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## Research Update:

# Russian City of Novosibirsk Affirmed At 'BB/ruAA'; Outlook Positive

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## Research Update:

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## Overview

- The Russian city of Novosibirsk has posted stronger budgetary performance in 2012, thanks to cost-control measures and revenue growth.
- The city's liquidity and debt policies remain prudent and have resulted in an only moderate debt burden and a neutral liquidity position
- We are affirming our 'BB' long-term credit and 'ruAA' national scale ratings on Novosibirsk.
- The positive outlook reflects our opinion of the increased likelihood that Novosibirsk will continue its financial policies over the next 18-24 months and improve its liquidity position.

## Rating Action

On April 25, 2013, Standard & Poor's Rating Services affirmed its 'BB' long-term issue credit rating on the Russian city of Novosibirsk. The outlook remains positive. At the same time, we affirmed the 'ruAA' Russia national scale rating on the city.

## Rationale

We affirmed the rating because Novosibirsk has improved its budgetary performance and maintained moderate debt and a "neutral" liquidity position. We kept the outlook positive because we think Novosibirsk will continue its existing financial policies over the next 18-24 months. We also think that improved budgetary performance could improve the city's liquidity position.

The ratings on Novosibirsk are constrained by what we see as limited financial flexibility and predictability, mostly resulting from Russia's developing and unbalanced public finance system, and low economic productivity. These constraints are mitigated by Novosibirsk's moderate debt, moderate liquidity supported by prudent debt management, and the city's improved budgetary performance achieved through cost discipline.

Novosibirsk's post-crisis revenue recovery in taxes and operating grants, coupled with reasonable cost containment, have allowed the city to improve its budgetary performance in 2012 to a solid operating surplus of 5.7% of operating revenues and only modest deficits after capital accounts of about 2% of operating revenues. Despite the ongoing spending pressure coming from the need to raise public sector pay, continued operating support from the Novosibirsk Oblast and the ability of the city's management to control

spending demonstrated in 2012 and first quarter 2013 will likely enable the city to maintain the improved financial indicators achieved over the medium term.

Continued and expanding capital support from Novosibirsk Oblast and the federal budget via subsidies and loans will likely continue, because over 56% of the oblast's population lives in the city, which makes it the primary target of the oblast's budget investments. For this reason, we think Novosibirsk will report only modest deficits after capital accounts of less than 5% of total revenues in 2013-2015, and tax-supported debt that will likely remain below 40% of consolidated operating revenues, which we see as modest by international standards.

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 still regard Russia's institutional framework as "developing and unbalanced" (see "Public Finance System Overview: Despite Some Progress, Structural Problems Persist In Russian Municipalities", published Oct. 1, 2012, on RatingsDirect).

The city's relatively 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. These constraints are mitigated by the diversified nature of Novosibirsk's economy and its role as a regional economic center, with important service, transport, and research and development sectors, which in our view could foster the city's economic potential.

### **Liquidity**

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

We consider that management's continued prudent policies have allowed Novosibirsk to significantly improve its debt profile over the last few years. In 2013, the city is planning to place a long-term bond and/or extend existing bank loans coming due in the second half of the year. Such policies should allow the city to contain debt service at less than 7% on average over the next three years.

Novosibirsk's cash on average has historically been low, which remains a rating constraint. Despite the recent improvement in budgetary performance, the city's cash holdings were still below 100% of expected debt service needs for the next 12 months.

But the city's good management of committed bank facilities helps mitigate this. The terms of the city'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 access of Russian LRGs 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 positive outlook reflects our opinion of the increased likelihood that Novosibirsk will continue its budgetary and liquidity policies over the next 18-24 months, despite spending pressure and upcoming elections cycle starting in 2014. The outlook also factors in the higher chances of improving liquidity thanks to the city's stronger cash generation capacity.

We could consider an upgrade if we were to get more certainty that the city is continuing its currently prudent debt and expenditure policies over the next 18-24 months, in particular after the upcoming mayoral elections. In the shorter term, stronger operating margins envisaged in our upside-case scenario could trigger positive actions. Stronger margins would likely mitigate low cash holdings and improve our assessment of Novosibirsk's liquidity position.

We would revise the outlook to stable if we saw that the city's management might change its existing financial policies over the next 18-24 months. Weakening budgetary performance that prevented improvements in the city's liquidity position could also result in negative rating actions.

## Related Criteria And Research

Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

## Ratings List

Ratings Affirmed

Novosibirsk (City of)

Issuer Credit Rating	BB/Positive/--
Russia National Scale	ruAA
Senior Unsecured Debt	BB
	ruAA

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