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ACRA upgrades the Sverdlovsk Region to A-(RU), outlook Stable, and bond issues to A-(RU)

Leading analysts:

Andrey Piskunov, Senior Director
+7 (495) 139-0485
andrey.piskunov@acra-ratings.ru

Alexander Shurakov, Expert
+7 (495) 139-0345
alexander.shurakov@acra-ratings.ru

Key rating assessment factors

ACRA has upgraded the credit rating of the [Sverdlovsk Region](#) (hereinafter, the Region) based on a substantially declining budget debt, extended debt repayment schedule, and stably high budget discipline. The rating is restricted by high mandatory budget expenditures and a strong dependence of the regional economy on the investment intensive industries.

The Sverdlovsk Region is a part of the Urals Federal District, bordering seven other administrative entities of the Russian Federation. The Region's population is about 4.3 million people (2.95% of the total population of the Russian Federation, the 5th place in the Russian Federation). In 2015, the regional GRP amounted to RUB 1.8 trillion (2.7% of the total GRP of the regions of the Russian Federation, the 6th place in the Russian Federation). The backbone of the regional economy is manufacturing sector (30.5% of GRP in 2016), in particular mechanical engineering, ferrous and non-ferrous metallurgy.

Extended debt repayment schedule and lower budget debt burden. Bank loans have been replaced by bond issues and budgetary loans have been restructured, which have improved the debt profile and repayment schedule. To date, the total debt due for repayment in 2018–2019 is 22% of the total debt of the Region (36% before the change in the debt repayment profile). ACRA also notes a slowdown in the debt growth rate to 5% in 2017 (+9% in 2016). In 2017, the Region's budget burden shrunk. The ratio of debt service costs to operating balance decreased to 7.8% in 2017 from 12.3% in 2016, while the ratio of total debt to operating balance amounted to 2.2 in 2017 compared to 2.3 in 2016.

Improving budget discipline and growing budget resistivity to economic shocks. The Region's budget is under pressure of a high share of compulsory expenditures (on average 80% in 2016–2017), substantial relying on own resources (as the share of own revenues has grown from 91% in 2014 to 95% in 2017). In addition, increasing operating balance (from 10% in 2014 to 16% in 2017) indicates a growing capacity to absorb negative external effects on the budget revenues, through a stricter control over expenditures. The Capex share was stable in 2014–2017.

Well-developed regional economy, the backbone of which is mechanical engineering and metals industry. The regional metals and mechanical engineering industries are supported by the defense contracts and large infrastructure projects financed by the federal budget. In 2016, the industrial production index of the Region was 107.7% compared to that of 2015 (or 101.1% against the national average). In 2017–2019, new metal production and mechanical engineering facilities are expected to be commissioned, which will further boost the manufacturing potential of the Region. At the same time, per capita incomes and unemployment trends show a strong dependence on the investment demand sectors most affected by the 2014–2015 economic crisis, as the unemployment rate significantly exceeded the national average in 2014 (117%) and declined to 113% in 2016, and the per capita income decreased from 120% in 2013 to 114% in 2016 against the national average.

Sufficient budget liquidity amid declining annual turnover of short-term financing. The Region's need to attract treasury loans and short-term bank funding has declined over the past three years. The current budget liquidity is characterized as sufficient. The Region places deposits, and, according to ACRA estimate, the annual need for short-term funding does not exceed RUB 10 billion, which amount turns over up to four times a year.

Key assumptions

- Annual growth rate of the regional economy at about 5% in 2017–2019;
- Control over mandatory expenditures; budget deficit of not more than 5% of budget revenues;
- Growing share of market debt in the debt portfolio;
- Not less than 12% of capex in the total expenditures.

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:

- Declining unemployment; per capita income going up above the national average;
- A continued decrease in budget deficit and debt burden;
- The share of capital expenditures growing above 15%.

A negative rating action may be prompted by:

- Higher debt burden;
- 5%+ decline in tax and non-tax incomes against 2017 amid stable mandatory expenditures;
- 5%+ growth of mandatory budget expenditures against 2017.

Issue ratings

[Sverdlovsk Region, 35003 \(ISIN RU000A0JWZ77\)](#), maturity date: November 15, 2024, issue volume: RUB 5 bln — **A-(RU)**.

[Sverdlovsk Region, 35004 \(ISIN RU000A0ZYDU3\)](#), maturity date: October 22, 2025, issue volume: RUB 10 bln — **A-(RU)**.

Rationale. ACRA is of the opinion that the above bonds issued by the Sverdlovsk Region are senior unsecured debt instruments, which credit ratings are equal to that of the [Sverdlovsk Region](#).

Regulatory disclosure

The credit ratings of the Sverdlovsk Region and bonds (ISIN RU000A0JWZ77, ISIN RU000A0ZYDU3) issued by the Sverdlovsk Region under the national scale for the Russian Federation were assigned and upgraded based on the [Methodology for Credit Ratings Assignment to Regional and Municipal Authorities of the Russian Federation](#), and the [Key Concepts Used by Analytical Credit Rating Agency within the Scope of Its Rating Activities](#). In the course of assigning a credit rating to the bond issues above, the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation was also used.

The credit rating of the Sverdlovsk Region and the credit ratings of the government bonds (ISIN RU000A0JWZ77, ISIN RU000A0ZYDU3) issued by the Sverdlovsk Region were first published by ACRA on September 08, 2017 and October 24, 2017, respectively.

The credit rating of the Sverdlovsk Region and its outlook, as well as the credit ratings of the government bonds (ISIN RU000A0JWZ77, ISIN RU000A0ZYDU3) issued by the Sverdlovsk Region are expected to be revised within 182 days following the rating action date (March 05, 2018) as per the [2018 Calendar of planned sovereign credit rating revisions and publications](#).

The credit ratings were assigned and upgraded based on the data provided by the Sverdlovsk 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 Sverdlovsk Region Government participated in the rating process.

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

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

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Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)
75, Sadovnicheskaya embankment, Moscow, Russia
www.acra-ratings.com

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