ALTERNATIVE REVENUE SOURCES AVAILABLE TO THE CITY OF FORT WAYNE TO FINANCE THE COMBINED SEWER OVERFLOW LONG-TERM CONTROL PLAN

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October 17, 2008

Introduction

Over the past approximately four months the Clean Rivers Task Force has been discussing alternative methods for financing the projects and activities set forth in the City of Fort Wayne's Combined Sewer Overflow Long-Term Control Plan (LTCP) and its Consent Decree with the U.S. Department of Justice and the U.S. Environmental Protection Agency (EPA). This document is intended to lay out those concepts that have been examined by the Task Force. In addition, several members of the Task Force have explored other alternatives with members of the City staff during other meetings. This paper offers some explanation and commentary on these suggested financing alternatives along with additional potential methods which have not otherwise been explored. The views and opinions presented herein are those of the author and do not represent the views, opinions and recommendations of the members of the Task Force or of the City of Fort Wayne.

The sole purpose of this paper is to facilitate a more organized discussion among the members of the Task Force as they move toward fulfilling the charge to make recommendations for financing CSO improvements as set forth by Mayor Henry. It is recognized that the recommendations of the Task Force will be those of its membership. It is further recognized that final decisions on how to finance the approximately $240 million (2005 dollars) in Combined Sewer Overflow (CSO)-related improvements will be made by the current and future City Administrations, Fort Wayne Boards of Public Works, and Fort Wayne Common Councils.

Sewer User Fees

The City of Fort Wayne has historically used revenue from monthly fees paid by the sanitary sewer customers – residential, commercial, industrial and institutional – to finance both the operating and capital needs of the Sewer Utility. Revenues from direct customers have been supplemented by revenues from several wholesale contract customers of the Utility (generally other public sanitary sewer collection systems that have connected to the Fort Wayne systems for treatment of their effluent) and other related sources such as area connection fees, and, to a lesser extent, federal grants.

Fort Wayne's sewer rates are governed by the Board of Public Works and the Fort Wayne City Council. User fee rates for Indiana municipal sewer systems are not subject to review by the Indiana Utility Regulatory Commission.

During the negotiations with the Department of Justice and the EPA, an underlying assumption was that Sewer Utility user fees would be the primary, if not exclusive, source of revenue to finance the agreed upon plan, similar to other cities under Federal Consent Decrees. In fact, a significant component of the settlement process was the rate impact relative to median household income for residential sewer customers. Those portions of the Long-Term Control Plan which have already been financed have relied upon sewer user fees as the principal source of revenue to either pay for these improvements in cash or to retire bonds and loans issued to provide up-front cash for the improvements, and pay the interest thereon.

There are several reasons favoring the continued use of sewer user fees as the primary source of revenue to pay for the remainder of the Long-Term Control Plan:

> *There is a direct relationship between the customers of the Utility and the fee-based method of revenue collection. This method offers the greatest degree of ability for the funder (customer) to regulate their use of the function (sewer system usage) of any alternative method.
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> *Unlike a revenue stream tied to the municipal corporate limits of Fort Wayne, sewer customers are directly related to the geographic boundaries of the Utility. Not all properties within the City of Fort Wayne are connected to the Fort Wayne sewer system and many connected customers are located beyond the corporate limits.
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> *Citizens here and throughout the United States have generally been more supportive of user fees than general taxes to finance those local government activities where the user of a given service can be specifically identified and to whom a charge can be directly tied. The concept of knowing the specific service/s toward which our money is being applied appeals to many citizens.

There are also several reasons that it makes sense to seek alternative financing mechanisms to offset or replace user fees:

> *The overriding objective of the federal policy mandating CSO reductions is to reduce pollution in our rivers, lakes and streams. The ultimate beneficiaries of this policy are all citizens, certainly many whom fall well beyond the direct customer base of the Fort Wayne Sewer Utility. Under this “benefits received” principle it would make sense for a broader-based, more generalized form of taxation to be utilized for at least a portion of the costs associated with implementing this policy objective.
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> *User fees are generally a regressive form of raising public revenue – households with lower incomes will generally pay a higher percentage of their total income from sewer fees than will a higher income household. Documentation provided to EPA in the Affordability Analysis prepared during the Consent Decree

negotiations illustrated that placing the full burden of financing the LTCP on sewer users would result in many lower-income households paying upwards of five percent of their annual incomes in sewer fees.

*Raising sewer rates on business customers to an extent that rates are appreciably higher than in other geographic areas/communities will tend to reduce Fort Wayne's economic competitiveness. The fact that EPA has adopted a strategy of enforcing the CSO provisions of the Clean Water Act on larger municipalities first is an inherently anti-urban policy (author's opinion). Because the Fort Wayne urbanized area remains significantly dependent on industrial activity as a key component of it basic sector economy, higher than average sewer rates will make it harder to both retain and to attract such employers.

*Negotiations with wholesale contract customers will be difficult. Each tends to believe that CSOs are a Fort Wayne "problem" that they should not have to finance. While there are several reasons why this issue is more complex than such a perspective asserts, determining the appropriate cost allocation will be difficult.

Historically, the Fort Wayne Sewer Utility has had a generally uniform sewer rate structure. Customers paid the same rate regardless of location, although there is some in-City, out-of City differential. It might be possible to add a surcharge to the customers in the Combined Sewer Area to assist in financing the CSO improvements. However, such a policy would also increase the financial burden on the most impacted lower-income population in our community and could undermine redevelopment efforts within the urban core. Conversely, in may be possible to restructure rates to add a differential for the distance in transporting effluent to the sewage treatment plant. This policy would place more of the burden of financing the system on newer, more suburban customers. However, such a policy might drive potential new customers into areas served by other sewer utilities.

Another consideration related to the use of sewer user fees concerns a broadening of the current customer base. While there is continuous change in the customer base caused by new development in some areas, loss of development in other areas (primarily due to housing and population loss in older parts of the community), and evolving change in the commercial and industrial components of the base; it may also be possible to expand the territory of the Fort Wayne Sewer Utility through the acquisition of the Aqua Indiana assts in the southwest portion of the community. This is a matter that has previously received some public discussion. It should be noted, however, that this service territory is primarily located in a separate watershed from much of the current Fort Wayne Sewer Utility service territory and is presently being served by a collection and treatment that is not directly related to the combined sewer overflow issues pertinent to the events leading to the settlement of the Consent Decree.

The principal use of sewer fees as the primary means to finance the CSO Long-Term Control Plan, along with all other financial needs of the Sewer Utility, is clearly the “default” method. It is the method we, as a community, are most familiar with; it is the method that the state and federal regulators expect (but do not require) that we utilize; and it is the method that most closely represents the “benefits received” principle that is seems to be most in vogue with constituents. But it is certainly not the only game in town.

Property Taxes

Indiana Code (I.C. 36-9-6) identifies the construction and operation of a sanitary sewer system as a permissible use of property taxes. More specifically, property taxes may be used fund sewer system improvements through a Cumulative Capital Building Fund for Municipal Sewers (I.C. 36-9-26) and a Municipal Cumulative Capital Development Fund (I.C. 36-9-15.5). Perhaps most importantly, the Municipal Cumulative Capital Development Fund has a rate-controlled property tax levy that is outside the maximum controlled levy for the City of Fort Wayne. The City has not, to date, chosen to implement the Cumulative Capital Development Fund.

Property taxes have, however, become an increasingly unpopular method for financing local government activities. The Indiana General Assembly’s recent enactment of HEA 1001 (2008), which included many provisions to reduce property taxes, is but one of several recent manifestations of this unpopularity. In addition, the geographic boundaries of the City of Fort Wayne (the tax base for its Cumulative Capital Development Fund should the City implement one) are substantially different than the geographic boundaries of the Sewer Utility service territory. As is the case with any form of taxation, the property tax does not uniformly impact all segments of the community. Lastly, if the City of Fort Wayne’s property tax rate is substantially higher than that of competing communities or immediately surrounding areas, it will tend to drive away current and prospective economic development opportunities.

Income Taxes

Local income taxes in Indiana are adopted on a county-by-county basis. Allen County currently has a local income tax rate of 1.0% of individual adjusted gross income (0.6% rate for the County Option Income Tax – COIT and 0.4% rate for the County Economic Development Income Tax – CEDIT). This is the maximum combined rate for these two taxes allowed by Indiana law. Countywide this combination raises approximately $70 million annually, with the City of Fort Wayne receiving approximately $34 million in local income tax revenue in 2008. These funds currently support basic city operational functions such as police protection, public infrastructure projects, economic development activities, and debt retirement for a variety of capital improvements. It is unlikely that significant amount of current income tax revenue could be diverted from these uses to support LTCP projects (author’s opinion).

In 2007, the Indiana General Assembly enacted a new type of income tax – the Local Option Income Tax or LOIT. This new variation of the income tax can be adopted at the countywide level to support several forms of property tax relief and, under certain circumstances, to increase funding for a variety of public safety-related purposes. To date, Allen County has not chosen to enact any of the LOIT provisions.

Local income tax decisions in Allen County are made by the Allen County Income Tax Council. The City of Fort Wayne Common Council currently holds the majority of votes in this Income Tax Council, and thus has the ultimate decision-making authority on local income tax matters. It should be noted that some officials in Allen County government would like to see this authority shift to the Allen County Council and may seek a legislative change toward that end.

It was primarily the City of Indianapolis that successfully urged the Indiana General Assembly to allow new income tax funding for public safety functions. One potential avenue available to Indiana CSO communities would be to lobby the General Assembly to similarly allow a specific use of new local income taxes (LOIT) for financing of CSO-related improvements. The current maximum LOIT rate for public safety is 0.25% (it is 0.5% in Marion County only). Countywide, a 0.25% income tax rate would raise approximately $17.5 million in Allen County.

<u>Sales Taxes</u>

Indiana law does not now, nor has it ever, allowed for a local general sales tax. The Indiana General Assembly has effectively reserved the general sales tax as a primary source of state revenue. The Indiana sales tax rate is currently at seven percent, higher than any surrounding state's rate. The rate was increased by 1.0% effective oin April 1, 2008 to assist in funding some of the property tax relief measures contained in HEA 1001.

However unlikely (author's opinion), a 0.5% general sales tax implemented and retained locally in Allen County could raise approximately $240 million over a thirty year period (this is a very rough estimate due to the lack of good county-specific data on state sales tax revenues). Generally, local governments in urban counties (retail centers) have encouraged the General Assembly to permit a local option sales tax and those from rural counties (whose residents are more likely to make purchases out-of-county) have opposed such efforts.

Indiana law does allow for limited local sales taxes such as a Food and Beverage Tax and an Innkeepers Tax. Allen County has both the former at 1.0% and the latter at a 7.0% rate. Recent legislation enacted to finance the Lucas Oil Stadium in Indianapolis permitted Marion and surrounding counties to raise the local Food and Beverage Tax to 2.0%, with eligible local counties outside of Marion County to keep a portion of the new revenue. A 1.0% Food and Beverage Tax increase would raise approximately $5 million annually in Allen County.

Both the local option income and sales taxes would likely be required to be adopted at the countywide level and thus many non-sewer customers would be subject to these taxes.

The local enacting authority for the two local limited sales taxes in place in Allen County has been the Allen County Council.

Federal Grants-in-Aid

When the Clean Water Act was first enacted in 1972, Congress also implemented a substantial grant-in-aid program to assist local governments in upgrading their municipal sewage collection and treatment facilities. The City of Fort Wayne benefited greatly from these grants. Over time, however, federal financial constraints and changing priorities ended these general grant-in-aid programs for sewer systems. They were replaced by federal funds provided to states to assist in capitalizing state revolving fund load programs (SRFs) to be accessed by local governments for financing sewer–related projects. While these programs have been helpful, there is a substantial difference between a grant to assist financing a project and a loan (even at a very low interest rate).

As the number of U.S. communities financially impacted by the CSO issue grows, perhaps they collectively will be able to place enough pressure on Congress to establish a new CSO grant-in-aid program at some level of financial significance. However, given the current federal budget deficit position, and the more recent general financial crisis, any such relief will likely be very hard to achieve. Seeking continued, and perhaps increased, support for capitalizing state revolving loan funds may be a more realistic collective municipal strategy. More immediately, should a second economic stimulus program move forward in Congress, funding for capital-intensive sewer projects might be a logical included use of such funds.

One active federal grant program currently being explored by the City as a modest source of capital funds for the LTCP is the State and Tribal Assistance Grant program through the U.S. Environmental Protection Agency. It may be possible to obtain annual grants from this program in the $500,000 to $1,000,000 range. For more information on this grant program please reference www.epa.gov/compliance/state/grants/stag/index.html.

The other approach to obtaining federal funding for CSO implementation is to aggressively seek project-specific earmarks. The City of Fort Wayne was the benefactor of such an approach with the federal grant awarded for the Camp Scott wetlands/stormwater management/sewer separation project. While this approach may provide some limited assistance, it is unlikely that it can support a significant portion of the total CSO Long-Term Control Plan cost (author's opinion).

State Assistance

There are over one-hundred CSO communities located in the State of Indiana. As more and more of these communities face implementation deadlines mandated by EPA and the Indiana Department of Environmental Management, it is very likely that pressure will grow for the General Assembly to provide some kind of financial assistance. This assistance could come through either additional state appropriations to the State Revolving Fund for sewer projects or the enactment of a new state-funded CSO grant-in-aid program. However, the state recently took on substantial new responsibilities for funding traditional local government activities (the remainder of school operating budgets, county child welfare funds and juvenile incarceration costs, and municipal police and fire pension obligations). There is some practical limit to how much more assistance the state can give to local governments before being required to find additional revenue sources. Further, it is questionable if they would raise state tax rates to fund what many legislators view as primarily a local responsibility (author's opinion).

<u>Stormwater Fees</u>

The sewer overflow events in Fort Wayne's combined sewer area are the direct result of heavy rainfall overwhelming the system. Such events are an issue for both the sanitary and stormwater utilities. For the past decade plus, the operating and capital costs associated with the Stormwater Utility have primarily been financed through a stormwater fee assessed on impervious surfaces throughout the City of Fort Wayne. While there is certainly logic in having the Stormwater Utility share some of the CSO financial burden, the geographic service territory of this utility is coterminous with the City, not the combined sewer area or the sewer utility service area. Significant opposition would likely generate from those areas within the City that are subject to the stormwater utility fee but are served by Aqua Indiana or are on private septic systems.

<u>Sale of Assets</u>

The City of Fort Wayne does own several income-producing assets that could be sold or leased to raise revenue which, in turn, could be allocated to funding CSO improvements. The lease of the Fort Wayne Electric Utility in the mid-1970s was an example of such an action. Both the Sewer and Water Utilities represent potential opportunities. Given the growing list of federal environmental mandates and requirements being placed on sanitary sewer systems (CSO measures being just one example), the market interest in sewer systems has waned in recent years. Water utilities, however, have retained more favorable interest given their significant revenue generating ability.

Certainly leasing or selling such assets can generate considerable political controversy. The elected City officials would lose all or substantial control over rates; utilities are a primary mechanism for municipalities to retain some control over their geographic destiny; and many citizens believe these utilities are a core function of municipal government. The sale or lease of such assets would be an is extremely complicated endeavor. Should the City seek to explore such a venture, it would be wise to obtain the best professional assistance possible.

<u>Community Trust Fund</u>

When the City of Fort Wayne leased its Electric Utility in 1975, it concurrently established the Community Trust Fund. $270,000 of the lease revenue the City received from I & M was annually placed into the Trust. Ostensibly at the end of the 35-year lease the corpus of the Trust would be available to either purchase the assets necessary for the

City to re-establish its Electric Utility or to have a fund of a magnitude such that the annual interest earnings would approximate the prior lease revenue (now about $1,700,000 annually).

The Trust is to remain without permanent invasion (unless approved by the City Council after an advisory citizens' referendum) until the expiration of the lease of the Electric Utility in 2010. At that time the use of the entire corpus of the Trust will be under control of the Mayor and the City Council. The balance of the Trust was approximately $33.4 million at the end of June, 2008. Obviously, current financial events on Wall Street have subsequently eroded this value. It would be very difficult to currently estimate what the value of the Trust will be 2010. Whatever the amount, however, those funds could be applied to funding CSO projects or the Trust could continue to be invested and the interest earnings could be applied to CSO activities. It must be noted that the possibilities for use of the Community Trust Fund are nearly endless. Mayor Henry has committed to a communitywide dialog on the future use of these funds before any commitments are made. It should be further noted that the current lease with Indiana Michigan Power is being negotiated, and funding some CSO projects could be taken from potential future lease revenues.

Gaming Revenues

In 1988, the voters of Indiana, through a referendum, approved state run gaming. The Hoosier Lottery was initiated soon thereafter. There has been a rather continual increase in the scope of state-approved gaming since that time – the lottery, riverboat casinos, wagering at Indiana horse tracks, off-track betting, "racinos", and pull-tabs. In each case, state government has taken a share of the proceeds or established a fee to operate such activities. These revenues have, in turn, supported a variety of state-funded activities. In certain cases local governments, particularly in host communities, receive a share of these proceeds.

Gaming revenue offers several potential funding alternatives to finance CSO improvements including: reallocating all or a portion of the approximately $1.5 million the City of Fort Wayne receives annually from the local revenue sharing component of the Riverboat Wagering Tax (such a reallocation would, of course, have to be taken at the expense of the Civil City's General Fund); a modest expansion of gambling opportunities at the Allen County Off-Track Betting facility (Allen County currently has one off-track betting facility); seeking a relocation of one of the eleven state-authorized riverboat casinos to Fort Wayne; or seeking new authority for a land-based casino in Allen County.

The expansion of gaming venues and opportunities is not without controversy. While many elected officials disdain such activities, gaming continues to represent an expanding source of revenue for state-funded activities. The specific amount of revenue each alternative might generate for local government activities is very dependent on the specifics related to each situation. The Riverboat casinos have, for example, provided substantial annual revenue to their host communities. There is, however, some indication that gaming is not an endless source of funding. As opportunities to gamble grow in both

Indiana and our surrounding states, there is evidence that we are beginning to see a leveling of revenue potential. The potential for state approval of any additional gaming venue authority is also just a gamble.

Concluding Comments

A substantial portion of the funds used to implement the Long-Term Control Plan will be directly obtained from a series of bond issues likely to be retired through one or more of the revenue streams outlined above. There are several important policy matters associated with issuing debt, including the balancing of higher total interest paid with lower annual debt service payments gained by extending the term of the bonds. Debt management of the financing of the Long-Term Control Plan must also be integrated with other debt policies for both the Sewer Utility and the City of Fort Wayne. In addition, there are always substantial technical matters related to vehicles used to obtain the lowest possible interest rates on such debt. However, the most fundamental issue is what is the most appropriate source or sources of revenue used to retire this debt. This paper concentrates on that question, but certainly recognizes that subsequent Task Force discussions may also explore debt management policies relevant to financing the LTCP.

Without question, the above ten basic alternatives do not exhaust all possibilities. There are surely many possible variations on these themes. It is quite possible that the best solution is represented by a combination of such alternatives. It is hoped that this paper can serve as a meaningful foundation for consideration of a recommendation to the Mayor from the Clean Rivers Task Force.