



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #295

Program Changes (Environmental Improvement Fund)

[LFB 2019-21 Budget Summary: Page 125, #2]

CURRENT LAW

The clean water fund program within the environmental improvement fund provides financial assistance to municipalities for the planning, design, and construction of wastewater treatment facilities. Financial assistance is generally provided as a loan with an interest rate of 55% of the market interest rate for most project types. This includes the following project types: (a) compliance maintenance projects to prevent a significant violation of an effluent limitation by a municipal sewage treatment facility; (b) projects to achieve compliance with a new or changed effluent limit; (c) projects to prevent or treat nonpoint source pollution or urban storm water runoff; and (d) projects to provide treatment facilities and sewers for unsewered areas.

The clean water fund program has \$646,283,200 in general obligation authority and \$2,526,700,000 in revenue obligation bonding authority. The state issues revenue bonds for the required 20% match on federal capitalization grants from the U.S. Environmental Protection Agency (EPA) and to provide capital to make loans to municipalities for eligible projects. As municipalities repay the loans, the funds remaining after debt service payments become available for new loans.

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. EPA provides federal capitalization grants to states that operate safe drinking water revolving loan programs. The program provides loans using proceeds of the federal 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 authorized a cumulative total of

\$71,400,000 in general obligation bonding authority.

GOVERNOR

Make the following program changes in the environmental improvement fund:

- a. Provide an increase in general obligation bonding authority of \$13,500,000 for the clean water fund program.
- b. Provide an increase in general obligation bonding authority of \$3,550,000 for the safe drinking water loan program.
- c. Authorize the Department of Natural Resources (DNR) and Department of Administration (DOA) to issue revenue obligations for the safe drinking water loan program in a manner consistent with the existing authority for the clean water fund revenue obligations. Specify that the current authorization for the state to issue up to \$2,526,700,000 in revenue obligations for the clean water fund program could also be used to issue revenue obligations for the safe drinking water loan program.
- d. The Executive Budget Book states the Governor recommended increasing the maximum loan term for the safe drinking water loan program from 20 years to 30 years to mirror the clean water fund program. The bill does not include this provision. On May 1, 2019, the Secretary of DOA submitted a request to include this change in the bill.

DISCUSSION POINTS

A. Clean Water Fund Program Bonding

1. To receive federal capitalization grants for the primary direct subprogram of the clean water fund program, the state must contribute an amount equal to at least 20% of the federal grant amount. Prior to state fiscal year 2016-17 (federal fiscal year 2016), Wisconsin's state match was provided with general obligation bond proceeds. Debt service on general obligation (GO) bonds is paid from the state's general fund taxes and loan repayments received from municipalities on clean water fund loans. In addition, the program used the proceeds of clean water fund revenue bonds to leverage a larger amount of capital to make loans to municipalities for eligible projects, and had used GO bonds for a portion of certain interest subsidy costs. In October, 2015, the EPA and the Wisconsin Building Commission approved a new funding structure for this subprogram of the clean water fund. Under the new funding structure, provision of the state match beginning in federal fiscal year 2016 is provided from the proceeds of environmental improvement fund revenue obligations, and interest repayments of loans made with the revenue bonds and future federal grants (but not for payment of debt service of prior state match from GO bonds).

2. Under the 2017-19 budget, the Governor recommended the repeal of the financial hardship assistance component and a decrease of \$40.46 million in GO bonding authority for the clean water fund program. DOA and DNR anticipated that under the clean water fund program

restructuring, the program would only need to use the proceeds of GO bonds, with GPR debt service payments, to fund the grant component of the financial hardship assistance component. At that time, DOA anticipated approximately \$6 million in GO bonding authority would remain, which could be used for additional costs related to financial hardship assistance grants allocated before enactment of the budget act, or for other unanticipated subsidy needs under the program. The recommended deletion of GO bonding authority was intended to eliminate bonding authority no longer needed for the program under the new program structure. Under 2017 Wisconsin Act 59, the 2017-19 biennial budget act, the Governor's recommendation was adopted to decrease GO bonding authority by \$40.46 million. In addition, Act 59 retained eligibility for a municipality for financial hardship assistance if it had submitted an initial application prior to June 30, 2017, and final application prior to June 30, 2018. (This provided eligibility to Bluffview Sanitary District in Sauk County and Three Lakes Sanitary District in Oneida County.)

3. After DNR and DOA submitted the required biennial finance plan for 2019-21 to the Building Commission and Legislature in September, 2018, and after the state issued the December, 2018, annual financial disclosure report, DOA identified two accounting errors totaling \$15.7 million made by the program several years earlier when it did not properly allocate GO bonds used to provide clean water fund subsidy of interest rates for loans to municipalities prior to the 2015 program restructuring. Had this allocation error been realized prior to consideration of the 2017-19 budget, a reduction of approximately \$27 million in clean water fund GO bonding authority would have been more commensurate with actual program obligations.

4. The following table shows how the recommended restoration of \$13.5 million in GO bonding for the program was calculated. The available bonding balance of \$6.0 million is sufficient to fund the estimated \$3.8 million needed for four remaining financial hardship assistance grants entered into prior to the 2017-19 repeal of the program (Bluffview, Three Lakes, Kendall and Rib Lake). The final amount needed for those hardship projects will not be known until all of those projects are completed, as GO bonds are issued when funds are disbursed during construction of the project. DOA indicates it will be able to reallocate a minimal amount from another clean water fund proprietary loan subprogram that has used GO bonds for projects that do not meet all of the federal program criteria, but that would not be sufficient to correct the error.

Components of Clean Water Fund General Obligation Bonding Authority Request

<u>Item Description</u>	<u>Amount</u>
Earlier errors in allocation of clean water GO bond subsidy	\$15,700,000
Estimated GO bonding needed for remaining hardship grants for projects qualifying in SFY 2017 and prior years	<u>3,820,343</u>
Total GO bonding needed	\$19,520,343
Less available GO bond balance (February 1, 2019)	<u>-6,018,559</u>
Potential Adjustment Needed	\$13,501,784

5. As 2017 Act 59 reductions to clean water fund GO bonding authority were based on an incomplete accounting of program obligations, it would be appropriate to approve the restoration of

\$13.5 million in GO bonding for the clean water fund program [Alternative A1].

B. Safe Drinking Water Loan Program Bonding

6. Currently, the safe drinking water loan program uses all of the authorized GO bonds to provide the 20% state match required to obtain the federal capitalization grant. The biennial budget act has historically authorized the amount of GO bonds anticipated for the 20% match needed to maximize federal grant receipts 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.

7. The September, 2018, biennial finance plan recommended approval of \$7.1 million in GO bonding to provide the 20% state match to an estimated \$37.9 million in federal grants during the 2019-21 biennium. The plan stated that approximately \$0.5 million in previously authorized but unallocated GO bonding authority could also be used for state match. The September, 2018, biennial finance plan did not include a recommendation to provide revenue obligation authority for the safe drinking water program.

8. The administration indicates the Governor's recommendation to create a safe drinking water revenue obligation component is intended to finance an amount of project costs expected to exceed the amount available from federal capitalization grants and loan repayments in 2019-21 and future biennia. In addition, creation of a revenue obligation component would allow the revenue obligations, and interest repayments of loans made with revenue obligations and future federal grants, to be used to pay future state match for federal grants. This would be expected to reduce the future need for issuance of GO bonds for the state match.

9. The Governor's recommendation to add \$3.55 million in GO bonding is intended to provide a transition during 2019-20 from using GO bonds for the state match to using proceeds of revenue obligations and loan repayments for the state match. DOA indicates that if the revenue obligation structure is not approved, an additional \$3.55 million in GO bonding authority will be needed to provide the 2020-21 state match [Alternative B2] to provide the \$7.1 million included in the September, 2018, biennial finance plan for two years of match. It is possible that, if the revenue obligation structure were approved, and if the program could issue revenue obligations early in 2019-20, it would not need the \$3.55 million in recommended GO bonding authority for the 2019-20 state match. However, if the state needs to provide the state match to the federal grant before it can complete the issuance of revenue obligations, the recommended \$3.55 million in GO bonding authority would be needed. Future need for GO bonding authority for state match could be evaluated during 2021-23 budget deliberations.

10. In the DNR and DOA first version of the biennial finance plan submitted in September, 2018, the agencies estimated that \$138.6 million would be available during the 2019-21 biennium under current law to provide financial assistance under the safe drinking water loan program. In the second version of the plan, submitted in March, 2019, as statutorily required 30 days after the Governor submitted his budget to the Legislature, the estimated available amount was \$153.3 million, based on updated information about closed loans and estimated loan repayments. This excludes any

funds available from the recommended revenue obligation bonding for the program. The departments further estimate that, under the proposed revenue obligation structure, the program could fund an additional \$43 million in project costs annually, with the availability of funds depending on the timing of issuance of revenue obligations for the program. This assumption of additional project cost funding is not based on any specific project needs or priority list.

11. The actual amount of financial assistance agreements entered into by the safe drinking water loan program averaged \$54.8 million annually in the four years of 2014-15 through 2017-18. For the 2018-19 funding year, municipalities submitted notifications of intent to apply for funding for potential costs totaling \$491.5 million. The final funding list for 2018-19, issued in October, 2018, included all eligible projects that applied for funding, with total project costs of \$62.6 million. It is possible that not all municipalities with projects on the 2018-19 funding list will enter into financial assistance agreements. As of May 8, 2019, the program had entered into financial assistance agreements totaling \$12.0 million in 2018-19, and staff anticipates more agreements could close before the end of the fiscal year. Municipalities submitted notifications of intent to apply for funding for potential costs totaling \$553.9 million in 2017-18, and the actual amount of financial assistance agreements entered into during 2017-18 was \$60.3 million, or 11% of the potential costs. The project priority list for 2019-20 includes notifications of an intent to apply for a total of \$506.5 million, but it is uncertain how much of this total will be submitted as actual applications for funding. Under the March, 2019, version of the biennial finance plan, the estimated \$153.3 million available in the 2019-21 biennium under current law, with no revenue obligation authority, would provide approximately \$76.65 million in each year of the biennium for project costs, which is approximately 40% more than the \$54.8 million average annual amount of financial assistance agreements entered into for the four years between 2014-15 and 2017-18.

12. The City of Waukesha submitted notifications of intent to apply for funding in 2016-17 through 2019-20 for project costs currently estimated at \$150 million to construct facilities to obtain Lake Michigan water and construct a water transmission main from Milwaukee to Waukesha. DNR anticipates that Waukesha will submit applications for a significant portion of these costs during the 2019-21 and 2021-23 biennia. The Waukesha project would represent a significant portion of the total funding available under the safe drinking water loan program during the 2019-21 and 2021-23 biennia. The statutes specify that no municipality can receive more than 25% of the funds that DOA projects will be available for the safe drinking water loan program for the biennium. This means that up to approximately \$38.3 million of the \$153.3 million anticipated as being available under the March, 2019, biennial finance plan could be provided to a single municipality. It is likely that Waukesha applications may exceed the 25% cap, even if revenue obligations were to add available funding beginning in the 2019-21 biennium. However, Waukesha is discussing with EPA options for obtaining separate federal financial assistance under the Water Infrastructure Finance and Innovation Act, reauthorized in 2018, that may provide long-term, low-interest loans for nationally and regionally significant projects.

13. If no additional general obligation bonding authority for the safe drinking water loan program were approved, and if no revenue obligation program component were created [Alternative B3], the state could use the \$0.5 million in bonding authority carried forward from 2017-19 to provide a 20% state match to a minimal amount of federal grant funds. This could allow the state to apply for

a minimal partial federal grant of approximately \$2.35 million, but the amount would not be sufficient to provide the necessary match to receive the full estimated grant of \$37.9 million in FFY 2019 and FFY 2020, and it is uncertain how EPA would handle issuance of a partial grant. The state is required to have the match in place before it can draw on any of the estimated federal grant funds, and it must spend all of the state match before it can spend any of the federal grant. If no GO bonding authority were provided, the program would be able to make loans with up to approximately \$118 million in funds available from the carry forward balance from the previous year, loan repayments, investment income, and the partial federal grant [Alternative B3].

C. Safe Drinking Water Loan Term

14. Prior to 2017, loans made under both the clean water fund and safe drinking water loan programs had a maximum term of 20 years, as determined by DOA, and the loans had to be fully amortized no later than 20 years after the original date of the financial assistance agreement. The federal Water Resource Reform and Development Act of 2014 authorized, but did not require, states to allow up to 30-year loan agreements for clean water fund projects (but not safe drinking water loans) if the state determines that the length of the loan does not exceed the projected useful life of the project to be financed.

15. Under 2017 Act 59, state statutes were amended to extend the maximum loan term for clean water fund loans as authorized by the 2014 federal law change (but not safe drinking water loans), to be no longer than 30 years, or the useful life of the project, whichever is less, as determined by DOA, and to require that the clean water fund loan would have to be fully amortized no longer than 30 years after the original date of the financial assistance agreements, and if repayment of principal and interest, if any, begins no later than 12 months after the expected completion date of the project.

16. The federal America's Water Infrastructure Act of 2018 authorized, but did not require, states to allow up to 30-year loan agreements for safe drinking water projects if the loan would be fully amortized not later than 30 years after the completion of the project, and if repayment of principal and interest, if any, would begin not later than 18 months after completion of the project. This federal authorizing language is slightly different from the federal language authorizing 30-year loan terms for clean water fund loans, and does not require the loan term to be the lesser of 30 years or the useful life of the project.

17. While the Executive Budget Book stated the Governor's intent to increase the maximum term of safe drinking water loans to 30 years, the bill did not include language to accomplish this. The Committee could choose to amend the bill to authorize the program to allow up to 30-year loan agreements for safe drinking water projects. Language consistent with federal requirements could be added to specify the 30-year term would be authorized if the loan would be fully amortized no later than 30 years after the expected completion date of the project, and repayment of principal and interest, if any, would begin not later than 18 months after the expected completion date of the project that it funds, as determined by DOA [Alternative C1].

18. A 30-year loan term could help some municipalities with large projects that have a long useful life have lower annual payments by spreading payments over 30 years instead of 20. The

program does not anticipate many municipalities would use the longer loan term. Loans with a 30-year term would pay a slightly higher loan interest rate than loans with a 20-year term, based on calculation of a slightly higher market interest rate.

19. The 2018 federal law change does not require the state to provide a 30-year loan term for safe drinking water loans. The Committee could choose to take no action and maintain the current 20-year loan term [Alternative C2].

ALTERNATIVES

A. Clean Water Fund Bonding

1. Approve the Governor's recommendation to provide an increase of \$13,500,000 in general obligation bonding authority for the clean water fund.

ALT A1	Change to	
	Base	Bill
BR	\$13,500,000	\$0

2. Take no action.

ALT A2	Change to	
	Base	Bill
BR	\$0	-\$13,500,000

B. Safe Drinking Water Loan Program Bonding

1. Approve the Governor's recommendations to: (a) provide an increase of \$3,550,000 in general obligation bonding authority for the safe drinking water loan program; (b) authorize issuance of revenue obligations for the safe drinking water loan program in a manner consistent with the existing authority for the clean water fund revenue obligations; and (c) specify that the current revenue obligations for the clean water fund program could also be used to issue revenue obligations for the safe drinking water loan program.

ALT B1	Change to	
	Base	Bill
BR	\$3,550,000	\$0

2. Modify the Governor's recommendation to provide an increase of \$7,100,000 in general obligation bonding authority for the safe drinking water loan program. Take no action on the recommendation to authorize issuance of revenue obligations for the safe drinking water loan

program, or to authorize use of clean water fund revenue obligations for safe drinking water loans.

ALT B2	Change to	
	Base	Bill
BR	\$7,100,000	\$3,550,000

3. Take no action. 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 for the program in the 2019-21 biennium.

ALT B3	Change to	
	Base	Bill
BR	\$0	-\$3,550,000

C. Safe Drinking Water Loan Term

1. Authorize the safe drinking water to provide a maximum 30-year loan term, instead of the current maximum of 20 years, if the loan will be fully amortized not later than 30 years after the expected completion date of the project, and if repayment of principal and interest, if any, begins not later than 18 months after the expected completion date of the project that it funds, as determined by DOA.

2. Take no action.

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