No savior: Can blended finance work for WASH?

By Sophie Edwards

September 10, 2018

Children gather around a tap. Photo by: IWRM AIO SIDS / CC BY-NC

STOCKHOLM — With new data revealing how far off target the water and sanitation sector is in meeting the Sustainable Development Goals, advocates are grappling with the question of how to catalyze more funding.

While many say there is new momentum building around innovative financing streams, discussions at the recent Stockholm World Water Week conference made clear that more focus is needed on building up the "demand-side," rather than solely on developing what one delegate described as "sexy" financial instruments.

"What we really need to do is look at the technical and financial efficiency of the service provider as well as the policy, institutional, and regulatory arrangements," according to Joel Kolker, head of the Global Water Security & Sanitation Partnership at the World Bank.

"We have to get these foundational issues squared away before we can really start talking about how we're going to leverage in more blended and private financing," he added.

A recent United Nations report revealed that billions of people are still without sustainable water, sanitation, and hygiene services and that 80 percent of countries do not have enough financing to meet the SDG targets. In 2016, the World Bank estimated that $114 billion per year would be needed to achieve SDG 6 — universal and fully sustainable access to WASH services. In 2014, development finance for water stood at just $18 billion.

As attention moves to the potential for blended and private finance in the sector, however, others said it is critical to ensure that investment opportunities don't eclipse a focus on reaching the poor.

Blended finance in action

To date, the WASH sector has been relatively slow compared to sectors such as climate to embrace innovative financial instruments. Still, numerous conference participants said they were seeing increasing interest in using blended finance and other financial mechanisms as a way of catalyzing more funding for the sector. Some cited the number and quality of financing sessions tabled during the conference as evidence.

Conference-goers heard from Water.org, which uses philanthropic funds to enable microfinance institutions to offer small loans to households to pay for water connections and toilets. This WaterCredit program has generated an estimated $1 billion in microfinance loans to date.

In 2014, Water.org launched the impact investment fund WaterEquity to raise capital to invest in microfinance institutions offering WASH loans. Investors expect a return but at below market rates. The model has since been spun out as a separate entity and expanded to cover pro-poor WASH enterprises, such as microutilities and sanitation companies.

Last year, WaterEquity launched a $50 million successor fund, WaterCredit Investment Fund 3, to invest in WASH enterprises. The fund has already raised $33 million, including from the Overseas Private Investment Corporation, Bank of America, Osprey Foundation, Conrad N. Hilton Foundation, and Skoll Foundation.

Another example presented at the conference was the Azure model, pioneered by humanitarian group Catholic Relief Services in El Salvador. Azure seeks to catalyze private capital for small water and sanitation service providers, typically serving between 10,000 and 30,000 people, as opposed to targeting households or large urban utilities. It works by offering donor-funded technical assistance, which can include engineering support, accounting, management training, and strategy to help operators access local bank loans to grow their operations.

To date, Azure has facilitated 43 loans worth $520,000 and is now looking to expand into Honduras later this year. It has also raised an impact investing fund to enable local banks to lend more.

Back to basics

While it is positive to see examples of innovative financing working in WASH, some delegates stressed the importance of staying focused on the fundamentals: Strengthening the organizational capacity of service providers and creating the right enabling conditions for them to operate successfully. Ian Moise, a WASH expert with CRS, described these approaches as the "real engines of success."

This is why the Azure model offers grant-supported technical services to help get service providers loan-ready while working in parallel on governance, relationship building, and improving the policy and regulatory conditions, he explained.

Yet working on these aspects is time consuming and less attractive to donors. It took CRS staff in El Salvador a decade to get Azure off the ground, Moise said.

IRC WASH's head of international program, Catarina Fonseca, said donors need to allocate more time and resources to funding "the boring stuff," such as building staff capacity to read budgets and strengthening policies and regulations.

For the World Bank's Kolker, this means spending more time working with service providers "to make them more efficient, better able to utilize the limited public and concessional finance going into the sector, and ultimately to become creditworthy so that they can prudently tap domestic commercial finance."

Helping utilities get creditworthy will need funders who are willing to take risks and make bigger bets however, experts told Devex. Currently, most development finance institutions are unwilling to put money into projects worth less than $35 million, which in practice limits them to supporting large-scale urban water and sanitation projects, Fonseca said.

Furthermore, impact investors and DFIs tend to circle around the same, relatively high-performing utilities such as Nairobi City Water and Sanitation Company, which this year received loans and investments from the World Bank Group. The Kenya Pooled Water Fund, set up with Dutch aid funding and aid support from Sweden, the United Kingdom, the United States, and the World Bank, will also work with Kenya's best-performing utilities by issuing bonds.

This means the utilities with the farthest to go are still starved of capital, Fonseca said, explaining that what the sector really needs is "first movers" willing to put capital into riskier propositions in order to prove blended WASH investments can work. "Once we have a track record, I think it [blended finance in the sector] will take off, as we'll have enough examples in different contexts ... but someone has to be the first risk-taker," she said.

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Louis Boorstin, managing director of the Osprey Foundation, which supports innovative WASH ventures, agreed that funders need to take riskier bets on struggling but promising utilities to help them become creditworthy, and thus able to access finance from the capital markets.

“[Funders] need to say: Here’s a relatively small amount of money for a relatively short period of time; we want you to demonstrate that you can start raising your tariffs, start reducing your losses … start making your customers happier … then we’ll give you more money and get you out of this no-win loop and into something much more positive,” he said.

Boorstin also cautioned against seeing blended finance and other innovative mechanisms such as development impact bonds as a savior for the sector. Instead, he recommended an “all-of-the-above” strategy, including institutional strengthening, supporting innovative models including small water enterprises and container-based sanitation, taking riskier bets, and using innovative finance such as partial-risk guarantees and microfinance.

Keeping the focus on the poor

Amidst this growing momentum for blended finance, Catarina de Albuquerque, executive director of Sanitation and Water for All, called on WASH actors to retain sight of the poor.

“There are many sexy solutions that might only work for better-off countries or regions,” she said. “Let’s talk also about how [donor money] … can be blended with the private money in such a way as to make sure the poorest get access,” she added.

Nick Burn, chief of scale and strategy at NGO Water for People, agreed. Rural WASH services are the most likely to miss out since “it’s still very hard to see how you can make money from that investment,” he said.

Currently, most blended finance is being used for urban infrastructure investments, Burn said, calling on donors, especially DFIs, to make room for other investors with an appetite for blended finance and instead move their “cheap finance” into areas such as rural infrastructure.

“Instead of putting their resources into putting sewerage in Kigali, DFIs need to push their grant money into rural infrastructure … where it’s difficult to see how … people will be able to repay that finance,” he said.

“The planning for ongoing and sustained [WASH] services is a much more complex thing than has traditionally been understood,” according to Burn, who said that Water for People and IRC WASH have been developing life-cycle costing tools for WASH, with projects in Honduras, Uganda and Rwanda. The costing exercises can help governments and donors get “a much tighter handle on the overall finance required to meet the SDGs,” he said, adding that the World Bank’s “seemingly unachievable” estimate of $114 billion in annual funding required to meet SDG 6 should be re-evaluated.

“Local costing exercises are starting to provide numbers which are more manageable, and when linked to amounts that it is possible to expect users of services to pay, provides a more optimistic picture,” he said.

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