



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #430

Clean Water Fund General Obligation and Revenue Bonding Authority, Present Value Subsidy Limit and Priority List Allocation (Environmental Improvement Fund)

[LFB 2001-03 Budget Summary: Page 290, #1; Page 291, #3(a); Page 291, #5(a)]

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 pollution abatement or urban stormwater 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. The state match is provided with general obligation bond proceeds. The program also uses general obligation bonding authority to leverage a larger amount of capital through the sale of state revenue obligation bonds, with the general obligation bonds paying the costs of the state subsidy to municipalities that results because loans to municipalities are made at an interest rate below the market interest rate the state pays for its revenue bonds.

To provide a financial control mechanism, the statutes provide a concept unique to the environmental improvement fund, termed a "present value subsidy" limit. This limit is a means for the Legislature to control the commitment of state financial assistance to municipalities in a biennium. Because it incorporates the debt service that will be paid on bond issuances, the present value subsidy limit reflects the total cost to the state, in current dollars, of subsidizing clean water fund program projects. 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. There is \$85.2 million authorized in present value subsidy for the 1999-01 biennium and \$1,000 authorized for subsequent biennia.

Clean water fund projects, other than financial hardship assistance projects, are funded on a continuous funding cycle. If the amount of present value subsidy, general obligation bonding authority or revenue bonding authority available for a biennium is 85% or less of the amount requested in the biennial finance plan prepared by DOA and DNR, funding is allocated on the basis of a priority list and funding may only be provided in a fiscal year to projects for which an application is submitted by the June 30 preceding that fiscal year. Under current law, if the Governor's budget recommendation includes an amount of present value subsidy, general obligation bonding authority or revenue bonding authority for a biennium that is 85% or less of the amount requested in the biennial finance plan, DNR is required to inform municipalities that, if the Governor's recommendations are approved, clean water fund assistance during a fiscal year of that biennium will only be available to municipalities that submit financial assistance applications by the June 30 preceding that fiscal year.

GOVERNOR

Provide \$177 million in additional bonding authority for the clean water fund program, as follows: (a) increase general obligation bonding authority by \$65 million on the effective date of the biennial budget act, from \$552,743,200 to \$617,743,200; (b) increase general obligation bonding authority by an additional \$20 million on July 1, 2003, from \$617,743,200 to \$637,743,200; and (c) increase revenue bonding authority by \$92 million, from \$1,297,755,000 to \$1,389,755,000. Provide a "present value subsidy limit" totaling \$90.0 million for the clean water fund program during the 2001-03 biennium. Reduce both thresholds for allocating clean water funds based on a priority list, as described under "Current Law" above, from 85% to 75%.

DISCUSSION POINTS

Bonding Authority and Present Value Subsidy Limit

1. The bill's provision of \$65 million of general obligation bonding authority during 2001-03 would equal 59% of the \$110.12 million in general obligation bonding authority requested in the biennial finance plan. After the bill adds \$20 million in general obligation bonding authority on July 1, 2003, in the 2003-05 biennium, the provided \$85 million would equal 77.2% of the amount requested in the biennial finance plan. The bill would provide 83.3% of the present value subsidy (\$90 million of the requested \$108 million) requested in the biennial finance plan.

2. The biennial finance plan requested sufficient general obligation bonding authority and present value subsidy limit to fund all expected wastewater needs during the biennium. DNR

identified needs of \$439.8 million, plus a 10% construction contingency, to equal \$483.7 million in estimated total financial assistance needs. DNR's projections represented the Department's best estimates of need as of September 1, 2000, based on both file materials and a comprehensive survey of municipalities.

3. The biennial finance plan was based on an estimated revenue obligation market interest rate of 7% for planning purposes, based on long-term historical trends. The bill provides \$25.1 million less in general obligation bonding authority and \$18 million less in present value subsidy than included in the biennial finance plan, based primarily on assuming a 6% instead of 7% revenue obligation market interest rate. DOA officials indicate the Governor's proposed levels of general obligation bonding authority and present value subsidy limit is intended to fund the same level of wastewater needs identified in the September 1, 2000, analysis.

4. The changes in assumptions made by the Governor are to: (a) assume a revenue obligation market interest rate of 6% instead of the earlier estimate of 7%, which decreases the need for general obligation bonding authority by approximately \$16.7 million and present value subsidy by approximately \$18 million; (b) allocate an additional \$4 million of municipal loan repayments for GPR debt service instead of new loans, which increases the need for general obligation bonding authority by approximately \$1 million; (c) carry forward \$10.8 million in unused hardship general obligation bonding authority that will not be needed in 1999-01; and (d) round the provided general obligation bonding authority to \$85 million and the present value subsidy to \$90 million.

5. The impact of market interest rates on the amount of funding needed under the clean water fund program, is demonstrated by the difference between the 7% "planning interest rate" and the lower 6% used in the Governor's assumptions. If actual interest rates are lower than the 7% planning interest rate, a smaller amount of general obligation bonding authority and present value subsidy limit would be required to fund the same amount of need. The market interest rate for most of the 1999-01 biennium was 5.4% and decreased to 5% when \$70 million in revenue obligation bonds were issued in April, 2001.

6. If market interest rates continue at the current 5% to 5.5% range during the 2001-03 biennium, the Governor's recommended levels of bonding authority and present value subsidy limit would be sufficient to fund a greater amount of projects than were projected in the biennial finance plan. For example, if the interest rate continues at 5.5% (or lower), general obligation bonding authority of \$75.5 million would be sufficient to fund all need projected in September, 2000, instead of the proposed \$85 million, and present value subsidy of \$80.8 million would be sufficient instead of the proposed \$90 million. (These amounts would represent 68.5% of the general obligation bonding authority and 74.8% of the present value subsidy limit included in the biennial finance plan.) If market interest rates increase above 6%, if need is the same as or greater than identified in the September, 2000, biennial finance plan, and if the program is operating on the current continuous funding cycle rather than using a priority list (see following section related to the priority list threshold), amounts provided in the bill may not be sufficient to fund all need. In such a situation, some projects that are ready to enter into a financial assistance agreement in the spring of 2003 might have to wait until the 2003-05 biennium for financing.

7. The DOA Budget Office indicates that the bill delays authorization for \$20 million of the general obligation bonding authority until July 1, 2003, because it is not needed until the 2003-05 biennium. DOA indicates that providing the authority at this time would ensure continuous bonding authority into the next biennium and is necessary to fund loans originated in 2001-03 but where loan disbursements will not be made until 2003-05.

8. In previous biennia, DNR, DOA and the Governor requested, and the Legislature approved, a level of general obligation bonding authority sufficient for allocation to a project at the time the financial assistance agreement is made. However, bonds are generally issued as loan funds are disbursed over two to four years of construction. While approval of the recommended \$20 million on July 1, 2003, instead of during 2001-03, represents a change in current policy, it could be argued that it is not necessary to authorize bonding authority until it needs to be issued. Alternatively, it could be argued that the current policy should be continued to have bonding authority in place for a project at the time the state enters into a financial assistance agreement with a municipality to fund a project, and that doing so demonstrates the state's commitment to a project.

9. As discussed earlier, the biennial finance plan and the bill are intended to fund all need identified in September, 2000. In August, 2000, the Milwaukee Metropolitan Sewerage District (MMSD) identified project costs for the District totaling \$134.7 million in the 2001-03 biennium. The biennial finance plan included MMSD low-interest project costs totaling \$158.8 million (including a construction contingency allowance) and present value subsidy of \$30.3 million. The percentage of the total present value subsidy allocated to MMSD is 33.8% of the present value subsidy limit provided in the plan and bill. This is within the statutory requirement that an individual municipality may receive no more than 35.2% of the total present value subsidy limit. MMSD and DNR officials are currently reviewing MMSD financing needs in order to maximize the amount of MMSD financial assistance agreements in 2000-01 and to update MMSD clean water fund program needs for future biennia. MMSD officials recently reestimated clean water fund program needs as \$135.9 million for 2001-03 (which is \$1.2 million more than identified in August, 2000, and within the funding provided by the bill under current interest rates). MMSD program needs for a northwest side relief sewer and other projects may change at some future date as MMSD implements plans to meet state and federal requirements related to sanitary sewer overflows and bypassing.

Priority List Threshold

10. The bill provides less than the current law threshold of 85% of the requested general obligation bonding authority and present value subsidy. Thus, if the threshold percentage remains at the current 85% instead of being modified to 75% as proposed or instead of being amended in some other way, DNR would have to establish a priority list for funding projects in the 2001-03 biennium. The priority list would be based on environmental factors. Compliance maintenance projects or projects to meet new or changed permit limits receive the highest priority. Current law requires DNR to notify municipalities that if the bill passes with less than the currently-required 85% of bonding authority and present value subsidy, the program would have to fund projects in 2001-02 based on a priority list and financial assistance would be available only to municipalities

that submitted applications before June 30, 2001. DNR sent the required notice to municipalities on March 14, 2001.

11. Although the bill changes the threshold for establishing a priority list from 85% to 75%, the bill provides less than 75% of the general obligation bonding authority requested for the 2001-03 biennium. This happens because the bill provides \$65 million of general obligation bonding authority in 2001-03 and provides the remaining \$20 million on July 1, 2003, which is in the 2003-05 biennium.

12. The DOA Budget Office indicates that it was not intended that the bill require the use of a priority list. In its March 22, 2001 "errata" memorandum to the Joint Committee on Finance, DOA recommended that the following changes be made to the bill so that a priority list would not be needed in 2001-03: (a) delete the references to the amount of bonding authority or present value subsidy required for a biennium for the threshold to go into effect, so that the total amount of bonding authority provided in the biennial budget act (including the amount authorized for future biennia) would be used to calculate whether the threshold will require use of a priority list; and (b) provide DNR with the authority to extend the financial assistance deadline, in a situation where the threshold would require implementing a priority list, beyond the current "June 30 preceding that fiscal year" to also include "or the date established by the Department." DNR officials indicate that if the second change would be made, and if implementation of a priority list is required in 2001-03 or future biennia, the Department would probably allow municipalities 30-45 days after the effective date of the budget act to submit applications.

13. DOA officials indicate that the intent of the change in the priority list threshold from 85% to 75% is to allow a smaller amount of general obligation bonding authority to be included than the amount recommended in the biennial finance plan, while maintaining a provision for a priority list if the amounts in the final budget act are much lower than included in the biennial finance plan.

14. The priority list funding threshold provision was added to the program in 1995 Act 27, effective January 1, 1996. The provision allowed the program to transition to a continuous funding cycle. Currently, projects are funded as they are ready for financing and do not have to wait for a specific funding cycle. The provision to use a priority list in years that provided funds are less than requested ensures that if available funds are less than estimated need, the program will fund projects with the highest environmental priority first.

15. In times, such as current or recent years, when interest rates are low or falling, a 75% or 65% threshold level may be adequate to fund all clean water fund demand. For example, if the bill is amended to provide a lower amount of general obligation bonding authority and present value subsidy limit based on a projected 5.5% interest rate, the threshold could be lowered to 65% and all need identified in the fall of 2000 could likely be funded without implementation of a priority list. However, in times of high or rising interest rates, a threshold set at 100% of the planning rate may be inadequate to fund program demand.

16. Since the impact of a percentage threshold for implementation of a priority list varies depending on interest rate assumptions, an alternative to the use of a statutory percentage threshold would be to require DNR and DOA to implement a priority list if they determine clean water fund program authority is insufficient to fund all projects in the biennium.

ALTERNATIVES TO BASE

A. Bonding Authority and Present Value Subsidy Limit

1. Approve the Governor’s recommendation to make the following clean water fund program changes: (a) increase general obligation bonding authority by \$65 million on the effective date of the biennial budget act, from \$552,743,200 to \$617,743,200; (b) increase general obligation bonding authority by an additional \$20 million on July 1, 2003, from \$617,743,200 to \$637,743,200; (c) increase revenue obligation bonding authority by \$92 million, from \$1,297,755,000 to \$1,389,755,000; and (d) provide a "present value subsidy limit" totaling \$90.0 million for the clean water fund program in the 2001-03 biennium.

Alternative A1	BR
2001-03 BONDING (Change to Base)	\$177,000,000
<i>[Change to Bill]</i>	<i>\$0</i>

2. Approve Alternative 1, as modified to provide the entire \$85 million in general obligation bonding authority in the 2001-03 biennium (instead of deferring authorization of \$20 million of the amount until July 1, 2003).

Alternative A2	BR
2001-03 BONDING (Change to Base)	\$177,000,000
<i>[Change to Bill]</i>	<i>\$0</i>

3. Provide the following levels of bonding authority and present value subsidy limit (assuming a 5.5% revenue market interest rate): (a) increase general obligation bonding authority by \$75.5 million on the effective date of the biennial budget act, from \$552,743,200 to \$628,243,200; (b) increase revenue obligation bonding authority by \$92 million, from \$1,297,755,000 to \$1,389,755,000; and (c) provide a "present value subsidy limit" totaling \$80.8 million for the clean water fund program in the 2001-03 biennium.

Alternative A3	BR
2001-03 BONDING (Change to Base)	\$167,500,000
<i>[Change to Bill]</i>	<i>-\$9,500,000</i>

4. Maintain current law. There would be no new bonding authorized for the clean

water fund program. The current law clean water fund present value subsidy limit for any biennium after 1999-01 is \$1,000, which would not be sufficient to fund any expected clean water fund projects during the biennium.

Alternative A4	BR
2001-03 BONDING (Change to Base)	\$0
[Change to Bill	- \$177,000,000]

B. Priority List Threshold

1. Approve the Governor’s recommendation to reduce the threshold for allocating clean water funds based on a priority list to 75%.

2. Adopt Alternative B1 and, in addition, include DOA’s requested modifications to: (a) delete the references to the amount of bonding authority or present value subsidy required for a biennium for the threshold to go into effect, so that the total amount of bonding authority provided in the biennial budget act (including the amount authorized for future biennia) would be used to calculate whether the threshold will require use of a priority list; and (b) provide DNR with the authority to extend the financial assistance deadline, in a situation where the threshold would require implementing a priority list, beyond the current "June 30 preceding that fiscal year" to also include "or the date established by the Department." (If Alternative A3 is also adopted, DNR and DOA would have to provide clean water fund program funding based on a priority list.)

3. Adopt Alternative B2 and, in addition, reduce the threshold to 65%. (If Alternative A1, A2 or A3 is also adopted, DNR and DOA would continue the current practice of providing clean water fund program funding on a continuous funding cycle.)

4. Delete the statutory threshold for when a priority list must be implemented. Rather, require DNR and DOA to implement a priority list upon determining clean water fund program authority is insufficient to fund all projects in the biennium.

5. Maintain current law. (If Alternative A1, A2 or A3 is also adopted, DNR would have to provide clean water fund program funding based on a priority list.)

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