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Rating Rationale

March 01, 2019 | Mumbai

Surat Municipal Corporation

'CRISIL AA+(SO)/Stable' Converted from Provisional Rating to Final Rating for bonds

Rating Action

Rs.200 Crore Taxable Bonds

CRISIL AA+(SO)/Stable (Converted from Provisional rating to final rating)

1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL has converted the provisional rating assigned to the taxable bonds of Surat Municipal Corporation (SMC) to a final rating of '**CRISIL AA+(SO)/Stable**' after receiving the final legal documents executed for the transaction. The executed documents are in line with the transaction terms at the time of provisional rating. Hence, CRISIL has converted the provisional rating into a final rating.

As required, CRISIL has received the following final legal documents:

- * Debenture trust agreement
- * Debenture trust deed
- * Escrow agreement
- * Representations and warranties letter

The rating reflects strong creditworthiness and low performance risk of originator, high debt service coverage ratio (DSCR) leading to low impact of future flow on originators' other obligations, additional security in the form of debt service reserve account (DSRA) created before pay-in, presence of a payment structure, and recourse to the originator. Performance linkage is low, as inflows are dependent on property taxes and user charges. Typically, property taxes increase over time, reducing risk of inflows. DSCR is expected to be adequately high at over 16 times. The bonds have a well-defined structure of escrow account, payment structure, and points of recourse in case of shortfalls.

The rating continues to reflect the corporation's strong operating performance and robust financial risk profile, driven by stable operating surplus, nil debt, ample liquidity, and strong debt protection metrics. Furthermore, SMC has a sound economic base, adequate service levels, healthy collection efficiency of taxes and charges, and good reform orientation. These strengths are partially offset by heavy reliance on state government grants and large capital expenditure (capex) requirement.

Analytical Approach

For arriving at the rating, CRISIL has applied its criteria of future flow securitisation.

Key Rating Drivers & Detailed Description

Strengths:

* Strong operating performance, reflected in healthy operating surplus

Revenue profile includes income from collection of property tax, user charges for water and sewerage service, income from other taxes such as professional tax, octroi compensation, other revenue grants, and other non-tax income. Operating surplus is healthy, backed by robust property tax collection, steady receipt of grants from the state government in lieu of octroi, and non-tax income primarily comprising collection from public places, town development income, and rental income. For fiscal 2018, SMC generated operating surplus of around Rs 613 crore.

Year ended March 31st		2014	2015	2016	2017	2018
Revenue receipts	Rs crore	1464	1672	1757	2138	2674
Revenue expenditure	Rs crore	1164	1303	1457	1639	2061
Operating surplus	Rs crore	301	369	300	499	613

Going forward, SMC is expected to maintain strong operating surplus over the medium term due to consistent property tax collections, increase in various user charges and non-tax income, and control over revenue expenditure.

* Robust financial risk profile and ample liquidity

SMC had no outstanding debt as on December 31, 2018. Healthy revenue surplus helped the corporation largely fund its increasing capex through internal accrual, without resorting to debt. The robust cash flow generated ample liquidity. Unencumbered cash and cash equivalents were Rs 885 crore as on March 31, 2018, including bank balance and fixed deposits.

Over the medium term, SMC has large planned capex under Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and Smart City Projects. The capex is likely to be funded primarily out of a mix of government grants and its own revenue surpluses. The corporation is planning to raise Rs 200 crore through municipal bonds in order to meet its own share of contribution towards the AMRUT mission. Despite increase in the corporation's debt, debt protection metrics and operating surplus will remain strong over the medium term since the quantum of proposed incremental debt is relatively low. However, any sizeable debt raised towards funding capex could weaken the financial risk profile and will be a key rating sensitivity factor.

* Adequate service levels and healthy collection efficiency of taxes and charges

The corporation has an adequate civic infrastructure and robust delivery systems. High infrastructure quality is reflected in good water supply coverage, adequate road and sewerage networks, and improving drainage and solid waste management practices.

Current collection efficiency of property tax is maintained at 95-97%; overall collection efficiency was stable at 84% in fiscal 2018. Cost of recovery for essential services has improved and is among the highest compared to other corporations in the state. Implementation of AMRUT and Smart City Projects should further drive improvement in the service-level arrangements of the corporation and result in increased collection efficiency of taxes and charges.

* Sound economic base

SMC's robust industrial base, favourable location, strategic importance in the state, and high per-capita income has led to a strong economic base. Industries in Gujarat have flourished due to favourable state government policies, affordable cost of living, surplus labour, and low transportation cost.

* Good reform orientation

SMC has been able to execute various reforms, backed by adequate technical capabilities and supportive staff. The corporation has robust processes and systems to take care of day-to-day activities. SMC has been a forerunner in implementing geographic information system mapping of properties and the double entry accounting method. Metering of water connections is an area where limited progress has been made. However, once done, it will significantly improve cost recovery.

Weaknesses:

* High dependence on state government grants

Although the share of grants and compensation from the state government reduced to 32% in fiscal 2018 from 49% in fiscal 2013, it continues to be a major part of total revenue receipts. Since the abolition of octroi in fiscal 2008, SMC has been consistently receiving compensation from the state government. In fiscal 2016, increased compensation, inclusive of a 15% hike, was provided. In fiscal 2018, Rs 723 crore was received as octroi compensation. With rise in property tax rates and non-tax revenue, dependence on government grants is likely to reduce further over the medium term.

* Large capex requirement

There is large capex requirement over the medium term for implementing the AMRUT, Smart City schemes and other planned expenditure. The estimated project cost under these schemes is Rs 5,000 crore, spread over five years. The corporation is planning to raise Rs 200 crore by issuing taxable bonds in fiscal 2019 in order to fund its own share under AMRUT.

SMC will, likely, maintain a healthy operating surplus over the medium term and is not expected to contract sizeable debt. However, any significant increase in capex, leading to substantial incremental debt, could weaken the financial risk profile and will remain a key rating sensitivity factor.

Liquidity

Liquidity is ample, driven by healthy operating surplus of 20% on average annually over the past five fiscals and unencumbered cash and bank balance of Rs 885 crore as on March 31, 2018, likely to be maintained over the medium term. Operating surplus was Rs 613 crore in fiscal 2018 against nil debt obligation. SMC is likely to maintain unencumbered cash and bank balance and continue to generate healthy operating surplus to meet future debt obligations and part-funded capex.

Outlook: Stable

CRISIL believes SMC will continue to generate high operating surplus over the medium term, while maintaining strong debt protection metrics.

Upside scenario

- * Sustained increase in own revenue of the corporation with controlled revenue expenditure leading to healthy operating surplus
- * Enhancement in services currently provided, such as water supply, sewerage, drainage, and solid waste management

Downside scenario

- * Significant decline in collection of property tax
- * Weakening of financial risk profile
- * Decline in support from state government in terms of adequacy and timeliness of octroi compensation; availability of funds under AMRUT and Smart City schemes and other grants

About the corporation

SMC is governed by the Bombay Provincial Municipal Corporation Act, 1949, as amended by the Government of Gujarat. It has jurisdiction over 326 square kilometres, a majority of which includes water supply, sewerage disposal, solid waste management, primary education, public safety, transportation, and slum improvement.

Key Financial Indicators

As on / for the period ended March 31	Units	2018	2017
Revenue receipts	Rs crore	2674	2138
Revenue surplus	Rs crore	606	495
Revenue surplus/ revenue receipts	%	23%	23%

Any other information:

Broad contours of the escrow structure pertaining to the current Rs 200 crore taxable bond issue are as follows:

- a. The tenure is five years with coupon half-yearly payment frequency
- b. Bullet/full redemption at the end of five years
- c. Escrow of property tax and user charges collected by and due to SMC-eligible bondholders and lenders shall have first and pari-passu charge over the escrow account, debt service account (DSA), and the collection account(s).
- d. Establishing separate DSA, DSRA, interest payment accounts (IPA), and sinking fund accounts (SFA) with the escrow banker as per the terms of each series. Bondholders/lenders of a particular series have first and pari-passu charge over DSA, DSRA, IPA, and SFA for the respective series.

e. In case of any shortfall from transfer from the escrow account to DSA, SMC shall compensate with funds from other account(s) to DSA.

Interest payment mechanism

T - Interest payment date

Day	
T-25	The trustees shall check the amount lying to the credit of IPA. In case of any shortfall in amount, the trustees shall intimate SMC
T-15	SMC shall make good the shortfall in the IPA, if applicable
T-14	In case of shortfall, trustees shall trigger the payment mechanism and instruct bank to transfer the shortfall amount from the DSRA to the IPA
T-10	Bank shall transfer the shortfall amount, if applicable*
T	Interest payment is done

* Any amount drawn from the DSRA should be deposited back in the account

Redemption mechanism

T - Redemption date

Day	
T-25	The trustees shall check the amount lying to the credit of the SFA. In case of any shortfall in amount, the trustees shall intimate SMC
T-15	SMC shall make good the shortfall in the SFA
T	Redemption payment is done

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Annexure - Details of Instrument(s)

ISIN	Type of instrument	Date of allotment	Coupon	Maturity date	Issue Size (Rs crore)	Rating Assigned with Outlook
INE05NX24015	Taxable bonds	01-Mar-19	8.68%	01-Mar-24	200	CRISIL AA+(SO)/Stable

Annexure - Rating History for last 3 Years

Instrument	Type	Current		2019 (History)		2018		2017		2016		Start of 2016
		Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
--	CCR		--		--		--		--	30-06-16	Withdrawal	
Bond	LT	200.00 01-03-19	CRISIL AA+(SO)/Stable	01-02-19	Provisional CRISIL AA+(SO)/Stable		--		--		--	--

All amounts are in Rs.Cr.

Links to related criteria

[Rating Criteria for Municipal and Urban Local Bodies](#)

For further information contact:

Media Relations	Analytical Contacts	Customer Service Helpdesk
<p>Saman Khan Media Relations CRISIL Limited D: +91 22 3342 3895 B: +91 22 3342 3000 saman.khan@crisil.com</p> <p>Naireen Ahmed Media Relations CRISIL Limited D: +91 22 3342 1818 B: +91 22 3342 3000 naireen.ahmed@crisil.com</p> <p>Vinay Rajani Media Relations CRISIL Limited D: +91 22 3342 1835 M: +91 91 676 42913 B: +91 22 3342 3000 vinay.rajani@ext-crisil.com</p>	<p>Anuj Sethi Senior Director - CRISIL Ratings CRISIL Limited B:+91 44 6656 3100 anuj.sethi@crisil.com</p> <p>Gautam Shahi Director - CRISIL Ratings CRISIL Limited B:+91 124 672 2000 gautam.shahi@crisil.com</p> <p>Digvijay Singh Rathore Rating Analyst - CRISIL Ratings CRISIL Limited D:+91 22 3342 3256 Digvijay.Rathore@crisil.com</p>	<p>Timings: 10.00 am to 7.00 pm Toll free Number:1800 267 1301</p> <p>For a copy of Rationales / Rating Reports: CRISILratingdesk@crisil.com</p> <p>For Analytical queries: ratingsinvestordesk@crisil.com</p>

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