



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #330

Bonding Authority and Present Value Subsidy Limit (Environmental Improvement Fund)

[LFB 2003-05 Budget Summary: Page 168, #1 and 2(a)&(c)]

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. 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. The state match is provided with general obligation bond proceeds. 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 with the general obligation bonds paying the costs of the state subsidy to municipalities that results because loans to municipalities are made at an interest rate below the market interest rate the state pays for its revenue bonds. DOA administers most aspects of the financial management of the environmental improvement fund. DNR primarily administers the loan and grant provisions.

To provide a financial control mechanism, the statutes provide a concept unique to the environmental improvement fund, termed a "present value subsidy" limit. This limit is a means for the Legislature to control the commitment of state financial assistance to municipalities in a biennium. Because it incorporates the debt service that will be paid on bond issuances, the present value subsidy limit reflects the total cost to the state, in current dollars, of subsidizing clean water fund program projects. 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. There is \$90 million authorized in present value subsidy for the clean water fund for the 2001-03 biennium and \$1,000 authorized for subsequent biennia.

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 and 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 preceding the fiscal year, and DOA would allocate funding to projects in the order they appear on the funding list.

The land recycling loan program within the clean water fund provides financial assistance to certain local governments for the investigation and remediation of contaminated (brownfields) properties. Eligible projects include investigation and remediation of contamination at sites or facilities owned by the local government if the contamination has affected, or threatens to affect, groundwater or surface water. The land recycling loan program is funded with up to \$20 million, which comes from reallocation of repayments of clean water fund program loans made with the proceeds of federal grants to the clean water fund.

GOVERNOR

Provide an increase in revenue obligation bonding authority of \$259,670,000 for the clean water fund program, from \$1,398,355,000 to \$1,658,025,000. No change would be made in the general obligation bonding authority for the clean water fund program, which is currently authorized \$637,743,200. Provide a "present value subsidy limit" totaling \$92.4 million for the clean water fund program and \$12.0 million for the land recycling loan program.

DISCUSSION POINTS

1. The environmental improvement fund biennial finance plan submitted by DNR and DOA to the Building Commission and Legislature in September, 2002, requested sufficient general obligation bonding authority and present value subsidy limit to fund all expected wastewater needs during the biennium. DNR identified wastewater project needs of \$463.7 million for the 2003-05 biennium, including: (a) \$172.2 million originally estimated as 2002-03 need for which applications had not been submitted as of August, 2002, and so were reestimated to be submitted in 2003-04 instead of 2002-03 (inclusion of this component meant that it was estimated that 2001-03 present value subsidy limit would not be needed for the projects, but that instead 2003-05 present value

subsidy limit would be needed); (b) \$265 million in estimated need for new applications in the 2003-05 biennium; and (c) \$26.5 million as a 10% construction contingency for the \$265 million in new applications. DNR's projections represented the best estimates of need as of September 1, 2002, based on both file materials and a comprehensive survey of municipalities.

2. Recently, DOA and DNR officials indicated that the bill's inclusion of \$12 million in present value subsidy limit for the land recycling loan program was an error and a technical correction of the bill should be made to provide \$4 million in present value subsidy limit for the land recycling loan program. This would allow for the \$10.1 million in remaining funds for land recycling loans to be awarded for project costs in 2003-05.

3. DNR and DOA officials have recently updated their projections of the clean water fund program wastewater need to reduce the estimate of 2002-03 projects that will be financed in 2003-04 downward from \$172.2 million to \$86.1 million. This is due to the program entering into more financial assistance agreements for projects between September, 2002, and March, 2003, than had been estimated earlier. It would be appropriate to make a technical correction of the bill to provide \$75.4 million in present value subsidy limit for the clean water fund program instead of the \$92.4 million provided in the bill and \$257.60 million in revenue obligation authority instead of \$259.67 million. This correction would reflect the more current estimate of wastewater need anticipated for the 2003-05 biennium. The correction would not include an adjustment in the cumulative need for general obligation bonding authority because the projects financed between September, 2002, and March, 2003, utilized general obligation bonding authority that, in September, 2002, had been projected by the biennial finance plan to be needed in 2003-05.

4. The biennial finance plan and the bill are based on an estimated revenue obligation market interest rate of 6% for planning purposes, based on historical trends. This is the same assumption that was included in the 2001-03 biennial budget. The revenue obligation market interest rate for most of the 1999-01 biennium was 5.4%, decreased to 5% in April, 2001, and has remained at or below 5% since.

5. If market interest rates continue at the current 5% rate during the 2003-05 biennium, the Governor's recommended levels of bonding authority and present value subsidy limit would be sufficient to fund a greater amount of projects than were projected in the biennial finance plan. For example, the biennial finance plan and bill did not include additional general obligation bonding authority because the actual interest rates of 5% were lower than the 6% "planning interest rate," which allowed a lower use of general obligation bonds. If the interest rate continues at 5.5%, cumulative general obligation (GO) bonding authority of \$630.5 million would be sufficient to fund all need projected through June, 2005. This would represent a \$7.2 million reduction to the currently authorized cumulative amount of \$637.7 million (see Alt. #2 in the following table). If the interest rate continues at 5.0%, cumulative GO bond authority of \$624.2 million would be sufficient, representing a \$13.5 million reduction to the currently authorized \$637.7 million (Alt. #3).

6. Any reduction in GO bond authority would not be expected to result in significant

GPR savings in debt service costs until after 2004-05. This is because bonds allocated for projects that are approved for funding in the 2003-05 biennium would likely be issued late in the biennium or in future biennia as facility construction is completed, and debt service would typically begin to be paid after 2004-05. Further, it is probable that any general obligation bonding authority not needed during 2004-05 would be needed for allocation to project costs in 2005-06. When using a 5.5% estimated market interest rate instead of the 6% used in the bill, a present value subsidy limit of \$67.6 million would be sufficient. Although interest rates are currently at, or below, 5%, a 5.5% rate would allow for some increase in market rates over the biennium without limiting anticipated projects. If interest rates rise beyond 5%, and if a 5.0% interest rate would be used for provision of funding, the higher than expected interest rates could limit funding for some projects.

**Provision of Present Value Subsidy and Bonding
(\$ Millions)**

<u>Alternative</u>	<u>Present Value Subsidy Limit</u>	<u>General Obligation Bonding Authority</u>	<u>Revenue Obligation Bonding Authority</u>
Bill	\$92.4	\$0.0	\$259.67
Technical Correction (Alt. #1)	75.4	0.0	257.60
Technical Correction at 5.5% Interest Rate (Alt. #2)	67.6	-7.2	257.60
Technical Correction at 5.0% Interest Rate (Alt. #3)	59.9	-13.5	257.60
Technical Correction at 5.5% Interest Rate plus Deletion of Contingencies (Alt. #4)	62.2	-15.9	217.60
Technical Correction at 5.0% Interest Rate plus Deletion of Contingencies (Alt. #5)	55.1	-21.5	217.60

7. In addition to the higher-than-actual interest rate used for planning purposes, the biennial finance plan and bill include a contingency of 5% of anticipated revenue obligation bond needs, or \$12.3 million, and, as mentioned earlier, a 10% construction contingency, equaling \$26.5 million of the \$265 million in applications anticipated during the 2003-05 biennium. While these contingencies are intended to accommodate unanticipated increases in program costs, they could be eliminated to allow for a lesser increase in the revenue obligation bonding authority. The impact of using a 5.5% market interest rate and eliminating contingencies is shown in the table (Alt. #4). The impact of using a 5.0% market interest rate and eliminating contingencies is shown as Alternative 5. However, there likely would be no GPR debt service cost savings from either of these changes during the 2003-05 biennium (since these GO bonds would likely not be needed in 2003-05). If the general obligation and revenue obligation bonding authority are not used in 2004-05, they would most likely be used in 2005-06.

8. If interest rates rise beyond expectations, municipalities encounter project cost increases, or need is greater than identified in the September, 2002, biennial finance plan, Alternatives #3 through #5 could result in some projects being deferred from the spring of 2005 to after June 30, 2005, when 2005-07 financing would be made available. On the other hand, it is possible that some demand currently expected for the 2003-05 biennium will not materialize until 2005-07. It is estimated that \$86 million in 2001-03 projects will not be realized until 2003-05. Similarly, some of the \$265 million in expected 2003-05 demand may not be realized until 2005-07.

9. As discussed earlier, the biennial finance plan and the bill are intended to fund all identified need and a construction contingency allowance. The Milwaukee Metropolitan Sewerage District (MMSD) borrows the largest percentage of project costs of any municipality in the program. The biennial finance plan estimated MMSD low-interest project costs of approximately \$116 million (excluding construction contingencies) and present value subsidy of \$22.3 million under the bill. The percentage of the total present value subsidy limit allocated to MMSD would be approximately 29.7% to 32.3% under the listed alternatives. This is within the statutory requirement that an individual municipality may receive no more than 35.2% of the total present value subsidy limit. While in the 1999-01 and 2001-03 biennia, MMSD used almost the statutory maximum percentage of present value subsidy available to it under the program, current estimates indicate that MMSD projects are likely to represent a lower percentage of the total present value subsidy in 2003-05.

ALTERNATIVES

1. Approve the Governor’s recommendation, as technically corrected, to provide: (a) an increase in revenue obligation bonding authority of \$257,600,000 (a correction from the \$259,670,000 in the bill) for the clean water fund program; (b) a "present value subsidy limit" totaling \$75.4 million for the clean water fund program (a correction from the \$92.4 million in the bill); and (c) a "present value subsidy limit" of \$4.0 million for the land recycling loan program (a correction from the \$12.0 million in the bill).

<u>Alternative 1</u>	<u>BR-REV</u>
2003-05 REVENUE (Change to Bill)	- \$2,070,000

2. Approve the technically corrected present value subsidy limit of \$4.0 million for the land recycling loan program. In addition, in the clean water fund program (assuming a 5.5% revenue market interest rate): (a) decrease general obligation bonding authority by \$7,200,000; (b) provide an increase in revenue obligation authority of \$257.6 million; and (c) provide a “present value subsidy limit” totaling \$67.6 million for the clean water fund program.

<u>Alternative 2</u>	<u>BR-REV</u>	<u>BR-GO</u>	<u>TOTAL</u>
2003-05 REVENUE (Change to Bill)	- \$2,070,000	- \$7,200,000	- \$9,270,000

3. Approve the technically corrected present value subsidy limit of \$4.0 million for the land recycling loan program. In addition, in the clean water fund program (assuming a 5.0% revenue market interest rate): (a) decrease general obligation bonding authority by \$13,500,000; (b) provide an increase in revenue obligation authority of \$257.6 million; and (c) provide a “present value subsidy limit” totaling \$59.9 million for the clean water fund program.

<u>Alternative 3</u>	<u>BR-REV</u>	<u>BR-GO</u>	<u>TOTAL</u>
2003-05 REVENUE (Change to Bill)	- \$2,070,000	- \$13,500,000	- \$15,570,000

4. Approve the technically corrected present value subsidy limit of \$4.0 million for the land recycling loan program. In addition, in the clean water fund program (assuming a 5.5% revenue market interest rate and deletion of \$26.5 million in construction contingencies and \$12.3 million in revenue obligation contingencies): (a) provide an increase in revenue obligation bonding authority of \$217,600,000 (instead of \$259,670,000 under the bill); (b) decrease general obligation bonding authority by \$15,900,000; and (c) provide a “present value subsidy limit” totaling \$62.2 million for the clean water fund program.

<u>Alternative 4</u>	<u>BR-REV</u>	<u>BR-GO</u>	<u>TOTAL</u>
2003-05 REVENUE (Change to Bill)	- \$42,070,000	- \$15,900,000	- \$57,970,000

5. Approve the technically corrected present value subsidy limit of \$4.0 million for the land recycling loan program. In addition, in the clean water fund program (assuming a 5.0% revenue market interest rate and deletion of contingencies): (a) provide an increase in revenue obligation bonding authority of \$217,600,000; (b) decrease general obligation bonding authority by \$21,500,000; and (c) provide a “present value subsidy limit” totaling \$55.1 million for the clean water fund program.

<u>Alternative 5</u>	<u>BR-REV</u>	<u>BR-GO</u>	<u>TOTAL</u>
2003-05 REVENUE (Change to Bill)	- \$42,070,000	- \$21,500,000	- \$63,570,000

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