

*Building a valuable
approach to PPP*

PPPs in the Water Sector

The purpose of this seminar...

« *Recent years have seen a marked increase in cooperation between the public and private sectors for the development and operation of infrastructure for a wide range of economic activities.*

Such Public-Private Partnerships (PPP) arrangements are driven by

- limitations in public funds to cover investments needs*
- efforts to increase the quality and efficiency of public services.*

The efforts of the Accession Countries and Member States alike to reform and upgrade infrastructure and services has in the past and could continue to potentially benefit from the PPP approach. ... »

The purpose of this seminar...

«PPPs should only be considered if it can be demonstrated that

- **They will achieve additional value compared with other approaches,**
- **There is an effective implementation structure**
- **The objectives of all parties can be met within the partnership. »**

SUMMARY

3. Define the **scope** of PPP in the water sector
5. Achieve the **objectives** of all **parties**
7. **Compare PPPs** to other structures
9. Achieve an **effective implementation** structure of PPPs

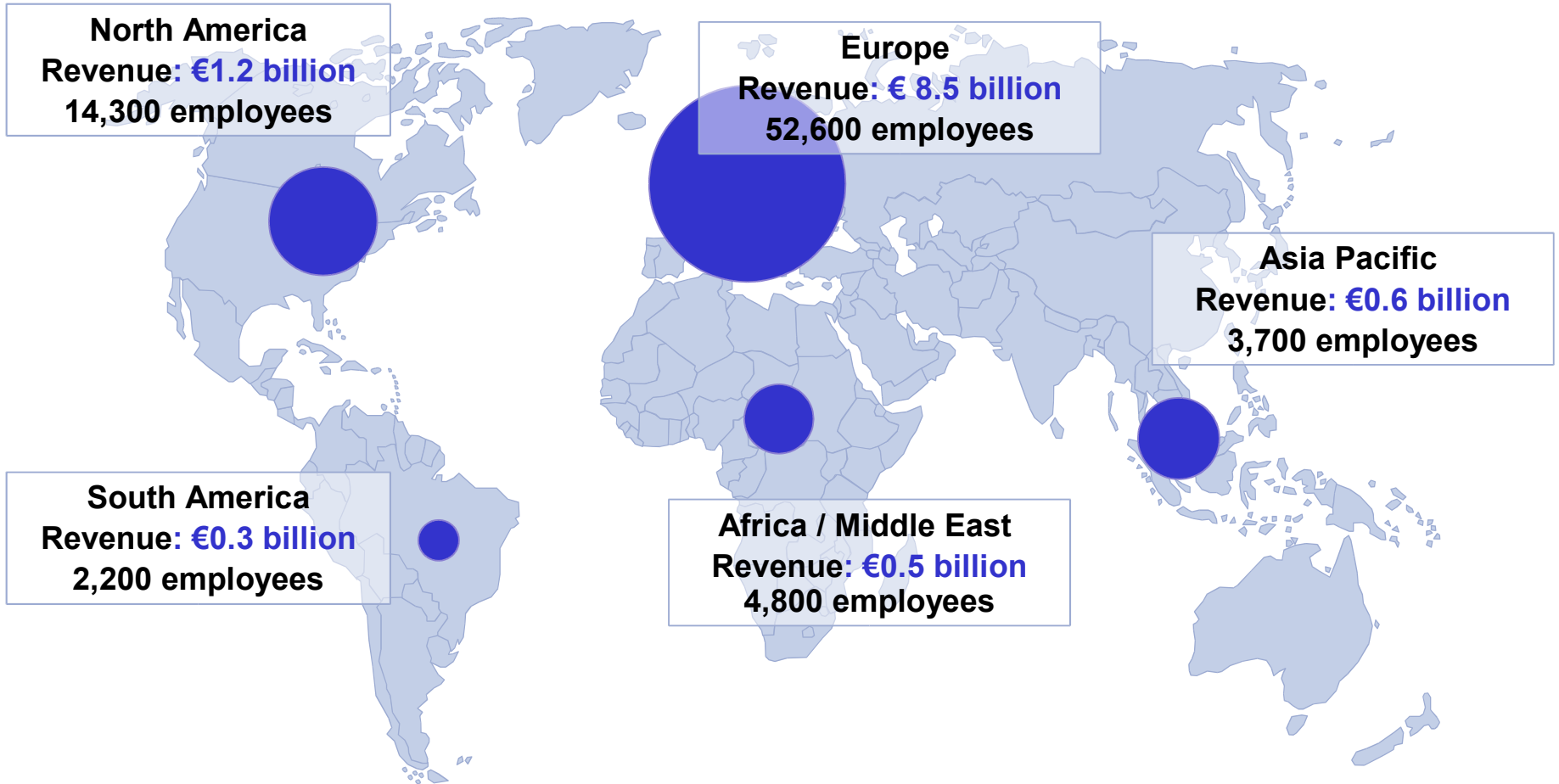
Veolia Water



One of the 4 divisions of Veolia Environnement, **Veolia Water** is the world leader in water services. It operates in three markets: municipal, industrial and residential services.

- A comprehensive expertise in water cycle management
 - Water and wastewater outsourcing services for municipalities
 - Design, build and supply of equipment, systems and water treatment facilities
 - Outsourcing services in process water and wastewater for industrial companies.
 - Residential customer services
- Key figures
 - **€11.1 billion** in revenues for 2003
 - **servicing 110 million** people throughout the world
 - **75,000 employees**

Veolia Water : a world-wide presence





Some examples of recent PPPs



1. Define the scope of PPP in the water sector

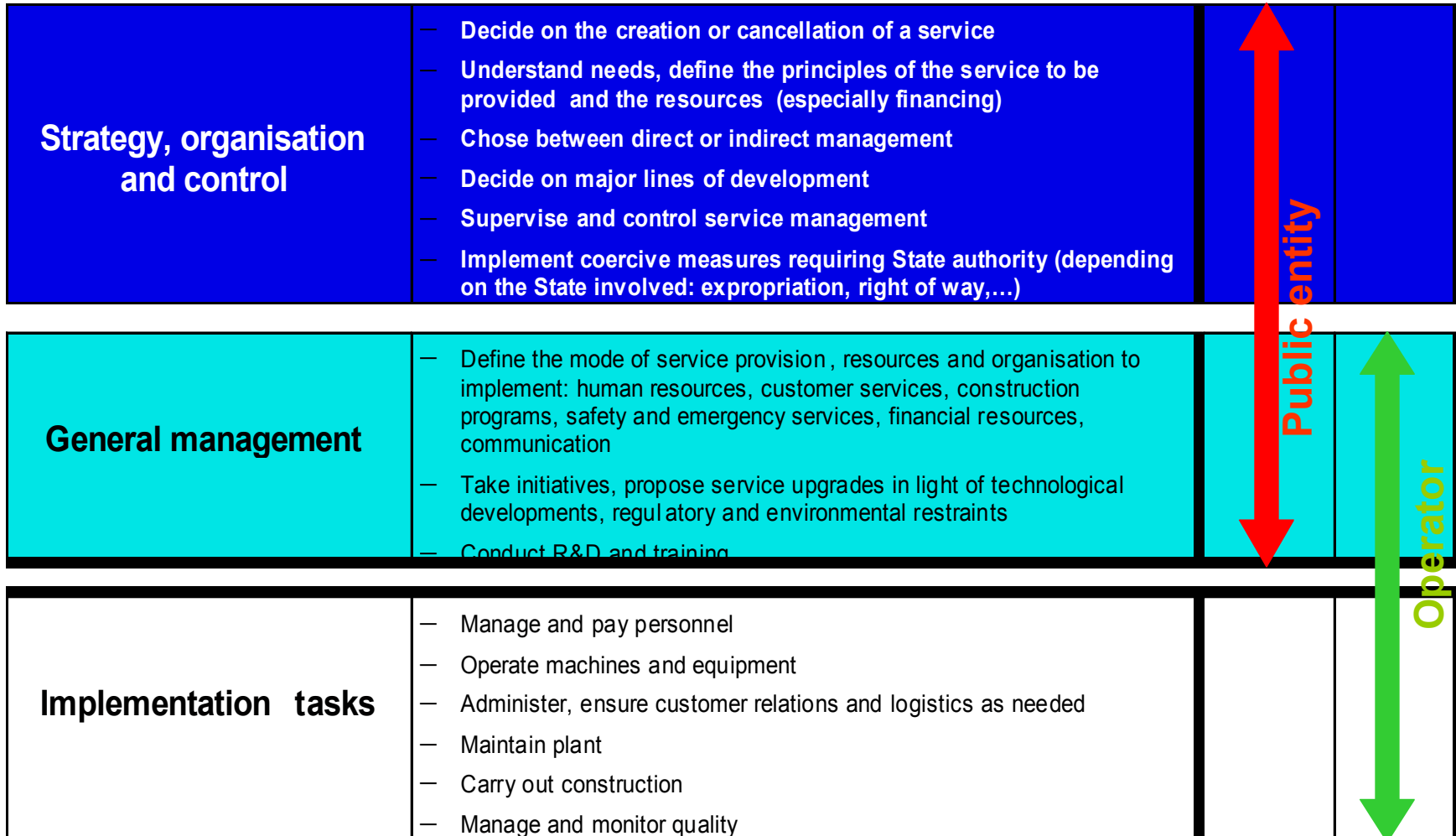
Large water cycle and small water cycle

	Large water cycle	Small water cycle
Characteristics of the cycle	Raw water cycle : rivers, lakes, aquifers, seas,...	The cycle of water use : domestic, industrial, agricultural
Management of the cycle	Public authorities 	Public or private operator 

The water industry has a long experience in PPP for the « small water cycle »

1. Define the scope of PPP in the water sector

The Public – private Partnership is based on a sharing of responsibilities tailored to local conditions



Define the SCOPE of PPP

- Strategy, Organization and Control stay ALWAYS in public hands (local or national Authority)
 - What matters is the distinction between « public » tasks (Strategy & Control) and « industrial » activities (Management & Implementation)
- General management and Implementation tasks can be outsourced to a « Partner », the Operator.
 - The « Partner » can be either a public entity or a private company ;
 - All General Management and Implementation Tasks can be the SCOPE of a PPP

The Scope of the PPP: General management & Implementation tasks

Idea Finance Design Build Operate



All In-house



Outsourcing

MGT Contract



Design & Build

Service Contract



BOT / PFI

Concession



Public Authority



Operator

Define the Scope of the PPP:

SWEDEN – City of Norrtälje

Service contract (12 years)

Scope	Norrtälje	Operator
Daily operation		●
Staff (management, training, ...)		●
Optimisation & investment proposal	●	●
Planning	●	●
Studies		●
Customer care, Invoicing		●
Maintenance		●
Renewal	●	
New Investments	●	
Setting tariffs	●	

● Municipality

● Veolia Water

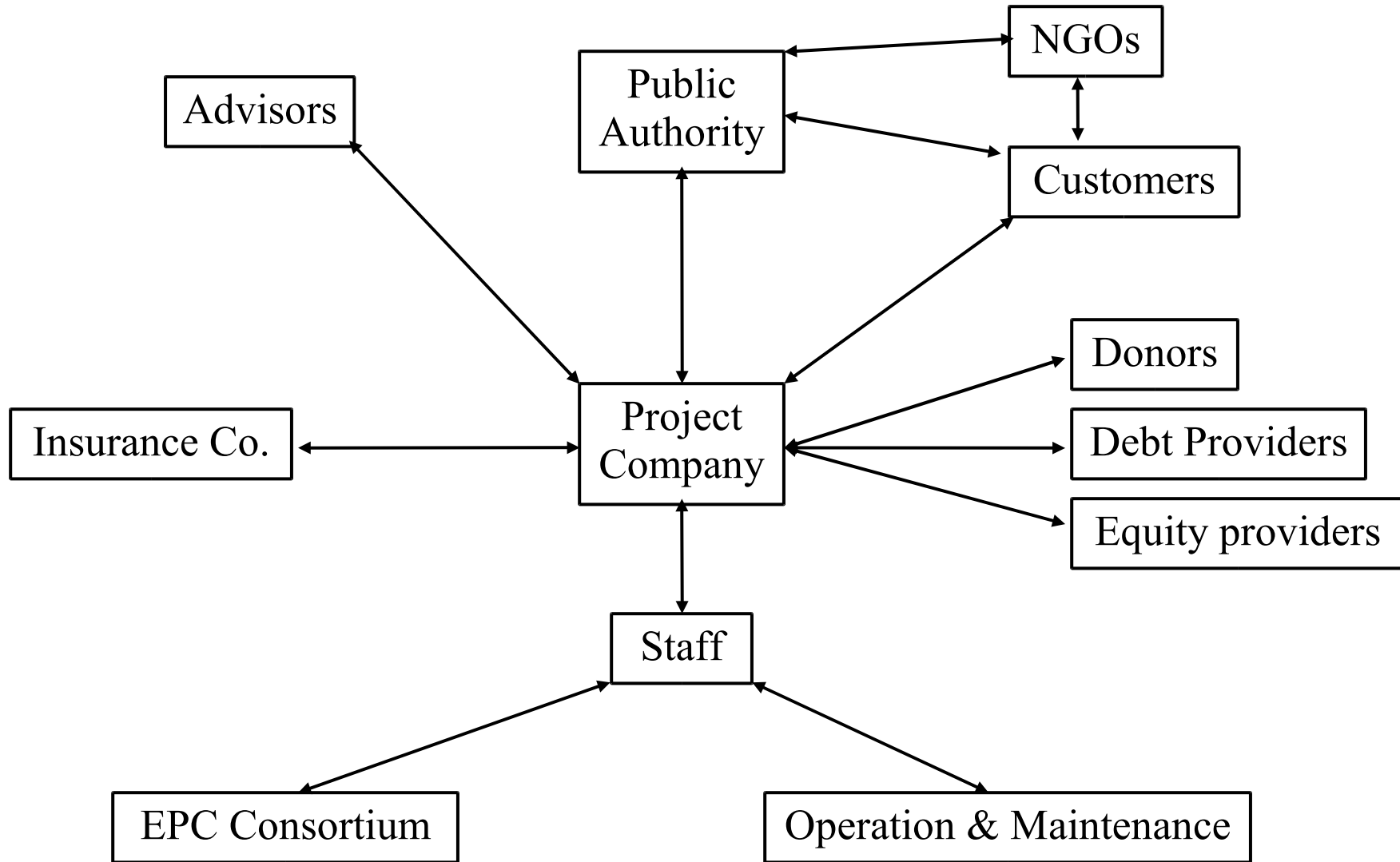
Scope PPP : Lessons

- **OPERATIONS** is the main scope of PPP
 - Combining Short-term management and Long-term vision
 - Staff organisation, Training, Human resources development
 - Technologies, R&D
 - Optimising Renewal and Capex
 - Purchasing (reduce volatility of prices : energy, chemicals...)
- When operation is optimised, **FINANCING** is easier
 - Long-term vision on cash-flows of the project
 - Transparency on the risk-sharing structure

2. Can PPPs achieve the objectives of all parties ?

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***Define the parties involved in a PPP
and the relationships among them.***



Objectives of all parties

PARTIES

- Customers
- Public Authority
- Staff
- Sub-contractors
- Lenders
- Advisors
- Etc...

OBJECTIVES

- Demand risk
- Value of investments
- Transfer of responsibility
- Risk transfer
- Fair competition
- Value added to citizens
- Financing, incl. EU grants
- Political and public sector support
- Legal, regulatory framework
- Etc...

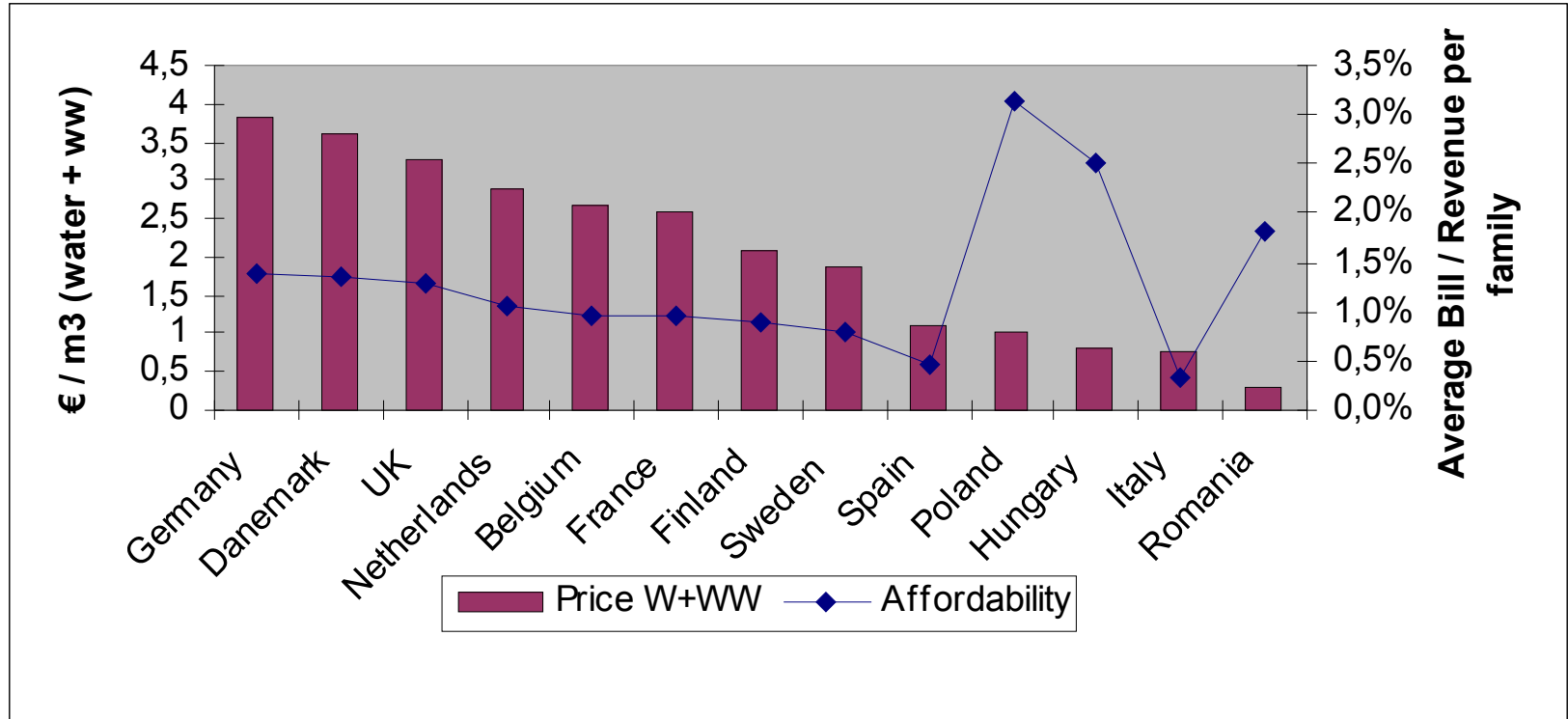
Focus on Customers' objectives

- Quantity and Availability
- Quality
- Price
- Transparency
-

➤ ***Customers needs are the key factor to design a PPP***

2. Can PPPs achieve the objectives of all parties ?

The Customers' objectives : « Affordability » (1/3)

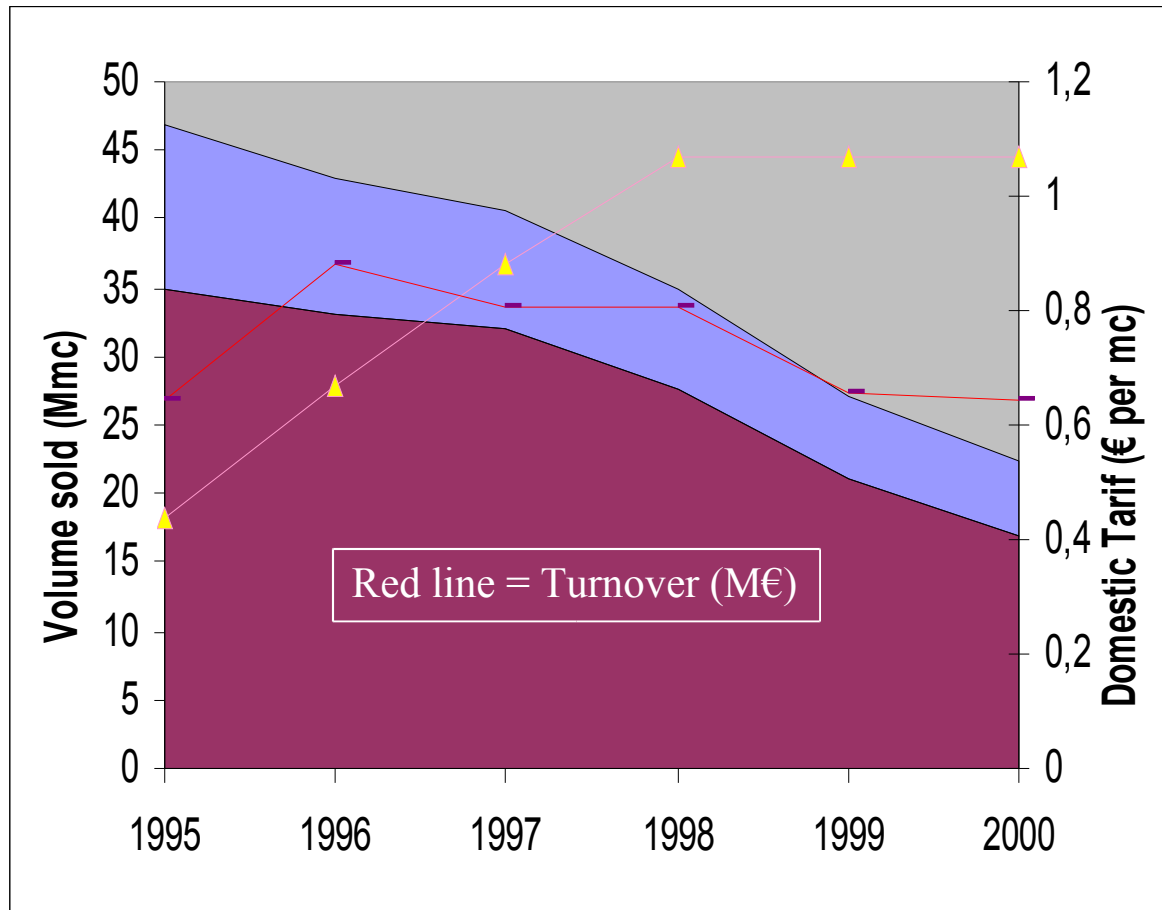


Different water prices in different EU countries don't have the same « social » meaning

2. Can PPPs achieve the objectives of all parties ?

The Customers' objectives : « Affordability » vs. Water consumption (2/3)

ESTONIA – City of Tallinn
Water consumption & tariff



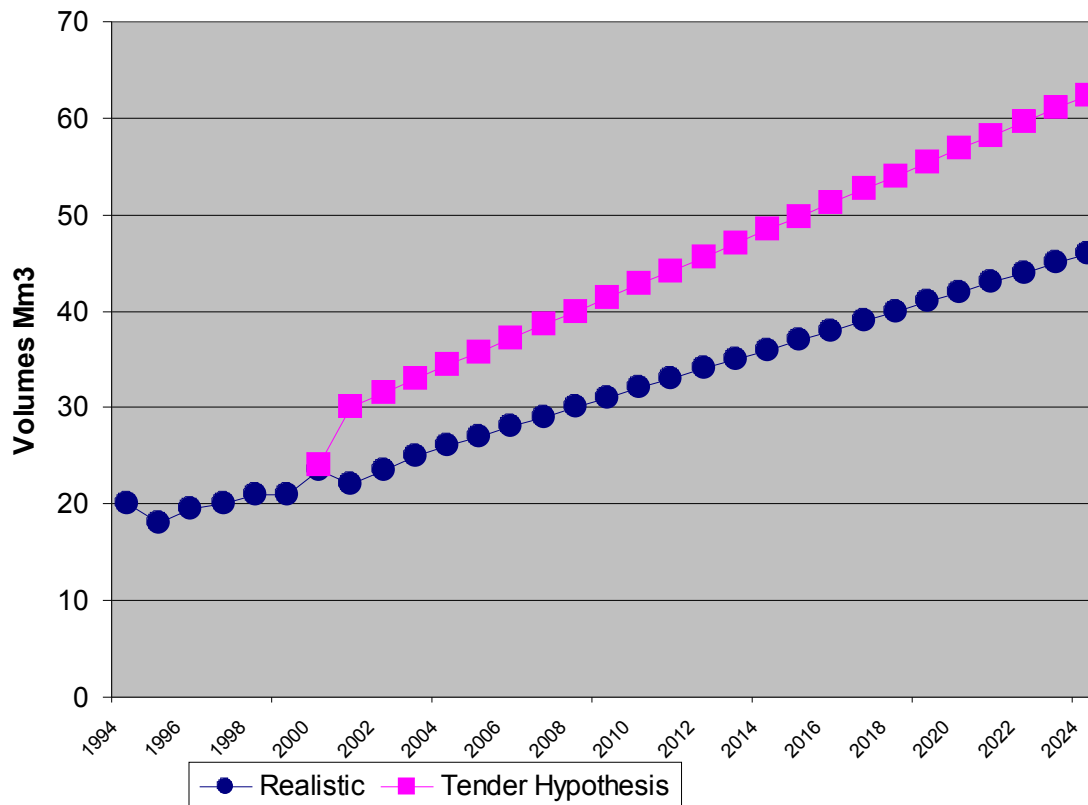
- In 1994, the Tallinn water company decided to increase tariffs in order to finance new investments.
- Price increase appeared to be too sharp, leading to a dramatic reduction in water consumption.
- As a consequence, Turnover remains stable
- A PPP has been organized in 2001

2. Can PPPs achieve the objectives of all parties ?

The Customers' objectives : Quantity & Availability (3/3)

MOROCCO - City of Tangiers

Forecasts of Water consumption over 30 years



- In 2000, the City of Tangiers decided a PPP for electricity, water and waste water services (awarded to Veolia in 2002).
- Due to the combined effect of demographic and economic growth, future demand was the key factor
- Long-term CAPEX planning and water availability depend on these forecasts
- A significant difference between initial forecasts and realistic hypothesis has been discovered during tender preparation

Customers objectives : Lessons

- Long-term planning is the key issue to reduce the Demand risk, considering several factors
 - population, industries, local habits...
 - Wealth (GDP per capita, affordability)
 - Legal requirements
 - Expected local economic growth
- Future customers needs is the key parameter for :
 - Planning CAPEX
 - Design future organisation for Operations
 - Design an secure Financing
- Long-term planning is often neglected in traditional schemes

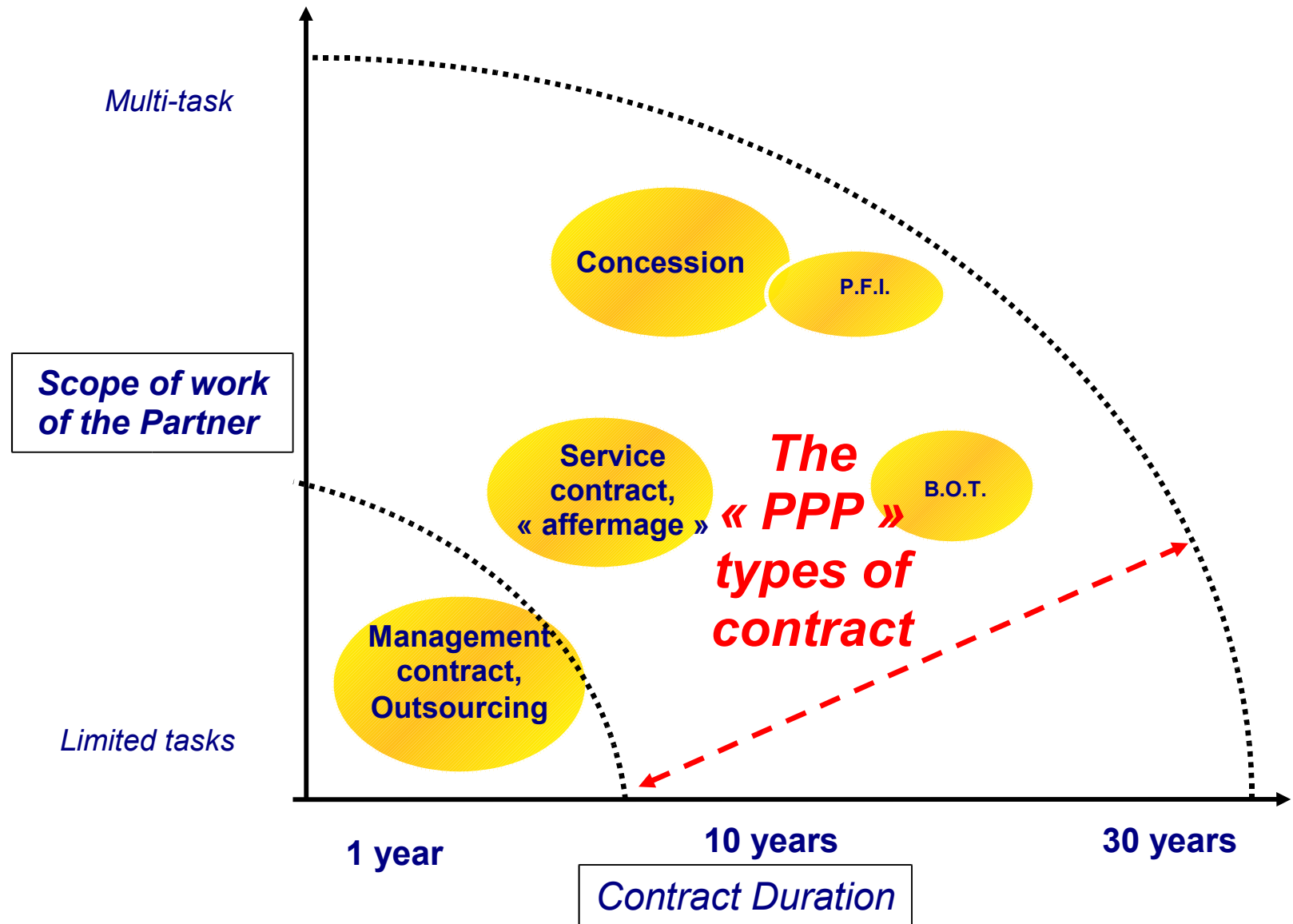
3. Comparing PPPs to other structures

The Public Authority can decide to outsource the Water services (or a part of it) :

- Drivers :
 - Scope of work of the Operator
 - Risk transfer to the Operator
- Contract duration depends on the Scope of work and Risk Transfer to the Operator
- Various contractual schemes exist:
 - Service Contract (without Financing)
 - Concession
 - PFI, BOT
- These schemes can be combined with Public-Private Joint Ventures

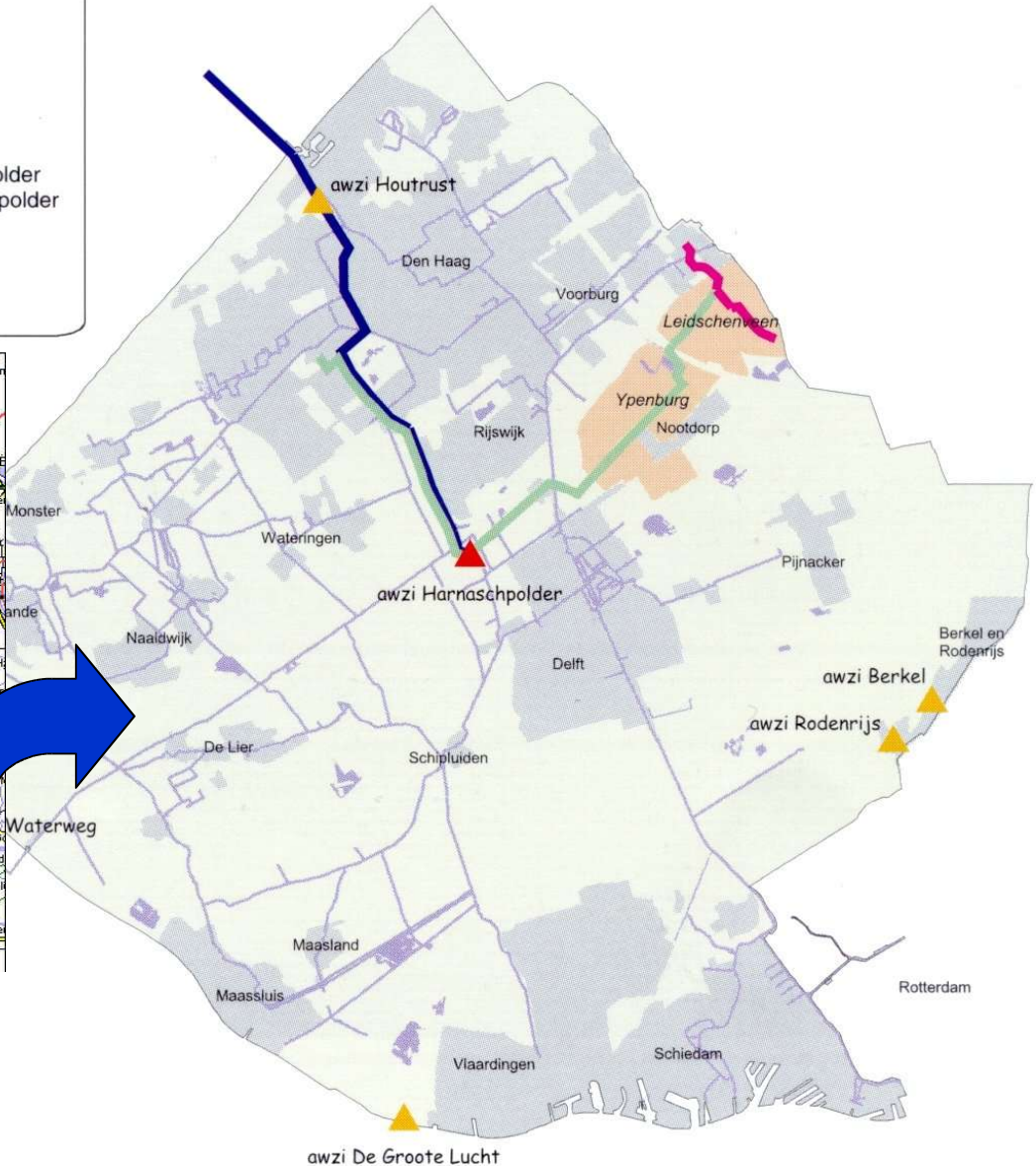
3. Comparing PPPs to other structures

In the water industry, many types of PPP contract have been experienced.



3. Comparing PPPs to other structures

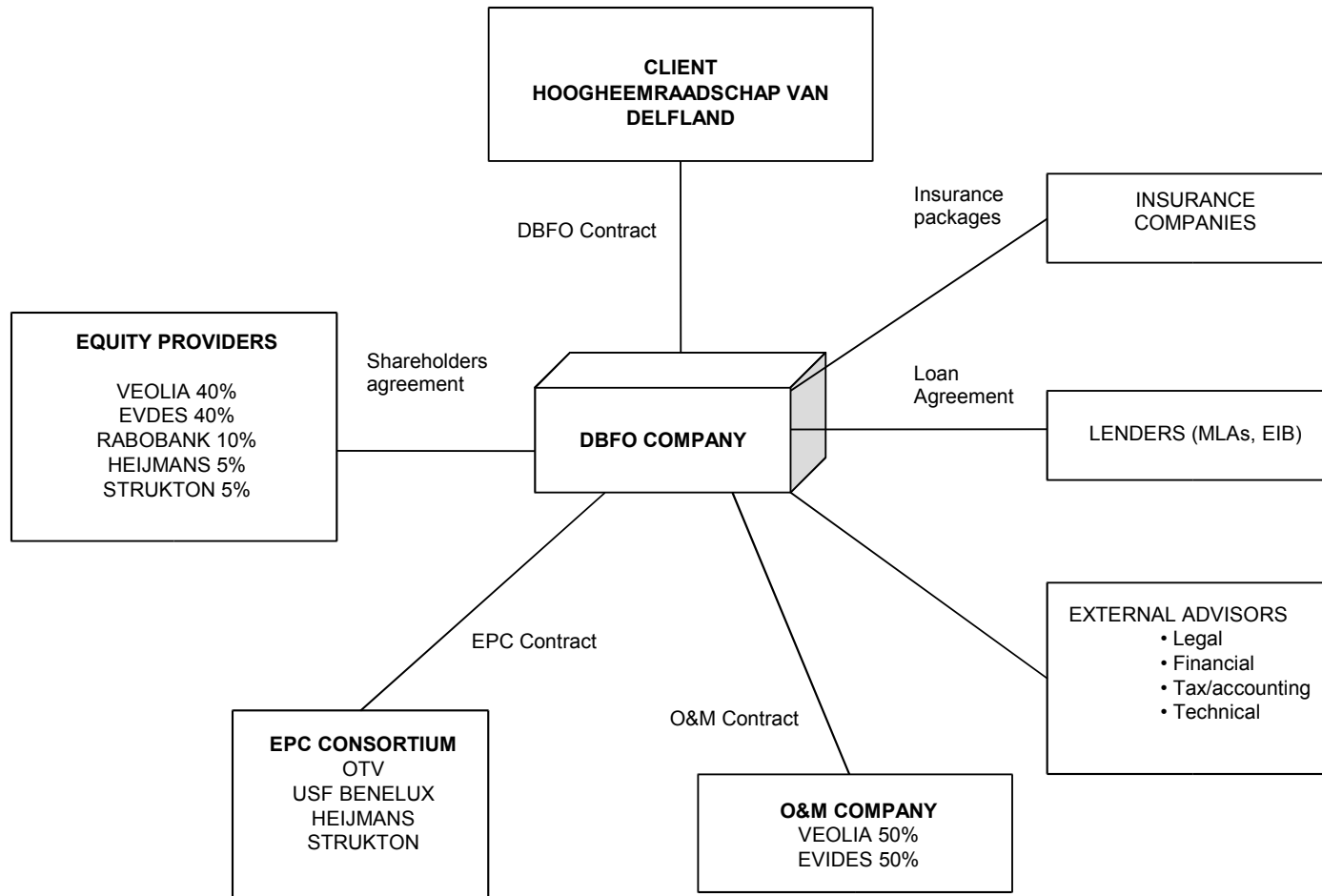
THE NETHERLANDS – Delfland Waterboard Contractual scheme PFI



3. Comparing PPPs to other structures

Adapting the contractual scheme to the scope (2/2)

THE NETHERLANDS – Delfland Waterboard Contractual scheme PFI



- **DRIVERS :**
 - Private financing
 - Time constraint
 - Difficult Project management
- **CLEAR CONTRACTUAL SCHEME**
addressing issues of all Parties involved in the transaction
- **BALANCED RISK SHARING:**
each risk has been transferred to the party best able to manage it most cost effectively
- **“ONE-SHOT” :**
all contracts are fixed at the same time (complex but efficient)

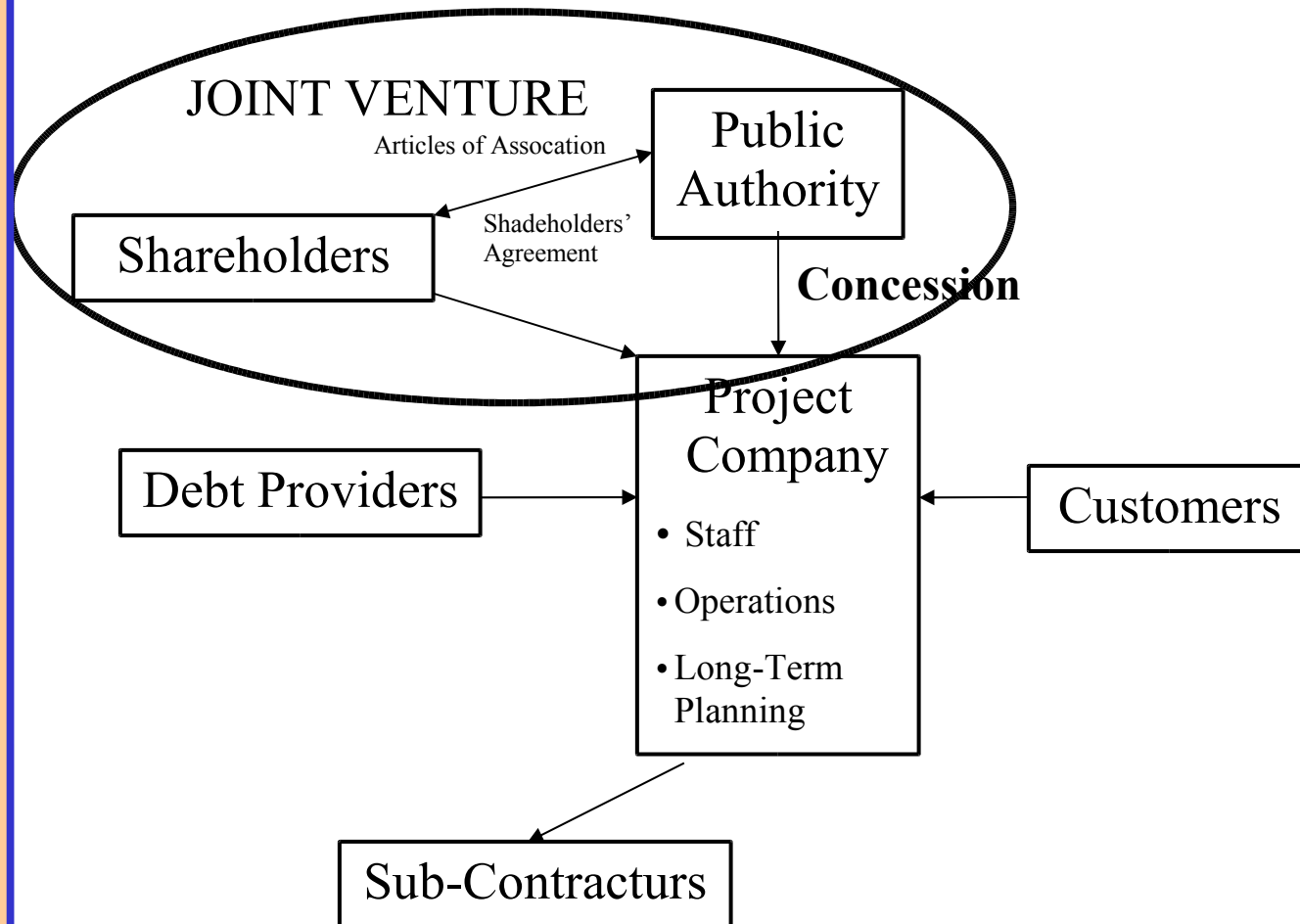
3. Comparing PPPs to other structures

Adapting the contractual scheme to the scope (2/2)

ITALY – Lucca (85.000 people)

POLAND – Tarnowskie Gory (74.000 people)

Concession + Joint Venture



- **DRIVERS** : improve efficiency, raise funds for the water service
- **CONCESSION CONTRACT** between the City and a Project Company, carrying out all the Water services for 25 years
- **JOINT VENTURE** : Both the City and the Operator are Shareholders :
 - Lucca: City 52%
 - Tarnowskie : City 36%

Contractual schemes : Lessons

- Different contractual schemes exist:
 - The water industry has implemented various types of PPP
 - PPP has already a long history in the water sector
- Existing PPP schemes provide:
 - large flexibility to adapt the contract to the scope
 - a balanced risk sharing policy
 - long-term vision on cash-flows
 - Need for efficient and broad communication, transparency
- Traditional Outsourcing and Management contracts are not appropriate in PPP
 - Limited scope
 - based on a « one-to-one » relationship

4. How to achieve an effective implementation structure of PPPs ?

Implementation of a PPP

- i. Design and Planning
- ii. Tender procedure
- iii. Financing
- iv. Adapt the PPP during the contract life

Design and Planning a PPP

- Assess Long term vision (strategy)
 - Main task of the Local Authority
 - essential to obtain political and public support
- Establish a Project team for PPP Implementation :
 - Multi-disciplinary (Technical, Legal, Financial)
 - Possibly, a national « agency » to support local Authorities (ex. Netherlands, Northern Ireland)
 - Financial support to Local Authorities
- Involve potential partner very soon (“private initiatives”)
- Welcome to Standardisation, benchmarks, best practices
- Role of advisors
 - PPP market development should increase efficiency (and lower costs)
 - Advisors committed to results (success fee)

Tender procedures

- **Current EU tender procedures to be adapted (?)**

Need of implementation of a specific regulations

Competitive dialogue ?

How to regulate private initiatives ?

- **Development of PPP leads to new challenges for the European Water Industry :**

By pushing EU water companies to join multi-disciplinary JVs, PPP can help regional cooperation and market construction

Creativity enhanced (R&D, new technologies, organisations' re-engineering)

Competitors must build up dedicated teams

Financing (1/3)

- The Operator's role is to maximize efficiency of the services provided to customers
- Investments must be planned in order to achieve "value for money"
 - Good balance between CAPEX and OPEX
 - Reduce Tariff level
 - Long-term efficiency
- The financing structure is driven by operating efficiency
 - securing long-term cash-flow
- Financing is NOT the core business of Operators, but Operators can optimise Investors return by
 - accepting liabilities based on performance (commitment to "results")

Financing (2/3)

- Fund raising for water PPPs should be easy...
 - Water is traditionally a low-risk sector
 - A good PPP achieves balanced risk sharing
 - Long term commitment of the Operator provides high visibility on the project
- Long-term view on cash-flow provides security to Investors
 - longer maturity, low margins, low liquidity ratios
 - limited recourse debt
- Different financing schemes can be combined :
 - Equity : essential, but not sufficient :
 - Water companies have limited resources
 - Public water entities should not invest outside their area
 - Grants :
 - essential for Accession Countries to reduce price level for customers (affordability)
 - Debt :
 - Strong appetite of Financial Institutions for Project finance
 - New financial schemes to develop : Bonds, Pension Funds

4. How to achieve an effective implementation structure of PPPs ?

Financing (3/3) - Examples of Project Finance

THE NETHERLANDS and MOROCCO

Long-term Financing conditions

	<u>The Hague</u> (The Netherlands)	<u>Tangiers-Tétouan</u> (Morocco)
Type of contract	PFI	Concession
Project award	2002	2001
Financial close	2003	2003
Project duration (years)	30	25
Debt Maturity (years)	27,5	15
Total Capex (MEUR)	363	100
Backlog (MEUR)	1.200	1000
Currency	EURO	DIRHAM
Equity (MEUR)	45	85
Debt (MEUR)	290	85
Gearing	87 / 13	50/50
Interest rate	Fixed	50% Fixed
Spread	95 bp	approx 220 bp
DSCR (average)	1,20	1,70
Debt provider :	EIB + Comm. Banks	BCM/BMCE (local Banks)

- The risk profile of a water PPP allows project finance
- Both financing have been provided on limited-recourse basis
- Higher risk of Morocco compared to the Netherlands is reflected in lower gearing an higher cover ratio, but the two structures are similar
- Strong appetite from (local) financial institutions

Adapt the PPP during the project's life

- Interim reviews can occur:
 - For unexpected reasons :
 - in case of significant changes in the technical background
 - in case of force majeure
 - following a change in the legislation
 - For convenience
 - after a period of x years
 - if the tariff escalation varies beyond certain limits
 - in case of a substantial investment or change in technical requirement
- Changes are normal facts in real life :
 - Need for clear and simple Change procedures
 - Avoid arranging costs
 - Anticipate changes in Financing

Conclusions

Driving factors of PPP

- Efforts to increase the quality and efficiency of public services
- Efforts to increase efficiency in use of public funds

Leads to :

- Increase of the scope of work of the Water Operators
- Increase of number of Parties involved in the water management

Different contract schemes exist:

- The water industry has implemented various types of PPP
- PPP has already a long history in the water sector
- Traditional schemes (outsourcing, management contract) are not adapted

Design an efficient PPP requires :

- Clear (political) vision
- Strong project management
- Adapted tender procedures
- Efficient market, European Joint-Ventures

Thank you !