



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

Fitch Ratings-Warsaw/London-10 March 2017: Fitch Ratings has affirmed the Polish City of Gdansk's Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) at 'A-' with Stable Outlook. Fitch has also affirmed the city's National Long-Term Rating at 'AA+(pol)', with Positive Outlook.

The affirmation is based on Fitch's unchanged baseline scenario regarding the city's sound operating performance, as well as strong debt service and debt payback ratios, which Fitch expects to continue over the medium term. The IDRs also reflect the solid strategic and financial management of Gdansk, which supports its strong self-financing capacity for the city's investment plans.

The Positive Outlook on the National Rating reflects Fitch's view that Gdansk will continue to perform better than the majority of 'AA(pol)' category peers in its operating margin and debt ratios over the medium term.

KEY RATING DRIVERS

The 'A-' IDR reflects our expectations that Gdansk will continue to demonstrate solid operating performance in 2017-2018, with an operating balance of around PLN300 million (13%-14% of operating revenue), in line with the 2010-2016 average. This will be underpinned by the city authorities' continued cost control measures and tax revenue increase, supported by the projected growth of the national economy.

In 2016, according to the city's authorities, the operating balance was high at PLN375 million or 14.8% operating revenue (2010-2015: average of PLN290 million), and above our expectations. This result was supported by, among other things, higher-than-budgeted tax revenue, especially from personal income tax, as well as the authorities' continued effective measures to limit opex growth.

The city is currently rolling out new investments under the 2014-2020 EU programme period. This means Gdansk's investments in 2017-2018 could total PLN1 billion or an average 20% of annual total spending. This will be below the 2010-2016 average of 28%. Similar to previous years, Fitch expects the city to finance the majority of its capex from the current balance and non-returnable investment grants available to Polish local and regional governments (LRGs), which should limit Gdansk's recourse to debt.

Gdansk has been reducing its debt since 2014, due to lower debt financing needs, and sound budgetary performance. Fitch expects the city's direct debt to return to a growth path from 2017 following investments, but not exceeding 50% of current revenue over the medium term (end-2016: 36%).

Fitch projects the city's debt service and debt payback ratios to remain healthy in 2017-2018. Debt servicing (excluding early repayments) will be around 30% of the operating balance and debt payback (debt-to-current balance) is likely to stabilise at around three years (2016: 2.5 years), which will be well below the city's final debt maturity (up to 21 years).

The city is to some extent exposed to interest-rate risk, as most of the Gdansk's direct debt (end-2016: 78.5%) had floating rates. However, this risk is largely mitigated by Gdansk's high cash reserves and a prudent budgetary approach, under which the city usually budgets higher amounts for interest payments on debt than the actual amounts paid.

Gdansk's debt structure does not create high pressure on the city's budget, as 90% of the debt outstanding at end-2016 was drawn from international financial institutions, and it has low interest rates and long maturities (15-25 years). This benefits the budget as it limits the city's annual debt-service burden.

Historically, Gdansk has had healthy liquidity. During 2016 cash in the city's accounts exceeded debt servicing almost 2.7x (3.6x when excluding early debt redemption). The city has a long track record of cash balances at year-end exceeding the scheduled annual debt service, which is positive for the ratings. Fitch expects the city's liquidity to be partly absorbed by investments in 2017-2018, but it should remain sound.

Fitch expects the city's tax revenue to continue to grow in 2017-2018, supported by forecast GDP growth of 3% per year. Gdansk is the capital of the Pomorskie region, in northern Poland, and is the largest and wealthiest city in the region, with a well-diversified 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 PLN61,851 in 2014 (the seventh-highest among 66 sub-regions, based on the latest available data), and exceeded the national average by 38.5%.

Fitch assesses the regulatory regime for Polish LRGs as neutral. LRGs' activities and financial statements are closely monitored and reviewed by the central administration. Disclosure in the LRGs' accounts is more than adequate. The main revenue sources such as income tax revenue, transfers and subsidies from the central government are centrally distributed according to a legally defined formula, which limits the central government's scope for discretion.

Local tax rates such as real estate tax, which some LRGs are entitled to collect, are capped by the state. This makes LRGs reliant to some extent on decisions made by the central government and limits their revenue-raising flexibility.

RATING SENSITIVITIES

Gdansk IDRs are currently equalised with those of Poland (A-/Stable). The ratings could be upgraded if the city maintains sound operating performance on a sustained basis, resulting in a debt payback ratio below three years, provided the sovereign is also upgraded.

A negative action on Poland's ratings will be reflected on Gdansk's ratings. Negative rating action could also result from a sustained deterioration of the operating performance or a significant rise in Gdansk's direct debt, leading to the city's debt payback ratio exceeding eight years.

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Additional information is available on www.fitchratings.com

Applicable Criteria

International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016) (<https://www.fitchratings.com/site/re/878660>)

National Scale Ratings Criteria (pub. 07 Mar 2017) (<https://www.fitchratings.com/site/re/895106>)

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