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Research Update:

Belgian Region of Brussels-Capital 'AA/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- We expect higher deficits for Brussels-Capital in the coming years owing to an increase in capital expenditure.
- In our opinion, the region benefits from a supportive institutional framework and prudent and highly efficient financial management that will allow it to achieve its main budgetary target and contain debt growth, while maintaining exceptional liquidity, despite the increase in investments.
- We are affirming our 'AA/A-1+' long- and short-term ratings on Brussels-Capital with a stable outlook.

Rating Action

On March 15, 2019, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on Belgium's Region of Brussels-Capital. The outlook remains stable.

Outlook

The stable outlook reflects our base-case expectation that Brussels-Capital will maintain a moderate debt burden and very sound liquidity, while significantly increasing capital expenditure over the next two years.

Downside scenario

We might consider a downgrade in the next 24 months if we observed a structural deterioration in Brussels-Capital's budgetary performance, leading to a significant increase of its debt burden. This could stem from, for example, weakening financial positions of government-related entities (GREs) or the region's inability to contain expenditure.

If we lowered our ratings on Belgium, or revised the outlook to negative, we would take a similar action on Brussels-Capital.

Upside scenario

We could consider a positive rating action in the next 24 months if we took a similar action on Belgium, and if Brussels-Capital structurally and significantly improved its budgetary performance. The latter would put tax-supported debt on a sharp downward path or enable the operating surplus to structurally cover at least one-third of direct debt.

Rationale

Our ratings on Brussels-Capital primarily reflect our belief that the region's financial management will allow it to step-up strategic investments over 2019-2021, while achieving its main budgetary target of presenting balanced accounts according to the European system of national and regional accounts (ESA) and maintaining very sound liquidity. The region's favorable institutional framework and wealthy local economy also support the ratings.

Deficits will significantly increase during 2019-2021, because of a temporary step-up in strategic investments, but the debt burden should remain contained

In 2018, we estimate the region's operating margin was 11% of operating revenue, slightly higher than in our previous base-case scenario (10%), mainly due to higher tax revenue. Operating performance should stay strong through 2021--we forecast operating surpluses averaging a high 10% of operating revenue. However, in line with 2018 estimates, we anticipate the deficit after capital accounts will remain high, close to 8% of total revenue on average during our forecast horizon through 2021, due to the step-up in strategic investments, and resulting in a weaker budgetary performance. After an estimated €1.4 billion in 2018, we expect capital expenditure will reach an average of €1.5 billion per year in 2019-2021, versus an average €1.1 billion during 2016-2017, mainly due to strategic investments in mobility infrastructure. We forecast a decrease of these strategic investments from 2022 or 2023, which should enable the region to start reducing its deficits.

Brussels-Capital continues to target a balanced budget through 2021, excluding strategic investments. At this stage, we do not expect the 2019 May elections to have any impact on this main budgetary target. As a result, debt-refinancing and funding needs related to strategic investments--which we expect will average €450 million a year in 2019-2021, or 8% of total expenditure--will likely continue to drive annual gross borrowing.

Consequently, Brussels-Capital's tax-supported debt will reach 117% of consolidated operating revenue in 2021, compared with 92% in 2017. Our estimates of tax-supported debt include the debt of the municipality fund, "Fonds régional bruxellois de refinancement des trésoreries communales" (FRBRTC), which is fully consolidated under ESA 2010. FRBRTC lends the majority of its debt proceeds to self-supporting municipalities in the region. At present, this debt represents about 13% of the region's consolidated operating revenue.

To abide by its budgetary target, Brussels-Capital could use its budgetary flexibility, both on the revenue and spending side, if any deviation risks occur. Its modifiable tax revenue, which is composed of the supplementary tax on personal income tax as well as regional taxes, accounts for a high 50% of operating revenue. Still, we believe that Brussels-Capital would be more likely to use its spending flexibility if needed rather than increase taxes, since it recently reduced tax pressure. Capital expenditure would be the primary source of leeway, in our view, accounting for 26% of total expenditure in 2019-2021 in our forecast.

Brussels-Capital enjoys a very favorable liquidity position. The region benefits from a direct multiyear €1.2 billion account facility, and FRBRTC holds €225 million in liquidity lines. Combined with the available cash reserves of the consolidated GREs' accounts, we expect these liquidity sources will cover more than 120% of its total debt service needs (including FRBRTC's short- and long-term debt repayments) over the next 12 months. Additionally, we think that the region has strong access to external funding via financial markets, especially through its medium-term note program, its Belgian commercial paper program, and its access to investors in Schuldschein loans.

We consider Brussels-Capital's contingent liabilities to be moderate. They mainly relate to the region's exposure to social housing mortgage companies, such as the "Fonds du Logement de la Région de Bruxelles-Capitale," and to the municipal sector's credit standing. Unlike ESA 2010 treatment of social housing mortgage companies, we do not include these companies' debt in the region's tax-supported debt, because we view them as self-supporting. The region's financial guarantees, mainly for social housing mortgage companies, accounted for about 30% of its consolidated operating revenue at year-end 2018. We understand that the social housing mortgage companies sector in Brussels-Capital is still undergoing some mergers, which should strengthen its overall financial situation. When assessing the region's contingent liabilities, we also factor in the financial situation of the municipal sector, which we view as having some weaknesses. Furthermore, we continue to see the public body "Commission communautaire commune" as a contingent risk since we would expect the region to provide extraordinary support in case of need. However, at this stage we view this risk as very limited.

The institutional framework, strong economy, and prudent management remain key credit strengths

Brussels-Capital benefits from a buoyant, service-based, and wealthy economy. We estimate its GDP per capita at an elevated €66,900 in 2018, which exceeds the national GDP per capita by some 1.7x. However, these levels are offset by a large number of commuter workers who work in the region but live and pay taxes outside it, and a relatively high level of unemployment. This results in the region's personal income per capita being one-fifth less than that of Belgium, and makes the region's tax base somewhat narrower. While the region makes up around 18% of Belgium's GDP, it accounts for only around 8% of national personal income tax receipts.

At the same time, we believe that Brussels-Capital benefits from the maturity and stability of the institutional system for Belgian regions and communities, and a generally adequate revenue and expenditure balance, not least due to the regions' relatively high tax autonomy. In our opinion, the gradual pace of the implementation of the sixth Belgian state reform since 2015--including the devolution of new responsibilities to regions and communities and revenue sources to regions--has demonstrated the system's predictability. We also think that Belgium's framework enables regions and communities to play an active role in the design and implementation of federal reforms, preventing or moderating those measures that potentially undermine their institutional and financial position.

Brussels-Capital has shown its capacity to handle new revenue sources and expenditure responsibilities under the sixth state reform, thanks to its very strong financial management. We view positively the region's political and managerial strength, reliable budgeting, close oversight of intra-annual budget execution, prudent and sophisticated debt management, efficient liquidity management, and close monitoring of GREs and other contingent risks, including its well-defined and active guarantee-management system. The region continually seeks improvements in its financial practices, demonstrated by ongoing policy efforts to enhance liquidity, debt-service, and financial risk management on a consolidated basis, including the region's GREs.

Key Statistics

Table 1

Brussels-Capital (Region of) Selected Indicators

(Mil. €)	2017	2018e	2019bc	2020bc	2021bc
Operating revenues	4,463	4,607	4,845	4,874	4,932
Operating expenditures	3,962	4,104	4,291	4,380	4,474
Operating balance	501	503	554	494	458
Operating balance (% of operating revenues)	11.2	10.9	11.4	10.1	9.3
Capital revenues	592	523	594	597	601
Capital expenditures	1,120	1,441	1,554	1,494	1,554
Balance after capital accounts	(27)	(416)	(407)	(403)	(496)
Balance after capital accounts (% of total revenues)	(0.5)	(8.1)	(7.5)	(7.4)	(9.0)
Debt repaid	737	747	655	680	603
Gross borrowings	522	1,089	1,011	1,033	1,048
Balance after borrowings	(241)	(74)	(50)	(50)	(50)
Modifiable revenues (% of operating revenues)	52.5	52.0	49.1	49.4	49.4
Capital expenditures (% of total expenditures)	22.0	26.0	26.6	25.4	25.8
Direct debt (outstanding at year-end)	4,072	4,551	4,908	5,261	5,706
Direct debt (% of operating revenues)	91.2	98.8	101.3	107.9	115.7
Tax-supported debt (outstanding at year-end)	4,110	4,595	4,952	5,305	5,750
Tax-supported debt (% of consolidated operating revenues)	92.1	99.8	102.2	108.8	116.6
Interest (% of operating revenues)	3.7	3.4	3.3	3.5	3.7
Local GDP per capita (€)	65,000	66,565	67,547	68,508	69,453

Table 1

Brussels-Capital (Region of) Selected Indicators (cont.)					
(Mil. €)	**2017**	**2018e**	**2019bc**	**2020bc**	**2021bc**
National GDP per capita (€)	38,778	39,607	40,681	41,785	42,875

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. e--Estimate. bc--Base case, reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

Region of Brussels-Capital -- Ratings Score Snapshot *	
Key rating factors	
Institutional framework	Very predictable and well-balanced
Economy	Strong
Financial management	Very strong
Budgetary flexibility	Average
Budgetary performance	Average
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	Moderate

*S&P Global Ratings bases its ratings on local and regional governments on eight main rating factors listed in the table above. Section A of S&P Global Ratings' "Methodology For Rating Non-U.S. Local And Regional Governments" summarizes how the eight factors are combined to derive the rating.

Key Sovereign Statistics

Sovereign Risk Indicators, Dec. 13, 2018. An interactive version is also available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- Criteria - Governments - International Public Finance: Methodology For Rating Non-U.S. Local And Regional Governments, June 30, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria - Governments - International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional

Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Governments - International Public Finance: Methodology And Assumptions: The Impact Of PPP Projects On International Local And Regional Governments: Refined Accounting Treatment, Dec. 15, 2008

Related Research

- Local Government Debt 2019: Economic Slowdown Is Set To Spur European LRG Borrowings In 2019-2020, Feb. 25, 2019
- Institutional Framework Assessments For International Local And Regional Governments, Nov. 6, 2018
- Belgium 'AA/A-1+' Ratings Affirmed; Outlook Stable, Sept. 21, 2018
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 2018

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

Ratings Affirmed

Brussels-Capital (Region of)

Issuer Credit Rating	AA/Stable/A-1+

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.