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Summary:

Prague (City of)

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Summary:
Prague (City of)

Credit Rating: A/Stable/A-1

Rationale

Standard & Poor's Ratings Services has affirmed its 'A' long-term and 'A-1' short-term issuer credit ratings on the City of Prague, the capital of the Czech Republic. The outlook is stable.

The ratings reflect Prague's solid socioeconomic fundamentals; its good financial performances, which have remained strong despite a notable decline in revenues in 2009; a healthy liquidity position; and a moderate, declining debt burden.

Constraining factors include exposure to bullet maturities and interest, revenue declines from the economic contraction, limited systemic revenue and expenditure flexibility, and potential pressures from the transport sector.

The city's historically strong budget performance has only been marginally eroded by the economic crisis. Operating balances averaged a high 36% of operating revenues in 2006-2008, including a very high 41% achieved in 2008. Preliminary 2009 results indicate an operating balance of 34%, thanks to the continuation of an effective cost-containment policy and still-respectable revenue collection.

Our base-case scenario points to a stabilization of the operating performances at 36% of operating revenues until the 2012 forecast horizon. We expect Prague's large capital-expenditure program to continue being self-financed, thus providing the city with the ability to continue eschewing net borrowing in subsequent years.

Debt has declined substantially since 2005 and remains well contained as a proportion of operating revenues, decreasing from 75.2% of operating revenues in 2005 to 53.5% in 2009. This result was achieved by Prague's large self-financing capacity, combined with the authorities' firm stance against taking on more debt. Our estimates show this declining trend continuing to our year-end 2012 forecast horizon.

Prague's tax-supported debt is only marginally higher than its direct debt, having declined from 84.4% of consolidated revenues in 2005 to an estimated 59.8% in 2009. It includes the debt of only one municipal entity--the transportation company--as well as the marginal debt of Prague's city districts. In the future we do not expect the debt of the transportation company to grow, and we forecast the districts' debt to demonstrate a declining trend. Tax-supported debt should therefore continue its downward trend in line with the city's direct debt.

Prague is home to the Czech Republic's political, economic, and commercial institutions. It accounts for only 12% of the country's population, yet generates at least 25% of the country's GDP. In terms of economic fundamentals, Prague far outperforms its Czech peers, particularly with a per capita income equivalent in purchasing power standard terms to 172.5% relative to that of the EU-27 average.

However, the city's capacity to benefit from its economic vitality and strength are very much constrained by the rigid intergovernmental framework under which the city retains only 8% of national tax proceeds while generating 48% of all tax revenues in the country.

Since 2007, the city has maintained and expanded its extensive range of cost-cutting measures which, in addition to contributing to the city's already-high operating surplus in 2008, also prevented the 2009 operating surplus from being lower than the 34% anticipated result. These measures will be maintained in 2010, therefore helping Prague contain the potential deterioration in operating balances. In addition, the signing of a new long-term contract with the transport company in particular could help diminish pressures on operating expenses, although uncertainty over its effective implementation persists. Moreover, continuing large investment requirements for transport will likely continue to pressure the city's budget.

Liquidity

Prague had on account as of year-end 2009 Czech koruna (CZK) 12.7 billion (€488 million) in cash, of which CZK9.547 billion was free cash. Liquidity was down from CZK25.6 billion at year-end 2008, among other reasons as a result of paying the CZK7.4 billion bullet bond from reserves.

The city is exposed to refinancing risks, particularly given its four remaining bullet bonds and loans which constitute 60% of its outstanding debt. In 2010, the city is planning to partly refinance the CZK3.750 billion bullet bond due, with the remainder to be repaid out of its cash reserves. In 2011 it intends to entirely refinance the two bullet bonds (totaling CZK5 billion) coming due. This strategy would allow it to maintain its liquidity while continuing its overall debt reduction via regular debt service (principal and interest) on its amortizing bank debt equivalent to 40% of total debt.

Outlook

The stable outlook reflects our expectation that economic growth will gradually resume from 2010, and with it the ability to generate the strong operating surpluses that support Prague's financial performances. The stable outlook factors in a continued decline of the debt burden beyond 2009, and only a partial refinancing of the 2010-2011 bond maturities.

Should the sovereign's creditworthiness improve, Prague's would likely improve, too, assuming that the city's high self-funding capacity and cash cushion are preserved.

Although we don't expect it, ratings downside could result in the event of a significant and sustained drop in operating balances alongside a subsequent and repeated resort to debt to finance capital expenditures.

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