

# The Use of Environmental Investment Charges for Meeting Debt Service Obligations: the New Jersey Experience

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## Introduction

Solid waste systems across the nation have implemented specific user fees and taxes as a means of paying “stranded costs”, such as debt service or other fixed costs that cannot be fully covered by operating revenues. Solid waste entities that recently built incinerators or other expensive disposal facilities in competitive waste markets are especially vulnerable to potential shortfalls in covering debt service. Nowhere are these conditions riper than in New Jersey. Furthermore, the solid waste environment in New Jersey presents perhaps the most striking example of a full cycle from regulated to competitive waste flow systems. The state initially implemented a system that directed waste flow to specific facilities, protecting them from any waste lost due to competitive market conditions. This insulated system revenues, making revenue forecasts and debt service coverage more reliable. When the U.S. Supreme Court ultimately ruled that New Jersey’s flow control violated the commerce clause, solid waste systems were then hurled into the competitive environment, with waste flows no longer guaranteed and, consequently, revenues less reliable at a time when debt service on expensive incinerators was increasing annually.

Solid waste systems in these competitive areas with high fixed costs have often resorted to revenue enhancements to supplement declining operating revenues. In New Jersey, environmental investment charges, known by the acronym “EICs”, have recently been implemented to cover debt service costs. EICs, denoted by different names, have been implemented in various forms by solid waste systems across the nation. The suddenness of changes in this state’s solid waste environment offers insight into the various economic, financial, and political issues concerning the viability of high-cost systems in competitive markets.

## EICs in the Competitive Environment

In its most practical and simplest form, an EIC is the component of total disposal charges, generally expressed as a per tonnage rate. Basically, an entity must project future revenues and operating costs, including the debt service component. The first hurdle in imposing the charge is determining the effect on waste held within the system.

For example, waste under contract is generally held as a strong credit trait, as it provides a more reliable stream of revenue. To reduce the level of non-contracted waste within the system, a solid waste authority might use the EIC to induce haulers and municipalities to enter into contracts. The Union County Utilities Authority (UCUA), for example, embeds an imputed EIC on waste under contract, producing a \$47.50 total tipping fee. Non-contracted waste is assessed a separate \$18.51 EIC that, when added to a \$42 estimated market rate on the low end, results in a \$60.51 per ton total charge. Obviously, an incentive is created for contracting waste, depending on the market rate.

It is important to note that the EIC is assessed on all waste, contracted or non-contracted, on waste produced within the county. Although legal flow control is no longer a remedy, counties have submitted amended plans to the appropriate state agencies to establish nondiscriminatory flow control, meaning that the bidding and procurement practices do not unfairly burden out-of-district vendors. The approved plans include authorization to impose EICs on stranded investment costs, including debt service. Under these same guidelines, the EIC may be broadened to include host community fees and administrative fees as well as debt service. Administrative fees may include enforcement costs, inspection, weighing, and billing. Hence, complex EIC structures with many components result in higher EIC assessments.

The competitive environment, or the economics of solid waste, is the largest challenge to the viability of EICs as well as all operating revenue. The risk is that any adverse changes in demographics, economy, technology or recycling could reduce tonnage collected by systems and, consequently, EIC revenues. The risks are numerous and are compounded by the fact that many systems have restructured debt so that debt service payments, while made more even, are extended for additional years. Tonnage in many systems has been reduced due to successful recycling, ironically, by the same authority that collects and disposes of waste. Advances in technology have further reduced packaging weight. Finally, areas in

economic decline could see both residential and commercial waste declines if populations fall and businesses leave. Paradoxically, herein lies both the potential and risk for EICs. As tonnage declines, causing lower tipping fees and EIC revenues, there might be a tendency to raise EIC rates, the same phenomenon that is often seen in declining tax bases. However, these additional burdens may merely exacerbate a loss of tonnage.

### **Collection**

In addition to a rate structure that is competitive, the collection process for EICs must also be effective. Even a system that seems fundamentally capable of implementing an EIC on all trash produced in its boundaries, legally imposed EICs will tempt haulers to by-pass the system in favor of cheaper alternatives outside the system. Weigh stations can be used to assess EIC against tonnage delivered, or estimates based on past waste generation levels. A system might consider a reserve for EIC uncollectibles, but legislation may not allow this. The UCUA uses prepaid accounts to lower the risk of uncollectible amounts and provide for better cash flow. This mechanism works well with commercial haulers, which have greater affordability. The weigh stations with prepaid accounts have an advantage over direct tax billings in that the actual determination of total EIC takes place on the spot and is calculated from measurable tonnage. Furthermore, money in the accounts is readily available for drawdowns. When EIC charges are billed, the waste has already been discharged, allowing haulers to delay payment indefinitely.

The weigh stations also present serious drawbacks, particularly in areas where cheaper disposal options are nearby. A commercial hauler may elect to transport waste to another transfer station in another county, bypassing weigh-in stations designated by the county in which the waste was generated, such as the UCUA example. This practice is less prevalent among haulers with municipal contracts that provide reliable revenues. In New Jersey, transfer stations must maintain records on total tonnage accepted, the classification of trash, and the point of origin. A county that believes trash has bypassed its system can petition the state Department of Environmental Protection and, in essence, become "deputized," with the power to examine the records of any transfer station in any county to determine the amount of waste originating within its borders and, consequently, subject to an EIC. A county system that is far away from viable alternatives will most likely have a weigh-in system that captures more in-county waste. For less competitive systems, EIC collection becomes a costly, time-consuming undertaking.

EICs can also be imposed, like a property tax, on all residential and commercial properties. The difference is

that the tax is based on actual or estimated garbage generated, not on property values. For commercial users, the EIC may be based largely on land use, not actual garbage generated. Unlike the UCUA's billings at weigh stations, the Atlantic County Utilities Authority (ACUA) directly bills 20 of the 23 municipalities that provide sanitation services for residents. It is easier to collect these billings from municipalities, which can accept the risk of passing on the costs to residential users. For residents in the other three municipalities, estimated waste generation is based on the waste record of the other 20 municipalities. For commercial entities, collection has proven much more difficult. The ACUA has based its EIC on land use allocated to businesses within certain classifications and the imputed waste generated by entities within these groupings. Under these criteria, it is difficult to determine whether they are paying too much or too little relative to the actual waste generated. In the same way property taxes can be used to shift burdens among residential and business entities, EICs may be used to achieve some economic or political goal, i.e. business retention if rates are lower for commercial users. The advantage of billed assessments based on estimated usage is the establishment of a regular billing system for continued, periodic collection without relying on costly weigh stations. A major disadvantage is the burden of keeping data current for numerous business classifications. This EIC requires new information reflecting improvements to property, closing and opening of new businesses, and any changes in land use. Also, users may challenge the fairness of any system that does not measure actual waste production.

### **EICs and Debt Structures**

Another issue is how the EIC term, cash flow, and charge components fit with the outstanding debt service. The EIC term should coincide with the debt service obligation and should take into consideration any future restructurings. With the EIC dedicated to debt service, an entity must plan for how shortfalls will be dealt with and whether an additional debt restructuring or additional EIC charge is possible. Also, if EIC charges exceed debt service and other fixed costs, system managers must consider EIC reductions, debt retirement, or transfers to reserves or other permitted funds, such as operating reserves or maintenance funds.

Most systems that have EICs in place to cover debt service also tend to show weak operations. When the EIC is carved out of an existing tipping fee as a dedicated source of debt service payments, less flexibility is maintained for operations, especially for competitive systems. When the tipping fee is raised to account for a new EIC assessment, monies flowing to operations are maintained, but greater competitive pressures might ultimately reduce waste flow and, hence, system revenues. The more an EIC includes in costs, such as administrative

charges, the riskier the coverage of debt service by future EIC receipts. Also, it is not clear whether additional EIC charges for existing waste or for another waste category would be allowed as a backstop in case projected receipts do not come into fruition.

### **Role of State and County Authorities**

The level and breadth of the EIC rates depend not only on competitive forces and facility costs but also on state governing agencies that oversee solid waste as well as local governments, which assess the economic, political, and systemic viability of imposing EICs. The funding landscape for facilities bailed out by EICs is volatile. Prior to instituting EICs, many county authorities waited to see what would be available from the state. If the state approves a bailout through its own dedicated revenues or state appropriations from available general funds, then the county systems that stepped forward might have assumed an EIC charge for naught. Many facilities in New Jersey, however, faced the prospect of imminent default in the absence of debt restructurings and, consequently, could not wait on passage of any bailout legislation. This was a prudent move. Various bills proposing stranded debt relief are in limbo in the legislature. Other systems, burdened by haulers that evade system weigh-ins or refuse to pay may be forced to tap both EICs and state loans to meet debt service payments.

With systems now competitive, many feel that the state is obligated to either fund debt service shortfalls through loans or grants from special dedicated funds. In New Jersey, the state has made \$20 million available in each of fiscal years 1998 and 1999. Furthermore, the state has \$61 million representing loan and grant approvals from prior years for solid waste projects eventually abandoned. Approximately \$107 million of the total \$168 million available was used as loans, repayment of which voters approved for forgiveness in 1998. To become eligible for the \$101 million in relief (\$20M + \$20M + \$61M), the local issuer must submit to an operating audit by the state's treasury department and implement any changes or improvements that are recommended.

For many types of projects, counties across the nation seek voter approval prior to committing funds. Electorate support is viewed as a strong credit feature that often reflects the willingness of the community to pay for various projects. Thus far, the state has actively sought voter approval on solid waste issues. It would be interesting to see if a local electorate would give support to a system-wide EIC. In the past, New Jersey counties have sought and received approval for special 1-cent tax levies dedicated to open space projects. However, the parks are very clean and give everyone a good feeling inside, not like dirty garbage. The idea that you have to pay extra for discarding waste rather than improving an asset is less

likely to garner widespread support. Since EICs have not been voter-approved, it is difficult to gauge taxpayer support for the charges.

Ultimately, a county and its issuing authority may decide against new EICs and, instead, use the county's general obligation pledge to secure bonds issued to restructure or refinance solid waste bonds. For example, the Essex County Improvement Authority may issue bonds backed by the county's ad valorem pledge. In this case, the costs of the debt service would be spread among all county taxpayers, without regard to specific garbage produced. The advantage in this case is that the security for the bonds would remove much of the legal and competitive risks associated with EIC-backed bonds. The disadvantage is that a county trying to put its budget in structural balance and lessen its dependence on one-shot revenues would add to its significant debt burden.

Another political issue is the resistance from counties that did not have to build incinerators or other garbage facilities. These systems owned their own landfills or contracted to send trash to other landfills or facilities outside their respective borders. Any state dedicated payments or general revenues could, in a significant way, cause less urbanized, predominantly southern New Jersey counties to subsidize counties that chose to build facilities to deal with a garbage dilemma.

### **Conclusion: Unknown Legal and Legislative Environments**

Legal challenges have plagued the impositions of EICs. In New Jersey, more than two dozen cases have inundated the courts. Challenges have been largely based on the belief that local authorities cannot authorize the imposition and collection of an EIC. Proponents claim that an EIC is valid under statutes allowing for financial plan approvals of solid waste systems. To date, there have been no court decisions that will seriously impede local solid waste authorities from imposing and collecting EICs. However, challenges continue and constitute a major, arguably the main, risk for the financial viability of solid waste systems in New Jersey. In fact, some commercial users in Atlantic County have refused to pay the solid waste assessment, challenging the statutory basis for the charge.

Even if strong legal provisions and precedents keep users within current EIC-based systems, objections from residents or businesses in high-rate areas may well lead to new legal challenges or legislative changes if the solid waste system in the next county assesses a competitive overall tipping fee with little or no EIC. With debt service in many systems extending over 30 or more years, there is a strong possibility that legislators, responding to the complaints of individual taxpayers and businesses, may fashion legislation that could impede the tipping fees and

EICs assessed by systems. As mentioned earlier, the injection of technological changes that make waste disposal less costly may render current fee structures obsolete.