BIPARTISAN POLICY CENTER

Testimony of Ms. Kathy Pape
Senior Vice President Regulatory Policy and Business Development
American Water

U.S. House of Representatives
Committee on Transportation and Infrastructure
Subcommittee on Water Resources and Environment
"Building a 21st Century Infrastructure for America: The Role of Federal Agencies in Water Infrastructure"
Thursday, March 9, 2017

Chairman Graves, Ranking Member Napolitano, and members of the Committee, thank you for the opportunity to join you today to discuss the important subject of the role of federal agencies in water infrastructure and to offer our perspectives and recommendations.

I am Kathy Pape, Senior Vice President Regulatory Policy and Business Development at American Water, the largest publicly traded U.S. water and wastewater utility company. American Water is proud to provide water, wastewater and other related services to an estimated 15 million people in 47 states and Ontario, Canada. We treat and deliver more than one billion gallons of water every day through 49,000 miles of pipe.

I am here today on behalf of the Bipartisan Policy Center's Executive Council on Infrastructure. The Bipartisan Policy Center (BPC) is a non-profit organization that combines the best ideas from both parties to promote health, security, and opportunity for all Americans. BPC drives principled and politically viable policy solutions through the power of rigorous analysis, painstaking negotiation, and aggressive advocacy.

As the only Washington, DC-based think tank that actively promotes bipartisanship, BPC works to address the key challenges facing the nation. BPC's policy solutions are the product of informed deliberations by former elected and appointed officials, business and labor leaders, and academics and advocates who represent both ends of the political spectrum. BPC is currently focused on health, energy, national and homeland security, the economy, housing, immigration, infrastructure, and governance.

BPC works to reconcile the competing aims of highly interested advocates, corporations, and policy experts, and design politically viable consensus solutions. BPC seeks out individuals and organizations that are deeply vested in the outcome of its policy projects. They ask that their project participants check absolutely nothing at the door and bring all their passion, political perspectives, and interests to the table. BPC believes that the fundamental strength of American democracy is unity forged amid diversity, and BPC endeavors to represent this pluralism in all policy negotiations.

BPC funding reflects the character and diversity of the organization. The majority of BPC funding comes from charitable philanthropies. The remainder of BPC's support comes from individual donors and corporate donors (a list of BPC donors can be found in their latest annual report). BPC believes that all of its donors as well as its project members have interests. A strength of BPC's consensus-based negotiation process is that no single interest can unduly influence consensus outcomes.

BPC convened the Executive Council on Infrastructure in early 2015 with a goal of developing recommendations on how to enable private investors to help finance public infrastructure projects. The council defined infrastructure broadly to include transportation, energy, broadband, and water projects among other sectors.

American Water's President and CEO Susan Story is a member of the Council. She is joined by:

- Doug Peterson, President and CEO of S&P
- Eric Cantor, Vice Chairman and Managing Director, Moelis & Co
- Patrick Decker, the CEO of Xylem, Inc.
- Michael Ducker, President and CEO, FedEx Freight
- Jack Ehnes, CEO, California State Teachers' Retirement System (CalSTRS)
- Jane Garvey, Chairman of North America for Meridiam
- P. Scott Ozanus, Deputy Chairman and COO, KPMG, and
- Suzanne Shank, Chairman and CEO of Siebert, Bradford Shank &Co.

I want to commend the Committee for holding this hearing and for your focus on the importance of water and wastewater infrastructure. Clean, safe, reliable, and affordable water and wastewater service is essential for life and economic development. We know you care deeply about this, and so do we. Quite simply, at American Water it's our focus every day --- our vision is Clean Water for Life.

In order to obtain this vision, we know there are significant challenges and a hefty price tag. This is highlighted in the BPC's "Bridging the Gap Together: A New Model to Modernize U.S. Infrastructure" report. We are here to offer solutions because we know our lives and our future and the future of our children and grandchildren, depend on it.

We admire the recent bold infrastructure proposals, including the proposal that was highlighted by President Trump in his recent address to a Joint Session of Congress. Understanding that there are many competing demands for infrastructure resources, if we are to meet our nation's future needs and preserve our American quality of life, the public sector alone cannot continue to cover the cost and absorb the risk of degrading infrastructure. We would highlight that while some categories of infrastructure may benefit more from direct federal investment, water and wastewater infrastructure is particularly conducive to leveraging private sector resources.

The private sector stands ready to partner and assist bringing necessary capital. Investors with billions of dollars to deploy, including American Water, are actively seeking water and wastewater infrastructure projects to support. The top 5 investor owned water utilities have budgeted capital expenditures of more than $2B in 2017, with American Water budgeting $6B over the next 5 years. The private sector can also provide innovative solutions and valuable expertise that can save time, money and improve projects. One example of this is Fairview, Pennsylvania.

In late 2015, Fairview Township sold its wastewater system to Pennsylvania American Water for $16.8 million. This decision helped to pay off $21 million in existing sewer debt, avoided additional debt (approximated at $14 million), and allowed property taxes to be cut by 50 percent. Pennsylvania American Water is investing $13 million in capital improvements, as well as up to $1 million in reimbursement for the relocation of a sewer line. The system serves approximately 4,000 customers in Pennsylvania.

Together, the public and private sectors can work together more closely to propel America's water and wastewater infrastructure into a more modern, technologically advanced, and integrated network that enables prosperity long into the future. Unfortunately, there are not enough "Fairview, PAs" occurring. A number of barriers still exist which prevent the investment of private capital into U.S. water and wastewater infrastructure projects. As a result, America is leaving dollars on the table. Thus, the federal government's role in breaking down barriers and establishing the framework needed to unleash greater private investment is essential.

Extensive details on this subject are included in the BPC's "Bridging the Gap Together: A New Model to Modernize U.S. Infrastructure" report, which we have provided to the Committee. However, the report did not delve into regulatory issues specifically associated with the water and wastewater sector.

To that end, BPC has launched a new task force to examine the specific infrastructure needs of water and wastewater systems. The task force includes American Water and Xylem as well as former mayors Henry Cisneros of San Antonio, George Heartwell of Grand Rapids and your former colleague Steve Bartlett of Dallas. The task force will issue recommendations related to innovations, affordability, and regulatory relief later this year.

While BPC has not completed their analysis of the water sector, based on the work of the council, there are several steps that Congress can take to ease some of the regulatory burdens on both public and privately-held water utilities and promote technological and management innovation.

The Executive Council's May 2016 report included several key principles:

1) Projects proceed only after public benefits have been identified and clearly stated;
2) Infrastructure investment decisions incorporate full life-cycle evaluation, beyond upfront costs;
3) Project benefits, costs, and risks are completely accounted for and made publicly transparent;
4) The risk of not investing is quantified and compared against the costs of action; and
5) Public and private sector partners share these risks, costs, and benefits.

The council issued several recommendations pertinent to the water and wastewater sector. I will briefly discuss a few of the key recommendations.

<u>Establish and consistently communicate a finding of public value</u>

Every project should begin with a statement of public value. Stakeholder outreach, engagement, and education throughout project development are central to a project's success. In particular, BPC calls for public and private partners associated with a project to assess public value and consistently disclose that information to the public.

If there is a private sector partner, it should identify, standardize, and publish project data in an accessible format and develop customized training and technical assistance tools for understanding and participating in public-private partnerships.

<u>Inventory all public assets</u>

It's hard to believe that in the year 2017 there is not a comprehensive inventory of the physical and economic condition of our nation's public assets. How can policy makers address a funding gap without complete information about the true state of our infrastructure?

BPC recommends federal, state, county, and municipal governments and independent public authorities develop a complete list of all assets owned, including transportation (streets, bridges, stations), water, civic buildings (schools, courthouses, convention centers), vacant land, and underutilized real estate, including air rights. The inventory should include the physical and economic condition of each asset with estimates of the cost of maintenance over its remaining useful life, cost of replacement, and the potential impact of a failure.

Incorporate a life-cycle approach and screening for the full range of delivery and financing options (including P3 and alternative management structures)

As part of required certifications for federal infrastructure funding and other financial support, applicants should demonstrate that they have evaluated all delivery approaches allowed by state law to determine which would provide the best value for taxpayers over the asset's life-cycle.

Public procurements today tend to overvalue low initial costs and undervalue future obligations, rewarding bidders who can build cheaply, rather than those who offer the best value over a project's lifecycle. This can increase costs down the road - higher operations and maintenance costs, more need for repairs that often go unaddressed, infrastructure failing prematurely requiring expensive rebuilds, etc. This is fiscally irresponsible.

Public officials must also identify the infrastructure needs they can handle on their own, which could be shared with the private sector, and which could be fully transferred. BPC recommends state and local governments conduct an "optionality analysis" to match infrastructure projects with the most cost-effective delivery and financing options.

Applicants for public dollars should, therefore, demonstrate that they have fully accounted for the long-term costs of their projects, including any risks inherent in construction, operations, or maintenance, and have selected the project delivery model that provides the best value.

Recognizing that not all projects are of sufficient size to make this level of screening cost-effective, Congress could establish a cost threshold below which these requirements would not apply. However, such a threshold should be set at a level, or otherwise be constructed, to encourage opportunities for the "bundling" of smaller projects as was done for Pennsylvania's Rapid Bridge Replacement Project.

BPC does not believe that projects proceeding as a public private partnership (P3) should receive extra weight in the evaluation process or be otherwise favored simply because they are P3s; what matters is that the proposed project has been shown to deliver the best value to the public, whether a P3 or not.

Though BPC recognizes that this change will require some additional effort among applicants for federal funds, it should result in better projects and the more efficient use of limited federal dollars.

Enforce and expand expedited permitting and review

BPC believes Congress and the new administration can expedite permitting and various reviews without impacting the environment or public health. In fact, much progress has already been made. The Bush

Administration created a task force to help move complex projects through the permitting process. The Obama Administration launched an online dashboard to make the review schedule and process for high-priority projects transparent to the public. As Members of the committee are well-aware, most recently, the 114th Congress passed new provisions in the FAST Act (P.L. 114-94) designed to formalize these steps and improve coordination and schedule adherence in permitting decisions.

The president or Congress should designate a lead agency for multi-agency reviews, and direct CEQ and OMB to make final decisions and resolve disputes during interagency collaboration on permitting decisions. And agencies should conduct simultaneous rather than sequential reviews to increase the speed with which decisions are made. Further, agencies should be required to track and report on the time it takes them to make permitting decisions. Recognizing that not all delays are the fault of federal agencies, improved reporting processes should allow agencies to provide an explanation for any delay while increasing broader understanding of what can hold up a project.

Expand financial tools that attract private investment and ensure robust and stable federal funding

Any serious infrastructure proposal must find long-term, stable funding for federal infrastructure programs. Private capital does not eliminate the need for robust public investment. With regard to private financing, other financing tools should be authorized to ensure a wide range of options for capital markets participants to invest in U.S. projects.

I would also like to take this opportunity to highlight some of American Water's recommendations of particular importance to our customers and the constituents you serve. We believe these recommendations will help break down existing barriers to private investment, improve the way current government programs function, and maximize the options and opportunities available to communities.

Investment should drive compliant sustainable water and wastewater systems

Because private systems are regulated by state public utility commissions, they must demonstrate capital efficiency and cost transparency. Municipal systems have a combination of federal dollars, state dollars, local property tax assessments as well as customer water and wastewater bills. This layering of costs obfuscates the true cost of water and wastewater to the consumer.

Many of today's water and wastewater systems are in disrepair. Money is almost never the biggest issue and non-compliance is typically a symptom of the lack of financial and operational expertise, not a cause. A one-time injection of funds is akin to a band-aid approach, and within a short time, a challenged system will soon be in need of help again. It is critical that limited federal dollars are directed towards water and wastewater systems that are managed efficiently and effectively. It is important to explore as many other policy options as possible to achieve desired outcomes, some of which I will address shortly

Maximize the options and opportunities available to communities to enable investment and better operations

The water sector in the United States is highly fragmented. There are currently 56,000 community water systems in the United States, and most are quite small, with 92 percent serving fewer than 10,000 persons. There are currently over 19,000 wastewater pipe systems and over 14,000 wastewater treatment facilities in the United States. As recently as 2002, 98 percent of wastewater systems were municipally owned.

Too many of these systems are failing or are experiencing serious violations posing increased risks to public health. At the same time, water and wastewater infrastructure is capital intensive to upgrade, replace, and even maintain, and conditions are only getting more challenging for most small systems, leading to failing infrastructure and non-compliant water and wastewater systems.

Unfortunately, there are statutory and regulatory hurdles that stand in the way of addressing these significant issues. One example is that private water and wastewater systems are given a short time period to comply with consent decrees; whereas there are examples of public systems operating under consent decrees for decades. Another example is the lack of private ownership of water and wastewater systems in a number of states.

Regardless of ownership structure, all water and wastewater systems should be subject to the same enforcement actions and have the same access to federal funds. We suggest encouraging partnerships among public water and wastewater systems in communities which currently rely on under-performing or failing water systems. We believe such an approach could result in: better managed water systems via operational and financial expertise of skilled partners; reduced operational costs; improved reliability; and spreading capital investment costs among a larger pool of customers. These partnerships should be encouraged in all states, not just those currently allowing for private ownership of water and wastewater systems.

Rather than provide public funding to those systems which are out of compliance with environmental laws and regulations, we believe federal water and wastewater infrastructure funding programs should provide incentives for systems that have demonstrated an ability to maintain compliance and become sustainable; the adoption of asset management practices; and sustainable pricing. Many states have proactively passed "Fair Market Value" legislation to provide communities with troubled water and/or wastewater systems more options. The essence of this legislation is that it allows a regulated water utility to offer a community "fair market value" or appraised value for its water or wastewater system and the utility can then build that appraised value purchase price into its base rates. This approach provides communities more value for their system and allows the utility to earn a return on and of its investment. Rather than using federal funds to support communities whose water or wastewater systems are chronically non-compliant, federal funds could be used to incent the increased usage of a "Fair Market Value" approach.

Providing struggling communities with the option to partner with larger water and wastewater utilities has many significant benefits. Offering alternatives to grant funding for small systems by encouraging better performance for those systems unable to maintain the technical, managerial, and financial capacity requirements of the State Revolving Fund would save money for both the government and customers. It would also offer a choice to communities who otherwise might be subject to an enforcement action and costly civil penalties by EPA or a state, and helps public water systems in states be in compliance with the laws.

In March 2001, Pennsylvania American Water acquired the water and wastewater assets of the City of Coatesville Authority (CCA). The City of Coatesville gained long-term financial stability as a result of the sale. Funds from the sale, which exceeded $39.5 million after the debt was paid, were placed in a reserve fund. These monies were invested by the city to maximize their return in the form of investment income. At the blended investment rate of 6.8 percent, the return on the reserve fund was a minimum of $2.686 million annually, which was initially utilized for tax cuts and program enhancements.

Since the acquisition, Pennsylvania American Water has invested tens of millions of dollars to upgrade the water and sewer systems serving Coatesville and the surrounding communities including the Coatesville

Wastewater Treatment Plant, which replaced an antiquated facility dating back to 1932. The upgrades were required to address environmental issues that the Pennsylvania Department of Environmental Protection had identified in a Consent Order, pertaining to projected hydraulic overloads at the wastewater plant. The project also expanded the plant's treatment capacity from 3.85 million gallons per day to 7 million gallons per day.

Better use of existing federal programs through expanded access

First, expand access to the Clean Water State Revolving Fund (CWSRF). Unlike the Drinking Water State Revolving Fund (DWSRF), private wastewater service providers are not eligible for the CWSRF. This disparity prevents private wastewater service providers from leveraging federal investment in wastewater with private capital and expertise as they have done with the DWSRF since 1994. We strongly recommend that eligibility in the CWSRF under section 603c of the Federal Water Pollution Control Act be extended to all wastewater treatment providers, regardless of ownership. Doing so will allow the CWSRF to provide loans to private community wastewater systems, unlocking much needed wastewater solutions and service to underserved communities and non-compliant systems.

Second, review the CWSRF program is to make sure it meets your primary goals. For instance, if a goal of the CWSRF program is to make rates more affordable for lower income families in the face of large new investments, it makes sense to review whether the current approach of providing relief to systems as a whole instead of directly to the lower income families is the best approach.

Third, make sure systems requesting CWSRF funds have reviewed all of their options. Many systems do not realize all of the options that are available to them to fund needed investments, including consolidation with other neighboring systems. By encouraging systems to pursue all of their other options, existing CWSRF funds will be better used and more total investments will be made in the wastewater systems.

Reform tax regulations to better support infrastructure investment

Current IRS regulations that pertain to P3s are in many cases outdated and may present obstacles to communities seeking to upgrade their municipal infrastructure through P3s. We recommend that the US Treasury Department and the IRS broaden their remedial action regulations to provide more flexibility to municipalities on the use of proceeds from P3 transactions. Local governments commonly finance their infrastructure needs through tax-exempt municipal bonds. When a municipality decides to sell these assets or to enter into other forms of public-private partnerships, it must consider IRS rules that exist to prevent the tax-exempt benefits of municipal debt from transferring to the private partner. In these circumstances the IRS rules provide a municipality with three primary ways - the "remedial actions" - to repay or retain its tax-exempt municipal bonds. Regardless of whether there are monetary savings, these changes have the potential to enable more P3 transactions by eliminating ambiguity and potential regulatory issues.

Remove Tax-Exempt Bonds for Water Infrastructure from State Volume Caps

In addition to federal dollars, another effective option for the federal government in providing long-term, capital-intensive infrastructure projects is the private activity bond (PAB), or exempt facility bond. These bonds are a form of tax-exempt financing for state and municipal governments that want to partner with a private entity to meet a public need. This 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 partners. In addition, the tax-exempt bond provides lower cost financing, which translates to lower costs for the customer.

However, 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, and historically most of the tax-exempt funding has been allocated to shorter-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.

Amending the Internal Revenue Service Code (26 USC 146) to remove from the volume cap private activity bonds for public-purpose water and wastewater facilities would allow local communities to leverage private capital markets in combination with other finance mechanisms. We believe this change would provide an influx of private capital to finance water infrastructure projects.

It is also important to note that exceptions from the volume cap are already currently provided for other governmentally owned facilities such as airports, ports, housing, high-speed intercity rail, and solid waste disposal sites. Volume cap limitations are not issues in all states, but removal of the caps provides for competitive access to lower cost funding for private investors similar to municipalities.

While we understand these final two recommendations, though extremely important for water infrastructure, are not technically within the jurisdiction of your committee, we urge you to work with your colleagues on the Ways and Means Committee as they negotiate tax reform issues.

Conclusion

Finally, I would like to make three important points. The first is that investment should drive compliant sustainable water and wastewater systems. While we strongly believe the private sector can and should play an important and valuable role, providing flexibility and choice for communities is vital to achieve this objective.

Second, while federal funding for water and wastewater infrastructure plays an important role, federal investments should be made strategically in order to create the most cost effective solutions for all customers and constituents.

And finally, I would like to conclude by reiterating comments I made earlier. Clean, safe, reliable, and affordable water and wastewater are a critical necessity for every person. Every person wants to make sure our children and future generations have clean water and healthy environment. We hope the recommendations and solutions we put forward today can be constructive in addressing the significant challenges we face and we look forward to continuing to work with you on these critical issues.