House
Legislative
Analysis
Section

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WATER QUALITY BONDS

House Bill 5316 (Substitute H-1)
First Analysis (3-21-00)

Sponsor: Rep. Jon Jellema
Committee: Local Government and Urban Policy

THE APPARENT PROBLEM:

Beginning in 1997, the Department of Environmental Quality sought changes to modify provisions of the state Safe Drinking Water Act and related programs, in order to comply with new provisions of the federal Safe Drinking Water Act. (See *BACKGROUND INFORMATION* below.) Generally, the new legislation replaced the state's after-the-fact regulatory program with one that placed strong emphasis on preventing contamination and enhancing water systems management. Central to this emphasis was the development of state prevention programs, including source water protection, capacity development and assessment, and operator certification. The new laws also substantially increased penalties when water suppliers failed to eliminate contaminants.

State officials acted because they wished to continue administering the safe drinking water program at the state level, and without the changes the state would have had to defer that responsibility to the U. S. Environmental Protection Agency. When a state maintains primary enforcement responsibility it is referred to as "primacy", and Michigan had assumed primacy since 1976.

In order to ensure continued regulatory primacy at the state level, the Michigan legislature enacted Public Acts 26 and 27 of 1997, which established the Safe Drinking Water Assistance Program and the Drinking Water Revolving Fund. One year later the legislature also enacted Public Act 56 of 1998 to update the state Safe Drinking Water Act, in order to meet the EPA requirements that a state have the authority to assess higher civil penalties for public water systems serving populations of more than 10,000; and to assess penalties on a "per day, per violation" basis. If states failed to act to enhance their authority, they risked a penalty that would have reduced by 40 percent the state capitalization grant from the EPA that was to be used to start up the Drinking Water Revolving Fund.

The Drinking Water Revolving Fund was a key component of the federal-state drinking water clean-up program. In order to start up the fund, the legislature enacted Public Act 27 of 1997 to amend the Shared Credit Rating Act, which is administered by the Michigan Municipal Bond Authority. The $12.2 million revolving fund (put in place with a $4.7 million EPA grant as provided under the Federal Safe Drinking Water Act, and a $7.5 million appropriation from the state's general fund) allowed the bond authority to provide assistance to a governmental unit for a community or noncommunity water supply. The new act specified that if the assistance was to be in the form of a loan, it had to be made through an explicit loan agreement. Or, a community could use a "fully marketable form", or municipal obligation for purposes of a community or noncommunity water supply, but if it did so, an order of approval issued by the DEQ was necessary. (The order of approval notified lenders that the proposed water supply had been approved for assistance by the DEQ.) Although the act further specified that a municipal obligation did not include "qualified bonds", as defined in the state constitution, it did specify that bonds issued by a governmental unit for a water supply financed through the revolving fund would be considered to be "qualified bonds". (Finally, the act exempted bonds or notes issued pursuant to the revolving fund from the then-current prohibition against authorizing new bonds or notes after December 31, 2000.)

When these programs were put in place, small municipalities wondered how they might afford to borrow, and the state was concerned about the adequacy of the fund they were about to create. During the past three years the adequacy of the fund has been established, and now legislation has been introduced to allow smaller community water suppliers to issue up to a $100,000 bond that would be reimbursable.

THE CONTENT OF THE BILL:

House Bill 5316 would create a new act to be known as the Safe Drinking Water Financial Assistance Act. It would take effect October 1, 2000.

Under the new act, a governmental unit could issue notes or bonds and use the proceeds to plan for a) the acquisition, construction, improvement, or installation of property comprising all or a portion of a community water supply or a noncommunity water supply, or b) the refunding or advance refunding of notes or bonds previously issued under the act, and c) the payment of the costs of issuing the notes or bonds. For any governmental unit, the aggregate principal amount issued less the principal amount used to purchase the notes or bonds could not exceed $100,000. The issuance of notes or bonds would not be subject to any right of referendum, notwithstanding any other statutory or charter provision to the contrary. The notes and bonds would be sold to the Michigan Municipal Bond Authority and would not be subject to the Municipal Finance Act. Further, each governmental unit could use note or bond proceeds to purchase notes or bonds issued under the act by another governmental unit.

Under the bill, the governing body of the governmental unit would be required to authorize by resolution the notes or bonds that are issued, and could pledge the full faith and credit of the unit to the payment of the principal and interest on the notes or bonds. The unit could establish a) interest rates, b) prices, c) discounts, d) maturities, e) principal amounts, f) denominations, g) dates of issuance, h) interest payment dates, i) optional or mandatory redemption or tender rights, j) obligations to be exercised by the unit or the bond- or note-holders, k) the place of delivery and payment, and l) other matters and procedures necessary or desirable in connection with the issuance of the notes or bonds.

The bill would allow the government unit to secure the notes or bonds with additional security, including but not limited to a) a pledge or assignment of any school aid payments, revenue sharing payments, or similar payments to be received from the state, b) a letter of credit, c) a line of credit, or, d) an insurance contract.

In its authorizing resolution, the government unit could specify that it was the duty of each officer and official of the governmental unit that issues notes or bonds to include in the annual taxes levied an amount such that the estimated collections would be sufficient to pay, when they are due, all payments of the principal and interest on the notes or bonds, before the collection of the following year's taxes, and after taking into account the money on hand (or expected to be on hand) for such payments. However, under the bill the governing body of the unit would be required to budget and to pay the necessary principal and interest on the notes or bonds, including overdue installments or maturities, when they became due. In addition, the authorizing resolution of the governmental unit could authorize the unit to enter into a) loan agreements, b) security agreements, c) pledge agreements, including but not limited to the pledge of water supply revenues, d) mortgages, e) assignments, or f) other agreements that were determined to be necessary.

The bill specifies that the new act would be construed as cumulative authority for the exercise of the powers granted under it. Further, it specifies that the purpose of the act would be to create full and complete additional and alternate methods for the exercise of the powers described, and that the powers conferred by the act would not be affected or limited by any other statute or by any charter or incorporating document, except as otherwise provided. However, the act would not authorize the governing body of a unit to levy taxes in excess of constitutional, statutory, or charter limits without the approval of electors.

Under the bill, "assistance," "community water supply," "noncommunity water supply," and "water supplier" are defined to mean those terms as they are defined in part 54 of the Natural Resources and Environmental Protection Act, the Safe Drinking Water Assistance Act (Public Act 26 of 1997, which went into effect on June 17, 1997). [In that act, "assistance" means one or more of the nine activities listed, including loans, authorized by the Federal Safe Water Drinking Act. "Community water supply" means a public water supply that provides year-round service to not less than 15 living units or which regularly provides year-round service to not less than 25 residents. "Noncommunity water supply" means a public water supply that is not a community water supply, but that has not less than 15 service connections or that serves not less than 25 individuals on an average daily basis for not less than 60 days per year. "Water supplier" means a municipality or its designated representative accepted by the director, a legal business entity, or any other person who owns a public water supply. However, water supplier does not include a water hauler.]

Further, under the bill, "department" means the Department of Environmental Quality, and "governmental unit" means a governmental unit as defined in section 3 of the Shared Credit Rating Act,

that is eligible for reimbursement of project planning costs under the Natural Resources and Environmental Protection Act. [The Shared Credit Rating Act, Public Act 227 of 1985, defines "governmental unit" in a lengthy manner, but generally the term means a county, city, township, village, school district, public school academy, intermediate school district, community college, public university, authority, district, any other body corporate and politic or other political subdivision, any agency or instrumentality of the forgoing, or any group self-insurance pool, and in some instances, an Indian tribe. For the purposes of a community water supply or a noncommunity water supply, governmental unit includes a community water supplier.]

BACKGROUND INFORMATION:

Federal Safe Water Drinking Act and State Revolving Fund. The 1996 amendments to the federal Safe Drinking Water Act (SDWA) placed a strong emphasis on preventing contamination, rather than regulating water problems after-the-fact, by establishing a Drinking Water State Revolving Fund (DWSRF) program. The federal program is similar to the state water pollution control revolving fund (SRF) established under Title VI of the federal Clean Water Act. The amendments to the federal act provide that the Environmental Protection Agency (EPA) may now award a capitalization grant to a state, which, in turn, may provide low cost loans and other assistance to eligible public water suppliers. The state must agree to provide an amount in state matching funds equal to at least 20 percent of the amount of each grant into an SRF, and must deposit the grant and the state matching funds into the SRF.

Under the DWSRF program, each state has considerable flexibility in determining the design of its program and in directing funds toward its most pressing needs in the areas of public health protection and compliance with SDWA. For example, the federal act allows a state to reserve, or "set aside", a certain percentage of its capitalization grant for purposes that are outside the scope of the loan program. It may use this money to provide technical assistance to public water systems serving 10,000 persons or less. A state may also administer its revolving fund program in combination with other state loan funds, including a state water pollution control revolving fund program such as the one Michigan operates under the provisions of the Clean Water Assistance Act (MCL 324.5301 et al.) to finance municipal water pollution control projects.

A state must formally apply to the EPA for an annual capitalization grant. A central component of the application is an Intended Use Plan (IUP), which describes how the state intends to use available DWSRF program funds for the year to meet the objectives of the SDWA. Specifically, an IUP must describe how all available funds, including capitalization grants, state matching funds, and other proceeds, will be spent. The IUP must also include a prioritized list of projects eligible for funding. The state must prepare an IUP and provide it to the public for review and comment prior to submitting it to the EPA.

FISCAL IMPLICATIONS:

The Department of Environmental Quality notes that the fiscal implications of the bill are minimal. The department also notes that the Drinking Water Revolving Fund receives 80 percent of its revenue from the federal government through the federal capitalization grant, and 20 percent from the state's general fund/general purpose budget. The total revenue in the fund for fiscal year 1999-2000 is $22,821,900, of which $4,564,380 is from the general fund. (3-20-00)

ARGUMENTS:

For:

When the Drinking Water State Revolving Fund program was created three years ago, small municipalities wondered how they might borrow, and the state was uncertain about the financial adequacy of the fund. Now the fund's adequacy has been established, and the program can safely be extended to smaller governmental units, allowing them to issue up to $100,000 in reimbursable bonds or notes in order to clean up their drinking water supplies.

For:

The 1996 amendments to the federal Safe Drinking Water Act (SDWA) established a Drinking Water State Revolving Fund (DWSRF) program, and replaced the previous, after-the-fact, regulatory program with one that places a strong emphasis on preventing contamination and enhancing water systems management. Central to this emphasis is the development of state prevention programs, including source water protection, capacity development, and operator certification. According to the EPA's *Drinking Water State Revolving Fund Program Guidelines*, EPA 816-R-97-005, issued February, 1997,

the main goal of the fund is to finance aging drinking water infrastructure improvements. Each state may use

a portion of federal capitalization grants to fund eligible activities under a drinking water state revolving fund (SRF) program.

The program that would be established under the provisions of the bills would enable cities and villages that own and operate drinking water delivery systems to compete for low interest loans to finance improvements to comply with SDWA requirements. Projects that would qualify as improving such infrastructure would include the rehabilitation or development of water sources to replace contaminated sources; the installation or upgrading of treatment facilities if the project would improve the quality of tap water; the installation or upgrading of storage facilities, including finished water reservoirs, to prevent microbiological contaminants from entering the water system; and the installation or replacement of transmission and distribution pipes to prevent contamination caused by leaks or breaks in the pipe. In addition, land acquisition would be eligible only if it was integral to a project that was needed to meet or maintain compliance and further public health protection. Projects involving dams or reservoirs, except for finished water reservoirs and those that are part of the treatment process, would not be eligible for funding.

POSITIONS:

The Department of Environmental Quality supports the bill. (3-20-00)

The Michigan Townships Association supports the bill. (3-17-00)

The Michigan Municipal League supports the bill. (3-9-00)

Analyst: J. Hunault

■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.