

This key sheet is one of a series aimed at applicants responding to the ACP-EU Water Facility Second Call for Proposals 2006. The ACP-EU Water Facility requires applicants to provide or ensure a minimum level of co-financing. The key sheet series aims to provide guidance to various categories of applicants with regards to potential sources of co-financing.

Key sheet 03 is targeted at sub-sovereign and parastatal entities that are ACP national, local and regional public bodies with a distinct juridical personality from the ACP state, and involved in either water supply and sanitation services delivery or integrated water resources management.

Applicants are advised to refer to the ACP-EU Water Facility Second Call for Proposals Guidelines and Annexes, these being the only binding documents, when preparing their application.



## Introduction

The ACP-EU Water Facility (*hereinafter* ACP-EUWF) encourages applicants in all categories to seek flexible and innovative co-financing. The key sheet series is aimed at providing applicants with suggestions of possible co-financing options they may want to consider. The key sheets are not prescriptive or comprehensive and the co-financing options presented here may not all be of relevance to all applicants.

This key sheet will briefly consider the role of the ACP sub-sovereign (municipal) and parastatal applicants and consider sources of funding that are available to them.

In many countries, decentralisation has meant that the role of water supply and sanitation (WSS) service provision and integrated water resources management (IWRM) has shifted to local and regional or sub-sovereign levels of government. In urban areas, management of water supply and sanitation services is usually carried out within a municipal department or through a separate water board/authority. In addition, parastatal bodies and trust funds may also play a variety of roles in the water and sanitation sector. For effective IWRM, the institutional framework often needs to be based on autonomous water basin level organisations that promote holistic basin-wide planning and management.

Devolving the responsibilities of WSS service provision to the sub-sovereign level offers the potential to exploit considerable economies of scale by aggregating/coordinating activities among various city/town departments and form partnerships or formal contractual arrangements that will facilitate WSS service provision. For example, while the municipality may still retain primary responsibility for management of the infrastructure, it may collaborate with small scale infrastructure providers (SSIPs), civil society, or private sector firms for water supply or sanitation service delivery, in order to increase the efficiency in service delivery and leverage more resources to the sector. Such arrangements often have the potential to be pro-poor in nature. For example, partnerships with SSIPs or civil society may help municipalities improve water supply and sanitation services for neighbourhoods to which piped networks cannot be extended.

## Who can apply for ACP-EUWF funds?

The ACP-EUWF may receive applications from sub-sovereign (municipal) and parastatal entities that are ACP national, local and regional public bodies with a distinct juridical personality from the ACP state, and involved in either water and sanitation services delivery or integrated water resources management.

In addition to sub-sovereign and parastatal agencies themselves, (EU/ACP) private, NGOs and civil society actors, (EU)

(i) Africa, Caribbean and Pacific (ACP)

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public entities that are interested to support sub-sovereign activities relating to the water sector can apply. The type of partnerships that may be proposed could involve for example, non-state actors looking to partner with a sub-sovereign to either a) improve water quality or water efficiency as part of water resource management, or b) help extend access to water and sanitation services (including hygiene) in underserved areas. From another angle, it could include partners looking to strengthen the financial viability of sub-sovereigns to allow for municipal borrowing, such as foundations, donor agencies, or commercial banks themselves. In fact, EU and ACP private sector, EU NGOs and EU public bodies are required to partner with a “relevant ACP public body with a distinct juridical personality from the state”, or an ACP NGO and civil society actors.

**Actions** - *Section 2.1.2* of the 2006 Call for Proposals Guidelines provides details of the type of activities related to the three components, which will be considered for support. However proposals for other activities could also be considered where appropriate

### Suggested source and type of co-finance

**ACP-EUWF co-financing requirement** - The co-financing from the ACP-EUWF is in the form of a grant to supplement funds raised by the applicant. The applicant's funds must be from its own sources, its partner's and/or co-donor's sources and from sources other than the European Development Fund (EDF) or the European Community's (EC) budget. This financing is intended to be available and used concurrently with the ACP-EUWF grant.

**Suggested co-financing options and sources** - Finance for sub-sovereign levels of government usually comes from internal local revenue collection (via service charges, local taxes and commercial activities, including returns from own investments and rental income), and external resources via central government budget grants and transfers and funds from donors, IFIs and borrowing from financial institutions. Adequate provision of WSS services, in quantity and in quality, as well as planning and investments in infrastructure requires financial autonomy on the part of municipalities and parastatals, with regular and sufficient finance.

Working within the framework of the 2006 Call for Proposals, the applicant could access funds/ co-finance from several sources:

- **Inter-governmental fiscal transfers into municipalities and local authorities** - The applicant could use part of the inter-governmental fiscal transfers (grants) from the central budget to the municipal/ parastatal budgets as the co-financing needed for proposals made to the ACP-EUWF. Inter-governmental transfers are revenue and expenditure assignments from the central budget to the sectors/local authorities and constitute one of the key financing mechanisms for increasing WSS services. These transfers may take the form of conditional grants, discretionary transfers, local authority funds, etc., and the funds may come from state revenues and aid from donors. For use as co-financing, these funds may need to be guaranteed and ring-fenced specifically for the purposes stated in the proposals. In addition, if for a given proposal co-financing from the recipient country budget is proposed, the specific arrangements for the channelling of funds should be indicated and confirmed by the Ministry of Finance. Any contribution from government should be in the form of actual funding and not as a subsequent exemption or refund of taxes.
- **Local Government “Fund”** - In a few ACP countries (for example in Kenya and Zambia), the government has set up a local authority fund to act as a source of a predictable pool of funds for local authorities to access, via grants, to enable it to deliver local services. This fund may be capitalised by income tax revenues from the state and supplemented by funds from donors. Some of these funds have been specially set up for water related activities.
- **Service charges and tariffs** - Tariffs are another major source of finance for the applicant. In many countries, decentralisation reforms have given the municipalities or water authorities autonomy to set their own tariffs (to better reflect the costs) and spend the resulting revenue on improving and developing the water supply facilities.

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This has resulted in an improved ability to collect revenues and enabled the authorities to become more financially self sustainable through internal cash generation. In cases where the water authority or parastatal has become “commercially” oriented, the applicant could use the revenue streams coming from the WSS services that it provides, as co-financing for the ACP-EUWF proposals. Such a revenue stream could also be used as collateral for credit from financial institutions (both domestic and international). These funds may need to be ring-fenced specifically for the purposes stated in the proposals and the application needs to provide adequate supporting evidence to show how and on what basis future revenue projections have been calculated. In this respect, the applicant is advised to develop a detailed and a robust financial strategy that maps out the capital requirements, revenue streams and any underlying assumptions that the figures are based on.

- **Abstraction and discharge (or pollution) charges paid by commercial or large scales users in a given river basin or catchment area** - Depending on the sophistication of the river basin authority, charges for abstraction and discharge could be collected and managed to leverage funds from the ACP-EUWF, in support of river basin management. This could also have the benefit of raising awareness of water’s economic value throughout a river basin area.
- **Grants and Soft loans from bilateral agencies** – Many bilateral donors have set up a variety of modalities through which grants can be channelled and often combine grant components with soft loans. Bilateral Agencies offer soft loans at low or zero interest rates over varying amounts of time. The grant component of the soft loan maybe used for technical assistance in project preparation and set-up for example, whereas the loan could be used for financing capital investment in the water sector. Soft loan facilities and mechanisms can help to further infrastructure development by providing finance for projects that would be unable to obtain credit elsewhere. In the first instance, the applicant is advised to approach bilateral donors operating in country to discuss the viability and use of such funds as co-finance for WSS proposals to the ACP-EUWF.
- **Multilateral programmes (for example World Bank, UNDP, UNICEF, etc.)** - These are another important source of co-finance, mostly in the form of grants and concessional/ soft lending. Grants for technical assistance could be used for policy and regulatory development and to improve the enabling environment (such as institutional and tariff reform) to increase the future flows of funds from non-traditional sources such as the private sector. Soft loans could be used for financing capital investments in infrastructure projects and programmes.

*Some examples of multilateral grant sources include i:*

- The Public Private Infrastructure Advisory Facility (PPIAF), administered by the World Bank, can provide technical assistance to sub-sovereign governments to improve infrastructure related service delivery with private sector involvement. PPIAF’s support includes assistance in innovative transaction design, regulatory strengthening and pro-poor tariff design.
- Funding from the Global Partnership on Output-Based Aid (GPOBA). The GPOBA is a multi-donor trust fund administered by the World Bank. The goal of GPOBA is to provide increased access to reliable basic infrastructure and social services to the poor in developing countries through the wider use of Output-Based Aid (OBA) approaches. GPOBA funding is open to general application from international financial institutions, bilateral donors, NGOs, public and private infrastructure operators, and national and local governments. GPOBA funding can be used to facilitate learning on the potential contribution of OBA approaches through three types of activities, including technical assistance (project design, implementation and evaluation), dissemination, and OBA subsidy funding that will complement user fees.
- Global Environment Facility (GEF) is an independent financial organisation that provides grants to developing countries for projects that benefit the global environment and promote sustainable livelihoods in local communities.

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(i)If an applicant is intending to consider output based aid mechanism in the frame of a proposal,he should clarify with the ACP-EUWF (helpdesk), the feasibility of this mechanism from the contractual/procurement point of view in particular regarding compliance with contract procedures for project co-financed by the 9th EDF.

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*Debt from multilateral programmes – Multilateral programmes offer a range of debt products, applicable to sub-sovereign borrowers on concessional terms. These include:*

- The applicant as a sub- sovereign borrower could seek long term loan finance from the European Investment Bank (EIB) Investment Facility for ACP states and from the EIB's own resources. The EIB ACP-IF has a large set of financial instruments like equity, loans (where loans could be senior or subordinated debt and/or coupled with grace periods issued in both foreign and local currency) and guarantees (used to promote lending in local currencies and also to assist in catalysing the development of local financial markets). The EIB through the Investment Facility is ready to consider the provision of guarantees for long-term infrastructure projects.
- The African Development Bank has a range of financial instruments for use to facilitate water sector infrastructure investment at a sub-sovereign level, including grants, concessionary loans, loans, lines of credit, equity, risk management products, and guarantees. Through the public sector and private sector windows, these instruments can support a range of capacity building and financing activities at the sovereign and non-sovereign levels, whether for direct support for investments, or to create an enabling environment for increased investment.
- The Development Bank of Southern Africa provides a range of loan-type mechanisms as part of its portfolio of products. These include senior debt, subordinated debt, lines of credit, and co-financing for projects with a development component, along with refinancing options for existing debts.
- The Municipal Fund is a joint International Finance Corporation (IFC)/World Bank initiative aimed at facilitating access of sub-sovereign entities (municipalities, municipal corporations/ parastatals) to financial markets and to promote sustainable services delivered along commercial principles. The Fund supports investments made by states, municipalities and municipally controlled entities, including in the water sector, by offering loans, guarantees, and/or equity and quasi-equity. Examples of transactions include a partial credit guarantee for a loan issued to a municipal water company to finance a treatment plant. The guarantee could enhance the rating to the level required to allow institutional investors to invest or a loan to a municipality to finance sanitation related capital expenditure to be managed/implemented by a private management contractors, lessor or concessionaire.

→ **Commercial loans and guarantees** - Sub-sovereign governments can easily build up unsustainable debts by borrowing from domestic finance providers to cover shortfalls in their budgets, without good terms and conditions and pre-requisite financial restructuring. The use of guarantees could lower the cost of borrowing and play an important role in increasing access to domestic financial markets for water sector investments. The applicant could seek a loan from domestic or international credit providers, with the use of guarantees to mitigate the risks faced by these lenders that are not inherent in the project. Guarantees could also enhance the credit worthiness of the applicant (as a borrower) and thus lower the cost of the debt. Guarantees can be obtained from many bilateral agencies such as SIDA or Proparco and the Development Credit Authority (DCA) of USAID and also from a range of multilateral programmes such as the EIB, World Bank and the IFC for example. It is important to note that to access debt instruments from financial institutions, the applicant would need to improve its commercial orientation and financial sustainability and is therefore linked to tariff and institutional reforms.<sup>i</sup>

Further information on the sources listed in this Key Sheet is available on the EUWI Financing Guide website at <http://financeguide.euwi.net>

The objective of the EUWI Financing Guide is to provide users of finance in developing countries with a means to identify different types of finance mechanisms that are available for the water sector, how they work (broadly), and finally to provide linkages to other sites on the Internet, featuring additional details and information. This effort is a first step towards creating a comprehensive “one-stop” source of information about the range of finance mechanisms available for the water and sanitation sector, with a view to increase knowledge and capacity for accessing finance.

(i) It is important to note that these financial instruments cannot be used in isolation from one another. Many of the more sophisticated instruments require prior reform and restructuring before they can be accessed and the instruments that facilitate this (for example the technical assistance provided by PPIAF) could form part of a coherent package of co-financing. The applicants are therefore advised to devise an adequate financial package that includes more up-stream financing as well.