

29. Privatization in the US Water Industry & Factors Affecting

It

Presenter

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Privatization in the US Water Industry & Factors Affecting It

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NAWC

- Trade association representing over 200 private and investor-owned water companies
- Members serve 21 million Americans in 42 states and have sales of about \$3 Billion
- We are taxpaying businesses and our rates are regulated

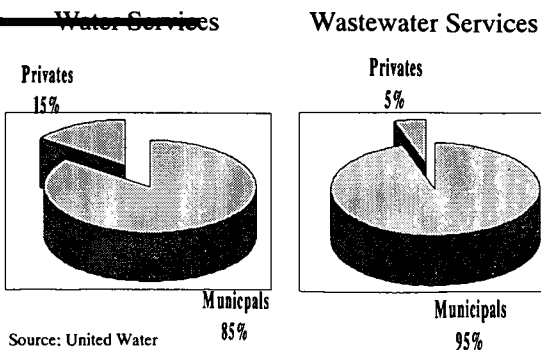
Topics to be Discussed

- Market Share of Private Utilities
- Regulation of Drinking Water Utilities
- Trends in the US Water Industry
- Economic Characteristics of the Industry
- Municipal Role in Privatization

Topics to be Discussed

- Facts on How Privatizations have Performed
- Why Privatize
- Obstacles to Privatization and Critical Elements for Success

Percentage of Population Served by Private Utilities



Regulation of Drinking Water Utilities in the US

Regulation of Water Utilities

- Both municipal and private water utilities must meet health standards established by EPA and enforced by the states
- Private water utilities are also regulated by the state public utility commissions (PUCs), who approve capital expenditures, establish allowable rates of return, monitor service, and set rates

Regulation

- ◊ PUCs exist to prevent private utilities from exercising monopoly power
- ◊ PUCs also regulate private gas, electric, and telephone utilities
- ◊ Municipal water utilities are not generally regulated by PUCs
- ◊ Mayors, who should be sensitive to demands of their customer/voters, are the only control over rates and service at municipalities

Definition of Privatization & Public Private Partnership

- ◊ Privatization is a broad term including everything from sale of municipal assets to the private sector to setting up various public private partnerships (P³)
- ◊ All these forms of privatization involve a redefinition of the roles of the private and public sectors

Trends in the US Water Industry

Their Impacts on the Industry & Privatization

Trends - Market Players

- ◊ Private water industry consolidating rapidly
- ◊ Municipal utilities not selling their assets but are contracting out many functions
- ◊ Many non-utility and foreign companies are entering the market

Trends - Deregulation

- ◊ Other private utility sectors (gas, electric, and telephone) are being deregulated at both the federal and state levels
- ◊ Differences between water and the other utilities are likely to make deregulation impractical in the water sector
- ◊ However, alternative regulation to enhance competition and efficiency are likely

Trends - EPA Regulation

- Future will bring increasingly stringent regulations - vulnerable subpopulations must be considered
- Monitoring advances and public concerns will continue to drive more stringent rules & enforcement

Trends - EPA Regulation

- Need for significant capital and technical expertise may strain municipal capabilities, opening privatization opportunities for IOUs

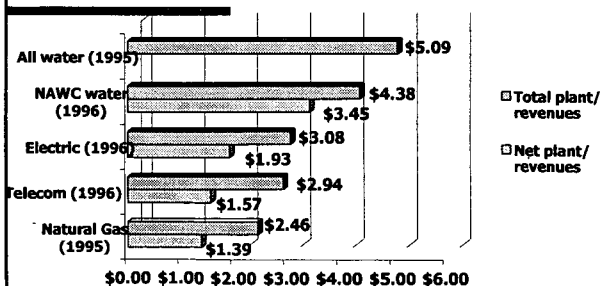
Trends - Privatization

- British model not being implemented here.
- Wastewater more active than DW
- Larger investor owned companies are bidding on P³ opportunities as are non-utility companies
- ConOps is fastest growing area and has significant competition

Economic Characteristics of the US Drinking Water Industry

Capital, Costs, Prices

Capital Intensity: Ratio of Plant to Revenues

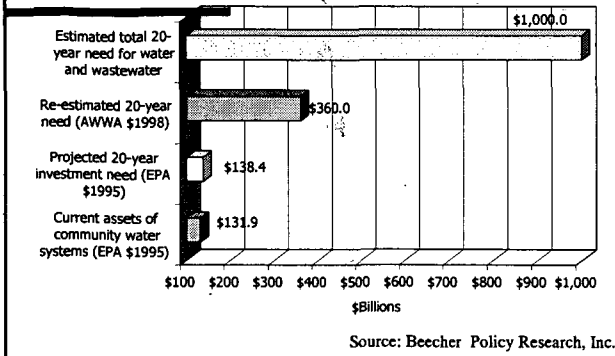


Source: Beecher Policy Research, Inc.

Water Capital Needs

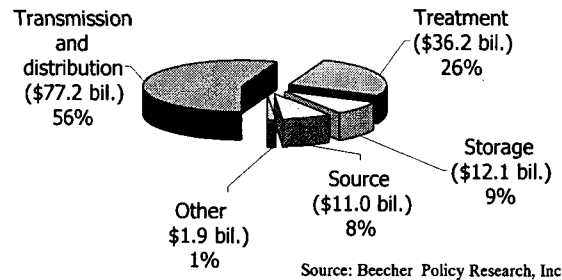
- Infrastructure capital needs over the next 20 years are staggering
- Most of the need is for transmission and distribution

20 Year Water Capital Needs



Specific Infrastructure Needs

20 Years



Municipal Role in Privatization

- All privatization decisions are local
- Threat of privatization has stimulated municipals to try to improve efficiency

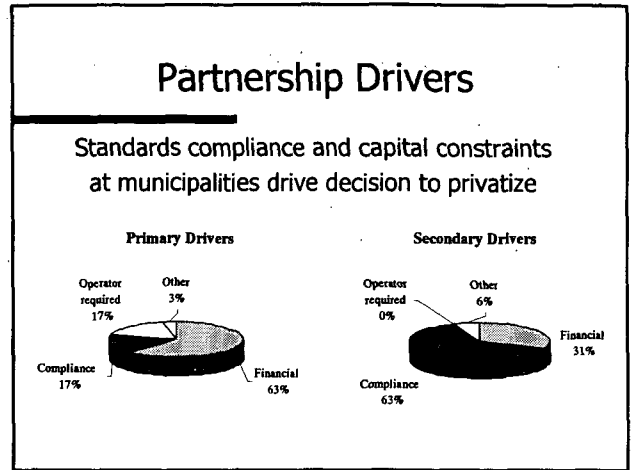
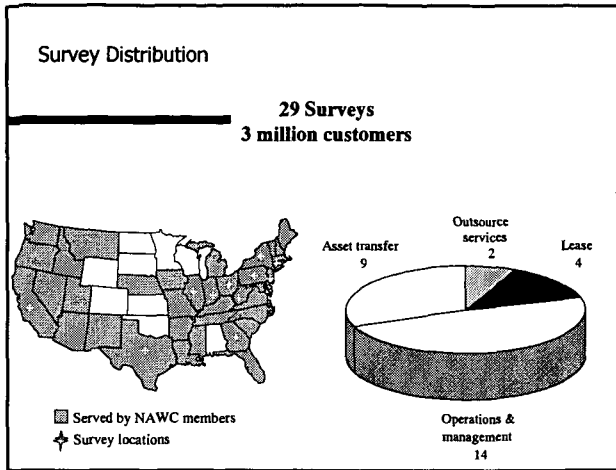
Municipal Role in Privatization

- While many will succeed, many will not and will be compelled to consider some form of privatization
- The recession and anemic economic recovery has reduced municipal tax revenues and put pressure on city budgets.

Facts on How Privatizations have Performed

Our Experience with Privatizations

- Debate about privatization driven by philosophical and political arguments rather than facts
- NAWC sponsored a study conducted by the Hudson Institute to get the facts about reasons for privatization and performance
- Study shows that privatizations deliver



- ### Partnership Benefits
- #### Compliance
- 41% of facilities were out of compliance before privatization
 - 100% were in compliance 1 year after privatization

- ### Partnership Benefits
- #### Increased Financial Support
- \$55 Million in capital expenditures
 - \$35 Million in concession fees
 - \$537 Million in asset transfer fees

- ### Partnership Benefits
- #### Service Improvements
- Water Quality and Delivery
 - Taste, odor improvements
 - Correction of low pressure/shut-offs in all cases
 - Customer Service
 - Specific municipalities experienced 50% reduction in customer complaints
 - No evidence of increased customer complaints
 - Reduced call waiting times

- ### Partnership Benefits
- #### Additional Benefits
- Cost Savings
 - 17% of facilities experience cost savings between 10% and 40%
 - Rate Stabilization at Private-Operated Facilities
 - 25% of projects surveyed faced major rate increases due to investment backlog
 - P³ operating efficiencies soften major rate increases in all cases

Privatization Survey Summary

- Provides capital
- Improves compliance
- Enhances service
- Mitigates potential rate increases

Why Privatize?

Increasing Resource Needs

- * More stringent water quality regulations
- * Compliance problems at some munis
- * Huge infrastructure replacement costs and backlog of deferred muni investments
- * Accelerating non-water municipal capital needs
- * Inability of municipal capital markets to generate necessary capital to meet all needs

Less Government Help

- ◊ Virtual elimination of federal wastewater infrastructure grants
- ◊ Only part of loss made up with state revolving loans for water and wastewater
- ◊ Constrained state and local budgets and frequent operating deficits

Higher Public Expectations

- * Improve operating efficiencies and keep rates under control
- * Improve quality and reliability
- * Meet needs of economic development

Solutions Offered by Private Sector

- ◊ Private sector has access to substantial sources of new capital
 - Helps municipalities meet capital needs
 - Frees up municipal resources and debt capacity for other needs
- ◊ Private sector has significant technical and operational expertise and a record of efficiency
 - Compliance is consistently achieved
 - Operational savings can be significant

Obstacles to Privatization & Critical Elements for Success

Obstacles to Privatization

- * State laws and regulations
- * Municipal union opposition because of fear of loss of job or benefits
- * Political risk from loss of control if sell assets
- * Lack of expertise in many smaller cities to manage a privatization
- * Resistance of municipal managers
- * Absence of a champion for privatization

Critical Elements for Success

- * Full and open competitive bidding is essential on both asset sales and contracts
- * Focus of analysis should be what best meets the needs of the consumer and the municipality
- * Credible third party comparative analysis of bids is important

Critical Elements for Success

- * Agreements must clearly specify all terms of the arrangement
- * Municipality must diligently monitor performance - only performance will foster more privatization

