June 08, 2017

Hospet City Municipal Council

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Issuer Rating	Nil	IrBBB-(Stable) ; assigned
*Instrument details are provided in Annexure-1		

Rating action

ICRA has assigned a long-term issuer rating of IrBBB- (pronounced I R triple B minus) to the **Hospet City Municipal Council** ('HCMC' or 'council').[1] The outlook on the long-term rating is Stable.

Rationale

The assigned rating takes into account the HCMC's importance to the State Government of Karnataka (GoK) as a provider of key municipal services to the city of Hospet. The rating also positively factors the rule-based transfers of grants from the GoK, which assists the council in making non-discretionary payments like salaries, pensions and electricity bills. The rating further factors in the revenue surplus position of the HCMC during the last four years, which is attributed majorly to the grants received from the GoK. A revenue surplus position provides flexibility to the council in planning and prioritising its capital expenditure to that extent. The rating considers healthy collection efficiency of property tax over the past four years, and satisfactory service levels in the areas of sewerage network and road side drains coverage.

The rating, however, is constrained by the HCMC's weak information management systems with instances of inconsistencies in data. The rating also factors in the HCMC's relatively small size of own revenue base, low collection efficiency of user charges (water charges), and less-than-satisfactory service standards in the areas of solid waste management, water supply, street lights, and road coverage. ICRA notes that the HCMC proposes large outlays for various projects under the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) as well as other urban infrastructure schemes, which could stretch the cash flows of the council. Moreover, given the limited track record of the council in executing large projects, the timely execution of these projects within the budgeted costs would be critical for the HCMC's financial position going forward. ICRA notes that the council has implemented reform such as accrual-based accounting system. However effective implementation of other key reforms such as introduction of e-governance in key functions and revenue enhancement measures would be important determinants of the HCMC's ability to improve its overall performance. Finally, adequate number of staffs coupled with continuity of such staffs especially in critical functions would be crucial for the timely implementation of key projects and reforms going forward.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.*

Key rating drivers

Credit strengths

- Rule-based transfers of grants from the state government, which has a high credit quality
- Revenue surplus position during the last four years, majorly on account of grants received from the state government
- Satisfactory collection efficiency of property tax during FY2013-16, though the size of the tax base remains small at present
- Satisfactory service levels in terms of sewerage and drainage coverage

Credit weakness

- Weak information system
- Relatively small size of own revenue base
- Low collection efficiency of water charges
- Less-than-satisfactory services levels in the areas of solid waste management, street lights and overall road coverage necessitates substantial investment by the council
- Lack of adequate staff in key departments
- Risk related to execution of large projects

Description of key rating drivers:

The council receives grants from the GoK on recommendation by the State Finance Commission (SFC). The grants from the GoK have been a regular in nature and it is the main source of revenue for the council as it accounted to 80% of the total revenue income in FY2016. The council has managed to generate 46% of the total revenue income as revenue surplus in FY2016. This was majorly on account of steady flow of revenue grants from the GoK in proportion to the revenue expenditure incurred by the council. The overall collection efficiency of property tax has been healthy at more than 85% during the period FY2013-16. The city has sewerage network covering 60% of the population 100% coverage of road side drains.

However, other service indicators remain modest with collection efficiency of solid waste at 65%, water supply of 107 litre per capita per day (lpcd) as against required norm of 135 lpcd, 18.3 streetlights per km of road as against accepted norm of 30, and modest surfaced road coverage. The management information system (MIS) of the council remains weak with instances of inconsistencies in data. The size of the council's own revenue base has remained low on account of a low base of property tax, key charges and no significant upwards revision in the tax rates and charges during the past years. Moreover, the collection efficiency of user charges has remained at a low level in the past four years.

ICRA also notes that HCMC has proposed to execute key projects under the AMRUT and other schemes. The total cost of project under the AMRUT scheme is Rs. 160.0 crore, which is funded in the ratio of 50% by the Government of India (GoI), 20% by the GoK, and 30% by the HCMC. The council also has Rs. 99.60 crore projects funded by Asian Development Bank (ADB), and these projects would be executed by KUIDFC (Karnataka Urban Infrastructure & Finance Corporation). ICRA notes that some of the gaps in the existing service levels are proposed to be covered under the AMRUT and ADB projects. However, adequate staffs in key functions and timely execution of these projects within the budgeted costs will remain critical. Also, given the large outlays towards projects, the financial position of the HCMC would be adversely impacted if the project assets after commissioning are unable to generate adequate revenues to part fund the operations and maintenance (O&M) costs, which are expected to increase significantly going forward.

Analytical approach:
For arriving at the ratings, ICRA has applied its rating methodologies as indicated below:

Links to applicable criteria:
Urban Local Body Rating Methodology
http://www.icra.in/Files/Articles/Urban%20Local%20Bodies-%20Aug%202016.pdf
Assessing Credit Quality of State Government Finances
http://www.icra.in/Files/Articles/Rating%20Methodology%20Aug%202015.pdf

About the entity
The HCMC being an urban local body (ULB), it provides civic services to the Hospet city. The city is situated in the Ballari district and is at a distance of 350 km from the state capital, Bengaluru. According to Census 2011, the HCMC, covering an area of 50.92 sq. km., serves a total population of 2.06 lakh. It is governed by the Karnataka Municipalities Act, 1964. The council of the HCMC comprising 35 Ward Councillors is headed by a President who is elected by the Ward Councillors. The executive wing is headed by a Municipal Commissioner, who is appointed by the GoK and is supported by the head of various departments.

The key services extended by the ULB are water supply, construction and maintenance of roads and drains, solid waste collection, street lights and amenities such as shopping stalls, community hall, playgrounds, and parks/gardens, among other civic amenities.

In FY2016, HCMC generated a revenue surplus of Rs. 15.87 crore on a total revenue income of Rs. 34.50 crore compared to a revenue surplus of Rs. 9.96 crore on a total revenue income of Rs. 26.32 crore in FY2015.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	Instrument	Current Rating (2017)			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. crore)	FY2018	FY2017	FY2016	FY2015
				June 2017	--	--	--
1	Issuer Rating	Long Term	NA	IrBBB-(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

Name of the instrument	Date of Issuance/ Sanction	Coupon rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
Issuer rating on long-term scale	-	-	-	NA	IrBBB-(Stable)

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