

Financing Options for Water Projects in CEEC

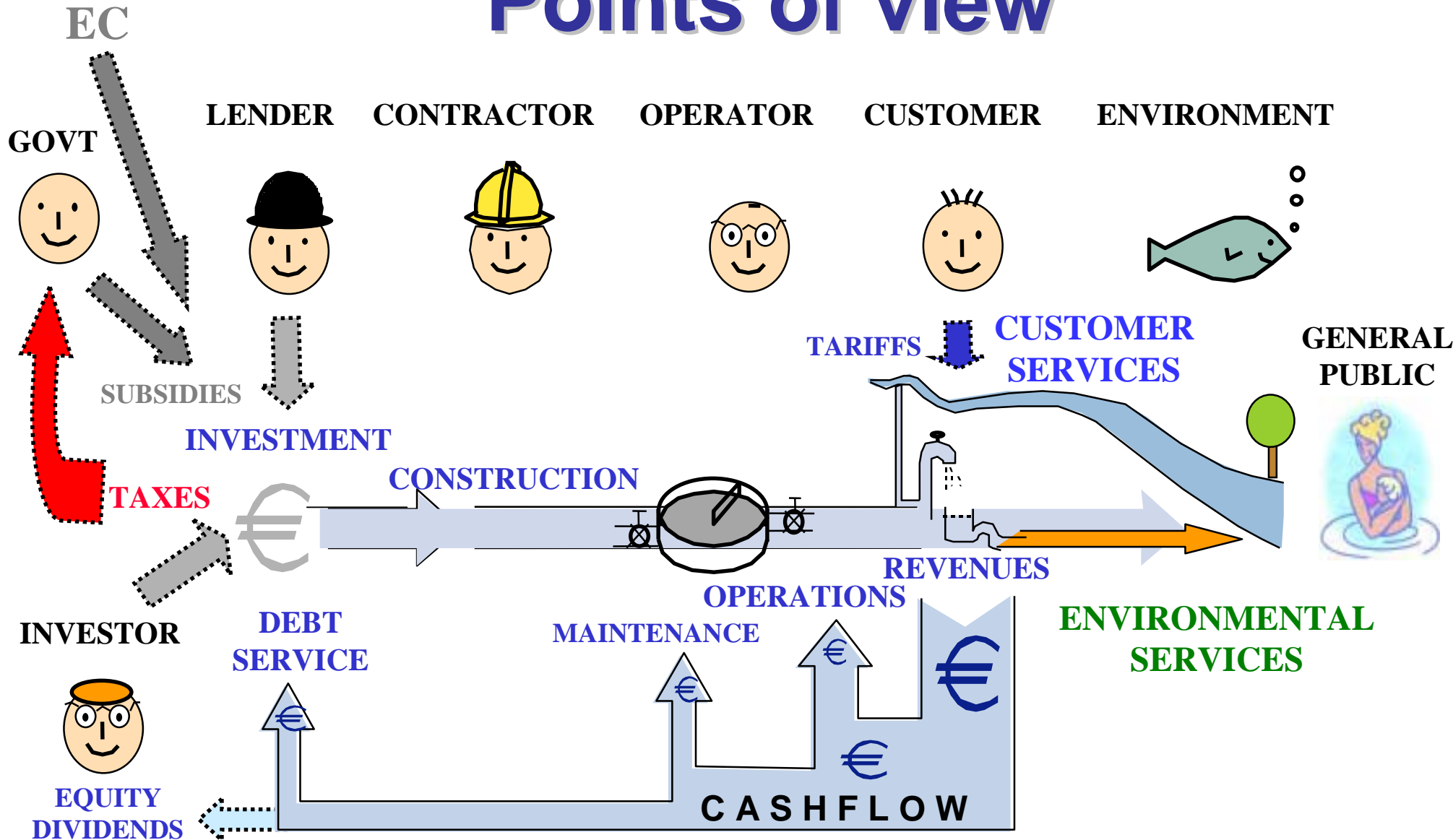


***Hugh Goldsmith
Water Division – Projects Directorate
European Investment Bank***

Financing Water Projects

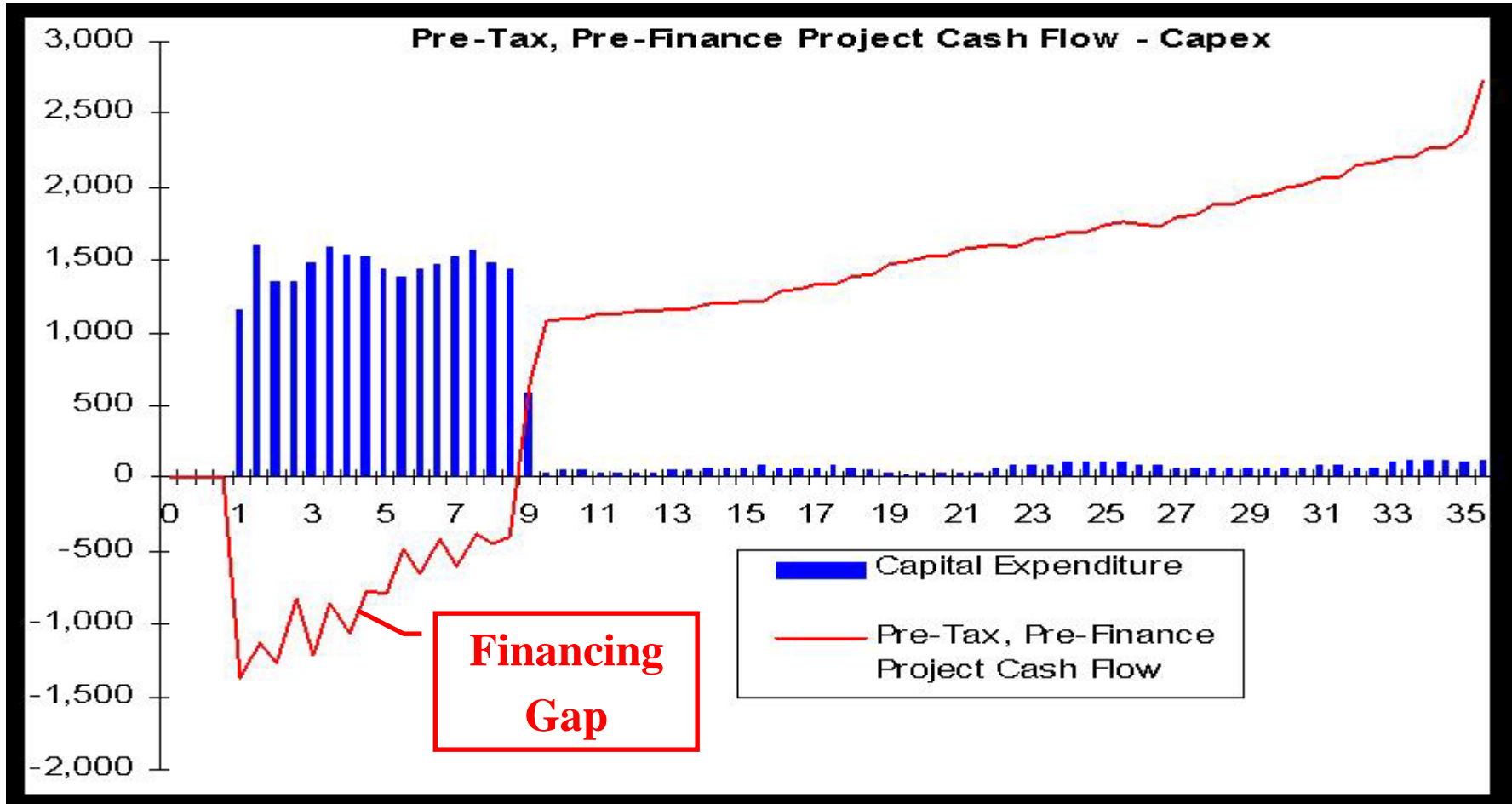
- Finance basics
- Sources of funding
- Private sector participation
- Risks and reality
- Trends & Choices
- Information sources

Points of view



The Financing Problem

Its all about cashflow & risk



Where does cash come from?

- Grants/Subsidies – great if you can get them!
- Own resources (cash flow) – as much as you can!
- Debt – cost depends on risk/guarantees
- Bonds – depends on risk rating (cashflow volatility & sovereign ceiling)
- Other (e.g. Buy & Lease Back) – sophisticated
- Equity – expensive, but highly motivated

- But eventually ... users and/or taxpayers



INCREASING COST

Sources of External Funds

LOANS

- IFIs:
 - EIB
 - EBRD
 - World Bank
- National Development Bank
- Commercial Banks

GRANTS

- EU:
 - ISPA
 - PHARE
 - Cohesion Funds
 - Structural Funds
- National Funds
 - Environment Fund
 - National Budget

ISPA - Instrument for Structural Policy for Pre-Accession

COUNTRY	MIN	MAX	MEDIAN
BULGARIA	83	124	104
CZECH	57	83	70
ESTONIA	21	36	29
HUNGARY	73	104	88
LATVIA	36	57	47
LITHUANIA	42	62	52
POLAND	332	384	348
ROMANIA	208	270	239
SLOVAKIA	36	57	47
SLOVENIA	10	21	16

- Annual allocations in Eur million
- Eur 1.05 billion/year in total
- 50- 50% for transport & environment projects
- 50 % to 75% grant rate
- On Accession, will shift to Cohesion Funds

The EIB's Perspective

RISK

- Credit Risk
Will Bank be repaid ?
- Project Risk
Will project perform ?

MITIGATION

- Robust cash flow
- Guarantees
- Asset value
- Robust planning & design
- Realistic demand forecasts
- Competent operator

Private Sector Participation

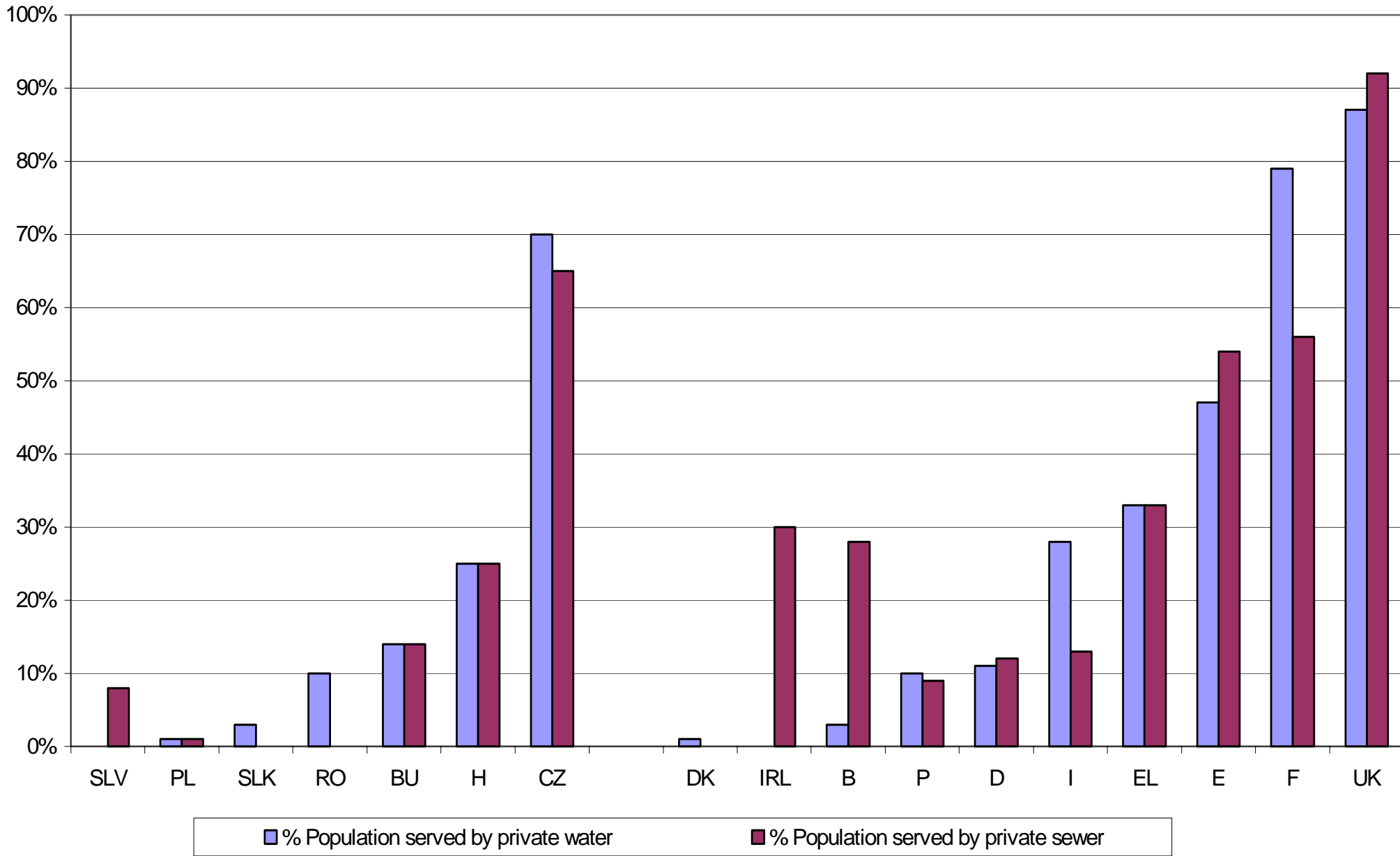
Private water co.s bring:

- Knowledge of operations!
- Contracting expertise
- Commercial approach
- Innovation
- Financial expertise
- *Equity?*

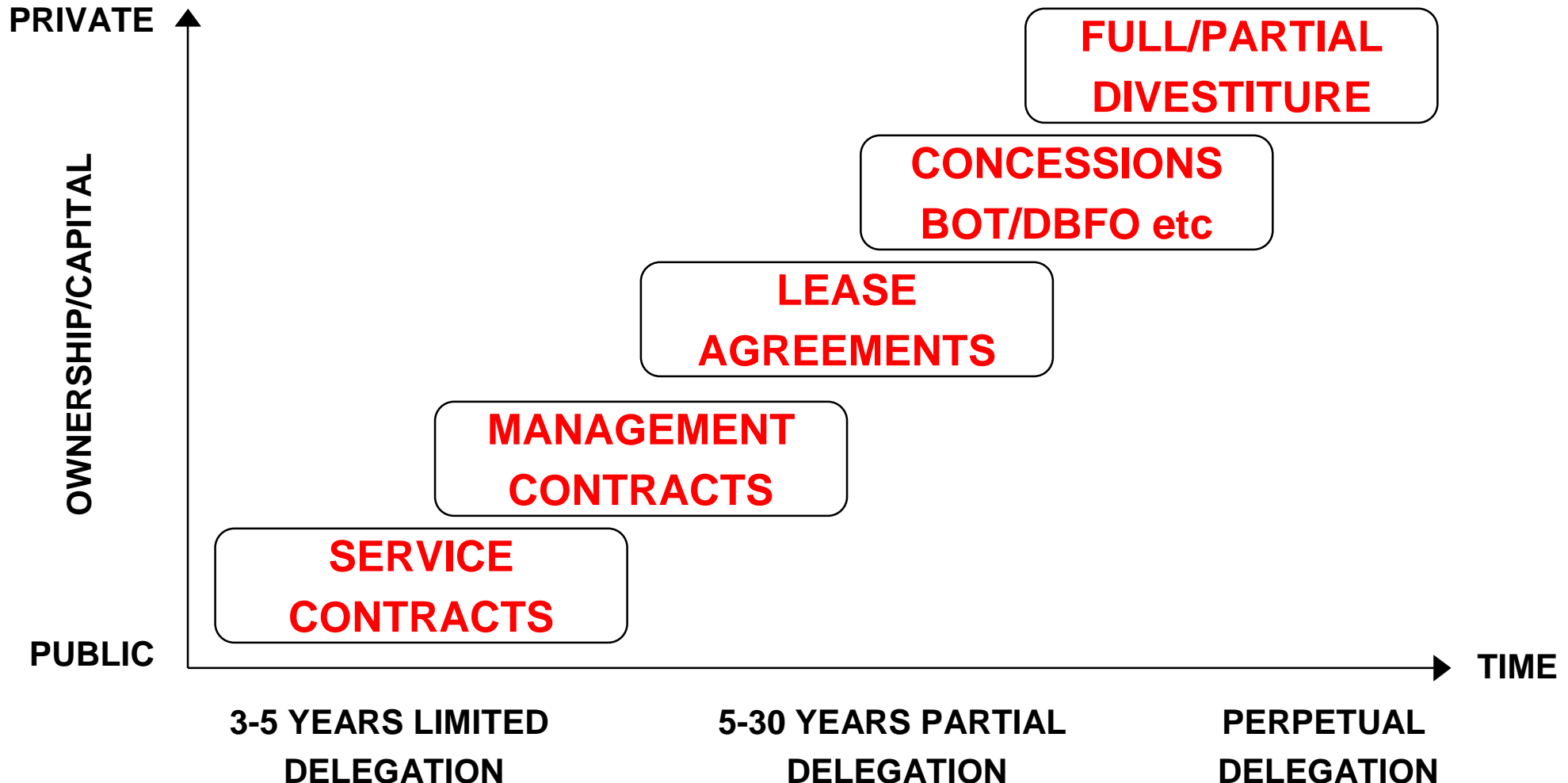
Private Water in the EU ... not new

Company	Country	Formed	Comments
Thames Water (New River Water Co.)	UK	1619	Nationalised 1894
Canal de Isabel II	Spain	1851	Always municipally controlled
Acque Potabili	Italy	1852	Acquired by Italgas in 1941
Générale des Eaux	France	1853	Private sector since foundation
Aguas de Barcelona	Spain	1867	Private sector since foundation
Eaux de Banlieue de Paris	France	1867	Subsumed into GDE and S-LDE
Lyonnaise des Eaux	France	1880	Private sector since foundation
Cia. Generale dell Acque	Italy	1884	Municipally owned since 1918
Gelsenwasser	Germany	1887	Indirect municipal control
Aguas de Valencia	Spain	1890	Became a private company in 1976
Eaux et Ozone	France	1910	Acquired by GDE
FCC	Spain	1911	Award of Barcelona's sewerage
Thames Water PLC	UK	1989	UK WASC privatisation

Degree of Privatisation in EU and CEECs (1999)



PSP - A staircase of choices



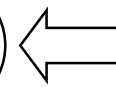
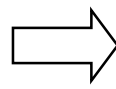
PSP Theory

Asset Management

Know-how



Operations
Know-how



Private
Finance

Better
services



?

Lower
tariffs



?

Risk
management



? Efficiency gains > Extra cost of capital ?

The equity paradox

“Popular wisdom has it that high risk may bring high returns, but the paradox of infrastructure projects may be that it is higher returns that *cause* higher risk.”

Wells & Gleason (1995)

Is Foreign Infrastructure Investment Still Risky?

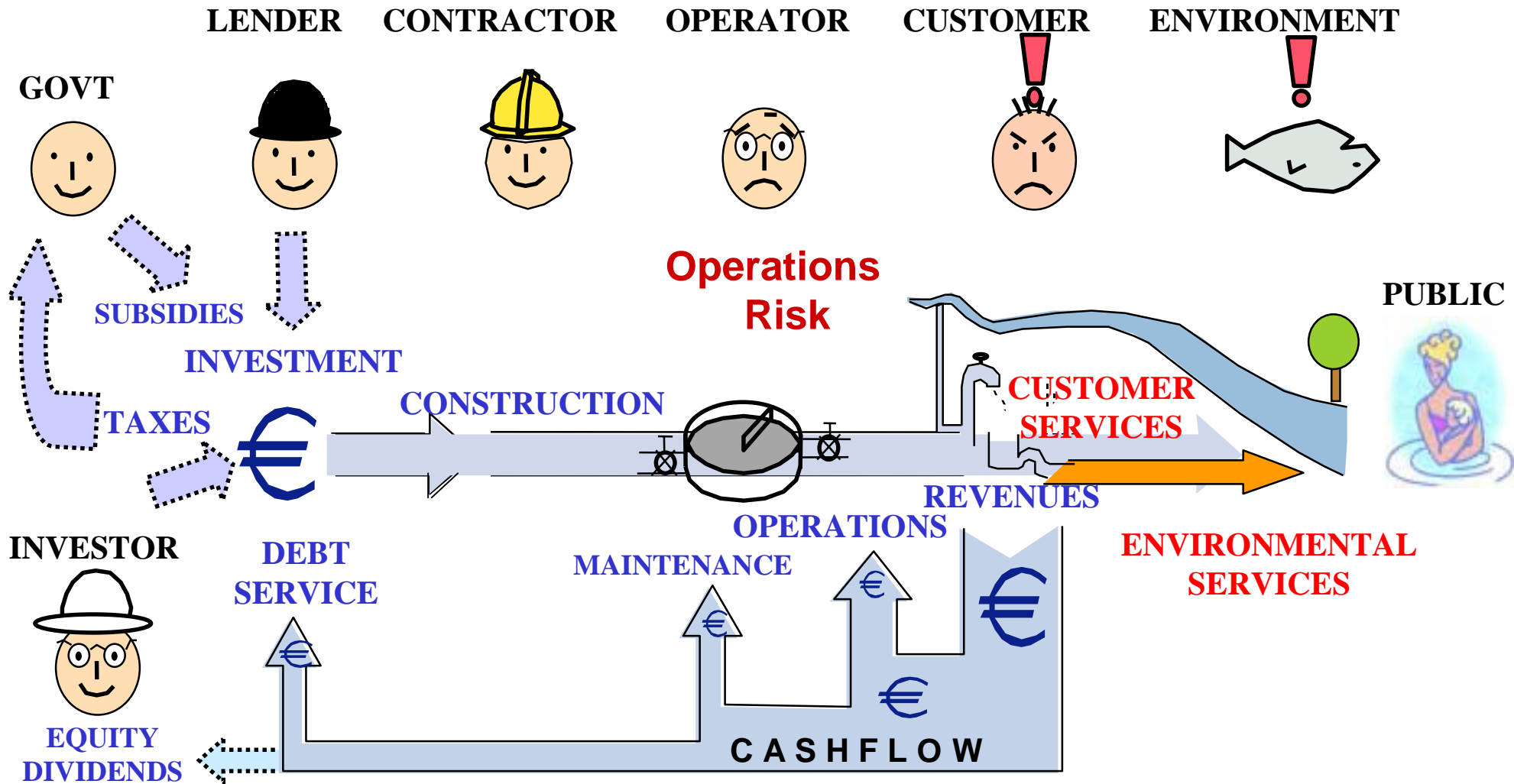
Harvard Business Review

- More equity
→ Greater profitability incentives
- More profits
→ Higher political risk

GOLDEN RULE

Always make equity bet on performance NOT tariff policy

Risks to Sustainability



Operations Risk

Water Sector Performance

EIB ex-post evaluation findings:

- **Poorest performing sector in portfolio**
- **Sub-optimal design (over-capacity etc.)**
- **Weak financial management**
- **Institutional weaknesses**
- **Need to address sustainability issues**

Operations Risk Mitigation & Management

- **Cost recovery tariffs**
- **Incentives**
 - Performance (customer & environmental services)
 - Demand management policies
 - Efficiency (technical & commercial)
 - Cost effectiveness
- **Regulation**
 - Compliance monitoring & enforcement
 - Tariff adjustments
 - Benchmarking

CEEC Water Project Risks

- REVENUES
 - Tariffs (indexation, low fixed tariff, political dimension)
 - Demand (E German model - how far will it fall?)
-
- OPERATING COSTS
 - Staffing (over-manning)
 - Inefficient assets (pumps, leakage etc.)
 - Inefficient scale
 - CAPITAL COSTS
 - Inefficient procurement
 - Quality of Contracts
 - Out-of-date design

EU Financing Trends – Diversity!

Country	Financing trend	EIB loans
Netherlands	Increased debt for publicly owned Co.s	✓
	First DBFO (Scottish model) for WWTP	✓
England & Wales	Increased gearing for privatised water co.s	✓
	Restructuring (100% debt financed NFP)	✗
Scotland	DBFO all bond financed	✗
France	Traditional municipal companies	✓
	Leases & concessions	✗
Portugal	Public holding co. (bulk supplier) + CF grants	✓
	Private concessions with CF grants	✓
Italy	Partial flotation (51% Municipal shareholding)	✓
	Private Concessions (limited to date)	✗

Financing Choices

- Only bring in equity if justified by potential efficiency savings (value-for-money)
- Get good advice in preparing PSP contracts to ensure fair risk sharing
- Use cheapest long-term funding available to buffer tariff increases
- In long run, aim to develop creditworthy, commercial and efficient water service companies with clear tariff policy
 - Cash is King but Credit is Queen

Informed Choices for better Projects

Assets
Operations
Performance



Equity
Debt
Grants

In Practice ...

- EU grants will drive investment for coming years (ISPA ⇒ Cohesion Fund)
- Difficulties of combining grants with private concessions (ISPA PPP Guidelines)
- Non-grant financing should aim to keep tariff rises affordable & acceptable (interest rate & duration)
- Main loan co-financers are EIB and EBRD
- Need to focus on operating efficiency, cost-effectiveness & **GOOD PROJECTS!**

TYPICAL ISPA PROJECT

- **Wastewater Treatment Plant:** 14.0 MEuro
 - **Sewerage network:** 2.5 MEuro
 - **Water Distribution network:** 3.5 MEuro
 - **Laboratory equipment:** 0.2 MEuro
- Total:** 20.2 MEuro

Proposed financing scheme:

75% ISPA Financing

5% Municipality co-financing

2% Water Company own funds co-financing

18% EIB loan to be contracted by Water Company

Information sources:

- EU Regional Development ISPA Funds:
 - http://europa.eu.int/comm/regional_policy/funds/ispa/ispa_en.htm
- EIB:
 - <http://www.eib.org/>
- EBRD:
 - <http://www.ebrd.org/>