

28 Feb 2020 | Affirmation

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

Fitch Ratings-Barcelona-28 February 2020:

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

### 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 'High-Midrange' risk profile reflects a low risk of operating balance shrinking below EUR475 million or debt servicing requirement overshooting the EUR111million as projected in Fitch's rating case scenario.

#### Revenue Robustness: 'Midrange'

Barcelona's revenue robustness is underpinned by regional GDP per capita that is 10% higher than the EU average in 2017, and an employment rate of 54.7%, higher than the national level (50.4%).

Barcelona's operating revenues are stable, evidenced by a CAGR in 2008-2018 of 1.2% despite lower national GDP CAGR in the same period of 0.8%. This is driven by a large 32.4% 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 fiscal valuation instead of regional GDP growth.

Fitch expects operating revenue to grow in its base case scenario on average 3.1% over the next five years, while in rating case for it to slow to 2.8%, based on lower GDP growth.

The dependence on a 'A-' rated counterparty for a material proportion of local revenue drives the 'Midrange' assessment of the robustness of Barcelona's revenue framework. Operating revenue is mostly composed of transfers from the central government (42% of operating revenue in 2019) through participation in some nationally collected taxes and the Complementary Fund for local entities.

#### 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 that would cover more than 200% of a reasonably expected decline of operating revenue of EUR90 million.

Barcelona has legal control of self-collected taxes (representing 52.7% of operating revenue in 2019), i.e. property tax, the major tax contributor (24.9% of operating revenue in 2019), with a rate 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, which would represent only a modest proportion of median saving per capita. Moreover, GDP per capita and the average provincial salary are above the national average. Regional GDP per capita is also above international standards (EU average).

#### Expenditure Sustainability: 'Stronger'

Barcelona's control of expenditure is underpinned by a low proportion of inflexible expenses, and the nature of local expenditure, which is mostly non-cyclical, apart from social spending, which represents just 12.1%.

#### 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 which 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.

#### Liability and 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 (2% in 2020) 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 45.3% in 2019), which is mitigated by a low fiscal debt burden (net adjusted debt-to-operating revenue) of 23.1% in 2019 and a favourable debt structure. The city's debt is characterised by a good weighted average life of debt of 5.8 years in 2019, low average cost of debt of 1.5% in 2019, and non-reliance on short-term debt. Debt service is also well covered by the operating balance (2019: 1.4x) and the

city has limited off-balance sheet risks (21% of direct debt in 2019).

#### Liability and Liquidity Flexibility: 'Midrange'

Barcelona's unrestricted liquidity available is strong, covering more than 2x the short- and long-term debt that matured in 2019. 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 such liquidity support. This drives the 'Midrange' assessment of Barcelona's liability and liquidity flexibility.

#### Debt Sustainability Assessment: 'aaa'

Fitch expects the net payback ratio - the primary metric of debt sustainability assessment - to remain strong at below four years in 2024, according to our rating case scenario.

The secondary metrics - the actual debt service coverage ratio (operating balance/ debt service, including short-term debt maturities in the current year) and fiscal debt burden - should remain close to 7x and 22%-23%, respectively, in 2024. All these metrics under our 'aaa' debt sustainability assessment.

Barcelona's direct debt remained moderate between 2015 and 2018 at EUR836 million. In 2019, direct debt declined to EUR780.2 million, and in our rating case scenario, is expected to increase to around EUR836 million in 2020, driven by higher expected capital spending. We expect direct debt to stabilise in the following years, instead of falling, despite anticipated budgetary surpluses.

Barcelona is considered a type B local and regional government (LRG) in Fitch's criteria as it is required to cover debt service from operating balance and is subject to requirements imposed and enforced by the central government. The city is the administrative, political and economic centre of the Autonomous Community of Catalonia (BB/Stable), hosting 21.4 % of the region's population in 2019. The city has a diversified and wealthy economy and benefits from strong tourist activity.

#### Derivation Summary

Barcelona's standalone credit profile (SCP) is assessed at 'aaa', reflecting 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 (A-/Stable), and are therefore below the city's SCP.

Barcelona's Short-Term IDR is 'F1', resulting from a strong liquidity coverage ratio estimated at 6.6x in 2020 and 'Stronger' debt structure robustness and 'Midrange' debt flexibility.

## Key Assumptions

### KEY ASSUMPTIONS

Qualitative assumptions and Assessments:

Risk Profile: High Midrange

Revenue Robustness: Moderate

Revenue Adjustability: Stronger

Expenditure Sustainability: Stronger

Expenditure Adjustability: Stronger

Liabilities and Liquidity Robustness: Stronger

Liabilities and Liquidity Flexibility: Midrange

Debt sustainability: 'aaa' category

Support: none

Asymmetric Risk: none

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 2015-2019 figures and 2020-2024 projected ratios.

The key assumptions for the scenario include:

-Nominal growth of operating revenue at 2.8% p.a. in the next five years

-Nominal growth of operating expenditure at 2.9% p.a. in the next five years

-Net capital balance of a negative EUR489 million in the next five years

-2.3% cost of debt in the next five years

### RATING SENSITIVITIES

Barcelona's IDRs are constrained by the sovereign IDRs and are sensitive to changes in the sovereign ratings. Barcelona's IDR would also be downgraded on a sustained increase in leverage, particularly if the debt payback ratio worsens beyond 13 years.

## Sources of Information

### ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the ESG credit relevance is a score of 3. This means ESG issues are credit-neutral. Given the missions of the issuer and the institutional framework, these issues are minimally relevant to the rating.

Barcelona, City of; Long Term Issuer Default Rating; Affirmed; A-; RO:Sta  
----; Short Term Issuer Default Rating; Affirmed; F1  
----; Local Currency Long Term Issuer Default Rating; Affirmed; A-; RO:Sta  
----senior unsecured; Long Term Rating; Affirmed; A-

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### **Applicable Criteria**

[Rating Criteria for International Local and Regional Governments \(pub. 13 Sep 2019\)](#)

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