Comments of the
Association of California Water Agencies
to the
U.S. Senate Finance Committee
Tax Working Groups on
Community Development & Infrastructure
(Submitted April 15, 2015)

As California continues to suffer from record drought conditions, the Association of California Water Agencies (ACWA) believes congress should reject proposals to limit municipal bond financing. ACWA is a statewide alliance of public water agencies. ACWA's 430 public water agency members supply over 90 percent of the water delivered in California for residential, agricultural, and industrial uses.

Background: State and local governments have issued municipal bonds for centuries. Initially, these were issued as revenue bonds—repayment of which is tied to the revenue to be generated by the project—and used to finance a wide variety of activities. The first recorded general obligation bond—repayment of which is backed by a "general obligation" of the issuer—was issued in 1812 by New York City to finance a canal. Today, there are $3.7 trillion in municipal bonds outstanding, with nearly $400 billion in issuances every year.

Benefits to California Water Districts: California Water Districts use municipal bonds to finance the construction of the majority of their core infrastructure, particularly when it comes to local water and sewer projects. In 2012 alone, California issued over $12 billion in municipal bonds just to finance water and sewer projects.

The Problem with Proposed Changes: Interest paid on a municipal bond is generally exempt from federal income tax (just as interest paid on Treasury bonds is exempt from state and local tax). This tax-exempt status makes municipal bonds a very attractive investment vehicle to private investors. As of 2012, individuals/households held 45.2% of municipal, with another 26% held by mutual funds and money market funds. Were these bonds to lose their tax-exempt status, many of these investors would flee to other investments. Moreover, those who remained would require a significantly higher yield to take on a larger amount of the municipal bond supply. This decrease in demand would significantly increase the costs for California water and sewer agencies, costs that would inevitably be passed down to ratepayers. Raising costs during times of record drought will only decrease water districts ability to manage the water crisis in California.

Conclusion: California's water districts have issued municipal bonds to help build water systems for the state's communities and our economy. While we understand and are sympathetic to the fiscal realities that have led to tax reform municipal bond proposals, ACWA does not believe that endangering a critical source of water infrastructure financing is the right way to fix the federal deficit.