

City of Madrid Downgraded To 'AA-' On Unexpected 2008 Deficit And Economic Deterioration; Outlook Still Negative

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CreditWire/Vendor Headline

S&P Downgrades City of Madrid To 'AA-'; Outlook Still Negative

MADRID (Standard & Poor's) Feb. 9, 2009--Standard & Poor's Ratings Services said today that it has lowered its long-term issuer credit rating on the Spanish capital, the City of Madrid, to 'AA-' from 'AA'. At the same time, the 'A-1+' short-term issuer credit rating was affirmed. The outlook remains negative.

"The downgrade was prompted by the city's unexpected 2008 deficit and by worsening economic conditions," said Standard & Poor's credit analyst Alejandro Casas.

The 2008 preliminary results were unexpectedly weak, basically due to a combination of very dynamic operating expenditures, partly driven by some extraordinary items; the collapse of the real estate sector, resulting in almost no asset sales; lower-than-expected tax revenues; and flat state and regional transfers. The outcome was an unprecedented negative operating balance (which would have been close to nil in the absence of extraordinary items) and a sizable deficit after capital expenditures--representing 20% of total revenues--whereas the city expected a balanced result, in line with the goals set out in the 2005-2008 restructuring plan.

"As a result of this deficit, debt reached a record-high 176% of operating revenues at year-end 2008," said Mr. Casas.

The ratings continue to reflect Madrid's wealthy and diversified service-based economy--which is suffering, however, from its first recession since 1993--and its considerable revenue flexibility, thanks to below-average tax pressure (in a national context) and cadastral values that remain far below market values.

The ratings are constrained by weak operating performance and by very significant debt accumulation over 2003-2008, owing mainly to the large investments during the last political term. In addition, the ratings take into account the increased rigidity of Madrid's operating expenditures,

basically due to sizable multiyear payment commitments since 2007.

Our uncertainty has increased regarding the evolution of Madrid's budgetary performance and debt stock, particularly after the unexpectedly high 2008 deficit and the very pessimistic prospects for the local and national economies, which we expect to be in recession until 2010. There is also a great uncertainty regarding the reform of the municipal financing system.

"A downgrade is possible if the city is unable to substantially improve both its operating and overall performance in the short term so as to enable a substantial downward trend in the main debt ratios," said Mr. Casas. "This is all the more important considering that Madrid's debt burden is already high compared with that of its 'AA-' rated peers."

Conversely, we could revise the outlook to stable if the restructuring plan to be launched shortly by the city includes viable and powerful measures--both on the revenue and expenditure side--that quickly materialize into a structural and sustained improvement in the municipal finances, leading to a long-term fiscal consolidation process.

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