Research Update:

Outlook On Croatian City of Zagreb Revised To Negative Following Similar Action On The Sovereign; 'BB' Rating Affirmed

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Overview
• On July 17, 2015, we revised our outlook on Croatia to negative from stable and affirmed the 'BB/B' sovereign credit ratings.
• Under our methodology for rating local and regional governments, we currently do not rate the City of Zagreb higher than Croatia.
• Consequently, we are revising our outlook on Zagreb to negative from stable and affirming our 'BB' rating on the city.
• The negative outlook reflects that on Croatia.

Rating Action
On July 20, 2015, Standard & Poor's Ratings Services revised its outlook on the Croatian City of Zagreb to negative from stable and affirmed its 'BB' long-term issuer credit 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 Article 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2015 EMEA Sovereign, Regional, And Local Government Rating Publication Dates: Second-Quarter Update," published July 10, 2015, 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 outlook revision to negative from stable on the long-term rating on Croatia on July 17, 2015.

Rationale
The outlook revision follows a similar action on Croatia on July 17, 2015 (see "Croatia Outlook Revised To Negative On Lackluster Reform Efforts; 'BB/B' Ratings Affirmed").

In accordance with our criteria for rating non-U.S. local and regional governments (LRGs) and their related sovereigns, we generally cap the long-term rating on an LRG at the same level as its respective sovereign. We do not believe that the institutional and financial framework for Croatian LRGs allows any of them to be rated above the sovereign. In particular, we view Croatian LRGs' autonomy as limited by their revenues' dependence on transfers or shared taxes from the sovereign. In addition, Croatian LRGs' revenue-expenditure balance has been undermined several times over the past few years by the central government's changes to the tax system,
most recently the realignment of income tax brackets. As a result, we consider that
the long-term rating on Zagreb cannot be higher than that on the sovereign, leading
us to revise our outlook on the rating to negative in line with that on Croatia.

The rating on Zagreb reflects our view of the city's weak budgetary flexibility,
financial management, and liquidity position, as our criteria define these terms. It
also reflects our view of the volatile and unbalanced institutional framework for
Croatian cities and Zagreb’s average economy. These factors are somewhat offset by
the city's very strong budgetary performance, low debt, and moderate contingent
liabilities.

The long-term rating on Zagreb is equivalent to our assessment of its stand-alone
credit profile, which we assess at 'bb'. In our base case, we believe that tight
control over operating spending should allow Zagreb to maintain strong budgetary
performance and gradually reduce its debt burden amid economic stagnation in
Croatia.

**Liquidity**

We view Zagreb's liquidity position as weak, owing to the city's limited access to
external liquidity. We also believe that the dwindling operating surplus indicates
that the city's internal cash-generating capacity has weakened somewhat.

**Outlook**

The negative outlook on Zagreb reflects that on Croatia.

If we lowered the long-term rating on Croatia, we would lower the long-term rating
on Zagreb because we consider that Croatian cities cannot be rated above the
sovereign, according to our criteria.

Moreover, we might consider a negative rating action on Zagreb, if we see weakening
budgetary performance and debt increases that exceed our forecast. We could also
lower the ratings if we saw the city's liquidity position deteriorate further due to
dwindling cash reserves, or if we changed our assessment of the city's financial
management due to uncertainties regarding the political leadership.

We could revise the outlook on Zagreb to stable if we revised the outlook on the
long-term sovereign credit rating on Croatia to stable and, at the same time, Zagreb
continued to perform in line with our base-case scenario.

**Key Statistics**

Please see "Croatian Capital City of Zagreb Affirmed At 'BB' On Ongoing Very Strong

**Ratings Score Snapshot**
Please see "Croatian Capital City of Zagreb Affirmed At 'BB' On Ongoing Very Strong Budgetary Performance; Outlook Stable," published Feb. 13, 2015

**Key Sovereign Statistics**

Croatia Outlook Revised To Negative On Lackluster Reform Efforts; 'BB/B' Ratings Affirmed, July 17, 2015

**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

**Related Research**


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**
Research Update: Outlook On Croatian City of Zagreb Revised To Negative Following Similar Action On The Sovereign; 'BB' Rating Affirmed

Ratings

To

Zagreb (City of)

Issuer credit rating

Foreign and Local Currency BB/Negative/-- BB/Stable/--

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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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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