Commercial Finance for Water Service Providers in Kenya
Opportunity or Complexity?

Frederik Claasen
Jean Pierre Sweerts (co author on chapter 3)

Commissioned by
Vitens Evides International
Financed by Netherlands’ Embassy in Nairobi

March 2016
Project number 2560

Aidenvironment
Barentszplein 7
1013 NJ Amsterdam
The Netherlands
+ 31 (0)20 686 81 11
info@aidenvironment.org
www.aidenvironment.org

Aidenvironment is part of Stichting AERA, registered at the Chamber of Commerce of Amsterdam in the Netherlands, number 41208024
Commercial Finance for Water Service Providers in Kenya

Contents

Executive Summary 4

Why access for commercial finance is relevant 5

1. Challenges and perspectives of WSPs and financiers 7
   1.1 Why WSPs have difficulty attracting commercial finance 7
   1.2 Why commercial financiers face issues in assessing the credit worthiness of WSPs 7

2. Getting to a deal 9
   2.1 Current involvement and trends 9
   2.2 Meeting each other’s expectations 9
   2.3 Additional support to the process 11
   2.4 Successful example: extending the grid of EWASCO 12
   2.5 Nearly getting there: a mini hydro plant at THIWASCO 14

3. Opportunity or complexity? 15
   3.1 Improve ‘bankability’ of WSPs and develop a pipeline of ‘bankable’ investment projects 15
   3.2 Improve mutual understanding of the water and financial sectors’ performance 15
   3.3 Enhance additional support and create alternative financial instruments 16
Executive Summary

Kenya became a ‘lower middle income country’ in 2015\(^1\). Therefore, the amount of donor funded support will drastically decrease in the coming decade. Access to alternative funding sources is a necessity for the Kenyan Water Service Providers (WSPs). WSPs and related organizations (supporting the Kenyan water service sector) need to prepare for this change.

Many WSPs have difficulties to attract commercial finance and financiers face a lack of understanding of the water service sector and the specific risk of financing WSPs. This paper summarizes a best practice and elaborates on the general requirements and conditions when financiers and WSPs are getting to a deal. However, given the finance GAP the Kenyan Water Sector faces (KSH 1.2 billion), the current estimated portfolio (KSH 500 million) and pipeline (KSH 260 million) of commercial loans is still relatively small.

This is being confirmed by financiers. The uptake of commercial loans by WSPs has been slowly. Due to the involvement of many actors, the structuring of loans is complex. The assessment of projects has been time consuming, as banks are not used to provide loans on cash flow (CF) bases. As a result, providing loans to WSPs is still a tailor made process. The high turnover of staff at local branches, together with the lack of a standard product hampers the role out of loan products through the banks’ networks.

This paper elaborates on three advises how to increase the access to commercial finance for WSPs. First, WSPs have to improve their bankability and efforts should be made to create a pipeline of bankable projects. Second, trust has to be built among the boards and management teams of WSPs and the financial sector by creating mutual understanding on sector performance, standards and requirements. Third, additional support should remain but refocused, while alternative (domestic capital) instruments should be developed.

\(^1\) Based on the World Bank’s estimates of Gross National Income per capita
Why access for commercial finance is relevant

Water Service Providers (WSPs) in Kenya face several investment needs that relate to the following areas:
- Abstracting water from sources (while meeting strict regulation on environment),
- Replacing aging water pipeline network, and decreasing NRW losses,
- Expanding current networks meeting growing demand for water in cities (industries), and reaching out to unserved/under-served areas,
- Introducing cost efficient technologies, especially on energy savings (water and sewer treatment plants), and billing and revenue collection.

The Kenyan national government’s budget on water and sanitation for 2013-2030 totals to KES 1,764 billion investments against KES 592 billion funding. The Water Service Regulatory Board (WASREB) emphasizes the need to attract private sector funding and improve the self-financing capacities of Water Service Providers (WSPs) as a means to bridge the gap. Meanwhile there is a strong push towards cost recovery and ring fencing of revenues of WSPs.

Devolution under Kenya’s new 2010 Constitution has wide range implications for the water sector. A new legislative framework is on its way, and the counties have direct responsibility over provision of water and sanitation. A Public Private Partnership (PPP) policy is in place that allows private sector involvement in the provision of water services. As a result of these reforms, the institutional landscape is changing and roles and responsibilities are currently not always clear.

When approved by the county, WSPs are allowed to attract commercial funding for commercially viable investments. In practice not that many successful examples exist. There are several reasons for financiers to withhold their funding, and not all WSPs are eager to open a window for commercial finance.

This paper does not question whether commercial finance will be suitable to finance WSPs investments and/or operations. The paper elaborates on the different challenges financiers and WSPs face in relation to this topic. The paper describes how commercial financiers and WSPs can come to a deal, and whether the current available instruments will be applicable to bridge the funding GAP.

The goal is to provide sufficient background information for WSP’s boards to decide whether to investigate the opportunities for commercial finance or not. Chapter 3 of this paper provides suggestions to the drinking water sector in Kenya in general how to increase access to commercial finance in order to bridge the funding GAP mentioned above.

This paper is one of the results of the Water Operating Partnership between Vitens Evides International and Mowasco, funded by the Netherlands’ Embassy in Nairobi. One of the goals of this partnership is to increase access to commercial finance. We thank Mr Philip Oyamo of WSUP for his guidance during our research. We especially thank Dr Jean Pierre Sweerts for his valuable contribution to chapter 3.

---

2 Partly based on ‘a primer for commercial financing of water utilities in Kenya, USAID/Suwasa’, 2015
1. Challenges and perspectives of WSPs and financiers

This chapter explains why using commercial finance is not simple for WSPs, and why financiers will have to cope with specific issues when assessing credit worthiness of WSPs.

1.1 Why WSPs have difficulty attracting commercial finance

Many WSP operate on negative or neutral cash flow, mainly caused by the high amount of Non Revenue Water (due to a low billing efficiency and high leakage levels), the low collection efficiency (due to the lack of a strictly enforced debt collection mechanisms), and the regulated fee structure that -although encouraged by the regulator- does not allow WSPs easily to propose new tariffs.

Due to the lack of sufficient cash flow, WSPs hardly have capital available to co finance investments. As financiers will require 20-30% (equity) contribution, WSPs face difficulties in securing their own financial means. For the same reasoning, the capacity to meet debt service obligations is limited; this requires specific loan modalities as grace periods, long repayment periods and moderate interest rates. Not all commercial financiers are willing and able to meet these specific conditions.

WSPs do not have marketable assets to pledge for security, as WSPs do not have significant assets on the balance sheet that can be liquidated easily to pay off debt. Even when the cash flow is sufficient to meet the debt service obligations, commercial financiers will ask for guarantees. Unfortunately, not all WSPs have easily access to third party guarantees.

Good performing WSPs have good leadership. These WSPs have applied for the right tariffs, are operationally efficient, and are making enough money to meet debt repayment. Management Teams of well performing WSPs are more open to financial and technical innovations, and are able to manage the complex relationship with local government (political interference).

How can WSPs improve their self financing capacity?
- Review the tariff structure,
- Prioritize efficient billing and revenue collection,
- Select investments that have a quick result in terms of improving the cash flow,
- Claim the inherited bad debts at treasury (one WSP is negotiating with the county on this matter),
- Reorganize the staffing to increase efficiency,
- Adapt to private sector financing, create partnerships with financial institutes.

1.2 Why commercial financiers face issues in assessing the credit worthiness of WSPs

In general, Kenyan WSPs have a bad reputation in providing services to their clients, and financiers face a lack of understanding of the sector and the specific risk of financing WSPs. Information and data needed to assess the credit worthiness is often lacking or unreliable, a sector wide accepted and applied credit rating mechanism is lacking.

Financiers will be interested in projections on revenues, costs and investments in assets. As WSPs have an obligation to provide water and sanitation services to the inhabitants/organizations of a city (or area), a growth strategy should be in place that navigates the WSP in increasing the network and
improving its services. In practice however, board members of WSPs and Water Service Boards change frequently and this does not contribute to a consistent execution of such a strategy.

The public sector still has a strong grip on WSPs operations. The government regulator (WASREB) has set a target of NRW percentage < 25%. Regulation is currently enforced through Service License Agreements between the Water Services Boards (WSBs) and WSPs. In the new Water Act, WASREB will most likely be regulating the WSPs directly. As a result, the regulator will not easily enter discussions on e.g. fee rates unless the NRW percentage is within agreed limits. Besides the process to apply for adjusted fee rates is complex, and WSPs lack the capacity to implement such a request successfully.

WSPs generally have weak balance sheets, the solvency ratio (own means versus total assets) is often below ‘banking standards’ (30%). Financiers analyze the aging of the accounts payable, the performance of (debt) collection and aging of the portfolio accounts payable. Most WSPs inherited significant debtor and creditor accounts from their predecessors (municipalities). As these claims are not backed by proper documentations, WSPs continuously have to make provisions to write of the amounts. WSPs will need to explain this issue to the financiers.

Financiers will make sure that collected fees will be used for meeting debt service obligations first while leaving room for financing the operational costs and payment of short term obligations, and saving cash to co finance future investments. In other words, revenues should be ring fenced and a mechanism should be in place to allocate cash to specific expenditures in a logical (or required) sequence. This might conflict with the intentions of other stakeholders.

Access to water is ‘key’ in analyzing the bankability of WSPs. Financiers have to be convinced the WSPs are able to meet current payment of bulk water fees and levies, and contracts plus infrastructure is in place securing reliable supply of water. Current and future access to finance is important as well. Financiers will analyze the WSPs loan portfolio, making sure WSPs can meet current and future debt service obligations. Besides, many WSPs are not solely financed by loans and rely therefore on subsidies; financiers will analyze WSPs future expectations on this matter.

---

3 Financiers consider WSPs to have an efficient collecting mechanism when the collection efficiency is > 85%
2. Getting to a deal

This chapter describes current involvement of the commercial financial sector, how commercial financiers and WSPs can meet each other’s expectations, what is needed to facilitate this process, and two interesting examples in the Kenyan market.

2.1 Current involvement and trends

KRep bank is the frontrunner in financing the urban water sector. The bank has been actively involved during the past 3 years, closing deals with Kisumu (KSH 22 million for expanding infrastructure to 500 households), Nolturesh Water Company (KSH 60 million), Muranga South (KSH 86 million for financing expansion of the network), Meru Water (KSH 100 million, for financing improvements on water treatment plant), Kakamega (KSH 160 million), and Murang’a water (KSH 34 million). K Rep pipeline of deals (proposed projects by WSPs) is around KSH 260 million (November 2015).

K Rep is still market leader in this sector, having around 70%¹ of the volume of closed deals. Currently, KRep is facing competition from Housing Finance (financing Embu KSH 80 million, see section 2.4), Cooperative Bank (financing Nairobi Water, size of portfolio and pipeline is unknown), and Family Bank (portfolio and pipeline unknown). Kenya Commercial Bank seems to be active in the urban water sector as well. We estimate the total volume of closed transactions at KSH 500 million; the banking sector’s pipeline should be around KSH 370 million.

According to financiers, the uptake of loans has been slowly. There is a lack of trust among the management of WSPs to enter into relationship with commercial banks. Due to the involvement of many actors, the structuring of loans is complex. The assessment of projects has been time consuming, as banks are not used to provide loans on cash flow (CF) bases. As a result, providing loans to WSPs is still a tailor made process. The high turnover of staff at local branches, together with the lack of a standard product hampers the role out of loan products through the banks’ networks.

2.2 Meeting each other’s expectations

Commercial finance is only an applicable instrument to finance specific investments in assets that generate relatively high cash flows (compared to the day to day business of a WSP). ‘Patient capital’ is needed to finance investments in assets that do not generate ‘high cash flows’. Ideally these means are sourced on the capital market or offered by specific financiers that are able to offer loans at moderate interest rates and extended repayment periods.

It is important financiers and WSPs agree on the structure of loans first:

- Financiers can finance investments as a project (often a Special Purpose Vehicle will be incorporated). The financier will focus on assessing the modalities of the project (how input (e.g. bulk water) is being secured, how reliable the technology works, and how the output is being secured (contracts on purchase and pricing)),
- Financiers can provide a loan to a company; the financier will assess the credit worthiness of the company taking the effect of the investment into account. In such case the financier will primarily assess the predictability of the project’s cash flow and the effect on the company’s performance,

¹ Based on experts’ opinions and interviews
The priority of the loan (both project and company finance) is a critical issue to discuss. The priority of the loan (called seniority) is the position the financier has toward other financiers. In practice banks will agree on a ‘pari-passu’ clause (being equal to similar financiers).

In all cases WSPs must meet the general requirements of commercial finance: excellent management and governance should be in place securing good operations and asset management that leads to predictable cash flows. Across the board the following conditions will be in place.

**Table 1: Structuring loans**

*General terms and conditions*

<table>
<thead>
<tr>
<th>Topic</th>
<th>Condition</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of funds</td>
<td>Strictly on the project</td>
<td>Projects should have an immediate positive contribution to operational cash flow</td>
</tr>
<tr>
<td>Disbursement</td>
<td>Flexible in tranches, depending on the planning of construction</td>
<td>Will decrease interest costs</td>
</tr>
<tr>
<td>Amount</td>
<td>USD 100.000-1.700.000</td>
<td>On average USD 700,000</td>
</tr>
<tr>
<td>Term</td>
<td>6-8 years</td>
<td>In practice, up to 10 years including a grace period of 12 months applying to</td>
</tr>
<tr>
<td>Own contribution</td>
<td>20-30% of the initial loan amount</td>
<td>Of project value</td>
</tr>
<tr>
<td>Co investments</td>
<td>30-50% of the initial loan amount</td>
<td>Output based subsidies by WSTF (see section 2.3)</td>
</tr>
<tr>
<td>Interest</td>
<td>15-20%</td>
<td>On average 17% (spread is about 7% on the base rate)</td>
</tr>
<tr>
<td>Fees</td>
<td>Upfront fee 1% on the initial loan amount</td>
<td>Legal fees regarding the set up of documentation are applicable as well</td>
</tr>
<tr>
<td>Security</td>
<td>Floating debenture on receivables, 50% guarantee on the principal</td>
<td>Additional guarantees are often required but the bank has to realize lending on CF is the basic principle</td>
</tr>
<tr>
<td>Other conditions</td>
<td>Position toward other financiers, ring fencing and agreement on the allocation of revenues Letter of comfort (including statement of non interference) by county and Water Service Board. Applicable board resolutions Open an account at the lending bank, part (negotiable) of the WSP’s income should pass this account</td>
<td>Other conditions can apply, depending on the specific modalities of the project and the performance of the WSP</td>
</tr>
</tbody>
</table>

Source: USAID/Stuwasa, Aidenvironment

---

To receive a competing offer WSP should invite banks to submit an uncommitted term sheet first. Doing so, WSPs can negotiate on the interest, upfront fee and the allocation of the legal fees from start on. The high interest rate should not withhold WSPs management to explore access to commercial finance. WSPs can lower the cost of interest by arranging e.g. suppliers-credit and include a condition in the loan documentation regarding extra reimbursements on the loan without facing penalties.

What are the critical success-factors in making the deal?
The management teams of WSPs have to look at the operations more from a commercial point of view. The management teams of WSPs that attracted commercial finance understood the benefits, were focused on solving the bottlenecks, and on improving performance of the service (NRW, billing efficiency and collection rate). These teams managed the company using a rigorous framework of KPIs, defining clear working packages that were clearly assigned to staff.

The Water Service Trust Fund (WSTF) should come on board first. Meanwhile, the WSP management team has to work closely with the board. The relationship with the county is a ‘balancing act’. On one hand, the county must support and approve management efforts to attract commercial finance. On the other hand, the county should not politically interfere with the WSP business, and agree on a ring-fenced operation (no money leaking away).

The WSP should be able to clearly define the project. The scope of the work should be clear, just as the technical viability. WSPs must proof they are able to manage the construction properly. WSP’s finance department must be able to draft realistic financial projections (both the project and the company). The project should ideally be presented as a business case; the own contribution of the WSP should be well defined (and committed).

2.3 Additional support to the process

In many cases WSPs need additional support in order to meet the requirements of commercial financiers. Support is needed in two ways:

- WSPs must have access to additional financial sources to meet the requirement on the own contribution (through equity, grants or in kind contributions) and co finance,
- WSPs must have access to additional sources that can provide security to the loan.

To finance the own contribution, WSPs often must have support from counties. Counties can bring in materials or cash; both will be acceptable for financiers. In such case, counties need to have budgets or align with central treasury to receive additional means.

Regarding co finance, WSPs need access to grant and subsidy mechanisms like the output based aid (OBA) and Aid on Delivery (AoD) programs of the Water Service Trust Fund. Access to financiers that provide subordinated loans against so-called soft conditions (extended term, low interest) is important as well.

To meet requirements on additional security, WSPs should have access to third party guarantee programs like the USAID Development Credit Authority (DCA) guarantee, or traditional guarantee programs of the Kenyan Government.

The regulator’s annual impact report also helps in identifying utilities to target for commercial financing. The development of risk analysis tools and credit rating systems will support commercial financiers in
assessing the credit worthiness of WSPs, in such case access to commercial finance will increase and transaction costs (and interest rates) will go down. As a spin-off, credit rating systems will support WSPs in making the right decision on improvement of the operations.

To our opinion, WSPs should take a commercial (service oriented) view on their operations. WSPs still need technical assistance in making bankable proposals, and (to our surprise) the WSPs hardly work together in sharing experience on the topic of increasing access to commercial finance. On the other side of the spectrum, financiers should get training on the sector specifics, and solutions have to be found to cope with the rather high transactions costs.

2.4 Successful example: extending the grid of EWASCO

Description:
Embu Water And Sanitation Company (EWASCO or Embu) was incorporated in March 2003 in order to comply with the new water act and became operational in July 2005. Embu is located on the South East Slopes of Mount Kenya. Its mandated area covers 972 km². Currently its water supply coverage is 527 km². In terms of people, EWASCO serves 109,900 out of 160,000 people in its mandated coverage area.

Embu operations started with a capacity of 2,000 m³/day against 7,000 m³/day demand. Through the efforts of attracting commercial finance the company increased production to 10,000 M³/day. The first step was to arrange credit from suppliers of pipes and fittings, and agree on deliverance on credit of 24 months. This credit financed extension of the grid from 24 km² to 80 km², achieved during first 3 year of operation. In parallel a supplier’s credit (12 months period) on metering was negotiated, in order to replace 50% of meters. As a result, the revenue collection and billing doubled.

The investment
Embu Water and Sanitation Company needed finance to extend the water grid to approximately 6,000 households, schools, clinics and commercial buildings. This would ultimately allow the company to connect a total of up to 15,000 households. The total budget of the project was about KSH 120 million.

Structure of the loan
Credit assessment was based on the proposal and financial accounts (audited). The loan amount required was KES 79,632,000, which represented two third of the total project cost. The county funded the remaining part. The WSTF committed an AoD grant of 40% of the project costs, WSTF released the grant when EWASCO met targets on 1) construction and delivery of the project, 2) volumes of water delivered to the households, and 3) the level of NRW. A loan, submitted by the Housing Finance Bank was backed by a 50% USAID DCA guarantee. Embu had to present letters of comfort from the county (promising the county would not politically interfere), board of directors, and WASREB.

Initially Housing Bank offered a mortgage product, so Embu had to renegotiate the conditions. Embu had to open an account at Housing Bank (agreeing 40% of the WSPs’ revenues would go through the accounts). Interest rate was negotiated at 17%. To avoid high interest costs, the company was allowed to call the loan in tranches, without interest paid on the committed loan amount that was not being disbursed yet. Although the bank initially offered 15 years tenor, the loan tenor was set at 5 years.

Success factors:
In 2005 the operational and financial status of Water Supply in Embu was poor and the capacity of the company was limited. There was no funding available for investments from ‘traditional sources’. During a period of 10 years the performance of EWASCO improved significantly.
Table 2: EWASCO operations
Improving performance

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Water production capacity (m3/day)</td>
<td>2,000</td>
<td>28,000</td>
<td>28,000</td>
</tr>
<tr>
<td>Water produced (m3/day)</td>
<td>2,000</td>
<td>15,000</td>
<td>24,000</td>
</tr>
<tr>
<td>Mandated Service Area (km2)</td>
<td>80</td>
<td>975</td>
<td>975</td>
</tr>
<tr>
<td>Area with pipe network (km2)</td>
<td>24</td>
<td>546</td>
<td>700</td>
</tr>
<tr>
<td>Hours of water supply per day</td>
<td>1.5</td>
<td>&gt;20</td>
<td>&gt;20</td>
</tr>
<tr>
<td>Total no of water connections</td>
<td>4,000</td>
<td>17,000</td>
<td>24,000</td>
</tr>
<tr>
<td>Total population in the mandated area</td>
<td>58,000</td>
<td>160,000</td>
<td>173,000</td>
</tr>
<tr>
<td>Population supplied with water</td>
<td>23,000</td>
<td>109,900</td>
<td>155,700</td>
</tr>
<tr>
<td>Billing per month (KES)</td>
<td>2,000,000</td>
<td>20,000,000</td>
<td>26,000,000</td>
</tr>
<tr>
<td>Non-Revenue Water</td>
<td>&gt;70%</td>
<td>38%</td>
<td>25%</td>
</tr>
<tr>
<td>No of sewerage connections</td>
<td>1,500</td>
<td>2,720</td>
<td>5,000</td>
</tr>
<tr>
<td>No of people connected to sewerage</td>
<td>10,500</td>
<td>18,900</td>
<td>50,000</td>
</tr>
</tbody>
</table>

Source: V.Post, 2015

According to Embu’s General Manager, the improvement of results would not have been possible without ‘commercial financing catalyst’.

Looking at the investment Embu took a businesslike approach. Embu successfully generated the own contribution. Planning and design was done by staff, saving money. The staff conducted the construction work and was supported by the community, saving upfront 30% of costs.

USAID provided technical assistance for a social economic study, the assessment of credit worthiness of the utility, the preparation of a financing proposal, community outreach and education, and linkage of Embu with commercial banks and Water Service Trust Fund and oversight of project milestones during implementation phase.

The cash flow projection was based on an average consumption of 6 m3 per household and therefore billed on the lowest tariff band. The actual average consumption per household is 10 m3 and therefore the company is collecting almost double of the projected revenues. The loan was to be repaid over 5 years but the company did pay extra each month and repaid debt within 3 years.

Embu had to proof to the bank they were able to deliver the works (construction), and meet debt service obligations during operations. By doing so Embu became more credit worthy, as they built a good track record. Now, Embu will have better access to commercial finance in the future.

For the industry the Embu case proofed WSPs could get loans. Embu presented a solid and robust CF forecast and argued with banks that CF should be the principle in lending to WSPs. When the WSP runs its operations well, the CF is predictable as WSPs have monopoly. This discussion was important, as banks did not have experience in working with the water sector.
2.5 Nearly getting there: a mini hydro plant at THIWASCO

Description:
Thika Water & Sewerage Company Ltd was registered in the 2009 as Water and Sewerage services providing Company. Throughout its operation period, Thika Water & Sewerage Company Ltd. (THIWASCO) operated in the distribution of safe and quality water and sewerage services in the region. Its service area is approximately 254 km². It is a fast growing county North East of Nairobi.

THIWASCO’s engagement with commercial financiers started from a number of studies that focused on the energy side of the operations, these studies were supported by:
- 2011: SWAP-bfz (Germany), WASPA, KAM financed an Energy audit for THIWASCO,
- 2013/14: SWAP-bfz financed a feasibility study for Mini-Hydro Power plant.

The business case:
The feasibility study based on Energy Audit Report of 2012 confirmed that the installation of a Mini-hydropower plant at THIWASCO was technically and financially viable. The investment generated cash flow by savings on energy costs (table 3).

Table 3: THIWASCO business case
Savings on energy costs

<table>
<thead>
<tr>
<th>Month</th>
<th>No. of days</th>
<th>Average Power generation potential (KW)</th>
<th>Energy generation potential (kWh)</th>
<th>Value of Energy generated (KSH)</th>
<th>Net savings (KSH)</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>31</td>
<td>54</td>
<td>40,176</td>
<td>704,840</td>
<td>534,840</td>
</tr>
<tr>
<td>February</td>
<td>28</td>
<td>37</td>
<td>24,864</td>
<td>436,209</td>
<td>266,209</td>
</tr>
<tr>
<td>March</td>
<td>31</td>
<td>200</td>
<td>148,800</td>
<td>2,610,519</td>
<td>2,440,519</td>
</tr>
<tr>
<td>April</td>
<td>30</td>
<td>200</td>
<td>144,000</td>
<td>2,526,309</td>
<td>2,356,309</td>
</tr>
<tr>
<td>May</td>
<td>31</td>
<td>200</td>
<td>148,800</td>
<td>2,610,519</td>
<td>2,440,519</td>
</tr>
<tr>
<td>June</td>
<td>30</td>
<td>160</td>
<td>115,200</td>
<td>2,021,047</td>
<td>1,851,047</td>
</tr>
<tr>
<td>July</td>
<td>31</td>
<td>60</td>
<td>44,640</td>
<td>783,156</td>
<td>613,156</td>
</tr>
<tr>
<td>August</td>
<td>30</td>
<td>60</td>
<td>43,200</td>
<td>757,893</td>
<td>587,893</td>
</tr>
<tr>
<td>September</td>
<td>30</td>
<td>60</td>
<td>43,200</td>
<td>757,893</td>
<td>587,893</td>
</tr>
<tr>
<td>October</td>
<td>31</td>
<td>140</td>
<td>104,160</td>
<td>1,827,363</td>
<td>1,657,363</td>
</tr>
<tr>
<td>November</td>
<td>30</td>
<td>140</td>
<td>100,800</td>
<td>1,768,416</td>
<td>1,598,416</td>
</tr>
<tr>
<td>December</td>
<td>31</td>
<td>140</td>
<td>104,160</td>
<td>1,827,363</td>
<td>1,657,363</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>1,062,000</td>
<td>18,631,526</td>
<td>16,591,526</td>
</tr>
<tr>
<td>Monthly Average</td>
<td></td>
<td></td>
<td>88,500</td>
<td>1,552,627</td>
<td>1,382,627</td>
</tr>
</tbody>
</table>

Source: V.Post, 2015

Bfz GmbH confirmed its willingness to assist THIWASCO in accessing finance for the project from a local commercial bank - Housing Finance - with additional support from SUWASA and Kiambu County Government. However, the company did not take on financing due to negative operational cash flow while the county did not issue a letter of no objection for the company to borrow as per financier requirement. Besides, the company was not able to explain the financial projections well.
3. **Opportunity or complexity?**

This chapter provides advice to the Kenyan drinking water (service) sector in general how to increase access to commercial finance. Kenya became a ‘lower middle income country’ in 2015\(^6\). Therefore, the amount of donor funded support will drastically decrease in the coming decade. Access to alternative funding sources is a necessity for the Kenyan WSPs. WSPs and related organizations (supporting the Kenyan water service sector) need to prepare for this change.

### 3.1 Improve ‘bankability’ of WSPs and develop a pipeline of ‘bankable’ investment projects

Looking at the Creditworthiness Index Report of the Kenya Water Service Providers (WASREB, WSP, World Bank Group, 2015), 13 WSPs meet the risk profile of commercial lenders (A-BBB) and 14 WSPs are close with a BB rating. The numbers were 13 and 16, respectively, in the earlier Utility Shadow Credit Ratings Report (WASREB, WSP, 2011). Also, the pipeline of bankable projects is growing. However, current volume and trend will not be ‘sufficient’ to meet the expected funding deficit as mentioned in the introduction to this paper.

According to the WASREB Impact Report 2015, 30 WSPs were able to cover the operational and maintenance costs, while 1 WSP met targets on Non Revenue Water (NRW). To improve bankability of WSPs, management should start decreasing the NRW to acceptable levels, while reaching sufficient coverage. Identifying investments that directly contribute to NRW improvement and increased coverage will support the current pipeline of bankable projects to grow. Meanwhile the implementation of such projects will improve the bankability of WSPs. It works both ways so to say.

### 3.2 Improve mutual understanding of the water and financial sectors’ performance

From our observations so far, the WSPs could gain from working more together in sharing experience on the topic of increasing access to commercial finance. The managing directors of different WSPs meet regularly during the year; such structure could be used to facilitate focused working groups on increasing access to commercial finance.\(^7\)

On the other side of the spectrum, commercial financiers hardly work together. Competition between financiers might hinder the sharing of sector knowledge, however given the size of the investment need (the gap referred to in the introduction), there should be room for multiple players and the development of sector knowledge could be seen as a ‘project within the pre competitive domain’.

The process of creating mutual understanding (between the water service and financial sector) must be geared towards the improvement of both the creditworthiness of the WSPs and the project proposals (investment requests) from the WSPs, as well as the development of risk assessment tools and applicable finance products and supporting instruments. This can be structured in master classes, or knowledge forums that will deliberately bring together sector experts and practitioners from both sectors.

---

\(^6\) Based on the World Bank’s estimates of Gross National Income per capita  
\(^7\) Part of the PEWAK project, initiated by Vitens Evides International, is a working group focusing on cost recovery. As we speak, 25 WSPs participate, meeting 2-3 times a year. Such structure could be used as well to facilitate mutual understanding
3.3 Enhance additional support and create alternative financial instruments

Section 2.3 provides an overview of current additional support. The current mechanism that supports commercial finance is quite complex and requires specific expertise. This results in time consuming processes and high transaction costs. In our opinion the current mechanism will face difficulties in scaling-up (see section 2.3).

Regarding the access to commercial banking finance, additional support should be focusing on five aspects:
- Improvement of the performance and creditworthiness of the WSPs,
- The creation of bankable projects based on bankable project proposals,
- Blending of concessional loans and grants with commercial financing,
- Attract commercial financing from additional sources such as the domestic debt capital market,
- Enhancement of mutual understanding between the water sector and the financial sector.

Here, we focus a bit more on attracting commercial financing from the domestic debt capital market. According to a recent scoping study financed by Dutch Ministry of Foreign Affairs, there is a strong need and interest by the better performing utilities to attract commercial loans. Also, there is an interest by the domestic pension funds (long term financing) and banks (short and medium term financing) as well to provide financing to those utilities (for water infrastructure projects) that will be able to pay the interest and repay the loans.

This scoping study formulated a Kenya Water Finance Facility for Water (KIFFWA) as a possible solution. The concept of a Water Finance Facility has been applied in a number of countries. A Water Finance Facility provides commercial long tenor finance to Water Companies for infrastructure projects that have the capacity to service the debt.

A Water Finance Facility sources the funding primarily from the domestic debt capital market through the issuance of bonds to domestic pension funds and other institutional investors. Through the pooling of many water projects the bonds will have lower risk.

This risk can be further reduced, if guarantees, soft loans or grants can be obtained by the Water Finance Facility. The borrowers will, however, not cross-collateralize each other’s loans. Through the combination of long tenor lending and whether credit enhancement can be obtained, the annual debt service for the WSPs will be lower than through commercial bank lending and long term financing can be achieved.

Sound business plans for the projects and creditworthiness of the WSPs are essential. This includes the possibility to ring-fence revenues of the WSPs to be sure that the debt service will be paid. It is of critical importance for any form of commercial lending that the new water bill will allow this ring-fencing of revenues from the WSPs to pay the interest and repay the loans. The Netherlands Embassy (EKN) in Kenya has decided to financially support the establishment of as Kenya Finance Facility for Water (KIFFWA). One of the first steps is to prepare a Business Plan for the Facility and to develop a pipeline of bankable project proposals in 2016. If this is successful, the KIFFWA could be established and a first issuance of bonds could be prepared.