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RURAL WATER PROJECTS

Federal Assistance Criteria
Related to the Lewis and
Clark Rural Water Project

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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 Lewis and Clark 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 Lewis and Clark Project. Our report, issued to that Subcommittee last month, provided information on the characteristics of the projects and the criteria that selected federal programs apply when considering applicants for assistance.¹

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 Lewis and Clark 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 Lewis and Clark 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

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

about 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.

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.² 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.³ Our focus today is on two of these: 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. 1688, would authorize the Lewis and Clark Rural Water System. If constructed, the system would provide a supplemental supply of drinking water to 22 communities in South Dakota, Minnesota, and Iowa. It would serve 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 proposed federal share is 50 percent for the Sioux Falls component and 80 percent for the remaining area, for a total of about \$226 million and does not require the communities to repay the federal share. 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

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

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

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.” We did not evaluate the reasonableness or costs and benefits of the project.

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

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 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"> — 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 <ul style="list-style-type: none"> — 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, 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. Two of the states (South Dakota and Minnesota) have had their plans approved by EPA; the other state (Iowa) had not yet had its plan approved as of the completion of our review.

Characteristics Do Not Meet Some Program Criteria

The characteristics of the Lewis and Clark Rural Water Project that would be authorized by H.R. 1688 meet some but not all of the criteria of the three agencies. Table 2 shows the match-up of selected characteristics of the Lewis and Clark Project with the criteria and policies of the agencies.

Table 2: Comparison of Selected Agency Criteria and Policy With Lewis and Clark Project Characteristics

Project's characteristics	USDA	EPA	BOR
Envisions 80-percent federal grant funding (50 percent for Sioux Falls component)	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
Includes Sioux Falls, with a population of 120,000	Population of a city or town cannot exceed 10,000	At least 15 percent of funding is to be used for water systems with 10,000 or fewer users	
Not assessed by states in prioritization process		States must prioritize projects on basis of health threats, standards, and needs	
Located in South Dakota, Iowa, and Minnesota			Service area of 17 western states (excludes Iowa and Minnesota)

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. The project 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 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 the project's 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.

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

USDA, EPA, and BOR officials we contacted believe that the Lewis and Clark 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 Lewis and Clark. Furthermore, the project envisions federal authorizations at a higher percentage of the project than is allowed under the agencies' policies.

USDA's Views

USDA's Rural Utilities Service's Director of Engineering and Environment Staff said that it appears that 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 Lewis and Clark project relative to the agency's available funding. USDA annually allocates rural water project funding to the states. The allocations in all three states involved would not fund the project. 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 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 project over several years, if economically feasible solutions can be found.

EPA's Views

EPA officials said that the biggest limitation to federal assistance for a large rural project such as Lewis and Clark is the limited amount of funding in the program and the high cost of the project. With its estimated federal funding of \$226 million, the project is too costly to be accommodated by available grants to the states. For example, the fiscal year 1997 grant for one of the states—South Dakota—was \$9.5 million, and the state has commitments for funding six projects with the grant. The state has applied for its \$7.1 million share of available fiscal year 1998 funds. Officials said that the only way they could envision involvement of Lewis and Clark in their program would be the use of a loan to provide a state match of federal funds if a match were required. Furthermore, when a system is located in more than one state, as with Lewis and Clark, the states could decide which state would provide a loan, but funding such a system jointly could be complicated by the different ranking criteria and requirements among the states. In any event, only a small portion of funding could come from the fund, compared with the size and cost of the large regionalized system of Lewis and Clark.

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 about \$226 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 authorization for the project would provide nonreimbursable grant funding for 80 percent of the costs of the project (50 percent for Sioux Falls). 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. 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 guidance, oversight, and technical assistance in the planning process for the Lewis and Clark project.

In conclusion, the Lewis and Clark 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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