Fitch Affirms City of Moscow at 'BBB'; Outlook Negative

Fitch Ratings-Moscow/London-06 June 2014: Fitch Ratings has affirmed the Russian City of Moscow's Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB' with Negative Outlooks, Short-term foreign currency IDR at 'F3' and National Long-term rating at 'AAA(rus)' with a Stable Outlook. Moscow's outstanding senior unsecured debt has also been affirmed at 'BBB' and 'AAA(rus)'.

KEY RATING DRIVERS

The affirmation reflects Moscow's capital status, its robust wealth and economic indicators, sound budgetary performance, capex flexibility and strong debt ratios. The ratings also factor in the slowdown of tax revenue due to the national economy's deceleration and corresponding pressure on its operating balance.

Fitch forecasts that the city will continue to record a stable operating performance and strong operating balance at about 17%-18% of operating revenue in 2014-2016. Despite the deterioration in the city's operating margin to 16%-20% in 2009-2013 compared with the high pre-crisis levels of 35%-40%, Moscow has a sound financial position, reflecting its capacity to absorb shocks.

Moscow receives significant tax proceeds from major national businesses headquartered in the city. However, due to the large proportion of direct taxes in its budget, it is vulnerable to economic shocks. In addition, new national tax regulation regarding corporate income tax paid by large consolidated taxpayers negatively affected the city's budget. Together with the decline of current transfers from the federal budget, this led to a deceleration of operating revenue growth to average 4% yoy in 2012-2013, below the average growth of 16% yoy during 2011-2012.

Fitch expects operating expenditure growth will correspond to inflation and average 7% in 2014-2016. The city has managed to limit its operating expenses in line with a slowdown of tax revenues. Fitch expects that the city's recent territorial expansion will not lead to considerable investments in the medium term but there will be additional spending for new infrastructure development in the next 10-15 years.

Moscow's debt burden is low by both national and international standards. Fitch expects Moscow's direct risk will account to RUB181bn at end-2014 or 12% of current revenue. It will grow to about RUB296bn by end-2016, which is still a low 17% of current revenue. The expected debt increase will be due to a sharp decline in asset sales proceeds starting from 2015 as large scale privatisation programme will end in 2014. As a result, Moscow will need to use market borrowing to finance its investment programme. The city has strong debt coverage (direct risk to current balance) below one year and a long direct risk maturity profile up to 2022. Combined with strong liquidity (RUB222bn at 1 January 2014), these factors underpin its financial position.

The city directly and indirectly controls an extensive public sector. This involves additional contingent risk and puts pressure on budget expenditure via administrative expenses and subsidies. Due to the large size of the city's budget, Fitch does not consider risk from the sector to be significant. The administration is making a significant and successful effort to reduce the number of public companies and has privatised several shareholdings. Moscow earned RUB105bn from asset sales in 2013, the bulk of which related to selling shares of Moscow Integrated Power Company (BB/Negative/B). The city expects to earn another RUB58bn in 2014.

Moscow benefits from its status as the Russian capital and the country's economic and financial centre. It has a strong, service-oriented economy and contributed about 17% of Russia's GDP in

2013. Per capita gross city product was almost 2.5x the national average in 2012, making the city one of the wealthiest regions in the country.

RATING SENSITIVITIES

Moscow's ratings are constrained by Russia's ratings (BBB/Negative). A downgrade is unlikely due to the city's intrinsic strength, unless the sovereign is downgraded. However, a consistent material downward deviation from the baseline scenario would be negative for the city's ratings.

The ratings would be positively affected by a revision of the sovereign Outlook to Stable from Negative accompanied by healthy debt and debt coverage ratios.

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Additional information is available at www.fitchratings.com.

Applicable criteria, 'Tax-Supported Rating Criteria', dated 14 August 2012, and 'International Local and Regional Governments Rating Criteria outside United States', dated 23 April 2014, are available on www.fitchratings.com.

Additional Disclosure
Solicitation Status