Public-Private Partnerships
for Water Supply and Sanitation

Implementation Guidelines

Manual for Sustainable
Municipal Water Services

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Preface

Water is fundamental to life and health. By extension, it is a prerequisite for realizing other, basic human rights and in the fight against poverty. The vital importance of water for development is also reflected in one of the Millennium Development Goals (MDGs): by 2015, the number of people without access to safe drinking water and adequate sanitation must be cut in half. Innovative partnerships are needed to meet this huge challenge. Concerning such partnerships there are various options; one of them is a Public-Private Partnership (PPP) between the public authorities and the local, national or international private sector. Deciding on the best option should be the result of an informed and transparent local process.

One of the main challenges in introducing PPPs lies in the proper definition of governance structures for all actors: roles and responsibilities must be assigned and regulatory mechanisms must be established from the outset. What is more, a PPP can only be successful if the involvement of civil society is ensured. Not surprisingly, these issues are crucial for public utilities as well. Yet, while under public service provision, the relevant policies may be adapted gradually, in a PPP, the "rules of the game" need to be set from the start.

The Swiss Agency for Development and Cooperation (SDC), the Swiss State Secretariat for Economic Affairs (**seco**) and Swiss Re have facilitated a process to develop instruments to respond to these challenges. The objective of this initiative is to enable optimal use of PPP as one of the options and contribute to the overall performance improvements of water supply and sanitation services. While Swiss Re contributed its risk expertise in this partnership, SDC and **seco** placed additional emphasis on improving the sustainability and poverty focus of PPPs. The tools were developed on the basis of a multi-stakeholder process and input from a variety of experts, and have benefited from many individual contributions. We would like to take this opportunity to thank all those who contributed for their constructive criticism and advice. We believe that effective PPPs have the potential to play an important role in achieving the MDGs. In this regard, we hope our initiative will contribute to providing access to safe drinking water and adequate sanitation for the rural and urban poor, and, in turn, deliver the basis for improved health and prosperity.

Walter Fust,
Director General
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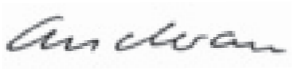

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This document is the result of an extensive expert consultation process. It does not necessarily reflect the views of all the partners.

The Implementation Guidelines have been written by a team of water professionals led by Fritz Brugger and Dieter Rothenberger.

Contributors to the text were Richard Franceys, Peter Gleick, Jim Lamb, Meena Panaliappan, Neigel Scott, Luis Uzin, and Gary Wolff.

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Content

Acronyms

ADB	Asian Development Bank (www.adb.org)
BPD	Building Partnerships for Development (www.bpd-waterandsanitation.org)
[cap]	Capacity building
CBA	Cost-benefit analysis
CBO	Community-based organization
[comm]	Communication
CSO	Civil society organization
CVM	Contingent valuation method
HIPC	Heavily indebted poor countries
IBT	Increasing block tariff
IFC	International Finance Corporation
IFI	International financial institutions
IWRM	Integrated water resource management
NGO	Nongovernmental organization
NIS	New independent states of Eastern Europe
NWP	Netherlands Water Partnership
OBA	Output-based aid (payment scheme)
ODA	Official development assistance
O&M	Operation and maintenance
PIDG	Private Infrastructure Development Group
PRI	Political risk insurance
PRSP	Poverty Reduction Strategy Paper
RFP	Request for proposal
PPA	Public performance assessment
PPP	Public-Private Partnership
PSP	Private Sector Participation
ROI	Return on investment
SC	Stakeholder committee
[stake]	Stakeholder cooperation
SLA	Service level agreement
TA	Technical assistance
TI	Transparency International (www.transparency.org)
UFW	Unaccounted for water
VfM	Value for money
WB	World Bank (www.worldbank.org)
WEDC	Water, Engineering and Development Centre at Loughborough University, UK
WHO	World Health Organization (www.who.int)
WSDF	Water Sector Development Fund
WSP	Water and Sanitation Program (www.wsp.org)
WSS	Water supply and sanitation

Detailed Overview of Guideline Notes Headlines

Purpose

Objective

Providing reliable water supply and sanitation services (WSS) involves many challenges to both national and local governments. Among the most critical are running/maintaining existing services in a sustainable manner as well as making safe water accessible to those not yet connected, especially the poor.

Governments have been and still are increasingly seeking the expertise and experience of the private sector in their search for sustainable – and affordable – ways to deliver water and sanitation services to their populations.

While this approach promises numerous benefits, experience shows that involving the private sector in the provision of basic services needs to be carefully planned and monitored if the benefits of such a model are to be fully realized, transaction costs minimized and the numerous potential pitfalls avoided.

Four key challenges to Public-Private Partnerships have proven to be critical for sustainable water supply and sanitation service delivery and shape the trust of customers and investors in service providers. These challenges, which need to be overcome in order to obtain best results for water supply and sanitation, are the following:

- Achieving economic efficiency by reducing transaction costs caused by friction between parties and stakeholders
- Effective delivery of services to customers
- Equitability in responding to needs, especially those of the poor
- Transparency in processes, structures, responsibilities and results

How these challenges are addressed is determined – to a major extent – by the level and quality of governance in water issues. For this reason, good water governance ultimately stands at the center of interest in this publication.

Water governance concerns the question of how political, economic, and administrative authority should be exercised in managing water affairs. Governance refers to the range of political, organizational, and administrative processes through which needs and demands are established, communities articulate their interests, decisions are made and implemented, and decision makers are held accountable. Governance is thus not only about the importance of institutions but also about the importance of the interactions between different levels/bodies of government, the interaction between the public, nongovernmental organizations, business, the consumers, and government.

Hence, there are two complementary levels that have to be addressed in order to achieve good water governance:

- Firstly, the *political level,* where discussions about basic values, roles, and responsibilities are key. Within the instruments developed by the initiative 'Public-Private Partnerships for Water Supply and Sanitation', this political level is covered by the 'Policy Principles', which provide a framework for participatory dialogue and negotiation
- Secondly, the *project level,* where specific service operations are structured, the private operator is involved and coverage has to be expanded. This implementation level is the concern of the Implementation Guidelines, the publication in your hands, providing hands-on guidance for all involved in or affected by a PPP transaction

Good water governance is equally relevant to private and public providers, and most of the underlying success factors are the same for both. Transparency, accountability, customer focus, and poverty responsiveness – to name but a few – are key to sustainable water supply and sanitation services, irrespective of whether they are delivered by private or public providers.

But for all that, the Guidelines are defined as 'Implementation Guidelines for Public-Private Partnerships….' The reason is that, before you enter into a contract with a private operator, consensus has to be reached on all of the important issues and topics which determine the rules of the game you will have to follow, whereas in the case of public service provision there is no such hard and fast looming deadline.

Scope

The Implementation Guidelines focus:

- On municipal services, i.e. urban and periurban settings and also small towns and rural centers in which municipalities and local governments have to set up reliable grid-based municipal water services
- On all forms of delegated management, from service contracts to concession contracts. Some of the content can be disregarded in the context of less complex contract forms such as management contracts

Pulling together best-practice cases, information gathered from failed scenarios, and contributions from international experts in many relevant fields (including local government, regulatory, private sector, financial sector, donors, consumers, NGOs, researchers, etc), these guidelines are designed to assist:

- Contracting parties (contracting public agency, private operator and their staff in charge of preparing and implementing Public-Private Partnerships
- Stakeholders (regulators, other ministries and public institutions, donors, financing institutes, civil society groups such as development organizations, consumer and environmental groups, and other relevant stakeholders)

With this in mind, there are at least two situations in which the Implementation Guidelines provide assistance:

- Setting up and implementing a PPP
  Municipalities intending to restructure water service delivery and considering involving the private sector. This can take various contract forms, from a service or management contract to a lease or even a concession contract. Private sector operators may be local or national companies or international operators, depending on the skills/competences needed and services available. The Implementation Guidelines assist staff in preparing and executing process design and process management throughout the PPP preparation, implementation, and service delivery. Utility managers may find the implementation guidelines useful for achieving high Corporate Social Responsibility (CSR) standards. They may be used as checklists for due diligence in water service governance.

- Restructuring public services
  Although the Implementation Guidelines are mainly intended for PPP purposes, they are also useful for organizations seeking to move away from traditional, public service management structures towards greater autonomy. This may apply, for instance, to (a) a *municipal utility,* established under public law, which is a legally autonomous statutory body and has an independent corporate supervisory board, but whose assets remain the property of local government, or to (b) a *municipal company:* a government-owned public limited company

(PLC) created under company law, the shares of which are owned by national, regional or local government authorities, provided that the tasks and responsibilities are defined in a form similar to a contract.

In both public and private service provision, continuous improvement processes are an effective way of optimizing services to customers. Although the Implementation Guidelines discuss the subject along a project life cycle, they can also be used to improve specific aspects of a given water and sanitation service.

In order to facilitate the identification of priority areas for improvement, a self-assessment tool for water service governance helps utility managers, politicians and other stakeholders to assess the quality and level of the governance of the water service and to establish and maintain state-of-the-art governance. This tool can be found on www.partnershipsforwater.net/selfassessment.

Since the Implementation Guidelines focus on water governance, they highlight especially process-related aspects of project development, transaction processes and contract management, including the relevant financial and technical frameworks.

They do not offer technical guidance, detailed contracting guidance or contract templates. Nor do the Guidelines cover broader aspects of water supply and sanitation policy.

Framework

Key Factors

[1]The Policy Principles are the first part of this toolkit. For more details see: *www.partnerships forwater.net*

The Implementation Guidelines aim to support the development of good water governance. To this end, they follow ten *Key Factors* comprising all relevant dimensions of water governance. These Key Factors originate in the Policy Principles instrument[1] and are described there extensively.

The Implementation Guidelines turn the Key Factors into tangible activities following the logic outlined in Figure 2.

Therefore, as a preparatory step to make the Key Factors operational, in this section we outline the criteria resulting from each of the Key Factors that have to guide the development of activities, measures and options.

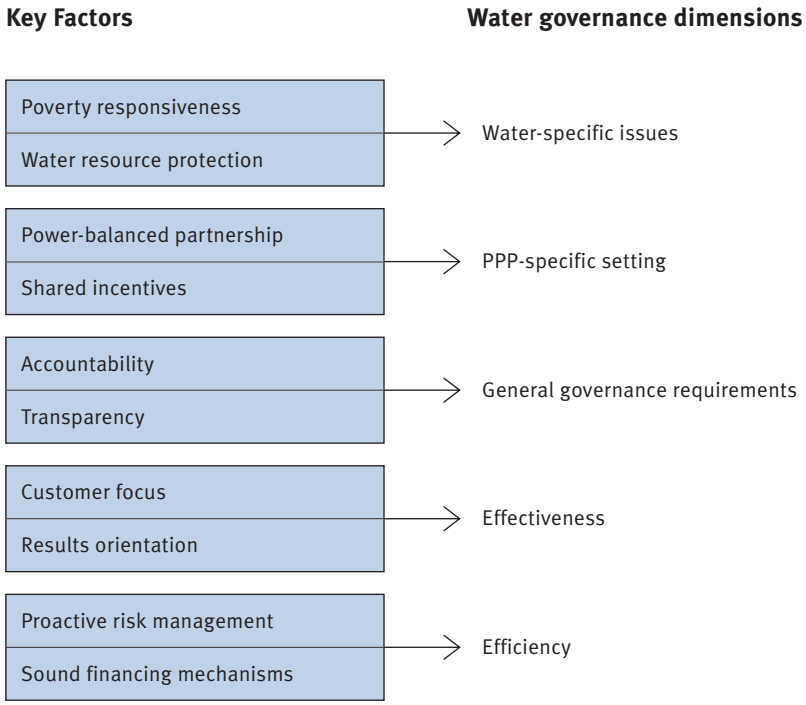


Figure 1: Overview of Key Factors outlining the dimensions of good water governance

Poverty responsiveness

Poverty and the inability to access safe water most often directly correlate, making water and sanitation service projects sensitive issues and a key responsibility of governments. Getting the private sector involved is firstly a tool for improving technical, financial, and managerial efficiency and effectiveness and secondly an approach for increasing the available financial resources, depending on the type of contract. Bringing in the private sector does not inherently address poverty issues but strives for technically and financially sustainable water operations.

Hence, explicit efforts such as a clear and transparent subsidy policy are needed to assure

affordability for the poor in order to compensate possible adverse impacts on low-income customers.

As a basic rule, the social problems of poor customers should not be transferred to the private operator without the commitment and capability of the government to provide the funding needed to make extensions to serve low-income areas feasible in order to avoid false expectations.

Therefore, poverty responsiveness includes:

- Identifying poor customers and vulnerable groups and determining their needs, with a special focus on gender issues; this process must involve the poor themselves
- Respecting those needs in project development and in designing operational procedures
- Developing transparent support mechanisms (e.g. project design: service levels adopted; investment: equity, guarantees; connections: subsidies, payment mechanisms adopted, etc.) targeted effectively to bridging the gap between cost-recuperating tariffs and tariffs that are affordable to the poor
- Assessing the direct and indirect impact of any (project) activity on the poor

Water resource protection

According to the overall approach of integrated water resource management (IWRM), water resource protection has to be taken into account at three complementary levels:

- Environmental protection
- Water resource management (quantity and quality of available water resources, competing water uses)
- Service management (demand side as well as supply side)

More specifically, water resource protection in water and sanitation services has to:

- Take into account the utilization of all resources: water resources (water withdrawal, water quality, nutrients in water), chemicals, energy, materials and land
- Assess the environmental impact of planned decisions, activities, investments or other measures on water, land (sludge reuse/quality of sludge), air and biological diversity
- Respect ecological needs in setting project priorities (e.g. no water without sanitation, water treatment, repair of leakages, etc)
- Apply the precautionary principle wherever direct ecological impact cannot be positively ascertained

Power-balanced partnership

Each Public-Private Partnership refers to a set-up in which a number of affected stakeholders (e.g. consumers, NGOs, unions, environmental groups, independent providers, regulators, donors) are involved in a project in addition to the contracting parties. Hence, not only the identification and selection of the legitimate/appropriate stakeholders is important, but also the quality of cooperation between participating actors is crucial to the success of a PPP approach.

Successful partnerships require the participants to be balanced in terms of power, means, and capacity. This may demand specific measures in the area of capacity building and support to enable all stakeholders to perform their roles.

Furthermore, if partnerships are to be stable, reliable, and equitable, all participants must be committed to:

- Working within an agreed and defined framework in which roles and responsibilities are clearly allocated (including also a clear and respected contract)
- Resisting (political) pressures from outside the project
- Collaborating in an effective, respectful and fair manner, based on mutual trust
- Mediating potential conflicts

Shared incentives

Delegated management systems should not only deliver the best value for money but should ensure that they provide value added over and above that delivered by previous water supply and sanitation service providers. Public-Private Partnerships should offer both financial and nonfinancial incentives for contracting parties and stakeholders:

- Expectations should be transparent
- (Private) Relations and connections that may potentially affect the interests of actors / stakeholders involved in the project should be disclosed
- Stakeholders need to negotiate for and agree upon reasonable expectations

In any change process there will inevitably be winners and losers. It is vital not only to address the benefits, but also to explicitly address the possible negative impact on stakeholders.

Accountability

Accountability for service delivery has various complementary layers in water services with delegated management:

- The administration (the 'bureaucrats') is accountable to the executive ministers
- The executive – the ministers and their departments ('the government' or 'the administration') – is obliged to account to the people's elected representatives for *what it does* (policy accountability) and for *how it spends* the taxpayers' money (financial accountability)
- The elected politicians account to their constituencies
- The service provider accounts to the consumers regarding the service delivered and charged for and also to the contracting public party (ministry) or other entities as defined by the contract or law (e.g. regulator) for fulfillment of their contractual obligations

The complementary side of accountability is effective oversight, i.e. monitoring compliance with laws, regulations, procedures and contracts. Such oversight is a prerequisite of sound governance; it should extend across the decision-making and execution continuum in order to enforce policy accountability as well as financial accountability:

- The elected politicians oversee the executive
- The executives check the administration
- The elected ministers and/or mayors have oversight over the delegated management itself
- The regulatory body has oversight over the contract for delegated management

Transparency

Transparency is one of the key prerequisites for accountability. Provision of clear and comprehensible information to – and openness to interrogation by – the people's elected representatives is a basic requirement for compliance with this obligation. However, in well-governed utilities, attention is paid to public information and explanation as well.

Furthermore, transparency is key to countering corruption and eradicating bribery, not only during procurement and investment but also throughout operation. On an institutional level, the separation of roles in general, and especially those of operator and regulator, is a critical basis for establishing transparency. From a procedural point of view, transparency is essentially achieved through access to high-quality information, which should:

- be organized in a structured and systematic way
- take into account the sometimes limited ability of poor and illiterate consumers to grasp information
- be maintained continuously through all phases of service provision
- provide rationale behind decisions

- Cover all procedural, financial, organizational, operational and regulatory aspects
- Create clear data protection rules to ensure that legitimate corporate secrets are not divulged

Customer focus

Customers of water supply and sanitation services are legitimate actors with rights, obligations and responsibilities. Gaining the long-term support and acceptance of customers is vital to any organization wishing to provide services on a sustainable basis. Customers are only willing to pay if they perceive both service standards and quality to be adequate.

Any service that is responsive to local demand entails:

- Identifying current and potential customers along the full service-delivery chain in water and sanitation
- Investigating consumers' needs and expectations
- Offering a choice of options to enable consumers to make an informed decision about service levels and tariffs
- Paying due attention to customer services that are able to resolve problems, answer consumer's questions and manage customers complaints, and to customer-relations activities (e.g. performance communication)
- Adapting to changing customer requirements/preferences

Results orientation

Orientation toward results should comprise identifying overall goals and setting priorities. Subsequently, wherever possible, activities should be defined not by input or means but by output and targets, as this increases scope for appropriate, flexible, innovative, and less expensive solutions. The following must be observed if results orientation is to be an effective steering mechanism:

- Identification of needs based on a comprehensive analysis including stakeholders and covering technical, economic, environmental, social and institutional dimensions
- Clear definition and communication of objectives
- Transfer of objectives into measurable and appropriate measures [contract, Service Level Agreement (SLA), etc.], including unambiguous measurement criteria
- Built-in flexibility to review and adapt goals regularly to changes in the background conditions; this also includes how to deal with existing information gaps and uncertainties about the accuracy of data and assumptions
- Continuous improvement process during the life cycle of the Public-Private Partnership

Proactive risk management

Risks are an inherent part of any business activity, and operators will be exposed to them during the entire process cycle. In addition to commercial risks, water service management is also exposed to a broad range of noncommercial risks (e.g. political, macroeconomic, and environmental, etc.). Risk mitigation makes the service more sustainable by reducing potential costs in the event of loss or damage.

Proactive risk management should:

- Develop and maintain an open risk management culture
- Define processes for identifying risks (e.g. analyzing the sensitivity of the project by altering the key variables)
- Assess a project's risk exposure, i.e. the probability of changes actually occurring in key variables
- Endeavor to take all possible measures to mitigate risks

- Define how risks should be spread
- Monitor the risk landscape in order to adjust risk allocation, where necessary
- Define procedures for how to react if unanticipated risks come to light
- Define procedures for arbitration and renegotiation, and exit scenarios

Sound financing mechanisms

Sound financing in investment and operation (i.e. financing that is economically viable for the operator, socially acceptable for poor consumers and politically feasible in terms of protecting the public budget) is crucial to long-term operation, maintenance, replacement and extension:

- The organizational set-up has to grant *financial autonomy* to the water and sanitation providers, giving them entrepreneurial scope
- When attracting *private funds* for investments, special attention must be paid to the financing architecture (securities, recourses, exposure to foreign-exchange risk, etc.) and to ensuring that these investments are harmonized with project priorities linked to other Key Factors such as poverty responsiveness (e.g. through credit enhancement mechanisms
- Overall income from water services must make it possible to *recover costs* and generate sufficient cash flow to ensure sustainable, long-term operation, including the cost of operation and maintenance, regulation, depreciation, and renewal of assets, debt service on loans incurred to finance investments (e.g. for extension). The extent to which activities in the area of water resource management and protection need to be covered through user charges and to which extent by tax income must be clearly defined
- The sources of revenue are collection of bills (charges) and – if necessary – subsidies (taxes). Pricing a service is a political decision that must balance social and economic factors and be designed in a transparent formula. By the same token, subsidies should be tailor-made and targeted to those most in need
- *Return on investment* should be kept transparent

Cross-cutting Issues

Introducing Partnerships with the private sector means setting off major change processes in the water sector. In addition to the Key Factors described above, various aspects arise as cross-cutting issues contributing significantly to sustainable solutions. These are described in the following sections:

Political support and interaction with the socio-political context

Strong political support for restructuring water service delivery and for involving the private sector is an essential precondition for success. Introducing the private sector just as a means of getting rid of the responsibility for service delivery will not lead to sustainable results.

In addition to the prerequisite of political support, the Implementation Guidelines are based in various aspects on the concept of deliberative processes, assuming that sustainable development can be achieved only through the involvement of all actors and stakeholders. Concerning these issues, the Implementation Guidelines follow an approach agreed in Principle 10 of the Rio Declaration and reaffirmed at the World Summit on Sustainable Development WSSD event in Johannesburg 2002.

However, such processes cannot succeed unless they are embedded in a broader socio-political framework that is discursive itself and supportive in financial and political terms of deliberative processes. Existing structures – whether of a political, social, or economic nature – may sometimes impose barriers to the adoption of deliberative processes. It is necessary to address such structures.

Striving for gender sensitivity

Women not only bear the responsibilities and burden of water and sanitation issues at the household level, they also have considerable knowledge about water. It is therefore important to follow a gender-sensitive approach, recognizing that men and women have particular needs, knowledge, interests, and aspirations and thus contribute in different ways. This makes it possible to appreciate women's and men's different roles in the use, supply, administration, and conservation of water resources and also to reinforce equal participation of women in decision-making, in community organizations, and water users' organizations. Adopting gender-sensitive water policies empowers women, men, and local organizations to promote more equitable relationships between actors and stakeholders.

Exploring innovative solutions

The world of solutions is only as limited as the creativity of those responsible. The Implementation Guidelines can only offer options, give input on criteria that are relevant when designing water supply and sanitation services – but it remains up to the reader to transfer these into his/her own location-specific situation, which will always be different from the others.

There is thus plenty of room for adapted and innovative solutions. This is true not only in terms of institutional set-ups but also in the area of technological solutions, where the traditional western engineering approach of big centralized piped systems both in the water supply and the sanitation sector often tends to be less sustainable and affordable and is being criticized more and more even in industrialized countries. Hence, the search for alternative, maybe more decentralized solutions, should be an integral part of the Preparation and Planning Phase of (PPP) projects.

Since this publication does not deal with technical dimensions, we refer to the ToolContainer, where examples and best cases featuring innovative solutions can be found.

Structure

General structure

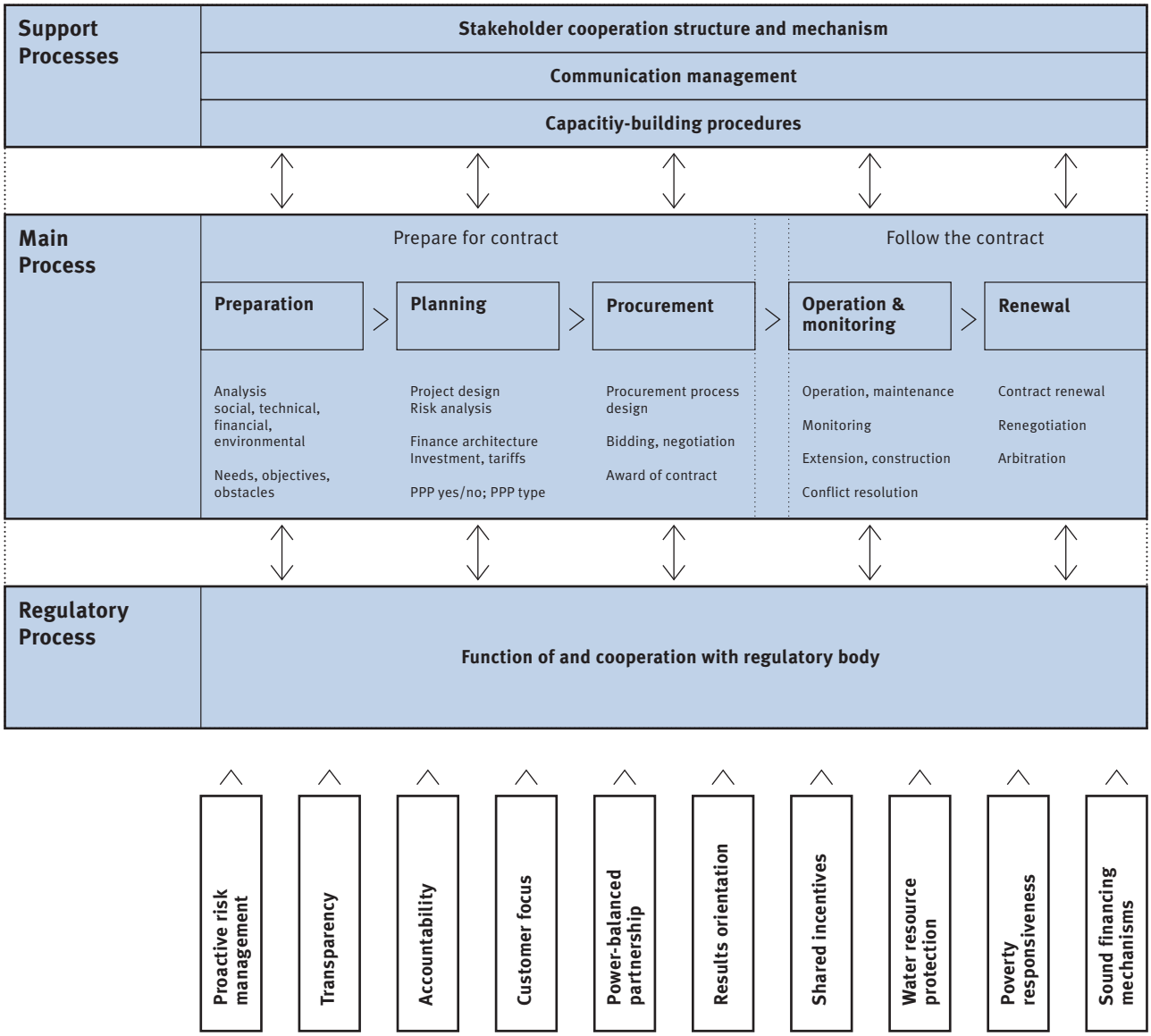
Firstly, the Implementation Guidelines are structured around the phases of a Public-Private Partnership (preparation, planning, procurement, operation, monitoring and renewal), and this is reflected in the chapter form.

Secondly, the PPP process itself is divided in each of these phases into the following three parallel process lines:

- The Main Process, covering the core business of service delivery
- the Regulatory Process, addressing the enforcement of the contract between the private and the public parties and regulatory functions
- three support processes: (a) stakeholder cooperation, (b) communication among stakeholders, (c) capacity-building (for all stakeholders except technical professional capacity development)

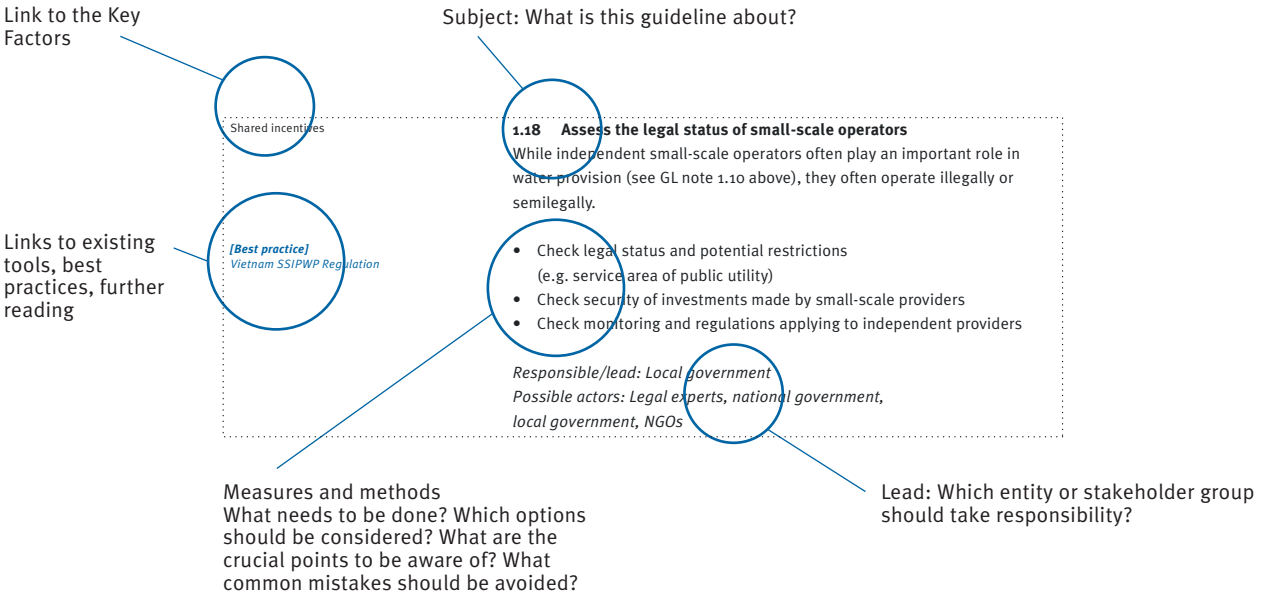
Thirdly, the Key Factors are systematically applied to each stage of the project life cycle (e.g. how and with which measures can we achieve transparency during the Preparation Phase?), resulting in numerous individual Guideline notes, the smallest unit of the Implementation Guidelines.

Figure 2: Structure of the Implementation Guidelines



Structure of guideline notes

A ‘Guideline note’ is the smallest unit and normally consists of the following elements:



All guideline notes offer options for actions, crucial points for consideration, and provide input for developing appropriate solutions. Like the present Implementation Guidelines, they are in no way prescriptive nor a blueprint. Solutions always have to be found in practice on a case-by-case basis.

As reader/users of the Implementation Guidelines you will need to select from the content presented those elements which might be useful for your specific situation, always bearing in mind:

- The practical aspects of the PPP process in order to maintain a healthy balance of resources and time in the context of the specific duties and tasks to be achieved (‘the best’ can be an enemy of ‘the good’)
- The transaction size, depending on the size of the municipality (small, medium, big)
- The requirements of the selected type of contract

Implementation Guidelines

Preparation

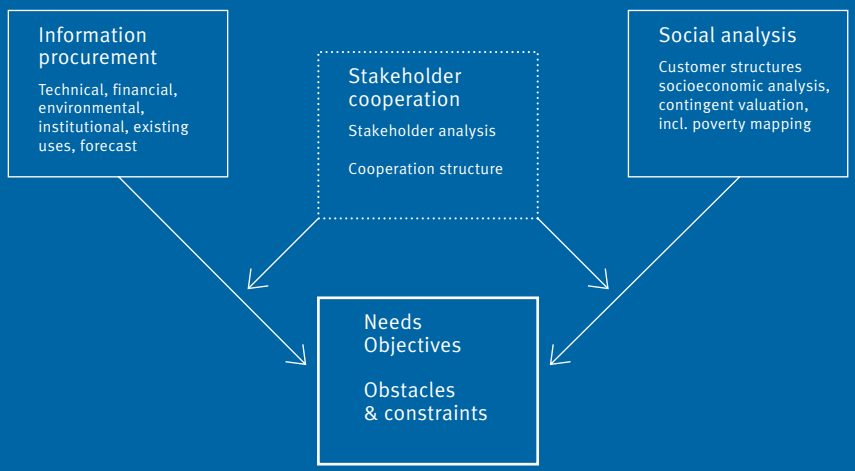


Figure 3: Tasks and outcome of the Preparation Phase

Tasks and challenges during the Preparation Phase

At the start of any process designed to improve the quality of water supply and sanitation services, it is crucial to carry out a comprehensive review and analysis of the current state of service provision. Accurate planning – planning that will genuinely lead to a system's shortcomings being addressed – can only be conducted on the basis of reliable data gathered from all relevant areas and in conjunction with appropriate stakeholders and experts. Problems and obstacles that are not detected at the outset may cause difficulties later in the process and lead to delays, disputes, and conflicts.

Main tasks:

- **Needs assessment and analysis of project environment:** institutional, technical, economic, social, and environmental status of the existing water supply and sanitation provision system
- **Identification of objectives:** define desired gains in coverage extension, operation efficiency, and resource protection; identify the skills and resources needed to meet these needs as well as possible sources of those skills and resources
- **Identification of weaknesses and obstacles**
- **Setting up a cooperation structure with stakeholders**

Main challenges:

- **Time constraints:** If insufficient time is allocated to preparation, issues that were not addressed during the planning phase will cause problems during implementation. This may jeopardize the project
- **Financing for thorough preparation:** Analysis and preparation are upfront investments. As such – and irrespective of whether the organization is publicly or privately operated – they are independent of the business model. Special financing must be arranged for these tasks
- Information gaps: Information gaps will always exist, no matter how thoroughly a project is planned. Dealing with such information gaps is thus one of the most challenging tasks facing a project team
- **Hidden agendas:** Parties with vested interests may supply misleading information
- **Prejudging:** Avoid making any judgments at this stage about the desirability of private involvement. Consider the full range of service delivery mechanisms
- **Clarification of expectations**

Guideline Notes for the Preparation Phase

Guideline Notes for the Main Process in the Preparation Phase

Results orientation
Poverty responsiveness
Customer focus

1.01 Present motivation for project and expected nature of outcome

- Define the nature of expected project outcomes, together with an approximate timetable for completion. Communicate this to stakeholders. Outcomes would normally include:
  - Improved quality of the service
  - Improved financial sustainability
  - Optimized system and reduced cost
  - Provision of safe drinking water to a specified population (extension)
  - Possible reduction in cost of drinking water below existing vendor charges
  - Time saved (mostly for women) in carrying water
  - Provision of hygienic sanitation to a specified population
  - Improved health for the population (lower child mortality rate)
  - Improved water resource quality resulting from installation of proper sanitation systems
  - Increased availability of clean water for industry and agriculture

[Further reading]
WSP2002: Water supply and sanitation in PRSP initiatives

- Ensure that the planned project takes account of national poverty reduction strategy. Water supply development projects should tie in with Poverty Reduction Strategy Papers (PRSP) agreed by government and donors.
  - The participatory processes used in compiling the poverty reduction strategies may be reused for future water service projects
  - Influence PRSP development to integrate water supply and sanitation services

[Further reading]
Wate raid: PRSP and water – failing the poor?

- Ensure that planned extensions and restructuring exercises in water supply and sanitation are in line with overall municipal and urban planning and development expectations and – if it exists – with the water resource management plan
- Engage in discussion with potential customers to establish whether there are any obstacles (e.g. land tenure, water rights, extreme poverty, cultural, or religious issues), which might prevent the customers from taking advantage of new facilities

Responsible/lead: local government, national government (depending on the country-specific roles/responsibilities)
Possible actors: local government, national government

Accountability
Transparency
Results orientation

1.02 Establish a comprehensive analysis process

Attention should be paid to the outcome of the review and analysis of the current situation. This serves as the basis not only for planning but also for consensus about goals, measures, and priorities.
All analyses should be:

  - Conducted in an independent and cooperative manner
  - Transparent in terms of processes and results (see GL note 1.11 below)
  - Subject to public consultation (findings, results)
  - Inclusive of marginalized stakeholders
- Be aware of limitations in information procurement: although accurate information is key to successful Public-Private Partnerships, information gaps will always remain a fact of life
- Information gaps may persist for the following reasons:
  - Insufficient funds available to procure the required information
  - Vested interests: information providers might supply inadequate or misleading information
  - Information cannot easily be checked for reliability
- Consider how to approach the remaining information gaps:
  - Wherever possible, try to find alternative sources for the same information
  - If some basic information is already available, awarding a short-term management contract (e.g. 3–5-years) which includes the task of information procurement may be a pragmatic way of addressing information deficits. (see also GL note 2.09 below, on 'phasing-in' approaches)
  - Build some flexibility into the project and contract. This will allow you to adjust plans in response to changing information/circumstances without having to renegotiate
  - Prefer simple systems rather than complicated ones

Responsible/lead: local government
Possible actors: local government, utility staff, consultants

Results orientation
Proactive risk management

1.03 Review current technical status, operation and maintenance

The condition of existing assets, the level of technical losses, existing service levels and service areas covered are often not known in detail but are key to designing improvements. The technical analysis should assess:

- Infrastructure status, including connection rates/types (with a special focus on poor areas), intake and treatment facilities, transport and distribution network, wastewater treatment facilities
- Service levels in terms of quality (standards, control facilities) and quantity (hrs/day, etc.)
- Unaccounted for water UfW (technical aspects, including extension of metering, illegal connections, etc.)
- Sanitation: systems used, coverage and deficiencies
- Operational procedures and overall performance
- Order of magnitude of uncertainties and risks associated with inaccuracy of data (e.g. UfW based on estimates)

[Tool]
WHO 2000: Tools for assessing the O&M status of water supply and sanitation in developing countries

www.who.int/docstore/water_sanitation_health/wss/O_M/tools.htM

addendum to WHO-tools by wedc2003: http://wedc.lboro.ac.uk/publications/pdfs/tfsomui/tfsomui-insides.pdf

Responsible/lead: local government
Possible actors: water utilities, technical experts

1.04 Analyze existing and potential customer structure

Knowing the composition of the customer portfolio helps to assess the risk situation. The following should be investigated:

- Bulk versus retail consumers
- Poor versus rich households
- Industries, public institutions
- Industries with own supply
- Potential future customers: currently 'unserved' populations in newly developed urban areas; poor that may be served by alternative providers, new industries and businesses
- Comparison of existing consumer portfolio and projected portfolio following extension of delivery network
- How to avoid overestimation of future water sales and projected revenues (a common problem in the past)
- Potential and limitations of cross-subsidies between consumer groups

Responsible/lead: local government
Possible actors: water utilities, consultants

[Further reading]
ADB2003/Arthur McIntosh: ASIAN WATER SUPPLIES Reaching the Urban Poor

1.05 Identify the poor

Special efforts are needed to identify the poor in order (a) to prioritize water and sanitation service provision in those areas, and (b) to create effective subsidies. Special focus must be paid to marginal groups and to identifying crucial gender aspects which might be affected by the project. Common methods include:

- Using appropriate indicators to identify and assess poverty:
  - Economic factors: income, consumption, access to and payments for water and sanitation services (consider also the extent and role of the grey economy!), impact of poor water quality on health and income generation
  - Social factors: household characteristics (size, composition), employment situation, nutrition, role, and status in the community
  - Physical factors: dwelling quality, overcrowding, infrastructure

[Tool]
www.Poverty.worldbank.org
www.povertymapping.net

- Conducting analyses by means of participatory processes:
  - It may be expedient to use local CSOs, but these may not have experience of working together with local government or private-sector entities. In such cases, capacity-building may be required for all parties to enable organizations to maximize contributions to the project process

[Tool]
WEDC2002: Willingness to pay survey – a streamlined approach

- Asking residents to identify:
  - Their objectives for water management in the community
  - Problems or obstacles to providing water supply and wastewater services
  - Economic and social factors that might limit residents' ability to take advantage of improved water supply and sanitation services
- Poverty mapping: poverty maps can enhance the quality and transparency of public decision-making, as they provide a visible and direct interface which can be used to target assistance
- Surveys on willingness and ability to pay:
  - Such surveys make it possible to identify where financial savings will be made against current payments for water and these savings,

in turn, may be used to finance additional cost
  - Surveys enhance understanding of the possible consequences of price increases and help to design subsidy models. 5% of income is generally seen as the upper limit people should be expected to pay for water services. Bear in mind the connection charges, which might be the major obstacle for poor households
  - Choose the appropriate survey method. The contingent valuation method (CVM) delivers relatively reliable results and also covers different service levels and options. On the other hand, CVM surveys are more costly than other approaches and should be used especially where larger and more complex programs are planned
- Disaggregate and respond to different poverty levels: destitute, very poor, poor, developing/better-off poor, lower middle-income/vulnerable, nonpoor
- Reflect issues brought up by customers in the assessment
- Avoid: discussing the needs and obstacles entirely within the confines of the water authority or among agencies to the exclusion of end users

Responsible/lead: local government
Possible actors: NGOs, consultants, local government

Results orientation
Sound financing mechanisms
Poverty responsiveness

[Tool]
Asian Development Bank; Handbook for the Economic Analysis of Water Supply Projects

1.06 Review current economic and organizational status

The financial situation and performance, including direct and indirect subsidies, reveals the current extent of cost recovery, major obstacles to sound and financially viable operations and enables a comparison with other utilities. The economic analysis should assess:

- Existing income structure:
  - Cost structure of the utility: operational expenditures (including salaries), capital costs, amortization
  - Income structure: tariff structures and collection rates by customer segment (including collection efficiency by customer segment), as well as subsidies and including previous in-kind contribution from other municipal departments/budgets (e.g. vehicles, road repair etc.)
- Existing tariff structure: Who sets the tariff and how? What do the tariff levels and structure look like? How do the charges compare to what customers can afford? How can payment of charges be enforced in the existing framework?
- Existing subsidy policy: level, beneficiaries, financing strategy/source
- The valuation and ownership structure of existing assets
- Investment requirements for rehabilitation
- Investment requirements for extension of the infrastructure (intake, treatment, distribution, collection, wastewater treatment)
- Existing financial liabilities and debts (maturity, interest, recourse situation, lenders, etc) in relation to the current value of the water supply and sanitation utility
- Possibilities for dealing with these liabilities (e.g. transferring them to the public party or to the new utility)
- Investment conditions in the country: the macro-economic market for investments and political interference with these national or local capital markets

- Creditworthiness of utility and/or municipality on the local and on the international market
- The organizational and institutional set-up of the existing water supply and sanitation service provider:
  - Autonomy and degree of corporatization
  - Management structure
  - Decision-making procedures
  - Organization of customer service
  - Extent of institutional overlap
  - Extent of political interference

Responsible/lead: local government
Possible actors: water utilities, financial experts, donors

Water resource protection
Results orientation

[Tool]
online IWRM-Toolbox under www.Gwpforum.org

1.07 Review environmental situation

The environmental review has to focus on raw water availability (quality and quantity), source protection, sanitation, and protection of water bodies (surface water and aquifers) from an integrated water resource management (IWRM) approach:

- Analyze water sources: quantity, quality, and exposure to contamination through settlements, industry, deposits
- Identify competing uses/shortages (e.g. with agriculture) which could cause conflicts or require the tapping of new sources
- Analyze the quantity and quality of wastewater discharge: how much is collected and treated (centrally and locally); what is the extent of pollution?
- Sanitation: systems used and coverage, major deficiencies

Responsible/lead: local government
Possible actors: water utilities, local government, environmental experts and NGOs

Results orientation
Shared incentives
Poverty responsiveness

[Best practice]
Association of independent water providers in Uganda

[Best practice]
CCAEP, Mali; see: WSP 2000: Independent Water and Sanitation Providers in African Cities

[Further reading]
WB2003: Independent Entrepreneurs in Latin America; the other private sector in water services

[Further reading]
ADB2003: Small-piped water networks; helping local entrepreneurs to invest

1.08 Investigate roles and relevance of informal providers

Very often, informal water providers service a significant share of the market in municipal areas. Informal water providers range from individuals to local enterprises to NGOs or customer groups operating via small-scale networks, trucks, water vendors, etc; they may serve groups of between ten and several thousand customers. They frequently contribute significantly to investment in the sector.

- Analyze the existing water distribution network of the various private, small-scale and informal providers and the scope of competition among them (or restriction thereof via cartels, entry barriers, etc). Map the results against the service area of the public utility. Then compare this with the results of a poverty map (see GL note 1.05 above)
- Assess ownership patterns and size (company, infrastructure)
- Assess the product and service lines of informal providers: tariffs and service levels, access to funds, investment levels, efficiency and effectiveness
- Recognize informal providers as legitimate actors and motivate them to organize themselves

- Explore ways to integrate them into a broader framework of:
  - Professional development
  - Coordination
  - Technical and quality inspections
  - Financial audits
  - Securing investment
- As formal providers, check the possibility of sub-contracting, franchising or other forms of cooperation

Responsible/lead: local government
Possible actors: public utility, ministry for urban planning, consultants, NGOs

Customer focus

1.09 Clarify customs and cultural issues related to water

Traditional water rights and informal, also often gender specific structures, hierarchies, and customs may influence the restructuring of water services. Be sure to contact community leaders and informal figureheads and conduct surveys on issues such as:

- Existing responsibilities for water management (community and household level)
- Sanitation practices
- Current levels of understanding on basic hygiene
- Domestic and manufacturing water use
- Irrigation for small-scale urban farming and livestock production
- Cultural aspects: how is the notion of 'paying a water bill' perceived by locals

Responsible/lead: local government
Possible actors: NGOs, local government, community leaders

Sound financing mechanisms
Costumer orientation

1.10 Seek funds for conducting a thorough assessment

In addition to time constraints, financing is one of the most crucial preconditions for effective information procurement. Possible sources of financing:

- Official development assistance (ODA) may be used for the Preparation Phase, provided it does not prejudice the decision on the appropriateness of a particular PPP option to be selected at a later stage
- Upfront public investment that has to be paid back (either partially or totally) by the selected operator
- National revolving fund for water assessment

Responsible/lead: local government
Possible actors: local governments, donors

Transparency
Costumer focus

1.11 Establish a transparency policy and define how it will be financed

A written transparency policy renders the public party (and later on the private operator) more accountable vis-à-vis local residents and civil society.

[Tool]
UN-Habitat2004: Tools to support transparency in local governance

- Define the transparency policy with respect to:
  - The provision of water supply and sanitation services
  - Attempts to extend coverage, build facilities

  - Public education on water service issues
- Include measures for monitoring the enforcement of the transparency policy (see GL note 1.13 below)
- Before entering into the process to establish a Public-Private Partnership, document the resources to be allocated to transparency, public education and communication during the process:
  - Estimate the cost of conducting outreach/public education/input processes requested by the community, including the cost of reproducing educational materials, translating all of them into major languages, holding public input events, live interpreting at events, and responding to public input during the procurement process
  - These funds should be set aside at the start of the process

Responsible/lead: local government
Possible actors: local government, donors

Guideline Notes for the Regulation Process in the Preparation Phase

Accountability

1.12 Review the current institutional, legal and political situation

Laws and regulations must be clarified early, as the legal framework will determine the scope of any action. Assess:

[Tool]
Policy Principles – framework for sustainable partnerships

- The existing institutional/legal framework for:
  - Water supply and sanitation services
  - Public-Private Partnerships (investment, private management of water services, foreign company law, etc.)
  - Regulatory regime
  - Environmental legislation relevant to water supply and sanitation services, wastewater, pollution, etc.
- Overlapping responsibilities between local, regional and national governments
- The scope of political interference
- The extent and status of decentralization (political and financial)
- The need for institutional/legal reform
- The probability of legal changes affecting water services
- Unwritten laws and local customs in the water sector

Responsible/lead: national government
Possible actors: legal experts, national government, local government

Accountability
Sound financing mechanisms
Customer focus
Result orientation
Transparency

1.13 Review regulatory arrangements

Regulation is required to protect the public interest in a 'natural monopoly' situation where the market could create undesired effects, but also to protect the contractually defined rights of the service provider.

[Further reading]
OECD 2004: Regulatory schemes for water provision in theory and practice

[Further reading]
WEDC2003: Public-Private Partnerships and the poor – Regulation

- Main objectives of regulation include:
  - Ensuring that water/wastewater services are delivered at a fair and reasonable price
  - Protecting the short-term and long-term interests of customers
  - Ensuring that customers receive the expected levels of service
  - Providing certainty for public and private sector investment

  - Enhancing accountability and transparency in the sector
  - Ensuring fair competition in bidding processes
  - Protecting the service provider from undue political interference and actions
- Check what regulation is in place and determine whether there is a need for adjustment:
  - It is possible to ensure universality and consistency of standards, comparisons between providers and extensive customer involvement where there is a single national regulator
  - Where individual contracts are regulated via local regulatory bodies without a general regulatory framework, it may be easier to tailor the regulations to specific circumstances and accommodate local needs and priorities to a greater extent. However, the risks under these types of regulatory set-up should also be taken into account, e.g.: Greater attention may sometimes be paid to interpreting and applying contract terms than to pursuing wider regulatory principles. Exposure to regulatory capture (by politicians or the operator) may also be greater
- Check existing regulatory functions, their responsibilities and scopes, and ascertain whether there is a need for adjustment in:
  - Economic regulation, including setting/adjusting tariffs and charges; controlling asset investment; monitoring and controlling operating costs and profits; monitoring financial transactions to ensure there is no corruption. Consider whether existing economic regulations are appropriate for achieving the financial, institutional, and technical objectives designed to benefit the poor as discussed and agreed with the Stakeholder Committee following the poverty impact assessment (see GL note 1.18, 1.22 and 1.23 below) and enable the operator to provide a sustainable service
  - Quality regulation, including monitoring the quality of treated water and sewage effluent
  - Environmental regulation, including controlling the extraction of water from rivers, lakes, and aquifers; monitoring the condition of habitats; monitoring the quality of rivers receiving effluents; and monitoring the quality of water resources used as sources for drinking water
- Check for the existence of and importance attached to process regulation: Process regulation goes beyond economic, quality, and environmental regulation and covers topics such as transparency of communications, accountability and the extent of public involvement. Ensure that:
  - All analysis documents are made public
  - Stakeholder input is sought and integrated into the needs assessment
  - Procedural, financial, organizational, operational, and regulatory information is made public
  - Financial transactions are monitored in order to prevent bribery and corruption
- Where no process regulator exists to monitor transparency:
  - Define how transparency and public input are to be regulated. Then

assign this new regulatory function to the relevant regulatory body before proceeding with the Public-Private Partnership project

Responsible/lead: national government
Possible actors: national government, local government, regulation experts, Stakeholder Committee

Accountability
Transparency

1.14 Assess independence of existing regulatory arrangements

It is important that any regulatory authority not only is, but is also perceived to be, independent. Assess whether the regulator:

- Is sufficiently autonomous to be effective in political, administrativ and financial terms:
  - Under no circumstances may the regulator be the public party or any department linked to this party
  - Political control of the public party and regulator must be formally separate
  - The regulator must be independent of local government, both in organizational and personnel terms, and must have its own (independent and geographically distinct) offices
- Occupies the middle ground between government, private firms and civil society and not is captured by private operator or political interference
- Is paid from revenues raised from the regulated water utility or by local government
  - It is preferable to pay a fixed fee rather than a percentage of the tariff to ensure consistent regulation irrespective of the amount of water sold or bills collected
- Regulator should oversee public and private operators alike

Responsible/lead: national government
Possible actors: national government, local government, regulation experts, Stakeholder Committee

Shared incentives
Poverty responsiveness
Customer focus

1.15 Assess the legal status of small-scale operators

While independent small-scale operators often play an important role in water provision (see GL note 1.08 above), they often operate illegally or semi-legally:

[Best practice]
ADB2003Pro-SSIPWP regulation (VIETNAM)

- Check legal status and potential restrictions (e.g. service area of public utility)
- Check security of investments made by small-scale providers
- Check monitoring and regulations applying to independent providers

Responsible /lead: local government
Possible actors: legal experts, national government, local government, NGOs

Poverty responsiveness
Customer focus

1.16 Address political and legal issues relating to illegal settlements

Poor, informal settlements often do not receive water supply and sanitation services due to:

- Legal and political constraints limiting service delivery

- Do existing laws restrict water supply and sanitation provision to illegal settlements
- Obstacles faced by dwellers in connecting to the grid
  - Insecure land tenure prevents dwellers from investing in infrastructure

Responsible/lead: national government, local government
Possible actors: legal experts, national government, local government, NGOs, donors

Guideline Notes for the Support Processes in the Preparation Phase

Power-balanced partnership

1.17 [stake] Identify and analyze relevant stakeholder groups

A stakeholder analysis consists of identifying, the stakeholders, their interests, and powers:

[Tool]
DFID: Tools for Development

Worldbank 2003: Social Analysis sourcebook

[Tool]
WB: Stakeholder Analysis Worksheet

- Develop and communicate systematic criteria for identifying legitimate (i.e. affected) stakeholders
- Identification of stakeholders: Check which of the following may have an interest in your project and develop a stakeholder interest table:
  - Local and national governmental bodies concerned with water and sanitation
  - Existing water supply and sanitation service providers (formal, informal), suppliers
  - Regulators
  - Consumers to be served (rich, poor, commercial entities, industry)
  - Consumer organizations
  - Women's groups
  - Private sector organizations
  - Labor organizations, unions (public and private sector)
  - Environmental groups
  - Civil rights groups
  - Politicians
  - IFIs / Donors (bilateral, multilateral, NGOs)
  - New stakeholder groups which might emerge as a result of the project
  - Also consider: agriculture in the area, industry in the area, upstream/downstream communities, governments in neighboring countries that may share the resources (e.g. a river)
- Key questions that can help you understand your stakeholder's position:
  - Interest in project: What motivates them most of all? What are stakeholders' expectations of the project? How does the 'political economy' influence positions? Are there stakeholders with an interest in project failures?
  - Power to facilitate or impede the project
  - Resources/mandates: What resources will the stakeholder wish to commit (or avoid committing) to the project?
  - Potential conflicts: What other interests do stakeholders have which may conflict with the project? How does the stakeholder perceive others on the list? Which group might be influenced by whom?
- Avoid marginalizing certain stakeholder groups:
  - The issue here is to avoid focusing on those whose voices are the

loudest, whose risks matter most, who exert the strongest influence, etc.
  - Map out your stakeholders using the power/interest matrix and classify them by their power over project-related decisions and by their interest in the project, typically resulting in four groups, providing some system for prioritizing (and keeping the system manageable): High-power, interested people: these are the group you must closely manage, fully engage and make the greatest efforts to satisfy. High power, less interested groups: keep them informed and satisfied. Low-power, interested groups: keep them adequately informed, and involve them so as to ensure that no unexpected issues arise and to avoid planning errors. These groups can be very helpful with the details of the project. Low power, less interested groups: monitor and keep these groups informed
- Where necessary, establish representation groups:
  - Formal structures in residential communities tend to be political (in which case they may not truly reflect the views of local consumers), or weak, especially where populations are transient or have migrated from all over a country resulting in a mix of languages and cultures
  - In such instances it may be necessary to set up special representative groups e.g. 'neighborhood committees'
  - Accountability can be conferred on these groups by giving them some form of recognized legitimacy (e.g. the way their members are appointed and how the group reports to its constituency)
  - These groups need not be exclusively concerned with water. They may also deal with other sectors of municipal infrastructure
  - Neighborhood committees will need training, as the individuals comprising them will probably lack the skills necessary to act effectively (e.g. literacy, numeracy, democratic processes, participatory approaches)
  - Take account of traditional leadership structures when establishing such committees but avoid simply replicating existing power structures. It will be necessary to include powerless groups, often women, ethnic minorities, etc.
  - Manage expectations: communication is essential to ensure that communities (and groups representing them) are clear about their role and what is expected of them at all stages of the project (e.g. time commitment)
- Be aware of risks and pitfalls linked to stakeholder analysis:
  - The analysis can only be as good as the information collected and used
  - Matrices can oversimplify complex situations
  - The judgments used in placing stakeholders are often subjective; several judgments help achieve a better balance
  - Trying to describe interests and (hidden) conflicts can alienate powerful groups

Responsible/lead: local government
Possible actors: local government, stakeholders

1.18 [stake] Set up a stakeholder cooperation structure (Stakeholder Committee)

Form a stakeholder cooperation structure. This structure should be (a) the central mechanism for ascertaining customers' needs and preferences and for answering their queries and (b) installed as a perpetual structure to go along with water supply and sanitation issues:

- Check whether there are already any stakeholder forums that could be used as platforms or be integrated into one for certain purposes such as consultation, training, awareness raising, etc.
- Establish a Stakeholder Committee (SC):
  - The SC should be comprised of representatives from the consumers that are to be served and from other groups who have a legitimate interest in the project (see GL note 1.17 above)
  - NGOs should only be accepted as representatives of individual stakeholder groups if the groups are unable to represent themselves
  - Strive for a balance between a manageable size of the SC and appropriate representation. This will heavily depend on (a) size of the municipality (b) size of the envisaged transaction
  - Define selection criteria for membership of the SC; there may need to be a quota for representatives
  - Special safeguards are needed to avoid dominance by certain (stakeholder) groups
- Lay down the SC's functional specifications in written form: role in the institutional set-up, rights, and duties and degree of involvement (see GL note 1.19):
  - Determine the SC's role in the decision-making process: influence, participation procedures
  - Determine review procedures in order to be able to evaluate and modify effectiveness, etc.
  - Draw up a set of indicators (e.g. number/points of consultation) showing whether participation has materialized (and as a means of demonstrating to consumers, shareholders, and the regulator that best practice has been observed)
- Decide on the modus operandi: structure (platform, round table, forum, etc), chairperson, frequency of meetings, distribution of information
- Depending on the composition, consider establishing within the Stakeholder Committee:
  - subordinated groups for special issues, such as advice on poverty issues / poverty impact assessment, tariff issues etc. (see e.g. GL note 1.22 or 2.25 below)
  - If needed, invite external specialists into these groups
- Define a person within the management of the public administration to be responsible for cooperation with the Stakeholder Committee
- Avoid making commitments to accept the demands of certain stakeholders in advance
- Any decisions – especially those concerning demands made by stakeholders – should be explained, justified, and discussed within this committee

Responsible/lead: local government
Possible actors: local government, stakeholders

Power-balanced partnership
Transparency

1.19 [stake] Enable effective participation

Participation can take many forms and the level of involvement may range from very intense to low, depending on the objectives and constraints of the project:

[Further reading]
Aarhus Convention
www.unece.org/env/pp

[Tool]
OECD2001: Citizens as Partners; OECD Handbook on information, consultation and public participation in policy-making

[Further reading]
BPD2003: The Purist's Partnership: Debunking the terminology of partnerships

- Decide on how much participation you want/need to achieve your goals and put in relation to the duties, responsibilities and risks that will arise for the stakeholders:
  - Information (passive participation): You tell people what is going to happen, is happening or has happened
  - Involvement (participation by consultation): People are consulted, and external professionals listen to their views. These external professionals define both the problems and possible solutions; the institutional power-holders make the decisions
  - Partnership: Local residents negotiate with institutional power-holders on roles, responsibilities and levels of control with the aim of reaching decisions by consensus
  - Delegated power: Some power is delegated (e.g. decisions on certain aspects such as design or service level, payment structures)
  - Citizen control: Full delegation of all decision-making and resulting actions
  - Joint implementation: Stakeholders are directly involved in carrying out the project and are invited to make a significant contribution towards its practical implementation
- Identify, appoint, and train facilitators to promote activities and mobilize communities:
  - Facilitators may be drawn from professional circles (e.g. local government departments, NGOs), or from local residents in the region or country
  - Local residents will need training in mobilization techniques, but will be better able to penetrate target communities
  - Previously trained workers will be familiar with mobilization techniques, but will still need training to help them understand how the utility will operate
  - Appropriate incentives will need to be devised
- Create a clear awareness of what the participation model is designed to achieve by stating unambiguously:
  - The goal of planned participation
  - The degree of participation
  - The planned procedure for participation
- Avoid:
  - Letting the participatory processes be manipulated by existing power structures
  - Excluding marginalized groups from processes
  - Imposing unrealistic deadlines on participatory activities

Responsible/lead: local government
Possible actors: local government

Results orientation
Shared incentives
Transparency

1.20 [stake] Explore political attitudes towards PPP

Public-Private Partnerships are politically sensitive issues. The general characteristics of water make state control politically attractive: as a basic

good, water has high political visibility and may be used as an election campaigning tool; sunk and durable assets mean that prices may be below cost without short-term effects; overstaffed utilities cause legitimate concerns over retrenchment and redeployment. Hence an analysis of the political discussions and interaction at the national and local levels is a major component of any preparation for a Public-Private Partnership:

- Areas to assess include following questions:
  - Is the undertaking politically desirable? Do the political benefits outweigh the political costs? (debate about the cost of water, subsequent job losses etc.)?
  - Is reform politically feasible? Can the decision-makers overcome opposition and implement reform? How does it fit in the national strategy?
  - A primary challenge is that there is usually only a small window of opportunity for making these things happen. The proposal generally has to come at the right time within an electoral cycle, when politicians are willing to take the chance

[Tool]
Worldbank 2003: Social Analysis sourcebook

- The answer depends on:
  - Utility conditions (Scope for improvement? Who will benefit? [Consumers, politicians, those charged with the responsibility of reforming the sector] Who will lose out?)
  - Macroeconomic (e.g. hyperinflation or recession?) and political changes (upcoming election, regime change, or coalition shift)
  - Political institutions (Who are the veto players? Who are their constituents? Is government credible?)
- Gains are significantly higher where government:
  - Carefully assesses the key problems to be solved (short & medium term)
  - Assumes leadership and provides a clear policy, legislative and institutional framework
  - Ensures alignment of incentives with goals
  - Enhances competition for or in the market
  - Includes propoor policies as part of the deal

[Tool]
Policy Principles – Framework for sustainable partnerships

- All stakeholders who have the opportunity to influence the Public-Private Partnership should be required to give a clear and enforceable declaration that they do not have any conflicts of interest. These could include: relationships with suppliers and service providers, family links, and historic involvement in the utility. This will assist in eliminating hidden agendas and forestalling corruption

Responsible/lead: local government
Possible actors: local government, consultants, independent observers of the political situation

Customer focus
Transparency
Proactive risk management
Shared incentives
Poverty responsiveness

1.21 [stake] Explore public attitude towards current situation, proposed project and PPP options

Conduct an assessment with community residents to incorporate their objectives and constraints. Stakeholders' views, expectations and preferences should be taken into account from the beginning. Local support is crucial to the long-term success of any Public-Private Partnership as it is ultimately the locals who will benefit from and pay for the services. If the

proposed project is given low priority by the various stakeholder groups, it will be difficult to engage stakeholders during the remaining stages of the project life cycle. Possible approaches are:

[Tool]
UN-Habitat: Urban Governance Toolkits

- Use participatory needs assessment techniques
- Organize focus group discussions with representatives from different consumer groups (poor, industry, etc.)
- Hold public hearings, conduct public surveys (including interviews)
- Communicate the goal of the assessment and what the results will be used for early on in order to avoid generating false expectations

Avoid common mistakes where public input is sought in the interest of transparency:

- Failure to give the local community the resources to review the materials and to provide it with technical assistance
- Seeking – but not responding to – stakeholder input
- Transparency is useless if the findings of the assessment are not made accessible to or understood by a majority of the population

Responsible/lead: local government
Possible actors: independent specialists in social interaction and/or NGOs with close contacts to the poor

Poverty responsiveness

[Tool]
WB2000: Evaluating the Impact of Development Projects on Poverty: A Handbook for Practitioners

1.22 [stake] Provide for poverty impact assessment

After a first analysis of the water-related poverty situation (see GL note 1.05 above), poverty issues need to be considered throughout the project. Local government and stakeholders should assess the direct and indirect impact of any decisions on poor consumers.

- Assign this task to the Stakeholder Committee (SC):
  - Consider establishing within the SC a subordinated Poverty Advisory Group (see GL note 1.18 above); this allows for more effectiveness without creating new entities
  - Involve representatives of community-based organizations (CBO) and the people affected in the assessments
- Since 'the poor' are not a homogeneous group, it will be necessary to:
  - Identify traditional power structures and vested interests
  - Pay attention to gender issues
  - Manage conflict between various segments of the poor (see also GL note 1.24 below)

Responsible/lead: local government
Possible actors: Stakeholder Committee, CBo's, social workers

Customer focus
Transparency
Accountability

1.23 [stake] Establish consensus on key issues

It is important to reach robust consensus on all key issues through consultation/dialogue with the Stakeholder Committee.

Common key issues:

- Analysis of current situation and need for action
- Desired gains in coverage extension (water supply, sanitation)
- Establishing priorities where resources are limited
- Process design: accountability and transparency

Responsible/lead: local government
Possible actors: Stakeholder Committee, communication specialists, local government

Power-balanced partnership

1.24 [stake] Establish procedures to resolve stakeholder disputes

In any consultation process, disputes and conflicts will inevitably arise as a result of differing priorities, agendas, and limited resources. Such conflicts need to be actively managed to ensure that the project is not slowed down excessively or even jeopardized, and to prevent a situation arising in which stakeholder consultation is avoided altogether.

[Tool]
conflict resolution network: 12 conflict resolution skills

Preconditions for effective conflict management:

- Whenever conflicts become serious, a facilitator or mediator is highly recommended. These key persons in conflict management will often be private individuals (religious leaders, retired judges, local wise-men and women, etc.) who are respected for possessing special characteristics and skills:
  - Facilitators–assist only in the running of a process and never allow themselves to be drawn into the arguments
  - Mediators–act as facilitators, but also help develop a wide range of options for the parties to discuss and choose from. They help conflicting parties to reach an agreement that is satisfactory to everyone
- Steps to be taken in resolving conflict:
  - Reliable data on points of conflict
  - Shift the attention from positions to underlying interests
  - Appreciate the merits of fair compromise
  - Address both the procedural and substantive dimensions of conflicts
  - Include all significantly affected institutional actors in devising solutions
  - Understand the power of various institutional actors, and take this into account in the process

Responsible/lead: local government
Possible actors: Stakeholder Committee, mediators, facilitators

Accountability
Transparency

1.25 [comm] Start public awareness campaigns

Open communication with the general public (beyond stakeholder groups, etc.) contributes to building awareness, interest and support for the project. This is an appropriate way to ensure that residents are well informed and in a position to make decisions on water-related services:

[Tool]
materials for sanitation campaigns: www.wash.org

[Tool]
GWP2002: Ideas for Water Awareness Campaigns

- The following topics should be covered as a minimum during the Preparation phase:
  - results of the various assessments: develop fact sheets and educational materials including training sessions and workshops on the current state of the water system, explaining why the public party is exploring a Public-Private Partnership, and outlining a proposed process for this option
  - intention and goals of the project
  - sensitize for and inform about sanitation issues
- Keep public awareness campaigns alive during the whole project:

- Information about project progress, milestones, challenges, and backlogs
- Sensitize the public to water conservation and water-use efficiency issues

Responsible/lead: local government
Possible actors: communications professionals

Transparency, Accountability

1.26 [comm] Enable access to information

It is vital that stakeholders have access to information throughout the entire project, and basic principles should be defined at the beginning of the Preparation Phase:

[Further reading]
www.access-initiative.org

- Consider your information policy (see also GL note 1.11 above):
  - Communicate proactively
  - Make all existing analyses of the water system available to the public in forums and at venues requested by stakeholders, particularly resident users
  - Ascertain the most appropriate way to communicate throughout the process by talking to local residents; special attention should be paid to the planning and procurement process
- Communicate effectively:
  - All communications must be understandable to all stakeholders. It is important to focus on 'getting the message across' instead of pure 'informing'
- Define channels for actively disseminating information:
  - Residents should identify through which media they wish to receive communication (Internet, written, presentations) and at which venues (libraries, community centers)
  - Make use of complementary information channels: public meetings, road shows, television, radio, community radio, press, Internet
  - Use innovative techniques such as mobile information points, theaters, soap operas, radio drama, or celebrities
  - Illiterate audiences require special attention. Use local artists to maximize nonwritten content in preparing printed promotional material
  - Establish possibilities for interactive communication when canvassing the opinion of target groups. Be careful not to 'preselect' or exclude certain groups by using certain technologies that are not available to everyone (e.g. phone-in radio chat shows, SMS voting, Internet discussion forums, etc.)
  - In some societies, traditional leadership structures, and word of mouth are a highly effective means of communication
- Define the ways for passively disseminating information:
  - Design and implement standard procedures for responding to data requests made by individuals, the media, and citizens' groups

Responsible/lead: local government
Possible actors: local government, communications professionals

[Tool]
Académie de l'eau: method guide to inform, awareness-raising & train the public respect to water problems

1.27 [cap] Organize systematic capacity building

Developing effective and sustainable water supply and sanitation services requires public awareness of both the problems and the implications of working together with a private provider. Whilst capacity-building cannot replace local ownership, it can certainly contribute towards fostering it. During the Preparation Phase, it is important to:

- Establish clear responsibilities for ongoing capacity-building by appointing a manager to oversee all such activities
- Invest in public education as well as institutional capacity-building for local government, the regulator, local private players, etc;
  This will ensure that key stakeholders are informed and will smoothen cooperation
- Systematically analyze the training needs of each stakeholder group and plan activities responding to those needs
- Adapt methods to the training issues and target groups; make use of interactive workshops, on-site training, information delivery channels, etc
- Educate community representatives in specific water-related know-how and skills. Funds for such educational activities could come from ODA arrangements, NGOs or tax income

Responsible/lead: local government
Possible actors: local government, trainers, consultants, NGOs

Planning, Strategy and Project Design

Main Process
page 44–60

Regulation Process
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Support Processes
page 63–66

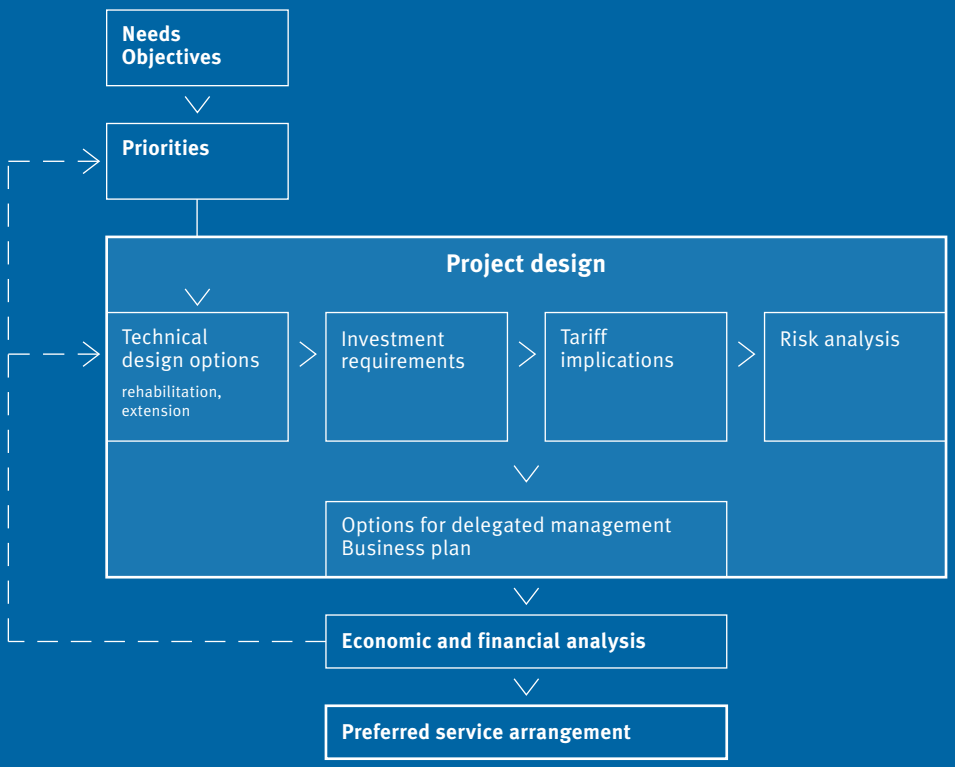

Figure 4: Tasks and results of the Planning Phase

Tasks and challenges during the Planning Phase

Once key information has been gathered during the Preparation Phase and the basic cornerstones are in place, it is time to start making important strategic decisions.

Main tasks:

- **Engineering, project design:** (a) rehabilitation, (b) extension:
  - Water intake, treatment, delivery, network extension, sewage collection, treatment
  - Considering the possibility and advantages/disadvantages of centralized systems vs decentralized ones in water distribution and sanitation
  - Exploring other innovative approaches
- **Financial architecture**:
  - Business plan: securing cash flow, costs/revenue, tariffs
  - Analysis of budget implications and availability of project finance,
  - Investment/project finance, bankability requirements, guarantee packages.
- **Risk management:** Determination, analysis, mitigation, and allocation of risks
- **Comparison of options:** Costs and benefits of PPP, PPP yes/no, type of PPP, PPP components

Main challenges:

- **Priorities:** creating a list of priorities (goals and related measures) which are financially sustainable, fulfills poverty responsiveness criteria and is agreed on by all stakeholders
- **Forecast:** developing realistic estimates for service demand (predictions are frequently overoptimistic) different scenarios

Guideline Notes for the Planning Phase

Guideline Notes for the Main Process in the Planning Phase

Results orientation
Power-balanced partnership

[Tool]
PPIAF toolkit: A guide for hiring and managing advisors for private participation in infrastructure

2.01 Evaluate and select consultants

Since technical assistance (TA) providers play an important role in any PPP process, it is in the interest of all actors and stakeholders to select these carefully.

Optimize the selection process by:

- Proposing a shortlist of independent TA providers that have no prior association or financial relationship with any of the potential private parties:
  - Disclose the offers of the consultants in the Stakeholder Committee and get their opinion on the preferred consultant(s)
- Considering the idea of providing a technical advisor (TA) to the community:
  - Grant funding to the Stakeholder Committee to enable it to hire a TA provider (complementarily to the consultants of the local government) to support the community in the understanding/analysis of planning documents and of the benefits of PPP, in considering various PPP, and on other issues to be dealt with by the SC in order to promote the SC's forming of its opinions (see GL note 2.22 below)

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee

Results orientation
Customer focus
Transparency
Sound financing mechanisms

2.02 Analyze technical options to meet demand

Based on the various analyses, including the results of the contingent valuation and input from stakeholders as done in Phase I:

- Outline service levels to be achieved. In the process of developing service levels and options on the basis of the surveys done in Phase I (including contingent valuation and others), it is important:
  - To interact with the consumer representatives at ward level
  - To communicate the options and the results of the cost-benefit analysis

[Further reading]
Development of a NRW-reduction strategy
Part 1: Investigating and Assessing Water Losses
Part 2: Planning and Implementing the Strategy

- Identify measures for optimum use of existing facilities [technically (including reduction of nonrevenue water), economically, management]
- Establish the gap between future demand and existing facilities after their optimum use:
  - Use various scenarios for future demand

[Further reading]
Links to ecological sanitation: Ecosan-Links
www.gtz.de/ecosan/english/
www.sanicon.net
www.iees.ch/news.html
www.mvula.co.za/work.htm#sanitation
www.ecological-engineering.com

- Identify technical and institutional alternatives to close the above gap:
  - Consider innovative concepts in project planning (ecosanitation, decentralized systems, demand-side management activities, etc.); large infrastructure networks may lead to inexpedient incentives, expensive solutions, ineffectiveness and technical inflexibility
- Include basic requirements in planning activities:

[Best Practice]
SDC2004: Sanitation is a Business

- No water without sanitation
- Demand-side management
- Introduce flow and consumption metering, since this is crucial to designing the water tariff system for demand management. Consider a stepwise introduction where affordability is not an issue per se

[Further reading]
GHK2003: Effective Strategic Planning for Urban Sanitation Services

- Explore mechanisms that allow community groups in illegal/informal settlements (where people have no land titles nor the covenant to remain there) to gain access to secure and fair credit in order to pay for the capital cost of service provision, e.g. connection fees

[Tool]
UNEP/WHO/UN-HABITAT/ WSSCC2004: Guidelines on Municipal Wastewater Management

- Prepare technical project documents for tenders

Responsible/lead: local government
Possible actors: local government, consultants, utility, Stakeholder Committee, CBOs

Customer focus
Transparency
Accountability

2.03 Develop and agree target framework

Prepare a framework for delivering project targets based on consultations with the Stakeholder Committee (see GL note 2.28 below). Performance should be measured against these targets and reported to the residents:

- Targets should, as a minimum, include:
  - Project timelines and key milestones
  - Priorities and programs for connecting customers to facilities
  - A log frame to provide a brief overview of outputs and activities using objectively verifiable indicators

[Tool]
Log frame Example:

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government, utility, consultant

Results orientation

2.04 Analyze the options for PPP

[Tool]
WB/PPIAF2005: Approaches to Private Participation in Water Services – A Toolkit

Once the local requirements have been ascertained in the Preparation Phase and the target framework (see GL note 2.03 and 2.28 below) has been agreed, the following options for water supply and sanitation services should be explored:

[Best case]
Lease contract in Senegal: WorldBank 2004: Innovative Contracts, Sound Relationships: Urban Water Sector Reform in Senegal

- Service contracts (1–3 years):
  - Private companies are employed under service contracts to carry out certain narrowly defined tasks (e.g. meter reading, billing services). The public authority pays a fixed fee to the private utility to fulfill the service contract. The degree of risk transferred to the private sector is limited to the particular service task
- Management contract (3–5 years):
  - Management contracts extend a service contract to include the management of the utility as a whole. Management risk is thereby transferred to the private sector. The private party is usually paid a fixed fee and a performance-related bonus
  - As a further option between a service and a management contract, a management support contract is a possibility focusing on coaching the existing management and training its capacity. The payment system could also include incentives
- Lease contract (10–12 years):

[Best case]
Service Public 2000; 2001: un nouveau modèle de cahier de charge de l'affermage de service public de distribution de l'eau potable

  - The private sector operates the system for a given period, but assets remain state-owned. The public sector generally remains responsible for financing new investment, and the private company for working capital and maintenance. The private sector is also responsible for collecting revenue that it used to fund its operations
  - Lease contracts do not involve significant infusions of private capital, nor do they necessarily create a base from which to optimize entire water and waste systems. As a result, the contractor's effectiveness in improving the service performance hinges on the government's ability to provide the necessary capital investments and direction. Misunderstanding over responsibility for 'maintenance' (private) and 'investment' (public) can also arise
- Concession contract (15–30 years):
  - In a concession contract, the government turns over full responsibility for the delivery of water and wastewater services in a specified area, including all related construction, operation, maintenance, collection, and management activities, to a private 'concessionaire' for a defined period of time (15–30 years). All assets normally belong to the public party
  - The concessionaire is responsible for any capital investments required to build, upgrade, or expand the system, and for financing those investments out of the tariffs paid by water users. In return, the private operator collects the tariff directly from the system users. The tariff level is established by the concession contract, which also includes provisions on how it may be changed over time
  - Financing for concession investments typically involves a combination of equity, loans from development banks and international debt and is remunerated by the users' tariff. Moving from guaranteed payments by governments to anticipated revenues from customers increases the risk to the private sector party. This is particularly true of currency risks, as the revenues are in local currencies, while debt payments often need to be made in foreign currencies
- BO: Build-Own-type contracts (10 to 20 years):
  - BO contracts are designed for *greenfield investments* to bring private capital into the construction of specific infrastructure facilities such as bulk supply, reservoirs and drinking water or wastewater treatment plants
  - The most frequent forms of BO contracts are: BOOT: build, own, operate, transfer; BOT: build, operate, transfer; BLOT: build, lease, operate, transfer; DBFO: design, build, finance, operate; ROT: rehabilitate, operate, transfer
  - Under a BO contract, the private firm basically finances, builds and operates a plant for a set period of time in accordance with performance standards set by the government
  - In return, the government agrees to purchase a minimum level of output (or to provide a minimum level of input, e.g. wastewater for a wastewater treatment plant) over time, regardless of the demand. The purpose is to ensure that the private operator can recover its costs over the contract period
  - This makes it necessary for the government to estimate demand with some accuracy at the time the contract is set. Otherwise, it will have

to pay for water that is not being used if demand is less than expected
  - The size and time frames associated with BOTs call for the development of sophisticated and often complicated financing packages These frequently involve substantial infusions of equity directly from the private project developers (in the range of 10% to 30%), combined with debt from third parties – usually international commercial banks or development banks

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee, consultants

Results orientation
Sound financing mechanisms
Poverty responsiveness

2.05 Choose the perimeter and market structure

It is important to define appropriate geographical boundaries for regulated water and sanitation businesses and to determine the development of the expected coverage ratios within these boundaries over the years:

- When deciding on the service area, consider:
  - Environmental and technical factors
  - Impact on service efficiency
  - Administrative boundaries and collective choice
  - Demographic development (especially migration)
  - Inclusion of poor areas (to keep it financially viable, the balance between wealthy and poor areas together with available public investment/subsidies needs to be considered)
  - Financial attractiveness and capacity
  - Transaction costs
- Also consider a mix of services:
  - Private participation in a single service
  - Bundle water and sanitation
  - Bundle water with other utilities
  - Competition between providers
- Inclusion of small and medium-sized towns: Consider aggregating water supply and sanitation services with other neighboring towns:
  - Functions that can be aggregated include: operations (e.g. system operation, maintenance, quality control, billing, customer relations); management (e.g. financial and technical management, strategic planning, human resources, legal departments); procurement (e.g. acquisition of regular or special inputs, goods and services); investment (e.g. for maintenance operations, new projects, projects at municipal level or shared projects); financing (identifying and procuring financial resources)
  - The advantages of aggregating service providers include: economies of scale, increased efficiency, access to finance, access to PPP (especially in small towns), more effective IWRM, greater scope for cross-subsidization
  - Challenges include: designing an appropriate structure (new entity, grouping, clustering for a specific purpose, etc.); allocation of voting rights; resistance to cost-sharing, and potentially high transaction costs
- Inclusion of rural and urban areas: There are also arguments for setting geographical boundaries for regulated businesses to embrace all or part

[Best case]
WB/PPIAF 2002 Emerging Lessons in Private Provision of Infrastructure Services in Rural Areas: Water Services in Cote d'Ivoire and Senegal

[Further reading]
WB2004: Models of Aggregation for Water and Sanitation Provision

of a water basin or, where this is not feasible, an area that encompasses large and small towns and rural areas (e.g. a regional company with local subsidiaries in which local stakeholders could also be involved):
  - This will facilitate cross-subsidizing between small/large and wealthy/poor customers utilizing 'cost recovery' user charges on the better-off to subsidize discounted (lifeline) charges to the poor. This approach has the advantage of enabling the regulated business to diversify its business risks across a portfolio of projects within the geographical boundary
  - In addition there are sound technical reasons for developing water resources within a water basin on a coordinated basis – best achieved by granting development rights to a single regulated business
  - This structure can be used to aggregate credit demand. The 'top' company would raise debt on behalf of the subsidiaries. This credit demand aggregation will enable the 'top' company to raise finance efficiently – spreading the transaction costs over a larger baseline
- Define responsibilities and objectives for areas outside the perimeter

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee

Results orientation
Poverty responsiveness

[Further reading]
WB2004: Can the Principles of Franchising be used to Improve Water Supply and Sanitation Services? – A Preliminary Analysis

2.06 Define the roles of alternative providers in your preferred model

- The roles of existing small-scale providers must be clearly defined under the new model (see GL note 1.08 above):
  - Where necessary, define the amount and time of compensation if livelihoods of small-scale providers are negatively impacted
- The potential role of other stakeholders (e.g. CBOs) in delivering water supply and sanitation services must be defined (e.g. construction, maintenance, billing, etc.)

Responsible/lead: local government
Possible actors: local government

Sound financing mechanisms
Proactive risk management

[Best practice]
NWP: success Factors in Self-Financing Local Water Management

[Best practice]
Mobilizing local funds in Casablanca, Morocco

[Further reading]
IADB: Pension Funds in Infrastructure Project Finance

[Further reading]
www.developmentfunds.org

2.07 Explore ways to mobilize local funds and local currency financing

Mobilizing local funds will provide two complementary benefits: (a) it helps to strengthen the local capital market and the local banks and (b) money in local currency mitigates foreign exchange risk that can seriously affect operators and customers and may even jeopardize an entire project.

Furthermore, direct lending to municipalities is difficult since it is harder for them to provide guarantees and the municipalities' experience in financial issues is most often very slight or nonexistent.

Although local capital markets are often underdeveloped or, in some countries, virtually nonexistent, PPP managers should nevertheless investigate the following financing instruments to mobilize local funds and/or local currency financing, usually in one of the following four types:

- Credits in local currency:
  - loans in local currency from IFIs are only available in countries with developed and stable markets
  - subsovereign lending by donors in local currency

[Best case]
Bond issue in Ahmedabad, India
PaDCO 2003, Innovations and solutions for financing water and sanitation investments

  - Loans from local banks, sometimes backed through IFI's for securing the risks of long-term loans or through currency swaps
  - At the national level, specialized infrastructure funds can provide long-term loans to municipalities, provided there is some stability in the financial market
- Bonds:

[Best case]
Bond issue in Johanesburg

  - These tap local capital markets, are less expensive than credits and make it possible to tap long-term savings (e.g. pension funds)
  - Bond issues: only available where finance markets are developed to some extent, but there are already some initial examples
  - Bond issues by municipalities are an option only for strong municipalities (initial examples in developing countries: Johannesburg, South Africa / Ahmedabad, India) and even these need additional assistance to get an acceptable rating

[Best Case]
Pradhan2004: Connecting Markets and Cities; The Case of Tamil Nadu Urban Development Fund (India)

  - Bonds issued by IFIs (for utilities, these equate to credits)
- Credit enhancement/guarantees:
  - Credit enhancement instruments are available for loans and for bonds and are important for attracting lenders
  - E.g. GuarantCo partial risk facility from PIDG, Private Infrastructure Development Group)

[Further reading]
IADB2002: An Alternative Model for Financing Water Projects

- Compare cost of this money with international financing mechanisms:
  - Local currency may be more expensive than foreign currency lending but is also more predictable
  - Foreign currency lending will need more sureties, e.g. guarantees or liquidity facilities

[Further reading]
WB2000: Building Local Credit Systems

- Consider innovative approaches at the national and project level:
  - A national or regional water-sector development fund (WSDF) such as a revolving fund designed to cross-subsidize new connections for poor people or to enable urban-rural transfer
  - Microlending for small projects (e.g. short-term revolving fund to finance sanitation connections)
  - Invite local private companies as utility shareholders

Responsible/lead: local government, national government
Possible actors: local government, national government

Sound financing mechanisms
Shared incentives
Proactive risk management

2.08 Develop a business plan, including an investment model

Based on the strategic options (see GL note 2.02 above), investment models and a business plan need to be developed in order to verify and compare the economic feasibility of various options through a cost/benefit analysis (CBA). Business plan:

[Tool]
Asian Development Bank: Handbook for the Economic Analysis of Water Supply Projects

- The business plan comprises not only operating plans and key human resource considerations but also the financial plan as the key element in converting the plans and assumptions into monetary terms and verifying their feasibility. Propose financing arrangements that are perceived to be socially responsible:
  - Service levels by customer segment
  - Future tariffs by customer segment
  - Connection charges
  - Sources of additional financing
  - Where service extension is planned: commitment from government to

provide equity for mandatory coverage of the poor
  - Compensation structure for the private party (e.g. regulated rate of return or fixed annual fee with inflation adjustment)
  - ROI: The target return on investment (ROI) rate must be agreed among the parties and discussed with the Stakeholder Committee, and negotiation criteria should be stipulated. Are efficiency gains to be passed on to consumers, or retained as profits, or a mix of both; will local government benefit from taxes on profits?
  - Income analysis, as the result of projected volumes and charges, identifying the annual revenues and expenses of a business over the period of time that the plan covers; with a resulting cash flow summary
  - Planned capital sales and purchases and their financing (land, building, equipment)
  - Financing schedule: summary of existing and new loans, including: interest rate paid, frequency of payments, security given, type of loan (amortized, nonamortized), term of the loan

Investment options include:

- Market finance:
  - Commercial banks are usually not very interested in long-term lending without a public sector guarantee, which might not be available. This makes international commercial lending even more difficult. Several mechanisms for securing bank loans exist
  - Municipal bonds for infrastructure guarantee full repayment in the case of default through the levying of additional taxes, and thus are only available to governments. The critical requisites for developing a countries' access to this international bond market are: having a good reputation with respect to governance; a sound municipal fiscal policy; and adequate collateral or other means of securing risk (for example, royalties from state assets, tax revenues or loan guarantees) to cover foreign exchange and other risks involved
- Soft finance (through subsidies):
  - Subordinated loans (longer repayment period, higher risks), provided by IFI's
  - Subsidized loans through interest subsidy or credit risk guarantees
  - Direct investment subsidies as a grant (see also GL note 2.11 below)
  - Tax allocations
- Risk mitigation see 2.15 below. Bankability requirements (will be necessary especially for BO contracts and concessions)
- Bankability ratings cover aspects of:
  - business profile: regulation, markets, operation, competitiveness, management
  - financial profile: profitability, capital structure, cash flow analysis, financial flexibility
- Debt/equity ratio for project finance:
  - Consider the amount and possible sources of equity for the private water utility (or project company) (see also GL note 2.07 above) to ensure a sound debt/equity ratio
  - Try to achieve a balance of liability between sponsors and government. Ensuring that sponsors bear a portion of the liability in the

[Tool]
Standard & Poor's criteria for Water and Wastewater utility regulation

utility beyond their share capital may serve to foster their results orientation
  - Limited recourse financing: ability to structure a concession as a project finance initiative can be seen as the most efficient way to mobilize private equity and debt
  - Debt service cover ratio: align the timing of investments with project priorities and the availability of cash flow for debt service (interest and principal)

Cost-benefit analysis helps to compare systematically the economic efficiency of the alternative scenarios:

- Costs and benefits:
  - Include all costs for the full project life cycle
  - Benefits are the services, capabilities, and qualities of each alternative system (for both the customers and the organization that provides the service(s) to the customers)
  - Account for nonfinancial costs borne by customers or third parties (e.g. losses to downstream fishermen resulting from water extraction) as determined by stakeholder and political processes
- Schedule costs and benefits over time
- Carry out a sensitivity test to identify to what extent the viability of a project alternative is influenced by changes in major quantifiable variables:
  - Identify the key variables to which the project alternatives may be sensitive (e.g. demand forecast, per capita consumption, water tariffs, investment cost, O&M cost, discount rate, availability of raw water etc.)
  - Calculate the effect of likely changes in these variables on the base case
  - Consider possible combinations of variables that may change simultaneously in an adverse direction
  - Analyze the direction and scale of likely changes in the key variables involving identification of the sources of change
- Compare the alternatives

Responsible/lead: local government
Possible actors: local government, financing institutions

Results orientation

2.09 Decide on the preferred service arrangement (type and duration) and corporate vehicle

- Assess pros and cons:
  - Which model (see GL note 2.02 above) best suits the situation in hand and the goals to be met?
  - What consequences does the selected model have (financially and in terms of the distribution of responsibilities)?
  - What are the special risks and opportunities of the different models?
  - Evaluate potential disputes over responsibility (e.g. the distinction between 'maintenance' and 'replacement' may not always be clear in a lease contract)
  - Which model best matches the investment conditions in the country?
- Which option offers best value for money?
  - The central proposition should always be that PPP should only be

[Best case]
Piaseczno, Poland: WB/OECD 2004: Market development study Eastern Europe and Central Asia)

[Further reading]
GTZ2004: Private Sector Participation; Recent Findings and Assessments Experiences of GTZ MEN-REM

pursued where it delivers value for money (VfM)
  - VfM is the optimum combination of whole project life cycle cost and quality to meet the user's requirement, and does not always mean choosing the lowest-cost bid
  - PPP should not be chosen just to get rid of financial responsibility

[Further reading]
WSSCC/Gvt of Netherlands 2000, private business, public owner; Government shareholdings in water companies www.nwp.nl/objects/plc.pdf

- Consider a phasing-in approach: Award a clear and focused short-term contract initially with the option of converting to a more complex contract (e.g. lease or even concession contract) at a later date. This approach:
  - Helps to improve local knowledge
  - Creates more equal parties, helps to build up trust between the parties and greater information symmetry for a future PPP contract
  - Helps to show the public operator how to work in a more flexible framework (e.g. with new staffing policies and different career opportunities)
  - Helps to foster competition for assignments and contracts
  - Might encourage the involvement of local, private service companies, thereby promoting local development

[Further reading]
Restructuring within public utility in Uganda: Internally delegated area management contracts

- Check the preferred PPP model and compare it with public provision:
  - To the extent that this is possible, assemble information on future tariffs, revenues, and expenses without PPP
  - When considering public provision, include models providing some autonomy, such as a municipal utility created under public law or a municipal company created under public law
- Decide on a corporate structure for the utility company: there is no 'best' solution. Consider the following points:
  - Private sector majority shareholding (e.g. with local and international investors and possibly a public minority shareholding)
  - Public sector majority shareholding (will rarely be compatible with mobilizing large amounts of long-term finance because of lenders' concerns over political 'interference' by future governments)
  - Mixed-share company (private, public, employees, local communities, none of which hold a controlling shareholding)
  - Whether local government should contribute equity to the project company at all (and thereby retain some degree of control); investigate possible conflicts of interest (conflicts of interests can also be an issue where IFIs are shareholders and at the same time lenders)

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee

Sound financing mechanisms
Resource protection

2.10 Define a local tariff policy

National tariff policy is formulated by central government. Local government then adapts this overarching policy to factor in the particularities of the system and the social and economic conditions of the population, affluent and poor consumer groups, etc.

[Further reading]
ADB 2004: beyond cost recovery: setting user charges for financial, economic, and social goals

The tariff strategy plays the key role in establishing a cost-recovering strategy (together with payment options, customer service and a balanced set of rewards and punishments). Independent of whether the service is provided by a public or a private operator, self-financing of water and sanitation operations is crucial to their long-term sustainability.

[Further reading]
OECD2004: key issues of tariff reform in the water sector in the EECCA

Therefore, a tariff strategy should:

- generate reliable revenue flows to cover the full cost of water:
  - Operating costs
  - Appropriate maintenance of infrastructure
  - Debt service
  - Depreciation of assets to accumulate funds for rehabilitation
  - Financing of regulation
  - Environmental costs linked to water supply, from source protection to operation and the final deposit. A clear statement is needed that makes it possible to determine which more general water resource management measures are financed by tax money
  - Rate of return (which must be agreed between the private party and the local government and accepted by the customers)
- Be efficient:
  - Base the tariff and billing system on flow and consumption metering (start metering and billing the wealthier consumers already served before expanding to low-income areas)
  - Set targets for (improved) billing and collection efficiency
- Be fair and protect consumers:
  - Define the tariff and its development over time in relation to the purchasing power of consumer groups (rich, industry, poor)
  - Promote solidarity among consumers
  - Take account of consumers' ability to pay. Subsidies: see GL note 2.11 below
- Provide enforcement mechanisms for regulations and bills:
  - Enforcement of the tariff structure is critical to financial sustainability. [Illegal connections or nonpayment of bills may be attempted by all sorts of customer (poor, wealthy, industry, public institutions)]
  - Define an effective cut-off policy and include provisions striking a balance between efficiency and social acceptability [e.g. long enough payment terms (cut-off after the third bill) and reasonable debt repayment options for poor consumer groups)]
  - Illegal connections: define sanctions for illegal connections and for corrupt staff installing or abetting the installation of such connections
- Protect the resource: consider introducing a tariff for raw water: Introducing a raw-water tariff to be paid by the utility operator is positive since it:
  - Creates incentives for efficient operation by (a) preventing over-abstraction and (b) reducing losses in the water production process (treatment) and in distribution (leakages)
  - Generates funds for water resource protection

Responsible/lead: local government
Possible actors: national government, local government, Stakeholder Committee

Poverty responsiveness

2.11 Design effective subsidy policy

The goals described in the tariff policy might conflict directly, since the full cost of water services might lead to tariffs that are not affordable for poor customers. The gap between affordability and the full cost must be made up

[Best case]
WB2001: Incentive-Based Subsidies (Chile)

via tailor-made subsidies. There are basically two approaches for governments to support the poor: Subsidies to investments, reflected in lower connection fees, and subsidies to consumption:

- As part of the tariff policy, subsidies targeted at the poor should:
  - Not interfere with economic incentives
  - Be transparent in the subsidy structure
  - Together with tariffs, cover the total cost as described in GL note 2.10 above

[Further reading]
WSP/PPIAF2003: Water Tariffs and Subsidies in South Asia: Do current water subsidies reach the poor?

- Avoid relying on a single source of subsidies, as this increases risk and renders the system vulnerable:
  - Cross-subsidies between customer groups (rich → poor, in a given service area or through a nationwide fund) are only effective when there is a sufficiently large middle-income consumer base. However, if cross-subsidies become too large, are badly communicated, or cause price increases that encourage industrial users to dig their own wells, they may be counterproductive
  - Consider using tax money to subsidize part of the consumption or connection charges for poor customers. Relying heavily on tax money can make a utility more beholden to those in charge of authorizing transfers than to consumers
  - Use bilateral ODA or IFI funds to subsidize connection charges for poor customers

[Best practice]
WSP2002: Urban water supply innovations in cote d ivoire – how cross-subsidies help the poor

- Subsidize connection charges rather than consumption tariffs:
  - Connection charges are often the major financial obstacles for poor customers
  - This could provide incentives to the utility to provide services to poor consumers
  - Make sure subsidies for consumption do not induce overconsumption and do not undermine conservation incentives

[Best practice]
WSP2004: Mobilizing resources for sanitation (Burkina Faso)

- Provide for the possibility of subsidy adjustment:
  - Conditions may change, calling for a review/adjustment of subsidies. Define situations where subsidy reviews/adjustments are mandatory, e.g. following tariff adjustments, due to economic development and if existing subsidies turn out to be ineffective
  - Consider 'sunset' subsidies, i.e. phasing-out subsidy regulations. This at least makes it mandatory to discuss the need and appropriateness of subsidies from time to time
- Choose a channel for delivering subsidies that is as close as possible to the individual recipient:
  - If a customer database is available, deliver the subsidy straight to the customer
  - Deliver subsidies directly to the utility based on the amount of water delivered in a target area (in the form of OBA, it could be an incentive to the utility to serve the poor)
  - Often, increasing block tariffs (IBT) with lifeline tariff (i.e. the first block is set at a low level covering basic daily needs) are used as channel for subsidy delivery; be aware of difficulties related to IBT where connections are shared or a household with metered connection supplies unconnected neighbors or vendors

[Further reading]
WB2002: Output-Based Aid: possible applications for the design of water concessions

- Consider using effective payment mechanisms for subsidies such as an output-based aid contract: establish incentives for promoting the project goals and target investment subsidies using an output-based aid

[Further reading]
WB2002: Output-Based Aid: possible applications for the design of water concessions

[Tool]
WB2004: OBA payment mechanisms and risk mitigation

contract (OBA), where disbursement of public funding is tied to specified outputs or services delivered by a private operator. One advantage of this is that it transfers largely controllable risks to the private operator:
  - Target intended beneficiaries/outcomes (e.g. OBA funding per new connection in a defined area/customer segment)
  - Define performance requirements (e.g. the connection has been installed and the customer is receiving water)
  - Disbursement of public funding can be tied to achievement of specific environmental targets (e.g. quality and volume of wastewater treated)
  - Design a payment mechanism and structure: The OBA should cover not only the cost of water connections per household but should also factor in the cost of upgrading the capacity of the production, distribution and recollection system
- Be aware of the challenges linked to OBA:
  - Ensure basic safeguards
  - Credible commitment is critical in private financing. Using a foreign donor or an independent trust fund institution to manage the scheme could reduce the political risks associated with OBA
  - Ensure effective performance monitoring; involve regulators, NGOs, community groups

Responsible/lead: national government, local government
Possible actors: national government, local government, Stakeholder Committee, regulator

Sound financing mechanisms

2.12 Set out and agree on the tariff calculation and adjustment formula

The tariff structure has to be calculated on the basis of the full cost of service delivery and any subsidies. Structuring the tariff and the accompanying regulatory system is often the most complicated part of any arrangement (mainly due to asymmetry in information). Tariffs need to be high enough to allow the operator to make a profit if it performs well, but not so high that the profits are excessive:

[Further reading]
ADB 2004: Beyond cost recovery: setting user charges for financial, economic, and social goals

- A successful tariff structure has five key characteristics:
  - Public acceptability: It is noncontroversial and does not lead to public criticism of the water utility
  - Political acceptability: A tariff structure that is objectionable to political leaders will lead to loss of political support and may cause increased political interference in the utility's operations
  - Simplicity, predictability and transparency: A tariff structure should be easy to explain and easy to understand. It should be possible for most users to know what price they are paying for their water
  - Net revenue stability: When water use changes as a result of weather or economic conditions, revenue and cost should change proportionately. If this does not happen, cyclical changes will result in net-revenue volatility, creating cash flow bottlenecks and financing difficulties for the utility (e.g. introducing a fixed fee to cover high overheads)
  - Ease of implementation: The promulgation and implementation of the revised tariff should not encounter significant barriers in terms of

[Further reading]
OECD2004: Key issues of tariff reform in the water sector in the eecca

legal authority, administration, information requirements, or billing procedures

- The two most widely used approaches for establishing the intended profit margin are the 'price cap' and 'rate of return' models:
  - Price cap approach: Water prices are set for a number of years (usually three to five). If the water operator achieves higher-than-expected efficiencies, and therefore lower costs, it can keep the savings as profit – until the next periodic price review (used e.g. in Peru, Chile, Argentina, Malaysia, UK). More difficult to administer
  - Rate of return (cost plus) approach: An allowable level of profit is determined (often in the range of 6 to 12 percent), and the operator is allowed to charge rates that result in that level of profit over its costs. No incentive for cost reduction (used e.g. Canada, Japan, NIS states)
- Make the calculation of the water tariff more transparent towards stakeholders by breaking down costs and investments for each project along the water production and distribution chain (potable water production, water distribution, wastewater collection, wastewater treatment, resource protection). Communicate this information clearly to the Stakeholder Committee (see GL note 2.25 below)
- This makes it possible to build an adequate tariff structure that includes one or more of the following elements:
  - Connection: water and sewage connection fees
  - Payments for water consumption per unit consumed
  - Fixed payments for water supply and for sewerage, irrespective of consumption/output
  - Payments tailored to customer segments (residents, business, industry etc.)
  - Subsidies and cross-subsidies (e.g. lifeline tariffs, IBT)
- Define possible reasons for tariff adjustment:
  - Automatic adjustments: When changes in the following areas exceed agreed levels: inflation, demand, operational costs, interest rates, and collection rates. If investments are financed in foreign currency, tariffs should not be linked to currency but to inflation
  - Extraordinary adjustments: Investment program, amendments to service obligations; changes in the law and other government regulations that affect cash flows; below-market interest rate financing from any multilateral or bilateral sources; erroneous bidding assumptions provided by local government prior to the bid; increases in fees to be paid by the operator to the public contractor, and increases in the operational cost as a result of an uninsured 'force majeure' event
  - General price review: after a first contract period (e.g. three or five years)
- Outlining tariff adjustment mechanisms have to consider:
  - Tariff adjustment formula that poor customers can afford
  - Link tariff adjustment to a review of the subsidy formula
  - In order to protect consumers, exposure to exchange rate risk should not be directly linked to the tariff; for mitigation measures see also GL note 2.07 above and 2.15 below
- A calculation method must also be devised for raw-water charges, where applicable
- Be aware of the strength of the remaining informal service providers who

[Further reading]
WSP: Water Tariff Design in developing countries: Disadvantages of Increasing Block Tariffs (IBT) and Advantages of Uniform Price with Rebate (UBR) Designs

may be able to organize resistance groups against the project and protest against the tariff system.

Responsible/lead: national government, local government
Possible actors: national government, local government, Stakeholder Committee, financial experts

Customer focus
Shared incentives
Poverty responsiveness
Sound financing mechanisms

2.13 Explore appropriate payment mechanisms

The collection of payments is important to achieve financial sustainability. Failure to collect all charges is a common reason for financial deficits – improving collection rates is usually the most significant change introduced by private companies. It is a technically and managerially simple process to create a comprehensive and up-to-date database of users (at least where customers have addresses), and to issue invoices for the amounts owed.

For many poor customers, affordability is not simply a matter of price but also of liquidity. Appropriate payment mechanisms are vital in situations where customers have neither addresses nor bank accounts and conventional billing systems cannot be used. It is thus important to discuss the following points with the Stakeholder Committee (or the group within the Stakeholder Committee responsible for poverty and tariff advice):

- Methods of payment for water services for poor customers:
  - Frequency: Synchronize it with customers' liquidity, better matched to the way the poor manage their money (e.g. short payment intervals; synchronize billing dates with payment of pensions etc.)
  - Reduce the cost of and constraints on making the payments themselves, e.g. pay-points within walking distance where users don't pay by payment order
  - Charge collectors (local representative who collects payments in installments from community members)
- Methods of payment for connections:
  - Payment plan for paying connection fees in installments with reasonable interest (e.g. microcredit revolving fund)
  - Microcredit program in collaboration with financial institutions or NGOs
  - Reduced connection charges in cases where consumers perform part of the labor themselves

[Tool]
WEDC: Microcredit for Sanitation

[Further reading]
www.microfinancegateway.org

Responsible/lead: local government
Possible actors: local government, consultants, Stakeholder Committee (poverty and tariff group)

Proactive risk management
Sound financing mechanisms

2.14 Analyze relevant risks

Identify the various risks and set up regular review sessions during the project cycle. Include the Stakeholder Committee (see GL note 1.18 above) in order to gain a more comprehensive view of the risk landscape, which will vary with the contract form:

- Demand-side commercial risks:
  - Revenue/demand risk (e.g. lower-than-expected demand, low collection rates)
- Supply-side commercial risks:

  - Construction risk (e.g. capital cost overrun, delay, failure to meet performance criteria)
  - Operating risk (e.g. underperformance, operating cost overrun, interruption)
- Financial risks:
  - Financial risks (e.g. exchange rate, interest rate fluctuations)
- Political/country risk (sovereign risk):
  - Political risks (e.g. change in government, political interference)
  - Legal risks (e.g. actions eroding the value of regulatory or commercial contracts)
  - Force majeure (e.g. flood, earthquake, riot)
- Development risks:
  - Design risk [e.g. errors or incomplete information in request for proposal (RFP), unrealistic objectives]
  - Environmental risks (e.g. preexisting liability, site remediation, pollution/discharge, raw-water quantity/quality)
- Establish a risk matrix to develop a common understanding of your exposure:
  - Weight the identified risks against their impact (how severe will the impact be if the risk materializes?) and probability (Is there a low/medium/high probability of such a risk event over the various Phases of the contract period?). Where a risk cannot be accurately quantified, it should be addressed through qualitative assessment
  - Summarize the risks and their weighting in a risk assessment matrix. Create a risk landscape with 'red,' 'yellow' and 'green' areas and establish priorities for action

Responsible/lead: local government
Possible actors: national government, local government, Stakeholder Committee, consultants, IFIs

Proactive risk management

2.15 Prepare for risk allocation

The risks assessed (see GL note 2.14 above) must be mitigated by and/or allocated to the various parties. The parties must clearly determine who is liable in the event of noncompliance with regulations:

- Risk mitigation through change in the project profile:
  - Change the project profile (downsizing of project, service levels, time scale, PPP model, etc.)
  - Set criteria to be met by subprojects prior to approval.

[Further reading]
www.worldbank.org/guarantees

- Risk mitigation through credit enhancement, a mechanism for selectively transferring specified risks from borrowers to the provider of credit enhancement:
  - Political risk insurance (PRI): This can bridge credibility gaps until a policy track record has been established, leading to longer credit terms and lower interest rates (e.g. MIGA, Multilateral Investment Guarantee Agency)
  - Financial guarantees: owing to uncertainties regarding the long-term-financial viability of the project (even where prices fully reflect costs).
  - Currency risk guarantees: through currency swaps or other mechanisms
  - Performance risk guarantees: These guarantee that the private party

[Further reading]
WV2003: Foreign exchange risk mitigation for power and water projects in developing countries

performs to an agreed level

[Further reading]
ADB 2000: Developing best practices for promoting private sector investment in infrastructure/water supply

- Risk mitigation through contract enforcement measures
- Allocate risks to the contracting party that can minimize and manage them most effectively. Bearing risks increases the cost to the respective party and hence to the project. The more influence a party has on its risks, the lower is the cost of bearing them, and the better it is for the project. Where no party has a clear comparative advantage in managing the risks, they should be shared equally. Assess:
  - Risks arising from factors actually or potentially under the control of either the public or the private party (e.g. inadequate information, poor design, ineffective management, poor communications, poor performance in construction, operation, etc.)
  - Risks arising as a result of the broader policy/institutional framework (e.g. poor policy environment, institutional weakness, political interference) which are controllable only by external decision-makers,
  - Risks that are essentially uncontrollable (e.g. natural disasters, political instability, currency devaluation)
- Risk transfer must be agreed upon by the public and private parties – and in conjunction with stakeholders – during the Procurement Phase
- Establish procedures and define responsibilities for the event of unanticipated risks
- Establish a balance between risks and penalties/incentives

[Further reading]
WB1999: Tapping the private Sector: Approaches to Managing Risk in Water and Sanitation

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee, consultants, IFIs

Proactive risk management

2.16 If needed, establish a 'transition' process for employees

[Tool]
PPIAF Labor Tool Kit; Labor Issues in infrastructure reform

Where a lease contract or a concession contract is chosen, some of the former public utility staff will move to the new operator:

- PPP process managers must develop and review partnership contracts for employees. These contracts will typically include:
  - Limits on layoffs or definition of retrenchment packages
  - Benefits and compensation protection
  - Salaries, holidays
  - Social security
  - Preservation of union rights
- Introduce sunset clauses: Define how long the employees will be protected, i.e. when will the transition period end (e.g. after 5 years)
- Provide professional advice to avoid deprivation of benefits (e.g. loss of pension)

Responsible/lead: local government
Possible actors: local government, public utility, unions, future operator

Shared incentives
Proactive risk management

2.17 Address sensitive issues and potential disadvantages for stakeholder groups

In the course of the Preparation Phase, certain reservations will have been voiced and obstacles will have arisen. These need to be addressed in a practical way in the project design. Depending on the policy objectives that are set:

- Announce measures for overcoming obstacles that might prevent customers from connecting to new facilities (land tenure, etc.)
- Agree with the Stakeholder Committee on systems and procedures to ensure that concerns arising from project delivery are handled in an effective way
- Anybody who stands to lose (e.g. money, influence, power, etc.) as a result of a change process is likely to oppose it. It is important to identify and communicate with potential losers in order to seek solutions and mitigate potential negative impact on both parties
- Some public utility employees may lose their jobs. Ascertain whether these individuals have the skills to take over different tasks in the new structure (e.g. via 'insourcing' or hiring them as a subcontractor or franchisee)
- Informal providers may lose their business – at least temporarily (see GL note 1.08 above)
- Changes in the power structure as a result of people occupying new positions in the water distribution system

[Further reading]
WEDC2002: Small enterprises and water provision in Kibera, Nairobi

Responsible/lead: local government
Possible actors: local government, unions, independent providers

Guideline Notes for the Regulation Process in the Planning Phase

Accountability

2.18 Where necessary, introduce effective changes in legislation

Depending on the outcome of the institutional, legal and regulatory analysis (see GL note 1.12 to 1.15 above), changes in the legal framework may be required in order to:

- Clarify competencies and define functions
- Provide an investment framework
- Include informal providers
- Contractual arrangements between formal and informal private-sector entities and NGOs may need to be amended to allow community-based organizations to become involved in PPP processes

Responsible/lead: national government
Possible actors: regulator, national government, national platform for policy coordination, multilateral institutions, IFIs

Accountability
Sound financing mechanisms

2.19 Put regulation in place

The Procurement Phase should not begin until:

- The regulator has been determined and its duties defined and agreed (see also GL note 1.13 above. Duties normally include:
  - Ensuring compliance with licenses and/or contracts
  - Tariff approval for water supply and wastewater services (see GL notes 2.10 and 2.12 above)
  - Monitoring levels of service and operational performance (including customer services)

  - Compiling and publishing information on sector & service provider performance
  - Addressing disputes between companies and consumers
- Methods have been defined for monitoring outcomes and the achievement of targets
- Reporting methods and indicators have been proposed for financial accountability
- The regulator has been authorized (i.e. given legal authority for financial auditing)

Responsible/lead: national government
Possible actors: regulator, national government, local government, multilateral institutions, IFIs

Proactive risk management
Power-balanced partnership

2.20 Establish procedures for resolving disputes between contracting parties

Since minor disputes will inevitably arise between the contracting parties, it is important to put a mechanism in place, in order to settle them quickly and efficiently without recourse to the courts:

- As a 'preventive measure': organize regular (e.g. monthly) meetings between the contracting parties to discuss/settle current matters
- Starting point for dispute resolution is negotiation between the parties; this has advantages such as preservation of relationship, range of solution, speed, low cost:
  - Negotiation may involve higher-ranking officials
  - Mediation: in certain circumstances it may be useful to involve a third neutral party as facilitator for the negotiations
- If the regulatory framework allows, consider setting up a Contract Dispute Commission or Expert Panel that provides for independent expert judgement in the event of a dispute. The following points should be borne in mind:
  - Composition (e.g. financial, technical and legal experts, stakeholder representatives)
  - Appointment procedure (e.g. agreement of public and private party), including alternatives where members are not available
  - Rules of conduct and procedure (e.g. the obligation to hear parties and stakeholders to the case), including timetable
  - Enforcement of the expert's decision by the parties
  - Funding
  - The Dispute Commission should meet regularly
- If these mechanisms do not succeed, the case will have to be referred to the local courts or international arbitration (to be defined in the contract and country law)

Responsible/lead: regulator
Possible actors: regulator, local government, regulation experts

Water resource protection
Results orientation

2.21 Establish water resource management standards

- Establish a reliable water resource model to decide on:
  - Total abstraction from water bodies within the relevant basin boundaries

  - Allocation to the (competing) uses
- Institute environmental impact assessments and identify protection needs. This will involve:
  - Setting sustainable water abstraction limits
  - Protecting habitats during construction
  - Defining minimum flow levels in rivers
  - Establishing water resource quality standards
- Establish drinking water and sewage-effluent quality standards. These should be at least comparable to WHO standards and should include:
  - Standards for drinking water quality, including maximum permissible levels of certain substances and microorganisms
  - Limits on volume and concentration of effluents to be discharged from sewage treatment plants
  - Limits on the volume and toxicity (for humans and ecosystems) of effluents discharged into sewers by industry
- Establish charges for:
  - Direct abstraction from water sources (flat fee or metered)
  - Discharging industrial waste into sewers
  - (See also GL note 2.10 and 2.12 above)

[Tool]
WHO: Standards for Drinking water quality

Responsible/lead: regulator
Possible actors: regulator, local government

Transparency
Accountability

2.22 Oversee public consultation process

There will be a need for regulation in the area of procedures and process control before PPP becomes a reality:

- Require that stakeholder input be procured as outlined in GL notes 1.20, 1.22–1.23 above and GL notes 2.27–2.28 below
- Require that all planning documents are made public
- Ensure that there is adequate time for community residents to respond to planning documents and that they have the capacity to do so
- Provided that there is an agreement to provide a TA to the Stakeholder Committee (see GL note 2.01 above), request that a fee be paid to community organizations to enable them to hire a TA provider (e.g. via NGOs). This funding, while originating from the same source from which the other consultants are paid, should be fully under the control of the regulator, who will delegate it to the SC's TA provider

Responsible/lead: regulator
Possible actors: regulator, Stakeholder Committee, local government

Proactive risk management

2.23 Regulate the regulators

The regulatory process needs to strike a balance between predictability and flexibility in order to minimize regulatory risk and allow project design to be amended in response to unexpected outcomes. It is thus important to:

- Demand that regulators' discretion is limited to those aspects where it is essential
- Ensure that operators' rights, obligations and responsibilities are set out in binding regulatory contracts that provide reasonable security and predictability over the medium and long term

- Ensure that certain basic steps must be observed before the regulatory bodies can take a decision (e.g. submissions by operator and other stakeholders; sufficient time for preparing submissions; obligation to publish and justify its decisions, etc.)
- Establish transparent criteria for the regulators' decision-making process, placed in the public domain
- Put in place clear procedures for coordination and consistency between economic, quality and environmental regulation (see also GL note 1.13 above)
- Set up an effective appeal process

Responsible/lead: national government
Possible actors: national government, regulator, regulation experts

Guideline Notes for the Support Processes in the Planning Phase

Accountability
Transparency

2.24 [stake] Test readiness of cooperation instruments

The cooperation structures agreed with stakeholders during the Preparation Phase (see GL note 1.19, 1.18, and 1.22 above) should now be implemented:

- Relevant stakeholders/participants must be identified
- Appropriate systems for communicating project information, financial information and water use information to all stakeholders must be designed and tested
- The first meetings of the Stakeholder Dispute Commission (if any, see GL note 1.24 above) should be held
- Cross-check representation (see also GL note 1.18 above):
  - Check whether the composition of the Stakeholder Committee is appropriate and all groups are represented
  - It is important to be sure that representatives in the Stakeholder Committee accurately represent the views of their constituencies. This can be achieved by organizing occasional public meetings at which all stakeholders can witness what proposals are being made
  - Check whether the representatives are the most qualified ones to represent their stakeholders (see also GL note 1.18 above)

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee

Sound financing mechanisms
Poverty responsiveness

2.25 [stake] Determine the role of the Stakeholder Committee in tariff issues

Since tariffs can be a highly sensitive matter, customers must understand the issues that affect and determine them (see GL note 2.10, 2.11, and 2.12 above). Making tariffs a major issue in the Stakeholder Committee is a good way of encouraging greater customer involvement and helping customers to understand how prices are calculated:

- The following groups should be invited to Stakeholder Committee meetings discussing tariff issues (e.g. to hearings/discussions): ministry/municipality, private operator, regulators
- Tasks of the Stakeholder Committee regarding tariffs

- Facilitating public discussion (e.g. with their respective constituencies) on tariff. This should focus on broad social development goals, like: desired SLAs versus corresponding tariff levels
- Consulting on the tariff structure when it is being established (or is to be changed): Explain the proposed tariff system and solicit input from consumers
- Check within the Stakeholder Committee every six months whether tariffs are generating sufficient revenue to cover all of the operating costs and investments, including the private operator's return (based on reports from operator/regulators)
- Consult the Stakeholder Committee whenever tariffs are to be changed and explain economic needs, the investment situation and how – and by how much – tariffs will need to be adjusted to meet financial targets
- Check the usefulness of payment systems (see GL note 2.13 above)

Responsible/lead: local government
Possible actors: Stakeholder Committee (poverty and tariff group), regulator

Poverty responsiveness

2.26 [stake] Include stakeholders in assessment of impact on vulnerable customers

Investigate in the Stakeholder Committee concerns about the project's potential consequences for the poor; consider inviting further representatives to express their evaluation (see GL notes 1.18, 1.22 above):

- The analysis should be based on the needs assessment and focus on social, financial and other objectives, obstacles, and constraints
- Stakeholders should refrain from prejudging the desirability of PPP in the abstract. Rather, they should seek to describe, as comprehensively as possible, the problems/benefits that could arise as a result of the Public-Private Partnership
- This 'invitation' should include allowances for participants (to be paid by the local government, e.g. through ODA arrangements) who cannot afford to contribute without receiving financial support

Responsible/lead: Stakeholder Committee
Possible actors: local government, Stakeholder Committee, moderator

Transparency
Customer focus

2.27 [stake] Review draft documents

Consult with the stakeholders before making a recommendation as to whether to proceed with PPP or not, and decide on the type and structure of PPP, along with the financial mechanisms and tariff structure:

- Make all planning documents available to all stakeholders in the relevant languages, venues, and forms identified by the community (see GL note 1.26 above)
- Special attention should be paid to:
  - The adequacy of the project's improvement targets
  - Financial aspects and consequences of the proposed projects for (poor) consumers
  - Conducting a thorough evaluation of the quantitative costs and

benefits of PPP; consider reengineering or restructuring the public system
  - Water resource protection: this is a fundamental component of any water system and is just as important as supply considerations/ planning
- Give stakeholders sufficient time to:
  - Review all draft planning document
  - Support or oppose the proposals of the public party. Where stakeholders oppose certain proposals, they should check the appropriateness of their objections first and consider alternative solutions
- Consider hosting independently facilitated meetings within the framework of the stakeholder cooperation structure at which stakeholders present their views on the proposals, and other parties respond to those views. If necessary, the local governmental or an NGO may pay for independent facilitation
- Do not forget to consult the regulator during the Planning Phase

Responsible/lead: local government
Possible actors: Stakeholder Committee, facilitators, moderators, TA providers, utility

Power-balanced partnership

2.28 [stake] Find agreement on basic approach and roles

On the basis of the consultations and discussions with stakeholders described above (GL note 2.27 above), local government should agree, together with the Stakeholder Committee, on:

- An acceptable approach to PPP
- The options for providing and paying for the water supply and sanitation services
- The potential role of stakeholders in delivering water services. Stakeholders could, for instance, become involved in:
  - Monitoring and informally regulating the use of communal facilities,
  - Subcontracting labor or services for constructing or operating water service facilities
  - Acting as small-scale providers (operating under license) of services to the very poor
  - Collecting charges within communities
  - Microfinancing for connections, etc.

[Further reading]
BPD2004: The Partnership Paperchase
Structuring Partnership Agreements in Water and Sanitation in Low-Income Communities

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government

Sound financing mechanisms
Power-balanced partnership

2.29 [cap] Build knowledge around tariff issues

Conducting major tariff discussions requires a good understanding of the issues that affect prices (see GL note 2.08, 2.10, 2.11, 2.12, and 2.13 above). It is therefore important to organize capacity-building sessions for stakeholders and interested consumers:

- Below are some of the wider issues that should be addressed in these sessions:
  - What do we mean by adequate quantity and quality in water services?

- How can we reduce water losses and excessive consumption?
- How do we go about protecting the environment in the water system?
- What do we mean by ‘appropriate infrastructure’?
- How do we determine an adequate rate of return for the private operator?
- How do we go about setting an appropriate regulation fee?
- How do we ascertain the consumer’s ability to pay?
- How do we ascertain the consumer’s willingness to pay?
- How can we promote a sense of solidarity amongst consumers?

Responsible/lead: local government
Possible actors: development agencies, independent advisors, Stakeholder Committee

Results orientation

2.30 [comm] Communicate expected benefits

After a Phase in which several options have been discussed and checked, active public communication of the results of the Planning Phase and informing the public about the outcome are important measures with a view to managing consumers’ expectations and avoiding confusion:

- The quantitative benefits of the project should be communicated
- Potential future customers should be informed about ways of overcoming obstacles that may prevent them from connecting to new facilities
- The public should be made aware of where the responsibilities for the various parts of the water system will lie post-PPP
- Communicate how progress is to be monitored

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government

Procurement

Main Process
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Regulation Process
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Support Processes
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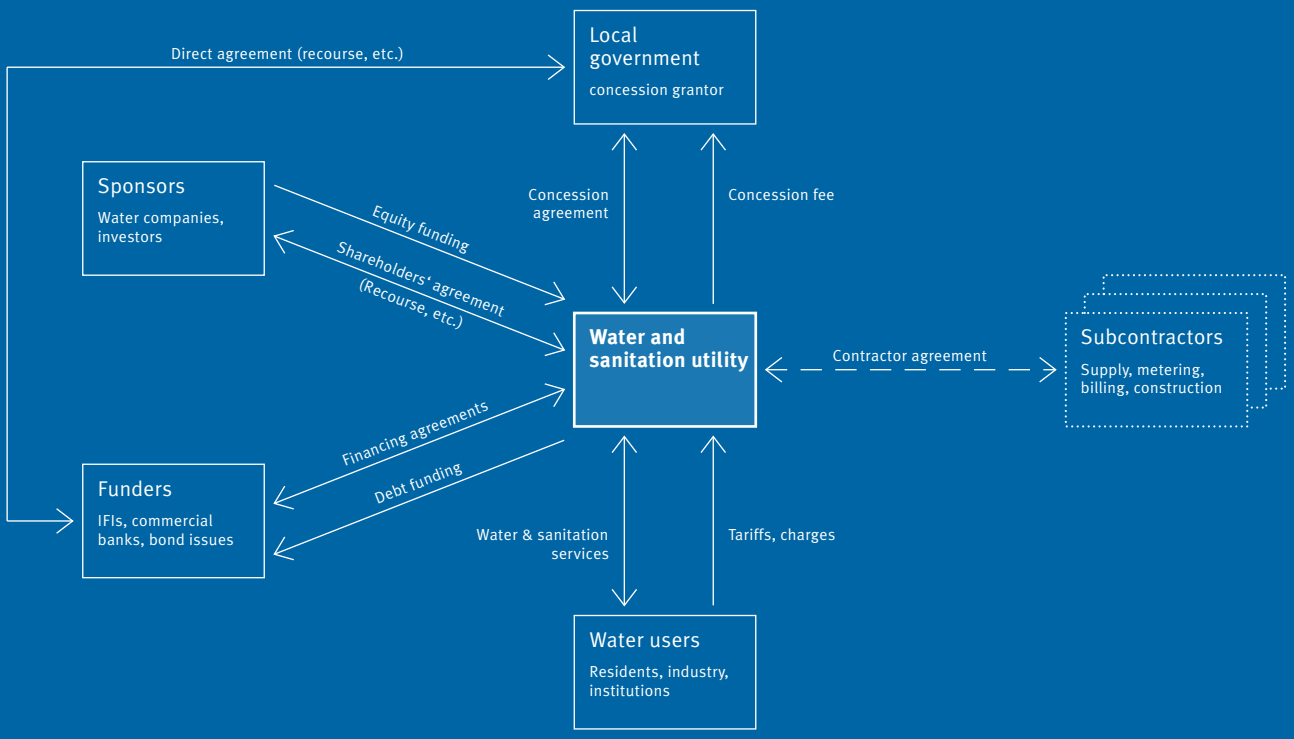

Figure 5: Typical contract and financing structure for concessions following a procurement process

Tasks and challenges during the Procurement Phase

Any successful Public-Private Partnership starts with a transparent and effective process to procure a private operator. Procurement processes that are not properly designed often cause unnecessary expenditure and waste time and resources both for the public entity and potential private parties. The partnership should be based on a well-structured risk-sharing arrangement (including appropriate supporting provisions) that is flexible enough to allow adaptation to internal and external changes over the entire project life cycle.

Main tasks:

- **Process design:** procurement process, selection and evaluation criteria, procedure
- **Bidding, negotiation, contract signing**

Main challenges:

- **Design:** The design of the contract can make an enormous difference to the future success of monitoring the contractor. Strategic thinking on monitoring needs to begin at the time the deal is structured – not after
- **Fair negotiation:** Maintain a power balance during negotiations
- **Balance:** Strive to find a balance between obligation and flexibility when drafting the contract
- **Enabling partnership:** Although a well-drafted and unambiguous contract is crucial, productive partnerships are the result of the constructive attitude of the people involved in the process, and not simply the terms of the contract. It is fundamentally important that governments establish and cultivate this positive attitude during PPP procurement and subsequently during the entire term of the contract

Guideline Notes for the Procurement Phase

Guideline Notes for the Main Process in the Procurement Phase

Transparency
Accountability
Proactive risk management

3.01 Design procurement processes in a transparent manner

A procurement plan must cover bidding, negotiation, and contract award. Often there are national policies in place, providing a procurement framework. Within this framework, consider the following:

[Further reading]
Procurement Guidelines:
EBRD, WB/IBRD
ADB: AfDB, IADB

- Organize a transparent and accountable bidding process:
  - This will normally include a formal public notification of the proposed tender, a prequalification process, and a structured approach to requesting and evaluating proposals
  - Before designing the procurement process, solicit the Stakeholder Committee's (see GL note 1.18 above) input
  - Provide adequate time and support to the Stakeholder Committee for public review
  - Disclose the final rules/proceedings for the procurement process, including transparent evaluation procedures
  - Do not change the rules during the process
  - Establish a Contract Evaluation Board appointed by the local government to be responsible for the evaluation process . This Board has to be well balanced and should rely mainly on the delegating authority, experts and water user representatives (i.e. delegates from the Stakeholder Committee)
  - Request input from the Stakeholder Committee on the procurement rules

[Tool]
WB/PPIAF2005: Approaches to private participation in Water Services – A Toolkit

- Draft a clear 'request for proposal' (RfP), articulating the program objectives and defining explicit performance standards (service level agreement, SLA) that the successful bidder must meet. A RfP typically includes:
  - Background and objectives
  - Description of the desired services (see target framework, GL note 2.03 and 2.28 above)
  - Evaluation criteria and their respective weights in the evaluation
  - Insurance and bonding requirements
  - Financing responsibilities
  - Responsibilities for obtaining permits and complying with regulations
  - Information required (content, form, frequency) to evaluate whether the private party is performing in accordance with agreed standards
  - Terms of contract
  - Draft service agreement indicating mandatory and negotiable terms and conditions
  - Instructions for submitting a bid
- Organize a cost-efficient bidding process:
  - The cost of bidding can be excessive, which may put off companies, especially small and medium enterprises.
  - In particular, it is crucial to provide good, reliable financial, and

operational data relating to the contract

- The criteria against which bidders are evaluated:
  - May include one or more of the following (depending on contract form): fees for operating the system, tariffs, investment programs, service quality standards, experience (and performance) in similar projects, proposed methodology, experience of proposed staff, etc.
  - Communicate the broad framework of bid evaluation to candidates and to the public
- To avoid difficult negotiations on key points of the contract once the preferred bidder has been selected, consider requiring a 'letter of commitment' together with the bid, stating that the bidder is prepared to enter into a contract on the terms set out and that no negotiation will be required in respect of the finalized bid documents post-selection of preferred bidder
- Open the bidding to public as well as private service providers:
  - Explore the possibility of using local service providers wherever possible
  - Discuss approach and performance of potential service providers in similar cases with the Stakeholder Committee
- Define procedures for complaints and appeals:
  - Who will be responsible for hearing and arbitrating?
  - On what basis will complaints and appeals be heard, including formal requirements and deadlines?
  - Consider requiring a fee to be deposited to discourage frivolous complaints
- If no bids are received:
  - check whether the chosen PPP model is appropriate
  - go for direct negotiation. However, it is important to be aware that this approach may put municipalities at a disadvantage, as they have little experience in negotiating; it also lacks transparency and gives rise to opportunities for corruption. On the other hand, there are advantages such as lower transaction costs

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government, regulator

Proactive risk management
Transparency

3.02 Actively prevent corruption

Concrete measures will be needed to reduce the risk of corruption in any PPP venture. These measures must be applied right from the start to even the most provisional design documents to ensure that a dishonest consultant does not engineer the entire preparation process for the benefit of preferred contractors or suppliers.

- Possible anticorruption measures:
  - Maximize transparency of processes and transactions.
  - Make all financial transactions during the Procurement Phase transparent to the Stakeholder Committee
  - Demand a declaration that there is no potential conflict of interest from the involved players (see GL note 1.20 above), including sanctions for incorrect statements
  - Independent process monitoring (e.g. through civil society organizations or contracted experts). Such a process gives civil society

representatives access to confidential proprietary information. Appropriate contractual terms need to be in place to make sure that such data is secure and does not get passed on any further

[Tool]
Transparency International: Public Procurement: Integrity pact for public contracting

TI for public sector: Anti-corrution initiatives at local level

TI Principles for Business: Business Principles for Countering Bribery

- Employ Transparency International's (TI) 'Integrity pact for public contracting.' This model may be applied when contracting consultants or awarding any form of contract for delegated management (see GL note 2.04 above). It establishes the contractual rights and obligations of all parties vis-à-vis the local government and eliminates uncertainties as to the quality, applicability and enforcement of criminal and contractual legal provisions in a given country. The TI pact includes:
  - A model contract between a government office and companies submitting a tender
  - A statement by each bidder committing it to abstain from paying/accepting bribes
  - A provision on the disclosure of all payments made in connection with the contract
  - A provision whereby each bidder explicitly acknowledges that the no-bribery commitment, the disclosure obligation and the attendant sanctions remain in force for the winning bidder until the contract has been fully executed
  - A preannounced set of sanctions for any bidder violating its commitments. These sanctions include refusal to award or cancellation of the contract, forfeiture of the bid security and performance bond, liability for damages to the local government and competing bidders, debarment of the violator by the local government for an appropriate period of time

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government

Results orientation
Poverty responsiveness
Shared incentives

3.03 Create explicit poverty incentives for the private operator

Define the incentives in the bidding document in a manner that makes serving poor customers interesting to the private operator. Be aware that public subsidies might still be required with a clear propoor strategy, as in the case of a purely public provision:

- Contract award: adopt more qualitative criteria instead of focusing only on price (e.g. on the basis of the number of connections to be installed instead of a lowest-tariff basis); best value for price
- Ensure that service and technology levels can be adapted to local requirements
- Make provision for involvement of NGOs and CBOs which can play a very important part in service delivery within these communities
- Foster the use of local labor forces. This will bring an immediate benefit to low-income communities and will help to improve the profile of the project

  Be aware of the following:
  - Residents in low-income communities might tend to lack skills, meaning that they will generally only be able to offer labor
  - Avoid placing unreasonable obligations on contractors to use local labor, especially where the need for labor is limited

[Further reading]
WB2002: Output-Based Aid: possible applications for the design of water concessions

[Further reading]
Global Partnership on output-based aid www.gpoba.org

[Tool]
WB2004: OBA PAYMENT MECHANISMS AND RISK MITIGATION

- Quality control problems: unskilled laborers will need training and extra quality control
- Avoid expecting residents in beneficiary communities to carry out tasks they are not competent to perform (even if they have undergone training)

- Consider the use of OBA as described in GL note 2.08 above

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government, regulator

Results orientation
Proactive risk management

3.04 Invite the bidders to use innovative approaches

- Invite bidders to comment on ambiguities and contradictions in the documents if they believe that such exist
- Where appropriate, bidders should be requested to make counter-proposals or put forward alternative technical or financial arrangements, provided these are to the benefit of the poor and are economically feasible and appropriate for achieving the requirements
- Private parties should comment on the adequacy of the proposed financial arrangements in favor of the poor and on their economic feasibility:
  - Failure to comment does not absolve the private party of responsibility for problems that the financial arrangements cause to poor customers at a later stage. Only by commenting in this phase can private parties ensure that these arrangements will work from their perspective
- The public party must evaluate any comments or counter-proposals on financial arrangements in favor of the poor and clearly describe how they will resolve any problems or change any part of the proposed final documents (contracts, ordinances, etc), before awarding a contract

Responsible/lead: local government
Possible actors: local government, bidders

Results orientation
Power-balanced Partnership
Proactive risk management

3.05 Make sure the contract contains clear definitions and targets

- There are normally six main criteria to be considered in a PPP tender:
  - Service area and the scope of work (see GL note 2.05 above)
  - Levels of service: water (quality, pressure, continuity, technical losses, etc.); sanitation and sewerage (effluent, spillover maintenance, etc.); customer service (billing and collection, responses to queries or complaints, interruption notifications, etc.),
  - Tariffs: tariff formula and structure, indexation, adjustment and renegotiation criteria
  - Level of social commitment: staffing, salaries, etc.
  - Levels of investment (where rehabilitation and/or extension is included in the contract): the level of investment should relate to the amount needed to cover a defined area and specified levels of service. Since the tariff will be calculated as an amount per cubic meter of water, the expected volume of water delivered to cover a defined service area and level of service, and any subsequent investment requirements should be determined. It is preferable also

to define targets (time, coverage, extension, quality, UFW, etc.) rather than only the amount or method of investment in the contract.
  - levels of maintenance (e.g. as an annual percentage of defined asset value or as a fixed annual amount, etc.)
- Specify what is expected of the private party rather than how it should meet the expectations:
  - Allow for innovative technical solutions or supply arrangements with subcontractors
  - Make it clear that the contract holder remains ultimately accountable to the public contractor for complying with the terms of the delegated management contract
- Further elements the contract should address:
  - Risk allocation: who carries which risks to what extent (see also GL note 2.15 above)
  - Changes in the operating environment, including regulatory changes (see also GL note 2.14 above)
  - Insurance and bonding requirements
  - Expected fluctuation margin for rate of return to the operator
  - Contract management and oversight
  - Contract termination (see GL notes 3.06, 3.07 below) and status of services and (for concession and lease contracts) status of assets
- The contract should contain clear details and guidelines on:
  - Who (public or private party) will assume responsibility for communicating with the public
  - Continuing the public consultation process throughout the contract lifespan on a recurrent basis and whenever major decisions are made that might cause rate increases or alter services
  - Transparency in relation to financial, process, system, and SLA information
- Demand capacity-building of utility staff:
  - Capacity-building of local staff should prepare them to take over operations and management responsibility after contract termination
- The contract must stipulate that:
  - The private party (a) accepts responsibility for operating facilities in compliance with all regulations, (b) commits to financial arrangements designed to benefit the poor, as described in the procurement documents
  - The public party accepts responsibility for its share of payments, granting licenses (see GL-Note 2.21 above), etc.
- Be aware of the difficulties that can arise when setting targets due to missing or unreliable information as described in Phase I:
  - Possible consequences in operation: revenues below forecast, loss reduction targets not realistic, etc.
  - Possible consequences in construction: cost overrun, delay
  - Both will lead to tariff increases and contract disputes possibly jeopardizing the project

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government, regulator

Proactive risk management

3.06 Define termination procedures in the event of breach of contract

'Termination for cause' occurs when either the private or public party fails to perform in accordance with the terms of the contract.

- Cases of breach of contract by the private operator:
  - Persistent failure to fulfill the contract targets
  - Changing the objectives of the contract without the authorization of the regulator
  - The private operator commits a specified number of serious infractions in a defined period of time
  - The private operator goes bankrupt
- Cases of breach of contract by the local government:
  - Changing the objectives of the contract without the authorization of the regulator
  - The local government fails to fulfill the contract clauses on investment and other required measures
- Termination criteria should be defined in advance, as should appropriate 'exit strategies' and financial penalties/reimbursements:
  - Scope for corrective action must be determined in advance.
  - In the event of termination for cause, the public party must be compensated for the cost of rectifying damages resulting from non-performance and for transitioning back to public operation, or to another private party
  - The public party must demand assurances entitling it to compensation in the event of nonperformance. These may include: a letter of credit, a performance bond, a parent company guarantee, or other guarantees
  - Reasonable upper-bound estimates can be developed for damages resulting from contract termination
  - The contract must discourage noncompliance by the public party. Stability of the contract should be pursued, for instance, to cope with cases in which a new local government administration takes actions adverse to the project for political reasons. Appropriate arrangements to prevent and compensate for breach of contract or nonperformance by the local government are also needed. These could include: revaluation of targets and obligations of the private operator (e.g. delay, reduction of targets), reduction of license fees, compensation of private party, others
- Appeal procedures also need to be determined in the contract

Responsible/lead: local government
Possible actors: local government, private operator, regulator, Stakeholder Committee

Proactive risk management
Result orientation

3.07 Define termination procedures in the event of 'termination for convenience'

This occurs when the public or private party wishes to end the contract for reasons other than poor performance. Regulations are part of the contract:

- If the public party initiated the termination, the private party must be compensated for demobilization costs and lost revenues, and profits
- If the private party initiated the termination, the public party's costs must be reimbursed to ensure continuity and replacement of contractor

- The contract should specify which standards are to be applied and define the process for reaching a financial settlement

Responsible/lead: local government
Possible actors: local government, private operator, regulator, Stakeholder Committee

Accountability
Transparency

3.08 Award the contract in a traceable manner

The contract should be awarded in such a way as to maximize value for money for the consumers.

[Tool]
WB/PPIAF2005: Approaches to private participation in Water Services – A Toolkit

- Evaluate the bids received regarding:
  - Compliance with statutory procurement procedures and requirements as set out in the bidding instructions
  - Changes to the contract (if any) proposed by the bidders and their potential influence on risk allocation; this may lead to noncompliance (if the bid was requested on the basis of unconditional acceptance of the draft contract) or suitable risk adjustment has to be taken into account in the financial evaluation to ensure that all bids are compared on an equivalent basis
  - Evaluate the technical and financial proposals, using predetermined scoring
- If bidders were invited to propose (in addition to the base bid) variations to the draft contract delivering better value for money, a second round of evaluation (and negotiation) will have to follow after bid evaluation
- The awarding authority must be able to justify its choice of contract to consumers (see also GL note 3.01 above on awarding criteria)
- See also GL note 3.12 below on appropriate stakeholder involvement methods

Responsible/lead: local government
Possible actors: local government, evaluation board, Stakeholder Committee

Guideline Notes for the Regulation Process in the Procurement Phase

Transparency

3.09 Oversee the accuracy and transparency of the procurement process

- Put in place legal requirements for draft contract review and public consultation, including a defined time frame for this process
- Prepare systems for monitoring bidding processes and ensuring that budgets are met
- Make sure any violation of rules in the bidding/contract negotiations or Preparation Phase are suitably penalized
- Ensure that all financial transactions are available for public scrutiny during the Procurement Phase (see GL note 3.02 above on corruption), and that all documents are released to the public in ways that are accessible and understandable

- The regulator must make its evaluation of the transparency and public input process available to the public

Responsible/lead: regulator
Possible actors: regulator, local governments, bidders, Stakeholder Committee

Poverty responsiveness
Transparency
Water resource protection

3.10 Review the arrangements for the poor and the transparency clauses in the contract

The regulator must pay special attention to critical issues in the contract (see GL note 3.05):

- Review and comment in writing on the arrangements designed to benefit the poor in the proposed final documents (contracts, ordinances, etc.) prior to contract award:
  - In particular, the contract must stipulate performance yardsticks for poverty responsiveness (e.g. number of new service connections made in each time period) that are deemed adequate by the regulator
  - The regulator must assess the impact of these propoor measures on the contract in terms of investment, subsidies, and costs
- Review adequacy of transparency requirements in the contract:
  - Formulate explicit transparency guidelines throughout the Operation Phase, and clearly state which parties are responsible for what
  - Ensure that the regulator can continue to monitor adherence throughout the Operation Phase
  - Possible exceptions: financial details should not be reviewed if disclosure would substantially impact the ability of the private or public party to comply with their contractual or other legal obligations (e.g. divulging information on the cash flows of either party could impair that party's ability to borrow the funds it needs to fulfill its contractual obligations)
- Review and comment in writing on the obligations relating to the protection of water resources

Responsible/lead: regulator
Possible actors: Stakeholder Committee, local government

Power-balanced partnership

3.11 Avoid regulatory vacuum

In cases where the parties have decided to go ahead with a Public-Private Partnership in the absence of adequate regulations (i.e. there is no satisfactory legal framework or regulatory authority in place), or where deficits in the regulatory regime have not been remedied by the time the project is launched, the contract itself will be the only 'regulatory' instrument. If this is the case:

- Establish a special-purpose entity, e.g. a Contract Monitoring Unit (CMU):
  - The CMU is responsible for monitoring the contract
  - Decide how this body is to be appointed (e.g. mutual consent by public and private party) and what its status will be as an entity balanced between the public and private parties

- Decide whether this CMU will be part of the ministry, the municipality or have its own legal corporate status
- Define the CMU's competencies: monitoring and reporting only, setting penalties for noncompliance, decision-making power in the event of dispute, etc.

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee

Guideline Notes for the Support Processes in the Procurement Phase

Transparency
Accountability
Proactive risk management

3.12 [stake] Allow review of the procurement process design, bidding, negotiation, and contract

The Stakeholder Committee plays an active role in the Procurement Phase. Consider the following:

- Consult with the Stakeholder Committee on the procurement rules and the RFP and communicate input transparently
- Include one or two representatives of the Stakeholder Committee in the contract evaluation board (see GL not 3.01 above). In order to ensure appropriate protection of proprietary information, they must sign a respective agreement
- Deliver a summary of the evaluation report to the Stakeholder Committee for consultation, including SLA and financial key data:
  - If the time for review is too short, the public may oppose or become skeptical about their real involvement in the process
- After contract award, provide stakeholders with the final documents

Responsible/lead: local government
Possible actors: Stakeholder Committee, local government, outside consultants/reviewer

Power-balanced partnership

3.13 [cap] Elicit capacity-building needs for procurement and contract management

The request for proposals, service level agreements and other procurement documents make different demands in terms of competencies from the public party and stakeholders:

- Avoid putting former public utility staff in positions for which they are not prepared
- Explore the competencies and training needs of the public party for effective contract management
- Provide appropriate training for the Stakeholder Committee representatives on the contract evaluation board

Responsible/lead: local government
Possible actors: Regulator, local government, Stakeholder Committee, consultants

3.14 [comm] Publish results of the bidding process

In order to avoid false expectations and rumors, actively communicate the results of the bidding process draw attention to:

- Financial results
- SLA and schedules
- Any deviations from the original plans
- Situations in which tenders differ significantly from estimates
- Next steps in the process
- Roles and responsibilities

Responsible/lead: regulator
Possible actors: regulator, local governments, bidders, NGOs

Operation and Monitoring

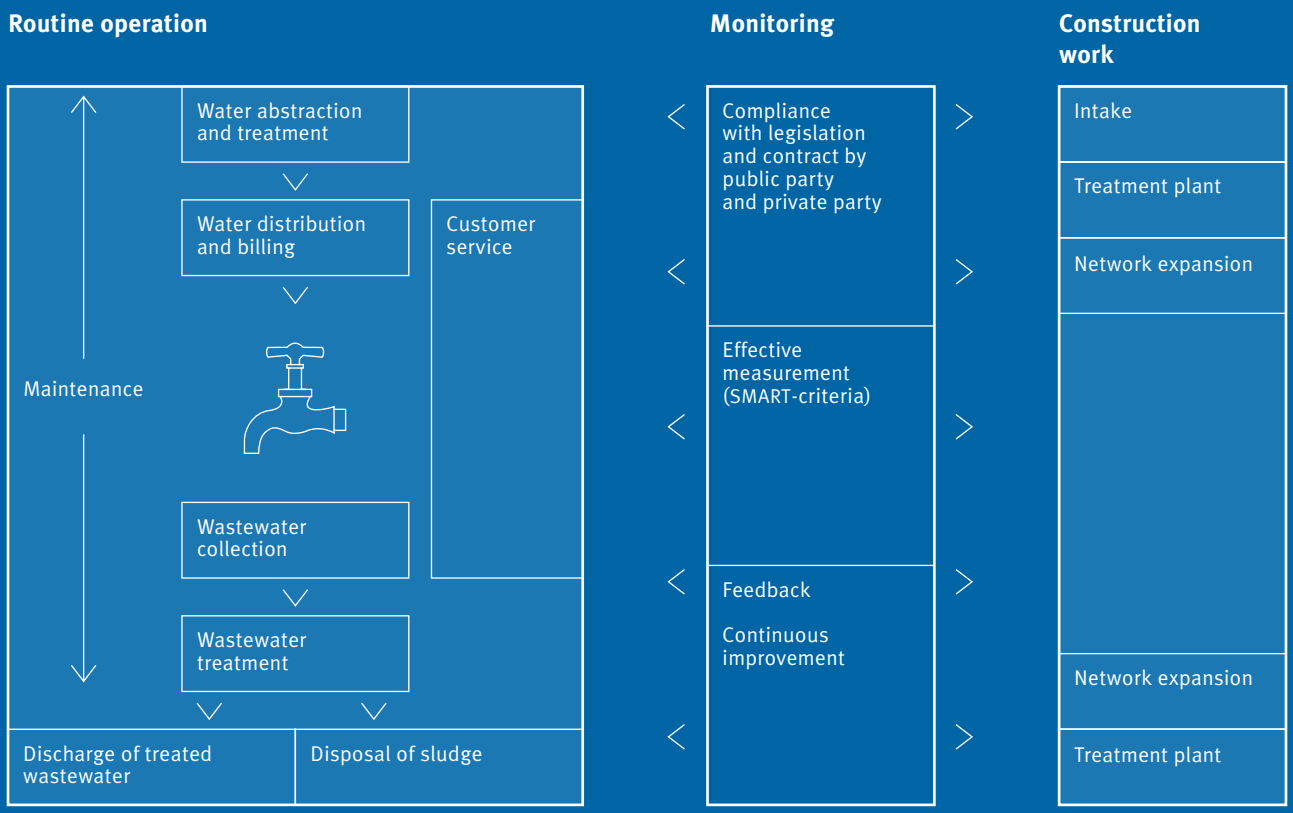

Figure 6: Link between operation and monitoring

Tasks and challenges during the Operation Phase

The success of a Public-Private Partnership depends to a very large extent on whether the private and public parties comply with the terms of the contract, but also on the readiness to cooperate closely and with appropriate flexibility.

Main tasks:

- **Service delivery/operation:** production of potable water (water intake and treatment); distribution of potable water to customers; collection of sewage; treatment and final disposal of sewage; metering and billing
- **Maintenance:** keeping assets and facilities, the grid and other infrastructure in good working order; repairing burst pipes; reducing leakages
- **Construction:** source development; treatment plants; pumping stations; storage facilities; network extension and connection of new customers
- **Monitoring/regulation:** enforcing the terms of the contract between the public and private party; monitoring the operator's performance interpreting key contract terms

Main challenges:

- **Flexibility** in response to changing frameworks and conditions (e.g. state of assets not as expected, changes in demand, changing economic, and financial aspects)
- Proactive communication among parties, address disputes at an early stage
- Developing suitable parameters for monitoring; to be effective, the criteria should meet the **SMART** conditions: **S**pecific: do they measure what we think they ought to measure? **M**easurable: does the indicator provide measurable data? **A**ttainable: the identified indicator may be measurable, but is it attainable? **R**elevant: do actors and stakeholders see the indicator as being relevant to the project? **T**imely: can the information be collected in a timely manner and at regular intervals (time, effort, resources?)

Guideline Notes for the Operation and Monitoring Phase

Guideline Notes for the Main Process in the Operation and Monitoring Phase

Power-balanced partnership

4.01 Appoint a qualified contract manager

Once the public party starts delegating service delivery to the private operator, the skills and competencies it will need to manage the contract will be quite different from those required in the past when it provided all of the services itself:

- Designate an individual or a team (contract manager) within the public contracting party: He or she will:
  - Have primary responsibility for managing the contract and contract oversight
  - Ensure that the public party complies with its contractual obligations
  - Act as the primary liaison with his or her private counterpart
- criteria for selecting the contract manager to represent the public entity include:
  - No vested interest in returning the facility to public operation
  - Familiarity with operation of the facility
  - Detailed understanding of the contract terms and conditions
  - Experience in contract monitoring
  - Expertise in negotiation
  - Strong communication and interpersonal skills
- the contract manager's skills could be enhanced through:
  - Formal training
  - Executive coaching
  - Exposure visits to communities that have experience with PPP
- As a general rule, the public authority should avoid putting former public utility employees in positions for which they do not possess the required professional know-how

Responsible/lead: local government
Possible actors: local government, trainers

Results orientation
Sound financing mechanisms

4.02 Get the economic base right

After taking over responsibility for water and sanitation service, operators' initial activities should keep a sound balance between:

- Prioritizing service improvements for customers: measures that visibly demonstrate effective customer focus
- Improving operating efficiency, e.g. installing a tight cost control system; implementing effective management information systems
- Increasing revenues, e.g. introducing effective billing and collection systems, rolling out programs for installing meters

- Proactively communicating effective measures and efforts

Responsible/lead: private operator
Possible actors: private operator

Results orientation

4.03 Focus on effective service development

Investment-related programs (where provided for in the contract) need careful and detailed planning and prioritization, based on both technical and financial analysis and consultation:

- Detailed 'service development plans' are to be developed by the private operator in accordance with the stipulations of the contract:
  - A service development plan for the whole contract period must be presented to the regulator no later than about a year after the contract start date
  - An updated service development plan must be presented annually
- An Annual Report must be presented each year:
  - These documents must be accessible to all stakeholders, including customers, and must be actively divulged. Divulgation would normally be the task of the regulator
- Likewise:
  - the public party must comply with its obligations
  - politicians must have no influence on day-to-day operations which might influence for example the location of improvement works

Responsible/lead: private operator
Possible actors: private operator, regulator, local government

Socially balanced financing

4.04 Implement the tariff system

- The private operator must comply with the tariff system as defined in the tariff policy (GL note 2.10 and 2.12 above)
- If the private operator wishes to adjust tariffs, it must submit its proposals together with financial performance data to the regulator. This data will normally include:
  - operation and maintenance expenditures
  - investment performance
  - mix of financing
  - interest rate information
- Before implementing the tariff structure, the regulator should offer the Stakeholder Committee the opportunity to comment (see GL note 2.12 above)
- Inform the consumers about their rights and obligations
- Respond to the complaints and/or queries of any CSO relating to the tariff system
- In case of conflicts, promote consensus building, e.g. through consultation with the Stakeholder Committee (see 2.25 above)

Responsible/lead: private operator
Possible actors: private operator, regulator, Stakeholder Committee

Customer focus

4.05 Implement customer-friendly payment systems

- Use payment systems that have been tailored to the local situation as defined during preparation and planning (see GL note 2.13 above)
- If the payment systems are not covered under the contract, they must be discussed and agreed with the Stakeholder Committee at the beginning of the Operation Phase (see GL note 1.18 above)

Responsible/lead: private operator
Possible actors: private operator, customers, Stakeholder Committee

Customer focus
Shared incentives

4.06 Continuously improve customer service and service awareness

Customer focus is not solely the domain of the customer service manager but a question of corporate culture, of the organization's dedication to serving its customers:

- Establish local customer service offices together with a range of communication channels with customers, adapted to their preferences:
  - Set up local customer service offices for processing transactions. Where illiteracy is widespread and postal and phone services are unreliable, people tend to prefer personal contact
  - The offices act as a center where customers can present their complaints
  - They provide a channel for information exchange

[Further reading]
DFID/WELL2001 Customer relations management, Part A: Introduction

- Establish and actively communicate a customer charter that publicly affirms the roles and responsibilities of the utility and the rights of its consumers:
  - The charter sets out the functions of the utility transparently and defines each service provided by the utility and the obligations of each party (service provider and customer)
  - It creates service accountability and friendliness with customers
  - It exposes the efficiency and reliability of the service rendered by the utility

[Tool]
DFID/WELL2001 Customer relations management, Part B: Draft Customer Service Guidelines

- Establish methods/procedures for accepting, processing and solving customer problems/complaints and set time frames for providing responses and solutions. Frequent subjects of questions and complaints are: meter reading, billing, and collection, connection and connection fees, major repairs, illegal connections, service interruption
- Institutionalize close collaboration within the utility departments to assist the staff at the primary customer interface in providing quality customer service
- Given that many utility staff will have an engineering background or – if they come from abroad – may not be familiar with the local situation, they may need training in:
  - customer care, especially when new or alternative technologies and low-cost connections are a departure from traditional practice
  - participatory methods (especially in engineering functions)
  - safety training: updates, and access to refresher courses
- Actively engage in demand-side management through information

Responsible/lead: private operator
Possible actors: private operator, staff

Poverty responsiveness
Shared incentives
Proactive risk management

4.07 Take advantage of local entities

Employing subcontractors helps to build a local economy and involves local people in building and operating the water service facilities, thereby creating a sense of 'local ownership'. It helps also to reduce a community's dependence on imported skills and labor (see also GL note 3.04 above).

- Consider all possible local subcontractors:
  - Local formal private sector: small and medium-sized enterprises (SMEs) may be contracted to perform specific tasks (e.g. metering, billing, repair)
  - Local informal private sector: these entities will often be able to perform a variety of tasks
  - NGOs or civil society groups for social interacting, surveys, etc.
  - Subcontracting (e.g. meter reading) may be an interesting alternative for both parties:
  - It may allow operational tasks to be carried out in a cost-effective manner
  - Close ties with the local community may facilitate revenue collection.
  - It may enhance communications with consumers
  - In extreme cases (e.g. insecurity and civil unrest) local entities will likely be the only actors that can operate with any degree of safety
- Subcontractors may need capacity-building if they have little commercial experience
- Subcontractors may need to change their mandate if existing arrangements exclude them from 'commercial' activities
- Whenever the private operator intends to subcontract to local entities:
  - Only source out when you have the capacity to coach subcontractors
  - Define binding rules
  - Note that the private operator holding the contract with the public contractor remains responsible towards the local government and to the customers
  - Consult local leaders/community representatives to find out about the reputation of potential subcontractors. Choosing reputable subcontractors will help to improve public acceptance of the utility

Responsible/lead: private operator
Possible actors: CBOs, NGOs, informal private sector, private operator

[Further reading]
BPD2004, The Partnership Paperchase: Structuring Partnership Agreements in Water and Sanitation in Low-Income Communities

[Tool]
WEDC2000: Performance Monitoring of Micro-contracts for the procurement of urban infrastructure

Accountability

4.08 Introduce agreed systems for routine measurement

- Performance reports must be provided on a clearly defined time basis (e.g. quarterly, half-yearly and annually, see GL note 4.11 below for indicators)
- The private operator should employ companies to conduct an independent audit (technical and financial)
- Monitor the quality of industrial wastewater fed into the sewer systems and, in the event of noncompliance with agreed standards (environmental law, etc.), report this to the authority in charge

Responsible/lead: private operator
Possible actors: private operator, regulator

Shared incentives

4.09 Introduce a performance incentive program for staff

The definition of individual performance criteria for staff often is a delicate issue and might take some time:

- As a first step, a bonus scheme could be linked to the following:
  - Achieving high drinking water quality
  - Consistently achieving agreed sewage effluent standards
  - Achieving defined customer service standards
  - Achieving defined collection efficiency levels
- Any labor incentive scheme should be reviewed regularly to ensure that it is delivering the intended benefits
- Avoid introducing practices which exempt employees of the service from having to pay for their water

Responsible/lead: private operator
Possible actors: private operator, staff

Transparency

4.10 Provide information on status of service delivery and contract progress

Both the public and private parties need to be actively involved in supplying the public with relevant information – and in coordinating this information effectively, as described in GL note 4.31 below:

- The private party assumes responsibility for communicating with the public:
  - On the status of implementation and construction
  - Update potential customers on any changes in connection dates if programs change
- He provides this information via monthly bills, public meetings, and educational materials

Responsible/lead: private operator
Possible actors: local government, private operator, contractors

Guideline Notes for the Regulation Process in the Operation and Monitoring Phase

Accountability
Shared incentives
Results orientation
Water resource protection

4.11 Monitor operations from the beginning

- System performance must be monitored using indicators chosen early in the process and must be reported to the regulator and then to the public
- Performance measurement must not only collect data but also turn data into information. General steps include:
  - What to measure (see below): depending on the goals to be achieved, focus on a few key indicators. These should be chosen for what they tell you (areas that require modification, areas that require greater oversight) and meet the SMART (specific, measurable, attainable, relevant, timely) criteria
  - How to measure: link indicators to objectives and key performance 'themes', (e.g. value for money, equity, effectiveness) reduce overlapping indicators, lay down definitions

[Tool]
WHO2000: Tools for assessing the O&M status of water supply and sanitation in developing countries

WEDC2003: Addendum to WHO-tools:

  - How to collect data? – consider scope for rationalizing data collection exercises, reassess indicators if data collection is too costly, agree frequency of data collection, allocate roles for data collection)
  - How to analyze and present data?–determine data analysis systems, develop graphical and other clear ways of presenting data)
  - What to do with the data?–feed results into budgeting and planning cycle, assess policy implications, adjust future objectives if necessary, apply bonus/malus incentives where necessary)
- Areas for performance measurement typically include:
  - Number of customers being served (water supply and sanitation)
  - Quality of goods and service provided
  - Customer satisfaction (i.e. number of customer complaints)
  - Cost control/economic performance (water supply, wastewater treatment, source protection), financial efficiency (day receivable ratio, bill collection efficiency), liquidity, profitability (operation ratio, return on fixed assets), creditworthiness (debt equity ratio)
  - Investment
  - Rates of water abstraction from sources and any overabstraction that might occur (abstraction rate compared to source capacity and/or authorized abstraction volumes specifically reserved for drinking water as opposed to other uses such as irrigation or energy production by local government)
  - Source quality (contamination through mining, industry, agriculture)
  - Energy consumption
  - Unaccounted for water: technical (losses during treatment and distribution); commercial (bill collection efficiency, see above); compared with loss targets in the service development plan
  - Any service interruptions, planned and unplanned
  - The quality of treated water being put into supply and any failure to meet standards
  - The quality of sewage effluent discharged into watercourses and any failure to meet standards
  - Safety
  - Schedule, technical and financial status of project progress (if any)
- Define how and when the performance information should be reported to the regulator (if this is not already laid down in the contract)
- Make use of incentives to foster performance, if provided for in the contract
- Where necessary, levy fines or penalties on the basis of regulatory monitoring. Fines and penalties may be imposed for:
  - Overabstracting from water sources
  - Interruption of water production
  - Failing to meet drinking water or sewage effluent standards
  - Polluting water resources
  - Failing to communicate planned interruptions
  - Failing to pay charges (penalty could be disconnection from the system)
  - Unauthorized discharge of industrial waste into sewers
  - Failing to meet industrial waste consent standards
  - Unauthorized connections to systems
- Gather stakeholders' opinions when assessing the seriousness of 'misdemeanors' and before taking any punitive action or referring a case

for such action

- Fines should be calculated according to the:
  - Area affected
  - Severity of breach
  - Duration/time taken to repair
  - Time elapsed before service was repaired/replaced
  - Number of breaches

Responsible/lead: regulator
Possible actors: private operator, regulator

Water resource protection

4.12 Actively promote water conservation measures

Within the discretion of the regulator and based on resource management standards (see GL note 2.21 above):

- Define water-use efficiency improvement goals, linked to incentives
- Push for water conservation before granting new abstraction and wastewater discharge licenses. Check whether additional water abstraction can be avoided:
  - Prioritize repair of leakages
  - Introduce effective billing as a disincentive to wasting water
  - Demand and monitor programs for demand-side management by the private operator
  - Incentives should be used to encourage people to meet or exceed conservation targets; likewise, disincentives should be applied for failure to meet targets
- Where needed, grant water abstraction licenses:
  - According to the project's progress
  - Charge for the licenses according to the tariff policy or national legislation

Responsible/lead: regulator
Possible actors: private operator, regulator, local government

Customer focus
Sound financing mechanisms

4.13 Manage price reviews effectively

- Tariffs are revised regularly as laid down in the tariff policy (GL notes 2.10 and 2.12 above) and in the contract, based on the review of the operator's information (GL note 4.04 above), and in consultation with the Stakeholder Committee (or the group within the Stakeholder Committee responsible for tariff advice) (GL note 4.23 below:
  - Tariff components (water consumption charge, sewerage charge, water and sewerage connection fees)
  - Tariff payments (one payment for all, separate payments)
  - Tariff structure: fixed payment irrespective of consumption (unmetered) and/or consumption-linked payment (metered), subsidized tariffs
  - Payment frequency (monthly, bi-monthly)
  - Measures to be taken in the event of non-payment
  - Allocation of work carried out by consumers (digging installation, etc.)

Key issues are:

- Appointing a panel of independent experts to resolve disputes relating

to tariff adjustments is often a cost-effective and flexible solution:
- The tariff expert panel makes recommendations.
- Rules for appointing this panel should be written into the contract.
- The final decision remains with the regulator.

Responsible/lead: regulator
Possible actors: regulator, private operator, panel of tariff experts, Stakeholder Committee

Sound financing mechanisms

4.14 Survey the effectiveness of subsidies

- Public and private parties must comply with all terms of the contract documents (financial and others) designed to benefit the poor and with any other applicable laws and regulations, including any modifications to monitoring requirements made by the regulator
- Investigate who ultimately ends up receiving the subsidies and compare this with the initial data/assumption in the subsidy policy (see GL note 2.11 above):
  - Conduct household surveys
  - Make use of CBOs and NGOs
- Determine the real cost of subsidies and emphasize that someone is paying that cost
- Propose possible improvements to make subsidy policy clearer, more transparent and more effective

Responsible/lead: regulator
Possible actors: private operator, regulator, Stakeholder Committee, Poverty Advisory Group, NGOs

Customer focus
Results orientation

4.15 Introduce a system for continuous improvement in performance

- The system should include all items regularly covered by periodical customer satisfaction surveys:
  - Visual appearance of drinking water
  - Taste of drinking water
  - Interruptions in the supply of drinking water
  - Response time to customer complaints
  - Low pressure at drinking water taps
  - Flooding from sewers
  - Blockages in sewers
  - Smells from sewers
  - Inadequate communal facilities (fountains or latrines)
- Introduce a benchmarking system: Systematically compare performance not only against targets but also against that of other utilities

[Tool]
worldbank benchmarking network:
www.IB-Net.org

Responsible/lead: regulator
Possible actors: private operator, regulator

Results orientation
Power-balanced partnership

4.16 Define procedures for dealing with customer complaints

Clear and transparent procedures for dealing with customer complaints help to highlight the rights of consumers

- Complaints should be addressed to the private operator:
  - The private operator must establish methods/procedures for accepting, processing, and solving customer problems and set time frames for finding solutions commensurate with the nature of the problem (see also GL note 4.06 above)
  - The regulator approves the proposed system regarding criteria defined in the contract
- If the private operator does not respond to a complaint satisfactorily, the customer must have other options for presenting his/her case. These options may include:
  - The regulator: domestic consumers must have easy access to the regulator to lodge complaints
  - An independent ombudsman or a customer dispute mediation board, appointed by the local government, consisting of local wise men (see also GL note 1.24 above): again, this must be easily accessible to poor and illiterate customers (Both the board and/or the ombudsman must be established by the government and be anchored in the regulatory framework). It has to take decisions quickly
  - The courts

Responsible/lead: regulator
Possible actors: regulator, private operator, Customer Dispute Mediation Board

Poverty responsiveness
Transparency
Accountability

4.17 Establish direct contacts with customers

Regulators need to seek ways of gathering the opinions and experience of domestic consumers, especially the poor. They should therefore:

- Participate in Stakeholder Committee meetings and other community meetings and focus groups
- Conduct regular customer surveys

Responsible/lead: regulator
Possible actors: regulator, Stakeholder Committee

Results orientation

4.18 Carry out a review of the project(s)

Inspect the assets regularly to establish whether they are in the condition stipulated in the contract, and whether the defined benefits, as well as the customer service criteria, have been fulfilled:

- Involve the Stakeholder Committee to comment on whether the expectations have been met
- Whenever it is agreed that the services have fallen short of the targets in the contract, establish whether this is the result of construction or operational failures
  - If construction failures are causing problems, they should be remedied under the terms of the original contract
  - Where there are operational problems, targets should be set for improving any aspect of the provision of water services that is failing to meet standards or customer expectations
  - If the problems are not remedied, the regulator should impose penalties in line with the terms of the contract

- If the failure is due to:
  - The contractor or operator, fines or penalties should be imposed.
  - Other factors such as population growth, further investment may be required. In these circumstances, the regulator should agree with the operating authority on an appropriate investment program designed to overcome the problems
  - Impact of acts or omissions by the public party or the regulator on insufficient performance, e.g. failure of public party to invest or refusal of appropriate tariff increases, these parties bear responsibility for the deviation from targets
  - Insufficient stakeholder cooperation, the regulator should require the operating authority to liaise with stakeholders to achieve the cooperation required for success
- Where there are conflicting views as to the causes of failure or the achievement of asset conditions, arbitration procedures may need to be introduced according the defined regulation procedures (see GL note 5.02 below) or renegotiation of contract may follow

Responsible/lead: regulator
Possible actors: local government, private operator, regulator, Stakeholder Committee

Transparency
Accountability

4.19 Publish outcome of regulation process

- Inform stakeholders using the established communication systems (see GL note 1.26 above), about:
  - All failures to meet standards and about any fines or penalties imposed, as well as positive outcomes of the regulation procedures
  - All licenses and consents that have been issued by the regulator. In some circumstances, commercial confidentiality may legitimately prevent full disclosure of details on industrial-effluent permits
  - Issue regular (annual) reports on compliance with regulatory standards and achievement of customer satisfaction
- Coordinate information activities of the public and private party (see GL note 4.31 below)

Responsible/lead: regulator
Possible actors: regulator

Guideline Notes for the Support Processes in the Operation and Monitoring Phase

Accountability

4.20 [stake] Set up a business unit within the private service provider responsible for social and environmental issues

This group will assume responsibility for forging relationships with key people and institutions within target communities as well as cooperating with the Stakeholder Committee (see GL note 1.18 above):

- A start-up team should be established within the private water utility and assigned the role of promoting and facilitating the process for defining jointly with the Stakeholder Committee the system of communication between stakeholders and the utility

- Appoint a Community Liaison Officer (must speak local language, possibly resident)
- For challenging tasks demanding special know-how and skills, include professionals (e.g. sociologists)

Responsible/lead: private operator
Possible actors: private operator, Stakeholder Committee

Power-balanced partnership
Accountability

4.21 [stake] Continue regular communications with stakeholder groups

Make use of the established Stakeholder Committee (see GL notes 1.17 to 1.19 above) to keep the partnership alive. If necessary, hold meetings during construction, including site visits:

- Public and private parties and the regulator should engage in a regular dialogue (see also GL note 4.31 below) aimed at continuous improvement in performance
- Use the regular meetings as 'early warning systems':
  - Seek to understand in advance the actions of customers, e.g. why they might fail to make connections to systems
  - Use the meetings as a forum for investigating any other dissatisfactions stakeholders might have with the facilities or the way they are being operated

Responsible/lead: private operator
Possible actors: Stakeholder Committee, private operator, local government

Accountability
Results orientation

4.22 [stake] Evaluate the adequacy of stakeholder cooperation

If participatory approaches are followed as advised in these guidelines, monitor their effectiveness and adequacy. An independent group should be contracted to carry out a performance assessment and to report to the regulator:

- Measure stakeholder cooperation against agreed participation levels (see GL notes 1.19, 1.18 above)
- Has stakeholder cooperation contributed to more effective solutions or has it just slowed down or even hampered the process?
- If necessary, propose, negotiate, and introduce modifications to the stakeholder cooperation structure and procedure

Responsible/lead: private operator
Possible actors: Stakeholder Committee (poverty and tariff group), private operator, local government, regulator

4.23 [stake] Initiate discussion on tariff changes

Once the contract has been tendered and awarded, this means that the desired SLAs over the contract duration have been decided. Periodic tariff adjustment should depend on a well-defined mechanism (see GL note 2.12 above) and should not be matter of public discussion.
Nevertheless, since tariffs are a sensitive issue and often subject to change (see GL note 4.04 and 4.13 above), ongoing communication on the tariff structure with Stakeholder Committee is important.

- Make operating statistics and reports relevant to financial and technical arrangements in favor of the poor available to stakeholders in a form that is readily understandable to a layman
- Inform the Stakeholder Committee on any proposed changes to:
  - Tariffs
  - Other customer charges
  - Compensation of the private party
- The final decision over tariffs and charges remains with the regulator

Responsible/lead: regulator
Possible actors: stakeholder Committee, private operator, regulator

Accountability
Transparency
Results orientation

4.24 [stake] Consider a public performance assessment (PPA) initiative

[Best practice]
PPA Project in Manila

A public performance assessment (PPA) can be used to create reliable public reports on service performance and to build a basis for discussion on improvements in the broader context of municipal/urban development:

- Use it as a 'partnership tool' not as an additional external audit
- The assessment should include:
  - Data from the private service provider
  - Consumers' perception of service from surveys
  - Public health data (if available at sector/district level of the municipality)
- Cover by location:
  - Network (quality, interruptions, pressure, breakage, leakage)
  - Water quality (taste, smell, coliform/chlorine content)
  - Service response (percentage of complaints, speed of response speed of resolution, effectiveness of resolution)
  - Coverage
- Prepare the data by sector/district of the municipality
- Organize PPA through the regulator or hire an independent project team to establish the PPA system and process
- Alternatively, if this is agreed with the Stakeholder Committee (see GL note 2.01 above), the Stakeholder Committees' TA provider may also monitor contract management during the Operation Phase, reporting to the community through town hall meetings and independent reports.
- Compare outcome with other utilities (benchmarking)

Responsible/lead: regulator
Possible actors: regulator, local government, private operator, Stakeholder Committee, consultants

Transparency
Customer focus

4.25 [stake] Discuss effectiveness of the regulation process

Request that the Stakeholder Committee comments on issues like:

- Inadequate documentation or possible failure to comply with the financial, institutional or technical arrangements in favor of the poor
- Modifications of monitoring requirements made by the regulator
- Nevertheless, final decision will always remain with the regulator

Responsible/lead: Regulator
Possible actors: Regulator, Stakeholder Committee

Results orientation
Transparency
Power-balanced Partnership

4.26 [cap] Set up a knowledge management system

Water utilities and other institutions concerned with water are typically engaged in ongoing long-term operations, but often do not properly manage the knowledge and information processes that are essential to their performance and success and that enable the organization to take advantage of new opportunities in its future operations and to manage uncertainty:

- Establish knowledge management including an inbuilt monitoring and learning cycle covering all aspects (technical, social, institutional, economical, environment, rules & regulations)
- Assure that know-how remains within the utility/institution and is available independent of key persons
- Establish a clear direction and purpose for strategic information collection
- Employ modern knowledge management tools to handle at least the explicit knowledge available within your systems and organizations (manuals, job, and process descriptions, etc.)
- Tap the tacit knowledge of your experienced staff and make it available to others

Responsible/lead: operator
Possible actors: local government, private operator, regulator

Customer focus

4.27 [cap] Educate water users

- Extension programs are carried out during the Operation Phase and should be accompanied by information and education programs on the following topics delivered shortly before connections become available:
  - Basic hygiene
  - Water use efficiency (demand-side management)
- It is often useful to ask prominent individuals in a community to nominate people to supervise the use of communal facilities and advise on:
  - Behavior
  - New technology
  - Economic incentives for conservation

Responsible/lead: operator
Possible actors: local government, private operator, regulator, facilitators

Results orientation
Customer focus

4.28 [cap] Train local contractors or local staff

Carry out training sessions according to the tasks and local needs:

- Train laborers and contractors on (statutory) safety regulations and specific safety measures
- Local laborers and local contractors might need training in hygiene practices to be adopted during construction and operation. This includes:
  - Keeping tools clean (including sterilization of specialized tools),
  - Ensuring that tools used on drinking water facilities are not used on sanitation facilities
  - Respecting hygiene rules when staff switches from working in drinking water facilities to working in sanitation facilities
- Local small-scale providers that continue to operate as part of the new

water services regime also need to be educated in hygiene matters (see above)
- Local staff of the utility operating water supply and sanitation facilities need to be fully trained and ready to take over maintenance and operation roles should a foreign contractor leave the project

Responsible/lead: operator
Possible actors: customers, private operator, regulator

Poverty responsiveness
Power-balanced partnership

4.29 [cap] Train communities if appropriate

Communities will probably need training at various levels and on various issues:

- Organize community education and training initiatives to enable communities to manage their own small extensions and domestic installations on the 'last mile':
  - Labor (e.g. plumbing, small business development)
  - Operation and maintenance (accounting, community management)
- The 'legal literacy' of consumers tends to be low and they are often unaware of their rights when they enter into contracts:
  - Community groups should be given training on legal rights, contractual obligations, grievance procedures, etc.
  - Consumer groups will need training on how regulatory processes work, and how they can interact with these processes
  - Continue to build capacity of consumer groups. This will be especially important in urban environments where populations are highly transient. Look for evidence that such groups are contributing to a stronger civil society (i.e. they are playing a positive role in urban development above and beyond the water sector)
- Any training activity can be used to:
  - Build awareness of the real cost of water supply and sanitation service delivery
  - Promote understanding of utility supplies as something that is of universal benefit to communities
  - Reinforce awareness of the importance of hygiene and sanitation
- These training activities should be financed preferably within the framework of ODA arrangements. If they are to be paid for by the private operator, the cost must be allowed for in the tariff

Responsible/lead: regulator,
Possible actors: customers, private operator, regulator, facilitators, consultants

Customer focus

4.30 [comm] Communicate consumer rights and obligations

- Inform consumers and stakeholders clearly and transparently about the tariff system and their rights and obligations in all processes within that system
- Inform the public about the possibility of submitting complaints regarding failure to meet agreed performance targets to the operator's complaints department, or, in the case of prolonged or severe noncompliance, to the competent regulatory authority's consumer rights department

- Explain the roles of the regulators and their power actively to all stakeholders

Responsible/lead: regulator,
Possible actors: customers, private operator, regulator, facilitators, consultants

Accountability
Transparency
Results orientation

4.31 [comm] Maintain a continuous information flow

Citizens hold their local government responsible for providing safe drinking water supply and sanitation services. Local government can never relinquish this responsibility entirely. It is therefore important to ensure that the public is kept informed (see also GL note 1.26 above):

- The public party should provide overall oversight for the Operation Phase
- The private party's tasks:
  - Fulfill contractual information obligations (i.e. information on planned and unplanned service interruptions)
  - Inform about the status of implementation and construction work and update potential customers on any anticipated changes in connection date (see GL note 4.10 above)
  - Proactive information policies on services, water quality, challenges, general water issues, etc.
- It is the task of the regulator to inform stakeholders about the contractor's financial performance. This should include:
  - Performance against budget
  - Agreed additional work
  - Changes in rates for work
- Wherever possible, do not let difficulties or obstacles – whether technical, financial or political – prevent you from communicating effectively. This might cause significant reputation damage and spark rumors about the project's viability.

Responsible/Lead: local government, private operator
Possible actors: local government, private operator

Renewal and Termination

Main Process
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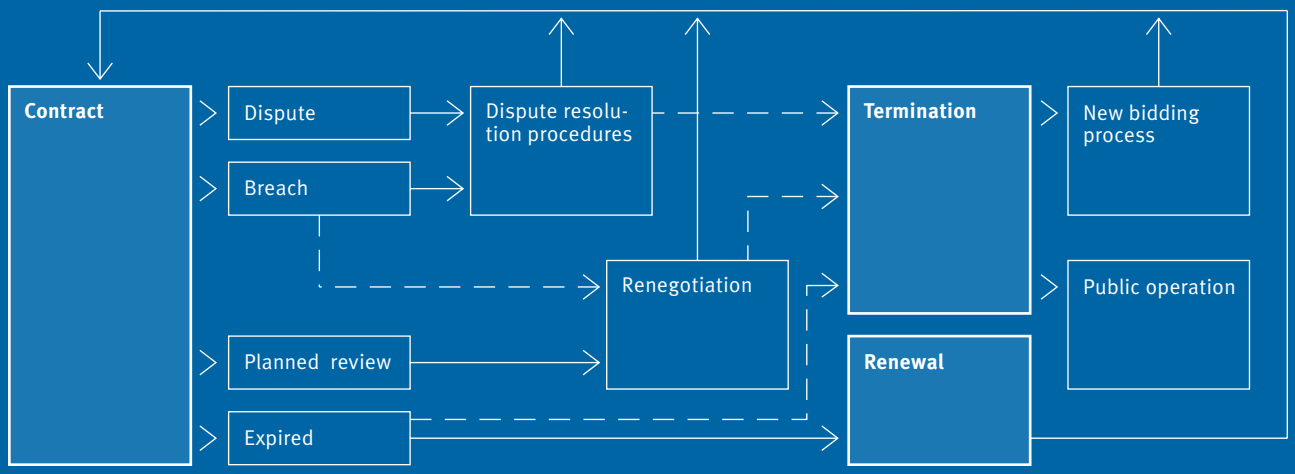

Figure 7: Contract dispute scenarios, review and termination

Tasks and challenges during Renewal

A contract may be terminated simply because the contract period has expired or because a given event causes it to be broken off prematurely. Termination rules covering both types of scenario must be defined in the contract.

Main tasks:

- **Service delivery:** ensure service continuity
- **Transfer of assets:** check condition of assets and facilities according to contract definitions (if responsibility for assets is part of the contract, e.g. concession, lease)

Main challenges:

- In the case of normal contract termination
  - **Continuity:** transfer to the new operator without service interruption
  - **Fairness:** current private operator and local government should not lose funds
- In the case of premature termination
  - **Continuity:** maintain service to consumers without interruption
  - **Fairness:** fair and transparent conflict management and settlement

Guideline Notes for the Termination Phase

Guideline Notes for the Main Process in the Termination Phase

Shared incentives

5.01 Hand over after contract completion

- Upon completion of the contract, the operator's successor (whether public or private) assumes operational responsibility
- Trial periods (under running contract) where local labor and new operator run the facilities whilst being overseen by the leaving contractor should be completed to identify any potential weaknesses. Agreement must be reached on whether the leaving contractor is required to eliminate the weaknesses
- Pay due attention:
  - To common difficulties in transfer of personnel, information, and tools developed by the private operator (for example information technologies applications)
  - To ensure that manuals, process descriptions, etc. are written down and can be used
- The hand-over conditions should be clearly set out in the contract

Responsible/lead: regulator
Possible actors: regulator, operator, Stakeholder Committee

Accountability
Proactive risk management
Transparency
Results orientation

5.02 Follow defined arbitration procedures in conflicts between contracting parties

Serious conflicts may arise at any time during the contract period and in the context of contract termination.

- The entities responsible for arbitration, according to severity of dispute, need be defined in the contract. These may include:
  - Regulators
  - Dispute commission with legal, technical and financial expertise, appointed in accordance with agreed rules (see GL note 2.20 above)
  - Specialized arbitration organizations (e.g. the Environment Council)
  - Arbitrators appointed by professional bodies (e.g. professional accountancy or engineering professional institutions) usually designated in the contract documents
- Measures to be taken in the event of inappropriate performance must be predetermined in the contract (see GL note 3.06 above). An arbitration and correction mechanism must be triggered when such performance deficits are detected
- All parties should participate in mediation, binding arbitration, or other administrative conflict resolution procedures specified in the contract
- The public party and the private party need to clearly lay out the nature of the dispute and release any information on the history of noncompliance by either party

- Inform the public about the arbitration process

Responsible/lead: regulator
Possible actors: local government, private operator

Results orientation

5.03 Conduct renegotiations equitably

Long-term contracts are not written in stone. They require monitoring, adjustments, and sometimes renegotiation to keep them viable over the entire contract life cycle:

[Further reading]
WB2003: Price caps, efficiency payoffs, and infrastructure renegotiation in Latin America

- Choose not too long a period of time between renegotiations in order to make the contract more flexible
- Define criteria which trigger non-scheduled renegotiations
- Handle any proposed renegotiation in contract terms as if it were a planning proposal in Phase 2 of this process. External assistance may be useful as expert or as process facilitator

Responsible/lead: Local government
Possible actors: Private operator, local government, regulator

Guideline Notes for the Regulation Process in the Termination Phase

Results orientation

5.04 Take precautions

Take measures to assure continuous service in the event of unexpected contract termination:

- Establish a fund financed by the public and private party (details must be laid down in the contract)
- In order to ensure continuity of services to customers in the event of unexpected contract termination, consider appointing an administrator before the private operator contract comes to an end. This administrator should be paid from revenues

Responsible/lead: regulator
Possible actors: private operator, local government, regulator

Transparency
Accountability
Results orientation

5.05 Qualify the infractions leading to breach of contract

The infraction can be reported by the regulator alone, or be the result of a formal complaint. An infraction may be minor or serious:

- The regulator qualifies the infractions in advance based on the relevant contract clauses (see GL note 3.06, 3.07 above), e.g.:
  - Private operator fails to provide an emergency service when water provision is interrupted for a long period of time. (Possible qualification: serious if a large area is affected.)
  - Unanticipated interruption of water service. (Possible qualification: serious if service is interrupted for a long time.)
  - The private operator fails to report scheduled service interruptions. (Possible qualification: serious if a large area is affected.)
  - The private operator fails to meet its contractual obligations to report to the regulator or to inform customers

  - The private operator fails to meet agreed customer service standards (see GL note 4.06 above)
  - The private party discharges treated water that fails to meet quality standards
  - The private party supplies drinking water that does not meet quality standards
  - The private operator changes tariffs without obtaining the regulator's permission; misappropriation of goods or funds; misuse or retention of the regulation fee
  - The private operator fails to fulfill the specific tasks outlined in the contract
  - If the private operator commits three serious infractions in a defined period of time, this counts as a breach of contract
- The regulator also qualifies whether the public party complies with its contractual obligations and payments
- Consequences of termination by or due to the public party and by or due to private party are described in GL note 3.06 and 3.07 above

Responsible/lead: regulator
Possible actors: regulator, Stakeholder Committee

Transparency

5.06 Keep full transparency

Situations of renegotiation and (premature) contract termination or renewal are as sensitive situations as are the preparation and planning Phases.

- Ensure that:
  - All aspects of a dispute are made public,
  - The community is consulted during renegotiations.
- When developing an exit strategy:
  - The regulator needs to ensure transparency in all negotiations and in the final outcome and ensure that there is a smooth transition to another operator
  - Avoid regulatory capture by politicians, the operator or the public when developing exit strategy
- Continue to produce annual reports which include details of:
  - Compliance with regulations
  - Achievement of customer service criteria
  - Fines and penalties imposed

Responsible/lead: regulator
Possible actors: regulator

Results orientation

5.07 Initiate new bidding process

Decide whether to launch a new bidding process in cooperation with the current private operator:

- The current private operator may participate in the bidding process for the new PPP provided there has been no breach of contract
  - If the current private operator is not selected in the bidding process but has invested in the services, it should receive the value of these investments as defined in the accounts. If either the private operator or the local government refuses to accept this value, a technical

auditor, previously accepted by both sides, should be called upon to decide. If the issue still cannot be resolved, both parties may settle the matter in a court
- Handle the new bidding process as in Phases 1–3 of this process

Responsible/lead: regulator
Possible actors: local government, private operator

Guideline Notes for the Support Processes in the Termination Phase

Power-balanced partnership
Transparency

5.08 [stake] Keep the stakeholder network alive

- Upon completion of a project and after satisfactory commissioning of all installations, the stakeholder network can be reduced to stakeholder meetings concerning customer service and routine meetings with neighboring communities and countries which could be affected by the operation of the facilities
- Keep stakeholders informed about all actions taken during this Phase

Responsible/lead: local government
Possible actors: private operator, local government, Stakeholder Committee

Transparency

5.09 [stake] Involve stakeholders in exit strategy evaluation

- If the contract is being renegotiated or is in dispute, the public and all stakeholders should be kept informed about the nature of the contract dispute, and the history of contract management
- In the case of contract renegotiation due to unanticipated causes, public discussion through the Stakeholder Committee on water tariffs could be necessary in terms of desired SLAs vs. acceptable tariff
- Stakeholder Committee should also be consulted to come to an effective exit strategy that will not disrupt service but will ensure a smooth transition

Responsible/lead: local government
Possible actors: local government, Stakeholder Committee

Annex

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Glossary

Preliminary remark: For many terms listed below there is more than one definition available. This glossary indicates in which sense such terms are to be understood in the present instruments. Wherever possible, the source of definition is given in brackets.

Basic Need
Minimum amount of a public service that society would like to provide to everyone. (ADB)

Basic Water Supply and Sanitation
Water supply and sanitation services which are based on relatively simple technologies, often managed either directly by families or by a water committee at community level. In the majority of the cases, expenses are covered by the payment of user charges.

Capacity Building (individuals, organizations, institutions)
The process by which (i) individuals and groups develop the skills, knowledge and competence to perform functions, solve problems and achieve objectives more effectively and efficiently, (ii) an organization or a system of organizations is strengthened to serve a specific existing or new purpose and role, and (iii) the institutional framework (laws, attitudes rules, norms) is created, reformed, developed, and/or strengthened. (OPM)

Charge
Total amount a customer pays for the service consumed. (ADB)

Commercial Water and Sanitation Service Providers
Public or private sector water and sanitation service providers operating under commercial terms, seeking an adequate return on their investments.

Concession
A contractual arrangement whereby a private company acquires the right to provide a service at a given standard or specification, for a fixed time, usually on behalf of the government or a government agency. The private company operates and manages the system, usually makes the necessary investments, and carries the commercial risks for the agreed concessionary period, usually of around 25–30 years. This allows the contractor to recoup expended capital. The role of the government in concession contracts is predominantly regulatory and as the owner of the assets.

Connection
On-grid provision of water and/or sanitation services to a user (customer) on commercial terms in a piped system. The connection itself is normally compensated through the payment of a connection fee. Water consumption is usually metered, and afterwards billed to the customer on the basis of a water tariff.

Contingent Valuation Method (CVM)
A direct method of nonmarket valuation in which consumers are asked directly their willingness to pay for a specific quantity or quality of goods or services such as water supply.

Contracting Party
An actor who has concluded a PPP contract with one or more other actors and is bound by the terms of that contract.

Cost-Benefit Analysis (CBA)
CBA provides a mean for systematically comparing the value of outcomes with the value of resources achieving the outcomes required. It measures the economic efficiency of the proposed technology or project. When there are many options to consider during a decision-making task, it is useful to evaluate the options with a common metric. CBA refers to any type of structured method for evaluating decision options.

Decentralization
The transfer of authority and responsibility for public functions from the central government to intermediate and local governments or quasi-independent government organizations and/or the private sector.

Deliberative Process
See Integrated Deliberative Decision Process (IDDP).

Force Majeure
An event or effect that cannot be reasonably anticipated or controlled.

Independent Providers in the Water and Sanitation Sector (or Small-Scale Providers)
Small scale enterprises, often of the informal sector, providing goods and services for the water and sanitation sector. Examples are: water sellers, producers of latrine components, hand pumps, cement rings, private drillers.

Indexation
Adjustment of price levels in accordance with movements of economic indicators, primarily related to inflation or deflation rates in the economy in question.

Informal Sector
The informal sector consists of persons engaged in the production of goods and services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate on a low level of organization, with little or no division between labor and capital as factors of production and on a small scale. The informal sector includes, first, unregistered commercial enterprises, and second, all noncommercial enterprises that have no formal structure in terms of organization and operation (ILO). In African cities, the informal sector accounts for 40 to 80% of all employment.

Integrated Deliberative Decision Process (IDDP)
A deliberative decision process consisting of one or more debates with different participants' representations, based on social

robust information and knowledge; taking explicitly into account in its design and conduct the presence of multiple values and being embedded in an inclusive and discursive governance framework (institutional, regulatory, social). (Advisor project)

Integrated Water Resources Management (IWRM)
A concept to deliver a required quantity of water with an admissible quality to the required place in the specified time using organizational and technological frameworks and other resources in a sustainable manner. A system that bases on accounting all potential water sources, on hydrographic methods, and rational water resource use, coordinating intersectoral interests and all levels of water use hierarchy, widely involving all water users. It ensures ecological security and sustainable water supply to society and nature. (IWMI)

Lease Contract
A lease contract is a written agreement between the public owner of a facility/property and an operator that stipulates the conditions under which the operator may possess the facility/property for a specified period of time and amount of rent. Under a lease contract the private firm operates and maintains the assets at its own commercial risk, providing services to the customers and deriving revenue directly from tariffs. In contrast to the concession contract, the private operator does not invest in infrastructure, and hence only receives the parts of the revenue which cover operation and maintenance cost. Investment costs are borne by the public partner. The usual duration of a lease contract is 6–10 years.

Management Contract
Contractual arrangement in which management, operation, and maintenance of the public infrastructure are contracted to the private sector; but in which ownership, capital investments, and commercial risks remain with the public sector, typically with a duration of around 5 years. There is usually a performance-based component in the remuneration for the private operator. This is therefore a medium-risk contract but with greater responsibility of the private company than a service contract.

Monitoring
The measurement of information on the implementation progress of a project, program, or policy and the achievement of its objectives. There is a distinction between implementation monitoring, which concerns progress in undertaking activities, completing the work plan and utilizing the budget; and results monitoring, which concerns the measurement of results and the attainment of the project purpose. (OPM)

Normal Profit
Profit required to induce the owners of an enterprise to keep it in operation indefinitely. (ADB)

Operation and Maintenance Costs
Costs necessary to operate the water supply and/or sanitation system, and to maintain the existing infrastructure, including rents, payments to the regulator, duties, and taxes, etc.

Key Stakeholders
Actors directly involved in the Public-Private Partnership. It includes the contracting parties, other government agencies, major sector organizations, donors, financing institutions and facilitators but excludes loosely associated or consulted stakeholders with no active role in the PPP.

Partnership
In general: Individuals and/or organizations that collaborate to achieve mutually agreed upon objectives. The concept of partnership connotes shared goals, common responsibility for outcomes, distinct accountability and reciprocal obligations. Partners may include governments, civil society, non-governmental organizations, professional and business associations, multilateral organizations, private companies, etc. (OECD)

Private Sector
A commercial organization of any scale that is self-financing and operating on profit. Comprises all formal and informal businesses.

Pro-Poor
Focusing activities on the low-income segment of the society, which often has inadequate access to water services of sufficient quality and at affordable price. Pro-poor implies that the overall aim is beneficial towards the poor, while poverty focused implies a greater degree of targeting.

PPP Contract
A legally binding agreement concluded between two or more actors under the applicable legislation with the aim of developing and implementing a PPP for water and sanitation services.

Facilitator / PPP Facilitator
An entity involved in the facilitation of a PPP contract, in assisting in the negotiation, establishment and implementation of PPPs, and in the mediation of disputes. This term includes financing institutions and development agencies if they act in a facilitating role between the contracting parties.

Public Sector
International, regional, national and/or local (municipal) authorities; in the context of this document in particular authorities entrusted with policy and law making, regulation and financing in water-related fields.

Public Service
Output of a public utility. The paper refers to all such output as a "public service", or simply a "service", even though the paper is meant to apply also to outputs that are perhaps better described as goods rather than services. "Public good" has a specific, technical meaning in economics, not necessarily associated with public utilities. (ADB)

Public Utility
Privately or publicly owned enterprise that has a legal monopoly over the supply of a good or service. A public authority usually regulates the operations of a privately owned public utility. (ADB)

Public-Private Partnership (PPP)
Agreement between the public sector and a private sector entity, whereby both parties share risks, responsibility and in some cases investment. PPP arrangements typically involve a government agency contracting with a private partner to renovate, construct, operate, maintain and/or manage a facility or system, in whole or in part, that provides a public service. PPP differs from PSP in that the private sector has a greater responsibility with regard to service provision. (WEDC, USGAO)
In the present documents PPP always refers to contract-based Public-Private Partnerships in water and sanitation services.

Regulator / Regulatory Authority
A public and/or independent institution or institutions, monitoring and observing operations and behavior of the operators with a

particular focus on its compliance with the PPP contract. It also monitors tariffs and services, manages reset processes and arbitrates disputes between consumers and the service providers.

Regulatory Capture
This is an economic term describing a situation where one operator (or group of operators) in the market uses its influence or resources to extract a regulatory decision, or lack of decision, for their own benefit rather than the benefit of society as a whole. It is associated with patterns of behavior on the part of a regulatory body in one, or a combination, of the following situations:

- the regulatory body is tending to further producer interests over consumer interests,
- the regulatory body has become overly protective towards the regulated entities,
- the regulatory body is tending to adopt objectives that are very close to those of the entities it is supposed to regulate.

Revenue Target
Revenue required from a tariff to provide funds to sustain the utility. (ADB)

Sanitation (Environmental Sanitation)
Interventions to reduce people's exposure to disease by providing a clean environment in which to live, with measures to break the cycle of disease (WHO). This usually includes disposal and treatment of human excreta, solid waste and wastewater treatment and disposal, hygienic management, control of disease vectors, and provision of washing facilities for personal and domestic hygiene. In the context of this document solid waste treatment and disposal is not included under the term Sanitation.

Service Providers in the Water and Sanitation Sector
Organizations (profit, non-profit; government, municipal, private firms), officially registered and recognized to provide water and sanitation services in a defined area.

Small Towns
Small towns are settlements that are sufficiently large and dense to benefit from the economies of scale offered by piped systems, but too small and dispersed to be efficiently managed by a conventional urban water utility. They require formal management arrangements, a legal basis for ownership and management, and the ability to expand to meet the growing demand for water. Small towns usually have populations between 5,000 and 50,000 but can be larger or smaller. (The Small Towns Water and Sanitation Electronic Conference)

Stakeholder Participation
Stakeholder participation means that those affected by decision-making processes are able to make their voices heard in these processes. This requires consultation in decision-making and articulation of interests within the decision-making process either through direct participation or through representatives who are effectively accountable to those they represent.

Stakeholders
Agencies, organizations, groups or individuals who have a direct or indirect interest in or who are affected by a project, program or development intervention, e.g. national and local governments, municipalities, residents, water users, politicians, service providers, suppliers and contractors.

Subsidies
Contributions to the costs of an enterprise from other sources, (governmental or non-governmental) external to the particular purpose for which these costs are incurred.

Sustainable Development / Sustainability
Development which meets the needs of the present without compromising the ability of future generations to meet their own needs. (Brundtland Report). While there is no universally accepted interpretation of this term, it is usually seen as having three dimensions:

- Economic
- Social
- Environmental (UNDP).

Tariff
General schedule of charges that a customer faces in using a public service. The term "tariff" can also refer to a tax on imports, but this paper uses "tariff" only to refer to the schedule of charges for a public service. (ADB)

Transaction Costs
The time, effort, and money necessary to implement a PSP project, including such things as process consulting, capacity building with governments, adaptation of legal frameworks, multi-stakeholder processes, etc., including the costs for the contracting process and the costs for establishing the financing arrangements.

User Groups
User groups are defined on the basis of the type of water user, average water consumption and with specific tariff structures. Examples are: (a) households in residential areas, (b) residents in apartment blocks, (c) commercial users, (d) industrial users, (e) municipal water use.

Value for Money (VfM)
VfM is the optimum combination of whole life cost and quality (or fitness for purpose) to meet the user's requirement, and does not always mean choosing the lowest cost bid.

Water Governance
Water governance refers to the range of political, organizational and administrative processes through which communities articulate their interests, their input is absorbed, decisions are made and implemented, and decision makers are held accountable in the development and management of water resources and delivery of water services. (Bakker, 2003)

Water Operators
Public or private water service operators, formal or informal.

Water Supply System
System for the collection, transmission, treatment, storage and distribution of water from source to consumers, e.g. homes, commercial establishments, industry, irrigation facilities and public agencies.

Water Use
In the context of this document, the term water use is restricted to domestic, commercial, industrial and municipal water uses. It includes the production of wastewater.

Water User (Groups)
An individual or group of individuals requiring access to water at a specific place and on a regular basis. Water-user groups imply some sort of aggregation of several users into a group which shares interests and responsibilities regarding water services.

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These documents are intended to evolve as “living documents”. New findings and concepts, future experience and lessons learnt from other sectors will be assimilated. The website www.partnershipsforwater.net will also feature the latest version of all available documents and the ToolContainer. We are curious to hear your experience from working with the instruments and look forward to reading your feedback at feedback@partnershipsforwater.net.

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