MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
17 March 2021

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RATINGS

Belgrade, City of

Domicile	Serbia
Long Term Rating	Ba2
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.

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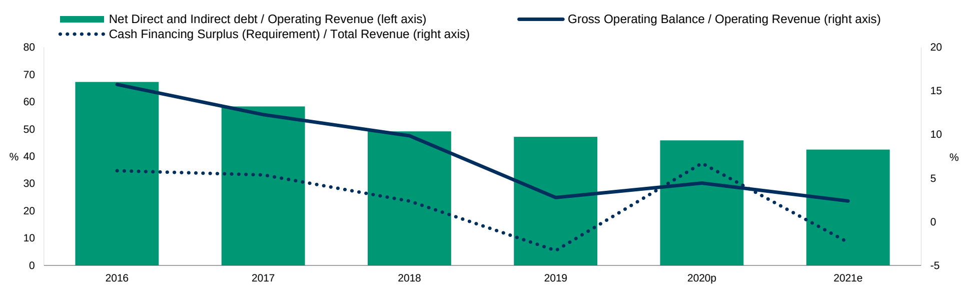
City of Belgrade (Serbia)

Update following upgrade to Ba2 stable

Summary

The credit profile of City of Belgrade (Ba2 stable) reflects its strong fiscal management, which results in solid financial performance and a track record of declining debt burden with limited borrowing requirements. The rating is also underpinned by Belgrade's role as the capital city and the country's largest economic hub, accounting for almost 40% of Serbian gross domestic product (GDP). Economic growth prospects this year is around 5% which will help the city to maintain sound financials. At the same time, the rating takes into account the city's high investment requirements, associated with pressure stemming from the transport company. We assess a strong likelihood that the Government of Serbia (Ba2 stable) would provide support in case the city were to face acute liquidity stress.

Exhibit 1
Good financial position despite economic and fiscal impact of the pandemic



p - preliminary results; 2021e - Moody's estimate
Source: City of Belgrade, Moody's Public Sector Europe

Credit strengths

- healthy operating performance buffers economic shock of the pandemic
- overall balanced financial results, notwithstanding the huge investment needs
- sound 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 stable outlook on Belgrade's rating mirrors the stable outlook on the sovereign rating. It also reflects Moody's expectation that the city will be able to preserve its overall solid and stable financial performance, and moderate debt level. The city's history of prudent budgetary management further supports the stable outlook.

Factors that could lead to an upgrade

Given the limited fiscal autonomy and market insulation of the city, an upgrade of Belgrade's rating would require an upgrade of Serbia's sovereign rating. In addition, the city's ultimate dependence on the central government is underpinned by the sovereign's ability to change the institutional framework under which Serbian sub-sovereigns operate. This prevents the City of Belgrade being rated above the sovereign. An upgrade of Serbia's sovereign rating associated with a continuation of solid budgetary performance, moderate debt level and adequate liquidity level would likely point to an upgrade of the city's rating.

Factors that could lead to a downgrade

Although unlikely given the recent sovereign upgrade, a deterioration of the sovereign credit strength would apply downward pressure on the city's rating given the close financial, institutional and operational linkages between the two tiers of governments. Significant financial deterioration driven by reduced operating margins, an unexpected sharp increase in debt as well as the emergence of liquidity risks, would also exert downward pressure on the rating.

Key indicators

Exhibit 2
City of Belgrade

	2016	2017	2018	2019	2020
Net Direct and Indirect Debt/Operating Revenue (%)	67.3	58.4	49.2	47.2	45.9
Debt Service/Total Revenue (%)	9.7	8.6	4.8	4.7	4.2
Gross Operating Balance/Operating Revenue (%)	15.8	12.3	9.9	2.8	4.5
Cash Financing Surplus (Requirement)/Total Revenue (%)	5.9	5.4	2.4	-3.3	6.7
Intergovernmental Transfers/Operating Revenue (%)	0.3	0.5	1.6	2.3	2.4
Self-Financing Ratio	1.4	1.3	1.1	0.8	1.5
Capital Spending/Total Expenditure (%)	16.9	16.9	16.5	19.1	13.2

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

Detailed credit considerations

On 16 March 2021, we upgraded Belgrade's issuer rating to Ba2 from Ba3 and stabilised the outlook. The rating action followed an upgrade of Serbia's sovereign bond rating.

Belgrade's Ba2 rating combines (1) the baseline credit assessment (BCA) of ba2, and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faces acute liquidity stress.

Baseline credit assessment

HEALTHY OPERATING PERFORMANCE BUFFERS ECONOMIC SHOCK OF THE PANDEMIC

Based on preliminary figures, Belgrade's gross operating balance (GOB) is expected to be around 5% of operating revenues in 2020, compared with 3% a year earlier. We consider this a healthy level, although lower than the around 10% in 2018 and earlier years. 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 in 2019.

Tax revenues - mainly comprising personal income tax and other shared tax revenues - which together constitute the lion's share of the city's operating revenue, are expected to continue to grow over 2021 and 2022. The development of tax revenues is following the development of ecomomic development, which we predict to recover with around 5% real gross domestic product (GDP) growth rate in 2021, recovering from a slight GDP contraction in 2020 due to the pandemic.

According to preliminary 2020 figures, 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 and current transfers and donations.

As a result, we expect Belgrade's GOB to remain low at around 2% of operating revenue in 2021. We expect city's management to continue its traditionally prudent budgetary management because of financial rigidity. Own source revenue represents a minor proportion of the city's revenue and it accounts for around 20% of operating revenue, incorporating property tax, local utility fees, and administrative fees. The high fiscal dependence on state decisions exposes city's finances to the performance of the general government budget and evolving intergovernmental relations.

The coronavirus pandemic presents a shock for Serbia's economy, but we expect economic activity to resume in 2021 with real GDP expanding by around 5%, driven by the recovery in domestic demand supported by the normalization of economic activity on the back of a relatively rapid vaccination rollout and significant public investment. This should help the city's revenue to regain its dynamism. We, therefore, expect the city's GOB to improve over the coming two to three years.

OVERALL BALANCED FINANCIAL RESULTS, NOTWITHSTANDING THE HUGE INVESTMENT NEEDS

According to preliminary 2020 figures, the city posted a healthy 7% financing surplus of total revenue compared with a financing deficit of 3% in 2019. We understand that preliminary figures may be revised slightly but given the economic decline, this represents a strong outcome. In 2021 and 2022, we expect the city to report slight financial deficits. Belgrade has some flexibility to improve its financial results, by postponing some of its initially planned capital investments, estimated at RSD20 billion in 2021 and following years, to prevent the broadening of financing deficits.

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. We consider obligations related to the project as self-supporting, netted off from indirect debt. We will closely monitor the implementation of this project given the risk which is associated with realization of such an investment.

SOUND LIQUIDITY POSITION

We expect Belgrade's liquidity to improve in 2021 from a healthy level. In 2020, year-end cash balance on its accounts was RSD10.2 billion, (RSD6.3 billion in 2019). The city's cash reserves cover 2.0x of its debt service requirements falling due in 2021 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 2021-22. 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, we believe the city's liquidity will remain in line with comfortable 2020 level.

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 is around 170% of the national average. 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 is expected to have declined to RSD35.2 billion in 2020 from RSD37.6 billion in 2019, representing 40% of operating revenue, which is slightly lower than previous year, but significantly lower than 76% posted five years earlier. We expect the city's direct debt to remain stable or slightly increase, reflecting also its 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) is expected to have accounted for 46% of operating revenue as of year-end 2020, down from 47% in 2019. 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 entire debt of Belgrade was denominated in euro as of year-end 2020, 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 2021-22.

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

How environmental, social and governance risks inform our credit analysis of Belgrade

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. Its main environmental risk exposure relates to floods. However, as evidenced during the floods in 2014, in the event of natural disasters, the national government would provide support and bear most of the costs of recovery and reconstruction at the local level.

Social considerations are material to Belgrade that is more specifically exposed to the evolution of its demography, with its population exposed to net immigration flows. The population growth is putting some strain to the city's budget to meet the infrastructure and housing needs.

Governance considerations are material to Belgrade's credit profile. While the city has moderate fiscal flexibility, it follows prudent budgetary management practices. 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 ba2 is close to the scorecard-indicated BCA of ba3. The matrix-generated BCA of ba3 reflects (1) an idiosyncratic risk score of 2 (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 Ba2, as reflected in the sovereign bond rating.

Exhibit 3

Belgrade, City of

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**1**	**20%**	**0.20**
Economic Strength [1]	1	166.99%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**6**	**20%**	**1.20**
Legislative Background	5		50%			
Financial Flexibility	7		50%			
Factor 3: Financial Position				**2**	**30%**	**0.60**
Operating Margin [2]	3	6.34%	12.5%			
Interest Burden [3]	3	1.28%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	3	47.22%	25%			
Debt Structure [5]	1	9.08%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**2.30 (2)**
Systemic Risk Assessment						**Ba2**
Suggested BCA						**ba2**

[1] Local GDP per capita as % of national GDP per capita
[2] Gross operating balance/operating revenues
[3] Interest payments/operating revenues
[4] Net direct and indirect debt/operating revenues
[5] Short-term direct debt/total direct debt
Source: Moody's Investors Service; Fiscal 2019.

Ratings

Exhibit 4

Category	Moody's Rating
BELGRADE, CITY OF	
Outlook	Stable
Issuer Rating	Ba2

Source: Moody's Investors Service

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Americas	1-212-553-1653
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