



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #284

### **Safe Drinking Water Loan Eligibility for Certain Privately-Owned Systems (Environmental Improvement Fund)**

[LFB 2015-17 Budget Summary: Page 153, #6]

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#### **CURRENT LAW**

The safe drinking water loan program provides low-interest loans to local governments (including cities, villages, towns, counties, town sanitary districts, public inland lake protection and rehabilitation districts and municipal water districts) for eligible projects to plan, design, construct or modify public water systems, if the projects will facilitate compliance with national primary drinking water regulations under the federal Safe Drinking Water Act or otherwise significantly further the health protection objectives of the Act. The program is funded through federal capitalization grants, and a 20% state match, which the state provides with general obligation bonds (with debt service costs paid with GPR). A "public water system" is defined as a system providing piped water to the public for human consumption if the water system has at least 15 service connections or regularly serves an average of at least 25 individuals for at least 60 days each year.

#### **GOVERNOR**

Expand eligibility for financial assistance under the safe drinking water loan program to include private owners of a community water system or nonprofit noncommunity water system. A "community water system" is a public water system that serves at least 15 service connections used by year-round residents or that regularly serves at least 25 year-round residents (such as residential rural subdivisions, mobile home parks, apartments, and condominiums). A "noncommunity water system" is a public water system that is not a community water system, and is either: (a) a non-transient system which regularly serves at least 25 of the same persons over six months per year (including some schools, churches, day care centers, and businesses); or

(b) a transient system which serves at least 25 persons per day at least 60 days out of the year (including some seasonal commercial establishments, restaurants, motels, and campgrounds).

Require that private owners of a community water system or nonprofit noncommunity water system would be required to: (a) demonstrate that there is adequate security for the repayment of the financial assistance; and (b) comply with the provisions of the federal Safe Drinking Water Act, state statutes, and the rules and regulations promulgated under the provisions that DNR specifies. [Local governments are currently required to comply with (b).] Private owners would not be required to comply with the following requirements that local governments are required to comply with under current law and the bill: (a) establish a dedicated source of revenue for the repayment of the financial assistance; (b) develop and adopt a water conservation program as required by DNR; (c) develop and adopt a program of systemwide operation and maintenance of the public water system, including the training of personnel, as required by DNR; and (d) develop and adopt a user fee system.

## **DISCUSSION POINTS**

1. The federal Safe Drinking Water Act authorizes, but does not require, states that receive federal capitalization grants for safe drinking water state revolving funds, to lend to private owners of community water systems, and to nonprofit noncommunity water systems.

2. DNR indicates that a private company operating the City of Superior municipal public water system would be the most likely private owner of a community water system to request safe drinking water loan program assistance under the bill. It is a relatively large system, has undertaken several infrastructure improvement projects annually, and is likely to have the financial ability to meet the credit-worthiness requirements of the bill and repay loans under the program. DNR is aware of two or three other private companies that operate municipal systems that appear to serve small subdivisions outside the boundaries served by existing municipal systems. It is uncertain whether these smaller private owners would have the financial ability to meet the credit-worthiness requirements under the bill.

3. DNR maintains a drinking water database that shows eligibility could become available under the bill to up to approximately 445 privately-owned community water systems that are not operated for municipalities. These systems serve mobile or manufactured home parks, residential subdivisions, and apartment or condominium buildings. In addition, the DNR database shows that up to approximately 2,400 nonprofit noncommunity systems could become eligible, most of which are churches and schools. DNR anticipates there would be a limited increase in applications for financial assistance from these systems because of the credit-worthiness requirements of the bill.

4. The administration indicates the rationale for expanding eligibility to privately-owned systems that provide public water supplies to municipalities is that it would provide the same access to a state loan as a system owned by municipality. DNR indicates the rationale for expanding eligibility to the other privately-owned systems in the bill is that it could allow some systems that are currently not providing safe drinking water to its consumers a low-interest method of improving

their existing infrastructure.

5. DNR and DOA anticipate the program would make loans to private owners under the bill with funds received from loan repayments received from municipalities that received prior loans, rather than from proceeds from general obligations. This would be done to make sure that general obligation bond proceeds would not be used to benefit private property.

6. Private applicants would not have to comply with certain provisions that municipalities are subject to. DNR indicates the rationale for this includes several points. First, private owners might not have a dedicated source of revenue for the repayment of the financial assistance like municipalities are required to demonstrate, but the bill would require private owners to demonstrate there is adequate security to repay the loan. DNR indicates private owners would not be required to develop and adopt a water conservation program because DNR does not currently require this of municipalities. The bill would not require private owners to develop and adopt a program of systemwide operation and maintenance of the public water system, including the training of personnel, as required by DNR, but DNR indicates the systems would be subject to administrative code requirements related to operation and maintenance.

7. Currently, the safe drinking water loan program requires municipal borrowers to have a dedicated revenue source such as water user fees or property taxes. Before approving the loan, DOA reviews how the dedicated revenue stream compares to the expenses paid from the revenue stream, and requires the difference, or "net revenue" to be at least 110% of the maximum annual debt service on the loan and any other outstanding loans paid from the same revenue stream. If the revenue from the dedicated revenue stream is not sufficient to cover those loan payments, the borrower needs to adopt and implement a plan to increase revenue before a safe drinking water loan is approved.

8. The bill would not require private owners to develop and adopt a user fee system. DNR indicates many of these systems would likely be churches and schools, and thus would likely not have user fees. The Public Service Commission does not regulate water rates of privately-owned community water systems.

9. It is uncertain what private owners of a community water system or nonprofit noncommunity water system would have to do to demonstrate that they can provide adequate security for the repayment of the financial assistance under the bill. It is possible that some schools, churches, or owners of residential developments may be able to demonstrate they have a secure source of funds to repay the loan. It is probable that others, such as some mobile home parks, may have difficulty meeting the credit-worthiness requirements to borrow funds under the bill.

10. DNR establishes an annual priority ranking list that scores each safe drinking water loan project and is used to establish a list of projects to be funded. The ranking system provides first priority for projects that address acute public health risks, especially related to a confirmed waterborne disease outbreak, and then other human health and water contamination issues.

11. The safe drinking water loan program has had sufficient funds in 2011-12 through 2014-15 to provide financial assistance to all applicants. Between 2006-07 and 2010-11, some

years did not have sufficient funding for some applicants. Between the first year of the program in 1998-99 and 2006-07, the program ran out of money every year before being able to fund all eligible applications. For 2014-15, DNR established a final project priority list with total costs estimated at \$264.9 million for projects with submittals of an "intent to apply" form. Of this total, municipalities submitted applications for 24 projects for \$42.1 million in financial assistance, and there was sufficient loan funding for all applications. DOA and DNR estimate that approximately \$148 million in safe drinking water loan program project costs could be funded during the 2015-17 biennium. This includes funding from federal grants, state match, carry forward balance from 2013-15, and loan repayments from previously made loans.

12. The federal capitalization grants for the safe drinking water loan program in federal fiscal year 2010 and subsequent years have allowed states to use up to 20% to 30% of the federal grant for principal forgiveness (in effect, a grant). The scoring formula for awarding principal forgiveness to eligible projects is established in the Intended Use Plan (IUP) prepared by DNR and DOA, which is an annual plan for use of federal funds as required by the U.S. Environmental Protection Agency (EPA). The scoring formula is not in state statutes or administrative code, but DNR and DOA have a public comment process for review of the IUP before the scoring formula is finalized. The scoring formula provides more points for municipalities with the smallest population size and the lowest median household income. Depending on the project score, a municipality can receive principal forgiveness of 0%, 15%, 30%, 45% or 60% of project costs, with a maximum of \$500,000 per applicant. Principal forgiveness is awarded to applications in the same order they appear on the priority ranking list. For the federal fiscal year 2014 grant being used to provide financial assistance in state fiscal year 2014-15, the state program allocated \$4,627,500 in principal forgiveness to 12 of 24 applications that received loans. There was insufficient principal forgiveness for seven applications that were eligible. DNR is developing revisions to the scoring formula, in response to recent federal requirements to include factors related to unemployment and areas of declining population, and solicited public comment in April, 2015.

13. DNR indicates that if the provision in the bill is enacted, and if the Department decides it wants to award principal forgiveness to privately-owned systems, it would probably have to revise the methodology for awarding principal forgiveness to account for these systems. For example, it would likely have to revise the system of how points are awarded for the population size because some of the newly-eligible systems under the bill would have a small population (such as small rural subdivisions) or no residential population (such as schools or churches). It is unknown how DNR would include "members" or "attendees" in the population factor. DNR would utilize a public comment process before revising the principal forgiveness criteria and submitting it to EPA.

14. It is uncertain how the priority ranking score of privately-owned public water systems that become eligible under the bill would compare with the ranking of currently-eligible municipal systems. It is possible some systems that become eligible under the bill could have a higher priority score than currently-eligible systems. For example, if a system becomes eligible under the bill, and applies for financial assistance to replace a well that has contaminated water which poses a threat to human health, it could have a higher priority score than a project to replace pipes that do not pose a threat to human health. The priority ranking system would continue to rank and score projects based on priority score whether or not they are municipally-owned or privately-owned. If there is

sufficient funding in a given fiscal year, all eligible projects would be funded. If there is not sufficient funding for all projects, it is possible that some newly-eligible systems would be funded and some currently-eligible projects would not be ranked high enough to be funded.

15. While there has been sufficient safe drinking water loan program funding for all applicants in the past few years, it is unknown whether there will be sufficient funding in a given future fiscal year to provide financial assistance to all currently-eligible applicants and applicants who become eligible under the bill. DOA and DNR estimate that there will be sufficient funding for approximately \$148 million in project costs during the 2015-17 biennium. In March, 2015, DNR established a draft project priority list for 2015-16 with total costs estimated at \$348.6 million for projects that submitted an "intent to apply" form by December 31, 2014. It is unknown how many of them will be ready to proceed and apply by June 30, 2015, for financial assistance in 2015-16. In 2011-12 through 2013-14, the program entered into an average of \$39 million annually in safe drinking water financial assistance agreements.

16. If the Committee has concerns that providing eligibility for privately-owned systems could result in insufficient funds being available for currently-eligible systems, it could approve only the expansion of eligibility to private owners of municipal systems (which would provide eligibility for the private owner of the City Superior system) and not provide eligibility to private owners of other systems such as schools, churches and subdivisions [Alternative 2]. Alternatively, the provision could be deleted in order to maintain the allocation of limited state resources to systems owned by municipalities [Alternative 4]. Private owners could continue to borrow from private sources.

17. It is possible that some systems with private owners which become eligible under the bill would have a high enough priority ranking score to be awarded principal forgiveness before it is awarded to lower scoring municipalities that are currently eligible for principal forgiveness. It is possible that this scenario could result in insufficient principal forgiveness remaining for some municipal systems that would have otherwise received principal forgiveness under current law.

18. If the Committee has a concern that principal forgiveness should not be provided to private owners, but should only be provided to municipalities, or to privately-owned systems operated for municipalities, the bill could be amended to prohibit DNR and DOA from awarding principal forgiveness to private owners of a system that does not serve a municipality [Alternative 3]. This would allow DNR to award principal forgiveness to the owner of a system that serves a municipality, but not to other privately-owned systems. Under the bill's expansion of eligibility to private owners, DNR would determine how to award principal forgiveness under the intended use plan submitted to EPA.

19. If the provision is deleted, it will not change the eligibility or system of priority ranking for currently-eligible public water systems owned by municipalities [Alternative 4].

## **ALTERNATIVES**

1. Approve the Governor's recommendations to: (a) expand eligibility for financial

assistance under the safe drinking water loan program to include private owners of a community water system or nonprofit noncommunity water system; and (b) require that the private owners demonstrate that there is adequate security for the repayment of the financial assistance, and comply with the provisions of the federal Safe Drinking Water Act, state statutes, and the rules and regulations promulgated under the provisions that DNR specifies.

2. Expand eligibility for financial assistance under the safe drinking water loan program to include private owners of a community water system for a municipality. Require that the private owners demonstrate that there is adequate security for the repayment of the financial assistance, and comply with the provisions of the federal Safe Drinking Water Act, state statutes, and the rules and regulations promulgated under the provisions that DNR specifies. Delete the bill's expansion of eligibility for other private owners of a community water system or nonprofit noncommunity water system.

3. Approve Alternative 1 or 2. In addition, prohibit DNR and DOA from awarding principal forgiveness to private owners of a community water system or nonprofit noncommunity water system that are not systems that serve a municipality.

4. Delete provision.

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