

# Water Infrastructure Funding

National Association of Water Companies (NAWC) member companies are prepared to partner with the public sector, but there are impediments to effective public-private partnerships (P3s) that should be eased so that our members can do what they do best: drive innovation and resourcefully manage water systems to add value to customers through effective operations. Private sector solutions are viable in communities across the country with the right policies.

## Federal Role in Water

Although 98 percent of investment in water is made at the local level, federal policy plays an important role in establishing incentives for water investment. Congress and the Administration can act to remove barriers to unleash the vast potential of private capital in much-needed water infrastructure improvement projects.

## Public-Private Partnerships (P3s)

**No sector alone can solve the nation's water challenges on its own.**

Well over 2,000 cities and towns have water P3s. Such partnerships with municipal and other public systems create opportunities for innovative solutions and have served communities well; the arrangements have a renewal rate of over 90%. P3s are contractual agreements between public and private sector, sharing skills, assets, and resources to deliver water service or maintain a water facility for the use of the general public. Through the contract and its clear-cut, objective performance standards, the public sector continues to control the facility or system, including rates paid by the customer.

**State and local government leaders must think of new ways to plan and fund infrastructure.**

Budgetary pressure on state and local governments make P3s attractive as flexible and innovative solutions for financing water and wastewater treatment infrastructure needs. Incentivizing capital formation through P3s can be a critical tool used to address these infrastructure challenges.

**P3s encourage local control and are best managed by local leaders.**

P3s are collaborations between local governments and private enterprise and are often an attractive option as they optimize the strengths of both the public and private sectors. Under this arrangement private entities incur financial risks, while asset ownership remains with the public sector. P3s have proven to reduce municipal costs and shift debt burdens to provide the economic relief municipalities seek to address other important city priorities.

## Clarify Internal Revenue Code for Beneficial P3s

Most municipal infrastructure projects are financed by tax-exempt municipal bonds. As a general rule, the tax exemption on such bonds is lost if a private-sector business acquires a long-term interest in the project. However, the IRS has issued rules meant to give state and local governments a reasonable path for preserving the tax-exempt status of these bonds in such event; the governments can take certain prescribed remedial actions to preserve the tax exemption. Unfortunately, as currently drafted, these remedies are not practicable for water utility projects and thereby inadvertently deter beneficial water P3 projects. One of the prescribed remedial actions is to re-characterize or reissue the bonds as private activity bonds, but the tax code places an annual volume cap on such bonds and a state may have no available volume. A second remedial action is defeasance of the bonds, but defeasance is prohibitively expensive in the current low interest rate environment; defeasance imposes costs of up to 15-20% of the project costs. The third remedy is the use of cash proceeds received in the arrangement by the state or local government for governmental purposes. Only the third remedial action is realistic, but Treasury guidance is needed to clarify that proceeds from a P3 transaction—such as a concession/lease agreement—would qualify under this action. The Treasury rules currently refer only to dispositions. In addition, for both dispositions and P3s, Treasury guidance is needed to make clear that legitimate governmental purposes for the use of proceeds include the payment of debt service on other obligations of the issuer and contributions to public pension plans.

**“Ninety-three percent of public-private partnership contracts are renewed annually, indicating a very high public satisfaction with their service and accountability.”**

*-Public Works Financing*

## Private Activity Bonds: Remove volume cap on water and wastewater projects

One of the most effective financing tools of the federal government for long-term, capital-intensive infrastructure projects is the private activity bond (PAB)—a form of tax exempt financing for state and municipal governments that want to partner with a private entity to meet a public need. The use of PABs spurs capital investment in public projects, and investors prefer PABs because interest accrues tax-free.

### PABs can generate capital investment and tax revenue at all government levels.

The economic and public health benefits of using PABs for water and wastewater infrastructure improvement projects are noteworthy. Benefits include:

- Generates \$5-6 billion in private capital for water projects;
- Supports up to 142,500 jobs with \$400-500 million in increased state and local tax revenue;
- Prevents significant costs associated with deferred maintenance, repair and replacement,
- Minimal cost to the federal government: only \$354 million over the next 10 years.

## Other Financing Mechanisms

The private water industry sector strongly supports the Clean Water and Drinking Water State Revolving Fund programs (SRFs). Proposals for additional federal programs could provide further needed capital investment if structured effectively.

**State Revolving Loan Funds (SRFs):** NAWC encourages Congress to fund the SRF programs as robustly as possible in a time of pressure on the federal budget.

**Water Infrastructure Finance and Innovation Authority (WIFIA) and other financing alternatives:** The 113<sup>th</sup> Congress approved an innovative financing approach via a pilot program under WRRDA 2014, which is aimed at lowering the cost of water infrastructure investments and increasing availability of lower-cost capital to public and private utilities. NAWC members are participating in the implementation process through the EPA.

## Policy Recommendations

**Remove barriers to effective P3s and provide increased private investment.**

**US Treasury should broaden the remedial actions under Section 141 so that permitted alternative uses of disposition proceeds also apply to P3 transactions.** This simple change will provide municipalities with greater financial flexibility and eliminate the economic loss of funds through a defeasance action. In addition, for both dispositions and P3s, Treasury guidance is needed to make clear that legitimate governmental purposes for the use of proceeds include the payment of debt service on other obligations of the issuer and contributions to public pension plans.

**Remove the Annual Volume Cap on Water Project PABs:** Federal limitations on tax-exempt bonds for public-private water and wastewater projects must be removed to give municipalities certainty that PABs are available for innovative water projects. This will encourage more water P3s, and, in turn, more capital investment for necessary infrastructure upkeep and construction. The *Sustainable Water Infrastructure Act of 2011* received overwhelming bipartisan and bicameral support in the 112th Congress, and the same measure was reintroduced in the 113<sup>th</sup> Congress.

**Fill market gaps and leverage federal funds and private co-investment:** NAWC believes that any new program should explicitly encourage private sector investment.

**The NAWC is the voice of the private water industry, including the regulated drinking and waste water utilities. We proudly represent this group of quality water service providers, innovation drivers, creative financiers and responsible partners. We're moving water forward. We invite you to join us.**

**For more information, contact Petra Smeltzer at 202.466.0013 or visit [www.nawc.org](http://www.nawc.org) today.**



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