NatLUST's Proposal To Create A 'Betterments' Statute To Help Solve The Problem of Failing Septic Systems

Public Policy Issue:

Failing home septic systems represent a material source of pollution impacting Virginia's State waters, including the Chesapeake Bay[1]. The Commonwealth has some 1,000,000 home septic systems, and estimates are that at least 10% are failing. NatLUST estimates that it will likely cost over $1 billion to address this problem.

Virginia's General Assembly passed HB 2691 in 2007, which for the first time grants VDH civil enforcement remedies to compel homeowners with failing systems to make necessary repairs. Many homeowners will need financial help to repair or replace their failing systems, and the current difficulties in the mortgage market. A creative financing program that is widely available to all homeowners would also serve to prevent the type of political backlash that Ohio experienced, thereby aiding VDH in discharging its responsibilities.

Unfortunately, Virginia's existing revolving loan programs available through VRA/DEQ are for multiple reasons ill suited to helping VDH solve the septic problem. An opportunity therefore exists for the administration & legislature to enable the marketplace to provide low-cost financing.

Creative Financing Solution:

By creating a 'betterments' statute, the legislature can help facilitate access to low cost tax-exempt bond financing to repair failing septic systems, irrespective of the homeowner's own financial situation. Importantly,

- The financing would not be structured as 'debt' to the State or local governments; and
- The financing need not create financial burdens[2] (or unfunded mandates) on localities.

Definition of 'Betterment':

The term 'Betterment' is defined as a charge assessed against real property that receives a benefit from public improvements made by local or state government. In this case, it means VDH would enable the homeowner to receive low cost financing to repair and/or replace their septic system. The betterment loan is recorded by the locality in its land record books, and the homeowner agrees to repay the loan over a period of 20 to 25 years. The loan would only jump in front of preexisting mortgage loans in the event the homeowner defaults.

Notable Elements of a Betterments Statute:

Among other things, a betterment statute would likely include:

- Authority for Virginia state agencies (VDH & DEQ) and local governments to qualify homeowners to receive betterment loans for certain public purpose objectives (ex. fixing failing septic systems, removing underground fuel tanks; improvements needed to meet federal regulations, etc.);
- The ability for property owners who later sell their homes to be released from personal liability when the new buyer agrees to assume the remaining balance of

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1 DEQ's TMDL reports for certain bodies of water (e.g. the Corrotoman River, a Rappahannock tributary) suggest that the cause of the pollution is failing septic systems from waterfront homes, as there is no industry or farm runoff. HB 1408's sponsor, Del. Poindexter, reports there are homeowners in his district with 'straight pipes' that flow into creeks.

2 Betterment financing can be structured in various ways. NatLUST believes that the betterment financing program run by Massachusetts, while innovative, would likely not be politically acceptable in Virginia for various reasons, including that it imposes a substantial burden on local governments and essentially 'socializes' the financing costs.

the betterment loan[3];

- Authority for state agencies and localities to, at their option, require certain loan covenants (e.g., requirement for timely inspections of onsite septic systems);

- Language stating that any funds advanced by a third party financing entity must be totally nonrecourse to state & local governments (ex. no 'moral obligation'). The lender is essentially making the loan based on the value of the property, knowing they are first in line to be repaid;

- Language stating that in the event of default, the betterment is equivalent to a tax lien, thereby jumping ahead of other liens and mortgages (similar to Virginia Code 15.2-900, et. seq., or Massachusetts MGL 111 Section 127 ½);

- Language stating that betterment agreements made between property owners and state agencies/localities will not be considered a breach of any note, mortgage or contract on the transfer of an interest in said property; and

- If applicable, the fees localities may charge for recording betterment loans.

Current Loan Programs Not Well Suited For Septic: While most of Virginia's revolving loan programs have been successful, with respect to financing homeowners with failing septic systems, they have proven largely ineffective. There are several reasons:

- VRA, which is effectively a creature of the State Treasurer, cannot lend directly to homeowners because it cannot bear the political risk of foreclosing. Instead, VRA traditionally lends to local governments, which in turn lend to homeowners. VRA typically seeks a 'moral obligation' pledge from the locality in return for the financing. With respect to the home septic issue, this structure has significant flaws, including:

  - Many localities are opposed to incurring VRA 'moral ob' debt to help finance private homeowners, and therefore refuse to participate; and

  - Many localities ---just like VRA---are quite naturally reluctant to be put in the position foreclosing on homeowners who default, and therefore refuse to participate.

- The present revolving loan programs are not remotely adequate to address a billion dollar problem.

Example of a Betterment Loan:

- NatLUST believes the process would be simple: When a homeowner has determined the cost of the needed repair to their septic system (and VDH deems that the proposed solution meets the requirements), VDH would at the homeowner's request qualify them for a betterment loan of a specified amount. VDH would sign a one-page form that the homeowner could then take to any lender;

- Assuming the homeowner wants financing from NatLUST, they would present us with the form and sign NatLUST's loan documents. Upon completion of the repair, NatLUST would fund 100% of the cost;

[3] Virginia Code 15.2-900 et. seq., which grants authority to any locality to remove nuisances and hazards and then lien the subject property, is defective for purposes of this program because the lien follows the original homeowner.

- Concurrently with releasing funds, the betterment loan would be recorded in the local government's land records books;

- As specified in the financing agreement, the homeowner would begin making payments; and

- As required, NatLUST would provide VDH and the local government with certain web based database tools to track the periodic inspection and maintenance of the homeowner's septic system

Financing Options: NatLUST would expect to offer various financing options, including one with no monthly payments. In such case, the loan balance would be repaid at earlier of, say, 20 years or when the home is sold. This would likely be particularly attractive to persons of limited means.

Minimal Burden on Local Government: The local government could play several roles, none of which represent a burden.

- The locality would record the betterment agreement on its books, charging a usual & customary fee;

- Optionally, the locality could collect the payments from the homeowner and remit to the lender. The locality would receive compensation for this service, too.

Benefits to State and Local Government From Betterment Financing:

- Enables the financial markets to deliver large amounts of tax-exempt bond financing, while allowing homeowners the flexibility to choose which credit provider has the best program;

- Repairing failing septic systems will help VDH/DEQ clean up State waters, including the Chesapeake Bay;

- Betterment financing can be structured to not be 'debt' to state or local governments. No 'moral obligation' from local governments is required;

- Betterment financing can be structured to avoid socializing the costs of what is at heart the liability of private homeowners;

- Eliminates the risk that state and local governments would have to foreclose on homeowners, a key structural defect of present revolving loan programs;

- Avoids creating a new bureaucracy or adding to costs of VDH/DEQ/local governments.

Comparison of NatLUST's Proposal to Massachusetts' Betterments Program: Massachusetts likely deserves credit for being the first state to enact a betterments statute, which can be found at MGL 111-Section 127B.5. While MA's program has proved successful, NatLUST's proposal is more market based, and eliminates features that Virginia's political leaders would likely reject as being unwarranted burdens on local government.

Pros to MA's Approach

- Low cost financing is available to homeowners who live in participating localities, where the loan is recorded against the real estate (thereby creating the 'security');

- MA adopted legislation requiring that septic systems be inspected when a home is sold (this is waived if the locality has a state approved septic management program). Anecdotal comments from MA DEP suggest the 'inspect-on-sale' statute is catching a number of failing systems.

<u>Cons to MA's Approach</u>

- The financing requires the active participation of local governments, much like VA's revolving loan programs. Like VA's current loan programs, MA uses a state bond issuer to lend money to the locality, which in turn loans money to homeowners. To no surprise, MA's program has the same flaws as VA:

  - The locality has the unpleasant duty to foreclose in event of default; and
  - The financing is 'debt' to the local government.

  Consequently, some MA localities do not participate.

- MA's program appears to create significant burdens on local government (ex. To manage a septic inspection programs, develop database systems, etc.).

- MA's program involves the state bond bank lending money to the locality at 0%--- and the local government then lends money to homeowners at 5%. This is decidedly inefficient.

  a) The bond bank is losing money, in effect subsidizing the program;

  b) By implication, the locality is paid 500 basis points annually to administer the program. NatLUST is confident the private sector could do this for a fraction of the cost.

  c) MA's program puts the burden on local governments to create their own septic database programs. NatLUST believes the private sector (e.g. Carmody) has web based systems that are far superior and less expensive system, and could likely be integrated with VDH's existing systems.

Advantages to NatLUST's Approach:

- Inexpensive financing could be made available to all homeowners; thereby aiding VDH in discharging its responsibilities;

- Reduced burdens on local governments.

  a) No responsibility on localities to create and manage their own septic programs;

  b) Avoids the issue with traditional revolving loan programs where local governments have to foreclose on homeowners who default;

  c) Avoids the issue of localities refusing to participate because of they do not want moral obligation debt on their balance sheet; and

  d) The only burden on local government is to record the betterment loan in its land records books, for which they charge a fee;

- Doesn't socialize the costs onto the backs of the state's taxpayers. Only those who use the program pay the costs.

NatLUST:

- 501(c)(3) environmental financing program
- Outgrowth of Virginia Resources Authority UST claim financing program developed in conjunction with DEQ. Have funded over $70 million VPSTF claims. Currently operating UST program in VA, CT, and IL. Expanding UST program into MA in Q2-2008
- Unlimited access to tax-exempt bond financing
- Interest in providing financing program for septic repairs

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