

16 Oct 2020 | Affirmation

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

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Fitch Ratings-Warsaw-16 October 2020:

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 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, and the central government's decisions to cut personal income tax (PIT) and increase teachers' salaries. Fitch assesses Gliwice's Standalone Credit Profile (SCP) at 'a-'.

While Polish local and regional governments' (LRGs) most recently available data may not have indicated performance impairment, material changes in revenue and cost profiles are occurring across the sector and likely to worsen in the coming weeks and months as economic activity suffers and some form of government restrictions are maintained or broadened due to the coronavirus pandemic. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector for their severity and duration, and incorporate revised base- and rating-case qualitative and quantitative inputs based on performance expectations and assessment of key risks.

### 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 CAGR of 8.4% in 2015-2019, underpinned by higher GDP per capita and lower unemployment rate than the average for Polish

cities. Tax revenue accounted for almost 43% of Gliwice's total revenue in 2019, and is based on moderately cyclical economic activities, which means that tax revenues will not fall too much from the expected contraction of national GDP (Fitch forecast, dated 7 September 2020, of -3.5% for 2020). Personal income tax and local taxes accounted for almost 41% of total revenue, while corporate income tax, as a more volatile revenue item, accounted for 2%.

Current transfers accounted for 36% of total revenue in 2019, 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. We expect the main revenue sources to decline in 2020 before slightly improving in 2021. The economic downturn is factored into our debt sustainability assessment through our rating case scenario, but will not impact the Revenue Robustness assessment.

#### Revenue Adjustability: 'Weaker'

We assess Gliwice's ability to generate additional revenue in response to possible economic downturns as 'Weaker'. This is in line with our assessment for the majority of Polish cities rated by Fitch. Income tax rates are set by the central government and current transfers decided by the state. 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 not necessarily cover 50% of a reasonable expected decline of revenue. Although an equalisation scheme is in place for Polish LRG, revenue from this source is insignificant relative to the city's budget.

#### Expenditure Sustainability: 'Midrange'

Fitch assesses the expenditure sustainability of the city's spending as 'Midrange', in line with the majority of Polish cities. The city's main responsibilities are non-cyclical, including education, public transport, municipal services, administration, housing, culture, sport, as well as public safety and family benefits that are mandated and financed from the central budget. Historically, Gliwice's operating expenditure growth has been well below revenue growth, which resulted in a high and stable operating margin (15.9% on average in 2015-2019). In our rating case scenario, we expect Gliwice's operating spending to grow on average 5.6% in 2020-2024 as it maintains tight control over operating spending to cope with a decline in tax revenue. We expect the city's capex to remain high in 2020-2022, leading to budgetary deficits averaging 8% of total revenue, according to our rating case scenario.

#### Expenditure Adjustability: 'Midrange'

Fitch assesses the city's ability to reduce spending in response of shrinking revenue as 'Midrange'.

It has influence over 15% of current spending, while the remainder is inflexible. The share of inflexible costs is in the range of 70%-90% 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 2019 capex was a high 26% of total spending, significantly above the average of other Polish cities.

#### Liabilities and Liquidity Robustness: 'Stronger'

National regulations for Polish LRG 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 of August 2020 was dominated by European Investment Bank (EIB, AAA/Stable) loans (about 99% of the debt stock). 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 denominated in Polish zloty and almost all at fixed-rate, which eliminates foreign-currency or interest rate risk, also uncommon among Polish LRGs.

From 2029 annual principal payments will be about 6% of the end-2019 debt stock. The city has PLN300 million available under a framework loan facility with EBI, which would secure all future financing needs connected with EU co-financed investments during 2019-2022. The new loans have a maximum 25-year maturity and up to four years grace period. In 2017, the city signed an agreement for a loan of PLN100 million under EBI facility, which was fully disbursed (PLN75 million in 2019 and PLN25 million in 1H20). Additionally, Gliwice plans to issue PLN150 million of bonds by end-2020.

#### Liabilities and Liquidity Flexibility: 'Midrange' Changed from 'Stronger'

We have changed our assessment to 'Midrange' to reflect our assessment for the majority of Fitch-rated Polish cities and improve comparability with international peers. The 'Midrange' assessment reflects 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 not used credit line of PLN60 million provided by ING Bank Śląski (A+/Stable). Liquidity at end-2019 (PLN60 million of unrestricted cash and committed liquidity credit line of PLN60 million) by far exceeded the annual debt service of PLN34 million.

#### Debt Sustainability: 'aa' category

Under our Rating Criteria for LRGs Fitch classifies Gliwice - like all other Polish LRGs - as type B as it covers debt service from its cash flows on an annual basis.

Under its rating case for 2020-2024, factoring in the expected economic downturn triggered by the coronavirus pandemic, Fitch projects Gliwice's payback ratio to remain below 9x and the fiscal debt burden below 50% by 2024. In the uncertain global environment, we project a weaker synthetic coverage ratio, although it will remain above 1.4x in 2020-2024. Under the revised projections, Gliwice's debt sustainability score remains in the 'aa' category, underpinning some fiscal resilience to sharp shocks. However, this assessment could be revised lower if there were a more severe and longer deterioration in economic activity.

The operating balance increased to PLN185 million 2019 from PLN137 million in 2015 as a result of a faster increase in operating revenue than increase in operating expenditure. In our rating case scenario, we expect it to drop sharply in 2020 to close to PLN90 million in the medium term due to the central government's decisions to cut PIT and increasing expenditure pressure in the education sector.

Net adjusted debt increased to PLN313 million in 2019, from PLN151 million as Gliwice implemented a large capex plan, mainly related to EU investments. However, the payback ratio remained very low at 1.7x in 2019, due to the improvement in operating balance. In our rating case scenario, we expect the net adjusted debt to continue to increase and approach PLN700 million at end-2024 as the city aims to maintain a high level of investments in transport infrastructure. This increase, coupled with the expected decline in the operating balance, would lead to a payback ratio of around 8x in 2024.

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 the crossroads of the main Polish rail and road corridors, and from a well-educated and highly qualified labour force.

## Derivation Summary

Gliwice's 'a-' SCP reflects a combination of a 'Midrange' risk profile and debt sustainability metrics assessed in the 'aa' category 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 its SCP and 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' category

Support: n/a

Asymmetric Risk: n/a

Sovereign Cap or Floor: n/a

Quantitative assumptions - issuer specific

Fitch's rating case scenario is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on the 2015-2019 figures and 2020-2024 projected ratios. The key assumptions for the scenario include:

- yoy 3.4% increase in operating revenue on average in 2020-2024;
- yoy 5.6% increase in operating spending on average in 2020-2024;
- net capital balance of 144 on average in 2020-2024;
- 3.2% average cost of debt and 25-year maturity for new debt

#### RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- The debt payback ratio sustainably remains lower or equal to 7x under Fitch's rating case, provided the sovereign is also upgraded, as the city's IDRs are currently equal to those of the Polish sovereign.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A downgrade of the sovereign's IDR,
- A debt payback ratio sustainably rising above 9x under Fitch's rating case.
- A prolonged COVID-19 impact and much slower economic recovery lasting until 2025 would put pressure on net revenues. If Gliwice was unable to proactively reduce expenditure or supplement weaker receipts from increased central government transfers, this could lead to a downgrade.

#### 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 OF 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](http://www.fitchratings.com/esg)

Gliwice, City of; Long Term Issuer Default Rating; Affirmed; A-; Rating Outlook Stable  
---; Local Currency Long Term Issuer Default Rating; Affirmed; A-; Rating Outlook Stable  
---; National Long Term Rating; Affirmed; AA+(pol); Rating Outlook Stable

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

**Applicable Criteria**

[International Local and Regional Governments Rating Criteria \(pub. 11 Sep 2020\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub. 08 Jun 2020\)](#)

**Additional Disclosures**

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