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Research Update:

City of Novosibirsk Upgraded To 'BB/ruAA' On Prudent Debt Policies And Moderate Budgetary Performance; Outlook Stable

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Overview

- Siberian City of Novosibirsk has continued its prudent debt policies and maintained its moderate budgetary performance.
- We are raising our ratings on Novosibirsk to 'BB/ruAA' from 'BB-/ruAA-'.
- The stable outlook reflects our assumption that Novosibirsk's management will continue to ensure cost control and deliver moderate operating surpluses, as well as continuing prudent debt policies to ensure a favorable debt profile.

Rating Action

On March 30, 2011, Standard & Poor's Ratings Services raised its long-term issuer credit rating on the City of Novosibirsk, Russia's third-largest city, to 'BB' from 'BB-' and raised the Russia national scale rating to 'ruAA' from 'ruAA-'. The outlook is stable.

Rationale

The upgrade reflects Novosibirsk's continuation of prudent debt policies and maintenance of moderate budgetary performance, in our view.

The ratings are constrained by the city's low financial revenues, what we see as limited spending flexibility and modest financial predictability, and low productivity of its economy.

These constraints are mitigated by Novosibirsk's moderate debt and its favorable profile, in our view, reasonable cost control that stimulates moderate financial performance, and a relatively diversified economy.

Novosibirsk's wealth levels are average by Russian standards. Its economy suffers from low productivity, especially in the industrial sector, the poor state of municipal infrastructure, with a number of bottleneck issues such as transport, utilities, and housing still to be resolved in the long term. These constraints are somewhat mitigated by the city's role as the regional economic center, with important service, transport, and research and development sectors, which we think help support the city's economic potential.

We consider that management's efforts throughout 2010 to extend the city's debt profile have resulted in a sharp drop of debt service from 16% of operating revenues in 2009 to 2% in 2011 and about 4%-5% in 2012-2013. Given the city's seeming willingness to shift its debt policy from bank borrowings to issuing medium-term bonds, our base-case scenario implies further improvement of the existing debt profile.

Despite a crisis-driven hike in tax-supported debt, by March 2011 it comprised 25% of consolidated operating revenues, which we see as a moderate level by international standards. The budgeted borrowings from the higher-tier budget will slightly increase debt levels, yet our base-case scenario does not anticipate that the city's debt burden will exceed a moderate 35% of consolidated operating revenues in the medium term.

Like other Russian local and regional governments, Novosibirsk's financial predictability and flexibility is severely limited because the federal government regulates tax rates and shares and the distribution of responsibilities to different layers of government. The intergovernmental system continues to evolve.

Despite this and existing spending pressures, Novosibirsk management's reasonable spending control, in our view, coupled with some recovery of revenues, is likely to enable the city to continue to deliver moderate operating surpluses and modest deficits after capital accounts in 2011-2012. According to our base-case scenario, a recovering economy, growing inflation, and still strong fiscal grants from the Novosibirsk Oblast budget are likely to result in somewhat stronger, yet still moderate, revenue growth in 2011-2012. Given the budgeted increase in public salaries and rising costs, our base-case scenario now expects the stabilization of operating margins at 3%-5% of operating spending.

Recovering property markets will likely allow Novosibirsk to generate stronger capital revenues in 2011-2012, in our view. Nevertheless, we believe that support from the oblast and federal budgets-–via subsidies and medium-term loans--will be vital for maintaining the city's investment program (with projects like the city bridge construction being top priorities) at 23%-25% of total spending. This will result in only moderate deficits after capital accounts in the medium term in 2011-2013.

Liquidity

Novosibirsk's liquidity position has a "neutral" impact on the ratings. The city's free cash and committed bank facilities comfortably cover Novosibirsk's direct debt repayment needs over the next 12 months.

Despite historically low cash reserves, accounting on average for two-three weeks of budgeted operating spending, the city has access to a wide range of bank facilities. As of mid-March 2011, Novosibirsk had several committed bank lines, with 10% of the total size not withdrawn. The terms of Novosibirsk's access to bank lending are more favorable than those for higher-rated entities, with a number of local and federal banks reserving internal lending limits for the city. Nevertheless, according to our methodology, we qualify

Novosibirsk's access to financial markets as "limited" by international standards because of what we see as a weak domestic bank system and the limited development of Russia's capital market.

The earliest principal debt payment the bank loans is scheduled in April-May 2012.

Outlook

The stable outlook reflects our base-case assumption that, despite spending pressures, Novosibirsk's management will continue to ensure cost control and thereby deliver moderate operating surpluses. The outlook also factors in the continuation of prudent debt policies ensuring a favorable debt profile.

Our scenario for negative ratings actions assumes that market sentiments would prevent the city from securing access to long-term borrowings, which would in turn lead to a rise in debt service above the levels we currently expect. The pace of operating spending growth also would increase, which would result in the continued weakening of the city's operating performance.

In our view, ratings upside is unlikely in the next 12 months unless the city manages to achieve structurally stronger operating balances in 2011, significantly improves its own cash position, and consolidates its cash policies.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.
Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings List

Upgraded

	To	From
Novosibirsk (City of)		
Issuer Credit Rating	BB/Stable/--	BB-/Positive/--
Russia National Scale Rating	ruAA	ruAA-

Additional Contact:
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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4011.