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General Obligation Bonding Authority and Present Value Subsidy Limit - Safe Drinking Water Loan Program (Environmental Improvement Fund)

[LFB 2013-15 Budget Summary: Pages 153 to 154, #1 (part) and #2 (part)]

CURRENT LAW

The safe drinking water loan program within the environmental improvement fund provides 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 program provides loans using proceeds of federal capitalization 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 currently authorized a cumulative total of $54,800,000 in general obligation bonding authority.

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 estimated cost to the state, in current dollars, of subsidizing safe drinking water loan projects. The present value subsidy limit acts as a cap on the sum of all assistance provided through the safe drinking water loan 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 $30.7 million in present value subsidy for the safe drinking water loan program for the 2011-13 biennium and $1,000 authorized for subsequent biennia.

Safe drinking water loan projects are scored according to a priority ranking system that is used to establish a list of projects to be funded. Top priority is provided for projects that address an acute public health risk, especially risk related to a confirmed waterborne disease outbreak or confirmed microbial contamination. Second priority is provided for projects that address chronic and longer-term health risks to people who drink the water. Safe drinking water projects receive loans at 55% of the market interest rate, or 33% of the market rate if the municipality meets financial need criteria. The market interest rate is established as the interest rate at which the state issues revenue obligation bonds for the clean water fund program, and is currently 3.5%.

Federal capitalization grants for federal fiscal years 2010 through 2012, and federal funds provided under the American Recovery and Reinvestment Act of 2009 (ARRA) have authorized use of a portion of federal funds for principal forgiveness. In Wisconsin, 2009 Act 384 and 2013 Act 7 were enacted to authorize the program to utilize the principal forgiveness provisions.

GOVERNOR

Provide an increase in general obligation bonding authority of $7.1 million for the safe drinking water loan program. Provide a "present value subsidy limit" totaling $29.6 million for the safe drinking water loan program for the 2013-15 biennium. Provide a present value subsidy limit of $1,000 for any biennium after 2013-15.

DISCUSSION POINTS

1. Current law authorizes a present value subsidy limit for the safe drinking water loan program totaling $1,000 for any biennia after 2011-13. This would be insufficient to fund any expected projects during the 2013-15 biennium. In every biennial budget enacted since the safe drinking water loan program was created in 1997 Act 27, the Legislature has approved a present value subsidy limit for the programs as a method of establishing a maximum amount of state financial assistance provided to municipalities in a biennium.

2. The safe drinking water loan program uses all of the authorized general obligation bonds to provide the 20% state match to the federal capitalization grant under the Safe Drinking Water Act. This differs from the clean water fund program, which uses part of the general obligation bonds for the 20% state match to the federal capitalization grant under the Clean Water Act, and the remainder to pay the costs of the state subsidy to municipalities under the revenue obligation bond component of the program.

3. The bill is based on the DOA and DNR biennial finance plan estimate of a total need of $9.6 million for general obligation (GO) bonding authority to provide the 20% state match to approximately $48 million in federal capitalization grants (estimated as three years at $16 million per year). Based on the DOA and DNR estimate of $2.5 million in available previously authorized but unused GO bonding authority carried forward from 2011-13 to 2013-15, the bill provides $7.1

million of additional GO bonding authority. DOA and DNR estimate that approximately $115.3 million in project costs could be funded during the 2013-15 biennium. This includes funding from federal grants, state match, and loan repayments from previously made loans.

4. Of the recommended $29.6 million in present value subsidy limit for the safe drinking water loan program, $20.0 million would be for the regular program, and $9.6 million would be available for principal forgiveness anticipated to be available if the federal fiscal year 2013 and 2014 appropriations acts authorize principal forgiveness (based on 30% of two years of $16 million federal grants).

5. The biennial finance plan and the bill are based on an estimated clean water fund program revenue obligation market interest rate of 5.5% for long-range planning purposes. While the safe drinking water loan program does not issue revenue obligations, the clean water fund program estimated market interest rate is used to calculate the amount of state subsidy needed to fund anticipated safe drinking water loan projects. Safe drinking water loan program projects receive subsidized interest rates as a percent of the market rate, which is currently 3.5%.

6. The market interest rate has averaged 5.1% for the 21 years that the program has issued bonds. The program issues bonds as needed during construction of the project, often over a four- to five-year period after the project financial assistance agreements are entered into. Thus, bonds issued over a six- to seven-year period after budget enactment may have varying interest rates for determining actual state subsidy costs.

7. The Legislature approved levels of general obligation bonding authority and present value subsidy limit based on an estimated 5.0% market interest rate in 2003-05, 2005-07, 2007-09, and 2011-13, and based on an estimated 5.5% market interest rate in 2009-11.

8. Providing funding for 2013-15 based on an estimated market interest rate of 5.0% or 4.5% would allow a lower level present value subsidy limit to be provided than if an estimated market interest rate of 5.5% would be used. It would still allow for some increase in market rates over the biennium without limiting anticipated projects. However, project costs are limited by the amount of general obligation bonding authority provided, and available federal capitalization grants, in addition to the amount of present value subsidy limit.

9. The proposed general obligation bonding authority assumes a continuation of federal grants for the three federal fiscal years 2013, 2014 and 2015, at approximately $16 million annually as DOA and DNR estimated, in September, 2012, as a continuation of the anticipated federal fiscal year 2012 grant amount. The administration requested 20% match sufficient for three years of federal grants rather than two so that any potential delay in adoption of a state budget, or any increases in federal capitalization grants above estimated amounts, would not delay having sufficient general obligation bonding authority in place to accept the federal capitalization safe drinking water grant.

10. The actual federal safe drinking water capitalization grants for federal fiscal years 2011 and 2012 totaled $33.9 million ($18.43 million and $15.74 million), and are being used to finance projects during the 2011-13 biennium. The two years of grants received for federal fiscal

year 2013 and 2014 will fund safe drinking water projects during the 2013-15 biennium. In late March, 2013, DNR received EPA's preliminary notification that the post-sequester federal fiscal year 2013 federal grant will be approximately $17.8 million.

11. 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, based on recent estimates of potentially available amounts, plus provide a contingency of less than a full third year. For example, instead of providing bonding sufficient to match $46 million of federal funding (three years of $16 million annual federal grants as estimated in September, 2012), a reestimate could provide bonding sufficient to match approximately $39 million of potential federal funding. This would include approximately $17.8 million for each of two years (based on the preliminary federal fiscal year 2013 amount), and a contingency of approximately 20% of one year's grant. Based on this reestimate, the total GO bonding need would be $7.9 million, and, after subtracting the $2.5 million in unused previous authorization, $5.4 million in new GO bonding authority could be provided instead of $7.1 million under the bill, a decrease of $1.7 million (Alternative 2 or 3).

12. The state is required to have the entire 20% state match in place before it can accept the federal safe drinking water grant. Thus, if actual federal grants are substantially higher than estimated, it is possible that some safe drinking water projects would have to wait to finalize financial assistance agreements until 2015-17, or until a bill would be passed to authorize additional bonding authority sufficient to receive the federal fiscal year 2014 grant in state fiscal year 2014-15. Any general obligation authority provided, but not needed, in the 2013-15 biennium, would carry forward to be available for use in 2015-17.

13. If the amount of needed GO bonding authority is reestimated, and if an estimate of a 5.0% market interest rate is made, a present value subsidy limit of $29.0 million could be provided for the safe drinking water loan program instead of the $29.6 million under the bill, a decrease of $0.6 million (Alternative 2). If the GO bonding authority would be reestimated, and if a 4.5% market interest rate is estimated, a present value subsidy limit of $26.9 million could be provided for the program, a decrease of $2.7 million from the $29.6 million under the bill (Alternative 3).

14. If no additional general obligation bonding authority for the safe drinking water loan program is approved, the state could use the $2.5 million in bonding authority carried forward from 2011-13 to provide a 20% state match to approximately $13 million in federal grant funds. However, this would not be sufficient to provide the necessary match to receive one full federal fiscal year grant or the full $39 million in federal grant funds that may be available during the biennium. The program would be able to make loans with up to approximately $48 million in funds available from loan repayments and investment income, but would not be able to take full advantage of federal funds for the program.

ALTERNATIVES

1. Approve the Governor's recommendation to provide the following for the safe drinking water loan program: (a) an increase in general obligation bonding authority of $7,100,000; and (b) a "present value subsidy limit" totaling $29.6 million.

2. Approve the following for the safe drinking water loan program: (a) an increase in general obligation bonding authority of $5,400,000 (based on estimated federal funding of $39 million instead of $46 million); and (b) a "present value subsidy limit" of $29.0 million for the safe drinking water loan program, based on an estimated 5.0% revenue market interest rate (a decrease of $0.6 million from the bill).

ALT 2	**Change to Bill** Revenue
BR-GO	- $1,700,000

3. Approve the following for the safe drinking water loan program: (a) an increase in general obligation bonding authority of $5,400,000 (based on estimated federal funding of $39 million instead of $46 million); and (b) a "present value subsidy limit" of $26.9 million for the safe drinking water loan program, based on an estimated 4.5% revenue market interest rate (a decrease of $2.7 million from the bill).

ALT 3	**Change to Bill** Revenue
BR-GO	- $1,700,000

4. Delete provision. There would be no new bonding authorized for the safe drinking water loan program. The current law safe drinking water loan program present value subsidy limit for any biennium after 2011-13 is $1,000 which would not be sufficient to fund any expected projects during the 2013-15 biennium. The state would not be able to accept federal capitalization grants in 2013-15.

ALT 4	**Change to Bill** Revenue
BR-GO	- $7,100,000

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