



Legislative Fiscal Bureau

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January 25, 2006

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Natural Resources: Forestry Biomass Research and Development Grants -- Agenda Item II

REQUEST

The Department of Natural Resources requests an increase of \$537,000 forestry account SEG in 2005-06 and \$500,000 forestry account SEG in 2006-07.

BACKGROUND

DNR Program. As a part of 2005 Act 25, a forestry biomass grant program was created in the Department of Natural Resources. Under the forestry biomass grant program, DNR may make grants: (1) for research and development of technologies that use forestry biomass as energy sources; (2) to encourage the use of forestry biomass as energy sources; (3) to increase the beneficial uses of forestry biomass; and (4) to encourage the development of biochemicals from forestry biomass. These grants may only be used by DNR for state matching requirements for federal forestry biomass grants for the four purposes listed above.

Under the program, grants (to the extent they are allowed by federal law) may not exceed \$300,000 for one project, of which up to \$150,000 may be for planning and \$150,000 may be for implementation, not to exceed 50% of total project costs. Funding of \$500,000 would have been provided in 2006-07 by the Legislature in AB 100 (the enrolled biennial budget bill) for the required state match for federal grants under this program. However, this funding was item-vetoed by the Governor.

Federal Grant Program. The United State Department of Energy and the United States Department of Agriculture will jointly be allocating a total of \$14 million for research and

development of biomass based products, bioenergy, biofuels, and related processes. Grant applications are due April 3, 2006, with awards to be made no later than September 20, 2006, and lasting for three years. The maximum federal grant is \$2 million for any one project, and a federal grant requires a 20% cost-share match for research, development and demonstration projects, and a 50% match for commercial application projects.

ANALYSIS

As noted earlier, 2005 Assembly Bill 100 (the 2005-07 biennial budget bill), as passed by the Legislature, included the provision of up to \$500,000 forestry SEG in 2006-07 as a second draw on certain increased timber harvest revenues anticipated under the bill for the state match for federal grants made under the forestry biomass program. However, the Governor item-vetoed these allocations, but as a part of his veto message the Governor requested that DNR pursue additional spending authority for this program (as well as other forestry programs for which he vetoed funding) through the process under section 13.10 of the statutes (Joint Finance Committee quarterly meetings) or the 2007-09 biennial budget request, as additional forestry revenues became available.

Currently, it is anticipated that there would be sufficient funds within the forestry account to support additional expenditures over the current and subsequent biennia. The following table shows the estimated condition of the forestry account.

Estimated Forestry Account Condition (\$ in millions)

	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
Opening Balance	\$16.18	\$13.29	\$8.83
Revenue	<u>93.02</u>	<u>95.63</u>	<u>99.04</u>
Total Available	\$109.20	\$108.92	\$107.87
Expenditures	84.26	98.29	98.15
Encumbrances/Reserves*	<u>11.65</u>	<u>1.8</u>	<u>2.57</u>
Total	\$95.91	\$100.09	\$100.72
Closing Balance	\$13.29	\$8.83	\$7.15

*Includes continuing balances from assigned segregated revenue appropriations (such as recording fees, county severance loan payments, and closed acreage payments in 2004-05) and pay plan reserves in the 2005-07 biennium.

The forestry account of the conservation fund receives the majority of its revenue from the forestry mill tax, a statewide property tax of 0.2 mill (20¢ per \$1,000 of property value). Other sources of revenue to the forestry account include: (a) revenues from the sale of timber on state forest lands; (b) revenues from the sale of stock from the state's tree nurseries; (c) camping and entrance fees at state forests; (d) severance and withdrawal payments from timber harvests on cooperatively-managed county forests and on privately-owned land entered under the forest crop land and managed forest land programs; (e) closed acre fees under the managed forest law program; and (f) a portion of the revenue from the sale of the conservation patron licenses, to reflect the fact that license holders are granted admission to state forests at no additional charge as part of the license.

Potential applicants for a federal forestry biomass grant could include a nonprofit group that is researching biofuel uses for wood chips or researching new ways to deal with paper manufacturing waste. National laboratories, institutions of higher education, and federal and state research agencies are eligible to apply for grants under the federal program.

The \$500,000 now requested by DNR would be expected to leverage \$2,000,000 of federal grants under the program, or the equivalent of one maximum grant to a nonprofit organization for research, development or demonstration purposes (since DNR staff are currently uncertain about the likelihood of any commercial grants, the required cost-share would be expected to be 20% of the total project cost). However, due to uncertainty as to when federal grants would be received and when the required cost-share would be needed, DNR officials initially requested \$500,000 SEG in both 2005-06 and 2006-07 in order to ensure the agency had the required matching funds to receive the grant. DNR officials have subsequently agreed that the appropriation of \$500,000 of funding in 2006-07 should be sufficient to ensure the cost-share requirement for one \$2.5 million project is met.

Further, should the state provide additional funding for the required cost-share amount, DNR staff indicate it is possible that grant applicants from Wisconsin could be selected in excess of the current target of one \$2 million federal grant. However, under the federal program, grant applicants are also free to raise the required cost-share amount on their own, or seek these funds from entities or businesses other than the state. As a result, some might argue that no state funding should be provided, as an applicant is still able to receive a federal grant (four times greater than any funds they provide) by raising or providing cost-share funds on their own.

The DNR also requested \$37,500 forestry SEG in 2005-06 to contract with a non-profit organization for the administration of the grant program. This amount, which equals 7.5% of the requested state grant amount, was arrived at primarily based on DNR discussions with legislative supporters of the forestry biomass grant program. Administrative duties would include: (a) making recommendations on the applicants suitability for a state grant; (b) helping the applicant with the receipt of federal and state funds; (c) implementing the grant and monitoring the progress of the grant; and (d) ensuring the grant recipient remains in compliance with all federal requirements.

DNR staff indicate the agency does not currently have forestry biomass expertise. They argue that the use of an entity with more extensive forestry biomass knowledge would be able to more effectively oversee the implementation and progress of the grants. In addition, DNR staff argue that an entity with better knowledge of forestry biomass issues would be better able to evaluate and select applications for state commitments, thereby increasing the likelihood that state commitments yield federal grants. While Department staff indicate they do not currently have a specific non-profit group in-mind to serve as an administrator, they would use a request for proposal purchasing process to select a non-profit organization with experience and expertise related to forestry biomass to serve as the grant administrator.

Further, while the Department's request asked for the administrative funding in 2005-06, DNR officials now indicate that while some administrative duties would likely be performed in 2005-06 (making recommendations on the suitability of an applicant for a state matching grant), provision of the administrative funding in 2006-07 (when the majority of the private contractor's duties would be performed, as discussed above) would likely be sufficient. Any administrative efforts performed in 2005-06 would likely pertain to the initial grant application process, which is expected to be as follows: (1) a potential grant applicant develops a proposal and submits it to the private administrator for review; (2) the administrator reviews the proposal and makes a recommendation to the DNR as to whether or not the state should provide the matching grant required to receive a federal grant; (3) if the state commits the required match amount, the applicant submits the proposal to the federal government seeking the federal grant. However, it should be noted that if the federal government rejects an applicant that has received a state commitment, the state funds would become available for commitments to other applicants.

If additional funding for administration were not provided, DNR staff indicate administrative costs would likely be paid for from funds otherwise available for state grants (meaning total state grants would be \$500,000 minus administrative costs, thereby potentially reducing the amount of federal funding that could be leveraged).

Since a one-time federal grant is anticipated, the Committee could specify that any funds provided in 2006-07 be one-time only. Any ongoing need for funding that might arise could then be considered during 2007-09 budget deliberations.

DNR indicates if funds are not needed to match a federal biomass grant, the funds would lapse back to the balance of the forestry account. However, in addition to forestry biomass grants, monies available in this appropriation may be allocated for private forest grants, for forestry research and development grants, for the forestry education grant program, for school forest transportation funding, for transfer to the Wisconsin Technical College System for master logger apprenticeship grants, or for forestry internships. The Committee could specify that any additional funding provided may only be used for state matches of federal forestry biomass grants. Funding for additional programs could be considered in future budget requests.

DATCP Program. In addition to the forestry biomass grant program created in DNR as a part of 2005 Act 25, a bio-industry grant program was created in the Department of Agriculture,

Trade and Consumer Protection (DATCP) that also may make grants related to forestry biomass research and development. Under the program, DATCP may make grants for: (a) research and development of technologies that use agricultural products or waste, including digesters, as energy sources; (b) encouraging the use of agricultural products or waste as energy sources; (c) reducing the generation of agricultural wastes or increasing their beneficial uses; and (d) encouraging the development of bio-chemicals from agricultural products. As a part of the program, the definition of agricultural waste includes forestry waste, and DATCP may also make grants for the research and development of bio-diesel technologies. A grant may not exceed \$300,000 to one recipient, of which up to \$150,000 may be for planning and \$150,000 may be for implementation, and may not exceed 50% of project costs.

Funding for the program is provided from an annual GPR appropriation (\$380,000 annually in 2005-06 and 2006-07) and a biennial SEG appropriation (\$1,000,000 SEG in 2005-06 and \$0 in 2006-07). The SEG appropriation is funded from the agrichemical management (ACM) fund, which receives revenues from several feed, fertilizer and pesticide license and tonnage fees and expends these funds for: (a) DATCP administration of the agricultural chemical cleanup reimbursement program; (b) inspection and regulation of the individuals and businesses that manufacture and distribute feed, fertilizer and pesticide products in Wisconsin; (c) DATCP administration of groundwater management programs; and (d) agriculture in the classroom grants that help teachers educate students about agriculture. Along with the bio-industry grant program, funds from these appropriations may also be used to make agricultural development and diversification (ADD) grants and sustainable agriculture grants.

Under the ADD program, DATCP provides grants for projects that it determines are likely to stimulate Wisconsin's agricultural economy. ADD grants are competitive and may be requested by individuals, associations, agribusinesses and industry groups. The statutes specify a maximum ADD grant of \$50,000 per project, and specify that DATCP may not make an ADD grant to a project that will last more than three years. ADD grants may be made for research and development purposes of new or alternative agricultural technologies, but may not fund start-up or operational costs. Department officials state that while the bio-industry grant program can fund the research and development of bio-chemicals and the use of agricultural wastes (similar to ADD), the bio-industry grant program can also fund planning and operation costs of bio-industry ventures, whereas the ADD grant program may only fund the research and development of technologies.

The statutes also allow DATCP to make sustainable agriculture grants. These grants support an agricultural method, practice or system that attempts to use and maintain renewable local physical, biological, social and other resources and minimize the need for energy inputs and other purchased, nonrenewable inputs. However, Department officials indicate that DATCP has not made a sustainable agriculture grant from this appropriation for at least eight years (federal funding has been used for this purpose).

There is no statutory requirement on the amount of available funds that DATCP may allocate to the three programs. However, Act 25 does require DATCP to provide a \$150,000 planning grant and a \$150,000 implementation grant under the bio-industry grant program to the Cashton Area Development Corporation for the Cashton Greens Renewable Energy Park during the 2005-07 biennium. DATCP staff indicate they plan to award \$380,000 in ADD grants annually (the same

amount as available prior to the current biennium), and \$700,000 in bio-industry grants (plus the \$300,000 earmarked grant) in 2005-06.

ALTERNATIVES

1. Approve DNR's request to provide \$500,000 forestry SEG in each of 2005-06 and 2006-07 for required state matches of federal forestry biomass grants, and \$37,500 forestry SEG in 2005-06 to contract for the administration of the grant program.

2. Provide \$537,500 forestry SEG in 2006-07 for required state matches of federal forestry biomass grants (\$500,000), and to contract for the administration of the grant program (\$37,500).

3. Provide \$500,000 forestry SEG in 2006-07 for required state matches of federal forestry biomass grants.

4. In addition to one of the above alternatives, specify one or both of the following:

a. the funding be one-time only (ongoing funding levels could be considered in the 2007-09 biennial budget);

b. the funding may only be used for state matches of federal forestry biomass grants.

5. Deny the request.

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