Private finance and Equitable delivery of WASH services

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Ministry of Foreign Affairs of the Netherlands

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Session Plan

Time chart	Topic	Speaker/ Table leads
+ 5’	Welcome to the session (5 min)	Maria-Angelica Sotomayor, Program Manager, World Bank
+ 20’	Introductory presentation (15 min): Leveraging commercial finance whilst preserving affordability	Sophie Trémolet, Senior Economist, World Bank
+ 70’	Table discussions (50 minutes: 2 x 25 minutes)	Table leads from OECD, DGIS, World Bank, IRC
+ 90’	Group feedback and concluding remarks (20 minutes)	Facilitated by Patrick Moriarty, CEO, IRC

Financing and Equity

Private Finance and Equitable Delivery of WASH services

Sophie Trémolet, Senior Economist, Water Global Practice
Stockholm World Water Week, 31st August 2017

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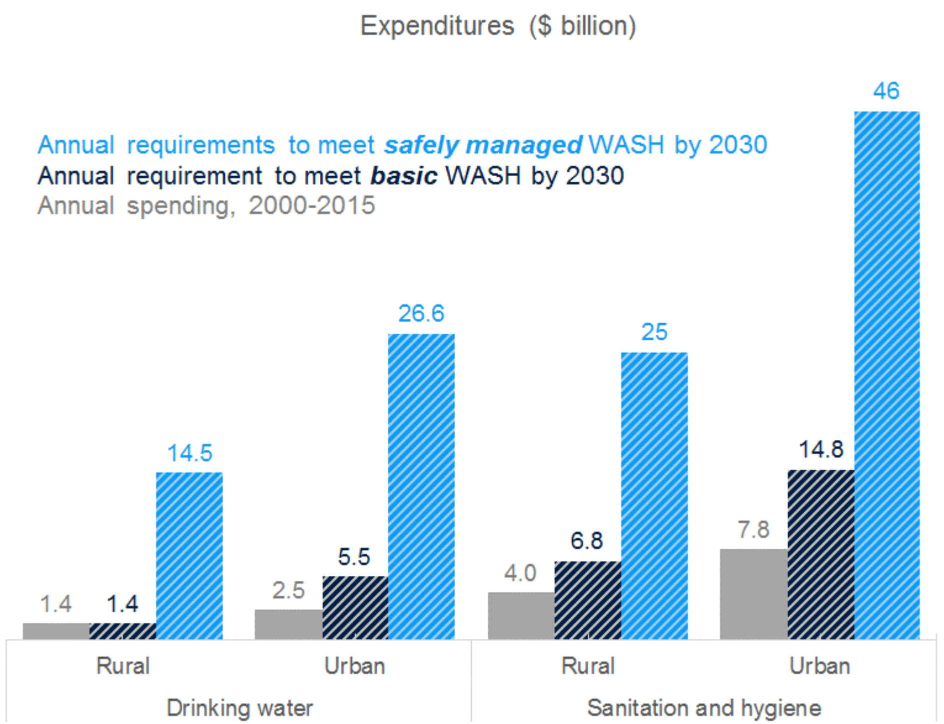
Reaching universal access will require massive increase in investments vs MDG period

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

Water service provider's finances

Costs

Capital maintenance

Financial costs

Operation and maintenance

Investment costs

Funding

Financing gap

Transfers

Taxes

Tariffs

REPAYABLE FINANCING

Concessional finance

Commercial finance

Funding

PUBLIC

PRIVATE

Vast majority of repayable finance comes from concessional finance
= 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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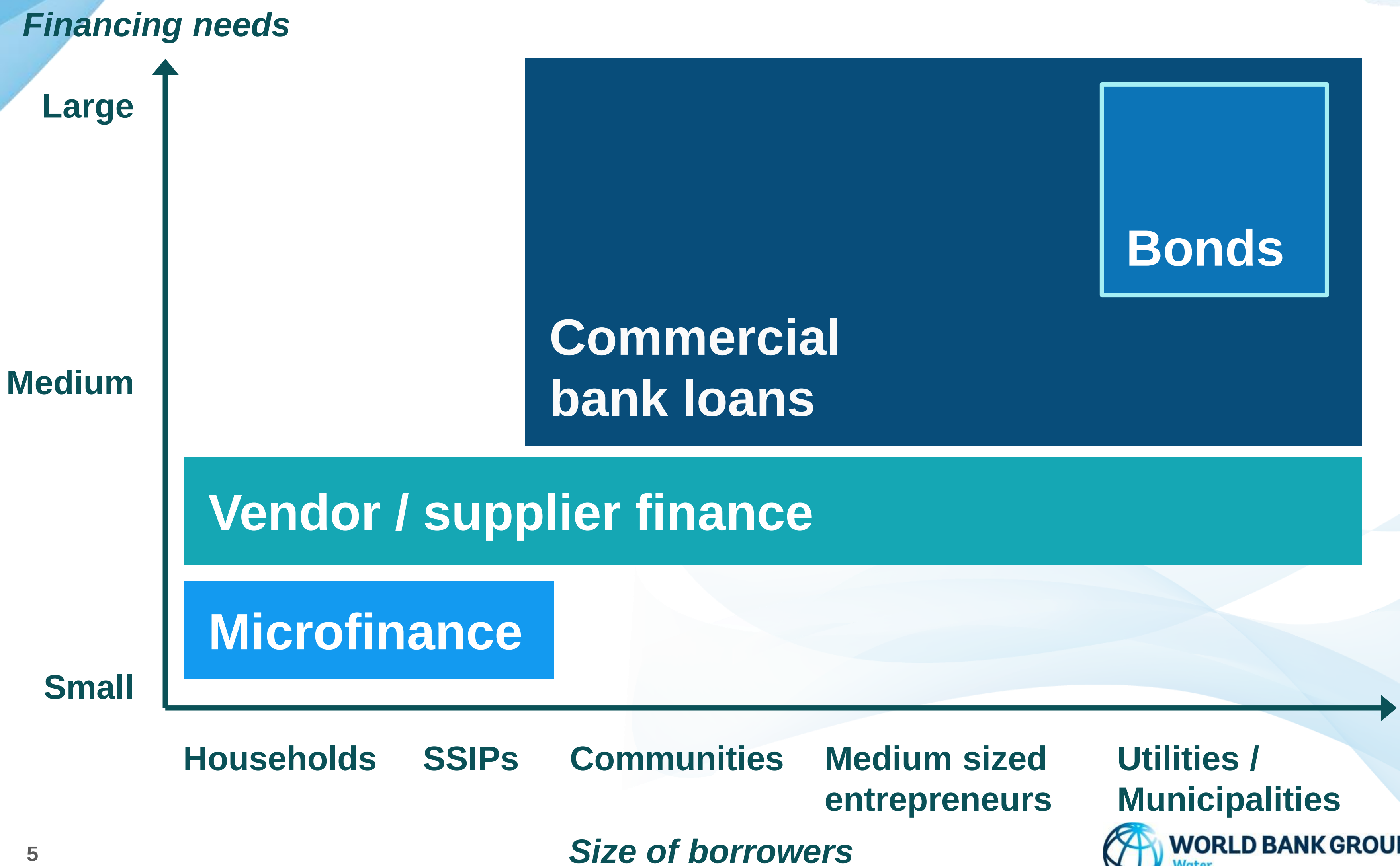
Options for commercial finance

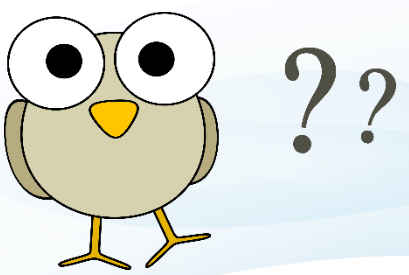


Commercial finance and equity: do they clash?

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?

Public sector benefits are significant

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

BENEFITS FOR SOCIETY

- Reduce public debt burden and FX exposure
- Credit-worthy providers are more efficient
- Allows reallocating taxes / transfers and concessional finance to other sectors in need of public funding
- Water providers may pay corporate taxes and dividends

DISADVANTAGES FOR SOCIETY

- 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

Service providers can reap long-term benefits

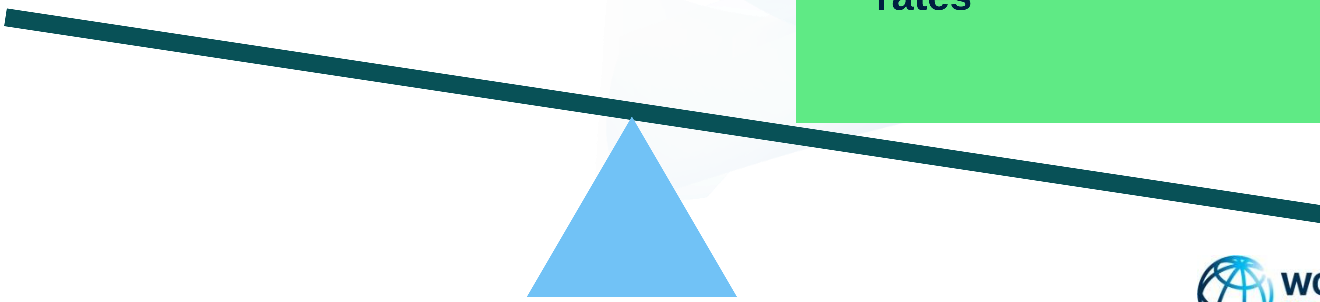
Service providers can reap long-term benefits from accessing commercial finance

BENEFITS FOR SERVICE PROVIDERS

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

RISKS FOR SERVICE PROVIDERS

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



Potential solutions to address constraints

At country level

- Sector reforms: corporatization, strengthened sector governance, adoption of pro-poor sector strategies
- 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

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Blending strategies help ensure equity

BLENDING: smart public finance to leverage private finance

Grants / subsidies	Concessional loans / public finance	Credit enhancements
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	**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**	**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

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COMBINING COMMERCIAL FINANCE AND EQUITY

FINDING SPECIFIC SOLUTIONS

Questions for Table Discussions

Microfinance

Key question #1: How can microfinance be used to expand access to sanitation in high-interest rates environments in an equitable manner?

Potential solutions

- Provide up-front capital subsidies to lower the total cost of borrowing, rather than subsidize interest rates
- Provide guarantees to domestic commercial banks to increase their interest in this market segment
- Collaborate with national government to link access to sanitation with national objectives

Table 1 – Lesley Pories, water.org

Commercial loans

Key question #2: How can utilities be encouraged to borrow at higher commercial rates whilst maintaining tariffs at affordable levels?

Potential solutions

- Compare long-term costs: lower currency risk, lower transaction costs, avoided cost of delays
- Bring Ministry of Finance in the loop to highlight long-term benefits from country's perspective and drive increased access to commercial finance
- Start with small amounts of commercial finance as part of a concessional loan package; potentially for ring-fenced project with clear revenue streams

Table 2 – Sophie Trémolet, World Bank

Commercial loans

Key question #3: From a sector perspective, how can a transition towards more commercial financing be organized?

Potential solutions

- Define and consistently implement sector financing policies
- Focus on improving service providers' efficiency and performance
- Support overall sector reform for corporatization, stronger governance and transparency
- Segment the market: wean better performing utilities off concessional finance first (although that may result in higher borrowing costs for these utilities)
- Build the capacity of weaker utilities to improve their credit-worthiness

Table 3 – Maria Angelica Sotomayor, World Bank

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Concessional loans and blending

Key question #4: How can donors focus on “de-risking” commercial investments rather than finance entire investments with concessional finance – whilst still focusing on extending access for poor?

Potential solutions

- Support the establishment of blended finance structures (e.g. Water Financing Facility)
- Overcome internal dynamics in order to provide de-risking instruments (e.g. a guarantee) instead of a straight loan
- Build partnerships with NGOs / TA providers that can support borrowers

Table 4 – Patrick Moriarty (IRC) and Pim Vander Male (DGIS)

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The role of innovation

Key question #5: How can innovation (in service delivery, business models or contractual arrangements) mobilize additional finance and minimize the costs of access to water services?

Potential solutions

- Value-capture mechanisms to finance new investment to extend coverage of water supply and sanitation services
- Technological solutions, such as smart pre-paid water meters, to improve collection ratios, improve utilities’ cash flow and lower OPEX
- Water-Energy Purchase Agreements to provide wastewater treatment as a service, reducing upfront CAPEX requirements

Table 5 – Kathleen Dominique (OECD)

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Please choose your tables for 2 x 25 minutes rotations

Thank you!

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
- **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

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