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KKR Seeks Buyer for Water Ventures, Testing Appetite for Trump-Style Infrastructure Deals.

Private-equity firm owns 90% stake in water systems in New Jersey and Pennsylvania

KKR & Co. is shopping its stake in ventures that provide water services to two U.S. cities, a test of whether Wall Street has found a way to profitably invest in public works at a time when President-elect Donald Trump has promised to steer private money to aging infrastructure.

KKR and partner Suez SA, the French company formed to build the Egyptian canal of the same name, in recent years struck deals to pay off public debt and assume responsibility for operating and repairing municipal water systems in Bayonne, N.J., and Middletown, Pa. In exchange, they are due decades of payments from billing the systems' customers.

Now KKR is seeking a buyer for its 90% interest in the water pacts, according to people familiar with the matter. The firm, best known for its takeovers of public companies, invested roughly $175 million in the ventures and has committed more than $200 million for repairs and maintenance over the course of the agreements, 40 years in the case of Bayonne and 50 years in Middletown.

The firm is pitching the water deals to long-term investors seeking steady returns, such as insurance companies and pensions, the people said. Suez plans to keep its minority stake and continue operating both systems, they said.

A profitable sale would help validate the structure that KKR and its partners crafted to invest in municipal utilities at a time when Wall Street has raised more cash than ever to invest in public works.

Investors committed a record of $57.5 billion to private infrastructure funds this year, according to data provider Preqin, pushing to more than $140 billion the amount of ready-to-invest cash in such funds.

Water and sewage systems have been singled out by politicians, civil engineers and government agencies as particularly in need of investment. The Environmental Protection Agency has said that more than $655 billion is needed to repair and expand U.S. water and sewage systems over the next two decades.

Mr. Trump has proposed $1 trillion of new infrastructure spending that relies on private investment, proposing tax breaks to draw investors to spend on roads, pipelines and ports.

But deals of this kind come with a special set of challenges for Wall Street. Relationships with the counterparties and customers are often tenuous and can quickly turn contentious, especially because such deals usually outlast the political administrations that make them.

Carlyle Group LP earlier this year sold a package of three western water systems to Canada's Algonquin Power & Utilities Corp. for $250 million, more than twice what the Washington, D.C., firm paid for them. Yet that profit came at the expense of bruising public relations and court battles.

Three years after Carlyle purchased the water systems, Missoula, Mont., successfully sued under eminent domain laws to take back the system operating there, claiming Carlyle skimped on upkeep and repairs while enriching itself.

Missoula is now waiting for a judge to tell it how to take over the system and how much it would have to pay Algonquin for the system. A court determined last year that Missoula should pay $88.6 million, though that could rise if legal fees and other expenses are added.

Apple Valley, Calif., has filed its own eminent domain suit to wrest control of another of the three water systems Algonquin bought from Carlyle. Officials from the city east of Los Angeles say rates have risen too much under private ownership. “Our only recourse is to condemn the water company,” said Apple Valley Mayor Scott Nassif.

Algonquin and Carlyle have defended their management of the systems.

It took KKR two years to negotiate terms and win approval from state regulators to lease the system from Bayonne, which sits across the Hudson River from New York City. The deal involved an upfront payment of $150 million, used mostly to pay down debt, and a commitment to spend $157 million maintaining the system over the next four decades.

Tim Boyle, who heads the city’s utilities department, said the city’s current leadership, which took office two years into the deal, was initially skeptical. But they warmed to the pact once they considered improvements that were being made, such as the repair of a leaky water main that runs beneath the Passaic River and installation of equipment that enables workers to clear storm-water outflows without climbing into the sewers.

A contractual cap on KKR’s profits helped, too. “They are not free to gouge away at the ratepayers,” Mr. Boyle said.

The investors are guaranteed minimum revenue for the life of the deal. This year’s revenue is about $27 million before operating and capital expenses and is set to rise about 4% annually. If the utility doesn’t produce enough revenue, rates could be increased above the roughly 3.5% outlined in the deal. That happened last year when projections that proved too optimistic and unexpected repairs necessitated a 13.25% increase, or about $12 for the average monthly bill.

If revenue rises above projections, the extra cash is to be banked away to limit future rate increases.

KKR can’t hold its water deals for their duration. The ventures were funded with its 2011 infrastructure fund, which only has a lock on investors’ cash for 10 years.

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