Water Utility Capital Financing

Fourth Edition
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The American Water Works Association (AWWA) recognizes that customers’ and the general public’s interests are best served through well-maintained and efficiently operated water systems that are sufficiently funded to meet a utility’s annual operating and capital needs. In support of this position, AWWA has published and regularly updated the M29 manual, now titled *Water Utility Capital Financing*, to assist utility management and stakeholders address the capital financing needs of their water systems. The terminology used in this manual is applicable to the United States and Canada; the manual does not attempt to identify practices and terminologies used in the myriad other countries with public utilities. It is likely that many countries outside the United States and Canada have financial instruments and government-sponsored programs that resemble those that are referenced in this manual. The financial management strategies presented herein are seen by AWWA as universal and thus valuable to all who make use of this document to guide their programs and decisions.

The financial operations of many water utilities are continually challenged by a variety of factors, such as adverse weather conditions, inflation, changes in the economy and/or political environment, growth or decline in service demand due to new construction, conservation programs, changes in environmental regulations, backlog of infrastructure repairs and improvements, staff turnover, and above all, public pressure to keep water rates low. Regardless of such challenges, water utilities remain very capital-intensive businesses. Despite the growing maintenance needs of aging water systems, many water utilities elect to postpone repairs, replacements, and rehabilitation expenditures to keep current operating costs, and corresponding service charges, as low as possible. However, deferring capital expenditures invariably results in higher operating costs in the short run and higher construction costs in the future.

Strategic planning helps utility management develop the steps necessary to reach the utility’s short- and long-term goals and objectives. A strategic financial plan helps management meet the utility’s operating and capital financing needs during a specified period. Similarly, strategic capital planning, while consistent with and supported by the strategic financial plan, addresses the utility’s smaller recurring capital needs as well as its long-term expansion, upgrade, replacement, and reliability needs.

Strategic financial and capital plans also provide a platform for communicating the utility’s needs to the public, thereby gaining greater stakeholder confidence in utility management. The plans inform investors of a utility’s potential and support rating agencies’ debt ratings. Whatever a particular water utility’s capital requirements may be, knowledge
of available alternatives for obtaining funding is a key element in developing successful financing plans. Some financing alternatives come into, or are phased out of, current practice with changes in federal tax law and market conditions. Thus, an effective capital financing program should contain a variety of fundamental approaches to financing infrastructure that create a systematic means of addressing the utility’s needs over time. One resource that should not be overlooked is the utility’s financial advisor, who is often able to propose current financing alternatives that may provide greater benefit to the utility than originally envisioned in a utility’s financing plan.

PURPOSE

This manual provides a comprehensive overview of best management financing practices that water utility management should evaluate when determining short- and long-term strategies for meeting capital requirements. Only by thorough analysis of a particular water utility’s long-term capital requirements and financial position will utility management be able to determine the feasibility of one or more specific financing concepts.

This manual is not intended to be, nor should it be considered, a complete text on water utility capital-financing concepts. A variety of other sources are available through various industry and professional organizations. Instead, this manual should primarily be considered a guide for determining capital requirements, strategic planning, and financing alternatives. It also provides general information for those utilities considering the issuance of long-term debt. Each of these areas is critical to the capital planning and financing process but must be tailored to and reflect factors applicable to a local situation. No recommendations or opinions about the relevance of alternative forms of available financing have been provided. Determining the relevance of alternative financing options is considered to be the prerogative of utility management.

ORGANIZATION

The material presented in this manual is intended for use by both government-owned and investor-owned water utilities. Because financing alternatives and markets may differ for these two primary types of ownership, financing alternatives for each are discussed in separate places throughout this manual.

This manual covers six general areas:

1. The capital and financial planning process
2. Identification of financing alternatives
3. Evaluation of financing alternatives
4. The process of taking a debt issue to market
5. Participants’ roles in the debt issuance process
6. Special considerations for investor-owned utilities

Information presented in this manual has certain limitations. Water utility capital requirements continually change, as do financial sources available to the utility. At any given time, financing alternatives available to a utility depend on:

- Tax laws and Internal Revenue Service rules and regulations
- Interest rates charged for various financing alternatives
• A utility’s credit rating
• Decisions by governing bodies, by regulatory agencies, and in some instances, by investors, ratepayers, and/or voters

Appendix A provides a summary of capital project prioritization using asset management principles. Appendix B provides example financial plans based on various capital financing scenarios. Appendix C provides information regarding the general requirements of bond-rating agencies, which is particularly useful as a utility considers the use of long-term debt and begins the process of going to the financial markets. The glossary provides terms commonly used by the financial community and is a continuing step toward establishing uniform definitions.

AWWA advocates that specific financing requirements for any particular water utility be based on sound economic, financial, accounting, and engineering principles. Often the services of consultants and counselors experienced in such matters are required. When such advisors are employed, this document should serve as a resource that the policymakers and utility managers may draw on to guide their evaluations of the validity of any proposed financing alternative.

Several other AWWA manuals and books address financial management topics that may interest the reader are identified throughout the text and in the reference and bibliography sections.