

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA**BILL ANALYSIS**

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

House Bill 4625 (Substitute S-1 as passed by the Senate)
House Bill 5892 (Substitute S-1 as passed by the Senate)
House Bill 5893 (Substitute S-1 as passed by the Senate)
Sponsor: Representative Bruce Patterson (H.B. 4625)
Representative Tom Meyer (H.B. 5892)
Representative David Mead (H.B. 5893)
House Committee: Commerce
Senate Committee: Natural Resources and Environmental Affairs

Date Completed: 5-24-02

RATIONALE

Sanitary and wastewater sewer systems are generally designed to handle expected sanitary waste flows generated from residences and businesses during peak usage. Many sewer systems are aging, however, and maintenance, rehabilitation, and replacement are inevitable. In addition, the aging infrastructure is not equipped to handle the increased demands of current use. During extreme events such as heavy downpours or substantial snowmelt, the sewer capacity may become overloaded and may lead to the back-up of sewage into basements and/or the overflow of untreated wastewater into nearby watercourses.

According to many reports, sewer overflows may contain suspended solids, toxic chemicals, pathogens, grease, debris, human drugs, pesticides, and detergents, which can pose severe environmental and health problems. These sewage discharges are considered one of the largest threats to water quality, aquatic life, and public health.

Failing on-site septic systems provide another source of concern about the environment and public health. The Michigan Townships Association estimates that there are 1.2 million on-site septic systems in Michigan; like sewer systems, many septic systems are aging and experiencing problems. Poor performance (such as partially treated sewage pooling on the ground or flowing into drinking water wells or surface waters) and inadequate maintenance can threaten public health, contaminate drinking water, and cause environmental harm.

In recent years, inadequate sewer and septic systems have been responsible for beach closings and threats to the water quality throughout the State, especially on and near Lake St. Clair. According to an article in the *Detroit News* (3-21-01), during just January and February 2001, State environmental experts estimated that more than 800 million gallons of untreated and partially treated wastewater were discharged from Oakland, Macomb, and Wayne County wastewater treatment facilities and retention basins into area rivers and Lake St. Clair.

In 1996, the Michigan Department of Environmental Quality (DEQ) conducted a needs survey for the U.S. Environmental Protection Agency. The estimated need for wastewater construction projects in the State at that time totaled \$5.1 billion. According to a study of infrastructure needs by the Southeastern Michigan Council of Governments, an estimated \$14 billion to \$26 billion will be required by 2030 to maintain and improve southeastern Michigan's sewer infrastructure. In addition, Federal storm water regulations will require most urban communities in Michigan to face additional costs associated with water pollution control requirements within the next three years.

The State Water Pollution Control Revolving Fund (SRF) provides low-interest loans to assist municipalities in funding wastewater treatment improvements. The projects may include wastewater treatment plant upgrades or expansions, combined sewer overflow abatement, new sewers designed to reduce existing sources of pollution, nonpoint source

pollution management measures, and other related wastewater treatment efforts. Qualified municipalities must meet Federal and State program requirements, and demonstrate environmentally sound water pollution control project plans. According to an Auditor General Report on Sewage Issues (October 2000), the SRF is not adequate to fund the anticipated needs over the next several years.

Article 9, Section 15 of the State Constitution allows the State to borrow money for specific purposes in amounts as provided by statute. Approval by two-thirds of the Senate and House of Representatives, and by a majority of the electors voting in a general election, is required. The question submitted to the electors must state the amount to be borrowed, the specific purpose for which the funds are to be devoted, and the method of repayment. Many people believe that indebting the State's taxpayers with general obligation bonds is appropriate in instances in which a large sum of money is needed to deal with an immediate and widespread problem, such as sewer treatment works projects.

CONTENT

House Bill 4625 (S-1) would create the "Great Lakes Water Quality Bond Authorization Act" to require the State, subject to voter approval, to borrow up to \$1 billion and issue general obligation bonds to finance sewage treatment works projects that would improve the quality of the waters of the State.

House Bill 5892 (S-1) would add Part 52 to the Natural Resources and Environmental Protection Act to require the Michigan Municipal Bond Authority, in consultation with the Department of Environmental Quality, to establish the Strategic Water Quality Initiatives Program, which would make low-interest loans to municipalities for sewer improvement projects and on-site septic system upgrades or replacements. The bill also would create the "Strategic Water Quality Initiatives Fund", which could be used only to make the low-interest loans, and to cover costs of the Authority and the DEQ in administering the Fund.

In addition, the bill would add Part 197 to the Act, to establish criteria for the

issuance of the bonds; create the "Great Lakes Water Quality Bond Fund", which would receive the bond proceeds; and require 90% of the Bond Fund to be deposited into the State Water Pollution Control Revolving Fund and 10% into the Strategic Water Quality Initiatives Fund. The first bond issuance would have to be structured so that debt payments did not begin before October 1, 2003.

House Bill 5893 (S-1) would amend Part 53 of the Natural Resources and Environmental Protection Act, which governs the State Water Pollution Control Revolving Fund, to require the DEQ to develop a separate priority list for projects funded by the Strategic Water Quality Initiatives Fund. The bill also would require an additional 100 priority points for projects that addressed on-site septic systems and projects that included the construction of facilities to treat septage collected from on-site septic systems.

The bills are tie-barred to each other. House Bills 5892 (S-1) and 5893 (S-1) could not take effect unless a majority of the registered electors voting on the question approved the proposed Great Lakes Quality Bond Authorization Act.

House Bill 4625 (S-1)

General Obligation Bond

The State would be required to borrow up to \$1 billion and issue general obligation bonds, pledging the State's full faith and credit for the payment of principal and interest on the bonds, to finance sewage treatment works projects that would improve the quality of the waters of the State. The bonds would have to be issued in accordance with conditions and procedures established by law.

Bond Proceeds

The proceeds of the sale of the bonds, premium and accrued interest received on the delivery of the bonds, and any interest earned on the bonds' proceeds would have to be deposited in the State Treasury and credited to the "Great Lakes Water Quality Bond Fund" (pursuant to House Bill 5892). The proceeds and interest could be disbursed only for the purposes for which the bonds had been

authorized, including the expense of issuing the bonds, and could be spent only for the purposes set forth in the proposed Act.

Vote

The question of borrowing up to \$1 billion and issuing general obligation bonds would have to be submitted to a vote of the State's qualified electors. The Secretary of State would have to perform all acts necessary to submit the question properly to the qualified electors to vote on at the next general election. The proposed bonds could not be issued unless a majority of the qualified electors voting approved the question.

Appropriation

The bill would require that, after the bonds were issued, a sufficient amount be appropriated from the State's General Fund each fiscal year to pay promptly the principal of and interest on all outstanding bonds and costs incidental to their payment. The Governor would have to include the appropriation in his or her annual executive budget recommendation to the Legislature.

House Bill 5892 (S-1)

Part 52 (Strategic Water Quality Initiatives)

Strategic Water Quality Initiatives Loan Program. The bill would require the Michigan Municipal Bond Authority, in consultation with the DEQ, to establish a Strategic Water Quality Initiatives Loan Program to provide low-interest loans to municipalities to provide assistance for one or both of the following sewage system improvements: improvements to reduce or eliminate the amount of groundwater or storm water entering a sanitary sewer lead or a combined sewer lead; and upgrades or replacements of failing on-site septic systems that were adversely affecting public health and/or the environment. ("On-site septic system" would mean a natural system or mechanical device used to store, treat, and dispose of sewage from one or more dwelling units that use a subsurface trench or bed that allows the effluent to be absorbed and treated by the surrounding soil, including a septic tank and tile field system.)

In implementing the loan program, the DEQ would have to establish annually the interest

rate that would be charged for loans.

Loan & Fund. A municipality wishing to apply for a loan would have to submit a loan application to the DEQ in accordance with the application requirements of Part 53. The DEQ would have to process the loan applications and otherwise administer the proposed Strategic Water Quality Initiatives Fund according to the procedures established by Part 53.

Before releasing a loan, the Authority, in consultation with the DEQ, would have to enter into a loan agreement with the loan recipient in accordance with Part 53. All money that was received for the repayment of a loan would have to be forwarded to the State Treasurer for deposit into the proposed Fund.

The Fund would be created in the State Treasury. The State Treasurer could receive money or other assets from any source for deposit into the Fund. The State Treasurer would have to direct the investment of the Fund, and credit to it all interest and earnings from investments. The Authority would have to act as fiscal agent for the Fund. Money in the Fund at the close of the fiscal year would remain in the Fund and not lapse to the General Fund. The Authority, in consultation with the Department, could spend money from the proposed Fund, upon appropriation, only for loans and for the costs of the Authority and the DEQ in administering the Fund. The Fund could be pledged as security for bonds to be issued by the Authority for the purchase of funding loans if authorized by the State Administrative Board.

Part 197 (Great Lakes Water Quality Bond Implementation)

Bond Issuance. The bill describes the manner and form in which the bonds authorized by the proposed Great Lakes Water Quality Bond Authorization Act would have to be issued.

The bonds would not be subject to the Revised Municipal Finance Act, but would be subject to the Agency Financing Reporting Act (proposed by Senate Bill 1201). The bonds would be sold at a price and at a public or private sale, or could be issued and deposited directly into the State Water Pollution Control Revolving Fund or the Strategic Water Quality Initiatives Fund, as determined by the State

Administrative Board. Not more than 10% of the bonds could be sold in any year.

Bonds issued under the proposed Act would be fully negotiable under the Uniform Commercial Code. The bonds and the interest on them would be exempt from all taxation by the State or any political subdivision of the State. The bonds would be securities in which banking businesses, insurance businesses, and fiduciaries could properly and legally invest funds, including capital, belonging to them or within their control.

The State Administrative Board could authorize and approve an interest rate exchange or swap, hedge, or similar agreement in conjunction with bonds issued, payable from the same sources as the bonds.

Fund Allocation. The total proceeds of all bonds issued under the proposed Act would have to be deposited into the Great Lakes Water Quality Bond Fund, which would be created in the State Treasury. The Fund would consist of the proceeds of sales of the bonds sold at public or private sale and any premium and accrued interest received on the delivery of the bonds; any interest or earnings generated by those proceeds; and any Federal or other funds received. The Department of Treasury could establish restricted subaccounts within the Fund as necessary to administer it.

The total proceeds of all bonds sold at public or private sale would have to be deposited in the Fund. The State Treasurer would have to direct the Fund's investment. The unencumbered balance in the Fund at the close of the fiscal year would have to remain in the Fund and not lapse into the General Fund.

Use of Funds. The State Treasurer would have to transfer money in the proposed Fund as follows: 90% would have to be deposited into the State Water Pollution Control Revolving Fund and 10% would have to be deposited into the proposed Strategic Water Quality Initiatives Fund. Also, the Department of Treasury could use money in the Great Lakes Water Quality Bond Fund to pay the cost of issuing bonds and the costs incurred in maintaining their tax-exempt status. The first bond issuance would have to be structured so that debt payments did not begin before October 1, 2003.

Money in the Bond Fund could not be used as the State match for receipt of Federal funds for purposes of the State Water Pollution Control Revolving Fund. If Federal revenue became available at higher levels than were provided in 2002, however, money from the Bond Fund could be used to match Federal revenue in excess of 2002 levels.

The bill would require the DEQ to provide an annual accounting of bond proceeds spending on a cash basis to the Department of Treasury. This accounting would have to be submitted to the Governor, the House and Senate standing committees that address natural resources and the environment, and the House and Senate Appropriations Committees.

The bond proceeds would have to be spent in an appropriate manner that maintained the tax-exempt status of the bonds.

Part 53 (Clean Water Assistance)

The bill would amend Part 53 to require the DEQ Director to allocate annually at least 2% of the available funds to the extent needed to provide assistance to projects on the nonpoint source priority list. If these funds were not awarded, the allocation would have to revert to provide assistance to projects on the sewage treatment works priority list.

Legislative Finding

In parts 52 and 197, the bill states the following legislative finding and declaration: "...that the environmental, natural resources, and water quality protection programs implemented under this 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".

House Bill 5893 (S-1)

Under Part 53, each year the DEQ must develop priority lists for projects requesting assistance from the SRF, based on project plans submitted by municipalities. If a project is a sewage treatment works project or a stormwater treatment project, the priority lists must be based on the following criteria: the severity of the water pollution problem; the population to be served by the project; the dilution ratio existing between the discharge volume and the receiving stream; and 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 that was issued by the DEQ or entered as part of an action brought by the State against the municipality.

The bill would require the DEQ to develop a separate priority list for projects funded by the Strategic Water Quality Initiatives Fund. The bill specifies that one of the existing criteria for the project priority lists, the population to be served by a project, would not apply to projects funded by the Strategic Water Quality Initiatives Fund.

The bill also would amend the priority list criteria to require the addition of 100 priority points if a sewage treatment works project addressed on-site septic systems that were adversely affecting the water quality of a water body and soil and hydrologic conditions were not suitable for the replacement of those septic systems, and 100 points if a sewage treatment works project included the construction of facilities for the acceptance or treatment of septage collected from on-site septic systems.

MCL 324.5301 et al. (H.B. 5892)
MCL 324.5303 (H.B. 5893)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bills have several essential objectives: to improve sewer systems, enhance the quality of the waters of the State, and protect public health and the environment. By increasing funds available for wastewater treatment improvement projects, and providing additional funding for projects that address sewer overflows and failing on-site septic systems, the proposed legislation would enable Michigan to go a long way toward meeting these objectives. Beneficiaries of this proposal would include all Michigan citizens, including future generations; people who enjoy fishing, swimming, and boating; people who visit State waters; and people who live in Michigan communities, whether large or small, or urban or rural.

In addition, the bills would encourage more

municipalities to correct sewage-related water pollution problems, by increasing the amount available in the State Water Pollution Control Revolving Fund. Borrowing from the SRF is advantageous to municipalities due to the below-market interest rate and the opportunity to obtain all of a project's financing from one source. This could reduce the time it takes to commence construction and result in lower bid costs.

In view of the high cost of health care, and the importance of tourism, recreation, and agriculture to the State's economy, it would make fiscal sense to keep the drinking water and groundwater safe, clean up beaches, and protect lakes and streams.

Opposing Argument

There are some financial concerns regarding the proposed legislation. The State's ability to take on a significant additional debt is questionable considering the level of the State's current debt. There also would be a substantial budgetary impact from repaying a \$1 billion bond issue, since repayment would be a direct General Fund obligation.

Response: The bonds would not be issued without the approval of the electorate. The State's voters should have the opportunity to decide whether to incur this debt.

Legislative Analyst: Nobuko Nagata

FISCAL IMPACT

The debt service on the bonds that would be authorized by the voters, assuming 20-year bonds issued over a 10-year period at a constant interest rate of 5%, would be approximately \$8 million in the first year. The debt service would increase by \$8 million per year until the 10th year, when the entire amount of the bond issue had been distributed, and the debt service amount would be \$80.2 million. The debt service amount would remain \$80.2 million for 11 years, after which it would decrease gradually until the bonds were paid off. The bonds would all be paid off in 30 years. The interest costs would be \$605 million, bringing the total cost of the bonds to \$1.605 billion GF/GP.

The bills would result in an increase in the amounts deposited to the State Water Pollution Control Revolving Fund by approximately \$90 million per year for 10 years. This increase to the SRF would translate initially into an increase in the

amounts available for loans to local units of government for wastewater projects of approximately \$180 million per year, given current investment and interest conditions.

The bills also would create a new Strategic Water Quality Initiatives Fund. Approximately \$10 million per year for 10 years would be deposited to this Fund from the proceeds of the sale of general obligation bonds that would be authorized by the voters. The money in the Fund would be used to provide low-interest loans to local units of government for certain sewage system improvement projects; or, if authorized by the State Administrative Board, as security for bonds issued by the Municipal Bond Authority for the purpose of providing loans for sewage system improvements. If the money in the Fund were used to provide loans, loan repayment amounts would be returned to the Fund. The Fund, therefore, would grow, at a minimum, at a rate equivalent to the interest rate charged for the local loans. If the money in the Fund were used as security for Bond Authority-issued bonds, then there is the potential that a greater pool of funding could be leveraged for providing loans.

The bills would result in an indeterminate increase in the administrative costs of the Departments of Environmental Quality and Treasury and the Michigan Municipal Bond Authority. The bills would allow the Department of Treasury to recover the cost of issuing bonds from the proceeds of the bonds, and the Department of Environmental Quality and the Authority to recover administrative costs from the Strategic Water Quality Initiatives Fund.

Fiscal Analyst: Pam Graham

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.