

October 10, 2019

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## Key rating assessment factors

# ACRA affirms BBB-(RU) to the Magadan Region, outlook Stable, and BBB-(RU) to bond issue

The credit rating of the [Magadan Region](#) (hereinafter, the Region) is based on the Region's high debt load, low economic diversification, and low operating balance. The high cost of living coupled with the need to import most goods, as well as the small effect of the gold mining sector (the core of the Region's economy) on other industries, limit the development of the regional economy.

The Magadan Region is located in the Far East Federal District and is part of the Far North Territory. The Region is home to 0.1% of the Russian population and its GRP accounted for roughly 0.2% of Russia's aggregate GRP in 2017. The Region produces over 10% of the total volume of gold mined in Russia, and nearly 60% of Russia's silver.

**Low budget discipline is due to low economic diversification, high living costs, and dependence on federal transfers.** The mining industry – the Region's leading sector – accounts for nearly 45% of the regional budget's tax revenues. The Region's average per capita income exceeds the national average by 1.7 times. However, high prices due to climate and logistics costs reduce the effect of this figure for the population. This causes a constant migration outflow; since 2005, the Region's population has decreased by almost 20%. The Region's budget is dependent on federal transfers. The share of proprietary budget revenues (excluding subventions) has averaged 68%<sup>1</sup> for 2016-2019. At the same time, the share of mandatory budget expenses is very high at 82% for the above-mentioned period. The share of capital expenses is low, averaging 6-8% for 2016–2019. In 2018, the Region's operating balance decreased due to the non-fulfillment of planned capital expenses. However, in 2019 it is expected to recover to the 2017 level.

**The Region's high debt load increases credit risk.** At the end of 2018, the Region's debt amounted to RUB 14.3 bln. The Region's draft budget for 2019 implies a slight decrease (by RUB 115 mln) in absolute debt for the year. According to ACRA, the Region's debt to operating balance ratio should be about 4.7x at the end of 2019, which corresponds to a high level of risk according to ACRA's methodology. Nevertheless, the relative debt load has decreased by more than 7x compared to the previous year. The ratio of debt service costs to operating balance should be about 22%. These forecasted values are based on the planned growth of the operating balance in 2019, the value of which depends on tax revenues from the production of non-energy minerals. For the six months of 2019, tax revenues from this sector increased by 46% compared to the same period of the previous year.

As of October 1, 2019, bank loans accounted for 43% of the Region's debt, while budget loans accounted for 33%, federal treasury loans for 17%, and bonds for 7%. The Region's repayment schedule is uneven and depends on the share of bank loans at the end of the year. The majority of payments, about 35% of the Region's debt, will come in 2021. This year, the Region held five auctions to attract bank loans, but failed to attract any funding. Limited access to external sources of liquidity and the need to replace federal treasury loans could lead to a liquidity deficit by the end of 2019.

ACRA notes that the Region is at high risk of repeatedly violating the rules on budget loan restructuring in 2019. The draft budget meets the targets of the Ministry of Finance, but there is no room for maneuver. A slight decrease in proprietary revenues or an increase in debt would lead to repeated non-fulfillment of obligations to the Ministry of Finance. Nevertheless, early repayment of the amount exceeding the limits of the public

<sup>1</sup> Budget indicators were analyzed excluding the transfers from RusHydro PJSC in 2017–2020 under the program aimed at attaining base tariffs in the Far East Federal District.

debt and its replacement with market debt in the short-term will not have a significant impact on the Region's credit rating.

ACRA also notes the continuing growth of overdue loans, which amounted to RUB 3.7 bln as of the last reporting date.

## Key assumptions

- Executing the budget with a deficit of about 2% of tax and non-tax revenues (TNTR) at the end of 2019;
- Growth of tax revenues at a rate no lower than inflation;
- Executing planned capital expenses in 2019;
- Meeting budget loan restructuring requirements.

## 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:

- Significant increase in tax revenues compared to 2018 without an equivalent increase in mandatory expenses;
- Reduced debt load;
- Decrease in overdue loans;
- Increased liquidity.

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

- Violating the terms of budget loan restructuring, entailing forced budget measures other than early repayment of the amount exceeding the limits of the public debt;
- Executing the budget in 2019 with a deficit of more than 2% TNTR;
- Increased mandatory expenses not supported by increased budget revenues, and capital expenses below the average for 2015-2018.

## Issue ratings

[Magadan Region, 35001 \(ISIN RU000A0ZYL48\)](#), maturity date: December 25, 2022, issue volume: RUB 1 bln — **BBB-(RU)**.

**Rationale.** In ACRA's opinion, the bond listed above is a senior unsecured debt instrument, the credit rating of which corresponds to the credit rating of [Magadan Region](#).

## Regulatory disclosure

The credit ratings were assigned to the Magadan Region and bond issued by the Magadan Region (RU000A0ZYL48) 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 applied.

The credit ratings of the Magadan Region and bond issued by the Magadan Region (RU000A0ZYL48) were published for the first time by ACRA on April 26, 2018.

The credit rating of the Magadan Region and its outlook as well as the credit rating of the bond issued by the Magadan Region (RU000A0ZYL48) 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 ratings were assigned based on data provided by the Magadan 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 Magadan Regional Government participated in their assignment.

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

ACRA provided no additional services to the Magadan Regional Government. No conflicts of interest were discovered in the course of credit rating assignment.

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