



Allianz Global Water strategy

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GLOBAL WATER – WHY NOW? Investment propels investment

Infrastructure spending returns

The 2008 financial crisis triggered a decade of underinvestment in water infrastructure across developed countries. The need for investment has been accruing since, and today both the ability and the desire to invest have returned.

During the boom years prior to the crisis, especially in the US, water infrastructure was

over-built in anticipation of a larger inflow of new housing. This led to lower investment until the backlog could be fully utilised. In addition, following the financial crisis, municipal expenditure was suppressed due to austerity measures and low tax revenues, and political focus was directed on other priorities, ignoring the long-term implications of underinvestment.



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Today, three main factors support higher spending on water assets:

- 1. The social, environmental and financial consequences of underinvestment have become ever more apparent and larger in scale.**
 - Neglected infrastructure faces accelerating failures, exemplified by the water crisis in Flint, Michigan, US (see figure 1).
 - There are also growing implications of climate change affecting water networks' resilience and capacity. For example the water crisis in Cape Town, South Africa (see figure 2).

- 2. The economy is back to a more normalised inflow of new housing.**

This leads to a more balanced ratio of new networks relative to the needs, and, more importantly, a stable planning environment.
- 3. Developed markets are facing better funding conditions.**

Incremental fiscal policies are under review, as the monetary stimuli run their course. Infrastructure investments with the most urgent needs, like water, are starting to see incremental funding support.



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Unsurprisingly, therefore, both municipal and private investments are on the rise, as various alternative financing sources emerge. Among public financing projects, Australia expanded its National Water Infrastructure Development Fund by AUS 500 million in 2018¹. US president Trump has also doubled the size of the Water Infrastructure Finance and Innovation fund and alleviated several restrictions in obtaining funds^{2,3}. Private capital is also emerging as an important financing source, and privatisation of water infrastructure assets, primarily in the US, enables the private sector to engage in the build-out.

US public infrastructure spending

US public infrastructure spending has been falling for years. This, however, has only delayed the necessary investment, and the recent pick-up in spending is likely, we believe, to continue to grow, given the pressures (see figure 3).

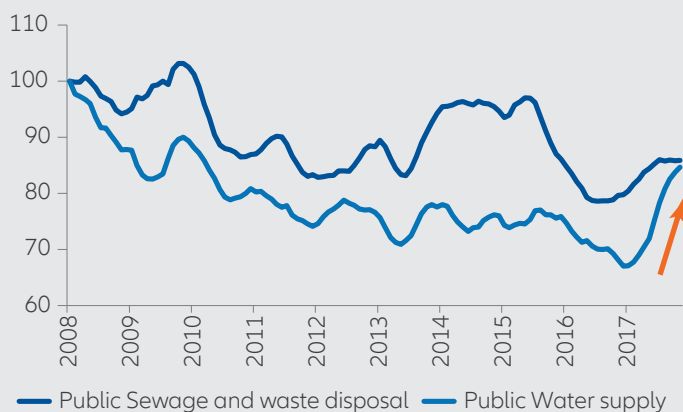


FIGURE 3: Value of public construction put in place (%) – seasonally adjusted annual rate, rolling 6 months – (December 2008 = 100%)⁴

The direct beneficiaries of this influx are utilities and water technology companies that supply the utilities with the needed equipment and solutions. Despite the uptick, however, we are still facing a long road of

further demand for enhancement and renewal of the water networks. The need to improve the state of water assets, and reduce the environmental, social and economic consequences of failure, remain present for years to come.

Mitigating the cost

More capital investment results in increasing costs of water services for the end consumers. Almost every dollar that is spent on improving water assets will have to be financed by higher bills.

Social pressures against water tariff inflation are therefore mounting. UK water utilities have been privatised since 1989, but in 2017 the government raised a discussion of re-nationalisation. Inefficient capital management financed by expanding customer bills is claimed as the main rationale.

This means water utilities need to improve the efficiency of their operations. They need to reduce the daily cost of managing the assets to offset the incremental cost of investment in the assets. These measures will also improve the efficiency of capital investment, the quality of service provided to customers, and deal with the issue of labour shortage in the water industry.

Consequently, there is a whole new market – enthusiastically called ‘Smart Water’ – that aims to serve these needs of utilities. It covers a range of solutions: from smart meter equipment, through sensors and remote management controls, all the way to specialised software systems for network monitoring, management and planning.



FIGURE 1: Flint, Michigan, USA, 2016 – Flint Water Plant Tank

Flint, Michigan, US: in 2015, tests revealed dangerous levels of lead in the water after the city turned to the Flint River as its water source.



FIGURE 2: The water crisis in Cape Town, South Africa sent people to harvest water from natural springs daily.

In Cape Town, South Africa, severe water shortages resulted in plans for ‘Day Zero’, when the municipal water supply would be largely shut off, potentially making Cape Town the first major city to run out of water.



Water is a global problem

Emerging markets continue to build out their water infrastructure, too. Laying out piping for clean water distribution and sewage discharge has been their primary focus. Still today, Asia is increasing its service coverage but, compared to the developed world, it is patchy. Over 90% of Asia’s population is now connected to water networks. However the underlying regional statistics vary significantly, with coverage

down to 30-60% of the rural population in some countries.⁵

As connections are completed, further problems emerge. The treatment stations often are not designed to deal with the higher volume and struggle to meet water quality requirements. Consequently, the focus of utilities’ investments today is in using improved technology for effective and reliable water and wastewater treatment.

Conclusion

Water infrastructure has been neglected for a number of reasons but this cannot continue. Recognising the lack of incentives for these investments, regulators across the globe are accelerating the implementation of supportive frameworks to attract capital. The economic, environmental and social implications of under-investment are further advancing water as a topic on the global agenda.

These supporting factors create an attractive environment for investors that can benefit from the scope and nature of the spending.

Utilities need to accelerate and increase their capital expenditure – the development of new technologies can help address immediate needs and also enhance the overall efficiency of water services to the benefit of consumers. The Allianz Global Water strategy invests to capture the benefits of a renewed investment cycle, focusing on companies along the entire investment chain, and across the core dimensions of water scarcity and quality issues.

AllianzGI's Global Water Investment Team has extensive sector expertise and regularly runs reality checks in the field. This equips the portfolio managers with the knowledge required to best exploit the existing challenges and perspectives of the water market around the globe.

Want to know more about our Water investment solutions?

Visit: <https://lu.allianzgi.com/allianzglobalwater>

Key Investment Takeaways:

- As emerging markets continue to build their water infrastructure, in developed markets, maintenance of water infrastructure has been neglected.
- Investment will have to increase due to the ever more apparent social, environmental and financial consequences of underinvestment.
- Recently, there has been a pick-up in spending, which we believe is likely to continue to grow.
- The direct beneficiaries of this influx are utilities and water technology companies.

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AllianzGI, as of February 2019.

Sources:

¹ <https://infrastructure.gov.au/infrastructure/water-infrastructure/nwi-development-fund/>

² <https://www.thesourcemagazine.org/trump-administration-raises-water-infrastructure-funding/>

³ <http://efc.web.unc.edu/2018/02/28/four-federal-water-infrastructure-funding-programs-watch/>

⁴ US Census Bureau, data as at December 2018

⁵ <http://www.uncred.or.jp/content/documents/5782FINAL-Background%20paper-Prof.%20Visvanathan.pdf>

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