Fitch Affirms Russian City of Novosibirsk 'BB'; Outlook Stable

Fitch Ratings-Moscow-19 August 2016: Fitch Ratings has affirmed the Russian City of Novosibirsk's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) at 'BB' with Stable Outlooks and Short-Term Foreign Currency IDR at 'B'. The agency has also affirmed the city's National Long-Term Rating at 'AA-(rus)' with Stable Outlook.

Fitch has also affirmed Novosibirsk's senior unsecured debt at 'BB' and 'AA-(rus)' ratings.

The affirmation reflects Fitch's unchanged base line scenario that the city will continue to record a stable positive current balance and narrowing fiscal deficit, leading to direct risk stabilising at below 50% of current revenue.

KEY RATING DRIVERS

The ratings reflect Novosibirsk's moderate direct risk with a smooth maturity profile, our expectation of a stable operating margin sufficient to cover interest payment in 2016-2018 and the city's diversified economy. The ratings also factor in Russia's weak institutional framework and a downward national macro-economic trend.

In its base case scenario, Fitch expects a moderate recovery of the city's fiscal performance, with an operating margin of 6%-7% in 2016-2018. The improvement will be backed by the city's cost-efficiency measures to limit expenditure growth below inflation (Fitch's projects 7.5% consumer price increase for 2016). The city's operating margin dropped to 5% in 2015 from a sound average 11% during 2011-2014, following sharp tax revenue declines due to a 10ppts reallocation of personal income tax (PIT) to the regional budget. This was not compensated by an increase in current transfers from the region or equivalent expenditure reallocation to the regional budget.

Fitch expects the city's direct risk to be about RUB16.5bn by end-2016 (2015: RUB16bn), and to stabilise at close to a moderate 50% of current revenue over the medium term. Novosibirsk demonstrates sophisticated debt management and, unlike most Russian peers, the city does not rely on short-term funding. The city's prime source of borrowing is amortising domestic bond issues (54% of direct risk as of 1 June 2016) with up to 10-year maturity followed by revolving lines of credit from local banks with maturity up to six years (21% of total direct risk). This smooths the city's annual refinancing needs.

Novosibirsk's exposure to contingent risk is low, as the city's public sector is compact with few public sector entities. The city has no outstanding guarantees and is unlikely to issue new ones under our base case scenario.

With a population of over 1.5 million inhabitants, the city is the capital of Novosibirsk Region (BBB-/Negative) and is the largest metropolitan area of Siberian Federal District. The city's economy is diversified, with a well-developed processing industry and service sector. The sound economic performance of local companies supports Novosibirsk's fiscal capacity, with taxes accounting for 49% of operating revenue in 2015. However, Fitch's forecast of a 0.5% decline of national GDP in 2016, after a 3.7% drop in 2015, will weigh on the city's economic and budgetary performance.

The City of Novosibirsk's credit profile remains constrained by the weak institutional framework for local and regional governments (LRGs) in Russia. Russia's institutional framework for LRGs has a shorter record of stable development than many international peers. The predictability of Russian LRGs' budgetary policy is hampered by the frequent reallocation of revenue and expenditure responsibilities among government tiers. The city's budgetary performance in 2015 particularly suffered from changes in allocation of revenue and expenditure.

RATING SENSITIVITIES

Restoration of the operating margin sustainably above 10% and maintaining direct risk below 60% of current revenue with a debt maturity profile corresponding to the debt payback ratio could lead to an upgrade.

Deterioration of the budgetary performance, leading to an inability to cover interest expenditure with operating balance, and direct risk increasing to above 70% of current revenue would lead to a downgrade.

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Fitch has made a number of adjustments to the official accounts to make the LRG comparable internationally for analytical purposes, including

- Transfers of capital nature received were re-classified from operating revenue to capital revenue.

- Transfers of capital nature disbursed were re-classified from operating expenditure to capital expenditure.

- Staff expenses for budget entities employees were segregated from current transfers to a respective expenditure item.

- Goods and services of capital nature were re-classified from operating expenditure to capital expenditure.

Additional information is available on www.fitchratings.com

Applicable Criteria
International Local and Regional Governments Rating Criteria - Outside the United States (pub. 18 Apr 2016)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy