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General and Revenue Obligation Bonding Authority, Present Value Subsidy Limit, and Reduce Clean Water Fund Interest Rate Subsidy and Hardship Assistance (Environmental Improvement Fund)

[LFB 2011-13 Budget Summary: Pages 171 to 175, #1, #2, and #5]

CURRENT LAW

Clean Water Fund Program

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 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. 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 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. The 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. 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 estimated cost to the state, in current dollars, of subsidizing clean water fund and safe drinking water loan projects. The present value subsidy limit acts as a cap on the sum of all assistance provided through the clean water fund program and safe drinking water loan 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 $134.9 million authorized in present value subsidy for the clean water fund for the 2009-11 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, 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. 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 15% of the total present value subsidy authorized during a biennium.

Clean water fund program projects receive the following subsidized interest rates as a percent of the market rate: (a) 60% of market rate for compliance maintenance projects, which are projects to prevent a significant violation of an effluent limitation by a municipal sewage treatment facility; (b) 60% of market rate for new or changed limits projects, which are projects to achieve compliance with an 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; (c) 65% of market rate for projects to abate nonpoint source pollution and to control urban stormwater runoff; (d) 70% of market rate for projects to provide treatment facilities and sewers for unsewered areas, if two-thirds of the initial flow is from wastewater from residences that were in existence prior to October 17, 1972; (e) 0% for the portion of a project loan related to septage receiving and storing facilities and capacity for septage treatment; and (f) hardship financial assistance interest rates as low as 0% and grants for up to 70% of project costs, for projects where the municipality's median household income is 80% or less of the statewide median household income and the estimated annual residential wastewater treatment charges would exceed 2% of the median household income in the municipality. The 2009-11 biennial budget act increased the interest rate for projects under (a) and (b) from 55% of the market rate to 60% of market rate.

Safe Drinking Water Loan Program

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 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 program does not have a state revenue obligation bond component like the clean water fund program has. There is $17.6 million in present value subsidy for the safe drinking water loan program for the 2009-11 biennium and $1,000 authorized for subsequent biennia.

Safe drinking water loan projects are scored according to a priority ranking system that is used to establish a list of projects to be funded. Top priority is provided for projects that address an acute public health risk, especially risk related to a confirmed waterborne disease outbreak or confirmed microbial contamination. Second priority is provided for projects that address chronic and longer-term health risks to people who drink the water. Safe drinking water projects receive loans at 55% of the market interest rate, or 33% of the market interest rate if the municipality meets financial need criteria.

Land Recycling Loan Program

The land recycling loan program within the clean water fund provides financial assistance to 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. There is $2.7 million in present value subsidy for the land recycling loan program for the 2009-11 biennium, and $1,000 for subsequent biennia. Land recycling loans are made with a 0% interest rate. No funds were available for the program in 2009-11 because the 2009-11 biennial budget act authorized DNR and DOA to transfer up to the remaining $6.2 million in unallocated funds, as a loan from the land recycling loan program to the dry cleaner environmental response program to provide reimbursement to owners for a portion of the costs of cleaning up discharges of dry cleaning solvents.

GOVERNOR

Provide an increase in bonding authority of $362.4 million for the environmental improvement fund, as shown in Table 1. This includes $9.4 million in general obligation and $353 million in revenue obligation bonding authority.

TABLE 1

Environmental Improvement Fund (EIF) Bonding Authority

	Current	Bill	Total
Clean water fund -- general obligation	$777,043,200	$0	$777,043,200
Clean water fund -- revenue obligation	2,363,300,000	353,000,000	2,716,300,000
Safe drinking water -- general obligation	45,400,000	9,400,000	54,800,000
Total	$3,185,743,200	$362,400,000	$3,548,143,200

Provide a "present value subsidy limit" totaling $85.1 million for the environmental improvement fund for the 2011-13 biennium, including: (a) $54.4 million for the clean water fund program; (b) $30.7 million for the safe drinking water loan program; and (c) $0 for the land recycling loan program. Provide a present value subsidy limit of $1,000 for any biennium after the 2011-13 biennium.

Reduce the subsidy for most clean water fund program projects to provide an interest rate of 80% of the market rate instead of the current 60%, 65%, or 70% of market rate.

Reduce the amount of present value subsidy allocated to financial hardship assistance from 15% to 5% of the total present value subsidy limit.

DISCUSSION POINTS

1. Current law authorizes a present value subsidy limit for the environmental improvement fund totaling $3,000 for any biennia after 2009-11 ($1,000 for each of the three programs within the fund). This would be insufficient to fund any expected projects during the 2011-13 biennium.

2. The American Recovery and Reinvestment Act of 2009 (ARRA) provided additional federal capitalization grants to Wisconsin of $105,948,300 for the clean water fund (of which $2,200,000 was allocated for administration) and $37,750,000 for the safe drinking water loan program (all of which was allocated for financial assistance). The federal requirement for a state match (normally 20%) was waived for federal grants provided to states under ARRA. States were required to use a portion of ARRA funds for grants or principal forgiveness. Under 2009 Act 11, the state enacted one-time provisions to authorize present value subsidy of $105,948,300 for the clean water fund and $37,750,000 for safe drinking water loan program financial assistance provided with ARRA funds which would represent providing up to 100% of the ARRA financial assistance as principal forgiveness. The Act 11 present value subsidy was provided in addition to regular present value subsidy approved under the 2009-11 biennial budget act. Act 11 also authorized DNR and DOA to: (a) establish procedures, deadlines and criteria for awarding funds; (b) provide grants, forgiveness of a portion of the principal amount of a loan, and loans at different interest rates than provided under the regular clean water fund and safe drinking water loan

programs; and (c) establish a percentage limit on the amount of ARRA financial assistance that could be received by any eligible applicant. DNR and DOA used all funds to provide principal forgiveness of 50% of project costs and awarded all of the funds in the fall of 2009.

3. Regular federal capitalization grants do not authorize states to provide grants. The federal fiscal year 2010 appropriations act required states to use a portion of federal capitalization grants for clean water fund and safe drinking water loan program funds for principal forgiveness. Under 2009 Act 384, the state enacted one-time provisions to authorize DNR and DOA to: (a) allocate funds received under the federal fiscal year 2010 capitalization grant before December 31, 2011; (b) provide additional subsidy to municipalities as forgiveness of a portion of the principal of a loan; (c) establish a percentage limit on the amount of principal forgiveness that may be received by any municipality; and (d) establish deadlines and criteria for awarding assistance. Act 384 did not provide additional present value subsidy limit to allocate funds for principal forgiveness. The federal fiscal year 2010 capitalization grants were recently provided to the state totaling: (a) $55.1 million for the clean water fund, including $44.6 million for loans, $8.3 million for grants (principal forgiveness), and $2.2 million for administration; and (b) $23.4 million for the safe drinking water loan program, including $13.1 million for loans, $7.0 million for grants, and $3.3 million for administration and technical assistance.

Clean Water Fund Program

4. If general obligation bonding authority for the clean water fund program is not increased, the program still would be expected to have sufficient authority to provide the required 20% state match to the federal capitalization grants. However, it would not be expected to have sufficient bonding authority to fund the expected level of project demand under current law subsidy levels. The program would be expected to have sufficient bonding authority to fund expected project demand under the reduced levels of subsidy under the bill.

5. The environmental improvement fund biennial finance plan submitted by DNR and DOA to the Building Commission and Legislature in September, 2010, requested sufficient general obligation bonding authority and 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 $684.1 million for the 2011-13 biennium, including: (a) $455.6 million of $1,215.0 million in estimated 2010-11 project costs for which applications had not been submitted as of August, 2010, and are now expected to be submitted in 2011-12 instead of 2010-11 (inclusion of this component meant that it was estimated that 2009-11 present value subsidy limit would not be needed for the projects, but that 2011-13 present value subsidy limit would be needed); (b) $208.6 million in estimated need for new clean water fund program applications in the 2011-13 biennium; and (c) $19.9 million as a 3% construction contingency for the $664.2 million in applications described above. DNR's projections represented the best estimates of need as of September, 2010, based on both file materials and a comprehensive survey of municipalities.

6. During 2007-09 biennial budget deliberations, estimated project costs were $709.8 million. Subsequently, the actual project costs in financial assistance agreements entered into with 2007-09 funding were $584.1 million. During 2009-11 biennial budget deliberations, estimated

project costs were $804.3 million. Actual project costs in financial assistance agreements with 2009-11 funding were $194.2 million as of April 20, 2011. It is anticipated that additional financial assistance agreements will be entered into with 2009-11 funding. The actual project costs for both the 2007-09 and 2009-11 biennia include regular and ARRA funding.

7. The biennial finance plan submitted in September, 2010, was based on the current law loan interest rates of 60%, 65% or 70% of the market rate for most projects, the current allocation of 15% of the total present value subsidy for hardship assistance funding, and an estimated market interest rate of 5%. Under the assumptions of current law subsidy levels, $684.1 million in estimated wastewater project costs would require a present value subsidy limit of $110.2 million, general obligation bonding authority of $80.6 million, and revenue obligation bonding authority of $471.7 million. However, the $40.9 million in carryover general obligation bonding authority and $118.7 million in carryover revenue obligation bonding authority from 2009-11 allowed the request in the biennial finance plan to be $39.7 million in general obligation bonding authority and $353.0 million in revenue obligation bonding authority. The main reasons for carryover general obligation bonding authority from 2009-11 include actual market interest rates of 4.0% instead of the estimated 5.0%, availability of ARRA funds, and unused financial hardship assistance funds.

8. The bill would reduce the state subsidy for most projects from 60% of the market interest rate to 80% of the market interest rate (approximately 93% of projects), or from 65% or 70% of market to 80% of market, and decrease the set-aside for hardship assistance from 15% to 5%. The reduction in state subsidies would reduce the need for general obligation bonding authority and the associated future GPR debt service costs. The recommended reduction in state subsidy also reduces the present value subsidy limit (cost of 20 years of subsidy in today's dollars) from the amounts included in the biennial finance plan.

9. Based on the October, 2010, biennial finance plan submitted by DNR and DOA, the reduction in the state subsidy in the bill would reduce the proposed increase in general obligation bonding authority from the $80.6 million included in the biennial finance plan, by $39.7 million, to $40.9 million. The amount of carryover general obligation bonding authority was $40.9 million, so the proposed decrease in state subsidy levels resulted in no need for additional general obligation bonding authority for the program.

10. The bill includes a clean water fund program present value subsidy limit of $54.4 million instead of the $110.2 million in the biennial finance plan, a reduction of $55.8 million in the need for present value subsidy limit. The present value subsidy limit under both the biennial finance plan and the bill include $6.8 million to allocate the $8.3 million in principal forgiveness available under the federal fiscal year 2010 appropriations act. (The present value subsidy for the clean water fund program is calculated incrementally from the lowest subsidized interest rate to 100% principal forgiveness, or subsidy of approximately 82% of project costs.)

11. The reduction of $55.8 million in requested present value subsidy limit means the state's costs of providing 20 years of subsidy for projects funded in the 2011-13 biennium would be expected to decrease by approximately $55.8 million from the levels that would be expected under current law interest rates and hardship set-asides. Lower state subsidy costs mean that costs to

municipal borrowers would be expected to increase by the same amount.

12. The DNR and DOA biennial finance plan estimated that approximately 93% of anticipated project costs in 2011-13 would be financed at 60% of the market interest rate under current law, and would receive the decrease in subsidy to 80% of the market rate under the bill. Based on the current market interest rate of 4%, this means most projects would be funded at an interest rate of 3.2% (80% of 4%) instead of the current 2.4% (60% of 4%). Under the current 4% market interest rate, this would mean an increase in municipal borrower repayment costs of $4.92 annually (41¢ per month) per $1,000 borrowed, or $4,922 annually ($410 per month) per $1 million borrowed. Under a planning market interest rate of 5%, this would mean an increase in municipal borrower repayment costs of $6.37 annually (53¢ per month) per $1,000 borrowed, or $6,366 annually ($530 per month) per $1 million borrowed.

13. Table 2 shows the level of subsidy for various types of projects under current law and under the bill. It also shows the interest rate under the current 4% market rate and an estimated 5% market rate.

TABLE 2

Project Interest Rates by Project Type and Interest Rate - Current Law and the Bill

		Current 4% Market Rate			Estimated 5% Market Rate	
Project Category	% of Market	Current Law	% of Market	Bill	Current Law	Bill
Clean Water Fund						
Compliance maintenance	60%	2.40%	80%	3.20%	3.00%	4.00%
New and changed limits	60	2.40	80	3.20	3.00	4.00
Stormwater or nonpoint	65	2.60	80	3.20	3.25	4.00
Unsewered (2/3 pre-1972)	70	2.80	80	3.20	3.50	4.00
Violator, reserve capacity, industrial or unsewered (2/3 post 1972)	100	4.00	100	4.00	5.00	5.00
Hardship*	--	Variable	--	Variable	Variable	Variable
Septage treatment and capacity	0	0.00%	0	0.00%	0.00%	0.00%
Safe Drinking Water						
Regular eligibility	55%	2.20%	55%	2.20%	2.75%	2.75%
Financial need community	33	1.32	33	1.32	1.65	1.65

*Hardship projects are eligible for grants and loan interest rates as low as 0%.

14. The biennial finance plan and the bill are based on an estimated revenue obligation market interest rate of 5% for long-range planning purposes. In biennia prior to 2011-13, the biennial finance plan was based on an estimated market interest rate of 6%. The Legislature approved levels of general obligation bonding authority and present value subsidy limit based on an estimated 5.0% market interest rate in 2003-05, 2005-07, and 2007-09, and based on an estimated 5.5% market interest rate in 2009-11.

15. The market rate has averaged 5.2% for the 19 years that the program has issued bonds. The program issues bonds during construction of the project in the four to five years after the project financial assistance agreements are entered into.

16. The revenue obligation market interest rate has been at or below 5% since April, 2001, is currently 4.0%, and may change when revenue obligations are next sold for the program in late 2011. If market interest rates remain at an interest rate lower than the 5% "planning interest rate" used in the biennial finance plan during the 2011-13 biennium, the Governor's recommended levels of bonding authority could be sufficient to fund a greater amount of projects than were estimated under the biennial finance plan. If actual market interest rates would rise to a rate higher than the 5% planning rate during the biennium, the amounts provided under the bill might fund a smaller amount of projects than estimated (depending on when during the biennium the interest rate would rise above 5%).

17. When a municipality submits a clean water fund application, DOA currently allocates present value subsidy limit to the project based on the planning market interest rate of 6%, and would allocate it in 2011-13 based on the planning market interest rate of 5%. When the program and the municipality enter into a financial assistance agreement, projects are assigned a loan interest rate based upon the actual market interest rate (currently 4.0%), and present value subsidy is allocated as funds are disbursed under the loan during construction of the project. As long as actual interest rates remain below 5% during disbursal of funds under the loan, the actual present value subsidy decreases to less than the amount allocated at the time of the application, and less general obligation bonds are issued. This allows the state to spend less money to subsidize individual projects, and allows the state to finance a greater number of projects than estimated. Interest rates for loans under the program are currently at 4.0%. However, it is expected that the next revenue bond issue (potentially in late 2011) would have a higher market interest rate.

18. Any general obligation or revenue obligation bonding authority authorized, but unused during a biennium, remains available for program use in subsequent biennia.

19. If market interest rates rise beyond the estimated 5.0% rate, municipalities encounter project cost increases, or need is greater than identified in the September, 2010, biennial finance plan, some projects might be deferred from the spring of 2013 to after June 30, 2013, when 2013-15 financing would be made available, or projects might have to obtain interim financing (with a higher interest rate) and refinance with clean water fund program loans at a later date.

20. It is also possible that some demand currently expected for the 2011-13 biennium will not materialize until 2013-15, similar to what has happened in recent biennia. This means that bonding authority approved prior to 2011-13 will be used in 2011-13 to finance projects that were previously anticipated to be financed in 2009-11. Similarly, some of the $208.6 million in expected new 2011-13 project costs may not be realized until 2013-15, and bonding authority that would be approved in anticipation of that demand may not be needed until 2013-15.

21. The Governor's Executive Budget Book states the subsidized loan rates would be changed under the bill because the state can no longer afford the current subsidy level. It could be argued that the proposed decrease in the level of subsidy for municipal wastewater projects from

60%, 65% or 70% of the market interest rate to 80% should be approved because the current level of subsidy is too expensive for the state to sustain in difficult budgetary times, scarce state general funds must be spent on other state priorities than wastewater projects, and local governments should support an increased share of wastewater project costs. Under the proposed decrease in subsidy, the state would commit an estimated $54.4 million in the aggregate during the biennium in present value costs of subsidizing municipal wastewater projects. All subsidized clean water fund program projects would be financed at the 80% of market interest rate, except financial hardship projects (interest rates as low as 0% and grants for up to 70% of project costs) and the portion of costs for septage management.

22. It could be argued that the proposed decrease in the level of subsidy for municipal wastewater projects should not be approved because the subsidy level was decreased in the 2009-11 biennial budget, the change would make it more expensive for municipalities to finance wastewater projects, and it could make it more difficult for municipalities to obtain financing for projects. Some might also argue that the state's budget problems should not be passed along to local governments in the form of decreased subsidy for local projects. Finally, some might argue that the decrease in state subsidy is inappropriate because the change would mean the state would provide a smaller level of subsidy for wastewater projects than for drinking water projects, which would continue to be financed at 55% of the market interest rate.

23. The Committee could choose to make a smaller reduction in the subsidy provided to municipalities than that proposed in the bill. If the loan interest rates would be changed from 60%, 65% or 70% of the market interest rate to 75%, instead of 80% under the bill, $6.7 million in new GO bonding authority would be needed to fund all need projected through June, 2013, instead of no new GO bonding authority under the bill (Alternative #A2). In addition, a present value subsidy limit of $65.7 million would be needed for the clean water fund program, which represents an increase of $11.3 million from the $54.4 million provided under the bill.

24. If the loan interest rate would be changed to 70%, instead of 80% under the bill, an additional $14.2 million in new GO bonding authority would be needed to fund all need projected through June, 2013 (Alternative #A3). In addition, a present value subsidy limit of $76.9 million would be needed for the clean water fund program, which represents an increase of $22.5 million from the $54.4 million provided under the bill.

25. If the loan interest rate would be changed to 65%, instead of 80% under the bill (but maintain the current project interest rate of 70% of market rate for projects in unsewered areas, an additional $21.2 million in GO bonding authority would be needed (Alternative #A4). In addition, a present value subsidy limit of $87.5 million would be needed for the clean water fund program, which represents an increase of $33.1 million from the $54.4 million provided under the bill.

26. The Committee could choose to maintain the current clean water fund program interest rates of 60%, 65% or 70% of the market interest rate. Under this alternative, an additional $28.1 million in GO bonding authority would be needed (Alternative #A5). In addition, a present value subsidy limit of $98.6 million would be needed for the clean water fund program, which represents an increase of $44.2 million from the $54.4 million provided under the bill.

27. Clean water fund projects, other than financial hardship assistance projects, are funded on a continuous funding cycle. If the bill is amended to restore the subsidy levels to an amount greater than provided under the bill without increasing the amount of general obligation bonding authority, it is possible DNR and DOA will determine, under statutory requirements, that the amount of funding provided for the program is insufficient to provide funding for all projects to be funded during the biennium. In such an event, the program would revert to an annual funding cycle and DNR would establish a funding list that ranks projects according to a priority scoring system. It is possible that this could delay projects in municipalities that might be ready to proceed before a funding list is developed. In addition, the level of staff vacancies in the program could slow the development of a funding list.

28. The Milwaukee Metropolitan Sewerage District (MMSD) borrows the largest percentage of project costs of any municipality in the program. The statutes require that an individual municipality may receive no more than 35.2% of the total available present value subsidy limit. In 2005-07, MMSD was allocated 31.0% ($38.6 million) of the $109.6 million in available (budgeted) present value subsidy limit. This represented 61.2% of the $55.6 million of the final present value subsidy allocated statewide. MMSD project costs were approximately 65% of the statewide total ($256.9 million of $395.2 million in financial assistance agreements statewide). MMSD represented a higher proportion of total actual (final) costs than its proportion of the budgeted present value subsidy limit, primarily because the amount of actual projects funded for other communities were lower than had been projected. In the 2007-09 biennium, MMSD project costs totaled $190.6 million, out of $584.1 million in statewide project costs (32.6%). In the 2009-11 biennium, as of April 20, 2011, MMSD project costs totaled $110.4 million, out of $194.2 million in statewide project costs (56.8%). It is anticipated that DOA and DNR will allocate additional 2009-11 present value subsidy to MMSD and other municipalities.

29. The Milwaukee Metropolitan Sewerage District, Madison Metropolitan Sewerage District, Green Bay Metropolitan Sewerage District, and Municipal Environmental Group (96 municipalities throughout the state) expressed concern that reductions to state subsidy levels could motivate larger communities such as Milwaukee, Madison, and Green Bay to seek other funding sources such as issuing their own general obligation and revenue bonds. They also anticipate that, if that happens, smaller communities who do not have easy access to financial markets on their own might see a higher state market interest rate and higher interest costs in addition to the reduced subsidy. It is uncertain whether or which communities might be able to borrow on their own at an interest rate lower than 80% of the state market rate, and could absorb the bond issuance costs that are currently paid by the state program rather than individual borrowers.

30. In April, 2011, the federal fiscal year 2011 appropriations act (P.L. 112-10) was enacted with an appropriation for the federal clean water capitalization grants for states and a requirement that states use a portion of federal capitalization grants for clean water fund program funds for principal forgiveness. The 2009 Act 384 provisions authorized DNR and DOA to provide principal forgiveness on a one-time basis with funds received from the federal fiscal year 2010 federal capitalization grant. Current law does not authorize the program to provide principal forgiveness with funds received from the federal fiscal year 2011 grant. The bill does not include any changes related to provision of principal forgiveness with 2011 federal funds.

31. The Committee could choose to either: (a) include in the budget bill the authority for the clean water fund program to provide principal forgiveness with funds received from the federal fiscal year 2011 capitalization grant (Alternative #A7); or (b) take no action related to the issue. If no action is taken in the budget, the administration and DNR could choose whether or when to submit separate legislation to address any needed modifications to state law. The statutes would need to be amended to authorize principal forgiveness before the state could receive a federal fiscal year 2011 capitalization grant from U.S. EPA, probably in early 2012.

32. If the Committee wishes to provide the same type of one-time authority for principal forgiveness as was provided in 2009 Act 384, the bill could be amended as follows (Alternative #A7): (a) if the state receives funds under P.L. 112-10 as the federal fiscal year 2011 capitalization grant for the clean water fund program, DNR and DOA would be authorized to allocate the funds before December 31, 2013, to municipalities for eligible projects; (b) DNR and DOA would be required to provide additional subsidy to municipalities as forgiveness of a portion of the principal of a loan, in the amount that P.L. 112-10 requires to be used as principal forgiveness, notwithstanding statutory limits on the methods of providing financial assistance; (c) DNR would be authorized to establish a percentage limit on the amount of principal forgiveness that may be received by any municipality; (d) DNR would be authorized to establish a deadline for submitting applications for financial assistance for principal forgiveness; (e) in selecting projects to receive financial assistance with principal forgiveness, DNR would be authorized to consider any of the following: (1) the population of the municipality in which a project would be located; (2) the median household income of the municipality; (3) the extent to which a project promotes water efficiency or energy efficiency, is environmentally innovative, or uses natural systems or engineered systems that mimic natural processes, also called green infrastructure; and (f) DNR and DOA would not be required to promulgate rules for the principal forgiveness provisions. DOA and DNR estimate $4.2 million will be subject to principal forgiveness provisions under the federal fiscal year 2011 capitalization grant for the state. An additional $3.5 million in clean water fund present value subsidy limit would be required in order to allocate funds for principal forgiveness.

Clean Water Fund Hardship Assistance

33. The financial hardship assistance subprogram was included in the clean water fund program to address the concern that not all communities are equally able to bear the additional costs associated with treatment plant construction or rehabilitation. Particularly in small, rural communities, the cost per capita can be high because of the limited number of individuals financing the necessary capital investment. Information developed by DNR shows that user charges for wastewater services vary greatly across the state. The financial hardship assistance subprogram provides interest rates as low as 0% and grants for up to 70% of project costs, for projects where the municipality's median household income is 80% or less of the statewide median household income and the estimated annual residential wastewater treatment charges would exceed 2% of the median household income in the municipality.

34. Through June 30, 2010, the clean water fund program had entered into financial hardship assistance agreements with 90 municipalities totaling $175.4 million, including hardship grants totaling $112.3 million and hardship loans totaling $63.1 million. Under the current statutory limit of 15% of the total present value subsidy for hardship assistance, the available funding has

been sufficient to fund all eligible requests for hardship assistance since 1998-99. Since that time, the program has allocated between 2% and 5% of the total available clean water fund program present value subsidy for hardship in any given biennium. One project was provided financial hardship assistance in 2008-09, and none were provided assistance from the regular financial hardship assistance program in 2009-10. Any general obligation authority not needed for hardship assistance in a given biennium would be carried forward to the subsequent biennium (reducing the need for an increase in bonding authority in 2013-15).

35. The ARRA one-time funds provided $103.9 million for principal forgiveness for 50% of eligible project costs. This minimized the need for financial hardship assistance under the regular clean water fund program during 2009-10 and 2010-11.

36. It could be argued that the allocation of 15% for financial hardship assistance should be decreased to 5% because the larger set-aside has not been needed for approximately 10 years, the larger allocation requires the commitment of scarce general obligation bonding authority (and associated GPR debt service costs in future biennia) for select projects, and the state subsidy provided for any individual community would be much higher in comparison with the reduced amount of subsidy provided for non-hardship projects under the bill (Alternative #B1).

37. Alternatively, the allocation of present value subsidy for financial hardship assistance could be decreased to 10% instead of 5% under the bill (Alternative #B2). This would provide a set-aside larger than has been needed in the past several years, in the event numerous or large financial hardship projects apply for assistance in a given biennium. It would also provide a smaller set-aside than current law to reflect the full amount of the current 15% allocation has not been needed. If the bill would be amended to provide an allocation of 10% of present value subsidy limit for financial hardship assistance, additional general obligation bonding authority of $5.4 million and present value subsidy limit of $5.4 million would be needed.

38. It could also be argued that the allocation should remain at the current 15% of total present value subsidy limit because it would be available if needed for communities with the lowest income and highest user charges (Alternative #B3). If the bill would be amended to restore the current law allocation of 15% of present value subsidy limit for financial hardship assistance, additional general obligation bonding authority of $11.6 million and present value subsidy limit of $11.6 million would be needed. If the general obligation bonding authority allocated for hardship assistance is not needed it would be available in the subsequent biennium.

39. Approval of general obligation bonding authority at a level greater than provided in the bill would not be expected to increase GPR debt service costs until after 2012-13. This is because bonds allocated for projects that are approved for funding in the 2011-13 biennium would likely be issued late in the biennium or in future biennia as facility construction is completed. If current law is maintained in regard to both clean water fund loan subsidy levels and hardship assistance allocations (Alternatives #A5 and B3) it would require the allocation of an additional $39.7 million in general obligation bonding authority. While no debt service payments would be expected during 2011-13 under this option, once all bonds were issued debt retirement costs of over $3 million GPR annually would be expected over a period of approximately 20 years.

Safe Drinking Water and Land Recycling Loan Programs

40. The safe drinking water loan program uses all of the authorized general obligation bonds to provide the 20% state match to the federal capitalization grant under the Safe Drinking Water Act. This differs from the clean water fund program, which uses part of the general obligation bonds for the 20% state match to the federal capitalization grant under the Clean Water Act, and the remainder to pay the costs of the state subsidy to municipalities under the revenue obligation bond component of the program. The state is required to have the entire 20% state match in place before it can accept the federal capitalization safe drinking water grant.

41. The bill would provide $9.4 million in general obligation bonds for the safe drinking water loan program, which would provide the 20% state match to approximately $46.8 million in federal capitalization grants anticipated to be received for federal fiscal years 2011 and 2012. DOA and DNR estimate that approximately $112.7 million in project costs could be funded during the 2011-13 biennium.

42. If general obligation bonding authority for the safe drinking water loan program is not approved, the state would not be able to provide the 20% match necessary to receive the $46.8 million in federal grant funds anticipated to be available during the biennium. The program would be able to make loans with up to approximately $63 million in funds available from loan repayments and investment income, but would not be able to take advantage of federal funds for the program.

43. Of the recommended $30.7 million in present value subsidy limit for the safe drinking water loan program, $16.7 million would be for the regular program, $7.0 million would be available for allocation of principal forgiveness grants available under the federal fiscal year 2010 appropriations act, and $7.0 million for allocation of principal forgiveness anticipated to be available under the federal fiscal year 2011 appropriations act. However, current law and the bill do not authorize the program to provide principal forgiveness with funds received from the federal fiscal year 2011 grant.

44. The Committee could choose to: (a) include in the budget bill the authority for the safe drinking water loan program to provide principal forgiveness with funds received from the federal fiscal year 2011 capitalization grant (Alternative #C3); (b) delete $7.0 million in present value subsidy provided under the bill for principal forgiveness to defer a decision on the issue until subsequent legislation (Alternative #C2); or (c) approve the $7.0 million for present value subsidy for principal forgiveness but take no action related to authorizing DNR and DOA to provide principal forgiveness (Alternative #C1). If no action is taken in the budget, the Administration and DNR could choose whether, or when, separate legislation may be needed.

45. If the Committee wishes to provide the same type of one-time authority for principal forgiveness under the safe drinking water loan program as was provided in 2009 Act 384, the bill could be amended in the same manner as described earlier for the clean water fund program (Alternative #C3). Act 384 provided the same authorization and criteria for principal forgiveness for both programs.

46. All of the $20 million originally authorized for the land recycling loan program in the 1997-99 biennial budget act has been committed. The program entered into nine financial assistance agreements totaling $15.2 million (actual disbursements were less) in 12 years, and has allocated the remaining $6.2 million as a loan to the dry cleaner environmental response fund. As of May 1, 2011, $3,452,700 has been transferred from the land recycling loan program to the dry cleaner environmental response fund. It is expected that the remainder of the $6.2 million will be transferred within the next two to three years.

ALTERNATIVES

A. Clean Water Fund Subsidy Level

1. Approve the Governor's recommendation to provide the following for the clean water fund program: (a) an increase in revenue obligation bonding authority of $353,000,000; (b) a "present value subsidy limit" totaling $54.4 million; and (c) a reduction in the subsidy to provide an interest rate of 80% of the market rate instead of the current 60%, 65% or 70% of market rate for all subsidized clean water fund projects (except the portion of the project for septage management and hardship financial hardship assistance).

2. Approve the following: (a) a reduction in the subsidy for all subsidized clean water fund program projects (except no change for the portion of the project for septage management) to provide an interest rate of 75% of the market rate (instead of the current 60%, 65%, or 70% of market rate, or 80% under the bill); (b) an increase in general obligation bonding authority of $6,700,000; (c) revenue obligation bonding authority of $353,000,000 (same as the bill); and (d) a "present value subsidy limit" totaling $65.7 million (an increase of $11.3 million from the bill).

ALT A2	**Change to Bill** Revenue
BR-GO	$6,700,000

3. Approve the following: (a) a reduction in the subsidy for most clean water fund program projects to provide an interest rate of 70% of the market rate for compliance maintenance projects, new or changed limits projects, projects to abate nonpoint source pollution and projects to control urban storm water runoff; (b) maintain the current interest rate of 70% of the market rate for projects to provide treatment facilities and sewers for unsewered areas; (c) an increase in general obligation bonding authority of $14,200,000; (d) revenue obligation bonding authority of $353,000,000 (same as the bill); and (e) a "present value subsidy limit" totaling $76.9 million (an increase of $22.5 million from the bill).

ALT A3	**Change to Bill** Revenue
BR-GO	$14,200,000

4. Approve the following: (a) a reduction in the subsidy for most clean water fund program projects to provide an interest rate of 65% of the market rate for compliance maintenance projects, and new or changed limits projects; (b) maintain the current interest rate of 65% of the market rate for projects to abate nonpoint source pollution and to control urban storm water runoff; (c) maintain the current interest rate of 70% of the market rate for projects to provide treatment facilities and sewers for unsewered areas; (d) an increase in general obligation bonding authority of $21,200,000; (e) revenue obligation bonding authority of $353,000,000 (same as the bill); and (f) a "present value subsidy limit" totaling $87.5 million (an increase of $33.1 million from the bill).

ALT A4	**Change to Bill** Revenue
BR-GO	$21,200,000

5. Delete the Governor's recommended decrease in subsidy and instead maintain the current subsidy levels of 60%, 65% or 70% of the market interest rate. Approve the following: (a) an increase in general obligation bonding authority of $28,100,000 for the clean water fund program; (b) revenue obligation bonding authority of $353 million; and (c) a "present value subsidy limit" totaling $98.6 million (an increase of $44.2 million from the bill).

ALT A5	**Change to Bill** Revenue
BR-GO	$28,100,000

6. Delete provision. There would be no new bonding authorized for the clean water fund program. The current law present value subsidy limit for any biennium after 2009-11 is $1,000, which would not be sufficient to fund any expected projects during the 2011-13 biennium.

ALT A6	**Change to Bill** Revenue
BR-REV	- $353,000,000

7. In addition to any of Alternatives #A1 through #A5, provide the same type of one-time authority for principal forgiveness as was provided in 2009 Act 384, as follows: (a) if the state receives funds under P.L. 112-10 as the federal fiscal year 2011 capitalization grant for the clean water fund program, DNR and DOA would be authorized to allocate the funds before December 31, 2013, to municipalities for eligible projects; (b) DNR and DOA would be required to provide additional subsidy to municipalities as forgiveness of a portion of the principal of a loan, in the amount that P.L. 112-10 requires to be used as principal forgiveness, notwithstanding statutory limits on the methods of providing financial assistance; (c) DNR would be authorized to establish a percentage limit on the amount of principal forgiveness that may be received by any municipality; (d) DNR would be authorized to establish a deadline for submitting applications for financial assistance for principal forgiveness; (e) in selecting projects to receive financial assistance with

principal forgiveness, DNR would be authorized to consider any of the following: (1) the population of the municipality in which a project would be located; (2) the median household income of the municipality; (3) the extent to which a project promotes water efficiency or energy efficiency, is environmentally innovative, or uses natural systems or engineered systems that mimic natural processes, also called green infrastructure; (f) DNR and DOA would not be required to promulgate rules for the principal forgiveness provisions; and (g) provide an additional $3.5 million in clean water fund present value subsidy limit to allocate funds for principal forgiveness.

B. Clean Water Fund Hardship Assistance

1. Approve the Governor's recommendation to reduce the amount of present value subsidy allocated to financial hardship assistance from 15% to 5% of the total present value subsidy limit.

2. Reduce the amount of present value subsidy allocated to financial hardship assistance from 15% to 10% of the total present value subsidy limit. Increase general obligation bonding authority by $5.4 million and the present value subsidy limit by $5.4 million.

ALT B2	**Change to Bill** Funding
BR-GO	$5,400,000

3. Maintain the current amount of present value subsidy allocated to financial hardship assistance at 15% of the total present value subsidy limit. Increase general obligation bonding authority by $11.6 million and the present value subsidy limit by $11.6 million.

ALT B3	**Change to Bill** Funding
BR-GO	$11,600,000

C. Safe Drinking Water and Land Recycling Loan Programs

1. Approve the Governor’s recommendation to provide: (a) an increase in general obligation bonding authority of $9,400,000 for the safe drinking water loan program; (b) a "present value subsidy limit" totaling $30.7 million for the safe drinking water loan program; and (c) a "present value subsidy limit" of $0 for the land recycling loan program.

2. Approve the Governor's recommendation, as modified to provide a present value subsidy limit totaling $23.7 million (instead of $30.7 million under the bill) for the safe drinking water loan program. (This would defer a decision on the principal forgiveness component of the federal program.)

3. Approve the Governor's recommendation. In addition, provide the same type of

one-time authority for principal forgiveness as was provided in 2009 Act 384, as follows: (a) if the state receives funds under P.L. 112-10 as the federal fiscal year 2011 capitalization grant for the safe drinking water loan program, DNR and DOA would be authorized to allocate the funds before December 31, 2013, to municipalities for eligible projects; (b) DNR and DOA would be required to provide additional subsidy to municipalities as forgiveness of a portion of the principal of a loan, in the amount that P.L. 112-10 requires to be used as principal forgiveness, notwithstanding statutory limits on the methods of providing financial assistance; (c) DNR would be authorized to establish a percentage limit on the amount of principal forgiveness that may be received by any municipality; (d) DNR would be authorized to establish a deadline for submitting applications for financial assistance for principal forgiveness; (e) in selecting projects to receive financial assistance with principal forgiveness, DNR would be authorized to consider any of the following: (1) the population of the municipality in which a project would be located; (2) the median household income of the municipality; (3) the extent to which a project promotes water efficiency or energy efficiency, is environmentally innovative, or uses natural systems or engineered systems that mimic natural processes, also called green infrastructure; and (f) DNR and DOA would not be required to promulgate rules for the principal forgiveness provisions.

4. Delete provision. There would be no new bonding authorized for the safe drinking water loan program. The current law safe drinking water and land recycling loan programs present value subsidy limit for any biennium after 2009-11 is $1,000 for each program, which would not be sufficient to fund any expected projects during the 2011-13 biennium. The state would not be able to accept federal capitalization grants in 2011-13.

ALT C4	**Change to Bill** Revenue
BR-GO	- $9,400,000

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