Tools for Mobilizing Finance

Municipal water and sanitation projects require costly infrastructure investments that are difficult for many towns and cities to finance on their own.

Mobilizing investment involves building market institutions and governance capacity for municipalities.

Water and wastewater treatment systems in India have been initiated with innovative finance tools provided by USAID.

U.S. Agency for International Development
Development Credit Authority (DCA)
http://www.usaidwater.org

The Need for Increased Investment

It is estimated that over one billion people do not have access to clean drinking water and over two billion people lack access to proper sanitation. Current estimates suggest that meeting the developing world's water sector needs will require an increase from current annual investment levels of $70 billion to approximately $180 billion. Funds from public sector donors alone are expected to meet less than 5% of the increased financing requirement.

Access to clean drinking water and adequate sanitation for much of the world will only become a reality through substantial private, primarily local, investment. Mobilizing this investment is a challenge that involves building market institutions and governance capacity and the deployment of creative pooled financing mechanisms such as the revolving fund model developed under the United States' Clean Water Act.

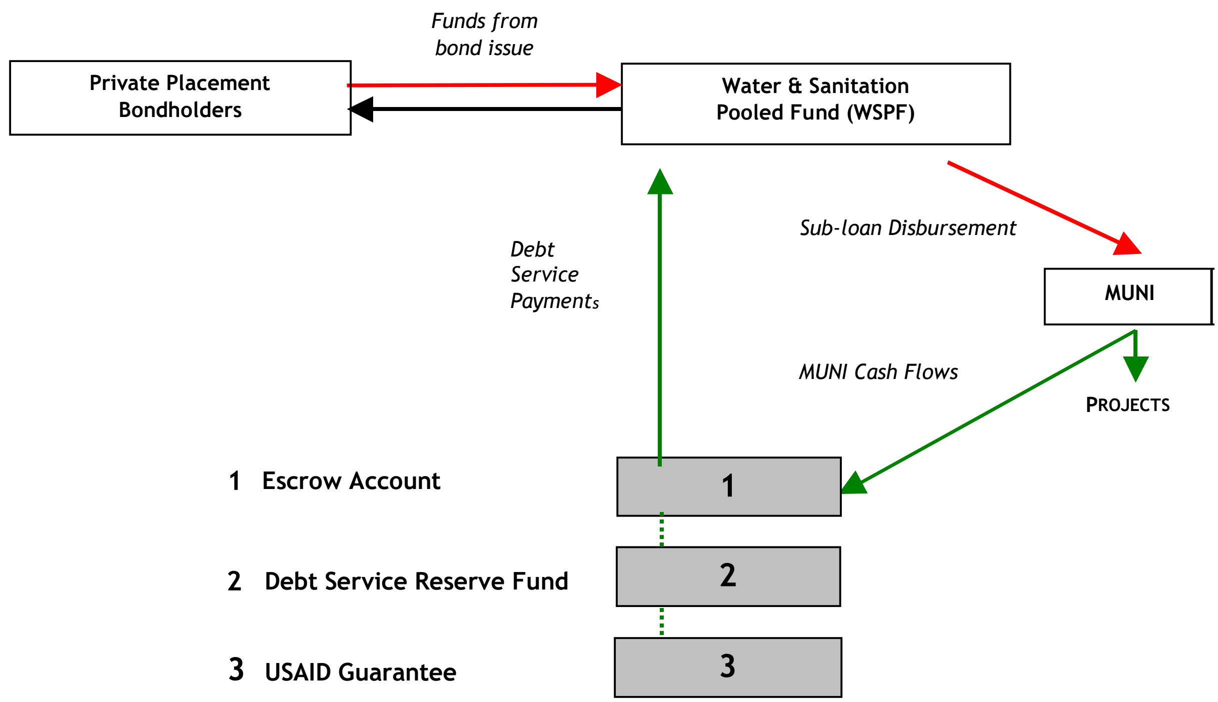
Pooled Financing and Revolving Funds: Flexible Tools

In the Indian state of Tamil Nadu, a pooled financing mechanism is providing a cost-effective approach for villages, towns and cities to implement water and sanitation projects. ***It has made $6.4 million available to villages and towns, benefiting an estimated 593,000 people. The cost of providing a 50% guaranty for this pool through USAID's Development Credit Authority (DCA) was only $392,000, a leverage ratio of 16:1.***

The Valasaravakkam Township in India, with a population of 26,260, is one such community. This township has no adequate water supply system, with existing water supplies coming from a number of open and bore wells. The township has three overhead tanks, connected to 11 miles of piping, which provide an estimated per capita water supply of 2 liters per capita per day (lcpd).

Like many small communities, the financing required to upgrade the township system has been beyond this Township's reach. Under USAID's DCA program for Tamil Nadu, credit enhancement is being provided for the "pooled" financing of several municipal infrastructure projects throughout the state, including Valasaravakkam's. Valasaravakkam will use the funds to lay 250 mm diameter pipe to feed water from a safe source into 2 new underground tanks with a capacity of 1,000,000 liters. These investments, in conjunction with investments in new water pumps, will increase per capita water supply from 2 to 35 lpcd. Total project cost will be $402,760, with 90% of the funding coming from borrowing. When completed, the project will benefit the entire town's population, half of which are poor. The benefits of improved water access and supply are expected to have a dramatic effect on public health.

The Tamil Nadu project is one of a number of innovative DCA projects in India that have financed over $450 million for the provision of water and sanitation projects for the urban and rural poor, but it is the first to incorporate many of the aspects of the Clean Water State Revolving Fund program.



The United States Experience

The Tamil Nadu project builds on and adapts an innovative financing approach pioneered in the United States. Under the United States Environmental Protection Agency Clean Water State Revolving Fund (CWSRF) program, the EPA provides grants or "seed money" to states to capitalize state loan funds. This money, in turn, is made available to local communities for water quality activities. Through federal contributions, state match, leveraging, loan repayments and interest earnings, total assets in CWSRFs have grown to over $42 billion. For each federal dollar invested, this program is making $1.90 available for important water quality projects each year.

A key to the program is its flexibility. A state can tailor the assistance it receives according to its needs. Options include *loans, refinancing, purchasing or guaranteeing local debt and purchasing bond insurance*. States have devised financial management approaches that increase funding available for critical projects, lower the cost of borrowing to the CWSRF program, enhance financial security of the program, and reduce the administrative burden of managing the program. States can also set specific loan terms, including interest rates—from zero percent to market rate—and repayment periods—up to 30 years.

Due to these financial innovations, projects funded by a community through the CWSRF program cost less than they would if funded through conventional means. Typically, CWSRF monies are loaned to communities and loan repayments are recycled back into the program to fund additional water quality protection projects. The revolving nature of these programs provides for an ongoing funding source that will last far into the future.

A number of states use CWSRF to *operate state-level bond banks* that support borrowing by smaller municipalities which otherwise would find it difficult to tap the capital market. A bond bank is essentially a state-sponsored intermediary, which borrows from the capital market, usually with some state or federal credit enhancement. It then on-lends to participating local governments by purchasing their bonds or providing them with direct loans. By pooling debt in this manner, significant savings can be realized through reduction in marketing costs and reduced spreads due to a higher credit rating, larger issue size, and wider investor coverage.

States may also *customize loan terms to meet the needs of small and disadvantaged communities*. In 2001, 65 percent of all loans (26 percent of funding) were made to communities with populations less than 10,000. In addition, some states provide specialized assistance for communities that are disadvantaged or experiencing financial hardship. These states might offer lower or no-interest loans to provide greater subsidies for disadvantaged communities.