

Environmental Improvement Fund

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May 12, 2015

Joint Committee on Finance

Paper #280

Safe Drinking Water Loan Program Bonding Authority (Environmental Improvement Fund)

[LFB 2015-17 Budget Summary: Page 149, #1]

CURRENT LAW

The safe drinking water loan program was created within the environmental improvement fund in 1997 Act 27 to provide low-interest loans to municipalities for planning, designing, constructing, or modifying public drinking water systems, if the projects will facilitate compliance with national primary drinking water regulations under the federal Safe Drinking Water Act. The program provides loans using proceeds of federal capitalization grants and a 20% state match provided with general obligation bond proceeds. All of the general obligation bond debt service costs are paid by general purpose revenues (GPR). The safe drinking water loan program is currently authorized a cumulative total of \$60,200,000 in general obligation bonding authority.

GOVERNOR

Provide an increase in general obligation bonding authority of \$7.5 million for the safe drinking water loan program.

DISCUSSION POINTS

1. The safe drinking water loan program uses all of the authorized general obligation (GO) bonds to provide the 20% state match to the federal capitalization grant under the Safe Drinking Water Act. The biennial budget act has historically authorized the amount of GO bonds anticipated to be needed to provide the 20% match needed to maximize receipt of federal grants during that biennium. Any previously authorized but unused GO bonding authority is carried forward to the subsequent biennium. The federal government requires the state to have the entire

20% state match in place before it can accept the federal safe drinking water grant.

2. The bill is based on the DOA and DNR September, 2014, biennial finance plan estimate of a total need of \$9.6 million for GO bonding authority to provide the 20% state match to approximately \$48 million in federal capitalization grants (estimated at \$16 million per year for the three federal fiscal years 2015, 2016, and 2017). Based on the DOA and DNR estimate of \$2.1 million in available previously authorized but unused GO bonding authority carried forward from 2013-15 to 2015-17, the bill provides \$7.5 million of additional GO bonding authority. DOA and DNR estimate that approximately \$148 million in project costs could be funded during the 2015-17 biennium. This includes funding from federal grants, state match, carry forward balance from 2013-15, and loan repayments from previously made loans.

3. The administration requested 20% match sufficient to match \$48 million of federal grants over three years rather than two so that any potential delay in adoption of a state budget, or any increases in federal capitalization grants above estimated amounts, would not delay having sufficient general obligation bonding authority in place to accept the federal capitalization safe drinking water grant.

4. In his 2013-15 biennial budget, the Governor proposed bonding sufficient to match \$48 million of federal funding (three years at \$16 million each). In the 2013-15 final budget act, the Legislature provided a reestimated amount of bonding sufficient to match an estimated \$39 million of federal funding over two years (an estimated \$17.8 million for each of two years, plus a contingency of 20% of one-year's grant). The actual federal safe drinking water capitalization grants for federal fiscal years 2013 and 2014 totaled \$29.95 million (\$14.52 million and \$15.43 million), and are being used to finance projects during the 2013-15 biennium.

5. The two years of grants received for federal fiscal year 2015 and 2016 will fund safe drinking water projects during the 2015-17 biennium. In January, 2015, DNR received EPA's notification that the final federal fiscal year 2015 federal grant will be \$15.43 million. The President has proposed a federal fiscal year 2016 grant of \$20.24 million for the state. It is probable that federal grants will not exceed \$35.7 million for the two years, equaling the sum of the actual FFY 2015 grant and the President's proposed FFY 2016 grant.

6. A reestimate could be made of the amount of GO bond authority needed to provide a 20% match for two full years of federal grants, based on recent estimates of potentially available amounts. For example, instead of providing bonding sufficient to match \$48 million of federal funding (three years of \$16 million annual federal grants as estimated in September, 2014), a reestimate could provide bonding sufficient to match approximately \$37.7 million of potential federal funding. This would include \$15.43 million for the actual federal fiscal year 2015 grant amount, \$20.24 million for federal fiscal year 2016 under the President's budget, plus a 10% contingency of \$2.02 million for the second year. Based on this reestimate, the total GO bonding need would be \$7.5 million, and, after subtracting the \$2.1 million in unused previous authorization, \$5.4 million in new GO bonding authority could be provided instead of \$7.5 million under the bill, a decrease of \$2.1 million [Alternative 2].

7. If actual federal grants are substantially higher than estimated, it is possible that some safe drinking water projects would have to wait to finalize financial assistance agreements until

2017-19, or until a bill would be passed to authorize additional bonding authority sufficient to receive the federal fiscal year 2016 grant in state fiscal year 2016-17. Any general obligation authority provided, but not needed, in the 2015-17 biennium, would carry forward to be available for use in 2017-19.

8. If no additional general obligation bonding authority for the safe drinking water loan program is approved [Alternative 3], the state could use the \$2.1 million in bonding authority carried forward from 2013-15 to provide a 20% state match to approximately \$10.5 million in federal grant funds. However, this would not be sufficient to provide the necessary match to receive the full federal fiscal year 2015 grant of \$15.43 million, but could allow for a partial federal grant. The state is required to have the state match in place before it can draw on any of the federal grant funds, and must spend all of the state match before it can spend any of the federal grant. The program would be able to make loans with up to approximately \$116 million in funds available from the carry forward balance from the previous year, loan repayments, and investment income, but would not be able to take full advantage of federal funds for the program.

9. Safe drinking water federal capitalization grants authorize the state to provide up to 30% of available funds as principal forgiveness. For the federal fiscal year 2015 grant that would be received if the state provides sufficient bonding authority to provide a 20% state match, \$4,627,500 of the \$15,425,000 in federal funds will be provided as principal forgiveness. DNR and DOA provide up to 10%, 30% or 50% of eligible project costs as principal forgiveness, based on the population and median household income of the municipality. Municipalities with smaller and lower-income households receive the larger percentages of principal forgiveness. If the state doesn't receive any federal grants, it will not be able to provide principal forgiveness to applicants.

ALTERNATIVES

1. Approve the Governor's recommendation to provide an increase in general obligation bonding authority of \$7,500,000 for the safe drinking water loan program.

2. Approve an increase in general obligation bonding authority of \$5,400,000 (based on estimated federal funding of \$37.7 million over two years instead of \$48 million over three years) for the safe drinking water loan program.

ALT 2	Change to Bill
BR	-\$2,100,000

3. Delete provision. There would be no new bonding authorized for the safe drinking water loan program. The state would only be able to accept limited federal capitalization grants in 2015-17.

ALT 3	Change to Bill
BR	-\$7,500,000

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May 12, 2015

Joint Committee on Finance

Paper #281

Program Structure Changes (Environmental Improvement Fund)

[LFB 2015-17 Budget Summary: Page 150, #3]

CURRENT LAW

The clean water fund program within the environmental improvement fund provides low-interest loans to municipalities for planning, designing, constructing or replacing a wastewater treatment facility, or for nonpoint source water pollution abatement or urban storm water runoff control projects. The program provides loans using proceeds of federal capitalization grants, general obligation bonds, and revenue obligation bonds. The federal grants are used for a state revolving loan fund, and must be matched by state funds equaling at least 20% of the federal grant amount. Wisconsin provides the state match with general obligation bond proceeds. Most of the general obligation bond debt service costs are paid by general purpose revenues (GPR), and a portion is paid from segregated loan repayments from municipalities. The program also uses general obligation bonding authority to leverage a larger amount of capital through the sale of state revenue obligation bonds for loans to municipalities. State revenue obligation bonds are retired primarily through repayments of program loans made to municipalities at below market interest rates. General obligation bonds pay the remainder of revenue obligation debt service costs related to the costs of providing the state subsidy because loans to municipalities are made at an interest rate below the market interest rate the state pays for its revenue bonds.

The clean water fund program is currently authorized a cumulative total of \$3,449,743,200 in bonding authority as follows: (a) \$740,843,200 for general obligations; and (b) \$2,708,900,000 for revenue obligations.

The safe drinking water loan program within the environmental improvement fund provides low-interest loans to municipalities for planning, designing, constructing, or modifying public drinking water systems, if the projects will facilitate compliance with national primary drinking water regulations under the federal Safe Drinking Water Act.

The land recycling loan program within the clean water fund provides financial assistance to local governments for the investigation and remediation of certain contaminated (brownfields) properties owned by local government if the contamination has affected, or threatens to affect, groundwater or surface water. It is funded with up to \$20 million, from reallocation of repayments of clean water fund program loans made with the proceeds of federal grants to the clean water fund. Unallocated funds of \$300,000 remain, after \$13.5 million was disbursed to nine communities and \$6.2 million was loaned to the dry cleaner environmental response program administered by DNR. The dry cleaner environmental response program provides reimbursement to owners for a portion of the costs of cleaning up discharges of dry cleaning solvents from dry cleaner facilities.

Subsidy is defined as the amounts provided from the environmental improvement fund to program projects for the following purposes: (1) to reduce the interest rate of project loans from the market rate to a subsidized rate; and (2) for the clean water fund program only, to provide for financial hardship assistance, including grants.

The statutes provide a financial control mechanism for the clean water fund, safe drinking water loan, and land recycling loan programs called a "present value subsidy limit." This limit is intended as a means for the Legislature to control the commitment of state financial assistance to municipalities in a biennium. The subsidy limit represents the estimated state cost, in today's dollars, to provide 20 years of state subsidy for the projects that would be funded in the biennium, that is, for the state to pay the difference between the actual low-interest state loan and a market rate loan. Because it incorporates the debt service that will be paid on bond issuances, the present value subsidy limit reflects the total estimated cost to the state, in current dollars, of subsidizing environmental improvement fund projects. The safe drinking water loan program is further limited by the amount of federal funds available for project costs.

The present value subsidy limit acts as a cap on the sum of all assistance provided through the clean water fund program in a biennium. To the extent that actual bond interest rates are greater or less than assumed rates, the number of projects that may be funded would decrease or increase. The amount of present value subsidy is intended to be the equivalent of the amount the state would expend, but not be repaid, for a given project if that entire subsidy were provided in the year the loan was made, rather than over twenty years. Conceptually, the present value subsidy is the amount the state would need to invest today at a 7% annual rate of return to receive interest payments equal to the annual subsidy provided to municipalities. The 2013-15 biennial budget authorized a present value subsidy limit of \$89.1 million for the environmental improvement program for the 2013-15 biennium, including: (1) \$61.9 million for the clean water fund program; (2) \$26.9 million for the safe drinking water loan program; and (3) \$0.3 million for the land recycling loan program.

Clean water fund projects, other than financial hardship assistance projects, are funded on a continuous funding cycle. If DNR and DOA determine that the amount of present value subsidy, general obligation bonding authority, or revenue bonding authority approved for a biennium is insufficient to provide funding for all projects for which applications will be approved during the biennium, the program would revert to an annual funding cycle. DNR would

establish a funding list for each year of the biennium that ranks projects of municipalities that submit financial assistance applications by June 30 of the preceding fiscal year, and DOA would allocate funding to projects in the order they appear on the funding list. The priority ranking has not been used since before the continuous funding cycle was enacted in 1995 Act 27.

Financial hardship assistance projects are scored according to a priority ranking system that is used to establish a list of hardship projects to be funded. Funding for financial hardship assistance is statutorily limited to 5% of the total present value subsidy authorized during a biennium.

Clean water fund program projects receive subsidized interest rates as a percent of the market rate. The market interest rate is the effective interest rate on a fixed-rate revenue obligation issued by the state to fund a loan under the program. The market interest rate was 3.5% between mid-2012 and the end of 2014. DOA changed the market interest rate to 3.0% effective January 1, 2015.

The 2009-11 and 2011-13 biennial budget acts decreased the state subsidy by increasing the portion of the interest rate paid by the municipality for projects. As of 2011-12, municipalities with projects financed under the clean water fund program pay an interest rate of 75% of the market interest rate (other than projects that meet financial hardship criteria). This provided a loan interest rate of 2.625% during 2014, and is providing an interest rate of 2.25% in 2015. Municipalities with projects financed under the safe drinking water loan program pay an interest rate of 55% or 33% of market interest rate.

GOVERNOR

Eliminate the present value subsidy limit. Repeal the definition and use of the term "subsidy." Specify that DOA would allocate "financial assistance" to projects instead of "subsidy."

Create an additional method for DOA to calculate a market interest rate for purposes of determining the interest rate for financial assistance loans provided under the program. The additional method would authorize DOA to determine that there has been a significant change in interest rates after the fixed-rate revenue obligation has been issued or if a fixed-rate revenue obligation has not been issued by the state to fund a loan under the program, the effective interest rate that DOA determines would have been paid if a fixed-rate revenue obligation had been issued on the date financial assistance is allotted.

Specify that if DNR and DOA determine that the amount available to provide financial assistance for projects under the clean water fund program for a biennium is insufficient to provide funding for all projects for which applications will be approved during the biennium, a funding list and priority ranking will be established, with applications due no later than September 30 of the fiscal year.

Specify that, under the clean water fund program, no municipality may receive more than

35.2% of the amount that DOA projects will be available to provide financial assistance for the biennium, instead of the current limit of 35.2% of the present value subsidy limit approved by the Legislature for the biennium.

Specify that, under the safe drinking water loan program, no municipality may receive more than 25% of the amount of financial assistance planned to be provided or committed for projects for the biennium, instead of the current limit of 25% of the present value subsidy limit approved by the Legislature for the biennium.

Specify that the program may expend, for clean water fund financial hardship assistance, up to five percent of the amount available to provide financial assistance for projects, instead of up to five percent of the amount of present value subsidy limit approved by the Legislature.

Specify that the biennial finance plan submitted by DOA and DNR by October 1 of each even-numbered year to the Building Commission, Joint Committee on Finance, and appropriate legislative standing committees include the total amount that DOA projects will be available to provide financial assistance during the next biennium, rather than the total amount of financial assistance planned to be provided or committed for projects during the biennium.

Delete the requirement that the report submitted by DOA and DNR by November 1 of each odd-numbered year to the Building Commission, Joint Committee on Finance, and appropriate legislative standing committees must report on the implementation of the present value subsidy limit. Maintain the requirement for the two agencies to report on the operations and activities of the clean water fund program, the safe drinking water loan program, and the land recycling loan program.

Specify that if a land recycling loan recipient sells a site or facility for which the recipient received a loan under the program, if the sale proceeds are greater than the cost of the land plus the cost of the cleanup, the recipient must repay to DOA an amount equal to the remaining loan balance plus the lesser of: (1) 75% of the amount by which the sale proceeds exceed the cost of the land plus the cost of the cleanup; or (2) the difference between the amount of interest paid on the loan and the amount of interest that would have been paid if the loan had been made at the market rate (instead of repayment of the amount of subsidy incurred for the project).

DISCUSSION POINTS

Clean Water Fund Program Need

1. The environmental improvement fund biennial finance plan submitted by DNR and DOA to the Building Commission and Legislature in September, 2014, requested a present value subsidy limit for 2015-17 of \$53.4 million for the clean water fund program, based on an estimated market interest rate of 5%. The agencies anticipated this would provide sufficient present value subsidy limit under the clean water fund program to fund all expected wastewater needs during the biennium under the current law interest rates. DNR and DOA identified wastewater project needs of \$477.0 million for the 2015-17 biennium, including: (a) \$281.5 million of \$555 million in

estimated 2014-15 project costs for which applications had not been submitted as of August, 2014, and are now expected to be submitted in 2015-16 instead of 2014-15 (inclusion of this component meant that it was estimated that 2013-15 present value subsidy limit would no longer be needed for the projects, but that 2015-17 present value subsidy limit would be needed); (b) \$181.6 million in estimated need for new clean water fund program applications in the 2015-17 biennium; and (c) \$13.9 million as a 3% construction contingency for the \$463.1 million in applications described above. The DNR and DOA projections represented their best estimates of need as of September, 2014, based on their review of file materials and a comprehensive survey of municipalities.

2. The DNR and DOA September, 2014, biennial finance plan identified a need for \$35.7 million in general obligation bonding authority to provide the state match for anticipated federal capitalization grants and state subsidy for funded projects during the 2015-17 biennium. The plan identified an available balance of \$115.0 million in general obligation bonding authority carried forward from the 2013-15 biennium. The biennial finance plan also identified a need for \$236.3 million in revenue obligation bonding authority to fund anticipated projects during the biennium, and an available balance of \$604.8 million (which DOA recently indicated should be corrected to show \$595.7 million) in revenue obligation bonding authority carried forward from the 2013-15 biennium. Based on the identification of these available balances, the biennial finance plan and Governor's budget did not include recommendations for additional bonding authority for the clean water fund program.

3. Reasons for the large balance of previously-authorized bonding include: (a) the availability of ARRA funding in 2009-10 and associated principal forgiveness provided a one-time upsurge in funding for projects ready to proceed at that time; (b) the decreases in the market interest rate to 3.5% during the 2011-13 and 2013-15 biennia resulted in increases in municipalities prepaying old loans made with older, higher interest rates at over 5%; (c) the program has a long-enough history that the need for general obligation bonds to be used for credit reserves has been minimized (general obligation bonds continue to be used for the 20% state match to the federal grant and for the costs of state subsidy of loans made with revenue obligation proceeds); and (d) demand decreased because of recessionary delays in project starts and reduced state subsidy levels beginning in 2011-13.

Potential Program Restructuring

4. After DNR and DOA submitted the September, 2014, biennial finance plan, the DOA Capital Finance Office took actions to seek approval from the U.S. Environmental Protection Agency (EPA) to restructure and merge the two major existing clean water loan portfolios in a way that would reduce GPR debt service costs for general obligation bonds. The federal direct loan portfolio is the state revolving fund (SRF) subject to approval by EPA, and uses the proceeds of a federal capitalization grant and the required 20% state match to make loans. The state has chosen to provide the current state match with general obligation bond proceeds, with debt service costs paid by GPR and a portion of loan interest repayments from loans made with general obligation bonds. The state leveraged loan portfolio is a state account that uses the proceeds of state revenue obligation bonds to provide loans to municipalities, and uses the state's general obligation bonds, with GPR debt service payments, to "leverage" a larger amount of capital and pay the costs of the

state subsidy to municipalities. The "cost" or "subsidy" results because loans to municipalities are, in most cases, made at an interest rate below the market interest rate the state pays for its revenue bonds.

5. During the 25-year life of the clean water fund program, over \$4 billion has been provided in financial assistance agreements. Under the restructuring, DOA proposed that interest repayments of loans made under the direct loan portfolio with the proceeds of federal grants and general obligation bonds would be used to pay for the GPR debt service costs of the direct and leveraged loan portfolios, in addition to the current practice of being used to make future clean water fund loans. DOA officials indicate this would decrease, and eventually eliminate, the use of GPR for debt service costs for general obligation bonds.

6. The two loan portfolios are not established as separate entities in statutes, and thus, the restructuring would not need statutory approval. However, the restructuring would also need approval from EPA that the delegation of authority for the state to administer the clean water state revolving loan fund continues to meet federal requirements.

7. On March 10, 2015, the state's bond counsel submitted a memorandum to EPA on behalf of DOA and DNR, indicating that the state proposed refunding all or a part of its \$764 million in outstanding clean water revenue bonds, combining the federal direct and leveraged loan portfolios, and using interest repayments from direct portfolio loans to pay debt service on the refunded bonds.

8. On April 2, 2015, EPA sent a letter to the DOA and DNR administrators of the clean water fund. EPA notified the agencies that the state may not use loan repayments from loans made under the federal direct portfolio (state revolving fund or SRF) to pay state debt incurred in the state leveraged portfolio. The EPA letter included the following statements:

"... our position remains that the assets of the Federal SRF may not be used to secure or repay any such refunding bonds that the State may issue. This determination is based on the conclusion that the Federal SRF Program and the State Leveraged Program are two separate programs and that Clean Water SRF regulations prohibit a state from using SRF assets to secure or repay bonds issued for any purpose other than depositing the bond proceeds into the SRF to support SRF loans."

"The Contemplated Refunding Approach in the state's proposal seeks to pledge assets of the Federal SRF to refunding bonds that the State may issue to defease a portion of the outstanding bonds that the State issued to support the State's separate leveraged program, and also to use Federal SRF assets to repay those refunding bonds. One of the seven eligible uses [of SRF funds] does allow a state to secure and repay bonds that are issued to support Federal SRF loans, however, the proceeds of the bonds must be deposited into the Federal SRF. The proceeds of the contemplated refunding bonds would be used to defease outstanding bonds of the separate State leveraged program, not to support Federal SRF loans. Therefore, securing or repaying the refunding bonds would not be an eligible use of SRF assets."

"We support the State's plans to initiate leveraging in the Federal SRF, as a means to increase and stabilize funding capacity for those communities that seek financing from the SRF, and to also provide a consistent source of State Matching funds for the SRF. We look forward to providing any assistance you request to aid in your transition of the Federal SRF from a direct loan program to a leveraged loan program."

9. DOA indicates the state will continue to work with EPA on a way to restructure the program that will reduce GPR debt service costs.

10. DOA had hoped that, under the restructuring, the state would not need to issue general obligation bonding authority in the future, except possibly to provide the subsidy for hardship projects. DOA had also indicated that, under the restructuring, the state hoped to use loan repayments received from previously made loans to provide the required 20% state match to the federal grant, instead of the current practice of using general obligation bonds. This will not happen unless or until a restructuring plan is developed that is approved by EPA.

11. DOA indicates that it intends to obtain short-term program GPR savings in 2014-15 through 2015-16 by refunding outstanding revenue obligation bonds within the state leveraged portfolio to pay GPR debt service for general obligation bonds issued within the state portfolio. For 2016-17, DOA is reviewing options for using debt restructuring, existing funds or loan repayments within the state portfolio to reduce GPR costs. DOA indicates it has not identified a long-term way of reducing or eliminating GPR debt service costs in subsequent years.

12. At this time, there are many uncertainties about what the potential restructuring might look like, the timeline for reaching an agreement with EPA, what EPA will permit the state to do with the federally-approved state revolving fund program, and the potential for using loan repayments as a substitute for GPR to provide financial assistance under the clean water fund program. Given that EPA has already indicated it will not approve the use of loan repayments under the federal direct portfolio to repay GPR debt under the state leveraged portfolio, it is uncertain what GPR savings will be implemented in the program, and when. The administration indicates overall GPR debt service, including that for EIF, is being addressed as part of an economic refinancing of state general obligation bonds.

Present Value Subsidy Limit

13. In every biennial budget enacted since the clean water fund was created in 1987 Act 399, the Legislature has approved a present value subsidy limit for each of the programs within the environmental improvement fund as a method of establishing a maximum amount of state financial assistance provided to municipalities in a biennium. Each budget has included an amount of present value subsidy limit anticipated to be sufficient to fund applications expected to be received in the biennium. The Legislature has approved additional general and revenue obligation bonding authority in several biennia as it was anticipated to be needed.

14. The administration indicates that a present value subsidy limit would not be needed anymore because its hopes to restructure the clean water fund program would change the focus of the program from "subsidy" to "financial assistance." In addition, the administration indicates that it hopes to provide "subsidy" from loan repayments instead of from general obligation bonds so there would be no new state GPR costs.

15. Under the bill, there would no longer be a statutory provision allowing the Legislature to approve a maximum amount of subsidy or loans for either the clean water or safe drinking water loan program. However, the statutes would continue to specify the municipal loan interest rates as a

percent of the market rate, which would serve as a limit on the amount of subsidy provided to an individual municipality. In addition, the amount of general obligation bonds authorized and issued, and the associated GPR debt service costs, have been a measure of the state cost of the program in a given biennium. As the clean water fund program has matured during the 25 years of its existence, it has relied more on the statutory loan interest rates as a percent of the market rate to provide a limit on the amount the state spends on the program, and less on the present value subsidy limit. Further, the concept has been difficult for many to understand and has not, in practice, restricted program participation or costs.

16. The present value subsidy limit has historically been based on the historical long-term average revenue market interest rate, and estimated current rates, but has usually been based on a higher planning interest rate than the actual rate. This provided a higher present value subsidy limit than needed for all projects expected to be funded. For example, the 2013-15 present value subsidy limit was based on an estimated 4.5% revenue market interest rate, but the actual revenue market interest rate during the biennium was 3.5% until DOA reduced it to 3.0% in January, 2015.

17. Currently, DNR and DOA would be required to implement a clean water fund program funding list and priority ranking if the amount of present value subsidy approved by the Legislature is insufficient to fund all projects for which applications will be approved during the biennium. The program has not needed to implement a funding list, and has been able to accept and process applications on a continuous funding cycle. It is possible that the provision has provided an incentive to the Governor and Legislature to approve sufficient present value subsidy limit so that a funding list is not needed. Under the bill, this provision would be modified to require a funding list and priority ranking if DNR and DOA determine that the amount available to provide financial assistance for all projects for which applications will be approved during the biennium.

18. When the safe drinking water loan program was created in 1997 Act 27, the concept of the present value subsidy limit was also applied to that program. However, the safe drinking water loan program differs from the clean water fund program in that it only has a federal loan portfolio with the state revolving fund consisting of federal capitalization grants and general obligation bonds issued to provide the 20% state match to the federal grant. Thus, the amount of federal grants and general obligation bonds serves as a limit on the amount of funds that can be provided to municipalities as loans, or as principal forgiveness if certain need criteria are met under federal requirements.

19. The Governor's recommendation to delete use of the present value subsidy limit could be approved whether or not the potential loan portfolio restructuring occurs during the 2015-17 biennium [Alternative A1]. This could be done along with continuing provisions for statutory loan interest rates for municipal borrowers, and potential implementation of a funding list, along with recognition of the increasing use of loan repayments for future loans.

20. Alternatively, the use of the present value subsidy limit could be restored as a method of continuing to provide some estimate of the cost of providing state subsidy for the 20-year life of a loan [Alternative A2]. The concept would continue to represent a way of measuring that there is a cost to the state for lending money to a municipality at a lower rate than the state borrows funds.

21. If the Committee chooses to restore use of the present value subsidy limit, approval of amounts based on a 4.0% estimated revenue market interest rate would likely be sufficient for the 2015-17 biennium. This would provide a planning interest rate greater than the 3.5% or 3.0% used by the program as the market interest rate during the 2013-15 biennium. Using this estimated revenue market interest rate, a present value subsidy limit of \$27.6 million could be approved for the safe drinking water loan program and \$0.3 million for the land recycling loan program [Alternative A2]. A present value subsidy limit could be approved for the clean water fund program based on the statutory loan interest rates discussed under a subsequent section of this paper.

Determination of Market Interest Rate

22. Currently, and under the bill, the DOA determination of the market interest rate is used to establish the loan interest rate that the municipal borrower pays as a percent of the market interest rate. Currently, the market interest rate is the effective interest rate on a fixed-rate revenue obligation issued by the state to fund a loan, or the effective rate that DOA determines would have been paid if a variable rate obligation had been sold at a fixed rate. The bill would delete the references to a variable rate. Instead, the bill would authorize DOA to establish a market interest rate if it determines that there has been a significant change in interest rates after the last fixed-rate obligations were issued, or, if fixed-rate obligations were not issued, the effective interest rate that DOA determines would have been paid if a fixed-rate revenue obligation had been issued on the date financial assistance is awarded to a municipality.

23. DOA lowered the market interest rate from 3.5% to 3.0% effective January 1, 2015, not because of a recent revenue bond sale, but to reflect current market conditions. DOA indicates the change was made under authority of administrative code Chapter Adm 35.06 (1), which specifies: "When a current market rate cannot be determined from an actual bond sale, the department may estimate such market rate based on market comparables and market indices."

24. The proposed statutory method of determining the market interest rate would be consistent with the provision in the administrative rule. It is anticipated that it would be used in situations such as the January, 2015, determination, when the program is making loans from previous loan repayments and not from proceeds of a new revenue bond sale. DOA indicates it could, potentially, modify the market interest rate up to four times per year, but generally not for small market movements of under 0.1%.

25. Approval of the additional method of determining a market interest rate for the program could be viewed as a way of updating language in the statutes and providing a clear way of reflecting changes in market conditions that may occur more frequently than issuance of revenue bonds [Alternative B1]. If the change is not approved, DOA would likely continue to use the methodology in administrative rule to make changes in the market interest rate in between issuances of revenue obligations [Alternative B2].

Municipality Loan Interest Rates

26. Most clean water fund projects pay a loan interest rate of 75% of the market interest rate. Interest rates were increased in the 2009-11 and 2011-13 biennial budgets (and state subsidy

was decreased), by increasing the statutory loan interest rate as a percent of the market rate. Table 1 shows the loan interest rate municipalities pay under the current 3.0% market interest rate, and the loan interest rate municipalities would pay, at the current market interest rate, if the subsidy level were at the percent of market interest rate provided prior to 2009-11 or in 2009-11.

TABLE 1
Clean Water Fund Program Loan Interest Rates by Project Type

<u>Project Category</u>	<u>Percent of Market Rate</u>			<u>Current Loan Interest Rate for Various Percent of Market Rate</u>		
	<u>Prior to 2009-11</u>	<u>2009-11</u>	<u>As of 2011-13</u>	<u>Prior to 2009-11</u>	<u>2009-11</u>	<u>As of 2011-13</u>
Compliance maintenance/ New and changed limits	55%	60%	75%	1.65%	1.80%	2.25%
Storm water/nonpoint	65	65	75	1.95	1.95	2.25
Unsewered	70	70	75	2.10	2.10	2.25
Violator, reserve capacity, Industrial flow or unsewered not meeting two-thirds rule	100	100	100	3.0	3.0	3.0
Transition	N.A.	N.A.	N.A.	2.5	2.5	2.5
Hardship	Variable	Variable	Variable	0.0 to 3.0	0.0 to 3.0	0.0 to 3.0
Hardship grants and principal forgiveness	Grant	Grant	Grant	Grant	Grant	Grant
Septage treatment and capacity	0	0	0	0.0	0.0	0.0

27. The reductions made in 2009-11 and 2011-13 to state subsidy levels were done to reduce long-term state costs of the program, particularly for GPR debt service on general obligation bonds, in recognition that the state faced difficult budgetary times. Some may argue that, if the state is able to restructure the program's loan portfolios to rely more on repayments of previously made loans than on general obligation bond proceeds to make future loans, the state could increase the state subsidy above the current levels. Amending the statutes to provide lower-interest rate financing could provide an opportunity for the state to provide additional assistance to municipalities for financing of wastewater treatment projects. Finally, an increase in state subsidy levels could provide some municipalities an incentive to borrow through the state program instead of borrowing on their own at a higher interest rate or bond issuance costs.

28. Some may argue that no increases in state subsidy should be made unless, and until, a state restructuring of the loan portfolios has been approved by EPA, in a way that reduces GPR debt service costs. In addition, some may argue that the current subsidy level is sufficient to make the program attractive to municipal borrowers, especially when the state has the flexibility to adjust the revenue market rate to reflect current market conditions.

29. DOA estimated that, under the proposed restructuring plan, the clean water fund program could finance approximately \$550 million (\$275 million per year) in project costs during the 2015-17 biennium at the current statutory loan interest rates of 75% of the market rate. DOA

also estimated that, if a restructuring were approved, the program could finance lower amounts if the interest rate for municipalities would be lowered, as shown in Table 2. While EPA has stated the restructuring is not approvable in its current form, Table 2 provides an illustration of the amounts of funding that could potentially be provided under the hoped for restructuring scenario at various interest rates.

TABLE 2

**Estimated Amount Available for Clean Water Fund Financial Assistance in 2015-17
Under a Potential Program Restructuring, at Various Loan Interest Rates**

<u>Interest Rate as Percent of Market Rate</u>	<u>Amount Available (\$ Millions)</u>
75% (Current Law)	\$550
70%	510 to 530
65%	460 to 490
60%	440 to 460
55%	420 to 430

30. As described earlier, current law and the bill would require DNR and DOA to implement a clean water fund program funding list and priority ranking if the agencies determine that the amount available for financial assistance for all anticipated projects is insufficient in a biennium. DNR and DOA identified wastewater project needs of \$477 million for the 2015-17 biennium. In the absence of an approved program restructuring plan, it is uncertain what amount of decrease in the loan interest rate (and associated increases in state subsidy) would be large enough to prompt DOA and DNR to decide that a funding list would need to be implemented. For example, under the restructuring scenario shown in Table 2, DOA estimated that a loan interest rate of 65% of the market rate might be sufficient to fund \$460 million to \$490 million in projects during the 2015-17 biennium, which might or might not exceed anticipated needs. DOA also estimated that a loan interest rate of 60% or 55% of the market rate might provide insufficient funds to meet the estimated need. The amount of projects funded over the last 10 years has averaged \$207 million annually. At this average rate of perhaps \$414 million during the two years of the biennium, there would be sufficient program assets to fund this level of projects at the current interest rate of 75% of the market rate, or at any of the lower interest rates shown in Table 2. Under the current program, increased state subsidy is provided primarily by issuing additional general obligation bonds (GPR debt service).

31. If the Committee chooses to maintain the current use of a present value subsidy limit for the clean water fund program, and if it chooses to decrease loan interest rates paid by municipalities, it could establish a present value subsidy limit anticipated to be sufficient to fund all projects expected to be approved. Table 3 shows the estimated amount of present value subsidy limit that could be provided, assuming an estimated 4.0% market interest rate, for various loan interest rates as a percent of the market rate [Alternatives C1, C2, C3, C4, and C5].

32. The effect of increasing the state subsidy level on 2015-17 GPR debt service payments

would be minimal, because projects approved in the 2015-17 biennium generally would not begin construction until late in the biennium or in the 2017-19 biennium, and any bonds issued for projects would be issued during the four to five years of construction. However, state costs would rise and increased state general obligation bond issues would be required to support the increased subsidy levels. To return to the 2009-11 level of state subsidy (a loan interest rate of 60% of market rate) would require \$12.5 million BR more than current law to accommodate estimated 2015-17 program demand (at a 4.0% planning rate). To the extent this full amount was needed for 2015-17 projects, and while interest rates established at the time of bond issuance may vary, it could be expected that debt service payments (principal and interest) on that amount of bonds would total approximately \$18 million over the 20 year life of the bonds. To return to the state subsidy level in effect prior to 2009-11 (a loan interest rate of 55% of market rate) would require \$16.8 million BR more than current law to accommodate estimated 2015-17 program demand (at a 4.0% planning rate). Debt service payments on that level of bonds could be expected to total approximately \$24 million over the 20-year life of the bonds. It could be anticipated that municipalities would experience corresponding decreases in local borrowing costs.

TABLE 3

Clean Water Fund Loan Interest Rates, Present Value Subsidy, and General Obligation Bonding Authority Needed (\$ Millions)

Interest Rate as Percent of Market Rate	Present Value Subsidy Needed in 2015-17*	General Obligation Bonding Authority Needed in 2015-17**	Excess Authorized, Unissued GO Bonding Authority that will not be needed in 2015-17
75% (current law)	\$42.6	\$37.7	\$77.3
70%	48.8	41.8	73.2
65%	54.6	46.1	68.9
60%	59.9	50.2	64.8
55%	65.6	54.5	60.5

* Assumes estimate of 4.0% market interest rate for planning purposes.

** Includes addition of a 20% contingency beyond anticipated need. The program has \$115 million in authorized unissued general obligation bonding authority, so no new authority would be needed.

Bonding Authority

33. As described earlier, the biennial finance plan identified an available balance of \$115.0 million in general obligation bonding authority carried forward from the 2015-17 biennium. DOA indicates that a goal of the potential program restructuring was to not have to issue any general obligation bonds during the 2015-17 biennium, unless needed to provide subsidy for hardship financial assistance projects, or for the 20% state match to the federal grant. In the absence of an approved restructuring plan, it can be anticipated that general obligation bonds will continue to be needed for the program. Table 3 shows the amount of general obligation bonds estimated to be needed under the identified loan interest rate scenarios, and includes a 20% contingency beyond anticipated need. The amount of general obligation bonding authority needed would increase as the

loan interest rate paid by a municipality decreases, because the bonds would be used to pay the increased costs of state subsidy (the difference between the market interest rate paid by the state and the loan interest rate paid by the municipality when it borrows from the state). The table also shows, for each loan interest rate scenario, the amounts of excess authorized but unissued amounts of the \$115.0 million in carryforward general obligation bonding authority that are not expected to be needed during the 2015-17 biennium.

34. The biennial finance plan also identified a need for \$236.3 million in revenue obligation bonding authority to fund anticipated projects during the biennium, and an available balance of \$595.7 million in revenue obligation bonding authority carried forward from the 2013-15 biennium (as recently corrected by DOA). This estimated need for revenue obligation bonding would not change if the statutory loan interest rate changes, but rather, would change if the total amount of project costs is higher or lower than estimated.

35. The excess general obligation and revenue obligation bonding authority could be deleted. If a 20% contingency is added to the \$236.3 million in revenue obligation authority identified by DOA as needed during the 2015-17 biennium, the total revenue obligation authority needed would be approximately \$283.6 million, and the excess \$312.1 million. These amounts are shown in Alternatives D1a, D2a, D3a, D4a, and D5a.

36. Any general obligation or revenue obligation bonding authority authorized, but unused during a biennium, remains available for program use in subsequent biennia. The currently authorized but unused bonding authority could be retained for use in the 2017-19 biennium if needed at that time.

37. General obligation and revenue obligation bonding authorized for the clean water fund program can only be used for that program. It is possible that, depending on how a potential program restructuring is organized, bonding authority not used during the 2015-17 biennium may be needed for allocation to project costs in the 2017-19 biennium. Thus, if available bonding authority carried forward from 2013-15 is deleted, it is possible that the Legislature will need to reauthorize some or a portion of it in the 2017-19 biennial budget.

38. Another alternative for deleting excess general obligation and revenue obligation bonding authority would be to maintain a contingency of approximately 75% of the anticipated need during the 2015-17 biennium. This would retain a reserve to minimize, or eliminate, the need to increase bonding authority for projects to be funded in the 2017-19 biennium. This would maintain revenue obligation bonding authority of \$413.5 million, and delete the excess \$182.2 million. A corresponding contingency of approximately 75% of the general obligation bonding authority would be retained, and the excess would be deleted. These amounts are shown in Alternatives D1b, D2b, D3b, D4b, and D5b.

39. Approval of general obligation bond authority at a level less than the current law amounts continued in the bill would not be expected to result in GPR savings in debt service costs during the 2015-17 biennium because the bonds are issued only as financial assistance is disbursed to municipal borrowers over the typical four to five years of construction of a project.

ALTERNATIVES

A. Present Value Subsidy Limit

1. Approve the Governor's recommended environmental improvement fund program changes to: (a) repeal the use of the present value subsidy limit; (b) use the term "financial assistance" instead of subsidy; (c) change the maximum amount of present value subsidy per municipality to the specified percentage of the total amount of financial assistance; (d) require DNR and DOA to implement a funding list if they determine that the amount available to provide assistance is insufficient to provide funding for all projects for which applications will be approved (instead of current references related to present value subsidy); (e) delete the requirement that the biennial finance plan report on implementation of the present value subsidy limit; and (f) make changes related to the sale of a site or facility under the land recycling loan program and repayment of proceeds instead of subsidy.

2. Maintain the current use of present value subsidy limit. Provide a present value subsidy limit of \$27.6 million for the safe drinking water loan program and \$0.3 million for the land recycling loan program. Provide a present value subsidy limit for the clean water fund program under one of the alternatives under the section on loan interest rates.

B. Definition of Market Interest Rate

1. Approve the Governor's recommendation to create an additional method of determining the market interest rate, to authorize DOA to determine that there has been a significant change in interest rates after the issuance of revenue obligations, or to determine the effective interest rate that would have been paid if a fixed-rate revenue obligation had been issued.

2. Maintain current law.

C. Clean Water Fund Loan Interest Rates and Present Value Subsidy

1. Approve the Governor's recommendation to maintain the current loan interest rate paid by clean water fund projects as 75% of the market interest rate. Provide a present value subsidy limit of \$42.6 million for the 2015-17 biennium (if Alternative A2 is approved).

2. Increase state subsidy for clean water fund projects by decreasing the municipal interest rate from 75% to 70% of the market interest rate. Provide a present value subsidy limit of \$48.8 million for the 2015-17 biennium (if Alternative A2 is approved).

3. Increase state subsidy for clean water fund projects by decreasing the municipal interest rate from 75% to 65% of the market interest rate. Provide a present value subsidy limit of \$54.6 million for the 2015-17 biennium (if Alternative A2 is approved).

4. Increase state subsidy for clean water fund projects by decreasing the municipal interest rate from 75% to 60% of the market interest rate. Provide a present value subsidy limit of

\$59.9 million for the 2015-17 biennium (if Alternative A2 is approved).

5. Increase state subsidy for clean water fund projects by decreasing the municipal interest rate from 75% to 55% of the market interest rate. Provide a present value subsidy limit of \$65.6 million for the 2015-17 biennium (if Alternative A2 is approved).

D. Bonding Authority

1. Approve Alternative C1 (75% of market interest rate). In addition, reduce clean water fund program bonding authority by one of the following amounts:

a. \$389.4 million, including \$77.3 million for general obligations and \$312.1 million for revenue obligations (assumes a 20% contingency).

ALT D1a	Change to Bill
BR-GO	- \$77,300,000
BR-REV	- <u>312,100,000</u>
Total BR	- \$389,400,000

b. \$242.3 million, including \$60.1 million for general obligations and \$182.2 million for revenue obligations (assumes a 75% contingency).

ALT D1b	Change to Bill
BR-GO	- \$60,100,000
BR-REV	- <u>182,200,000</u>
Total BR	- \$242,300,000

2. Approve Alternative C2 (70% of market interest rate). In addition, reduce clean water fund program bonding authority by one of the following amounts:

a. \$385.3 million, including \$73.2 million for general obligations and \$312.1 million for revenue obligations (assumes a 20% contingency).

ALT D2a	Change to Bill
BR-GO	- \$73,200,000
BR-REV	- <u>312,100,000</u>
Total BR	- \$385,300,000

b. \$236.3 million, including \$54.1 million for general obligations and \$182.2 million for revenue obligations (assumes a 75% contingency).

ALT D2b Change to Bill	
BR-GO	- \$54,100,000
BR-REV	<u>- 182,200,000</u>
Total BR	- \$236,300,000

3. Approve Alternative C3 (65% of market interest rate). In addition, reduce clean water fund program bonding authority by one of the following amounts:

a. \$381.0 million, including \$68.9 million for general obligations and \$312.1 million for revenue obligations (assumes a 20% contingency).

ALT D3a Change to Bill	
BR-GO	- \$68,900,000
BR-REV	<u>- 312,100,000</u>
Total BR	- \$381,000,000

b. \$230.0 million, including \$47.8 million for general obligations and \$182.2 million for revenue obligations (assumes a 75% contingency).

ALT D3b Change to Bill	
BR-GO	- \$47,800,000
BR-REV	<u>- 182,200,000</u>
Total BR	- \$230,000,000

4. Approve Alternative C4 (60% of market interest rate). In addition, reduce clean water fund program bonding authority by one of the following amounts:

a. \$376.9 million, including \$64.8 million for general obligations and \$312.1 million for revenue obligations (assumes a 20% contingency).

ALT D4a Change to Bill	
BR-GO	- \$64,800,000
BR-REV	<u>- 312,100,000</u>
Total BR	- \$376,900,000

b. \$224.1 million, including \$41.9 million for general obligations and \$182.2 million for revenue obligations (assumes a 75% contingency).

ALT D4b Change to Bill	
BR-GO	- \$41,900,000
BR-REV	- <u>182,200,000</u>
Total BR	- \$224,100,000

5. Approve Alternative C5 (55% of market interest rate). In addition, reduce clean water fund program bonding authority by one of the following amounts:

a. \$372.6 million, including \$60.5 million for general obligations and \$312.1 million for revenue obligations (assumes a 20% contingency).

ALT D5a Change to Bill	
BR-GO	- \$60,500,000
BR-REV	- <u>312,100,000</u>
Total BR	- \$372,600,000

b. \$217.8 million, including \$35.6 million for general obligations and \$182.2 million for revenue obligations (assumes a 75% contingency).

ALT D5b Change to Bill	
BR-GO	- \$35,600,000
BR-REV	- <u>182,200,000</u>
Total BR	- \$217,800,000

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May 12, 2015

Joint Committee on Finance

Paper #282

Clean Water Fund Eligibility for Connection Laterals (Environmental Improvement Fund)

[LFB 2015-17 Budget Summary: Page 152, #4]

CURRENT LAW

The clean water fund program within the environmental improvement fund provides low-interest loans to municipalities for planning, designing, constructing, or replacing a wastewater treatment facility, or for nonpoint source pollution abatement or urban stormwater runoff control projects.

GOVERNOR

Expand eligibility for financial assistance under the clean water fund program to include connection laterals or sewer lines if water other than wastewater is entering the connection laterals or sewer lines from the ground or from above-ground sources and is being transported from a nonindustrial structure in a way that may interfere with compliance with a publicly owned treatment work's compliance with a Wisconsin Pollutant Discharge Elimination System (WPDES) permit.

DISCUSSION POINTS

1. Laterals are the portion of the sanitary sewer system that conveys sewage from an individual residence or establishment to a public sewage collection system. Laterals are generally privately owned and maintained.
2. Examples of the type of connection lateral that would become eligible under the provision include: (a) areas of infiltration and inflow of water other than wastewater into leaking

laterals, such as exist in many older residential developments; and (b) portions of the Milwaukee area and some other municipalities where stormwater drains are connected to laterals that subsequently transport wastewater and stormwater from homes or other buildings to sewer lines in the street, sometimes known as combined sewers.

3. Some municipalities with older established neighborhoods have major issues with stormwater leaking into joints and cracks in the older pipes in laterals of some neighborhoods. This is an issue throughout the state. The infiltration and inflow of "clean" or "clear" stormwater into laterals is carried into the sanitary sewer system, where it is mixed with sewage and transported to the wastewater treatment facility. When it reaches the wastewater treatment facility, it is treated even though it is stormwater rather than sewage. Some municipalities have had to expand the capacity of the wastewater treatment facility to treat the additional stormwater from the leaky laterals. Many of the municipalities with leaking laterals are looking for ways to reduce infiltration and inflow, and thus, to reduce the need for facility expansions.

4. DNR currently allows clean water fund eligibility for costs of lining of laterals to prevent or reduce infiltration and inflow if it is done in a way where the municipality does not need to enter or take ownership of private property. For example, a technology exists where a sock-like tube of a fiberglass-type substance can be jettisoned from the street where the connection exists between the sewer main and the lateral, towards the house. When the substance comes into contact with water, it hardens and forms a seal that prevents liquids from leaking into or out of the lateral. This technology works with some types of laterals, but not with some types of older pipes. DNR does not track how much of this type of technology has been included in sewer rehabilitation projects, or which municipalities have used it to reduce infiltration and inflow. Some types of repairs of laterals would require entering the private property.

5. DNR indicates that repairs of laterals are usually a minor component of larger sewer rehabilitation projects. Inspections and repairs of laterals can cost \$8,000 to \$12,000 per house, depending on the type and amount of work needed, and on the length of the lateral connection between the street and the house.

6. Under the bill, the newly eligible connection laterals or sewer lines would be eligible for a loan interest rate of 75% of the market rate if the project is: (a) part of a compliance maintenance project to prevent a significant violation of an effluent limitation by a municipal sewage treatment facility; or (b) needed to achieve compliance with a new or changed effluent limitation established after May 17, 1988, if the project is for a municipality that is not a violator of the specific limit that is changing. The newly eligible connection laterals or sewer lines would be eligible for an interest rate of 100% of the market rate if it is a project to plan, design, construct or replace treatment works that violate effluent limitations contained in an existing permit.

7. Federal Clean Water Act requirements do not allow clean water fund loans to private property owners for the private property. The clean water fund has not provided loans for projects that serve individual homeowners because of a concern about using proceeds of general or revenue obligation bonding authority for projects that benefit private property owners. However, use of loan repayments offers the program more flexibility for funding work on private laterals.

8. Approval of the expanded eligibility for laterals would provide a new financial resource for some municipalities to use to repair laterals. DNR officials do not know how much demand for financial assistance there may be from municipalities under the provision. They anticipate demand would be small because the provision would still require a municipality to take ownership of the lateral, and the municipality might not want to take on that responsibility. However, the Department anticipates some municipalities might choose to take ownership of laterals by passing an ordinance to give them a 20-year easement to laterals located on private property. In this way, an improvement (repair or replacement) to a lateral could be implemented because of water quality needs rather than as a private property improvement. However, some municipalities may find it easier to use other sources of financing for work on private property.

9. DNR and DOA are reviewing options for implementing a way to authorize municipalities to borrow money to make improvements to laterals on privately-owned property. The bill could be amended to specifically authorize municipalities to use clean water fund loans to fund connection laterals on privately-owned property without having to take ownership of the lateral [Alternative 2a].

10. If clean water fund eligibility would be expanded to lend to municipalities for work on connection laterals on private property, demand for clean water funds would increase by an unknown amount. In addition, workload in DNR and DOA to process additional loans could increase.

11. If the provision is not approved, DNR could continue its current practice of including connection lateral work in municipal projects if the work is done in such a way that the municipality does not have to enter or take ownership of a privately-owned property [Alternative 3].

ALTERNATIVES

1. Approve the Governor's recommendation to expand clean water fund program eligibility to include connection laterals.

2. In addition to approving Alternative 1, authorize the program to provide loans to municipalities to fund connection laterals located on private property.

3. Delete provision.

Prepared by: Kendra Bonderud



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May 12, 2015

Joint Committee on Finance

Paper #283

Clean Water Fund Eligibility for Unsewered Areas (Environmental Improvement Fund)

[LFB 2015-17 Budget Summary: Page 153, #5]

CURRENT LAW

Under the clean water fund program within the environmental improvement fund, wastewater treatment facility construction projects in unsewered communities receive a reduced interest rate loan only if two-thirds of the initial wastewater flow is from residences that were in existence prior to October 17, 1972. These projects are eligible for a loan at an interest rate of 75% of the market interest rate. Projects for unsewered communities that do not meet this criteria are eligible only for loan at the market rate interest.

GOVERNOR

Require that two-thirds of the initial wastewater flow for new wastewater collection systems be from residences that were in existence 20 years prior to the date of submission of the application to DNR for financial assistance in order for a municipality to be eligible for a reduced interest rate loan under the clean water fund program.

DISCUSSION POINTS

1. The October 17, 1972, date in the current two-thirds requirement is the date the original federal Water Quality Act was signed. The use of the date originally distinguished existing development from future development. Since the October 17, 1972, date has not changed, it now distinguishes older development from major development that has taken place since the early 1970s, or is projected to take place in the future.

2. The U.S. Environmental Protection Agency deleted the two-thirds requirement from

federal regulations in the late 1990s. DNR believes that Wisconsin is the only state that still uses the requirement. Federal regulations do not require Wisconsin to keep or eliminate the requirement.

3. The bill would immediately provide eligibility for low interest loans for projects to provide sewers for areas of unsewered residences where two-thirds or more of the initial wastewater flow is from residences constructed between 1972 and 1995. In the future, the date would continue to move forward so that unsewered area projects would be eligible for low-interest loans if two-thirds or more of the initial wastewater flow is from residences constructed more than 20 years ago. If the project does not meet the two-thirds rule, it could receive a state loan at the market interest rate.

4. Under current law, the long-term demand for clean water fund low-interest loans has likely decreased over time because of the two-thirds rule. The further the October 17, 1972, date moves into the past, the more likely it is that growing municipalities and subdivisions that seek funding for providing sewers in currently unsewered areas will not meet the two-thirds rule. DNR indicates that the program has not received applications for entirely new sewer systems for unsewered areas for several years due to the restrictions of the date in the current two-thirds rule.

5. Currently, public sanitary sewer mains, interceptors and systems which exclusively serve future development are ineligible under the program. To be eligible for low-interest rate financing, the reserve capacity included in a project is limited to the future capacity which will be needed to serve the region 10 years after the project becomes operational. Reserve capacity is extra wastewater system capacity not currently needed, but constructed to take future growth into consideration.

6. DNR anticipates the amount of financial assistance provided under the provision for unsewered areas in the 2015-17 biennium would be minimal. Further, they anticipate that the provision in the bill might generate a few applications per year from municipalities with older areas previously using septic systems. Often costs for unsewered areas are a small portion of larger project costs. There are some small rural communities scattered throughout the state that are completely unsewered and might become eligible for low-interest loans under the bill. Projects to provide sewers to unsewered areas tend to be expensive on a per-household basis.

7. The provision could be approved so that unsewered "older development" built in the 1970s through mid-1990s would become eligible for low-interest loans but unsewered "newer development" would not. The provision would provide the incentive of a subsidized loan to encourage development of municipal wastewater service in unsewered communities and could improve water quality in those communities [Alternative 1]. The 20-year date in the bill could be viewed as appropriate because it is similar to the length of time a private onsite wastewater treatment system (septic system) could be expected to last, and could encourage providing public sewers after the end of the anticipated lifespan of a septic system.

8. The provision could be denied so that state funds would not be used to provide subsidized loans to provide municipal wastewater service to unsewered areas that were largely constructed after the early 1970s. Under current law, communities with substantial unsewered development in the last forty years would not receive state low-interest loans for the provision of

wastewater service (but could receive market interest rate loans) [Alternative 4].

9. It could be argued that the provision should be expanded to apply to 10 years before submission of the application instead of 20 years prior, so that major unsewered development that occurred more recently (in the late-1990s and early 2000s) would receive an incentive to provide municipal wastewater service to residents who currently reside in unsewered areas [Alternative 2]. However, this could be viewed as unnecessarily providing low-interest loans to unsewered areas where septic systems may be 10 to 20 years old, should still be within their expected lifespan, and should not need to be replaced yet.

10. To be consistent with current federal regulations, the two-thirds requirement could be eliminated [Alternative 3]. However, this could be viewed as encouraging low-interest rate loans for future growth in new areas or in formerly unsewered areas.

ALTERNATIVES

1. Approve the Governor's recommendation to require that two-thirds of the initial wastewater flow for new wastewater collection systems be from residences that were in existence 20 years prior to the date of submission of the application to DNR for financial assistance in order for a municipality to be eligible for a reduced interest rate loan under the clean water fund program.

2. Modify the Governor's recommendation to require that two-thirds of the initial wastewater flow for new wastewater collection systems be from residences that were in existence 10 years prior to the date of submission of the application to DNR for financial assistance in order for a municipality to be eligible for a reduced interest rate loan under the clean water fund program.

3. Delete the two-thirds rule.

4. Maintain current law.

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May 12, 2015

Joint Committee on Finance

Paper #284

Safe Drinking Water Loan Eligibility for Certain Privately-Owned Systems (Environmental Improvement Fund)

[LFB 2015-17 Budget Summary: Page 153, #6]

CURRENT LAW

The safe drinking water loan program provides low-interest loans to local governments (including cities, villages, towns, counties, town sanitary districts, public inland lake protection and rehabilitation districts and municipal water districts) for eligible projects to plan, design, construct or modify public water systems, if the projects will facilitate compliance with national primary drinking water regulations under the federal Safe Drinking Water Act or otherwise significantly further the health protection objectives of the Act. The program is funded through federal capitalization grants, and a 20% state match, which the state provides with general obligation bonds (with debt service costs paid with GPR). A "public water system" is defined as a system providing piped water to the public for human consumption if the water system has at least 15 service connections or regularly serves an average of at least 25 individuals for at least 60 days each year.

GOVERNOR

Expand eligibility for financial assistance under the safe drinking water loan program to include private owners of a community water system or nonprofit noncommunity water system. A "community water system" is a public water system that serves at least 15 service connections used by year-round residents or that regularly serves at least 25 year-round residents (such as residential rural subdivisions, mobile home parks, apartments, and condominiums). A "noncommunity water system" is a public water system that is not a community water system, and is either: (a) a non-transient system which regularly serves at least 25 of the same persons over six months per year (including some schools, churches, day care centers, and businesses); or

(b) a transient system which serves at least 25 persons per day at least 60 days out of the year (including some seasonal commercial establishments, restaurants, motels, and campgrounds).

Require that private owners of a community water system or nonprofit noncommunity water system would be required to: (a) demonstrate that there is adequate security for the repayment of the financial assistance; and (b) comply with the provisions of the federal Safe Drinking Water Act, state statutes, and the rules and regulations promulgated under the provisions that DNR specifies. [Local governments are currently required to comply with (b).] Private owners would not be required to comply with the following requirements that local governments are required to comply with under current law and the bill: (a) establish a dedicated source of revenue for the repayment of the financial assistance; (b) develop and adopt a water conservation program as required by DNR; (c) develop and adopt a program of systemwide operation and maintenance of the public water system, including the training of personnel, as required by DNR; and (d) develop and adopt a user fee system.

DISCUSSION POINTS

1. The federal Safe Drinking Water Act authorizes, but does not require, states that receive federal capitalization grants for safe drinking water state revolving funds, to lend to private owners of community water systems, and to nonprofit noncommunity water systems.

2. DNR indicates that a private company operating the City of Superior municipal public water system would be the most likely private owner of a community water system to request safe drinking water loan program assistance under the bill. It is a relatively large system, has undertaken several infrastructure improvement projects annually, and is likely to have the financial ability to meet the credit-worthiness requirements of the bill and repay loans under the program. DNR is aware of two or three other private companies that operate municipal systems that appear to serve small subdivisions outside the boundaries served by existing municipal systems. It is uncertain whether these smaller private owners would have the financial ability to meet the credit-worthiness requirements under the bill.

3. DNR maintains a drinking water database that shows eligibility could become available under the bill to up to approximately 445 privately-owned community water systems that are not operated for municipalities. These systems serve mobile or manufactured home parks, residential subdivisions, and apartment or condominium buildings. In addition, the DNR database shows that up to approximately 2,400 nonprofit noncommunity systems could become eligible, most of which are churches and schools. DNR anticipates there would be a limited increase in applications for financial assistance from these systems because of the credit-worthiness requirements of the bill.

4. The administration indicates the rationale for expanding eligibility to privately-owned systems that provide public water supplies to municipalities is that it would provide the same access to a state loan as a system owned by municipality. DNR indicates the rationale for expanding eligibility to the other privately-owned systems in the bill is that it could allow some systems that are currently not providing safe drinking water to its consumers a low-interest method of improving

their existing infrastructure.

5. DNR and DOA anticipate the program would make loans to private owners under the bill with funds received from loan repayments received from municipalities that received prior loans, rather than from proceeds from general obligations. This would be done to make sure that general obligation bond proceeds would not be used to benefit private property.

6. Private applicants would not have to comply with certain provisions that municipalities are subject to. DNR indicates the rationale for this includes several points. First, private owners might not have a dedicated source of revenue for the repayment of the financial assistance like municipalities are required to demonstrate, but the bill would require private owners to demonstrate there is adequate security to repay the loan. DNR indicates private owners would not be required to develop and adopt a water conservation program because DNR does not currently require this of municipalities. The bill would not require private owners to develop and adopt a program of systemwide operation and maintenance of the public water system, including the training of personnel, as required by DNR, but DNR indicates the systems would be subject to administrative code requirements related to operation and maintenance.

7. Currently, the safe drinking water loan program requires municipal borrowers to have a dedicated revenue source such as water user fees or property taxes. Before approving the loan, DOA reviews how the dedicated revenue stream compares to the expenses paid from the revenue stream, and requires the difference, or "net revenue" to be at least 110% of the maximum annual debt service on the loan and any other outstanding loans paid from the same revenue stream. If the revenue from the dedicated revenue stream is not sufficient to cover those loan payments, the borrower needs to adopt and implement a plan to increase revenue before a safe drinking water loan is approved.

8. The bill would not require private owners to develop and adopt a user fee system. DNR indicates many of these systems would likely be churches and schools, and thus would likely not have user fees. The Public Service Commission does not regulate water rates of privately-owned community water systems.

9. It is uncertain what private owners of a community water system or nonprofit noncommunity water system would have to do to demonstrate that they can provide adequate security for the repayment of the financial assistance under the bill. It is possible that some schools, churches, or owners of residential developments may be able to demonstrate they have a secure source of funds to repay the loan. It is probable that others, such as some mobile home parks, may have difficulty meeting the credit-worthiness requirements to borrow funds under the bill.

10. DNR establishes an annual priority ranking list that scores each safe drinking water loan project and is used to establish a list of projects to be funded. The ranking system provides first priority for projects that address acute public health risks, especially related to a confirmed waterborne disease outbreak, and then other human health and water contamination issues.

11. The safe drinking water loan program has had sufficient funds in 2011-12 through 2014-15 to provide financial assistance to all applicants. Between 2006-07 and 2010-11, some

years did not have sufficient funding for some applicants. Between the first year of the program in 1998-99 and 2006-07, the program ran out of money every year before being able to fund all eligible applications. For 2014-15, DNR established a final project priority list with total costs estimated at \$264.9 million for projects with submittals of an "intent to apply" form. Of this total, municipalities submitted applications for 24 projects for \$42.1 million in financial assistance, and there was sufficient loan funding for all applications. DOA and DNR estimate that approximately \$148 million in safe drinking water loan program project costs could be funded during the 2015-17 biennium. This includes funding from federal grants, state match, carry forward balance from 2013-15, and loan repayments from previously made loans.

12. The federal capitalization grants for the safe drinking water loan program in federal fiscal year 2010 and subsequent years have allowed states to use up to 20% to 30% of the federal grant for principal forgiveness (in effect, a grant). The scoring formula for awarding principal forgiveness to eligible projects is established in the Intended Use Plan (IUP) prepared by DNR and DOA, which is an annual plan for use of federal funds as required by the U.S. Environmental Protection Agency (EPA). The scoring formula is not in state statutes or administrative code, but DNR and DOA have a public comment process for review of the IUP before the scoring formula is finalized. The scoring formula provides more points for municipalities with the smallest population size and the lowest median household income. Depending on the project score, a municipality can receive principal forgiveness of 0%, 15%, 30%, 45% or 60% of project costs, with a maximum of \$500,000 per applicant. Principal forgiveness is awarded to applications in the same order they appear on the priority ranking list. For the federal fiscal year 2014 grant being used to provide financial assistance in state fiscal year 2014-15, the state program allocated \$4,627,500 in principal forgiveness to 12 of 24 applications that received loans. There was insufficient principal forgiveness for seven applications that were eligible. DNR is developing revisions to the scoring formula, in response to recent federal requirements to include factors related to unemployment and areas of declining population, and solicited public comment in April, 2015.

13. DNR indicates that if the provision in the bill is enacted, and if the Department decides it wants to award principal forgiveness to privately-owned systems, it would probably have to revise the methodology for awarding principal forgiveness to account for these systems. For example, it would likely have to revise the system of how points are awarded for the population size because some of the newly-eligible systems under the bill would have a small population (such as small rural subdivisions) or no residential population (such as schools or churches). It is unknown how DNR would include "members" or "attendees" in the population factor. DNR would utilize a public comment process before revising the principal forgiveness criteria and submitting it to EPA.

14. It is uncertain how the priority ranking score of privately-owned public water systems that become eligible under the bill would compare with the ranking of currently-eligible municipal systems. It is possible some systems that become eligible under the bill could have a higher priority score than currently-eligible systems. For example, if a system becomes eligible under the bill, and applies for financial assistance to replace a well that has contaminated water which poses a threat to human health, it could have a higher priority score than a project to replace pipes that do not pose a threat to human health. The priority ranking system would continue to rank and score projects based on priority score whether or not they are municipally-owned or privately-owned. If there is

sufficient funding in a given fiscal year, all eligible projects would be funded. If there is not sufficient funding for all projects, it is possible that some newly-eligible systems would be funded and some currently-eligible projects would not be ranked high enough to be funded.

15. While there has been sufficient safe drinking water loan program funding for all applicants in the past few years, it is unknown whether there will be sufficient funding in a given future fiscal year to provide financial assistance to all currently-eligible applicants and applicants who become eligible under the bill. DOA and DNR estimate that there will be sufficient funding for approximately \$148 million in project costs during the 2015-17 biennium. In March, 2015, DNR established a draft project priority list for 2015-16 with total costs estimated at \$348.6 million for projects that submitted an "intent to apply" form by December 31, 2014. It is unknown how many of them will be ready to proceed and apply by June 30, 2015, for financial assistance in 2015-16. In 2011-12 through 2013-14, the program entered into an average of \$39 million annually in safe drinking water financial assistance agreements.

16. If the Committee has concerns that providing eligibility for privately-owned systems could result in insufficient funds being available for currently-eligible systems, it could approve only the expansion of eligibility to private owners of municipal systems (which would provide eligibility for the private owner of the City Superior system) and not provide eligibility to private owners of other systems such as schools, churches and subdivisions [Alternative 2]. Alternatively, the provision could be deleted in order to maintain the allocation of limited state resources to systems owned by municipalities [Alternative 4]. Private owners could continue to borrow from private sources.

17. It is possible that some systems with private owners which become eligible under the bill would have a high enough priority ranking score to be awarded principal forgiveness before it is awarded to lower scoring municipalities that are currently eligible for principal forgiveness. It is possible that this scenario could result in insufficient principal forgiveness remaining for some municipal systems that would have otherwise received principal forgiveness under current law.

18. If the Committee has a concern that principal forgiveness should not be provided to private owners, but should only be provided to municipalities, or to privately-owned systems operated for municipalities, the bill could be amended to prohibit DNR and DOA from awarding principal forgiveness to private owners of a system that does not serve a municipality [Alternative 3]. This would allow DNR to award principal forgiveness to the owner of a system that serves a municipality, but not to other privately-owned systems. Under the bill's expansion of eligibility to private owners, DNR would determine how to award principal forgiveness under the intended use plan submitted to EPA.

19. If the provision is deleted, it will not change the eligibility or system of priority ranking for currently-eligible public water systems owned by municipalities [Alternative 4].

ALTERNATIVES

1. Approve the Governor's recommendations to: (a) expand eligibility for financial

assistance under the safe drinking water loan program to include private owners of a community water system or nonprofit noncommunity water system; and (b) require that the private owners demonstrate that there is adequate security for the repayment of the financial assistance, and comply with the provisions of the federal Safe Drinking Water Act, state statutes, and the rules and regulations promulgated under the provisions that DNR specifies.

2. Expand eligibility for financial assistance under the safe drinking water loan program to include private owners of a community water system for a municipality. Require that the private owners demonstrate that there is adequate security for the repayment of the financial assistance, and comply with the provisions of the federal Safe Drinking Water Act, state statutes, and the rules and regulations promulgated under the provisions that DNR specifies. Delete the bill's expansion of eligibility for other private owners of a community water system or nonprofit noncommunity water system.

3. Approve Alternative 1 or 2. In addition, prohibit DNR and DOA from awarding principal forgiveness to private owners of a community water system or nonprofit noncommunity water system that are not systems that serve a municipality.

4. Delete provision.

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ENVIRONMENTAL IMPROVEMENT FUND

LFB Summary Item for Which No Issue Paper Has Been Prepared

<u>Item #</u>	<u>Title</u>
7	Safe Drinking Water Loan Program Service Fee

LFB Summary Item to be Addressed in a Subsequent Paper

<u>Item #</u>	<u>Title</u>
2	Debt Service Reestimate

