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

Link to Fitch Ratings' Report: Novosibirsk City - Rating Action Report

Fitch Ratings-Moscow/London-25 February 2016: Fitch Ratings has assigned the Russian City of Novosibirsk Long-term foreign and local currency Issuer Default Ratings (IDRs) of 'BB' with Stable Outlooks and a Short-term foreign currency IDR of 'B'. The agency has also assigned the city a National Long-term rating of 'AA-(rus)' with Stable Outlook.

Fitch has assigned Novosibirsk's senior unsecured domestic bonds (ISIN RU000A0JVUD3, ISIN RU000A0JU1T2, ISIN RU000A0JSY25) 'BB' and 'AA-(rus)' ratings.

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 consider our expectation of the city's weaker than historical average fiscal performance over the medium term and Russia's weak institutional framework amid a downward macro-economic trend.

In its base case scenario, Fitch expects a moderate recovery of the city's fiscal performance, with an operating margin of 7% in 2016-2018, which is still below the sound 11% average during 2011-2014. The improvement will be backed by the city's cost-efficiency measures to limit expenditure growth below inflation (Fitch's projects 9.5% consumer price increase for 2016). The city's operating margin dropped to 5% in 2015 following a 17.5% tax revenue decline due to a reallocation of 10 percentage points 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 views Russia's institutional framework for local and regional governments (LRGs) as a constraint on the city's ratings. It has a shorter track record of stable development than many of its international peers. Frequent changes in allocation of revenue and expenditure responsibilities between the tiers of government lead to lower predictability of city's budgetary policy and hamper long-term planning. The city's budgetary performance particularly suffered from changes in allocation of revenue and expenditure in 2015.

Fitch expects the city's direct risk to be about RUB16.5bn by end-2016 (2015: RUB16bn), and stabilise at close to a moderate 50% of current revenue in the medium term. Following a sharp deterioration of the operating balance and an increase in interest expenditure, the city's debt payback ratio (direct risk to current balance) weakened to 29 years in 2015 from a sound four years average during 2011-2014. Fitch expects improvement of debt payback to 15 years in 2016-2018 back on an operating balance rebound, but it will remain above direct risk maturity of six years.

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 revolving lines of credit from local banks with maturity up to six years (48% of total direct risk) following by amortising domestic bond issues (39% of direct risk) with up to seven years maturity. This smooths the city's annual refinancing needs. By end-2016, Novosibirsk needs to refinance RUB3.2bn, which was fully covered by RUB3.5bn committed credit lines as of 1 February 2016.

Novosibirsk's exposure to contingent risk is low, as its public sector is compact with few public sector entities, which had modest RUB217m outstanding debt in 2015. The city has no outstanding guarantees and is unlikely to issue new ones according to 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 well-developed processing industry and service sector. The sound economic performance of local companies supports Novosibirsk's fiscal capacity, with taxes averaging 51% of operating revenue in 2011-2015. The city does not receive general-purpose grants from the region, as its budget capacity is higher than the average budget capacity of the municipalities in the region.

RATING SENSITIVITIES

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

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

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Additional information is available on www.fitchratings.com

Applicable Criteria
International Local and Regional Governments Rating Criteria (pub. 18 May 2015)
Tax-Supported Rating Criteria (pub. 14 Aug 2012)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form