



A National Nonprofit Program to Provide Liquidity to LUST Fund Claimants

Updated July 2, 2004



Table of Contents

Page 3	NatLUST – Executive Summary
Page 4	Problems Caused by LUST Fund Payment Delays
Page 5	Understanding LUST Fund Payment Delays
Page 6	Virginia’s “VRA” Financing Program
Page 9	NatLUST (“National LUST Funding”)
Page 12	Benefits to Regulated Tank Owners
Page 14	Benefits to State Environmental Agencies
Page 16	Benefits to Environmental Consultants



Executive Summary

As described in more detail herein, various state LUST funds do not have sufficient revenues to clean up all contaminated sites and still be able to reimburse claims in a timely manner. Irrespective of whether the LUST fund delays its claim review process or processes claims as they are submitted, the result is the same tank owners (Responsible Parties or "RP's") sometimes end up waiting months or even years for reimbursement, tying up significant amounts of working capital. LUST fund payment delays can cause serious cash flow problems for RP's, which can slow the pace of clean up & lead to higher clean up costs, increased public health risks, as well as other public policy problems

NatLUST, was created on June 22 as a Virginia non-stock, non-profit corporation. **The mission: To help state sponsored LUST funds keep their clean up programs going by providing immediate liquidity to Responsible Parties ("RP's") with approved LUST fund claims. NatLUST will purchase the approved claims, essentially stepping into the RP's shoes to wait in line for reimbursement**

NatLUST will be modeled after Virginia's highly successful **Virginia Resources Authority ("VRA") Accelerated Payment Program**, but will be designed to finance claims on a national basis. By providing liquidity, NatLUST will not only reduce cash flow problems for RP's, but will directly promote the continued viability of LUST funds as financial assurance mechanisms. NatLUST will also promote the public purpose goal of cleaning up LUST's in a timely manner, thereby reducing public health risks and improving our environment



LUST Fund Payment Delays Create Problems for Both RP's & Regulators

- Payment delays create cash flow problems for both small and large regulated tank owners. For smaller operators, tying up significant amounts of working capital for long periods can materially impair their profitability & balance sheets, slow job creation and depress property values. Large regulated tank owners are not immune from payment delays either, which when combined with the real-world reality of annual environmental budget constraints, cause inefficiencies that slow the clean up process (ex., spreading work over several budget cycles), leading to higher total costs to the RP & and, inevitably, to the LUST fund
- Payment delays can cause a breakdown in the market when RP's simply run out of financial capacity to continue clean up's, and their environmental consultants are no longer able to "carry" LUST clean up work and wait for a reimbursement check
- Reduced voluntary cooperation from RP's can sometimes result in increased public health risks & higher total costs to the fund
- Regulators spend limited management resources pursuing enforcement actions against financially strapped RP's rather than pursuing actual clean ups
- Growing perception that fund is insolvent; Risk that the fund may no longer be deemed viable for meeting EPA's financial responsibility regulations
- Payment delays can lead to delays in closing real estate transactions & depressed property values
- Payment delays can lead to increased "political risk" to the fund



Understanding Lust Fund Payment Delays

Certain LUST funds suffer from "**Asset – Liability Mismatches**", a financial term that describes a periodic imbalance between the dollar volume of submitted claims and the fund's source of revenues. What happens is that the fund's cash balance is eventually depleted and a payment queue results*, with claimants having to wait months or sometimes years for reimbursement

Virginia's experience shows that over the past 17 years there have been several multi-year periods where the volume of claims exceeds revenue, but that the imbalance tends to work itself out over time. The key is to bridge the funding gap using accepted financial techniques, and put liquidity into the marketplace

Financial Problems Require Financial Solutions - The good news is that A/L mismatches can in many cases be fixed using time tested financial techniques. Virginia has demonstrated through its **Virginia Resources Authority ("VRA")** financing program that "finance" is a tool that can benefit all stakeholders, including promoting the state's goal of cleaning up LUST's in a timely manner and preserving its LUST fund as a viable mechanism for meeting EPA's financial responsibility requirements

* Some LUST funds resort to other means to preserve their cash balance, such as slowing down (or stopping) claim approval, or implementing prioritization measures where medium risk sites are not cleaned up, or reimbursing one class of RP before another.



Virginia's VRA Financing Program

Background - By mid 2001 VA's LUST fund deficit had reached \$24 million and claimants were waiting over one year to receive reimbursement. Payment delays had reached the point where it was causing serious problems for RP's, consultants and VA's DEQ. At the request of Virginia's legislature, DEQ adopted a proactive position and formed a stakeholder group to explore solutions to the Fund's financial situation, working with the Virginia Resources Authority ("VRA", a state infrastructure financing authority), to create the **"VRA Accelerated Petroleum Fund Claim Payment Program"**

- **VRA Program Not "Debt"** - VRA is not technically "lending" money. Instead, it uses a 100 year old financing technique known as "factoring" to provide liquidity. Factoring simply means that VRA purchases approved claims (a type of receivable) from RP's, and pays using a "two-step" payment process. It is through the two-step payment process that the cost of capital is allocated on the back end when the claim is eventually reimbursed. In essence, the approved claims serve as collateral, with VRA simply stepping into the shoes of the RP. **Because VRA's credit provider is relying on the approved claims for collateral, no credit analysis on the RP or consultant is required. Importantly, the financing is not "debt" to the RP or their environmental consultant***

Factoring the claims is the perfect structure for a nonprofit program of this type because it eliminates much of the risk that VRA could get dragged into the bankruptcy of an RP, yet it also offers substantial accounting & financial benefits to the RP and their environmental consultant* In short, everyone wins.

*VRA purchases claims on a "non-recourse" basis. An important accounting benefit is that RP's can generally treat this as an "asset sale" rather than a secured financing.



Virginia's "VRA" Financing Program

Initial Payment - Participants receive 92% of amount approved by VRA immediately upon VA's DEQ issuing the claim decision. Checks typically go in the mail the following day, irrespective of the fact that VA's Petroleum Fund may not have cash to reimburse a purchased claim for months. Approximately 95% of VRA participants elect to use the "**Direct Pay**" feature, where the RP directs VRA to send the check directly to their environmental consultant

• **Residual Payment** - The 8% "holdback" is retained as excess collateral until such time as the RP's claim is reimbursed, at which time the balance – less each claim's pro-rata carrying costs – is remitted in the form of a second "residual payment" to the same party that received the initial payment check. VRA issues the residual payment shortly after VA DEQ reimburses a batch of claims. The party that receives funding absorbs VRA's carrying costs. Formula for Residual Payment: Approved amount of claim (100%), less initial payment (92%), less carrying charges (XX %) = Residual Payment

• **Carrying Costs** – Formula to figure carrying costs on any claim: Daily pro-rata cost of (A+B+C) x the exact number of days a claim is outstanding x the dollar amount advanced on a claim. Where A = the daily cost of VRA's borrowed money; B = amortized legal costs; C = ongoing administrative costs. Essentially, VRA is allocating costs on a pro-rata basis based on the size of each claim and the number of days it takes until the claim is reimbursed. This is fair as all parties – big and small – are treated equally

• **Simple Structure = Low Carrying Costs** - The simple financing structure allows for low total carrying costs. Current VRA charges dropped to < 1.3% in January 2004 (see www.vpstf.org). Annualized carrying charges are now about 3%. Interest rates will fluctuate with the market, but will likely always be attractive given that "governmental" entities can borrow money at extremely low interest rates through ability to raise tax-exempt bond financing

• **Bank Assumes Credit Risk and Servicing Risk** - Because VRA assigns the purchased claims to a large commercial bank as collateral for the financing, the bank assumes the credit risk of the fund. This means that the VRA program is not debt to VA's LUST Fund, VA's DEQ or VA's taxpayers, which would have required formal legislative approval.



Virginia's "VRA" Financing Program

"Finance" is a Tool That Works

- Virginia's Governor Mark Warner announced the VRA Program in May 2002; VRA sold a tax-exempt revenue bond issue to raise funds; claimants in payment queue were offered the opportunity to "tender" their backlogged claims, plus there was sufficient bond proceeds available to fund new claims as DEQ approved them
- To date have financed over 2,400 claims totaling more than \$24,000,000
- Program has proved successful both politically and in the marketplace; Data from DEQ shows that approximately 2/3 of all claims submitted for reimbursement are voluntarily participating in the VRA program. Participants include everyone from homeowners, schools, churches, jobbers & C-Stores, to most of the major oil companies. Many environmental consultants actively market the program, believing that it is a valuable business tool
- The political problems caused by payment delays were eliminated immediately. VA's petroleum fund has turned the corner & the backlog is now shrinking
- VA's DEQ can aggressively pursue LUST clean ups, knowing that the "carrot" of immediate reimbursement is available, without diverting management resources to enforcement actions
- All participants appear to come out "winners"; nobody is a "loser"
- VA's DEQ received the 2003 annual State LUST Fund Administrators "Innovation and Policy" award for its role in the creating VRA financing program
- The VRA Program does not tie hands of VA's DEQ, Governor or legislature with respect to making future changes to the fund



National LUST Fund Program - "NatLUST"

The National LUST Fund Program (known as "NatLUST") was created on June 22, 2004 as a Virginia non-stock, non-profit corporation. NatLUST has already applied to the IRS for 501(c)(3) certification. The NatLUST program will be modeled after Virginia's highly successful VRA Program, but will be designed to finance claims on a national basis.

Key Points:

- **Tax-Exempt Financing** – Upon receiving 501 (c)(3) certification, NatLUST will have access to low cost tax-exempt bond funding. Proceeds from bond issues will be used to purchase approved petroleum fund claims from claimants on a non-recourse basis, thereby providing immediate liquidity to the marketplace
- **Economies of Scale** - NatLUST will realize immediate and significant economies of scale from large and regular issuance of tax exempt bonds (or commercial paper), resulting in low carrying costs for the participants

Likely That Most States Can Participate With Little Governmental Action & Minimal Changes to Their State LUST Fund Program

- Because NatLUST is not lending money to the state's LUST fund or otherwise obligating the state's taxpayers, in most cases little official governmental action will be required in order for stakeholders to receive funding (however, like with Virginia, the state regulatory agency will need to provide evidence of their consent and, depending on circumstances, may be asked to appoint someone to NatLUST's board of directors and/or advisory committee)
- It is expected that NatLUST **will not** provide funding in states where the regulatory agency formally objects, or the state operates (or intends to set up) its own VRA type financing program



NatLUST

Governance / Advisory Committee - Because NatLUST will essentially operate as a financing conduit, it will have few, if any, paid employees. NatLUST has organized an “advisory committee” comprised of LUST fund administrators, LUST fund board members and/or other state officials, representatives from major industry stakeholder organizations, and others. The following persons have been approached to serve on NatLUST’s initial advisory committee:

- **Darrell Hill** – Executive Director, Virginia Resources Authority
 - **Elizabeth Lamp** – Financial Programs Manager, Virginia Department of Environmental Quality
 - **Cindy Williams** – President, Williams & Ross, national LUST claims preparation firm
 - **Michael O’Connor** – President, Virginia Petroleum, Convenience & Grocery Association
 - **Michaela Brockmann** – Rhode Island RIUST
 - **TBA** – [other industry representative]
 - Additional advisory committee members may be added from participating states from time-to-time
- State Agency** - In order for stakeholders to participate, essentially the only things that the state agency will need to do is:
- (a) Allow claims to be assigned to NatLUST using an approved assignment form;
 - (b) Agree to send reimbursement payments directly to NatLUST; and
 - (c) Honor claim decisions when issued

To meet certain IRS technical requirements, someone in an official capacity with the state may be asked to execute a letter attesting that the NatLUST program reduces the burden on their state by eliminating the expense of setting up their own VRA type program. Depending on circumstances, the state may be asked (or request) that they appoint an advisory committee member



NatLUST

- **Commonwealth Acceptance** - VRA's current program manager, will manage NatLUST's portfolio of financial assets under contract, performing much the same duties as with current VRA Program. Lindsay Trittipoe, Commonwealth Acceptance's manager, will serve as NatLUST's Executive Director to help promote the program, and will report to NatLUST's board and advisory committee
- **Participation Voluntary** - As with the VRA Program, participation by individual claimants & consultants will be completely voluntary. Claimants who choose to remain in their state's payment queue will do so, without being harmed in any way.
- **Success Will Be Determined By the Market** – Just like the VRA Program, because participation is voluntary, NatLUST's success will be determined by the market and its ability to meet the needs of the participants. And if a state is unhappy with NatLUST, it can always establish its own program



BENEFITS TO REGULATED TANK OWNERS

Not Debt – NatLUST financing is not “debt” to the RP. The RP is simply selling an asset on a non-recourse basis to NatLUST. The RP elects to either receive payment or use NatLUST’s **“Direct Pay”** feature, where NatLUST sends the initial & residual payments directly to the consultant

- **Direct Pay Shifts Risk of Denial** – In states where Direct Pay is not prohibited, many RP’s will likely move to a business model where they pay their deductible or co-pay, and their consultant performs the reimbursable portion of the clean up, receiving Direct Payment from NatLUST as soon as the claim is approved by the state agency. This model benefits the RP by shifting the risk of claim denial to the consultant, the “expert” who is typically best positioned to understand a states’ LUST program. The consultant will also be financially motivated to cooperate with the state environmental agency and follow its established procedures & get the clean up project done as quickly as possible
- **NatLUST Improves RP’s Cash Flow & Financial Condition** – NatLUST saves the RP from tying up substantial amounts of working capital, thereby directly improving their cash flow and balance sheet
- **RP Retains Control** – Even though RP’s may choose to use Direct Pay, they still retain full authority over their environmental program and ability to guide their sites to closure. (ex. Some large RP’s as a matter of policy specify additional work that goes beyond the state clean up standards. They can still do so, paying their contractor directly for such non reimbursable work). NatLUST has no involvement with the technical aspects of how an RP manages its environmental program



BENEFITS TO REGULATED TANK OWNERS

- **Accounting Benefits** – NatLUST’s non-recourse and Direct Pay features may allow certain RP’s the ability to reduce or even eliminate the need to include reimbursable items in their annual environmental liability reserve calculation
- **Accelerate Clean Up Program** – The NatLUST program will allow RP’s to accelerate their clean up program
 - Likely would achieve additional cost savings if clean up could be completed in one budget cycle rather than over several budget cycles; better utilization of management resources
 - Intangible benefit of better relations with regulatory agencies
- **Helps Preserve LUST Funds** - NatLUST helps preserve financially strapped LUST funds as viable mechanisms for meeting EPA’s financial responsibility rules, which may be more desirable than private insurance. May eliminate risk that an “insolvent” fund is terminated
- **No Risk from Other State Programs** – RP’s and Consultants doing business in a single state will not be exposed to credit risk from other states. NatLUST’s credit providers will assume the credit risk on the claims on a state-by-state basis. In this manner, a small RP in Tennessee would not be exposed to any risk from the Virginia fund



Benefits to State Environmental Agencies

- Immediate liquidity through NatLUST will improve voluntary cooperation from RP's. LUST clean ups can continue, irrespective that the LUST fund may not reimburse an approved claim for months or even several years
- Complaints about the fund's "slow pay" problem disappear overnight; political risk to their fund is likely reduced
- May eliminate need to ask legislature for a tax increase or fund bailout.
- NatLUST spares the state agency from the expense and burden of trying to create its own VRA type program. In most cases, no formal legislative action would be required
- NatLUST will not result in the agency or LUST fund having to add staff or increase departmental expenses (VA's experience suggests that it will likely provide minor reduction in staff workload once program is up and running)
- Virginia's experience suggests that the Direct Pay feature financially motivates environmental consultants to cooperate with agency technical staff and follow established procedures, and to quickly complete each phase of LUST clean up in order to receive the initial funding



Benefits to State Environmental Agencies

- NatLUST will not interfere with the agency or legislature's ability to make future changes to their fund (eg., NatLUST funding is perfectly compatible with pay-for-performance; changes to technical rules, changes to reimbursement procedures, transition to private insurance, etc.)
- Funding is not "debt" to the state's taxpayers, its LUST fund or regulatory agency. The LUST fund just continues to do what it has always done ---reimburse approved claims
- NatLUST will be self-supporting-- the program's participants---and not their state's taxpayers or LUST fund---will bear the program's costs. Also, their LUST fund is not exposed to interest rate risk
- NatLUST will not impede agency's ability to seek "cost recovery" from RP's and/or the RP's environmental contractor. NatLUST will likely retain right of set-off to protect the particular state regulatory agency and itself, but the agency may not seek cost recovery from NatLUST where such recovery would impair NatLUST's collateral position
- Participants from one state will not be exposed to risk from other participating states. NatLUST's credit providers will assume such risk
- No requirement that the state agency force RP's into the NatLUST program. The agency can simply present it as an option and let the marketplace decide whether to use it



Benefits to Environmental Consultants

- **Not Debt** – NatLUST financing is not “debt” to the consultant, it is not capped at any maximum amount, and NatLUST does not require that the consultant supply tax returns, financial statements, in order to receive Direct Payment. It is expected that NatLUST financing will also be non-recourse to the consultant in the event a particular fund should cease reimbursing claims
- **Direct Pay** – NatLUST initial payment checks will be mailed directly to the consultant days after each claim is approved. Residual payments will be remitted shortly after each claim is reimbursed
- **Inexpensive** - NatLUST financing is likely materially less expensive than bank financing. Smaller consulting firms that may not have access to traditional bank financing can compete for business, thereby benefiting their own businesses (such competition will also provide the public purpose benefit of helping state LUST fund’s keep costs down by relying on smaller, less expensive firms). Larger environmental firms may compete for national account business on a portfolio basis



Contact Information

Lindsay Trittipoe
Commonwealth Acceptance, LLC.
VRA Accelerated Payment Program Manager
Richmond, Virginia
(804) 358-6661 lt@comm-accept.com

Copies of the most up to date version of this presentation can be downloaded at www.vpstf.org/NatLUST.pdf

Information about Virginia's Virginia Resources Authority Accelerated Claim Payment Program can be found at www.vpstf.org and www.virginiaresources.org