

Financing Mechanisms and Reforms to Leverage Local Resources

Regional Workshop on Water Utilities

Bangkok, July 2006

Meera Mehta, Water and Sanitation Program – Africa

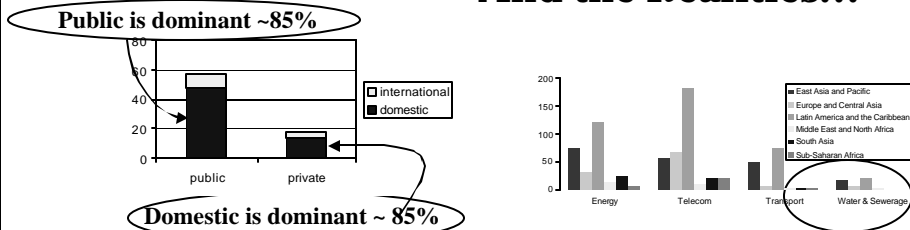
Outline

- 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”...

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...

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 **rahhabilitation/ 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

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?

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

Outputs

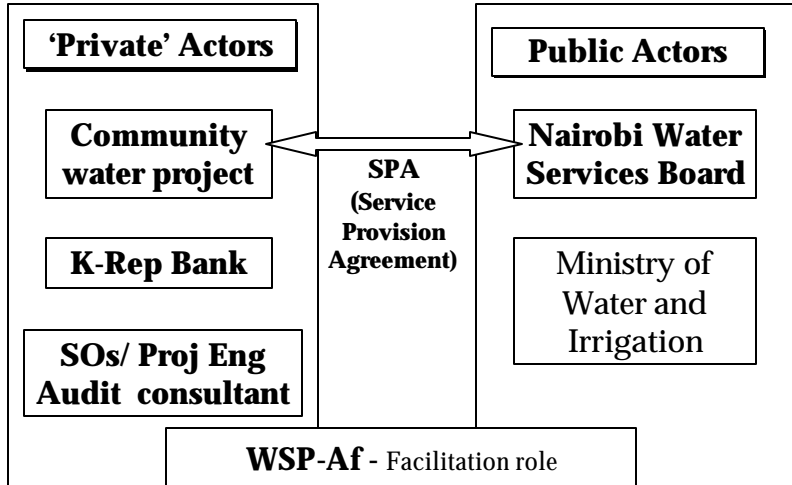
Output 1 – Increased Service Coverage

- Ensuring full coverage through –
 - increased number of household connections (minimum specified) + kiosks meeting standards

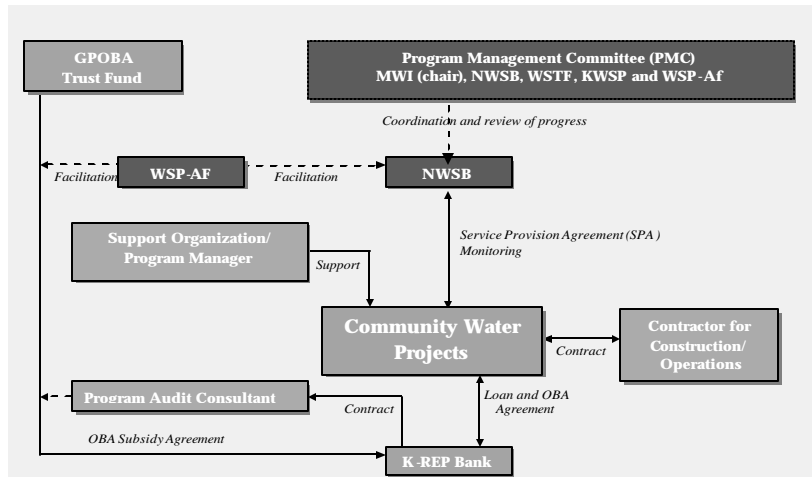
Output 2 – Increased Service Levels

- Increased quantity of water supplied, billed and revenue collected
 - Potential output indicator – total revenue collection from user charges

Institutional Roles

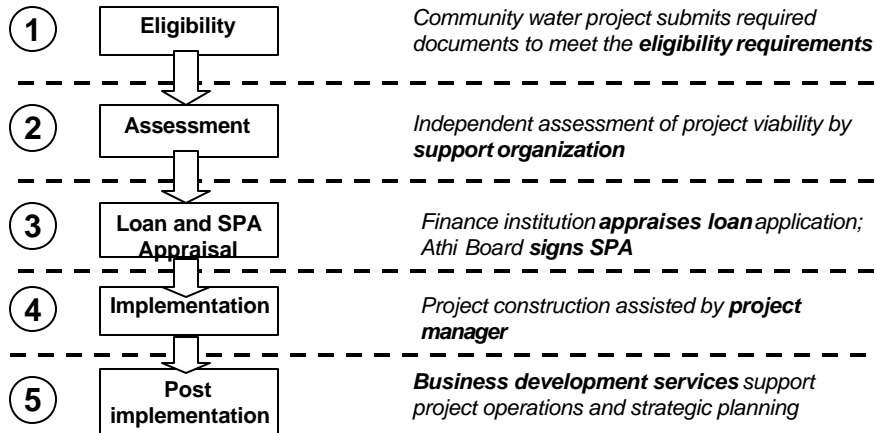


Role of Key Agencies



Revised Community Project Cycle

PROJECT STAGES



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**

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...**

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