**Legislative Fiscal Bureau**

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# Convert Debt Service from GPR to SEG (Environmental Improvement Fund)

[LFB 2009-11 Budget Summary: Page 246, #4]

## CURRENT LAW

The clean water fund program within the environmental improvement fund provides loans to municipalities for planning, design and construction of surface water and groundwater pollution abatement facilities, primarily for municipal wastewater treatment. The state receives federal capitalization grants from the U.S. Environmental Protection Agency (EPA) for a state clean water fund revolving loan program, for which Wisconsin provides the required 20% match through issuance of general obligation bonds. Most of the general obligation bond debt service costs are paid by general purpose revenues (GPR). In addition, the clean water fund program expends $6,000,000 SEG annually for general obligation bond debt service. The SEG comes from 50% of the interest repayments received from municipalities for loans which were originally provided from the proceeds of general obligation bonds issued to provide the 20% state match to the federal grants.

## GOVERNOR

Convert $3,000,000 annually from GPR to environmental improvement fund SEG to increase, from $6 million to $9 million, the amount of clean water fund program general obligation bond debt service paid by loan repayments received from municipalities from loans that were originally provided from the proceeds of general obligation bonds.

## DISCUSSION POINTS

1. In order to receive federal clean water fund capitalization grants, states must manage a revolving loan program so that the amount received in federal capitalization grants is available in

perpetuity. This is accomplished through the requirement that all repayments of loans made from federal grants plus the state match be credited to the revolving fund for future loans. However, state statutes authorize the use of half of the interest repayments received for loans which were originally provided from the proceeds of general obligation bonds issued to provide the 20% state match to federal capitalization grants for general obligation bond debt service.

2. The use of SEG loan repayments for future loans reduces the future reliance of the program on general obligation bond issuance for loan financing. Use of SEG loan repayments to replace a portion of GPR debt service costs for general obligation bond debt service decreases short-term GPR debt service costs. However, the long-term effect of using SEG loan repayments is to increase the need for future issuance of general obligation bonds and revenue bonds because loan repayments are used for debt service instead of clean water fund program loans. Use of SEG loan repayments for general obligation bond debt service costs lengthens the time period that it takes for the revolving loan program to become a self-sustaining fund.

3. State legislation has authorized the use of SEG loan repayments beginning in 1994-95, instead of GPR for a portion of clean water fund program general obligation bond debt service. A total of $73.8 million in SEG loan repayments has been used through 2008-09. Use of SEG loan repayments increased from $4 million to $6 million annually in 2002-03, and a one-time use of $10.2 million was made in 2001-02.

4. In order to comply with federal requirements, the amount of SEG repayments used for debt service may not exceed the amount of debt service on general obligation bonds used to provide the 20% state match to the federal capitalization grants. It is likely that the amounts available from SEG loan repayments will not increase significantly as loans made in the early 1990s mature and are replaced with new loans.

5. The recommended $6,000,000 increase ($3,000,000 annually) in the use of SEG loan repayments for general obligation bond debt service will increase the future need for general obligation bonding authority by approximately $800,000 and for revenue obligation authority by approximately $6,600,000. The Governor's bill does not include this adjustment. The bill could be amended to provide this bonding authority (Alternative #B1). The additional general obligation bonding authority and revenue obligation authority will probably not be needed in the 2009-11 biennium because loans are disbursed as project costs are incurred over a two to four-year period. However, the program generally sets aside the needed amount of general obligation bonding authority when the financial assistance agreement is entered into for a project. Obligations are subsequently issued when loan funds are disbursed.

6. It appears that the amount of SEG loan repayments, beyond the amount in the bill, that has not been used for GPR debt service in recent years on bonds issued for the state match is roughly $6,000,000. Due to the uncertainty of future federal grants for the program, this could be used for GPR debt service on a one-time basis in 2009-10. Additional general obligation bonds of $800,000 and revenue obligations of approximately $6,600,000 would have to be issued over several years to replace the use of $6,000,000 beyond the levels in the bill. The bill could be

amended to recognize the additional authorization, or the authorization could be provided in future biennia (consistent with the Governor's recommendation).

7. In the 2007-09 biennium, the debt service costs funded by municipal loan repayments are approximately 12.2% of the total general obligation bond debt service costs ($12 million of $98.3 million). Under the bill, municipal loan repayments would fund approximately 16.0% of the total general obligation bond debt service costs in the 2009-11 biennium ($18 million of $112.7 million).

8. If the current use of $6,000,000 annually of SEG loan repayments for general obligation bond debt service is maintained, GPR costs would increase by $3,000,000 annually from the amounts provided in the bill. However, over the long-term a greater amount of loan repayments would be used for new loans instead of using additional general obligation bond proceeds.

9. In March, 2007, the U.S. EPA Office of the Inspector General issued an audit report that found EPA's policies that allow states to use bonds repaid with clean water revolving fund interest repayments reduces the funds available for water projects. The Inspector General found that 20 states (including Wisconsin) have used the interest on clean water loan repayments to repay bonds issued to meet the required 20% state match to the federal grant. The Inspector General recommended that EPA revise its regulations and policy on state match options to no longer allow states to use bonds repaid from the interest on clean water loan repayments to meet state match requirements. The EPA response to the audit stated that while EPA supports the state match policy decisions made at the inception of state programs, it also believed it is appropriate to assess the impacts under current conditions. EPA further indicated it would conduct a survey of states to obtain a better understanding of current practices regarding state match, and the impact changes to the state match policy would have on program implementation.

10. EPA has not made any changes related to the state match requirement or to the allowance for states to use interest repayments for repayment of bonds issued for the state match. If it does, such action could affect Wisconsin's future ability to use interest repayments for general obligation bond debt service.

## ALTERNATIVES

### A. Loan Repayments

1. Approve the Governor's recommendation to convert $3,000,000 annually from GPR to environmental improvement fund SEG to increase, from $6 million to $9 million, the amount of clean water fund program general obligation bond debt service paid by loan repayments received from municipalities from loans that were originally provided from the proceeds of general obligation bonds.

2. Approve the Governor's recommendation, and convert an additional $6,000,000 from GPR to SEG, on a one-time basis in 2009-10.

| ALT A2 | Change to Bill Funding |
|---|---|
| GPR | - $6,000,000 |
| SEG | 6,000,000 |
| Total | $0 |

3. Delete provision.

| ALT A3 | Change to Bill Funding |
|---|---|
| GPR | $6,000,000 |
| SEG | - 6,000,000 |
| Total | $0 |

**B. Bonding Authority**

1. Provide an additional $800,000 in general obligation bonding authority and $6,600,000 in revenue obligation bonding authority to fund the estimated need resulting from adopting the Governor's recommendation under Alternative A1.

| ALT B1 | Change to Bill Revenue |
|---|---|
| BR-REV | $6,600,000 |
| BR-GO | 800,000 |
| Total | $7,400,000 |

2. Provide an additional $1,600,000 in general obligation bonding authority and $13,200,000 in revenue obligation bonding authority to fund the estimated need resulting from adopting Alternative A2.

| ALT B2 | Change to Bill Revenue |
|---|---|
| BR-REV | $13,200,000 |
| BR-GO | 1,600,000 |
| Total | $14,800,000 |

3. Take no action (consistent with the Governor's recommendation).

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