

EA/PHI/new: **Small Water Utilities Improvement and Financing (SWIF) – Phase 2** **Year 1 of 2**

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Client: **Local Water Utilities Administration (LWUA), Department of the Interior and Local Government (DILG), Cooperative Development Authority (CDA), National Water Resources Board (NWRB)**

Country: **Philippines**

Partners: **National Economic and Development Authority (NEDA), Department of Finance (DOF), LWUA, DILG, CDA, NWRB, a Provincial Government and its Water Utilities, PPIAF**

Desired Project Outcome:

Water sector oversight agencies (DoF, NWRB, NEDA, LWUA) adopt operational policies that assist small water utility improve performance and access increasingly market-based finance in line with the Government Water Sector Financing Strategy.

Project Description:

The benchmarking exercise of Philippines water utilities in 2004 found small utilities¹ are able to operate and provide a satisfactory level of service and make modest incomes through cost-recovery tariffs. The major areas of weakness in their performance were linked to those needing capital financing. As a means to rationalize the use of limited concessional funds, the Government introduced a policy (EO 279 of 2004) to ‘graduate’ creditworthy water service providers to private finance institutions, and semi- and pre-creditworthy water service providers to access the more concessional sources of funds through government financial institutions (which operate on commercial principles but can avail of cheaper sources of financing). In support of this policy, SWIF-1 was implemented with the following components:

- a) Component 1. Capacity-building of small utilities in improvement and investment planning (completed);
- b) Component 2. Customer survey and water tariff pricing study (completed); and
- c) Component 3. Support for the development/improvement of market-financing for small utilities (on-going).

SWIF-2 will provide follow-up technical, coordination and knowledge management support to the Government to mainstream completed results of SWIF-1 and to complete Component 3 of the former project.

The performance improvement process tested under SWIF-1, Component 1 comprised self-assessment instruments (including key performance indicators, metric and process benchmarking and competitive analysis) and tools for improvement planning (including service demand gap analysis, financial and tariff projection modeling, action plans, customer satisfaction & willingness to pay, and organizational design). Under the sector reform agenda, LWUA has responsibility to support semi- and pre-creditworthy utilities improve their viability through a technical assistance group. LWUA presently provides off-the-shelf training courses on a fee-basis and technical services as part of loan packages. However, small utilities will have limited means to pay for consultants or loan-based planning. The combination of a mentoring process (combining LWUA’s expertise and building utility ability to do-it-yourself) tested under SWIF-1 is a potentially appropriate model for capability-building. However, this will need a lot of intermediation and coordination on the part of LWUA. It will need to work closely with other agencies who have oversight of particular types of water utilities, such as cooperative (CDA), local governments (DILG) and other commercial private providers (NWRB) and with local governments. A competitive grant financing structure may also be necessary to support high-potential small utilities access technical support. This could be tested in a province – likely to be the same province identified in a related WSP Philippines project, NWRB Registration Process for Water Utilities. SWIF-2, Component 1 seeks to provide technical and coordination support towards enhancing and institutionalizing the performance improvement process for this segment of LWUA’s clientele.

SWIF-1, Component 2 looked into customer satisfaction and quantitative willingness-to-pay with household survey using choice model analysis. Small utilities found the surveys extremely useful in understanding and aligning investment plans with consumer demand and dialoguing with their owners, financiers and customers. Given the rigor of the survey, the results were also useful for oversight agencies in policy discussions. However, as an instrument in the performance improvement process, the analytical methodology needs to be simplified through the use of pre-designed analytical models. SWIF-2, Component 2 will work with utilities and oversight agencies to develop a pre-designed analytical model that could simplify the use of this instrument.

SWIF-1, Component 3 aims to assess the constraints of private financing in small and medium water enterprises, and identify interventions on the financial supply-side (banks, non banks, equity investors, etc.) to expand access. PPIAF is providing financial support for this activity, which started in December 2007 and is expected to continue until December 2008. It is

¹ Water utilities providing water piped to homes, having less than 5,000 connections

anticipated that some of these interventions may relate to: (i) developing a system of subsidiary accounting for local government-owned utilities to ring-fence their water operations, (ii) analyzing and modeling the financing needs of small utilities based on the SWIF-1 pilot of 11 utilities and documenting their experience in applying for finance, (iii) developing a new financing or finance enhancement product (such as a rediscount window); enhancing the evaluation policies of bank and non-banks (such as a process of incubation/graduation to build utility credit history and bankability); or, structures for reducing transaction/closing costs, and (iv) exploring other models of private financing such as equity financing. A rapid assessment of the constraints has been conducted and yielded a number of theories upon which the next phase of the work builds on. SWIF-2, Component 3 will continue the work started in SWIF-1, Component 3.

Assumptions:

1. Concerned oversight agencies recognize the importance of supporting small utilities and allocate resources and staff to undertake the project by August 2008 as well as to support results continuation post-project.
2. Grant financing is available to enhance small utility access to capacity-building and financing services by July 2009.
3. Private sector financiers consider small utility financing a competitive investment and will be commercially interested in financing them by December 2008.

Start Date : July 2008

End Date : June 2010

Project Milestones:

1. Project terms of reference and workplan reflect shared interest/commitment for improving performance and financing of small utilities and therefore endorsed by the DoF Oversight Committee and LWUA – August 2008.
2. Memorandum among concerned agencies (LWUA, DILG, CDA, NWRB and a participating province) outlining the terms of partnership/cooperation for the trial institutionalization is agreed and receives resource and staffing support from all parties – October 2008.
3. Participating province directs municipalities and utilities about their participation in the trial institutionalization by November 2008 and supervises their progress throughout the project.
4. Small utilities are able to use pre-designed customer satisfaction and willingness to pay analytical models – March 2009.
5. Under LWUA leadership, concerned institutions that have been trained in the performance improvement process, have successfully mentored at least 10 small utilities in the participating province – August 2009.
6. Viable utility project design proposals and financing strategies are considered and acted upon by the Board of Directors of the participating utilities – September 2009.
7. Partner financial institutions and DoF Oversight Committee consider the results and findings of Component 3 and take the necessary steps to take some of the recommendations forward – June 2010.

Indicators of Outcome:

1. 10 small utilities are mentored through an improvement planning process and produce their performance improvement plans – September 2009.
2. Operational policies and policy discussions by DoF Oversight Committee and other concerned agencies reflect the recommendations of the project as reflected in agency resolution, partnership agreements, minutes of Board meetings, etc – June 2010.

Project Updates:

4/08: New project for FY09; carries over Component 3 of SWIF-1 project (PHI/64).

Project Activities and Outputs:

Activities	Outputs
<p>Component 1 – Institutionalizing the Process of Utility Performance Improvement</p> <ul style="list-style-type: none"> • Preparation of concept note and TOR • Selection of consultants • Discussions with agencies involved on how to institutionalize the process of utility performance improvement and project proposal preparation • Selection of utilities where toolkit will be tested 	<ul style="list-style-type: none"> • Approved concept note, TOR Jul-08 • Consultants mobilized Sep-08 • Strategy on institutionalizing the processes Oct-08 • Selection criteria, utilities Jan-09 Feb-09

Activities	Outputs
<ul style="list-style-type: none"> • Implementation of the institutionalization by the agencies involved on the selected utilities <ul style="list-style-type: none"> ○ Preparation of Performance Improvement Plans ○ Loan proposal packaging • Evaluation and report preparation 	<ul style="list-style-type: none"> selected • Board Resolution/Office Order to institutionalize the Toolkit Feb-09 • Performance Improvement workshop Sep-09 Nov-09 • PIP Finalization workshop Dec-09 • PIPs approved by utility's Board Jan-10 • Project proposals presentation workshop Feb-10 • Project proposals submitted to banks • Final report
<p>Component 2 – Developing Pre-designed Customer Satisfaction and Willingness to Pay Instruments and Analytical Tools</p> <ul style="list-style-type: none"> • Preparation of concept note and TOR • Selection of consultants • Development of analytical model • Testing of analytical model • Training of users on use of the model • Conduct of the Survey, if appropriate • Collating and analyzing data, if survey conducted • Integrating data into PIP • Development of guidebook 	<ul style="list-style-type: none"> • Approved concept note, TOR Jul-08 • Consultants mobilized Sep-08 • Analytical model Jan-09 • Training workshop for users Feb-09 • Survey report Oct-09 • Workshop on survey results Oct-09 • Guidebook on use of the model Nov-09
<p>Component 3 – Support for Development of Financial Product/Window</p> <ul style="list-style-type: none"> • Discussions and agreements with partner institutions • Conduct of financial, market and institutional study • Development of subsidiary accounting system for local government-owned utilities • Development of financial models if necessary • Development of a new financing / finance enhancement product • Enhancing evaluation policies of financing institutions or structures for reducing transaction/closing costs • Dissemination and discussion of results with financial partner institutions, the Financing Oversight Committee and World Bank Philippines; • Training of bank credit officers 	<ul style="list-style-type: none"> • Report on Feasibility Study on Financing for Small Utilities Sep-07 • Subsidiary accounting system May-08 • Financial models or marketing strategies (as necessary) developed Aug-08 • New financing / finance enhancement product Oct-08 • Enhanced evaluation policies or structures Oct-08 • Recommendations for discussion Nov-08 • Trained bank credit officers Dec-08