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PROJECT FINANCE & MANAGEMENT CONSULTANTS

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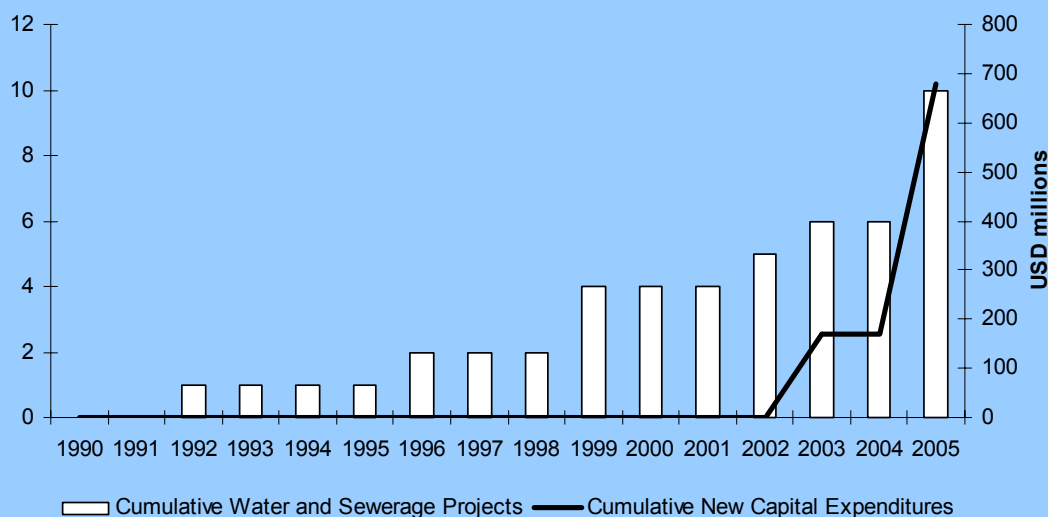
Private Participation in MENA Water

According to the World Bank, there is a worldwide failure to manage water resources properly. Heavy dependence on centralized administration to develop, operate, and maintain water systems, coupled with the fact that most countries have not treated water as having economic value, have meant that investments have not been economically and environmentally viable. MENA countries are aware that they need to build an appropriate water sector to foster economic growth. New investments have to be made that will, in the short term, make the average cost of most projects two to three times that of existing investments due to water scarcity and environmental regulations.

Despite major efforts to extend water and sanitation throughout developing countries, the majority of the world's poor are still without safe drinking water or adequate sanitation services. Access to clean, safe water is key to public health and environmental quality. Over eight percent of the world's fresh water is used just to maintain basic health and sanitation, yet less than three percent of the world's water is fresh water. Governments and other organizations attempting to provide water and sewerage services face enormous challenges.

Like the wave of private participation in telecommunications and electric power that has circled the globe, privatization in the water sector has now captured the attention of government policy makers and private investors seeking to jump-start supply and improve service.

Cumulative Water & Sewerage Projects and Cumulative New Capital Expenditure in Private Water & Sewerage Projects in Middle East and North Africa, 1990-2005:



Source: World Bank

A Strong Recovery

In MENA countries private sector participation in water and sewerage is a relatively recent phenomenon. Before 1990 almost all MENA countries relied on government provision of water supply and sewerage services. The potential for gains from private sector involvement, through greater efficiency and improved access to finance for new investments, was as great in water and sewerage as in other infrastructure sectors. But governments' willingness to take the steps to secure private participation was relatively limited. In many countries water continued to be treated as a social rather than an economic commodity. There was considerable political resistance to raising tariffs to cost recovery levels, increasing the risk of long-term investment in water and sewerage assets. In addition, many national governments in recent years decentralized responsibility for water and sewerage services to municipal or provincial governments, which often had little experience with private sector contracting and regulation and were thus relatively unlikely to initiate private transactions.

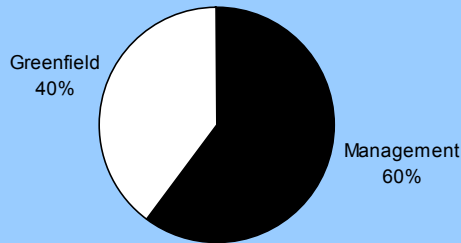
Since 1992 private participation in the water sector in MENA countries has accelerated. By the end of 2005 private companies operating in these countries had reached financial closure on US\$679 million of investment in water and sewerage projects. In total, ten projects had been implemented in the MENA countries, ranging from management contracts to greenfield build-operate-own (BOO) or build-operate-transfer (BOT) arrangements. Though private involvement is still small relative to public provision in the water sector and to private participation in other infrastructure sectors.

Management Contracts Are the Most Popular

One striking feature of the private participation in water and sewage sector is the dominance of management contracts compared with other forms of private participations.

Management contracts and leases are intended to improve the performance of loss-making public utilities while leaving the public sector primarily responsible for new investments. Funding for this investment often comes from development bank

Private Participation in Water & Sewerage Projects in Middle East and North Africa, by type of Contracts, 1990-2005:



Source: World Bank

Operations and Management Contracts: These are concession contracts for existing facilities. The private entity takes over the management of a publicly owned enterprise for a given period.

Greenfield projects: A private entity or a public-private joint venture builds and operates a new facility. This category includes build-operate-transfer and build-operate-own contracts.

loans, and all investment risk is borne by the government. These types of contracts have therefore proved attractive in countries where the private sector perceives investment risk to be high. Management contracts attempt to improve efficiency through incentive payments based on measured performance and involve minimal transfer of risk to the private sector. Management contracts constitute 60 percent of all projects. Six of the ten projects in the MENA are management contracts.

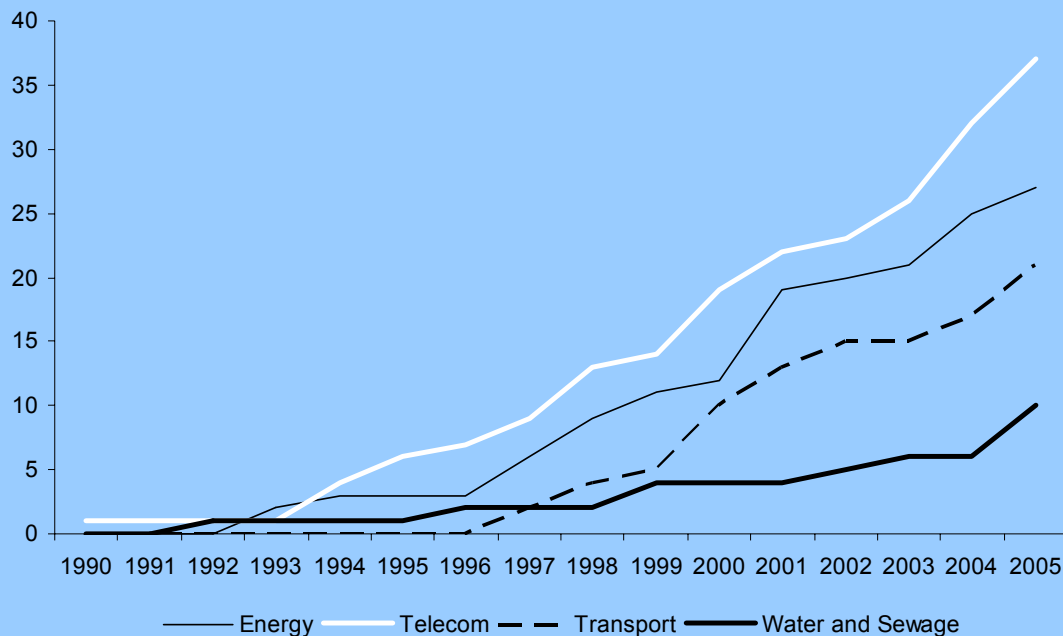
The four greenfield contracts account for 40 percent of all projects and US\$679 million of private investment. Almost all Greenfield projects take the form of BOT contracts, with ownership reverting to the government after the initial contract period. In public-private joint ventures ownership of the assets often remains with the public partner during the contract term. Some BOT contracts also give the private sponsor responsibility for management of the distribution network, making them more like concession contracts.

Advantages

Private participation is one means of improving performance in water and sanitation and for achieving significant gains in productivity and efficiency. Economies in MENA suffer from poor water management and inefficient investment. Increased private participation in water management now seems inevitable. Advantages of involving the private sector include:

- Competition in the market
- Improvement in operating efficiency
- Technical and Managerial Expertise
- Responsiveness to Consumer needs
- Economies of scale
- Research and development capabilities

Private Participation in Infrastructure Projects in Middle East and North Africa, by Sector, 1990-2005:



Source: World Bank

Conclusion

The water sector has a long history of tariffs below costs and political resistance to raising them. Considerable government commitment is required to raise tariffs to cover costs, and to build regulatory arrangements that give private companies confidence that they can make a fair rate of return on their investments. Even relatively low-risk contracts, such as management contracts and leases, still require governments to establish their credibility as good partners for the private sector. While many governments are currently

contemplating reforms that will make private participation in water and sewerage possible, only few countries in the MENA region have so far succeeded in implementing private transactions in the sector.

In fact, each government, in conjunction with its advisers and investors, must choose the option best tailored to local needs, capacities, and circumstances. The option has to make sense technically, financially, and politically, be compatible with the existing framework, and must target the problems faced by the public sector.

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