Selling off Spain's municipal crown jewels

The formation of a new government in Madrid could catalyse a new wave of water privatisation in the country. Richard Weyndling investigates.

Spain's private sector water operators are convinced that circumstances have gifted them a one-off opportunity to expand their business into some of Spain's largest metropolitan areas, which have hitherto been the impregnable domain of long-established public sector water companies.

On the one hand, with public finances shattered by the collapse of Spain's construction boom and savage cuts in central government funding, municipal and regional authorities are desperate for cash. On the other, conservative parties which are ideologically amenable to the privatisation of commercially attractive public sector enterprises have made sweeping gains in local and national elections.

In Spain, private sector operators typically acquire 25-year municipal water concessions (but not the infrastructure assets themselves) by public tender. The winning bidder makes a one-off payment up-front (called a canon) to the municipality, which the municipal government can then use to rebalance its finances.

Ciril Rozman, director for concessions at Spain's largest water operator, Suez Environnement-owned Agbar, told GWI: "we have detected a great deal of interest for privatisation among municipalities, with the water sector the principal focus of attention." As a result of the municipalities' need for quick cash, private sector water operators will end up serving an additional 10 million inhabitants and have a 60 to 65% share of the total municipal water market within the next five years, he predicts.

Agbar's most accessible opportunities are in its home territory of Catalunya. Not only does the region have many cash-strapped municipalities, but the Catalan government itself has its back to the wall, with its water agency (ACA) €1.35 billion in the red.

The recently elected conservative Catalan administration and ACA are jointly preparing to package Aigües Ter Llobregat (ATLL), the bulk water operator in the Barcelona metropolitan region, into a concession for a period of up to 50 years as a means of reducing the agency's debt. "The longer the concession period, the more money it would raise," ACA director Leonard Carcolé told GWI, adding that "while the canon would not pay off the whole debt, it would greatly help." The concession-holder would operate the whole bulk water system, including water treatment plants and wastewater treatment plants. It would also be responsible for certain specified infrastructure investments, but not for big-ticket infrastructure capex.

Carcolé says ACA's maximum priority is "to gain credibility with financial institutions" in order to be able to attract the private sector investment required to finance the €1.4 billion worth of wastewater treatment infrastructure needed to comply with EU legislation. Raising water tariffs (up 40% in 2011 for large consumers), cost-cutting through staff reduction, and selling off the ATLL concession by as soon as the middle of 2012 are seen as important steps towards restoring the agency's status, according to Carcolé.

Critics of the privatisation proposal worry about the strong influence that Agbar has with Catalan administrations. Eloy Badía of NGO Enginyería sense Fronteres argues that ATLL is a viable enterprise which should stay in public hands. He ascribes ACA's debt burden partly to "the excessive scale of some of Barcelona's new infrastructure", but principally "to the failure of politicians to create the financial infrastructure to pay for it". By not raising tariffs in the past, "the politicians have ended up by handing a profitable water operation to the private sector on a plate." As a result, "citizens will have to pay off the debt, future capital investment and the operator's profits as well."

Ciril Rozman counters that Agbar, which already operates retail water services in most of the municipalities of greater Barcelona, could "add value to the operation, which would be made optimal by the integration of the water cycle."

Agbar sees its role "not as a financier, but in providing expertise so that we draw investors into the project. What we have done at Bristol Water, selling equity to Capstone and keeping our operational role, is a model for our expansion in Spain," according to Rozman.

Agbar also has its eyes on a role in Madrid's soon-to-be-privatised Canal Isabel II (CYII). "In the first phase, the Madrid regional government is likely to sell a 20% stake to institutional investors and bring in an operator, and then go public on the stock market at a later date," Rozman believes. "The model has not been defined yet, but there will be an opening for stable partners like ourselves," he adds.

Top targets for water privatisation in Spain

- **CYII:**
Area served: Madrid
Population served: 6 million
Revenue: €776.96 million
Net result: €93.89 million

- **ATLL:**
Area served: Barcelona
Population served: 4.5 million
Deficit 2010: - €40 million

- **EMASESA:**
Area served: Seville
Total customers 2009: 337,000
Population served: 1.06 million
Revenue 2009: €108.49 million
Net result: 2009: €74,640

- **EMASA:**
Area served: Malaga
Population served: 680,000
Revenue 2010: €60 million

CYII is profitable under public ownership and is universally regarded in Spain as a model of quality and efficiency. As a result of CYII's healthy financial condition, Madrid is almost the only region where wastewater infrastructure investment has continued, unaffected by the economic crisis. Rozman believes, nonetheless, that "an international company like Agbar could add value" to its operation.

Another rumoured candidate for privatisation is EMASESA, the public sector operator in Spain's third-largest metropolitan area, Seville. Like CYII, it is a company with a record of quality of service, investment in infrastructure, efficiency in reducing water losses and an active expansionist policy in international markets.

Sevilla's mayor Juan Antonio Zoido has publicly denied that his recently elected Popular Party (PP) administration intends to privatise EMASESA. But according to Socialist opposition spokesman Juan Espadas, "political manoeuvring by suburban PP municipalities to get seats on EMASESA's board indicates they are, in reality, planning something along these lines."

Also in Andalucía, the PP ruling group on Malaga's city council, which has held discussions with private sector operators, actually supported an opposition motion in September rejecting privatisation of the municipal water company EMASA. According to Luís Babiano of the public sector water operators' association AEOPAS, there is a significant practical barrier to privatisation here, because "the financial operation has already been done in the form of a €75 million canon recently paid by EMASA to the council."

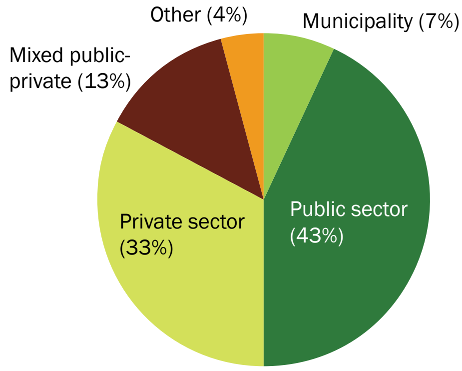
Despite local setbacks, Agbar's Rozman expects rumoured privatisation plans to become concrete now that Mariano Rajoy is set to lead a PP government in Madrid. PP mayors "avoided making public commitments to privatisation between municipal election victories in May and the general election in November, in order to help Rajoy," he told GWI.

Opposition will nonetheless be vocal, and the arguments against the privatisation of these profitable urban water cycles are more often practical than ideological. Luís Babiano says his association does not oppose private sector participation per se, but adds that there are several deep-seated problems within the model of privatisation in Spain.

First of all, the Spanish private sector is essentially a duopoly: "when you privatise, you privatise to Suez or FCC, so the element of free competition is weak." Secondly, the system of awarding concessions through the payment of a canon acts as a bait for cash-strapped councils to sell off the most profitable water operations for "money which is then spent on other priorities, leaving no resources for investment in water." Thirdly, there is no independent regulator or established criteria for assessing relative performance of operators to ensure efficiency and quality of service.

AEOPAS firmly supports private sector investment for the provision of wastewater infrastructure – which is a major national priority. However, Babiano argues that BOT (build-operate-transfer) contracts work better when the integral water cycle is operated by public companies "which can make the investment effort more easily", especially in a region such as Andalucía, which has a ring-fenced water infrastructure charge included in tariffs.

Spain: water operators' market share



Source: AEAS

These arguments are unlikely to be strong enough to deter cash-strapped municipal administrators, however. As Rozman points out, "for Rajoy, the reduction of the fiscal deficit is non-negotiable", noting that he is committed to "a 4.4% reduction in public spending in 2012, with a further 3% cut projected for 2013." He is quite open in recognising that "the principal driver pushing city councils to privatise water is the payment of the canon", rather than a belief in the intrinsic benefits of private sector operation.