

Novosibirsk (City of)

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Novosibirsk (City of)

Major Rating Factors

Weaknesses:

- Low financial flexibility and predictability.
- Still some reliance on short-term debt, despite gradual extension of debt maturities.

Strengths:

- Moderate debt levels.
- Improved access to committed bank facilities.
- Spending discipline resulting in some improvement of budgetary performance.
- Relatively diverse economy.

Issuer Credit Rating

BB-/Stable/--

Russia National Scale Rating

ruAA/--/--

Rationale

The ratings on Novosibirsk, Russia's third-largest city, are constrained by the city's low financial flexibility and predictability and some continued reliance on short-term debt. These constraints are mitigated by moderate debt, improved access to bank facilities, fiscal discipline, and a diverse economy.

As with other Russian local and regional governments, Novosibirsk's financial predictability and flexibility is 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.

Novosibirsk's reliance on a stable source of revenues-- personal income tax--and stronger grants from Novosibirsk Oblast (not rated) budget enabled the city to post only a minor drop in operating revenues in 2009. This, coupled with Novosibirsk's willingness and ability to adhere to disciplined spending, resulted in an only moderate further erosion of operating budgetary performance in the course of the year.

The city's ability to control operating costs is a credit strength, in our view. Consequently, some improvement in revenues, in particular due to stronger support from the oblast, will likely result in slightly improved operating surpluses of 5%-6% in 2010-2011. The city's capital program is likely to remain constrained compared with a peak reached in 2008. Moreover, Novosibirsk's recovering self-financing capacity and capital support from higher-tier budgets should result in modest deficits after capital expenditure in 2010-2012.

Although it rose in 2009, Novosibirsk's direct debt remains moderate in an international context. Given an expected budget loan and new bond placement in the second half of 2010, the city's debt burden will likely expand slightly to 24%-25% of operating revenues in 2010-2011, followed by a gradual decline in 2012.

Management has made efforts to extend the city's debt maturities. By year-end 2010, debt falling due within 12 months will likely account for about 20%, which is one-half of the previous year's figure. Our base-case scenario factors in a continuation of this trend, which should enable Novosibirsk to reduce debt service from a material 16% in 2009 to 6% in 2011.

Novosibirsk's economy is relatively diverse and its wealth levels are average by Russian standards. Despite low industrial productivity and poor municipal infrastructure, the city's role as a regional economic center, with material service, transport, and research and development sectors, will likely support its economic potential over the long term.

Liquidity

We regard Novosibirsk's liquidity as adequate, given the credit facilities it has managed to secure.

The city's access to bank borrowings has significantly improved since the end of 2009. At the moment it has a number of bank facilities totaling up to RUB4 billion, but has drawn only 25% of that amount so far.

The remainder comfortably covers Novosibirsk's debt repayment needs over the next 12 months: a RUB1 billion bond repayment and RUB1.25 billion in bank loans. Nevertheless, we note that Novosibirsk's cash reserves were weak during 2009 and as of early May, 2010, accounted for only two weeks' worth of budgeted 2010 spending.

Recovery analysis

The issue ratings on Novosibirsk's RUB1.5 billion senior unsecured bond due June 24, 2010, are 'BB-/ruAA-', the same as the long-term and Russia national scale ratings on the city. The '3' recovery rating on the bond indicates our expectation of meaningful (50%-70%) recovery in an event of payment default.

Reported availability of some ready-to-sell assets and somewhat higher institutional stability due to Novosibirsk's importance as a large city support the recovery rating. At the same time, the recovery rating is constrained by high short-term debt under our hypothetical default scenario, our view of weak financial flexibility, and the need to implement non-debt-related expenditure. A weak institutional framework and lack of an insolvency framework for local governments also pressure the recovery rating.

Outlook

The stable outlook reflects our expectation that, despite spending pressures, Novosibirsk's management will continue the spending discipline it displayed in 2009, which will likely improve budgetary performance in 2010-2012. The outlook factors in continued management measures to extend the maturity of the city's debt obligations.

A negative rating action could result if market sentiment were to prevent the city from improving its debt profile, in turn leading to a rise in debt service in 2010-2011 above the levels we currently expect. The ratings could come under pressure if the speed of growth of operating spending were to increase and result in a structurally weak operating performance over the next two-three years.

We could revise the outlook to positive if the city manages to achieve higher-than-forecast operating balances and extend its debt profile beyond 2013, which would likely lead to much-lower-than-expected debt service in 2010-2011.

Comparative Analysis

Novosibirsk's economy is more diverse than the economies of most of its peers, especially Nizhny Novgorod, Surgut, and Vologda Oblast, and benefits from developed service and transport sectors.

In line with its peers, Novosibirsk's fiscal flexibility is constrained. However, with the exception of Nizhny Novgorod, the city allocates the biggest share of budget spending to capital projects, which gives it some, albeit restricted, spending flexibility. Novosibirsk's budgetary performance is on par with the average performance of its city peers, but is better than those of Vologda Oblast and Sverdlovsk Oblast.

Novosibirsk's debt levels are among the highest in the city's peer group, yet still moderate in an international context. Due to material levels of short-term debt, Novosibirsk's debt service was one of the highest in its peer group in 2009. However, if the city extends its debt maturities as planned, its debt maturity profile should come into line with those of Volgograd Oblast and Vologda Oblast by 2011.

Table 1

Novosibirsk (City of) 2009 Peer Comparison					
	Novosibirsk	Nizhny Novgorod	Surgut	Ufa	Vologda Oblast
Issuer credit rating	BB-/Stable/--	BB-/Stable/--	BB-/Stable/--	BB-/Stable/--	BB-/Negative/--
National scale ratings	ruAA-/--/--	ruAA-/--/--	ruAA-/--/--	ruAA-/--/--	ruAA-/--/--
--Three-year averages, using actual results only--					
Operating balance (% of operating revenues)	7.0	9.8*	6.3	6.4	6.4
Balance after capital expenditures (% of total revenues)	(0.9)	5.4*	1.8	0.7	(7.3)
Capital expenditures (% of total expenditures)	24.4	11.8*	20.9	14.4	15.7
Transfers received (% of total revenues)	33.1	23.3*	45.6	33.3	20.3
(\$)					
--Year ended Dec. 31, 2009--					
Total revenues	878,979,454.4	649,801,279.9	544,540,249.2	484,971,370.8	1,052,886,493.8
Modifiable revenues (% of operating revenues)	36.4	25.2	24.9	26.7	5.7
Direct debt (at year-end)	176,490,400.8	27,547,996.0	29,558,774.0	32,775,345.2	191,175,480.0
Direct debt (% of operating revenues)	22.7	5.3	6.6	7.8	19.1
Direct debt (% of GDP)	N/A	N/A	0.3	N/A	2.6
Tax-supported debt (% of conso oper revenues)	22.7	5.3	6.6	17.0	34.9
Net financial liabilities (% of conso oper rev)	20.7	3.2	(5.0)	10.6	29.2
Interest (% of operating revenues)	2.2	0.1	0.9	0.4	0.5
Debt service (% of oper revenues)	15.7	3.3	3.6	5.6	2.3
Free cash & liquid assets as % DS	12.6	64.4	318.8	114.9	254.2
Population	1,409,137	1,280,400¶	298,466¶	1,028,671*	1,216,000
Unemployment rate (%)	N/A	0.5*	3.0¶	1.4*	7.9
GDP (nominal) per capita, unscaled	N/A	N/A	N/A	N/A	6,132.5
GDP per capita (% of national average)	N/A	N/A	N/A	N/A	63.2
GDP (real) growth (%)	(15.0)	(10.3)¶	(1.8)¶	N/A	(3.3)¶
Total revenues (% of GDP)	N/A	N/A	5.7	N/A	14.1

*Figures for 2007. ¶Figures for 2008. N/A--Not applicable.

Economy

The economy of Novosibirsk, despite average wealth levels, is diverse by Russian standards, with the 10 largest enterprises accounting for about 5% of total employment and tax revenues. This enabled the city to post only a moderate drop in output and report some growth in its average wage in 2009. Low industrial productivity as well as

poor municipal infrastructure remain the city's long term challenges, however. Even so, the city's economic potential is likely to be boosted by an expanding service sector and transport links and increasing research and development activity (mainly at the local branch of the Russian Academy of Science).

Management And Organizational Structure

In 2009, Vladimir Gorodetsky was reelected to a third term as mayor of Novosibirsk. He is a member of the United Russia party which has a majority in the city council.

The city administration's transparency is high by Russian standards, and its financial and management skills are improving. Novosibirsk's debt management team is experienced and more skilled than the Russian average.

Novosibirsk's management has demonstrated its ability to control costs by differentiating its spending policy approach under different revenue forecasts. Coupled with personnel spending, debt service remains the city's key priority in comparison with other expenditure programs.

Financial Flexibility And Budgetary Performance

The city's revenue flexibility is weak, with only a modest recovery of revenues expected in 2010. Control over spending displayed in 2009 is likely to continue in 2010.

Novosibirsk's means of generating extra revenue remain constrained, with only non-tax revenues and a number of local taxes representing small, though modifiable, sources of revenues. However, reliance on personal income tax as opposed to corporate profit tax (as is the case with Russia's regions) as well as stronger operating grants from Novosibirsk Oblast enabled the city to post only a minor drop in operating revenues, despite a material drop in non-tax revenues. This, coupled with the diverse nature of the city's economy, contained the decline at a modest 2.5%.

We expect a moderate recovery of operating revenues mostly as a result of slightly stronger non-tax revenues and grants from Novosibirsk Oblast in 2010. Our forecast for earnings from personal income tax in 2010 is conservative given that no public sector salary increases are planned and that the local economy continues to stagnate. However, we expect stronger revenue growth in 2011-12, as the economy recovers.

Due to stagnating property markets, Novosibirsk's ability to generate capital revenues is likely to remain constrained over the medium term. We believe that the city's key ongoing capital projects (metro and bridge construction) are likely to be co-financed by the oblast and federal budgets.

As with other Russian cities, Novosibirsk's spending flexibility is low. It was undermined after an increase in public sector salaries in late 2008, which resulted in personnel spending accounting for 60% of operating expenditure.

However, in 2009, willingness and ability to adhere to fiscal discipline enabled the city to keep spending at 2008 levels. A policy of freezing public sector salaries in 2009 is likely to continue in 2010. Although we factor in a modest increase in public sector pay in 2011-2012, the city's ability to control operating costs remains a credit strength, in our view.

The extent of Novosibirsk's flexibility in terms of capital spending has been historically high; capital spending

accounted for 30% of pre-2009 budgets. Although this item was severely cut in 2009, it continues to present cost optimization possibilities.

Budgetary performance

We expect Novosibirsk's budgetary performance to recover slightly, but to remain moderate over the medium term.

The city's operating surplus declined to 3% in 2009 from 12% in 2007. In 2010-2011, a modest improvement of revenues from stronger grants and non-tax revenues, coupled with constrained spending is likely to result in slightly stronger, but still moderate, operating surpluses. The city's capital program is likely to remain constrained compared with its 2008 levels. Recovering self-financing capacity as well as capital support from higher-tier budgets is likely in our opinion to result in modest deficits after capital expenditure in 2010-2012.

Liquidity, Debt Management, Debt Burden, And Contingent Liabilities

Liquidity

We regard Novosibirsk's liquidity as adequate. The city's cash reserves accounted for only two weeks of budgeted spending in 2010, as of early May 2010. However, the city's access to bank borrowings has significantly improved since the end of 2009. At the moment, the city has a number of secured bank facilities totaling about RUB4 billion, of which 75% is undrawn. This comfortably covers Novosibirsk's debt repayment needs over the next 12 months: a RUB1 billion bond repayment and RUB1.25 billion in bank loans.

Debt burden

Novosibirsk's debt burden remains moderate. Despite improvements, the city's debt maturity profile is still somewhat short term.

Despite an increase in 2009, Novosibirsk's direct debt remains moderate in an international context. The city's debt is likely to expand slightly in 2010-2011 to 24%-25% of operating revenues as a result of a federal loan and a bond placement planned for 2010. This is likely to be followed by a gradual decline in 2012.

Novosibirsk has taken some steps to extend the maturity of its debt obligations. By end-2010, the city's direct debt will mostly comprise two-year bank loans and a new medium-term bond. Importantly, debt falling due within one year is likely to account for about 20% of total debt compared with about 45% at end-2009.

Our base-case scenario factors in a continuation of this trend. We expect the city to obtain three-year bank loans or place a new medium-term bond in the second half of 2010. Such developments, in our view, will enable Novosibirsk to reduce its debt service from a material 16% of operating revenues in 2009 to 6% in 2011.

The city does not issue guarantees and is not planning to do so over the next three years.

Novosibirsk's debt management team is experienced. Having serviced significant debt levels in the past, and working with a large number of banks, the administration has never defaulted on its obligations and enjoys a good reputation among Russian banks.

Contingent liabilities

Novosibirsk's contingent liabilities are low as a result of negligible involvement in the economy, zero guaranteed debt, and insignificant past-due payables of municipal companies (less than 5% of total revenues as of end-2009) and the city itself.

Related Criteria And Research

Methodology And Assumptions: Rating International Local And Regional Governments, Jan. 5, 2009

Table 2

Novosibirsk (City of) Financial Statistics						
	--Year ended Dec. 31--					
(Mil. RUB)	2012e	2011e	2010e	2009	2008	2007
Operating revenues	32,287.0	28,552.0	25,302.0	23,081.9	23,646.6	22,154.8
Operating expenditures	29,925.0	26,770.0	23,990.0	22,402.4	22,071.7	19,605.6
Operating balance	2,362.0	1,782.0	1,312.0	679.5	1,574.9	2,549.2
Operating balance (% of operating revenues)	7.3	6.2	5.2	2.9	6.7	11.5
Capital revenues	3,400.0	3,500.0	3,300.0	3,015.0	6,851.2	5,647.6
Capital expenditures (capex)	6,250.0	5,700.0	5,600.0	5,453.5	9,632.0	5,937.3
Balance after capex	(488.0)	(418.0)	(988.0)	(1,759.0)	(1,205.9)	2,259.5
Balance after capex (% of total revenues)	(1.4)	(1.3)	(3.5)	(6.7)	(4.0)	8.1
Net budget loans	0.0	0.0	0.0	0.0	(42.1)	0.0
Balance after debt repayment and onlending	(2,538.0)	(1,568.0)	(3,378.0)	(4,858.7)	(1,470.3)	(668.7)
Balance after debt repayment and onlending (% of total revenues)	(7.1)	(4.9)	(11.8)	(18.6)	(4.8)	(2.4)
Gross borrowings	2,400.0	2,000.0	3,027.0	4,600.0	2,200.0	740.0
Balance after borrowings	(138.0)	432.0	(351.0)	(258.7)	729.7	71.3
Balance after borrowings (% of total revenues)	(0.4)	1.4	(1.2)	(1.0)	2.4	0.3
Modifiable revenues (% of operating revenues)	100.0	100.0	100.0	36.4	41.7	43.0
Capex (% of total expenditures)	17.3	17.6	18.9	19.6	30.4	23.2
Operating-revenue growth (%)	13.1	12.8	9.6	(2.4)	6.7	49.2
Operating-expenditure growth (%)	11.8	11.6	7.1	1.5	12.6	40.0
Direct debt (debt outstanding at year-end)	7,077.0	6,727.0	5,877.0	5,240.0	3,739.5	1,846.0
Direct debt (% of operating revenues)	21.9	23.6	23.2	22.7	15.8	8.3
Tax-supported debt (% of conso oper revenues)	21.9	23.6	23.2	22.7	15.8	8.3
Interest (% of operating revenues)	2.1	2.7	2.9	2.2	1.1	1.2
Debt service (% of oper revenues)	8.5	6.7	12.3	15.7	2.4	14.5
Free cash & liquid assets as % operating expenditures	3.4	4.4	3.1	2.0	1.8	3.1
Free cash & liquid assets as % DS	37.5	61.2	23.6	12.6	71.8	19.2

RUB--Russian ruble. e--S&P estimate.

Table 3

Novosibirsk (City of) Economic Statistics								
	2011f	2010f	2009	2008	2007	2004	2003	2002
Population	1,413,137	1,411,612	1,409,112	1,397,191	1,390,513	1,409,285	1,418,100	1,405,500
Population growth (%)	0.1	0.2	0.9	0.5	(0.1)	(0.6)	0.9	0.9

f--City forecast.

Ratings Detail (As Of June 3, 2010)*

Novosibirsk (City of)

Issuer Credit Rating

BB-/Stable/--

Ratings Detail (As Of June 3, 2010)* (cont.)		
<i>Russia National Scale Rating</i>		ruAA-/--/--
Senior Unsecured (1 Issue)		BB-
<i>Russia National Scale Rating</i> (1 Issue)		ruAA-
Issuer Credit Ratings History		
28-May-2010	<i>Foreign Currency</i>	BB-/Stable/--
15-Apr-2009		BB-/Negative/--
21-Mar-2008		BB-/Stable/--
26-Mar-2007		B+/Positive/--
23-Mar-2006		B/Positive/--
28-May-2010	<i>Local Currency</i>	BB-/Stable/--
15-Apr-2009		BB-/Negative/--
21-Mar-2008		BB-/Stable/--
26-Mar-2007		B+/Positive/--
22-Dec-2006		B/Positive/--
21-Mar-2008	<i>Russia National Scale Rating</i>	ruAA-/--/--
26-Mar-2007		ruA+/--/--
23-Mar-2006		ruA/--/--
Default History		
None		
Population	1 409 137 (as of Jan. 1, 2010; Novosibirsk data)	
Per Capita GDP	\$7,100 (S&P estimate)	
Current Government		
Mayor Vladimir Gorodetsky represents the United Russia party		
Election Schedule		
Mayoral:		
Last: 2009		
Next: 2014		
City Council:		
Last: 2010		
Next: 2015		

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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