



RATING ACTION COMMENTARY

Fitch Takes Rating Actions on Polish LGs

Mon 26 Sep, 2022 - 5:00 PM ET

Fitch Ratings - Warsaw - 26 Sep 2022: Fitch Ratings has taken the following rating actions on 17 Polish local governments' (LGs) Issuer Default Ratings (IDRs) after clarification of the fiscal reform's 'Polish Deal' expected impact on the municipalities' performance:

- The cities of Gdansk, Gliwice, Plock, Poznan and Warsaw have been affirmed at 'A-', with Stable Outlooks
- The cities of Bydgoszcz, Katowice and Szczecin and the municipality of Ostrow Wielkopolski have been downgraded to 'BBB+' from 'A-', with Stable Outlooks
- The city of Rybnik has been affirmed at 'BBB+', with Stable Outlook
- The cities of Czestochowa and Rzeszow have been downgraded to 'BBB' from 'BBB+', with Stable Outlooks
- The city of Opole has been affirmed at 'BBB', with Stable Outlook

- The cities of Bialystok and Torun have been affirmed at 'BBB', with Negative Outlooks
- The city of Chorzow has been affirmed at 'BBB-', with Stable Outlook
- The city of Zabrze has been affirmed at 'BB', with Negative Outlook

The ratings have been removed from Rating Watch Negative (RWN). A full list of rating actions is at the end of this rating action commentary.

Under applicable credit rating agency (CRA) regulations, the publication of local and regional government reviews is subject to restrictions and must take place according to a published schedule, except where it is necessary for CRAs to deviate from the schedule in order to comply with the CRAs' obligation to issue credit ratings based on all available and relevant information and disclose credit ratings in a timely manner.

Fitch interprets this provision as allowing us to publish a rating review in situations where there is a material change in the creditworthiness of the issuer that we believe makes it inappropriate for us to wait until the next scheduled review date to update the rating or Outlook/Watch status.

In this case the deviation was caused by the impact of the fiscal reform 'Polish Deal' on the creditworthiness of the issuers. The amended rating scenarios allowed Fitch to take action on the LGs' ratings and remove them from RWN before the next scheduled reviews. The next scheduled review date for Gliwice and Plock is 30 September 2022, for Chorzow, Czestochowa, Gdansk, Opole and Rybnik 7 October 2022, for Bialystok, Ostrow Wielkopolski, Szczecin and Zabrze 21 October 2022, for Bydgoszcz, Katowice and Warsaw 4 November 2022 and for Poznan, Rzeszow and Torun 18 November 2022, but Fitch believes the developments for the issuers warrant such a deviation from the calendar and our rationale for this is set out in the first part (High weight factors) of the Key Rating Drivers section below.

KEY RATING DRIVERS

Debt Sustainability: We believe that the future subsidies from the state budget will be insufficient to compensate for the financial implications of the reform. This will lead to substantial deterioration of the LGs' debt metrics, which will not be

commensurate with their Standalone Credit Profiles (SCP) prior to the tax reform implementation.

Our reassessment of debt sustainability as a consequence of the 'Polish Deal' reform, considering all the pre-emptive measures already applied or that will be implemented by the respective LGs in the near to medium term, has led to the following downward reassessment of SCPs:

- Warsaw - lowered to 'a+' from 'aa'
- Gdansk and Poznan - lowered to 'a-' from 'a+'
- Bydgoszcz, Katowice, Szczecin, and Ostrow Wielkopolski - lowered to 'bbb+' from 'a'
- Czestochowa and Rzeszow - lowered to 'bbb' from 'bbb+'

Risk Profile: The risk profiles of the rated LGs are unaffected and remain High-Midrange for Warsaw and Midrange for the remaining municipalities.

Revenue Robustness and Adjustability: The 'Polish Deal' fiscal reform will negatively impact LGs' tax revenue, especially the revenue from personal income tax (PIT), which constituted on average more than 25% of the total revenues of Fitch-rated municipalities. In our opinion, the compensatory measures envisaged in the amended regulation for the LG revenue system will be insufficient to fully compensate the expected drop in PIT revenue. The municipalities will be forced to continue to implement measures such as increasing local taxes and fees.

The additional transfers from the state budget envisaged in the reform, ie from a 'A'-'BBB' rated counterparty, will partially support revenue stability, which leads to an unchanged 'Midrange' assessment of revenue robustness. Affordability of additional taxation remains unchanged at low (or moderate for Warsaw and Poznan) due to the lack of additional revenue sources, unchanged shares in PIT tax for municipalities and legal caps on local tax rates. Consequently, our assessment of revenue adjustability is unchanged at Weaker (Midrange for the two cities).

Expenditure Sustainability and Adjustability: The "Polish Deal" reform does not affect the expenditures of the municipalities so our assessments are unchanged. However, the municipalities will be forced to implement measures, such as reducing current spending, to counteract the revenue fall. This will be challenging, given the high inflation environment (16% inflation in August 2022), pressurising not only cost of goods and services (29% of operating spending) but also wages, which are inflexible and accounted for 37% on average in 2017-2021. Prices for electricity and heating as well as fuel prices have increased at an unprecedented pace, jeopardising the LGs' efforts to reduce spending.

LGs will have to adjust their investment programmes due to a shortage of contractors and elevated prices for building materials and construction cost, with the end of the current EU budget and non-returnable capital grants co-financing approximately half of the investment costs. We expect that the share of capital expenditure in total spending for the rated municipalities will fall to close to 13% on average in 2022-2026, compared with an average of 17% in 2017-2021.

Liability and Liquidity Robustness and Flexibility: The "Polish Deal" reform will not directly impact the debt framework of the municipalities, so our robustness and flexibility assessments are unchanged. However, we expect a shift from domestic banks towards long-term investment financing from European Investment Bank (AAA/Stable), which supports our Midrange/Stronger assessments.

The majority of the rated entities have debt stock based predominantly on floating interest rates (except for Warsaw, Gliwice, Czestochowa and Szczecin). Reference rates increased to 6.75% in September 2022, from 0.10% in September 2021, significantly raising interest costs and making the once negligible (in relation to the size of the budget) amount of interest payable a significant cost factor. The cost of debt will increase from about 1.6% per year in 2021 to around 6.0% per year in our scenario.

We expect the liquidity of our rated municipalities to remain good in 2022 and 2023 as a result of good 2021 actuals as well as the one-off subsidy of PLN8 billion, which the Polish state paid to the LGs at the end of 2021, to compensate PIT losses in 2022.

DERIVATION SUMMARY

The Midrange risk profiles combined with unchanged SCPs of 'a-' for Gliwice and Plock, 'bbb+' for Rybnik, 'bbb' for Bialystok, Opole and Torun, 'bbb-' for Chorzow and 'bb' for Zabrze result in IDRs that are equal with the SCPs. The same applies to the IDRs of Gdansk and Poznan, which are unaffected despite the lowering of the municipalities' SCPs. However, the latter's IDRs are now equal to, but not constrained by the sovereign's IDRs (A-/Stable).

The lowering of the SCPs of Bydgoszcz, Czestochowa, Katowice, Rzeszow, Szczecin and Ostrow Wielkopolski justify their IDR changes.

The High-Midrange risk profile of Warsaw, combined with the SCP of 'a+' results in the city's 'A-' IDR as the IDRs remain capped by the sovereign IDRs.

Polish LGs are not affected by any other asymmetric risk factors and do not benefit from budget loans or ad-hoc support from the state budget.

DEBT RATING DERIVATION

The ratings of Plock and Warsaw's senior debt instruments are aligned with their 'A-' Long-Term IDRs. The ratings have been removed from RWN under this debt level.

KEY ASSUMPTIONS

Qualitative and quantitative assumptions, their respective change since the last review 1 April 2022 (Gliwice, Plock), 8 April 2022 (Chorzow, Czestochowa, Gdansk, Opole, Rybnik), 22 April 2022 (Bialystok, Ostrow Wielkopolski, Szczecin, Zabrze), 6 May 2022 (Bydgoszcz, Katowice, Warsaw), 27 May 2022 (Poznan, Rzeszow, Torun) and weight in the rating decision:

Risk Profile: High Midrange (Warsaw), Midrange (all other) / unchanged with low weight

Revenue Robustness: Midrange/ unchanged with low weight

Revenue Adjustability: Midrange (Warsaw), Weaker (all other/ unchanged with low weight

Expenditure Sustainability: Midrange/ unchanged with low weight

Expenditure Adjustability: Stronger (Warsaw, Gdansk, Plock, Katowice), Midrange (all other) / unchanged with low weight

Liabilities and Liquidity Robustness: Stronger (Warsaw, Gliwice), Midrange (all other) / unchanged with low weight

Liabilities and Liquidity Flexibility: Stronger (Warsaw), Midrange (all other) / unchanged with low weight

Debt sustainability:

- Bialystok: 'a' category / deteriorated with high weight
- Bydgoszcz: 'a' category / lowered with high weight
- Chorzow: 'a' category / unchanged with high weight
- Czestochowa: 'a' category / deteriorated with high weight
- Gdansk: 'aa' category / deteriorated with high weight
- Gliwice: 'aa' category / unchanged with high weight
- Katowice: 'a' category / lowered with high weight
- Opole: 'a' category / unchanged with high weight
- Ostrow Wielkopolski: 'a' category / lowered with high weight
- Plock: 'aa' category / unchanged with high weight

- Poznan: 'aa' category / deteriorated with high weight
- Rybnik: 'a' category / unchanged with high weight
- Rzeszow: 'a' category / deteriorated with high weight
- Szczecin: 'a' category / lowered with high weight
- Torun: 'a' category / deteriorated with high weight
- Warszawa: 'a' category / lowered with high weight
- Zabrze: 'bbb' category / deteriorated with high weight

Budget Loans or Ad-Hoc Support: n/a / unchanged with low weight

Asymmetric Risk: n/a / unchanged with low weight

Rating Cap or Rating Floor: A- (Warsaw), n/a (all other) / unchanged with low weight

Quantitative assumptions - issuer specific: changed with high weight

Fitch's rating case scenario is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on the 2017-2021 figures and 2022-2026 projected ratios. Common assumptions for all LGs:

- no further significant changes to the tax reform

Quantitative assumptions for Bialystok:

- On average 2.2% yoy increase in operating revenue;
- On average 2.5% yoy increase in operating spending;
- Negative net capital balance on average at PLN94 million; and
- 5.4% per year average cost for long term debt, compared with 1.6% in 2021.

Quantitative assumptions for Bydgoszcz:

- On average 2.3% yoy increase in operating revenue;
- On average 3.4% yoy increase in operating spending;
- Negative net capital balance on average at PLN150 million; and
- 5.3% per year average cost for long term debt, compared with 1.7% in 2021.

Quantitative assumptions for Chorzow:

- On average 2.4% yoy increase in operating revenue;
- On average 3.3% yoy increase in operating spending;
- Negative net capital balance on average at PLN40 million; and
- 5.2% per year average cost for long term debt, compared with 1.6% in 2021.

Quantitative assumptions for Czestochowa:

- On average 2.8% yoy increase in operating revenue;
- On average 3.2% yoy increase in operating spending;
- Negative net capital balance on average at PLN92 million; and
- 4.8% per year average cost for long term debt, compared with 1.9% in 2021.

Quantitative assumptions for Gdansk:

- On average 1.6% yoy increase in operating revenue;
- On average 2.6% yoy increase in operating spending;
- Negative net capital balance on average at PLN324 million; and
- 5.0% per year average cost for long term debt, compared with 1.6% in 2021.

Quantitative assumptions for Gliwice:

- On average 2.5% yoy increase in operating revenue;
- On average 4.1% yoy increase in operating spending;
- Negative net capital balance on average at PLN122 million; and
- 5.0% per year average cost for long term debt, compared with 2.2% in 2021.

Quantitative assumptions for Katowice:

- On average 3.1% yoy increase in operating revenue;
- On average 4.1% yoy increase in operating spending;
- Negative net capital balance on average at PLN228 million; and
- 5.0% per year average cost for long term debt, compared with 1.4% in 2021.

Quantitative assumptions for Opole:

- On average 3.0% yoy increase in operating revenue;
- On average 3.8% yoy increase in operating spending;
- Negative net capital balance on average at PLN61 million; and
- 5.9% per year average cost for long term debt, compared with 1.8% in 2021.

Quantitative assumptions for Ostrow Wielkopolski:

- On average 1.9% yoy increase in operating revenue;
- On average 2.2% yoy increase in operating spending;
- Negative net capital balance on average at PLN31 million; and
- 6.4% per year average cost for long term debt, compared with 2.4% in 2021.

Quantitative assumptions for Plock:

- On average 4.2% yoy increase in operating revenue;
- On average 5.2% yoy increase in operating spending;
- Negative net capital balance on average at PLN128 million; and
- 6.1% per year average cost for long term debt, compared with 2.0% in 2021.

Quantitative assumptions for Poznan:

- On average 2.7% yoy increase in operating revenue;
- On average 4.0% yoy increase in operating spending;
- Negative net capital balance on average at PLN472 million; and
- 5.8% per year average cost for long term debt, compared with 1.6% in 2021.

Quantitative assumptions for Rybnik:

- On average 1.7% yoy increase in operating revenue;
- On average 2.7% yoy increase in operating spending;
- Negative net capital balance on average at PLN83 million; and
- 5.7% per year average cost for long term debt, compared with 1.3% in 2021.

Quantitative assumptions for Rzeszow:

- On average 2.2% yoy increase in operating revenue;
- On average 2.3% yoy increase in operating spending;
- Negative net capital balance on average at PLN113 million; and
- 6.0% per year average cost for long term debt, compared with 1.6% in 2021.

Quantitative assumptions for Szczecin:

- On average 2.7% yoy increase in operating revenue;
- On average 3.5% yoy increase in operating spending;
- Negative net capital balance on average at PLN204 million; and
- 2.9% per year average cost for long term debt, compared with 1.8% in 2021.

Quantitative assumptions for Torun:

- On average 2.1% yoy increase in operating revenue;
- On average 3.2% yoy increase in operating spending;
- Negative net capital balance on average at PLN121 million; and
- 5.4% per year average cost for long term debt, compared with 2.1% in 2021.

Quantitative assumptions for Warsaw:

- On average 2.5% yoy increase in operating revenue;
- On average 4.0% yoy increase in operating spending;
- Negative net capital balance on average at PLN1,379 million; and
- 4.8% per year average cost for long term debt, compared with 3.6% in 2021.

Quantitative assumptions for Zabrze:

- On average 1.9% yoy increase in operating revenue;
- On average 1.6% yoy increase in operating spending;
- Negative net capital balance on average at PLN45 million; and
- 6.2% per year average cost for long term debt, compared with 2.4% in 2021.

Quantitative assumptions - sovereign related (note that no weights and changes since the last review are included as none of these assumptions were material to the rating action)

Figures as per Fitch's sovereign actual for 2021 and forecast for 2024, respectively:

- GDP per capita (US dollar, market exchange rate): 17,774.48; 19,509.02
- Real GDP growth (%): 5.9; 2.3
- Consumer prices (annual average % change): 5.2; 4.9

- General government balance (% of GDP): -1.9; -3.1
- General government debt (% of GDP): 53.8; 50.8
- Current account balance plus net FDI (% of GDP): 3.07; -5.01
- Net external debt (% of GDP): 6.98; 3.63
- IMF Development Classification: EM (emerging market)
- CDS Market Implied Rating: 'A'

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Warsaw:

- An upgrade of the Polish sovereign IDRs, as the city's IDRs are currently constrained by those of the sovereign.

Gdansk, Gliwice, Plock, Poznan:

- Debt payback ratio remaining lower or equal to 7.5x on a sustained basis under Fitch's rating case, provided the sovereign is also upgraded, as the city's IDRs are currently equal to those of the Polish sovereign (A-/Stable).

Bydgoszcz, Katowice, Ostrow Wielkopolski, Rybnik, Szczecin:

- Debt payback ratio remaining lower or equal to 9x on a sustained basis under Fitch's rating case.

Bialystok, Czestochowa, Opole, Rzeszow, Torun:

- Debt payback ratio remaining lower or equal to 10.5x on a sustained basis under Fitch's rating case.

Chorzow:

- Debt payback ratio remaining lower or equal to 12x on a sustained basis under Fitch's rating case.

Zabrze:

- Debt payback ratio remaining lower or equal to 15x on a sustained basis under Fitch's rating case.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Warsaw:

- A downgrade of Poland's sovereign ratings;
- A multiple-notch downward revision of the city's SCP to below 'a-', which could be driven by a material deterioration in debt metrics, particularly debt payback rising above 13x on a sustained basis under Fitch's rating case.

Gdansk, Gliwice, Plock, Poznan:

- A downgrade of Poland's sovereign ratings;
- A downward revision of the cities' SCP, which could be driven by deterioration in debt metrics, particularly debt payback rising above 9x on a sustained basis under Fitch's rating case.

Bydgoszcz, Katowice, Ostrow Wielkopolski, Rybnik, Szczecin:

- A downward revision of the cities' SCP, which could be driven by deterioration in debt metrics, particularly debt payback rising above 10.5x on a sustained basis under Fitch's rating case.

Bialystok, Czestochowa, Opole, Rzeszow, Torun:

- A downward revision of the cities' SCP, which could be driven by deterioration in debt metrics, particularly debt payback rising above 12x on a sustained basis under Fitch's rating case.

Chorzow:

- A downward revision of the city's SCP, which could be driven by deterioration in debt metrics, particularly debt payback rising above 13x on a sustained basis under Fitch's rating case.

Zabrze:

- A downward revision of the city's SCP, which could be driven by deterioration in debt metrics, particularly debt payback rising above 17x on a sustained basis under Fitch's rating case.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

SUMMARY OF FINANCIAL ADJUSTMENTS

We have adjusted one-off subsidy resulting from the 'Polish Deal' paid in November and December 2021 for cost coverage in 2022 by subtracting it from current transfer in 2021 and adding it back in 2022.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Warsaw's ratings are capped by the ratings of Poland, while Gdansk, Gliwice, Plock and Poznan's ratings are on par with the sovereign.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Gliwice, City of	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Watch Negative
	LC LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Watch Negative
Bialystok, City of	Natl LT	AA+(pol) Rating Outlook Stable	Affirmed	AA+(pol) Rating Watch Negative
	LT IDR	BBB Rating Outlook Negative	Affirmed	BBB Rating Watch Negative
	LC LT IDR	BBB Rating Outlook Negative	Affirmed	BBB Rating Watch Negative

	Natl LT	A+(pol) Rating Outlook Stable	Affirmed	A+(pol) Rating Watch Negative
Rzeszow, City of	LT IDR	BBB Rating Outlook Stable	Downgrade	BBB+ Rating Watch Negative
	LC LT IDR	BBB Rating Outlook Stable	Downgrade	BBB+ Rating Watch Negative
	Natl LT	AA-(pol) Rating Outlook Stable	Downgrade	AA(pol) Rating Watch Negative
Ostrow Wielkopolski, Municipality of	LT IDR	BBB+ Rating Outlook Stable	Downgrade	A- Rating Watch Negative

[VIEW ADDITIONAL RATING DETAILS](#)

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PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[International Local and Regional Governments Rating Criteria \(pub. 03 Sep 2021\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

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ENDORSEMENT STATUS

Bialystok, City of	EU Issued, UK Endorsed
Bydgoszcz, City of	EU Issued, UK Endorsed
Chorzow, City of	EU Issued, UK Endorsed
Czestochowa, City of	EU Issued, UK Endorsed
Gdansk, City of	EU Issued, UK Endorsed
Gliwice, City of	EU Issued, UK Endorsed
Katowice, City of	EU Issued, UK Endorsed
Opole, City of	EU Issued, UK Endorsed
Ostrow Wielkopolski, Municipality of	EU Issued, UK Endorsed
Plock, City of	EU Issued, UK Endorsed
Poznan, City of	EU Issued, UK Endorsed
Rybnik, City of	EU Issued, UK Endorsed
Rzeszow, City of	EU Issued, UK Endorsed

Szczecin, City of
Torun, City of
Warsaw, City of
Zabrze, City of

EU Issued, UK Endorsed
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