Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: Poprad, City of

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Slovak Republic

Ratings

Category	**Moody's Rating**
Outlook	Stable
NSR Issuer Rating -Dom Curr	Aa1.sk

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Key Indicators

Poprad, City of

	2004	**2005**	**2006**	**2007**	[1]**2008**
Net Direct and Indirect Debt/Operating Revenue (%)	**17.23**	**15.58**	**11.96**	**8.95**	**7.02**
Interest Payments/Operating Revenue (%)	**0.98**	**0.63**	**0.59**	**0.50**	**0.48**
Gross Operating Balance/Operating Revenue (%)	**6.32**	**14.37**	**15.56**	**14.94**	**8.28**
Cash Financing Surplus (Requirement)/Total Revenue (%)	**8.76**	**8.52**	**-2.63**	**9.68**	**-5.81**
Discretionary Own Source Revenue/Operating revenue (%) [2]	**32.97**	**28.73**	**28.34**	**27.09**	**25.95**
Self-financing ratio	**1.00**	**1.00**	**0.93**	**1.00**	**0.75**
Capital spending/Total expenditure (%)	**22.82**	**26.74**	**38.02**	**16.18**	**21.61**

[1] Budget as of March 2008 - adjusted by Moody's [2] Own taxes + non-tax revenue

Opinion

SUMMARY RATING RATIONALE

The City of Poprad's national scale issuer rating of Aa1.sk with stable outlook reflects a Baseline Credit Assessment (BCA) of 7 on a scale of 1 to 21 (where 1 represents the lowest risk) and our assessment of a low likelihood that the national government of Slovakia (A1, positive on Moody's global scale) would act to prevent a default by the jurisdiction.

Poprad's BCA of 7 reflects a number of factors, including the low level of systemic risk and the prudent fiscal policy of the city's administration. The BCA is constrained by the current institutional framework, the main features of which are a narrow spending flexibility assigned to municipalities and a broad reliance on central government transfers, with only limited leeway to generate additional own-source revenue. The BCA also takes account of the city's low debt burden and robust cash reserves.

Credit Strengths

Credit strengths for the City of Poprad include:

Prudent fiscal and debt management policies

Consistent operating surpluses, satisfactory financing results

Good liquidity

Low debt burden

Credit Challenges

Credit challenges for the City of Poprad include:

Limited revenue flexibility

Rigid expenditure structure

Additional transfer of new responsibilities without adequate funding

Rating Outlook

The stable outlook reflects Moody's expectation that the city will maintain its prudent and disciplined policies, which should enable the city to avoid any material deterioration in its operating performance and overall debt exposure.

What Could Change the Rating - Up

Only significant changes within the institutional framework that have the effect of augmenting the city's self-funding and debt-repayment capacity, notably by fostering discretionary own-revenue streams and broadening spending autonomy, could exert upward pressure on the rating.

What Could Change the Rating - Down

A reversal of the city's existing prudent fiscal and debt management policies, combined with a significant increase in the stock of debt, would exert downward pressure on the rating.

DETAILED RATING CONSIDERATIONS

The rating assigned to the City of Poprad reflects the application of Moody's Joint-Default Analysis (JDA) rating methodology for regional and local governments (RLGs). In accordance with this methodology, Moody's first establishes the Baseline Credit Assessment (BCA) for the city and then considers the likelihood of support coming from the national government to avoid a default by the city.

Baseline Credit Assessment

The City of Poprad's BCA of 7 reflects the following factors:

Financial Position and Performance - Poprad's operating performance remains very good in the Slovakian context. An effective cost-control and focused fiscal planning enable the city to keep its operating expenditure growth in line with the rise in operating revenues. The city's gross operating margins (GOB) were stable and averaged a solid 15.0% of operating revenues over the past three years. These results underpin Poprad's position as the best-performing municipality in our Slovak rated universe.

Poprad's medium-term fiscal forecast predicts that GOB will halve to 8.3% of operating revenues in 2008. While the operating expenditure growth is forecast to remain modest (+6.2% year-on-year), a decline in operating revenues (-1.9%) is expected for 2008. This will mainly be due to a reduction in the government subsidy for non-government school facilities (2.2% of operating revenues) and a conservative assumption for PIT revenues (1.8%). Going forward, the pace of growth in Poprad's operating expenditure is also likely to be dependent on public transport subsidies and any transfer of new responsibilities without adequate funding (such as non-government school facilities). However, these are not likely to have a major impact on the size of city's budget.

Because of the administration's track-record of applying a cautious and disciplined fiscal policy, Moody's considers the city's 2008-2010 budget forecast as typically conservative. We expect the city will post GOB at the low end of the 10-19 percentage-point range over this period. We believe that the risk arising from the cooling national economy and accelerating inflation, both of which could possibly weigh on the city's operating margins, is mitigated by the administration's proven ability to adapt its budgetary policy to the changing environment.

Despite some high-volume investments being in place, Poprad has applied a cautious capital investment (capex) implementation strategy over the past few years. The strong inflow of capital revenues, supported by capital transfers and the sale of assets along with solid operating performances, has enabled the city to fund almost all of its capex over the past five years without substantial borrowings. The city has posted solid pre-funding surpluses over most of this period. The only exception was in 2006, when the implementation of an exceptionally large capex programme resulted in a modest pre-funding deficit and the city's cash reserves were used to fund it.

The current 2008 pre-funding deficit of 5.8% (SKK50.8 million) as a percentage of total revenues is a reflection of an upsurge in the city's capex (+52.0% from 2007 to 2008). While the expected additional rises in the city's capex (notably due to social housing) will have a significant broadening impact on the deficit (by a low 10-19 percentage points), the better-than-expected operating performance will have a somewhat narrowing effect. Consequently, Moody's believes that the city's final 2008 pre-funding deficit will be in the range of high single-digit percentage points. The deficit is expected to be covered by new debt issuance and the city's robust cash reserves.

Beyond 2008, the city's capex is forecast to revert to levels of about 15% of total expenditure. However, the final figure is likely to be higher as the city's representatives have presented this projection as the basic/entry level of capex. Poprad's ability to tap EU funds will be also a key driver of its future capex levels. The city's future capex programme is primarily focused on infrastructure upgrades and its most important projects will take place with or without EU funding. The large-scale multi-year capex programme is focused on roads, pavements and sewage network upgrade, with an expected volume of approximately 30-50% of operating revenues. Going forward, we assume that the administration will be able to contain any unsustainable development in the city's overall budget performance.

Debt Profile - Poprad's positive overall budget performance has led to a further decline in its debt burden. The city's ratio of direct debt to operating revenues was 9.2% at the end of 2007, down from 12.0% the previous year. The ratio is low by international standards and is well below the average for its Slovak peers (32%). The city's direct debt consists of long-term amortising bank and government loans. Poprad's current loan portfolio is denominated in Slovak korunas (55%) and euros (45%). The bank loans carry floating interest rates and the city does not use any interest rate hedging or foreign exchange. Moody's assumes that the risk arising from the exchange rate and interest rate volatility would not be significant as Slovakia will enter the Eurozone in January 2009.

The current 2008-2010 projection of a gradual decline in Poprad's debt burden is unlikely to materialise. According to the latest updates, the city will tap a government soft loan (8.1% of operating revenues) in 2008. As a result, the ratio of direct debt to operating revenues will rise to 15.1% in 2008 (3.7% excluding government-related borrowings). Going forward, the city will consider an option to take on a bridge financing debt facility to speed up a major infrastructure upgrade. Given the low debt and strong operating performance, we do not expect any substantial deterioration in credit metrics over the medium term.

Despite the expected rise in its debt burden, Poprad's debt servicing needs will remain modest and below 3% of operating revenues in 2008 and beyond. Given the city's solid operating performance and its prospects, Moody's assumes that no major concerns would arise to service its existing debt.

Poprad enjoys a sound liquidity position. The solid financing surplus the city posted in recent years has helped the city to build up substantial cash reserves. At the end of 2007, the balances on the city's bank accounts and extra-budgetary funds reached 40.0% (up from 32.1% in 2006) of its operating expenses for the year, or 11 times the annual debt service requirements. The average daily balance on the city's bank accounts reached 4.6% of operating expenses in 2007. Poprad has not had to use any short-term credit lines.

The city has not issued any guarantees and carries no contingent liabilities.

Governance and Management Factors - Governance and management practices are sound. It is very unlikely that the prudent fiscal approach applied by the city over the past five years will significantly ease in forthcoming years. Management's ability to keep a strong grip on its operating expenditures has been reflected in sound operating margins. The city's advanced fiscal planning is clearly visible in its medium-term capex programme, which is more detailed than those of most of its Slovak peers. The city has applied a conservative investment strategy over the past few years, as seen in its healthy pre-funding surpluses. Institutional capacity is adequate.

Economic Fundamentals - The City of Poprad, with roughly 55,000 inhabitants, is located in the Region of Presov, in the eastern part of Slovakia. Its demographic profile is characterised by long-term negative migration flows that are only partially offset by positive natural flows. Like other Slovak cities, Poprad's population is ageing. The share of Poprad's residents over the age of 65 is in line with the national average but is expected to rise steadily. This exerts pressures on social services, which are a municipal responsibility in Slovakia.

The Presov Region is Slovakia's poorest according to GDP measures (on a GDP per capita basis, the region reaches about 61% of the national average). The regional economy is growing rapidly, along with the national economy. The regional economy is service-based with a strong industrial foothold. Key sectors are home appliances, heavy machinery, plastic components, food processing and the chemical industry. Tourism is also very important for the local economy as the city is a gateway to Slovakia's top destination - the High Tatras mountain range.

Taking into account the city's strong economic fundamentals, we assume that local GDP is significantly higher than the regional average. This assumption is also underpinned by the fact that the city has the lowest unemployment rate in the region. However, given the institutional and financial framework under which Slovak municipalities operate - local economic fundamentals only marginally influence their budgets and the growth of the national economy is a key factor - Moody's does not focus primarily on the local economic environment. Conversely, the legal framework is considered the key credit factor due to its critical influence on these issuers.

Operating Environment - The operating environment for Slovak RLGs reflects that of OECD emerging-market economies, with relatively high GDP per capita within the emerging-market universe, modest GDP volatility and a relatively high ranking on the World Bank's Government Effectiveness Index. The combination of these characteristics suggests a low level of systemic risk, as reflected in the A1 rating assigned to the debt issued by Slovakia.

Institutional Framework - The framework for Slovak municipalities, which underwent major changes in the period 2002-2004, is now relatively stable and predictable. Following a number of institutional and financial changes in recent years, the funding of municipal responsibilities and their budget structure have been gradually settling down and are unlikely to be substantially changed in the medium term. Based on previous experience, Moody's has some concerns that the central government may try to squeeze the funding of existing responsibilities or try to under-finance new responsibilities, if redistribution is launched. However, these concerns are mitigated by procedures established for negotiation with municipal representatives that must be followed before major changes to the institutional framework can be implemented.

From 2008, the Slovak public sector has switched to accrual accounting under International Financial Reporting Standards (IFRS). In the first stage of this process, the accounting will remain delinked from budgeting, which will continue on a cash basis. The implementation of IFRS currently represents by far the biggest challenge for Slovak municipalities. Not only did the government fail to prepare all necessary guidelines well in advance, but the time schedule for training staff and adjusting IT systems was also very challenging. Moreover, municipalities have to switch to programme budgeting from 2009 along with the adoption of the euro.

Under the current local government framework in Slovakia, municipalities have only limited scope for control over operating revenue, which comprises personal income tax (PIT), which is set and collected nationally, and transfers from the state budget. On average, PIT represents 43% of Slovak cities' operating revenues. As much as 72% of their operating revenue comes from the central government in the form of either shared taxes or transfers. The remainder of municipalities' operating revenue consists of own taxes and fees, accounting for 15% of operating revenue (10% real-estate tax and 5% other local taxes and fees), and other non-tax revenue (12%), thus limiting their ability to tap into wealth generated by the local economic environment. While the municipalities enjoy broad discretion over their own taxes and fees, their discretion over tax rates is limited by the political sensitivity of this issue.

The flexibility of municipal expenditure is not much greater. Three of the main components of current expenditure - personnel (48%), transfers to companies/population (13%) and interests paid on capital (1%) - are extremely rigid and municipalities' ability to control expenditure growth is very low. The majority of this spending is mandated by national law, with some programmes directly funded by the central government through earmarked transfers provided to the municipalities. The fourth category of expenditure - energy and services (38%) - is mostly provided by commercial partners, based on long-term contracts with pricing driven by the market.

The only leeway municipalities have is flexibility over capex. However, there is a strong correlation between the volume of spending on capital items and capital revenue, which typically comes from the sale of property and earmarked transfers. This makes the capex highly volatile from year to year. Although capex represents 27% of total expenditure, approximately one-third in 2006 was funded by earmarked transfers, and was therefore inflexible.

Slovak municipalities' debt level is currently low (32% of operating revenue in 2006), reflecting the sufficiency of funds to finance municipal responsibilities and the limits imposed on the municipal stock of debt and debt service (which cannot exceed 60% and 25% of their operating revenue, respectively). However, it should be noted that municipalities' debt is constantly growing in absolute terms, under pressure from the need to upgrade municipal infrastructure to EU standards following Slovakia's entry into the EU.

Slovak municipalities enjoy adequate liquidity. Although the most important operating revenue component (PIT) fluctuates over the year, with revenues typically highest in the first quarter/half, the municipalities do not face any liquidity problems. There is almost no fluctuation on the current expenditure side and relatively high fluctuation on the capex side. As the municipalities technically enjoy full discretion over their capex, they are able to synchronise this with their cash flows.

Extraordinary Support Considerations

Moody's rating of Aa1.sk for the City of Poprad reflects the BCA of 7 and our assessment of the low likelihood (0% - 30%) of extraordinary support from the central government, which takes into account the central government's track record of allowing Slovak municipalities to default. Finally, reputation risk issues for the central government would appear modest given Slovak cities' debt structure, which relies more on bank loans than bonds.

Moody's rating committee also assesses a very high level (71% - 100%) of default dependence, reflecting a heavy reliance on central government resources, in the form of either shared taxes, which are determined and collected nationally and redistributed on a formula basis, or transfers.

Output of the Baseline Credit Assessment Scorecard

In the case of the City of Poprad, the rating committee assigned a BCA of 7, the same as that generated by the BCA scorecard (presented below).

The BCA scorecard, which generates estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, is a tool used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by the scorecard provide a good statistical gauge of stand-alone credit strength; however, the estimated BCAs generated by the scorecard do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Concomitantly, scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Moreover, the limited number of variables included in the scorecard cannot fully capture the breadth and depth of our analysis. Nevertheless, the performance statistics captured in the scorecard are important and, in general, higher ratings can be expected among issuers with the highest rankings from the scorecard.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings.The Moody's Global Scale rating for issuers and issues in local currency allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the government's intrinsic credit strength and accounts for ongoing operating subsidies and transfers from the supporting government. In effect, the baseline credit assessment reflects the likelihood that a local government would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a regional or local government (RLG) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), moderate (31% - 50%), high (51% - 70%), very high (71% - 95%) or fully supported (96% - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can materially change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to RLGs, default dependence reflects the tendency of the RLG and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the higher-tier government to provide extraordinary support and prevent a default by an RLG is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' baseline default risks, the lower the benefits achieved from joint support. In most cases, the close economic links and/or overlapping tax bases and/or close intergovernmental fiscal arrangements between different levels of government result in a moderate to very high degree of default dependence. Default dependence is described as either low (0% - 30%), moderate (31% - 50%), high (51% - 70%) or very high (71% - 100%).

Rating Factors

Poprad, City of

Baseline Credit Assessment Scorecard - 2006	**Value**	**Score**	**Sub-Factor Weighting**	**Sub-Factor Total**	**Factor Weighting**	**Total**
Factor 1: Operating Environment						
National GDP pc PPP ($US)	16,849	9	50.0%	6.75	60.0%	4.05
National GDP Volatility (%)	4.0	3	25.0%			
National Gov't Effectiveness (World Bank Index)	0.91	6	25.0%			
Factor 2: Institutional Framework						
Predictability, Stability, Responsiveness	7.5	7.5	50.0%	10.01	10.0%	1.00
Fiscal Adequacy - Own-source revenues	15	15	16.7%			
Fiscal Adequacy - Spending	15	15	16.7%			
Fiscal Adequacy - Extent of borrowing	7.5	7.5	16.6%			
Factor 3: Financial Position & Performance						
Interest Payments/Operating Revenue (%)	0.7	1	33.3%	4.33	7.5%	0.33
Cash Financing Surplus(Req)/Total Revenue (%)	2.2	6	33.3%			
Gross Operating Balance/Operating Revenue (%)	13.9	6	33.3%			
Net Working Capital/Total Expenditures (%)						
Factor 4: Debt Profile						
Net Direct and Guaranteed/Operating Revenue (%)	12.0	1	33.4%	2.67	7.5%	0.20
Short-term Gross Direct Debt/Gross Direct Debt (%)	20.1	6	33.3%			
3 Yr Chg in Net Direct & Guar Debt/Op Rev (%)	-44.4	1	33.3%			
Factor 5: Governance & Management						
Fiscal Management	7.5	7.5	40.0%	4.90	7.5%	0.37
Investment & Debt Management Approach	7.5	7.5	20.0%			
Transparency & Disclosure (A)	1	1	15.0%			
Transparency & Disclosure (B)	1	1	15.0%			
Institutional Capacity	1	1	10.0%			
Factor 6: Economic Fundamentals						
Regional or Local GDP pc PPP - Estimated ($US)	10,245	12	100.0%	12.00	7.5%	0.90
Total Score [1]						**6.84**

[1] Scores less than, or equal to, 1.49 map to a BCA of 1; scores greater than 1.49, but equal to or less than 2.49, map to a BCA of 2; scores greater than 2.49, but equal to or less than 3.49, map to a BCA of 3; etc.