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Ratings

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Research Update:

Belgian Region of Brussels-Capital Long-Term Rating Lowered To 'AA-' From 'AA'; Outlook Stable

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Overview

- We anticipate the combined effects of strategic investments and the impact of the COVID pandemic on regional revenue and expenditure will keep Brussels-Capital's budgetary performance subdued in 2021 after a record high deficit in 2020 of more than 25% of total revenue.
- Debt increased significantly in 2020 and will continue to grow in 2021, slowing only from 2022 on the back of lower budgetary deficits.
- We have therefore lowered the long-term rating on Brussels-Capital to 'AA-' from 'AA' and affirmed the 'A-1+' short-term rating.
- Despite the debt increase, debt service remains relatively stable, liquidity adequately covers the debt service requirements, and we assess Brussels-Capital's access to capital markets as strong, notably thanks to very proactive and efficient debt and liquidity management.
- The outlook on the long-term rating is stable.

Rating Action

On March 26, 2021, S&P Global Ratings lowered its long-term issuer credit rating on the Region of Brussels-Capital to 'AA-' from 'AA'. The outlook is stable. At the same time, we affirmed the 'A-1+' short-term issuer credit rating.

Outlook

The stable outlook reflects our expectation that Brussels-Capital will gradually decrease its very high deficits, mainly through cost control and increased revenue stemming from the improved economic situation after the pandemic wanes. The stable outlook also reflects our expectation that Brussels-Capital will maintain solid debt service coverage and its liquidity will remain solid, underpinned by its strong access to external liquidity.

Upside scenario

We could raise the rating if, while maintaining stable liquidity-to-debt service coverage, Brussels-Capital's financial performance strengthened, with only moderate deficits below 5% of total revenue, resulting also in a reduced pace of debt growth. This could occur once cost controls result in lower expenditure, and the effects of COVID-19 on regional revenue and expenditure dissipate.

Downside scenario

We could lower the rating if the anticipated improvement in performance did not occur and debt continued to grow at a sustained pace. This would likely also reduce the liquidity-to-debt service coverage ratio because of higher debt service requirements or lower available liquidity.

Rationale

We lowered our long-term rating on Brussels-Capital because performance deteriorated markedly in 2020 and we still forecast high deficits in 2021, and any improvement in performance will likely manifest beyond our forecast horizon through 2023. The drop in performance also signals weaker budgetary management.

The region's proactive and skilled financial oversight continues to support the rating on Brussels-Capital, in particular as regards debt and liquidity management. The region has a fairly smooth debt service profile, despite its rapidly increasing debt levels, and very good access to capital markets. This results in a very comfortable debt service coverage ratio that also supports the rating.

The rating also reflects Brussels-Capital's wealthy economy, in spite of the GDP contraction in 2020, and the favorable institutional framework in which Belgian regions operate. The rating is constrained by Brussels-Capital's currently weak financial performance and its high debt burden.

COVID-19-related effects in 2020 and 2021 dim five-year average results beyond our expectations, and although results will gradually improve from 2022, debt levels will remain high

COVID-19 effects decreased Brussels-Capital's overall operating revenue by more than €200 million in 2020 versus the initial budget, and increased operating expenditure by more than €600 million versus the budget to support the local economy and health care system. As such, operating deficits reached 8.5% of operating revenue (versus our previous estimate of -2.3%). The deficit after capital accounts also sank to 26.5% of total revenue, caused by both the operating deficit and the sustained level of investments, including strategic investments linked to mobility infrastructure and security, of €1.7 billion overall, above the €1.6 billion in 2019. For 2021, contrary to our previous expectation, we now forecast continuous operating deficits, although halved compared with those of 2020. We think operating revenue will pick up very mildly compared with 2020 and operating expenditure will fall slightly. The deficit after capital accounts will remain high in 2021, above 20% of total revenue.

Stronger revenue growth thanks to a resumption of economic activity and stricter cost controls will push the operating performance into a surplus in 2022, recovering further in 2023. We believe

Brussels-Capital's financial management will rein in costs by containing growth of personnel expense, reducing transfers and goods and services outlay, and will be able to implement some economies suggested from the spending reviews that it is conducting on mobility and social housing. Deficits will remain high over 2022-2023 at 11.8% on average, essentially linked to strategic investments that began in 2018 and will finish by 2024.

The investments are essentially focused on mobility infrastructure like the subway, trams, and buses through the transport government-related entity (GRE) STIB-Société des transports intercommunaux de Bruxelles. To speed up and monitor such investments, Brussels-Capital has created an ad hoc committee to follow closely their implementation through the political mandate. The plan is to end such investments by 2024. If this is the case, from 2025, Brussels-Capital's after capital results could almost reach a balance.

We forecast debt will continue rising over 2021-2023, although in 2022 and 2023 the pace of growth will diminish compared with 2019-2021. Brussels-Capital's tax-supported debt could consequently reach about 190% of consolidated operating revenue in 2023, versus 151% in 2020 and around 120% in 2019. Our estimate of tax-supported debt includes the debt of the municipality fund Fonds régional bruxellois de refinancement des trésoreries communales (FRBRTC), which is fully consolidated under the European System of Accounts 2010.

Although the stock of debt has increased considerably, liquidity debt service coverage remains high because debt service remains smooth and Brussels-Capital continues to enjoy a very favorable liquidity position, benefiting from a direct multiyear €1.2 billion account facility, while the FRBRTC has €350 million of liquidity lines. Such liquidity lines remain largely unused. On top of the unused liquidity lines, Brussels-Capital has secured a relevant amount of the funding needed for 2021 already. We expect these liquidity sources to comfortably cover the region's debt servicing needs (including FRBRTC's short- and long-term debt repayments) over the next 12 months, despite expectations of a noteworthy deficit after capital accounts. Additionally, the region has proven that it has very strong access to external funding via financial markets, especially through its medium-term note program, Belgian commercial paper program, and access to investors in German Schuldschein loans.

The region's strong economy and skilled financial management remain credit strengths

We expect Brussels-Capital's nominal GDP growth to remain close to that of Belgium. The sovereign's real GDP contracted in 2020 by more than 6% because of COVID-19. However, GDP per capita, although reduced versus 2019, remains very high in an international comparison, at $44,700. We forecast real GDP will start recovering in 2021, reaching about 4% growth. Having said this, large urban centers and their surrounding regions could take longer to recover from the pandemic. Services, which thrive on interaction of people, form the backbone of their economies. Such areas tend to have large social welfare programs to fight widespread inequalities and support public transport systems, therefore putting further pressure on their budgetary performance.

Brussels-Capital is the smallest region in Belgium, with around 10% of the total population. Its tertiary sector accounts for 93% of regional employment, compared with the 75% that services comprise nationally. The public sector is predominant, making up 35% of total employment, of which 20% is employment with international institutions including the European Commission and NATO. This ensures stability of the employment base. The region has become increasingly attractive for foreign and domestic investors and now hosts the largest concentration of jobs and value generated by foreign firms in the country. However, despite the high GDP per capita, the average income of Brussels-Capital's inhabitants is about 20% lower than the national average, mainly because many commuters work in the region, but reside outside of it. Moreover, although Brussels-Capital accounts for approximately 20% of Belgium's GDP, it receives only about 10% of the shared proceeds of national personal income taxes, given that these are shared based on place of residence and not place of employment. This means that Brussels-Capital's economic attractiveness and buoyancy do not fully feed into its budgetary performance.

The distribution of national personal income taxes is part of wider political discussions with the other two regions concerning tax distribution and tax modifications, including the road tax and first vehicle registration tax, the collection of which was recently transferred by the federal government to the regions. The multiplicity of institutions and the complexity of the institutional framework in Belgium lengthen political discussions and negotiations.

Despite this, we believe that the Belgian institutional system for regions and communities is mature and stable. We view very positively the region's prudent and proactive debt and liquidity management. Brussels-Capital issues frequently in the capital markets, with numerous and small issues to avoid lumpy debt amortization. Brussels-Capital took advantage of favorable market conditions in 2019 and 2020 to secure funding and prefinance the funding needs of the following year. The region's management continually seeks to improve its financial practices, demonstrated by ongoing policy efforts to enhance liquidity and financial risk management on a consolidated basis. In the last few years, it has reduced its exposure to complex derivatives and plans to further reduce its exposure. Plain vanilla products that swap variable rates into fixed ones account currently for 84% of the derivative exposure. The region also closely monitors its GREs and other contingent risks, including having a well-defined and active guarantee-management system.

Although we consider that budgetary management has weakened, we view positively Brussels-Capital's willingness to curtail expenditure once the effects of the pandemic fade. We believe that this, together with the spending review on specific areas of the budget (notably mobility and social housing), could contribute to lowering costs and help Brussels-Capital gradually reduce its deficits from 2022.

Environmental, social, and governance (ESG) credit factors for this credit rating change:

- Health and safety

Key Statistics

Table 1

Region of Brussels-Capital -- Selected Indicators

	--Fiscal year ended Dec. 31--					
(Mil. €)	2018	2019	2020	2021bc	2022bc	2023bc
Operating revenues	4,608	4,567	4,731	4,777	4,958	5,082
Operating expenditures	4,130	4,293	5,132	4,995	4,793	4,759
Operating balance	478	274	(401)	(219)	165	323
Operating balance (% of operating revenues)	10.4	6.0	(8.5)	(4.6)	3.3	6.4
Capital revenues	528	585	597	735	721	728

Table 1

Region of Brussels-Capital -- Selected Indicators (cont.)

	--Fiscal year ended Dec. 31--					
(Mil. €)	2018	2019	2020	2021bc	2022bc	2023bc
Capital expenditures	1,509	1,535	1,607	1,671	1,639	1,655
Balance after capital accounts	(503)	(676)	(1,411)	(1,154)	(753)	(604)
Balance after capital accounts (% of total revenues)	(9.8)	(13.1)	(26.5)	(20.9)	(13.3)	(10.4)
Debt repaid	751	809	779	784	771	721
Gross borrowings	1,123	1,824	2,951	1,938	1,523	1,325
Balance after borrowings	(131)	339	761	0	0	0
Direct debt (outstanding at year-end)	4,545	5,454	7,122	8,276	9,029	9,633
Direct debt (% of operating revenues)	98.6	119.4	150.5	173.3	182.1	189.6
Tax-supported debt (outstanding at year-end)	4,579	5,487	7,156	8,310	9,063	9,667
Tax-supported debt (% of consolidated operating revenues)	99.4	120.1	151.3	174.0	182.8	190.2
Interest (% of operating revenues)	2.8	2.8	3.2	3.9	4.0	4.0

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Region of Brussels-Capital -- Ratings Score Snapshot

Key rating factors	Score
Institutional framework	2
Economy	2
Financial management	2
Budgetary perfomance	4
Liquidity	1
Debt burden	4
Stand-alone credit profile	aa-
Issuer credit rating	AA-

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Economic Outlook Europe Q2 2021: The Path To A Strong Restart, March 25, 2021
- Belgium Full Analysis, March 22, 2021

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Local Government Debt 2021: Global Borrowing To Hit $2.25 Trillion, March 25, 2021
- Belgium Full Analysis, March 22, 2021
- Institutional Framework Assessments For International Local And Regional Governments, March 3, 2021
- Economic Research: European Economic Snapshots: Policy Is Keeping The Impact Of The Second COVID Wave At Bay, Dec. 16, 2020
- Sovereign Risk Indicators, Dec. 14, 2020. Interactive version available at http://www.spratings.com/sri
- Major Capital Cities Must Be Vigilant About Rising ESG Risks As They Look To A Post-Pandemic World, Dec. 10, 2020
- Local And Regional Governments Outlook 2021: Gradual Recovery Will Test Rating Resilience, Dec. 10, 2020
- Default, Transition, and Recovery: 2019 Annual International Public Finance Default And Rating Transition Study, Dec. 8, 2020
- Comparative Statistics: European Local And Regional Government Risk Indicators, June 30, 2020

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Downgraded; Ratings Affirmed

	To	From
Brussels-Capital (Region of)		
Issuer Credit Rating	AA-/Stable/A-1+	AA/Negative/A-1+
Senior Unsecured	AA-	AA