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Rating Rationale

February 26, 2021 | 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 Ratings 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 healthy 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 Ratings 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 2020, the operating surplus was around Rs 533 crore.

The revenue receipts of SMC were impacted in the first few months of fiscal 2021 on account of restrictions imposed to contain the Covid-19 pandemic. The non-tax revenue collections were lower because of the pandemic, while the tax receipts were only marginally lower till November 2020, compared to the same period last fiscal. The rebate provided on the property tax led to recovery of property tax collections after first few months of lockdown. In addition, SMC continues to receive the octroi compensation on timely basis.

The healthy 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, 2020, outstanding debt was Rs 200 crore. The robust cash flow generates ample liquidity. Unencumbered cash and cash equivalents were over Rs 1069 crore as on March 31, 2020, including bank balance and fixed deposits. SMC is expected to maintain the cash balances at same similar level, going forward.

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.

- 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 93-98%; overall collection efficiency is also stable at 75-85% over last 3 fiscals. 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 27% in fiscal 2020 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 2020, 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

Liquidity is superior, driven by healthy operating surplus of over Rs 500 crore annually over the past five fiscals and unencumbered cash and bank balance of over Rs 1069 crore as on March 31, 2020. The liquidity is maintained at over Rs 1000 crore by SMC. Operating surplus was Rs 533 crore in fiscal 2020. 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 Ratings believes SMC will continue to generate healthy 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% on sustainable basis
- 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 Company

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	2020	2019
Revenue receipts	Rs.Crore	2890	2957
Revenue surplus	Rs.Crore	465	760
Revenue surplus/revenue receipts	%	16%	26%

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

- The tenure is five years with half-yearly coupon payment
- Bullet/full redemption at the end of five years
- 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).
- 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.
- 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

Note on complexity levels of the rated instrument:

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Annexure - Details of Instrument(s)

ISIN	Type of instrument	Date of allotment	Coupon Rate (%)	Maturity date	Issue Size (Rs.Crore)	Complexity Level	Rating Assigned with Outlook
INE05NX24015	Taxable Bonds	01-Mar-019	8.68%	01-Mar-2024	200	Simple	CRISIL AA+/Stable

Annexure - Rating History for last 3 Years

Instrument	Type	Current		2021 (History)		2020		2019		2018		Start of 2018
		Outstanding Amount	Rating	Date	Rating	Date	Rating	Date	Rating	Date	Rating	Rating
Corporate Credit Rating	LT		--		--		--		--		--	Withdrawn
Bond	LT	200.0	CRISIL AA+/Stable		--	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](#)[CRISILs rating methodology for future flow securitisation](#)

Understanding CRISILs Ratings and Rating Scales

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>Anuj Sethi Senior Director CRISIL Ratings Limited B:+91 44 6656 3100 anuj.sethi@crisil.com</p> <p>Gautam Shahi Director CRISIL Ratings Limited B:+91 124 672 2000 gautam.shahi@crisil.com</p> <p>Saurabh Milind Bhide Senior Rating Analyst CRISIL Ratings Limited B:+91 22 3342 3000 Saurabh.Bhide@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: ratingsinvestor@crisil.com</p>

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