

## Municipality of Burgas

**Vesela Velichkova, Lead Financial Analyst**

v.velichkova@bcra-bg.com

**Nikoleta Koleva, Financial Analyst**

n.koleva@bcra-bg.com

Credit Rating of Municipality of Burgas	Initial Rating	Update	Update
Date of Rating Committee:	17.04.2015	04.05.2016	03.05.2017
Date of Publication:	24.04.2015	06.05.2016	05.05.2017
Long-term Rating:	BBB-	BBB-	BBB-
Outlook:	stable	stable	stable
Short-term Rating:	A-3	A-3	A-3
National-scale long-term Rating:	AAA (BG)	AAA (BG)	AA- (BG)
Outlook:	stable	stable	stable
National-scale short-term Rating:	A-1+ (BG)	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 AA- (BG), (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](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.

During 2015, the economy of the country reported a 3.6% real growth – the highest value after the financial crisis, as the major growth factors are export of commodities and services and growth in final consumption. The marked growth in GDP is twice higher than the achieved for the last two years (1.6% in 2014, 1.3% in 2013). In the first half of 2016, there was an increase in importance of the domestic consumption for economic growth.

The FIF (foreign investment flow) reach 3.7% of GDP after hesitations of about 3.1%-3.3% over the last three years. A substantial increase in the reinvested profit after the last year and in investments in the share capital is observed. The investors, however, remain cautious as the levels of investments remain considerably lower compared to the years before the crisis. For the first half of 2016, the foreign investments reduce slightly compared to the same period of the last year – decline to 2.0% of GDP (2.1% of GDP as of Q2 2015).

The favourable changes in the labour market remain the same – unemployment rate (as well as continuous unemployment rate as a percent of the active population) maintain their downtrend after 2013. In 2015, the average unemployment rate is 9.2% (11.5% in 2014).

Since early 2014, deflationary processes have been detected and reached their peak in early 2015 and remain the same at the end of the year.

	<b>CREDIT RATING</b> <b>Municipality of Burgas</b> <b>Long-term/ short-term rating: BBB- / A-3</b> outlook: stable <b>National-scale rating: AA- (BG) / A-1+ (BG)</b> Outlook: stable
<b>95, Evlogi Georgiev, fl. 1</b> Sofia 1142	<b>phone: (+359-2) 987 6363</b> <b>www.bcra-bg.com</b>

The situation of deflation remains in 2016, as the change in price level is expected to be about -0.7% at the end of the year. EC foresees the factors causing a decline in the price level to be removed, and in 2017 the country to shift to a situation of low inflation.

The 2014 banking system events led to the emergence of a potential threat to banking institutions to deepen the banking crisis and involvement of a larger number of participants in the sector. Despite the increased risk in the financial system raised by the removal of one of the main players and the risk of dropping the second, the banks in Bulgaria maintained its stability. The announced on 13.08.2016 results from the assets quality review and stress tests for stability of the banks in Bulgaria show that the banking sector is stable, well capitalized and public support to the banks with funds given by the public budget is not needed.

The own revenues of municipalities in the country increased for the fifth consecutive year in 2015; for this period the cumulative increase was 28.0%, and for the last year - 4.0%, compared to 3.7% for the previous year. During 2015, however, the uptrend was interrupted in total revenues, a decline of 5.6% was reported compared to 2014. A positive factor is the increase in the share of own revenues in total revenues, which, after 39.1% in 2013 and 38.0 % in 2014 reached 41.8% in 2015 and this is its highest level from 2003 to now. The uptrend remain the same, in revenues from taxes and local fees, as their rates are respectively 4.0% and 5.3% and exceed the reported for the past year (3.7% and 4.4%).

After a growth of 15.3% in 2014, during the year after that the level of costs for local activities and extra financing of the government activities remain almost unchanged (a growth below 1%). The maintenance costs have the largest share in their structure (47.6%) which marked an increase of 4.8% on a yearly basis.

After two consecutive years of reduction of the overdue liabilities of the municipalities in the country, in 2015 they grow again (19.2% on a yearly basis) and their amount reach 189.9 million BGN (159.3 million BGN at the end of 2014). At the end of the third quarter of 2016, the overdue liabilities grow to 193.7 million BGN. The largest overdue liabilities are observed during this period with Municipality of Pernik (16.9 million BGN),

Municipality of Sliven (15.3 million BGN), Municipality of Kardzhali (14.8 million BGN), Municipality of Velingrad (9.5 million BGN), Municipality of Varna (8.5 million BGN), Municipality of Dospat (6.0 million BGN). A decline is observed at the end of 2016, when the overdue liabilities reduce to 184 million BGN.

In June 2016, amendments are adopted in the Law on public finances related to municipalities in a poor financial condition as the provisions of the law define a set of criteria for determining a municipality as a municipality with financial difficulties. A procedure for financial recovery of these municipalities and implementation of a recovery plan is planned, and possibility to support with a temporary government interest-free loan, whose parameters will be determined by the Minister of Finance. At present, the first two interest-free loans are granted – to Municipality of Pernik (4 million BGN) and Municipality of Belovo (2 million BGN), after their recovery plans have been approved.

During 2015, the population of Municipality of Burgas and of the country decrease by the same rate – 0.67%. The density of population in Municipality of Burgas decreases slightly but remain much higher than the average for the country. The municipality continues to maintain a higher rate of active population compared to the average for the country. A positive factor is the higher share of the population at underactive age.

The output made by the companies on the territory of Burgas in 2015 reduce for a third consecutive year with an intensifying rate: after 2.4% for 2013 and 5.3% for 2014, during 2015, the decline amounts to 15.6%. The decline is mainly in line of the leading sector – manufacturing – where the production reduces by 16.3% on a yearly basis. The investments in FTA of companies in Municipality of Burgas in 2015 report a substantial decline of 43.7%, also mainly in line of manufacturing which is a leading sector with a share of 48.4% and reports a decline of 60.0%.

After the substantial loss which the companies in the municipality reports during 2014, during 2015 their joint financial result is positive, with the highest value from the beginning of the crisis up to now. For the improvement contributes to a great extent the reduction of loss in manufacturing, and also the commercial sector, whose net result is positive and increases by 65.4% on a yearly basis.

	<b>CREDIT RATING</b> <b>Municipality of Burgas</b> <b>Long-term/ short-term rating: BBB- / A-3</b> outlook: stable <b>National-scale rating: AA- (BG) / A-1+ (BG)</b> Outlook: stable
<b>95, Evlogi Georgiev, fl. 1</b> Sofia 1142	<b>phone: (+359-2) 987 6363</b> <b>www.bcra-bg.com</b>

Municipality of Burgas continues to realize a positive result from operating activity which in 2016 is in the amount of BGN 7 547 thousand (by 44.5% less compared to 2015) and is 7.2% of incomes for local activities. The result from investment activity is negative but is covered entirely by the operating surplus, as a result the total result is a surplus in the amount of BGN 617 thousand.

During 2016, the own income of the municipality report growth of 11.7%. The increase in tax income is 12.4%, as a leading item in their structure is kept the real estate tax with a share of 37.6%, the revenues from which increase by 16.3% (9.0% for 2015). The uptrend in vehicle tax with a growth of 16.6%, and the increase in tax property acquisition tax is less manifested (4.2%).

In the structure of non-tax income dominant remain the taxes with a share of 52.9%, income from which reduce by 2.4% compared to 2015. The decline is mainly in line of the main article – domestic waste tax (a decline of 4.5%). Second in importance in non-tax income are the revenues from ownership, which are characterized by a growth of 14.4% compared to 2015. To greatest extent, it is due to growth in sales income of goods, services and production (43.2%), which hold the biggest share over the year (44.1%, 35.2% during 2015). Their increase is due to expansion of the activities of municipal companies, as well overall operation of MP „Purity Eco“. The income from sales of property is volatile through the years, as during 2016 there was a growth of 15.8% to 4 498 thousand BGN which is 8.9% of non-tax income.

The expenses for remunerations and social security (in local activities and extra financing) remain their uptrend, reporting growth of 13.8% during 2016. Their share in current expenses decrease by 2.5 p.p. to 16.2%. The maintenance is a main article in current costs, and its size over the last year increases by 9.7% reaching BGN 50 447 thousand. The interest costs increase for a second consecutive year (growth of 14.6%). Their share in current costs remains low (1.4%), which is a positive factor. During the period of updating, the municipality has not taken any new loans. After a decline of 13.9% in 2015, during the next year the capital costs with budgetary funds of Municipality of Burgas increase by 48.9%, reaching 32 033 thousand BGN, which is their highest value from 2004 up to now.

Municipality of Burgas continues not to report overdue liabilities which is a markedly positive factor.

Regarding the structure of the expenses on functions, the funds for public utility remain leading despite the decline in their share (7.4 p.p., to 43.7%). Growth is observed in the costs for recreation and culture which reach 13.0% (9.0% for 2015), as well economic activities and services whose share of 12.9% for 2015 reach 15.2% during the last year. The share of the expenses for total public services decreases slightly (0.5 p.p., to 13.6%).

Substantial by size off-budget funds are invested in education in 2016. 5 026 thousand BGN is the size of the funds for renovation, construction and reorganization of buildings, yard playgrounds and playgrounds at some schools and kindergartens. Investments in size of BGN 813 thousand are made to increase energy efficiency of central heating of three municipal educational buildings in Burgas.

In the field of education Municipality of Burgas has started some projects with EU funds on a new programme period which will contribute substantially for improving the educational infrastructure in the municipality. The projects on OPs „Science and education for smart growth“ and „Regions in growth“ and are in a total value of BGN 28 330 thousand.

The investments for public utilities during 2016 are in the amount of BGN 11 611 thousand which is a decline of 20.3% on a yearly basis and 36.2% of the capital expenses with budgetary funds for the year. 80.7% are invested in activities on water supply and sewerage. The main directions of the investments are:

- BGN 2 196 thousand for sewage and WWTP in the villages Banevo, Mineralni bani and Vetren. The project is on OP „Environment“ with a total budget of BGN 24 426 thousand and it is completed in September 2016;
- BGN 4 111 thousand for an integrated project for management of water and waste water in villages of Chernomore and Rudnik;
- BGN 2 201 thousand for construction of water-conduits in the villages Marinka, Tvarditsa and Dimchevo.

	<p><b>CREDIT RATING</b>  <b>Municipality of Burgas</b>  <b>Long-term/ short-term rating: BBB- / A-3</b>  outlook: stable  <b>National-scale rating: AA- (BG) / A-1+ (BG)</b>  Outlook: stable</p>
<p><b>95, Evlogi Georgiev, fl. 1</b>  Sofia 1142</p>	<p><b>phone: (+359-2) 987 6363</b>  <b>www.bcra-bg.com</b></p>

During June 2016, the project for integrated urban transport is completed with a total budget BGN 120 463 thousand, financed on OP „Regional development“. „Integrated project for reshaping of urban landscape in Burgas“ with an approved budget of BGN 16 618 thousand on OP „Regional development“ is completed. The project covers a number of projects, part of which are neighborhoods 60B, D Zone (зона „Г“), Meden rudnik, Vazrazhdane, playground facilities in neighborhood Slaveykov, scater park in park Izgrev.

In the area of recreation and culture a key cultural project during 2016 is the project for sport facilities „Slaveykov“ in the amount of 16 million BGN. The financing is on European initiative JESSICA and is negotiated between the municipality, Societe Generali Expressbank and Regional fund for urban development. The sport facilities are expected to be open during the second half of 2017.

After reaching a substantial growth in the entire capital programme of Burgas in 2015 (incl. Off-budget funds), connected to a great extent with completion of the previous programme period, during 2016 its size reduce to BGN 47.5 million (compared to BGN 138.5 million for 2015). The share of financing with European funds reduce – from 73% for 2015 to 30% during the last year.

The position of Municipality of Burgas for 2015 is reviewed in a comparative aspect by a set of indicators calculated per capita. Burgas takes a markedly favourable position during the period compared to the average levels for the country, as well as the average for the country and group of municipalities which are districts. The comparison with Municipality of Varna (as a municipality with a similar profile) displays that Burgas takes a better position concerning total income per capita, whereas Varna takes a better position regarding income for local activities, own funds and capital costs with budgetary funds.

During the period of updating, Mayor of Municipality of Burgas is Dimitar Nikolov (PP GERB), elected at the local elections during the autumn of 2015. This is his third mandate as a mayor of the municipality. His activity is assisted by five deputy mayors as there are not personal changes with them during the period of updating.

The reported collection for 2016 with main income sources is as follows: 78.4% for real estate tax,

73.7% for vehicle tax rates and 75.5% for domestic waste tax, as those levels are close to the registered for the previous year.

BCRA prepares a financial forecast of the municipality for the period 2017-2019. The results display that in development which is similar with the forecast, Municipality of Burgas will realize a positive operating result. The free cash flow is negative after the last year but the shortage is little and is covered entirely by the funds on accounts.

*As far as the rating of Municipality of Burgas is limited by the rating of Bulgaria, favorable influence on it could have a possible rise in sovereign rating, however, at the moment we assess it as less likely.*

*Negative influence on the rating of Municipality of Burgas might have a future accumulation of overdue libilities, substantial growth of leverage, negative trends in the main income articles, as well as generation of a negative operating result.*

	<b>CREDIT RATING</b> <b>Municipality of Burgas</b> <b>Long-term/ short-term rating: BBB- / A-3</b> outlook: stable <b>National-scale rating: AA- (BG) / A-1+ (BG)</b> Outlook: stable
	<b>95, Evlogi Georgiev, fl. 1</b> Sofia 1142

**Main financial indicators in BGN:**

(лева)	2016	2015	2014
Income for local activities, incl.	104 946 817	65 425 065	88 944 818
Own Income:	79 554 022	71 206 973	75 572 176
- tax income	33 993 017	30 229 941	28 992 331
- non-tax income	45 561 005	40 977 032	46 579 845
Subsidies and transfers for local activities	25 392 795	-5 781 908	13 372 642
Capital expenses	32 033 101	21 518 608	25 004 412
Operating result	7 546 830	13 588 468	9 820 834
Operating result before taxes	8 560 951	14 473 088	10 654 798
Result from Investment Activity	-6 929 700	-24 869 699	-7 374 759
Deficit/Surplus for local activities	617 130	-11 281 231	2 446 075

the municipality in a comparative aspect for Bulgaria.

**Resume of the Minutes of the Rating Committee:**

The members of Rating Committee reviewed the credit rating report of Municipality of Burgas and discussed the factors assigning the rating of the Municipality.

The dynamics was discussed with the indicators of the companies operating in the municipality. The focus was drawn to the continuing lack of overdue liabilities of the municipality. The attention was drawn to the capital costs and, in particular, the investment projects on operating programmes from the new programme period.

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 rating<sup>1</sup> was assigned at level A-.

The sovereign risk rating and its level 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 AA- (BG) and the short-term rating A-1+ (BG) were assigned on the basis of the position of the rating characteristics of

<sup>1</sup> The base rating is an intermediate step in assigning credit rating to the municipality according to the adopted methodology.