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# PPPs: A Solution for Texas Water Management

## *Private Investment in U.S. Water Infrastructure*



September 11, 2013

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## M3 Creates, Invests with, and Advises Specialized Real Asset Companies

**Real Asset  
Private Equity Focus**

- Manages \$3.4 billion of equity commitments on behalf of a U.S. public pension plan for investment in real assets

**Global Perspective,  
Local Investment  
Expertise**

- Global access to capital markets, with offices in Chicago, New York, London, Hong Kong and São Paulo

**Independent Firm  
Owned by Senior  
Management**

- M3 is owned by its Principals, providing management stability and a focus on long-term strategic relationships

# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## U.S. Water Infrastructure Sector Overview

- Highly fragmented sector, primarily owned and operated at the local level
  - Water: 54,000 community systems<sup>1</sup> – 85% of population served by municipal-owned utilities
  - Wastewater: 15,000 community systems<sup>1</sup> – over 95% municipal-owned
- Significant precedent for private sector ownership and/or operation
  - Private-sector owned utilities (regulated by state Public Utility Commissions)
  - Private-sector O&M of municipal-owned utilities
- Limited precedent for public-private partnerships (“P3s”) utilizing private equity
  - Upfront investment, with performance responsibility throughout a “concession” period
  - **Not a privatization**; municipalities retain control over rate setting and long-term asset ownership
- Significant need for investment in the sector
  - Annual investment need of \$91 billion and annual “**capital gap**” of \$55 billion<sup>2</sup>
  - EPA actively pursuing violations and increasing regulatory standards

Sources: American Society of Civil Engineers (ASCE), Environmental Protection Agency (EPA).

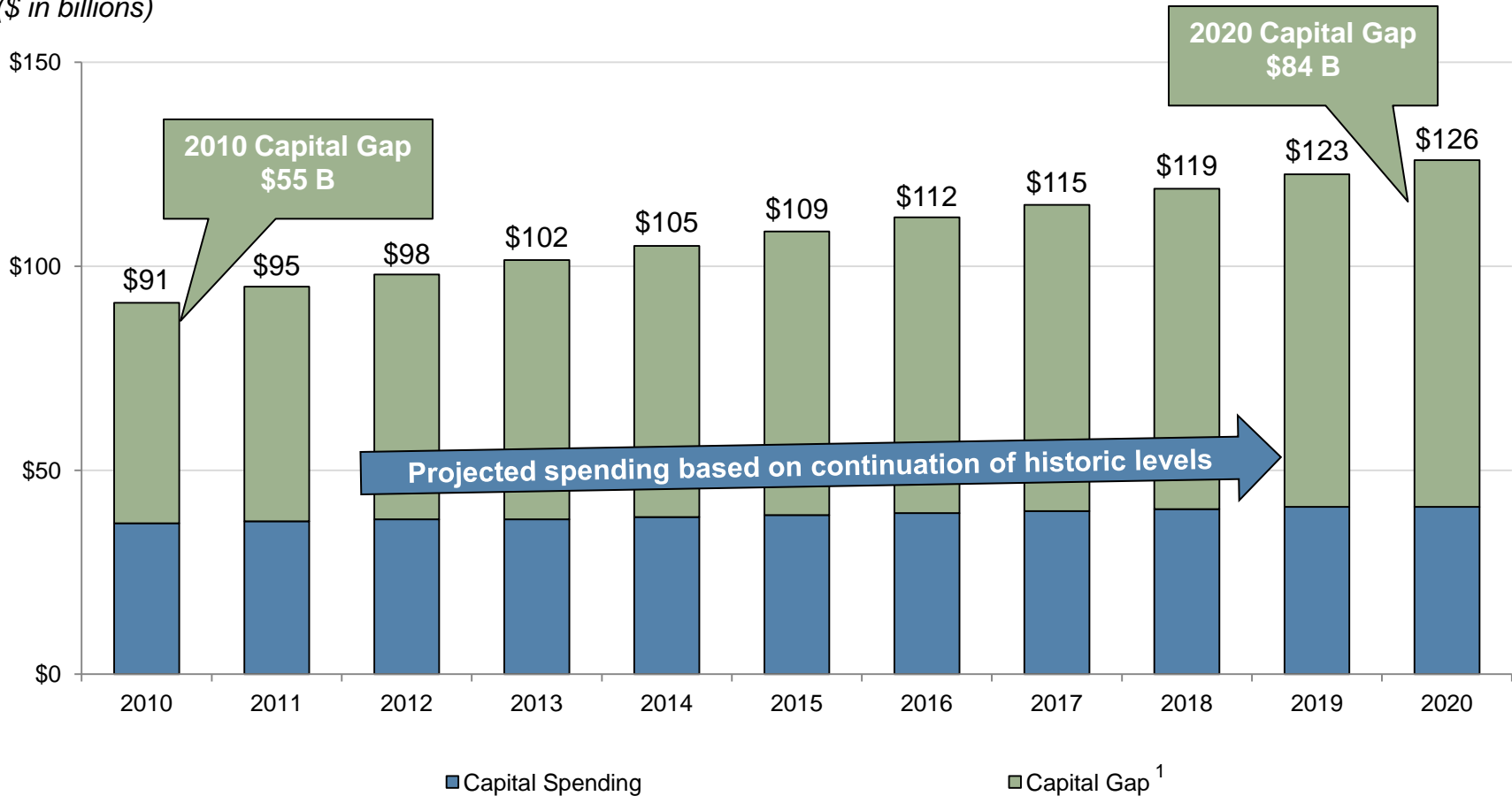
<sup>1</sup> Community systems serving at least 25 year-round residents each.

<sup>2</sup> Figures for 2010. “Capital Gap” based on (a) estimated future annual capital needs for maintaining and expanding U.S. water delivery systems, wastewater treatment plants, and sanitary and storm sewer systems, less (b) projected annual spending based on a continuation of past spending levels and growth rates.

# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Projected U.S. Water Infrastructure Investment Need and “Capital Gap”<sup>1</sup>

(\$ in billions)



Source: American Society of Civil Engineers: *Failure to Act – The Economic Impact of Current Investment Trends in Water and Wastewater Treatment Infrastructure*.

<sup>1</sup> “Capital Gap” projections based on (a) estimated future annual capital needs for maintaining and expanding U.S. water delivery systems, wastewater treatment plants, and sanitary and storm sewer systems, less (b) projected annual spending based on a continuation of past spending levels and growth rates.

# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Rationale for Private Entities to Invest in U.S. Water Infrastructure

### Asset Profile

- Economic infrastructure providing essential services
  - Capital-intensive, long-life assets
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### Stability of Payments

- Revenues from a broad base of rate payers
  - Monopolistic characteristics within a particular municipality
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### Immediate & Growing Investment Need

- EPA enforcement actions
  - Projected annual U.S. investment need of \$126 billion by 2020
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### Anticipated Interest in Private Solutions

- Strained municipal finances; decreasing federal / state funds
- Potential efficiencies of P3 solutions

# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Privatization vs. P3 Structures

	Privatization / Acquisition of Regulated Utilities	P3 / Concession of Discrete Water Assets
<b>Investment Approach</b>	<p>Acquisition of existing water / wastewater utilities</p> <ul style="list-style-type: none"> <li>▪ 10 publicly traded companies</li> <li>▪ Private equity-owned utilities</li> </ul>	<p>“Benefits of ownership” of discrete assets (may not take title)</p> <ul style="list-style-type: none"> <li>▪ <b>Greenfield Concession</b> – “DBOF” of a <i>replacement</i> facility</li> <li>▪ <b>Brownfield Concession</b> – O&amp;M of an <i>existing</i> facility</li> </ul>
<b>Investment Term</b>	Open-ended	20 – 35 year concession term
<b>Investment Scope</b>	Entire utility	Discrete assets
<b>Rate Setting</b>	<p>Transferred to state PUC</p> <ul style="list-style-type: none"> <li>▪ Based on target ROE for utility</li> </ul>	<p>Retained by municipality</p> <ul style="list-style-type: none"> <li>▪ Support service fee in P3 contract</li> </ul>

# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Rationale for Municipalities to Utilize P3s to “Close the Gap”

### Risk Transfer

- Certainty of project cost, schedule and performance
  - Private capital is “at risk” for performance
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### Accelerated Delivery

- Private capital deployment process can be more efficient
  - Potential to meet compliance deadlines / generate near-term jobs
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### Life-Cycle Cost Savings

- P3 motivated to invest upfront to reduce long-term O&M costs
  - Potential to reduce change orders / cost overruns
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### Municipalities Retain Ownership / Control

- Municipalities retain long-term asset ownership
- Municipalities retain control over rate setting and performance requirements (as detailed in P3 contract)



# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Investment Parameters for P3s in the US Water Sector

### Water Sector Focus

- Develop knowledge base of water sector issues, requirements
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### Public Sector Partnership

- Work closely with public sector to develop optimal structure
  - Potentially combine public and private project financing
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### Service Provider Partnership

- Invest via strategic ventures with experienced service providers
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### Relatively Small Projects

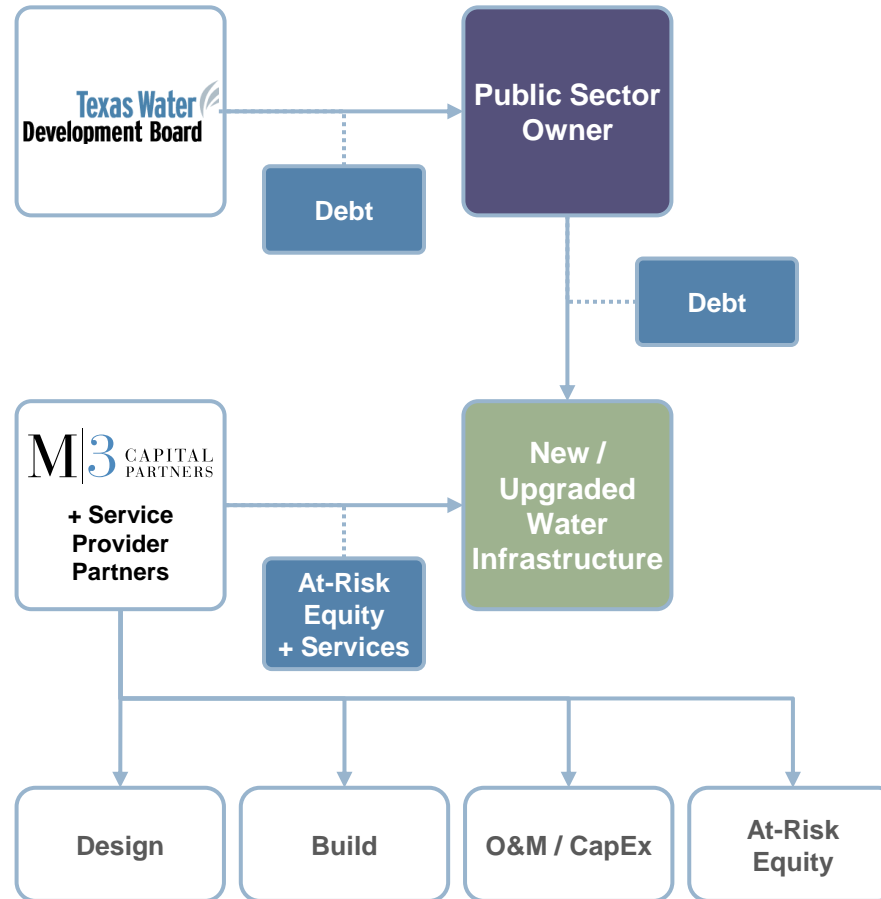
- Ability to invest in relatively small municipal projects
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### Long-term Hold

- Long-term hold objective, throughout concession term

# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Potential Structure – Utilizing Multiple Sources of Financing



# PRIVATE INVESTMENT IN U.S. WATER INFRASTRUCTURE

## Potential Cash Flow Distributions – Utilizing Multiple Sources of Financing

