

## Poland Credit Analysis

## City of Gdansk

### Ratings

	Current Ratings
<b>Foreign Currency</b>	
Long-Term	BBB+
<b>Local Currency</b>	
Long-Term	BBB+

### Outlooks

Foreign Long-Term	Stable
Local Long-Term	Stable

### Financial Data

City of Gdansk	31 Dec 07	31 Dec 06
Operating revenue (PLNm)	1,461.6	1,308.6
Debt (PLNm)	239.6	271.8
Operating balance/operating revenue (%)	16.3	11.8
Debt service/current revenue (%)	6.1	6.8
Debt/current balance (yrs)	1.0	1.8
Operating balance/interest paid (x)	20.0	11.9
Capital expenditure/total expenditure (%)	23.6	16.8
Surplus (deficit) before debt variation/total revenue (excluding new debt; %)	0.7	2.1
Current balance/capital expenditure (PLNm)	57.1	59.1

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### Related Research

- [International Rating Methodology for Local and Regional Governments \(July 2008\)](#)
- [Institutional Framework for Polish Subnationals \(February 2008\)](#)
- [Revenue Bonds in Poland \(October 2008\)](#)

### Rating Rationale

- The ratings reflect Gdansk's satisfactory operating performance, high liquidity, low debt and strong debt payback ratio. They also reflect budgetary surpluses in 2003-2007 and good financial management. The ratings take also into account the possible negative impact of recent legal changes on personal income tax (PIT) revenue and high pressure on capital expenditure resulting in an increase of direct and indirect debt.
- Between 2005-2007, Gdansk reported sound operating performance with an operating margin of more than 16% at end-2007 supported by a strong increase in income taxes. The 2008 pre-closing results indicate that operating balance could amount to PLN150m, representing about 10% of operating revenue. In 2003-2007, Gdansk's liquidity remained high, averaging about PLN80m at year-ends. Fitch Ratings expects that in FY09-FY10, the operating margin may average about 9%. Gdansk's revenue from PIT may decrease due to the lower tax rates that will be paid by individuals from 2009.
- Gdansk boasts a favourable socio-economic profile. It is one of the wealthiest and fastest-growing cities in Poland. Its well-diversified economy is competitive and attractive to investors, as proved by growing tax revenue. The city's ongoing investments in local infrastructure should support these positive trends.
- Gdansk's authorities implement long-term comprehensive strategic and financial management which helps monitor the city's financial position during the course of each year and adjust its operational decisions to meet the city's strategic targets.
- Since 2004, the city has focused on reducing debt which has improved Gdansk's capacity to incur external financing for its planned investment of more than PLN5bn between 2009-2012. At end-2007, debt amounted to PLN239m, down from PLN515m in 2003. Fitch expects that debt may increase to about 50% and debt servicing to above 6% of total revenue between 2008-2012. Some investments will be undertaken by municipal companies or special-purpose vehicles (SPVs). This will require the city to carry out capital injections to some of these companies or issue guarantees for their debt. Consequently, Gdansk's indirect risk will increase significantly between 2009-2012.

### Key Rating Drivers

- A positive rating action could result from sound operating performance – with an operating margin of above 12% in the medium term – accompanied by strong debt servicing ratios and limited indirect risk.
- A negative rating action could result from a deterioration in operating performance (ie, with the operating margin declining to around 7% in the medium term) and a strong rise in the city's debt (with debt repayment longer than the debt average maturity) associated with high indirect risk stemming from companies that are not self-funding.

### Profile

Gdansk is located on the Gulf of Gdansk and is home to approximately 455,700 people. Gdansk, together with the neighbouring cities of Gdynia and Sopot, forms a large conurbation.

## Administration

### Political Stability

Following the most recent local elections in November 2006, only two parties are represented on the city council. Of the 34 seats on the council, 20 went to the Civic Platform Party (Platforma Obywatelska, PO) and 13 to the Law and Justice Party (Prawo i Sprawiedliwosc, PiS), both broadly centre-right parties. One member is independent. The city councillors and the president are elected in a public vote for a four-year term.

The city's president, Pawel Adamowicz, with over 60% of the votes cast, was re-elected for a third term in November 2006. He is a member of the PO party and also the party deputy chairman in the Pomorskie Region or voivodship. The president, as a member of PO, has an absolute majority in the city council, which guarantees political stability and continuity.

The local government consists of the city's president, four vice presidents appointed by the president, and the city council, the legislative body.

### Political Priorities

In 2004, the city's authorities set out their strategic objectives until 2015 in a document called Strategia Rozwoju Gdanska do roku 2015 (the Gdansk Development Strategy until 2015) which focuses on the economic development of Gdansk, increasing its attractiveness and competitiveness, improving the quality of services provided to inhabitants and improving local infrastructure.

Implementation of the strategy is supported by operational plans for each objective and the Wieloletni Plan Inwestycyjny (WPI – Multiyear Investment Plan). In consideration of the Gdansk authorities' priorities, the city's policy will focus on:

- improving infrastructure (such as roads, water and waste water systems and public transport) and services (including sport, education and culture);
- attracting investors, which will help strengthen the local economy, create new jobs and improve the local tax base;
- continuing heavy investment, some in tandem with neighbouring cities, and increasing the economic, cultural and educational integration of these cities;
- active promotion of the city internationally, directed especially at investors and tourists;
- increasing the attractiveness of the city as a tourist destination;
- supporting the development of tourism; and
- improving housing and generally supporting the city's small and medium-sized enterprises (SMEs).

The current administration has drawn up detailed plans for further development of the city and has a clear view of its most important priorities and challenges.

The city is aiming to facilitate the development of new technology and innovation, and support SMEs, the maritime sector (including Gdansk's Shipyard and the development of associated services such as construction of deep container terminals) and the logistics industry. The city is also focusing on investments that will improve the quality of life for Gdansk's residents and eliminate barriers to local development, such as the lack of roads and housing.

A large number of the city's investments will benefit from capital transfers from the EU. The city is also aware that it has to maintain its self-financing capabilities to be able to carry out its investment plan. Thus the WPI is accompanied by multiyear financial projections.

## Economy

### One of the Wealthiest Cities in Poland

The city of Gdansk is the capital of Pomorskie Region, located on the southern coast of the Baltic Sea. Gdansk, Gdynia and Sopot form a large conurbation with more than 740,000 residents and over 98,780 companies.

### A Dynamic and Diversified Economy

In 2005 (the latest data available), the GDP of the conurbation<sup>1</sup> accounted for 2.9% of national GDP and 51% of the regional GDP. GDP per capita represented 146.4% of the national average.

The services sector is well developed and dominates the local economy, generating 74% of Gdansk's gross value added (GVA) and employing about 72% of the local workforce, in comparison with the national averages of 66% and 49% respectively. The industrial sector (including construction) is strong and well developed; it accounted for over 34% of GVA and was above the national average of 26.5% in 2005.

The city's economy is very well diversified, reliant as it is on SMEs – of the 59,000 business entities in operation in the city in 2007, 99% were SMEs, and only about 1% employed more than 100 staff. Nevertheless, Gdansk also appears to be an attractive place for multinational companies from the electronics and IT sectors, as evidenced by the arrival in recent years of companies such as Intel Technology Poland, AT&T Polska, Ericsson, Lufthansa Systems Poland, Compuware (IT programming), Zen Sar Technology (IT), Young Digital Planet, and also Moeller Electric and ProLogis Gdansk (from the distribution and logistics sector).

The largest and most significant investment in the northern seaport area is the construction of the 40-hectare deepwater container terminal, DCT Gdansk SA, at a total cost of EUR190m. The project was split into two phases, the first of which, involving the construction of two berths with overall annual throughput of 500,000 TEU (20-foot equivalent units), came into operation in 2007. The second phase covers the construction of additional berths. The targeted total annual capacity of the container terminal will be 1 million TEU, and this should be completed in 2009-2010.

In 2007, the city and the port authority agreed on the construction of a 210-hectare logistics centre near the port of Gdansk. The total cost is expected to be EUR250m, which, together with the berths that are currently under construction, should lead to the creation of 5,000 new jobs. The construction of the logistics centre will be a joint project involving the city of Gdansk, the Gdansk Special Economic Zone (SSE) and the port authority.

In 2005, the SSE was extended after Gdansk made an in-kind contribution of a plot of land that will be the site of the Gdansk Technology Park. The Gdansk SSE will primarily be a hi-tech business park spanning some 15 hectares. Individuals or entities that invest in it are entitled to income tax and property tax exemptions. Many foreign companies from the IT, metallurgy and automotive sectors are developing their operations in the SSE.

The services sector is represented by financial services (many banks have branches in Gdansk), business services (such as Ernst & Young), IT, real estate, tourism, educational facilities and healthcare institutions (including nine hospitals). The importance of services to the local economy is growing. The city with its historic and architectural monuments, a benign climate and proximity to the coast is a popular tourist destination. Gdansk hosts more than one million tourists a year.

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<sup>1</sup> GRP for the city of Gdansk is not published

Several investment projects involving new hotels and tourist centres are underway in the city.

Poland's second-largest oil refinery, Lotos Group SA (Lotos), is located in Gdansk. Previously state-owned, it has since June 2005 been listed on the Warsaw Stock Exchange. The company has reported consistent growth in sales and net profit since end-2001 and remains one of the biggest taxpayers to the city. Lotos is investing some PLN13bn in the construction of new premises between 2006-2012 as the company wants to boost its oil production to one million tonnes per year from 0.2 mln tonnes. This investment will rank as the largest ever in the Pomorskie region and one of the largest in Poland ever. This will increase the city's tax revenue from property tax and PIT due to the expected increase in employment.

### An Important Higher Education and Research Centre

Gdansk is a major national educational, cultural and scientific centre, with 14 universities and high schools. These include six public universities, the Technical University, Gdansk University and the Medical Academy. There are about 4,600 teachers and 72,270 students in total (or 87,800, if those in Gdynia and Sopot are included). The presence of the universities provides a highly qualified labour force, which, together with the city's favourable location and the availability of attractive plots of land, makes Gdansk one of the prime locations for investment in Poland.

### Very Low Unemployment

Gdansk's strong economy is also reflected in the high demand for skilled labour and the continuously falling unemployment rate, which at end-2007 was only 3.7%, down from 12.7% in 2003, and one of the lowest among other large cities in Poland.

### Falling Population

The city's population has been falling over the last 15 years due to negative natural growth and net migration (by about 900 people a year): the population fell to 455,700 in 2007 from 462,300 in 1996. The city's authorities want to counteract the trend of negative migration by investing in sport and entertainment facilities and making it easier for private investors to construct new apartments by, for example, selling off publicly-owned land to encourage real estate development.

### Gross Value Added Composition in the Major Polish Cities (End-2005)

(%)	Warsaw	Wroclaw	Gdansk-Gdynia-Sopot	Lodz	Poland
Agriculture and forestry	0.0	0.1	0.2	0.1	4.5
Industry and construction	15.2	22.0	25.8	26.8	29.5
Services	84.8	77.9	74.0	73.1	66.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: GUS - Central Statistical Office

## Finances and Performance

### Revenue

#### Mainly Tax-Based

Taxes accounted for 56% of operating revenue in 2007. As with other Polish local governments (LGs), Gdansk has benefited from legal changes implemented in 2004 which increased its share of income taxes collected in its administrative area. Since 2004, revenue from income taxes has grown dynamically, supported by the strong and developing local economy and the expanding tax base. Since 2004, revenue from income taxes has increased by 272%; revenue reached PLN525m in 2007, up from PLN193m in 2003. The collection of income tax in this period exceeded the amount budgeted. In 2007, taxes were about 6% higher than the amount projected, and 24% higher than the amount collected in 2006.

Gdansk, like other cities in Poland, is permitted to levy some local taxes and charges: in 2007, these constituted 20% of Gdansk's operating revenue.

Property tax is the most important local tax, representing 71% of local taxes. It has grown dynamically, averaging about 5.5% per year in 2003-2007, which reflects the city's strong and developing tax base. The 10 largest payers of property tax accounted for about PLN88.2m or 46.3% of attributed property tax (PLN190m) in 2007. Such a high concentration indicates that there are several large companies in Gdansk. The largest, the Lotos refinery, is in a very strong financial position and pays large taxes due to the amount of property it owns and corporate income tax (CIT). Its investment programme to modernise and construct new production lines is expected to further boost Gdansk's tax revenue from property, CIT and PIT. At end-2007, overdue accumulated property tax amounted to PLN32.5m, down from PLN42.3m at end-2006, of which the city regained PLN6.7m in H108.

Rates of modifiable (local) taxes are increased every year in accordance with the rates established by the Ministry of Finance. In line with its tax policy, the city maintains tax rates close to maximum levels. In particular, property tax rates for houses and commercial premises have been set at the highest permitted level. Not-for-profit organisations or healthcare entities pay preferential rates. Some tax relief on local levies is offered to potential investors which create new jobs – especially new investors in the SSE.

The city has not lost significant revenue as a result of some local tax rates being set below the maximum limits and overdue taxes being written off by the city. Uncollected revenue from local taxes due to lower tax rates and overdue taxes being written off to about PLN9.4m in 2007 – about 3% of local tax revenue or 4% of the operating balance.

### *Current Transfers*

In 2007, current transfers rose 5.5% yoy to account for 27% of operating revenue, amounting to PLN396.7m, up from PLN376m in 2006. Their main component is the general subsidy (70% of transfers), 94% of which is directed at education, nominally PLN278.8m. The city also receives state grants for “delegated tasks” (25% of current transfers, about PLN98m) and “own tasks”, which are co-financed from the state budget and from grants from the EU Human Resources Programme for social projects. In 2007, current grants amounted to PLN122m.

### **Breakdown of Taxes**

(PLNm)	2004	2005	2006	2007
PIT	269.3	319.0	366.0	465.7
CIT	44.0	38.4	58.0	59.2
Property tax	183.8	187.1	202.5	208.9
Other local taxes	43.5	49.8	68.8	71.8
<b>Total tax revenue</b>	<b>540.6</b>	<b>594.3</b>	<b>695.3</b>	<b>818.0</b>

Source: Fitch own calculations based on the city of Gdansk's budgets

### *Prospects*

Revenue from local taxes and fees will continue to increase in the medium term due to the growing tax base and increasing tax rates[please confirm]. However, Fitch expects that in 2009 revenue from PIT may be lower than in 2008, or, in a more optimistic scenario, it may stabilise at the 2008 level. This will result from a number of legal changes which will be implemented by the state government in 2009. In 2007, the national government implemented PIT exemptions to which families with children are entitled. This may negatively affect Gdansk's PIT revenue in 2009. In 2008, this negative change was mitigated by the growing economy and increasing revenue from other sources (eg local taxes).

The other legal change relates to tax rates paid by individuals. In 2008, the state government cut PIT rates to 18% and 32% from 19%, 30% and 40% before. In Fitch's opinion, this loss will not be compensated by the state government. According to the Ministry of Finance's estimates, the state budget may lose about PLN8.6bn as a

result of this change, 49% of which can be lost by local governments. Should the national economy suffer a slowdown, this loss may even be more severe. The city projects that the decline of revenue from PIT, due to lower tax rates and tax relief for families with children, may amount to about PLN120m. It may be partly offset or mitigated by growing salaries and employment and higher local tax rates and rents paid from leased space. However, in view of the current world economic crisis, it is unlikely that this loss will be fully counterbalanced. In its draft budget for 2009, the city projected very conservatively its revenue from PIT.

## Expenditure

Traditionally, the city's largest area of expenditure is education, which in 2006-2007 represented 40% of operating expenditure. In 2007, the city spent PLN492m on the sector, including educational care. Operating expenditure on education is largely made up of rigid items, such as staff costs, which average 70% of operating expenditure on education. Educational subsidy and targeted grants aimed at education covered only 54% of operating costs in 2007. The remaining PLN249m (including PLN17m of capital expenditure) was financed from the city's budget. The strong increase of operating expenditure in the sector in 2007 was caused by a rise in teachers' salaries (PLN26m). From the educational subsidy, the city also has to give grants to non-public schools (schools run by organisations other than local governments – eg, non-profit organisations). In 2007, Gdansk spent about PLN28m on non-public schools and PLN32m is projected for 2008.

In 2009, teachers' salaries will automatically increase by 5% in January and by another 5% in September, as agreed between the state and teachers' trade unions in negotiations which took place in 2008. There will also be a rise in salaries for administrative staff. As a result, the city's financing of educational operating costs may increase, despite Gdansk's implementation of a costs restructuring programme. As teachers' salaries are financed from the educational subsidy from the state government, the pressure on the city's budget should be moderate. In its restructuring programme, the city has standardised the ratio of teachers and administrative staff per pupil, and will close some classes where these standards are not met. The restructuring programme also includes the privatisation of kindergartens, which will limit the city's participation in kindergarten financing to 70% from the current 100%.

As a result of the restructuring programme, the number of teachers decreased by 100 during the 2007/2008 school year. A similar decrease will also take place in the 2008/2009 school year. According to the city, the number of teachers is to be cut by about 150 per year in the next three to four school years, which should help slow rising education expenditure.

The city is also aiming to limit other operating costs such as heating and electricity. It is thus continuing the modernisation of school buildings – eg, through thermo insulation: in 2008, the city will spend about PLN27m on such modernisations.

However, Gdansk's authorities are seeking to provide a high level of education to meet the increasing demand for highly qualified employees. Gdansk is providing additional classes for school pupils, such as in a second and third foreign language or sports. These lessons will be financed from costs savings, EU funds and state grants (for language training).

Social care is the second-largest operating expenditure item in Polish cities. In Gdansk, it accounted for about 14% in 2007. In 2007, spending on social care increased to PLN174.8m from PLN167m. About 50% of operating expenditure on social care is financed from state grants.

The vast majority of operating expenditure on social care relates to spending on central-administration-delegated tasks, which are fully financed through state grants and which the city has no means of limiting. Its "own tasks" are financed

from the city's revenue and partly from state grants. Owing to improvements in the local economy, the city has noted decreasing demand for some categories of social welfare such as, for example, housing allowances. The city delegates the performance of its own tasks in social care to non-profit organisations, which are more effective and cheaper for the city.

### **Capital Revenue and Expenditure**

Gdansk updated its Multiyear Investment Plan (WPI) in April 2008. The current WPI covers the period 2008-2012. Its projected expenditure during this period will amount to PLN5.2bn. The WPI includes all investment projects which are strategic to the city, but several will be undertaken by municipal companies or SPVs established especially for implementing specific projects. The full version of the WPI (including all projects implemented both by the city and by municipal companies) enables the city to aggregate all its financial needs and assess the amount of available own financing and the need for external financial sources.

The WPI is accompanied by the Multiyear Financial Plan which details the source and amounts of investment project financings from the city's budget. The city projects that its capital expenditure will grow dynamically in 2008-2012 as several investments projects relates to sport facilities (stadiums) which have to be completed before the 2012 European football championships.

In 2007, capital expenditure increased to about 24% of the total, or PLN406m. A further increase was projected (to about PLN520m) for 2008 in the 2008 amended budget. According to the city, the actual capex may total about PLN470m. About 30% of capex will be financed from grants (the EU and the state government) with the remainder coming from the city's own sources and debt. The WPI for 2008-2012 projects revenue from grants and subsidies of PLN2.6bn, or 49% of capex. In the last five years, capital revenue financed about 70% of capex.

The city's main areas of investment are roads and public transport, which will absorb over 40% of capex, and cultural sports facilities (more than 20%).

### **Off-Budget Capital Expenditure**

Several investments will be undertaken by municipal companies. The largest of these projects is the construction of a PLN600m water and waste water network by Gdanska Infrastruktura Wodociagowo-Kanalizacyjna (GIW-K), a company set up for this project. The city has made a PLN675m in-kind contribution to the water and sewerage network to GIW-K; this has reduced pressure on the city to increase its direct debt. Moreover, the GIW-K is entitled to reclaim the VAT, currently at a rate of 22%, which reduces costs of the projects. About 29% of the project will be financed from the company's own sources (including a PLN47m loan from the European Bank for Reconstruction and Development), with the remaining 71% coming from the EU's Cohesion Fund.

Gdansk and the City of Sopot have signed an agreement to build the Wielofunkcyjna Hala Widowiskowo-Sportowa (a sports and entertainment facility). The total cost of the project amounts to about PLN303m. This will be financed from EU sources (PLN32m), grants from the state budget (PLN50m) and Gdansk's and Sopot's own resources.

A new company, BIEG2012, will be responsible for the construction of the Baltic Arena sports stadium; the stadium is projected to cost PLN500m, of which PLN144m will come from the state budget, PLN100m from the city and the remaining from bonds.

Gdanskie Inwestycje Komunalne EURO 2012, 100% owned by the city, will be responsible for six projects with a total value of PLN3bn which relate to public transport, roads and the European Solidarity Centre, among others.

A project to purchase new buses and new trams will also be carried out by public transport company Zarzad Komunikacji Miejskiej Sp. z o.o (ZKM). The project will be co-financed from EU sources. ZKM's expenditure will amount to PLN33m. Another project – a PLN250m solid waste management project – will be carried by the Zaklad Utylizacyjny (a municipal company). The financing of the project will be via the EU and bonds.

## Budgetary Performance

Gdansk's operating performance has improved since 2006, helped by dynamic growth of operating revenue (mainly taxes) and strict control on operating expenditure. In 2006-2007, operating revenue rose by 13% annually while operating expenditure increased by 7.5%. This resulted in an improvement in the operating margin, which in 2006 was 12% and in 2007 reached its historical peak of 16.3%.

Since 2004, Gdansk's authorities have focused on reducing its debt. In 2004-2007, direct debt decreased by PLN220m, which strengthened debt ratios. At end-2007, debt accounted for 16% of current revenue, down from 58% in 2003. Due to its improved operating performance, the operating balance has been sufficient to meet debt servicing requirements since 2004, which was not the case in 2003. In 2007, about 37% of the operating balance was spent on debt servicing and the debt pay-back ratio was only one year (10 years in 2003).

During 2003-2007, the city posted surpluses before debt variation which represented about 3.7% of total revenue or nominally PLN11m in 2007. The improvement in operating and budgetary performances enabled the city to limit its demand for debt. The city's debt fell by about 10% in 2006 and 11% in 2007, although 14% and 18% increases were budgeted.

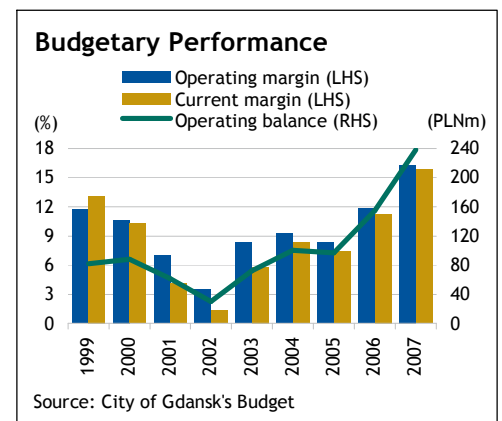
## Prospects

Fitch expects that the actual operating performance of the city in 2008 will be satisfactory with the operating balance amounting to about PLN150m. The negative consequence of tax relief on PIT set by the national parliament to which families with children have been entitled since 2008 was compensated by growing employment and salaries and higher revenue from other taxes. In its 2008 budget, the city assumed that revenue from PIT would be only by 0.8% (PLN4m) higher than in 2007. However, the actual PIT in H108 was 40% of the amount budgeted for the whole year which suggests that the actual PIT by end-2008 will be higher than projected in the 2008 budget.

Fitch expects that in the next three to four years, the operating margin may average about 9%-10%.

The city's direct debt will increase in the medium term due to the investment programme. High levels of cash at year-end may limit Gdansk's demand for debt. The city is aware that it needs to maintain a satisfactory operating performance in 2009-2012 if it wants to fully implement its WPI and limit its recourse to debt. To compensate for potential losses in PIT revenue from 2009, the city will increase rents for leased space from 2008 (eg, for shops and other types of services). Gdansk has some potential to limit its operating expenditure as some expenditure items are of a temporary nature or are less important and could be cut if necessary.

The city complies with the internal measures in its integrated financial





management system, implemented in 2003, which stipulate that the ratios of free financial resources<sup>2</sup> to debt servicing and of operating balance to total revenue should not be lower than 1.1 and 7% respectively. The city has always met these requirements. In 2007, reported ratios were 3.5 and about 15% respectively. Projections for 2008-2011 show that financial resources to debt servicing may vary from 2.2 to 3.6 and operating balance to total revenue from 7% to about 12%.

## Debt, Contingent Liabilities and Liquidity

### Moderate Debt Burden

Direct debt has decreased sharply since 2003, as the city has focused on improving debt coverage ratios and having more flexibility to incur debt in the EU programming period of 2007-2013. At end-2007, direct debt totalled PLN239.6m compared with PLN515m in 2003. 22% of the debt portfolio consists of loans denominated in euro and 78% are loans in PLN.

At end-2007, all debt carried floating rates linked to various indices (three- and six-month WIBOR or three- and six-month EURIBOR). Of the total debt, 7.4% were subsidised loans from the National and Regional Environment Protection and Water Management Funds (NFOSiGW and WFOSiGW) and other financial institutions, which carry very low interest rates and entail grace periods of one to six years. The interest rates for NFOSiGW and WFOSiGW loans are 0.3x or 0.1x of the promissory notes rediscount rate but should not be lower than 3% or 4%.

### Strong Debt Coverage

Gdansk still has good debt coverage ratios despite its significant investment efforts. At end-2007, the operating balance was 20x the interest paid, the debt payback ratio was one year and debt servicing costs were 6% of current revenue. In nominal terms, debt servicing totalled PLN90m.

### Breakdown of Debt

	(PLNm)		(% )	
	2007	2006	2007	2006
Bank credits	221.8	238.8	92.6	87.9
Preferential loans	17.8	33.0	7.4	12.1
<b>Total debt</b>	<b>239.6</b>	<b>271.8</b>	<b>100.0</b>	<b>100.0</b>
Floating interest rate (%)			93.8	94.4
Foreign-currency debt (%)			21.8	33.3

Source: City of Gdansk

### Debt Prospects

In 2008, Gdansk's debt will be lower than budgeted. The city has sufficient own sources for financing capex. For 2008, the city has budgeted an increase of direct debt by PLN238m to PLN544m. However, according to accrual data, after nine months debt will be significantly lower amounting to about PLN400m. In 2009-2012, direct debt and debt servicing will increase. In Fitch's opinion, direct debt may grow to about PLN700m-PLN800m in 2011-2012 and debt servicing to about PLN140m.

As shown in previous years, debt may spread out more evenly as Gdansk's budgetary projections are pessimistic. Moreover, debt may increase at a lower pace than projected due to the city's high own sources for financing investment. The city has a contract with the European Investment Bank (EIB) for a credit of PLN140m, which was withdrawn in tranches in 2007-2008 and will be repaid by 2026. The highest annual servicing of the credit from the EIB is about PLN16m. The interest is below WIBOR.

<sup>2</sup> Free financial sources are: total revenue - capital grants - current expenditure + proceeds from municipal asset sales

## Contingent Liabilities

### *Low Guarantees but Expected to Increase*

At end-2007, guarantees issued by the city to companies' debt were immaterial, amounting to PLN2.6m (down from PLN3m in 2006), which related to a 10-year loan taken by Towarzystwo Budownictwa Społecznego Motława Sp. z o.o. (MTBS – Motława housing association), which is responsible for the construction of apartments for families with medium income but which are able to service debt. The loan will be repaid from rental income. The initial value of this guarantee was PLN3.7m, issued in 2003.

In December 2007, the city declared a guarantee of PLN230m to notes which one of the municipal companies – Zakład Utylizacyjny Sp. z o.o. (ZUT) – wanted to issue. Currently, the company is analysing its financial needs and the costs of available external financing. According to the city, ZUT will probably issue bonds in 2009 instead of notes to a total value of PLN300m, for which a guarantee from the city may be required (or the city may carry out a capital injection into the company).

The city will also guarantee bonds of PLN29m which will be issued by Gdanska Infrastruktura Społeczna Sp. z o.o. for the construction of an apartment building. The guarantee will expire by end-2009 when the building is completed, and from that point in time the collateral for this issue will be tenants' rents.

It is also likely that Gdansk will guarantee a bond issue of PLN500m to BIEG2012, which was established by the city in 2008. BIEG2012 is responsible for the construction of the Baltic Arena for the 2012 European football championships. However, the financial model for this project has not yet been decided. It is also possible that the city will establish an SPV which will be responsible for operating the stadium and so the financing of the project may not need a guarantee from the city.

### *Healthcare Sector Fully Privatised*

The city does not report any indirect risks relating to the healthcare sector, as Gdansk is not a funding body for any healthcare entities.

The city's only healthcare responsibility is to finance educational and preventative diagnostic healthcare programmes for different diseases, such as breast cancer, stomach cancer and heart disease. In 2007, healthcare expenditure totalled PLN13.2m, about 1% of operating expenditure. Medical services are provided by hospitals and polyclinics owned by the Pomorskie Voivodship and the Medical Academy, among others.

## Liquidity

Gdansk reports high liquidity. In 2005-2007, monthly cash and liquid deposits averaged PLN117m. The city makes several deposits a year, which give it significant

## Key Financial Figures on Corporate Exposure (PLN m)

Company	2007			Net income		Long-term debt	
	City's stake (%)	Equity	Total assets	2007	2006	2007	2006
Gdansk Infrastruktura Wodociagowo-Kanalizacyjna (water and sewerage utility)	100.0	682.2	750.3	0.4	0.2	18.8	0.1
Zakład Komunikacji Miejskiej w Gdansk (public transport)	100.0	68.8	139.7	2.4	1.5	0.0	11.6
Gdanskie Towarzystwo Budownictwa Społecznego (Gdańsk housing association)	100.0	52.2	162.9	0.7	0.4	73.2	66.4
Towarzystwo Budownictwa Społecznego - Motława (Motława housing association)	100.0	30.6	79.7	0.3	0.4	26.0	23.7
Zakład Utylizacyjny (solid waste treatment)	100.0	7.6	42.1	7.4	-8.0	0.0	0.0
Gdanskie Melioracje (sewerage)	60.0	0.2	5.7	0.6	0.0	0.0	0.0
Wielofunkcyjna Hala Sportowo-Widowiskowa Gdansk-Sopot (sports facility)	50.0	0.4	0.2	-0.01	-0.01	0.0	0.0
Gdansk Infrastruktura Społeczna - (municipal housing)	100.0	11.1	11.9	-0.2	n.a.	0.0	n.a.
<b>Total</b>						<b>118.0</b>	<b>101.6</b>

Source: City of Gdansk

financial revenue. In 2004-2007, interest revenue covered almost 50% of interest paid. Gdansk also has a stand-by liquidity credit line of PLN50m, which was not used in 2006-2007.

Gdansk has reported high year-end cash reserves, averaging PLN80m in 2002-2007 and covering about 40% of debt.

## Appendix A

### City of Gdansk

(PLNm)	Actual				
	2003	2004	2005	2006	2007
Taxes	407.5	540.6	594.3	691.4	818.0
Transfers received	355.1	333.7	360.9	376.0	396.7
Charges, fines and other operating revenue	106.7	210.9	204.5	241.2	246.9
<b>Operating revenue</b>	<b>869.2</b>	<b>1,085.2</b>	<b>1,159.7</b>	<b>1,308.6</b>	<b>1,461.6</b>
Operating expenditure	-797.0	-985.2	-1,063.3	-1,154.2	-1,223.5
<b>Operating balance</b>	<b>72.2</b>	<b>100.0</b>	<b>96.4</b>	<b>154.4</b>	<b>238.1</b>
Financial revenue	6.4	12.4	11.2	7.3	6.1
Interest paid	-27.7	-21.2	-20.5	-13.0	-11.9
<b>Current balance</b>	<b>50.9</b>	<b>91.2</b>	<b>87.1</b>	<b>148.7</b>	<b>232.3</b>
Capital revenue	101.0	198.1	81.2	133.3	185.7
Capital expenditure	-134.0	-141.5	-135.7	-251.8	-406.6
Capital balance	-33.0	56.6	-54.5	-118.5	-220.9
<b>Surplus (deficit) before debt variation</b>	<b>17.9</b>	<b>147.8</b>	<b>32.6</b>	<b>30.2</b>	<b>11.4</b>
Debt repayments	-70.5	-59.0	-73.4	-76.4	-77.7
New borrowing	65.3	5.6	1.5	1.6	51.0
Net debt movement	-5.1	-53.4	-71.9	-74.8	-26.7
<b>Overall results</b>	<b>12.8</b>	<b>94.4</b>	<b>-39.3</b>	<b>-44.6</b>	<b>-15.3</b>
<b>Debt stock</b>					
Short-term	0.0	0.0	0.0	0.0	0.0
Long-term	515.1	430.1	348.9	271.8	239.6
<b>Direct debt</b>	<b>515.1</b>	<b>430.1</b>	<b>348.9</b>	<b>271.8</b>	<b>239.6</b>
+ Other Fitch classified debt	0.0	0.0	0.0	25.3	33.2
<b>Direct risk</b>	<b>515.1</b>	<b>430.1</b>	<b>348.9</b>	<b>297.1</b>	<b>272.8</b>
- Cash, liquid deposits, sinking fund or pre-financing	37.2	130.4	91.8	72.1	64.2
<b>Net direct risk</b>	<b>391.8</b>	<b>204.2</b>	<b>163.6</b>	<b>167.5</b>	<b>208.6</b>
Guarantees and other contingent liabilities	12.2	3.8	3.5	3.0	2.6
Net indirect risk (public-sector entities exc. gteed amount)	78.4	73.7	78.8	101.6	117.9
<b>Net overall risk</b>	<b>482.4</b>	<b>281.7</b>	<b>245.9</b>	<b>272.1</b>	<b>329.1</b>
<b>Memo</b>					
Debt in foreign currency (%)	41.4	38.9	36.0	33.3	21.8
Issued debt (%)	0.0	0.0	0.0	0.0	0.0
Fixed-interest-rate debt (%)	3.0	3.6	4.5	5.6	6.2

Source: City of Gdansk

**Appendix B**

**City of Gdansk**

	Actual				
	2003	2004	2005	2006	2007
<b>Fiscal performance ratios (%)</b>					
Operating balance/operating revenue	8.30	9.21	8.31	11.80	16.3
Current balance/current revenue <sup>a</sup>	5.81	8.31	7.44	11.30	15.8
Surplus (deficit) before debt variation/total revenue <sup>b</sup>	1.83	11.40	2.60	2.08	0.7
Overall results/total revenue	1.31	7.28	-3.14	-3.08	-0.9
Operating revenue growth (annual change)	1.15	24.85	6.87	12.84	11.69
Operating expenditure growth (annual change)	-3.89	23.61	7.93	8.55	6.00
Current balance growth (annual change)	351.62	79.15	-4.45	70.72	56.22
<b>Debt ratios</b>					
Direct debt growth (annual % change)	4.78	-16.49	-18.88	-22.10	-11.85
Interest paid/operating revenue (%)	3.19	1.96	1.77	0.99	0.18
Operating balance/interest paid (x)	2.6	4.7	4.7	11.8	20.0
Direct debt servicing/current revenue (%)	11.21	7.31	8.02	6.79	6.10
Direct debt servicing/operating balance (%)	136.02	80.20	97.41	57.90	37.63
Direct debt/current revenue (%)	58.82	39.19	29.80	20.66	16.32
Direct risk/current revenue (%)	58.82	39.19	29.80	22.58	18.59
Net overall risk/current revenue (%)	55.09	25.66	21.00	20.68	22.42
Direct debt/current balance (yrs)	10.12	4.72	4.01	1.83	1.0
Direct risk/current balance (yrs)	10.12	4.72	4.01	2.00	1.2
Direct debt/GDP (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Direct debt per capita (PLN)	1,117	937	760	592	526
<b>Revenue ratios</b>					
Operating revenue/budget operating revenue (%)	n.m.	n.m.	n.m.	103.77	108.18
Tax revenue/operating revenue (%)	46.88	49.82	51.25	52.84	56.00
Modifiable tax revenue/total tax revenue (%)	43.80	35.29	32.73	30.66	27.07
Current transfers received/operating revenue (%)	40.85	30.75	31.12	28.73	27.14
Operating revenue/total revenue <sup>a</sup> (%)	89.00	83.75	92.62	90.30	88.40
Total revenue <sup>a</sup> per capita (PLN)	2,119	2,822	2,727	3,157	3,628
<b>Expenditure ratios</b>					
Operating expenditure/budget operating expenditure (%)	n.m.	n.m.	n.m.	96.65	97.37
Staff expenditure/operating expenditure (%)	52.10	44.84	44.06	42.60	42.41
Current transfer made/operating expenditure (%)	14.09	7.84	6.72	7.66	8.63
Capital expenditure/budget capital expenditure (%)	n.m.	n.m.	n.m.	77.43	107.88
Capital expenditure/total expenditure (%)	13.02	11.72	10.50	16.84	23.64
Capital expenditure/local GDP (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Total expenditure per capita (PLN)	2,233	2,629	2,816	3,257	3,774
<b>Capital expenditure financing (%)</b>					
Current balance/capital expenditure	37.97	64.42	64.19	59.05	57.13
Capital revenue/capital expenditure	75.37	140.00	59.84	52.94	45.67
Net debt movement/capital expenditure	-3.82	-37.72	-52.98	-29.71	-6.57

<sup>a</sup> Includes financial revenue

<sup>b</sup> Excluding new borrowing

n.a.: not available

n.m.: not meaningful

Source: City of Gdansk

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