

Surat Municipal Corporation

Credit rating report

March 2022

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Instruments and ratings

Rs 2 billion taxable bonds

CRISIL AA+/Stable (reaffirmed)

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Rating history

Date	Long Term	Fixed Deposit	Short Term	Rating Watch/Outlook
January 19, 2022	CRISIL AA+	-	-	Stable
February 26, 2021	CRISIL AA+	-	-	Stable
February 28, 2020	CRISIL AA+	-	-	Stable
September 07, 2019	CRISIL AA+	-	-	Stable
March 01, 2019	CRISIL AA+(SO)	-	-	Stable
February 01, 2019	Provisional CRISIL AA+(SO)	-	-	Stable

Analytical approach and adjustments

Portfolio performance/networth/ gearing/parent or group support	Analytical treatment
Future Flow Securitisation	For arriving at the rating, CRISIL Ratings has applied its criteria on future flow securitisation

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.

Rating drivers

Supporting factors	Constraining factors
<ul style="list-style-type: none"> Strong operating performance, reflected in healthy operating surplus Strong financial risk profile Adequate service levels and healthy collection efficiency of taxes and charges Sound economic base Good reform orientation 	<ul style="list-style-type: none"> High dependence on state government grants Large capex requirement

Rating sensitivity factors

Outlook: Stable

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

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

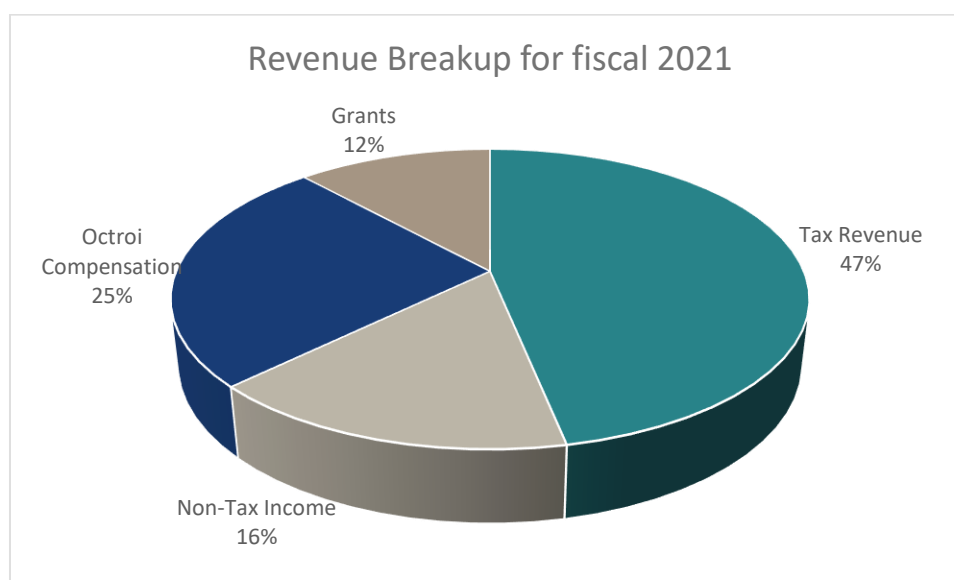
Overview

SMC is one of the largest municipal corporation in Gujarat, governed by the Bombay Provincial Municipal Corporation Act, 1949, as amended by the Government of Gujarat. It has jurisdiction over 462.149 square kilometres. Services mainly include water supply, sewerage disposal, solid waste management, primary education, public safety, transportation, and slum improvement.

Key credit factors

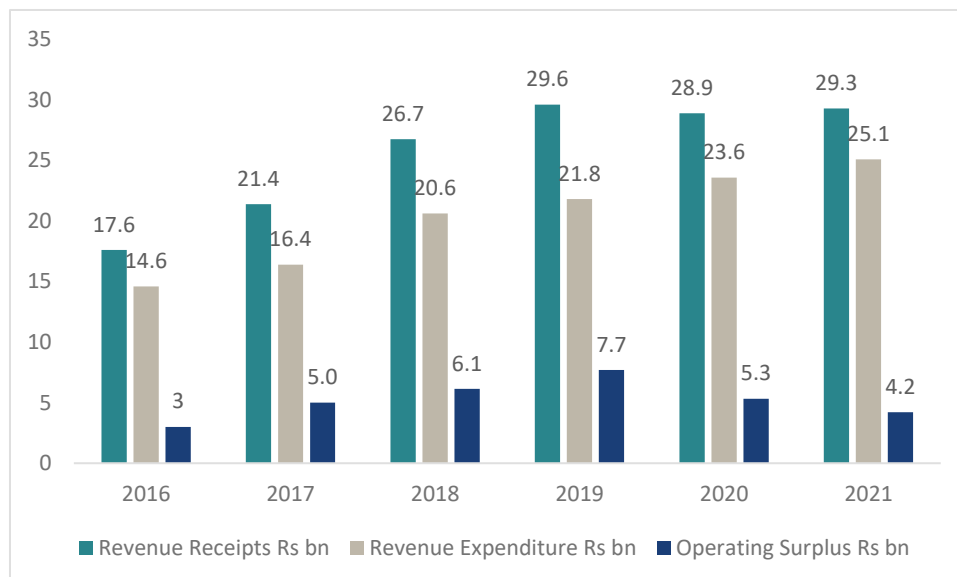
Strong operating performance, reflected in healthy operating surplus

Revenue is derived from collection of taxes, user charges for water and sewerage services, octroi compensation, revenue grants, and non-tax income (collection from public places, and town development and rental income).



Revenue surplus is healthy, backed by tax collections, non-tax income and steady receipt of compensation from state government in lieu of octroi.

SMC, for fiscal 2021, had an operating surplus of Rs 4.4 bn against Rs. 5.3 bn during the previous fiscal. The operating surplus is lower due to decline in non-tax revenues on account of the lower economic activity induced by the pandemic. However, it has been supported by timely receipt of grants from the state government. Operating surplus is expected to increase marginally in fiscal 2022 over a low base of previous fiscal, driven by consistent property tax collections, increase in various user charges and non-tax income and reimbursement of covid expenses from state government. This, coupled with control on revenue expenditure, will result in strong operating surplus over the medium term.



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, 2021, outstanding debt was Rs 2 billion. The robust cash flow generates ample liquidity. Unencumbered cash and cash equivalents were over Rs 11.77 billion as on September 30, 2021, 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 2 billion 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 85-95%; overall collection efficiency is also stable at 65-85% over last 3 fiscals. Cost of recovery for essential services 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

SMC's robust industrial base, favourable location, strategic importance to Gujarat, and high per-capita income has led to a strong economic base. Surat is one of the most important cities on the industrial map of India. The economic base comprises textile manufacturing, trade, diamond-cutting, and polishing segments; intricate Zari works; chemical industries; and petrochemical- and natural gas-based industries in Hazira, which are established by leading players such as Oil & Natural Gas Corporation Limited, Reliance Industries Limited (rated 'CRISIL AAA/Stable/CRISIL A1+'), ESSAR, and Shell. 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 manage daily activities. It has been a forerunner in implementing geographic information system (GIS) mapping of properties and 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.

High dependence on state government grants

Although the share of grants and compensation from the state government reduced to 36% in fiscal 2021 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 2021, 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 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 50 billion, 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 4 billion annually over the past five fiscals and unencumbered cash and bank balance of over Rs 11.77 billion as on September 30, 2021. 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.

The rating on SMC's Rs 2 billion taxable bonds is based on:

Well-defined escrow account structure, payment mechanism, and points of recourse to meet any shortfall

Taxable bonds of SMC have a well-defined payment waterfall structure through an escrow account, adequate DSCR, and liquidity support, in form of a DSRA. DSCR is likely to remain adequately high at over 10 times, which, along with strong inflow and no additional debt, will have negligible impact on SMC's financial risk profile.

Broad contours of the escrow structure are as follows:

- a) 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).
- b) Establishing separate DSRA, interest payment account (IPA), and sinking fund accounts (SFA) with the escrow banker as per the terms of each series. Bondholders/lenders of particular series have first and pari-passu charge over DSRA, IPA, and SFA, for respective series.

- c) In case of any shortfall in transfer from escrow account to DSA, SMC shall make good the shortfall from the funds from other account(s) to DSA.
- d) The tenure is five years with half-yearly coupon payment
- e) Bullet/full redemption at the end of five years

Interest payment mechanism

T – Interest Payment Date

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

Salient features of the Rs 2 billion taxable bonds

Instrument	Unsecured, listed, taxable, non-convertible, redeemable bonds in the nature of debentures
Coupon rate	8.68%, payable semi-annually
Issue Amount	Rs 2 billion
Tenor	5 years
Redemption	Bullet
Trustee	SBICAP Trustee Company Ltd

Financial summary

(Consolidated; CRISIL-adjusted numbers)

		As on/ For the year ended March 31		
		2021 Actual	2020 Actual	2019 Actual
Revenue receipts	Rs Billion	29.29	28.90	29.57
Revenue expenditure (excluding interest)	Rs Billion	24.94	23.57	21.83
Operating surplus	Rs Billion	4.35	5.33	7.74
Debt charges	Rs Billion	0.83	0.68	0.14
Revenue surplus/(deficit)	Rs Billion	3.52	4.65	7.60
Capital receipts	Rs Billion	11.09	14.07	16.24
Capital expenditure	Rs Billion	12.79	18.76	19.86
Capital surplus/(deficit)	Rs Billion	-1.70	-4.69	-3.62
Overall surplus/(deficit)	Rs Billion	1.82	-0.04	3.98
Cash and bank balance(as reported)	Rs Billion	16.22	10.69	13.83
Total debt	Rs Billion	2.00	2.00	2.00
Operating surplus/ revenue receipts	%	15%	18%	26%
Revenue surplus/ revenue receipts	%	12%	16%	26%
Operating surplus/ total debt	Times	2.18	2.67	3.87
Total debt / revenue receipts	%	7%	7%	7%

Above reflects analytical adjustments made by CRISIL Ratings.

Key assumptions to CRISIL Ratings' projections

Assumptions for fiscals 2023 and 2024

Revenue receipts	Revenue receipts growth of around 10% per annum
Operating Surplus	Rs 7.2-8 billion per annum
Debt	Rs 2.0 billion per annum
Capex	Rs 19 - 20 billion per annum
Liquidity	Rs 26-34 billion per annum

Repayment schedule

Particulars	FY 22	FY23
Repayment schedule* (Rs Billion)	0	0

*Doesn't include sinking fund contribution of Rs 400 Million.

Contingent liabilities: Not applicable

Details of Shares pledged: Not applicable

Key Covenants: Not Applicable

Key PPA: Not Applicable

Peer Comparison

C. Comparison on qualitative parameters	Surat	Ahmedabad	Vadodara	PCMC
Demographic Profile				
Area (Sq. Km)	462.149	469	220	177.30
Population (Nos.) (as per 2011 census)	44,66,826	55,77,940	17,41,791	17,29,359
Population Density (Nos./Sq km)	13,680	12,015	7909	9,754
Literacy Rate (%)	87.89	88.29	90.63	90.9
Slum Population (%)	10.78	4.49	4.84	7.47
WATER SUPPLY				
Population coverage (%)	99%	100%	99%	88%
Treatment facility (%)	100%	100%	100%	100%
Un-accounted for water (%)	NA	22%	26%	38%
SEWERAGE				
Population Coverage (%)	100%	95%	96%	85%
Treatment (&)	92%	98%	87%	100%
SOLID WASTE MANAGEMENT				
Door-to-door (%)	100%	100%	100%	94%
Sweeping coverage (%)	100%	100%	100%	85%
PROPERTY TAX COLLECTION				
Efficiency (Current) (%)	85%	74%	93%	70%
Efficiency (Overall) (%)	65%	28%	80%	48%
Method	UA	UA	ARV	ARV
MAINTENANCE COST RECOVERY				
Water (%)	100%	50%	66%	66%
Sewerage (%)	100%	NA	71%	71%
Solid Waste Management (%)	NA	NA	NA	NA
CAPEX				
Capex under AMRUT (Rs. Cr.)	840	847.4	585	300
Smart city (Rs. Cr.)	2597	2492	5404	1175
Average capex (past 4 years)	1680	2180	591	871
Final Rating	CRISIL AA+/Stable	CRISIL AA+/Stable	Provisional CRISIL AA/Stable	CRISIL AA/Stable

Criteria details

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](#)

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