Alternative Financing for Water and Sanitation Infrastructure

OUTLINES OF THE PRESENTATIONS

- Public Private Partnerships (PPP)
- The First Nations Finance Authority (FNFA)
- Social Impact Bond (SIB)

Option 1: PUBLIC PRIVATE PARTNERSHIPS (PPP,P3)

PPPs: multi-year, often multi-decade agreements where public sectors enter into long-term contractual agreements with private sector entities for the construction or management of public sector infrastructure facilities by the private sector entity

Why PPP?

PPPs are justified by providing the public sector with ’’Value for Money’’

Value for Money (VfM): Aanalysis of “the lowest combination of capital, operating and maintenance costs over the life of a project.”

Cost minimization is the real meaning of VfM

British Columbia Ministry of Finance, 2002

What other considerations should be taken into account?

(John Loxley, 2012)

- Employment
- Economic development
- The environment
- Health as well as safety

Growth of PPP in Canada

- Between 1985 and 2011, 200 PPPs were planned or implemented in Canada (137 finalized), costing US$71.6 billion *(Public Works Finance database, 2012.)*

- Pressure to expand the use of P3s in several sectors, including municipal infrastructure and services.

Different forms

- Finance only: A private entity finances the project directly.
- Design-Build- Finance (DBF): The private sector designs and builds the facility; finances the capital cost only during the construction Period.
- Design-Build-Finance-Operate (DBFO): The private sector designs, builds and finances the facility; provides operation and maintenance services under a long-term contract (the concession agreement).
- Operations and Maintenance (O&M): The private operator is responsible for the community owned facility under a contract stating specified levels of service.
- Build-Own-Operate (BOO): The private sector finances, builds, owns and operates the facility in perpetuity, usually with a process specifying how the facility can be transferred back to public ownership.

PPP Private Financing

- **Private Equity**
  - Project sponsors, developers
  - Other equity investors, pension funds
  - Domestic & international source

→ The private company invests usually about 10% proportion of the equity

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- **Debt**
  - lenders (Bank debt)
  - Bonds (Capital markets)
  - Other - pension funds, etc
- **Other Sources**
  - Other public funds (e.g. PPP Canada Fund)
  - Specialized infrastructure funds

At least nine risks facing any infrastructure project:

- Technical risk
- Construction risk
- Operating risk
- Revenue risk
- Financial risks
- Force majeure risk
- Regulatory/political risks
- Environmental risks
- Project default

P3s transfer risks from the public to the private sector

Advantages and Disadvantages

Advantages

- Expanding new possibilities for project funding

- P3’s are based on a contract causing a discipline that benefits the service providers and the owners

- Key elements of P3’s are the proper allocation and management of risk

- Collaborating with an experienced facility provider

Advantages and Disadvantages continued

Disadvantages

- Lack of government accountability , the private sector might somehow let the federal government off the hook
- Over a long period, The contract may bring constraints or obligations to FN budget
- P3’s might be expensive to execute
- The residual risk in terms of failure is that the FN still needs to be able to pick up the pieces and provide the service regardless of what the contracts states

Option 2: The First Nations Finance Authority (FNFA)

A not-for-profit organization without share capital and acting on behalf of its members , operating under the authority of the First Nations Fiscal Management Act, 2005.

"pooled borrowing" organization modelled after the Municipal Finance Authority of British Columbia

The FNFA's purposes are to

- **Provide investment options and capital planning advice**
- **Provide access to short-term and long-term loans with preferable interest rates**

The funds borrowed are primarily used for large, expensive on-reserve infrastructure development projects such as roads, sewer and water, that communities need in order to operate

What is FNFA's lending mandate?

FNFA's lending mandates are to supply both short-term and long-term loans for its borrowing members.

Short-term loans provide flexibility, the rates are very low (2.5%, to a maximum of 5 years) and the only requirements during the construction stages of the project are interest payments.

Once construction is complete, the Borrowing Member will substitute the short-term loan for a long-term loan that suits their budget.

No mark-up on the interest rates for loans, therefore the members of First Nations can borrow millions of dollars. Pay it back up to 30-year terms with the same interest rates available to municipal governments.

Who can borrow from FNFA ?

Two types of members: Borrowing and investing members

1. Borrowing members: FNs that have applied to and accepted

2. Investing members: FNs invested in Authority’s Pooled Investment Funds

- A Borrowing Member: a First Nation registered in the process of the First Nations Financial Management Board (FNFMB) and certified for their financial processes.

- Currently includes 25 Borrowing Members

Basis for First Nations to borrow through the FNFA

First Nations may borrow through the FNFA on the basis of two types of revenue streams:

1. Property taxation revenues
2. Other revenue stream not including property tax such as transfers from a provincial, regional, municipal or local government to a First Nation

Advantages

- Access to low-interest, fixed rate borrowings and the sharing of transaction costs

- Flexibility in choosing the repayment terms, payments can be matched with the budgeted cash flows.

- Availability of loans when communities need them

- No collateral or cash deposit is required

- Refinance the existing debt at lower rates therefore providing cash flow savings (Membertou FN in Nova Scotia)

Option 3: Social Impact Bond (SIB)

SIBs are funding mechanisms which invest in social outcomes.

(Geoff Mulgan et al, 2013)

- SIBs attract private financial investment into complicated areas of social policy, such as offender rehabilitation to improve targeted social outcomes

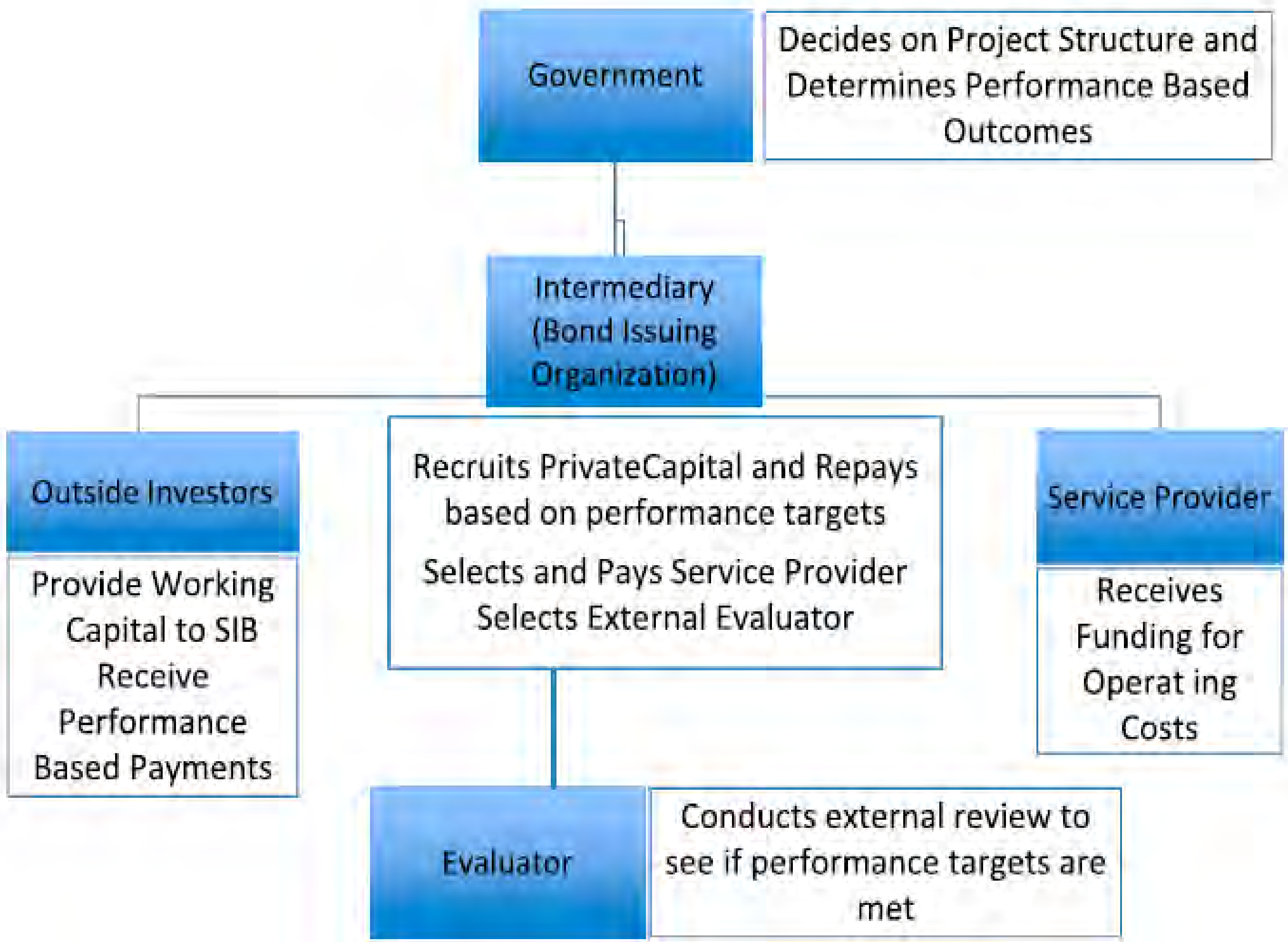
- SIB is a contract based on outcomes
- Could be used for water/sanitation

- SIBs operate over a fixed period of time but do not assure a fixed rate of return

- Investors can expect to receive a return on their investment, based on the savings government makes

Organizational Structure

(Mildred E. Warner, 2013)



Organizational Structure

Who are the main participants?

(Mildred E. Warner, 2013)

An intervention that has been tested and proven

Willing partners: government, investors, program implementers, and evaluators.

Intermediary that coordinates the investors, the program deliverers, and the evaluators.

Evaluators are crucial, improvements in outcomes need to be carefully scanned to precisely examine the return that will be paid (or not) to investors

Differences from earlier models

- Performance management is the only requirement for payment.

→ Reliance on performance measurement is the key to the SIB process since this is how to determine the rate of return in the project design causing the payment to only be triggered when performance targets are accomplished.

- The risk is transferred to the private partner.

- Time frames are intentionally kept short.

Advantages of SIBs

- Unlike PPPs, SIBs are not determined by long-term contracts, confidentiality agreements, or guaranteed market share.
- SIBs pay only for success and achieved outcomes.
- SIBs give no voice to the consumer (not any payment as user fees).

Challenges of SIBs

- Transferring performance risk to private investor has made SIBs unattractive to private investors without substantial guarantees.

- Mix of a participants, more complex organizational structure

- How to measure the impact of SIBs fairly?

Successful SIB Examples

- Social Finance in UK (prisoner re-entry)
- Capital Partnership in Alexandria, VA (early childhood education)
- MDRC, in the NYC case, a policy think tank (youth offender rehabilitation)

Conclusions

- Certain circumstances may lead a FN to consider financial alternatives
- Three main alternatives to Federal government financing of water/sanitation infrastructure
- Each has advantages and disadvantages
- Each FN can only properly weigh the advantages/disadvantages

Thank You