October 2008

WATER AND WASTEWATER INFRASTRUCTURE FUNDING CHALLENGES TO COLORADO MUNICIPALITIES

By Kevin Bommer, CML legislative and policy advocate
Orders of Water and Wastewater Funding: Challenges for Colorado Municipalities have been provided to members of the CML Policy Committee and CML Statewide Municipal Water and Wastewater Issues Committee. This publication can be downloaded for free at www.cml.org/pdf_files/08_water_funding.pdf or purchased with the following form.

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### WATER CONSERVATION PLAN MANDATE

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SUMMARY

In 2006, the Colorado Municipal League distributed a memorandum to its membership providing an overview the various types of funding available for water and wastewater projects and water supply projects.

In conjunction with the Colorado Department of Public Health and Environment, the Colorado Water Resources and Power Development Authority, and the Colorado Department of Local Affairs, CML also summarized the need of Colorado's local governments for water and wastewater treatment infrastructure projects. At that time, the scope of the need was dramatic, and funding options for municipalities and special districts for financing necessary improvements were limited.

Since 2006, the needs have not diminished and the available funding has not increased. This is even more evident in areas where there is not a significant population that is able to absorb the cost of the required improvement. In communities with fewer than 5,000 people, there are now approximately 439 water or wastewater projects needing nearly $750 million in funding, and many of these communities are unable to afford the debt service.

In 2008, the State of Colorado still has no dedicated, direct grant assistance program for disadvantaged communities.
WATER & WASTEWATER PROJECT FUNDING CHALLENGES

A significant gap

The Water Quality Control Division of CDPHE conducts an annual survey of public water and wastewater treatment systems to identify projects and document their infrastructure needs. The Project Eligibility Lists are developed each year based on information received from the surveys as well as through discussions with the department's engineering, permitting, and the compliance assurance programs. The lists are submitted to the Water Quality Control Commission as part of the programs' Intended Use Plans for the commission's approval each October and serve as the basis for identifying the estimated overall funding need for water and wastewater systems in Colorado.

The total need of any particular system may be met in whole or in part through financing arranged through several of public and private sources. Grant funding makes up very little of the amount used toward project costs because of the severe lack of grant funding from state and federal sources. Large systems can often afford local solutions through financing and bonding. Generally, larger systems in more populated areas are able spread the cost of the required improvements through minor rate increases among their population base. Smaller systems do not have the luxury of many options.

### Drinking Water Projects

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Information Source: Water Quality Control Commission approved Intended Use Plans/Approx. 40-45% survey return rate

The smaller the population base, the more the more limited the financing options, and the overall costs are often proportionately much higher. The WQCD generally defines any system serving a population of less than 5,000 people as a “small community system,” many of which are financially disadvantaged and cannot even afford the debt service on low- or no-interest loans. This makes them reliant on grants to reduce the total cost of their projects. Otherwise they face crippling debt or are required to pass on exorbitant rate increases to a limited population that may have difficulty absorbing them due to limitations created by their economic status.

When the Colorado Municipal League testified before the Water Resources Review Committee in the summer of 2006, there were a total of 618 water and wastewater projects needing $2.3 billion in funding statewide. Of that total, 439 of those projects were in communities with fewer than 5,000 population — “small communities.” Those small communities had an aggregate need of around $750 million.

Two years later, there is no reduction in the need. There are now 292 drinking water projects needing $1 billion and 352 wastewater projects needing nearly $1.65 billion – a total need of over $2.6 billion. In small communities, there are now 236 identified wastewater projects needing $365 million and 303 drinking water projects needing $472 million – a total of 439 projects in communities under 5000 population that need roughly $750 million.

The need in small communities is the most critical, particularly for wastewater treatment projects. Forty wastewater projects were designated public health hazards and need $70 million in funding, and 163 were in significant non-compliance and need $310 million. Fourteen drinking water projects were designated as “acute” and need $20 million in funding. Another 20 were designated as “chronic” and also need $20 million.

### No new state funding, shrinking federal funding

In CDPHE, the Small Community Drinking Water and Wastewater Grant Programs intended to help local governments and private, not-for-profit systems afford the cost of their improvements. The major obstacle is that there has been no funding for these programs since the last year of the Owens Administration, and inconsistent funding prior to that year. Because the funds are technically not a creation of state statutes, the only opportunity for them to receive funding has been through the state’s Capital Construction Fund.

The Capital Development Committee of the Colorado General Assembly, a joint committee, establishes an annual list of funding priorities. The committee consistently eliminates the grant programs from the priority list on an annual basis. CDPHE continually requests bare bones funding for the program and was able to take the paltry $3 million appropriated in 2006 and buy down the cost of 16 projects to the point that the local entities could afford the debt on the remainder of the financing. Given the Capital Development Committee's continual denial of funding prioritization for the grant programs, coupled with a predicted reduction in revenue available to the committee for distribution to statewide capital construction projects, it seems clear there is need for a more substantive and comprehensive approach.

As identified above, the current total statewide need for drinking water and wastewater projects is nearly $2.6 billion. In addition to the necessity to replace and upgrade infrastructure as it reaches the end of its useful life, the cost of compliance
with increasingly stringent standards being mandated from the federal government without corresponding funding means that many systems will continue to struggle to fund projects they are required to complete. Equally important is ensuring the Colorado Water Quality Control Commission does not exacerbate the problem by implementing standards and criteria that unnecessarily exceed those passed along by the federal government.

While several different programs in existence for funding projects are described hereafter, it is important to note the significant lack of dedicated, affordable funding options for water and wastewater projects in municipalities and special districts that serve municipalities. Even local governments that can afford financing are having difficulty getting the most affordable loan money, thanks to cuts by the federal government to the state revolving loan funds administered by CDPHE and the Colorado Water Resources and Power Development Authority, in particular.

For the last several years, there has been a major disparity in loan demand versus loan capacity in the Water Pollution Control Revolving Fund, which means the cost to the entities that do not receive WPCRF loans are increased dramatically either by having to wait for the next cycle or settling for more expensive funding options. Currently, the Water and Power Authority has demand for $60 million in loans but only has loan capacity in the program of $30 million. The result is that the local government must wait for the next loan cycle or pursue other funding options that are usually at higher rates or generally more expensive.

While it will be exceedingly difficult to try to change the federal budget in the short term, several national interest groups, including the National League of Cities, continually lobby the president and U.S. Congress to fund the mandates that have been passed by Congress and mandated by the Environmental Protection Agency. The likelihood of success in the near-term, though, is not very high because funding problems are not just an issue in Colorado.

In a recent Congressional briefing organized by the U.S. Chamber of Commerce’s National Chamber Foundation, Fayetteville, Ark. Mayor Dan Coody testified that local governments (and their citizens) pay for 95 percent of all the water and wastewater infrastructure and services in the United States. Mayor Coody, who also co-chairs the U.S. Conference of Mayors Water Council, stated that the annual costs to local governments increased from $45 billion in 1992, to $82 billion in 2005. Looking back to 1970, local spending has continued to dramatically increase while the federal government eliminated grants and has reduced appropriations to the revolving loan funds significantly.

NLC, the U.S. Conference of Mayors and others are pressing for recapitalization of the revolving loan funds and recreating a grant program to assist with capital needs and funding Congressional/EPA mandates. However, even if lobbying at the federal level is ever somewhat successful, pursuing solutions within the state for shared responsibility for “homegrown” solutions – particularly for the most disadvantaged of local governments – would have the most profound and immediate impact.

**SHARED RESPONSIBILITY FOR SOLUTIONS**

Properly treating wastewater and providing clean drinking water is a shared responsibility between the State of Colorado and the various local governments as a cooperative effort to provide for the health and welfare of all citizens and the environment. Simply, in the absence of federal assistance to comply with imposed mandates, the state and local governments must work together to find additional funding for entities to meet mandates, particularly for those entities that do not have the ability to ask their residents to shoulder any more of the burden than has already been placed on them.

While it is clear that the State of Colorado has an obligation to ensure that the Safe Drinking Water Act and the Clean Water Act are enforced through the state’s assumption of primacy over both drinking water and wastewater, there exists an often tenuous and fine line between regulation and assistance. The Water Quality Control Commission develops the rules for water quality management in Colorado, as well as regulations to ensure compliance. The Water Quality Control Division then implements and enforces the policies established by the commission.

The division has historically tried to assist local governments in maintaining compliance or getting back into compliance when in violation. A policy adopted in 2003 recognizes that outright punishment through fining of water or wastewater utilities that do not have the financial means to achieve compliance only exacerbates the problem. The “Agency-Wide Policy on Settling Administrative and/or Civil Penalties Against Counties and Municipalities” recognizes that:

- public financing typically is more cumbersome than for regulated entities in the private sector;
- municipal functions can trigger large environmental obligations, which may overwhelm county or municipal tax bases; and
- despite noncompliance, some services provided by a county or municipality are essential and must often continue to operate (e.g., provision of water and sewer service).

The policy further directs that the division “should consider suspending or waiving a penalty based solely on inability to pay only when a county or municipality satisfactorily demonstrates that payment of any penalty would result in an inability to comply with, or perform, a remedial measure.” In addition, the policy directs that the division “should consider whether implementation of a supplemental environmental project … is an appropriate mechanism with which to resolve some, or all, of the administrative penalty.”

Recent additional regulations include standards for removal and disposal of radionuclides from drinking water systems and new ammonia standards for treatment of wastewater. Combined with existing enforcement related to aging infrastructure, the Water Quality Control Division is faced with having no ability to financially assist the local governments on which it will ultimately have to enforce new and existing regulations – local governments that are unable to come into compliance because of financial hardship and little or no affordable assistance from the state.

This reality lends itself to a perception that the climate in Colorado is moving away from assistance and more toward enforcement. Indeed, the effect is that the State of
Colorado – responsible along with local governments for the health, welfare and safety of Colorado citizens and the environment – will be potentially punishing disadvantaged local governments (and thereby their citizens) with compliance violations while providing no financial assistance to assist them coming back into compliance.

User fees: A potential additional burden

Local governments generally accept a shared responsibility in supporting the activities of CDPHE’s Water Quality Control Division. From the local perspective, the assumption of primacy by the State of Colorado over implementation of the Safe Drinking Water Act and the Clean Water Act means working with “local people,” as opposed to the Environmental Protection Agency. The relationship is important enough that the regulated community has accepted fees for various aspects of the permitting process. However, the state’s ever tightening fiscal situation has created a wave of fee increases and new fees to support the cost of running state programs in lieu of general fund support. The end result is still the same.

Prior to 2003, CML worked with the legislature to secure an approximately 40 percent increase in wastewater permit fees to assist the division meet increasing regulatory responsibilities passed along by the federal government. At that time, the drinking water program was completely supported by the general fund and federal dollars and no user fees existed.

With the recession of 2002, dramatic budget cuts were required for the legislature to balance the budget in the 2003 session. Cash funds were depleted, and many programs supported by the general fund were changed to fee-based support – including fees charged to the WQCD’s regulated community. The legislature eliminated nearly all general fund support for the division programs in the 2003-2004 budget year through SB 03-276. This legislation included an increase of another 67 percent for wastewater permit fees and, for the first time in Colorado, the establishment of a fee system for drinking water systems. Again, local governments, along with industry and agriculture, accepted these fees out of necessity but were successful in ensuring the legislation included a two-year sunset provision requiring the State of Colorado to resume the previous level of general fund support for its employees and programs.

In 2005, the fees sunset as planned but led to pressure from the Joint Budget Committee to find sources other than the state’s general fund to support necessary and programmatic increases in the division. CDPHE was unable to find a consensus solution in 2006, but was able to pass HB 07-1329 in the 2007 session, that reinstated drinking water fees, increased wastewater fees for a third time in seven years and instituted fees-for-service for site applications and design reviews. The fees-for-service have recently caused problems in some small communities because of the inflexible nature of the statute that fixed the cost for services, regardless of the time and effort that actually goes into providing the service. For example, in late 2007, the Town of Hudson was billed $20,281 for site application review on a $150,000 wastewater lagoon improvement – a review fee totaling 13.5 percent of the total project cost.

CDPHE has indicated a potential for more fee increases to fund additional FTE and programmatic expansion. While the Colorado Municipal League supports full funding of the WQCD, local governments already struggling to meet the fiscal requirements placed on them to maintain compliance through expensive upgrades driven by tighter standards should not be mandated to pay for the division’s employees and programmatic expenses when the state has not fully explored funding through the general fund or explaining to citizens why it does not have the funds to do so. The legislature does and should have the responsibility to support state programs through the state budget via the general fund rather than indirectly charging them to citizens through burdensome fees that are ultimately passed on by impacted local governments.

Clear solutions from the General Assembly

The General Assembly must guard against new programs, mandates or fee increases that will increase costs to local governments and ultimately the people of Colorado.

One, the State must establish a reliable, consistent and continuous grant program to assist the most disadvantaged communities in reducing the cost of projects enough to be able to finance the remainder. The price of delay is too significant to defer action.

Two, the legislature and CDPHE should not look to the regulated community to fund expansion of FTE and programs. The State of Colorado should be responsible for all new employees and programmatic expansion or for finding other sources of revenue if not general fund dollars. The study of funding options required by SB 03-276 established a multitude of water users and beneficiaries of clean water and safe drinking water that are not asked in any way to contribute to the costs of making the water clean and safe to drink. Also, the fees-for-service established by HB 07-1329 should be reassessed in light of the fact that the division is unable to adjust the cost based on the actual work being done. CML would further suggest that fee amounts should be capped or waived based on the relative wealth of the local government in instances when the community is financially disadvantaged.

CML will continue to work with CDPHE and the legislature to try to identify affordable funding for local governments, particularly those in greatest need, as well as defend local governments and their citizens from unnecessarily underwriting the state government through additional user fees.
FUNDING WATER AND WASTEWATER SYSTEM IMPROVEMENTS

In Colorado, there is a significant shortfall of affordable funding for cities, towns, and special districts that must complete significant improvements in order to maintain compliance with federal and state regulations and standards. Grant funds dedicated solely to water and wastewater project assistance are non-existent, and many entities have difficulty servicing debt on even low- or no-interest loans. Currently, there are only a handful of major government-based funding sources for improvement projects.

Energy and Mineral Impact Assistance Program

The Energy and Mineral Assistance Program in the Department of Local Affairs is available to fund planning, construction, and maintenance of public facilities and the provision of public services. Recipients must be political subdivisions socially or economically impacted by the development, processing or energy conversion of minerals and mineral fuels, which covers some but not all communities under 5000 population in Colorado and does not include public, not-for-profit water and wastewater systems.

Recently, the program was changed such that grants will be awarded in three different tiers.

• Tier I grants: $200,000 or less with expedited review
• Tier II grants: up to $2 million
• Tier III grants (under development): The goal is provide up to three grants per year up to $10 million if dollars are available. Implementation in 2009.

Loans may also be made through the program for domestic water treatment and distribution system improvements (not for raw water) at a rate of 5 percent for up to 20 years. There are three application deadlines throughout the year: April 1, Aug. 1, and Dec. 1.

In 2006, more than $22 million was awarded for local water and sewer projects, and in 2007 that amount was more than $33 million. Because of the recent surge in both severance tax revenues and financial needs of municipalities, approximately one-fifth of all requests to the fund are for water and sewer projects. If not for the ability of the grant program to assist impacted communities, the list of entities waiting for funding would be much larger. While the new tiered system for grants will significantly assist many communities, the Energy and Mineral Impact Assistance Grant Program must also fund many other types of infrastructure needs in impacted communities and cannot become a substitute for dedicated water and wastewater funding for any disadvantaged community.

Community Development Block Grants

Community Development Block Grants are another potential source of funding from the Department of Local Affairs for water, sewer and other public facilities projects. Eligible recipients are “non-entitlement” municipalities and counties. Special districts and private non-profit entities may be sub-recipients when a municipality or county is the applicant. The grants are limited to public facilities and services that primarily benefit low and moderate income persons, eliminate slum or blight, or address other urgent needs (needs of recent origin that present a serious and immediate threat to the public health or safety and for which there are no other funding sources).

The suggested maximum for the grants is $500,000. Approximately $3 million annually is available for water, sewer and other public facilities. The application deadline is December 1 and ongoing as funds permit. Projects are funded by CDBG are subject to federal environmental review, Davis-Bacon wage rates and other requirements.

Private activity bonds

Tax-exempt private activity bond allocations are available to municipalities and counties as well as issuing authorities. These entities can in turn issue bonds or other obligations to private entities with interest exempt from federal income taxation. Privately owned water, sewer, and certain waste disposal facilities are eligible for this funding. Local governments with populations greater than 27,000 receive a direct allocation. Local governments which do not receive a direct allocation may receive an allocation from the statewide balance. The statewide balance can be accessed through application to the Department of Local Affairs.

State Drinking Water & Domestic Wastewater Grants

These grants are funded by the Department of Public Health and Environment out of the state’s capital construction budget, although only one appropriation was made to the programs between 2002 and 2008. (The program is discussed significantly earlier in this document) The total amount available is not significant – $1.5 million total for each program – but is at least a source of some additional grant funding for areas with less than 5000 population.

Twenty-nine communities applied for the funding in 2006, requesting more $12 million. The division awarded grants ranging from $45,000 to $300,000 to 18 small communities. Projects included funding Homestead Improvement District’s consolidation with City of La Junta’s drinking water treatment facility, eliminating a community water source that was high in radionuclides, and funding wastewater treatment facility upgrades and replacing aging infrastructure in the Towns of Haxtun and Ordway.

The grants are available to governmental agencies, counties on behalf of unincorporated areas, and privately owned not-for-profit public water systems for the planning, design and construction of eligible projects. Applications for funding are due annually on Aug. 1, when money is available.

State revolving loan funds

The Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund are jointly administered by the Department of Public Health and Environment’s Water Quality Control Division, the Colorado Water Resources and Power Development Authority, and the Department of Local Affairs’ Division of Local Government. Each agency has a designated role in the funding process.

Drinking Water Revolving Fund and Water Pollution Control Revolving Fund

The DWRF and the WPCR are low-interest loan programs that will bring water systems into compliance or keep them in compliance with the Federal Safe Drinking Water Act and Clean Water Act. The funds can cover up to 100 percent of the eligible project costs with terms up to 20 years. There are two main types of loans out of each program and one special loan in each for communities with significant funding challenges. Leveraged loans are for projects
greater than $2 million and have interest rates that are 80 percent of market. The loan application deadlines are Feb. 1 and July 1 each year. Direct loans are for projects less than $2 million. The interest rate is set each December by the CWRPDA board and was 3.5 percent for 2008. There is no application deadline for direct loans. The Disadvantaged Community Program was recently created for communities under 5000 people in areas with median household incomes that are 80 percent or less than state average, using the 2000 Census. The interest rate for areas with MHI from 61 percent to 80 percent of the state average is 1.75 percent, and the rate for areas with MHI 60 percent or less is 0.0 percent. The maximum loan amount is $2 million.

Projects eligible for DWRF loans are treatment facilities, distribution/transmission lines, treated water storage, source water protection, water conservation (e.g., dual water lines), meters, and limited supply systems. In 2008, the fund has a loan capacity of $75-$80 million, and the loan demand is $25 million. Current drinking water needs statewide total $1.1 billion. Most of the aggregate project need exists in smaller communities, while the bulk of the total dollars needed exists in larger communities.

Projects eligible for WPCRF loans are wastewater treatment facilities, interceptor/ collection lines, bio-solid facilities, stormwater systems, re-use facilities and non-point source projects. The 2007 loan capacity is $30 million and the loan demand is around $60 million, continuing a trend of a shortfall in available wastewater loan funding. Of greater concern is the growing total statewide wastewater need – which totals $1.8 billion – in the context of annual appropriations to the WPCRF from the EPA that are declining rapidly and had been slated by the current administration to be eliminated by 2011.

**Pre-loan assistance Program**

Associated with both DWRF and WPCRF are $10,000 grants for both planning and design to help address requirements of the Revolving Loan Funds, such as preliminary engineering reports; technical, managerial, and financial assessments (drinking water); environmental assessments; plans and specifications; and legal fees associated with an entity capable of receiving revolving fund assistance. Entities must be on the eligibility list, under 10,000 population, and either a median household income lower than the state average or current or projected user charges for water or sewer greater than the statewide average. $100,000 total is available each year in both the DWRF and WPCRF.

**Water Quality Improvement Fund**

HB 06-1337 created the fund, administered by the Water Quality Control Division, to credit fines and penalties for violations of the Colorado Water Quality Control Act to the fund to be used for the following purposes:

- improving water quality in the community or water body impacted by the violation;
- design, construction or upgrades of domestic wastewater treatment plants;
- grants for stormwater projects; and
- non-federal match for Nonpoint Source Grants.

HB06-1337 established a fund for addressing various water quality issues, including providing grants for stormwater projects, designing, construction, or upgrades of domestic wastewater treatment plants, and non-point source projects. The Fund consists of penalties collected as a result of violations in accordance with the Colorado Water Quality Control Act. To date, the fund has received some penalty money. No grants have been given to date.

**Water Revenue Bond Program**

Administered by the Colorado Water Resources and Power Development Authority, the Water Revenue Bond Program may be used to fund water and wastewater treatment plants, pump stations, dams/reservoirs, water rights, pipelines, wells, meters, reuse and storage tanks, including facilities for streamflow improvements, and for stabilization of stream and river banks. Loans are in the range of $300,000 to $500,000, and the cost of issuance of the bond up to $150,000 and other associated costs are currently covered by the CWRPDA. Terms are usually 20 or fewer years, but may be longer, and the interest rate is based on the market rate for AAA-insured revenue bonds.

**Water Project Loan Program**

Since 1971, the CWCB Water Project Loan Program provides low-interest loans to agricultural, municipal and commercial borrowers for the development of raw water resource projects in Colorado. Eligible projects for financing include new construction or rehabilitation of existing raw water storage and delivery facilities, such as:

- Reservoirs
- Ditches and canals
- Pipelines
- Diversion structures
- Groundwater wells
- Water rights purchases
- Flood control projects

CWCB can finance up to 90 percent of the total project costs, including engineering and construction, for a term of up to 30 years. A Loan Feasibility Study is required and must include the technical, financial, and institutional feasibility of the project. Rates for municipalities range from 3.5 percent to 4.5 percent. Rates are reduced by 0.25 percent for 20-year loans and 0.5 percent for 10-year loans, and 1.0 percent service fee applies to all loans. Other conditions apply. Applications for loans under $5 million are accepted at any time, and the deadline for loans greater than $5 million is Aug. 31 in order to receive funds by the following July.

**USDA-Rural Development**

USDA-RD is another source of funding for which many communities are eligible. Depending on the nature of annual Congressional appropriations, USDA-RD can provide grant and loan assistance for water and wastewater projects. The Colorado office of the USDA-RD works very closely with the state agencies that provide funding, in order to coordinate assistance with local governments.

A comprehensive list of the various programs that can give grant and loan money to local governments can be found on the Department of Local Affairs Web site. The document is located at www.dola.state.co.us/dig/ta/utility/docs/available_financial_assistance.pdf.
WATER CONSERVATION PLAN MANDATE

Starting June 4, 1996, governmental agencies using more than 2,000 acre-feet of water per year and contemplating a loan through the Colorado Water Resources and Power Development Authority are required to have adopted a water conservation plan as defined by 37-60-126 C.R.S.

The legislature amended the statute with the Water Conservation Act of 2004. The act expanded the duties of the Office of Water Conservation and Drought Planning, amended the list of plan elements to be considered, and mandated that no CWCB or CWRPDA loans or grants could be distributed until an approved plan was on file with the state. However, the act provided little money to pay for the mandate imposed.

More recent legislation has provided planning assistance dollars, but there are still variations in the interpretation of the requirements of the act. In addition, 2008 legislation now requires that a filed plan not just consider each of the required water conservation elements for the plan, but rather include a full evaluation of each plan element.

CONCLUSION

A steady increase over time in the number of water and wastewater standards and mandates, coupled with the need to replace aging infrastructure, is creating a significant current and anticipated future fiscal burden on cities and towns in Colorado, as well as special districts that serve many municipalities. This need is most prevalent in Colorado’s small communities.

This paper is meant for use by state and municipal officials to better understand regulatory factors and potential funding sources for water and wastewater projects. This understanding is necessary to better comprehend the scope of the shortage of affordable funding that already exists. Beginning a dialogue now with constituents, the press, state legislators, and fellow local officials about water/wastewater project funding issues at the local and state levels will be a key factor in a cooperative state and local efforts toward cleaner, safer water.