

Water and waste-water Company

Summary of the Operation Performance Evaluation Review

THE PROJECT

In 1994 the Bank approved a loan of approximately DM 40 million to partially finance improvements to the city's water and waste-water systems. This was a sovereign loan. PED evaluated this project in 1998 and rated it *Partly Successful*. Subsequently the municipal water and waste--water enterprise (the Company) became a joint stock company. The Bank then approved a second project (Project Two) at approximately €20 million to support pre-privatisation of the company and re-finance the prior sovereign loan. An additional €10 million equity investment, part of the privatisation process, was also approved but eventually cancelled. The municipality repaid the sovereign loan after funds for a third project (Project Three) were disbursed. While the second transaction resulted in an increased return to the Bank and helped the government by removing the sovereign guarantee, it also increased the debt service costs and therefore costs to the consumers.

In 2000, the city council passed a resolution to privatise the Company via an international tender in which an equity stake would be sold to a strategic investor. This was an open and transparent process and attracted three internationally recognised bidders. The EBRD had a right of no-objection to the sale and issued a no-objection statement after the pre-qualification process was complete and a final short-list of bidders was drawn-up. All companies were acceptable to the Bank. In the end two technical and financial offers were submitted. The winning bidder formed a special purpose company (SPC). The contract was signed in 2001 and in the same year the Bank approved Project Three (subject of this OPER) which involved a corporate loan to the newly privatised Company and a separate acquisition loan to the SPC. The corporate loan has been implemented, but the acquisition loan has yet to be implemented. A companion project, Project Four, was also prepared but cancelled as the desired objectives were better accomplished by combining the two loans under one project.

PROJECT RATIONALE

Under the first project, the Bank worked with the government to support technical improvements to the water company's infrastructure, and helped prepare the company for privatisation. Project Three is a continuation of the Company's privatisation process which has successfully resulted in ownership and operation of the new private water and waste-water utility being transferred to a respected international operator while a minority stake is still held by the municipality.

ACHIEVEMENT OF OBJECTIVES

The project had four objectives, three of which have been implemented. There were also two implicit objectives: privatisation and environmental improvement.

At the time of privatisation, half of the proceeds paid by the SPC went immediately to the municipality. These proceeds went to the general municipal budget, for which the

EBRD has no accounting. It could be argued that an appropriate first call on these funds could have been to pay off any existing debt associated with the Company, including the original EBRD sovereign loan, subsequently non-sovereign loan. The remaining 50 per cent of the funds went to the newly privatised Company for the issuing of new shares, and in exchange for a 50.4 per cent equity share. These funds were added to the capital of the privatised Company. These payments are outside the structure of the EBRD's third project, but critical to understanding the beneficiaries of the privatisation. The Municipality was an indirect beneficiary of this loan, while also having outstanding debt to the EBRD.

OVERALL ASSESSMENT

This Bank operation was rated *Successful* overall. The Bank's additionality was *Verified in all respects*. The project fulfilled its objectives and was rated *Good* on this indicator. The transition impact was rated *Good*. On the basis of past and current investments, and performance against EU environmental standards, environmental performance for this project was rated *Good*. On the basis of the significant improvements achieved on waste-water quality, partly as a function of the new nitrogen removal system funded under this project, environmental change was rated *Substantial*. Achievement of objectives was rated *Good*. The Company's financial performance was *Good*. Bank handling was rated *Satisfactory*.

The project is in compliance with the strategies and policies of the Bank and meets EU environmental standards. This project serves as a best case example of a successful privatisation of a municipal water and waste-water company.

The overall assessment is based on the success of the operation and the role of this project in contributing to the successful privatisation of the Company. To achieve a *Highly Successful* rating, the project would have had to have been rated *Excellent* on Company financial performance and/or transition impact.

TRANSITION IMPACT AND THE BANK'S ADDITIONALITY

PED has assigned this project an overall transition impact rating of *Good* with a *Low* level of risk. This project was the Bank's first full privatisation in the region and is a demonstration case for moving a utility from a municipal department to a fully privatised company. This specific project was critical to a successful privatisation process. Throughout the privatisation of the Company the Bank has indicated its willingness to provide investment capital to the new company. The EBRD has played an instrumental role in assisting the municipality with the design, functioning and implementation of the privatisation process. As a result, PED has rated additionality as *Verified in all respects*.

BANK HANDLING

This project has gone through a series of changes, moving the utility from a municipal company to a fully privatised company. However, this has necessitated a series of projects and the Bank's internal systems have not been kept up to date. While four specific projects have been developed, presented to and approved by the Board, in fact only two projects are viable. It takes a significant amount of staff time to develop

and present a project to the Board. It would have been far more efficient to have modified the initial project – which is in effect what the Banking Team eventually did. Finally, there is a lack of division between the various teams responsible for the Bank's debt and equity investments in the new Company. For these reasons bank handling has been rated *Satisfactory*.

MAIN OPER ISSUES AND LESSONS LEARNED

Groundwork must be done to prepare a project for privatisation. Through its early projects, the Bank worked with the municipality to address facility engineering, and legal and regulatory concerns to ensure a successful privatisation launch. The new company did not have to immediately address facility failures and breakdowns, and tariffs were already being adjusted to allow for a financially strong and viable company. The Bank had to be willing to take a long-term view and work with the Sponsor/Company over several projects to achieve desired outcomes.

To maximise the benefits of a privatisation process, there needs to be an independent regulator in place. To further the Bank's privatisation objectives and to ensure fair distribution of water and waste-water services throughout the country, PED argues that an independent regulator is required. Further, the Bank should consider providing extended TC support to the regulator to ensure that they have the appropriate technical skills and independence in the early years during the transition when such independence is fragile.

There should be standard term sheets for all bidders to a privatization deal. To ensure a fair, open and transparent process, the Bank should announce the terms of its post-privatisation lending to all acceptable bidders, in advance, so that all bidders compete and operate on the same terms. This approach is standard industry practice on large municipal and state sector procurements.

PED also provides recommendations with respect to (1) the evaluation of sequential municipal projects and taking a programme perspective and (2) the establishment of clear guidelines on the division of tasks and training for staff on the rules of engagement when the Bank has both a debt and equity position in the same project.