FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Warsaw - 15 Mar 2024: Fitch Ratings has affirmed the Polish City of Gliwice's 'A-' Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-'. The Outlooks are Stable. A full list of rating actions is below.

The affirmation reflects our expectations that despite expenditure pressures, Gliwice will maintain its payback ratio at levels corresponding to 'aa' debt sustainability. We forecast a deterioration of the payback ratio in the medium term due to continued high investment expenditure requiring debt finance, coupled with weaker operating performance expectations. Changes to the local and regional governments' (LRGs) funding mechanism, which started with the Polish Deal tax reform, and still high inflation will continue to put pressure on the city's operating balance.

Gliwice's National Ratings have been upgraded to 'AAA'(pol) from 'AA+(pol)' due to good financial performance, which in our view qualifies the city for a higher National Rating.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

This assessment is in line with other Fitch-rated Polish municipalities. It reflects Fitch's view of a moderately low risk of the city's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt-service requirements.

Gliwice's 'Midrange' risk profile combines of a 'Stronger' assessment of liabilities and liquidity robustness, 'Midrange' assessments of revenue robustness, expenditure sustainability, expenditure adjustability, liabilities and liquidity flexibility, and a 'Weaker' assessment of revenue adjustability.

Revenue Robustness: 'Midrange'

This assessment is in line with other rated Polish cities. Tax revenue accounted for about 44% of Gliwice's operating revenue in 2023, and is based on moderately cyclical economic activities (39% of the total revenue). Personal income tax (PIT) accounted for about 21% of operating revenue, followed by local taxes at about 20%; and corporate income tax (CIT), a more volatile revenue item, at about 3%. Current transfers accounted for 38% of operating revenue in 2023 (34% the total revenue), the majority of which was transfers from the Polish state budget. These transfers are not subject to discretionary changes as the majority are defined by law.

We expect revenue growth to be positive and slightly above GDP growth, with the exceptions of 2024 and 2025. The strong growth in operating revenue of 13.3% in 2024 will be fueled by high allocation of PIT and CIT (37% more versus 2023), and should be followed by marginal growth of only 1.9% in 2025, due to lower expected CIT revenue as an effect of compensation calculations in both years. Capital revenue should remain stable at PLN126 million on average in 2024-2028.

Revenue Adjustability: 'Weaker'

We assess Gliwice's ability to generate additional revenue in response to economic downturns as limited. This is in line with our assessment for the majority of Fitch-rated Polish cities. Income tax rates and current transfers are set by the central government.

Gliwice has limited flexibility on local taxes, which accounted for just above 19% of operating revenue in 2023, as rates are constrained by ceilings set within national tax regulation. In our view, additional revenue using discretionary tax leeway would cover less than 50% of an expected revenue decline in an economic downturn. The city has a 10-year record of successful asset sales, bringing on average an annual PLN72 million of revenue, which Fitch deems would be feasible in a downturn, as in 2022 when the city received about PLN74 million and about PLN100 million in 2023.

Expenditure Sustainability: 'Midrange'

This assessment is in line with the majority of Polish cities. The city has a record of moderate control over operating expenditure growth. 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 well below operating revenue in 2019-2023, leading to operating balances averaging 15.1% of operating revenue. Capex was of total expenditure on average 24.3% in 2019-2023, with 19.5% in 2023.

Gliwice has a good financial management practices with effective cost controls in place. Fitch expects opex growth to follow operating revenue dynamics in the longer term, although the operating balance is likely to stabilise at a lower level than historically.

Expenditure Adjustability: 'Midrange'

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as 'Midrange'. It can influence over 15% of current spending, while the remainder is inflexible. The share of inflexible costs is in the range of 70% to 90% of total expenditure and mainly results 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.

Liabilities & Liquidity Robustness: 'Stronger'

National regulations for Polish LRG debt and liquidity are moderate but in Gliwice's case we assess the framework 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-2023 was dominated by European Investment Bank (EIB, AAA/Positive) loans (about 59% of the debt stock) followed by bonds (41%; PLN150 issued at the end of 2020; PLN20 million issued in December 2022; PLN50 million issued in December 2023; maturity up to 2035). The EIB loans result in a long-term and smooth repayment schedule, with final debt maturity in 2034.

All of the city's debt is zloty-denominated and 59% is at fixed-rate, which eliminates foreign-currency and interest rate risk is also uncommon. Annual principal payments do not exceed 11% of the debt stock outstanding at end-2023. The new loans will have a maximum 25-year maturity and up to four years grace periods.

Liabilities & Liquidity Flexibility: 'Midrange'

This assessment reflects the lack of emergency liquidity support from upper tiers of government in Poland and the lack of banks rated above 'A+' in the Polish market. Gliwice has a long record of good liquidity. The city has a committed but unused credit line of PLN60 million provided by Bank Millennium S.A. (BB; Positive) Liquidity at end-2023

(PLN45 million of unrestricted cash and committed liquidity credit line of PLN60 million) exceeded annual debt service of PLN71 million.

Net adjusted debt increased to PLN416 million in 2023 from PLN151 million in 2015 as Gliwice implemented a large capex plan, mainly related to EU investments. However, the payback ratio remained very low at 2.5x in 2023, due to a good operating balance. In our rating case scenario for 2024-2028, we expect net adjusted debt to continue to increase as the city aims to maintain a high level of investments in transport infrastructure, flood control infrastructure projects and the hospital.

Debt Sustainability: 'aa category'

Fitch's rating case projects a weakening of the operating balance in 2024-2028 and an increase in debt, which will erode debt payback to 7.5x (2023: 2.5x) towards the end of the scenario period, although this remains consistent with 'aa' debt sustainability (DS) score.

For the secondary metrics, we project that the fiscal debt burden will increase over the same period, but remain strong and below 60% throughout the scenario horizon, in line with the 'aa' DS category. The city's synthetic debt service coverage ratio (SDSCR) is likely to gradually worsen to about 1.3x (2023: 4.2x), which corresponds to a 'bbb' DS assessment. The SDSCR is typically underestimated for Polish LRGs as it calculates debt annuities for 15 years, whereas the duration of loan agreements for Polish LRGs is typically above 15 years. Gliwice's weighted average life of debt is 5.5 years and its final debt maturity is in 2035.

These metrics result in an overall DS assessment at the lower end of the 'aa' DS category, due to the projected payback ratio in the middle of the 'aa' DS category, and good fiscal debt burden ratio mitigating lower assessment of the SDSCR.

Gliwice's operating balance, which is one of the factors in determining payback ratio, reduced to PLN168 million last year, or 11.9% of operating revenue, from an historical high of PLN189 million in 2022 (value adjusted for the additional subsidy of PLN40 million earmarked for 2022, but received by end of 2021). Fitch's rating case expects the city's operating balance to decline in 2024-2028 to a minimum of PLN144 million in 2028, averaging PLN162 million in 2024-2028, compared with PLN179 million on average in 2019-2023.

These are better outcomes than forecast in Fitch's 2023 rating case, but as net adjusted debt increasing to PLN1,077 million in 2028 from PLN 416 million in 2023, the payback ratio remains in line with the 'aa' DS category.

DERIVATION SUMMARY

Gliwice's 'a-' Standalone Credit Profile (SCP) continues to reflect a combination of a 'Midrange' risk profile and a 'aa' debt sustainability assessment. The city's IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state. City's IDRs are equal to Poland's sovereign ratings (A-/Stable).

National Ratings

Fitch has upgraded Gliwice's National Ratings to 'AAA (pol)' from 'AA+(pol)'. The 'A-' IDRs map to 'AAA(pol)' or 'AA+(pol)'. Based on the improved financial performance, which positions the city in line with the other cities rated 'AAA (pol)' with the same risk profile and SCP, we have revised our assessment of the city to the higher of the available options.

KEY ASSUMPTIONS

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'

Rating Cap (LT IDR): 'N/A'

Rating Cap (LT LC IDR) 'N/A'

Rating 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 2019-2023 figures and 2024-2028 projected ratios. The key assumptions for the scenario include:

- Annual average 5.5% increase in operating revenue, including tax revenue CAGR 8.5% and transfers received CAGR 3.1%, driven by the anticipated rebound of the Polish economy.

- Annual average 6.5% increase in operating spending; due to inflationary increases of goods and services and salaries, also driven by increased minimum salaries.

- Negative net capital balance on average at PLN246 million annually; taking into consideration the uncertainty about the timing and amount of available non-returnable EU capital grants;

- Average cost of debt increasing to 5.8% in 2024-2028 from 3.0% in 2019-2023, due to higher policy rates.

Issuer Profile

Gliwice is an urban county in the Slaskie region, and had around 171,023 inhabitants at mid-2023. Its economy is well-developed and attractive to investors. The unemployment rate was 2.1% (Poland: 5.1%) at end-2023.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of Poland's sovereign ratings or a downward revision of the city's SCP, which could be driven by deterioration in debt metrics, particularly 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

The debt payback ratio remaining lower or equal to 7.5x on a sustained basis under Fitch's rating case, provided the sovereign was also upgraded, as the city's IDRs are currently equal to those of the Polish sovereign.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

DISCUSSION NOTE

Committee date: 12 March 2024

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

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.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Gliwice, City of	LT IDR Affirmed	A- Rating Outlook Stable	A- Rating Outlook Stable

	LC LT IDR Affirmed	A- Rating Outlook Stable	A- Rating Outlook Stable
	Natl LT Upgrade	AAA(pol) Rating Outlook Stable	AA+ (pol) Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

International Local and Regional Governments Rating Criteria (pub. 03 Sep 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Gliwice, City of	EU Issued, UK Endorsed

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