Promoting Investment for Utilities through PPPs and Local Capital Markets

Presentation to the International Consortium on Government Financial Management
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Outline

• Introduction to MCC
• Sustainable Access to Private Capital for Utilities
• Strengthening Utilities: Improved Operating Environment & Credit Risk
• Malawi Case Study: Power Sector Reform
• Zambia Case Study: Utility Creditworthiness
• Jordan Case Study: Successful BOT
• Creditworthiness Vision
• Managing Unsolicited Proposals for PPPs
• Conclusion: Pillars of Sustainable Access to Finance and PPPs
What is MCC?

A U.S. Government foreign assistance agency fighting to end global poverty.

What’s so different about MCC?

Created by the U.S. Congress in 2004, with bipartisan support, as a different approach to U.S. foreign assistance.

Focused mandate: Reduce poverty through economic growth.
Competitive Selection

MCC measures countries’ policy performance based on 20 independent indicators in three categories:

- Ruling justly
- Investing in people
- Economic freedom

Only low-income and low-middle-income countries are considered for MCC funding.
Country Ownership

MCC partner countries are responsible for the **design** and **implementation** of MCC programs.

Two types of MCC-funded programs:

**Compacts:**
- $60 million to $698 million
- 5-year grant

**Threshold Programs:**
- $10 million to $50 million
- 2-3 year grant
Operationalizing Country Ownership

Countries determine their own priorities.

Countries lead program implementation, building capacity and strengthening country systems.

Countries are held accountable for achieving results.

Sustainability
Focus on Results
Distribution of MCC Investments
(US$ Billion cumulative through FY 2014)

- Transport $2.9633
- Agriculture & Irrigation $1.7089
- Water Supply and Sanitation $1.074
- Health, Education & Community Services $1.2548
- Rule of Law & Land $0.6102
- Energy $0.973
- Financial Services $0.2554
- Program Administration & Monitoring $1.0268
Compact Process Overview

- Preliminary Analysis
  - Constraints to growth analysis informed by:
    - Investment Opportunity Assessment
    - Initial Social & Gender Assessment

- Program Design
  - Objective: Remove constraints to growth and raise incomes
  - Project selection (co-design with MCAs)

- Due Diligence
  - Economic (ERR)
  - Technical / Institutional
  - Social, Gender & Environment

- Compact Negotiation
  - Final program content
  - Policy / institutional reforms

- Entry Into Force
  - Preparations for implementation
  - Satisfy Conditions Precedent

- Compact Implementation
  - Five years
Defining Private Sector Development (PSD)

• PSD is defined as creating markets
• MCC seeks competitive, efficient markets for
  ➢ Labor
  ➢ Capital
  ➢ Products
  ➢ Public services
• Competition for the market
• Competition within the market
## MCC’s PSD Framework

<table>
<thead>
<tr>
<th>Private Sector Development Segment</th>
<th>MCC Compact Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SME / Corporate Sector Development</strong></td>
<td><strong>Assets &amp; Products</strong></td>
</tr>
<tr>
<td>Enhancing growth of domestic enterprises and organizations through:</td>
<td>Investing in business expansion and/or start-up support for businesses</td>
</tr>
<tr>
<td><strong>Financial Sector Development</strong></td>
<td>Increasing access to credit/deposits and reducing the costs of financial services by means of:</td>
</tr>
<tr>
<td><strong>Private Sector Participation (PSP) in Public Sector Services</strong></td>
<td>Supporting increased efficiency and scope of public services through the involvement of the private sector by:</td>
</tr>
<tr>
<td><strong>Public Sector Management and Governance</strong></td>
<td>Improving the core market-supporting functions of government and public sector interface with the private sector by:</td>
</tr>
</tbody>
</table>
Sustainable Access to Private Capital Requires Sector and Utility Reform for Infrastructure Markets

Governments

• Need to capitalize utilities
• Have limited ability to provide credit enhancements for PPPs
• Need to manage direct and contingent liabilities with PPPs

Sustainable Markets

• Price setting: strong, independent regulation
• Competition: IPPs
• Payments discipline: creditworthy utilities & counterparties
Access to Capital: Improving the Fiscal Operating Environment for Utilities

• Utilities need sustainable access to capital for commercial investment in resilient operations

• Yet, performance of utilities performance is constrained by non-cost-recovering tariffs and other operating challenges
Access to Capital: Improving the Fiscal Operating Environment for Utilities

Energy subsidies, although aimed at protecting consumers:

- Aggravate fiscal imbalances
- Crowd out priority public spending
- Depress private investment
- Are captured by higher-income households
World Bank research finds large performance gains from private sector participation, particularly in operating efficiency, labor productivity, product/service quality, compared with public utilities.
# Case Study: Malawi Power Sector Reform

**Vision:** Corporatized utility has access to finance through credit rating and can act as creditworthy counterparty for IPPs

<table>
<thead>
<tr>
<th>Financial</th>
<th>Operations</th>
<th>Utility Governance</th>
<th>Sector Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Balance sheet</td>
<td>• Budgeting</td>
<td>• Utility board</td>
<td>• Power market structure</td>
</tr>
<tr>
<td>• Accounting</td>
<td>• Planning</td>
<td>• Internal Audit function of utility</td>
<td>• Institutional roles &amp; responsibilities</td>
</tr>
<tr>
<td>• Financial model</td>
<td>• Billing / revenue management</td>
<td></td>
<td>• Strengthened regulator</td>
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<tr>
<td>• Tariff / regulatory strengthening</td>
<td>• MIS</td>
<td></td>
<td>• Tariff / cost of Service</td>
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<td></td>
<td>• Procurement</td>
<td></td>
<td>• IPP framework</td>
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<td></td>
<td>• O&amp;M</td>
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<tr>
<td></td>
<td>• Human resources</td>
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**Challenges:** Absorptive capacity; integration of all the different consultancies
Case Study: Lusaka Water & Sewer Company in Zambia

- System expansion
- Non-revenue water reduction
- Regulatory reform
- Credit rating
- PPP options analysis

**Vision:** Credit rating and PPPs as possible mechanisms to help fill $3 billion gap in LWSC’s capital investment plan
Case Study: As-Samra WWTP BOT in Jordan

- **Viability Gap Funding from MCC**: $93 million grant enabled project with strong economic/environmental benefits
- **Client**: Government of Jordan represented by the Ministry of Water and Irrigation (MWI)
- **Donor**: Millennium Challenge Corporation; U.S. foreign aid agency
- **Grant Fund Manager**: Millennium Challenge Account (MCA)
- **Authority Engineer**: Fichtner (+ local consultant Eco Consult)
- **Project Companies**: Samra Wastewater Treatment Plant Company Ltd. (SPC) and Samra Plant Operation and Maintenance Co. Ltd. (O&M)
- **Sponsors**: Suez Environment, IDI and Morganti-CCC
- **Lenders**: Lender Syndicate led by Arab Bank
- **Lenders Advisor**: Mott Mac Donald
MCC Partner Countries Have Limited Experience with PPPs

Private Participation in Infrastructure Database, 1990-2014

<table>
<thead>
<tr>
<th>Country</th>
<th>Moody's Foreign</th>
<th>Moody's Local</th>
<th>S&amp;P Foreign</th>
<th>S&amp;P Local</th>
<th>Fitch Foreign</th>
<th>Fitch Local</th>
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<tr>
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<td>Ba3</td>
<td>Ba3</td>
<td>B-</td>
<td>B-</td>
<td>B+</td>
<td>B+</td>
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<td>BB+</td>
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<td>BBB-</td>
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<td>Jordan</td>
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<td>Lesotho</td>
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<td>Liberia</td>
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<td>Madagascar</td>
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<td>Malawi</td>
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<td>Mali</td>
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<td>BBB-</td>
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<tr>
<td>Mozambique</td>
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<td>B</td>
<td>B+</td>
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<td>Namibia</td>
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<td>Nepal</td>
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<td>Nicaragua</td>
<td>B3</td>
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<td>Niger</td>
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<td>Vanuatu</td>
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<td>Zambia</td>
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<tr>
<td><strong>Investment grade cutoff</strong></td>
<td>Baa3</td>
<td>Baa3</td>
<td>BBB-</td>
<td>BBB-</td>
<td>BBB-</td>
<td>BBB-</td>
</tr>
</tbody>
</table>

Legend:
- Investment-grade ratings listed in bold face
- No rating available from agency
- Countries with at least one investment-grade foreign currency sovereign rating

MCC partner countries account for only 14% of the total 6,338 projects in PPI Database (30% of total number of countries)

Only four MCC compact countries are investment grade
Creditworthiness Vision

- Sustainable access to finance for utilities
  - PPPs as viable, sustainable financing instrument
  - Commercial banks / institutional investors

- Local capital market development
  - Alternative to T-bonds
  - Lengthening the yield curve
  - Partial listing / deepen equity markets

- Discipline of capital markets
  - Better governance model
A Digression...Managing Unsolicited Proposals (USPs)

- Many governments rely on USPs due to shortage of human and financial capacity to identify, prioritize, analyze, prepare, and procure new infrastructure projects.
- USPs in countries with developed PPP frameworks and institutions have been more successful than in countries without them.
- Lack of adequate decision making tools and processes leads to poor governance and transparency issues.
- USPs have problematic record of placing more risk onto governments.
- USPs face challenges including misuse of resources, corruption, fraud, lack of competition, and poor quality.
- Recommendations:
  - Create global PPP frameworks (Policy, Law, Regulations and Procedures)
  - Build capacity in PPP institutions and staff
  - Try to follow competitive tendering procedures
  - Use USPs as the exception to public procurement
Conclusion: Pillars of Access to Sustainable Finance and PPPs

• Conducive market structure and investment enabling environment for BOTs as a financing instrument and for utility finance

Sector reform

• Finance: Strong balance sheet, cost-recovery tariffs
• Operations: Capex, O&M, asset management, procurement
• Governance: Board, management, relationship with regulator

Utility reform

• Support offtake obligations
• Force majeure payments
• Termination payments

Direct & contingent liability management for BOTs
THANK YOU!
Stephen Gaull
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Millennium Challenge Corporation
202-521-3632
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Back up slides
## Sample of MCC’s Work in the Power & Water Sectors

<table>
<thead>
<tr>
<th>Country (Sector)</th>
<th>Infrastructure Investment (US$ million)</th>
<th>Sector Reform Investment (US$ Million)</th>
<th>Total Program* Value (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malawi (Power)</td>
<td>$256</td>
<td>$26</td>
<td>$351</td>
</tr>
<tr>
<td>Ghana (Power)</td>
<td>$354</td>
<td>$96</td>
<td>$498</td>
</tr>
<tr>
<td>Cabo Verde (Water)</td>
<td>$20</td>
<td>$20</td>
<td>$66</td>
</tr>
<tr>
<td>Zambia</td>
<td>$283</td>
<td>$27</td>
<td>$355</td>
</tr>
</tbody>
</table>

* Total program value includes infrastructure and reform activities plus costs for additional project, monitoring & evaluation, and program administration.
## Representative Power Sector Reform Activities

<table>
<thead>
<tr>
<th>Country</th>
<th>Financial &amp; Operational Turnaround</th>
<th>Policy, Legal, Regulatory, and Market Structure</th>
</tr>
</thead>
</table>
| Malawi  | • ESCOM financial / operational turnaround support team  
          • Financial model / accounting support  
          • Procurement operations advisory support  
          • Management Information System | • Power market restructuring road map and implementation  
          • Capacity building at regulator  
          • Support for IPP framework |
| Ghana   | • Support private sector participation in utility management  
          • Capacity building / technical assistance to reduce losses, improve service quality, and improve revenues  
          • Technical assistance to increase access to electricity in underserved communities | • Technical assistance / capacity building for regulator in tariff process and monitoring of sector performance  
          • Support to increase investment in power generation, including through better sector planning, improved IPP frameworks, and better natural gas policies |
## Representative Water Sector Reform Activities

<table>
<thead>
<tr>
<th>Country</th>
<th>Financial &amp; Operational Turnaround</th>
<th>Policy, Legal, Regulatory, and Market Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zambia</td>
<td>• Technical assistance, capacity building to Lusaka Water &amp; Sewer Company (LWSC) and Lusaka City Council (LCC) to advance sector reform efforts to improve sector management, environmental management, strategic planning, and operations &amp; maintenance of assets</td>
<td>• Support to LWSC and LCC for mainstreaming gender policies; improving service delivery to poor and underserved populations; and information, education and communications campaigns, with aim to increase innovation in pro-poor service delivery in the water sector</td>
</tr>
<tr>
<td>Cabo Verde</td>
<td>• Support establishment of consolidated corporatized utility on the Island of Santiago and provide technical assistance to strengthen capacity for planning, financial and operational management, and public engagement</td>
<td>• Support to operationalize new and reformed planning and regulatory institutions through review of legislation and policies, technical assistance in sector planning and regulation, and engaging public in establishing policy and regulatory framework</td>
</tr>
<tr>
<td></td>
<td>• Support for immediate capital needs and long-range master plan at the island / utility level</td>
<td>• Support for fair and transparent tariff setting through assessing finances of utilities and developing tariff and regulatory strategies to establish financial sustainability</td>
</tr>
<tr>
<td></td>
<td>• Support to develop a non-revenue water (NRW) study and activities to address cause of NRW</td>
<td>• Support to develop strategic national plan for water resources, including but not limited to water supply and sanitation</td>
</tr>
</tbody>
</table>