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.

Additional information is available on www.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