

Municipality of Burgas

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	Initial Rating 17.04.2015	Update 04.05.2016
Credit Rating of Municipality of Burgas		
Long-term Rating:	BBB-	BBB-
Outlook:	Stable	Stable
Short-term Rating:	A-3	A-3
National-scale long-term Rating:	AAA (BG)	AAA (BG)
Outlook:	Stable	Stable
National-scale short-term Rating:	A-1+ (BG)	A-1+ (BG)

BCRA - Credit Rating Agency (BCRA) is the third qualified rating agency in the EU, registered under Regulation (EC) 1060/2009 of the European Parliament and of the Council. The credit ratings, assigned by BCRA, are recognized throughout the EU, and are entirely equal with the other ratings, recognized by European Securities and Markets Authority (ESMA), without any territorial or other restrictions.

„BCRA – Credit Rating Agency” (BCRA) retains the assigned ratings to Municipality of Burgas as follows:

- **Long-term credit rating BBB-, outlook: stable, short-term credit rating A-3;**
- **National-scale long-term AAA (BG), outlook: stable, national-scale short-term rating A-1+ (BG).**

The officially adopted by BCRA methodology for assigning a credit rating to municipalities is applied (http://www.bcra-bg.com/files/file_319.pdf).

To elaborate the credit report and to assign the credit rating, BCRA uses information, provided by the rated municipality, Ministry of Finance, NSI, National Employment Agency, its own database, consultants and other sources of public information.

The political environment as of the time of preparation of the report could be determined as relatively stable. In October 2015, the held local

elections did not lead to any significant changes in the political layers.

The country registered a considerably high real growth of economy, which did not decrease below 2.8% in 2015 – respectively 3.3% for Q1, 2.8% for Q2, 3.0% for Q3 compared to the same quarters of 2014, and according to flash estimates of the NSI the growth for the last quarter is expected to be around 3.1% compared to the same of 2014.

During 2015, the flow of investments in the country increased compared to 2014 (by 0.290 billion euro to 1.575 billion euro) after a decrease observed in interest of the foreign investors after 2012 and more considerably – during 2014 after increased uncertainty in the economic environment.

During 2015, the favourable changes at the labour market maintained the same – the unemployment rate (as well as the continuous unemployment as a percent of active population) maintained their downtrend after 2013.

During 2014, deflation processes were observed that continued also in 2015 and are due to the fall in international oil prices, weak economic activity in the region and within the country, as well as internal economic developments in the major trading partners of Bulgaria.

There has been deterioration in the budget imbalance of the country for 2014 and a slight improvement in 2015. The government debt increased significantly in 2014 due to political and economic instability in the country and the resultant increase in the budget deficit, but in the

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second half of 2015 this development was suspended.

The 2014 events in the banking system led to the emergence of a potential risk for the banking institutions of deepening the banking crisis and involving a larger number of participants in the sector. Despite the increased risk in the financial system caused by the dropping of one of the main players and a risk of dropping of another, the banks in Bulgaria maintained their stability. During 2015, the banking environment could be determined as stable, as evidenced by the high capital adequacy and liquidity of assets and growth in the attracted deposits. The share of the classified loans also marked a decrease that contributed for improvement of the balances of the banks in the country.

The own incomes of the municipalities in the country increased in 2014 as their growth rate (3.7%) is lower than the past year (6.9%) and is higher than 2012 (1.4%). The number of the municipalities, which have increased their own income year on year, have reduced greatly – 139, and 192 for 2013 compared to the prior year of 2012. For second consecutive year, the expenses for local activities have increased (including additional funds needed for the government costs), with a higher rate compared to the past year – 15.3%, 5.6% for 2013. A positive factor is the considerable growth of the capital expenses¹ – 53.3%, compared to 11.8% for 2013. The overdue debts of the municipalities continued to reduce in 2014, and after the decline of 2.6% for 2013, in 2014 it amounted to 5.9% year on year, and their size was 159.3 million BGN. During 2015, there was an increase to 184.8 billion leva. At the moment, there are municipalities in a very difficult financial situation that they are not able to carry out public services. The accumulation of debts and deterioration of the financial condition of the municipalities over the last year, to a great extent, is due to quick absorption of EU funds due to the end of the programming period.

During the update, there have had changes in legislation regulating the activities of municipalities. In the Municipal Debt Act amendments have been adopted which state that the municipalities would be able to take a short-term debt to finance public

services in temporary shortages of funds occurred in temporary cash disruptions in the budget, and for payments to projects financed with EU funds. Legal texts regulating the sources from which payments on municipal debt could be done are dropped out.

During early 2015, amendments were adopted in the Value Added Tax Act and the Water Act regarding the use of tax credits on the costs of the water projects of municipalities. By 2013, the VAT has been refunded with EC funds, then this practice was suspended. A decision was taken that the funds to be refunded from the central government budget, which is a form of support for municipalities. Those municipalities that have already had VAT refunds paid by OP "Environment" should transfer the sums to the account of the Ministry of Environment and Water of Bulgaria incl. those that are in a process of recovery of such a tax.

At present, in a process of consultation is a **project for changing** the Public Finance Act which defines a range of criteria for identifying a municipality as a municipality with financial difficulties. A procedure for financial recovery is foreseen for these municipalities, and introduction of a recovery plan, as well as an opportunity for supporting with a temporary free of interest loan from the government, whose parameters will be set by the Minister of Finance. During 2014, the population of Municipality of Burgas decreased by 0.35%, compared to a 0.18% growth over the previous year. Despite the decline during the period, the population dynamics remained comparatively favourable compared to the average for the country (a decline of 0.60% for 2014). The population density remains without changes compared to 2013 and is multiple times higher than the average for the country. During the period, the trend of slight decrease continued in the share of active population in Burgas, as well as for the country, as the indicator level for the municipality retained slightly higher. The share of below-active age population in Burgas continues to increase slightly, as its level exceeded slightly the reported for Bulgaria.

By data of NSI, unemployment rate for people aged between 15 and 64 for 2015 in Burgas district is 10.3%, that is a slight decrease compared to 2014 (11.1%). Its level, however, is

¹ With budget funds

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slightly higher than the average for the country - 9.2% for 2015 (11.5% for 2014).

Manufacturing is dominant for sectoral structure of the companies in Municipality of Burgas. The sector forms 67% of the output in 2014, and its decrease by 14.8% yoy determines a decline of 5.3% for aggregate output. The production in the second most important sector increased highly - construction (54%). The investments in fixed assets of the companies in the municipality during the period fell slightly (5.6%), and more serious deterioration exists in the generated aggregate financial result, which for the first time since 2010 is negative.

In 2015, Municipality of Burgas realized a positive result from operating activity which is by 38.4% higher compared to the reported for the past year. The result from investment activity is negative, as by absolute value is considerably higher than the operating. As a result, the municipality reported a negative net cash flow that is covered mainly by loans and cash on account.

The own incomes of the Municipality of Burgas registered a decline of 5.8% in 2015 mainly due to reduction of incomes from sales of property (29.2%), which is not considered to be a negative factor due to their irregular character. The tax incomes registered a growth of 4.3%, incl. growth of 9.0% of the income from tax on real estates while the other important item – tax on acquisition of properties – decreased by 8.4%, which, however, happened after a considerable growth of 37.6% over the past year.

A major item in the non-tax incomes remain the fees with a share of 57.3% for 2015 (52.9% for 2014). The revenues from them register a growth of 3.8% in 2015, and dominant continues to be the domestic waste tax which is 69.2% of the incomes from taxes in 2015, as well as for the past year. The revenues from it increase by 3.8% in the last year.

During 2015, there was a considerable decrease of the subsidies and transfers, as their size decreased to a negative value due to the large size of outcoming transfers, connected with funds on EU programmes (-20 786 thousand leva).

During the update, the current costs decreased by 10.3% yoy, but, to a great extent, the decrease is in line of a negative number and size of 9 009

thousand leva, representing VAT refunds for costs on completed water projects in relation with changes in the VAT Act and the Water Act (see above). The costs for salaries and insurances of the employees continue its growth trend, but their rate in 2015 (9.7%) was significantly lower compared to those reported over the previous three years (average ~ 25%). After decreasing in the previous three years (respectively 2.9% for 2012, 3.1% for 2013 and 1.0% for 2014) during the last year the maintenance increased by 5.2%. The capital expenses decreased with budgetary funds by 13.9%.

Municipality of Burgas continue not to report overdue debts which is markedly a positive factor.

The expense structure is dominated by public utilities expenses whose share continues to increase reaching 51.1% (45.2% for 2014). The increase is on the account of the expenses for economic activities and services whose share decreased from 16.0% for 2014 to 12.9% for 2015. Second in importance is the total state services over the last year which form 14.1% of the expenses for local activities and additional financing (13.4% in 2014r.).²

50.9% of the investments with budget funds in public utilities are directed for water supply and sewage, incl.:

- WWTP and sewage in village of Marinka. At the beginning of 2016, the sewage treatment plant was completed, and in April the construction of sewage should be completed and gradual asphaltting of streets should launch;
- An integrated project for management of water and waste waters – Chernomore and village of Rudnik;
- During the year was completed "Integrated project for improvement and development of infrastructure for water and waste waters of the quarters Banevo, Vetren and Mineral baths, Burgas";
- During the analyzed period was also completed "Integrated project for

² In this section the calculations are made as the influence of the refunded VAT is excluded, because it deforms highly the budget and conclusions of the analysis.

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management of water and waste waters in Gorno Ezerovo, Burgas"

- The project „Sewage treatment plant for waste waters - "Meden rudnik", Burgas - 2 stage: expansion“;

The project implementation for integrated public transport of Burgas continues, as during the analyzed period the amount of 72 175 thousand leva have been invested in the project – this is funding through the financing programme „Regional development“. The project has an approved budget of 109 523 thousand leva and should be completed in June 2016.

Another major project is the regional waste depot in village of Bratovo where 6 178 thousand leva have been invested over the year. The depot was open to exploitation in May 2015, and since June it has worked at full capacity. It is used by the municipalities of Burgas, Sredets, Kameno, Nesebar, Pomorie, Aytos, Ruen, Karnobat and Sungurlare. The depot includes a system of separation, composting, processing construction and outside waste, eco depot for storage of specific domestic waste and first depot cell.

The overall capital programme of Municipality of Burgas (incl. budget and off-budget funds) continues to increase considerably, reaching 138.5 million leva (compared to 79 million leva for 2014). During the period, the share of financing with EU funds amounted to 73% (compared to 67% for the previous year).

The position of Municipality of Burgas is reviewed in a comparative aspect by a set of indicators calculated per capita. Burgas takes a markedly favourable position during the entire period compared to the average levels for the country, as well as the average for the group of municipalities which are districts. The comparison with Municipality of Varna (as a municipality with a similar profile) displays that by most indicators both municipalities take very close positions as this of Burgas is more favourable.

During the analyzed period local elections took place which have been won by the current Mayor – Dimitar Nikolov (PP GERB) in the first round of voting with 84.0%. This is his third mandate as a mayor of the municipality. In the organizational structure of the municipal administration some

changes were taken. The achieved collection with main tax and non-tax items is comparatively high.

BCRA prepares a financial forecast of the municipality for the period 2016-2018. The obtained results display that in development which is similar with the forecast, Burgas will realize a positive operating result, as well as a positive free cash flow during the entire period.

As far as the rating of Municipality of Burgas is limited by the rating of Bulgaria, favorable influence on it could have possibly rise of sovereign rating, however, with view of the negative outlook at the moment we assess as unlikely.

Negative influence on the rating of Municipality of Burgas might have a future accumulation of overdue debts, descending trends in main tax and non-tax items, as well as generation of negative operating result.

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Main Financial Indicators in BGN

(BGN)	2015	2014	2013
Income for local activities, incl.	65 425 065	88 944 818	76 676 153
Own Income	71 206 973	75 572 176	69 954 414
- tax income	30 229 941	28 992 331	26 889 533
-- non-tax income	40 977 032	46 579 845	43 064 881
Subsidies and transfers for local activities	-5 781 908	13 372 642	6 721 739
Capital Expenses	21 518 608	25 004 412	15 103 394
Operating Result	13 588 468	9 820 834	9 610 253
Operating Result before Taxes	14 473 088	10 654 798	10 445 076
Result from Investment Activity	-24 869 699	-7 374 759	-6 967 712
Deficit/Surplus for local activities	-11 281 231	2 446 075	2 642 541

Resume of the Minutes of the Rating Committee:

The members of the Rating Committee reviewed the credit rating report of Municipality of Burgas and discussed the factors determining its credit rating. The changes in the revenue and expenditure of the budget were marked during the analyzed period highlighting on the continuing lack of arrears and massive capital programme, executed during the period. The position of the municipality was outlined in a comparative aspect.

Due to the specific risk profile of the municipality, as well as the condition of the overall legal regulation of the municipalities in Bulgaria, the base rating³ was assigned at level A-.

The evaluation of the sovereign risk of the country and its degree of influence on municipality of Burgas limited the assigned long-term credit rating to BBB- and short-term rating A-3.

The national-scale long-term rating AAA (BG) u short-term rating A-1+ (BG) were assigned on the basis of the positioning of the rating characteristics of the Municipality in a comparative perspective compared to the other municipalities in Bulgaria.

³ The base rating is an intermediate step in assigning the credit rating of the municipality according to the adopted methodology.