

September 30, 2019

Machilipatnam Urban Development Authority: Rating downgraded to Provisional [ICRA]A-(CE); Outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Unallocated	1385.0	1385.0	Provisional [ICRA]A- (CE) (Negative); revised from Provisional [ICRA]A (SO) (Stable)
Total	1385.0	1385.0	

*Instrument details are provided in Annexure-1

Rating Without Explicit Credit Enhancement

[ICRA]B+

Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. Earlier, the rating symbol for this instrument/facility used to be accompanied by the (SO) suffix. This rating is specific to the rated instrument/facility, its terms and its structure and does not represent ICRA's opinion on the general credit quality of the entity concerned. The last row in the table above also captures ICRA's opinion on the rating without factoring in the explicit credit enhancement

Rationale

The rating derives credit strength from the unconditional and irrevocable guarantee to be extended by the Government of Andhra Pradesh (GoAP) to the rated instrument over its entire tenure. The Negative outlook on this rating reflects ICRA's outlook on the rating of the guarantor, GoAP. The above rating is provisional and would be converted into final upon execution of the necessary transaction documents being in line with ICRA's expectations.

Adequacy of credit enhancement

The rating of the instrument is based on the credit substitution approach, whereby the rating of the guarantor has been translated to the rating of the said instrument. The proposed guarantee would be legally enforceable, irrevocable and unconditional covering the entire amount and the tenor of the rated instrument and has a well-defined invocation and payment mechanism. Given these attributes, the proposed guarantee to be provided by the GoAP is adequately strong to result in an enhancement in the rating of the said instrument to Provisional [ICRA]A- (CE) (Negative) against the Unsupported Rating of [ICRA]B+. In case the ratings of the guarantor were to undergo a change in future, the same would reflect in the rating of the aforesaid instrument as well.

Salient covenants related to the credit enhancement, expected to be specified in the guaranteed documents

- » The borrower will open a no-lien escrow account (in the nature of trust and retention account) with a designated bank within 30 days from the date of the sanction of the term loan. The amount to be paid to the lenders is to be credited into the escrow account. Any amount credited into the escrow account shall be held in the trust only for the benefit of the lenders. All withdrawals from the said escrow account shall be made only after obtaining the approval from the lenders' agent, and such withdrawal shall be exclusively for the payment of the principal and/or interest to the lenders. Any credit balance lying in the escrow account can be withdrawn, with the approval of the lenders' agent, by the borrower at the end of the tenure of the bonds, when all the dues to the lenders have been paid.

- » The borrower shall credit adequate funds in the escrow account for servicing the lenders, at least 10 days prior to the forthcoming due date for payment of principal and/or interest. As and when funds are credited in the escrow account, the borrower and/or the designated bank shall send to the lenders' agent a written confirmation regarding the balance of funds in the said escrow account.
- » If, on the 9th working day prior to every due date for payment of interest and/or principal, the amount in the said escrow account is not sufficient for servicing the lenders on the forthcoming due date for payment of principal and/or interest, the lenders' agent shall forthwith invoke the guarantee issued by the GoAP. On invocation of the guarantee, GoAP must transfer funds into the escrow account to the extent of shortfall, at least one working day prior to the due date. The lenders' agent would utilise funds from the escrow account on the due date towards timely and full repayment to the lenders.

Key rating drivers and their description

Guarantee from GoAP – The proposed term loans of MUDA would be backed by an unconditional and irrevocable guarantee from the GoAP, which has an adequate credit profile.

Structured payment mechanism for the rated limits – The guarantee from the GoAP would cover all the obligations of MUDA on the rated facility. The payment mechanism is designed to ensure timely payment of the obligations on the rated facility including a mechanism of guarantee invocation by the lender's agent prior to due date in case of a shortfall.

Key rating drivers and their description (Guarantor)

Credit strengths

- **High revenue receipts supported by Central transfers** – GoAP's revenue receipts stood at a healthy 13.0% of GSDP in FY2018, augmented by substantial Central transfers (share in Central taxes + grants from Centre), which accounted for a considerable 49% of its revenue receipts in that year. However, the revenue receipts of the GoAP are likely to ease to 12.3% of GSDP in FY2019 RE, on account of lower grants from the centre.
- **Strategic geographical location** – AP benefits from its strategic geographical location on the Southeast coast of India. The state has the second longest coast line (approx. 972 km) among the Indian states, along which it has 14 minor ports and one major port, which provides potential for port-led growth in the state.

Credit challenges

- **Revenue deficits despite large Central transfers** – GoAP has displayed substantial revenue deficits since bifurcation, the size of which has worsened to Rs. 16,206 crore in FY2018 from Rs. 7,306 crore in FY2016. While the GoAP has indicated an improvement in its revenue deficit to Rs. 11,711 crore in FY2019 RE, the variance analysis for FY2017 and FY2018 reveal that the actual revenue deficit turned out to be two to four times the amount indicated in the revised estimates of those years.
- **Fiscal deficit above FFC norms** – GoAP's fiscal deficit breached the cap of 3.0% of GSDP recommended by the Fourteenth Finance Commission (FFC) in FY2016 (3.7%), FY2017 (3.2%) and FY2018 (4.0%). It is expected to exceed this threshold in FY2019 RE (3.6%) and FY2020 BE (3.3%; source: Medium Term Fiscal Policy Statement published with the July 2019 state budget) as well.

- **Worsening leverage levels partly led by rise in guarantees outstanding** – The guarantees extended by the GoAP rose sharply to Rs. 35,985 crore in FY2018 from Rs. 9,665 crore in FY2017. Additionally, its debt outstanding increased by 12.8% to Rs. 182,381 crore in FY2018. Accordingly, the leverage as a proportion of revenue receipts of the GoAP deteriorated to 2.1 times in FY2018 from 1.7 times in FY2017.
- **Frequent tapping of the WMA and/or overdraft** – GoAP frequently availed the WMA and/or OD facilities of the RBI in FY2018 and FY2019, whereas these facilities are essentially meant to be used for tiding over short-term mismatches in liquidity.
- **High relative dependence on agriculture** – The share of agriculture in GoAP’s GSV (constant prices at FY2012) stood at 29.5% in FY2018, nearly double than the national average of 14.9%. As per the Socio-Economic Survey of 2018-2019, published by the state government, agriculture was the main source of livelihood of 60.0% of the population of AP in 2017, indicating high dependence on this sector.

Liquidity position of GoAP (Guarantor): Stretched

The GoAP has availed the ways and means advances and/or the overdraft facilities from the Reserve Bank of India on several occasions during FY2019 and FY2020 (till July 2019). Based on the aforementioned indicators, the liquidity position of the state government can be implied to have been stretched during the recent times.

Rating sensitivities

The rating assigned to the Rs. 1385-crore proposed bank lines would remain sensitive to any movement in the rating or outlook of the guarantor GoAP.

Rating sensitivities (for GoAP)

Positive triggers – Sustained improvement in the performance of the SGST collections in the state might result in a rating upgrade.

Negative triggers – Adverse impact of the evolving macroeconomic scenario on the pace of growth of the tax revenues of the GoAP, both own and share in Central taxes, or lower-than-budgeted magnitude of grants received from the Centre might exert downward pressure on the ratings. Additionally, impact of the impending pay revision and additional welfare schemes on the state’s overall fiscal health and leverage levels also remain critical.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for State Government Finances ICRA’s Policy on Assigning Provisional Ratings Approach for rating debt instruments backed by third-party explicit support
Parent/Group Support	Parent: Government of Andhra Pradesh The proposed term loans of MUDA would be backed by an unconditional and irrevocable guarantee from the GoAP
Consolidation/Standalone	The rating is based on standalone financial statements of the issuer.

About the entity

Machilipatnam Urban Development Authority (MUDA) was constituted as an urban development authority on March 13, 2017 under the Andhra Pradesh Metropolitan Region and Urban Development Authorities Act, 2016, after the former authority Machilipatnam Area Development Authority (MADA) ceased to exist. MUDA is responsible for planning and development of the Machilipatnam Urban Region (MUR), which includes Machilipatnam Municipality and surrounding 29 villages, covering an area of 426 sq. km. in Machilipatnam Mandal and one village in Pedana Mandal, in Krishna district. The city (Machilipatnam) is located on the coast line of Bay of Bengal and at a distance of around 70 km from Vijayawada. Machilipatnam port is one of the key upcoming projects in Andhra Pradesh and MUDA is responsible for development of the same. MUDA is administered by the Municipal Administration and Urban Development Department of GoAP as per the provisions of the Act. The overall functions of MUDA are governed by an authority, members of which are appointed by GoAP. The Vice Chairman, as the Chief Executive Officer of MUDA, manages the regular operations.

About the guarantor: GoAP's finances

GoAP's revenue expenditure has consistently exceeded its revenue receipts during FY2016 to FY2018, leading to sustained revenue deficit during these years. Its revenue deficit worsened FY2016 to Rs. 8,964.0 crore (1.3% of GSDP) in FY2017 and further to a substantial Rs. 16,205.9 crore (2.0% of GSDP) in FY2018 from Rs. 7,306.4 crore (1.2% of Gross State Domestic Product or GSDP) in. Moreover, GoAP's fiscal deficit in each of these years (3.7% in FY2016, 3.2% in FY2017 and 4.0% in FY2018) was higher than the threshold of 3% of GSDP recommended by the Fourteenth Finance Commission.

GoAP's revised estimates (RE) for FY2019 and the budget estimates (BE) for FY2020 indicate an improvement in its revenue deficit to Rs. 11,711.2 crore and further to Rs. 1,836.0 crore, respectively (refer Exhibit 1). In FY2020 BE, the GoAP has projected a considerable YoY expansion of 55.8% in its revenue receipts and 42.9% in its revenue expenditure. In particular, the state government has projected the grants from the Centre in FY2020 BE to be nearly thrice the amount that it expects to have received in FY2019 RE, which may prove optimistic. Regardless, after the introduction of the goods and services tax (GST), the state GST (SGST) collections in AP have been favourable relative to many other states, as suggested by the low receipt of GST compensation by the GoAP in FY2018 and FY2019.

The increase in GoAP's revenue expenditure in FY2020 is led mainly by sharply higher allocation to the agriculture and education sector, reflecting the introduction of various welfare schemes in July 2019. Despite the expected reduction in the revenue deficit in FY2019 RE and FY2020 BE, GoAP's fiscal deficit is expected to remain above the cap of 3% in both these years.

Reflecting the increase in GoAP's fiscal deficit, its debt outstanding rose by 12.8% to Rs. 182,380.7 crore in FY2018 from Rs. 161,755.0 crore in FY2017. Additionally, the guarantees extended by the GoAP quadrupled to Rs. 35,964.1 crore in FY2018 from Rs. 9,664.9 crore in FY2017, led by an increase in guarantees extended to sectors including agriculture, housing and urban development and power. Accordingly, its leverage (debt +guarantees) level has deteriorated to 27.0% of GSDP in FY2018 from 24.6% of GSDP in FY2017.

ICRA shall take note of the actual Central transfers received by the GoAP in FY2020. The Central Tax devolution that the state government receives in FY2020 will be contingent on the realisation of the tax collections projected by the Government of India (GoI) in the FY2020 Union Budget, which could be negatively impacted by the recent cut in corporate tax rates and the overall slowdown in the economy. Moreover, the grants projected by the GoAP in FY2020 appear to be optimistic.

Additionally, the GoAP had constituted the Eleventh Pay Revision Commission for its employees in May 2018, which is yet to submit its report. Revision in scale for employees and pensioners is likely to bloat the GoAP's expenditure, going forward.

Key financial indicators (audited)

Recent financial results are not available.

Key fiscal indicators (GoAP)

	FY2018	FY2019 RE	FY2020 BE
Revenue			
Revenue Receipts*	1,04,981.7	1,14,627.8	1,78,639.9
State's Own Tax Revenue	49,812.7	58,125.3	75,438.0
State's Own Non-Tax Revenue*	3,733.4	4,335.1	7,297.2
Share in Central Taxes	28,674.9	32,710.7	34,833.2
Grants from Centre	22,760.7	19,456.7	61,071.5
Capital Receipts ^{&}	54.3	56.3	57.5
Expenditure			
Revenue Expenditure [#]	1,21,187.6	1,26,339.1	1,80,475.9
Capital Outlay	13,490.7	20,398.2	32,293.4
Net Lending	2,730.2	1,565.9	1,188.7
Revenue & Fiscal Balance			
Revenue Balance	-16,205.9	-11,711.2	-1,836.0
Fiscal Balance	-32,372.6	-33,619.0	-35,260.6
Leverage			
Debt [@]	1,82,380.7	2,08,346.1	2,43,725.3
Guarantees	35,964.1	NA	

*Adjusted for sale of land, debt relief from Government of India and double entries of interest on loans of departmental commercial undertakings.

& Adjusted for sale of land; Amount in Rs. crore

#Adjusted for double entries of interest on loans of departmental commercial undertakings.

@Includes internal debt; loans from the Centre; provident fund etc

Source: State Budget, Finance Accounts and ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Rating (FY2020)				Rating History for the Past 3 Years				
	Type	Amount Rated	Amount Outstanding	Current Rating 30-Sep-2019	Earlier Rating 31-May-2019	FY2019		FY2018	FY2017
						18-Jan-2018	26-Sep-2018		
1	Unallocated	Long Term	1385.0	1385.0	Provisional [ICRA]A-(CE) Negative	Provisional [ICRA]A (SO) (Stable)	Provisional [ICRA]A (SO) (Stable)	Provisional [ICRA]A (SO) (Stable)	

Amount in Rs. crore

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

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Unallocated	NA	NA	-	1385.0	Provisional [ICRA]A- (CE) (Negative)

Source: MUDA

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