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Research Update:

**Russian City of Novosibirsk
Outlook Now Negative On Higher
Short-Term Debt, Weaker
Financials; Affirmed At 'BB-/ruAA-'**

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Research Update:

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Rationale

On April 15, 2009, Standard & Poor's Ratings Services revised its outlook on the City of Novosibirsk, the third-largest city in the Russian Federation (foreign currency BBB/Negative/A-3; local currency BBB+/Negative/A-2; Russia national scale rating 'ruAAA') to negative from stable. At the same time, the 'BB-' long-term issuer and 'ruAA-' Russian national scale ratings were affirmed.

The outlook revision reflects Novosibirsk's increased short-term debt and weaker self-financing capacity.

The ratings are constrained by the city's low financial flexibility and predictability, downside pressures on budgetary performance, and pressure on liquidity due primarily to a recent accumulation of short-term debt.

These constraints are mitigated by moderate debt, rather sophisticated debt management, limited contingent liabilities, and a relatively diversified economy.

Like other Russian local and regional governments, Novosibirsk's financial predictability and flexibility is limited because the central government regulates tax rates and shares, distribution of responsibilities of different layers of government, and their reshuffling, and this system continues to evolve. Novosibirsk's budget flexibility was additionally stressed by the macroeconomic downturn and accelerated capital expenditures, both of which started 2008.

The city's revenue growth had slowed by the end of last year, and this negative trend will continue in 2009 due to the contraction of trade and real estate operations, which are among Novosibirsk's biggest tax-generating sectors. We believe operating revenues will grow only moderately (in nominal terms) in 2009-2010. Novosibirsk's economy and revenue base is rather diversified overall, so the impact of macroeconomic downturn will be less harmful than for many of its Russian peers with highly concentrated tax bases.

The city administration is focused on controlling expenditures to avoid financial performance slippage and to keep debt moderate or low. Management plans to cut capital expenditures and keep operating expenditures at 2008 levels.

In this context, we forecast the operating performance to remain at least breakeven on average in 2009-2010, and the deficit after capital expenditures at less than 5% of total revenues in the medium term.

At 16% of operating revenues as of year-end 2008, Novosibirsk's debt burden remains low in the international context. Despite anticipated new debt accumulation in 2009, it should remain below 20% in the medium term. The city has no guarantees, and doesn't plan to issue any in the near future.

Novosibirsk'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 levels are average for Russia, but low by international standards. The average salary grew by 15.2% in real terms in 2008, but will likely stay at that level in 2009.

Liquidity

We consider Novosibirsk's liquidity to be modest. As of April 1, 2009, the city's cash on accounts stood at Russian ruble (RUR) 1.4 billion (about \$41.7 million), which covered from 2 to 3 weeks of average 2009 planned monthly operating expenditures. However, 90.5% of this cash was transferred from the upper budgets and is earmarked.

The share of short-term debt (including the share of long-term debt maturing during the year) has increased to a high 72.2% in 2009. Debt repayment due in 2009 amounts to RUR2.7 billion, and consists of a RUR500 million bond issue and RUR2.2 billion in bank loans. This will bring debt service to 13.6% of operating revenues in 2009.

The city plans to refinance this debt with new bank loans, most of them with maturities of more than one year. An agreement with Sberbank has already been reached for a RUR1.1 billion loan. Although the city has no committed credit lines, JSC VTB Bank and several regional banks have expressed their intention to participate in the city auctions for borrowings this year.

We expect that Novosibirsk will obtain the necessary refinancing in time. Our expectations are based on the city's successful management of its debt, as it obtained financing on better-than-average terms in 2008-2009 and earlier.

Outlook

The outlook is negative because of Novosibirsk's higher liquidity risks following short-term debt accumulation in 2008 and its weakening self-financing capacity.

A downgrade is possible if the economic downturn persistently lowers Novosibirsk's revenue growth, leading to structurally weaker self-financing capacity, and to persistently high dependence on short-term debt.

We could revise the outlook to stable if the city manages both to curb expenditure growth and returns to its strong self-financing capacity in line with 2007 levels, and succeeds in reducing the share of short-term debt, gradually reducing debt service to less than 10% of operating revenues.

Ratings List

CreditWatch/Outlook Action; Ratings Affirmed

	To	From
City of Novosibirsk		
Issuer credit rating	BB-/Negative/--	BB-/Stable/--
Russia national scale rating	ruAA-	ruAA-
Senior unsecured debt rating	BB-	BB-

ruAA-

ruAA-

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