

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 02 is targeted at potential applicants from ACP state public agencies, departments, ministries and decentralised authorities (at a local, district and regional levels) of the ACP states, which are legally not distinct from the ACP state and which have been entrusted with responsibilities related to the implementation of the activities relevant to the call.

**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 state applicants and consider sources of funding that are available to them.

Under decentralisation, the role of the central government in many countries, has shifted away from a being a service provider to that of a policy maker. Responsibility for water supply and sanitation (WSS) services and integrated water resources management (IWRM) often rests with local, district or regional levels of government including water resource management agencies. The central government may have responsibility for sector reforms and creating an enabling environment for non-state actors to participate in service delivery. The ACP state, through the ministry/department or public agency responsible for IWRM and WSS may have the following main responsibilities and functions:

- Develop, review and improve water sector and strategy;
- Secure or facilitate the necessary funds needed to implement the strategy;
- Implement WSS service delivery via local or regional government;
- Facilitate co-ordinate, monitor and regulate IWRM and WSS services; and
- Develop competent sector professionals.

## Who can apply for ACP-EUWF funds?

For both Component A and B, the ACP-EUWF may receive applications from ACP state public agencies, departments, ministries and decentralised authorities (at a local, district and regional levels) of the ACP states, which are legally not distinct from the ACP state and which have been entrusted with responsibilities related to the implementation of the activities relevant to the call. Proposals for Component C cannot be submitted by the ACP state applicant.

An ACP state applicant may partner with a public entity, a non profit institution or association involved in providing services, where the activities are of an institutional nature. In all cases, the applicant and the partner/s should not be motivated by economic or commercial considerations. An ACP state or public body (without a distinct legal personality) can

(i) Africa, Caribbean and Pacific (ACP)

never act as partner.

**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** - Traditionally the state has financed its efforts in WSS services from revenues (tax, and other earnings), supplemented to various degrees, depending on the country, by overseas development assistance (ODA). ODA has generally taken the form of grants, technical assistance, long term concessionary loans and budgetary support mechanisms. Many bilateral aid organisations also channel their assistance via specific projects or earmark support for the sector if funds go via the government. In many countries, user finance is increasingly an important source for financing the operations and management costs of WSS services, although the tariffs may not always recover the full costs.

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

- **Inter-governmental fiscal transfers into the water sector** - In countries where there is a strong commitment to decentralisation, including fiscal decentralisation and the relevant institutions in place to facilitate this, the applicant could use part of the inter-governmental fiscal transfers from the central budget to the water sector/ local authority 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 WSS. These transfers may take the form of conditional grants, discretionary transfers, local authority funds, etc., and the funds may come from state revenues and ODA 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.
- **National Social Investment Funds (SIF)** - Many countries in the ACP region have SIFs to promote community driven development for small investments in physical or social infrastructures in rural areas or for institutional reform. SIFs are an important vehicle for the World Bank to channel resources for community managed investments at the country level. SIFs are set-up by the state and mainly capitalised by World Bank funds, as autonomous, non-profit organisations to manage block grants. They operate on the principle of the beneficiary communities contributing to the capital and maintenance costs. Use of such funds for co-financing may depending on the eligibility, exclusivity and institutional structures of the SIF. Examples of SIFs include the Ethiopian Social Rehabilitation and Development Fund and the Fonds d'Investissement pour le Developpement in Madagascar.
- **Water User Associations or Entities capitalised by the beneficiary communities and set-up within the local government framework** - In some ACP countries, the state has supported the formation of formal institutional arrangements that collect funds from beneficiary communities in the form of capital contributions and user fees (tariffs), intended to partly cover the capital and fully cover the maintenance costs of WSS investments in rural

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areas. Such arrangements will need to have adequate accountability and transparency measures with ring-fencing to ensure that the funds are used for the stated WSS purpose. As most of these associations may be small in scale, it may be possible to aggregate them to achieve economies of scale. The state could facilitate the creation and management of such associations using a NGO or technical assistance provided by bilateral agencies. Alternatively, proposals could be designed to leverage future tariff revenues and upfront capital contributions from the beneficiaries. Such proposals may need to be adequately backed up by willingness to pay studies and the setting of cost recovering and sustainable tariffs, and supported by measures to promote financial management amongst the beneficiary communities. Adequate supporting evidence will be needed 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 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** - In many countries, bilateral agencies are the main source of funds for the water sector and hence an important source of co-financing for ACP-EUWF proposals. Bilateral funds normally take the form of grants (e.g., seed grants or matching grants) and soft loans at concessionary terms. In recent years, there has been a clear move away from direct project-based grants by some the EU bilateral donors (most noticeably DFID), towards budgetary support. The 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 may be 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 ACP state applicant is advised to approach bilateral donors operating in their country to discuss the viability and use of such funds to co-finance the ACP-EUWF proposals.
- **Multilateral programmes (for example World Bank, UNDP, UNICEF, etc.)** - These programmes offer 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 water infrastructure projects and programmes.

*Some examples of multilateral grant sources include:*

- The Public Private Infrastructure Advisory Facility (PPIAF), administered by the World Bank, can provide technical assistance 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.
- The Financial Sector Reform and Strengthening (FIRST) Initiative aims to provide technical assistance grants for short and medium-term capacity-building and policy development in the financial sector, in order to increase its capacity to tailor products that meet the needs of clients in the water sector.
- 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

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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.

- The 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.

*Some examples of multilateral debt sources include:*

- The ACP state as a 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 offers a Public Sector Sovereign Guaranteed Loan which is made either to a regional member country, or to a project in a regional member country with its full backing. These loans are for long-term financing, with a maximum maturity of up to twenty years, inclusive of the grace period. The Bank offers fixed and variable rates, based on the project, calculated on the basis of the cost of borrowing.
- Countries that are eligible for World Bank/International Development Association (IDA) loans can apply for the Sector Investment and Maintenance (SIM) Loan from the World Bank. SIM has been created to develop the institutional capacity to plan, implement and monitor an investment programme.

→ **Guarantees** - The ACP state could make use of a range of guarantees (partial loan guarantees or partial credit enhancement from SIDA or the USAID Development Credit Authority (DCA), for example) to facilitate loans from international or local credit markets, to the local authorities. The borrower would need to have undertaken institutional and tariff reforms and feasibility studies to show the commercial viability of the project/programme. Likewise, guarantees from these sources and/ or facilitated by donor funds (other than the ACP-EUWF) could be used for development bank lending to the ACP state for water sector infrastructure projects.

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.