IWRM Action Hub

CASE STUDY

Peru: Local Financing of Water Utilities - Challenges and opportunities

Summary

The legal and regulatory framework of water utilities in Peru provides opportunities for local financing of investments. Despite this, the sector remains heavily dependent on public financing. Action has been taken by the World Bank to initiate a study investigating the barriers to local private funding. This case study illustrates that public loans, private loans and equity investment are appropriate to fund the necessary investment.

Background

Since the early 1990s, local municipal governments have been responsible for the provision of water supply and sewerage (WS&S) services, except in Lima, the capital city. As part of the devolution process, Peruvian Local Municipalities received in ownership WS&S infrastructure and were mandated to organize urban water utilities as autonomous ring-fenced corporations under private company law. For Lima, the central government (CG) retained ownership of infrastructure and created SEDAPAL under private company law as well. All water utilities' costs are expected to be financed by tariff revenues.

The legal and regulatory framework of water utilities in Peru, established in 1994, is considered sound and provides opportunities for local financing of investments. A number of barriers stand in the way of moving the sector from its dependence on direct public financing or central government guarantees to a more sustainable model. First and foremost, private investors have little confidence in the sector due to the weak financial and operational performance of local water utilities.

Despite this, the sector remains heavily dependent on public financing. The majority of local water

utilities cannot meet credit rating and governance standards required to access private financing.

Consequently, loans from financial markets are rare. The World Bank initiated a study to investigate the barriers to local private financing facing the urban WS&S sector in Peru.

Actions taken

In recent years, private pension funds have become the most important institutional investors in Peru and have experience in financing infrastructure through project-based and balance sheet financing. PPFs may be willing finance the WS&S sector provided that sound risk mitigation instruments are included in contracts and could have up to $800 million/year to allocate to infrastructure projects. Most PPPs in infrastructure projects have been arranged through PROINVERSION.

The upgrading of Peruvian issues of debt has made the cost of debt more competitive in both international and local markets. CRPAOs issued recently to finance a tool road project as irrevocable GoP payment obligations were given the same rating as GoP debt. Investment activity in the Urban Local Utilities' service areas was paralyzed from the early 2000s to 2006, with the exception of SEDAPAL.

Recently, investment activity has dramatically increased, from US$89 million in 2006, more than doubling in 2007 (US$ 184 million) and increasing to US$556 million in 2008. This increase is explained by the launch and implementation of the Water for All program (APT), started in February 2007. Investment activity in the WS&S sector has dramatically increased in the past few years, mainly due to the launch and implementation of the Agua para Todos program. Multilateral and bilateral donor funding is channelled through the APT program but there are also ODA loans to water utilities and several concessions in the WS&S sector have been financed privately. It is estimated that Peru’s investment needs to meet the MDG are in the order of $420 million per year. Meanwhile, the cost of underperforming utilities poses a significant burden on both the government and on consumers.

Outcomes

A simplified framework for the analysis of investment opportunities in the local water utilities sector in Peru has been prepared by considering the following analytical inputs: (i) a review of the water utility sector and its current operating and financial situation; (ii) a review of recent local financing of infrastructure experience in Peru, including balance sheet and project based finance; and (iii) a preliminary assessment of barriers for local financing of water utilities. . International experience shows that the right governance conditions can be attained under: (i) an effective public management model; or, (ii) a private management model, using concession contracts or outright privatization as in the Telecoms sector in Peru.

Lessons Learned

The availability of local financing through Private Pension Funds and others, and their interest in the infrastructure sector, offers an opportunity for water utilities to reduce their dependence on public funding and become financially solvent.

Two challenges that municipalities need to overcome: (a) government commitment to address insolvency of water utilities; (b) fulfilment of conditions for local financing, including a governance structure that enables local investors to retain appropriate oversight over their investments.

The main challenge remains to demonstrate that objectives of Water for All Program (Agua para Todos) can be achieved sustainable way in urban areas through a radical overhaul of balance sheet of water utilities and reforms in their governance framework.

The World Bank study made specific recommendations for key players in the Peruvian Water Utility sector.

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World Bank, Water Sector Board, United Nations Secretary - General Advisory Board - UNSGAB

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Related IWRM Tools
Private sector water service providers , Pricing for Water and Water Services, Water-Related Financial Disclosures

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