Moody's Central Europe

Credit Opinion

Liberec Region

Czech Republic

Ratings

Category	Moody's Rating
Outlook	Stable
NSR Issuer Rating – Dom Curr	Aa1.cz

Contacts

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Key indicators

Liberec Region

	2001	2002	2003	2004	2005
Intergovernmental rev./ total revenues (%)	99.66	67.18	85.63	82.95	62.25
Financing deficit/ surplus as % of total revenues (%)	0.85	2.68	1.16	2.88	-0.64
Interest expenses/ total revenues (%)	0.00	0.00	0.00	0.00	0.02
Debt/ total revenues (%)	0.00	0.00	0.00	3.39	2.59
Primary operating balance/ operating revenues (%)	1.02	6.14	3.76	4.57	9.83
Net operating balance/ operating revenues (%)	1.02	6.14	3.76	4.57	9.81
Net operating balance/ capital expenses (%)	2.64	57.74	54.21	62.74	82.83

Opinion

Credit Strengths

- Greater spending autonomy following recent changes to revenue structure
- Very good operating performances
- Moderate cash position and comfortable level of cash-flows within the year
- Debt obligations comfortably manageable, despite limited repayment capacity of Czech regions under current framework

Credit Challenges

- Very limited revenue flexibility and capacity to generate independent sources of revenue
- Current expenditures lower flexibility,
- Increase in capital spending heavily reliant on external resources (loans or transfers), constraining the region's investment capacity
- Increasing stock of debt
- Likely increase in short-term debt to pre-fund projects that will be covered by EU funding

Rating Rationale

The Aa1.cz domestic currency national scale long-term issuer rating of the Liberec Region (LBR) is based on (i) very good operating performances, (ii) satisfactory cash position and comfortable level of cash-flows, and (iii) manageable debt obligations, despite a recent increase in its stock of debt.

Despite the rigid and still evolving framework under which Czech regions operate, the LBR's operating results have been positive and enabled the LBR's capital expenditure to be self-financed so far. Good net financial performances have enabled the region to accumulate comfortable, above average cash reserves. In 2005, the region achieved a moderate financial deficit reflecting a sharp increase in capital expenditure covered by accumulated surpluses.

The region has recently resorted to long-term debt to cover reconstruction of its roads network, pushing its total indebtedness slightly above the peer group average. However, LBR's debt obligations remain easily manageable, well within the region's repayment capacity under current operating performances and repayment schedules. Indeed, any additional significant amount of long-term debt contracted under the current financial framework, whereby revenue is heavily dependent on central government decisions and economic growth at the national level, would be likely to put pressure on the region's financial profile.

LBR's rating is predominantly constrained by the immature local government financial framework, the main features of which are limited spending flexibility based on jurisdiction, which makes the regions obliged to offer particular public services, and a heavy reliance on earmarked central government transfers (especially in education), with no leeway for the regions to generate additional sources of revenue. This combination of factors affects LBR's ability to realize capital expenditure, as well as constraining its debt repayment capacity. Nonetheless, it also increases the likelihood of further adjustments to the framework going forward.

Rating Outlook

The stable rating outlook is based on the assumption that the region will not, under the current institutional framework, incur further long-term debt and will maintain positive financial performances.

What Could Change the Rating – UP

Any change in the financial and institutional framework that significantly improves the region's self-funding and debt-repayment capacity, notably in the form of changes in law or additional sources of revenue and greater spending autonomy, would have a positive impact on the rating.

What Could Change the Rating – DOWN

A sharp deterioration in operating performance or, under the current financial framework, any significant increase in the amount of long-term debt would have a negative impact on the rating.