

Summary note: Mobilising Finance for Cities' Water Infrastructure

On 4 April 2019, DFID hosted a session coordinated by Infrastructure and Cities for Economic Development (ICED) to explore mechanisms for mobilising finance for investment in urban water infrastructure. During the session, more than 15 leading development practitioners and financiers shared their viewpoints on how to achieve the goal of mobilising more than \$6.7 trillion – the estimated amount required for universal access across the water sector by 2030.

Background

Stakeholders, including those from the financial sector, have regularly expressed interest in finding ways to invest in the water sector despite a range of challenges. In 2015, cities, companies and water utilities collectively invested \$657 million in watershed restoration and protection, which makes up only a small portion of the overall water cycle¹. Cities themselves are cognisant that they are vulnerable to water scarcity; a study commissioned by the Western Cape Province following its 2016-18 drought showed that, with no action, the province would suffer a 17% drop in GDP, and the city of Cape Town itself an 11% drop².

Key themes

Participants acknowledged core themes around the need for a supply chain approach to water, considering all stakeholders, from those responsible for upstream water management through the mid-stream users (agricultural and industrial) down to the utilities and the households themselves. Encouraging water-intensive agricultural and industrial users (who make up an average of 70% of global water use) to have higher accountability and responsibility for their water usage may be more effective than exclusively focusing on residential consumers. Participants had divergent views on how to facilitate flows of capital and discussed the apparent disconnect between:

- The motivations of profit-seeking financial institutions and the public interests of government, whether local or national;
- The time horizon expectations of financiers, who are often driven by the short-term transactions and payback periods of projects. By contrast, governments typically focus on long-term institutional reform – a complex goal that is often best approached indirectly.

Three key points were identified in the course of discussion.

First, the public sector, broadly defined to include development finance institutions (DFIs), can sometimes 'crowd out' rather than 'crowd in' private sector investors. As DFIs offer financing at concessionary rates with accompanying TA, it is difficult for the private sector to be competitive with their market rate offerings.

Second, a lack of bankable projects is often highlighted by financial institutions as one of the main barriers. Yet the challenge is in fact a combination of a lack of bankable projects *and* creditworthy institutions. The latter refers to good corporate governance, strong financial management, and a sense of how the overall entity thesis is financially sustainable. Financiers, who often look at infrastructure investment opportunities without a holistic background in the sector, may ultimately choose to reject considerations of the sector if entities and projects do not conform to traditional expectations of bankability.

Third, capacity-building, and subsequent demonstrations of creditworthiness, of an entity is a precursor for bankable transactions, regardless of the type of instrument or mechanism used to finance a specific project. Building utilities' financial management capacity can be a time-consuming

¹ Browder, G. et al. (2019) Integrating Green and Gray: Creating Next Generation Infrastructure. WB and WRI.

² Water Resilient Cities Conference, July 2018, Durban, South Africa. Presented by Helen Davies, Chief Director: Green Economy, Western Cape Department of Economic Development and Tourism.

process; one participant shared that the turn-around time for utilities in eastern Europe ran over three years before bankability, from a concessionary financier, was possible. In the water sector, a good proxy for utility management is management of water as a resource and a low level of non-revenue water can be seen as a good signal of institutional creditworthiness.

Key opportunities

Participants discussed specific projects, tools and mechanisms that have delivered water to urban dwellers from across the value chain, although many of these are not financially-sustainable.

- The **Nature Conservancy's Water Funds** or the interventions sponsored by **C40's Cities Finance Facility** among others, focus on upstream water resource management are highly dependent on government transfers, charitable foundations, and corporate social responsibility (CSR), all of which are unpredictable and not financially sustainable in their current applications.
- The **Kenya Pooled Water Fund** has sought to structure pass-through mechanisms to finance water infrastructure in urban settings through capital-market issuances to allow for participation from institutional investors. Despite the merit of the idea as a way to expand the sources of finance available to utilities (beyond international financial institutions and commercial banks) it has not been successful.
- **Public-private partnerships across sub-Saharan Africa** have experienced mixed success. While the legal agreements are valid and water service is occurring with better results than it would have in a purely public setting, local governments and utilities rarely have the technical and legal expertise to negotiate effectively with the private sector.

Options for DFID

DFID has an opportunity to play an important role in helping to unlock financial flows to cities for urban infrastructure. To this end specific areas and opportunities for DFID programming include:

- **Articulating the relationship between urban productivity and water security by working with partner governments in Africa** to highlight the financial implications of water shortages on the private sector. This assistance should help cities to model the impact of changes in the quantity or predictability of their water resources in terms of GDP, tax revenue, and employment as a means of using data to help drive decision making.
- **Addressing water affordability by helping local governments and utilities develop a deeper understanding of how to design, implement and communicate cost-reflective tariffs to end users.** Through this work, entities responsible for water provision can model and explain the justification for higher tariffs to consumers, matching capital improvements to increases in costs.
- **Providing long-term embedded technical assistance to municipalities/utilities that enables them to demonstrate their financial readiness/creditworthiness to potential lenders/investors.** Such support should help municipalities and utilities to reduce their levels of non-revenue water, both as a signal of strong management and as a means to diminish any waste in their usage of upstream water supply.
- **Working with CDC, the Private Infrastructure Development Group and multilateral development banks to provide transaction advisory services to project sponsors** (whether municipalities or utilities). Those services should identify the most appropriate type of instrument for raising financing and subsequently assist municipalities in the negotiation process.

Disclaimer:

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