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Fiscal loans of Russian regions: write-off or restructuring?

Restructuring of fiscal loans to have a positive effect on credit quality of the regions with a substantial share of such loans in their debt structure

Restructuring of fiscal loans of Russian regions

Revising repayment schedule for some of regional debts to the federal budget (49.6% of the total debt of regions as at September 1, 2017) will reduce debt loan of regional budgets and, in ACRA's opinion, have a positive effect on the creditworthiness of certain constituent entities. In fact, this is about long-term restructuring and partial write-off of 70% of the subfederal debt. As at end of Q3 2017, the total debt of regions to the federal center was a little over RUB 1 trillion, RUB 700 mln of which are subject to restructuring according to the new rules: for 7 or 12 years depending on the region's economic growth rates.

Time subordination (extending repayment dates) of the federal debt of regional authorities for the benefit of banks and bondholders will enable constituent entities to improve their debt structure and reduce budget deficit. By implementing this measure, debt repayment expenses of regional authorities to the federal center will be cut from the previously planned RUB 250-300 bln in 2018 to the estimated RUB 36.8 bln in 2018-2019 (5% annually of the accumulated debt of regions to the Ministry of Finance). Subsequent repayments of 10% (RUB 73.7 bln) in 2020 and 20% (RUB 147.4 bln) annually until 2024 also represent no significant threat to regional budgets.

In addition to debt restructuring, constituent entities of the Russian Federation will also benefit from partial inflationary write-off of fiscal loans. As the restructured debt is in fact interest-free (fiscal loans are issued at 0.01% p.a.), by virtue of inflationary depreciation the constituent entities will save from RUB 108 bln or 15.2% of restructured fiscal loans (in a 7-year restructuring program) to RUB 181 bln or 25.6% of restructured fiscal loans (in a 12-year restructuring program) with an official inflation projection of 4%. If prices accelerate, the restructured fiscal loans will cost the regions even cheaper. The restructuring period is determined on the basis of tax and non-tax revenue dynamics against inflation in the consolidated budgets of constituent entities. Change of region administration's executive as an additional condition for a restructuring until 2029 extends the number of beneficiary regions considering recent staff reshuffling among executives in the constituent entities of the Russian Federation.

The announced easing measures can change the current debt market strategy of some of the Russian regions by lowering their needs in raising commercial debt in order to replace expiring federal loans. At the same time, ACRA expects no significant decline in the efforts of regions in the bond market in the long term. Although the actual amount of fiscal loans to be issued in 2018 is still not set in the proposed budget, the lending expenses of subfederal authorities, according to ACRA estimates, will not exceed RUB 100-150 bln considering the trend of continuously reducing appropriations under this item in the previous years.

It is worth noting that the federal government in its Order No.1109 dated September 18, 2017 extended the number of regions that are potential recipients of fiscal loans. This document sets forth lower requirements to the market debt reduction rates for the most debt-ridden regions with total debt exceeding 80% of own revenues.

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ACRA assessed fiscal loans restructuring probability as high (see ACRA research titled [Russian regions to favor bonds](), published on February 14, 2017).

This measure is totally in line with the logic of federal government actions: mass restructuring of fiscal loans and targeted aid to the regions that are most in need. The restructuring is not the first one for fiscal loans. Fiscal loans totaling RUB 50 bln issued in 2011 for construction and maintenance of motorways were extended in 2015. After that, the repayment period has changed to 2025-2034. Also, there were restructuring cases in the past involving fiscal loans issued to specific regions for specific purposes. For instance, loans issued to the Krasnodar Krai as part of preparations to the 2014 Olympics were extended. In 2017, some regions will see their fiscal loans restructured, which they received to finance preparations for international Olympic sporting competitions held in 2015 and 2016.

Fiscal loans issued in 2015-2017 are subject to restructuring. It is difficult to estimate the current level of debt to the federal budget, as the calendar period when regions may use loans from the Federal Treasury Department has not yet ended. By the end of November, these loans will be repaid from own funds of the regions (less often) or by credit lines raised from banks (more often). In addition, the seasonality of spending enables regions to reduce their debt during the year.

Regions with the highest share of fiscal loans in the total debt will benefit from the restructuring the most (Table 1).

Table 1. Regions with the highest share of loans potentially subject to restructuring (vs total debt as at September 1, 2017)

Region	Debt to be restructured vs accumulated debt as at September 1, 2017	Debt to tax and non-tax revenues ratio (as at year-end 2016)	Debt to be restructured, RUB bln
Kaluga Region	88%	85%	26,6
Chukotka Autonomous Okrug	84%	76%	9,4
Tver Region	78%	66%	13,7
St. Petersburg	77%	3%	6,1
Republic of North Ossetia-Alania	75%	91%	7,3
Altai Krai	70%	4%	1,5
Chechen Republic	69%	53%	3,8
Bryansk Region	69%	56%	7,0
Republic of Ingushetia	67%	77%	2,0
Perm Krai	65%	23%	8,2
Altai Republic	63%	51%	1,0
Republic of Adygea	62%	36%	1,8
Primorsky Krai	61%	9%	3,8
Vologda Region	60%	71%	16,7
Vladimir Region	57%	10%	1,8

Source: Ministry of Finance, Federal Treasury, ACRA estimates

However, regions with the highest debt load (debt to tax and non-tax revenues ratio as at year-end 2016) have a small share of fiscal loans and can look to no fundamental changes in their debt servicing profile (Table 2).

Table 2. Significance of fiscal loans restructuring for Russian regions with the highest debt load*

Region	Debt to tax and non-tax revenues ratio (as at year-end 2016)	Debt to be restructured vs accumulated debt as at September 1, 2017	Debt to be restructured, RUB bln
Republic of Mordovia	176%	29%	13,2
Republic of Khakassia	145%	12%	2,9
Kostroma Region	143%	34%	7,3
Astrakhan Region	135%	46%	12,1
Republic of Korelia	115%	50%	11,2
Smolensk Region	113%	51%	15,8
Mari El Republic	101%	31%	4,1
Jewish Autonomous Region	101%	23%	1,3
Pskov Region	99%	33%	5,1
Udmurt Republic	96%	33%	16,3
Republic of Kalmykia	95%	40%	1,7
Kirov Region	95%	56%	15,6
Oryol Region	95%	10%	1,6
Zabaykalsky Krai	92%	53%	14,6
Republic of North Ossetia-Alania	91%	75%	7,3

*based on total debt to tax and non-tax revenues ratio as at year-end 2016

Source: Ministry of Finance, Federal Treasury, ACRA estimates

The regions mentioned in the table above appear to be forced to continue refinancing their debt using market instruments.

See ACRA research titled [Private pension funds outpaced state peers by assets in 2016 and will outperform them by the number of policies by 2020], published on May 23, 2017.

Subfederal borrowers were increasingly active on the debt market over the 9-months period of 2017, including debut issues by regions that have never before used bonds to finance their budget deficits. For the period from January to September 2017, the nominal amount of bond issues was more than 1.5x higher than for the same period of 2016. According to ACRA estimates, the amount of issues by constituent entities and municipalities of the Russian Federation on the bond market will be close to RUB 300 bln in 2018, which is almost twice as much as in 2016. This segment of the bond market will also benefit from the expected increased interest to it from non-state pension funds and asset management companies due to insufficient coverage of the corporate sector is by national ratings, and the banking sector is now going through turbulent times.