

FITCH AFFIRMS CITY OF KATOWICE AT 'A-'; OUTLOOK STABLE

Fitch Ratings-Warsaw/London-14 July 2017: 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 the direct debt to grow to finance investments, which will not negatively affect the safe debt service and debt payback ratios. In addition, the ratings are supported by the city's wealthy and service-oriented local economy.

KEY RATING DRIVERS

Katowice has a strong capacity for self-financing investments. For 2017-2020 we forecast the city will spend close to PLN1.7 billion on capex, ie about 20% of total expenditure annually on average. We expect the highest capital spending in 2018-2019. Around 60% of capex will be on roads and on 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 2016, capital expenditure was PLN146 million (a low 9% of total expenditure), well below the original plan, mainly due to the delay in availability of EU grants under the 2014-2020 budget. The investments will be postponed to the following years and the achieved budgetary surplus at end-2016 has further increased the cash available for investment finance.

The city has a track record of strong liquidity, with cash balances averaging PLN330 million in the last five years. The cash balances exceeded the annual debt service by 11x on average in 2012-2016, which is a strong rating factor. We assume that the 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 when European Investment Bank (EIB) loans totalling PLN400 million start to be redeemed.

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 2017-2020, excluding some non-recurring operating revenue. Operating balances of this level may cover principal and interest payments more than three times despite the expected growth in debt service. We assume management will keep its goal of maintaining operating balances at this level, which implies to curb the operating expenditure growth. However, it may be difficult in the election year 2018.

In 2016, Katowice reported an operating balance of PLN236 million or 14% of operating revenue, which was high also due to the one-off civil activities tax revenue of PLN54 million. For 2017 the city also expects PLN27 million of extraordinary civil activities tax revenue and we project the operating balance could be about PLN220 million or 13% of operating revenue. Due to

extraordinary revenues, the operating balance increased above the PLN200 million benchmark from 2015 and was higher than the average PLN168 million achieved in 2011-2014.

To finance the planned investments Katowice has secured financing through a loan from the EIB, which will have a smoothly 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 PLN654 million at end-2016. Direct debt should remain moderate relative to current revenues and not exceed 45% in 2020 (2016: 39%). We project the debt payback ratio (direct-debt-to-current-balance) to stay healthy at around four years (2016: 2.8 years), despite the projected debt growth.

The city is the centre of a large 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 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 137% of the national average in 2014. 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) thus 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, providing the sovereign ratings 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.

Contact:

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

Secondary Analyst
Renata Dobrzynska
Director
+48 22 338 62 82

Committee Chairperson
Christophe Parisot
Managing Director
+33 1 44 29 91 34

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@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)

<https://www.fitchratings.com/site/re/895106>

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, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. 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 WEBSITE.

Copyright © 2017 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