

13 Sep 2019 | Affirmation

Fitch Affirms Polish City of Kielce at 'BBB'; Outlook Negative

Fitch Ratings-Warsaw-13 September 2019:

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.

The Negative Outlook of Kielce reflects uncertainty over 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.

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 than that of other cities that are also capitals of their respective regions.

Key Rating Drivers

Revenue Robustness Assessed as 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 EU level. The city's revenue sources are stable as current transfers account for 46% of operating revenue, with the majority from the state budget (A-/Stable) as defined by law. Tax revenue accounts for 37% of Kielce's operating revenue, the majority 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 Assessed as Weaker

We assess Kielce's ability to generate additional revenue in response to economic downturns as limited, in line with the majority of Polish cities. Income tax rates and the majority of 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.

Expenditure Sustainability Assessed as Midrange

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

Kielce had exhibited 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 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 thus to improve operating results.

We expect the city's capex to remain high in 2019-2022, averaging PLN220 million annually ie. 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 Assessed as 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 in case of need.

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 respect to other sectors, including public transport, culture, sport, healthcare and housing economy.

Liabilities and Liquidity Robustness Assessed as 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 a 11% share of 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 its 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.

Liabilities and Liquidity Framework Flexibility Assessed as 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 avert 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).

Due to low debt repayments over the next three years, 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.

Fitch assesses Kielce's risk profile as 'Midrange' based on its 'Midrange' assessment of five key factors and one 'Weaker' key factor outlined above, with less weight being placed on the latter in the overall assessment.

Debt Sustainability Assessment: 'a'

Under its rating case for 2019-2023, Fitch projects the city's debt payback ratio (net adjusted debt-to-operating balance), to improve to about 10.1x in 2023 from 16.8x in 2018, thus more in line with a 'a' assessment rather 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.

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' debt sustainability assessment. The city's final IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state.

Key Assumptions

Fitch's key assumptions within our rating case for the issuer include:

- Operating revenue CAGR of 4% over 2019-2023 (CAGR of 5.8% in 2014-2018)
- Operating expenditure CAGR of 3.3% over 2019-2023 (CAGR of 6.7% in 2014-2018)
- Capital revenue and capex respectively averaging 7% of total revenue (8.6% in 2014-2018) and 13% of total expenditure (17.6% in 2014-2018)
- Interest rates paid on debt higher than in Fitch's base case by 0.5pp annually over 2019-2023.

RATING SENSITIVITIES

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.

Kielce, City of; Long Term Issuer Default Rating; Affirmed; BBB; RO:Neg

---; Local Currency Long Term Issuer Default Rating; Affirmed; BBB; RO:Neg

---; National Long Term Rating; Affirmed; A+(pol); RO:Neg

Contacts:

Primary Rating Analyst

Renata Dobrzynska, PhD

Director

+48 22 338 6282

Fitch Polska SA

Krolewska 16, 00-103

Warsaw

Secondary Rating Analyst

Anna Drewnowska-Sus,

Analyst

+48 22 338 6284

Committee Chairperson

Raffaele Carnevale,

Senior Director
+39 02 879087 203

Media Relations: Athos Larkou, London, Tel: +44 20 3530 1549, Email:
athos.larkou@thefitchgroup.com
Malgorzata Socharska, Warsaw, Tel: +48 22 338 6281, Email:
malgorzata.socharska@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

[National Scale Ratings Criteria \(pub. 18 Jul 2018\)](#)

[Rating Criteria for International Local and Regional Governments - Effective from 9 April 2019 to 13 September 2019 \(pub. 09 Apr 2019\)](#)

Additional Disclosures

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

[Solicitation Status](#)

[Endorsement Policy](#)

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](http://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 © 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, 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.

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.