



American Recovery and Reinvestment Act: Opening the door to new subsidization policies

By Jeff Hughes



For years to come, communities across the country will remember the American Recovery and Reinvestment Act (ARRA) of 2009 as the source of funds that enabled them to carry out a much-needed water tower, treatment plant, or sewer line replacement project.

However, the impacts of ARRA on water and wastewater funding go beyond the additional dollars the act provides. ARRA is also fundamentally changing the way funding organizations provide water and wastewater assistance. In particular, the act introduced new features and requirements to the Environmental Protection Agency's State Revolving Fund programs that have been continued in subsequent funding appropriations and that are likely to remain a part of these programs for at least the near future and possibly longer.

Prior to ARRA, the State Revolving Fund (SRF) program was primarily a water and wastewater loan program consisting of state-run community water and wastewater infrastructure banks. Under the requirements of ARRA, these water and wastewater bankers are suddenly transformed into water and wastewater grant-funding agencies and are given new and additional requirements for the types of projects they can and should fund.

ARRA includes provisions that require SRF programs to implement a range of new procedures from requiring materials to be built in America to assuring that a minimum amount of their funds go toward qualified green infrastructure projects. Many of the features of ARRA have been incorporated into the 2010 EPA appropriations bill and the SRF reauthorization bills currently being considered in Congress.

continued on page 11

RCAP plays a role in project rescued by stimulus funds

By Jean Thompson-Ibbeson, RCAC



Davenport is an unincorporated coastal community of 250 residents located 12 miles north of Santa Cruz in Santa Cruz County, Calif. The town's water source is the San Vicente Creek. During winter storms, due to excessive turbidity, the treatment plant is often unable to produce an adequate amount of potable water and is out of compliance with state and federal standards.

In 2001, the county's sanitation district, which services Davenport, applied for \$1.2 million in grants and loans from the Safe Drinking Water State Revolving Fund (SRF) for upgrades to the water treatment plant. However, the California Department of Public Health informed the community that, according to the 2000 census, it did not fit the requirement of being a disadvantaged community to get the loan it had applied for and would not have adequate revenue to repay it. Over the following year, Davenport educated its residents, preparing them for a large rate increase to enable the community to qualify for a SRF loan while researching additional grant funding.

The sanitation district completed SRF loan applications in 2004 and 2007 in order to

satisfy the updated requirements. In the meantime, it started issuing notices to Davenport residents to boil their water because newly mandated filtration requirements had taken effect that resulted in treatment technology violations. The district also included the project to upgrade Davenport's water system in the Proposition

50 Integrated Water Resource Management grant application for Santa Cruz County. Under the proposition, Davenport received a \$600,000 grant for its project.

In 2007, the California Department of Public Health asked Rural Community Assistance Corporation (RCAC), the Western RCAP, to perform a median household income (MHI) survey of the service area. RCAC's survey determined that Davenport was, in fact, a disadvan-

tagged community, making it eligible for the terms of the original loan it had applied for.

In 2008, it seemed that everything was coming together for the community to get the project underway. Nearly all of its plans were completed, and it was awaiting approval for the remaining funds it needed – \$204,000 in low-interest loans and \$816,000 in grants. The total cost of the project was estimated at \$1.62 million, and construction was expected to begin in 2009.

However, in June 2009, after eight years of trying to get enough funding together, the community's officials received a phone call from the state Department of Public Health informing them that their SRF loan/grant agreement was not completed in time. But, they were told, if they could get their paperwork completed within two weeks, they could be one of the first to receive American and Recovery and Rein-





continued from page 9

Direct subsidization

During the last year, the rate for a 25-year term revenue bond fluctuated between 5 and 6 percent. Compare this with interest rates of 0 to 3 percent charged by most state SRF programs during the same period, and it is clear that communities borrowing money from the SRF enjoy subsidization.

From the programs' inception, subsidization has been a core feature of the Drinking Water SRF (DWSRF) and Clean Water SRF (CWSRF). Prior to ARRA, the subsidization was distributed primarily through below-market interest rates. Communities signing loan agreements often forget about this "hidden subsidization," even though it often saves them hundreds of thousands of dollars.

The Safe Drinking Water Act, the legislation guiding subsidization in the DWSRF prior to ARRA, gave states the option of offering disadvantaged communities an even higher level of subsidization through principle forgiveness. According to the 2007 DWSRF annual report, \$300 million in principle forgiveness had been provided to communities through 2007.

ARRA requires that states provide greater subsidies to communities and that they do it in a more direct form than subsidized interest rates. States are required to provide at least 50 percent of the ARRA funds to communities in the form of grants, principle forgiveness or negative interest rates.

The 2010 EPA appropriation bills included direct subsidy provisions similar to the ARRA. Under the appropriations bill, both state Drinking Water and Clean Water SRF programs have to provide communities with direct subsidies of at least 30 percent of the capitalization funds the state receives from EPA. (SRFs are funded by a combination of annual capitalization grants from EPA, mandatory state match-

ing funds, and revolving debt-service payments from past loans.)

While a minimum of direct-subsidy funds is set, states still retain a wide degree of flexibility in how they determine who receives these subsidies. One of the defining characteristics of the SRF program compared to other federally funded water and wastewater programs is the design flexibility afforded to states to customize their programs to meet their state policy goals.

States responded to ARRA subsidy requirements in a variety of ways and are likely to continue to have very different approaches in delivering subsidies. Preliminary analysis of the subsidization approaches used under ARRA provides some basic insight into the subsidization programs communities may see in the future. States are currently evaluating their subsidization approaches under ARRA, and while some states may continue the subsidy approaches under ARRA, many are likely to modify their approaches to reflect lessons learned. At a minimum, analyzing ARRA subsidy programs shows the range of potential subsidy schemes that are possible.

ARRA subsidy approaches fall into a variety of general categories. Some states chose to subsidize all projects equally, either at 50 percent or, in at least a few cases, at even higher rates.

States that varied the amount of subsidies used a range of criteria to determine subsidy rates. Some states, such as Washington, relied on income criteria to determine how much to subsidize a particular project.

Some states used a mixture of criteria in order to integrate specific policy goals into their subsidization scheme. For example, South Carolina used formulas that took into consideration the size of the applicant and a "level of effort" statistic that factored

vestment Act funds in the form of a grant to cover the entire cost of the "shovel-ready" project.

There was pressure to take advantage of this rare and big opportunity, but RCAC was able to assist the community again. It updated the community's reports from its earlier income survey in order to complete its application for the stimulus funds.

The project's engineer and county staff also scrambled and were able to get a funding commitment in early July from the Department of Public Health and awarded the construction contract the next month.

Construction is underway. The project includes an expansion of the water treatment plant with a new membrane filtration system and new storage facility. It is expected to be completed by June 2010.

Those involved are excited.

"I am thrilled that we are on the way to high-quality water for the community of Davenport," said Neal Coonerty, supervisor of the county's district where Davenport is located.

A sixth-grade student at Pacific Elementary School in Davenport said he "was looking forward to drinking out of the water faucet again when playing outside."

Photos courtesy of Ron Perkins, HDR

continued on next page

Different approaches to subsidization

According to Income - Washington State

| Income Level of Households | Interest Rate | Loan Fee | Loan & Fee Repayment Period |
|---|--|----------|------------------------------------|
| Water system not located in economically distressed county | 1% | 1% | 20 years |
| Water system located in economically distressed county | At least 50% Principal Forgiveness & 1% interest on loan | 1% | 20 years |
| 51% of the water system households in the community served by the project are at or below 80% of the county's median income | 100% Principal Forgiveness | 1% | Loan fee is paid back over 5 years |

Source: Washington State DWSRF IUP, www.doh.wa.gov/ehp/dw/final-iup.pdf

According to Community Size - South Carolina

| Service Area Population | Principal Forgiveness | Level of Effort |
|-------------------------|-----------------------|-----------------|
| > 100,000 | 0% | < .90 |
| 75,000 - 99,999 | 5% | .90 - 1.04 |
| 50,000 - 74,999 | 10% | 1.05 - 1.14 |
| 25,000 - 49,999 | 15% | 1.15 - 1.24 |
| 10,000 - 24,999 | 20% | 1.25 - 1.34 |
| < 10,000 | 25% | > 1.35 |

Source: South Carolina DWSRF Intended Use Plan, Fiscal Year 2009

According to Category - Georgia

| Fund Type | Fund Share of Total | Available Clean Water Funding | Available Drinking Water Funding |
|---|---------------------|-------------------------------|----------------------------------|
| Rural Fund (with 70% principal forgiveness) | 30% | \$32,143,600 | \$12,939,308 |
| Non-Rural Fund (with 40% principal forgiveness) | 50% | \$53,572,666 | \$21,565,513 |
| Green Project Fund (with 60% principal forgiveness) | 20% | \$16,867,350 | \$7,339,850 |

Source: Georgia DWSRF IUP, www.gefa.org

in the percentage of median household income spent on water. Small communities with higher rates and lower median household incomes were offered much higher rates of subsidization than larger communities with lower existing rates.

Georgia developed a comprehensive program that carefully allocated its subsidies between different categories, providing higher levels of subsidies to support projects in rural areas and to support green projects.

In deciding how to allocate subsidies, states had to make trade-offs. More sophisticated subsidy approaches linked to policy goals typically are harder to administer and require a more detailed vetting and application process. States that took a "shotgun" approach to subsidization may have been able to spend money faster; one of the stated goals of ARRA.

There are many arguments for and against subsidization. Rural communities with high unemployment and increasing infrastructure needs may view these subsidies as the only way they can stay in the water and sewer business. On the other hand, providing subsidies to many communities allows them to avoid charging their customers rates that reflect the true costs of water and wastewater service and ultimately may make the utilities less sustainable.

Given the debate about subsidies, how they are delivered is incredibly important. The key decision now for states will be how they will use this new tool. ■

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