

**Public Private Partnerships**  
*and the Poor*

*Series Editor: M. Sohail*



# **Public Private Partnerships** *and the Poor*

**Pro-Poor Longer Term (Concession and Lease) Contracts**

*Edited by M. Sohail*  
*with assistance from*  
*Halcrow Management Sciences*



Water, Engineering and Development Centre  
Loughborough University  
2003



Water, Engineering and Development Centre  
Loughborough University  
Leicestershire  
LE11 3TU UK

© WEDC, Loughborough University, 2003

Any part of this publication, including the illustrations (except items taken from other publications where the authors do not hold copyright) may be copied, reproduced or adapted to meet local needs, without permission from the author/s or publisher, provided the parts reproduced are distributed free, or at cost and not for commercial ends, and the source is fully acknowledged as given below. Please send copies of any materials in which text or illustrations have been used to WEDC Publications at the address given above.

Sohail, M., and Halcrow Management Sciences(2003)  
*Public Private Partnerships and the Poor*  
*Pro-Poor Longer Term (Concessions and Lease) Contracts*  
Series Editor: M. Sohail

A reference copy of this publication is also available online at:  
<http://www.lboro.ac.uk/wedc/publications/>

ISBN Paperback 1 84380 051 9

This document is an output from a project funded by the UK  
Department for International Development (DFID)  
for the benefit of low-income countries.  
The views expressed are not necessarily those of DFID.

Designed and produced at WEDC  
by Sue Plummer

## **Acknowledgements**

The authors gratefully acknowledge the many different people who have willingly contributed their knowledge, opinions and time to the development of this work.

It is very difficult to provide an exhaustive list, but the following is an indicative list of organizations and/or people who have provided support.

1. Department for International Development (DFID), UK, and country and regional offices, in particular Mr Ian Curtis and Mr Martin Walshe.
2. Binnie Black and Veatch: Mr Roger Brown.
3. Halcrow Management Sciences: Mr Jon Bateman and Mr Tim King.
4. Mr Colin Schoon - Freelance consultant (Ex-Halcrow Management Sciences).

We are also grateful to the external reviewers including Dr Derek Miles, and for proof reading and editing Ms Kimberly Clarke and Ms Jane Lanigan.

Special thanks to the people from the low-income settlements in the various case locations who have contributed to the research and have provided their perspectives on the issues. We feel greatly indebted to them.

## **List of tables**

Table 4.1.	Local level success factors .....	23
Table 5.1.	Development of pro-poor solutions .....	31
Table 6.1.	Outline structure and content for a pro-poor concession contract .....	37

# Contents

Acknowledgements .....	v
List of tables .....	vi
Contents .....	vii
About this guide and the series .....	ix
Who should read this guideline and the series .....	x
<b>Section 1 .....</b>	<b>1</b>
<b><i>Introduction</i></b>	
<b>1.1 Basis .....</b>	<b>1</b>
<b>1.2 Definitions .....</b>	<b>2</b>
<b>Section 2 .....</b>	<b>7</b>
<b><i>Background</i></b>	
<b>2.1 Objectives .....</b>	<b>7</b>
<b>2.2 Forms of PSP .....</b>	<b>8</b>
<b>2.3 The institutional context .....</b>	<b>9</b>
<b>2.4 Water sector regulation .....</b>	<b>10</b>
<b>2.5 The PSP preparation and procurement process .....</b>	<b>11</b>
<b>Section 3 .....</b>	<b>13</b>
<b><i>The basis for a pro-poor approach</i></b>	
<b>3.1 Basis for the review and subsequent analysis .....</b>	<b>13</b>
<b>3.2 Conditions for success .....</b>	<b>13</b>
<b>3.3 Potential technical methods (or infrastructure options) .....</b>	<b>14</b>
<b>3.4 Local and sector levels .....</b>	<b>14</b>
<b>Section 4 .....</b>	<b>15</b>
<b><i>Local level success factors</i></b>	
<b>4.1 Introduction .....</b>	<b>15</b>
<b>4.2 Functionality .....</b>	<b>15</b>
<b>4.3 Affordability .....</b>	<b>18</b>
<b>4.4 Appropriateness .....</b>	<b>20</b>

<b>Section 5 .....</b>	<b>25</b>
<b><i>Sector level success factors</i></b>	
<b>5.1 Introduction .....</b>	<b>25</b>
<b>5.2 Inclusivity .....</b>	<b>25</b>
<b>5.3 Feasibility .....</b>	<b>29</b>
<b>5.4 Bankability .....</b>	<b>29</b>
<b>Section 6 .....</b>	<b>35</b>
<b><i>The pro-poor concession contract</i></b>	
<b>6.1 Introduction .....</b>	<b>35</b>
<b>6.2 The outline concession contract .....</b>	<b>36</b>
<b>Annex A .....</b>	<b>47</b>
<b><i>Categories of water supply and sanitation</i></b>	
<b>A.1 Water supply .....</b>	<b>47</b>
<b>A.2 Sewage disposal .....</b>	<b>47</b>



## **About this guide and the series**

This guidance note is based on a collection of discussion paper by our partners and case studies undertaken in Africa, Asia and Latin America for the Department for International Development (DFID)-funded research project Public Private Partnerships and the Poor in Water and Sanitation (R-7388 funded by DFID). Detailed reports of these case studies are published as a series of documents and can also be found on the project webpage:

<http://www.lboro.ac.uk/wedc/projects/ppp-poor/>

Readers should consult other papers prepared in this series for more detail on closely related aspects, in particular those dealing with:

- The PPP procurement process;
- Tariffs for the poor; and
- Regulation and the poor.

The purpose is to determine workable processes whereby the needs of the poor are promoted in strategies that encourage public-private partnerships (PPPs) in the provision of water supply and sanitation services. One of the key objectives is to fill some of the gaps that exist in evidence-based reporting of the facts and issues concerning the impact of PPP on poor consumers. This series of reports presents the findings and cases studies based on both the pre-contract and operational phases of a number of PPP contracts. A broad perspective on PPPs has been taken, and situations where the public sector is acting in partnership, with small-scale local entrepreneurs or with NGOs employed in a private sector capacity, have been included.

Many bilateral and multilateral agencies seek to foster involvement of the private sector through public-private partnerships as a means of delivering better water and sanitation services. Participation of the private sector is also seen as a key factor in meeting the Millennium Development Goals, particularly, Goal 7 (Ensure Environmental sustainability) and under which the Target 10 calls for halving the proportion of people without sustainable access to safe drinking water by 2015. Furthermore target 11 demands for significant improvement in the lives of at least 100 million slum dwellers.

The number of poor people positively affected by (PPP) arrangements needs to grow soon to meet the Millennium Development Goals.

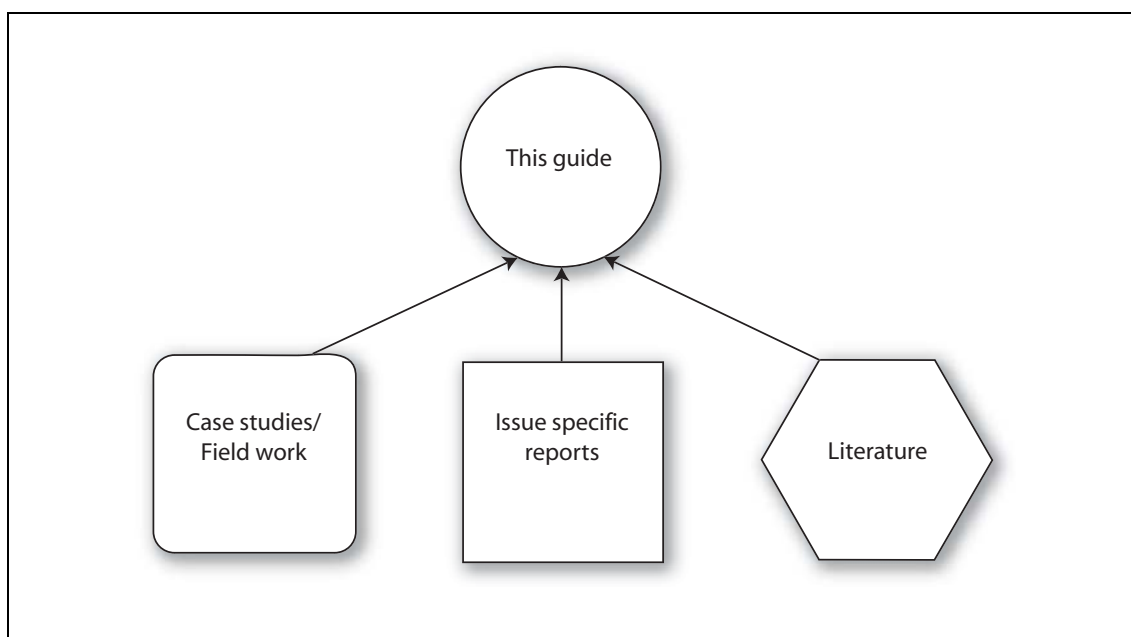
## Who should read this guideline and the series

This series and the guide should be of interest *inter alia* to:

- engineers and others with a professional interest in water supply and sanitation;
- managers and administrators involved in procurement and governance;
- policymakers who are developing strategies for PPP in water supply and sanitation; and
- staff of private sector firms, local government officials, NGOs and CBOs who are involved in the development and implementation of PPPs.

*This document is neither a discourse that advocates views on the desirability or otherwise of privatization, nor does it promote particular courses of action on the basis of theory alone. One of the most important things that the authors have done is to go and talk to poor consumers to elicit their views. This has been crucial to their investigation of the operational end of how things actually work - as opposed to how they are intended to work. The evidence the authors present is based on a review of actual contract documents and on case studies carried out through an extensive programme of site visits and interviews with low-income consumers, public sector agencies, private sector operators and local politicians. The richness of the data is a tribute to local partners who undertook the actual fieldwork; their knowledge, experience and understanding of systems and people are central to the findings the authors present.*

The principal evidence presented in the series appears in the form of process analysis and case studies. The following is a diagrammatic representation of the different documents in the series and how this particular document fits in with the others in the knowledge package.



The series will be of particular importance to readers interested in topics such as:

- Partnerships
- Public-private partnerships
- Project design and management
- Water and sanitation service delivery
- Decentralization and capacity building
- Poverty
- Livelihoods strategies
- Social impact analysis
- Sector planning
- Social exclusion
- Gender

Teams working on the following themes in DFID may find the Partnerships series of particular relevance:

- Policy division management
- Drivers of change
- Human capital/ skills
- Investment/ competition
- Millennium Development Goals
- Poverty and social impact analysis
- Reaching the very poorest
- Service delivery
- Strategic challenges
- Urban and rural changes



# Section 1

## Introduction

### 1.1 Basis

The term 'pro-poor' covers not only approaches that help the poor directly, but also those that improve overall water supply and sanitation services. Such service improvements have an indirect impact on the poor.

The authors have prepared this guide in order to provide guidance on the design of concession contracts that provide pro-poor water services, and in doing so use experiences of private sector involvement in the water sector. The authors do not attribute findings to any specific project, and they highlight particular contractual features only in the interests of sharing knowledge and improving services to all consumers, including the poor.

**Lack of attention to the needs of the poor is not by any means a characteristic that is uniquely associated with the involvement of the private sector. Many public authorities have also performed badly, and this explains the present international drive to reduce the number of those without access to safe water. Conversely, a number of private sector providers are at the forefront of the development of improved services to the poor. However, any private sector success in improving services to the poor is dependent to a large degree upon the effective actions of the public sector. This joint approach to water supply and sanitation can be termed 'Public Private Partnership (PPP)', which reflects the important and complementary roles of the public and private sectors working together. Alternatively, it may be termed 'Private Sector Participation (PSP)', which reflects the role of the private sector in the provision of a public service. Both terms are in general use.**

The discussions in this paper generally refer to the water sector, but are equally applicable to the sanitation sector.

The paper shows how a PPP contract can be structured so that poor consumers are not disadvantaged, and may even be given some preference. However, the same objectives should be achieved if water supply is provided by the public sector alone. Therefore, the basic concepts have wide application to all combinations of public and private operations.

There is a perceived danger that, as the private sector has to be profitable to survive, there are commercial forces that tend to maximize revenue and minimize expenditure. Therefore, service delivery that involves the private sector may be concentrated on

provision for higher paying customers, particularly in cases where resources of raw water and money are inadequate. On the other hand, the serious private sector operators are fully aware of the importance of establishing and maintaining a good reputation. Private sector providers are largely aware of their responsibilities to the wider community, and of the need to maintain and enhance their reputations if their business is to expand. However, it is important that the PPP contract should address any special measures that are necessary to safeguard the poor.

There is a growing awareness that the public sector should also aim to be more self-sufficient and autonomous. Many of the standard business procedures of the private sector are being introduced to government-run systems as a result. This in turn is developing a more commercial approach within the public sector; however, public operators should also recognize that specific provision should be made for services to the poor. Such a pro-poor approach should be included in operational procedures.

There are very few explicit pro-poor features identified in documents dealing with existing contracts, but some adjustments have been made during their operation to improve services to the poor. This paper is designed as a contribution to help to fill that void.

The introduction of PPP does not preclude the use of subsidies, but it does require that any such subsidies are identifiable and guaranteed.

In order to stand alone, this paper passes through outline descriptions of the problems and potential solutions in order to arrive (in Section 6) at guidance on the structure and provisions in a pro-poor concession contract.

## **1.2 Definitions**

### **1.2.1 The 'poor'**

The 'poor' might otherwise be known as those people on low-incomes, the economically deprived, the financially constrained, those deprived of services that contribute to quality of life and so on. At the risk of offending sensibilities, the authors refer simply to the 'poor'. The locations in which many of these people live are, then, 'poor' areas. The social organizations that sometimes exist are low-income communities.

'Poor' is not restricted solely to money income. Broader definitions are common. In this paper the authors have assumed that one factor that makes people poor is lack of adequate water supply and sanitation for households or groups. Such a situation arises possibly because of low family incomes or because the water utility has insufficient funds. Those most at risk are predominantly in urban and peri-urban areas.

**A common feature of the poor is that there has generally been little incentive for water utilities (be they public or private sector) to address these problems. This has been in part due to financial constraints and the limited enhancement of revenues that would result from investments in water provision for the poor. It is also in part due to a lack of understanding of the problems and possible solutions. In addition, the public sector may not be allowed to serve poor areas that lack legal status, as this could reduce the power of government to remove illegal occupiers.**

## SECTION 1: INTRODUCTION

For the purposes of considering the inclusion of solutions to the problems of the poor in PPP arrangements, it is appropriate initially to consider the four categories of low-income groups listed below. These are listed together with the main factors that must be considered in finding a solution.

- a) The poor who live in areas of informal housing (possibly generically known as 'squatter areas', "slums" or "Shanties"). Such areas usually have severe deficiencies in social, administrative, financial and infrastructure provision. Careful integration of institutional, social, technical and financial factors is key in finding a solution for the problem of service provision here.
- b) The poor who live in recognized (formal) but separate housing areas (possibly generically known as 'townships'), but where the level or extent of service provision and ability to pay for improvements is limited. Key factors in this category are primarily tariffs and technical aspects.

### **Box 1.1. Example of informal settlement: Cato Crest, Durban, Republic of South Africa**

Cato Crest is an informal settlement established in the 1980s on land that is now owned by Durban Metro, who installed standposts initially and later ground tanks. Durban Water established bailiffs to distribute water to householders' ground tanks at a fixed time each day, following a pre-payment made by those householders. The bailiff also had a metered standpipe on his/her property from which he/she could sell water, at a fixed price, to consumers who did not have ground tanks. Bailiffs were paid on the basis of water sold and the number of consumers they served/ were responsible for. They were also responsible local maintenance.

Tanks and connections were subsidized by Durban Water. Contributions from consumers were charged over a maximum period of 18 months with the first 6 months free of interest.

Initially charges were made for all water supplied, but in 1997 central government decreed that the first 6 m<sup>3</sup>/household/month was to be free. As a result, Durban Water adjusted its rising block tariff to include a free initial block, but increased charges in higher consumption blocks to generate enough income. However, as there was no charge to those with ground tanks or to those who purchased from the standpipes, the bailiffs lost their main role in collecting money and they were not required any more. As a result, Durban Water lost its direct link with the community.

- c) The poor who live in city low-income housing areas (formal slums), who in theory receive a full service. However, such people are mainly disadvantaged by an inability to pay, and in some cases an unwillingness to pay, especially for services that may be well below standard. Tariff aspects and improvements in services are the main factors that will solve water supply problems in this category.
- d) The individual poor who may live in any part of the community, but who simply are unable to pay for the services, whether temporarily or over the long term. Key factors in this category are mainly provisions for preventing disconnection and for the provision of a 'safety net'.

The types of pro-poor actions, and the provisions that could be made in PPP contracts, differ in some aspects for each of the four categories above.

**Box 1.2. Large proportion of poor in some cities:  
Information from a recent investigation in Kathmandu, Nepal,  
for piped water supply**

Using the Nepalese government's poverty indicator - 9,000 Nepalese Rupees (NRs.) per person per year - approximately 15 per cent of the population of Kathmandu would be classified as poor (2002/2003). However, Kathmandu has a high cost of living compared to the rest of Nepal, leading to an under-estimation of the urban poor.

The proportion of households that are poor was examined in a willingness to pay study. Using a multi-faceted definition of poverty, which included income, type of housing material, cooking fuel and self-description, the number of households in the sample that could be categorized as poor was found to be 520, or 34 per cent. Of this group, 68 per cent had completed less than 10 years of schooling, and 30 per cent had never attended school. Over 60 per cent of the poor category lived in mud-based houses (compared with 35 per cent of the overall sample), and only 9 per cent had concrete roofs, floors and walls. Fifty per cent owned a radio and a television, while 11 per cent owned neither. The median monthly income was NRs.6000. One third of this group said that it would not be possible to borrow NRs.3000 to 5000 from a moneylender.

In low-income formal housing areas (categories b and c), appropriate tariffs and other charges are likely to be the key to enabling improved and affordable services. In informal settlements, the problems of providing adequate services are far wider. In both formal and informal cases, improvements are more likely if appropriate contractual provisions are made.

**1.2.2 Other definitions**

A large variety of terms is used for the various entities and elements involved in a PSP arrangement, sometimes rather indiscriminately. The terms the authors use are given below, together with an outline of those that are synonymous or related. This is not intended to be a rigorous or exhaustive list.

***PSP***

PSP is used to denote Private Sector Participation. Another term widely used is Public Private Partnership (PPP). The former term denotes that the private sector is participating in service delivery, whilst the public sector usually continues to own the assets and acts as facilitator. However, such an arrangement may also be a partnership to a greater or lesser extent.

***Contract***

The authors use the term 'contract' to denote a long term arrangement (including licence) such as concession and lease awarded by a public sector 'authority' to a private sector 'operator' and regulated by a 'Regulator'. As finalized, the contract may be known as an 'agreement'. The term 'Licence' has a meaning related to entitlement to provide services in accordance with provisions and regulations in legislation.

***Authority***

The public party to the contract will normally be a national, provincial or local authority. The authors generally use the term 'authority' in this paper, but in the outline contract at



## SECTION 1: INTRODUCTION

the end of the paper they revert to the term 'promoter', which is more correct in that specific context.

### **Operator**

The term 'operator' is widely, and sometimes imprecisely, used for the entity responsible for the provision of services. Synonymous and related terms include:

- Provider - a provider of services, which could be either a private or public entity. Under different PSP arrangements, the operator might not necessarily be legally responsible as provider.
- Contractor - the corporate body that is the private party to the contract.
- Concessionaire - the corporate entity to which the concession is awarded.
- Special Purpose Company (SPC) - usually a company formed and incorporated in the country in which the contract is awarded, and which comprises an international or national operator, local investors and construction firms.
- International Operator - a company with technical experience and financial and human resources to enable it to operate water businesses in its home country and internationally, often under a variety of contractual and regulatory frameworks.
- Sponsor - an operator or SPC that sponsors negotiations or a competitive bid to provide water services.

### **Regulator**

In the use of the term 'regulator' the authors normally mean the bodies or individuals responsible for the regulation of the services and economic rewards of the operator and for adjustment to the contract/ Licence under changing conditions. The regulator would preferably be a separate independent statutory body, but may be, temporarily or permanently, the authority.



## Section 2

### **Background**

#### **2.1 Objectives**

Poor households often spend a high proportion of their incomes, and incur substantial indirect costs that are not priced (for example, considerable time), in order to obtain water that is fit (and in many cases unfit) for human use.

In many countries, past investments in publicly delivered water and sewage services have been inadequate, and have benefited high- and middle-income groups more than the poor. The increasing introduction of private sector participation (PSP) in service provision has to varying extents improved efficiency and increased investment. However, to date PSP has made a limited direct contribution to providing solutions to service provision for the poor.

Over the past few years practical self-help and NGO initiatives, along with some public utility and private provider programmes, have helped to improve general understanding of the needs of the poor; such initiatives have also contributed to understanding of the types of actions that can be effective in improving access and services. In most cases, the more successful means of serving the poor have been introduced through contractual re-negotiations and programme development; such improvements have taken place some years after the original PSP arrangement started (Box 2.1).

Research papers, case studies and guidance on actual and potential solutions to improve services for the poor are now relatively abundant. In most cases however, PSP contracts still contain few if any specific provisions to ensure that the poor benefit significantly from the implementation of that PSP.

In this paper, the authors aim to provide practical guidance on the integration of pro-poor solutions into the contractual terms under which the private sector is engaged to provide services. The problems and potential solutions are described in sufficient depth to indicate the possible methods of treatment. Nonetheless, the authors recommend that readers review other sources for a more detailed discussion of possible pro-poor actions and case studies. In particular, the Lyonnaise des Eaux (now Ondeo) publication ‘Alternative solutions for water supply and sanitation in areas with limited financial resources’\* provides a good review of the issues and methods of approach.

### **Box 2.1. Buenos Aires, Argentina**

Following a competitive bidding process based on price, a 30-year concession was awarded to Aguas Argentinas on 1 May 1993 for water and sanitation provision to almost 10 million people in Buenos Aires. Contractual targets were set for increasing coverage, together with connection and supply charges. Most properties to be served were charged on a flat monthly rate reflecting their location and size; few were metered. Tariffs were subject to a price cap, and this cap was to be reviewed every five years. Alternatively, tariff changes might be triggered by cost increases above 7 percent. The regulatory body, ETOSS (Ente Trepartito de Servicios Sabitarios), was established shortly after the concession.

The original water supply system had been installed in the 1930s giving full coverage to 2.4 million people. Buenos Aires is on the south bank of the River Plate, which provides unlimited fresh raw water and allows for the disposal of wastewater. The water distribution system had not been enlarged enough to keep up completely with the expansion of the city and was, up until the concession, operated by the public sector. Areas of the city not covered by the water supply system were supplied from local groundwater schemes. The public system had deteriorated because of inadequate investment and was overstaffed (8 staff per 100 connections; this has now been reduced to 1.7 staff per 100 connections).

The privatization of water and sanitation in Buenos Aires was part of a political strategy covering many other sectors as well; it was at the time considered a model of free market reforms.

Various renegotiations and adjustments have taken place since the original concession contract in order to meet new external and internal conditions. Stakeholders have also developed a better understanding of the assets and mechanics of operations, including how to create incentives for improvements.

Under the original contract, primary distribution costs were shared by all consumers, whereas secondary distribution (infrastructure charges) and connection costs were paid for individually by new consumers, who were obliged to connect to any new local system. However, most of the unconnected population had low or middle incomes and these secondary charges were relatively high. NGOs have been active in assisting the private operator in working with communities by training staff and carrying out social and environmental diagnoses and environmental impact assessments.

In the first tariff revision these charges to new consumers were increased even more, which hit poor consumers most. However, in later renegotiations the infrastructure charges were spread over all consumers and connection charges were made payable by instalments. Also, the concession expansion targets were relaxed which will have an impact on the delivery of service to the poor in the long term.

In this case then, pro-poor measures were introduced through joint efforts of the operator, the community, the municipality and NGOs, after the contract had been awarded.

**\*As noted in that publication '...the drafting of clauses for inclusion in formal long-term concession contracts represents a considerable challenge...' The authors' objective in this paper is to take a further step towards meeting that challenge.**

## **2.2 Forms of PSP**

PSP in the water sector is taking place in a number of different forms (or models) ranging from service contracts, through management, lease and concession contracts and in a few cases divestiture (see Box 2.2). As the development of PSP becomes more sophisticated,

the particular needs that arise out of widely different circumstances have led to arrangements that will frequently be hybrids of two or more of the standard solutions.

### **Box 2.2. Range of PSP arrangements**

There are well-tried mechanisms that use the skills of the private sector in operation, namely:

- Outsourcing or service contracts for particular services;
- Management contracts to boost senior capability and introduce new concepts;
- Lease contracts to transfer commercial and technical responsibility and risks to the private sector; and
- Concession contracts to transfer full commercial and technical responsibility and risks to the private sector and, in addition, to transfer responsibility for obtaining capital funds.

Capital funds for infrastructure components (such as water treatment works or pumping stations and pipelines) can also be obtained under arrangements such as:

- Build Own Operate and Transfer (BOOT), which involves assets transfer to the public sector at the end of the operating period;
- Build Operate and Transfer (BOT) used for BOOT; and
- Build Own Operate (BOO), whereby assets remain with the private sector indefinitely.

The provisions that need to be made to improve access and services to the poor will (or could) to some extent apply in any PSP model or hybrid, or indeed to continuing public service - for example, by a corporation contracted to a city council. The reason for focussing on the concession case is that this is the most common form that maximizes the transfer of responsibility and risk to the private sector. In a political climate that is positive for PSP to take place, a concession is seen by experts as the most desirable vehicle for increased investment and efficiency.

## **2.3 The institutional context**

The PSP contract (or agreement) will be between the public authority (municipal, state or national) and a private sector operator/ investor. It is only one part, albeit a key part, of a complex water sector's institutional and legal framework that is needed for PSP to be successful.

The PSP is also the end result of a long process of study, planning, procurement and negotiation that will have taken a few years. Shortcomings in either the legal and institutional framework or the process can limit the extent to which PSP attains its objectives.

Institutional and legal structures that have inadequate provisions to deal with land tenure, administrative structures, representation, health and social security create problems and make solutions more difficult.

Clearly, the public sector has not been effective in serving the poor in the past when it has been faced with institutional shortcomings in the water sector and shortcomings in other institutional provisions for the poor. Largely because of this, some NGOs and CBOs are

promoting improvements with poor communities. The knowledge that NGOs have of the social, demographic and financial situation in the poorest communities can make a valuable contribution to effective PSP.

The introduction of water sector PSP frequently takes place in conditions where water sector policy is not fully developed or implemented. There is seldom a coherent set of legislation (ideally a 'Water Act'), which clearly defines the roles and relationships of the numerous institutions and stakeholders that should be concerned with the technical, social and financial aspects of water services provision. The creation of this enabling environment is very important, especially if the private sector is expected to take serious risks.

## **2.4 Water sector regulation**

The regulation of services and financing is a specific and important element of the institutional and legal framework, especially in cases where piped water is provided through a monopoly market. The economic regulator has the roles of ensuring that all consumers receive the agreed services and are charged a fair price, and that the operator can make the necessary improvements in infrastructure to provide those agreed services. At the time of preparation for PSP in developing countries there is usually no established entity for this function, and the introduction of PSP is the catalyst for its creation. Often regulation will be established in parallel with, or following completion of, the PSP preparation process. In the interim period there may be a less than satisfactory situation based on the notion of so-called 'regulation by contract', i.e. the contract has to be followed during this period without any changes being allowed to take place to meet new circumstances.

Apart from the fact that it takes time to build adequate capacity in a regulatory body, it is also sometimes the case that such a body's establishment is based on an idea of constant 'control' of the private sector provider. The PSP contract should encourage the development and implementation of innovative solutions for the poor. If this were the case, the public sector could then give the private sector the freedom to manage and deliver service improvements.

Certain distinguishing aspects of the water sector have a significant bearing on the nature of regulation (and of contract design):

- long planning horizons and high capital investment needs, which are influenced by changes in population growth and demography;
- poor information about the extent and condition of underground assets;
- poor information about the customer (revenue) base and the extent and types of populations that are not yet served;
- a high environmental impact and susceptibility to changes in environmental policies; and
- a high social profile as the provider of a basic need for life and health.

The nature and emphasis of regulation may be different depending on the type of PSP. In a concession contract, as the term implies, all of the necessary duties and powers to

operate, invest in the system (including expansion to the poor) and collect revenues are transferred to the private operator, along with the exclusive right to use the sector's existing assets for those purposes. Other forms of PPP give less responsibility to the private sector and more to the public sector. However, the regulator should monitor both the public and private sector elements in such cases.

**Performance of the contractual obligations is mainly judged on outputs. The business information at the start of the contract is often far from perfect, and there are inevitably numerous changes - over a 20-25 year period, for example - in the circumstances that were initially forecast and assumed as the basis for the contract. The contract cannot specifically identify all of the possible changes in circumstances that will take place, but it must define how such changes will be dealt with.**

For a concession contract, therefore, the primary roles of the regulator will be to monitor performance, and to interpret the contract and adjudicate on the adjustments required in response to the inevitable changes in circumstances. Such an approach to regulation should provide the flexibility and adaptability that is needed in order to solve the problems of the poor. This wider regulatory role should be recognized in the overall legal framework for the sector.

## **2.5 The PSP preparation and procurement process**

The importance of an effective preparation and procurement process in achieving sustainable PSP is described in detail in separate papers in this series.

Three aspects, in particular, merit brief reinforcement in relation to provisions for the poor in concession contracts.

### **Consensus building**

The provision of acceptable services for the poor involves resolution of many technical, institutional and financial aspects amongst numerous institutions and the consumers themselves. Effective solutions cannot be achieved without extensive consultation to develop a consensus. In some cases changes in legislation will be necessary.

### **Targets and modelling**

The viability, form and performance targets for PSP will be in large part established through detailed planning, and this will include operational and financial modelling carried out by the transaction advisors. During the preparation phase, the business model will be an invaluable tool for exploring the options for service improvements to the poor, and for identifying the conditions that will render those options viable. Clearly, to maximize its effectiveness in producing the desired results, the model must include the most comprehensive and accurate information possible on all aspects relating to the present circumstances and future proposals for improvement of services to the poor.

The 'indicative' business model, which is based on assumptions, will provide a basis for the evaluation of bids. When modified during negotiations to include parameters from the successful bidder, this model will become the business plan against which the progress of and variations to the contract will be monitored.

**Bid evaluation**

In many cases in the past, bid evaluation for concession contracts has been based on a system in which technical proposals are evaluated on a 'pass/ fail' basis. The successful bidder is then the one - out of the proposals that passed - that quotes the lowest tariff (at contract commencement, or in some aggregated present value form).

This approach has been derived in order to promote transparency and eliminate subjectivity in bid evaluation. Against these advantages it can have drawbacks, notably that operator's experience and commitment in relation to the poor may not count towards its chances of selection, unless such experience/ commitment forms part of the 'pass/fail' test.

Alternatively, previous experience of serving the poor effectively could be made to count to some degree at prequalification stage. Demonstrating experience of serving the poor could, for example, be one factor in prequalification. Those with an insufficient track record in this respect could be excluded; however, these bidders may be new entrants that are committed to an equitable water supply system for all, and that would soon adjust to actual conditions.

The alternative is a more comprehensive bid evaluation based on some 'best value for money' concept, but the evaluation rules must be clearly stated to bidders so that they can aim at the targets set by the client.



## Section 3

### **The basis for a pro-poor approach**

Some people would suggest that PSP itself does not bring solutions, but rather resources, finance and a specific approach. There is not yet the perfect concession contract, or anything near it, but of all the forms of PSP (excluding divestiture) the concession is the one in which outputs, rather than simply the means of achievement, are most strongly the core objectives.

#### **3.1 Basis for the review and subsequent analysis**

Abundant literature exists on **what** actions can be taken in order to enable effective solutions to the problem of providing water services for the poor. The primary objective of this paper is to explain **how** the necessary actions can be implemented and supported in the context of PSP. In order to do this, it is helpful to review the potential technical solutions, and to analyse the social, institutional, financial and contractual conditions that need to be satisfied for those solutions to be successful.

Solutions for the improvement of services to the poor must encompass the technical methods available and the organizational and institutional provisions necessary to support them. Successful solutions will be those that are both effective and sustainable. The identification of **effective** solutions is mainly related to local circumstances, whereas the **sustainability** of those solutions is more often related to sector-level provisions, including institutional frameworks and mechanisms. The two requirements - effectiveness and sustainability - have to be provided for by the concession contract (and, where they exist, by the regulatory mechanisms).

Analysis of effectiveness and sustainability should indicate what institutional actions are needed in order to support appropriate solutions, and the requirements in terms of definitions, information, specifications, procedures and the allocation of rights and responsibilities within the contract.

#### **3.2 Conditions for success**

A starting point for such an analysis of solutions is analysis of the purely technical method, and the end point is the means of implementing those effective and sustainable solutions. Between these points, we need to consider the inter-relationships that exist between the local and sector levels, between the technical, financial and social aspects of solutions, and between the contractual and institutional means of enablement.

In order to analyse the relationships, we can consider conditions that must be satisfied (or success factors met) in order to enable successful solutions. As noted previously, such conditions should be met at local level in order to achieve effectiveness, and at sector level in order to achieve sustainability.

### **3.3 Potential technical methods (or infrastructure options)**

Detailed descriptions of technical methods are provided in literature and case studies, but a range of the most common technical options for water supply and sewage disposal is listed in Annex A; generally, the list is in the order of most to least sophisticated.

### **3.4 Local and sector levels**

In the following chapters, the authors outline the conditions that must be satisfied for solutions to be successful, and they identify potential technical solutions. The remaining analyses, and proposals for pro-poor concession contracts, follow the steps below.

- Analysis of the local or community conditions that are needed in order to accommodate and support different methods of service delivery, including provisions for a contract - Section 4.
- Analysis of the sector- or institutional-level framework that is needed in order to provide the conditions that are necessary to sustain the local solutions, and an enabling environment for the concession contract, including provisions for that contract - Section 5.
- Pro-poor provisions for a typical concession contract structure - Section 6.

## Section 4

### **Local level success factors**

#### **4.1 Introduction**

At the local level, success factors can be grouped under three broad headings:

**Functionality** - The technical solution must deliver water supply of acceptable quality that is adequately accessible and reliable, and sewage disposal that provides acceptable standards of hygiene and privacy.

**Affordability** - Solutions and charges must be affordable, and payment methods must be designed to assist consumers in managing their limited financial resources.

**Appropriateness** - The solutions must recognize or address conditions in poor areas, including mainly institutional and social factors.

Ideally, in the preparation of solutions that benefit the poor in terms of service provision, suitable actions would be identified and conditions would be created to make those actions effective. However, in practice, the preparation will be a combination of those measures that are possible under less than ideal conditions.

The outcomes of the analysis of local level success factors are summarized in Table 4.1. Another important outcome will be the initial identification of issues that are critical in formulating an effective and sustainable contract.

#### **4.2 Functionality**

A fully effective technical option will need to be functional, as well as affordable and responsive to local conditions. The term 'functionality' as used here means the potential, within the physical conditions in the community area, for each option to meet the requirements for:

- water quality;
- accessibility of water supply;
- reliability of water supply; and
- hygiene and privacy of sewage disposal.

#### **4.2.1 Water quality, accessibility and reliability**

With properly installed, operated and maintained systems, piped water to individual dwellings has the potential to provide the best levels of quality, accessibility and reliability. Sufficient water pressure should be maintained in the distribution system so as to avoid infiltration from contaminated groundwater. Many urban locations across the developing world have an intermittent water supply, without this water pressure safeguard.

In formal poor community areas, piped connections are technically feasible. Individual connections in apartment housing blocks (in some cases tenement slums) are also possible with payment by the individuals or by the whole block.

In informal areas, access for pipe laying may be difficult. Also communities may be moved or buildings may be improved, and factors such as these militate against the provision of individual connections. If these consumers want house connections, the distribution of water through overground flexible piping is cheap and easily modified in the event of a change in conditions. However, such pipes need to be safeguarded against damage and overground pipes are only suitable if temperatures do not fall below freezing.

Communal standpipes, individual taps at communal points, and water kiosks are all means for providing water of adequate quality and reliability, although with higher risks of contamination than with piped supplies. Accessibility in such cases depends on the number of installations and on their site.

#### **Box 4.1. Manila East, Philippines: Concessions**

In 1997, the Government of the Philippines entered into two 25-year concessions, one for the East Zone (with 5 million consumers) and the other for the West Zone (with 6 million consumers). Prior to these PPP arrangements, the public services were run by the Metropolitan Waterworks and Sewerage System (MWSS), which still controls the main source of raw water from Angat multi-purpose dam. One objective of splitting responsibility for running the system was to create a means for the regulator to compare performance. A quasi-independent regulator was set up within MWSS.

The concession for the East Zone was awarded to the Manila Water Company, which has subsequently increased 24-hour availability of water from 26 per cent to 83 per cent and has reduced staff levels from 6.6 to 3.2 employees per 1,000 connections.

Manila Water Company's '*Tubig Para sa Barangay*' (Water for the village) programme has serviced some 64,000 households within its area providing access to safe water to some 400,000 consumers. This scheme provides legal connections to poor communities who live in crowded, densely populated areas where it is difficult to install conventional water pipes. Banks of meters have been installed, to which each household can connect its own flexible pipe leading to its property. Alternatively, cluster and bulk meters have been installed.

This programme was not envisaged in the original contract, but was agreed by the regulator and concessionaire in response to a perceived need. It has served poor areas, increased income to the operator and has reduced traffic congestion in narrow passages because tricycles vending water are no longer required.

Water vendors and water tankers can also carry and deliver water of adequate quality and reliability, if properly organized and regulated. However, access for water tankers may be impossible or restricted in informal community areas.

Communal wells are at risk of contamination by nearby septic tanks and pit latrines, so present significant water quality risks, especially in densely populated areas.

Any water supply system, including conventional piped supply, can present health hazards if it is not operated and maintained effectively.

#### **4.2.2 Sewage disposal hygiene and privacy**

In principle, only on-plot toilet facilities provide the level of privacy that most people would wish for sanitation.

Full waterborne sewage disposal with sewer connections to each house provides good sanitation if well maintained, but requires substantial pipework and uses a lot of water for toilet flushing. The cost and the need for plentiful water make full sewerage inappropriate for informal poor communities. Full sewerage is technically suitable for formal poor areas and apartment blocks where sewers can be laid. However, the costs within houses and in the collection and treatment systems of such an arrangement are often not affordable.

Condominial sewerage (see Box 4.2 for details) offers some cost savings over full waterborne sewerage in formal areas that have appropriate housing types. In better-quality informal areas, it may take discharges from septic tanks. Operation and maintenance is particularly critical in such cases to avoid overflow or spillage of sewage (see Box 4.2).

On-plot latrines can be healthy if they are designed and built to recognized standards, for example the VIP latrine. A specialist's guidance aids the effective installation of this type of facility. Pit latrines are expensive to build on rocky ground. In areas with a high water table, the pit latrine can be elevated.

Public toilet blocks are sometimes combined with laundry facilities and provide hygienic facilities in areas where improvements on an individual household basis would be difficult. Such blocks need full-time supervision and cleaning, usually through community involvement, to maintain the facilities in good order (see Box 4.3).

Potential options for sewage disposal are to some extent more detached from the normal activities of a PSP operator than are those for water supply. However, contractual questions of responsibility remain to be addressed, and the relationships between sewage disposal and drainage and solid waste disposal all involve a closer technical relationship with municipal authorities.

### **Box 4.2. La Paz-El Alto concession**

A 25-year concession was signed in August 1997 for La Paz, the capital city of Bolivia, and El Alto a low-income neighbouring town.

The contract was designed to help the poor through a number of strategies that did not always develop quite as planned. The areas to be served were defined, as were areas that were not to be served because of low density of population. In fact, it was found that as connections were made the population moved in and density increased in those areas. In effect, the concessionaire had exclusivity, which prevented services being provided by neighbours and also had a negative effect in areas that were not served.

Coverage mandates were in terms of numbers of people to be provided with water supply and percentage for sewerage, with full coverage where an area met certain density criteria. The concession mandated outputs, not inputs. The fixed connection fee tended to reflect the price of 'fill-in' connections rather than connections to entirely new areas that would be more expensive, so no more than half could be in-fill. The operation of the concession was later modified by agreement to respond to conditions that had been overlooked and were to be met and those that had developed.

In order to reduce costs to poor consumers, a pilot project was started in 1998 to identify and test innovative systems to provide water supply and sanitation for the urban poor. Condominial systems for water pipes and sewers reduced costs to between one quarter and one third of the cost of conventional systems. The condominium system uses small diameter, shallow pipes laid at flat gradients in properties, yards or sidewalks, but not in roads. Maintenance and control of the system by the operator would be difficult because of access to properties, so responsibility is passed to house owners for the upkeep of services passing through their own properties. Installation costs are recovered from consumers with instalments paid over five years with no interest.

Considerable effort was put into working with the community on development of the pilot project, including ways of making maximum use of the new water supply and sewers, along with hygiene education/ promotion. Micro-credit was offered for installation of internal water use facilities, mainly flush toilets, but this was not popular. Nonetheless, the number of water and sewage facilities increased significantly.

The disadvantage of the condominium systems is that the reliability of service depends on the community using and maintaining the system properly. Because of small pipes on flat gradients, sewers can be blocked easily and will then flood upstream properties with sewage. The householder in the property in which the blockage occurs is faced with the task and cost of clearing it. Similarly, any breakage in a water pipeline will cut off those downstream until the owner of the property with the break has repaired it. These problems are already creating a difficult situation and will increase with time.

### **4.3 Affordability**

The main factors to be considered in satisfying the affordability criterion are:

- minimizing costs (consistent with levels of services);
- tariff structure, subsidy and credit (which should be consistent with social policy);
- payment methods (which should make payment easy); and
- willingness to pay (which depends on the service and alternatives).

### **Box 4.3. Public toilets and laundry facilities**

Public health facilities are established in many poor urban areas by operators and by local and national NGOs. India has a well-established network of such facilities.

These are normally permanent buildings with toilets and washbasins, but they may also have showers and areas for washing clothes. Normally a small charge is made. A janitor is in charge to take money and to keep the facilities clean. In Dhaka, Bangladesh, the schedule of charges is fixed. Private individuals bid for the annual operating franchise. These operators often come from poor communities.

In Jakarta, Indonesia, a number of washing and toilet facilities were established in poor areas by the public sector. Each serves a part of the community, who select one of their members to run the facility. Other adjacent sections of the community have similar arrangements. The water supply is metered and the janitor has to charge the section of the community at a rate that covers all operating costs plus his/her living costs. In addition, shallow boreholes with hand pumps can provide non-potable water.

The quality of facilities depends on the original workmanship, the thoroughness of the janitor, plus the availability of adequate water and removal of wastewater. The last two should be accommodated within a concession agreement.

#### **4.3.1 Minimizing costs**

Costs can be minimized through:

- choice of service levels and method of supply;
- technical standards adopted;
- community labour contributions (potentially for installation, operation and maintenance); and
- use of secondary providers for distribution (where the cost reduction would be relative to the costs of it being done by the PSP operator).

Minimizing costs in the technical methods of supply are clearly a further reason for avoiding fully piped systems in informal areas. The choice of technical standards is also connected to the permanency of communities.

All of the factors noted above present issues that have to be resolved in a PSP concession contract.

Clearly, the charging structure should reflect any lower costs of supply to poor communities.

#### **4.3.2 Tariff structure, subsidy and credit**

Subsidy and credit facilities are common, especially where the charges to pay even for low-cost services are not affordable by poor consumers. These facilities will involve sector issues, and probably legislation.

Potential solutions are explored in the authors' separate paper - Tariffs for the Poor.

Where there is a high risk of non-payment by consumers, it might be necessary for the authority (promoter) to be responsible for tariff collection, with some other form of payment (fee) made by the authority to the operator. However, in most circumstances operators would prefer not to have to rely on payment from one source only.

#### **4.3.3 Payment methods**

With tight family budgets and concern over the potential size of retrospective bills, paying small amounts as and when needed is attractive to the poor. Pre-payment methods involving tokens, 'smart-cards' and the like are used. This also enables poor people to establish for themselves the quantity of water they can afford.

#### **4.3.4 Willingness to pay**

Willingness to pay for piped water or other supplies is particularly dependent upon:

- realization of the benefits of safe accessible water and hygienic sewage disposal (promoted by education as necessary);
- quality of service received;
- affordability and ease of payment; and
- availability of other free or cheaper sources of water.

### **4.4 Appropriateness**

Appropriate solutions need to fit physical and financial conditions (as above) and the social and institutional circumstances at the local level. These circumstances can be defined as follows:

- permanence of the community and its physical characteristics;
- land tenure - extent of address registration;
- community organization for management of services;
- roles of NGOs and CBOs; and
- secondary providers - existing and potential.

#### **4.4.1 Permanence of the community or its physical characteristics**

Informal housing areas may be truly spontaneous and temporary or may have existed for many years. In both cases, wider attention to the situation of the poor may lead, in the short- to medium-term, to re-housing or improvements in housing either on the site or on new sites.

The expected time period over which services will be required for an area should be taken into account in choosing the technical solutions. Where there is good reason to expect improvements in the short-term, least-cost solutions schemes should minimize fixed infrastructure but at the same time should use components that are either re-usable or have a relatively short design life.

#### **4.4.2 Land tenure - extent of address registration**

In many informal areas the community has no right to occupy the land it is on. There may be no official representation and few, if any, physical addresses. This causes multiple



## SECTION 4: LOCAL LEVEL SUCCESS FACTORS

problems of institutional support for the poor, and specific problems for the provision of water services, for example:

- the installation of infrastructure and facilities on illegally occupied land may not be allowed because of implicit recognition of rights; and/or
- the registration of individual households as customers is not possible, and this will exacerbate the risk of non-payment for services.

The adopted technical solutions need to recognize these constraints, but at the same time:

- institutional changes should address the fundamental problem; and
- community solutions for service delivery may reduce legal and financial risks.

### **4.4.3 Community organization, NGOs and CBOs**

In informal areas the factors considered above all point towards technical solutions that are likely to be low-cost, possibly with shared (communal) facilities (at least for water supplies) and possibly with services provided and revenues collected by secondary providers. Such solutions require stronger community structures than for services to individual households.

Particularly in informal areas, community involvement should be mobilized through all phases of development. These phases include:

- consultation with and advice to sector authorities, and provision of information on local communities for the concession design phase;
- planning of service improvements to acceptable levels;
- possible labour contributions to reduce construction costs; and
- assistance in operation and maintenance.

The last two aspects could lead to lower charges, whereby the community assists the operator to be more efficient.

The presence and activities of NGOs and CBOs can help the promotion of poor people's concerns at the sector level, and in representation and capacity development in individual communities.

### **4.4.4 Secondary providers**

The term 'secondary provider' covers a wide range of methods for supplying water. Potential arrangements include:

- provision by private water tankers from the operator's bulk supplies outside the community;
- supplies bought from the operator and distributed by private vendors;
- supplies sold at distribution points, including water kiosks, by operator employees, or by licensed private vendors;

## PRO-POOR LONGER TERM (CONCESSION AND LEASE) CONTRACTS

- community or private organization for the management of communal distribution points such as standpipes, or the operation of secondary piped supply and collection systems; and
- privately operated septic tank cleaning services.

Secondary providers are potentially most useful where individual piped delivery and collection are not appropriate.

Responsibilities for water quality and reliability, and ownership of revenues should be defined. Formalization of the activities of secondary providers, through engagement under sub-contracts with the PSP operator, should cover scope, quality and prices.

Existing private secondary providers (water vendors or tanker suppliers) are likely to have a good understanding of poor communities and their problems. However, in many cases such providers might turn this to their advantage through unreasonable pricing. In many urban situations, a very substantial proportion of the population can be dependent upon such supplies. Improving the supply can take time because of resistance from these vested interests. In such cases, the necessary contractual and regulatory provisions should be in place from the commencement of the concession.

**Table 4.1. Local level success factors**

Factors in the success of pro-poor PSP	Ref	How the factors can be recognised in a pro-poor concession contract	Enabling and supporting actions and provisions
<b>Functionality</b>			
Water quality Water reliability Water accessibility Sewage disposal	1.	a) The specifications for services must allow the flexibility for appropriate methods to be used to suit different circumstances, especially for the poor. The range of methods that will be accepted should be described, and minimum standards defined for all potential solutions.	Preparation of adequate specifications will benefit from extensive consultation with communities and NGO/ CBOs.
<b>Affordability</b>			
Minimizing costs	2.	a) Cost-effective solutions will be promoted by the pressure on tariffs and supported by flexibility allowed in the choice of solutions. Minimum technical standards must be defined for each potential solution. b) The contract must define the roles and responsibilities of the operator and any NGOs/ CBOs or other local organizations involved with the installation, maintenance etc. of infrastructure for reasons which include cost reduction.	Costs are normally a direct factor in concession bid evaluation. Potential for cost saving to the poor could be included.
Tariff structure, subsidies and credit	3.	a) The tariff structure and levels at the start of the concession will be defined in the contract, and associated agreements may be required to define subsidy and credit provisions. The contract will specify the period over which there will be no change, and will require review or redesign of structures and levels at specific times or under specific circumstances. b) The contract will provide an agreed profile of tariff increases and/or specify the conditions for tariff changes, and the mechanisms by which proposed changes are regulated and agreed. c) Internal cross-subsidy will be covered by the tariff structure. d) If it is part of the concession design, the contract might include provisions for the payment and management of a 'concession fee' or similar mechanism, which might contribute to subsidies. e) The terms and features of any credit facilities for poorer customers (by the operator) should be defined.	Principles must be defined that govern the basis for any charging for various potential types of solution for the poor.  This would normally be the subject of agreements between the operator, the authority and funding agencies.

**Table 4.1. Local level success factors**

Factors in the success of pro-poor PSP	Ref	How the factors can be recognised in a pro-poor concession contract	Enabling and supporting actions and provisions
Payment methods	4.	<ul style="list-style-type: none"> <li>a) The contract can provide definitions for acceptable and appropriate methods of payment.</li> <li>b) Contract performance requirements should include development of good access for all customers to payment points and to utility offices for help and advice.</li> </ul>	
Willingness to pay	5.	<ul style="list-style-type: none"> <li>a) The concession can include requirements for surveys, if required, and for provision of assistance in education and awareness campaigns.</li> <li>b) The design of service performance and tariff profiles in the contract should be such that improvements in service become evident to consumers in advance of any significant tariff increases.</li> </ul>	Willingness to pay should preferably be indicated through surveys and consultation during or before the preparation phase.
<b>Appropriateness</b>			
Permanence of community and physical characteristics	6.	<ul style="list-style-type: none"> <li>a) The geographical areas and communities, which are to receive different types of services, should be identified in schedules to the contract.</li> <li>b) Normally such identification will be far from perfect. To accommodate this, and changes over time, the conditions under which the operator is obliged to provide services, and has the right to provide services, must be clearly defined. Clear definitions must be provided for 'poor' consumers and 'poor' communities.</li> </ul>	The definitions must be such as to ensure that the operator is not expected to take actions ultra vires (i.e. that are beyond its authority).
Land tenure etc. (effectively official recognition of the customer)	7.	<ul style="list-style-type: none"> <li>a) This would be recognised in the definitions in the relevant bye-laws.</li> </ul>	
Community organization, NGOs and CBOs	8.	<ul style="list-style-type: none"> <li>a) Depending on the extent of preparation, the contract could possibly identify specific NGOs and CBOs as approved sub-contractors for the purposes of local system management or secondary distribution.</li> <li>b) The contract should include a recommendation that NGOs/ CBOs be consulted in the preparation of detailed service plans for specific communities.</li> </ul>	Specific agreements between the operator and NGO/ CBOs may be appropriate.
Secondary providers	9.	<ul style="list-style-type: none"> <li>a) The contract must provide minimum requirements (quality and price) for the basis for contractual and financial relationships between the operator and sub-contracted secondary providers, and the basis for the evaluations of labour contributions by members of the communities.</li> </ul>	Acceptable forms of agreement should be presented, but bidders could offer alternatives.

## Section 5

### **Sector level success factors**

#### **5.1 Introduction**

Sustainability, as determined by provisions at sector level, will be dependent on factors that can be considered under three broad headings:

**Inclusivity** - Inclusivity means that solutions must be provided for all of the population, in all locations and of whatever means and circumstances. It also means that all relevant institutions concerned with development, finance and welfare must be included in the agreement of actions. These factors must be incorporated in legislation, agreements and guarantees and in contract provisions, which will promote and support local level activities.

**Feasibility** - In order to incorporate local solutions into a stable contract at the sector level, contractual and institutional mechanisms are required that are based on a feasible model of development, service levels, costs, revenue security, financing and public subsidy.

**Bankability** - In order to attract finance, the complete package of the contract and related legislative provisions, agreements and guarantees must be cohesive and consistent with the feasible project. Bankers want to see where their repayments will come from.

Sector factors are summarized in Table 5.1

#### **5.2 Inclusivity**

The main factors to be considered in obtaining satisfactory solutions are:

- effective and accurate basic information;
- institutional preparation and co-ordination;
- operator (bidder) perceptions and proposals; and
- scope of regulation.

##### **5.2.1 Effective information**

Good information on the water utility and its environment is essential for the success of the bidding process and the eventual contract. The timescale for the PSP feasibility study and preparation is often insufficient for adequate information preparation and its incorporation into decision-making. This can lead to disputes later on.

Unfortunately, most public utilities that are being handed over to a private operator do not have long-term registers of assets, including the quality of those assets. Hence it is becoming more usual for preliminary studies to be carried out, for example to improve estimates of non-revenue water, or to provide improved accounts data.

The authors suggest that achievement of successful solutions for the poor warrants similar efforts in terms of obtaining information through preliminary studies. The following main areas could be covered.

- **Information on the existing situation at the macro level**  
The objective of this information would be to provide a broad picture of the demography and geography of the poor at the sector level (that is, within the likely PSP service area).
- **Information on the characteristics and potential solutions for individual classes of disadvantaged communities and consumers**  
This would provide a basis for identifying the needs of low-income groups and potentially appropriate solutions and, in combination with macro information, would enable the poor sectors of the community to be included in the PSP concession requirements.
- **Development of awareness and understanding at the community level**  
The awareness and understanding would include the importance of the contribution to public health that water and sanitation make. It would also include the principle that improvements would be made that might involve different levels of service and price factors. Development of awareness and understanding would involve gathering views on appropriate technical and institutional arrangements.
- **Information on pro-poor initiatives and municipal development plans**  
As well as preparing information on the poor, and 'poor' communities, documentation of local government initiatives to address any legal and institutional barriers to service improvement is essential for preparation of an effective contract. Similarly, municipal development policies and plans will form the basis for the development plan in the concession.

NGOs and CBOs can assist in the successful implementation of the work described above.

The information and initiatives described above are essential if full provision is to be made for the poor in a workable concession contract. It will also enable a more effective case to be made for financial support from central government and international funding agencies. Much of the information gathered will have relevance for the contract, in that circumstances that are materially different from those described in bidding documents could trigger renegotiations. The better the conditions are known and defined, the less likely will be the need for substantial renegotiations later based on unexpected conditions or changes.

### **5.2.2 Institutional co-ordination and preparation**

The process described in the previous section should be developed through the period of transaction preparation, and a co-ordinated approach by all stakeholders should be in place by the time the concession commences.

## SECTION 5: SECTOR LEVEL SUCCESS FACTORS

The overall objectives of government may include plans to alleviate the community-level problems of the poor (their social and legal status, land registration, employment, earnings or income support, health etc.) and to define and implement long-term programmes for the improvement of infrastructure and housing. These plans and improvements will help the water sector operator to be effective. However, in many cases the task of improving poor communities will be long-term, whereas the improvement of water supply and sanitation may be short- or medium-term.

Relevant politicians and officials can guide and assist in developing understanding of, and agreement on, the many complex factors and relationships that need to be considered, accepted and actioned in order to produce an effective pro-poor concession contract. These will include:

- The principles behind a concession contract, and particularly the principle that expectations of benefits must be related to economic and financial factors.
- The principle that there can be different levels of service and charges available to different sections of the population.
- The recognition of the legal and social changes that are needed in order to maximize the benefits that can be brought to the poor through improvements in infrastructure.
- The understanding that over the term of a concession contract circumstances will change, requiring the adaptation of flexible concession targets to suit these changes.
- The understanding that long-term planning of the concession outputs requires a realistic view of the expected development of a city's overall infrastructure, and that the evolution of services to the poor will need to be adapted as the city's development plans change.
- The understanding that in the short term it may be necessary to allow the continuation of unofficial independent services. This will be until such time as the operator provides the services to a specified level, either directly or through sub-contracts (see Box 5.1).
- The understanding that tariff structures and financing mechanisms, including subsidies and cross-subsidies, must be developed to include equitable contributions (including resources and actions) from all of those with an interest in the improvement of urban conditions, including:
  - existing customers;
  - future customers;
  - municipal authorities and state and central governments;
  - public development authorities and private developers; and
  - international donor institutions.

Once provision for the poor has been defined in practical service and payment terms, the contract must be drafted to suit that provision. In addition, the institutional and financial measures that will be essential to enable and support it must be enshrined in the legislation, agreements, and guarantees as appropriate.

**Box 5.1. Karachi - a failure in consultation and an institutional opportunity lost**

Failure to consult with NGOs and CBOs contributed, amongst other factors, to the inability to introduce PSP to Karachi in the late 1990s.

The major problems caused by unofficial secondary providers (the so-called 'tanker Mafia') were identified and analysed by the researchers. However, it was also recognized that continuation of these services would be essential alongside the introduction of PSP in the short term. A 'Water Act' was drafted and accepted by the parliament of the Province of Sindh. The Act provided for the continued operation of secondary suppliers, under regulated licences, until superior services could be offered by the proposed PSP operator.

With the failure to introduce PSP, this opportunity to improve and control the secondary service providers also fell by the wayside.

**5.2.3 Operator perceptions and proposals**

It is becoming more common for operators' (potential bidders') views to be taken into account during the process of contract preparation. Although this may be precluded by the procurement rules of some international funding agencies (which might be financing the transaction preparation work), it can, if properly handled, add to the effectiveness of concession contracts.

A further point, at which valuable operator ideas and proposals can be invited and evaluated, is in the bidding process itself. This requires careful design of the bid and evaluation process. In many cases it has been precluded because, in the interests of transparency, award is on the basis of the lowest average tariff only. Technical proposals on the other hand are judged only as a statement to meet specified standards; they have only to be cleared (pass/ fail) before opening of financial bids.

However, selection on the basis of 'best value for money' requires clear directives to bidders as to what the client wants and an indication of any financial limitations. Without a statement of priorities, bidders will not be able to structure their offer to match the perceived needs of the client. The risk of preparing a bid that is too far from the client's requirements, and therefore is unresponsive, may put off potential bidders.

**5.2.4 Scope of regulation**

Regulatory issues in relation to solutions for the poor are discussed in a separate paper by the same authors. For completeness in this paper, they note that on the basis of the foregoing points, and those in the following section, the scope of regulation must include:

- aspects of the service and financial performance of the concession contract;
- the particular conditions of contract that relate to services for the poor, where these are different from normal utility operations;
- the relationships between the PSP operator and secondary providers (for example, terms of sub-contracts, and price agreements or competition between secondary providers);



- the regulation of independent providers who may continue to operate during the initial period of a contract; and
- a role in the development of institutional co-ordination and policy-making decisions that is consistent with a regulatory duty to promote and enable effective and sustainable services.

### **5.3 Feasibility**

Specifically, 'feasibility' means a contract design that will convince a private sector operator that the contract performance requirements can be achieved; that risks are appropriately shared and manageable; and that the operator will be able to achieve its commercial objectives. Some key elements are described briefly below.

- The concession must operate on the business basis of adequate income, enabling the long-term sustainability of assets and services. This does not preclude the use of cross-subsidy (within the utility business) or external support or subsidy provided either to the utility or to individual consumers. (Refer to the authors' separate paper - Tariffs for the Poor).
- The information base for the utility and the environment in which it is to operate must be sufficient to support the objectives of the concession and must be the basis for pricing.
- The contracted rate of expansion and improvement of services must be realistic, and it must reflect the availability of retained earnings and external financing to sustain investment, whilst maintaining acceptable business indicators.
- Business projections must assume that planned levels of service for stated areas will not be changed without commensurate increases in tariffs or other sources of finance to meet their development costs.
- The operator must be able to see that the projected revenue stream is dependable. There are three major factors in this respect - the size of the customer base, tariff levels, and recourse in the event of non-payment by customers. In order to ensure that planned revenues are realized through the life of a concession, operators will expect to have defined rights (not necessarily exclusive rights) to supply customers within the PSP service area. Support or subsidy arrangements must be clearly defined in the contract and supported by legislation where appropriate. Normally in a concession the operator bills and collects from consumers and accepts the risk of non-payment. Collection of customer payments by the authority on behalf of the operator, where proposed, must be clearly defined in the contract. The authority would then take the risk of non-payment.

### **5.4 Bankability**

Assessment of the bankability of a proposed concession will be the concern of all those who expect to finance it, or who in some way or another are expected to provide guarantees. These stakeholders will include participant shareholders in the operator's consortium (or SPC), commercial investors and lenders, international funding agencies and government.

## PRO-POOR LONGER TERM (CONCESSION AND LEASE) CONTRACTS

Bankability will depend upon the legal, institutional and financial provisions and on the financial feasibility of the contract. It will be expected that these factors be demonstrated by a complete and consistent package of legislation agreements and guarantees, which will share risks appropriately and reduce the risks of investment to an acceptable level commensurate with the return.

**Table 5.1. Development of pro-poor solutions**

Factors in the success of pro-poor PSP	Ref	How the factors can be recognised in a pro-poor concession contract	Enabling and supporting actions and provisions
<b>Inclusivity</b>			
General	1.	<ul style="list-style-type: none"> <li>a) The contract must specify service level performance requirements including coverage, which must include provisions for all consumers including classes of poor consumers by area.</li> <li>b) The concession performance requirements for 'coverage' must be based on a definition of coverage that includes appropriate solutions as alternatives to conventional network services.</li> <li>c) The granting of the concession must bring with it the obligation to provide, maintain and operate services in accordance with a development programme in the contract.</li> <li>d) The contractual rights to supply services shall not exclude independent providers during a period and in locations where there is no practicable alternative.</li> </ul>	
Effective information	2.	<ul style="list-style-type: none"> <li>a) Information obtained and analysed during the transaction preparation will form the basis for the performance targets and allowable tariffs that are incorporated in the contract. As noted above, these should include any pro-poor targets.</li> <li>b) A municipal development plan should be referenced in the contract and should provide the context for the relevant performance requirements of the concession. The plan would provide part of the basis for renegotiations in the event of material departures from assumed developments in the service area.</li> <li>c) The contract must contain clear definitions of the service area covered by the PSP arrangement and more specifically of the 'poor' communities within the area. Identification of these areas and communities should result in service targets being well defined.</li> <li>d) Information obtained during the transaction preparation should allow appropriate outputs, or, possibly technical solutions, to be built into the contract as part of the Operator's performance targets.</li> </ul>	<p>Information that is the basis for bidding will be included in the Information Memorandum that is part of the Bidding Documents.</p> <p>Consultation and integration with local authorities is essential in the preparation phase. This should enable integrated and economically effective decision-making for the various types of poor consumer and the characteristics of poor communities. Close liaison will be needed with local authorities, NGOs, etc. in the preparation phase, and preferably in a separate study before that phase.</p>

**Table 5.1. Development of pro-poor solutions**

<b>Factors in the success of pro-poor PSP</b>	<b>Ref</b>	<b>How the factors can be recognised in a pro-poor concession contract</b>	<b>Enabling and supporting actions and provisions</b>
Institutional preparation and co-ordination	3.	a) The results will be legislation and clarity of roles of different stakeholders that must be consistent with both the pro-poor objectives and the commercial objectives of the contract. The contract in turn must be consistent with the roles.	Pro-poor legislation and roles should cover, inter alia: <ul style="list-style-type: none"> <li>• liaison with local authorities over access to poor areas and co-ordinated development;</li> <li>• subsidies;</li> <li>• finance;</li> <li>• secondary and independent advisors.</li> </ul>
Operator (bidder) perceptions and proposals	4.	a) The bidding, evaluation and negotiation process can provide for operator proposals to be incorporated into the contract as performance requirements.	Marketing, bidding and evaluation processes may be designed to recognize and reward bidders with experience of, and a positive approach to, serving poor areas.
Scope of regulation	5.	<p>a) The general and specific rights of the regulator (or the conceding authority, in the absence of a separate regulatory body) must be described in the contract.</p> <p>a) Rights will include monitoring of performance, which in turn may include specific pro-poor performance targets.</p> <p>b) The contract will define timing and procedures for planned periodic reviews of service and financial performance and tariffs, and the triggers and basis for extraordinary reviews required because of changes in circumstances.</p> <p>c) The contract may describe regulatory requirements vis-à-vis water vendors subcontracted to the operator, and any joint responsibilities (e.g. provision of information to the regulator) with independent providers.</p>	
<b>Feasibility</b>			
General	6.	a) The technical and financial feasibility of the concession will have been established during the transaction preparation and confirmed in the evaluation of bidders' proposals. The agreed service performance projections and targets will be incorporated into the contract.	

**Table 5.1. Development of pro-poor solutions**

Factors in the success of pro-poor PSP	Ref	How the factors can be recognised in a pro-poor concession contract	Enabling and supporting actions and provisions
Full cost recovery basis	7.	a) This would be the normal expectation of a concession operator. Full cost recovery from consumers can be stated as part of the objectives of the contract, together with the stipulation that this is not expected to be to the detriment of services to all or any classes of customers. b) In some cases a concession could be supported by capital or operating subsidy, possibly in the initial years. Conditions relating to such support would be included in the contract.	
Sufficiency of information	8.	a) Refer to item 2. above.	
Realistic business plan	9.	a) Definitions should be provided of the minimum urban infrastructure required to be in place in order to permit expansion of services in the form of conventional pipe networks. b) Requirements for the levels of service in the PSP service area, and specific poor communities within that area, must be defined and must form the basis of the contracted future tariff structures.	

**Table 5.1. Development of pro-poor solutions**

Factors in the success of pro-poor PSP	Ref	How the factors can be recognised in a pro-poor concession contract	Enabling and supporting actions and provisions
Dependability of revenue stream	10.	<p>Size of the customer base</p> <p>a) In the short-term, the operator should have the exclusive right to use the existing assets, including the development of services in specified poor communities. In the long-term, rights must include supply to all of the population connected by a 'final' system (as would be defined in the contract), including extension of the system to those not initially receiving such a service.</p> <p>b) Also in the short-term, the operator should have the right (and obligation) to develop and operate improved services in defined poor communities, through sub-contracting mechanisms where appropriate.</p> <p>Recourse in the event of non-payment by customers</p> <p>c) In the event of non-payment by customers, provisions must be made for actions that the operator might take; such actions might involve different treatments depending on the level of service provided or the financial standing of customers</p> <p>Tariffs</p> <p>a) The contract will contain provision and mechanisms for tariff adjustments. Provision is also needed for renegotiations of performance outputs in the event that properly justified tariff increases are not allowed.</p>	<p>Legislation must be amended if necessary to mitigate the risk to the operator's revenue stream.</p>
Provision for changes in circumstances	11.	a) Refer to 2b), 5c) and 10d) above.	
<b>Bankability</b>	12.	a) The contract must be feasible, as discussed above, and must be supported as described in 3a) above.	

## Section 6

### **The pro-poor concession contract**

#### **6.1 Introduction**

Incorporating pro-poor provisions into a concession contract is a delicate balancing act between fulfilling public policy and not compromising the commerciality of the transaction and service delivery. Though the discussion is focussed on concession contract, it can be applied to other forms of long term contract such as lease or combination lease and management contract.

Concession type documents have now been in existence for at least a decade. There are also various competing styles and conventions emanating from differing parts of the world. These have been driven by, and from, the styles and conventions of the home base of the advisors and compilers. However, all variations are upon the same theme and all claim to be internationally recognizable. To a large extent this is true, but it is important to tailor the product to suit the understanding and expectations of the participants; these include the contracting parties and also any support agencies/ lenders and particularly the concessionaire financiers. Bankability is key to successful implementation. What may be acceptable to a concessionaire may not be acceptable to its financier, and this in turn risks failure of the whole process.

An effective concession contract is only the 'front-end' of substantial institutional change. That change will be enshrined in various legislation and inter-entity agreements and guarantees. The concession company itself will be formed and will operate under numerous internal agreements - for example, between the international operator, shareholders in the Special Purpose Company, financiers, suppliers and constructors. The contract and all of the other acts, agreements and guarantees must be cohesive and consistent in all respects, including their provisions in respect of the poor.

The authors have reviewed in earlier chapters the conditions that will be necessary to enable a commercially successful concession to also be pro-poor. Two of these conditions are stressed again:

- clear definitions of service areas, service targets and technical standards for the poor; and
- robust arrangements for payment and/ or subsidies or other support for services to the poor.

Finally, in all respects the contract must have a firm legal basis in order to avoid later frustration or it becoming void.

## **6.2 The outline concession contract**

In this section of the report the authors deal only with the concession contract itself. Table 6.1 gives a running list of contract sections relative to a 'standard' concession contract (column 2). Each contract section contains broad clause headings (column 3), in each of which we have noted the main features (column 4). The impact upon the concession contract of pro-poor provisions is noted in column 5.



**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
1.	Contracting parties	<ul style="list-style-type: none"> <li>Promoter</li> <li>Provider</li> </ul>	<p>The contract will define the agreement between the concessionaire (provider, operator) and the public sector (promoter, authority). Separate contracts may exist if the service area is divided between different PSP operators (concessionaires). Separate contracts or licence agreements may exist between the public authority and independent service providers.</p> <p>Normally a national, provincial or local authority</p> <p>Normally a consortium of an international water services operator and local property, construction or financing firms. Usually the consortium company will be specifically created and incorporated in the country in which the services are being provided.</p>	None
2.	Recitals	<ul style="list-style-type: none"> <li>The parties</li> </ul>	Definitions and legal status including declaration of intra vires (what factors come within the consortium's legal authority).	None
		<ul style="list-style-type: none"> <li>The legal basis</li> </ul>	Statutory and institutional framework.	The provision for pro-poor services needs to have been included in both these frameworks; it should acknowledge that certain types of customers will receive beneficial terms and that the necessary support for this has been designed (subsidy or cross-subsidy).
		<ul style="list-style-type: none"> <li>The practical basis</li> </ul>	The service framework.	This will include the defined pro-poor services. It will probably reference schedules attached to the contract in which full and detailed definitions will be given. The definition will be of 'the poor', the service to be provided and the performance levels, if different from the general obligations
		<ul style="list-style-type: none"> <li>The objectives</li> </ul>	The parties' common goals.	One of the common goals will be the provision of water/ sanitation services for the poor. This will reflect the provision in the service framework
3.	Definitions	<ul style="list-style-type: none"> <li>Use of terms and abbreviations</li> </ul>	The terms, acronyms and abbreviations used must be listed in full and then fully described	Terms such as 'poor', 'services for the poor', 'poor communities' and 'technical solutions', must all be defined to avoid ambiguity and contradiction.
4.	General principles	<ul style="list-style-type: none"> <li>General legal principles, including the following:</li> </ul>		
		<ul style="list-style-type: none"> <li>Amendments</li> </ul>	Will note that the Contract provides for accommodation to changing circumstances in order to avoid frustration.	This will include the service for the poor. The basis of the bid and thus the contract (and vice versa) will have been established; however, changes will arise due to economic and political forces.

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Third parties</li> </ul>	Normally notes that the Contract is restricted to the two parties, but should identify the relationships between the provider and any secondary providers and/or independent providers (which should be expanded upon later in the Contract).	Often third party services (either derived or independent) operate in providing the poor with water (and sometimes sanitation). These, if they are to continue (see the legal basis and statutory framework) must be reserved in the contract. Such reservation will include the operational areas, the service provided, the risk transfers, rights and obligations affecting the contract.
5.	Appointment	<ul style="list-style-type: none"> <li>Grant</li> </ul>	Normally the promoter would grant the concession on the basis of the Authority's Service Area. This would need to be qualified in respect of possible arrangements for secondary providers and independent providers. The details of the qualification would be in subsequent sections (8) and the schedules.	The pro-poor service must be included as part of the grant (Award of Concession).
		<ul style="list-style-type: none"> <li>Acceptance</li> </ul>	Provider's acceptance.	Will acknowledge the pro-poor services
		<ul style="list-style-type: none"> <li>Term</li> </ul>	The term of a concession is usually 20 or 25 years.	None
		<ul style="list-style-type: none"> <li>Legal title</li> </ul>	This normally confirms the ownership of existing assets by the promoter and the right (of the provider) to act and to use the assets for the purposes of providing the services.	None
		<ul style="list-style-type: none"> <li>Exclusivity</li> </ul>	The normal concession contract provides that there shall be no competition within the Service Area.	In the pro-poor contract this must be qualified, as noted against grant, above. The term 'exclusivity' would still be appropriate in respect of the provider's entitlement to use existing assets, extend those assets, and to provide all new services that require a defined and permanent level of infrastructure development.
6.	Conditions precedent	<ul style="list-style-type: none"> <li>General provider, promoter</li> </ul>	Actions needed before the Contract takes effect	These may include actions relating to services for the poor
7.	Obligations (of the provider)	<ul style="list-style-type: none"> <li>Service area</li> </ul>	With reference to details in schedules, these clauses must indicate and define the extent of the service areas in terms of physical locations and characteristics.	<p>The locations and extents of poor communities of various socio-economic characteristics that are to benefit from the pro-poor provisions.</p> <p>Division of responsibilities in areas defined for direct service to the poor (or poor communities) and any subcontract or independent service arrangements.</p>

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Coverage</li> </ul>	<p>Again with reference to details in schedules, these clauses must indicate and define the timescale and targets for:</p> <p>the extension of network infrastructure and the connection of new customers to piped water and sewerage services.</p> <p>The output and programme performance of extended coverage must be related to the Business Plan (including the operational and financial models) submitted in the provider's bid. Ideally, the coverage definitions and targets, and hence the business model, will have been based on a Municipal Development Plan. In this case the plan should have a contractual standing, and would thus provide a basis for controlled and rational re-negotiation of targets or finances in the event of material changes.</p>	<p>The development of separate services in poor transient communities as measured by population served by acceptable methods.</p> <p>The extension of infrastructure and provision of appropriate levels of service in permanent low-income communities.</p> <p>'Fill-in' connections of customers in areas of existing infrastructure, in cases where failure to previously connect has been for financial reasons that are now addressed in the Contract and attendant agreements (for example, by means of subsidized or waived connection charges).</p>
		<ul style="list-style-type: none"> <li>Service Performance in areas of developed infrastructure</li> </ul>	<p>Details would be provided in a Schedule. The usual contract would include performance and timescale requirements for existing and future served areas. Normally this will apply to customers receiving individual supply (or sewage disposal facilities) through a house connection that provides continuous pressurized supply and complete sewage removal (or individual house septic tanks).</p> <p>Customers served through a common connection in housing blocks or tenements.</p>	<p>Poor customers could receive supply through other means, such as yard tap, yard tank, semi-pressure, communal taps, delivery tankers, or intermittent supply. Similar provisions could be made with regard to sanitation.</p> <p>Only in the defined poor areas.</p>
		<ul style="list-style-type: none"> <li>Service Performance in areas of under-developed infrastructure</li> </ul>	<p>Content and intent as for areas of developed infrastructure, including the expansion of the service to paying customers.</p>	<p>The clauses would outline the requirement for poor communities of various types to receive services, and the types of service that will be acceptable in each case.</p> <p>The basis of permissible means of service delivery would be defined, including through a subcontractor, NGO/ CBO, or contributed labour. Relationships with independent providers would be defined, including obligations to supply water in bulk.</p> <p>Details of minimum standards of infrastructure provision and type would be provided in a Schedule together with a timescale for upgrading.</p>
8.	Performance Criteria	<ul style="list-style-type: none"> <li>Water quality</li> <li>Pressure, continuity and connections</li> </ul>	<p>Standards would be defined in a schedule. They should be uniform regardless of customer type, but could be the responsibility of the provider only where he/she is responsible for service provision, directly or through subcontracts.</p>	<p>Water quality should be uniform, but other elements may deviate with regard to the services to the poor. If so, they must be described.</p>

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Customer service</li> </ul>	Describes the obligations of the provider to its customers. This will include billing and collection, customer payment terms (customer obligations), cut off rights and customer rights (of service, complaint and resolution procedures). It should also include customer access, payment and complaint centres and a customer charter.	The poor are customers (although someone else may be contributing to their payments) and so they should have the same rights for the defined service they are intended to receive, including a customer charter (or variations thereof reflecting the defined service). It can be politically difficult to differentiate the service, and great care must be taken over customer charters if they do vary
		<ul style="list-style-type: none"> <li>Consultation with representative community bodies</li> </ul>	<p>This obligation may be shared with the promoter. The significant change from public to regulated private supply will have been legislatively made, but may not have been 'sold' to the customers. The benefits should be self-evident and if the economic analysis is correct, the revised tariffs should be acceptable.</p> <p>Nonetheless, consultation obligations are necessary, especially with regard to the CAPEX (capital expenditure) works and the temporary disruption this will impose upon traffic and normal life. The importance of keeping customers and potential customers informed and 'on-side' cannot be overestimated.</p>	Similar obligations. If representative bodies do not exist, they should be formed so as to provide a point of consultation; this will avoid issues festering and becoming political problems in the future
		<ul style="list-style-type: none"> <li>Disconnection</li> </ul>	The Contract will specify rules and practices governing the rights of the provider to disconnect customers; this will probably be linked to an agreement that the promoter will compensate the provider if there is prohibition of disconnection.	Similar provision will apply. However, the cost of administration and enforcement is unlikely to be fully recoverable, and special provisions will be needed. Making examples of non-payers will only work in more affluent areas.
		<ul style="list-style-type: none"> <li>Procurement</li> </ul>	Transfers the obligations of providing CAPEX works and/or OPEX (operating expenditure) services to the provider. It will include such constraints as imposed upon the provider.	None
		<ul style="list-style-type: none"> <li>Secondary providers</li> </ul>	Introduces subcontract arrangements for provision of some services, some of which may be for the poor.	These may be existing arrangements (but these could also be proposed arrangements) providing pro-poor services that will become the responsibility of the provider. The terms and conditions, rights and obligations for such will be defined.
		<ul style="list-style-type: none"> <li>Performance damages</li> </ul>	Penalty clauses must be built into the Contract for failure to meet the specified/ defined coverage levels and performance criteria.	Separate provisions will be required, designed to suit failures against the targets for the service to the poor.
		<ul style="list-style-type: none"> <li>Asset management</li> </ul>	Provision for the transfer of obligations to the concessionaire for maintaining existing and expanding with new assets, and maintaining them in defined serviceable order.	Existing and new assets for the service to the poor will be equally described with maintenance obligations that should in principle be no different to the full service; however, in practice type and performance may be different. Standards that should exist at the handing over at the end of the concession should be defined.

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Operational model</li> </ul>	Defines the practice of the customer base, operations and capital development of the concession, and how it will meet all the targets. The model introduces the expenditure and other resources necessary to achieve it (that is, resources other than the finance).	Operation of the service to the poor will be one of the aspects of the model.
		<ul style="list-style-type: none"> <li>Financial model</li> </ul>	This converts the operational model into the finance (generated from revenue, CAPEX, loans, support and the expenditure profiles) required to service the concession. This will include depreciation and debt servicing and all necessary expenditure that produces a net cash flow through various levels of the accounting process such as operating profits/ cash flow and net profits/ cash flow with periodic balance sheet forecasts.	The financial modelling of the service to the poor will be included in the predictions.
		<ul style="list-style-type: none"> <li>Existing assets</li> </ul>	These must be retained by the promoter, but their exclusive use must be transferred to the provider. All aspects must be defined, and in the ownership of the promoter (or use transferred by other owners).	Will be included as part of the existing asset base.
		<ul style="list-style-type: none"> <li>New assets</li> </ul>	To be provided by the provider (unless any reservation, which is a contractually dangerous practice) and retained under its ownership for funding purposes for the duration.	To be included as part of the new asset requirement. Service to the poor will be a part of the overall service.
		<ul style="list-style-type: none"> <li>Employee responsibility</li> </ul>	The transfer of existing employees and the rights of the provider to hire/fire are critical. This is a very sensitive issue. Private efficiency versus public policy can have a considerable impact upon staffing levels. The provider must be given full responsibility for all employees instrumental to the provision of the service, with constraints imposed in line with public policy.	Most of the service employees will be required whether the service is for the poor or not. There will, however, be a general increase in employment in line with service expansion. This will depend upon whether staff members are charged or not. The main employee increase might be in community bailiffs.
		<ul style="list-style-type: none"> <li>Other obligations.</li> </ul>	Further clauses would include obligations in respect of taxes, audit, insurance, law compliance, equity capital, and provider debt limitations that would not have particular relevance in respect of different parts of the community.	None
9.	Obligations (promoter)	<ul style="list-style-type: none"> <li>Co-operation</li> </ul>	<p>Relevant in promoting pro-active approach.</p> <p>Promoter should have resolved/ be contracted to resolve any issues such as land tenure so as to enable the provider to fulfil its service obligations.</p> <p>Promoter may be required to engage in public education/ awareness campaigns as this may facilitate revenue collection and ease the case for necessary tariff increases.</p>	<p>Particularly relevant in the case of informal settlements.</p> <p>Establishing ownership and rights in poorer areas can be a problem.</p> <p>Relevant if tariff charged.</p>
		<ul style="list-style-type: none"> <li>Raw water</li> </ul>	The promoter must provide access to suitable raw water in quantity and of defined quality parameters. There should also be mechanisms for adjusting service and performance levels and/or tariffs should there be shortfalls/ changes. Sources and constraints must be described.	Unless there is an acute shortage of raw water, there should be no need for special provisions

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Easements, rights of way, construction permits and planning matters</li> </ul>	These are a major contributor to delay is the provision of the necessary permits and permissions to allow CAPEX works to proceed expeditiously. The provider will be obligated to provide the necessary programming and proper applications, but the risk of unreasonable rejection remains with the promoter. If the risk is transferred to the provider, there may be a significant premium affecting tariffs.	Part of the service, but questions of land ownership may be an issue
		<ul style="list-style-type: none"> <li>Retained functions</li> </ul>	Any function to be retained by the promoter (or through the promoter by others) must be defined.	Unlikely to be of particular relevance, except in terms of direct subsidy payment to poor.
10.	Representations and Warranties (of the provider)	<ul style="list-style-type: none"> <li>Legal provisions</li> </ul>	These cover declarations of propriety and performance warranties.	Unlikely to be of particular relevance.
11.	Representations and Warranties (of the promoter)	<ul style="list-style-type: none"> <li>Legal provisions</li> </ul>	The mirrored provisions	Unlikely to be of particular relevance.
12.	Indemnities and guarantees	<ul style="list-style-type: none"> <li>From provider</li> <li>From promoter</li> <li>Procedures</li> </ul>	These underwrite the representations and warranties in callable financial form, including performance bonds as appropriate.	May be relevant in respect of responsibilities for secondary providers.
13.	Transfer arrangements	<ul style="list-style-type: none"> <li>Employees</li> <li>Unions</li> <li>Terms and conditions</li> <li>Cultural change</li> <li>Revenues liabilities, inventory and the like</li> </ul>	This defines the freedom and constraints of the provider in its employment policy (and there may be geared levels of employment), marrying the objectives of private sector efficiency with public policy. A sensitive issue requiring full and careful elaboration.	Not likely to be directly relevant.
14.	Regulation	<ul style="list-style-type: none"> <li>Regulator office</li> </ul>	As regulation cannot be through the contract for a long duration concession; the regulator office, resources and payment thereof needs creating and including. Usually payment for regulation through the contract by way of concession fee, or surcharge on tariffs, or may be paid by promoter	Will cover regulation of the pro-poor provisions
		<ul style="list-style-type: none"> <li>Methodology</li> </ul>	Defines how the regulator or regulatory body will operate.	Will cover regulation of the pro-poor provisions
		<ul style="list-style-type: none"> <li>Powers and obligations</li> </ul>	These will be defined in detail.	Will cover regulation of the pro-poor provisions
		<ul style="list-style-type: none"> <li>Regulation of independent providers</li> </ul>	If appropriate; similarly the powers and obligations will need to be defined and the impact upon the provider mitigated.	Will cover regulation of the pro-poor provisions
		<ul style="list-style-type: none"> <li>Funding</li> </ul>	By the provider or the promoter or both.	Will cover regulation of the pro-poor provisions

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Reporting requirements, service performance, financial</li> </ul>	Defines in detail the reporting required by the provider (content and timing). The performance criteria and achievements, and default remedies.	Will cover regulation of the pro-poor provisions
15.	Tariff and charges		The contract must define the tariff structure at the start of the concession period. These tariffs may be fixed (or fixed within defined upper and lower limits) for a given period of time. Where a range of levels of service is possible, permitted tariffs for each should be stated.	
			Future tariff increases and criteria for adjusting tariffs will be agreed. This review process must be stated in the Contract.	Tariff changes (increases), which impact directly upon poorer consumers, must be vetted and agreed.
		<ul style="list-style-type: none"> <li>Audit and certification</li> </ul>	Requirements, if appropriate, for auditing and certifying the provider reports and progress.	Will cover regulation of the pro-poor provisions
			Minimum and technical standards for payment facilities should be defined. Key criteria might include access, and flexibility in terms of methods of payment and ease of use.	
			The provider can be required to commission affordability studies and data-gathering exercises prior to increasing tariffs.	
		<ul style="list-style-type: none"> <li>Base tariffs</li> </ul>	The commencing (usually bid) tariff(s) from which all changes are calculated.	May be a discounted tariff.
		<ul style="list-style-type: none"> <li>Tariff adjustments, inflation, exchange and interest rates</li> </ul>	The various categories of change must be defined, together with robust and transparent mechanisms for calculation.	May vary depending upon support levels and methods.
		<ul style="list-style-type: none"> <li>Tariff adjustments, unforeseen events</li> </ul>	To avoid frustrating the Contract (to give a level bidding base) and to acknowledge that unforeseen adverse/ beneficial events may impact upon tariffs. Again, including robust and transparent calculation mechanisms.	May vary depending upon support levels and methods.
		<ul style="list-style-type: none"> <li>Information requirements</li> </ul>	Obligation upon the provider to keep and provide all reasonable records to support applications for tariff adjustments.	May vary depending upon support levels and methods.
		<ul style="list-style-type: none"> <li>Audit and certification</li> </ul>	Requirements may be included to ensure audit and certification of records and applications.	May vary depending upon support levels and methods.
		<ul style="list-style-type: none"> <li>Customer charter, rate limits, connection charges</li> </ul>	<p>Obligations to the benefit of the customer and caps to the tariffs (subject to unforeseen events, otherwise frustration).</p> <p>Connection charging constraints - commerciality versus public policy.</p>	May vary depending upon support levels and methods; connections may be free to poorer customers.

**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		<ul style="list-style-type: none"> <li>Connection compulsion</li> </ul>	Usually more relevant to sewerage, water being such a necessity. Sewerage network expansion can be frustrated without compulsion.	Sewerage connection and connection charge compulsion may be irrelevant, but might be appropriate with support in whole or part.
16.	<i>Force Majeure</i>		Provisions include event definition, obligations and mitigation.	Not of any more significance than for other consumers.
17.	Termination (early)		Provider default, promoter default, procedures, default damages, legal title.	Not of any more significance, except that poor may be less able to cope with interrupted services.
18.	Dispute resolution		Provisions include consultation, independent appeals panel, which may be final or arbitration/ litigation.	Not of any more significance.
19.	Termination (expiry)		Provisions include reversion, asset condition, inventory, moveable property, legal title etc.	Not of any more significance.
20.	Schedules (defining)	Service area	Defines the geographical parameters.	Includes demarcated poorer communities.
		Population	Per capita, per family, per household, economic-social mix (estimated if not known).	Similar for poorer customers (or consumers).
		Industrial base	Industrial and commercial customers, and known or estimated usage of raw or treated (or independent) supply/ wastewater collection and treatment.	None
		Assets	Inventories	Not of any more significance.
		Coverage targets	Network expansion criteria.	Will include provision for the poor.
		Existing projects	Assets in the course of construction, type and purpose/ output, with progress and cost/ time to completion.	Will include provision for the poor.
		Existing loans	Drawn-down loans/ funding of existing assets and assets under construction, together with balance of loans and expiry dates (with extension terms as relevant). Also, any other loans, which may not be directly linked to assets.	Not of any more significance.
			Provision will have to be made in the Contract for the treatment of any such loans, whether retained by promoter or transferred to provider, and of course for provision to pay back existing and new draw-downs.	
		Employee information	Numbers, skills, costs (net and gross), unionization, length of service etc.	Not of any more significance.
		Financial performance	Monitoring, auditing and reporting provisions.	Not of any more significance.



**Table 6.1. Outline structure and content for a pro-poor concession contract**

Ref	Contract sections	Contract clause(s)	Content and intent	Pro-poor impact
		Service performance	Monitoring, auditing and reporting provisions, including performance measuring.	Will include the service expansion and performance targets for the poor.
		Technical assumptions	The basis of the bid. It will include the technical criteria upon which the bid, and thus the concession, is based. To be used for evaluation of change.	Will include the service expansion and performance targets for the poor.
		Business plan	The document that gives a detailed written statement of the concession objectives; how they will be achieved (methodology) both in OPEX and CAPEX terms; and the resources required in order to achieve those objectives. The financial aspects will be included, according to the financial model and giving the resource levels upon which it is based.	Will include the service provisions for the poor, itemising the cost and the revenue source (by tariff or support).
			The Business Plan will forecast the practical and financial progress initially upon an annual basis (say first ten years). Thereafter, at say five yearly intervals for the duration, with balance sheet predictions and terminal cost/ values.	



## Annex A

### **Categories of water supply and sanitation**

#### **A.1 Water supply**

- a) **Individual house connections** provide potentially the safest and most accessible levels of supply, but at the highest cost of installation.
- b) **Yard taps** can provide an adequate quality and accessible supply for formal areas. Cost savings over individual house connections may be relatively small.
- c) **Yard tanks** can provide good quality and effective access, but rely on intermittent supply. They are technically more appropriate in formal than in informal areas.
- d) **Dedicated customer taps** are provided at common points, but with access to individual customers using smart cards or similar technology.
- e) **Communal standpipes** can provide good quality water, but good control is needed in order to keep the environs safe, and sufficient numbers must be installed to prove adequate accessibility.
- f) **Water kiosks** are effectively a technically more advanced form of communal standpipe.
- g) **Water vending** is usually an enterprise of secondary providers, who can provide an accessible service but with potential problems of predictability, quality and price control.
- h) **Water tankers** are a specific vending system, either under the control of the operator or private vendors. The same potential problems apply as for water vending, and in addition accessibility may be difficult in informal settlements.
- i) **Communal wells** may exist in informal and formal areas, but are at significant risk of drawing contaminated water and of developing health hazards in their environs.

#### **A.2 Sewage disposal**

- a) **Full waterborne sewerage** provides the highest level of removal, with individual house connections.
- b) **Condominial sewerage** is a system comprising aqua-privies with solids-free simplified sewers.
- c) **Septic tanks** servicing 10-20 households with pour-flush latrines can be appropriate for formal areas where planning has been carried out for operation and maintenance.

## PRO-POOR LONGER TERM (CONCESSION AND LEASE) CONTRACTS

- d) **On-plot latrines** range from simple bucket and latrine systems to cistern-flush and pour-flush facilities.
- e) **Public toilet blocks** (possibly combined with laundry facilities) could provide supplementary good quality facilities.