FitchRatings

RATING ACTION COMMENTARY

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

Fri 16 Apr, 2021 - 5:03 PM ET

Fitch Ratings - Warsaw - 16 Apr 2021: Fitch Ratings has affirmed the Polish City of Gliwice's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-'. The Outlooks are Stable. A full list of rating actions is detailed below.

The affirmation reflects Fitch's unchanged view that Gliwice's operating performance and debt ratios will remain in line with 'A-' rated peers' over the medium term, despite an economic downturn triggered by the coronavirus pandemic. Fitch assesses Gliwice's Standalone Credit Profile (SCP) at 'a-'.

Gliwice is a medium-sized city by Polish standards, located in the Slaskie region and is part of the Silesia Metropolis (more than two million inhabitants). The city's economy is well-developed and attractive to investors, as it benefits from the city's location at a crossroads of the main Polish rail and road corridors, and from a well-educated and highly qualified labour force.

Feedback

KEY RATING DRIVERS

Risk Profile: 'Midrange'

Fitch assesses Gliwice's risk profile as 'Midrange', which reflects the combination assessment of four factors at 'Midrange' (revenue robustness, expenditure sustainability and adjustability and liabilities and liquidity flexibility), one at 'Stronger' (liabilities and liquidity robustness) and one at 'Weaker' (revenue adjustability).

Revenue Robustness: 'Midrange'

The city has a proven record of operating revenue growth, with a compound annual growth rate (CAGR) of 9.7% in 2016-2020, underpinned by higher GDP per capita and lower unemployment rate than the average for Polish cities. Our rating case expects income tax revenue (personal income tax (PIT), corporate income tax (CIT)) in 2021 to grow at a slower pace than in 2016-2020 due to the economic downturn caused by the pandemic before rebounding in 2022-2023 on expected economic recovery.

In 2020 the city's revenue was affected by the central government's decisions to cut PIT rates, as a result of which PIT revenue fell PLN7.4 million to PLN327 million. The loss in PIT was mitigated by an increase of property tax, transfers and a return of VAT. Despite the pandemic, operating revenue growth in 2020 was faster than that reported in the last five years at 15.2%.

Tax revenue accounted for almost 36% of Gliwice's total revenue in 2020, and is based on moderately cyclical economic activities, which means tax revenues are not materially affected by a contraction of national GDP. Current transfers accounted for 35% of total revenue in 2020, 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.

Feedback

Revenue Adjustability: 'Weaker'

We assess Gliwice's ability to generate additional revenue in response to economic downturns as 'Weaker', in line with the majority of Fitch-rated Polish cities'. Income tax rates are set by the central government as are current transfers. Gliwice has limited flexibility on local taxes, as the rates are constrained by ceilings set in national tax regulation. In our view, additional revenue using discretionary tax leeway would cover less than 50% of an expected decline of revenue in an economic downturn. Although an equalisation scheme is in place for Polish local and regional governments (LRG), revenue from this source is insignificant in relation to the city's budget.

Additionally, the city has a 10-year record of successful asset sales, bringing on average an annual PLN61 million of revenue, which Fitch deems would also be feasible in a downturn, as in 2020 when the city received PLN50.8 million in sales proceeds.

Expenditure Sustainability: 'Midrange'

The city's expenditure sustainability is underpinned by non-cyclical responsibilities such as education, public transport, municipal services, and administration. The city's administration has a record of strict control of operating expenditure growth, which was in line with or below operating revenue growth in 2016-2020, leading to an operating margin averaging 15.4%.

During the pandemic year the city made savings from closing schools and kindergartens, cancelled cultural and sport events, lower utility charges, fewer purchased services and goods, as well as lower personnel expenditure in the months when the social security fund covered personnel expenses. Rationalisation of the city's current expenditure was sufficient to maintain its operating balance at the 2019 level.

Our rating case expects Gliwice's operating spending to grow on average 3.6% in 2021-2025 as it maintains tight control over operating spending to mitigate a decline in tax revenue. We expect the city's capex to remain high in 2021-2023, leading to budget deficits averaging 3.6% of total revenue under our rating case.

Expenditure Adjustability: 'Midrange'

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as 'Midrange'. It has influence over 15% of current spending, while the remainder is inflexible. The share of inflexible costs is 70%-90% of total expenditure and results mainly from mandatory responsibilities in education, family benefits, social care, administration and public safety. Capex is, to some extent, flexible as it is implemented in phases, and can be postponed in case of need. In 2020 capex was a high 23% of total spending, significantly above the average of other Polish cities.

Liabilities & Liquidity Robustness: 'Stronger'

National regulations for Polish LRGs' debt and liquidity are moderate but in Gliwice's case the framework is assessed as 'Stronger'. The city has a debt-management strategy in place (by decree of the President), which is not common practice.

The city's loan portfolio at end-2020 was dominated by European Investment Bank (EIB, AAA/Stable) loans (about 71% of the debt stock), followed by bonds (29%; PLN150 million issued in 2H20 with maturity up to 2030). The EIB loans result in a long-term and smooth repayment schedule, with a final debt maturity in 2034. All of the city's debt is denominated in Polish zloty and almost all at fixed-rate, which eliminates foreign-currency and interest-rate risks, also uncommon among Polish LRGs.

Annual principal payments are less than 10% of end-2020 outstanding debt stock. The city also has available PLN300 million from EIB, which would secure all future financing needs of EU co-financed investments during 2021-2022, among others. The new loans will have a maximum 25-year maturity and up to four years of grace period.

Liabilities & Liquidity Flexibility: 'Midrange'

The 'Midrange' assessment reflects the absence of emergency liquidity support from upper tiers of government in Poland and the lack of banks rated above 'A+' in Poland. Gliwice has a long record of healthy liquidity. The city has a committed but un-used credit line of PLN60 million provided by ING Bank Slaski (A+/Negative). Liquidity at end-2020 (PLN220 million of unrestricted cash and a committed liquidity credit line of PLN60 million) exceeded annual debt service of PLN36 million.

Net adjusted debt increased to PLN301 million in 2020, from PLN151 million in 2015 as Gliwice implemented a large capex plan, mainly related to EU investments. However, debt payback remained low at 1.6x in 2020, due to an improved operating balance. Our rating case expects net adjusted debt to continue to increase towards PLN800 million at end-2025 as the city seeks to maintain a high level of investments in transport infrastructure. This increase, coupled with an expected decline in the operating balance, would lead to a debt payback of around 8x in 2025.

Feedback

Debt Sustainability: 'aa category'

Fitch classifies the City of Gliwice as a 'type B' LRG, as it covers debt service from its cash flow on an annual basis.

Under its rating case for 2021-2025, factoring in the economic downturn triggered by the coronavirus pandemic, Fitch projects Gliwice's debt payback to rise on average to 7.9x (corresponding to a 'aa' debt sustainability score) from 1.6x in 2020, reflecting the city's debt increase and expected shrinkage of the operating balance. Fitch's rating case projects that the fiscal debt burden will increase but remain strong ('aaa' debt sustainability score) and below 50% on average (2020: 22%). It more than counterbalances the city's weaker synthetic debt service coverage ratio (SDSCR) of 1.6x on average ('a' debt sustainability score). All these metrics result in a final debt sustainability assessment of 'aa'.

Despite the central government's decisions to cut PIT rates and to increase teachers' salaries, both of which fully affected the city's budget in 2020, Gliwice managed to maintain an unchanged operating balance at PLN184 million in 2020. This was due to additional revenue from property tax, VAT proceedings and transfers as well as cost-rationalisation measures.

Fitch projects that the city's operating balance may still weaken in 2021 to about PLN80 million, before gradually recovering to PLN100 million in 2025. This is because, in our view, the recovery of GDP, which we project at 4.1% in 2021 and 4.7% in 2022, will benefit the city's budget with some time lag, translating into higher tax revenue from 2022 rather than from 2021 when some tax items may still decline.

DERIVATION SUMMARY

Gliwice's 'a-' SCP reflects a combination of a 'Midrange' risk profile and 'aa' debt sustainability metrics under Fitch's rating case. The 'a-' SPC also reflects peer comparison. The city's IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state. The city's IDRs are equal to the SCP and currently at the same level as the sovereign ratings.

KEY ASSUMPTIONS

Qualitative assumptions and assessments:

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Weaker'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Midrange'

Liabilities and Liquidity Robustness: 'Stronger'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'aa'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): 'N/A'

Asymmetric Risk: 'N/A'

Sovereign Cap: 'N/A'

Sovereign Floor: 'N/A'

QUANTITATIVE ASSUMPTIONS - ISSUER SPECIFIC

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2016-2020 figures and 2021-2025 projected ratios. The key assumptions for the scenario include:

- 2.1% yoy increase in operating revenue on average;

- 3.6% yoy increase in operating spending on average;

- Negative net capital balance of PLN171 million on average; and

- Average debt costs rising to 2.7% in 2025 from 2.1% in 2020.

Feedback

RATING SENSITIVITIES

FACTORS THAT COULD, INDIVIDUALLY OR COLLECTIVELY, LEAD TO NEGATIVE RATING ACTION/DOWNGRADE:

- Downgrade of the sovereign's IDRs; and

- Debt payback rising above 9x on a sustained basis under Fitch's rating case.

FACTORS THAT COULD, INDIVIDUALLY OR COLLECTIVELY, LEAD TO POSITIVE RATING ACTION/UPGRADE:

- Debt payback below or equal to 7.5x on a sustained basis under Fitch's rating case, provided the sovereign is also upgraded, as the city's IDRs are currently at the same level as the Polish sovereign's.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of 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 the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Gliwice, City of	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
•	LC LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
•	Natl LT	AA+(pol) Rating Outlook Stable	Affirmed	AA+ (pol) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Michal Ochijewicz
Analyst
Primary Rating Analyst
+48 22 338 6285
Fitch Ratings Ireland Limited spolka z ograniczona odpowiedzialnoscia oddzial w Polsce
Krolewska 16, 00-103 Warsaw

Maurycy Michalski
Director
Secondary Rating Analyst
+48 22 330 6701

Guilhem Costes
Senior Director
Committee Chairperson
+34 91 076 1986

MEDIA CONTACTS

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Feedback

Malgorzata Socharska
Warsaw
+48 22 338 6281
malgorzata.socharska@fitchratings.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 27 Oct 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 22 Dec 2020)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Gliwice, City of	EU Issued, UK Endorsed

DISCLAIMER

Feedback

(OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

Feedback

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

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

International Public Finance Supranationals, Subnationals, and Agencies Europe Poland

ga('set', '732-ckh-767', 'USER_ID');

Feedback