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PPIAF Support Helps Kenyan Water Utility Access Commercial Financing

In 2009, the Government of Kenya (GoK) requested PPIAF support to assess four water utilities in Kenya. The objective was to provide borrowers and lenders with an overview of the creditworthiness of water service providers to support access to local currency financing from the domestic financial market. PPIAF and the Water and Sanitation Program (WSP) conducted these credit rating assessments through the Sub-National Technical Assistance Program. At the conclusion of the credit assessment, the Embu Water and Sanitation Company Limited (EWASCO) was one of the BB-rated utilities, defined as being likely to fulfill financial obligations with small improvements in some financial and operating performance indicators. In 2014, following this result, EWASCO received \$1 million in commercial financing toward the construction of a 17-kilometer water pipeline that is expected to expand connectivity to 6,000 households and a pproximately 100 schools in Embu County..

Because few Kenyan utilities have ever been asset holding or legal entities, officials working in Kenya's water sector had limited experience in raising funds from domestic and regional banks or from financial institutions. For many decades, commercial finance was seen as a supplementary resource in a sector whose predominant funding source remained public finance.

That began to change when Embu Water and Sanitation Company Limited (EWASCO) became an asset holding legal entity. It was incorporated in 2004 by the Embu Municipal Council following the Water Act of 2002, which provided water and sewerage services. At that time, the community became the owner of the Company by proxy, as the Council operates as a trustee of the community. It is managed by nine directors at policy level and day to day by a Corporate Management Team.

This leadership faced challenges immediately after the utility incorporated: Embu was experiencing a severe water supply shortage, with only 2,000 cubic meters (2,000m³) supplied against a demand of 7,000m³ per day. Despite the rapid urbanization and population growth in the town, the water supply system had not been improved since 1970. As a result, water rationing remained in effect, and households were supplied with water at a very low pressure for three hours every two days. Sewerage was also a major issue, as facilities served only 16 percent of the area.

Another problem discovered after incorporation was that EWASCO lacked an organized billing and collection system. It had inherited huge debts and its poor financial management reporting system made it difficult to plan any new improvements. Once a robust financial management and accounting system was put into place, revenue collection improved, enabling the company to implement some of its forward-looking projects.

PPIAF SUPPORT

The PPIAF-WSP work effort to improve utilities' access to market finance resulted in development of a mechanism to access utility creditworthiness. This mechanism rates utilities according to internal factors, such as financial and credit management, management quality and capacity, and operational performance. It also measures external factors, including economic base, susceptibility to external shocks, and changes in sector policy.

With PPIAF and WSP support, Kenya's Water Services Regulatory Board (WASREB), a national regulatory body, launched a credit assessment report for 43 water utilities. WASREB carries out performance benchmarking and approves Service Performance Agreements (SPAs) and tariff adjustments.

OUTCOMES

Overall, the rating process helped identify management and operational weaknesses that needed to be addressed in order to secure commercial funding. In 2011, EWASCO was listed as potentially creditworthy with a "BB" rating. This report indicated that EWASCO's ratings could improve through relatively small improvements in financial and operating efficiency. Enhancements since then have included measures to improve operating cost coverage, metering ratios, and collection efficiency through investments in network rehabilitation. Rates of non-revenue water have also decreased. Revenue collection

has dramatically improved, and EWASCO is now operating at a surplus. Its credit rating has enabled the company to increase its staff while purchasing equipment to service its clients.

EWASCO continues to experience positive outcomes resulting from its credit rating. In May 2014, it received a loan of \$1 million from Housing Finance, a local financial institution. These funds will go toward the construction of a 17 kilometer water pipeline that is expected to expand connectivity to approximately 6,000 households and some 100 schools in Embu County. The loan will cover 80 percent of the project cost, and EWASCO will finance 40 percent of the balance through international cooperation.

DONOR COORDINATION

Before PPIAF-WSP support, EWASCO had worked with the Japan International Cooperation Agency (JICA) to build a new water treatment facility and partnered with Kenya's K-Rep Bank to construct household water connections in low-income areas. EWASCO applied for assistance from the Government of Japan through the GoK to finance the Project for Improvement of Water Supply in Embu and the surrounding areas.

USAID's Sustainable Water and Sanitation in Africa (SUWASA) facilitated the innovative financing deal with Housing Finance through business advisory services. The German development bank KfW subsidized part of the balance of the project cost through results-based aid administered by the Kenyan Water Services Trust Fund.

The PPIAF-WSP support also catalyzed a follow on project by IFC advisory services. This project assisted EWASCO to conduct a professional financial audit, and subsequently provided an extended period of advisory support to build their internal capacity to address the issues identified in the audit. This was intended to help build EWASCO's capacity to access and manage future commercial investment.

RELATED PPIAF ACTIVITIES

- 2009: Kenya: Assessment and Development of Market Transactions in the Kenyan Water Utility Sector, \$486,000
- 2008: Africa: Water Utility Credit Ratings, \$320,300