MOODY'S
PUBLIC SECTOR EUROPE

Rating Action: Moody's assigns B1 issuer rating to City of Belgrade; outlook positive

Global Credit Research - 25 Oct 2016

London, 25 October 2016 -- Moody's Public Sector Europe (MPSE) has today assigned a B1 issuer rating to the City of Belgrade. The outlook on the rating is positive.

The B1 rating reflects the city's:

(1) prudent budgetary management, characterized by sound operating surpluses

(2) continuing comfortable cash reserves

(3) relatively high but declining debt burden

(4) crucial role in the national economy

RATINGS RATIONALE

The first driver supporting the rating is the Belgrade's sound fiscal performances, with double-digit operating surpluses recorded over the last five years. In 2015, the city's gross operating balance-to-operating revenue ratio stood at 12% in line with the performance in 2014. In 2016 and 2017, Moody's expects Belgrade's operating margin to improve to 14% and 16% of operating revenue respectively, attributable to combined effect of (1) the positive national economic growth prospects, which will translate into growing proceeds of shared taxes, coupled with increased collection of property tax and own-source non-tax revenues; and (2) slower growth in operating expenditures.

According to Moody's, the improvement in the operating margins, combined with a drop in capital expenditure, led to a financing surplus between 3%-7% of total revenues during 2013-15, compared with a financing deficit of 7% in 2012 and 18% in 2011. However, the City of Belgrade's capital investment plan for 2016-17 envisages large capital investments, which if fully implemented could trigger the city's financing result to revert into negative territory.

The second driver is Moody's view that the city's cash reserves will remain above RSD10 billion and represent a cushion well in excess of Belgrade's debt service requirements in 2017. Moody's says that Belgrade's sound financial performance has led to a comfortable liquidity position. Its accumulated cash reserves averaged 17% of operating revenues in the first three quarters of 2016, representing 1.5x of projected debt servicing costs.

The third driver is the City of Belgrade's relatively high debt, although its net direct and indirect debt levels declined to 85% of operating revenue from 101% in 2014. Moody's expects that the city's debt will further decline to around 58% of operating revenues by year-end 2017 following the city's commitment to fund the majority of its investment programme from the operating margin, asset sale or central government transfers. A high FX exposure represents an additional financial risk for the City of Belgrade as 87% of the city's debt was denominated in euros at year-end 2015. However, Moody's notes that the city's debt burden will remain manageable with annual debt repayments at around 9% of total revenues during 2016-17.

The fourth driver is the important role Belgrade plays in the national economy as Serbia's capital and most developed city. The local economy is dynamic and much more diversified than other Serbian cities, limiting its exposure to economic cycles. The city is of central strategic importance to the Serbian economy and it is the country's largest economic hub, accounting for about 39% of national GDP. With 1.7 million residents, accounting for approximately 24% of Serbia's population in 2015, Belgrade is the country's largest labour market. Belgrade's relative affluence is evident in its GDP per capita, which is 70% above the national average.

RATIONALE FOR POSITIVE OUTLOOK

The rating outlook mirrors the positive outlook on the B1 sovereign rating, reflecting the macroeconomic and financial linkages between the state and local governments in Serbia. Belgrade is dependent on intergovernmental revenues in the form of shared taxes, which represent around 55% of operating revenue. In addition, the institutional linkages intensify the close ties between the two levels of government through the sovereign's ability to change the institutional framework, under which the Serbian sub-sovereigns operate.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Upgrade of the City of Belgrade's rating would require an upgrade of the sovereign rating, associated with maintenance of sound operating margin and sustained balanced financial performance. Significant change in the city's revenue and expenditure flexibility and ability to raise an additional own-source revenues would also have positive implications on the rating.

Any downward movement in the sovereign rating could exert downward pressure on the Belgrade's rating due to the close macroeconomic and operational linkages with the central government. Downward pressure on the rating could also occur if the city (1) further materially increases its debt burden; and/or (2) suffers a deterioration in its operating and financial performance.

The specific economic indicators, as required by EU regulation, are not available for these entities. The following national economic indicators are relevant to the sovereign rating, which was used as an input to this credit rating action.

Sovereign Issuer: Serbia, Government of

GDP per capita (PPP basis, US$): 13,671 (2015 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 0.7% (2015 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 1.6% (2015 Actual)

Gen. Gov. Financial Balance/GDP: -3.8% (2015 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -4.8% (2015 Actual) (also known as External Balance)

External debt/GDP: [not available]

Level of economic development: Moderate level of economic resilience

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983*.

*Events related to the debts of the Former Yugoslavia

On 21 October 2016, a rating committee was called to discuss the rating of the Belgrade, City of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength. The issuer's institutional strength/framework. The issuer's governance and/or management. The issuer's fiscal or financial strength, including its debt profile. The systemic risk in which the issuer operates. The susceptibility to event risks.

The principal methodology used in this rating was Regional and Local Governments published in January 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

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