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D.C. gets kudos for its approach to infrastructure maintenance

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WASHINGTON – The District of Columbia is taking positive steps to determine the funding needed for maintenance of its critical infrastructure, S&P Global Ratings said.

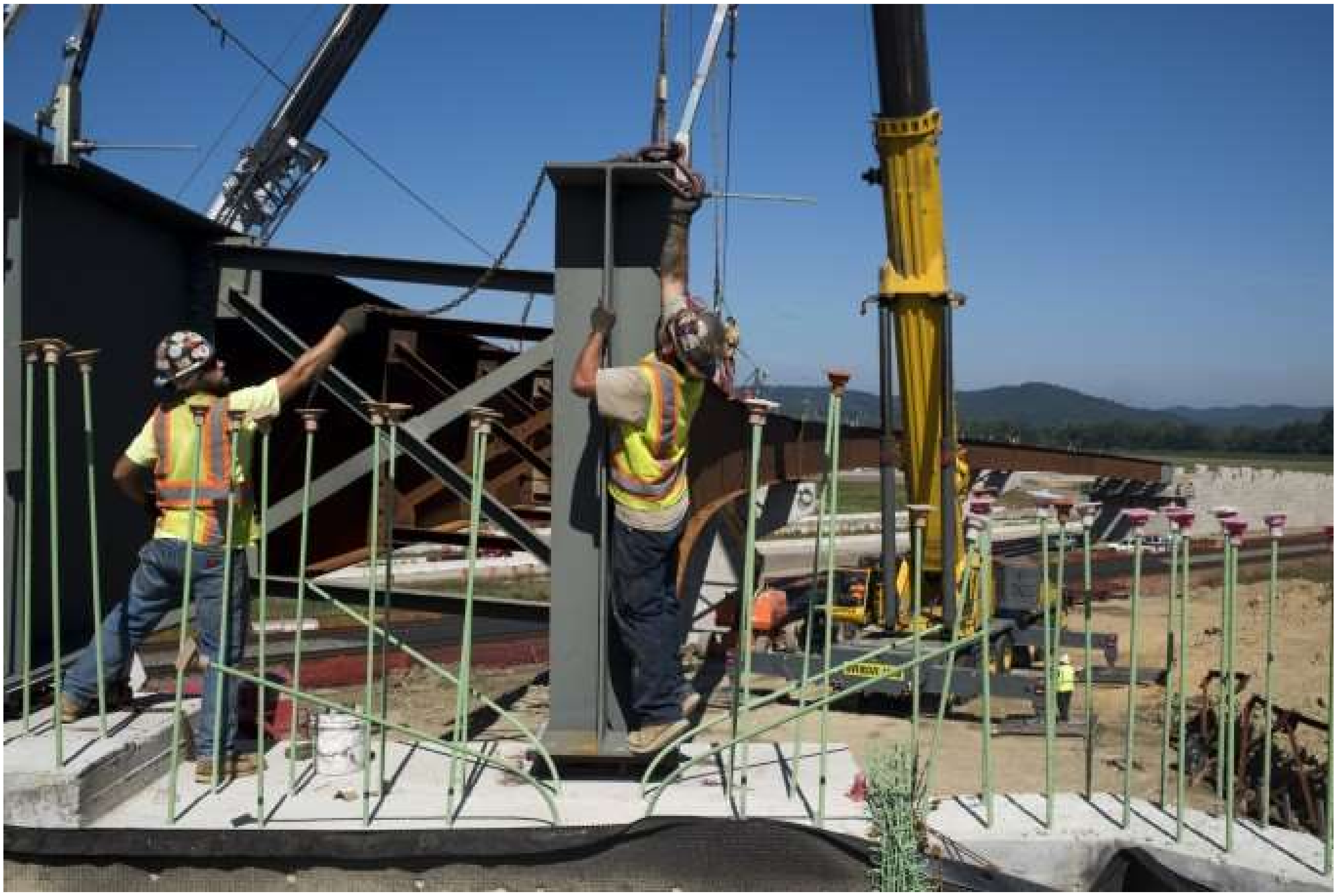
The rating agency recommended in a report released this month that other state and local governments follow the District of Columbia's approach to inventory, assess, prioritize and develop plans to fund deferred maintenance.

The District took the approach in developing its long-range capital financial plan. D.C. finance employees obtained data on: the assets are owned that need to be maintained; the quality of the assets; the priority of the assets for capital needs; and the funding is available to address capital needs and asset maintenance.

The S&P report, "Between A Budget And A Hard Place: The Risks Of Deferring Maintenance For U.S. Infrastructure," warned that state and local governments are deferring maintenance on their critical infrastructure at the risk of hurting their credit ratings.

"At high enough levels, deferred maintenance is a credit concern, and we think this will be an area of increasing focus in our analysis," the rating agency wrote.

"Significant under-spending in maintenance can reduce asset life and increase capital costs, pressuring a government's future financial flexibility," S&P said. "Failure to maintain and invest in infrastructure could also lead to slower economic growth or public safety lapses."



Work on an Ohio transportation project.
Bloomberg News

The issue of deferred maintenance of infrastructure has grown in recent years in part because of the Great Recession and resulting sluggish growth in gross domestic product, as well as the fact that state and local governments have faced increasing fixed obligations including Medicaid, OPEB (other post-employment benefits than pensions, such as health care), debt service, and pension contributions that have crowded out other needs.

This is an important issue for bond investors, who currently hold some $3.7 trillion in U.S. municipal debt outstanding, S&P wrote in the report, adding that an estimated two-thirds of U.S. infrastructure projects are financed by municipal bonds, according to the Municipal Securities Rulemaking Board.

S&P cited California as an example. The state has a strong AA- credit rating on its general obligation (GO) debt, but seven years ago, its A- GO rating was S&P's lowest for any state. Better budget management beginning in 2011 combined with an increase in personal income taxes – which drives much of the state's revenues – led to a gradual recovery in California's credit quality.

"By all accounts this represents a job well done in the annals of municipal finance," S&P wrote. "But this spring when the state issued $2.1 billion in new debt that was snapped up by investors, we cited as a credit weakness the state's infrastructure profile – it has a backlog of deferred maintenance that even the governor's budget summary is calling 'staggering.' "

One key problem is measuring the size and cost of deferred maintenance of infrastructure, according to the report.

"There has been no shortage of studies and statistics that quantify the gap in spending needed for the U.S. to regain its status as a nation with world-class infrastructure," S&P wrote. "But the policy discussion on the woeful condition of U.S. infrastructure often overlooks that much of it is owned and operated by state and local governments."

In addition, there is no consistent approach to measure and report deferred maintenance, according to the report.

According to the Volcker Alliance's November 2017 report, "Truth and Integrity in State Budgeting: What is the Reality." California and Alaska are two states that report deferred infrastructure cost estimates as part of their budget process. All other states were found to be lacking in following best practices for disclosing deferred infrastructure replacement costs, S&P wrote.

Also, while many states disclosed accumulated depreciation as part of their annual reports, their calculation methods differed. Most did not provide the replacement costs estimates required to keep key infrastructure such as roads and buildings in good repair because of the costs of preparing condition assessments.

In Statement 34 released in June 1999, the Governmental Accounting Standards Board called for state and local governments to calculate the original cost of infrastructure constructed or improved during the 20-year period prior to the Statement's issuance date and include it in their annual financial reports. But for capital assets they could report the condition of their infrastructure according to either a modified approach or using depreciation-based reporting under GASB accounting methods.

To take steps to address the issue of deferred maintenance of infrastructure S&P suggested state and local governments begin self-reporting in a standardized way.

"Last month, the Global Projects Center at Stanford University kicked off a research initiative with the Lincoln Institute of Land Policy to start a conversation among policymakers, governments, and the finance community about standardizing deferred maintenance estimating and reporting," the rating agency said the report.

"A standard system to measure and disclose deferred maintenance is likely to underline problems that may need to be resolved through a number of policy solutions, including potentially asset privatization and/or public private partnerships, especially if debt funding requirements grow to unsupportable levels for some states or local governments," S&P wrote.

Better disclosure would give credit rating agencies and municipal bond investors better visibility into the relative ranking of state and local governments' deferred maintenance levels, S&P said, but added that this will take time to achieve.

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