



**House
Legislative
Analysis
Section**

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**\$1 BILLION GREAT LAKES WATER
QUALITY BOND PROPOSAL**

**House Bill 4625 as introduced
Sponsor: Rep. Bruce Patterson**

**House Bill 5892 as introduced
Sponsor: Rep. Tom Meyer**

**Committee: Commerce
First Analysis (4-23-02)**

THE APPARENT PROBLEM:

Although experts say Michigan has made great progress in recent decades in controlling water pollution and improving the quality of the Great Lakes and the state's inland waters, by all account, huge amounts of public investment will be necessary in the near future if the wastewater treatment systems of Michigan's local communities are to be adequately maintained and improved. Reportedly, billions of gallons of untreated and partially treated sewage enter Michigan waters each year due to the state's inadequate wastewater treatment infrastructure. The dangers to public health, to the Great Lakes ecosystem, to the quality of life of residents, to tourism, and to economic development are obvious.

A recent report by Public Sector Consultants for Clean Water Michigan, entitled Managing the Cost of Clean Water: An Assessment of Michigan's Sewer Infrastructure Needs, said in its executive summary,

Many of the facilities constructed to correct the pollution problems evident in the 1960s are reaching the end of their serviceable life. Faced with limited financial resources, many communities are deferring the investments needed to maintain, rehabilitate, and/or replace older wastewater infrastructure in order to afford the cost of correcting combined sewer overflow (CSO) and separate sanitary sewer overflow (SSO) problems. Deferred expenditure on existing infrastructure, however, increases the risk of major system failures. National studies predict an unprecedented demand for sewer infrastructure upgrading and replacement over the next 20 years. This study confirms that a majority of Michigan sanitary sewers and many waste treatment facilities, like those in the rest of the nation, will soon be more than 50 years old. Without a major investment, sewer maintenance costs will continue to rise, and frequent system failures are inevitable.

An April 2001 report on a study of sewer infrastructure needs by SEMCOG, the Southeast Michigan Council of Governments, reported that, "Over the next 30 years, an additional \$14-26 billion will be needed to maintain and improve the region's sewage collection and treatment systems. These estimates grow to \$29-52 billion when inflation and interest charges on borrowing for capital projects are considered". The report's executive summary goes on to point out that, "Collapsing service in older, urban areas will inhibit urban revitalization efforts and push additional sewer development into greenfield areas -- in turn, creating even more infrastructure that will be costly to build and maintain". (SEMCOG is the regional planning agency for Livingston, Macomb, Monroe, Oakland, St. Clair, Washtenaw, and Wayne counties.)

Testimony in a series of hearings held by the House Committee on Commerce suggests that similar wastewater conveyance and treatment infrastructure needs exist throughout the state, particularly in older urban areas. Many communities are said to be dramatically increasing water and sewer rates to pay for necessary improvements, including meeting new federal standards taking effect soon. At the same time, say municipal officials, federal financial support for such projects has declined substantially from previous decades. According to SEMCOG, the federal government contributed \$255 million to state sewer infrastructure projects in 1974. In 2000, the federal contribution was \$68 million.

The principal source of assistance to local communities in Michigan is the state water pollution control revolving fund, commonly called the state revolving fund (or SRF). The SRF provides subsidized low-interest loans to municipalities for use in upgrading wastewater treatment systems. Eligible projects include treatment plant upgrades and expansions, combined sewer overflow abatement,

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new sewers designed to reduce existing sources of pollution, nonpoint source pollution management, sludge management, and similar efforts to address the problems of the state's aging wastewater treatment infrastructure. Federal funds are channeled to local units through this fund; the state is required to provide a 20 percent match. The fund is administered jointly by the Department of Environmental Quality and the Michigan Municipal Bond Authority. Municipalities apply for the loans, which are repaid into the fund. Assistance is awarded based on a project priority list developed by the DEQ. According to recent information from the DEQ, 189 projects have been funded totaling \$1.61 billion over the life of the program. However, the needs today far outstrip the available revenues. The fund anticipates providing about \$200 million annually for new project loans. (In fiscal year 2000, local units made applications for projects totaling \$350 million.) In a document presented jointly by SEMCOG and the Michigan Municipal League to the House Committee on Commerce, the costs eligible for the SRF in Southeast Michigan alone (that is, excluding growth-related projects) were estimated at \$5.7 billion to \$10.1 billion over the next 30 years, and the organizations estimated costs for cities and villages alone over the next 20 years at between \$3 to \$5 billion.

The recent Public Sector Consultants report cited earlier says, "The SRF loan program has been very successful, but the capitalization of this fund must be substantially increased in order to assist local governments with wastewater infrastructure projects". The report predicts a severe funding crisis within the next decade without increases in federal and state appropriations. Legislation has been proposed that could inject \$1 billion of state bond revenues into the SRF if the state's voters approve.

THE CONTENT OF THE BILLS:

House Bill 4625 would create the Great Lakes Water Quality Bond Authorization Act, under which the state would borrow up to \$1 billion, through the issuance of bonds, to finance water pollution control projects for the prevention of discharges of untreated or improperly treated sewage into state waters. The bonds to be issued would be general obligation bonds, pledging the full faith and credit of the state for the payment of principal and interest. The borrowing and the issuance of bonds would be submitted to state voters at the next general election, and bonds could not be issued unless the question was approved by a majority of registered electors voting on the question. House Bill 5892 would

create a new Part 197 of the Natural Resources and Environmental Protection Act, or NREPA, (MCL 324.19701 et al.) to provide for the issuance of the water quality bonds and for the creation of the Great Lakes Water Quality Bond Fund into which all bond proceeds would be deposited. Money in the fund would then be transferred, minus the cost of issuing the bonds, into the State Water Pollution Control Revolving Fund. The bill would specify that not more than 10 percent of the bonds could be sold in any one year. House Bill 5892 would not take effect unless House Bill 4625 was enacted and unless voters subsequently approved the issuance of bonds at the November 2002 general election.

House Bill 4625. Under the bill, the proceeds from the sale of bonds, any premium and accrued interest received on the delivery of the bonds, and any interest earned on the proceeds of the bonds would be deposited in the state treasury and credited to a restricted fund and would be disbursed only for the purposes for which the bonds were authorized, including the expense of issuing the bonds. Money would be expended for the purposes set forth in this bill in a manner provided by law. (The accompanying House Bill 5892 would provide that manner of spending.)

After the issuance of bonds authorized by the bill, the state would have to appropriate from the general fund each fiscal year a sufficient amount to pay promptly, when due, the principal of and the interest on all outstanding bonds and the costs incidental to the payment of the bonds. The governor would be required to include the appropriation in his or her annual executive budget recommendations to the legislature.

The question on the borrowing and the issuance of bonds submitted to voters, in accordance with Section 15 of Article IX of the State Constitution, would be substantially as follows:

Shall the State of Michigan finance water pollution control projects that prevent discharges of untreated or improperly treated sewage into the waters of the state, by borrowing a sum not to exceed \$1 billion and issuing general obligation bonds of the state, pledging the full faith and credit of the state for the payment of principal and interest on the bonds, the method of repayment of the bonds to be from the general fund of the state?

House Bill 5892. The bill contains a legislative finding as follows: "the legislature finds and declares that the environmental and natural resources

protection programs implemented under this [new] part are a public purpose and of paramount public concern in the interest of the health, safety, and general welfare of the citizens of this state.”

Much of the language in the bill is technical in nature to provide for the issuance of the bonds. Generally speaking, the bill would specify that the bonds would be in a form and would be executed in a manner determined by a resolution of the State Administrative Board, and would require that the board rotate the services of legal counsel when issuing bonds. The State Administrative Board could authorize the state treasurer to sell and deliver and receive payment for the bonds; to deliver bonds partly to refund bonds and partly for other authorized purposes; to select which outstanding bonds would be refunded, if any, by the issue of new bonds; to approve interest rates or methods for fixing interest rates, prices, discounts, maturities, principal amounts, purchase prices, purchase dates, remarketing dates, denominations, dates of issuance, interest payment dates, redemption rights, the place and time of delivery and payment, and other matters and procedures necessary to complete the authorized transactions; and to execute, deliver, and pay the cost of remarketing agreements, insurance contracts, agreements for lines of credit, letters of credit, commitments to purchase bonds or notes, and any other transaction to provide security to assure timely payments or purchase of any bond issued under the new part. The bonds would have to be approved by the Department of Treasury before their issuance but would not otherwise be subject to the Revised Municipal Finance Act. No more than 10 percent of the bonds could be sold in any year. The bonds would be fully negotiable under the Uniform Commercial Code and the bonds and interest on the bonds would be exempt from all taxation by the state or any political subdivision of the state.

The total proceeds of all bonds would be deposited in the newly created Great Lakes Water Quality Bond Fund and the state treasurer would direct the investments of the fund. Bond proceeds would have to be expended so as to maintain the tax exempt status of the bonds. The unencumbered balance in the fund at the close of a fiscal year would remain in the fund and would not lapse to the general fund. The Department of Environmental Quality would be required to provide an annual accounting of bond proceeds spending on a cash basis to the Department of Treasury. The account would be submitted to the governor, the standing committees of the House of Representatives and Senate that primarily address issues pertaining to the protection of natural

resources and the environment and to the appropriation committees of the House and Senate.

BACKGROUND INFORMATION:

Under Part 52 of NREPA, the DEQ is required annually to develop a priority list for sewage treatment works projects and stormwater treatment projects and a separate priority list for nonpoint source projects for use in distributing SRF assistance. The act lists the following criteria for sewage treatment works projects and stormwater treatment projects.

- The severity of the water pollution problem to be addressed, maximizing progress towards restoring beneficial uses and meeting water quality standards;
- A determination of whether a project is or was necessary to comply with an order, permit, or other document with an enforceable schedule for addressing a municipality's sewage-related water pollution problems issued by the DEQ or entered as part of an action brought by the state against the municipality, or any component of the municipality. A municipality may voluntarily agree to an order, permit, or other document with an enforceable schedule;
- The population to be served; and
- The dilution ratio existing between the discharge volume and the receiving stream.

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that the debt service payments on the general obligation bonds (up to \$1 billion) would be made from the General Fund. The initial annual payment would be about \$12.1 million. This would increase to \$24.2 million as the next bond issue is sold. The HFA says that if five separate bond issues of \$200 million were made every three years, the total debt service for the program would be \$2.1 billion. This assumes a 5 percent interest rate and a 35-year term. It would take about 46 years to pay off the bonds. Annual debt service would range from the initial \$12.1 million level to as much as \$60.6 million, beginning in the 12th year of the program. (HFA fiscal analysis dated 4-15-02)

ARGUMENTS:**For:**

The proposal would pump up to \$1 billion in state revenues into the State Revolving Fund to finance water pollution control projects aimed preventing the discharges of untreated and partially treated sewage into state waters. While this is not a sufficient amount to fully address the state's staggering need to improve water treatment systems, many of which are said to be outdated or dilapidated, it is an important step. And it will signal to the federal government the high priority that the state places on protecting its water quality. This, in turn, could attract additional federal funding. There is widespread agreement that the state's communities need a stable, long-term source of funding to help them rehabilitate deteriorating sewage collection and treatment programs. This legislation represents a sound investment in the state's future by providing additional dollars that will protect public health, safeguard the environment, eliminate threats to recreation and tourism, and help with economic development efforts in core communities around the state. It makes use of an existing mechanism, the state revolving fund, that has an excellent reputation. The bond issue would depend on approval in November by the state's voters.

According to information provided to the House Commerce Committee, Michigan's per capita debt of \$398 puts the state 34th highest among the states. (The average and median are said to be \$697 and \$505.) Moreover, several states with higher levels of debt per capita reportedly have credit ratings equal to or higher than Michigan's. It should be noted that the legislation says not more than 10 percent of the bonds could be sold in any one year.

Response:

There are two financial concerns with the proposal expressed by the Department of Treasury, which has yet to take a position on the legislation. First is the potential impact of the additional debt on the state's bonding rating. A \$1 billion bond issue would double the amount of general obligation bonds, pledging the full faith and credit of the state, outstanding. The second concern is the state's ability to repay the bonds. Repayment would have to come from the state's general fund (because the repayment of SRF loans would go back into the revolving loan fund). If all the bonds were issued at once, this would cost \$80 million per year (assuming 5 percent interest). The state budget, and the general fund in particular, are already under enormous pressure. The department continues to investigate these issues.

Against:

Some people, while supporting the idea of additional funding of water quality programs, believe that the funds should not all go to the SRF with its current distribution criteria. Some would propose setting aside dollars for outstate areas, so more of those communities could qualify despite the relative small population served. Some would like dollars set aside for projects not currently eligible, such as the disconnecting of footing drains. Footing drains have been described as drains built around the foundations of homes to drain water away from basement walls. Footing drains are said to be a major source of wet-weather flows and can overwhelm sanitary sewer pipes, leading to overflows. Disconnecting such drains would reduce excess flows. Some cities are conducting pilot programs in which footing drain flow is redirected from the sanitary sewers to a new drainage system and sump pumps are installed in homes with local reimbursement to homeowners. Other critics would like to see priority given to the replacement of failing septic systems and to septage acceptance stations, to address problems associated with on-site disposal systems. One proposal would eliminate the current emphasis given to the number of people served by a project in evaluating which projects to fund. House Bill 5893, currently in the House Commerce Committee, addresses some of these issues.

Response:

The DEQ has provided information indicating that 13 percent of SRF dollars have gone to communities with populations under 10,000 and that 28 percent of the dollars have gone to outstate areas. Moreover, SRF administrators say that the current criteria emphasize the severity of problems, including, for example, the amount of pollutants being discharged and the ability of the body of water receiving the pollutants to deal with them. This approach is preferable to designating types of systems to be addressed. Advocates for developing or redeveloping center cities, including small core cities outstate, have pointed to the need to protect existing infrastructure rather than subsidizing growth (or "sprawl") in undeveloped areas with water quality projects. Putting the revenues from the bond issue into the current SRF program would help maintain focus on the most pressing needs around the state.

Against:

Some people argue that many areas of the state would get no benefit from the increased funding of the state revolving fund (because they have little hope of

qualifying for assistance) and yet would have to help repay them anyway. They would have to spend their own tax dollars on their own sewage treatment needs and pay for the assistance to other areas of the state. Moreover, some communities have already stepped up to fund sewage treatment improvements out of their own pockets and they too would be unfairly asked to help repay bonds that will do them little good.

POSITIONS:

The Michigan Municipal League supports the bills. (4-18-02)

The Michigan Townships Association supports the bills but would like to see additional criteria for distributing assistance that would allow rural outstate areas to qualify. (4-22-02)

The Michigan Environmental Council supports the bills. (4-18-02)

SEMCOG has indicated support for the bills. (4-18-02)

The Department of Treasury has no position on the bills at present. (4-18-02)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.