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Department of Environmental Conservation

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Agency of Natural Resources

MEMORANDUM

To: Douglas Farnham, Chief Recovery Officer and Clean Water Board Chair
From: Emily Bird, Clean Water Initiative Program Manager
Through: Julie Moore, Secretary of Natural Resources 
Date: February 16, 2024
Subject: Clean Water Fund Contingency Reserve Guidelines
Cc: The Clean Water Board

Herein is the Clean Water Fund Contingency Reserve Guidelines (the "Guidelines") which sets aside a portion of Clean Water Fund ("the Fund") revenues to function as a contingency reserve in the Fund (the "Reserve"). The Guidelines replace the Clean Water Fund Expenditure Contingency Plan, put in place in 2018. These updated Guidelines maintain the primary purpose of the Reserve to manage risk in the event of *revenue underperformance*. Updates to these Guidelines in 2024 add an additional secondary purpose of the Reserve to manage risk in the event of *Clean Water Project loss*.

The intent of these Guidelines is to support and provide continuity in the Clean Water Board's (the "Board") decision making by documenting best practices for revenue monitoring and reconciliation already employed by the Board. These Guidelines also provide transparency for Clean Water Budget stakeholders and the public on the importance of maintaining the Reserve to mitigate risk. The Guidelines will remain in effect until such time that the Clean Water Board (the "Board") modifies these Guidelines.



THE CONTINGENCY RESERVE

The Guidelines require maintaining a Reserve balance in the Fund. Annually, prior to allocating funds across other line items in the Clean Water Budget, the Board determines the preferred Reserve balance, and replenishes the Reserve to the target balance level (if needed).

Reserve Balance: The Reserve balance is held as a minimum unappropriated balance to maintain a positive cash balance in the Clean Water Fund. The Clean Water Board established a \$2.5 million Reserve balance as part of the SFY 2024 Clean Water Budget.¹ Historically, the Board has maintained a Reserve balance equal to roughly 10% of the annual Fund revenue as an appropriately conservative best practice. The most current Board approved Reserve balance will be tracked in the Clean Water Fund Operating Statement.

Reserve Balance Replenishment: In the event Reserve funds are utilized, the Board must first replenish the Reserve balance when recommending the subsequent state fiscal year Clean Water Budget, before allocating projected revenues to Clean Water Budget line items for appropriation to state agencies.

Considerations for Reserve Balance Adjustment: The Board may review and recommend changes to the Reserve balance, if warranted, as part of the annual budget process. The Board should consider the risk of revenue underperformance (Reserve's primary purpose) before reducing the Reserve balance. The Board should consult with the Vermont Department of Taxes and the Department of Finance & Management to assess the risk of requiring use of Reserve funds for revenue underperformance, considering the most current Clean Water Fund Operating Statement's revenue projections and other pertinent data/information on the economic outlook and degree of revenue projection uncertainty.

The Guidelines require maintaining a Reserve balance in the Fund to manage risk of revenue underperformance and Clean Water Project loss. These two purposes are described further in the following sections.

PRIMARY PURPOSE: REVENUE UNDERPERFORMANCE

Purpose: The primary purpose of the Reserve is to maintain a positive balance in the Fund to avoid/minimize risk of expending more funds than revenues available in any state fiscal year, in the event revenues underperform and fall short of projections. ***Given the long timelines for project development and year-to-year variability in the funding sources used to support clean water work, it is critical to maintain a reserve sufficient to ensure the overall integrity and***

¹ The SFY 2024 Clean Water Budget increased the Contingency Reserve balance from \$0.5 million to \$2.5 million. The Contingency Reserve was originally established at \$0.5 million (10% of the Clean Water Fund's roughly \$5 million annual revenue at establishment). The State Fiscal Year 2024 Clean Water Budget proposed to add \$2 million in "one-time" funds to increase the total Contingency Reserve to \$2.5 million (10% of the current Clean Water Fund's roughly \$25 million annual revenue).

sustainability of the State of Vermont's Clean Water Budget implementation and associated financial commitments.

Definition of Risk: Revenue projections for the upcoming state fiscal year are the basis of annual Clean Water Budget targets and appropriations. Actual revenues accrue in parallel with implementation of each state fiscal year's Clean Water Budget, as state agencies are executing grants and contracts and encumbering and expending funds against annual appropriations. As such, the Fund would approach a negative cash balance if, in any given state fiscal year, revenues fall short of projections. In this event, without the Contingency Reserve, the Board would be required to reconvene and reprioritize reduced funds, resulting in a budget adjustment to prior and/or current year authorized Clean Water Budget(s). Agencies would be required to reconsider and delay or possibly cancel financial commitments encumbered in grant/contract agreements. The Reserve guards against the following risks tied to revenue instability in the Fund.

- Risk of limited ability to apply the Fund's statutory priorities: The Clean Water Budget funds a diversity of programs across multiple state agencies operating on different timelines based on the partners they serve and field/construction seasons. Without the Reserve, the Board may be limited in its ability to meaningfully prioritize the reduced funds, as state agencies will have already begun encumbering/expending funds in grant/contract agreements. This may result in funds being prioritized based on the timing of agreement execution and not based on the Clean Water Fund statutory priorities.
- Risk of passing burden of revenue underperformance onto individual agencies/funding programs: Without the Reserve, individual agencies/funding programs may be inclined to individually manage revenue underperformance risks by building contingencies into their own appropriations. Some programs may hold more funds in reserve than necessary, while others may hold none in reserve, making them susceptible to running at a deficit. This could present inequities and inconsistencies in management of risk across the Fund. (As such, a reduction in the Reserve amount may not necessarily mean more funds released for implementation on the ground.)
- Risk of costs to agency staff capacity: Without the Reserve, the frequency of prior and/or current year budget adjustments could increase, diverting agency staff capacity away from implementing programs to instead focus on managing budget adjustments.
- Risk of costs to recipient/partner capacity: Without the Reserve, instability in funding programs could present instability for grant and contract recipients who rely on state funds to implement projects. This would present capacity constraints for partner organizations and risk project viability or slow project implementation. Providing stability for partner organizations will help achieve consistent water quality results in the long term.
- Risk of reduced accessibility of public process: The Clean Water Budget is subject to public process to allow opportunity for public comment and transparency around decision making. Without the Reserve, the frequency of prior and/or current year budget adjustments could

increase, which would present difficulty/barriers for stakeholders and public to remain engaged in the process, thus reducing participation and accessibility.

The Clean Water Fund is a state “special fund.” Many state special funds are set up to manage funds at the revenue, appropriation, and expenditure-level, known as “directly managed special funds.” In some cases, this may offer flexibility to manage deficits in real time without a contingency reserve. However, this approach is not feasible for the Clean Water Fund, which is considered “indirectly managed special funds” and cannot be run at a deficit. Due to the interagency nature of the Clean Water Budget, funds are appropriated to and expended by multiple state agencies. Each agency tracks expenditures and financials differently. This makes it infeasible to actively manage the Fund at the expenditure-level, in terms of prioritizing and re-evaluating appropriations if revenues fall short. Due to these challenges, the Board was not given authority to directly manage the special fund. As such, it is required to manage the Fund based on revenues and appropriations (as tracked in the Clean Water Fund Operating Statement) and the Reserve provides a safety net to minimize risk of Fund instability and necessity for budget adjustments.

Mitigation of Risk: ***The State of Vermont is committed to expending only the funds that are available within the Clean Water Fund to maintain the stability and integrity of the Fund.*** The Contingency Reserve guards against downward swings (compared to projections) in Clean Water Fund revenue by maintaining an unappropriated positive cash balance in the Fund. In the event revenues fall short against projections, the Reserve reduces the risk and related program impacts of spending above available amounts by:

- Maintaining alignment of the Clean Water Fund with its statutory priorities;
- Providing a consistent mechanism to mitigate risk across all Clean Water Budget-supported funding programs;
- Minimizing capacity burdens on agency staff and recipients/partners;
- Providing stable/predictable project funding to achieve consistent water quality results long term; and
- Streamlining budget public process to minimize barriers of public participation and accessibility.

Application of the Reserve’s Primary Purpose: Clean Water Fund revenue updates are available biannually following the Vermont Emergency Board’s adoption of consensus revenue forecasts in January and July. The Vermont Department of Taxes and Vermont Department of Finance and Management use the Emergency Board’s forecasts to update actual and projected Clean Water Fund annual revenue. Revenue updates are presented to the Board in the Clean Water Fund Operating Statement. The Operating Statement includes actual revenues received from the most recently closed state fiscal year and projected revenues for the current and proceeding two fiscal years. The January/February Operating Statement is a mid-state fiscal year monitoring checkpoint

and indicates which direction revenues are trending. The July/August Operating Statement confirms final actual revenues for the most recent state fiscal year ending June 30th, which determines one of the three outcomes listed below (also depicted in Figure 1, page 6). Items 1 and 2, listed below, would not require budget adjustment of already appropriated and/or planned budgets. Item 3, listed below, would warrant budget adjustment of already appropriated and/or planned budgets.

July/August Operating Statement determines one of the following outcomes:

1. If the July/August Operating Statement indicates the recently closed state fiscal year actual revenue **overperformed**, generating funds at higher than projected/appropriated levels, the Board shall program these actual “unallocated/unreserved” balances effectively as a “one-time” increase to subsequent state fiscal year(s) Clean Water Budget proposal(s). Actual (for a closed state fiscal year) and projected (for current/future state fiscal year(s)) unallocated/unreserved balances are tracked in the Clean Water Fund Operating Statement by state fiscal year.
2. If the July/August Operating Statement indicates the recently closed state fiscal year ends with **a deficit balance less than the Reserve amount** (e.g., actual revenues underperformed equal to or less than the Reserve amount), the Reserve will be activated to maintain a positive Fund cash balance and maintain existing appropriations for the recently closed and/or current state fiscal year. In other words, the Reserve is applied to make the recently closed state fiscal year’s revenue “whole” to avoid impact to state agencies’ grants and contracts. In this event, the Board must first replenish the Reserve balance as part of the next state fiscal year’s Budget proposal.
3. If the July/August Operating Statement indicates the recently closed state fiscal year ends with **a deficit balance greater than the Reserve amount** (e.g., actual revenues underperformed greater than the Reserve amount), the Reserve will be insufficient to maintain a positive Fund cash balance and maintain existing appropriations for the recently closed and/or current state fiscal year. In this event, the Board would be required to reconvene, determine whether to activate the Reserve to partially cover revenue gaps, and reprioritize reduced funds, resulting in a budget adjustment to the recently closed and/or current state fiscal year authorized Clean Water Budget(s).

Depending on the severity of downward trends in revenue across multiple state fiscal years, the Reserve may be insufficient to guard against revenue underperformance. In this case, the Administration and/or the Board may recommend budget adjustments to recently closed and/or current state fiscal year budgets to align appropriations with actual and/or projected revenue.

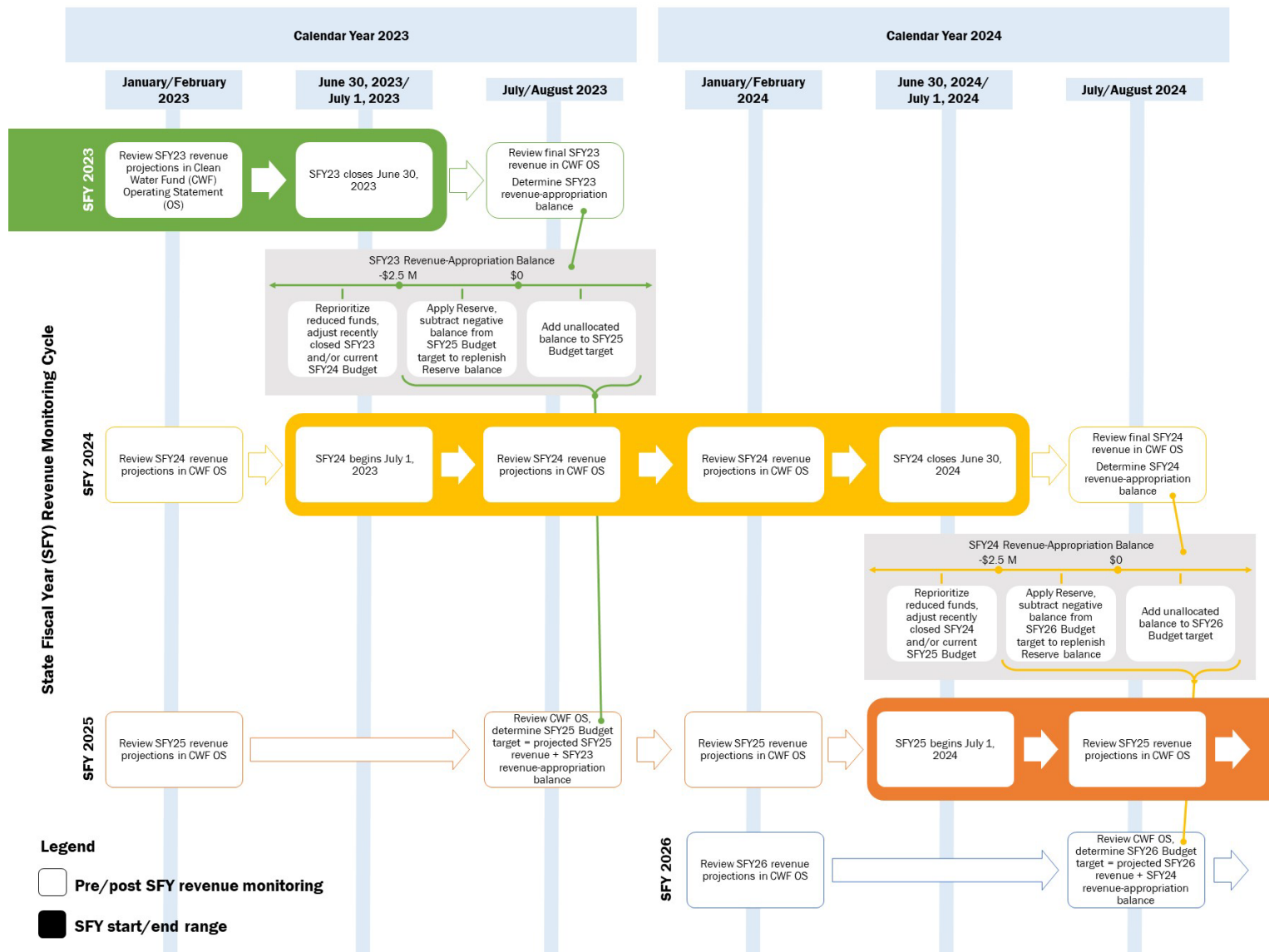


Figure 1. Revenue monitoring and reconciliation milestones, demonstrating outcomes based on July/August Clean Water Fund Operating Statement and end of SFY revenue-appropriation balances. Example based on Calendar Years 2023-2024 and SFYs 2023-2026 with current Contingency Reserve balance of \$2.5 million (note: Contingency Reserve balance amount is subject to change per recommendation of the Board).

SECONDARY PURPOSE: CLEAN WATER PROJECT LOSS

Purpose: The secondary purpose of the Reserve is to avoid/minimize risk of losing pollution reduction performance of Clean Water Projects² that contribute to Clean Water Service Provider targets, in the event projects are lost/fail (“Clean Water Project loss” or “Project loss”) due to eligible circumstances outlined in the [Clean Water Service Provider Rule](#) § 39-404.

Clean Water Project loss is the secondary purpose of the Reserve, prioritized below the primary purpose (described above) because Project loss’ implications are mainly limited to one Clean Water Budget activity, while revenue underperformance could impact all Clean Water Budget activities.

Definition of Risk: The State of Vermont relies on Water Quality Restoration Formula Grants awarded to Clean Water Service Providers to meet the non-regulatory portion of pollution load reductions required to achieve total maximum daily loads (TMDLs). Clean Water Projects implemented under the Formula Grant program are not compelled by regulation but are necessary in most cases to successfully meet water quality standards.

The State of Vermont provides financial and technical assistance to Clean Water Service Providers and a network of project implementers to support non-regulatory Clean Water Project implementation and long-term operation and maintenance. As such, the state has formalized its reliance and stake in the long-term performance of Clean Water Projects.

A Clean Water Project may be lost or fail in what is anticipated to be unforeseen circumstances, Acts of God, and/or negligence or intentional acts of others and not the Clean Water Service Provider. With the loss of a Clean Water Project, the pollution reduction performance would also be lost, no longer contributing to the state meeting its TMDL targets. In this event, redirecting base Formula Grant funds, intended for new Clean Water Project implementation and forward progress toward pollution reduction targets, to fund restoration of a previously implemented lost/failed project’s performance is possible, but could slow forward progress toward meeting TMDL pollution reduction targets.

² [Act 76 of 2019](#) defines “Clean Water Project” as “a best management practice or other program designed to improve water quality to achieve a target established under section 922 of this title [Act 76 of 2019] that: (A) is not subject to a permit under chapter 47 of this title, is not subject to the requirements of 6 V.S.A. chapter 215, exceeds the requirements of a permit issued under chapter 47 of this title, or exceeds the requirements of 6 V.S.A chapter 215; and (B) is within the following activities: (i) developed lands, sub-jurisdictional practices related to developed lands including municipal separate storm sewers, operational stormwater discharges, municipal roads, and other developed lands discharges; (ii) natural resource protection and restoration, including river corridor and floodplain restoration and protection, wetland protection and restoration, riparian and lakeshore corridor protection and restoration, and natural woody buffers associated with riparian, lakeshore, and wetland protection and restoration; (iii) forestry; or (iv) agriculture.”

Mitigation of Risk: The Board may recommend the allocation of one-time funds for the restoration of Clean Water Project pollution reduction performance. Clean Water Project pollution reduction performance may be restored by re-implementing the lost project or implementing a new project that restores the pollution reduction performance of the lost project.

Application of the Reserve's Secondary Purpose: Process steps for considering allocation of one-time funds for Clean Water Project loss are as follows. Figure 2, below, summarizes process steps in the context of the annual Clean Water Budget process, using State Fiscal Year 2026 as an example.

1. Clean Water Service Providers report at least annually any Clean Water Project loss to DEC.
2. DEC reviews reported instances of Project loss and determines if they meet the minimum Clean Water Project loss eligibility threshold defined in Clean Water Service Provide Rule.
3. DEC recommends annual Water Quality Restoration Formula Grant line-item funding levels to the Clean Water Board as part of the subsequent annual Clean Water Budget process, including one-time increases to cover Project loss, if applicable.
4. The Board reviews the proposed annual Clean Water Budget, including proposed one-time funds for Project loss, if applicable, and makes one of the following recommendations (4a or 4b). In doing so, the Board considers costs of restoring the lost Clean Water Project's(s') performance in the context of the Clean Water Fund's statutory priorities (10 V.S.A. § 1389(e)). The Board effectively determines if Project loss costs should be spread across all Clean Water Budget-supported activities or if costs should be borne by the Formula Grant program, specifically.
 - a. The Board prioritizes funding Project loss and recommends a one-time increase to the Formula Grant line item.
 - b. The Board de-prioritizes Project loss and does not recommend a one-time increase to the Formula Grant line item.
5. If the Board deems funding Project loss a priority, the Board may recommend one-time funds to cover Clean Water Project loss by making one of the following recommendations (5a or 5b). In doing so, the Board should consider the risk of revenue underperformance (Reserve's primary purpose) before allocating Reserve funds to Clean Water Project loss (Reserve's secondary purpose). The Board should consult with the Vermont Department of Taxes to assess the risk of requiring use of Reserve funds for revenue underperformance, considering the most current Clean Water Fund Operating Statement's revenue projections and other pertinent data/information on the economic outlook and degree of revenue projection uncertainty. The Board may determine at any point that the risk of allocating

Reserve funds to address Clean Water Project loss is not tolerable, in order to protect Reserve funds to guard against revenue underperformance.

- a. Board determines risk of allocating reserve funds is not tolerable and recommends absorbing Project loss costs within the budget target (i.e., projected revenues for the State Fiscal Year), without allocating funds from the Reserve; or
- b. Board determines risk of allocating reserve funds is tolerable and recommends one-time allocation of funds from the Reserve (Reserve balance to be replenished from Clean Water Fund revenues in the following State Fiscal Year).

Either approach (5a or 5b), listed above, may partially mitigate the risk of Clean Water Project loss by effectively spreading the costs across all Clean Water Budget activities rather than those costs being borne solely by the Water Quality Restoration Formula Grant budget line item. The distinction between options 5a and 5b, listed above, is the timing of when the costs are applied to the Clean Water Fund: (5a) in the upcoming State Fiscal Year Clean Water Budget development process by allocating funds from projected revenues versus (5b) allocating Reserve funds and replenishing Reserve funds in the subsequent budget year.

- 6. If the Board does not deem funding Project loss a priority, or elects to partially fund Project loss:
 - a. Any portion of Project loss not funded must be covered within the base Formula Grant line item.
 - b. In this case, DEC would adjust Water Quality Restoration Formula Grant targets tied to implementing new pollution reductions to account for funds diverted to cover Project loss.

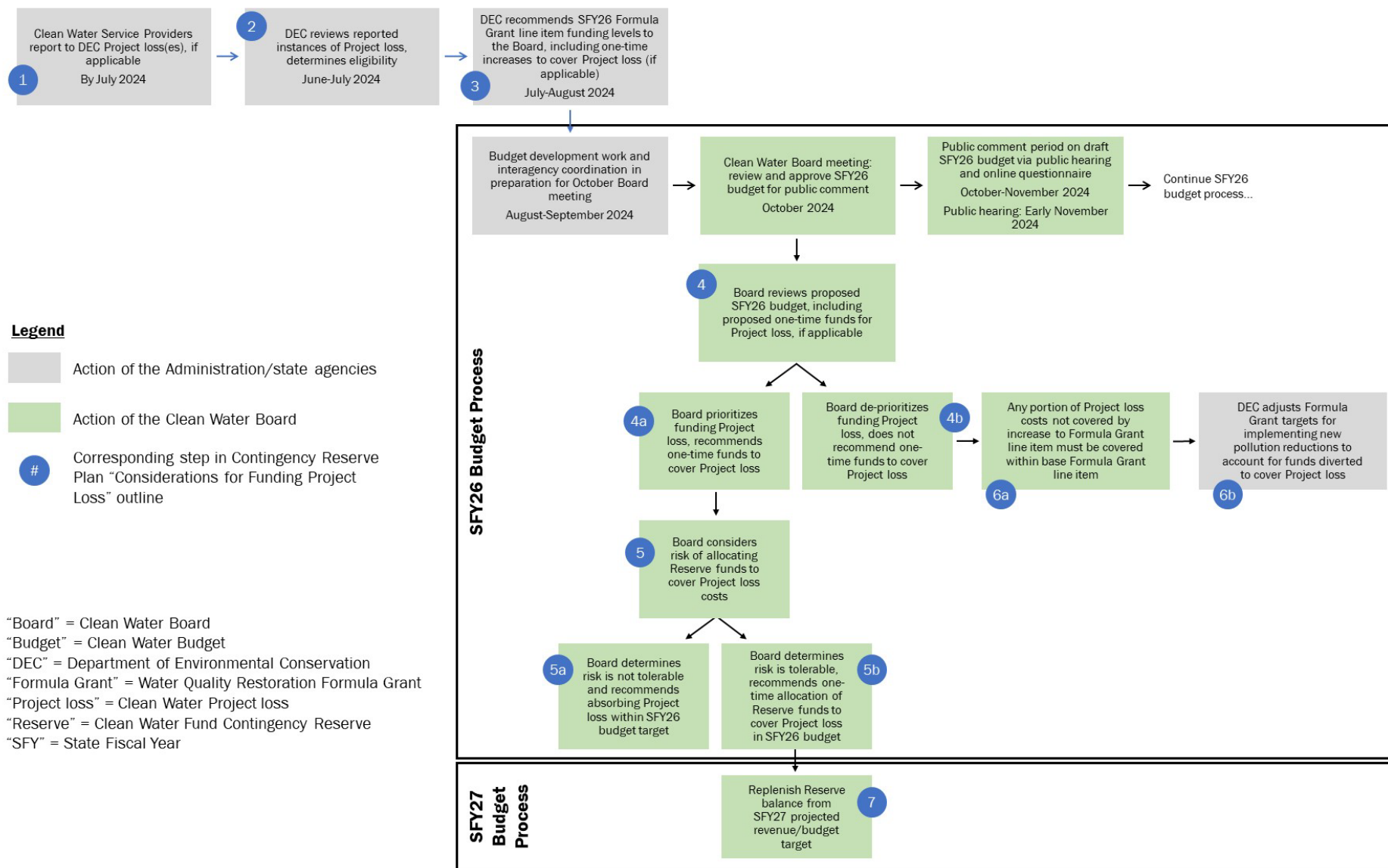


Figure 2. Process steps for considering Clean Water Project loss funding and possible application of the Reserve's secondary purpose in the context of the annual Clean Water Budget process, using State Fiscal Year 2026 Clean Water Budget process as an example.

Administrative Approach: DEC will be responsible for administering and determining eligibility and prioritization for use of Project loss funds. DEC will determine how the Project loss funds are allocated across Formula Grants using the Formula Grant Targets and Fund Allocation Methodology and factoring pollution reduction progress and remaining targets.³ In the event the Board determines Reserve funds should be allocated to DEC for Project loss and Project loss funding is needed in response to an emergency/time sensitive situation that cannot be supported by the standard Clean Water Budget process, DEC will work with Department of Finance and Management to obtain necessary authorizations for such expenditures.

The Guidelines, as updated herein, are adopted by the Clean Water Board on February 14th, 2024 and authorized by:

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Douglas Farnham
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2/20/2024

Douglas Farnham
Chief Recovery Officer
Clean Water Board Chair

Date

³ Final Water Quality Restoration Formula Grant Targets and Fund Allocation Methodology can be found here:
<https://dec.vermont.gov/water-investment/statutes-rules-policies/act-76/law-rule-guidance>