January 28, 2021

Karimnagar Municipal Corporation: [ICRA]BBB+(Stable) Assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Issuer rating	-	[ICRA]BBB+ (Stable) Assigned
Total	-	

**Instrument details are provided in Annexure-1*

Rationale

The assigned rating takes into consideration the Karimnagar Municipal Corporation's (KMC) importance to the Government of Telangana State (GoTS) as a provider of municipal services and other basic amenities to the city of Karimnagar. Karimnagar, one of the largest cities in Telangana, has been selected for the Government of India's (GoI) Smart Cities Mission, which would augur well for the development of the city. The rating factors in the healthy improvement in water supply over the last three years to 129 litres per capita per day (LPCD) from 109 LPCD and healthy service levels in solid waste collection and street lights. The rating considers the healthy revenue surplus position of the urban local body (ULB) over the past five years, enabling it to fund a part of the capital expenditure from its internal resources. The rating also considers KMC's limited dependence on the state government as it derived over 85% of its revenue from own revenues in the past four years. The ULB derives less than 15% of its revenues from rule-based transfers such as surcharge on stamp duty; discretionary grants have been negligible over the past four years. Nevertheless, ICRA notes that the ULB derives significant financial benefit as its permanent staff are designated as the state government employees and their salaries are paid directly by the state government.

The rating, however, is constrained by the KMC's moderate revenue base as inadequate revisions in key charges such as property tax limited its revenue growth in the past. However, the overall collection efficiency of the property tax has been healthy at over 95% during FY2015-FY2019. The collection efficiency has been impacted by the Covid-19 pandemic in FY2020. ICRA also notes that the tax revenues are expected to be lower in FY2021 because of a 50% waiver on the property tax announced by the GoTS for certain categories. However, the GoTS is expected to compensate the revenue deficit through discretionary grants. The rating also considers an expected increase in the operating costs such as establishment and operating expenses while revenues are expected to witness a limited growth in the absence of regular revision in key taxes and charges / fees. Moreover, the service levels have been less-than-satisfactory in sewerage coverage and solid waste treatment. The rating also considers risks associated with the execution of large and complex projects given the ULB's limited track record in the same.

The Stable outlook on the rating reflects ICRA's belief that the KMC would continue to remain important to the state and it will enjoy strong linkages with the state government. Further, the tax base of the ULB is expected to remain strong.

Key rating drivers and their description

Credit strengths

Importance of the ULB to the state government as a provider of urban infrastructure and basic services – The KMC is important to the GoTS as a provider of civic services and other basic amenities to the city of Karimnagar. Karimnagar has also been selected under the GoI's Smart Cities Mission, which would augur well for the development of the city. The key services rendered by the ULB are urban planning, water supply, sewerage, construction and maintenance of roads and drains, solid waste management, street lights and amenities such as playgrounds, parks/gardens etc.

Healthy revenue surplus position – The KMC consistently had healthy revenue surplus of ~Rs. 10-22 crore over the past five years, which enabled the ULB to fund a part of its capital expenditure from internal resources.

Limited dependence on the state government, especially through discretionary grants – KMC has limited reliance on state government as it derives over 85% of its income from own revenues. Consistent growth in both tax and non-tax revenues, with an increase in tax assessments and growth in building permission, water supply and mutation charges resulted in healthy own revenues. The ULB derives less than 15% of its revenues from rule-based transfers such as surcharge on stamp duty; discretionary grants have been negligible over the past four years. The ULB derives significant financial benefit as its permanent staff are designated as state government employees, and salaries of them are paid directly by the state government.

Significant improvement in the service levels of some functions, especially water supply – The city witnessed significant improvement in water supply services over the past four years, as reflected in the current water supply of 129 LPCD against 109 LPCD earlier, backed by the recently completed project. The city also has healthy service levels in street lights with 44 lights per km and in solid waste management, as reflected in 100% collection efficiency of municipal solid waste (MSW).

Credit challenges

Moderate size of revenue base, though collection efficiency has been healthy – The revenue base of the ULB is moderate with a modest growth during the past four years as the rates of key revenue sources such as the property tax have not been revised regularly. Moreover, the tax revenues are expected to be lower in FY2021 because of a 50% waiver on the property tax announced by the GoTS for certain categories. However, revenue deficit grant by the GoTS as a compensation for the waiver is expected to mitigate the impact. The overall collection efficiency of the property has been healthy at over 95% during FY2015-FY2019. The collection efficiency has been impacted by the Covid-19 pandemic in FY2020 and FY2021. While the demand for water supply charges increased in the last three years on account of a revision in the charges, the collection efficiency of the same stood low at 40-55%.

Expected increase in operating costs with limited growth in revenues – The operating costs of the ULB are expected to increase with a consistent increase in the wage bill of the contractual/temporary staff and incremental operation and maintenance (O&M) cost towards fresh infrastructure. However, the tax rates and user charges / fee have not been revised regularly, limiting the growth in revenues. The upward revision of key rates and user charges would remain critical for the overall financial position of the KMC.

Less-than-satisfactory service levels in key service areas – The KMC's service levels have been less-than-satisfactory in key services such as sewerage coverage, road network and MSW treatment. The coverage of sewerage network is very low in the city at less than 10%. Moreover, only 4-5% of the solid waste collected from the city is treated. The road coverage is also low with 7.7 km road per sq.km. area. However, over 70% of the roads are surfaced. The projects to improve sewerage coverage, roads, and solid waste treatment are being undertaken / expected to be undertaken under the Smart City Mission, which would improve the service levels in the medium term.

Risks associated with execution of large and complex projects – The ULB does not have a track record of executing large projects and therefore successful execution of such projects within the budgeted cost and estimated timeframe would remain critical, going forward. Moreover, lack of adequate staff could impact the execution. However, ICRA believes that the KMC will derive support from the state government for funding and executing the projects, which would partially mitigate the project execution risks.

Liquidity position: Adequate

As on March 31, 2020, the entity had low outstanding debt (Rs. 0.5 crore). However, ICRA expects the ULB to avail fresh term loan of around Rs. 15 crore in FY2022 to part fund some of its proposed projects, repayment of which would start in FY2023. The future debt obligations would be met through the annual revenue surpluses generated by the ULB. Going forward, the liquidity position of the ULB is expected to be supported by its sizeable cash and bank balances of Rs. 106.5 crore as on March 31, 2020, of which the ULB's own cash balance (excluding funds earmarked for the projects) is over Rs. 50 crore, which would be adequate to cover any immediate capex or proposed debt servicing.

Rating sensitivities

Positive triggers – ICRA may upgrade the rating if the ULB witnesses a consistent growth in revenue income while maintaining healthy revenue balances.

Negative triggers – Pressure on the rating may arise if the revenue balance and liquidity position of the ULB deteriorate on a consistent basis. Any additional expenditure passed on by the state government without any funding support, and/or any major debt-funded capital expenditure could also result in a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology on Urban Local Bodies
Parent/Group Support	The assigned rating factors in the ULB's importance to the GoTS as a provider of urban infrastructure and basic services as well as its strong operational and financial linkages with the state government.
Consolidation/Standalone	Standalone

About the entity

The KMC, an urban local body, was upgraded to a Municipal Corporation in 2005 from a selection-grade municipality. The ULB provides municipal services to the city of Karimnagar, situated in the Karimnagar district of Telangana and is governed by the Telangana Municipalities Act 2019. It covers an area of 65.83 sq. km. and serves a population of 3.5 lakh (projected for FY2021). The limits of the ULB have been expanded in 2019 as eight nearby villages were merged with the ULB. Its major functions include water supply, solid waste management and construction, repair and maintenance of roads and streetlights in its area. The ULB is divided into 60 municipal wards and is governed by an elected body (Council), headed by a Mayor, while the Commissioner acts as the chief executive, overseeing its everyday functioning.

Key financial indicators (audited)

KMC	FY2019	FY2020
Revenue income (Rs. crore)	48.5	61.2
Revenue expenditure (Rs. crore)	37.4	48.4
Revenue balance (Rs. crore)	11.1	12.9
Closing balance (Rs. crore)	93.3	106.5
Revenue balance / Revenue income (%)	23%	21%
(Principal + Interest) / Revenue Income (%)	0.4%	0.3%
(Revenue Balance + Interest) / (Interest + Debt repayments) (%)	5878%	6886%
Debt / Revenue Income (%)	1%	1%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument		Current Rating (FY2021)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in			Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
					28-Jan 2021	28-Dec-2020	24-Jun-2020	-	31-Jan-2019	10-Jul-2017
1	Issuer Rating	NA	NA	NA	[ICRA]BBB+ (Stable)	[ICRA]BB+ (Stable); ISSUER NOT COOPERATING; Withdrawn	[ICRA]BB+ (Stable) ISSUER NOT COOPERATING	-	[ICRA]BBB (Stable) ISSUER NOT COOPERATING	Ir BBB (Stable)

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details *Not Applicable*

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