

**UFM WATER FINANCING TASK FORCE (WFTF)**

**UfM Water Agenda's Financial Strategy**

Financial Strategy document

20 November 2018

## EXECUTIVE SUMMARY

### THE UfM WATER AGENDA'S FINANCIAL STRATEGY

The development of this Financial Strategy responds to the mandate by the Ministers of the Union for the Mediterranean members in charge of Water and other Heads of Delegation at their meeting in Malta on the 27th of April 2017. Ministers called for a Union for the Mediterranean Water Agenda to enhance regional cooperation towards sustainable and integrated water management in the UfM region. They also requested that the UfM Water Agenda should be accompanied by a financial strategy designed to support its implementation and prepared by UfM members, in consultation with financial actors and the private sector as well as relevant regional stakeholders.

The Financial Strategy promotes the financial sustainability of the Mediterranean water sector in order to secure the social, economic and environmental benefits to be gained from the implementation of the UfM Water Agenda. It identifies challenges that are shared by many countries in the region, while recognizing that not all countries face the same exact challenges or to the same degree. It sets a shared goal, common strategic objectives, and a menu of actions, but individual countries will implement different actions according to their individual circumstances, priorities, and capacities.

### KEY CHALLENGES

**Approaching water financing in a strategic way.** Ensuring the financial sustainability of the water sector is of paramount importance to support economic growth and achieve the Sustainable Development Goals in the UfM region. There is a significant funding gap for water management in the Mediterranean region to achieve the water-related SDGs, to uphold the human rights to safe drinking water and sanitation, and – for EU member states – to comply, as well, with the demands of EU legislation. To close the financing gap, there is a need to adjust tariffs, taxes and transfers. UfM member states need to make the most of the opportunities offered by a financial landscape that is evolving. The basic foundations for sustainable funding models need to be adopted across the UfM region. If private sector involvement in financing the water sector is to be increased, more attention needs to be paid to defining its role and improving the enabling environment.

**Making the best use of existing financial resources.** There is a need improve the balance between building new hard infrastructure, making the most of existing infrastructure, and adopting non-structural solutions. Low level of coordination of planning of infrastructure investments at national and regional levels is preventing countries to get the most of their infrastructure investments. Inefficiencies in the water sector are not always tackled head on. The monitoring and evaluation of expenditures could be stronger.

**Mobilising additional domestic and international financial resources.** The water sector in the UfM region (which includes UfM member states as well as water service providers, water users, technical and financial partners, and other actors) does not make consistent use of all the options to finance its development. Unaddressed affordability concerns undermine the internal generation of financial resources. Allocation of public budgetary resources to sustainable water management is generally insufficient to address the current and future needs. The user/beneficiary pays principle and the polluter pays principle are not applied consistently across the region. Not enough attention is being paid in many countries to engaging private sector investors. The main barrier for attracting funding from international financial partners is the low capacity to increase the quality of project proposals. In most countries, any increase in financial resources for water-related projects will require policy reforms and/or significant efforts towards implementation.

### STRATEGIC OBJECTIVES

1. Reform the water sector to enhance its financial sustainability.

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.
4. Improve the coordination of water-related investments.
5. Increase value-for-money in the implementation of water-related projects and the delivery of water services.
6. Increase efficiencies in water use and ensure adequate asset management to optimise the use of existing financial resources.
7. Increase revenues internally generated in the water sector.
8. Increase allocations of public budgetary resources to water-related activities.
9. Mobilise more resources from domestic private actors.
10. Use resources from international financial partners strategically to leverage other sources of finance.

### **IMPLEMENTATION PLAN OF THE FINANCIAL STRATEGY**

The responsibility for achieving the objectives of the Financial Strategy will remain with UfM member states, individually and collectively. Multiple actors have a role to play (whether leading or supporting) in order to achieve the objectives of the Financial Strategy. The exact actors and roles will vary from country to country, according to their specific institutional settings and policies. Those actors include:

- Ministries in charge of water and irrigation.
- Ministries in charge of finance, investment, planning, development, international cooperation, and foreign affairs.
- Ministries in charge of energy, agriculture, environment, and urban development.
- Regulators.
- Legislative authorities.
- Local-level authorities.
- River basin organisations and agencies.
- Water service providers (small and large, public and private).
- Water users.
- International technical and financial partners.
- Domestic banks and other domestic financial partners.
- Domestic donors.
- Civil society organisations.

The UfM will support the implementation of the Financial Strategy by making use of its convening power to provide a platform for policy dialogue, through the relevant work of the four thematic task forces mandated to support the implementation of the UfM Water agenda, and through targeted work to be carried out under the umbrella of a renewed Water Financing Task Force. The Water Financing Task Force will support UfM member states to achieve the objectives of the Financial Strategy through multi-year work programmes developed by the Members of the Water Financing Task Force and the UfM Secretariat, and approved by the Water Expert Group. Support will be sought from technical and financial partners for the implementation of those work programmes and synergies with other ongoing work will be identified and exploited.

## CHAPTER 1 – INTRODUCTION

**The development of this Financial Strategy responds to the mandate by the Ministers of the Union for the Mediterranean members** in charge of Water and other Heads of Delegation at their meeting in Malta on the 27th of April 2017. Ministers called for a Union for the Mediterranean Water Agenda to enhance regional cooperation towards sustainable and integrated water management in the UfM region. They also requested that the UfM Water Agenda should be accompanied by a financial strategy designed to support its implementation and prepared by UfM members, in consultation with financial actors and the private sector as well as relevant regional stakeholders.

**The Financial Strategy draws upon political leadership and technical expertise.** It has been developed under the guidance of the Water Expert Group (WEG), which was mandated by the Ministers to develop the UfM Water Agenda and the Financial Strategy. The WEG created in February 2018 the Water Financing Task Force (WFTF), co-chaired by Jordan and the European Commission, to develop the Financial Strategy. Membership of the WFTF was open to UfM member states as well as technical and financial partners. The WFTF met three times in order to develop the Financial Strategy: in April, July, and September 2018. The draft Financial Strategy was discussed by the WEG on 6th November 2018 and a final draft was subsequently adopted by the Senior Officials' Meeting (SOM) on 17<sup>th</sup> December 2018.

**The aim of the Financial Strategy is to facilitate increased financing of investments that contribute to access to water; protection against risk of droughts, floods or polluted water; and sustainable growth in the Mediterranean region, while enhancing the financial sustainability of the water sector.** It will do so by raising the profile of the issue on the international political agenda and within the finance community, improving the evidence-base with analytical work on how to overcome the barriers to investment, pushing the boundaries of traditional thinking about financing water-related investments, and promoting impactful ways of financing water-related investments. The time horizon of the Financial Strategy follows that of the UfM Water Agenda: 2019-2030.

**There is a strong rationale to develop a Financial Strategy for the UfM Water Agenda** since UfM member states are facing a number of common challenges that demand a strategic financial response:

- **demographic trends** of population growth, urbanisation, and migration– which results in a constant increase in funding needs to serve the new population with water and sanitation services;
- **economic growth and transformation** – which results in increased needs in terms of water availability, quality, and water-related assets;
- **increasing water scarcity and decreasing water quality** – which require stronger policy responses and investments;
- **climate change** – which has a significant impact on water resources with the potential for devastating effects of more frequent and extreme floods and droughts, increases water demand while shrinking water supplies, increases the vulnerability of water-related assets, and threatens the socio-economic status of vulnerable areas;
- **imbalance between water supply and demand** – which is the result of combining previous challenges and requires investments in developing new water supplies alongside policy responses to increase efficiency and manage demand;
- **past failures to ensure sustainable financing** – some related to the performance of the water sector (including unstable and weak tariff systems), some to institutional and capacity weaknesses (including for the development of bankable projects), and some to the wider investment climate;

- and, in some cases, **weak regional cooperation** and a **political situation** that is affecting the ability to mobilise financial resources for investments.

**The Financial Strategy is a regional, evidence-based document on water financing that provides value added by:**

- offering *strategic guidance* for water financing to support the water agenda for the Mediterranean region owned by all UfM member states;
- providing a *framework* for individual UfM member states to develop their own national financial strategies;
- providing a *basis for dialogue* with financial and technical partners around a number of agreed high-priority strategic objectives; and
- identifying *specific actions* to be carried out at regional level in the short term to support progress towards financial sustainability of the water sector in the Mediterranean region.

**The principles of the Financial Strategy are:**

- promote the financial sustainability required to secure the social, economic and environmental benefits to be gained from the implementation of the UfM Water Agenda;
- identify challenges that are shared by many countries in the region, recognizing that all countries do not face the same challenges or face these to the same degree;
- set a shared goal, common strategic objectives, and a menu of actions, but individual countries will implement different actions according to their individual circumstances, priorities, and capacities.

**The primary target audience for the Financial Strategy are decision-makers within the broader water sector** -- which includes ministers of water and irrigation; ministers of finance, investment, economic development, and planning; ministers of international cooperation; and ministers of energy, agriculture, environment, and urban development; heads of water authorities and water-related governmental regulators, and local authorities. The Financial Strategy is also aimed at technical and financial partners, water users, and other water actors.

**The remainder of this Financial Strategy document consists of three substantive chapters and a brief implementation plan, as follows:**

- Chapter 2 – Approaching water financing in a strategic way.
- Chapter 3 – Making the best use of existing financial resources.
- Chapter 4 – Mobilising additional financial resources.
- Chapter 5 – Implementation Plan for 2019-2021.

## CHAPTER 2 – APPROACHING WATER FINANCING IN A STRATEGIC WAY

### KEY CHALLENGES

**Ensuring the financial sustainability of the water sector is of paramount importance to support economic growth and achieve the Sustainable Development Goals in the UfM region.** The SDG framework includes a goal dedicated to water (SDG-6<sup>1</sup>) as well as several other goals related to water<sup>2</sup>. For the purposes of this document “financial sustainability” is understood as the availability of sufficient financial resources to plan, develop, operate, manage and maintain water systems and to develop and operate the related policy and regulatory frameworks (including tariff mechanisms), so that water is available in sufficient quantity and quality, water services are provided effectively and efficiently, water resources are protected, and water-related disasters are adequately managed. For the purposes of this document “water investments” encompass those at different *scales* (from watershed to household), covering different *functions* (water supply, wastewater management, flood protection), and including the *operating environment* (ownership, governance, regulation).

**There is a significant funding gap for water management in the Mediterranean region** to achieve the water-related SDGs, to uphold the human rights to safe drinking water and sanitation, and – for EU member states -- to comply, as well, with the demands of EU legislation. UfM member states need to work both on improving the management of current water-related expenditures and on raising additional financial resources if the objectives of the UfM Water Agenda are to be achieved. Chapter 3 of this Financial Strategy focuses on the challenge of making the best use of existing financial resources; while Chapter 4 focuses on the challenge of mobilising additional financial resources.

**To close the funding gap, there is a need to adjust tariffs, taxes and transfers.** There are different models for funding the water sector around the Mediterranean region, but all rely on a combination of the three ultimate sources of finance (the 3Ts): contributions from users (“tariffs”), contributions from government budgets (“taxes”), and contributions from donor countries (directly or through multilateral instruments) and from local and international charities and foundations (“transfers”). Lenders (such as public domestic banks, public multilateral banks, and private banks) and investors (such as private companies or public pension funds) can provide finance in the form of loans, bonds and equity investments, but they require remuneration in the form of interest and dividends. Ultimately, the money to pay for interests and dividends must come from a combination of the 3Ts.

**The private sector can mobilise financial resources, but these will need to be paid for.** For example, in a Build-Operate-Transfer (BOT) scheme a private company would provide financial resources to build infrastructure and operate it but by the time the transfer has been completed it will have to get its investment back plus a risk-adjusted remuneration for the capital invested and the management services provided. Financial instruments such as credit guarantees can reduce the remuneration required by lenders and investors, but someone (to be determined in advance) has to pay the cost of the guarantees.

**UfM member states need to make the most of the opportunities offered by a financial landscape that is evolving.** The situation has largely improved over the last decade, with several countries having introduced or making a wider use of less traditional instruments. The use of loans from domestic commercial banks and domestic development banks in some of UfM member states is particularly

---

<sup>1</sup> “Ensure availability and sustainable management of water and sanitation for all”.

<sup>2</sup> For example, there exists synergy with the SDGs regarding resilient infrastructure (9.1, 9.4, 9A), sustainable cities (11B, 11.5), sustainable consumption (12.2), inclusive societies (10.2), and global partnership (17.6, 17.9).

encouraging. At the same time, some financial partners have refocused their roles – for example using grants to support project preparation instead of project implementation – which may not always suit the current demands of recipient countries.

**The basic foundations for sustainable funding models need to be adopted across the UfM region.**

This requires improvements in governance arrangements, policy formulation, implementation and evaluation, and capacities. While innovation in financial instruments is always taking place, some additional innovation may be needed for some specific types of funding requirements, particularly related to integrated and non-structural solutions.

**If private sector involvement in financing the water sector is to be increased, more attention needs to be paid to defining its role and improving the enabling environment.**

Different countries in the region have different positions about the desired level of involvement of the private sector. The private sector is made of different actors – private water sector providers, large water users, banks, and financial investors, to name a few – with different goals and requirements. The international experience suggests that private water sector providers cannot be expected to mobilise significant funding unless very specific conditions are in place. Mobilising commercial finance, in particular from domestic sources, would require in most cases additional policy reforms to promote efficiency gains, cost reduction and cost recovery.

**Good Practice 1 – Adopting a proactive approach to facilitate financial sustainability in Palestine**

Palestine has developed a package of strategic work to guide the development of the water sector and facilitate the mobilisation of the financial resources required to achieve their water objectives. The elements of the package include a Water Sector Strategy, a Water Sector Working Group, the preparation of project concept notes and fundraising documents, and the organisation of pledging conferences. Part of this effort to take a proactive approach towards improving the financial sustainability of the sector includes the identification of actors and responsibilities, including those for fund-raising.

Source: Palestinian Water Authority

**Good Practice 2 – Developing strategies to facilitate the mobilisation of EU funds in Spain**

Spain has taken full advantage of the opportunities generated by its membership of the European Union to develop the water sector. Since 2000 and by 2020 it will have received over EUR 90 billion from EU cohesion and structural development funds, of which almost EUR 19 billion for environmental and water programmes. Those funds have enabled Spain to achieve universal drinking water supply, reduce water losses to 35%, double the share of the population with wastewater treatment, implement EU legislation related to environment and water, and develop and implement emergency plans on droughts and floods. Given the Constitutional allocation of responsibilities, those funds had to be managed by different authorities (central, regional, and local). In order to maximise the mobilisation of EU funds in successive funding periods (2000-2006, 2007-2013, 2014-2020), Spain had to ensure that the available funds were spent effectively and efficiently by all authorities and other relevant actors. For each funding period, Spain developed a strategic document that, based on an analysis of investment needs and the ability to absorb EU funds, identified priorities for EU support. As a consequence, Spain was able to receive more funds than initially allocated, as funds originally pre-allocated to other EU member states and that had not been spent were re-assigned to Spain.

Source: Directorate-General for Water, Spanish Ministry for the Ecological Transition.

## STRATEGIC OBJECTIVES AND ACTIONS

### *Strategic Objective 1. Reform the water sector to enhance its financial sustainability.*

In order to achieve this objective, UfM member states will:

- Improve the water sector governance, in particular regarding engagement with actors and coordination of initiatives across levels of governance.
- Clarify the responsibilities of relevant actors regarding the financial sustainability of the water sector, and make efforts to facilitate their contributions.
- Review how the current policies and legislation in the water sector support or undermine its financial sustainability.
- Integrate financial sustainability considerations in the design of new water sector policies (including cost-recovery tariff systems).
- Develop capacities for strategic financial planning in the water sector.

### *Strategic Objective 2. Integrate water financing considerations across water-related sectors.*

In order to achieve this objective, UfM member states will:

- Review how the current strategies, policies and plans of sectors that benefit from or affect sustainable water management (such as agriculture, energy, environmental protection, land use, and urban development) affect the financial sustainability of the water sector.
- Consider how to mobilise financial resources from the sectors that benefit from or affect sustainable water management (such as agriculture, energy, environmental protection, land use, and urban development) in order to fund expenditures for sustainable water management.
- Improve cross-sector planning of infrastructure that will involve or impact water resources (see also Objective 4).
- Consider how to combine different sources of finance, from different sectors, with due attention to the allocation of risks and returns.
- Develop capacities for cross-sectoral planning across water-related sectors.



## CHAPTER 3 – MAKING THE BEST USE OF EXISTING FINANCIAL RESOURCES

### KEY CHALLENGES

**There is a bias towards building new hard infrastructure, with less attention being paid to making the most of existing infrastructure, and adopting non-structural (“soft”) solutions.** New hard infrastructure (such as storage structures, desalination plants, irrigation canals, water treatment plants, water distribution networks, or waste water treatment plants, among others) is required in the Mediterranean region, as detailed in the different chapters of the UfM Water Agenda. But because new hard infrastructure projects are highly visible, bring prestige and are sometimes easier to implement than non-structural solutions (such as governance reforms, demand side management, metering, leak detection programmes, land use planning, or wetland management, among others) expenditures in water management are not always well balanced between structural and non-structural solutions. Moreover, within structural (hard infrastructure) solutions there is often not a good balance between building new infrastructure and ensuring that existing infrastructure delivers the expected social, economic and environmental benefits by spending sufficient financial resources on operation and maintenance.

**The low level of coordination of planning of infrastructure investments at national and regional levels is preventing countries to get the most of their infrastructure investments.** Infrastructure investments often need to be coordinated to provide the intended benefits. For example, a new irrigation network may be depending on a new dam to supply it with water, a new coastal tourism facility may be depending on a wastewater treatment plant to ensure clean coastal waters, a wastewater treatment plant may be depending on a wastewater collection network to supply it with wastewater, a housing development may be depending on a desalination plant to provide it drinking water, or a hydropower dam may be dependent on upper watershed management to prevent siltation. Developing individual investment projects without good coordination or a master plan too often leads to wasting the scarce financial resources available and prevents their use to finance other projects that would provide benefits from the moment they are implemented.

**Inefficiencies in the water sector are not always tackled head on.** There are many potential sources of inefficiencies, as detailed in the different chapters of UfM Water Agenda. Inefficient use of water by water users generates demand for more water supply and thus more water infrastructure that would be required if water was used efficiently. High levels of losses in the distribution networks (irrigation canals, drinking water networks) have the same impact. Poor implementation of water infrastructure programmes may result in cost overruns. Each of those problems may require different solutions, but they all have a negative impact on the scarce financial resources of the sector.

**The monitoring and evaluation of expenditures could be stronger.** Well-designed expenditure programmes that deliver tangible benefits are an essential pillar of a robust financial strategy: they ensure that financial resources are used to maximum benefit, and they can enhance the willingness to pay for water. Improved monitoring and evaluation of expenditures is required at different levels – from local projects to national programmes and regional initiatives. Improved financial monitoring and reporting is required to make sure that the allocated financial resources are effectively spent as intended and address integrity issues. Improved evaluation is required to inform future planning and implementation – both at sector and project level. Monitoring and evaluation is only effective if decision-makers use the findings from these activities.

### **Good Practice 3 – Reviewing public expenditure in the water sector in Mauritania**

In 2017, at the request of the Government of Mauritania, the World Bank carried out a review of public expenditure (PER) in the water sector. This was the second PER of the water sector in Mauritania, after the one conducted with support from the French Development Agency (AFD) for the period 2003-2005. This second PER focused on analysing the funding and the expenditure of the water sector throughout the previous decade (2006-2016). The review also identified a number of recommendations to improve the financial sustainability of the water sector in Mauritania, such as: developing a full vision of expenditure in the sector (including those from local municipalities, regional organisations, and international NGOs); clarifying responsibilities across the sector to increase the efficiency of public expenditures; strengthening synergies between public institutions; carrying out a study on drinking water and sanitation tariffs; or establishing a roundtable with the technical and financial partners around the National Strategy for Sustainable Access to Water and Sanitation (SNADEA).

Source: Extracted from World Bank (2017) Mauritanian Water Sector: Public Expenditure Review

### **Good Practice 4 – Reducing inefficiencies in the water sector in Egypt**

Egypt new National Water Resources Plan for 2017-2030 is built around four pillars: improve water quality; enhance management of water use; enhance availability of freshwater resources; and improve the enabling environment for IWRM, planning and implementation. Governorate-level plans have been developed thanks to a combination of EU funding (EUR 2 million for five pilot governorates) and Egyptian funding. The expected outcomes of those plans include, among other, an increase in water use efficiency and an increase of the productivity of agriculture per unit of water used. This focus on increasing efficiency builds on the achievements of the Second National Drainage Program (2011-2015), financed through two World Bank loans totalling USD 80 million, which was designed to increase agricultural productivity by 30% in 400,000 feddans, among other objectives.

Source: Ministry of water Resources and Irrigation of Egypt.

## STRATEGIC OBJECTIVES AND ACTIONS

*Strategic Objective 3. Use existing financial resources to fund water-related activities that provide the highest social, economic and environmental benefits*

In order to achieve this objective, UfM member states will:

- Develop expenditure programmes that align with the water sector strategic plan and benefit from best international practices in terms of transparency, accountability and participation. Expenditure programmes will factor climate change and uncertainties about future water demand and availability, and value flexibility and the capacity to adjust to shifting circumstances.
- Enhance the ex-ante analyses of proposed water management and investment programmes in order to identify and assess the social, economic and environmental benefits and costs of interventions for all stakeholders at appropriate levels.
- Carry out governance and policy reforms to facilitate prioritisation of projects and evidence-based allocation of financial resources within the broad water sector.

- Carry out evaluations on the use of financial resources for water that look at integrity issues, costs, and benefits delivered across water-related projects in order to inform subsequent planning cycles.
- Develop capacities for financial planning, financial management, financial control, and evaluation (with an emphasis on the evaluation of non-conventional technical solutions).

*Strategic Objective 4. Improve the coordination of water-related investments.*

In order to achieve this objective, UfM member states will:

- Strengthen institutional structures and water sector policy implementation to facilitate the coordination (regarding focus, location and sequencing) of projects across the broad water sector.
- Improve coordination of planning and, when appropriate, implementation of projects financed by international finance institutions.
- Coordinate efforts to develop multi-sectoral investment portfolios that select and combine projects so as to contribute the highest social, economic and environmental benefits.
- Enhance transboundary basin cooperation and encourage regional projects agreed between riparian countries to achieve mutual benefits and equitable, reasonable, sustainable and optimum use of transboundary waters.
- Develop capacities for cross-sectoral planning and investment planning.

*Strategic Objective 5. Increase value-for-money in the implementation of water-related projects and the delivery of water services.*

In order to achieve this objective, UfM member states will:

- Consider options that may result in lower costs over the life-cycle of new projects, including nature-based solutions and non-structural solutions.
- Expand the use of competitive bidding procedures that combine price and quality criteria.
- Introduce or strengthen independent regulation and benchmarking of water service providers.
- Develop capacities for sustainable operation and maintenance as part of all infrastructure projects.

*Strategic Objective 6. Increase efficiencies in water use and ensure adequate asset management to optimise the use of existing financial resources.*

In order to achieve this objective, UfM member states will:

- Review the current incentive framework for water use, and develop and implement policy packages to increase water efficiency among water users and water service providers (as detailed in the relevant chapter of the UfM Water Agenda).

- Analyse the current status of water related-assets and the causes of their deterioration, and develop and implement policy packages to improve asset management.
- Develop water-related asset master plans.
- Develop capacities for asset management in water sector providers.

## CHAPTER 4 – MOBILISING ADDITIONAL DOMESTIC AND INTERNATIONAL FINANCIAL RESOURCES

### KEY CHALLENGES

**The water sector in most of the UfM region does not make consistent use of all the options to finance its development.** The water sector relies mostly on direct funding from user charges, central government subsidies, and grants and loans from development partners. Only about half of the countries mobilise loans from domestic commercial banks or domestic development banks, and concessional loans from international financial institutions. Examples of the use of grants from non-state actors (e.g. charities), climate funds, municipal bonds, sovereign bonds in domestic currency, and equity investments exist but are limited.

**Unaddressed affordability concerns undermine the internal generation of financial resources.** There is a low uptake of approaches that combine cost recovery tariffs with social protection measures in order to address affordability concerns. Regulatory constraints regarding tariff setting are also limiting the potential of water charges to mobilise funding from users and beneficiaries of water services and water management programmes.

**Allocation of public budgetary resources to sustainable water management is generally insufficient to address the current and future needs** in view of climate change, demographic growth and urbanisation trends. Apex institutions in the water sector generally struggle to make the case for sufficient budgetary allocations. At the same time, budgetary allocations to water-user sectors are rarely applied to achieve water management objectives.

**The user/beneficiary pays principle and the polluter pays principle are not applied consistently across the region.** Water users and beneficiaries of water management programmes in the agriculture, industrial and other economic sectors are not always asked to contribute enough to ensure the financial sustainability of the services that they receive, or to compensate for the opportunity cost of using water or the damage that they cause to society and the environment.

**Not enough attention is being paid in many countries to engaging private sector investors.** Economic growth has increased savings in most countries in the region. Domestic commercial finance institutions (commercial banks) are looking for opportunities to lend money to projects with appropriate risk/return profiles. There are opportunities to blend development finance (including guarantees) and domestic commercial finance to provide such appropriate risk/return profiles, provided that the sector is adequately funded from tariffs, taxes, and transfers.

**The main barrier for attracting funding from international financial partners is the low capacity to increase the quality of project proposals,** followed by low knowledge of funding opportunities and application procedures (including for cross-sectoral approaches). Low cost-recovery levels are an important barrier and perhaps the most important one for international financiers. The political situation in some countries has led to postponement of priority investments by international financial institutions.

**In most countries, any increase in financial resources for water-related projects will require policy reforms and/or significant efforts towards implementation.**

**Table 1. Current use of financial instruments in the Mediterranean water sector**

	Extent of use	Importance for countries that use them	Evolution in the last 10 years
User charges (e.g. water supply charges, pollution charges)	<b>Wide</b> across countries and sub-sectors	<b>Medium-High</b>	<b>Stable-Increasing</b>
User in-kind contributions (e.g. self-supply)	<b>Limited</b>	<b>Low</b>	<b>Stable-Increasing</b>
Subsidies from the central budget	<b>Wide</b> across countries and sectors	<b>Medium-High</b>	<b>Stable-Increasing</b>
Subsidies from the municipal budget	<b>Medium</b> -- about half of countries across most sectors	<b>Medium</b>	<b>Stable</b>
Grants from development partners	<b>Wide</b> across countries and sectors	<b>High</b>	<b>Increasing</b>
Grants from non-state actors (e.g. charities, foundations)	<b>Limited</b> -- about half of countries but scattered across sectors	<b>Medium</b>	<b>Stable-Increasing</b>
Grants from climate funds (e.g. Green Climate Fund)	<b>Limited</b> -- about half of countries but scattered across sectors	<b>Medium</b>	<b>Stable-Increasing</b>
Concessional loans – infrastructure investments	<b>Medium</b> - about half of countries, mostly for WASH infrastructure	<b>High</b>	<b>Stable-Increasing</b>
Concessional loans – budget support	<b>Limited</b>	<b>Medium-High</b>	<b>Increasing</b>
Loans from domestic commercial banks	<b>Medium</b> -- about 50% of countries	<b>Medium</b>	<b>Stable</b>
Loans from domestic development banks	<b>Medium</b> -- about 50% of countries	<b>Medium</b>	<b>Increasing</b>
Municipal (and other sub-sovereign) bonds	<b>Very limited</b>	<b>Low</b>	<b>Stable</b>
Sovereign bonds -- in domestic currency	<b>Very limited</b>	<b>High</b>	<b>Increasing</b>
Sovereign bonds – in foreign currency	<b>None</b> in sample		
Equity investments	<b>Limited</b>	<b>Medium-High</b>	<b>Stable-Increasing</b>

Source: Initial mapping of the use of financial instruments in the UfM region. Background paper to support the development of the Financial Strategy commissioned by the UfM Secretariat.

### **Good practice 5 – Mobilising internally generated revenues in Israel**

The Israel Water Authority (IWA) is an autonomous government agency combining planning and regulatory responsibilities for all the elements of the water chain (drinking water and sanitation, irrigation, water resources management) and is the national water regulator that sets tariffs for all water users. IWA has set performance targets for increased water efficiency and it has gradually increased water tariffs for all users with the aim to approach full cost recovery for the overall water chain (while maintaining significant cross-subsidies between domestic and agricultural users). After many years of reforms and massive investment, the Israeli water sector is close to full financial autonomy – almost all the costs of building, maintaining and operating the water infrastructure are now paid by users through tariffs, with the exception of wastewater reuse, which still relies on investment subsidies.

Source: Israeli Water Authority

### **Good Practice 6 – Mobilising funds from domestic development banks in Turkey**

II Bank (Provincial Bank) is a development and investment bank owned by the Turkish state and subject to the provisions of private law. Turkish municipalities are able to use loans from II Bank in order to finance the infrastructure facilities that they need within the framework of existing legislation and their municipal investment programmes. II Bank provides loans from its own resources and also acts as intermediary for the mobilisation of external credits provided by international financial institutions. In 2011, II Bank initiated the SUKAP programme to finance municipal investments in water supply and sanitation infrastructure. II Bank can loan 100% of investment costs to large municipalities (population above 25,000) and 50% to small municipalities (population below 25,000), which, subject to approval by the Higher Planning Council, can get a grant of 50% of investment costs funded from the central budget. By August 2018, the SUKAP programme had mobilised EUR 1.5 billion— of which EUR 572 million were grants and EUR 892 million were loans.

Source: Government of Turkey

### **Good Practice 7 – Mobilising climate finance in Morocco**

Morocco has already initiated efforts to mobilize climate finance to complement other financial sources to support sustainable water management. A project to improve the climate resilience of agricultural systems in the Moroccan Saïss Plain will be co-financed by an EBRD loan of USD 138.9 million, a Kingdom of Morocco's state grant budget of USD 62.3 million, Green Climate Fund (GCF) funding of USD 33 million, and an EBRD's donor funds grant of USD 1 million. In addition, a loan has been requested from the GCF to co-finance a EUR 309 million project in Agadir (of which EUR 250 million is to build the country's largest desalination plant) that aims to supply drinking water to 2.3 million people and irrigation water to 13,600 hectares of farmland.

Source: Government of Morocco

## STRATEGIC OBJECTIVES AND ACTIONS

### *Strategic Objective 7. Increase revenues internally generated in the water sector.*

In order to achieve this objective, UfM member states will:

- Set and monitor cost recovery targets across water sub-sectors and water service providers, taking into account social considerations.
- Improve the regulation of water tariffs and review water tariff structures and levels, as part of broader policy packages, to efficiently achieve social, economic and environmental goals, while developing and enforcing compulsory service standards to be guaranteed by the water sector providers.
- Strengthen the incentive framework to improve bill collection by water service providers.
- Strengthen economic policy instruments for water management (such as water abstraction or water pollution charges).
- Develop capacities for increasing the customer-orientation of water service providers, and for metering.

### *Strategic Objective 8. Increase allocations of public budgetary resources to water-related activities.*

In order to achieve this objective, UfM member states will:

- Further develop evidence of the social, economic and environmental benefits of allocating higher public financial resources to the water sector, both at national and sub-national level.
- Reform priority-setting mechanisms to allow water-related agencies and projects to compete for public funding vis-à-vis other agencies and projects on their merits.
- Enhance the credibility of the water sector regarding the use of public financial resources by making substantial progress towards Strategic Objectives 3, 4, 5 and 6 of this Financial Strategy.
- Ensure that public expenditures managed in water-related sectors (energy, agriculture, environment, urban development) contribute to achieving water objectives by promoting efficient water use, reduction in water pollution, and reduced vulnerability to flood, droughts and climate change adverse impacts in general, at all levels and among all stakeholders.
- Develop capacities for executing allocated financial resources.

### *Strategic Objective 9. Mobilise additional resources from domestic private actors.*

In order to achieve this objective, UfM member states will:

- Ensure that public policies and policy instruments in the water, energy, agriculture, environment, and urban development sectors promote private expenditures in efficient water use, reductions in water pollution, and reduced vulnerability to flood and droughts.



- Raise awareness among potential investors about the opportunities to invest in the water sector.
- Deepen the dialogue with potential investors in the water sector to identify the main barriers that prevent them from investing in the water sector – whether through issuing loans, buying bonds, taking equity investments, or other mechanisms.
- Undertake policy reforms to further increase the creditworthiness of water projects and water service providers.
- Develop capacities for showcasing investment opportunities and for entering into a dialogue with potential investors.

*Strategic Objective 10. Use resources from international financial partners strategically to leverage other sources of finance.*

In order to achieve this objective, UfM member states will:

- Develop regional and national objectives and strategies for the use of resources from international financial partners, based on an analysis of past successes and failures, likely evolution of future financial flows, and how international financial resources can add most value. This could include arrangements for blending finance, which adequately allocate risks and returns across financiers, building on good international practices.
- Strengthen the dialogue with traditional and new international financial partners (both at national and regional levels) to improve alignment of their support with national objectives.
- Identify the role that climate finance can play in financing the water sector, and integrate water-based solutions in Nationally-Determined Contributions (NDCs) and National Adaptation Plans (NAPs).
- Develop good quality proposals for water-related projects to mobilise climate finance for the implementation of NDCs and NAPs.
- Develop capacities for project preparation and for blending finance.

## CHAPTER 5 – IMPLEMENTATION PLAN OF THE FINANCIAL STRATEGY

The responsibility for achieving the objectives of the Financial Strategy will remain with UfM member states, individually and collectively.

**Multiple actors have a role to play** (whether leading or supporting) in order to achieve the objectives of the Financial Strategy. The exact actors and roles will vary from country to country, according to their specific institutional settings and policies. Those actors include:

- Ministries and governmental authorities in charge of water and irrigation.
- Ministries in charge of finance, investment, planning, development, international cooperation, and foreign affairs.
- Ministries in charge of energy, agriculture, environment, and urban development.
- Regulators.
- Legislative authorities.
- Local-level authorities.
- River basin organisations and agencies.
- Water service providers (small and large, public and private).
- Water users.
- International technical and financial partners.
- Domestic banks and other domestic financial partners.
- Domestic donors.
- Civil society organisations.

For illustrative purposes, the table below provides suggestions of potential leading and supporting actors for the implementation of the UfM Water Agenda's Financial Strategy.

<b>Strategic Objective</b>	<b>Leading actors</b>	<b>Supporting actors</b>
<i>1. Reform the water sector to enhance its financial sustainability</i>	Ministry or governmental authority in charge of water	National water council River basin authorities Regional and local authorities Water service providers Water users
<i>2. Integrate water financing considerations across water-related sectors</i>	Ministry of finance Ministry or governmental authority in charge of water Head of government office	Line ministries Regional and local authorities Water service providers Water users
<i>3. Use existing financial resources to fund water-related activities that provide the highest social, economic and environmental benefits</i>	Ministry of finance Ministry or governmental authority in charge of water	Regional and local authorities Water service providers Water users
<i>4. Improve the coordination of water-related investments.</i>	Ministry or governmental authority in charge of water	Regional and local authorities
<i>5. Increase value-for-money in the implementation of water-related projects and the delivery of water services.</i>	Ministry or governmental authority in charge of water	Water service providers Water users
<i>6. Increase efficiencies in water use and ensure adequate asset</i>	Ministry or governmental authority in charge of water	River basin authorities Water service providers Water users

<i>management to optimise the use of existing financial resources.</i>		
<i>7. Increase revenues internally generated in the water sector.</i>	Ministry in charge of water Legislative authorities	River basin authorities Regional and local authorities Water service providers
<i>8. Increase allocations of public budgetary resources to water-related activities.</i>	Ministry of finance	Ministry in charge of water Regional and local authorities
<i>9. Mobilise more resources from domestic private actors.</i>	Ministries or governmental authority in charge of water Business associations	Water service providers Water users
<i>10. Use resources from international financial partners strategically to leverage other sources of finance.</i>	Ministry of finance Ministry of development cooperation	Ministry in charge of water River basin authorities Regional and local authorities International technical and financial partners

**The UfM will support the implementation of the Financial Strategy** by making use of its convening power to provide a platform for policy dialogue, through the relevant work of the four thematic task forces mandated to support the implementation of the UfM Water agenda, and through targeted work to be carried out by a renewed Water Financing Task Force.

The four Thematic Task Forces are:

- Task Force on Water and Climate Change Adaptation
- Task Force on Water-Energy-Food-Environment Nexus
- Task Force on Water-Employment-Migration
- Task Force on Water Supply, Sanitation and Hygiene

The table below identifies possible activities that could be carried out in the short and medium-term by the four Thematic Task Forces to contribute to achieving the objectives of the UfM Water Agenda's Financial Strategy. Further contributing activities might emerge from each of the thematic outputs included in the long-term WEG work programme and its rolling biannual works plans.

<b>Strategic Objective</b>	<b>UfM Thematic Task Forces</b>	<b>Possible activities</b>
<i>1. Reform the water sector to enhance its financial sustainability</i>	Water Supply and Sanitation, Nexus and WEM	Reviewing legal and regulatory frameworks for water supply and sanitation services. Elaborating guidelines for designing and implementing multi-sector Nexus policy dialogues. Elaborating guidelines for mainstreaming WEM considerations into national plans.
<i>2. Integrate water financing considerations across water-related sectors</i>	Water and Climate, Nexus, and WEM	Organising joint workshops on climate finance and nexus finance in the water sector. Elaborating regional scoping notes on financing Nexus and WEM through existing and new international financing frameworks [also for Obj. 10]
<i>3. Use existing financial resources to fund water-related activities that</i>	Water Supply and Sanitation	Analysing the cost-effectiveness of alternative technical solutions

<i>provide the highest social, economic and environmental benefits</i>		
<i>4. Improve the coordination of water-related investments.</i>	Nexus	Organising Nexus Policy Dialogues in the South East Europe and MENA sub-regions, potentially leading to nexus strategies and identification of priority investments.
<i>5. Increase value-for-money in the implementation of water-related projects and the delivery of water services.</i>		
<i>6. Increase efficiencies in water use and ensure adequate asset management to optimise the use of existing financial resources.</i>	Water Supply and Sanitation	Organising capacity development activities on increasing water use efficiency and asset management.
<i>7. Increase revenues internally generated in the water sector.</i>		
<i>8. Increase allocations of public budgetary resources to water-related activities.</i>		
<i>9. Mobilise more resources from domestic private actors.</i>	Water and Climate	Organising national and sub-national political dialogues to help boost domestic funds for the implementation of water related NDC projects and NAPs.
<i>10. Use resources from international financial partners strategically to leverage other sources of finance.</i>	Water and Climate, Nexus, and WEM	Launching a study on mapping water-related climate finance flows in the Mediterranean region. Organising a capacity building workshop with the Green Climate Fund and other partners on how to mobilise climate funding. Elaborating regional scoping notes on financing Nexus and WEM through existing and new international financing frameworks [also for Obj. 2]

**The Water Financing Task Force will support UfM member states to achieve the objectives of the Financial Strategy.** Multi-year work programmes will be developed by the Members of the Water Financing Task Force and the UfM Secretariat, and submitted for approval to the Water Expert Group. Support will be sought from technical and financial partners for the implementation of those work programmes and synergies with other ongoing work will be identified and exploited. For the period 2019-2021, activities to be implemented under the umbrella of the Water Financing Task Force (whether led by the UfM, specific member countries, or technical and financial partners), subject to resources available and further prioritization, could include:

#### **Regional knowledge products**

- *A regional study on the socio-economic outcomes of water infrastructure.*

- *A regional study* comparing (benchmarking) existing governance regimes and identifying regulatory environments and water management practices most conducive to investments.
- *A mapping study* that would map and estimate current financial flows; project financing needs and assess financing capacities; identify existing relevant international financial instruments; and will provide guidance on the procedures to apply for funding.
- *A series of guidance notes* focused on specific water financing topics. In view of the findings of the initial mapping of the use of financial instruments, possible topics the guidance notes include: preparation of project proposals; engagement of the private sector; and using development finance to leverage other sources of finance (e.g domestic commercial finance).
- *A webpage* (in the UfM website) to gather all the information regarding the implementation of the Financial Strategy -- including information about planned and completed activities, financial actors, and contacts to facilitate peer networking.

#### **Regional events**

- *A series of high-level regional conferences* on water finance and investment in the Mediterranean region (including public-private partnerships).
- *A series of regional capacity development workshops* focused on specific water financing topics (including climate finance). One regional workshop could be organised every year, possibly back-to-back with the Autumn meetings of the WFTF. The topics of the regional workshops could be aligned to the topics of the guidance notes.
- *Regular meetings of the Water Financing Task Force* to report on actions taken by individual countries, share experiences and lessons learned, and have “safe dialogues” with financial partners on specific topics. The WFTF meetings could take place twice a year, in spring and autumn.

#### **Country-level activities**

- *A series of targeted national workshops* to present the UfM Water Agenda’s Financial Strategy; launch national processes to implement the UfM Water Agenda’s Financial Strategy; and develop capacities for implementing the UfM Water Agenda’s Financial Strategy (building on the guidance notes, the materials developed for the regional capacity development workshops, and the findings and recommendations of the country peer reviews).
- *A series of country peer review studies* analysing the financial sustainability of the water sector in countries that volunteer to be peer reviewed and providing recommendations.