

Department of Legislative Services
Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 671 (Senator West)
Education, Health, and Environmental Affairs
and Budget and Taxation

**Bay Restoration Fund - Allocation of Fees, Authorized Uses, and County
Authority to Incur Indebtedness**

This bill redirects \$25 million annually, beginning in fiscal 2021, from the Wastewater Account of the Bay Restoration Fund (BRF) within the Maryland Department of the Environment (MDE) into MDE's Septics Account, a portion of which is transferred to the Maryland Department of Agriculture (MDA) for its Cover Crop Program. The bill also expands the authorized uses of the Septics Account to include *all* costs associated with the installation of a new on-site sewage disposal system (septic system) with a system that utilizes the best available technology for the removal of nitrogen (BAT), as specified. Finally, the bill authorizes a county to borrow money and incur indebtedness through the issuance and sale of notes in anticipation of the receipt of the county's allocation of funds under BRF, as specified. **The bill takes effect July 1, 2020.**

Fiscal Summary

State Effect: Overall BRF revenues are not affected, but a total of \$25 million annually is redirected from MDE's Wastewater Account to MDE's Septics Account (\$15 million) and to MDA's Cover Crop Program (\$10 million). As a result, MDE's special fund revenues and expenditures decrease by \$10 million annually beginning in FY 2021, and MDA's special fund revenues and expenditures increase correspondingly.

Local Effect: Local grant revenues and expenditures from BRF for wastewater projects decrease, while local grant revenues and expenditures for septic system upgrades and connections increase. Local revenues and corresponding debt service expenditures increase to the extent a county issues notes under the bill; administrative expenditures may increase.

Small Business Effect: Meaningful.

Analysis

Bill Summary: Funding from the Septics Account may be used for all costs associated with installing a new septic system that utilizes BAT, including engineering costs and costs associated with the installation or replacement of a disposal system.

County Bond Authority

The bill authorizes a county to incur indebtedness through the issuance and sale of notes in anticipation of the receipt of the county's allocation of funds from BRF. A county may expend the net proceeds of the sale of notes to make grants and loans (1) for the authorized uses under § 9-1605.2(h)(2)(i) of the Environment Article, which addresses authorized uses of the Septics Account and (2) to refund one or more issues of notes. The principal of the notes may be paid from the county's BRF allocation and any other revenues that are pledged to the payment of the notes in the authorizing resolution. The interest on the notes may not be paid from the county's BRF allocation, but may be paid from money made available to the county to finance upgrades to septic systems from any other source, including other State and federal programs.

A county may pledge its full faith and credit and taxing power to the payment of the principal and interest on the notes in the authorizing resolution. If a county pledges its full faith and credit and taxing power to the payment of a note, a county must, in each fiscal year that the note is outstanding, impose *ad valorem* taxes on all assessable property in the county at a rate and amount sufficient to pay the principal and interest. If tax proceeds are inadequate for the payment, the county must impose additional taxes in the succeeding fiscal year to make up the deficiency.

The authority to borrow money and issue notes under the bill is supplemental to any other power granted to a county by any other law, and is not in derogation of any other existing county borrowing power.

Current Law

Bay Restoration Fund

Chapter 428 of 2004 established BRF, which is administered by the Water Quality Financing Administration (WQFA) within MDE. The primary purpose of the fund is to support upgrades to Maryland's 67 major publicly owned wastewater treatment plants (WWTPs) with enhanced nutrient removal (ENR) technology; funds are also used for septic system upgrade grants, among other things, and MDA's Cover Crop Program.

As a revenue source for the fund, Chapter 428 established a bay restoration fee on users of wastewater facilities, septic systems, and sewage holding tanks and Chapter 150 of 2012 doubled the fee for most users. Of the fee revenue collected from users of septic systems and sewage holding tanks, 60% must be deposited into a separate account, commonly referred to as the Septics Account. The remaining funds collected from users of septic systems and sewage holding tanks (40%) must be transferred to the Maryland Agricultural Water Quality Cost Share Program within MDA to provide financial assistance to farmers for planting cover crops.

Uses of MDE's Wastewater Account

Fee revenue generated from users of wastewater facilities is deposited into MDE's Wastewater Account and used, among other specified uses, to provide grants for up to 100% of the eligible costs to upgrade WWTPs to ENR.

Pursuant to Chapters 124 and 153 of 2015, beginning in fiscal 2018, the priority for project funding from the Wastewater Account is as follows:

- (1) ENR upgrades at major WWTPs (design capacity of at least 500,000 gallons per day (gpd));
- (2) the most cost-effective ENR upgrades at minor WWTPs (design capacity of less than 500,000 gpd);
- (3) as determined by MDE and based on water quality and public health benefits, for the following:
 - a. beginning in fiscal 2016, combined sewer overflow abatement, rehabilitation of existing sewers and upgrading conveyance systems, including pumping stations;
 - b. nitrogen reduction from septic systems; and
 - c. the most cost-effective and efficient stormwater control measures by local governments who have implemented a system of charges to fully fund a stormwater management program.

MDE is required to determine the eligibility and priority ranking of a project based on criteria established in regulations.

Uses of MDE's Septics Account

The Septics Account within MDE may be used for grants or loans for up to 100% of (1) the cost of upgrading septic systems to a system using BAT; (2) the cost difference between a conventional septic system and one that uses BAT; (3) the cost of repairing or replacing a failing septic system with one that uses BAT; (4) the cost of replacing multiple septic systems in the same community with a new community sewerage system that meets ENR standards and other specified conditions; or (5) the cost of connecting a property served by a septic system to an existing municipal wastewater facility that is achieving specified levels of treatment.

The Septics Account may also be used (1) for specified administrative costs for MDE (up to 8% of funds deposited) and for certain local entities (up to 10% of funds deposited); (2) to provide financial assistance to qualifying low-income homeowners for up to 50% of the cost of an operating and maintenance contract of up to five years for a BAT system; (3) to provide financial assistance (not to exceed 10% of the funds allocated to the local jurisdiction) to eligible homeowners for the reasonable cost of pumping out a septic system at least once every five years if the homeowner lives in a local jurisdiction that has developed and implemented a qualifying septic stewardship plan, among other requirements; and (4) in fiscal 2020 and 2021, to provide financial assistance to a local jurisdiction to develop a qualifying septic stewardship plan.

Grant awards for septic system upgrades under BRF are income based. In addition, Chapter 280 of 2009 created a subtraction modification against the personal income tax for the cost of upgrading a septic system, less any assistance provided.

MDE Distribution of Block Grants to Local Health Departments

MDE awards the balance of funds in the Septics Account to local health departments as block grants for BAT septic system upgrades. MDE makes awards based on the following factors: (1) the total number of septic systems within a county; (2) the number of septic systems within the Critical Area within a county; and (3) the grant funding requested by the county or its authorized agent.

With the factors above taken into consideration, projects that upgrade septic systems to BAT are then prioritized for grant funding by local health departments as follows: (1) failing systems in the Critical Area; (2) failing systems outside the Critical Area; (3) nonconforming systems in the Critical Area; (4) nonconforming systems outside the Critical Area; (5) other systems in the Critical Area, including new construction; and (6) other systems outside the Critical Area, including new construction.

Background: According to the Comptroller’s Office, through December 31, 2019, a total of \$1.2 billion in bay restoration fees collected from wastewater facility users had been deposited in MDE’s Wastewater Account. In addition, of the fee revenues collected from users of septic systems and sewage holding tanks, almost \$181.0 million had been deposited in MDE’s Septics Account and \$129.2 million had been provided to MDA to support the planting of cover crops.

State Fiscal Effect: Although overall special fund revenues for BRF are not affected, beginning in fiscal 2021, \$25 million annually in fee revenue is redirected from MDE’s Wastewater Account into MDE’s Septics Account and to MDA’s Cover Crop Program. **Exhibit 1** shows the annual effect of the redistribution of fee revenue under the bill. Since 60% of the funds are deposited into MDE’s Septics Account and 40% are transferred to MDA, beginning in fiscal 2021, MDE’s Septics Account receives an additional \$15 million annually, and MDA’s Cover Crop Program receives an additional \$10 million annually.

Exhibit 1
Estimated Revenues for BRF Accounts under the Bill

<u>Fees/Account</u>	<u>Current Law</u>	<u>The Bill</u>	<u>Difference</u>
Wastewater	\$107,545,499	\$82,545,499	(\$25,000,000)
Septics (Total)	28,139,534	53,139,534	25,000,000
MDE (60%)	16,883,721	31,883,721	15,000,000
MDA (40%)	11,255,814	21,255,814	10,000,000

BRF: Bay Restoration Fund

Note: Based on fiscal 2019 bay restoration fee revenues.

Source: Comptroller’s Office; Department of Legislative Services

MDE notes that fiscal 2021 fee revenues that are slated under current law to be deposited into the Wastewater Account are already accounted for; accordingly, MDE advises that, under the bill, it will not have enough funding for currently planned projects in fiscal 2021. MDE also advises that, unlike the Wastewater Account, which is fully subscribed, in recent years, counties have occasionally been unable to use the full amount of grant funding provided from the Septics Account. Thus, based on current expenditures and annual reversions, it is unlikely that local governments can use the full amount of additional funding provided each year under the bill. Even so, for purposes of this fiscal and policy note, it is assumed that MDE special fund expenditures from the Septics Account increase correspondingly with the increase in available special fund revenues to that account (even if some of that funding eventually reverts back to the account).

As shown in Exhibit 1, the bill also results in an increase in special fund revenues for MDA's Cover Crop Program of \$10 million annually beginning in fiscal 2021. According to MDA, the Cover Crop Program is generally fully subscribed each year, although the amount of funding provided to farmers can vary depending on the weather. This analysis assumes that MDA special fund expenditures increase by \$10 million annually beginning in fiscal 2021.

The Comptroller can implement the bill's changes with existing budgeted resources.

Local Fiscal Effect: The bill's redirection of bay restoration fee revenue likely affects the type and amount of grant funding provided to local governments under BRF. Although the bill results in additional grant funding for septic system upgrades and septic connections, the bill results in fewer grants for projects eligible for funding from the Wastewater Account. In addition, because \$10 million annually is redirected to MDA's Cover Crop Program, the overall amount of funding provided to local governments from BRF decreases.

The bill authorizes a county to issue debt in anticipation of the receipt of the county's allocation of funds from BRF to (1) make grants and loans in accordance with authorized uses of the Septics Account and (2) refund one or more issues of notes. Revenues and corresponding debt service expenditures increase to the extent a county issues notes under the bill. However, the number of counties that choose to issue notes and the total amount of debt issued as a result of the bill cannot be reliably estimated. It is unclear to what extent a county would take on the additional responsibility to issue loans as authorized under the bill. To the extent that any counties do so, county administrative costs likely increase to administer a loan program.

Small Business Effect: Contractors who are involved with the installation and replacement of septic systems or who are involved with septic connections may benefit from the additional funding for the Septics Account. Similarly, farms, which are often small businesses, benefit from the additional funding available for the planting of cover crops. However, businesses involved in wastewater projects, such as WWTP upgrades, stormwater projects, and sewer overflow work, are negatively affected due to a decrease in funding available for those projects.

Additional Comments: MDE notes that WQFA has issued bonds to secure funding for upgrades to WWTPs pursuant to its authority under BRF. Although not a direct impact, MDE advises that redirecting fee revenue from the Wastewater Account may affect the terms of the bonds and could potentially jeopardize the BRF bond rating.

Additional Information

Prior Introductions: SB 851 of 2019, a similar bill, received a hearing in the Senate Education, Health, and Environmental Affairs Committee but was subsequently withdrawn.

Designated Cross File: None.

Information Source(s): Baltimore, Charles, Frederick, and Montgomery counties; Maryland Association of Counties; Comptroller's Office; Maryland Department of the Environment; Maryland Department of Agriculture; Department of Legislative Services

Fiscal Note History: First Reader - February 17, 2020
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