Financing and Equity

Private Finance and Equitable Delivery of WASH services

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4TH MEETING OF THE EXPERT GROUP ON EQUITABLE ACCESS TO WATER AND SANITATION UNDER THE PROTOCOL ON WATER AND HEALTH , 12st September 2017

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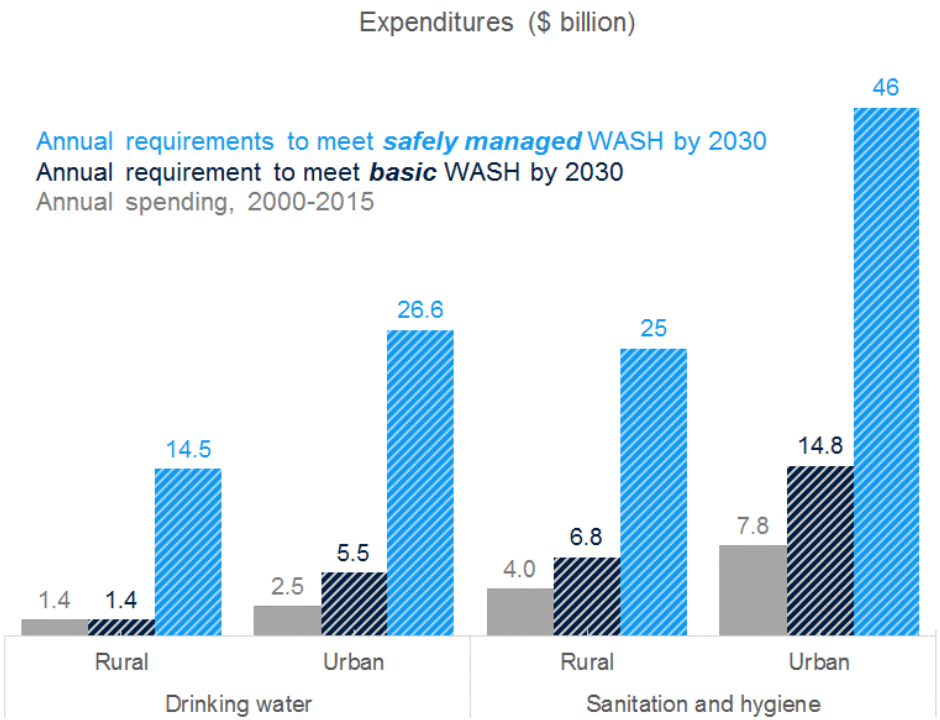
Reaching universal access will require massive increase in investments vs MDG period

Approximately $16 billion were invested per year to expand access between 2000-2015

Total capital investment to deliver universal access to safely managed WASH: around $114 billion per year

Sanitation accounts for 60% of estimated costs, including 40% for urban sanitation alone



Source: Hutton and Varughese. 2016. The Costs of Meeting the 2030 Sustainable Development Goal Targets on Drinking Water, Sanitation, and Hygiene. Washington, DC. World Bank.

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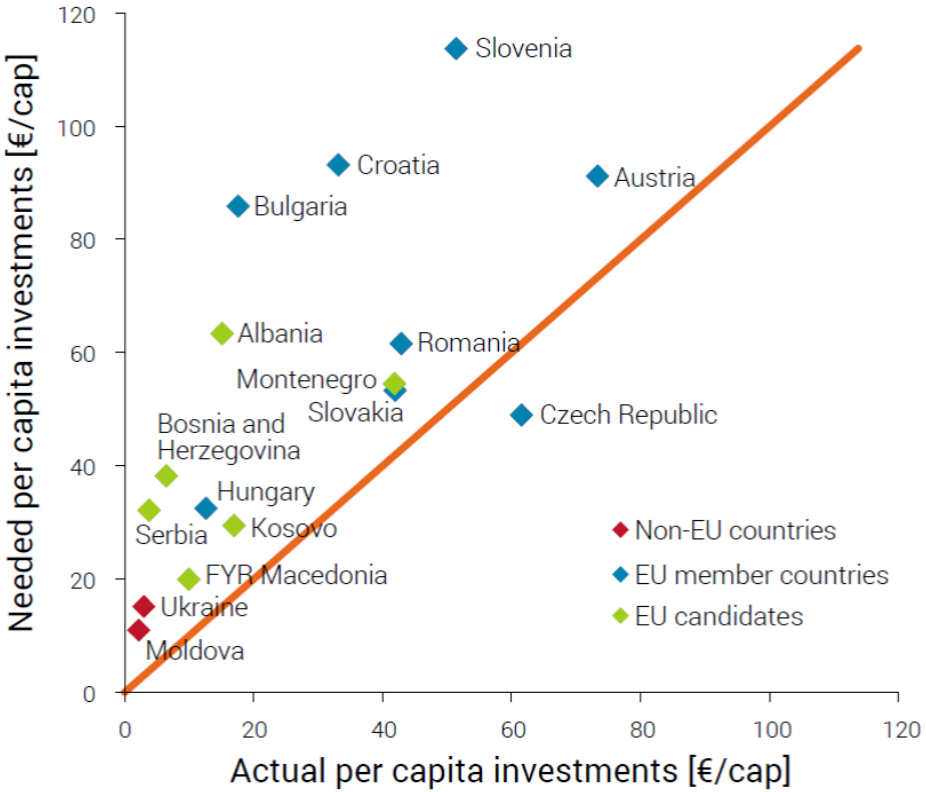
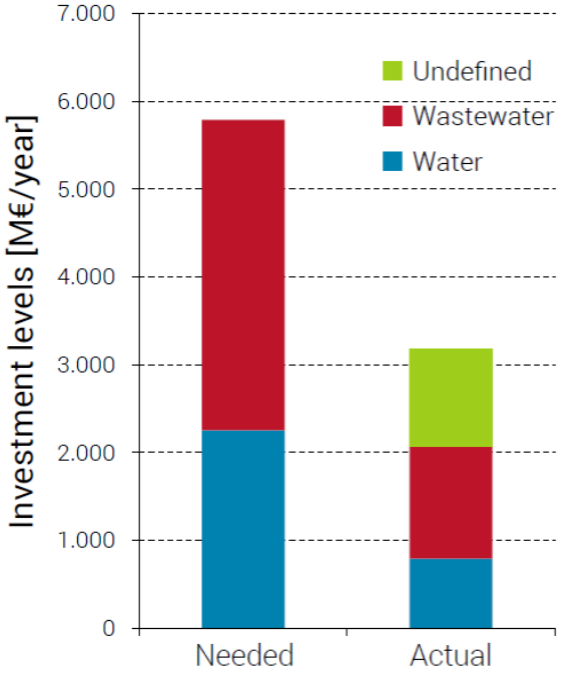
Closer look at investments needed in the region

Most countries in the region will need to invest beyond current levels to meet EU or national targets, even higher will be needed to meet SDGs

FIGURE 52: ACTUAL COMPARED TO NEEDED PER CAPITA INVESTMENT COSTS IN COUNTRIES OF THE REGION





Source: WB and IAWD, State of the Sector report (2015)

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Limited Sources of Funding and Financing

Funding sources ("3Ts")

Tariffs
User fees for services provided and households' investment for self-supply

Transfers
Transfers from external sources, such as international donors (ODA grants), foundations, NGOs, remittances

Taxes
Domestic taxes levied by local and central governments and provided as grants or subsidies

Pre-finance ←

→ **Repay**

Repayable financing

Concessional finance
Provided by development agencies with a grant element (e.g. "soft loans")

Private finance
Provided by private sector financiers at market rate (vendor finance, microfinance, loans, bonds, equity)

Key

- Private funds
- Mixed public and private funds
- Public funds

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Direct user payments should be the predominant funding source for the sector

Tariffs
User charges
Household contributions / investments in self-provision

PRIMARY CHALLENGE
ensure "willingness to charge"

Tariffs are the most sustainable source of funding over time

More sustainable sector financing

Boost creditworthiness

Incentives to improve service delivery

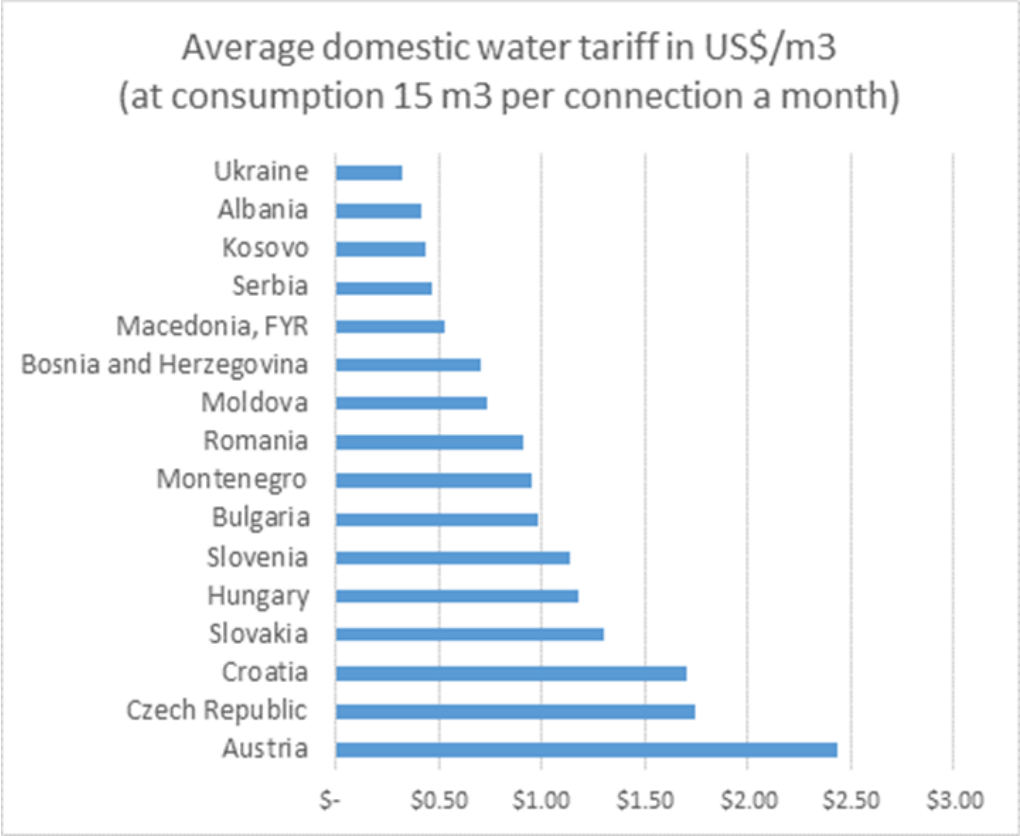
Greater consumer satisfaction leads to

Improved revenues

Tariffs should be set to balance affordability, efficiency and cost recovery

Targeted connection charge subsidies

Social consumption tariffs



What does not come from tariffs must come from taxes

Public funding for WASH sector is needed in all countries

- For **strong water sector governance**: policy, planning and budgeting, monitoring
- To **invest in services with strong externalities** to ensure that all society benefits
- To **extend services to those who need it most**, on equity grounds

Effectiveness of public taxes needs to be improved

- **Assign taxes to public investments with greater benefit/cost ratio** and greater number of people served (e.g. safe fecal sludge management vs. sewerage) across sub-sectors
- **Subsidies should be predictable, transparent and well-targeted**
- **Performance-based tax transfers**

All countries, regardless of their state of development, need repayable financing

Water service provider's finances

Costs	Funding	REPAYABLE FINANCING
Capital maintenance	Financing gap	Concessional finance
Financial costs		Commercial finance
Operation and maintenance	Transfers	
Investment costs	Taxes	
	Tariffs	

Funding

PUBLIC

PRIVATE

Traditionally, bulk of repayable finance for water came from concessional finance, i.e. from development finance institutions with a grant element

To meet the SDGs, commercial finance needs to be leveraged with a particular focus on *domestic commercial finance*

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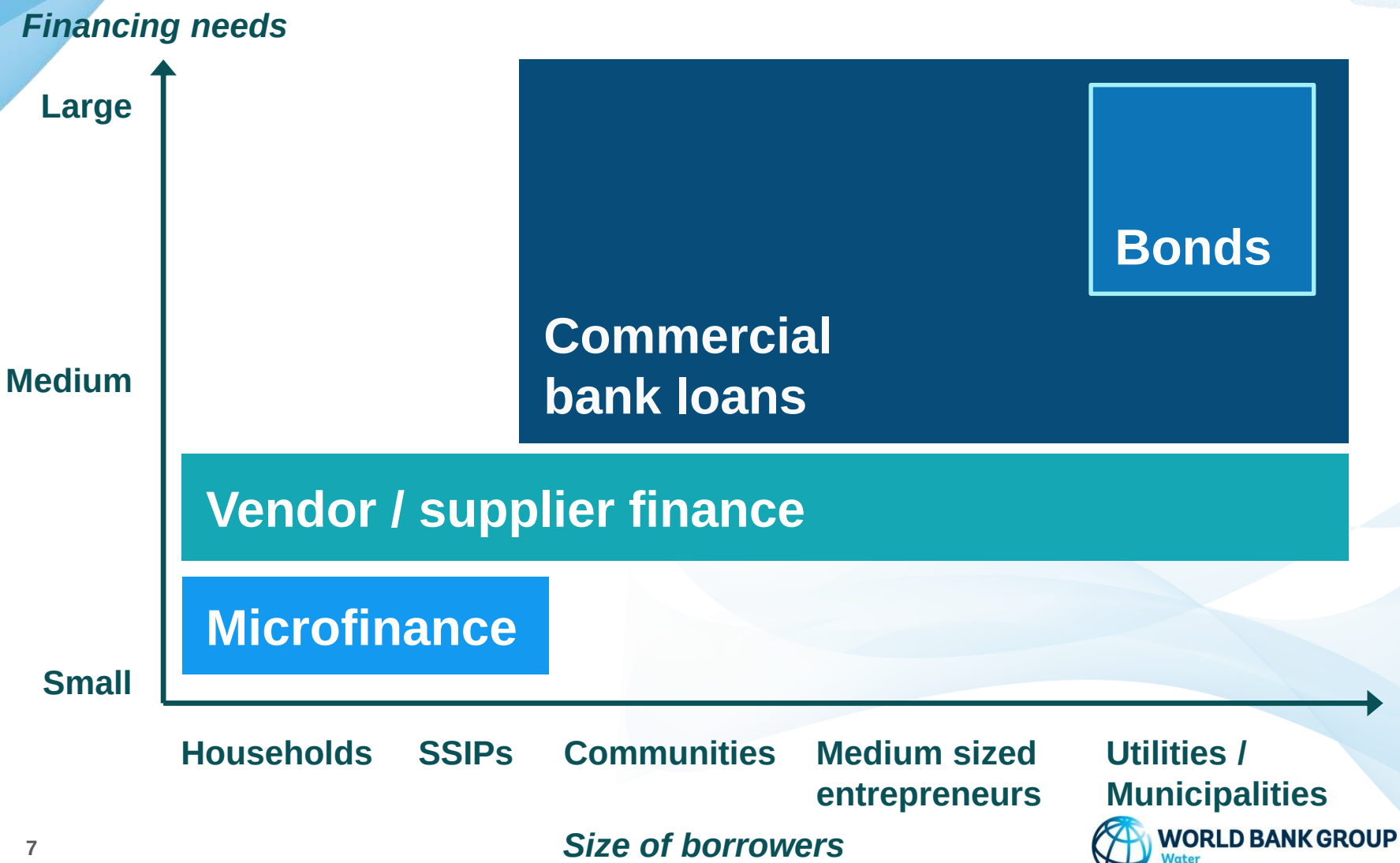
Options for commercial finance



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Public sector benefits are significant

Countries can benefit immediately from greater commercial finance for the water sector

BENEFITS OF COMMERCIAL FINANCE

- Reduce public debt burden and Foreign Exchange risk exposure
- Credit-worthy providers are more efficient
- Allows reallocating taxes / transfers and concessional finance to other sectors in need of public funding (eg. rural water and sanitation)
- Water providers may pay corporate taxes and dividends

RISKS OF COMMERCIAL FINANCE

- Uncreditworthy service providers are not able to access it
- Over-borrowing by weak service providers could lead to failure
- Higher borrowing costs could result in higher tariffs

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Service providers can reap long-term benefits

Service providers can reap long-term benefits from accessing commercial finance

BENEFITS OF COMMERCIAL FINANCE

- Additional resources in domestic currency
- Easier and quicker to access
- Increased skills and capacity
- External oversight and accountability: greater transparency and reduces risk

RISKS OF COMMERCIAL FINANCE

- Water sector professionals not familiar with commercial financing approaches and vice versa
- Shorter tenors and higher interest rates

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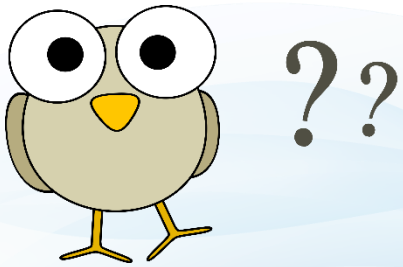
Commercial finance and equity: do they clash?

Commercial finance costs more

Most water service providers are not credit-worthy

Commercial finance will necessarily lead to higher tariffs



What can be done to address those perceived constraints?

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Commercial finance costs more?

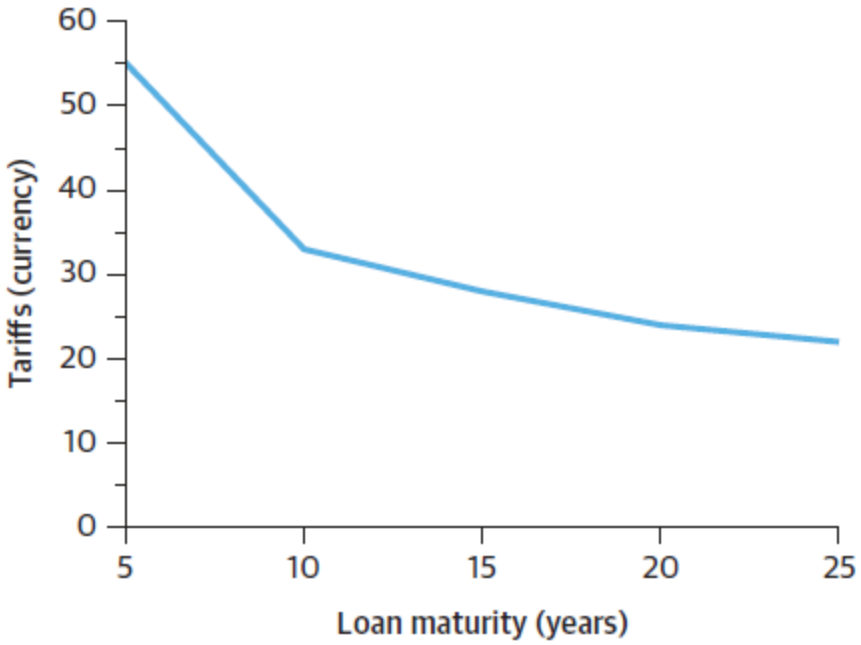
While, at face value, commercial finance seems to have higher financial costs than concessional finance, that is not always the case. If all implicit costs are quantified, commercial finance can sometimes be less expensive in the long run than concessional finance.

Key considerations are:

- **The repayment terms, which affect affordability**: Commercial loans, generate larger annual payments but could cost less overall if the impact of creeping currency devaluation, inflation and potential delays in arranging concessional financing, are factored in.
- The **implicit costs associated with borrowing in Foreign currency**: If a local currency devaluation occurs, the repayment in foreign currency becomes costlier. This was a major lesson learned from the 1997 East Asia financial crisis.
- The implicit costs associated with **waiting for concessional finance**

Commercial finance will necessarily lead to higher tariffs?

FIGURE B.1. Effect of Loan Maturities on Tariffs



Source: Compiled from Baietti and Raymond 2005.

The pressure on tariffs also depends on the type of investments that are being financed.

Major investments can include both those with longer payback periods, such as expansion of the network and development of a new water source → maybe better served by concessional financing

Quick-paying investments (NRW reduction, leak detection, improvements to billing and collection, energy efficiency improvements) could effectively support commercial borrowing with shorter maturities without necessarily affecting tariffs.

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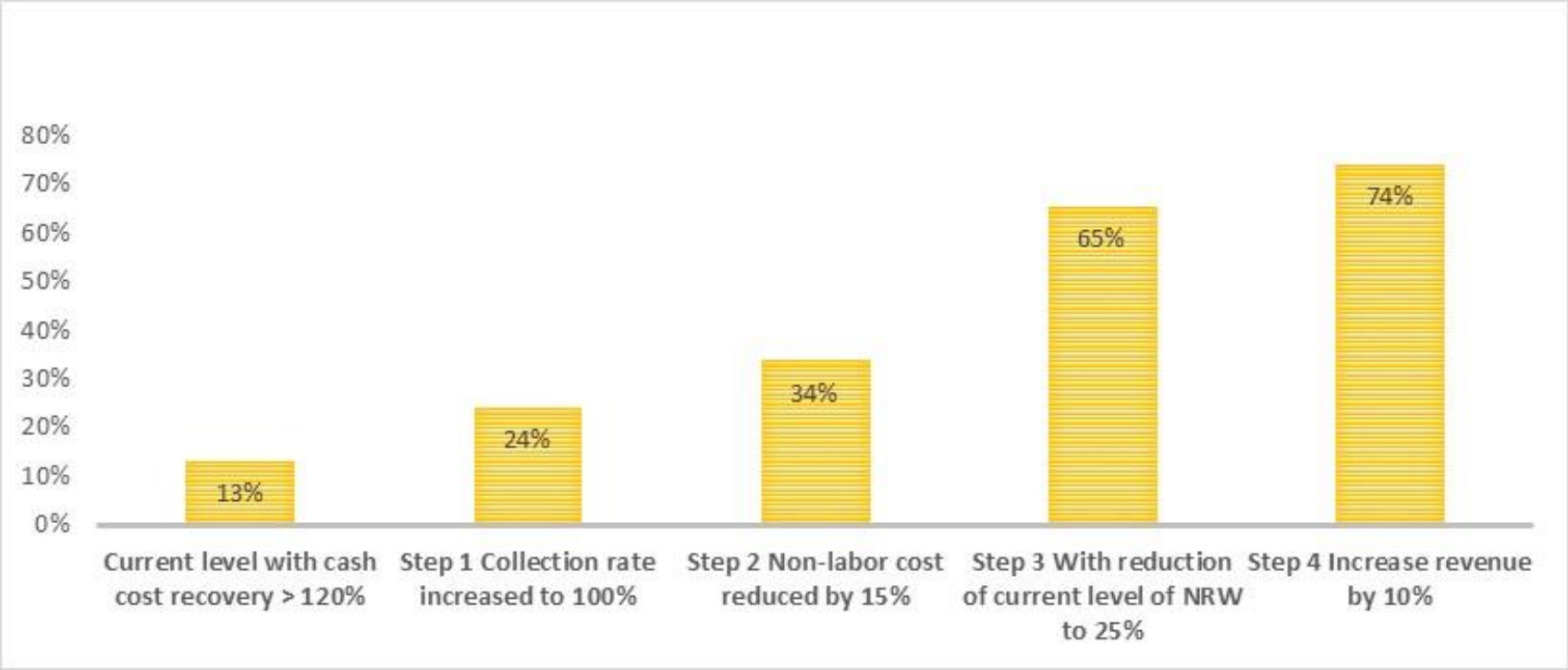
Most water service providers are not credit-worthy

Information on 278 utilities in Danube region (IBNET)

- 13% are currently “financially viable”
- 74% could be viable with efficiency gains, particularly reduction in NRW



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Potential solutions to address constraints

At country level

- Sector reforms: corporatization, strengthen sector governance, adoption of pro-poor sector strategies, incentivize operational and commercial efficiency
- Adopt an incremental and targeted approach to increasing the role of commercial finance, for different types of investments
- Identify sub-sectors and service providers (within these sub-sectors) for which commercial finance can be leveraged
- Engage with financial sector to increase interest in the water sector

From a global/ donor perspective

- Reallocate international transfers: use concessional finance to leverage commercial finance where possible via blending
- Reallocate concessional finance to countries / sub-sectors where commercial finance cannot be mobilized immediately or not in sufficient amounts
- “Sing from the same hymn sheet”: avoid that efforts to move towards private finance are undermined by ‘easy’, free grant funding

Blending strategies help ensure equity

BLENDING: smart public finance to leverage private finance

Grants / subsidies

Results-based subsidies,
e.g. to support access extension

Capacity-building and training
e.g. training of borrowers and lenders

Technical assistance
e.g. sensitize banks to market opportunities, assess water investment projects, project preparation, shadow credit ratings

Support water sector pooling / grouping to access larger commercial finance providers

Concessional loans / public finance

Provide liquidity to commercial finance providers

Blend concessional with commercial finance to soften lending terms

"First loss" agreements

"Patient capital": equity participations at below market-rate return expectations can signal commitment

Credit enhancements

Guarantees: reduce risk perception, leading to lower interest rates and longer tenors

Revenue intercepts, escrow accounts: to secure access to funds and reduce risk of non-payment

Take Away Messages

- **Spending requirements to reach universal access are substantially higher than what was invested in the MDG era**
- **Leveraging commercial finance is necessary:** SDG 6 will not be met without additional resources, including commercial finance
- Commercial finance brings requirements for **greater investment discipline and transparency, which in turn supports improved efficiency in the sector,** an objective for most water sector reform efforts around the world.
- Private sector financing for creditworthy or close to creditworthy investments would **allow reallocating public funds to other areas where public subsidies are likely to be needed.**

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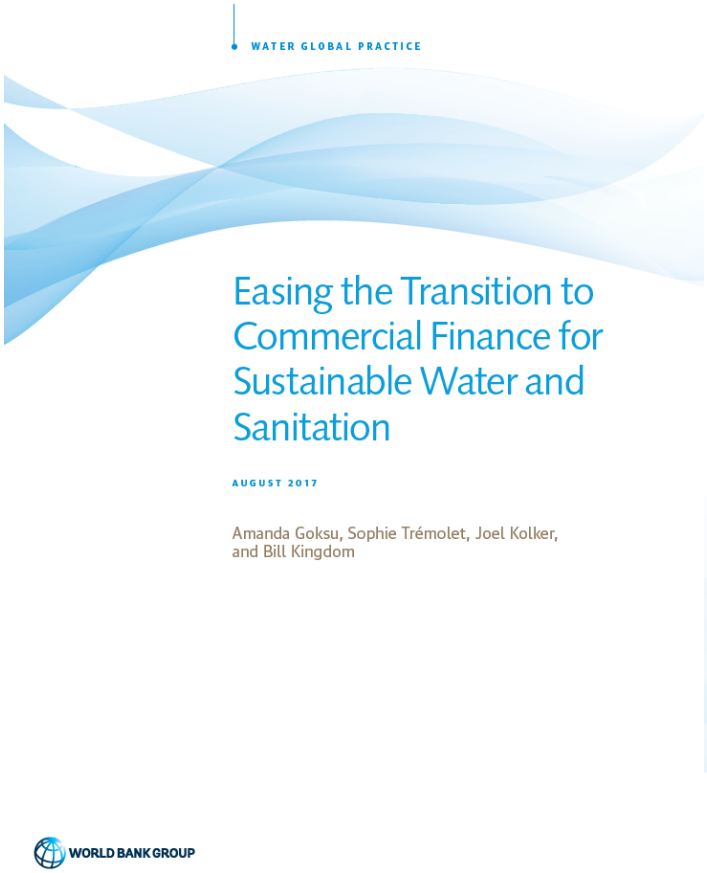
Take Away Messages

- Commercial financing can change sector dynamics by introducing **increased accountability towards lenders, which in turn can act as a stabilizing force for the sector.**
- **It will be necessary to identify which commercial finance solutions across a continuum are the most suitable**
- **Service providers and users will need to become credit-worthy to access commercial finance**
- **An incremental approach is recommended to ensure equity**: in the most nascent capital markets, donor\public resources will be needed to start leveraging commercial finance

For more information

https://openknowledge.worldbank.org/handle/10986/27948


WATER GLOBAL PRACTICE

Easing the Transition to Commercial Finance for Sustainable Water and Sanitation

AUGUST 2017

Amanda Goksu, Sophie Trémolet, Joel Kolker, and Bill Kingdom

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LEARN from other practitioners in the sector

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BENEFIT from regional and global experiences from other utilities

Program description and covered topics

Water supply and sanitation utilities often identify medium-size investments (metering, energy

Technical Partner

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