

## CREDIT OPINION

13 April 2021

 Rate this Research

### RATINGS

#### Barcelona, City of

|                  |                                |
|------------------|--------------------------------|
| Domicile         | Spain                          |
| Long Term Rating | Baa1                           |
| Type             | LT Issuer Rating - Fgn<br>Curr |
| Outlook          | Stable                         |

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## City of Barcelona (Spain)

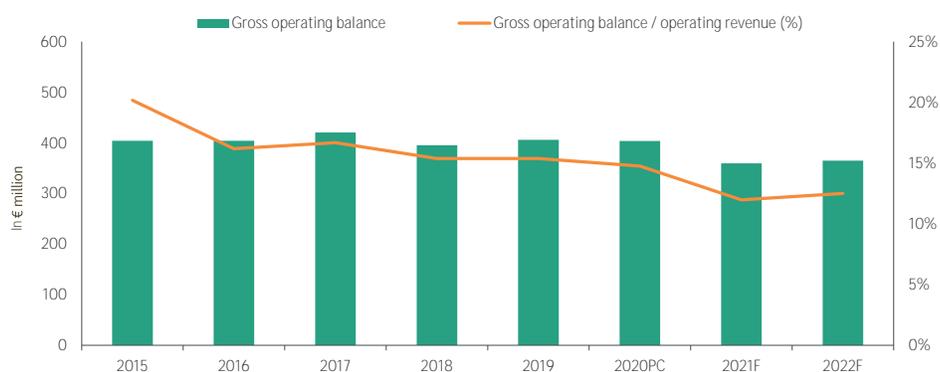
### Update to credit analysis

#### Summary

The credit profile of the [City of Barcelona](#) (Baa1 stable) reflects the city's robust budgetary management and solid financial fundamentals in recent years, which have ensured a high self-financing capacity and low need for debt financing. Because of its self-imposed financial rules, Barcelona has generated high levels of operating surpluses during the last decade (18% on average) and limited its debt to below 60% of operating revenue (around 29% as of year-end 2020). Although the coronavirus pandemic led to lower tax revenue because of a slowdown in the city's economy, 2020 preliminary results showed a similar operating and financing performance as in 2019.

Exhibit 1

#### Barcelona's good operating performance will remain for the following two years



PC: Pre-Closing; F: forecast. This represents Moody's forward view, not the view of the issuer.  
Sources: Issuer and Moody's Investors Service

#### Credit strengths

- » Robust governance and financial management
- » Strong financial performance
- » Low indebtedness and good liquidity
- » Large diversified economy

#### Credit challenges

- » Limited fiscal flexibility

## Rating outlook

The rating outlook is stable, reflecting our view that Barcelona will maintain its sound fiscal position in the coming years. Although the city's finances in 2021 will deteriorate because of the impact of the pandemic, we expect the deterioration in its fiscal metrics to be temporary.

## Factors that could lead to an upgrade

Because Barcelona's rating is at par with that of [Spain](#) (Baa1 stable), an upgrade of its rating would require an upgrade of the sovereign rating.

## Factors that could lead to a downgrade

Any downgrade of Spain's rating would likely have implications on Barcelona's rating. A substantial deterioration in Barcelona's budgetary ratios, together with financing deficits and rising debt, could also strain the city's rating.

## Key indicators

Exhibit 2

### City of Barcelona

|  | 2015 | 2016 | 2017 | 2018 | 2019 | 2020PC | 2021F | 2022F |
|--|------|------|------|------|------|--------|-------|-------|
| Gross Operating Balance as a % of Operating Revenue      | 20.2 | 16.2 | 16.7 | 15.4 | 15.4 | 14.8   | 12.0  | 12.5  |
| Capital Expenses as a % of Total Expenses                | 18.7 | 17.7 | 17.4 | 16.7 | 14.2 | 12.6   | 24.3  | –     |
| Self Financing Ratio                                     | 1.3  | 1.1  | 1.1  | 1.1  | 1.3  | 1.3    | 0.8   | –     |
| Financing Surplus(Deficit) as % of Total Revenue         | 5.4  | 1.3  | 1.3  | 1.2  | 4.0  | 3.9    | -5.8  | 0.0   |
| Interest Expenses as a % of Operating Revenue            | 0.9  | 0.7  | 0.7  | 0.5  | 0.7  | 0.5    | 0.6   | 0.7   |
| Gross Borrowing Need as a % of Total Revenue             | 5.9  | 4.8  | 3.6  | 0.8  | 0.0  | 0.0    | 8.6   | –     |
| Net Direct and Indirect debt as a % of Operating Revenue | 33.0 | 33.6 | 33.3 | 32.6 | 29.6 | 29.3   | 32.7  | 35.4  |
| PC= Pre-Closing  |      |      |      |      |      |        |       |       |
| F= Forecast  |      |      |      |      |      |        |       |       |

Forecasts for 2021 and 2022 represents Moody's forward view, not the view of the issuer.

Source: Moody's Investors Service

## Detailed credit considerations

The credit profile of the City of Barcelona, as expressed in its Baa1 stable rating, combines its Baseline Credit Assessment (BCA) of baa1 and a strong likelihood of extraordinary support from the central government if the city faces acute liquidity stress.

### Baseline credit assessment

#### Robust governance and financial management

Barcelona's strong governance and management are reflected in its prudent budgetary practices, such as over-budgeting for current spending and under-budgeting for current revenue, thereby generating large operating balances. We regard the quality of Barcelona's internal controls and financial planning as very high. Barcelona also takes a conservative approach to debt and investment management, which limits its exposure to market risk. Comprehensive financial reporting supports fiscal and debt management.

#### Strong financial performance

Despite the disruption caused by the pandemic, Barcelona maintained a good budgetary performance in 2020. According to 2020 preliminary results, the city's gross operating balance (GOB) was €404 million, equivalent to 14.8% of its operating revenue, slightly below the €406 million, or 15.4% of operating revenue, in 2019. This slight deterioration mainly reflects a 4.4% increase in operating expenditure, while the operating revenue increased 3.6%. The rise in expenditure was driven by a 6.7% increase in transfers to the city's public entities and a 2.3% increase in personnel costs, mainly for new staff (police and firemen). The city's positive GOB, together with a 44% decrease in capital revenue and a 9% increase in capital spending, resulted in a financing surplus of €109 million, or 4% of operating revenue, unchanged from the 2019 level.

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To ease the strain on the regional and local economies, the Spanish government suspended fiscal rules for the whole of the public sector in 2020 and 2021. However, Barcelona continues to follow its "Plan de Actuación Municipal". The plan aims to generate operating surpluses of more than 15% of operating revenue, limit debt to below 60% of operating revenue and ensure payments to suppliers within 30 days (22 days on average in 2020 versus 27 days in 2019).

While we expect a decrease in tax revenue collection in 2021 mainly because of the slowdown in economic activity, we also expect an increase in transfers from the central government to compensate for the impact of the pandemic on the city's economy, resulting in a limited effect on the city's operating balance forecasted at around 12% of operating revenue in 2021 and 2022. However, in view of the social emergency arising from the pandemic, the city budgeted a €350 million increase in investment for 2021, with an expected financing deficit of €156 million, equivalent to 5.8% of its operating revenue. We expect the city's fiscal deterioration to be temporary, which is already captured in its current rating of Baa1.

#### **Low indebtedness and good liquidity**

Barcelona has low debt compared with the city's European peers. In 2020, the city's direct debt increased by just 3% to €800 million from €780 million in 2019, with net direct and indirect debt/operating revenue of 29.3% as of year-end 2020, similar to the 29.6% reported in 2019 and well below its self-imposed limit of 60%.

The city's indirect debt is low compared with that of other Spanish municipalities at around 6% of operating revenue in 2020. Indirect debt in 2020 comprised €165 million of debt incurred by public companies (€169 million in 2019) and just €1 million of debt guarantees to other related entities or companies. This indirect debt was mainly composed of debt from the Instituto Municipal de la Vivienda y Rehabilitación de Barcelona (IMHAB), the city's public company in charge of the construction of public housing in the city as part of a new housing plan to build around 2,500 houses by 2023, of which around 2,000 will be for social renting.

Although the city plans to raise new debt of around €300 million due to the capital expenditure increase in 2021, we expect its net direct and indirect debt/operating revenue to be around 33% (35% in 2022). Despite the increase, this ratio will still be low and lower than its self-imposed limit of 60%. We consider Barcelona's debt manageable even if increasing in the following two years. In addition, we expect Spain's gradual economic recovery will provide further support and limit debt accumulation.

The city's liquidity is very good, with cash on hand of €661 million as of year-end 2020, equivalent to around 24% of its operating revenue, compared with €581 million a year earlier. This cash on hand will be more than sufficient to cover debt repayments of just €97 million due in 2021. The high level of cash will be sufficient to cover 82% of Barcelona's outstanding direct debt. We expect cash on hand to decrease but liquidity to remain good at around €475 million, as forecast by the city for year-end 2021.

#### **Large diversified economy**

Barcelona is the capital of the northeastern Spanish region of Catalunya and is one of the country's most developed and wealthiest cities, acting as a decentralising counterweight to the capital city of Madrid. For the past few years, Barcelona's population has grown largely because of migration inflow; its 1.6 million inhabitants accounted for 3.5% of the national population and 21.7% of the Catalan population in 2020.

Barcelona's economy is mainly concentrated in the services sector, primarily focused on business, healthcare, education, commerce, the hotel industry and tourism. While there is high uncertainty surrounding the impact of the pandemic on the city's economy, especially in terms of tourism, we consider Barcelona's economy to recover quickly from difficult conditions and expect a relatively quick recovery by the second half of 2021 (although this will depend on the duration of the pandemic). According to the city's statistical office, Barcelona's GDP will decline by around 10% (a 11% decline is expected for Spain), mainly in the commercial, hotel and construction sectors.

In line with the slowdown in the economy, the city's unemployment rate increased to 12.6% in 2020 from 8.5% in 2019. However, despite the increase, it is still below the national average of 16.1% and the 13.9% for the region of Catalunya. While there was a significant drop in employment related to the tourism sector of around 16% in Q3 2020, we expect a quick recovery once domestic and international travel resumes.

**Limited fiscal flexibility**

The City of Barcelona mainly depends on transfers from the central government for its revenue. It has the authority to raise a variety of taxes, but has limited flexibility in setting their rates because the central government determines the maximum and minimum rates. With respect to spending, Barcelona faces significant payroll costs, similar to other Spanish local governments. Although the Spanish local governments control staff numbers, pay increases largely reflect decisions taken at the central government level, leaving municipalities with limited flexibility.

**Extraordinary support considerations**

Barcelona has a strong likelihood of extraordinary support from the central government, reflecting our assessment of the risk to the government's reputation if the city defaults. Despite the government's promotion of greater accountability for Spanish municipalities, Barcelona's strategic role in Spain provides the government with an incentive to support the city in the event of need.

**ESG considerations****How environmental, social and governance (ESG) risks inform our credit analysis of Barcelona**

We take into account the impact of ESG factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Barcelona, the materiality of ESG factors to its credit profile is as follows:

Environmental considerations are not material to Barcelona's credit profile.

Social risks are not material to Barcelona's credit profile. While we consider the pandemic a social risk, its impact will be limited for this entity; the main cost implications of the pandemic will be concentrated at the regional level rather than at local governments. Other social aspects include the ageing population, which will also affect social expenditure.

Barcelona has very robust governance and management, demonstrated by its self-imposed fiscal and financial rules, which are more restrictive than rules under current legislation for local governments in Spain. The city also provides transparent and timely financial reports.

Further details are provided in the Detailed credit considerations. Our approach to ESG is explained in our cross-sector rating methodology [General Principles for Assessing ESG Risks](#).

## Rating methodology and scorecard factors

The assigned BCA of baa1 is close to the scorecard-indicated BCA of baa2. The scorecard-generated BCA of baa2 reflects an Idiosyncratic Risk score of 2 (presented below) on a scale of 1 to 9, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Baa1, as reflected in Spain's Baa1 stable sovereign bond rating.

For details on our rating approach, please refer to [Rating Methodology: Regional and Local Governments](#).

Exhibit 3

### Barcelona, City of Regional & Local Governments

| Baseline Credit Assessment – Scorecard     | Score | Value   | Sub-factor Weighting | Sub-factor Total | Factor Weighting | Total           |
|--|-------|---------|----------------------|------------------|------------------|-----------------|
| <b>Factor 1: Economic Fundamentals</b>     |       |         |                      | <b>1</b>         | <b>20%</b>       | <b>0.20</b>     |
| Economic Strength [1]                      | 1     | 200.70% | 70%                  |                  |                  |                 |
| Economic Volatility                        | 1     |         | 30%                  |                  |                  |                 |
| <b>Factor 2: Institutional Framework</b>   |       |         |                      | <b>3</b>         | <b>20%</b>       | <b>0.60</b>     |
| Legislative Background                     | 1     |         | 50%                  |                  |                  |                 |
| Financial Flexibility                      | 5     |         | 50%                  |                  |                  |                 |
| <b>Factor 3: Financial Position</b>        |       |         |                      | <b>1.50</b>      | <b>30%</b>       | <b>0.45</b>     |
| Operating Margin [2]                       | 1     | 15.03%  | 12.5%                |                  |                  |                 |
| Interest Burden [3]                        | 1     | 0.55%   | 12.5%                |                  |                  |                 |
| Liquidity                                  | 1     |         | 25%                  |                  |                  |                 |
| Debt Burden [4]                            | 1     | 29.30%  | 25%                  |                  |                  |                 |
| Debt Structure [5]                         | 3     | 10.36%  | 25%                  |                  |                  |                 |
| <b>Factor 4: Governance and Management</b> |       |         |                      | <b>1</b>         | <b>30%</b>       | <b>0.30</b>     |
| Risk Controls and Financial Management     | 1     |         |                      |                  |                  |                 |
| Investment and Debt Management             | 1     |         |                      |                  |                  |                 |
| Transparency and Disclosure                | 1     |         |                      |                  |                  |                 |
| <b>Idiosyncratic Risk Assessment</b>       |       |         |                      |                  |                  | <b>1.55 (2)</b> |
| <b>Systemic Risk Assessment</b>            |       |         |                      |                  |                  | <b>Baa1</b>     |
| <b>Suggested BCA</b>                       |       |         |                      |                  |                  | <b>baa2</b>     |

[1] Local GDP per capita as % of national GDP per capita

[2] Gross operating balance/operating revenues

[3] Interest payments/operating revenues

[4] Net direct and indirect debt/operating revenues

[5] Short-term direct debt/total direct debt

Source: Moody's Investors Service; Fiscal 2020.

## Ratings

Exhibit 4

| Category                  | Moody's Rating |
|---------------------------|----------------|
| <b>BARCELONA, CITY OF</b> |                |
| Outlook                   | Stable         |
| Issuer Rating             | Baa1           |

Source: Moody's Investors Service

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