The Tambov Region

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Credit rating components	
Institutional factor	
Final assessment	0.04
Regional economy	
Assessment prior to adjustment	0.17
Final assessment	0.16
Budget structure and budget discipline	
Final assessment	0.23
Debt load	
Assessment prior to adjustment	0.14
Final assessment	0.13
Budget liquidity	
Final assessment	0.07
Credit rating	**BBB+(RU)**
Outlook	**Stable**

Key rating assessment factors

A relative weakness of the regional economy is due to its agricultural orientation. Agriculture (mainly crop production) accounts for up to a quarter of the GRP of the Tambov Region (hereinafter, the Region) (the Region ranks 4th in the Central Federal District by produced agricultural products in monetary terms), while food processing industry is a backbone of the regional economy (up to a half of the volume of manufactured products). The Region's development is constrained by the current capacity of enterprises to process local agricultural products, which, however, will gradually be offset by growing processing capacities and deeper processing of raw materials.

Stable budget discipline indicators with large share of capital expenditures. While the regional budget is marked by a medium self-sufficiency level, the budget discipline indicators show persistently high capital expenditures (23-31% in 2014-2016) and moderate level of mandatory budget expenditures (58-63% in 2014-2016), which, however, does not adversely affect the Region's operating balance. Tax proceeds to the Region's budget are deemed to be well diversified in terms of specific taxpayers – the share of 10 largest taxpayers within total tax proceeds does not exceed 17%. However, ACRA notes budget risks associated with tax base concentration on allied industries, i.e. agriculture, and processing of agricultural products. The aggregate share of these industries within the Region's GRP is roughly 30%, in tax proceeds – 15%. Further growth in proceeds will correlate with wage dynamics, and deepening of agricultural products processing.

Imbalanced debt profile in terms of maturity and debt burden risk. Almost half of the Region's debt is subject to refinancing in 2017 (bank and budget loans), which adversely affects debt burden ratios. In addition, ACRA is of the opinion that the Region will be forced to increase the amount of debt compared to the figures planned for 2018-2019 (mainly owing to market borrowings). Nevertheless, the Region's debt to operating balance ratio will remain safe in the forecast period (not higher than 2.09 by end-2019), while debt servicing costs will not exceed 20% of the operating balance.

Sufficient budget liquidity. The Region has sufficient liquidity for timely fulfillment of its expenditure obligations, including interest payments. However, the budget account balances at the beginning of a month are mostly lower than expenditures for the current month, so the Region is regularly in need of financing expected cash gaps; hence, in order to replenish account balances short-terms loans provided by the Federal Treasury Department and bank credit lines are used.

Key assumptions

- Using short-term loans provided by the Federal Treasury Department for financing cash gaps;
- Financing of Region's budget deficit through market debt instruments;
- Improvement of regional debt structure in terms of maturity;
- Retaining the share of mandatory expenditures at the level within 65% of budget expenditures;
- Receiving the amount of transfers in 2017 not lower than in 2016;
- High regional GRP growth rate.

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:

- Positive economic and tax effect on the back of growing output of high value-added products;
- Household income growth outrunning the national average;
- Decreasing budget dependence on external liquidity sources.

A negative rating action may be prompted by:

- Increasing mandatory expenditures of the Region's budget;
- Material decline in capital expenditures of the budget;
- Growing unemployment in the Region.

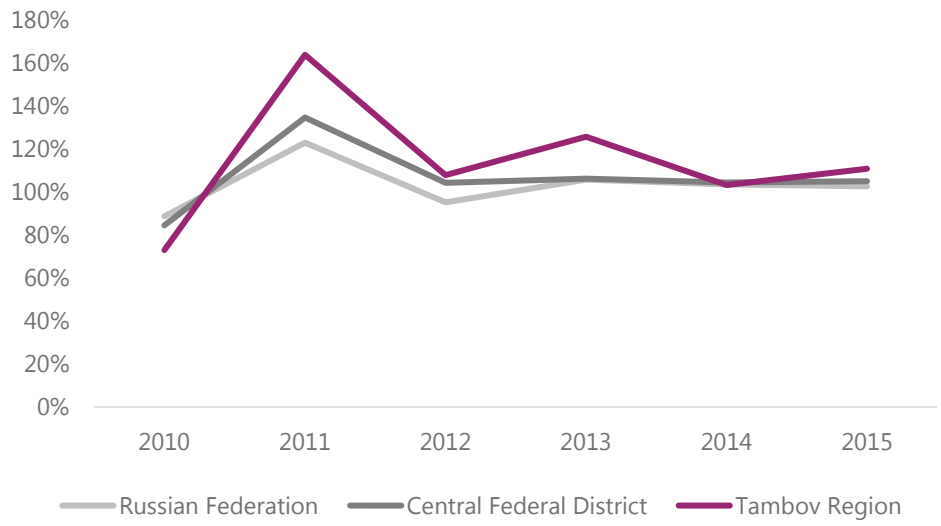
Brief information about the Region

The Tambov Region is located in the Central Federal District, bordering five other regions of the Russian Federation. About 1% of the Russian population live in the Region. In 2015, the Region's GRP amounted to RUB 345 billion (0.5% of the aggregate GRP of Russian regions). ACRA estimates that the Region's GRP may reach RUB 370 billion in 2016. The regional economy is focused on agriculture, as about 1/3 of the GRP is generated by agroindustry (farming and food industry).

In 2015, the main regional GRP contributors were: agroindustry (26%, 2nd largest GRP contributor among Russian regions), wholesale and retail sales (16%), and construction industry (15%).

In recent years, the agricultural production index predominantly outrun the national average and the CFD average; the 2015 index is 111%.

Figure 1. Agricultural production index of the Tambov Region



Source: Rosstat

Michurinsk, a science city focused on agriculture, is located in the Region. There are plans to develop a technology valley around the city.

Rating assessment factors

Institutional factor

The budget process is characterized by a sufficient planning accuracy, although the non-repayable receipts indicated in the first versions of Region's budget laws differ substantially from those indicated in the final versions (ACRA is of the opinion that such situation does not depend heavily on the regional Administration). In 2013–2016, the budget revenue performance ratio was 98-101% and the budget expenditure performance ratio was 95–98%. Budget expenditure deviations in 2015 and 2016 are ascribed mainly to the regional economy (in particular, subsidies to agribusinesses). Other insufficiently financed items include road construction, housing and utilities, and social policy.

The regional laws established unified standards of personal tax income allocations to municipal district budgets (40%) and urban districts (10%). No other standards of personal tax income allocations replacing grants for equaling the municipal budgets are established. Taxes form over one-third of the municipal revenues (personal income tax forms almost a half of the amount). About 64% of revenues stably depend on non-repayable receipts. The regional Administration encourages municipal entities for more efficient tax collection and managing local businesses.

The aggregate debt burden of municipal entities in 2013-2016 increased from 26 to 40% of their own revenues and amounted to RUB 3.3 billion. At the same time, the share of commercial debt reached RUB 2.2 billion. Commercial debt is the debt of the city of Tambov to credit institutions. The rest of arrears of municipal entities refers to the budgetary credits of the Region (RUB 1 billion). The relative value of municipal debt remains low: 1% of the total expenditure.

A relative weakness of the regional economy is due to its agricultural orientation

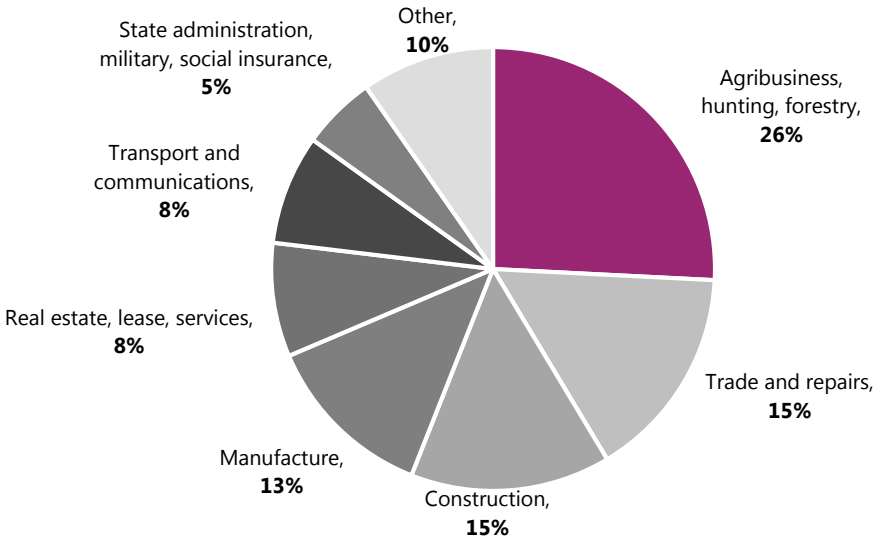
The Region demonstrates moderate economic indicators. Absolute GRP and per capita GRP correspond to average values for the CFD. ACRA notes a steady increase in the nominal GRP and, as a result, the average GRP per capita, which reached 73% of the national average by the end of 2015. The Agency expects that the GRP growth relative to the national average will continue and may reach 80% by the end of 2019.

In 2015, the main contributors to the GRP included agriculture (26%), trade and repair (16%), construction (15%), manufacturing (13%). The aggregate contribution of other industries was 31% of the GRP.

The basis of the Region's agroindustry is crop production (approximately 62% of the total agricultural output in 2014–2016). In 2015, the Region was eleventh among the Russian regions in terms of agricultural output. In 2010–2015, the annual production growth rate was 29% in monetary terms (in current prices). The Region occupies strong positions in sugar beet production (11% of the total Russian output in 2015 in physical terms), sunflower seeds (8%), grains (3%), and potatoes (2%). Over the recent years, pig farming has been the most developing sector, and today the Region ranks third in the Russian Federation in terms of pig population (the Region's share in the all-Russian pig population reaches 4%.)

The backbone of the Region's industrial sector is the processing industry (13% of GRP in 2015). The industrial sector profile is determined by the agrarian orientation of the Region (40-50% of industrial output accounts for food products). The largest enterprises of the sub-sector are sugar factories and flourmills. Another cluster (in aggregate, about 20-25% of the industrial output) includes machine-building enterprises (including electric, digital and optical equipment, motor vehicles, machines and accompanying equipment). Leading enterprises in these sub-sectors manufacture radio and communications equipment, aircraft equipment, fractionator and heat-exchange equipment.

Figure 2. GRP profile in 2015



Source: Rosstat

The socio-economic development concept of the Region provides for increased depth of processing of agricultural products produced locally, which will positively affect both the economic indicators and the budget revenues. The concept also includes the development of two industrial parks and, in the long term, provided that an investor is found, a mineral deposit to produce raw materials used in the production of titanium.

The Region boasts a high and stable (over 30%) share of investments in its GRP (one of the highest indicators in the country). The main contributors to such investments are manufacturing industry, agroindustry and transport and communications sector. Investment projects in the Region are mainly of agribusiness nature and include projects for deep processing of agricultural products. Despite the fact that further development of the agroindustry will not contribute to the diversification of the regional economy, the development of a non-cyclical industry with a further increase in output of high

added value products (compared to agricultural products) will have a favorable effect on the tax revenues of the budget.

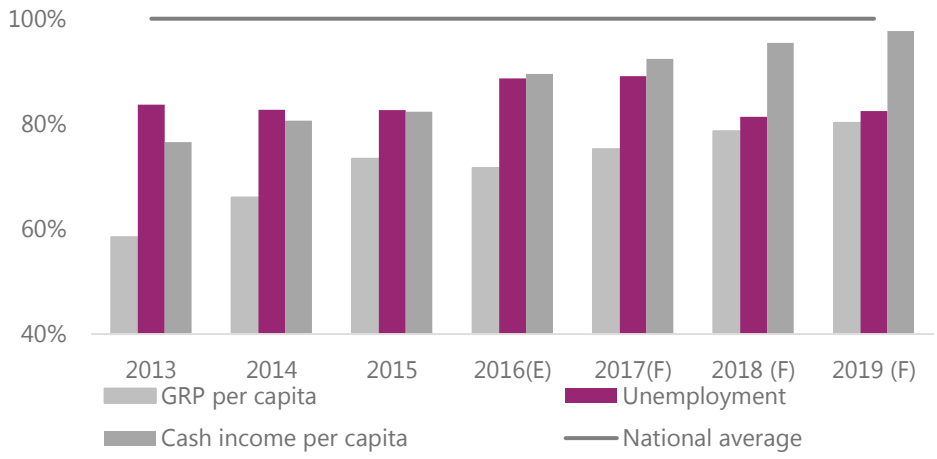
A gradual increase in the average per capita income of the population, which is still lags far behind the national average (90% (est.) in 2016), creates favorable conditions for increasing the fiscal base of the budget.

To date, the Region's unemployment is rather low (4.6%) under the ILO methodology. For comparison: the Russian average unemployment is 5.6%. Over the past 10 years, the employment profile has changed significantly. The number of employees in the regional economy declined from 514 thousand in 2005 to 507 thousand in 2015. At the same time, the unemployment rate in 2005 (8.6%) was almost twice as high as in 2016 (4.6%). A significant drop in the unemployment rate and a relatively small decrease (-1.4%) of those employed in the regional economy from 2005 to 2015 was achieved due to the growth of the employed in the wholesale and retail trade (+ 32%, or 22.5 thousand people) and real estate sector (+ 90%, or 15 thousand people). The growing employment in these sectors made it possible to compensate for the decline in the number of workers in the spheres of agriculture (-10% or 13 thousand people), education (-27% or 13 thousand people) and processing enterprises (-9% or 7 thousand people). The decline in employment in agroindustry is due to higher intensification of production and, in the sphere of education, optimized structure of educational institutions.

There are no large companies with high tax potential in the wholesale, retail trade, and real estate sectors. This segment is represented mainly by SMEs, which causes a significant risk for the regional economy, as the resistivity of the SME sector to economic shocks is low.

The unfavorable demographic situation in the Region has developed as a result of both migration outflow (an average of about 5,000 people per year) and natural population decline. The proportion of minors and able-bodied population is low in the Region, as compared with the RF and the CFD average, but the share of older population is high. With this in mind, ACRA is of the opinion that, in the long term (beyond the forecast horizon), the regional budget may face the threat of increased social expenditures.

Figure 3. The Tambov Region economy indicators compared to national average (100%)



Source: the Tambov Region, Rosstat, ACRA estimates

The Region is characterized by a moderate urbanization (60% of the population lives in cities), a moderately developed transport infrastructure (only half of the roads have hard surface, but almost all of them are of improved type), and a steady growth of GRP in absolute terms, which has been higher than the Russian average GRP since 2011.

Sustainable budget discipline; high share of capital expenditures

The self-sufficiency of the revenue side of the budget is at an average level: the share of own revenues[1] was 54% of total revenues, net of subventions, in 2014-2016. The Region receives significant transfers (up to a half of the total budget revenues), over 40% of which are applied for budget levelling off.

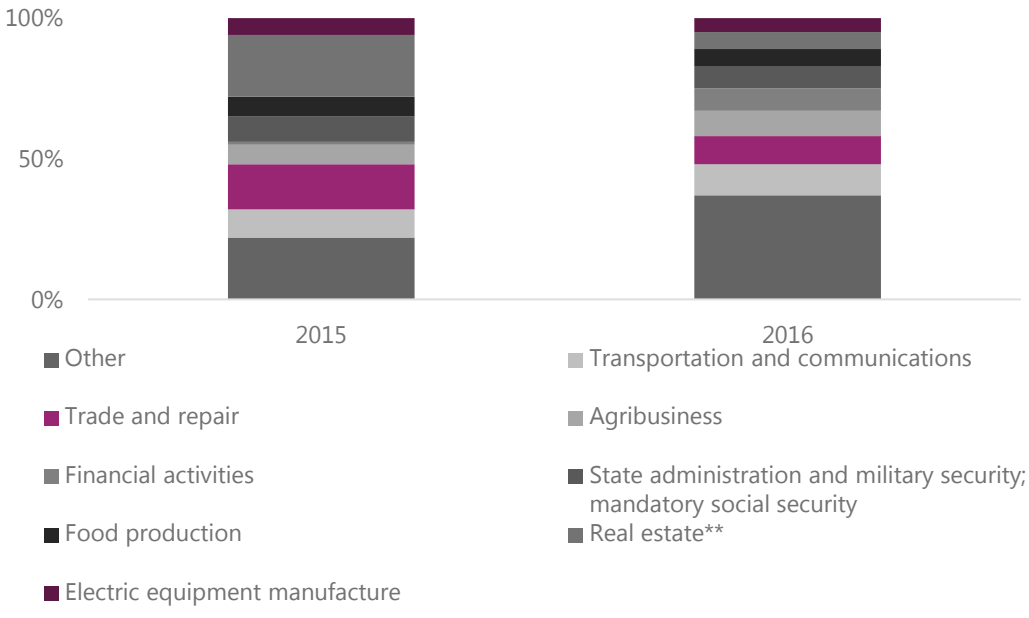
One-third of the Region's own revenues comes from personal income tax, but wages paid in the Region are among the lowest in the country. Low wages, on the one hand, limit the growth of the budget revenue base, but, on the other hand, it is a competitive advantage when negotiating with potential investors.

The rates of most regional taxes are set at their maximum allowable levels, except the transport tax in socially significant categories. Thus, the Region is unable to increase regional tax rates to boost own revenues. Regional taxes accounted for 14% of Region's own revenues in 2014–2016.

The trade and repair sector forms the maximum share of the Region's tax revenues[2] (about 15-16%). In 2015, the largest share of tax revenues came from the real estate sector (from a single real estate transaction). Tax revenues are assessed as highly diversified.

The tax base is also well diversified in terms of large taxpayers, as ten largest taxpayers accounted for 17% of the Region's tax revenues in 2016.

Figure 4. Tax revenues by industry* in 2015 and 2016



Source: FTS, ACRA estimates

* The estimates include profit tax, personal income tax, property tax, and transport tax.

** Including: real estate transactions; lease of equipment; consumer rentals; IT services; research and development; other services.

[1] Own revenues = tax revenues + non-tax tax revenues.

[2] The tax proceeds analysis includes profit tax, personal income tax, corporate property taxes, and transport tax.

In 2014–2016, the share of mandatory expenses reached 61%; no significant fluctuations are expected in 2017. Such level of mandatory expenses does not create a negative pressure on the budget. The average operating balance of the Region was 34% of the regular revenues in 2014-2016. In the forecast period (2017-2019), the operating balance is expected to decline to 26-28%, which is estimated as a sufficient level of budgetary discipline. The mandatory expenditures have been growing steadily. The 2017 budget provides for lower mandatory expenditures (including expenses for road maintenance), but ACRA is of the opinion that the expenses will slightly increase by the year-end. The ACRA stress test, which assumes an annual decline in the Region's own revenues by 7% compared to the planned ones, results in a reduction of the operating balance down to 22% of the regular revenues at the end of the forecast period, with a stable share of mandatory expenses and a small drop in the share of own revenues.

In 2014–2016, the Region maintained its capital expenditures at 27% on average. The costs are partially covered by transfers from a higher budget.

Table 1. Budget discipline assessments

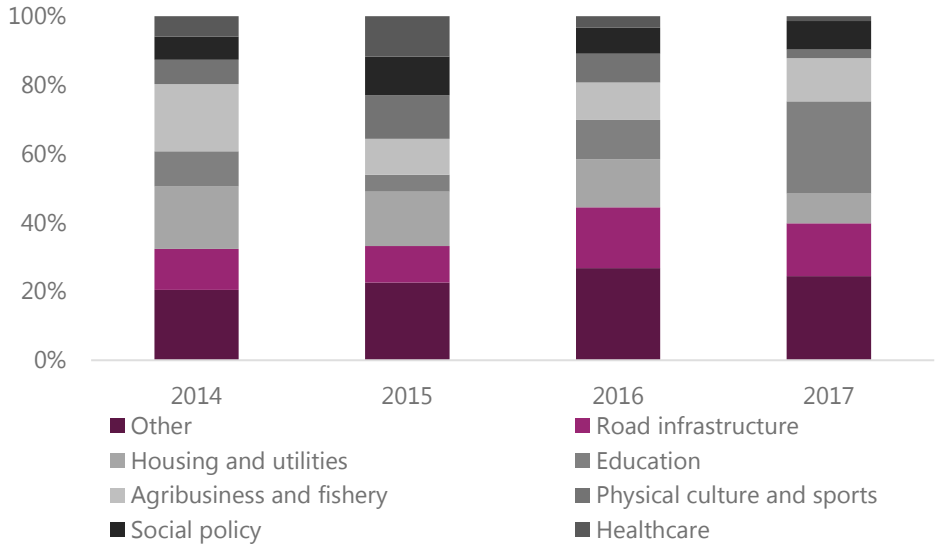
	2014	2015	2016	2017 (E)
Share of own fiscal revenues	below medium	medium	medium	medium
Share of mandatory expenses in the budget	sufficient	moderate	moderate	moderate
Operating balance	high	sufficient	sufficient	moderate
Share of capital expenditures in the budget	high	high	high	high

Source: ACRA estimates

A third of the Region's capital expenditures, largely financed by targeted non-repayable transfers, is allocated to support agribusinesses.

The amount of capital expenditures funded by transfers is about a half of the total capital expenditures of the Region. Without expenditures funded by transfers, the capital expenditures of the Region is about 12% of the total expenditures of the regional budget (medium level). Taking into account the capital expenditures profile in the context of economic classification, the real reduction in capital expenditures in favor of noncapital expenditures may amount to not more than a quarter of the capital expenditures of the regional budget, excluding transfers, i.e. not more than 6% of the total budget expenditures.

Figure 5. Own capital expenditures

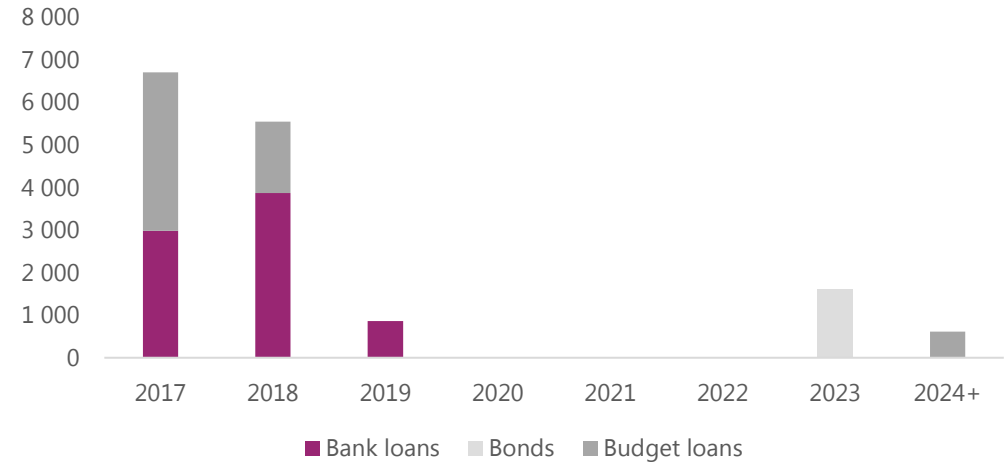


Source: the Tambov Region, ACRA estimates

Debt profile imbalanced in terms of maturity; debt burden risk

As of May 1, 2017, the core of the Region's debt portfolio included Sberbank's credit facilities (50.3%) and budget loans (39.2%). In 2017–2018, the Region plans to repay budget loans for RUB 3.7 billion (2017) and RUB 1.6 billion (2018) and to partially replace them with a RUB 3.5 billion bond issue in 2017. The Region's loans borrowed from banks will also be refinanced, including a net repayment of RUB 1 billion (2017) and a net borrowing of RUB 0.5 billion (2018).

Figure 6. Current debt repayment schedule of the Tambov Region, RUB million



Source: the Tambov Region, ACRA estimates

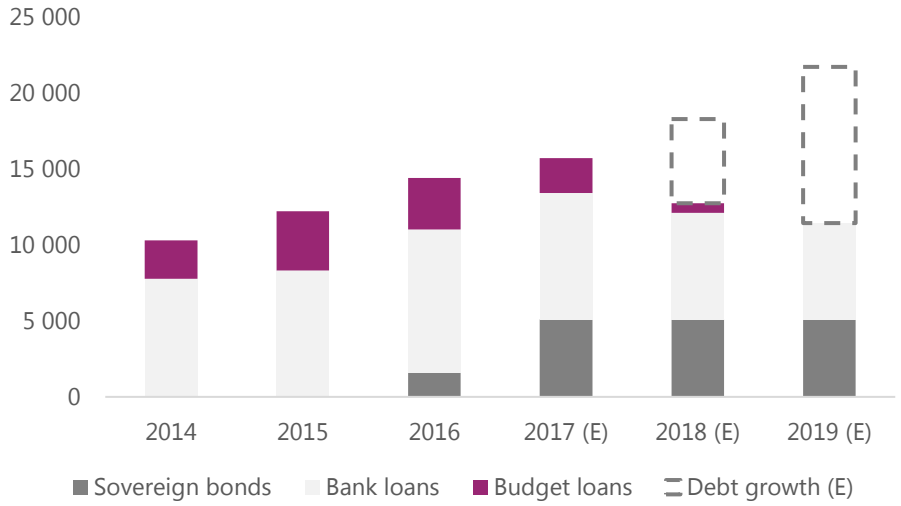
The Region's 2017-2019 debt strategy provides for a smooth reduction of debt burden, including by replacing the bank debt with bond issues, with a gradual approach to the 60/40% proportion between bond issues and bank loans.

ACRA estimates the likelihood of the implementation of this strategy as low, predicting a smooth growth in the Region's debt to operating balance ratio.

Taking into account the regional budget deficit forecasted by ACRA in 2018-2019, the 2019-end aggregate debt burden may reach 93% of the Region's own revenues, compared to 61% in 2016.

As the Region intends to reduce the share of budget loans in the portfolio, the debt burden will grow through commercial debt.

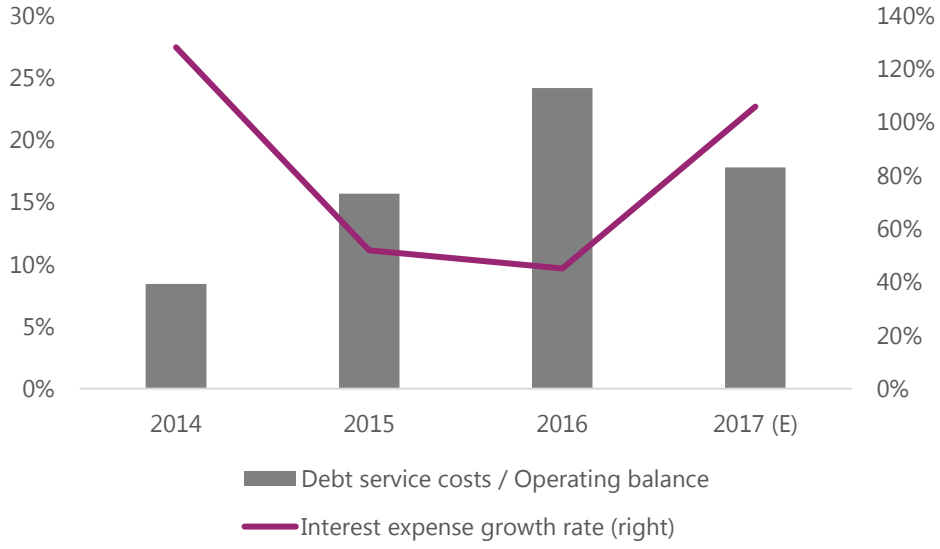
Figure 7. Debt portfolio trends and additional funding needs, RUB billion



The debt burden of the Region (the direct debt to operating balance ratio) has increased over the past three years from 0.71 to 1.16. Given the debt growth rate projected by ACRA, the debt burden will reach 2.09 by the end of 2019, which is estimated by ACRA as a medium risk level.

Despite the moderating growth of interest expenses seen in 2014–2016, the interest expense to operating balance ratio has increased steadily over the same period. The reason is the decreasing operating balance caused by mandatory expenditures outrunning regular revenues.

Figure 8. Interest expenses of the Tambov Region



Source: the Tambov Region, ACRA estimates

The imbalanced structure of current debt repayments is reflected in a high ratio (equal to 1.42) of the operating balance (net of interest expenses) to the debt due for repayment in 2017 (net of annual utilization of a non-revolving credit facility), which indicates potential refinancing risks.

The financial debt of companies of high social or systemic significance owned by the Region amounted to RUB 1.1 billion at 2016-end. The financial position of such companies is stable, and therefore ACRA considers it inappropriate to include such debt in the indirect obligations of the regional government.

As of the end of 2017, there were no guarantees provided by the regional government to public sector companies. The financial assistance to organizations owned by the Region was provided in the form of contributions to authorized capital. The regional government has no plans of further capital injections to public sector companies.

There is no information on any significant commercial liabilities that can affect the creditworthiness of the Region.

According to the data provided by the Region, there are no overdue accounts payable as of April 01, 2017.

ACRA does not have information about the existence of overdue debt obligations and cases of providing emergency assistance to a higher budget in order to repay loans.

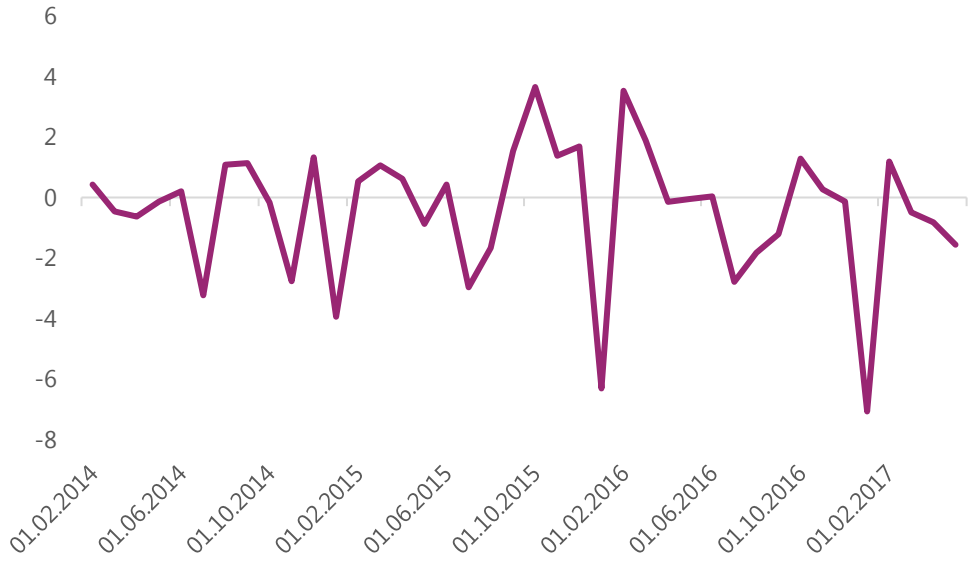
ACRA is unaware of any late repayments or any emergency transfers from the higher-level budget to repay any loans.

Sufficient liquidity

The regional Administration has no right to open deposits with banks.

The Region has sufficient liquidity for timely fulfillment of its expenditure obligations, including interest payments. However, the start-of-month budget account balances have been lower than monthly budget expenditures, and the Region has regularly been in need to finance the projected cash gaps. Due to imbalanced tax revenues and budget expenditures, the Region Administration uses short-term loans from the FTD and bank loans to manage liquidity. In this regard, the annual turnover of funding and repayments has exceeded a half of the total budget revenues in some years.

Figure 9. Liquidity balance* of the Tambov Region, RUB billion



Source: the Tambov Region, ACRA estimates

* Start-of-month account balances vs monthly budget expenditures.

At the time of the analysis, non-revolving credit facilities covered about a half of monthly budget expenditures of the Region.

Issue ratings

Assigned:

The Tambov Region, 35002 (ISIN RU000A0JWT75), maturity date: September 20, 2023,

RUB 1.6 billion — **BBB+(RU**).

The Tambov Region, 35003 (ISIN RU000A0JXVH8), maturity date: July 12, 2024,

RUB 3.5 billion — **BBB+(RU**).

Credit rating rationale. The Agency believes that bonds issued by the Belgorod Region have a status of senior unsecured debt. Credit ratings of such debt instruments correspond to the credit rating of the Tambov Region.

Rating history

No.

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, the Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities, and the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments Under the National Scale of the Russian Federation.

A credit rating has been assigned to the Tambov Region for the first time. The credit rating and its outlook are expected to be revised within 182 days following the rating action (June 30, 2017).

The assigned credit rating is based on the data provided by the Tambov 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 Tambov Region participated in its assignment.

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

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

Appendix

Table 2. Consolidated financials of the Tambov Region

	2014	2015	2016 (E)*	2017 (E)	2018 (E)	2019 (E)
GRP, RUB mln	285,657	344,880	374,438	419,642	468,576	512,005
GRP growth rate	21%	21%	9%	12%	12%	9%
Real GRP growth rate	6%	3%				
GRP per capita, RUB	268,052	326,467	326,668	403,301	453,313	499,536
GRP per capita (% of national average)	66%	73%	72%	82%	86%	88%
Unemployment, %	4.3%	4.6%	4.9%	4.9%	4.8%	4.7%
Unemployment (% of national average)	83%	83%	89%	89%	81%	82%
Average monthly per capita income, RUB	22,377	25,076	27,070	29,070	31,315	33,840
Average per capita income (% of national average)	81%	82%	90%	92%	95%	98%
Degree of economic diversification (estimated value), incl.:						
Largest sector/company share in GRP, estimated	22%	26%				
Largest taxpayer share, estimated	n/a	n/a				
Largest sector/company share in employment, estimated	23%	23%				

Source: the Tambov Region, Rosstat, ACRA estimates

* Hereinafter, all estimates shown are made by ACRA

Table 3. Consolidated budget financials of the Tambov Region, RUB mln

	2014	2015	2016	2017 (E)	2018 (E)	2019 (E)
Budget revenues	40,545	41,364	43,276	43,088	43,860	44,115
Budget expenses	-42,536	-43,899	-45,758	-45,208	-46,564	-47,961
Tax and non-tax revenues	17,921	21,510	23,652	22,922	23,695	23,949
including:						
Taxes	16,615	20,013	21,785	20,561	21,334	21,588
including:						
Profit tax	4,185	6,109	4,696	4,515		
Personal income tax	6,928	7,655	9,434	9,226		
Commodity tax	1,999	2,231	3,340	2,570		
Property tax	2,658	3,082	3,338	3,219		
Other proceeds	1,306	1,497	1,867	2,361	2,361	2,361
Transfers	22,624	19,854	19,624	20,166	20,166	20,166
Regular income	39,239	39,866	41,409	40,727	41,499	41,754
Mandatory expenses	-24,521	-26,586	-29,006	-29,316	-30,196	-31,102
Operating balance	14,718	13,280	12,404	11,411	11,303	10,652
Interest expenses	-421	-639	-928	-1,909	-1,928	-2,334
Interest income	11	5	2	0	0	0
Other expenses	-4,293	-5,329	-5,429	-4,284	-4,742	-4,828
Other income	952	1,281	1,468	2,361	2,361	2,361
Capital expenses	-13,300	-11,345	-10,396	-9,698	-9,698	-9,698
Capital income	343	211	396			
Deficit/Surplus	-1,990	-2,535	-2,482	-2,120	-2,704	-3,846
Debt raising	24,348	29,900	15,958	26,400	22,115	19,027
Debt repayment	-21,877	-27,979	-13,761	-25,100	-19,411	-15,141
Debt repayment, debt book				-6,700	-5,546	-858

Source: the Tambov Region, ACRA estimates

Table 4. Consolidated debt burden indicators of the Tambov Region, RUB mln

	2014	2015	2016	2017 (E)	2018 (E)	2019 (E)
Market debt	7,767	8,325	9,410			
Short-term market debt	3,013	1,772	2,982			
Long-term market debt	4,754	6,553	8,028			
Non-market debt	2,533	3,898	3,411			
Issued guarantees	110	69	0			
Total debt	10,410	12,293	14,421	15,721	18,425	22,311
Account balance at period end	4,668	4,869				
Net debt	5,741	7,424	14,421	15,721	18,425	22,311
Relevant public sector debt	0	0	0			
Augmented debt including public sector debt	5,741	7,424	14,421			

Source: the Tambov Region, ACRA estimates

Table 5. Consolidated key financial ratios of the Tambov Region

	2014	2015	2016	2017 (E)	2018 (E)	2019 (E)
Budget ratios						
Share of own revenues in budget	47%	56%	58%	53%	54%	54%
Own revenues growth rate	10%	20%	10%	-3%	3%	1%
Share of regular income in budget	78%	82%	83%	84%	95%	95%
Regular income growth rate		7%	6%	1%	15%	1%
Share of tax income in regular income	52%	59%	61%	57%	51%	52%
Share of mandatory expenses in budget	58%	61%	63%	65%	65%	65%
Mandatory expenses growth rate		8%	9%	1%	3%	3%
Operating balance (% of regular income)	38%	33%	30%	28%	27%	26%
Operating balance variation		2%	-4%	-2%	64%	-6%
Share of capital expenses in budget	31%	26%	23%	21%	21%	20%
Debt ratios						
Market debt growth rate		7%	13%			
Total debt growth rate	31%	18%	17%	9%	17%	21%
Share of short-term debt in market debt	39%	21%	32%			
Debt service expenses to own revenues	2.3%	3.0%	3.9%	8.3%	8.1%	9.7%
Debt service expenses to operating balance	2.9%	4.8%	7.5%	16.7%	17.1%	21.9%
Debt to operating balance	0.71	0.93	1.16	1.38	1.63	2.09
Operating balance (net of interest expenses) to debt due for repayment in the current period	0.65	0.45	0.83	1.42	1.69	1.50
Market debt to operating balance	0.53	0.63	0.76	0.45	0.45	0.48
Net debt to operating balance	0.39	0.56	1.16	1.38	1.63	2.09
Total debt to GRP	3.6%	3.6%	3.9%	3.7%	3.9%	4.4%
Interest expense growth rate	128%	52%	45%	106%	1%	21%

Source: the Tambov Region, ACRA estimates

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