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Joint Committee on Finance

Paper #281

Program Structure Changes (Environmental Improvement Fund)

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

CURRENT LAW

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

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

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

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

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

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

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

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

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

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

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

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

GOVERNOR

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

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

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

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

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

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

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

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

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

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

DISCUSSION POINTS

Clean Water Fund Program Need

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

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

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

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

Potential Program Restructuring

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

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

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

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

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

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

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

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

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

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

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

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

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

Present Value Subsidy Limit

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

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

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

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

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

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

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

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

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

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

Determination of Market Interest Rate

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

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

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

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

Municipality Loan Interest Rates

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

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

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

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

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

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

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

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

TABLE 2

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

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

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

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

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

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

TABLE 3

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

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

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

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

Bonding Authority

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

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

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

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

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

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

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

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

ALTERNATIVES

A. Present Value Subsidy Limit

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

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

B. Definition of Market Interest Rate

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

2. Maintain current law.

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

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

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

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

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

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

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

D. Bonding Authority

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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