

India Ratings Affirms Surat Municipal Corporation's NCDs at 'IND AA+'; Outlook Stable

Ind-Ra-XX January 2020-Mumbai: India Ratings and Research (Ind-Ra) has rated Surat Municipal Corporation's (SMC) non-convertible debentures (NCDs) as follows:

Instrument Type	ISIN	Date of issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
NCDs	INE05NX24015	01 March 2019	8.68	01 March 2024	INR2,000	IND AA+/Stable	Affirmed

The frequency of the interest payment is semi-annual (01 September and 01 March each year), and the principal repayment will be bullet.

Removal of Suffix: Ind-Ra has removed the suffix associated with the rating of SMC based on SEBI Circular "Guidelines for Enhanced Disclosures by Credit Rating Agencies (CRAs)" on introduction of 'CE'" dated June 13, 2019. As per the guidelines, no suffix will be assigned to the rating if:

1. The ratings factor in internal credit enhancement, but the rated instrument is not bankruptcy remote of the issuer.
2. The ratings do not factor in any explicit credit enhancement or payment mechanism / structure around cash flows.

Bond's Purpose: SMC has raised INR2,000 million by issuance of NCDs 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 (AMRUT) scheme. The sanctioned amount for projects is INR5,433 million, of which SMC would fund INR3,588.9 million: INR2,000 million from the bond proceeds and INR1,588.9 million from its own funds. The balance was provided by the government of India and government of Gujarat under the scheme.

Analytical Approach: The rating of the NCDs is a reflection of the operational and financial performance of SMC, the nature of the escrowed assets, strength of the structured payment mechanism and healthy debt service coverage.

1. The rating is based on the stability in performance of assets which are escrowed (property tax, fees and user charges) and the enforceable nature of these collections by the corporation.
2. The rating also factors in a sound legal foundation of the structured payment mechanism which is monitored and controlled by the Trustee. The structured payment mechanism is backed by a prefunded debt service reserve account (DSRA) constituting of two semi-annual interest instalments, interest payment account (IPA) and sinking fund account (SFA). The NCD's are issued at a fixed rate of interest that mitigates interest rate risk.
3. The rating benefits from the SMC's coverage of debt servicing obligations (Interest payment + proportionate principal deposited in sinking fund or instalment of principal redemption) which IND-Ra expects to remain above 2.5x.

KEY RATING DRIVERS

Adequacy of escrowed revenue stream: Under the structure, revenues from property tax, fees and user charges, are escrowed for servicing of the debt repayment obligations. The escrowed collections will be first utilized for meeting the minimum balance required to be transferred to the IPA and SFA. The Revenue from these streams grew at a CAGR of 12.9% over FY15-FY19 to INR10.8 billion. The escrowed receivables from property tax, fees and user charges are expected to provide strong cover for SMC's debt service obligations.

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 two semi-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 DSA – will be transferred to DSA from the escrow account. The funds in the debt service account shall be used in the following order of priority: a) transfer funds from the debt service account 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.

The debenture trustee shall also 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.

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. The trustee has given confirmation that SMC is adhering to the structured payment mechanism.

Debt service coverage: At FYE19, the SMC did not have any additional debt other than the NCDs issued. The absence of any interest servicing obligations in the past has resulted in a healthy credit profile for the corporation. Ind-Ra expects SMC's DSCR to remain comfortable at above 2.5x over the medium term. This takes into consideration the debt service obligations from the issuance of the NCD's of INR 2,000 million. Ind-Ra also expects the coverage of its instrument level debt servicing obligations based on the receivables from property tax, fees and user charges to remain healthy over the medium term. Ind-Ra will closely monitor the coverage adequacy during the entire tenure of the NCD's.

Liquidity Indicator – Superior: SMC's liquidity position is supported by sustained revenue surpluses, capital grants to fund capex, sizeable cash and bank balances and unencumbered investments. Debt servicing requirement pertaining to bonds is backed by way of escrow of receivables from property and other taxes and user charges. SMC's cash balances and unencumbered investments amounted to INR13, 832.18 million as on FY E 19.

Adequate 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 39.95% and 16.51%, on average, of the total revenue income over FY15-FY19. The corporation's revenue income increased to INR29.56 billion in FY19 (FY15: INR16.72 billion) and its own revenue/total revenue income ratio stood at 67.06% (FY 15: 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 revenue income reduced to 28.29% in FY19 from a high of 35.52% in FY15.

Consistent Revenue Surplus: SMC generated consistent revenue surpluses during FY15-FY19 (FY19: INR 7,600.79 million, FY 15: INR 3,647.45 million). The corporation funded its entire revenue expenditure out of revenue income during this period. Revenue surplus is projected at INR 2387.06 million for FY20(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.

Scope for Improvement in Civic Services Delivery and Capital Utilisation: SMC's capital expenditure constituted 50.53%, on average, of the total expenditure during FY15-FY19. Roads, water supply and sewerage were the key areas of capex during this period. The corporation's capital receipts increased to INR16,240.03 million in FY19 (FY18: INR 13,032.14 million) and its capital utilisation (capex/capital income) ratio stood above 1.34x on average during FY15-FY19. SMC's service delivery levels for the water, sewerage and solid waste segments remained comfortable as reflected in coverage network (water supply: 98.1%; sewage network: 99.6%; solid waste management service: 100%), 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 146.7 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 FY15-FY19.

RATING SENSITIVITIES

The rating of the NCDs will be downgraded on downgrade of SMC's rating, which forms the starting point for the rating of these NCDs.

Positive: Future developments could, individually or collectively, lead to a positive rating action includes:

- Improvement in operating margins to or above 40% on a sustained basis.
- Improvement in civic service deliverables like hours of water supply, extent of water metering, segregation of municipal solid waste, wastewater recycle and reuse to the benchmark levels

Negative: The following developments could individually or collectively lead to a negative rating action:

- Breach of financial covenant as per term sheet will trigger a negative rating action.
- Unanticipated increase in debt levels resulting in Debt service coverage ratio falling below 2x for consecutive 2 years.
- Higher dependence on grants and/or deterioration in revenue balance for two consecutive years.
- Property tax collection efficiency (including arrears) falling below 70% for two consecutive years.

CORPORATION 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	FY19	FY20(RE)
Revenue Income (INR million)	29,568.27	29,525.22
Revenue expenditure (INR million)	21,967.48	27,138.16
Revenue balance (INR million)	7,600.79	2,387.06
Capital expenditure/total expenditure (%)	47.48%	44.61%
Revenue expenditure /Revenue income (%)	74.3%	91.9%
Source: SMC, Ind-Ra		

Annexure I Covenants

- SMC shall maintain the following financial ratios at all times and the same shall be tested atleast at the end of each financial year:
Debt Service Coverage ratio for SMC will not be less than 1.25x
DSCR = operating surplus/total debt service
- The amount collected in escrow shall be atleast 1.25 times of the debt service amount on an annual basis. In case ratio falls below 1.25 times SMC shall not borrow against the cash flow(s) of the escrow account. No permission to borrow further is required from the bond holders as long as this condition is met.
DSA is defined as follows:
DSA= Interest Payment for the month+ Proportionate Principal deposited in the SFA or installment of principal redemption
- SMC shall not borrow any further funds against the cash flows of the Escrow Account in case there is a shortfall in the contribution to Debt Service Account and the shortfall has not been made good by SMC.

Applicable Criteria

[Local and State Governments Rating Criteria , December 2018](#)

[Tax Supported Criteria , December 2018](#)

COMPLEXITY LEVELS OF THE INSTRUMENTS

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

Contact:

Primary Analyst

Bhushan Joshi

Analyst

+91 22 4035 6113

India Ratings and Research Private Limited

Secondary Analyst

Nikita Shah

Senior Research Associate

+91 22 4035 6177

Committee Chairperson

Dr Devendra Kumar Pant

Chief Economist and Head Public Finance

+91 11 4356 7251

Media Relations: Namita Sharma, Mumbai, Tel: +91 22 4035 6121, Email: namita.sharma@indiaratings.co.in.

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

About India Ratings and Research: India Ratings and Research (Ind-Ra) is India's most respected credit rating agency committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies, and structured finance and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

Ind-Ra is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.

ALL CREDIT RATINGS ASSIGNED BY INDIA RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.INDIARATINGS.CO.IN/RATING-DEFINITIONS](https://www.indiaratings.co.in/rating-definitions). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE WWW.INDIARATINGS.CO.IN. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. INDIA RATINGS' CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE.

PRIVATE & CONFIDENTIAL