



Issue Brief

Challenges Ahead for the Water Utilities: Bridging the Cap-Ex Funding Gap

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Challenges ahead

Water utilities will face a challenging business environment in coming years. (In this report, we use the term “water utilities” generically to refer to water systems that provide drinking water, those that handle wastewater, and those that do both, unless otherwise noted.) During the severe 2008-09 economic recession, many utilities delayed capital projects and now find themselves under mounting pressure to replace aging infrastructure or expand capacity. These financial pressures will be more pressing for government-owned utilities than for large investor-owned utilities as the latter have greater access to private capital. Additionally, regulatory mandates are exacerbating the utilities’ capital funding problems, especially in the wastewater sector, because they often dictate the priority of capital projects in a way that does not align with a utility’s service requirements or ability to raise revenue or issue bonds.

Federal funding support for water infrastructure improvements has waned in recent years, forcing many municipalities and water districts to delay projects in anticipation of future increases in government funds rather than tapping the capital markets. However, given the current austere fiscal climate in Washington DC, many water infrastructure projects are likely to end up delayed for years to come. A few municipalities, however, have opted for public-private partnerships (PPPs), usually involving capital-intensive projects costing more than \$100 million; but these arrangements remain the exception rather than the rule.

Aging infrastructure

The need to update and replace aging infrastructure remains one of the greatest challenges facing the water industry. Cap-ex spending for water and wastewater projects is expected to grow from about \$33 billion in 2013 to \$40 billion in 2018, with most of the growth back-loaded into 2017-18. (See *Figure 1.*) Looking ahead to 2035, cost estimates for needed system improvements range from hundreds of billions to trillions of dollars.

Going forward, many water utilities will be focused primarily on lining up funding for this massive investment in water and wastewater infrastructure. Municipal bonds will continue to be the main source of capital financing in the water sector. According to a tally by Thomson Reuters, tax-exempt municipal debt issued for water and sewer projects across the country topped \$39 billion in 2012, far exceeding the annual average of \$25 billion between 2003 and 2011. However, given the current unusually high state and municipal deficits, the ability of municipal managers to issue large sums of new debt will be put to the test in coming years.

The current tight fiscal climate has also reduced federal funding of rural water supply projects across the country. For example, the U.S. Bureau of Reclamation set aside \$40 million in the 2014 Water and Related Resources budget for rural water projects. Approximately 45 percent of rural water funds will go to tribal projects, and what remains will be dispersed among five existing water system projects.