

CREDIT OPINION

24 July 2020

 Rate this Research

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 to credit analysis

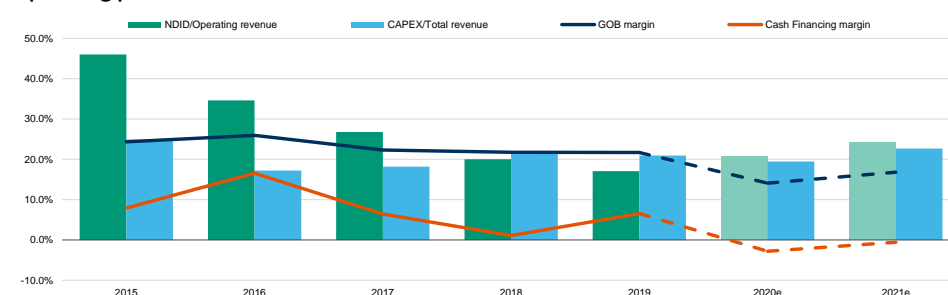
Summary

The credit profile of the [City of Ostrava](#) (Aa3 stable) reflects its strong operating performance, strengthening liquidity and a moderate likelihood that the [Government of Czech Republic](#) (Aa3 stable) would provide support if the city were to face acute liquidity stress. Even though the operating performance is hurt by the coronavirus pandemic, Ostrava will continue to generate solid operating surpluses that will serve as the main funding source for capital spending. The already-low debt levels provide room for additional funding of the city's major capital projects. Ostrava's credit profile is constrained by a decline in the local population.

The rapid and widening spread of the coronavirus pandemic and the associated deterioration in the global economic outlook (see our publication [Global economy is limping back to life, but the recovery will be long and bumpy](#), 22 June 2020), combined with falling oil prices and asset price declines, are creating a severe and extensive credit shock across many sectors and cities, including Ostrava.

Exhibit 1

Operating performance will deteriorate amid the coronavirus outbreak



2020-21 are Moody's estimates.

Sources: City of Ostrava and Moody's Investors Service

Credit strengths

- » Likely solid operating performance in 2020-21
- » High liquidity, which will help absorb the pandemic shock
- » Debt to remain moderate

Credit challenges

- » Continuous decline in local population

Rating outlook

The stable rating outlook reflects our expectation that the city will maintain its solid operating performance, high liquidity and moderate debt levels over the next 12-18 months. The rating outlook also reflects the stable outlook on the sovereign rating.

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

An unexpected deterioration in the financial and debt credit metrics of Ostrava, as well as a downgrade of the sovereign rating, would exert downward pressure on the rating and outlook.

Key indicators

Exhibit 2

City of Ostrava

	2015	2016	2017	2018	2019
Local Gdp per capita as % of National Gdp per capita	83.0%	83.0%	82.4%	83.5%	84.6%
Net Direct And Indirect Debt/Operating Revenues	40.4%	31.2%	25.2%	20.0%	17.1%
Debt Repayment / Operating Revenue	10.9%	7.7%	9.5%	6.0%	2.8%
Interest Expenses/Operating Revenues	0.5%	0.4%	0.4%	0.3%	0.4%
Gross Operating Balance/Operating Revenues	24.3%	26.0%	22.3%	21.7%	21.7%
Cash Financing Surplus / Total Revenues	7.9%	16.2%	6.4%	1.1%	6.5%
Capital Expenses / Total Expenses	24.9%	17.2%	18.2%	21.7%	20.9%
Cash And St And Lt Investments / NDID	87.4%	138.0%	178.5%	187.5%	240.7%

Sources: City of Ostrava, National Statistical Office and Moody's Investors Service

Detailed credit considerations

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

Baseline Credit Assessment

Likely solid operating performance in 2020-21

In 2019, the City of Ostrava posted a solid gross operating balance (GOB) of 21.7% of operating revenue. The GOB margin was the same as in 2018. The growth in operating revenue was balanced by a growth in wages and related costs, such as subsidies for the municipal companies. The increase in shared taxes, a key revenue source, resulted from the growth of the national economy (real GDP increased by 2.6% in 2019), which led to stronger-than-expected income. In 2019, the main components of shared taxes, personal income tax and corporate income tax, rose by 11.8% and 10.6%, respectively.

The coronavirus pandemic will constrain the city's revenue significantly. In 2020, we expect the volume of shared taxes to decrease by 10% from the 2019 levels, which will result in a deterioration in the city's GOB to below 15% of operating revenue. This deterioration will be caused by a decline in the national economy; we expect the real GDP to decline by 6.6% in 2020. The city council has tightened its grip on operating expenses, mainly in areas of public transportation and other services, to mitigate the negative pressure stemming from the likely decline in operating revenue. In 2020, we expect the operational expenses to slightly increase by 2% from that a year earlier.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

In 2021, we expect a recovery of the Czech economy (we project real GDP growth of 5%), resulting in an increase in proceeds from shared taxes and an improvement in the GOB margin to a solid 17% of operating revenue.

High liquidity, which will help absorb the pandemic shock

Ostrava's improved financial performance over the last 5 years bolstered its accumulated liquidity, which amounted to a solid 41.1% of operating revenue as of year-end 2019. In 2019 alone, the city has reached a financial surplus of 6.5% of total revenue. Liquidity is a mitigating factor to the shortfall in shared tax revenue. Although Ostrava's cash reserves remain slightly below those of its peers we rate in the Czech Republic, the reserves represent a solid financial buffer against potential budgetary strain and provide a potential support for capital spending funding in the next 24 months. Moreover, the city's cash and cash equivalents, amounting to CZK4.7 billion, cover almost 13x debt service requirements for 2020.

Ostrava's prudent cash management strategy, together with regular distributions of shared taxes by the national government, lead to smooth cash flow. We expect Ostrava's cash reserves to slightly deteriorate in 2020-21 because of the decline in operating revenue, as well as the city's commitment to its capital plan. However, we project that the city's liquidity will remain sufficient to cover more than 100% of the city's direct debt over the same period.

Debt to remain moderate

In 2019, Ostrava's net direct and indirect debt (NDID) decreased to a low 17.1% of operating revenue from 20% in 2018. This level is below the average for Czech cities (21% of operating revenue in 2019) and well below that of its international peers. Ostrava's debt has been declining since 2013, with NDID falling to CZK1.9 billion in 2019 from CZK4.3 billion in 2013. Ostrava's outstanding debt as of year-end 2019 consisted of a loan from the [European Investment Bank](#) (EIB, Aaa stable) which accounted for 89% of the total direct debt. The rest of the direct debt is represented by loans taken by the city districts. In 2019, the Poruba district had the biggest loan of CZK129 million outstanding. In 2020-23, two municipal districts (Marianské Hory and Moravska Ostrava) plan to take additional loans amounting to CZK150 million.

Ostrava is acquiring new debt financing to fulfill its medium-term capital spending plan. We expect the city to start using the new credit line in 2020-23. Apart from the new city's credit facility, Dopravni podnik Ostrava, the municipal transportation company, is considering a loan to modernise its streetcar fleet. This will increase the city's NDID to CZK2.8 billion or just under 25% of the annual operating revenue as of year-end 2021. The case of the new street cars is conditioned upon a subsidy from the [European Union](#) (Aaa stable).

We expect the new debt amount to remain manageable for the city's credit profile. Interest expenses will remain low because of the conservative stance of the central bank, as well the high willingness of domestic commercial banks and the EIB to finance the city. The city's debt service costs will remain below 4% of operating revenue in 2020-22.

Continuous decline in local population

Ostrava's population has been constantly falling since the peak of 330,000 inhabitants in 1990 to 288,000 in 2019. The restructuring of the local economy, which previously concentrated on heavy industry and coal mining, caused inhabitants to seek opportunities elsewhere. The decline in population has slowed in the recent years because of the presence of local universities as well as companies in IT and advanced machinery fields. The size of the local population is a significant factor in the calculation of shared tax attribution of local municipalities and its decline will be credit negative for the city.

Extraordinary support considerations

Ostrava has 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 the 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.

ESG considerations

How environmental, social and governance risks inform our credit analysis of the City of Ostrava

We take account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of the City of Ostrava, the significance of environmental, social and governance considerations to its credit profile are as follows:

Environmental considerations are not material for Ostrava's credit profile. The highest risk comes from air pollution because the [Moravian-Silesian Region](#) (A1 stable) is one of the industrial centers of the Czech Republic and is affected by cross-border pollution coming from [Poland](#) (A2 stable). Ostrava is a leader in green public transportation and aims to be a pioneer in operating hydrogen buses, which will strain the city's capital budget.

Social considerations are material for Ostrava's credit profile. The unemployment rate in Ostrava is higher than the average in the Czech Republic and the salaries are lower. Since 1989, the city has lost a fifth of the population, but the decline slowed dramatically since 1990. We also classify the coronavirus pandemic as a social risk, which will lead to lower income from shared taxes. There is a risk that the measures to counter the disruptions caused by the coronavirus pandemic will be in place for longer than expected.

Governance risks are material for Ostrava's rating profile. Ostrava uses prudent finance planning, which allows for 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.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing ESG Risks](#).

Rating methodology and scorecard factors

The assigned BCA of aa3 is higher than the scorecard-indicated BCA of a1. The matrix-generated BCA of a1 reflects an Idiosyncratic Risk score of 2 (presented below) on a scale of 1-9, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aa3, as reflected in the sovereign bond rating for the Czech Republic.

For details about our rating approach, please refer to the rating methodology [Regional and Local Governments](#), published in January 2018.

Exhibit 3

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	83.97	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	21.79	12.5%	1.5	30%	0.45
Interest payments / operating revenues (%)	1	0.37	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	17.06	25%			
Short-term direct debt / total direct debt (%)	3	16.83	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						Aa3
Suggested BCA						a1

Source: Moody's Investors Service

Moody's related publications

- » [Government of Czech Republic – Aa3 stable: Update following forecast changes](#), published in May 2020
- » [Regional & Local Governments – Czech Republic: Exceptional liquidity and strong fundamentals will mitigate significant coronavirus effects](#), published in April 2020

Ratings

Exhibit 4

Category	Moody's Rating
OSTRAVA, CITY OF	
Outlook	Stable
Issuer Rating	Aa3

Source: Moody's Investors Service

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