

May 10, 2023

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	665.78	475.95	[ICRA]AA-(CE) (Stable); reaffirmed
Total	665.78	475.95	
Rating Without Explicit Credit Enhancement			[ICRA]A+

*Instrument details are provided in Annexure-1

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 of 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 of 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 the Government Orders (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 satisfactory 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 the 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 the 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 – As KWSPF is a Trust, its own revenues are modest, comprising interest on deposits. This implies almost complete reliance on the GoK for adequate and timely receipt of funds for debt servicing of the term loans rated by ICRA.

Less-than-satisfactory compliance with the transaction structure – There has been a single instance of funding of the escrow accounts for the term loans after T-5 in FY2023, though the number of such instances has reduced compared to the past years. Further, in case of a delay in funding escrow accounts before T-5, as per the terms of the transaction structure, the shortfall undertaking was not invoked. Nevertheless, there have been no instance of delay in servicing the lenders.

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

Credit strengths

Adherence to fiscal deficit target – The GoK consistently reported a revenue surplus from FY2005 till FY2020, albeit with a varying magnitude. Aided by the revenue surplus, the GoK's fiscal deficit as a proportion of the gross state domestic product (GSDP) remained below 3.0% between FY2011 and FY2020, in compliance with the target set by the successive Finance Commissions (FCs). Despite slipping into a revenue deficit in FY2021 and FY2022, the GoK's fiscal deficit was in line with the limits fixed by the GoI for those years.

Healthy capital outlay and net lending – The GoK's capital outlay and net lending have been healthy in the range of 2.4-2.9% of its GSDP during FY2018-22.

Superior leverage levels – Reflecting its healthy fiscal balances and modest extension of guarantees, the GoK has relatively lower leverage levels compared to most other states, which is also reflected in the relatively modest appropriation of revenue receipts towards interest payments. At 22.9% of GSDP in FY2022, the GoK's leverage was lower than many other states.

Credit challenges

Decline in own-tax effort after transition to GST – The GoK's own tax effort (state's own tax revenues divided by GSDP) has declined to 6.2% in FY2022 from 6.9% in FY2017, partly reflecting the decline in the average tax rate after the transition to the GST regime.

Liquidity position of the support provider (GoK): Adequate

The GoK has not availed Ways and Means Advance (WMA) and OD facilities from the RBI during FY2016 to FY2023 (data available till February 2023). Additionally, the GoK had an investment of Rs. 243 billion in auction treasury bills in end-February 2023. Based on the said 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. In case the 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 around Rs. 20.0 crore, which is sufficient for debt servicing in the near term including monthly interest amount of around Rs. 10.0 crore and quarterly principal repayment amount of various term loans, which is spread over different months/ dates. Separately, KUIDFC also 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 and leverage levels 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 also be impacted by an increase in the debt outstanding of the state power sector entities (either supported or unsupported by the GoK), leading to a significant worsening of the consolidated leverage levels of the state government and its power entities. The rating could also be downgraded if there are frequent instances of non-adherence to the structured payment mechanism by the GoK and KWSPF.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Rating Methodology for State Governments Rating Approach – Implicit parent or group support Rating approach – Structural Features (Non-Securitized Transactions) Rating Approach – Explicit third-party support
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 GoK as a fully-owned trust under the Indian Trusts Act, 1882, and is managed by the Karnataka Urban Infrastructure Development and Finance Corporation Limited (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 in the state.

Key financial indicators (audited)

KWSPF	FY2021	FY2022
Total Income (A)	146.7	143.3
SFC Devolution	145.7	143.0
Balance	1.0	0.3
Total Expenses (B)	160.4	141.1
Excess of Income over expenses (A-B)	-13.7	2.2

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

About the GoK's Finances

The GoK's revenue receipts as a proportion of the state's GSDP have declined to 10.0% in FY2022 from 11.0% in FY2017, led by state's own tax revenues (SOTR) and share in Central taxes. However, during this period, grants from the Centre relative to GSDP increased on account of GST compensation grants.

The GoK's revenue expenditure eased to 10.7% of GSDP in FY2022 from 10.9% of GSDP in FY2017. After consistently reporting revenue surplus since FY2005, the GoK had recorded a revenue deficit in FY2021 and FY2022, mainly reflecting the impact of the Covid-19 pandemic. The GoK's capital outlay and net lending, as a proportion of GSDP, rose to 2.7% in FY2022 from 2.5% in FY2017. Overall, the GoK's fiscal deficit remained below the net borrowing ceiling set by the GoI on the recommendations of the Finance Commissions during FY2017-22.

In the Budget Estimate (BE) for FY2024, the GoK has forecast its revenue account to rebound to a surplus of Rs. 4 billion, from a revenue deficit of Rs. 60 billion in the revised estimates (RE) for FY2023. Additionally, the fiscal deficit is projected to decline to Rs. 606 billion in FY2024 BE from Rs. 611 billion in FY2023 RE. As per the Medium-Term Fiscal Plan statement, the GoK's fiscal deficit in FY2023 RE and FY2024 BE would remain under the net borrowing limit recommended by the 15th Finance Commission for these years.

With the rise in guarantees extended by the state government to power sector and irrigation entities in the state, as well as the increase in debt in FY2022 necessitated by the wider fiscal deficit, the GoK's leverage levels rose to 22.9% of GSDP in FY2022 from 15.4% of GSDP in FY2017.

ICRA would analyse the GoK's provisional actuals for FY2023 to assess the performance of their key fiscal indicators relative to FY2023 RE as well as the evolving trends in revenues and expenditure in FY2024. 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

	FY2022	FY2023 RE	FY2024 BE
Revenue Receipts*	1,958	2,123	2,259
Revenue Expenditure[§]	2,094	2,184	2,255
Revenue Balance	-137	-60	4
Capital Outlay & Net Lending	524	552	610
Fiscal Balance	-660	-611	-606

*Adjusted for double entries of interest on loans of departmental commercial undertakings (DCUs) and sale of land; § Adjusted for double entries of interest on loans of DCUs

Source: State Budget and ICRA Research; RE (Revised Estimates); BE (Budget Estimates)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current Rating (FY2024)			Chronology of Rating History for the past 3 years			
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date and Rating on	Date & Rating			
					FY2023	FY2022	FY2021	
				May 10, 2023	-	Mar 31, 2022	Jan 04, 2021	Apr 09, 2020
1	Term Loans	143.65	143.65	[ICRA]AA-(CE) (Stable)	-	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)
2	Term Loans	332.30	332.30	[ICRA]AA-(CE) (Stable)	-	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)
3	Term Loans	-	-	-	-	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)	[ICRA]AA-(CE) (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term - Fund based – Term Loans	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 Loans	Dec 27, 2019	8.50% p.a.	Dec 2028	143.65	[ICRA]AA- (CE)(Stable)
NA	Long-term – Term Loans	Mar 07, 2019	8.60% p.a.	Mar 2027	332.30	[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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