CREDIT OPINION
22 May 2024

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.*

Contacts

Maksym Rudnichenko +44.20.7772.8725
*Ratings Associate*
maksym.rudnichenko@moodys.com

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



# City of Belgrade (Serbia)

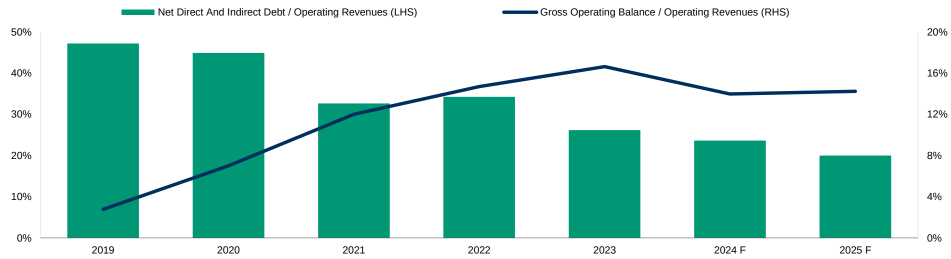
## Update following rating affirmation

## Summary

The credit profile of City of Belgrade (Ba2 stable) reflects its robust fiscal management, demonstrated by its strong financial results and a strong likelihood that the Government of Serbia (Ba2 stable) would provide support in case the city were to face acute liquidity stress. The rating is also underpinned by a track record of low debt levels with limited borrowing needs, as well as comfortable liquidity position. The credit profile is further supported by Belgrade's position as the nation's capital and the largest economic center, contributing to around 40% of Serbia's GDP. However, the rating takes into account the city's substantial investment requirements and the pressure stemming from the transportation company.

Exhibit 1

**Continuation of strong operating performance and declining debt trends**




F = Forecast.
*Source: City of Belgrade, Moody's Ratings*

## Credit strengths

» Strong operating performance fueled by robust rise in tax revenue and prudent budgetary management

» Overall positive financial results, notwithstanding investment needs

» Low and declining debt burden as well as sound liquidity position

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

## Credit challenges

» Indirect debt exposure related to the city-owned public transportation company

» Limited revenue and expenditure flexibility

## Rating outlook

The stable outlook 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. It also mirrors the stable outlook on the sovereign rating.

## Factors that could lead to an upgrade

An upgrade of Serbia's sovereign rating associated with a continuation of very solid budgetary performance, contained debt and adequate liquidity levels will lead to an upgrade of the city's rating.

## Factors that could lead to a downgrade

A deterioration of the sovereign credit strength will 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**

| | 2019 | 2020 | 2021 | 2022 | 2023 | 2024F | 2025F |
|---|---|---|---|---|---|---|---|
| Net direct and indirect debt as a % of operating revenues | 47.2 | 44.9 | 32.7 | 34.3 | 26.0 | 23.7 | 20.0 |
| Accrual financing surplus (deficit) as % of total revenues | -3.3 | 7.5 | 2.4 | 5.1 | 8.3 | 4.2 | 2.9 |
| Gross operating balance as % of operating revenues | 2.8 | 7.0 | 12.0 | 14.7 | 16.6 | 14.0 | 14.2 |
| Debt Service % of total revenues | 4.7 | 4.1 | 3.8 | 3.6 | 3.9 | 3.1 | 3.0 |
| Capital spending as a % of total expenditures | 19.1 | 14.5 | 19.0 | 18.6 | 17.6 | 16.7 | 16.6 |
| Interest payments as a % of operating revenues | 1.2 | 1.0 | 0.7 | 0.7 | 0.9 | 0.8 | 0.8 |

F = Forecast.
*Source: City of Belgrade, Moody's Ratings*

## Detailed credit considerations

On 17 May 2024, Moody's affirmed the City of Belgrade's Ba2 ratings and maintained the stable outlook. The key drivers for the rating affirmation were a track record of very solid financial performance as well as prudent financial management as reflected in consistently strong gross operating balances (GOB) over the previous decade, with financial outcomes frequently aligning with budgeted projections. 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.

## Baseline credit assessment

### Strong operating performance fueled by a robust rise in tax revenue and prudent budgetary management

The City of Belgrade has exhibited an improvement in its operating performance, with the GOB increasing to strong 16.6% of operating revenue in 2023 from 14.7% in 2022 (Exhibit 1). This notable advancement is largely attributable to the robust growth of income tax revenue and prudent budgetary management.

The key driver behind this strong performance was a surge in tax revenue growth, which was underpinned by a Serbia's real gross domestic product (GDP) growth of 2.5% in 2023, along with inflation of 12.4% (annual average) recorded over the same period. These contributed to a higher tax revenue base, which in turn bolstered Belgrade's operating performance. Income tax and other shared tax revenues form more than a half of Belgrade's operating income.

Furthermore, the city's prudent budgetary management has played a crucial role in the improved operating performance. The city's administration has shown a strong commitment to maintaining fiscal discipline, which is reflected in the effective management of expenditures, prioritization of investments, and efficient allocation of resources. The city has been able to balance its budget and even generate a surplus, contributing to the increased operating margin.

Moody's forecast the country's GDP to grow by 3.2% in 2024 and 4.0% in 2025, which will lead to a strong proceeds from income tax, maintaining the Belgrade's financial health with GOB at around 14% of projected operating revenue over the same period.

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.

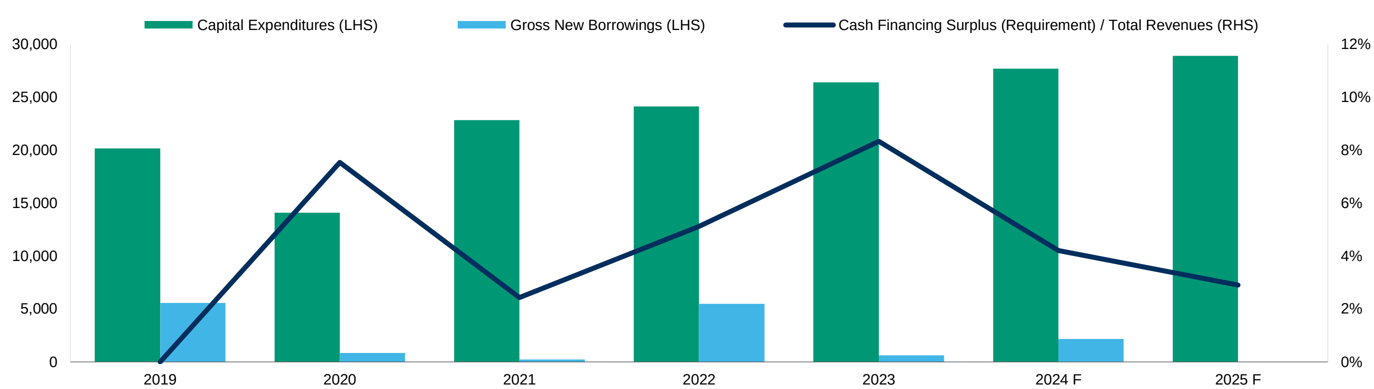
### Overall positive financial results, notwithstanding investment needs

In 2023, the City of Belgrade demonstrated considerable financial stability, posting a financing surplus of 8.3% of total revenue, an increase from a surplus of 5% reported in the prior year.

Looking ahead, we expect the city's capital spending to remain at around 17% of total expenditures over 2024-2025, a level that can put some pressure on city's finances, given that greater part of capital expenditures are funded from own source revenues rather than debt financing. The City of Belgrade retains some flexibility to enhance its financial outcomes by deferring some of the capital investments that were initially planned.

Exhibit 3

**Growing spending pressure to address investment needs**




F = Forecast.
*Source: City of Belgrade, Moody's Ratings*

The city's capital spending program is primarily directed towards infrastructure development, including transportation-related projects such as a new metro line, as well as the reconstruction of the water supply system and enhancements to the sewage system. Other planned infrastructure projects encompass street renovation, the rehabilitation of public building facades, and the construction and renovation of bridges.

Belgrade's investment strategy also extends to projects within the areas of education, culture, and social services. This multifaceted approach reflects the city's commitment to comprehensive development and progress.

The refurbishment and expansion of the Vinča landfill, along with the disposal and processing of solid waste, are crucial undertakings for the city. These initiatives have been realized through Serbia's inaugural public-private partnership (PPP) in the waste management area. In 2021, the private partner initiated operations, offering specific services to the city. Alongside the completion of the landfill's sanitation and the establishment of a facility for treating construction waste, additional activities such as waste incineration and the functioning of a waste-to-energy plant were launched in 2023.

This project represents a significant development for the city of Belgrade, both in terms of environmental sustainability and financial implications. The center's operation helps the city manage waste more effectively, reducing environmental impact and potentially saving costs in the long run through reduced landfill usage and decreased expenses related to pollution control. Moreover, by converting waste into valuable resources, such as energy or recyclable materials, the center could potentially generate additional income for the city of Belgrade

The total investment for this project, forecasted to be around EUR 300 million, is financed by the private partner. The city has contributed the land for the facility and made the necessary infrastructure provisions. Apart from the essential costs for the site's infrastructure arrangements, no additional impact on the city's budget is anticipated. The project-related obligations are deemed to be self-sustaining, and are excluded from indirect debt calculations.

The city has set aside approximately RSD1 billion in the budget for guaranteed payments pertaining to waste management obligations. This represented less than 1% of the city's total expenditures in 2023.

**Low and declining debt burden and sound liquidity position**

The city has kept its direct debt burden low at RSD29.3 billion by the end of 2023, compared to RSD32.8 billion in 2022. This indicates a manageable 18% of operating revenue, which is a reduction from 24% recorded in 2022. This downward trajectory is projected to continue into 2024, with the city's borrowing tendencies remaining restrained. We estimate that the direct debt will amount RSD28.9 billion, which would constitute a mere 16.7% of the forecasted operating revenue in 2024.

At year-end 2023, Belgrade's direct debt consisted of bank loans: (1) RSD15.9 billion loans with European Investment Bank (EIB, Aaa stable), (2) RSD5.4 billion loans with European Bank for Reconstruction and Development (EBRD, Aaa stable), and (3) RSD8 billion loan with Banca Intesa.

The city's debt structure reveals a favorable maturity profile, with 70% of the total debt scheduled to mature between 6 and 20 years. This extended maturity timeline is beneficial for the city as it allows for more manageable debt repayments spread over a longer period, reducing the pressure on the city's annual budget. Belgrade's debt service costs remain low at 3.9% of total revenue in 2023 and will decline to around 3% in 2024-2025.

Lengthy maturity and amortizing nature of Belgrade's debt partially mitigate the pressures associated with the foreign-currency risk as the entire debt of Belgrade is denominated in euro, making the city debt somewhat vulnerable to exchange-rate fluctuations.

The city's month-end cash reserves throughout 2023 averaged RSD15.7 billion representing 12.7% of operating expenditures compared with 9.5% at year-end 2022. The city follows a prudent cash management strategy, which, together with regular distributions of shared taxes, ensures smooth cash flow.

The liquidity coverage ratio, a key indicator of Belgrade's ability to cover short-term liabilities with its short-term assets, was 2.83x in 2023, and is projected to rise to 3.87x in 2024 from 2.46x in 2022. This forecasted improvement indicates an expected strengthening in the city's liquidity position over the next couple of years.

Belgrade does not maintain emergency lines of credit from banks in addition to those that have been signed and committed for project financing.

### 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 by 2041. Belgrade's economy is diversified, limiting its exposure to economic cycles. Belgrade contributes significantly to the country's economy, accounting for 40.2% of the national GDP (2021 latest available data). The city's unemployment rate remained moderate at 7.8% in 2022, compared to 8.8% in 2021. This compares favourably with national unemployment statistics.

The city's relative wealth is evident in its GDP per capita, which is around 163% of the national average according to the 2021 statistics. 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.

### Indirect debt exposure related to the city-owned public transportation company

The city of Belgrade, through its more than 30 majority-owned companies, is striving to balance its infrastructure needs with its financial constraints. This strategy was crucial in the face of inflation and high energy costs, as evidenced over the past two years, which were exerting pressure on Belgrade owned companies' operational performances.

The city-owned transportation company, GSP, which has been operating at a loss, continues to pose a significant burden on the city's budget. This is largely due to ongoing investments, notably the modernization of its bus fleet, which has necessitated the company to incur additional debt on top of the funding supplied by the city. Nevertheless, the city government has initiated a series of measures including a new ticketing system aimed at enhancing the operational and financial efficiency of GSP. Once these measures take effect, they are likely to alleviate some of the financial strain on the city's budget.

The rising costs associated with inflation and energy are not being reflected in the transportation tariffs, necessitating increased operational subsidies from the city to ensure the continuity of public transport services, which amounted RSD2.3 billion in 2023. In addition, the city provided a capital injection of RSD930 million and regular payments made on the basis of the contract between the city and GSP, which allows a full compensation for public transportation service obligations as well as a fair level of profit (including depreciation).

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 34.3% of operating revenue as of year-end 2022 (Exhibit 4), up from 32.7% in 2021 (44.9% in 2020). All of the company's debt of RSD9.5 billion in 2022 (compared to RSD4.5 billion in 2020) is included in Belgrade's indirect debt exposure.

### Limited revenue and expenditure flexibility

Belgrade's ability to adjust its budget is somewhat constrained. About half of the city's operating revenues in 2023 came from shared taxes, including personal income tax, which the city does not have the power to change. This suggests a significant reliance on the central government for tax revenues. However, the city's institutional framework does provide some counterbalance to this lack of control over tax revenue. Unlike other local governments in Serbia, Belgrade has a larger capacity to increase revenue through local taxes and fees, which made up over 20% of operating revenues.

The rating of Belgrade is also constrained by the institutional structure governing local governments in Serbia. This structure is characterized by frequent alterations, leading to limited financial stability and predictability. This, in turn, hampers the effectiveness of city-level policies and restricts Belgrade's capacity for efficient long-term planning.

Belgrade's spending flexibility is somewhat constrained due to a substantial portion of legally mandated costs, including employee wages and social contributions. These, combined with other fixed expenses like interest payments, subsidies, and transfers to other government levels and city-owned entities, make up around 60-70% of the city's operational expenditures. The city's primary area of financial maneuverability lies in capital expenditures, though this is also limited by the extensive infrastructure requirements that are typical for all local governments in Serbia.

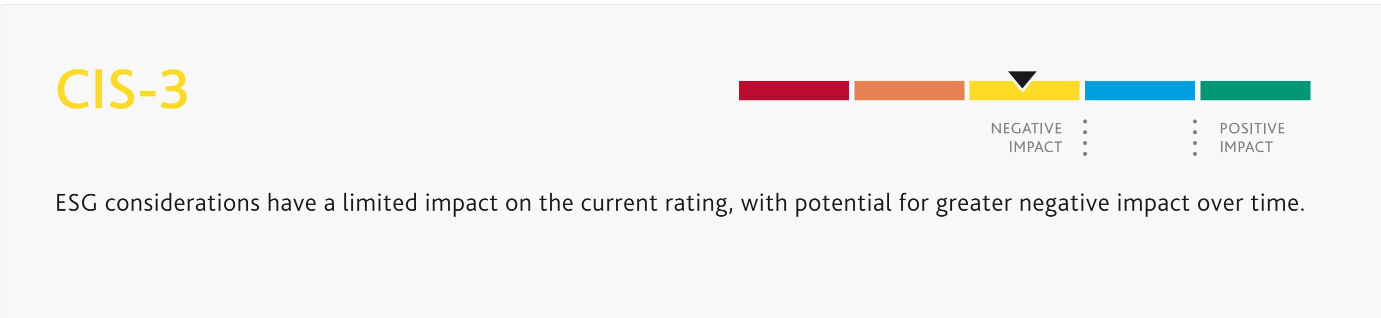
### Extraordinary support considerations

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 CIS-3

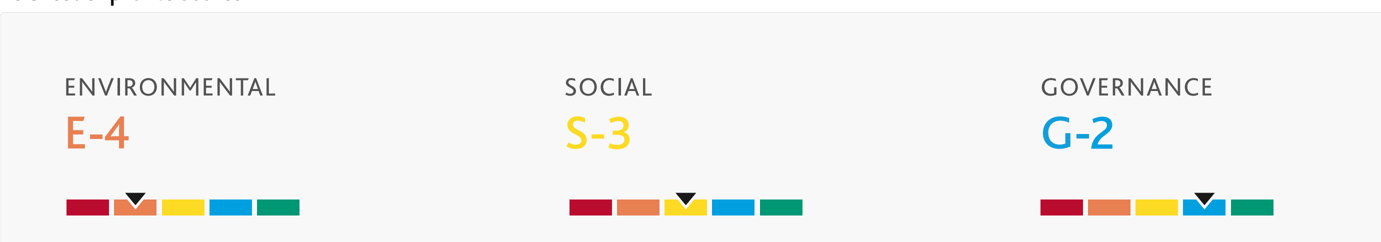
Exhibit 4
**ESG credit impact score**




*Source: Moody's Ratings*

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 5
**ESG issuer profile scores**




*Source: Moody's Ratings*

### Environmental

The (**E-4**) score assigned to City of Belgrade reflects its exposure to environmental risk mainly related to physical climate risk and exposure to flood risk. Other environmental risk exposure is related to weather-related events including heatwaves as well as air pollution. However, the protecting measures and adaptation plans introduced, the City of Belgrade manages these risks and the amounts do not result in significant pressure on the city's fiscal profile. In case of an emergency the measures are predominantly managed by national authorities.

### 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.

**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 | 169.27% | 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** | | | | **1.50** | **30%** | **0.45** |
| Operating Margin | 1 | 12.84% | 12.5% | | | |
| Interest Burden | 1 | 0.73% | 12.5% | | | |
| Liquidity | 1 | | 25% | | | |
| Debt Burden | 1 | 34.29% | 25% | | | |
| Debt Structure | 3 | 12.58% | 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** | | | | | | **2.15 (2)** |
| **Systemic Risk Assessment** | | | | | | **Ba2** |
| **Suggested BCA** | | | | | | **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 2022.*

## Ratings

Exhibit 7

| Category | Moody's Rating |
|---|---|
| **BELGRADE, CITY OF** | |
| Outlook | Stable |
| Baseline Credit Assessment | ba2 |
| Issuer Rating | Ba2 |

*Source: Moody's Ratings*

REPORT NUMBER 1408090

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