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

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Fitch Ratings - Barcelona - [publication date will be automatically inserted]
Fitch Ratings has affirmed the Autonomous Community of Madrid 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 is based on Madrid's unchanged Standalone Credit Profile (SCP) at 'bbb+', reflecting a combination of a better-than-average 'Midrange' risk profile and debt sustainability assessed in the 'a' category under Fitch's rating-case scenario. 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 consider that there would be no limitation to the access should the region ask for it. Fitch has not applied any asymmetric risk to the ratings.

KEY RATING DRIVERS

Risk Profile: 'Midrange'

The assessment reflects Fitch's view that there is a moderately low risk of the issuer's ability to cover debt service with the operating balance weakening unexpectedly over the scenario horizon (2024-2028) due to lower revenue, higher expenditure, or an unexpected rise in liabilities or debt-service requirements.

Revenue Robustness: 'Midrange'

Madrid benefits from moderately cyclical revenue sources that should benefit from the expected sound economic growth. It includes robust tax proceeds made of VAT (32% of 2023 tax revenues) and PIT (53%).

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

Revenue Adjustability: 'Stronger'

Like all autonomous communities, Madrid's theoretical revenue flexibility is high. The region has full rate flexibility of PIT (53% of tax revenues in 2023) and diversified self-collected taxes (16%) and there are no legal caps on tax rates, allowing the assessment of its revenue adjustability as 'Stronger'. Given its strong regional socioeconomic profile, we consider that Madrid's ability to increase taxes is not limited.

We consider the affordability of taxpayers to absorb a tax increase as high, allowing for a ‘Stronger’ assessment. Regional socioeconomic indicators are stronger than national average, such as Madrid’s GDP per capital (close to EUR38,000 at end-2022), while the level of taxation is lower than the national average.

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 have been impacted by the pandemic and explains the dynamic growth of spending over the past 5 years. The pace of Madrid’s operating expenditure growth (6.3% CAGR in 2018-2023) has been slightly higher than that of operating revenue (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 maintain the fiscal balance and have resulted in a gradual reduction of Madrid’s overall deficit, although it has failed to meet stability targets on several occasions. Our assessment is also driven by the share of mandatory expenditure that Fitch estimates between 70% and 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 of staff are civil servants and their wages are decided nationally.

Liabilities & Liquidity Robustness: 'Stronger'

Madrid’s debt carries low risk, with relatively low apparent cost of debt (2.3% in 2023), low short-term debt (representing 0.5% of its direct debt at end-2023. The direct debt portfolio is entirely denominated in euros. The average maturity of debt (7.2 years at end-2023) is longer than other autonomous communities, and it has low exposure to rising interest rates (the share of fixed-rates was at 94% at end-2023). The amortisation profile is smooth. Fitch includes in ‘other Fitch-classified debt the capitalised payments of EUR1.4 billion for public-private partnerships (PPP) 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, the autonomous community of Madrid had EUR2.1 billion in available credit lines, contracted with counterparties mostly rated '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 type ‘A’ local and regional government, 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 scenario (2023: 85%), in line with the 'a' category. We expect its debt payback ratio, to be close to 16x in 2025-2028 (2023: 87x, 'bbb' category), and actual debt service coverage to be in the ‘b’ category (0.6x in 2028)

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

We expect Madrid’s net adjusted debt to increase to EUR40 billion by 2028 (EUR36 billion) at end-2023. This increase will be driven by expected deficit of the capital balance (EUR-2,5 billion per year on average over 2024-2028) but limited by Madrid’s structurally positive operating balance.

Derivation Summary

Fitch assesses Madrid's SCP at 'bbb+', reflecting a 'a' debt sustainability assessment combined with a better-than-average 'Midrange' risk profile, which allows the SCP to be higher than comparable peers. 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 (representing 61% of the Spanish regions' total debt at end-2023). Madrid does not currently benefit from this support, but we consider that there would be no limitation to the access should the region ask for it. Fitch does not apply any asymmetric risk.

Short-Term Ratings

Fitch has affirmed Madrid's Short-Term IDR at 'F1'. 'F1' is the higher of the two options for a 'A-' Long-Term IDR, reflecting Madrid's 'Stronger' assessment of Liability and Liquidity Robustness and 'Midrange' assessment of Liability and Liquidity Flexibility.

Debt Ratings

The senior unsecured outstanding debt rating have been affirmed at 'A-', the same level as 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:

- Compound average growth of operating revenue at 6.1% over 2024-2028, driven by dynamic tax collections and high tax settlement in 2024;

- Compound average growth of operating expenditure at 4.9% over 2024-2028 driven by inflation expected above 2% over the period;

- Net capital balance at a negative EUR2.5 billion per year on average over 2024-2028;

- 2.8% average cost of debt in the next five years due to relatively 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 were downgraded to 'BBB+'. They would also be downgraded if Madrid's SCP was lowered to 'bbb'. This would be triggered by an ELB 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 was upgraded to 'A', and its SCP was raised to 'a-'. This would require an ELB below 70% under Fitch's rating case, provided the sovereign was 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 OF RATING

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

RATING ACTIONS

ENTITY	RATING			PRIOR
Madrid, Autonomous Community of	LT IDR	A-	Affirmed	A-
	ST IDR	F1	Affirmed	F1
	LC LT IDR	A-	Affirmed	A-
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)(includes rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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