Karnataka Water and Sanitation Pooled Fund Trust (Revised)

December 20, 2022

Rating

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities[@]	82.78 (Reduced from 116.24)	CARE AA- (CE); Negative [Double A Minus (Credit Enhancement); Outlook: Negative]	Reaffirmed
Total bank facilities	**82.78 (₹ Eighty-two crore and seventy-eight lakh only)**		

Details of instruments/facilities in Annexure-1.
[@]Backed by an unconditional and irrevocable undertaking provided by the Government of Karnataka (GoK) to make budgetary allocations for timely debt servicing and make good without demur any cash shortfall arising on this loan commitment.

Unsupported rating	**CARE A- (Single A Minus) [Reaffirmed]**

Note: Unsupported rating does not factor in the explicit credit enhancement.

Detailed rationale and key rating drivers for the credit-enhanced debt

The rating of the bank facilities of Karnataka Water and Sanitation Pooled Fund Trust (KWSPFT) is based on the credit enhancement (CE) in the form of an unconditional and irrevocable undertaking from the Government of Karnataka (GoK) to make a budgetary allocation under the state finance commission (SFC) devolution for the timely repayment of the debt servicing obligation of KWSPFT and make good any cash shortfall, if any, arising between the SFC devolution and the actual commitment. The debt servicing is facilitated by a structured payment mechanism containing salient features such as a tripartite agreement between GoK, KWSPFT, and its lenders, delineating the transaction structure; the shortfall undertaking by GoK to fund any deficit; a dedicated no-lien escrow account in which SFC devolutions will be pooled and funds transfer by GoK into the escrow account at least five working days (T-5) prior to the forthcoming due date.

Detailed rationale and key rating drivers of GoK

The rating derives comfort from the state recording favourable economic growth over the years, driven by a sizeable tax potential of its service-driven economy with a satisfactory growth rate and its high ranking in ease of doing business. The rating takes cognisance of the state's healthy demographic profile, aided by consistently above-average per capita income and growth, a high share of the urban population, relatively better social indicators, and satisfactory education infrastructure.

The rating also derives comfort from the availability of other infrastructure, marked by high per capita power consumption, moderate rail and road density, moderate availability of national resources, and significantly-improved irrigation potential over the years. Despite slippage into a revenue deficit position consequent to the COVID-19-induced pandemic-led lockdown in FY21 (refers to the period from April 1 to March 31), the state has been exhibiting reasonable fiscal strength and resilience. The state has been adhering to most of the fiscal consolidation norms prescribed by the Finance Commission (in FY22 [RE] as well as FY23 [BE]) in terms of controlling its fiscal deficit and the sustainability of its debt obligations. The state is self-reliant, with nearly 75% of its revenues comprising its own revenue sources and is seen to be focusing on asset creation to enhance its future economic potential. Karnataka has also been following prudent liquidity management practices.

The rating strengths are, however, tempered due to the quantum of the state's revenue expenditure, which has been growing at a faster pace than its revenue receipts. In addition, the increase in committed expenditure and subsidies have been weighing on the state's finances in recent years. The state's financial position will continue to be constrained in FY23 owing to the discontinuation of the Goods and Services Tax (GST) compensation grant from June 30, 2022.

Key rating drivers of KWSPFT

The Unsupported rating of KWSPFT continues to consider its strategic importance to the GoK, with the trust engaged in mobilising financial resources for infrastructure development projects undertaken by urban local bodies (ULB), statutory bodies and public sector undertakings (PSUs) in the state of Karnataka. Furthermore, the rating derives strength from 100% ownership

[1]Complete definition of the ratings assigned are available at HYPERLINK "http://www.careedge.in" www.careedge.in and other CARE Ratings Ltd.'s publications

by GoK, its strong and experienced trustees, and funding support received from GoK by way of SFC grants to meet its repayment obligations, and as such, the cash flows of the trust are not exposed to the credit risk of underlying ULBs, which is generally weak. However, with no operations on its own, KWSPFT is fully dependent on GoK for any funding.

Rating sensitivities – GoK

Positive factors – Factors that could lead to positive rating action/upgrade:

- Attainment of revenue surplus.
- Sustained adherence to the fiscal consolidation norms prescribed by the Finance Commission.
- Significant reduction in (debt + guarantees) gross state domestic product (GSDP).

Negative factors – Factors that could lead to negative rating action/downgrade:

- Widening of revenue deficit.
- Sustained non-adherence to the fiscal consolidation targets prescribed by the Finance Commission for fiscal deficit and debt parameters.
- Further worsening of (debt + guarantees) to GSDP.
- Loan waivers that can pressurise the state finances.

Outlook: Negative

The outlook is being retained at 'negative' considering the increase in the revenue deficit levels going forward. The outlook can be revised to stable if the state is able to attain the economic and fiscal strength of the pre-pandemic level.

Detailed description of the key rating drivers – GoK

<u>Key rating strengths</u>

Primarily service-driven economy with high economic potential: The state is perceived to hold economic potential given the favourable economic growth seen over the years prior to the pandemic. Karnataka has had one of the fastest-growing economies in India. The state accounts for 8.8% of the national GDP while accounting for less than 5% of India's population. The state is among the most developed states in the country and is reform-oriented, which boosts its economic profile, and consequently, its finances. The services sector continued to contribute to more than 65% of the state's gross state value added (GSVA).

Adherence to most fiscal consolidation norms: Despite the financial challenges of FY21 and FY22 due to the COVID-19 pandemic, the state has been in adherence with most of the fiscal consolidation norms prescribed by the Finance Commission, reflective of its prudent financial management. The fiscal deficit was maintained well within the flexible norm (due to the pandemic) of 3.50% of GSDP at 2.84% in FY22 (RE) and is expected to be 3.26% in FY23 (BE), while there is likely to be a minor breach in the interest and revenue receipts within the 15% limit and debt/GSDP at 25% norm.

Self-reliance: The state is fairly self-reliant, with nearly 75% of its revenues comprising its own revenue sources (tax and non-tax sources).

Focus on asset creation: The state government has been incurring higher expenditures towards asset creation. The capital outlay, which accounts for nearly 71% of the total capex of the state, is estimated to increase by 10% in FY23 (BE) as against the negative growth in the preceding year. The capital outlay of the state is mainly concentrated towards irrigation and flood control, transport, agriculture and related works, and urban development.

Maintenance of consolidated sinking fund (CSF) to meet contingencies: The state has been maintaining a CSF with the Reserve Bank of India (RBI) since FY13 towards the amortisation of its debt obligations. The corpus in this fund as on May 31, 2022, was ₹10,420 crore.

<u>Key rating weaknesses</u>

Slippage into sizeable revenue deficit consequent to the pandemic: The COVID-19 pandemic impacted the finances of the state government in FY21 and FY22, resulting in the state slipping into a sizeable revenue deficit for the first time since FY05. The revenue deficit in FY22 (RE) and FY23 (BE) is estimated to be ₹6,235 crore and ₹14,699 crore, respectively.

Increase in the guarantees: There has been an increase in the guarantees extended by the state government to state entities. The outstanding guarantees of the state rose to ₹32,506 crore as on March 31, 2021, 12% more than the previous year. The guarantees were mainly extended to irrigation (43%), power (26%), housing and urban development (12%). Also, the state is not maintaining any guarantee redemption fund (GRF).

Off-budget borrowings: The borrowings by state PSUs and corporations in FY23 are budgeted to be ₹1,997 crore, 25% lower than the off-budget borrowings of ₹2,657 crore in FY22. These borrowings are essentially off-budget borrowings.

Liquidity: Adequate
The state has not availed of the ways and means advances (WMA) facility from the RBI since FY04, reflective of its prudent liquidity management practices.

Analytical approach

Credit-enhanced debt: Based on the CE in the form of an unconditional and irrevocable undertaking from GoK to make budgetary allocations for the timely repayment of principal and interest.

Unsupported rating: Standalone

Applicable criteria

Policy on default recognition
Factoring Linkages Government Support
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Credit Enhanced Debt
Rating Outlook and Credit Watch
State Governments
Policy on Withdrawal of Ratings

About the company – KWSPFT

KWSPFT, constituted by GoK as a fully-owned trust under the Indian Trusts Act 1882, and is engaged in mobilising financial resources for infrastructure development projects undertaken by ULBs, statutory bodies and PSUs. Karnataka Urban Infrastructure Development and Finance Corporation (KUIDFC) is the fund manager of KWSPFT. KWSPFT, in the past, has raised funds for the Chief Ministers Small and Medium Town Development Programme (CMSMTDP) and Nagarothana Scheme.

Brief Financials (₹ crore)	March 31, 2021 (A)	March 31, 2022 (A)	September 30, 2022 (Prov)
TOI	146.68	143.32	NA
Excess of income/(Deficit) over expenditure	-13.73	2.22	NA
Overall gearing (times)	38.59	72.85	NA

A: Audited; Prov: Provisional; NA: Not available.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated for this company: Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook

Fund-based - LT-Term Loan	-	-	-	April 30, 2025	82.78	CARE AA- (CE); Negative
Un Supported Rating-Un Supported Rating (Long Term)	-	-	-	-	0.00	CARE A-

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1.	Fund-based - LT-Term Loan	LT	82.78	CARE AA- (CE); Negative	-	1)CARE AA- (CE); Negative (23-Dec-21)	1)CARE AA- (CE); Negative (19-Nov-20) 2)CARE AA- (CE); Negative (13-Aug-20)	1)CARE AA- (CE); Stable (30-Aug-19)
2.	Unsupported rating-Unsupported rating (Long Term)	LT	0.00	CARE A-	-	1)CARE A- (23-Dec-21)	1)CARE BBB+ (19-Nov-20) 2)CARE BBB+ (13-Aug-20)	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Name of the Instrument	Detailed Explanation
A. Financial covenants	NA
B. Non-financial covenants	Structured payment mechanism (SPM) 1. The GoK, KWSPF, and lenders executed a tripartite agreement delineating the transaction structure. GoK unconditionally commits to deduct the due amount from the SFC devolutions towards servicing the loan liability (both principal and interest). 2. The agreement has a provision for shortfall undertaking commitment to fund any deficit if any arising between the SFC devolutions in the escrow account and the actual commitment under this loan. 3. The trust has opened a dedicated no-lien escrow account in which SFC devolutions will be pooled. 4. GoK will transfer adequate funds for the repayment of principal and interest into the escrow account of KWSPFT at least five working days (T-5) prior to the forthcoming due date. In the event of failure to do so, the lender shall have an option of trigger mechanism to issue notice to both trust and GoK. 5. Notwithstanding the allocation of adequate funds for debt servicing of the term loans made through state government budget or otherwise, upon receipt of intimation from the lender/KWSPF trust, GoK will without demur make good any shortfall in the escrow account maintained by KWSPFT or any amount due to the lender on the term loan by crediting the said escrow account, atleast one working date (T-1) prior to the forthcoming due date. 6. That the obligation of the GoK under this will rank pari passu to any other commitment

	given/made and/or to be given/made by GoK, which relates to deduction by GoK from the SFC devolutions.

Annexure-4: Complexity level of the various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1	Fund-based - LT-Term loan	Simple
2	Unsupported rating-Unsupported rating (Long term)	Simple

Annexure-5: Bank lender details for this company

To view the lender-wise details of the bank facilities, please click here.

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:

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