ASIAN DEVELOPMENT BANK

TA 7055-IND: Capacity Development of National Capital Region Planning Board (NCRPB) – Package 1 (Components A and C)

Criteria for Financial Assessment of Borrowers

(Draft)

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ACRONYMS

ADB	:	Asian Development Bank
CRISIL	:	Credit Rating Information Services of India Limited
DSCR	:	Debt Service Coverage Ratio
NCRPB	:	National Capital Region Planning Board
ICR	:	Interest Coverage Ratio
ICRA	:	Investment Information and Credit Rating Agency of India Limited (now ICRA Limited)
NCRPB	:	National Capital Region Planning Board
P&L	:	Profit and Loss
PHED	:	Public Health and Engineering Department
PWD	:	Public Works Department
ROCE	:	Return on Capital Employed
SIDC	:	State Infrastructure Development Corporations
IFRS	:	International Financial Reporting Standards
VaR	:	Value at Risk

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1 Introduction

1. NCRPB rules empower the Board to sanction assistance to participating state governments, urban development authorities, housing boards and such other authorities of the state government for implementing the sub-regional plans and project plans or for developing the counter-magnet area. The borrowing entities therefore are the local (sub-national) authorities/governments, urban development authorities, statutory bodies set up by the state governments, the utility boards or corporations and special purpose vehicles sponsored by the above.

2. It is therefore essential to identify the broad parameters to assess creditworthiness of the borrowers over and above the detailed project evaluation for the projects sponsored by them. This evaluation is part of the three tier credit appraisal process which looks at the project risks, borrower creditworthiness and finally credit enhancements and security mechanisms structured for the specific borrowing program from NCRPB. The following sections attempt to outline these parameters for different classes of borrowers..

2 Local Governments

3. It is essential to assess the powers of the local governments to borrow money, to review whether prior approval/sanction of the [state] government is needed from time to time to borrow or re-borrow and take upon itself the interest liability arising out of term loans or bond issuances. Provisions of the governing act relating to repayment of loans, permissible security to lenders against loans such as establishment of sinking fund also needs to be reviewed.

4. Typically a statement of account for a local government comprises of revenue account and capital account. The major sources of revenue income are Octroi (where levied) & Toll Tax, municipal taxes, tax and fees from services, receipts from provision of infrastructure services such as water and sewerage works, grants and contributions and miscellaneous income.

5. Expenditure on revenue account comprises expenditures on water supply services, education, conservancy, street lighting, general administration including salaries and fire services, public works and debt servicing including interest payments and contributions to sinking fund. Capital inflows on capital account comprise of grants, loans and sale of assets. Capital expenditures are on account of creation of infrastructure assets and principal repayments. The revenue account needs to be assessed for availability of operating surpluses for debt servicing (measure of operating efficiency and ability to support capital expenditure through own revenues).

6. An assessment of trends in revenues and expenditure and reasons for variations if any, needs to be carried out. Proportion of non-tax revenues in the overall revenue base, level of dependence on state governments for fiscal transfers, extent of cost recovery and expenditures incurred in operations and maintenance are some important parameters that need to be evaluated.

7. A review needs to be undertaken of the debts outstanding for the local governments. Indicators such as Debt Service Coverage Ratio (DSCR) and Interest Coverage Ratio (ICR) needs to be computed.

- Typically such indicators should have a value of at-least 1.25 on a year-over-year basis.
- Lower values indicate that the local body does not have the ability to support the borrowing program and additional credit enhancement measures in the form of guarantees, debt service reserve accounts etc need to be provided for.

8. The following financial indicators need to be computed as part of the financial analysis of the local government.

Sl.	Indicators
1	Operating Ratio (Total revenue receipts/Total revenue expenditure)
2	Non tax receipts / Total revenues
3	State Government grants / Total revenues
4	Operating Surplus (Deficit) / Total revenue receipts
5	Establishment expenditure / Total revenue expenditure
6	Non debt capital receipts / Total capital expenditure
7	Outstanding liabilities / Total revenues
8	Debt Service Coverage Ratio (Operating Surplus + Balances in sinking fund) / (Annual Debt Servicing)
9	Interest Coverage Ratio (Operating Surplus) / (Annual Interest Payments)

3 Utilities and Statutory Boards

9. Utilities/Statutory Authorities/Boards entrusted with infrastructure provision: state governments often set up a nodal agency or a statutory authority or a Board which is responsible for provision of specific infrastructure services such as power generation, water supply & sewerage services in the state. This utility is the predominant agency for asset creation and operations and maintenance thereof across urban and rural areas.

10. The analysis of such borrowers should include existing financial position, future financial profile, cash flow adequacy, trends in revenues from operations, an analysis of cost and profitability, interest coverage ratios, return on capital employed and an analysis of debt outstanding and track record of timely debt servicing.

11. Analysis of the revenue account / profit & loss (in case of corporate entities) needs to be carried out for the immediate preceding five years and financial projections need to be drawn up for the next five years. In the P&L account, the composition of the revenues in terms of volumes and per unit realizations needs to be analyzed. The overall operating profits (Profits before depreciation, interest and taxes) in relation to the revenues and emerging trends over the analysis period (typically 10 year periods) need to be undertaken.

12. The following financial ratios need to be computed as part of the financial analysis of these state-owned entities.

Sl.	Indicators
Profitability Ratio	
1	(Profit Before Interest Depreciation Taxes) / (Operating Income)
2	(PAT or Surplus after debt servicing and depreciation) / (Total Income)
3	Average Revenue Realization per unit
4	Average Cost Incurred per unit
5	Return on Capital Employed (ROCE) (Operating revenues-Operating expenses)/(Total Assets – Current

Sl.	Indicators
	Liabilities)
Solvency Ratio	
6	Gearing Ratio (Debt or Borrowed Resources)/(Equity or own capital + internal accruals)
7	Interest Coverage Ratio (Earnings before depreciation, interest and taxes) / (Interest Expense)
Liquidity Ratio	
8	Current Ratio – (Current Assets) / (Current Liabilities)
Turnover Ratio	
9	Average Collection Period
10	Working Capital Turnover Ratio

3.1 State Industrial Development Corporations (SIDC)

13. NCRPB also provides loans to SIDCs for land acquisition and provision of infrastructure services in industrial estates. SIDCs are typically involved in creating and managing industrial estates and providing term loans and equity support from State Governments to small and medium sized industrial enterprises in the State.

14. A financial analysis of SIDCs would involve a detailed analysis of revenues from different operating sources to understand their sustainability. In addition, level of support from State Government in the form of equity infusions and guarantees for debt need to be studied. The following ratios are required to be computed As part of this analysis.

Sl.	Indicators
1	(Profit Before Interest Depreciation Taxes) / (Operating Income)
2	Return on Capital Employed (ROCE) (Operating revenues-Operating expenses)/(Total Assets – Current Liabilities)
3	Cost of Capital
4	Net Spread (difference between lending rates and borrowing terms)
5	Gearing Ratio (Debt or Borrowed Resources)/(Equity or own capital + internal accruals)
6	Interest Coverage Ratio (Earnings before depreciation, interest and taxes) / (Interest Expense)

3.2 Development Authorities

Typically, Development Authorities are engaged in planning activity for new areas and area development. The planning activity includes preparation of development plans for the city and individual scheme plans as per existing bye-laws and approval of development plans for housing schemes/buildings. The development functions include acquisition of land, formation of layouts/schemes to provide for residential, commercial and civic amenity sites and construction of commercial complexes, houses and flats.

15. The following indicators may be computed for the past five years for Development Authorities. Projections need to be carried out, estimating the land bank acquired and in possession of the authority, extent of leveraging involved in land acquisition and site development and liquidity cushion available with the authority.

Sl.	Indicators
1	Revenues from sale of sites / Total Revenues
2	Total Debt / Net Worth
3	OPBDIT / Revenue Receipts
4	Loans / Capital Expenditure
5	Cash and Bank Balances / Total Assets

3.3 State Government Departments

16. Typically, state government departments such as Public Works Department (PWD) or Public Health Engineering Department (PHED) are part of the state government and their finances are consolidated with that of the state. It is important to analyse the budgets allocated to these departments and ensure that liabilities incurred for capital expenditures undertaken by these departments are properly accounted for by the finance department.

3.4 State Government Ratings

17. NCRPB has exposure to state government departments which are inherently the arms of the state government, where . A NCRPB lends to state entities which have explicit guarantees from the state government as a form of credit enhancement. As NCRPB deals with only four state governments, it is recommended that NCRPB engage its existing rating agencies to carry out a detailed credit assessment of these state governments.

18. Based on above criteria, it is recommended that NCRPB staff involved in appraisal carry out sample analysis of existing and new borrowers. These criterions can be fine tuned based on the initial experience.