American Water Works Association

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Water Infrastructure Financing and Alternatives to Meet National and Local Needs

Presented by
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Good morning, Chairman Simpson and members of the Subcommittee. My name is Aurel Arndt, and I am General Manager of the Lehigh County Authority based in Allentown, Pennsylvania. I deeply appreciate this opportunity to offer input on the critical issue the subcommittee is addressing today: water infrastructure financing and alternative tools to meet national and local needs.

As for my background, the Lehigh County Authority provides high-quality, affordable and reliable water and sewer service to more than 22,000 customers in Lehigh County and Northampton County, Pennsylvania. I have worked for the Lehigh County Authority since 1974. Throughout my career, which includes service on the Executive Board of the Government Finance Officers Association, then the board of the Pennsylvania Infrastructure Investment Authority (PennVest), and now on the Water Utility Council of the American Water Works Association (AWWA), I have focused my efforts and interest on water infrastructure finance. I am here today representing AWWA and its more than 50,000 members across the United States.

Water infrastructure is vital to our nation's well-being for a variety of reasons. Most obviously, water infrastructure protects public health and the environment, supports local economies, protects us from fires, and brings us a better quality of life. Moreover, the US Department of Commerce Bureau of Economic Analysis (BEA) estimates that for every dollar spent on water infrastructure, about $2.62 is generated in the private economy. And for every job added in the water workforce, the BEA estimates 3.68 jobs are added to the national economy.

In 2012, AWWA released a report titled, "Buried No Longer: Confronting America's Water Infrastructure Challenge," which revealed that restoring existing water systems as they reach the end of their useful lives and expanding them to serve a growing population will cost at least $1 trillion over the next 25 years. Please note that this $1 trillion is only for buried drinking water assets. Above-ground facilities, waste water, storm water, and other water-related investment needs are at least as large, and must be added to reflect the true magnitude of the water investment needs before our country. I am providing copies of that report to members of the subcommittee.

I might also note that in the coming weeks, EPA is expected to release its latest drinking water infrastructure needs survey. That report will yield a much lower dollar figure in drinking water needs, because the EPA survey focuses only on projects that would be eligible for the state revolving loan fund program. AWWA's study considers a broader universe of drinking water infrastructure, including projects not eligible for the SRF.

The fact that the United States needs to invest much more in its water infrastructure is widely accepted these days. The hard question centers on how to do that. AWWA has a long-standing position that communities are best served by water utilities that are self-sustaining through local rates and charges. However, there are times when a large investment in infrastructure is required that might be too large to be accommodated affordably in a short time frame only through those local rates and charges. These larger investments are critical during those times when a treatment plant or a pipe network reaches the end of its lifespan and large-scale replacement or upgrades are needed. New drinking water regulations can also drive the need to upgrade or replace water facilities the costs of which are super imposed on communities where water charges and other utility and tax rates are already beyond the means of the community and its residents.

In addition to those local rates and charges, we have a few additional tools in the infrastructure finance "toolbox," but they need to be protected or strengthened. These include, tax-exempt municipal bonds, private activity bonds and state revolving funds (SRFs)

Municipal Bonds
Tax-exempt municipal bonds have been an invaluable tool for water utilities, and at least 70% of U.S. utilities rely on them to some degree. They provide lower interest rates than commercial bonds and provide relatively quick access to capital. They are often the core funding source to finance many water infrastructure projects.

We know that in the current fiscal climate, all tax issues are on the table here in Washington. One of those may be the degree to which higher-income earners can utilize the tax-exempt features of municipal bonds. On the surface, this might have some appeal but I don't think it stands up to serious scrutiny. In my experience and in the experience of fellow utility managers at AWWA, a large share of the purchases of tax-exempt municipal bonds are made by those very higher-income earners. If they are denied tax-exempt interest, the result for utility finance would be devastating. Moreover, no other financing vehicle is as flexible for utilities as these bonds. We must keep our access to this particular tool in the finance toolbox, and so AWWA joins several groups of locally elected officials in urging you to protect the current tax exemption of municipal bonds.

Build America Bonds
As you know, many utilities issued Build America Bonds (BABs) on the promise of federal payments to the utility designed to make those bonds at least as attractive to the issuer and buyers as traditional tax-exempt debt instruments. Now utilities have been notified by the Treasury that BAB payments must be reduced in order to comply with the sequester. We urge you in the strongest possible terms to take whatever steps are necessary to ensure that no reduction in Build America Bond payments to utilities occurs. Utilities that issued Build America Bonds relied on the United States' promise to make up the difference in borrower interest costs over the life of the bonds, compared to traditional local government debt. Reducing such payments to utilities now after bonds have been issued represents a grossly unfair breach of that promise and can only serve to diminish limited utility funds that would otherwise be available for investment in water infrastructure.

Private Activity Bonds
Another tool that could help meet our water infrastructure investment needs is greater use of private activity bonds (PABs). Currently, municipal bonds that meet certain private use tests are considered private activity bonds and become subject to state-by-state volume caps. This severely limits the amount of PABs that can be issued for water facilities. To encourage public-private partnerships and reduce financing costs, PABs for community water systems could be exempted from the state volume cap, just as PABs for publicly owned solid waste facilities are currently exempted. We urge Congress to take that step.

State Revolving Loan Funds (SRFs)
Created in the 1996 Amendments to the Safe Drinking Water Act, the drinking water state revolving loan fund has been an excellent tool for providing funds for water infrastructure, primarily for small to medium-sized utilities facing compliance challenges. The Clean Water SRF has existed since 1988. AWWA supports robust funding of the state revolving loan fund programs for drinking water and wastewater.

That said, there are gaps in what the SRF is able to support. The drinking water SRF in particular was authorized to support infrastructure projects necessary for regulatory compliance and must give highest priority to projects where there is the most immediate threat to public health. This rules out replacing aging infrastructure unless there is a compliance challenge, and leaves out expanding infrastructure to address growing populations. The latter is a particular issue in the South and the West, where many communities are still growing. Finally, because annual appropriations for the SRF are divided up among the 50 states, the body of funds available for loans is over-subscribed in most states. We realize there are exceptions here and there, but in surveying SRF loans, we find that the typical cap on a drinking water SRF loan is about $20 million. In one state in the Pacific Northwest, our members have been told not to bother applying if the loan is to be above $6 million.

It is not hard for even modestly sized water project to exceed this $20-million threshold. Lehigh County authority is involved in a multifaceted, multi-municipal project which is estimated to cost about $40 million dollars. It will reduce wet weather flows and eliminate sanitary sewer overflows in a regional wastewater collection, transmission and treatment network. This project will increase overall service cost and rates by about 10% above current levels, in addition to the annual 5% increase in cost and rates in recent years. If this project were funded through WIFIA, the interest rate on the financing would be reduced by approximately by about 1% based on current interest rates, which equates to a 9% reduction in the financing cost of the project over the financing period.

The SRF is unable to make loans to larger projects simply because large loans would exhaust all of the state's capitalization funds. This means there is a gap for funding assistance for large, regionally and nationally significant water infrastructure projects. Given the enormous scope of this challenge, we strongly urge Congress to enact a new, modern, innovative finance tool to address this national need.

A New Approach: The Water Infrastructure Finance and Innovation Act
Last year, Congressman Bob Gibbs of Ohio, chair of the House Subcommittee on Water Resources and Environment, floated a draft bill titled the Water Infrastructure Finance and Innovation Act (WIFIA). As described in the draft, WIFIA would fill a significant gap between what current water infrastructure tools can do and what needs to be done.

As we mentioned earlier, about 70 percent of American communities use municipal bonds and other forms of debt to finance water infrastructure projects. Being able to lower the interest rate by just a few percentage points in a multi-million-dollar loan can amount to significant savings in the cost of an infrastructure project. These savings for local borrowers can significantly accelerate needed water infrastructure investment by making it more affordable for utilities and their customers. In fact, lowering the cost of borrowing by 2.5 percent on a 30-year loan reduces the lifetime project cost by almost 26 percent, the same result as a 26-percent grant.

Lowering the cost of infrastructure investment pays dividends in other ways as well. Most fundamentally, it makes it possible to do more with less, that is, to rebuild more infrastructure at the same or lower total cost. Consequently, WIFIA would assist communities in meeting the nation's water infrastructure needs in a manner that would have minimal cost to the federal government while complementing existing financing mechanisms, maintaining the current federal role, leveraging private capital, and creating vital manufacturing and construction jobs.

We urge Congress to enact Mr. Gibbs' WIFIA legislation. We note that it is modeled after the highly successful Transportation Infrastructure Finance and Innovation Act (commonly called TIFIA). Similar to TIFIA, WIFIA will lower the cost of capital for water utilities while having little or no long-term effect on the federal budget.

Replicating the TIFIA Model
We largely agree with the approach taken in Mr. Gibbs' draft, which would access funds from the U.S. Treasury at long-term Treasury rates and use those funds to provide loans, loan guarantees, or other credit support for water infrastructure projects. Funds would flow from the Treasury, through WIFIA, to funding recipients to enlarge their pool of capital. Loan repayments – with interest – and guarantee fees would flow back to WIFIA and thence into the Treasury – again, with interest.

Eligible water infrastructure projects would include drinking water, waste water, storm water, water reuse and desalination, and similar projects, and associated water infrastructure replacement and rehabilitation.

We believe that WIFIA should have the authority to:

- Provide direct loans, loan guarantees, and lines of credit for large water infrastructure projects. We believe it makes sense for WIFIA to make loans above a minimum size, proposed as $20 million. That ensures that WIFIA complements but does not replace the SRF program by specifically focusing on larger projects that are generally unable to access capital through the SRFs.

- Provide state authorities with the ability to aggregate a collection of loans for smaller projects that would meet the $20 million threshold. Collectively this will allow states to make more loans for small and medium-sized projects, and remove larger projects from the SRF loan pool.

AWWA believes that, like the TIFIA program, WIFIA should be able to take a subordinate position in any project. This would be extremely helpful in attracting and leveraging private capital in particular projects. We do recommend, however, that it must be the utility that applies for and receives a WIFIA loan, and not a private participant in a project.

I'd like to emphasize that we are not asking that WIFIA provide loan forgiveness or negative-interest loans or similar credit aspects that would increase the cost of the WIFIA program to the federal government. We support a straightforward approach that passes the very low cost of Treasury funds on to American communities for investment in water and wastewater projects, and those loans would be repaid with interest to the Treasury. In addition, a small interest surcharge or fee could be added to cover WIFIA's operating expenses, thus minimizing or offsetting the amount needing to be appropriated for administrative expenses. Alternatively, Congress could appropriate those expenses.

It is also essential to ensure a streamlined approach to financing. WIFIA needs a streamlined review and application process so that applicants face no more burden than required by traditional credit markets. We believe it is important to avoid federal cross-cutter requirements and complications of that kind to the maximum possible extent.

Low Cost to the Federal Treasury

A key feature of the draft proposal for WIFIA, as in TIFIA, is the minimal cost to the Federal Government. Under the Federal Credit Reform Act, a federal entity can provide credit assistance to the extent that Congress annually appropriates budget authority to cover the "subsidy cost" of the loan, i.e. the net long-term cost of the loan to the Federal government. In this way, Congress directly controls the amount of lending – but the budgetary impact is also minimal because it reflects the net long-term cost of the loan. As you may know, virtually all water-related loans are repaid in full. In fact, Fitch Ratings, a top credit rating agency, determined that the historical default rate on water bonds is 0.04 percent. Indeed, water service providers are among the most fiscally responsible borrowers in the United States. Moreover, those states that leverage their SRF programs have no history of defaults, placing them among the strongest credits in the country. Consequently, WIFIA – because it involves loans that are repaid with interest – involves minimal risks and minimal long-term costs to the federal government. TIFIA is able to leverage federal funds at a ratio of approximately 10:1. With the water sector's strong credit ratings and history, that ratio could be even greater for WIFIA. In other words, because of the sector's strong credit rating and history, the "subsidy cost" called for by the Federal Credit Reform Act would be minimal.

We do recommend modifying the TIFIA model in at least one important respect: we suggest explicitly providing that a utility which pays its own "subsidy cost" up front should be able to get a loan or guarantee that does not count against WIFIA's appropriated budget authority. In effect, such a utility would be paying for credit insurance and would be able to access funds at Treasury rates in the same degree as a utility that had its "subsidy cost" paid through the ongoing interest payment.

In short, WIFIA will allow our nation to build more water infrastructure at less cost. And on top of that, we will get a cleaner environment, better public health and safety and a stronger foundation for our economy.

Summary
To help provide for sound water infrastructure across the country for communities of all sizes, AWWA urges Congress to

- preserve the current tax-exempt status for municipal bonds;
- remove the annual volume caps for private activity bonds for water infrastructure projects;
- maintain funding for robust drinking water and wastewater state revolving loan fund programs; and
- enact a Water Infrastructure Finance and Innovation Act (WIFIA) modeled after the successful transportation program known as TIFIA, offering meaningful assistance to American communities in a modern, cost-effective way, at the lowest-possible cost to federal taxpayers.

We thank this subcommittee for the leadership it is taking today in holding this hearing. We are eager to help in any way we can to advance your work on all aspects of water infrastructure.

Thank you again for the opportunity to appear today. I will be happy to answer any questions or to provide you with any other assistance I can, now or in the coming months.

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