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PRIVATISATION OF AUSTRALIA'S WATER UTILITIES

Water is the sleeping element in the privatisation debate. With all the activity and angst focused on electricity and telecommunications, investors are thinking that any move on water and sewerage is at least 10 years away. The reality is different. The potential $70 BILLION to be realised through the sale of water assets is becoming too tempting for the State treasurers committed to economic rationalism.

Governments are already chipping away at their water systems and at least three commissioned reports to evaluate the impact of privatisation. Victoria, seen as the state closest to an asset sale, has corporatised its water boards and, earlier this year, introduced a user-pays system.

South Australia is not far behind. It has out-sourced water and sewerage for 15 years to United Water consortium, composed of the French group GCE, Britain’s Thames Water and the Kinhill Group, which has its headquarters in Adelaide. Queensland is contemplating privatising three of its main water pipes and New South Wales has increased the private sector’s involvement in water-treatment projects.

Victoria’s Government is about to announce the successful tender for the $30 million Castlemaine waste-water project. Three other projects, valued at up to $80 million each, are to be announced in the next few months.

Water is one of the most emotive, sensitive issues in the privatisation debate. As a staple of life - far more so than electricity and telephones - any move to privatisation raises concerns that water will become more expensive for low-income households. Even in the United States, water remains largely in the public sector.

European water companies are watching developments in Australia with great interest. Much of Western Europe’s water and sewerage has been privatised and the companies involved are making fat profits. The British lobby group Water Watch says shareholder dividends accounts for between 12% and 42% of water bills for ordinary customers.

In Australia, investment bankers are salivating at the prospect of water privatisation. Many have hired specialists from public sector to prepare them for when the lobbying intensifies.

With a reasonable prospect of most States being run by Liberal or conservative coalitions after their elections, the bankers believe privatisation can only gain momentum. John Walters, executive Vice-President of BT Investment Bank, says: "We are very interested in the water industry because there are so many potential opportunities for the private sector to get involved".

But most States first need to look seriously at selling off electricity. In Victoria, where most of the power infrastructure has already been privatised, the previous Kennett Government took two important steps towards preparing the water system for sale: it changed the pricing structure and corporatised the water boards.

From January 1, 1998, Victorian households began paying for water on a user-pays basis rather than simply by flat rate with fees for excess consumption. The then Premier Jeff Kennett said water privatisation is possible after the next election. "We have given a commitment that we are not going to privatise this item...what happens beyond 2000 I have no idea" he said during a speech in late 1998.

Industry observers believe privatisation of water is inevitable. Mark Green, national director of utilities and partner at the accountancy firm Ernst & Young says: "I think after electricity and gas, it (WATER) is likely to be next utility cab off the rank. I also think it could happen in the next few years."

Britain has the way among English-speaking countries. Margaret Thatcher's Tory administration privatised most of its water utilities in 1989. Unlike in Australia, water privatisation came before electricity.

And, unlike electricity companies, water companies do not operate in highly competitive markets: they have regional monopolies whereas companies compete against other generators on a shared grid.

Private water firms, many of them European, are also taking leading roles in building the water supplies of developing nations. According to a report in London’s Financial Times about an international conference on water in Turkey last year, the World Bank estimates the poor countries intend to spend $600 billion on water in the next 10 years. In turkey, Thames Water of Britain, also active in Australia, is leading an $864 million project to provide drinking water to more than one million people of the city of Izmit, 100 kilometres east of Istanbul.

In Buenos Aires, the capital of Argentina, Lyonnaise des Eaux, a private French water company, has taken over the entire water network.

The British experience is most relevant to Australia. British water companies are reported to have extracted big efficiency gains since being privatised. The state-based water and sewerage industries in Australia also are big and there are a lot of potential profits to be extracted. But they are capital-intensive and in some areas extensive upgrading.

Victoria’s water industry has an overall debt of $3 billion. Kennett government Treasurer, Alan Stockdale said on many occasions that a higher proportion of industry revenue is now spent on finance charges and this has weakened the incentive to improve efficiency. To satisfy demand and stiffer health and environmental standards, Australia needs to spend heavily on upgrading and expanding its water system.

INTERESTED PARTIES ARE ON THEIR MARKS

If the private sector is saying it can meet these costs, the Victorian Government is listening. It has set up a water-reform unit in Treasury and is involving an ever-growing number of private-sector interests in water-treatment projects. Many of these involve so-called BOOT (Build, Own, Operate, Transfer) schemes. An operator enters a long-term contract with a government agency to build, operate and provide a facility on a fee-for-service basis. Tax and accounting incentives are offered to ensure investors receive a return on their investment earlier than they normally would through such huge infrastructure commitment.

Governments argue that, through BOOT projects, they can reduce building costs, avoid the operating risks that owners face and still access to the latest technology and expertise.

Sources in Sydney Water board say that the recent spate of private-sector involvement in the building of water-treatment plants in New South Wales will save the Government millions of dollars. "Had they been built by the Sydney Water itself, they would have cost 40% more," one says.

Mario D'Elia, a Vice-President of BT Investment Bank, says that most BOOT projects make a net return of 11-13%. "The after-tax return on some of these projects is pretty good, but there are no guarantees of payments," he says. "If you don't provide the service, you don't receive the fee. This shifting of the risk to the private sector is very advance in Victoria, and that is good news because it means they are serious about making it work in the private sector."

Among imminent private-sector work in Victoria, an information memorandum is expected shortly on the Bendigo water-treatment project; expressions of interest in the Ballarat project has now closed; and expressions of interest were invited for the Grampians water-upgrade project in May 1998. These projects each involve between $60 million and $90 million worth of capital costs and will open the way to three or four other projects valued at up to $60 million.

D'Elia says the main interest is coming from the French and English Companies, as well as the Australian groups Lend Lease and Transfield. "What they really want is to win the $200-600 million projects when they come up," he says.

Governments that decide to privatise will be under pressure to ensure a consumer benefit. Wayne Schachtel, Andersen Consulting's managing partner for the utilities industry (Asia-Pacific), says government will not consider water privatisation until they work out an effective regulatory regime that passes the risks to the private sector but ensures it does not get excess profits at the expense of consumers. "It would be political dynamite to have companies making big profits through water rationalisation when Australia is prone to droughts," he says." "Water privatisation is a big, thorny political issue, but it doesn't mean it won't happen. I just think it will be very considered."

Again, Britain's case is worth consideration. There, water-company share prices and profits surged because of efficiency gains. Although there is some price regulations in Britain, there has been increasing pressure on companies to justify their earnings growth.

Customers argue that they, as well as investors, should share in the benefits of privatisation. According to a report on the regulation of utilities in Britain, released by the specialist FT Energy Publishing, at least one company has been forced to act to contain customer resentment.

The FT report says. "In March 1995, in an offer to avoid regulatory action over ‘excessive’ profits, North West Water (since merged with Norweb to form United Utilities) announced a package of One Hundred and Eighty Million Pounds to share some benefits of its efficiency gains with consumers over the following five years. By offering such a benefit-sharing package outside the price-capping process, regulatory is implied."

Governments are studying the British model of privatisation closely. In South Australia, the Liberal Government has retained ownership of its water system but has out-sourced management and operations to United Water. The move is widely seen as a precursor to privatisation, with United Water a front-runner to buy the business.
A report leaked to the state Opposition four months ago canvassed options for the privatisation of SA Water (estimated to be about $8 billion), including a share float.

In Victoria, water and sewerage assets have been estimated at between $16 billion and $18 billion, because of the vastness of the system and the revenue its five businesses generate. In the past six months, Melbourne’s water industry generated revenue of almost $1 billion.

FIRST MOVES ARE ALREADY BEING MADE

In Queensland, where the water assets are valued at $12 billion, the previous Borbidge Liberal-National Government was considering privatising three pipelines in the centre of the state. The then Treasure, Mrs Joan Sheldon, set up an interdepartmental working party to manage the sales of the Eungella, Blackwater and Collinsville pipelines.

The Queensland Commission of Audit, a body set up by the Borbidge Government in 1997, recommended an end to public ownership of water assets. The Government appointed Deutsche Morgan Grenfell to advise it on the sale of the pipes. An announcement was expected in August 1998.

In New South Wales, all water boards have been corporatised and Bob Carr’s Government is in the process of awarding projects to the private sector. Water and sewerage assets in NSW are estimated to be worth up to $20 billion. NSW turned to the private sector early in the 1990’s for the construction and operation of three water-treatment plants valued at a total of more than $500 million.

The largest, the $300 million Prospect water treatment plant was awarded to a consortium including P & O Australia, Lend lease and Lyonnaise des Eaux.

Ernst & Young's Green says water is not a commodity that lends itself as easily as electricity or gas. "The distinguishing factor is that water has a quality about it," he says. "To retain the quality and keep prices from escalating, you need regulation. Those powers need to be much greater than for electricity and gas."

Green says there is not a lot of growth in the basic consumer retail market because people cannot be encouraged to use more, but he sees many opportunities for growth in industries such as beverages, hospitals, mines, nurseries, pulp and paper, and in co-generation plants. "All these industries need water and if you can tap into that, there is a lot of potential to make money," he says.

Green says that before water privatisation can be considered, bulk water entitlements as well as quality and price to be examined. Heavy consumers of water are given a ceiling on their consumption entitlement. If they do not use it all, they can sell the balance to consumers that need water above given ceiling. Such a system is supposed to promote more efficient use of limited water resources. " It is a form of competition based on tradeable water rights," Green says. Chile has had this system for 40 years "

All sides of the water-privatisation debate agree that the value in water assets lies in the fact that they have a captive customer base. Green says "There is a good wholesale market in water for the private sector to make money out of and, in terms of retail, there is a captive audience".

Some corporate advisers envisage the time when a company, for example, energy utility, will bid for water assets so that it can provide a one-stop-shop for gas, electricity and water on one meter. Schachtel says such utilities companies will be interested in water as a means to diversify their portfolios and gain "synergies". He says, "Customer retailing is a big factor that will generate their interest".

This has already occurred in Britain. The first merger of a power company and a water company was in 1995. The FT Energy report, Regulation of UK Utilities - Prospects to 2000, nominates such a trend as a challenge. "As utility companies from one industry seek to enter the markets in another, the exploitation of synergy across related industries is a key business strategy." it says. "For the regulators, however, it creates a need for greater co-ordination of policies and information-sharing between them."

The report warns that, without adequate regulation, there are two possible outcomes:

a) Excessively high prices: or
b) Poor service.

Australian governments will need to get the regulatory structures right before they privatise, and this will take time.

There are differences between the individual Australian States and Britain. The report Reforming Victoria's 1995 Water Industry says: "The 1989 UK reform covered 31 water authorities, 21 of which were already in private hands. The remaining 10 government authorities were privatised and all businesses were placed under the same regulatory regime."

By contrast, Australian states have full control over their water systems and the structure is much simpler. This means Australia has two advantages over Britain:

a) Ownership structures are simpler: and
b) Australia can learn from Britain's mistakes.

Private contracts and trade sales of water assets are likely to precede share offerings, so water-company floats are probably still a few years off. Nevertheless, multinational investors will start preparing themselves.

WATER and the UNITED NATIONS

The United Nations hosted a 3-day conference in Paris, during March 1998, on managing the world's limited fresh water supplies. According to the British BBC and the United States Boston Sunday Globe this conference was attended by environment ministers and officials from 84 countries. It was agreed that water should be paid for as a commodity rather than be treated as an essential staple to be supplied free!

French President, Jacques Chirac, told delegates "no more barren wrangling over the market versus the state. Water has a price and zero price is a forewarning of scarcity".

Chirac (who chaired the conference) estimated that it would cost $400 billion to set up reliable water networks around the world and told participants that governments could not foot the bill alone. The proposed solution was to market water as a prime opportunity for investors.

The Australian People have every right to ask:

- Why can't governments foot the bill?

- Why didn't the Australian media cover this conference?

- Why doesn't the Australian government immediately implement the Bradfield Scheme?