Katowice, City of (/gws/en/esp/issr/80442592)

Fitch Affirms City of Katowice at 'A-'; Outlook Stable

Fitch Ratings-Warsaw/London-29 June 2018: Fitch Ratings has affirmed the Polish City of Katowice's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'A-'. Fitch has also affirmed the city's National Long-Term Rating at 'AA+(pol)'. The Outlooks are Stable.

The affirmation reflects our unchanged view of the city's strong capacity for self-financing investments and sound liquidity, which we expect to be maintained over the medium term. We project direct debt will grow to finance investments, without negatively affecting the city's debt service and debt payback ratios. The ratings are further supported by the city's wealthy and service-oriented local economy.

KEY RATING DRIVERS
Fiscal Performance (Neutral): We expect Katowice's operating performance to remain sound, fuelled by growing income and local tax revenue due to expected national economic growth of at least 3% per year in the medium term. We forecast the operating balance to average PLN200 million annually in 2018-2021, which should cover debt service (principal and interest) by more than 3x.

We assume the administration will maintain its operating balance at current levels, including its control over operating expenditure growth. However, it may be difficult in 2018 as it is an election year and due to one-off operating expenditure as Katowice hosts the United Nations Climate Change Conference (COP24). Thus we expect the operating balance to be lower in 2018. In 2017, Katowice reported an operating balance of PLN212.5 million, which was boosted by one-off civil activity tax revenue of PLN27 million.

Katowice has a strong capacity for self-financing investments. For 2018-2021 we forecast the city will spend close to PLN1.6 billion on capital expenditure, ie on average about 20% of total expenditure annually. The majority of capex will be on roads and public transport. We expect that about half of the investments will be financed by the city's current balance and about 30% from capital revenue. The rest will be covered by new debt and accumulated cash. Some investments will be postponed to the following years and the budget surplus at end-2017 of PLN113 million has further increased the cash available for investment financing. In 2017, capital expenditure was PLN157 million.

Debt, Liabilities and Liquidity (Strength): The city has a track record of strong liquidity, with cash balances averaging PLN350 million in 2014-2017. Cash balances exceeded annual debt service by 11x on average (2017: 13x). In January-May 2018 month-end cash averaged PLN533 million compared with PLN440 million in the same period in 2017. We assume that sound liquidity will be maintained despite the expected partial cash absorption by investments. This will mitigate the risk of higher redemption as Katowice's debt service will double to about PLN70 million annually in 2020-2021.

To finance the planned investments Katowice has secured financing through loans from the European Investment Bank (AAA/Stable), which will have a smooth amortising and long-term repayment schedule, lowering the pressure on debt service. We project Katowice's debt will peak at around PLN810 million by 2021, from PLN625 million at end-2017. Direct debt should remain moderate relative to current revenue at no more than 45% in 2021 (2017: 35.5%). We project the debt payback ratio (direct-debt-to-current-balance) to remain healthy at around four years (2017: three years), despite projected debt growth.

Economy (Neutral): The city is the centre of a large Katowice conurbation, with 2 million of 4.6 million inhabitants in the whole Slaskie region. The city's economy is well-diversified and service-orientated. GDP per capita in the Katowice sub-region is stable, accounting for 135% of the national average in 2015. The unemployment rate was low at 2% at end-April 2018, well below the national average of 6.3%. The formation of a metropolis from mid-2017, consisting of 41 municipalities with Katowice as the centre, should have a low financial impact on the city's expenditure in the medium term. The metropolis provides opportunities for joint investments and streamlined municipal services (eg public transportation), so we expect it to have a positive impact on Katowice's economy and budget.

Management and Administration (Neutral): The administration's budgeting practice is prudent. The city's credit policy is to seek long-term financing from international institutions to secure a smooth repayment schedule. Debt is incurred with headroom to legally set prudential borrowing limits. The city is gradually reducing FX risk on its debt. Katowice has a strong cash position, which provides a buffer for unexpected events and delayed revenue realisation. Capital expenditure is planned with headroom under maximum indebtedness levels and capex finance will be financed first from the current balance and capital revenue, then from new debt and supplemented by available cash.

Institutional Framework (Neutral): Fitch assesses the regulatory regime for Polish local and regional governments (LRGs) as neutral. LRGs' activities and financial statements are closely monitored and reviewed by the central administration. LRGs' finances are public and LRGs are obliged to disclose their financial accounts on time and in detail. The main revenue sources such as income tax revenue, transfers and subsidies from the central government are centrally distributed according to a legally defined formula, which limits the central government's scope for discretion. Prudent borrowing limits are in place, which should help protect LRGs against taking on excessive debt.

RATING SENSITIVITIES

The ratings could be upgraded if Katowice improves its operating performance with an operating margin of about 15% on a sustained basis and maintains a debt payback ratio of below three years, provided the sovereign IDRs - with which the city's ratings are equalised - are also upgraded.

Conversely, a sharper-than-expected deterioration in the city's debt payback ratio to above eight years, due to a sustained weakening in the operating margin or a significant rise in the city's direct debt to above 70% of current revenue, could result in negative rating action. Additionally, a downgrade of the sovereign rating would lead to a downgrade of Katowice's IDRs.

Contact:
Primary Analyst
Dorota Dziedzic
Director
+48 22 338 62 96
Fitch Polska S.A.
16 Krolewska Street
Warsaw 00-103

Secondary Analyst
Magdalena Mikolajczak
Analyst
+48 22 338 62 85

Committee Chairperson
Vladimir Redkin
Senior Director
+7 495 956 9901

Media Relations: Athos Larkou, London, Tel: +44 203 530 1549, Email: athos.larkou@fitchratings.com

Malgorzata Socharska, Warsaw, Tel: +48 22 338 62 81, Email:
malgorzata.socharska@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016) (https://www.fitchratings.com/site/re/878660)
National Scale Ratings Criteria (pub. 07 Mar 2017)
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