Convergence-Sida  Blended Finance
Knowledge Exchange
Financing WASH in EMs

May 2018
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Lion’s Head brings developed markets financial expertise and solutions to emerging and frontier markets, focusing on sectors which support development.

**FINANCIAL ADVISORY**

Lion’s Head designs innovative and solution-driven financing structures in multiple sectors across a range of instruments and markets. We provide transaction structuring for debt and equity in the public and private sectors, fund structuring, market scoping and investment evaluations.

**CAPITAL RAISING**

We have worked with clients in numerous emerging and frontier markets to raise capital to finance their growth. We help our clients identify their capital needs, optimise capital structures, identify sources of capital, manage risk and execute transactions.

**ASSET MANAGEMENT**

Lion’s Head is the Fund Manager for the Africa Local Currency Bond Fund (sponsored by KfW), and is currently structuring the Off Grid Energy Access Debt Fund which we will manage for the AfDB. We previously structured, fundraised and managed the Global Health Investment Fund.
Water and Sanitation are a hybrid of infrastructure and service provision;
Unlike energy WASH is “hyperlocal” – no trading;
WASH (traditionally) has high upfront CAPEX and significant ongoing OPEX;
Water is a political commodity and sometimes offered for free.
3 FINANCING WASH: IN DEVELOPED MARKETS

WASH has been known to be a reliable, relatively safe investment in developed markets:

- Dominated by utilities (state owned or private) and large engineering + services firms;
- Business Model:
  - Monopolies: assured customer base;
  - Large and dependable, little growth but steady returns;
- Financing Strategy:
  - Long term debt in capital markets;
  - Key investors include Pension Funds and Insurance Firms;
  - Project finance for infrastructure: utilities + government + private sector

**Side Note**

- WASH services became private in Developed Markets;
- The high cost of initial CAPEX was borne by the state;
- Many utilities still receive support from government (more on this later)
WASH has in EMs has suffered form chronic under-investment and investment in the wrong type of activity...

- Financing WASH in EMs more difficult:
  - Smaller established customer base;
  - Low collection rates;
  - Tariffs don’t cover costs (also true in DMs);
  - Political uncertainty;
  - Poor or inexistent infrastructure (CAPEX needs).

- There is some funding for infrastructure (public);
- Very little private capital participation in service delivery;
- Many underperforming or non-performing assets.
## 5 Financing WASH: Different Opportunities

### Types of WASH investments in EMs:

<table>
<thead>
<tr>
<th>Type</th>
<th>Examples</th>
<th>Business Model Risk</th>
<th>Return in EMs</th>
<th>Investor Perception</th>
<th>Capital Need</th>
<th>Capital Source in EMs</th>
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<tbody>
<tr>
<td>Start-up / innovative models</td>
<td>SANERGY, PIVOT</td>
<td>High</td>
<td>Uncertain, low c.f. developed markets</td>
<td>Unproven, barriers to entry, lack of contracts</td>
<td>Venture Capital</td>
<td>Philanthropic</td>
</tr>
<tr>
<td>Utilities</td>
<td>CITY WATER (TANZANIA)</td>
<td>Low</td>
<td>Low and uncertain</td>
<td>Political risk, poor historical performance</td>
<td>Long-Term Debt, Equity</td>
<td>Public (MDBs, governments)</td>
</tr>
<tr>
<td>Project Finance for Infrastructure</td>
<td>HIGALI WATER</td>
<td>Medium</td>
<td>Low and uncertain</td>
<td>Lack of buyers, political risk</td>
<td>Short terms debt, Equity</td>
<td>DFIs, some private capital (Metito, Veolia etc.)</td>
</tr>
</tbody>
</table>
WASH in EMs suffers from:

- Lower average income → lower tariffs and/or smaller customer base;
- Higher political risk → investors need higher potential returns to justify risk;

**Result:** Limited participation by private capital;

\[ \beta = 1 \quad \beta = 2 \quad \beta = 3 \]

Risk-free return

Market return

Return here too high for the project: not economically viable

Risk here too high: no investor interest

WASH investments in EMs
Different ways of blending capital:

- **To reduce risk:** capital tranching (e.g. first-loss equity), guarantees: \( a \rightarrow b \)
- **To increase returns:** tariff top ups, tax incentives: \( c \rightarrow d \)
- **To reduce cost of capital/CAPEX:** viability gap funding: \( e \rightarrow d \)
Blended finance is mainly being used for de-risking in WASH:

- **Kenya Pooled Water Fund:**
  - Pools loans to water utilities;
  - Uses tranche of **first loss equity** to enhance credit of pool of loans;
  - De-risks product offered to investors;

- **Kigali Water:**
  - PPP for water treatment and distribution;
  - DFI debt + private sector equity;
  - **Viability gap funding** to reduce upfront costs (believe connections);

- **TIDEWAY Sewer (UK!):**
  - Sewer system construction;
  - SPV created – too big for Thames Water on-balance sheet;
  - Strategically important project;
  - UK government “bought tail risk” – i.e. **guarantee**;