

May 23, 2024

Karnataka Water and Sanitation Pooled Fund: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Term loan	475.95	362.43	[ICRA]AA-(CE) (Stable); reaffirmed
Total	475.95	362.43	
Rating Without Explicit Credit Enhancement			[ICRA]A+

*Instrument details are provided in Annexure-I

Note: The (CE) suffix mentioned alongside the rating symbol indicates that the rated instrument/facility is backed by some form of explicit credit enhancement. 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

For the [ICRA]AA-(CE)(Stable) rating

The rating for the various term loans of the Karnataka Water and Sanitation Pooled Fund (KWSPF) derives strength from the Government Orders (GOs) issued by the Government of Karnataka (GoK), which include a shortfall undertaking by the state government to make good any shortfall in the servicing of the term loans, if the budgetary allocation under the State Finance Commission (SFC) devolution is inadequate. The said GOs would remain effective till the ICRA-rated term loans are fully repaid. The Stable outlook on this rating reflects ICRA's outlook on the rating of the GoK, which has provided the shortfall undertaking.

Adequacy of credit enhancement

The rating for the term loans of KWSPF is based on the credit substitution approach, whereby the rating of the GoK, which has provided the shortfall undertaking, has been translated into the rating of the said instruments. The shortfall undertaking by the GoK is legally enforceable, irrevocable and unconditional, covering the entire amount and the tenure of the term loans rated by ICRA and has a well-defined invocation and payment mechanism. Given these attributes, the shortfall undertaking by the GoK is adequately strong to result in an enhancement in the rating of the said instruments to **[ICRA]AA-(CE) (Stable)** against the rating of [ICRA]A+ without explicit credit enhancement. In case the rating of the GoK undergoes a change in the future, the same would reflect in the rating of the aforesaid instruments of KWSPF as well.

Salient covenants related to the credit enhancement, as specified in GOs (dated November 20, 2009, December 3, 2018 and October 11, 2019)

The GoK unconditionally and irrevocably undertakes to:

- Make a budgetary allocation on an annual basis for timely and full repayment of principal and interest with respect to the servicing of the loans during the entire tenure under the Global Protection component of the SFC devolutions.
- Transfer adequate funds for repayment into the escrow account of the KWSPF Trust at least five working days prior to the due date.
- Make good any shortfall in the escrow account (for repayment) at least one working day prior to the due date upon receipt of an intimation from the lender/KWSPF without demur.
- Accept that the amount indicated by the lender / KWSPF shall be final and binding on the GoK.
- Rank obligation under the GO pari-passu to any other commitment of the GoK, which relates to the deduction by the GoK from the SFC devolution.

- Accept that the commitment of the GoK is valid till any amount is outstanding under the term loans.
- Form GO a part of the documentation related to the term loans.

The Stable outlook assigned to the long-term rating reflects ICRA's expectation of adherence to the structured payment mechanism by KWSPF and ICRA's outlook on the rating of the GoK, which has provided the shortfall undertaking. ICRA expects the GoK to adhere to the fiscal deficit targets set by the Government of India (GoI), going forward.

Key rating drivers and their description

Credit strengths

Shortfall undertaking by the GoK for rated term loans – All rated term loans are backed by GOs, indicating adequate budgetary allocations under the SFC devolution for servicing of such loans raised by KWSPF. If the budgetary allocation for the debt servicing of the term loans is inadequate, the GoK will make good the shortfall by transferring the required amount in the escrow account at least one working day prior to the due date of debt servicing.

Structured payment mechanism for rated instruments – The SFC devolution would be deducted from source and deposited in the respective escrow accounts at least by T-5, where T is the due date of payment, in line with the structured payment mechanism of the rated instruments. Moreover, all withdrawals from the respective escrow accounts would exclusively be limited to (a) payment of principal and/or interest to the lender(s) and/or (b) for making investments.

Credit challenges

Limited own revenues leading to high reliance on state government – KWSPF has high reliance on the GoK for adequate and timely receipt of funds for debt servicing of the term loans rated by ICRA, as it has limited revenue source of its own. Nonetheless, ICRA takes note of the demonstrated track record of timely funding support from GoK to KWSPF, which is expected to sustain going forward as well.

Non-adherence to debt transaction structure could adversely impact credit profile – Adequate funds were transferred into the escrow accounts by T-5 days on all the instances in FY2024. However, during the pandemic, there were some instances of administrative delay by 2-3 days in transfer of funds into the escrow accounts by T-5 days, i.e., the amount was transferred 1-2 days in advance instead of 5 days. ICRA takes note of the management guidance that such instances were due to exceptional circumstances during Covid-19 pandemic-induced challenges, and adequate processes are now in place to ensure adherence to the debt structure.

Key rating drivers and their description (of the GoK, the support provider)

Credit strengths

Adherence to FC-set fiscal deficit target – The GoK consistently reported a revenue surplus during FY2005-FY2020 and in FY2023. The GoK's fiscal deficit as a proportion of gross state domestic product (GSDP) remained below the net borrowing limits during FY2020-FY2023, despite healthy capital spending.

Relatively healthy structure of expenditures – The GoK's capital outlay and net lending has been healthy, ranging within 2.6-2.9% of its GSDP during FY2021-FY2023.

Moderately healthy performance on leverage indicators – Healthy fiscal balances and guarantees limited to under 2% of GSDP, during FY2020-FY2023, restricted the GoK's average leverage levels to around 20% of GSDP, which is moderately healthy compared to most other states.

Credit challenges

Moderation in revenue receipts relative to GSDP – The GoK’s revenue receipts declined to 10% of GSDP in FY2023 from 11.2% of GSDP in FY2019, primarily led by tax devolution (to 1.5% from 2.4% GSDP). This reflected the lower inter-se share of the GoK during the 15th Finance Commission’s (FC) award period compared to the inter-se that prevailed during the 14th FC’s award period. However, this reduction was partly offset by the receipt of the GST compensation grants from the GoI to the GoK during this period. With the cessation of the GST compensation in FY2023, the GoK’s revenue receipts as a proportion of GSDP has eased to 9.2% in FY2024 and may remain range bound during FY2025-FY2026 (last year of the 15th FC’s award period).

Liquidity position of the support provider (GoK): Adequate

The GoK has not availed the Ways and Means Advances (WMA) and overdraft facilities from the RBI during FY2016 to FY2024 (as per data available till February 2024). Additionally, the GoK had an investment of Rs. 292 billion in auction treasury bills as of end-February 2024. Based on the aforementioned indicators, the liquidity position of the state government can be inferred to be adequate during the recent years.

Liquidity position of KWSPF: Adequate

The GoK has been making budgetary allocation under the SFC devolution for servicing the rated debt of KWSPF and has been releasing the same in a timely manner in the recent years. Moreover, as per various GOs, if the budgetary allocation for the debt servicing of the term loans is inadequate, the GoK will make good the shortfall by transferring the required amount in the escrow account at least one working day prior to the due date of debt servicing. The budgetary allocation and the shortfall undertaking in the GOs provide adequate comfort to KWSPF’s liquidity profile. If funds from the GoK are not received within the due date, KWSPF has the option to tap any surplus available with it. KWSPF maintains cash and bank balance of more than Rs. 20.0 crore, which is sufficient for debt servicing in the near term, including monthly interest amount and quarterly principal repayment amount of various term loans, which is spread over different months/dates. Separately, Karnataka Urban Infrastructure Development and Finance Corporation Limited (KUIDFC) maintains large balances, which would be temporarily utilised with the approval of the competent authority in case of any delay in transfer of funds from the treasury.

Rating sensitivities

Positive factors – The rating could be upgraded in case of a sustained improvement in the fiscal deficit and leverage as a proportion of GSDP of the GoK.

Negative factors – The rating could be downgraded in case of a sustained deterioration in the GoK’s revenues, leading to sizeable revenue deficits, and/or a rise in the leverage levels, going forward. The rating could be impacted by an increase in the debt outstanding of the state power sector entities (either supported or unsupported by the GoK), resulting in a significant worsening of the consolidated leverage levels of the state government and its power entities. The rating could also be downgraded if there is a non-adherence to the structured payment mechanism by the GoK and KWSPF.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for State Governments
Parent/Group support	Parent: Government of Karnataka (GoK) The assigned rating factors in the credit profile of the GoK, which has extended a letter of commitment indicating adequate budgetary allocations under the SFC devolution for servicing of the rated term loans.
Consolidation/Standalone	Standalone

About the company

KWSPF was constituted by the Government of Karnataka (GoK) as a fully-owned trust under the Indian Trusts Act, 1882, in 2003 and is managed by the Karnataka Urban Infrastructure Development & Finance Corporation (KUIDFC, a GoK-owned entity). KWSPF mobilises financial resources for urban infrastructure development in Karnataka and on-lends the same to various urban local bodies (ULBs) in the state.

The trust established by the Government of Karnataka (GoK) is fully managed by the Karnataka Urban Infrastructure Financial Services Limited (KUIFSL). The members of KUIFSL's board of directors are senior government officials, who are appointed by the state government. Most of these officials have been appointed as the trustees of KWSPF.

Key financial indicators (audited)

KWSPF	FY2022	FY2023
Total income (A)	143.3	123.4
SFC devolution	143.0	122.8
Balance	0.3	0.6
Total expenses (B)	141.1	123.3
Excess of income over expenses (A-B)	2.2	0.1

Source: KWSPF, ICRA Research; Amount in Rs. crore

About the GoK's finances

The GoK's revenue receipts and revenue expenditure averaged 10.3% and 10.5% of the Gross State Domestic Product (GSDP), respectively during FY2019-FY2023. During this five-year period, the state recorded revenue deficit of 0.7-1.2% of GSDP in the Covid-19 impacted fiscal (FY2021-FY2022), while maintaining a revenue surplus in the remaining three years. Additionally, the GoK's fiscal deficit as a proportion of GSDP was within the borrowing limits set by the GoI during FY2019-FY2023. The GoK's leverage relative to GSDP was moderate at 20.1% in FY2023, although it has increased from 16.8% in FY2019. This mainly reflected the utilisation of higher borrowing limits by the GoK during FY2021-FY2022 that were permitted by the GoI to the states during the pandemic.

As per the provisional actuals (PA; unaudited) published by the Comptroller and Auditor General of India (CAG) for FY2024, the GoK recorded a small revenue deficit of Rs. 2,718 crore or 0.1% of GSDP. Notably, the GoK's revenue receipts recorded a muted ~1% growth in FY2024 PA primarily on account of high double-digit contraction in grants from the Centre. Grants included GST compensation from the GoI which ended on June 2022, in line with the provisions of the GST (Compensation to States) Act, 2017. Additionally, with the implementation of five welfare schemes after the formation of the new government in FY2024, the GoK's revenue expenditure expanded by 8.5% in as per FY2024 PA.

While the GoK's capital spending contracted by 6.7% in FY2024 PA from the year ago levels to Rs. 56,081 crore, it remained healthy at 2.2% of GSDP. The GoK's fiscal deficit widened to Rs. 58,763 crore in FY2024 PA from Rs. 46,622 crore in FY2023. However, at 2.3% of GSDP, the GoK's fiscal deficit in FY2024 PA was within the net borrowing limit recommended by the 15th FC for that fiscal.

Subsequently, in the budget estimate (BE) for FY2025, the GoK has forecast its revenue deficit and fiscal deficit to rise to Rs. 27,354 crore and Rs. 82,981 crore, respectively. As per the Medium-Term Fiscal Plan statement, the GoK's fiscal deficit at 2.95% of GSDP is expected to remain under the net borrowing limit of 3.0% of GSDP for the year.

ICRA would analyse the GoK's provisional actuals for FY2025 to assess the performance of their key fiscal indicators relative to FY2025 BE. ICRA will closely assess the state's spending on the new schemes and its impact on revenue account balance, going forward. ICRA would also analyse the financial health of the state's power sector entities and its impact on the state's finances.

Key financial indicators of the GoK

	FY2023	FY2024 PA	FY2025 BE
Revenue receipts*	2,29,079	2,31,229	2,63,177
Revenue expenditure [§]	2,15,583	2,33,948	2,90,530
Revenue balance	13,496	-2,718	-27,354
Capital outlay & net lending	60,120	56,081	55,665
Fiscal balance	-46,622	-58,763	-82,981

*Adjusted for double entries of interest on loans of departmental commercial undertakings in FY2023 and FY2025 BE

Source: State Budget, CAG and ICRA Research; PA (Provisional Actuals); BE (Budget Estimates); Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2025)		Chronology of Rating History for the past 3 years			
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore) as on Mar 31, 2024	Date and Rating on	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022
				May 23, 2024	May 10, 2023	-	Mar 31, 2022
1 Term loan	Long-term	247.96	247.96	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)	-	[ICRA]AA-(CE) (Stable)
2 Term loan	Long-term	114.47	114.47	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)	-	[ICRA]AA-(CE) (Stable)
3 Term loan	Long-term	-	-	-	-	-	[ICRA]AA-(CE) (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund-based – Term loan	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term – Term loan	Mar 07, 2019	8.75% p.a.	Mar 2027	247.96	[ICRA]AA- (CE)(Stable)
NA	Long-term – Term loan	Dec 27, 2019	8.50% p.a.	Dec 2028	114.47	[ICRA]AA- (CE)(Stable)

Source: KWSPF

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis: Not applicable

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Branches



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