Exempt Facility Bonds for Water and Sewage Infrastructure

ISSUE:
Aging and deteriorating public water systems threaten economic vitality and public health. Tax incentives such as exempt facility bonds would encourage private capital investment, create jobs and provide more affordable financing for water infrastructure, which in many cities is beyond or nearing the end of its life-cycle

BACKGROUND:
$500 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 upgrade and maintain aging and failing water infrastructure. Capital investment for such projects will be difficult as many states and local governments face mounting budget deficits and revenue shortfalls. Recent studies by the U.S. EPA and the GAO predict an investment funding gap of more than $500 billion for upgrades and repairs to public water 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 financing tool of the federal government in providing long-term, capital-intensive infrastructure projects is the private activity bond (PAB) or exempt facility bond, which is 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 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 shifts the risk and long-term debt from the municipality to the private partner. In addition, the tax-exempt bond provides lower cost financing, which translates to lower costs for the customer.

Annual Volume Cap Restricts Water Infrastructure Investment
Section 146 of the Internal Revenue Code limits the amount of tax-exempt private activity bond debt that may be issued annually in a state. The volume limit or cap is based on the state population. In 2011, the cap shall be the greater of $95 per resident or $277.82 million. Historically, most of the tax-exempt funding has been allocated 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. In 2007, only 1.3% of all exempt facility bonds were issued to water and wastewater projects.

POLICY RECOMMENDATION:
Remove Tax-Exempt Bonds for Water Infrastructure from State Volume Caps
Amend the Internal Revenue Code (26 USC 146) to remove from the volume cap, private activity bonds for public-purpose water and wastewater facilities. The modification would allow local communities to leverage private capital markets in combination with other finance mechanisms. Essentially, the change would provide an influx of private capital to finance water infrastructure projects, which in turn would be repaid over time by the local users. <u>Exceptions from the volume cap are currently provided for other governmentally owned facilities such as airports, ports, housing, high-speed intercity rail, and solid waste disposal sites</u>.

COST/BENEFIT:
$354 Million Infuses $50 Billion in Private Capital and Creates/Supports 1,425,000 Jobs

Low Cost to Federal Government
$354 million over ten years, according to the Joint Committee on Taxation

Exempt Facility Bonds for Water Create Local Jobs and Ensure Clean, Safe Water
- Encourages public-private partnerships and the use of private capital to repair and replace the nation's corroding water infrastructure and to create jobs in local communities
- Partnership approach transfers risk and long-term debt from municipality to private partner
- $1 billion investment in infrastructure creates or supports 28,500 jobs
- Every dollar invested in water and sewer infrastructure, adds $8.97 to the national economy