This paper deals with issues involved in providing capital to a sector for projects that are characterised by:

(a) high up-front capital outlay;
(b) high degree of asset specificity;
(c) high foreign input in the provision of the operational assets; and
(c) risky revenue stream in local currency stretching years into the future.

Caribbean Utilities have traditionally accessed funds to finance capital expenditure from:

a. Internally generated funds
b. Government subventions
c. Bilateral funding grants and concessionary loans, Canadian Development Agency (CIDA), DIFID, various funding agencies of the French Government

d. Multilateral financial institutions - CDB, World Bank and IDB.

These sources of financing have in recent times performed poorly. Clearly if there is to be a quantum leap in the funding of water supply and sewerage projects, ‘other providers’ of financing (OPFs) must be tapped, such as:

(a) Commercial banks;
(b) Direct investment (foreign and/or local); and
(c) Portfolio investments (bonds and securities).

In assessing whether a project should be pursued, providers of finance usually perform an assessment of *inter alia* the financial viability of the project sponsor and the technical, environmental, economic and financial viability of the project itself. The methods used in assessing the financial viability of a water utility are well known and will not be dealt with in this paper. However, in particular where 'project financing' is being contemplated, an important element of project analysis is the identification, mitigation and allocation of risks associated with the project and an assessment of the true cost of capital therefrom.
The cost of capital has two dimensions, firstly there is the utility's overall cost of capital and secondly there is the cost of capital for a specific project. The former is used in performance evaluation techniques, and the latter is used in capital budgeting applications for individual projects. This paper is concerned with the cost of capital for a project which is generally determined by first starting with the utility's overall cost of equity capital and then tailoring the debt to reflect the project's relative riskiness to those providing the debt capital, therefore reflecting the opportunity cost of capital in the market.

The greater the cost of capital for projects undertaken by the utility, the greater the need for direct or indirect subsidies by Government and/or higher tariffs for consumers. The cost of capital is typically used as the benchmark to assess the financial viability of a project and is the discount rate that should be used in the financial benefit-cost analysis.

For the debt part of the cost of capital, generally the greater the risks assumed by the provider, the greater the reward required and by extension the cost of capital. For water and sewerage projects categories of risks to be assessed include:

(a) Political and country
(b) Economic
(c) Commercial
(d) Construction
(e) Project Performance.

The paper goes on to classify the providers of capital in accordance with their acceptance of risk and the consequential cost of capital.