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

Fitch Ratings-Moscow-11 August 2017: 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'. Novosibirsk's senior debt has been affirmed at long-term 'BB'.

The affirmation reflects Fitch's expectation that the city will continue to record a stable, positive current balance and will narrow its fiscal deficit over the medium term, leading to a stabilisation of its direct risk.

KEY RATING DRIVERS
The ratings reflect Novosibirsk's moderate direct risk with a smooth maturity profile, satisfactory budgetary performance with a positive current balance and the city's diversified economy. The ratings also factor in Russia's weak institutional framework and a sluggish national economic environment.

According to Fitch's base case scenario the city will continue to record stable fiscal performance, with an operating margin between 5% and 7% in 2017-2019, which will be sufficient to cover annual interest payment. This will be backed by steady growth of personal income tax, which accounts for about two-thirds of the city's tax revenue. Novosibirsk's budgetary performance improved in 2016 with an operating margin of 8.6%, from a low 5% in 2015. However, the improvement was due to additional transfers from the regional budget of about RUB0.8 billion in December 2016, which were not spent. If adjusted for this amount, the operating margin would have been 6.4%.

For 6M17 the city collected 43.4% of its budgeted revenue for the full year and incurred 46.5% of budgeted expenditure, leading to an interim RUB2.1 billion deficit. We expect higher tax revenue proceeds over 2H17 to take the full-year deficit to around RUB1.4 billion, or 3.7% of total revenue (albeit still larger than the RUB0.8 billion deficit or 2.3% in 2016). Deficit widening in 2017 is likely to be a result of some expenditure being shifted from 2016 but Fitch expects the deficit will gradually narrow to 1.5%-2% in 2018-2019.

Novosibirsk's fiscal flexibility remains limited and the city's performance is supported by regular transfers from Novosibirsk Region (BBB-/Stable). Current transfers are largely earmarked for certain expenditure, including the region's mandated responsibilities, and accounted for about 40% of the city's operating revenue in 2016.

Fitch expects the city's direct risk to total around RUB18.5 billion by end-2017 (2016: RUB17.5 billion), and to increase to RUB20 billion in 2018-2019, driven by an expected modest fiscal deficit. We expect direct risk to peak at 53.4% of current revenue in 2017 (2016: 52.8%) before declining toward 50% over the medium term on the back of revenue growth exceeding nominal debt increase.

Novosibirsk demonstrates sophisticated debt management and unlike most of its Russian peers, the city does not rely on short-term funding. The city's primary source of borrowing is amortising domestic bond issues (49% of direct risk as of 1 July 2017) with up to 10-year maturity followed by revolving lines of credit from local banks with maturity of up to six years (28% of total direct risk). This smooths the city's annual refinancing needs.

With a population of about 1.6 million inhabitants, the city is the capital of Novosibirsk Region 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 tax revenue accounting for 47.5% of operating revenue in 2016. Fitch forecasts national GDP will start to gradually recover with 1.6% growth in 2017, after a 0.2% decline in 2016, which should support Novosibirsk's economic and budgetary performance.

The city'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.

RATING SENSITIVITIES
Restoring the operating margin to above 10% on a sustained basis 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 the city's operating balance, and direct risk increasing to above 70% of current revenue would lead to a downgrade.

Contact:
Primary Analyst
Vladimir Redkin
Senior Director
+7 495 956 2405
Fitch Ratings CIS Ltd
26 Valovaya Street
Moscow 115054

Secondary Analyst
Elena Ozhegova
Director
+7 495 956 2406

Committee Chairperson
Guido Bach
Senior Director
+49 69 768076 111

Media Relations: Julia Belskaya von Tell, Moscow, Tel: +7 495 956 9908, Email: julia.belskayavontell@fitchratings.com;

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

It should be noted that the data stated on the city's debt in our previous commentary dated 17 February 2017 were based on preliminary financials.

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