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Who Will Pay the Water Bill?

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No question about it. Present population and economic growth in Texas mean increasing demands for water in the state. But the big question remains: Who will pay for the development necessary to meet these water demands?

Financing future water resources and water quality projects in Texas was a major topic for the 1982 Water for Texas Conference sponsored by the Texas Water Resources Institute on the Texas A&M University campus in November 1982. Bankers, lawyers, economists, politicians, and water resources planners participating in the conference all agreed that the State of Texas would have to play a larger role in water resources financing in the future.

"Historically, local water users and local taxpayers have paid the lion's share of the bill for water supply and sewage treatment," said Alan Henry, immediate past president of the Texas Municipal League (TML). Local governments have, in fact, customarily paid more than 80 percent of the bill, with the balance made up by federal and state government.

"Since the federal share is certain to decrease in the future, the load borne by the cities and regional authorities will have to increase proportionately," Henry told participants at the conference. Many local governments, he pointed out, will need financial help from the state to fill the void left by decreased federal funds.

The Texas Municipal League, Henry said, does not recommend shifting the financial burden for water resources from local governments to the state but recommends that the state help local governments finance water-related facilities. One program the TML will recommend to the 68th Legislature is that voters in a specific region should be allowed to impose a water surcharge on themselves to finance regional water supply systems or other projects such as water importation facilities. A few pennies per month per water user, said Henry, could be leveraged into hundreds of millions of dollars over a period of time to solve a water resources problem of a particular area.

The Texas Municipal League, which boasts a membership representing 850 city governments in Texas, also recommends a statewide financing plan designed to alleviate the long-term cost of meeting the water resources requirements of cities and other local governments. Louis A. Beecherl, Jr., chairman of the Texas Water Development Board and the Governor's Task Force on Water Resources Use and Conservation, told conference participants: "Texas' growing population and expanding economy require new sources of financing to help cities and water authorities to meet the need for water before crises occur."

Demographers estimate that by the year 2000 Texas population will be half again as large as it is today. "Frankly, as we exist today," said Beecherl, "we don't have the water to serve that size of population, much less the demands on water that will be presented to us in trying to develop an economy that will maintain that many people."

He used figures from a recent review by the Texas Department of Water Resources of all reservoir projects, conveyance systems, water treatment plants, and wastewater treatment plants needed in the state by the year 2005. The survey estimates that $39.1 billion will be needed to meet water development requirements in the next 22 years. This figure, based on eight percent inflation rate, includes a whopping $20 billion for wastewater treatment facilities. Beecherl explained that in the next 22 years, because of increased population and more stringent regulations, over 2,000 Texas wastewater treatment plants will have to be built or rebuilt. He said that presently 500 sewer systems are out of compliance in the state.

Reservoir construction will use $11.5 billion of the $39.1 billion total with the remaining $7.1 billion going for water conveyance, water treatment, and well fields. Beecherl expects the state, through loans or loan guarantees, to assist in almost half of these costs.

According to Beecherl, federal participation in practically all phases of the water program is decreasing. Federal funding is being withdrawn not only from financing of water development projects and water quality enhancement projects, but also from operational funds for carrying out the programs established by federal laws.

Beecherl reported that the Texas 2000 Commission, which was established by Governor Clements in 1981 to identify key issues for Texas' future, identified water as a major determinant in the state's future. The commission recommended that the state develop a water plan as soon as possible and that a financing strategy be adopted to implement the plan. Past financial assistance to water projects by the state, according to State Senator Ed Howard, has been minimal considering the importance of water to our survival and growth. Federal assistance has been of far greater significance, he said, but reductions are sure to come in the immediate future leaving a substantial void which local governments will be unable to fill without help from the state. During the Water for Texas Conference, Howard reviewed existing state programs designed to help local governments finance water projects.

The Water Development Fund (WDF), created in 1957 and increased three times by voters since then, now has authorization to issue up to $600 million worth of bonds. Of the $600 million authorized, $400 million is for construction of water projects (primarily dams and reservoirs) and water supply systems, and $200 million is for water quality enhancement purposes (primarily sewage disposal facilities).

Only those entities which cannot finance a project through sale of bonds in commercial channels at reasonable rates of interest can qualify for the funds. The lending rate for these "hardship cases" is set by statute and is approximately one-half percent more than the cost of the state's money at the particular time the loan is made.

Primary source for repayment of the principal and interest on these bonds is the income from loans made by the TDWR to local political subdivisions.

The constitution, however, provides that at the beginning of the fiscal year, if there is not enough money in the interest and sinking fund for the Water Development Fund to pay principal and interest coming due on those bonds in the forthcoming fiscal year, then the first revenues coming into the state treasury in that fiscal year from any source will be used to supplement the fund until there is sufficient money to provide for that year's principal and interest requirements. Because of this pledge of the state to pay, the State of Texas has in the past obtained a "triple A" bond rating on its water development bonds.

To date, approximately $250 million of the $400 million authorized bonding capacity has been issued. One-half of the $200 million authorized for water quality enhancement purposes has been issued. An interest ceiling of six percent on the bonds has kept the remainder from being issued, but a constitutional amendment approved by the voters in November 1982 authorized raising the ceiling limitation to twelve percent. Total draw on the general revenue has been $62.7 million since 1967. There have been no draws since 1980.

Another state program, created in 1981 and called the Water Assistance Fund, extends state assistance for water related projects. The criteria established for this fund of $40 million is similar to that of the Water Development Fund, that of "hardship" or the inability of a local subdivision to sell bonds for a reasonable rate through commercial channels. Loans totaling $25 million have been given through the Water Assistance Fund.

This fund was the first state water funding program to be approved by the Legislature rather than through constitutional amendment. The Legislature, at its option, may remove uncommitted funds from this account for other state purposes. "We need to think through the question of why we need to have a water resources finance program at all," Don Howell, a partner in the Houston law firm of Vinson and Elkins, told the Water for Texas Conference participants.

Texas does not need state financing to provide cheap water, said Howell. "I think that our recent national experience with the price of energy, particularly oil and electricity, shows that we do not need a subsidized price of water that will artificially stimulate demand and discourage conservation."

Howell believes that a market price of water can be afforded and can be paid, but he did cite the following reasons why the state should have a water finance program.

1. Capital markets simply do not function well with major water reservoir projects. Water reservoir projects and the attendant raw water conveyance, pumping, and storage systems are large, very capital intensive, projects that produce enormous and generally unmanageable bulges into the capital requirements of an urban area.

This bulge in capital requirements strains the credibility of the market place and creates insecurity. When capital markets feel insecure, they express this insecurity by high interest rates or simply by not providing a market at all.

2. Water projects come along irregularly in the life of an urban area, sometimes as far apart as 50 to 100 years. An unusually large number of water projects are designed for a future need. Except in a case of replacing an existing water supply because of subsidence or similar situation, any water reservoir project of necessity is a supply for the future.

3. Water projects are unpredictable as to cost and construction time. Uncertainties such as interest rate changes and environmental constraints during construction make the bond market insecure at best.

4. In view of the limited number of sites still available for water storage projects, it is important that each site be developed to its optimum capacity. State assistance should be available for that purpose.

Howell sees the state's role as an interim lender, a construction lender, to see a project through to completion. The state would provide the money to fund the project without regard to changes in land costs, interruptions of construction, or changes in interest rates.

He points out that 50-year financing is almost unheard of in the commercial bond markets. "We have had 50-year financing from the Corps of Engineers and the Bureau of Reclamation in the past. I think the absence of that kind of long-term finance is a clear impediment to our ability to fairly share the burdens and benefits of water resource projects."

One type of financing Howell would like to see the State consider is a 50-year bond requiring refinancing at the end of 25 years.

According to Howell, a bond attorney in Houston, the task of selling Texas voters, particularly in urban areas, on financing future water development for the state may be tougher than the actual engineering of water projects. Howell reminded conference participants that Texas voters have rejected state financing schemes three times in the past 13 years.

"One thing is clear," said Josiah Wheat, who chaired the finance subcommittee for the Governor's Task Force on Water Resources Use and Conservation. "Very large investments and a wide range of water projects are going to be needed within the next two decades, and the sources of funding now available are inadequate to meet these needs."

Wheat's committee assignment included identification of as many alternative approaches to financing the construction of the water related projects as possible. The committee was also asked to recommend those programs which appeared most practical and most likely to meet the approval of the Legislature and the voters in the state.

Wheat, a Woodville lawyer, told the conference his committee found that the existing financial assistance the state provides to local subdivisions has worked extremely well. The finance committee recommended that the Water Development Fund be continued and that the Legislature offer a constitutional amendment to the voters which would authorize an additional $250 million in bonding capacity. The committee stipulated that this program should be entirely self-sufficient with no drain whatsoever on the state general fund.

Wheat reported that the committee did recommend one additional form of financial assistance to local and regional entities. The committee concluded that a water bond insurance program should be created by the Legislature. The funds held in this account would guarantee the repayment of water-related bonds, thus further strengthening the credit rating of the bonds.

The committee left two big unanswered questions for the state legislators and voters, according to Wheat:

- 1. Should the funds in the insurance account be appropriated by the Legislature or should they be raised through the sale of state bonds pursuant to a constitutional amendment approved by the voters?
- 2. Should this account be used to guarantee state bonds or should the program be used to guarantee directly the payment of such state and local bonds?

The committee headed by Wheat also recommended that the Texas Legislature appropriate additional money for the Water Assistance Fund and for the optimum development of the remaining sites in the state suitable for reservoir construction. Keynoting the conference, State Senator Grant Jones emphasized that because the federal government is pulling out water development financing, state and local governments must play a much greater role in water planning and development. "What we have gone through in the name of the energy crisis was absolutely nothing," warned Jones, "compared to what we have as a potential crisis if we don't recognize and meet the needs for our state's water in years to come."