A Water Plan and Policy for Texas – Funding and Financing of Alternative Water Resource Projects

Andrew L. Shea
USA Development Director
Acciona Water
Topics for Discussion

- Defining the Challenge - Finding the Solutions
- Spectrum of Funding and Financing Options
- Funding Tools on the Horizon
- Alternative Project Delivery and Financing Options
- Concluding Comments
Defining The Water Infrastructure Challenge

- Growing Texas populations are exhausting urban water supplies and compromising water quality
- More stringent regulations limit conventional water supply and treatment options
- TWDB estimates capital costs for water management strategies to be $30.7 billion within planning horizon
- Limited State Funding due to Competing Alternatives
- Federal Deficit Limits New Project Starts
- GASB -34 Accounting impact on municipal credit ratings
Finding Timely Solutions

- **New Sources** - Communities need to look at Alternative Water Resource development options using proven technologies.
- **Desalination and Reuse Water Projects** bring “New Water” into the Urban Watershed to Complement existing Environmental Resources and Conservation.
- **Innovative Public-Private Partnership Options** can Leverage Private Sector Capital and Extend Purchasing Power of Local Government Resources.
Funding - Where will the Money Come From?

- Current rates and revenues
- Federal grants
- Federal/State revolving funds
- Long-term debt – revenue bonds, general obligation bonds
- Private Sector Capital
- Increased user fees
Financing Options for New Infrastructure Projects

- There is a broad spectrum of project financing options:

  Tax-exempt financing can be used for a significant portion of most structures

  Publicly Owned and 100% Financed with Governmental Purpose Tax-Exempt Bonds

  Privately Owned and 100% Financed with Equity Contributions

  Between these two extremes, a variety of financing structures utilizing tax-exempt private activity bonds, taxable bonds and equity funding are possible to help optimize project development.

  (Courtesy of Lehman Brothers)
Financing/Ownership Options for New Infrastructure Projects

Financing

- Tax-Exempt Bonds
  - Governmental Purpose Bonds: Limits private participation
  - Private Activity Bonds: Allows private participation
- Taxable Bonds: Unlimited use, but potentially higher all-in cost
- Private Equity: Can be used in conjunction with certain types of Tax-Exempt Private Activity Bonds and all Taxable Bonds
Ownership

- Public Ownership: Limits private participation in many types of projects
- Public “Benefit” Corporations: 501(c)(3) or 63-20 non-profit corporations
- Private Ownership: Limits use of Tax-Exempt Bonds
Capital Markets Infrastructure Project Financing

- The capital markets have been an increasing source of “off-balance sheet” non-recourse financing for large public-private partnership projects in the US infrastructure market.
- With public ownership (including 63-20 and 501(c)3 corporations), the tax-exempt market is possible to access, but with limits on operating flexibility and private equity investment/return.
- Under most public ownership structures private partners can, at a minimum, recover development expenses, fees and a profit through completion of construction and a fixed return during the operating period.
- Under certain public and all private ownership structures, developers can earn “equity” returns in addition to the above.
Funding Tools on the Horizon

- Title XVI Water Reuse Authorizations for Bur. Rec. States
- Tax Credit Bonds
- Loan Guarantees/Credit Enhancements
- Bond Cap Removal for Water PAB’s (HR 1708 - Rep. Shaw)
Proposed Elements of Tax Credit Bonds

- Proposed Purposes: Stimulate Investment in Desalination, Reuse, and Groundwater Conjunctive Use/Remediation Facilities
- Concept Proposal Stage – US Desal Coalition
- Essentially an Interest Free Loan
  - Bondholder Receives Federal Tax Credit
  - Federal Government Effectively Pays Interest
- Similar to Qualified Zone Academy Bonds (QZABs), Clean Renewable Energy Bonds (CREBs) and Gulf Zone Tax Credit Bonds
- Maturity – 20 years with Balloon Payment
What is a Tax-Exempt PAB?

- Tax law provides exceptions for interest on certain public purpose PABs to be excluded from taxation
- *One* category of exception is “exempt facility bonds”, including: airports, docks and wharves, mass commuting facilities, water, sewage, and solid waste facilities, some rental housing, some electric and gas facilities, district heating and cooling facilities, some hazardous waste facilities, high-speed intercity rail, some hydro projects, some educational facilities
When are PAB’s Useful

- PAB’s can be used in Public-Private Partnerships when Private Sector Capital is used in a Project Financing
- Remove forced decision between “low-cost capital/high-cost operations” or “high-cost capital/low-cost operations”
- Structure partnerships to optimize development, construction, and operations “beyond” Rev. Proc. 97-13 Restrictions
- Opens access to Capital Markets for Project Financing
Project Finance Contracting Structure

Water Agency
River Authority

Development/Permitting
DevCo

Host Site
Lease Agrm’t

DEBT FINANCING
Public Agency

WATER SUPPLY AGREEMENT

ENGINEERING/PROCUREMENT/CONSTRUCTION

O&M SERVICES

EQUITY FINANCING
Private Sector

PROJECT
Recent Project Financings

• Cauley Creek Water Reclamation, Duluth, GA – 5 mgd recycled water project using UF membranes
• Cranston, RI – $80 million taxable debt, PAB’s, and equity for WWTP Tertiary Upgrade
• Tampa Bay Desalination - $108 million PAB package supported by the Florida Governor
Projected Water/Wastewater PAB Issuance

- Tested and proven tax-exempt bond financing structures exist to finance public-private partnerships for alternative water resource infrastructure
- Projects can be structured as public-private partnerships to optimize development, construction and long term operation, as well as appropriate sharing of risks between the public and private partners
- Highly-regarded private companies active in the water/wastewater market facilitate the structuring of long-term public-private partnerships
- Long term private partner risk assumption and equity investment for water/wastewater projects would increase with the use of PABs and benefit all public and private participants developing projects to meet water quality infrastructure needs
“Stop planning. Start Doing!”

TWDB Vice Chairman Jack Hunt

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