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CREDIT OPINION
20 June 2018

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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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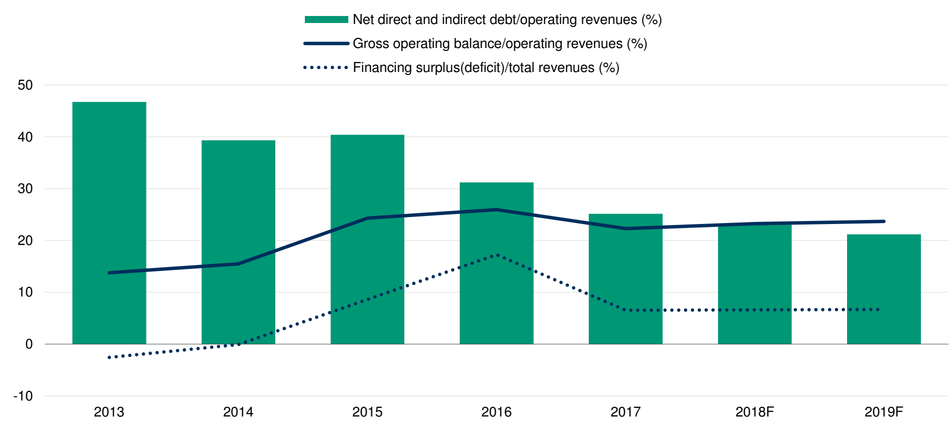
City of Ostrava (Czech Republic)

Update to credit analysis

Summary

The credit profile of the City of Ostrava (A1 positive) reflects its strong operating performance supported by prudent budgetary management and growing tax revenue, conservative capital spending plan as well as 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 the city's decreasing debt levels and its importance in the Czech economy as the country's third-largest city. The credit profile also reflects Ostrava's above-average, but comfortably manageable debt service costs, due to a favorable amortizing debt structure.

Exhibit 1
SOLID FINANCIAL PERFORMANCE AND DECLINING DEBT LEVELS



Note: F - forecast
Source: Moody's Investors Service, City of Ostrava

Credit strengths

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

» Strengthened liquidity position

» Continued decline of moderate debt levels due to 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, associated with the city's shift to more prudent budgetary management reflected in an improved operating and financial performance and conservative capital spending plan, leading to decreasing indebtedness.

Factors that could lead to an upgrade

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

Factors that could lead to a downgrade

» Given the positive outlook on the sovereign bond rating, the negative pressure is not expected.

» A sustainable deterioration of Ostrava's financial and operating performance or a sharp increase in its debt could have a negative effect on the rating.

Key indicators

Exhibit 2

City of Ostrava

Key Indicators

Ostrava, City of

	2013	2014	2015	2016	2017
Net Direct and Indirect Debt/Operating Revenue (%)	46.7	39.3	40.4	31.2	25.2
Interest Expense/Operating Revenue (%)	2.2	2.1	0.5	0.4	0.4
Gross Operating Balance/Operating Revenue (%)	13.8	15.5	24.3	26.0	22.3
Cash Financing Surplus (Requirement)/Total Revenue (%)	-2.2	-0.1	7.9	16.2	6.4
Self-Financing Ratio	0.9	1.0	1.3	2.1	1.4
Current Intergovernmental Revenue/Operating Revenue (%) [1]	70.5	72.1	72.0	71.3	77.6
Capex/Total Expenditure (%)	29.2	25.7	24.9	17.2	18.2

[1] Current intergovernmental revenue = current transfers + shared taxes

Source: Moody's Investors Service, City of Ostrava

Detailed credit considerations

On 25 April 2018, we changed to positive from stable the outlook on the rating of the City of Ostrava. At the same time, we affirmed the A1 global scale rating. The rating action followed a strengthening of the Czech Republic's sovereign credit profile as captured by Moody's outlook change to positive from stable on the Czech government bond rating of A1 on 20 April 2018.

The credit profile of the city of Ostrava, as expressed in an 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 faced acute liquidity stress.

Baseline credit assessment

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

In 2017, Ostrava posted a solid gross operating balance (GOB) of 22.3% of operating revenue, reaching the average of Czech municipalities. The GOB decreased from 26% in 2016, however it is still relatively high compared to 2013-14 average of 14.6% of operating revenue. We assume that GOB will remain stable at above 20% of operating revenue in 2018-19.

The improvement in operating revenues results from national real GDP growth of 4.4% which caused stronger than expected growth in revenue from shared taxes (a national pool of personal income tax (PIT), corporate tax (CIT) and value added tax (VAT)), an increase in the share of VAT to 21.40% from 20.83% for local governments, and central government measures that improved the effectiveness of tax collection.

Shared taxes accounted for 70% of Ostrava's operating revenue in 2017 or CZK6.8 billion, an 13.3% increase from CZK6 billion in 2016. We expect Ostrava's revenue from shared taxes to grow in each of the next two consecutive years, driven mainly by expected national GDP growth of 3.6% in 2018 and 3.2% in 2019, according to Moody's estimates.

Non-tax revenue, representing 15.9% of operating revenue in 2017, decreased by 5.7% to CZK1.55 billion from CZK1.65 billion in 2016 driven by the decline of revenue from rents and leases. Overall the operating revenue grew by 4.8% and were exceeded by the 10% growth in operating expenditure which was driven mainly by growth in city's transfers and wages and salaries set by the central government. Transfers to companies and other institutions, approximately 48% of operating expenditure, increased by 17.8% in 2017. The city's transport company received approximately one third of these outflows.

We expect the city's operating margin to remain stable further in 2018 and 2019, due to continued economic growth coupled with the administration's continuous efforts to keep a tight rein on budgetary expenditure.

Strengthened liquidity position

The city's improved financial performance over the last two years has helped to restore its accumulated cash reserves, that amounted to a comfortable 28.9% of operating revenue (up from 27.1% in 2016). Though Ostrava's cash reserves remain slightly below those of its rated peers, they represent a solid financial buffer against potential budgetary pressures and support for capital spending funding in the medium term. As a result, the city's reserves, amounting CZK2.8 billion, comfortably covers 5.6x debt service requirements for 2018.

The city follows a prudent cash management strategy which together with regular distributions of shared taxes by the national government favors smooth cash flows. We expect the Ostrava's cash reserves to slightly decrease throughout 2018-19 as the city will partially use the available cash to co-fund the capital investments and to repay the debt outstanding.

Continued decline of moderate debt levels due to conservative spending plan

Ostrava's net direct and indirect debt (NDID) decreased to a moderate 25.2% of operating revenue at the end of 2017 from 31.2% in 2016, dropping below the average of Czech municipalities and well below that of international peers. The city's debt level has been on a downward trajectory since 2013, with NDID falling to CZK2.5 billion (€98 million) in 2017 from CZK4.3 billion in 2013.

Ostrava's debt at the end of 2017 consisted of a European Investment Bank (EIB) loan, which accounted for 90% of the total debt, promissory notes made up 6.2% and other bank loans and loans from municipal districts accounted for the remainder of 3.8%.

A significantly improved self-funding capacity, strengthened cash reserves and controlled capital spending, will ensure debt continues to decline in the medium term. It is expected to fall close to 20% of operating revenue in 2018 reflecting the gradual redemption of existing loans and plan not to deploy any new debt.

In addition to using its own resources to fund capital spending Ostrava will continue to focus on EU and central government subsidies. To cover the co-financing of projects in the EU's current 2014-20 programming period that started in 2017, Ostrava agreed a CZK1 billion loan from the EIB available until 2020. This loan, representing 11% of the city's operating revenue has been postponed by city management and is unlikely to be drawn by 2019, hence will not change the downward trend of the NDID.

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 plan's main priorities include city center revitalization, infrastructure upgrade, education, health care, culture, the development of the local economy, community development and the environment improvement. The city also plans a construction of Scientist library, Gallery of 21 century art and Concert hall. These project should be financed by a joint initiative of Moravian-Silesian Region (A2 positive) and the central government.

In 2017, Ostrava's capital spending amounted 18.2% of total expenditure, which is slight increase compared to 17.2% in 2016. Of the CZK1.7 billion spent on capex in 2017, 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' 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 2017, which is slight increase compared to 4.7% of operating revenue in 2016. We expect that the debt service costs will remain around this level, which is slightly above the average for Czech peers, in the medium term.

Although above the average of 3% of operating revenue for the last five consecutive years (excluding a redemption of bonds in 2014), Ostrava's debt service costs remain comfortably manageable thanks to the stable operating performance. The city also has a favorable debt profile, dominated by a long-term amortizing EIB loan. In 2016, almost half of the city's direct debt denominated in local currency was swapped for fixed interest rates until maturity. In addition Ostrava's NDID is fully covered by its accumulated cash reserves.

The potential drawdown of the new CZK1 billion EIB loan, which was postponed by city management to 2019, will not raise the city's debt service costs thanks to a grace period linked to the full redemption of the promissory notes issue.

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

Rating methodology and scorecard factors

The assigned baseline credit assessment (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 1 to 9 scale, 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.

For details about our rating approach, please refer to Rating methodology: Regional and Local Governments, January 2018 (1091595).

Exhibit 3
City of Ostrava

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	83.88	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	23.64	12.5%	1.5	30%	0.45
Interest payments / operating revenues (%)	1	0.41	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	25.20	25%			
Short-term direct debt / total direct debt (%)	3	18.80	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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