

Capital Spending Plan
For TWDB
Infrastructure Financing
Programs



Submitted to the 79th Legislature and the
Legislative Budget Board

By the

Texas Water Development Board
December 2004



TEXAS WATER DEVELOPMENT BOARD



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December 15, 2004

To: The Honorable Rick Perry, Governor of Texas
The Honorable David Dewhurst, Lieutenant Governor of Texas
The Honorable Tom Craddick, Speaker of the House of Representatives
Members of the Legislative Budget Board
Members of the 79th Legislature

Re: Capital Spending Plan for TWDB Infrastructure Financing Programs

This Capital Spending Plan (Plan) is the second biennial report submitted in compliance with §6.110 of the Texas Water Code passed in Senate Bill 312 of 77th Legislature. The Plan identifies water funding needs of the State and sets forth a methodology for meeting those needs. The Plan also addresses the report on the Pilot Rural Community Water and Wastewater Loan Program, as required by §15.919 of the Texas Water Code.

The Board's financial assistance programs play a major role in financing a broad range of needed water-related projects such as facilities that produce drinking water, treatment works that clean up water going into our streams and lakes, and flood protection. For this reason the Board has chosen to expand the scope of the Plan to include all of the Board's financial assistance programs, since each one is significant to meeting the State's overall water-related needs. This information supplements the Board's 2005- 2009 Strategic Plan and 2006-2007 Legislative Appropriation Request.

The Board respectfully transmits this Plan to the Texas Legislature.

E. G. Rod Pittman, Chairman

J. Kevin Ward, Executive Administrator

Our Mission

To provide leadership, planning, financial assistance, information, and education for the conservation and responsible development of water for Texas.

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INTRODUCTION

In 2001, the 77th Legislature added a requirement in Chapter 6 of the Texas Water Code requiring the Texas Water Development Board (TWDB) to adopt and submit a Capital Spending Plan to the Legislature each biennium. The Capital Spending Plan (Plan) is to identify water funding needs and set forth a basis for allocating the TWDB's funds to address those needs. The Plan would specifically address the Texas Water Development Fund, the Agricultural Water Conservation Fund and the Water Assistance Fund. The Plans are due prior to January 1, of each odd numbered year. This is the second such report.

The purpose of the Plan is to provide the TWDB and Legislature a framework for regularly assessing the effectiveness of the TWDB's programs in addressing water funding needs. This plan supplements information provided on the agency's performance measures. The biennial review and update process identifies possible changes to TWDB allocation methodologies or other aspects of its programs. Also, based upon the biennial review and update process, the TWDB will be in a better position to advise the Legislature regarding need for appropriations and legislative changes that may be appropriate. The Plan is also an agency resource to educate the Legislature and other stakeholders about TWDB financial assistance programs.

This Plan is submitted in compliance with the statutory requirement. It addresses the programs identified in the statute and includes comparable discussion of the TWDB's major ongoing financial assistance programs as well. The inclusion of other programs was considered necessary to enable an understanding of the targeted programs in context of the full array of financial assistance programs administered by the TWDB. It should be noted that material is presented in the context of financial assistance programs, rather than in the context of funds. This arrangement is necessary since the individual program peculiarities and restrictions such as applicant eligibility and existing priority systems apply to financial assistance programs more so than to funds.

In part two, the Plan also addresses the report on the Pilot Rural Community Water and Wastewater Loan Program, as required by §15.919 of the Texas Water Code.

The Plan generally spans a five-year period, from fiscal years 2005 through 2009, and is consistent with TWDB policies and priorities elaborated in other TWDB publications including:

- *2005-2009 Texas Water Development Board Strategic Plan;*
- *2006-2007 Texas Water Development Board Legislative Appropriations Request;*
- *2003 Assessment of Water and Wastewater Facility Needs for EDAP Counties;*

- 2002 State Water Plan, *Water for Texas – 2002*; and
- 2002 *Infrastructure Financing Report*.

In addition, the TWDB recently established the following legislative priorities and exceptional items, which will be pursued during the 79th Legislative Session:

- Request state matching funds to the federal grant for the Drinking Water State Revolving Fund program to maximize federal grant funding dedicated to disadvantaged communities;
- Request additional funds for continuation of the TWDB’s Economically Distressed Areas Program to accommodate needs of ongoing and planned water and wastewater infrastructure projects in economically distressed areas primarily along the Texas-Mexico border;
- Reinstatement of funding for TWDB’s State Participation Program to implement regional infrastructure projects;
- Requesting continued funding for the demonstration seawater desalination project; and
- Education of the State leadership on the infrastructure and funding needs of non-border colonias.

Although it is not necessarily a legislative issue, the TWDB believes that maximizing federal investment dollars through the provision of state matching dollars is critical to meeting Texas’ infrastructure needs in the future. All of these priorities are consistent with the policy recommendations discussed in each of the above mentioned publications and they are reflected in the TWDB’s allocation methodologies discussed later in this report. If successful in achieving its legislative initiatives the TWDB will be able to make available approximately \$570 million per year, on average, toward satisfying project funding objectives.

**TEXAS WATER DEVELOPMENT BOARD
CAPITAL SPENDING PLAN**

**PART ONE: WATER AND WASTEWATER INFRASTRUCTURE
FUNDING NEEDS**

One of the significant accomplishments in the preparation of the state's water plan, *Water for Texas, - 2002*, was the compilation of comprehensive data for the various water-related infrastructure needs. According to the 2002 Plan, Texas needs to invest over \$108 billion in water-related infrastructure over the next 50 years to meet the water infrastructure needs of the State's current and future population (**Figure 1**). Without this investment the State's residents could potentially face water supply shortages, failing infrastructure, noncompliance with federally mandated drinking water and wastewater treatment standards and flood control issues. Within the next six years, by 2010, Texas will need to invest approximately \$19.1 billion in water-related infrastructure not including flood control costs. Although the Regional Plans included known flood control project costs, the full magnitude of statewide flood control needs has not been determined. See Table 1 for the estimated costs per type of need.

Figure 1 - Relative proportion of estimated capital costs to meet water-related needs for Texas through 2050.

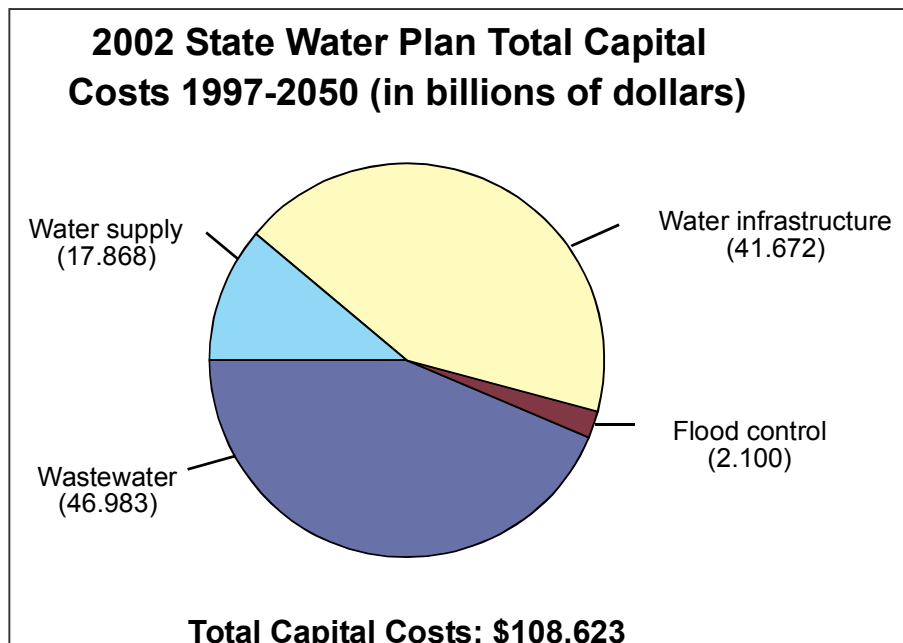
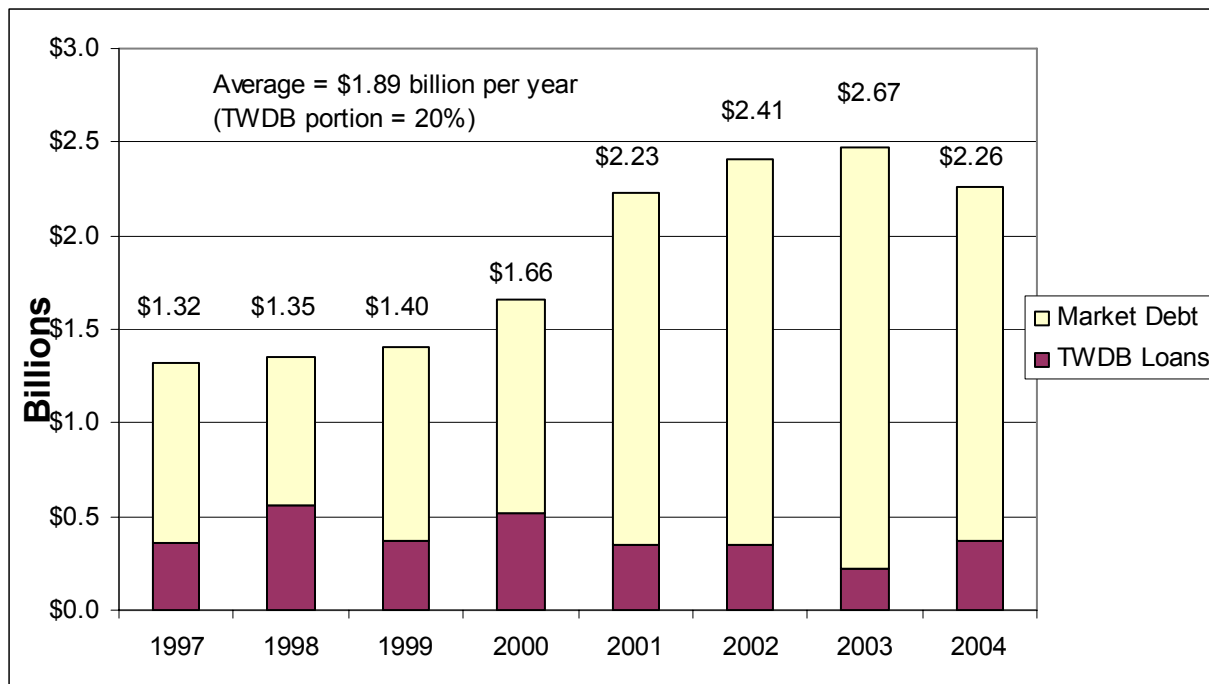


Table 1 - Statewide Water Related Infrastructure Capital Cost Needs (in billions of dollars)

Type of Need	Cost through 2010	Cost through 2050
Municipal Water Supply	\$ 4.90	\$16.20
Agriculture Water Supply	\$ 0.13	\$ 0.58
Mining, Manufacturing, Electrical Power Generation	N/A	\$ 1.20
Subtotal	\$ 5.03	\$ 17.98
Water Treatment and Distribution Systems	\$ 6.69	\$ 41.67
Wastewater Collection and Treatment Systems	\$ 7.38	\$ 46.99
Flood Control	\$ 2.10	\$ 2.10
State-Wide Total	\$21.20	\$108.74

In Texas, local governments have historically provided the majority of the financing required for water-related infrastructure projects and can reasonably be expected to continue to do so, except in some of the small and disadvantaged communities and regional water supply projects. See **Figure 2** for the amount of water related infrastructure project financing through bond closings that have occurred for over the last eight years. While these new bond issues are not necessarily to fund projects identified in the State Water Plan, the rate of bond issuance over the last three years would come close to funding the \$21.2 billion estimated need through the year 2010.

Figure 2 - Total Water and Wastewater Bond Debt Issued In Fiscal Years 1997-2004



The TWDB provides cost effective financial assistance to all types of projects and communities, and has special additional assistance where it is most needed, and in line with state and federal priorities.

In addition to the four categories of need presented in the State Water Plan, and our analysis of the water supply needs in the *Infrastructure Financing Report*, data exist for two other categories: 1) economically distressed areas, and 2) non-border colonias and rural community needs. The needs reflected in these categories are captured in the over-all four categories, however they are discussed here since they relate to TWDB priorities.

The most recent estimate of economically distressed areas needs is documented in a December 2003 study, titled *Assessment of Water and Wastewater Facility Needs for EDAP Counties*, conducted on behalf of the TWDB. According to the survey, approximately \$785 million is needed to provide adequate water and wastewater infrastructure in communities within counties that meet or have recently met the criteria for being an “Affected County” under the TWDB’s Economically Distressed Area Program (EDAP). An affected county is one that is adjacent to the Mexico border, or has an unemployment rate 25% above the state average and a median household income 25% below the state average. Not all the projects represented by this estimate would qualify for funding through the EDAP due to specific eligibility criteria applicable to the applicant and the project. This estimate is compiled from a variety of sources. Some of the project costs estimates are based on conventional solutions which may not be economically feasible to implement. Of this \$785 million, approximately \$389 million is for water needs and \$396 million is for wastewater needs. The \$785 million need is in addition to the \$551 million that the TWDB has funded through the EDAP and Colonia Self-Help programs since 1989.

A study performed in 2001, *Water and Wastewater Needs of Non-EDAP Eligible Disadvantaged Areas*, identified colonias and rural communities’ needs for water and wastewater infrastructure that exist in counties that are not eligible for EDAP funding. These needs are estimated (as current needs) to be \$3.8 billion for both water and wastewater infrastructure. This estimate reflects both the needs of disadvantaged communities near urban areas as well as in rural areas of the studied counties. The non-EDAP colonias and rural communities’ needs (\$3.8 billion), together with the Economically Distressed Areas needs (\$0.785 billion), represent the best available estimate of the statewide water and wastewater infrastructure needs of disadvantaged communities.

The Regional Water Planning Groups (the authors of the Regional Water Plans) expect that the 18% growth in water supply needs (between 2002 and 2050) will require some subsidies as the total cost of the improvements exceeds the collective financing abilities of the service providers. While the TWDB has statutory authority and has implemented rules to provide subsidized funding for water supply management strategies through the Water Infrastructure Fund (WIF), the WIF has yet to be funded. Further, funding for the WIF was not included as part of the TWDB’s 79th Legislative Appropriations Request.

Texas Commission on Environmental Quality Compliance Issues

The Texas Commission on Environmental Quality (TCEQ) enforces standards on drinking water and stream quality. The priority rating systems for the Clean Water SRF and Drinking Water SRF accommodate the TCEQ issues. Otherwise there are no TCEQ compliance issues that are directing the TWDB’s allocation of funds.

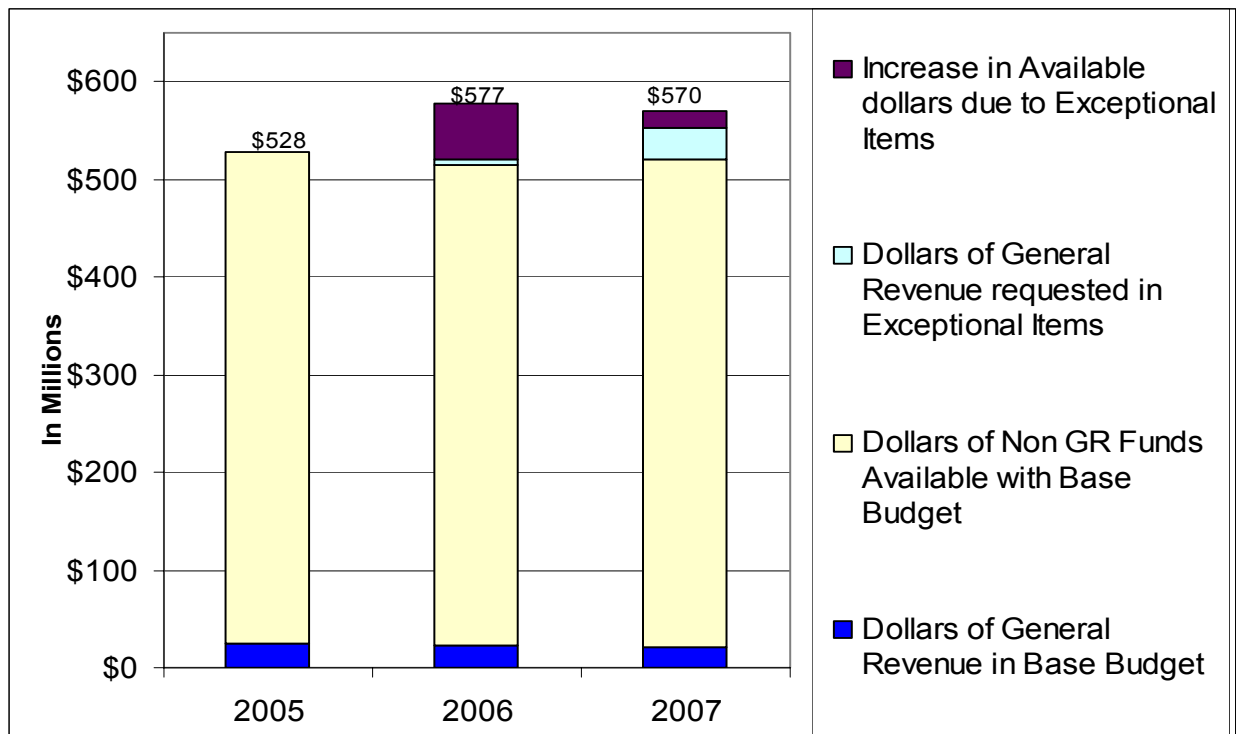
PART TWO: ALLOCATION OF TWDB FUNDS

Most of the TWDB infrastructure financing programs have limited and specific sources, and there are few discretionary funds available to distribute. The TWDB has tried to accommodate all applications for water related funding that conform to the statutory restrictions of the programs and has not added unnecessary restrictions beyond what the statutes impose.

The TWDB has committed financial assistance to communities at an average rate of \$478 million per year over the last five years through the main TWDB programs. **Figure 3** shows the amount of assistance that is projected to be available over the Fiscal Year 2005-2007 time frame. **Figure 4** depicts the historical five-year average financial assistance from each program, except for the RWA program, which has been in operation for three years. The TWDB has developed an outcome performance measure to track the percentage of available funds that are given out (committed) each year. The annual target for this outcome is around 85%, as indicated by **Table 2**, which assumes the FY 2006-2007 base budget request of the agency will be approved, and shows the impact of the Exceptional Items requested in the TWDB’s Fiscal Year 2006-2007 Legislative Appropriation Request (LAR).

In addition to the base budget request in the Legislative Appropriations Request, the TWDB requested exceptional item funding for three programs; Economically Distressed Area Program, Drinking Water State Revolving Fund Program and the State Participation Program. The several legislative appropriations exceptional item requests and legislative initiatives that will assist the TWDB in allocating financial assistance to better meet the priority needs identified herein are described in Part Three of this Plan.

Figure 3 – TWDB Financial Assistance Made Available

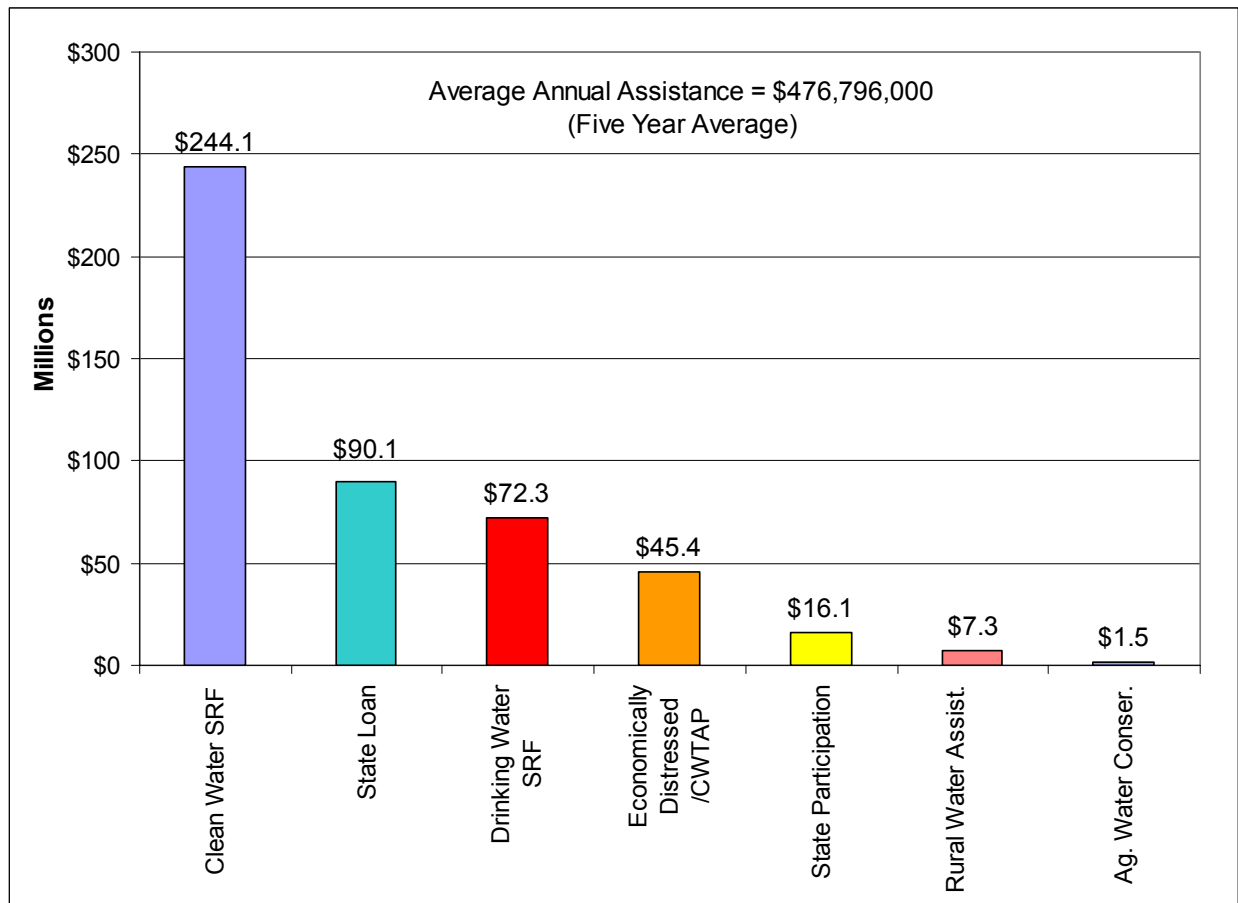


Each of the financial assistance programs that TWDB manages has separate state and, in some instances, federal enabling legislation. This legislation sets forth the purposes for which the program was created, and identifies eligible applicants, eligible projects and types of financial assistance offered. Some of them have prescriptive priority system requirements. The enabling legislation also identifies the sources of funds available to the program. In general, the sources of funds are state and federal appropriations, proceeds from the sale of general obligation and revenue bonds and, in some instances, loan repayment revenue streams.

Since the requirements and limitations for each program and source of funds are very specific, each program tends to be better suited to meet a certain kind of need than others, even though more than one program might be able to meet that particular need. However, the more financially attractive funding tend to be federally subsidized and have limited capacity. Consequently, it is not uncommon to have a single project receive funding from more than one program.

The following discussion identifies the different capital financial assistance programs available to the TWDB, and provides information regarding the potential uses of the program, the restrictions imposed upon the program and the sources and amounts of funds historically available.

Figure 4 – Average Annual Financial Assistance Provided from TWDB Programs



**Table 2. Percentage of Available Funds Committed to Projects Items
Projected Commitments by Program**

PROGRAM	FY 2005	FY 2006	FY 06 with	FY 2007	FY 07 with
			Exceptional Items		Exceptional Items
Drinking Water SRF	\$100,000,000	\$67,000,000	\$67,000,000	\$69,000,000	\$69,000,000
Colonia Plumbing Loan Program	\$100,000	\$0	\$0	\$0	\$0
Clean Water SRF	\$298,000,000	\$300,000,000	\$300,000,000	\$300,000,000	\$300,000,000
Economically Distressed Area Program	\$7,000,000	\$0	\$37,000,000	\$0	\$25,000,000
Colonia Self-Help Projects	\$250,000	\$250,000	\$250,000	\$250,000	\$250,000
Water Development Fund	\$55,000,000	\$55,000,000	\$55,000,000	\$60,000,000	\$60,000,000
State Participation loan	\$243,000	\$0	\$21,000,000	\$0	\$21,000,000
State Loan economy of scale					
Rural Water Assistance Fund	\$11,000,000	\$11,000,000	\$11,000,000	\$11,000,000	\$11,000,000
Water Infrastructure Fund	\$0	\$0	\$0	\$0	\$0
Groundwater Conservation District LP	\$65,000	\$65,000	\$65,000	\$0	\$0
Small Community Hardship Program Grants	\$3,400,000	\$0	\$0	\$0	\$0
Agriculture Water Cons. Loans	\$300,000	\$300,000	\$300,000	\$300,000	\$300,000
Agriculture Water Conservation Linked Deposit	\$420,000	\$420,000	\$420,000	\$420,000	\$420,000
Agriculture Water Conservation Grants	\$600,000	\$600,000	\$600,000	\$600,000	\$600,000
Total	\$476,378,000	\$434,635,000	\$492,635,000	\$441,570,000	\$487,570,000

Dollars Available by Program

PROGRAM	FY 2005	FY 2006	FY 06 with	FY 2007	FY 07 with
			Exceptional Items		Exceptional Items
Drinking Water SRF	\$157,000,000	\$95,800,000	\$95,800,000	\$95,800,000	\$95,800,000
Colonia Plumbing Loan Program	\$100,000	\$0	\$0	\$0	\$0
Clean Water SRF	\$353,000,000	\$353,000,000	\$353,000,000	\$353,000,000	\$353,000,000
Economically Distressed Area Program	\$7,000,000	\$0	\$37,000,000	\$0	\$25,000,000
Colonia Self-Help Projects	\$250,000	\$250,000	\$250,000	\$250,000	\$250,000
Water Development Fund	\$55,000,000	\$55,000,000	\$55,000,000	\$60,000,000	\$60,000,000
State Participation loan	\$243,000	\$0	\$25,000,000	\$0	\$25,000,000
Rural Water Assistance Fund	\$11,000,000	\$11,000,000	\$11,000,000	\$11,000,000	\$11,000,000
Water Infrastructure Fund	\$0	\$0	\$0	\$0	\$0
Rural CWWLP	\$1,350,000	\$0	\$0	\$0	\$0
Groundwater Conservation District LP	\$65,000	\$65,000	\$65,000	\$0	\$0
Small Community Hardship Program Grants	\$3,400,000	\$0	\$0	\$0	\$0
Agriculture Water Cons. Loans	\$300,000	\$300,000	\$300,000	\$300,000	\$300,000
Agriculture Water Conservation Linked Deposit	\$500,000	\$500,000	\$500,000	\$500,000	\$500,000
Agriculture Water Conservation Grants	\$600,000	\$600,000	\$600,000	\$600,000	\$600,000
Total	\$589,808,000	\$516,515,000	\$578,515,000	\$521,450,000	\$571,450,000
Available funds committed	80.77%	84.15%	85.16%	84.68%	85.32%

FEDERAL FUNDS

Clean Water State Revolving Fund

Background: The Clean Water State Revolving Fund (CWSRF) Program was created by the Federal Clean Water Act amendments of 1987. The CWSRF was a revolutionary program for Congress, and has arguably been the most successful federal funding program ever created. The SRF is required by federal statute to be a perpetual fund.

Source of Funds: The U.S. Congress, through the United States Environmental Protection Agency (EPA), has made annual “capitalization” grants to the states. The states, in turn, add a minimum 20 percent match from state funds which TWDB raised through the sale of General Obligation bonds. Loan repayments in excess of the debt retirement go back into the fund. The agency charges an administrative fee on each loan that goes toward the processing and monitoring of the projects.

Allocation of funds: Federal capital grants to Texas have averaged over \$71.8 million per year, for a total of over \$1.1 billion since the beginning of the program in 1987-8. Through leveraging the TWDB has made over \$3 billion available during this same time period.

All funds from the identified sources are allocated to the program. The TWDB has a capacity model to account for the variables and ensure that the CWSRF remains a perpetual fund. The long term capacity of the program is adjusted by the amount of bonds issued. It is also influenced by the amount of interest rate subsidy provided on the loans. The capacity is approximately \$353 million per year. Of this amount \$30 million is reserved to provide a higher subsidy (1% and 0% loans) to disadvantaged communities.

Eligible Uses:

- ◆ Reduced interest loans (0.95 basis point to 1.20 basis point subsidy) of wastewater projects addressing compliance issues consistent with the Clean Water Act goals.
- ◆ One percent and zero percent interest loans for wastewater projects addressing compliance issues in disadvantaged communities.
- ◆ Linked deposits to local lending institutions, such as banks or farm credit associations, to make loans to individuals for nonpoint source projects.
- ◆ Loans for Estuary Management projects.

Borrower’s Advantage: Savings to the community are due to subsidized interest rates.

Constraints: The Federal Clean Water Act requires that projects funded through the CWSRF be rated and listed in ranking order, in a “Project Priority List.” Prioritization for the CWSRF program is specified by federal law and regulations, and is designed to elevate those projects with the greatest likelihood of pollution to the State’s receiving streams. Data and information used in calculating priority ratings include Texas Commission on Environmental Quality (TCEQ) effluent monitoring data, TCEQ information regarding enforcement, and receiving stream sensitivity and the TWDB’s facility needs information.

The CWSRF program averaged approximately \$308.4 million in loan commitments each year from 1998 through 2002, and is the primary financial assistance program for wastewater infrastructure needs of the State.

Drinking Water State Revolving Fund

Background: The Drinking Water State Revolving Fund (DWSRF) Program was created by the federal Safe Drinking Water Act amendments of 1996. The program is targeted toward drinking water projects for public water systems. The amount of funds available each year from the DWSRF is dependent on the amount of the capitalization grant for the year.

Source of Funds: The U.S. Congress, through the United States Environmental Protection Agency (EPA), has made annual “capitalization” grants to the states. The DWSRF grant has a 20 percent state match requirement, which the TWDB raises through the sale of General Obligation bonds and General Revenue requests to enable subsidizing disadvantaged communities. Loan repayments in excess of the debt retirement go back into the fund. The agency charges an administrative fee on each loan that goes toward the processing and monitoring of the projects.

Bond Repayment: Revenue from loan re-payments from political subdivisions goes toward debt retirement of the General Obligation bonds.

Allocation of Funds: Portions of the federal grant funds are required by statute to be set aside for the various program administration costs. All of the remaining funds are allocated to the program.

The federal enabling legislation for the DWSRF also provides for a limited “disadvantaged communities” program feature. Under this feature, the TWDB can offer one percent, or zero percent loans and up to 35 percent forgiveness of loan principal to applicants that qualify as disadvantaged communities. However, total assistance is limited to up to 30 percent of the annual capitalization grant, or approximately \$22 million each year.

Financial assistance from this program averaged \$72 million per year from 2000 through 2004. The average amount available is approximately \$95 million per year, including the amount for disadvantaged communities; although there is a larger amount for FY 2005 due to carry over from prior years.

Constraints: The Federal Safe Drinking Water Act requires that projects funded through the DWSRF be rated and listed in ranking order in a comprehensive priority list. EPA’s criteria for the rating system are based on achieving and maintaining compliance with the National Drinking Water Standards, as well as on funding projects “most in need on a per household basis.” Data and information utilized in calculating the rating scores include Texas Commission on Environmental Quality data on public water system monitoring and compliance and United States Bureau of Census data on income.

This program is intended to meet drinking water infrastructure needs that are necessary to ensure federal compliance and address public health issues, and to a limited extent, serve the needs of rural and disadvantaged communities. The DWSRF cannot be used for projects intended to develop a long-term water supply, unless such projects are necessitated by other public health concerns.

Colonia Plumbing Loan Program

Source of Funds: The original source was an allocation of \$15 million from 1990 Clean Water Federal Capitalization Grant, out of the Clean Water State Revolving Fund Appropriation.

Bond Repayment: No repayment of the federal grant is required; Revenue from loan repayments from political subdivisions for the G.O. bonds.

Allocation of Funds: The original \$15,000,000, less \$600,000 for program administration, has been allocated to the program. Loan repayments to the agency are recycled to the program. Due to low interest in utilizing the program the TWDB plans to reallocate the funds back to the CWSRF or other border programs.

Eligible uses: Low-interest loan program available to assist colonia residents in financing the cost of plumbing connections to water and wastewater systems and with the installation of necessary plumbing improvements within their homes.

Borrower's Advantage: Subsidized interest rates for which loan repayment is requested but not required.

Constraints: State law requires this assistance be in the form of a loan though the funds could be disbursed as grants under federal oversight.

Colonias Wastewater Treatment Assistance Program

Background: The Colonias Wastewater Treatment Assistance Program (CWTAP) began in 1993, through a grant and operating agreement with the Environmental Protection Agency. The program is used to make grants for wastewater projects within 100 kilometers of the Texas/Mexico border. The TWDB is implementing this program in conjunction with the state's Economically Distressed Areas Program which is providing financial assistance to economically distressed areas of the state for water and sewer projects.

Source of Funds: A total of five federal grant appropriations have been received between federal Fiscal Years 1993 and 1999. The federal grants require a state match of varying levels from 100 percent, in some cases, to 20 percent for the 1998 and 1999 appropriations. A total of \$300 million has been made available to this program.

Bond Repayment: No repayment of the grant is required. The debt retirement of the state match from General Obligation bonds is repaid with state general revenues.

Allocation of Funds: A portion of the grant funds is allocated to program administration while the remainder of the grants and match funds are allocated to the program. All of these available funds are have been committed to projects except for a small amount which has been set aside for pending known or anticipated project cost increases. No additional federal grants are expected to be made.

Eligible uses: Grants for wastewater projects and water projects for unincorporated areas of the state that meet the definition of an “economically distressed area” and located in counties within 100 kilometers (62.14 miles) of the Texas/Mexico border.

Borrower's Advantage: Grants

Constraints: The funds were initially only for wastewater projects, but now are also available for water projects. Projects/applicants must be within 100 kilometers of the international border to qualify for funding.

STATE and GENERAL OBLIGATION BOND FUNDS

Economically Distressed Areas Program

Background: The Economically Distressed Areas Program (EDAP) was established in 1989 to provide combination grants and/or loans for development of adequate water supply and wastewater facilities in certain areas where such facilities were lacking and the financial resources of the residents were inadequate to meet those needs. The EDAP program will not fund ongoing operation and maintenance expenses, and applies only to areas of the state meeting the definition of an “economically distressed area,” primarily in counties along the Texas/Mexico border. An “economically distressed area” is an area within an affected county, where the water supply or wastewater systems are inadequate to meet minimal state standards, the financial resources are inadequate to provide services to meet those needs, and a subdivision existed on or before June 1, 1989.

Since 1993, the program has been operated in conjunction with the Colonias Wastewater Treatment Program. EDAP projects along the Texas/Mexico border are almost always funded in conjunction with the CWTAP program to maximize the use of the federal funds and make EDAP funds available for economically distressed areas in other affected counties of the state.

Sources of Funds: The program was funded by legislative and voter bond authorizations of \$250 million in TWDB issued state General Obligation (G.O.) bonds. The EDAP program is used in conjunction with all other available state and federal programs.

Bond Repayment: Approximately 90 percent of the bonds are repaid through general revenue appropriation and approximately 10 percent come from loan repayments from political subdivisions.

Allocation of Funds: Of the \$250 million G.O. Bond authorization only \$213 million has been issued due to appropriation limitations on the debt retirement. Essentially, this entire amount (\$213 million) has been committed to on-going projects. Funding of the EDAP and CWTAP

programs combined have averaged \$42 million per year for Fiscal Years 2000 through 2004. The TWDB's 2006-2007 Legislative Appropriation Request is requesting additional general revenue for debt retirement to accommodate the sale of the remaining \$37 million in bond authorization, and an additional \$25 million in grants to complete EDAP projects.

Eligible Uses: The program can fund construction, acquisition or improvements to water supply and wastewater collection and treatment works, including all necessary engineering work.

Constraints: The program applies only to areas of the state meeting the definition of an "economically distressed area," primarily in counties along the Texas/Mexico border.

Funding is presently limited to projects for which a facility plan is completed, or currently being developed.

Colonia Self-Help Program (CSHP)

Background: The CSHP is intended to provide reimbursements to nonprofit organizations for expenses incurred in a self-help project that results in the provision of adequate water or wastewater services to a colonia. The Legislature did not appropriate funding for this grant program, but the TWDB identified a limited amount of funds from the Water Assistance Fund to provide grants for CSHP projects.

Source of Funds: Currently funded from future payments of Texas Water Resource Finance Authority. Potential funding sources include legislative transfers, and gifts, grants and donations.

Bond Repayment: Not applicable.

Allocation of Funds: No funds have been appropriated by the legislature. TWDB is using TWRFA proceeds as may be available, for which approximately \$250,000 is available for FY 2005. The TWDB may annually consider transfers from the available TWRFA funds if needed to meet demands.

Eligible uses: Water and wastewater projects sponsored by non-profit organizations that rely on community residents' labor to help construct the project.

Borrower's Advantage: 100 percent grant funds.

Constraints: Limited funding; limited to non-profit organizations.

State Loan Program - Water Development Fund

Background: The Water Development Fund was created in 1957, originally for the purpose of helping communities develop water supplies and drinking water infrastructure. The program has evolved over the years, including additional statutory authority to fund wastewater and flood control projects. Current Development Fund loans are made to political subdivisions for water supply, water pollution control, and flood control projects. The funds are managed through the Water Development Fund.

The State Loan Program can be used to fund the same types of projects as the CWSRF and DWSRF, but do not require a long lead time or compliance with stringent federal requirements to access. As a result, the water supply and wastewater projects funded tend to be projects of a more urgent nature, or projects which are ineligible for CWSRF or DWSRF funding. The Development Fund is also the source of approximately \$25 million per year in funds for state match for the CWSRF and DWSRF. This is considered a very high priority, since each dollar of state funds brings in five dollars of federal grant funds.

Source of Funds: TWDB issues General Obligation (GO) bonds for the program. The TWDB is authorized to provide up to \$4.68 billion in Texas Water Development Bonds. As of the end of Fiscal Year 2004, the TWDB has sold over \$2 billion of these bonds.

Bond Repayments: Revenue from the loan repayments is used to retire the debt on the TWDB general obligation bonds.

Allocation of Funds: Annual financial assistance from this program has averaged \$90.1 million over the last five years, excluding funds used to match the Clean Water and Drinking Water SRF programs. The TWDB will sell a sufficient amount of GO bonds to meet the estimated annual demands for the funds, which is anticipated to be between \$50 and \$75 million per year.

Eligible uses: The State Loan Program provides loans for water and wastewater infrastructure projects, water development, water quality enhancement, flood control, drainage, reuse and recycling, municipal solid waste, and desalination.

Borrower's Advantage: Political subdivisions and water supply corporations that borrow from the fund (typically entities without a credit rating) receive a lower interest rate than they might otherwise receive due to the superior credit rating of the State and TWDB.

Constraints: Water supply projects must be consistent with the State Water Plan.

State Participation Program

Background: The State Participation Program was created to encourage regional water supply, wastewater or flood control projects where local interests could not afford such projects at the time the assistance is provided. The State provides the assistance by financing and owning all or a part of the excess capacity in the regional facilities until such time as the State's interest can be bought out by the regional participants.

Sources of Funds: TWDB issued General Obligation Bonds issued under the authority provided for the Water Development Fund. General Revenue appropriations pay the related debt service until a sufficient rate base develops in the project area to allow local participants to purchase the State's interest. Ultimately, the state recovers the total amount of bonds and appropriations from the local government. The last \$35 million authorization was for the 2002/2003 biennium, and all funds except \$243,000 have been committed to projects.

Bond Repayment: General Revenue appropriations pay the related debt service until a sufficient rate base develops in the project area to allow local participants to purchase the State's interest. Ultimately, the state recovers the total amount of bonds and appropriations from the local government. The bonds are retired by general revenue provided by the Legislature, and by the Recipients' loan repayments. Any net gain goes back into the general revenue fund.

Allocation of Funds: All of the bonds sold for the State Participation Program are made available to the program. As an exceptional item in the TWDB's Legislative Appropriations Request, general revenue of about \$5.4 is being sought for the biennium so that another \$50 million (\$25 million per year) of State Participation Bonds can be made available. The State Water Plan has identified many large potential State Participation Projects and indicates that the usage could be as much as \$50 million per year. Historical annual financial assistance for the State Participation Program has averaged \$16.1 million over the past five years.

Eligible uses: Water, wastewater, and flood protection projects to be "built for the future" using both local and state funding. Local interests pay for the portion of the project that meets current and near term-projected needs. The state purchases the portion of an eligible facility that results in excess capacity above current and near term-projected needs that is beyond the ability of the current rate-paying base to ensure the optimal development of the project. The state may purchase an ownership interest in such excess capacity of the eligible regional facility of up to 100 percent.

Borrower's Advantage: Local governments obtain economies of scale for projects that are beyond their current financial capability to implement without assistance. In addition to interest savings, the program reduces the necessity and added capital expense of building new structures or replacing undersized structures in the future. The TWDB's experience has been to fund projects producing over 30 percent in capital savings.

Constraints: Legislature has limited the funding level each biennium in the appropriations bill. Prior to fiscal year 2002, the State Participation Program operated on a first-come, first-served basis, without a priority system. However, due to the success of the program in recent years, and the limited funding, this approach is no longer appropriate. Consequently, the TWDB has recently adopted rule amendments to include priority considerations in its program rules. The new priority system will favor regional water supply projects with near-term demands, in which TWDB funding is leveraged with other sources of funds.

Agricultural Water Conservation Program

Background: The Agricultural Water Conservation Loan Program was created in 1989 to encourage conservation in irrigation water use by providing low interest loans for the purchase of water conserving irrigation equipment. The program was used in conjunction with earnings from the Agricultural Trust Fund to enable low interest rate funding. In this program, the TWDB usually lent monies to "lender" water conservation districts, which, in turn, made loans to individual farmers for the purchase of water conserving irrigation equipment. The TWDB also has the authority to make loans to "borrower" districts to make improvements to their systems that result in water conservation, although only two such loans have been made to date.

The 78th Legislature amended the water code which provided for the consolidation of the funds and agriculture water conservation programs. The Agricultural Water Trust Fund and the Agricultural Soil and Water Conservation Fund have been consolidated into the Agricultural Water Conservation Fund. Through this consolidated fund the TWDB will make grants, loans to Districts, and is developing a Agricultural Water Conservation Linked Deposit Program which will provide loan funds to banks at a nominal interest rate which may then loan the funds to individuals. The linked deposit program is still in development, and is expected to be operational during the latter part of Fiscal Year 2005.

Source of Funds: The Agricultural Water Conservation Fund consolidation resulted in total existing assets of approximately \$20 million, together with TWDB authority to issue state G.O. bonds. Note that \$10 million of this is presently reserved for a long term water conservation demonstration grant project. The investment earnings on the cash that is in the fund is kept within the fund. The fund can also accept appropriations.

Bond Repayment: Revenue from loan repayments from political subdivisions will go toward debt service.

Allocation of Funds: Annual financial assistance in loans from this program for the past five years has averaged \$1.49 million. Since the fund is used for both grants and loans and receives interest earnings and loan repayments, the TWDB has developed a capacity model to ensure that sufficient funds are available for grants. The capacity of the program to make loans and grants will be determined annually.

The TWDB allocated \$600,000 from the fund to go toward agricultural water conservation grants during fiscal year 2004. The TWDB will annually consider designating the amount of funding for grants, based on the long term capacity model. In September 2004 the TWDB allocated \$10 million over the next ten years for Agriculture Water Conservation demonstration grants. The tentative annual disbursement schedule is:

FY2005-2007 is \$1,200,000 per year;

FY 2008-2011 is \$1,100,000 per year;

FY 2012 is \$1,200,000 per year;

FY 2013 is \$400,000;

FY 2014 is \$300,000; and

FY 2015 is \$100,000.

The remainder of the Agriculture Water Conservation funds is available for loans, and the linked deposit program, the TWDB expects to provide approximately \$300,000 per year for loans and \$500,000 per year for the linked deposit program. The TWDB could sell sufficient bonds to meet the demands for loans that are in excess of available cash funds.

Eligible uses:

Grants may be made to state agencies, political subdivisions (such as soil and water conservation districts, irrigation districts and groundwater conservation districts) for conservation programs (such as technical assistance, research, demonstration, technology transfer, or educational programs), or conservation projects (such as irrigation systems efficiency improvements,

converting irrigated land to dryland and improving dryland use of natural precipitation, installing water meters, and brush control activities).

Loans may be made to political subdivisions for conservation programs or conservation projects or to make loans to individual farmers and ranchers.

Linked deposits to local lending institutions (such as banks or farm credit associations) may be utilized to enable institutions to provide loans to individuals for conservation projects.

Borrower's Advantage: Grants and subsidized loan interest rates.

Constraints: Access to this program is limited to loans that result in conservation of agricultural irrigation water. Grants are limited to cash on hand and loans are limited by bond authority.

Amount available: G.O. Bond authorization not to exceed \$200 million; \$ 35.16 million has been issued to date.

Rural Water Assistance Fund

Background: The RWAFF is intended to provide financial assistance for water projects to smaller, rural water suppliers at a lower cost than is currently accessible to such entities, and to ensure the public outreach and technical assistance necessary for these smaller systems to succeed. The RWAFF can also assist small systems in participating in regional water projects, which benefit from economies of scale. Although the RWAFF was established to consist of appropriations, which would allow for the “buy down” of interest rates and a public outreach component, the Legislature has not appropriated funds for this program.

It is anticipated that the RWAFF will play an important role in filling the needs of rural communities and the TWDB anticipates continuing to apply for funding through the Private Activity Volume Cap in the future. However, in order for the program to provide the types of loan subsidies and outreach assistance envisioned in the enabling legislation, a cash funding source is required. In addition, the TWDB’s use of private activity bonds as a funding source is not guaranteed because the State uses a lottery process to allocate the State’s Private Activity Volume Cap.

Source of Funds: Currently funded with TWDB-issued G.O. bonds using the state’s Private Activity Bond Cap to access tax-exempt rates. As of the end of September 2004, approximately \$14.5 million in bond proceeds were available for commitment. Appropriations are a possible future source of funds.

Bond Repayment: Revenue from the recipient’s loan repayments is used to retire the bonds issued by the TWDB.

Allocation of Funds: The TWDB is currently funding the RWAFF with approximately \$75 million in general obligation bond proceeds which were sold under the State’s Private Activity Volume Cap.

Due to the nature of the funds available to the RWAFF program, serving the needs of water supply corporations will be the primary use of this program. Because this is a relatively new program that offers limited access, no priority system is proposed for this program.

Since the program was created in FY 2002, the TWDB has committed an average of \$12.1 million per year.

Eligible uses: Water and wastewater projects for political subdivisions and water supply corporations.

Borrower's Advantage: Below market loans for terms of up to 40 years. Water supply corporations benefit from this program because they can obtain loans at near tax-exempt interest rates, rather than taxable rates. Additionally, water supply corporations are exempt from paying sales taxes on materials and supplies used in constructing the project that is financed through the RWAFF.

Constraints: Unless appropriated funds become available to supplement the program, it will remain economically unavailable for a great majority of the communities it is designed to help, since most of these communities need some sort of increased subsidy for their infrastructure. The program is restricted to rural communities with service area $\leq 10,000$ population or that otherwise qualifies for financing from a federal agency, or to counties in which no urban area exceeds 50,000 population.

Water Infrastructure Fund Program (WIF)

Background: The WIF is designed to provide a mix of funding options including market rate loans, below market rate loans, zero interest loans, and grants. An additional provision allows for certain project elements that are key to obtaining environmental approvals (planning, design, permitting and etc.) to receive principal and interest payment deferrals for up to 10 years. Only up to 10% of the fund can be used for deferrals. In addition, the WIF is designed to provide up to 10 percent of funding in the form of a grant or zero interest loan to areas outside metropolitan statistical areas or for projects to serve economically distressed areas. All of the provisions that make the WIF an attractive and viable program for funding water supply projects require a cash source to implement. However, the 77th and 78th Legislature did not provide appropriations for the WIF. Currently, the TWDB has \$50 million general obligation bond authorization “earmarked” for the WIF as required by House Joint Resolution 81 (77th Legislature). However, implementation of the WIF using bond proceeds does not achieve the intended purpose of the program to provide subsidized loans and grants. This is due to the fact that Article 3, §49-c of the Texas Constitution includes provisions that restrict the use of bond proceeds, thereby preventing the TWDB from offering grants for water projects and from offering zero interest loans.

The primary intended use for the WIF is to make financial incentives available for implementation of the strategies recommended in the State and regional water plans. Because of this restriction and the limited funds available, the TWDB does not propose a priority system for the WIF at this time.

Source of Funds: To date, no financial assistance has been made available from this program. The program may be funded with appropriations and fees, or revenues from legislature, gifts, grants and donations, and other available sources.

Bond Repayment: NA

Allocation of Funds: No funds have been available to date.

Eligible uses:

- ◆ Loans for projects to political subdivisions, at or below market rates;
- ◆ Grants, or low-or-zero-interest loans for projects outside metropolitan areas to ensure implementation of projects, or for economically distressed areas (but not to exceed 10 percent of financial assistance each year); and
- ◆ Loans for planning and design, permitting, and state and federal regulatory activities, at or below market rates, with deferral of principal and interest payments for up to 10 years, or until construction begins.

Borrower's Advantage: Up-front funding for preliminary project costs with payment deferral; low interest loans or grants.

Constraints: Program has not been funded.

Rural Community Water and Wastewater Loan Fund

Background: The Rural Community Water and Wastewater Loan Fund (RCWWF) is a pilot program established in 2001 by the 77th Texas Legislature to provide financial assistance to rural communities through loan agreements rather than through the issuing and selling of bonds. The original program had a \$250,000 limit on the amount of assistance that could be provided and allowed a maximum 20 year pay back term. The \$250,000 limit was removed by the 78th legislature. The program can be used to provide subsidized interest loans to rural communities, as defined by TWDB Rules, for the construction, acquisition, or improvement of water and wastewater projects.

Prior Applications: As of November, 2004 no applications have been received for funding from this program, but three eligible communities are currently preparing applications for funding. It is anticipated that the TWDB will offer loans to communities for wastewater infrastructure projects.

Source of Funds: Water Assistance Fund transfers have been made for the pilot program, which totals \$1,350,000. This was specifically appropriated by the Legislature from Texas Water Resource Finance Authority excess proceeds. General Revenue Appropriations are also a potential source of funds.

Bond Repayment: Not Applicable.

Allocation of Funds: All of the legislatively appropriated funds (\$1,350,000) are allocated to the program.

Borrower's Advantage: The program offers a subsidized loan at 150 basis points below the “A” scale Delphis rate scale.

Available Performance Measures: Funding through this program contributes to two proposed TWDB performance measures. One measure will count the number of commitments made to small, rural and disadvantaged communities, and the other will total the dollar value of commitments made to small, rural and disadvantaged communities.

Constraints: Limited to cities and counties with population less than 5,000, or districts or authorities of similar population located outside cities ETJ. The RCWWF addresses a demand for assistance from rural communities that lack the technical expertise or resources to obtain funding from the Clean Water State Revolving Fund (CWSRF) and the Drinking Water State Revolving Fund (DWSRF). The program provides assistance without the long lead-time associated with both the CWSRF and DWSRF and also provides assistance for projects that may not qualify for funding under either program. The loan repayment term is limited a maximum of 20 years.

Feasibility and Demand for an Expanded Program: The TWDB has only recently amended its rules to eliminate the dollar ceiling on the size of the loan. There are approximately 550 political subdivisions outside of standard metropolitan statistical areas with populations below 5000, which make up the bulk of the potential eligible applicants. During Fiscal Years 2003 and 2004 the TWDB funded projects in six of these communities through its other programs: 1 in CWSRF 4 in DWSRF, 1 in State Loan Program, and 1 with a direct General Revenue grant through the Water Assistance Loan Fund. In September 2004, the TWDB funded projects in two additional communities through the TWDB’s Small Community Hardship Program, which provides grant funding.

The TWDB analysis indicates that it is feasible to continue the program, and that the demand for expanding the program is moderate to low. The TWDB has been able to accommodate some of the previous community needs through other financing programs. Many of the smaller communities need grant funding in order to provide affordable services for its customers. The TWDB desires to keep the program available for those small communities that have urgent water and wastewater needs that have not otherwise been able to obtain CWSRF, DWSRF or grant funding.

Eligible uses: Loans to rural communities for water and wastewater projects.

Small Community Hardship Program (Water Assistance Fund)

Background: TWDB created this program in 2004 which was made possible due to the legislatively expanded ability to make grants from the Water Loan Assistance Fund.

Source of Funds: Appropriations are a potential future source. The TWDB utilized \$3.4 million in funds available from Texas Water Resource Finance Authority.

Bond Repayment: Not applicable.

Allocation of funds: Most of the initial \$3.4 million allocation has been committed to projects. As of November, 2004, \$489,000 was left to be committed to projects. No other funds are presently available for allocation.

Eligible uses: Water and wastewater projects in communities with populations of 5,000 or less.

Borrower's Advantage: Up to 90 percent of project costs, not to exceed \$1 million, may be the form of in grant funds.

Constraints: Applicants must meet hardship criteria. Limited funding is available. Program will need to access funds that allow reduced rate loans and grants to be useful.

Groundwater Conservation District Loan Program (Water Assistance Fund)

Background: TWDB created this program in 2002. Only three Districts have applied for and obtained funding through the program.

Source of Funds: The 77th Legislature provided \$300,000 in general revenue to finance the program.

Bond Repayment: Not applicable.

Allocation of funds: As of October, 2004, approximately \$170,000 remained to be committed. This is expected to meet the demand over the next two years.

Eligible uses: The funds may be used for initial operational expenses of startup water conservation district.

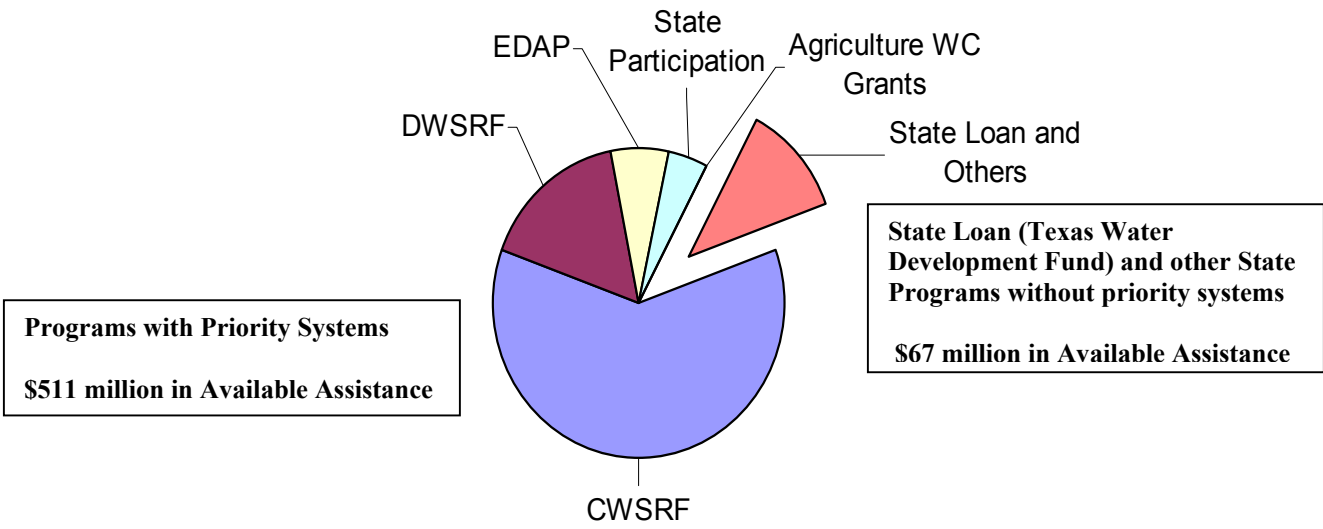
Borrower's Advantage: New conservation districts get the benefit of the state's superior credit rating, and may not be able to raise funds elsewhere.

Constraints: Applicants must have a revenue source to pledge for the loan repayment.

The However it emphasizes the Water Development Fund program, which are the only operating financial assistance programs for which access is not restricted because of eligibility requirements or a priority system. Currently only 11 percent of the TWDB's funding is not restricted.

Figure 5 – Anticipated FY 2006 Available Financial Assistance in Programs with Access Restricted by Priority Systems

11% of the Anticipated FY 2006 Available Assistance does not have any priority restrictions.



PART THREE: TEXAS WATER DEVELOPMENT TWDB PRIORITIES

The TWDB has identified general priorities to guide its capital financial assistance programs.

- Implement the State Water Plan;
- Continue to serve the needs of the statutorily defined Economically Distressed Areas;
- Serve the statewide needs of small, rural and disadvantaged communities;
- Advance the development of desalination within Texas;
- Facilitate the implementation of regional projects through the State Participation Program; and
- Maximize the amount of federal funds received and utilized to meet water and wastewater infrastructure needs.

The TWDB has been able to successfully maximize receipt and use of federal funds through the Clean Water and Drinking Water SRF programs, and the Colonias Wastewater Treatment Assistance Program. However, the restrictions imposed by the separate enabling legislation and sources of funds, as well as the amounts of funds available, limit the TWDB's ability to target funding effectively to all of the TWDB's priorities.

The TWDB's ability to allocate funding toward implementation of the State Water Plan by funding new water supply needs is limited. The primary program designed to address this need is the Water Infrastructure Fund, for which no funds have been appropriated. The only other program that can address a significant portion of this need is the State Participation Program.

The funding available to the Economically Distressed Areas Program and the CWTAP has been largely utilized, leaving only minimal amounts available for the next biennium. These programs are the primary means for continuing to meet the needs of the Economically Distressed Areas.

Finally, there are no viable funded programs currently available to serve the nonborder colonias needs in a significant manner. The only program that can currently attempt to meet these needs is the disadvantaged communities component of the DWSRF and CWSRF, for which funding is very limited.

Never the less, the TWDB continues to find ways to help serve its priority needs. The TWDB's fiscal year 2006/2007 Legislative Appropriations Request contains specific recommendations to address three of these needs.

- State Water Plan water supply needs – The TWDB is requesting legislative appropriations to offset General Revenue Draws to authorize an additional \$50 million for the State Participation Program for the fiscal year 2006/2007 biennium.
- Economically Distressed Areas Needs – The TWDB's LAR contains an exceptional item requesting an appropriation of General Revenue funds of \$36.9 million for the EDAP program over the next biennium which would provide

\$61.9 million in additional funding. If appropriated, this amount of funds would enable the TWDB to fund the additional EDAP projects for which viable facility plans have been identified.

- Non-border Colonias and Rural Community Needs – The TWDB’s LAR contains an exceptional item requesting state matching funds to federal capitalization grants for the Drinking Water State Revolving Fund (DWSRF) program to provide better assistance to disadvantaged communities. The state matching funds will make available up to \$20 million per year during FY 2006 and 2007 to the disadvantaged communities. The DWSRF disadvantaged program may provide zero percent or one percent interest rate loans, plus loan forgiveness of up to 30% of the principal loan. Note that the TWDB will also continue to offer up to \$30 million per year to disadvantaged communities through the Clean Water State Revolving Fund program in the form of loans at either zero percent or one percent interest rates.
- Water Supply Strategies - Desalination technology continues to evolve rapidly and the TWDB has decided to pursue further development through the Research and Planning Fund during the next couple of years. The TWDB requested \$3.3 million as an Exceptional Item in its LAR to continue development, demonstration and evaluation of the technology. Future full scale projects may be funded under several of the existing agency programs.

PART FOUR: CONCLUSIONS

The timing of needed investments in water infrastructure projects is of critical importance when considering anticipated population growth and the current budgetary climate. The State's population is expected to nearly double by 2050 and the State is facing a budget shortfall unlike any experienced in well over a decade. This underscores the importance of the TWDB's Plan for allocating resources to address identified priorities related to implementing the State Water Plan, leveraging federal investments, and addressing the needs of rural and disadvantaged communities. However, constraints of federally supported programs and the need for cash supplements provide significant challenges for the TWDB in meeting its priorities. For these and other reasons, the TWDB has been forced to identify innovative ways of meeting its priorities. To a limited degree, this has proven successful as evidenced by the TWDB's success in implementing the Rural Water Assistance Fund using private activity bonds. The TWDB is currently developing recommendations for consideration by the 79th Legislature for funding a large-scale demonstration desalination projects. It is anticipated that this initiative will involve the use of federal, state and private financing sources. Continuing to identify innovative solutions and implementing them through existing statutes and proposed revisions to statute will help the TWDB achieve state capital investment goals for water development. This Plan supports the TWDB's stated priorities and lays the groundwork for achieving those priorities. In short, full implementation of this Plan accomplishes the following:

- Continues providing state matching dollars to leverage federal investment in the two SRF programs to continue addressing compliance issues related to the federal Safe Drinking Water and Clean Water Acts;
- Sets aside \$30 million in the Clean Water SRF and \$20 million per year in the Drinking Water SRF to implement a disadvantaged communities program to address wastewater needs of colonias and rural communities;
- Restores the amount of State Participation funding to \$50 million per biennium to facilitate implementation of regional projects;
- Increases funding available for the Economically Distressed Areas Program to address the water and wastewater needs of colonia residents in eligible counties;
- Continues using the State's general obligation bond authority to access the State's Private Activity Cap to fund the Rural Water Assistance Program to address water infrastructure needs in rural communities; and
- Continues using the State's general obligation bond authority to fund the Texas Water Development Funds to fund those urgent water, wastewater and flood control projects that cannot qualify for funding from other TWDB programs.

It is important to note that full implementation of this Plan will require positive action on the part of the Legislature as the TWDB pursues its priorities during the 79th Legislative Session. In the future, the TWDB anticipates that historical funding patterns will show a relative shift toward meeting these priorities.