FitchRatings

01 MAR 2024

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

Fitch Ratings - Warsaw - 01 Mar 2024: Fitch Ratings has affirmed the Region of Mazowieckie's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-'. The Outlooks are Stable.

The affirmation reflects Fitch's expectations that Mazowieckie's IDRs will remain compatible with the current level, despite an assumed deterioration of the payback ratio to about 5x in the projection period, from 0.7x on average in 2019-2023. We expect the operating performance to weaken in 2024-2025 due to the unfavourable compensation scheme in corporate income tax (CIT), which is the region's most important revenue source. The ratio also deteriorates due to assumed high debt-financed investments.

The Stable Outlook reflects our expectations that despite the deterioration in the debt ratios its Standalone Credit Profile (SCP) will remain 'a+', which results in the region's ratings being capped by Poland's ratings (A-/Stable). The Polish framework does not allow for local and regional Governments (LRG) to be rated above the sovereign.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

Fitch assesses Mazowieckie's Risk Profile as 'Midrange' in line with other Fitch-rated Polish regions. The region's risk profile combines one factor assessed at 'Weaker' (revenue adjustability), one at 'Stronger' (expenditure adjustability), and the remaining four factors at 'Midrange' (revenue robustness, expenditure sustainability, liabilities and liquidity robustness and flexibility).

The 'Midrange' assessment reflects Fitch view of a moderately low risk of the issuer's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon due to lower revenue, higher expenditure, or an unexpected rise in liabilities, debt or debt-service requirements.

Revenue Robustness: 'Midrange'

Mazowieckie's revenues are dominated by CIT, which amounted to PLN4.5 billion or 77% of total revenue in 2023. The second-largest revenue source was transfers, mainly from the state budget, which amounted to PLN563 million (10% of the total). The share of CIT is extremely high, which results from the region being the wealthiest of the Polish regions. CIT is sensitive to economic cycles, but this is somewhat mitigated by the national economy growth prospects, with GDP expected to grow 3.2% on average in the medium term.

Revenue Adjustability: 'Weaker'

We assess Mazowieckie's ability to generate additional revenue in response to possible economic downturns as 'Weaker' compared with other Polish regions. Income tax rates and tax redistribution rates are set by the Polish government so the regions do not have the affordability of additional taxation.

There is an equalisation scheme but Mazowieckie does not benefit from it due to its wealth and is the only contributor to the scheme. Moreover, Mazowieckie will pay yoy more to the system. In 2024, it budgeted PLN1,257 million, compared with PLN1,169 million in 2023. The payments will use up between 22%-25% of the region's forecasted tax revenues. Although the contributions are far away from the legal cap of 35% of total income tax revenue, the amounts are significant for the budget.

The equalisation mechanism is determined by law and depends on national tax collection. The higher an LRG's income tax collection, the higher its contribution to the system. The Ministry of Finance recently proposed a revamp of the LRGs' Income Act, including abolition of the equalisation mechanism. The proposal suggests developing a special algorithm to more accurately estimate LRGs' expenditure needs in relation to their income potential and to adjust subsidies accordingly. The reform is at an early stage and not incorporated in our scenario.

Expenditure Sustainability: 'Midrange'

This assessment reflects the region's moderate control over expenditure growth and its moderately counter-cyclical responsibilities. Mazowieckie's current spending is mostly on regional transport (22% of total expenditure in 2023), administration (7.1%), culture (6.9%) and healthcare (4.2%). The region organises rail passenger transport (it owns two railway operators), where spending relates to compensation for the transport services.

Healthcare-related expenditure (around 25 healthcare units) covers the deficit from undervalued reimbursements from the National Health Fund. The region has high capex (average 28.3% of total expenditure in 2019-2023). Persisting high inflation (6.2% for 2023) and high energy costs will put further pressure on the budget.

Expenditure Adjustability: 'Stronger'

Mazowieckie has a proven record of reducing total expenditure in case of need. The region could take advantage of its spending flexibility as it has moderate fixed operating costs (staff costs averaged 12.4% of total spending in 2019-2023) and a high share of capex (28.3%). Operating expenditure subject to discretionary cuts includes road maintenance and repairs, promotion of the region's heritage and economic strengths, and cultural events. Mazowieckie can also postpone some of its investments or partially scale them back.

Liabilities & Liquidity Robustness: 'Midrange'

Mazowieckie's direct debt (end-2023: PLN1,186 million) carries moderate risk. The debt stock consists of loans from international financial institutions (60.4% of debt stock at end-2023, from the Polish

Development Bank (Bank Gospodarstwa Krajowego; BGK; A-/Stable; 25.3%) and a state budget loan (14.3%). The debt matures by end-2038 and has a smooth amortisation profile.

The region is less exposed to foreign-currency risk (9.9% in euro) than it was in 2022 (18%) due to repayments. It has floating rates, which exposes it to interest-rate risk. Higher reference rates (6.75% in September 2022 and 5.75% currently) led to higher interest expenses PLN49 million in 2023 (PLN18.9 million in 2021). We expect falling reference rates in the rating horizon, although this will not translate into lower interest payments as the region plans new debt to finance investments.

Liabilities & Liquidity Flexibility: 'Midrange'

Mazowieckie's liquidity is strong, despite average cash balances decreasing to PLN160 million in 2023 from PLN287 million in 2022, but the region allocated substantial amounts to deposits (PLN333 million monthly on average). The region has strong access to liquidity from banks and has a short-term credit line with a PLN300 million limit available from a local bank. The credit line covers the region's needs for liquidity and liabilities financing.

The region has a framework agreement for PLN700 million with the European Investment Bank (EIB; AAA/Stable) with PLN550 million still available for financing investments. Additionally, the region has a loan agreement with BGK for PLN500 million, of which it can still draw PLN200 million and has negotiated an additional loan of PLN200 million. This covers the bulk of financing needs for 2024.

Debt Sustainability: 'aa category'

Under its rating case for 2024-2028, Fitch projects the region's payback ratio will rise to about 5x-6x in 2026-2028, from a low 0.8x in 2023. This reflects the debt increase driven by high capex and the expected reduction of the operating balance due to inflationary pressure, high contributions to the equalisation mechanism and the LRGs' funding system introduced by the Polish Deal. The fiscal debt burden ratio will increase to 60%-70% of operating revenue, but remain strong over the rating horizon, provided the region will start with the envisaged investments.

The strong payback and fiscal debt burden ratios will counterbalance Mazowieckie's weakened synthetic debt service coverage ratio, which will deteriorate to below 2.5x over the rating horizon from a very strong 13.2x in 2023. However, this has less of an impact as it does not factor in high interest revenue. All three ratios are in the 'aa' category, justifying the debt sustainability score of 'aa'.

From 2022, LRGs receive income tax revenue in 12 equal instalments, based on the Ministry of Finance forecasts. After two years, the income taxes are reconciled with actual results. Mazowieckie's CIT for 2022 was PLN922.6 million less than when calculated on the basis of the state budget realisation. This amount should be compensated to the region in 2024. However, it will not receive it as it falls under the new exemption to the compensation mechanism. We also expect the region to face a PLN351 million shortfall in CIT for 2025 as excess CIT was allocated from the state to the regional budget in 2023 and will be returned.

The introduction of the CIT compensation limits in January 2024 is in contrast to what we anticipated during our last review. We assumed compensation to be PLN1.2 billion in 2024, but the region will be deprived of it. Consequently, we anticipate a temporary decline in the operating balance below PLN700 million in 2024-2025. This will weigh on debt ratios, which will deteriorate significantly in this period, before they rebound to levels justifying the current SCP. This situation demonstrates the systemic disadvantages of the Polish Deal tax reform to the LRGs, which may be overcome by the proposed revamp of the LRGs' Income Act.

The envisaged large investment programme with capex close to PLN10 billion in total in 2024-2028 consists of a large number of small and medium-sized projects. They include investments into roads (35% of the plan), railway transport (13%) and healthcare (10%). A large share of funds is dedicated to regional development (20%), where the region provides grants to local governments, SMEs and entrepreneurs.

Overall adjusted debt (PLN2,111 million at end-2023) comprises direct debt and the region's government-related entities' (GRE) debt. The GRE debt is mostly related to debt of the rail companies and hospitals. Guarantees issued by the region to protect repayment of the healthcare units' debt amounted to PLN56.5 million. The indebtedness of the company "Koleje Mazowieckie - KM" sp. z o.o. (PLN560.7 million) mainly relates to rolling stock investments. The company's debt matures in 2031 and its smooth repayment profile does not represent a major risk for the region. The GRE investment programmes (rolling stock renewal, modernisation of hospitals) will cause their debt to grow in the rating horizon, peaking at about PLN850 million in 2026-2028.

Derivation Summary

Fitch assesses Mazowieckie's SCP at 'a+', which reflects the combination of a 'Midrange' risk profile and 'aa' debt sustainability, stemming from a payback ratio in the upper end of the 'aa' category and moderate debt level and synthetic debt coverage, both corresponding with the 'aa' category. The region's IDRs are not affected by any other rating factors and are capped by Poland's IDRs.

National Ratings

Mazowieckie's National Long-Term Rating is 'AAA(pol)', the highest possible on the National Rating Scale.

Key Assumptions

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Weaker'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Stronger'

Liabilities and Liquidity Robustness: 'Midrange'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'aa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Rating Cap (LT IDR): 'A-'

Rating Cap (LT LC IDR) 'A-'

Rating Floor: 'N/A'

Quantitative assumptions - Issuer Specific

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2019-2023 figures and 2024-2028 projected ratios. The key assumptions for the scenario include:

- Annual average 6.8% increase in operating revenue, including tax revenue CAGR 7.2% and transfers received CAGR 3.5%; the tax revenues should be fueled by the expected rebound of the national economy;

- Annual average 8.2% increase in operating spending; the still high inflation puts pressure on spending;

- Net capex PLN1,564 million on average annually; taking into consideration the uncertainty about the timing and amount of available non-returnable EU capital grants;

- Average cost of debt increasing to 5.8% per year in 2024-2028 and long-term maturities of new debt (above 15 years); the cost increase results from a risk premium for unexpected rise in interest rates;

- Financial support up to PLN200 million annually for healthcare units; this is the maximum amount which should not be exceeded;

- We do not take into consideration the proposed changes to the LRG Income Act due to the initial stage of the legislative initiative.

Liquidity and Debt Structure

Mazowieckie secures the bonds issued by the regional airport Modlin (2023: PLN65.2 million) via a support agreement signed between the region and the agent bank. Should the airport be not able to service the bonds, the region would inject equity into the company, which would it allow to service the debt. As it is not the case and the region has a 36% stake in the company, the debt is not included into Other Fitch classified debt. However, the amount needed for the equity increase (about PLN12-13 million a year) is included in the region's multiyear financial prognosis.

Issuer Profile

Mazowieckie is the largest and richest of Poland's 16 regions, with 5.5 million inhabitants at mid-2023. Services dominate the economy around the region's capital, the city of Warsaw, with a wealthy and diversified tax base. Distant sub-regions have weaker economic development and wealth indicators. The unemployment rate was 4.1% (Poland: 5.1%) at end- 2023.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

Sovereign Downgrade, Weaker Payback: A downgrade could be triggered by negative rating action on Poland, or a multiple-notch downward revision of the SCP to 'bbb+'. The latter could be driven by a material deterioration of debt metrics, particularly a debt payback of 9x under Fitch's rating case.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Sovereign Upgrade: Positive rating action on Poland would lead to an upgrade, as Mazowieckie's IDRs are capped by the sovereign ratings.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Discussion Note

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

Public Ratings with Credit Linkage to other ratings

Mazowieckie's ratings are capped by Poland's ratings.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

Fitch Ratings Analysts

Dorota Dziedzic
Senior Director
Primary Rating Analyst
+48 22 103 3017
Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce Marszalkowska 107, 00-110 Warsaw

Marcin Lipecki
Associate Director
Secondary Rating Analyst
+48 22 103 3042

Chiaramaria Mozzi
Director
Committee Chairperson
+39 02 9475 7264

Media Contacts

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Mazowieckie, Region of	LT IDR	A-	Affirmed		A-
	LC LT IDR	A-	Affirmed		A-
	Natl LT	AAA(pol)	Affirmed		AAA(pol)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		

RATINGS KEY **OUTLOOK** **WATCH**

STABLE

Applicable Criteria

International Local and Regional Governments Rating Criteria (pub.03 Sep 2021) (including rating assumption sensitivity)

National Scale Rating Criteria (pub.22 Dec 2020)

Additional Disclosures

Solicitation Status

Endorsement Status

Mazowieckie, Region of	EU Issued, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.