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TRANSFORMATION TOWARDS SUSTAINABLE
AND RESILIENT WASH SERVICES

# Sector and project financing in Kenya: financing strategies for service delivery

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*Kenya requires innovative funding strategies, mechanisms and tools to ensure that it will reach national and international development goals regarding water and sanitation. The WASH sector, and Kenya as a whole, must explore innovative funding tools and mechanisms that can adequately leverage finance from a number of different sources, including domestically-generated revenues, as well as new mechanisms such as climate-related funding. To date, the lack of a comprehensive national investment plan has resulted in disjointed investment interventions and poor targeting that has not addressed sector needs across the country. This paper examines potential public financing strategies for the sector in Kenya and provides recommendations for their monitoring and evaluation to ensure sustained change and steady financial development.*

## Introduction

To reach Goal 6 of the Sustainable Development Goals (SDGs) and "ensure availability and sustainable management of water and sanitation for all", there is an urgent need to address systemic service delivery inefficiencies and build strong institutions that can professionalize the water and sanitation sector and attract large public and private financing.

From 2012 to 2015, external aid commitments for water and sanitation, as a portion of total investment commitments, declined from 6.2% to 3.8%, a significant reduction in contribution. Global aid commitments have decreased from USD 10.4 billion to USD 8.2 billion and from USD 3.8 billion to USD 1.7 billion in Sub-Saharan Africa specifically. In comparison, available data on national budgets and expenditure indicates that government allocation and spending for WASH is increasing (WHO 2017). However, more than 80% of countries report that current financing levels will be insufficient to meet national WASH targets or the higher levels of service outlined in SDG 6.

In Kenya, a lack of non-capital expenditure and support for counties, service providers and the necessary systems results in high rates of non-functionality, inefficient services and stagnation in coverage. Sanitation in Kenya is particularly off-track to reach SDG 6. This paper will explore the country's current trends in sector funding and financial performance, with a particular emphasis on public funding, and ways in which the funding gap could be reduced by improving coordination, planning, monitoring and evaluation.

## Overview of current sector funding trends and practices

### Investment planning

Kenya requires clear and coordinated water and sanitation investment planning, as it is a water-scarce country with a rapidly growing population and consumption demand. Kenya's Vision 2030 seeks to make water and basic sanitation available to all by year 2030. The total cost of investment required for water supply services investment to attain this target is estimated at Ksh 1.7 trillion, or just over USD 17 billion (WRMA 2013). According to the Kenya National Water Masterplan 2030, the available government allocation is Ksh 592.4 billion (around USD 6 billion). This leaves a shortfall of USD 12 billion (see

Figure 1). This gap could be bridged through improving sector efficiency, increasing consumer payment through tariffs, and encouraging private sector financing.

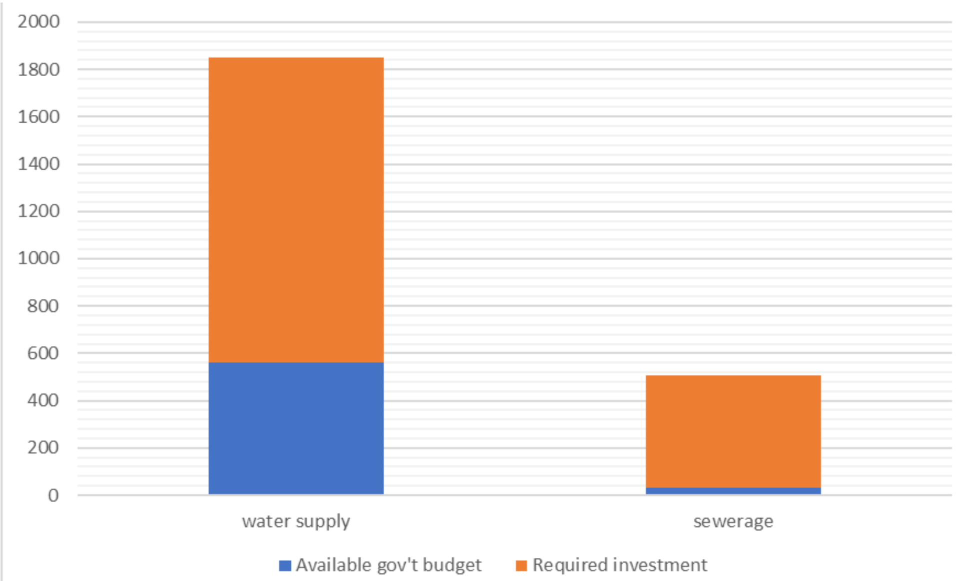


**Figure 1. Required investment costs compared to available government budget up to 2030 (KSh billion)**

Source: Kenya National Water Master Plan 2030, p.145

Kenya does not yet have the required infrastructure for adequate water resource management, harvesting and storage to meet universal water and sanitation targets. A major challenge standing in the way of sector progress is weak coordination among national and county governments, national and regional sector institutions and other stakeholders, particularly regarding investment planning. In the water sector, this kind of planning has not been properly linked with national and county economic planning and budgetary processes. Further, county and cross-county sector plans have not been adequately developed to integrate with national investment planning. Overall, Kenya is characterized by disjointed infrastructural investments, a lack of synergy, and poor targeting to address different needs and inefficiencies. This is mainly due to lack of a comprehensive national investment planning to support implementation of the national water master plan.

### Resource mobilization and public financing for public water sector investment

In Kenya, government allocations for WASH sector investment have increased marginally from approximately USD 400 million to 450 million. However, the sector has not been able to generate enough revenue to plug the additional gap. The projected budgets for one such national programme can be found in Figure 2; the reductions in planned public investment reflects the increasing prominence that will be accorded to private sources of finance, although it is currently unclear what these sources will be.

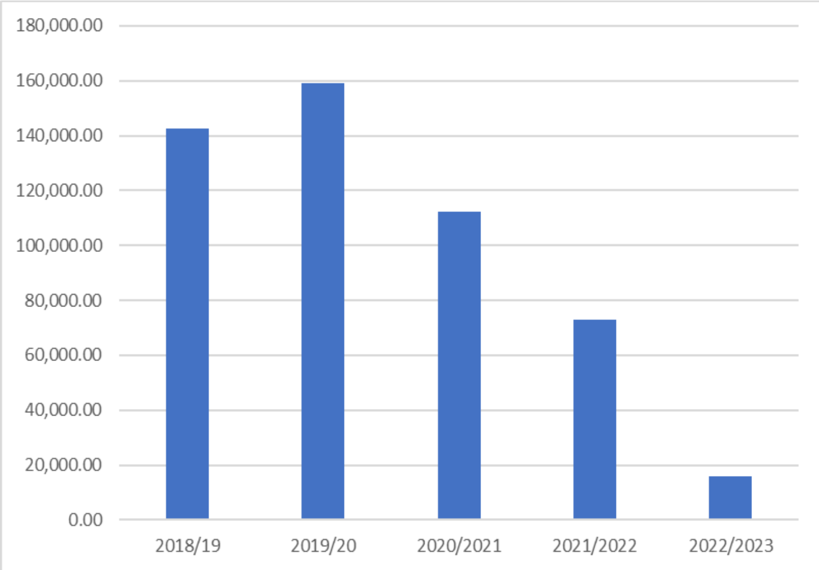


**Figure 2. Indicative National Water and Sanitation Supply Programme budget, 2018-2023 (KSh million)**

Source: Environment, Water and Sanitation Sector: Water sub-sector draft report. Third Medium Term Plan 2018-2022.

Financial resources for public investments in the WASH sector are limited, and to date, there is overreliance on the Consolidated Fund and external sources such as loans and grants (MWI 2017). Innovative additional pathways for resource mobilization are available from private, domestic and international sources, including output-based grant-financing, commercial debt, tariffs and internally generated revenue such as household contributions, equalization funds and trust funds – but these have not yet been properly explored. The sector has also not exploited opportunities in international climate and concession financing mechanisms. Water abstraction revenues have not been properly allocated to preserving and conserving surface and groundwater sources on which water harvesting and storage rely. Ring-fencing strategies for revenues in the sector are therefore weak.

The sector continues to face other resource mobilization challenges, including weak operational and governance performance by utilities, which undermine solvency and commercial viability; inefficiency in revenue collection; and high levels of non-revenue water - all resulting in low cost recovery.

### Financial management

The sector continues to face other financing challenges, including disparities in reconciled water sub-sector funding. Absorption levels for allocated financial resources are low, which is linked to weak capacity in project execution, bureaucratic procurement procedures and inefficient contract management. The sector has not optimized the balance between recurrent and capital expenditure, with most utilities retaining a historically bloated workforce to pacify political forces. According to the National Water Master Plan 2030, the Kenyan water sector development budget is around 2.8% of the total national budget. However, in terms of GDP, water sector development expenditure accounts for less than 1%. There are also challenges regarding financial leakages and wastage, duplication and unpredictable flows.

## Proposed sector financing strategies

The overall objective for water sector financing should be to maximize the social return on public investment. Financing and costing in the water and sanitation sector should be guided by the following principles:

1. **Develop and implement a national resource mobilization strategy** through traditional and new, innovative financing models and partnerships, including (among others) climate and concessional financing sources. This should incorporate an information sharing framework on financing options. Section 117 of the Water Act 2016 establishes that sources of sector funds can include:

- appropriations from the national budget;
- proceeds from the equalization fund;
- allocations from county governments on agreed programmes;
- donations, grants and bequests;
- proceeds of the Levy imposed under subsection 2 of the Act; and
- payables into the fund under any other Act.

Enactment of this law opened the way for new sector financing opportunities that can be exploited to accelerate investment.

1. **A coordinated cost-benefit analysis of investments** will enable stakeholders to gauge value-for-money in the implementation of investment programmes through pro-active cost management and prudent utilization of resources. Sector and public participation in cost-benefit analysis and accountability of proposed investments will be critical in evaluating and committing financing.
2. **Encouraging private sector investments in the sector through public-private partnerships** is also critical, and will require clear engagement and incentive frameworks or other incentivization strategies. Further considerations should be given to debt and equity financing options (primarily from the vibrant Kenyan capital market). For a start, the proposed investments could focus more on areas of quick operational cost-cutting and revenue generation boosting such as reduction of non-revenue water and installation of efficient energy sources.
3. **Considering investment opportunities for green growth and technologies.** This will include climate-friendly technologies, renewable energy sources and climate change resilience strengthening.

2. **A comprehensive national water investment plan should include the establishment of a unit that determines prioritization for investment.** Investments should aspire to build equitability in order to reach most of the Kenyan population in a balanced manner, primarily guided by:

- Population/poverty index;
- Water coverage;
- Catchment abstraction and investment status;
- Sanitation coverage; and
- Value-for-money analysis of existing investments.

3. **All investment activities should be compliant** with any applicable legislation and related regulations, mainly:

- The Constitution of Kenya, 2010 – Amongst other key provisions, the new constitution saw devolution of the provision of WASH services to the county governments. In addition, it guarantees water as a basic human right, obligating the government to ensure that every Kenyan has access to clean, affordable water.
- Water Act, 2016 – Catalyzed the transformation of key institutions like the Water Sector Trust Fund (WSTF) from a financing mechanism to a financial institution. It expanded WSTF's mandate and scope, providing wider coverage of the sector to include water resources financing, inclusion of research activities, and was expressly authorized to provide loans to water utilities that can afford to re-pay and including all the underserved and marginalized areas.
- The Public Finance Management Act, 2012 - Seeks to ensure that public finances are managed in accordance with the principles set out in the Article 201 of the Constitution including: openness and accountability; public participation in financial matters; promotion of an equitable society, with expenditure promoting the equitable development of the country, making special provisions for marginalised groups and areas; use of public money in a prudent and responsible way; and responsible financial management and clear fiscal reporting.

4. **All public investments should seek to strike a balance between efficiency of the risk mitigation measures and the cost of implementation**. Risk management includes planning, identification, performing qualitative and quantitative risk analysis, planning responses, monitoring and controlling of risks. They should also review approaches used in deployment of financial resources to instill balance in allocation between recurrent and development expenditure, and equitability within WASH sub-sectors.
5. **To mitigate against risk, the investment portfolio should be diversified** by project type, investment mechanism, origin of resources and regional distribution, ensuring that investment needs assessment,

planning and implementation coordination will include all water sub-sectors: water resources management; water harvesting and storage; water supply and sanitation services.

6. **Develop a framework to enhance best practices in financial management within utilities to improve their commercial viability and creditworthiness**. This includes guidelines for revenue ring-fencing, full operational cost-recovery, good corporate governance and strict adherence to regulatory performance standards a. Develop an incentive framework to promote investment in projects where commercial viability is low, yet they are priority areas with respect to human rights, for example.
7. **Put in place adequate human, technical and institutional capacity** to support water sector institutions in enhancing finance absorption capacity by addressing operational bottlenecks that result in delays in utilization.
8. A**ll projects should embrace multi-stakeholder approaches** from planning through to post-implementation. This will enable planning and execution of projects to avoid financing on non-priority projects that serve other purposes other than improved service delivery.
9. **Public investments should embrace social, economic and environmental aspects of development, so that social benefits to the communities are sustainable**, which is enhanced through; building social and environmental safeguards, multi-faceted planning, multi-stakeholder consultation, gender and vulnerability inclusion and citizen engagement.

## Monitoring and evaluation

The key M&E guidelines can be found in the government's National Monitoring and Evaluation Policy (March 2012). These include: indicator identification; data collection frequency; responsibility for data collection; data analysis and use; reporting and dissemination to guide the monitoring process; assessment of progress towards achieving planned outcomes; focusing evaluations on results and non-performance; and clear pathways where results from one level flow towards the next level, leading to the achievement of overall objectives.

M&E for financing WASH investments should be the responsibility of those most closely involved in their implementation. At a minimum, the key parameters for monitoring are:

- **Expected outcomes**: A specification of the expected outcome from a particular investment. They should be tangible as to be measurable.
- **Performance indicators**: Measurable parameters used to assess the extent to which the investment objectives have been met within the context of a particular investment. They should be presented in the form of a particular action completed or the extent to which the action has been completed. Performance indicators should be SMART; simple, measurable, attainable, reachable, and time-bound.
- **Baselines***:* This should be the present state of accomplishment for the various performance indicators tied to each specific investment. Where relevant, and for cases where a baseline is not available, an appropriate intervention should be taken to obtain this information. Besides ordinary engineering viability considerations, this should include environmental and social impact assessments.
- **Targets***:* Indicators of the desired final states for each of the performance and outcome indicators. They provide a measure of the on the fulfilment of the specific investment parameter.
- **Timeframe***:* Indicates the time within which a particular investment will be completed.
- **Responsibility***:* Provides for the office or officer responsible for the specific action.
- **Budget***:* Quantification of the cost of each of the investments, including administrative and support costs, that will aide in planning and ensuring adequate resources are availed as required.
- **Action plans**: For investments that span more than one year, the implementation matrices form the basis for annual action plans.

## Conclusion

Investing in public goods such as water and sanitation is an efficient and effective use of scarce government resources. This provides an opportunity to attract private funding and improve risk/reward profiles. Other tools that blend public and private finance must be explored to further assist governments in meeting their SDG targets.

Identifying effective ways to address risk is a major barrier that could be overcome through new applications and updates to existing tools, including the establishment of mechanisms to provide guarantees, risk insurance, structuring emergent debt/equity vehicles or co-investment platforms at multilateral, national, county or WSP levels to reduce costs.

Increased resources and political will is required in order to track public spending flows and understand their final destination, as well as the populations who benefits and why some are not reached (Fonseca & Pories 2017). To achieve SDG6, information on financial flows must inform public policy to ensure that public allocation and spending is efficiently directed and targeted toward sustainable water and sanitation services.

Government policies and investment practices should facilitate investment from domestic and international investors and from consumers themselves. Effective combination of policies and practices can catalyze household, utility, and sector-level financing models.

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