

May 31, 2017

Rajapalayam Municipality ^(Revised)

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Issuer Rating	Nil	[ICRA]BB+(Stable) ; assigned
*Instrument details are provided in Annexure-1		

Rating action

ICRA has assigned a long-term issuer rating of IrBB+ (pronounced I R double B plus) to the Rajapalayam Municipality (RPM/municipality).¹ The outlook on the long-term rating is Stable.

Rationale

The assigned rating takes into account the rule-based transfers of grants from the State Government of Tamil Nadu (GoTN), which assists the council in making non-discretionary payments like salaries and pensions. The rating also factors in the revenue surplus position of the municipality during the past years, which enables it to partly fund its capital expenditure from internal sources. The assigned rating takes into account the healthy contribution of the RPM's own tax revenues (49% in FY2016) to the total revenue receipts (RR) of the municipality with limited dependence on state grants. The satisfactory collection efficiency of property tax by the RPM and a steady increase, although at a low rate, in non-tax revenue provides a comfort to the RPM's own revenue base. ICRA also notes the satisfactory service levels provided by the RPM in relation to construction of roads, street lights, and collection of solid-waste.

However, the rating is constrained by the less-than-satisfactory service standards in the areas of scientific treatment and disposal of municipal solid waste (MSW), inadequate water supply and absence of a sewerage system. The rating is further constrained by the relatively moderate size of the RPM's revenue base and its nominal growth rate during the past years due to lack of timely upward revisions in key taxes, charges and fees; nevertheless, revision of lease rentals is under process, which is expected to increase the non-tax revenue substantially from FY2018.

ICRA notes that the RPM proposes a large outlay (Rs. 172.70 crore²) for improving the water supply under the Combined Water Supply Scheme (CWSS) and various other projects under the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) scheme, which could stretch the cash flows of the municipality. Moreover, given the municipality's limited track record in executing large projects, the timely execution of these projects within the budgeted costs would be critical for the RPMs financial position going forward. ICRA also notes that the financial position of the RPM 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. Although the municipality has implemented reforms such as regular audit of financial statements, effective implementation of other key initiatives such as shifting to accrual-based accounting system and revenue enhancement measures would be a key determinant of the RPM's ability to improve its overall performance. Finally, adequate number of staff, coupled with continuity of such staff, 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.

² 100 lakh = 1 crore = 10 million

Key rating drivers

Credit strengths

- Revenue surplus position during the last three years; although the same has been supported by the rule-based transfers from the state government, which has an adequate credit quality
- Satisfactory collection efficiency of property tax
- Satisfactory service levels in the areas of solid waste management (SWM), roads and street lights

Credit weaknesses

- Lack of scientific treatment and disposal of MSW, inadequate water supply and absence of a sewerage system
- Relatively small size of own revenue base at present, which has remained stagnant during the recent years
- Risk related to execution of large projects

Description of key rating drivers

The RPM receives grant from the GoTN based on the recommendations of the State Finance Commission (SFC), and a share in the stamp duty collected in the town by the state government. Together, both the transfers contribute to more than 51% of the RM's total revenue income. The rule-based nature of these transfers provides comfort to the council to an extent. However, the frequency of such transfers has not been regular in the past years, as reflected by the inconsistencies in the amounts received.

The municipality has maintained the property tax collection efficiency of current and overall demand at above 89% and 64% respectively in FY2016. The own revenues of the corporation have been consistent and healthy in the range of 49% - 56% over the last three years with the tax officials implementing effective measures to improve the overall collection efficiency. As a result, the municipality has consistently maintained a surplus position during the past years.

Over the years, the RPM has incurred expenditure for the construction and maintenance of roads, installation and maintenance of street lights, and collection of MSW. Nevertheless, the municipality's service levels of key services have remained weak as reflected by low coverage of water supply and lack of sewerage network. The water supply is low as reflected by the supply of 72 litre per capita per day (LPCD). Also, the town lacks an underground sewerage system at present and a majority of the households have individual septic tanks.

ICRA also notes that the RPM has proposed to execute key projects under the CWSS, AMRUT and other schemes. The total cost of project under the CWSS scheme is Rs. 172.70 crore, which is funded in the ratio of 52% by the Government of India (GoI), 20.8% by the GoTN, 10% by the RPM and 17.2% through fresh borrowing. ICRA notes that some of the gaps in the existing service levels are proposed to be covered under the AMRUT projects. Post completion of the CWSS project for improving the water supply under the CWSS, the municipality is expected to benefit from healthy water supply of 135 LPCD and limit the periodicity pressure. However, adequate staff 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 RPM 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 RPM, being an urban local body (ULB), it provides civic services to Rajapalayam town, which is located in Virudunagar district and is at a distance of 560 km from the state capital, Chennai. The ULB in Rajapalayam was constituted in 1941 as a municipality, which was later upgraded as a special grade municipality in December 2008. According to Census 2011, the RPM, covering an area of 11.36 sq. km., serves a total population of 1.30 lakh. It is governed by the Tamil Nadu District Municipalities Act, 1920 (Act). The council of the municipality comprising 42 Ward Councillors is headed by a Chairman, who is elected by the Councillors. The Councillors also elect a Vice-Chairman among them. The executive wing is headed by a Commissioner, who is appointed by the GoTN and is supported by heads of various departments.

In FY2016, the RPM generated a revenue surplus of Rs. 9.11 crore on a total revenue income of Rs. 30.29 crore compared to a revenue surplus of Rs. 4.18 crore on a total revenue income of Rs. 24.95 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 May 2017	FY2017	FY2016	FY2015
1	Issuer Rating	Long Term	NA	IrBB+(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	IrBB+(Stable)

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About ICRA Limited:

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