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The Safe Drinking Water State Revolving Fund and Drinking Water Program Governance

LEGISLATIVE ANALYST'S OFFICE

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Senate Environmental Quality Committee
Hon. Jerry Hill, Chair





Overview

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Overview of SDWSRF

- The SDWSRF Provides Funding to Meet Drinking Water Standards.*** The SDWSRF provides funding for projects that bring public water systems into compliance with drinking water standards; to assess or protect source water; and improve the technical, managerial, and financial capacity of public water systems. The SDWSRF provides financial assistance for the capital costs associated with water quality infrastructure projects, but not for ongoing operations and maintenance costs. Examples of eligible projects include consolidating water systems, providing water treatment, replacing aging infrastructure, or improving water conservation and security. The majority of SDWSRF funds are allocated to construction projects. Funding is also available for planning and feasibility studies for certain eligible applicants. Several forms of financial assistance are provided, including low-interest loans, zero-interest loans, debt refinancing, principal forgiveness, and grants.
- The SDWSRF Was Established by Federal and State Law.*** The SDWSRF, intended to advance the objectives of federal and state safe drinking water acts, was established federally in 1996, and in California in 1997 (Chapter 737, Statutes of 1997 [SB 1307, Costa]).
- The SDWSRF Is Administered by DPH.*** The SDWSRF is administered by DPH through the DWP. The DPH drinking water field operations district offices and regional funding coordinators rank potential projects on a Project Priority List and oversee the individual projects. The DPH Technical Programs Branch provides statewide consistency. The DPH also contracts with the Department of Water Resources to provide certain administrative services relating to the SDWSRF, including conducting a completeness review of applications, evaluating the applicant's ability to repay the loan, and recommending the amount of loan subsidy and the terms and conditions of the loan.



Funding of SDWSRF

- The SDWSRF Is Funded Through Federal and State Monies.*** The SDWSRF is funded by annual federal capitalization grants from the U.S. EPA and requires a 20 percent match from the state (that is, the state provides \$1 for every \$5 of federal funds). The federal and state funds are then used to provide financial assistance, including below-market loans for water infrastructure projects. The proceeds from these loans are then paid back, with interest, into the State Revolving Fund (SRF) in later years, providing funding for new loans in the future (the revolving nature of the SRFs). In federal fiscal year (FFY) 2011-12, the U.S. EPA provided California with an \$84 million capitalization grant for the SDWSRF.
- State Match May Come From Several Sources.*** In recent years, the state match for the SDWSRF has been generated through revenues from two state General Obligation bond measures, Proposition 50 (2002) and Proposition 84 (2006). The SDWSRF state match for FFY 2011-12 was \$17 million. Current law allows the SDWSRF to issue revenue bonds—leveraging the assets of the fund—to increase the resources available in the fund to make additional loans. The DPH has not leveraged the SDWSRF in this way.
- The SRF Loan Repayments Also Fund the SDWSRF.*** The DPH expects to receive \$38.8 million in principal repayment and interest on outstanding loans for the SDWSRF in 2012-13, increasing the SDWSRF's resources available to make new loans.
- Funding for Administration of SDWSRF.*** The U.S. EPA allows up to 4 percent of the SRF federal capitalization grant to be set aside for SRF administrative costs. The DPH funds the cost of administering the SDWSRF entirely through full use of the administrative set-aside. The DPH has the authority to bill water systems for the costs associated with processing SRF applications, but it has not, to date, exercised this authority.



U.S. EPA Notice of Noncompliance

- The U.S. EPA Issued Notice of Noncompliance.*** On April 19, 2013, the U.S. EPA issued a Notice of Noncompliance to DPH for FFYs 2009-11. In the notice, the U.S. EPA stated that DPH had not timely and efficiently committed and expended funds in the SDWSRF or employed adequate financial resources to operate the SDWSRF in a sound financial manner. The DPH has 60 days to submit a Corrective Action Plan to the U.S. EPA. If the state fails to submit a plan which the U.S. EPA deems acceptable, the U.S. EPA may fully or partially withhold future grant awards or suspend, or terminate, current awards.

- Substantial Balances of Unspent Funds.*** The DPH is required to commit and expend all funds in the SDWSRF in an expeditious and timely manner. At the end of 2011-12, DPH had disbursed 63 percent of its SDWSRF funds—significantly less than the national average of 81 percent. As of October 2012, there was an unspent balance of \$455 million in federal funds. The DPH has since reduced this balance to approximately \$375 million in federal funds.

- Inadequate Administrative Support of SDWSRF.*** The U.S. EPA found that the DPH has inadequate personnel and resources to manage the SDWSRF program. In particular, the U.S. EPA called for a dedicated accounting and financial staff and noted that DPH has not provided the U.S. EPA with a quarterly schedule of estimated cash draws, as required.



Stakeholder Concerns With DWP

Concerns With DWP. Several concerns with the DWP have been raised by stakeholders and others, prompting an evaluation of the current governance structure of the state's drinking water activities. These include concerns that:

- The current location of DWP—in DPH—results in a lack of integration with overall water quality management.
- There has been a slow distribution of financial assistance by DPH for projects that enable public water systems to comply with safe drinking water standards.
- DWP's slow rulemaking process has delayed progress in meeting legislative goals, such as developing regulatory criteria for the use of recycled water, and distributing financial assistance. (The DPH has identified increasing the speed of rulemaking as a strategic goal for the department.)
- The level of fees assessed by DWP may not be sufficient to generate adequate administrative resources.
- The current structure of decision making in DWP may not be sufficiently transparent.



Broad Potential Solutions Suggested by U.S. EPA and Stakeholders

- ☑ ***Administrative Resources in SDWSRF Could Be Enhanced.*** Dedicating additional, targeted, resources to the administration of the SDWSRF could potentially improve performance.

- ☑ ***Two Similar State SRFs Could Be Consolidated.*** The SDWSRF could be consolidated with the Clean Water State Revolving Fund (CWSRF)—a similar SRF administered by SWRCB. The CWSRF has generally performed better than the SDWSRF, although there are several factors that may explain that difference, including a focus on larger projects and greater administrative resources. In 2005, the U.S. EPA's Environmental Financial Advisory Board found that combined SRF operations could result in administrative efficiencies and financial benefits. While administering the SRFs jointly in a single agency may yield administrative advantages, it may also result in increased need for coordination. If the SDWSRF were administered by the SWRCB, such reorganization would increase the need for communication between SWRCB and DPH, as the administration of the SDWSRF would be in a different agency than that which administers the core drinking water regulatory program that is tied to the SDWSRF.

- ☑ ***Shifting DWP to SWRCB.*** We have been previously asked by the Legislature to evaluate the potential transition of the DWP from DPH to the SWRCB. We provide our findings on the following pages. While there are advantages and disadvantages to the potential transfer, on balance, we supported such a transition.



DPH-to-SWRCB Transfer: Policy Rationales For Reorganizations in General

When considering a reorganization, the Legislature should evaluate the extent to which it will meet the following objectives:

- Achieve Legislative Goals and Objectives.** What priorities has the Legislature expressed in this policy area, and will the reorganization proposal help achieve those priorities? What are the intended outcomes of the reorganization?
- Increase Efficiency.** Will there be savings from the elimination of overlapping and duplicative functions or economies of scale?
- Improve Effectiveness.** Would the reorganization make the programs more effective at meeting their goals? Are the missions of the programs proposed for consolidation compatible?
- Improve Accountability.** What impact will the reorganization have on opportunities for public involvement? Can the Legislature, the Governor, and the public identify the party responsible for a decision and hold that party accountable?



DPH-to-SWRCB Transfer: Federal Flexibility in Governance Structures



Federal Law Allows Flexibility in Water Agency

Organization. The federal Clean Water and Safe Drinking Water Acts allow states significant flexibility in how they structure their water management agencies. For example, 30 states have consolidated drinking water and water quality programs in a single state entity. Some states have also consolidated their water quality-related revolving loan programs in agencies that focus solely on providing financial assistance. In California, DPH administers the federal Safe Drinking Water Act (and the parallel state statute) and SWRCB administers the federal Clean Water Act (and the parallel state statute).



DPH-to-SWRCB Transfer: Potential Advantages

Transferring DWP to the SWRCB could have several advantages, including:

- Greater Policy Integration on Water Issues.** Consolidating the functions of the DWP with SWRCB's water quality and water rights regulatory activities could increase the effectiveness of the state's water regulation activities by addressing water issues more comprehensively. For example, there would be a more coordinated focus on the sources of pollution and their effects on drinking water. In addition, there may be opportunities to streamline permitting processes for entities that are currently regulated by both DWP and SWRCB.
- Potential for Accelerated Rulemakings.** The SWRCB is authorized to make some changes to rules by updating its policy handbook—an annual process that allows for public participation through board meetings and can be faster than making changes to regulations that are subject to the Administrative Procedures Act, such as DWP's rulemakings.
- Potential for Efficiencies and Increased Administrative Capacity.** Consolidation of the SWRCB's clean water and DPH's safe drinking water financial assistance programs could increase efficiency and increase administrative capacity through economies of scale. In addition, SWRCB appears to use its existing fee authority to support program administration to a greater extent than DPH. (For example, DPH has the authority to bill water systems for the costs associated with processing financial assistance applications, but it does not currently do so. The SWRCB, on the other hand, exercises its authority to assess fees on loan applicants.) These factors suggest that a SWRCB-administered drinking water program may be more likely to have the administrative resources required to adequately run the program and get financial assistance out the door in a timely manner.



DPH-to-SWRCB Transfer: Potential Advantages

(Continued)



Potential for Increased Transparency and Greater Public Participation. The SWRCB's board structure provides for regular, structured opportunities for comments on proposed rules or other issues from all interested parties in a public process.



DPH-to-SWRCB Transfer: Potential Disadvantages

Transferring the DWP to SWRCB could have several disadvantages, including:

- Loss of Some Integration With Public Health Programs.*** Transferring the DWP away from DPH may result in a loss of some integration of drinking water activities with other public health programs, such as those that monitor infectious diseases (including waterborne illnesses) and incidences of birth defects and cancer.
- Temporary Disruption to Activities.*** Transferring the DWP to the SWRCB may result in disruptions that temporarily reduce the program's capacity to perform regulatory activities. For example, the existing relationships between DWP staff and local primacy agencies may be disrupted.
- Potentially Increased, Mainly Short-Term, Costs.*** These costs could include relocation expenses, increased personnel costs from consolidation of classifications, and costs to integrate information technology systems.



DPH-to-SWRCB Transfer: Legislative Considerations

- ☑ ***Shift May Not Address All Issues.*** Some factors that currently hinder the effectiveness of DWP may not be resolved by this transfer. Certain statutory restrictions will continue (unless amended or repealed). These include: (1) restrictions on what activities may be funded from fee revenues, (2) requirements to distribute a minimum percentage of financial assistance to disadvantaged communities (these cases can slow down distribution of assistance), and (3) requirements that water systems must meet a minimum size to be subject to regulation and receive public assistance funds. In addition to these statutory restrictions, very small water systems may continue to suffer from a lack of technical, financial, and managerial capacity.

- ☑ ***Consideration of Other Organizational Structures.*** Other structures could be considered, including:
 - Consolidating DPH's and SWRCB's water-related financial assistance programs, but leaving regulatory programs intact. These financial assistance programs could be consolidated in SWRCB or in a newly created financing authority.
 - Shifting additional environmental health responsibilities from DPH to SWRCB or the California Environmental Protection Agency.



DPH-to-SWRCB Transfer: Implementation Considerations

If the Legislature decides that moving the DWP to SWRCB is the best solution to the concerns with the current program, it may wish to address the following implementation considerations:

- Ensure Emergency Response Capacity.*** It will be important to ensure that SWRCB has the necessary authority and capacity to quickly respond to drinking water-related emergencies, and that it can efficiently coordinate with other agencies. For example, DWP staff currently work closely with local health officers to respond to emergencies when drinking water quality and supply is impaired.

- Determine Apportionment of Responsibilities Between State and Regional Boards.*** Any new drinking water responsibilities transferred to SWRCB will have to be assigned to either the state board or the regional boards. For example, certain activities may be more effectively performed by the state board than the regional boards. (Currently, DPH's district offices perform some of the activities that require close interaction with local agencies.)

- Clearly Delineate Responsibilities Between SWRCB and DPH Prior to Transition.***

- Allow Adequate Time for Transition.*** Potential disruption resulting from the transition can be minimized by allowing sufficient time to plan the transition. Additionally, the transition should occur with the start of the fiscal year.

- Require Progress Updates to Ensure Legislative Oversight.***