FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms the Autonomous Community of Madrid at 'A-'; Outlook Stable

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Fitch Ratings - Barcelona - 26 Apr 2024: Fitch Ratings has affirmed the Autonomous Community of Madrid's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'A-'. The Outlooks are Stable. Fitch has also affirmed the Short-Term Foreign Currency IDR at 'F1.

The affirmation reflects Madrid's unchanged Standalone Credit Profile (SCP) at 'bbb+', derived from a better-than-average 'Midrange' risk profile and debt sustainability (DS) assessed in the 'a' category under Fitch's rating case. The SCP is uplifted by one notch to the 'A-' IDR to factor in very high support from the central government to the sector in the form of liquidity mechanisms to refinance debt (representing 61% of the sector total debt at end-2023). Madrid does not currently benefit from this support, but we see no limitations to access should the region ask for it.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

Fitch sees a moderately low risk that Madrid's ability to cover debt service with its operating balance may weaken unexpectedly over 2024-2028, due to lower-than-projected revenue, higher-than-anticipated expenditure, or an unexpected rise in liabilities or debt-service requirements.

Revenue Robustness: 'Midrange'

Madrid has moderately cyclical revenue sources that should benefit from expected sound economic growth over the next five years. It includes robust tax proceeds made up of VAT (32% of 2023 tax revenues) and personal income tax (PIT; 53%).

We view self-collected taxes (8% of 2023 tax revenues) and special taxes (7%) as less robust revenue sources since some items are linked to highly cyclical activities, such as the real-estate market.

Revenue Adjustability: 'Stronger'

Like all autonomous communities, Madrid's revenue flexibility is high. The region has full rate flexibility of PIT (53% of tax revenues in 2023) and diversified self-collected taxes (16%), with no legal caps on tax rates. Given its strong regional socio-economic profile, we see high affordability of tax increases. Regional socio-economic indicators are stronger than the national average, with Madrid's GDP per capita (close to EUR38,000 in 2022 versus EUR28,000 nationally), while its tax rates are lower than the national average, leaving scope for tax raises.

Expenditure Sustainability: 'Midrange'

Madrid has overall moderate control over spending growth. This reflects the nature of Madrid's expenditure, as around 60% of its total expenditure comprises inflexible items, such as healthcare and education. Healthcare spending has increased sharply over the past five years due to the pandemic. Operating expenditure growth (6.3% CAGR in 2018-2023) has also been slightly higher than operating revenue growth (5.5%) over the past five years.

Expenditure Adjustability: 'Midrange'

Like other autonomous communities, Madrid is subject to the Budgetary Stability Law, and must comply with deficit, debt and spending targets. This has helped the region maintain its fiscal balance and resulted in a gradual narrowing of its overall deficit, although the region has failed to meet stability targets on several occasions. Madrid also has a high share of mandatory expenditure that Fitch estimates at 70%-90% of total spending.

Inflexible cost items comprise committed transfers for healthcare and education, as well as staff costs (35% of total spending in 2023), as most staff are civil servants with their wages decided nationally.

Liabilities & Liquidity Robustness: 'Stronger'

Madrid's debt carries low risk, with a fairly low cost of debt (2.3% in 2023), and short-term debt is limited, at 0.5% of its direct debt at end-2023. Its direct debt is entirely denominated in euros. The average maturity of debt (7.2 years at end-2023) is longer than other autonomous communities', and exposure to rising interest rates is low (the share of fixed-rate debt at 94% at end-2023). The amortisation profile is smooth.

Fitch includes in 'other Fitch-classified debt' capitalised payments of EUR1.4 billion for public-private partnerships in roads, train, metro, hospitals, and from Consorcio Regional de Transportes de Madrid (which manages and regulate public transport in the region).

Liabilities & Liquidity Flexibility: 'Midrange'

At end-2023, Madrid had EUR2.1 billion in available credit lines, contracted with counterparties mostly rated at 'BBB-'and 'A-'. In 2020, the central government authorised a EUR1.1 billion commercial paper programme for Madrid, of which EUR1 billion was available at end-2023.

Debt Sustainability: 'a category'

As a type 'A' LRG, Madrid's primary debt sustainability metric is the economic liability burden (net adjusted debt + a pro-rata share of central government debt/regional GDP), which we expect to be close to 83% in 2028 in our rating case (2023: 85%), in line with the 'a' category. We expect its debt payback to be close to 16x in 2025-2028 (2023: 87x) or 'bbb' category, and debt service coverage 0.6x in 2028, in the 'b' category.

We expect operating revenue to sharply increase in 2024 in our rating case, driven by a 12% increase in tax revenues due to positive tax settlement under the financing system. This will lift Madrid's operating balance as the region should keep tight control on its operating spending growth. We then expect operating balance to remain fairly stable until 2028 at around EUR2.4 billion as tax revenue slow and operating spending gradually increases on inflation of around 2% over the period.

We expect Madrid's net adjusted debt to increase to EUR40 billion by end-2028 (EUR36 billion at end-2023). This will be driven by a deficit of the capital balance (on average EUR2.5 billion per year over 2024-2028) but limited by Madrid's structurally positive operating balance.

DERIVATION SUMMARY

Madrid's 'a' debt sustainability assessment combined with a better-than-average 'Midrange' risk profile allow its SCP to be higher than comparable peers' at 'bbb+'. The SCP is uplifted by one notch to the 'A-' IDR to factor in available support from the central government in the form of liquidity mechanisms to refinance debt. Fitch does not apply any asymmetric risk.

Short-Term Ratings

Fitch has affirmed Madrid's Short-Term IDR at 'F1', which is the higher of two options for a 'A-' Long-Term IDR, reflecting Madrid's 'Stronger' liability and liquidity robustness and 'Midrange' liability and liquidity flexibility.

Debt Ratings

The 'A-' senior unsecured outstanding debt rating is aligned with Madrid's Long-Term IDR.

KEY ASSUMPTIONS

Risk Profile: 'Midrange'

Revenue Robustness: 'Midrange'

Revenue Adjustability: 'Stronger'

Expenditure Sustainability: 'Midrange'

Expenditure Adjustability: 'Midrange'

Liabilities and Liquidity Robustness: 'Stronger'

Liabilities and Liquidity Flexibility: 'Midrange'

Debt sustainability: 'a'

Support (Budget Loans): 'N/A'

Support (Ad Hoc): '1'

Asymmetric Risk: 'N/A'

Rating Cap (LT IDR): 'N/A'

Rating Cap (LT LC IDR) 'N/A'

Rating Floor: 'N/A'

Quantitative assumptions - Issuer Specific

Fitch's rating case is a "through-the-cycle" scenario, which incorporates a combination of revenue, cost and financial risk stresses. It is based on 2018-2023 figures and 2024-2028 projected ratios. The key assumptions for the scenario include:

- Compounded average growth of operating revenue at 6.1%, driven by dynamic tax collections and high tax settlement in 2024

- Compounded average growth of operating expenditure at 4.9%, driven by inflation above 2% over the period

- Net capital balance on average in EUR2.5 billion deficit per year

- Average cost of debt at 2.8% due to fairly high, although decreasing, policy interest rates over the period

Issuer Profile

Madrid is a single-province region in the centre of Spain, with a population of 6.8 million (14% of the national population) and around 20% of the national GDP in 2022. The regional economy is mainly driven by services, which account for 85% of employment. Madrid's responsibilities include health, education and social care.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Madrid's IDRs would be downgraded if the sovereign's IDRs are downgraded to 'BBB+'. They would also be downgraded if Madrid's SCP is revised lower to 'bbb'. This would be triggered by an economic liability burden above 100% under Fitch's rating case.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Madrid's IDRs could be upgraded if the sovereign rating is upgraded to 'A', and its SCP revised higher to 'a-'. This would require an economic liability burden below 70% under Fitch's rating case, provided the sovereign is upgraded at the same time.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

DISCUSSION NOTE

Committee date: 22 April 2023

There was an appropriate quorum at the committee and the members confirmed that they were free from recusal. It was agreed that the data was sufficiently robust relative to its materiality. During the committee no material issues were raised that were not in the original committee package. The main rating factors under the relevant criteria were discussed by the committee members. The rating decision as discussed in this rating action commentary reflects the committee discussion.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The ratings of Madrid are linked to Spain's sovereign ratings.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Madrid, Autonomous Community of	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
	ST IDR	F1	Affirmed	F1

	LC LT IDR A- Rating Outlook Stable Affirmed	A- Rating Outlook Stable
senior unsecured	LT A- Affirmed	A-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

International Local and Regional Governments Rating Criteria (pub. 03 Sep 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Madrid, Autonomous Community of	EU Issued, UK Endorsed

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