

Department of Legislative Services
Maryland General Assembly
2008 Session

FISCAL AND POLICY NOTE
Revised

House Bill 369

(The Speaker, *et al.*)

(By Request – Administration)

Environmental Matters

Education, Health, and Environmental Affairs

Chesapeake Bay and Atlantic Coastal Bays 2010 Trust Fund and Nonpoint Source Fund

This Administration bill modifies the purpose of the Chesapeake Bay 2010 Trust Fund by specifying that it be used for nonpoint source pollution control projects and by expanding it to apply to the Atlantic Coastal Bays. The fund is renamed as the Chesapeake and Atlantic Coastal Bays 2010 Trust Fund. The bill generally codifies the BayStat Program and requires it to administer the trust fund. The bill establishes a BayStat Subcabinet and a related scientific advisory panel. Money in the trust fund would be distributed by the subcabinet agencies (1) through competitive grants to various entities; (2) to the Maryland Agricultural Water Quality Cost Share Program (MACS) within the Maryland Department of Agriculture; (3) to the Woodland Incentives Fund within the Department of Natural Resources; and (4) to the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund, a new special fund administered by the Water Quality Financing Administration within the Maryland Department of the Environment to provide financial assistance for urban and suburban stormwater management practices and stream/wetland restoration. WQFA is authorized to issue revenue bonds and deposit the net proceeds into the new fund. Finally, the bill establishes financial accounting provisions related to WQFA.

The bill takes effect July 1, 2008.

Fiscal Summary

State Effect: The FY 2009 budget includes \$25.0 million in special funds for the trust fund; this bill would not affect the overall funding for the trust fund but establishes a process by which annual allocations would be determined and provides more specifics

regarding the use of funds. Special fund revenues and expenditures could increase significantly if WQFA issues bonds for the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund.

Local Effect: Local revenues for nonpoint source pollution control projects could increase as a result of grants awarded from the two funds. Local expenditures could increase to comply with any grant requirements.

Small Business Effect: The Administration has determined that this bill has minimal or no impact on small business (attached). Legislative Services concurs with this assessment. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary:

Chesapeake and Atlantic Coastal Bays 2010 Trust Fund

The bill specifies that the purpose of the trust fund is to provide the financial assistance necessary to advance Maryland's progress in meeting the goals established under the Chesapeake 2000 Agreement and to restore the health of the Atlantic Coastal Bays and their tributaries, by focusing limited financial resources on nonpoint source pollution control projects. Funds may only be used for the implementation of nonpoint source pollution control projects to achieve the State's tributary strategy and to improve the health of the Atlantic Coastal Bays and their tributaries. It is the intent of the General Assembly that, when possible, funds must be granted to local governments for specified nonpoint source pollution control projects.

Bay Stat Program

The bill generally codifies the BayStat Program to measure and evaluate bay restoration efforts, expands its charge to include the Atlantic Coastal Bays, and expands its duties to include the administration of the trust fund. The BayStat Subcabinet, composed of the Secretary of Natural Resources; the Secretary of the Environment; the Secretary of Planning; the Secretary of Agriculture; the President of the University of Maryland Center for Environmental Science; the Dean of the College of Agriculture and Natural Resources at the University of Maryland, College Park; and the Chair of the Critical Area Commission, must oversee the administration of the program.

The program must • provide accurate and timely data to policymakers and the public about the efficacy and cost effectiveness of bay restoration programs; • track and assess the progress of programs to improve the health of the Chesapeake and Atlantic Coastal Bays; • assess the effectiveness of enforcement programs and institute actions to improve their effectiveness; • adopt measurable bay restoration goals; • identify new threats to the health of the Chesapeake and Atlantic Coastal Bays; • increase public awareness of and participation in bay restoration efforts; and • direct the administration of the trust fund.

The subcabinet must report annually to the public regarding the health of the Chesapeake Bay tributary basin and the health of the Atlantic Coastal Bays and their tributaries, the status of restoration programs, and estimated nutrient reductions achieved through projects financed by the trust fund. The subcabinet is required to develop an annual work plan that identifies the planned work to be funded from the trust fund for the next fiscal year, including annual nutrient and sediment reduction targets, performance measures, and accountability criteria. The subcabinet also must develop an annual expenditure plan that identifies planned expenditures for the work plan and includes an accounting of all monies distributed from the trust fund in the previous fiscal year. The Governor is required to submit the plans to the General Assembly as part of the annual budget submission. Based on the budget approved by the General Assembly, the subcabinet must also prepare a final work and expenditure plan each year.

The program is required to implement nonpoint source pollution reduction measures to achieve the tributary strategies by targeting funds (geographically and by practice) to proven, scientifically based projects that provide the most cost-effective and measurable water quality benefits to the Chesapeake and Atlantic Coastal Bays. The program must distribute the trust fund monies on a competitive basis to the maximum extent practicable. The program is charged with distributing funds from the trust fund to the subcabinet agencies in accordance with the final work and expenditure plans. The agencies, in turn, must administer the funds in accordance with those plans, including the distribution of funds • through grants to specified entities; • to the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund established by the bill (discussed in more detail below); • to MACS for nonpoint source pollution control projects; and • to the Woodland Incentives Fund within DNR.

The bill authorizes the subcabinet agencies to distribute to an administrative cost account the amount that is necessary to administer grant programs, not to exceed 1.5% of their allocations. The bill establishes limitations on the use of funds and requirements for trust fund grant agreements and recipients of funds from the trust fund.

The bill also establishes a BayStat Program Scientific Advisory Panel to, among other things, provide annual recommendations to the subcabinet on the use of funds for the following fiscal year.

Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund

The bill establishes a Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund administered by WQFA to provide financial assistance for the implementation of urban and suburban stormwater management practices and stream and wetland restoration. The special, nonlapsing fund would consist of money distributed from the Chesapeake and Atlantic Coastal Bays 2010 Trust Fund, net proceeds of bonds issued by WQFA, interest or other investment income, and any other monies from any other source. The bill expands WQFA's current bonding authority to include the new fund. Money in the fund may not revert to the general fund. The fund is subject to audit by the Office of Legislative Audits.

The fund must be used • to award grants for up to 100% of projects costs for planning, design, and construction of urban and suburban stormwater management practices and stream/wetland restoration; • as a source of revenue or security for the payment of principal and interest on bonds issued by WQFA for the benefit of the fund; • for bond issuance costs; • to earn interest on accounts within the fund; and • for reasonable administrative costs.

Other

The bill requires WQFA to establish a system of financial accounting, controls, audits, and reports with respect to the various accounts it administers.

Current Law: Chapter 6 of the 2007 special session established a Chesapeake Bay 2010 Trust Fund, effective July 1, 2008, to provide the financial assistance necessary to meet, by 2010, the C2K goals. This special, nonlapsing fund is financed with a portion of existing revenues from the motor fuel tax and the sales and use tax on short-term vehicle rentals. The fund may be used only to implement the State's tributary strategy developed in accordance with C2K. The fund is intended to be supplemental to funding that otherwise would be appropriated for bay restoration.

BayStat was established by executive order in February 2007 as a joint project of MDA, DNR, MDE, and the Maryland Department of Planning. It was established as an accountability process for measuring and evaluating State initiatives directed toward restoring the Chesapeake Bay, with the intent of ensuring those government programs are coordinated and operating at their highest efficiency.

MACS, which is administered by MDA, provides farmers with grants to cover up to 87.5% of the cost to install best management practices on their farms to control soil erosion, manage nutrients, and safeguard water quality in streams, rivers, and the Chesapeake Bay.

The Woodland Incentives Fund is a special fund within DNR used to finance the Woodland Incentives Program and related cost-share assistance. The program assists eligible landowners in conducting a program of woodland management.

Background: While the Chesapeake Bay is America's largest and most productive estuary, its health has declined significantly over the past several decades due to nutrient and sediment pollution. In 1999, the U.S. Environmental Protection Agency identified the bay as an impaired water body. In 2000, the Chesapeake Bay partners (the bay states, the District of Columbia, the Chesapeake Bay Commission, and EPA) negotiated C2K, which specified restoration goals to improve the bay and remove it from the EPA's List of Impaired Waters. As part of C2K, specific pollution reduction goals have been allocated to the various bay states. Maryland's reduction goals are summarized in **Exhibit 1**. The largest source of Maryland's nutrient and sediment pollution is runoff from agricultural lands, followed by urban runoff and point sources.

Exhibit 1
Maryland's Pollutant Reduction Goals

<u>Pollutant</u>	<u>1985 Loads</u>	<u>2005 Loads</u>	<u>2010 Goal</u>
Nitrogen (million lbs/yr)	82.4	56.2	37.3
Phosphorus (million lbs/yr)	6.8	3.8	2.9
Sediment (million tons/yr)	1.3	1.0	0.7

Source: U.S. Environmental Protection Agency's Chesapeake Bay Program

In April 2004, DNR released Maryland's Tributary Strategy, which outlines basin-specific nutrient and sediment control actions necessary to reduce pollution from every source with the aim of achieving the C2K goals. Following the development of the Tributary Strategy, the tributary teams and the State of Maryland began to develop Maryland's Tributary Strategy Statewide Implementation Plan. A final implementation plan was released in August 2007. The purpose of this plan is to chart Maryland's course for achieving the Tributary Strategy goals in the areas of point sources, stormwater, septic systems, growth management, agriculture, and air deposition. The plan also includes strategies to achieve, maintain, and monitor water quality goals. It is anticipated

that the plan will be updated as new funding sources and technologies emerge and understanding of the response in water quality to actions taken in the watershed improves.

While numerous efforts to restore the bay's water quality are underway, the State is expected to fall short of its C2K goals absent further action. EPA's Chesapeake Bay Program reports that progress has been made toward meeting the C2K nutrient and sediment reduction goals in the areas of agriculture, wastewater, and atmospheric deposition of nitrogen. However, urban/suburban stormwater is the one pollution sector where progress has been negative due to population growth and related development.

In its January 2007 report, the Maryland Transition Work Group on Environment and Natural Resources estimated the cost of implementing all the actions in the tributary strategies at \$5.1 billion. In an effort to address the significant funding shortfall that exists with respect to the State's bay restoration activities, the creation of a fund to finance bay restoration efforts was proposed in both the 2007 regular and special sessions. The concept was originally proposed as a fund that would be financed by an "impervious surface fee" on new development in the State – intended to have a nexus with the urban/suburban runoff caused by impervious surfaces. The bill (HB 1220) passed in the House during the 2007 regular session but was not acted on by the Senate.

In the 2007 special session, a Chesapeake Bay 2010 Trust Fund was included in tax-related House and Senate bills (HB 5 and SB 2) seeking to address the State's structural deficit. The fund was subsequently established through the enactment of HB 5 (Chapter 6), financed with a portion of existing revenues from the motor fuel tax and the sales and use tax on short-term vehicle rentals. The Act, while stating that the funding must be used for implementation of the State's tributary strategy, does not give more specific direction for how the funding must be spent.

Maryland's Atlantic Coastal Bays, often called the back bays, are shallow water lagoons behind Ocean City and Assateague Island. According to the Maryland Coastal Bays Program, more than 300 species of migratory waterfowl, songbirds, and birds of prey seek the shallow bays for food and shelter. Additionally, the shallow bays provide habitat for rare species of plants and animals as well as blue crabs, flounder, and clams. The Maryland Coastal Bays Program has developed a comprehensive conservation and management plan for the coastal bays that identifies conservation goals and the strategies needed to accomplish them.

State Fiscal Effect:

Chesapeake and Atlantic Coastal Bays 2010 Trust Fund and the BayStat Program

The fiscal 2009 budget includes \$25.0 million in special funds for the trust fund in the Department of Budget and Management's budget for Statewide Expenses – Office of Personnel Services and Benefits, a program that contains statewide expenses that are later distributed to State agencies. DBM advises that the funding was included in this program pending more specific direction from the General Assembly as to how the funds should be spent.

Legislative Services notes that the Fiscal and Policy Note for Chapter 6 of the 2007 special session, which established the trust fund, estimated the trust fund revenues from the motor fuel tax and the sales and use tax on short-term vehicle rentals at \$50.3 million in fiscal 2009, increasing to \$55.5 million in fiscal 2012. Based on more recent projections made by the Bureau of Revenue Estimates and the Maryland Department of Transportation, special fund revenues from these sources are currently estimated to total approximately \$50.6 million in fiscal 2009, increasing to \$59.5 million in fiscal 2013. However, SB 527 of 2008, the Spending Mandate and Revenue Dedication Relief Act, diverts \$25.0 million of the fiscal 2009 distributions to the general fund. As enacted, the fiscal 2009 budget includes \$25.0 million in special funds for the trust fund.

This bill would not affect the total funding available to the trust fund. It merely sets out the process by which funding allocations would be determined and provides more specifics with respect to how the funds may be spent.

It is assumed that, for fiscal 2009, a budget amendment would be submitted to shift the funds in the budget from DBM to DNR and, ultimately, to the other subcabinet agencies required to distribute grants under the bill (MDE, MDA, MDP, and the University System of Maryland). However, because the bill does not specify the distribution of funds among the various agencies, the amount of funding each agency would receive cannot be determined at this time. In future years, allocations would be determined through the development of the annual work and expenditure plans, which would be submitted to the General Assembly by the Governor with the annual budget submission.

In any event, Legislative Services notes that, even in the absence of this bill, the Administration could spend the \$25.0 million that has been included in the fiscal 2009 budget on activities related to tributary strategy implementation, pursuant to current law. The budgeted funds are not contingent upon the enactment of any legislation relating to the trust fund.

After some portion of the money in the trust fund is redirected to the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund, MACS, and the Woodland Incentives Fund (described below), a large portion of the remaining funds would be directed toward grants for nonpoint source pollution control projects, as defined in the bill, although expenditures are also expected to fund new administrative and technical assistance positions. The impact on each agency cannot be reliably estimated until the distribution of funds is determined. In any event, administrative costs, which would be borne by the trust fund, would not exceed 1.5% of the funding provided to each agency, as provided by the bill.

It is assumed that the subcabinet agencies could implement BayStat's expanded duties, including the preparation of the annual work and expenditure plans, with existing budgeted resources.

Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund

Pursuant to the bill, some portion of the funds in the trust fund would be redirected to the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund and used to provide financial assistance for urban and suburban stormwater management practices and stream and wetland restoration. The bill does not specify a percentage or dollar amount that would be allocated to this special fund from the trust fund. Rather, the amount would be determined through the annual work and expenditure plans and the annual budget process. Accordingly, the amount of funding that would be provided from the trust fund in any given year is unknown.

In addition to money redirected from the trust fund, the bill authorizes WQFA to issue revenue bonds for the benefit of the special fund. MDE advises that it does not anticipate issuing any bonds in fiscal 2009, but that it may issue revenue bonds in future years depending on the demand for grants under the program. Accordingly, special fund revenues could increase significantly as a result of the net proceeds of any bonds issued by WQFA in accordance with the bill. Special fund expenditures could, therefore, also increase significantly to provide grants for the purposes described above.

Because the amount of funding that would be available to the fund in any given year is unknown, the total amount of bonds that could be issued cannot be estimated at this time. However, *for illustrative purposes only*, if \$10.0 million annually were dedicated to debt service payments over 15 years, at current interest rates, the State could sell \$100.0 million in bonds. This assumes an even debt service payment schedule and an average maturity of just under 10 years. (Consistent with current policy, this estimate assumes that the first two years of debt service are interest only (\$4.0 million). If debt is retired beginning in the first year instead of the third year, the amount of debt the State

could sell increases to \$110.0 million). This projection also assumes that interest rates remain at current rates (4%).

Legislative Services advises, however, that the amount of bonds issued by WQFA could be affected by overall State debt limitations. The October 2007 report of the Capital Debt Affordability Committee indicated that the State's outstanding tax-supported debt will approach the State's current personal income affordability criterion of 3.2% of personal income in fiscal 2011 or 2012, but will improve thereafter. However, action taken during the 2007 special session that raised the transportation bonds debt limit is expected to eliminate remaining debt capacity. Current estimates project that debt outstanding will exceed the State's current personal income affordability criterion in fiscal 2011. In its October 2007 report, however, CDAC recommended the continued study and reevaluation of the State's debt affordability criteria from the general standpoint of allowing for increased debt capacity.

Given that the budget of the new special fund has the potential to be significant, MDE would likely need additional staff to manage the grant process, funds, and funded projects. The number of staff that would be needed is, to some extent, dependent on the overall budget of the fund, which is unknown. For informational purposes, however, MDE advises that the Bay Restoration Fund utilizes seven staff (five staff to manage projects and two accountants to manage the fund). As provided in the bill, reasonable administrative costs would be borne by the special fund.

The Office of Legislative Audits within the Department of Legislative Services advises that it could implement the bill's requirement to audit the new fund with existing budgeted resources.

Maryland Agricultural Water Quality Cost Share Program

Pursuant to the bill, some portion of the funds in the trust fund would be redirected to MACS for nonpoint source pollution control projects. The bill does not specify a percentage or dollar amount that would be allocated to the program. Rather, the amount would be determined through the development of the annual work and expenditure plans and the annual budget process. Accordingly, the amount of funding that would be provided from the trust fund in any given year is unknown. In any event, MDA advises that its administrative costs would not exceed 1.5% of the funding provided.

The fiscal 2009 budget includes \$1.8 million in general obligation bonds for the program.

Woodland Incentives Fund

Pursuant to the bill, some portion of the funds in the trust fund would be redirected to the Woodland Incentives Fund within DNR. The bill does not specify a percentage or dollar amount that would be allocated to this fund. Rather, the amount would be determined through the development of the annual work and expenditure plans and the annual budget process. Accordingly, the amount of funding that would be provided from the trust fund in any given year is unknown. In any event, DNR advises that its administrative costs would not exceed 1.5% of the funding provided.

The fiscal 2009 budget includes \$215,000 in special funds for the Woodland Incentives Program.

Other Impacts

The bill requires WQFA to establish a system of financial accounting, controls, audits, and reports with respect to the various accounts it administers. With respect to existing accounts, this activity would be handled with existing budgeted resources. With respect to the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund established by the bill, this activity would fall within MDE's reasonable administrative costs to be borne by the fund.

Local Fiscal Effect: Local governments could benefit from grants awarded from the Chesapeake and Atlantic Coastal Bays 2010 Trust Fund for nonpoint source pollution reduction projects. The bill establishes the intent of the General Assembly that, when possible, funds from the trust fund be granted to local governments for specified nonpoint source pollution control projects. Specifically, the bill authorizes the subcabinet agencies to provide grants to counties, bicounty agencies, municipalities, forest conservancy district boards, soil conservation districts, and academic institutions. However, some grants could require a local match or cost share. Local governments could also benefit from grants awarded from the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund for project costs relating to planning, design, and construction of urban and suburban stormwater management practices and stream/wetland restoration.

Additional Comments: Legislative Services notes that, because the bill does not specify a percentage or dollar amount of funding that would be redirected from the trust fund to the Chesapeake and Atlantic Coastal Bays Nonpoint Source Fund each year, this adds a component of risk with respect to the ability of the State to repay future debt service on any bonds issued. Additional risk results in higher interest rates, increasing total debt service payments.

Additional Information

Prior Introductions: None.

Cross File: SB 213 (The President, *et al.*) (By Request – Administration) – Education, Health, and Environmental Affairs.

Information Source(s): Maryland Department of the Environment, Department of Natural Resources, Maryland Department of Agriculture, Maryland Department of Planning, University System of Maryland, Comptroller's Office, Governor's Office, Department of Budget and Management, Maryland Department of Transportation, Maryland Municipal League, Washington Suburban Sanitary Commission, Maryland-National Capital Park and Planning Commission, *Maryland Transition Work Group Report on Environment and Natural Resources* (January 2007), U.S. Environmental Protection Agency, Maryland Coastal Bays Program, Department of Legislative Services (Office of Legislative Audits)

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