

Financing Urban Services

A private operator approach
(ex: Water Sector)

Foreword (1)

- It is undoubtedly a hot and controversial topic which has been, during the past two years, extensively covered by the best experts: an illustration being the excellent brochure “Sustainable Urban Services” edited by Geneviève Dubois Taine.
- If during the last two years, Water, and more specifically because of private involvements, has become a political issue, this stems largely from a refusal to treat water as an economic good not withstanding the fact, clearly mentioned in the PECC’s brochure that “Urban Services have a cost”.
- Moreover, choosing to involve a private partner into a urban service remains the privilege of the Public Authority as it is well demonstrated by Mr Wang Dehui, Vice Chairman of the Standing Committee of the Tianjin People Congress.
- Last but not least, I would like to reemphasize two facts:
 - ➔ At present, over 90% of the world’s water is still delivered by publicly owned entities (90% being local public authorities),
 - ➔ Only around 200 million people in the world are served by private operator, most of them in Europe, and half of them in the UK and France alone.

Foreword (2)

Therefore our approach will be based exclusively on VEOLIA Environnement, and more specifically VEOLIA Water, concrete experiences :

- There is not a single model of Public Private Partnership
- Whatever the model chosen, the private partner should act as a fund raising catalyst (and not as a “banker”)
- The private partner should also contribute to the improvement of urban services governance.

1st proposal: there is not a single PPP model

A. The different PPP's contractual agreements

Form of the contractual agreement	Tariff collection	Assets ownership
Management & service contracts (2 to 5 years)	Public	Public
Build-Operate-Transfer (BOT) (10 to 30 years)	Public	<ul style="list-style-type: none">■ Until transfer : private■ After transfer : public
Lease contract (7 to 15 years)	Private	Public
Concession contract (15 to 50 years)	Private	Private
Asset sales (perpetuity)	Private	Private

Remark: it should be noted that complete privatisation of water services is less and less a solution chosen by public authorities.

1st proposal: there is not a single PPP model

B. Differing responsibilities between the public and private partners

<u>Form of PPP contractual agreements</u>	<u>Public sector Main responsibilities</u>	<u>Private sector main responsibilities</u>				
		<u>Technical</u>	<u>Operational: OPEX & commercial services</u>	<u>Capex</u>	<u>Sources of financing</u>	
					<u>Debt</u>	<u>Equity</u>
BOT	<ul style="list-style-type: none"> Tariff (for the water treated) Concession and "take or pay agreement" Regulatory framework 	<ul style="list-style-type: none"> Limited to: <ul style="list-style-type: none"> Design Build 	<u>Limited to:</u> <ul style="list-style-type: none"> Maintenance Project management No commercial services 	No new capex	Project financing (70% project cost)	30% project cost and specific guaranties
Lease contract	<ul style="list-style-type: none"> Regulatory framework Tariff structure Approval of the Capex proposed by private partner New capex financing 	<ul style="list-style-type: none"> Proposed Capex Supervision of the new capex 	<u>Full responsibility</u> <ul style="list-style-type: none"> Global maintenance Commercial services Management 	Only supervision <u>No ownership</u>	None	<u>Limited to:</u> Operational and maintenance
Privately owned company either long term concession or privatisation (asset sales)	<ul style="list-style-type: none"> Regulatory framework Tariff structure 	<ul style="list-style-type: none"> Planning Design new capex Supervision 	<u>Full responsibility:</u> <ul style="list-style-type: none"> Global maintenance Commercial services Management 	New assets ownership	<ul style="list-style-type: none"> Financing new assets Working capital 	Equal to the cost of the company acquired

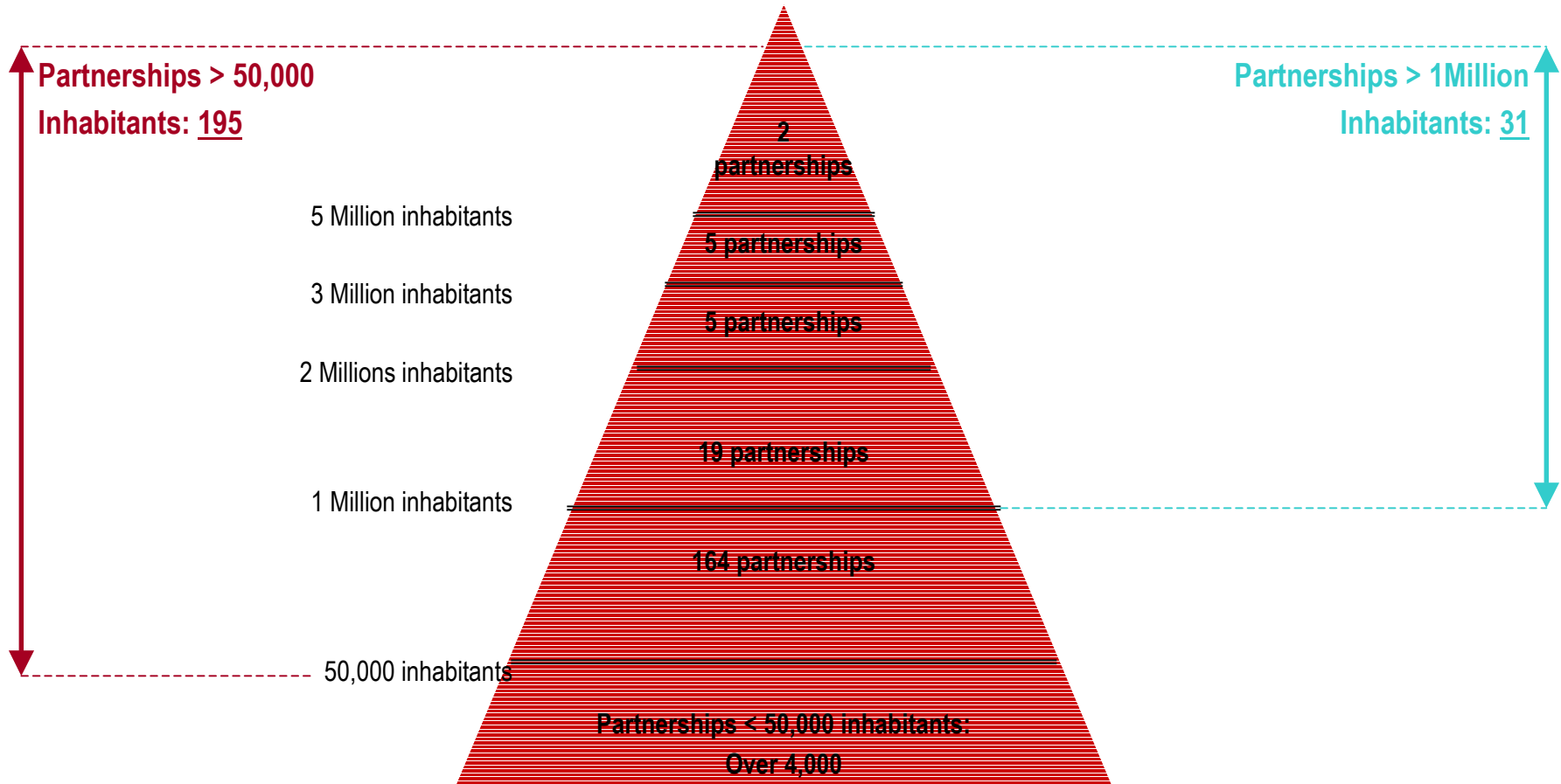
1st illustration: Recent international VEOLIA Water experiences

The full scope of PPPs

BOT	Concession, rehabilitation, asset sales	Lease contracts or management contracts (Asset owned by Public Entity)		
Sydney: (water treatment plant: BOT)	1997. Gabon: concession water & electricity services Tianjin (China) (Rehabilitation and management)	France (water treatment distribution and <u>waste water</u>)	Czech Republic	Row
1998. Chengdu (China) (water treatment plant: BOT)	1998. Bogota (Tibitoc) (Rehabilitation and management) Sanepar (Asset sale) (Brasil) (Water / waste water)			1996. Adelaide Delegated management of water and sewerage services Papakura (New Zealand) Delegated management of water and sewerage services
	1999 Berlin (Concession) (Water treatment and distribution)	France 3 900 contracts 8 000 municipalities	38 % of the consumers (Water treatment and distribution and <u>waste water</u>)	
	2000 Bucharest (water Treatment and distribution -BOT : Crivinal)			
2001 - Durban (BOT) Water recycling plant - Bruxelles (BOT) waste water - Incheon (BOT) waste water - Ashkelon (Israel) (desalination:BOT)	2001 Tanger & Tetouan (Full utilities concession : water, waste water, electricity)	Water: <u>38%</u> of the consumers Waste water: <u>17%</u> of the consumers	2001 Prague (water treatment and distribution and waste water)	2001. Niger (lease contract of the state's water service)
2002 The Hague (Netherlands) (Waste water treatment plant-BOT)	2002 Shanghai – Pudong (asset sales) (water treatment and distribution) Rabat (full utility concession: water, <u>waste water</u> , electricity)			2002 - Indianapolis - Tbilissi (Georgia: International Bid organized by World Bank - Baogji
				2003. Oslo (DBOM)

2nd illustration: PPPs are limited to large municipalities

- On going partnership references of VEOLIA Water with municipalities
- All on-going partnerships managed by VEOLIA Water in the world : nearly 5,000



2nd proposal: the private operator should act as a catalyst for fund raising

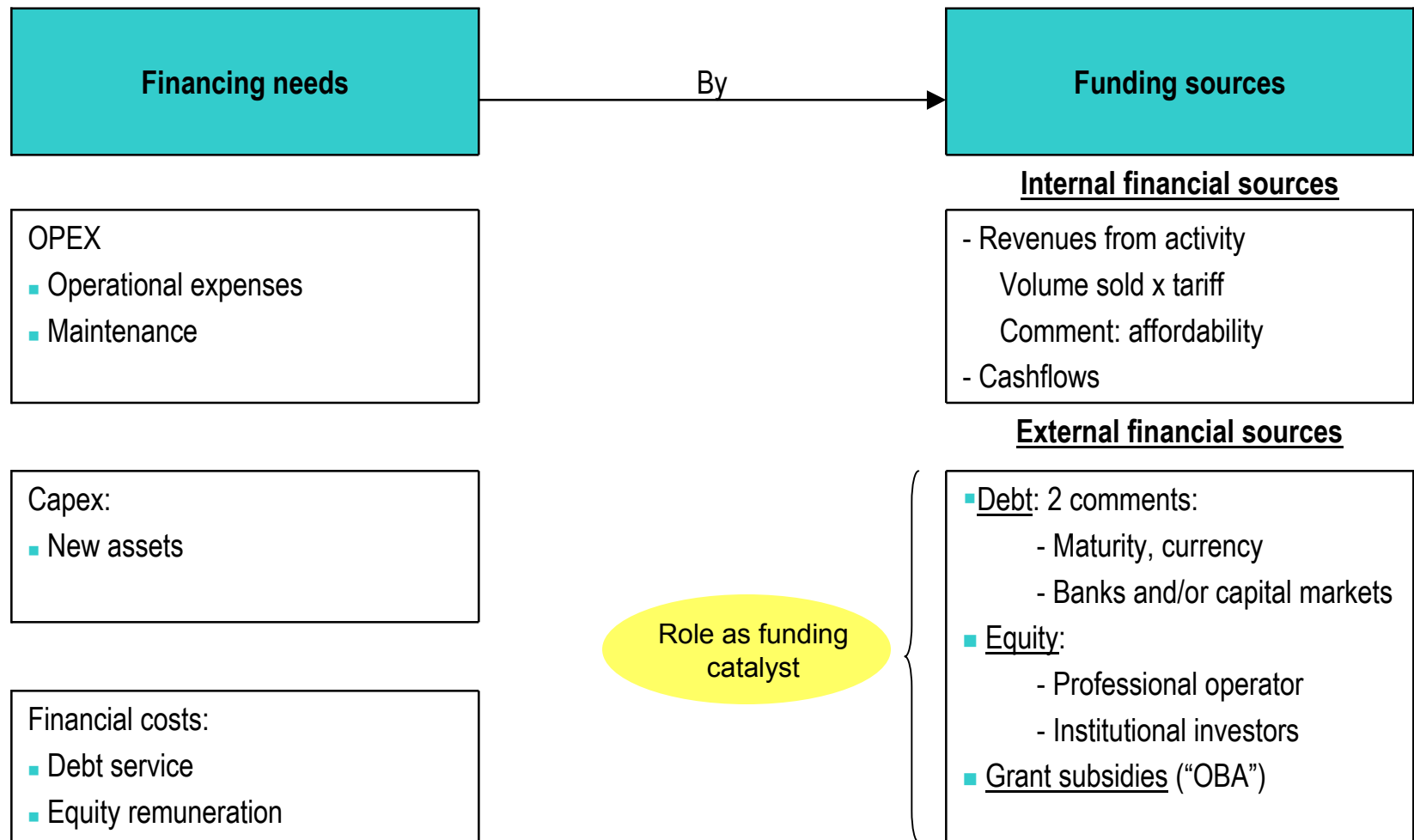
There are three distinct categories of financing for which the private operator can act as a catalyst:

- ➔ Financing an existing privately owned water company
- ➔ Project financing
- ➔ Financing municipal capital expenditures through a lease contract

Being a funding catalyst means:

The private partner being responsible for the company's operational management and Capex, should induce lenders and equity investors to participate to the financing of urban services.

Synthetic financial model of a privately owned water company

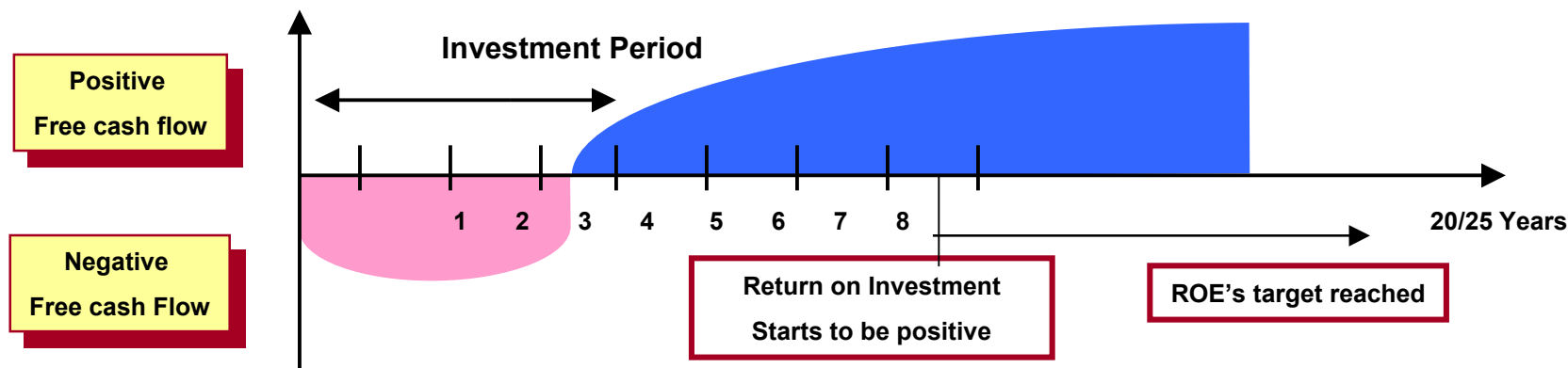


B - Project financing : BOT

Two comments:

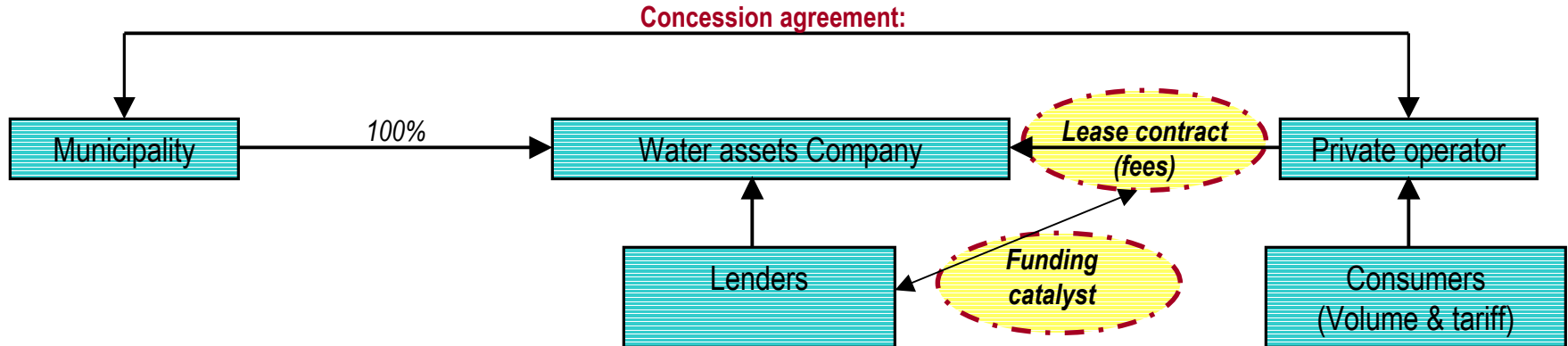
- The Private Partner is more than a fund raising catalyst: it acts as a quasi direct borrower: no recourse financing does not exist
- The “BOT” financial instrument should be used only if specific conditions are met.

	<u>Pros</u>	<u>Cons</u>
<u>Public sector</u>	<ul style="list-style-type: none"> • Financing not supported by the municipal budget and available • Volume and quality guaranteed by a professional partner 	<ul style="list-style-type: none"> • The cost of financing supported by the private sector could impact negatively the tariff (and therefore affordability) <ul style="list-style-type: none"> - cost of equity - maturity of the loan - foreign exchange exposure (currency of the debt) - legal cost attached to project financing
<u>Private sector</u>	<ul style="list-style-type: none"> • Take or pay agreement • Design and build expertise • Management expertise 	<ul style="list-style-type: none"> • Project ROE is “back end loaded”: no interest for institutional investor • “Take or pay risk” on a municipal entity (sub sovereign risk) will require specific guarantees.



C – The lease contract

Synthetic scheme



■ Pros:

- ➔ Such a scheme, by limiting the private partner's equity involvement, has less of an impact on the tariff structure
- ➔ Lenders (MLA, banks, bond investors) provide long term financing without asking the same guarantees as for project financing or corporate financing
- ➔ The level of lease fees can be adjusted with the tariff and the debt service

■ Cons:

- ➔ Few municipalities (in developing countries) can finance directly their urban capital expenditures.

But various solutions are facilitating sub sovereign financing:

★ Examples :

- Shanghai : “adaptable program loan” from the World Bank
- The French solution: the inter-municipalities sharing of facilities
- Direct loan to subsovereign risk: EBRD, ADB
- Direct financing by local banks - ex : China Development Bank, Moroccan Banks, etc...

3rd proposal: Urban services governance's enhancement

Being involved in the management of urban services, as a technology, services providers and fund raising catalyst should also induce the private partner to contribute to the enhancement of urban services governance.

Four contributions (ex: VE):

■ Training a key priority - ex: VEOLIA's Urban Environment Institute:

- ➔ 1.1 million hours training given in 2002 to VEOLIA Water employees,
- ➔ Specific training programs for each company, creation of local water institute, etc...

■ 40 cooperation agreements with universities, Recherche & Development centers:

➔ Ex : Asia

- ★ Hong Kong: University of Science and Technology
- ★ Beijing: VEOLIA's sponsorship of the "Environment and sustainable development leadership program" designed by Yale and Tsinghua University in order to facilitate wider collaboration between municipal leaders and specialists of Chinese key institutions in the environment, economics and sustainable development areas.

■ Concrete responsibility toward society: VEOLIA Water's humanitarian emergence response unit

- ➔ Joint work between permanent employees of VEOLIA Water, governments, UN organisations, NGOs and associations.

■ Being an education partner on water and environmental issues by providing the municipality with high standard teaching tools.

Conclusion

Therefore,

If a local public Authority chooses to contract with a private partner it should not be **only for financial reasons.**