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Fitch: Material ARPA Funds for Water Projects Bolster Utility Credit

Fitch Ratings-Austin/New York-02 March 2022: Allocations under the American Rescue Plan Act (ARPA) to water and sewer utilities will provide a material infusion of cash that will boost capex and improve water supplies and infrastructure resilience, supporting credit quality, Fitch Ratings says. Water, sewer and stormwater projects are set to receive a meaningful amount of the \$350 billion designated for cities and counties under ARPA's State and Local Fiscal Recovery Fund. Water/sewer is the largest subcategory of planned infrastructure spending under ARPA, according to initial reporting from the ARPA Investment Tracker, a partnership of the National League of Cities, the National Association of Counties and Brookings Metro.

Under the Treasury Department's final rule for ARPA published in January, eligible projects include those meeting the Environmental Protection Agency's (EPA) requirements for the Clean Water State Revolving Fund and Drinking Water State Revolving Fund. The rule further expands eligible projects to include culvert repair, removal and replacement of storm sewers and other stormwater infrastructure, dam and reservoir rehabilitation for drinking water supplies, along with lead remediation projects such as testing and lead service line replacement. Governments must commit ARPA funds by 2024 and spend them by 2026.

Federal funds under ARPA, combined with the unprecedented \$55 billion allocated primarily to the state revolving funds under the Infrastructure Investment and Jobs Act, will allow water and sewer utilities to accelerate capital projects to meet critical needs and address maintenance and plant improvements, improving a utility's life-cycle ratio and annual capex/depreciation, which we consider as part of a utility's operating risk profile. Moreover, these funds could also temper rate increases or the need for additional debt to cover capex.

A number of water and sewer utilities have already received sizable ARPA allocations, which are expected to help systems preserve cash and potentially limit additional debt. In Florida, for example, the Okaloosa County water and sewer system received about \$12 million in ARPA funds, which is about 18% of their budgeted capex between fiscals 2021-2025. Roughly 16% of the Polk County utility system's five-year, \$230 million capital improvement plan is supported by ARPA funds. Broward County plans to use \$21.4 million of ARPA funds for a septic tank elimination project, and Palm Beach County has allocated \$75.0 million for various improvements, including septic-to-sewer conversion.

ARPA aid and, in some cases, rate increases will help alleviate pressures on operating margins. Water and sewer utilities face higher operating and capex costs due in part to federal mandates and inflation. Costs associated with per- and polyfluoroalkyl substances (PFAS) remediation and the EPA's Lead and Copper Rule will likely be realized over the next few years. Government construction prices were up 10.5% yoy in January and construction wages rose 3.8% yoy at YE 2021.

According to the ARPA Investment Tracker, 45% of all U.S. large cities and counties with populations of at least 250,000, 152 entities in total, have reported and designated funding for

specific projects. So far, about \$885.6 million has been allocated for water and sewer improvements. Another 185 such entities have not specified projects or have not reported. Smaller cities and counties do not need to report on their uses of ARPA funds until April 30, 2022.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.