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Key rating assessment  
factors

## ACRA assigns BBB(RU), outlook Stable, to the Novgorod Region

The credit rating assigned to the [Novgorod Region](#) (the Region) is based on the comparably high debt load coupled with irregular debt repayment schedule and low flexibility of budget expenditures, as well as moderate indicators of the regional economy.

The Novgorod Region is located in the North-West Federal District and borders with four other regions of the Russian Federation. 0.5% of the Russian population live in the Region; its GRP is 0.3% of the total Russian GRP. The main railway and automobile highways connecting Moscow, St. Petersburg and the Baltic countries pass through the territory of the Region.

**Diversified economy with developed chemical industry and a growth potential in the transportation services segment.** The largest local enterprise is PJSC Acron, a fertilizer manufacturer that generates about 40% of the total shipped products of the Region's manufacturing sector. The share of tax revenues coming from Acron is low: 6–12% of the total tax revenues in the Region in different periods. Other major sectors of the regional economy include construction, whose share will decrease with the completion of the M11 highway project, and transport and communications, whose prospects, on the contrary, will increase after the M11 project is completed. The economic development indicators (per capita GRP, per capita income) are below (about 85%) the national averages. The rate of unemployment is below the national average. Ageing and thinning local population may lead to a shortage of employees and, possibly, an increase in the social spending in the long term.

**Budget flexibility is low due to a significant share of mandatory expenditures.** The regional budget revenues include mainly own revenues (82% on average without subventions in 2015–2018). Due to the high share of mandatory expenses (78% on average for the above period), the average Region's operating balance is 19%, and the share of capital expenditures is 10%, therefore, capital expenditures cannot be reduced in favor of current expenditures. A short-term increase in the operating balance in 2016 was due to a twofold increase in the profit tax collectibles in the chemical industry from a one-time transaction. ACRA expects that, with the gradual increase in the share of capital expenditures, the operating balance will decrease to 11% by 2020, and the share of capital expenditures will drop to 6%.

**Irregular debt repayment schedule and high debt-to-operating balance ratio.** The Region's budget debt load varied in 2015–2017, driven by the operating balance volatility (the absolute debt almost did not change in the last three years). The current debt to operating balance ratio is 3.7, and it is expected to grow to 4.4 by the year-end due to a contraction of the operating balance. Irrespective the low operating balance, the debt service costs are low, as the proportion of budget loans in the debt structure is high (two-thirds). After the completion of budget loans restructuring, the operating balance ratio after interest expenses and debt repayments in 2018 is expected to be very high (more than 8). However, in 2019, the ratio will be 0.6, as the debt repayment schedule involves refinancing of the entire commercial debt.

**Sufficient budget liquidity.** The Region has sufficient liquidity for timely fulfillment of expenditure obligations, including interest payments. On the other hand, the balances of funds on the budget accounts at the beginning of month are regularly lower than the current month's expenditures, and the Region regularly experience the need for funds to cover cash gaps. When necessary, the regional government borrows short-term loans from the Office of the Federal Treasury.

**Key assumptions**

- The operational costs will create headwinds for the operating balance in the forecast period;
- In 2019–2020, the Region will receive transfers approximately equal to the average amount of transfers in 2015–2016 and 2018;
- The share of capital expenditures will be low in 2019–2020 (not more than 6% of budget expenditures).

**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:**

- a limited growth of mandatory expenditures in 2019–2020;
- growing budget capital expenditures;
- improving commercial debt repayment schedule.

**A negative rating action may be prompted by:**

- a growth of mandatory expenditures not supported by growing budget revenues;
- use of short-term (less than 1 year) loans to refinance the commercial debt.

**Issue ratings**

No.

**Regulatory disclosure**

The credit rating have been assigned to the Novgorod Region under the national scale for the Russian Federation based on the [Methodology for Credit Rating 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](#).

ACRA assigns a credit rating to the Novgorod Region for the first time.

The credit rating of the Novgorod Region and its outlook are expected to be revised within 182 days after the rating action date (July 25, 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 Novgorod 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 Government of the Novgorod Region participated in its assignment.

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

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

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