

Saint Lucia: new generation water sector PPP

White Paper for Water Investment World

The bidding process for the water and sewerage concession in the Caribbean island of Saint Lucia presents a new generation of emerging market Public Private Partnerships (PPP) in the water sector. Departing from the classic concession / management-contract models, it selects a minority private investor to participate in the capitalization of a new service provider (NewCo), and grants the investor / operator full managerial and operational control over the company. The capitalization of NewCo will make possible tangible investments in the sector despite the credit crisis.

The International Finance Corporation (IFC) is the lead Government advisor on the transaction; the regulatory framework was designed by Castalia, under a sector reform project funded by the World Bank.



Background

Saint Lucia has 180,000 inhabitants and 40,000 active water customers. The Water and Sewerage Company of Saint Lucia (WASCO) is the state-owned incorporated company that currently provides water supply and services. The water distribution system is already well developed, however connected households often obtain an intermittent supply, in particular in elevated areas and in the South of the island. Current demand is not totally supplied and is expected to rise due to natural population growth and demand generated by the tourism industry.

Half the utility's sales are to residential customers, 20 percent to resorts, and the remainder to other firms, cruise ships and government institutions. In 2007, WASCO's revenues were US\$12 million and EBITDA was US\$2 million.

Objectives of the Government

The Government objectives in selecting a PPP and transaction structure were the following:

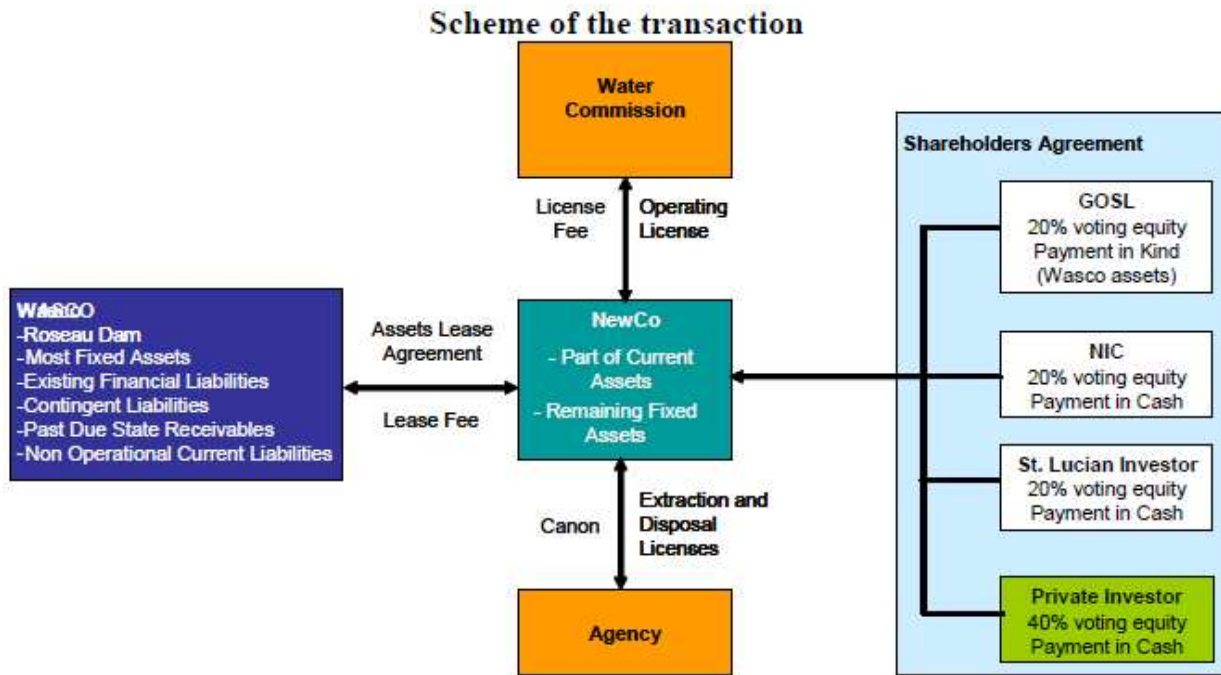
- Creating the conditions for an economically sustainable water services provider.
- Retaining ownership of the existing infrastructure, including a major dam, in public hands.
- Leveraging local funding sources, and encouraging local participation.
- Achieving significant level of services improvements in the short term, through a front-loaded investment program, without immediate tariffs increases.

- Balancing the wish to select the investor on the basis of its qualifications and the quality of its business plan, with the need for high financial offers to partially offset the cost of the transaction to the Government budget.
- Avoid the risk of future re-negotiations with the winning bidder.

Transaction structure

WASCO will be transformed into an asset holding company that would lease its fixed assets to the new licensee. WASCO will grant NewCo a 25-year renewable non-onerous lease on its infrastructure assets. The National Water and Sewerage Commission, the sector regulator, will grant NewCo a License to provide water and sewerage services in the island. NewCo be the dominant service provider.

All project agreements (Shareholder Agreement, License, Subscription, Level of Service Lease, etc.) were pre-negotiated with investors during the bid process, and formed the base for the offers. The minimum equity capital of NewCo was set by the Government during the bidding process.



The PPP structure is the following:

- The Government will retain 20% of the shares in NewCo, through WASCO, in exchange for the lease on the existing fixed assets, and for transferring selected assets (vehicles, IT, stocks and inventories, etc.). The Government will maintain ownership of the existing infrastructure assets through WASCO, but will assume all of WASCO’s existing liabilities.
- The winning bidder will subscribe to 40% of NewCo’s shares in cash. Despite the minority shareholding, the shareholder agreement grants the winning bidder operational and managerial control over NewCo.
- The National Insurance Corporation (a Government owned pension fund) subscribe to 20% of NewCo’s shares in cash (pari-passu with the winning bidder).
- An institutional investor will also subscribe to 20% of NewCo’s shares in cash (pari-passu with the winning bidder), with the understanding that its shareholding will be sold to the general public as soon as the economic and market conditions will permit.

Transaction process

The bid was awarded through a combined score (80% - 20%) of the valuation of the proposed business plan and the amount of the bid price payable to the Government. The Government will use the receipts of the bid price payment from the winning bidder to partially service the WASCO liabilities it retains.

The bidding process will be concluded in early 2009 with the award of the tender process.

Regulatory structure

Revenue for NewCo will derive from the Services for which the Water Act establishes tariffs following a “cost plus” regulation for fixing the tariff scheme. Tariffs and service quality will be regulated by the independent Water Commission. There shall be three types of tariff reviews, carried out by the Commission:

- Annual tariff review: to the extent necessary as to maintain the tariff in real terms, the tariff shall be modified using an index stipulated in the service license. This review will be carried out in any year of the triennial period in which a triennial review is in full force an effect.
- Triennial tariff review: the Commission shall review the tariff structure and level of tariffs in the service licensee’s tariff scheme, taking into consideration new quality and expansion goals set by the Commission and the investment plan of the service licensee for the ensuing triennial period. The Commission shall draft and publish a tariff review proposal and shall allow a public hearing period.
- Extraordinary tariff review.

The first triennial tariff review will be three years after the start of operations of NewCo.

NewCo will be responsible for financing water production plants, water distribution (extensions and rehabilitation), connections (new and rehabilitation of existing ones), sewerage systems and connections and waste water treatment plants, financing new investments from the equity injected by its shareholders, cash generated from operations and debt. The Government will determine in collaboration with NewCo the appropriate means to finance the realization of sewerage infrastructure investments that could include tariff adjustments, subsidized financing and/or grants. Within 12 months of its mobilization, NewCo will be required to submit to the Commission’s approval an investment program for the period up to the first triennial tariff review.

The “Output Based Aid” (OBA) scheme

OBA is a strategy for using explicit performance-based subsidies to support the delivery of basic services where policy concerns would justify public funding to complement or replace user-fees. The core of the OBA approach is the contracting out of service delivery to a third party, usually a private firm, where payment of public funds is tied to the actual delivery of these services. The Global Partnership on Output-Based Aid (GPOBA) is a partnership of donors and international organizations working together to support OBA approaches.

In the case of the Saint Lucia PPP, GPOBA agreed to fund a grant of US\$ 1.7 million to finance increase access to piped water services to low income households. GPOBA will pay NewCo a capital subsidy for each newly connected household in carefully selected low income areas, assuming that the service has been functional for six months after installation of the connection in line with service standards.

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