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CREDIT OPINION
28 May 2019

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RATINGS

Ostrava, City of

Domicile	Czech Republic
Long Term Rating	A1
Type	LT Issuer Rating
Outlook	Positive

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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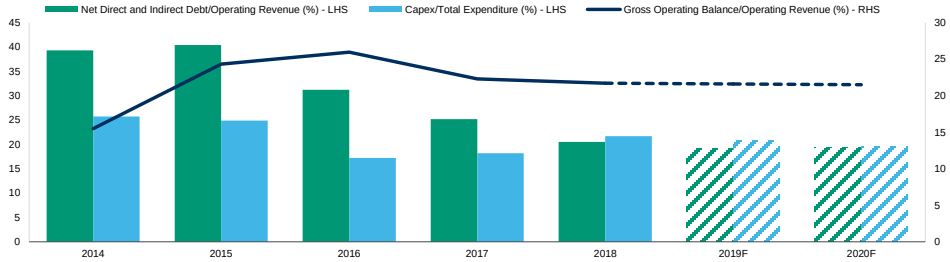
City of Ostrava (Czech Republic)

Update to credit analysis

Summary

The credit profile of the City of Ostrava (A1 positive) reflects (1) its strong operating performance, supported by its prudent budgetary management and growing tax revenue; (2) its solid financial results, which contributed to the high levels of liquid reserves; (3) its low level of debt; and (4) a moderate likelihood that the Government of Czech Republic (A1 positive) would provide support if the city were to face acute liquidity stress. Other factors underpinning the rating include (1) the city's decreasing debt levels, and (2) its importance in the Czech economy as the country's third-largest city and industrial hub. The credit profile also reflects Ostrava's above-average, but comfortably manageable, debt service costs because of a favorable amortizing debt structure.

Exhibit 1
Solid operating performance underpinned by stable, already low debt balance



F - Forecast.
Sources: City of Ostrava, Moody's Investors Service

Credit strengths

» Solid operating performance, supported by growing tax revenue and prudent budgetary management

» High level of liquid reserves

» Low debt levels resulting from conservative capital spending plan

Credit challenges

» Debt service costs will remain relatively high but manageable in the medium term

Rating outlook

The positive rating outlook reflects the improved sovereign environment, along with Ostrava's shift to a more prudent budgetary management. We expect the city to preserve its sound operating and financial performance going forward, thanks to good cost controls and growing shared taxes.

Factors that could lead to an upgrade

An upgrade of the sovereign rating, combined with a continuation of the city's good financial performance and low debt levels, could lead to an upgrade of Ostrava's rating.

Factors that could lead to a downgrade

Given the positive outlook on the sovereign bond rating, negative rating pressure is not likely. A deterioration of Ostrava's operating performance and liquid reserves on a sustained basis or a sharp increase in its debt could have a negative effect on the rating.

Key indicators

Exhibit 2
City of Ostrava

	2014	2015	2016	2017	2018
Net Direct and Indirect Debt/Operating Revenue (%)	39.3	40.4	31.2	25.2	20.0
Interest Expense/Operating Revenue (%)	2.1	0.5	0.4	0.4	0.3
Gross Operating Balance/Operating Revenue (%)	15.5	24.3	26.0	22.3	21.7
Cash Financing Surplus (Requirement)/Total Revenue (%)	-0.1	7.9	16.2	6.4	1.1
Self-Financing Ratio	1.0	1.3	2.1	1.4	1.0
Current Intergovernmental Revenue/Operating Revenue (%) [1]	72.1	72.0	71.3	77.6	77.7
Capex/Total Expenditure (%)	25.7	24.9	17.2	18.2	21.7

[1] Current intergovernmental revenue = current transfers + shared taxes.
Source: Moody's Investors Service

Detailed credit considerations

The credit profile of the City of Ostrava, as expressed in its A1 rating, combines (1) a Baseline Credit Assessment (BCA) of a1, and (2) a moderate likelihood of extraordinary support from the national government in the event that the city faces acute liquidity stress.

Baseline Credit Assessment

Solid operating performance supported by growing tax revenue and prudent budgetary management

The City of Ostrava posted a solid gross operating balance (GOB) of 21.7% of operating revenue in 2018, reaching the average for Czech cities. The GOB decreased from 22.3% in 2017, but is still relatively high compared with 15.5% of operating revenue in 2014. The improvement in operating revenue results from the national real GDP growth, which led to stronger-than-expected growth in revenue because of (1) shared taxes (a national pool of personal income tax, corporate tax and value-added tax), (2) an increase in the share of value-added tax to 23.58% from 21.4% for Czech cities in 2018, and (3) central government measures that improved the effectiveness of tax collection.

Shared taxes accounted for 70% of Ostrava's operating revenue in 2018 or CZK7.4 billion, an 8.3% increase from CZK6.8 billion in 2017. We expect Ostrava's revenue from shared taxes to grow in each of the next two consecutive years, driven mainly by the expected national GDP growth of 3.0% in 2019 and 2.5% in 2020.

Nontax revenue, representing 15.6% of operating revenue in 2018, increased by 6.8% to CZK1.66 billion from CZK1.55 billion in 2017. The operating revenue growth of 8.7% was exceeded by the 9.5% growth in operating expenditure, which was driven mainly by the growth in Ostrava's transfers and wages and salaries set by the central government. Transfers to companies and other institutions represented around 48% of the operating expenditure. The city's transport company received around one-third of the outflow. We

assume that GOB will remain stable at above 20% of operating revenue in 2019-20 because of the continuing economic growth and prudent budgetary management.

High level of liquid reserves

Ostrava's improved financial performance over the last years bolstered its accumulated liquid reserves, which amounted to a comfortable 37.6% of operating revenue in 2018. Though Ostrava's cash reserves remain slightly below those of its peers we rate, reserves represent a solid financial buffer against potential budgetary strain and provide a potential support for capital spending funding in the medium term. As a result, the city's cash reserves, amounting to CZK3.4 billion, covers almost 10x debt service requirements for 2019. Furthermore, the city owns more than CZK400 million of available-for-sale bonds. The city follows a prudent cash management strategy, which, together with regular distributions of shared taxes by the national government, leads to smooth cash flow. We expect Ostrava's cash reserves to slightly deteriorate in 2019-20, as the city will partially use the available cash to co-fund capital investments and repay the outstanding debt.

Low debt levels resulting from conservative capital spending plan

Ostrava's net direct and indirect debt (NDID) decreased to a low 20% of operating revenue as of year-end 2018 from 25.2% in the same period in 2017, dropping below the average for Czech cities and well below that of its international peers. Ostrava's debt level has been on a downward trajectory since 2013, with NDID falling to CZK2.1 billion (€84 million) in 2018 from CZK4.3 billion in 2013. Ostrava's outstanding debt as of year-end 2018 consisted of a loan from European Investment Bank (EIB, Aaa stable), which accounted for 97% of the total direct debt.

A significantly improved self-funding capacity, strengthened cash reserves and controlled capital spending will ensure that debt continues to decline in the medium term. NDID is likely to fall below 20% of operating revenue in 2019, reflecting the gradual redemption of existing loans and largely self-funded capital spending plan.

In addition to using its own resources to fund capital spending, Ostrava will continue to focus on the European Union (EU, Aaa stable) and central government subsidies. To cover the co-funding of projects within the EU's current programming period, Ostrava opened a CZK1 billion EIB credit facility available in two tranches of CZK500 million that will be activated in 2019 and 2020, respectively. We expect the disbursement of both tranches to have a limited impact on the city´s debt service, and they will not be a significant burden for the city's financial position. The city declared that debt levels at the end of the election cycle in 2022 will not be higher than the current levels. Ostrava's capital spending plan is based on the 2017-23 development strategy called "fajnOVA", which was prepared in collaboration with the general public. The main priorities include a revitalization of the city center, infrastructure upgrade, education, healthcare, culture, the development of the local economy, community development and an improvement of the environment. Ostrava also plans to construct a science library, a gallery of 21st-century art and a concert hall. These projects will be financed by a joint initiative of the Moravian-Silesian Region (A2 positive) and the central government. In 2018, Ostrava's capital spending represented 21.7% of the total expenditure, up from 18.2% in 2017. Of the CZK2.3 billion spent on capital spending in 2018, the majority was self-financed. Investment grants from the EU and the central government covered almost one-third of the amount. Capital spending is likely to remain at levels close to the average of previous years' values, with own revenue representing the key source of funding.

Debt service costs will remain relatively high but manageable in the medium term

Ostrava's debt service costs were 5% of operating revenue in 2018. The increase compared to 4.7% in 2017 was due to repayment of a CZK160 million Ceskoslovenska Obchodni Banka, a.s. (A1 stable) promissory note programme. We expect the debt service to fall by one-third in 2019. Ostrava's debt service costs remain comfortably manageable because of its stable and solid operating performance. The city also has a favorable debt profile, dominated by a long-term amortizing EIB loan. Since 2016, almost half of the city's direct debt denominated in local currency has been swapped for fixed interest rates until maturity. In addition, Ostrava's NDID is fully covered by its accumulated cash reserves.

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' indebtedness and liquidity. Finally, reputational risk issues for the central government appear to be modest, given the cities' debt structure that relies on bank loans.

Rating methodology and scorecard factors

The assigned BCA of a1 is close to the scorecard-indicated BCA of a2. The matrix-generated BCA of a2 reflects (1) an Idiosyncratic Risk score of 2 (presented below) on a scale of 1 to 9, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a Systemic Risk score of A1, as reflected in the sovereign bond rating for the Czech Republic.

Exhibit 3

City of Ostrava

Regional and Local Governments

Rating Factors						
Ostrava, City of						
Baseline Credit Assessment	**Score**	**Value**	**Sub-factor Weighting**	**Sub-factor Total**	**Factor Weighting**	**Total**
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	7	83.94	70%	5.2	20%	1.04
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	3	20%	0.60
Financial flexibility	5		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	1	22.49	12.5%	1.5	30%	0.45
Interest payments / operating revenues (%)	1	0.34	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	20.05	25%			
Short-term direct debt / total direct debt (%)	3	14.20	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						**2.39(2)**
Systemic Risk Assessment						**A1**
Suggested BCA						**a2**

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
OSTRAVA, CITY OF	
Outlook	Positive
Issuer Rating	A1

Source: Moody's Investors Service

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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