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Research Update:

Belgian Region of Brussels-Capital 'AA' Long-Term Rating Affirmed; Outlook Stable; 'A-1+' Short-Term Rating Assigned

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Overview

- In our opinion, the Region of Brussels-Capital benefits from a supportive institutional framework and prudent and highly efficient financial management that will allow the region to maintain its strong budgetary performance and exceptional liquidity.
- We are affirming our 'AA' long-term rating on Brussels-Capital and assigning the region our 'A-1+' short-term rating.
- The outlook is stable.

Rating Action

On Sept. 21, 2018, S&P Global Ratings affirmed its 'AA' long-term issuer credit rating on Belgium's Region of Brussels-Capital. The outlook remains stable.

At the same time, we assigned Brussels-Capital our 'A-1+' short-term issuer credit rating.

Outlook

The stable outlook reflects our base-case expectation that Brussels-Capital will maintain high operating and budgetary performance, a moderate debt burden until 2020, and exceptional liquidity.

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 rising debt. This could stem from, for example, weakening financial positions of government-related entities (GREs) or the region's unwillingness to use its own expenditure flexibility, showing an inability to contain expenditure pressures.

If we lowered our ratings on Belgium, or revised the outlook to negative, we would take a similar action on Brussels-Capital. We believe that the credit characteristics of Belgian local and regional governments would unlikely remain stronger than those of the sovereign in a scenario of economic or political stress.

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 posted structurally stronger 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 are supported by the predictable and well-balanced institutional framework under which it operates, as well as the region's wealthy local economy, strong budgetary performance, and exceptional liquidity. The ratings are constrained by the region's average fiscal flexibility as well as moderate debt and contingent liabilities.

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 €65,900 in 2017, which exceeds the national average by some 1.7x. These levels, however, are offset by a large number of commuter workers who work in the region but live and pay taxes outside it, and 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 accounts for around 20% of Belgium's GDP, it only receives around 10% 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 relatively high tax autonomy of regions. In our opinion, the gradual pace of the implementation of the sixth Belgian state reform since 2015--including the devolving 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 and debt-service management on a consolidated basis (i.e., including the region's GREs).

Strong budgetary performance continues to limit debt intake

We expect the region's budgetary performance will stay strong through 2020, with operating surpluses averaging a high 10% of operating revenues and only modest deficits after capital accounts. This is thanks to the management's tight monitoring of operating costs (including those at the GRE level), leading us to estimate that operating expenditures will increase annually by a modest 2%.

In our forecast, we adjust for the property tax that the region has started to collect this year on behalf of cities (estimated at €900 million), since we consider this a pass-through item. Moreover, we continue to expect that the region's capital expenditures will increase to an average €1.3 billion per year in 2018-2020, in line with our previous forecast, and maintain deficits after capital accounts, on a five-year average, below 5% of total revenues.

We also note that actual budgetary results in 2017 came in somewhat weaker than our March 2018 base-case estimates. This is because spending at some important GREs was not fully available at that time. Nevertheless, the city's overall financial position is unchanged since debt intake remained in line with initial expectations.

In addition, we expect budgetary performance will remain strong on the back of Brussels-Capital's existing budgetary flexibility, both on the revenue and spending side. Its modifiable tax revenues, comprising the supplementary tax on personal income tax and regional taxes, account for a high 50% of operating revenues. Still, we believe that Brussels-Capital would be less willing to tap its tax leeway and more likely to use its spending flexibility if needed, especially regarding capital expenditure, which we expect will account for 23% of total expenditures in 2018-2020.

We understand Brussels-Capital targets a balanced budget through 2020, excluding strategic investments. As a result, annual gross borrowings will likely consist of debt refinancing needs and funding of those strategic investments (which we expect to average €260 million a year in 2018-2020, or 5% of total expenditures).

Consequently, Brussels-Capital's tax-supported debt will reach about 105% of consolidated operating revenues in 2020, compared with 89% in 2016. 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 the European system of national and regional accounts 2010 (ESA 2010). FRBRTC lends the majority of its debt proceeds to self-supporting municipalities in the region. At present, this on-lent debt accounts for about 12% of the region's consolidated operating revenues.

Brussels-Capital enjoys exceptional liquidity. 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 to 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 a relatively financially weak municipal sector. 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 revenues at year-end 2017. We understand that the social housing mortgage companies sector in Brussels-Capital is undergoing some mergers, but this restructuring does not affect our assessment of the associated risks. 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 will continue to monitor the risks that could emerge from the significant financial change faced by the public body Commission Communautaire Commune since its annual budget increased under the sixth state reform to nearly €1.3 billion in 2015 from €100 million in 2014.

Key Statistics

Table 1

Region of Brussels-Capital Selected Indicators

	--Fiscal year end Dec. 31--				
(Mil. €)	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Operating revenues	4,349	4,463	4,537	4,614	4,696
Operating expenditures	3,765	3,962	4,081	4,176	4,226
Operating balance	583	501	456	438	470
Operating balance (% of operating revenues)	13	11	10	9	10
Capital revenues	538	592	506	559	562
Capital expenditures	1,133	1,120	1,240	1,279	1,279
Balance after capital accounts	(11.8)	(26.8)	(277.8)	(281.5)	(246.3)
Balance after capital accounts (% of total revenues)	(0.2)	(0.5)	(5.5)	(5.4)	(4.7)
Debt repaid	649	737	714	603	616
Gross borrowings	601	522	992	884	862
Balance after borrowings	(59)	(241)	0	0	0

Table 1

Region of Brussels-Capital Selected Indicators (cont.)

	--Fiscal year end Dec. 31--				
(Mil. €)	**2016**	**2017**	**2018bc**	**2019bc**	**2020bc**
Modifiable revenues (% of operating revenues)	48.5	52.5	50.7	50.5	50.2
Capital expenditures (% of total expenditures)	23.2	22.2	24.6	24.7	24.3
Direct debt (outstanding at year-end)	3,842	4,068	4,346	4,627	4,874
Direct debt (% of operating revenues)	88.3	91.2	95.8	100.3	103.8
Tax-supported debt (outstanding at year-end)	3,873	4,102	4,380	4,661	4,908
Tax-supported debt (% of consolidated operating revenues)	89.1	91.9	96.5	101.0	104.5
Interest (% of operating revenues)	3.9	3.7	3.9	4.0	3.4
Local GDP per capita (€)	63,800	65,878	67,113	68,411	69,681
National GDP per capita (€)	37,512	38,615	39,645	40,726	41,805

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, reflecting 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	
Institutional framework	Very predictable and well-balanced
Economy	Strong
Financial management	Very strong
Budgetary flexibility	Average
Budgetary performance	Strong
Liquidity	Exceptional
Debt burden	Moderate
Contingent liabilities	Moderate

*S&P Global Ratings' credit ratings on local and regional governments are based 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

- Belgium 'AA/A-1+' Ratings Affirmed; Outlook Stable, Sept. 21, 2018

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

- Belgium 'AA/A-1+' Ratings Affirmed; Outlook Stable, Sept. 21, 2018
- Sovereign Risk Indicators, July 5, 2018. An interactive version is also available at http://www.spratings.com/sri.
- Default, Transition, and Recovery: 2017 Annual International Public Finance Default Study And Rating Transitions, June 11, 2018
- Institutional Framework Assessments For Non-U.S. Local And Regional Governments, Sept. 21, 2017

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; New Rating

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

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