

Governor's Narragansett Bay & Watershed Planning Commission

Finance Panel

Interim Report of Findings and Recommendations

March 18, 2004

Contents

Executive Summary

I. A statement of the problem

II. Background and Analysis

III. Recommendations

Members

| | |
|------------------------------|----------------------------------------|
| Michael M. Tikoian, Chairman | Coastal Resources Management Council |
| Anthony B. Simeone | Clean Water Finance Agency |
| Fred Vincent | Department of Environmental Management |
| George Welly | Department of Administration |
| Karen Giebink | Narragansett Bay Commission |
| Gary Schuler | SENESCO |
| Judy Doerner | Natural Resource Conservation Service |
| Margherita Pryor | US Environmental Protection Agency |
| Mike Walker | Economic Development Corporation |
| Rick Reed | Economic Development Corporation |
| Robert Byrne | US Army Corps of Engineers |
| Jeff Willis | Coastal Resources Management Council |



Governor's Narragansett Bay & Watershed Planning Commission
Interim Report of the Finance Panel

Executive Summary

As a result of Executive Order 03-16 and the Governor's December 15, 2003 letter, the Finance Panel of the Governor's Narragansett Bay & Watershed Planning Commission was created to address the financial implications of managing Narragansett Bay and the watersheds of the state.

The stated purpose of the Panel is to develop a comprehensive funding strategy for priority activities relating to the Bay and the state's watersheds, while also addressing its short-term charges to review and analyze the proposed Clean Water 2004 bond to ensure that the proposed initiative reflects the necessary requirements for abating water quality issues.

The Panel met eight times over 10 weeks and developed a clear and concise path to follow for meeting its intended purpose:

Provide the governor with a comprehensive financial plan for the restoration, management and protection of Narragansett Bay and the state's watersheds that optimizes their environmental and economic health by:

- *Identifying opportunities to maximize funding for projects and programs by improving and better leveraging the use of existing financial resources;*
- *Providing realistic estimates of capital and non-capital funding needs;*
- *Seeking and recommending new and innovative financing strategies and techniques; and,*
- *Safeguarding funding opportunities to satisfy and sustain the environmental and economic health of the Bay and the state's watersheds.*

The Panel is in the process of identifying the financial needs to implement water quality improvement projects for Narragansett Bay and the state's watersheds. These needs will address infrastructure construction, planning, monitoring, habitat restoration and land acquisition projects. It will ultimately include the operational oversight for these projects, and the additional financial needs that may be recommended by the various Commission panels. However, because of the time and complexity in compiling financial need, none of the Commission's panels have finalized their efforts for inclusion in this Interim Report. Therefore, the figures discussed herein are only estimates that will be revised over time.

A Statement of the Problem

The Panel has initially identified the following issues in meeting its charge to develop a comprehensive funding strategy for priority activities relating to the Bay and the state's watersheds.

I. Issue Statement

The stated purpose of the Panel is to develop a comprehensive funding strategy *for priority activities* (emphasis added) relating to the Bay and the state's watersheds, while also addressing a short-term charge to review and analyze the proposed Clean Water 2004 bond to ensure that the proposed initiative reflects the necessary requirements for addressing water quality issues.

Drawing from established analyses¹ of needed infrastructure improvements to maintain or improve the water quality of Narragansett Bay and the state's watersheds, the Panel estimates that the state's long term funding needs exceed \$1.4 billion. This amount does not include all foreseeable infrastructure investments necessary to meet water quality goals, especially those investments tied to additional requirements resulting from other Commission panels' recommendations. It also does not account for the operational oversight for these projects, nor any planning, monitoring and land acquisition projects.

II. Background and Analysis

While awaiting full information from the Commission's other panels, the Finance Panel has developed preliminary recommendations to better prepare the ability of the state to finance both the immediate and long-term needs of water quality improvement projects in Narragansett Bay and the state's watersheds. The panel's report focuses on three key areas: needs; capacity issues; and financing strategies.

Needs

The Panel, in addressing its charge to create a recommendation for the financing of water quality improvement initiatives for the State, first inventoried the statewide universe of projects that are currently waiting funding for implementation. The identified needs total over \$1.4 billion.

| | |
|--------------------------------------------------|---------|
| Point Source Abatement Projects (next 20 years): | \$1.38B |
| Nonpoint Source Abatement Projects (to 2011): | \$0.06B |
| Stormwater Projects (to 2011): | \$0.03B |

¹ RIDEM's annual Project Priority List (PPL), projections of TMDL and stormwater implementation costs, and the U.S. EPA's Clean Watersheds Needs Survey 2000

Governor's Narragansett Bay & Watershed Planning Commission
Interim Report of the Finance Panel

The panel anticipates that nutrient removal at wastewater treatment plants will be recommended at substantial additional cost; in addition, communities now subject to stormwater regulations will be required to implement best management practices. And finally, as they are completed, Total Maximum Daily Limits (TMDLs) analyses will specify pollutant reductions necessary to meet water quality standards and these will have to be implemented as either point or nonpoint source controls.

Capacity Issue

The Panel noted that there exists a substantial current investment in meeting the state goal of improving water quality to Narragansett Bay and the watersheds of the state. A number of projects have been completed, are under construction, or are in the planning and design stages to address water quality issues.

The State Revolving Loan (SRF) program has been a successful tool for Rhode Island in carrying out its objectives of providing funding for projects that mitigate water pollution abatement. Since its first loan in 1992, the fund, administered by the Rhode Island Clean Water Finance Agency (RICWFA) and the Department of Environmental Management, alone has provided over \$500 million in funding for water pollution abatement projects within the majority of communities of the state, including many of the coastal communities. For example, the Narragansett Bay Commission (NBC) has borrowed more than \$220 million from the RICWFA, a significant portion of which has been used to finance NBC's CSO Abatement Facilities. Investments in municipal sewer projects and upgrades, such as those at West Warwick, and the establishment of municipal Wastewater Management Districts in the South County communities of Charlestown and South Kingstown, are each funded through the SRF loan process and are contributing to the improvement of water quality.

Nevertheless, the panel found a significant backlog of designed projects waiting funding.

The State Revolving Fund Program is a perpetual revolving loan fund designed to be a source of low-cost financial assistance for qualified water pollution abatement projects which contribute to the removal, curtailment or mitigation of pollution of the waters of the state, as vetted and prioritized by DEM on a Project Priority List. The Project Priority List also incorporates many of the projects identified by DEM as part of their Total Maximum Daily Load (TMDL) Program. The Project Priority List serves to annually identify a universe of projects that meet the goal of water pollution abatement. For example, as projects are designed to address Phases II and III of the Narragansett Bay Commission's CSO project, NBC will request that they be added to this list.

Unfortunately, due to financial capacity limitations, projects lower on the Project Priority List are not reachable for funding even if they are ready for implementation. Each year, there is a set of projects that cannot be reached because there simply is not enough money in any given year to effectively fund each project. As a result, this set of projects must seek alternative funding, or they may not be implemented. This set of projects is carried over to the next year's funding cycle, hoping that additional funds will become available and the project will be "reachable" for funding. This "backlog" of water pollution abatement projects had led to the issue of "financial

Governor's Narragansett Bay & Watershed Planning Commission
Interim Report of the Finance Panel

capacity” i.e.: the ability of the state to assist with the funding of worthwhile/programmatically acceptable projects.

In addition, while the SRF continues to address major point source needs, nonpoint sources increasingly contribute to impairments. Although nonpoint source projects are eligible for loans, technical issues of dedicated repayment streams and project sponsorship mostly preclude access to the SRF, even if the needed financial capacity were available.

This year, the Governor is proposing a \$15 million Clean Water bond to fill some part of this gap by providing matching grants to state and local agencies, nonprofit organizations, and the private sector to abate nonpoint sources of pollution and restore riparian buffer areas. The \$15 million will be apportioned at \$11 million for state and local nonpoint source abatement; \$2 million for private sector pollution abatement; and, \$2 million for riparian buffer restoration. Improvements to water quality and natural habitats have resulted from the completion of various projects that have been funded over the years from state and federal grant and loan programs, and this bond is an important first step in meeting the need for dedicated funding for non-point source pollution problems along with habitat restoration.

The bond will ultimately further the improvements to water quality and natural habitats by providing much needed matching funds for these types of projects; in effect, the bond will result in \$30 million worth of water quality improvement and habitat restoration projects. However, this bond and the various current grant and loan programs have finite resources and are not sufficient to address all identified needs. Given this, more should be done to address both point source and non point source pollution.

While capacity cannot be limitless, it can be increased and made more effective.

Financing Strategies

While the SRF program is a successful tool for Rhode Island in carrying out its objectives of providing funding for projects that mitigate water pollution abatement, it has become clear that increased loan capacity will enhance the State's ability to fund more projects, sooner enabling the State to meet its water quality improvement goal timeline.

The issue of financial capacity was found by the Panel to be a significant one. There simply are not enough financial resources available to provide a capacity that is sufficient enough to meet the anticipated funding needs for the realization of all of these projects in any given year, let alone over a 20 year period. This does not mean that the goal of improved water quality will not be met if these projects cannot all be funded; it does mean however that water quality improvement possibly will occur incrementally and at a slower pace. It also acknowledges the realization that with “updated/revised” regulatory and federal requirements, there will always be “new” projects created to address water quality improvement that will also be added to “the list” and which will also seek funding for their implementation.

The capacity of the state to finance water pollution abatement projects fluctuates almost annually. Because the ability to fund state SRF programs revolves around Congressional

Governor's Narragansett Bay & Watershed Planning Commission
Interim Report of the Finance Panel

reauthorization of the Clean Water Act every five years, states must wait to make their financial responsibilities to an SRF until Congress has set a funding limit. Additional SRF capacity could be attained if the State were to issue additional general obligation bonds on behalf of the RICWFA. The bond proceeds could be used to leverage a significant amount of new subsidized SRF loans.

Bonding is an important means of paying for capital projects and the state revolving fund has made great strides in effectively increasing the purchasing power of the grants it received. The state, however should investigate other innovative ways to raise operating funds for the program, i.e. conservation stamps, bay use stamp, boating use stamp, etc.

A suggestion discussed by the Panel was to address the arbitrage limitations currently governing SRF transactions. Simply put, an SRF must account for the "profit" made between the rate of a loan it makes against that of its investment rate. If the difference is, for example, one percent, then the SRF must report that as "profit" to the IRS and make a payment to the federal government over that difference. If an SRF can simply keep that profit and re-loan it, it can immediately increase its own capacity without receiving new funding.

Efforts, such as this seemingly simple one, should be made at the appropriate federal levels to help increase the capacity of SRF programs.

III. Recommendations

Through the SRF, funding is available to finance infrastructure improvements that address point sources of pollution (i.e.: wastewater treatment plant improvements); however, funding is limited by the current capacity of the SRF. And, while the SRF also currently provides low-interest cost loans for cesspool replacement, repair or replacement of failed or failing septic systems and landfill closure, a complementary program is needed to effectively address some of the equally pervasive nonpoint sources of pollution such as stormwater runoff. This program would also need to address ways that provide for improved or maintained water quality through habitat restoration projects.

The Finance Panel therefore makes the following preliminary recommendations:

Financing Capacity

- The proposed \$15 million bond initiative is a good start to addressing identified nonpoint source water pollution abatement and habitat restoration issues in the state over the next five to six years. However, it should be made clear that this amount of money will not completely address these issues: additional bond monies need to be made available to continue the work of the state in mitigating impaired waters;
- A regularly-implemented state bond program is required to address the financial needs of water pollution abatement; i.e.: increase the loan capacity of the RICWFA;

Governor's Narragansett Bay & Watershed Planning Commission
Interim Report of the Finance Panel

- State matching funds are critical to securing federal funds. The Panel recommends further investigation of the use of restricted receipts accounts as a method of providing revenue for additional federal funds;

SRF Enhancements

- Seek Congressional assistance in reviewing SRF program requirements and exploring such concepts as relief from arbitrage requirements;
- Increase the national SRF authorization and appropriations, including revising the state allocation formula;
- Increase SRF loan terms from 20 years to 30 years or more;

Program Improvements/Investments

- A requirement for the mandatory hook-up to sewer lines to maximize investment in upgraded treatment plants, contribute to water quality improvements, and create a revenue stream;
- Connections to public sewer service is often not feasible, hence, the need to replace failing septic systems including substandard cesspools, must also be addressed. Low interest loans for cesspool phase out and failed septic system replacements should be a component of a larger statewide funding strategy for water quality;
- There exists a great opportunity to partner with nongovernmental, academic, and corporate organizations to further water quality improvement goals and promote habitat restoration. Investigate ways to streamline state administrative processes to simplify involvement of these partners and federal funding agencies;
- Investigate other innovative ways to raise operating funds, like a bay use or conservation stamp.