



Exploring Development Impact Bonds Faecal Sludge and Septage Management (FSSM)

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Round Table Discussion

Dasra Office, Mumbai

India is seen as potential market by impact investors. As per McKinsey report, Impact investing in India has the potential to grow six to eight times by 2025. One such impact investment model that has gained much attention in recent times is Development Impact Bonds (DIB) or Social Impact Bonds (SIB). Success of Development Impact Bond in India in education and health sector provide encouraging signs as well as ideas around structuring such instruments.

Center of Water and Sanitation (C-WAS), CEPT University has been working on an action research project funded by BMGF to explore various financing options and framework for sustainable FSSM services. As a part of this, our aim is to also explore the possibility of impact investments using a Development Impact Bond (DIB) or Social Impact Bond (SIB) structure.

A round table discussion to explore DIB/SIB in urban sanitation particularly FSSM was held on 25th February 2019 at Dasra Office in Mumbai. The participants included sanitation and finance experts, private service providers, legal expert and social organizations. The aim was to show preliminary ideas on DIB in FSSM and assess opportunities and challenges around it and discuss potential impact investors and outcome funders.

CWAS team shared the background of increasing importance of FSSM in India with examples of emerging opportunities in Maharashtra. Discussion centred around the relevance and need for impact investments in FSSM along with alternatives structures for a possible DIB. Following the meeting, further discussions with the legal team at the Nishith Desai Associates also helped to clarify issues around a possible DIB structure, as well as potential investors who can be approached for further deliberations.

Summary of Discussions

1. It will be crucial to re-orient thinking around investment needs in sanitation and FSSM in particular

The success of Swachh Bharat Mission and priority by the Government of India and State Governments has helped to build the narratives around benefits of improved sanitation. There is a more awareness of health and environmental benefits of improvement and safe sanitation practices. This has resulted in investments and some CSR funding. However, investments have largely been limited to building toilets and to some extent awareness activities. However, safely managed sanitation as per the new Sustainable Development Goal (SDG) 6 on Clean Water and Sanitation requires attention to the full sanitation service chain. There is still a lack of awareness and sensitization on what happen after toilets. As a large part of urban India depends on onsite sanitation, safe emptying and treatment are crucial in cities without a citywide sewerage network.

It was suggested that selling the sanitation story for impact investment is difficult, it is important to have a simple and strong storyline which is easily understood by investors. It was also suggested that it is necessary to re-orient thinking of investors around sanitation, and to demonstrate that it can be made attractive from business and investment perspectives.

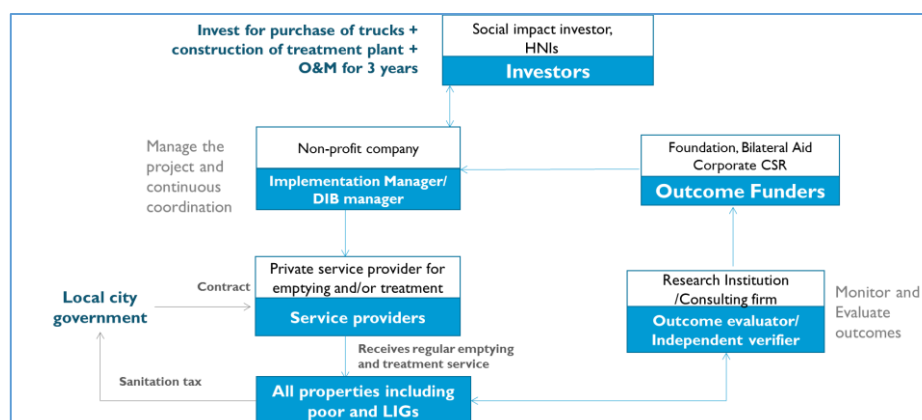
2. Various service models for emptying and treatment of fecal sludge and septage are possible and involve private service providers. A simple DIB structure seems possible for these different models.

Based on a review of desludging and treatment practices, a number of different options for developing Development Impact Bonds (DIB) for FSSM were discussed

- Citywide scheduled desludging of septic tank
- Integrated model of citywide scheduled desludging, treatment and reuse services
- Cluster based approach scheduled desludging and treatment services to group of small cities and nearby villages.

A simple structure for a possible DIB for FSSM was presented by the CEPT team and was further deliberated.

Possible structure of DIB in FSSM



Key points from these deliberations included:

Role of private sector service providers: It was discussed that private players should also be asked to put certain percentage of investment in the project, so that they are motivated to perform well and achieve desired outcomes.

Role of Local Governments: It was also highlighted that, since local government is responsible for provision of sanitation services in the city, their role in the DIB will be crucial. Though at this pilot stage involving local government financially will complicate the process, they should be encouraged in monitoring activities.

Sustainability of sanitation services: While no payments are envisaged from the Local Governments in the DIB structure, it would be important to provide incentives to local governments to continue to collect sanitation tax from households. This would help to sustain and continue sanitation services after the DIB intervention period. Later, after the success of a pilot DIB project, the role of government as a full or partial outcome funder can also be explored.

Use of CSR for outcome funding: It was pointed out it will be necessary to assess whether corporate funds under current CSR framework and rules can be used to provide 'outcome funding'. The credit finance group set up the India Sanitation coalition (ISC) has developed a paper on this and intends to take this forward with the GoI and RBI. From a legal perspective, as the suggested DIB structure envisages a non-profit (Section 8) company as the Implementation Manager.

3. Measuring FSSM outcomes – Emptying and Treatment

For DIB, the return on payments is linked to the outcomes achieved. It was highlighted that investors are not only looking at neat and measurable outcomes but also social indicators and impact achieved from the intervention.

It was discussed that in FSSM, it is possible to show and rigorously measure outcomes to attract potential investors. For emptying - the impact could be in terms of full coverage with a particular focus on the poor and low income communities, and for treatment it could be in terms of quality standards achieved and extent of reuse. Though direct impact with health or environment is difficult to measure, a secondary matrix could be developed to monitor health and environment impact and small outcome amount could be linked to this matrix.

Through DIB it is possible to introduce a rigorous monitoring system which is easily possible but somehow missing in the sanitation sector. In Wai and Sinnar projects, CEPT is performing the monitoring and evaluation functions. While intermediate outcomes can be tracked using mobile apps and monitoring software, a different evaluation methodology will be required for tracking long-term health and environment outcomes.

Sustainable Development Goals (SDGs) has recognized the importance of Safe sanitation practices under its goal 6 of "Ensuring availability and sustainable management of water and sanitation for all". The FSSM practice of safe emptying and treatment will help in achieving the SDG goal and targets.

4. Legal perspectives around DIB/SIB (based on discussion with Nishith Desai Associates)


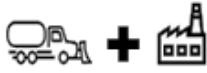
Implementation manager has to be section-8 Company. It would be necessary to do tripartite agreement between private service providers, DIB implementation manager and local government.

The domestic outcome funder, usually a charitable organization, under current regulatory framework may face issue with the income tax benefits that they get under section 12 A. There is a risk that income tax authorities may turn around and ask these organizations, if the money has been used to pay the risk investors and not for charity benefits. This may be a huge risk for them even to convince them to invest in this. This could be overcome through agreement with conditional grant saying that if the project meet the following outcomes than only the money is released, which is charitable in nature.

If conditional grant comes to DIB manager, then they also will face issue on paying back returns to investors. As DIB manager will be section-8 company they will be bounded by two rules- first they cannot give returns or dividends and second whatever money they get, they will have to spend in that same year. This could be overcome if domestic impact investors give loan to DIB manager, then when outcome funding comes, DIB manager can say they are paying back the interest. It will be recoverable grant model and but in that case risk on DIB manager will be high. Hence, alternative model needs to be thought through. It will also depend on who the investors and outcome funders are and what are their lookouts and concerns in this.

It was discussed that, we should first work out financial model as it will play very crucial role for investors. It was highlighted that investors are first going to talk about payment structures and milestones for its payback. They will always compare the cashflows and returns from this project as compared to market investment in other options. Apart from this, investors will also look at the risk involved in the achieving the outcomes and may ask for more return if risks in the project are very high. Hence, at this stage it will be crucial to show them success case example and buy their trust that we will be able to achieve at least these many outcomes for sure.

It was pointed out that as the investors will get returns only at the end of 3 years they may find such investment more risky. It was suggested to develop milestones for returns, so that at end of each year investors may get at least a part of their investments based on the outcomes achieved. In the same vein, milestones for investments could be developed to spread the investments during the period to help reduce the initial investments. While the year 1 payment can include capex and 1-year opex, remaining opex can be paid later based on outcomes achieved. The return for investors can be based on the outcomes achieved as illustrated below.

Financial analysis		
For an expected IRR for expected performance @12% at end of year 3		
	 Scheduled desludging of septic tanks	 Integrated desludging and treatment of FS
Investment requirement*	INR 2.0 Crore <i>One time payment</i>	INR 4.0 Crore <i>One time payment</i>
Legal, monitoring and management cost <i>By outcome funder</i>	INR 0.5 Crore	INR 1.0 Crore
Outcome payment to investor @ Year 3 <i>Considering threshold performance at achieving 50% of target</i>	INR 2.7 Crore	INR 5.3 Crore
Total outflow of Outcome funder <i>Considering Legal, monitoring and management cost</i>	INR 3.2 Crore	INR 6.3 Crore

* For procurement of trucks and construction of treatment plant + O&M of 3 years

A number of issues related to legal aspects in the DIB structure were also discussed. The first relates to the need to cover the entire cost of the proposed model, including both capital and operating costs for the private service provider. This will make it possible to enter into a contract to provide the FSSM services with the urban local government without a normal bidding process. In case of an integrated DIB, the contract will also include provision of land for the treatment facility. Secondly, the DIB manager could be a non-profit, or a section 8 company. This will make it easier to arrange the flow of funds through this company. However, further efforts will be needed to enable the use of CSR funds for outcome payments.

5. Operationalizing pilot DIBs for FSSM

Approaching potential outcome funders: Discussions and buy-in from the outcome funders should be the first priority. Based on this, informal conversations with potential investors can be started in parallel for structuring the DIB.

Approaching potential investors: It was suggested that two or three models should be developed and taken to investors. It was also highlighted that instead of foreign investors, it would be good to also look for local investors interested in the WASH sector.

Selection of specific case: Two cities where CEPT is currently providing support for FSSM were discussed for a DIB pilot. It was also discussed that pilot DIB should be taken up with a town in Maharashtra where implementation of activities have not been started to show clear impact before and after intervention.

List of Participants

Ms. Vedika Bhandarkar, Managing Director	Water.org
Mr. Manas Rath, Senior Advisor	BORDA
Ms. Suma Pathy, Director Programs leads	PSI
Ms. Arti Dhar, Senior Consultant	Social Finance
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The Center for Water and Sanitation (C-WAS) at CEPT University carries out various activities – action research, training, advocacy to enable state and local governments to improve delivery of services. In recent years C-WAS has focused its work on urban sanitation.