



SHORT
ANALYTICAL PAPER



FUNDING OF THE WATER SECTOR

BY PUBLIC DEVELOPMENT BANKS

LEARNING FROM EXPERIENCE

ESMD OCTOBER 2022



Disclaimer

By accessing the information presented in this report, the reader releases the IDBZ to the full extent permitted by law from all claims relating to the usage of material or information made available in this report. In no event shall the IDBZ be liable for any incidental or consequential damages resulting from the use of this report. While IDBZ has made every effort to ensure that the information contained in this report has been obtained from reliable sources, the authors remain responsible for any errors or omissions.

The information contained in this report is general in nature and should not be legal, tax, accounting, consulting or any other professional advice.

©2020 Infrastructure Development Bank of Zimbabwe. IDBZ™ IDBZ is a registered trademark of the Infrastructure Development Bank of Zimbabwe. All rights reserved.

1. Introduction

Water and Sanitation struggle to get funding in the developing world due to limited fiscal space. In general governments spend between 1% and 3% towards water and sanitation (Fonseca, Mansour , Smits, & Rodriguez, 2021) . About US\$ 27-30 billion is spent annually on water and sanitation sector in developing countries. It is estimated that 70% is from domestic public sector; 20% international aid flow; and 10% from international private sector and community/ household investment (Fonseca, Mansour , Smits, & Rodriguez, 2021). Given the constrained fiscal space and limited international aid flow in Zimbabwe, investment in water and sanitation sector has been paltry over the years. It therefore calls for innovative interventions in the sector to cover the funding gap. Historically, national public development banks have played a significant role in the water sector in high income countries such as France, Italy and the Netherlands. In many emerging and developing economies public development banks involvement in the water sector has not yet reached full potential. Like manner, the Bank has had limited interventions in the water and sanitation sectors over the years. However, there exist potential for the Bank to raise finance for achieving both the SDG 6 and the water related Paris Agreement Goals.

2. Development Finance Institutions Involvement in the Water Sector

National public development Banks involvement in the water sector includes:

- 1. Providing credit for infrastructure investments in different forms:** 1) balance sheet credit; 2) credit to local governments and utilities for specific investments; 3) project finance, usually directed to private sector entities, which may set up dedicated Special Purpose Vehicles (SPVs). The Bank over the years have tried the first two, however, most local authorities or utilities charged with the responsibility to manage water sources have weak balance sheet, are highly geared, struggling with debts and have a very weak record of revenue collection. Utilising these instruments would require that utilities are reformed to improve on revenue collection. Additionally, there is need to improve

their credit worthiness. There are limitations on the extent to which local governments can take on debt or spend more in the sector (fiscal space). Even though, these instruments remain important for the future. Project finance has been popular with the Bank. Its beauty is in sharing risks among partners. However, the instrument has not been effective in the water sector because of unviable pricing models in the sector. The situation is exacerbated by lack of borrowing powers by many local authorities. There are also statutes that guide utilisation of revenues collected by local authorities which at times make structuring of water projects more complicated. The Bank's approach in the water and sanitation sector should entail proposals for regulatory and institutional reforms to attract private sector capital in water development. The Bank should bring all stakeholders together and agree on the steps that need to be taken for private sector to finance water and sanitation sector. Government should be prepared to de-risk investments in the water sector and offer viability gap funding.

2. **Structuring project finance** – including co-financing mechanisms and private-public partnership (PPPs) for the operation of water and sanitation services. Whereas the previous point referred to providing the credit, there is often technical assistance involved in structuring the financing and co-financing of the more complex investments.
3. **Project preparation, either grant-funded**, or through loans that are repayable if the project preparation leads to a bankable project. The extent to which PDBs offer this service depends very much on the extent to which they have non-repayable funds available for this. The Bank can provide technical assistance to local authorities and utilities in project preparation and fundraising. As the country pursues re-engagement bilateral and multilateral institutions may become amenable to providing development assistance to Zimbabwe. Some of the targeted projects will be in water and sanitation. In anticipation, the Bank can work in partnership with local authorities to develop a pipeline of projects and recommend appropriate type of funding for each project. This pipeline can be also very useful even for input into the National Budget.
4. **Technical assistance (capacity strengthening) to utilities and local governments**, oriented at their technical and financial performance improvement. This is done with the dual aim of making the utilities and local government more creditworthy, and of strengthening the sustainability of the investments. Whereas this service is considered very important, not all PDBs have the ability to provide it, as this is usually funded through non-repayable finance. The Bank should continue with its capacity building programme targeting local authorities training project preparation and packaging. Also, the Bank can mobilise for technical assistance from development partners like World Bank, African Development Banks etc in identified areas of need. One area which that require focus is financial management. Local authorities should be capacitated to produce Financial Statements in time. There is also need for technical support in tendering, contracting, procurement, supervision of works for many local authorities in Zimbabwe.

5. **Influencing sector reforms and sector dialogue for improving regulatory frameworks and funding related studies.** Only a few PDBs were involved in national level reforms. The Bank should be an advocate for appropriate reforms to attract private sector capital in the water and sanitation sector. The Bank can also fund related studies as part of its contribution to knowledge generation and sharing.
6. **Channelling central government transfers to local governments and utilities** (from taxes or sovereign loans). Only a few PDBs mentioned this role. The Bank used to perform this role very well but there has been changes to the interpretation of the regulations that guide use and disbursement of public funds. The Bank should discuss with relevant ministry with a solid value proposition so that it can continue with this role.
7. **Administering dedicated trust funds for the water sector.** In some cases, these are trust funds set up at the request of national government or external financiers. The PDBs may or may not replenish these funds out of their own profits. This was mentioned by only two PDBs. The Bank should explore how it can get involved in such funds like the ZIMREF (Zimbabwe Reconstruction Fund). The fund made some significant investments in the water sector.
8. **Finance climate change adaptation investments**, with financing sourced from climate funds as a few PDBs are accredited to manage such funds. The Bank's accreditation to the green climate fund offers an opportunity to finance water sanitation projects that meet the investment criteria. Examples include solar powered water and sewer treatment plants. Adaption elements could be included like exploring alternative water sources in light of climate change or adapting the existing water plants to receding dam levels and water table levels.

It has been established that it takes time for projects to originate and source finance. The combination of limited skills, knowledge, data and studies in the sector and the limited capacity of utilities/municipalities to formulate projects, means that it can take 3-5 years for projects to originate and source financing. In order to address this constraint, several PDBs have dedicated financing to project preparation. While, the Bank has also established the PPDF facility it is constrained to cover the needs in the sector. The Bank should continue to pursue technical partnerships in project preparation as a way of augmenting available limited PPDF funding.

3. Conclusion

The Bank should come with a strategic decision on what options to pursue in the water and sanitation sector given macroeconomic imperatives. The Bank can pursue managing project implementation and disbursements in the water and sanitation sector by donors and Government. There are opportunities for blended finance presented by this role. In anticipation of resumption of development assistance during the Long-Term Strategy period, the Bank needs to scale up project preparation activities and mobilise preparation funding through GCF. When coming up with the GCF pipeline there is need to

consider water and sanitation projects as they require grant funding and project preparation. The Bank needs to build a strong track record in the sector going forward.

References

1. Fonseca, C., Mansour, G., Smits, S., & Rodriguez, M. (2021). The role of national public banks in financing the water and sanitation SDG 6 and the water related goals of the Paris Agreement and Biodiversity Protection. *Global Summit of All Development Banks*.