THE WATER FINANCE FACILITY (WFF)

Tapping local capital markets

Supporting local structures

The global Water Finance Facility (WFF) catalyses the creation of national-level water financing facilities in various developing countries that will be structured to become long-term, sustainable stand-alone, local non-bank financial institutions in those countries (referred to in this document as a National Water Finance Facility, or NWFF). WFF provides early stage financial development support and expertise to the NWFFs for organizational set-up, financial and legal structuring of the bonds and loans, compliance with all regulatory authorities, and placement of the bond and related matters.

In parallel, the NWFFs will assess and select local water and sanitation companies that are credit worthy and provide transactional support to ensure they have developed sound capital investment and financial plans, to guide them to complete all of their project designs and the procurement of contractors, to critically review their financials to ensure that they can commit to capital market loan agreement terms and demonstrate their ability to pay back their loans, all of which are necessary to enable the NWFF to regularly issue have long tenor bonds in the local capital market to finance the expansion of the water companies' infrastructure.

WFF plans to develop follow-on NWFFs after achieving the successful set-up of the first one in Kenya, thus creating a series of local water financing facilities in several countries. The WFF team's activities early on will mostly be spent in identifying the candidate countries to be targeted and preparing the ground for local implementation, including identifying eligible projects with the water and sanitation companies, working with the government agencies, donors, technical assistance groups, local capital markets authorities, regulators and general stakeholders to prepare the market for bond issuances, and working with interested investors to provide them with an investable security.

The first country for WFF to develop a National Water Finance Facility is Kenya, where WFF creates the Kenya Pooled Water Fund (KPWF). This includes covering all development and management expenses for the full operationalization of the KPWF, with a first local pooled fund transaction is expected to be completed in 2018.

Preparatory work for selection of the next countries is underway. Several scoping missions have already been undertaken to select the next country. Ultimately, we expect to develop some 5-8 countries within the 10-year scope of this proposal, subject to substantial new funds becoming available and when a successful launch of the first pooled fund in Kenya is more certain.

WFF consists of a central management team in Amsterdam and local NWFF management teams in each country of operation. WFF's central management team is tasked with the serial development of sustainable NWFFs, gradually establishing and guiding a permanent local team in each country. The WFF central management team is also responsible for arranging the required donor and DFI support for the local pooled funds.

Why WFF?

The availability of financing and safely managed water and sanitation services for all (as formulated in SDG 6) cannot be achieved by public sector funding and management alone. WFF, as a non-bank, public benefit financial company, can make a difference by using its capital to develop local water financing facilities that catalyse the contribution of the domestic private institutional, large-scale and long-term capital market financing into the water sector.

WFF will catalyse local capital market development by providing alternative, creditworthy, long-term investment opportunities for the local pension funds and other institutional investors in the domestic capital market. WFF's target is to help local water utilities develop financeable projects and obtain access to financing and thus provide approximately 20 million people with sustainable access to safe water and adequate sanitation services.

Capital market-driven

The NWFFs that WFF will create will be structured to fit the usual terms and requirements for private debt funding in the local capital market, typically through either a publicly listed bond, a private placement or another form of debt.

NWFFs will exclusively fund creditworthy water and sanitation institutions, with predictable cash flows that can cover operational costs and debt service. Maturities will be targeted to match the economic life of the assets funded and borrowers will be required to have acceptable governance and appropriate reporting responsibilities.

On the other hand, blended finance, such as viability gap funding or output-based aid to cover non-commercial elements of a financial structure can be important to elevate borrowers to a bankable level and will, when available, be incorporated appropriately into transactions without distorting market pricing.

Risk-mitigating tools will also be used, if needed, to enhance the creditworthiness of the pool of loans entered into by water and sanitation borrowers to meet requirements of the local capital market investors. It is expected that in economies with no or low issuance of water related infrastructure securities, institutional investors generally will require some type of credit enhancement, including guarantees, to achieve a successful first launch.

Pooled Funds

Although WFF can catalyse the issuance of standalone transactions (i.e. the issuance of a debt for a single water or sanitation company), WFF is expected to predominantly utilize the technique of issuing pooled bond transactions. A pooled bond transaction involves aggregating or bundling loans from several creditworthy water and sanitation companies and funding them through the issuance of a single bond in the capital market. The local pooled bond transaction can be, where needed, appropriately credit enhanced with de-risking instruments (e.g. guarantees) to become a viable investment proposition for the local institutional investor community.

Pooling a number of loans into a single transaction for financing has three advantages over single issuance vehicles: (1) the common financing structure spreads the transaction costs among all borrowers, creating an economy of scale; (2) it creates a larger capital market financing, which attracts more investors; and (3) it diversifies risk making the transaction less costly to credit enhance.

In Kenya, each bond transaction will be implemented using a Trust, a special purpose vehicle (SPV), established with the sole purpose of issuing a single bond or privately placed note. The proceeds of the bond issue will fund a pool of loans to cover the capital infrastructure costs of defined creditworthy water and sanitation companies. Payment of interest and principal on the loans by the water and sanitation companies will cover the debt service on the bond or note, the fees associated with the issuance as well as the NWFF's operational costs. Each subsequent bond is expected to be managed through a similar but new SPV. A dedicated locally established NWFF Management entity will be responsible for managing the complete transactional process in each country.

Public‐private partnership: stakeholders buy‐in

Consultation and cooperation with relevant stakeholders is an important basic principle for WFF. It will lead to a better understanding of the concept and, as such, reduce the risks of implementation. We feel that it is important that stakeholders are consulted and are regularly engaged in the process. To be successful, WFF needs full support from both the public sector and the capital markets.

In Kenya, KPWF has achieved full buy‐in by all levels of governmental stakeholders, from the central government as well as the counties, the Ministries of Finance and Water & Irrigation, the capital markets regulator, the water companies and the private institutional investors. Last but not least, KPWF has engaged with the predominant development partners institutions supporting the sector: USAID has become an advocate for KPWF, providing funding for the set‐up and providing guarantees for the first transaction. SNV and the Kenya Market Trust assist the development of the project pipeline. The World Bank has been very supportive and instrumental in preparing the sector for commercial financing.

In other target countries, we will reach out to both public and private sector entities, like we did in Kenya, to ensure local support for the implementation of the NWFF concept.

A country‐by‐country approach to development impact

WFF will be requiring a separate business plan to justify the establishment of each NWFF, centered on a country‐specific theory of change (ToC) and development impact target. Approval to prepare each country business plan and eventually possibly setting up new NWFFs will be the responsibility of WFF, subject to its Board's approval.

The NWFF proposition and structure in each potential country of operation will be tailored to that country's legal, regulatory and capital market's framework and each one can be expected to be slightly different. In countries such as Kenya, where private sector financing of the water sector is a new concept, the main development impact target is the transition into bankability of the water and sanitation providers and the ability to access private institutional funding for the sector to contribute to SDG 6. The impact approach further emphasizes on governance, safely managed services, health gains, gender equality, affordability, services to the pro‐poor, climate resilience and other societal objectives.

Achieving a target business volume of €1 billion by the end of 10 years

WFF's goal is ultimately to achieve a business size of circa €1 billion in water bonds in 5‐8 countries. Each country will have widely differing requirements compared to other countries, and, as a result, show very different budgeting needs.

Activities

The WFF activities include the following elements:

WFF Business Development:

- WFF global team activities: leadership, strategy, country selection and quick scans and identification missions, impact strategy and monitoring and reporting, governance, relationship management with organizations in the financial and water sectors, risk management, control, innovation, knowledge management, back‐office and administration.
- Preparation of the set---up of NWFFs: business plan development, build local public and private sector support and networks, preparations for structuring the first bond issuance and loans to the water

companies, identify and analyse creditworthy water companies for the first two years, identify and support project development teams at local NWFF level.

- Secure funding for the next WFF Development Phase.

NWFF Set Up and Business Development (within target countries):

- WFF supports all NWFFs financially 100% until they reach sufficient business volume to achieve breakeven levels (i.e. local fee income meets or exceeds expenses levels)
- The NWFF teams are fully responsible to manage all aspects of running the local financial structure after the start---up phase, including managing the existing financing portfolio's, arranging the next financing batch, complying with all legal and regulatory requirements, managing stressed loans, etc.

NWFF Project development revolving funds

- Establishment of the Revolving Fund to finance project development activities that cannot be provided or funded by the water and sanitation companies (preliminary investigations, feasibility studies, detailed design, tendering, etc) Project development cost that incurred are to be refinanced to the NWFF by the water and sanitation companies out of the bond proceeds.

WFF contribution to Credit Enhancement (first loss reserves)

- WFF is expected to be able to provide or arrange the subsidized de---risking required in the pooled funding, to "skin in the game" and to retain control over the issuance process in case of insufficient third---party funds being available.

Presented in this document but not included in WFF's budget (to be funded from external sources) are the following items:

- Guarantees (first loss / additional). Guarantees are a key requirement to achieve the desired investment grade levels for the loan pools to be acceptable to institutional investors.
- Output Based Aid, Technical Assistance or Viability Gap Funding. As mentioned, for less affluent WSPs or for particular purposes (such as serving the urban poor) lowering the CAPEX of their investments and thereby increasing their ability to service the loan. However, this "blending" will be done "outside" the bonds.

In summary, WFF needs substantial donor support, additional to a €10M contribution from DGIS, and various interventions to set up the WFF structure including several NWFFs in target countries whilst comforting local private capital markets. In time, WFF can be revolving and self-sustaining.

WFF Partners

WFF is associated with Cardano Development, a manager of alternative and focused funds with a strong track record in developing and scaling-up innovative finance solutions in frontier markets. WFF received initial funding of EUR 10 million from the Government of the Netherlands, and is endorsed by the Global Innovation Lab for Climate Finance.

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