

# Unlocking financial pathways: A strategic overview for repayable finance opportunities in Ethiopia's Water, Sanitation and Hygiene Sector

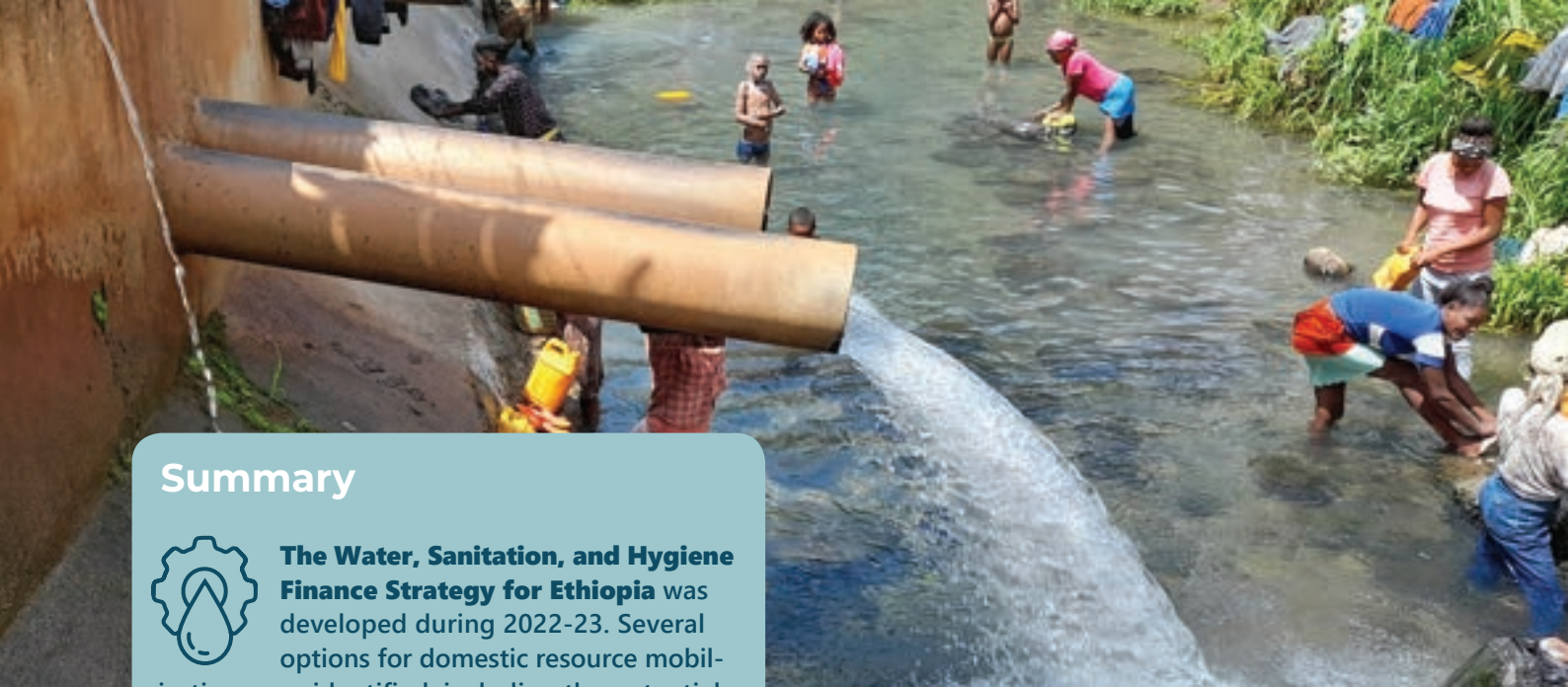
**ETHIOPIA WATER SANITATION, AND HYGIENE  
FINANCE STRATEGY BRIEFING NOTE**

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## Summary



### **The Water, Sanitation, and Hygiene Finance Strategy for Ethiopia** was developed during 2022-23. Several options for domestic resource mobilisation were identified, including the potential for accessing repayable finance, estimated to cover at least 10% of the yearly finance gap in the sector. This briefing note focuses on the supply side of repayable finance.

Neither the Development Bank of Ethiopia nor commercial banks are at present financing the **Water, Sanitation, and Hygiene (WASH)** sector and although the **Water Development Fund (WDF)** has been providing loans for urban water utilities, it has limitations in accessing capital. On the other hand, the portfolios of microfinance institutions for household, community and enterprise microloans in the sector are increasing rapidly.

This briefing note argues that there are several low hanging fruits that can be pursued to increase repayable finance in the sector. The first is by reducing risk perception amongst finance suppliers and the second is by standardising loans and developing further savings products for different segments in the sector. Parallel to these is capacity building for mainstreaming climate finance in the sector and establishing matchmaking platforms for the identification and prioritisation of projects.

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## Background

**The Water, Sanitation and Hygiene Finance Strategy for Ethiopia** was developed during 2022-23, drawing upon international experience, key informant interviews, quantitative analysis utilising financial and economic models and validation workshops with key stakeholders.

The Strategy aims to maximise domestic resource mobilisation for the WASH sector. The analysis has identified a range of domestic finance options and has estimated their potential for generating revenue, considering various assumptions and estimates.

### **BOX 1. Repayable finance**

Is an amount of capital, or the sum of money provided to an organisation, with the expectation of repayment. Organisations are liable to pay back the capital amount along with a certain percentage of interest.

## The role of repayable finance in the Ethiopia Water and Sanitation Finance Strategy

Accessing repayable finance (Box 1) represents up to an estimated 10% of the options to fill the finance gap in the WASH sector.

Repayable finance is adequate for both large scale, long term and multisector investments and investments in water and sanitation by households and entrepreneurs using microfinance. This briefing note explores immediate opportunities for increasing repayable finance and what is needed to make them happen.



## Key factors influencing financial institutions to invest in Ethiopia's WASH sector

### 1 Reduce risk perception among suppliers of finance

For the development of the Finance Strategy, a detailed bottleneck analysis was carried out on suppliers of finance such as Commercial Banks, Development Banks, the Water Development Fund and Micro Finance Institutes. The analysis identified that the WASH sector is considered high-risk amongst finance suppliers, but that this perception derives from being unaware of the different types of enterprises and businesses that seek loans along with their business models.

There are two immediate opportunities to reduce this risk perception among finance institutions (which have been successful in other countries and were mentioned in interviews with finance experts in Ethiopia). The first is to organise learning/ sharing events where finance institutions with success cases in the sector share their business models and approaches (i.e. commercial banks that are financing utilities, WDF successful loan repayments, MFIs that are expanding their portfolios). The second is to ensure guarantees, either from the Ministry of Finance via the Development Bank of Ethiopia; other bilateral agencies; or MFIs.

The future operational modalities for the WDF are under revision/ evaluation and therefore cannot be explored further in this briefing note.

Political support to make WASH an investment priority in the lending portfolios of financial institutions is critical. For instance, in addition to the support from the Ministry of Finance (MoF), commercial banks could earmark 5% of their current loanable amount to the WASH sector. For this to happen, the regulatory banking agency – the National Bank of Ethiopia – would need to prioritise WASH (which features already in its annual reports) and send out circulars or directives to the DBE and to commercial banks.

Lending institutions will need to become more familiar with the WASH sector, its opportunities and its constraints. Likewise, those wishing to borrow money – whether from a public or private entity – will also need to understand the conditions of the lending institution and what actions they need to take in order to meet their borrowing conditions.



### The present landscape

The **Development Bank of Ethiopia** (DBE) channels national and international funding to investments in agriculture and energy, but not to the WASH sector. The assets under management in 2022 reached USD 3 billion<sup>1</sup>.

Very few **commercial banks** provide short term and expensive loans directly to some private larger companies (suppliers) and a handful of water utilities.

The **Water Development Fund**, (WDF) a semi-autonomous government institution established in 2002 pools funds from various multilateral and bilateral financial sources to provide long term loans for towns' potable water supply and sanitation enterprises as well as irrigation associations. The Fund currently has around 38 towns water supply projects that have applied for loan financing; however, the demand for financing cannot be met as WDF has limited access to capital.

Finally, **microfinance institutions** (MFIs) are rapidly expanding,<sup>2</sup> with an average of Ethiopia Birr (ETB) 49 million<sup>3</sup> per year contributing to the WASH sector as loanable funds. However, of the 43 MFIs operating in the country<sup>4</sup>, only five provide WASH loans. Most of the WASH products offered by these MFIs are aimed at household sanitation services and for community piped connections.

<sup>1</sup> Public Development Banks and Development Financing Institutions Database. 2023. University of Peking and Agence Francaise de Development

<sup>2</sup> Alibhai, S., B. Mengistu, W. Toni. 2021. How to escape the microfinance lending squeeze: evidence from Ethiopia International Bank for Reconstruction and Development/ The World Bank

<sup>3</sup> 56.57 Ethiopian Birr to 1 USD January 2024

<sup>4</sup> National Bank of Ethiopia. 2023. Annual report 2021-2022

## 2 Standardise loans and saving products for different segments

There are a limited number of standardised products and finance for the many segments in the sector that need loans.

**Woredas<sup>5</sup> and utilities** are not borrowing from commercial banks for various reasons, but there are a few good examples in the country, such as Ambo and Wolayta Sodo Water Utilities, where this is occurring, which can be documented and shared. Water utilities and woredas can also explore borrowing options for concession models and private partnerships through which loans could be disbursed – the WDF provides some examples where this is already taking place.

The ongoing work from many organisations on utility and woreda performance strengthening (i.e. improved billing, effective asset management, development of business plans, etc.) is critical to make them eligible for loans (and the ability to pay them back). However, there are not many sources of finance to which these utilities can apply to access finance.

There is also an increase in **WASH business enterprises**, which request larger loans (between ETB 500 thousand and ETB 1 million). There is a real gap in the offer of finance for micro entrepreneurs that wish to fill critical gaps in providing private sector supply of WASH services, by for example, leasing water tanks or creating plastic recycling enterprises.

Some MFIs are innovative and provide WASH loan products following increasing demand from households by developing WASH saving products, working with Ethio Telecom to digitalise access to WASH credit using mobile banking and aiming to increase loan amounts to expand services to micro enterprises.



Since MFIs are primarily obtaining their capital from commercial banks, this leads to high interest rates for beneficiaries and lack of uptake of financing. There is an opportunity from International Finance Institutions and the DBE to provide concessional capital to MFIs, making loans cheaper for the poorer segments of the population. This is already occurring in the energy and agriculture sectors with funding from the World Bank to the DBE which then on-lends to MFIs.

## 3 Mainstream climate finance in the sector: the urgent need for capacity building

Ethiopia is one of the most vulnerable countries to climate change due to its high dependence on rain-fed agriculture and natural resources<sup>6</sup>. In 2023, Ethiopia was in its sixth consecutive failed rainy season, prolonging a drought that began in 2015 and has affected over 24 million people.<sup>7</sup>

Ethiopia's National Adaptation Plan (NAP) and updated Nationally Determined Contribution (NDC) outlines prioritised actions for adaptation, which includes a focus on agriculture and water and represents USD 4-6 bn/year in adaptation-related costs.<sup>8</sup> Based on data from 2019/2020, only USD 945 m in adaptation finance was committed; the majority of which was funded through public sources (92%) channelised through grants (72%); and of which, 16% (165m) was directed to the water and wastewater sector. Despite this, adaptation financing still lags behind the required adaptation costs as identified by Ethiopia's updated NDC.

To date, there is only one water related project approved by the Green Climate Fund (approved in 2017) which focuses on responding to the increasing risk of drought. This project (GCF, 2017 ) mobilised USD 50 million (all grants) and is still under implementation.

<sup>5</sup> Woredas are districts.

<sup>6</sup> The World Bank Group. 2021. Climate Risk Profile: Ethiopia.

<sup>7</sup> International Rescue Committee. 2023. <https://www.rescue.org/country/ethiopia>

<sup>8</sup> Climate Policy Initiative. 2022. Landscape of Climate Finance in Ethiopia

Very few institutions in the country have integrated NAP or NDC priorities into their activities, and these are not costed or budgeted for. Immediate opportunities include capacity building in this area and integrating the NDCs within the targets of water entities; coordinating its implementation (how much Green House Gas (GHG) will be averted or decreased by which sub-sector); building the capacity of national and local stakeholders to develop climate rationales; gather the necessary data; and develop a pipeline of projects at different levels. Some of these will be financed by grants alone, and others by a mix of grants and repayable finance. These are included in this brief as low hanging fruit because the amounts of capital that can be mobilised are significant.

For instance, Ethiopia's WASH Finance Strategy has identified the reduction of Non-Revenue Water (NRW) as a measure that can potentially mobilise significant funds. NRW reduction helps conserve

freshwater resources, which is crucial in drought-prone regions facing increasing water scarcity due to climate impacts. NRW reduces energy consumption for pumping and treating water. This presents mitigation co-benefits by aligning with climate finance goals aimed at reducing energy-related carbon emissions (mitigation). See more examples in Box 2.

Many stakeholders will need to collaborate to make access to climate finance a reality for the country. With a given mandate, this is also an area where the MoF and DBE can play key roles.

As in other finance segments, MFIs are already ahead in this area. Their clients – which access mostly agriculture related loans - are the frontline victims of climate change. Loan products for low carbon emission businesses and for companies that promote energy efficiency and environmental protection are already available from MFIs.



## BOX 2. Examples of water and sanitation adaptation and mitigation activities

### ADAPTATION ACTIVITIES

- Climate proofing hardware , infrastructure and services to survive floods, fires and droughts and other climate hazards
- WASH services for persons relocating due to climate change –‘climate refugees’
- Boosting supply when climate change raises water demand (agriculture, evapotranspiration, heat in towns)
- Addressing declining water quality (especially saline intrusions)
- Water storage if rainfall is more variable
- Recycling water to farmers/ industry in drought-affected areas
- Drainage and sanitation
- Irrigation and food security in water scarce contexts
- Flood management
- Wastewater (reuse)
- Groundwater recharge
- Catchment management (including nature-based solutions)
- Youth engagement – skills for greening
- Capacity building for all of the above

### MITIGATION ACTIVITIES

- Reducing methane gas emissions from sanitation
- Reducing carbon fuel and non renewable energy use of water supply infrastructure (or green energy substitution)
- Hydropower (rehabilitation/ new build)
- Mini-hydro
- Projects linked to hydropower as a renewable energy source
- Leakage reduction (less energy use)
- Biogas (renewable energy and lower emissions)
- Capacity building for all of the above

## Policy recommendation

To increase repayable finance to the sector, lending institutions will need to gain the buy-in of their boards and political commitment will need to come from the MoF to commit publicly to include WASH as a priority sector for finance institutions. Quotas and other incentives may be introduced to overcome initial bottlenecks in increasing lending for water and sanitation, including the use of de-risking instruments.



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