

PRIVATE ACTIVITY BONDS

REQUEST

Support the Clean Water Investment and Infrastructure Security Act of 2005 (HR 708) to amend the Internal Revenue Code of 1986 to provide that the volume cap for private activity bonds shall not apply to bonds for facilities for the furnishing of water and sewage facilities.

Support H.R. 4993 to restore tax-exempt status to air and water pollution control facilities financing.

According to the Texas state water plan, *Water for Texas – 2002*, the cost of water supply acquisition projects is approximately \$17.9 billion through 2050. Needs for water and wastewater treatment, flood control and internal community infrastructure costs will raise the amount for this time period to \$108.6 billion. State and local resources will not be adequate to address these needs. These staggering numbers are not exclusive to Texas. An EPA study, *The Clean Water and Drinking Water Infrastructure Gap Analysis*, estimates a funding gap for water and wastewater infrastructure capital costs to be up to \$224 billion over 20 years. Clearly, financing of water and wastewater infrastructure needs is a significant and urgent issue. Additional financial assistance tools, such as an exemption from the private activity volume cap for water and wastewater projects, are needed to ensure reliable water-related supplies and infrastructure to meet the needs of our economy, environment, and public health.

Private activity bonds are essentially tax-exempt investments (the income upon which is subject to the Alternative Minimum Tax calculation) that spur investment in private activities for the public good, such as affordable housing and education. The aggregate principal amount of tax-exempt private activity bonds that may be issued by a state within a calendar year is restricted to an amount calculated pursuant to the Internal Revenue Code, Section 146. The calculated amount is referred to as the State ceiling or volume cap. The Private Activity Bond Allocation Program, administered in Texas by the Texas Bond Review Board, regulates the volume cap and monitors the amount of demand for and the use of private activity bonds each year. The total volume cap is allocated among six types of issuers, and over 60% of the volume cap is allocated to housing and education.

Generally, to access tax-exempt financing for water and wastewater projects for entities other than political subdivisions of the state, the Texas Water Development Board (TWDB), or a local entity, must submit an application to the Texas Bond Review Board to reserve a portion of the state's private activity volume cap. The application process is governed by a prescribed annual schedule and involves a certain level of administrative tasks. Under the current vehicle for providing private activity bond financing, water and wastewater projects must compete with other interests for a portion of the private activity volume cap, based on a lottery system established by the Texas Bond Review Board. One exception to this process is the recent carve out of private activity volume cap for large-scale water projects.

The private activity bond process increases costs and uncertainty for entities that are interested in private activity bond financing as a way to help manage costs to the water or sewer utility (and ultimately, the rate payers). The process requires that entities have sophisticated business acumen in order to not only understand, but also navigate the process.

Impact on Texas:

Numerous water-related entities could benefit from an exemption to the private activity volume cap, including the following in Texas:

- (1) Texas communities who rely on water supply and sewer service corporations (WSCs);
- (2) Certain public purveyors of water-related services; and
- (3) Partnerships that include private sector investment in public projects.

By exempting water and wastewater projects from the private activity volume cap, such projects would be able to borrow capital at interest rates near that of tax-exempt financing, without the restrictions and administrative burdens of competing for the private activity volume cap.

In Texas, numerous smaller systems are built, operated, and maintained by WSCs, which when unable to obtain a piece of the private activity volume cap, pay up to two percent in additional annual interest cost for borrowed capital. These typically rural nonprofit water supply corporations, but not for the fact that they are corporations, have every other characteristic of a municipal water supplier. The same can be said of private for-profit water supply corporations, with the exception that they can make a *regulated* profit. All of these entities are regulated at the state and federal levels to ensure quality water supplies. In the last few years, it has not been uncommon for a rural community to experience severe water management issues as a result of drought. If such a community's water system was operated by a WSC, it may not be able to access private activity bond financing to address infrastructure or system needs because its emergency situation did not coincide with the cycle of private activity volume cap distributions. This would increase financing costs for the entity and needlessly result in more adverse impact on what is already a catastrophic event.

Even larger, public water suppliers can be affected by the private activity volume cap constraints. For example, a river authority in Texas is a political subdivision of the state but might not be eligible for tax-exempt financing if it exceeds certain criteria for defining "public supply", such as the percentage of its water supply used for industrial purposes. Related is the need to restore tax-exempt eligibility for "air and water pollution control facilities," which can be achieved without removing these facilities from existing caps. Tax-exempt status would help state and local governments deal with high costs of environmental regulations. Public-private partnerships that form to serve the public good are also not eligible for tax-exempt financing. Broader and more readily available private activity bond financing could provide considerable savings to public-private partnership projects to develop large-scale facilities to produce a dependable water supply for a region of the State.

The impact of obtaining near-tax-exempt financing on water rates could be significant. According to estimates developed by TWDB, a tax-exempt bond issue could save up to 30% in financing costs for a community's water or wastewater project. The difference could make or break the feasibility of a project. The private activity bond issue would still be required to comply with federal regulations on such issues.