

Rating Rationale

19 Dec 2022

Lucknow Municipal Corporation

Brickwork Ratings reaffirms the ratings for the Bonds/NCDs of Rs. 200.00 Crs of Lucknow Municipal Corporation.

Particulars

Facilities/ Instrument**	Amount (Rs. Crs)		Tenure	Rating*	
	Previous	Present		Previous (30-Nov-2021)	Present
Bonds/NCDs	200.00	200.00	Long Term	BWR AA/Stable Reaffirmation	BWR AA/Stable Reaffirmation
Total	200.00	200.00	Rs. Two Hundred Crores Only		

*Please refer to BWR website www.brickworkratings.com/ for the definition of the ratings

** Details of NCD/Bonds are provided in Annexure-I

RATING ACTION/OUTLOOK

Brickwork Ratings (BWR) reaffirms the ratings of Lucknow Municipal Corporation (LMC or the corporation). The ratings derive strength from low debt and comfortable net worth, adequate average monthly cash flows available from the property taxes and fees and user charges, availability of escrow account and moderate tax collection efficiency. The rating also factors the implicit support extend to the rated bonds in the form of funds available from the Infrastructure Development Fund - the Government of Uttar Pradesh (GoUP) with a T-Structure for meeting the shortfall of the Sinking Fund and replenishment of the Debt Service Reserve Amount, backed by upfront DSRA that covers four semi-annual coupon payments, an escrow mechanism with respect to cash inflows of property taxes, and fees and user charges, and a structured payment mechanism for timely monitoring the funds availability in the Interest Payment Account and Sinking Fund Account. However, the ratings are constrained by moderate service levels, moderate surplus margins and high receivable levels.

The outlook has been kept as Stable considering LMC's performance is likely to remain consistent owing to cash flows from property taxes, and fees and user charges, along with grants from the government.

KEY COVENANTS OF THE INSTRUMENT/FACILITY RATED: The rated NCDs of Rs.200 Crs have an upfront DSRA of four half-yearly coupon payments, and a structured payment mechanism for a mismatch or shortfall in the cash flows for meeting the debt obligations as detailed in the structured payment mechanism. In addition, the rated bonds have implicit support extended by the GoUP for the utilisation of funds available in the Infrastructure

Development Fund with a T-Structure for meeting the shortfall of the Sinking Fund and replenishment of the DSRA. Furthermore, the rated bonds are backed by the incentive received of Rs.26.00 Crs from Government of India (GoI) as part of the AMRUT Scheme, and these cash flows are kept in the form of fixed deposits, and a lien has been created in favour of the debenture trustee throughout the tenor of the debentures.

KEY RATING DRIVERS

Credit Strengths:-

- **Low debt and comfortable net worth** - LMC has Outstanding unsecured loan of Rs. 599.20 Crs from the State Government as on 31-Mar-2022 and Rs. 594.53 Crs. as on 30-Sep-2022 and Bonds of Rs. 200.00 Crs. LMC has informed that the unsecured loan will be an interest free loan and does not have any fixed repayment obligation on LMC. The same may only be adjusted/deducted by the State Government from the grants/transfers to LMC. The Loans to Reserve ratio considering the unsecured loans and bonds of LMC as debt works out to 0.18x as on 31-Mar-2022. LMC has reported Municipal funds, Reserves and Grants of Rs. 4487.87 Crs as on 31-Mar-2022 and Rs. 4606.81 Crs. as on 30-Sep-2022. As on FY22, Municipal Fund and reserves was at Rs. 2836.45 Crs. and Grants, contribution to specific purposes was at Rs. 1651.42 Crs. The same is reported at Rs. 3005.02 Crs. and 1601.78 Crs. respectively as on 30-Sep-2022.
- **Adequate average monthly cash flows available in the Property taxes and Fees and user Charges** - For the rated bonds, the property taxes and fees and user charges have been escrowed and these cash flows are transferred to the respective interest payment account and sinking fund account as per the terms of the Bonds. During FY22, the average cash flows received with respect to property taxes and fees and user charges were Rs. 29.02 Crs. as compared to Rs. 29.22 Crs. in corresponding period. Approximately, Rs. 4.00 Crs will be transferred to the respective sinking fund account and interest payment account.
- **Implicit support from the state government** - The NCD/Bonds issue of Rs. 200.00 Crs. factors implicit support from the state government which includes funds available from Infrastructure Development Fund, Government of Uttar Pradesh for meeting any shortfall in the Sinking Fund and/or DSRA replenishment.
- **Availability of Escrow account, structured payment mechanism and upfront DSRA** - LMC has created a separate escrow account for the receivables of property taxes and fees & user charges. Structured payment mechanism has been set up for transferring of the funds from escrow account to Interest payment account and sinking fund account. LMC is also backed by upfront DSRA for 4 half yearly coupon payments and these DSRA has to be placed in an Interest payment account.
- **Moderate tax collection efficiency:** In FY22, property tax collection efficiency for current dues is reported at 60.11%. However, in H1FY23, the property tax collection is reported at Rs. 170.68 Crs. This is mainly because of the increase in the number of properties and timely realisation of property taxes. During FY22, the property taxes reported at Rs. 290.11 Crs as compared to Rs. 312.67 Crs in the corresponding period.

Credit Risks:-

- **Moderate surplus margins** - LMC reported operating surplus of Rs. 164.90 Crs. and net surplus of Rs. 17.66 Crs. in FY22. The operating surplus margin is assessed at 12.40% and net surplus margin is assessed at 1.33% in FY22 because of the increase in total expenditure of the corporation as compared to 12.72% and 1.53% respectively in FY21. However, in H1FY23, the operating surplus margin is assessed at 30.79% and net margin is assessed at 21.93% because of the increase in revenue grants, contribution & subsidies.
- **Moderate service levels** - LMC has reported moderate service levels with respect to water supply connections and sewerage network services.
- **High receivable levels** - LMC on an average reporting outstanding receivables at an level of Rs. 631.71 Crs. during the last three years (FY20 to FY22).
- **Auditor's observations** - BWR takes note of the various observations highlighted by the auditor in the Annual report which BWR took up with the corporation. LMC stated that the issues have already been taken up with the respective authorities and the same would be looked into.

ANALYTICAL APPROACH - Standalone

To arrive at the ratings, BWR has considered the standalone financials of the corporation, along with the structured payment mechanism, including the interest payment account, a DSRA comprising four half-yearly coupon dues, the build-up of the sinking fund account in the months preceding the due dates and replenishment of the DSRA (if utilised) as per the interest payment mechanism. In addition, the rated bonds have a structured payment mechanism enabling the utilisation of funds available with the GoUP in the Infrastructure Development Fund with a T-Structure for meeting the shortfall of the Sinking Fund and replenishment of the DSRA. BWR has applied its rating methodology as detailed in the Rating Criteria below (hyperlinks provided at the end of this rationale).

RATING SENSITIVITIES:

- **Upward:** Substantial improvement in the structured payment mechanism, tax collection efficiency, monthly collection of property taxes & fees and user charges and substantial reduction in the receivables position.
- **Downward:** Reduction in the monthly collection of property tax and fees and user charges or any sharp reduction in the available surplus in the Municipal Corporation and delay in meeting the shortfall in the DSRA/sinking fund obligations as per the tripartite agreement from Infrastructure Development Fund.

LIQUIDITY: Adequate

The liquidity position of LMC is adequate. As on 31 March 2022, the corporation does not have any debt obligations to be met. For the O/s unsecured loans of Rs. 594.53 Crs as of 30-Sep-2022, LMC has stated that the unsecured loan will be an interest free loan and does not have any fixed repayment obligation on LMC. The same may only be adjusted/deducted by the State Government from the grants/transfers to LMC. LMC has strong liquidity to meet its interest payment obligations and the fixed repayment obligation for NCD/Bonds issue of Rs. 200.00 Crs. commences from FY25 onwards and the property taxes and fees and user charges

have been escrowed. During FY22, the average monthly cash flows received with respect to property taxes and fees and user charges were Rs. 29.02 Crs. as compared to Rs. 29.22 Crs corresponding period. Approximately, Rs. 4.00 Crs on monthly basis will be transferred to the respective sinking fund account and interest payment account. These cash flows from the property taxes and fees & user charges are adequate for building up the funds in the Interest Payment account and for the Sinking Fund account for meeting the debt obligations. LMC is maintaining upfront DSRA with HDFC Bank and the outstanding amount of DSRA as on 30-Nov-2022 is Rs. 34.00 Crs. Also, the LMC has reported cash and bank balances of Rs. 568.30 Crs. as on 30-Sep-2022.

About the Corporation

Lucknow Municipal Corporation (LMC) is administered under the Uttar Pradesh Municipal Corporation Adhiniyam, 1959. Till the year 1884, Lucknow was known as Municipal Committee however in the same year it was given the name of Municipal Board and continued till 1959. Lucknow Nagar Mahapalika was constituted in the year 1959 under Uttar Pradesh Nagar Mahapalika Act 1959. At the time of constitution, total area under its jurisdiction was 48 Sq Km which was expanded four times to 101 Sq Km, 107 Sq Km and 350 Sq Km. till the year 1987. Under 74th Constitution amendment act Lucknow Nagar Mahapalika was again reconstituted on 31.05.94 and given the status of Municipal Corporation. The area under LMC is divided into eight zones and further subdivided into 110 municipal wards. It has a coverage area of 568 sq. kms, and serves a population of 28.17 lakh as per 2011 census and density of 4959 person/Sq. Km.

Terms of the NCDs/Bonds

The tenor of the NCD/bonds is 10 years, and the redemption starts from FY25. LMC has created an interest payment account and a sinking fund. Additionally, an escrow account has been created, and the cash flows received from the property tax, and fees and user charges will be transferred to this escrow account.

- **Interest Payment Account:**

- The interest payment account is an account from which interest payments on the debentures will be serviced and the required DSRA will also be maintained. For ensuring the maintenance of the required DSRA, the four succeeding coupon payments amount has been reserved.
- Furthermore, on each of the first five transfer dates occurring in each 12-month block, an amount equivalent to 20% (twenty percent) of the coupon payment is to be made on the first coupon payment date in such a 12-month block and any further interest payable as per the terms of the issuance and any shortfall in the earlier contribution is to be transferred to the interest payment account.
- On each of the 6th to 10th transfer dates occurring in each 12-month block, an amount equivalent to 20% (twenty percent) of the coupon payment is to be made on the 2nd coupon payment date in such a 12-month block and any further interest payable as per the terms of the issuance and any shortfall in earlier contribution is to be transferred to the interest payment account.

- Any shortfall in the funds available in the escrow account to complete the aforesaid transfers to the above account(s) shall be made good by LMC by transfer from the other account(s) of LMC.
- **Sinking Fund Account:**
 - On each of the first 10 (ten) transfer dates occurring in each 12-month block, an amount equivalent to 1/10th of 10% (ten percent) of the issue size and any shortfall in the earlier contribution is to be transferred to the sinking fund account.
 - Any shortfall in the funds available in the escrow account to complete the aforesaid transfers to the above account(s) shall be made good by the LMC by transfer from the other account(s) of LMC.
- **Infrastructure Development Fund:** The replenishment of the required DSRA, as well as funding of the shortfall in the sinking fund account (created for principal repayment) a tripartite agreement has been executed among the GoUP/state government, the debenture trustee and LMC. The GoUP has issued a Governmental Order (GO) dated 30 July 2019, wherein it has created a policy for the utilisation of the funds in the Infrastructure Development Fund to promote/incentivise the issuance of municipal bonds. Pursuant to the GO, a tripartite agreement with the GoUP, debenture trustee and LMC has been executed for agreeing and covenanting to make the payment of funds from the Infrastructure Development Fund in terms of such an agreement
 - into the interest payment account for the creation of the upfront required DSRA,
 - into the interest payment account on the occurrence of a DSRA shortfall
 - and into the sinking fund account on the occurrence of a sinking fund mismatch
- **GoI incentive:** LMC has received an incentive from the GoI as part of the AMRUT incentive during June 2021. This incentive amount of Rs. 26.00 Crs has been deposited in the form of fixed deposits, and a lien has been created in the favour of the debenture trustee over such fixed deposits throughout the tenor of the debentures. Interest amounts earned on such fixed deposits shall be utilisable by the issuer, in accordance with the terms set out in the transaction documents.
- **Interest Payment Mechanism- Structured Payment Mechanism**
 - The debenture trustee shall check the amount lying to the credit of the interest payment account (which is over and above the required DSRA) at 25 (twenty five) days prior to the coupon payment date (T-25 days). In the case of any shortfall in the amount required to make the payment of the coupon on the coupon payment date in the interest payment account (calculated on the basis of the amounts available in addition to the required DSRA), the debenture trustee shall intimate the issuer of the shortfall, and the issuer shall make good the shortfall in the interest payment account prior to the date falling 10 (ten) days prior to the coupon payment date (T-10 days).
 - In the case of a shortfall in the amount required to make the payment of coupon on the coupon payment date in the interest payment account (calculated on the basis of the amounts available in addition to the required DSRA) at nine days prior to the coupon payment date (T-9 days), the debenture trustee shall trigger the payment mechanism and instruct the bank to utilise the DSRA to the extent of the shortfall in the amount required to make the payment of the coupon on the coupon

payment date on or prior to the date falling eight days prior to the interest payment date (T-8 days).

- The coupon shall be paid by the issuer on the coupon payment date (T).
- In case the DSRA (or part thereof) is utilised to fund the shortfall in the amount required to make payment of the coupon in respect of any coupon payment date, immediately after the debenture trustee has instructed the bank to utilise the DSRA as above and in any event prior to seven days prior to the relevant coupon payment date (T-7), the debenture trustee would issue a notice in writing to the issuer (and the GoUP shall be informed of the same, by the debenture trustee, marking a copy of such a notice to the GoUP).
- On the issuance of such a notice, the issuer shall make good the DSRA shortfall prior to the date falling on the relevant coupon payment date (T). In the event that the shortfall is not made good by the issuer on the relevant coupon payment date (T), the debenture trustee shall issue a notice to the issuer (and GoUP shall be informed by marking a copy to GoUP) on the date immediately succeeding the relevant coupon payment date (T+1).
- On the issuance of such a notice, the GoUP shall remit funds required to replenish the required DSRA (such that the amount in the interest payment account (calculated on the basis of the amounts available in addition to the minimum balance) is atleast equivalent to the required DSRA) within 15 (Fifteen) days from the relevant coupon payment date (T+15) by depositing such amounts into the interest payment account.

- **Principal Repayment (Sinking Fund) Mechanism:**

- The debenture trustee shall check the balance in the sinking fund account prior to the end of each 12-month block, and in the case of any shortfall in the sinking fund account, i.e., a sinking fund mismatch, it shall be replenished as per the following mechanism.
- The debenture trustee shall check the amount lying to the credit of the sinking fund account at 25 (twenty five) days prior to the end of each 12-month block (T-25 days). In the case of any shortfall in the amount, the debenture trustee shall intimate LMC of the shortfall (and the GoUP shall be informed by marking a copy to the GoUP), and LMC shall make good the shortfall in the sinking fund account prior to the date falling 15 (fifteen) days prior to end of each 12-month block (T-15 days).
- In case a shortfall in any amount still persists in the sinking fund account at 14 (fourteen) days prior to the end of each 12-month block (T-14 days), the debenture trustee shall trigger the payment mechanism and issue a notice to the issuer (and the GoUP shall be informed by marking a copy to the GoUP). On the issuance of such a notice, the state government shall remit funds to fund the shortfall into the sinking fund account prior to the end of each 12-month block (T).
- The redemption shall be made by LMC on relevant redemption dates.

KEY FINANCIAL INDICATORS

Key Parameters	Units	H1FY23	FY22	FY21
Result Type		Unaudited	Audited	Audited
Total Income	Rs. Crs	768.68	1329.54	1150.13
Total Expenditure	Rs.Crs	532.01	1164.64	1003.79
Cash Surplus before depreciation and interest	Rs. Crs	236.67	164.90	146.34
Net Surplus	Rs. Crs	168.57	17.66	17.57
Municipal Fund and Reserves	Rs. Crs	4606.81	4487.87	4543.72
Loans to Reserve Ratio	In Times	0.17	0.18	0.18

NON COOPERATION WITH PREVIOUS CREDIT RATING AGENCY IF ANY: NIL

Rating History for the previous three years (Including withdrawal and suspended)

S.No	Instrument /Facility	Current Rating			Chronology of Rating History for the past 3 years (Rating assigned and press release date) along with outlook/watch, if applicable		
		Type (Long Term / Short Term)	Amount (Rs. Crs)	Rating	Date(s) & Rating(s) assigned in 2021	Date(s) & Rating(s) assigned in 2020	Date(s) & Rating(s) assigned in 2019
1	NCDs / Bonds	Long Term	200.00	BWR AA / Stable (Reaffirmation)	BWR AA / Stable (30-Nov-2021)	BWR AA (CE) / Stable Affirmation (20-Nov-2020) Provisional BWR AA (CE) / Stable (28-Oct-2020) Provisional BWR AA (CE) / Stable (05-Oct-2020) Provisional BWR AA (CE) / Stable (05-Feb-2020)	Provisional BWR AA (SO) / Stable (04-Feb-2019) Provisional BWR AA (SO) / Stable (08-Feb-2019) Provisional BWR AA (CE) / Stable (1-Oct-2019)
2	Issuer Rating	Long Term	--	--	--	--	Rating Withdrawn (25-Mar-2019)
Total			200.00	Rupees Two Hundred Crores Only			

COMPLEXITY LEVELS OF THE INSTRUMENTS - Simple

BWR complexity levels are meant for educating investors. The BWR complexity levels are available at [www.brickworkratings.com / download / ComplexityLevels.pdf](http://www.brickworkratings.com/download/ComplexityLevels.pdf). Investors' queries can be sent to info@brickworkratings.com.

Hyperlink/Reference to applicable Criteria

- [General Criteria](#)
- [Approach to Financial Ratios](#)
- [Public Finance- Municipal and Urban Local Bodies](#)

For any other criteria obtain [hyperlinks](#) from website

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Lucknow Municipal Corporation

Annexure-I

Instrument Details

Instrument	Issue Date	Amount (Rs. Crs)	Coupon Rate	Maturity Date	ISIN Particulars
NCD/Bonds	18 Nov 2020	28.58	8.50%	18 Nov 2024	INE05OC24017
NCD/Bonds	18 Nov 2020	28.58	8.50%	18 Nov 2025	INE05OC24025
NCD/Bonds	18 Nov 2020	28.58	8.50%	18 Nov 2026	INE05OC24033
NCD/Bonds	18 Nov 2020	28.58	8.50%	18 Nov 2027	INE05OC24041
NCD/Bonds	18 Nov 2020	28.58	8.50%	18 Nov 2028	INE05OC24058
NCD/Bonds	18 Nov 2020	28.58	8.50%	18 Nov 2029	INE05OC24066
NCD/Bonds	18 Nov 2020	28.52	8.50%	18 Nov 2030	INE05OC24074



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