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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 low operational efficiency of the regional budget combined with a significant need for debt financing, a moderately low level of capital expenditures, and low available liquidity. The rating is limited by the high concentration of the region economy on the extractive sector and a moderately high debt load.

The Magadan Region is located in the Far Eastern Federal District (FEFD) and is part of Russia's Far North. The Region is home to around 140,000 people (0.1% of the Russian population). According to the Region, its gross regional product (GRP) was approximately RUB 182 bln in 2019 (roughly 0.2% of Russia's aggregate GRP). The Region produces over 10% of the total gold mined in Russia, and around 60% of the country's silver.

Moderately weak budget profile and stable need for debt financing. The Region's budget law¹ assumes 13% growth (+RUB 3.1 bln) of tax and non-tax revenues (TNTR) in 2020. When coupled with 4% growth of transfers (+RUB 0.7 bln) compared to 2019, this increases the income part of the Region's budget by 10% (+RUB 3.7 bln) compared to the year before. Year-on-year growth of expenditures by 13% (+RUB 4.9 bln) is expected, and the Region will finance almost all of its planned deficit (4% of TNTR, RUB 1.0 bln) through borrowing.

The Region's internal revenues grew by 22% over the first seven months of 2020 compared to the same period in 2019. The largest growth in revenues came from profit tax (+26%) due to high prices for precious metals extracted in the Region. Income tax revenues increased by 4%, while proceeds from aggregate income and property tax remained practically unchanged. At the same time, transfers grew by 39%. Budget expenses increased by 20%, and as of 7M 2020, the budget deficit amounted to 4% of TNTR (RUB 0.6 bln).

ACRA expects that this year, the regional budget's tax revenues may grow to a smaller extent than stipulated by the current version of the budget law, and this will impact expenses. In addition to this, ACRA notes the high volatility of precious metals prices, which may have an adverse effect on the Region's income. According to ACRA's assessment, the 2020 budget deficit may exceed the target and will be financed primarily through increased borrowing.

The balance of the current operations to current income² ratio for the analyzed period stands at -2%. The averaged³ value of this indicator in 2017–2021 should be moderate (2%), however, the averaged ratio of the modified budget deficit to current income in the same period should remain negative (-2%). At the end of 2019, this indicator amounted to -1.3%, and may reach -1.6% at the end of 2020. This indicates that the budget has a consistent need for additional debt finance.

The averaged share of TNTR in income (excluding subventions) should amount to 63% in 2017–2021. The share of capital expenditures in 2020 is expected at 7%, which is similar to the figure for 2019. The averaged value of this indicator stands at a moderate 6%.

The debt repayment schedule is a source of medium-term refinancing risks. Over eight months of the current year, the Magadan Region's debt increased by RUB 463 mln and amounted to RUB 14.6 bln as of September 1, 2020. The structure of the debt portfolio in the aforementioned period remained practically unchanged, with budget loans accounting

¹ Magadan Region Law No. 2452-OZ (amended on July 29, 2020) "On the Regional Budget for 2020 and Planned Period of 2021 and 2022" dated December 26, 2019

² Hereinafter, income and expenses do not include transfers from PJSC RusHydro provided in 2017–2020 under the program for achieving basic tariff levels in the regions of the FEFD.

³ Hereinafter, averages are calculated according to the [Methodology for Credit Ratings Assignment to Regional and Municipal Authorities of the Russian Federation](#).

for 33% of debt, bank loans — 60%, and bonds — 7%. The debt repayment peak (50%) will fall in 2022, and the Region will have to repay RUB 829 mln (6% of debt) by the end of 2020. However, ACRA assumes that the Region will be exempted from repaying its budget loans, and as a result, the repayment volume will decrease by RUB 529 mln. Given the current budget loan restructuring schedule, over the next three years the Region must repay or refinance 86% of its debt. In addition, repayments planned for 2021 amount to 30% of total debt (RUB 4.4 bln).

At the end of 2019, the Region's debt to current income ratio stood at 43%. ACRA expects this indicator to grow to around 46% in 2020 (the debt to TNTR ratio may exceed 65%). The Region's interest expenses are not burdensome: the averaged level of interest expenses in 2017–2021 will amount to around 2% of total budget expenses (excluding subventions).

Since 2019, on average the Region's account balances have covered no more than 7% of monthly expenses of the regional budget, and amounted to RUB 100 mln at the start of 2020. As of September 9, 2020, the Region had access to revolving credit lines to a total of RUB 5.6 bln. The use of loans from the Federal Treasury Department and autonomous and state-financed institutions will allow the Region to avoid possible cash gaps.

ACRA notes that the Region has a considerable volume of overdue payables. They amounted to RUB 3.5 bln as of January 1, 2020, and RUB 3.8 bln as of August 1, 2020.

The Region's economic profile is highly concentrated on the mining of precious metals. The mining industry, the Region's leading sector, accounts for nearly 42% of the regional budget's tax revenues, according to ACRA's assessment. In 2019, the five largest taxpayers in the Region all operated in this sector. The averaged monthly wage to subsistence wage ratio in the Region exceeded 400% in 2016–2019. Historically, the average wage in the Region has exceeded the subsistence wage by more than 3.5x. However, high prices due to climate and logistics costs offset the effect of this figure for the population. This causes a constant migration outflow; from 2005 to early 2020, the Region's population decreased by almost 20%. At the same time, high wages in the Region provide for the collection of comparatively high personal income tax revenues. In 2015–2018, the Region's average per capita GRP was more than double the national average.

Key assumptions

- Growth of TNTR by at least 3% compared to 2019;
- Lower budget expenses amid a possible shortfall in income;
- Transfers to the regional budget at a level no lower than planned;
- Execution of the 2020 budget with a deficit of no more than 6% of TNTR;
- Debt growing by no more than 10% in 2020 compared to 2019.

Potential outlook or rating change factors

The **Stable outlook** assumes that the credit rating will most likely remain unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Stable growth of budget liquidity;
- Extension of the debt repayment schedule and reduction of debt load coupled with a reduction in the level of overdue payables.

A negative rating action may be prompted by:

- Growth of debt load;
- Lower share of internal revenues in the budget;
- Lower modified budget deficit indicator.

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 of the Magadan Region is a senior unsecured debt instrument, the credit rating of which corresponds to the credit rating of the [Magadan Region](#).

Regulatory disclosure

The credit ratings of the Magadan Region and the bond issued by the Magadan Region (ISIN RU000A0ZYL48) have been assigned under the national scale for the Russian Federation based on the [Methodology for Credit Ratings 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 [Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments Under the National Scale for the Russian Federation](#) was also applied when assigning the credit rating to the above issue.

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

The credit rating of the Magadan Region and its outlook and the credit rating of the bond issued by the Magadan Region (ISIN RU000A0ZYL48) are expected to be revised within 182 days following the publication date of this press release in compliance with the [Calendar of planned sovereign credit rating revisions and publications](#).

The credit ratings were assigned based on the data provided by the Government of 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 Government of the Magadan Region participated in the rating process.

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

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

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