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Key rating assessment factors

Key assumptions

Potential outlook or rating change factor

ACRA affirms BBB-(RU) to the Kostroma Region, changes outlook to Positive

The change in the credit rating outlook of the [Kostroma Region](#) (hereinafter, the Region) is based on the effective measures taken by the Region to reduce debt load. The credit rating remains restricted by the Region's high debt load, low flexibility of budget expenses, and comparatively weak economic development. The credit rating is supported by the Region's smooth debt repayment schedule through 2023.

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

A declining, yet still very high debt load and smooth long-term debt repayment schedule. The Region's expected debt to operating balance ratio should not exceed 3.6x for 2019, compared to 4.7x a year earlier. The Region can reduce its debt load by reducing the absolute amount of its debt; as of September 1, 2019, it had already decreased by 7%, or RUB 1.4 bln. To do this, the Region will use account balances, since the current version of the budget law does not provide for a significant surplus. The current debt repayment schedule (as of September 1, 2019) assumes that over the next three years, the annual volume of the Region's debt refinancing will not exceed 13% of the total debt. In 2023, the Region will have to refinance half of its debt, most of which is represented by long-term bank loans. According to agreements with the Ministry of Finance, the Region's debt should be less than 100% of its proprietary revenues by 2020. ACRA expects that the Region will be able to meet these requirements.

Low flexibility of budget expenses, dependence on federal transfers. Since 2018, the Region has received a large part of its budget from transfers that had not previously been provided (off-target transfers for partial compensation of additional expenses to raise the salaries of public sector employees, as well as other purposes). In addition, transfers for capital expenses have increased significantly in 2019. Thus, the Region maintaining budget revenue growth is mainly due to the increase in transfers, and budget discipline is largely dependent on federal funds. Revenues excluding subventions have decreased as a result of increased transfers. However, the Region's operating balance to regular revenues ratio has increased. Mandatory budget expenses are high, averaging 74% in 2016-2018 and according to the planned values for 2019. This indicates low flexibility in budget expenses.

The Federal Treasury has supported the Region's budget since 2018. ACRA notes that this support regulates the execution of expenses and does not aim to contribute to the growth of budget revenues. Therefore, ACRA assesses this support of regional budget expenses as neutral.

Weak but diversified economy. The regional economy is dominated by the wood processing, metal, jewelry, food, and electricity industries. At the same time, GRP per capita and per capita income are low (around 52% and 74%, respectively, of the national averages for 2015-2018).

- Off-target transfers for partial compensation of additional expenses to raise the salaries of public sector employees, as well as other purposes, provide only temporary assistance to the Region's budget;
- Adhering to the 2017 budget loan restructuring agreement in 2019-2020.

The **Positive outlook** assumes that the rating will most likely change within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Sustainable deficit-free budget excluding temporary transfers;
- Decline in the ratio of debt to operating balance not exceeding 3.5x.

A negative rating action may be prompted by:

- Increased mandatory expenses and decreased operating balance going below 12% of regular revenues;
- Budget deficit that requires financing via increased relative debt load;
- Violation of the budget loan restructuring agreement with partial prepayment of debt and increased interest expenses.

Regulatory disclosure

The credit rating was assigned to the Kostroma Region 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](#).

The credit rating of the Kostroma Region was published by ACRA for the first time on October 12, 2017. The credit rating of the Kostroma Region and its outlook are expected to be revised within 182 days following the publication date of this press release as per the [Calendar of planned sovereign credit rating revisions and publications](#).

The credit rating was assigned based on 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 provided data and 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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