

# Funding Infrastr

## The Challenge of Utility Infrastructure Funding and Financing

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The United States water and wastewater industry has billions of dollars of deferred maintenance. The major reason for this is insufficient investment in the maintenance of existing infrastructure stemming from a lack of comprehensive planning and inadequate funding.

Proactively planning for infrastructure funding provides the opportunity for a utility to consider all viable options. It also provides the opportunity for transition in both capital infrastructure planning and in financing and rates. The following are some key areas that utilities must focus on.

### Adopt a Long-Term Capital

**Improvement Plan.** Moving forward proactively begins with the development

and adoption of a comprehensive plan or a long-term capital improvement plan. This provides a systematic framework for assessing capital infrastructure needs and a “road map” of needed investments (see next page). The capital improvement plan lists projects, costs, timing, and potential funding sources. More importantly, by creating and formally adopting such a plan, the utility will have begun the

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process of prioritizing needs, which can then be reviewed in the context of the utility’s financial planning/rate model.

### Establish Written Financial Policies.

A written financial policy that addresses and sets target goals around issues such as minimum annual funding levels for rate-financed capital improvements, debt funding of capital infrastructure, minimum capital improvement reserve levels, and target debt service coverage ratios is a valuable management and policy tool that few utilities have. Developing such policies will provide the management team with clear direction on minimum annual funding levels. These become critical input to the financial planning/rate setting process.

### Conduct a Comprehensive Rate Study.

Revenues are the primary funding source for capital infrastructure. A comprehensive rate study provides a rational financial framework for policy-maker decisions related to additional long-term borrowing and rate adjustments. A cash-basis revenue requirement analysis can be used to determine means to adequately fund both operation and maintenance expenses and capital infrastructure.

Capital infrastructure is paid through a combination of long-term borrowing and rate-funded capital. The critical funding component within the cash-basis revenue requirement is cash-financed capital improvements. At a minimum, the utility should fund an amount greater than or equal to its annual depreciation expense.

**Develop a Transition Plan.** The current underfunding of rates and huge backlog of projects did not happen overnight, nor can these problems be solved overnight. However, many utilities have water and wastewater rates that may be 20 to 50 percent below adequate funding levels. When deferred maintenance of capital infrastructure is included, the picture is even worse. A financial/rate transition plan that adjusts rates over a three- to five-year period allows the utility to gradually phase in higher rates and meet the financial needs of the utility.

### Consider Customer Impacts and

**Affordability.** The impact of any rate increase on low-income and fixed-income customers is of concern. Utility management must work with policy-makers to explore options to minimize impacts to this segment of the customer base. Concurrently, the utility should review affordability measures. One such measure uses 1.5 percent of median household income (MHI) to determine the affordability level for a utility. Annual bills greater than 1.5 percent of the MHI are considered unaffordable. Utilities with “unaffordable” rates may have access to sources of financing not normally available to utilities with “affordable” rates.

While there are no simple or easy solutions to the infrastructure funding dilemma, the time to start developing a prudent and rational financial/rate plan is now.

Contact Tom Gould at 425-450-6200.

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