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CREDIT OPINION
28 July 2023

Update

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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)

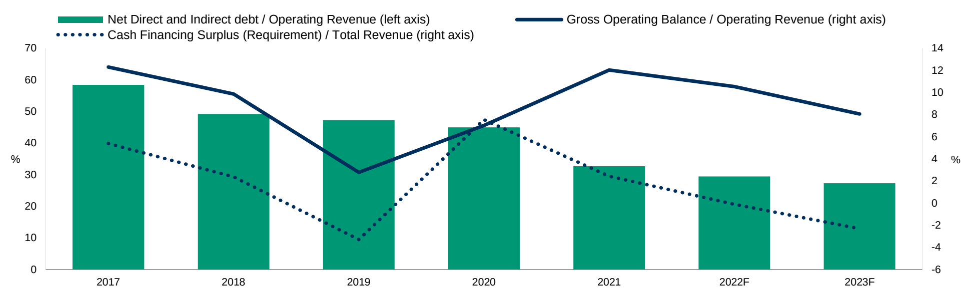
Update to credit analysis

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, as well as a good liquidity position. The credit profile is also underpinned by Belgrade's role as the capital city and the country's largest economic hub, accounting for 42% of Serbian gross domestic product (GDP). Economic growth prospects forecasted at 2.5% in 2022 will help the city to maintain sound financials. At the same time, the rating takes into account the city's high investment needs, 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 and declining debt trend



F - Moody's estimate
Source: City of Belgrade, Moody's Investors Service

Credit strengths

» Healthy operating performance

» Overall balanced financial results, notwithstanding investment needs

» Low direct debt burden and sound liquidity position

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

Credit challenges

» Some exposure to city-owned public transportation company

» 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 the city's capacity to preserve its overall solid and relatively stable financial performance, and modest 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 local governments 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, modest debt level and adequate liquidity level would likely point to an upgrade of the city's rating.

Factors that could lead to a downgrade

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

	2017	2018	2019	2020	2021	2022F	2023F
Net Direct and Indirect Debt/Operating Revenue (%)	58.4	49.2	47.2	44.9	32.7	29.4	27.2
Debt Service/Total Revenue (%)	8.6	4.8	4.7	4.1	3.8	5.5	3.3
Gross Operating Balance/Operating Revenue (%)	12.3	9.9	2.8	7.0	12.0	10.5	8.0
Cash Financing Surplus (Requirement)/Total Revenue (%)	5.4	2.4	-3.3	7.5	2.4	-0.1	-2.3
Intergovernmental Transfers/Operating Revenue (%)	0.5	1.6	2.3	2.3	9.6	6.8	6.8
Self-Financing Ratio	1.3	1.1	0.8	1.6	1.1	1.0	0.9
Capital Spending/Total Expenditure (%)	16.9	16.5	19.1	14.5	19.0	20.8	20.4

Source: City of Belgrade, Moody's Investors Service

Detailed credit considerations

The credit profile of Belgrade, as expressed in its Ba2 stable rating, combines a baseline credit assessment (BCA) of ba2, and a strong likelihood of extraordinary support coming from the Serbian government in the event that the city faces acute liquidity stress.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.

Baseline credit assessment

Healthy operating performance

In 2021, Belgrade's gross operating balance (GOB) was 12% of operating revenues, compared with 7% a year earlier. We consider this a healthy level, following two weaker years during the corona pandemic. Improvement of operating performance was primarily driven by strong uptick of tax revenues, which were more than 20% higher than 2020, and relatively contained cost increases. Our expectation for 2022 and 2023 points to a slightly weaker but sound operating surplus of up to around 10%, a reflection of the city's management to continue its traditionally prudent budgetary management.

Tax revenues - mainly comprising personal income tax and other shared tax revenues - which together constitute more than half of the city's operating revenue, are expected to continue to grow over 2022 and 2023. The development of tax revenues is following the economic development, which we expect continue to remain relatively good in light of expected around 2% real gross domestic product (GDP) growth rate in each 2022 and 2023, which is somewhat less than previously expected due to the deteriorating external environment as a result of the Russia-Ukraine military conflict. The country's risks to the macroeconomic outlook are tilted to the downside, mainly reflecting the spillovers from the Russia-Ukraine military conflict but also risks from domestic challenges in the energy sector and rising inflation.

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.

Belgrade successfully manages to keep operating spending growth in check through a combination of spending reviews and cost controls. Most recently, the new government announced plans to take steps to reduce transfers to its deficit-making public transportation company.

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.

Overall balanced financial results, notwithstanding investment needs

In 2021, the city reported a healthy 2% financing surplus of total revenue compared with 8% in previous year. In 2022, we expect the city to report a slight financial deficit, mainly a result of higher capital spending. Due to increasing level of planned capital spending, the city may not reach a balanced budget in 2023 as well.

Belgrade has some flexibility to improve its financial results, by postponing some of its initially planned capital investments, estimated at more than RSD30 billion execution in 2022 and 2023.

Belgrade's capital spending program targets transportation infrastructure (e.g. a metro line), reconstruction of water supply system and improve sewage system, street renovation, public buildings facade rehabilitation, bridges construction and renovation. The city's investments also include projects focused on education, culture and social services.

The rehabilitation and extension of Vinča landfill as well as the treatment and disposal of solid waste are another important projects for the city. These projects are built through the first-ever public-private partnership (PPP) in waste management in Serbia. In 2021, the private partner has started operations and provides selected services to the city. Besides completion of sanitation landfill, other operations including incineration and waste-to-energy plant are expected to start in 2023. A special purpose vehicle 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 further operations of this project given the risk which is associated with realization and operation of such an investment.

Low direct debt burden and sound liquidity position

The city was able to continuously reduce its direct debt burden over the past eight years. Belgrade's direct debt is expected to decline to around RSD31 as of year-end 2022, compared to RSD31.6 as of year-end 2021 (and 35.2 billion as of year-end 2020), representing a low 26% of operating revenue. We expect the city's direct debt burden, as a percent of operating revenue, to continue to decline.

As of mid-November 2022, Belgrade's direct debt consisted of bank loans: (1) RSD18 billion loans with European Investment Bank (EIB, Aaa stable), (2) RSD7 billion loans with European Bank for Reconstruction and Development (EBRD, Aaa stable), and (3) RSD6 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 entire debt of Belgrade was denominated in euro, making the city debt somewhat 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 will remain moderate at around 4% of the total revenue projected for 2022.

We expect Belgrade's already sound liquidity to improve towards an expected level of well above RDSD10 billion as of year-end 2022. In 2021, year-end cash balance on its accounts was RSD9.5 (RSD11 billion in 2020). We expect the city's liquidity will remain in line with comfortable 2021-22 level over the next two years.

The city's cash reserves cover around 2.0x of its debt service requirements falling due in 2022 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 2022 and 2023. The city follows a prudent cash management strategy, which, together with regular distributions of shared taxes, ensures smooth cash flow.

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 1.7 million inhabitants within its administrative territory, as of 2021. The city is expected to grow towards nearly 2 million inhabitants over the coming two decades. Belgrade's economy is diversified, limiting its exposure to economic cycles. Belgrade contributes significantly to the country's economy, accounting for 42% of the national GDP. The city's unemployment rate remained relatively low at 8.8% in 2021, compared to 8.1% in 2020. This compares favourably with national unemployment statistics.

The city's relative wealth is evident in its GDP per capita, which is slightly more than 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.

Some indirect debt exposure to city-owned public transportation company

The loss-making transportation company GSP, which is under the city's direct ownership and 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. However, the new city government announced plans to take steps to improve operating and financial efficiency of the company, which would relief the city's budget in the future and could provide budgetary relief once implemented.

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. An amount of RSD14.5 billion was paid for 2020 and 2021 with RSD10 billion to be paid through the contract and additional RSD4.5 billion were 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 amounting to RSD4.2 billion in 2019 and another capital injection of RSD2.1 billion in 2021.

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 33% of operating revenue as of year-end 2021, down from 45% in 2020. All of the company's debt of RSD4.5 billion in 2020 (compared to RSD3.7 billion in 2020) is included in Belgrade's indirect debt exposure.

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 50% of operating revenues in 2021, 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 more than 20% of operating revenues in 2021.

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, which play an active role in providing core public services. Belgrade provides various services through its more than 30 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

Belgrade, City of's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 3
ESG Credit Impact Score

CIS-3

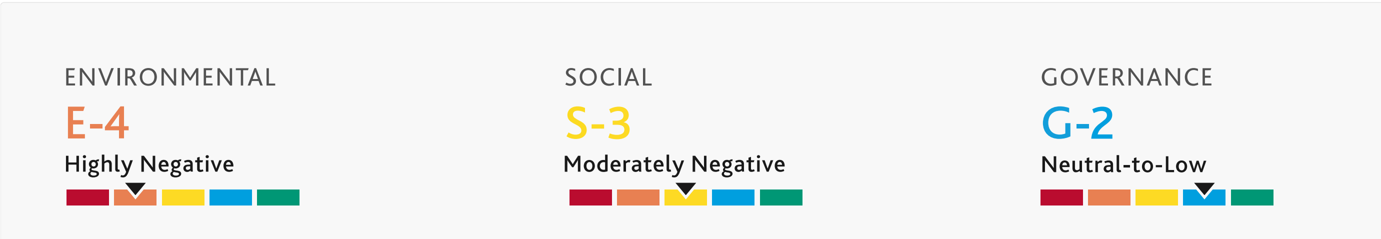
Moderately Negative

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

City of Belgrade's **CIS-3** indicates that ESG considerations have a limited impact on the current credit rating with potential for greater negative impact over time. Belgrade's credit impact score reflects high exposure to environmental risks, along with moderate exposure to social risks and neutral to low governance risk.

Exhibit 4
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

The (**E-4**) score assigned to City of Belgrade reflects its exposure to environmental risk mainly related to physical climate risk. Other environmental aspects include air pollution and flooding, however, it is predominantly managed by national authorities in case of an emergency.

Social

The (**S-3**) score assigned to City of Belgrade reflects its moderate exposure to social risks, including net immigration flows, which poses budgetary pressure to secure provision of public services. In addition, population growth is putting some strain to the city's budget to meet the infrastructure and housing needs. This issuer profile score reflects good housing availability and good access to basic services.

Governance

The (**G-2**) score assigned to City of Belgrade reflects institutions and governance strength that is not material in differentiating credit quality. In recent years, the city's implementation of budgetary control plans is indicative of positive management actions and there is a proven track record of the city frequently meeting or exceeding its fiscal targets. The city has moderate fiscal flexibility and follows prudent budgetary management practices, 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.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned baseline credit assessment (BCA) of ba2 is in line with the suggested BCA of ba2 generated by the scorecard. The suggested BCA of ba2 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.

For details about our rating approach, please refer to Rating Methodology: Regional and Local Governments, published on 16 January 2018.

Exhibit 5
Belgrade, City of
Regional & Local Governments

Belgrade, City of						
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	168.81%	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				**1.75**	**30%**	**0.53**
Operating Margin	3	9.27%	12.5%			
Interest Burden	1	0.88%	12.5%			
Liquidity	1		25%			
Debt Burden	1	32.66%	25%			
Debt Structure	3	12.15%	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						**2.23 (2)**
Systemic Risk Assessment						**Ba2**
Scorecard-Indicated BCA Outcome						**ba2**
Assigned 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 2021.

Ratings

Exhibit 6

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

Source: Moody's Investors Service

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