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Rating Rationale

February 28, 2020 | Mumbai

Surat Municipal Corporation

Rating Reaffirmed

Rating Action

Rs.200 Crore Taxable Bonds	CRISIL AA+/Stable (Reaffirmed)
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1 crore = 10 million

Refer to annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL has reaffirmed its 'CRISIL AA+/Stable' rating on the taxable bonds of Surat Municipal Corporation (SMC).

The rating continues to reflect strong creditworthiness and low performance risk of the originator, high debt service coverage ratio (DSCR) leading to low impact of future cash flow on the other obligations, additional security in the form of a debt service reserve account (DSRA) created before pay-in, presence of a payment structure, and recourse to the originator. The rating also reflects a strong operating performance and strong financial risk profile, driven by stable operating surplus, low debt, superior liquidity, and strong debt protection metrics. Furthermore, the corporation 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 on future flow securitisation.

Key Rating Drivers & Detailed Description

Strengths:

* Strong operating performance, reflected in a healthy operating surplus

Revenue 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 2019, the operating surplus was around Rs 774 crore.

The strong operating surplus is likely to be maintained over the medium term due to consistent property tax collections, increase in various user charges and non-tax income, and control over revenue expenditure.

* Strong financial risk profile

The healthy operating surplus helped to fund the increasing capex through internal cash accrual, with low reliance on debt. As on March 31, 2019, outstanding debt was Rs 200 crore. The robust cash flow has strengthened liquidity. Unencumbered cash and cash equivalents were over Rs 1,130 crore as on March 31, 2019, including bank balance and fixed deposits.

Over the medium term, the corporation has large planned capex under the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and Smart City Projects. The capex is being funded primarily out of a mix of government grants and own revenue surplus. In March 2019, it had raised Rs 200 crore through municipal bonds in order to meet its own share of contribution towards AMRUT. Despite the increase in debt, debt protection metrics have remained strong and are expected to remain so over the medium term due to no incremental borrowings. 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 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 94-97%; overall collection efficiency is also stable at 80-85%. Cost of recovery for essential services has improved and is among the highest compared with other corporations in the state. Implementation of AMRUT and Smart City Projects should further drive improvement in service-level arrangements and result in increased collection efficiency of taxes and charges.

* Sound economic base

A robust industrial base, favourable location, strategic importance in the state, and high per-capita income have led to a sound 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

The corporation has been able to execute various reforms, backed by adequate technical capabilities and supportive staff. It has robust processes and systems to take care of day-to-day activities. It 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 23% in fiscal 2019 from 45% in fiscal 2013, it continues to be a major part of total revenue receipts. Since the abolition of octroi in fiscal 2008, the corporation has been consistently receiving compensation from the state government. In fiscal 2016, increased compensation, inclusive of a 15% hike, was provided. In fiscal 2019, Rs 723 crore was received as octroi compensation. With a 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**

The large capex requirement over the medium term would be for implementing the AMRUT and Smart City schemes, and other planned expenditure. The estimated project cost under these schemes is Rs 5,000 crore, spread over five years.

A healthy operating surplus is likely to be maintained and no sizeable debt is expected to be contracted, over the medium term. 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 Superior

Operating surplus has been healthy at an average of over 20% during the five fiscals through 2019. The unencumbered cash and bank balance of over Rs 1,130 crore as on March 31, 2019, is likely to be maintained over the medium term. Operating surplus was Rs 774 crore in fiscal 2019 against nil debt obligation. The unencumbered cash and bank balance and continued healthy operating surplus should be sufficient to meet future debt obligation 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.

Rating Sensitivity factors**Upward Factors:**

- * Significant improvement in service arrangements such as water supply, sewerage, and solid waste management
- * Increased collection efficiency in existing own-revenue sources and generation of income from additional sources
- * Substantial and sustained increase in operating surplus to over 30%

Downward Factors:

- * Significant decline in collection of property tax
- * Fall in operating surplus to below 15%
- * Weakening of debt protection metrics
- * Reduction in support from the state government in terms of adequacy and timeliness of octroi compensation, and availability of funds under AMRUT and Smart City schemes and other grants
- * Any adverse change in the payment structure mechanism

About the Corporation

SMC is the largest municipal corporation in Gujarat and is governed by the Bombay Provincial Municipal Corporation Act, 1949, as amended by the Government of Gujarat. It has jurisdiction over 326 square kilometre. Services mainly include 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	2019	2018
Revenue receipts	Rs crore	2957	2674
Revenue surplus	Rs crore	760	606
Revenue surplus/ revenue receipts	%	26%	23%

Any other information:**Broad contours of the escrow structure:**

- a. The tenure is five years with half-yearly coupon payment
- 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 the bank to transfer the shortfall amount from the DSRA to the IPA
T-10	The 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 in 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-019	8.68%	01-Mar-2024	200	CRISIL AA+/Stable

Annexure - Rating History for last 3 Years

Instrument	Type	Current		2020 (History)		2019		2018		2017		Start of 2017
		Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Bond	LT	200.00 28-02-20	CRISIL AA+/Stable			07-09-19	CRISIL AA+/Stable		--		--	--
						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](#)

[Understanding CRISILs Ratings and Rating Scales](#)

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