

City of Olsztyn

Key Rating Drivers

Ratings Assigned: Fitch Ratings has assigned the Polish City of Olsztyn's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'BBB', reflecting the agency's view that Olsztyn's operating performance and debt ratios will remain in line with 'BBB' rated peers over the medium term.

Rating Derivation Summary: Fitch assesses Olsztyn's Standalone Credit Profile (SCP) at 'bbb', which results from a 'Midrange' assessment of its Risk Profile and 'a' assessment of Debt Sustainability. Olsztyn's SCP assessment factors in positioning among peers in the same rating category. The city's final IDRs are not affected by any asymmetric risk or extraordinary support from the Polish state.

'Midrange' Risk Profile: Fitch assesses Olsztyn's Risk Profile as 'Midrange' through the combination of five factors assessed as 'Midrange' and one factor assessed as 'Weaker' (Revenue Adjustability). This last has lower weight in the overall assessment.

Stable Revenue, Limited Flexibility: The city has stable revenue sources. Tax revenues (personal income tax, corporate income tax and local taxes), which accounted for almost 40% of operating revenue in 2018, are based on moderately cyclical economic activities. Transfers mainly from the state (44%) are based on formulae defined by law. Only about 13% of operating revenue depends on the city's rate-setting power, so we consider Olsztyn's ability to generate additional current revenue in response to possible economic downturn as limited.

Moderate Spending Flexibility: Olsztyn has a track record of control of operating expenditure growth, resulting in an operating margin of 5% in 2014-2018 (excluding revenue items). The city can reduce or postpone a significant part of its capital expenditure and at least 10% of its operating expenditure. In 2018 capex was a high 22% of total spending, significantly above the average for other Polish cities. Investments are concluded in phases, allowing them to be postponed or skipped if needed.

Debt Sustainability in 'a' Category: Fitch's rating case forecasts that the city's direct debt payback will increase due to new investments and reach more than 10x by end-2023 (2018: 5x), but will still remain within the 'a' category threshold. The synthetic DSCR ratio will deteriorate to 1.0x (2018: 2.5x). These factors justify the city's debt sustainability 'a' assessment.

Diversified Tax Base: Olsztyn is the capital of the Warminsko-Mazurskie region and is a medium-sized city by Polish standards. We estimate that the city's wealth indicators are above or at least on par with the national average, as Olsztyn is the strongest area in this sub-region. The city's tax base is well diversified, albeit smaller than other regional capitals.

No ESG Impact: The ESG credit relevance score is '3', meaning that ESG issues are credit neutral. The issuer's mission and institutional framework mean that these issues are minimally relevant to the rating.

Rating Sensitivities

Payback Ratio Changes: The ratings could be upgraded if Olsztyn maintains its debt payback ratio below 10x on a sustained basis according to Fitch's rating case. Conversely, the ratings could be downgraded if Olsztyn's debt payback ratio deteriorates above 12 years on a sustained basis according to Fitch's rating case.

Ratings

Foreign Currency
Long-Term IDR BBB

Local Currency
Long-Term IDR BBB

Outlooks
Long-Term Foreign-Currency IDR Stable
Long-Term Local-Currency IDR Stable

Financial Data

City of Olsztyn (PLNm)	2018	2023rc
Payback (x)	5.0	10.7
Synthetic coverage (x)	2.5	1.0
Actual coverage (x)	0.9	1.1
Fiscal debt burden (%)	22.2	35.4
Net adjusted debt	230	429
Operating balance	46	40
Operating revenue	1,038	1,212
Debt service	53	35
Mortgage-style debt annuity	18	38

rc: Fitch's rating-case scenario
Source: Fitch Ratings, City of Olsztyn

Applicable Criteria

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

Related Research

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

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

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

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Rating Synopsis

Olsztyn's IDR of 'BBB' is solely based on the city's SCP of 'bbb', reflecting a combination of a 'Midrange' risk profile (See 'Midrange' Risk Profile) and debt sustainability metrics assessed in the 'a' category under Fitch's rating case for 2019-2023 (see *Debt Sustainability of 'a'*). The city's IDR, which is equal to the SCP, is not affected by any asymmetric risk or extraordinary support from the Polish state.

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

Olsztyn is a medium-sized city with over 172,000 inhabitants and is the capital of Warminko-Mazurskie Region in northeast Poland. This region is among the lowest five Polish regions by wealth indicators, and is eligible for additional EU grants for regional development (Operational Programme Eastern Poland 2014-2020).

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 unemployment rate in the city (2018: 3.4%) is lower than the national average (5.8%).

The region's GDP per capita was 71% of the national average in 2016 (latest available data), although the Olsztyn sub-region's GDP per capita was higher at 80.2%. The city's economy is diversified, with the services sector playing an important role, employing over 78% of the local workforce in 2018 (national average 53%). This sector contributed about 62.2% of the sub-region's gross valued added in 2016, above the regional average.

Risk Profile: Midrange

Fitch assesses Olsztyn's Risk Profile as Midrange due to the combination of five factors assessed as 'Midrange' and one factor assessed as 'Weaker' (Revenue Adjustability), this last being of lower weight in the overall assessment.

City of Olsztyn – 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
22 Nov 19	BBB	BBB

Source: Fitch Ratings

City of Olsztyn



Source: Fitch Ratings

Socioeconomic Indicators

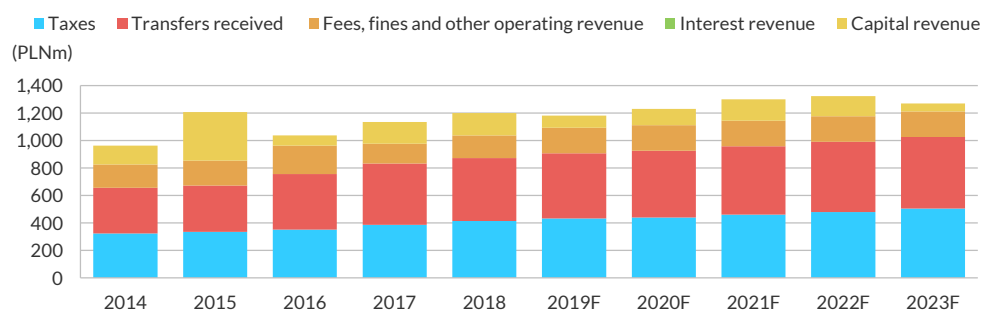
	City	Poland
Population in 2018 (000)	172	38,411
Average salary in 2018 (PLN)	4,649	4,835
Unemployment rate, 4Q18 (%)	3.4	5.8

Source: Fitch Ratings, City of Olsztyn, Central Statistics Office Poland

Revenue Robustness: Midrange

We assess Olsztyn'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 accounts for almost 40% of Olsztyn's operating revenue (in 2018), being based on moderately cyclical economic activities. Personal income tax accounts for 26% of operating revenue and local taxes for 13% while corporate income tax, which is more volatile, accounts for less than 2%. Current transfers accounted for almost 44% of operating revenue in 2018, with most made of transfers from the state budget (A-/Stable). These transfers are not subject to discretionary changes as most are defined by law. Olsztyn's tax base is diversified, with no concentration risks.

Revenue Structure - Rating Case Scenario



F: Forecast. Source: Fitch Ratings, City of Olsztyn

Revenue Adjustability: Weaker

We assess Olsztyn's ability to generate additional revenue in response to a possible economic downturn as 'Weaker', like most Polish cities, but this is mitigated by the proven track record of revenue growth, even in times of lower GDP growth.

Income tax rates are set by the central government, as are most 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 the ceilings set in the national tax regulations. The city could increase its revenue by intense 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 times of economic downturn.

Revenue Breakdown, 2018

	Operating revenue (%)	Total revenue (%)
Taxes	39.8	
- Personal income tax	25.6	
- Corporate income tax	1.7	
- Property tax	10.0	
Transfers received	44.0	
- Educational subsidy	23.4	
- Grants for family programme 500+	12.5	
- EU grants current	0.5	
Other operating revenue	16.2	
Operating revenue	100.0	86.6
Financial revenue		0.0
Capital revenue		13.4
- Sale of asset		3.3
- EU capital grants		9.6

Source: Fitch Ratings, City of Olsztyn

Expenditure Sustainability: Midrange

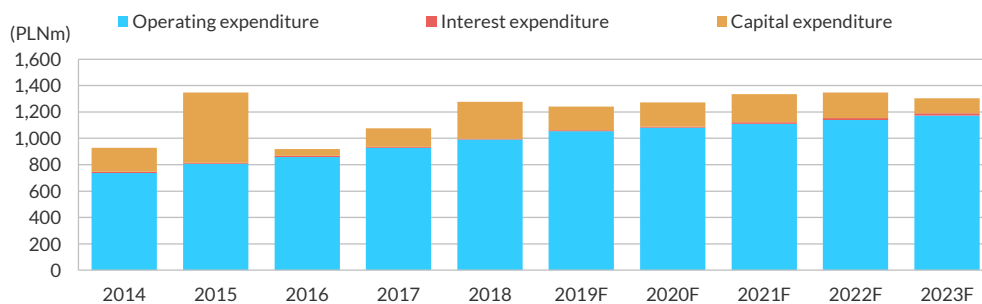
Fitch assesses the sustainability of the city's spending as 'Midrange', in line with most Polish cities. The city's main responsibilities are non-cyclical, including education, public transport, municipal services, administration, housing economy, culture and sport, and public safety and family benefits mandated and financed from the central budget.

Olsztyn had a track record of moderate control of operating expenditure growth. Its opex grew generally in line with operating revenue growth, which resulted in an operating balance accounting on average for 5% of operating revenue in 2014-2018 (when excluding one-off revenue, such as VAT returns after investments). We expect the city's capex to remain high in 2019-2023 (average 14% of total spending), leading to budgetary deficits of up to 5% of total revenue in this period, according to our rating case scenario.

Expenditure Adjustability: Midrange

Fitch assesses the city's ability to reduce spending in response to shrinking revenue as 'Midrange'. The city can influence a significant part of its capital expenditure and at least 10% of its operating expenditure.

Expenditure Structure - Rating Case Scenario



F: Forecast. Source: Fitch Ratings, City of Olsztyn

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 relation to other sectors, including public transport, culture, sport, healthcare and housing economy. 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 Olsztyn's capex totalled more than PLN279 million or almost 22% of total expenditure, predominately for investments. Through implementing a number of smaller investments and the larger ones in phases, the city is able to postpone the least important ones in case of need.

Expenditure Breakdown, 2018

	Opex (%)	Total expenditure (%)
Education	38.3	
Social care ^a	25.8	
Public administration	5.9	
Housing	0.9	
Transport	12.2	
Communal services	6.9	
Other	10	
Operating expenditure	100	77.7
Financial charges		0.4
Capital expenditure		21.9

^a Includes "Family" section

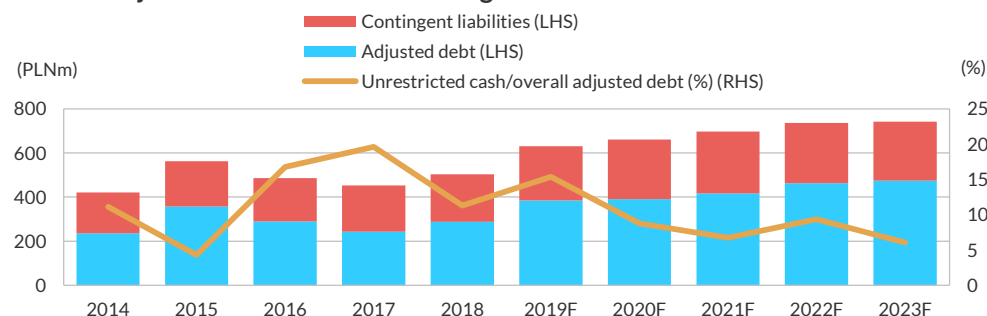
Source: Fitch Ratings, City of Olsztyn

Liabilities and Liquidity Robustness: Midrange

Fitch assesses the national framework regulations for Polish local and regional governments' liabilities and liquidity, and Olsztyn's individual framework for debt, liquidity and off-balance-sheet management as 'Midrange'.

At end-1H19 the city's loan portfolio was 92% composed of bonds (with final maturities up to 2032) with the rest loans from local banks. However, the maturity profile is smooth, with average principal repayments not exceeding 12% of the stock outstanding at end-2018 (average 7%). The city's debt is in Polish zloty with floating interest rates, which exposes the city to interest rate risk. The city mitigates this with its prudent budget practice, securing in its budget higher amounts for debt service.

Overall Adjusted Debt Structure - Rating Case Scenario



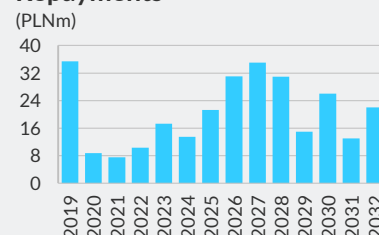
F: Forecast. Source: Fitch Ratings, City of Olsztyn

Liabilities and Liquidity Flexibility: Midrange

Fitch assesses the city's liquidity framework as 'Midrange' as there is no emergency liquidity support from upper tiers of government, but Olsztyn has liquidity available under its committed liquidity line (with a limit of PLN50 million).

Historically the city had good liquidity, with a liquidity coverage ratio averaging 2.1x in 2010-2018. Cash and liquid deposits in 2018-2019 have been above PLN70 million on average.

Debt Amortisation Schedule 2019-2032 - Capital Repayments



Source: Fitch Ratings, City of Olsztyn

Liquidity

(PLNm)	End-2018
Available cash	56.9
Unrestricted cash	56.9
Undrawn committed credit lines	50,0

Source: Fitch Ratings, City of Olsztyn

Debt Analysis

	End-2018
Fixed rate (%)	0
FX debt (%)	0
Issued bonds (%)	83.4
Final debt maturity (year)	2032
Debt service (2018, PLNm)	52.8
Operating balance (2018, PLNm)	46.3

Source: Fitch Ratings, City of Olsztyn

Debt Sustainability of 'a'

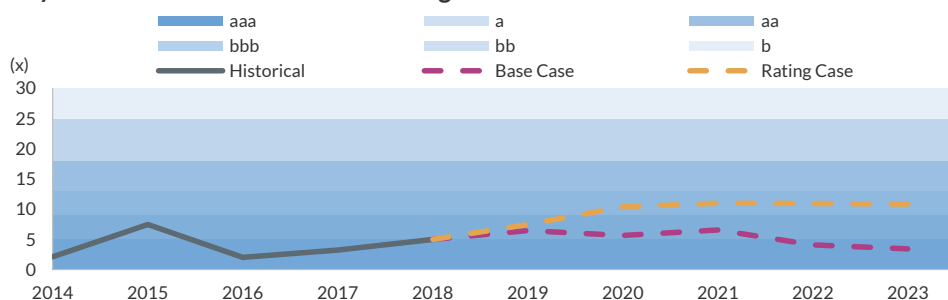
Debt Sustainability – Type B

	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

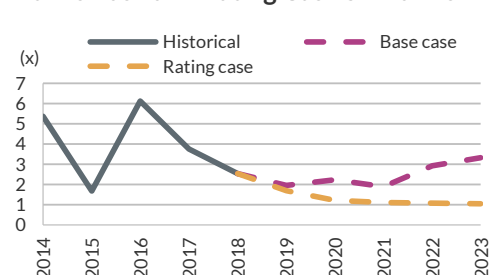
Under its rating case for 2019-2023, Fitch projects the city's payback ratio (net adjusted debt/operating balance) to rise to above 10x in 2023 from 5x in 2018, in line with a 'a' assessment. For the secondary metrics, Fitch's rating case projects that, despite a debt increase, the fiscal debt burden will remain relatively low and close to 35% of operating revenue (2018: 22%), counterbalancing the city's weaker synthetic DSCR of about 1x. The fiscal debt burden appears comparatively stronger ('aaa' category in Fitch's guidance table) than the payback ('a' category) and coverage ratios ('bb' category), which reflects a structural feature of Polish cities. All these metrics together underpin the city's debt sustainability assessment at 'a'.

Payback Ratio - Fitch's Base and Rating Case Scenarios



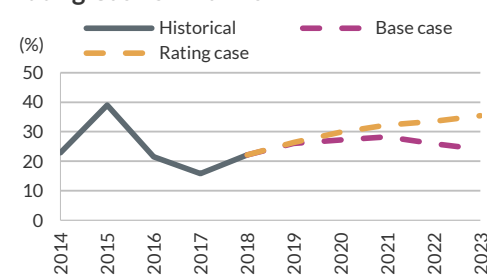
Source: Fitch Ratings, Olsztyn

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



Source: Fitch Ratings, City of Olsztyn

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



Source: Fitch Ratings, City of Olsztyn

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)

Fitch's Base and Rating Cases Main Assumptions

	2014-2018	2019-2023	
		Base case	Rating case
National nominal GDP growth (Fitch's assumptions) ^a	5.4	5.6	4.8
Operating revenue growth (CAGR; %)	5.9	3.5	3.1
Incl. tax revenue	6.3	4.8	4.0
Incl. transfers received	8.3	2.7	2.6
Incl. non-tax revenue	-0.6	2.3	2.3
Operating expenditure growth (CAGR; %)	7.7	3.0	3.4
Net capital expenditure (average per year; PLNm)	59.0	64.0	64.0
Cost of new debt (average; %)	2.7	2.7	2.9

^a Base case is based on Fitch's sovereign assumptions. Rating case is a stressed assumption used for City of Olsztyn rating case scenario

Source: Fitch Ratings

Other Rating Factors

Olsztyn'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		Support	Asymmetric risks	IDR
	Sovereign rating	Rating cap			
bbb	A-	A-	-	-	BBB

Source: Fitch Ratings

Peer Analysis

Polish Cities

Entity	Risk profile	Primary metric (x)	SCP	IDR	Outlook
Rzeszow	Midrange	9.4	bbb+	BBB+	Stable
Olsztyn	Midrange	10.7	bbb	BBB	Stable
Kielce	Midrange	10.1	bbb	BBB	Negative
Bialystok	Midrange	11.0	bbb	BBB	Stable
Torun	Midrange	11.0	bbb	BBB	Stable
Chorzow	Midrange	11.5	bbb-	BBB-	Stable

Source: Fitch Ratings

International Peers

Entity (Country)	Risk profile	Primary metric (x)	SCP	IDR	Outlook
City of Busto Arsizio (Italy)	Midrange	4.1	a+	BBB	Negative
Metropolitan City of Milan (Italy)	Midrange	8.8	bbb+	BBB	Negative
Region of Sicily (Italy)	Midrange	10.4	bbb	BBB	Negative
City of Bucharest (Romania)	Low midrange	5.7	bbb+	BBB-	Stable

Source: Fitch Ratings

Olsztyn has different risk profile from Romanian cities, which have better primary and secondary metrics. However, it fits well among Polish and Italian peers with debt sustainability in the 'a' category. Olsztyn compares well with the cities of Torun and Bialystok, having the same risk profile (Midrange) and payback ratio of around 11x. Rzeszow, with payback ratios below 10x, is rated one notch higher, at 'BBB+', while Chorzow, with a payback ratio of 11.5x, is rated one notch lower. Kielce's IDR has a Negative Outlook, which indicates that over the next year the city's payback ratio may weaken, leading to an SCP downgrade and therefore an IDR downgrade.

Debt Sustainability Ratios – Fitch's Rating Case Scenario

	2018	2023rc
Payback (x)	5.0	10.7
Synthetic coverage (x)	2.5	1.0
Fiscal debt burden (%)	22.2	35.4

rc: Fitch's rating case

Source: Fitch Ratings, City of Olsztyn

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.

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 Olsztyn

(PLNm)	2015	2016	2017	2018	2019rc	2023rc
Taxes	336	352	386	414	433	504
Transfers received	336	405	445	458	474	522
Fees, fines and other operating revenues	181	206	145	166	186	186
Operating revenue	853	962	977	1,038	1,093	1,212
Operating expenditure	-808	-859	-929	-991	-1,054	-1,172
Operating balance	45	103	48	46	39	40
Interest revenue	0	0	0	0	0	0
Interest expenditure	-7	-8	-7	-6	-8	-18
Current balance	38	95	40	40	31	22
Capital revenue	354	75	158	163	89	57
Capital expenditure	-532	-52	-139	-279	-178	-113
Capital balance	-178	23	19	-116	-89	-56
Total revenue	1,207	1,037	1,135	1,201	1,182	1,269
Total expenditure	-1,347	-919	-1,075	-1,276	-1,240	-1,303
Surplus (deficit) before net financing	-140	118	59	-75	-58	-34
New direct debt borrowing	163	0	0	91	133	28
Direct debt repayment	-35	-61	-46	-47	-35	-17
Net direct debt movement	128	-61	-46	44	98	11
Overall results	-12	57	14	-32	40	-23
DEBT						
Short-term debt	19	0	0	0	0	0
Long-term debt	338	289	244	287	385	474
Direct debt	357	289	244	287	385	474
Other Fitch-classified debt	0	0	0	0	0	0
Adjusted debt	357	289	244	287	385	474
Guarantees issued (excluding adjusted debt portion)	0	0	0	0	0	0
Majority-owned GRE debt and other contingent liabilities	206	197	209	216	246	268
Overall adjusted debt	563	486	453	503	631	742
Total cash, liquid deposits, and sinking funds	24	82	89	57	97	45
Restricted cash	0	0	0	0	0	0
Unrestricted cash	24	82	89	57	97	45
Net adjusted debt	333	207	155	230	288	429
Net overall debt	539	405	364	447	534	697

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

Appendix B

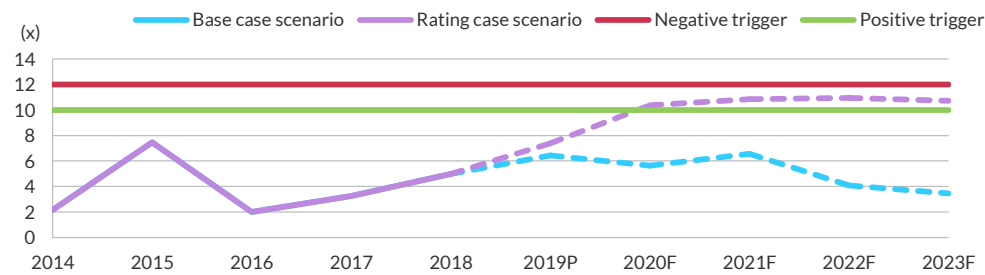
City of Olsztyn

	2015	2016	2017	2018	2019rc	2023rc
Fiscal performance ratios						
Operating balance/operating revenue (%)	5.2	10.7	4.9	4.5	3.6	3.3
Current balance/current revenue (%)	4.4	9.9	4.1	3.9	2.8	1.8
Operating revenue growth (annual % change)	3.2	12.8	1.5	6.2	5.3	3.1
Operating expenditure growth (annual % change)	9.5	6.3	8.2	6.7	6.3	2.8
Surplus (deficit) before net financing/total revenue (%)	-11.6	11.4	5.2	-6.3	-4.9	-2.7
Total revenue growth (annual % change)	25.3	-14.1	9.4	5.9	-1.6	-4.1
Total expenditure growth (annual % change)	45.1	-31.8	17.0	18.7	-2.8	-3.3
Debt ratios						
Primary metrics						
Payback ratio (x)	7.5	2.0	3.3	5.0	7.4	10.7
Secondary metrics						
Fiscal debt burden (%)	39.0	21.6	15.8	22.2	26.3	35.4
Synthetic debt service coverage ratio (x)	1.7	6.1	3.7	2.5	1.7	1.0
Other debt ratios						
Liquidity coverage ratio (x)	2.2	1.8	2.4	2.6	2.2	3.1
Direct debt maturing in one year/total direct debt (%)	18.8	12.5	14.6	12.3	0.0	0.0
Direct debt (annual % change)	51.5	-19.0	-15.7	17.9	34.1	2.4
Apparent cost of direct debt (interest paid/direct debt) (%)	2.3	2.6	2.7	2.2	2.4	3.8
Revenue ratios						
Tax revenue/total revenue (%)	27.9	33.9	34.1	34.4	36.6	39.7
Current transfers received/total revenue (%)	27.8	39.0	39.3	38.1	40.1	41.1
Interest revenue/total revenue (%)	0.0	0.0	0.0	0.0	0.0	0.0
Capital revenue/total revenue (%)	29.4	7.2	13.9	13.6	7.5	4.5
GDP deflated total revenue growth (annual % change)	24.3	-14.2	7.5	3.8	-3.1	-5.9
Expenditure ratios						
Staff expenditure/total expenditure (%)	23.3	35.2	31.6	28.4	n.a.	n.a.
Current transfers made/total expenditure (%)	9.2	14.4	14.2	13.3	n.a.	n.a.
Interest expenditure/total expenditure (%)	0.5	0.9	0.7	0.5	0.6	1.4
Capital expenditure/total expenditure (%)	39.5	5.6	12.9	21.9	14.4	8.7
GDP Deflated Total Expenditure Growth (Annual % Change)	44.0	-31.9	15.0	16.4	-4.3	-5.2

rc: Fitch's rating case, based on conservative assumptions. 2023 is the last year of the rating case scenario
n.a. - no data
Source: Fitch Ratings, City of Olsztyn

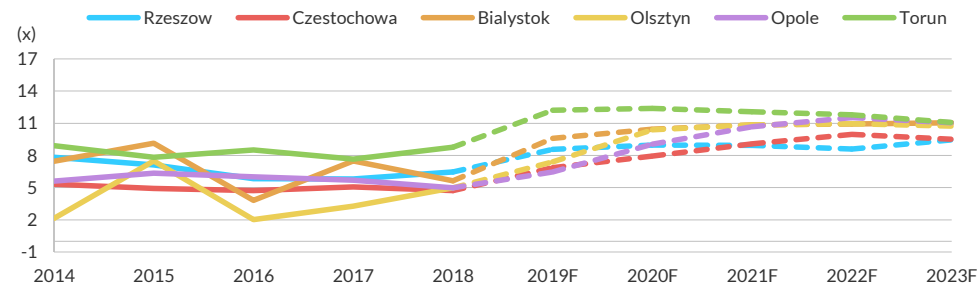
Appendix C: Rating Cases Comparisons and Rating Sensitivities

Payback - Fitch's Base and Rating Case Scenario



F: Forecast
Source: Fitch Ratings, City of Olsztyn

Fitch-Rated Cities in Poland Rating Case Scenarios - Payback



Source: Fitch Ratings, Fitch-rated cities in Poland

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