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M E M O R A N D U M

August 22, 2016

TO: Water Resources Review Committee
FROM: David Beaujon, Senior Analyst, 303-866-4781
SUBJECT: State Funding for Water Projects

Summary

This memorandum identifies state funding for water supply projects, including the:

- Colorado Water Conservation Board Construction Fund;
- Severance Tax Trust Fund Perpetual Base Fund;
- Water Supply Reserve Fund;
- Water Efficiency Grant Program; and
- Colorado Water Resources and Power Development Authority Water Revenue Bonds and Small Hydropower Loans

The memorandum also identifies state funding for public drinking water and wastewater projects, including the:

- Drinking Water Revolving Fund;
- Water Pollution Control Revolving Fund;
- State revolving funds for planning and design grants;
- Small Communities Water and Wastewater Grant Fund;
- Water Quality Improvement Fund; and
- Energy and Mineral Impact Assistance Fund.

State Funding for Water Supply Projects

Overview. Historically, the state of Colorado has played a limited role in the financing and construction of water development projects. Most of Colorado's water projects were constructed using private moneys, property tax revenue, user fees, and federal moneys. However, the state funds several smaller loan and grant programs for the planning, construction, and rehabilitation of private and public water supply projects. These state funding programs are discussed in the following section.

The Colorado Water Conservation Board Construction Fund. The Colorado Water Conservation Board (CWCB) Construction Fund is the state's largest revolving loan program to finance water diversion and storage projects.¹ According to state law, the first priority for moneys in the fund must be for projects that increase the beneficial consumptive use of Colorado's undeveloped compact entitled waters. The balance of the moneys in the fund must be used for the repair and rehabilitation of existing water storage and delivery systems, controlled maintenance of the satellite monitoring system, and for investment in water management activities and studies. Moneys in the fund may also be used to pay for up to 50 percent of the cost of feasibility studies and water supply investigations. Loans may not be used for water treatment facilities. Loans for more than \$10 million must be approved by the General Assembly. Also, grants may not be made from the fund unless authorized by bill. The CWCB is authorized to issue loans for less than \$10 million without General Assembly approval. For loans under \$10 million, the CWCB is required to submit a report by January 15 of each year to the Colorado General Assembly describing the basis for such loans, called the small project loan report. The board loaned \$30.6 million for 15 small projects during 2015.

The fund receives revenue from the repayment of loans, interest on the fund in the state treasury, and federal mineral royalty distributions. As of June 30, 2016, the fund's value was \$560 million, of which \$440 million is authorized for projects or in loan repayment, \$40 million is available for new loans, and \$80 million in water rights ownership.² The CWCB is authorized to adjust loan interest rates that currently range from 1.5 percent for agricultural loans and 2.25 to 3.25 percent for municipal loans.

Severance Tax Trust Fund. The severance tax is paid by producers of oil, gas, coal, and other minerals. State law provides that 50 percent of severance tax revenues are credited to the Severance Tax Trust Fund and 50 percent of the revenues are credited to the Department of Local Affairs for grants and distributions to local governments impacted by mining activities.³ Of the revenue credited to the Severance Tax Trust Fund, 50 percent is allocated to the Perpetual Base Fund of the Severance Tax Trust Fund (or 25 percent of total severance tax revenues) for use by the CWCB to build water projects. The other 50 percent of Severance Tax Trust Fund revenues (or 25 percent of total severance tax revenues) are allocated to the Operational Fund to fund programs that "promote and encourage sound natural resource planning, management, and development related to minerals, energy, geology, and water."

¹ Section 37-60-121, C.R.S.

² The CWCB owns water rights in the Nighthorse Reservoir and Chatfield Reservoir.

³ Section 39-29-108 (2), C.R.S.

Severance Tax Trust Fund Perpetual Base Fund loans. The CWCB is authorized to issue loans for water projects from moneys in the Severance Tax Trust Fund Perpetual Base Fund.⁴ As of June 30, 2016, the fund's value was approximately \$400 million, of which \$340 million is authorized for project or loans in repayment. Approximately \$41 million is available for future projects and \$19 million is restricted from being used until released by the Joint Budget Committee pursuant to Senate Bill 16-218. In 2014, the General Assembly appropriated \$87.8 million for the Chatfield Reservoir Reallocation Project and \$43.4 million for the Water Infrastructure and Supply Efficiency (WISE) Project. In 2016, the General Assembly appropriated \$1.5 million for watershed restoration projects, \$2.5 million for the Bear Creek Reservoir Reallocation Study, and \$1 million for reservoir dredging projects.

Senate Bill 16-218 concerning severance tax refunds. Senate Bill 16-281 addresses a severance tax refund obligation related to the Colorado Supreme Court's April 25, 2016, decision in *BP America v. Colorado Department of Revenue*. The act creates a mechanism for refunds of severance tax revenue to businesses, including businesses that revise their severance tax returns to claim additional tax deductions for tax years 2012 through 2015. The act establishes a reserve in which all severance tax revenues are set aside and maintained in order to make severance tax refunds prior to allocation to the severance tax trust fund and the local government severance tax fund. The following amounts are restricted from being used until released by the Joint Budget Committee:

- \$19.1 million from the Severance Tax Perpetual Base Fund;
- \$10 million from the Severance Tax Operational Fund; and
- \$48.3 million from the Local Government Severance Tax Fund, which amount comes from money that would otherwise be distributed through grants to political subdivisions socially or economically impacted by the development, processing, or energy conversion of minerals and mineral fuels.

Tier 1 and Tier 2 programs in the Operational Fund. A law enacted in 2008 divides programs funded from the Operational Fund of the Severance Tax Trust Fund into two tiers. The tier 1 programs support the operations of the Colorado Department of Natural Resources, including paying salaries for employees. The tier 2 programs support grants, loans, research, and construction. Tier 2 programs are subject to proportional reduction if mid-year revenue projections indicate there are insufficient funds. The distribution of funding for tier 2 programs is staggered over the course of the fiscal year with 40 percent released July 1; 30 percent released January 4; and the final 30 percent released April 1.

Water Supply Reserve Fund. The Water Supply Reserve Fund (WSRF) — part of tier 2 of the Operational Fund of the State Severance Tax Trust Fund — was created in 2006 to help address Colorado's water needs and support the Interbasin Compact Committee process.⁵ Since FY 2006-07, \$81 million has been transferred from the Severance Tax Trust Fund to the WSRF. Moneys in the fund may be used for grants or loans. Spending from the WSRF does not require legislative approval. The WSRF criteria and guidelines split the WSRF into basin and statewide funds. Once a request for funding from the WSRF is approved by a basin roundtable, the request is forwarded to the CWCB for funding evaluation and final authorization.

⁴ Section 39-29-109 (2)(a), C.R.S.

⁵ Section 39-29-109 (2)(a) C.R.S.

Eligible activities include:

- competitive grants for environmental compliance and feasibility studies;
- technical assistance regarding permitting, feasibility studies, and environmental compliance;
- studies or analyses of structural and nonstructural water projects or activities; and
- structural and nonstructural water projects or activities.

Since 2006, each basin fund has received \$3 million as of June 30, 2016. The statewide account has received \$53.9 million, with \$73.6 million in approved grants. For example, in 2014, the CWCB approved a grant of \$400,000 from the statewide fund for the enlargement of the Eagle Park Reservoir in the Colorado River Basin. It also awarded \$100,000 from the Colorado Basin Account to help pay for the project.

In 2009, the legislature passed a law that transfers \$10 million annually from the Operational Fund of the Severance Tax Trust Fund to the WSRF and continues these transfers indefinitely thereafter.⁶ However, the transfers will be reduced according to a statutory formula if appropriations exceed available severance tax revenue. In FY 2015-16, the transfer is expected to be \$10 million. This law also prohibits the CWCB from allocating moneys by grant or loan from the fund to "covered entities" unless they have adopted a water conservation plan. Covered entities are defined as a municipality, agency, or utility with a legal obligation to provide retail water to a customer base with a total annual demand of at least 2,000 acre-feet. Repayments of principal and interest on loans from the fund are credited to the fund. Due to restrictions placed on the Severance Tax Operational Fund by Senate Bill 16-218, the WSRA is not expected to receive any money in FY 2016-17.

Water Efficiency Grant Program. The Water Efficiency Grant Program — also part of the tier 2 Operational Fund — is administered by the CWCB's Office of Water Conservation and Drought Planning. The program provides financial assistance to communities, water providers, and eligible agencies for water conservation-related activities and projects.⁷ Eligible entities, state and local governments, and agencies can receive funding to develop water conservation and drought plans, to implement water conservation goals outlined in a water conservation plan, and for public education and outreach regarding water conservation. In 2010, the General Assembly extended the Water Efficiency Grant Cash Fund to 2020 and authorized annual appropriations of up to \$550,000 from the Water Efficiency Grant Program beginning on July 1, 2010. In FY 2015-16, the CWCB issued \$583,000 in grants for 16 projects.

Colorado Water Resources and Power Development Authority loans and grants. In 2001, the Board of the Colorado Water Resources and Power Development Authority (CWRPDA) committed \$20 million for water resources development by certain public entities through the Water Revenue Bond Program.⁸ The authority's Water Revenue Bond Program helps finance projects by purchasing bond insurance, pooling borrowers, investing proceeds, and providing other cost-saving services. Eligible borrowers include Colorado cities, towns, counties, water districts, water and sanitation districts, metropolitan districts, water conservancy districts, water conservation districts, irrigation districts, and any enterprise created by these entities. The authority is allowed to provide similar assistance for loans over \$500 million, provided the projects are determined to be feasible by the CWCB. The General Assembly must

⁶ Section 39-29-109.3 (2)(a), C.R.S.

⁷ Section 37-60-126 (12), C.R.S.

⁸ CWRPDA Resolution No. 98-12.

adopt a joint resolution authorizing the authority to consider projects that are over \$500 million, and the resolution must be signed by the Governor. Due to the streamlined approval process, projects under \$500 million may receive funds approximately three months after application. Because of the legislative cycle, projects over \$500 million may require up to one year to complete the approval process. Nearly \$508 million has been issued for water supply project loans since 2001.

Small Hydropower Loan Program. In 2009, the CWRPDA Board authorized the Small Hydropower Loan Program (SHLP) to support the development and use of clean and renewable sources of electrical power. The board budgeted \$10 million in authority funds to provide loans to local governments for new small hydropower projects that are 5 megawatts or less. For 2016, the CWRPDA board has authorized \$150,000 (up to \$15,000 each) of matching grant funds for the evaluation and development of small hydropower projects. As of July 15, 2016, the authority has issued four SHLP loans totaling \$6 million.

State Funding for Public Drinking and Wastewater Projects

Overview. Each year, state agencies identify public drinking water and wastewater projects that are eligible for state loans and grants, called the project eligibility list. The following section describes the preparation of this list and identifies the major state loan programs that help local communities fund necessary drinking water and water pollution control improvements.

Project eligibility list — annual joint resolution. Each year, the Water Quality Control Division (WQCD) in the Colorado Department of Public Health and Environment, the CWRPDA, and the Division of Local Government in the Department of Local Affairs (DOLA) prepare a list of projects that are eligible for loans from the Water Pollution Control Revolving Fund and the Drinking Water Revolving Fund. The lists are approved annually by the Water Quality Control Commission (WQCC). The projects on the eligibility list are then included in an annual joint resolution that is considered by the General Assembly. This resolution must be submitted to the General Assembly by January 15 of each year and signed by the Governor by April 1. Once the joint resolution is approved, the CWRPDA may issue loans for public drinking water and wastewater projects.

In 2016, the General Assembly approved the project eligibility list for the Water Pollution Control Revolving Fund that identified 305 projects with an estimated cost of \$4.6 billion. The 2016 project eligibility list for the Drinking Water Revolving Fund identified 377 projects with an estimated cost of \$5.4 billion.⁹

Drinking Water Revolving Fund. The Drinking Water Revolving Fund (DWRF) is a low-interest loan program to assist public drinking water systems with financing the cost of the infrastructure needed to comply with the requirements and objectives of the federal Safe Drinking Water Act. DWRF loans are administered by the CWRPDA. Most of the money in the fund is obtained from annual grants from the U.S. Environmental Protection Agency (EPA). In 2016, the DWRF received a \$14.5 million capitalization grant from the EPA. Pursuant to federal law, the state must provide a match of 20 percent for each dollar that it loans. This match is financed from loan repayments and revenue bonds. As of July 15, 2016, the authority has issued 231 loans totaling approximately \$561 million. It has also provided \$57.2 million to match federal capitalization grants.

⁹ Senate Joint Resolution 16-003.

In addition to loans, Colorado may set aside 31 percent of the capitalization grant for non-project or set-aside activities to fund activities necessary to accomplish the requirements of the Safe Drinking Water Act. Work plans are developed and submitted to EPA describing the activities to be accomplished with these set-aside funds. The authority also provides the 20 percent state match to receive this part of the federal capitalization grant. The 20 percent match for the set-aside portion is obtained from the loan administration fee account. For 2016, the authority is offering disadvantaged communities direct loans of \$2.5 million, or less, at an interest rate of 2 percent, or less. The interest rate is based on a community's median household income. Loans of over \$2.5 million are leveraged loans, which require the issuance of municipal bonds. Leverage loan interest rates are subsidized to approximately 70 percent of market rates on the municipal bonds issued.

Water Pollution Control Revolving Fund. The Water Pollution Control Revolving Fund (WPCRF) is a low-interest loan program that helps public entities finance, design, and construct wastewater treatment projects, nonpoint source projects, and reuse projects. In 2016, the fund received \$10.7 million in capitalization grant funds from the EPA. The state must provide a match of 20 percent for each dollar that it loans that is historically obtained from loan repayments and revenue bonds. As of July 15, 2016, the authority has issued 259 loans representing \$1.09 billion in projects. It has also provided \$61.3 million in matching dollars.

State revolving fund grants for planning and design grants. Disadvantaged governmental entities are eligible for grants from both funds for up to \$10,000 for engineering and design; energy audits; plans and specifications; environmental assessments; technical, managerial, and financial capacity (DWRF only); and legal fees for special district formation. In addition, these entities are also eligible for grants for up to \$250,000 for design and engineering directly associated with a proposed project.

Small Communities Drinking Water and Wastewater Grant Fund. The CDPHE administers state grant programs for drinking and domestic wastewater projects to communities with fewer than 5,000 residents. Drinking water grant funds may be used to plan, design, construct, upgrade, or consolidate water systems. Domestic wastewater treatment grant funds are used to construct or upgrade wastewater treatment facilities. In 2009, the General Assembly capped the amount of severance tax revenues that may be transferred annually to the Perpetual Base Fund of the Severance Tax Trust Fund at \$50 million. If this cap is exceeded, up to \$10 million may be transferred annually from the Perpetual Base Fund to the Small Communities Water and Wastewater Grant Fund. The cap was reached in FY 2014-15 — the first time since 2009 — and reached again in FY 2015-16. The fund will receive \$10 million in FY 2015-16. According to the CDPHE, the fund is not expected to receive any Perpetual Base Fund moneys in FY 2016-17 or FY 2017-18 due to declining severance tax revenues.

Water Quality Improvement Fund. The Water Quality Improvement Fund consists of penalties collected from violations of the Colorado Water Quality Control Act, and is administered by the WQCD.¹⁰ These moneys are available to provide grants for the improvement of water quality in the impacted community, as well as grants for planning, design, and construction of stormwater and domestic wastewater treatment facilities. In addition, grants may be provided for match funding of non-point source projects, such as projects that control agricultural runoff. The fund has received \$7.1 million in penalties and interest since it was created in 2007. In FY 2015-16, the fund received \$1.8 million.

¹⁰ Section 25-8-608, C.R.S.

Energy and Mineral Impact Assistance Fund. DOLA provides funds and technical assistance to towns, school districts, and other political subdivisions impacted by mineral development. Funding for the loans and grants is obtained from federal mineral lease royalties and the state severance tax. These moneys may be used to pay for water and sewer improvements; road improvements; recreation centers, senior centers, and other public facilities; fire protection buildings and equipment; and local government planning. The department is also authorized to provide loans for potable water treatment facilities and domestic wastewater treatment works. During the economic downturn, from FY 2008-09 through FY 2011-12, over \$270 million from the local share of government severance and mineral impact moneys was transferred to the General Fund. While local government direct distributions were maintained, grant funding was suspended and only began to be awarded again during mid-FY 2012-13. Since reinstatement of the impact program in 2013, over \$377 million in grants have been awarded to local governments in Colorado. In FY 2015-16, over \$107 million was awarded to local governments, and nearly \$28.2 million has been awarded to local governments since the beginning of the current fiscal year.