

IMPLEMENTATION REPORT

Road to the 10th World Water Forum 2024
Sustainable Water Finance Subtheme

Workshop 2: **Blended Finance for Water Sector**

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Authors acknowledge that this document serves solely as an event implementation report, summarizing the proceedings and outcomes of the event. The information and insights presented herein are derived from the contributions and knowledge shared by the respective speakers during the event.

FOREWORD



Herry Trisaputra Zuna

Director General for Public Works and
Housing Infrastructure Financing,
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Water is the core aspect of our planet. It is fundamental to human survival and integral to ecosystems and economies. Yet, the challenges we face in managing this major resource are immense. Climate change, population growth, urbanization, and pollution are exerting unprecedented pressures on our water systems, making sustainable water management more urgent than ever.

As the world prepares for the 10th World Water Forum in Bali, the theme of sustainable water finance emerges as a critical cornerstone for our discussions. It is both an honor and a privilege to contribute to this dialogue, which is valuable for the future of our global water resources.

The journey to Bali is not just a path to a prestigious forum, it is a call to action to create robust financial frameworks that ensure the long-term availability and quality of water by integrating economic, environmental, and social considerations into water policies and projects. This approach is essential for achieving the Sustainable Development Goals (SDGs) 6, which aims to ensure the availability and sustainable management of water and sanitation for all.

As the co-coordinator of the Sustainable Water Finance subtheme, Directorate General of Infrastructure Financing for Public Works and Housing is honored to host distinguished speakers and stakeholders to the workshop series held in 4 consecutive themes to the innovative solutions, collaborative efforts, and, critically, sustainable financing mechanisms that can turn ideas into reality.

As we progress towards the 10th World Water Forum in Bali, let us be guided by a shared commitment to sustainable water management and the recognition that our collective future depends on the decisions we make today. Together, we can create a future where water is managed sustainably, equitably, and with resilience.

Introduction

Indonesia was the elected host of the 10th World Water Forum in 2024. The forum held on 18–25 May 2024 in Bali with the main theme of “Water for Shared Prosperity” to answer global challenges and potentials caused by increasing population growth and urbanization. Leading up to the main event, there are three interconnected forum processes, namely political process, regional process, and thematic process. Every forum process has its own agenda and throughout the thematic process, all multi-stakeholders will develop action plans and facilitate the implementation of action plans to address issues identified associated with several sub-themes. Six subthemes were introduced to enhance the discussion in the thematic process. Those are Water Security and Prosperity, Water for Humans and Nature, Disaster Risk Reduction and Management, Governance, Cooperation and Hydro-diplomacy, Sustainable Water Finance, and Knowledge and Innovation.

In the thematic process of the Sustainable Water Finance subtheme, five topics to be further explored:

- 1)** Revisiting of international water financing architecture (including new economic approaches) with emphasis on transparency, accountability, fairness & equity;
- 2)** Innovative and sustainable funding, financing, and delivery mechanisms; Improved funding for basic access to safe water and sanitation for all at all scales;
- 4)** Special schemes and incentives promoting green finance; and
- 5)** Enhanced funding to cope with water crises, water disasters and for climate resilience.

Directorate General of Infrastructure Financing for Public Works and Housing as the coordinator of Sustainable Water Finance subtheme is hosting a series of workshop as part of the side event of the Sustainable Water Finance subtheme, inviting distinguished speakers and stakeholders. The workshop series covers problem mapping, setting up a working group including expert panel and funding solution. The workshop series event consists of 4 workshops with 4 different topics that took place from February 2023 to February 2024. The 1st Workshop was held in February 2023 entitled “Government Support and Private Sectors’ Perspective on Public-Private Partnership (PPP) for Water Resources Infrastructure”, the 2nd Workshop was held in March 2023 entitled “Blended Finance for Water Sector”, the 3rd Workshop was held on July 4th 2023 entitled “Secure and Increase Funding for Basic Access to Safe Water and Sanitation for All at All Scales”, and the 4th and final workshop was held on February 5th 2024 entitled covers the topic of “Designing Global Water Fund Establishment”.

This series of events will be summarized in 4 implementation reports each of which will highlight a specific theme and the corresponding discussions. The output of each seminar/workshop will be catalyzed as an input for the sessions of Sustainable Water Finance subtheme in the main event of World Water Forum 2024.



2023

Seminar 1

Topic: Government Support and Private Sectors' Perspective on Public Private Partnership for Water Resources Infrastructure

Feb

Mar

Workshop 2

Topic: Blended Finance for Water Sector

Workshop 3

Secure and Increase Funding for Basic Access to Safe Water and Sanitation for All at All Scales

Jul

2024

Jan

Workshop 4

Designing Global Water Fund Establishment



May

Figure 1. Sustainable Water Finance Subtheme Seminar/Workshop Series Timeline

Source: DGIF, 2024

Executive Summary

The 2nd Workshop discussed the risk allocation and lessons learned or case studies from national and international experiences of the Blended Finance for water resources investment. The workshop is attended by 207 participants from Ministries, International Organizations, State Owned Enterprises, Banks, Financing Agencies, Consultants, and Academics. The event comprises 2 sessions: a panel dialogue and a breakout session.

The Panel Dialogue covered the following topics:

- 1) Concept and implementation of a blended finance scheme;
- 2) Exploration of best practices in the application of blended finance schemes from various countries;
- 3) Risk management in the application of a blended finance scheme; and
- 4) Water management in the application of the blended finance scheme.

During the breakout session, three sub-topics were discussed: **the Blended Finance concept, Risk Management on Blended Finance for the Water Sector, and Water governance on blended finance practice.**

Key takeaways from the breakout session are:

- 1) Blended finance integrates funding from various sources to ensure proper project implementation. Water management must be holistic, considering service pricing and financing risks;
- 2) Blended financing sources include the private sector, Company Social Responsibility (CSR), Central and Local Government Budget, using instruments like Viability Gap Fund (VGF), soft loans, mezzanine loans, grants, and bonds/sukuk. The feasibility and risk-sharing of each source must be evaluated;
- 3) Risk allocation in blended finance should be fair to attract private investment. Key risks include interface, political, and commercial risks. An integrated plan from upstream to downstream is crucial for water absorption and revenue, with Water Service Providers' performance also considered.

Background



Water is a basic need for everyone; increasing water needs should be fulfilled by infrastructure delivery. The problem is that water-related infrastructure requires a high investment, while the available funds are limited. To achieve universal and equitable access to safe and affordable drinking water for all by 2030, as stated in Sustainable Development Goals 6 on water and sanitation, the present value of the additional

investment needed is around USD 1.7 trillion, which is about three times the current investment levels.

Over the years, water resources infrastructure relied heavily on public funding and had difficulty securing the funding from the private sector. This is primarily due to the nature of investment in water infrastructure projects, which are capital-intensive and require a large initial investment, with no revenue generated.

Innovative water financing becomes a fundamental issue to ensure water security and achieve SDG targets. The 'business as usual' approach should be left out and the key stakeholders need to work together to increase investment in the water sector.

The 2nd Workshop "Blended Finance in Water Sector", how blended finance can work in water sector-related investment was discussed, particularly regarding these topics: the blended finance concept, exploration of the best practices of blended finance from other countries, risk management in blended finance, and also water governance on blended finance.

The result of this workshop is expected to provide knowledge and ideas needed in structuring and establishing a framework to implement blended finance for the water sector, and developing key issues or topics identification for the Sustainable Water Finance Subtheme for the 10th World Water Forum, resulting from the participatory approach of the workshop.

Objectives



The objective of the 2nd workshop was to discuss the risk allocation and lessons learned or case studies from national and international experiences of the Blended Finance for water resources investment.

A panel dialogue and breakout sessions were held covering the following topics:

- Concept and implementation of blended finance scheme;
- Exploration of best practices in the application of blended finance schemes from various countries;
- Risk management in the application of blended finance scheme;
- Water management in the application of a blended finance scheme.

During the breakout session, three sub-topics were discussed, including:

- The Blended Finance concept;
- Risk Management on Blended Finance for the Water Sector; and
- Water governance on blended finance practice.

The output of this workshop is expected to provide knowledge and ideas needed in developing:

- Structure and framework establishment to implement blended finance for the water resources sector;a
- Risk management in urban water provision: the role of Multilateral Agencies, governments, and private sector.

Challenges

Today's world is not on track to meet Sustainable Development Goals 6 on water and sanitation largely due to insufficient levels of water-related investment. Estimated global costs of achieving SDG 6 exceed USD 1 trillion per year or 1,21% of GDP. To achieve universal and equitable access to safe and affordable drinking water for all by 2030, the present value of the additional investment needed is around USD 1,7 trillion, which is about three times the current investment levels.

Water-related investments are key for sustainable development and inclusive growth, especially for the still-developing countries. As such, blended finance is defined as a strategic use of development finance to mobilize additional finance

towards sustainable development in developing countries (OECD, 2018). The structuring mechanism provided by blended finance is very critical in the water sector which typically concerns investment in an overall system. Through the use of blended finance, the Government can tap into potential funding from various sources and attract market-building instruments to create more self-sustaining financing approaches.

Despite the benefit of blended finance, there are challenges in the implementation that are important to be addressed. In general, the challenge will be related to how the Government can prepare an environment that integrates key factors: investors, financial institutions, and project structures.



The key challenges in bringing blended finance into the water sector to be implemented are as follows:

- Supporting water provision globally requires an extraordinary level of capital investment through blended finance to provide long-term, large-scale capital to fund critical development;
- A variety of innovative, public-private financing approaches are needed so that private investors may choose among various levels of risk and potential reward;
- Solving these challenges requires stronger collaboration between the public and private sectors. Good governance is essential as an enabler through a political commitment to create a sustainable and profitable environment for investment.

Topic of Discussion



Figure 2. Director General of Infrastructure Financing with distinguished panelists on 2nd Workshop: "Blended Finance for Water Sector"

Source: DGIF, February 2023

I. Concept and Implementation of Blended Finance Scheme

Victoria Delmon, Head, Upstream and Advisory, INR Asia Pacific Department, International Finance Corporation

According to the International Finance Corporation, blended financing is a combination of concessional financing from donors or third parties alongside Development Finance Institutions (DFI) normally own account finance and/or commercial finance from other investors, to develop private selector markets, address Sustainable Development Goals (SDGs), and mobilize private resources.

Blended finance is an innovative financing scheme to tackle challenges faced in water sector projects which are not bankable with off-takers who are not creditworthy.

To implement blended finance, it is necessary to strengthen policies and strategies, including:

- Improving efficiency and effectiveness by focusing on beneficiaries, cost recovery system, and increasing utility capacity in managing assets and finances.
- Transparency to increase the market creation potential of each transaction.
- Creating market

II. Exploration of Best Practices in the Application of Blended Finance Schemes from Various Countries;

Pius Chong, Executive Director Deals and Strategy, Deloitte

The application of blended finance requires leading strategies and innovations to help overcome challenges and obstacles to mobilizing capital for sustainable development, such as:

- A risk management mechanism to mitigate credit risk and encourage private investment in water sector infrastructure financing.
 - Financing mechanisms such as equity, credit (including loans and green bonds), Sukuk, securitization, and public-private partnerships (PPP) to finance water projects such as water treatment facilities, sanitation, and water delivery systems.
 - Digital Technology through blockchain and fintech that can be used to increase the efficiency, transparency, and inclusiveness of mixed financial transactions.
- The blended finance platform, as a forum for bringing together various stakeholders in mixed finance, including investors, project developers, public institutions, etc.
-
- There are several ways blended finance is implemented in other countries, namely Water Credit Investment Fund, DFAT Australia's program: Investing in Infrastructure Program Cambodia, Upper Tana-Nairobi Water Fund, and Municipal Bond Issue by the Municipality of Tlalnepantla de Baz.

III. Risk Management in the Application of Blended Finance Scheme

Wahid Sutopo, President Director of Indonesia Infrastructure Guarantee Fund (IIGF)

Water sector projects have high complexity with high risks and involve many stakeholders, therefore long-term investment and strong collaboration between government and private is required.

There are several key risks commonly faced in water sector projects including:

a. Connectivity risks.

Connectivity risks include government and private sector's non-willingness to connect caused by a lack of awareness or understanding of the project's benefit and the limited financial capacity of potential consumers. The second is a mismatch of project schedules between the public and private side.

b. Interface risk

Interface risk can be encountered in various financing schemes, these risks include incomplete or inaccurate project specifications that lead to design errors or omissions, workschedule setbacks, and uncertainty of obtaining and disbursing government support.

c. Revenue risk

Revenue risks in water sector development projects include mismatched business plans in ramp-up periods caused by inefficient processes which result in reduced revenue growth and profitability, and an inability to reach a mutual agreement on tariffs.

d. Political risk

Changes in government policy or regulations can impact project viability and continuity.

Although these risks occur in all funding schemes, the application of blended finance requires different risk mitigation, among others:

- Integrated preparation stage from upstream to downstream, including business plans and tariff schemes.
 - A legally binding agreement from all stakeholders with a synchronized timeline with the construction stage, business plan, and operation stage that needs to be monitored together.
 - Adjustment and improvement of regulations to support State-Owned Enterprises (SOEs) or Regional-Owned Enterprises (ROEs) (BUMN/BUMD)
- as operators and off-takers, as well as financial support and the ability to cooperate with the private sector, especially for market management and non-revenue water (NRW) issues.
- Blended finance can be an effective tool for funding water projects by combining the public and private sectors to reduce investment risks and enhance financial returns. Here's a comprehensive look at how blended finance can be applied to water projects.

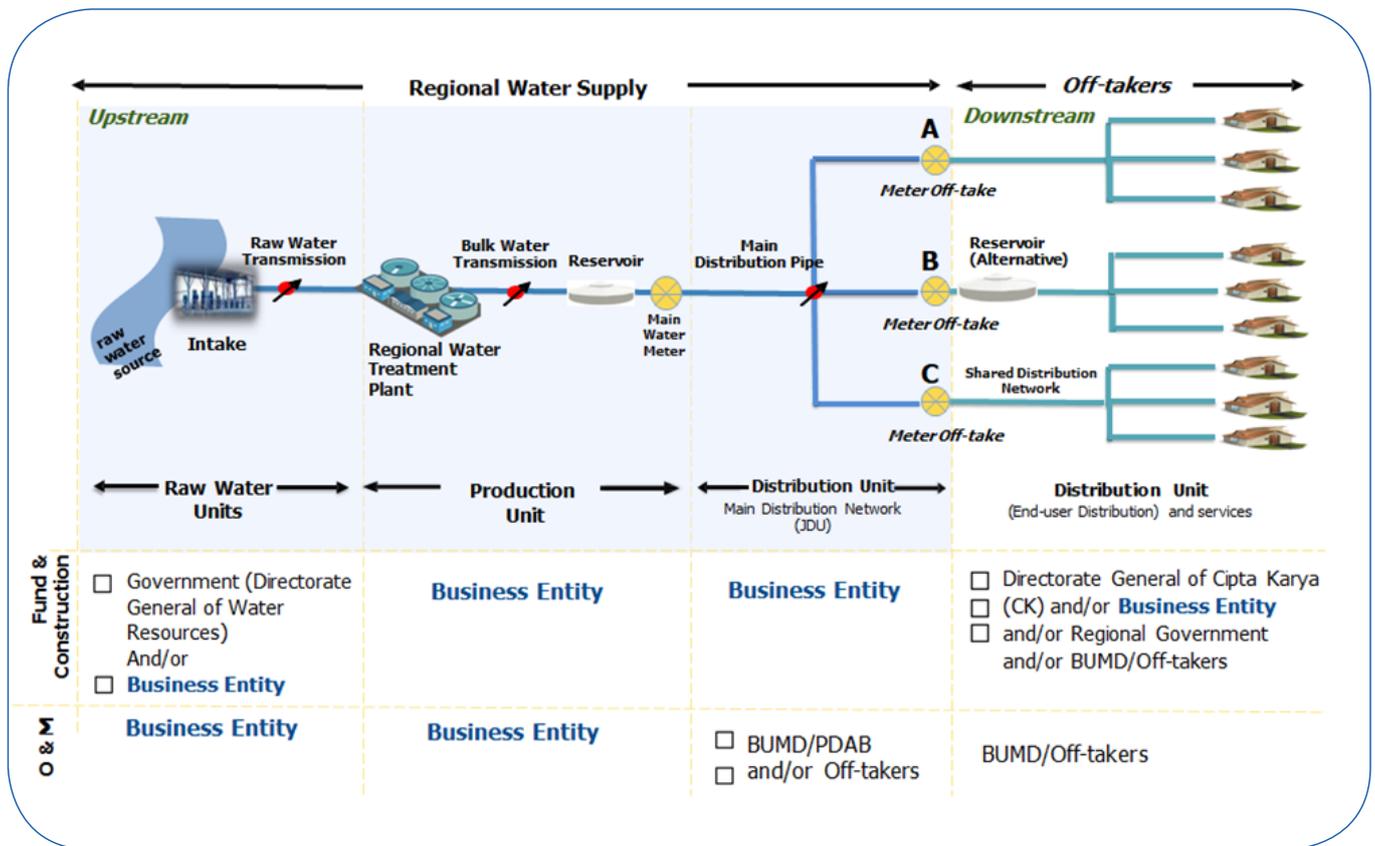


Figure 3. Potential blended finance in water project - Water Supply System

Source: PT PII, March 2023

IV. Water Management in the Application of Blended Finance Scheme

Setiawan Wangsaatmaja, Regional Secretary for West Java Province, Republic of Indonesia

The water sector governance principles that need to be implemented to support blended finance include transparency and accountability, inclusiveness, sustainability, collaboration, and capacity building. There are several

benefits of governance of the water sector including reducing investment risk, facilitating coordination, encouraging innovation, increasing public acceptance, and mobilizing resources.

In the breakout session, three sub-topics including the Blended Finance concept, Risk Management on Blended Finance for the Water Sector, and Water governance on blended finance practice were discussed.

1. Blended finance emphasizes project financing from various sources so that the project can be implemented properly. Water management institutions and systems must be integrated as a whole, and consider financing services (price levels and financing risks).
2. Sources of financing for blended finance can be from the private sector, CSR, APBN, and APBD. The instruments used can be in the form of VGF, soft loans, mezzanine loans, grants, and bonds/sukuk. In choosing the financing instrument, it is necessary to consider the feasibility of each source under the right conditions. The portion of each source of financing in blended

finance must be considered, taking into account the final price and risk sharing that each institution receives.

3. There should be a fair and proportional risk allocation between parties involved in blended finance to attract private financing. Several key risks need to be taken into account including interface risks, political risks, and commercial risks. For water sector projects, the integrated plan from upstream projects to downstream projects is emphasized because this will affect the level of water absorption and revenue of Water Service Providers. In addition to that, for drinking water service, Water Service Providers' performance must also be considered.



Key Takeaways

Blended financing combines concessional financing from donors or third parties with Development Finance Institutions and/or commercial finance from other investors, aiming to develop private sector markets, address Sustainable Development Goals (SDGs), and mobilize private resources. Blended finance implementations require strategy and innovation, since water sector projects are complex and high-risk, requiring long-

term investment and strong collaboration between the government and the private sector.

Water governance principles that need to be implemented include transparency, accountability, inclusiveness, sustainability, collaboration, and capacity building. Benefits include reducing investment risk, facilitating coordination, encouraging innovation, increasing public acceptance, and mobilizing resources.



Some key takeaways from the breakout session are as follows.

- 1.** Blended finance integrates funding from various sources to ensure proper project implementation. Water management must be holistic, considering service pricing and financing risks.
- 2.** Blended financing sources include the private sector, CSR, Central and Government Budgets, using instruments like VGF, soft loans, mezzanine loans, grants, and bonds/sukuk. The feasibility and risk-sharing of each source must be evaluated.
- 3.** Risk allocation in blended finance should be fair to attract private investment. Key risks include interface, political, and commercial risks. An integrated plan from upstream to downstream is crucial for water absorption and revenue, with Water Service Providers' performance also considered.

Conclusion

Blended Finance is one of the financing delivery mechanisms for water provision. By leveraging the strategic use of development finance, blended finance enables additional finance to a wider base of investors and allows support for infrastructure financing.

Several ways to mitigate risk for blended finance, including:

- Appropriate risk allocation by assigning risk to the party that can most bear the risk
- Strengthening the commitment of relevant stakeholders through a memorandum of understanding
- Strengthening readiness criteria
- Scanning of project compliance with agreement criteria
- Setting one door regulation (clearing house mechanism)
- Integrate the National Medium Term Development Plan (RPJMN) and Regional Medium Term Development Plan (RPJMD) to mitigate differences in regional autonomy

As for the water governance in implementing blended finance, the parties involved are Government, Special Project Vehicle (SPV), and Water Service Providers. For the implementation of blended finance to run well and encourage private participation, several things that can be implemented, including:

1. Well preparation of investment arrangements and blended finance;
2. The process of project financing and preparation is carried out transparently and involves various elements in a participatory manner;
3. Comprehensive management of natural resources;
4. Integrated planning of upstream and downstream;
5. Encourage government support such as Project Development Facility, Viability Gap Fund, and Guarantee for Public-Private Partnership (PPP) implementation.
6. Providing water tariff certainty through regulations both at the local government and national levels.



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