

## **RATING ACTION COMMENTARY**

# **Fitch Affirms City of Barcelona at 'A-'; Outlook Stable**

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Fitch Ratings - Barcelona - 14 Jul 2023: Fitch Ratings has affirmed the City of Barcelona's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-' with Stable Outlook.

Fitch assesses Barcelona's Standalone Credit Profile (SCP) at 'aaa', reflecting the combination of a 'High-Midrange' risk profile and 'aaa' debt sustainability assessment. Fitch does not apply any asymmetric risk. Barcelona's IDRs are capped by the sovereign IDR (A-/Stable), and are therefore below the city's SCP.

## **KEY RATING DRIVERS**

### **Risk Profile: 'High Midrange'**

Fitch assesses Barcelona's risk profile at 'High-Midrange', reflecting a combination of 'Midrange' and 'Stronger' attributes on six key risk factors. The assessment reflects Fitch's view of a low risk relative to international peers that Barcelona's ability to cover debt service with the operating balance may weaken unexpectedly over the forecast horizon (2023-2027) due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt or debt-service requirements.

### **Revenue Robustness: 'Midrange'**

Barcelona's revenue robustness is underpinned by regional GDP per capita that was 4% higher than the EU average in 2020, and an employment rate of 55.0% in 2022, higher than the national level (51.1%).

Barcelona's operating revenue is stable, evidenced by a CAGR in 2010-2020 of 2.3%, compared with CAGR of national GDP in the same period of 0.4%. Growth is driven by a large 32% of operating revenue being based on property tax and the tax on land value increase, with the latter subject to a levy on assets based on a fiscal valuation instead of regional GDP growth.

## **Revenue Adjustability: 'Stronger'**

We assess Barcelona's ability to generate additional revenue in response to possible economic downturns as strong. It has discretionary tax leeway to increase revenue by EUR1.2 billion, which would cover more than 200% of a reasonably expected decline of operating revenue of EUR90 million, or 4%, as was observed in 2010 versus 2009.

Barcelona has legal control of self-collected taxes (representing 38% of operating revenue in 2022), i.e. property tax, the major tax contributor (24% of operating revenue in 2022), with a ceiling set by the state. We estimate that increasing tax rates would increase operating revenue by about 46%.

Barcelona benefits from strong affordability of additional taxation, evidenced by the better local and regional socio-economic indicators (GDP per capita, employment and poverty rates) than the national average.

## **Expenditure Sustainability: 'Stronger'**

Barcelona's control of expenditure is reflected by 2.9% CAGR growth, below revenue growth (3.0%) in 2017-2022. Control is underpinned by a large share of responsibilities with municipal discretion. The national law establishes the responsibilities of municipalities under the common regime according to their size.

This factor also reflects the nature of local expenditure, which is mostly non-countercyclical, apart from social spending, which represented just 15.4% of total spending in 2022 and tends to grow when unemployment rises. Moreover, the law does not set the level of quality of services to be provided, reducing the risk of an uncontrolled rise in expenditure during an economic downturn.

## **Expenditure Adjustability: 'Stronger'**

This assessment reflects a low proportion of inflexible items, largely coming from social spending (14.4% of total spending) and staff costs, as most of the municipality's employees have the status of civil servants (15.4% of total spending in 2022).

Barcelona's ability to reduce spending in response to shrinking revenue is underpinned by the Budgetary Stability Law. This enables the central government to control the local administration's spending and has been strengthened in recent years. Prudential rules, particularly the compliance with deficit, debt and spending targets, help maintain the fiscal balance and have resulted in meeting stability targets over the past 10 years

(2011-2020). However, these were put on hold for 2020 and 2021 as a result of the pandemic, and a deficit target of 0.1% was established for 2021 and onwards.

### **Liabilities & Liquidity Robustness: 'Stronger'**

This assessment is underpinned by a solid national framework for debt and liquidity management, with strict prudential borrowing limits. The city can only contract new debt in the financial markets up to 75bp above national government bonds, has a debt guarantee limit (authorised guarantees cannot exceed 30% of current revenue), a limit on debt-to-GDP and must seek explicit debt authorisation from the central government in certain cases of non-compliance.

Barcelona is exposed to floating interest rates (the share of unhedged floating-rate debt was 40.1% in 2022). However, Fitch believes the city could access financial products to cover the risk of rising interest rates or renegotiate this debt with fixed rates.

The city's debt was characterised in 2022 by a good weighted average life of 6.2 years and low average cost of 1.4%. It has strong financial market access and no reliance on short-term debt. Debt service is also well covered by the operating balance (2022: 4.9x) and the city has limited off-balance sheet risks (31% of direct debt or 0.7x of operating balance in 2022).

### **Liabilities & Liquidity Flexibility: 'Midrange'**

Barcelona's unrestricted liquidity available is strong, covering the short- and long-term debt that matured in 2022 by more than 2.1x. At end-2021, the municipality had EUR684 million available cash, including EUR172 million considered as unrestricted and available for debt service by Fitch.

The city does not have committed liquidity lines, but would be exposed to counterparty risk at between 'BBB-' and 'A+' in case of need for liquidity support. This drives the 'Midrange' assessment of Barcelona's liability and liquidity flexibility.

### **Debt Sustainability: 'aaa category'**

Fitch considers Barcelona a type B local and regional government under its criteria as the city is required to cover debt service from the operating balance and is subject to requirements imposed and enforced by the central government.

Fitch has revised up its main rating case for 2023-2027 following better than expected 2022 results. This reflects a better debt payback ratio (net direct risk-to-operating

balance; the primary metric of debt sustainability assessment) of under five years in 2027 ('aaa' category). Together with a forecast synthetic debt service coverage ratio (operating balance/mortgage-style debt annuity) of six years on average in 2027 ('aaa' category), this justifies the assessment of Barcelona's debt sustainability at 'aaa'.

Barcelona's direct debt increased to EUR868 million in 2022, driven by a deterioration of the capital balance, from EUR817 million in 2021. Our rating case expects the municipality's net adjusted debt to grow to about EUR1.0 billion at end-2027 from EUR696 million at end-2022, driven by a deterioration of the operating balance and capital balance in the rating case scenario.

## **DERIVATION SUMMARY**

Barcelona's 'aaa' SCP reflects a combination of a 'High-Midrange' risk profile and a 'aaa' debt sustainability assessment. Fitch does not apply any asymmetric risk. Barcelona's IDRs are capped by the sovereign's and are therefore below the city's SCP.

### **Short-Term Ratings**

Barcelona's Short-Term IDR is 'F1', resulting from a strong liquidity coverage ratio estimated at 6.1x in 2023 and 'Stronger' debt structure robustness and 'Midrange' debt flexibility.

### **Debt Ratings**

The senior unsecured 'A-' rating is at the same level as Barcelona's Long-Term IDR.

## **KEY ASSUMPTIONS**

**Risk Profile: 'High Midrange'**

**Revenue Robustness: 'Midrange'**

**Revenue Adjustability: 'Stronger'**

**Expenditure Sustainability: 'Stronger'**

**Expenditure Adjustability: 'Stronger'**

**Liabilities and Liquidity Robustness: 'Stronger'**

**Liabilities and Liquidity Flexibility: 'Midrange'**

**Debt sustainability: 'aaa'**

**Support (Budget Loans): 'N/A'**

**Support (Ad Hoc): 'N/A'**

**Asymmetric Risk: 'N/A'**

**Sovereign Cap (LT IDR): 'A-'**

**Sovereign Cap (LT LC IDR) 'A-'**

**Sovereign Floor: '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 2018-2022 figures and 2023-2028 projected ratios. The key assumptions for the scenario include:

- Nominal growth of operating revenue at 1.7% in the next five years
- Nominal growth of operating expenditure at 1.5% in the next five years
- Net capital balance of negative EUR595 million in the next five years
- 2.7% cost of debt in the next five years

### **Liquidity and Debt Structure**

Fitch's overall adjusted debt includes Barcelona's financial debt (EUR868 million at end-2022), as well as the public housing entity's net debt (EUR268 million), included in the majority-owned government-related entity debt and other contingent liabilities. Net adjusted debt corresponds to the difference between overall adjusted debt and the year-end available cash viewed as "unrestricted" by Fitch (EUR167 million at end-2021).

The city's available cash was EUR684 million at end-2022. Fitch considers that EUR512 million was restricted, which corresponds to the gap between receivables (net of provisions for difficult-to-collect revenue) and payables.

### **Issuer Profile**

The city is the capital of the region of Catalonia. Its registered population is 21% of the region's population. The city is the administrative, political and economic centre of Catalonia and benefits from its important tourism position in Europe.

## **RATING SENSITIVITIES**

### **Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade**

Barcelona's IDRs are constrained by the sovereign IDRs and are sensitive to changes in the sovereign ratings. Barcelona's IDRs would also be downgraded if there was a sustained increase in leverage, particularly if the debt payback ratio worsened beyond 13 years, which is unlikely.

### **Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade**

Barcelona's IDRs would be upgraded if the sovereign ratings were upgraded.

## **ESG CONSIDERATIONS**

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means 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 Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

## **DISCUSSION NOTE**

Committee date: 12 July 2023

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.

## **PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS**

Barcelona's ratings are capped by Spain's ratings.

### **Best/Worst Case Rating Scenario**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of

rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

### RATING ACTIONS

| ENTITY / DEBT ↕    | RATING ↕  |                          |          | PRIOR ↕                  |
|--------------------|-----------|--------------------------|----------|--------------------------|
| Barcelona, City of | LT IDR    | A- Rating Outlook Stable |          | A- Rating Outlook Stable |
|                    |           | Affirmed                 |          |                          |
|                    | ST IDR    | F1                       | Affirmed | F1                       |
|                    | LC LT IDR | A- Rating Outlook Stable |          | A- Rating Outlook Stable |
|                    |           | Affirmed                 |          |                          |
| senior unsecured   | LT        | A-                       | Affirmed | A-                       |

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[International Local and Regional Governments Rating Criteria \(pub. 03 Sep 2021\)](#)  
(including rating assumption sensitivity)

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