

Spain Special Report

Spanish Autonomous Communities' 2010 Budget

Deficit To Grow Further

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Related Research

- *Widening Deficit Limits Raising Spanish Regions' Downgrade Risk (June 2009)*
- *Spain's Employment Indicators to Continue Deteriorating in 2009 (June 2009)*
- *2009: a Challenging Year for Spanish Autonomous Communities but Credit Profile Expected to Remain Sound (January 2009)*
- *2008 Budget of Spanish Autonomous Communities: Tax Revenues Again Too Bullish (February 2008)*

Autonomous Communities Rated by Fitch

Andalusia	'AA'/Negative/'F1+'
Asturias	'AA'/Stable/'F1+'
Canary Islands	'AA'/Negative/'F1+'
Cantabria	'AA'/Stable/'F1+'
Castile-la Mancha	'AA-'/Stable/'F1+'
Catalonia	'A+'/'Negative/'F1'
Valencia	'A+'/'Stable/'F1'
Madrid	'AA'/Negative/'F1+'
Murcia	'AA'/Negative/'F1+'
Basque Country	'AAA'/Negative/'F1+'

Source: Fitch

The draft budgets for 2010 presented by Spanish autonomous communities take a rather different approach from previous years. They appear more realistic in terms of current revenue. In Fitch Ratings' view this contrasts with the regions' previous annual budget proposals made for 2009 and 2008. Although Fitch now expects the 2010 accounts to show a slightly higher deficit than expected in 2009, this by itself should not trigger automatic downgrades of regions already on Negative Outlook – as during the 2009 review, a deterioration of the current balance and an increase of debt for 2010 was already factored into the revisions to Negative Outlook. If there are strong indications that autonomous communities would return to satisfactory current margins by 2011, that debt would not increase beyond Fitch's expectations (EUR120bn-140bn), and that all else would remain equal, a Negative Outlook could be revised to Stable without any downgrade.

In Fitch's Special Report "2009: a Challenging Year for Spanish Autonomous Communities but Credit Profile Expected to Remain Sound" (see link under *Related Research*) on the assessment of the 2009 annual budget, the agency considered that, despite the expected deterioration in public finances for 2009, Spanish regions would be able to maintain a good credit profile thanks to a period of strong fiscal and financial discipline. Therefore, Fitch did not envisage any major impact on the ratings. In December 2008 out of the 10 rated autonomous communities, only one was on Negative Outlook, with nine Stable.

The situation changed substantially in June 2009 when the central government decided to allow the regions much larger deficits. This change in budgetary deficit limits stemmed from uncertainty about the ongoing economic downturn. The budgetary stability goals for 2010-2012 were softened compared with those in 2008 and 2009. Consequently, autonomous communities could generate a cumulative deficit up to the equivalent of about 7.5% of regional GDP in 2008-2012.

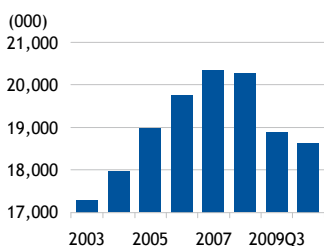
However, the situations of individual autonomous communities differ substantially. For example, Valencia and Catalonia's debt levels are not only quite significant in absolute terms, but more importantly, their debt exceeds their respective current revenue. In contrast, the Basque Country, Cantabria and Asturias' debt represents a more moderate 21%-28% of their current revenue.

Management of liquidity is especially important in this climate of growing funding needs. Although financial markets returned to normality in H109, there is still uncertainty about the pace of liquidity reduction. Fitch considers there still to be strong appetite for Spanish regional debt, especially among international investors. However, with new borrowing of about EUR32bn in 2010, Spanish regions will probably have to compete with many other European local and regional governments (LRGs), whose funding needs are expected to increase greatly, and with state (Spain: EUR35bn) and state agency issuance. The potential restructuring of many financial institutions in Spain in 2010 would also limit their demand for Spanish autonomous communities' debt.

Rating Perspectives

In the context of rapid changes affecting autonomous communities, Fitch's review process in 2009 led to many of the regions being on Negative Outlook (see the table *Rating Actions in 2009* below). Most of the rating actions taken in 2009 resulted from the agency's view that autonomous communities would face challenges in 2009 that are likely to continue into 2010.

Employment Development: Past and Expected Performance



2009 data corresponds to Q309, 2010 expected

Source: National Statistics Office (INE)

Debt and Debt Coverage Ratio

Country	Debt Q309 (EURm)	Debt (% current revenue 2010)
Andalusia	9,580	36
Asturias	958	28
Canaries	2,081	37
Cantabria	530	27
C. Mancha	3,145	43
Catalonia	24,054	104
Valencia	14,533	119
Madrid	11,173	67
Murcia	1,335	34
Basque Country	1,684	21

Source: Bank of Spain and Ministry of Economy and Finance

After the Council of Fiscal Policy and Finance's (CPFF) decision to soften budgetary goals for 2010-2012 (see *Economic Uncertainty Driving Changes in Medium-Term Budgetary Goals* below), Fitch considered in June 2009 that the debt payback ratio (debt to current balance) could deteriorate to 15 years (see "*Widening Deficit Limits Raising Spanish Downgrade Risk*" under Related Research on the first page) and become negative in 2009 and 2010 (as current balance is likely to be negative in these two years).

The presentation of a draft budget with a moderate negative current balance in 2010 and significant increase in debt by several autonomous communities was already largely taken into account in the Outlook revisions to Negative in Fitch's 2009 review. Rating through the economic cycle (and not just according to annual results) is an important element in the rating process for public entities; the Outlook revisions to Negative resulting from the 2009 review indicated that Fitch expects deterioration in the accounts for 2009, 2010 and 2011. The fact that the 2010 accounts are likely to be worse than Fitch expected would not by itself convert a Negative Outlook into a downgrade, as there is still the possibility of a recovery of budgetary performance in 2011. The decision whether to downgrade or not will largely depend on the autonomous community's ability to demonstrate that its current balance will start to recover from 2011.

Nevertheless, the situation varies across the sector, particularly relative to the debt level. Even where debt is poised to increase steeply, the weight of the nominal debt amount of each autonomous community relative to budget size differs in each case. The table *Debt and Debt Coverage Ratio* indicates that Asturias, Cantabria and the Basque Country have more favourable positions than their peers. In contrast, for Castile-la Mancha the deterioration was so severe in 2008, and expected to continue in 2009-2010, that the downgrade was carried out in 2009. In other cases the downgrade might occur if the 2009 accounts indicate a greater deterioration than Fitch expected at end-2008, or if there are clear signs during 2010 that the autonomous community will have difficulty curbing expenditure.

Signs of Economic Recovery Still Hard to Discern

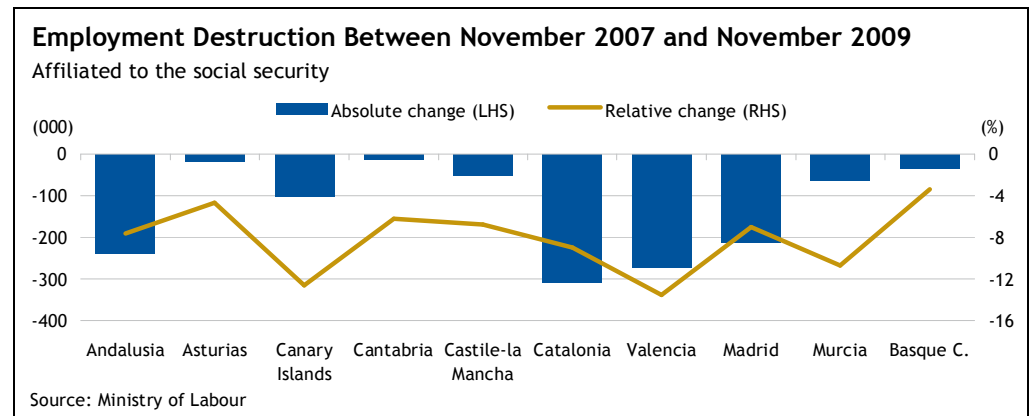
Each autonomous community differs in the presentation of its individual budget. However, the section dedicated to the outlook for the economy in 2010 and beyond is generally relatively small, as it is in the state's general budget. In many of those presentations there is an acknowledgment of the difficult economic situation. Nevertheless, several autonomous communities, including Andalusia, Murcia, the Basque Country and Valencia claim that there might be a slight improvement in some economic indicators beginning in H210. In Fitch's view, although some data point to a slight recovery in 2010, this might also be due to the implementation (domestic and external) of policy-stimulating measures. The agency is more inclined to expect the pace of expansion to be rather modest, at least in 2010 (the agency expects a decline in Spain's real GDP of 0.6%).

Rating Actions in 2009

Date	Entity	Action	Before	After
18 Feb	Autonomous Community of Madrid	Affirmed at 'AA' but Outlook revised	Stable	Negative
13 Jul	Autonomous Community of Cantabria	Affirmed at 'AA'	Stable	Stable
15 Jul	Autonomous Community of Murcia	Affirmed at 'AA' but Outlook revised	Stable	Negative
24 Jul	Autonomous Community of Canary Islands	Affirmed at 'AA' but Outlook revised	Stable	Negative
19 Aug	Autonomous Community of Asturias	Affirmed at 'AA'	Stable	Stable
5 Oct	Autonomous Community of Andalusia	Affirmed at 'AA' but Outlook revised	Stable	Negative
26 Oct	Autonomous Community of Catalonia	Affirmed at 'A+' but Outlook revised	Stable	Negative
25 Nov	Autonomous Community of Basque Country	Affirmed at 'AA' but Outlook revised	Stable	Negative
7 Dec	Autonomous Community of Castile la Mancha	Downgrade	'AA'	'AA-'
23 Dec	Autonomous Community of Valencia	Affirmed at 'A+'	Stable	Stable

Source: Fitch

The most recent forecast from the Ministry of Economy and Finance (published on 28 September 2009) also indicates that the central government still expects high unemployment in 2010, even above the 2009 forecast. Trends in the labour market are often considered a good proxy for economic outlook, and in this context they give little ground for optimism, although the position differs among regions. The chart *Employment Destruction Between November 2007 and November 2009* below shows that three Fitch-rated regions lost more than 10% of jobs between November 2007 (when the employment rate was close to its peak) and November 2009, compared with 8% for Spain. However, two regions recorded a loss below 5%. For more on regional labour market disparities, see Fitch’s Special Report “*Spain’s Employment Indicators to Continue Deteriorating in 2009*” under *Related Research* on the first page.



The Spanish economy is still shedding workers. However, Fitch notes positively that whereas during H109 job destruction was significant (the number of those affiliated to social security fell by 2% during January-August, a loss of 354,000 jobs), the latest statistics disclosed by the Ministry of Labour, for November 2009, show that it had slowed. In total, Spain lost about 0.1% of jobs (19,000) during August-November 2009. Apart from the Balearic Islands (19.3% fewer social security affiliations in this period), all the regions achieved either slight decreases or increases (between negative 1.8% registered by the Basque Country and positive 2.2% by Valencia). The labour survey published at end-October 2009 and covering Q309 (the summer season) indicated that only four autonomous communities (Andalusia, Murcia, Valencia and Madrid) registered negative growth compared with Q209. The remainder achieved positive performance, particularly the Balearic Islands (up 6.37%) and Canary Islands (up 1.65%), reflecting the reliance of the regional economies on tourism.

Economic Uncertainty Driving Changes in Medium-Term Budgetary Goals

The central government and then the Council of Fiscal Policy and Finance (CPFF), which includes representatives from autonomous communities and the Ministry of Finance, decided to soften budgetary stability goals for 2010-2012 in June 2009 (see “*Widening Deficit Limits Raising Spanish Downgrade Risk*” under *Related Research* on the first page). This was a response to extensive job destruction and uncertainty about the pace of recovery. Although in 2009 autonomous communities were allowed to have a deficit of 0.75% of GDP, for 2010 the limit softens to 2.5% (see the table *Budgetary Stability Goal as a Percentage of Regional GDP* below). However, if they have a deficit greater than 0.75% of GDP in 2010, the regions will still need to file an economic and financial plan.

Accounts for 2009 still have to be published, but based on data on indebtedness provided by the Bank of Spain and Fitch’s own observations during the 2009 rating reviews, it is likely that several autonomous communities will overshoot the 0.75%

Autonomous Communities’ Presentations of Economic and Financial Plans^a

Andalusia	Never
Aragon	Never
Asturias	Never
Basque Country	2008
Valencia	2003; 2008
Canary Islands	2004
Cantabria	2008
Castilla y Leon	Never
Castile-la Mancha	2004; 2008
Catalonia	2003; 2008
Extremadura	2008
Galicia	2005 budget
Balearic Islands	2004, 2008
Madrid	Never
Murcia	2008
Rioja	2008
Navarra	2008

Details of plans related to non-compliance in 2008 have not yet been disclosed

^a The year indicates the year of non-compliance

Source: Ministry of Economy and Finance

target. They will therefore have to file a plan, if they had not already filed one due to non-compliance in 2008 (see the table *Autonomous Communities' Presentations of Economic and Financial Plans*). Based on 2008 accounts, the CPFF disclosed that 10¹ autonomous communities had not complied with the 0.75% maximum deficit allowed for 2008, although at end-December 2009 the details of these plans had not yet been disclosed. If those 10 autonomous communities would report a deficit for 2009 larger than 0.75% of their own GDP, they might not have to file a new plan, as long as the actual 2009 deficit remains below that forecast in the plan submitted in 2009.

Budgetary Stability Goal as a Percentage of Regional GDP

	8 October 2008		17 June 2009		
	2008	2009	2010	2011	2012
General objective ^a	-0.75	-0.75	-0.75	-0.75	0.00
With EFP	-0.75	-0.75	-2.50	-1.70	-1.30

^a Without the necessity to present an Economic and Financial Plan (EFP). It does not take into account the "Golden Rule"

Source: Ministry of Finance

According to the initial 2009 budget presented at end-2008, autonomous communities already expected to report a deficit before debt variation of about EUR11.5bn in 2009, equivalent to 1% of national GDP (see "2009: a Challenging Year for Spanish Autonomous Communities but Credit Profile Expected to Remain Sound" under *Related Research* on the first page). Nevertheless, during the 2009 rating review, Fitch considered that several autonomous communities would not meet their initial targets and that the aggregate deficit might even exceed 1.5% of national GDP (EUR16.5bn under accrual accounting).

New Funding System Gradually Implemented From 2009

After several years of negotiations, on 15 July 2009 the CPFF agreed on a new funding system for the autonomous communities under the common regime. The funding system includes the following features: almost the same basket of taxes as under the previous regime but with a greater percentage going to the regions (see the table *Tax Share*); a new formula for sharing resources, which Fitch considers more supportive for regions; a global sufficiency fund (GSF) that ensures that all autonomous communities gain extra funding under the new system, ensuring financing for all transferred responsibilities; and two new funds (convergence and competitive) granted to the most and least dynamic regions.

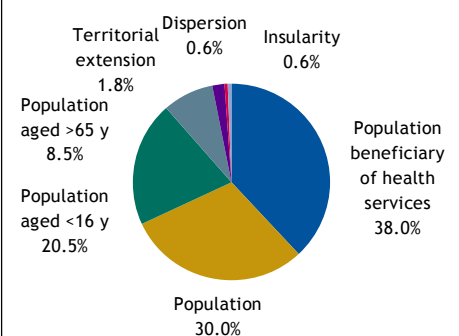
In 2011, once the new funding system is in place, 75% of the resources from the new basket of taxes and about EUR7.4bn of the additional funds granted by the state will make up the "general fund for social services" and will be shared among autonomous communities according to adjusted population (see the chart *Terms Defining Adjusted Population*). The individual autonomous communities will retain the remaining 25% of the basket of tax revenue. The GSF will ensure that autonomous communities meet their funding needs with the resources

Tax Share

(%)	Old system	New system
Personal income tax	33	50
VAT	35	50
Special taxes	40	58

Source: Agreement of the CPFF

Terms Defining "Adjusted Population"



Source: Agreement of the Council of Fiscal and Financial Policy

¹ Basque Country, Catalonia, Cantabria, Castile-la Mancha, Rioja, Murcia, Valencia, Navarra, Extremadura and Balearic Islands

assigned under the new model. Autonomous communities will also receive funds from the convergence and competitive funds.

The new funding model will be introduced gradually, and the additional funding (totalling EUR11.1bn, at 2007 values) will be incorporated as follows: a downpayment corresponding to 70% of the resources to be integrated in 2009 (about EUR6.1bn), a downpayment of 85% in 2010 (about EUR9.4bn) and a 100% transfer of funding in 2011. This means that autonomous communities will not feel the full effect of the new financial model until 2012, when the 2010 extra funds are settled; in 2009 only EUR7.4bn of the EUR11bn total additional funds were integrated, of which EUR6.1bn (70%) had to be accrued in 2009. The regions will receive the rest in 2011, when the system is settled.

Limited Impact of the New Funding System on 2010 Budget

The funding model will also be introduced gradually, with a limited impact on the 2010 budget:

- The tax revenue and Sufficiency Fund will follow the previous model, but the settlement of the system (in 2012) will take into account the new percentages and formulas.
- The additional funding granted for 2010 is shared as follows for that year only:
 - EUR4.1bn: 75% shared according to change in adjusted population during 1999-2009; 25% shared depending on adjusted population and on dependent population.
 - EUR85m: shared among regions with higher geographic dispersion and lower population density.
 - EUR1bn: distributed according to number of dependents entitled to receive service/pension at 5June 2009.
 - EUR1bn: shared according to adjusted population at end-January 2009.
 - EUR3.2bn from the convergence and competitive funds: shared among the most dynamic and least dynamic regions.

The Ministry of Economy and Finance has not publicly disclosed the allocation of the additional funds to each autonomous community under the new funding system for the 2010 budget. However, it has included the aggregate amount in its budgets (EUR9.75bn, see table in the margin). Autonomous communities have therefore integrated the extra funds into their budgets in different ways, sometimes creating a new heading "Additional funds, new system" or grouping them with other items (see the table *Extra Funds From New Funding System in 2010 Budgets*). Some autonomous communities assert that the amounts included in their 2010 budgets result from informal conversations, as no official data was available when the budgets were being drafted.

Delays on Return of Excess Transfers Accrued in 2008 Allowed under June 2009 Agreement

The CPFF Agreement 6/2009 not only established a new funding system but also allows autonomous communities to defer the return of the excess of funds allocated in 2008. Initial estimates indicate that the excess of taxes allocated to autonomous communities in 2008 are around EUR6bn. The agreement established that autonomous communities that accept the new funding system and are state debtors in these terms can make the repayment via 60 monthly payments and from January 2011. The original law required the excess of transfers to have been returned during 2010.

Impact of New Funding System on 2010 Budget

	(EURm)	% revenues (excl. new debt)
Andalusia	1,350	4.8
Aragon	310	6.5
Asturias	175 ^a	4.5
Valencia	1,100 ^a	8.7
Canary Islands	340.8	5.4
Cantabria	93.5	4.6
Castilla y Leon	442	4.8
Castile-la Mancha	450 ^a	5.3
Catalonia	2,372	10.1
Extremadura	313.1	6.2
Galicia	527	14.5
Balearic Islands	260	9.0
Madrid	1,480.8	8.7
Murcia	363.4	8.5
Rioja	34	3.0
State	9,750	

^a Declaration/estimation, the budget does not segregate this concept

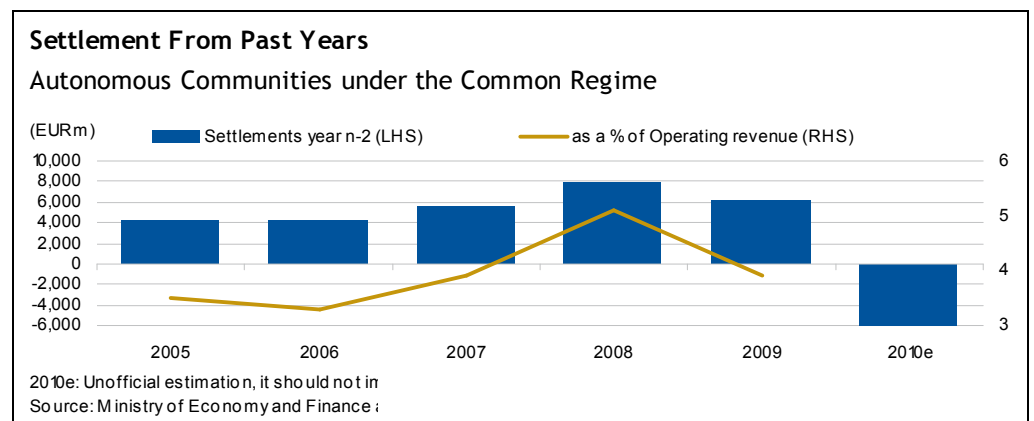
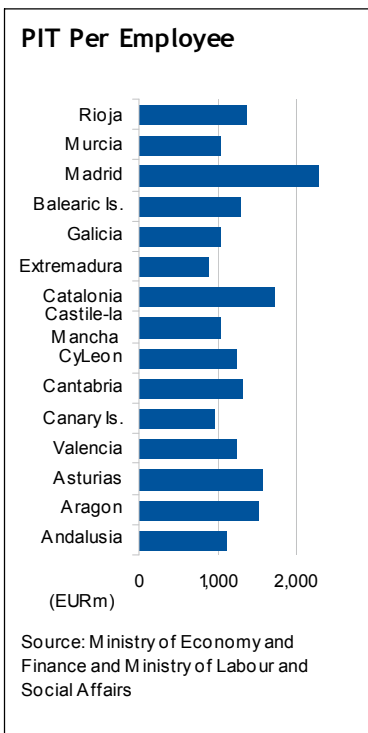
Source: Individual budgets and declarations

Revenue Decline

Wide Range of Tax Cuts in 2010

There are sharp differences in individual autonomous communities' receipts from the two main taxes, PIT and VAT. The amount allocated to each autonomous community is not the result of an estimate made by the budget department of each autonomous community, but is determined by the Ministry of Economy and Finance. PIT allocated for 2010 falls by 20% compared with 2009 for the sector, to EUR26,787m. The decline of VAT is even more acute, at 33%, to EUR13,306m. Income from less important taxes, including those on tobacco, alcohol and fuel, is generally much less dependent on the economic cycle, and therefore the decline is smaller, at 0.7% to EUR12,689m.

These amounts are subject to settlement after two years. Due to conservative estimates elaborated by the state, settlements have resulted in significant income in past years (see the chart *Settlement From Past Years* below). During 2005-2009 autonomous communities were able to integrate some settlement in their initial budget (more than 5% of their operating revenue); this opportunity does not exist for 2010, and regions will be returning funds to the state (see *Delays on Return of Excess Transfers Accrued in 2008 Allowed under June 2009 Agreement* above).



In addition to the sharp decline in PIT (20% for a tax that accounts for 18.8% of operating revenue in the 2010 draft budget), there are also different inter-annual variations in the amounts allocated by the Ministry of Economy and Finance to each of the 17 autonomous communities. As shown in the table in Appendix C, there is a wide range of changes in allocations, from 0% for Andalusia to a decline of 33% for Murcia, which could result from an adjustment in the estimates made by the state during the presentation of the 2009 budget.

In addition to that, PIT per employee maintains wide differences between regions. For instance, Madrid was 51% above the national average, reflecting not only its attractive market place but also above average salaries whereas neighbouring Extremadura reports a PIT per employee 40% below national average.

Shrinking VAT and Sufficiency Fund

The regional differences in the decline of VAT allocations appear narrower; all are very large, down 23% for Asturias and down 50% for Madrid (see the table *Main Tax Development* in Appendix C). These sharp declines not only indicate that a recovery is quite unlikely in 2010 but also largely confirm Fitch's view that the expected rise reported in the 2008 and 2009 budgets (EUR23.9bn in the initial 2008 budget) was very optimistic.

Transfers from the Sufficiency Fund total EUR31bn in the 2010 budget, 10% less than in 2008 (when it peaked). The reduction results from the state's shrinking fiscal revenue, but it still covers around 22% of operating expenditure. This makes

regional revenue less exposed to the economic cycle and gives the revenue base greater predictability.

Underestimated Expenditure

According to the information compiled by the Ministry of Economy and Finance, the 17 autonomous communities' annual draft budgets (consolidated with their autonomous bodies) presented to their regional parliaments showed expenditure (excluding debt repayment) of EUR178.2bn. This is about the same as the budgets initially approved for 2009 (EUR178bn). As shown in the table *Budgets: Key Data* below, 2% growth of current expenditure has been budgeted, from a 2009 budget that in Fitch's view was already underestimated.

Budgets: Key Data

(EURm)	2007	2008	2009	2010
Current revenue	141,431.6	156,350.4	154,730.4	142,409.9
... Growth		14,918.9	-1,620.0	-12,320.5
Current expenditure	120,399.5	133,526.4	142,599.2	145,469.4
..Growth		13,126.9	9,072.8	2,870.2
Capital revenue	9,078.3	9,240.6	11,679.4	8,944.0
... Growth		162.3	2,438.8	-2,735.5
Capital expenditure	31,906.9	33,788.6	35,390.7	32,817.6
... Growth		1,881.7	1,602.1	-2,573.1
Current balance	21,032.1	22,824.0	12,131.2	-3,059.5
Balance Before Debt Variation	-1,796.6	-1,724.0	-11,580.0	-26,933.1

Source: Fitch based on Ministry of Economy and Finance data

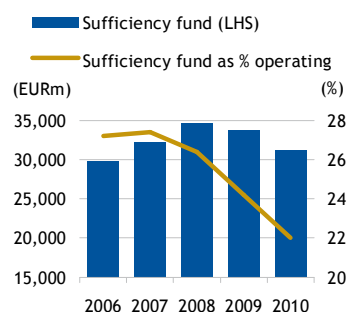
In 2009: a Challenging Year for Spanish Autonomous Communities but Credit Profile Expected to Remain Sound, the agency questioned the ability of the autonomous communities to curtail current expenditure growth, particularly in light of its compound annual growth rate (CAGR) of 9.1% during 2003-2007, underpinned by population growth. The regions' aim to constrain growth to the 6.8% given in the 2009 budget appeared to Fitch to be too ambitious. In the context of announced anti-cyclical measures and with the requirement to provide services in education and healthcare (which account for about two-thirds of operating budget and are still experiencing demand growth), the agency considers achieving the 2% budgeted growth in current expenditure to be a huge challenge.

Fitch also considers that in the present challenging revenue environment the gradual implementation of the Care Law might be further delayed. The Care Law was approved by the state in 2006 with the aim of providing social services or economic aid to individuals that need help to perform basic daily activities. The reform is scheduled to be implemented gradually (up to 2015). Its overall cost is difficult to assess accurately but likely to be an additional at least EUR10bn shared between the state, autonomous communities and the beneficiaries. Fitch understands that autonomous communities have integrated a slower implementation of the law into their 2010 budgets due to the lack of resources. However, related expenditure continues to grow robustly and in general above other departments.

Margins to Decline and Become Negative in 2010

As shown in the chart *Degree of Adaptation to New Funding Capacity* below, autonomous communities have reacted differently to their new revenue environment. Although all autonomous communities expect a decline in their current revenue, 12 of them have presented a budget with an increase in current expenditure between 2009 and 2010. Due to the recent sharp population growth and the scope of the autonomous communities' responsibilities, they have found it difficult to reduce operating expenditure in 2010. On the adoption of the 2009 budget, Fitch already considered that the moderate annual growth of operating expenditure would be very difficult to achieve.

Sufficiency Fund Development



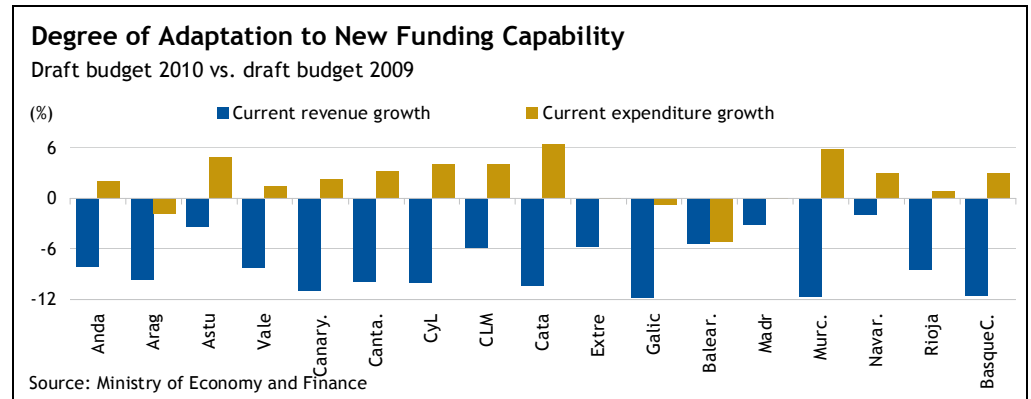
Source: Ministry of Economy and Finance

Current Margin 2010 Budget (%)

Andalusia	4.2
Aragon	0.1
Asturias	0.6
Valencia	0.4
Canary Islands	-11.7
Cantabria	0.8
Castilla y Leon	5.9
Castile-la Mancha	1.5
Catalonia	-17.4
Extremadura	0.8
Galicia	2.4
Balearic Islands	0.0
Madrid	-0.7
Murcia	-7.1
Rioja	2.8
Navarra	12.7
Basque Country	-6.7

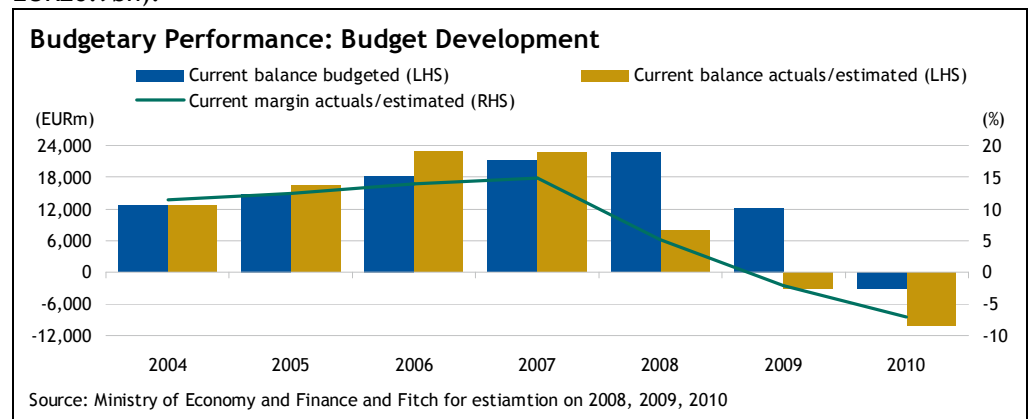
Source: Ministry of Economy and Finance

The consequence of negative growth of current revenue and positive growth of current expenditure is that five autonomous communities have budgeted a negative current balance, with Catalonia and the Canary Islands expecting negative current margins of 17% and 11%, respectively (see the table *Current Margin 2010 Budget*). This is in sharp contrast to 2006-2007, when the sector had operating margins of about 15%.



As autonomous communities will maintain their investment effort in 2010, to help the economy recover, their financial needs will increase further. With the exception of the Autonomous Community of Madrid, all the autonomous communities expect to record a deficit greater than 2% of their own GDP.

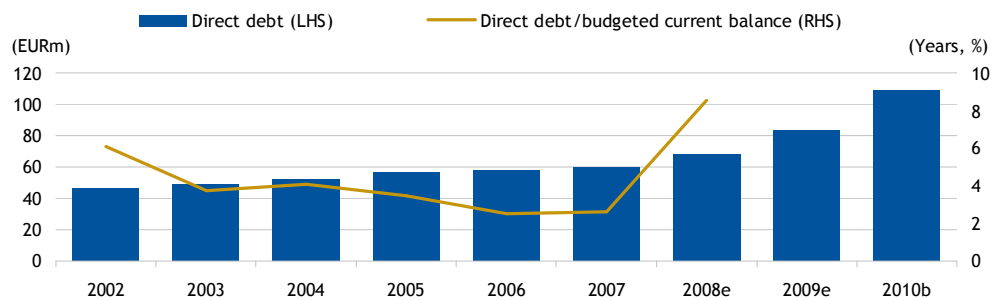
Fitch considers that overall growth in operating expenditure has been underestimated. With more realistic operating expenditure growth targets, for example 8% in 2009, and 6% for 2010 (still below that posted before 2008), and unchanged expectations on current revenue, Fitch would expect a negative current balance of EUR10.4bn (instead of the budgeted negative EUR3.1bn) and an overall deficit before debt variation of EUR34bn (instead of the budgeted negative EUR26.9bn).



Rising Funding Needs

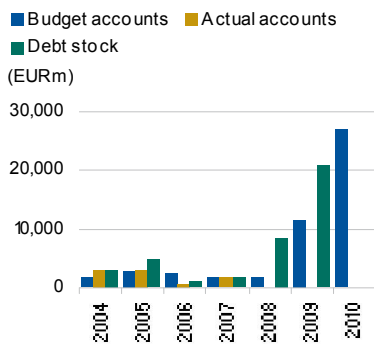
In the context of negative current balance and maintenance of high capital expenditure amid decreasing capital revenue (for example, most autonomous communities will lose EU funds in 2007-2013), funding needs are expected to rise sharply. Consequently, debt is expected to reach about EUR110bn by end-2010 (This figure does not fully coincide with that given on Appendix A; the latter reflects data provided by the Bank of Spain at Q309 and adapted to reflect new debt budgeted for 2010, while the chart *Debt Development* below shows Fitch's estimation).

Debt Development



e: Estimated by Fitch; b: As budgeted
Source: Bank of Spain, Ministry of Economy and Finance and Fitch

Annual Debt Variations



Source: Fitch

In their 2010 budget, autonomous communities have scheduled to borrow EUR32.6bn while paying back EUR5.7bn (slightly above previous years' payback of EUR2bn-4bn). This increase in payback stems chiefly from a change in financial market conditions, with financial institutions under pressure to lend on shorter terms, and the overall increase in indebtedness. This EUR5.7bn represents only 6.8% of debt expected to be outstanding in Q310, indicating that the average life of debt is still quite long. This is a positive rating factor, especially in light of the liquidity stress in Q109.

The chart "Annual Debt Variations" in the margin illustrates the sector's steep rise in funding needs in 2009 and particularly in 2010. The chart also shows that the effective increase in debt has often exceeded that budgeted for. For 2010, debt servicing is budgeted to total EUR9.5bn, more than 2x the amount budgeted for 2004. Although net funding needs were restricted to around EUR2bn during 2003-2008, 2009 marked a turning point. That year's EUR11bn funding need was budgeted to widen to EUR26bn in 2010.

Although there has traditionally been strong appetite among foreign investors for Spanish autonomous communities' debt, growing funding needs from other public sector entities in Europe (including Spanish state agencies) might reduce demand for autonomous communities' debt. Furthermore, the restructuring of many financial institutions in Spain, which might take place in 2010, would also limit demand for Spanish autonomous communities' debt.

Appendix A

Aggregated Autonomous Communities (Consolidated General Administration + Autonomous Bodies)

(EURm)	Budget				Draft budget
	2006	2007	2008	2009	2010
Taxes	72,241.0	79,803.2	88,073.0	81,140.1	66,069.1
Transfers received	53,436.5	57,064.2	63,940.9	68,261.2	70,930.3
Fees, fines and other operating revenue	4,019.0	4,170.6	3,813.5	4,736.9	4,859.4
Operating revenue	129,696.4	141,038.0	155,827.4	154,138.2	141,858.8
Operating expenditure	-109,659.2	-118,095.7	-131,056.0	-139,858.6	-141,754.7
Operating balance	20,037.2	22,942.3	24,771.4	14,279.6	104.1
Financial revenue	411.1	393.5	523.0	592.2	551.1
Interest paid	-2,272.2	-2,303.8	-2,470.4	-2,740.5	-3,714.7
Current balance	18,176.1	21,032.1	22,824.0	12,131.2	-3,059.5
Capital revenue	8,918.7	9,078.3	9,243.3	11,679.4	8,944.0
Capital expenditure	-29,409.8	-31,906.9	-33,788.6	-35,390.7	-32,817.6
Capital balance	-20,491.1	-22,828.6	-24,545.3	-23,711.3	-23,873.6
Surplus (deficit) before debt variation	-2,315.0	-1,796.6	-1,721.3	-11,580.0	-26,933.1
Debt repayment	-3,006.7	-3,436.3	-3,446.2	-3,854.4	-5,713.2
New borrowing	5,321.7	5,232.9	5,167.5	15,434.4	32,646.3
		5,740.1			
Net debt movement	2,315.0	1,796.6	1,721.3	11,580.0	26,933.1
Overall results	0.0	0.0	0.0	0.0	0.0
Debt stock^a					
Total debt (general adm. + autonomous bodies)	53,115.0	54,761.0	63,636.0	78,808.0	105,741.1
Universities	1,396.0	1,304.0	1,236.0	1,224 ^a	0.0
PSEs (under ESA95 criteria)	3,442.0	3,638.0	3,469.0	3,811 ^a	0.0
Rest of regional PSEs	8,789.0	10,398.0	12,753.0	14,927 ^a	0.0

^a As shown by the Bank of Spain at the year-end (2005, 2006, 2007, 2008); 2009 figure relates to Q309 and 2010 has been calculated as the difference between debt stock and net debt movement

Source: Ministry of Economy and Finance, Bank of Spain, and Fitch

Appendix B

Aggregated Autonomous Communities (General Administration + Autonomous Bodies)

	Budget				Draft budget
	2006	2007	2008	2009	2010
Fiscal performance ratios (%)					
Operating balance/operating revenue	15.4	16.3	15.9	9.3	0.1
Current balance/current revenue ^a	14.0	14.9	14.6	7.8	-2.1
Surplus (deficit) before debt variation/total revenue ^b	-1.7	-1.2	-1.0	-7.0	-17.8
Overall results/total revenue	0.0	0.0	0.0	0.0	0.0
Operating revenue growth (annual change)	9.9	8.7	10.5	-1.1	-8.0
Operating expenditure growth (annual change)	8.1	7.7	11.0	6.7	1.4
Current balance growth (annual change)	22.6	15.7	8.5	-46.8	-125.2
Debt ratios					
Debt (annual % change)	2.0	3.1	16.2	23.8	34.2
Interest paid/operating revenue (%)	1.8	1.6	1.6	1.8	2.6
Operating balance/interest paid (x)	8.8	10.0	10.0	5.2	0.0
Debt servicing/current revenue (%)	4.1	4.1	3.8	4.3	6.6
Debt servicing/operating balance (%)	26.3	25.0	23.9	46.2	
Debt/current revenue (%)	40.8	38.7	40.7	50.9	74.3
Debt/current balance (yrs)	2.9	2.6	2.8	6.5	-34.6
Debt per capita (EURm)	1,196	1,212	1,381	1,711	2,266
Revenue ratios					
Tax revenue/operating revenue (%)	55.7	56.6	56.5	52.6	46.6
Current transfers received/operating revenue (%)	41.2	40.5	41.0	44.3	50.0
Operating revenue/total revenue ^b (%)	93.3	93.7	94.1	92.6	93.7
Total revenue per capita ^b (EURm)	3,132	3,330	3,595	3,613	3,244
Expenditure ratios					
Staff expenditure/operating expenditure (%)	39.9	39.5	33.2	39.6	39.9
Current transfer made/operating expenditure (%)	39.8	39.9	52.8	39.6	39.2
Capital expenditure/total expenditure (%)	20.4	20.5	19.8	19.5	17.8
Total expenditure per capita (EURm)	3,251	3,446	3,707	3,948	3,943
Capital expenditure financing (%)					
Current balance/capital expenditure	61.8	65.9	67.5	34.3	-9.3
Capital revenue/capital expenditure	30.3	28.5	27.4	33.0	27.3
Net debt movement/capital expenditure	7.9	5.6	5.1	32.7	82.1

^a Includes financial revenue

^b Excluding new borrowing

Source: Fitch

Appendix C

Main Tax Development

(EURm)	PIT			VAT			Special taxes		
	2009 budget	2010 draft budget	(%)	2009 budget	2010 draft budget	(%)	2009 budget	2010 draft budget	(%)
All autonomous communities	33,548.0	26,787.5	-20	19,981.4	13,306.5	-33	12,776.6	12,689.8	-0.7
Andalusia	3,191.7	3,191.7	0	3,138.7	2,230.7	-29	2,076.5	1,930.8	-7.0
Aragon	1,024.6	882.5	-14	639.4	434.0	-32	419.1	431.8	3.0
Asturias	660.4	655.7	-1	511.2	393.3	-23	299.2	322.3	7.7
Valencia	3,027.6	2,464.5	-19	2,137.3	1,426.0	-33	1,532.8	1,507.8	-1.6
Canary Islands	1,083.0	775.5	-28	0.0	0.0	0	302.8	305.6	0.9
Cantabria	411.6	331.1	-20	301.8	192.9	-36	180.0	180.0	0.0
Castilla y Leon	1,484.8	1,263.7	-15	1,128.6	759.1	-33	807.2	823.2	2.0
Castile-la Mancha	835.6	826.7	-1	981.6	591.8	-40	829.7	794.5	-4.2
Catalonia	7,385.8	5,472.5	-26	3,667.7	2,438.8	-34	2,525.4	2,418.2	-4.2
Extremadura	454.2	349.5	-23	398.8	270.0	-32	278.1	290.6	4.5
Galicia	1,380.1	1,203.4	-13	1,178.0	790.2	-33	643.0	744.5	15.8
Balearic Islands	714.3	671.5	-6	901.1	590.8	-34	377.9	355.9	-5.8
Madrid	8,106.3	6,528.2	-19	3,289.4	1,647.1	-50	1,563.3	1,623.0	3.8
Murcia	872.8	587.9	-33	536.0	380.3	-29	425.9	447.7	5.1
Rioja	261.0	188.3	-28	138.5	98.9	-29	63.7	88.0	38.3
Navarra ^a	1,446.4	1,394.8	-4	1,033.1	1,062.6	3	452.0	425.9	-5.8

^a Navarra does not belong to the "common regime"

Source: Ministry of Economy and Finance

Deficit Before Debt Variation

	EURm	as % revenues (excl c-9)	as a % expected GDP
Andalusia	-4,389	-15.5%	-2.9
Aragon	-728	-15.2%	-2.1
Asturias	-615	-15.8%	-2.6
Valencia	-2,127	-16.9%	-2.0
Canary Islands	-1,208	-19.2%	-2.8
Cantabria	-400	-19.7%	-2.8
Castilla y Leon	-1,322	-14.5%	-2.3
Castile-la Mancha	-1,122	-13.3%	-3.0
Catalonia	-7,661	-32.5%	-3.8
Extremadura	-482	-9.6%	-2.7
Galicia	-1,532	-42.1%	-2.7
Balearic Islands	-622	-21.6%	-2.3
Madrid	-1,415	-8.3%	-0.7
Murcia	-704	-16.5%	-2.5
Rioja	-196	-17.2%	-2.4
Navarra	-495	-12.7%	-2.7
Basque Country	-1,914	-23.1%	-2.8

Source: Ministry of Economy and Finance and Fitch

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