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Research Update:

Croatian Capital City of Zagreb Outlook Revised To Stable Following Similar Action On Croatia; 'BB' Rating Affirmed

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Research Update:

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Overview

- On Dec. 16, 2016, we revised our outlook on the Republic of Croatia to stable from negative and affirmed the 'BB' sovereign credit rating.
- We cap the long-term ratings and outlook on Zagreb at the level of the long-term ratings and outlook on Croatia. We see no change in any of the key factors underpinning the ratings on Zagreb.
- We are therefore revising the outlook on Zagreb to stable from negative, and affirming the ratings at 'BB'.
- The stable outlook reflects our view that Zagreb will maintain its very strong budgetary performance and low debt levels over the next year.

Rating Action

On Dec. 22, 2016, S&P Global Ratings revised its outlook on Croatia's capital, the City of Zagreb, to stable from negative. We affirmed our 'BB' long-term issuer credit rating on Zagreb.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Zagreb are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2017 EMEA Sovereign, Regional, And Local Government Rating Publication Dates," published Dec. 16, 2016, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In the case of Zagreb, the deviation has been caused by the revision of the outlook on the Republic of Croatia to stable from negative on Dec. 16, 2016. The next scheduled rating publication on our rating on Zagreb will be in 2017.

Rationale

The rating action on Zagreb follows our revision of the outlook on Croatia to stable from negative on Dec. 16, 2016 (see "Croatia Outlook Revised To Stable On Stronger Growth And Reduced Fiscal Pressure; 'BB/B' Ratings Affirmed," published on RatingsDirect). The long-term rating on Zagreb remains at the same level as that on the sovereign. We would not currently rate Croatian local or regional governments (LRGs) above the sovereign.

The rating on Zagreb reflects the city's weak budgetary flexibility, financial management, and liquidity position, as well as the volatile and unbalanced

institutional framework for Croatian LRGs. Supportive factors are our assessment of Zagreb's average economy, very strong budgetary performance, low debt, and moderate contingent liabilities. We assess Zagreb's stand-alone credit profile (SACP) at 'bb'.

Outlook

The stable outlook on Zagreb reflects our expectation that the city will continue to perform in line with our base-case scenario over the coming 12 months.

We might consider a negative rating action on Zagreb if we see weakening budgetary performance, which could also lead to a weaker assessment of the city's debt if operating surpluses were lower than expected in our forecast. We could also lower the rating if the city's liquidity position deteriorated due to dwindling cash reserves, or if we changed our assessment of the city's financial management because of uncertainties regarding political leadership.

We could raise the rating if the city structurally improves its liquidity position, resulting in free cash consistently exceeding 80% of annual debt service. The prospect of an upgrade would, however, also be contingent on us taking a similar rating action on the sovereign, as we consider that Croatian cities cannot be rated above the sovereign under our criteria.

Key Statistics

Table 1

City of Zagreb Financial Statistics						
	--Fiscal year end Dec. 31--					
(Mil. HRK)	2013	2014	2015	2016bc	2017bc	2018bc
Operating revenues	6,604	6,607	6,167	6,535	6,605	6,697
Operating expenditures	5,560	5,808	5,519	5,796	5,861	5,901
Operating balance	1,044	799	648	739	744	797
Operating balance (% of operating revenues)	15.8	12.1	10.5	11.3	11.3	11.9
Capital revenues	229	66	46	32	100	100
Capital expenditures	992	790	567	583	650	650
Balance after capital accounts	281	75	127	188	194	247
Balance after capital accounts (% of total revenues)	4.1	1.1	2.0	2.9	2.9	3.6
Debt repaid	272	308	522	430	440	410
Net budget loans	2	5	1	N/A	N/A	N/A
Balance after debt repayment and onlending	11	(229)	(394)	(242)	(246)	(163)
Balance after debt repayment and onlending (% of total revenues)	0.2	(3.4)	(6.3)	(3.7)	(3.7)	(2.4)
Gross borrowings	150	190	193	200	200	200
Balance after borrowings	161	(39)	(202)	(42)	(46)	37
Operating revenue growth (%)	3.5	0.0	(6.7)	6.0	1.1	1.4

Table 1

City of Zagreb Financial Statistics (cont.)

(Mil. HRK)	--Fiscal year end Dec. 31--					
	2013	2014	2015	2016bc	2017bc	2018bc
Operating expenditure growth (%)	0.3	4.5	(5.0)	5.0	1.1	0.7
Modifiable revenues (% of operating revenues)	36.9	35.1	36.2	35.7	35.6	35.3
Capital expenditures (% of total expenditures)	15.1	12.0	9.3	9.1	10.0	9.9
Direct debt (outstanding at year-end)	2,801	2,445	2,798	2,568	2,328	2,118
Direct debt (% of operating revenues)	42.4	37.0	45.4	39.3	35.3	31.6
Tax-supported debt (% of consolidated operating revenues)	85.0	66.4	83.3	75.2	70.3	69.1
Interest (% of operating revenues)	0.8	1.9	1.9	1.7	1.7	1.7
Debt service (% of operating revenues)	4.9	6.6	10.4	8.3	8.4	7.8

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. HRK--Croatian kuna. N/A--Not available.

Table 2

City of Zagreb Economic Statistics

	--Fiscal year end Dec. 31--					
	2013	2014	2015	2016bc	2017bc	2018bc
Population	793,930	795,500	796,000	797,000	798,000	800,000
Population growth (%)	0.1	0.2	0.1	0.1	0.1	0.3
GDP per capita (HRK)	142,220	140,360	142,890	146,460	150,560	155,380
Unemployment rate (%)	9.5	9.5	13.7	12.5	12.0	12.0

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. Sources typically include national statistical offices, Eurostat, and Experian Limited. HRK--Croatian kuna.

Ratings Score Snapshot

Table 3

City of Zagreb Ratings Score Snapshot

Key rating factors

Institutional framework	Volatile and unbalanced
Economy	Average
Financial management	Weak
Budgetary flexibility	Weak
Budgetary performance	Very strong
Liquidity	Weak
Debt burden	Low
Contingent Liabilities	Moderate

*S&P Global Ratings bases its ratings on local and regional governments (LRGs) 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 foreign currency rating on an LRG.

Key Sovereign Statistics

Croatia Outlook Revised To Stable On Stronger Growth And Reduced Fiscal Pressure; 'BB/B' Ratings Affirmed, Dec. 16, 2016

Related Criteria And Research

Related Criteria

- Criteria - Governments - International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign - December 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 - November 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 - October 15, 2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- Sovereign Risk Indicators, Dec. 14, 2016. An interactive version is available at <http://www.spratings.com/SRI>
- The Former Yugoslav Republics 25 Years After The Fall Of Yugoslavia. Where Are They Now?, Nov. 14, 2016
- 2015 Annual International Public Finance Default Study And Rating Transitions - June 30, 2016
- Public Finance System Overview: Croatian Municipalities, May 7, 2015
- Banking Industry Country Risk Assessment: Croatia, Oct. 22, 2015

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

	Rating	
	To	From
Zagreb (City of)		
Issuer Credit Rating		
Foreign and Local Currency	BB/Stable/--	BB/Negative/--

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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site 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.

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