Written Testimony by

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addressing

"Municipal Bond Turmoil: Impact on Cities, Towns and States."

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Chairman Frank, Ranking Member Bachus, and Honorable Members of the Committee, my name is Terry Dillon. I am the owner of Atlas Excavating Inc. in West Lafayette, Indiana. We have 150 employees who work on sewer and water construction and highway and road reconstruction projects throughout the state.

I appreciate the opportunity to participate in this hearing regarding the turmoil in the municipal bond market on behalf of the National Utility Contractors Association (NUCA). NUCA is a family of more than 1,750 companies from across the nation that build, repair and maintain underground water, wastewater, gas, electric, and telecommunications systems.

The current municipal bond market is indeed in trouble, and every day the "ripple effect" is taking its toll on a wide variety of public works projects, including those intended to improve the nation's dilapidated underground water systems and wastewater treatment facilities. I'm here today to describe the needs facing America's underground environmental infrastructure and what is at stake when projects to repair and rebuild it are put in jeopardy, as well as address the role played by the bond market in this situation.

America's Decrepit Environmental Infrastructure

NUCA has the privilege of testifying regularly before Congress on the state of America's water and wastewater infrastructure. Our testimony comes from the unique perspective of those who work on our underground infrastructure systems every day and see firsthand what it looks like when they fail. In brief, the view from the trenches isn't pretty.

Utility contractors build and repair America's unglamorous but vital water and wastewater infrastructure. What is out of sight and out of mind to most people is clearly visible to NUCA members every day. We routinely uncover rotting pipes with gaping holes that spill raw sewage into the surrounding ground of residential neighborhoods. This leakage can go undetected for months, even years in some cases. To make matters worse, these conditions are often within yards of waterways where we fish, beaches where we swim, and playgrounds where our children play.

The need to fund projects for the nation's water and wastewater infrastructure is clear. The U.S. Environmental Protection Agency's (EPA) 2002 *Clean Water and Drinking Water Infrastructure Gap Analysis* found that there will be a $534 billion gap between current spending and projected needs for water and wastewater infrastructure in 2019 if investment is not stepped up. Furthermore, EPA's 2004 *Clean Watersheds Needs Survey* documents America's existing wastewater infrastructure needs at $202.5 billion. That is not a projection. That number reflects a snapshot of documented wastewater needs in 2004.

NUCA serves as chair of the Clean Water Council (CWC), a coalition of some 34 national organizations representing underground construction contractors, design professionals, manufacturers and suppliers, labor representatives and others committed to ensuring a high quality of life through sound environmental infrastructure. These industries work collectively to improve critical underground systems that unquestionably enhance America's quality of life. For your reference, a list of CWC members is attached to this testimony.

An active member of the CWC, the American Society of Civil Engineers (ASCE) evaluates the nation's infrastructure and reports on the status of it every few years. For the past several years, America's wastewater infrastructure has been graded a "D minus" in the ASCE's *2005 Report*

Card for America's Infrastructure. Clearly, there is a consensus among both government and industry professionals that the state of this infrastructure is quickly going from bad to worse. Meanwhile, federal resources to address this quandary are plummeting every year.

The SRF Program and Use of Bonds

The 1987 amendments to the Clean Water Act (CWA) fundamentally changed the way the federal government provides financial assistance for water pollution control facilities by replacing the construction grants program with the Clean Water State Revolving Fund (SRF) program. Controlled and operated by the states, the SRF program provides loans and other financial assistance for water pollution control projects. The Drinking Water SRF was subsequently implemented for similar projects relating to infrastructure improvements for drinking water systems.

In general, SRF loans work in perpetuity over time, providing necessary resources for public projects that promote public health, protect the environment, create scores of high-paying American jobs, expand the local tax base and enhance our overall quality of life. The revolving nature of the program has made it an extremely successful federal financing program, and has been the primary reason for its continued funding through annual appropriations, despite the fact that SRF authorization expired in 1994. Nationally, interest rates for SRF loans average at approximately 2.5 percent compared with substantially higher market rates, and provide flexible repayment terms up to 20 years.

Here is where bonds enter the picture. Under the SRF structure, states are required to provide at least 20 percent of the federal capitalization grant in state matching funds. In order to provide states as much flexibility as possible in designing SRF programs, the Clean Water Act allows states to provide the match from a variety of sources. Match payments may be cash deposits made directly from state accounts or may come from proceeds of SRF bonds that are repaid with SRF interest earnings. In fact, the use of bonds as the source of state match has become very popular. Additionally, several states also use bonds to “leverage” SRF earnings in order to make the most of their federal resources.

Impacts of Turmoil in the Bond Market

NUCA and the CWC have taken the lead for years in advancing a host of legislative efforts to begin to address the skyrocketing water/wastewater infrastructure needs facing our nation. Our focus in recent years has been on increasing annual appropriations for the SRF programs and on reauthorizing them at significantly higher funding levels. Unfortunately, traditional annual funding of $1.35 billion for the Clean Water SRF has been significantly cut in recent years, and the program is facing a $555 million appropriation level in FY2009, reflecting more than a 50 percent cut at a time when the nation simply cannot afford it. The recent uncertainty in the municipal bond market only exacerbates an already enormous problem.

As noted previously, SRF projects are funded in large part by municipal bonds, which provide local governments with needed resources for a variety of projects, including water, wastewater, and surface transportation infrastructure improvements. Traditionally, they have been one of the safest choices of lending in the public market. Once issued, these bonds are traded on the market with the benefit of being tax free, at least with regard to federal taxes. The problem today is that the corporations that have insured municipal bonds have been caught up in the problems associated with subprime mortgages. This has caused them to lose top-tier credit ratings. Unfortunately, municipalities often depend on these firms to ensure a quality credit rating for their bonds, which in turn allows them to borrow at more affordable rates when looking to fund infrastructure projects. However, because their bond rating depends on the rating of their insurer, local governments are avoiding firms whose credit rating has been called into question.

In some cases, local governments have opted to skip insurance altogether, which creates yet another set of costly problems. Without quality insurance, local governments are forced to pay higher interest rates in order to attract investors rather than work with troubled bond insurers. Last month, for example, only $5.4 billion (27 percent) of the $20 billion in issued municipal bonds was covered by financial underwriters. All of these problems are especially hard on smaller towns and cities like those in my State of Indiana.

Overlooked Economic Benefits of Infrastructure Rehabilitation Projects

Although underground infrastructure rehabilitation projects are recognized for their success in enhancing public health and environmental protection, the *economic* benefits that result from this work is often overlooked. Clean water projects help maintain a strong economic foundation by creating jobs, expanding the local tax base and ensuring that safe, clean lakes, streams and shorelines will be available for our children, grandchildren and generations to come.

Clean water goes hand-in-hand with a healthy economy. According to the American Public Works Association, more than 40,000 jobs are created with every $1 billion invested in funding for this infrastructure. These are quality, high-paying jobs in both the short and long term. Importantly, the job creation and increased economic activity that comes with it enhances local economies and opportunities for disadvantaged communities to revitalize and empower themselves.

It is important to highlight three important types of economic impacts that are associated with water and wastewater infrastructure projects. There are:

- <u>direct</u> impacts through job creation and the purchase of materials and supplies related to the operation of the project;

- <u>indirect</u> impacts through jobs and the purchase of materials and supplies by vendors indirectly related to the operation of the project; and

- <u>induced</u> impacts, which are supported by the spending and re-spending of the income earned by workers. (Induced economic impact is often referred to as the “multiplier effect.”)

Another essential point is that the jobs offered in this industry are good, high-paying jobs that are provided right here in America. These are not jobs that can be shipped overseas.

One need look no further than the stakeholders represented in the Clean Water Council to see the direct and indirect jobs that are provided. Contractors and subcontractors, engineers, suppliers and manufacturers, as well as countless construction laborers, all benefit from work that impacts virtually all sectors of our society. And, the economic benefits resulting from these projects don’t stop with the construction industry. Clean water enhances individual productivity through reduced sickness and missed work opportunities, as well as increases community productivity through the influx of new residents and businesses resulting from revitalized neighborhoods.

Conclusion
America's underground water and wastewater infrastructure is in enough trouble already. These systems face hundreds of billions of dollars in existing needs at a time when federal resources are dwindling. And, the gap between what is needed and what is being provided to repair and rebuild this critical infrastructure is growing at a rapid pace. Moreover, federal water quality mandates are promulgated regularly without providing adequate resources to meet them. The current chaos in the municipal bond market only makes a bad situation much worse.

The bottom line facing states and municipalities is this: The mortgage quandary has moved into the world of municipal bonds. It costs more to borrow less. Insurers are losing their credibility, and some local governments are opting out of insurance and paying higher interest rates as a result. Because it is taking money to borrow, the downstream result is less money for badly-needed infrastructure improvements.

The turmoil in the municipal bond market is very real, with the impacts now reaching the public and private sectors, cities and towns, business, labor, and, in the end, all American citizens. Infrastructure needs are going through the roof while the resources to address them are declining. The current uncertainty in the bond market is making matters considerably worse, and is only tightening the stranglehold on America's already struggling economy.

Thank you for the opportunity to submit testimony for the record.