



**House
Legislative
Analysis
Section**

House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

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

**House Bill 4625 as enrolled
Public Act 396 of 2002
Sponsor: Rep. Bruce Patterson**

**House Bill 5892 as enrolled
Public Act 397 of 2002
Sponsor: Rep. Tom Meyer**

**House Bill 5893 as enrolled
Public Act 398 of 2002
Sponsor: Rep. David Mead**

**House Committee: Commerce
Senate Committee: Natural Resources
and Environmental Affairs**

Second Analysis (7-2-02)

House Bills 4625, 5892 and 5893 (7-2-02)

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 accounts, 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 collection, conveyance, and treatment systems. Sewer overflows, particularly in times of heavy rains or melting snow, threaten the safety of drinking water, force beaches to close, endanger aquatic life, flood basements, and more. 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 not only in southeastern Michigan but 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.

There are also concerns around the state about failing on-site septic systems. An estimated 1.2 million households rely on so-called on-site sanitary disposal systems, including many homes in new developments in the countryside. While experts say these can be efficient and effective waste disposal systems, they caution that they can have high failure rates unless properly designed, operated, and maintained. Further, many on-site systems in the state are old and need replacing. The report by Public Sector Consultants cited earlier says, "In some urban areas in Michigan, particularly those developed more than 25 years ago, failing septic systems are a significant source of pollution of both ground and surface waters".

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, 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. (Nonpoint sources include runoff from the land and deposits from the air.) 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:

The three bills in the package would, taken together, propose the issuance of up to \$1 billion in state bonds for local water pollution control projects. The proposal would require the approval of the state's voters at the November 2002 general election. The bills are tie-barred to one another, meaning all must be enacted for any to be enacted, and all the bills depend on voter approval of the ballot proposal in November.

Under the legislation accompanying the ballot proposal, 90 percent of bond proceeds would go into the existing State Water Pollution Control Revolving Fund (also known as the state revolving fund or SRF), and 10 percent would go into a new fund that would be established to make loans to municipalities to help them reduce the flow of groundwater or storm water entering sewer systems or to help them upgrade or replace failing on-site septic systems. No more than 10 percent of the water quality bonds could be sold in any one year, and the first bond issue would have to be structured so that the debt payments would not begin before October 1, 2003.

House Bill 4625 would create a new act, 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 sewage treatment works projects, storm water projects, and nonpoint source projects, that improve the quality of the waters of the state. 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 November 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 1) create a new Part 197 of the Natural Resources and Environmental Protection Act, or NREPA, (MCL 324.19701 et al.) to provide for the actual issuance of the water quality bonds and for the creation of the Great Lakes Water Quality Bond Fund into which bond proceeds would be deposited; and 2) amend Part 52 of NREPA in order to create the Strategic Water Quality Initiatives Fund and a related loan program to make loans to municipalities to help them reduce the flow of groundwater or storm water entering sewer systems or to help them upgrade or replace failing on-site septic systems.. Under the bill, not more than 10 percent of the water quality bonds could be sold in any one year, and the first bond issuance would have to be structured so that the debt payments would not begin before October 1, 2003. The bill would require that 90 percent of the money in the bond fund then be transferred into the State Water Pollution Control Revolving Fund and 10 percent transferred into the Strategic Water Quality Initiatives. Money in the bond fund could also be used by the Department of Treasury to pay for costs associated with issuing bonds. Money from the bond fund could not, however, be used as the state match for federal funds at 2002 match levels. If additional federal money became available, then money could be used as the state match for the federal funds in excess of 2002 levels. The bill would also require that at least two percent of the available funds in the SRF be allocated annually to the extent needed to projects on the nonpoint source priority list. (If not awarded, these funds would revert to projects on the sewage treatment works priority list.)

House Bill 5893 would amend Part 53 of NREPA (MCL 324.5303), which requires the Department of Environmental Protection to annually develop priority lists for use in providing assistance to municipalities through the state revolving fund (or

SRF). One priority list is for sewage treatment works projects and storm water treatment projects and a separate priority list is required for nonpoint source projects. The priority lists are based on project plans submitted by local units of government and on criteria for evaluating projects as specified in NREPA. House Bill 5893 would add criteria to be used in evaluating projects, alter the application of current criteria in certain cases, and require an additional priority list for projects to be funded from the Strategic Water Quality Initiatives Fund, the new fund that would be created in House Bill 5892.

Further information on each of the bills follows.

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 Bills 5892 and 5893 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 sewage treatment works projects, storm water projects, and nonpoint source projects, that improve the quality of 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.”

The bill would create the Strategic Water Quality Initiatives Fund within the state treasury, which would receive 10 percent of the money going into the Great Lakes Water Quality Bond Fund from the proceeds of the new state bonds. (The state treasurer could receive money from any other source for deposit in the fund as well.) Money in the fund could be used only for loans and for the costs of administering the fund. The bill also would require the Michigan Municipal Bond Authority, in conjunction with the Department of Environmental Quality, to establish a strategic water quality initiatives loan program to provide low interest loans to municipalities in order to improve sewage systems through either 1) improvements to reduce or eliminate the amount of groundwater or storm water entering a sanitary sewer lead or a combined sewer lead; or 2) upgrades or replacements of failing on-site septic systems that are adversely affecting public health and/or the environment. The DEQ would annually establish the interest rate charged for loans. Municipalities would apply for the loan following the procedure now in place for seeking SRF assistance. Loan repayments would go back to the new fund. Money in the fund at the end of the fiscal year would remain in the fund and not lapse to the general fund. The municipal bond authority would act as fiscal agent for the fund, and the DEQ would be authorized to promulgate rules to implement the loan program.

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, operating within the limitations contained in the resolution, 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 buy issued bonds; to approve interest rates or methods for determining 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; 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; to determine the details of, execute, deliver, and pay the cost of any interest rate exchange or swap, hedge, or similar agreement; and pledge all or a portion of the Strategic Water Quality Initiatives Fund to secure bonds issued or to be issued under the associated loan program.

The bonds would not be subject to the Revised Municipal Finance Act but would instead be subject to the Agency Financing Reporting Act. 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 bonds or any series of the bonds would be sold at public or private sale at such price or could be issued and deposited directly into the State Water Pollution Control Revolving Fund (or SRF) or into the Strategic Water Quality Initiatives Fund, as determined by or under a resolution of the State Administrative Board.

The total proceeds of all bonds sold at public or private sale 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.

House Bill 5893

The bill would make a number of changes to Part 53 of NREPA. It would require a separate priority list for projects to be funded from the Strategic Water Quality Initiatives Fund, which would receive 10 percent of the proceeds from new water quality bonds in order to finance a state loan program to municipalities. It also would specify that the current criterion that focuses on the size of population when evaluating municipal applications for SRF assistance would not apply to the new "initiatives" projects.

The bill also would affect how applications for current state assistance from the SRF are evaluated. In the case of sewage treatment works projects, it would require that 100 priority points be awarded for each of the following that applied to the project: 1) the project addressed on-site septic systems that were adversely affecting the water quality of a water body or represented a threat to public health, providing that soil and hydrologic conditions were not suitable for the replacement of those systems; and 2) the project included the construction of facilities for the acceptance of or treatment of septage collected from on-site septic systems. Moreover, the bill would require as part of the documentation in applications for a "tier 1" SRF project that feasible alternatives that offered "volume reduction opportunities" had been evaluated in developing the project plan.

BACKGROUND INFORMATION:

Under Part 52 of NREPA, the DEQ is required annually to develop a priority list for sewage treatment works projects and storm water 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 storm water 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 Senate Fiscal Agency has estimated that the debt service on the bonds would be about \$8 million in the first year. This assumes 20-year bonds issued over a 10-year period at a constant interest rate of 5 percent. The debt service would increase by \$8 million per year until the 10th year, by which time all the bonds would have been issued and the annual debt service would be \$80.2 million. The SFA says the debt service would remain at that level for 11 years and then gradually decrease until the bonds were paid off. The total interest cost after all the bonds had been paid off (in 30 years) would be \$605 million, bringing the bond's total cost to \$1.605 billion from the general fund.

The agency also notes that the bills would increase the amounts deposited in the State Water Pollution Control Revolving Fund by about \$90 million per year for 10 years. The SFA says that this increase to the SRF would mean an increase in the amounts available for loans to local units of government for wastewater projects of about \$180 million per year, given current investment and interest conditions. The SFA analysis says the bills would result in an indeterminate increase in administrative costs for the Department of Environmental Quality, the Department of Treasury, and the Michigan Municipal Bond Authority. The bills allow the Department of Treasury to recover costs of issuing bonds from the proceeds of the bonds, and allow the DEQ and the bond authority to recover administrative costs from the new Strategic Water Quality Initiatives Fund. (SFA analysis dated 5-24-02)

ARGUMENTS:

For:

The proposal would pump up to \$1 billion in state revenues into state programs to help municipalities finance sewage treatment works projects, storm water projects, and nonpoint source projects to improve the quality of the state's waters. While this is not a sufficient amount to fully address the state's staggering need to improve sewage treatment systems, many of which are said to be outdated or dilapidated, it is a vitally 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, as well as to deal with other sources of water pollution. 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 administrative mechanism, the state revolving fund, that has an excellent reputation. The bond issue would depend on approval in November by the state's voters.

In response to critics of current water quality spending patterns, the proposal also directs funding to efforts to upgrade or replace failing on-site septic systems and to help municipalities reduce the flow of groundwater and storm water entering sewer systems. A new special fund would be established to provide assistance to local units for these purposes, which are said to have a lower priority under current state assistance criteria. Further, local units would be specifically required to demonstrate that they had looked at alternatives that offered opportunities for volume reduction while in the planning stages preceding applying for state assistance for treatment works projects.

Against:

Two financial concerns have been expressed about the proposal. 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 outstanding general obligation bonds, pledging the full faith and credit of the state. 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). Once all the bonds are issued this will cost \$80 million per year (assuming 5 percent interest). The state budget, and the general fund in particular, are already under enormous pressure.

Response:

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.) 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, which limits the impact of the debt service on the state's general fund. Moreover, the proposal will be put to the electorate, who can decide if they want to take on the amount of debt.

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 the bonds anyway. They would have to spend their own tax dollars on their own sewage treatment and on-site septic system needs and at the same time pay for assistance to other areas of the state. Furthermore, 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.

Analyst: C. Couch

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