

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

# 04

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India Ratings and Research (Ind-Ra) has affirmed 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	1 March 2019	8.68	1 March 2024	INR2,000	IND AA+/Stable	Affirmed

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

**Analytical Approach:** The instrument rating reflects the nature of the escrowed assets, strength of the structured payment mechanism, and a healthy debt service coverage ratio (DSCR). The rating builds on the operational and financial profile of SMC.

The rating is based on the stability in performance of assets that are escrowed (property tax, fees and user charges) and the enforceable nature of these collections by the corporation. The rating also factors in a sound legal framework of the structured payment mechanism which is monitored and controlled by the debenture trustee. The structured payment mechanism is backed by a prefunded debt service reserve account (DSRA) constituting two semi-annual interest instalments, interest payment account (IPA) and sinking fund account (SFA). The NCDs are issued at a fixed rate of interest that mitigates the interest rate risk. The rating benefits from 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 at healthy levels during the tenor of the NCDs.

## KEY RATING DRIVERS

**Adequacy of Escrowed Revenue Stream:** Under the bond structure, revenues from property tax, fees and user charges, are escrowed for servicing of the debt repayment obligations. The escrowed collections will be first utilised for meeting the minimum balance required to be transferred to the IPA and SFA. The escrowed revenue from these streams grew at 9% yoy to INR 14.97 billion in FY21 (FY20: INR13.70 billion) on cash basis. The collection efficiency of property tax (including arrears) remained at an average of 93.72% over FY17-FY21 period. Ind-Ra expects the collections from property tax, fees and user charges to remain healthy and provide strong cover for SMC's debt service obligations during the entire bond tenor.

**Structured Debt Servicing Mechanism:** Under the structure, a DSRA was 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 of INR173.6 million each.

SMC has created an escrow mechanism, where in the funds (property tax and user charges) will 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 the DSA from the escrow account. The funds in the DSA shall be used in the following order of priority: a) transfer funds from the DSA to DSRA to meet a shortfall, if any, b) monthly transfers to the IPA on the last business day of every month and c) monthly transfers to the SFA an amount equivalent to 1/11th of the annual principal redemption requirement on the last business day of every month.

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

The debenture trustee will 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 trustee shall also check the amount lying to the credit of SFA at T-25 days before the redemption date. In case of any shortfall in the amount, the trustees shall intimate SMC of the shortfall and SMC will meet the shortfall by T-15 days before the redemption date.

**Trustee Monitoring:** All accounts will be monitored by the debenture trustee. The amount deposited in IPA, DSRA and SFA will 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 confirmed that SMC is adhering to the structured payment mechanism. The corporation has adhered to the SFA amount obligation of INR1,152.54 million till December 2021 and has already accumulated INR1,175.95 million including accrued interests as on 3 January 2022. The interest payment is semi-annual in nature and SMC has paid the first semi-annual interest payment for FY22 in September 2021 and the second interest payment is due in March 2022. The amount required to be deposited in the IPA on a monthly basis is INR14.46 million, which is also being adhered by SMC as per the term sheet. The DSRA is maintained at the required level of INR173.60 million as on 30 November 2021.

**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 41.25% and 20.57%, on average respectively, of the total revenue income over FY17-FY21. The corporation's revenue income, which expanded consistently at a CAGR of 10.09% over FY17-FY21 period, stood at INR29.29 billion in FY21 (FY20: INR28.86 billion) on accrual basis. SMC's own revenue/total revenue income ratio stood at 56.23%% in FY21 (FY20: 65.42%) and share of grants in total revenue income was 36.07% in FY21 (FY20: 29.16%). Property, water, vehicle and professional tax collections were the key drivers of revenue from tax collections during this period. Ind-Ra expects SMC's own revenue streams to remain adequate in the medium term.

**Consistent Revenue Surpluses:** SMC maintained its revenue surplus position in FY21. The revenue surplus was INR3,978.29 million in FY21 (FY20: INR5,019.74 million). The corporation funded its entire revenue expenditure out of revenue income in FY21. The corporation has garnered a high revenue surplus of INR3,912.32 million in 1HFY22 as compared to that of entire FY21. Ind-Ra expects the revenue balance in FY22 to come in closer to the FY20 level and to remain in surplus over the medium term.

**Debt Service Coverage:** At FYE21, the SMC did not have any additional debt other than the NCDs issued. SMC's DSCR was at 10.19x in FY21 (FY20: 19.08x). The debt servicing obligation is backed by escrowed receivables of property taxes, fees and user charges. Ind-Ra expects the coverage ratio to remain healthy over the medium term. The agency will also closely monitor the coverage adequacy during the entire tenure of the NCDs.

**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. Its debt servicing requirement pertaining to bonds is INR173.60 million annually (till FY24) which is backed by way of escrow of receivables from property and other taxes and user charges, the collection of which stood at INR14,976.63 million in FY21 on cash basis. SMC's cash balances and unencumbered investments were INR11,773.88 million as on 30 September 2021 (FYE21: INR8,215.93 million). Ind-Ra believes the cash and investment position is more than adequate to fund debt servicing obligations, if required, in the near term.

**Capital Utilisation and Civic Services Delivery:** The consistent revenue surplus has enabled the corporation to undertake significant capital expenditure which stood at INR12,792.83 million in FY21 (FY20: INR18,747.18 million) where road and street lighting works, building work and sanitation work constituted 26%, 22% and 12%, respectively, of the total capital expenditure in FY21. Water supply and sewerage were the other key areas of capex during this period. The corporation's capital utilisation (capex/capital income) ratio stood above 1.28x on average during FY17-FY21, indicating of its' ability to undertake capex in core areas of civic services. Ind-Ra expects the capital utilisation ratio to remain above 1x in the medium-term.

SMC's service delivery levels for the water, sewerage and solid waste segments remained comfortable as reflected in coverage network (water supply: 99.1%; sewerage network: 100%; 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 supply of water stood at 156.9 litres per capita per day in FY20 (benchmark: 135 litres per capita per day). However, SMC's performance was weaker 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 FY16-FY20.

## RATING SENSITIVITIES

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**Positive:** The positive rating triggers are not applicable for the rated instrument of the urban local body as the instrument rating will have a cap of 'IND AA+' in absence of any unconditional, irrevocable, pre-default and continuing guarantee from the sovereign for principal and interest payments throughout the life of the instrument or a full/partial credit guarantee from any multilateral donor agency.

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

- § any breach of financial covenant as per term sheet.
- § an unexpected increase in debt levels resulting in DSCR falling below 2x for consecutive two years.
- § a reduction in own revenues due to low property tax collection efficiency, leading to higher dependence on grants and/or deterioration in the revenue balance position
- § property tax collection efficiency (including arrears) falling below 70% for two consecutive years.

## ESG ISSUES

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**ESG Factors Minimally Relevant to Rating:** Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on SMC, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please [click here](#). For answers to frequently asked

questions regarding ESG Relevance Disclosures and their impact on ratings, please [click here](#).

## COMPANY PROFILE

SMC, a local self-government, was established in 1966 under the Bombay Provincial Corporation Act, 1949. The corporation 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 462.15 sq. km and the Surat city is divided into nine zones namely, east, west, north, south a, south b, central, south west and south east A, south east B zone. There are 30 municipal wards and each municipal ward has four seats of municipal councillors.

### FINANCIAL SUMMARY

Particulars (INR million)	FY20	FY21	1HFY22
Revenue income	28,862.81	29,290.22	16,340.56
Revenue expenditure	23,843.06	25,311.92	12,428.21
Revenue balance	5,019.74	3,978.29	3,912.32
Debt service coverage ratio (x)	19.08	10.19	-
Debt payment/Revenue income (%)	0.96	1.48	-
Source: SMC, Ind-Ra			

## RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (million)	Rating	5 Feb 2021	6 Feb 2020	1 March 2019	31 January 2019
NCDs	Long-term	INR2,000	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+(SO)/Stable	IND AA+(SO)/Stable

## ANNEXURE

### Covenants

- SMC shall maintain the following financial ratios at all times and the same shall be tested at least 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 at least 1.25x the debt service amount on an annual basis. In case ratio falls below 1.25x 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 instalment of principal redemption.

3. 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 DSA and the shortfall has not been made good by SMC.

## COMPLEXITY LEVEL OF INSTRUMENTS

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Instrument Type	Complexity Indicator
NCDs	Low

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

## SOLICITATION DISCLOSURES

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## Applicable Criteria

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Evaluating Corporate Governance  
Local and State Government Rating Criteria

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