

March 12, 2012

Review of February T&I Briefing Document in Support of February 28 Hearing on “A Review of Innovative Financing Approaches for Community Water Infrastructure Projects.”

#### Jurisdiction of the T&I Committee

- T&I has jurisdiction under the Clean Water Act over water quality and wastewater infrastructure programs administered by USEPA. This includes treatment and other regulatory requirements under Title 111 of the CWA. Title IV NPDES permit Program. Title VI which provides for the establishment and capitalization of the State SRF program.

#### Importance of wastewater infrastructure to the nation

- Wastewater sustains public health, supports our economy, and protects the environment.
- Wastewater infrastructure includes 16,000 publically owned wastewater treatment plants, 100,000 major pumping stations, 600,000 miles of sanitary sewers, and 200,000 miles of storm sewers.
- Since 1972 and the enactment of the Clean Water Act, Federal, State, and local investment in wastewater totals more than \$250 billion.
- Wastewater infrastructure contributes over \$300 billion each year to the national economy through the environmental, public health, and economic benefits which it brings.
- But existing wastewater infrastructure is deteriorating and in need of repair while new infrastructure is desperately needed to keep up with population growth.

#### Regulatory Pressures and Inadequate Infrastructure Issues Facing Communities

- Addressing our nation’s clean water infrastructure needs over the next 20 years could exceed \$400 billion which is roughly twice the current level of investment at the local, state, and federal levels.
- The need for drinking water infrastructure drives this figure even higher.
- One growing and costly burden for local wastewater agencies is combined sewer overflows and sanitary sewer overflows.
- EPA has launched an aggressive national campaign to reduce these overflows by securing commitments from local governments to implement extremely expensive infrastructure upgrades.
- Entering into an enforcement settlement with USEPA results in major new costs at a time when EPA infrastructure funding is shrinking.
- The projected total cost to larger municipalities who enter into settlement agreements can range from \$1 to \$5 billion per city.

- More than 700 communities in 31 states with combined systems and CSO's face these sorts of compliance costs.
- EPA estimates that CSO's are responsible for from 3 to 10 billion gallons per year of untreated releases.
- Additional regulatory issues are also driving up prices over and above the removal of conventional pollutants. Removing the next increment of pollutants plus control of pollutants from urban runoff will further increase demand for infrastructure.
- This includes the EPA rule-making to regulate stormwater discharges which may include expanding the scope of the municipal separate storm sewer systems and the regulation of stormwater from existing development.
- Yet another future cost is EPA's framework for managing nutrient pollution. Stringent effluent limits for nutrients in NPDES permits could mean that many municipalities would have to install and operate, at great expense, nutrient treatment removal technologies at their wastewater treatment plants.
- These requirements will add an additional layer of regulatory requirements and economic burdens that communities will have to deal with.
- A large portion of these Federal and State regulatory mandates are not being funded by the Federal and State governments.

#### Community Concerns

- Local governments are speaking up with regard to EPA policies and unfunded mandates which are being borne largely at the local level.

#### Traditional Means of Financing Wastewater Infrastructure Needs

- From 1972 to 1990, Federal Clean Water Act grants provided more than \$60 billion to local communities.
- Beginning in 1987 to the present, most Federal assistance has been in the form of capitalizing Clean Water SRF's in which EPA distributes money to the States which match the amount by 20%. From 1987 to 2011, this program has provided about \$32 billion in Clean Water funding.
- Each State CWSRF makes loans for wastewater infrastructure and nonpoint source projects through refinancing existing local debt and provisioning guarantees or bond insurance for local debt.
- A number of States have also participated through the issuance of bonds to assist local communities.

#### Other Potential Approaches for Addressing Water Infrastructure Financing Needs

- One concept is a "Clean Water Trust Fund." Proponents argue that this would provide a new revenue stream which would be a more stable and secure funding source with addition funding coming through a state matching requirement and/or local rate increases.

- One of the great challenges with this concept is to identify the revenue source. This could include water based recreational products industrial discharge, flushable products, beverages or a clean water restoration fee, or perhaps a combination of these options.
- However, none of the suggested sectors who would provide the revenue for the trust fund are supportive of the concept.
- There is also the issue of Federal intrusion into local and State management of water, including the setting of fees.

### Improved Asset Management and Sustainable Infrastructure

- Communities are feeling pressured to improvement management of their systems to reduce costs and maintain sustainable systems and hopefully in turn to reduce the demand for new infrastructure.
- EPA is promoting issues like water efficiency, full cost pricing of water, watershed approaches etc. in support of this quest.
- By properly operating and maintaining infrastructure and by planning for capitol improvements wastewater utilities can reduce cost and avoid catastrophic failures.
- While helpful, improved asset management and sustainable infrastructure alone cannot meet the needs of communities.
- Increased investment from both government and the private sector is needed to close the gap between current and projected infrastructure funding needs.
- To fail in this challenge is to risk losing the environmental gains over the past three decades.
- Our \$250 billion investment in wastewater infrastructure is at risk as is the \$300 billion a year in economic activities that rely on clean water.

### Private Investment

- Municipally owned water and wastewater facilities have traditionally not had much access to private sector investment outside the traditional municipal bond market.
- Investors recognize the potential to help fund infrastructure needs and are looking for ways to participate in the market.
- This potential has caused investors to begin reconsidering their long term investment strategies in the water sector and to consider entirely new categories of investment.
- This includes pension funds that are looking for stable long term investment returns that can be provided by basic water infrastructure. This is because water resources provide long-lived tangible assets that generate predictable and stable cash returns that are indexed or hedged against inflation and pose limited risks.
- Water resource agencies provide an essential service to residential and commercial end users or which there is no viable alternative. They serve a diversified customer base of households and businesses and there is little potential for new competing providers.

- One investment strategy is to purchase existing utility assets or create a public/private partnership. The partnerships operate agencies for a period of time and receive a return on their assets using private investment capital through lending and purchase of bonds.
- But the way that the US water and wastewater industry has been structured makes this difficult. The vast majority of utilities in the United States are owned by local government entities. Only about 15% of the US population is served by investor owned utilities and only 10% of wastewater. There are more than 50,000 utility systems around the country.
- Historically, municipal bond funding has worked well for most public utilities but rising Clean Water investment needs and unfunded mandates are stretching bond raising capacity. This may adversely affect credit quality.
- Many believe that with some restructuring of the industry and by developing creative project financing mechanisms outside of direct utility asset purchases that ways can be found to bring private sector capital into the municipal water and wastewater markets.
- Projects could be structured as public/private partnerships to address development and long terms O&M.
- Well qualified private companies are able to facilitate the structuring of these arrangements.
- Private Activity Bonds are used to attract private investment for projects that have some public benefit. Tax exempt status can be gained if a public benefit derives from the private activity bond.
- A tax exempt PAB results in reduced financing costs by generating significant interest savings because of the exemption from Federal and some State taxes.
- The chief drawback to a PAB is the “Unified Volume Cap” which restricts the amount of PAB’s that States and localities may issue.
- In 2012 that limit is 95 times the population of the State or \$284.56 million, whichever is greater.
- In most States the great majority of PAB’s go to uses other than water infrastructure.
- Congress has exempted some activities from the PAB cap. An example was in the 1980’s the cap was lifted for the construction of landfills.
- Legislation has been introduced in the 112<sup>th</sup> Congress which would lift the PAB cap on water and wastewater infrastructure. It is HR 1802.

#### Water Infrastructure Finance and Innovation Act (WIFIA)

- The House Transportation and Infrastructure Committee is preparing to introduce WIFIA legislation which would establish an additional financing mechanism to supplement existing means for funding water infrastructure projects.
- This assistance would provide Federal credit assistance in the form of direct loans and loan guarantees to finance significant water and wastewater infrastructure projects.

- WIFIA credit assistance would provide improved access to capital markets, flexible repayment terms, and potentially more favorable interest rates than can be found in private capital markets.
- WIFIA would be governed by the Federal Credit Reform Act of 1990 (FRCA) and be administered by the EPA which would establish a capital reserve to cover credit losses.
- A direct grant from the Treasury would capitalize WIFIA while a Program Account would pay for the administration of the program and provide a subsidy cost for defaulting loans. The default rate would be very low.
- Congress would only have to appropriate the “subsidy cost” of the WIFIA loans which would be the amount to cover the risk of defaults and the government’s cost of funds.
- The subsidy and expenses would be the only costs reflected in the Federal budget.