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Key rating assessment
factors

Key assumptions

ACRA assigns BBB-(RU) to the Kostroma Region, outlook Stable

The credit rating assigned to the [Kostroma Region](#) (hereinafter, the Region) is caused by a critical lag in regional economic development as compared to the national average figures, sufficient self-sustainability of the budget, average control over expenditures and high debt load.

The Kostroma Region is located in the Central Federal District and borders five regions of Russia. The Region's population is 648,000 people. In 2015, the gross regional product (GRP) of the Region totaled RUB 171 bln (69th in the Russian Federation).

Diversified economy with low unemployment. Woodworking, jewelry and metallurgical industries as well as electric power generators, vehicle manufacturers and automotive component producers dominate the Region's economy. At the same time, the Region's economy demonstrates critically low figures of GRP per capita and per capita income (55% and 75% of the national average figures in 2014-2017). The population size is in decline, which, however, slowed down significantly – from -1.6% in 2005 to -0.5% in 2016.

Low flexibility of the expense side of the budget with relatively stable capital expenditures. In 2014-2016, the Region's operating balance was below 9% of regular revenues. By year-end 2017, ACRA expects the operating balance to increase to 21% and to stay at this level in 2018-2019. The Region's operating balance growth is driven by increase in its regular revenues. The Region's development budget equals 17% of the total budget spending (on average in 2014-2017), around 36% of which are financed from non-repayable funding sources. The need to execute the May Orders is partially compensated by low average monthly earned income (which is used to calculate the level of wages in the public sector).

Operating balance growth reduces the debt load. The Region's debt load (direct debt to operating balance ratio) decreased from 20x in 2014 to 14x in 2016, and, according to ACRA estimates, will be as low as 5x by year-end 2017, which is, however, assessed by ACRA as high risk. Although the share of market debt is significant (above 60%), the debt servicing expenses to operating balance ratio corresponds to low risk in 2017. In Q4 2017, the Region plans to issue bonds worth of RUB 8 bln; as a result, their share in the debt structure may increase from 8% as at September 1, 2017 to 34% as at January 1, 2017 (vs 37% and 29% for bank and fiscal loans respectively). Bond issue proceeds are planned to be used to repay bank loans as well as to finance budget deficit. The expected restructuring of fiscal loans and issuance of bonds will significantly improve the Region's debt repayment schedule: around 65% of debt (as percentage of the expected debt as at January 1, 2018) will be repaid in 2020 and in subsequent years.

Low budget liquidity. Since January 2016, the average balance of budget funds is around 20% (reaching or exceeding 38% from time to time) of the current-month expenses. The liquidity resources are replenished using funds from the Federal Treasury Department.

- Tax and non-tax revenues growing by 3% a year in 2018-2019;
- Budget deficit declining below RUB 1.5 bln in 2018;
- Operating balance is maintained above 20% in 2017-2018;
- Restructuring of Fiscal loans worth of RUB 7.269 bln;
- Extending repayment of debt obligations in 2017.

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:

- Growth of tax and non-tax revenues exceeding 4% per year;
- Decrease of the budget deficit below 4% of tax and non-tax revenues in 2018;
- Increase of economic development indicators (GRP per capita, per capita income) in relation to the national average figures;
- Substantial decline of debt to operating balance ratio.

A negative rating action may be prompted by:

- A significant drop in the operating balance;
- A substantial increase in debt servicing expenses to operating balance ratio;
- A substantial reduction of capital expenditures.

Issue ratings

None.

Rating history

None.

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](#) and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

A credit rating has been assigned to the Kostroma Region for the first time. The credit rating and its outlook are expected to be revised within 182 days following the rating action (October 10, 2017).

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

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

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

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