WilmerHale

Infrastructure Series: Cost-Sharing with State and Local Governments

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This is the fifth issue of WilmerHale's 10-in-10 Infrastructure Series. In this series, our attorneys share insights on current and emerging issues affecting infrastructure project developers in the United States. Attorneys from various practice groups at the firm offer their take on issues ranging from permitting reform to financing to litigation, and share their insights from working with clients in a variety of infrastructure sectors, from water infrastructure to energy development to infrastructure development on tribal lands.

As discussed in previous issues of WilmerHale's Infrastructure Series, the Trump Administration proposes several initiatives to seek and secure long-term changes in the government's approach to funding infrastructure projects. One significant proposal to help support the Administration's ambitious $1.5 trillion infrastructure initiative is to encourage cost-sharing arrangements among federal, state and local entities.

The Administration's Goal: Encourage Federal, State, and Local Cost-Sharing

The White House's February 2018 "Legislative Outline for Rebuilding Infrastructure in America" (Legislative Outline) states that it will stimulate roughly $1.5 trillion in investments over ten years to repair and upgrade America's infrastructure. But federal spending would account for only $200 billion of this total amount. State and local governments are expected to make up the difference by matching any federal allocation by at least a four-to-one ratio. The Administration wants to accelerate a trend, seen over the past several years, whereby states and other non-federal entities have assumed more of the responsibility for funding large-scale infrastructure projects.

How cost-sharing among federal, state and local entities will actually work remains to be definitively explained, and some of those details may be the subject of legislation. In the meantime, the Administration's Legislative Outline and related statements provide concepts that are worth exploring. Current legislative authorities allowing federal cost sharing for large infrastructure projects will likely be relied upon to support the Administration's goals. Notably, with regard to water infrastructure, the Administration calls for an expansion of legislative programs used by the U.S. Army Corps of Engineers (Corps) that rely upon "non-federal sponsors"—such as states, tribes, interstate agencies or non-profit organizations—to fulfill the requirements of cost-sharing, among other obligations.

Case Study: Cost-Sharing and the Army Corps

While the Administration has not elaborated on the specifics of the Legislative Outline, the example of the Corps and its history with non-federal sponsors provides a valuable case study that can inform how cost-sharing initiatives among federal, state and local entities may work.

The Corps is an agency within the Department of Defense with both military and civil works responsibilities. Congress directs the Corps' civil works responsibilities through authorizations, appropriations and oversight of the Corps' study, construction and operation of water resource projects. Projects overseen by the Corps maintain navigable channels, reduce flood and storm damage, and restore aquatic ecosystems. These projects have substantial local and regional economic benefits, notes the Congressional Research Service (CRS).

Generally, the U.S. Congress authorizes Corps activities prior to funding them. The authorizations can be project specific, programmatic or general. Most Corps programs are authorized through Water Resources Development Acts (WRDAs), which authorize Corps studies, projects and programs, and establish policies for Corps civil works activities, such as the requirements for non-federal cost-share programs.

A typical Corps project requires two separate Congressional bills. The first bill authorizes studies to understand the feasibility of the project. The second bill authorizes the actual project construction. Notably, Congress must also appropriate funds for both authorizations in order for studies and project implementation to proceed. In recent years, Congress has authorized project construction based upon a favorable report by the Corps' Chief of Engineers and an accompanying feasibility report, according to CRS. The specific requirements for cost-sharing vary by project type, with some projects (such as levees) allowing the non-federal sponsor to own the completed work, provided the non-federal sponsor operates and maintains the structure.

According to the Corps, a non-federal sponsor “may be a state, a political sub-part of a state or group of states, a Native American (Indian) nation, quasi-public organizations chartered under state laws (e.g., a port authority, flood control district or conservation district), an interstate agency or non-profit organizations.” Sponsors are obligated to provide all lands, easements, rights-of-way and like permissions to the US government without cost, provide cash or work-in-kind contributions to meet cost-share requirements, comply with the provisions of relevant federal laws, like the Endangered Species Act among others, and maintain and operate the completed project without cost to the US.

The sponsor is also a study partner and plays many roles during project development. The non-federal sponsor helps define the water resources project need, study scope, tasks, cost estimates and schedules. The sponsor also participates in study decisions, communicates with landowners about project proposals and assists with public communications about the project, contributes to project design, including environmental and aesthetic features, and ensures that factors that affect sponsoring communities are addressed during the planning process.

Typically, a non-federal sponsor's cost-share requirements include an obligation to provide an initial

$100,000 of the feasibility study's costs. The sponsor then contributes 50 percent of costs that exceed $100,000 and 25 to 35 percent of preconstruction, engineering and design costs, and 100 percent of operation and maintenance costs. Some of these sponsor costs can be provided as work-in-kind while other programs may require a minimum cash contribution. Given the large price tag on many of these water infrastructure projects, the non-federal sponsor's financial obligations can be quite substantial, running into the tens or even hundreds of millions of dollars.

Non-federal sponsors have been responsible for an increasing portion of financing of projects in every WRDA since 1986, according to CRS. For example, the 2014 WRDA expanded and consolidated the authorities for non-federal entities to both perform studies and construct projects (or elements of projects) that typically would be undertaken by the Corps.

Under existing authorities, a non-federal sponsor can provide funds to the Corps for water infrastructure projects through “contributed funds” (non-federal sponsor pays the federal share of the work to be performed, with the potential of repayment or credit), or “advanced funds” (funds provided by non-federal sponsor in excess of required cost-share amount with no opportunity for repayment or credit). However, as noted in the Legislative Outline, under current law, the process to accept contributed and advanced funds is protracted and limited by several factors, including limitations on the types of water projects that are eligible and the requirement that the project has been specifically authorized by Congress. To rectify these limitations, the Legislative Outline calls for a program to “incentivize the development of effective and efficient water infrastructure, outcome-based procurement, and full life-cycle asset management to improve water infrastructure.” The White House believes key legislative changes—the details of which are not in place at this time—will give the Corps and its non-federal partners more flexibility “to use available Federal and non-Federal funds, generate new revenues and retain certain revenues in support of project requirements, make greater use of contributed funds, and allow for innovative use of contracting tools.”

For example, to resolve what the White House views as the Corps' inability to take full benefit of a willing sponsor to provide non-federal funds absent a congressional appropriation for the federal share, the Administration calls for amending the law (33 U.S.C. § 701h) “to expand authority for the acceptance of contributed funds even if no Federal funds have been appropriated for the authorized project . . . and expanding applicability of advanced funds authority to all authorized water resources development studies and projects.” The Administration believes these changes will “increase non-Federal spending and expedite project execution.”

Questions abound about how such an initiative will work in practice. Even if the federal government would have the authority to accept advance non-federal payments, would the federal portion of projects be subject to individual appropriations bills, which may not pass? Will contractors be required to contract with federal, state and local governments individually to be paid? And will the government be able to rely upon non-federal sponsors to meet all their obligations, such as securing the required lands and easements necessary for construction, complying with pertinent federal laws, and maintaining and operating the projects without cost to the United States once they are completed?

Potential Pitfalls

This growing reliance on non-federal sponsors to shoulder increased responsibilities for Corps projects has several potential drawbacks.

- *Audits*. Increased dependence on state and local funds raises the likelihood of state and local audits of cost-sharing agreements, in addition to audits that might be performed by federal officials. These audits may well turn up abnormalities. For example, an audit by the South Florida Water Management District into a major Corps project in the Everglades that was to be half-funded by the local district showed that the Corps undervalued the district's work-in-kind contributions by millions of dollars. The district's audit report faulted the Corps' unclear requirements for documenting in-kind contributions.
- *Concerns about Reimbursements*. Because Corps projects require both authorizing and appropriating legislation, there is potential for Congress to fail to fund previously authorized projects, to the detriment of non-federal sponsors who are unable to receive promised reimbursements for the federal share of projects. For example, a report by the Government Accountability Office (GAO) identified concerns about reimbursement as the main disadvantage of undertaking water projects with the Corps led by non-federal sponsors. "Specifically, Corps officials . . . noted that construction projects may be authorized in legislation but may not receive appropriated funds, which may result in nonfederal sponsors not getting reimbursed for projects they undertook," the GAO wrote. GAO interviewed 20 non-federal sponsors and fully half of them listed the risk of not being reimbursed, "especially given constrained federal budgets and the Corps funding priorities, as a primary disadvantage of and potential deterrent to undertaking projects."
- *State and Local Hurdles to Funding*. When rolling out the Administration's infrastructure priorities, an unnamed White House official praised a Los Angeles initiative called "Measure M" as a "good case study" for the kind of local programs the federal infrastructure plan would rely on to meet its ambitious investment goals, reported the Los Angeles Times. Measure M was a significant tax Los Angelenos voted on themselves (of an additional half-cent to one-cent sales tax collected countywide) to support improved public transit, such as new rail lines, better roads, and an expansion of bike-shares. By praising Measure M, the Administration inadvertently pointed to another potential pitfall to a major expansion in cost-sharing programs: state and local governments face their own challenges on increasing infrastructure funding, and many may not be as supportive as Los Angeles was of Measure M. State finances "face new uncertainties," the Pew Charitable Trusts reported in March 2018, adding that the states' revenue growth has lagged despite the recovery from the Great Recession. The states' "slow pace of tax revenue growth has left many with little or no wiggle room in their budgets." In such a climate, it is unclear if cash-strapped state and local governments will successfully navigate their own legislative appropriations and authorizations processes to support cost-shared projects.

Conclusion

The Administration's infrastructure outline focuses on local funding and control, relying heavily on cost-sharing among federal, state and local entities. The ambitious proposal would leverage $200 billion in federal dollars—funded by cuts elsewhere in the overall federal budget—to secure an additional $1.3 trillion in state, local and private spending over ten years for the $1.5 trillion infrastructure initiative.

While the details of the funding proposals remain to be seen, the Administration's emphasis on expanding programs used by the Army Corps of Engineers that relies upon cost-sharing with non-federal sponsors provides a helpful case study to analyze both the benefits and drawbacks of such proposals.

Going forward, contractors will need to be aware of the extra scrutiny cost-sharing governments can pose and the reimbursement risks attendant to government financing, which depends on separate legislation for authorizations and appropriations. There will also be considerable uncertainty about how the state and local entities will raise the necessary capital to meet their substantial obligations under the proposed initiative.