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November 2006

## Establishing the Water Financing Partnership Facility

Asian Development Bank

## ABBREVIATIONS

ADB	–	Asian Development Bank
APWF	–	Asia Pacific Water Forum
DMC	–	developing member country
IWRM	–	integrated water resources management
MDG	–	Millennium Development Goal
OCO	–	Office of Cofinancing Operations
RSDD	–	Regional and Sustainable Development Department
WFPF	–	Water Financing Partnership Facility

## NOTE

In this report, "\$" refers to US dollars.

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## I. THE PROPOSAL

1. I submit for your information the following report on the establishment of the Water Financing Partnership Facility (WFPF), with an initial target of \$100 million by 2008 and, for your approval, a recommendation to establish a WFPF trust fund component.

2. In line with its new financing partnership strategy,<sup>1</sup> the Asian Development Bank (ADB) is taking a novel approach to structuring cooperation with development partners through "financing partnership facilities" for ADB's core business areas. Financing partnership facilities represent strategic, long-term, multi-partner cooperation platforms that tie together various forms of assistance in a coordinated manner for a well-defined purpose. Financing partnership facilities may include trust fund elements for grants administered by ADB, framework agreements, and letters of intent with development partners to streamline and facilitate the provision of project-specific financing (grants, concessional loans, or guarantees) on a joint or parallel basis, alongside ADB's own assistance in the sector. They may also include cooperation arrangements for knowledge provision and exchange, and any other form of cooperation that partners and ADB may agree upon for a defined program of activities.

3. This report introduces the overall concept of the WFPF and details the envisaged WFPF trust fund component for which approval is sought. Sections II and III provide the rationale and objectives of the WFPF. Section IV provides implementation details for the WFPF and the WFPF trust fund component. Sections V and VI cover contributions under the WFPF trust fund component and their administration.

## II. BACKGROUND AND RATIONALE

4. In response to the huge unmet water needs of the Asia and Pacific region, and consistent with the recommendations of various international initiatives<sup>2</sup> to double water investments, ADB has made water a core business area under its medium-term strategy II.<sup>3</sup> ADB envisages doubling its water investments to well over \$2 billion annually. This will represent a significant contribution to the achievement of the Millennium Development Goals (MDGs) in the Asia and Pacific region.<sup>4</sup>

5. ADB's water financing program, 2006–2010 was launched at the 4<sup>th</sup> World Water Forum in March 2006 in Mexico City. It comprises a strong portfolio and pipeline of loan and technical assistance projects developed after the adoption of ADB's water policy in 2001.<sup>5</sup> It focuses on the delivery of substantial investment, reform, and capacity development in three key areas: rural water services, urban water services, and water resources management in river basins. Concrete outcomes targeted by the water financing program include safe drinking water and improved sanitation for about 200 million people, better irrigation and drainage services affecting the livelihoods of about 40 million people, reduced flood risk for about 100 million

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<sup>1</sup> ADB. 2006. *ADB's Financing Partnership Strategy*. Manila.

<sup>2</sup> The World Panel for Financing Water Infrastructure in 2003 and the Gurria Task Force on Water Financing in 2006. The Gurria Task Force was chaired by Angel Gurria and followed up on the recommendations of the World Panel on Financing Water Infrastructure chaired by Michel Camdessus. It reported its findings to the 4<sup>th</sup> World Water Forum in March 2006 in Mexico City. ADB was a member of the panel and the task force.

<sup>3</sup> ADB. 2006. *Medium-Term Strategy II 2006–2008*. Manila.

<sup>4</sup> MDG target 10 is to halve, by 2015, the proportion of people without sustainable access to safe drinking water and improved sanitation. Investments in water are also crucial in meeting other MDG targets such as those relating to the incidence of poverty, the proportion of the poor who suffer from hunger, reducing child and maternal mortality, the incidence of major diseases, and environmental sustainability.

<sup>5</sup> ADB. 2001. *Water for All*. Manila.

inhabitants in rural and urban areas, and the introduction of integrated water resources management (IWRM) in 25 river basins. Delivery of these targets will be measured as part of ADB's managing for development results initiative.

6. Recognizing that the delivery of these targeted outcomes will require a concerted effort, ADB's approach is to work in partnership with government agencies, international organizations, bilateral funding agencies, the private sector, and civil society organizations. Additional support from development partners will help to catalyze investments with high development impact, innovation, and demonstration value and to support reforms and capacity development in water organizations. ADB is therefore establishing the WFPF to provide its water financing program with additional financial resources and technical support for components of investment projects, technical assistance operations, knowledge management, and regional cooperation.

7. By supporting the WFPF, partners will directly help to improve the lives of millions of people and make a significant contribution to achieving the MDG targets through supporting pro-poor project design, subsovereign financing, water sector governance, the performance of water sector organizations, environmentally sustainable approaches, and the introduction of IWRM in river basins. At the same time, the WFPF provides an opportunity for development partners to increase donor harmonization, realize efficiency gains and joint impact, and improve transparency in the preparation and implementation of water projects. It will enable them to support reforms and capacity development in water organizations. WFPF will further strengthen partnerships in the water sector among governments, donors, civil society, and the private sector at project and country level, and through regional cooperation as part of the Asia-Pacific Water Forum and Asia-Pacific Water Summits.

8. ADB has made water investments in its developing member countries (DMCs) over the past four decades. ADB's water policy (footnote 5) takes a holistic view of water investments, emphasizes a participatory approach, and makes an essential distinction between the governance of delivery of water services and the management of water as a resource.

9. The implementation of ADB's water policy was reviewed recently by an independent panel of experts from the region and the Netherlands Ministry of Foreign Affairs. The review panel's report in May 2006 endorsed the policy and recommended that ADB increase its water investments to meet the burgeoning needs of the region. The panel also recommended strengthening long-term partnerships with clients and development partners and employing innovative approaches to the delivery of water services for poor communities.

10. In supporting the implementation of ADB's water policy, the WFPF will build on the achievements of the Cooperation Fund for the Water Sector, which has catalyzed the implementation of ADB's water policy over the past 5 years.<sup>6</sup> An independent review of the fund in 2006 concluded that it had significantly raised the profile of water investments in ADB and its DMCs through awareness, knowledge products, innovative solutions, and regional cooperation. Specific lessons learned from this review have been incorporated into the WFPF:

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<sup>6</sup> ADB. 2001. *Cooperation Fund for the Water Sector*. Manila. The Cooperation Fund for the Water Sector was established in 2001 to catalyze the implementation of ADB's water policy, and has been supported by the governments of the Netherlands and Norway for a total of approximately \$20 million over the period 2001–2006. The fund's resources have been fully committed.

- (i) the facility will be allowed to support ADB's water operations directly and to bring additional resources to projects that deliver the targeted outcomes of the water financing program;
- (ii) the pilot and demonstration activities program will be continued as it has demonstrated innovative solutions that can be adopted in larger programs, and has contributed directly to poverty reduction and better livelihoods;
- (iii) support for regional cooperation will move from large regional meetings on IWRM toward separate networks for key types of water organizations (e.g., utilities, river basin organizations, and apex bodies), with the introduction of performance benchmarking and peer reviews; and
- (iv) specific advocacy messages on policy and institutional reforms and better practices will be targeted at policy and decision makers in developing countries, thereby moving beyond the promotion of awareness of key issues in the sector.

11. The water financing program and the design of the WFPF have taken into account the findings of the independent panel of experts on the implementation of the water policy (para. 9), and the independent review of the Cooperation Fund for the Water Sector in 2006 (para 10). The WFPF also takes into consideration several ADB initiatives, including the enhanced poverty reduction strategy, the management for development results initiative, the innovation and efficiency initiative, and ADB's focus on helping countries to achieve the MDGs. WFPF implementation is expected to start in the first quarter of 2007.

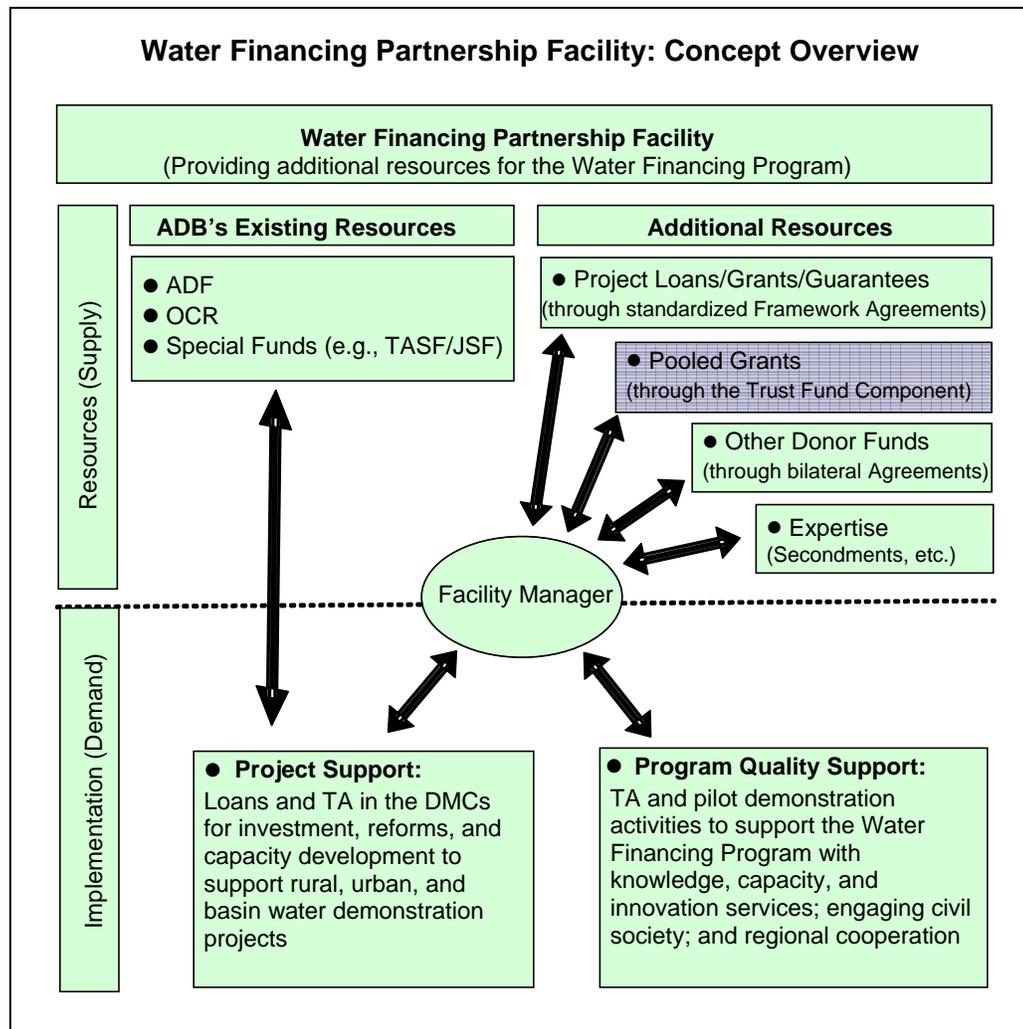
### **III. OBJECTIVES AND SCOPE**

12. The WFPF aims to provide additional financial and knowledge resources from development partners for the implementation of ADB's water financing program to help achieve the targeted outcomes.

13. Resources from partners under the facility will be provided through project-specific loans, grants, or guarantees under framework agreements<sup>7</sup> to be negotiated with each financing partner; pooled grants through the WFPF trust fund component; or other forms of assistance. The WFPF will use these resources to support demonstration projects under the water financing program in DMCs (about 70%) and to support the quality of the water financing program (about 30%) through knowledge, capacity, and innovation services; engaging civil society; and regional cooperation (see figure below).

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<sup>7</sup> Such framework agreements will comprise (i) a letter of intent or similar document on the scope of cooperation under the facility, and (ii) procedural arrangements that standardize processes and documentation for the activities to be financed under the facility. Administration of the loan, grant, or guarantee can be by ADB, the financing partner, or administration arrangements may be shared, depending on partner preferences.



ADB = Asian Development Bank, ADF = Asian Development Fund, DMC = developing member country, JSF = Japan Special Fund, OCR = ordinary capital resources, TA = technical assistance, TASF = Technical Assistance Special Fund.

## A. Project Support

14. The WFPF's support for demonstration projects in the three key areas of the water financing program will take place through in-country work for project preparation, implementation, reforms, and capacity development in the organizations concerned.

- (i) Rural water service projects will aim to improve health and livelihoods in rural communities. Projects may include investments in water supply and sanitation, irrigation and drainage, and multiple uses of water in rural communities.
- (ii) Urban water service projects will support sustained economic growth in cities, and may include investments in water supply, sanitation and wastewater management, and environmental improvement.
- (iii) Water management projects in river basins will promote IWRM and healthy rivers. They may include investments in the infrastructure and management of

multifunctional water regulation and hydropower facilities developed in a basin context, flood management, and the conservation and improvement of watersheds, wetlands, and ecosystems.

15. ADB is committed to promoting and supporting a balanced and coherent program of investments in the water financing program's three key areas: rural water, urban water, and basin water. WFPF will contribute to water financing program targets by helping to prepare and implement demonstration projects for innovative approaches and partnerships in rural and urban water services, and in basin water management, and that can be easily replicated in the region. Project selection criteria will be developed in consultation with participating partners to guide the allocation of WFPF assistance for such projects, which can be used to provide either technical assistance, and/or to finance goods, works, and services for project components.

16. WFPF can provide technical assistance for project preparation, financial structuring, and implementation; reforms and capacity development in project organizations; and policy and institutional reforms to enable IWRM and better water services at project, local government, river basin, and country levels. For project implementation, WFPF can finance goods, works, and services in project components, e.g., to fund interventions that expand water services and sanitation for poor communities, and that introduce IWRM in river basins.

## **B. Program Quality Support**

17. The program quality support window will provide support to facilitate reforms and strengthen capacity. It will help ensure quality, synergy, and innovation in the implementation of the water financing program, with priority given to reducing poverty, improving governance, and conserving the environment. The scope is outlined below, and a work program will be developed during WFPF implementation.

- (i) **Knowledge, capacity, and innovation services.** WFPF will invest in (a) knowledge and policy services for ADB's operations departments and its clients, (b) expert services through a pool of contracted and seconded specialists to supplement ADB's own staff resources, (c) pilot and demonstration activities building on a similar program under the Cooperation Fund for the Water Sector, and (d) innovative approaches to empower water organizations.
- (ii) **Engaging civil society.** Engaging civil society organizations in water reforms and investment is an important part of the Agenda for Change adopted at ADB's Water Week in 2004. WFPF will provide three ways for civil society organizations to support ADB-financed water projects in consultation with ADB's regional departments: (a) project preparation support, (b) independent monitoring of project progress and results by civil society organizations where appropriate, and (c) capacity development to improve collaboration between ADB and civil society organizations.
- (iii) **Regional cooperation.** WFPF will support regional cooperation activities that increase water financing, catalyze reforms, share knowledge and experience, and build capacity in critical water sector organizations, including the introduction of performance benchmarking services and peer review processes. In supporting regional cooperation, ADB will partner with the Asia-Pacific Water Forum (APWF), the Global Water Partnership, the United Nations Secretary-General's Advisory Board for Water and Sanitation, UN Habitat, the Water and Sanitation

Program, and others. Partnerships will be guided by the five key result areas of APWF: (a) developing knowledge and lessons on priority water sector topics through a network of knowledge hubs, (b) increasing local capacity through networking among practitioner organizations, (c) increasing public outreach and awareness, (d) monitoring water investments and results, and (e) organizing Asia-Pacific Water Summits. ADB has accepted the responsibility of serving as lead organization for APWF's theme of water financing and for its key result area of increasing public outreach and awareness.

#### **IV. IMPLEMENTATION ARRANGEMENTS**

18. In ADB, the Regional and Sustainable Development Department (RSDD) will be the manager of the WFPF. A dedicated and experienced water team led by RSDD will work in close consultation with (i) ADB's interdepartmental water committee, (ii) operations directors responsible for water projects, and (iii) ADB's water community of practice. The water team will be the focal point for WFPF partners for technical matters. Guidance will be given by a steering committee, including the directors-general of regional departments and RSDD. The Office of Cofinancing Operations (OCO) will facilitate contributions and will act as the official channel of communications between WFPF partners and ADB for the financial aspects. OCO will also lead negotiation and discussion with financial partners on procedural agreements for contribution to the facility.

19. Selection of project proposals will be undertaken by ADB based on criteria agreed between the WFPF partners and ADB. Project proposals can be initiated by agencies in DMCs, development partners, or ADB. For project support, screening and prioritization will be done by the concerned regional department in ADB. Selection of shortlisted proposals will be done by ADB's water committee in consultation with concerned operations directors. The selected proposals will be submitted to the steering committee for approval. Proposals for support should be consistent with ADB's water policy, contribute to water financing program targets, introduce innovative solutions, adopt a participatory approach, have a high demonstration value in the sector, and have good potential for replication in the country and/or region. For activities under the program support window, screening and selection will be done by RSDD based on a rolling work program prepared in consultation with the water committee and concerned operations directors.

20. Financial assistance from the WFPF may be provided for components of investment projects and technical assistance operations, as well as for any other activities which may be agreed upon between WFPF partners and ADB. Assistance under the WFPF may be combined with other ADB resources and forms of bilateral or multilateral assistance, such as other dedicated funds, to provide the most effective support to the water financing program.

21. All of ADB's DMCs will be eligible for WFPF support for projects and activities prioritized under the water financing program. Program quality support activities may be implemented in DMCs or in other countries as needed. Assistance under the WFPF trust fund component may be made available to central and local governments, government agencies, and other entities, including nongovernment organizations. The WFPF trust fund component will be used to finance operational expenses related to eligible projects in the form of foreign exchange and/or local expenditures for goods, works, and services from ADB member countries following ADB's applicable guidelines and procedures.

22. Projects and activities to be supported by the WFPF trust fund component will be identified, designed, processed, approved, and implemented in accordance with applicable ADB policies, procedures, and guidelines, including procurement, social and environmental safeguards, financial management and reporting, and governance. Arrangements for project accounting, auditing, and close monitoring and reporting will be in place for each of the projects supported by WFPF.

23. Procurement of all projects to be financed by the WFPF trust fund component will follow ADB's *Guidelines on the Use of Consultants* and *Procurement Guidelines*, as amended from time to time. In the case of the administration of technical assistance operations, the selection and engagement of consultants and the procurement of goods and services under such technical assistance operations will be the sole responsibility of ADB. In the case of components of investment projects, the recruitment and selection of consultants and procurement of goods, works, and services will be carried out by the DMC recipients in accordance with applicable ADB procedures.

24. Recipients of any WFPF contributions administered by ADB must ensure that they are ultimately deployed for their intended purposes on the same terms, conditions, and principles as set forth in this paper.

## V. CONTRIBUTIONS TO THE WFPF TRUST FUND COMPONENT

25. ADB will accept, on an untied grant basis, contributions to the WFPF trust fund component from bilateral, multilateral, and individual sources, including companies and foundations. To ensure cost-effective processing and reporting, the minimum contribution to WFPF will be \$5,000,000 for bilateral partners and \$1,000,000 for foundations and private partners. Contributions from WFPF partners will be effected through standardized forms and agreements, including instruments of contribution to be executed by the partners, substantially in the form contained in the Appendix, whereby the partner shall agree to contribute amounts to WFPF substantially in accordance with the terms of this paper.<sup>8</sup> Partner commitments shall not be subject to any conditions, except as provided in this paper. By depositing an instrument of contribution, the partner shall be deemed to have accepted the objectives of WFPF and the terms and conditions set forth in this paper with respect to the resources contributed under such instrument of contribution. Each contribution will be reported to the Board for information.

26. Contributions shall be made in the form of cash in a freely convertible currency or through the redirection of available funds under existing trust funds in ADB. Contributions will be deposited into a United States dollar interest-bearing account to be specified by ADB (the WFPF account). For contributions received in currencies other than US dollars, ADB will, upon receipt of the funds, convert them into US dollars and transfer them to the WFPF account.

27. Contributions will be held, administered, and invested at the discretion of ADB. Pending disbursements, ADB may invest and reinvest contributions, and any income earned in respect of such investment and reinvestment, as well as interest accrued in respect of the WFPF account (collectively, the available funds net of expenses) will be credited to the WFPF account and used for the purposes of the WFPF, including related administrative expenses.<sup>9</sup>

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<sup>8</sup> Contributions may be effected through channel financing agreements or similar agreements under exceptional circumstances. In such cases, the related contributions will be separately accounted for.

<sup>9</sup> Administrative expenses include service charges, cost of external audits, and finance charges that may be incurred in purchasing required currencies and in remitting funds.

28. ADB will make withdrawals from the WFPF account as necessary to meet the expenditures of projects and activities supported by the available funds. If other currencies are required for payment to meet eligible expenditures, ADB may purchase the required currencies with the available funds. Any fees and charges relating to such purchase will be paid out of the WFPF account.

## **VI. ADMINISTRATION ARRANGEMENTS FOR THE WFPF TRUST FUND COMPONENT**

29. ADB shall exercise the same care in the discharge of its functions under the WFPF trust fund component as it exercises with respect to its own affairs and shall have no further liability in respect of the contributions.

30. Contributions will be held and administered by ADB separately from ADB's other resources. As a multi-partner facility, WFPF will commingle all available funds in the WFPF account. ADB will maintain records and accounts, in accordance with its normal procedures, that identify the contributions made, the commitments to be financed out of the available funds, including eligible activities and administrative expenses. ADB will provide WFPF partners with financial statements on these records and accounts, audited annually by external auditors, with the cost of these audits to be charged to the available funds.

31. In accordance with its standard procedures, ADB will charge a service fee to cover ADB's incremental cost for the administration, management, supervision, and operation of the WFPF trust fund component. The service charge is currently 2% for grant components of loan projects, and 5% for technical assistance projects, of the amounts disbursed under the WFPF trust fund component. The service charge will be paid from available funds at the same time as disbursement.

32. ADB will submit to WFPF partners annual progress reports on the performance of the WFPF prepared in accordance with ADB's normal reporting standards, and annual work programs. ADB will also furnish to WFPF partners such reports and information as the partners may reasonably request concerning the progress of the projects under the WFPF. WFPF partners and ADB will meet once a year after the establishment of WFPF to review progress, administration matters, and the work program and strategic directions of WFPF.

33. RSDD will be responsible for coordinating with various ADB departments with respect to projects and activities to be supported by WFPF. RSDD will also be the focal point for preparing the progress report on implementation of WFPF to be submitted to the partners. OCO will liaise with financial partners on all financial matters related to the WFPF trust fund component.

34. ADB will promptly inform the partners of any condition which interferes, or threatens to interfere, with ADB's administration of the WFPF trust fund component.

35. ADB may adopt additional rules for administering the WFPF trust fund component from time to time.

36. Unless otherwise agreed by WFPF partners and ADB, the WFPF trust fund component will terminate on the earlier of (i) the date of termination of the water financing program, or (ii) such date as WFPF contributions will have been substantially disbursed by ADB. At such time, except for actions necessary for winding up the activities of the WFPF trust fund component in an orderly and expeditious manner, ADB's functions in relation to WFPF contributions will be considered terminated.

37. Upon termination of the WFPF trust fund component and subsequent liquidation of the WFPF account, unless otherwise agreed with the WFPF partners, any available funds will be returned to the individual partners in proportion to their respective available contributions made.

38. Following termination of the WFPF trust fund component, ADB shall, as soon as practicable, furnish to the partners a final report on the projects and activities supported by WFPF.

## **VII. RECOMMENDATION**

39. I recommend that the Board approve:

- (i) the establishment and administration of the proposed Water Financing Partnership Facility trust fund component under the Water Financing Partnership Facility in accordance with the provisions set forth in this paper; and
- (ii) the acceptance by ADB of contributions to the Water Financing Partnership Facility by bilateral, multilateral, and individual sources substantially upon the terms and conditions set forth in this paper.

## INSTRUMENT OF CONTRIBUTION

[date]

Asian Development Bank  
[address]

[Name and identity of partner] (hereinafter referred to as the "Partner") hereby undertakes to contribute to the WFPF trust fund component in an amount of [\$\_\_\_\_] in accordance with the provisions of the Board Paper entitled "Establishing the Water Financing Partnership Facility" of the Asian Development Bank (the "Paper") and subject to the terms and conditions set forth in the Paper.

The contribution will be paid to the Asian Development Bank in the form of immediately available funds on or prior to [specify date]/in accordance with the following schedule [insert disbursement schedule]:

The contribution shall be paid into [ADB to specify account details].

Dated this \_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_.

For and on behalf of

\_\_\_\_\_  
Authorized Representative