

India Ratings Assigns Surat Municipal Corp's NCDs Final 'IND AA+(SO)'; Outlook Stable

01

MAR 2019

By [Deepanshu Goyal](#)

India Ratings and Research (Ind-Ra) has assigned Surat Municipal Corporation's (SMC) non-convertible debentures (NCDs) a final rating as follows:

| Instrument Type | ISIN | Date of Issuance | Coupon Rate | Maturity Date | Size of Issue (million) | Rating/Outlook | Rating Action |
|-----------------|--------------|------------------|-------------|---------------|-------------------------|--------------------|---------------|
| NCDs | INE05NX24015 | 1 March 2019 | 8.68 | 1 March 2024 | INR2,000 | IND AA+(SO)/Stable | Assigned |

The frequency of the interest payment is semi-annual (1 September and 1 March each year), and the principal will be a bullet repayment.

The final rating has been assigned after the receipt of the final documents by the agency and the creation of a debt service reserve account (DSRA) on 27 February 2019. The structured payment mechanism conforms to the information already received by Ind-Ra, based on which the provisional rating was assigned. Therefore, the final rating is the same as the provisional rating assigned on 31 January 2019.

Analytical Approach: The rating is based on the trustee monitored structured payment mechanism, including debt service reserve, interest payment and sinking fund accounts, and SMC's financial and operational performance.

KEY RATING DRIVERS

Bond's Purpose: SMC raised INR2,000 million on 1 March 2019 for part financing the development of new sewerage treatment plants as well as the upgradation of the existing plants in Surat - at Asarma, Bamroli, Bhatar, Bhesan, Khajod, under the Atal Mission for Rejuvenation and Urban Transformation scheme. The sanctioned amount for projects is INR4,979.3 million, of which SMC would fund INR3,135.2 million: INR2,000 million from the bond proceeds and INR1,135.2 million from its own funds. The balance would be provided by the government of India and government of Gujarat under the scheme.

Structured Debt Servicing Mechanism: Under the structure, a debt service reserve account (DSRA) account has been created and funded on 27 February 2019 before the pay-in date of 1 March 2019 with an amount equal to annual interest payments. At all times, the DSRA is to be maintained at an amount equal to annual interest payments.

SMC has created an escrow mechanism, where in the funds (property tax and user charges) shall be transferred to an escrow account on a daily basis except the last day of the month. On the last business day of every month, the minimum balance – an aggregate of monthly fund requirement to service a debt service account (DSA) – will be transferred to DSA from the escrow account. The minimum monthly property tax and user charges during FY17-FY18 were 6.05x of the minimum balance requirement for the escrow account. The funds in the DSA shall be used in the following order of priority: a) transfer funds from DSA to DSRA to make good any shortfall, if any, in DSRA b) monthly transfers to an interest payment account (IPA) on the last business day of every month and c) monthly transfers to a sinking fund account (SFA) an amount equivalent to 1/11th of the annual principal redemption requirement on the last business day of every month.

The debenture trustees will verify the availability of requisite funds for interest servicing T-25 days before the due date. In case of a shortfall, they will intimate SMC to cover up the shortfall by T-15 days. In case of shortfall in IPA at T-14 days prior to the interest payment date, the trustee shall trigger the payment mechanism and instruct the bank maintaining DSRA to transfer the shortfall amount from DSRA so that funds equivalent to the next interest payment due are ensured by T-10 days.

Trustee Monitoring: All accounts will be monitored by the debenture trustees. The amount deposited in IPA, DSRA and SFA shall be used solely for meeting the dues to the bondholders. Any surplus funds available in the escrow account can be transferred to the account of SMC.

Sinking Fund: The debenture trustee shall check the balance in the SFA at the end of the year and in case of any shortfall, SMC shall replenish the account to that extent. The trustees shall also check the amount lying to the credit of SFA at T-25 days prior to the redemption date. In case of any shortfall in amount, the trustees shall intimate SMC of the shortfall and SMC shall make good the shortfall by T-15 days prior to the redemption date.

Own Revenue Sources: The rating also reflects SMC's ability to generate adequate revenue from its own sources to fund its revenue expenditure. Tax and non-

tax revenues constituted 39.17% and 15.87%, on average, of the total revenue income over FY15-FY19(RE). The corporation's revenue income increased to INR27.91 billion in FY19(RE) (FY15: INR16.72 billion) and its own revenue/total revenue income ratio stood at 59.93% (48.15%). Property, water, vehicle and professional tax collections were the key drivers of revenue from tax collections during this period. The share of grants in total income reduced to 25.59% in FY19(RE) from a high of 35.52% in FY15.

Consistent Revenue Surplus: SMC generated consistent revenue surpluses during FY14-FY18 (FY18: INR6,061.92 million, up 23.56% yoy). The corporation funded its entire revenue expenditure out of revenue income during this period. Revenue surplus is projected at INR2,101.06 million for FY19(RE), which is due to lower growth in revenue income (4% yoy) than in revenue expenditure (25% yoy). Ind-Ra expects SMC's revenue balance position to remain in surplus over the medium term.

Strong Liquidity: SMC's cash balances and unencumbered investments amounted to INR12,614.47 million as on 31 December 2018 and debt was INR2,000 million as on 1 March 2019.

Scope for Improvement in Civic Services Delivery and Capital Utilisation: SMC's capital expenditure constituted 47.2%, on average, of the total expenditure during FY14-FY18. Roads, water supply and sewerage were the key areas of capex during this period. The corporation's capital receipts increased to INR13,032.14 million in FY18 (FY17: INR10,999.03 million) and its capital utilisation (capex/capital income) ratio stood above 1.45x on average during FY14-FY18. SMC's service delivery levels for the water, sewerage and solid waste segments remained comfortable as reflected in coverage network (water supply: 97.3%; sewerage network: 97%; solid waste management service: 98.6%), as against the benchmark levels (water: 100%; sewerage: 100%; solid waste: 100%) set by the Ministry of Urban Development for all three services. The per capita supply of water stood at 150 litres per capita per day (benchmark: 135 litres per capita per day). However, SMC's performance was less than adequate in areas such as extent of water metering, segregation of municipal solid waste, wastewater recycle and reuse and hours of water supply, during FY14-FY18.

RATING SENSITIVITIES

Positive: A positive rating action could result from an increase in the share of own revenues in the total revenue income, and an improvement in the performance on delivery of civic amenities, all on a sustained basis.

Negative: A sustained reduction in own revenues leading to higher dependence on grants and/or deterioration in the revenue balance position, leading to a sharp worsening of the coverage ratios and a deviation from the proposed structure, would lead to a negative rating action.

COMPANY PROFILE

SMC is a local self-government. It was established in 1966 under the Bombay Provincial Corporation Act, 1949. SMC is mainly responsible for the administration of the city, maintaining infrastructure facilities, and providing various civic services such as water supply, solid waste management, sewerage, education, health and others to its citizens. SMC covers 326.52 sq km and the Surat city is divided into seven zones namely, east, west, north, south, central, south west and south east zone. There are 29 municipal wards and each municipal ward has four seats of municipal councilors.

FINANCIAL SUMMARY

| Particulars | FY18 | FY19(RE) |
|---|-----------|-----------|
| Revenue Income (INR million) | 26,736.27 | 27,906.19 |
| Revenue expenditure (INR million) | 20,674.35 | 25,805.13 |
| Revenue balance (INR million) | 6,061.92 | 2,101.06 |
| Capital expenditure/total expenditure (%) | 44.17 | 44.26 |
| Revenue income /Revenue expenditure (%) | 129.32 | 108.14 |
| Source: SMC, Ind-Ra | | |

RATING HISTORY

| Instrument Type | Current Rating/Outlook | | | Historical Rating/Outlook |
|-----------------|------------------------|------------------------|--------------------|--------------------------------|
| | Rating Type | Rated Limits (million) | Rating | 31 January 2019 |
| NCDs | Long-term | INR2,000 | IND AA+(SO)/Stable | Provisional IND AA+(SO)/Stable |

COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity level of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

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Applicable Criteria

[Local and State Government Rating Criteria](#)

Analyst Names

[Primary Analyst](#)

Deepanshu Goyal

Analyst

India Ratings and Research Pvt Ltd 601-9 Prakashdeep Building 7 Tolstoy Marg New Delhi 110001

011 43567289

[Secondary Analyst](#)

Nikita Shah

Senior Research Associate

[Committee Chairperson](#)

Dr Devendra Pant

Chief Economist and Head Public Finance

+91 11 43567251

[Media Relation](#)

Namita Sharma

Manager – Corporate Communication

+91 22 40356121 >
