S&P Global
Ratings

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Research Update:

Spanish City of Barcelona 'A-' Rating Affirmed; Outlook Remains Positive

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PRIMARY CREDIT ANALYST

Mariamena Ruggiero
Milan
(39) 02-72111-262
mariamena.ruggiero@spglobal.com

SECONDARY CONTACT

Alejandro Rodriguez Anglada
Madrid
(34) 91-788-7233
alejandro.rodriguez.anglada@spglobal.com

ADDITIONAL CONTACT

Alessandro Crocco
Milan
+ 00390272111290
alessandro.crocco@spglobal.com

Overview

- Barcelona's strong financials, with surpluses after investments, low debt, and ample liquidity reserves, follow both the city's prudent financial management and relatively sound economy.
- Similar to all Spanish cities, the budgetary links between Barcelona and the central government do not allow us to rate the city above our current long-term rating on Spain.
- We are therefore affirming our 'A-' long-term issuer credit rating on Barcelona.
- The positive outlook reflects that on Spain.

Rating Action

On Sept. 13, 2019, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on the Spanish City of Barcelona. The outlook is positive.

Outlook

We cap the rating on Barcelona at that on Spain (unsolicited; A-/Positive/A-2); therefore, the positive outlook reflects the outlook on Spain.

Upside scenario

We would raise our rating on Barcelona over the next 12 months if we upgraded the sovereign to 'A' or higher, all other factors unchanged.

Downside scenario

We would revise our outlook on Barcelona to stable over the next 12 months if we revised that on Spain to stable.

Rationale

We affirmed the rating because we believe that Barcelona's newly elected management will continue to post solid performances, low debt levels, and very sound liquidity, all supported by the still-solid economic growth we forecast for Spain. The city is gradually reducing its previously very high surpluses but remains committed to very sound financial results, with sustained operating margins and slight surpluses after investments and stable debt levels.

The solid economy supports revenue growth, which, together with prudent financial management, keeps Barcelona's creditworthiness sound

Our assessment of Barcelona's economy is in line with that on Spain, although some socioeconomic indicators are sounder, such as lower unemployment. However, compared with other major cities in Europe, Barcelona's unemployment is still high. We also believe that the city's revenue growth is substantially in line with the GDP growth forecast for Spain.

Barcelona operates within an institutional framework marked by a high level of central government control and support. Since the European debt crisis, the Spanish government has tightened controls on local and regional governments (LRGs), including cities. It has imposed spending and debt ceilings, and strengthened deficit control rules. At the same time, it has implemented financial support measures, such as extending central government loans to clear LRGs' debts to suppliers and allowing the LRGs greater tax flexibility on some fiscal items.

Barcelona has not benefited directly from the supportive measures because its financial performance has been sound for several years. The city's newly elected financial management will continue to comply with its own set of financial targets (which are more stringent than the national ones) with minor surpluses but consistent operating margins and debt levels below 60% of operating revenue. Barcelona had repeatedly posted surpluses in the past years, because of its own prudent budgetary practices. These surpluses have gradually decreased to an overall balanced position to avoid overshooting the target as occurred before. Spanish legislation is very restrictive with regard to the use of past surpluses.

The results of May's local elections confirmed that Barcelona's political framework is still fragmented. The government coalition, led by the former mayor Ada Colau, has a very narrow majority; therefore, political instability is still a risk. While this does not affect our view of management's commitment to fiscal discipline, it could complicate the budgeting process, as has happened before.

Funding needs are only for refinancing, reflecting small surpluses after capital expenditure

We expect that, in line with its own targets, Barcelona will post operating surpluses near 15% of operating revenue throughout our 2019-2022 forecast horizon. This is below the city's historical performance, in particular during 2012-2015 when operating margins exceeded 20% of operating revenue. However, Barcelona has increased operating spending in the past years, in particular social-related spending.

We believe operating spending will remain high in the next few years, although it will not threaten the city's operating margins, because we expect operating revenue will continue to increase alongside GDP growth. Barcelona stands to benefit from economic growth both affecting local taxes and larger government transfers (including shared taxes), which represent about 40% of the city's operating revenue.

We forecast Barcelona's investments around an average of €465 million per year from 2019-2022. The newly elected government has not drafted a new investment plan, but we do not expect investment levels to change substantially. Barcelona's housing operator--Instituto Municipal de la Vivienda y Rehabilitación de Barcelona--is carrying out a major investment with 163,000 square meters of housing and 60,000 square meters of other facilities (such as commercial space and services) by 2021.

We expect Barcelona will post a narrow surplus after capital accounts of about 0.3% of total revenue over 2019-2022. This surplus is lower than the average of 6.8% recorded over 2012-2015, owing to the city's efforts to adapt its budgetary process to reduce unwanted surpluses by executing expenditure plans.

For 2019-2022, Barcelona's funding requirements continue to be limited to refinancing. In 2018, the city's refinancing needs totalled €49.5 million, which it covered with a tranche of a €100 million loan from the Council of Europe Development Bank. Barcelona's refinancing needs for 2019 and 2020 stand at €55.9 million and €81.4 million, respectively.

We expect the city's direct debt will remain stable through 2022 at about €836 million. Tax-supported debt is set to rise slightly, due to the large investments of the housing operator, representing about 37.0% of consolidated operating revenue in 2022, compared with 33.6% in 2016.

We expect Barcelona's liquidity will remain solid in 2019 and 2020. Our debt service coverage ratio calculation for 2019 and 2020 points to a debt service coverage of roughly 5x. Liquidity could slightly trend down because of capital expenditure, but we do not expect the city to use liquidity to fund debt service requirements, which it will continue to refinance. Barcelona actively manages its liquidity, and maintains the period of payments to suppliers constantly below 30 days.

We assess Barcelona's stand-alone credit profile (SACP) at 'aa'. The SACP is not a credit rating but a means of assessing the intrinsic creditworthiness of an LRG under the assumption that the rating on the sovereign is not a constraint. The SACP results from the combination of our assessment of an LRG's individual credit profile and the institutional framework under which it operates.

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

	--Fiscal year ended Dec. 31--					
(Mil. €)	**2017**	**2018**	**2019e**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	2,751	2,806	2,822	2,851	2,877	2,902

Table 1

City of Barcelona -- Selected Indicators (cont.)

	--Fiscal year ended Dec. 31--					
(Mil. €)	2017	2018	2019e	2020bc	2021bc	2022bc
Operating expenditures	2,264	2,363	2,394	2,416	2,435	2,457
Operating balance	486	443	428	434	442	445
Operating balance (% of operating revenues)	17.7	15.8	15.2	15.2	15.3	15.3
Capital revenues	16	52	40	40	40	40
Capital expenditures	438	452	456	466	476	476
Balance after capital accounts	64	43	12	8	5	9
Balance after capital accounts (% of total revenues)	2.3	1.5	0.4	0.3	0.2	0.3
Debt repaid	126	49	56	81	93	83
Gross borrowings	126	49	56	81	93	83
Balance after borrowings	64	43	12	8	5	9
Direct debt (outstanding at year-end)	836	836	836	836	836	836
Direct debt (% of operating revenues)	30.4	29.8	29.6	29.3	29.0	28.8
Tax-supported debt (outstanding at year-end)	976	982	1,011	1,092	1,145	1,167
Tax-supported debt (% of consolidated operating revenues)	32.9	32.2	33.0	35.3	36.7	37.1
Interest (% of operating revenues)	0.7	0.5	0.6	0.6	0.6	0.5
Local GDP per capita (€)*	30,016	30,720	31,713	32,769	33,834	34,916
National GDP per capita (€)	25,067	25,896	26,849	27,701	28,570	29,417

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. e--Estimate. *Provincial data.

Ratings Score Snapshot

Table 2

City of Barcelona -- Ratings Score Snapshot

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

Table 2

City of Barcelona -- Ratings Score Snapshot (cont.)

Key rating factors	Scores
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 11, 2019. 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 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- 2018 Annual International Public Finance Default And Rating Transition Study, Aug. 19, 2019
- Institutional Framework Assessments For International Local And Regional Governments, July 4, 2019
- Spanish Municipalities' And Regions' Credit Story Since The Crisis: What You Need To Know, Feb. 11, 2019
- Public Finance System Overview: Spanish Normal Status Regions, Aug. 2, 2018

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-/Positive/--