

Executive Summary

Effectively Using the Clean Water State Revolving Fund to Improve Iowa Water Quality

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The Governor's 2003 Iowa Water Summit generated several proposals for solving Iowa's most significant water quality problems. The Clean Water State Revolving Fund (SRF) program has the flexibility and financial resources to fund many of those proposals.

The Clean Water SRF program is the primary source of federal assistance for implementing Clean Water Act goals. Through this program, the federal government provides annual grants for capitalizing state revolving loan funds. States are required to provide a 20 percent fund match, which is generated primarily by bonding. States have the flexibility to set loan interest rates between 0 percent and market rate and to offer loan terms of up to 20 years. Although states are encouraged to fund a wide range of projects, Iowa's SRF program has almost exclusively funded traditional point source (PS)¹ projects in the form of municipal wastewater treatment plants. This is despite the fact that non-point source (NPS)² contamination is the primary cause of Iowa's failure to meet water quality standards. In 2002, changes to Iowa's SRF program were implemented to make NPS projects eligible for funding.

The U.S. Environmental Protection Agency (EPA) has officially recognized that the Iowa Department of Natural Resources (DNR) has managed the SRF program adequately and that it is in compliance with program rules, regulations and agreements. At the same time, the EPA reports that Iowa has historically underutilized its assets. Considerable funds are currently available to undertake additional water quality projects in Iowa.

Wastewater infrastructure (Section 212) uses only a portion of the available SRF funds

Local governments often bypass the Clean Water SRF to fund new wastewater treatment infrastructure. The loan approval process can be too burdensome or too lengthy for some cities. In other cases, CWSRF funds are simply not the cheapest or most preferred source of funding when compared with grants, municipal bonding, or loans from other sources.

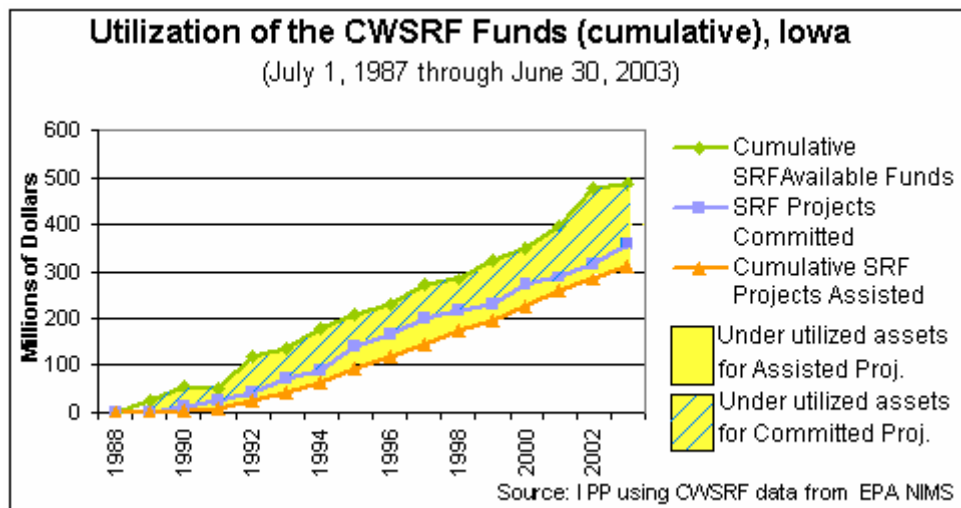
The graph below provides a visual display of the underutilization of the SRF since the program's inception in 1988. The orange line represents money disbursed, or loaned to projects ("projects assisted"); the blue line represents the amount of money "committed" to projects (loan agreements signed); and the green line represents available funds. The distance between the orange line and green line shows that *\$170 million in available funds has not been loaned to water quality projects* (although a portion of this amount, or \$46 million, has been "committed").

¹ Point source pollution happens when a pollutant comes from an identified source, generally from the pipes of industrial facilities and municipal sewage treatment plants.

² Non-point source pollution results from many diffuse sources of human and animal pollution that are carried into surface water, and even underground sources of drinking water, by rainfall and snowmelt.

The distance between the blue line and green line shows that \$124 million in available funds has not even been committed to water quality projects.

Some of the difference between the amount of money disbursed and the amount committed (the distance between the blue and orange lines) is due to the natural time lag between when a loan agreement is signed and when costs are incurred (loans are not disbursed until costs are incurred). However, some “committed” projects are never undertaken, are delayed for many years, or are switched to another financing source. On average, about 13 percent of “committed” funds are never actually disbursed. The distance between the green line, which represents total available funds, and the other two lines has increased since 2000—indicating greater difficulty in utilizing SRF money in recent years. In the last five years, only 62 percent of available funds have actually been disbursed and only 72 percent of available funds have been “committed.”



The loan and permit process has been streamlined by the DNR. However, this does not ensure an increase in funding for traditional PS projects. There are plenty of opportunities within the SRF program to finance additional NPS pollution control projects. If the entire \$170 million had been loaned out, Iowa could have increased its project funding to date by about 57 percent.

It is beneficial for Iowa to accelerate the use of the Clean Water SRF

Since 1988, Iowa has committed \$360.2 million in loans to wastewater treatment plants, while committing only \$449,027 for NPS projects (or 0.12 percent of the total). All of the NPS money has funded individual septic tanks rather than watershed-based projects. As mentioned previously, this total amount of \$360.6 million in loans is equal to only 72 percent of available funds, which leaves \$124 million uncommitted at this point in time.

Iowa has enough available funds (\$124 million) to assist current projects without even accessing FY 2003 and 2004 EPA grants. Although the 2004 Intended Use Plan (IUP) lists \$134 million in eligible projects, less than half of those projects have actually signed a loan agreement. A comparison between the 2004 IUP and the draft 2005 IUP shows that of the \$134 million in

projects on the 2004 IUP fundable list, over \$75 million has been carried over to the 2005 IUP. Thus, only \$59 million will be needed for loans to projects listed on the FY2004 IUP.

Since states must request SRF funds from the EPA each year, a weak demand for loans from private and public entities may reduce the amount of future grants allocated to Iowa. Furthermore, there is little justification for leaders to seek greater state or national investment in water protection when existing funds are not fully utilized.

In each of the last two years (FY2002 and FY2003), SRF fund balances (money not yet loaned) have earned less interest than the Iowa Finance Authority pays on the state bonds that were used to match and leverage the EPA grants. This further justifies putting all funds to use for program loans as soon as possible.

Higher than average interest rates have contributed to an underutilized fund

The EPA allows states to set interest rates on program loans anywhere between 0 percent and market rate. Currently, the rate is fixed at 3 percent for wastewater infrastructure, which is comparable to the average rate of inflation for the last 20 years. While this may seem reasonable, Iowa actually charges a higher interest rate than the national average, which has contributed to the build-up in the fund balance. Iowa's clean water loans are now earning 1.9 percentage points above the national SRF average interest rate. The incremental interest earned during the eight years of the Vilsack Administration will equal \$64 million.

Policy Recommendations

The Clean Water State Revolving Fund provides a unique opportunity to promote both environmental stewardship and economic progress in the state of Iowa. The federal SRF program provides Iowa with sufficient financial resources for treating water pollution (PS projects) as well as preventing water pollution (NPS projects). In the draft 2005 Intended Use Plan, the DNR has reserved \$31 million for supplemental NPS projects. This is a five-fold increase compared to the amount proposed in FY2004 and we believe DNR is headed in the right direction by increasing NPS funding. We recommend three specific policies for generating demand for these funds.

■ Develop a Sponsor Program to address both pollution prevention and treatment

Ohio has developed the Water Resource Restoration Sponsor Program, an innovative program that links wastewater treatment and water resource restoration. Between October 2000 (when the program was implemented) and June 2004, approximately \$52.1 million in WRRSP funds were spent on 20 projects that protected and restored more than 40 miles of stream corridor and more than 4,000 acres of wetlands. In 2004, the program is expected to spend \$15 million on additional sponsored projects.

Ohio's program works by lowering the interest rate on infrastructure loans to as low as 0.2 percent for those communities that are applying for wastewater treatment loans *and* that also agree to sponsor NPS projects. The community actually saves money by completing the desired sewage treatment plant and a restoration project that otherwise might have not been done. The

participant community usually enters into a sponsorship agreement with another entity such as a land trust or park district that takes responsibility to implement the restoration plan, but does not participate in repaying the loan.

Ohio's "sponsored program" serves as an example for how Iowa can use the Clean Water SRF program for more water quality improvement projects. By implementing a similar program in Iowa, the DNR could increase demand for SRF loans, encourage collaboration between cities and environmental organizations, and accelerate the clean up of Iowa's waterways. Additional priority projects common to the Iowa Non-Point Source Pollution Control Plan and the Iowa Water Summit recommendations could be more easily achieved through a sponsored program. Such a program would help Iowa to combat NPS pollution and ameliorate current levels of effluent discharge that are quite unsatisfactory.

■ Offer alternative financing structures

The DNR should consider alternative financing structures to meet the individual needs of borrowers, such as implementing the use of a balloon repayment structure or lowering the interest rate if the borrower agrees to a shorter repayment period. For disadvantaged communities with priority state needs it may be possible to offer more generous incentives. By offering flexible financing, Iowa would stimulate greater demand for loans.

■ Develop an Integrated Planning and Priority Setting List

An integrated priority list equally weights the application of funding for wastewater treatment plants and for non-point source projects. The adoption of a more integrated approach, as encouraged by EPA, allows states to be more proactive in allocating SRF resources to the various types of pollution control projects with the greatest public benefits.

Conclusion

The Clean Water SRF program is the primary source of federal assistance for implementing Clean Water Act goals. The flexibility that characterizes this program allows targeting a wide variety of projects and loan recipients to achieve the greatest public benefit. The use of more tools, such as sponsored programs and alternative financing, will help Iowa to utilize the full capacity of the SRF. Money from the SRF administrative account could be used to pay for major outreach and marketing efforts to help move the SRF to 100% utilization as soon as possible. These efforts will enable Iowa to achieve many significant recommendations of the 2003 Iowa Water Summit and to accelerate Governor Vilsack's goal of eliminating impaired waterways by 2010.