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

Fitch Ratings-Warsaw/London-20 January 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 Katowice's sound liquidity and strong debt ratios, which we expect to be maintained over the medium term.

KEY RATING DRIVERS
The ratings factor in Katowice's strong capacity for self-financing investments, due to satisfactory fiscal performance, expected significant EU capital grants and large cash surpluses. The ratings also reflect expected strong growth in debt servicing over the medium term, which is mitigated by the city's high liquidity buffers and prudent debt policy.

The city's operating result in 2016 was supported by personal tax revenue as well as revenue from the property transfer tax. As a result the city's operating balance is expected to total PLN225m, or 14% of operating revenue, up from an average operating margin in 2011-2014 of 12.5%. Excluding the one-off items (PLN56m) the operating margin would be 10%-11%.

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. We forecast the operating balance to average PLN200m annually, or 11% of operating revenue in 2017-2019, excluding some non-recurring operating revenue. Operating balance is under pressure as without the one-off revenue operating expenditure growth would be comparable to operating revenue growth. As a result, an inability to constrain operating expenditure growth could be rating-negative.

For 2017-2019 we forecast Katowice will spend PLN1.1bn on capex, ie about 17%-20% of total expenditure. Half of the capex will be on roads, more than 20% on public transport, and the remainder on sport, culture and thermo-insulation of municipal buildings. We expect that more than half of investment financing will come from the city's current balance and about 35% from capital revenue. The rest will be covered by available cash and additional debt.

In 2016 capital expenditure amounted to about PLN150m, much below the original plan, due to the lack of EU grants. As a consequence investments will be postponed and the city will report a much higher-than-expected budgetary surplus of above PLN100m. The surplus will improve the city's already strong liquidity. Katowice expects the year-end cash balance will increase to about PLN340m in 2016 from PLN262m in 2015.

We expect the city's liquidity to remain sound in the medium term, which is positive for the ratings. Investment will absorb part of its significant cash reserves, but still leave a sound cash balance significantly exceeding projected debt service. This is despite a likely increase in the latter to PLN65m by 2019 (2016: PLN30m) as two European Investment Bank (EIB) loans totalling PLN400m are being redeemed.

Katowice's direct debt fell to PLN654m in 2016, due to the EIB loan redemption and no new debt. However, we expect debt to gradually increase to PLN720m in 2017-2019 but no more than 45% of current revenue, similar to levels reported in 2013-2015. The debt payback ratio (direct riskto-current-balance) should remain healthy at three to four years in 2017-2019 (2016: three years), below the city's debt repayment profile of 17 years.

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 and 77% of employment from this sector in 2013 and 2014, respectively (both above the national average of 63.4% and 52%, respectively). GDP per capita in the Katowice sub-region in 2013 was 138.1% of the national average, ranking it the eighth-largest out of 72 sub-regions and translating into the city's high tax revenue.

RATING SENSITIVITIES
The ratings could be upgraded if Katowice improves its operating performance with an operating margin of above 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.

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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. 30 Oct 2013)
https://www.fitchratings.com/site/re/720082