

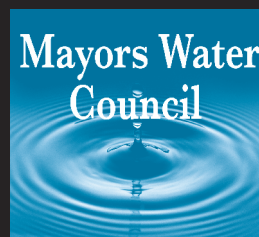
THE U.S. CONFERENCE OF MAYORS
MAYORS WATER COUNCIL

Major Capital Investment in Water and Wastewater Infrastructure

City Practices and Attitudes Concerning the State Revolving Fund Loan Program

by: Richard F. Anderson, Ph.D.
Mayors Water Council
Senior Advisor

July 25, 2006
Washington, D.C.



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Executive Summary

The United States Conference of Mayors (USCM) Mayors Water Council (MWC) conducted a survey of the nation's principal cities in early 2005 (2005 Survey) to generate information on water resource priorities and water infrastructure investment. The 2005 Survey was sent to 1,200 cities of 30,000 people or more, (the nation's principal cities). Mayors were asked to answer, or have staff answer, questions regarding municipal water resources priorities, water infrastructure investment and financing activities, the water supply situation, and water conservation activities. 414 cities responded to the survey, and the findings are reported on The U.S. Conference of Mayors website (www.usmayors.org).

Survey results confirmed that rehabilitating aging water infrastructure is the top water resources priority of responding cities. The Survey results also indicated that a significant amount of major capital investments in water infrastructure took place between 2000 and 2004; and the same can be said concerning city plans to invest between 2005 and 2009.

The survey was designed to elicit information on city water infrastructure investments and how they finance water projects. Information was generated that describes city *practices* in using the Clean Water Act and Safe Drinking Water Act State Revolving Fund loan programs (SRF). City *attitudes* concerning decisions not to use the SRF as a financing tool for water projects were assessed by using an open-ended question — *“If your City does not rely on the State Revolving Fund Loan program to finance water or wastewater facility capital investment please state why.”* Key findings concerning city practices and attitudes concerning the SRF loan program as a financing tool are presented below.

The SRF loan program was identified in the 2005 Survey as the third most frequently used water project financing tool when used in conjunction with other forms of financing such as bonds and pay-as-you-go approaches. The SRF was used for water project financing between 2000 and 2004 by 38 percent of the survey cities (148 cities out of 414 cities responding to the survey). Roughly 58 percent of those cities using the SRF loans derived more than 50 percent of project costs from the SRF loan program; while 42 percent derived 50 percent or less of project costs from the SRF.

City size is a factor in decisions to use, and success in obtaining, SRF loans for water projects. Small cities (50,000 population or less) are nearly 2.4 times more likely than large cities (greater than 100,000 population) to get over 50 percent of water project financing from SRF loans. Similarly, medium size cities (50,000 to 100,000 population) are 2 times more likely than large cities to get over 50 percent of water project financing from SRF loans. Some large cities do obtain substantial water project financing from the SRF loan program, but this is the exception rather than the rule.

In addition to the 38 percent of cities using the SRF loan program between 2000 and 2004, another 57 percent of survey cities provided information on why they did not use the SRF loan program for water infrastructure investments. This information indicates that:

- Cities generally prefer to use municipal bonds — revenue and general obligation bonds (35.2 percent of cities); and, Pay-As-You-Go — cash (26.0 percent of cities) rather than SRF loans. Cities perceive bonds as a more cost-efficient approach due to better finance terms and the greater certainty in timing. Cities with healthy bond ratings and robust user fees/charges usually anticipate the periodic need for reinvestment in water infrastructure.
- Red Tape, burdensome paperwork and SRF loan conditions and strings were identified by 15.1 percent of the survey cities as the critical reason why they did not turn to the SRF program for water projects.
- Another 11 percent of survey cities indicated that they applied for an SRF loan but were either rejected or did not receive a response to their application; or, they did not apply because they had knowledge that they would not qualify either because of the type of water project involved or because the state priorities would not favor their applications.
- A small percentage of survey cities (5 percent) stated that they prefer to seek grants over the use of SRF loans.

- A small percentage of cities (6.8 percent) indicated that they had used the SRF loan program in the past, and they “might” or “will” consider using it for water projects scheduled between 2005 and 2009.
- About 10 percent of the survey cities stated that they did not investigate the use of the SRF loan program for water projects; or that they did not need to use the SRF; or that they were not responsible for capital investments in water infrastructure (3.2 percent for this latter group).

The U.S. Conference of Mayors has adopted policies in the last decade that are intended to help cities expand the financing tools available to address the problems associated with investing in aging water infrastructure. Three goals of the USCM are to: 1) ensure that federal grants remain available for cities that have extraordinary economic or environmental problems that prevent them from adequately addressing water infrastructure investment or water quality problems; 2) ensure that cities have an opportunity to obtain 30-year no-interest or low-interest SRF loans; and 3) remove state volume caps for private activity bonds used for public-purpose water and sewer infrastructure investment.

There is great pressure on local government to close the so-called \$500 billion to \$1 trillion water infrastructure “Needs Gap.” Municipal expenditures for water and wastewater infrastructure are one of the highest expenditure categories, second only to educational expenditures. Despite the high level of municipal expenditures in the water arena, there has been no substantial progress in closing the water infrastructure investment “Needs Gap.” The SRF is one financing tool available to local government, and while it is a necessary tool it is by no means sufficient to satisfy the water infrastructure investment “Needs Gap.”

The United States Conference of Mayors has consistently supported Congressional and Administration efforts to recapitalize the SRF loan programs (see Attachments A and B). Yet the SRF loan program and the historical and on-going commitment of major municipal funds to rehabilitate an aging water and wastewater infrastructure may only help cities “run-in-place” rather than satisfy growing investment needs. Congress and the Administration should take a closer look at how current tax policy limits cities from accessing capital markets using private activity bonds for public-purpose water and wastewater infrastructure. Modifying the tax code to enable cities to access more private capital would enhance environmental policy goals, increase public health protection, and boost local economies.

Introduction

The purpose of this Report is to summarize survey information on city practices and attitudes concerning the use of State Revolving Fund Loan programs (SRF) for major capital investment in water and wastewater infrastructure. The federal wastewater construction grants program was a unique and important partnership between local and federal government. It provided a significant source of funds for local government to develop wastewater infrastructure, technology and expertise at the local level to protect the interstate waters that are a critical national resource. The construction grants program boosted many local and regional economies by increasing demand for goods and services, but also provided longer term economic stimulus by creating certainty for wastewater treatment and water quality to support our citizens, businesses and institutions. Congress recast the intergovernmental partnership from a wastewater construction grant program to the State Revolving Fund loan program in the late 1980s. Congress established a drinking water SRF loan program in the 1990s. As these SRF loan programs mature, The U.S. Conference of Mayors (USCM) Mayors Water Council (MWC) is examining how cities view the program as a financial tool that can be employed to help finance major capital investment in water infrastructure.

Congressional efforts to periodically recapitalize the SRF loan programs and the Administration’s budget request for these programs are of great interest to local government and many other parties involved in the provision of municipal water and wastewater technology and services. There is great pressure on local government to close the so-called \$500 billion to \$1 trillion water infrastructure “Needs Gap.” Municipal expenditures for water and wastewater infrastructure are, according to the U.S. Census reports, the second highest expenditure category after education; but those expenditures are not closing the “Needs Gap.” The SRF is one financing tool available to local government, but it is not the only tool available to cities, nor does it provide the means to completely, or even substantially, satisfy the water infrastructure investment “Needs Gap.”

The USCM Mayors Water Council conducted a survey of the nation's principal cities (30,000 population or greater) in 2005 to generate information about actual and planned major capital investment in key water and wastewater infrastructure from 2000 to 2009, (See Anderson, Rosenberg and Sheahan, 2006, *2005 National City Water Survey*, (www.usmayors.org/urbanwater)). The *2005 National City Water Survey* (2005 Survey) queried Mayors on how they financed major capital investments in water and wastewater infrastructure. A summary of selected results previously reported are included in this Report in order to provide a context for the discussion of City practices and attitudes concerning the State Revolving Fund Loan program. This report adds recently analyzed information generated from the 2005 Survey based on an open-ended question contained in the Survey. The question asked, *"If your City does not rely on the State Revolving Fund Loan program to finance water or wastewater facility capital investment please state why."*

The U.S. Conference of Mayors has adopted policies in the last decade that are intended to help cities expand the financing tools available to address the problems associated with an aging water infrastructure. Three goals of the USCM are to: 1) ensure that federal grants remain available for cities that have extraordinary economic or environmental problems that prevent them from adequately addressing water infrastructure or water quality problems; 2) ensure that cities have an opportunity to obtain 30-year no-interest or low-interest SRF loans; and 3) remove state volume caps for private activity bonds used for public-purpose water and sewer infrastructure investment.

The U.S. Conference of Mayors has adopted policy to support Congressional appropriations to re-capitalize the SRF loan programs for wastewater and for water (see Attachments A and B). The USCM recognizes that the SRF provides financial resources for cities to help with water infrastructure investments. It is one tool in the local elected official's tool box of financial resources, and it is, therefore, important to ensure that the SRF programs continue to provide financial assistance to cities. This report is intended to summarize the 2005 Survey information concerning the practices of cities in using, planning to use, or not using the SRF loan program for water infrastructure investments from 2000 to 2009.

While member cities of the USCM have relied on the SRF loan program to finance water projects in the past and plan to do so in the future, they also have indicated that certain aspects of the SRF loan program process are troublesome. The attitudes of some cities are conditioned, to some extent, by concerns about the loan process and how it is implemented by state authorities. Anecdotal information suggests that the SRF process is cumbersome and overly bureaucratic because of the paperwork involved. Other criticisms suggest that the "red tape" involved with a loan application is too costly. Still other criticisms suggest that the state SRF loan program process is unresponsive and too uncertain. This Report attempts to address some of the anecdotal information on city attitudes toward the SRF by categorizing city responses into summary information to guide future USCM policy.

Methods and Materials

A survey was conducted of 1,200 cities with mayoral forms of government in the first quarter of 2005. The survey (2005 Survey) contained questions posed to Mayors that were grouped into 4 categories of water resource issues that cities deal with on a routine basis: 1) Priorities — cities were asked to identify water resource priorities among 24 different water resources issues; 2) Water infrastructure investment and financing; 3) Water supply issues; and, 4) Water conservation activities. While Mayors were asked to provide responses to the questions in each of the four categories, they often relied on water and wastewater staff to provide specific answers to the survey questions.

414 cities responded to the survey. Follow-up efforts were taken to increase the responses to individual survey questions. The response rate for the 2005 Survey was robust compared to similar surveys that usually experience responses of about 200 cities.

This report is focused on the section of the 2005 Survey that dealt with actual water infrastructure investment by cities from 2000 to 2004 (the first five year period); and planned investment for 2005-2009 (the second five year period). Mayors were asked to identify their actual and planned "major capital investments" in water supply, water treatment facilities, water distribution facilities, wastewater treatment facilities, and wastewater collection systems.

Mayors were asked to identify how they financed these major capital investments. Response categories included general obligation bonds, revenue bonds, State Revolving Fund Loan Programs, private activity bonds, and “other.” They were further asked how much of the water project costs were financed by the SRF, whether used in whole or in part to finance the project. Finally, for purposes of this Report, cities were asked the open-ended question — *“If your City does not rely on the State Revolving Fund Loan program to finance water or wastewater facility capital investment please state why.”*

The methods employed in analyzing the 2005 Survey information were basic frequency distributions and comparisons of categorical data values. For example, city responses to specific questions are reported as either actual number of cities or as percentages; and in either case the tables identify the unit of measurement. Simple data comparisons are made for question-response categories broken out by size of city (Table 1). Finally, responses to the open-ended question were grouped into like-response categories based on professional judgment.

219 cities responded to the open-ended SRF question. The reader is cautioned to note, however, that 239 responses were grouped into the categories because some of the responses stated multiple reasons.

Table 1
414 City Survey Respondents Categorized
By Population Size (City Size)

Sort by Population Size	(%)
Smaller Cities — Less Than 50,000	41
Medium Cities — 50,000 to 100,000	34
Large Cities — Greater Than 100,000	25

Findings

City Practices:

Cities that Used the SRF for Water Infrastructure Investment 2000-2004

The 2005 Survey reported that the number of cities using the SRF loan program to finance major capital investment in water and wastewater infrastructure was 148, or roughly 36 percent of the 414 cities that responded. The amount of financing from the SRF ranged from full-funding to less than 10 percent. As a sole source of financial support, the SRF provided 100 percent of the water investment financing for only 5.9 percent of the survey cities. However, in combination with other sources of financing (leveraging approach) the SRF was used by 38.3¹ percent of the survey cities between 2000 and 2004.

The importance of the SRF to city water investment really depends on how a city views the loan program. One way to view the SRF’s importance is to examine the cost of water infrastructure projects and the percentage of financing provided by the SRF. The 2005 Survey indicates that more than half (58.1 percent) of the cities using the SRF loan program derived more than 50 percent of the necessary funds from the program for the water infrastructure project. Nearly 42 percent of the cities using the SRF program obtained 50 percent or less of the necessary funds to pay for their projects (Table 2); half of which derived 20 percent or less of the funds for their water projects.

¹ The 38.3 percent was reported in the 2005 Survey based on the 92 percent of cities making major capital investment in water infrastructure.

Table 2
Percentage of Financing for Water Infrastructure
Investment by Cities from SRF Sources

The SRF Provided What % of Water Infrastructure Major Capital Investment	No. of Cities	% of 414 Cities	% of 148 Cities
Don't know	1	0.2	0.7
10% or less	11	5.3	14.9
20% or less	12	2.9	8.1
50% or less	27	6.3	18.2
More than 50%	86	20.8	58.1

SOURCE: Adapted from Anderson et al., 2006, *2005 National City Water Survey*, Washington, DC: Tables 9 and 10.

Another perspective on the importance of the SRF in water infrastructure financing suggests that cities rely on some, but not a major portion, of the project financing to be provided by the loan program. A majority of cities in the 2005 Survey indicated that multiple sources of financing are used to develop water infrastructure projects. The SRF program, therefore, has a relative importance. Some cities need more or less funding from the SRF; but the most critical factor is that the program be available to provide some piece of the funding pie. Cities that can successfully access the SRF program for a portion of the project funding, whether it be large or small, find the program useful. Cities that cannot access the SRF for any part of project funding are less likely to attach importance to the SRF loan program.

The 2005 Survey data do not contain information on the total number of cities in the nation that applied for SRF loans between 2000 and 2004. The data does, however, provide information on surveyed cities that used the SRF, city size and categorical information on the percent of project costs attributable to SRF loans (Tables 3 and 4).

Based on actual use of SRF loans by cities between 2000 and 2004, roughly 42 percent of cities using SRF loans received financial support for 50 percent or less of project costs. Fifty-eight percent of cities using SRF loans received financial support for more than 50 percent of project costs. Thus, 86 cities financed a majority of their water project costs through the SRF loan approach.

Table 3
Cities Using the SRF for Project Financing: 2000-2004

The SRF Provided What % of Water Infrastructure Major Capital Investment	No. of Cities	Small Cities %	Medium Cities %	Large Cities %
Don't know	1	1	0	0
10% or less	22	4	5	13
20% or less	12	2	2	8
50% or less	27	12	6	9
More than 50%	86	38	32	16
Total No. of Cities	148	57	45	46

Table 4
Percentage of Cities Using the SRF for Project Financing: 2000-2004

The SRF Provided What % of Water Infrastructure Major Capital Investment	No. of Cities	% of 148 Cities	Small Cities %	Medium Cities %	Large Cities %
Don't know	1	0.7	0.7	0	0
10% or less	22	14.9	2.7	3.4	8.8
20% or less	12	8.1	1.4	1.4	5.4
50% or less	27	18.2	8.1	4.1	6.1
More than 50%	86	58.1	25.7	21.6	10.8

Some states have adopted SRF loan program policies that favor directing loans to smaller or rural communities, and not to large cities. Such policies are implemented through the SRF loan application, priority scoring and loan approval processes. Some states do not follow this approach, and rely more on documented need to award SRF loans.

The 2005 Survey data provides a general look at whether city size is a factor in using SRF loans for water projects. Comparing the percentage of small and large cities (Table 4) using the SRF indicates that small cities are nearly 2.4 times more likely to obtain greater than 50 percent SRF loan financing for water projects than large towns. The inverse is true, however, for SRF loan financing that is less than 50 percent of water project cost. Large cities are 1.6 times more likely than small cities to obtain SRF loans that provide less than 50 percent of project costs. The same pattern can be found when comparing medium size cities to large cities: (medium size cities are 2 times more likely to obtain greater than 50 percent SRF loan financing than large cities; and large cities are 2.3 times more likely to obtain SRF loans for less than 50 percent of project costs than medium size cities).

Cities that Plan to Use the SRF for Water Infrastructure Investment 2005-2009

The 2005 Survey reported that 148 cities actually used the SRF loan program to help finance major capital investments in water and wastewater infrastructure between 2000 and 2004. The Survey also asked Mayors to provide information on planned water infrastructure investments for 2005 to 2009. A brief comparison of actual use and planned use of the SRF loan program for project financing found that:

- 148 cities used the SRF loan program between 2000 and 2004; 152 cities plan to use the SRF loan program between 2005 and 2009.
- 32 of 148 cities that used the SRF loan program in the first five year period do not plan to do so again in the second five year period.
- 110 of the 148 cities plan to use the SRF loan program again in the second five year period.
- 42 cities that did not use the SRF loan program in the first five year period plan to use it in the second five year period

While there was a slight increase in the number of cities that plan to use the SRF over the earlier five year period, there is relatively little shift in the distribution of cities based on population size (Tables 5 and 6). The percentage of small cities seeking SRF loans decreases by 3 percent from 2000-2004 to 2005-2009. However, small cities are still 2.4 times more likely to seek greater than 50 percent of project costs via the SRF loan program than large cities. Similarly, large cities are 2.8 times more likely to seek 10 percent or less for project costs from the SRF loan program than small cities. Overall, 52 percent of cities plan to seek more than 50 percent of project costs from the SRF (down from 58 percent for 2000-2004); and 48 percent of cities plan to seek 50 percent or less from the SRF (up from 42 percent for 2000-2004).

Table 5
Cities Planning to Use the SRF for Project Financing: 2005-2009

The SRF Provided What % of Water Infrastructure Major Capital Investment	No. of Cities	Small Cities %	Medium Cities %	Large Cities %
10% or less	27	5	8	14
20% or less	26	5	9	12
50% or less	20	7	5	8
More than 50%	79	36	28	15
Total No. of Cities	152	53	50	49

Table 6
Percentage of Cities Planning to Use the SRF for Project Financing: 2005-2009

The SRF Provided What % of Water Infrastructure Major Capital Investment	No. of Cities	% of 152 Cities	Small Cities %	Medium Cities %	Large Cities %
10% or less	27	17.7	3.3	5.3	9.2
20% or less	26	17.1	3.3	5.9	7.9
50% or less	20	13.2	4.6	3.3	5.3
More than 50%	79	52.0	23.7	18.4	9.9
Total	152	100.0	34.9	32.9	32.3

City Attitudes Toward the SRF Loan Program:

The earlier discussion in this report focused on city practices where the SRF loan program was sought by cities to help finance water projects. This section of the Report focuses on the 2005 Survey information describing why cities do not seek to augment water project financing from the SRF programs. Thus, local government is provided an opportunity to express the attitude impacting the decision not to apply for SRF loans.

This report does not propose that the information from the 2005 Survey represents the attitudes of all cities concerning the SRF loan programs. Nor does it purport to provide a comprehensive treatment of city attitudes toward those programs. Yet the compilation of attitudes expressed serves to improve upon the patchwork of anecdotal information from a small number of sources on this subject that have dominated the discussion in public policy forums. Reporting these findings may inform the public policy debate, and, more likely, may inform future research endeavors to obtain more comprehensive information on city attitudes toward the SRF loan programs.

The 2005 Survey examined actual and planned city investment in major water infrastructure projects. The method used to finance those projects was a key question asked in the 2005 Survey. Five project financing methods categories were offered to survey respondents: general obligation bonds; revenue bonds; private activity bonds; State Revolving Fund; and other. The “other” category was intended to allow cities to provide information that did not fit the defined categories. As reported elsewhere (Anderson et al, 2006), responses by cities to the “other” category turned out to represent “Pay-As-You-Go” project financing. This was the most frequent response encountered in the data.

An open-ended question was included in the 2005 Survey instrument related to the SRF category. That question asked *“If your City does not rely on the State Revolving Fund Loan program to finance water or wastewater*

facility capital investment please state why.” The question offered cities an opportunity to express their candid opinion about their unique approach to water infrastructure financing.

A compilation of responses to the open-ended question was developed by sorting through each of the written responses. Using professional judgment in conjunction with a limited amount of telephone follow-up to clarify survey responses it was determined that 219 cities provided responses to this question. The reader should note, however, that some cities provided multiple reasons or factors in their response to the question. The responses were grouped in categories of “like responses.” The 219 city responses may be represented by more than that number in the response categories in order to accurately reflect the city attitudes where multiple responses were encountered.

The reasons stated by cities in the 2005 Survey about why they do not use the SRF loan programs for major capital investments in water and wastewater infrastructure are summarized in Table 7. Clearly, cities prefer to use municipal bonding authority instead of SRF loans. Reasons stated for the bond financing preferences (as well as for the other categories listed in Table 7) are elaborated upon below. Cash financing via Pay-As-You-Go approaches is the next most frequent reason stated for not using the SRF loan programs. Red Tape, and the complexities and administrative burdens imposed by the SRF loan process is the third most frequent set of reasons stated. Twenty-four cities stated that their water projects do not qualify for or were rejected by the SRF loan administrators in their states. The remaining categories presented in Table 7 were less frequently cited by cities in the 2005 Survey. Surprisingly, only 11 cities mentioned that they prefer to seek grants over all other forms of water project financing. This is contrary to a conventional wisdom which holds that most cities prefer to seek or wait for grants over debt instruments in financing water projects. The conventional wisdom may still be true, but the actual practices, as well as the attitudes of cities surveyed indicate otherwise. The attitudinal categories listed in Table 7 are described in greater detail below.

Table 7
Categories of City Attitudes Describing Why Cities
Do Not Use the SRF for Water Project Financing

The SRF Provided What % of Water Infrastructure Major Capital Investment	No. of Cities	% of Cities*	No. of Small Cities	No. of Medium Cities	No. of Large Cities
Prefer Municipal Bonds	77	35.2	34	23	20
Prefer Cash Financing—Pay-As-You-Go	57	26.0	25	20	12
Red Tape	33	15.1	6	15	11
SRF — Do Not Qualify/Rejected/Non-Responsive	24	11.0	6	9	9
SRF — Have Used/Might Use/Will Use	15	6.8	7	3	5
SRF — Not Needed/Not Investigated	15	6.8	10	4	1
Prefer Grants	11	5.0	3	5	3
Not Responsible for Infrastructure	7	3.2	5	1	1

* Based on 219 cities responding to the open-ended question on why the SRF loan program was not used to finance water infrastructure projects.

Prefer Municipal Bonds:

Number of Cities = 77

Small Cities = 34

Medium Cities = 23

Large Cities = 20

Many cities in the 2005 Survey identified prudent financial factors in determining their choice of water infrastructure financing approaches. A western city succinctly stated “We will use which ever financial vehicle that is most cost effective.” Fifty-two of the 77 cities grouped in this category identified more favorable interest rates from municipal bonds (general obligation bonds and revenue bonds) than the interest rates associated with an SRF loan from their state as a determining factor in not choosing the SRF approach. A common comment stated by cities in this category was that their good bond rating allowed them access to financing at lower interest rates than an SRF loan.

Some cities stated that the SRF loan program could provide lower interest rate terms than municipal bonds, but the “strings” attached to the SRF more than offset the favorable interest rates for these cities. A south western city of fewer than 50,000 population stated “Although state’s revolving loan traditionally has a lower interest rate, the additional administrative costs and engineering fees associated with the state’s program add cost to any project that offset potential differences in interest rates.” A large (over 100,000 population) mountain state city stated it was “Able to arrange for financing equal to the State loan program, but without the conditions.”

A number of cities were more descriptive about the trade-off between interest rates and perceived burdens associated with an SRF loan process. They mention the administrative costs, time line, lack of flexibility and other conditions that make the SRF loan approach less attractive or convenient. A large west coast city stated “Revenue bonds are preferred due to the extensive administrative and time costs associated with the State Revolving Loan Fund as it is currently implemented.” A medium size city (between 50,000 and 100,000 population) in the south-Atlantic region states “Administrative costs and requirements are too expensive and time consuming, especially facilities plan requirement. Interest savings have not been significant with lower market rates.” Another medium size city from the northeast region stated “With today’s low interest rates the use of SRF is costly because it raises the cost of design and construction due to MBE/WBE² and oversight with the paper work. Timing is everything and sometimes the money is not available when needed.” A medium sized midwest city stated “G.O. bond rates are just as competitive and are much more flexible. There is no advance refund of revolving loans.”

A lesser number of cities grouped in this category identified other reasons for not considering SRF loans for major capital investments in water infrastructure. Some cities simply stated that they just prefer to use general obligation and/or revenue bonds in conjunction with various Pay-As-You-Go approaches. A few cities stated that they did not perceive any “benefit” to using the SRF loan approach.

Cities that were grouped in this category should not be confused with cities grouped in the category referred to as Red Tape. The reader should note that cities grouped in that other category did not specifically identify more favorable financing terms as a key factor in their decision not to use SRF loans for their water infrastructure investments. However, some cities grouped in the Red Tape category alluded to “costs” in their responses, but not to interest rates per se.

Prefer Cash Financing – Pay-As-You-Go:

Number of Cities = 57

Small Cities = 25

Medium Cities = 20

Large Cities = 12

A substantial number of survey cities identified Pay-As-You-Go as a preferred method to finance major capital investments in water and wastewater projects. These cities exhibit a propensity for water infrastructure financing self-sufficiency. The term Pay-As-You-Go, however, may have multiple meanings. It does not necessarily imply that cash payments

² Minority Business Enterprise/Women Business Enterprise

are the only form of financing. Indeed, a number of cities indicated that a combination of cash and municipal bonds was used to finance actual major capital investments in water infrastructure between 2000 and 2004.

Where cash financing was identified as a preferred means of water infrastructure investment, the cash came from a number of sources. Some cities stated that cash financing came from “customer revenue,” “development fees,” “reserve funds,” “funds on hand,” “user charges,” “assessments,” “impact fees from new development,” “sales tax,” “user fees,” etc. These cash sources are substantially similar in nature, although different cities identify them differently. A few cities stated that cash financing was made available through use of the city’s “general fund,” although this was not very common.

There appears to be a commonality among the cities that rely on the Pay-As-You-Go approach. They share an expectation that the water and sewer systems should be financed primarily by the users (not unusual, even if bonds are the preferred method of financing). One western city stated “To the greatest extent possible, we use user fees collected on water sales and wastewater treatment to pay for the capital improvements needed to upgrade the system, expand it or implement other major capital improvements.” Another western city stated their “Target to have rates/fees pay for all capital improvements.” Three southwestern cities stated “We set aside funds yearly to finance water and wastewater CIP³ projects”; “The city has historically chosen to cash flow many water and wastewater projects”; and, “Current funds are used that are built into the rate structure.” Two northwestern cities stated “We are currently using cash reserves”; and, “Our policy is to pay as we go to the maximum extent possible.” Two upper midwest cities stated “All wastewater-related projects since about 1997 have been funded using utility cash”; and, “We cash-finance most capital projects.” A mid-Atlantic city stated that they are “Currently containing debt through the use of operating funds and reserves.”

Red Tape:

Number of Cities = 32

Small Cities = 6

Medium Cities = 15

Large Cities = 11

Nearly half (14 cities) of the cities grouped in this category stated that “red tape” and the “complexities” of the SRF loan application process were critical in deterring them from considering the SRF loan as a finance option. Some of the cities stated that the paperwork was “too burdensome.” Many cities in this category identified administrative costs and conditions (sometimes referred to as “strings attached”) as reasons why they did not consider the SRF program. One medium size mid-Atlantic region city stated “The SRF usually has numerous requirements that increase the overall cost of a project. It is as cost effective to utilize alternative funding sources such as a revenue bond, and not have to jump through all the SRF financing/state hoops and criteria imposed.” A medium size west coast city stated “Too much administrative work / state oversight / time required. Especially problematic is the requirement for mandatory use ordinances or user agreements for recycled water use.” Another medium size west coast city stated the “Cost of compliance with procedures outweighs benefit of lower cost funding.”

Do Not Qualify or SRF Non-Responsive to Applications:

Number of Cities = 24

Small Cities = 6

Medium Cities = 9

Large Cities = 9

Twenty-four of the survey cities were grouped according to their responses that indicated their applications for SRF loans were unsuccessful. The unsuccessful application experiences were mentioned by city water managers.

Many of the cities grouped in this category stated that their cities did not qualify for SRF funding. Some of the cities that identified this reason for why they no longer seek SRF loans added statements such as, “City has always received a low priority ranking in meeting loan criteria.” Another city stated that “Usually we do not have enough

³ Capital Investment Program

priority points to qualify.” Other comments included: “...needs assessment does not place our community in high priority.” Still other cities recognize state policies that direct SRF loans to smaller communities: “State funds are for small entities who cannot provide bonds,” “State gives preference to rural projects.”

Other reasons stated by cities in this category involved dissatisfaction with the SRF application review process. One city stated “...wait time too long and uncertain for planning.” Another city stated “...the process is too cumbersome and most projects do not qualify.” A west coast city stated “We have applied for assistance for the last five years without any financial assistance.” Another west coast city stated “State Revolving Fund Loan Program staff are very non-responsive and cannot be relied on to deliver in time.” A Gulf Coast city stated “Timeliness of getting the project going. More projects than money; have to wait for the ranking.”

Other concerns stated by the cities in this category of response indicated that there is a general lack of available SRF loan funds. One city stated “City is on list — but no available funds.” A small upper midwest city stated “There are not sufficient funds available for utilities our size in our state.”

Have Used, Might Use, Will Use the SRF:

Number of Cities = 15

Small Cities = 7

Medium Cities = 3

Large Cities = 5

The cities grouped in this category span a wide range of attitudes, from strong support for use of the SRF program, to statements indicating it may be a potential source of financing in the future. Some cities stated support for the use of SRF loans. A small city in the northeast stated, “we use SRF whenever possible.” Two small cities in the mid-Atlantic region stated “It is a good source of funds for wastewater projects”; and “We utilize SRF money to the extent it is available. Needs [in the] state are far greater than the fund can support.” A medium size city in the same region stated the SRF has “Great rates, [and an] easy process.” A small city in the midwest stated “The City utilizes state revolving loan funds.”

Some cities in this category indicated they will or might use the SRF loan program in the future. A small city in the south-Atlantic region stated “We are just in the discussion phase — we would use what fund source that would be most cost effective.” A large city in the same region stated “The majority of projects are funded through cash reserves generated by user fees. SRF loans are used to fund projects for which there are insufficient reserves.” A medium size city on the west coast stated, “Previously, projects were completed on a pay as we go basis. Should the funds be available in the future, the City will actively pursue the SRFL program.” A medium size city in the midwest region stated, “To this point we have been able to sustain our capital investments with local funds. SRF will likely become an attractive alternative over the next 10 years.” A large city in the southwest stated, “SRF funds used to finance portion of annual wastewater CIP. Working with [the] State on [the] possibility of funding additional projects with SRF funds.”

Not Needed or Not Investigated:

Number of Cities = 15

Small Cities = 10

Medium Cities = 4

Large Cities = 1

Eight cities in this category indicated that the SRF program was either “not needed,” “not considered,” or “not investigated.” Another five cities indicated that they would like to learn more about the program. Another two cities did not know why they have not looked into the SRF program as a possible source of water infrastructure project financing.

Prefer Grants or Combination of Grant and Other Financing:

Number of Cities = 11

Small Cities = 3

Medium Cities = 5

Large Cities = 3

Surprisingly, there were a small number of cities that indicated they prefer or rely on grants. Cities that did mention grants as a preferred source of financing also mentioned that other sources of financing were used in combination with the grants. A few cities relied on grants for the major portion of project financing; “[City X] has focused efforts on securing grants to fund major projects and use reserves to fund the local match. Currently do not have a large enough customer base to secure a major loan.”

Cities identified a variety of grant sources applicable to their major capital investments in water infrastructure. For example, a small west coast city stated that they “Choose to secure grants from state bond sources and rely on reserve funds.” A couple of cities indicated that they used Community Development Block Grants to help finance their water projects.

Not Responsible for Capital Improvements:

Number of Cities = 7

Small Cities = 5

Medium Cities = 1

Large Cities = 1

Cities grouped in this category were generally not responsible for providing water or wastewater services to their citizens. Some cities identified larger water districts or counties that provided water services. A few of the cities in this category identified private water providers who are responsible.

Discussion

City Practices and Plans Concerning the SRF Loan Programs for Water Infrastructure Investment

The nation’s principal cities are engaged in substantial spending on water and sewer infrastructure projects. The recent Survey conducted by the U.S. Conference of Mayors found that 92 percent of cities are making major capital investments in water supply, drinking water plants and pipes, and wastewater plants and pipes. Slightly more than one-third of the 2005 Survey cities actually used, or plan to use the SRF loan programs to finance some or all of these major capital investments between 2000 and 2009. The one-third of cities using or planning to use the SRF loan programs is fairly constant between 2000 to 2004 and 2005 to 2009.

The SRF loan program is the fourth most frequent form of water project financing among five financing approaches when used as the sole source of project financing in a community. When communities blend financing approaches (such as municipal bonds and SRF loans) the SRF loan program is the third most frequent form of water project financing.

Generally speaking, small cities are 2.4 times more likely than large cities to get 50 percent or more of the money to finance their water projects from the SRF loan program. Many states target SRF spending priorities to those communities that are less able to finance new water infrastructure construction or rehabilitation because they have smaller populations comprising the rate base. The SRF loan program is an important source of federal financial assistance to many small cities and rural areas.

City Attitudes Concerning the SRF Loan Programs for Water Infrastructure Investment

The 2005 Survey indicates that two-thirds of the nation’s principal cities are not using the SRF loan program to help finance major capital investments in public-purpose water infrastructure. Why is this so? Anecdotal information has long dominated this discussion.

The 2005 Survey provides information from 219 cities that did not use the SRF to finance water and wastewater projects provides a better snapshot of city attitudes toward use of the SRF than the anecdotal information often mentioned in water policy circles. Roughly 35 percent of those cities indicated that they prefer municipal bonds over the SRF. 26 percent stated that they prefer to pay cash (pay-as-you-go) for new projects. Only 15 percent

identified red tape and complex loan applications as a reason to avoid using the SRF loan program. 11 percent of cities indicated that their water projects did not or would not qualify under state spending priorities. Only 5 percent of cities said they preferred waiting for grants.

One common theme shared by over 60 percent of the cities that did not use the SRF was their desire to achieve cost-savings or cost-efficiencies. Cities that prefer using municipal bonds to finance major capital investments in water infrastructure often state that the difference in interest savings, combined with the need to hire consultants when applying for the SRF loans, and the strings attached to the loan offset any benefits from a cost-savings point of view. Cities that prefer to use cash generated from user fees and other rate-based methods suggest that they have an aversion to carrying debt and paying interest.

Federal Financial Assistance and Municipal Water Infrastructure Investments

If two-thirds of the nation's principal cities are not attempting to use the SRF loan program because they have other viable financial resources for water projects, why is the water infrastructure "Needs Gap" growing instead of closing?

The transfer of financial responsibility for water infrastructure investments from federal and state governments to local government over the last two decades is firmly entrenched. Simultaneously, major capital investments have shifted from federal and state grants to local borrowing by way of municipal bonds, user charges and low interest SRF loans. An often cited figure is that local government is responsible for 90 percent of public-purpose water investments. The U.S. Bureau of the Census reports that combined municipal expenditures for water and wastewater infrastructure are second only to educational expenditures. We are experiencing enormous investment, but a growing or, at best, stable water infrastructure investment "Needs Gap."

As municipal spending on water infrastructure has increased over the last two decades so has the number of unfunded federal mandates. The "Needs Gap" itself is measured in terms of what it will take to comply over a 20 year term with existing law. As new environmental requirements are set for water quality the cost to reach or maintain the compliance point is adjusted upward.

Traditional water infrastructure investment alternatives continue to be the primary way cities pay for water projects. Whether cities use a bond or a loan, the principal and interest must be repaid to the creditor. Current federal law contains favorable provisions for interest rates for municipal bonds and the SRF, but this does not keep pace with growing compliance costs and the substantial system maintenance and replacement costs experienced by cities.

Cities will continue to use traditional water infrastructure investment approaches because that is what is currently available. The expectation that traditional funding approaches will satisfy compliance needs has been shown by experience to be faulty logic. Local government cannot completely satisfy spending requirements in this area because the costs are too great and there are competing needs for public capital. Mayors face the daily challenge of balancing competing needs in the community for worthy public-purpose spending with limited financial resources. And, unlike the U.S. Congress that has the ability to continue to legislate relying on "deficit spending," Mayors are bound by legal requirements to balance their budgets.

The U.S. Conference of Mayors, as pointed out in the Introduction to this Report, has advocated on behalf of cities to: 1) ensure that federal grants remain available for cities that have extraordinary economic or environmental problems that prevent them from adequately addressing water infrastructure or water quality problems; 2) ensure that cities have an opportunity to obtain 30-year no-interest or low-interest SRF loans; and 3) remove state volume caps for private activity bonds used for public-purpose water and sewer infrastructure investment. The increased use of private activity bonds for public water infrastructure can boost aggregate spending on water infrastructure and help cities make progress in closing the "Needs Gap."

ATTACHMENT A

Resolution Adopted in Chicago June 2005

INCREASING FEDERAL FUNDS TO HELP COMMUNITIES IMPROVE WATER INFRASTRUCTURE AND MEET FEDERAL WATER MANDATES

WHEREAS, many of the nation's communities have aging or inadequate water infrastructure and face staggering costs for making upgrades and repairs to protect and improve water quality and to meet federal clean water and drinking water mandates; and

WHEREAS, generally, the federal Clean Water and Drinking Water State Revolving Funds intended to help communities meet federal water quality mandates continue to be substantially underfunded, and will not satisfy the \$530 billion plus "Needs Gap" estimated by the U.S. Environmental Protection Agency (USEPA) to comply with federal mandates; and

WHEREAS, many of the nation's communities experience wet weather episodes involving overflows of untreated wastewater that occur as a result of deteriorating or inadequate infrastructure, and thus are compromising many of the nation's waterways and causing considerable public health impacts each year; and

WHEREAS, the USEPA estimates that there are 21,264 Combined Sewer Systems (CSS) and Sanitary Sewer Systems (SSS), with a combined total of 784,000 miles sanitary and storm sewer lines in the nation; and

WHEREAS, a recent study by the U.S. Environmental Protection Agency estimates that it will cost communities approximately \$50.6 billion to address combined sewer overflows (CSOs) and \$88.5 billion to address sanitary sewer overflows (SSOs) over the next 20 years; and

WHEREAS, there is currently no dedicated source of direct federal funding to assist the nation's communities with efforts to prevent or mitigate CSOs and SSOs; and

WHEREAS, the nation's communities are vastly in need of additional federal resources to upgrade water infrastructure, and are especially in need of a dedicated source of direct federal funding to help prevent CSOs and SSOs; and

WHEREAS, the nation's communities believe direct federal assistance for water infrastructure upgrades and improvements is a more efficient and more effective approach for achieving real improvements to water quality than receiving federal funds through state-administered programs;

NOW, THEREFORE, BE IT RESOLVED, that The U.S. Conference of Mayors urges the Congress to approve legislation that would complement the Drinking Water State Revolving Fund and for the Clean Water State Revolving Fund by providing more targeted and direct federal resources to help the nation's communities deal with other water infrastructure-related issues, including \$50.6 billion for combined sewer overflows, and \$88.5 billion for sanitary sewer overflows and stormwater management; and

BE IT FURTHER RESOLVED, that The U.S. Conference of Mayors strongly urges the Congress to provide FY06 funds for the Drinking Water State Revolving Fund at the authorized level of \$850 million and for the Clean Water State Revolving Fund at the authorized level of \$1.35 billion; and

BE IT FURTHER RESOLVED, that The U.S. Conference of Mayors strongly urges the Congress to approve legislation to substantially increase the authorized levels for both Funds to help reverse the continuing decline of the federal share of financing these federally mandated improvements.

ATTACHMENT B

Resolution Adopted in Las Vegas

June 2006

RECAPITALIZING THE STATE REVOLVING FUND (SRF) LOAN PROGRAMS ANNUALLY TO HELP COMMUNITIES IMPROVE WATER INFRASTRUCTURE AND MEET FEDERAL WATER MANDATES

WHEREAS, a recent Survey conducted by The U.S. Conference of Mayors Urban Water Council identified rehabilitating the aging urban water resources infrastructure as the number one water priority facing America's principal cities; and

WHEREAS, the Survey also indicated that from 52 percent to 83 percent of cities are currently engaged in making major capital investments in five types of water infrastructure: water supply; water treatment plants; water distribution systems; wastewater treatment plants; and wastewater collection systems; and

WHEREAS, many of the nation's communities face staggering costs for making upgrades and repairs to protect and improve water quality and to meet federal clean water and drinking water mandates; and

WHEREAS, the federal Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund (DWSRF) are intended to help communities meet federal water quality mandates, but continue to be substantially underfunded, and will not satisfy the \$530 billion plus "Needs Gap" estimated by the U.S. Environmental Protection Agency (USEPA) to comply with federal mandates; and

WHEREAS, the federal Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund (DWSRF) have been significantly cut back in recent years, to the point where some communities are facing a 50 percent or greater reduction in new loan funds made available for public-purpose water and sewer projects; and

WHEREAS, the federal Clean Water State Revolving Fund (CWSRF), while inadequately funded, has proven to provide significant public benefits including: better water quality to protect drinking water, protection of aquatic life and wildlife, improvements in waters used for primary and secondary contact recreation, and protection of waters providing fish and shellfish for human consumption; and

WHEREAS, the continued implementation of federal unfunded mandates (like the drinking water standard for arsenic and other regulations) add significant capital costs for municipal water treatment systems that cannot realistically be complied with without federal financial assistance;

NOW, THEREFORE, BE IT RESOLVED that The U.S. Conference of Mayors supports the continuation of the Clean Water Act and Safe Drinking Water Act State Revolving Fund loan programs as currently implemented by the U.S. Environmental Protection Agency and the public and environmental benefits derived from these programs; and

BE IT FURTHER RESOLVED that The U.S. Conference of Mayors strongly urges the Congress and Administration to annually approve recapitalization authorizations to the CWSRF at \$1.355 billion or more, and the DWSRF at \$850 million or more; and

BE IT FURTHER RESOLVED that The U.S. Conference of Mayors strongly urges the Congress to approve legislation to substantially increase the authorized levels for both Funds to help reverse the continuing decline of the federal share of financing these federally mandated improvements.

Mayors Water Council

A Task Force of The U.S. Conference of Mayors

The MWC is open to all Mayors, and functions like a USCM task force. It provides Mayors with a forum for discussion of issues impacting how cities provide and protect water and wastewater services to the community. Some of the issues that the MWC focuses on include: watershed management; water supply planning; water infrastructure financing; rehabilitation of surface and sub-surface water infrastructure; water conservation; wetlands construction and education programs; water system program management and asset management; etc.

The MWC will continue to develop local government positions on Federal legislation, regulations and policy. The MWC acts through the USCM Environment Committee, and other Committees, as appropriate, to propose and adopt resolutions on water related matters that benefits the nation's cities.

MAYORS WATER COUNCIL

*The Mayors Water Council is a
task force of The U.S. Conference of Mayors*

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