

April 2015, Frankfurt am Main.

**METHODOLOGY FOR ASSIGNING CREDIT RATINGS TO REGIONS -  
SHORT PUBLIC VERSION**

**The Methodology presented is a short public version.**

**1. General definitions**

**Credit rating** of a region represents opinion of **Rating-Agentur Expert RA GmbH** on the ability of the region to fulfill its financial liabilities fully and in a timely manner.

The main risk factors, which according to the Agency's opinion can lead to a default on the region's liabilities, as well as the possible consequences for the region's development, are listed in the scheme on page 2.

This methodology is intended for assigning ratings to a region by determining to which creditworthiness (rating) class this region belongs to.

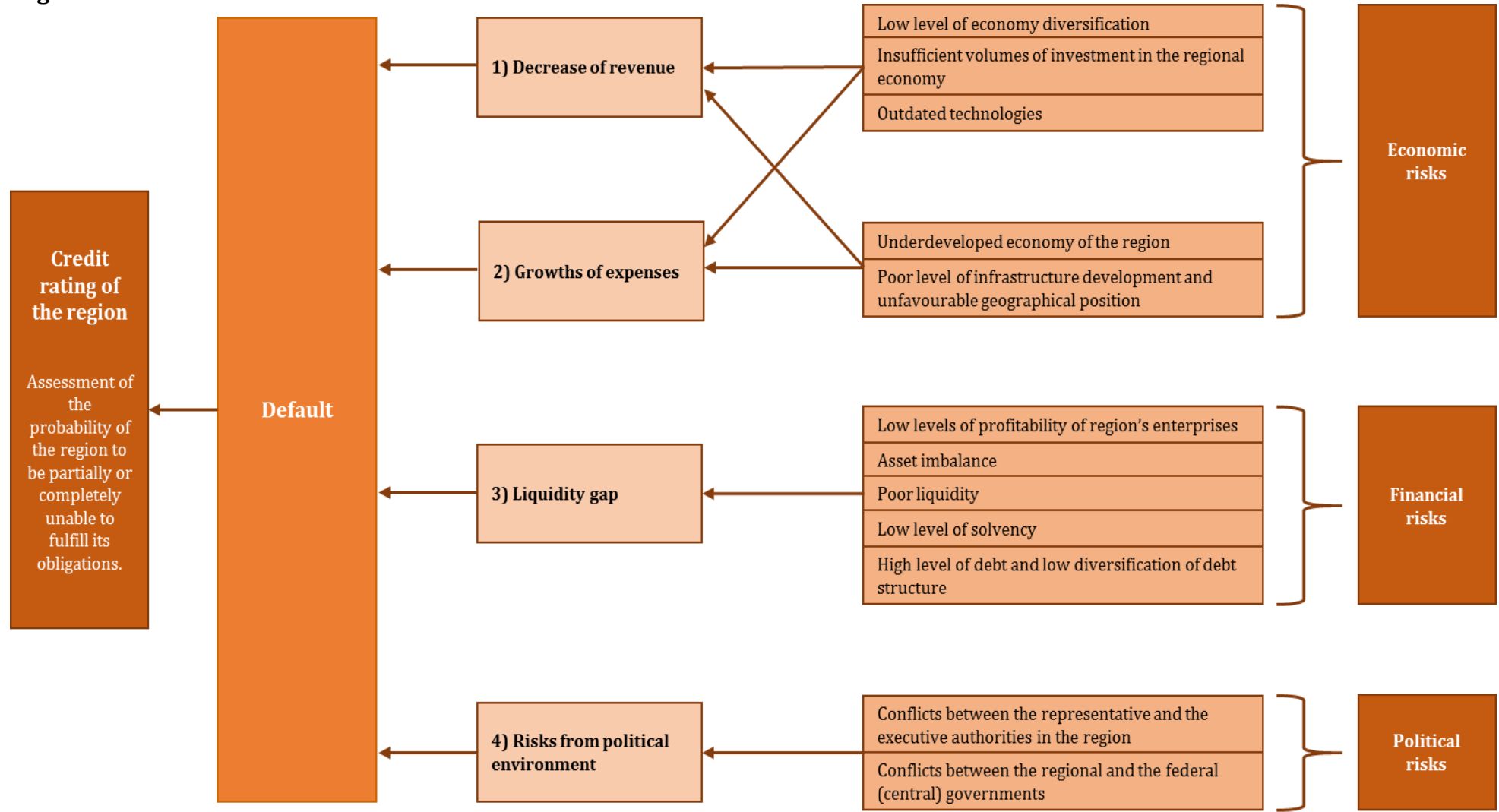
The rating is a complex discrete assessment of the region's activities, recognized by all stakeholder groups with different interests and qualifications.

Main users of the rating are region's creditors. Other users are investors and counterparties of the region whose interest is focused on the possibility of full and timely fulfillment of the region's liabilities, as well as the region's prospects for fulfillment of new liabilities (taking into account possible changes in the economic environment).

The rating is intended to be used by the administration of the region for assessing the efficiency of its work.

Only the region's rating and a brief conclusion about the region's creditworthiness (press-release on the rating) are published in the media. A full rating report containing confidential information is delivered to the administration of the region (delivered to the responsible person in charge of signing the rating agreement) and may be used only with its permission.

**Logic scheme:**



## 2. Sources of information

2.1. While assigning the rating score, the following sources of information are used:

- Annual reports on the region’s consolidated budget execution and the execution of budgets of state territorial off-budgetary fund<sup>1</sup> for three years preceding the rating assignment;
- Extracts from the book of regional government debt as of the last reporting date, as of the end of the last completed year and for two previous years;
- Standard questionnaire;
- Prospectuses for scheduled or circulated bond emissions.

2.2. The Rating Agency does not check the correctness of the reports provided by the region and reliability of the data contained therein.

2.3. The Agency may contact the region’s administration for clarifications of the indicators and data provided in the reports and questionnaire.

2.4 The Agency has the right to use other sources of information in case of data incompleteness.

## 3. Structure of the rating analysis

3.1 The scheme of the region’s creditworthiness analysis has several levels. The region’s creditworthiness analysis is based on the assessment of three main groups of factors: **1. Social and economic risks analysis; 2. Financial risks analysis; 3. Political risks analysis.** Each group is divided into several large integral factors.

3.2 Several indicators are analyzed within the framework of analysis of each integral factor. Scores for the indicators within each integral factor may be equal to one of the following values:

1	The factor (indicator) has positive influence on the creditworthiness level
0,5	The factor (indicator) has moderately positive influence on the creditworthiness level
0	The factor (indicator) has neutral influence on the creditworthiness level
-0,5	The factor (indicator) has moderately negative influence on the creditworthiness level
-1	The factor (indicator) has negative influence on the creditworthiness level

3.3 The score for each integral factor is determined as a sum of scores for separate indicators within a group being weighted in a certain manner. Weights of indicators are provided in the **List of indicators and corresponding weights** (page 6).

3.4 Benchmarks for each indicator are based on the data for all regions of a particular country, and then the score is assigned on the basis thereof. If the indicator for the region cannot be assessed directly according to the algorithm provided in this methodology, the

<sup>1</sup> For Russian regions: state territorial off-budgetary fund is a fund, which is formed out of the region’s budgets and is intended for financing constitutional rights of citizens. According to the Budget Code of the Russian Federation: state territorial off-budgetary funds include territorial compulsory health insurance funds.

expert shall use a similar indicator for local statistical or fiscal standards or assess this indicator based on his/ her reasoned opinion.

3.5 The **rating score** (according to the national scale) is determined as a weighted sum of scores for all integral factors.

3.6 The ratings assigned in accordance with the national scale shall be transferred to the international scale through the adjustment for the Country credit environment rating (CCE) in foreign currency (according to the “Instruction for transferring ratings from national to international scale”). Rating-Agentur Expert RA GmbH **publishes only final ratings in accordance with the international scale**. The rating of a region according to the international scale can't be higher than the Sovereign government credit rating of the country where this region is located.

#### 4. System of indicators

##### 4.1 Section “*Social and economic risks analysis*”

- The size and structure of the economy
  - Gross regional product (GRP)<sup>2</sup> per capita
  - Gross regional product (GRP) structure
- Demographic characteristics
  - Population
  - Dependency ratio<sup>3</sup>
- Characteristics of the labor market
  - Average salary
  - Unemployment rate (according to the methodology from the International Labor Organization)
- Level of infrastructure development and geographical location
  - Proximity of the region to the capital
  - Road density
  - Availability of big sea ports<sup>4</sup>
- Investment climate
  - Rating of investment attractiveness
  - Investments per capita
  - Foreign investments per capita

##### 4.2 Section “*Financial risks analysis*”

---

<sup>2</sup> Gross regional product - analogue of GDP for regions/ territories inside the country (the same as regional GDP).

<sup>3</sup> Dependency ratio is a measure which shows the number of dependents (aged 0-14 and over the age of 65) to the total population (aged 15-64). Also referred to as the "total dependency ratio".

<sup>4</sup> Only for regions from countries which have access to the sea. For land-locked countries availability of big transport nodes and river ports shall be assessed.

The structure of financial risks analysis provided in the methodology is intended for regions from countries with a fiscal federalism system. For regions of countries with another type of budget system, the algorithm of assessment of some indicators can be different.

- Budget balance
  - Volume of revenues
  - Structure of the budget expenses
  - Budgetary deficit/ surplus
  - Share of transfers from the higher budget level in the revenues structure of the consolidated regional budget
  - Structure of transfers from the higher budget level
  - Structure of the tax revenues
  - The volume of taxes collected on the territory of the region<sup>5</sup>
  - The level of tax collection<sup>6</sup> for taxes collected on the territory of the region<sup>7</sup>
  - The quality of budget planning<sup>8</sup>
- Debt load
  - The ratio of debt to own budget revenues (total revenues minus transfers from the higher budget level)
  - Share of debt servicing expenses in the region's expenses
  - The ratio of debt to the value of regional government's property
  - Debt structure by maturity
  - Debt structure by lenders
  - Currency structure of the debt
  - Credit history

#### 4.3 Section ***“Political risk analysis”***

- Risks of conflicts between representative and executive authorities of the region
- Risks of conflicts between regional and federal (central) governments

---

<sup>5</sup> Full name of this indicator: The volume of taxes collected on the territory of the region and transferred to all budget levels.

<sup>6</sup> The level of tax collection is assessed by the ratio of tax payments received in a certain period to the volume of tax liabilities that must be incurred in the same period according to the law.

<sup>7</sup> The full name of this indicator: The level of tax collection for taxes collected on the territory of the region and transferred to all budget levels.

<sup>8</sup> Expert assessment is based on the deviation of actual budget figures from planned budget figures (according to the budget execution).

## Annex 1. List of indicators and corresponding weights

Factors	Weight
<b>I. Social and economic risks</b>	<b>40,0%</b>
<b>The size and structure of the economy</b>	
<i>Gross regional product (GRP) per capita</i>	
<i>Gross regional product (GRP) structure</i>	
<b>Demographic characteristics</b>	
<i>Population</i>	
<i>Dependency ratio</i>	
<b>Characteristics of the labor market</b>	
<i>Average salary</i>	
<i>Unemployment rate (according to the methodology from the International Labor Organization)</i>	
<b>Level of infrastructure development and geographical location</b>	
<i>Proximity of the region to the capital</i>	
<i>Road density</i>	
<i>Availability of big sea ports</i>	
<b>Investment climate</b>	
<i>Rating of investment attractiveness</i>	
<i>Investments per capita</i>	
<i>Foreign investments per capita</i>	
<b>II. Financial risks</b>	<b>50,0%</b>
<b>Budget balance</b>	
<i>Volume of revenues</i>	
<i>Structure of the budget expenses</i>	
<i>Budgetary deficit/ surplus</i>	
<i>Share of transfers from the higher budget level in the revenues structure of the consolidated regional budget</i>	
<i>Structure of transfers from the higher budget level</i>	
<i>Structure of the tax revenues</i>	
<i>The volume of taxes collected on the territory of the region</i>	
<i>The level of tax collection for taxes collected on the territory of the region</i>	
<i>The quality of budget planning</i>	
<b>Debt load</b>	
<i>The ratio of debt to the own budget revenues (total revenues minus transfers from the higher budget level)</i>	
<i>Share of debt servicing expenses in the region's expenses</i>	
<i>The ratio of debt to the value of regional government's property</i>	
<i>Debt structure by maturity</i>	
<i>Debt structure by lenders</i>	
<i>Currency structure of the debt</i>	
<i>Credit history</i>	
<b>III. Political risks</b>	<b>10,0%</b>
<b>Risks of conflicts between representative and executive authorities of the region</b>	
<b>Risks of conflicts between regional and federal (central) governments</b>	

\*See Point 5 "Rating score adjustment" in the description above.