



MEMORANDUM

TO: Senator Dan Clodfelter
Senator Charlie Albertson
Representative Pryor Gibson
Representative Lucy Allen

CC: Secretary Dee Freeman
Deputy Secretary Manly Wilder
Assistant Secretary David Knight
Assistant Secretary Robin Smith
Susan Morgan
Kristin Walker
Kristine Leggett
Andrew Pennock
Elizabeth Biser

FROM: William Gilmore, Director, Ecosystem Enhancement Program

DATE: April 3, 2009

RE: Nutrient Offset Program Transition Progress Report

S.L. 2007-438 requires the N.C. Department of Environment and Natural Resources to report to the Environmental Review Commission on the matter of transitioning the Nutrient Offset Program under the Ecosystem Enhancement Program from a fee-based program to a program based on the actual costs of providing nutrient credits. The first progress report was provided in September of 2008. The second progress report is attached. If you have any questions, please contact me directly at (919) 715-1412.

Attachment



March 2009

**A Report of the Ecosystem Enhancement Program's Response to Session
Law 2007- 438 Requiring the Transition of the Nutrient Offset Program to
an Actual Cost Method**

Second Progress Report

**Prepared for
Environmental Review Commission**

**Prepared by
Ecosystem Enhancement Program
2728 Capital Blvd.
Suite 1H 103
Raleigh, NC 27604**

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I. Executive Summary

Session Law 2007-438 mandates that the N.C. Department of Environment and Natural Resources (DENR) develop and implement a plan to transition the N.C. Ecosystem Enhancement Program (EEP) Nutrient Offset Program from a fee-based program to a program based on the actual costs of providing nutrient credits. The development and implementation of the transition plan is to occur no later than Sept. 1, 2009. The legislation also requires DENR to “report on its progress in developing and implementing a new fee structure for the Nutrient Offset Program to the Environmental Review Commission on 1 September 2008 and 1 March 2009.” The first report was submitted as required last September and this report represents that which is required to be submitted in March of 2009.

In the report provided in September of 2008, EEP provided detailed information on a proposed approach to charging actual costs for nutrient reduction credits. The basic method presented is as follows:

$$ActualCostRate = \frac{ActualCosts}{TotalPoundsOffset} + AdjustmentFactor$$

This Actual Cost Method incorporates the complete costs of providing nutrient reductions (including data from negotiated consultant fees and competitive bid awards to private-sector companies) and adjusts for situations when revenues exceed or are below actual costs.

As described in the September report, EEP has worked with the N.C. Division of Water Quality to convene key stakeholders to consider the proposed method and assist in determining how particular components of the method should be applied. To effectively engage stakeholders, EEP secured the services of the N.C. State University Natural Resources Leadership Institute (NRLI). NRLI has interviewed representatives of important groups with a strong interest in the outcome of the Actual Cost Method and has reported their findings from those interviews in a report (see Appendix A). Principal issues uncovered in their report include:

- The need for greater accountability and transparency regarding the Nutrient Offset Program;
- The importance of ensuring that payments made cover all costs for achieving nutrient reductions;
- Consideration of whether the method should allow for the implementation of stormwater best management practices (BMPs);
- Concern about equity between regulated and unregulated local governments;
- Consideration of how broad of a geographic area nutrient reductions credits should apply; and
- Consideration of multiple approaches to meeting mitigation requirements.

The first meeting of stakeholders occurred on Feb. 4, 2009. During that meeting the group evaluated important issues related to the Actual Cost Method, setting the stage for providing input on matters requiring resolution (see Appendix B for a summary of the first meeting). Additional meetings are planned for March and April. These meetings will focus on gaining stakeholder input on how often to adjust actual cost rates, what geographic coverage the rates should have and how to account for inflation for future contracts associated with projects that are underway but not yet complete. The intended outcome of these discussions is an actual cost methodology that will be proposed through the rule making process. Initial steps to establish the method in rule should begin with a presentation to the Water Quality Committee of the Environmental Management Commission in later this year.

II. Background

EEP, an agency within the Department of Environment and Natural Resources, implements restoration projects that reduce nutrients entering the Neuse and Tar-Pamlico River basins. This program, known as the Nutrient Offset Program, is made available to developers in these river basins to help them comply with nutrient-sensitive-waters management strategies set by the Division of Water Quality (DWQ). Summary data for and a history of the Nutrient Offset Program were provided to the ERC in September 2008 as part of the first progress report on the effort to transition EEP from a fee-based system to a system that charges the actual cost to provide required reduction credits

(http://www.nceep.net/pages/FINAL_ERC_NO_Progress_Report_09-12-08.pdf).

Since its establishment in 2001, the Nutrient Offset Program has received payments of \$18,346,047.60 for 1,369,789 pounds of nitrogen reduction and 2,339 pounds of phosphorus reduction. As of March 1, 2009, EEP has used these funds to restore 545.42 acres of riparian buffer and to implement five stormwater wetland best management practices (BMPs). These projects represent 1,122,011 pounds of nitrogen and 11,217 pounds of phosphorus reduction in the Neuse and Tar-Pamlico river basins combined. The gap between required nitrogen reductions and provided reductions is the result of EEP suspending the acquisition of restoration projects while the legislature resolved fee issues as described below. EEP is actively procuring projects to achieve required reductions. EEP expects that the program will meet all required nutrient offsets within the next quarter.

Using the results of the legislative study conducted by Research Triangle Institute, the legislature ratified Session Law 2007-438, which established interim nutrient reduction fees for nitrogen and phosphorus in the Neuse and Tar-Pamlico river basins. This bill was passed in August 2007. As required by the session law, DENR has developed a proposed plan to transition the EEP Nutrient Offset Program from a fee-based program to a program based on the actual costs of providing nutrient credits. The proposed plan was presented to the ERC in September of 2008 (see Web link to report in previous paragraph).

With the framework of an Actual Cost Method developed and presented to the ERC, DENR has sought to invite outside input on the method and to involve stakeholders in determining how to apply particular method components. The content of this report is focused on a description of the stakeholder process, its status and the next steps involved in transitioning the EEP Nutrient Offset Program to an Actual Cost Method.

III. Involvement of Stakeholders in Method Development

In early 2007, when the General Assembly retained the Research Triangle Institute (RTI) to do an evaluation of what it costs to provide nutrient-reduction credits, George Givens, counsel to the ERC, conducted a “605 working group” to seek input on RTI’s scope of work. Representatives of many interest groups participated in this process and strong interest in the subject matter was demonstrated. Therefore, DENR believed it to be important to involve interested parties in deliberating issues related to the establishment of the Actual Cost Method before proceeding with the formal process of instituting a method in rule.

Given the level of interest in and complexity of the subject matter, EEP secured the services of the Natural Resources Leadership Institute (NRLI) to ensure an effective and smooth stakeholder process. Housed at North Carolina State University, NRLI has a breadth of experience in collaborative approaches to environmental decision making. For this process they have been tasked to uncover key stakeholder interests, convene a core group of individuals representing various organizations, and facilitate a dialogue around the proposed Actual Cost Method.

The first step of the process involved interviewing a number of individuals to gain an awareness of their general understanding of the Nutrient Offset Program and the key issues around nutrient offset pricing. Important findings of the interview process were as follows:

Accountability and Transparency

There was general consensus that information and data related to the Nutrient Offset Program was not readily available from EEP. Almost all interviewees expressed an interest in having more information to provide greater clarity on the program’s status. EEP explained that efforts were underway to improve the sharing of information of project-related data. Toward that end, EEP recently launched a spreadsheet of all projects, including links to all reports associated with each project on the EEP Web site (http://www.nceep.net/eeep_projects/eeep_projects.html).

Covering Costs

Most stakeholders expressed a desire to ensure that payments made to EEP for the purposes of nutrient reduction be sufficient to cover all costs associated with the delivery of nutrient reduction credits.

Buffers vs. Stormwater BMPs

On this issue, stakeholders had disparate opinions. Some believe that the Actual Cost Method should be set to account for the implementation of stormwater BMPs, while others are satisfied with the application of the least cost alternative (typically buffer restoration) to keep user costs lower.

Equity

Some government stakeholders expressed concern about the geographic equity of nutrient-offset payments. Specifically some stakeholders expressed equity concerns that not all municipalities were regulated and thus required to meet nutrient reductions (i.e., economic development opportunities may migrate away from areas required to provide

nutrient reductions). A similar issue raised was related to the implementation of low-cost projects in rural areas, diminishing property values and tax revenues.

Geographic Application of Credits

This is another issue that raised disparate opinions. Some believe that keeping nutrient-reduction projects close to the location of the impacts is the most beneficial approach, while others think such geographic restrictions will drive up the cost of nutrient credits.

Alternative Approaches

Many interviewees were supportive of additional alternative approaches to securing nutrient offsets such as private mitigation banks and local government mitigation programs.

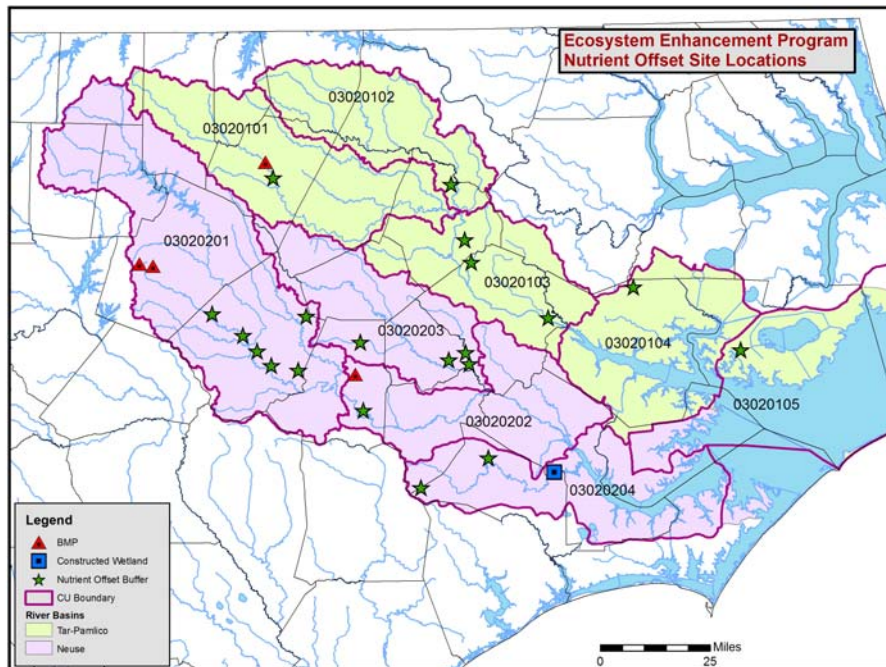
The entirety of the issue assessment conducted by NRLI is included in Appendix A for reference.

The results of the interviews were utilized to develop a framework for the stakeholder dialogue. Information gleaned from the interviews helps highlight information gaps that need to be filled and uncovers issues that will need to be discussed by the stakeholders before proposing a method through rule making.

On Feb. 4, 2009, the first meeting of the stakeholders was held at Yates Mill Pond County Park in Wake County. Representatives from key interest groups (local governments, non-profit environmental groups, private-sector companies) attended, along with staff from EEP and DWQ.

The focus of the first half of the five-hour meeting was to develop a common understanding of the existing Nutrient Offset Program and how it operates. DWQ presented the context for the program by describing the history of the nutrient-sensitive waters strategies in the Neuse and Tar-Pamlico River basins. EEP provided a history of the nutrient-offset fees along with data on payments to the program, projects implemented by the program and nutrient reductions associated with those projects. Figure 1 below is a map of all EEP nutrient-reduction projects in the Neuse and Tar-Pamlico basins that was provided at the meeting.

Figure 1 Map of the locations of nutrient reduction projects implemented by EEP



Participants were encouraged to ask questions and seek clarity on program details. The exchange was very productive and a number of issues were vetted. Highlights of the discussion included:

Discrepancy between Payment Levels and Project Costs

Questions were raised about the period of time when fees were admittedly below project costs. Stakeholders wanted to understand why the program continued to accept below-cost payments and how the program intends to make up for the historical below-cost payments. EEP staff explained that the authority to deny payments was unclear since payments were authorized through local government programs. Because of the legal uncertainty, the Department made the decision to continue to allow payments to be made. EEP has set a course for delivering the required payments within existing financial constraints, primarily through the implementation of low-cost projects.

Nutrient Reduction Credits for Projects

Some time was spent discussing how nutrient reductions are calculated for restoration projects. Participants were particularly interested in why developers are not required to pay for both nitrogen and phosphorus impacts when mitigation projects are allowed to generate both nitrogen and phosphorus reduction credits. DWQ committed to evaluating this issue in advance of the next meeting and reporting back to the group.

Questions about SL 2007-438

Participants sought to better understand the Session Law requiring the transition to the Actual Cost Method. It was noted that requiring the use of the “least-cost alternative” discriminated against the implementation of projects in urban areas. Some questioned the

session law's sunset provision. EEP staff explained that DENR's legislative liaison will be working to get the provision revised to sunset upon the effective date of the method when it becomes rule. Staff also explained that representatives of the Office of Administrative Hearings, the Rules Review Commission and DENR have indicated that rule making is the appropriate pathway for instituting the Actual Cost Method.

The focus of the remainder of the meeting was on describing the Actual Cost Method that was presented to the ERC in September of 2008 and conveying the fundamentals of the issues requiring stakeholder input. Key issues associated with the Actual Cost Method to be vetted by the stakeholders include:

- Frequency of rate adjustments;
- The geographic coverage of rates; and
- Using inflation to determine the actual cost of future contracts (for projects not yet completed).

IV. Next Steps

A number of efforts will begin or continue over the next several months:

1. EEP and DWQ will continue meetings with stakeholders in March and April to work toward the development of an Actual Cost Method that can be put forth during the rule-making process.
2. DENR's legislative liaison will work to revise the sunset clause in SL 2007-438 so that the existing fees sunset upon the effective date of the rule that includes the Actual Cost Method.
3. EEP and DWQ will proceed to establish the Actual Cost Method in rule. The rule making process will begin with a presentation to the Water Quality Committee of the Environmental Management Commission. This presentation will cover a proposed revision of the nutrient offset payment rule inclusive of input received during the stakeholder process described earlier in this report. It is anticipated that the presentation will occur in July or September of 2009. Subsequently, the Environmental Management Commission will be asked to approve a request to move ahead with the rule making process which will involve public notice and hearings.
4. EEP will report an updated status on the Nutrient Offset Program in its Annual Report in November of 2009.

EEP NUTRIENT OFFSET PRICING METHOD STAKEHOLDER REPORT

L. Steven Smutko

Mary Lou Addor

NC State University Natural Resources Leadership Institute

January 2009

BACKGROUND AND OBJECTIVES

Session Law 2007-438 mandates that the N.C. Department of Environment and Natural Resources (DENR) develop and implement a plan to transition the N.C. Ecosystem Enhancement Program (EEP) Nutrient Offset Program from a fee-based system to a program based on the actual costs of providing nutrient credits. EEP, in collaboration with the NC Division of Water Quality, has committed to convening a group of key stakeholders to discuss the basic approach to setting actual-cost rates for its nutrient offset program. The NC State University Natural Resources Leadership Institute has taken on the task of coordinating with EEP to assemble the stakeholder group and guide its deliberations.

Prior to convening these meetings, NCSU contacted key stakeholders and organizations and interviewed 22 people to gather information about their willingness to engage in discussions about the cost-based system, and the issues that they see that are important to resolve.

Specifically, we gathered information from prospective stakeholders on the following topics:

- Stakeholders' understanding of the nutrient offset program
- Key issues regarding nutrient offset pricing
- Stakeholders' perspectives on the characteristics of an optimum pricing method
- Key concerns with EEP's proposed actual cost method of nutrient offset pricing
- Ideas that stakeholders have for potentially resolving these concerns that might be acceptable to all parties
- Stakeholders' perspectives of a successful outcome of these meetings

- Data or information that stakeholders need for meaningful engagement in a discussion on pricing methods
- Conditions that must be in place for their participation in stakeholder meetings (e.g., other stakeholders who should or should not be present, data that should be available, meeting location and time, etc).

STAKEHOLDERS INTERVIEWED

Alissa Bierma, Neuse River Foundation

Derb Carter, SELC

Chandra Coats, Jamey Guerrero, and Haywood Phthisic, Johnston County

Glenn Dunn, Poyner & Spruill

Cindy Finan, Neuse R. Compliance Assoc

Matt Flynn, Town of Cary

Jonas Hill, Pitt County

Heather Jacobs, Pamlico-Tar River Foundation

Troy Lewis, City of Tarboro

Lisa Martin, NC Home Builders Association

Grady McCallie, NC Conservation Network

Paul Meyer, NC Association of County Commissioners

Nancy Nixon, Nash County

Adam Riggsbee, George Howard, John Preyer, and Barrett Jenkins, Restoration Systems, Inc

Joe Rudek, Environmental Defense Fund

Mike Schlegel, Triangle-J Council of Governments

Paul Wiebke, City of Durham

SUMMARY OF INTERVIEWS

Knowledge of Nutrient Offset Payment Program

Our first line of questioning was meant to determine stakeholders' familiarity with the nutrient offset payment program, and EEP's efforts to establish an actual cost method of pricing. All of the stakeholders we interviewed were knowledgeable about the nutrient offset program, but less than one-half were sufficiently aware of the proposed actual cost method to provide detailed comments.

Key Issues Related to Establishing a Nutrient Offset Pricing System

We asked stakeholders what they consider to be the most important issues related to establishing a nutrient offset pricing system. Responses were grouped into several contextual categories: accountability and transparency, matching payments to projects, covering costs, containing costs, buffers vs. retrofits, geographic equity, juxtaposition of impacts and mitigation, alternative approaches,

Accountability and Transparency

The most commonly stated issue regarding the nutrient offset program was that of agency accountability. Nearly everyone we interviewed, without prompting, declared that EEP should be more forthcoming with information about where and how offset payments are being used. Many stakeholders view the current system of offset payments to be too far removed from actual reductions in nutrients. They make the point that the nexus between payments received by EEP and projects being put on the ground is not clear. Says one stakeholder, "...their design, bid, build program causes [EEP] to focus on the outputs rather than the outcomes".

Stakeholders want to know that nutrient reduction payments are being spent on restoration projects with a commensurate reduction in nutrient loading. Said another stakeholder, "There are currently permit obligations in the pipeline, and the perception is that there is no

accounting for these projects, nor any display of work accomplished.” Without adequate transparency, it is doubtful that stakeholders will trust whatever rate is eventually adopted.

Covering Costs

Most stakeholders we interviewed were very clear that nutrient offset payments must cover the full costs of mitigation required under state permits. Most believed that the costs to mitigate development should not be subsidized by payments from the state general fund. It was clearly stated by many interviewees that the program should be self-sustaining and that development should pay for itself. Moreover, many underscored the basic principle that payments received must result in commensurate reductions.

Buffers vs. Stormwater BMPs

While the stakeholders we interviewed were nearly unanimous in their belief that the program must cover its costs, many raised the issue whether offset payments should be used only for buffer restoration, or if stormwater BMPs will be factored into the formula. More than one stakeholder we interviewed made the case that stormwater BMPs, rather than buffers, are the preferred method of reducing nutrient loading. Said one stakeholder *“I would like to see the highest level of nutrient reductions. Projects that treat stormwater runoff have a high probability of reducing nutrients and it is easier to document the results”*.

However, other stakeholders were concerned that the fees could become outrageously expensive if retrofits and BMPs are the primary mechanisms for providing nutrient credits. The word “reasonable” was used by more than one interviewee when discussing costs, and their stated interest was that EEP needs to be more efficient in its planning and operations.

The issue was succinctly summed up by one stakeholder this way, *“It will be difficult to charge a price for BMPs. [EEP’s] primary method for mitigation is to plant buffers, which is cheap. There will be a hard argument from [some stakeholders] if they are pricing offsets relative to BMPs but only putting in buffers. They’ll be stuck just putting in buffers because people won’t tolerate*

paying for stormwater BMPs. It will be politically difficult to charge a high enough price for BMPs.”

Equity

A few local government stakeholders brought up the issue of geographic equity with respect to nutrient offset payments. One respondent made the point that geographic differentiation of nutrient offsets put them at a disadvantage for community economic development opportunities relative to their neighbors. Another made the point that land is being bought up in rural counties to offset the rapidly growing areas. The result is that lands in conservation uses diminishes its value and results in loss of property tax revenue. Said one respondent, *“If you are in the [same] basin, then you should have to obey the same rules.”*

Another equity issue brought up by a stakeholder was the perception of differentiation between NCDOT projects and the private sector. Said the interviewee, *“[There] seem to be two banks, one that funds NCDOT projects on an actual cost basis, and one for the private sector that uses a different fee structure.”*

Geographic Application of Credits

Several stakeholders brought up the issue of the geographic concurrence of impacts and their associated mitigation projects. Because the costs of achieving nutrient reductions vary from watershed to watershed, many stakeholders felt that keeping projects in the same watershed was desirable. Reported one stakeholder, *“I see a lot of value in applying nutrient offset projects as close to the nutrient conditions that limit the localized impacts. Ideally this is as small watershed as possible. It makes sense to place it in the same 8-digit watershed.”* On the other hand, some respondents felt that forcing mitigation projects to be conducted in rapidly growing watersheds will drive up the costs of nutrient credits.

Alternative Approaches

Many of the stakeholders we talked to, most notably those in the conservation community, expressed a concern that the link between impacts and mitigation in EEP's nutrient offset program is not sufficiently direct. Many were supportive of alternative approaches to securing nutrient offsets such as private mitigation banks and local government mitigation programs as a desirable alternative. The most advantageous attribute of private banks cited by stakeholders is that the mitigation is conducted prior to the offset transaction. There is no time lag between payment and action. Reported one stakeholder, *"Mitigation banks seem to work because the obligation is already paid for up front. They have to actually produce the credit."* Said another, *"There is value in private mitigation banks, because the credits are created before they're sold. From the standpoint of temporal impacts, they are good for that, especially in comparison to EEP's track record."* Moreover, cited one stakeholder, the profit incentive will drive firms and individuals to create conservation measures.

Others indicated that private banks can be more responsive to changing conditions and that market signals are needed to ensure accurate pricing. As one stakeholder put it, *"The current system is cumbersome to reflect any changes in the price. You need to be flexible and responsive when circumstances change. You need the competition of the market to come into play to make it worthwhile for those involved."* Other benefits of private banks voiced by stakeholders were the potential for keeping a lid on prices if there were sufficient competition in the market, and the creation of "green jobs."

While there was significant support for the concept of private mitigation banking by stakeholders from conservation organizations, it was not unqualified. Some conservation interviewees indicated a concern that standards and safeguards could be compromised in order for banks to compete. Some local government stakeholders expressed a concern that new regulations requiring them to seek private alternatives will cost them time and money. Local governments see benefits in EEP's role as a central clearinghouse for servicing in-lieu payments. It reduces their transaction costs.

Others we spoke with were more direct in their belief in free-market solutions. Said one, *“EEP should examine a policy option of not setting a price, but having a price set by the market. If there is a private option available, then the state does not need to provide government produced pounds of nitrogen. The state should not compete with the private sector.”*

Another alternative approach, brought up by local government stakeholders, is to credit actions by local governments for nutrient offsets. Said one local government stakeholder, *“What the EEP does – constructed wetlands, etc. – are not as beneficial as what a town could offer. A town could purchase conservation easements, do stormwater retrofit projects, and extend buffers to get credit.”*

Point Sources and Nutrient Offsets

We interviewed three stakeholders who represent the interests of municipal point-source dischargers. They each conveyed a concern that offsets would be very expensive for them and their clients. Moreover, they don’t believe that the rates that have been established for point sources are accurate with respect to the actual nitrogen output by the dischargers. They also site an equity issue in the way that credits are calculated for point-source and nonpoint-source dischargers. Said one interviewee, *“Nonpoint sources only need to ‘claim’ reduction through a theoretical process. We should be able to earn credits via trading with nonpoint sources.”*

They were in agreement that other options should be available to them, specifically nutrient trading in the Neuse basin. Moreover, they would like to see credits granted for municipal actions taken to reduce nutrient loading, such as purchase of conservation easements, stormwater retrofit projects, and enlargement of regulatory buffers in municipal jurisdictions.

Pricing Mechanism Characteristics Desired by Stakeholders

We asked stakeholders, *“If you were to devise a method for pricing nutrient offsets, what would be the key characteristics that you would want to see included or reflected in such a pricing program?”* The most commonly mentioned characteristics focused on five aspects: accuracy, transparency/ accountability, equity/consistency, spatial relevancy, and timing. Other characteristics identified by interviewees included timing of implementation, cost effectiveness, flexibility, and ease of implementation, and free-market basis.

In a second question, we asked them to provide suggestions for how the issues or concerns they identified could be resolved in a way that would be acceptable to all parties. Many of the responses to this question were identical or closely related to the previous question. One key suggestion that was added here was the idea of establishing a comprehensive mitigation plan. We have combined the responses to these this question with the earlier question in the discussion below.

Full and Accurate Accounting

The most common response to the question of characteristics of a pricing system desired by stakeholders was that the nutrient offset fee must accurately reflect the full cost of mitigation. Many interviewees emphasized the importance of finding a way to reflect the variation in land values in the two basins. Others mentioned the need to fully realize the costs of program administration in the offset fee. Said one respondent, *“Whatever pricing EEP uses, it must use full cost accounting for its administrative costs. A percentage fee is not reflective of true costs. Full cost accounting should reflect all costs that could be considered a state subsidy of the mitigation price – labor, rent, health care, state retirement, salary etc.”* Said another, *“Survey the mitigation banks in the area to determine the market-based price, and then add their administrative cost to that.”*

Another cost consideration mentioned by more than one interviewee was maintenance cost. Some expressed the concern that without an accurate accounting of future maintenance,

projects would become less effective over time. Reported one interviewee, *“I have concerns about ‘least-cost’ alternatives. There are some BMPs that require considerable maintenance to keep in place. Least cost alternatives may not be effective.”*

Some interviewees expressed the importance of accurately reflecting inflation and other future costs into the fee system. Said one stakeholder, *“There is a time problem with inflation. You need to increase or automatically adjust the fee up or down periodically depending on current economic climate. Otherwise EEP will need to go back to rule making to adjust the cost every few years.”*

One stakeholder suggested using the full delivery program as the preferred method for accounting for the full cost of mitigation. Reports the stakeholder, *“Using an exclusively full deliver method makes a lot of sense and allows mitigation bankers to compete with other providers, but doesn’t make them the only game in town. So it allows competition while also spurring innovation. The advantage of full delivery is that it is true cost. Any other method is theoretical.”*

Transparent and Accountable

Many stakeholders made a point to include characteristics of transparency and accountability in their view of a desirable nutrient offset fee system. Many expressed the importance of clarity in pricing. They believe that EEP must show a clear connection between the proposed fee, the nutrient offset methods that will be used, and the commensurate cost per pound of nutrient abatement. Another mentioned the need to follow through on projects, citing a project that was initiated three years prior, but not maintained. Some expressed the need to make the fee components easy to communicate and explain. Said one stakeholder, *“Whatever price they set, it must be justified, and documented.”* Said another, *“Be transparent. Enable people to trace the money. That way stakeholders will have more confidence in how this program is being administered.”*

Equitable and Consistent

Several stakeholders stressed the importance of ensuring that whatever pricing mechanism is adopted, that communities are treated equitably across the basin. Several mentioned the terms “systematic approach”, “predictable” and “certainty” when describing a desired fee system. Others were concerned that artificial disparities could be established if the fee system is not equitable. Said one local government stakeholder, *“It should apply to everybody in the basin or nobody in the basin. DWQ needs to step forward in the legislature to make this happen.”*

Spatially Relevant

The need to tie costs to location was apparent in many of the responses we received. Many stated the importance of linking the mitigation site as close as possible to the development action requiring offsets, and that the fee should reflect this nexus. As one stakeholder put it, *“costs should reflect geographic reality.”* Hence, offset payments for projects in the upper Neuse basin may be higher than for those in the lower Neuse for example. The concept of spatial relevance also has equity implications. As one stakeholder reported, *“Is it really ok to run the pollution through the downstream system until we buy the offset? If the upper head waters are [being developed] but the cleanup is happening in Kinston or Havelock, this brings up an equity issue. Export your junk and keep your dollars. It is not just a cost of the clean up but also land loss to economic development.”*

A couple of strategies were proposed to deal with spatial differences. One was to identify potential mitigation projects within the cataloging unit (8-digit or 14-digit), and if no project is available in a particular unit, then set the price based on implementation costs in a similar, but not less expensive unit. Another suggestion was to zone each river basin and apply uniform fees within each zone.

Some local government stakeholders suggested that offset payments could be used to fund projects within the local jurisdictions that development is occurring. Said one stakeholder, *“we should be able to use the funds generated in [our town] to be used for future projects in [our town]. Although I say that, I understand how difficult that could be system-wide.”*

Short Time Horizon

Several stakeholders identified timing of implementation as an important characteristic of a pricing mechanism. In this regard, payments and projects need to be close in time. Many stated that the ideal would be that the mitigation precedes any payments. Said one stakeholder, *“Make the in-lieu programs produce the credit before engaging in the offset. Just like mitigation bankers are required to do. This makes the process transparent.”*

Cost Effective

Several stakeholders accentuated the need for any fee structure to reflect a cost-effective program. Cost effectiveness was expressed as both ‘cost conscious’ and ‘effective.’ Those expressing the need for being cost conscious were mostly concerned about keeping fees ‘reasonable.’ One method for doing so is to make the program less management dependent. Others expressed the need to ensure that the most nutrients are being abated per dollar spent, and were not so much concerned total cost. In their opinion, offset payments should fund projects that are proven to be effective.

Market Based

Several stakeholders, from both the private, for-profit sector and non-profit conservation organizations, would like to see EEP look to private markets in establishing a pricing method. Said one stakeholder, *“Get the pricing structure out of the political process. Have it be market based prices so it fluctuates with the market to take advantage of the market.”* And another,

“EEP’s ‘full delivery’ program is a good model. It drives the price down because the private sector competes to get the projects. It simplified the process. EEP knows what they are buying – they are purchasing credits.”

More than one interviewee was thinking about a potential role for EEP in a market based system. One suggestion was for EEP to develop the framework for private sale of nutrient credits, organize the trading and provide oversight.

One stakeholder talked about a system where several private firms as well as EEP provided offset credits. In such a system, a developer can *“go down the phonebook, contact mitigation banks and ask, ‘how much are you going charge?’. EEP can be on the list to call for buffers. Then the buyer can determine who he/she wants to purchase from.”*

Comprehensive Mitigation Plan

A few stakeholders discussed the idea of establishing a comprehensive mitigation plan of sorts. EEP would take the role of coordinating and overseeing that mitigation offset is performed in an area that can have the most benefit.

Other Desired Characteristics

Other characteristics of a nutrient offset payment program deemed desirable by stakeholders were ease of implantation, transparency, and flexibility. Local government stakeholders want a program that is easy to implement and explain to developers they work with. Moreover, they don’t want to be saddled with the responsibility of justifying whatever fee is set. Said one local government stakeholder, *“Whatever EEP decides to do, we need assistance in providing information to the development community. It shouldn’t be our role to explain why. Need better outreach by EEP in the affected watersheds.”*

Local government stakeholders voiced a desire for added flexibility in how the nutrient offset payment program is implemented. They see opportunities for mitigation beyond traditional EEP restoration projects. For example, according to one local government interviewee, *“EEP and a municipality can approach a project where the municipality purchases the conservation easement or some other discharge reduction scheme, rather than just having to pay money to EEP to develop the offsets. This could be a win-win for everyone. One of the problems that EEP is facing is finding places for projects within the offset needs to happen.”* Implementation flexibility was also cited as desirable by the point-source discharge interests. One stakeholder noted that there are options available for them to create their own projects and bank assets for themselves if given the flexibility to do so.

Other ideas included building incentives into the program to entice private landowner participation, banking an excess of credits to achieve actual restoration rather than maintenance of the status quo, and incorporating a factor to account for atmospheric deposition of nitrogen. Regarding offsets payments for point sources, one stakeholder brought up the idea of placing a premium on uncertainty. Because point sources know exactly how much they are discharging, their offset payments should be reduced since there is no need for any ‘fudge factor’ in calculating the offset.

Concerns about Proposed Cost-Based Method

We asked stakeholders about their concerns with EEP’s proposed actual cost method of nutrient offset pricing as recommended by RTI International in a study they conducted in 2007. About half of those we interviewed were not sufficiently informed of the proposed cost-based method to comment on it. Those who were familiar with the study had only general remarks.

Among the comments provided, one stakeholder noted that unless new practices are put into place by EEP, the proposed cost method will not provide the accountability that is needed.

Information about how and where the mitigation will occur on any given project should be provided up front, before payment is made. So although the amount is tied to a specific formula, the payment is not tied to any site or obligation.

Another questioned whether RTI's cost calculations were based on sufficient data. *"Did RTI actually review enough projects to determine the actual mitigation outcomes? Do we really know the cost of avoiding nutrient pollution? It has to be a long term study because projects don't always succeed. You need to monitor the success of the projects for several years."*

Another interviewee remarked that the focus of the proposed method *"seems to be on internal costs, which is only part of the story. The source of the loading should be paying for the restoration of these credits."* One other respondent remarked about the lack of a *"shadow cost of future maintenance to deal with future floods or other climatic events. Need to cover a failed BMP."*

Data and Information Needs

We asked stakeholders about data or information that they would like to see provided by EEP or others that would help stakeholders in a discussion on pricing methods. Everyone we interviewed had ideas about data needs. The most common data need cited by those we interviewed was **a detailed accounting of EEP nutrient offset projects to date**. Stakeholders reported that they wanted to know the following about these projects:

- The **budget** for the past few years to see how the money was being spent.
- **Description of projects** broken down by 14-digit HUC and the actual cost of their 'in the ground' projects to date. Projects should be identified by type, i.e., BMPs, buffers, etc, and procurement method – full delivery, design-bid-build.
- *How **costs differ regionally**. Whether the price is a reflection of the region from which it came, or the price of implementation in the location where the BMP is placed.*
- **Number of pounds** paid for, and the number reduced

- **Total obligation to date** – how much has been completed and how much remains
- **Maps** showing location of development projects and completed restoration projects

Other information that stakeholders requested from EEP includes:

- The **background** of how we got to where we are now. Why we are in a deficit.
- The **amount of the deficit** and plans for making up the shortfall.
- How much **land is available for restoration?**
- Provide an explanation of **how credits are estimated** and in particular the acres affected.
- **Nutrient reduction efficiencies.** Which mitigation methods work better under which conditions?
- Identify **where loading is occurring** and where future restoration projects should be located.
- **EEPs experience in setting prices in other markets** – wetlands and stream restoration.
- EEP should describe how many times they asked for a fee increase and the number of times the EMC granted them a fee increase.
- **Information about other effective in-lieu pricing programs** or otherwise successful government led pricing programs. Specifically, the EEP should highlight what they will borrow from these examples when setting the actual cost.
- Sharing a summary of work, discussions and research to date on **the technical aspects of nutrient reduction of various types of projects.** Need to understand the efficiencies of different practices. Sharing how those numbers were derived.
- **EEP should provide an in-depth explanation of its proposed cost method.** They should use all past projects as examples of how it will work, so the stakeholders can get an idea of what the “actual cost” would be if the calculations were performed today. They also need to explain how the time component is used in the pricing formula, showing how variations in this variable alter the actual cost.

Some stakeholders were also interested in information that can be provided by other stakeholders. Specific data inquiries include:

- Costs for the private mitigation bankers. How much money are they spending for each pound of nitrogen reduction?
- How do mitigation bankers determine credits?
- How will the private banking program be run?
- We don't have an appreciation for what developers pay for their offsets. It would be helpful to put into perspective for people what large developers would pay and what a municipal wastewater treatment plant would pay.

Successful Outcomes of a Stakeholder Meeting

Our last two questions were focused on the whether stakeholders would participate in a stakeholder forum to discuss EEP's proposed nutrient offset pricing program, and what they would consider to be a successful outcome for them or their organization.

Nearly all stakeholders we interviewed indicated that they, or someone from their organization, would participate in a stakeholder forum scheduled for February 4, 2009. Such a forum, to be successful for all participants, would result in:

- A rational pricing program. We need to find a way to structure the program so that the price paid in reflects the costs of the project on the ground. We need to have confidence that the mitigation program is actually reducing nutrients.
- A transparent process free politics that results in a net reduction in nutrients, protects the environment, and pays for itself.
- A formula that everyone can agree on or live with, and that would last awhile.
- A pricing program that results in a more effective program overall, a reduction in lag time, and that ensures quality projects are in place
- A rule that goes into effect that will take into account the true cost of the offset program

- A pricing scheme that is reflective of true costs that doesn't gouge the development community and pays for effective BMPs.
- A pricing scheme that deals with urban growth and does not adversely affect the rural counties
- A pricing scheme that treats communities equally in the same watershed
- Answering the key policy question – do you charge the full cost or not?
- Getting a better explanation of the things discussed here and better explanation about the current operations
- Clarity
- There is some commitment to an objective method as opposed to some 'black box' method.
- A program that results in money being spent in the same hydro unit being impacted.
- A program that would allow point-source and nonpoint source trading.
- Develop a methodology that is agreed upon for calculating the success of the different types of projects.
- Meeting EEP's September deadline.
- There is some change to way the system is run now
- That the nutrient offset program goes away and lets the developers mitigate on their own
- A greater understanding by all stakeholders about how EEP is run and gets things done.
- Something that everyone can live with.
- An agreement before the rule making process
- Some kind of proposal that all can accept in as short amount of time as possible.
- People are willing share information and try to reach agreement. That there is an effort by all parties to make this work.
- That diverse parties have the opportunity to participate. Proponents and opponents sit down at the table together.

RECOMMENDATIONS

Convene Stakeholders

Based on responses to our interviews, key stakeholders are willing and able to meet and discuss the nutrient offset payment program. We recommend that EEP follow through on its commitment to convene a group of stakeholders to discuss its proposed actual cost method and gather feedback on critical issues related to the payment program.

We recommend involving stakeholders who represent the following organizations or interests:

1. Local governments, particularly those that have experience in implementing the nutrient offset payment program. Participation should reflect various regions of the two affected river basins, urban and rural.
2. Conservation organizations that are active in water quality protection. These include the Neuse River Foundation, the Tar-Pamlico River Foundation, Environmental Defense Fund, the NC Conservation Network, and the Southern Environmental Law Center.
3. Organizations representing development interests. The key organization here is the NC Home Builders Association.
4. Firms involved in mitigation banking and developing projects for nutrient offsets.
5. State agency staff from EEP and DWQ.

Spend Time on Mutual Education

It was clear from our interviews that, although most stakeholders are generally familiar with the nutrient offset payment program, many lack information about program specifics. Moreover, many are keenly interested in understanding EEP's program activities. Across the board, those we interviewed wanted an accounting of how EEP has applied offset payments in the two basins. EEP should be prepared to present a detailed listing of nutrient offset payments, nutrient offsets (in pounds of N and P), and the type, cost, and nutrient reduction outcomes of projects undertaken. It is suggested that EEP present the results of Section 2 of

the RTI International report with updates to 2008. Stakeholders also need to become familiar with the proposed costs-based method that EEP is proposing. A presentation summarizing RTI's report would be helpful.

Focus on the Primary Purpose

The purpose of this effort is to provide stakeholders an opportunity to provide guidance to EEP in transitioning the nutrient offset payment program from a fee-based system to an actual cost method. The topics under discussion at the stakeholder meetings should be limited to the attainment of this goal. Discussion of related issues, while important, may be counter-productive to achieving this purpose. Peripheral issues that stakeholders consider to be important should be documented during the meetings and placed in a "parking lot." Time should be devoted toward the end of the meeting(s) to identify the proper venues and procedures for addressing these issues.

Consider EEP's Role in Public and Private Implementation

There are a wide range of alternative operational structures that could be developed to implement a nutrient offset trading system. The appropriate question for stakeholders to consider is what process models are the most effective model for operating North Carolina's nutrient trading bank. Stakeholders from nonprofit organizations, local government, and private firms want to see private mitigation efforts continue. To the extent that it affects decisions about the establishment of a cost-based method, EEP should engage stakeholders in a discussion of how private and public mitigation efforts can coexist most effectively. Discussion on this topic will be most productive if it centers on choices among public and private alternatives for acquiring nutrient credits, as well as EEP's role of planning, rule-making, and oversight.

Provide Key Unknowns and Decision Points

EEP staff should present the key points in their proposed actual cost method where they need feedback and information from stakeholders. For example, should the new fee contain a 'deficit premium' to recoup dollars never collected under below-cost rate structures? What should be the frequency of rate adjustments? What is the appropriate geographic basis to differentiate rates?

Strive Toward Common Understanding

An outcome of the stakeholder process should be to seek areas where consensus can be reached on specific program parameters. On issues where no consensus can be achieved, EEP should document them and present its best case to the Environmental Review Committee and the Environmental Management Commission.

DRAFT MEETING SUMMARY

EEP / DWQ Nutrient Offset Payment Program Transitioning to an Actual Cost-Based Pricing Method

February 4, 2009
Yates Mill Historic County Park
Raleigh, NC

1. [Welcome and Introduction](#)
2. [Purpose and Scope](#)
3. [Agenda Review](#)
4. [Process Review](#)
 - a. Roles
 - i. Stakeholders
 - ii. Facilitators
 - iii. EEP
 - iv. DWQ
 - b. Decision Rule
 - c. Ground Rules
 - d. Parking Lot
5. [Report on the Situation Assessment](#)
6. [Nutrient Management Strategies & the Role of EEP Nutrient Offsets](#)
7. [EEP Nutrient Offset Program: History and Status](#)
8. [Review of the Session Law 2007-438](#)
9. [Presentation and Discussion: Transitioning the EEP Nutrient Offset Program to an Actual Cost Method](#)
10. [Closing Summary and What's Next](#)

Reports and presentations are accessible via the NRLI website at:
<http://www.ncsu.edu/nrli/decision-making/projects/index.php>

List of Participants:

Name	Affiliation
Robert Brown	NC Ecosystem Enhancement Program
John Huisman	DWQ
Eric Ellis	NC Ecosystem Enhancement Program
Kristin Miguez	NC Ecosystem Enhancement Program
Suzanne Klimek	NC Ecosystem Enhancement Program
Charles Brown	Town of Cary
Kelly Williams	NC Ecosystem Enhancement Program
Haywood Phthisic	Johnston County
Eric Kulz	NC Division of Water Quality
Adam Rigsbee	Restoration Systems, Inc.
Sandi Wilbur	City of Durham
Jamie Guerrero	Johnston County
Bill Diuguid	NC Division of Water Quality
Joe Rudek	Environmental Defense Fund
Jim Stanfill	NC Ecosystem Enhancement Program
Mike Schlegel	Triangle-J Council of Government
Heather Jacobs Deck	Pamlico-Tar River Foundation
Mary Lou Addor	NCSU Natural Resources Leadership Institute
Steve Smutko	NCSU Natural Resources Leadership Institute
Bill Gilmore	NC Ecosystem Enhancement Program
Alissa Bierman	Neuse River keeper Foundation
Paul Meyer	NC Assoc of County Commissioners
Glenn Dunn	Poyner and Spruill
Rich Gannon	NC Division of Water Quality

1. Welcome and Introduction

Mary Lou Addor, NRLI, opened the meeting with introductions

2. Purpose and Scope

Mary Lou presented the purpose and scope of the stakeholder process:

- **Purpose:** *Provide guidance to the Ecosystem Enhancement Program in transitioning from a fee-based system to an actual cost system as required by the General Assembly.*
- **Scope:** The focus of stakeholder recommendations will be on the pricing methodology.

3. Agenda Review

See cover page for list of agenda items.

4. Process Review

a. Roles

- i. Stakeholders: responsible for disclosing interests, needs, actions, and issues in a timely manner and committing to the purpose of the stakeholder process. Stakeholders will be expected to represent the interests of (1) themselves, (2) organizations which they have the authority to represent, or (3) groups of constituents with similar interests.
- ii. Facilitators: responsible for helping the group stay on process and on topic, promoting open and balanced discussion, and organizing information for effective use.
- iii. EEP: responsible for convening the group, providing basic information about the cost-based pricing method and the nutrient offset payment program generally.
- iv. DWQ: responsible for assisting with understanding content and any agency policies that pertain to the formula.

b. Decision Rule

When proposals are presented for consideration by the group, each stakeholder will designate his or her approval/disapproval using the following scale:

Level 1: Endorsement (I like it)

Level 2: Endorsement with a minor point of contention (basically I like it)

Level 3: Agreement with reservations (I can live with it)

Level 4: Stand Aside (I don't like it but I don't want to hold up the group)

Level 5: Block (I will not support the proposal and will act outside the group to meet my interests)

Discussion on Decision Rule:

- i. **Question:** Given the number of agency representatives, do they all get a vote when we make decisions?

Response and discussion:

- a) The purpose behind using the levels of agreement is to make your choice and rationale transparent to others and give the group an opportunity to consider and work with anyone's reservations.
- b) Anyone can weigh in on any proposal before the group. Hence, any one person or affiliation has the opportunity to ask the entire

group to reconsider its decision (in particular at a level 4 or level 5).

- c) On key decisions, the DWQ and EEP will designate one person from each agency to weigh in.
- d) The final report will show at which level individuals or groups supported the final product.
- e) The focus for each stakeholder should be on making good decisions for his or her constituency, not simply to reach agreement.

c. Ground Rules

- i. Work the problem, not the person.
- ii. Make space for others to contribute
- iii. Follow the process
- iv. One speaker at a time
- v. Park-off agenda items
- vi. Rolling breaks
- vii. Cell phones on vibrate
- viii. Test assumptions/Ask Questions

d. Parking Lot

Topics not considered by the group to be germane to the day's agenda will be listed on a separate flip chart under the heading "Parking Lot." Prior to adjourning each meeting, the facilitators will review parking lot items, and the group will determine how (and possibly when) each item will be handled.

5. Report on the Situation Assessment

Steve Smutko, NRLI, distributed and presented the EEP Nutrient Offset Pricing Method Stakeholder Report to the group. The report was generated based on interviews with the stakeholders. The purpose of the assessment was to get stakeholder perspective on the characteristics of an optimum pricing method, what they want out of an optimum pricing method and key concerns with proposed actual cost based pricing method. (See the [Nutrient Offset Payment Program Stakeholder Report](#) on the NRLI website).

- a. Comment: One stakeholder suggested contacting the Farm Bureau for feedback, and inviting a Farm Bureau representative to future meetings.

6. Nutrient Management Strategies & the Role of EEP Nutrient Offsets

John Huisman from the Division of Water Quality Non-Point Source Planning Unit gave a presentation on the nutrient management strategies for the Tar-Pamlico and Neuse river basins. (See the [Nutrient Management Strategies and Nutrient Offset Program presentation](#) on the NRLI website). John's presentation focused on four aspects:

- 1) Why we have nutrient strategies in the first place
 - 2) What the strategies are comprised of (not in intense detail)
 - 3) Overview of the different components
 - 4) Role of the EEP Nutrient Offset Program
- a. Question: When will DWQ be developing nutrient management strategies for reservoirs other than Jordan and Falls Lake?
Response: For Falls Lake, you're looking at adoption by the EMC probably 2011, High Rock Lake is beyond that horizon and anything past that is further down the road yet.
 - b. Agriculture Rule in the three river basins/some basic backgrounds on this is given
 - c. Brief discussion on the storm water rule for the Neuse, Tar Pam and Jordan Lake. The storm water rule is in place that sets export targets for new development and that new development refers to both residential and commercial. If you are disturbing more than one acre per residential development or ½ acre for commercial, then you fall subject to the Neuse and Tar Pam Storm Water Rules.
 - d. There's an export rate that you have to achieve for your development, in the Neuse its 3.6 lbs N/acre/year and in the Tar Pam its 4.0 lbs N/acre/year and 0.4 lbs P/acre/year.
 - e. Discussion of point source is raised by one stakeholder and this ends up being discussed as somewhat of a side bar, but important to the nutrient management discussion as a whole.

7. EEP Nutrient Offset Program: History and Status

Kelly Williams, Ecosystem Enhancement Program In-Lieu Fee Coordinator, gave a presentation on the EEP Nutrient Offset Program History and Status (see the [Nutrient Offset Program History and Status presentation](#) on the NRLI website).

- a. Question: How many mitigation requests does EEP handle?
Response: About five per week. To date, we have received approximately 2,000 payments since May 2001. This represents 1.3 million lbs of nitrogen in

the Neuse, 21,000 pounds of nitrogen in the Tar-Pamlico, and 1,994 pounds of phosphorous in the Tar-Pamlico.

- b. Stakeholder comment: the payment program was originally established to cover storm water retrofits, which was the reason that the fee was \$57 per pound of nitrogen.

Response: The General Assembly enacted Session Law 2006-215 to reset the fees back to \$11 and to commission a study of costs associated with nutrient reduction measures. As a result of the fees being reset, DENR decided to place implementation of nutrient offset projects on hold until the fees were set at a level that would sustain the program (project procurement has since been restarted). There was a recognition that the fees were known to be insufficient. In Session Law 07-438 the GA set the fees at \$28.35/lb for nitrogen in the Neuse. In the Tar-Pam, the fees were set to \$21.67/lb for nitrogen and \$28.62/0.1lb phosphorous. The GA also required EEP to develop a plan to transition to the Actual Cost Method.

- c. Stakeholder Comment/Question: So EEP knowingly accepted payments that were less than what it cost to provide the reduction?

Response: Payments to EEP were being authorized at the local level. EEP's authority to deny such payments that had been authorized by local government was unclear. The Department made a determination to accept payments during this period until the GA resolved the fee issue.

- d. Discussion about balances between payments and offsets:
Requirements are being met at 25 sites in the Neuse and Tar-Pamlico basins. These sites are both BMPs and riparian buffer restoration sites and represent over 1.1 million pounds of Nitrogen reduction and 11,000 lbs of phosphorus reduction for the Tar-Pamlico. EEP has met all of its nutrient offset requirements in the Tar-Pamlico basin and has some advance mitigation available to meet future requirements. In the Neuse, we have 290,000 lbs of N unmet requirements. EEP's strategy to meet those requirements includes implementation of additional restoration projects and BMPs.

- e. Discussion about credits for projects in the Tar-Pamlico River Basin:
It was noted that nutrient reduction projects in the Tar-Pamlico River Basin yielded both nitrogen and phosphorus credits. Stakeholder questioned whether this made sense because the assumption was probably that if a project is built to provide reductions for one nutrient, you are also getting reductions of the other nutrient. DWQ committed to looking into the issue before the next meeting.

8. Review of the Session Law 2007-438

Suzanne Klimek, Ecosystem Enhancement Program Operations Director, reviewed the handout on Session Law 2007-438.

- a. Counsel and others advise rule-making process for proposed actual cost method.
- b. Sunset factor: will revert to existing rule and higher fees. EEP is working with DENR's legislative liaison to revise the law so that the fees it set sunset upon the effective date of the revised rule.
- c. Stakeholder Comment: The legislative amendment should also include a deadline for when rule making should be completed.
- d. Stakeholder Comment: the "least cost alternative" provision discriminates against project in urban areas.

9. Presentation and Discussion: Transitioning the EEP Nutrient Offset Program to an Actual Cost Method

Jim Stanfill, Ecosystem Enhancement Program Strategic Planning Supervisor, gave a presentation on the proposed Actual Cost Method (see the [EEP NOP Actual Cost Method presentation](#) on the NRLI website).

Jim's presentation covered three key points:

- a. Actual cost objectives
- b. Overview and details of the actual cost method
- c. Issues and choices in the actual cost method
 1. Frequency of adjustment
 2. Geographic application

Participants responded and discussed various topics as Jim proceeded through his presentation. The following topics, questions and responses were captured from that discussion:

a. Discussion: Actual Cost and Least Cost

Because Session Law 2007-438 mandates that the nutrient offset payment program shall use the least cost alternative for providing nutrient offset credits, participants engaged in a brief discussion on the difference between actual cost and least cost:

- i. Actual cost reflects what the project costs when it is completed. It must be a self-sustaining financial model. The program is a completely fee-based program and cannot be supported with money from the general fund.

- ii. Least cost sets a limit on the type of mitigation you can undertake.
Least cost means primarily we're doing riparian buffer projects.

b. **Completed Projects vs. Projects In Process**

Question: What is the difference between completed projects and projects in process?

Response: By definition a completed project has no future cost. Projects in process will have some type of future cost, either ongoing construction or maintenance costs.

c. **DOT's In-lieu Fee Program**

Question: How does DOT's in-lieu fee program relate to the nutrient offset payment program?

Response: The DOT in-lieu fee program has its own pot of money. It is completely independent of the Nutrient Offset program. Each pays for its own projects, administration, etc.

d. **Donated Lands**

Question: Hasn't EEP received donated lands for its projects, and doesn't this affect how you determine the actual cost of past projects?

Response: Yes, we've had some donations, but we can't assume we're going to get donated land in the future. We anticipate that we will purchase lands for our projects. Overall, donated land hasn't been much of a factor in the nutrient offset program.

e. **Calculation of the Adjustment Factor**

The calculation of EEP's adjustment factor sparked considerable discussion, mostly related to how the correction interval enters the calculation. It was noted that the longer the correction interval, the lower the adjustment factor. Much of the discussion was focused around the following example of an adjustment factor calculation:

Assume actual costs were \$1.2 million
Actual receipts: \$900,000
Correction interval 1 year
Pounds collected per correction interval 300,000 pounds

$$\frac{(\$1,200,000 - \$900,000)}{(1 \text{ Year} * 300,000 \text{ pounds/Year})}$$

Adjustment factor = 1 dollar per pound

- i. **Comment:** The time variable should cancel out in the adjustment factor equation. You could simplify it removing the correction interval.

Response: The "pounds per year" rate in the denominator is the delivery rate, so it must remain in the formula.

f. Frequency of Adjustment

This discussion focused on the issue of how frequently the offset price should be adjusted. Jim identified the following criteria that should be considered when making choices about the frequency of adjustment:

- Price volatility (predictability)
- Price stability
- Administrative Costs
- Size of Adjustment
- Risk of difference between expenses and receipts

The adjustment frequency will have a tremendous bearing on how we run the program. We could attempt to follow market conditions and adjust the price frequently, but this may result in considerable volatility in price (less predictability). Plus, it is more work on our end. How often is reasonable? How long does the business community want a stable price? With smaller adjustments, there is less risk of seeing a difference between receipts and actual cost. With more time between adjustment periods, we might improve the accuracy of the cost calculations by virtue of having more data available from which to make adjustments.

- i. **Question:** Have you considered using a percent change threshold to trigger the adjustment rate?

Response: That might be something we can consider

- ii. **Comment:** Think annually—project your costs a year in advance.

- iii. **Question/Comment:** How do developers deal with situations of having to make adjustments in their own pricing structures? They are certainly looking the cost of capital. Could the cost adjustment be modeled after, or follow the changing rate of loans etc? It would be useful to know how the development community cycles for stability.

- iv. **Comment:** It seems that one mitigation project can cover hundreds of payments, and that projects are not undertaken at a high rate of frequency. The frequency of adjustment should be relevant to EEP's own schedule of beginning projects.

- v. **Comment:** Consider establishing a contingency fund. Get ahead of the curve by getting projects in the ground before they are needed. A contingency fund will help you do that.

g. Discussion: Geographical Application

This discussion centered on the geographic spread of price differentials. It was noted that EEP is obligated under state law to mitigate in the same 8-digit cataloging unit where payments are made. In the past, it was simply required that EEP mitigate in the same river basin. Should the cost be calculated at a cataloging unit level? Or should we differentiate at the river basin level, or keep the cost consistent statewide? The following issues were identified as being pertinent to a decision about geographical application of rates:

- Price volatility
- Price predictability
- Number of rates
- Complexity (Regional subsidy)
- Distribution of local costs
- Risk of under collection

Discussion ended at this point.

10. Closing Summary and What's Next

Issues for future discussion

1. Full Cost - subsidizing DWQ oversight?
2. How costs are computed
3. How to address Nitrogen and Phosphorus in the Tar-Pam
4. Disposition of projects beyond maintenance period
5. How and whether to use private sales prices in cost calculation
6. A private sector non- competition rule?
7. Distance from water body of concern in the credit calculation

Items Remaining in the "Parking Lot"

1. Mitigation rate assessment for Point Source (Haywood would like to explore this; forum is with DWQ - who?)
2. Geographic application of storm water rules (DWQ- form small work group that is interested in this topic?)