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Aqua America CEO Sees Surge in Water-Related Deals.

Water deals are poised to pick up, according to the chief executive of one of the biggest publicly traded water investors, thanks to regulatory changes and critical infrastructure needs that weigh on municipal finances.

Water is a fragmented market. Some 85% of water is controlled by municipalities scattered across America—but that is slowly changing, according to the CEO of water and wastewater utility Aqua America (ticker: WTR), Chris Franklin.

Buyers like Aqua have been seeing more enthusiasm from local officials, in large part thanks to the squeeze on public finances and as new legislation allows more generous valuations. Six of the eight states where Aqua operates, including Illinois and Ohio, have passed “fair value” laws that let operators raise customer rates beyond just recouping the cumulative value of the utility’s assets.

Because purchase prices can be higher than the sum of the parts, this change helps loosen deals out of municipal hands, as they can get much a higher price—“in their minds a much fairer price,” Franklin says.

Last year Aqua did \$130 million worth of municipal transactions, Franklin tells Barron’s, and already has \$100 million in signed agreements so far this year.

“That’s big movement in the municipal sector,” he says.

[Deals related to water utilities](#) in the U.S. spiked in 2018, to 33 from 14 in 2017, according to data provider Preqin, and five so far this year.

It’s not just legislation: Many local governments are already under financial pressure, with looming pension payments and not enough money to meet them. The U.S. will need to spend \$1 trillion over the next 25 years to meet water-related demands, according to the American Water Works Association.

The crisis of undrinkable water in Flint, Mich.,—which Franklin says was “100% preventable”—has forced local officials to consider their own capacity to address such issues.

“It’s amazing how many people ask me about Flint,” he says. “I think that really shook up a few municipal officials, who think, on a blue sky day, ‘I probably have the team to run this’—but what happens when something goes wrong?”

At the end of last year, Aqua [announced it was buying Peoples](#), a natural gas company in Pittsburgh for \$4.3 billion in an all-cash transaction. The two companies’ functions are similar, Franklin says: conducting a natural resource through underground pipes to customers’ homes, measured by a meter.

Aqua undertook this diversifying deal, Franklin says, in part because “elected officials often ask us to wait a few years ‘till we can make the [water] investment, and raise the rates accordingly,

because there are elections to deal with and everything else.”

The resulting entity’s asset mix will be 70% water, 30% gas, he says, “so it’s largely a water utility owning a pretty good stake in a gas utility.”

To finance the deal, Aqua will issue \$2.5 billion of stock, Franklin says, in the coming months.

“We’re doing so much equity because we want to keep the balance sheet strong so we have debt capacity to continue to buy municipals,” he says. “Full speed ahead on muni transactions.”

The acquisition added \$14.2 million in costs last year, helping full-year expenses rise to \$308.5 million from \$282.3 million in 2017, [Aqua reported](#) this month. Net income sank to \$192 million from \$239.7 million, thanks to a wrong-way interest-rate swap it signed in October, along with other transaction-related expenses, the company said.

Muni deals do often meet local resistance. But the public is increasingly educated about the water they consume, and what they’re paying for, Franklin says. They want clean, safe water, and realize they “probably pay less than they should,” he says. “Those things aren’t always in concert.”

“Generally people understand: There is a bill coming; water is not free and wastewater services is not free,” he says. “There was a time when people said it falls from the sky, it’s in the lake or creek, why are you charging me for it? People today realize it has nothing to do with the cost of the raw material, and everything to do with how well you want to treat it, what does the pipe look like, and is it reliable to bring it to my home? These things are real costs.”

Barron’s

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