DATA BRIEF

BLENDED FINANCE FOR WATER & SANITATION

APRIL 2019

HIGHLIGHTS

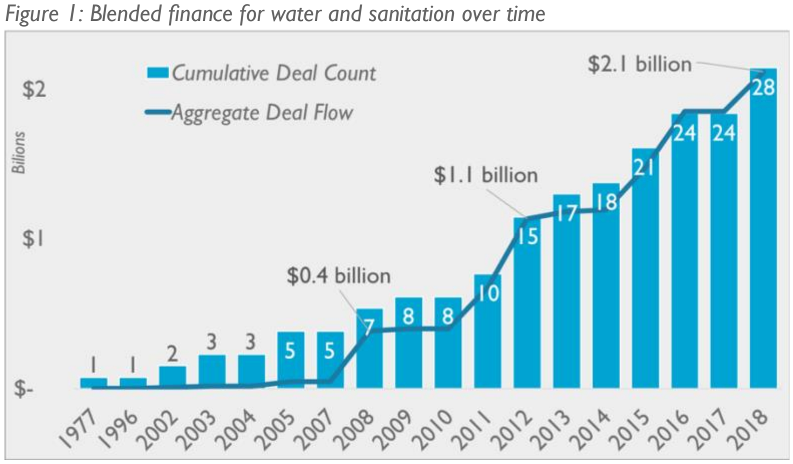
- Water and sanitation lags behind other sectors in terms of harnessing alternative financing sources. Blended finance is one potential tool to mobilize additional sources of financing for water and sanitation projects in developing countries to achieve Sustainable Development Goal 6 (*Clean Water & Sanitation*) by 2030.
- According to the Convergence database, there have been 28 blended finance transactions in the water and sanitation sector, which represent an aggregate volume of $2.1 billion invested. This does not include public-on-public blending or partnerships where no additional private sector commercial capital has been mobilized.
- Concessional capital and design funding have been deployed most frequently for water and sanitation projects, but guarantees / risk insurance have been associated with larger average deal sizes. Still, blended finance deals targeting the water and sanitation sector have been small relative to other sectors and SDGs, with an average transaction size of $76 million (versus $301 million for all blended finance).
- The largest proportion of blended finance transactions for the water and sanitation sector have focused on financing for water supply services, with a concentration in South Asia (32% of deals) and Sub-Saharan Africa (29% of deals). While 100% of transactions have targeted one or more lower-middle income countries, less than 30% have targeted one or more low-income countries.
- Foundations and NGOs have been the most frequent providers of concessional capital for the water and sanitation sector, while development finance institutions (DFIs) and multilateral development banks (MBDs) have been the top providers of commercial capital. Building the market for private sector investment in water and sanitation will take time and it will require ongoing support from the public – and philanthropic – sectors.

There is strong potential for the water and sanitation sector to strategically adopt innovative finance approaches like blended finance

Access to safe drinking-water and sanitation is a basic human right and critical to ensuring human welfare and unlocking economic growth and productivity. Goal 6 (*Clean Water & Sanitation*) of the Sustainable Development Goals (SDGs) aims to ensure access to safe water sources and sanitation for all; but, the World Bank estimates that $114 billion per year would be needed to achieve this ambitious target. The water and sanitation sector lags behind other sectors in terms of harnessing alternative financing sources, including blended finance approaches to mobilize commercial capital.

This Brief analyzes the use of blended finance to mobilize additional sources of financing for water and sanitation projects in developing countries. According to the Convergence database, there have been 28 blended finance transactions for the water and sanitation sector, which represent an aggregate volume of $2.1 billion invested in full or part in the sector. This Brief does not include transactions with public-on-public blending or public-private partnerships where no additional private sector commercial capital has been mobilized (i.e., beyond the project developer's contributions). The Brief also does not differentiate between rural and urban projects or water and sanitation projects, although most blended finance has been used for urban infrastructure projects.

Figure 1: Blended finance for water and sanitation over time



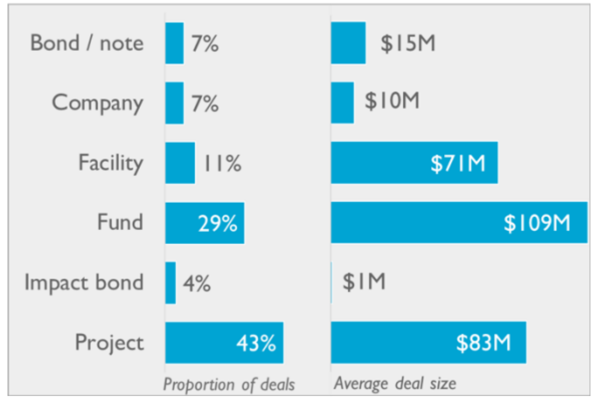
Blended finance is not and cannot be the full solution to financing Goal 6 (*Clean Water & Sanitation*), especially given the public-good nature of water and sanitation services. However, the water and sanitation sector faces significant barriers to attracting sufficient financing, including the local nature of projects and the considerable costs associated with operation and maintenance. It is important to consider where and how blended finance approaches can be used to attract additional commercial capital to viable projects, allowing traditional development aid to refocus on projects that should not attempt to or cannot attract private capital.

ANALYSIS

Blended finance deals for water and sanitation have been significantly smaller, on average, than typical blended finance deals

The majority of blended finance transactions in the water and sanitation sector have been projects (43%) or funds (29%). Water and sanitation is often one of many sectors targeted by the blended finance funds that were analyzed, but some funds do target the sector exclusively. More recently, there has been an increase in revolving loan facilities, which lend to multiple water and sanitation projects or companies and seek to mobilize capital from local financial institutions. Generally, blended finance deals targeting the water and sanitation sector have been small relative to other sectors and SDGs, with an average transaction size of $76 million (versus $301 million for all blended finance deals).

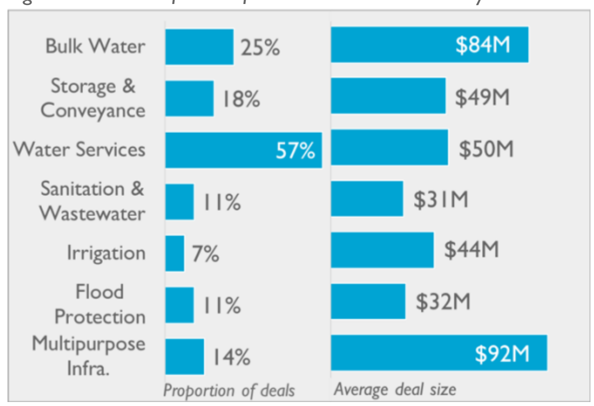
Figure 2: Blended finance for water and sanitation by deal type



Private water supply services have benefited most from blended finance, with water projects generally more common than sanitation projects

The largest proportion of blended finance transactions for the water and sanitation sector have targeted water supply services (70%). While blended finance approaches have been deployed for public water supply services (e.g., Philippines Water Revolving Fund), blended finance has been more commonly deployed for private / alternative water supply services (e.g., dloHaiti, Safe Water Network). Blended finance solutions for the water and sanitation sector have also focused notably on bulk water supply (25%), storage and conveyance (18%), and multipurpose infrastructure (14%).

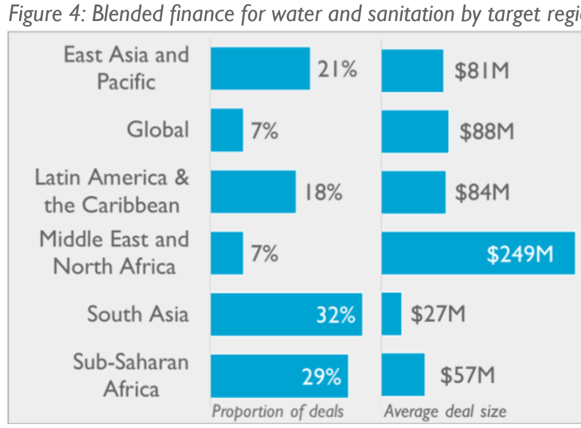
Figure 3: Blended finance for water and sanitation by sub-sector



60% of water and sanitation deals have targeted South Asia, East Africa

Water and sanitation blended finance transactions have most frequently targeted South Asia (32% of deals) and Sub-Saharan Africa (29% of deals). This may be a positive signal as there is a significantly greater financing gap for achieving Goal 6 (*Clean Water & Sanitation*) in Sub-Saharan Africa. While only 7% of blended finance solutions for water and sanitation have targeted Middle East and North Africa, the average deal size has been considerably larger due to large multipurpose infrastructure projects in the region. Relative to other sectors, there are few globally-focused water and sanitation blended finance solutions. There may be an opportunity here for blended finance to support more portfolio approaches, diversifying risk across projects and countries.

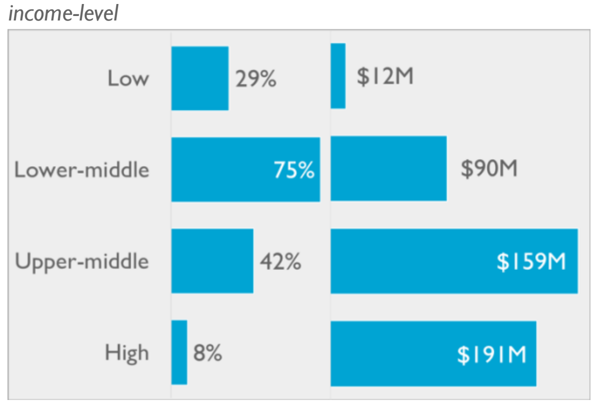
Figure 4: Blended finance for water and sanitation by target region



The majority of transactions have been in middle-income countries

Middle-income countries have been most frequently targeted by blended finance transactions in the water and sanitation sector, which mirrors similar analysis of commercial investment flows to the sector to date. 86% of blended finance transactions in the sector have targeted one or more lower-middle income countries and 43% have targeted one or more upper-middle income countries. Only a quarter of blended finance transactions have targeted one or more low-income countries. This highlights the challenges of attracting commercial and quasi-commercial (e.g., impact investors, DFIs) to this sector in lower-income countries and the importance of concessional development capital (e.g., grants) in funding these projects in the short- to medium-term.

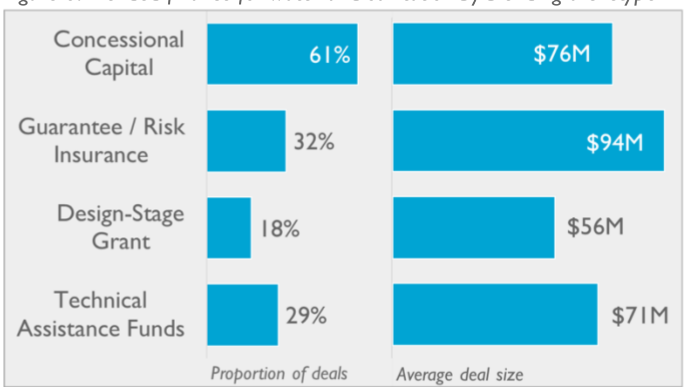
Figure 5: Blended finance for water and sanitation by country income-level



Do not underestimate the value of technical assistance funds

Concessional capital (e.g., first-loss debt or equity) has been deployed most frequently for blended finance transactions targeting the water and sanitation sector, followed by guarantees / risk insurance (32%) and technical assistance funds (29%). Deals have been larger, on average, when guarantees / risk insurance are deployed to water and sanitation projects. Partial credit guarantees have been successfully used in the sector to mobilize both international and local financiers (e.g., Municipality of Tlalnepantla de Baz Bond Issue in Mexico). Technical assistance funds alongside commercial investments can also be critical for increasing commercial viability, including building the operational efficiency of service providers / project developers and supporting the broader enabling environment.

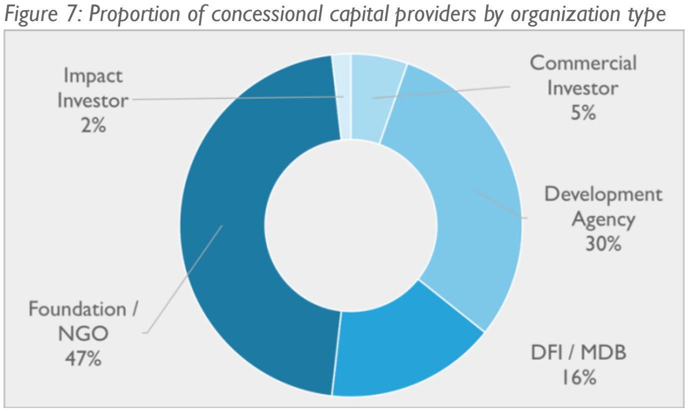
Figure 6: Blended finance for water and sanitation by blending archetype



Foundations and NGOs have provided half of all concessional commitments to blended finance for water and sanitation

Concessional capital providers play a critical role in supporting blended finance transactions in the wash and sanitation sector, with foundations and non-governmental organizations (NGOs) (e.g., Habitat for Humanity, the Stone Family Foundation) providing nearly half of the concessional commitments to date. Multilateral facilities, like the Multilateral Investment Fund (MIF) and the Green Climate Fund (GCF), as well as development agencies, especially the USAID Development Credit Authority (DCA), have accounted for 25% of concessional commitments.

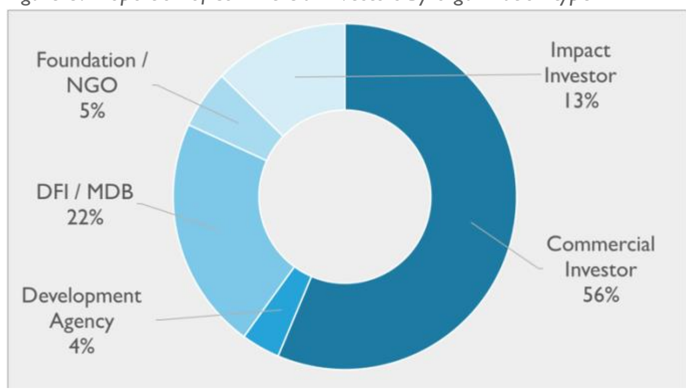
Figure 7: Proportion of concessional capital providers by organization type



DFIs and MDBs have been active commercial capital providers

Commercial capital providers for blended finance transactions in the water and sanitation sector have been primarily development finance institutions like the Overseas Private Investment Corporation (OPIC) and the Development Bank of Southern Africa (DBSA), and multilateral development banks, like the International Finance Corporation (IFC). While 54% of commercial commitments have been from the private sector, 73% of these commitments have been once-off investments (e.g., by Coca Cola, Inditex, BGI Properties). Building the market for commercial finance in the sector will take time and require ongoing support from the public sector. Local financial institutions and institutional investors, like PNB MetLife India and Arab Bank PLC, have also provided commercial capital.

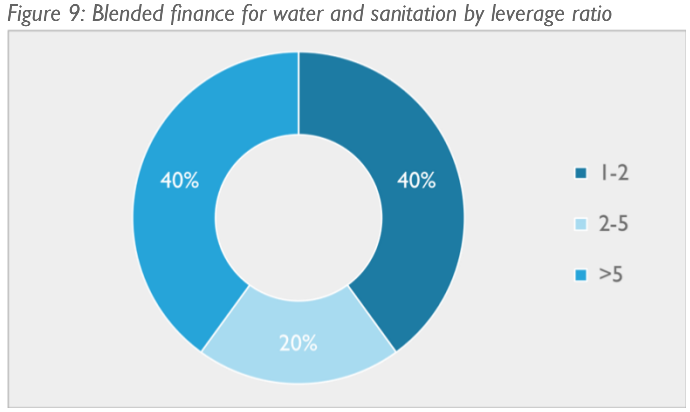
Figure 8: Proportion of commercial investors by organization type



Blended finance for water and sanitation has demonstrated an ability to achieve good leverage over the medium- to long-term

Leverage ratios for blended finance transactions in the water and sanitation sector have varied from 1:1 to 1:9. For every dollar of concessional capital, between $1 and $9 of commercial capital has been mobilized to the sector. Leverage ratios have been higher for blended finance funds that focus fully or in part on the water and sanitation sector, relative to other blended finance projects. Larger leverage ratios have been achieved for projects in later stages (e.g., expansion) and follow-on funds where the fund manager has a demonstrated track record.

Figure 9: Blended finance for water and sanitation by leverage ratio



REFLECTIONS

Achieving Goal 6 (*Clean Water & Sanitation*) requires significant additional financing for a wide variety of projects: from large-scale water and water treatment projects to small-scale off-grid projects. Increasing the level of commercial finance for the sector would allow service providers and project sponsors to borrow and invest in expanding and improving the quality of water and sanitation services. Well-designed blended finance solutions can improve the risk-return profile of water and sanitation projects, attracting new investors that, over time, become more comfortable with the investment opportunities and risks in the sector. For example, investors have become increasingly prepared to accept more risk in microfinance, renewable energy, and infrastructure projects in developing countries, where there is (more of) an established track record.

Nonetheless, blended finance is not and cannot be the full solution to financing Goal 6 (*Clean Water & Sanitation*). Beyond the public-good nature of these services, water and sanitation projects can be complex to design, relatively small in size (e.g., often local), and characterized by significant investment risk. Relative to water projects, financing sanitation projects can be particularly difficult because the infrastructure is often more challenging (fiscally, socially, and politically) to build; operators have more difficulty recovering costs via tariffs; and these projects tend to lag behind water supply service. Similarly, rural projects are often less commercially viable than urban or peri-urban projects. Overall, a gradual move towards mobilizing more commercial finance requires improving the financial performance of service providers through a mix of (i) improved technical and commercial efficiencies and (ii) governance and regulatory reforms.

METHODOLOGY AND NOTES

1. Convergence's database: Convergence maintains the largest and most detailed database of blended finance transactions that have reached financial close. Given the current state of information sharing, it is not possible for this database to be fully comprehensive. Efforts have been made to capture all relevant blended finance transactions in the water and sanitation sector from many sources; however, there are likely more transactions that have not been captured.
2. Scope of available data: This Brief analyzes 28 blended finance transactions that have targeted, in full or part, the water and sanitation sector. Convergence seeks to capture all blended finance deals that meet the key criteria of Convergence's definition. As such, this Brief does not include transactions with public-on-public blending (i.e., where concessional capital is deployed by development agencies to mobilize commercially-oriented public agencies) or public-private partnerships (PPPs) where no additional private sector commercial capital has been mobilized in the financing (i.e., beyond the project developer's contributions).
3. Target regions and countries: Convergence tracks region and country data by stated region(s) and countries of focus at the time of financial close, not actual investment flows. Often, regions and countries of eligibility are broader than those explicitly stated.
4. Note on leverage paragraph: The methodology for Convergence's leverage calculations and analysis is outlined in our first Data Brief here. It should be noted that analysis of leverage ratios is based on a subset of deals for which this information has been collected.
5. Additional reading: This Brief builds on the findings from the Sector Deep Dive commissioned by the Swedish International Development Cooperation Agency (Sida), which can be accessed here.