S&P Global
Ratings

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Research Update:

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

June 26, 2020

Overview

- We expect Brussels-Capital's deficit after capital expenditure to remain high in 2020, causing the region to incur significant additional debt, with gradual performance improvement from 2021.
- The debt burden is sustainable since debt service remains stable through our forecast horizon, and we acknowledge that Brussels-Capital has very good access to capital markets, as well as an extremely proactive and efficient debt and liquidity management.
- The region's performance could weaken, however, if operating margins did not return gradually to the levels before 2019, maintaining a deficit after capital accounts structurally below 10% of total revenues.
- We are therefore revising the outlook on Brussels-Capital to negative from stable, and are affirming the 'AA/A-1+' ratings.

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Rating Action

On June 26, 2020, S&P Global Ratings revised its outlook on Belgium's Region of Brussels-Capital to negative from stable. We affirmed our 'AA' long-term and 'A-1+' short-term issuer credit ratings on Brussels-Capital.

Outlook

The outlook on Brussels-Capital is negative.

Downside scenario

We could lower the rating if, over the next two years, the anticipated gradual improvement in performance did not materialize. This would suggest that the region's budgetary performance was set to stay at the low levels recorded in 2019, possibly signaling less strong budgetary and debt management practices than we currently foresee.

Upside scenario

We could revise the outlook to stable in the next two years if, all else being equal, Brussels-Capital's performance stabilized at the levels recorded before 2019, with operating margins above 5% of operating revenues and deficits contained below 10% of total revenues. This could happen if the fiscal repercussions from COVID-19 gradually diminished and the current spending review gave way to a meaningful improvement in the operating margin.

Rationale

The ratings on Brussels-Capital is supported by the region's extremely proactive and skilled financial management. Even during the COVID-19 outbreak, management has maintained a stable debt service despite increasing debt levels. We also note the region's very strong access to external liquidity with a debt service coverage ratio remaining comfortably above 100%. Furthermore, the ratings reflect Brussels-Capital's wealthy economy--despite the expected GDP contraction in 2020--the favorable institutional framework in which Belgian regions operate, and an adequate budgetary performance provided it improves gradually from 2021. However, the ratings remain burdened by Brussels-Capital's high and increasing debt levels.

COVID-19-related setbacks will dim 2020 results before deficits narrow gradually and debt accumulates at a slower pace from 2021

Due to COVID-19 fallout, overall operating revenue will decrease and operating expenditure will increase to support the local economy and health care system. As such, operating margins in 2020 will likely remain below 5% of operating revenue.

Deficits after capital accounts will, in turn, stand above 10% of total revenue both in 2019 and 2020, driven by the reduced operating margin and investments remaining high. The latter is associated with the region's strategic investment plan, worth approximately €500 million per year and linked to its mobility infrastructure and security.

We believe that COVID-19-related effects should start to fade in 2021. This, alongside the implementation of the spending review, should enable Brussels-Capital to gradually improve its operating margins to above 6% of operating revenue in 2022. In addition, deficits after capital accounts will likely shrink, despite high investments, and remain below 10% of total revenue in 2022.

Operating margins decreased in 2019 to 6% of operating revenue versus an average of 11% in 2017 and 2018. This was mainly due to one-off lower regional taxes and transfers from the Metropolitan area of Brussels. Although operating expenditure has decreased over the past four years, it has not been enough to counterbalance the lower revenue.

Debt-refinancing and higher-than-expected funding needs lifted debt levels in 2019. We forecast debt to continue rising over 2020-2022 but at a slightly slower pace than in 2019. Consequently, we expect Brussels-Capital's tax-supported debt will reach about 160% of consolidated operating revenue in 2022, versus 92% in 2017. 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 ESA 2010.

The region's economy and skilled financial management continue to be credit strengths

We expect Brussels-Capital's nominal GDP growth to remain close to that of the Kingdom of Belgium, as it has historically done. We forecast Belgium's nominal GDP will sharply fall in 2020 by more than 6% because of COVID-19 impacts, then recover by more than 7% in 2021. Still, we forecast national GDP per capita to stand at US$42,256 in 2020, which remains very high in an international comparison. Capital cities and regions around the world are under significant strain due to lockdowns and costly measures to contain the coronavirus, reflecting a spike in social expenses as well as overall high exposure to services, international tourism and business travel, and property market activity affected by the pandemic.

Brussels-Capital, with around 10% of the total population, is the smallest region in Belgium. Its tertiary sector is significant, accounting for 93% of regional employment, compared with 75% nationally. Brussels-Capital has become increasingly attractive for foreign and domestic investors. The region now hosts the largest concentration of jobs and value generated by foreign firms in the country.

Despite the high GDP per capita, the average income of Brussels-Capital's inhabitants is about 20% lower than the national average, mainly because of commuters that work in, but reside outside, the region. Moreover, while Brussels-Capital accounts for approximately 20% of Belgium's GDP, it only receives around 10% of national personal income taxes, as these are shared according to the place of residence. This means that the region's economic attractiveness and buoyancy do not fully feed into its budgetary performance.

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.

We view positively the extremely proactive debt and liquidity management. 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, with close monitoring of the region's related entities and other contingent risks, including its well-defined and active guarantee-management system. Besides, debt service requirements will remain stable through our forecast horizon and liquidity debt service coverage amply above 100%, demonstrating a very proactive debt and liquidity management even in more difficult times.

We also regard as favorable the new government's and management's implementation of a spending review to keep deficits under control, and the creation of an investment committee "Comité de Pilotage des investissements strategiques" to closely follow and effectively implement planned strategic investments. We believe this will enable Brussels-Capital to improve its performance gradually from 2021.

Brussels-Capital continues to enjoy a very favorable liquidity position, benefiting from a direct multiyear €1.2 billion account facility, and FRBRTC has €350 million of liquidity lines. We expect these liquidity sources to cover more than 100% of the region's debt service needs (including FRBRTC's short- and long-term debt repayments) over the next 12 months. Additionally, the region has a proven 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.

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 ends Dec. 31--					
(Mil. €)	**2017**	**2018**	**2019**	**2020bc**	**2021bc**	**2022bc**
Operating revenues	4,463	4,608	4,567	4,645	4,656	4,832
Operating expenditures	3,962	4,130	4,293	4,507	4,470	4,530
Operating balance	501	478	274	137	186	302
Operating balance (% of operating revenues)	11.2	10.4	6.0	3.0	4.0	6.2
Capital revenues	592	528	585	745	660	660
Capital expenditures	1,120	1,509	1,535	1,746	1,500	1,500
Balance after capital accounts	(27)	(503)	(676)	(863)	(654)	(538)
Balance after capital accounts (% of total revenues)	(0.5)	(9.8)	(13.1)	(16.0)	(12.3)	(9.8)
Debt repaid	737	751	809	738	702	757
Gross borrowings	522	1,123	1,824	1,754	1,356	1,295
Balance after borrowings	(241)	(131)	339	154	0	0
Direct debt (outstanding at year-end)	4,072	4,545	5,454	6,471	7,125	7,663
Direct debt (% of operating revenues)	91.2	98.6	119.4	139.3	153.0	158.6
Tax-supported debt (outstanding at year-end)	4,105	4,579	5,487	6,504	7,158	7,696
Tax-supported debt (% of consolidated operating revenues)	92.0	99.4	120.1	140.0	153.7	159.3
Interest (% of operating revenues)	3.0	2.8	2.8	2.9	3.3	3.3
National GDP per capita (single units)	39,424	40,420	41,433	38,661	41,202	43,408

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

Region of Brussels-Capital Ratings Score Snapshot

Table 2

Key rating factors	**Scores**
Institutional framework	2

Region of Brussels-Capital Ratings Score Snapshot (cont.)

Economy	2
Financial management	1
Budgetary performance	3
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

Sovereign Risk Indicators, April 24, 2020. An interactive version is available at www.spratings.com/sri

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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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Belgium 'AA/A-1+' Ratings Affirmed; Outlook Stable, March 20, 2020
- Institutional Framework Assessments For International Local And Regional Governments, July 4 ,2019
- 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; Outlook Action

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