



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #280

Safe Drinking Water Loan Program Bonding Authority (Environmental Improvement Fund)

[LFB 2017-19 Budget Summary: Page 166, #1 (part)]

CURRENT LAW

The safe drinking water loan program was created within the environmental improvement fund in 1997 Act 27 to provide 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 U.S. Environmental Protection Agency (EPA) provides federal capitalization grants to states that operate safe drinking water revolving loan programs. The program provides loans using proceeds of the federal grants and a 20% state match provided with general obligation bond proceeds. All of the general obligation bond debt service costs are paid by general purpose revenues (GPR). The safe drinking water loan program is authorized a cumulative total of \$65,600,000 in general obligation bonding authority.

GOVERNOR

Provide an increase in general obligation bonding authority of \$5.8 million for the safe drinking water loan program.

DISCUSSION POINTS

1. The safe drinking water loan program uses all of the authorized general obligation (GO) bonds to provide the 20% state match required to obtain the federal capitalization grant. The biennial budget act has historically authorized the amount of GO bonds anticipated to be needed to provide the 20% match needed to maximize receipt of federal grants during that biennium. Any

previously authorized but unused GO bonding authority is carried forward to the subsequent biennium. The federal government requires the state to have the entire 20% state match in place before it can accept the federal safe drinking water grant.

2. The bill is based on the Department of Administration (DOA) and Department of Natural Resources (DNR) estimates of a total need of \$6.4 million for GO bonding authority to provide a 20% match to approximately \$32 million in federal capitalization grants, including \$16 million in each of federal fiscal years (FFY) 2017 and 2018, to be used for financial assistance provided under the program in state fiscal years 2017-18 and 2018-19. The actual amount of federal capitalization grants received between FFY 2013 and FFY 2016 averaged \$14.9 million annually over the four-year period. Based on the DOA and DNR estimate of \$1.2 million in available previously authorized but unused GO bonding authority carried forward from 2015-17 to 2017-19, the \$5.8 million in GO bonding authority provided in the bill would provide \$7.0 million in available GO bonding authority. In addition to supporting the expected need of \$6.4 million, this would also be expected to provide a contingency of approximately 10% of the minimum state match anticipated for two years of federal capitalization grants.

3. DOA and DNR estimate that approximately \$146.4 million in project costs could be funded during the 2017-19 biennium. This includes the following estimated amounts of funding: (a) \$49.8 million in carry-forward balance from 2015-17; (b) \$66.8 million from loan repayments from previously made loans and investment income; (c) \$6.4 million from state match; and (d) \$23.4 million of the \$32 million federal capitalization grants for FFY 2017 and 2018, including \$13.8 million for loans and \$9.6 million for principal forgiveness. (The other \$8.6 million in anticipated federal capitalization grants would be used for administration and set-asides for activities such as technical assistance and local assistance to develop the capacity to sample and inspect water systems.) The environmental improvement fund biennial finance plans submitted to the Legislature in September, 2016, and March, 2017, did not state the amount of the estimated need for funds. The March, 2017, plan estimated that the potential need for safe drinking water loans may exceed the available amount, based on an increase of approximately 3% in the total amount of funding applied for in each of the last four years.

4. The actual amount of financial assistance agreements entered into by the program averaged \$41.8 million annually over the four prior fiscal years of 2012-13 through 2015-16. The final funding list for 2016-17, which includes all projects that have applied for funding and are eligible, includes total project costs of \$65.6 million. This includes \$51.2 million in regular projects and \$14.4 million in lead service line replacement projects. It is possible that not all municipalities with projects on the funding list will enter into financial assistance agreements for this funding year. (Municipalities had submitted notifications of intent to apply for funding for potential costs totaling \$425.9 million in 2016-17.) The project priority list for 2017-18 includes notifications of an intent to apply for a total of \$553.9 million in funding, but it is uncertain how much of this total will be submitted as actual applications for funding by the required deadline of June 30, 2017. The estimated \$146.4 million available in 2017-19 under the bill would provide approximately \$73.2 million in each year for project costs, which is approximately 75% more than the average amount for the four-year period of 2012-13 through 2015-16. DOA and DNR anticipate that the program will enter into financial assistance agreements totaling approximately \$77.5 million in 2016-17.

This includes projects on the 2016-17 funding list and projects that received supplemental funding from the 2015-16 funding list, and excludes cancelled projects.

5. The City of Waukesha submitted notifications of intent to apply for funding in both 2016-17 and 2017-18 for over \$121 million to construct facilities to obtain Lake Michigan water, but did not submit an application for funding in 2016-17. DNR anticipates that Waukesha will submit an application for 2017-18 funding for a portion of the \$121 million, for associated water main replacement projects, and that it will submit applications for water pipeline construction projects approximately two years later. The Waukesha project would represent a significant portion of the total funding available under the safe drinking water loan program during the 2017-19 biennium, and likely for the 2019-21 biennium. The statutes specify that no municipality can receive more than 25% of the funds that DOA projects will be available for the safe drinking water loan program for the biennium. This means that up to approximately \$36.6 million of the \$146.4 million anticipated as being available under the bill could be provided to a single municipality.

6. If the Governor's recommendation were adopted but actual federal grants were substantially higher than estimated, it is possible that some safe drinking water projects would have to wait to finalize financial assistance agreements until 2019-21, or until a bill would be passed to authorize additional general obligation bonding authority sufficient to receive the FFY 2018 grant in state fiscal year 2018-19. Conversely, if the Governor's recommendation were adopted but actual federal grants were lower than estimated, any GO authority not needed in the 2017-19 biennium would carry forward to be available for use in 2019-21.

7. It is uncertain what federal grant amounts will be in FFY 2017 or 2018. Two years ago, DNR received notification of the final FFY 2015 grant amount of \$15.43 million in January, 2015. As of April 24, 2017, DNR and DOA had not received notice of the FFY 2017 federal capitalization amount, and estimated it would be similar to the \$14.5 million received for FFY 2016. Bonding authorized for the program can only be used for the program.

8. A reestimate could be made of the amount of GO bond authority needed to provide a 20% match for two full years of federal grants at \$14.9 million per year, based on the most recent four-year average of federal grants, instead of the \$16 million per year estimated under the bill. This would base the GO bonding need on estimated federal grants of \$29.8 million rather than \$32 million. This would also be a higher annual amount than the actual FFY 2016 federal grant amount of \$14.5 million. Based on this reestimate of potential federal grant amounts during the biennium, if a 10% contingency would be provided, as estimated under the bill, the total GO bonding need would be \$6.6 million rather than \$7.0 million. After subtracting the \$1.2 million in unused previous authorization, \$5.4 million in new GO bonding authority could be provided instead of \$5.8 million under the bill, a decrease of \$0.4 million [Alternative 2].

9. Safe drinking water federal capitalization grants allow the state to provide up to 30% of available funds as principal forgiveness. Under an estimated \$29.8 million in FFY 2017 and 2018 grants that would be available with a sufficient state match, up to approximately \$8.9 million of federal funds could be provided as principal forgiveness. DNR and DOA provide up to 70% of eligible project costs as principal forgiveness, with the percentage for a project based on the population and median household income of the municipality. The maximum is \$500,000 in principal forgiveness per municipality per year. Municipalities with smaller and lower-income

households receive the highest priority ranking for, and larger percentages of, principal forgiveness.

10. Safe drinking water loans to local governments are for projects owned by the municipality for the 20-year life of the loan. In general, the state loans have not been used for projects on private property because of state constitutional prohibitions on using general obligation bonding proceeds, which provide the state match for the federal grant, for projects that benefit private property owners rather than improve publicly-owned infrastructure or provide a direct public benefit. In 2016-17, DNR received approval from EPA to allocate part of the federal safe drinking water capitalization grant for the first time to provide funding for principal forgiveness for lead service line replacement on private property. However, loans or principal forgiveness for improvements on private property remain ineligible to use general obligation bonding proceeds. EPA approved the use of \$14,434,500 for principal forgiveness for 38 communities that submitted applications to DNR by June 30, 2016. This included funding from the FFY 2016 capitalization grant, and additional authority EPA approved to be used from grants from prior years that was not used for principal forgiveness in those years. DNR will finish entering into financial assistance agreements with 35 communities before June 30, 2017. (Three communities withdrew their applications.)

11. DNR and DOA plan to allocate a portion of the FFY 2017 safe drinking water capitalization grant for 2017-18 principal forgiveness for lead service line replacement projects on private property. A total of 41 municipalities submitted notification of intent to apply for the 2017-18 principal forgiveness funding for lead service line replacement projects. The municipal applications are due to DNR and DOA by June 30, 2017. In April, 2017, the two agencies were developing ranking criteria and funding limits for 2017-18 lead service line projects. DNR and DOA intend to issue a draft safe drinking water loan program intended use plan in May, 2017, that will include proposed ranking criteria and funding limits, and will provide a 21-day public comment period.

12. In order to receive the federal grant, the safe drinking water intended use plan will be subject to approval by EPA, but not by the Legislature. However, if the Committee wishes to direct the maximum possible amount of federal principal forgiveness toward lead service line replacement, it could choose to require DNR and DOA to include related provisions in the intended use plan. For example, the Committee could consider directing DNR and DOA to request that EPA authorize use of the maximum available amount of principal forgiveness from the FFY 2017 federal grant for lead service line replacement [Alternative 3a]. It is uncertain whether the FFY 2018 federal safe drinking water grant will include principal forgiveness or, if it does, whether it will authorize use for lead service line replacement. The directive could also be made for the FFY 2018 federal grant. While this could potentially increase the amounts of federal principal forgiveness available for lead service line replacement projects in the state, it could also potentially decrease the amount of principal forgiveness available for drinking water low-interest loan projects on public property that do not include a lead service line replacement component.

13. Some have argued that, since the City of Milwaukee may include approximately 40% of the lead service lines in the state, it should receive a greater percentage of the available funding than it received in 2016-17. For 2016-17, municipalities with a population of more than 500,000 were eligible to receive up to \$1,000,000, municipalities with a population between 50,000 and

500,000 received up to \$500,000, and municipalities with a population of less than 50,000 were eligible for up to \$300,000. In addition, to the maximum award, municipalities were also eligible to receive uncapped amounts for the costs of privately-owned lead service line replacements for K-12 schools and licensed day care centers. The City of Milwaukee received \$2.6 million (18%) of the \$14.4 million awarded in 2016-17 for lead service line replacement projects, including: (a) \$1 million under the capped grant for general allocation to residential and commercial properties; and (b) \$1.6 million for lead service line replacements at K-12 schools and licensed day care centers.

14. The Committee could consider directing DNR and DOA to request approval from EPA to allocate a larger amount or percentage of funds to an individual municipality. For example, this could be done by directing DNR and DOA to request approval from EPA to increase the maximum award for municipalities with a population of more than 500,000 from \$1,000,000 to \$2,000,000 [Alternative 3b]. Alternatively, or in addition, DNR and DOA could be directed to request EPA approval to authorize any individual municipality to receive up to 25% of the amount available for lead service line principal forgiveness in the 2017-19 biennium [Alternative 3c]. This would be the same maximum as the safe drinking water loan program provides for low-interest loans under the program. While these alternatives could potentially increase the amount or percentage of federal principal forgiveness available for lead service line replacement in Milwaukee, it could potentially decrease the amount or percentage available for lead service line replacement in other municipalities in the state.

15. If no additional general obligation bonding authority for the safe drinking water loan program is approved [Alternative 4], the state could use the \$1.2 million in bonding authority carried forward from 2015-17 to provide a 20% state match to approximately \$6.3 million in federal grant funds. This could allow the state to apply for a partial federal grant, but the amount would not be sufficient to provide the necessary match to receive the full estimated grant in FFY 2017. The state is required to have the state match in place before it can draw on any of the federal grant funds, and it must spend all of the state match before it can spend any of the federal grant. If no additional GO bonding authority were provided, the program would be able to make loans with up to approximately \$116 million in funds available from the carry forward balance from the previous year, loan repayments, investment income, and the partial federal grant.

16. The program may have approximately \$12.4 million in carryforward principal forgiveness authority available from prior years for possible use in 2017-18. If the state receives a partial or no federal grant, it is uncertain how or whether DNR and DOA would choose to allocate principal forgiveness to potential eligible municipalities.

ALTERNATIVES

1. Approve the Governor’s recommendation to provide an increase in general obligation bonding authority of \$5,800,000 for the safe drinking water loan program.

ALT 1	Change to	
	Base	Bill
BR	\$5,800,000	\$0

2. Approve an increase in general obligation bonding authority of \$5,400,000 (based on estimated federal funding of \$29.8 million over two years instead of \$32 million) for the safe drinking water loan program.

ALT 2	Change to	
	Base	Bill
BR	\$5,400,000	- \$400,000

3. In addition to Alternative 1 or 2, direct DNR and DOA to request EPA approval of one or more of the following related to use of the federal grant for principal forgiveness for lead service line replacement:

a. Direct DNR and DOA to request EPA approval to use the maximum amounts of principal forgiveness available under the FFY 2017 and FFY 2018 safe drinking water capitalization grants for lead service line replacement projects on private property during the 2017-19 biennium.

b. Direct DNR and DOA to request EPA approval to increase the maximum award for lead service line replacement funding for a municipality with a population over 500,000 from \$1,000,000 to \$2,000,000 (excluding the uncapped amounts for schools and licensed day care centers) for funding under the FFY 2017 and FFY 2018 grants during the 2017-19 biennium.

c. Direct DNR and DOA to request EPA approval to award a single municipality up to 25% of the available funding for principal forgiveness for lead service line replacement during the 2017-19 biennium.

4. Delete provision. There would be no new bonding authorized for the safe drinking water loan program. The state would only be able to accept limited federal capitalization grants in 2017-19.

ALT 4	Change to	
	Base	Bill
BR	\$0	- \$5,800,000

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