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Privatization Of Public Facilities: Panacea Or Pipe Dream?

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Reprinted with permission from the March, 1993 issue of The National Utility Contractor, published by the National Utility Contractors Association, "NUCA." NUCA is an Arlington, Virginia-based association of nearly 2,000 contractors and suppliers who build, maintain, and supply materials for sewer, water, and gas underground utility systems throughout the United States.

To some, the privatization of public water and wastewater facilities represents an elixir to the nation's budgetary and environmental ills. They envision battle-hardened private companies, with white hats, riding in to save towns being held hostage by burgeoning pollution problems and government regulations. But others see a darker, more ominous picture. They fear that privatization strips valuable assets from the public domain, erodes accountability for vital services, and costs hard-working people their jobs. In reality, both sides miss the mark. The privatization of water and wastewater facilities, though not a panacea, provides a viable alternative for financially strapped states and local governments to address their environmental needs.

Simply, privatization entails a public-private partnership created to efficiently deliver services that are traditionally supplied by a public entity. The nature of these partnerships varies widely, as do the techniques and activities that they encompass. This article explores the basic types of privatization partnerships; the many issues and impediments to be resolved; the benefits and drawbacks for municipalities, contractors, and other private parties; and the past and future of privatized water and wastewater facilities.

A Brief History

Privatization in the United States dates back to the nineteenth century, when privately owned and operated toll roads and bridges were common. But privatization of water and wastewater systems received little attention until the late 1970s when private investment in infrastructure was enhanced by changes in the federal tax code. Increased private-sector access to tax-exempt debt and tax-deductible interest payments on that debt substantially reduced borrowing costs. Private involvement was further buoyed in the early 1980s by the pro-market strategies of the Reagan administration.

Privatization momentum was stalled in 1986 by tax reform legislation that discontinued the investment tax credit and reestablished longer depreciation schedules on most infrastructure. The reduced tax incentives significantly decreased private interest in owning public facilities.

Looking to rekindle interest in privatization and bolster the economy, the president issued an executive order last April that removed many regulatory impediments and encouraged state and local governments to sell or lease infrastructure assets obtained with federal assistance. The president ordered the EPA to issue policy guidance to permit increased private participation in wastewater treatment facilities as well as the privatization of existing plants. Citing tremendous environmental needs, the president sought to help local governments fund facilities critical to economic development and clean water.

"Private enterprise and competitively driven improvements are the foundation of our nation's economy and economic growth," the president stated in the order. "Federal financing of infrastructure assets should not act as a barrier to the achievement of economic efficiencies through additional private market financing or competitive practices, or both."

Types Of Privatization

Privatization partnerships vary greatly, but in the water/wastewater field, they can generally be divided into three categories: design and construction, operation and maintenance, and ownership.

Private design and construction of treatment plants and collection and delivery systems are commonplace in the U.S. The typical scenario includes a private developer with a parcel of land to develop and a municipality that lacks the money or the incentive to provide the necessary clean water support. Financing and risk are allocated in contract negotiations and are generally shared to varying degrees.

Basically Business As Usual

M.A. Bongiovanni, Inc., a NUCA contractor based in Syracuse, N.Y., was part of such a relationship in 1989 when it built a new sewage treatment plant to replace a small, outdated one in Maryland City, Md. A large Washington, D.C.-area developer was looking to build on a piece of land that had no existing utilities or capacity. The developer put up 80 percent for the construction of the plant and the connections, which entitled him to 50 percent of the flow and enabled him to develop his land. The plant is owned, operated, and maintained by Anne Arundel County.

According to Mike Bongiovanni, company president, the job was similar to other jobs, except the checks came from the developer rather than the county. The project was competitively bid, and the company had a contract with the county and was held to county regulations. "For us, it was pretty much a normal deal," Bongiovanni said. "The only real difference was that the developer was more involved in the planning and scheduling of the project."

Michael Deane, of the EPA's Alternative Financing Section, agrees that this type of privatization has little impact on contractors. "Our feeling is that the contractor will be just as happy working for Company X as opposed to Community Y," he said. "Working for a private company might be better because they can usually bring you on board more quickly and process change orders faster."

The partnership worked out well for both sides. The developer benefitted because he was able to develop the land much quicker than if he had waited for the county to update or rebuild the treatment plant. The county profited from top-quality, state-of-the-art construction at a lower cost and in a shorter time and by meeting its environmental compliance needs and enhancing community growth. "I don't see any drawbacks for the county," Bongiovanni said. "They got a treatment plant for 20 cents on the dollar."

Despite the rosy outcome of the project, Bongiovanni doesn't foresee a great rush of similar jobs without legislative and regulatory changes. "You aren't going to find many developers with that much front-end capital or with access to that type of financing," he said.

Operation And Maintenance Contracts

According to the EPA, there are currently between 300 and 400 private companies operating and maintaining publicly owned treatment facilities around the country. This is up from around 100 in the late 1980s. States and municipalities, faced with escalating treatment needs but limited by fiscal realities, turn to private companies that can get the job done more efficiently. Competition-toughened private companies can provide innovative methods and equipment, more relevant experience, and access to bulk prices for chemicals and supplies. In some cases, private companies take over existing facilities, and in others, they design, build, and run the systems.

In 1988, Howell Township, N.J., contracted PKF-Mark III, Inc., a NUCA member from Newtown, Pa., to design, build, and operate a 3.3 million gallon-per-day water treatment plant. To protect the area's groundwater supply, the state required the town to purchase water from a nearby reservoir. Howell Township, looking to maintain control of its water supply, decided to build a treatment plant rather than purchase treated water.

Given the time constraints involved, the town's engineers determined that contracting the work to a private firm was the most sensible course. The contract was awarded to PKF-Mark III for the fixed price of $11.8 million, which covered all costs including design, permits, construction, and three years of plant operation. The plant went into full operation on July 1, 1990 (right on schedule) and has been operating successfully ever since.

The advantages for Howell Township were numerous. "We've developed certain capabilities and experience that we used to benefit the community," said Tim Monsul, marketing manager for PKF-Mark III. "They got a very low price and a fast project. Other treatment plants built in the area with similar size and capacity cost 25 percent more."

The partnership will go on saving the town money even after the operation and maintenance contract expires. Because PKF-Mark III would be paying labor costs for three years, Monsul said, "we looked for—and found—a more efficient solution. We designed the plant to be manned by two employees working one eight-hour shift. During the other 16 hours, the plant is fully automated. The town wouldn't have chosen this design because they have civil servants to man the plant around the clock." To minimize operating costs, chemical conditioning at the plant is adjusted automatically using sensors and a fully computerized control system.

PKF-Mark III agreed to a fixed fee for three years of plant operation because they were confident in their capabilities. "That was a risk," Monsul reported. "But if you keep up with preventive maintenance, you can control costs. The typical municipality fixes things when they break and doesn't emphasize preventive maintenance."

The across-the-board success of the Howell Township project is not an isolated case, according to David Haarmeyer, senior policy analyst for the Reason Foundation, a privatization research and advocacy organization based in Los Angeles, Calif. "Municipalities, especially the small towns, don't have the money or the expertise to meet EPA regulations, so they bring in the private sector," he said. "Competition enables private firms to do this work at lower costs—anywhere from 10 to 50 percent lower. They have more operating experience, and often not just at one facility but at facilities across the state, across the nation, or even internationally. They save money because they can buy in bulk and bring in the most up-to-date methods and machines."

Knowledge Gap Slows Progress

State and federal regulations and municipalities' lack of knowledge about privatization realities are currently impeding the spread of privatized operation and maintenance contracts, according to Haarmeyer. "Not many municipalities are fully aware of these options," he said. "Or they see privatization as a loss of control over what they are doing. They have no incentive to privatize."

Monsul concedes that control is a key issue but reported that Howell Township remained involved with the project throughout. "The municipality loses direct control of the project because they haven't hired the engineer," he said. "But they had an engineer monitoring the entire job, and if he saw any problems, he'd blow the whistle. And the township has no hands-on control of the plant, but one of their representatives was on hand to monitor operations daily during the first year."

Private Ownership

The least common public-private partnership is private ownership of water and wastewater facilities. The broadest and most encompassing form of privatization, private ownership generally entails private sector planning, design, construction, and ownership of the facilities, though, in some cases, existing facilities are sold. By selling assets such as water treatment plants, states and cities reap a significant one-time windfall, put valuable properties onto the local tax rolls, and begin collecting income taxes from the private entities. They also benefit from more efficient construction and operation, as well as the increased ability to finance the cost of upgrading facilities and meeting state and federal clean water regulations.

"Between 1980 and 1986, a dozen or so well-known but smaller projects were sold," Haarmeyer said. "But since the tax incentives were removed (in 1986), there has been no sale of wastewater facilities."

In 1983, Auburn, Ala., needed a $32.6-million wastewater project, of which federal funding would have covered 33 percent. After extensive analysis of the various options, the city contracted a private firm to fully privatize its wastewater treatment plants. "Auburn selected the privatization option for primarily economic reasons," said Doug Watson, Auburn's city manager. "Even though federal grant money was available, Auburn would have incurred $25 million in costs over the life of the project because of the need to cover the local share, the high issuance costs, and future capacity not eligible for grant funding."

Auburn did not have to spend the $25 million because the privatizer provided the capital. Roles, responsibilities, and economic interests of both parties are specified in the contract, which provides for a reasonable return on the privatizer's investment, according to the EPA. "Auburn has been extremely pleased with the service and savings provided by our privatization contract for wastewater treatment services," Watson said.

Change On The Horizon

Since the president's executive order last April, the EPA has been working on a pilot program that assists local privatization initiatives and pinpoints federal regulatory impediments to privatizing assets financed with federal grants. EPA is empowered to facilitate privatization by granting deviations or waivers to grant regulations. "We are trying to form an advisory committee to help us move forward on privatization projects but have been slowed by budget constraints," EPA's Michael Deane said. The committee will include community officials, state regulators, potential investors, unions, and members of the environmental community, and Deane expects the first meeting to be held in March. [EPA Note — committee meetings will begin in mid-1993.]

As part of the pilot project, the EPA and the advisory committee will review three real-world cases: Indianapolis, Indiana; Miami (Ohio) Conservancy District; and Silverton, Oregon. Many private and public entities will be paying particularly close attention to the outcome of the pilot program, and Haarmeyer expects that privatization activity will increase once the results are in.

Indianapolis Explores Options

Indianapolis has undertaken a comprehensive study of the city's wastewater treatment plant operations, financial management, and value. The city is the largest in the country to openly explore full privatization as an approach to financing extensive wastewater treatment improvements. The study will explore ways to tap private sector resources, while at the same time, capitalizing on the city's existing resources to address the water quality infrastructure challenges it faces in the near future. Deane anticipated that a draft of the study would be released by mid-February and ready for review at the advisory committee's first meeting.

"We view Indianapolis' study as a model for how cities should approach the very difficult problem of funding infrastructure and environmental needs," said Alan Fox, associate assistant administrator for water at the EPA when the project was announced in November, 1992. "We look forward to working closely with the city on this pilot project, which will be a benefit to the citizens of Indianapolis and to the country as a whole."

The Miami Conservancy District is looking to sell all or part of its wastewater treatment system, though there will be permitting and other technical aspects to be worked out with EPA, Deane said. Silverton is considering private investment as part of a public-private partnership.

Many Issues to Resolve

Everyone interviewed for this article agreed that the implementation of the executive order will open the door to more privatization ventures in the near future. Still, even after regulatory impediments are lowered, many issues will have to be resolved on a case-by-case basis. Governments will have to become more comfortable with the contractual terms, private companies will have to believe that the political and legal protections built into the contracts will work, and financing, risks, and benefits will have to be allocated among the parties. Public employee unions and wary citizens groups will have to be appeased, as will elected officials and bureaucrats worried about losing some of their authority.

Privatization is not a cure-all remedy, and while several significant hurdles still exist, it is certainly an area worth watching. Privatization represents a huge potential growth area for businesses, including utility contractors, and a possible solution to many of the nation's clean water needs.

For more information about EPA's ***Partners Rebuilding America*** *initiative promoting public-private partnerships in wastewater finance, contact the Alternative Financing Section in the Office of Water at (202) 260-4060.*