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Key rating assessment
factors

ACRA affirms Kostroma Region's credit rating at BBB-(RU), outlook Stable, and assigns BBB-(RU) to its bond issues

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 and high debt load. The credit rating is supported by the fact that debt service expenses to operating balance ratio corresponds to a low risk. In addition, we note improvement in debt repayment schedule in Q1 2018, which resulted from a replacement of short-term bank loans by medium-term loans.

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 2016, the gross regional product (GRP) of the Region totaled RUB 160.7 bln (71th 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 (53.6% and 74.7% of the national average figures in 2014-2017).

Low flexibility of the expense side of the budget with relatively stable capital expenditures. In 2017, the Region's operating balance (according to the ACRA methodology) has increased to 16%, while in 2014-2016 it was below 9% of regular revenues. ACRA expects the operating balance to remain at 16%-17% of regular revenues in 2018-2019. The Region's development budget averaged 17% of aggregate spending of the budget in 2014-2017. The regional budget received a transfer for a partial reimbursement of additional expenses to increase compensation for public-sector employees. The transfer totaled RUB 3.378 bln (it was RUB 0.213 bln in the previous year), which would lower the pressure on the budget exerted by the need to comply with the May Orders targeting compensation of public-sector employees.

Since 2018, the Region's budget execution is supervised by the Federal Treasury. The debt servicing expenses are classified as the primary class of spending and that is why, treasury supervision would have no adverse effect on debt servicing. At the same time, treasury supervision would not result in increased spending of the regional budget in the short term. In connection with the above, ACRA assesses introduction of treasury supervision for the Region's budget spending as neutral.

Improvement in debt repayment schedule and reduction of debt servicing expenses. As at January 1, 2018, around 46% of the regional budget's debt was to be repaid in 2018. In Q1 2018, a substantial portion of the debt was replaced by medium-term bank loans (with repayment primarily falling on 2023), and therefore, less than 7.3% of the debt portfolio shall be repaid in 2018. As at April 1, 2018, fiscal loans with repayment in 2018-2024 accounted for around 57% of the debt. Increase of fiscal loans' share in the debt structure as well as lower interest rates would allow the Region to cut its debt servicing expenses almost in half versus 2017 figures.

Key assumptions

- The Region's budget performance in 2018 returning a maximum deficit of 3% of tax and non-tax revenues;
- The regional budget receives corporate income tax and personal income tax revenues at least at the 2017 level;
- Compliance with 2017 fiscal loans restructuring rules in 2018-2019.

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 the Region's GRP and average per capita income exceeding the national average rates;
- Reaching a sustainable deficit-free budget and by further reduction of the absolute debt amount;
- Growth of tax and non-tax revenues exceeding 4% a year.

A negative rating action may be prompted by:

- Growth of the mandatory expenses share in the budget and by decrease of the operating balance below 12% of regular income;
- Budget performance returns a deficit of more than 5%;
- Violation of the fiscal loans restructuring rules.

Credit rating rationale. In ACRA's opinion, the above bond issued by the Kostroma Region is senior unsecured debt instrument, and its credit rating is equal to the rating assigned to the [Kostroma Region](#).

Key issue properties

RegS / ISIN: **RU34007KOSO / RU000A0JU6N4**

Issue volume / outstanding	RUB 4 bln / RUB 450 mln
Final placement date / Repayment date	September 28, 2013 / September 28, 2018

Issue ratings

Regulatory disclosure

The credit ratings have been assigned to the Kostroma Region and to bond issued by the Kostroma Region (ISIN RU000A0JU6N4) under the national scale for the Russian Federation based on the [Methodology for Credit Rating 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](#). In the process of credit rating assignment to the above issue, the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation was also used.

For the first time, the credit rating of the Kostroma Region was published by ACRA on October 12, 2017. The credit rating has been assigned to government securities of the Kostroma Region (ISIN RU000A0JU6N4) for the first time. The credit rating and its outlook are expected to be revised within 182 days after the rating action date (April 10, 2018) in compliance with the [2018 calendar of planned sovereign credit rating revisions and publications](#).

The assigned and affirmed credit ratings are 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 ratings are solicited, and the Kostroma Region Administration participated in their assignment.

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

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

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