

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

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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 rating reflects the operational, financial performance and credit profile of SMC, the nature of the escrowed assets, strength of the structured payment mechanism, and healthy debt service coverage.

The rating is based on the adequate performance of the 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 the structured payment mechanism (monitored and controlled by the debenture trustee), where in funds are transferred to an escrow account on a daily basis. The structured payment mechanism is backed by a prefunded debt service reserve account (DSRA) constituting of two semi-annual interest instalments, an interest payment account (IPA) and a sinking fund account (SFA). The NCDs are issued at a fixed rate of interest that mitigates interest rate risk. The rating benefits from SMC's comfortable coverage of debt servicing obligations (interest payment + proportionate principal deposited in SFA or instalment of principal redemption), which Ind-Ra expects to remain above 2x in the medium term.

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 debt repayment obligations. The escrowed collections are first utilised for meeting the minimum balance required to be transferred to IPA and SFA. The escrowed tax revenue marginally declined 0.7% yoy to INR14.87 billion in FY22 on cash basis. Tax revenue collection was robust with 21.8% yoy growth to INR11.08 billion during April to December 2022. 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 debt service reserve account (DSRA) account 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 amounted to INR173.6 million.

SMC has created an escrow mechanism; where in funds (property tax, fees 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 debt service account (DSA) – will be transferred to DSA from the escrow account. The funds in 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 IPA on the last business day of every month, and c) monthly transfers to SFA an amount equivalent to 1/11th of the annual principal redemption requirement on the last business day of every month.

The debenture trustee verifies 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 also checks the balance in 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 are monitored by the debenture trustees. The amount deposited in IPA, DSRA and SFA are 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 INR1,559.3 million till December 2022 and has already accumulated INR1,593.22 million as on 1 January 2023. IPA is also funded timely before the interest pay in date. SMC is required to have INR173.60 million in IPA annually, which it has duly met.

Adequate Own Revenue Sources: Ind-Ra expects SMC's own revenue streams to remain satisfactory in the medium term. 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 40.93% and 20.89%, on average respectively, of the total revenue income over FY18-FY22. The corporation's revenue income, which expanded consistently at a CAGR of 4.73% over FY18-FY22, stood at INR33.63 billion in FY22 (FY21: INR29.29 billion) on accrual basis. SMC's own revenue/total revenue income ratio stood at 63.21% in FY22 (FY21: 56.23%) and share of grants and compensation in the total revenue income was 32.27% in FY22 (FY21: 36.07%). Property, water, vehicle and profession tax collections were the key drivers of revenue from tax collections during this period. The current demand collection efficiency of property taxes was higher at 91.2% in FY22 (FY21: 85.4%). The corporation expects to further improve its collection efficiency to around 95% in FY23.

Consistent Revenue Surpluses: Ind-Ra expects SMC's revenue balance position to remain in surplus over the medium term. SMC maintained its revenue surplus position in FY22 at INR4,414.13 million (FY21: INR3,978.3 million). The corporation funded its entire revenue expenditure out of revenue income in FY22. The revenue balance in FY23 is expected to be at par with FY22 levels.

Strong Debt Service Coverage: At FYE22, SMC did not have any additional debt other than the NCDs issued. SMC's debt service coverage ratio (DSCR) was 9.65x in FY22 (FY21: 10.19x). 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 the 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). The monthly amount required to be collected in IPA and SFA, combined, is INR48.36 million as per the terms of the instrument. SMC is able to meet this comfortably from its escrowed revenue. SMC's cash balances and unencumbered investments were INR11,473.56 million as on 30 September 2022 (FYE22: INR6,829.2 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 Scope of Improvement in Civic Services Delivery: Ind-Ra expects the capital utilisation ratio to remain above 1x in the medium term. The consistent revenue surplus has enabled the corporation to undertake significant capital expenditure which stood at INR18,686.68 million in FY22 (FY21: INR12,792 million) where road works, street lighting and sanitation work constituted 29.97% and 12.11% on average, of the total expenditure during FY18-FY22. 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 1.27x on average during FY18-FY22, which indicates SMC's ability to undertake capex in core areas of civic services.

SMC's service delivery levels for the water, sewerage and solid waste segments remained comfortable as reflected in coverage network (water supply: 93.5%; 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 Housing and Urban Affairs for all three services. The supply of water stood at 154.8 litres per capita per day in FY22 (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 FY18-FY22.

Rating Sensitivities

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 covenants as per the term sheet

an unexpected increase in the 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

current demand property tax collection efficiency falling below 75% for two consecutive years.

ESG Issues

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 councilors.

FINANCIAL SUMMARY

Particulars (INR million)	FY21	FY22
Revenue income	29,290.21	33,634.26
Revenue expenditure	25,311.91	29,220.13
Revenue balance	3,978.30	4,414.13
DSCR (x)	10.19	9.65
Debt payment/Revenue income (%)	1.48	1.52
Source: SMC, Ind-Ra		

Solicitation Disclosures

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.

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Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	4 February 2022	5 February 2021	6 February 2020
NCDs	Long-term	INR2,000	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/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:
 - DSCR not below 1.25x
 - DSCR = operating surplus/total debt service

2. The amount collected in escrow shall be at least 1.25x the debt service amount on an annual basis. In case the 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

Instrument Type	Complexity Indicator
NCDs	Low

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

Contact

Primary Analyst

Suyash Gangwal

Analyst

India Ratings and Research Pvt Ltd

Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East, Mumbai - 400051

For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst

Anuradha Basumatari

Associate Director

+91 22 40356123

Chairperson

Dr Devendra Pant

Chief Economist and Head Public Finance

0124 6687251

Media Relation

Ankur Dahiya

Senior Manager – Corporate Communication

+91 22 40356121

APPLICABLE CRITERIA

Local and State Government Rating Criteria

The Rating Process

Evaluating Corporate Governance

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