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Key rating assessment  
factors

## ACRA affirms Kostroma Region at BBB-(RU), outlook Stable, and withdraws rating on bond issue

The credit rating of the [Kostroma Region](#) (hereinafter, the Region) indicates the very high debt load, limited flexibility of budget expenditures and weak economic indicators of the Region as compared to national averages. The credit rating is supported by the smooth debt repayment schedule and the low debt refinancing risk forecasted until 2023.

The Kostroma Region is located in the Central Federal District. The Region's population is about 0.4% of the total Russian population. The gross regional product (GRP) of the Region is about 0.2% of the aggregate GRP of all Russian regions.

**Very high debt load with low debt refinancing risk.** By the end of 2018, the ratio of debt to operating balance will exceed 4x (and forecasted at 4.3x–4.5x by late 2019 and 2020). The current debt repayment schedule (as of October 01, 2018) suggests that, over the next four years, the annual share of debt that needs to be refinanced will not exceed 11% of the total debt. Therefore, in this period, the ratio of operating balance less interest payments to debt repayments will exceed 3x (no refinancing risk). Under the agreements with the Ministry of Finance of Russia, the Region's debt should not exceed 100% of its own revenues by 2020, otherwise, the debt repayment schedule would slightly change (the Region would pay about 15% of the total debt annually), while the debt servicing costs would increase by about a quarter annually. In 2023, the Region is to refinance almost a half of its debts, most of which are long-term bank loans.

**Low flexibility of budget expenditures; dependence on federal transfers.** The average share of own revenues is about 71% for the period from 2015 to 2018 (this year the share was analyzed excluding the increase in the subsidy for partial compensation of additional expenses for raising salaries of public sector employees and other goals). The above subsidy, which actually is not a target subsidy, will allow the Region to finance current expenditures and, possibly, to achieve a deficit-free budget. The operating balance of the Region, which is under pressure from a rather high proportion of mandatory expenditures (73%), is tending to increase on stricter control over mandatory expenditures and increasing regular revenues. In 2017–2018, the Region budget capital expenditures will be 15%.

In early 2018, the Region budget's regime was changed to "treasury supervision." ACRA notes that the treasury supervision regime restricts budget expenditures, but it is not aimed at higher budget revenues. Therefore, the Agency is neutral about the outcome of the treasury supervision regime in respect of regional budget expenditures.

**Weak but diversified economy.** The regional economy is dominated by woodworking, metals, jewelry, food, and electricity industries. At the same time, the GRP per capita and per capita incomes are critically low: 53.6% and 74.7% of the national averages in 2014–2017, respectively.

Key assumptions

- The subsidy to compensate growing expenditures for higher public sector salaries is a one-off event;
- The 2018 budget deficit will not exceed 3% of tax and non-tax revenues;
- The regional budget will receive about 3–5% more revenues through corporate income tax and personal income tax in 2018;
- Compliance with 2017 fiscal loans restructuring rules in 2019–2020, the Region will comply with the budget loan restructuring rules set forth by the agreements with the RF Ministry of Finance 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:

- A sustainable deficit-free budget and further reduction in the absolute debt;
- Annual growth of tax and non-tax revenues exceeding 5%.

### A negative rating action may be prompted by:

- Higher share of mandatory budget expenditures, and the operating balance going below 12% of regular revenues;
- Budget deficit that requires increasing the debt load;
- A breach of the budget loan restructuring rules, entailing acceleration of a part of the debt and increase in interest expenses.

## Issue ratings

**Credit rating withdrawal rationale.** The credit rating on the bond (ISIN RU000A0JU6N4) issued by the Kostroma Region was withdrawn because the above bond issue was redeemed in full.

## Regulatory disclosure

The credit ratings were 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 order to assign a credit rating to the above bond issue, the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation was also applied.

For the first time, the credit ratings of the Kostroma Region and the government bond (ISIN RU000A0JU6N4) issued by the Kostroma Region were published by ACRA on October 12, 2017 and April 12, 2018. The credit rating of the Kostroma Region and its outlook are expected to be revised within 182 days after the rating action date (October 09, 2018) in compliance with the [Calendar of planned sovereign credit rating revisions and publications](#).

The credit rating was assigned based on the data provided by the Kostroma Region Administration, 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 Administration participated in its 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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