POLICY NOTE

CREATING GLOBAL INVESTMENT OPPORTUNITIES IN SANITATION INFRASTRUCTURE DEVELOPMENT: A POLICY PROPOSAL FOR A NEW INVESTMENT INTERMEDIARY IN THE GLOBAL SANITATION SECTOR

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EXECUTIVE SUMMARY

The past several decades of global development have resulted in remarkable improvements to safely managed sanitation access worldwide. Despite this progress, there remains an urgent need for improved sanitation infrastructure, and those areas with the greatest need are precisely those in which the barriers to sanitation finance and investment are greatest. This is not a coincidence.

Today, new technologies and business models in the sanitation sector continue to evolve, and a growing network of service providers, development institutions, philanthropies and non-profit organizations work in tandem to promote sanitation infrastructure development. One question that remains is how these trends can be directed to best address the barriers to sanitation investment and improve the financial viability of projects.

This policy note includes a proposal for a new development institution to address the many barriers to increased sanitation investment where it is needed most. The new institution is referred to as the Global Sanitation Finance Institution (GSFI). The institution is proposed to mitigate specific barriers to investment inherent in global sanitation projects, assist public sponsors in developing bankable sanitation initiatives, and eventually to arrange financing on behalf of a blended stack of capital providers for the projects that it develops.

The policy note includes the purpose and need for this new institution and describes its key functions, stakeholders, objectives, organization and governance. It is intended as a starting point for a broader discussion of institutional solutions to address the remaining global sanitation need.

1. INTRODUCTION

The global sanitation sector is arguably the most difficult development sector for global capital markets to access. While the need for additional financing in the sector is acute, this remaining underserved sanitation need is difficult for capital markets to access for a wide range of reasons. Perhaps more than any other infrastructure sector, sanitation infrastructure requires significant subsidies at every level of the value chain. The unique economics of the sanitation sector make projects challenging to finance at the asset level (Perard 2018), necessitating very long-term financing and exposure to unique counterparty or political risks.

1 Stanford University, Center for Democracy, Development and the Rule of Law (CDDRL).
In recent years, significant progress has been made to increase sanitation access across the developing world. Between 2007 and 2017, the global population lacking access to basic sanitation services decreased from 2.7 billion to 2 billion, and the global population percentage using safely managed sanitation increased from 28% to 45% (UNICEF and WHO, 2019). Despite improvements, there is a clear remaining need highlighted in these figures, and there remain many barriers to delivering sanitation services to those still in need.

Today, promising new technologies and business models have created opportunities to improve the economic viability of sanitation investments in remaining underserved areas globally (Bugalia et al. 2020). The recently proposed Citywide Inclusive Sanitation (CWIS) approach to sanitation projects is particularly noteworthy. This approach to sanitation projects would combine multiple technologies and incremental approaches, including some centralized and some decentralized sanitation services, to tailor a sanitation program to the local urban context (Schrecongost et al. 2020).

Despite these promising developments, the remaining need for sanitation infrastructure investment remains massive and acute. And the communities most in need of sanitation infrastructure investment are precisely those in which capital markets and the development finance industry are most challenged.

Addressing the remaining sanitation infrastructure shortfall will require the combination of investment, development finance and philanthropic capital to create bankable sanitation investment opportunities. It will also require significant investments in transaction structuring to conduct early project planning, develop partnerships with local public sector and private partners, align projects with national sanitation development authorities, and create investible opportunities in the sanitation sector.

This policy note includes a proposal for a new institution to address these challenges. The institution would act as an intermediary between local and national public sponsors on the one hand and the global development finance and investment industry on the other, with an aim to develop a project pipeline of investment opportunities in the underserved sanitation sector, and to overcome the many barriers to greater sanitation investment in the developing world. This institution is referred to in this note as the Global Sanitation Finance Institution (GSFI) as a placeholder.

The institutional design included in this policy note was arrived at via two important design criteria, which are worth making explicit before enumerating the details of the proposed GSFI. The first design criteria is that the GSFI should be based on a clear evaluation of the challenges to increased investment in the global sanitation sector. It is natural that a proposed solution for the remaining global sanitation need must be derived from specific barriers to investment. Absent a clear linkage between impediments in the current market and specific solutions to address them, the GSFI would risk allocating valuable concessional or philanthropic capital to solutions that do not directly address the underlying problems.

The second design criteria is less straightforward. It is that the proposed institution should include commercial investors or service providers in the sanitation projects for which it arranges financing. In other words, there will be a market-based, or non-concessional investor or service provider participating in the project financing.

This objective by no means will limit the participation of philanthropic or concessional development institutions from participating in GSFI projects. As a matter of fact, they are proposed to be an essential component. However, the goal of the GSFI will be to leverage philanthropic or concessional capital to render projects financeable by market participants. This is an important factor influencing the GSFI design included in this policy note.
This non-concessional objective is included for several reasons. First, the inclusion of non-concessional investors in projects will effectively leverage valuable concessional capital, because it will catalyze supplemental funding from the market. Second, the inclusion of non-concessional investors is an important constraint to ensure that projects are economically viable in the long term. Third, non-concessional financing incorporates a participant into the project that has an aligned incentive to evaluate that long-term viability, and then preserve it over the life of the project. Fourth and finally, the inclusion of non-concessional financing will help the GSFI better delineate between project requirements and risks that are financeable and those which require concessional capital in an industry where that delineation is unclear.

This approach is based on the conclusion that a lack of financial viability and long-term, aligned incentives are a major impediment to successful sanitation projects globally. A 2017 report from the Independent Evaluation Group (IEG) at the World Bank found financial viability to be a crucial component of sector reform, despite the fact that financial viability was only included in the project development objectives for seven out of 163 projects in the study (The World Bank Group 2017).

This policy note includes a discussion of the barriers to greater sanitation investment that currently exist today, a discussion of the key stakeholders that would participate in the GSFI, the proposed success factors and functions of the GSFI, and finally the basic design elements of the new institution.

2. BARRIERS TO INCREASED GLOBAL SANITATION INVESTMENT

Over the last half-century, a wave of liberalization occurred in developing economy infrastructure finance. This did not proceed uniformly across regions and countries, nor did it occur without both local and global regressions that remain common in any major global political trend. It further varied based on sector economics and political regime, but it occurred in energy, telecommunications, transportation, and natural resources sectors alike, and even, to a lesser extent, in water. Even when countries sought to avoid the liberalization of the economics of a particular infrastructure sector (for any number of political reasons) they almost uniformly sought to liberalize the financing of infrastructure within that sector. The result has been a general increase in the amount of privately financed infrastructure investment globally.

The sanitation sector has not participated in this trend, relative to other sectors, though commercial financing in the sanitation sector has also increased. For many of the reasons discussed below, the sanitation sector is heavily subsidized via government transfers and concessional financing or grants. There are pressures on public sponsors to reduce local revenues via taxes or user fees, which are challenging to allocate equitably. There are many familiar drivers behind these underlying economics in the sanitation sector, but they result in a subsector lacking in financial viability, with fewer opportunities for investment. They can also lead to system degradation and reduced long-term sustainability in the sector (Goksu et al. 2019).

The challenges for the sanitation sector as an investment opportunity are derived from the underlying economics of the sector itself. Sanitation infrastructure provides a communal benefit rather than an immediate, individual use. This often creates barriers to sustainable funding from sanitation system users, and very high required public subsidies for projects in the sector. Sanitation networks are naturally dispersed for both urban and rural systems, often necessitating significant network capital expenditures. The combination of high capital requirements and heavy public subsidization necessitates very long-term financing requirements and significant counterparty or political risk. Long duration financing requirements also expose the subsector to increased currency or macroeconomic risks for international investors and development finance institutions.
The barriers to increased sanitation infrastructure investment can be categorized into four broad groups, each of which stems from the underlying economics of the sector discussed above.

**Barrier 1: High Transaction Costs**

Creating sanitation investment opportunities where they are needed most requires very high transaction cost expenditures to shape projects, develop the necessary contracts and legal authorities, and develop those projects or programs into structured investment opportunities.

In order to achieve the scale necessary for economic viability and to attract investment, sanitation projects will require participation from many regional stakeholders and public authorities, and will likely necessitate the creation of new public authorities for the project. Many public stakeholders will be unfamiliar with the structuring of international development assistance projects, requiring additional resources devoted to capacity development or advisory services. The institutional, legal, and engineering context of individual investments will vary widely, which will reduce scalability and require tailored solutions.

While a major barrier to the creation of any development pipeline in the sector, transaction costs can be mitigated by an effective intermediary. By evaluating potential investment opportunities, providing technical assistance, and creating capacity development opportunities for public sponsors, an intermediary may alleviate one of the most significant impediments to increased sanitation investment. In addressing transaction costs, an intermediary can effectively prepare projects for investment and increase the certainty in the investment market that planned projects will be brought through to financial close. By focusing on these costs across project opportunities, a dedicated intermediary may also reduce the total costs for individual projects through knowledge management and standardization.

**Barrier 2: Long-Term Financing Requirements**

Sanitation infrastructure investments often entail very long-term financial commitments due to the underlying political incentives for public sponsors in structuring project contracts. Sanitation investments are often heavily subsidized or cross-subsidized as elected officials prioritize equitable distribution of sanitation services. Many urban sanitation systems also have high capital costs and a very long useful life, necessitating very long remuneration periods for investments. Concessions in the sector thus often necessitate very long-term financing and patient capital.

The requirement for long-term financing exacerbates many of the other risks associated with developing economy sanitation investments, most importantly political or counterparty risk. The need for long-term capital in an asset class with emerging markets risk exposure significantly limits the market of potential investors in sanitation initiatives—very few private market investment institutions are able to invest in emerging markets with limited liquidity.

**Barrier 3: High Counterparty Risk**

The remaining global need for sanitation investment is fraught with counterparty risk for three broad reasons. First, remaining investment opportunities are almost uniformly in countries with weaker property rights protections. Second, sanitation investments are public-facing and naturally a commons. There is thus an expectation of public flexibility in managing or intervening in the operations of a sanitation investment. Third, because sanitation investments require high capital costs and a long remuneration period, they are often exposed to counterparty risks from multiple administrations and long-term changes in the local political climate.
In infrastructure investment, counterparty risks are addressed contractually and through strategic management practices, and in both of these areas, an effective intermediary can assist in mitigating counterparty risks. By partnering with international development institutions, maintaining a transparent contracting process, and developing a track record of sustainable investment practices, an intermediary can apply management practices that have proven to mitigate counterparty risks on global infrastructure projects in the past. The standardization of contractual provisions to address counterparty risks can provide investors additional security against counterparty risks.

**Barrier 4: Currency and Macroeconomic Risks**

Currency and other macroeconomic risks are another large impediment to potential investments in future sanitation projects, with many of the same underlying drivers as those for counterparty risks in the sector. Developing countries in need of significant sanitation investment often also include significant exchange rate risks. Outside of a swap or other insurance arrangement, there are few opportunities to protect sanitation investments from the risks of exchange rate fluctuations and other macroeconomic risks.

Currency risk is a challenge in any illiquid emerging markets investment. An effective intermediary can mitigate currency and other macroeconomic risks by allocating risks to the parties best able to price those risks and by arranging for risk-sharing in some cases. While no arrangement can completely mitigate exchange rate risk in foreign direct infrastructure investment, the combination of hedging instruments, public sponsor risk sharing, and risk-sharing between investors, can improve risk allocation and pricing.

**3. KEY STAKEHOLDERS**

**Local Public Sponsors**

Local public sponsors will be the primary stakeholder and clients of the GSFI. The GSFI will engage with local public sponsors or elected officials directly to build capacity, scope and evaluate projects, and structure needed programs into bankable projects. The GSFI will have three levels of engagement with local public sponsors. The first level of engagement will be through education and capacity development, with a broad range of local sponsor institutions participating. The second level of engagement will be through project screening, in which the GSFI works to evaluate potential, early-stage sanitation projects with local sponsor institutions. The third level of engagement will be through project structuring. The GSFI will work with select local sponsors to package a project or initiative into an investment opportunity. During this period the GSFI will be formally engaged with the public sponsor and will work with the public sponsor and development partners to source funding for necessary transaction costs.

**National-Level Public Sponsors**

The GSFI will also work with national or regional-level public sponsors during project planning and structuring. In many cases, national-level entities will be directly involved in the project development through the provision of payment guarantees for local sponsors, necessary entitlements and permitting, and other regulatory approvals. The regional nature of CWIS investment programs, in particular, may necessitate national-level sponsor support to adjudicate jurisdictional issues with local sponsors or create new public counterparty institutions to act as a public sponsor for the project.
National-level public sponsorship will also be critical to amend governing laws and regulations to the extent necessary to develop a bankable project financing, and this is often the case in developing economy sanitation projects. The GSFI will ensure potential projects have support at the national level and clear national-level public sponsors and champions identified. By working with international development institutions on the investment side of the network the GSFI will be well-positioned to develop and maintain these necessary relationships.

Local Private Service Providers and Industrial Partners

The inclusion of local industrial partners and private service providers can improve project outcomes for international investments in a number of ways, including incorporating knowledge of local markets and mitigating political risk (Woodhouse 2005). The benefits of local industrial partners include the incorporation of local expertise in the sector and in the local urban context, knowledge of local supply chains and a network of regional service providers, and the reduction of local political or counterparty risk. Local firm participation in water P3s is also a contributing factor to the persistence of contracts in terms of renegotiations or cancellations (Bataineh 2019). The GSFI will conduct outreach activities during early project development and create a network of service providers and key local investment partners for each of the projects it finances.

Commercial Partners (Non-Concessional Investors and Service Providers)

The GSFI will liaise with non-concessional investors and service providers as one of its activities on the international side of its project network. A key component of the GSFI will be the inclusion of non-concessional participants in each of the projects for which it arranges financing. In order to preserve the long-term financial sustainability and replicability of projects, the GSFI must maintain the requirement that projects include a non-concessional component of the financing or service provision. This practice will ensure sound governance, a clear project need, and that vital concessional capital is used in the most productive way possible. Absent participation from non-concessional investors or service providers, projects lack a clear set of metrics or incentives to ensure development projects are financially sustainable.

The GSFI will not manage investor capital directly but instead work with a select network of non-concessional investors and service providers to package project opportunities. First, the GSFI will develop a formal network of member institutions that meet these criteria. Second, the GSFI will work with non-concessional members or service providers to establish clear metrics for the bankability of GSFI projects, and, to the extent possible, generalized screening criteria for potential project opportunities. Third, during project structuring the GSFI will work with members of the network to present key draft project terms and get feedback in a market-making exercise.

Development Partners (Bilateral and Multilateral Partner Institutions)

The GSFI’s founding bilateral and multilateral capital partners will play a critical role in the GSFI’s general operations as well as in the investment structuring process. In project structuring and screening, bilateral and multilateral members partners will play a similar role as Commercial Capital stakeholders in defining acceptable screening criteria and investment terms for projects, with several important additional responsibilities.

The GSFI will leverage the experience and technical expertise of its bilateral and multilateral partners directly during deal screening and in project structuring. To the extent that development partners will be participating in the financing, the GSFI will also work with their safeguard organizations for necessary studies and project approvals. While the GSFI will not manage capital allocations from Development Partners directly, it will likely need to engage with partners for
resource sharing arrangements and will leverage Development Partners for the procurement of outside expertise during project structuring.

The GSFI’s strong partnership and flexible working relationship with its Development Partners will enable the institution to remain “lean” organizationally without losing the ability to scale up and meet the resource requirements of project structuring. For that reason, it will be crucial for the GSFI’s Development Partners to be actively engaged in the GSFI’s work on both a transactional basis and in terms of the GSFI’s outreach and ongoing operations.

**Philanthropic Partners**

For many of the reasons noted in the first sections of this policy note, philanthropic funding is all but necessary to facilitate access to the remaining global sanitation need. The GSFI will certainly require philanthropic capital but is designed to leverage those valuable philanthropic resources to have the maximum impact by catalyzing other sources of capital to finance sanitation projects.

Philanthropic Partners will engage with the GSFI in two ways. First, the GSFI will work with Philanthropic Partners to set annual objectives and activities. In the long-term, the GSFI will be funded primarily through remuneration for its services in structuring sanitation projects for investment. In the short term, however, its activities will need to be supported by its Philanthropic Partners and other concessional arrangements. As the GSFI develops a project pipeline and reaches financial close on initial projects, the aim will be to reduce and then eliminate the need for the GSFI to rely on valuable philanthropic funding for operations.

Second, Philanthropic Partners will review potential projects selected by the GSFI for structuring in their capacity as members of the GSFI Executive Board. In this capacity, the GSFI’s Philanthropic Partners may direct the use of capital for project structuring activities and propose the application of additional funding for specific components of the project in question.

4. **SUCCESS FACTORS FOR THE GSFI**

**Objective 1: Addressing Transaction Costs**

The GSFI will aim to reduce transaction costs or mitigate their impacts on project development in several ways:

*Standardization:* The standardization of contractual terms, risk allocation, and procurement policies is the primary method to reduce the transaction costs for the global sanitation sector. There are many impediments to standardization in the sector, including the unique circumstances of individual projects, public sponsors, and governing law. Through the development of domain expertise, the GSFI will identify areas where standardization in contracting and project preparation can be applied for individual investments.

*Syndication:* The GSFI will aim to structure sanitation projects for a range of financial institutions with varying risk and return targets, including bilateral and multilateral partners and philanthropic capital. While the transaction costs associated with sanitation investments may be prohibited for non-concessional investors, the offsetting of transaction costs with philanthropic or development capital can catalyze non-concessional capital in the sector.

*Collaboration:* Transaction costs have an outside impact on the development of financial markets because of the very high risk associated with those investments and the uncertainty over whether the project in question will move forward to commercial close. This uncertainty also causes reluctance on the part of public sponsors to invest in early project planning. By working with both sides of its network, along with its philanthropic and development partners, the GSFI can both
create certainty by establishing a degree of trust for public sponsors, and by establishing clear, objective metrics for investors to reach financial close. By making the requirements for financing clear very early in the development process, the GSFI will be able to raise threshold issues early so they can be addressed. This will add certainty to the development process and minimize transaction costs for those projects with threshold issues that cannot be resolved.

**Incremental Contracting:** Successful CWIS projects include a range of technologies and service types, from networked sewers in some areas and various non-sewer sanitation technologies in others. Structuring a large-scale, bankable sanitation initiative across regions and including different technologies is thus complex and requires addressing a wide range of local needs. To the extent possible, the GSFI will develop flexible concession terms that will allow for network expansions. This will enable GSFI projects to be structured at a minimum scale for bankability, thus reducing transaction costs, while still incorporating the flexibility to expand the network to meet development objectives.

**Objective 2: Public Counterparty Support**

Public sponsors in the sanitation sector are rightly cautious when considering long-term contracts to implement sanitation solutions in collaboration with international investors and institutions. Water and sanitation projects involving foreign investment or service providers have in the past led to public outcry or political pushback for a number of reasons. During early planning and structuring, public sponsors are thus often very interested in solutions but hesitant to make some of the necessary commitments to move projects forward.

The GSFI will aim to improve partnering activities with public sponsors by developing a reputation as a trusted advisor and project structuring institution, and by establishing clear project screening requirements for public sponsors. Trust will be engendered by the GSFI’s reputation and track record in the longer term but initially through the institution’s partnerships with development and philanthropic partners. Clear metrics will include institutional authorities and legal frameworks that must be met very early in the development process to frontload threshold issues.

**Objective 3: Market Making for Capital Providers**

Blended capital solutions will be necessary to facilitate financing for the remaining global sanitation needs. One of the key GSFI objectives will be to coordinate sources of capital and investment for project financing, similar to the role of an investment bank or transaction advisor for traditional project financing. The GSFI will layer on the additional complexity of incorporating the interests of its philanthropic and development partners to render projects bankable.

This transaction structuring will necessarily be tailored to the context of individual projects, but the GSFI will work to understand and where possible quantify the interests of various members of various commercial partners, development partners, and philanthropic partners generally to assist in its role as an arranger of financing for projects.

**Objective 4: Effective Intermediation**

The GSFI will provide a project structuring and development service as an intermediary between the many stakeholders defined in this policy note. Its primary activities will include sourcing and screening potential sanitation projects, and then structuring those project opportunities to render them financeable. However, it is probable that the GSFI will also need to provide a longer-term monitoring and oversight role in order to ensure its projects meet their sustainable development goals, and that its public sponsor and development partners have a clear interface to resolve issues over the long-term and adapt or grow sanitation systems as necessary. For this reason,
the GSFI will not serve only as an early-stage project shaping institution but will have a longer-term service role in projects as well, at the request of GSFI stakeholders for specific projects.

5. FUNCTIONS OF THE GSFI

The functions of the GSFI each map to the organization’s planned objectives as defined in the preceding section. The five sections below define these functions and some of the specific tasks involved at a more granular level.

Function 1: Education and Outreach

The GSFI's original mission will be focused on education and outreach for select public sponsor organizations. The GSFI education program will serve multiple purposes. It will educate current and rising leaders in public sponsor organizations on project finance, early project shaping, the contractual requirements of foreign direct investment, stakeholder engagement to implement sanitation projects, and early planning for regional CWIS projects. It will also help sanitation officials in developing countries network and collaborate with one another to address the many similar challenges that they face. Finally, the GSFI’s educational activities will serve as a sourcing mechanism for project opportunities and an initial connection point between the GSFI and local or national public sponsors seeking sanitation investment and development.

Specific tasks under the GSFI Education and Outreach function include:

- In coordination with development and philanthropic partners, the hosting of two annual education programs for public sponsors. One program would be oriented toward the global sanitation sector and a second program annually would be focused on a specific region. Attendees would be senior officials from public sponsor institutions or national sanitation sector institutions.
- At the request of public sponsors, virtual or in-person project workshops focused on the challenges of a specific project opportunity or region.
- Development of case studies of sanitation projects for use in classroom instruction.
- Development of lessons and other topical lectures or instruction materials for public sponsor officials in the sanitation sector.

Function 2: Early Pipeline Development

The GSFI will work with local and national public sponsors to prepare potential sanitation programs for investment and develop a pipeline of investible sanitation opportunities. This function of the GSFI is specifically for the activities the institution will undertake before project screening. This function thus includes specific very early-stage tasks for potential investments before the GSFI decides to move forward with project structuring, as well as general activities to create a pipeline of project opportunities.

Specific tasks under the GSFI Early Pipeline Development function include:

- Identification of project opportunities with public sponsors.
- Early collaboration and planning activities with public sponsors
- Project feasibility studies.
- Very early planning work associated with project opportunities, at the request of public sponsors.
**Function 3: Capital Provider Liaison**

The GSFI will be the focal point of a network for the Capital Partners, Development Partners, and Philanthropic Partners described in the Stakeholders section of this policy note. The GSFI network members will benefit from the GSFI’s project development activities and from the collaboration opportunities afforded to network members. The GSFI will leverage the network to understand and quantify the contractual requirements to render the sanitation projects in its development pipeline bankable. During later-stage partnership development activities, the GSFI will work on behalf of a subset of its capital provider institutions to arrange financing and finalize development agreements.

Specific tasks under the GSFI Capital Provider Liaison function include:

- Recruitment of network members.
- Convening of network members for collaboration and education through digital or in-person events.
- Through surveys and interviews, the GSFI will develop market intelligence from different investment institutions and service providers. These activities will enable the GSFI to understand the risk and return appetite of different segments of the sanitation sector, which will assist the GSFI in arranging financing and help identify key criteria or activities in early project development.
- Direct marketing of GSFI project opportunities with stakeholders in the network for feedback and market sounding.

**Function 4: Project Screening**

The GSFI will leverage the two sides of its networking activities to develop clear project screening criteria and apply these criteria to select a small subset of development projects for structuring. The GSFI screening process will consist of a screening checklist, a review by GSFI staff, and final approval by the GSFI Executive Board. The GSFI will aim to establish objective and/or quantifiable metrics for the screening checklist to the maximum extent possible. This approach will limit the use of valuable GSFI resources in both partnership development and screening/evaluation. It will also give GSFI public sponsors a clear “roadmap” through the development process.

The GSFI may implement additional project screening phases earlier in the development process as necessary.

Specific tasks under the GSFI Project Screening function include:

- Initial development of the GSFI project screening checklist based on initial input from Capital Providers.
- Periodic updates or additions to screening criteria based on review and feedback from GSFI stakeholders or changes in market conditions.
- GSFI staff review of projects that meet initial screening criteria.
- On GSFI recommendation review and final decision on project screening from GSFI Executive Board.
Function 5: Local Partnership Development and Monitoring

If the GSFI is successful in its other core functions, the institution will have the opportunity to work on its primary objective of project structuring for a small subset of development opportunities. This subset of GSFI activities includes predevelopment work to arrange necessary contracts entitlements, and a concession agreement with public sponsors, as well as necessary investment terms and documentation to reach financial close.

The successful arrangement of financing is also intended to be the main source of long-term funding for the GSFI. The GSFI will be remunerated for its predevelopment services by projects as a component of each financing it arranges. The GSFI may also receive funding from projects under a long-term oversight contract if requested by public sponsors.

Specific tasks under the GSFI Project Development and Monitoring function include:

- Negotiation of project concession agreement with public sponsors, and other necessary project contracts.
- With assistance from public sponsor, the completion of entitlements and necessary permits for development.
- Development of all necessary agreements or guarantees from national or regional public sponsors.
- Arrangement of financing and necessary contracts from the GSFI’s development partners and capital or service providers.
- To the extent required by the project, the negotiation and implementation of a long-term oversight or management role for the GSFI for the project.

6. ADDITIONAL DESIGN ELEMENTS OF THE GSFI

This section briefly and preliminarily addresses the additional design elements of Organization, Governance and Reporting for the GSFI. As with the preceding sections, these are intended as initial proposals for the new institution, to be refined in collaboration with the new institution’s key stakeholders.

GSFI Organization

The GSFI will remain a very small, nimble organization, not unlike a development company, in order to reduce overhead or operating costs. It will make up for its lower internal staff or technical resource primarily through its relationships with Development Partners for technical expertise and other services.

Initially, the organization will be led by an Executive Director and will include three offices pertaining to one or more of the GSFI’s key functions.

A Director of Education and Planning will be responsible for managing the GSFI’s education programs and generally liaising with public sponsors and other public officials responsible for sanitation development. This office will be responsible for coordinating education events, writing case studies and lesson plans, and for developing relationships with public sponsors for potential projects. This office will also be responsible for the top of the GSFI development funnel. These activities include identifying potential projects and early-stage predevelopment activities that precede the screening process. This office will also be responsible for early screening activities for potential development projects.
A Director of Partnership Development will be responsible for coordinating with the GSFI’s Capital Provider stakeholders and building the network of development partners, philanthropic partners, and Commercial Partners. This office will be responsible for all events and communication with this “side” of the GSFI’s networking activities. This will include surveys and other information gathering to develop a perspective on the investment criteria of participants. This information will be used to inform the GSFI’s project screening criteria and development activities.

A Director of Project Development will be responsible for the remaining GSFI development activities for projects which the institution selects for project structuring and financing. This will include working with investors, service providers, capital providers and development partners to arrange financing. It will also include working with public sponsors for the necessary agreements, entitlements, and contracts to reach financial close. This office will apply project screening criteria and make a recommendation to the Executive Board of the GSFI before proceeding with development activities. For those projects selected for development, this office will be responsible for all activities necessary to reach financial close for projects.

As the organization is successful in arranging financing for projects, and thus develops sources of sustainable long-term funding for operations, the intent is for it to grow as an organization and to add new oversight or management functions for projects.

GSFI Institutional Governance

The GSFI will be governed by an Executive Board consisting of representatives from the institution’s Development and Philanthropic Partners. Board members may also appoint non-voting members from the GSFI’s other stakeholder groups to observe meetings and contribute input.

The Executive Board will oversee all GSFI activities. Specific approvals will be required for projects to complete screening and move forward with the development process. The Executive Board will also approve the budgets for development activities associated with selected projects.

The Executive Board will also establish and approve the GSFI event topics and calendar for its educational activities and other events.

GSFI Reporting and Publication

The GSFI will make publicly available its early development and planning activities, and specific service offerings for each of the stakeholder groups in its network. The GSFI will also make publicly available its project screening criteria, and update it regularly. This will give market participants and public sponsors a clear view of the GSFI’s current perspective on the requirements for potential projects in the sector to reach financial viability.

The GSFI will also publish two general reports per year. One report will be the GSFI annual report, which will discuss the institution’s progress, challenges, and key activities. The second report will be an overview of the sanitation development market. This will consist of estimates of sanitation needs by region, key developments or new programs, a review of new technologies, and an assessment of current market conditions. This report will be similar to other “state of the industry” sector reports in water and sanitation.
7. OPPORTUNITIES FOR ADDITIONAL STUDY

While this policy note proposes a set of challenges, success factors, key functions, and general strategic direction of the GSFI, there remain many steps to refine the proposed institutional design and to design more specific operational details.

The current challenges in the sanitation sector are affected by existing multilateral and donor-funded institutions. Therefore, an institutional survey will inform the best positioning of the GSFI relative to those other programs with a general mandate to increase financing to the sanitation sector or otherwise promote sanitation investment. This survey would identify and assess these other institutions or programs in the global sanitation sector, and categorize them based on their specific activities and focus areas. Based on these results, the survey could also derive takeaways from the GSFI’s design or specific functions.

The proposed design of the GSFI here provides some scoping limitations on the activities of the institution, which would focus GSFI activities on early project shaping, planning, screening, and procurement structuring. However, there remain many other axes on which the GSFI’s activities could be limited to further focus the institution and limit goal proliferation. These could be informed by a further scoping study to formally assess the potential areas of activity of the GSFI. These could further limit the GSFI in terms of its geographical areas of operation, its focus areas based on particular sanitation technologies, or limit the GSFI’s participants to specific stakeholder networks.

All of the above steps could be supplemented by an informational stakeholder consultation, that would engage experts, public sponsors, and industry participants from each of the GSFI stakeholder groups defined in this policy note. By incorporating the expertise and interests of the GSFI’s future stakeholders in the global sanitation sector, the institution’s design can be better aligned to address the challenges for which it is intended.

8. CONCLUSION

There is a significant need for increased investment in the global sanitation sector, but there are many barriers to increased investment for those communities most in need of services. High transaction costs, high counterparty risks, and political impediments to adequate funding, all coincidental with currency other macroeconomic risks, are just a few of many barriers to increased sanitation investment. The global sanitation sector may be the most challenging subsector of infrastructure investment for project development and finance.

The purpose of this policy note is to propose a new institution – the GSFI – to address some of the challenges of arranging financing for sanitation investment. The goal of establishing this institution will be to reduce or mitigate the impacts of transaction costs in the sector, educate and assist public sponsors, build a development pipeline and project screening program for potential projects, overcome information asymmetries by forming a two-sided network for public sponsors and capital providers or development partners in the sector, and, ultimately, to complete project shaping and arrange financing for sustainable development projects. This is an ambitious mandate for a new, small development institution. The objective of the proposed institution is to make sanitation projects bankable in order to make them sustainable. Its design thus begins with a clear appraisal of the challenges of arranging financially sustainable sanitation projects.
REFERENCES


