



United States
General Accounting Office
Washington, D.C. 20548

160598

Resources, Community, and
Economic Development Division

B-280043

May 29, 1998

The Honorable Jon Kyl
Chairman, Subcommittee on Water and Power
Committee on Energy and Natural Resources
United States Senate

Subject: Rural Water Projects: Federal Assistance Criteria

Dear Mr. Chairman:

Legislation that would authorize rural water projects with the Bureau of Reclamation (BOR) as the designated source of funding has been referred to your Subcommittee. Given the backlog of authorized but unconstructed projects facing the Bureau and the significant constraints on the funding available, you expressed concern that passage of this legislation would further erode the basic responsibilities of the Bureau. In order to assist your Subcommittee in considering the legislation, you asked that we provide information on the characteristics of the projects proposed in the legislation and the criteria that selected federal programs apply when considering applicants for assistance.

Specifically, as agreed with your office, we were to (1) determine 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) determine how the characteristics of the individual projects align with the criteria of the identified programs; and (3) provide the views of officials of the three agencies as to the appropriateness of their being tasked with these projects.

BACKGROUND

The Reclamation Act of 1902 created BOR and 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

160598

control. Reclamation law determines how the costs of constructing projects are allocated among the projects' beneficiaries. 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.

At least two other federal agencies have programs that address rural water systems' needs: USDA's Rural Utilities Service and EPA's Drinking Water State Revolving Fund.¹ USDA's program, which provides loans and grants, is funded at \$577 million in fiscal year 1998. EPA's program, which provides capitalization grant funds to states for loans, has been funded at \$2 billion during fiscal years 1997 and 1998, its first 2 years.

Three pending bills would authorize BOR to finance the design and construction of three rural water projects in four states. All three projects are requesting nonreimbursable federal funding totaling nearly \$400 million:

- Senate bill 777 would authorize the Lewis and Clark Rural Water System to provide a supplementary treated domestic water supply to 22 communities in specified counties in South Dakota, Minnesota, and Iowa, at a total cost of about \$283 million.
- Senate bill 841 would authorize the Fort Peck Reservation Rural Water System to serve both the residents of the Fort Peck Indian Reservation and four surrounding counties in northeastern Montana at an estimated cost of \$179 million.
- Senate bill 744 would authorize the Fall River Water Users District Rural Water System to provide water to a sparsely populated area in South Dakota at an overall estimated cost of \$5 million.

Table 1 summarizes key cost and funding aspects of the three projects.

¹In 1995, we reported that eight federal agencies had 17 programs designed specifically for use by rural areas to construct or improve water and wastewater facilities. See Rural Development: Patchwork of Federal Water and Sewer Programs Is Difficult to Use (GAO/RCED-95-160BR, Apr. 13, 1995).

Table 1: Estimated Costs and Pending/Proposed Congressional Authorizations for Lewis and Clark, Fort Peck, and Fall River Rural Water Projects

Dollars in millions

	Lewis and Clark	Fort Peck Reservation	Fort Peck's surrounding counties	Fall River	Total
Total system cost	\$282.9	\$103.0	\$76.0	\$5.0	\$466.9
Pending/ proposed authorized funding ^a	\$226.3	\$103.0	\$65.0 ^b	\$4.0	\$398.3
Federal share of costs (percent)	80 ^c	100	85	80	

^aReflects GAO's calculations based on the most recent estimated total system costs relative to the percentage of the federal share.

^bThe authorization for the off-reservation portion is calculated using 85 percent of the estimated off-reservation cost, which is the latest proposal of Fort Peck officials.

^cFifty percent for the Sioux Falls portion of the project.

Source: Pending/proposed bills.

RESULTS IN BRIEF

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 program for funding rural water projects and therefore has no eligibility criteria. USDA's Rural Utilities Service program reviews projects according to various eligibility requirements, such as economic feasibility, population limits, and need. EPA's Drinking Water State Revolving Fund provides grants to the states, which in turn provide loans and other assistance as allowed by law to eligible public water systems. EPA requires the states to apply various criteria to the potential projects and to set priorities for projects on the basis of public health risks and need. Both USDA and EPA require 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 reimbursement for its contributions to local projects.

The characteristics of the Lewis and Clark, Fort Peck, and Fall River projects do not meet some of the criteria for participation in the USDA and EPA programs. Specifically, all three projects would rely on grants rather than loans and so do not meet the criteria for economic feasibility without exceeding standard federal spending assistance limits. In addition, the Lewis and Clark project has a city with a population larger than the maximum number allowed by the criterion of the USDA program. The same population limit is applicable to EPA's provision for setting aside funds for rural projects. Furthermore, the Fall River project was rejected by USDA officials on the basis of several eligibility factors, including an insufficient number of water users to make the project economically feasible. The Fall River project does not meet EPA's current criteria because it is not an existing public water system. None of the three projects is consistent with BOR's long-standing policy that users repay 100 percent of a project's costs.

Although officials of the three agencies agreed that the projects would meet real needs in their communities, they expressed concerns about project construction costs for two of three water projects—Lewis and Clark and Fort Peck. They cited program budgets for the areas in which the projects were located that were only a fraction of the total funds needed to construct the projects. Also, they noted that all three projects envision federal funding at cost-share levels above that provided for by the programs of all of the agencies. Some officials cited other limiting characteristics discussed above, as well as the need for congressional action to fund these projects.

CRITERIA FOR PARTICIPATION IN SELECTED FEDERAL PROGRAMS

We identified a number of elements from the controlling laws, regulations, and policies that constitute criteria proposed 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. It 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. The criteria for each agency are shown in table 2.

Table 2: USDA's and EPA's Criteria and BOR's Policy for Rural Water Projects

USDA's Rural Utilities Service	EPA's Drinking Water State Revolving Fund	BOR
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 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 -- undertake the project, -- operate and maintain the proposed facility, -- meet the financial terms of the project	Applicant must have technical, managerial, and financial capacity to operate the project	
	EPA requires that states set priorities on the basis of -- most serious health threat, -- meeting Safe Drinking Water Act standards, -- households most in need	
		Service area involves 17 western states

From a project-specific perspective, however, 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 any of the three projects we reviewed 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. Two of the states (South Dakota and Minnesota) have had their plans approved by EPA; the two other states (Montana and Iowa) have not yet had their plans approved.

PROJECTS' CHARACTERISTICS
DO NOT MEET SOME PROGRAM CRITERIA

The proposed rural water projects have characteristics that do not meet some of the criteria of either USDA's or EPA's program, nor BOR's long-standing cost-sharing policy. While all three projects are described as rural water systems, they differ in size, population of the service community, and other characteristics that relate to funding criteria and priorities. The projects are similar in their need to improve current drinking water supplies, which are low in quantity and quality, and, for the most part, are requesting grants because they are unable to repay loans.

Lewis and Clark Rural Water Project

The characteristics of the Lewis and Clark Rural Water Project that would be authorized by Senate bill 777 meet some but not all of the criteria of the three agencies' programs. If constructed, the system would provide a supplemental supply of drinking water to 22 communities in South Dakota, Minnesota, and Iowa, which have a population of over 180,000, including the city of Sioux Falls, South Dakota, with its population of approximately 120,000. The total cost is estimated at about \$283 million. The project is intended to solve water supply problems that none of the member communities could afford to solve on their own. The environmental report on the project says that "the project would provide adequate supplies of good quality drinking water to areas where current water supplies are insufficient, are at risk of contamination or are of inferior quality."

The project does not meet some of the criteria of the USDA program. Namely, it includes a city (Sioux Falls) with a population exceeding the definition of a rural area as a location with fewer than 10,000 people. Thus, only the rural component would meet the criterion. It also does not meet the criterion for economic feasibility for repayment in that the legislation envisions federal funding through grants of 80 percent of the design and construction costs (50

B-280043

percent for the Sioux Falls component). This amount exceeds the USDA program's policy to fund a maximum of 75 percent of eligible project costs.

The project also does not meet some of the criteria of the EPA program. For example, it does not meet the economic feasibility requirement for the state loan program in that it depends on grants to cover 80 percent rather than a loan (50 percent for the Sioux Falls component). In addition, the inclusion of an entity with more than 10,000 people would call into question its applicability for the portion of EPA's state grant moneys that states are to use for projects with populations under 10,000. Furthermore, the project has not been assessed by state officials in the prioritization process for funding, which would have considered health risks, Safe Drinking Water Act standards, and household income.

Similarly, the project's dependence on grants is inconsistent with BOR's long-standing policy of having water users repay 100 percent of the costs of projects. In addition, 2 of the 3 states involved in the project, Iowa and Minnesota, are not among the 17 western states that constitute BOR's service area.

Fort Peck Reservation Rural Water Project

The characteristics of the Fort Peck Water Project authorized by Senate bill 841 meet some but not all of the criteria of the three agencies. If constructed, the Fort Peck Rural Water Project would serve both the 13,700 residents of the Fort Peck Indian Reservation, Montana, and the 10,700 residents of four surrounding counties, at an estimated cost of \$179 million. The current proposal by the sponsors would have the reservation portion constructed with 100-percent federal funding and the off-reservation portion with 85-percent federal funding. The tribes of the reservation 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.

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 of eligible project costs.

The project also does not meet all of the criteria of the EPA program. The project does not meet the requirement for the loan program in that its economic feasibility depends on grants. In addition, its 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.

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.

Fall River Water Users District Rural Water Project

The characteristics of the Fall River Water Users District Rural Water Project authorized by Senate bill 744 do not meet some of the criteria of the three agencies' programs. If constructed, the proposed system would provide 200 miles of pipeline to supply water to nearly 660 permanent residents in eastern Fall River County, South Dakota. The residents are dispersed over 460,800 acres and currently obtain water from their own individual wells. Water supplies are of poor quality and do not meet minimum health and safety standards. In addition, approximately 6,500 head of livestock would be served on a daily basis. The overall estimated cost of the project is \$5 million.

The Fall River project does not meet some of the criteria for USDA. USDA rejected the project's application twice. USDA rejected the first application because the sponsors were unable to obtain a sufficient number of users to commit to system hookups for the system to be feasible. The second application, submitted under the "Water 2000" initiative,² was turned down by USDA officials, who determined the system was not feasible because of (1) high monthly user costs, (2) high project costs, (3) a low sign-up percentage, and (4) probable overestimation of water usage by livestock. USDA officials determined that the monthly fees for the users who were committed to hookups

²In 1996, the administration announced a "Water 2000" initiative to improve drinking water in rural America by targeting communities with the most serious problems.

B-280043

would be more than double the highest user fees in South Dakota, and therefore the system would be at risk of financial failure. USDA determined that while the project was an "eligible" entity, with funds to be used for "eligible" purposes, the project was not "feasible" as projected.

Fall River also did not meet some of EPA's criteria. EPA's current guidelines prohibit the agency from funding recipients who are not public water systems, making Fall River ineligible for funding. Also, the project is not on South Dakota's priority list, primarily because the recipient would not be able to repay a loan. In addition, EPA officials determined that it is doubtful the system could comply with other program requirements for technical and managerial ability.

Similarly, while the project is located in BOR's 17-state service area, the project's dependence on grants is inconsistent with BOR's long-standing policy of having water users repay 100 percent of the costs.

USDA'S, EPA'S, AND BOR'S VIEWS ABOUT FUNDING RURAL WATER PROJECTS

Although the USDA, EPA, and BOR officials we contacted believe that the Fort Peck, Lewis and Clark, and Fall River water projects are worthwhile and are needed by the communities, they provided numerous reasons for the inappropriateness of their agencies' being tasked with these projects. They said that their existing federal assistance programs were not funded at levels to accommodate large projects like Fort Peck and Lewis and Clark. Furthermore, all three projects envision federal authorizations at cost-share levels above that provided for by the programs of all of the agencies.

USDA's Views

The Rural Utilities Service's Director of Engineering and Environment Staff said that it appears that all or parts of the three projects are potentially eligible for financial assistance if the appropriate project structures can be devised. He said, however, that the biggest drawback is cost, which is very large for the Lewis and Clark and Fort Peck projects relative to the agency's available funding. The allocations in all three states involved would not fund one of these requests. For example, the proposed federal funding of the Lewis and Clark project totals about \$226 million, while the total fiscal year 1998 allocation to all three states that the project would serve is \$46 million. 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 Lewis and Clark and Fort Peck is such that funding from other sources will be critical to putting together a viable financing proposal. With respect to Fall River, the project as planned does not meet USDA's program criteria for funding. USDA's Rural Business Program Director said that the project would need a direct appropriation from the Congress with very high grant percentages in order to be feasible in today's economic environment. Finally, the Rural Utilities Service's Director of Engineering and Environment Staff pointed out that the agency has worked with officials of the projects 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.

EPA's Views

EPA officials said that the biggest limitation to federal assistance for large rural projects such as Fort Peck and Lewis and Clark is the limited amount of funding in the program and the high cost of the projects. 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, the state limits any single loan to no more than \$4 million. South Dakota has not included the Fall River project on its priority list, primarily because the recipient would not meet the financial requirement to be able to repay a loan. Also, while the Fall River system is not an existing public water system and therefore is not currently eligible for a state loan, EPA officials say they are working to develop a solution to this difficulty. The project may still have problems meeting requirements for financial management capability and demonstrating that public health risks are a major component of the project.

BOR's Views

The Director of Operations for BOR expressed concerns about funding for these projects in light of the Bureau's budget constraints and other demands for resources. The total proposed federal funding for the three projects is nearly \$400 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, pending authorizations for all three projects would provide nonreimbursable funding for as much as 85 percent of the costs of the projects (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, 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 their unique expertise in designing large water projects is very useful to rural communities in planning municipal water systems, and BOR has provided technical assistance to the sponsors of all three projects. For example, BOR provided guidance, oversight, and technical assistance in the planning process for the Lewis and Clark project.

OBSERVATIONS

All three rural water projects have some characteristics that match the criteria or policies of the programs we reviewed, but no one project has all of the characteristics that match all of the criteria or policies of any one of the programs. Thus, none would be likely to be successful in making a routine application to a program 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. The information and analysis in this report may be of assistance in assessing the relative merits of different policy choices.

AGENCY COMMENTS

We provided copies of a draft of this report to USDA, EPA, and BOR for review and comment. USDA, EPA, and BOR generally agreed with the report and provided technical comments, which we incorporated into the report as appropriate.

SCOPE AND METHODOLOGY

In conducting our review, we obtained documentation from BOR, USDA, and EPA on the agencies' policies, criteria, and priorities for funding rural water projects. To gain an understanding of the characteristics of the three projects and the history of efforts to procure federal funding assistance, we met with and interviewed the sponsors of the projects. We also obtained and reviewed documentation describing the proposed projects, including the Senate bills. We did not evaluate the reasonableness or costs and benefits of the water projects.

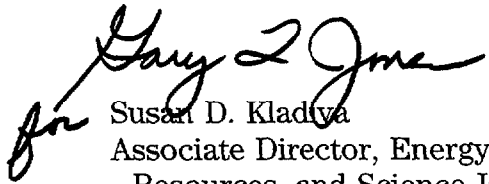
B-280043

To determine if the characteristics of the projects align with the federal funding criteria, we analyzed and reconciled information about the projects with eligibility and prioritization criteria. To obtain information about the agencies' views on the appropriateness of funding the three water projects, we interviewed BOR, USDA, and EPA officials in headquarters and regional and state offices. We performed our review from March through May 1998 in accordance with generally accepted government auditing standards.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of this letter. We will then provide copies to the Secretary of the Interior, the Secretary of Agriculture, and the Administrator of the Environmental Protection Agency. We will also make copies available to others on request.

If you or your staff have any questions, please call me at (202) 512-3841. Major contributors to this report were Arleen Alleman, Brad Hathaway, and Rudolfo Payan.

Sincerely yours,


for Susan D. Klady
Associate Director, Energy,
Resources, and Science Issues

(141175)

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

**U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013**

or visit:

**Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC**

**Orders may also be placed by calling (202) 512-6000
or by using fax number (202) 512-6061, or TDD (202) 512-2537.**

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>

**United States
General Accounting Office
Washington, D.C. 20548-0001**

<p>Bulk Rate Postage & Fees Paid GAO Permit No. G100</p>

**Official Business
Penalty for Private Use \$300**

Address Correction Requested
