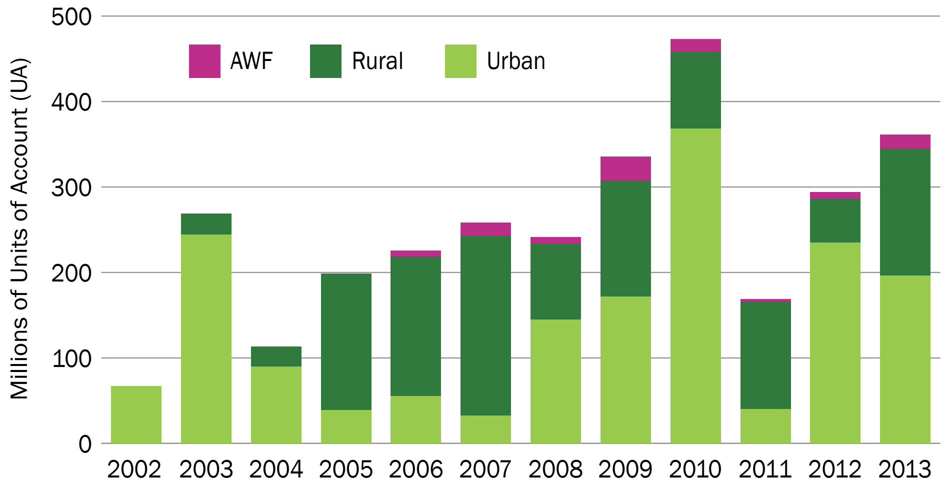
Developing Africa's true water potential

The changing face of Africa's water infrastructure landscape is leading the African Development Bank to adopt new strategies in order to support the sector. The bank's water head, Mohamed El Azizi, spoke to GWI.

AfDB funds committed to water and sanitation projects (2002-2013)



Source: AfDB

The African Development Bank is actively discussing opportunities for private sector financing in water and sanitation ahead of extending the first ever loan in the segment in its 50-year history.

Despite having $2.1 billion of exposure to the water sector across 71 projects and 42 countries, the bank's lending to date has been exclusively focussed on public sector entities, although it is keen to increase its exposure to projects which involve private sector participation. To be eligible for funding under the bank's Private Sector Window, the project sponsor must be incorporated in an African country, and would typically be expected to take a minimum 30% equity stake in any project SPV.

This broadening of the bank's mandate is natural, given its pre-eminent position as a lender to the water sector in Africa. "AfDB is now perhaps the financing institution with the largest staff dedicated to WSS for Africa," Mohamed El Azizi, head of the bank's water and sanitation department (OWAS), told GWI.

The bank was set up to promote sustainable economic growth and reduce poverty in Africa, and has become a financing stalwart on the African continent: between 1967 and 2012, it lent UA63.66 billion (Units of Account are directly equivalent to the IMF's Special Drawing Rights), or around $98 billion.

Infrastructure has always absorbed the lion's share of the bank's lending (around half), but water supply and sanitation (WSS) have only become a priority over the last decade and a half: between 1967 and 2000, the funds committed to drinking water and sanitation initiatives averaged $70 million per year. Between 2000 and 2010, that figure jumped to $340 million per year, peaking at $700 million in 2010 (*see chart above*).

El Azizi says that the increased sector focus is due to a "greater recognition about the importance of the water sector, and the role it plays in the socio-economic development of the continent, as well as greater visibility of the sector within the bank."

Along with lending volumes, the nature of the bank's activities in the sector has also changed. Lending initially focused on urban projects, but with the launch of the Rural Water Supply and Sanitation Initiative (RWSSI) in 2003, the Bank's support for rural projects increased from less than 15% of the WSS portfolio to 42% by 2012, during which time it has contributed to access to drinking water for 66 million people and improved sanitation for 49 million people. The bank has also shifted away from stand-alone projects to a more programmatic approach taking into consideration the cross-sectoral nature of water.

Sub-Saharan Africa is estimated to require $22 billion per year to meet water and sanitation Millennium Development Goals. With current investment flows falling well short of that, at around $8 billion per year, the bank has focused a lot of attention on project preparation in order to help reduce the shortfall. "The huge financing gap is not chiefly due to lack of financiers or money," says El Azizi, but to the fact that there are "few well prepared projects to finance. When detailed project designs and feasibility studies are prepared, our experience is that funding is generally obtained," he says.

This formed the rationale for the establishment of the African Water Facility (AWF), an institution that provides grants and technical assistance to bring innovative water projects to market. For every €1 it has invested, the facility has attracted €30 in follow-up investments, and its leverage capabilities are such that it expects to pass the €1 billion threshold in terms of raised capital this year.

While AWF is a relatively small fund, the bulk of AfDB's lending is channelled through two windows: the African Development Bank (ADB) and the African Development Fund (ADF). ADF provides concessional loans and grants to lower-income countries, and is replenished every three years. ADF XIII, meanwhile, has the firepower to invest $7.3 billion over the period 2014-2016.

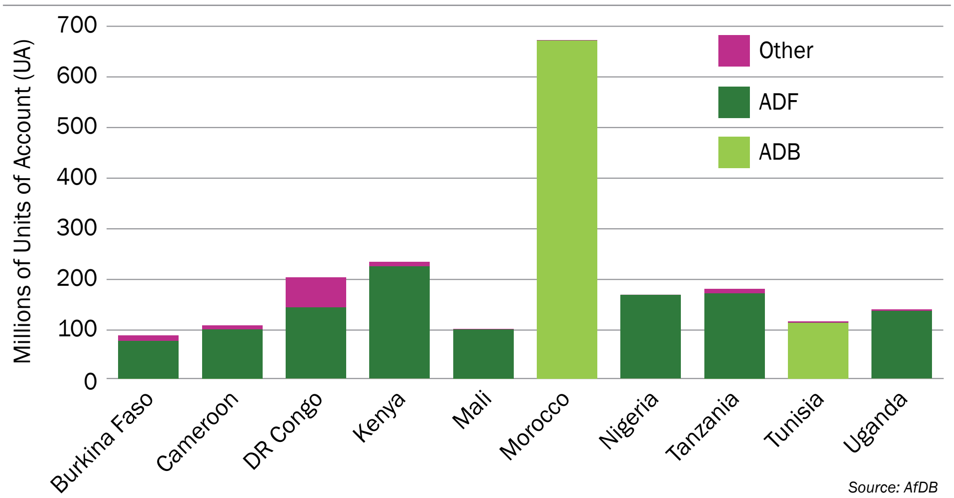
Richer countries cannot access ADF, and borrow through the non-concessional ADB window, whereby AfDB borrows on the wholesale capital markets using the strength of its AAA credit rating and

Water/sanitation projects to be submitted for AfDB board approval in 2014

Project name	Country	Total funding (UA million)
Urban Water Sector Reform and Port Harcourt Water Supply and Sanitation Project	Nigeria	134.8
Rural Water Supply & Sanitation Prog Phase II – OWNP support	Ethiopia	67.5
Projet Sectoriel Eau & Assainissement – AEPA Rural + Assainissement à Dakar et Ziguanchor	Senegal	25.3
Sustainable Rural Water Infrastructure for Health and Improved Livelihoods	Malawi	18.1
Ezulwini Water and Sanitation Project	Swaziland	15.0
Urgent Water Supply & Sanitation Rehab Phase 2 – Stage 2	Zimbabwe	11.0

Source: AfDB

Top ten beneficiaries of AfDB water and sanitation lending (2002-2013)



Source: AfDB

onlends the proceeds to regional member countries at rates cheaper than if they borrowed directly on the markets themselves.

Countries are usually classified as ADF, ADB or a blend of the two (such as Nigeria). Loans from ADB tend to be transaction-based and are limited by AfDB's lending limits and regional member countries' national debt ceilings. Only four countries have borrowed through the ADB window for water and wastewater projects since 2002: Morocco (which is by far the bank's largest beneficiary in the sector with more than UA667 million ($1.03 billion) borrowed since 2002; *see chart above*), Mauritius, Egypt and Tunisia.

How much countries borrow, whether through the ADF or ADB windows, depends on the funds available at the bank, and on national priorities. AfDB has a Country Strategy Paper for each regional member country. These are updated every five years, and set out priorities for the ensuing five-year period. Countries are allocated funding from the ADF according to a formula (which includes how well they have absorbed funding from the last round), and indicative planning is then done for each country to break down these allocations by sector.

El Azizi says that ensuring adequate allocations for the water sector remains a challenge. "Other infrastructure like energy, roads and health are often prioritised by governments," he says. "This is not specific to AfDB; the bank, together with the African Ministers' Council on Water (AMCOW) and other partners, is continuously working to raise the visibility and importance of the sector."

The bank's current exposure to the water and sanitation sector amounts to $2.1 billion, accounting for 7.5% of the bank's total lending portfolio. Looking ahead, El Azizi says that WSS represents 15% of the bank's 2014-2016 indicative lending programme, although this figure is likely to change as governments' priorities change.

The bank is increasingly focussing its lending in WSS on projects that include interventions in climate change and integrated water resource management, and where the needs of the poorest are addressed. This approach reflects AfDB's global mandate, which aims to put greater emphasis on fragile states, which are home to more than 200 million people, or approximately 20% of Africa's population.

Crucially, AfDB is investing a lot of time and effort into developing new funding mechanisms. "The investment gap, together with the recognition that the sector cannot reach any meaningful targets if it only relies on concessional funding, has created a greater acceptance of the idea of market finance," says El Azizi. The bank has therefore set up the Africa50 vehicle (*see box below*) to implement transformational infrastructure projects.

It is also working on a raft of non-lending activities, all geared towards enabling actors in the sector to access new sources of finance, be it commercial loans or private sector contributions through PPPs. Initiatives include running shadow credit ratings of high-performing utilities to alleviate commercial banks' concerns about the sector's risks; working with partners such as the African Water Association's Water Operators' Partnership to identify utilities that are making positive performance improvements; providing expertise on various levels of private sector intervention across urban and rural water infrastructure (from service contracts right through to full concessions); and undertaking tariff surveys and studies on water regulation.

"Most projects prepared and developed in WSS in Africa are technically feasible but are not bankable," says El Azizi. "This is a challenge that we are taking on and are working on increasing both feasible and bankable projects in the sector."

Leveraging 50 years of the AfDB

A new funding vehicle will revolutionise the way infrastructure in Africa is delivered. How does it plan to unlock $100 billion of co-financing?

The African Development Bank expects to make first use of its new Africa50 structured credit vehicle in the coming months, as it seeks to increase the number of bankable infrastructure projects in Africa.

The fund, which expects to leverage $100-150 billion of funding from an equity base of $10 billion, aims to deliver a "critical mass" of energy, transport, ICT and water infrastructure in Africa, whilst shortening the gap between project conceptualisation and financial close from an average of seven years to under three years. To this end, it plans to unlock new sources of funding from the private sector, as well as from sovereign wealth funds and pension funds.

Approved by the board of governors of the African Development Bank in May 2013 and endorsed by African heads of state at the African Union Summit in January 2014, Africa50 will provide support both for early-stage project development and in the form of project finance, across a series of measures including bridge equity, senior secured loans and credit enhancement provision.

Although Africa50 will be hosted at AfDB, it will be a completely independent entity, with a separate balance sheet. The fund plans to target a credit rating in the single-A bracket against which to issue bonds for onlending to key projects.

AfDB expects to seek board approval in Q2 2014 ahead of the bank's initial investment in Africa50, and will strongly encourage regional member countries to mobilise national resources to support the initiative. A number of donors have also expressed interest in investing.

Africa50 has already identified a pipeline of 176 projects worth a total of $144 billion.