

City of Kielce

Key Rating Drivers

Ratings Affirmed: Fitch Ratings has affirmed the Polish City of Kielce's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'BBB'. The Outlooks are Negative.

Negative Outlook: The Negative Outlook reflects uncertainty about the ability of the city's authorities to successfully implement their cost-rationalisation and cost-saving measures and improve the city's operating results. This follows significant deterioration in operating performance in 2018, when the city's operating balance and debt payback ratio fell below Fitch's expectations.

Fitch views the city's planned rise of local taxes and fees for its services as an important factor facilitating the improvement of the city's operating results, especially in view of the lower PIT revenue growth following the state government decision to cut PIT rates.

Rating Derivation Summary: Fitch assesses Kielce's standalone credit profile (SCP) at 'bbb' which reflects a 'Midrange' risk profile, or a low risk of shrinking operating cash flow and/or debt-servicing requirement exceeding our expectations, and a 'a' debt sustainability assessment. The city's final IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state.

'Midrange' Risk Profile: Fitch assesses the city's risk profile as in line with most Fitch-rated Polish cities. Kielce's risk factor assessment reflects the combination of five key factors at 'Midrange', and one key factor at 'Weaker'.

Debt Sustainability at 'a': Fitch projects the city's debt payback ratio (net adjusted debt to operating balance), to improve to about 10.1x in 2023 under its rating case for 2019-2023 from 16.8x in 2018, more in line with a 'a' assessment than a 'bbb' assessment when based solely on 2018 results. The city's fiscal debt burden will remain strong during the forecast period, at no more than 80% (69% in 2018). The strong fiscal debt burden ratio counterbalances the city's weak synthetic and actual debt service coverage ratios of 1.1x and 0.9x, respectively. All these metrics result in a 'a' debt sustainability assessment.

Credit Neutral ESG Considerations: The highest level of ESG credit relevance is a score of '3', meaning that ESG issues are credit neutral or have only a minimal credit impact on the city.

Rating Sensitivities

Weaker Payback: A failure to strengthen the debt payback ratio below 13 years and a debt service coverage ratio above 1x on a sustained basis according to Fitch's rating case will lead to a downgrade.

Ratings

Foreign Currency
Long-Term IDR BBB

Local Currency
Long-Term IDR BBB

National rating A+(pol)

Outlooks

Long-Term Foreign-Currency IDR Negative
Long-Term Local-Currency IDR Negative
National Long-Term Negative

Financial Data

City of Kielce		
(PLNm)	2018	2023rc
Payback (x)	16.8	10.0
Synthetic coverage (x)	0.7	1.1
Actual coverage (x)	0.9	0.9
Fiscal debt burden (%)	69.0	71.2
Net adjusted debt	815	1,022
Operating balance	49	102
Operating revenue	1,182	1,435
Debt service	55	116
Mortgage-style debt annuity ^a	66	92

rc: Fitch's rating-case scenario

^a Fitch's calculation (see Appendix C)

Source: Fitch Ratings, City of Kielce

Applicable Criteria

[Rating Criteria for International Local and Regional Governments \(September 2019\)](#)

[National Scale Ratings Criteria \(July 2018\)](#)

Related Research

[What Investors Want to Know: Polish Subnationals' Debt Regulations \(July 2019\)](#)

[Polish LRGs: 2018 Dashboard \(September 2018\)](#)

[Institutional Framework for Polish Subnationals \(March 2014\)](#)

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Rating Synopsis

SCP Positioning Table

Risk profile	Debt sustainability					
Stronger	aaa or aa	a	bbb	bb	b	
High midrange	aaa	aa	a	bbb	bb	b
Midrange		aaa	aa	a	bbb	bb or below
Low midrange			aaa	aa	a	bbb or below
Weaker				aaa	aa	a or below
Vulnerable					aaa	aa or below
Suggested analytical outcome (SCP)	aaa	aa	a	bbb	bb	b

Source: Fitch Ratings

Issuer Profile

Kielce is a medium-sized city in Poland with around 200,000 inhabitants. It is the capital of Swietokrzyskie region. Kielce's economy is diversified but is weaker those of other cities that are also capitals of their respective regions. GDP per capita in 2016 (latest available data) for the Kielecki sub-region, which includes Kielce and surrounding villages, was 78.2% of the national average. We estimate that the city's wealth indicators are on a par with the national average, as Kielce is the strongest area in the sub-region.

Kielce's economy is diversified, with services playing an important role, as reflected in the city's gross value added. In 2016 services accounted for 62.7% of the gross value added in the sub-region, followed by industry at 26.1% and construction 9.1%. The city's main industrial sectors are construction, printing, pharmaceuticals, metallurgy and machinery. The number of companies in Kielce has held stable in recent years, at around 28,000.

Kielce has around 200,000 inhabitants. The city's population is ageing, with a growing number of people of retirement age (25.7% in 2018, compared with a national average of 21.4%), which may lead to higher social and health care spending for the city in the long term. The demographic trend in the city is for a natural decline (2018: falling by 1.66 per 1,000 inhabitants compared with a national average of -0.68) and a negative migration rate (2018: -3.1 per 1,000 inhabitants).

National economic growth should continue to support the development of Kielce's economy. The city's economy should also benefit from the improving local infrastructure, which may stimulate business activity within Kielce and support tax revenue growth.

Kielce is the capital of the Swietokrzyskie Region, which is one of the five poorest regions in Poland. The region accounts for about 3.7% of the national territory and 3.2% of the population, but produces only 2.3% of national GDP; it qualifies for extra EU grants for regional development from the Operational Programme Eastern Poland 2014-2020, through which also the city of Kielce may acquire extra EU grants.

Risk Profile: Midrange

Fitch assesses the city's risk profile as 'Midrange' in line with most Fitch-rated Polish cities. Kielce's risk factor assessment reflects the combination assessment of five factors at 'Midrange' and one factor as 'Weaker'.

City of Kielce – Risk Profile Assessment

Risk profile	Revenue robustness	Revenue adjustability	Expenditure sustainability	Expenditure adjustability	Liabilities & liquidity robustness	Liabilities & liquidity flexibility
Midrange	Midrange	Weaker	Midrange	Midrange	Midrange	Midrange

Source: Fitch Ratings

Rating History

Date	Long-Term Foreign-Currency IDR	Long-Term Local-Currency IDR
15 April 2016	BBB	BBB
10 January 2007	BBB-	BBB-

Source: Fitch Ratings

City of Kielce



Source: Fitch Ratings

Socioeconomic Indicators

	Kielce	Poland
Population, 2018 (m)	0.196	38.4
Average Salary, 2018 (PLN)	4,493	4,835
Unemployment rate, 2018 (%)	5.4	5.8

Source: Fitch Ratings, Statistical Office Poland

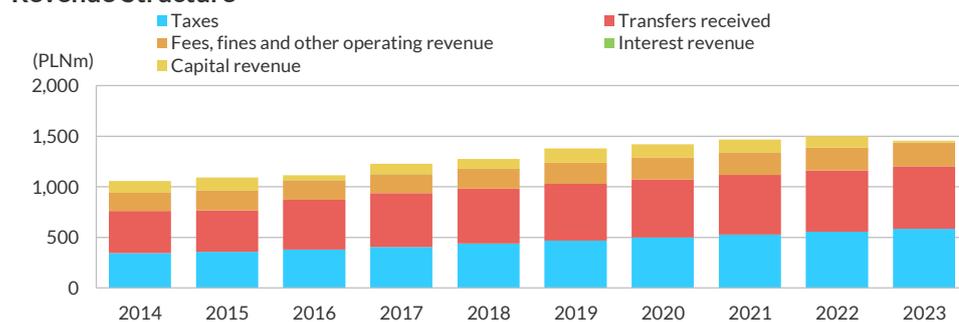
Revenue Robustness: Midrange

Kielce has a track record of operating revenue growth outpacing nominal national GDP growth, but our assessment is constrained by its low wealth indicators by international standards with a per capita GDP about 30% below the EU level. The city's revenue sources are stable as current transfers account for 46% of operating revenue, with most from the state budget (A-/Stable) as defined by law. Tax revenue accounts for 37% of Kielce's operating revenue, most of which is not particularly dependent on economic cycles, while corporate income tax, a more volatile revenue item, accounts for only 1.5% of tax revenue.

Revenue Adjustability: Weaker

We assess Kielce's ability to generate additional revenue in response to economic downturns as limited, in line with most Polish cities. Income tax rates and most current transfers are set by the central government. Kielce has little flexibility on local taxes (13% of operating revenue), which are constrained by the ceilings set in national tax regulation.

Revenue Structure



Source: Fitch Ratings, City of Kielce

Revenue Breakdown, Last Actual Year

	Operating revenue (%)	Total revenue (%)
Taxes	37	
-PIT	24	
-CIT	1	
-Property tax	9	
Transfers received	46	
-Educational subsidy	23	
Other operating revenue	17	
Operating revenue		93
Financial revenue		0
Capital revenue		7

Source: Fitch Ratings, City of Kielce

Expenditure Sustainability: Midrange

The city's expenditure sustainability is underpinned by non-cyclical responsibilities such as education, public transport, municipal services, and administration.

Kielce had had a track record of moderate control of operating expenditure growth until the last two years, ahead of the local elections held in November 2018, when the operating spending increase outpaced operating revenue growth. This led to a weak operating balance of PLN49 million, ie 4.1% of operating revenue (on average PLN70 million or 7.3% in 2014-2016). The coming months will test the city authorities' ability to successfully implement the city's cost-rationalisation and cost-saving measures and therefore to improve operating results.

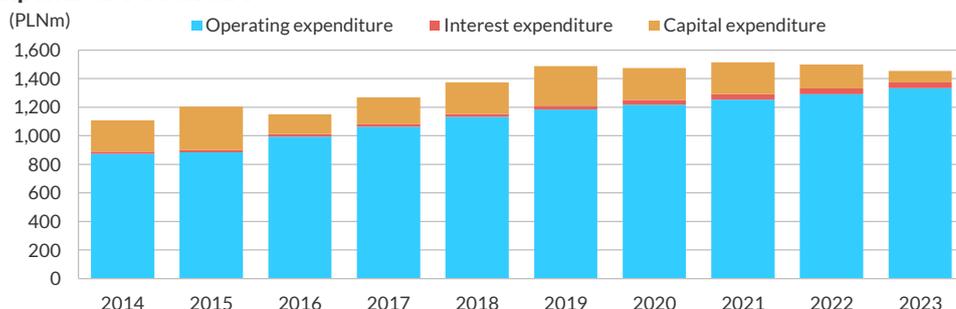
We expect the city's capex to remain high in 2019-2022, averaging PLN220 million annually, i.e. 15% of total expenditure, driven by EU co-financed investments. This will lead to average budget deficits of 4% of total revenue until 2022 before improving to a balanced budget.

Expenditure Adjustability: Midrange

Kielce's ability to reduce spending in response to shrinking revenue is primarily based on capex (on average 18% of total in 2014-2018), which could be significantly reduced, and on operating expenditure, 10% of which is discretionary. The city's planned PLN950 million capex over the next five years consists of a large number of small and medium-sized projects, many of which could be scaled down, postponed or abandoned if needed.

Mandatory responsibilities account for 73% of operating spending, including education, social care, administration, public safety and family benefits. The city has higher spending flexibility in other sectors, including public transport, culture, sport, healthcare and housing economy.

Expenditure Structure



Source: Fitch Ratings, City of Kielce

Liabilities and Liquidity Robustness: Midrange

Debt service limits mandate Polish local and regional governments (LRGs) to match debt servicing requirements with operating balance and require borrowing with a linear amortising repayment structure. Kielce's debt is fully zloty denominated, with 11% from the European Investment Bank (AAA/Stable, undrawn PLN160 million still available for capex financing). Following a successful extension of debt maturities coming due in the next six years, debt repayments over the next three years are modest (PLN36 million in 2019 and about PLN20 million each in 2020 and 2021). The figure will gradually rise to about PLN100 million annually in 2024-2026, but the projected operating balance should be sufficient to cover this high debt service in those years.

The city is exposed to interest rate risk as Polish cities are not allowed to use derivatives while most of the debt is in floating rates. However, this is mitigated by a developed national financial market and the city's prudent budget practice, including budgeting for higher-than-necessary debt service amounts.

Expenditure Breakdown, 2018

	Opex (%)	Total expenditure (%)
Education	35	
Social care	14	
Family	16	
Public administration	6	
Housing	2	
Transport	9	
Communal services	5	
Other	13	
Operating expenditure		83
Financial charges		1
Capital expenditure		16

Source: Fitch Ratings, City of Kielce

Debt Analysis

	End-2018
Fixed rate (% of direct debt)	0.6
FX debt (%)	0.0
Loans from IFIs (%)	10.7
Apparent cost of debt (%)	2.5
Final debt maturity (year)	2045
Debt service (2018, PLNm)	55.0
Operating balance (2018, PLNm)	49.0

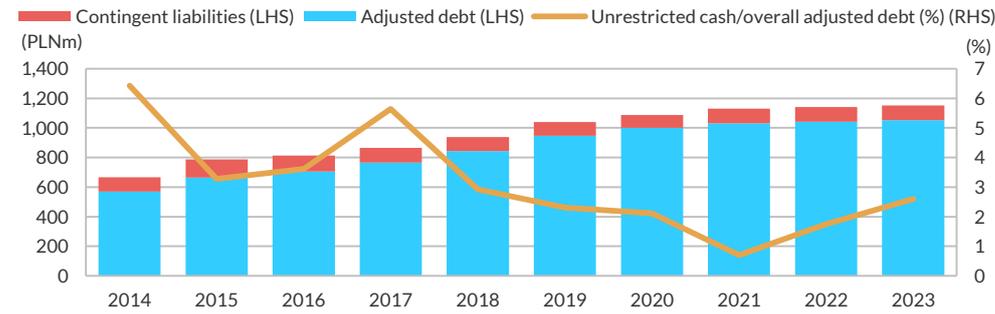
Source: Fitch Ratings, City of Kielce

Liquidity

(PLNm)	End-2018
Available cash	27
Unrestricted cash	27
Undrawn committed credit lines	210

Source: Fitch Ratings, City of Kielce

Overall Adjusted Debt Structure



Source: Fitch Ratings, City of Kielce

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 and liquidity available under a committed liquidity line (with a limit of PLN50 million) provided by ING Bank. Kielce frequently uses this liquidity to manage its liquidity during the year and to avoid drawing down more costly long-term debt closer to year-end. This policy results in low levels of cash at year-end (averaging PLN30 million annually in 2014-2018).

Our rating scenario projects a liquidity coverage ratio (operating balance plus unrestricted cash to debt service in current year) of 1.5x on average in 2019-2023, in line with that in 2015-2018, due to low debt repayments over the next three years.

Debt Sustainability of 'a'

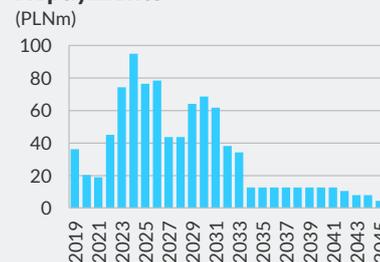
Debt Sustainability

	Primary Metric	Secondary Metrics	
	Payback (x)	Coverage (x)	Fiscal debt burden (%)
aaa	$X \leq 5$	$X \geq 4$	$X \leq 50$
aa	$5 < X \leq 9$	$2 \leq X < 4$	$50 < X \leq 100$
a	$9 < X \leq 13$	$1.5 \leq X < 2$	$100 < X \leq 150$
bbb	$13 < X \leq 18$	$1.2 \leq X < 1.5$	$150 < X \leq 200$
bb	$18 < X \leq 25$	$1 \leq X < 1.2$	$200 < X \leq 250$
b	$X > 25$	$X < 1$	$X > 250$

Source: Fitch Ratings

Fitch projects the city's debt payback ratio (net adjusted debt to operating balance), to improve to about 10.1x in 2023 under its rating case for 2019-2023 from 16.8x in 2018, therefore more in line with a 'a' assessment rather than the 'bbb' assessment that would result when based solely on 2018 results. The city's fiscal debt burden will remain strong during the forecast period, at no more than 80% (69% in 2018). The strong fiscal debt burden ratio counterbalances the city's weak synthetic and actual debt service coverage ratios of 1.1x and 0.9x, respectively. All these metrics result in a 'a' debt sustainability assessment.

Debt Amortisation Schedule 2019-2045 – Capital Repayments

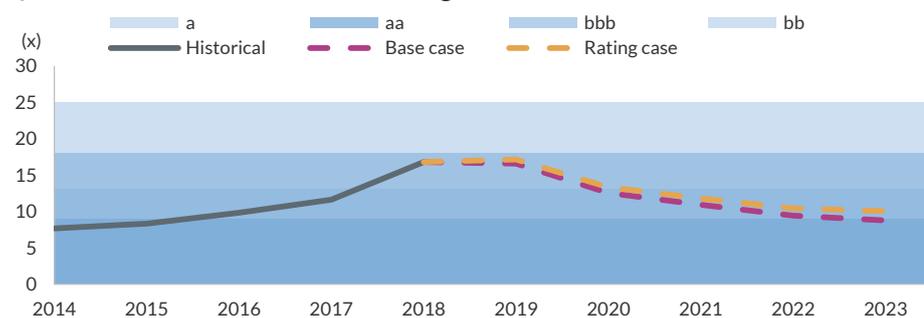


Source: Fitch Ratings, City of Kielce

Debt Sustainability Ratios:

- **Payback:** net adjusted debt/Operating balance (x)
- **Fiscal debt burden:** net adjusted debt/operating revenue (%)
- **Synthetic DSCR:** operating balance/mortgage style debt annuity; Fitch's synthetic calculation (x; see Appendix C)

Payback Ratio - Fitch's Base and Rating Case Scenarios



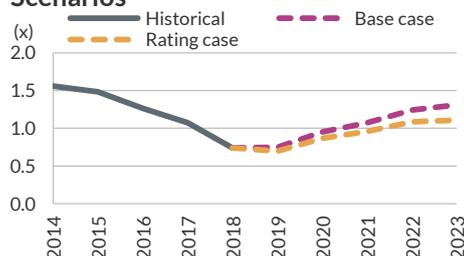
Source: Fitch Ratings, City of Kielce

Debt Sustainability Ratios - Fitch's Rating Case Scenario

	2018	2023rc
Payback (x)	16.8	10.0
Synthetic coverage (x)	0.7	1.1
Actual coverage (x)	0.9	0.9
Fiscal debt burden (%)	69.0	71.2

rc: Fitch's rating case
Source: Fitch Ratings, City of Kielce

Synthetic Debt Service Coverage Ratio - Fitch's Base and Rating Case Scenarios



Source: Fitch Ratings

Fiscal Debt Burden - Fitch's Base and Rating Case Scenarios



Source: Fitch Ratings

Fitch's base and rating case scenario end in 2023 and have the assumptions shown in the table below.

Fitch's Rating-Case Scenario:

The rating case is a through-the-cycle scenario that incorporates a combination of revenue, cost or financial risk stresses.

Fitch's Base and Rating Cases Main Assumptions

	2014-2018	2019-2023	
		Base case	Rating case
National nominal GDP average growth (Fitch's assumptions)	5.4	5.6	5.5
Operating revenue growth (CAGR; %)	5.8	4.0	4.0
Incl. tax revenue	6.2	6.0	5.9
Incl. transfers received	6.9	2.5	2.5
Incl. non-tax revenue	2.5	3.3	3.3
Operating expenditure growth (CAGR; %)	6.7	3.2	3.3
Net capital expenditure (average per year; PLNm)	116	88	88
Cost of new debt (average; %)	2.6	3.1	3.6

^a Base case is based on Fitch's sovereign assumptions. Rating case is a stressed assumption used for 2023 rating case scenario
Source: Fitch Ratings

In the rating case Fitch assumes lower tax revenue growth than in base case, reflecting lower GDP growth assumptions and the potential negative impact of state-implemented personal income tax relief for young employees and lower personal income tax rates. We also assume higher operating expenditure growth in the rating case than in the base case, taking into account potential extra pressure in the education sector following the reform and salary increases decided by the state government.

The base case and rating case assumptions for capital expenditure and the share in which they are capital revenue financed are the same, but the new debt financing needs result in higher debt in both the base and rating cases than in the last five historical years. Fitch's base and rating cases envisage higher costs for debt due to interest rate increases that the agency expects, but the increase is higher in the rating case.

Other Rating Factors

Kielce's final IDR is driven by the city's SCP. No other factor affects the final rating.

From SCP to IDR: Factors Beyond the SCP

SCP	Cap Sovereign rating	Support Rating cap	Asymmetric risks	IDR
bbb	A-	A-	-	BBB

Source: Fitch Ratings

Peer Analysis

Kielce has the same risk profile ('Midrange') as other Polish cities. Fitch's projection of the city's debt payback ratio (net adjusted debt-to-operating balance), improving to about 10.1x in 2023 from 16.8x in 2018, which justifies a 'bbb' SCP, which is comparable with City of Bialystok (11x and 'bbb') and City of Torun (11x and 'bbb'). Kielce's synthetic and actual debt-service coverage ratios are low (about 1x), but this is counterbalanced by a low fiscal debt burden of 71%, which is comparable with other Polish peers.

Kielce's international peers are Italian LRGs with a 'Midrange' risk profile and payback ratios of 10x (Region of Sicily has an SCP of 'bbb') or with a payback ratio of 8.8x (Metropolitan City of Milan with an SCP of 'bbb+'). International peers also include the Romanian City of Bucharest, which has a 'Low Midrange' risk profile and payback ratio of 5.7x, resulting in an SCP of 'bbb+'.

Polish Cities

Polish Cities	Risk profile	Primary metric (x) SCP	IDR	Outlook
Rzeszow	Midrange	9.4 bbb+	BBB+	Sta
Czestochowa	Midrange	9.5 bbb+	BBB+	Sta
Bialystok	Midrange	11.0 bbb	BBB	Sta
Kielce	Midrange	10.1 bbb	BBB	Neg
Torun	Midrange	11.0 bbb	BBB	Sta
Opole	Midrange	11.0 bbb-	BBB-	Sta

Source: Fitch Ratings

International Peers

	Risk profile	Primary metric (x)	SCP	IDR	Outlook
City of Busto Arsizio	Midrange	4.3	a+	BBB	Neg
Metropolitan City of Milan	Midrange	8.8	bbb+	BBB	Neg
Region of Sicily	Midrange	10.4	bbb	BBB	Neg
City of Bucharest	Low midrange	5.7	bbb+	BBB-	Sta

Source: Fitch Ratings

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3' – ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit <https://www.fitchratings.com/site/esg>.

Appendix A

City of Kielce

(PLNm)	2015	2016	2017	2018	2019rc	2023rc
Taxes	358	381	406	439	469	584
Transfers received	409	490	532	544	561	617
Fees, fines and other operating revenues	195	192	186	199	208	234
Operating revenue	962	1,063	1,124	1,182	1,238	1,435
Operating expenditure	-885	-995	-1,062	-1,133	-1,184	-1,333
Operating balance	77	69	62	49	54	102
Interest revenue	1	0	0	0	0	0
Interest expenditure	-16	-17	-18	-20	-27	-42
Current balance	62	52	44	29	27	60
Capital revenue	129	50	102	93	142	20
Capital expenditure	-304	-139	-188	-221	-277	-80
Capital balance	-175	-88	-86	-128	-135	-60
Total revenue	1,091	1,114	1,227	1,275	1,380	1,455
Total expenditure	-1,204	-1,150	-1,269	-1,374	-1,488	-1,455
Surplus (deficit) before net financing	-113	-36	-42	-98	-108	0
New direct debt borrowing	132	107	118	112	140	84
Direct debt repayment	-35	-68	-57	-35	-36	-74
Net direct debt movement	96	40	61	77	104	10
Overall results	-17	4	19	-22	-4	10
Debt						
Short-term debt	0	0	0	0	0	0
Long-term debt	665	705	765	843	947	1,052
Direct debt	665	705	765	843	947	1,052
+ Other Fitch-classified debt	0	0	0	0	0	0
Adjusted debt	665	705	765	843	947	1,052
Guarantees issued (excl. adj. debt portion)	0	0	0	0	0	0
Majority-owned GRE debt	122	108	100	96	93	100
Overall adjusted debt	787	813	865	939	1,040	1,152
Total cash and liquid deposits	26	29	49	27	24	30
Restricted cash	0	0	0	0	0	0
Unrestricted cash	26	29	49	27	24	30
Net adjusted debt	639	675	717	815	923	1,022
Net overall debt	761	784	816	912	1,016	1,122

rc: Fitch's rating case, based on conservative assumptions. 2023 is the last year of the rating case scenario
Source: Fitch Ratings, City of Kielce

Appendix B

City of Kielce

	2015	2016	2017	2018	2019rc	2023rc
Fiscal performance ratios						
Operating balance/operating revenue (%)	8.0	6.5	5.5	4.1	4.4	7.1
Current balance/current revenue (%)	6.4	4.9	3.9	2.5	2.2	4.2
Operating revenue growth (annual % change)	2.1	10.6	5.7	5.1	4.8	3.2
Operating expenditure growth (annual % change)	1.4	12.4	6.8	6.6	4.5	3.2
Surplus (deficit) before net financing/total revenue (%)	-10.4	-3.3	-3.4	-7.7	-7.8	0.0
Total revenue growth (annual % change)	3.3	2.1	10.1	4.0	8.2	-3.0
Total expenditure growth (annual % change)	8.6	-4.5	10.3	8.3	8.3	-2.9
Debt ratios						
Primary metrics						
Payback ratio (x)	8.3	9.8	11.6	16.8	17.1	10.0
Enhanced payback ratio (x)	8.3	9.8	11.6	16.8	17.1	10.0
Overall payback ratio (x)	9.9	11.4	13.2	18.8	18.8	11.0
Enhanced overall payback ratio (x)	9.9	11.4	13.2	18.8	18.8	11.0
Secondary metrics						
Fiscal debt burden (%)	66.5	63.5	63.7	69.0	74.6	71.2
Synthetic debt service coverage ratio (x)	1.5	1.3	1.1	0.7	0.7	1.1
Actual debt service coverage ratio (x)	1.5	0.8	0.8	0.9	0.9	0.9
Other debt ratios						
Liquidity coverage ratio (x)	2.3	1.1	1.2	1.8	1.3	1.1
Direct debt maturing in one year/total direct debt (%)	0.0	2.9	4.5	4.3	0.0	0.0
Direct debt (annual % change)	16.8	5.9	8.6	10.1	12.4	1.1
Apparent cost of direct debt (interest paid/direct debt) (%)	2.5	2.5	2.4	2.5	3.0	4.0
Revenue ratios						
Tax revenue/total revenue (%)	32.8	34.2	33.1	34.4	34.0	40.1
Current transfers received/total revenue (%)	37.5	44.0	43.4	42.7	40.7	42.4
Interest revenue/total revenue (%)	0.0	0.0	0.0	0.0	0.0	0.0
Capital revenue/total revenue (%)	11.8	4.5	8.3	7.3	10.3	1.4
GDP deflated total revenue growth (annual % change)	2.5	1.9	8.2	1.1	7.0	n.a.
Expenditure ratios						
Staff expenditure/total expenditure (%)	33.9	37.3	33.7	34.4	0.0	0.0
Current transfers made/total expenditure (%)	6.5	7.3	7.3	8.3	0.0	0.0
Interest expenditure/total expenditure (%)	1.3	1.5	1.4	1.4	1.8	2.9
Capital expenditure/total expenditure (%)	25.2	12.1	14.8	16.1	18.6	5.5

rc: Fitch's rating case, based on conservative assumptions. 2023 is the last year of the rating case scenario

n.a. - not available

Source: Fitch Ratings, City of Kielce

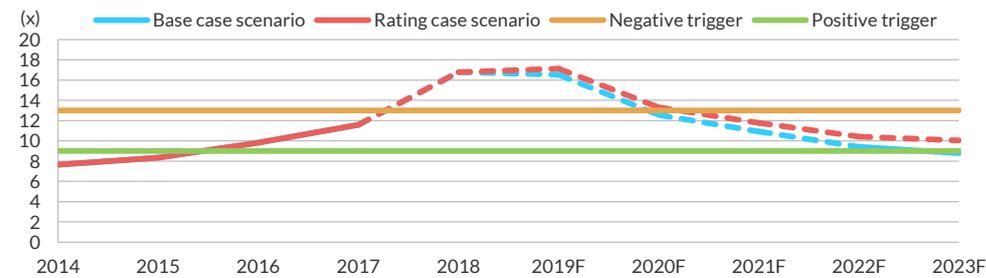
Appendix C: Data Adjustments

Synthetic Coverage Calculation

Fitch's synthetic coverage calculation assumes a mortgage-style amortisation over 15 years of the entity's net adjusted debt, using its average cost of debt. This synthetic calculation is used to assess the Polish LRGs' debt sustainability.

Appendix D: Rating Cases Comparisons and Rating Sensitivities

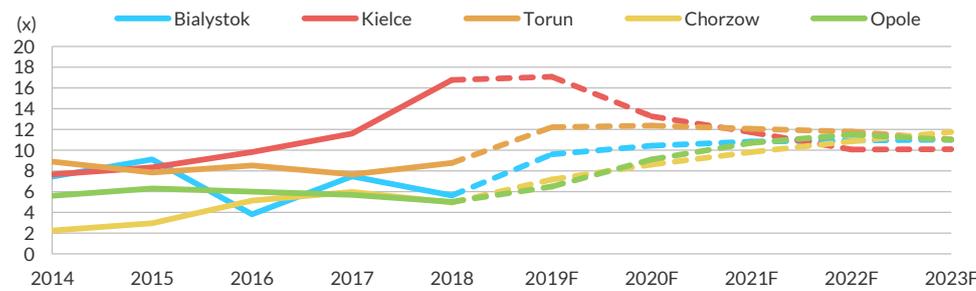
Payback - Fitch's Base and Rating Case Scenario



F - Forecast

Source: Fitch Ratings, City of Kielce

Fitch-Rated Polish Cities Rating Case Scenarios - Payback



F - Forecast

Source: Fitch Ratings, Fitch-rated cities

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