

Barcelona (City of)

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This report does not constitute a rating action.

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Credit Highlights

Overview

Credit context and assumptions

The City of Barcelona has maintained strong financials despite headwinds from the COVID-19 pandemic.

The city's revenue will come under pressure from some tax changes (land value increase), but it will also benefit from the introduction of new ones.

We expect the city to benefit from EU funds that should enable larger investments.

Base-case expectations

Barcelona is likely to post large operating balances and balance its budgets over our forecasting horizon to 2024.

Although investment in housing units may drive additional increases in tax-supported debt, debt ratios will likely remain low and stable.

Barcelona should be able to maintain a sound liquidity position and very strong debt service coverage ratios.

We cap our long-term rating on Barcelona at the level of the long-term rating on Spain (unsolicited A/Stable/A-1). The city does not meet the criteria under which we would rate it higher than the related sovereign. We believe Barcelona lacks sufficient financial autonomy to effectively resist significant sovereign intervention, such as reductions or delays in central government transfers. We assume Barcelona's credit quality would not withstand the stress of a sovereign default, given its reliance on central government transfers and tax transfers (for about 40% of operating revenue). Like all Spanish cities, Barcelona has no substantial legislative power over its budgetary and financial framework.

Barcelona's creditworthiness is characterized by a supportive institutional framework that has historically enabled Spanish local governments to post balanced accounts. We also see the city's strong financial management as a rating support. The city's performance in recent years has been driven by management's self-imposition of financial targets (on operating balance and debt, for example) that are more stringent than any legal requirements. Although Barcelona has increased expenditure during the COVID-19 pandemic, its budgetary performance has not suffered any meaningful deterioration, and its debt ratios have remained stable. Furthermore, the city maintains comfortable liquidity that amply covers its debt-service requirements.

We assess the city's stand-alone credit profile (SACP) at 'aa-'. In our view, the SACP is supported by what we regard as prudent budgetary management, ample liquidity reserves, and very low debt, both in an international and in a Spanish context, particularly

considering the city's structural ability to generate large operating balances. The SACP is a way to assess the intrinsic creditworthiness of a local or regional government under the assumption that the rating on the sovereign is not a constraint.

Outlook

The rating on Barcelona is capped by the ratings on Spain. Therefore, the stable outlook on Barcelona reflects that on Spain.

Downside scenario

If we were to downgrade Spain, we would downgrade Barcelona.

Upside scenario

We would raise the rating on Barcelona if we upgraded Spain, and if Barcelona continued to perform in line with our base-case expectations.

Rationale

Revenue stability and prudent financial management have kept budgetary performance steady

The pandemic has not had a meaningful impact on Barcelona's revenue, thanks to the relative stability and predictability of most of its revenue sources. We believe this is a structural feature of local governments in Spain.

The city's 2021 performance was better than we had anticipated. This is mostly on the back of strong revenue performance, particularly since the economic recovery and the accompanying increase in activity led to higher tax and fee collection. Operating expenditure rose as well, but the city managed to post an operating balance of about 17.8% of operating revenue, much higher than in 2020 (at about 14.7%), and in line with historical values. This allowed the city to post a surplus after capital accounts (in budgetary accounting terms) of about 1.2% of total revenue despite a notable increase in capital expenditure.

In national accounting terms (the official benchmark of performance), Barcelona posted a slight deficit, mostly due to an adjustment between cash and accrual accounting regarding revenue. We understand this stemmed from some tax deferral during the pandemic—which should be later largely recovered. In our view, the city made use of its leeway to moderately increase expenditure, given the suspension of fiscal rules that temporarily allowed such deficits in national accounting terms. Nevertheless, we expect the city will return to balanced budgets in both budgetary accounting and national accounting terms over our forecast period.

Central government transfers, the so-called Fondo Complementario de Financiación, represent about 40% of Barcelona's operating revenue. For 2020 and 2021, the central government decided to provide cities with higher transfers than national economic performance would suggest. For example, central government transfers increased 5.5% in 2020 from the 2019 level, despite an estimated 10.9% decline in the nominal national GDP. We think the Spanish government has taken this route to soften the impact of the pandemic on local governments' finances.

Excess transfers in 2020 have generated a negative settlement for Barcelona of about €178 million. The city must refund the amount in principle in three annual installments over 2022 and 2024, with the bulk falling in 2023. So far, the central government has decided to forgive the 2022 installment, but we do not have any clarity as to whether it will take a similar decision for the remainder. If not, these payments could constrain Barcelona's budgets. However, we understand that the city is taking a conservative approach and has assumed that such support will not be forthcoming.

The city (along with all other municipalities) has faced the challenge of a redefinition of the formulas to calculate one of its taxes, that on land value increase, following successful legal challenges from affected parties. This will imply a structural reduction of collection for this tax. That said, we note that this land tax only represented about 6% of operating revenue in 2021, and therefore a reduction in the tax collection should be manageable for the entity.

At the same time, however, the city's main tax figure, the property tax (or the "IBI," in Spanish) is following a structural upward trend, as the impact of the revision of cadastral values that became effective in 2018 continues to gradually increase tax bases. Conversely,

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Barcelona is set to start collecting new taxes and fees, on tourism stays and garbage collection, which should boost revenue. We therefore believe Barcelona's operating revenue should evolve positively.

We expect high inflationary pressure to affect the city's operating expenditure. Barcelona does not have the ability to set the wage increase for its public employees, since this is determined by the central government. We do not expect public wages to rise at a rate commensurate with inflation--currently close to 10% in Spain, driven by the increase in energy prices. Nevertheless, should this inflationary environment continue, we expect increased pressure to step up salary increases for public employees, so they can recover spending power.

At the same time, we do not believe inflation will spark sudden or immediate increases in goods and services purchases, since many contracts for such purchases are already signed, without automatic inflation-driven adjustments. However, as those contracts are renegotiated, particularly in 2023, we think it is likely that pressure on costs will build up.

Overall, we believe Barcelona should be in a good position to maintain sound operating balances, of close to 18% of operating revenue on average between 2022 and 2024. This is in line with historical values, which were only temporarily interrupted by the pandemic.

On the capital accounts, we expect Barcelona to benefit from an inflow of EU funds in the context of the Recovery and Resilience Facility. In the case of municipalities, we understand the city will receive these funds by participating in national tenders set up by the central government, having to submit its projects for consideration. The central government will then evaluate whether the submitted projects comply with the goals established by the European Union (alignment with goals on energy transition and digitalization, for example), and will then award the funds. Given this process, it is difficult to have as yet full visibility on the exact amounts received, or their calendar. However, we expect a substantial increase in capital revenues for the city over our forecasting period, which should also lead to a corresponding material increase in investments. We note that there may be some mismatches between the timing of the reception of these funds and the associated expenditure, which could generate some variability in outcomes in budgetary accounting terms (although such impact would be eliminated in national accounting terms). In any case, we believe these funds will in no case generate any meaningful strain on the budget or on the city's liquidity. On the contrary, there is an opportunity to boost the city's competitiveness.

In our view, Barcelona's financial management displays a strong commitment to budgetary discipline and reining in debt. Barcelona's economy has suffered pandemic-related fallout due to the importance of its tourism sector. However, as the impact of the pandemic subsidies and restrictions on mobility and economic activity are lifted, tourism has bounced back strongly and continues to thrive. We see this as a positive factor for the city's growth prospects.

That said, we note that the current economic outlook in Europe is highly uncertain because of the Russia-Ukraine conflict. This generates potential downside risks for our forecast, depending on the evolution of the situation.

Barcelona's low debt metrics should remain stable over 2022-2024

In 2021, Barcelona increased only slightly its direct debt, by about €16 million. However, our expectation of balanced budgets going forward, as well as the city's large liquidity reserves, lead us to believe that Barcelona may choose to issue debt below its debt repayments in 2022 and possibly as well in 2023 and 2024, depending on budgetary performance. If so, we should see a moderate reduction of direct debt overall during our forecast period.

We acknowledge, however, that the city remains committed to its planned investments in housing units through its municipal housing company. The city's housing operator--Instituto Municipal de la Vivienda y Rehabilitación de Barcelona--continues to advance its major project entailing the construction of about 180,000 square meters of housing units, mostly destined for social rentals. The plan is estimated to cost up to €360 million and is the main reason for our forecasts of tax-supported debt increase. Nevertheless, part of this debt increase should be compensated by the direct debt decrease. Moreover, our expectation of expanding revenue (due to inflation) should allow the city to maintain broadly stable tax-supported debt ratios, slightly above 30% of consolidated operating revenue, a value that we view as low in an international context, and very low in the Spanish context. This is particularly the case when factoring the entity's ability to generate recurring operating balances.

We expect Barcelona's liquidity will remain very strong in 2022 and beyond. Our debt-service coverage ratio, which compares available liquidity sources with debt service, is set to stay well above 100% through our forecast period, and we don't foresee Barcelona needing to resort to short-term credit lines or similar instruments. In our view, Barcelona's management seeks to maintain sufficient liquidity buffers. The city defines its treasury plans based on very conservative assumptions, which often translate into

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lower borrowing than initially planned in the budget. The city actively manages its liquidity and maintains the period of payment to suppliers constantly below 30 days.

City of Barcelona Selected Indicators

Mil. EUR	2019	2020	2021	2022bc	2023bc	2024bc
Operating revenue	2,864	2,918	3,113	3,243	3,386	3,497
Operating expenditure	2,351	2,489	2,560	2,648	2,788	2,885
Operating balance	513	429	552	595	597	612
Operating balance (% of operating revenue)	17.9	14.7	17.8	18.4	17.6	17.5
Capital revenue	29	21	27	95	125	85
Capital expenditure	447	343	541	661	692	660
Balance after capital accounts	95	108	38	29	30	37
Balance after capital accounts (% of total revenue)	3.3	3.7	1.2	0.9	0.9	1.0
Debt repaid	56	83	94	83	45	52
Gross borrowings	0	102	111	50	30	30
Balance after borrowings	40	126	54	(4)	16	15
Direct debt (outstanding at year-end)	780	800	817	783	769	747
Direct debt (% of operating revenue)	27.2	27.4	26.2	24.2	22.7	21.4
Tax-supported debt (outstanding at year-end)	949	969	1,058	1,005	1,087	1,106
Tax-supported debt (% of consolidated operating revenue)	32.6	32.7	33.5	31.0	32.1	31.6
Interest (% of operating revenue)	0.4	0.4	0.4	0.4	0.3	0.3
Local GDP per capita (\$)	35,525.1	--	--	--	--	--
National GDP per capita (\$)	29,679.7	27,074.1	30,068.9	29,476.0	31,728.3	34,040.2

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. EUR--euro. \$--U.S. dollar.

Ratings Score Snapshot

Key rating factors	Scores
Institutional framework	3
Economy	2
Financial management	2

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Budgetary performance	1
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa-
Issuer credit rating	A

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "**Methodology For Rating Local And Regional Governments Outside Of The U.S.**," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

Sovereign Risk Indicators, July 11, 2022. An interactive version is available at www.spratings.com/sri.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Spain Outlook Revised To Stable From Negative On Balanced Growth; 'A/A-1' Ratings Affirmed, March 18, 2022
- Institutional Framework Assessments For International Local And Regional Governments, March 7, 2022
- Local And Regional Governments Outlook 2022: Long-Term Challenges Resurface As The Pandemic Eases, Feb. 3, 2022

Ratings Detail (as of July 22, 2022)*

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Issuer Credit Rating

A/Stable/--

Ratings Detail (as of July 22, 2022)*

Issuer Credit Ratings History

25-Mar-2022	A/Stable/--
22-Sep-2020	A/Negative/--
24-Sep-2019	A/Stable/--
27-Mar-2018	A-/Positive/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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