HOUSE
RESEARCH
ORGANIZATION bill analysis | 4/29/2013 | HB 11
Ritter, et al.
(CSHB 11 by Pitts)

SUBJECT: Transferring $2 billion from the Rainy Day Fund to finance water projects

COMMITTEE: Appropriations — committee substitute recommended

VOTE: 17 ayes — Pitts, Ashby, Bell, G. Bonnen, Crownover, Darby, Gonzales, S. King, Longoria, Muñoz, Orr, Otto, Patrick, Price, Raney, Ratliff, Zerwas

3 nays — Carter, Hughes, Perry

5 absent — S. Davis, Dukes, Howard, Márquez, McClendon

2 present not voting — Sylvester Turner, Giddings

WITNESSES: For — Kip Averitt, Averitt and Associates; Steve Bresnen, North Harris County Regional Water Authority; Heather Harward, H2O4Texas; Laura Huffman, The Nature Conservancy; Lucy Johnson, City of Kyle and Texas Municipal League; Ken Kramer, Sierra Club - Lone Star Chapter; Stephen Minick, Texas Association of Business; *(Registered, but did not testify:* Jim Allison, County Judges and Commissioners Association of Texas; Fred Aus, Texas Rural Water Association; Carol Batterton, Water Environment Association of TX and Texas Association of Clean Water Agencies;Walt Baum, Association of Electric Companies of Texas; Allen Beinke, San Antonio River Authority; Cliff Braddock, United States Green Building Council; Sabrina Brown, Dow Chemical; Teddy Carter, Texas Independent Producers and Royalty Owners Association (TIPRO); Howard Cohen, Schwartz, Page & Harding L.L.P.; Heather Cooke, City of Austin and Texas Section American Water Works Association (TAWWA); Jeff Coyle, City of San Antonio; Dale Craymer, Texas Taxpayers and Research Association; Mindy Ellmer, Tarrant Regional Water District; Gary Gibbs, American Electric Power; Stephanie Gibson, Texas Retailers Association and Scotts Miracle Gro Company; Daniel Gonzalez, Texas Association of Realtors; Fred Guerra, Dallas Regional Chamber; Dan Hinkle, Atkins Global; Jay Howard, Guadalupe Blanco River Authority; Billy Howe, Texas Farm Bureau; Shanna Igo, Texas Municipal League; Max Jones, The Greater Houston Partnership; Donald Lee, Texas Conference of Urban Counties; Peyton McKnight, American Council Of Engineering Companies of Texas; David Mintz, Texas Apartment Association; Scott Norman, Texas Association of Builders;

Jessica Oney, Luminant; Joey Park, Texas Wildlife Association; Gardner Pate, Phillips 66; Matt Phillips, Brazos River Authority; Jim Reaves, Texas Nursery & Landscape Association; Dean Robbins, Texas Water Conservation Association; Carlton Schwab, Texas Economic Development Council; Stephanie Simpson, Texas Association of Manufacturers; Jason Skaggs, Texas and Southwestern Cattle Raisers Association; Brian Sledge, North Texas Municipal Water District and Dallas County Utility and Reclamation District (Las Colinas); William Stevens, Texas Alliance of Energy Producers; Tom Tagliabue, City of Corpus Christi; Rick Thompson, Texas Association of Counties; CJ Tredway, Central Harris County Regional Water Authority, Independent Electrical Contractors, and Texas Oil & Gas Association; Augusto Villalon, Freese and Nichols; Hope Wells, San Antonio Water System; Daniel Womack, Texas Chemical Council; Perry Fowler*)*

Against — None

On — Ted Melina Raab, Texas AFT; Luke Metzger, Environment Texas; *(Registered, but did not testify:* Carolyn Brittin, Melanie Callahan, Lewis McMahan, Piper Montemayor and Ed Vaughan, Texas Water Development Board*)*

BACKGROUND: The State Water Plan is designed to meet water needs during times of drought. Its purpose is to ensure that cities, rural communities, farms, ranches, businesses, and industries have enough water during a repeat of the 1950s drought conditions. In Texas, each of 16 regional water-planning groups is responsible for creating a 50-year regional plan and refining it every five years so conditions can be monitored and assumptions reassessed. The Texas Water Development Board (TWDB) develops the state plan, which includes policy recommendations to the Legislature, with information from regional plans.

The 2012 state water plan includes the cost of water management strategies and estimates of state financial assistance required to implement them. Regional water-planning groups recommended water management strategies that would account for another 9 million acre-feet of water (an acre-foot of water is 325,851 gallons) by 2060 if all strategies were implemented, including 562 unique water supply projects. About 34 percent of the water would come from conservation and reuse, about 17 percent from new major reservoirs, about 34 percent from other surface water supplies, and about 15 percent from various other sources.

Among TWDB's recommendations to the Legislature to facilitate implementation of the 2012 state water plan is the development of a long-term, affordable, and sustainable method to provide financing assistance to implement water supply projects.

Existing state funding for water management strategies within the state water plan relies primarily on general obligation bond issuances that finance loans to local and regional water suppliers. On November 8, 2011, voters approved a constitutional amendment (Proposition 2) authorizing additional general obligation bond authority not to exceed $6 billion at any time. With this authority, the TWDB can issue additional bonds through ongoing bond authority, allowing it to offer access to financing on a long-term basis. Bonds issued by the TWDB are either self-supporting, with debt service that is met through loan repayments, or non-self-supporting, which requires general revenue to assist with debt service payments, as directed by the Legislature through the appropriations process.

DIGEST:

CSHB 11 would appropriate $2 billion from the Rainy Day Fund to the State Water Implementation Fund for Texas (SWIFT), contingent upon passage of HB 4 by Ritter that would create the fund.

The money would be held and invested by the Texas Treasury Safekeeping Trust Company and available for use by the Texas Water Development Board for the purposes of the SWIFT.

CSHB 11 would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2013.

SUPPORTERS SAY:

CSHB 11 would provide the initial capitalization for the state water implementation fund for Texas (SWIFT), a water infrastructure bank that would be created through the enactment of HB 4 by Ritter to provide a perpetual fund to support low-interest loans to help local and regional entities launch water-related projects. CSHB 11 is necessary to ensure that meaningful financial assistance is available to provide an adequate water supply for the state's future, especially in times of drought.

According to TWDB, critical water shortages will increase over the next 50 years, requiring a long-term, reliable funding source to finance water and wastewater projects. The state water plan has identified projects intended to help avoid catastrophic conditions during a drought, but rising costs for local water providers, the capital-intensive investment required to implement large-scale projects, and the financial constraints on some communities necessitate a dedicated source of funding to help develop those projects. The capital cost to design, build, or implement the recommended strategies and projects between now and 2060 will be $53 billion. Municipal water providers are expected to need nearly $27 billion in state financial assistance to implement these strategies. Any delay in funding would put long-term planning of water projects in jeopardy and increase the overall cost to customers.

Unless the state fully implements its state water plan, 50 percent of Texans by 2060 will lack an adequate supply of water during times of drought. Without an adequate supply of clean, affordable water, the state's economy and public health would be irrevocably harmed. Water shortages during drought conditions cost Texas business and workers billions of dollars in lost income every year. If Texas does not implement the state water plan, those losses could grow to $116 billion annually.

The Rainy Day Fund would provide an ideal source of funding for the initial capitalization of the SWIFT. This one-time investment would seed a perpetual fund that could grow with limited need for further state allocations. The $2 billion capitalization could be used in conjunction with the TWDB's existing $6 billion evergreen bonding authorization, as well as revenue bonding support to provide a meaningful funding solution for larger Texas water projects and financing for many of Texas' smaller communities. Without the initial capitalization of $2 billion from the Rainy Day Fund, revenue for the SWIFT would have to be raised elsewhere, such as with a fee or tax.

Unlike other important funding decisions facing the state, such as ongoing expenditures for education, this one-time investment in water would not have to be matched with new funds each legislative session. Funding for education, for example, involves straight spending that must be supported by appropriations each session and cannot be secured through a perpetual loan program similar to the way a political subdivision could apply for a water infrastructure loan. CSHB 11's one-time investment in water infrastructure would protect Texans from the economic impact of drought and provide water for generations to come.

The intent of the Rainy Day Fund was never to count against the spending cap. In any case, other large items of state spending in the coming budget period, including recovery from the substantial spending cuts in fiscal 2012-13, late payments to Medicaid, and public education spending that may be required after the conclusion of the school finance lawsuit, all have the potential to push state spending above the constitutional cap, regardless of whether Rainy Day funds are spent on CSHB 11 or for other purposes.

Providing a funding program for water infrastructure to ensure an adequate water supply would be an appropriate use of the Rainy Day Fund. It was created as a savings account from which the Legislature may appropriate funds in times of emergency, and the state is on the cusp of a drought worse than the 1950s drought of record.

Use of the Rainy Day Fund would not jeopardize the state's credit rating or ability to handle an emergency. The Rainy Day Fund is expected to reach $11.8 billion by the end of fiscal 2015, according to the comptroller's January 2013 Biennial Revenue Estimate. A transfer of $2 billion from the fund would leave a comfortable balance for handling an emergency while preserving the state's superior credit rating. Given that the boom in the oil and gas sector shows no sign of slowing, any funds appropriated from the Rainy Day Fund would be quickly replenished. Not spending down the fund could result in its eventual spillover into general revenue for general-purpose spending.

Further, credit rating agencies base each state's credit rating on a variety of factors, including the state's reserve fund. Positive factors in determining the rating include that the fund balance be a percentage of the state's budget, that the reserve fund automatically replenish, and that the state have a willingness to spend the fund to overcome economic distress. Retention of a balance over a long period of time is seen as poor management by credit rating agencies because it gives the appearance that the state would be unwilling to use the fund in any circumstance, which defeats the fund's purpose.

Although the state's water supply is a clear priority, full implementation of the State Water Plan has been delayed for more than a decade. The state is in a position to finally address one of its most pressing needs. Texans have become more educated about drought and its debilitating effects on public health and our economy and the Rainy Day Fund balance is at a level to comfortably make the appropriation. Putting off the appropriation could result in a wasted opportunity because political landscapes change as other state priorities need funding. The immediate transfer of funds into the SWIFT would allow those funds to grow while the program was created. Also, delaying the Rainy Day Fund appropriation into the SWIFT until 2015 would likely delay the first round of funding. When it comes to water, Texas cannot afford to wait any longer.

While many entities that could benefit from the loan program created by HB 4 have the credit rating to complete a project without state assistance, financing projects through the SWIFT would offer an incentive of buying down their interest rate in order to encourage development and build-up of projects ahead of the critical need. Entities with the necessary credit rating to finance projects on their own would not typically be interested in using state financial assistance due to the administrative burden and additional oversight involved.

HB 4 and CSHB 11 are complementary bills. CSHB 11 is necessary to fund the loan program that would be created by HB 4. Enactment of CSHB 11 would align the funding mechanism with the financing tools laid out in HB 4.

OPPONENTS SAY:

A $2 billion transfer from the Rainy Day Fund would not be an appropriate source of funding for the water infrastructure fund proposed in HB 4 because it would exceed the state's constitutional spending cap. The spending cap is an important tool in limiting the size and scope of government because it limits spending growth to no more than the growth of the Texas economy.

Texas has a Moody's AAA bond rating, which allows tens of millions of dollars a year in lower borrowing costs for the state. Texas needs to keep 7.5 percent of its general revenue in the fund to keep its AAA bond rating. Anything less than $7.2 billion would imperil what has become a major state asset. Today Texas has $7.9 billion in the fund. Taking $2 billion out of the fund, not including any money for other priorities earmarked to receive Rainy Day funds, would all but ensure a credit downgrade and curtail the state's ability to deal with a revenue shortfall, a natural disaster, or a school finance case decision that required additional state spending on public education.

The comptroller estimates that the Rainy Day Fund will reach $11.8 billion by the end of fiscal 2015. However, deposits into the Rainy Day

Fund have been historically hard to estimate, and the last seven estimates have been off by an average of 166 percent, with the closest estimate off by 23 percent. The Rainy Day Fund primarily is funded by oil and natural gas production tax revenue. The oil and gas industry is both cyclical and volatile, and it would be irresponsible for the state to act in a way that assumes the fund will continue to grow at its current rate.

Funding another water lending program would be unnecessary and an inefficient use of Rainy Day funds because entities needing water infrastructure project funding already have tremendous access to capital. TWDB has several lending programs for water infrastructure through bonding programs that use the state's AAA credit rating to guarantee water debt, enabling TWDB to offer inexpensive financing on a long-term basis. TWDB recently received approval for ongoing general obligation bond authority not to exceed $6 billion at any time. This financing assistance is available even though many entities that are asking for help with projects in the state water plan already have a sufficient credit rating to complete a project without financial assistance from the state. Spending Rainy Day funds for infrastructure projects that already have access to capital would be inappropriate, given that there are several other critical needs in the state with limited funding options.

OTHER OPPONENTS SAY:

Much of the concern surrounding CSHB 11 is centered on the debate over which critical need of the state is most deserving of Rainy Day funding. If the funds are to be used for water infrastructure, it might be appropriate to delay the transfer of the funds to the SWIFT to better align with the timeline for project implementation.

While water infrastructure is a critical need for the state, funding roads and education is also a high priority. Other proposed legislation would be more inclusive of these priorities, including HB 19 by Darby, which proposes a one-time allocation of $3.7 billion from the Rainy Day Fund to capitalize both water and transportation infrastructure programs. This approach also appears in the governor's budget. SJR 1 by Williams proposes a constitutional amendment that would transfer Rainy Day funds for capitalization of the SWIFT ($2 billion), transportation ($2.9 billion), and education ($800 million).

Because some of the mechanics of HB 4, such as the prioritization of projects, would not be fully implemented until 2014, it would be more prudent to leave the money in the Rainy Day Fund to be appropriated in the fiscal 2016-17 budget when the money actually would be needed. This could avoid the possibility of busting the spending cap in fiscal 2014-15 and allow those funds to continue accruing interest in the Rainy Day Fund. Decreasing the balance of the Rainy Day Fund would decrease interest income that otherwise would be credited to the fund. HB 4 and CSHB 11 do not stipulate how much would be invested, nor which investments would be made, with the balances of the SWIFT, which means interest earnings in the SWIFT cannot be determined.

Delaying the actual transfer of funds into the SWIFT until they were actually needed also could provide flexibility to use Rainy Day funds for other critical needs that were more immediate.

NOTES:

A similar bill, SB 22 by Fraser, was left pending in the Senate Finance Committee subcommittee on Fiscal Matters on March 11.

HB 4 by Ritter, the complement to HB 11, would create the SWIFT to serve as a water infrastructure bank to enhance the financing capabilities of the TWDB. HB 4 was passed by the House on March 27, reported favorably as substitute from the Senate Natural Resources Committee and placed on the Senate intent calendar on April 24.

SB 4 by Fraser includes a provision that would create the SWIFT. SB 4 was reported favorably as substituted from the Senate Natural Resources Committee on April 22 and placed on the Senate intent calendar on April 24.

SJR 1 by Williams proposes a constitutional amendment to transfer Rainy Day funds for capitalization of the SWIFT ($2 billion), transportation ($2.9 billion), and education ($800 million). The Senate passed SJR 1 on April 24.

Committee substitute. The committee substitute differs from the bill as filed in that it removes a provision from the introduced bill that would have transferred the Rainy Day funds to the Texas Water Development Fund II in the event that HB 4 did not pass and the SWIFT was not created.

Fiscal note. According to the Legislative Budget Board (LBB), HB 11 would have no significant impact to general revenue related funds in fiscal 2014-15. By decreasing the balance of the Rainy Day Fund, the bill would also decrease interest income from that fund. The LBB says it does not have enough information about potential investments using SWIFT balances to estimate interest earnings to the receiving SWIFT fund.