STANDARD & POOR'S

RATINGSDIRECT®

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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 ratings on the City of Prague, the capital of the Czech Republic (foreign currency, A/Stable/A-1). The outlook is stable.

The ratings reflect Prague's far above average socioeconomic fundamentals compared with other Czech cities, solid and persistently improving financial performance due to growing revenues, excellent liquidity position, and moderate and declining debt burden.

Constraining rating factors include some exposure to bullet maturities and foreign currency, limited systemic revenue and expenditure flexibility, some potential pressures from the education sector, and--to a lesser extent--from the transport sector.

Prague has a track record of outstanding budgetary performance. Operating balances have averaged a high 35% over the past three years. We expect the 2008 operating balance to be about 37%, owing to the combined impact of cost containment, tax reform, and economic buoyancy. Balance after capital expenditures also remained largely positive at 2.2% on average over the past three years, and a 4% surplus should be reached in 2008.

According to our conservative base-case scenario, operating balances should stabilize at about 35% between 2009 and 2011. The ambitious capital program should continue to be entirely self-financed, helping the city to refrain from borrowing over the coming years, in line with the authorities' strong commitment to contain debt.

Owing to both Prague's large self-financing capacity and firm stance, debt has declined since 2005 and remains well contained as a proportion of operating revenue, decreasing to 66.2% of operating revenues in 2007 from 75.4% in 2005. We expect this trend to continue, with debt in 2009 reaching 50% of current revenue because the city is considering paying down its debt from a combination of operating surplus and reserve drawdown. Tax-supported debt is only moderately higher, at 69.5% in 2007, and includes only one non-self-supporting entity--the transportation company--and the debt of the districts. We do not expect the transportation company to take on additional debt. Tax-supported debt should therefore also post a downward trend.

Prague is home to the Czech Republic's political, economic, and commercial institutions. It accounts for only 10% of the country's population, but above 25% of total GDP. Its economic fundamentals far outperform its Czech peers, with per-capita incomes double the average for the Czech Republic and equivalent to 170% of the EU average (purchasing-power standard), and low unemployment level. Nevertheless, its capacity to benefit from its economic strength and buoyancy is constrained by the current intergovernmental framework. As a result, while it generates 48% of all taxes collected in the country, it retains only 8% of the revenues.

Recent cost cuts are expected to have a recurrent positive impact. We expect this policy to extend at least until the end of 2009, thereby helping the city regain flexibility in budget management. Nevertheless, high demand and large investment requirement in education and transport services will likely continue to pressure the city's budget.

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Liquidity
Prague has a strong cash position, which has improved consistently to CZK17.9 billion as of Dec. 31, 2007, (equivalent to 10x the city's 2008 debt service) from CZK11 billion at year-end 2004. By the end of 2008, cash should drop somewhat, owing to some drawdowns. Nevertheless, the year-end 2008 cash balance could total CZK19.5 billion because the city's balance after debt repayment is estimated to reach about CZK1.6 billion at that date.

The city is exposed to refinancing risks, notably with four bullet loans and bonds accounting for 68% of total debt to be repaid over the period 2009-2012. In past years, however, the city has constituted a sinking fund specifically dedicated to bond repayments, and currently holds CZK5.635 billion. The repayment scheme for the various bonds has not yet been finalized, but the city is considering using part of the sinking fund to pay the maturing 2009 bullet bond (€200 million), covering the remainder from the expected budget surplus. In any case, cash expected at year-end 2008 will amply cover 3.5x debt maturing in 2009. Should the city decide to pay down its debt by drawing down its large reserves rather than refinancing it, cash balances could cover up to 95% of bullet maturities coming due between 2009 and 2013.

Outlook

The stable outlook reflects Standard & Poor's expectation that economic growth, although subdued from previous years, will continue to support the city's strong operating surpluses and capacity to self-finance a large proportion of its capital expenditures, thereby enabling the city to eschew borrowing in further years. The stable outlook factors in a stabilization of the debt burden beyond 2009 (and therefore a refinancing of the 2010-2011 maturities).

Should the sovereign's creditworthiness improve, the ratings on Prague would likely improve as well, assuming self-funding capacity covers most of the coming capital program and debt stabilizes beyond 2009. Although not expected, the rating could come under pressure in the event of a significant and sustained drop in operating balances alongside a concomitant resort to debt to finance capital expenditures.

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