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Research Update:

City Of Novosibirsk Upgraded To 'BB+'/'ruAA+' On Likely Continuation Of Prudent Financial Policies; Outlook Stable

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Overview

- We believe the Russian City of Novosibirsk's management will continue its prudent spending and debt policies, which have already resulted in a marked extension of the debt profile and the securement of long-term liquidity.
- We are therefore raising our long-term credit rating on Novosibirsk to 'BB+' from 'BB' and our Russia national scale rating to 'ruAA+' from 'ruAA'. We also raised our ratings on Novosibirsk's senior unsecured bonds to 'BB+'/'ruAA+' from 'BB'/'ruAA'.
- The stable outlook reflects our view that in the next 12-24 months Novosibirsk's established management standards will likely counterbalance existing spending pressure and uncertainty coming from mayoral elections in 2014.

Rating Action

On Oct. 29, 2013, Standard & Poor's Ratings Services raised its long-term issue credit rating on the Russian City of Novosibirsk to 'BB+' from 'BB'. The outlook is stable. At the same time, we raised our Russia national scale rating on Novosibirsk to 'ruAA+' from 'ruAA'.

We also raised our long-term issue credit rating and our Russia national scale rating on Novosibirsk's senior unsecured bonds to 'BB+'/'ruAA+' from 'BB'/'ruAA'.

Rationale

The upgrade of Novosibirsk reflects our view that established prudent management procedures will likely ensure policy continuity beyond the 2014 mayoral elections and support the city's existing credit strengths over the next 18-24 months.

The ratings on Novosibirsk are constrained by a relatively poor economy and our view of a "developing and unbalanced" institutional framework in Russia, which limits the city's financial flexibility and predictability. These constraints are mitigated by Novosibirsk's "neutral" management quality, "neutral" liquidity, strong budgetary performance, moderate debt, and low contingent liabilities.

As with other Russian local and regional governments (LRGs), 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. We regard Russia's institutional frameworks as "developing and unbalanced."

Despite limited financial flexibility, the city's financial management demonstrates solid cost control and prudent debt and liquidity policies, which result in strong budgetary performance and a smooth debt profile. We now regard financial management as a "neutral" rating factor, and we believe that the track record and management's established procedures will likely prevent abrupt policy revisions over the next 12-18 months, even if the city's political leadership changes after the elections in late 2014.

As a result of management capabilities, as well as continued operating support from the Novosibirsk Oblast, the city will likely mitigate the ongoing spending pressure stemming from the need to raise public sector pay and post operating surpluses of some 5% of operating revenues in 2013-2015, under our base-case scenario. This will build on solid results in 2012 and the third quarter of 2013, when the city reported operating surpluses of 5.7% and 6.6% of operating revenues.

Continued and expanding capital support from Novosibirsk Oblast and federal budgets via subsidies and loans will likely continue, in our opinion, because over 55% of the oblast population lives in the city. This makes Novosibirsk the primary target of the oblast's budget investments.

So, we think that Novosibirsk will report only modest deficits after capital accounts of less than 5% of total revenues in 2013-2015 after achieving on average 5.5% in 2010-2012. Due to modest deficits, we expect tax-supported debt will stay below 40% of consolidated operating revenues until 2015, which we see as modest by international standards. The city's limited involvement in the local economy and the relatively stable financial position of its government-related entities translate into modest contingent liabilities for Novosibirsk.

Novosibirsk's fairly poor economy suffers from low productivity, especially in the industrial sector, and the inadequate state of municipal infrastructure--with a number of bottleneck issues such as obsolete transport, utilities, and housing. In our opinion, these constraints are partly mitigated by the diversified nature of the city's economy.

Liquidity

We see Novosibirsk's liquidity as "neutral" according to our criteria. The city's free cash and committed bank lines will likely comfortably cover its debt service over the next 12 months.

Management's continued prudent policies have allowed Novosibirsk to greatly

improve its debt profile over the last few years. Following this policy, the city has recently placed a long-term bond and refinanced bank loans coming due in the second half of 2013. Such policies have allowed the city to contain debt service at less than 7% on average over the next three years.

Novosibirsk's cash has historically been low. Despite the recent improvement in budgetary performance, the city's cash holdings are below 100% of expected debt service needs for the next 12 months.

However, the city's sound management of committed bank facilities helps offset this weakness. As of October 2013, the size of nonwithdrawn committed facilities exceeded debt service in the next 12 months by 4x and is enough to meet debt service over the following 24 months. The terms of Novosibirsk's access to bank lending are more favorable than those for many higher-rated entities. Most major Russian banks operating in the region have expressed willingness to extend existing medium- to long-term facilities or provide new ones, reserving internal lending limits for the city.

Nevertheless, according to our methodology, we universally qualify Russian LRGs' access to financial markets as "limited" by international standards because of what we see as a weak domestic banking system and the limited development of Russia's capital market.

Outlook

The stable outlook reflects our opinion that Novosibirsk's achieved management standards will likely counterbalance existing spending pressure, which will allow the city to deliver operating surpluses on average hitting 5% of operating revenues and deficits after capital accounts staying below 5% of total revenues. The outlook also factors in the low debt service and maintenance of the existing moderate debt level.

We would consider taking a positive rating action if the city's free cash position were to structurally increase, improving our assessment of Novosibirsk's liquidity position.

We could take a negative action if, as per our downside scenario, the city delivered weaker budgetary performance (with operating surpluses sliding below 5% of operating revenues) due to pronounced changes in management priorities, particularly weaker spending control. This would lead us to revise our assessment of management quality and budgetary performance.

Published Rating Factor Scores

Table 1

City of Novosibirsk Summary Of Published Rating Factor Scores*

Rating factor	Score
Institutional framework	Developing and unbalanced
Financial management	Neutral
Liquidity	Neutral
Overriding factors	None

*Standard & Poor's assigns scores across eight main rating factors, of which we publish three.

Key Statistics

Table 2

City of Novosibirsk Financial Statistics

(Mil. RUB)	--Financial year ending Dec. 31--					
	2010	2011	2012	2013bc	2014bc	2015bc
Operating revenues	24,675.9	26,683.5	28,837.7	31,296.0	33,623.0	35,867.0
Operating expenditures	23,850.8	26,473.1	27,208.7	29,366.0	31,438.0	33,670.0
Operating balance	825.1	210.4	1,629.0	1,930.0	2,185.0	2,197.0
Operating balance (% of operating revenues)	3.3	0.8	5.6	6.2	6.5	6.1
Capital revenues	4,557.9	7,247.9	7,452.3	8,000.0	9,000.0	10,000.0
Capital expenditures (capex)	7,001.5	10,396.6	9,961.2	10,500.0	12,000.0	13,000.0
Balance after capital accounts	(1,618.5)	(2,938.3)	(879.9)	(570.0)	(815.0)	(803.0)
Balance after capital accounts (% of total revenues)	(5.5)	(8.7)	(2.4)	(1.5)	(1.9)	(1.8)
Debt repaid	9,985.0	5,306.0	4,655.0	4,215.0	1,350.0	2,178.0
Balance after debt repayment and onlending	(11,603.5)	(8,244.3)	(5,534.9)	(4,785.0)	(2,165.0)	(2,981.0)
Balance after debt repayment and onlending (% of total revenues)	(39.7)	(24.3)	(15.3)	(12.2)	(5.1)	(6.5)
Gross borrowings	11,023.7	8,275.0	5,875.0	5,000.0	2,300.0	3,200.0
Balance after borrowings	(579.8)	30.7	340.1	215.0	135.0	219.0
Operating revenue growth (%)	6.9	8.1	8.1	8.5	7.4	6.7
Operating expenditure growth (%)	6.5	11.0	2.8	7.9	7.1	7.1
Modifiable revenues (% of operating revenues)	34.8	35.7	30.7	15.6	15.4	15.2
Capital expenditures (% of total expenditures)	22.7	28.2	26.8	26.3	27.6	27.9
Direct debt (outstanding at year-end)	6,278.7	9,247.7	10,467.7	11,253.0	12,453.0	13,075.0
Direct debt (% of operating revenues)	25.4	34.7	36.3	36.0	37.0	36.5
Tax-supported debt (% of consolidated operating revenues)	25.4	32.8	33.0	32.5	33.5	32.7
Interest (% of operating revenues)	1.9	1.6	1.6	2.4	2.5	2.1
Debt service (% of operating revenues)	42.3	21.5	17.8	15.9	6.5	8.2

bc--Base case, reflecting Standard & Poor's expectations of the most likely scenario. RUB--Russian ruble.

Table 3

City of Novosibirsk Economic Statistics				
	--Financial year ended Dec. 31--			
	2010	2011	2012	2013bc
Population*	1,464,988	1,475,136	1,498,921	1,523,801
Population growth (%)	4.9	0.7	1.7	1.6
GDP per capita (RUB)	181,050.0	221,851.4	244,711.5	265,644.2
Official registered unemployment rate (%)	1.5	1.1	0.9	0.6

*Figures recorded at the beginning of the year. bc--Base case, reflecting Standard & Poor's expectations of the most likely scenario. RUB--Russian ruble. N/A--Not applicable. N.M.--Not meaningful. Sources: Standard & Poor's and City of Novosibirsk.

Key Sovereign Statistics

- Sovereign Risk Indicators, July 1, 2013

Related Criteria And Research

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- International Public Finance: Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- International Public Finance: Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Upgraded; Outlook Action

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

Additional Contact:

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