

Research Update:

Outlook On Russian City Of Novosibirsk Revised To Positive On Stronger-Than-Expected Revenues; 'BB/ruAA' Ratings Affirme

Primary Credit Analyst:

Karen Vartapetov, Moscow (7) 495-783-4018; karen_vartapetov@standardandpoors.com

Secondary Contact:

Felix Ejgel, London (44) 20-7176-6780; felix_ejgel@standardandpoors.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

Outlook On Russian City Of Novosibirsk Revised To Positive On Stronger-Than-Expected Revenues; 'BB/ruAA' Ratings Affirmed

Overview

- Russian City of Novosibirsk has enjoyed stronger revenue growth than we expected in our base-case scenario, thanks to economic recovery and stronger support from Novosibirsk Oblast.
- Management's prudent policies have helped extend the debt profile.
- We are revising our outlook on the city of Novosibirsk to positive from stable and affirming the 'BB/ruAA' ratings on the city.
- The positive outlook reflects a more than 30% likelihood of an upgrade should Novosibirsk's budgetary performance exceed our existing base-case assumptions for 2011-2012 thanks to stronger-than-expected revenue growth. A stronger performance might also have a positive effect on the city's borrowing needs and result in a lower debt burden.

Rating Action

On Nov. 11, 2011, Standard & Poor's Ratings Services revised its outlook on the City of Novosibirsk to positive from stable. At the same time, we affirmed the 'BB' long-term issuer credit rating and the 'ruAA' Russia national scale rating on the city.

Rationale

The outlook revision reflects stronger revenues stemming from higher tax receipts and solid grants from Novosibirsk Oblast (not rated), which could result in better budgetary performance for 2011-2012 than we previously expected. We also recognize that the city's continuation of prudent debt policies has translated into further extension of its debt profile.

The ratings on Novosibirsk are constrained by what we see as limited financial flexibility and predictability, and low economic productivity. These constraints are mitigated by Novosibirsk's moderate debt, favorable debt profile, improved revenue growth, reasonable cost controls that stimulate moderate financial performance, and a relatively diverse economy.

Novosibirsk has enjoyed faster revenue growth in 2011 than we expected, which will likely result in better budgetary performance than we envisaged in our base-case scenario for 2011-2012. Stronger revenues stemmed from solid tax revenue growth due to economic recovery and increased operating and capital grants from Novosibirsk Oblast. Should this support continue through 2012, in

our view Novosibirsk will probably be able to withstand spending pressures triggered by a pre-election hike in public salaries and material capital needs, as well as delivering operating surpluses over 5% of operating revenues.

Capital support from the oblast and federal budgets via subsidies and loans will likely help the city maintain capital spending at 23%-25% of total expenditures. Recovering property markets will also contribute positively to capital revenues in 2011-2012. Because of these factors, we think Novosibirsk will have only moderate deficits, if any, after capital accounts in 2011-2012.

We take note of management's continued prudent policies to extend Novosibirsk's debt profile. By Oct. 31, 2011, the city had managed to secure several five-year committed bank facilities, which further suppressed debt service and extended the average debt maturity to 3.5 years (from 2.7 years a year ago). Now more than 50% of the city's direct debt repayment needs fall beyond three years, compared with only about 13% in late 2010.

By year-end 2011, tax-supported debt will likely comprise roughly 30% of consolidated operating revenues, which we see as modest by international standards. New loans from the federal budget, which are less predictable, but cheap and long-term, might slightly increase debt levels, yet our base-case scenario does not anticipate that the city's debt burden will exceed a moderate 35% of consolidated operating revenues in the medium term.

As with other Russian local and regional governments, Novosibirsk's financial predictability and flexibility is severely 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 frameworks as "developing and unbalanced" (see "The System For Russia's Regions Is Developing And Unbalanced", published Oct. 21, 2011, on RatingsDirect on the Global Credit Portal).

Novosibirsk's economy continues to recover. However, wealth levels are still only slightly above the Russian average. The city economy suffers from low productivity, especially in the industrial sector, and the poor state of municipal infrastructure, with a number of bottleneck issues such as obsolete transport, utilities, and housing. These constraints are mitigated by the city's role as a regional economic center, with important service, transport, and research and development sectors, which in our view help support the city's economic potential.

Liquidity

We see Novosibirsk's liquidity position as "neutral". As of mid-October 2011, the city's free cash comfortably covered its debt service over the next 12 months. The city's earliest principal debt payment is scheduled in April-May 2012 and consists of minor bank loans.

The city's cash on average has historically been low and volatile, which we

factor in as a credit concern. Moreover, despite currently high cash reserves (including earmarked funds from regional and federal governments), it is expected to remain volatile in the absence of a more prudent and established cash policy. However, this is mitigated by the city's access to a wide range of bank facilities. In July-October 2011 Novosibirsk obtained several committed bank lines. As of late October 2011, about 40% of the available total was not withdrawn.

The terms of Novosibirsk's access to bank lending are more favorable than those for many higher-rated entities, with a number of local and federal banks reserving internal lending limits for the city. Nevertheless, according to our methodology, we qualify Novosibirsk's access to financial markets as "limited" by international standards because of what we see as a weak domestic bank system and the limited development of Russia's capital market.

Outlook

The positive outlook reflects a more than 30% likelihood of an upgrade should Novosibirsk's budgetary performance exceed our existing base-case assumptions for 2011-2012 thanks to stronger-than-expected revenue growth. Under this scenario, the city's operating surplus would exceed 5% of operating revenues, whereas its deficit after capital accounts would stay below 4%-5% of total revenues. A stronger performance might also have a positive effect on the city's borrowing needs and result in a lower debt burden.

We would consider a positive rating action if the city's financial performance reaches our upside-case indicators in 2011-2012, which would also likely result in a somewhat lower debt burden. Positive actions would also depend on the city's ability and willingness to institutionalize its cash and liquidity policies, ensuring a structurally stronger and less volatile cash balance.

Our scenario for revising the outlook to stable assumes that the pace of operating spending growth would offset the currently observed revenue growth and lead to the budgetary performance envisaged in our base-case scenario and the stabilization of the debt burden at the existing level.

Related Criteria And Research

- Public Finance System Overview: The System For Russia's Regions Is Developing And Unbalanced, Oct. 21, 2011
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010

Ratings List

CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Novosibirsk (City of)		

Research Update: Outlook On Russian City Of Novosibirsk Revised To Positive On Stronger-Than-Expected Revenues; 'BB/ruAA' Ratings Affirmed

Issuer Credit Rating BB/Positive/-- BB/Stable/--

Ratings Affirmed

Russia National Scale Rating ruAA

Additional Contact:

International Public Finance Ratings Europe;PublicFinanceEurope@standardandpoors.com

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2011 by Standard & Poors Financial Services LLC (S&P), a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.