S&P Global Ratings

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Barcelona (City of)

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This report does not constitute a rating action.

Credit Highlights

Overview

Credit context and assumptions	Base-case expectations
The City of Barcelona has maintained strong financials despite the remaining stress from the COVID-19 pandemic.	Barcelona is likely to post large operating balances and balance its budgets over our forecast horizon to 2025.
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.	Although investment in housing units could drive increases in tax-supported debt, debt ratios will likely remain low and stable.
We expect the city to benefit from EU funds that should enable larger investments.	Barcelona should maintain a sound liquidity position and very strong debt service coverage ratios.

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

We assess the city's stand-alone credit profile (SACP) at 'aa-'. Supporting the SACP are what we regard as prudent budgetary management, ample liquidity reserves, and very low debt, both in an international and in a Spanish context and particularly considering the city’s structural ability to generate structurally 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.

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.

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 the city continued to perform in line with our base-case expectations.

Rationale

Revenue stability and prudent financial management have kept budgetary performance steady

The pandemic and the war in Ukraine have not had a meaningful impact on Barcelona's revenue, in our view, 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.

We do not have final data for 2022. However, we anticipate the city will post balanced accounts budget in budgetary accounting terms. It will likely post a deficit in national accounting terms (the official benchmark of performance), due to the booking in 2022 of the negative settlement of the 2020 financing system in its accounts. However, the central government has already committed to absorbing most of this through extraordinary transfers, so we do not think this will meaningfully affect Barcelona's performance.

The city government approved its 2023 budget in late 2022. While the budget envisages a substantial increase in expenditure, we expect this to be more moderate. This is mostly due to the upcoming May 2023 local elections. In our view, this electoral contest may tend to lower the level of expenditure execution, as administrative processes slow ahead of and immediately after the election. Any electoral outcome that required protracted negotiations between political groups to form a government would likely reinforce this.

While deficit targets for Spanish local and regional governments remain nonbinding, we believe they could once again become binding in 2024. We therefore believe the city will aim to balance its budgets (in national accounting terms) in 2023 and thereafter, to continue complying with these rules.

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

Excess transfers in 2020 generated a negative settlement for Barcelona of about €190 million. The city had to refund the amount in principle in three annual installments from 2022-2024, with the bulk falling in 2023. So far, the central government has forgiven the 2022 and 2023 installments, but we do not have clarity as to whether it will do so for the 2024 balance, amounting to about €50 million. Regardless, given that the central government has already funded the bulk of the negative settlement, we do not expect any meaningful impact of this factor in the city’s accounts.

Barcelona (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. This will imply a structural reduction of collection for this tax. Still, this land tax only represented about 6% of operating revenue in 2021, and therefore we expect a reduction in the tax collection should be manageable for the city.

At the same time, Barcelona's main tax figure, the property tax (or the IBI in Spanish), is following a structural upward trend, as the impact of real estate value revisions that took effect in 2018 continues to gradually increase tax bases. In addition, the city has started collecting new taxes and fees on tourism stays and garbage collection, which should boost revenue. We therefore believe operating revenue should improve.

We expect high inflation to affect operating expenditure. Barcelona does not have the ability to set the wage increase for its public employees, since the central government determines this. We do not expect public wages to rise commensurate with inflation. Nevertheless, should high inflation 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, because many contracts for these purchases are already signed without automatic inflation-driven adjustments. However, as those contracts are renegotiated, particularly in 2023, we think pressure on costs will likely build.

Overall, we believe Barcelona should be in a good position to maintain sound operating balances of close to 17% of operating revenue on average from 2022-2025. This is in line with historical values, which were only temporarily interrupted by the pandemic.

We expect Barcelona's capital accounts 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 EU's goals (alignment with goals on energy transition and digitalization, for example), then award the funds. Given this process, it is difficult to have as yet full visibility on how much and when Barcelona will receive these funds. However, we expect a substantial increase in capital revenue for the city over our forecast period, which should also lead to a corresponding material increase in investment. There could be some mismatches between the funds' arrival and the associated expenditure, which could generate some variability in outcomes in budgetary accounting terms (although the impact would be eliminated in national accounting terms). In any case, we believe these funds will not generate any meaningful strain on the budget or the city's liquidity. In fact, 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. The city's economy has suffered pandemic-related fallout due to the importance of its tourism sector. However, as the pandemic's impact subsides and restrictions on mobility and economic activity have ended, tourism has bounced back strongly and continues to thrive. We see this as a positive factor for Barcelona's growth prospects. Still, the economic outlook in Europe remains uncertain because of the Russia-Ukraine conflict. This generates potential risks for our forecast, depending on the how the war evolves.

Barcelona's low debt metrics should remain stable over 2022-2025

In 2022, Barcelona increased its direct debt only slightly, by about €30 million. Despite our expectation of balanced budgets and the city's large liquidity reserves, we now believe Barcelona may choose to issue debt at least in line with its debt repayments in 2023 and beyond, as a way to maintain its liquidity position.

However, the city remains committed to its planned investment in housing units through its municipal housing company. Its housing operator--Institut Municipal de l'Habitatge i Rehabilitació de Barcelona (IMHAB)--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. Our expectation of expanding revenue (due to inflation and economic growth) 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 Barcelona's ability to generate recurring operating balances.

Spain's audit body, IGAE, officially included IMHAB in the city's consolidation perimeter in 2022. This is broadly neutral to our analysis, given that our tax-supported debt figures already include IMHAB's debt. We took this approach considering the importance of the entity's mission for the city government, which in our view made it likely that it would receive support in case of need.

We expect Barcelona's liquidity will remain very strong in 2023 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 the city 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 lower borrowing than initially planned in the budget. It actively manages its liquidity and maintains the period of payment to suppliers constantly below 30 days.

City of Barcelona Selected Indicators

Mil. EUR	2020	2021	2022e	2023bc	2024bc	2025bc
Operating revenue	2,918	3,113	3,243	3,356	3,442	3,548
Operating expenditure	2,489	2,560	2,662	2,801	2,869	2,942
Operating balance	429	552	581	555	573	606
Operating balance (% of operating revenue)	14.7	17.8	17.9	16.5	16.7	17.1
Capital revenue	21	27	95	169	85	65
Capital expenditure	343	541	661	708	614	604
Balance after capital accounts	108	38	15	15	44	67
Balance after capital accounts (% of total revenue)	3.7	1.2	0.4	0.4	1.3	1.9
Debt repaid	83	94	83	45	52	56
Gross borrowings	102	111	114	80	60	60
Balance after borrowings	126	54	46	51	52	71
Direct debt (outstanding at year-end)	800	817	847	883	891	895
Direct debt (% of operating revenue)	27.4	26.2	26.1	26.3	25.9	25.2
Tax-supported debt (outstanding at year-end)	969	1,058	1,135	1,211	1,256	1,274
Tax-supported debt (% of consolidated operating revenue)	32.7	33.5	34.6	35.7	36.1	35.5
Interest (% of operating revenue)	0.4	0.4	0.4	0.5	0.6	0.7
Local GDP per capita ($)	32,392.8	36,197.7	--	--	--	--
National GDP per capita ($)	26,978.6	30,113.3	28,459.9	28,861.8	31,837.5	34,178.3

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. e--Estimate.

Ratings Score Snapshot

Key rating factors	Scores

Institutional framework	3
Economy	2
Financial management	2
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, Dec. 12, 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, Sept. 19, 2022
- Barcelona (City of), July 25, 2022
- Research Update: Spanish City of Barcelona Outlook Revised To Stable From Negative After Same Action On Spain; 'A' Rating Affirmed, March 25, 2022

- 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 January 25, 2023)*

Barcelona (City of)	
Issuer Credit Rating	A/Stable/--
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.