

Research Update:

Spanish City of Barcelona 'A' Rating Affirmed; Outlook Stable

September 11, 2020

Overview

- The COVID-19 pandemic will affect the city of Barcelona's performance, and we expect the city to post slight deficits, compared with previous sustained surpluses, with a marginal increase of debt.
- Barcelona continues to carry ample liquidity reserves, keeping low payment terms to suppliers without recurring to liquidity lines.
- Similar to all Spanish cities, the budgetary links between Barcelona and the central government do not allow us to rate the city above our long-term rating on Spain.
- We are therefore affirming our 'A' long-term issuer credit rating on Barcelona. The stable outlook reflects that on Spain.

Rating Action

On Sept. 11, 2020, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on the Spanish City of Barcelona. The outlook is stable.

Outlook

We cap the rating on Barcelona at that on Spain (unsolicited; A/Stable/A-1); therefore, the stable outlook reflects that on Spain.

Downside scenario

We would downgrade Barcelona over the next 24 months if we downgraded Spain.

Upside scenario

We would raise our rating on Barcelona over the next 24 months if we upgraded Spain, all other

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factors unchanged.

Rationale

The rating on Barcelona is primarily driven by that on the sovereign. The links between Spain and Barcelona, like all Spanish cities, do not allow us to rate Barcelona above the sovereign.

Barcelona's creditworthiness is supported by strong financial management that has prompted the city's sound performance in recent years and that is guiding Barcelona through the COVID-19 outbreak with only slight deficits and moderately increasing debt levels. The city's creditworthiness also reflects ample cash reserves that cover very comfortably debt service requirements and that the city will use partially to fund its 2020 deficit.

We assess Barcelona's stand-alone credit profile (SACP) at 'aa-'. The SACP is a way to assess the intrinsic creditworthiness of an LRG under the assumption that the rating on the sovereign is not a constraint.

Prudence of financial management and one-off GDP fall in 2020 maintain financials still relatively sound

We see Barcelona's economy substantially aligned to the national one, although the city posts sounder socioeconomic indicators in some cases. The sharp fall of GDP in 2020 will be followed by an increase in GDP in 2021, which in our view limits budgetary deterioration.

In addition, the city's financial management has temporarily set aside its own set of financial targets, which are more stringent than the national ones, but is facing the extra costs linked to COVID-19 and lower revenue stemming from the fall in GDP by only moderately increasing debt levels and partly using its liquidity cushion. Barcelona had repeatedly posted surpluses in the past years, because of its own prudent budgetary practices. These surpluses have gradually decreased to avoid overshooting the national target of balanced budgets as occurred before, given that Spanish legislation is very restrictive with regard to the use of past surpluses.

Spanish cities operate within an institutional framework marked by a high level of central government control and support. The control enacted on local governments since the European debt crisis has also helped cities generate an overall sound liquidity cushion that they can now use to partly fund the deficits of 2020.

Higher funding needs compared with the past, reflecting small deficits after capital expenditure

We forecast Barcelona's operating margins to average 10.2% of operating revenues over 2020-2022, below the very high 17.8% in 2019 and above recent levels. We anticipate lower revenue and higher expenditure linked to COVID-19, in particular social-related expenses. The city's objective is to gradually increase operating margins from 2022 to again generate margins in line with the 15% internal target.

We forecast Barcelona's investments will be lower on average over 2020-2022, at €377 million versus €446 million in 2019. In our view, this is due to the lockdown but also because Barcelona will try to limit budgetary deficits to comply with national legislation after 2020.

The city's housing operator--Instituto Municipal de la Vivienda y Rehabilitación de Barcelona--is

Research Update: Spanish City of Barcelona 'A' Rating Affirmed; Outlook Stable

undertaking a major project, with almost 164,000 square meters of housing and 60,000 square meters of other facilities (such as commercial space and services).

We expect Barcelona will post an average deficit over 2020-2022 of 1.9% of total revenues, compared with narrow surpluses before. Funding requirements will therefore increase above debt repayment requirements.

The city's direct debt will increase together with its government-related entity debt to fund investments in the housing sector. Tax-supported debt is set to represent nearly 40% of consolidated operating revenues in 2022, compared with almost 31% in 2019.

We expect Barcelona's liquidity will remain solid in 2020 and 2021. Our debt service coverage ratio calculation for those years points to a debt service coverage of roughly 4x. Liquidity will decrease slightly because management will use it partly to fund the 2020 deficit. The city actively manages its liquidity, and maintains the period of payments to suppliers constantly below 30 days.

We cap our long-term rating on Barcelona at the long-term rating on Spain. In our view, the city does not meet the criteria under which we would rate it higher than the related sovereign. We believe it lacks sufficient financial autonomy to effectively resist significant sovereign intervention, such as reductions or delays in central government transfers. We do not believe that Barcelona's credit quality could withstand the stress of a sovereign default, given its reliance on central government transfers and tax transfers (about 40% of operating revenue). Like all Spanish cities, Barcelona has no substantial legislative power over its financial framework.

Key Statistics

Table 1

City of Barcelona--Selected Indicators

(Mil. €)	--Fiscal year ended Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Operating revenues	2,751	2,806	2,864	2,800	2,856	2,929
Operating expenditures	2,264	2,363	2,354	2,505	2,586	2,616
Operating balance	486	443	510	295	270	313
Operating balance (% of operating revenues)	17.7	15.8	17.8	10.5	9.5	10.7
Capital revenues	16	52	29	20	28	42
Capital expenditures	438	452	447	417	332	385
Balance after capital accounts	64	43	92	(102)	(34)	(30)
Balance after capital accounts (% of total revenues)	2.3	1.5	3.2	(3.6)	(1.2)	(1.0)
Debt repaid	126	49	56	81	93	83
Gross borrowings	126	49	0	165	127	112
Balance after borrowings	64	43	36	(19)	(0)	(0)
Direct debt (outstanding at year-end)	836	836	780	863	897	926
Direct debt (% of operating revenues)	30.4	29.8	27.2	30.8	31.4	31.6
Tax-supported debt (outstanding at year-end)	976	982	949	1,119	1,206	1,257

Table 1

City of Barcelona--Selected Indicators (cont.)

(Mil. €)	--Fiscal year ended Dec. 31--					
	2017	2018	2019	2020bc	2021bc	2022bc
Tax-supported debt (% of consolidated operating revenues)	32.9	32.2	30.6	36.8	38.9	39.7
Interest (% of operating revenues)	0.7	0.5	0.4	0.5	0.5	0.5
Local GDP per capita (€)	30,016	30,720	31,713	N.A.	N.A.	N.A.
National GDP per capita (€)	24,972	25,766	26,532	23,209	25,168	26,545

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Ratings Score Snapshot

Table 2

City of Barcelona--Ratings Score Snapshot

Key rating factors	Score
Institutional framework	3
Economy	2
Financial management	2
Budgetary performance	2
Liquidity	1
Debt burden	1
Stand-alone credit profile	aa-
Issuer credit rating	A

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 14, 2020. Interactive version available at <http://www.spratings.com/sri>

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And

Research Update: Spanish City of Barcelona 'A' Rating Affirmed; Outlook Stable

Regional Governments Higher Than The Sovereign, Dec. 15, 2014

- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Credit FAQ: How Central Government Support Will Limit COVID-19's Impact On Spanish Regions' Finances, June 24, 2020
- Spain, March 20, 2020
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed

Barcelona (City of)

Issuer Credit Rating A/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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