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Research Update:

Russian City of Novosibirsk Ratings Raised To 'BB-/ruAA-' On Better Revenues And Reduced Debt

Primary Credit Analyst:

Irina Pilman, Moscow (7) 495-783-4061; irina_pilman@standardandpoors.com

Secondary Credit Analyst:

Felix Ejgel, Moscow (7) 495-783-4060; felix_ejgel@standardandpoors.com

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Rationale

On March 21, 2008, Standard & Poor's Ratings Services raised the long-term issuer credit rating on the City of Novosibirsk to 'BB-' from 'B+'. The outlook is stable. At the same time, the Russia national scale rating was raised to 'ruAA-' from 'ruA+'.

Novosibirsk is the third-largest city in The Russian Federation (foreign currency BBB+/Positive/A-2; local currency A-/Positive/A-2; Russia national scale rating 'ruAAA').

The upgrade reflects the city's growing revenues, improved budgetary performance, and reduced debt.

The ratings are constrained by low financial flexibility and predictability, pressures on performance from growing expenditures, and the need to develop a reliable medium-term investment program.

These constraints are mitigated by Novosibirsk's growing, diversifying, and services-oriented economy; solid budgetary performance, underpinned by increasing revenues; low debt; and prudent debt management.

Similar to that of other Russian local and regional governments, Novosibirsk's budget is highly pressured by increasing costs of budget services, especially growing salaries in the public sector. The city administration has controlled this growth effectively so far. However, risks potentially pressuring budgetary performance remain, because the main factors of growing expenditures--inflation and reshuffling responsibilities between the layers of government--are outside the administration's competence.

The city's financial performance continued to improve in 2006-2007, thanks to the growing economy. We expect that the operating performance will stay at 6%-7% of operating revenues on average in 2008-2010. The surplus after capital expenditures of 8.1% of total revenues in 2007 could turn to a deficit in the next three years, which we expect to be on average 5%-7% of total revenues in the medium term, in line with pressing capital needs.

Economic growth and improving living standards pressure capital expenditures. The city has committed to cofinancing federal and regional housing, road, and utility infrastructure programs. The elaboration of a reliable medium-term investment program, with projects scheduled and prioritized according to the city's recently adopted master plan, could mitigate the uncertainties of vast capital pressures, however.

Novosibirsk's economy is diversified and growing. Total investment grew by more than 40% in 2007, and the city forecasts 25% growth in 2008. The city's location as a transport and logistics hub, and its role as an academic center, will buoy economic growth in the medium term. The city's wealth level remains average for Russia, but low by international standards.

Novosibirsk's debt level stood at a low 8.3% of operating revenues at Dec. 31, 2007. The city's debt management is prudent, and we expect debt accumulation to be gradual. The debt burden should remain moderate in the international context, with debt service to operating revenues at 10% on average in 2008–2010.

Outlook

The stable outlook incorporates our expectation that the city will meet current forecasts for operating surpluses of about 6%–7% of operating revenues, as well as accumulating debt gradually and maintaining a moderate debt burden (less than 25% of operating revenues until 2010). We also expect that medium-term investment planning will improve and be further incorporated into the three-year budgeting process.

Ratings upside is possible if the city manages to achieve higher-than-forecast operating balances and adopts a multiyear, reliable investment program. The aim should be to implement a program and, at the same time, keep the debt burden moderate.

The ratings could come under pressure should the operating performance repeatedly fall below the improved 2005–2006 levels, thereby forcing the city to accumulate short-term debt.

Ratings List

	To	From
Issuer credit rating	BB-/Stable/--	B+/Positive/--
Russia national scale rating	ruAA-	ruA+

NB: This list does not include all ratings affected.

Additional Contact:

International Public Finance Ratings Europe;PublicFinanceEurope@standardandpoors.com

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