Research Update:

Autonomous Community of Madrid Ratings Affirmed At 'A/A-1'; Outlook Stable

July 26, 2024

Overview

- We expect the Autonomous Community of Madrid's operating performance to improve from 2024-2026 on high revenue from the regional financing system and contained expenditure growth, supported by compliance with the national fiscal rules in 2024.
- We expect Madrid's cash position to weaken as the region accelerates investments financed through past advance payments from Recovery and Resilience Facility grants, but note the government's liquidity position will continue to benefit from its strong access to domestic capital and financial markets.
- We project the region's tax-supported debt ratio to decline, thanks to strong revenue and gradual fiscal consolidation.
- We affirmed our ratings on the Autonomous Community of Madrid at 'A/A-1'. The outlook is stable.

PRIMARY CREDIT ANALYST

Marta Saenz
Madrid
+ 34 91 788 7231
marta.saenz@spglobal.com

SECONDARY CONTACT

Alejandro Rodriguez Anglada
Madrid
+ 34 91 788 7233
alejandro.rodriguez.anglada@spglobal.com

ADDITIONAL CONTACTS

Manuel Becerra
Madrid
+34 914233220
manuel.becerra@spglobal.com

Sovereign and IPF EMEA
SOVIPF@spglobal.com

Rating Action

On July 26, 2024, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on the Autonomous Community of Madrid. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Madrid will improve its budgetary performance over our two-year forecast period, thanks to increased revenue from the regional financing system and the region's commitment to containing costs.

Downside scenario

We could downgrade the region should spending discipline falter, preventing the recovery of operating budgetary performance. We could also lower our ratings on Madrid if we downgraded

Spain (unsolicited; A/Stable/A-1).

Upside scenario

Any upgrade of Madrid would be contingent on one to Spain because we do not think the region meets our requirements to be rated above the sovereign. Should it meet this condition, we could upgrade Madrid if the region's budgetary performance improves compared with our base-case scenario. Under this scenario, we would also expect a faster deleveraging path than we forecast.

Rationale

Madrid's wealthy economy supports the regional government's creditworthiness. The region has the largest GDP of all regional economies and the highest GDP per capita in Spain. Its economy continues to perform in line with Spain's, growing above the eurozone average. Also supporting our ratings is our expectation Madrid will operate a small operating surpluses over the forecast period, supported by high revenue from the regional financing system and management's commitment toward budgetary consolidation in the face of reinstated national fiscal rules.

Madrid's strong access to capital markets, even in periods of market volatility, remains a supportive factor in our liquidity assessment. The region is the largest and most frequent issuer among Spanish regions. This, in our view, mitigates Madrid's free cash position (previsly boosted by advance payments from the EU Recovery and Resilience Facility [RRF]) weakening over the past year due to accelerated related investments.

Madrid's debt levels remain high in an international context, although tax-supported debt ratios are declining. The region might benefit from debt relief from the central government, which could accelerate its deleveraging path beyond our current expectation.

Sound economic performance mitigates weaker predictability on revenue from the regional financing system

Madrid is Spain's wealthiest region, with per capita GDP at 137% of the national average, according to the most recent public data available from the National Statistics Institute. It also represents about 19% of Spain's total GDP. Moreover, unemployment is below the national average (at 9.7% versus 11.9% for Spain as of December 2023). Given its wealthy economy, Madrid is also a net contributor to the Spanish regional equalization system, although this prevents it from fully benefiting from its high wealth. We expect the regional economy to perform in line with Spain's over the forecast period, and expand beyond the eurozone average, with real GDP growth estimated at 2.2% for 2024. Madrid will continue to benefit from EU grants, and potentially loans from the Next Generation EU program (including the RRF), which will continue to support investment and economic growth over the forecast period.

We continue to view Spanish regions' institutional framework as supportive. However, the political fragmentation is leading to a lower degree of institutionalization of the relationship between government and regions, making them somewhat less predictable. Overall, in recent years, relations between the central government and normal status regions have shifted away from institutional, multilateral channels (such as the Fiscal and Financial Policy Council), toward bilateral negotiations with regions or political parties, and ad-hoc, temporary solutions to structural problems. Nevertheless, despite weaker predictability, the central government's commitment to subnational fiscal stability remains strong, in our view. The central government continues to provide funding to Spanish regions through its liquidity facilities and demonstrated strong budgetary support to Spanish regions throughout the pandemic.

Spanish normal status regions (including Madrid) benefit from a material increase in revenue from the regional financing system (a 12.4% increase overall for Madrid). However, the lack of a central government budget for the year has delayed the effective allocation of this additional revenue. This meant that regions had to compile their 2024 budgets with low visibility on revenue, in some instances even causing liquidity stress. Nevertheless, on June 25, the central government passed a Royal Decree Law that solves this problem, officially enacting the increase in resources for regions.

We view Madrid's financial management as adequately managing its budget, debt, and liqudity. This is despite the region facing the accumulation of payables related to some public-private hospitals, the settlement of which led to wider budgetary deficits in 2022. We consider this episode as one-off since the region has committed to budget additional funds to avoid running arrears to hospitals. We expect Madrid to pay these settlements to the hospitals every year as the auditing process comes due. The region's management has a prudent liquidity and debt policy, in our view. Madrid does not rely on central government liquidity facilities, allowing for additional autonomy in debt management.

High revenue will allow the region to return to operating surpluses and continue its deleveraging

We expect Madrid to return to small operating budget surpluses in 2024 on strong revenue and management's cost-containment measures anchored by binding fiscal rules, reinstated in 2024.

We project the region's operating revenues will increase by 9% this year, supported by high revenue growth from the reginal financing system and strong performance of Madrid's own taxes. In particular, we forecast a gradual recovery of the real estate transaction tax, which as of April 2024 was up 14% from April 2023.

From 2025, we expect operating revenue growth to moderate, after two consecutive years of its extraordinary high growth. This is supported by Spain's strong recovery from the pandemic, which has translated into very high tax intake over 2022-2023, itself leading to large positive settlements to Spanish regions in 2023 and 2024 (the regional financing system is settled two years later). The central government recently announced revenue from the financing system will rise 2.5% in 2025.

In 2024, fiscal rules became binding again, after being suspended from 2020-2023. This, in our view, should force the region to limit expenditure growth. Additionally, lower interest rates and inflation should ease some budgetary pressure, supporting improvement in the region's operating balance over the forecast.

Madrid will continue to post deficits after capital accounts as the region excutes large capital spending related to RRF. As of December 2023, we estimate Madrid has spent about 40% of the RRF funds allocated to the region. While RRF funds are neutral for the budget over their life, they generate variability in budgetary accounting outcomes depending on the timing of the recognition of revenue and expenditure.

Madrid's liquidity position deteriorated in 2023 due to the depletion of RRF-related cash reserves as the investment cycle picked up. Nevertheless, the region has contracted €1.8 billion in credit lines, a commercial paper program of €1 billion and high volume of signed, but not yet disbursed loans with the European Investment Bank (EIB). More broadly, we view Madrid's access to capital and financial markets as strong. The region is a benchmark issuer among Spanish regions and the largest and most frequent issuer in the capital markets. Madrid's gross borrowings needs for 2024 reached €3.96 billion, of which the region has raised 75% by midyear through bonds and loans.

Madrid's tax-supported debt stood at 150% of operating revenue at end-2023, which we consider high in an international context. Still, we project debt to decline to 136% of operating revenue by 2026 on improving budgetary performance. Similar to other normal status regions, Madrid could benefit from a debt write-off from the central government, which could imply a faster deleveraging path than what we project (see "Subnational Debt 2024: Spain (Debt Absorption Scenarios): All could benefit, with some more than others," published March 4, 2024, on RatingsDirect). We expect the central government to start bilateral conversation with the regions by the end of July, in which they will communicate the methodology that will determine amounts to be absorbed, as well as the details on implementation.

Madrid's tax-supported debt figures include the debt of its government-related entities, such as Metro de Madrid (which stood at €2.2 billion at year-end 2023), as well as public and private partnerships on hospitals and transportation entities (€1.4 billion at year-end 2023). About 60% of Madrid's debt is market issuance, while the rest is bank loans, including from multilateral institutions such as the EIB. The region's debt is fully denominated in euros and shielded from volatility in interest rates because about 94% of debt liabilities carry a fixed rate.

Key Statistics

Table 1

Autonomous Community of Madrid--Selected indicators

	--Fiscal year ended Dec. 31--					
Mil. €	**2021**	**2022**	**2023**	**2024bc**	**2025bc**	**2026bc**
Operating revenue	23,517	21,621	23,964	26,104	26,862	28,006
Operating expenditure	22,404	22,504	24,744	25,795	26,665	27,563
Operating balance	1,112	(884)	(780)	308	196	443
Operating balance (% of operating revenues)	4.7	(4.1)	(3.3)	1.2	0.7	1.6
Capital revenue	951	1,049	703	686	459	427
Capital expenditure	1,002	2,039	1,827	1,824	1,600	1,555
Balance after capital accounts	1,062	(1,873)	(1,904)	(830)	(944)	(684)
Balance after capital accounts (% of total revenue)	4.3	(8.3)	(7.7)	(3.1)	(3.5)	(2.4)
Debt repaid	2,622	2,926	2,694	3,015	2,826	2,965
Gross borrowings	2,622	3,773	3,803	3,956	3,770	3,649
Balance after borrowings	1,062	(1,026)	(795)	111	(0)	(0)
Direct debt (outstanding at year-end)	32,400	33,283	34,345	35,286	36,230	36,914
Direct debt (% of operating revenue)	137.8	153.9	143.3	135.2	134.9	131.8
Tax-supported debt (outstanding at year-end)	35,062	35,750	37,201	38,839	39,631	40,163
Tax-supported debt (% of consolidated operating revenue)	142.7	157.2	148.6	142.1	140.8	136.9
Interest (% of operating revenue)	3.0	3.0	3.2	3.3	3.2	3.0

Table 1

Autonomous Community of Madrid--Selected indicators (cont.)

	--Fiscal year ended Dec. 31--					
Mil. €	**2021**	**2022**	**2023**	**2024bc**	**2025bc**	**2026bc**
Local GDP per capita (€)	35,380	38,435	N/A	N/A	N/A	N/A
National GDP per capita (€)	25,787	28,385	30,402	32,000	33,356	34,634

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. N/A--Not applicable.

Ratings Score Snapshot

Table 2

Autonomous Community of Madrid--Ratings score snapshot

Key rating factors	
Institutional framework	3
Economy	2
Financial management	3
Budgetary perfomance	3
Liquidity	2
Debt burden	4
Stand-alone credit profile	a
Issuer credit rating	A

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, July 8, 2024. Interactive version available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Spanish Regions: Emerging Challenges Cloud Short-Term Stability, July 3, 2024
- Spanish Regions May Receive Debt Relief From State, Nov. 7, 2023
- Institutional Framework Assessment: Spanish Normal Status Regions, July 21, 2022

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

Madrid (Autonomous Community of)	
Issuer Credit Rating	A/Stable/A-1
Senior Unsecured	A
Commercial Paper	A-1