

Facilitated Access to Finance for Domestic Private Water Operators in Cambodia

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Summary Overview

Location: Cambodia, Southeast Asia

Approach to Blended Finance: A combination of non-sovereign concessional lending, guarantees, grants, and technical assistance has been used to leverage local commercial finance and equity investments so as to accelerate access to piped water supply. A concessional line of credit was provided by AFD (*Agence Française de Développement*) to the Foreign Trade Bank (FTB), a Cambodian commercial bank, to enable them to extend more attractive loans to small- and medium-sized water service providers, mostly active in small towns and rural areas. Output-based investments grants have been used in a complementary way as incentives for private water operators to connect poor households.

Context

Access to piped water supply is lower in Cambodia than in the majority of Southeast Asian countries and was estimated at 21 percent in 2015. Only 7 percent of rural households have access to piped water services on premise, while 75 percent of urban households enjoy such service (JMP 2015). Public utilities serve the capital and eleven other urban areas. In rural spaces and small towns, private water operators (which are either licensed or unlicensed) have invested in water systems. Driven by demand for improved services, steady economic growth, and relative water abundance, the private sector in Cambodia has the potential to be an important force for increasing access to piped water supply. The Government of Cambodia and development partners such as the World Bank, the SEDIF (the water service provider in the Paris area) and the Agence Française de Développement (AFD) have been supporting the



development of these dynamic small-scale operators since the early 2000s through a variety of financing and technical assistance approaches.

Limited access to finance is a key factor preventing these private operators from expanding and improving services. Domestic commercial banks are not used to lending to water sector actors, whereas water operators' capacity to develop sound business plans and build assets to a high standard is sub-optimal. Some local and regional banks have been providing loans to private water operators. However, collateral requirements are usually over 200 percent of the loan amount, and only land, buildings, and cash deposits can be accepted as collateral. Tenors are short (up to 5 five years) with no grace period, which means that only a few large water operators can access financing under such conditions.

Financial Structure and Approach to Blended Finance

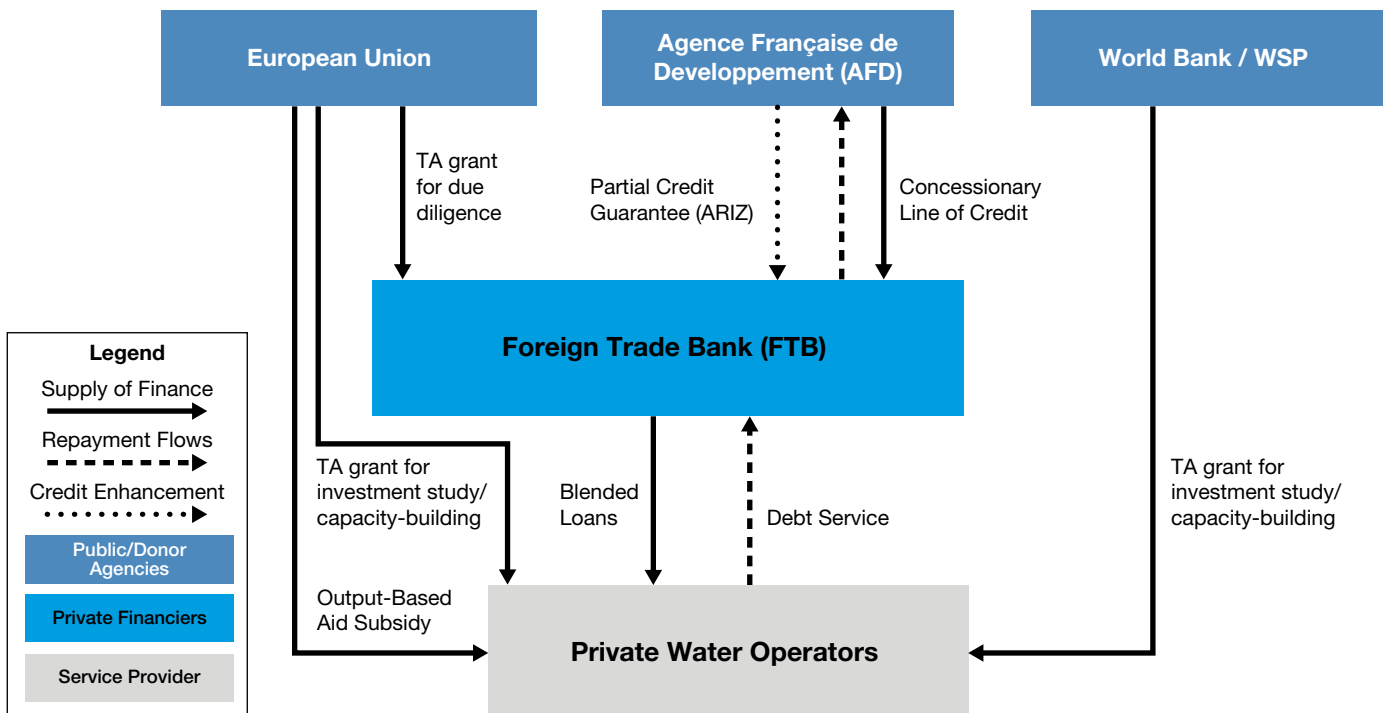
In 2014, the AFD initiated the “Access-to-Finance-Project” to facilitate access to financing for small private water and electricity companies in rural and peri-urban areas. As part of the project, the AFD signed a concessional loan agreement with the Foreign Trade Bank (FTB), a local bank that expressed interest in diversifying its lending portfolio in the energy and water sectors. Additionally, in order to address related challenges, a combination of instruments was deployed with the objective to: i) institutionalize the water supply loan products and develop the capacity of FTB to assess such investment proposals; ii) support water operators in the development of sound business plans and investment studies and; iii) incentivize water operators to improve service quality and connect the poor.

Three financial tools (a concessional line of credit, grant funding and a guarantee package), totaling approximately US\$24.2 million, are being used simultaneously in the project to support small private operators. The way in which these funding sources are combined is shown in Figure 1.

The multi-sectoral (water and electricity) non-sovereign concessional credit line of US\$15 million was setup with FTB. To ensure that at least some of this financing would go to the water sector, the FTB agreed to reserve at least one-third of the overall credit line for water sector operators. However, as a result of demand, mid-way through implementation, this allocation was shifted to two-thirds of the credit line going to water operators, resulting in US\$10 million being allocated to the water sector. The FTB can use the line of credit to extend loans to small and medium-sized water or energy operators. The concessional element is transferred by FTB to the loans it provides to the operators, leading to interest rates in the order of 6–8 percent per annum. The term is four to ten years, with an optional grace period of 12 months. The average water project investment cost is around US\$270,000, the water tariff is on average US\$0.58/m³ and the average connection fee is US\$64, with discounted fees for the poor.

A US\$5 million risk guarantee (for a US\$10 million portfolio) was provided by AFD’s risk sharing mechanism (ARIZ) to share risk between FTB and AFD on the water credit facility. The guarantee provides for a reduction of the

FIGURE 1 Facilitated Access to Finance for Domestic Private Water Operators, Cambodia: Financial Structure



collateral requirement from 200 percent to 100 percent of loan value, allowing operators to borrow higher amounts.

Finally, both the World Bank Water and Sanitation Program and the European Union (EU) provide grant funds. WSP has provided grant funding to support the development of business plans and investment studies for a minimum of 20 water operators applying for FTB loans. WSP technical assistance expanded to the overall regulatory environment, resulting in more transparent licensing and tariff regimes. The EU grant is managed through AFD and is used to provide technical assistance and output-based subsidies to help participating operators extend services to poor households. Technical assistance is provided by a range of service providers including GRET, Innovative Services, Engineering and Advisory (ISEA), SeeSaw, Enclude and Emerging Markets Consulting (EMC). The technical assistance includes: i) assistance to FTB to carry out due diligence for the loan applications; ii) assistance to an additional 15 water operators for business plans and investment studies and; iii) assistance to manage the disbursement of the loan and investment grants, and to ensure the quality of design and construction.

The EU provided a total of US\$0.8 million for output-based subsidies to operators for connecting poor households. Connection fees for the poor are capped at US\$30, but may be discounted further at the discretion of the operator depending on their marketing plan. The subsidy covers the difference between poor households' ability to pay and the actual cost of connecting them, which ranges between US\$50–70. Subsidies are paid to the operators once poor households have a functioning metered connection. In addition, the grant helps operators develop and implement a marketing strategy, including better water quality management measures, and provides a partial subsidy to water quality equipment.

Results

As of July 2016, a total of 32 projects that meet the eligibility criteria to receive funding had been identified, representing a total requested loan of US\$8.7 million. Five investment projects have been successfully completed. By the end of 2017, it is expected that almost 45,000 households will benefit from water service improvements, and more than 18,000 will receive new connections to a

piped water system (45 percent of which are expected to be for poor households).

An important result of the project has been the change in the way FTB is assessing collateral requirements to not only include land or buildings, but also to include part of the appraised value of water infrastructure assets, and part of the value of future cash flows. These are new practices that have not yet been adopted by other local commercial banks.

Lessons Learned

Introducing new lending practices/loan products requires a combination of different instruments and close support to local banks. Although various activities were organized to stimulate interest in the water sector at the level of other local and regional banks, this did not yet lead to significant changes in observed lending practices, with respect to tenors or collateral requirements. When different lending terms are required to match water sector needs, such as in Cambodia, technical assistance, a partial risk guarantee and a source of concessional credit proved necessary to initiate such changes, combined with the strong interest of a specific commercial lender. The concessional nature of the credit offered through FTB, with an attractive interest rate to operators proved essential to motivate operators to comply with other conditions set by the project.

Optimizing technical assistance to operators requires close alignment with local bank practices, consistent communication, and enforcement of technical standards. The attrition rate of operators—those who joined and later dropped out—has been gradually reduced since the project started. This was achieved through upfront involvement of FTB in the pre-financing stage and intensive communication on the eligibility criteria and conditions, such as the requirement for operators to finance consultants for detailed design and construction supervision. This not only protects the bank from the risk of sub-standard investments and consequent problems in operations, but also helps strengthen operators over time.

References

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This case study is part of a series prepared by the World Bank's Water Global Practice to highlight existing blended finance experiences in the water sector.

Blended finance refers to "the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets," as per the OECD definition (WEF OECD, 2015). Concessional funds can be used in a catalytic manner to open up new opportunities for commercial financing, by providing technical assistance to borrowers and lenders to help them become more familiar with each other, help structure transactions, provide credit enhancement mechanisms, etc.

Private capital flows can help with meeting immediate financing needs for investment in the water sector but ultimately need to be repaid. Repayable financing from private sources to the water sector can come in various forms, including as commercial bank loans, bonds or equity. To obtain such financing, water-sector actors need to be able to repay the borrowed amounts and the associated funding costs, which means that they need to be deemed "creditworthy" by providers of finance.

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