



**GUIDELINES ON
REVOLVING FUNDS
FOR
CONSTRUCTING LATRINES AND
WATER CONNECTIONS
IN
Luang Prabang, Lao PDR**

Mekong Region Water and Sanitation (MEK-WATSAN) Initiative

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PREFACE

Urbanization is placing an enormous burden on many secondary towns in Lao PDR, which will become ever more onerous as we move to the MDG target year of 2015. Urban areas are growing at 4.9 per cent in Lao PDR. The vast majority of the new urban citizens are poor, newly arrived rural migrants. They invariably have to pay higher prices for their water or use unsafe water, as well as endure unsanitary conditions.

Although urbanization drives economic growth, it brings with it serious challenges. Without policy and institutional reform, there is a real risk of urban services becoming unsustainable. Leading to environmental degradation and serious health problems. These outcomes ultimately undermine the competitiveness of towns and cities and make them less liveable. In Lao PDR, with the exception of the capital, Vientiane and the other provincial capitals, water supply and sanitation coverage in secondary and district towns remains a major concern for the government. Relatively high unit capital costs and large numbers of poor pose a special challenge for the government.

UN-HABITAT at the request of the Government of Lao PDR is supporting a fast-track activity in the town of Xieng Nguen in Lao PDR. This is a community-based initiative in which the community and the local service provider are each contributing around 20 per cent to the overall cost of the water supply and sanitation intervention. This pilot project will be a very useful demonstration of how community can mobilize and work effectively with local authorities to meet MDGs. UN-HABITAT is providing both financial and technical assistance for this initiative which will benefit the target population within a short period of one year.

In order to encourage households to construct latrines and also have individual household piped water connections, two revolving funds have been created by the Water Supply Enterprise which will be operated by Nam Papa Xieng Nguen branch. The principles, conditions and agreement between the revolving funds and the borrowers for constructing latrines and water connections are given in this guide document. The design of the revolving fund for latrines and water connections fully outlines the loan procedures as well as the institutional setup for the sustainability of the revolving funds.

These revolving funds will enable provision of water and sanitation services reach the urban poor and make them both affordable and acceptable.

Andre Dzikus
Programme Manager
Water for Cities Programmes
UN-HABITAT, Nairobi

Introduction

Asian region is seriously threatened by the growing water and sanitation crisis and the scale of challenge is of much higher order. Eighty percent of the global population without access to improved sanitation and almost two thirds without access to improved water supply live in Asia. Many Asian countries are ill equipped to provide the needed safe water and sanitation to their growing population. An additional 1.5 billion people in Asia will need access to adequate sanitation facilities and an additional 980 million for access to safe water, if the Millennium Development Goals (MDG) set to halve the world's population without access to safe water by 2015 and to achieve improvement in the lives of slum dwellers by 2020, were to be met.

Investments and Funding Scenario

The levels of investments in the sector within the region are quite inadequate to bridge the widening demand-supply gap and to extend services to low income and vulnerable sections of the society. There are no immediate prospects for rapid increase in external investments into the sector. Most governments are increasingly becoming aware of the need for more intensified domestic mobilization of funds including funds for advocacy, information and education to the people who need most. 'Funding' becomes the key instrument as an institution that administers the quantity of capital, raised with a special purpose.

Various types of loans/subsidies have helped to fill gaps in the more conventional financing, available for the development works but not the costs relating to community executed water and sanitation schemes. There is a need to devise innovative funding mechanisms that focus on filling the critical financing gap by providing loans to community-based organizations to initiate development of water and sanitation facilities. 'Revolving Fund' is one such solution for financing community initiatives to manage drinking water supply or construction of individual household toilets for safe sanitation.

'Revolving Fund' and its modalities

Concept

By definition 'Revolving Fund' is a capital raised with a certain purpose which can be made available to the same users **more than once**. 'Revolving' represents that the fund's resources circulate between the Fund and the Users. Revolving funds are established with an intention that they should be self-sufficient and sustainable.

Establishing Revolving Fund

Revolving funds are established in order to achieve a particular purpose or assist a particular target group. This could be possible if its continuity is guaranteed. Conflicts may occur if the purpose cannot be achieved or the target groups may be assisted in some other way. It is important to consider whether it could be attained effectively by means of an independent Revolving Fund or through a Revolving Fund associated with the existing institutions. One has to analyze the reasons in terms of risk factors, securities, profitability, institutional policies, past experiences, availability of funds, etc and adopt appropriate solutions. The following are some of the suggestive illustrations:

Difficulties may lie in the institutional structure, decision making systems and the statutory provisions. Eliminating such obstacles ought to form part of the project activities. It is necessary to analyze the causes of the past failures and if not available, it would be worthwhile to establish an experimental

Revolving Fund in cooperation with the existing institution. Providing the right funding as a part of the project activity would solve the institution's funding problems. Consideration may be given for improving the access of the target group to the existing institutional facilities for strengthening the cooperation between the target group and the institution.

Financing of Revolving Fund

A fund may be financed by its users or by users of projects or it may be financed by third parties or by both. In most cases, the fund will take time to become fully established if it depends on small injections of funds in the form of contributions, savings deposits or phased donor financing. Contributions may be voluntary or compulsory. Obtaining contributions from outside the fund's target group is termed as 'external financing' such as donor funds.

In development cooperation, many Revolving Funds initially draw on donor funds, which is true of credit funds and of guarantee funds. In majority of cases, the involvement of the users in enabling the fund to be financed by them is minimal or non-existent. Although there are no technical objections to hundred percent financing, experiences show that the financial involvement of the target group is a major precondition for successfully achieving the aim of the fund. When setting up a Revolving Fund, the aim should be to ensure that the target groups are financially involved, either voluntarily or compulsorily. Participation in Revolving Fund by a donor may be in the form of grants, interest-free advances, loans, combinations of any of these and guarantees. However, dependence on donor funding should be temporary and be gradually phased out. As regards, advances and loans to the Revolving Fund, the multi-year financial prognoses relating to the fund should indicate when repayment will be possible and the schedule for phasing out guarantees.

Legal status

It is important to know who is legally authorized to represent the fund and who owns or manages it. This determines the manner in which the fund can act vis-à-vis the financiers and the users, actions to be taken for transfer of funds and the influence the financier/donor can bring to bear or the requirements can be imposed on the fund.

It is necessary for the fund to acquire legal status for a clear relationship between the fund, its financiers and the users, which can be possible by giving the fund itself a legal status or by attaching the fund to an existing body with legal personality which will administer the fund under the terms of agreement. The type of legal personality which is felt to be appropriate for a fund, will depend on the aim of the project. When a fund acquires legal status, it shall be registered as a fund with appropriate public authority. Besides the requirement of legal status, it will also be necessary to comply with the statutory requirements.

Building up of Revolving Fund for Self-sufficiency

There are two possible ways of using Revolving Fund, namely, 'making the fund's capital available to the users' and the other, 'making income from the fund available to the users'. In the former case, the availability of fund's capital to users depends on lending periodicity and prompt repayments. In the case of later, the fund's capital is not directly available to the users and only yield from the investment of the capital is made available. The capital is not depleted and the interest received by the fund is lent to users and even part of these loans are subsequently repaid to the fund. Thus, the fund's capital grows. If the accumulated interest assumes the role of the original capital, the original capital can be repaid to the donors, provided the establishment of Revolving fund is by means of donor financing.

The fund itself can provide guarantees to enable local fund to be borrowed. The amount of capital which the fund possess determines the maximum guarantee it can provide.

Management and Administration of Revolving Fund

Revolving Fund has financial relationships with the financiers and the users of the fund which entail obligations to make payments or repayments and to submit reports. If the fund has independent legal status, there will be a statutory obligation to submit regular financial reports. This makes it necessary to keep separate financial records on the Revolving Fund at all times. In many countries, the financial reporting obligation and the form in which the reports have to be submitted are laid down by Law.

The financial report shall include profit and loss account, cash flow statement indicating overview of sources and applications of funds and a balance sheet approved by the fund's trustees and by an external auditor and shall be finalized annually within three months of the end of the financial year. It is advisable to produce profit and loss account quarterly for use in monitoring and planning a Revolving Fund Project together with a cash flow forecast for the rest of the year. Depending on the type of the project, a quarterly balance sheet may also be useful. The fund's multi-year planning must consist of a minimum of five year cash flow forecast, which should be adjusted and extended annually on the basis of the results achieved. The staffing of the Revolving Fund Project should be such to enable maintenance of adequate records including records on premiums, contributions, loans and advances. The information on the personal particulars and all financial aspects relating to the users should be kept confidential by storing and securing the relevant information and records appropriately. Third parties should not have access to them.

A fund may be terminated by premature termination, termination without transfer, termination combined with transfer or by change of fund's terms of reference with or without transfer. The termination may be due to the exhaustion of funds, external factors which impede activities or misuse.

Sustainability of Revolving Fund

The Revolving Fund is expected to become self-sufficient after an initial period. Its capital is expected to remain at a constant level more or less without any fresh external financing. The factors that affect the operation of a Revolving Fund are the interest rates (for lending and/or borrowing), levels of premiums; administrative expenses; payments/repayments and failure to make them; inflation and the liabilities. In order to keep the Revolving Fund self-sufficient and sustainable, appropriate measures would be required to be adopted to effectively appraise and monitor these factors for its improved operations.

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