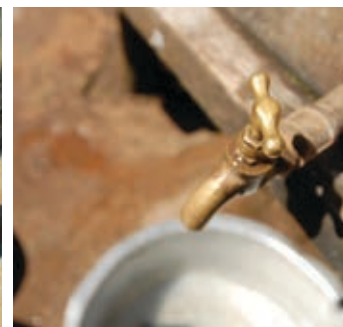


OBA Lessons Learned Series is a forum for discussing and disseminating project insights at the conclusion of projects in supporting the delivery of basic services to the poor. GPOBA is a partnership established in 2003 by the UK (DFID) and the World Bank. Its other donors are the International Finance Corporation (IFC), the Netherlands (DGIS), Australia (DFAT), and Sweden (Sida). For more information visit www.gpoba.org or email us at gpoba@worldbank.org.

LESSONS LEARNED



Kenya Microfinance for Community Managed Water Project

DEVELOPMENT CHALLENGE

Access to water supply is critical to lifting people out of poverty. This is especially true in Kenya, where only 1.4 million of the 13 million rural residents with access to improved water supply are served by municipal water services providers. In rural and peri-urban areas in Kenya, community-run, small-scale water systems play a crucial role in supplying and improving access to water services. Such organizations operate an estimated 1,200 small piped-water systems, serving 3.7 million people throughout the country. However, much of the infrastructure in these community-based facilities is run down because of underinvestment in maintenance and rehabilitation. Poor water-related infrastructure makes rural communities vulnerable to droughts and poses a major threat to Kenya's growth.

THE PROJECT AND ITS PARTNERS

In 2006, the Global Partnership on Output-Based Aid (GPOBA) approved an innovative pilot project for \$1.15 million to increase access and improve efficiency in water services for the poor in rural and peri-urban areas of central Kenya through investments in selected community subprojects.

The project was implemented by a commercial bank specialized in microfinance lending, K-Rep Bank, with support from the World Bank Group's Water and Sanitation Program. It financed investments of \$50,000 to \$125,000 in small piped-water subprojects, using commercial loans and community equity blended with output-based subsidies. The communities contributed 20 percent of project cost, with K-Rep financing the remaining 80 percent through a medium-term loan. An output-based subsidy of up to 40 percent was awarded to communities that successfully implemented subprojects, based on the number of new connections and average monthly revenue. The subsidy was used to pay down the

loan, giving the community responsibility for 60 percent of the total capital cost. Communities repaid the loans over a five-year period through operating revenues generated from water sales. The subsidy ensured that monthly loan repayments—and thus tariffs—would be more affordable. In 2010, the project received additional funding of \$1.8 million from the European Union's water facility to support a national scale-up of the financing mechanism. The scope of the project was also widened to target communities residing within the service areas of municipal water services providers.

RESULTS ACHIEVED

The project:

- Improved access to water supply. By February 2013, an additional 190,000 people had obtained access to improved piped-water supply in low-income communities in rural and peri-urban areas of Kenya as a result of the project.
- Enabled access to commercial loans and mobilized community investment. The project supported 35 community water projects to access \$3.4 million in loans from K-Rep Bank and mobilized \$1.2 million in equity from communities for investment.
- Catalyzed private sector lending. The project generated demand for commercial loans to finance investments in small piped-water systems in Kenya.
- Scaled up the financing mechanism. The World Bank and GPOBA are scaling up the pilot with funding from the Swedish development agency, Sida, to test the model in urban areas. A grant of \$11.70 million will help county water services providers access loans from local lenders to finance utility and water and sanitation subprojects, with OBA subsidies supporting access for low-income households. The grant will be managed by the Water Services Trust Fund of Kenya, a government fund for pro-poor investments in water and sanitation.



Lessons Learned

- 1 Subsidies can leverage commercial financing from banks to make pro-poor investments viable and attract equity from communities.** The project attracted additional investments of \$4.2 million for piped-water supply. Public funds accounted for only one-third of investments, freeing up public resources and leveraging additional funds from the private sector. A review following implementation noted that communities participating in the project reported an increase in productivity and related benefits due to the availability of the water supply. Households reported supplementary income generated from selling agricultural products and increased activity in areas such as animal husbandry and vegetable farming. It was estimated that every \$1 invested in the subprojects yielded economic benefits of \$2 to \$10.
- 2 Target communities must be willing to pay for piped-water supply.** The willingness and ability to pay for piped-water supply was a key factor in identifying viable subprojects—and identifying bankable community subprojects proved challenging. The lender sought to ensure that target consumers were willing and able to pay connection fees and monthly bills, and that demand for piped water would not be eroded by competing sources. A community subproject must have sufficient scale to generate enough revenue; a typical subproject has between 250 and 600 individual connections, with tariffs ranging from \$0.45 to \$1 per cubic meter and typical bills of \$7 to \$18 per month. Targeting larger, more creditworthy providers could provide a wider opportunity to scale up the successful blended financing mechanism tested in this project.
- 3 Investments financed with commercial loans should generate revenue within a relatively short period of time, and outputs linked to the subsidy payment need to be achievable in a timely manner.** The lender expressed a preference for subprojects that could be implemented within a year and in locales where the number of household connections could be increased rapidly, so operating revenues could be generated quickly. Of the 35 subprojects financed, 18 attained less than 97 percent of the planned subsidy, mostly because they failed to meet the revenue target in time. This resulted in a loss of \$250,000 to the communities. A softer target or more time to achieve the target would have helped communities access these funds and reduced their financial
- 4 The approach requires significant technical support, and a scale-up should be embedded in a programmatic water sector initiative.** Communities were keen to participate in the project, but many did not have the financial track record and experience to implement and manage the subprojects efficiently. Relative to the investment, the project spent a significant amount (22 percent) on technical assistance. This support was directed toward educating communities about the financing mechanism, hiring community mobilizers to help assess the viability of the subprojects, building capacity in operations and maintenance, helping communities complete the applications, and supporting supervision of the implementation phase. The use of private operators to run the systems was tested in one subproject. While this subproject achieved better financial and operating performance, most subprojects did not generate sufficient cash after operating expenses and debt service to pay for a private operator. K-Rep Bank field staff were trained to support the rollout of the project, under the leadership of an experienced water engineer-turned-banker. Without these efforts, the project could not have achieved its results.
- 5 Consideration should be given to institutionalizing support mechanisms necessary to further develop such financing approaches.** Kenya has dynamic water sector institutions that could increase support to service providers to develop capacity for self-financing and management. Currently, national institutions focus on constructing infrastructure, but could move toward providing technical assistance, project development support, and subsidy financing/grants to subnational governments at the county level and communities. This would help embed the initiative in a wider sector program and provide incentives for local governments to develop skills and experience in sector planning, management, and investment, while providing a check and balance through national oversight. Housing a subsidy scheme in a national organization would open the market for other local lenders to finance investments in water, creating competition for financing. This would also afford the national government an opportunity to ensure that goals for poverty alleviation and sustainable development could be achieved within a cooperative framework with local institutions.