

# SCALING UP PUBLIC INVESTMENT IN LOCALIZED WATER STRATEGIES

HOW CAN UTILITIES CAPITALIZE SPENDING ON CONSUMER REBATES?  
FREQUENTLY ASKED QUESTIONS

## WHAT IS LOCALIZED INFRASTRUCTURE?

Green roofs, permeable pavements, water-efficient appliances and landscaping are all examples of “localized” water infrastructure distributed across homes, businesses, and public spaces. These strategies work in concert with and supplement conventional water systems but are often more affordable and flexible than centralized alternatives. At scale, they are highly effective and perform the same functions as centralized approaches – expanding supply, safeguarding water quality, protecting ecosystems, and managing urban runoff.

## HOW CAN UTILITIES CAPITALIZE SPENDING ON LOCALIZED STRATEGIES?

For many water agencies, the challenge to scaling up localized infrastructure projects is how to pay for them. Consumer incentives for onsite and distributed water solutions, while providing real benefits to utilities, do not produce traditional assets for accounting purposes. So public utilities generally fund these programs out of annual operating cash, rather than bond proceeds. This limits the scale and impact of these strategies. But these programs provide lasting, multi-year benefits and so are not properly accounted for as annual expenses either.

This FAQ addresses some of the questions public utilities face when considering whether and how to shift to municipal bond revenue, or other forms of public debt, to finance localized, distributed strategies. As detailed in WaterNow’s TiR Toolkit ([tapin.waternow.org/toolkit](http://tapin.waternow.org/toolkit)), in most cases, the answers to the questions outlined below demonstrate that what may seem like barriers to increased investments in distributed infrastructure can, indeed, be readily addressed.

## DOESN'T MY UTILITY NEED TO CONTROL AN ASSET BEFORE WE CAN CAPITALIZE THE COST?

- ✓ Not always – this is the basic difference between GASB Concept 4 and GASB Statement 62.

Standard accounting for public entities is generally done in conformity with Governmental Accounting Standards Board (GASB) Concept 4 which reflects the GAAP rule that only assets controlled by the entity can be financed with debt, i.e., capitalized.

However, in 2010 GASB issued Statement 62, which establishes an alternative to Concept 4 for expenditures on “business type activities” that are not annual

expenses but also do not produce conventional assets. GASB Statement 62 authorizes public agencies to book these expenditures as “regulatory assets” that can be capitalized (see below). Statement 62 accounting does not require that the utility own or control the asset in order to capitalize the cost; the asset is the binding promise to repay the loan, not the items procured or produced with the loan.

### **BUT DOES STATEMENT 62 APPLY TO WATER UTILITY REBATE PROGRAMS?**

- ✓ YES. In May 2018, GASB issued technical guidance specifically linking Statement 62 to rebates issued by public water utilities.

The new guidance makes it clear that the regulated assets approach is available to any public water resource entity seeking to access capital for consumer rebate programs of any kind as long as the Statement 62 requirements are met.

### **HOW DO I KNOW IF MY PROPOSED SPENDING IS ELIGIBLE FOR STATEMENT 62 ACCOUNTING?**

Statement 62 has only three requirements, and they apply to virtually all public entities:

- ✓ Your agency has a governing Board or regulator empowered to set rates.
- ✓ Your Board can set rates to pay for the cost of the programs you want to finance (as for ordinary capital spending).
- ✓ Your Board can commit to setting rates in the future to pay for the cost of these programs (as for ordinary capital spending).

If you answer satisfy all three, you qualify for the Statement 62 alternative accounting approach. It does not matter that the spending will not result in an asset controlled by the utility; again, the asset is the promise of the relevant Board to set rates sufficient to repay the investors. You can read more about Statement 62 accounting here:

<https://bit.ly/34zF3Bb>.

### **DON'T MY UTILITY'S EXISTING BOND COVENANTS REQUIRE THAT PROCEEDS BE USED TO PAY FOR ASSETS MY UTILITY WILL OWN?**

- ✓ Not usually. Bond covenants are more typically focused on ensuring that spending will benefit a public purpose.

Most public utilities have existing outstanding debt, and bond issuance documents have additional bonds tests or covenants. While they may not expressly provide for spending on localized water solutions, existing bond covenants are often sufficiently flexible to allow for spending, even on private property. For example, bond covenants may include language that allows financing for improvements:

- ✓ of a “public nature” or
- ✓ that “benefit the system”

To determine whether bond documents allow the use of debt for spending on assets that are not owned by the entity, bond counsel will need to review covenants and related documents. You can learn more about navigating existing debt requirements here: <https://bit.ly/38OFZoG>.

## WON'T MY PUBLIC UTILITY'S INVESTMENTS IN PRIVATE PROPERTY RUN AFOUL OF STATE AND LOCAL LAWS?

- ✓ No. Most public entities have the legal authority to spend their funds on private land subject to certain conditions.

Every public utility's legal authority to spend ratepayer dollars is derived from either the state constitution, state statute, local ordinance, or some other enabling legislation. Many of these laws provide public utilities with broad authority to finance programs that benefit the utility and the public it serves even if the projects are not owned or controlled by the utility. For example, if your utility's authorizing legislation allows the utility to issue bonds:

- ✓ to improve water facilities for any lawful purpose
- ✓ for improvements of a public nature
- ✓ or a similar type of project

then your utility should have legal authority to debt-finance localized infrastructure. For example, the San Francisco City Charter allows the SFPUC to "issue revenue bonds ... for any [] lawful purpose of the water, clean water, or power utilities of the City... ." The Pennsylvania Revenue Bond Act allows cities to issue revenue bonds for "projects," meaning "...improvements of a public nature... ."

## WOULD LARGE-SCALE REBATES VIOLATE MY STATE'S CONSTITUTIONAL GIFT PROHIBITION?

- ✓ No. Most states have established exceptions to their gift clauses for grants of public funds to private parties that have a primarily public purpose.

Most state constitutions contain provisions, referred to as "gift prohibitions," limiting the ability of government entities to grant, donate, or gift assets or anything of value to private individuals, associations, or corporations. Nearly all states, however, have interpreted their gift clauses to allow the use of public funds for private improvements *if the investment serves a public purpose or provides a public benefit*. For example, Pennsylvania courts have determined that the State Constitution allows cities to use public funds for investments that benefit private companies, corporations, and associations so long as:

- ✓ the transactions also serve a public purpose and
- ✓ are otherwise lawful

WaterNow has developed a 50-state database covering these exceptions available here: <https://bit.ly/34Dq3Cn>.

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## WOULD USING BOND PROCEEDS FOR REBATES TO PRIVATE PARTIES TRIGGER THE “PRIVATE ACTIVITY” TEST FOR TAX-EXEMPT BONDS?

- ✓ Not necessarily. Municipal bonds can be easily structured to provide funds for localized water projects within the rules for tax-exempt bonds.

Ensuring that municipal bond issuances qualify as tax-free is a priority for many utilities for various reasons. A key requirement is that no more than 10% of the bond proceeds are “used in a private trade or business.” Thus, as a preliminary matter, incentives for residences would rarely (if ever) raise a concern with this requirement, as homeowners are not engaged in “private trade or business.”

Further, this rule applies to the entire proceeds of a bond issue. Thus, any bond including provisions for spending on localized water infrastructure of various kinds could be structured to address private trade or business concerns by including funding for distributed infrastructure incentives for businesses in a larger bond for financing of these systems on public properties as well as more conventional infrastructure. For example, a \$15 million program that offers incentives to businesses to install water conservation or stormwater management measures financed as part of a \$200 million revenue bond that also finances other improvements to the utility’s centralized water infrastructure would likely qualify as a tax-exempt governmental bond.

You can find additional details on issuing tax-exempt bonds infrastructure here:

<https://bit.ly/2sLUE3m>.

## ADDITIONAL INFORMATION

For more information about how to address common tax, accounting, legal, and other implementing questions when considering debt-financing localized infrastructure, go to WaterNow’s Tap into Resilience Toolkit at: [tapin.waternow.org/toolkit](http://tapin.waternow.org/toolkit).

You can also get community-specific answers by connecting with the TiR Experts through the Ask an Expert portal here:

<https://bit.ly/2Q6div7>.

Please contact WaterNow’s Water Policy Director Caroline Koch at [cak@waternow.org](mailto:cak@waternow.org) or 415-360-2999 with any questions.