Water is a

BIG DEAL.

Let's treat it like one.

Key measures to encourage private investment in water and wastewater infrastructure:

- Encourage Regionalization
- Lift Caps on PABs
- **Eliminate Defeaseance Penalty**
- Expand Eligibility of SRFs
- Incentivize Low-Income Programs

REMOVE DEBT DEFEASANCE PENALTY

Eliminating the need to defease public bonds cap is likely to encourage private investment for necessary infrastructure upkeep and construction. Preliminary estimates by PricewaterhouseCoopers indicate that taking this action along with other regulatory changes could lead to an additional **$43 billion** incremental private water infrastructure investment; **$15-25 billion** incremental private wastewater infrastructure investment; and generate **$20 billion** potentially from P3s.

How it supports increased investment

Eliminating the need to defease public bonds cap removes the obligation of the issuer to repay the bonds, and thus reduces the risk undertaken by the purchase of municipal bonds.

The cost benefit

Changes to IRS regulations regarding "remedial action" is a major opportunity to promote more asset sales and long-term P3s in the water and wastewater industry. A narrow reinterpretation of existing rules regarding municipal bonds could provide our municipal partners with up to 15% additional cash from the sale of its water system.

The NAWC is the voice of the private water service industry—the organization exclusively representing this group of quality water service providers, innovation drivers, creative financiers and responsible partners. We believe by working together with local governments and communities we can leverage our strengths to effectively address the opportunities and challenges facing our nation. We're moving water forward. For more information, visit www.nawc.org.

NAWC
National Association of Water Companies

REMOVE DEBT DEFEASANCE PENALTY

ISSUE

The private sector is working closely with local governments on dispositions (sales) and a wide range of public-private collaborations to promote greater investment in water and wastewater infrastructure.

Dispositions and other partnerships often begin years after a community has made a substantial investment of its own through the issuance of tax-exempt bonds. However, when a community seeks to transfer ownership or control of the water infrastructure to a private partner, IRS regulations require the private partner to undertake one of three "remedial actions" to preserve the tax-exempt status of the bonds.

Acceptable remedial actions include defeasance, reclassification as a private activity bond, or the re-investment of the proceeds in an approved alternate use.

- **Defeasance** – Municipal bonds very often prohibit redemption for a period of years after issuance. When a transaction occurs within this window, the bonds must be defeased. This requires the private partner to purchase a large amount of low-interest U.S. Treasuries to replicate the higher interest bonds' cash flow to the bondholders. This locks up capital in Treasuries that could otherwise be put to use in the community, resulting in up to 15% less cash from the deal going to the community. We have referred to this as the "defeasance penalty."
- **Private Activity Bond** – A second possibility is to re-classify the bonds as private activity bonds (PAB), but the bonds must meet all the PAB requirements at the time of re-issuance. The IRS allows each state (and its communities) to issue a limited dollar amount of private activity bonds each year and there may not be sufficient room under a state's PAB volume cap at the time of the transaction.
- **Alternative Use** – The third remedial action requires the community to reinvest the cash in an approved "alternative use" (generally new infrastructure) within two years.

POLICY NEEDED

The IRS should clarify the Alternative Use rule in the following ways:

1. The rule should apply to long-term leases and concessions as well as sales.
2. For concessions, the alternative use rule should apply only to cash deals.
3. The IRS should extend the two-year window to three years, with subsequent one-year windows for later cash payments called for in the transaction.
4. For sales and P3s, the rule should recognize the funding of public pension obligations or other debt obligations as a legitimate alternative use.

For more information, contact NAWC at 202-833-8383/ info@nawc.com or visit www.nawc.org.

NAWC
National Association of Water Companies