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

Fitch Ratings - Barcelona - 18 Feb 2022: Fitch Ratings has affirmed the City of Barcelona's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A-' with Stable Outlook.

Barcelona's Standalone Credit Profile (SCP) is assessed 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 (2022-2026) 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 1% higher than the EU average in 2018, and an employment rate of 52.7%, higher than the national level (48.5%).

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, the latter of which is 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 that 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 41.6% of operating revenue in 2021), i.e. property tax, the major tax contributor (25.4% of operating revenue in 2021), 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) compared with the national average.

Expenditure Sustainability: 'Stronger'

Barcelona's control of expenditure is reflected by 1.9% CAGR growth, below revenue growth (2.1%) in 2016-2021. 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 12.9% of total spending in 2021 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'

Barcelona's ability to reduce spending in response to shrinking revenue is underpinned by the Budgetary Stability Law (BSL). 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 coronavirus pandemic, and a deficit target at 0.1% was established for 2021.

The assessment also reflects a low proportion of inflexible items, largely coming from social spending (12.9% of total spending) and staff costs, as most of the municipality's employees have the status of civil servants (15.6% of total spending in 2021).

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 32% in 2021), taking advantage of a low interest-rate policy. However, Fitch believes that it 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 2021 by a good weighted average life of debt of 6.2 years and low average cost of debt of 1.5%. It has strong financial market access and no reliance on short-term debt. Debt service is also well covered by the operating balance (2021: 5.1x) and the city has limited off-

balance sheet risks (27% of direct debt or 0.4x of operating balance in 2021).

Liabilities & Liquidity Flexibility: 'Midrange'

Barcelona's unrestricted liquidity available is strong, covering more than 1.4x the short- and long-term debt that matured in 2022. At end-2021, the municipality had EUR685 million available cash, including EUR227 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'

Barcelona is considered a type B local and regional government in Fitch's criteria as it 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 2022-2026 following better than expected 2021 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 2026 ('aaa' category). Together with forecast synthetic debt service coverage ratio (operating balance/mortgage-style debt annuity) of five years on average in 2026 ('aaa' category), this justifies the assessment of Barcelona's debt sustainability at 'aaa'.

Barcelona's direct debt increased to EUR817 million in 2021, driven by a deterioration of the capital balance, from EUR800 million in 2020. Our rating case expects the municipality's net adjusted debt to grow to about EUR1.3 billion at end-2026 from EUR590 million at end-2021, 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 7.1x in 2022 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

Qualitative 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: '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 2017-2021 figures and 2022-2026 projected ratios. The key assumptions for the scenario include:

- Nominal growth of operating revenue at 2.1% in the next five years
- Nominal growth of operating expenditure at 2.7% in the next five years
- Net capital balance of negative EUR609 million in the next five years
- 1.7% cost of debt in the next five years

Liquidity and Debt Structure

Fitch's overall adjusted debt includes Barcelona's financial debt (EUR816.6 million at end-2021), as well as the public housing entity's net debt (EUR221 million), included in the majority-owned GRE 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 (EUR227 million at end-2021).

The city's available cash was EUR685 million at end-2021. Fitch considers that EUR458 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

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.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Barcelona, City of	LT IDR	A- ●	Affirmed	A- ●
	ST IDR	F1	Affirmed	F1
	LC LT IDR	A- ●	Affirmed	A- ●
• senior unsecured	LT	A-	Affirmed	A-

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	◉	

Applicable Criteria

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

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Barcelona, City of EU Issued, UK Endorsed

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