



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

Fitch Ratings - Warsaw - 24 January 2020:

Fitch Ratings has affirmed the Polish City of Gdansk's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'A-'. Fitch has also affirmed the city's National Long-Term Rating at 'AAA(pol)'. The Outlooks are Stable.

The affirmation is based on Fitch's unchanged view 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 Gdansk's solid strategic and financial management, which supports the city's strong self-financing capacity for its investment plans. Fitch assesses Gdansk's Standalone Credit Profile (SCP) at 'a+'.

### Key Rating Drivers

Risk Profile: Midrange

Fitch assesses Gdansk's risk profile as Midrange, which reflects the combination assessment of four factors at Midrange, one at Stronger and one at Weaker.

Revenue Robustness: Midrange

We assess Gdansk's revenue robustness as Midrange in view of the city's stable revenue sources with revenue growth prospects in line with national GDP growth. Tax revenue accounted for almost 50% of Gdansk's operating revenue in 2018, based on moderately cyclical economic activities. Personal income tax and local taxes accounted for over 47% of operating revenue, while corporate income tax, a more volatile revenue item, accounted for 3%. Current transfers accounted for 33% of current revenue in 2018, with the majority made up of transfers from the state budget (A-/Stable). These transfers are not subject to discretionary changes as the majority of them are defined by law. Fitch expects Gdansk to remain attractive to investors and inhabitants, supporting further development of the city's diversified tax base.

Revenue Adjustability: Weaker

We assess Gdansk's ability to generate additional revenue in response to possible 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. Gdansk has limited flexibility on local taxes, which accounted for about 15% of operating revenue on average in 2016-2018 as the rates are constrained by ceilings set in national tax regulation.

Expenditure Sustainability: Midrange

The city has a proven track record of control of operating expenditure. Gdansk's responsibilities mainly include non-cyclical expenditures, such as education, public transport, municipal services,

and administration. We expect the city's capex to remain high in 2019-2022, leading to budgetary deficits up to 10% of total revenue in 2021 and then gradually declining to about 2% by 2023, according to our rating case scenario.

#### Expenditure Adjustability: Stronger

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as Stronger. The city can reduce or postpone a significant part of its capital expenditure and more than 10% of its operating expenditure. In 2018, Gdansk's capex was more than PLN670 million or about 20% of total expenditure and we project in our rating scenario that it will average 17% in 2019-2023.

The city's mandatory responsibilities with the least spending flexibility only account for about 65% of operating expenditure, including education, social care, administration, public safety and family benefits. Additionally, the city spends 22% more than urban counties with the lowest spending per capita, and this could be reduced.

#### Liabilities and Liquidity Robustness: Midrange

Gdansk's debt portfolio is dominated by loans from IFIs (99% at end-2019) that ensure the city has a long-term and smooth repayment schedule, with final debt maturity in 2043. The repayment structure leads to low refinancing risk for the city, with debt repayment not exceeding 7% of the debt stock annually. The majority (89.2%) of the city's debt has floating interest rates, which exposes the city to interest rate risk as Polish cities are not allowed to use derivatives. The city partially mitigates this risk with its prudent budget practice, securing in its budget higher amounts for debt service. All debt is in local currency, so the city is not exposed to foreign exchange risk. Indirect risk is negligible.

#### Liabilities and Liquidity Flexibility: Midrange

Fitch assesses the city's liquidity framework as Midrange due to a lack of emergency liquidity support from upper tiers of government in Poland. Gdansk has a long track record of high liquidity. Liquidity during 2019 (PLN120 million average month-end cash on the city accounts and committed liquidity credit line of up to PLN50 million - provided by Bank Pekao SA; BBB+/Stable) exceeded the annual debt service of PLN109 million by more than 1.5x. Our rating scenario projects a liquidity coverage ratio (operating balance plus unrestricted cash-to-debt service in current year) of 5.4x on average in 2020-2023, similar to the average in 2014-2018.

#### Debt Sustainability: 'aa' category

Like all Polish local and regional governments (LRGs), Gdansk is classified as a type B LRG by Fitch as it covers debt service from its cash flow on an annual basis under our rating criteria for International LRGs.

Under its rating case for 2019-2023, Fitch projects the city's payback ratio (net adjusted debt-to-operating balance), which is the primary metric of the debt sustainability assessment for Type B LRGs, will grow to about 5.0x, up from about 3.1x expected at end-2019, in line with a 'aa' assessment. For the secondary metrics, Fitch's rating case projects that the fiscal debt burden will increase following investments during the forecast period, to just below 50% in 2023 from about 24.9% expected at end-2019. A strong payback ratio and fiscal debt burden ratio, coupled with sound synthetic debt service coverage ratio of just above 2x (end-2019: 4.2- expected), underpin the city's debt sustainability assessment at 'aa'.

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 almost 749,000 inhabitants (source: Central Statistical Office in Poland). The conurbation's gross regional product per capita was above PLN75,200 in 2017 (the sixth-highest among 73 sub-regions, based on the latest available data), and exceeded the national average by 45.3%. Unlike the majority of Polish cities, Gdansk's population has been growing (468,158 at the end of June 2019), due to positive net migration and a positive birth rate (6.4 and 0.1 per 1000, respectively, in June 2019).

## Derivation Summary

Fitch assesses Gdansk's SCP at 'a+', which results from a Midrange assessment of the city's risk profile and 'aa' assessment of debt sustainability, stemming from a payback ratio at the upper end of the 'aa' category and moderate debt level corresponding with the 'aaa' category. Gdansk's SCP assessment factors in the city's favourable comparison with national and international peers in the same rating category. The city's IDRs are not affected by any other rating factors, but are constrained by the sovereign's IDR.

## Key Assumptions

Qualitative Assumptions and assessments:

Risk Profile: Midrange

Revenue Robustness: Midrange

Revenue Adjustability: Weaker

Expenditure Sustainability: Midrange

Expenditure Adjustability: Stronger

Liabilities and Liquidity Robustness: Midrange

Liabilities and Liquidity Flexibility: Midrange

Debt sustainability: 'aa' category

Support: N/A

Asymmetric Risk: 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 2014-2018 figures and 2019-2023 projected ratios. The key assumptions for the rate case include:

- Operating revenue CAGR of 2.6%
- Operating expenditure CAGR of 3.3%

- Capital revenue and capital expenditure based on management's objectives set in the long-term projections and revised down in line with the historical pattern of investment implementation. We assume total capex of over PLN3.0 billion.
- Average cost of debt rising to 3.0% by 2023 from 2.0% in 2019.

## RATING SENSITIVITIES

As Gdansk's IDRs are currently constrained by the Polish sovereign ratings, a change in the sovereign IDRs will be mirrored on the city's IDRs.

The city's IDR would be also downgraded if the SCP is revised down by three notches, which could occur if the city's debt metrics sustainably weaken with a debt payback ratio exceeding 9x under Fitch's rating case. However, this scenario is extremely remote.

## ESG Considerations

### ESG CONSIDERATIONS

ESG credit relevant is a score of 3, meaning that ESG issues are credit-neutral. Given the mission of the issuer and the institutional framework, these issues are minimally relevant to the rating.

### COMMITTEE MINUTE SUMMARY

Committee date: 22 January 2020

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.

### RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Gdansk, City of	LT IDR A- ● Affirmed	A- ●
	LC LT IDR A- ● Affirmed	A- ●
	Natl LT AAA(pol) ● Affirmed	AAA(pol) ●

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## **Applicable Criteria**

National Scale Ratings Criteria (pub. 18 Jul 2018)  
Rating Criteria for International Local and Regional Governments (pub. 13 Sep 2019)

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