



Puget Sound Septic Financing Assessment

Financing Analysis

October 15, 2014



Contributors

Project Team	Organization	Role
Stuart Glasoe	Washington State Department of Health	<i>Project Manager</i>
Susan Gulick	Sound Resolutions	<i>Prime Contractor</i>
Allegra Calder	BERK Consulting	<i>Consulting Team</i>
Marc Daudon	Cascadia Consulting Group	<i>Consulting Team</i>
Kendra White	Cascadia Consulting Group	<i>Consulting Team</i>
Maryellen Hearn	Cascadia Consulting Group	<i>Consulting Team</i>
Eric Gertsman	Cascadia Consulting Group	<i>Consulting Team</i>
Terry Hull	Clean Water Consultant	<i>Consulting Team</i>
Hugh Spitzer	Foster Pepper	<i>Consulting Team</i>
Andy Brastad	Clallam County Health and Human Services	<i>Steering Committee</i>
Duane Fagergren	Puget Sound Partnership	<i>Steering Committee</i>
Melanie Tyler	Washington State Department of Ecology	<i>Steering Committee</i>
Art Starry	Thurston County Public Health and Social Services	<i>Steering Committee</i>

Advisory Committee	Organization
John Austin	Jefferson County Board of County Commissioners
Bill Dewey	Taylor Shellfish Farms
Keith Grellner	Kitsap Public Health District
Maryanne Guichard	Washington State Department of Health
Hansi Hals	Jamestown S'Klallam Tribe
Terri Jeffreys	Mason County Board of County Commissioners
Allan Martin	City of Port Orchard
Jeanette McKague	Washington Realtors
Ngozi Oleru	Public Health – Seattle and King County
John Thomas	Washington On-Site Sewage Association
Dennis Worsham	Washington State Department of Health
Stephen Wecker	Building Industry Association of Washington
Bruce Wishart	Washington Environmental Council
Jill Wood	Island County Public Health
Polly Zehm	Washington State Department of Ecology

Project Funding: *This project has been funded wholly or in part by the United States Environmental Protection Agency under assistance agreement PC-00J32601 to Washington State Department of Health. The contents of this document do not necessarily reflect the views and policies of the Environmental Protection Agency, nor does mention of trade names or commercial products constitute endorsement or recommendation for use.*

Table of Contents

1. Executive Summary.....	1
Overview.....	1
2. Introduction	3
Project Goals.....	3
Washington’s Approach to OSS Management	3
Report Organization	3
3. Property Owner Loan Program Funding.....	4
Overview.....	4
Loan Program Funding Sources.....	4
Other States.....	6
County Loan Programs	7
Targeted Loan Programs	8
Loan Program Considerations	9
4. Local Septic Management Programs.....	10
Overview.....	10
Funding Sources	10
Current Fund Sources and Revenues of Local Septic Management Programs	11
Annual Fees	13
5. Financing Options	16
Property Owner Septic Loan Program.....	16
Local Septic Management Programs	20

Tables and Figures

Table 1. Summary of County Loan Programs	8
Figure 1. Local Septic Management Program Funding by Revenue Stream by County, 2014.....	12

1. Executive Summary

The Financing Analysis evaluates sources and mechanisms to finance two Puget Sound septic programs: a regional loan program to repair and replace failing septic systems and provision of sustainable funding for local septic management programs. This document is one of three technical analyses regarding funding for septic management in the Puget Sound region. Two separate needs assessments have been prepared that assess the amount of funding needed to 1) capitalize and sustain a regional loan program to repair and replace septic systems, and 2) to implement local septic management programs throughout the Puget Sound region. This document builds on those analyses by assessing options for funding the identified needs.

Overview

The project team researched approaches used elsewhere in the country and assessed the mechanisms and funding sources best suited to the needs of the two Puget Sound septic finance programs. With input and direction from the Advisory Committee, the project team assessed the pros and cons, including legal and institutional barriers, to identify preferred options. In some cases, options were dismissed immediately based on political, legal, or other concerns; in other cases, additional research revealed other challenges on particular options. Input from the Advisory Committee throughout the project guided the research and development of various options.

Local Septic Management Programs

The *Local Septic Management Program Needs Assessment*, October 2014, identified a need of \$24.4 million or nearly \$40 per septic system to fund septic management programs throughout the region. Puget Sound counties currently have authority to charge rates or charges to cover the costs of implementing their local septic management plans. The revenue can be collected by county treasurers via property tax statements. Whatcom and San Juan are the only two counties so far that have implemented the fee county-wide. Some counties are considering it while others lack political will to impose new fees on septic system owners.

A fee on all septic systems is a desirable mechanism for many reasons. Having septic system owners pay for the cost of the programs is more equitable than charging the public at large, particularly because sewer customers already pay significant fees for wastewater management. Counties prefer a fee that is collected and retained locally. Other funding options are less desirable due to the competing demands for funding, because they offer a less direct link between the funds collected and benefits derived, or because they have practical or structural limitations.

Property Owner Septic Loan Program

The project team explored numerous revenue sources for the loan program. The Advisory Committee did not believe it was realistic to request a general fund appropriation or a new revenue source for this program given other fiscal priorities and challenges in the state. However, there are potential funds available for this program through a combination of Centennial Clean Water funds and the Washington Pollution Control State Revolving Fund (SRF). The Centennial Clean Water Grant Program is funded by the State through a variety of sources. The SRF is state funding capitalized by the U.S. Environmental Protection Agency (EPA) through their Clean Water Act money. In addition to the federal EPA funds, the State provides a required twenty percent match. Per state regulations, twenty percent of SRF funds are

set aside for nonpoint source activities, including septic loan programs. However, a review of recent years' funding shows that total loan and grant requests for nonpoint source projects are far below this set aside.

There is enough money in the SRF without tapping into Centennial funds. However, SRF funds are loans that need to be paid back while Centennial funds can be used to cover administrative costs, loan losses, and grants or subsidies to low-income individuals. Funds from both sources could be provided through a competitive application process administered by Washington Department of Ecology (Ecology).

2. Introduction

The Washington State Department of Health is leading a priority project of the Puget Sound Action Agenda to better protect public health and water quality for shellfish harvesting and other important uses. The project addresses sustainable funding for the repair and replacement of failed or malfunctioning on-site sewage systems (OSS) and for local health jurisdiction (LHJ) septic management programs. The Department of Health contracted with a consulting team led by Sound Resolutions with support from Cascadia Consulting, BERK Consulting, Foster Pepper, and independent consultant Terry Hull, to conduct the project's technical analyses and to facilitate policy recommendations and direction from the project's Advisory Committee.

This report complements work completed by Cascadia Consulting to 1) assess the estimated funding needed to capitalize a ten-year OSS loan program in the region and 2) summarize current expenditures and estimate the funding needs associated with local septic management programs.¹ The work builds on the research and findings in the Needs Assessments regarding existing funding sources in Washington and elsewhere in the country. This report identifies opportunities to build on or expand existing sources to support local septic management programs and a revolving loan program and identifies some options for new dedicated sources or mechanisms to support the two programs.

Project Goals

At the start of the project, goals were established for the two OSS funding programs. For the **loan program**, the goal is to reduce the financial risk to counties and defer lending functions to another entity to efficiently administer septic loans on a regional scale. The goal for the **local septic management programs** is to secure dedicated, sustainable funding to provide effective services, to help ensure good use and care of systems, and to better protect public health and water quality.

Washington's Approach to OSS Management

Currently, OSS management in Washington State is delegated to the LHJs as opposed to the state environmental agency, as is common in other states. The Washington State Public Health Improvement Partnership's foundational definition of Environmental Public Health includes the following: "Conduct mandated environmental public health laboratory testing, inspections, and oversight to protect food, water recreation, drinking water, and liquid and solid waste streams in accordance with federal, state, and local laws and regulations." Among other laws, OSS regulatory authority is spelled out in chapter 246-272A WAC and chapter 70-118A RCW. Given the institutional structure for addressing OSS in Washington, we have analyzed the funding options with this model in mind.

Report Organization

This report starts by summarizing the current funding sources and financial mechanisms for the OSS loan programs and for local septic management programs. While these summaries primarily focus on funding sources and mechanisms currently used in Washington State, we also explored sources and mechanisms used in other states and included those that were most relevant. The last section outlines the options explored with the Advisory Committee and our technical findings.

¹ See *Property Owner Loan Program Needs Assessment*, October 2014 and *Local Septic Management Program Needs Assessment*, October 2014.

3. Property Owner Loan Program Funding

Overview

Washington State law requires that the LHJs adopt management programs to help residents properly operate and maintain their septic systems. Proper operation and maintenance helps ensure that the systems stay in good condition, effectively treat sewage, and protect public health and water quality, keeping OSS on par with well-funded municipal sewer systems. When systems fail, requiring repair or replacement, homeowners can purchase services or systems outright or obtain financing. For those unable to obtain conventional bank financing, low-interest septic loan programs exist in some parts of the state, designed to ensure that needed repairs are made or systems are replaced. However, even the availability of these programs does not guarantee that all needed repairs or replacements are made.

Loan programs for OSS repair and replacement are primarily funded through Ecology's Integrated Water Quality Financial Assistance programs and private contributions through Craft3, a community development financial institution. Local OSS loan programs are eligible for loan and grant financing from the Water Pollution Control State Revolving Fund and the Centennial Clean Water Grant Program.

This section outlines the loan program funding sources used in Washington, funding sources used in other states, loan programs available by county, and targeted loan programs that serve specific populations. It ends with overall considerations for a loan program.

Loan Program Funding Sources

Water Pollution Control State Revolving Fund Program

The US Congress established the federal Clean Water State Revolving Fund as part of the Clean Water Act Amendments of 1987. The US Environmental Protection Agency (EPA) allocates capitalization grants annually to states on a formula basis for their own revolving loan funds. In Washington, this fund is known as the Water Pollution Control State Revolving Fund (SRF). In addition to the federal EPA funds, the State provides a required 20 percent match. Loan funds are available to local governments for use on a variety of water quality programs throughout the state. To date, the SRF has funded approximately \$1.3 billion in projects and the majority of the fund now consists of repaid principal and interest.

Total funds available to lend per year have risen sharply in the last few years.² In 2013, Ecology had \$75 million available (per their intended use plan) and actually committed approximately \$52 million. In 2014, they had \$125 million available and the Draft Intended Use Plan for 2015 estimates \$180 million will be available. SRF loan interest rates may be lowered if Ecology determines that financial hardship exists. Ecology adjusts the interest rate on the local loan program based on the income of loan recipients in comparison to the county median household income (MHI).

Per state regulations, 20% of SRF funds are set aside for nonpoint source activities, including OSS loan programs. However, a review of recent years' funding shows that total loan and grant requests for nonpoint source projects are far below this set aside. Once eligible nonpoint projects are funded, the

² The Department of Ecology began using a "cash flow acceleration" model in fiscal year 2014 which has increased the total available for funding.

remainder of the set aside funds can be allocated to other project types, such as wastewater and stormwater facility construction.

The Centennial Clean Water Grant Program

The Centennial Clean Water Grant program is funded by the State through a variety of sources, which vary from biennium to biennium. Past sources included the State General Fund, the State Building Construction Account, and the State and Local Toxics Account. For the 2013-2015 biennium, the program had approximately \$50 million available. Per Ecology Funding Guidelines, recipients may use Centennial grants and SRF loans for the following OSS loan needs:³

- Subsidized loans to property owners with financial hardship (defined as those at or below 80% of county median household income (MHI)).
- Project administration and management.
- A loan loss reserve account in accordance with the following:
 - The grant recipient can establish and accumulate a reserve account using Centennial funds and local sources to secure the potential loss from default on individual homeowner OSS repair or replacement local loans.
 - Up to 10% of the total eligible cost for an individual OSS repair and replacement project may be deposited from the Centennial grant into the reserve account.
 - Recipients must apply the amount of Centennial funds on deposit in the reserve account to either:
 - Cover, in part or in full, losses realized by the grant recipient on homeowner default.
 - Provide additional OSS repair or replacement local loans at the timing discretion of the grant recipient.

A review of recent years' funding shows that generally there are two to five individual requests to fund OSS projects or programs each year. The majority of these projects are county-level loan and financial assistance programs. Typical funding requests range from \$200,000 to \$500,000.

Examples of recently funded OSS loan programs include:

- FY2013: \$174,960 loan to Thurston County OSS Financial Assistance Program; \$172,675 grant to Pacific County OSS Repair Program.
- FY2014: \$500,000 loan and \$300,000 grant to Spokane County OSS Replacement Loan Program; \$250,000 grant to Pierce County Septic Financial Assistance Program.

The State Fiscal Year 2015 Final Water Quality Funding Offer List and Intended Use Plan⁴ included the following four OSS projects:

- \$298,500 loan plus \$292,659 grant to Snohomish County Public Works Department to launch a residential OSS loan program;

³ Department of Ecology. 2013. Funding Guidelines – SFY 2015, Water Quality Financial Assistance.

⁴ Department of Ecology. June 2014. State Fiscal Year 2015 Final Water Quality Funding Offer List and Intended Use Plan. Publication no.14-10-033. Available at: <https://fortress.wa.gov/ecy/publications/publications/1410033.pdf>

- \$250,000 loan plus \$250,000 grant to Skagit County Planning and Development Services for its residential OSS loan program;
- \$500,000 grant to Island County Public Health Department for its residential OSS loan program;
- \$1 million loan plus \$495,000 grant to Kitsap Public Health District on behalf of Kitsap, Clallam, Jefferson, and Mason counties for an OSS residential loan program to be run by a third party lender.

Other States

Loan programs in other states were also summarized in the *Property Owner Loan Program Needs Assessment*, October 2014. All 50 states plus Puerto Rico utilize the EPA Clean Water State Revolving Fund to capitalize and maintain their own state revolving funds. Other sources of funding include:

- **State General Funds** are used by some states to directly fund water quality programs, including OSS loan programs.
- **Bonds** issued directly by the state or by a state finance institution have been used for some OSS loan programs.
- **Water districts** are fairly common and are typically tied to existing jurisdictions or to specific water bodies or watersheds. They generally use fee-based systems, charging both septic and sewer users.
- **Linked deposit programs** have been used by some states (Iowa, Ohio, and Maryland) to encourage lending by providing borrowers and lenders a lower cost of capital. The agency administering the revolving funds agrees to a lower return on an investment (certificate of deposit or note) with a participating lender and the lender relends these funds to borrowers with a similarly reduced interest rate. However, with certificate of deposit annual percentage yields well below 1 percent, there is no room to lower the rate making the programs impractical in the current rate environment.
- **State Housing Finance Agencies** help to administer state loan programs in some states. For example, both Pennsylvania and West Virginia offer OSS loan programs in conjunction with their state housing finance agencies. In both cases the state environmental departments transfer CWSRF dollars to their housing agencies which use those funds to administer the loan programs. While still funded by the SRF, these states presumably benefit from the experience and administrative capacity provided by the housing finance agencies which already offer a range of finance options for homeowners. Housing finance agencies also work directly with other lenders throughout the state. West Virginia has a specific partnership with Safe Housing and Economic Development, Inc. (SHED), a non-profit housing development institution that offers financial assistance to homeowners. Starting in 2013, SHED began offering principal forgiveness programs for some very low-income OSS loan recipients.
- **Environmental Trust Funds** generally provide funding for a large range of water quality issues. They may be state-wide or attached to a specific watershed. Funding sources vary by state but may include a combination of general fund, fees, philanthropy, and proceeds from lottery, special license plates, stamps, or other sources. Examples include the Minnesota Clean Water Fund, the North Carolina Clean Water Management Trust Fund, and the Chesapeake Bay Restoration Fund in Maryland (see below).

Chesapeake Bay Restoration Fee

The creation of the Chesapeake Bay Restoration Fee is part of the Maryland's commitments under the Chesapeake Bay Agreement. First signed in 1983, the Chesapeake Bay Agreement between the Maryland, Virginia, Pennsylvania, the District of Columbia, and the EPA established the Chesapeake Bay Program with the goals of reducing toxic pollution, nutrient over-enrichment, and aquatic species loss within the Bay. The agreement was signed into the Clean Water Act and provided funding for those states efforts.

Senate Bill 320 in the 2004 Maryland Legislative Session enacted the Chesapeake Bay Restoration Fee (often referred to as the "flush fee"). The purpose of the bill was to create a dedicated funding source, financed by a fee paid by wastewater treatment plant users, to upgrade Maryland's wastewater treatment plants with enhanced nutrient removal technology. A separate fee paid by septic system users was also utilized to upgrade OSS and implement cover crops to reduce nitrogen loading to Chesapeake Bay. Initially, each property owner paid an annual \$30 fee for each habitable dwelling within the Chesapeake Bay or Atlantic Coastal Bays watersheds. The fee was implemented as \$2.50 per month for sewer utility users and a \$30 annual fee for OSS users. House Bill 446 in the 2012 Maryland Legislative Session doubled the Chesapeake Bay Restoration Fee to \$5 per month for sewer users and an annual fee of \$60 for OSS users. The OSS fee is estimated to generate revenues of \$27 million per year, 60 percent used for OSS upgrades and 40 percent for cover crops to reduce nitrogen loadings.

County Loan Programs

As noted in the *Property Owner Loan Program Needs Assessment*, October 2014, eleven of the twelve Puget Sound counties have OSS loan programs, six of which are administered by Craft3, a non-profit community development financial institution (CDFI). Snohomish County plans to begin implementing its program in 2015.

Clallam, Jefferson, King, Kitsap, Mason, and Pierce: Clean Water Loans

Craft3 currently administers the county OSS loan programs for Clallam, Jefferson, King (Vashon Marine Recovery Area), Kitsap, and Mason counties and began working with Pierce County in 2014. Since 2003, Craft3 has deployed over \$9 million through over 400 loans for residential OSS repair and replacement. Craft3's septic loan funds were capitalized through a combination of public and private sources including the Centennial Clean Water Fund and donations from local philanthropic organizations. At least \$2 million have been revolved and re-loaned since the program started.

Island, San Juan, Skagit, Thurston, and Whatcom

Table 1 summarizes loan programs run by Island, San Juan, Skagit, Thurston and Whatcom counties.⁵

⁵ More detail on these loan programs can be found in the *Property Owner Loan Program Needs Assessment*, October 2014.

Table 1. Summary of County Loan Programs

County	Program	Funding Sources
Island	Loans up to \$50,000 MHI determines interest rate	Water Pollution Control State Revolving Fund (SRF); Centennial Clean Water Fund (Grant)
San Juan	No maximum; 4% interest rate	SRF
Skagit	Commercial loans up to \$75,000 MHI determines interest rate 0-5%	SRF
Thurston	Interest rates 2%-3.5%	SRF; Centennial Grant
Whatcom	Reduced Interest – offered by Credit Union – rates of ~6.25% Deferred Option – 1% interest rate up to a maximum of \$18,000 – paid in full with interest at time of sale	\$500,000 Centennial Grant used for loan loss reserve; Industrial Credit Union & Community Assistance Organization

Source: *Property Owner Loan Program Needs Assessment*, October 2014.

In addition to utilizing these programs, homeowners may pay for repair and replacement without a loan or they may obtain a loan from another lender.

Targeted Loan Programs

Two federal loan programs offer funding for septic repair and replacement to jurisdictions or individuals meeting specific criteria.

- **Community Development Block Grant (CDBG)** funds can be administered by a state or local jurisdiction. Funding is directed toward economic and housing development broadly, and 70% of grant funds must be directed to low- and moderate-income populations. Residential septic system installation and replacement may be covered as part of a home rehabilitation grant under this program.
- **USDA Rural Development Section 504 Repair Program** offers loans and grants directly to homeowners in rural areas with fewer than 10,000 residents. To be eligible, homeowners must be low-income (earning at or below 50% of area median income), have a satisfactory credit history, and a stable source of income. Grants are available to homeowners over the age of 62. As with CDBG funds, septic system repair may be covered as part of general home repairs.

These programs are useful for the eligible populations, but do not hold any promise for a system wide solution due to the narrow eligibility parameters. An additional challenge of general home repair funds is that there may be a requirement to prioritize certain repairs such as roofing or electric over septic.

Loan Program Considerations

- The ultimate goal is a self-sustaining program that leverages existing organizations, agencies, and/or infrastructure to ensure that the selected option is an improvement on the status quo.
- Recapitalization could be necessary if loan loss reserves are tapped too often.
- The Washington State Constitution prohibits the lending of its money or credit to individuals, except for “necessary support of the poor and infirm.” However, federal or privately-sourced funds may be loaned to persons at any income level without raising state constitutional issues.
- Underwriting standards will exclude some potential borrowers, leaving them with few to no options if there is no grant program.
- An overarching challenge of the loan program is that it addresses a system issue through individual contracts with homeowners who may or may not qualify for a loan and, once granted a loan, may or may not pay.
- An important consideration in estimating demand for loans is the degree to which more effective, expanded, or better funded local septic management programs will increase demand for loans in the medium term. Increased demand would obviously affect the capitalization amount needed, the scale of operations, and the borrower pool. In the long term, improved maintenance should increase the life of septic systems eventually reducing demand for loans.
- If a regional loan program is capitalized several issues will need to be addressed, including: What happens to the capital and loans in the existing county loan programs? What is the best way to transition these existing loan programs into the regional program? These and other questions would need to be addressed in the implementation strategy.

4. Local Septic Management Programs

Overview

Chapter 246-272A-0015 of the Washington Administrative Code required that the state's LHJs develop and implement septic management plans to protect public health by minimizing a) the potential for public exposure to sewage from on-site sewage systems (OSS); and b) adverse effects to public health that discharges from OSS may have on ground and surface waters. As noted in the *Local Septic Management Program Needs Assessment*, October 2014, the twelve Puget Sound LHJs adopted local septic management plans in 2007-08 and subsequently designated Marine Recovery Areas (MRA) and other Sensitive Areas where they engage directly with OSS owners to help ensure that the systems are inventoried, inspected, and properly maintained.

The twelve LHJ septic management programs are currently funded with a variety of sources and mechanisms. As established in the *Local Septic Management Program Needs Assessment*, October 2014, the current funding does not adequately meet the funding needs for LHJs to deliver required services. Fully meeting these requirements will require dedicated, sustainable funding to improve the effectiveness of local septic management programs and ensure that they address the scope of the problem.

This section briefly outlines the funding sources and financing mechanisms used by LHJs to fund their programs, including a review of several annual fees authorized under different legislation.

Funding Sources

Counties fund local septic management programs using a variety of sources, specifically federal grants, state grants, local matching funds, local fee-for-service charges, and annual OSS or utility fees. These existing revenues streams and discrete funds that flow into them are described below.

Federal Grants

- **National Estuary Program Grant.** Established to protect and restore Puget Sound as an estuary of national significance, this special grant funding is generally reserved for one-time costs and is not intended to serve as base funding for local operating costs. The funds can also be used to prevent or mitigate nonpoint source pollution from OSS impacting Puget Sound.

State Grants

- **Water Pollution Control State Revolving Fund.** The SRF is funded by Ecology through the EPA Clean Water State Revolving Fund and funds high-priority water quality projects.
- **State Grants.** Washington State funding sources include the Centennial Clean Water Grant Program and state pass-through grants administered by the Department of Health (funded by State General Fund and Aquatic Lands Enhancement Account (ALEA)).

Local Matching Funds

- **County Grant Match.** County funds that are dedicated to meet the matching obligations of an accepted grant.
- **County General Fund.** Many counties contribute general fund dollars toward the local septic management program.

Local Fee-for-Service Charges

Owners of OSS pay fees to support the proper management of OSS systems by the local health jurisdiction. Fees include local permit, installation, repair, inspection, reporting, property transfer, maintenance, and operations charges. Several jurisdictions charge fees for services performed throughout the various stages of OSS purchase and ownership. These charges may be levied by the LHJ at the time of purchase and installation, inspection, maintenance, ownership transfer, or on an ongoing basis, through time-bound operational certificates. Several of the LHJs have existing local fee-for-service charges of this kind. These include:

- Septic Permit Charge
- Install, Repair, Inspection Charges
- O&M Report Charge
- Time of Transfer Report Charge
- Pump/Maintenance Charge
- Operational Certificate

Annual OSS and Clean Water/Utility Fees

- Fees levied to support the management of OSS systems (discussed in more detail below).

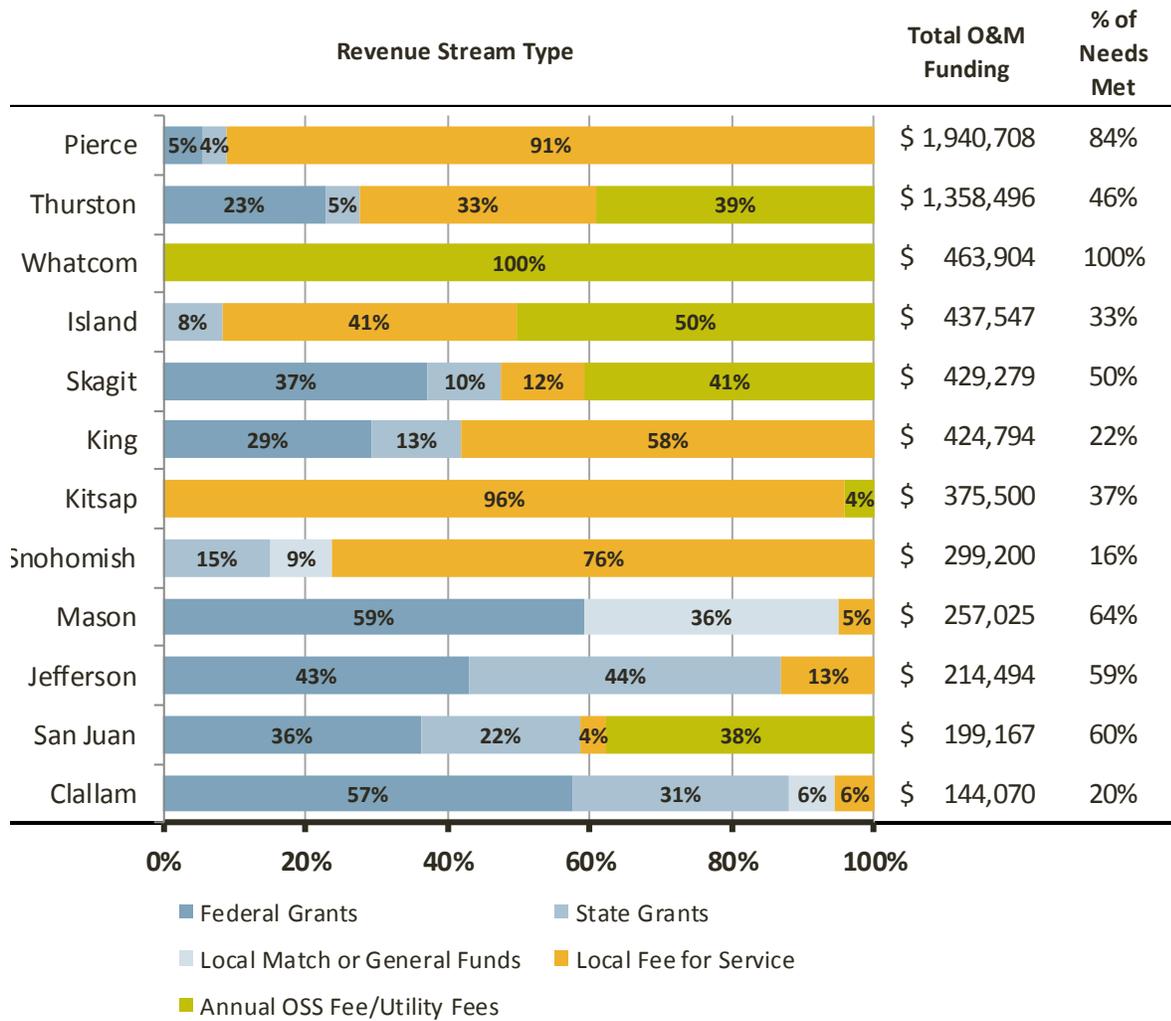
Current Fund Sources and Revenues of Local Septic Management Programs

As shown in Figure 1, individual LHJs currently receive as little as \$144,070 annually (Clallam) to almost \$2 million (Pierce) for total revenues across all twelve LHJs of about \$6.5 million annually. The funds collected meet varying levels of self-described need. In Snohomish County, it is estimated that only 16% of OSS needs are met with current funding, while Whatcom County claims to be meeting 100% of its needs using only an annual fee for revenue. Many counties are scaling their programs and outcome expectations to align with available funding.

State and federal grants are temporary funding sources and may not be able to fund OSS services on an ongoing basis. There will be an even greater need for funding of OSS services (particularly in those LHJs where a majority of OSS services are being funded by federal and state grants) when those funds expire.

While it is possible that some of these revenue streams will grow to meet the existing need, it is more likely that they will not. From that standpoint, it is important to consider new funding that could be established to fully fund programs that meet existing and future OSS needs.

Figure 1. Local Septic Management Program Funding by Revenue Stream by County, 2014



Source: *Local Septic Management Program Needs Assessment*, October 2014.

Annual Fees

One major opportunity for funding local septic management programs is the implementation of annual fees (or increased fees where they already exist) such that each LHJ supports an adequate level of services in its region. Local jurisdictions, cities, and counties, are able to do this by enacting ordinances that are then reflected in their local municipal codes.

Fees Collected Under Shellfish Protection Districts (RCW 90.72)

The legislative authority of each county having shellfish tidelands within its boundaries is authorized to establish a shellfish protection district to include areas in which nonpoint pollution threatens the water quality upon which the continuation or restoration of shellfish farming or harvesting is dependent.

RCW.90.72.070 allows the county to finance the shellfish protection program through:

- County tax revenues
- Reasonable inspection fees and similar fees for services provided
- Reasonable charges or rates specified in its protection program
- Federal, state, or private grants

Clean Water Program Fee, Skagit County Edison Subarea. In 1995, in response to the 1994 closure of parts of the Samish Bay commercial and recreational shellfish harvesting by the Department of Health as a result of bacterial pollution, a Clean Water (shellfish protection) District (CWD), covering the Edison Subarea of Skagit County, was formed under RCW 90.72.040 and codified by Skagit County in the Skagit County Code chapter 12.64. The CWD was intended to help finance a new community wastewater system and replace failing OSS that were contributing to the bacterial pollution in the Bay. Between 1999 and 2005 Skagit County monitored water quality and continued to see bacterial pollution. In 2005, the county established a broader Clean Water Program codified in Skagit County Code as chapter 6.68 to address nonpoint pollution from OSS and other sources affecting water quality in the county's shellfish growing areas. The Clean Water Program is funded by fees and charges that are differential based on density of development and the amount of impervious surface. The current annual rate is \$28.01 per parcel for a single-family residence (including accessory dwelling units) and \$34.53 for 2-4 unit homes.

Henderson Watershed Protection Area Septic System Operation and Maintenance Program, Thurston County. A Citizen Advisory Committee convened in December 2003 in response to the Department of Health's conditional closure of Henderson Inlet, which was due to fecal coliform bacteria contamination. On November 21, 2005 the Thurston County Board of Health adopted the Henderson Watershed Protection Area Septic System Operation and Maintenance Program which went into effect on January 1, 2007. This program ensures that all septic systems within the Henderson Watershed Protection Area are routinely maintained and inspected to ensure problems are quickly identified and addressed. As of January 1, 2012, annual fees for the program were \$35 per year for low-risk systems and \$96 per year for high-risk systems.

Nisqually Reach Shellfish Protection District, Thurston County. The Nisqually Reach Shellfish Protection District was formed in 2013 and modeled after the Henderson Program. Like the Henderson program, it was designed to ensure that septic systems in its jurisdiction are routinely maintained and inspected in order to minimize problems. This program is also a user pay model, in which only OSS owners pay annual fees. As of January 1, 2013 the base rate for low-risk systems is \$60 with an additional fee of \$10 for every additional septic system owned by the owner annually. The base rate for high-risk systems is \$135 also with an additional fee of \$10 for every additional septic system owned by the owner annually.

Fees Collected Under Storm Water Control (RCW 36.89)

RCW 36.89.080 allows any county legislative authority to fix rates and charges for services related to those served or receiving benefits or to be served or to receive benefits from any storm water control facility or contributing to an increase of surface water runoff. In fixing rates and charges, the county legislative authority may in its discretion consider:

- Services furnished or to be furnished.
- Benefits received or to be received.
- The character and use of land or its water runoff characteristics.
- The nonprofit public benefit status, as defined in RCW 24.03.490, of the land user.
- Income level of persons served or provided benefits under this chapter, including senior citizens and disabled persons.
- Any other matters which present a reasonable difference as a ground for distinction.

Clean Water Utility Fee, Island County. On December 20, 2010 the Board of Island County Commissioners adopted the Clean Water Utility through establishing ordinance, Resolution C-97-11, and an ordinance establishing a system of charges Resolution C-127-11. The Utility applies to the entire county, excluding the incorporated areas of Coupeville, Langley, and Oak Harbor; the areas affected by the Marshall Drainage Basin Utility; and those properties owned by the Federal Government, State, and County.

The system of charges establishes the fees for properties, generally a flat fee on top of property taxes, with the following exclusions and discounts:

- Rainwater harvesting projects receive a 10% discount.
- Forest and timber lands defined under RCW 84.33 and 84.34 are exempt.
- Property owners who qualify for the senior citizen/disabled person low-income tax credit receive a 50% discount.
- Commercial properties receive a 50% discount for the first three years of the Utility.
- Commercial and industrial activities that are already mitigating impacts may receive a rate adjustment upon application.

Beyond OSS projects, the Utility funds several programs including stormwater drainage projects, watershed planning, low impact development, surface water quality monitoring, hydrogeology, salmon recovery, shellfish protections, code compliance, and administration. The Utility's OSS program receives 13% of the proceeds from the fee, and funds a Public Health program to ensure that septic systems are properly constructed and maintained, with follow-up on complaints and failures.

Kitsap County Surface and Stormwater Management Fee, Kitsap County. Kitsap County levies a Surface and Stormwater Management Fee which funds stormwater facilities, operations, maintenance, and pollution control in addition to nonpoint sources of pollution in Kitsap surface waters. One nonpoint source of pollution the fee funds is OSS management, which is addressed through a partnership with the Kitsap LHH. In 2013, the fee levied was about \$73.50 per single-family residence, totaling a little over \$5 million dollars. Fourteen percent (14%) of this funded OSS programs through the Kitsap LHH.

The fee was established in 1994 under Kitsap County Code Title 12.36; the rate structure is defined in Title 12.40. The fee was increased in November 2012 by the Board of County Commissioners. The fee increase was established to maintain current level of services and regulatory mandates, construction program expansion, Pollution Identification and Correction program (PIC) expansion, and expected Navy SSWM fee revenue.

Annual OSS Fees

The ability to collect fees to fund OSS program management plans is governed under Chapter 70.05 RCW which relates to local health jurisdictions.

RCW 70.05.190 gives authority to a local board of health in the twelve counties bordering Puget Sound implementing an on-site sewage program management plan to:

- (a) Impose and collect reasonable rates or charges in an amount sufficient to pay for the actual costs of administration and operation of the on-site sewage program management plan; and
- (b) Contract with the county treasurer to collect the rates or charges imposed under this section in accordance with RCW 84.56.035.

Two local jurisdictions have implemented annual OSS fees:

- **On-Site Sewage System Program, Whatcom County.** This county program was developed to streamline and ensure the maintenance of OSS and mitigate ongoing pollution from compromised systems. It was codified in Chapter 24.05 of the Whatcom County Code on April 2, 2007. Between April 2007 and December 2012, the county collected two fees to help fund its program: a \$35 inspection filing fee and a 3¢ per gallon septage surcharge. Effective January 1, 2013, Whatcom County replaced the two fees with a \$19 annual fee imposed on all OSS owners collected via the property tax statement. The fee is applied evenly to about 24,000 OSS owners, costs less than the fees it replaced, and provides stable funding for the County's OSS program.
- **On-Site Sewage System Operation and Maintenance Program, San Juan County.** San Juan County developed an On-Site Sewage System Operation and Maintenance Program (originally adopted in December 1999 and governed by Chapter 8.18 of the San Juan County Code). The program levies a fee on all improved properties served by OSS, under the assumption that all OSS properties contribute to the need for and create burdens addressed by the program, and that those properties also benefit from the system and should fund the program fairly and equitably among themselves. Until 2014, fees were associated with inspection reports that had to be completed and returned every three years. As of 2014, the on-site sewage inspection report filing fee has been replaced with a \$10 annual fee which is collected along with property taxes for parcels with septic systems.

5. Financing Options

Financing options were presented to the Advisory Committee separately for the local septic management programs and a regional loan program. In all cases, a “reform with revenue” approach was emphasized as the desired outcome. In other words, the goal is to improve outcomes while raising adequate revenues and maintaining local flexibility.

In thinking about the financing options, several key questions were considered before settling on a preferred approach. These include:

- What are we buying and what are the benefits?
- How is it being paid for and by whom?
- How will we know that it works?
- How do we demonstrate return on investment?

This section outlines the project team’s findings that informed the Advisory Committee’s recommendations. In some cases, options were dismissed immediately based on political, legal, or other concerns; in other cases, additional research surfaced other challenges on particular options.

Property Owner Septic Loan Program

The following two options were presented to the Advisory Committee for their consideration:

1. Capitalize a regional publicly-funded loan program to be run by one (or more) lender.
 - a. The advantages of selecting one lender are greater ability to pool risk through a larger loan pool and less confusion in the marketplace.
 - b. There is also potential to leverage secondary markets with a diversified pool of loans with only one underwriter.
 - c. The program will still likely serve a subset of borrowers. Homeowners with more financial means will find other ways to pay for or finance repairs/replacement. Others will not qualify.
 - d. The existence of an assistance program removes a barrier to inaction on the part of homeowners once a problem is identified.
2. Attract public or private capital through a loan program administered by a state agency (for example, the Washington State Housing Finance Commission, Washington Department of Commerce, or Ecology)
 - a. Using the Commission could provide the ability to issue tax-exempt and/or taxable bonds, allowing for a lower interest rate without implicating state constitutional restrictions. Bond proceeds come through the state entity and not the state’s capital budget.
 - b. Since a loan loss reserve would likely be needed for a Commission bond program, state money could fund the portion of the reserve equivalent to the portion of the loan portfolio comprised of loans to homeowners at 80% or less of AMI, and federal (or other) money

could fund the reserve for the portion of the loans made to those above the income limit. This would ensure that state lending of credit restrictions are respected.⁶

- c. One or more lenders, including current lenders, could sign up to participate in an agency-funded loan program. Loan volumes may limit participation from large national lenders, but community development financial institutions, small banks, and credit unions might be interested.
- d. A government guarantee program might be possible, but it has to be treated as debt, which makes it less attractive (due to capacity limits).
- e. It is unclear at this point if there might also be secondary market opportunities.

The following potential sources for capitalization were also discussed:

- **State Funds.** Water Pollution Control State Revolving Funds (SRF) and Centennial Clean Water Grant Program Funds are potential sources. Currently, individual counties (or groups of counties) submit requests for their respective loan programs as part of a competitive process administered by the Department of Ecology.
 - Under a regional model, these requests could be combined (similar to the Kitsap Public Health District request), generating a larger overall amount to use as capital. Counties are eligible for up to \$500,000 each per funding cycle from the SRF and Centennial Clean Water Grant funds.
 - Per state regulations, 20% of SRF funds are set aside for nonpoint source activities, including septic system loan programs. A review of recent years' funding shows that total loan and grant requests for nonpoint source projects are far below this set-aside suggesting that it would be appropriate to submit competitive applications for a larger scale unified loan program from this set-aside.
- **Foundation Funds.** Foundations have contributed funds in the past, for example, with the Hood Canal Septic Loan Program.
- **Lending Institutions.** Participating lenders could be required to make a matching contribution. This was a requirement in the June 2014 Kitsap Public Health District RFP: Lending and Loan Management Services for Onsite Sewage Systems Repairs.
- **Bond Proceeds.** If the Commission (or another agency) were able to issue bonds, this would raise additional capital.

Advisory Committee Direction

The Advisory Committee asked for further analysis of both options.

1. **Capitalize a regional publicly-funded loan program to be run by one (or more) lender.**
2. **Attract private capital through a loan program administered by a state agency.**

⁶ 2. WASH. CONST. art VIII, § 7 provides: No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.

Additional Research

Through conversations with the Advisory Committee, the project team began to narrow in on the possibility of replicating the model used by Kitsap Health District where one public agency applies for existing funding sources (SRF and Centennial Grants) on behalf of other counties. This raised questions about the appropriate lead organization for such an application and how the loan program would be structured.

The project team had conversations with agencies with loan program experience—including the Commission, Commerce, and Ecology—to explore the possibility of accessing bond markets, increasing private lender participation, and other loan program approaches. The project team also spoke with representatives of Kitsap Public Health District and Craft 3 to learn more about the recent joint application.

Key points from these conversations included the following:

From 173-95A WAC Uses and Limitations of the Centennial Clean Water Program

(53) **Public body** means a state of Washington county, city or town, conservation district, other political subdivision, municipal corporation, quasi-municipal corporation, those Indian tribes recognized by the federal government, or institutions of higher education when the proposed project is not part of the school's statutory responsibility.

Accessing the bond markets for septic loans would probably not result in a lower rate or a better program/process.

- The Commission could not borrow at a tax-exempt rate because these septic loans are made to individuals.
- Investors in these markets typically prefer good credit borrowers and require principal and interest payments every six months. It is unlikely that investors would accept a 15-year deferred payment product.
- Bonds would probably need to be issued on behalf of the twelve counties as private activity bonds could likely not be issued on behalf of individuals. It is unknown whether the various county commissioners would support this idea.

Finding participating lenders for regional or state loan programs can be difficult and there are administrative costs to state agency involvement.

- In June 2014, Kitsap Public Health District issued a RFP for lending and loan management services of an OSS loan program and received one response from Craft3.
- In September 2013, the Department of Commerce issued a RFQ for the design of an energy revolving loan fund that would have access to \$15 million in federal funds and received three responses. They selected two lenders: Craft3 and Puget Sound Cooperative Credit Union.
 - The Attorney General costs to review and draft documents came to about \$8,000 in fees for a small program.

Ecology already has the authority, experience, and a process in place to address the need for a regional loan program through its existing competitive funding cycle.

- A combined twelve county application could request up to \$6 million in low-interest Water Pollution Control State Revolving Funds (or more) and up to \$6 million in Centennial grants in a single funding cycle with no statutory or rule changes needed.
- Current Washington Administrative Code (WAC 173-95A-020 Uses and Limitations of the Centennial Clean Water Program and WAC 173-98-030 Uses and Limitations of the Water Pollution Control Revolving Fund) and chapter 70.146 RCW limit applicants to “public bodies” and the definition does not include state agencies.
- While Kitsap Public Health District served as the lead agency on a four county application for \$1 million in SRF and \$500,000 in Centennial Grant funds, they expressed reluctance to take on additional risk or administrative work on behalf of additional counties.
- Grant funds can be used to cover program establishment and administration costs. In the Kitsap proposal, \$90,000 of grant funds are allocated to marketing and program administration costs. However, no new staff have been hired and existing staff have taken on the additional responsibilities.

Kitsap’s RFP for lending and loan management services of an OSS loan program is a model.

- As the lead, Kitsap is the fiduciary agency and is responsible for repayment of the loan back to Ecology. Using an RFP process, Kitsap contracted with a lender, Craft3. In the response, Craft3 was responsible for addressing program guidelines, application and underwriting processes, risk management, loan servicing, and marketing of the program. The risk of loan default has been shifted to Craft3, which is significant, but the remaining risk is the Health District’s responsibility. Kitsap speculated that Clallam, Jefferson, and Mason counties probably would not have signed the contract if they had to bear any of the remaining risk.
- Required program elements in the RFP also included:
 - The successful bidder is responsible for any loan loss reserves it decides to set aside. Public loan and grant dollars cannot be used for this purpose.
 - The Clean Water Loan Program must reduce financial barriers to repairing failing septic systems for low-income families.
 - The successful bidder must provide a minimum \$410,000 match of private funds to leverage the total dollars available for lending to \$1,820,000. *Note: \$90,000 of grant funds are allocated to marketing and Kitsap’s administrative costs.*

Findings

Analysis of the financing options for the property owner septic loan program led to the conclusion that a state agency other than Ecology (since they administer the SRF and Centennial Grant funds) should serve as the lead agency on a multi-county application. Putting a state agency such as the Department of Health in the lead would leave open the possibility that the program could be expanded beyond the twelve Puget Sound counties and eventually cover the state. Given the current funding environment and competing priorities at the legislative level, SRF and Centennial funds should serve adequately as the primary source of capital along with a lender match and potentially foundation funds.

The lead agency should contract with one or more lenders, selected through a competitive process. Kitsap Public Health District’s recent RFP provides a good model in that it requires the lender to propose the design of the loan program, and includes loan loss reserve and minimum match requirements. Under this proposed model, LHJs would continue to work with local populations to help people understand their responsibilities and refer septic system owners to the loan program as necessary.

In addition to reducing confusion in the marketplace, greater loan program uniformity with a single point of contact and one loan portfolio with a balanced risk profile would increase the possibility of eventually accessing secondary markets, providing additional capital.

Remaining Questions

Several program-level questions will need to be addressed during implementation:

- Do the current definitions allow the Department of Health or another state agency to serve as the applicant?
- How should loan repayments from a state agency back to Ecology be structured?
- How would counties with existing programs phase into the regional loan program? Could the lender(s) buy the portfolio of loans from existing county programs and add that existing capital to the mix?
- What are the implications (regulatory, political, policy) of a lender managing a warehouse of loans receivable by the Department of Health or another state agency?

Local Septic Management Programs

The following options were presented to the Advisory Committee:

1. Draft statutory language to establish minimum requirements for local septic management programs in exchange for access to State Grant Funds.
 - a. Requirements could include collecting an annual fee, having a pollution identification control program, and others.
 - b. This is a slightly enhanced version of the status quo.
2. Citing significant regional environmental and public health benefits to Puget Sound and Hood Canal, the State could require collection of an annual OSS fee for all twelve Puget Sound counties.
 - a. This authority is already available to counties under RCW 70.05.190. “May” could be changed to “shall” to require collection of a fee.
 - b. An amount sufficient to fund an adequate program in each county should be established.
 - c. Charge the fee to every property that is not on a sewer system, while providing for an appeals process in the event of an error.

From RCW 70.05.190 On-site sewage program management plans —

A local board of health in the twelve counties bordering Puget Sound implementing an on-site sewage program management plan may:

(a) Impose and collect reasonable rates or charges in an amount sufficient to pay for the actual costs of administration and operation of the on-site sewage program management plan; and

(b) Contract with the county treasurer to collect the rates or charges imposed under this section in accordance with RCW [84.56.035](#).

3. State creates a Puget Sound Water Quality Entity (like the State created the Washington State Public Stadium Authority) to oversee local septic management programs.
 - a. State creates the entity; counties are required to participate.
 - b. State provides the entity with authority to collect fees, establish local septic management programs parameters, and establish an inspection program
4. Amend RCW 39.106 Joint Municipal Utility Services to make OSS inspection and maintenance an eligible service.
 - a. Change the language in RCW 39.106.030 (2): (a) An authority may perform or provide any or all of the utility service or services that all of its members, other than tribal government members, perform or provide under applicable law; and (b) in performing or providing those utility services, an authority may exercise any or all of the powers described in RCW 39.106.040(1) so that OSS inspection and maintenance would be eligible without the county **directly** performing or providing the services.
 - b. All twelve counties would have to agree to form a Joint Municipal Utility Services Authority.
 - c. Once formed, they would have control over how it is structured and governed, write their own charter, and per 39.106.040 (m) could “determine and impose fees, rates, and charges for its utility services.”

From RCW 36.102.050 Public Stadium Authority – powers and duties —

(5) The public stadium authority may impose charges and fees for the use of the stadium and exhibition center, and may accept and expend or use gifts, grants, and donations.

From RCW 39.106 Joint Municipal Utility Services — Purpose

... to improve the ability of local government utilities to plan, finance, construct, acquire, maintain, operate, and provide facilities and utility services to the public, and to reduce costs and improve the benefits, efficiency, and quality of utility services.

Consistent with the State Constitution Article 11, Section 12, these options do not impose taxes upon the counties, but rather provide the power to assess and collect taxes or use fees for program purposes.

Advisory Committee Options

When asked for additional ideas to finance local septic management programs, Advisory Committee members suggested two additional options.

- Sewer Charges. The proposal was to impose a modest charge on sewer customers.
- Clean Water Fund. A new, comprehensive clean water fund to address a new generation of concerns and projects. A tax or other revenue source would need to be identified. Past and current state clean water funds have been supported by a cigarette tax and other sources.

Advisory Committee Direction

The Advisory Committee asked the project team to focus additional work on two options:

1. **The State could establish the annual OSS fee for all twelve local boards of health (Option 2),** and as part of this,
2. **Amend current statutes to provide more requirements on what the counties are doing (Option 1).**

Additional Research

Foundational Services

The project team met with Department of Health staff and LHJ representatives to discuss what an adequate program should include and identified the following foundational services for local septic management programs:

- Document OSS
- Educate homeowners
- Manage inspection and repair requirements
- Survey OSS and monitor water quality to identify problem systems
- Update management plans

Annual Fee

The Advisory Committee expressed support for the concept of septic system owners paying an annual fee to cover the costs of local septic management programs. The key issues regarding an annual fee are the amount, how it is collected, and how to ensure funds are spent effectively. Related to the amount, the project team's analysis estimated that the cost of providing the five foundational services throughout the twelve Puget Sound counties would be approximately \$24 million per year, or nearly \$40 per OSS.⁷

Under RCW 70.05.190, Puget Sound counties currently have the authority to assess a rate or charge on septic system owners to cover the costs of implementing their local septic management plans. The revenue can be collected by county treasurers via property tax statements. To date, Whatcom and San Juan are the only two counties that have implemented the fee county-wide. In other counties there may be limited political will or awareness of the authority to impose new rates on septic system owners. And in other situations counties have opted to use other finance authorities or await the outcome of this regional finance analysis to determine their course of action.

Findings

Analysis of the financing options for the local septic management programs led to the conclusion that the State should amend chapter 70.05.190 RCW to require an annual fee of all OSS owners to fund the local septic management programs. As this fee is intended to support the overall program, it should supplant other current funding sources. Because the money would be collected and spent locally, a key implementation challenge will be determining how the State can provide sufficient oversight of local septic programs to ensure that the desired program objectives and public health and environmental outcomes are achieved.

⁷ Details of this analysis are included in the *Local Septic Management Program Needs Assessment*, October 2014.



DOH 332-156 October 2014

For people with disabilities, this document is available on request in other formats. To submit a request, please call 1-800-525-0127 (TDD/TTY call 711).