Financing Mechanisms and Reforms to Leverage Local Resources

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Outline

1. Global trends – and the nature of financing challenge…

2. The case for leveraging local resources… and an example from Kenya

3. Sector reforms and financing mechanisms to facilitate leveraging local resources…


1990s – The Hope...
- Worldwide interest in the private sector in cross border infrastructure investments
- So... the private sector will “fill the gaps”...

And the Realities...

Financing flows into water in 2000

Total (international) private investment in infrastructure in 1990-2002

Source: adapted from Ginneken M. 2003: Presentation at Pan African water Conference

In the new millennium – 2000s:
A Plea for Aid Resources, and risk mitigation...

- Camdessus and Gurria Panel Reports
  - “There is widespread agreement that the flow of funds for water infrastructure has to roughly double…”
  - Also places emphasis on risk mitigation measures for private sector investments

- Sachs Report - UN Millennium Project
  - “The report says the MDGs can be achieved if total annual development assistance is doubled to $135 billion—or 0.44 percent of donors’ GNP—in 2006, and rises to 0.54 percent of donors’ GNP by 2015. ” (The Economist)
But, what is the financing challenge?

Not only “investments for more infrastructure”
   But, “financing improved WSS services”…

   Not only “doubling the aid”
   But, “leveraging additional ‘local’ resources”…

   Not only “increased coverage”
   But, “increased / affordable access for the poor”…

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Why leverage resources?

- For countries to achieve **economically feasible levels of sector expenditure** (say 2 to 3 percent of GDP) without hitting the MTEF ceiling for public expenditure
- To enable different levels of service – **ladder of access**, and public funds focusing on basic access
- To enable **rehabilitation/ augmentation** in existing projects
- **Customer participation and market rigour** helps increase sustainability
- Contribute to development of the financial sector through **new business lines in water projects** for micro-finance and domestic finance institutions

Sources for leveraging local funds

- **User contributions (domestic and commercial)** – capital cost contributions and user charges
- **Market borrowing (in the domestic market)** for capital investments by creditworthy service providers
Two Market Segments

- Small community-managed water (and sanitation) service providers – funded through ‘micro-finance’ by developing a business line in small water projects

- Medium to large utilities – funding through intermediation (domestic financing institutions) and direct market access (bonds or equity)

OBA Pilot Project in Kenya

- OBA Pilot Project for Community-Managed Piped Water Projects (CWPs) in rural/peri-urban areas for rehabilitation and new projects

- Key Innovations
  - Use of market based finance from domestic MFIs to pre-finance community-managed infrastructure
  - Risk sharing by Community Water Projects, CWP employed Project Manager and the MFI
  - Initial transaction support, development of credit assessment tools and development of professional ‘business development services’ (BDS)
How will OBA be used in Kenya?

<table>
<thead>
<tr>
<th>Organization</th>
<th>During construction</th>
<th>After ‘Outputs’ are achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community contribution</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>K-Rep Bank – loan</td>
<td>80%</td>
<td>40%</td>
</tr>
<tr>
<td>OBA subsidy</td>
<td>0%</td>
<td>40%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Outputs

Output 1 – Increased Service Coverage
- Ensuring full coverage through –
  - increased number of household connections (minimum specified) + kiosks meeting standards

Output 2 – Increased Service Levels
- Increased quantity of water supplied, billed and revenue collected
  - Potential output indicator – total revenue collection from user charges
**Institutional Roles**

- **Private’ Actors**
  - Community water project
  - K-Rep Bank
  - SOs/ Proj Eng
  - Audit consultant

- **Public Actors**
  - Nairobi Water Services Board
  - Ministry of Water and Irrigation

- **WSP-Af** - Facilitation role

**Role of Key Agencies**

- GPOBA Trust Fund
- Program Management Committee (PMC): MWI (chair), NWSB, WSTF, KWSP and WSP-Af
- Coordination and review of progress
- WSP-AF
- Support Organization/Program Manager
- Service Provision Agreement (SPA)
- Monitoring
- K-REP Bank
- Loan and OBA Agreement
- Contractor for Construction/Operations
- OBA Subsidy Agreement
- Contract
- Contract
- Support
- Facility
- Facility
- Contract
- Contract
Revised Community Project Cycle

**PROJECT STAGES**

1. **Eligibility**
   - Community water project submits required documents to meet the *eligibility requirements*

2. **Assessment**
   - Independent assessment of project viability by support organization

3. **Loan and SPA Appraisal**
   - Finance institution *appraises loan* application; Athi Board signs SPA

4. **Implementation**
   - Project construction assisted by *project manager*

5. **Post implementation**
   - Business development services support project operations and strategic planning

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**Policy and Regulatory Processes**

- **Service Provision Agreement** (SPA) grants legal status to the small community-managed water projects
  - SPA also provides for management changes in case of continuing poor performance or delinquency/default
- **Policy** (Water Act 2002) and **political feasibility** of introducing cost recovery tariffs
- **Economic regulation** that enables community projects to set their own fees and tariffs to cover O&M and also debt servicing costs
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What is needed to leverage local resources?

- **External environment**
  - to provide incentives for improved utility performance – intergovernmental transfers/OBA
  - to mitigate undue policy and regulatory risks
  - to facilitate transactions and benchmarking

- **Internal environment** of utilities and service providers to enhance financial viability and operational performance

Actual sequencing of these measures will depend on the specific country situation!
External environment – 1

❖ Policy and Regulatory Framework
  ➢ Appropriate *cost recovery policies and economic regulation* to ensure financial viability balanced by affordability concerns
  ➢ **Risk mitigation** through policy and regulation
    ▪ Recognize the legal basis/franchise of service providers
    ▪ Economic regulation for tariffs
    ▪ A national policy and oversight body to provide clear policy directions, and facilitate coordination
  ➢ **Incentives** through intergovernmental transfers and OBA

External environment – 2

❖ **Information, Mutual understanding and Benchmarking**
  ➢ Greater interaction and *common vocabulary* among players in the water and financial sectors
  ➢ A good information system to enhance *transparency and reduce risk perceptions* among potential lenders – backed by *utility benchmarking* regional and national performance reviews
External environment – 3

- Technical Assistance and Facilitation
  - Meeting initial transaction costs of project development and capacity building of all stakeholders
  - Developing standardized credit assessment tools to reduce cost of project appraisal by financing institutions
  - Facilitating a market in Business Development Services for project development and post-construction/operations phases

And, on the supply side

- Contribute to development of the financial sector through new business lines in water projects for micro-finance and domestic finance institutions

- This will also enable scaling up through the market…
Thank You