



## Offshoring the nation's water

When the 10 regional water authorities in England and Wales were floated on the London Stock Exchange in 1989, a shift in ownership inevitably followed from the privatisation of household water. The public listing of shares in water companies initially created a wide distribution of ownership across the UK population, with preference given to those who paid the water bills. Controls were put in place to ensure that no one individual or company could monopolise the shareholdings, with the UK government retaining a "golden share" precisely to avoid such an outcome.

Once those shares were relinquished by the government in 1994, however, the ownership of the nation's water started to shift abroad, with foreign investors largely attracted by the low-risk, stable returns on offer. Some two decades on, with seven of the 10 water authorities now in foreign ownership, the contrast from the idea of a British shareholding public that drove the early UK privatisations could not be greater.

But it is not simply the fact of foreign ownership itself that marks the contrast. It is the *type* of foreign owner that draws the sharpest difference: the movement into the water sector in recent years of privately run, global financial consortia for which infrastructure is a new and malleable asset class.

The shift in the pattern of ownership towards more consortia-led, global financial institutions has been accompanied by a delisting of water companies and a more opaque ownership structure involving so-called offshore locations and increasingly complex financial practices, none of which, it is fair to say, was foreseen by Ofwat, the industry's regulator. In what follows, we outline the changing pattern of ownership in the English and Welsh water industry, using the examples of the consortia-led Anglian, Southern, Yorkshire and Thames Water to raise issues of accountability, transparency and financialisation. (Scottish Water is publicly owned, directly accountable to the Scottish Parliament.) After that, we spell out how things could be different, in terms of both ownership structure and the treatment of water as an asset managed for the benefit of customers.

### Shifts in company ownership

Private provision of household water is not new to England and Wales, although it disappeared from view at the end of the 19th century when water delivery was municipalised, and then, in the 1970s, when it was effectively nationalised in the shape of the 10 water authorities that persist in much the same outline today. Whereas before privatisation, however, ownership and control were local and then regional, today they are thoroughly global and largely unlisted.

Of the 10 privatised water companies, only three remain listed on the London Stock Exchange: Severn Trent, South West Water (under Pennon), and United Utilities, with a shareholding largely confined to institutional investors drawn from banks, insurance companies and pension funds. The public listing allows for a degree of accountability and transparency which is largely absent from the six unlisted, privately run, water companies. The exception is Welsh Water (Dwr Cymru), which is run as a not-for-profit company that has no shareholders, and to which we will return later.

The unlisted companies can be divided into two groups: those that are part of overseas infrastructure corporations owned by wealthy individuals, and those that are part of offshore corporate structures owned by global financial consortia. Table 1 (overleaf) provides a breakdown of the two types of unlisted ownership and their global investor profile.

The first group comprises Wessex Water – owned by the Malaysian conglomerate YTL Corporation, an investment vehicle for its billionaire founder Yeoh Tiong Lay – and Northumbrian Water, owned by Cheung Kong Infrastructure, controlled by Asia's richest person, the Hong Kong-based Li Ka Shing. In contrast, the second group – Anglian Water, Southern Water, Yorkshire Water and Thames Water – are operated through special-purpose vehicles, three of which are registered offshore in Jersey.

Anglian Water is owned by the Osprey Consortium, made up principally of Australian and Canadian pension and banking funds, with the Commonwealth Bank of Australia a key player. Southern Water is under the control of the Greensands Group, in which JP Morgan and UBS (respectively, US and Swiss banking and finance houses), along with Australian pension and asset management firms, are the major investors. Cheung Kong Infrastructure also hold investments in Southern, through Sumaya Investments. Yorkshire Water is owned by the Kelda Consortium, whose main investors include Deutsche Asset & Wealth Management; Corsair Capital, a New York-based private equity firm; and GIC, the private equity arm of Singapore Investment Corporation. Thames Water, the largest of the four companies, is owned by the Kemble Consortium, led by Australian bank the Macquarie Group. Macquarie is the largest investor, followed by Abu Dhabi Investment Authority, China Investment Corporation and, more recently, British Telecom. The remainder of investors comprise Canadian, Dutch, Spanish and Australian pension funds.

The sheer extent of global ownership across the four consortia-led water companies is revealing and may come as something of a surprise to their local customers. What marks them out from the likes of Wessex and Northumbria, however, is not simply the extent of overseas ownership, but their opaque corporate structures and seeming ability

**Table 1: Global ownership of England's water companies**

	<b>Water company</b>	<b>Investor</b>	<b>Origin</b>
	<i>Overseas infrastructure companies</i>		
1	Wessex Water	YTL Corporation	Malaysia
2	Northumbrian Water	Cheung Kong Infrastructure Holdings	Hong Kong
	<i>Global financial consortia</i>		
3	Anglian Water	Colonial First State Global Asset Management Canada Pension Plan Investment Board IFM Investors 3i	Australian Canada Australia UK
4	Southern Water	JP Morgan Asset Management Challenger Infrastructure Fund UBS International Infrastructure Fund Sumaya Investments Hermes Investment Management Sky Brace Investments Australian Superannuation Funds Retail Employees Super Fund	US Australia Swiss Hong Kong UK Hong Kong Australia Australia
5	Yorkshire Water	Deutsche Asset & Wealth Management Corsair Capital GIC Special Investments Infracapital Investments	Germany US Singapore UK
6	Thames Water	Macquarie European Infrastructure Fund Abu Dhabi Investment Authority China Investment Corporation British Telecom Australian Super Queensland Investment Corporation SAS Trustee Corporation ABP PGGM Alberta Investment Management British Columbia Investment Management Corporation OP Trust	Australia Abu Dhabi China UK Australia Australia Australia Netherlands Netherlands Canada Canada Canada

to financially engineer significant returns for their consortia-led owners over and above profits earned.

### **Financialising water**

In comparison with the unlisted infrastructure companies, Anglian, Southern, Yorkshire and Thames all exhibit complex wedding cake-style corporate structures, with the global owners, the investors that comprise the consortia, at their apex. Below that sit a number of holding companies through which debts, dividends and interest payments on inter-company loans move up, down and across the group structure. Given the 8-10 holding companies that typically separate the operational side of the water business from the owner proper, financial transparency is an obvious concern.

The actual regulated water companies form part of the base of the respective wedding-cake structures, alongside an offshore financial offshoot whose role includes the leverage of debt through securitisation techniques, both to meet initial acquisition costs and to raise further debt by issuing bonds against revenue streams generated by water bills that households have yet to pay. More pointedly, all four water companies have been purchased with debt and refinanced with debt, to the point that around four-fifths of each company represents borrowed monies raised against future revenue. At the time of privatisation, given that all four companies had negative gearing, the extent of the debt which the water companies have been made to bear by their overseas owners is an obvious concern for their investment-grade ratings, particularly as it impacts upon their political rationale: their capacity to invest in sustaining the water network.

That said, the securitisation of debt does have the effect of freeing up value from the underlying asset and having the cash raised from the sale of securities at your disposal. It can be used to invest in upgrading infrastructure and as a means to simplify capital structures by reducing the peaks and troughs of debt repayments, with the efficiencies passed on to customers in the form of lower water bills. The leveraging of debt, however, can also be used for other purposes: namely, to pay a higher shareholder dividend and pay off intra-company loans.

In the case of Thames Water, for instance, their accounts show that the latter purposes rather than the former have more or less consistently been pursued, with the company paying out in dividends more than they actually earn from their cash flows and using the borrowed monies to fund substantial dividends to their investors.<sup>1</sup>

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<sup>1</sup> Allen, J & Pryke, M 2013 "Financialising Household Water: Thames Water, MEIF, and 'Ring-fenced' Politics" in *Cambridge Journal of Regions, Economy and Society* no 6, pp419-439

Much the same has been shown to be true of Yorkshire Water.<sup>2</sup> Indeed, the pattern of large regular dividends, as Seth Armitage<sup>3</sup> has documented, is typical of the privatised, standalone water companies and is a particular feature of the consortia-led companies that operate on a highly geared basis. Overseas investors have also benefited from high interest loans paid to them by the water companies that they themselves own, with the company debt channelled through offshore holding companies so that interest goes to them tax-free, and has the added bonus of reducing taxable corporate profits in the UK.

The offshore route by which both dividends and company debt travels makes public scrutiny onerous, with disclosure far more limited than required by UK law. In effect, such offshore practices not only mask the ownership structures of the consortia-led firms; they also make it harder to trace the money leaving the UK by such routes and the ability to hold overseas owners to account. The nexus between financialisation and offshore dealings, in that respect, works to place the owners more or less out of reach and thus out of regulatory control when it comes to matters of who has benefited from the privatisation of the nation's water.

Borrowing and finance costs turn on questions of ownership, public or private, local or global. Debt-driven, private finance is only one way by which UK water infrastructure may be funded and, likewise, offshore corporate structures are only one type of route by which water can be financially managed. Things could be different, most obviously if in public ownership, but even if the nation's water remained in less profit-orientated private hands.

### **Customising water**

Returning water to public ownership is often seen as the obvious means to avoid the siphoning off of water profits into private hands and provide a more accountable service. Indeed, an increasingly Europe-wide disillusionment with the privatisation of household water has seen such services brought back into the fold of public ownership across France and Germany, as a process of remunicipalisation has taken hold.<sup>4</sup> Driven, in part, by private-sector failure and the control of assets that local ownership can provide, remunicipalisation offers a more accountable political choice of delivery, but as a strategy it also has to address the issue of finance.

Remunicipalisation leaves unresolved questions of financing (where the capital comes from to build the infrastructure) and funding (the charges levied for the use of the infrastructure).

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2 Turner, G 2013 *Money Down the Drain: Getting a Better Deal for Consumers from the Water Industry* (Centre Forum)

3 Armitage, S 2012 "Demand for Dividends: The Case of UK Water Companies" in *Journal of Business Finance and Accounting*, 39, pp464-499

4 Hall, D 2012 *Remunicipalising Municipal Services in Europe* (Public Services International Research Unit)

This is a wider political issue, because – among other things – investors will be looking for a return, and this can only be provided by taxpayers or by users. In the case of water, the issue is about charges to users and does not involve the taxpayer because of the existence of a “regulatory asset base”. What remunicipalisation may well enable is much clearer and more transparent control of the processes of financing, the links between charges and investor returns, and fuller control over reinvestment in the water infrastructure.

Utilities, then, are not something conveniently separable from the world of finance, easily retrieved and placed neatly back into public ownership through a one-off programme of renationalisation or remunicipalisation. There are other ways to bring utilities such as water effectively under public control, principally by using, not rejecting, private finance; that is, by tailoring it to the needs of bill-paying households, both in terms of price and future investment. In other words, by adapting private finance to provide water *customised* for citizens.

The privately owned Welsh Water (Dwr Cymru) is a case in point. Welsh Water, as mentioned earlier, is a not-for-profit company with no shareholders yet, unlike its global financial counterparts in the water industry, it has used securitisation to good effect.<sup>5</sup> Rather than use the financing technique to disperse tax-efficient profits globally, they used it to raise bonds to finance their assets and capital investment programmes, and retained the surpluses to reinvest in the water business. As such, the financial efficiencies gained have been passed onto the customer in the shape of an annual “customer dividend” and lower water bills, rather than offshored into the pockets of global investors.

Moreover, because it does not have shareholders or issue equity, a good credit rating matters to Welsh Water’s investment performance, and its ability to reduce its gearing has enabled it to raise further investment funds. Indeed, the company’s sound use of private finance has met with the approval of the leading rating agencies, earning an A rating (the only such rating in the sector).

Ironically, such stability and predictability were sold by the sector’s delisted consortia owners as precisely the qualities that ringfenced, privately controlled water monopolies could offer investors globally. These qualities are evident in Welsh Water’s performance and are precisely the characteristics looked for by pension funds and insurance companies as they search for safe outlets for their investment monies.

Thus the opportunity presents itself to establish a *different* type of ownership in the

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<sup>5</sup> Bayliss, K 2014 *The Financialisation of Water in England and Wales*, Working Paper Series 52, (FESSUD)

English water sector, one that provides investment opportunities to private investors, yet guides such investment monies into utilities that work for customers, not shareholders or their financial intermediaries. The accountable nature of ownership and the question of who benefits can coexist with private finance in a transparent manner, where distributed profits circulate in the local, not the offshore economy.

The political issue, then, does not boil down to some kind of Orwellian equation – “private finance bad, public ownership good” – but recognises that private finance can be used to renew and build water infrastructure and put to work transparently, shaped to meet the needs of a nation’s households. The impact of financialisation in and on the everyday has not been well articulated politically in England. But to start to talk about a fight-back in terms of nationalisation or municipalisation is perhaps to miss the point. The task, as we have tried to sketch in terms of just one type of utility, is to politicise the effects of financialisation so that we can *master* private finance rather than be its slave.

To combat shadowy financial practices and evasive offshore dealings is a political task that goes well beyond the scope of the nation’s privatised water, but a first step towards sidestepping such unaccountable and opaque structures is to bring ownership within reach of those who can manage the asset for the benefit of customers, whether they be public or private bodies, funded by foreign pension funds and insurance companies or otherwise. Offshoring the nation’s water simply makes such a possibility ever more remote.