Fitch Revises Polish City of Gdansk's Outlook to Positive; Affirms at 'A-'

Fitch Ratings-Warsaw/London - 18 March 2016: Fitch Ratings has revised the Outlook on the Polish City of Gdansk's Long-term local currency Issuer Default Rating (IDR) and National Long-term rating to Positive from Stable. Fitch has affirmed the local currency IDR at 'A-' and the National Long-term rating at 'AA(pol)'. Simultaneously, Fitch has affirmed the city's Long-term foreign currency IDR at 'A-' with Stable Outlook.

The revision of the Outlook reflects Fitch's view of the city's continued sound operating performance and strong debt service and debt payback ratios in the medium term. The IDRs reflect the city's solid strategic and financial management, which coupled with a strong operating performance supports strong self-financing capacity for the city's investment plans. The IDR also reflects city's moderate level of debt.

KEY RATING DRIVERS
The rating action reflects the following rating drivers and their relative weights:

HIGH
Fitch expects Gdansk to continue to demonstrate solid operating performance in 2016-2018. In our base case scenario, we estimate an operating balance averaging PLN300m per year or 14% of operating revenue, which would comfortably cover projected debt servicing 3x (debt repayment and interest). This will be driven by the city authorities' policy of limiting operating expenditure growth, coupled with growth of tax revenue, and supported by the expected continued expansion of the national economy.

In 2015, according to the city's authorities, the operating balance was high at PLN369m or 16.3% operating revenue (similar to that posted in 2014), which was above our expectations. This result was supported mainly by higher than budgeted corporate and personal income tax revenue and the authorities' effective measures to contain opex growth. For the third consecutive year, the city has posted a budgetary surplus, irrespective of high investment spending (average 27% of total spending).

In 2016, Gdansk does not plan to drawdown any new debt, and also intends to repay PLN29m of high interest bearing debt ahead of schedule like it has done in previous years, therefore the city's direct risk is likely to further decline to about PLN926m at year end (end-2015: PLN1.0bn). Fitch expects city's direct risk to return to a growth path from 2017, but to not exceed 50% of current revenue in the medium term (2015: 45%). In 2016-2018 debt servicing (excluding premature repayments) will be around 30% of the operating balance and the debt payback (debt-to-current balance) is likely to stabilise at three years (2015: 2.9), which will be well below the city's final debt maturity (up to 16 years).

MEDIUM
Gdansk is the capital of the Pomorskie region, in northern Poland, and is the largest and wealthiest city in the region, with a well-developed local economy. Together with Gdynia and Sopot, the city forms a conurbation with about 747,000 inhabitants (source: Central Statistical

Office in Poland). The conurbation's gross regional product per capita was above PLN61,847 in 2013 (the seventh-highest among 66 sub-regions, last available data), and exceeded the national average by 43.8%.

The rating action also reflects the following key rating drivers:

Fitch projects that Gdansk's investment spending in 2016-2017 could total PLN1bn (about 20% of annual total expenditure on average) as the city prepares to roll out investments under the 2014-2020 EU budget. However, over 80% of investment financing may come from the city's current balance and capital revenue, provided Gdansk's administration continues to be successful in obtaining high EU and state grants to fund its investment programme. This should limit the city's recourse to debt in the medium term.

The city's authorities follow a prudent budgetary and financial policy, which guarantees a solid operating performance, despite persistently high pressure on operating expenditure. Much of this pressure arises from under-funded responsibilities that were transferred to local governments by the state in the past and from the dominance of rigid spending items, such as education and social care. Additionally, pressure on the budget comes from growing maintenance costs as investments are completed.

RATING SENSITIVITIES
The ratings could be upgraded if the city sustainably maintains its operating margin around 15%, accompanied by direct risk below 50% of current revenue.

KEY ASSUMPTIONS
Fitch expects the city to continue its efficient operating expenditure growth control and to manage the budget prudently in the medium term.

Fitch assumes that the city will continue to receive EU funds to co-finance its investment programme. Fitch also assumes that the city will continue to comply with all the EU regulations and procedures when implementing investments projects co-financed by the EU. Otherwise, Gdansk could face the penalty of having to return previously received EU grants.

Fitch based its projections on the currently binding legal framework for Polish local governments, especially revenue and expenditure allocation. In addition, Fitch assumes that any new delegated tasks from the central government will be neutral to the city's operating budget.

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Applicable Criteria
International Local and Regional Governments Rating Criteria (pub. 18 May 2015)
TaxSupported Rating Criteria (pub. 14 Aug 2012)

Additional Disclosures
DoddFrank Rating Information Disclosure Form
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