Financing Conservation Projects Under Texas’ New Water Infrastructure Bank

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Texas has been in drought for almost four years. In 2011, the state endured its worst single year of drought on record, causing as much as $7.6 billion in direct agricultural losses. As the drought persisted, state leaders warned that the shortage of water for power generation could lead to rolling blackouts.

In 2012, with the drought still in full force, the primary state agency that oversees water infrastructure financing – the Texas Water Development Board (TWDB) – adopted its latest State Water Plan (SWP), which serves as the official blueprint for state water policy. The SWP cautioned that, if Texas did not develop additional sources of water, its water supplies could fall short of need in 2060 by 2.7 trillion gallons a year.

The severity of the SWP warnings and immediate pain of the drought drew significant political attention to Texas’ water supplies. In its 2013 session, the state legislature acted with near unanimity and passed bills creating a new water infrastructure bank, subject to voter approval. In November 2013, voters gave their blessing, passing Proposition 6 by a nearly three-to-one margin.

The infrastructure bank that was created consisted of two new funds under the auspices of the TWDB. The statutory framework for these funds includes a provision that directs TWDB to allocate at least 20 percent of financial assistance to projects for conservation or reuse. It includes an additional provision that mandates that the TWDB prioritize funding for projects according to certain factors, among them conservation.

In July 2014, the TWDB published draft regulations in the Texas Register that give shape to the set-aside and prioritization process.

In the spring 2014 academic semester, the Center for Global Energy, International Arbitration and Environmental Law (“Energy Center”) at The University of Texas School of Law convened an interdisciplinary workshop and released two white papers on the subject of the
new infrastructure bank. This paper draws upon the workshop and white papers to discuss the manner in which TWDB has now, through the release of its draft regulations, proposed implementing the conservation set-aside and prioritization process. It is divided into three parts. The first part generally explains the new financing framework, the second part looks at the set-aside, and the third examines the prioritization process.

Part I – New Financing Framework

To enact the new financing scheme, the Texas legislature passed three bills: (1) H.B. 4, which created a comprehensive statutory scheme contingent upon voters approving the move through a proposition; (2) H.B. 1025, which appropriated $2 billion from the Economic Stabilization Fund (commonly referred to as the Rainy Day Fund) contingent on the proposition; and (3) S.J.R. 1, which put the proposition on the ballot.

Proposition 6 passed in November 2013 and the conditional provisions of H.B. 4 and H.B. 1025 took effect. At a constitutional and statutory level, two new funds were created – the State Water Implementation Fund for Texas (SWIFT) and the State Water Implementation Revenue Fund for Texas (SWIRFT). The legislation left open the exact relationship that SWIFT and SWIRFT would have with each other, but it did generally set forth the roles of the two funds. Through SWIFT, TWDB may disburse money via a “bond enhancement agreement” to certain other TWDB funds, which may then provide approved forms of financial assistance to applicants for state aid, for projects proposed in the SWP. Through SWIRFT, TWDB has additional revenue bonding authority.

Following the passage of Proposition 6, TWDB conducted outreach efforts by holding forums across the state and seeking input from stakeholders. On July 11, 2014, TWDB published a proposed rule that would govern the implementation and operation of SWIFT and SWIRFT. As part of the notice and comment process required under the Texas Administrative Procedures Act, TWDB held a comment period that ran until September 1, 2014.

Part II – Conservation Set-Aside

H.B. 4 included a provision that has now been codified as Water Code 15.434(b). It provides:

Of the money disbursed from the fund during the five-year period between the adoption of a state water plan and the adoption of a new plan, the board shall undertake to apply not less than: (1) 10 percent to support projects described by Section 15.435 that are for: (A) rural political subdivisions as defined by Section 15.992; or (B) agricultural water conservation; and (2) 20 percent to support projects described by Section 15.435, including agricultural irrigation projects, that are designed for water conservation or reuse.

Subpart (1) establishes a closely related set-aside for rural and agricultural projects that the TWDB, in its rulemaking, has attempted to address through the same provision. Subpart (2) establishes the 20 percent set-aside for conservation and reuse and has been the focus of the Energy Center’s efforts.

In its white papers, the Energy Center identified several legal and policy issues that TWDB would have to consider when attempting to implement the set-aside, including:

- **Definition of “Undertake”:** The set-aside provides that the TWDB “shall undertake to apply not less than … 20 percent to support projects … that are designed for water conservation or reuse.” The term “undertake”
creates uncertainty as to what precisely the agency must do to comply with the set-aside requirements.

- Definition of “Conservation”: H.B. 4 does not define “conservation.” Under the standard definition found throughout Texas water law – including the statutory chapter where the set-aside has been codified – conservation can have one of two meanings: (1) the development of water resources; or (2) the reduction in water use or loss. This latter meaning expressly encompasses water reuse.

- Reuse v. Conservation: The set-aside is for conservation or reuse. Conservation and reuse are related but have important legal, financial, and hydrological differences. Conflating the two terms ignores these differences and the policy implications.

In the proposed rule, TWDB does not define “undertake.” In the preamble, however, it implicitly interprets its understanding of its obligations by describing the sorts of efforts it would pursue to improve the likelihood that the SWP would include sufficient conservation and reuse projects eligible for set-aside financial assistance. The TWDB states that it views the 20 percent requirement “as a floor and not a ceiling” and that it would “undertake to apply” funding according to that requirement “by a very aggressive marketing and outreach program to ensure that potential applicants for all of these special classes of projects know the requirements and benefits of the programs.”

The proposed rule would define “water conservation” as “[t]hose practices, techniques, programs, and technologies that will protect water resources, reduce the consumption of water, reduce the loss or waste of water, improve the efficiency in the use of water, or increase the recycling and reuse of water so that a water supply is made available for future or alternative uses.” In the preamble, the TWDB states that it drew this definition from the best water management practices guide prepared by the legislatively created Water Conservation Implementation Task Force, which has since been reconstituted as the Water Conservation Advisory Council. Although unstated in the preamble, the definition would also parallel a standard definition of “conservation” found throughout the Texas Water Code, including in Chapter 15, where the set-aside has been codified.

The set-aside requires that the board undertake to apply at least 20 percent of funding to “conservation or reuse” (emphasis added), but the proposed definition of conservation subsumes reuse and eliminates any distinction between the two concepts. In the preamble, the TWDB invites comments regarding the potential deletion from the definition of references to recycling and reuse. The TWDB notes, however, that “if this deletion was made, reuse projects would still count toward satisfying the requirement of the 20% of funds for water conservation and reuse.” In other words, Section 15.434(b)(2) may use the disjunctive “or” to distinguish between “conservation” and “reuse,” but it creates a single shared set-aside; whether the definition of “conservation” thus distinguishes is meaningless.

The preamble further states that, to carry out the Section 15.434(b) set-aside, the proposed rule would add Section 363.1311 to Title 31 of the Texas...
Administrative Code. As drafted, it provides: “After the closing of a project and release of funds to the political subdivision, the executive administrator shall determine what portion of the project funds, if any, qualify as funding for: (1) rural political subdivisions; (2) agricultural water conservation; (3) water conservation, including agricultural irrigation projects; or (4) reuse.” The TWDB must then submit biennial reports to the legislature describing the percentage of SWIFT and SWIRFT funding used for these four purposes.

Section 363.1311 imposes a procedural step that must be met after rather than before funds have been released. The TWDB will have to make allocative decisions with the knowledge that it will be held to account through the reporting requirement, but Section 363.1311 is essentially backward-looking.

Part III – Prioritization Process

The amount of cash appropriated to SWIFT is significant but still falls short of the estimated level of state contributions needed to move forward with all of the projects in the SWP. To counter this limitation, H.B. 4 directed the TWDB to develop a point system that it could use to prioritize projects applying for financial assistance. The legislation left the particulars of the point system to the TWDB but dictated that the agency award points on the basis of certain factors. One factor is “the demonstrated or projected effect of the project on water conservation.”

To implement the prioritization process, the TWDB has proposed 31 TAC 363.1303 and 363.1304, which would create a point system that awards a predetermined amount of points based on first-tier and second-tier factors (i.e., a project would receive five points if its applicant would be funding at least half of the project costs). It would assign points on the basis of factors prescribed in the statute. Section 363.1304(11) sets forth parallel standards by which applicants for municipal and agricultural projects may demonstrate conservation. For a municipal project, an applicant must have “already demonstrated significant water conservation savings, as determined by comparing the highest rolling four-year average total gallons per capita per day within the last thirty years to the average total gallons per capita per day for the most recent four-year period based on board water use data; or significant water conservation savings will be achieved by implementing the proposed project, as determined by comparing the conservation to be achieved by the project with the average total gallons per capita per day for most recent four-year period.”

For an agricultural project, “significant water efficiency improvements will be achieved by implementing the proposed project, as determined by the projected percent improvement.” Section 363.1304 awards different amounts of points based on these percentages. The breakpoints are generally similar for agricultural and municipal project applicants. For both, the highest breakpoint is for applicants that have achieved an 18 percent or greater total gallons per capita per day reduction. For attaining that threshold, a municipal project will receive 10 points and an agricultural project will net 15 points.

To put that in perspective, a project that will expand the capacity of a system that serves 1 million or more people will automatically receive 30 points. The conservation points are meaningful, but they are far from determinative.

The conservation factor could carry additional influence, however, because the proposed rule embraces it as a tie-breaker. If two or more projects receive the same number of points under the prioritization process, the one that scores highest on the conservation factor will be considered the winner.