MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
30 September 2020

Rate this Research

RATINGS

Belgrade, City of

Domicile	Serbia
Long Term Rating	Ba3
Type	LT Issuer Rating - Fgn Curr
Outlook	Positive

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

Gjorgji Josifov +420.23.474.7531
AVP-Analyst
gjorgji.josifov@moodys.com

Massimo Visconti +39.02.9148.1124
VP-Sr Credit Officer/Manager
massimo.visconti@moodys.com

Sabina Kathrin Coca +49.69.7073.0894
Associate Analyst
sabinakathrin.coca@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

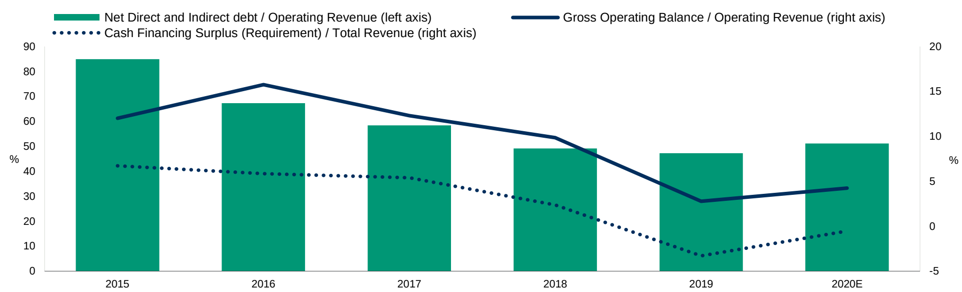
City of Belgrade (Serbia)

Update to credit analysis

Summary

The credit profile of City of Belgrade (Ba3 positive) reflects its prudent fiscal management, which results in solid financial performance and a strong likelihood that the Government of Serbia (Ba3 positive) would provide support in case the city were to face acute liquidity stress. The unprecedented shock caused by the coronavirus pandemic and the decline in economic activity will affect the city's revenue in 2020. The rating also reflects Belgrade's still relatively high debt levels and its crucial role in the national economy. At the same time, the rating takes into account the city's high investment requirements, associated with pressure stemming from the transport company.

Exhibit 1
Good pre-crisis financial position mitigates the economic and fiscal shock of the pandemic



E - estimate; 2020 - Moody's estimate
Source: City of Belgrade, Moody's Public Sector Europe

Credit strengths

» healthy pre-crisis operating performance buffers economic shock of the pandemic

» overall satisfactory financial results, notwithstanding the huge investment needs

» comfortable liquidity position

» Belgrade's wealthy economy and important role as national economic hub

Credit challenges

» manageable debt but indirect exposure remains considerable

» limited revenue and expenditure flexibility

Rating outlook

The positive outlook on Belgrade's rating mirrors the positive outlook on the sovereign bond rating. It also reflects our expectation that the city will be able to preserve its overall stable financial performance and that debt burden will remain below 60% of operating revenue in 2020-21. The city's history of prudent budgetary management further supports the positive outlook.

Factors that could lead to an upgrade

» Upward pressure on the rating of Belgrade could arise from an upgrade of the sovereign rating associated with the city's ability to maintain its good financial performance and satisfactory liquidity position.

Factors that could lead to a downgrade

» Although unlikely, given the positive outlook, a deterioration in the sovereign credit strength could exert pressure on Belgrade's rating because of the close financial, institutional and operational links between the two tiers of governments.

» A material deterioration in the city's operating and financial performance and a material increase in its debt exposure could also lead to a rating downgrade.

Key indicators

Exhibit 2

City of Belgrade

	2015	2016	2017	2018	2019
Net Direct and Indirect Debt/Operating Revenue (%)	84.9	67.3	58.4	49.2	47.2
Debt Service/Total Revenue (%)	9.2	9.7	8.6	4.8	4.7
Gross Operating Balance/Operating Revenue (%)	12.0	15.8	12.3	9.9	2.8
Cash Financing Surplus (Requirement)/Total Revenue (%)	6.7	5.9	5.4	2.4	-3.3
Intergovernmental Transfers/Operating Revenue (%)	0.2	0.3	0.5	1.6	2.3
Self-Financing Ratio	1.5	1.4	1.3	1.1	0.8
Capital Spending/Total Expenditure (%)	13.4	16.9	16.9	16.5	19.1

Source: City of Belgrade, Moody's Public Sector Europe

Detailed credit considerations

Belgrade's Ba3 rating combines (1) the baseline credit assessment (BCA) of ba3, and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity face acute liquidity stress.

Baseline credit assessment

HEALTHY PRE-CRISIS OPERATING PERFORMANCE BUFFERS ECONOMIC SHOCK OF THE PANDEMIC

Belgrade's gross operating balance (GOB) deteriorated to a low 3% in 2019, compared with healthy 10% in the previous year despite the annual growth of 5.4% of operating revenue. Deterioration of the operating performance was primarily driven by the temporary increase of 35% of costs for goods and services mostly attributable to contractual services consuming RSD27 billion or 32% of operating expenditures.

We expect the personal income tax and other shared tax revenues, which together constitute around 55% of the city's operating revenue, to decrease by 6% in 2020, before recovering in 2021 if the pandemic is contained. The expected decline of the proceeds from PIT, estimated at RSD1.8 billion, will mostly be driven by the economic contraction of 3.5%, resulting from the coronavirus pandemic-induced shock.

According to the latest budget adjustment for 2020, Belgrade will keep operating spending growth in check through a combination of spending reviews and cost controls. Given the rigidity in Belgrade's operating spending, these measures will focus primarily on containing the growth of costs of goods and services (projected annual decline of 13%), and current transfers and donations (decline of 10%).

As a result, we expect Belgrade's GOB to remain low at around 4% of operating revenue in 2020. The drop in revenue from income tax will test Belgrade’s traditionally prudent budgetary management because of financial rigidity. Own source revenue represents a minor proportion of the city's revenue and it accounts for 20% of operating revenue, incorporating property tax, local utility fees, and administrative fees, which we expect to decrease by 9% in 2020. This high fiscal dependence on state decisions exposes city's finances to the performance of the general government budget and evolving intergovernmental relations.

Although the coronavirus pandemic presents a severe shock for the Serbia's economy, we expect economic activity to gradually resume in 2021 and the city's revenue to regain its dynamism. We, therefore, expect the city's GOB to improve in 2021.

OVERALL SATISFACTORY FINANCIAL RESULTS, NOTWITHSTANDING THE HUGE INVESTMENT NEEDS

In 2019, the city posted a low financing deficit of 3.3% of total revenue compared with a financing surplus of 2.4% in 2018. Belgrade will probably resize or postpone some of its initially planned capital investments, estimated at RSD18 billion in 2020, to prevent the broadening of financing deficits, projected at 2% of total revenue.

Belgrade's capital program targets transportation infrastructure, street renovation, public buildings facade rehabilitation, bridges construction and renovation, as well as extension of sewage system and reconstruction of water supply network. The city’s investments also include projects focused on education and social services.

The rehabilitation and extension of Vinca landfill as well as the treatment and disposal of solid waste are another important projects for the city. These projects will be built through the first-ever public-private partnership (PPP) in waste management in Serbia. The construction works have already started in H2 2019 and the operations are scheduled to begin in 2021. A special purpose vehicle (SPV) was created to serve as an operator, and the total value of the investment is estimated to be in the range of EUR300 million, which will be funded by the private partner. The city has provided the land for the facility site and necessary infrastructure arrangements. Beside the necessary costs for infrastructure arrangements of the site no other impact is expected on the city’s budget. Moody’s will closely monitor the implementation of this project given the risk which is associated with realization of such an investment.

COMFORTABLE LIQUIDITY POSITION

We expect Belgrade’s liquidity to remain satisfactory in 2020. In 2019, the average cash balance on its accounts was RSD12.1 billion, (RSD13 billion in 2018), accounting for 14% of operating revenue. The city’s cash reserves comfortably cover 3.4x of its debt service requirements falling due in 2020 and provide the city with sufficient funds against potential budgetary pressures and support for capital investments in the medium term.

Belgrade’s regular and predictable inflows and outflows throughout the year and its cash-generating capacity provide sufficient cash to cover the city’s debt servicing requirements due in 2020-21. The city follows a prudent cash management strategy, which, together with regular distributions of shared taxes, ensures smooth cash flow.

While we expect some volatility resulting from the negative effects of the pandemic in 2020, we believe the city's liquidity will remain broadly stable.

BELGRADE'S WEALTHY ECONOMY AND IMPORTANT ROLE AS NATIONAL ECONOMIC HUB

The City of Belgrade plays an important role in the national economy as Serbia’s capital and largest city with 1.694 inhabitants (2019 latest available data). Belgrade's economy is diversified, limiting its exposure to economic cycles. According to the latest available data of 2018, the city contributes significantly to the country's economy, accounting for 41% of the national GDP. The city's unemployment rate was 8.7% as of year-end 2019, below the national rate of 9.7%.

The city's relative wealth is evident in its GDP per capita, which was 171% of the national average in 2018. Belgrade economically outperforms domestic peers and is also well positioned relative to other South-Eastern European cities. Belgrade is a seat of the central government and hosts the country’s main universities and the headquarters of the largest companies.

MANAGEABLE DEBT BUT INDIRECT EXPOSURE REMAINS CONSIDERABLE

Belgrade's direct debt grew to RSD37.6 billion in 2019 from RSD36.3 billion in 2018, representing 43% of operating revenue, which is similar level to the previous year, but significantly lower than 87% posted five years ago. We expect the city's direct debt to increase to 45% in 2020 and to 50% of projected operating revenue in 2021 following the new loan agreement signed with European Investment Bank (EIB, Aaa stable) in September 2019 to fund the construction of the sewage on the left bank of Danube river in the amount of EUR35 million.

In 2019, Belgrade's direct debt consisted of bank loans: (1) RSD22.3 billion loans with EIB, (2) RSD11.1 billion loans with European Bank for Reconstruction and Development (EBRD, Aaa stable), and (3) RSD4.2 billion loan with Banca Intesa. Loans were used for modernization of transportation, public roads and streets, construction of a new bridge over the Sava river, rehabilitation of water supply and sewage network, and modernization of social and housing infrastructure.

The loss-making transportation company GSP, which is under the city's direct control, will remain a continuous source of budgetary pressure to the city's budget, given the ongoing investments, in particular the renewal of its bus fleet for which the city has provided the funding sources.

As of January 2019, subsidies from the city's budget to GSP were replaced by new contract following the adjustments in the way the sector is financed and amounted RSD14.5 billion. The same amount is planned in 2020, with RSD10 billion to be paid through the contract and additional RSD4.5 billion will be provided as subsidies. New agreement between the city and GSP allows a full compensation for public transportation service obligations as well as a fair level of profit (including depreciation). In addition, the city provided a capital injection to GSP amounted RSD4.2 billion in 2019.

When taking into account the debt of GSP, which we consider as a non-self supporting company according to our methodology, the city's net direct and indirect debt (NDID) accounted for 47% of operating revenue as of year-end 2019, down from 49% in 2018. All of the company's debt of RSD3.8 billion in 2019 (down from RSD4.6 billion in 2018) is included in Belgrade's indirect debt exposure. The latest projections suggest that the city's NDID will slightly grow to 50% of projected operating revenue in 2020, driven by the new debt of the city to support planned investments.

The entire debt of Belgrade was denominated in euro as of year-end 2019, making the city debt more vulnerable to exchange-rate fluctuations. However, the lengthy maturity and amortizing nature of Belgrade's debt partially mitigate the pressures associated with the foreign-currency risk. Belgrade's debt service costs should remain moderate at around 5% of the total revenue projected for 2020-21.

LIMITED REVENUE AND EXPENDITURE FLEXIBILITY

We consider Belgrade's budgetary flexibility as limited. Shared taxes, including the personal income tax, which the city cannot modify, accounted for roughly 54% of operating revenues in 2019, implying the city's dependance on the central government regarding tax revenues.

Partially mitigating this lack of discretionary powers on the tax revenue side, the institutional framework attributes a greater revenue rising capacity related to the city's local taxes and fees compared to other local governments in Serbia, representing 21% of operating revenues in 2019.

Belgrade's rating is also constrained by the institutional framework under which Serbian local governments operate. The framework exhibits frequent changes, which results in low financial predictability and stability, constraining policy effectiveness at the city level and limiting Belgrade's ability to effectively plan for the long term.

The expenditure flexibility of Belgrade is also limited as significant proportion of costs cannot be reduced according to the law such as salaries and social payments. When adding other inflexible costs, including interest payments, subsidies and transfers to other governing levels and city owned companies, the share of such expenditures fluctuates in the range of 60-70% of operating expenditures. The capex remains a major leeway for Belgrade, although it is curbed by high infrastructure needs, common for all Serbian local governments.

Belgrade's spending also comes from subsidies and transfers to other governing levels and its owned companies (12.2% of total expenditures in 2019), which play an active role in providing core public services. Belgrade provides various services through its 31 majority-owned companies and affiliates. However, the active role played by city-owned companies should contain the operating expenditure pressure going forward.

Extraordinary support considerations

We consider Belgrade to have a strong likelihood of extraordinary support from the central government, reflecting our assessment of the city's strategic importance to the national economy. The assessment also indicates a moderate system of oversight by the central government that requires regular monitoring of cities' indebtedness.

ESG considerations

We take account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Belgrade, the materiality of ESG factors to its credit profile is as follows:

Environmental considerations are not material to Belgrade's credit profile. The city has only limited exposure to some flood risk, but in that case, the central government would provide support.

Social considerations are material to Belgrade's credit profile. We view the coronavirus pandemic as a social risk under our ESG framework, given the substantial implications for public health and safety. Belgrade is more specifically exposed to the evolution of its demography, with its population exposed to net immigration flows. The unemployment rate in Belgrade is lower than the average for Serbia, and the average salary in Belgrade is higher than that in the remaining parts of the country. These factors have led to immigration to the city recently.

Governance considerations are material to Belgrade's credit profile. Belgrade uses prudent financing planning, which allows for multiyear forecasting of key trends, providing the city with the ability to identify potential pressures and allowing for sufficient time to adjust plans to mitigate any credit implications.

Further details are provided in the "Baseline Credit Assessment" section above. Our approach to environmental, social and governance factors is explained in our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks.

Rating methodology and scorecard factors

The assigned baseline credit assessment (BCA) of ba3 is close to the scorecard-indicated BCA of b1. The matrix-generated BCA of b1 reflects (1) an idiosyncratic risk score of 4 (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 Ba3, as reflected in the sovereign bond rating.

Exhibit 3

Rating Factors

City of Belgrade

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	1	169.73	70%	1	20%	0.20
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	5		50%	6	20%	1.20
Financial flexibility	7		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	3	6.19	12.5%	2	30%	0.60
Interest payments / operating revenues (%)	3	1.33	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	3	47.20	25%			
Short-term direct debt / total direct debt (%)	1	9.40	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			5	30%	1.50
Investment and debt management	5					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						**3.5(4)**
Systemic Risk Assessment						**Ba3**
Suggested BCA						**b1**

Source: Moody's Public Sector Europe

Ratings

Exhibit 5

Category	Moody's Rating
BELGRADE, CITY OF	
Outlook	Positive
Issuer Rating	Ba3

Source: Moody's Investors Service

REPORT NUMBER 1246314

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454