



WATER FINANCE AND PPPs

UfM WATER
FINANCE
SERIES

#2

Public Private Partnerships and the financial sustainability of the Mediterranean water sector



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This report provides information on the first UfM Water Investment and Financing Forum held in the framework of the implementation of the UfM Financial Strategy for Water.

The Forum was organized with the generous support of the Swedish International Development Cooperation Agency.

The event was politically supported by the Italian Government, in partnership with the Italian Institute for International Political Studies (ISPI), and hosted by the Mediterranean Dialogues (MED).

The First UfM Annual Conference on Water Investment and Financing was organised by the UfM Water Team, led by Almotaz Abadi (UfM Managing Director for Water). Roberto Martin Hurtado (Special Advisor on Water Economics) supported the design of the workshop and wrote the workshop report.



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FOREWORD

We are proud to present the report of the First UfM Annual Conference on Water Investment and Financing. In the process of developing the UfM Financial Strategy for Water, we heard from our partners that a regional platform was very much needed to facilitate dialogue and peer learning on this crucial topic among all stakeholders. We promptly reacted to that demand, with an ambitious vision, and launched what we hoped could soon become an important feature in the calendar of the water and financing sectors in our region.

The first Annual Conference did not disappoint. We were fortunate to enjoy high political support from our kind host, the Government of Italy, and excellent organisation from our partner ISPI. Governments, financiers, service providers and civil society organisations responded to our call. Countries reported on their recent efforts and identified priorities, financiers told water people how they can improve, ministers highlighted the political importance of the UfM Water Agenda, water service providers and regulators discussed the benefits and limitations of public private partnerships...

The quality of those exchanges has prompted us to publish this Conference report. We hope it will be useful to all those that care about ensuring universal access to water and sanitation and sustainable management of water resources in the Mediterranean.

We organised the Conference in December 2019, in a world that was different. The COVID-19 pandemic forced us to pause, and reflect. Given the social and economic impacts of the COVID-19 health crisis, we find that the UfM work on promoting water investments and ensuring the financial sustainability of water services is more important than ever. We will be back soon, better.

BACKGROUND AND OBJECTIVES

The First UfM Annual Conference on Water Investment and Financing took place in Rome (Italy) on 5th December 2019. It was organised by the UfM Secretariat in partnership with ISPI and GWP-Med and with the financial support from Sweden. The Conference took place within the framework of the Mediterranean Dialogues.

The UfM Annual Conference on Water Investment and Financing is one of the activities organised by the UfM Secretariat to support UfM Member States to achieve the objectives of the UfM Financial Strategy for Water. The development of the UfM Financial Strategy for Water was mandated by the UfM Ministers at their 2017 meeting in Malta. It was developed by a task force of UfM Member States developed throughout 2018 and approved by the UfM Senior Officials' Meeting in December 2018. Activities carried out in 2019 by the UfM Secretariat to support its implementation include the organisation of national workshops on water financing in Jordan (Amman, 19th March) and Albania (Tirana, 31st October), the organisation of regional training on climate finance (Brussels, 11th-12th June), and the organisation of special sessions at the EU-UfM Water Governance and Business Forum (Cairo, 20-21 October).

The UfM Annual Conference on Water Investment and Financing has three objectives:

- to raise the profile of water investment and financing issues on the regional political agenda and within the finance community;
- to push the boundaries of traditional thinking about water investments and financing by dissemination and discussing evidence-based knowledge on opportunities to facilitate investments and enhance the financial sustainability of the sector; and
- to promote water investments as well as policy reforms to enhance the financial sustainability of the water sector.

The UfM work on water financing is steered by the UfM Water Expert Group (WEG), co-chaired by the European Commission and Jordan. Following the guidance of the WEG at its 10th meeting (Brussels, 13th-14th June), the special topic of the inaugural edition of the Annual Conference was "Public Private Partnerships and the Financial Sustainability of the Water Sector".

PARTICIPATION AND STRUCTURE

The Conference attracted about 40 participants from UfM governments and parliaments, international organisations (GIZ, EIB, OECD, World Bank), water operators (EurEau, AquaFed), water regulators (ARERA), private financiers (Association of Banks in Jordan, Climate Fund Managers), and civil society organisations (CEDARE, Eco-Peace Middle East, GWP-Med, Med-Cities, MENBO, WIMA).

The Conference was organised around seven sessions:

- Opening speeches by WEG co-chair (Jordan), Sweden, GWP-Med, UfM Secretariat and host country (Italy).
- Roundtable session to inform peers about priority objectives, recent progress and future efforts – which featured interventions from Algeria, Egypt, Israel, Jordan, Malta, Morocco, Palestine, Tunisia, Turkey as well as from selected partners including GIZ, GWP-Med, Med-Cities, MENBO, OECD, Sweden, and WIMA.
- Panel discussion on how and why to engage private financiers – which featured interventions from OECD, Association of Banks in Jordan, Climate Fund Managers European Investment Bank (EIB), and European Federation of National Associations of Water Services (EurEau).

- High Level Session on the regional dimension of water cooperation – which featured interventions from the Italian Vice Minister for Foreign Affairs, the UfM Secretary General, the Tunisian Minister for Agriculture, Water Resources and Fisheries, the Maltese Minister for Energy and Water Management, and the Jordanian Secretary General of the Ministry for Water and Irrigation.

- Session on sharing country experiences with public-private partnerships -- which featured presentations from Algeria, Israel, Jordan, and Palestine.

- Panel discussion on the role of private operators in contributing to the financial sustainability of the water sector – which featured interventions from the UfM Secretariat, The International Federation of Private Water Operators (AquaFed), and the World Bank.

- Closing session chaired by the UfM Secretary General and featuring interventions by Jordan, Malta, GWP-Med, World Bank, and Italy.

SESSION 1 - OPENING

The establishment of the UfM Annual Conference on Water Investment and Financing is highly relevant and timely. Improved water management and development is essential to achieve the Sustainable Development Goals in the Mediterranean, as well as to maintain peace and stability in the region. There is an urgent need to move into action – 160 million living in the Mediterranean are water poor, water demand will increase by 60% by 2050, and the region is already the 2nd region most affected by climate change (after the Arctic).

UfM member states are making substantial efforts to address the water challenges in the region, but financing represents a key bottleneck. The combination of large financing needs and limited public funds calls for a larger involvement of private financiers. Attracting private funding will require sustained public action (sector reforms, tariff reforms that respect affordability thresholds, guarantees) and should thus be considered a medium-to-long term target.

SESSION 2 - IMPLEMENTATION OF THE UFM FINANCIAL STRATEGY FOR WATER

The UfM Financial Strategy for Water is a useful tool to support UfM member states in making progress towards mobilising financial resources and achieving the financial sustainability of the water sector. While the priorities are different from every country, almost all the objectives of UfM Financial Strategy for Water are a top priority for at least one country.

The three pillars of the UfM Financial Strategy for Water are equally relevant: approaching water financing in a strategic way (objectives 1 and 2), making the best use of existing financial resources (objectives 3, 4, 5 and 6), and mobilizing additional financial resources (objectives 7, 8, 9 and 10).

Two objectives have been highlighted by most countries as being a priority: reforming the water sector (pillar 1) and reducing inefficiencies (pillar 2).

Several countries have introduced or are in the process of introducing new laws, and some have developed a policy reform matrix to guide their efforts. Tunisia has started to organise annual sector reviews. For pillar 3, most countries identified increasing internally generated revenues. This could be done by improving billing systems (Malta) and other customer management systems (Tunisia) and by reforming tariffs (Algeria, Egypt, Israel). Several countries also mentioned mobilising climate funding (Morocco, Palestine, Tunisia).

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Objective	Countries for which it is a top 3 priority
1-Reform the water sector to enhance its financial sustainability	Israel, Jordan, Malta, Morocco Palestine, Tunisia
2-Integrate water financing considerations across water-related sectors	
3-Use existing financial resources to fund water-related activities that provide the highest social, economic and environmental benefits	Algeria, Egypt, Palestine, Turkey
4-Improve the coordination of water-related investments	Tunisia
5-Increase value-for-money in the implementation of water-related projects and the delivery of water services	Turkey
6-Increase efficiencies in water use and ensure adequate asset management to optimize the use of existing financial resources	Egypt, Israel, Malta, Morocco Tunisia, Turkey
7-Increase revenues internally generated in the sector	Algeria, Israel, Jordan, Malta
8-Increase allocations of public budgetary resources to water-related activities	Egypt, Morocco
9-Mobilize more resources from domestic private actors	Jordan
10-Use resources from international financial partners strategically to leverage other sources of finance	Algeria, Palestine

Partners support the need to continue engaging a broad set of actors in water financing discussions both at national and regional levels. Specific issues highlighted include:

- Pillar 1: regulatory reform, intersectoral approaches, the role of local authorities and the need to increase their capacities,
- Pillar 2: optimisation of operational costs
- Pillar 3: definitions of affordability, enabling sub-national lending from IFIs, engaging private financiers

SESSION 3 - WHY AND HOW TO ENGAGE PRIVATE FINANCIERS IN FINANCING WATER INVESTMENTS

In all world regions there is mismatch between the water and financing communities. The OECD Roundtables on Financing Water aim to bridge this gap by mapping financing needs and flows, helping to enhance financing decisions, and analyse policies that drive investments. One such Roundtable could be established in the Mediterranean.

Water investment needs are very large. Traditional drivers for water-related investment needs include compliance, population growth, adaptation to climate change, achieving the appropriate level of security, and the state of existing assets. Emerging drivers include sludge management and new pollutants. Compliance alone will require an estimated EUR 290 billion in water investments in the EU.

The quality of water expenditure programmes needs to increase. This includes minimising future financial needs (by enhancing operational efficiency and void building future liabilities) and making best use of financial resources (by planning and setting priorities and reaping economies of scale).

While public funds for water investments will likely decrease, there are significant opportunities to attract private financiers to the water sector. These are good times for attracting investments (not least because the current low interest rates), but it requires stable revenue streams, careful allocation of risks, and the right enabling environment.

It is important to distinguish two forms of private financing: equity and debt. In the water sector most private financing is through debt – even in the UK, where the private sector has taken ownership of utilities, but in a highly leveraged way. Commercial banks can be expected to be the main private financiers. For example on Jordan 24 banks managing USD 73 billion in assets are using part of their excess liquidity to financing water investments – over USD 1.4 billion in 5 years to financing over 700 projects (mostly to the public sector or to private sector with government guarantees).

The role of private financiers is evolving and will continue to do so. One option is to develop partnerships between international banks and local banks, as local banks can assess local risks better and could provide guarantees to reduce the overall cost of financing. Bundling of multiple projects/utilities together can help to decrease risks for private financiers. Other possible option is to use blending of concessional funding and private equity for project development, and once the project is up and running use refinancing from commercial banks (for creditworthy utilities).

Public and development finance can be deployed to facilitate private involvement. For example through blending different sources of capital. But attention needs to be paid to prevent undue competition with private financiers.

Many issues at the interface of water and finance need to be further analysed. They include valuing water, determining the appropriate level of de-risking, how best to avoid competition and capture synergies among financial actors, adopting a landscape approach, diversifying sources of revenue by applying the polluter pays and beneficiary pays principles, and attracting intermediaries (to facilitate negotiations between multiple actors such as those required for the implementation of blending or the landscape approach).

Private financiers face important barriers to finance water investments. These include well-known issues such as the absence of strong pipelines of projects and the overall governance framework, but also operational issues such as leading with multiple stakeholders, and when lending to contractors (rather than to project promoters) the high risk of contractors and delayed payments to contractors by project promoters. UfM member states can enhance the contribution of private financiers to the financial sustainability of the water sector, for example by putting in place government guarantees or tax incentives, and leveraging donor support for technical financial support and guarantee programmes.

There is a role for the UfM process and partners to enhance the contribution of private financiers to the financial sustainability of the water sector. Options include creation of networking opportunities (bringing more financiers to water meetings, setting up a permanent dialogue platform), analytical work (collect and share good experiences and lessons learned), capacity development of member states, and technical assistance (facilitation of project structuring and pipeline development).

SESSION 4 - HIGH LEVEL SESSION

The Mediterranean welcomes private sector investment and financing. Water is both a commodity and a fundamental right, and is one of the most pressing issues in the region – climate change could reduce water availability by 15%. UfM member states are aware that there is money available from financial institutions to finance water investments and management improvements. Both international and domestic private financiers are invited to participate.

UfM member states are already making significant efforts to facilitate water investments and attract private financing, but further efforts will be required. Current efforts include priority setting, legal and institutional reforms, improvements in investment planning, and significant budgetary allocations. UfM member states need to do more work both at sector and project-level, including a balanced use of the ultimate sources of finance (3Ts), adequate risk/reward profiles of projects, improved project structuring, and use of blending/guarantees.

There is high-level political support for the implementation of the UfM Financial Strategy for Water to increase the financial sustainability of the water sector. The Strategy can be used at national level to launch a process to mobilise relevant actors (including domestic private sector actors) and monitor progress. Some countries have already organised national workshops and more should consider to do so. National efforts, successes and lessons learned should be documented and shared at regional level.

SESSION 5 - PUBLIC PRIVATE PARTNERSHIPS IN THE MEDITERRANEAN REGION

There is already significant experience with public-private partnership in the water sector in the Mediterranean. The GWP-Med/OECD Water Governance and Financing project analysed the cases of Jordan, Lebanon and Tunisia and identified important findings regarding institutional frameworks and capacity development:

- Institutional frameworks. Cross-institutional interaction is key for successful PPPs. The relationship between ministries of water and water regulators that needs to be carefully navigated. The institutional location of PPP Units (as well as their responsibilities) need to be carefully determined. Financial independence of regulators and utilities would increase the likelihood of success.
- Capacity development. There is often confusion of PPPs with privatisation. Private sector actors, including banks, are largely unclear on their role, benefits and obligations. Changes of administration hurt the capacities of public institutions. Learning by doing is a promising strategy to develop capacities.

The Conference discussed further examples from Algeria, Israel, Jordan, and Palestine. Several lessons learned were identified in the areas of enabling environment, managing PPPs, financing of PPPs, and the contribution of PPPs to financial sustainability of the water sector.

- Enabling environment. The discussion reiterated the importance of having a water regulator, but also emphasised the usefulness of having “one table” for decision making (like Israel’s Water Authority Board).
- Managing water PPPs. It is important that the government gets ready to manage PPPs (Jordan). Governments can build on their experience with management contracts before entering into more complex PPP arrangement (Palestine). Design and tendering contracts takes time (Israel). It is important that private operators are familiar with the language, culture, and legal and institutional framework of the country (Algeria).

- Financing water PPPs. PPPs allow to combine government financing with financing from development partners (Algeria) and with financing from domestic bank consortiums (Jordan), but government guarantees may be needed (Jordan). Reducing risks for private investors will allow to obtain better terms of price (Israel).
- PPPs and financial sustainability of the water sector. The private sector can construct and operate more efficiently (Israel). Private operators help to reduce operational cost, such as those related to water losses and energy consumption (Jordan, Palestine). PPPs may allow to reap economies of scale (Israel). PPPs can improve cost recovery through improved billing and customer management (Algeria).

SESSION 6 - WHY AND HOW TO ENGAGE PRIVATE OPERATORS IN ENHANCING THE FINANCIAL SUSTAINABILITY OF THE WATER SECTOR

The recent EU-UfM Water Governance and Business Forum has examined the relationship between water PPPs and the financial sustainability of the water sector, as an input to this Conference. The conclusions can be structured as follows:

- Getting the concept right. A better label may be private sector participation in the provision of water-related services. It is important to broaden the perspective on what constitutes the relevant private sector. There is also a need to broaden the discussion on water-related services to include irrigation and flood management.
- What private operators can and cannot do. Private operators should not be seen as source of financing for the water sector. However, private sectors can contribute significantly to enhancing the financial sustainability of the water sector. They can do so by helping to (i) develop a long-term vision of financial sustainability for the water sector, (ii) reducing costs, both short-term costs (through improved operational efficiency), long-term costs (through improved asset design and management), and financial costs (through improved creditworthiness of utilities), and (iii) increasing revenues (through improved billing and collection systems, and kickstarting a virtuous circle of improved services/increased willingness to pay/tariff reform).

- Governments need to learn to drive. PPPs will happen when there is a confluence of interest from government, operators and financiers. Government action will determine the success of PPPs. Specific areas where government action needs to focus includes: economic regulation, strategic use of public finance, project screening procedures, getting ready efforts, careful contracting, and functioning billing and collection systems.
- Development partners can support government efforts. They can bring more attention to the water sector as a whole sector (as opposed to paying attention just to projects in isolation), finance preparatory studies, support peer learning, and supporting implementation of PPPs that could later be showcased. The UfM could implement a regional programme that would enable: regional benchmarking, peer learning, and engagement of private financiers.

The session confirmed the conclusions of the EU-UfM Water Governance and Business Forum and showed that discussions about water PPPs in the region have become more sophisticated than a decade ago. It highlighted a number of additional recommendations.

- Place water users and beneficiaries at the centre of water PPPs. In the last 10 years the share of world population served by private operators has increased from 5% to 10%. Successful water PPPs require engaging with the users and communicating service changes to the population, including transparent information about the PPP contracts and what they are expected to deliver.
- Focus first on optimising existing assets. The temptation to focus water PPPs in building new infrastructure should be avoided. Water PPPs should focus on delivering sustainable services to the population. This may or may not require building new infrastructure, and attention should be paid initially on how to make the most of existing infrastructure.
- Realize that independent regulators are a catalyst for water investment and financing. Credible regulation increases the creditworthiness of utilities, by increasing the likelihood that any loans and bonds will be effectively repaid. In Italy since the creation of ARERA in 2012 water investments increased from EUR 1 billion to EUR 4 billion.
- Promote and take advantage of competition in private sector participation. As more PPP contracts are implemented around the Mediterranean, it is important to expand the pool of potential private operators that take part in PPPs. Increased competition among private operators can be expected to deliver better results overtime.
- Take advantage of and contribute to knowledge management on water PPPs. There are already a number of related knowledge initiatives (PPP Knowledge Lab, PPI Database, PPIAF) of which UfM member states can benefit from. It will also be important to share new knowledge through those initiatives or other mechanisms, including future UfM platforms and events. The UfM is seen as a “honest broker” and could leverage its regional convening power to facilitate knowledge sharing .

SESSION 6 - CONCLUSIONS AND CLOSING

Promoting the financial sustainability of the water sector is key to achieve national and regional development goals. The UfM Water Agenda provides a broad and integrated perspective of the water challenges while engaging civil society in addressing them. While the four pillars of the Water Agenda include a financial dimension, the water-food-energy-environment (WEFE) nexus pillar in particular is important to facilitate the engagement of different ministries in water financing decisions.

The UfM has an important role to play in promoting the financial sustainability of the water sector. The recent work has been moving in the right direction. Further dialogue is necessary, as many water people don't understand water financing. Future work needs to look for failure and successes, and engage private financiers.

People needs to be placed at the centre of future efforts by UfM member states and partners. Building new water infrastructure is important, but the goal is to deliver good services, which require customers/users/beneficiaries to be part of solution.



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