

Rating-Agentur Expert RA GmbH assigned 'BB' credit rating to Krasnodar Region according to the international scale. The rating outlook is stable.

Rating-Agentur Expert RA GmbH assigned 'BB' (Sufficient level of creditworthiness) credit rating according to the international scale to Krasnodar Region. The rating outlook is stable which means that in the mid-term perspective the likelihood of the credit rating stability is high.

MAJOR FACTORS THAT INFLUENCED RATING:

Positive factors:

- Structure of the region's debt is fully formed by local currency with a high share of long-term loans. Additionally, around 40% of total debt are loans issued by the Ministry of Finance of the Russian Federation, debt which may be rolled over or restructured with high probability;
- Improving fiscal performance of the region with the consolidated budget surplus equal to 0,9% of total revenues or 1,1% of own budget revenues in 2016, which is a significant enhancement when compared to a deficit of 7,2% and 8,6% respectively a year ago. This positive dynamic is explained by an increase in tax revenues (mostly profit tax and excises) as well as a one-year non-tax increase from the revenue side, combined with a conservative spending policy from the expenditure side;
- Positive structure of the budget revenues with reduced share of transfers equal to 12,8% of consolidated budget revenues in 2016 and high level of tax revenues diversification by types of taxes and industries;
- Large and well diversified economy with a high share of "defensive" (non-cyclical) industries positively influencing the region's tax base: transport, agriculture and food production formed more than 30% of gross regional product in 2015;
- High level of investment attractiveness: Krasnodar Region occupied the number one position in the rating of Investment attractiveness by RAEX-Moscow (the region with the lowest investment risks);
- Outstanding geographical location with access to the Black Sea combined with a high level of infrastructure development, underpinned by elevated road density as compared to the country average.

Restricting factors:

- Elevated share of debt servicing expenditures at 3,5% of total expenditures of the consolidated budget of the region against 1,5% average for Russian regions in 2016;
- Reduced quality of regional budget management according to the national definition. Krasnodar Region was described as a region with "low quality of budget management" by the 2015 results according to the assessment by the Ministry of Finance of the Russian Federation. In addition, it was included in the list of regions which violated the terms of the agreement on the budget loans provision¹ for two years in a row;
- Negative dynamic of investments in fixed capital between 2014 and 2016 related to the

¹ Since 2014 the Ministry of Finance of the Russian Federation started to issue loans to Russian regions with long-term maturity and interest rate at 0,1% in order to provide funds for commercial debt repayment. The agreement on such loans includes additional conditions for the regional government: stabilization of the debt ratio to own budget revenues at current levels; level of budget deficit must be limited by 10% of tax and non-tax revenues, etc.

end of the effect from the Olympics' related projects: the share of Krasnodar Region in total investments in Russia returned to its "pre-Olympic" values;

- Moderate level of nominal wages combined with increasing share of "shadow" revenues in the structure of net personal income. The share of "other" income, which includes "hidden" revenues and remittances in national classification, increased from 34,8% in 2010 to 40,1% in 2014 and has a strong adverse effect on the personal income tax base;
- Elevated dependency ratio² at 77,4% in 2015 compared to an average of 74,0% for the country with growing trend over the last years, increases the risk of additional social expenditures.

Negative factors:

- High and rising debt load of the region, with the total amount of regional debt outstanding equal to RUB 150 bn by end-2016 (the largest volume among all Russian regions) and the ratio of debt to total regional revenues and regional own revenues³ at 73,7% and 88,3% respectively as compared to an average of 27,4% and 33,8% for all Russian regions;
- Unfavorable structure of budget expenditures with the share of CAPEX as low as 5% of consolidated budget expenditures and 3,2% of non-consolidated budget⁴ expenditures in 2016, compared to an average of 12,6% and 10,6% respectively for all Russian regions. The substantially low share of CAPEX creates a narrow space to cut expenditures in case of a sharp drop in revenues and, therefore, increases the risk of debt growth.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Further consolidation of the fiscal balance combined with a continued decrease of debt to total regional revenues and regional own revenues ratios;
- Significant improvement of the quality of regional budget management as assessed by the Federal authorities of the Russian Federation.

The following developments could lead to a downgrade:

- Reverse trend in current fiscal consolidation process which would result in constantly widening fiscal deficits and government debt increases;
- Strong adverse changes in the structure of the regional debt by creditors with increasing share of short-term bank loans.

"The 'BB' rating of Krasnodar Region was positively supported by the fiscal performance in 2016, current structure of government liabilities with a high share of budget loans, as well as by the favorable structure of budget's revenues showing reduced share of transfers and high level of tax revenues diversification. In addition, the large and well diversified economy of the region also contributed favorably to the creditworthiness assessment.

However, the rating was negatively affected by high and rising debt load of the region, as well as moderately low level of CAPEX in budget expenditures." – Clarified Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH.

Responsible expert: Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH

² 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 from 15 to 64.

³ Total regional revenues consist of tax, non-tax revenues and transfers from other levels of budgetary system; regional own revenues include only tax and non-tax revenues.

⁴ Consolidated budget of the region includes regional budget, budgets of all municipalities in the region and off-budget funds; non-consolidated budget of the region includes only regional budget.

Reviewer: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Krasnodar Region is available at:

http://raexpert.eu/reports/Research_report_Krasnodar_Region_14.04.2017.pdf

Next scheduled rating publication: 13 October 2017

<http://raexpert.eu/regions/#conf-tab-5>

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Minute's summary

The rating committee for Krasnodar Region was held on 5 April 2017. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Methodology for regions. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The rating was disclosed to the rated entity prior to the publication and was not changed during the process of coordination.

The following methodology was used for the rating assessment: Methodology for assigning Credit Ratings to Regions. Short Public Version (from April 2015) can be found under the following link: <http://raexpert.eu/files/methodology/Methodology-Short-Credit-Ratings-Regions.pdf>. Descriptions and definitions of all rating categories can be found under the following link: <http://raexpert.eu/regions/> under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

This rating is solicited. The rated entity participated in the rating process.

All information was provided to the Rating Service directly by the representative of the government of Krasnodar Region. Closed joint-stock company Krasnodar Region Development Corporation is the entity, responsible for signing the agreement with the Agency. No other parties participated in the rating assessment.

Main sources of information: Government of Krasnodar region, Ministry of Finance of the Russian Federation, Rosstat, RAEX-Moscow web site.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information as well as non-public information (obtained from the rated entity and/or other third parties) which was considered to be reliable, complete and non-biased. The responsible expert performed rating assessment of the region with information considered as the most reliable and up to date in accordance to the overall position of the region and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. The experts involved in the rating assessment and revision of the rated entity showed no conflict of interests before initiation of the rating assessment.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies from RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.