

CREDIT OPINION

27 April 2020

 Rate this Research

RATINGS

Barcelona, City of

Domicile	Spain
Long Term Rating	Baa1
Type	LT Issuer Rating - Fgn 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.

Contacts

Marisol Blazquez +34.91.768.8213
 AVP-Analyst
 marisol.blazquez@moodys.com

Sebastien Hay +34.91.768.8222
 Senior Vice President/Manager
 sebastien.hay@moodys.com

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City of Barcelona (Spain)

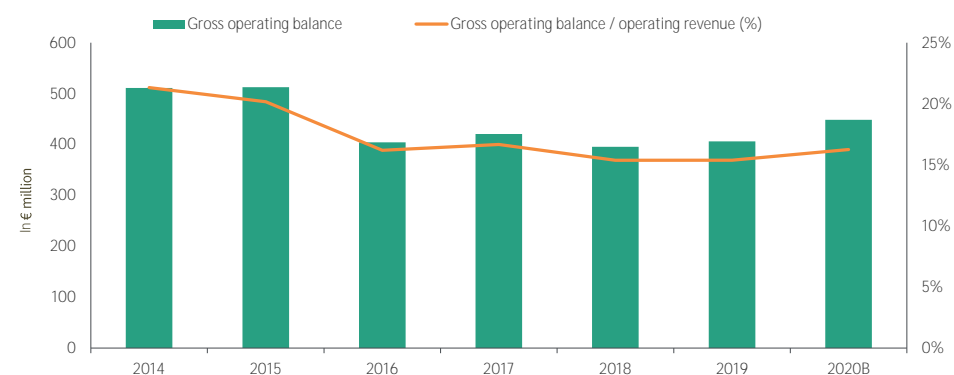
Update to credit analysis

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 high self-financing capacity and low need for debt financing. Because of its self-imposed financial rules, Barcelona has generated operating surpluses of more than 15% of operating revenue since the onset of the 2008 economic crisis (18% on average between 2014 and 2019) and limited its debt to below 60% of operating revenue (34% on average for 2014-19). The realised budget of 2019 shows that Barcelona's gross operating balance (GOB) and debt stock were equivalent to 15.4% and 29.6% of operating revenue, respectively.

Exhibit 1

Barcelona's good operating performance



B: Budget.

Sources: Issuer and Moody's Investors Service

Credit strengths

- » Robust governance and financial management
- » Very strong financial performance
- » Low indebtedness and very good liquidity profile
- » 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, and mirrors the rating outlook on the [Government of Spain](#) (Baa1 stable).

Factors that could lead to an upgrade

As Barcelona's rating is at par with that of Spain, 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

	2014	2015	2016	2017	2018	2019	2020B
Gross Operating Balance as a % of Operating Revenue	21.3	20.2	16.2	16.7	15.4	15.4	16.3
Capital Expenses as a % of Total Expenses	25.1	18.7	17.7	17.4	16.7	14.2	21.6
Self Financing Ratio	1.2	1.3	1.1	1.1	1.1	1.3	0.9
Financing Surplus(Deficit) as % of Total Revenue	5.4	5.4	1.3	1.3	1.2	4.0	-2.8
Interest Expenses as a % of Operating Revenue	1.2	0.9	0.7	0.7	0.5	0.7	0.6
Gross Borrowing Need as a % of Total Revenue	0.0	5.9	4.8	3.6	0.8	0.0	5.7
Net Direct and Indirect debt as a % of Operating Revenue	40.9	33.0	33.6	33.3	32.6	29.6	31.2

B= Budget

Source: Moody's Investors Service

Detailed credit considerations

The credit profile of the City of Barcelona, as expressed in its Baa1 stable rating, combines (1) a Baseline Credit Assessment (BCA) of baa1, and (2) 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.

Very strong financial performance

Barcelona achieved an average annual gross operating surplus of 18% between 2014 and 2019. According to the realised budget of 2019, the city's GOB was €406 million, equivalent to 15.4% of operating revenue, slightly more than the €395 million in 2018. This slight improvement mainly reflected a 2.6% increase in operating revenue, while operating expenditure was contained at a year-on-year increase of 2.6%, compared with an increase of 3.5% in 2018. The rise in revenue was driven by a 4% increase in tax revenue and a 2% increase in transfers from the central government, as the economy improves. The city's positive GOB, together with a 4% increase in capital revenue and a 15% decrease in capital spending, resulted in a financing surplus of €109 million, or 4% of operating revenue, above a surplus of €31 million or 1.2% of operating revenue in 2018. This good result was mainly explained by a 74% year-on-year decrease in capital transfers to the city's public sector, as the city realised extra one-off transfers of around €48 million to some of the public companies in 2018.

Although the full economic impact of the coronavirus is currently unknown, we expect its effects on the city's finances to be limited, as the city's main revenue source doesn't fluctuate in accordance with the economic cycle, in particular property tax, which represented

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56% of total tax revenue in 2019. In addition, transfers from the central government, which represented 43% of the city's operating revenue, are also guaranteed, as a high portion of these transfers depend on the city's population rather than on the growth of the economy.

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 (27 days on average in 2019).

Low indebtedness and very good liquidity

Barcelona has a low level of debt relative to the city's European peers. In 2019, the city's direct debt decreased by 7% to €780 million from €836 million over the past four years, with a net direct and indirect debt-to-operating revenue ratio of 29.6% as of year-end of 2019 (2018: 32.5%), well below its self-imposed limit of 60%.

In 2019, indirect debt increased by 16%, but it is still low compared with that of other Spanish municipalities (6% of operating revenue in 2019). Indirect debt in 2019 comprised €169 million of debt incurred by public companies (€145 million in 2018) and just €1 million of debt guarantees to other related entities or companies. The increase was mainly driven by an increase in the debt of the Instituto Municipal de la Vivienda y Rehabilitación de Barcelona, 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 2,303 houses for social renting until 2022.

To diversify its investor base, Barcelona issued a €35 million sustainable bond in 2017. Bonds accounted for 12% of the city's total debt in 2019. The city did not contract any new debt in 2019 and reduced a part of its direct debt by amortising €56 million during the year.

Although decreasing, the city's liquidity position is very good, with cash on hand as of year-end 2019 of €581 million, equivalent to around 22% of operating revenue, compared with €758 million a year earlier. This cash on hand will be more than sufficient to cover debt repayments of just €81.5 million due in 2020. The high level of cash will be sufficient to cover 74% of Barcelona's outstanding direct debt. We expect cash on hand to continue a lower trend but liquidity to remain good at around €521 million, as forecast by the city for year-end 2020.

Large diversified economy

Barcelona is the capital of the north-eastern Spanish region of Catalunya and one of the country's most developed and wealthiest cities, acting as a decentralising counterweight to the capital Madrid. For the past few years, Barcelona's population has grown largely because of migration inflows; its 1.6 million inhabitants accounted for 3.5% of national population and 21.7% of the Catalan population in 2019.

Barcelona's economy is concentrated in the services sector, which provided employment for around 91% of the total active population as of year-end 2019, well ahead of the industry (6%) and construction (3%) sectors. The services sector mainly focuses on business, healthcare, education, commerce, the hotel industry and tourism. The tourism sector was strong in 2019, as demonstrated by the stable number of visitors to and overnight stays in the city (8.5 million and 21.3 million, respectively). The city's unemployment rate decreased to 8.5% in 2019 from 10% in 2018, below the national average of 13.9%.

While there is a high uncertainty around the impact of the coronavirus outbreak on the city's economy, especially for tourism, we consider Barcelona's economy to be resilient and expect a relatively quick recovery by the second half of the year (although this will depend on the duration of the pandemic).

Limited fiscal flexibility

The City of Barcelona largely depends on transfers from the central government for its revenue. It is responsible for raising a variety of taxes but has limited flexibility in setting their rates, as the central government imposes maximum and minimum ranges. In respect of spending, Barcelona faces significant payroll costs, in common with other Spanish local governments. Although the Spanish local governments control staff numbers, pay-rise packages 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 defaulted. While recognising the government's promotion of greater accountability for Spanish

municipalities, we also believe that 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 risks inform our credit analysis of Barcelona

We take into account the impact of environmental, social and governance (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. Its main environmental risk exposures relate to flood risk, which is predominantly managed by national authorities in case of an emergency. Negative economic and fiscal pressure on the city's credit profile is, therefore, limited.

Social risks are not material to Barcelona's credit profile. While we consider the coronavirus outbreak a social risk, we believe its impact will be limited for this entity, the main cost implications of the outbreak 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.

In terms of governance, Barcelona has a 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" section. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing ESG Risks](#).

Rating methodology and scorecard factors

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

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

Exhibit 3

City of Barcelona

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	1	193.43	70%	1	20%	0.20
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	3	20%	0.60
Financial flexibility	5		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	1	15.56	12.5%	1	30%	0.30
Interest payments / operating revenues (%)	1	0.62	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	29.64	25%			
Short-term direct debt / total direct debt (%)	1	7.33	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						1.4(1)
Systemic Risk Assessment						Baa1
Suggested BCA						baa1

The above scorecard includes 2019 closing figures.

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
BARCELONA, CITY OF	
Outlook	Stable
Issuer Rating	Baa1

Source: Moody's Investors Service

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