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Key rating assessment factors

ACRA affirms Murmansk Region's credit rating at **BBB+(RU)**, 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) and low flexibility of budgetary expenses. The latter results in a higher debt load to operating balance ratio of the Region, which is mitigated by an acceptable debt repayment schedule and low interest expenses.

The Murmansk Region is located in the Northwestern Federal District; it has land borders with Finland, Norway and the Republic of Karelia. The Region's territory belongs to the region of the Far North. 0.5% of the Russian population live in the Region; its gross regional product (GRP) equals 0.6% of the total GRP of Russia. The Region's GRP totaled RUB 413 bln in 2016.

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 is influenced by world market prices for extracted raw materials (extraction of apatite and nickel generates 15% of the regional GRP, while 15% of the industrial production is attributable to metallurgy). The Region's economy also depends on the procyclical transport industry (9-11% of GRP) represented mainly by the Murmansk Sea Commercial Port, being a point for thermal coal transshipment by SUEK. According to ACRA estimates, tax revenues of the regional budget from three sectors (mineral production, nonferrous metals and transportation) accounted for 41% of the 2017 total. 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 administration and military security sectors of the economy (around 8% of GRP). Their shares in 2017 tax revenues are estimated at 6% and 17%, respectively.

High level of mandatory expenses puts pressure on budget indicators. Expenses of the Murmansk Region are mainly financed by its own revenues¹, and their share increases gradually. High share of mandatory spending (over 80%) achieved, in particular, by maintaining the compensation rate results in a low operating balance to regular income ratio of the Region (17% as at year-end 2017 and a further decline to 10% expected in 2018). Capital expenses that are largely financed from own funds averaged 12% of the total expenses in 2015-2018 (plan). Although the Region's budget is significantly dependent on mineral production, the wide range of commodities extracted in the Region allows for recognizing the tax revenue profile as sufficiently diversified: the contribution of the largest taxpayer is at or below 16% of tax revenues in the Region's consolidated budget.

High debt to operating balance ratio is somewhat mitigated by two factors: debt repayment schedule and small share of interest expenses. The share of budget loans in the Region's loan portfolio is quite substantial: it comprised nearly a half of all debt obligations as of January 1, 2018. By virtue of raising loans from the Federal Treasury Department their share increases intra-year. Owing to the debt restructuring done, the Region has substantially reduced the refinancing risks, and the peak repayment of the acceptable 28% of the debt falls on 2019.

¹ Own revenues = tax and non-tax revenues.

Following 2017 results, the debt is double the operating balance amount as the latter is quite small. According to ACRA estimates, the ratio would continue growing in 2018 (primarily by virtue of further decline of the operating balance). The interest expenses to operating balance ratio would rise by the same token (from 6% in 2017 to 15% in 2018), but this would still have no significant effect on budget spending as social spending represents the bulk of expenses.

Sufficient liquidity of the budget. The Region has sufficient liquidity to timely perform its expense obligations including interest payments. However, free cash on budget accounts as at month start is consistently below current months expenses, and therefore, the Region regularly requires financing of 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;
- Maintaining the share of capital expenditures of the budget at 10%-12% in the medium term;
- The Region stays compliant with fiscal loans restructuring terms and conditions.

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 spending and debt load;
- Increase in capital expenditures of the budget;
- Decline of budget reliance on external sources of liquidity.

A negative rating action may be prompted by:

- Growth of mandatory spending of the regional budget without equivalent increase of revenues, which would drive the need for further borrowings;
- Significant decrease in tax revenues in 2018-2020 not accompanied by a pro rata spending cuts;
- Slowdown in economic growth against expected growth rates.

Issue ratings

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](#).

For the first time, the credit rating of the Murmansk Region was published by ACRA on October 18, 2017. The credit rating and its outlook are expected to be revised within 182 days after the rating action date (May 15, 2018) in compliance with the [2018 calendar of planned sovereign credit rating revisions and publications](#).

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 Government 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 Government. No conflicts of interest were discovered in the course of credit rating assignment.

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