American Water Works Association

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The Federal Role in Keeping Water and Wastewater Infrastructure Affordable

Presented by
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Good morning, Chairman Inhofe, Ranking Member Boxer and members of the committee. My name is Aurel Arndt, and I am chair of the Water Utility Council of the American Water Works Association*.* Established in 1881, the American Water Works Association is the largest nonprofit, scientific and educational association dedicated to managing and treating water, the world's most important resource. With approximately 50,000 members, AWWA provides solutions to improve public health, protect the environment, strengthen the economy and enhance our quality of life.

AWWA deeply appreciates this opportunity to offer input on the critical issue the subcommittee is addressing today: water infrastructure financing and innovative tools to meet national and local needs.

As for my background, I recently retired as CEO of the Lehigh County Authority based in Allentown, Pennsylvania. Lehigh County Authority is a municipal utility providing high-quality, affordable and reliable water and sewer service to more than 50,000 customers in Lehigh County and Northampton counties. I worked for the Lehigh County Authority for more than 40 years, and served as CFO for 27 years during my employment there. 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 AWWA, I have focused my efforts and interest on water infrastructure finance. I am here today representing AWWA and its 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.

The recent events in Flint, Michigan, have highlighted how vital it is to operate, maintain and reinvest in our nation's water infrastructure.

Back 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 <u>buried</u> 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 committee. We are currently working on a similar report that will provide an estimate for wastewater infrastructure wastewater needs.

AWWA has a long-standing policy that communities are best served by water utilities that are self-sustaining through local rates and charges. However, the current sources of funding are woefully inadequate to finance our future water infrastructure needs, leading to the difficult question of how to do that.

Often a large investment in infrastructure is required that is too large to be accommodated affordably in a short time frame only through those local rates and charges. These larger investments are often driven by the critical, large-scale need to replace or upgrade a treatment plant or a pipe network that has reached the end of its lifespan or also when new drinking water regulations require new facilities and those costs are super imposed on communities where water charges and other utility and tax rates are nearly or already beyond the means of the community and its residents. Often, a large amount of a utility's operating costs are dedicated to debt service. Reducing the cost of these necessary expenditures through a variety of financial mechanisms which lower the cost of debt service should be the goal of all responsible water utility administrators and elected officials.

AWWA has long supported the adoption and use of a multi-faceted toolbox of water infrastructure finance tools to address the widely varied water infrastructure investment challenges that water systems face currently and in the the future. In addition to preserving and growing the existing sources of capital, other finance tools must be identified, developed, implemented and applied to fulfill our responsbibility to the water ratepayers and consumers across the country. Clearly the federal government has a significant role in maximizing the availability and value of some of these tools, including tax-exempt municipal bonds, the Water Infrastructure Finance and Innovation Act (WIFIA) program, state revolving loan funds (SRFs) and private activity bonds. Remember that municipal bonds, WIFIA loans and private activity bonds are fully repaid through those local rates and charges. SRF loans are generally repaid the same way, but do offer features such as principal forgiveness and negative-interest loans to assist more financially challenged communities.

Primarily, we need to expand the available amount of water infrastructure capital and minimize its cost. Effectively, the result will be significant acceleration of needed water infrastructure investment and making it more affordable for utilities and their customers. 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 at a lower total cost.

Tax-Exempt 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.

The lower the interest rate on such bonds, even by just a few percentage points in a multi-million dollar loan can amount to significant reduction in the cost impact of an infrastructure project to ratepayers. For example, lowering the cost of borrowing by 2.5 percent on a 30-year loan reduces the lifetime project costs by almost 26 percent, the same result as a 26-percent grant.

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, but they accept a lower interest rate in exchange and water utilities and their customers directly benefit from those lower rates. 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 preserve this particular tool in the finance toolbox, and so AWWA joins organizations representing locally elected officials in urging you to protect the current tax exemption of municipal bonds.

The Water Infrastructure Finance and Innovation Act

AWWA and its colleagues in the water sector thank the Congress and this committee in particular for its leadership in seeing through enactment of WIFIA as a part of the Water Resources Reform and Development Act in 2014. As you know, WIFIA has tremendous potential to help municipal and privately held water utilities fill a significant gap between what current water infrastructure tools can do and what needs to be done.

WIFIA would assist communities in meeting water infrastructure needs in a manner that would have minimal to the federal government while complementing existing financing mechanisms, maintaining the current federal role, leveraging private capital and creating vital manufacturing and construction jobs.

As you know, WIFIA 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. WIFIA can provide loans too large or outside the scope of the SRF program. While the SRF program does an excellent job of helping primarily small-to-medium-sized communities facing the most direct threats to public health in water, WIFIA can finance larger-scale projects that help communities prevent their becoming at risk for regulatory compliance and the consequential hazards to public health and safety.That said, the SRFs can package a number of loans to small and medium-sized systems to access WIFIA funding, and WIFIA allows loans to small systems at lower project-size thresholds than required for other systems.

Under WIFIA, funds will 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 include drinking water, waste water, storm water, water reuse and desalination, and similar projects, and associated water infrastructure replacement.

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 should be even greater for WIFIA. We’ve heard discussions in Congress estimating the leverage ratio for the water sector could be 1:50, which would mean a tremendous amount of low-cost finance could be available to help address the nation’s water infrastructure challenges. That also means that because of the sector’s strong credit rating and history, the “subsidy cost” called for by the Federal Credit Reform Act would be minimal.

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.

- **Recommendations for WIFIA**
  We urge Congress to fully fund WIFIA at its authorized level of at least $35 million in Fiscal Year 2017. We understand this is not an appropriations committee, so we ask that you communicate the need to more fully invest in our nation's water infrastructure to your colleagues on those committees. So far, Congress has only appropriated $2.2 million in each of the previous two fiscal years for EPA to set up the program. The time has come for EPA to be able to issue WIFIA loans.
- WIFIA was enacted as a five-year pilot program. As mentioned above, the first two years have been lost to setting up the program. We urge Congress to at least extend the pilot test for another two years. However, given the success of TIFIA, we do feel Congress would be justified in making WIFIA a permanent program as well.
- We deeply appreciate Congress not only enacting WIFIA, but last fall removing the ban on the use of tax-exempt finance for a project receiving support from WIFIA. To fully realize WIFIA's potential, we urge Congress to remove the 49 percent cap on WIFIA support of a project, which was adopted from TIFIA. Transportation projects receive funding from a variety of local, state and federal sources, so we understand where this cap came from. However, water utilities are a much safer risk and this cap will push communities toward applying for a variety of financial instruments, thus increasing administrative and financing costs for a project significantly.

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.

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. However, this can tend to put a lower priority on 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. These factors led to our support for WIFIA, but we do not want support of WIFIA in Congress to come at the expense of the SRFs.

- **Recommendation for the SRFs**
  We urge Congress to appropriate at least $1.3 billion each for the drinking water and

wastewater SRF programs. We have known for years that the infrastructure needs for drinking water and wastewater are roughly equal, and investment in the SRF ought to reflect that. We understand there is interest in reauthorizing the SRF programs. Indeed, authorization for the drinking water SRF expired in 2003 and that gives us concern. We offer the experience and expertise of our members as Congress considers this important issue.

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.

Summary

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

- fully fund WIFIA at its authorized level of $35 million in FY2017;
- remove the 49 percent cap for WIFIA support of a project;
- extend WIFIA at least for two more years;
- preserve the current tax-exempt status for municipal bonds;
- maintain funding for robust drinking water and wastewater state revolving loan fund programs; and
- remove the annual volume caps for private activity bonds for water infrastructure projects.

We thank the Environment and Public Works Committee for the leadership it has taken today and over many sessions of Congress in addressing the nation's water infrastructure needs. 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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