

CREDIT OPINION

4 December 2023

Update



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RATINGS

Ostrava, City of

Domicile	Czech Republic
Long Term Rating	Aa3
Type	LT Issuer Rating
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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City of Ostrava (Czech Republic)

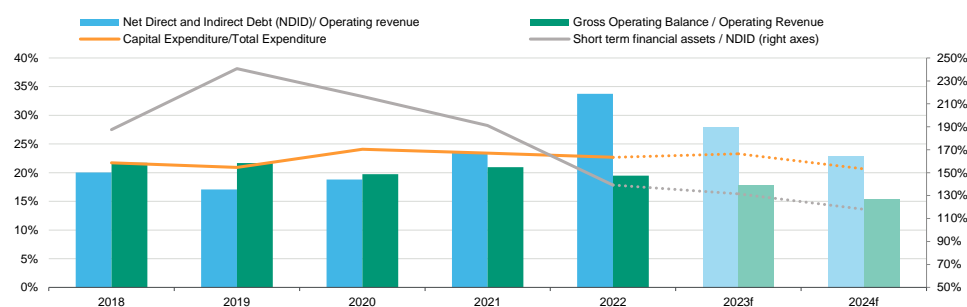
Update following outlook change to stable from negative

Summary

The credit profile of the [City of Ostrava](#) (Aa3 stable) reflects its strong operating performance supported by prudent budgetary management, robust liquidity profile and a moderate likelihood that the [Government of the Czech Republic](#) (Aa3 stable) would provide support if the city were to face acute liquidity stress. It also reflects city's moderate debt levels and low debt service, which is fully covered by liquid funds. Ostrava will continue to generate very good operating surpluses, which will be a key funding source for the capital spending. Ostrava's credit profile is constrained by a constant decline in the local population since 1990.

Exhibit 1

Strong operating performance and contained debt despite elevated capital investments



2023-24 are Moody's estimates.

Source: City of Ostrava and Moody's Investors Service

Credit strengths

- » Track record of very good operating performance despite the economic slowdown at the national level
- » Abundant liquidity despite sizeable investment projects planned in 2023-24
- » Decreasing debt levels in 2023-24

Credit challenges

- » Decline in local population mitigated by remediation policies which will take time to be effective
- » Pressure on financial performance stemming from investment requirements

Rating outlook

The stable outlook reflects the city's capacity to preserve solid operating performance, high liquidity and moderate to low debt levels over the medium term.

Factors that could lead to an upgrade

An upgrade of the sovereign rating, along with Ostrava's continued sound operating performance, strong liquidity and contained debt burden, would exert upward pressure on the city's rating.

Factors that could lead to a downgrade

Downward pressure on the rating could result from a downgrade of the sovereign rating and/or indications of weakening government support. Additionally, deterioration in the city's operating performance, combined with a decline in liquidity and an unexpected increase in debt would lead to downward pressure on the rating.

Key indicators

Exhibit 2

City of Ostrava

(31 st December)	2018	2019	2020	2021	2022	2023f	2024f
Net Direct and Indirect Debt (NDID)/ Operating revenue	20.0%	17.1%	18.8%	23.4%	33.8%	27.9%	22.9%
ST Debt/Operating revenue	6.0%	2.8%	2.9%	3.9%	3.6%	4.4%	3.4%
Interest Expense/Operating Revenue	0.3%	0.4%	0.3%	0.2%	0.5%	0.6%	0.5%
Gross Operating Balance / Operating Revenue	21.7%	21.7%	19.7%	20.9%	19.5%	17.9%	15.3%
Cash Financing Surplus/Total Revenue	1.1%	6.5%	0.0%	1.9%	-0.5%	-4.9%	-4.9%
Short term financial assets / NDID	187.5%	240.7%	216.4%	191.0%	139.2%	131.5%	118.1%
Capital Expenditure/Total Expenditure	21.7%	20.9%	24.1%	23.4%	22.7%	23.3%	20.7%
Self-financing ratio	105.1%	133.5%	99.9%	108.1%	97.8%	80.1%	77.2%
Short term financial assets / direct debt	187.5%	240.7%	241.0%	206.8%	205.6%	194.2%	181.7%

2023-24 are Moody's forecasts

Source: City of Ostrava, Moody's Investors Service

Detailed credit considerations

On 28 November 2023, Moody's has [affirmed the Ostrava's Aa3 long-term issuer ratings](#) and changed the outlook to stable from negative, following [the change of outlook](#) to stable from negative on the Czech Republic's government bond rating on 24 November 2023. This reflects city's tight linkages to the national economy.

The credit profile of the City of Ostrava, as expressed in its Aa3 rating, combines (1) a Baseline Credit Assessment (BCA) of aa3 and (2) a moderate likelihood of extraordinary support from the national government in the event that the city faced acute liquidity stress.

Baseline Credit Assessment

Track record of very good operating performance despite the economic slowdown at the national level

The City of Ostrava has a good track record of strong operating surpluses with average gross operating balance (GOB) at 20.5% of operating revenue over the past decade.

In 2022, Ostrava's operating revenue posted a growth at 10.8% compared to 2021 due to strong collection of taxes which grew by 14.6%. Shared taxes, the national pool of value-added tax, personal and corporate income tax, represented over 90% of tax revenue and grew by 15.1% in 2022 as the result of stubbornly high inflation in the Czech Republic. Inflationary environment (in average 15.1% in 2022, significantly above the average 3.8% in 2021) contributed to a 16.6% increase of value-added tax collection despite the national economic slowdown. The national real GDP grew by 2.5% in 2022 which remains 1.1 percentage points below the real GDP growth during the pandemic in 2021. The operating expenditure grew by 12.8% in 2022 due to higher transfers to subsidiaries and

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non-profit organizations. Furthermore the Czech government almost fully compensated expenses related to the Ukrainian refugees, enabling Ostrava to post a very good financial performance in 2022 with GOB at 19.5% of operating revenue.

We expect the GOB to stay around 18% in 2023 of operating revenue. This will be attributable to the expected economic slowdown at the national level (Moody's expects the real GDP to contract by 0.3% with average inflation at 11.6% in 2023), receding inflationary pressures and slight increase in operating expenses driven by higher financial support to public nonprofit organizations and rising expenses related to transportation compared to 2022.

In 2024, we expect positive economic growth for the Czech economy with real GDP growth at 1.9%. This will lead to the GOB margin's stabilization at 15%. We believe that Ostrava will continue to manage its operating performance in prudent manner with the tight grip over operating expenditure.

Abundant liquidity despite sizeable investment projects planned in 2023-24

Ostrava's track record of very good financial performance has bolstered its accumulated liquidity, which was about 47.0% of operating revenues as of year-end 2022. The accumulated cash and short term investments increased by CZK896.9 million (or 6.6% of operating revenue) compared to year-end 2021, which was attributable mainly to the strong operating performance in 2022. The cash reserves represent a very good financial buffer against potential budgetary strain and provide potential support for capital spending funding in the next 24 months. The extensive capital program funded by the combination of external financing and own liquidity resulted in the deterioration of cash to net direct and indirect debt ratio from 240.7% in 2019 to 139.2% in 2022.

The liquidity management remained conservative using mainly term deposit for the free liquidity to take interests. The interest rate acceleration during 2022 contributed to the significant growth of interest revenue which posted a growth representing 2.4% of operating revenue in 2022 from 0.3% in 2021.

We expect the high demand for capital investments in 2023-24, with capital spending reaching about CZK6.9 billion. This will lead to a one off financial deficit of 5% of total revenues in both 2023 and 2024, according to our estimates. We expect Ostrava's cash reserves to deteriorate in 2023-24 because of the city's commitment to its capital plan and repayment of the outstanding debt. However, we project that the city's liquidity will remain sufficient to cover more than 100% of its direct debt over the same period and more than 7x its debt service requirements for 2023 and 2024.

Decreasing debt levels in 2023-24

In 2022, Ostrava's net direct and indirect debt (NDID) increased in line with our projections to a moderate 33.8% of operating revenues from 23.4% in 2021. The growth was attributable to the growth of the indirect debt represented by the loans of city transportation company. The city's debt levels remained above the levels of its Czech peers we rate, [Prague](#) (Aa3 stable) and [Brno](#) (Aa3 stable) with NDID to operating revenues at 7.4% and 14.5% at year-end 2022 but well below that of its international peers.

The city's outstanding debt as of year-end 2022 consisted of CZK820 million loan from the [European Investment Bank](#) (EIB, Aaa stable) and CZK1.5 billion loan from Česká Spořitelna to support capital projects. Both loans accounted for 74% of its total direct debt. The rest of the direct debt is represented by loans taken by the city districts which have simple repayment plan. Part of the EIB loan (4 tranches representing approximately 21.2% of the direct debt at year-end 2022) had a floating interest rate as of year-end 2022, but Ostrava hedged the interest rate for two tranches (15.6% of total direct debt at year-end 2022) to eliminate interest rate risk. The interest expenses to operating revenue ratio was very low at 0.5% in 2022 and we expect it to remain around 0.6% in 2023-24.

Indirect debt consisted of the outstanding debt of city-owned companies. The long term loans, totally amounting CZK1.45 billion at year-end 2022, taken by the municipal public transportation company accounted for 98% of city's total indirect debt. These loans were contracted to the purchase of new street cars' fleet.

We estimate NDID to decrease to 27.9% of operating revenues in 2023 and further to 22.9% in 2024 due to the regular loan amortization.

Decline in local population mitigated by remediation policies which will take time to be effective

Ostrava's population has been constantly falling since the peak of 330,000 inhabitants in 1990 to 280,000 in 2021 at an annual rate of close to 2%. The restructuring of the local economy, which previously concentrated on heavy industry and coal mining, caused inhabitants to seek opportunities elsewhere. The small but steady annual decline in population has slowed in the recent years

reinvigorated by the presence of local universities, companies in the IT and advanced machinery sectors which require younger and skilled workforce. Recently the city's management included policy measures to increase Ostrava attractiveness for population across social, environmental or business areas (expanding public housing and urban green areas, supporting new industrial and commercial areas etc.) which has contributed to the population increase in 2022 of 1.3%. The size of the local population is a significant factor in the calculation of shared tax attribution of local municipalities and a further decline over the next few years will be credit negative for the city.

Pressure on financial performance stemming from investment requirements

Ostrava's capital spending plan is based on the multiyear development strategy approved by the City Council. In 2022, capital spending represented CZK3.2 billion (the highest capital budget in city's history) or a significant 22.7% of total expenditures. They flow mainly into the sewage system renovation, health care and cultural projects.

For 2023, Ostrava budgeted CZK4.9 billion of capital spending or 34.3% of budgeted total expenditure. The main priorities include a construction of parking house, concert hall and further revitalization of sewage system. Ostrava regularly monitors its investment plan and revises the capital spending in the budget for the respective year. The execution of capital plan is usually below the budgeted level therefore we estimate capital expense at about CZK3.6 billion (or 23% of Moody's estimated total expenditure). The extensive capital spending will exert pressure at Ostrava's liquidity position in 2023, but city's liquid funds will remain comfortable, fully covering city's outstanding debt in 2023.

Extraordinary support considerations

We consider Ostrava to have a moderate likelihood of extraordinary support from the central government, reflecting the central government's promotion of greater accountability for Czech cities. The system of oversight implemented by the central government requires regular monitoring of the cities' debt and liquidity. Reputational risk issues for the central government appear to be modest, given the cities' debt structure, which relies on bank loans rather than bonds.

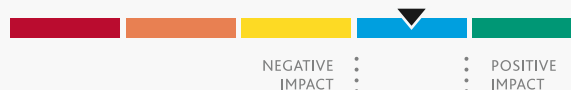
ESG considerations

City of Ostrava's ESG credit impact score is CIS-2

Exhibit 3

ESG credit impact score

CIS-2



ESG considerations do not have a material impact on the current rating.

Source: Moody's Investors Service

Ostrava's ESG Credit Impact Score (**CIS-2**) indicates that ESG considerations do not have a material impact on the rating. The score reflects limited impact of social on the rating, along with only moderate exposure stemming from environmental risks and positive governance aspect.

Exhibit 4

ESG issuer profile scores

ENVIRONMENTAL

E-3



SOCIAL

S-2



GOVERNANCE

G-1



Source: Moody's Investors Service

Environmental

The environmental issuer profile score of **E-3** reflects exposure to physical climate risks and waste and pollution risks. The highest risk comes from air pollution, the [Moravian-Silesian Region](#) (A1 stable) where the City of Ostrava is situated, has the lowest air quality among the Czech regions. The air pollution reflects city's industrial character, cross-border pollution from [Poland](#) (A2 stable) and city's geomorphology (area of Ostrava basin). The city's industrial character does not allow to significantly improve air quality in short-term horizon despite realized investments in environmental protection amounted to CZK2.8 billion in 2021. Ostrava is a national leader in green public transportation and the first Czech city which joined the European association Covenant of Mayors. This association, launched in 2008, gathers local governments voluntarily committed to achieving and exceeding the EU climate and energy targets. Ostrava has published a Sustainable Energy and Climate Action Plan 2030 with the aim to reduce CO2 emissions by 55% compared to the CO2 emissions in 2000.

Social

We assess its social issuer profile score as **S-2**, reflecting good access to education and health care facilities as well as developed infrastructure which provides access to basic services. The city is however exposed to labor and income risks as the city's unemployment rate (5.61% in 2021) is above the national and regional average (3.49% and 5.14% in 2021) meanwhile the regional the average salary lags behind the national average by approximately 10% which might constrain further economic development in the city. Ostrava has suffered from the population decrease in the recent years but the city posted a slight population increase of 1.3% in 2022 due to the migration to the city. In addition, demographic change in the form of relatively fast ageing population poses a long-

term fiscal sustainability challenge to Ostrava. The city has presented several projects to make the city more attractive from social and economic perspective.

Governance

Ostrava's strong institutions and governance profile is captured by a positive governance issuer profile score of **G-1**. The city operates within a strong institutional framework with clearly defined intergovernmental relationship. Institutional changes, if any, take place at a measured pace and without any disruption for the financial architecture of the Czech regions and the cities. Like every Czech city, Ostrava enjoys a moderate level of revenue raising flexibility enabled by the national legislation. The city can partially change property taxes and some fees related to public transportation and waste management securing additional structural revenues in case of need. On the expenditure side Ostrava can easily delay or reduce some services, repairs and contributions to nonprofit organizations, and cut a portion of its significant annual capex in case of need. The city uses prudent finance planning, which allows multiyear forecasting of key trends, providing the city with the ability to identify potential pressures, as well as with sufficient time to adjust plans accordingly to mitigate any credit implications. Annual execution prove to be prudent and in line with initial budgets without significant gaps. Fiscal and debt policies are overall prudent and transparent. Debt structure is simple with amortizing profiles and contained debt service payments over the years. Strong financial performances over time, coupled with solid liquidity position, enable the administration to mitigate any E and S risks.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of aa3 is higher than the suggested BCA of a2. The matrix-generated BCA of a2 reflects an Idiosyncratic Risk score of 3 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aa3, as reflected in the Czech Republic's sovereign bond rating.

The two-notch differential reflects a number of factors that the scorecard does not capture. These include the city's long history of prudent financial management and limited impact of local GDP per capita on the city's fiscal income.

Exhibit 5

Ostrava, City of Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				6.60	20%	1.32
Economic Strength [1]	9	78.16%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				3	20%	0.60
Legislative Background	1		50%			
Financial Flexibility	5		50%			
Factor 3: Financial Position				2	30%	0.60
Operating Margin [2]	1	19.94%	12.5%			
Interest Burden [3]	1	0.39%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	1	33.76%	25%			
Debt Structure [5]	5	20.59%	25%			
Factor 4: Governance and Management				1	30%	0.30
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						2.82 (3)
Systemic Risk Assessment						Aa3
Suggested BCA						a2
Assigned BCA						aa3

[1] Local GDP per capita as % of national GDP per capita

[2] Gross operating balance/operating revenues

[3] Interest payments/operating revenues

[4] Net direct and indirect debt/operating revenues

[5] Short-term direct debt/total direct debt

Source: Moody's Investors Service; Fiscal 2022.

Ratings

Exhibit 6

Category	Moody's Rating
OSTRAVA, CITY OF	
Outlook	Stable
Baseline Credit Assessment	aa3
Issuer Rating	Aa3

Source: Moody's Investors Service

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