Committee on Transportation and Infrastructure
U.S. House of Representatives
Washington, DC 20515

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March 21, 2014

BACKGROUND MEMO

TO: Members, Panel on Public-Private Partnerships
FROM: Staff, Panel on Public-Private Partnerships
RE: Roundtable Policy Discussion on "Overview of Public-Private Partnerships for Water Supply and Treatment"

PURPOSE

On Tuesday, March 25, 2014, at 10:00 a.m., in 2167 Rayburn House Office Building, Members of the Panel on Public-Private Partnerships will participate in a roundtable discussion on "Overview of Public-Private Partnerships for Water Supply and Treatment." The Panel will hear from: the Honorable Deborah Robertson, Mayor of the City of Rialto, California; Bruce Tobey, Partner, Pannone Lopes Devereux & West; Dan Sugarman, Vice President, United Water; Sandra Sullivan, President-Elect, National Center for Public-Private Partnerships; and Mitch Jones, Program Director, Food & Water Watch.

JURISDICTION

The Transportation and Infrastructure Committee has jurisdiction, under the Clean Water Act (CWA), over water quality and wastewater infrastructure programs administered by the United States Environmental Protection Agency (EPA). Three titles of the CWA are directly relevant to the issue of public-private partnerships and water supply and treatment. Title III of the CWA places a number of treatment and other regulatory requirements on municipalities' wastewater treatment works. Title IV of the CWA requires permits, under the National Pollutant Discharge Elimination System (NPDES) permit program, for the discharge of pollutants from wastewater treatment works and certain municipal storm sewer systems. Lastly, Title VI of the Clean Water Act provides for the establishment and capitalization of Clean Water State Revolving Loan Funds (SRFs) to aid in funding the construction of wastewater treatment works and other wastewater infrastructure around the nation.

The Transportation and Infrastructure Committee also has jurisdiction over water supply infrastructure. The Committee does not have jurisdiction over Safe Drinking Water Act

regulatory requirements. The Energy and Commerce Committee has jurisdiction over the regulatory requirements of the Safe Drinking Water Act, which include providing assistance for drinking water infrastructure to meet such regulatory requirements.

BACKGROUND

Clean drinking water and public wastewater services are national priorities which are necessary to sustain public health, support our economy, and protect the environment. Significant amounts of public resources, including funding and technical assistance, have been devoted to the planning, design, construction, and management of water infrastructure in American communities over the last 40 years to meet these priorities.

The Nation's wastewater infrastructure includes more than 16,000 publicly owned wastewater treatment plants, 100,000 major pumping stations, 600,000 miles of sanitary sewers, and 200,000 miles of storm sewers.

Since 1972, with enactment of the Clean Water Act, federal, state, and local governments have invested more than $250 billion in our national wastewater infrastructure. This investment has provided significant environmental, public health, and economic benefits to the Nation. The Nation's farmers, fishermen, manufacturers, and tourism industries rely on clean water to support and carry out activities that contribute hundreds of billions of dollars to our national, state, and local economies each year.

However, the Nation's ability to provide clean and safe water is being challenged, as existing wastewater infrastructure is aging, deteriorating, and in need of repair, replacement, and upgrading. The life expectancies for these systems are being approached or exceeded in many cities and towns. Old and deteriorated infrastructure often leak, have blockages, and fail to adequately treat pollutants in wastewater, thereby creating water pollution problems. Moreover, as water demand rises, the need to reinvest in our water infrastructure increases.

The needs of municipalities to address water and wastewater infrastructure are substantial. According to studies by EPA, the Congressional Budget Office, and the Water Infrastructure Network, the cost of addressing our Nation's clean water infrastructure needs over the next 20 years could exceed $400 billion, roughly twice the current level of investment by all levels of government. The needs for drinking water infrastructure drive this figure even higher.

Traditional Financing Methods for Water Systems

The principal financing tool that local governments use is issuance of tax-exempt municipal bonds – at least 70 percent of United States water utilities rely on municipal bonds and other debt vehicles to some degree to finance capital investments. In 2011, bonds issued for water, sewer, and sanitation projects totaled $29.6 billion, of which $14.2 billion was new-money financing.

Enactment of the Clean Water Act consolidated the Nation's approach to addressing

water infrastructure. From 1972 to 1990, the federal government provided more than $60 billion of direct project grants for CWA wastewater treatment capital improvements.

Since 1987, most of the federal government's assistance has been in the form of capitalizing Clean Water State Revolving Funds (SRFs). In this program, federal money is appropriated to EPA and distributed to states through federal capitalization grants. This financial assistance is funded through general taxpayer revenues. States must match the federal SRF funding with a 20 percent non-federal match. Under the SRF program, the federal government has provided approximately $40 billion in SRF capitalization grants to date.

Each state's SRF operates much like a specialized water infrastructure bank, by making loans for wastewater infrastructure and nonpoint source projects, refinancing existing local debt, and providing guarantees of or bond insurance for local debt. As financial constraints have emerged, many state financing authorities have developed and implemented innovative debt financing techniques to help make adequate and economical funding for water infrastructure available and accessible.

Small, rural, and disadvantaged communities continue to face a shrinking pool of financing resources, and are especially at a disadvantage in financing water and wastewater infrastructure. Rural community assistance programs, such as those sponsored through the United States Department of Agriculture's Water and Environmental Program in the Rural Utilities Service, provide some assistance (including direct loans, grants, and loan guarantees) for projects in unincorporated rural areas and small towns to develop and rehabilitate water and waste facilities. However, the amount of available assistance does not meet the needs of these small, rural, and disadvantaged communities.

Despite these substantial federal and state investments in infrastructure, more investment is needed to address all of the demands that communities face, especially as the original infrastructure reaches the end of its life cycle. As a result, many communities are seeking new ways to increase funding for water infrastructure.

Private Sector Investment in Water Systems

Private sector capital is a potential source of funding for water and wastewater infrastructure. Municipally owned water and wastewater utilities traditionally have not had much access to private sector investment capital outside the traditional municipal bond market.

Traditionally, private sector investors in these funds are often pension funds (including public pension funds such as state-sponsored teacher and public employee plans), insurance companies, or foundations, which have large amounts of capital to invest and are looking for stable, long-term investment returns that basic infrastructure assets can provide. Many of these funds are looking for opportunities to invest in long-lived tangible assets that generate predictable and stable revenue returns that are indexed or hedged against inflation and pose limited risk. Water and wastewater infrastructure projects may meet these criteria.

The investments may take the form of purchasing existing utility assets or, through public-private partnerships, the private sector can invest its own capital in new water or wastewater infrastructure and operate facilities over periods of time to receive a return on its investment (through long-term concessionaire agreements). Private investment capital may also be available for providing financing to utilities through lending and the purchase of bonds.

Concessionaire-type partnerships for water systems are rare in the United States. However, in the past several years, two communities have elected to enter into such agreements to manage their water systems:

- Rialto, California: In 2012, the City of Rialto signed a 30-year concession agreement with Rialto Water Services LLC, in which the City of Rialto retains asset ownership, while the private entity oversees a $41 million investment in capital improvements and provides operation and maintenance of the water facility. All construction, operations, and customer service are performed by Veolia Water North America.

- Bayonne, New Jersey: In 2012, the Bayonne Municipal Utilities Authority (BMUA) signed a 40-year concession agreement with United Water (and investment firm KKR) for its water and wastewater systems. In this concession agreement, the BMUA retains ownership of assets and responsibility for setting rates, while the private entity operates the system, invests $107 million, and retires $130 million of debt.

Role of Private Activity Bonds (PABs)

Private activity bonds, issued by states and municipalities, are used to attract private investment for projects that have some public benefit. The state or municipality issuing the bond must be able to prove that a public benefit derives from the private activity bond to qualify for tax-exempt status. A tax-exempt PAB results in reduced financing costs by generating significant interest savings because of the exemption from federal and, in some cases, state taxes, and promotes infrastructure projects important to the local community. PABs may be issued for wastewater and drinking water treatment projects involving private interests, but there are strict tax rules that limit the use of PABs.

The most serious limitation on the issuance of tax-exempt PABs is the "unified volume cap," which restricts the amount of PABs that individual states and localities may issue in any given year. Under the Internal Revenue Tax Code, states and municipalities are subject to a state-wide cap on the volume of PABs that may be issued each year. In 2012, that limit is 95 times the population of the state, or $284.56 million, whichever is greater (this amount is adjusted annually for inflation). In most states, the vast majority of financing by PABs has gone to other sectors, such as housing and education.

In addition, Congress has exempted some activities from this volume cap. For example, in the late 1980s, to avert a crisis of lack of landfill capacity, Congress exempted the construction of solid waste landfills from the PABs volume cap. This resulted in many billions of dollars of PABs being issued to help fund the development of new infrastructure to help solve the disposal crisis.

Wastewater and drinking water projects currently are not exempted from the PAB volume cap. If wastewater and drinking water infrastructure also were exempted from the volume cap, this could enable states and municipalities to issue lower-cost tax-exempt bonds to finance such projects. A state or municipality could issue tax-exempt bonds to finance a project directly or, alternatively, it could use bond revenues to partner with a private company to build and operate wastewater or drinking water facilities.