

Annex B

Finance Mechanisms

Table C.1 Financial Mechanisms

Source: User Finance				
Mechanism	Function	Demanders	Suppliers	Who benefits
Rotating savings and credit associations (ROSCAs), also known as savings pools	People without access to credit can pool funds over time; then individually gain access to those funds to support water-related (or other) needs	→Participants to the pool →Typically those without access to credit	→Participants to the pool	→Individual participants and communities in urban or rural areas →Communities (small scale), due to the impacts of investments and community improvement efforts
<i>Example?</i>				
Water and sanitation tariffs	Fees for WATSAN service; used to support functioning of service provider or utility	→Service provider (small scale or utility)	→Paying users of the service	→Urban or Rural areas →Service providers →Communities
<i>Example?</i>				
Sweat equity	Use of labour and/or materials as a means to offset minimum contribution requirements for projects	→Project funders	→Communities	→Urban or Rural areas →Poorer communities →Importantly, contributions of this type generate local knowledge, as well as sense of ownership of the assets and the success of the project.
<i>Example?</i>				
Remittances	Funds from emigrant family members or friends, sent back through either formal or informal channels. Often used for consumer goods, can be used for connections and other WATSAN related activities	→Individual family members or friends of emigrants	→Emigrants to developed country economies →Emigrants to urban areas (from rural areas) within the same country	→Individuals in low income areas →Communities, when remittances are channeled for community investments
<i>Example?</i>				

Source: Government				
Mechanism	Function	Demanders	Suppliers	Who benefits
National and municipal grants	Redistribution of government revenues to achieve development objectives	→Local governments →Service providers	→National government →Sub-sovereign government	→Urban or Rural areas
<i>Example?</i>				
Local government funds	To fund service provision or support for non-governmental service providers	→Local communities	→Local tax revenues (users) →Government (State & Nat'l)	→Local communities →Urban or Rural
<i>Example?</i>				
Natural environment funds	To provide environmental protection and support for environmental finance	→Communities with wastewater issues that impact environment →Other communities or agencies that qualify for funding	→General tax revenues →Dedicated environmental taxes →Dedicated environmental funds (potentially with external support)	→Local communities →Urban or Rural
<i>Example?</i>				
Municipal bonds	To stimulate long-term investment in municipal infrastructure, are secured by a pledge of gross revenues, making payment of debt service senior to payment of operating expenses	→Institutional investors seeking long term investments →Domestic banks →International banks	→Municipalities, often with government (or donor) guarantees	→Municipalities with some credit history and administrative/financial/technical capacity
<i>Example?</i>				
Revenue bonds	A municipal bond issued to finance public works and supported directly by the project or by a category of projects, or other non-tax sources.	→Institutional investors seeking long term investments →Domestic banks →International banks	→Municipalities, often with government (or donor) guarantees	→Municipalities with some credit history and capacity →Utilities →While potentially viable in some countries, it is not used due to high “first mover” costs
<i>Example?</i>				
Leasing	Water service provision (typically a utility or group of utilities) is leased to a private operator for a given amount of time, to improve operations and maintenance as well as build capacity.	→Private operators →Banks →Bi- and multi- lateral agencies	→Governments →Municipalities	→Urban areas →Small towns that can aggregate assets under a single (public) holding company for the duration of the lease
<i>Example?</i>				

Source: Donors/IFIs				
Mechanism	Function	Demanders	Suppliers	Who benefits
Grants	Can be used for technical assistance to support improved policy and regulatory frameworks; or direct assistance to projects	→ Governments → Local communities → NGOs	→ Bi-lateral agencies → Multi-lateral agencies, Facilities (eg PPIAF or DevCo)	→ Urban and Rural areas → Governments → Communities → NGOs
<i>Example?</i>				
Concessionary loan	Loans with a grant element for development purposes, resulting in lower interest rates. For sovereign loans, this reduces risk and promotes long-term investment. For non-sovereign loans, LDC and HIPC countries can finance PPP (eg performance contract, lease, concession.)	→ Governments → Private Sector	→ IFIs → Bi-lateral and multi-lateral agencies	→ Urban areas → Governments seeking to attract private investment → Sub-sovereign governments
<i>Example?</i>				
Output-based aid (OBA)	Subsidies or concessionary loans that rely on some public contribution linked to the non-profitable part of the service for disbursement	→ Government → Service providers	→ Donors → IFIs	→ Generally seen as a pro-poor tool for extension by utilities into peri-urban and un-connected areas.
<i>Example?</i>				
Guarantees	Support investments by governments or the private sector through reducing different types of risk (eg currency, political, contractual, etc.). Objective is to attract banking institutions and financial markets' resources without having them assume long-term risk.	→ National government → Sub-sovereign government → Domestic private sector	→ Donors → IFIs → ODA supported financing facilities	→ Private investors (whether domestic or otherwise) interested to invest in water sector in developing countries → Cities and towns where projects are developed due to use of the mechanism
<i>Example?</i>				
On-lending (principally to commercial banks)	Provides loans at favorable rates to SME clients who then lend on a competitive basis to smaller clients; hence, IFIs bear the credit risk of the bank financing. In some cases (eg for sector specific purposes) on-lending can be structured to share credit risk between recipients and lenders.	→ Donors → IFIs	→ Domestic banks → Public sector development banks → Domestic private sector	→ Banking sector, which then indirectly benefits domestic private sector for investments specific to the water sector.
<i>Example?</i>				

Source: Donors/IFIs				
Mechanism	Function	Demanders	Suppliers	Who benefits
Equity investment in SMEs	Made available through local or regional (or sectoral) venture capital funds. The IFI takes a (minority) equity participation in the fund itself alongside other investors, and the Fund negotiates equity business with the local SMEs.	Domestic private sector industry (SMEs)	→ IFIs → Donors → Donor-backed funding facilities → Private sector	→ Domestic private sector (helps to grow business, which could include supply chains for technology, service provision, etc.)
<i>Example?</i>				
Direct equity	IFI participates as a (mostly) temporary minority shareholder in a private company for water-related investment. Can involve “warehousing” of shares—for example, temporary holding of shares in companies as part of a privatization or restructuring program	→ Private companies → Private service providers	→ Normally limited to financial institutions (IFIs)	→ Private company → Communities where the company invests (presuming that the equity from the IFI supports pro-poor development)
<i>Example?</i>				
Co-financing with other sources of bilateral and multilateral co-financing	Mechanism to harmonize donor and IFI financing for projects at a country level funding through	→ Government mandate for donor financing → Donors who wish to collaborate on projects	→ Bi- and multi- lateral agencies → IFIs	→ Governments: through targeted financing 7
<i>Example?</i>				
Commercial bank co-financing (types of co-financing include syndicated loans, bonds, floating rate notes, and convertible debt)	Mechanism to mobilize additional financing from sources other than the borrowing country (for public sector projects), the project sponsor (for private sector projects) or directly from the IFI. Encourages banks to extend maturities or to take more risk in more mature markets.	→ Commercial banks → Insurance companies → Institutional investors → Export credit agencies	→ IFIs (EBRD, ADB, etc.) → Bi- and multi-lateral agencies	→ Lenders who may be unwilling to lend for projects, given perceived commercial and country risk, due to questionable financial viability for a project
<i>Example?</i>				
Partial risk guarantee	The public FI provides a guarantee to ensure payment to a commercial investor in the case of debt service default resulting from nonperformance of contractual obligations undertaken by governments or their agencies in private sector projects.	→ Commercial banks and institutions	→ IFIs → Multi-lateral agencies → Bi-lateral agencies	Private sector borrowers whose investment face the following risks → Breach of contract → Foreign currency convertibility → Changes in law → Expropriation/nationalization

Source: Donors/IFIs				
Mechanism	Function	Demanders	Suppliers	Who benefits
<i>Example?</i>				
Interest subsidies (also known as interest rate buydowns)	Subsidizes interest rates, grace periods, or repayment periods on commercial loans in order to charge a lower rate to the borrower, who still earns a market return. Function is to attract private sector investment. The buydown can be temporary or permanent: the temporary type is an initial lump sum paid by a third party (generally a donor) to reduce the borrower's monthly payments in the early stages of the loan. A permanent buydown is a flat interest rate subsidy that reduces the interest rate over the life of the loan.	→Private sector	→IFIs →Multi-lateral agencies	→Private sector, as interest subsidies help to reduce the costs of borrowing →Temporary buydowns help to lessen the burden of repayment in the early stages of a loan, before a project is able to cost recover.
<i>Example?</i>				
Facility – project prep (also may be known as a grant facility)	To develop capacity within different spheres of government for putting together projects that are economically and/or financially viable (eg, DevCo)	→National government →Local government →Private sector	→Bi-lateral donors →Multi-lateral donors →IFIs	With strong project prep (due diligence) projects are likely to be more sustainable and achieve desired objectives
<i>Example?</i>				
Lines of credit (known in the EIB as “global loans”)	Borrowers with a line of credit are approved up to a certain amount of borrowing without having to submit lengthy application forms each time	→Municipalities →Infrastructure companies	→IFIs	→Municipalities →Infrastructure companies →Reduces paperwork/ increases speed of disbursements
<i>Example?</i>				
Partial credit guarantee (can be applied to loans or bonds)	A guarantee of full and timely debt service payment, up to a predetermined amount, and does not require a sovereign guarantee. Essentially, the guarantee enhances the rating of the project or municipality required to attract other investors (eg institutional investors)	→Private investors →Public sector (all spheres)	→IFIs →Multi-lateral agencies →Bi-lateral agencies →Donor-backed facilities (eg GuarantCo)	→Sovereign borrowers (national, regional, local) that have access to credit markets for finance but may not have AAA credit ratings →Low income, urban areas (if these are explicitly incorporated into the arrangements)
<i>Example?</i>				

Source: Private				
Mechanism	Function	Demanders	Suppliers	Who benefits
Private funds	Direct investment into water companies or water service providers. Often can support informal providers/small scale providers as well as larger providers	→Small scale providers →Informal providers →Utilities →Water-related business	→Trust funds →Development agencies →Companies →Individuals	→Service providers who lack access to formal markets →Companies in need of equity
<i>Example?</i>				
Local bank debt	Strengthen local credit markets	→Domestic private sector	→Domestic banks	→Borrowers in local currency, →Small scale providers →Commercial service providers →Governments
<i>Example?</i>				
Local long term private capital	Local investors purchase municipal bonds or provide funds to a city for its projects, or to other private companies requiring long-term investment	→Municipalities →Local supply chain firms →Local water service providers (for infrastructure investments)	→Local banks →Local private investors	→Local community. Currently, private long-term capital from local sources is the least exploited avenue of financing for cities. Municipalities need to demonstrate a satisfactory revenue stream over time, which in turn requires adequate taxes and user charges.
<i>Example?</i>				
Micro-credit	Small-scale lending to community members or small businesses at higher-than market interest rates. Can be used to finance connections as well as general service provision. Can be considered user or private finance.	→Community-based organizations/users	→Savings pools, local financiers, sometimes donors through equity support to providers	→Peri-urban or Rural areas →Local communities →Users →Investors
<i>Example?</i>				
Equity finance/Equity facilities	Business owners sell shares in the company (utility or service provider) in order to raise cash for investments	→Individual investors →Commercial banks →National banks →IFIs	→Utilities →Business owners	→Owners expand access to capital →Benefits to local banks as well as international banks seeking investments in local currency
<i>Example?</i>				

Source: Mixed, or Combinations				
Mechanism	Function	Demanders	Suppliers	Who benefits
Social Development Fund/Local Development Fund	Direct loans to demand-led projects for small communities, emphasis on the poor. The community, with technical assistance from the fund, manage all aspects of the project from identification through implementation and beyond.,	→Small projects that adhere to stated criteria	→IFIs →Donors →Governments →NGOs	→Poor communities. Key benefits include their rapid disbursement, flexibility, responsiveness to local needs, coordination, and ability to attract co-financing from donors.
<i>Example?</i>				
Mezzanine capital	Using a combination of debt and equity components. Basically, debt capital, with current repayment requirements, but with an option to convert to an equity interest or an option to purchase shares. Because bank financing tends to be short term, infrastructure projects long-term, and credit markets weak, mezzanine financing is a way to bridge the long-term debt gap in (advanced) developing countries.	→Governments →Private companies →Utilities	→Commercial banks →IFIs	→Beneficial to companies (or governments, or utilities) as it appears on balance sheets as equity rather than debt
<i>Example?</i>				
Non-revolving fund	Requires a one-time allocation of funds, transferred to a new facility, and used for interest rate buy-down, co-financing, or credit enhancement for projects for a set timeframe. Is less administratively complex than a revolving fund (see “pooled fund” below)	→Private sector	→Donors →Governments (potentially, to support sub-sovereign programs)	→Private sector →Communities where investments are made
<i>Example?</i>				
Pooled Finance Development Funds (or, bond banks) Also known as revolving fund	“Pools” project-related risk for infrastructure projects at a networked level (urban/small town) in order to enhance credit for domestic capital market. This transfers repayment capacity to the portfolio rather than individual project level, and the establishment of a reserve fund	→ Municipalities and urban areas with infrastructure requirements who can benefit by pooling the financial element of projects with other cities/municipalities.	→ Donors → IFIs → Government → Private sector (potentially)	→For municipalities, collateralized cash flows results in stronger credit/ lower interest rates; greater liquidity also leads to lower interest rates. Also, benefits from lower transaction costs to attract financing. →Reserve fund (supplemented by

Source: Mixed, or Combinations				
Mechanism	Function	Demanders	Suppliers	Who benefits
	mitigates cash flow concerns			intercepts and guarantees), helps to reduce risk for investors → In the US, funding from the federal level is channeled to state level revolving funds, which are then leveraged through the sale of tax-exempt bonds. On completion of the project, the loan recipient repays the loan back into the fund, which then provides loans to other applicants. The “revolving” nature of the fund benefits the municipality by ensuring a dedicated source of finance for investments.
<i>Example?</i>				
Project/Structured finance	Financing mechanism for long-term infrastructure whereby the cash flow from the project supports the debt and equity interests. Project risks are allocated to parties most capable to assume them; contracts can assume several forms (BOT, BOOT, ROT, etc)	→ Utilities → Commercial banks → International investors → Governments	→ IFIs → Commercial banks → International investors → Governments	→ Benefits are that the debt is off-balance sheet for private companies and potentially for governments; although sovereign guarantees are generally required.
<i>Example?</i>				
Revenue backed loans	Loans whose repayment is linked to the revenue of the project. For well-structured projects, transfers the risk from local creditors to the project itself.	→ Municipalities with an advanced credit framework and capacity → Project sponsors (public or private) → Private lenders	→ Governments → Private investors → IFIs	→ For the scope of the project, the lenders benefit as the risks are transferred to the project alone and not linked to tax revenues or balance sheet statements
<i>Example?</i>				
Loan syndication	By allowing numerous lenders into various portions of a loan, the lead lender can provide a larger loan than it would be able to without the other	→ Private investors	→ Commercial banks → National Development Banks → IFIs	→ Utilities → Municipalities

Source: Mixed, or Combinations				
Mechanism	Function	Demanders	Suppliers	Who benefits
	lenders, while maintaining reasonable credit exposure, also due to the other creditors in the syndicate.			
<i>Example?</i>				