Preparatory Process

For the Third International Conference on Financing for Development

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I am a member of the United Nation's Secretary General's Advisory Board on Water and Sanitation (UNSGAB), formed in 2004 by Secretary General Kofi Annan and continued by Secretary General Ban Ki Moon. UNSGAB is a group of 20 eminent people, all committed to catalyze action to meet the Millennium Goal for water and sanitation by 2015 and to advocate for a more focused water and sanitation Sustainable Development Goal post-2015. I am also a private sector finance member of the High-Level Panel on Financing Infrastructure for a Water-Secure World being convened by the World Water Council (WWC) and the Organization for Economic Co-operation and Development (OECD)

UNSGAB strongly believes that there is a need to improve access by local water utilities to local currency capital markets by advocating changes to legal and regulatory frameworks in emerging market countries and by encouraging development banks to leverage their resources and target some of their technical assistance to develop the capacity of local water utilities. It is critical that water utilities develop the capacity to become creditworthy and finance their infrastructure costs in their own local currency capital markets.

It is UNSGAB's view that ODA assistance is diminishing as a reliable funding source for infrastructure in many countries. Consequently those countries are faced with figuring out how to finance their capital needs elsewhere. With the development banks know-how and available ODA technical assistance aid, we believe it is important that ODA focus some of its technical assistance funding to develop the local currency capital markets of emerging countries and help teach their central government and local government officials how to prepare their capital projects in a credit worthy manner to be able to access both domestic and international capital markets. This focused and targeted assistance would also benefit countries by helping them to better identify their internal legal, regulatory and organizational barriers to capital market financing and help them to make appropriate changes.

The Challenge: Developing and Financing Infrastructure

Infrastructure projects are notoriously difficult to develop and finance in even the most highly functioning operating environments. There are several reasons for this. First, the due diligence associated with infrastructure projects, such as technical and financial feasibility, environmental and social impact, and permitting, is costly, complex and time-consuming. Second, delays or obstacles during project development are at best costly and, at worse, fatal to the transaction. Third, such due diligence may rightly raise issues that indicate the transaction is not financially viable; in such an instance, project developers have no hope of recouping their investment. Blended finance approaches using taxes, tariffs and transfer (3Ts) need to be applied to mitigate this risk.

Once properly developed, a project meets the next significant hurdle: **financing**. Infrastructure financing is often characterized as "lumpy": a toll road, electric generation or water treatment plant requires a sizeable up-front investment that is repaid over a long period of time. Repayment typically relies on user fees, which presents investors with risk: will politicians and regulatory bodies support a tariff structure that accurately sets and enforces collection of fees that cover the project's operating and capital costs?

In addition, sourcing significant amounts of long-term capital is often difficult, particularly in countries where capital markets are less developed. Infrastructure finance largely relies on debt, but often has an equity component. Lenders are typically quite conservative: they seek full repayment of their interest and principal, on time and in full. The equity component, which is exposed to greater risk because it is the first to be lost, can be in the form of a private equity investment or in the form of a government grant. If private, then the equity investors seek a high return for the risk they take; if a grant, then the government has decided to provide an important subsidy to the project. Regardless of type, the equity component provides an important risk-absorbing "cushion", which is needed to attract those with the deepest pockets, the debt investors.

In order to reach the next level of development and progress, governments must design innovative institutional and market solutions, including pooled financing and revolving fund models, to develop and finance the necessary infrastructure to sustain economic growth. The existing institutional capacity cannot efficiently build new infrastructure to meet existing and future demand. Due to limited government budgets and ODA, the optimal solution for financing billions of dollars in infrastructure is by leveraging domestic and international capital markets to attract private investment, as well as to develop the management and technical expertise to build, operate and manage world class economic and social infrastructure projects.

A market-based solution requires a demand-driven institutional capacity that meets investor requirements to respond to national infrastructure priorities. In order to leverage domestic and international capital markets, each country must establish investor confidence through policy, legal and institutional reforms that meet international standards.

<u>Pre-requisites for Success</u>

A new legal and institutional framework is needed to encourage private investment in public-purpose infrastructure and should establish transparent rules that respond to domestic and international investor requirements. Investors only focus on financing bankable projects. Bankable projects are those that are structured to ensure investors are repaid. Serious investors will only put up their money to finance local infrastructure projects, if they:

1. Are confident that sufficient revenues will be generated to make timely payments to shareholders and lenders;
2. Believe that the government will honor its contractual commitments in partnerships (for example through policy legislation or tariff setting);
3. Believe that all risks have been identified and mitigated;
4. Can identify experienced and reliable management with project implementation and operational expertise;
5. Can expect all contracts to be enforced;
6. Can rely on a pipeline of projects rigorously prepared and reviewed to create a reliable deal flow; and,
7. See a transparent budgetary, accounting and auditing process that creates incentives and confidence.

It is recommended that new centralized institutions be established to overcome the current obstacles that frustrate government and provincial leaders, private investors, and citizens and enterprises. Based on international experience and current institutional environment, the proposed new institutions are:

- An Infrastructure Development entity to centrally review and approve proposed infrastructure projects based on a new standard for bankable projects that develops a deal flow of credit worthy projects for investment by domestic and international finance institutions, private investors and government.

- An Infrastructure Finance entity to manage the process for routing bankable, governmentally approved projects into the capital markets, especially those approved by Infrastructure Development entity and have the authority to incorporate blended financing, such as funding from state budgets, ODA and private capital to achieve leverage.

The benefits from this proposed market-based approach include: greater transparency and improved governance in the procurement of infrastructure and maintenance services; higher rates of capital mobilization from debt and equity markets, creating a sustainable solution; lower transaction costs and higher efficiency for business operations for all enterprises; and, greater efficiency in service delivery for poor, remote, as well as rich sub-national entities.

<u>Conclusion</u>

The post-2015 SDG process is focused on fundamental policy issues like food, water and energy, etc. This Financing for Development process needs to focus on developing pragmatic financial recommendations, which are key to making progress in the post-2015 SDGs.