

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

Fitch Ratings-Warsaw-13 December 2019:

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 Fitch's unchanged view that Katowice will maintain a sound overall budgetary performance and strong debt sustainability ratios in the medium term, despite pressure on debt growth following investments. Fitch assesses Katowice's standalone credit profile (SCP) at 'a-'.

Key Rating Drivers

Risk Profile: Midrange

Fitch assesses Katowice's risk profile as 'Midrange', which reflects a combined assessment of three 'Midrange', two 'Stronger' and one 'Weaker' factors.

Revenue (Robustness): Midrange

We assess Katowice's revenue robustness as 'Midrange' in view of the city's stable revenue sources with revenue growth prospects in line with national GDP growth. Tax revenue accounted for almost 50% of Katowice's operating revenue in 2018, and is based on moderately cyclical economic activities. Personal income tax and local taxes accounted for over 45% of operating revenue, while corporate income tax, being a more volatile revenue item, accounted for 5%.

Current transfers accounted for 32% of current revenue in 2018, 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 to remain attractive to investors and inhabitants, supporting further development of the city's diversified tax base.

Revenue (Adjustability): Weaker

We assess Katowice's ability to generate additional revenue in response to possible economic downturns as limited. This is in line with our assessment for the majority of Polish cities rated by

Fitch. Income tax rates and current transfers are set by the central government. Katowice has limited flexibility on local taxes, which accounted on average for about 17% of operating revenue in 2016-2018 as the rates are constrained by ceilings set in national tax regulation.

Expenditure (Sustainability): Midrange

The city has a proven track record and good control over operating expenditure. Katowice's responsibilities mainly include non-cyclical expenditures, such as education, public transport, municipal services, and administration. We expect the city's capex to remain high in 2019-2020, driven by large infrastructure investments that will be completed by end-2020. This will lead to a budget deficit of up to 13% of total revenue in 2020 before gradually narrowing to about 5% by 2023 under our rating case.

Expenditure (Adjustability): Stronger

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as 'Stronger'. The city can reduce a significant portion of its capex (after completion of the infrastructure investments in 2020) and more than 10% of its operating expenditure. In 2018 Katowice's capex amounted to more than PLN310 million or almost 16% of total expenditure and we project that it will rise to an average of about 20% of total expenditure in 2019-2023.

The city's mandatory responsibilities with the least spending flexibility account for about 70% of operating expenditure, including education, social care, administration, public safety and family benefits. Additionally, the city spends 22% more on several non-compulsory services for citizens than urban counties with the lowest spending. This means such spending can be cut back by at least 10% in case of need.

Liabilities and Liquidity (Robustness): Midrange

Katowice's loan portfolio is dominated by loans from international financial institutions (IFIs; 99% at end-2018). This provides the city with a long-term and smooth repayment schedule, with final debt maturity in 2035. The repayment structure leads to low refinancing risk for the city, with repayment at no more than 8% of the debt stock annually. The city's debt has floating interest rates, which exposes the city to interest rate risk as Polish cities are not allowed to use derivatives. Over 13% of the outstanding debt at end-2018 was in euros, although the share of foreign-currency debt will fall to zero by end-2035. The city partially mitigates those risks by prudently setting aside more funds than is necessary for debt service.

Liabilities and Liquidity (Flexibility): Stronger

Fitch assesses the city's liquidity framework as 'Stronger' despite a lack of emergency liquidity

support from upper tiers of government in Poland. Katowice has a long track record of high liquidity. Liquidity at end-2018 (PLN484 million of unrestricted cash and a committed liquidity credit line of PLN50 million) exceeded annual debt service of PLN46 million. Our rating case projections foresee a liquidity coverage ratio (operating balance plus unrestricted cash-to-debt service in current year) of 6x on average in 2019-2023, compared with an average of 15x in 2015-2018. The city has a committed but unused credit line of PLN50 million provided by PKO BP Bank, a major bank in Poland.

Debt Sustainability Assessment: 'aa'

Under its rating case for 2019-2023, Fitch projects the city's debt payback ratio will increase, from about 1.3x in 2018. It should, however, remain within the 5x-9x threshold, in line with a 'aa' assessment. Fitch's rating case also projects that the fiscal debt burden will increase following investments during the forecast period, to over 50% in 2023 from about 14% in 2018, which is still in line with a 'aa' assessment. Both these metrics counterbalance the city's weaker synthetic debt service coverage ratio (DSCR) of below 2x (2018: 10x) to yield a 'aa' debt sustainability.

Katowice is a medium-sized city with a population of about 300,000 located in the Slaskie region and the region's capital. Its unemployment rate of 1.6% at end-2018 was one of the lowest among Polish cities (5.8% national average). The local economy is dominated by services.

Derivation Summary

Katowice's 'a-' SCP is reflects a combination of a 'Midrange' risk profile and 'aa' debt sustainability under Fitch's rating case for 2019-2023. The city's IDR, which is equal to the SCP and to the sovereign rating, is not affected by any asymmetric risk or extraordinary support from the Polish state.

Key Assumptions

Qualitative assumptions and assessments and their respective weight in the rating decision:

Risk Profile: Midrange

Revenue Robustness: Midrange

Revenue Adjustability: Weaker

Expenditure Sustainability: Midrange

Expenditure Adjustability: Stronger

Liabilities and Liquidity Robustness: Midrange

Liabilities and Liquidity Flexibility: Stronger

Debt sustainability: 'aa' category

Support: none

Asymmetric Risk: none

Quantitative Assumptions - Issuer-Specific

Fitch's rating case scenario is "through-the-cycle", which incorporates a combination of revenue, cost and financial risk stresses. It is based on the 2014-2018 figures and 2019-2023 projected ratios.

Fitch's key assumptions for the scenario include:

- Operating revenue CAGR of 4.6%
- Operating expenditure CAGR of 5.2%
- Total capex of over PLN2.5 billion
- Cost of debt rising to 3.2% by 2023 from 2.2% for 2019

RATING SENSITIVITIES

Katowice's IDRs are currently equal to those of the Polish sovereign (A-/Stable). They could be upgraded if the city maintains its sound operating performance, leading to an improving debt payback ratio towards five years on a sustained basis, provided the sovereign is also upgraded.

Negative action on Poland's ratings will be reflected in Katowice's ratings. Negative rating action could also result from sustained deterioration of operating performance or a significant rise in the city's direct debt, leading to a debt payback ratio above nine years on a sustained basis under Fitch's rating case.

ESG Considerations

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 to the way in which they are being managed by the entity. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

Katowice, City of; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta
----; Local Currency Long Term Issuer Default Rating; Affirmed; A-; RO:Sta
----; National Long Term Rating; Affirmed; AA+(pol); RO:Sta
----; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta

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Applicable Criteria

[National Scale Ratings Criteria \(pub. 18 Jul 2018\)](#)

[Rating Criteria for International Local and Regional Governments \(pub. 13 Sep 2019\)](#)

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