State Notes
TOPICS OF LEGISLATIVE INTEREST
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Great Lakes Water Quality Bond
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In November 2002, the voters approved a $1.0 billion general obligation bond called the Great Lakes Water Quality Bond (GLWQ) to support the existing State Revolving Fund and to create a new Strategic Water Quality Initiatives Fund. Two and half years later, little of this approved funding has been awarded for loans. This article is a look at the circumstances that have delayed full implementation of the bond.

The ballot proposal specified that $100.0 million of the bond revenue would be directed to the Strategic Water Quality Initiatives Fund (SWQIF) and $900.0 million of the bond revenue would be for the State Revolving Fund (SRF). Both programs offer loans to local units of government with an interest rate of 1.625% for approved projects. The local governments have 20 years to repay the loans and must demonstrate the financial means to pay the loans in order to qualify. For most local governments, financial means come in the form of a millage levy or increased user fees. Administration of the programs is a joint effort of the Department of Environmental Quality (DEQ) and the Michigan Municipal Bond Authority. The DEQ reviews the project plans and applications for approval and the Bond Authority addresses the financing obligations.

State Revolving Fund

The State Revolving Fund, formally known as the Water Pollution Control Revolving Fund, provides loans to local units of government for construction of sewage treatment works projects, stormwater treatment projects, nonpoint source projects, and refinancing assistance. The program was established in 1989 and demand for the loan funds traditionally has been high. Federal funds, State matching funds, and loan payments are leveraged through revenue bonds to maximize money available for loans. By leveraging the funds with revenue bonds, which the program has been doing since 1992, the State was able to make $2.1 billion available in SRF loans to local units of government through fiscal year (FY) 2003-04.

When the GLWQ proposal was adopted in 2002, the State had been unable to meet fully the demand for financing from the State Revolving Fund for the previous four years. However, at about the same time the proposal was adopted, the economy began to decline and demand for SRF loans decreased. According to the DEQ, in FY 2000-01, over $300.0 million in SRF loans was requested and $210.0 million was awarded. Loan requests dropped to $175.0 million in FY 2004-05 and all projects received financial support. With the economy in recession, local units of government are experiencing the same budget troubles as the State is facing. They simply do not have the revenue to qualify for bonds or make loan payments. It is easier and less expensive to pay for interim repairs for an ailing wastewater treatment plant and postpone major expansion or construction, than to ask citizens for a fee increase during a difficult economic period with high unemployment.

From the State's perspective, it is fortunate that sufficient funds for State Revolving Fund loans have been available without using the GLWQ bonds because it cannot afford the debt service on additional general obligation bonds, which is paid from the General Fund. If full debt service payments were due in the current fiscal year on the $100.0 million in bonds issued, the State would have additional General Fund expenses of $6.0 million to $8.0 million. The bond financing has been structured to require only interest payments beginning in FY 2007-08 on the portion of the bonds used. Since the slowing economy has reduced the annual revenue to the General Fund, additional demands on the Fund would be difficult to fulfill. For the past three fiscal years, the State has used non-General Fund sources to pay a portion of the debt service costs on other general obligation bonds, but this means that those funds are not available for programmatic purposes. The availability of other State funds is shrinking as they are used in many other areas of the budget to replace declining General Fund dollars. Statute provides that debt service on GLWQ bonds will be paid with the General Fund. It is unknown if the Legislature would use non-General Fund dollars to pay the debt service on GLWQ bonds, as has occurred recently for other general obligation bonds. That question may be postponed until 2008, which is when the DEQ estimates that the SRF program will need to supplement the existing resources with GLWQ bond revenue in order to meet loan demand.

Strategic Water Quality Initiatives Fund

The Federal law governing the use of Federal and State matching dollars in the State Revolving Fund program limits SRF projects to public facilities and public property. The SWQIF was designed to fill a gap between public and private residential sewer use. Using only State-provided revenue, the SWQIF program awards loans for two types of projects that are not eligible for support from the State Revolving Fund: 1) the construction of on-site upgrade or replacement of septic systems, and 2) the removal of clear groundwater or stormwater from household sewer leads. Many of the SWQIF projects may supplement SRF projects. For example, a project may involve work on both public and private property. The work on public facilities would be covered by the SRF and the work on private property would be covered by the SWQIF. All of the current loans are for footing drain disconnections, which will redirect clear groundwater or stormwater away from a sanitary sewer system and into a storm sewer system or other area where it will not receive unnecessary treatment.

Two and half years after voters approved $100.0 million in funding for this new program, only $2.0 million has been awarded in loans. There are two reasons this revolving fund has had a slow start. Since the SWQIF is new funding for a new program, local units of government did not have project planning completed at the time the bond was authorized. The planning process can take from six to 18 months depending on weather conditions. The first two applications for loans were approved in 2004 for communities that had already been in the planning process with the intent to pursue other funding when the SWQIF program was enacted. There are two more SWQIF loans anticipated for 2005 and one future listing of additional segments for a current project. This is a short list of future projects compared with the State Revolving Fund list of 17 future projects, many of which are the continuation of existing multi-year projects. The DEQ is generally aware of upcoming SWQIF projects since applicants are required to work with either the Department's stormwater contact or the local health department during the project planning stage.

Another reason the SWQIF program is just getting rolling is that, similar to the SRF situation, municipalities do not have the money to qualify for and pay the loan obligations due to current economic conditions. A new public works project falls lower on the priority list than many other municipal responsibilities. As local governmental units stabilize their budgets, applications for this program should increase.

The first appropriation of SWQIF loan funds was enacted in FY 2003-04. Approximately $10.0 million has been appropriated each year, following the original bond issuance schedule recommended in the implementing statute. Appropriations totaling $20,007,600 have been enacted to provide loans in the two fiscal years since the program was created. The Governor has recommended an appropriation of $10,010,700 for FY 2005-06, which would bring the total appropriations for SWQIF to $30,018,300. The appropriations include economic adjustments for the administrative functions to run the program. The statute has been amended to allow up to $20.0 million in bonds annually for the SWQIF, but annual appropriations have remained near $10.0 million and loan demand is much lower.

The current SWQIF projects are supported with borrowed funds, and revenue from issued bonds is pledged as security for the loan. The balance of the appropriation was placed in a work project account, which holds the funding for four more years and allows additional expenditures over that period. If the work project funds are not spent after four years, then the money will lapse to the SWQIF and be available again for future loan applicants, subject to appropriation.

Conclusion

The economy and local units of government were not prepared for the Great Lakes Water Quality bond when it was adopted in November 2002. Demand for the loans and projects existed, but economic pressures forced municipalities to delay proposals. In addition, the SWQIF was a new program and municipalities need project planning time. As the economy recovers and the State and local government budgets are stabilized, the full implementation of the bond should be realized.