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CLEAN WATER ACT

Nine States' Experience With the Clean Water State Revolving Fund

Statement for the Record by
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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to present this statement for the record, which discusses selected states' experience with the Environmental Protection Agency's (EPA) Clean Water State Revolving Fund (SRF) Program. In 1987, the Congress authorized the creation of state revolving funds to help local governments and others construct projects to improve water quality and thereby help safeguard public health and the environment.¹ All 50 states and Puerto Rico have established such revolving funds, and through fiscal year 1996, the Congress provided more than \$11 billion to them.

Through this program, the federal government provides annual grants to the states as "seed money" to help capitalize their revolving loan funds. The states use their revolving funds to make loans to local governments and others; as the loans are repaid, the funds are replenished, and additional loans can be made. In December 1996, we issued a report on nine states' use of their revolving funds, including (1) the amount of funds lent and the percentage of available funds lent, as of the end of each state's fiscal year 1996 and (2) information on factors at the federal and state levels that constrained the amount and percentage of funds lent.² This statement is based on that report.

In summary, we found:

- The nine states increased the total amount of funds they lent from \$3.3 billion in 1995 to \$4.0 billion in 1996. All nine states increased the amount they lent by 15 percent or more, and three states achieved increases of 30 percent or more. In addition, seven of the nine states increased the percentage of available funds they lent. Of these seven, three states increased this proportion by 17 percentage points or more. Nevertheless, the percentage of funds lent as of the end of 1996 varied substantially among the nine states. Specifically, five states had lent 80 percent or more of their available funds, three states had lent between 70 and 79 percent, and one state had lent 60 percent.
- In eight of the nine states, officials identified the expiration of the authorizing legislation, as well as federal requirements, as affecting the

¹The program was established in the 1987 amendments to the Federal Water Pollution Control Act, also known as the Clean Water Act. It was authorized through 1994. Since then, the Congress has continued to fund the program with annual appropriations.

²Clean Water Act: State Revolving Fund Loans to Improve Water Quality (GAO/RCED-97-19, Dec. 31, 1996).

amount and percentage of funds lent. For example, officials in seven states said the legislation's expiration created uncertainty about the loan conditions that might apply in the future and caused some communities to postpone seeking or accepting loans. Also, officials in seven states said that other federal requirements—such as a prevailing-wage provision—discouraged some communities from seeking loans. Finally, in two states, officials said that state program decisions constrained lending.

Background

In 1972, the Congress established the Construction Grants Program to provide grants to help local governments construct wastewater treatment facilities. These federal grants provided most of the funding for these projects, with the remainder provided by the local government constructing the project. In 1987, the Congress began to phase out that program and authorized the creation of SRFs, which provide loans to local governments and others.

The states are required to match SRF capitalization grants at a rate of at least one state dollar for every five federal dollars. The states have the option of increasing the amount of SRF funds available to lend by issuing bonds guaranteed by the money in the SRFs. According to a national survey, as of June 30, 1995 (the latest data available), the states collectively had \$18.9 billion in their SRF accounts; over one-half of this amount (approximately \$11 billion) was provided by federal capitalization grants.³ (The appendix provides additional information on the nine states' sources and uses of funds.)

For the most part, the Congress gave the states flexibility to develop SRF loan assistance programs that meet their particular needs. However, the states must ensure that the projects funded with loans issued up to the amount of the federal capitalization grants meet two types of federal requirements. The first type includes those contained in the various statutes that apply generally to federal grant programs. These requirements—also called “cross-cutting” authorities—promote national policy goals, such as equal employment opportunity and participation by minority-owned businesses. The second type applies various provisions applicable to the Construction Grants Program (known as title II requirements because that program was authorized by title II of the

³Between 1992 and 1995, the Ohio State Water Development Authority annually surveyed all 50 states and Puerto Rico on certain aspects of the SRF program. See *State Revolving Loan Fund Survey - 1995*, Ohio Water Development Authority, Council of Infrastructure Financing Authorities Monograph No. 8, May 1996.

Federal Water Pollution Control Act Amendments of 1972).⁴ These include compliance with the federal prevailing-wage requirement.⁵ The title II requirements apply only to those projects wholly or partially built before fiscal year 1995 with funds made directly available by federal capitalization grants.

The transfer of federal funds to SRFs begins when the Congress appropriates funds annually to EPA. EPA then allots capitalization grants to the individual states, generally according to percentages specified in the Clean Water Act.⁶ To receive its allotment, a state has up to 2 years to apply for its capitalization grant. In order to apply, a state must, among other things, propose a list of potential projects to solve water quality problems and receive public comments on that list. After completing the list and receiving its capitalization grant, a state generally has 2 years to receive payments of the grant amount (via increases in its letter of credit). After each such increase, a state has up to 1 year to enter into binding commitments to fund specific projects. Next, a binding commitment is typically converted into a loan agreement.

We collected detailed information on the use of revolving funds by nine states with SRF programs—Arizona, Florida, Illinois, Louisiana, Maryland, Missouri, Oregon, Pennsylvania, and Texas. We selected these states because they provide diversity in terms of the size and complexity of their SRF programs and other factors, such as geographic location. However, the conditions in these states are not necessarily representative of the conditions in all 51 SRFs.

We used a questionnaire and follow-up discussions to collect information on SRF activities and finances from program officials from the nine states. We also interviewed EPA headquarters and regional officials who are responsible for the SRF program. We did not attempt to independently verify the information collected from EPA or the states.

⁴For a more detailed description of the cross-cutting and title II requirements, see *Water Pollution: States' Progress in Developing State Revolving Loan Fund Programs* (GAO/RCED-91-87, Mar. 19, 1991).

⁵Federal law requires that workers on covered projects be paid the prevailing wage. The prevailing wage is defined as the wage paid to the majority of the workers in the job classification on similar projects in the same geographic area. For additional information on issues related to prevailing-wage rates, see *Davis-Bacon Act: Process Changes Could Raise Confidence That Wage Rates Are Based on Accurate Data* (GAO/HEHS-96-130, May 31, 1996).

⁶The 1987 amendments specified percentages for the 50 states, the District of Columbia, and seven other jurisdictions. As some of these other jurisdictions—such as Palau—have gained independence since 1987, they lost their entitlement to SRF funds. Their shares of the funds are allocated among the states and other jurisdictions that remain eligible for funds.

The data cited in this statement are as of the end of the applicable state's fiscal year or the federal fiscal year, as appropriate. In seven of the nine states, the state fiscal year ends on June 30; in Texas, it ends on August 31; and in Florida, it ends on September 30, which is also the end of the federal fiscal year.

Amount and Percentage of Funds Lent Generally Increased

The overall amount of funds lent by the nine states increased between 1995 and 1996, from \$3.3 billion to \$4.0 billion. The amount lent by each state also increased. During the same time period, seven states increased their percentage of funds lent, and two states maintained or decreased their percentage of funds lent.⁷

All nine states increased the amount of funds they lent between 1995 and 1996. Six states increased their amount by 15 to 29 percent. For example, Pennsylvania increased the amount lent by 17 percent, from \$267 million to \$311 million. The other three states increased their amount of funds lent by 30 percent or more. The largest change—95 percent—was in Arizona, which increased from \$50 million to \$99 million.

Seven of the nine states increased their percentage of funds lent between 1995 and 1996. Three states increased their percentage by 17 percentage points or more. Four other states increased theirs by 2 to 9 percentage points. Finally, one state's percentage stayed the same, and another state's declined by 2 percentage points.

Among the nine states, the percentage of funds lent at the end of 1996 ranged from 60 to 99 percent. Specifically, five states lent 80 percent or more of their available funds, another three states lent 70 to 79 percent, and the final state lent 60 percent.

⁷It is possible for the amount of funds lent to increase, while the percentage of funds lent decreases (or stays the same). This situation can occur when the increase in the amount of funds lent is proportionately smaller than (or equal to) the increase in the available funds.

Lack of Legislative Reauthorization and Other Federal-Level Factors Constrained Lending in Eight States

Officials in eight of the nine states cited one or more factors at the federal level as affecting the amount and percentage of funds they lent. In seven states, officials said that uncertainty about the reauthorization of the SRF program discouraged some potential borrowers. Also, in seven states, officials cited a concern about compliance with federal requirements, including possible increases in project costs because of a federal prevailing-wage requirement. Finally, in three states, officials identified other reasons, such as federal restrictions on the use of SRF funds.

Expiration of Legislative Authorization Discouraged Some Potential Borrowers

Officials in seven of the nine states said that the lack of reauthorization of the Clean Water Act limited their success in lending funds. Among other things, the lack of reauthorization made it difficult to assure the communities applying for loans that SRF funds would be available to finance their projects and created uncertainty among communities about the terms of their loans.

Officials from the seven states generally agreed that the amount and timing of federal funding became more uncertain after the SRF program's authorization expired at the end of September 1994. These officials said that, prior to 1994, they used the amounts in the authorizing legislation to help determine how much money they would have to lend each year. According to these officials, these amounts also helped reassure the communities that federal funding would be available for projects. These officials said that the uncertainty created by the lack of reauthorization made it difficult for states to schedule projects and assure the communities applying for loans that construction money would be available when needed.

In addition, Pennsylvania officials said that the lack of reauthorization caused some communities to delay accepting SRF loans because they hoped for more favorable loan terms after the act was reauthorized. Specifically, the Congress has considered a proposal to extend the maximum term for an SRF loan, in certain cases, from 20 years to as much as 40 years and to provide lower interest rates. The state officials said that the communities were interested in both longer repayment periods and lower interest rates.⁸

⁸In January 1992, we reported that the 20-year maximum term for SRF loans posed particular problems for small communities. We reported that low-technology solutions, such as filtration ponds and lagoons, which are often appropriate in small communities, generally have design lives extending far beyond 20 years. Limiting the loan term increases the annual debt service payments, and hence user charges, in communities that may not be able to afford higher charges. See *Water Pollution: State Revolving Funds Insufficient to Meet Wastewater Treatment Needs* (GAO/RCED-92-35, Jan. 27, 1992).

According to a Pennsylvania official, several communities in the state had a loan approved by the state but had not formally accepted the loan. In three cases, local officials told us that they were delaying further action pending the act's reauthorization; the total dollar value of the loans was about \$15 million. The Pennsylvania official told us that small, low-income communities in particular would benefit from the proposal to lengthen the repayment period. For example, in March 1995 Pennsylvania approved a \$3 million loan for Burrell Township, which has approximately 3,000 people. However, as of October 1996, the community had not accepted the loan on the chance that a reauthorized act would provide for a longer loan term and thus lower annual repayments.

The Federal Prevailing-Wage and Related Requirements Discouraged Potential Borrowers

Officials in seven of the nine states said that compliance with the federal requirements made financing projects with SRF funds less attractive and, in some cases, caused communities to turn down SRF loans. In particular, five states raised concerns that a federal prevailing-wage requirement could make SRF-financed projects more expensive to construct than projects constructed with other funds. While the title II requirements—which include the federal prevailing-wage requirement—ceased to apply to new projects after October 1, 1994, state officials said they were concerned that these requirements would be reinstated in the reauthorization act.

For example, an Arizona official said that the prevailing-wage requirement could inflate a project's costs from 5 to 25 percent. A Louisiana official said that the community of East Baton Rouge Parish withdrew its 1990 SRF loan application for a project to serve about 120,000 people when it discovered that the prevailing-wage requirement would increase the labor cost of the project by more than \$1.1 million—31 percent.

Louisiana officials said that before the prevailing-wage requirement expired, the state had experienced difficulties in making loans largely because local officials perceived the requirement as increasing project costs. The officials said that Louisiana's lending rate increased in part because the wage requirement expired. The state's lending rate was 44 percent at the end of 1994, before the requirement expired; 62 percent at the end of 1995; and 79 percent at the end of 1996.

EPA officials said they were aware that many states had a concern about the prevailing-wage requirement. They noted, however, that the requirement expired at the end of September 1994 and that the continued application of the requirement would be a state's management decision.

They also noted that, even before the requirement expired, it applied only to projects funded with federal capitalization grants (as opposed to projects funded solely with state matching or borrowed funds, for example). Also, they noted that some states have chosen to continue requiring projects to comply with the requirement, even though they are no longer required to do so; however, they said, both Arizona and Louisiana no longer apply the requirement to projects they fund.

Other Federal-Level Factors Also Discouraged Potential Borrowers

Officials from three states identified other factors at the federal level that constrained lending. These included the awarding of federal funds directly for selected communities and federal restrictions on the use of SRF funds.

Maryland and Pennsylvania officials said that the earmarking of federal funds—not from the SRF program—for specific communities raised the expectation in other communities that if they waited long enough, they might also receive funds directly. This expectation reduced these communities' incentive to apply for an SRF loan.

For example, a Maryland official said that state SRF lending was limited by a congressional decision to provide federal funds directly for a project in Baltimore, which SRF officials had expected to finance. He said that the City of Baltimore turned down the SRF loan because it received \$80 million in federal grant funds for the project in 1993 and 1994. The state official said that it took time to find other communities to borrow the money that was originally set aside for the Baltimore project. The state increased its percentage of funds lent from 61 percent at the end of 1995 to 70 percent at the end of 1996.

Officials from Missouri said that certain federal restrictions on the use of SRF funds limit the amount of loans they can make. For example, a state official cited restrictions on financing the costs of acquiring land. Under the Clean Water Act, SRF loans cannot be made to purchase land unless the land itself is an integral part of the waste treatment processes.⁹ Thus, wetlands used to filter wastewater as part of the treatment process are an eligible expense under the act. However, other lands, such as the land upon which a treatment plant would be built, are not eligible. According to the official, because purchasing land for a wastewater treatment facility represents a large portion of the facility's cost but is ineligible for SRF financing, some communities are discouraged from seeking SRF loans.

⁹In our January 1992 report (cited in the previous footnote), we reported that the ineligibility of certain land costs for SRF assistance posed a financial problem for many communities.

States' Management Decisions Limited Lending in Two States

In Pennsylvania and Arizona, the amount of funds lent was limited by decisions on how to manage the loan fund. These decisions related to how to use SRF funds in Pennsylvania and how to publicize the program in Arizona.

Pennsylvania established a state-funded program, independent of the SRF, in March 1988 to help communities finance wastewater and other projects.¹⁰ In the early years of the SRF program, Pennsylvania officials decided to finance about \$248 million in wastewater projects with these state funds rather than wait for SRF funding to become available, according to state officials. According to these officials, the state decided to fund these projects as soon as possible with state funds to reduce public health risks. For example, about \$30 million was awarded to the City of Johnstown to upgrade an existing treatment plant and thereby prevent raw sewage overflows and inadequately treated wastewater from being discharged into surface waters.

According to a state official, Pennsylvania's percentage of funds lent would have been higher if the state had chosen to fund the \$248 million in projects with SRF funds. In that case, he said, Pennsylvania's total amount of funds lent through the end of 1996 would have been \$558 million, instead of \$310 million, and the state would have lent all available funds, instead of 60 percent of those funds.

Likewise, in Arizona, state decisions limited the amount of funds lent. According to a state official, efforts to inform local government officials about the SRF program and interest them in participating were not effective in the program's early years. This difficulty was compounded by restrictive provisions of state law that further limited the amount of SRF funds lent.¹¹ The state official said that the outreach effort was refocused in 1995. He also noted that the approval of changes in state laws in 1995 and 1996

¹⁰Five of the other eight states also had grant and/or loan programs, namely, Illinois, Maryland, Missouri, Oregon, and Texas. These programs ranged in size. For example, in 1995 the funding available through Maryland's program was approximately \$1 million, while the funding available through Illinois' program was about \$185 million.

¹¹Several provisions of Arizona State laws restricted some localities' ability to participate in the SRF by requiring that voters approve loan agreements and other means. According to a state official, largely because of the marketing and legal factors, the state did not make any loans during 1993 and 1994. In July 1994, EPA notified Arizona that it was not in compliance with the program's regulations because it had not entered into binding commitments to fund specific projects within a year of receiving its payments. EPA required Arizona to take corrective action or face the loss of these grants. In response, Arizona developed a corrective action plan, which EPA approved. Among other things, the plan recommended several changes to the laws that limit local participation in the program. In 1995 and 1996, the Arizona State legislature approved many of the recommended changes. The state resumed making loans in August 1995 and, according to an EPA official, was in compliance with the program's requirements in April 1996.

helped create a more positive atmosphere for outreach, even before the changes took effect. Arizona's percentage of funds lent was 55 percent at the end of 1995 and 81 percent at the end of 1996.

Sources of Funding and Amount of Funds Lent, by State

Under the Clean Water State Revolving Fund (SRF) Program, the states use funds from six primary sources to make loans for wastewater treatment and related projects. These are:

- federal grants,
- state matching funds,
- borrowed funds,
- unused funds from the Construction Grants Program,
- repayments of loans, and
- earnings on invested funds.

All nine states received federal grants and provided state matching funds. These two sources generally accounted for most of the money in the nine states' revolving funds. Four of the nine states borrowed money for their revolving funds. Five states transferred unused funds from the old Construction Grants Program. All nine states received some loan repayments. Finally, eight states had investment earnings on loan repayments.

Table I.1 shows the amount and sources of funding for the nine states we reviewed through each state's fiscal year 1996.

**Appendix I
Sources of Funding and Amount of Funds
Lent, by State**

Table I.1: Sources of Funding for Nine States, Through Fiscal Year 1996

Dollars in thousands

State	SRF grants awarded	State match	Borrowed funds	Transfers from Construction Grants Program	Loan repayments	Investment earnings	Total
Arizona	\$82,214	\$12,559	\$25,338	0	\$475	\$444	\$121,030
Florida	376,183	102,010	0	\$67,558	47,591	57,946	656,441^a
Illinois	478,098	92,520	0	24,900	77,610	10,200	683,328
Louisiana	134,389	28,063	0	0	4,126	0	166,578
Maryland	239,892	49,566	143,046	0	12,717	9,052	454,273
Missouri	298,550	59,710	216,072	681	79,340	11,026	665,379
Oregon	124,033	20,399	0	0	16,400	2,600	163,432
Pennsylvania	390,178	83,276	0	1,255	43,866	2,514	521,088
Texas	528,078	144,284	554,352	197,502	86,871	21,988	1,533,075
Total	\$2,651,615	\$592,387	\$938,808	\$291,896	\$368,996	\$115,770	\$4,964,624

^aTotal includes \$5,153,000 in administrative funds that did not fit in any of the categories.

To determine the percentage of funds lent by each state as of the end of 1995 and 1996, we divided the total amount of funds lent by the total funds available to lend, as defined above, both as of the end of the year. This method was based on the approach used by the Ohio Water Development Authority in conducting annual SRF surveys during 1992 through 1995.

Table I.2 shows the amount and percentage of funds lent for the nine states for each state's fiscal year 1995 and 1996.

Appendix I
Sources of Funding and Amount of Funds
Lent, by State

Table I.2: Amount and Percentage of Funds Lent, 1995 and 1996, by State

State	Amount of funds lent (thousands of dollars)		Percentage of funds lent	
	1995	1996	1995	1996
Arizona	\$50,500	\$98,555	55	81
Florida	538,896	651,595	99	99
Illinois	529,000	614,000	86	90
Louisiana	91,173	131,983	62	79
Maryland	268,889	318,889	61	70
Missouri	461,973	531,368	82	80
Oregon	82,900	122,900	57	75
Pennsylvania	266,575	310,787	53	60
Texas	1,023,788	1,267,548	81	83
Total	\$3,313,694	\$4,042,207	62^a	80^a

^aThe percentage shown is the median of the nine states' individual percentages. We believe this is a better way to measure the various states' experience than to calculate the cumulative average for the nine states, which would give greater weight to the states with large programs.

Source: GAO's analysis of data provided by the states.

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