



Financing Mechanisms and Reforms to Leverage Local Resources

Regional Workshop on Water Utilities

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Outline

- 1. The nature of financing challenge and case for leveraging**
2. Micro-finance for small water projects – Kenya experience
3. Leveraging market resources for water utilities

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 **rahabilitation/ augmenetation** 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

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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

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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)

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- ❖ **Microfinance for rural community-managed water projects (CWPs)**
- ❖ Projects pre-financed with market based finance from domestic private microfinance institution (K-Rep Bank)
 - Rehabilitation/augmentation of existing projects
 - New/greenfield projects
- ❖ **Key Innovations**
 - Use of **technical assistance** to meet high transaction costs and build local capacity
 - Use of **Output based Aid** to address affordability concerns
 - **Business development services** for Community Water Projects – private sector based support organization and Project Manager

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How will microfinance and OBA be used ?

Organization	During construction	After 'Outputs' are achieved
Community contribution	20%	20%
K-Rep Bank – loan	80%	40%
OBA subsidy	0%	40%
Total	100%	100%

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Defining Outputs

Output 1 – Increased Service Coverage

- Ensuring full coverage through –
 - increased number of household connections (min. 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

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Looking beyond Kenya

- ❖ Exploring micro-finance option in other countries
- ❖ Key parameters
 - Conducive policy environment that gives **'space' and does not crowd out private market finance**
 - Policy environment that supports a **gradual move towards cost-recovery tariffs**
 - Reasonably **well developed domestic financial institutions**
 - Regulatory framework that gives **'legitimacy' to small service providers**
 - Viable demand from a **sizeable 'market size'**
- ❖ Exploring the potential in Senegal

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Market Finance for Water Utilities

- ❖ Practitioners' Workshop in Africa held in South Africa, Aug 2006 for addressing:
 - challenges of accelerating market financing to improve delivery of services, and
 - ensuring that these investments result in sustainable delivery of services
- ❖ 100 participants from 25 countries
 - incl. water utilities managers/ regulators and key players in the financial sector (commercial banks, credit rating agencies, insurers and project development facilities)
- ❖ Partnership of WSP, WUP, DWAF (SA), PPIAF, AfDB, WBI

www.wsp.org/marketfinance.asp

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Key workshop messages

- ❖ Market finance and utility reform are intertwined
- ❖ A need to demonstrate and create room for market transactions
- ❖ A need to strengthen the niche for water in the many instruments and support facilities that are available to facilitate access to market finance

Innovative financing instruments to facilitate market borrowing: constraints, responses and challenges

Constraints	FI Response	Challenge	Instruments
1. Difficult to attract market finance <i>'Ex 1st timers/ tenor issues/ exchange risks'</i>	➤ Guarantees and insurances <i>'Mitigating risk and provide affordable credits to borrowers'</i>	✓ Not to be applied indiscriminately, but to bankable projects where underlying policy and demand issues are addressed	<ul style="list-style-type: none"> • Developmt Credit Authority • Africa's Export Credit Agency
2. Sovereign financing constrains access for local creditworthy borrowers <i>'Ex LMs/ utilities cannot access finance'</i>	➤ Sub-sovereign/ local level lending/ finance <i>'Responding to decentralization and local needs'</i>	✓ Use the development funds to leverage market finance	<ul style="list-style-type: none"> • IFC Municipal Fund
3. Market Finance is often too costly <i>'Ex If priced at market price, to high for borrower'</i>	➤ Smart subsidies schemes <i>'Leveraging user fees and market finance'</i>	✓ Not to crowd out existing user fees and potential market finance	<ul style="list-style-type: none"> • (GP)OBA • African Water Facility

Action areas for utility finance

- ❖ “Getting the basics right” within utilities and at Government/ ODA
- ❖ Initiate country processes for reforms and transactions
 - Country process started in Kenya
 - Two utilities identified in West Africa
- ❖ Initiate regional processes for benchmarking and “credit rating” and capacity building/ experience Sharing
 - Collaboration with AfDB (as well as CRAs, IFC, DCA) rating for selected utilities

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What is needed to leverage market 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!

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Thank You