Research Update:

Autonomous Community of Madrid Upgraded To 'A/A-1' On Expected Stronger Budgetary Performance; Outlook Stable

November 4, 2022

Overview

- We expect the Autonomous Community of Madrid's (AC Madrid's) budgetary performance will improve over 2023 and 2024, supported by high revenue from the financing system, allowing the region to deleverage more rapidly.
- We estimate higher revenue will more than offset expenditure pressure arising from high inflation and expected increases in public salaries, and allow AC Madrid to post improving budgetary results.
- Moreover, AC Madrid's liquidity should remain solid, supported by its recurrent access to market funding.
- We therefore raised the long and short-term ratings on AC Madrid to 'A/A-1' and assigned a stable outlook.

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Rating Action

On Nov. 4, 2022, S&P Global Ratings raised its long- and short-term issuer credit ratings on the Autonomous Community of Madrid (AC Madrid) to 'A/A-1' from 'A-/A-2'. The outlook is stable.

Outlook

The stable outlook reflects our expectation that AC Madrid will improve its budgetary performance over our forecast period through 2024, thanks to increased revenue from the financing system, which will offset higher cost pressures. It also reflects our view that AC Madrid's financial management will remain committed to budgetary and fiscal consolidation, while maintaining the region's solid liquidity position.

Upside scenario

Any upgrade of AC Madrid would be contingent on an upgrade of Spain, as we do not believe the region meets our requirements to be rated above the sovereign.

However, should this condition be met, we could upgrade AC Madrid if the region's budgetary performance materially improves compared with our current base case. In this context we would expect a stronger deleveraging path than the one we currently forecast.

Downside scenario

We would downgrade AC Madrid if we downgrade Spain. We could also downgrade AC Madrid if we saw loosened controls over budgetary spending. This would likely result in materially weaker budgetary performance than what we currently project. In this context we would also expect liquidity to deteriorate.

Rationale

AC Madrid will post stronger budgetary performance in 2023 and 2024, despite weaker results in 2022 due to the phase out of COVID-19 support funds and a one-off settlement with some of the region's privately managed hospitals.

AC Madrid's revenue from the financing system in 2023 will grow by 17%, thanks both to an increase in advances for the year and to a large positive settlement from 2021 that will affect 2023 accounts. The increase is higher than we had previously anticipated, and we believe it should be sufficient to cover the high expenditure pressures arising from high inflation.

We also view AC Madrid's strong access to external liquidity as a strength for its credit profile. The region is a recurring issuer in the capital markets, having issued several green and sustainable bonds, and has managed to raise debt even during periods of market turbulence, including 2022.

Strong increases in regional financing system transfers for 2023 underpin regional finances, despite a challenging macroeconomic environment

Although the central government phased out the transfer of extraordinary COVID-19 support funds in 2022, it has continued to provide budgetary support to the regional tier. Spain's regional financing system generated a negative settlement in 2020, following the decline in tax collection, which would have required most regions to return funds to the central government in 2022. As a form of support, the central government decided to forgive regions this negative settlement. This measure also benefited AC Madrid, which did not have to return about €432 million, or 2% of the region's operating revenues.

In 2023, AC Madrid will receive in total 17% higher revenue from the financing system, including a €1.1 billion positive settlement from 2021, the effect of which will be booked in 2023. We understand this decision from the central government follows the high tax collection observed since the end of 2021 in Spain because of the country's post-pandemic recovery and the ongoing high inflation.

We expect AC Madrid's financial management to maintain its commitment to budgetary stability and cost control, and continue to perform in line with the reference targets set by the central government, which are nonbinding as per the EU's suspension fiscal rules. As such, we acknowledge management's efforts in scaling back almost half of the region's COVID-19-related expenditure, preventing it from becoming structural over time. We also expect AC Madrid's financial management to remain committed to its period of payment to suppliers (PPS), and end the year 2022 with a PPS below the maximum limit of 60 days.

The region's government has announced some fiscal measures in the context of weaker economic prospects; however, we expect these to have a limited impact on regional accounts, at about 2% of operating revenue. These include updated personal income tax (PIT) brackets in 2022, to account for the impact of inflation on salaries, and lowered rates on all PIT brackets. While these measures will tend to reduce PIT tax collection, part of the lost revenue could be compensated by higher consumption and therefore higher collection of taxes such as value-added or excise taxes, in our view.

AC Madrid's economy is a strength to its creditworthiness, in our view. It is the wealthiest among Spanish regions, with GDP per capita at 135% of the national average, and it has lower unemployment, at 11.3% of the active population on Sept. 30, 2022, versus the 12.7% national average on the same date. AC Madrid's economy recovered strongly in 2021 and above that of Spain, with GDP increasing by 6.5% versus the national average of 5%. In our view, AC Madrid benefits from being the capital region and from its diversified economic structure. We believe that execution of EU funds from the Next Generation EU pack will also support AC Madrid's economic growth. However, in budgetary terms the region does not fully benefit from these comparatively high economic indicators, because it is a net contributor to the equalization transfers to other regions.

We expect AC Madrid's deleveraging to accelerate, thanks to expected strong budgetary performance in 2023-2024, while its liquidity remains solid

We estimate the region's budgetary performance will improve in 2023 and 2024. AC Madrid will benefit from higher revenue from the financing system, which in our view will more than offset high cost pressures over 2023. The region will have to absorb a maximum of 3.5% public salary increase, while also renewing its contracts with suppliers at a higher rate. We also expect AC Madrid could take on some measures to support the local economy during 2023. In 2024, we expect the region could benefit again from a positive settlement coming from the financing system, allowing it to maintain a high revenue base. This is underpinned by a higher tax collection than what the central government advanced to the regions through the financing system.

We expect EU funds to mark the evolution of the capital accounts dynamic over our forecast. Spanish regions, including AC Madrid, will continue to benefit from large EU grants until 2023. While there have been some delays in the execution of these funds, we expect capital expenditure will intensify in 2023, because regions are allowed to spend these funds up to 2026.

This year, however, AC Madrid will post weaker budgetary performance than what we anticipated, due to a one-off settlement with some of its privately managed hospitals. The region has outstanding obligations with some concessional public-private hospitals in the region arising from 2018-2020, which we estimate will reach €950 million. These amounts, although they were already accounted for in national accounting terms in 2020, will only now be reflected in 2022 budgetary terms, which is when the payment will be made. To eliminate the one-off effect from the operating performance trend, we have reflected these payments as capital expenditure in our base case, with a neutral impact on the overall deficit figures.

We expect the region's tax-supported debt ratios will decline from 2023, driven by expected stronger budgetary performance and a higher revenue base. The region also had a lower debt intake than previously anticipated in 2022 because it overfinanced its needs during 2021.

We expect AC Madrid's liquidity will remain exceptional, supported by its strong access to external liquidity. The region's cash is supported by large transfers from EU funds, €1.82 billion in available liquidity lines, and contracted but undrawn long-term funding with the European Investment Bank and Council of Europe Development Bank. We expect AC Madrid's cash position will gradually decline as EU funds are spent and inflows decrease after 2023. However, we expect the region will generate budgetary surpluses by the end of 2024 and so liquidity coverage ratios should remain stable.

The region has strong access to capital markets, as demonstrated even during volatile market times, such as the eurozone financial crisis, the pandemic, and the military conflict in Ukraine. The region enjoys a wide investor base and it is a recurrent bond issuer. AC Madrid issued a €500 million green bond in October 2022, becoming the first public institution in Spain to issue a green bond in line with the EU taxonomy on sustainable economic principles. Since 2018, AC Madrid has issued a total of three green and five sustainable bonds, for a combined total of €7.2 billion. We expect the region to continue to finance its needs through a combination of bonds, commercial loans, and funding from multilateral institutions, without the need to make use of central government liquidity facilities, even though it would be entitled to the latter, as are all other Spanish regions.

Key Statistics

Table 1

Autonomous Community of Madrid--Selected Indicators

	--Fiscal year ending Dec. 31--				
Mil. €	**2020**	**2021**	**2022bc**	**2023bc**	**2024bc**
Operating revenues	23,068	23,517	21,399	23,652	24,534
Operating expenditures	21,590	22,404	22,186	23,484	23,971
Operating balance	1,479	1,112	(787)	169	563
Operating balance (% of operating revenues)	6.4	4.7	(3.7)	0.7	2.3
Capital revenues	260	951	1,124	847	349
Capital expenditures	1,114	1,002	2,617	1,493	904
Balance after capital accounts	625	1,062	(2,279)	(477)	8
Balance after capital accounts (% of total revenues)	2.7	4.3	(10.1)	(1.9)	0
Debt repaid	4,112	2,622	2,892	2,678	2,945
Gross borrowings	4,946	2,622	3,676	3,156	2,937
Balance after borrowings	1,459	1,062	(1,495)	0	0
Direct debt (outstanding at year-end)	32,338	32,400	33,184	33,662	33,654
Direct debt (% of operating revenues)	140.2	137.8	155.1	142.3	137.2
Tax-supported debt (outstanding at year-end)	35,179	35,062	36,004	36,439	36,381
Tax-supported debt (% of consolidated operating revenues)	145.9	142.7	160.4	147.5	142.2

Table 1

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

	--Fiscal year ending Dec. 31--				
Mil. €	**2020**	**2021**	**2022bc**	**2023bc**	**2024bc**
Interest (% of operating revenues)	3.2	3.0	3.3	3.3	3.3
Local GDP per capita (€)	32,048	N/A	N/A	N/A	N/A
National GDP per capita (€)	23,620	25,462	27,244	27,914	28,898

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	Score
Institutional framework	3
Economy	2
Financial management	3
Budgetary perfomance	3
Liquidity	1
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, Oct. 11, 2022, 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

- Criteria | Governments | International Public Finance: Methodology: Rating Non-U.S. Local And Regional Governments Higher Than The Sovereign, Dec. 15, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Institutional Framework Assessments For International Local And Regional Governments, Sept. 13, 2022
- 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

Upgraded

	To	From
Madrid (Autonomous Community of)		
Issuer Credit Rating	A/Stable/A-1	A-/Positive/A-2
Senior Unsecured	A	A-
Commercial Paper	A-1	A-2

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website 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; or Stockholm (46) 8-440-5914