

GAO

Testimony

Before the Subcommittee on Water and Power, Committee  
on Resources, House of Representatives

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For Release  
on Delivery  
Expected at  
2 p.m. EDT  
Thursday  
June 18, 1998

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RURAL WATER PROJECTS

Federal Assistance Criteria  
Related to the Fort Peck  
Reservation Rural Water  
Project

Statement of Susan D. Kladiva, Associate Director,  
Energy, Resources, and Science Issues,  
Resources, Community, and Economic  
Development Division



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Mr. Chairman and Members of the Subcommittee:

We are pleased to testify on legislation referred to your Subcommittee that would authorize the Bureau of Reclamation (BOR) as the designated source of funding for the Fort Peck Reservation Rural Water Project. In past years, legislation has tasked BOR with specific rural water projects. However, the Bureau's backlog of authorized but unconstructed projects, the significant constraints on the funding available, and concern that passage of such legislation would further erode the basic responsibilities of the Bureau prompted the House Subcommittee on Water and Power, Committee on Energy and Natural Resources, to request our review of selected rural water projects, including the Fort Peck Project. Our report, issued to that Subcommittee last month, provided information on the characteristics of three proposed projects, and the criteria that specified federal programs apply when considering applicants for assistance.<sup>1</sup>

Specifically, we (1) determined the criteria for participation in specified programs of the U.S. Department of Agriculture (USDA), the Environmental Protection Agency (EPA), and BOR for funding rural water projects; (2) determined how the characteristics of the individual projects align with the criteria of the identified programs; and (3) provided the views of officials of the three agencies as to the appropriateness of their being tasked with these projects. We are here today to summarize the results of our work, focusing on the Fort Peck Project.

In summary, we reported that both USDA and EPA have programs under which rural communities that meet specific criteria may receive grants or loans for the construction of rural water projects, but BOR has no established program for funding rural water projects and therefore has no eligibility criteria. Instead, BOR has undertaken such projects when tasked by the Congress. Both USDA and EPA require, among other things, that recipients demonstrate the ability to repay the loans provided to them. Despite its lack of eligibility criteria, BOR, which has concentrated its activities in 17 western states, does have a long-standing policy on full reimbursement for its contributions to local projects. The characteristics of the Fort Peck project do not meet some of the criteria for participation in either USDA's or EPA's program, nor BOR's long-standing reimbursement policy. Specifically, the project relies on grants rather than loans and thus does not meet the criteria for economic feasibility and repayment. Officials of the three agencies agreed that the project would meet real needs in the communities. However, they expressed concerns about

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<sup>1</sup>Rural Water Projects: Federal Assistance Criteria (GAO/RCED-98-204R, May 29, 1998).

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project construction costs and noted that the project envisions the federal government's funding a higher percentage of the project than is allowed under agencies' policies.

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## Background

BOR was created at the time of the Reclamation Act of 1902, which provided for the construction of single-purpose irrigation projects in the West. Over the years, new projects have grown more ambitious, and today they provide a host of benefits, including municipal and industrial water supply, hydroelectric power, recreation, and flood control. Reclamation law determines how the costs of constructing projects are allocated among the projects' beneficiaries, and last year we testified on how that law has evolved.<sup>2</sup> BOR has no established program for the construction of rural water projects, but it has undertaken specific projects when tasked by the Congress to do so. BOR has a long-standing policy that projects' beneficiaries are responsible for repaying their allocated share of the construction costs plus interest.

In 1995, we reported that eight federal agencies had 17 programs designed specifically for rural areas to construct or improve water and wastewater facilities.<sup>3</sup> Our focus today is on two of them: USDA's Rural Utilities Service and EPA's Drinking Water State Revolving Fund. USDA's program, which provides rural communities with loans and grants, is funded at \$577 million in fiscal year 1998. EPA's program, which provides states with capitalization grant funds for loans, has been funded at \$2 billion during fiscal years 1997 and 1998—its first 2 years.

The legislation before you, H.R. 2306, would authorize the Fort Peck Reservation Rural Water System. If constructed, the system would serve both the 13,700 residents of the Fort Peck Indian Reservation, Montana, and the 10,700 residents of four surrounding counties in northeastern Montana, at an estimated cost of \$179 million. The current proposal by project proponents, which is not reflected in the bill, would have the reservation portion constructed with 100-percent federal funding and the off-reservation portion constructed with 85-percent federal funding and the communities are not required to repay the federal share. The proposed federal funding would total \$103 million for the reservation portion and \$65 million for the surrounding counties. The tribes of the reservation

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<sup>2</sup>Bureau of Reclamation: Reclamation Law and the Allocation of Construction Costs for Federal Water Projects (GAO/T-RCED-97-150, May 6, 1997).

<sup>3</sup>Rural Development: Patchwork of Federal Water and Sewer Programs Is Difficult to Use (GAO/RCED-95-160BR, Apr. 13, 1995).

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would operate the system through agreements with BOR, which would monitor the system's operation. The system is to be held in trust for the tribes by the U.S. government. The Chairman of the Assiniboine and Sioux Tribes, who reside on the reservation, in testimony before the Congress, said that a new water district will be formed by the off-reservation recipients in the four neighboring counties to operate that portion of the system. He explained that the project is important because poverty levels are high on the reservation and the lack of water for drinking, cooking, and sanitation is a source of disease and poor health. We did not evaluate the reasonableness or costs and benefits of the project.

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## Criteria for Participation in Selected Federal Programs

We identified a number of elements from the controlling laws, regulations, and policies from USDA, EPA, and BOR that constitute the criteria that proposed rural water projects must meet. USDA's program has direct criteria for participation. EPA, which provides grants to the states that must, in turn, develop their own plans and policies for participation, established minimum requirements for those plans, which constitute applicable criteria. EPA also requires that the states establish priorities for the projects and sets forth criteria for doing so. BOR, which has no formal program for rural water projects, does have a long-standing policy on full reimbursement for its contributions to the local projects it funds, and it has concentrated its activities in the 17 western states that constitute its service area. These criteria and policy matters are summarized in table 1.

**Table 1: USDA's and EPA's Criteria and BOR's Policy for Rural Water Projects**

<b>USDA's Rural Utilities Service</b>	<b>EPA's Drinking Water State Revolving Fund</b>	<b>BOR</b>
Population of a city or town cannot exceed 10,000	At least 15 percent of state fund must be used yearly for projects serving no more than 10,000 users to the extent projects are available	
Projects may be for constructing, enlarging, extending, or improving rural water supplies among a variety of other uses	Drinking water infrastructure projects address compliance with the Safe Drinking Water Act and public health problems	
Applicant must be a public entity, not-for-profit organization, or an Indian tribe	Applicant must be a community water system publicly or privately owned or nonprofit noncommunity water system; federally owned systems are not eligible	
Project must be economically feasible with regard to repayment	Applicant must be able to repay loan (with certain exceptions when principal can be forgiven)	100-percent repayment with interest
Project's economic feasibility should not be threatened by a drop in population		
Applicant must be unable to finance the project from own resources or through commercial credit and be free of federal debt judgment		
Project should be designed to meet the needs of present or projected population	Project is not eligible if it is needed primarily for growth	
Project must be necessary for orderly development and consistent with an approved development plan	Project may meet needs for reasonable growth over its life	
Facilities to be constructed must be modest in size, design, and cost		
Applicant must have legal authority and responsibility to <ul style="list-style-type: none"> <li>— undertake the project,</li> <li>— operate and maintain the proposed facility,</li> <li>— meet the financial terms of the project</li> </ul>	Applicant must have technical, managerial, and financial capacity to operate the project	
	EPA requires that states set priorities on the basis of <ul style="list-style-type: none"> <li>— most serious health threat,</li> <li>— meeting Safe Drinking Water Act standards,</li> <li>— households most in need</li> </ul>	

Service area involves 17 western states

From a project-specific perspective, a major distinction when considering EPA's program is the requirement that each state set priorities for the projects within its boundaries. The relative position of a project would

depend on the characteristics of the other projects competing with them for funding. The states' intended-use plans, including priorities among projects, must be approved by EPA by September 1998. Montana, the intended site of the Fort Peck Project, has had its plan approved by EPA.

## Characteristics Do Not Meet Some Program Criteria

The characteristics of the Fort Peck Water Project under the current proposal meet some but not all of the criteria of the three agencies. Table 2 shows the match-up of selected characteristics of the Fort Peck Project with the criteria and policies of the agencies.

**Table 2: Comparison of Selected Agency Criteria and Policy With Fort Peck Project Characteristics**

Project's characteristics	USDA	EPA	BOR
Envisions 85-percent federal grant funding for off-reservation portion	Project must be economically feasible with regard to repayment (policy of 75-percent maximum federal share)	Applicant must be able to repay loan (with certain exceptions for forgiving principal)	100-percent repayment with interest (for off-reservation portion)
Would serve 13,700 residents on reservation and 10,700 in surrounding area		At least 15 percent of funding is to be used for water systems with 10,000 or fewer users	
Not assessed by state in prioritization process		States must prioritize projects on basis of health threats, standards, and needs	

The project does not meet all of the criteria of the USDA program. The criterion for economic feasibility is based on funding through grants of 85 percent of the design and construction costs, as recently proposed by Fort Peck officials. This amount exceeds the USDA program's maximum level of 75-percent funding for eligible project costs.

The project also does not meet all of the criteria of the EPA program. It does not meet the requirement for the loan program in that its economic feasibility depends on grants. In addition, the project's service population is greater than the 10,000 allowed for consideration as part of the set-aside for rural projects. The project has not been assessed by state officials in the prioritization process, which would have considered health risks, Safe Drinking Water Act standards, and household income.

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Similarly, the project's dependence on grants for the off-reservation portion is inconsistent with BOR's long-standing policy of having water users repay 100 percent of the costs of projects when the federal government does not have a trust relationship with the recipients, such as in the case of Indian tribes.

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## USDA's, EPA's, and BOR's Views About Funding the Project

USDA, EPA, and BOR officials we contacted believe that the Fort Peck Project is worthwhile and needed by the communities. However, they provided numerous reasons for the inappropriateness of their agencies' being tasked with the project. They said that their existing federal assistance programs were not funded at levels to accommodate large projects like Fort Peck. Furthermore, the project envisions federal authorizations at a higher percentage of the project than is allowed under the agencies' policies.

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### USDA's Views

USDA's Rural Utilities Service's Director of Engineering and Environment Staff said that it appears that all or part of the project may be potentially eligible for financial assistance if the appropriate project structure can be devised. He said, however, that the biggest drawback is cost, which is very large for the Fort Peck project relative to the agency's available funding. According to the Assistant Administrator, Rural Utilities Service, the average loan for rural water projects last year was \$800,000, while the average grant was \$638,000. The magnitude of the Fort Peck Project—at an estimated \$168 million federal share—is such that funding from other sources will be critical to putting together a viable financing proposal. Finally, the Rural Utilities Service's Director of Engineering and Environment Staff pointed out that the agency has worked with officials of the project as well as other federal agencies and would be willing to continue to do so in an effort to explore possible solutions, such as developing the projects over several years, if economically feasible solutions can be found.

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### EPA's Views

EPA officials said that the biggest limitation to federal assistance for a large rural project such as Fort Peck is the limited amount of funding in the program and the high cost of the project. For example, the proposed federal funding for the Fort Peck project is estimated at \$103 million for the reservation portion and \$65 million for the off-reservation portion. However, EPA expects that Montana will be eligible to apply for \$7.1 million in federal funds for projects in fiscal year 1998. Furthermore,



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the state limits any single loan to no more than \$4 million. In addition, the state did not include the project on its priority list for funding.

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## BOR's Views

The Director of Operations for BOR expressed concerns about funding for this project in light of the Bureau's budget constraints and other demands for resources. The proposed federal funding for the project is \$168 million, while BOR's annual budget targets for the planning, design, and construction of water projects in the Great Plains Region is \$40 million to \$50 million. Furthermore, BOR's long-standing position is that nonfederal interests should repay the full costs of projects. However, the current proposal for the project would provide nonreimbursable funding for 85 percent of the costs of the project (excluding the portion for the Fort Peck Indian Reservation). According to BOR area officials, the Bureau's role in financing rural water projects has evolved partly because a federal funding mechanism suitable for large regional projects does not now exist. The potential operation and maintenance costs to the federal government on Indian projects, such as at Fort Peck, are another important factor in light of budget constraints. Nevertheless, officials we spoke with maintained that the Bureau, which is within the Department of the Interior, has a role to play when a project's users are tribes for which the United States has a trust relationship. BOR officials said that their unique expertise in designing large water projects is very useful to rural communities in planning municipal water systems and that BOR has provided technical assistance to the sponsors of the project.

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In conclusion, the Fort Peck Project has some characteristics that do not match the criteria or policies of the agencies we reviewed. Thus, it would not likely be successful in making a routine application to an agency for support. The Congress has, in the past, taken legislative action to authorize projects and assigned them to specific agencies for execution. Deciding which agency and under what conditions is, of course, a policy question within the purview of the Congress. We hope that this information and analysis assists you in assessing the relative merits of different policy choices. This concludes my statement, Mr. Chairman. I would be happy to respond to any questions that you or other Members of the Subcommittee may have.

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