Exempt Facility Bonds for Water and Wastewater Infrastructure

ISSUE:

Aging and crumbling public water and wastewater systems threaten economic vitality and public health. Incentives such as tax exempt private activity bonds for water and wastewater projects encourage private capital investment, create jobs and provide more affordable financing for water and wastewater infrastructure, which in many cities is beyond or nearing the end of its useful life. However, federally imposed state volume caps for private activity bonds limit bond issuance for water projects.

BACKGROUND:

$635 Billion Funding Gap for Nation's Aging Water and Wastewater Infrastructure

Cities, towns and communities across the nation face major challenges over the next 20 years to replace aging and worn out water and wastewater infrastructure. Capital investment for such projects will be difficult as many states and local governments face mounting budget deficits, revenue shortfalls and opposition to new taxes. Recent studies by the U.S. EPA and the GAO predict an investment-funding gap of more than $635 billion for upgrades and repairs to public water and wastewater systems many of which were constructed 50 to 100 years ago.

Exempt Facility Bonds: A Public-Private Partnership Approach to Infrastructure Investment

The single-most effective tool for financing long-term, capital-intensive infrastructure projects is the private activity bond (PAB) or exempt facility bond, a form of tax-exempt financing that encourages state and municipal governments to collaborate with sources of private capital to meet a public need. The partnership approach makes infrastructure repair and construction more affordable for municipalities and ultimately for users or customers. Exempt facility bonds utilize private capital instead of public debt and shift the risk and long-term debt from the municipality to the private partner. In addition, the tax-exempt bond provides lower cost financing, which can translate to lower costs for the customer.

Annual Volume Cap Restricts Water and Wastewater Infrastructure Investment

Congress provides to states an annual allocation of the federal tax-exempt bonds, based upon population (Section 146 of the Internal Revenue Code). In 2012, the state allocation or volume cap shall be the greater of $95 per resident or $284.56 million. Historically, most of the tax-exempt bonds have been issued to politically attractive, short-term projects such as housing and education loans. The annual volume cap hinders the use of PABs for water and wastewater infrastructure, which are generally multi-year projects and out of sight. In 2007, only 1.3% of all exempt facility bonds were issued to water and wastewater projects.

POLICY RECOMMENDATION:

Lift the Volume Cap for Tax-Exempt Bonds for Water Infrastructure

Amend the Internal Revenue Code (26 USC 146) to remove the volume cap applicable to private activity bonds for public-purpose water and wastewater projects. This modification would allow local communities to leverage private capital markets in combination with other finance mechanisms and provide an influx of low cost private capital to finance water infrastructure projects. The local users in turn repay the bond issuances over time. Exceptions from the volume cap are currently provided for other governmentally owned facilities such as airports, ports, high-speed intercity rail, and solid waste disposal sites.

COST/BENEFIT:

This policy change would infuse $50 billion in private capital investment and create/support 1,425,000 jobs at a cost of only $354 million in lost tax revenue over ten years.

Exempt Facility Bonds for Water and Wastewater Infrastructure Create Local Jobs and Ensure Clean, Safe Water

- Encourages the use of private capital to assist water utilities in meeting infrastructure replacement and compliance challenges
- Partnership approach: private partner assumes financial risk and long-term debt – not the municipality
- Every dollar invested in water and wastewater infrastructure, adds $8.97 to the national economy
- $1 billion investment in infrastructure creates or supports 28,500 jobs