

Increasing Private Investment in Water

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 sector investment. Mobilizing such investment is a formidable challenge and will require significant legal and regulatory reforms and interventions, credit enhancements, commercial advisors and managers, an enabling public sector and most importantly a public willing to pay market-based rates for water.

The U.S. Agency for International Development (USAID) and the Environmental Protection Agency (EPA) are developing a framework for the use of local currency capital market financing mechanisms pioneered in the US under EPA's Clean Water State Revolving Fund program. The USAID/EPA framework envisions the creation of Clean Water Revolving Funds (CWRFF) in selected developing countries. CWRFFs are modeled on similar programs developed and successfully operated in the U.S. By pooling the credit risk, these programs have reduced the cost of financing water sector investment and leveraged billions of dollars in public sector resources.

The Clean Water Revolving Fund

- Provides incentives for the adoption of best practices in drinking water and sewerage services and will lead to significant financial technology transfer and ultimately, will add depth to developing countries financial markets.
- Designed to mobilize and leverage local private capital for public water and sanitation infrastructure, constituting a framework with substantial opportunities for donor cooperation.
- Leads to the development of water sector projects and investments that can properly value water service provisions through municipal development of financially viable designs and accountable service providers.

These benefits provide a basis to support private sector lending in the water sector for select developing countries on commercial terms when coupled with targeted technical assistance programs. By mobilizing local capital where possible and adopting a country-by-country approach, rather than creating a single international fund, the concept will reduce the costs associated with cross-border debt financing as well as allow for greater flexibility in applying the model to the financing needs of other prospective countries.

Technical Assistance Component

Technical assistance for project identification and design of financially viable water projects in developing countries will be provided through the coordinated use of USAID and international donor grant funds. These regional or global grant facilities will solicit and receive proposals primarily through USAID Missions for grant-assistance for eligible project development. Grants will serve needs such as capacity-building in municipalities or local urban bodies in core areas such as financial management and revenue structuring, service provision and project management, needs assess-



U.S. Agency for International Development
Office of Development Credit
http://www.usaid.gov/economic_growth/egad/ci
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Environmental Protection Agency
Office of International Affairs
<http://www.epa.gov/international>

Clean Water Revolving Fund

ment and project design. These grants will be targeted toward producing management and ownership entities or concessions ultimately capable of attracting private debt and/or equity financing, and financially viable water sector projects. The CWRP will only be introduced in countries committed to creating a legal and regulatory environment that encourages private investment in the water sector. Technical assistance efforts will help national governments and municipalities design and implement laws and regulations that establish a favorable enabling environment.

USAID's Development Credit Authority (DCA) guarantee agreements would partially cover the repayment of the underlying water project loans through the on-lending of a debt issuance to private sector investors. The use of DCA guarantees is highly cost effective as compared to the use of grant funds to capitalize reserve fund protection for the Clean Water Fund. The DCA guarantee is designed to share risk with private sector partners.

Example: Tamil Nadu, India

In a number of U.S. states, state-level bond banks have been created to support borrowing by smaller municipalities, who otherwise would find it difficult to directly 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.

In a similar manner, the pooled financing mechanism offered by DCA is providing a cost-effective approach for villages, towns and cities in the Indian State of Tamil Nadu to implement water and sanitation projects. 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 this system has been beyond this Township's reach. Under DCA program, credit enhancement is being provided for the "pooled" financing of several municipal infrastructure projects throughout India. 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 pooled financing program in Tamil Nadu has made \$6.4 million available to all of the municipalities participating in this DCA program. This financing will provide benefits to an estimated 593,000 people. The DCA subsidy cost for the program is \$392,000. This is 16:1 leverage with a per capita cost of approximately \$11.00. This 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.

