

Fitch Rates Polish City of Olsztyn 'BBB'; Outlook Stable

Fitch Ratings - Warsaw - 22 November 2019:

Fitch Ratings has assigned the Polish City of Olsztyn's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'BBB'. The Outlooks are Stable.

The ratings reflect Fitch's view that Olsztyn's operating performance and debt ratios will remain in line with 'BBB'-rated peers over the medium term. Fitch assesses Olsztyn's standalone credit profile (SCP) at 'bbb'.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

Olsztyn's 'Midrange' risk profile reflects five 'Midrange' key factors and a 'Weaker' key factor, with a lower weighting of the latter in the overall assessment.

Revenue Robustness: 'Midrange'

We assess Olsztyn's revenue robustness as 'Midrange' due to stable revenue sources with revenue growth prospects being in line with national GDP growth. Tax revenue accounted for almost 40% of Olsztyn's operating revenue in 2018, based on moderately cyclical economic activities. Personal income tax accounted for 26% of operating revenue, local taxes for 13% while the more volatile corporate income tax (CIT) at only below 2%. Current transfers accounted for almost 44% of operating revenue in 2018, with the majority being transfers from the state budget (A-/Stable). These transfers are not subject to discretionary changes as the majority of them are defined by law. Olsztyn's tax base is diversified with no concentration risks.

Revenue Adjustability: 'Weaker'

We assess Olsztyn's ability to generate additional revenue in response to possible economic downturns as 'Weaker', in line with most Polish cities, but this is partially mitigated by the city's proven track record of revenue growth, even in times of slower GDP growth.

Income tax rates are set by the central government, as are the majority of current transfers. Olsztyn has little flexibility on local taxes (13% of operating revenue) as the city's ability to determine rates on local taxes is constrained by legal ceilings set in national tax regulations. The city can potentially increase its revenue with intensive asset sales (on average PLN36 million of proceeds in 2014-2018, ie. about 3% of total revenue), but this source of revenue may prove not sustainable in an economic downturn.

Expenditure Sustainability: 'Midrange'

Fitch assesses the expenditure sustainability of the city as 'Midrange', in line with most 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 mandated by and financed from the central budget.

Olsztyn has a track record of moderate control of operating expenditure growth. Olsztyn's operating spending growth has generally been in line with that of operating revenue, yielding an average operating margin of 5% in 2014-2018 (excluding one-off revenues, such as VAT refunds). We expect the city's capex to remain high in 2019-2023 (average 14% of total spending), leading to budget deficits on average of up to 5% of total revenue under our rating case.

Expenditure Adjustability: 'Midrange'

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as 'Midrange'. It has influence over at least 10% of current spending, while the remainder is inflexible. Olsztyn's inflexible costs result from mandatory responsibilities in education, family benefits, social care, administration and public safety, which together accounted for about 75% of operating expenditure in 2018. The city has higher spending flexibility in respect to other sectors, including public transport, culture, sport, healthcare, and housing. Capex is, to some extent, flexible as investments tend to be implemented in phases, and can be reduced or postponed in case of need. In 2018 capex was at a high 22% of total spending, significantly above the average of other rated Polish cities.

Liabilities and Liquidity Robustness: 'Midrange'

Fitch assesses the national framework regulations for Polish local and regional governments' (LRGs) liabilities and liquidity as 'Midrange'.

At end-1H19 the city's loan portfolio was dominated by bonds at 92% (with final maturity up to 2032) and the remainder being loans from local banks. However, the maturity profile is smooth with average principal repayments not exceeding 12% of outstanding debt. The city's debt is in Polish zloty with floating interest rates, which exposes the city to interest-rate risk. The city partially mitigates this risk by prudently setting aside more funding than necessary for debt service.

Liabilities and Liquidity Flexibility: 'Midrange'

Fitch assesses the city's liquidity framework as 'Midrange' given the lack of emergency liquidity support from upper tiers of government, but Olsztyn has liquidity available under its committed liquidity line (with a limit of PLN50 million).

The city has a history of sound liquidity, with a liquidity coverage ratio averaging 2.1x in 2010-2018. Cash and liquid deposits in 2018-2019 are on average above PLN70 million.

Debt sustainability: 'a' category

Under our new criteria introduced in April 2019 (Rating Criteria for International Local and Regional Governments) Fitch classifies the City of Olsztyn - as with other Polish LRGs - as type B as it covers debt service from its cash flow on an annual basis.

Under its rating case for 2019-2023, Fitch projects the city's debt payback ratio (adjusted net debt-to-operating balance), which is the primary metric of debt sustainability assessment for Type B LRGs, will grow, to just below 11x, up from about 5x in 2018, in line with an 'a' assessment. For the secondary metrics, Fitch's rating case projects that the fiscal debt burden will increase following investments during the forecast period, to around 35% in 2023 from about 22% in 2018, which, however, is still in line with an 'aaa' assessment. This 'aaa' fiscal debt burden, together with our 'bb' assessment of the city's synthetic debt service coverage ratio (SDSCR; about 1x in 2018), results in a debt sustainability assessment of 'a'.

Olsztyn is a medium-sized city with over 172,000 inhabitants and is the capital of Warminsko-Mazurskie Region in northeast Poland. The region is among the bottom five Polish regions by wealth indicators, and is eligible for additional EU grants for regional development (Operational Programme Eastern Poland 2014-2020). However, Olsztyn is a major business, cultural and educational centre in the region. In Fitch's opinion the city's wealth indicators are likely to be above or at least at the national average. The city's economy is diversified, with services playing an important role. This sector contributed about 62.2% of the sub-region's gross value added in 2016, above the regional average. The unemployment rate in the city (2018: 3.4%) is lower than the national average (5.8%).

RATING ACTION COMMENTARY

RATING DERIVATION

Fitch assesses Olsztyn's SCP at 'bbb', which results from a 'Midrange' risk profile and an 'a' assessment of debt sustainability. Olsztyn's SCP assessment also factors in peer comparison. There is no other rating factor affecting the city's IDRs.

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: Midrange

Liabilities and Liquidity Flexibility: Midrange

Debt sustainability: 'a' 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 3.1% over the next five years;
- Operating expenditure CAGR of 3.4% over the next five years;
- Capital revenue and capex based on the city administration's long-term projections and in line with past trend of investments
- Interest rates paid on debt higher than in base case by 0.25pp annually from 2021

Quantitative assumptions – sovereign related

- Figures as per Fitch's sovereign actual for 2018 and forecast for 2021, respectively:
- GDP per capita (US dollar, market exchange rate): 15,541 and 16,834
- Real GDP growth: 5.2% and 2.9%
- Consumer prices (annual average change): 1.2% and 2.5%
- General government balance (of GDP) : -0.4% and -1.9%
- General government debt (of GDP) : 48.5% and 47.1%
- Current account balance plus net foreign direct investments (of GDP) : 1.4% and 0.6%
- Net external debt (of GDP): 23.4% and 22.9%
- IMF development classification: emerging market
- CDS market-implied rating: N/A

RATING SENSITIVITIES

The ratings could be upgraded if Olsztyn maintains its debt payback ratio below 10x on a sustained basis under Fitch's rating case.

The ratings could be downgraded if Olsztyn's debt payback ratio deteriorates above 12x on a sustained basis under Fitch's rating case.

ESG CONSIDERATIONS

RATING ACTION COMMENTARY

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: 20 November 2019

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.

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

[Rating Criteria for International Local and Regional Governments \(pub. 13 Sep 2019\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

COPYRIGHT

Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports,

RATING ACTION COMMENTARY

engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

RATING ACTION COMMENTARY

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.