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CREDIT OPINION
3 November 2023

Update

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RATINGS

Prague, City of

Domicile	Czech Republic
Long Term Rating	Aa3
Type	LT Issuer Rating - Fgn Curr
Outlook	Negative

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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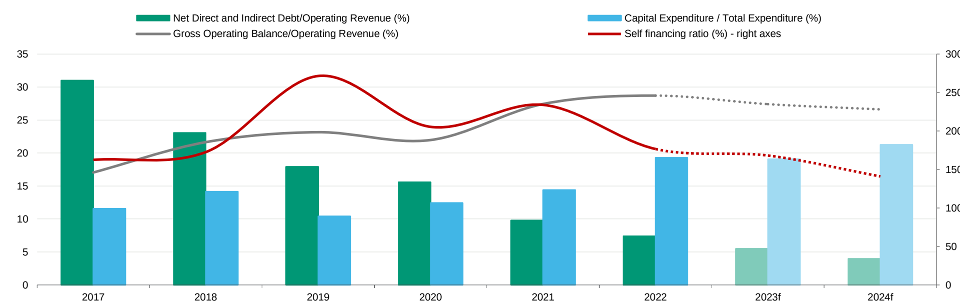
City of Prague (Czech Republic)

Update to credit analysis

Summary

The credit profile of the City of Prague (Aa3 negative) reflects its consistently solid fiscal position, prudent financial management, the strength of its economy and a high likelihood that the Government of the Czech Republic (Aa3 negative) would provide support if the city were to face acute liquidity stress. Prague will continue to generate very strong operating surpluses that will provide a significant funding source for capital spending, while preserving its extensive liquidity buffer. The rating is constrained by the limited revenue flexibility and reliance on the national economy performance.

Exhibit 1
Very low debt levels and strong operating performance in 2023-24



2023-24 are Moody's forecast. Self financing ratio = (Gross Operating Balance + Capital Revenue) / Capital Expenditure
Source: City of Prague, Moody's Investors Service

Credit strengths

» Strong financial performance to fuel its already-high liquidity

» Low net direct and indirect debt expected to modestly increase in 2025

» Crucial role in the national economy

Credit challenges

» Limited revenue flexibility and pressure on the spending

Rating outlook

The negative rating outlook reflects the negative outlook on the sovereign and tight institutional, economical and financial linkages between the Czech government and regional and local governments.

Factors that could lead to an upgrade

An upgrade of Prague's rating is unlikely, given the negative outlook.

The outlook could be changed to stable in case the sovereign rating is stabilized, provided that Prague continues to display sound operating performance, strong liquidity and low debt levels.

Factors that could lead to a downgrade

Further downward pressure on the rating could result from a downgrade of the sovereign rating and/or indications of weakening government support. Additionally, deterioration in the city's operating performance, combined with a decline in liquidity and an unexpected increase in debt would lead to downward pressure on the rating.

Key indicators

Exhibit 2

City of Prague

Prague, City of								
As of 31 December	2017	2018	2019	2020	2021	2022	2023f	2024f
Net Direct and Indirect Debt/Operating Revenue (%)	31.0	23.1	17.9	15.6	9.8	7.4	5.5	4.0
ST Debt/Operating revenue (%)	1.3	1.1	1.0	0.8	5.8	1.1	5.3	0.5
Interest Expenses/Operating Revenue (%)	0.8	0.8	0.8	0.7	0.6	0.6	0.5	0.3
Gross Operating Balance/Operating Revenue (%)	17.0	21.7	23.2	22.0	27.4	28.7	27.4	26.6
Cash Financing Surplus / Total Revenue (%)	6.7	9.3	15.2	11.6	16.2	12.9	11.5	8.0
Cash and ST Investments /Net direct and Indirect debt (%)	149.3	200.5	286.3	398.6	744.4	1048.2	1478.7	2165.4
Capital Expenditure / Total Expenditure (%)	11.6	14.2	10.4	12.5	14.4	19.3	19.1	21.3
Self financing ratio (%)	162.6	172.6	271.5	205.4	234.0	176.6	168.2	141.0

2023-24 are Moody's forecast.
Source: City of Prague, Moody's Investors Service

Detailed credit considerations

The credit profile of the City of Prague, as expressed in its Aa3 rating, combines (1) a Baseline Credit Assessment (BCA) of aa3 and (2) a high likelihood of extraordinary support from the central government in the event that the city faces acute liquidity stress.

Baseline credit assessment

Strong financial performance will fuel its already-high liquidity

Prague keeps a track record of very strong operating surpluses with average gross operating balance (GOB) at 24.6% of operating revenue over the past decade.

Prague's financial performance remained very strong in 2022, GOB reached 28.7% of operating revenue, the best result since 2014. Very strong operating surplus was attributable to the significant increase in tax revenue's collection which grew by 13.4% compared to 2021. Shared taxes, the national pool of value-added tax, personal and corporate income tax, represented almost 96% of tax revenue. Shared taxes collection grew by 12.7% as the result of stubbornly high inflation in the Czech Republic in 2022. The inflation reached in average 14.8% in 2022 (significantly above the average 3.3% in 2021) while the national real GDP grew by 2.5% in 2022 which remains 1.1 percentage points below the real GDP growth during the pandemic in 2021. Thus, shared taxes increased to CZK73.7 billion (65.4% of operating revenue in 2022) from CZK65.4 billion in 2021 (65.4% of operating revenue in 2021). Higher collection of shared taxes provided sufficient cover for the 10.8% increase in operating expenditure in 2022. The Czech government almost fully compensated expenses related to the Ukrainian refugees, enabling Prague to post very strong operating margin at 28.7% in 2022.

In 2023, we expect the Prague's GOB to slightly deteriorate to still very strong 27.4% of operating revenue. it will be driven by the prudent budgetary management, expected economic slowdown at the national level (we expect the real GDP to grow by 0.3% with average inflation at 10.6% in 2023), receding inflationary pressure and only modest growth in operating expenses attributable to higher transfers to subsidiaries and non-profit organizations.

Very strong operating performance and subdued infrastructure spending in the past years resulted into solid cash financing surpluses, which further boosted the city's high cash buffer. We estimate the abundant cash reserves to preserve despite the high-ticket project, new metro line construction. As of year-end 2023, we expect the city´s cash pool to reach almost CZK95.0 billion (more than 81% of operating revenue) which provides an ample cushion to mitigate budget pressure. The city's exceptional liquidity position will be the key funding source for planned capital expenditures.

Low net direct and indirect debt expected to modestly increase in 2025

In 2022, Prague's net direct and indirect debt (NDID) declined to CZK8.4 billion or 7.4% of operating revenue from 9.8% in 2021. The decline stemmed mainly from the regular amortization. Its debt levels are significantly lower than that of its international peers and are likely to further decrease to 5.5% of operating revenue in 2023 as the result of the bonds maturity. Prague's direct debt consisted of bond issuance and European Investment Bank (EIB, Aaa stable) loans. The bonds at nominal value of €200 million matured in July 2023 were fully repaid which further decreased the direct debt levels to estimated 4.1% of operating revenue in 2023. The city follows prudent financial management and has established a sinking fund for the outstanding bonds and future debt service. The sinking fund significantly mitigates the refinancing risk and according Moody's methodology, we deduct the sinking fund from direct and indirect debt. The city's EIB loan service costs are modest and will not exceed 1% of operating revenue in 2023 and onwards. The currency and interest rate risks have been largely eliminated by swaps. It is highly unlikely that Prague will take on new loans in 2023.

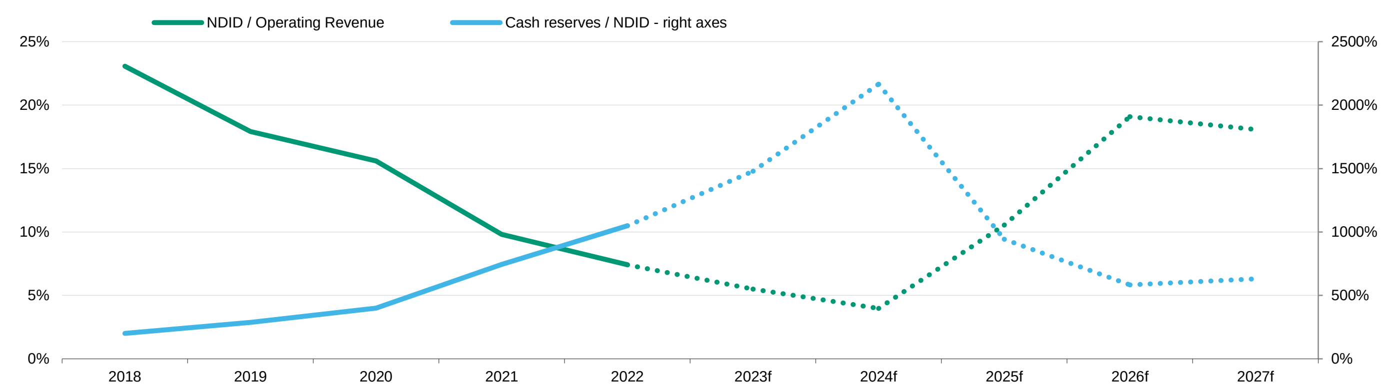
Indirect debt, represented solely by debt obligations incurred by the city's transport company Dopravní podnik Hlavního města Prahy, a.s. (DPP), was equivalent to 1.5% of operating revenue in 2022.

Prague plans to finance the construction of the new metro D line by the combination of EIB loan, the loan taken by DPP and own sources. The estimated costs related to the first section of the line amount to CZK57.4 billion. The construction officially started in 2022 and is scheduled to be finished in 2029. Despite the strategical importance of the new metro line, the central government will most likely not participate in the financing. Prague has also limited access to the supranational investment subsidies. The city is allocated in a relatively affluent region, making it ineligible for some European Union funds that are available for other Czech cities.

We estimate that the new EIB loan will increase Prague's direct debt to moderate 22% of operating revenue by 2027 from 10.2% at year-end 2022, the city has no plans to raise new debt to fund other infrastructure projects for this year and next. We project NDID to stabilize below 20% of operating revenue past 2027 because of predominance of long-term amortizing loans. Despite modest debt's growth, Prague's liquidity will fully cover the debt levels according our estimates.

Exhibit 3

Prague debt will increase modestly in 2025-26 but exceptional liquidity position will preserve



2023-27 are Moody's forecast

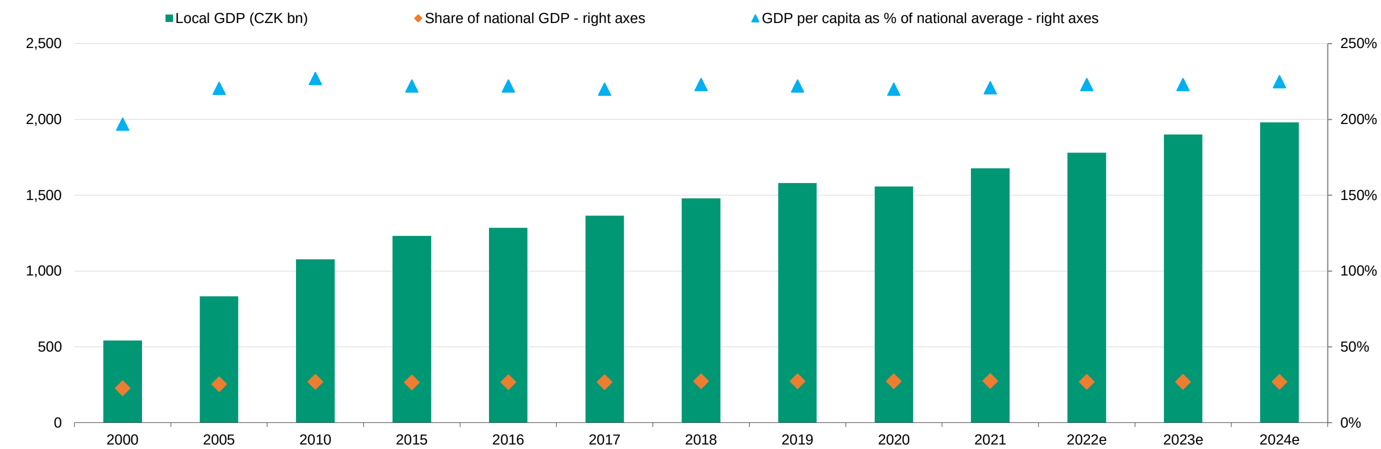
Source: City of Prague, Moody's Investors Service

Crucial role in the national economy

Prague is the Czech Republic's largest city in terms of budget volume, as well as the size, total population and structure of its debt. With 1.37 million residents as of June 2023, Prague is home to 12.6% of the Czech Republic's total population. The city's economic importance and relative wealth are evident in its 27% contribution to the national gross domestic product (GDP). Its GDP per capita is estimated to reach 221% of the national average in 2022 which remains the highest among Czech cities as Prague economically outperforms its domestic peers. The local economy is strongly inclined towards the service industry which accounts for almost 85% of the gross added value, well above the national average at 65%. By contrast, the share of industry and construction is below the national average (33%), at around 15%.

Exhibit 4

Prague's economic performance remains strong and vitally important for the country



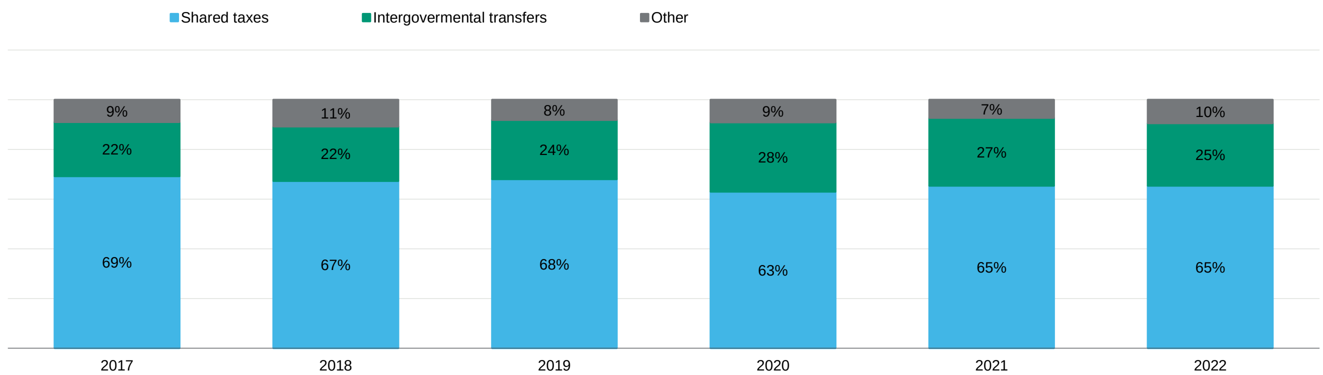
2022-24 are Moody's estimates
Source: Czech Statistical Office, Moody's Investors Service

Prague continues to be among the cities that have the highest standards of living in Europe, ranked highly in various liveability indices. The labor market's conditions mirror the wealthy economy in Prague, the unemployment rate remains below the national average and average income is significantly above the national average. The city is also home to almost 40 universities which attract students from all around the Czech Republic and Slovakia (A2 negative), some of whom stay after graduation and further bolster the labor market with highly qualified workforce.

Limited revenue flexibility and pressure on the spending

The fact that Prague is the Czech Republic's economic center and the capital city has a limited impact on its revenue. Under the institutional and financial framework in the Czech Republic, regional and local governments' budgets are tied more closely to the national instead of the local economy. As a result, Prague's operating revenue growth depends mainly on the collection of shared taxes and intergovernmental transfers. Prague has no flexibility over these revenue's streams, representing about 90% of operating revenue (Exhibit 5). The city has a possibility to increase the local fees (for example levy on waste, accommodation fee for tourists, fares in public transportation) but there is usually a political resistance to these actions. We don't expect changes in revenue flexibility in the medium term.

Exhibit 5
Operating revenue's structure



Source: City of Prague, Moody's Investors Service

According to the official statistics, Prague had 1.37 million residents as of June 2023 but there are estimated additional 0.25 million people (representing 18% of official residents) living in the city but being officially residents elsewhere. This fact puts additional pressure on various services provided by the city as health care, education or public transportation, as well as on the city's infrastructure. Nevertheless, the spending pressures are broadly offset by the city's extensive liquidity buffer and prudent financial management.

DPP is the biggest single recipient of the operating transfers absorbing over 50% of operating transfers. City of Prague provides to DPP both operating and capital assistance for funding its activities, this support is in line with Prague's Climate plan 2030 to promote more sustainable transportation. We expect that the city will increase its funding to DPP in the upcoming years as the result of combination of both rather rigid fares and growing operating costs (maintenance, salaries or fuel).

Extraordinary support considerations

Prague has a high likelihood of receiving extraordinary support from the central government, reflecting our assessment of the city's strategic importance to the national economy and its presence in the capital markets. The assessment also indicates a moderate system of oversight by the central government that requires regular monitoring of cities' indebtedness and liquidity.

ESG considerations

City of Prague's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 6
ESG Credit Impact Score

CIS-2
Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Prague's ESG Credit Impact Score (**CIS-2**) indicates that ESG considerations do not have a material impact on the rating. The score reflects a limited impact of social and governance risks on the rating, alongside with strong governance profile that supports the capacity to respond shocks.

Exhibit 7
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-2	G-1
Neutral-to-Low	Neutral-to-Low	Positive

Source: Moody's Investors Service

Environmental
The environmental issuer profile score of **E-2** reflects low exposure across all the environmental risk categories. The environmental risks come from the city's high urbanization and low presence of industrial manufacturing compared to other larger Czech cities. The main environmental risk exposure is related to flood as the city has experienced two major floods since 2002. As a response, the city has prepared counter-flood walls to mitigate the potential damage to the city´s infrastructure. In 2021, Prague approved and published its Climate plan 2030 with the focus on the reduction of CO2 emissions, lowering the overall energy consumption of buildings, electrification of the transport sector and application of the circular economy principles.

Social
The social issuer profile score(**S-2**) reflects broadly neutral-to-low risk from the most social factors other than housing. The city's economic importance is one of the key driver for better socio-economic indicators compared to the national average. Local labor market is characterized by more skilled work force, lower unemployment rate and higher salaries compared to the national average. Attractive labor market and almost 30 universities located in Prague have led to strong immigration to the city, providing basis for future local economic growth. However, these factors, along with low housing construction and an increasing number of short-term rentals, have hurt the housing affordability entailing a moderately negative social risk.

Governance
Prague's very strong institutions and governance profile is captured by positive governance issuer profile score (**G-1**), further supporting the city's rating. The city operates within a strong institutional framework with clearly defined intergovernmental linkages. Prague, the capital city, has an exceptional position among Czech cities being the economic hub of the country. Despite this fact Prague enjoys only moderate level of revenue raising flexibility enabled by national legislation. Prague's financial and debt policies formulation and implementation are overall prudent and transparent. The city's management capacity to execute budgets remains strong and we expect it will continue to ensure city's solid financial position. Exceptional liquidity underpins city's prudent liquidity management and serves as a sufficient buffer to mitigate unexpected risks. Coupled with high wealth levels, this supports a high degree of resilience, mitigating further already low E and S risks.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of a1 is close to the suggested BCA of aa3. The suggested BCA of a1 reflects an Idiosyncratic Risk score of 2 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aa3, as reflected in the Czech Republic's sovereign bond rating.

Exhibit 8

City of Prague

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**1**	**20%**	**0.20**
Economic Strength	1	241%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**3**	**20%**	**0.60**
Legislative Background	1		50%			
Financial Flexibility	5		50%			
Factor 3: Financial Position				**3**	**30%**	**0.90**
Operating Margin	1	27.38%	12.5%			
Interest Burden	1	0.65%	12.5%			
Liquidity	1		25%			
Debt Burden	1	7.41%	25%			
Debt Structure	9	54.15%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**2.00 (2)**
Systemic Risk Assessment						**Aa3**
Suggested BCA						**a1**
Assigned BCA						**aa3**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance/operating revenues
[3] Interest payments/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2022.

Ratings

Exhibit 9

Category	Moody's Rating
PRAGUE, CITY OF	
Outlook	Negative
Baseline Credit Assessment	aa3
Issuer Rating	Aa3

Source: Moody's Investors Service

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