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

FitchRatings

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

Fitch Ratings-Warsaw/London-12 January 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 expect direct debt to grow to finance investments, which will not negatively affect the safe debt service and debt payback ratios. The ratings are further supported by the city's wealthy and service-oriented local economy.

KEY RATING DRIVERS
Katowice has a strong capacity for self-financing investments. For 2018-2020 we forecast the city will spend close to PLN1.5 billion on capital expenditure, ie about 20% of total expenditure annually on average. Around 60% of capex will be on roads and public transport, and the remainder on sport, culture and thermo-insulation of municipal buildings. We expect that about 40% of investment financing will come from the city's current balance and about 40% from capital revenue. The rest will be covered by new debt and accumulated high cash.

In 2017, capital expenditure was about PLN185 million (a low 10% of total expenditure), well below the original plan, mainly due to the delay in availability of EU grants under the 2014-2020 budget and/or prolonged tender procedures. Consequently, Katowice financed all investments from own sources and capital grants. The investments will be postponed to the following years and the achieved budgetary surplus at end-2017 has further increased the cash available for investment finance.

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, which is a strong rating factor. We assume that sound liquidity will be maintained despite the expected partial cash absorption for investment finance as management's policy is to keep a high cash balance to have headroom for unforeseen developments rather than spend it. The expected sound liquidity will mitigate the risk of higher redemption as Katowice's debt service will double to about PLN70 million annually in 2019-2020 according to the redemption schedule.

To finance the planned investments Katowice has secured financing through a loan from the European Investment Bank (EIB), which will have a smooth amortising and long-term repayment schedule, lowering the pressure on debt service for the city's budget. We project Katowice's debt will peak at around PLN820 million by 2020, from PLN621 million at end-2017. Direct debt should remain moderate relative to current revenues and not exceed 45% in 2020 (2017: about 35%). We project the debt payback ratio (direct-debt-to-current-balance) to stay healthy at around four years (2017: about three years), despite the projected debt growth.

Our base case scenario expects Katowice's operating performance to remain satisfactory for the rating, 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, or about 11% of operating revenue in 2018-2020, excluding some non-recurring operating revenue. Operating balances of this level could cover principal and interest payments by more than three times despite the expected growth in debt service. We assume management will maintain its goal of maintaining operating balances at this level, which implies it will curb operating expenditure growth. However, it may be difficult in 2018 as it is an election year.

For 2017, Fitch expects Katowice to report an operating balance of about PLN215 million or 12% of operating revenue, which is high also due to the one-off civil activities tax revenue of PLN27 million. Without the one-off revenue the operating margin would be 11%. Katowice's operating balance covers the annual debt service (principal and interest) by close to 6 times.

The city is the centre of a large Katowice conurbation, with 2 million inhabitants of 4.6 million in the whole Slaskie region. The city's economy is well-diversified and service-orientated with 67.8% of gross value added from this sector in 2014 (national average: 62.8%). GDP per capita in the Katowice sub-region is relatively stable, accounting for 135% of the national average in 2015. The foundation of a metropolis from mid-2017, consisting of 41 municipalities with Katowice as the centre, should have a low financial impact on the expenditure side of the city's budget in the medium term. The metropolis bears opportunities for joint investments and streamlined municipal services (eg public transportation), so we expect it to have a positive impact on Katowice's local economy and budget.

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. As the IDRs are equalised with the sovereign rating, their upgrade is subject to the sovereign IDRs being 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.

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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) (https://www.fitchratings.com/site/re/895106)

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