PLN100m-PLN150m annually. In contrast, the financial situation of the region's railway companies, whose debt is the highest among the region's shareholdings (2015: PLN735m on preliminary basis) allows them to service their own debt.

The ratings also factor in the following drivers:

We consider the legal framework supportive of the region's financial situation in the medium term. Although the permanent law regulating the equalisation payments for regions is still a work in progress, the transitional law has already significantly unburdened the region's budget (see "2016 Equalisation Payments for Polish Regions" dated October 2015 at www.fitchratings.com). The precautionary programme has also imposed spending discipline, which allowed Mazowieckie to structurally improve operating spending.

The region's wealth indicators are above national average. The region's gross regional product per capita (the region has over five million inhabitants) was 161% of the national average in 2013 (the latest available data), mainly driven by the service sector dominating the local economy. The sector accounted for 73% of gross value added (Poland: 63%) and 67% of employment (Poland: 57%) in 2013. The unemployment rate was 8.5% at end-March 2016, below Poland's 10.0%.

RATING SENSITIVITIES
The ratings could be upgraded if the region's net overall risk falls below 70% of current revenue and if the region maintains sustainably strong operating performance with the operating margin above 20%.

Mazowieckie's ratings could be downgraded if net overall risk exceeds 130% on permanent base along with a material deterioration of operating performance.

KEY ASSUMPTIONS
The equalisation law 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.

The region's administrative borders remain unchanged.

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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/creditdesk/reports/report_frame.cfm?rpt_id=878660