



RATING ACTION COMMENTARY

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

Fri 04 Dec, 2020 - 4:05 PM ET

Fitch Ratings - Warsaw - 04 Dec 2020: Fitch Ratings has affirmed the City of Katowice's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-'. Simultaneously, Fitch has affirmed Katowice's National Long-Term Rating at 'AA+(pol)'. The Outlooks are Stable.

The affirmation reflects Fitch's view that Katowice's operating performance and debt ratios will remain in line with 'A-' rated peers over the medium term, despite an economic downturn triggered by the coronavirus pandemic, and the central government's decisions to cut personal income tax (PIT) and increase teachers' salaries. Fitch assesses Katowice's Standalone Credit Profile (SCP) at 'a-'.

While Polish local and regional governments' (LRGs) most recently available data may not have indicated performance impairment, material changes in revenue and cost profiles are occurring across the sector and likely to worsen in the coming weeks and months as economic activity suffers and some form of government restrictions are maintained or broadened due to the coronavirus pandemic. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector for

their severity and duration, and incorporate revised base- and rating-case qualitative and quantitative inputs based on performance expectations and assessment of key risks.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

Fitch assesses Katowice's risk profile as 'Midrange', which reflects a combined assessment of four factors at 'Midrange' (revenue robustness, expenditure sustainability and liabilities and liquidity flexibility and robustness), one 'Stronger' (expenditure adjustability) and one 'Weaker' (revenue adjustability).

Revenue Robustness: 'Midrange'

The city has a proven record of operating revenue growth, with a CAGR of 6.7% in 2015-2019, underpinned by higher GDP per capita and lower unemployment rate than average for Polish cities. Tax revenue accounted for 46.2% of Katowice's total revenue in 2019, and is based on moderately cyclical economic activities, which means that tax revenues will not fall too much from the expected contraction of national GDP (Fitch forecast, dated 7 September 2020, of -3.5% for 2020). Personal income tax and local taxes accounted for 41.7% of total revenue, while corporate income tax, as a more volatile revenue item, accounted for 4.5%.

Current transfers accounted for 32% of total revenue in 2019, with the majority being transfers from the Polish state budget (A-/Stable). These transfers are not subject to discretionary changes as the majority of them are defined by law. Fitch expects Katowice, whose economy is strongly driven by services, to remain attractive to investors and inhabitants, supporting a faster rebound after coronavirus pandemic. The economic downturn is factored into our debt sustainability assessment through our rating case scenario, but will not impact the Revenue Robustness assessment.

Revenue Adjustability: 'Weaker'

We assess Katowice's ability to generate additional revenue in response to possible economic downturns as 'Weaker'. This is in line with our assessment for the majority of Polish cities rated by Fitch. Income tax rates are set by the central government and current transfers decided by the state. Katowice has limited flexibility on local taxes (16% of total revenue), as the rates are constrained by ceilings set in national tax regulation. In our view, additional revenue using discretionary tax leeway would not necessarily cover 50% of a reasonable expected decline of revenue. Although an equalisation scheme is in place for Polish local and regional governments (LRG), revenue from this source is insignificant in relation to the city's budget.

Expenditure Sustainability: 'Midrange'

Fitch assesses the expenditure sustainability of the city's spending as 'Midrange', in line with the majority of Polish cities. The city's main responsibilities are non-cyclical, including education, public transport, municipal services, administration, housing, culture, sport, as well as public safety and family benefits that are mandated and financed from the central budget.

Historically, Katowice's operating expenditure growth has been in line with revenue growth, when excluding one-off revenue, which resulted in a stable operating margin of 12% on average in 2015-2019. In our rating-case scenario, we expect Katowice's operating spending to grow by 4.7% CAGR in 2020-2024, compared with 3.8% CAGR of operating revenue growth. We expect the city's capex to remain moderate and average PLN385 million annually in 2020-2024, leading to budgetary deficits of 6% of total revenue.

Expenditure Adjustability: 'Stronger'

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as 'Stronger'. The city's mandatory responsibilities account for about 60% of total expenditure and compared with other Polish cities, Katowice always spend higher amounts to provide citizens with high standard services. Fitch assumes that Katowice could reduce operating expenditure by at least 10% in case of need. In addition, the city can reduce or postpone a significant portion of its capex (after completion of the infrastructure investments in 2020-2021), which we project at 15% of total expenditure in 2020-2024 (2019: 20%).

Liabilities and Liquidity Robustness: 'Midrange'

National regulations for Polish LRG debt and liquidity are moderate. Katowice's loan portfolio is dominated by loans from international financial institutions (IFIs; 96% at end-October 2020). This provides the city with a long-term and smooth repayment schedule, with final debt maturity in 2035. The city's debt has floating interest rates, which exposes it to interest rate risk as Polish cities are not allowed to use derivatives to hedge. Of the outstanding debt at end of October 2020, 11.5% was in euros and this share will decrease gradually as the city does not plan to incur new debt in foreign currency. The city partially mitigates those risks by prudently setting aside more funds than necessary for debt service.

Liabilities and Liquidity Flexibility: 'Midrange' changed from 'Stronger'

We changed our assessment to 'Midrange' to unify with our assessment for the majority of Fitch-rated Polish cities and improve comparability with international peers. The Midrange assessment reflects the lack of emergency liquidity support from upper tiers of government in Poland and the lack of banks rated above 'A+' in the Polish market. Katowice has a long record of good liquidity. The city has a committed but not used credit line of PLN50 million. Cash at the city's bank accounts at end-October 2020 was PLN442 million and by far exceeded the annual debt service estimated at PLN54 million.

Debt sustainability: 'aa' category

Under its rating case for 2020-2024, factoring in the expected economic downturn triggered by the coronavirus pandemic, Fitch projects Katowice's payback ratio to remain below 9x and the fiscal debt burden below 50% by 2024. In the uncertain global environment, we project a weaker synthetic coverage ratio, but it will remain above 1.5x in 2020-2024. We assess Katowice's debt sustainability in the 'aa' category, which underpins some fiscal resilience to sharp shocks. However, this assessment could be revised lower if there were a more severe and longer deterioration in economic activity.

Operating balance hovered around PLN200 million 2015-2019. In our rating case scenario, we expect it to drop sharply in 2020 due to central government's decisions to cut PIT and increasing expenditure pressure in the education sector and to be PLN90 million-PLN140 million in the medium term.

Net adjusted debt decreased to PLN345 million in 2019, from PLN407 million in 2015 as Katowice finished a large capex plan, mainly related to EU investments. However, the payback ratio remained stable and very low, at 1.7x-1.8x in 2015-2019. In our

rating case scenario, we expect the net adjusted debt to start increasing and approach PLN1.0 billion at end-2024 as the city aims to debt finance new investments. Coupled with the expected decline in the operating balance, this would lead to a payback ratio of around 7x in 2024.

Katowice is a medium-sized city with a population of close to 300,000 located in the Slaskie region and the region's capital. The local economy, in terms of gross value added in 2017, is dominated by services. The unemployment rate of 1% at end-2019 was one of the lowest among Polish cities (5.2% national average). The city's average salary at end-2018 was PLN5,699, 18% higher than the national average (PLN4,835).

DERIVATION SUMMARY

Katowice's 'a-' SCP reflects a combination of a 'Midrange' risk profile and debt sustainability metrics assessed in the 'aa' category under Fitch's rating case. The 'a-' SCP also reflects peer comparison. The city's IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state. The city's IDRs are equal to its SCP and to the sovereign ratings.

KEY ASSUMPTIONS

Qualitative Assumptions and Assessments:

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Weaker'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Stronger'

Liabilities and Liquidity Robustness: 'Midrange'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'aa' category

Support: n/a

Asymmetric Risk: n/a

Sovereign Cap or Floor: n/a

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 2015-2019 figures and 2020-2024 projected ratios. The key assumptions for the scenario include:

- 3.8 % yoy increase in operating revenue on average, including one off deterioration of tax revenue by 4% in 2020
- 4.7% yoy increase in operating spending on average;
- net capital expenditure of PLN284 million on average;
- 2.8% average cost of debt and 20-year maturity for new debt.

RATING SENSITIVITIES

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

- Debt payback ratio remains lower or equal to 7x on a sustained basis under Fitch's rating case, provided the sovereign is also upgraded, as the city's IDRs are currently equal with those of the Polish sovereign (A-/Stable).

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

- Downgrade of the sovereign IDR.
- Debt payback ratio sustainably rising above 9x under Fitch's rating case.
- A prolonged COVID-19 impact and much slower economic recovery lasting until 2025 would put pressure on net revenues. If the city was unable to proactively reduce expenditure or supplement weaker receipts from increased central government transfers, this could lead to a downgrade.

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>].

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Katowice, City of	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
●	LC LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
●	Natl LT	AA+(pol) Rating Outlook Stable	Affirmed	AA+ (pol) Rating Outlook Stable

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Dorota Dziedzic

Senior Director

Primary Rating Analyst

+48 22 338 6296

Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce

Krolewska 16, 00-103 Warsaw

Michal Ochijewicz

Analyst

Secondary Rating Analyst

+48 22 338 6285

Kelvin Tsui, CFA, FRM

Senior Director

Committee Chairperson

+852 2263 9965

MEDIA CONTACTS

Athos Larkou

London

+44 20 3530 1549

athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 08 Jun 2020\)](#)

[International Local and Regional Governments Rating Criteria \(pub. 27 Oct 2020\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

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

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

Katowice, City of

EU Issued

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, THE FOLLOWING [HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT](https://www.fitchratings.com/rating-definitions-document) DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

[READ LESS](#)

COPYRIGHT

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report

were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

[READ LESS](#)

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the [EU Regulatory Disclosures](#) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

International Public Finance Supranationals, Subnationals, and Agencies Europe Poland
