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ACRA AFFIRMS A-(RU) TO NIZHNY NOVGOROD, OUTLOOK POSITIVE

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The credit rating of Nizhny Novgorod (hereinafter, the City) is based on its moderately low debt load, positive current account balance, and the budget's declining need for additional financing on the back of an expected reduction of capital expenditures in 2023. The rating is supported by the increase of available liquidity in 2022 and moderate risks for refinancing liabilities in the short term, while it is constrained by the City's considerable dependence on the budget of the Nizhny Novgorod Region and the possibility of growth of short-term debt.

The Positive outlook remains in place because ACRA expects the City's internal revenues to grow (excluding subventions). The City Administration forecasts that in 2023, the volume of capital transfers will decline compared to last year, which will result in a lower share of total transfers in the City's revenues. Although lower capital transfers will lead to a smaller share of capital expenditures, this will not impact the level of the credit rating.

The City is the administrative center of the Nizhny Novgorod Region and the Volga Federal District (VFD). It is Russia's fifth largest city, with a population of over 1.25 mln. The City is a major transportation hub of the VFD and one of Russia's largest industrial centers.

KEY ASSESSMENT FACTORS

Moderately high operational efficiency of the budget amid expected growth of the share of internal revenues. The averaged[1] share of tax and non-tax revenues (TNTR) in 2019–2023 will amount to around 57% (excluding subventions). At the same time, the value of this indicator projected for 2023 may exceed 71%, which is much higher than the actual result for 2022 (around 40%). If the approved budget allocations are implemented (which imply a significant reduction of the volume of capital transfers), ACRA expects the share of the City's internal revenues to increase, which may have a positive impact on the assessment of the budget profile.

The averaged ratio of capital expenditures to total expenditures (excluding subventions) for 2019–2023 will be 52%, which corresponds to the highest level according to the Agency's methodology. This indicator stood at 67% in 2022 due to due to a doubling of capital expenditures (using transfers) compared to 2021. According to the City's predictions, capital expenditures will return to 2021 levels this year, while the flexibility of budget expenditures may be around 45%. Despite an expected decline of capital expenditures, the assessment of flexibility (taking into account averaging as per ACRA's methodology) will be at the highest level.

The averaged ratio of the current account balance to current revenues will be 12% in 2019–2023. At the same time, throughout this period the current account balance will be positive, which indicates complete coverage of the City's current expenditures by its current revenues.

[1] Hereinafter, averages are calculated according to the Methodology for Assigning Credit Ratings to Regions and Municipal Entities of the Russian Federation.

The ratio of the averaged modified budget deficit to current revenues for 2019–2023 will be slightly more than -5%. This shows that the City's budget has a moderate need to use accumulated funds or resort to borrowing to finance capital purposes.

In 2022, the revenue side of the City's budget increased by 51% vs. 2021, which was mainly driven by the size of transfers increasing by 76% (while capital transfers grew by more than 2.5x). TNTR grew by 16% in the aforementioned period, mainly due to personal income tax revenues increasing by 18%. The expenditure side of the budget grew by 53% in 2022, while capital expenditures more than doubled. The budget deficit was around 7% of TNTR as of the end of last year and was financed largely using borrowed funds.

According to the current version of the City's budget law, revenues will decline by approximately a third in 2023 compared to last year. This will mainly be due to a possible decline of transfers by almost 2x due to lower capital transfers. The expenditure side of the budget will decline by just over a quarter on the back of lower capital expenditures. A budget deficit of 10% of TNTR is expected; it will be financed mainly using borrowed funds.

Moderately low debt load and moderate risks for refinancing liabilities. In 2022, the City's debt increased by 14% year-on-year and amounted to RUB 15.1 bln. The debt portfolio is mainly made up of budget loans (87%), while bank loans account for the remaining share. The share of budget loans increased significantly in 2022 because the City was provided RUB 7.7 bln to refinance its commercial debt, which reduced refinancing risks. As of January 1, 2023, most of the debt (65%) is scheduled for repayment in 2026–2027, while the City must repay no more than 21% of its debt annually from 2023 to 2025 (although this year only RUB 2.1 bln or 14% of total debt must be repaid or refinanced). In the Agency's opinion, this repayment schedule has moderate refinancing risks in the short-term.

The ratio of the City's debt to current revenues was 41% in 2022. ACRA assumes that the debt load may increase to 44% (or 76% of TNTR) by the end of 2023. The considerable difference between these indicators is due to significant income in the form of transfers, which is traditionally characteristic of the budgets of municipalities.

The ratio of interest expenses averaged for 2019–2023 to the City's total expenditures (excluding the volume of subventions) will amount to 1.5%.

The ratio of City's debt to gross municipal product (GMP) is not calculated due to its absence of the latter. According to ACRA's estimates, this ratio may be much lower than 20%.

The City usually enters into lease agreements to acquire public transit vehicles, which can be viewed as indirect debt load.

Moderate budget liquidity. As of the end of 2022, the volume of balances in the City's accounts increased by 42% compared to the figure for 2021, which covers about half of the debt repaid this year. However, the average monthly balances in the accounts do not allow the City to cover a significant amount of its monthly expenses, which is typical for municipal entities. The City takes out loans from the Federal Treasury Department and uses funds from municipal organizations to replenish account balances. The City has a certain volume of undrawn credit limits that do not exceed (or slightly exceed) 365 days.

The liquidity ratio of the municipal budget will exceed 25% as of the end of 2023 (excluding funds from municipal organizations).

According to the City Administration, there were no overdue accounts payable as of January 1, 2023.

Comparatively high level of economic development. The City is one of the largest industrial centers in the VFD. The average accrued nominal wage covering all organizations in the City is four times higher than the subsistence minimum in the Nizhny Novgorod Region. Unemployment calculated according to the ILO's methodology is low in the Nizhny Novgorod

Region, while the official unemployment rate in the City is almost equal to that observed at the regional level.

The City's GMP is not calculated. However, in different years, according to ACRA's estimates, the City could have accounted for from 40% to 60% of the volume of shipped goods of the Nizhny Novgorod Region's output. The annual gross regional product of the Nizhny Novgorod Region is about 77–78% of the national average.

According to the City Administration, manufacturing facilities contributed around 45% of shipped products in 2022, with vehicles accounting for about half of this, according to ACRA's estimates. Transportation and storage accounted for around 13% of shipments.

KEY ASSUMPTIONS

- Stable budget policy of the Nizhny Novgorod Region with respect to allocation of personal income tax revenues and a portion of total income tax revenues;
- Execution of the budget in 2023 as per the approved budget allocations;
- No significant short-term loans;
- Growth of TNTR in budget revenues after major infrastructure projects are completed;
- Gradual decline of the budget's need for borrowed funds to finance capital expenditures in the forecast period from 2023 to 2025.

POTENTIAL OUTLOOK OR RATING CHANGE FACTORS

The **Positive outlook** assumes that the rating will highly likely be upgraded within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Higher share of the City's internal revenues;
- Maintaining the share of debt subject to repayment this year or next year at no lower than 20% of total debt, coupled with a moderately low debt load.

A negative rating action may be prompted by:

- Materialization of refinancing risks in the short term;
- Changes to regional laws that increase the share of personal income tax revenues and the portion of total income tax revenues transferred to the Nizhny Novgorod Region;
- Significant decline of the current account balance;
- Growing need of the budget to obtain borrowed funds for capital purposes;
- Significant increase of the budget's debt load coupled with the share of short-term debt exceeding 20% of total debt.

ISSUE RATINGS

There are no outstanding issues.

REGULATORY DISCLOSURE

The credit rating has been assigned to Nizhny Novgorod under the national scale for the Russian Federation based on the Methodology for Assigning Credit Ratings to Regions and Municipal Entities 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 of Nizhny Novgorod was published by ACRA for the first time on November 21, 2017. The credit rating and its outlook are expected to be revised within 182 days following the publication date of this press release as per the Calendar of sovereign credit rating revisions and publications.

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

In assigning the credit rating, ACRA used only information, the quality and reliability of which were, in ACRA's opinion, appropriate and sufficient to apply the methodologies.

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

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