

Chesapeake Bay Financing Authority

Organizational Template

July 13, 2005

Introduction

In January of 2005, the Chesapeake Executive Council issued Directive 04-1 in response to the recommendations set forth by the Blue Ribbon Finance Panel. That directive instructed the Principals' Staff Committee "to convene a Committee of federal, state, and regional finance and legal experts to provide a specific proposal" for a regional financing authority that would help finance and implement programs to restore and protect water quality throughout the Chesapeake watershed. This Report of the Committee of experts outlines the conceptual framework for a Chesapeake Bay Regional Financing Authority.

The Report provides the four core deliverables in the Directive:

1. The governance structure for an authority
2. Regulatory and/or legislative changes necessary (state and federal)
3. Specific examples of funding mechanisms that could generate necessary revenue streams
4. Decision-making mechanisms relative to the allocation of loan and grant funds

In addition to these four deliverables, the Committee has identified a number of key issues critical to the establishment of a successful authority. Over the past four months, the Committee reviewed and analyzed a variety of potential authority structures and organizations from around the country, and worked directly with regional leaders to identify legal, political, and administrative issues for resolution. The recommendations were vetted through a number of legal, political, and administrative experts from across the region.

Why a Regional Financing Authority?

Financing authorities serve a multitude of functions in communities throughout the country. The structure of these organizations and how they accomplish their missions depends on the resource need they are addressing within the communities they serve. What is consistent with all financing authorities, however, is their overall purpose in the community: ***to facilitate investment for the public good.*** Therefore, the purpose of a Chesapeake Bay Financing Authority would be to facilitate on a priority basis investment into programs and projects targeting Bay protection and restoration.

The purpose of regional financing authorities is to leverage fiscal resources by creating efficiencies, economies of scale, and political synergies for addressing community needs that cross jurisdictional boundaries. Therefore, a Chesapeake Bay Financing Authority will be successful if it can help assure the needed resources and reduce the cost of implementing watershed restoration and protection programs.

Each of the Chesapeake Bay jurisdictions already has financing authorities that fund infrastructure and community needs, including wastewater treatment, transportation, and drinking water supply. For a regional financing authority to work, it must enhance the work of these state authorities in one of two ways: (1) improve the capacity of state financing systems, and/or (2) provide access to additional capital that otherwise would not be available to jurisdictions. If either of these needs exists within the watershed, then a regional authority would be beneficial. The Blue Ribbon Finance Panel recommendation to develop a financing authority therefore assumes that doing so will meet these two needs.

Implementing a regional funding effort also has advantages in addition to financing and program efficiency. Most importantly, creating a regional financing authority provides the opportunity to increase the political will to tackle significant water quality improvement efforts across the watershed. By agreeing to take the bold steps to establish and fund a regional financing authority, the Chesapeake Executive Council will send a clear message to citizens across the region that protecting and restoring the Chesapeake Bay is an essential community priority and will require unprecedented coordination and cooperation.

Key Issues

Obviously, there will be conflicts, barriers, and concerns within each of the Bay's jurisdictions concerning the development of a regional funding strategy and financing authority. Therefore, the Committee identified a variety of issues that must be addressed as the structure for an authority is established.

- 1. *Developing a Financing Strategy.*** In the absence of an agreed-upon overall financing strategy for Chesapeake Bay restoration, it is difficult to set out the roles and responsibilities for a regional financing authority. What an authority does will depend on sources of funds currently available and anticipated by the partners. These sources could be in the form of public funds, but might also involve incentives for private sector investments. In the absence of such a comprehensive strategy, the Committee made assumptions on what would be the traditional roles and responsibilities of a financing authority based upon current programs and needs estimated by the Blue Ribbon Finance Panel Report.
- 2. *Funding a Regional Financing Authority.*** A regional financing authority will provide the opportunity for leveraging untapped resources and for expediting programs and projects necessary for implementing the Tributary Strategies. The Committee has outlined three funding models or scenarios in which a regional financing entity would be beneficial. But designing a regional financing authority does not answer the most difficult question of all: who should pay for the restoration

of the Chesapeake Bay? Each of these models requires that very difficult, bold decisions be made as to who should pay and how money would be collected and disseminated. If these funds are not available, then any attempts to develop a regional financing effort will be unsuccessful.

3. ***Commitment by the Bay Partners.*** The Blue Ribbon Finance Panel was correct when it stated that restoring the Chesapeake Bay will require many billions of dollars and an unyielding commitment by the Bay states and the federal government. A regional financing authority will provide the opportunity for leveraging untapped resources and for expediting programs and projects necessary for implementing the Tributary Strategies. Intrinsic to an authority's success is the unyielding financial commitment from each of its partners. It is clear that the Bay restoration effort – including the development and operations of a financing authority – will require an increased commitment by all six states, the District of Columbia, and the federal government. Without fiscal commitments of new money from each partner, the financing authority will not become a reality.
4. ***The Role of the Federal Government.*** Though it is essential for the federal government to expand its financial involvement in the restoration effort, determining exactly how this will manifest itself remains unclear. There are many different federal funding programs directly related to the Chesapeake Bay watershed restoration effort, and each has its own authorization and annual appropriation process. A regional financing authority would need to support a broad spectrum of watershed issues related to the Tributary Strategies. These issues – agriculture, stormwater, air deposition, and wastewater management – have specific, and often overlapping federal agencies with responsibilities and funding. The role of each of these agencies in the development of federal financial support needs to be sorted out and coordinated (see below).
5. ***Coordination with Existing Programs.*** The Committee agreed with the Blue Ribbon Finance Panel's recommendation to improve the coordination of current federal and state programs. This is especially critical as it relates to developing and managing a multi-jurisdictional financing effort. All of the jurisdictions in the watershed have state and Federal programs working to address Bay restoration issues. It is essential that an authority work in partnership with these programs rather than in conflict. Not only is this important for the obvious political and administrative reasons; it also will ensure that an authority can keep administrative and operational costs low.
6. ***Regional v. Jurisdictional Views.*** There is potential for conflict between regional and jurisdictional implementation. The power of a regional financing effort is that it creates a tool for addressing watershed problems regardless of geopolitical boundaries. However, a jurisdiction may change its priorities or desire to have the funds they have contributed spent within their own borders. The need for cooperation and coordination must not overlook the need for an authority to remain independent and flexible in the application of its programs. This independence is essential for its long-term success. Balancing this with jurisdictional interests will be a critical task for an authority's leadership.

7. ***Debt Management.*** The capacity to borrow money through debt financing is essential for many large-scale water quality projects. The Committee feels that it is an important long-term goal of the authority to have the ability to leverage resources through debt financing. Therefore, long-term, regularized streams of payments to the authority will be essential. The best bond ratings will be realized if the streams of payments are legally guaranteed and not at risk.
8. ***Building On Experience.*** Though creating and funding a regional financing authority presents a major challenge to regional leaders, the groundwork for its success has been laid by each of the Bay partners. Each of the Bay jurisdictions has already implemented a wide variety of Bay restoration programs and projects. Elected officials in each jurisdiction have taken the first steps in funding and financing essential programs and projects. In addition, the federal government has provided significant leadership and resources to the Bay restoration effort through a variety of programs, agencies, and partnerships. Developing a regional financing authority will build on these important efforts.

Though these issues outline many potential problems to overcome, the Committee feels that a strong, well-funded financing authority would enhance regional efforts to restore water quality throughout the Chesapeake Bay watershed. If structured appropriately, a Chesapeake Bay Financing Authority will create a flexible, effective financing vehicle to help resolve Chesapeake Bay water quality protection efforts that span multiple jurisdictions. This report provides a template for the authority's organizational structure and provides recommendations on its purpose and how it should function. In addition, the Committee has outlined a recommended funding model, governing structure for the organization, as well as some necessary criteria for decision-making. Finally, the report outlines important legal and administrative changes that will occur, as well as some recommended next steps for ensuring that a financing authority is developed effectively.

Purpose and Function

Core Functions

The purpose of a Chesapeake Bay Financing Authority should be to facilitate investment in programs and projects targeted towards restoring and protecting the Chesapeake Bay watershed. Its role should be to fund critical, priority projects that have regional impact and importance. When fully operational and consistent with an overall funding strategy for the restoration of the Bay, the Authority would perform the following four core functions:

1. Fund cost-effective programs and individual projects that help implement the Tributary Strategies of each partner, as submitted to the Chesapeake Bay Program;
2. Focus resources on strategic, watershed-wide issues and programs;
3. Reduce the cost of implementation of the Tributary Strategies by encouraging the development of innovative market-based programs and resources;
4. Provide opportunities to coordinate the various funding streams targeted at water quality protection and restoration efforts in the Chesapeake Bay watershed; and,
5. Obtain new, enhanced or redirected funding and financial resources from federal and state governments, as well as the private sector. The Authority will require its partners to dedicate sustained, long-term funding to the organization.

The Authority would accomplish these functions by managing and implementing low interest loan programs and targeted grant programs. Because many water quality best management practices require significant upfront capital investment, the Authority should be empowered to raise money by issuing revenue bonds.

In addition, the Authority should focus on implementing innovative financing programs that target cost reduction and efficiency. Examples of these types of programs include:

- Working with state, local, and federal officials to develop innovative tax programs such as tax credits related to watershed stewardship to engage the private sector.
- Establishing financing tools that implement innovative agricultural incentive, insurance, or cost-share programs such as nutrient use efficiency and precision agriculture.
- Encouraging market-based programs and private sector investment into implementing best management practices.

The goal of a regional financing authority should be to reduce the cost of implementing the Tributary Strategies and to maximize the ability of the Bay jurisdictions to pay for watershed protection and restoration efforts. Therefore, the Authority must cooperate with existing organizations, institutions, and programs already in place across the region. Its primary impetus is to work directly with the Chesapeake Bay Program and the Tributary Strategies process. The work of the Authority will be

grounded on the activities, findings, conclusions and recommendations generated from the Bay Program partners and the Tributary Strategies effort. The Authority would work to leverage rather than duplicate the work of existing programs and entities. Moreover, the Authority would work closely with existing organizations to fund and support high priority nutrient and sediment control programs.

The Financing Authority should therefore work in direct partnership with the Chesapeake Bay Program and each of the jurisdictions to identify priority projects for achieving the Tributary Strategies within the Chesapeake watershed of each Bay jurisdiction. The Committee feels that is essential that the Environmental Protection Agency through its Chesapeake Bay Program continue to serve as the lead federal agency related to the Bay's restoration. In addition, the Authority should work closely with the Chesapeake Bay Commission and nonprofit organizations such as the Chesapeake Bay Foundation.

Funding Mechanisms

Three Core Funding Models

No issue is more critical to restoring the Chesapeake Bay, and to the success of a regional financing effort, than how it will be funded. Success of a regional financing authority will be directly tied to the level of guaranteed, secure funding sources committed to the effort. Permanent funding streams are needed for two reasons. First, they provide the foundation for the issuance of low-cost debt. In general, the more uncertain the funding streams, the higher the cost to service the debt. Second, funding guarantees lend credibility and legitimacy to the organization, providing assurances to all stakeholders that the Authority will be an active and permanent participant in protecting water quality and in restoring the Bay and its tributaries.

The creation and structure of an authority is essentially determined by how the overall Bay restoration effort will be funded. Based on existing and proposed Bay programs and funding sources, case studies, and examples of other regional public authorities around the country, the Committee identified the following three primary funding models.

Model 1: Federal Appropriation

The Blue Ribbon Finance Panel recommended that the Chesapeake Bay restoration effort be funded through a federal appropriation of \$12 billion over five years. The Panel recommended that the federal funding should be matched by each jurisdiction at a ratio of 80/20 for a total capitalized fund of \$15 billion. In such a scenario, the function of a regional financing authority would essentially be to disseminate some of these funds through revolving loan and grant programs, as part of an overall financing strategy.

Given the complexity of the Chesapeake Bay restoration effort and the immediacy of the need, federal funding and involvement is critical. There are different examples of how such programs can work, and the structure of the authority or organization that manages the federal funds can vary.

One type of organizational structure based on federal appropriation is the regional commission. Perhaps the best example of this type of program is the Appalachian Regional Commission (ARC). Congress appropriates funds each year to run the ARC. The basic appropriation is approximately \$90 million; in addition, the ARC receives Congressional funds earmarked for special projects such as the construction of transportation and telecommunication infrastructure. Administrative expenses are shared, half being paid by the federal government, and half being paid by the states. The ARC governing board determines the share paid by each state. The ARC does not perform two core functions of a financing authority in that it does not issue and manage loans and it does not issue and manage debt. It essentially operates as a pay-as-you-go program that

funds projects through existing state agencies. (*See Appendix 1: Appalachian Regional Commission.*)

A second type of federally funded program is the State Revolving Loan Fund (SRF) program of the Clean Water Act and Safe Drinking Water Act. The federal government funds the programs at an 80/20 cost-share ratio, with the states providing the 20 percent match. The state SRF programs often operate as true financing authorities:

- Issuing and servicing low interest loans and returning principle and interest payments back into the loan pool (hence the revolving nature of the program);
- Leveraging SRF funds by borrowing money through the bond markets; and,
- In the case of the drinking water SRF program, providing grants and technical assistance to disadvantaged communities.

The SRF program was the model for the Blue Ribbon Finance Panel's recommendation. If the federal government were to authorize and appropriate billions — or even hundreds of millions — of dollars for the restoration effort, a regional financing authority would be necessary to manage and disseminate the resources on a watershed basis.

There are several advantages to the federal appropriations model. Having a single funding source such as the federal government can reduce administrative costs. The funds can be disseminated through existing state programs, thereby reducing the need for new programs. Also, major federal support provides the opportunity for coordinating other federal resources through other federal agencies and programs. But perhaps the greatest advantage from the states' point of view is that a major federal appropriation reduces the need for jurisdictions to either divert state revenue from other programs or to develop new revenue sources through taxes and fees.

The decision to develop a regional funding approach based on a significant federal appropriation does have disadvantages. The most obvious is the uncertainty of obtaining increased federal appropriations. Overcoming this will require a major commitment of time and political capital at the highest levels.

Model 2: Fee-Based System

The second regional funding model is a fee-based system. Fee-based funding efforts are the mainstay of infrastructure and utility financing efforts across the country, and may rest not only on charges and fees, but also tax levies. Typically, a utility is charged with providing some type of service to the community, such as providing clean drinking water, treating wastewater, or developing and providing electrical power. Thereafter, the utility collects fees for the services it renders, using them to pay for service costs and leveraging them through debt financing.

The intrastate fee or tax-based system has been implemented for ecosystem protection efforts. Florida, for example, has divided the state into five water management districts. As with traditional water utilities, each district is responsible for providing adequate water supplies to citizens within its geographic area. In addition, however, each district is responsible for protecting aquatic habitats, managing storm water, and

protecting and maintaining water quality. To support these water resource management activities, the districts have the authority to levy ad valorem taxes.

Fee-based systems have also been applied at the regional level. Traditionally, these types of regional funding efforts have focused on infrastructure and economic development needs. When a fee is being collected from citizens and businesses across a region, regardless of geopolitical boundaries, then a regional financing authority is essential. Under these circumstances, the authority would have the capacity to collect the fees and then apply the revenue directly to the community need it was developed to address. For example, the Port Authority of New York and New Jersey was developed to administer common harbor interests between the two states. The Port Authority's responsibilities have expanded over the years – it now manages and maintains bridges, tunnels, bus terminals, airports, and other transportation services for the two states. The Port Authority is funded 100 percent through the user fees it charges for each of these services.

A second example of the regional financing model is the Tennessee Valley Authority (TVA). The U.S. Congress set up TVA in 1933, primarily to reduce flood damage, improve navigation on the Tennessee River, provide electrical power, and promote agricultural and industrial development in the Tennessee Valley region. The TVA is a federal corporation and the nation's largest public power company. It receives no public tax dollars but finances all of its programs, including those for environmental protection, integrated river management, and economic development, through power sales and the sale of bonds in the financial markets.

There are a host of fees and charges that can be considered under this type of financing structure. For example, the system might employ user fees, interest charges on loans that it issues, surcharges on mortgages, real estate transfer fees, or development impact fees. It might even sell a product or service. A system also could rely on taxes, imposed individually by each jurisdiction or by the regional authority if the power to tax were granted it.

There would be important advantages to regional fee-based program targeting the Chesapeake Bay watershed. The most obvious one is that fee-based systems can relieve, in whole or in part, affected jurisdictions from having to support the cleanup effort with general tax revenues. Obviously, this benefit can only occur if user fees and charges rather than taxes support the system. If so, the absence of the need for support from general revenues makes the politics behind establishing these entities easier than it might be otherwise. These systems also are attractive because they allow for full cost pricing of a service, by directly attaching payment for a service to the user of a service. If a fee-based system were used in the Chesapeake region, it would provide an opportunity to internalize the cost of pollution by having each resident in the watershed pay his or her proportionate share of the cost of restoring the Chesapeake Bay and its watershed based on the benefits received.

The primary potential barrier with fee-based systems arises in part when they rely on local jurisdictions to enact laws requiring citizens to bear the burden. If there appears to be the imposition of a new tax, the political fallout may destroy any chances for creating a regional authority. In the absence of a public revenue-supported system, there

must be a product or service people would be willing to buy or rent. In the case of the Chesapeake Bay, this service would be the natural system's ability to assimilate our pollutant load – both nutrients and sediment. If no such product or service can be leveraged, there is nothing on which to base a fee. Another disadvantage is that many fees account to surcharges on locally provided services. The potential diversion of such fees from local governments to a regional effort like restoring the Chesapeake Bay could have a considerable impact on the ability of local communities to maintain existing services.

Model 3: Jurisdictional/Member Contributions

The Jurisdictional/Member Contributions model is a common structure for inter-jurisdictional efforts across the country. Though there are no interstate public financing authorities based on this model, interstate funding models are common, especially for supporting commissions and planning authorities.

A good example of this model is the Tahoe Regional Planning Authority. The TRPA was the first bi-state regional environmental planning agency in the country. It was created as a regional agency because the lake Tahoe watershed crosses two states and five local political boundaries. The governors and lawmakers in California and Nevada approved a bi-state compact that created the TRPA, and in 1969 the United States Congress ratified the agreement.

The TRPA, which is governed by a 15-member board, was established to create and administer a regional development plan. Its governing body is empowered to adopt all ordinances, rules, and regulations to effectuate the adopted regional plan. No project may be developed in the region without obtaining the review and approval of the TRPA, and no project can be approved unless it is found to comply with the regional plan and the TRPA's ordinances, rules and regulations. The TRPA is funded by each affected jurisdiction, as required under the interstate compact that created the TRPA. Each year the TRPA establishes its budget and apportions the cost according to a formula among all the county and state governments involved. (*See Appendix 2: Tahoe Regional Planning Authority.*)

Though the Committee was not able to identify any jurisdictional/member contribution organizations that were developed as financing authorities, there is precedence for this type of organization at the international level. Both the World Bank and the North American Development Bank are funded through direct payments by their members. Both organizations implement a variety of financing programs, including providing low interest loans and grants. The North American Development Bank (NADB), for example, is supported by direct appropriations by both the Mexican and U.S. Governments. NADB funds projects that have difficulty attracting traditional financing. Approximately 90 percent of the Bank's funds are directed towards environmental projects along the U.S./Mexican border. (*See Appendix 3: North American Development Bank.*)

The advantage of this type of system – when payment is required by law – is the certainty of payments to the regional authority. The certainty of support provides a sense

of legitimacy to the organization by providing stability and assurance to stakeholders of its long-term presence as a regional influence. The certainty of the funding streams also allows such organizations to establish low-cost debt financing as the risk of default is minimized. When payments are not required by law or are otherwise at risk, the advantages are less robust. In effect, the advantages are directly related to the amount of risk associated with the funding stream. This is in line with the precept that the cost of financing debt increases in proportion to the degree of risk associated with the funding stream.

Critical to the success of the system – as with the others – is public support. Most if not all public programs must compete for public funding annually, and must constantly show their value to the government entities that fund them. Whatever the merits of this system of funding, it jeopardizes the existence of any organization that relies heavily on public funds.

Funding Authority Operations

Certainly other inter-jurisdictional financing efforts provide useful models for the development of a financing authority in the Chesapeake Bay region. However, each region, each jurisdiction, and each resource protection challenge is unique and requires a unique solution. The Committee analyzed a variety of interstate compacts and financing agreements from around the country, and identified components of each that have applicability in the Chesapeake Bay restoration effort. As a result, the Committee recommends the following revenue model for funding a regional Chesapeake Bay Financing Authority.

Jurisdictional/Federal Approach

The Financing Authority should be funded through direct payments by each of the jurisdictions, as well as the federal government. In effect, this approach is combining the federal appropriation and the jurisdictional/member contribution models. The most critical concern is that resources be guaranteed and secure. Various formulas could be used to determine how member contributions would be allocated, including:

- Equalizing contributions among all members. Anticipated objections to this formula would be that each jurisdiction does not contribute equally to the Bay's pollution, nor does each jurisdiction benefit equally from its restoration.
- Apportioning contributions based on a state's population that lies within the watershed. The chief objection to this method is that population is not strongly correlated with the amount of pollution generated from a state or the benefits gained by other states.
- Allocating contributions by the amount of benefit a state receives from proximity to the Chesapeake Bay. The chief objection to this method is that those most responsible for the Bay's pollution may pay less than those less responsible.

- Allocating contributions by the nutrient load originating from each state. This method has the advantage of requiring payments in proportion to a state's annual contribution to the Bay's pollution. However, the disadvantage is that those benefiting most from the Bay's restoration may not pay as fair a share as those benefiting least.

Three steps characterize the funding process. **Step 1** requires the partners to provide the Authority's initial capitalization. **Step 2** requires each member to contribute annual payments to operate the Authority. **Step 3** is the creation of guaranteed, sustainable revenue sources to fund the Authority over its lifetime, if such guarantees are not already in place in Step 2. The formation of an interstate compact or other instrument that legally compels the partners to identify and codify funding streams would provide such guarantees to the maximum extent possible.

It is possible that in the future other funding sources could be made available to the Authority. Contributions from private corporations, program fees, foundation grants, and grants from governmental entities could help fund the Authority's programs and projects. Several Committee members felt strongly that the concept of a Chesapeake Bay watershed fee, targeting citizens and businesses throughout the watershed, should be investigated. Such a fee would be a very effective tool for funding and financing the Authority and its programs. Conversely, several Committee members were concerned that proposing a single watershed fee as the preferred funding method might limit political and legislative support for establishing an authority within member states.

It is important to note that each of the jurisdictions could finance its contribution to the Authority in its own way, as long as the sources are sustainable and guaranteed. There are examples from across the country where jurisdictions have made very difficult, bold decisions to finance environmental and natural resource protection, including:

- New York's agricultural tax credit program
- Florida's water district ad valorem tax system
- Maryland's Chesapeake Bay Restoration Fund program
- Pennsylvania's Growing Greener program
- Virginia's Water Quality Improvement Fund

Each jurisdiction in the Chesapeake Bay watershed has and will continue to develop and implement programs that are essential for the overall success of the Chesapeake Bay restoration effort. Often, it is local governments that are at the forefront, and environmental financing is no exception. There are myriad examples of communities across the Chesapeake Bay region and the rest of the country that are taking steps to address local environmental needs through innovative financing programs. Storm water utilities, impact fees, and open space protection programs are becoming commonplace across the region. These types of financing and funding strategies can be implemented very effectively at the jurisdictional level and would help create the revenue streams that the Bay restoration effort needs, including secure funding for the Financing Authority.

Governance, Authority, and Decision Making Processes

Governing Body

The governing body of the Chesapeake Bay Financing Authority should consist of representatives from those who have a financial stake in the Authority. Since the executive and legislative branches of each partner must support the funding requirements, the governing body should be composed of their representatives. Ultimately, leaders throughout the region should determine the size and composition of the governing body.

Voting Rules

Voting rules are significant because they determine how the resources of the members ultimately are used and allocated around the watershed. Voting rules can get complicated, however, especially if the partners do not contribute equally to an authority. One method is to allocate votes in proportion to a member's financial contribution to an authority; or votes could be based on the proportion of the watershed population. If some members cast more votes than other members there are at least two ways decisions can be made: (1) by a simple majority rule in which approval requires 50 percent of all votes cast; or (2) by a double majority rule in which approval requires 50 percent of all votes cast *plus* the approval of a majority of members. Without proportional voting, the more common voting procedure permits one vote per member with decisions requiring majority approval.

Decision-making and organization

The Authority as envisioned would be composed of the governing body, the professional staff and the advisory boards. The governing body would establish the general policies and operating guidelines and be responsible for making the final determination of which programs and projects will be supported by the Authority. It would also play an important role in developing new funding sources. The professional staff would manage day-to-day operations, make funding recommendations, and perform project oversight and program evaluation.

The governing body should rely on the advice and information of a variety of advisory boards. These advisory boards should be composed of representatives from citizen and stakeholder groups, program technicians and experts, financial specialists, and scientists and resources experts. Advisory boards could help to evaluate funding proposals and offer recommendations to the governing body.

Distribution of Funds

For the Authority to operate as efficiently and effectively as possible, decisions on how funds are distributed should be based on the following:

- The Authority should work through partner agencies whenever feasible to implement programs and projects. The purpose of the Authority should not be to implement

programs and projects, but to fund implementation through existing institutions throughout the watershed.

- The Authority staff should conduct oversight and evaluation of program and project implementation, including performance and financial audits. The governing body should monitor the results.
- The Authority should fund programs and projects that would otherwise be underfunded by one or more partners. In effect, project funding by the Authority should complement current funding efforts, not serve as a replacement.
- The Authority should fund programs and projects that further the Chesapeake Bay Tributary Strategies and promise substantial positive environmental consequences in the watershed as a whole.

Decisions about the nature and location of projects funded will be determined by a set of rules and priorities developed by the governing body. The deliberations will be informed by partner interests *but ultimately decided independent of them*, based on what best protects and promotes the watershed's regional health. In effect, the Authority is envisioned as an independent entity operating in the interest of the region as a whole.

The Authority's power to make decisions on the distribution of funds around the watershed has raised concerns that one or more of the partners may benefit more than others, or that the benefits received by a partner may not equal the dollar amount it has contributed to the Authority. These concerns, though understandable, strike at the heart of why a regional authority is necessary in the Chesapeake Bay watershed – to address watershed-wide concerns regardless of jurisdictional boundaries. Regional environmental problems require regional leadership, regional cooperation and coordination, and practical problem solving on a regional basis. The partners must support that concept – politically and financially – before an authority can succeed. Leveraging new financial resources can mitigate these concerns. The Committee feels that the assurance of additional federal funding was essential to the Authority's success.

Necessary State and Federal Regulatory And/or Legislative Changes

The nature and composition of a regional, inter-jurisdictional financing partnership establishes the need for creating a *public financing authority*. A public authority in some way derives from and partakes in the sovereignty of its creating parties – in this case, the federal government, the Bay states and the District of Columbia. There are four ways to create a public authority: (1) by act of a single state legislative body; (2) by formal interstate compact; (3) by interstate agreement (that is, an agreement without the federal government’s participation); or (4) by Congress.

Creating the Authority in a Single Jurisdiction

The first option – creating the authority in a single Chesapeake Bay jurisdiction – does have the advantage of expediency. However, in order for an authority to succeed, it must be conceived as a partnership among the jurisdictions, where no state is any more or less active than any other partner. Establishing the authority as an entity of a single state undermines the tenets of the partnership. It also may retard, reduce, or eliminate financial contributions from one or more partners, although whether these problems are compelled to arise, as a matter of law, is unknown at this time.

Developing an Interstate Compact

The second option – developing an authority through a formal interstate compact – is a model that has been used for many other interstate relationships and agreements. There are hundreds of state compacts around the country that codify state agreements on a broad array of issues. For example, an interstate compact was used to create the Port Authority of New York and New Jersey. The process would require the legislative bodies of each partner to enact identical legislation that establishes the powers and duties of the Authority as well as the rights, obligations, and duties of each partner. Congress must ratify the agreement. The ratification usually comes after each state formally adopts its own legislation, but in some instances Congressional action has preceded state adoption.

An advantage of developing a formal state compact for the Chesapeake Bay Financing Authority is that it could require all partners, including the federal government, to guarantee funding streams to the Authority and to the Chesapeake Bay restoration effort. These funding guarantees would allow the Authority to institute the financing tools and options mentioned above. A major disadvantage of the approach is that it can take years to accomplish, as each partner must pass identical legislation. The greater the number of partners involved in the process, the more time consuming the process can become.

Interstate Agreements

The third option – using an interstate agreement to establish the Authority – is similar in process to the creation of a formal state compact, except that the federal government is not party to the agreement. Under this option the legislative body of each signatory party would pass identical legislation, pledging to create and support a regional authority. The legislation would establish the duties and responsibilities of the Authority, as well as the rights, duties, and obligations of the partners. It may also provide that no amendment to the agreement is valid unless all parties agree to an amendment, and may further provide for the duration of the agreement. The Chesapeake Bay Commission, which was established using this option, uses similar provisions in its interstate agreement.

This option has some of the same advantages as a formal interstate compact. It would require the partners to guarantee funding streams to the Authority and to the Chesapeake Bay restoration effort. The guarantees would allow the Authority to institute the financing tools and options mentioned above. Unlike a formal state compact, however, the approval process may be quicker because Congress is not a party to the agreement.

But this fact is one of its disadvantages. Not all the intended partners in the proposed regional authority would be party to the agreement. The federal government would not be formally pledging its support of the Authority if this option were chosen. Another problem arises in that the legislative body of each partner may be free to withdraw from the agreement at any time, unlike a formal interstate compact. This means that support for the entity is not as secure as it would be under a formal interstate compact. This fact would most likely impact the perceived risk associated with debt instruments issued by the Authority. Finally, the length of time needed to create the necessary legislation in each state may be similar to that needed for a formal interstate compact.

Creating the Authority Through Congress

The fourth option – where Congress creates the public authority – was used to create the Tennessee Valley Authority. Examples exist all across the country of regional authorities or corporations that were developed and authorized by Congress. Fannie Mae and Freddie Mac, Sallie Mae, and the North American Development Bank, all were corporations authorized by Congress.

Several advantages are apparent if Congress creates the Authority. First, as its creator, Congress would forever have a stake in the success of the Authority. For this reason, it most likely would provide its continued financial support. Second, creating the entity by Congressional act may prove to be the quickest way to get the organization up and running. Interstate compacts and agreements take time, as they work through the processes and politics in each of the member states. Congressional creation has some of the same political hurdles to mount, but with a well supported and coordinated approach on Capitol Hill, the length of time required to lobby only one legislative body may prove less than having to lobby seven others.

Disadvantages to the federal approach exist as well. A significant barrier may be simply convincing Congress of the need for action. In each of the examples listed above, there was a compelling federal or national need that the corporation was designed to address. The national importance of protecting the Chesapeake Bay watershed, and the need for a federally authorized inter-jurisdictional approach, must be articulated in a way that will capture attention and demonstrate real need.

Use of this option also raises the possibility that regional control over the entity could be undermined or lost entirely to Congress, if Congress alone determines how the Authority will operate. Not only may it want to determine much of its operational characteristics, but also it may want to impose some level of controls on the use of federal funds. Congress often jealously guards how federal funds are used and may resist ceding control over them.

Committee Recommendation

The Committee reviewed all four options and feels that there are two core needs that need to be addressed. First, it is essential that the Authority be created as quickly as possible. Second, it is essential that the Authority be funded through long-term, guaranteed, sustained revenue sources. The Committee feels that a formal interstate compact would be the ideal instrument for creating a regional authority because all partners would be involved in every step of its creation. However, the amount of time required to pursue the option successfully could be lengthy. Therefore, the Committee recommends the following phased approach to establishing the Authority.

Phase One: Interstate Agreement

The District of Columbia and all the Bay states should agree to establish and support a regional financing authority, each enacting specific legislation to effect the creation of an interstate agreement. This process should commence as soon as possible. Each of the Bay jurisdictions will commit funding resources for the initial capitalization of the Authority. In conjunction with the state's efforts, Congress should be lobbied to formally support the agreement. Again, it is essential that each Bay partner commit new funding resources to the effort.

The creation of the Interstate Agreement will allow the Authority to begin operating and funding priority projects through revolving loans, grants, and other pay-as-you-go type programs. It is also possible that the Authority could leverage funding in the debt markets on a project-by-project basis.

Phase Two: Interstate Compact

Each of the states and the federal government must develop an interstate compact that guarantees funding to the Authority. The structure of the Interstate Agreement will serve as the basis for the compact, thereby expediting its creation. Developing a formal interstate compact, which includes the federal government, is the only way to ensure continuing financial support by all the partners. Once the compact has been established,

the Authority will have the ability to issue debt on its own without the need for moral obligation assurances.

It is important to reiterate the two primary goals of this recommendation: to establish the Authority as soon as possible, while at the same time taking the necessary steps to establish guaranteed, sustainable revenue sources. The Committee believes that this two-phased approach provides that best opportunity for accomplishing both goals.

Conclusion

The Committee believes that a Chesapeake Bay Financing Authority would enhance regional efforts to restore water quality throughout the Chesapeake Bay watershed. A financing authority would provide an effective tool for resolving many of the Chesapeake Bay's most entrenched regional watershed problems, if (1) it is assured adequate and secure funding; (2) its roles and responsibilities are clearly set out as part of an overall Bay restoration finance strategy; and (3) it is structured according to the framework developed in this report. In summary, the Committee feels strongly that the following characteristics and issues should be central to the Authority's development:

- The purpose of a Chesapeake Bay Financing Authority should be to facilitate investment into programs and projects targeted towards restoring and protecting the Chesapeake Bay watershed. By doing so, the Authority must increase the effectiveness of current financing and funded programs across the region, and provide access to new sources capital that would otherwise not be available.
- For a regional authority to function effectively, it must be supported through sustainable, guaranteed financing streams. Though a variety of funding models exist, the Committee feels that the Jurisdictional/Member Contribution model, with matching federal contributions, provides the most effective approach at this time.
- For the Authority to be successful, it must function as a partnership among the Bay jurisdictions, the federal government, the Chesapeake Bay Commission, and other partners and organizations working towards Bay restoration goals. Its governance structure must include representatives from each of these groups.
- The purpose of the Authority should be to assist jurisdictions in their efforts to implement the Tributary Strategies. The Authority should focus on innovative programs that reduce costs associated with implementing best management practices throughout the watershed, regardless of geopolitical boundaries.

If an authority is founded on these basic characteristics, then it will have the opportunity to increase the efficiency of current restoration efforts by leveraging innovative funding sources and revenue streams, thereby making all jurisdictions and Bay partners more effective in their own restoration efforts.

Recommended Next Steps

The work done by this Committee over the past several months is part of an iterative process that is necessary for developing the programs and resources necessary for implementing the Tributary Strategies, and ultimately restoring the Chesapeake Bay. However, the effectiveness of this effort, as well as the hard work of the Blue Ribbon Finance Panel, requires that the effort to develop innovative, effective financing strategies move forward. Therefore, this Committee recommends the following next steps for the Principals' Staff Committee and the Chesapeake Executive Council.

Convene a Joint Meeting with the PSC

The Committee recommends that the Chesapeake Bay Program convene a joint meeting between this Committee and the Principal's Staff Committee to discuss their response to this proposal. This meeting should occur no later than July 2005. The goals of this meeting should be:

- To determine the fiscal responsibility of each jurisdiction and Bay partner for the initial funding of a regional financing authority, including how much each partner should contribute and the formulas for funding those contributions.
- To articulate a clear strategy for engaging federal leadership for developing and funding the Authority.

Convene a Meeting of the Chesapeake Executive Council

The Committee feels strongly that time is of the essence for this proposal. Therefore, it is recommended that the Chesapeake Executive Council convene an ad hoc meeting by September 1, 2005 to discuss this proposal and to develop a strategy for its implementation. Again, a regional financing authority could play a vital role in increasing the effectiveness of the Chesapeake Bay restoration effort. However, it will require a coordinated effort by the Executive Council and leaders throughout the region. Convening the Council as soon as possible to develop a strategy for that coordination is essential.

The challenges facing jurisdictions and communities across the watershed are immense. With Chesapeake Bay restoration costs estimated in the tens of billions of dollars, success will not be cheap, nor will it be easy. Yet despite these challenges, leaders throughout the watershed are faced with an equally enormous opportunity. Jurisdictions throughout the watershed have taken strides to restore and protect the Bay, developing funding and implementation programs targeting a variety of best management practices. The federal government has also played a vital leadership role in coordinating information and restoration activities. The Chesapeake Bay Commission has provided an invaluable tool for inter-jurisdictional cooperation and coordination of restoration activities. And nonprofit organizations, lead by the Chesapeake Bay Foundation and the Alliance for the Chesapeake Bay, have become national models in their ability to educate citizens and leaders throughout the basin on our responsibility for protecting this national treasure. By taking action now, we can leverage the extraordinary efforts of the past twenty years into a sustainable, lasting restoration strategy.

Appendix 1: Appalachian Regional Commission

General Description

The Appalachian Regional Commission (ARC) was established by Congress in 1965 to support economic and social development in the Appalachian Region, which includes 13 states. ARC undertakes projects that address four general goals:

1. Increase job opportunities and per capita income in Appalachia to reach parity with the nation;
2. Strengthen the capacity of the people of Appalachia to compete in the global economy;
3. Develop and improve Appalachia's infrastructure to make the Region economically competitive; and,
4. Build the Appalachian Development Highway System to reduce Appalachia's isolation.”

To meet these goals, ARC helps fund such projects as education and workforce training programs, highway construction, water and sewer system construction, small business start-ups and expansions, and development of health-care resources. ARC’s mission is to be a strategic partner and advocate for sustainable community and economic development in Appalachia.

Governance

The Commission is composed of 14 members: the governors of the 13 Appalachian states and a federal co-chair. The federal co-chair is appointed by the president and is subject to Senate confirmation. Each year the 13 governors elect one of their members to serve as states' co-chair of the Commission.

Each governor appoints an alternate who oversees the state's ARC program and serves as the state-level contact for those seeking ARC assistance. The states' interests at ARC/Washington are handled by the states' Washington representative, who is hired by the states.

Grassroots participation is provided through a network of 72 local development districts (LDDs) covering all 410 counties in the ARC program. LDDs are multi-county agencies, established by the ARC, with boards made up of elected officials, businesspeople, and other local leaders. The LDDs' most important role is to identify priority needs of local communities. Based on these needs, the LDDs work with their board members and other local citizens to develop plans for their communities' economic development, to target and meet the most pressing needs, and to build community unity and leadership.

Powers

The ARC exercises no regulatory powers. It serves primarily as a funding vehicle for regional development, using federal dollars to pay for projects. The federal government, in the person of the federal co-chair of the ARC, ultimately determines which projects are funded.

The ARC, however, does serve as an information resource for development issues affecting the region. It compiles data and conducts research and evaluations of key economic, demographic, and quality of life factors that affect the current and future development prospects of the Appalachian Region.

Finances

Congress appropriates funds each year to run the ARC. The basic appropriation is currently \$90 million (approximately), which is in addition to funding the ARC receives from Congress for special projects such as the construction of transportation and telecommunication infrastructure. Administrative expenses are shared, half being paid by the federal government, and half being paid by the states. The share paid by each state is determined by the ARC.

Project funding works as follows: The Appalachian governors are required to submit to ARC their state spending plans for the year, which include lists of projects they recommend for ARC funding. The spending plans are reviewed and approved at a meeting of all the governors and the federal co-chair. Next, the states submit project applications to ARC. Each project is reviewed by ARC program analysts. The process is completed when the federal co-chair reviews a project and formally approves it.

More Information

For more information on the Appalachian Regional Commission, visit www.arc.gov.

Appendix 2: Tahoe Regional Planning Authority

General Description

The Tahoe Regional Planning Authority (TRPA) was the first bi-state regional environmental planning agency in the country. It was created as a regional agency because the Lake Tahoe watershed crosses two states and five local political boundaries. The governors and lawmakers in California and Nevada approved a bi-state compact that created the TRPA, and in 1969 the United States Congress ratified the agreement. Its mission is to cooperatively lead the effort to preserve, restore and enhance the unique natural and human environment of the Lake Tahoe region now and in the future.

Governance

The Compact created a 15-member Governing Board, seven from California, seven from Nevada and one non-voting Presidential Appointee.

Six members, who are locally elected officials or their designees, represent the units of local government. The Compact provides for a majority of the seats to be held by citizens from outside the Tahoe Region who represent at-large voters from the two states. This ensures that the Board reviews issues not only from a local perspective, but also from statewide and nationwide viewpoints.

The 19-member Advisory Planning Commission assists the Governing Board with technical and scientific issues. The Commission is made up of local planners, general members of the community and other representatives who are experts in their fields.

Powers

The TRPA was established to create and administer a regional plan that contains the following elements: a land-use plan; a transportation plan, a conservation plan, a recreation plan; and a public services and facilities plan. In addition, the regional plan provides for attaining and maintaining federal, state, or local air and water quality standards.

The TRPA's governing body is empowered to adopt all ordinances, rules, and regulations to effectuate the adopted regional plan. Each ordinance, rule, and regulation establishes the minimal standards applicable throughout the region. Any political subdivision or public agency may adopt and enforce an equal or higher requirement applicable to the same subject of regulation in its territory.

No project may be developed in the region without obtaining the review and approval of the TRPA, and no project can be approved unless it is found to comply with the regional plan and the TRPA's ordinances, rules and regulations.

In addition to its regulatory powers, the TRPA provides a number of services. One branch provides environmental review services, which includes project review, permitting, and master planning, among other things. Another branch focuses on environmental improvements, BMPs, and the enforcement of the TRPA's regional plan. Still another branch focuses on research and evaluation.

The TRPA is in the process of delegating the permit process to its local governments.

Finances

The Compact requires the states and political subdivisions to support the TRPA. Each year the TRPA establishes its budget and apportions \$75,000 of this amount among the counties of the region, where each county pays according to the portion its assessable base bears in relation to the total assessable base of the region. In addition, each county in California pays \$18,750 to the agency, and each county in Nevada pays \$12,500 to the agency. The states of California and Nevada pay the agency any additional sums it may need.

More information

For more information on the Tahoe Regional Planning Authority, visit www.trpa.org.

Appendix 3: The North American Development Bank

General Description

Established in 1994, the North American Development Bank (NADB) is a bilaterally-funded, international organization, capitalized and governed equally by the United States and Mexico for the purpose of financing environmental infrastructure projects along their joint border. The NADB provides financial assistance to public and private entities involved in developing environmental infrastructure projects in the border region. Potable water supply, wastewater treatment and municipal solid waste management form the core sectors of the Bank's activities and are its primary focus. However, assistance can also be provided in other areas—such as air quality, clean energy and hazardous waste—where sponsors are able to demonstrate tangible health and/or environmental benefits for residents living in the area. The NADB's mission is to serve as a binational partner and catalyst in communities along the U.S.-Mexico border in order to enhance the affordability, financing, long-term development and effective operation of infrastructure that promotes a clean, healthy environment for the citizens of the region.

Governance

The NADB is governed by a Board of Directors, which it shares with its sister organization, the Border Environment Cooperation Commission (each institution has its own officers and employees). The Board of Directors consists of ten members: five from the United States and five from Mexico. The chairmanship of the board alternates between U.S. and Mexican representatives every year. All powers of the BECC and NADB are vested in the Board of Directors, which determines policy within the framework of the Charter, and approves all project certifications and loan proposals. All decisions of the Board require the assent of a majority of the directors appointed by each country.

Programs and Services

The NADB provides loans for direct financing for infrastructure projects with a demonstrable and reasonable assurance of repayment when private sector financing is not available on reasonable terms and conditions on a timely basis. In other words, NADB loans are intended to fill financing gaps not covered by other funding sources. Moreover, the loans cannot cover more than 50 percent of the total capital cost of a project. The remaining 50 percent must come from other sources in the form of grants, equity or co-financing. The loans are a market rates, currently 5 to 6 percent.

The NADB provides a grant program entitled the "Border Environment Infrastructure Fund (BEIF)." The grants are to be used to help fund water and waste water facilities and can be used in two ways: (1) Transition assistance or (2) construction assistance. Transition assistance is designed to ease a community's adjustment to higher user fees over time. Specifically, grant funds are used to help pay system debt up to a seven year period, so that user fees may be gradually raised to the level required for the system to become self-sustaining with proper operations and maintenance. Transition assistance may be applied to debt service and certain reserves. Construction assistance

may be applied towards the costs of final design and construction, including residential hook-ups and construction management.

The NADB also provides a specialized grant program for water conservation and a special loan and grant program for solid waste services and facilities.

Financing

The total authorized capital of NADB under the Charter is \$3 billion with equal commitments from the United States and Mexico. Each country has authorized the subscription of 150,000 shares of the bank's capital stock with a par value of \$10,000 per share. Fifteen percent of NADB's authorized capital is in the form of paid-in capital to be provided in scheduled installments as agreed by the two governments, and the remaining 85 percent is in the form of callable capital.

Paid-in capital consists of cash funds contributed to the NADB after appropriation by the two governments. Paid-in capital, once contributed, is actually held by the NADB and invested in short- to medium-term, high quality, fixed-income securities. It acts as the bank's cash reserves, which, in addition to providing loan loss reserves, can be used for a limited amount of direct lending. The paid-in capital must be maintained at adequate levels to protect the bank's creditors and ensure its operational integrity. The United States and Mexico each contribute \$225 million in paid-in capital.

Callable capital does not represent actual cash funds contributed to the NADB by the two governments. It is composed of funds that are pledged to be provided to the NADB from the two countries only if required to meet the bank's obligations on borrowings of funds for inclusion in its capital resources as specified in the Charter. In other words, callable capital is essentially a guaranty for any bonds issued by the bank to raise funds in the capital markets for its lending program. Because no actual cash funds are received, callable capital may not be used to make loans directly. The United States and Mexico have each pledged 1.275 billion in callable capital.

Ninety percent of the NADB's authorized capital may be used to finance environmental infrastructure projects in the border region. The remaining ten percent of the capital subscribed by each country has been allocated to finance community adjustment and investment throughout the United States and Mexico in support of the purposes of NAFTA.

More information

For more information on the North American Development Bank, visit www.nadbank.org.