



RESULTS-BASED FINANCING FOR WATER SERVICES PROVIDERS IN KENYA





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TABLE OF CONTENTS

Abbreviations and acronyms	iv
Output Based Aid for Water and Sanitation	1
Kenya OBA Fund for Low-Income Areas	3
Flow of Funds	4
Eligibility Criteria	4
Application and Disbursement Process	5
Roles of Project Partners	7
Indicative Term Sheet	9
Output Based Aid (OBA)	9
Debt Service Example	11
The Essentials of Preparing for OBA Projects	12



ABBREVIATIONS AND ACRONYMS

KES	-	Kenya Shilling
GoK	-	Government of Kenya
GPOBA	-	Global Partnership for Output Based Aid
MDG	-	Millennium Development Goals
MoF	-	Ministry of Finance
OBA	-	Output-Based Aid
SIDA	-	Swedish International Development Aid
SUWASA	-	Sustainable Water and Sanitation in Africa
USAID	-	United States Agency for International Development
WASREB	-	Water Services Regulatory Board
WSB	-	Water Services Board
WSP	-	Water Service Provider
WSTF	-	Water Sector Trust Fund

Output Based Aid for Water and Sanitation

The Water Sector Trust Fund of Kenya (WaterFund) is running an output-based aid (OBA) program that provides financial incentives to water services providers (WSPs) to invest in rehabilitation and expansion of water and sanitation infrastructure. The objective of the program is to improve the operating efficiency and financial performance of WSPs, and to extend access to unserved consumers. The program is supported by the World Bank, with funds from the Swedish International Development Agency (Sida).

To qualify for financial incentives, WSPs need to finance their investments with commercial loans.

Domestic lenders, primarily commercial banks operating in Kenya, will appraise and finance WSP investment projects. WaterFund will pay a subsidy to WSPs that successfully implement projects that achieve pre-agreed results. The subsidy is a non-repayable grant to reimburse the WSPs for part of the capital investment cost.

Kenya OBA Fund for Low-income areas.

This project provides OBA to WSP projects financed with commercial loans that achieve a mix of the following outputs: new individual water and sewer connections, water kiosks and public water supply points, and public toilets.

The maximum OBA subsidy is 60% of the amount borrowed for investment.

Types of investments funded:

- » Technical assistance to prepare and implement projects
- » Construction/expansion of water and sewer networks to reach unserved consumers
- » Rehabilitation/improvement of existing networks e.g. NRW reduction program
- » Water and/or sewer connections to households and public points
- » Water and sewer treatment facilities

Kenya OBA Fund for Low-Income Areas

OBA is a performance-based subsidy, meaning that most of it is paid only after the services or outputs have been delivered and verified by an independent agent. The subsidy targets the poor by focusing on areas in which poor people live.

Under the OBA Fund, WSP sub-projects will be pre-financed with commercial loans from domestic lenders on market terms. While the WSP is free to select any financial institution, Housing Finance, Sidian Bank, Co-operative Bank and Kenya Commercial Bank have access to a 50% guarantee provided by USAID.

Loans will support investments that result in improved access in low income areas. The targeted outputs are:

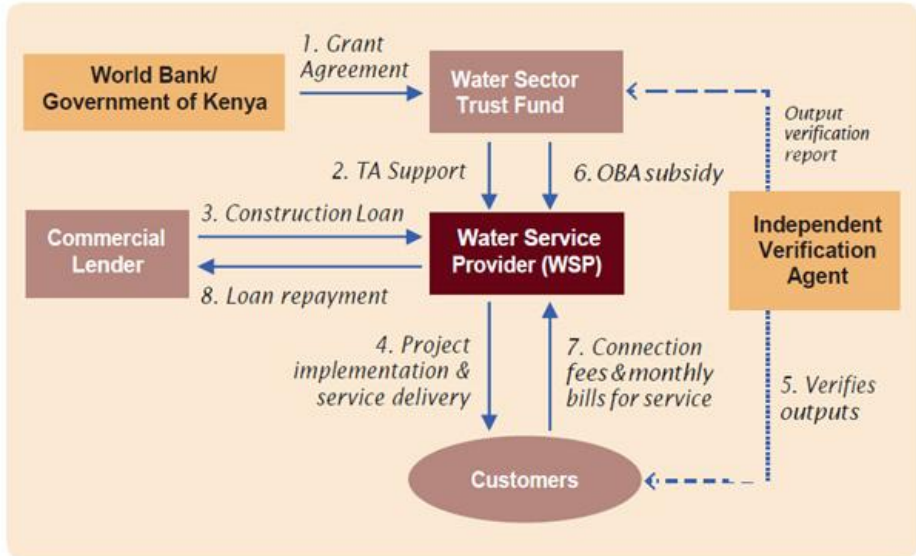
- » Individual water connections
- » Individual sewer connections
- » Public water kiosks & water points
- » Public toilets

A WSP is eligible to receive technical assistance funding for hiring a consultant to assist with project preparation and supervision, to ensure that a bankable project proposal is prepared for evaluation by commercial lenders, and that the project is effectively supervised during implementation. WSPs must contribute at least 10% towards the total cost of technical assistance.

The loans will fund investments that provide household water and sewer connections, public water kiosks, and public toilets to low-income households. The OBA grant will pay for 60% of the sub-project cost financed by domestic lenders, subject to a cap of US\$115 per beneficiary. Areas eligible for subsidies will be identified through WaterFund's poverty database, Majidata, which has mapped over 1,880 urban settlements, considered 'low income' based on an index of quality-of-life indicators.

Note that areas not mapped in Majidata may be eligible for financing if they meet the Majidata criteria.

Flow of Funds



Eligibility Criteria

The minimum criteria for a WSP to be considered for financial support under the Kenya OBA Fund are listed below:

- » WSP is in compliance with WASREB and WRMA guidelines and has the support of the county government to develop the project.
- » WSP may either be county owned or a private operator or community licensed to provide water and sanitation services.
- » Proposed subproject is demonstrated to be technically feasible and commercially viable as shown in the project proposal.
- » WSP has secured a loan offer to finance the project from a commercial lender in Kenya, and is able to demonstrate its capability to repay the non-subsidized portion of the loan.
- » Proposed subproject is situated in a low-income area that meets the Majidata criteria. In cases where partial project is based in a Majidata area, the portion of the project attributable to the low-income area is eligible for subsidy.
- » WSP has WASREB approved tariff and will charge appropriate connection and

consumption fees to cover operating and maintenance costs and the non-subsidized investment cost of the subproject.

- » WSP connects consumers that can pay at least 40% of the approved connection fee (up to 60% of consumer connection fees may be subsidized, and fees may be payable in installments to increase affordability and uptake by low-income consumers).

Application and Disbursement Process

- 1. Application**

WSPs submit application giving an overview of the planned project. WSP may apply for technical assistance funds to develop a 'bankable' loan proposal or directly for subsidy funds if a loan application is ready.
- 2. Proposal to WSTF and Lender**

WSP submits subproject proposal to WSTF with a request for subsidy and to commercial lender(s) with a loan application.
- 3. Loan Application Appraisal**

Commercial bank assesses proposal for technical feasibility and financial viability, and WSTF appraises project proposal for subsidy eligibility. If due diligence is satisfactory, lender issues conditional loan offer and WSTF issues Certificate of Eligibility for OBA subsidy.
- 4. Baseline Assessment**

WSTF commissions baseline assessment of subproject by IVA. WSTF and WSP agree on outputs against which subsidy will be paid, and this is recorded in the baseline assessment report for OBA subsidy.
- 5. Subsidiary Agreement**

On acceptance of the conditional loan offer by the WSP, a subsidiary agreement between the WSTF and WSP is signed. WSTF disburses 10% of projected subsidy to the WSP.
- 6. Project Implementation and Supervision**

On acceptance of the conditional loan offer by the WSP, a subsidiary agreement between the WSTF and WSP is signed. WSTF disburses 10% of projected subsidy to the WSP.
- 7. Output Verification and Release of Subsidy**

On completion of project implementation, WSP requests WSTF for independent verification of outputs. IVA verifies extent to which outputs have been achieved and recommends subsidy payment to WSP.
- 8. Subsidy Payment**

Upon independent verification, balance of subsidy (90%) is payable as follows: 65% against meeting output targets; final 25% after confirmation that at least 80% of consumers' connections under project are active (as demonstrated by monthly bills and receipts). Subsidy may be swept into WSP loan account to pay down part of the loan.
- 9. Project Continuation**

WSP continues operating the system, billing consumers and collecting revenue. Proceeds are used to cover O&M costs and repay the outstanding loan balance.

Roles of Project Partners

Entity	Role
WaterFund	<ul style="list-style-type: none"> » Project implementing unit » Ensure project is implemented in accordance with the Grant Agreement and operating manual » Verify target investments are being made in low-income areas » Monitor and evaluate the project impacts » Disburse and audit project funds
WSPs	<ul style="list-style-type: none"> » Develop and implement water and sanitation sub-projects within their service areas in accordance with the project rules » Access loans from commercial lenders for pre-financing » Provide services to consumers in low-income areas » Repay non-subsidized portions of commercial loans during sub project post-implementation operational phase
Private Operators & Communities	<ul style="list-style-type: none"> » Alternative service providers under the project with a similar role to the WSPs
Lenders	<ul style="list-style-type: none"> » Appraise WSP loan applications » Pre-finance sub-projects and manage longer term loans
World Bank	<ul style="list-style-type: none"> » Subsidy and implementation support funding » Management and supervision of the project » Support to WaterFund and WSPs to meet the project objectives » Support private sector/commercial lending initiatives
Beneficiaries (households)	<ul style="list-style-type: none"> » Payment of connection fees » Payment for monthly consumption
Independent Verification Agent	<ul style="list-style-type: none"> » Baseline assessment and output verification » Assessment of subproject costs and eligible subsidy » Verify investments made in the targeted low-income areas
WASREB	<ul style="list-style-type: none"> » Monitor/report on WSP compliance » Approve any changes to Service Provision Agreement » Review and approve (case by case) tariff change applications
MoEWNR	<ul style="list-style-type: none"> » Support for WSPs to clear requests with National Treasury

Indicative Term Sheet

Output Based Aid (OBA)

Item	Condition
Loan Amount	Up to 100% of project cost
Purpose	Improving access to water & sanitation for low- income households
Maximum loan amount	Up to 100%
Loan tenure	Grace Period - Up to 1 year
Interest rate	Market rates (currently 13.5% – 14%)
Loan appraisal fee	1% to 2% (depending on commercial lender)
Security for Bank	Assets debenture over the WSP's assets
Level of subsidy	Maximum of 60% of loan amount
Subsidy cap	Each subproject is subject to a subsidy cap of US\$115 per beneficiary
10% of subsidy	Payable after WSP and Bank sign loan agreement
65% of subsidy	Payable after WSP has achieved agreed outputs
25% of subsidy	Payable after confirmation that 80% of connections are active for at least 3 months

Debt Service Example

The actual amount of monthly debt service payable to a commercial lender by the WSP will vary according to:

- » Timing of disbursements
- » Interest rate
- » Loan tenure
- » Amount of subsidy awarded to the WSP

This is an example of a monthly debt service payable for a KES 100 million loan facility.

OBA Facility without subsidy	
Item	Amount (KES)
Project infrastructure cost	100,000,000
Principal loan amount (assuming WSP contributes 10% equity – project has no equity requirement so this depends on lender's criteria)	90,000,000
Loan condition: 5 Years term loan + 12 Months grace period	
Monthly interest payable over grace period	1,050,000
Monthly principal + interest loan repayment	2,033,750
Total loan repayment	134,625,000
OBA Facility with subsidy	
Project infrastructure cost	100,000,000
Principal loan amount	90,000,000
Loan condition: 5 Years term loan + 12 Months grace period	
Monthly Interest payable over grace period	1,050,000
Monthly principal + interest loan repayment	813,500
Total loan repayment (including subsidized interest during grace period)	53,850,000

The Essentials of Preparing for OBA Projects

Four basic steps are required to qualify for WaterFund's OBA financial support:

1. Application and prerequisites:
 - » Documents accrediting registration under the Company Act
 - » Documents accrediting registration at the Water Services Regulatory Board
 - » A valid Service Provider Agreement (SPA)
 - » Valid tax compliance certificate
 - » Social and Environmental impact assessment report
 - » Consent from Water Services Board and county government
 - » Project brief containing facts and figures on:
 - › Service area and population (beneficiaries)
 - › Water supply scheme
 - › Consumer categories and numbers
 - › Sewerage collection and treatment scheme (if any)
 - › Financial statements for last 3 financial years, supported by audited accounts
 - › Main challenges
 - › Objective and scope of project
 - › Cost estimates of proposed project/related financial costs
 - › Cash flow projections with and without project
 - › Expected results and proposed outputs and outcomes in line with relevant RBF facility

All documents and relevant information, using standard formats where available, should be submitted to WaterFund with an application letter.

2. WaterFund will assess the project for its viability and suitability based on submitted information and site visit(s). If the project passes this initial assessment, detailed technical discussions with the WSP should result in a Memorandum of Understanding detailing the output targets and expected project outcomes agreed between the parties concerned.

3. Bankable proposal, selection of financial institution, and offer letter.

4. WaterFund will enter into a financing contract with the WSP detailing the terms and conditions of the OBA subsidy.

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