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Propositions 1&2: Their Impact on Texas

Following last November's elections, headlines of Texas newspapers trumpeted the good news: "Voters Pass Water Package."

Now, almost a year later, many Texans are still waiting to see results from their approval of the \$1.69 billion constitutional amendments.

Implementation of the bill-technically Proposition 1 and Proposition 2-has been slow. The Texas Department of Water Resources (TDWR) has been reorganized into the Texas Water Commission (TWC)

and the Texas Water Development Board (TWDB), so new roles have been assigned to new agencies. Federal tax reform has put new bond sales on hold. Economic uncertainties in agriculture have made producers cautious about new investments in irrigation.

Some progress, however, has been made. Rules for loan and grant programs authorized by the bill have been drawn up. Grants have been awarded to irrigation and soil and water conservation districts. Loan applications are being accepted, reviewed, and in some cases approved. Studies of "critical" groundwater areas, mandated by the legislation, have begun. In the near future, expanded efforts to study bays and estuaries are expected to begin.

The impact of the propositions, which authorized a series of water projects specified by House Bill 2, is just now beginning to be realized. One thing is certain-the wheels have been set in motion to put the new water package to work.

BACKGROUND

The genesis of House Bill 2 began soon after voters rejected Proposition 4 in 1981 by a 57 to 43 percent vote. (That proposition would have committed one half of the state's surplus revenues to the financing of water projects). In fact, many of the basic elements

of House Bill 2 were drafted during the preceding legislative session but died in committee, casualties of political infighting. To survive, House Bill 2 became a compromise measure designed to appeal to the varied water interests of specific voting groups around the state.

Whatever the reasons, the package passed by a convincing margin. Proposition 1, which contained funding for water supply and water quality projects, received 74 percent of voter approval. Proposition 2, which conditionally established a \$200 million agricultural water conservation program, passed with 69 percent of the vote.

FINANCIAL PROVISIONS

The easiest way to understand financial aspects of the amendments is to break them into their component parts (see Components of House Bill 2). Proposition 1 gives the state the authority to issue up to \$190 million in bond revenues for both water supply and water quality projects, as well as \$200 million for flood control projects. Additionally, the state can participate in reservoirs and in regional sewer and water systems and can issue up to \$500 million (\$250 million of bonds leveraged at a 2-to-1 ratio) in state bond insurance. As previously stated, Proposition 2 authorizes \$200 million for an agricultural water conservation program. Implementation of the program, however, depends on the success of two projects currently under way: a \$5 million pilot loan program for agricultural water conservation and a \$10 million agricultural trust fund, both set in motion by House Bill 2.

Proposition 1 provided additional sources of funding for some existing programs. At the time the amendment was approved, roughly \$80 million was still available in the Water Development Fund from the \$600 million that had been authorized through previous elections and bond sales. TWDB officials estimated that supply would have lasted through 1987.

Despite the fact that some monies from previous bond issues remained, state projections show the need for new bond sales. TWDB, the agency that administers the loan and grant programs authorized by the propositions, estimates that \$1.48 billion of projects will be needed by 1989. By 2005 that figure will soar to a staggering \$26.1 billion (see Water Projects Needed in Texas).

Even though Proposition 1 only authorizes \$1.48 billion, this package will still be a plus for smaller communities with poor credit ratings. Larger municipalities throughout the state, which account for many water projects TWDB estimates will be needed in the short-term future, often finance projects through local bond issues without state support. These municipalities usually won't tap into the funding authorized by Proposition 1.

Smaller communities, however, might be unable to fund projects without legislation such as Proposition 1, particularly in light of declining federal support. Bond sales authorized by Proposition 1 will result in lower interest rates for borrowers because of state participation. In addition, TWDB generally sells bonds at a "AAA" interest rate, the best

rate available.

Water supply projects authorized by Proposition 1 include surface water reservoirs, conveyance facilities, storage tanks, water treatment plants, and additional water wells. Water quality projects could entail water and wastewater treatment plants and sewer systems.

State assistance in flood control is a new endeavor made possible by the passage of Proposition 1. Monies can be used for developing floodplain management plans, constructing drainage projects, conducting watershed studies, enlarging stream channels, modifying or reconstructing bridges, and relocating buildings located in floodplains.

CONSERVATION MANDATED

In addition to making more funding available, the amendment also alters conditions that must be met before applicants can receive state financial assistance. Water conservation plans are now mandatory for most recipients of TWDB loans. The plans can involve public information and education, tightened plumbing codes, leak detection and repair, drought contingency planning, water conservation landscaping, water recycling and reuse, and rate structures that encourage conservation. The only exceptions would be 1) if the applicant requests less than \$500,000, 2) if TWDB determines that an emergency exists, or 3) if the applicant already has an ongoing water conservation program.

Another major change brought about by passage of Proposition 1 is expansion of the "hardship rule." In the past, this standard stipulated that only those political subdivisions unable to sell bonds in the open market at reasonable interest rates could receive TWDB loans. The amendment provides that the "hardship" criterion will no longer be the sole factor in determining loans for regional water treatment, wastewater treatment, or flood control loans. Among factors TWDB now considers when making these types of loans are 1) the needs and benefits of the project to the area served, 2) the ability of the lender to repay the loan, 3) the "hardship" criterion, and 4) the relationship of the project to overall statewide water needs and the state water plan. The traditional hardship criterion will be retained, however, for \$380 million of TWDB loans.

The state will also be able to insure local bonds for water projects under Proposition 1. In the event of default on the part of local governments, the state would assist in repaying outstanding principal and interest on water bonds or other obligations.

It's too early to tell the speed at which TWDB will make these revenue sources available. It's also premature to estimate what the demand will be from agencies wishing to borrow from the expanded funds. As of mid-July, TWDB had authorized the sale of \$50 million in bonds created by the passage of Proposition 1: \$25 million for flood control projects and another \$25 million for state participation in regional water and wastewater projects.

Two projects have been approved under the new program, a \$22.8 million dam and reservoir by the Palo Duro River Authority and an \$8.25 million regional water treatment

facility by the Cameron County Fresh Water Supply District No. 1. Five applications for loans under the new program have also been received. None of the money, however, has yet reached local governments.

AGRICULTURAL CONSERVATION

House Bill 2 transferred \$15 million from the Water Assistance Fund and authorized two agricultural programs: 1) a two-year \$5 million pilot program of loans for the purchase of water-efficient irrigation equipment, and 2) a \$10 million agricultural trust fund to provide grants for specific water-saving projects to measure irrigation efficiency, on-farm technical assistance, and research.

Loans from the initial pilot program will be made through the end of 1987. TWDB officials will report to the legislature on the success of the pilot program, which will then determine its fate. If the pilot program receives a two-thirds favorable vote, Proposition 2 would be implemented, authorizing as much as \$200 million of additional loan money. (Other options would be to authorize a lesser amount or discontinue the program.) Bond sales to finance the program would have to be finalized by November 1989.

The loan program functions this way. TWDB can loan monies from the Agricultural Soil and Water Conservation Trust Fund to underground water conservation districts and soil and water conservation districts. (Multiple-county districts can borrow as much as \$1 million at a time, while single-county districts are limited to \$300,000. Monies not loaned by the districts after 120 days must be returned to TWDB.) The districts can then act as bankers, loaning the money to producers in their regions at low-interest (currently 6.75 percent) rates.

In addition, districts can tack on fees for administering loans. The High Plains Underground Water Conservation District No. 1 in Lubbock (High Plains District), recently received a \$1 million loan, TWDB's first and only loan through the program so far. That district is charging borrowers a 2.5 percent processing fee in addition to TWDB's interest charges. Still, loans through the program are two to three percentage points lower than those available through commercial banks.

Other TWDB loan rules also need to be mentioned. TWDB has specified items for irrigation application and distribution systems that are eligible in the loan program. LEPA sprinkler systems, furrow dikers, and drip irrigation systems are all acceptable. Second, TWDB loans to individual farmers can cover 80 percent of the cost of water-conserving irrigation equipment but only 50 percent of the labor costs to install the equipment. Finally, loan funds can be used only on land that has been irrigated during at least two of the previous six years.

In addition to TWDB, individual districts can also create rules. The High Plains District, for example, specifies that if the loan is for the purchase of permanent equipment, all the land where the equipment will be operated must be within the district's boundaries. To

loan money for portable equipment purchases, at least half the land where the equipment will be used must be within the area served by the district.

PAYBACK PROVISION

One of the most controversial features of the loan program (and one that has prevented other districts from taking part) is the payback provision in case of default. TWDB rules state that if a farmer borrows money under this program but cannot repay his loan, the district is given the authority to repossess and liquidate the collateral. The High Plains District has also put liens on land and other assets owned by producers who make loans. The net loss after liquidation is absorbed by both the district making the loan and TWDB on a 50-50 basis.

Soil and water conservation districts illustrate the quandary the payback provision has created for many would-be lenders. These districts, most of which are single-county, receive their only income from state appropriations (and what they do get is usually less than \$5,000). If they make conservative loans of \$100,000 and half their borrowers default, the districts would be responsible for losses that far exceed their annual budgets.

Efforts are being pursued to diminish the negative consequences of this default clause. The High Plains District, for example, has invested \$100,000 of its own funds in a high-interest certificate of deposit and has designated that money for the purpose of "default insurance."

For the soil and water conservation districts, one promising idea is to obtain letters of credit from local banks guaranteeing that the loans can and will be repaid. TWDB officials have said that letters of credit covering the life of the loan would be allowable in this program. Additional loan applications are expected at TWDB's August meeting from districts that may use the letter of credit plan. Banks may be unwilling to issue long-term letters of credit, however. One suggestion is to have the letter of credit cover only the amount owed on the loan for the TWDB program. The letter of credit might be good for all \$80,000 of a loan for an irrigation system in the first year, but in following years its value would drop as the loan was repaid.

The other agricultural water conservation programs, financed by the agricultural trust fund, have so far received more interest from participants than has the loan program. The trust fund initially is a \$10 million interest-bearing account. Half of the interest earned, roughly \$600,000 over the next two years, goes back into the fund, so that it will gradually increase. The other half is being equally divided between TWDB, the State Soil and Water Conservation Board (SSWCB), and The Texas Agricultural Experiment Station (TAES), the agricultural research unit of The Texas A&M University System. Senate Bill 249 designated TAES, TWDB, and SSWCB to receive monies from the fund this biennium. The legislature will decide how monies are divided in future sessions.

Each of the three agencies is using its share of the trust fund to activate key projects. TWDB, for example, is using its portion of the grant money to provide grants to districts

to monitor irrigation efficiency. So far, the High Plains District, the Maverick County Water Conservation and Improvement District, the Wharton County Soil and Water Conservation District, and the Brazos-Robertson and Lee-Burleson Soil and Water Conservation districts have received grant funds. The grant money will be used to upgrade field laboratories, to provide additional testing equipment, and to measure flows of irrigation water in canals. Grants from TWDB will cover up to 75 percent of the cost of equipment used to monitor irrigation efficiency.

The SSWCB program is aimed at putting technicians in the field to work with individual farmers on a one-to-one basis. These workers will advise irrigators on ways to reduce runoff, will help plan irrigation systems and strategies, and will give site-specific advice on water harvesting and soil and water conservation. The additional technicians will supplement SSWCB's existing staff in 49 soil and water conservation districts, and funds have been allocated for additional technicians in those service areas. Although 20 of these districts are in the High Plains, assistance will be statewide.

Research will be the emphasis of TAES programs, accelerating specific aspects of ongoing programs in irrigation water management and water conservation.

Time is one of the main constraints to the agricultural programs. TWDB has to submit an initial report on the pilot loan and grant program to the legislature by the end of 1986 and a follow-up review at the end of 1988. This timetable only gives TWDB slightly more than a full growing season to disburse \$5 million. Widespread participation in the program, both by farmers and irrigation districts, will be an essential element in judging its success.

MANAGEMENT ASPECTS

Although a large part of Proposition 1 dealt with financing water projects, two key areas of the legislation concerned water management.

Proposition 1 authorized the Texas Department of Water Resources to create a committee to study groundwater-using areas. TDWR could determine "critical" areas where groundwater supplies or quality were threatened and could call for an election to create groundwater districts. (Before Proposition 1, the only way to create an underground water conservation district was to have citizens petition that a district be formed.)

Due to another piece of legislation passed during the last session, a snag has developed. Senate Bill 249 divided TDWR into TWDB and TWC. It wasn't entirely clear in either bill which of the new agencies was charged with administering this portion of Proposition 1. Negotiations are underway between TWC and TWDB to determine which role each agency will take in this process.

In the meantime, TWC has created a Groundwater Conservation Section as part of its Water Rights and Uses Division. That new unit has already identified several critical groundwater areas (see map). In the fall TWC will hold hearings in as many as 10 of

these areas to discuss groundwater problems and solutions. Following the hearings, advisory committees may be created, district boundaries prepared, and after a vote districts may be formed. If the voters veto the idea, a district would not be created. However, political subdivisions in the area would be ineligible to receive TWDB assistance.

Freshwater inflow to bays and estuaries will also be protected as future reservoirs are constructed near the Gulf Coast. Proposition 1 set apart 5 percent of yields from new reservoirs built with state financial assistance within 200 river miles of the Gulf Coast to guarantee freshwater inflow to bays and estuaries. Inflows lower salinities and enhance conditions for fish and wildlife along the coast. Studies of freshwater inflow mandated by the bill have also been put on hold while negotiations between TWDB and TWC continue.

TAX REFORM: A THREAT?

TWDB officials say that proposed federal tax reform legislation is the major reason there has been such little movement on issuing bond sales so far. It's unclear how much of the bond money authorized by both Proposition 1 and Proposition 2 would be tax exempt under the reforms, and no one will know for sure until the bill takes its final form.

Three elements of the proposed tax overhaul most concern TWDB officials. First, a limit on the amount of tax-exempt bond money that a state could have in the market at any one time has been proposed. For Texas this ceiling cap would be \$2.8 billion (roughly \$175 per capita). The maximum amount of tax-exempt bond money that Texas could authorize exclusively for water projects would be \$1.22 billion. If all components of Propositions 1 and 2 were authorized, together with existing bonds in the market, Texas would be over the cap.

Second, another proposal would limit to 10 percent the amount of a project that could be dedicated to private uses, yet retain tax-exempt status. For example, if a water treatment project were funded that would provide 75 percent of its water to a municipality and the other 25 percent to a nearby large factory, the project would not be tax exempt if the 10 percent rule were adopted. Third, if Proposition 2 were implemented allowing low-interest loans directly to farmers, the loans might not be tax exempt.

Even if TWDB wanted to issue major bond authorizations now, the tax reform legislation is making that process difficult. Bond counsels and bond insurers are hesitant to sell bond issues when there are doubts as to whether or not they would be taxable, and would-be bond purchasers are delaying decisions to buy until the final verdict is in.