Fitch Ratings

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

Fitch Ratings - Barcelona - 26 Feb 2021: 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 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 IDR (A-/Stable), and are therefore below the city's SCP.

Fitch classifies the City of Barcelona as a 'Type B' local and regional government (LRG), as it covers debt service from cash flow on an annual basis. Barcelona is a Spanish municipality under a common regime, with responsibilities such as urbanism, social well-being, security, culture, and transport, among others. Its main resources come from local taxes and current transfers from the central government through shares in nationally collected taxes.

For Barcelona, a prolonged coronavirus impact and much slower economic recovery lasting until 2025 would put pressure on tax receipts. If Barcelona is unable to proactively reduce expenditure or supplement weaker receipts from increased regional transfers, this could lead to a downward revision of its SCP.

Risk Profile: 'High Midrange'

Barcelona's risk profile is assessed at 'High Midrange', reflecting a low risk of the city's operating balance shrinking below EUR299 million or debt servicing requirement overshooting the projected EUR75 million in Fitch's rating case up to 2025. This reflects a 'Stronger' assessment on four of the six key risk factors: revenue adjustability, expenditure sustainability and adjustability, liabilities and liquidity robustness. Revenue robustness and liabilities and liquidity flexibility are assessed as 'Midrange'.

Revenue Robustness: 'Midrange'

Barcelona's revenue robustness is underpinned by regional GDP per capita that is 1% higher than the EU average in 2018, and an employment rate of 52.5%, higher than the national level of 48.4%. Barcelona's operating revenues are stable, evidenced by a CAGR in 2009-2019 of 1.5%, in line with national GDP CAGR in the same period.

This was driven by a large 32% of operating revenue being based on the property tax and a tax on land value increase, the latter of which is based on fiscal valuation rather than on regional GDP growth. Fitch base case expects operating revenue to grow on average 2% over the next five years, while our rating case sees operating revenue growth slowing to 1.7%, based on lower GDP growth.

The dependence on a 'A-' rated counterparty - the Spanish sovereign - for a material proportion of local revenue drives our 'Midrange' assessment of the robustness of Barcelona's revenue framework. Operating revenue is mostly composed of transfers from the central government (43.9% of operating revenue in 2020) 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 an operating revenue decline of EUR90 million that we would expect in a downturn.

Barcelona has legal control of self-collected taxes (representing 52.1% of operating revenue in 2020), including the property tax. The latter is the major tax contributor (25.3%), with a ceiling rate set by the state. We estimate that increasing the property tax rate would increase operating revenue by 46%. Barcelona benefits from strong affordability of additional taxation, which would represent only a modest proportion of the median savings per capita.

Moreover, the city's GDP per capita and average provincial salary are above the national average. Regional GDP per capita is also above the EU average.

Expenditure Sustainability: 'Stronger'

Barcelona's control of expenditure, reflected by a CAGR decline of 0.3% on average in 2015-2020, versus revenue growth of 0.6%, is underpinned by a low proportion of inflexible expenses. This factor also reflects the nature of local expenditure, which is mostly non-cyclical, apart from social spending, which represents just 14%.

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 compliance with deficit, debt and spending targets, help maintain the fiscal balance and have resulted in Barcelona meeting stability targets over the past 10 years. However, as a result of the coronavirus pandemic, these were put on hold for 2020 and 2021, and a deficit target referenced at 0.1% of GDP has been established for 2021.

The assessment also reflects a low proportion of mandatory and inflexible items, essentially from social spending and staff costs, as most of the municipality's' employees have the status of civil servants (15.5%).

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 at a cost of up to 75bp above national government bonds, has limits on both debt guarantees (authorised guarantees cannot exceed 30% of current revenue), and 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 36.1% in 2020), which is mitigated by a low fiscal debt burden (net adjusted debt-to-operating revenue) of 20.1% in 2020 and a favourable debt structure.

The city's debt is characterised by a sound weighted average life of debt of 5.9 years, low average cost of debt of 1.5% in 2020, and non-reliance on short-term debt. Debt service is also reasonably covered by the operating balance (2020: 4.3x) and the city has limited off-balance sheet risks (21% of direct debt in 2020).

Liabilities & Liquidity Flexibility: 'Midrange'

Barcelona's unrestricted available liquidity is strong, covering more than 1x the city's short- and long-term debt that mature in 2021. 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.

Barcelona is considered a type B 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.

In 2021, we expect Barcelona's operating revenue to increase 1.6%, due to higher state funds. Operating revenue in 2022 will be affected by an estimated negative revenue settlement from 2020 of EUR407 million that we expect the city to return in the medium- to-long term, and lower revenue allocation compared with 2021.

Fitch has revised down its main rating-case assumptions due to increasing capex following suspension of fiscal targets in 2021. This reflects a weaker debt payback ratio (net direct risk-to-operating balance) - the primary metric of debt sustainability assessment - of under five years in 2025 (aaa category). This, together with forecast actual debt service coverage ratio (operating balance/ debt service, including short-term debt maturities in the current year) of 4.9 years in 2025 (aaa category), justifies Barcelona's debt sustainability 'aaa' assessment.

Barcelona's direct debt increased to EUR799.7 million in 2020, driven by a fall of the operating balance as a consequence of the pandemic, from EUR780.2 million in 2019. Direct debt had remained moderate between 2015 and 2018 at EUR836 million. Our rating case expects the municipality's net adjusted debt to grow to about EUR1.3 billion at end-2025 from EUR549 million at end-2020, as the city increases its capex and operating expenditure while revenue received declines.

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 6.2x in 2021 and 'Stronger' debt structure robustness and 'Midrange' debt flexibility.

Key Assumptions

Qualitative assumptions and assessments:

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 2016-2020 figures and 2021-2025 projected ratios.

The key assumptions for the scenario include:

-Nominal growth of operating revenue at 1.7% in the next five years

-Nominal growth of operating expenditure at 2.3% in the next five years

-Net capital balance of -EUR452 million in the next five years

-1.8% cost of debt in the next five years

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 on a sustained increase in leverage, particularly if the debt payback ratio worsens beyond 13 years.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Barcelona's IDRs would be upgraded if the sovereign ratings are upgraded.

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].

Liquidity and Debt Structure

Fitch's overall adjusted debt includes Barcelona's financial debt (EUR799.7 million at end-2020), as well as the city public housing entity's net debt (EUR169 million). Net adjusted debt corresponds to the difference between overall adjusted debt and the year-end available cash viewed as unrestricted by Fitch (EUR250.5 million at end-2020).

The city's available cash was EUR660.7 million at end-2020. Fitch considers EUR410 million as restricted, which corresponds to the gap between receivables (net of provisions for difficult-to-collect revenue) and payables.

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.

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

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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-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	LT	A-	Affirmed		A-

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊙	

Applicable Criteria

International Local and Regional Governments Rating Criteria (pub.27 Oct 2020) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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