



**American Water Works  
Association**

The Authoritative Resource on Safe Water <sup>SM</sup>

**Statement  
of Mr. Chips Barry, Manager, Denver Water,  
on behalf of the American Water Works Association**

**Regarding  
Financing Water Infrastructure**

**Before the House Subcommittee on Water Resources  
and Environment  
July 15, 2009**

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**Summary Points**

1. The primary responsibility for funding water infrastructure has always been local, and should remain so. Americans are best served by water and wastewater systems that are self supporting through rates and other local charges. This important principle fundamentally shapes our approach to the issue of water infrastructure finance.
2. Aging water infrastructure is an issue in the United States, but it is not a crisis, and it is not all “crumbling;”
3. There is a role for the federal government in lowering the cost of capital and in special circumstances such as very low-income communities, combined sewer overflow issues, and very small systems. But the problems of aging water infrastructure, though widespread, are not primarily federal problems;
4. AWWA has evaluated a number options for improving water infrastructure finance, and concluded that a water trust fund is not the most effective or efficient option. Key factors in this view include the overhead costs of sending money to Washington instead of retaining and spending it locally; the encouragement of delay in adopting full-cost-of-service rates as local officials wait for trust fund assistance; and Congress’ history, after creating hundreds of trust funds over the years, of not spending all revenues raised on the purpose for which they were collected. According to a recent AWWA analysis, the unspent balance in existing trust funds adds up to billions of dollars.
5. More effective tools for financing water infrastructure include enhancement of the existing state revolving loan fund (SRF) programs. It is particularly important to ensure that large water systems have guaranteed access to and meaningful participation in SRF programs. Other effective tools include removal of the annual volume caps for private activity bonds for water projects, full-cost pricing for water

service, and creation of a dedicated federal water infrastructure bank (to be described in more detail later). And

6. AWWA strongly opposes a national water tax, because it is inefficient, regressive, highly inequitable, and punishes those communities that have done the hard work of paying for and maintaining their infrastructure through local revenues. We make this point because we see a difficult road ahead in achieving the specific taxes described in the legislation under discussion today, absent a water tax.

### **Opening**

Good afternoon, Mr. Chairman and members of the subcommittee. My name is Chips Barry and I am Manager of Denver Water. I have been involved in natural resources and water issues since 1969, as either a practicing attorney or as a state official or city official. Prior to becoming Manager of Denver Water in 1991, I was in then-Gov. Roy Romer's cabinet as Executive Director of the Colorado Department of Natural Resources. That department concerns itself with water mining, parks, wildlife, geology, and oil and gas. I graduated cum laude from Yale College in 1966 and obtained a law degree from Columbia University Law School in 1969.

The American Water Works Association (AWWA) applauds this committee for taking up issues surrounding financing water infrastructure, and we appreciate having the opportunity to comment on these issues. We also applaud Congressman Earl Blumenauer for focusing Congress' attention on water infrastructure and for his search for solutions. He and his staff have conducted discussions on this in an open, collegial manner.

### **Background on Water Infrastructure Challenges**

AWWA's policy with regard to financing of drinking water utilities is that "the public can best be provided water service by self-sustained enterprises adequately financed with rates and charges based on sound accounting, engineering, financial, and economic principles." This policy was adopted in 1965 and affirmed over the years, most recently in 2005.

In February the U.S. Environmental Protection Agency (EPA) issued its fourth "Drinking Water Infrastructure Needs Survey and Assessment." That report concluded that drinking water utilities will need to invest \$334.8 billion over the next 20 years, above the level of current spending, to continue to provide safe and sufficient water to the American public. A needs survey is in progress for wastewater, but we can note that previous wastewater needs surveys have shown wastewater needs almost equal to drinking water needs. While these are large numbers, they need to be placed in the perspective of over \$80 billion annually that local officials now spend on water and wastewater infrastructure. Thus, the so-called infrastructure gap represents a shortfall of about 20 percent relative to current spending. While significant, this is hardly a crisis and certainly does not justify some of the alarmist rhetoric we have been hearing about crumbling water systems. In the past, EPA officials have noted that if water and wastewater utilities were to increase their customer charges by the rate of inflation plus

3 percent annually, the gap between needed investments and investments already taking place would all but disappear.

We appreciate this committee's interest in water infrastructure because it has been a subject of keen concern to us for some time. In 2001, AWWA issued its report, "Dawn of the Replacement Era: Reinvesting in Drinking Water Infrastructure," which showed that while the United States is not in a water infrastructure crisis right now, we need to begin very soon to ramp up our efforts to maintain and replace our current infrastructure. We followed that report with the following publications:

- "Avoiding Rate Shock: Making the Case for Water Rates," to help water utilities make the case to local decision-makers, customers, and other stakeholders about the need for sustainable local financing of water infrastructure improvements, operations, and maintenance.
- "Thinking Outside the Bill: A Utility Manager's Guide to Assisting Low-Income Water Customers," to assist utilities that need to raise their rates and that are concerned about the affordability of water for all of their customers.
- "Water Infrastructure at a Turning Point: The Road to Sustainable Asset Management," to provide an understanding of water infrastructure issues and how asset management can be used to address infrastructure challenges we face now and in the years to come.
- "Financing Water Infrastructure: A Water Infrastructure Bank and Other Innovations," to find the financing option or options for water utilities with the greatest opportunity to provide significant, subsidized capital for water infrastructure projects, while limiting the cost to the federal government.

I will come back to this last report in more detail later.

I would like to note that the Aspen Institute recently convened a group of noted experts in the field of water infrastructure and completed a series of discussions on this subject. I served on this group. The Institute has just released our report titled, "Sustainable Water Systems: Step One – Refining the Nation's Infrastructure Challenge." The report has 10 recommendations with regard to water infrastructure, and I believe three of them are particularly applicable for today's discussion. Those three points are as follows:

- The water management and policy community must redefine "water infrastructure" as one that integrates built infrastructure components with the protection and restoration of its supporting natural watershed infrastructure and the use of emerging small-scale water technologies and water management solutions.
- Utility and system managers as well as regulators and governing boards should ensure that the price of water services fairly charges ratepayers or customers the total cost of meeting service and sustainable water infrastructure requirements, subject to concerns about affordability. Funding for water utilities should generally rely on cost-based rates and charges, and water revenues should not be diverted to unrelated purposes.
- Water utilities should employ a variety of practices on the path to sustainability, including: transparency in governance and operation; public outreach and consultation; integrated water management; asset management; workforce

management; conservation and efficiency (both water and energy); advanced procurement and project delivery methods; adaptation to and mitigation of climate change; research and development; and technological and managerial innovation.

AWWA recommends the Aspen report to the committee as a thorough and thoughtful treatise on the subject at hand. I also note that, after much discussion and analysis, the Aspen project did not recommend the creation of a trust fund to address water infrastructure challenges.

### **The Water Protection and Reinvestment Act of 2009**

With regard to today's discussion of the Water Protection and Reinvestment Act of 2009, AWWA does have some thoughts to share. We were glad to see that the bill recognizes the existing state revolving loan fund (SRF) programs for drinking water and wastewater infrastructure as worthy programs in channeling additional funding into those programs. Because the SRFs are loan programs, in the long term they do provide additional pools of funding to assist communities with their water infrastructure challenges. We are particularly pleased to see that large drinking water systems are assured a meaningful percentage of the funds that would be disbursed through the trust fund. We also applaud the programs of assistance for climate change adaptation, workforce development, and water-related research. These are important and deserve federal attention, whether through a trust fund or some other mechanism.

We were also glad to see that greater weight would be given to applicants who can show that they are implementing asset management practices and long-term financial planning. AWWA has long sought such improvements to the SRF programs, including increased funding, explicit eligibility of SRF loans for infrastructure rehabilitation or replacement, and encouragement of better utility management.

Having said this, we do have certain reservations about federal trust funds in general, and are not prepared to support the Water Protection and Reinvestment Act at this time. Federal trust funds are designed to provide dedicated sources of revenue to fund specific programs, but they are not guarantees that the monies raised will actually be spent on the intended purpose. Rather, federal trust funds are accounting entries that Congress is free to ignore in the annual appropriations process.

In most instances, as in the Water Protection and Reinvestment Act of 2009, a federal trust fund needs an annual appropriation from Congress in order to spend money collected into the fund. Congress may appropriate more or less than the amount of revenues available in the trust fund. In practice, federal trust funds routinely collect more in revenue than they are allowed to spend by Congressional appropriation. The extra funds collected are "loaned" to the general fund of the Treasury and used to pay for non-trust programs. At the present time, the Treasury owes many billions of dollars to federal trust funds, not counting the vastly larger sums that are owed to the Social Security and Medicare Trust Funds. Although trust funds generally earn "interest" on their loans to the Treasury, the only way that money can be repaid is if Congress raises taxes by that amount, cuts other spending by that amount, or increases the deficit by that amount to redeem these "balances." When Congress does not pay out all that is collected for a dedicated purpose, it represents a broken trust, not a trust-worthy approach. We believe a water trust fund bill, regardless of the revenue sources it

employs, should include a guaranteed or automatic appropriation of all monies collected to the EPA for the program's intended purposes.

A particular concern with regard to a water trust fund is the source of funding. AWWA has long been and remains staunchly opposed to a national water tax. We appreciate that the authors have no intention of assessing a national water tax or user fee, and that the Water Protection and Reinvestment Act does not include one. However, obtaining the taxes being sought will likely be a long, difficult task, and in the end, we remain concerned that Congress could institute a national water tax or user fee that local water utilities must assess to pay for the trust fund at least in part. This will likely have the unintended consequence of making it more difficult for local utilities to assess more realistic water rates.

If a water utility collects a federal tax or user fee to support a water trust fund, its customers are likely to believe that they have made sufficient payment for that purpose. If the utility tries to raise its own rates to address local infrastructure needs, customers and local elected officials are apt to question why that is necessary, since they are already paying the federal levy for water infrastructure. Even if they understand the need, many will likely want to hold off rate increases in the hopes of obtaining a grant from the trust fund. Thus the federal trust fund is likely to have the perverse effect of slowing or discouraging local investments in water infrastructure. Furthermore, a community that does address its own needs with local resources will only find itself subsidizing those communities that have declined to adopt needed rate hikes, better asset management, and better financial planning practices. To at least some extent, this effect is likely regardless of the revenue sources used to finance the trust fund. They all create the expectation that someone else will pay for what is an important local responsibility.

Again, AWWA is strongly opposed to a national water tax or user fee because it would siphon away local funds that would be used more effectively if they stayed local; would erode away local responsibility for infrastructure; and would result in communities that have implemented realistic rates subsidizing those that have not. We acknowledge that there are communities in difficult economic circumstances, particularly small communities, and larger communities having to deal with regulations for combined sewer overflows that need special assistance. However, a national water tax is not the way to address these problems.

### **So, What are We For?**

AWWA has expressed its concerns about a water trust fund before. We have then been challenged with the question, "So, what are you for?" That is a fair question and we have answers.

First, as stated previously, we support a stronger SRF program with administrative improvements. President Obama supported more funding for the SRFs in his budget proposal, and House and Senate appropriations committees are increasing levels of appropriation for these programs, though not yet by enough. In addition, there is an SRF reauthorization bill that the Senate Environment and Public Works Committee has passed, S. 1005, that would substantially increase authorized funding for the SRFs. That bill would also give greater weight to loan applicants that can demonstrate that they are implementing asset management plans and responsible financial planning. S.

1005 would have EPA study ways to make the SRF programs more efficient and user friendly for local communities that want to apply for loans. These are steps we endorse.

Second, we believe that local communities and their utilities have the primary responsibility for maintaining, rehabilitating, and replacing water infrastructure. Utilities need to educate their customers and governing boards about the true cost of safe and sufficient water. Utilities must also work with the public and governing entities to increase awareness of the infrastructure challenges ahead, assess local rate structures, and adjust rates where necessary. AWWA supports the principle that water rates and other local fees should reflect the full cost of service, including infrastructure renewal. AWWA has invested considerable amounts of our own resources to produce materials that can assist utilities through the rate-setting process. We have also developed a sophisticated campaign helping to educate customers and the general public about the value of water. We have made most of these materials available to water utilities without charge.

Third, we support efforts to remove the annual volume caps from private activity bonds (PABs) used for water infrastructure projects, as H.R. 537 would do. AWWA released a study this June on the potential impacts of such action, following an independent analysis which found that removing PABs from the state volume cap could lower the cost of capital for water projects and that removing the cap would not be expected to raise interest rates on traditional municipal bonds or have any effect on the possible privatization of water systems, which can be controversial.

#### **Fourth, a Federal Water Infrastructure Bank**

We know that the SRF does not meet all of the water infrastructure needs in this country. That brings us to our fourth recommendation: creation of a federal water infrastructure bank. We have recently released a report on a water infrastructure bank that would provide the same amount of financial assistance being proposed in the water trust fund, but at a very low cost to the federal government and without the need for new taxes. There is precedent for looking in this direction. Congress has floated proposals for infrastructure banks in the past, and in his budget proposal for Fiscal Year 2010, President Obama proposed such a bank as well. AWWA's study only looks at a water infrastructure bank because that is the area of infrastructure we can speak to best.

The model for a water infrastructure bank we have takes a two-pronged approach to providing assistance to water utilities. To help small to medium-sized utilities, the infrastructure bank would help leverage state SRF programs. Twenty-seven states issued almost \$3 billion in leveraged bonds in 2008 to expand their pool of funds in their SRF programs. The water infrastructure bank could purchase or guarantee SRF bonds, lowering their interest rates to a level at or below the U.S. Treasury bond rate. These reduced interest rates would allow SRF programs even greater leverage and thus expand the pool of SRF capital. To further assist small, rural communities, the bank could be structured to loan funds for water infrastructure projects to the U.S. Department of Agriculture's Rural Development program, similar to how the SRF programs would be assisted.

As has been noted previously, large utilities are often left out of SRF programs altogether. This is a significant limitation and must be addressed. The federal water infrastructure bank would provide direct low interest financing or loan guarantees for projects of regional or national significance, or which were simply too large for the state to accommodate. With loans at the Treasury bond rate, communities would typically save 10 to 20 percent compared to their current borrowing rates, and would save significantly more if the bank were authorized to provide additional subsidies.

I have briefly mentioned the financing options the bank would use. Here is additional explanation of the three tools the federal water infrastructure bank could utilize:

- Treasury-rate loans / purchase of SRF bonds. Last December, 20-year municipal bonds traded at rates of 1 to 2.5 percent higher (depending on credit rating) than Treasury bonds with similar terms. Reducing the interest rates on municipal bonds to the Treasury bond rate could result in savings between 9 and 19 percent for borrowers.
- Loan guarantees. A federal guarantee would provide savings to borrowers and SRF programs because the additional security would result in interest rates close to the Treasury bond rate. Obtaining a tax exemption on earnings on SRF and municipal bonds with a federal guarantee would provide significant additional savings, as investors would be willing to accept a lower interest rate.
- Subsidized lending. Allowing the federal water infrastructure bank to access subsidized borrowing from the federal banking system, including interest-free loans for a limited term or partial principal forgiveness, could dramatically increase benefits to communities. For example, if the federal banking system forgave 20 percent of its loan to the bank, the bank would be able to reduce its lending rate to communities and SRFs to approximately 2 percent, with savings amounting to hundreds of millions of dollars a year in the overall cost of water infrastructure investment.

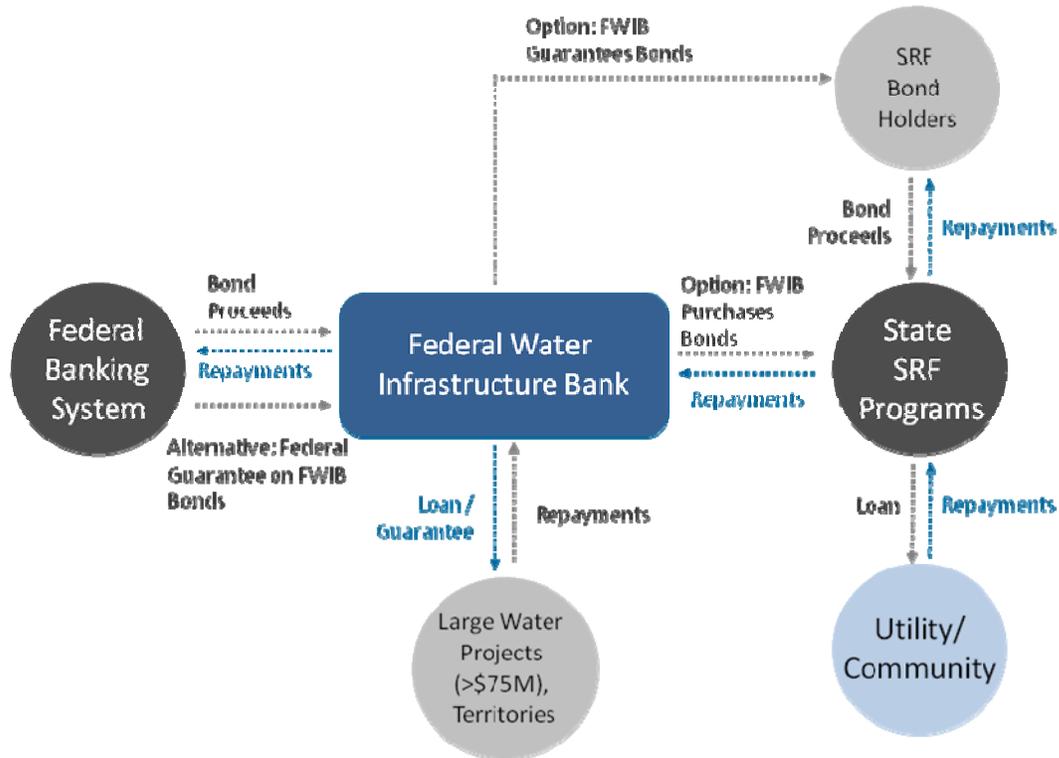
The cost to the federal government of a federal water infrastructure bank would be relatively small. Fitch Ratings calculates the historical default rate on water and sewer bonds as only 0.04 percent, and SRF bonds are considered among the safest on the market. Thus the cost of federal guarantees through the water infrastructure bank would be exceedingly low. In addition, unless Congress authorized subsidized lending, all monies provided to large systems and SRFs would be repaid with interest to the bank, and repaid by the bank to the Treasury, making the cost of the bank essentially zero.

As financing by this bank would be in the form of loans and loan guarantees, the main federal budgetary impact of the bank would be from any additional subsidies provided to reduce interest rates below the Treasury bond rate for communities and SRFs. This impact is small, however. Calculations show that if the federal banking system were to forgive 20 percent of the principal on \$10 billion in financing to the water infrastructure bank (i.e., a 20-percent grant), the cost to the federal government would be only \$150 million a year. That is, the federal government would appropriate \$150 million each year in order to forgive 20 percent of the principal on a 20-year, \$10 billion loan to the federal water infrastructure bank. That is a small amount relative to the large number of projects that could benefit from \$10 billion in low-cost financing. As a result, the federal water infrastructure bank would be able to provide significant cost savings,

including subsidies, to a wide variety of water and wastewater projects with a very modest impact on the federal budget.

A chart of our bank model is below:

**Figure 1: Federal Water Infrastructure Bank Model, Flow of Funds**



AWWA would be happy to share copies of our report on a federal water infrastructure bank with committee members or other interested Members of Congress.

Thank you for the opportunity to comment on this and other water infrastructure finance issues. We would eagerly work with Congress to help pass legislation to create such a bank.

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*AWWA is an international non-profit, scientific and educational society dedicated to the improvement of drinking water quality and supply. Our 60,000 members include more than 4,600 utilities that supply roughly 80 percent of the American people with safe drinking water. Many of our utility members also provide sewer and sanitation services.*