

FITCH AFFIRMS MUNICIPALITY OF MEDELLIN'S RATINGS; OUTLOOK STABLE

Fitch Ratings-Monterrey-21 December 2015: Fitch Ratings has affirmed the ratings for the Municipality of Medellin as follows:

- Long term foreign Issuer Default Rating (IDR) at 'BBB';
- Long term local currency IDR at 'BBB+';
- National Rating at 'AAA (col)';
- Short term National Rating at 'F1+ (col)';
- COP141,000 million notes at 'AAA(col)';
- COP248,560 million notes at 'AAA(col)'.

The Rating Outlook is Stable.

The rating action reflects Medellin's financial strength, its importance in national context as well as its manageable debt metrics.

KEY RATING DRIVERS

The rating actions are the result of the city's relevant role in the Colombian economy; its high and dynamic collection of municipal taxes and significant cash flow, which supports a good financial administration; and the important financial support from Empresas Publicas de Medellin (EPM, Foreign and Local Currency IDRs 'BBB+').

The main risks or limitations for Medellin are a manageable but higher debt-burden relative to historical, dynamism of its operating income exceeding expenditure, political risk associated with the public sector and quality of the administration, and low coverage of pension liabilities financed according to Colombian Law.

Medellin is the second largest economy nationwide with a strong industrial influence. It has strong socioeconomic indicators as indicated by high coverage of public services. In recent years, the city has registered a dynamic economy, with an improvement in employment and security indicators.

Medellin has a good fiscal and financial performance, but its operating margin has diminished in the last years. The decline in margins in 2014 was largely attributable to significant increase in staff expenditure following an administrative reform. Also the margin has been affected by growing capital expenditure related to education, health and other services. According Medellin's Fiscal Framework, is expected a recovery in its operating margins due to a decrease in operating expenditure. Fitch will monitor the expenditure control in the next years.

The 100% participation in the EPM represents credit strength to Medellin due to the important amount of common and special dividends transferred from the entity, increasing Medellin's financial flexibility. Also in 2014 the city received a significant amount from the merger between UNE and Millicom.

Regarding debt, in 2014 Medellin disposed of USD50 million with a development bank. Additionally, in August the Municipality issued bonds for COP248,560 million in two series with maturities of 10 and 30 years. The proceeds were used to substitute domestic debt with local banks.

Medellin registered COP1,179,433 million (approximately USD357.5 million) debt as of Sep. 30, 2015, concentrating 67% of it in foreign debt, these are not hedged to the exchange rate risk. Internal debt is composed of two programs of bonds, in 2016 is programmed the payment of COP141,000 million notes. Considering the composition of debt and the payment of ordinary bonds in 2016, the administration is considering measures to reduce the risks, and is working to get a hedge to the exposure to the exchange rate. Fitch will monitor the actions defined.

By 2014 and according to Medellin's estimations, the interest to operational savings ratio ascended to 5.3%, level significantly low relative to the maximum 40% established by the Ley 358 (Law 358). On the other hand, debt represented 78.5% of current revenues at the end of the year, level below the 80% maximum established as a limit in the mentioned law.

Since the commitment through future budget allocations that the administration has adopted as a mechanism to execution of the development plan, the sustainability indicator rose in 2013 - 2014. Nevertheless, Fitch believes that credit metrics are appropriate for the risk level assigned, and the indicators will fall in the next years.

Pension liabilities could represent a contingency in the long-term. According to Medellin the coverage of its pension liabilities will be of 29.4% at the end of 2015, considering resources in FONPET and own funds. The coverage has been financed according to Law 549 from 1999.

Medellin has a number of public companies, but these do not represent a significant burden to the municipality either because they are self-financing or because of their limited budget. Fitch will continue to monitor their financial situation to ensure that they maintain their financial profiles in line with levels registered in recent years.

RATING SENSITIVITIES

An upgrade of the sovereign rating, in conjunction with positive trends in Medellin's operating performance, could trigger a positive rating action. Future developments that may, individually or collectively, lead to a negative rating action include a significant debt increase (short-term and/or long-term), a substantial deterioration in operating margins and deterioration of cash levels.

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Applicable Criteria

International Local and Regional Governments Rating Criteria (pub. 18 May 2015)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=865254

Tax-Supported Rating Criteria (pub. 14 Aug 2012)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

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