

Change in Rating Symbol

September 16, 2019

Lucknow Municipal Corporation

Total Instruments Rated	Rs. 200.00 Cr
Long Term Rating	ACUITE Provisional AA / Stable

Pursuant to SEBI Circular SEBI/ HO/ MIRSD/ DOS3/ CIR/ P/ 2019/ 70 dated June 13, 2019 there is a revision in the rating symbol. The change to 'CE' suffix / removal of 'SO' suffix for the rated instrument(s) is not to be construed as any change in the rating or Acuité's credit opinion on the said instrument(s). The previous rating rationale is appended herewith for reference.

For the background note, please visit: [https://www.acuite.in/pdf/General%20Communication%20For%20Website%20\(1\).pdf](https://www.acuite.in/pdf/General%20Communication%20For%20Website%20(1).pdf)

Criteria for assigning ratings with 'SO' suffix: <https://www.acuite.in/view-rating-criteria-48.htm>

Criteria for assigning ratings with 'CE' suffix: <https://www.acuite.in/view-rating-criteria-49.htm>

Press Release

Lucknow Municipal Corporation

February 07, 2019



Rating Reaffirmed

Bond Programme*	Rs. 200.00 Cr.
Long Term Rating	ACUITE Provisional AA (SO)/ Outlook: Stable (Reaffirmed)

* Refer Annexure for details

Rating Rationale

Acuité has assigned long-term rating of '**ACUITE Provisional AA (SO)**' (**read as ACUITE provisional double A (Structured Obligation)**) on the Rs. 200.00 crore proposed bond of Lucknow Municipal Corporation. The outlook is '**Stable**'.

Update

Acuité had assigned the rating of ACUITE Provisional AA (SO) / Stable on 30 January, 2019 based on the initial term sheet received from LMC. Subsequently, LMC has revised the term sheet with regard to repayment timeline. As per the initial term sheet, the bonds were to be repaid in eight annual tranches (in the nature of STRPPS) from the end of year 3. As per the revised term sheet, the bonds are to be repaid in seven annual tranches starting from the end of year 4.

Lucknow Municipal Corporation, constituted in 1960, services an area of 350 square kilometres. The total population of Lucknow is around 28.2 lakh (as per 2011 census) spread across 110 wards. The corporation provides key obligatory services such as roads and bridges, public health, solid waste management, and education. It also offers discretionary services such as public transportation. LMC has another integral arm, Jal Kal Vibhag Lucknow Municipal Corporation. This department provides key obligatory services such as water supply, sanitation, drainage and sewerage. The water and sewerage taxes are also collected under Jal Kal Vibhag Lucknow Municipal Corporation.

The rating on the Rs. 200.00 Cr. Bonds is provisional and the final rating is subject to:

- Finalisation of term sheet in name of Lucknow Municipal Corporation
- Finalisation of Legally binding undertaking by GoUP in favour of Debenture Trustee in respect of the bond obligations of LMC ensuring timely fund support by GoUP (in the event of any shortfall in servicing of bond) through the revolving credit facility available for LMC under the Pandit Deen Dayal Upadhyay Nagar Vikas Yojana.
- Confirmation from the debenture trustee regarding execution support from Government of Uttar Pradesh (GoUP) and compliance with other terms and conditions as per the term sheet

The provisional rating is valid for 90 days and Acuité reserves the right to alter/modify/extend/withdraw the rating any time prior to 90 days, if such an action is deemed appropriate.

Analytical Approach

Acuité has considered the standalone financial and business risk profile of LMC to arrive at the rating.

Key Rating Drivers

Strengths

- **Benefits from Lucknow's status as an Administrative and Political Capital of Uttar Pradesh**

Lucknow Municipal Corporation (LMC) provides civic services to Lucknow city, the administrative and political capital of Uttar Pradesh, the largest state of the country. Being a capital city of a state with significant political importance, Lucknow is a base for all major state government offices. As a centre for major decision making, Lucknow has enhanced ability to attract

investments from wide range of sectors. Lucknow city is located in the eastern part of Uttar Pradesh, and is the hub of various small, medium and large scale industries like handicraft (Chikan embroidery and Zardosi), aeronautics, machine tools, distillery chemicals and furniture. Lucknow city is also a major centre for research and development. A few large scale companies located in and around Lucknow include Hindustan Aeronautics Limited (HAL), Tata Motors Ltd., and Scooters India Limited among others. Lucknow is also the headquarter for Small Industries Development Bank of India (SIDBI). Major research and development centers in Lucknow are Central Drug Research Institute (CDRI), National Botanical Research Institute (NBRI), Council of Scientific and Industrial Research (CSIR) and Indian Institute of Toxicology Research (IITR). Further, Lucknow is a growing IT hub with software and IT companies resident in the city including HCL Technologies, Tata Consultancy Services, to name a few. Acuité believes the significant employment opportunities generated by varied range of industries located in and around Lucknow is expected to lead to higher per capita income which augurs well for LMC.

LMC's owned revenues stood at Rs.397.41 crore for FY2018 against Rs.412.05 crore for the previous year. The surplus stood at Rs.26.45 crore for FY2018 (PY: Rs.30.82 crore). Besides the owned revenues, LMC has been a recipient of continuous support from the government in the form of grants. The capital grants received by LMC stood at Rs.1456.95 crore as on 31 March 2018 (PY: Rs.1469.97 crore). LMC's owned revenues to total revenues stood at 41.78 per cent in FY2018 as against 40.97 per cent in the previous year. The below average coverage ratios inhibit its ability to scale up its owned revenue over the near to medium term. However, the support from State and Central Government by way of Grants is expected to continue in coming years which will be critical to maintain the pace of capital expenditure necessary to bring the coverage ratios to the benchmark levels as envisaged under AMRUT scheme. As a measure of support to LMC, UP government has also instituted a revolving fund with supplementary provision from the annual budget which will also be available to LMC for meeting its financial/operational commitments.

Lucknow has also been identified as one of the cities under Atal Mission for Rejuvenation and Urban Transformation (AMRUT). The purpose of AMRUT is to ensure every household to have access to tap water and sewerage connection, increase the amenity value of cities, and reduce pollution in the city. Along with being an AMRUT city, Lucknow is also one of the 100 cities selected for the SMART City project.

Acuité believes that LMC will continue to benefit significantly from its pivotal position as the capital city of largest state (by population) in the country. Since the ongoing support from state government will be critical for maintaining of a stable credit profile, the credit rating of UP government will also be a key monitorable.

• Structured Payment Mechanism

The proposed issue is for secured non-convertible bonds aggregating to Rs.200.00 crore. These bonds will be general obligation bonds and issued in the nature of Separately Transferable Redeemable Principal Parts (STRPPS). Each bond will be divided into seven annual tranches that is redeemable from end of year 4. The bonds also have a put and call option at the end of year 5.

The payment mechanism entails maintenance of an Escrow Account, Debt Service Reserve Account (DSRA), Interest Payment Account (IPA), and Sinking Fund Account (SFA):

- I. The DSRA is required to be funded one day prior to the pay-in date with an amount equal to two succeeding coupon payments (one year interest payments) required to be paid by LMC in respect of the Debenture.
- II. The funds (property tax and fees and user charges) received/pooled in the Escrow Account will be first utilised to meet the amount of minimum balance for transfer to IPA and SFA on a monthly basis as per the terms of the bonds.
- III. As regards the interest payments (expected to be half yearly), the IPA will be funded on a monthly basis as per the terms of the bonds.
- IV. SFA, which shall be funded monthly equivalent to the amount as per the terms of bonds.

• IPA:

An amount, as per the terms of bonds, will be transferred to IPA from Escrow Account on monthly basis. In case of any shortfall in the amount lying to the credit of interest payment account on transaction date T-25 days prior to debt service, the trustee shall inform LMC, and the latter shall cover the shortfall prior to the date falling by T-5 business days from the coupon payment date. If

the corporation fails to cover the shortfall by T-4 business days, then the trustee will instruct the bank to transfer the deficit from DSRA to IPA by T-3 business days. The coupon payment shall be made by LMC on the due date (T).

- **SFA:**

The debenture trustee shall check the balance in SFA at the end of each year; in case of any shortfall, the trustee shall inform LMC to replenish the same. Further, the trustee shall check the balance in SFA in T-25 business days prior to the principal redemption date. In case of any shortfall, the trustee shall ask LMC to make good the shortfall in T-20 business days.

In case any shortfall still persists in SFA at T-19 business days prior to the principal redemption date, the Debenture Trustee shall trigger the payment mechanism and call upon the State Government to remit funds to fund the shortfall in to the Sinking Fund Account from the revolving credit facility, in terms of the undertaking provided by GoUP, prior to the date falling by T-5 business days from the principal redemption date. The redemption shall be made by LMC on the due date (T).

As per the term sheet, In case of utilisation of DSRA to fund any shortfall in IPA during the time of interest payment or any shortfall in SFA account during the time of repayment, LMC is eligible for revolving credit facility from GoUP under Pandit Deen Dayal Upadhyay Yojna, in terms of the undertaking provided by GoUP, for replenishment of DSRA and/or funding the shortfall in SFA. Acuité believes adherence to the structured payment mechanism is central to the rating.

- **Management of Funds**

The management of funds in the various designated accounts will be overseen by the trustee. Any surplus funds available in the Escrow account, after meeting the aforesaid minimum balance for IPA and SFA, can be transferred to LMC's general fund account. Escrow Account, DSRA, IPA and SFA shall be maintained with a scheduled commercial bank, rated at least 'AA+' by two rating agencies, throughout the tenure of the instruments. If the rating of senior debt of the concerned bank falls below 'AA+', LMC will move the fund to other bank, satisfying the aforesaid conditions. The status of the designated accounts will be shared with the debenture trustee and rating agencies on a periodic basis during the tenor of the bonds. The funds credited and lying in Escrow Account, IPA, SFA and DSRA can be kept in permitted investments in accordance with the terms of the bonds. The interest income earned on the investments made from SFA, DSRA and IPA can be utilised towards obligations of the respective accounts.

Weaknesses

- **Sub Optimal Civic Service Coverage Parameters**

LMC's coverage ratios have remained sub optimal. The water supply connection coverage (based on land area) and sewerage coverage remained below average at 65.38% and 60.20%, respectively, in FY2017-18, against the benchmarks service levels required under AMRUT mission. LMC has been on an aggressive infrastructure buildup strategy which is reflected in the increase in the net block from Rs.1490.12 crore as on March 31, 2016 to Rs.2900.04 crore as on March 31, 2018. Acuité expects high level of capex going forward to meet the required service levels. The high level of committed capital expenditure will require significant resource generation either from own sources or through state government grants. In the event of slowdown in owned revenues or lower pace of flow of grants from government, LMC might have to go in for additional debt to support the high level of capex. The covenants imposed by bondholders such as maintaining a DSCR of 1.50 times at all times may inhibit the ability of LMC to raise additional debt. This in turn will impact its capex plans.

Acuité believes that the sub optimal level of coverage indicators will continue to impinge on its credit profile by way of significant capital expenditure commitments and commensurate requirement of funding support either by way of government grants or additional debt.

- **Significant Buildup in Receivables**

The debtors position as on 31 March, 2018 stood at Rs.607.01 Cr. as compared to Rs.566.38 Cr. as on 31 March, 2017 i.e. 558 days for FY18 (previous year 502 days). The debtors outstanding as on March 31, 2018 mainly pertain to past accumulated overdues in property taxes and the same has been increasing on Y-O-Y basis. Of the above, Rs.447.93 crore, representing 74 per cent of the total receivables, pertain to outstanding beyond two years.

Acuité believes LMC's ability to ensure timely collection of its owned revenues and recovery of its past receivables will be key credit monitorable.

Outlook: Stable

Acuité believes LMC will maintain a stable outlook on the back of the continued support from government of UP on account of its pivotal position as the administrative and political capital of Uttar Pradesh. The outlook may be revised to 'Positive' in case there is a significant improvement in cost recovery and service coverage indicators. The outlook may be revised to 'Negative' in case of a sharp deterioration in the coverage indicators or fiscal position of LMC or UP state government. Any significant slippages in UP government's fiscal parameters will inhibit its ability to support LMC.

Liquidity Position

LMC has been generating revenue surplus over the past three years. While the flow of grants from the government has been robust, the high buildup of receivables continues to be an area of concern. Since LMC is debt free at present, it has a reasonable financial flexibility. However, considering the proposed debt its financial flexibility could be impacted in the event of a slowdown in revenues especially in case of exercise of a put option by the investors at the end of fifth year. Under the Pandit Deen Dayal Upadhyay Nagar Vikas Yojna, LMC will be eligible for revolving credit facility from GoUP, in terms of the undertaking provided by GoUP, thus giving a further liquidity for LMC for servicing of the bond.

About the Rated Entity - Key Financials

	Unit	FY18 (Actual)	FY17 (Actual)	FY16 (Actual)
Revenue Receipts	Rs. Cr.	939.89	997.14	895.93
Surplus / Deficit	Rs. Cr.	26.45	30.82	41.39
Total Debt	Rs. Cr.	NA	NA	NA
Interest Coverage Ratio^ ((Surplus/Deficit + Interest)/Interest)	(%)	530.00	1,028.33	NA

^Interest expenses also includes bank charges

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

None

Applicable Criteria

- Default Recognition - <https://www.acuite.in/criteria-default.htm>
- Urban Local Bodies - <https://www.acuite.in/view-rating-criteria-39.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-20.htm>
- Criteria For Rating Of Securitized Transactions - <https://www.acuite.in/view-rating-criteria-29.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/criteria-complexity-levels.htm>

Rating History (Upto last three years)

Date	Name of Instrument / Facilities	Term	Amount (Rs. Cr.)	Ratings/Outlook
30-Jan-2019	Proposed Bond	Long Term	200.00	ACUITE Provisional AA (SO) / Stable (Assigned)

*Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Proposed Bond	Not Applicable	Not Applicable	Not Applicable	200.00	ACUITE Provisional AA (SO) / Stable (Reaffirmed)

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About Acuité Ratings & Research:

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