FitchRatings

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

Fitch Ratings-Warsaw/London-22 January 2016: 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 Katowice's sound operating performance, which we expect will be maintained in the medium term.

KEY RATING DRIVERS
The ratings factor in our expectations that Katowice's direct risk will not exceed 50% of current revenue in the medium term. This is based on the city's policy of financing investments mainly with capital revenue, current balance and the city's significant cash reserves.

We expect in our base case scenario that Katowice's operating performance will remain solid, fuelled by growing income and local tax revenue and supported by the expected growth in the national economy. We forecast operating balances averaging PLN200m annually, ie accounting for about 13% of operating revenue in 2016-2018. This should be sufficient to cover 4x-5x the city's debt servicing (including debt repayments and interest), which we project to average to PLN40m in the projection period. The city's operating margin improved to 15% in 2015 according to the preliminary results, which was due to good income and local tax revenue and a one-off VAT refund of PLN50m. Without the tax refund, the margin would be about 12%, close to the 13% achieved in 2014.

For 2016-2018 we forecast Katowice will spend PLN1bn on capex, ie about 20% of total expenditure annually on average, a similar level to 2010-2013. Half of the capex will be on roads and more than 20% on public transport. The city aims to finance investments to a high extent from capital revenue (mainly EU capital grants), cash reserves and from the current balance in 2016-2018. In 2015, capex was PLN290m or 18% of total expenditure on a preliminary basis, due to the completion of major infrastructure investments and lack of availability of EU funds under the new budget.

Katowice's direct debt is likely to fall in 2016 in line with redemption and start to increase gradually but not exceed 45% of current revenue in 2018 (2015: 43% on preliminary basis). Debt may total PLN670m at end-2018 (end-2015: PLN669m), according to our projections. The debt payback ratio (direct risk-to-current-balance) should remain healthy at a moderate four to five years in 2016-2018, well below the city's weighted average debt maturity of about 17 years.

We expect the city's liquidity to remain sound in the medium term, although Katowice will continue to use its cash reserves to finance investments. We project cash reserves will decline to about PLN120m by 2018, from PLN241m expected at end-2015, but significantly exceeding the projected debt service.

The city is the centre of a huge Katowice conurbation, with 2 million inhabitants out of 4.6 million in the whole Slaskie region. The city's economy is well diversified and service-orientated, with 67.8% of GVA from the service sector in 2013 and 77% of employment in this sector in 2014 (both above the national average of 63.4% and 52%, respectively). GDP per capital in the Katowice subregion is well above the national average (138.1% in 2013), ranking the subregion eighth of 72 subregions and translating into the city's high tax revenue. The city's unemployment rate of 3.9% at end-November 2015 was well below the national average (9.6%); ie it ranked fourth in terms of cities with the lowest unemployment rate in Poland.

Katowice performs its tasks within a predictable regulatory regime. The region is transparent in its operations, which is supported by the publication of long-term financial projections and regular disclosure of annual accounts.

RATING SENSITIVITIES
Katowice's ratings could be upgraded if the city improves its operating performance with an operating balance of above 15% of operating revenue on a sustained basis and if it maintains a debt payback ratio of below three years (2015: three years on a preliminary basis).

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.

KEY ASSUMPTIONS
Fitch expects the city to continue its efficient operating expenditure control and to manage the budget prudently in the medium term.

Fitch assumes that the city will continue to receive EU funds to co-finance its investment programme.

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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)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
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