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Key rating assessment
factors

ACRA assigns BBB+(RU) to the Murmansk Region, outlook Stable

The credit rating assigned to the [Murmansk Region](#) (hereinafter, the Region) is determined by average level of regional economic development (dependence on extraction of natural resources), average budget discipline indicators along with low flexibility of budgetary expenses, as well as by a favorable effect on the Region's debt profile resulting from planned restructuring of budget loans.

The Region is located in the Northwestern Federal District and has land borders with Finland, Norway, and the Republic of Karelia. The Region's territory belongs to the region of the Far North. Its population makes up 0.5% of the country's total, while its gross regional product (GRP) amounts to roughly 0.6% of Russia's aggregate GRP. In 2016, the Region's GRP reached RUB 413 bln.

The Region's economy is resource-based: nearly a third of GRP is generated by extraction of natural resources, metallurgy, and fishing. The dynamics of the Murmansk Region's economic indicators are influenced by world market prices for extracted raw materials (extraction of mineral resources, in particular, apatite and nickel, generates 17% of the regional GRP, while 15% of the industrial production refers to metallurgy). In addition, the regional economy depends on the procyclical transport industry (12% of GRP), represented mainly by the Murmansk Sea Commercial Port, being a point for thermal coal transshipment by SUEK. However, the structure of the Region's economy is recognized as sufficiently diversified due to the high share of other sectors that are not directly related to resource prices and economic cycles. These sectors include the fishing industry (11% of GRP), which, however, does not create significant added value due to low depth of raw materials processing and the persisting orientation of fisheries towards neighboring countries' processing capacities, and the public sector of the economy (8% of GRP).

High level of mandatory expenses puts pressure on budget indicators. Expenses of the Murmansk Region are mainly financed by its own revenues¹. At the same time, steadily high mandatory expenses, which demonstrate constant growth due increasing labor costs and social payments, adversely affect the Region's operational balance to regular income ratio, which will amount to 14% as of the end-2017 (11% as of the end-2019, by ACRA estimate). Owing to high mandatory expenses, the Region's capability of capital spending is rather low: in 2014-2017, capital expenses accounted on average for 12% of total expenses of the Murmansk Region and were financed mainly by its own funds. By ACRA estimate, extraction of minerals accounts for more than a third of tax proceeds to the regional budget. However, the largest taxpayer in 2014-2016 accounted for no more than 16% of tax proceeds to the consolidated budget of the Region, while the range of raw materials produced in the Region makes it possible to consider the structure of tax revenues to be sufficiently diversified. The Region's operating balance showed a short-term improvement in 2016 and reached 23% of regular income due to the increase in tax revenues resulting from the largest taxpayers' exchange rate differences and revenue increase. According to ACRA, in the long term, operating balance of the Region as a percentage of its regular income will not exceed 11-12%.

¹ Own revenues = tax and non-tax revenues.

Debt risk profile is supported by the planned prolongation of budget loans. The share of budget loans within the Region's loan portfolio is quite substantial: it comprised nearly a half of all debt obligations as of January 1, 2017. Due to the planned restructuring, the regional debt repayment structure is improving: in 2018, the Region would have to pay 25% of its total current debt to the higher budget, but after restructuring the volume of maturing budget loans will be as low as 2% of the current debt. The plain debt to operating balance ratio of the Murmansk Region will amount to 2.52 as of year-end 2017 owing to low operating balance indicators. The Region's debt strategy assumes a gradual reduction in the debt burden on the back of increase in budget revenues and intensive use of bank limits within the year for financing current needs. However, given the regional budget deficit expected by ACRA in 2018-2019, the Region's debt burden may upsurge to 4.45 by the end of 2019. Implementation of the planned restructuring (prolongation) of budget loans will support the debt burden cumulative assessment in 2019 (in comparison with the assessment in 2017).

Sufficient budget liquidity. The Region has a sufficient liquidity to timely perform its expense obligations including interest payments. However, budget accounts balance as at month start is constantly below current month expenses, therefore, the Region regularly needs to finance projected cash gaps. The Murmansk Region Government uses short-term loans provided by the Federal Treasury Department, as well as funds of autonomous and budgetary institutions in order to manage its liquidity.

Key assumptions

- Retaining the share of mandatory expenses within 83% of total budget expenses;
- Stabilization of the nominal volume of tax revenues in 2018-2019 at the 2017 level;
- Transfer amounts in 2018-2019 not lower than the level planned for 2017;
- Capital expenses in 2018-2019 not below the level planned for 2017;
- Prolongation of budget loans for seven years.

Potential outlook or rating change factors

The Stable outlook assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Increase in tax revenues, including by means of eliminating a part of tax exemptions, along with decrease in mandatory expenses;
- Increase in capital expenses of the budget;
- Decrease in debt burden;
- Decline of budget reliance on external sources of liquidity.

A negative rating action may be prompted by:

- Increase in mandatory expenses of the regional budget without an equivalent increase in the revenue side of the budget resulting in the need for further borrowing;
- Significant decrease in tax revenues in 2018-2019 not accompanied by a decline in expenses;
- Slowdown in economic growth against expected growth rates.

Issue ratings

None.

Rating history

None.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Regional and Municipal Authorities of the Russian Federation](#), and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

The credit rating has been assigned to the Murmansk Region for the first time. The credit rating and credit rating outlook are expected to be revised within 182 days following the rating action (October 16, 2017).

The credit rating was assigned based on the data provided by the Murmansk Region, information from publicly available sources (the Ministry of Finance, the Federal State Statistics Service, and the Federal Tax Service), as well as ACRA's own databases. The credit rating is solicited, and the Murmansk Region participated in its assignment.

No material discrepancies between the data provided and the data officially disclosed by the Murmansk Region in its financial report have been discovered.

ACRA provided no additional services to the Murmansk Region. No conflicts of interest were discovered in the course of credit rating assignment.

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