

PERFORMANCE AUDIT REPORT

Pennsylvania Infrastructure Investment Authority

Nonpoint Source Management Program Projects

April 2023



Commonwealth of Pennsylvania
Department of the Auditor General

Timothy L. DeFoor • Auditor General

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TIMOTHY L. DEFOOR
AUDITOR GENERAL

March 21, 2023

The Honorable Josh Shapiro
Governor
Commonwealth of Pennsylvania
Harrisburg, PA 17120

Dear Governor Shapiro:

This report contains the results of the Department of the Auditor General's performance audit of the Pennsylvania Infrastructure Investment Authority (PENNVEST). This performance audit was conducted pursuant to Pennsylvania House of Representatives Resolution 948 adopted on June 21, 2018, during the Session 2017-2018, and under the authority of Section 751.12 (relating to Audits) of the PENNVEST Act, 35 P.S. § 751.12 (Act 16 of 1988), and Sections 402 and 403 of The Fiscal Code, 72 P.S. §§ 402 and 403.

The audit was performed in accordance with generally accepted *Government Auditing Standards*, issued by the Comptroller General of the United States.¹ Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit included two objectives. The audit period for the first objective was July 1, 2017, through June 30, 2018, and was as follows:

- Evaluate PENNVEST's process for determining applicant/project eligibility and approval for loans and grants provided for Nonpoint Source (NPS) Management Program Projects.

¹ U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision Technical Update April 2021.

The audit period for the second objective was from July 1, 2017, through April 30, 2022, with updates through October 21, 2022, and was as follows:

- Evaluate PENNVEST's monitoring activities related to the loans awarded to LFF IV Timber Holding LLC (d.b.a. Lyme Timber), to ensure compliance with the respective loan agreements.

Our methodology to satisfy these audit objectives, along with our evaluation of management's internal controls significant to these audit objectives, is included in *Appendix A* of this report. This report presents two findings and seven recommendations, including two that recommend collaborative efforts by PENNVEST and the General Assembly.

As discussed in *Finding 1*, we found that although we verified the eligibility of all 7 NPS projects selected for review from the 14 NPS projects approved during the fiscal year ended June 30, 2018, we determined that PENNVEST management used its administrative discretion to very broadly interpret certain undefined terms in the PENNVEST Act to conclude that two Lyme Timber NPS projects were eligible for PENNVEST financial assistance.

In *Finding 2*, we found that the PENNVEST Board of Directors (Board) overly relies on management to ensure NPS project eligibility because management does not provide the rationale it used to conclude projects are eligible for PENNVEST financial assistance with other project information sent to the Board. Additionally, for two of the seven NPS projects reviewed, we found that PENNVEST management did not provide certain information to the Board, which may have limited Board members' understanding of the projects' eligibility and the Pennsylvania Department of Environmental Protection's assessment of the projects. These two projects involved loans approved for Lyme Timber.

We also found that PENNVEST adequately performed monitoring activities through April 30, 2022, to ensure compliance with the terms in the Lyme Timber loan agreements, with certain activities still on-going.

While PENNVEST disagreed with our findings, we are encouraged that management intends to seek the Board's opinion on the need to amend the language in the PENNVEST Act, and review the information provided to Board members to determine if clarifications or additional information would be helpful as the Board considers approving projects to fund. We address PENNVEST's disagreement to our findings in the *Auditor's Conclusion* section of our report.

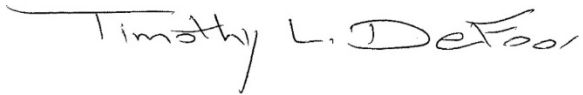
The Honorable Josh Shapiro

March 21, 2023

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In closing, we thank PENNVEST for its cooperation and assistance during the audit. We reserve the right to follow up at an appropriate time to determine whether and to what extent our recommendations have been implemented.

Sincerely,

A handwritten signature in black ink that reads "Timothy L. DeFoor". The signature is written in a cursive, flowing style with a horizontal line extending from the start of the name.

Timothy L. DeFoor
Auditor General

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Executive Summary

This performance audit focuses on the eligibility of Nonpoint Source (NPS) Management Program projects approved by the Pennsylvania Infrastructure Investment Authority (PENNVEST) Board during the fiscal year ended June 30, 2018, pursuant to Pennsylvania House of Representatives Resolution No. 948 of the legislative session 2017-2018 adopted on June 21, 2018 (*see Appendix B*). Based on an informational meeting held by the Pennsylvania House of Representatives Agriculture and Rural Affairs Committee on March 26, 2018, the focus of this resolution specifically related to two projects that were awarded a total of \$50 million in low-interest loans to Lyme Emporium Highlands II, LLC (Lyme Timber), to aid the firm's purchase of large tracts of private timberland in northwest Pennsylvania.

The objectives of this audit were as follows:

1. Evaluate PENNVEST's process for determining applicant/project eligibility and approval for loans and grants provided for NPS Management Program projects awarded during the 2017-18 fiscal year.
2. Evaluate PENNVEST's monitoring activities related to the loans awarded to Lyme Timber, to ensure compliance with the respective loan agreements.

For our first audit objective, we reviewed 7 of 14 NPS projects approved for financial assistance during the period July 1, 2017, through June 30, 2018, including the two Lyme Timber projects. Although we verified that all seven projects were eligible, we determined that PENNVEST management used administrative discretion to very broadly interpret certain undefined terms in the PENNVEST Act in its conclusion that the two Lyme Timber projects were eligible for financial assistance (*see Finding 1*). We also evaluated the sufficiency of information shared with Board members before they approved the recommended funding offers for the seven selected NPS projects. We discuss our results in Finding 2.

For our second audit objective, we found that PENNVEST adequately performed monitoring activities through April 30, 2022, to ensure compliance with loan agreements awarded to Lyme Timber.

Findings

Finding 1 – The specific undefined terms in question in the PENNVEST Act relate to the definition of "Project" which stipulates that an NPS project must be "... *all or part of any facility or system*..." to be eligible for project financing. The Act, however, fails to specifically define these terms or prohibit certain types of projects. For the Lyme Timber projects however, the facility or system associated with the purchase of forest acreage is not clear. According to

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PENNVEST management, the “system”, as it relates to the Lyme Timber projects, pertains to “the geographic area where an eligible PENNVEST project can be implemented or constructed.” Based on that broad definition, it appears that project eligibility is practically limitless, which potentially renders the other limiting criteria for projects meaningless.

Finding 2 – PENNVEST’s process for Board approval of NPS project funding offers appears automatic, by overly relying on management to determine eligibility and make recommendations. We found that project documentation presented to the Board (Board Summary Reviews) does not include the rationale explaining why the project was deemed eligible. As such, Board members rely solely on PENNVEST management to determine project eligibility. We also found the Board Summary Reviews failed to include comments to explain the low ratings that the Pennsylvania Department of Environment Protection (DEP) assigned to the Lyme Timber projects. DEP determined that the projects would potentially protect water quality but not have a direct and substantial water quality benefit or elevate a critical, chronic, or potential safety or health hazard while having a very high cost for NPS projects. We found instead that PENNVEST management used strongly favorable project descriptions in Lyme Timber’s Board Summary Reviews regarding water quality benefits and benefit-to-cost of the NPS projects. This over-reliance on management and incomplete description of DEP’s assessment of the Lyme Timber projects, coupled with management’s acknowledgement that all projects presented to the Board have been approved since the 2015-2016 fiscal year, fosters the appearance that automatic approvals may have occurred for the Lyme Timber projects.

Overall Conclusion

Potential changes to state law and PENNVEST’s procedures could result in a more thorough review and deliberation of projects being considered for financial assistance, with a particular emphasis on ensuring those projects are eligible and consistent with the intent of the law, and a prudent use of taxpayer funds with tangible environmental benefits.

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Introduction and Background

The Department of the Auditor General conducted this performance audit of the Pennsylvania Infrastructure Investment Authority (PENNVEST) for two stated objectives. The **first objective** was to evaluate PENNVEST’s process for determining applicant/project eligibility and approval for loans and grants provided for Nonpoint Source (NPS) Management Program projects awarded during the fiscal year July 1, 2017, through June 30, 2018. The **second objective** was to evaluate PENNVEST’s monitoring activities related to the loans awarded to Lyme Emporium Highlands II, LLC, an affiliate of The Lyme Timber Company LP (Lyme Timber) to ensure compliance with the respective loan agreements from July 1, 2017, through April 30, 2022 (Lyme Timber information is discussed later in this section). Refer to *Appendix A* of this report for a detailed description of the audit objectives, scope, methodology, data reliability, and our evaluation of management’s internal controls related to the audit objectives.

The audit was conducted under the authority of Section 751.12 (relating to Audits) of the “Pennsylvania Infrastructure Investment Authority Act” (PENNVEST Act), Act 16 of 1988, Sections 402 and 403 of The Fiscal Code, and pursuant to Pennsylvania House of Representatives Resolution No. 948 adopted during the 2018 legislative session.² The audit was performed in accordance with applicable generally accepted *Government Auditing Standards* (GAS), issued by the Comptroller General of the United States.³

In the following sections, we present information on: (1) PENNVEST’s mission, organization, and project funding; (2) PENNVEST’s NPS project eligibility determination and approval process; (3) background and details regarding Lyme Timber and its approved NPS projects; and (4) House Resolution 948 of 2018, which requested this audit.

PENNVEST’s Mission, Organization, and Project Funding

The PENNVEST Act created PENNVEST for the purpose of financing long-term, low-interest loans for corporations, partnerships, sole proprietorships, non-profit organizations, authorities, and municipalities for the repair, construction, reconstruction, rehabilitation, extension, and improvement of drinking water, storm water, and wastewater systems, which includes NPS projects.⁴ This is mirrored by its mission statement:

² 35 P.S. § 751.12 (Act 16 of 1988); 72 P.S. §§ 402, 403; and *see also* House Resolution No. 948, PN 3586 (adopted on June 21, 2018) (“A Resolution requesting the Auditor General to conduct a financial audit of nonpoint source program projects approved by the Pennsylvania Infrastructure Investment Authority”), *see Appendix B* of this report.

³ U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision Technical Update April 2021.

⁴ 35 P.S. § 751.1 *et seq* (Act 16 of 1988, as amended), Pennsylvania Infrastructure Investment Authority Act.

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“To serve communities and the citizens of Pennsylvania through capital funding for drinking water, sewer, storm water, non-point source pollution prevention and other related projects that benefit the health, safety, environment, promote economic development, and improve water quality.”⁵

The PENNVEST Act established a Board of Directors (Board) with the powers and duties to award financial assistance in the form of grants and loans to eligible entities that meet specified criteria.⁶ The Board approves an Executive Director at the recommendation of the Governor to oversee the operations of PENNVEST. The executive team under the Executive Director includes the Deputy Executive Director for Project Management, the Deputy Executive Director for Financial Management, and the Deputy Executive Director for Information Technology, as well as the Chief Counsel. PENNVEST agency staff assist the Board by processing project funding applications and presenting eligible projects with a recommended funding offer to the Board for approval at quarterly Board meetings. PENNVEST sends approved funding offers to the project applicants for consideration. Applicants may request changes to the terms of the funding offers, which may or may not require Board approval. PENNVEST and the applicants’ representatives sign funding agreements after all the details of the funding transaction are finalized.

PENNVEST finances projects using several sources, including the Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund, as stipulated in the PENNVEST Act and pursuant to the Safe Drinking Water Act amendments of 1996 and the Water Pollution Prevention and Control subtitle of the federal Clean Water Act.⁷ NPS project funding is typically provided through the CWSRF and disbursed on a reimbursement basis as entities complete construction of the projects. PENNVEST has the authority to offer funding assistance as a loan, a grant, or a combination of a loan and grant, to applicants as specifically set forth in the

⁵ <https://www.pennvest.pa.gov/Pages/Mission.aspx> (accessed January 3, 2023).

⁶ Under Section 751.4 of the act the authority is to be a 13-member board of directors to be composed of the Governor; the Secretary of Environmental Resources (renamed Environmental Protection in 1995); the Secretary of Commerce; the Secretary of Community Affairs (both merged into Community and Economic Development in 1996); the Secretary of General Services; the Secretary of the Budget; two Senators, one each to be appointed by the Senate President pro tempore and the Senate Minority Leader; two members of the House of Representatives, one each to be appointed by the House Speaker and the House Minority Leader; and four appointees of the Governor (granted an additional appointee position for a total of four in 1996 which has been vacant since the 2013-2014 Fiscal Years). See 35 P.S. § 751.4, as amended.

⁷ 42 U.S.C. § 300f *et seq.* Safe Drinking Water Act Amendments of 1996, August 6, 1996, P.L. 104-182. They provide for the protection of source waters for public water systems, among other things.; 33 U.S.C. § 1251 *et seq.*; Enacted in 1948, the Federal Water Pollution Control Act was significantly reorganized and expanded in 1972 and became known as the Clean Water Act. Changes in 1987 advanced a new funding strategy to address water quality needs through U.S. Environmental Protection Agency-state partnerships and replacing the construction grants program with the Clean Water State Revolving Fund. [https://www.epa.gov/laws-regulations/history-clean-water-act#:~:text=The%20Federal%20Water%20Pollution%20Control,Clean%20Water%20Act%20\(CWA\)](https://www.epa.gov/laws-regulations/history-clean-water-act#:~:text=The%20Federal%20Water%20Pollution%20Control,Clean%20Water%20Act%20(CWA)) (accessed January 3, 2023); <https://www.epa.gov/cwsrf/learn-about-clean-water-state-revolving-fund-cwsrf> (accessed January 3, 2023).

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PENNVEST Act.⁸ Grants shall be made only when the Board determines that the repayment of a loan is unlikely and that the applicant cannot proceed with the project without a grant.

The portion of loan and/or grant awarded to an applicant is based on the applicant's financial capacity to handle the repayment of the debt and the amount of grant funding available for award at each quarterly Board meeting.⁹ If the demand for project funding exceeds the amount available, PENNVEST will utilize its project ranking system to determine which projects will be funded and which will be deferred until the next quarterly Board meeting.

Since its inception, PENNVEST has helped finance more than 3,100 water quality/control projects statewide totaling more than \$10.4 billion, as shown in the table below.

PENNVEST Projects Financed (1988 - 2022)		
Project Type	Projects	Amount Financed
Wastewater	1,741	\$ 6,526,084,854
Drinking Water	1,157	\$ 3,369,450,824
NPS Pollution	204	\$ 356,989,070
Stormwater	147	\$ 221,250,428
Total	3,249	\$ 10,473,775,176

Source: Developed by Department of the Auditor General staff from the PENNVEST 2021-22 Annual Report.¹⁰

According to PENNVEST's 2021-22 Annual Report, since 2015-16, the Board has approved funding offers for every applicant that satisfied the following three criteria:¹¹

1. A complete application package was submitted for an eligible project prior to the cut-off date for Board consideration.
2. The Pennsylvania Department of Environmental Protection (DEP) determined the application and project design to be technically complete.
3. The project was ready to start construction in a timely fashion.

⁸ 35 P.S. §751.10(e) and (f) (Act 16 of 1988). PENNVEST CWSRF loans typically have a 20-year term with funds disbursed at specified intervals during construction. Interest rates on applicable loans are determined in accordance with Section 751.10(f) of the PENNVEST Act. *See* 35 P.S. § 751.10(f) (Act 16 of 1988, as amended). *See* also 25 Pa. Code § 963.15. The principal and interest repayments from low-interest loans issued through the program are used to fund future projects. States can tailor the financial assistance available, including loans and grants, and terms offered, to suit the needs of their communities.

⁹ <https://www.pennvest.pa.gov/Information/Funding-Programs/Pages/Clean-Water-State-Revolving-Fund.aspx> (accessed January 3, 2023).

¹⁰ <https://www.pennvest.pa.gov/about-us/Pages/Publications.aspx> (accessed January 25, 2023).

¹¹ PENNVEST Annual Report for 2021-2022, page 13. <https://www.pennvest.pa.gov/about-us/Pages/Publications.aspx> (accessed January 25, 2023).

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PENNVEST Nonpoint Source Project Eligibility Determination and Approval Process

Our audit focused on NPS projects approved for PENNVEST financing between July 1, 2017, and June 30, 2018. Since 2009, PENNVEST has supported NPS projects using the CWSRF to award loans and grants to various entities. NPS pollution occurs when rainfall or snowmelt, moving over and through the ground, picks up and carries natural and human-made pollutants, depositing them into lakes, rivers, wetlands, coastal waters, and ground waters. According to the EPA, NPS pollution is reported by states as the leading cause of water quality problems.¹² NPS pollution may include sediment, nutrients, agricultural chemicals, animal waste, and urban runoff, among other pollutants. PENNVEST funds NPS projects to help prevent those pollutants from impacting groundwater, streams, or waterways. Eligible NPS projects include those listed on the Pennsylvania Nonpoint Source Management Program Update and include but are not limited to constructing manure handling best management practices, installing green infrastructure in an urban area to filter stormwater, constructing passive acid mine drainage treatment systems, brownfields remediation to protect groundwater and the installation of riparian buffers. Public or private entities may apply for PENNVEST NPS project financing assistance.¹³

During the fiscal year ended (FYE) June 30, 2018, the Board approved funding offers for 14 NPS projects totaling approximately \$67.8 million, including \$62.2 million in loans and \$5.6 million in grants as shown in the table below.

NPS Projects Approved (FYE June 30, 2018)			PENNVEST FUNDING OFFER	
No.	Applicant	Board Approval	Loan Amount	Grant Amount
1	Armstrong County Conservation District	Jul 2017	\$ 0	\$ 925,754
2	Chester County Conservation District	Jul 2017	\$ 0	\$ 394,520
3	Tri-Municipal Park	Jul 2017	\$ 107,891	\$ 215,778
4	York County Rail Trail Authority	Jul 2017	\$ 0	\$ 950,000
5	Homestead Borough*	Oct 2017	\$ 1,209,656	\$ 0
6	Lyme Emporium Highlands II, LLC**	Oct 2017	\$25,450,115	\$ 0
7	Lyme Emporium Highlands II, LLC**	Jan 2018	\$24,549,885	\$ 0
8	Mann Township	Jan 2018	\$ 0	\$ 444,031
9	Old Lycoming Township	Jan 2018	\$ 0	\$ 622,175
10	Stormwater Authority – City of Chester	Jan 2018	\$ 4,888,205	\$ 0

¹² <https://www.epa.gov/nps/basic-information-about-nonpoint-source-nps-pollution> (accessed January 3, 2023).

¹³ 25 Pa. Code § 963.4(a);
<https://www.pacodeandbulletin.gov/Display/pacode?file=/secure/pacode/data/025/chapter963/chap963toc.html>
(accessed January 3, 2023).

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11	Chester County Conservation District	Apr 2018	\$ 0	\$ 394,520
12	Coal Township	Apr 2018	\$ 0	\$1,094,250
13	Armstrong Township	Apr 2018	\$ 0	\$ 600,000
14	Stormwater Authority – City of Chester	Apr 2018	\$ 5,960,276	\$ 0
		TOTAL	\$62,166,028	\$5,573,908

*- Homestead Borough declined the PENNVEST loan offer.

** - Lyme Timber initially submitted one application for a \$50 million PENNVEST loan. However, when PENNVEST only offered a loan for \$25,450,115, Lyme Timber then split the project into two projects and submitted a second application to purchase the remaining acreage for \$24,549,885. According to PENNVEST management, the Lyme Timber loans were the two largest NPS loans approved since it began funding NPS projects.

Source: Developed by Department of the Auditor General staff from the FYE 2018 PENNVEST Board meeting minutes.

PENNVEST staff prepares NPS project summary information and recommends the eligible projects for Board approval after completing its review process for project financing applications and required documents that applicants submit online.¹⁴ Using this method allows PENNVEST program staff, DEP, the Department of Community and Economic Development (DCED), and a third-party vendor to readily conduct review procedures designed specifically to assist with PENNVEST's assessment of applicants' projects. PENNVEST oversees this review process. DEP evaluates and scores each NPS project after reviewing the technical design, expected water quality impact, and other aspects of the project, while DCED scores each project after evaluating the reasonableness of the applicant's estimate of the economic impact the project will have on the surrounding communities. PENNVEST also contracts with a third-party vendor to analyze applicants' financial capacity to incur the debt associated with a PENNVEST loan.

PENNVEST calculates an overall score for each NPS project using the scores from DEP and DCED, plus any additional points it may award based on Board-approved criteria, so that all projects pending approval at the next Board meeting can be ranked.¹⁵ This ranking only becomes relevant when the CWSRF funding available for award at the next board meeting is insufficient to fund every eligible project on the list. Otherwise, all eligible projects that are technically and administratively complete are recommended for Board approval, which was the case during FYE June 30, 2018. If the available funding is not sufficient for a particular board meeting, PENNVEST defers the lowest-ranked projects until the next quarterly board meeting. Any project that is deferred must reapply for consideration at a subsequent Board meeting. For the projects that it determines can be funded, PENNVEST management develops Board Summary Reviews for each project and distributes them to Board members approximately one week prior to the Board meeting. The Board Summary Reviews include the following:

¹⁴ Prior to applying for PENNVEST funding assistance, applicants must attend an initial consultation meeting with PENNVEST and DEP to determine if a project is potentially eligible and identify the water quality benefits, required permits, and other funding opportunities that may be available. After PENNVEST receives an application, DEP reviews it for completeness before it proceeds through the application review process.

¹⁵ Ranking Framework for PENNVEST Non-Point Source Projects, April 1, 2016. *See Appendix C.*

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- Project/Applicant name and address
- Legislative District
- DEP's and DCED's project evaluation results
- Financial/Project cost information
- Funding Request Type
- Financial assistance offer:
 - Loan/Grant amount
 - Loan interest rate
 - Loan duration
 - Collateral
- PENNVEST staff recommendations:
 - Executive Director (Approve/Disapprove/Defer)
 - Legal Counsel (Recommended/Not recommended)
- Project description:
 - Problem to be solved
 - Project Construction Schedule
 - Population impacted
 - Number of jobs created (estimate)
 - Major project benefits
- PENNVEST's financial consultant recommendation on the applicant's financial capability to repay the loan, if applicable.

Background on Lyme Timber and Pre-Application Information¹⁶

Lyme Timber is a private timberland investment management company headquartered in New Hampshire which, since its founding in 1976, has invested in forestland and rural real estate in the United States and Canada.¹⁷ The company is committed to stewardship practices that maintain long-term forest productivity while conserving the ecological health and biological diversity of the forest.¹⁸ One of its core investment strategies is to sell conservation easements. Working Forest Conservation Easements (WFCE) allow communities to achieve environmental and economic benefits by permanently preventing development and fragmentation of the respective lands while allowing income generation from ongoing sustainable forest management.¹⁹

¹⁶ See Appendix D for a timeline prepared by the Department of the Auditor General that includes pre-application information.

¹⁷ <https://www.lymetimber.com/> (accessed January 3, 2023).

¹⁸ <https://www.lymetimber.com/sustainability/sustainable-forestry/> (accessed January 3, 2023).

¹⁹ <https://www.lymetimber.com/sustainability/land-conservation/> (accessed January 3, 2023).

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According to documentation prepared by Lyme Timber, its company representatives initially approached the Pennsylvania Department of Conservation and Natural Resources (DCNR) in Spring 2017. The purpose was to gauge DCNR's interest in purchasing WFCEs to conserve the forests on more than 60,100 acres of land that Lyme Timber planned to purchase in seven northern tier Pennsylvania counties in which it would conduct sustainable timbering operations. Lyme Timber's summary suggested that DCNR considered these lands a *major* priority because of their proximity to public lands already conserved and the WFCEs would secure public access for outdoor recreation and conserve the forests. This was a key objective reported by the Governor's Green Ribbon Task Force on Forest Products, Conservation, and Jobs in 2016.²⁰ While DCNR's forest conservation goals aligned with Lyme Timber's business strategy, DCNR explained to Lyme Timber executives that it lacked funding for WFCE purchases in the near term.²¹

DCNR's interest in conserving the forests prompted its management to assist with discussions between Lyme Timber and PENNVEST. Lyme Timber contacted PENNVEST for financial assistance to purchase the timberlands. Lyme Timber executives met with PENNVEST, DCNR, and DEP representatives in June 2017. While the focus of the discussions about the timberlands purchase was initially about forest conservation efforts with DCNR, coordination among the agencies and Lyme Timber resulted in identification of two water quality improvement projects proposed for sites located on a tract of land the company planned to purchase. Correspondence between Lyme Timber executives, DCNR and PENNVEST management, as well as documents from DEP, indicate that it was important for Lyme Timber to add specific water quality benefits to the Lyme Timber project before it applied for PENNVEST financing. Improving water quality is directly aligned with PENNVEST's objective for funding NPS projects. Consequently, Lyme Timber agreed to fund two acid mine drainage (AMD) remediation projects at the two sites identified in exchange for a PENNVEST low-interest loan to purchase more than 60,100 acres of timberlands, where it would responsibly harvest timber and sell WFCEs to permanently conserve the forests.

Details of the Lyme Timber Applications and Loan Funding Agreements²²

In August 2017, Lyme Timber applied for a \$50 million PENNVEST NPS project loan to help finance its purchase of 23 large tracts of privately-owned forestland totaling more than 60,100 acres in seven Pennsylvania counties. Its application indicated that the fragmentation and selling-off of large-scale timberlands threatens the forests and water quality in northwest Pennsylvania, because smaller parcels of forests are more likely to be converted from sustainable forest

²⁰ <https://elibrary.dcnr.pa.gov/GetDocument?docId=1742871&DocName=GreenRibbonTaskForceReport-2.pdf> (accessed January 3, 2023).

²¹ Lyme Timber Project Summary, April 9, 2018.

²² See *Appendix D* for a timeline prepared by the Department of the Auditor General related to Lyme Timber's NPS project applications and receipt of two PENNVEST loans.

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management to other uses. The streams and tributaries in this area form the headwaters of the Allegheny and Susquehanna rivers. Its application also contended that conservation easements are critical for protecting those landscapes and watersheds. In its application, Lyme Timber offered to:

- Transfer 9,362 of the more than 60,100 acres to the commonwealth at no cost as a WFCE.
- Provide up to \$550,000 to restore streams impacted by AMD at two sites within the WFCE.
- Grant the commonwealth a seven-year option to purchase additional WFCEs from the remaining 50,700 acres.

The application listed a total cost of nearly \$141.1 million to purchase the land, of which \$50 million would be financed through PENNVEST. Lyme Timber also estimated the project would create 50 new jobs within the seven counties where the tracts of land were located.

PENNVEST program staff processed Lyme Timber's application following its established procedures for all NPS applications. PENNVEST management presented the Lyme Timber Board Summary Review packet to the Board and recommended a loan offer of \$25,450,115 at a one percent interest rate, slightly over half of the \$50 million requested by Lyme Timber. Management stated that it did not recommend the entire requested amount because it would have pulled allocated funding from future board meetings which could have impacted future projects. The Board unanimously approved this recommended funding offer at a special meeting on October 27, 2017, nine days after deferring a vote to approve funding at the regularly scheduled quarterly board meeting.

After learning of the reduced offer, Lyme Timber management contacted the PENNVEST Executive Director to emphasize how the scope of the project would be reduced or the entire project terminated if they could not secure the other half of the requested funding from another source. The email indicated that Lyme Timber might consider submitting a second application for the remainder of the \$50 million for consideration at the next board meeting on January 31, 2018.

Lyme Timber submitted a second application to PENNVEST in November 2017, after working with PENNVEST staff to determine what the first \$25 million loan could cover, essentially splitting the project in half. Lyme Timber's second application requested \$24,549,885 to purchase 11 large tracts of forest land totaling 28,054 acres. As part of the second funding application, Lyme Timber would:

- Transfer 5,135 acres to the commonwealth as a WFCE. The application indicated that combining these acres with the 4,227 acres related to the first offer totals the 9,362 acres listed on its first application.

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- Provide up to \$200,000 to restore streams impacted by AMD at one site within the WFCE. This increased Lyme Timber's total commitment to a maximum of \$750,000 to fund AMD remediation at three sites.
- Grant the commonwealth a seven-year option to purchase additional WFCE's on the remaining 28,054 acres purchased with the second \$25 million financed. The application indicated a total of more than 60,100 acres would be conserved or subject to conservation easements considering the combination of the WFCE and option rights included in both applications.

The Board unanimously approved a second funding offer to Lyme Timber on January 31, 2018, a \$24,549,885 loan with a one-percent interest rate to purchase 28,054 acres.

Lyme Timber and PENNVEST signed two funding agreements on July 31, 2018, which cumulatively established a \$50 million loan to Lyme Timber with a 20-year term and an interest rate of one percent. However, other project details in the agreements differed from the applications and Board Summary Reviews prepared to inform Board members about the projects before voting to approve funding offers. Lyme Timber combined the PENNVEST loan funds with funds from other sources to purchase **37,205 acres of forest land** located in **just three counties**, which represented approximately 62 percent of the more than 60,100 acres located in seven counties as indicated in the project description in the Board Summary Review prepared for the October 2017 board meeting.²³ Lyme Timber transferred 9,152 acres as a WFCE to DCNR; however, the agreements **did not** include any options for the commonwealth to purchase additional WFCEs.

House Resolution 948 of 2018

The Pennsylvania House of Representatives Agricultural and Rural Affairs Committee (Committee) held an informational hearing two months after the Board approved a loan for the second project to discuss concerns about the eligibility of both Lyme Timber projects. Various legislators in both the Pennsylvania House and Senate questioned whether providing public funds to assist a private company with the purchase of timberlands was the best use of CWSRF monies in terms of the benefits for the public and environment. Consequently, the Pennsylvania House of Representatives unanimously adopted House Resolution 948 of 2018, "Requesting the Auditor General to conduct a financial audit of the nonpoint source program projects approved

²³ The original Lyme Timber application indicated that it intended to purchase more than 60,100 acres of land. The funding agreements show that the Lyme Timber affiliate, Lyme Emporium Highlands II, LLC., purchased **only 37,205 acres** of land using the \$50 million in PENNVEST loans combined with funds from other sources. Other Lyme Timber affiliates purchased the remaining 22,897 acres, however, **no PENNVEST loan proceeds were used** for those purchases.

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by the Pennsylvania Infrastructure Investment Authority.”²⁴ It noted that certain undefined terms in the PENNVEST Act prompted legislators to question some NPS projects’ eligibility.²⁵ Specifically, the resolution states, in part:

“WHEREAS, There is some uncertainty as to the eligibility of some of the approved nonpoint source program projects, arising from whether the transactions are actually projects under the Pennsylvania Infrastructure Investment Authority Act”.

PENNVEST’s Executive Director indicated during testimony and in correspondence with the Committee that the Lyme Timber projects were eligible under the PENNVEST Act and its policy, as confirmed by PENNVEST’s chief counsel and approved by the EPA under federal regulations. He also stated that PENNVEST did not bypass or withhold funding offers for any other eligible projects in order to fund the Lyme Timber projects. *See Finding 1* of this audit report where we address the question of the Lyme Timber project eligibility.

²⁴ See *Appendix B* to read House Resolution 948 of 2018, P.N. 3585, Session 2018, adopted on June 21, 2018, in its entirety.

²⁵ Pennsylvania Infrastructure Investment Authority Act, Act 16 of 1988, as amended. See 35 P.S. § 751.1 *et seq.*

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Audit Procedures and Results

Our performance audit included two audit objectives related to the Pennsylvania Infrastructure Investment Authority's (PENNVEST) Nonpoint Source (NPS) Management Program, which provides loans and grants for pollution control projects. We discuss in this section our audit procedures and results for each of our two audit objectives.

Objective 1: Evaluate PENNVEST's process for determining applicant/project eligibility and approval for loans and grants provided for NPS Management Program projects.

We interviewed PENNVEST management and reviewed policies, procedures, and relevant legislation related to NPS projects to gain an understanding of this program. This audit objective covered the period from July 1, 2017 through June 30, 2018. During that period, PENNVEST's Board of Directors (Board) approved 14 NPS projects, as listed in the *Introduction and Background* section of this report. Of the 14 projects, we judgmentally selected 7 projects and performed various audit procedures.

The table below identifies the seven projects we selected for review and includes the amount of Board-approved loan or grant funding offered. The table also lists the project scores assigned by the designated agencies, which play a critical role in PENNVEST's NPS project application review process if funding demand exceeds available funding. The Pennsylvania Department of Environmental Protection (DEP) and the Pennsylvania Department of Community and Economic Development (DCED) act as expert consultants and evaluate project applications for PENNVEST. Specifically, DEP evaluates the NPS projects' technical aspects and predicts environmental outcomes, while DCED assesses the economic impact described in the applications. PENNVEST also adds a score to individual projects that meet specific criteria. PENNVEST program staff calculates the total score for each NPS project and ranks eligible projects ready for a vote at the Board's next quarterly meeting.

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NPS Project Review Scores (Fiscal Year Ended June 30, 2018)

Board Approved							
NPS Project		Funding Offer		Project Scores*			Total Score
No.	Applicant	Loan	Grant	DEP	DCED	PENNVEST	
1	Stormwater Authority-City of Chester	\$ 4,888,205	\$ 0	64	5	20	89
2	Stormwater Authority-City of Chester	\$ 5,960,276	\$ 0	55	5	20	80
3	Homestead Borough**	\$ 1,209,656	\$ 0	58	5	10	73
4	York County Rail Trail Authority	\$ 0	\$ 950,000	46	5	10	61
5	Armstrong Township	\$ 0	\$ 600,000	44	5	0	49
6	Lyme Emporium Highlands II LLC (Lyme Timber)	\$24,549,885	\$ 0	14	10	0	24
7	Lyme Emporium Highlands II LLC (Lyme Timber)	\$25,450,115	\$ 0	1	10	0	11

*- See a summary description of the NPS project scoring/ranking process in the *Introduction and Background* section, and a more detailed explanation in *Appendix C* of this report.

** - Homestead Borough declined the PENNVEST loan offer.

Source: Developed by Department of the Auditor General staff from PENNVEST NPS application review documentation and Board-approved funding offers.

Our review of PENNVEST's NPS application documentation for each of the seven projects listed above found that it followed the procedures in place to review and rank each project before recommending funding offers to the Board for approval. Specifically, we found the following for each project reviewed:

- PENNVEST and DEP jointly conducted a consultation meeting with the applicant prior to application submission.
- DEP timely reviewed and approved the application to ensure that the project was designed to remediate the pollution problem identified.
- DCED scored the project after assessing the reasonableness of the applicant's description of the project's economic impact included on the application.

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- PENNVEST accurately calculated the final score based on project scores assigned by DEP, DCED, and PENNVEST, and properly ranked the project for Board approval.
- PENNVEST staff and a third-party financial consultant assessed the applicant's financial capacity and determined the collateral needed for a low-interest loan or whether to offer a grant for the project funding requested.
- PENNVEST's Executive Director and legal counsel approved each project as eligible and recommended it for Board consideration prior to sending the Board Summary Reviews to Board members.
- The Board approved all NPS projects at quarterly board meetings.

We additionally reviewed project eligibility in accordance with the PENNVEST Act for the seven selected NPS projects. Although we verified that all seven projects were eligible, we determined that PENNVEST management used its administrative discretion to very broadly interpret certain undefined terms in the PENNVEST Act in its conclusion that the two projects approved for Lyme Timber, a private timber company headquartered in New Hampshire, were eligible for PENNVEST financial assistance.²⁶ (*See Finding 1*).

We further reviewed the sufficiency of information PENNVEST management shared with its Board members before it approved the recommended funding offers for the seven selected NPS projects. We found that management did not provide the rationale used to determine projects eligibility in the documents sent to the Board. Therefore, members rely solely on PENNVEST management to properly determine project eligibility. It is important that the rationale be included with the project information, so Board members understand how NPS projects are eligible for funding. This may have prevented questions raised about eligibility of the Lyme Timber projects after the Board had approved funding offers and given the appearance of automatic approval by the Board (*See Finding 2*).

We also found that PENNVEST management did not provide DEP's review comments to the Board to explain the low assessment scores for the Lyme Timber projects, but instead chose to include positive descriptions verbatim from an email received from DCNR sent to convey its interest in Lyme Timber's acquisition of the timberlands. Including these descriptions without DEP's comments may have limited Board members' understanding of DEP's assessment of the

²⁶ Public or private entities may apply for PENNVEST NPS project financing assistance as indicated in 35 P.S. § 751.1 *et seq.* (Act 16 of 1988, as amended) and under the Pennsylvania Code, 25 Pa. Code § 963.4(a); <https://www.pacodeandbulletin.gov/Display/pacode?file=/secure/pacode/data/025/chapter963/chap963toc.html> (accessed January 3, 2023). Additionally, Lyme Timber registered as a valid Pennsylvania legal entity. <https://www.corporations.pa.gov/search/corpsearch> (accessed January 3, 2023).

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Lyme Timber projects.²⁷ Our review of the documents PENNVEST management prepared for the Board associated with the five other NPS projects approved during the fiscal year ended June 30, 2018, found the project descriptions included were similar to DEP's review comments. (*See Finding 2*).

Objective 2: Evaluate PENNVEST's monitoring activities related to the loans awarded to Lyme Timber to ensure compliance with the respective loan agreements.

We reviewed PENNVEST's project monitoring procedures related to the Lyme Timber NPS projects and found that they are designed to ensure Lyme Timber complies with the funding agreements provisions. The atypical nature of the Lyme Timber projects however, has delayed completion of certain monitoring procedures, as described after the second bulleted list below.

Certain funding agreement provisions required Lyme Timber to provide specific deliverables at the time or soon after the agreements were executed. We confirmed that PENNVEST ensured timely receipt of the following items:

- Two irrevocable bank letters of credit in the amount of \$4 million each as part of the collateral required for the two loans.
- Agreement showing the conveyance of a 9,152-acre permanent working conservation easement to DCNR.
- Documentation that Lyme Timber fully repaid interim funding obtained through another entity, which it needed to purchase a portion of the timberlands in December 2017, after receiving the PENNVEST funds.

Compliance with other funding agreement provisions requires PENNVEST to conduct periodic monitoring activities. We reviewed documents to confirm its staff has timely monitored Lyme Timber's compliance with those provisions during the audit period by doing the following:

- Annually reviewed Lyme Timber's financial statements to ensure the company has adequate cash flow to cover the debt service during the next fiscal year.

²⁷ Refer to the *Introduction and Background* section of this audit report for additional information regarding the Lyme Timber projects.

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- Obtained an appraisal of the land purchased with PENNVEST funds, due at least every three years after the loan closing date, to confirm that the fair market value of the land under agreement is not less than \$55 million.
- Tracked monthly payments to ensure Lyme Timber complies with the loan repayment provisions in the agreements.
- Received Lyme Timber's certifications from the Sustainable Forestry Initiative and the Forest Stewardship Council Program along with an onsite inspection of the land that was to be performed within three years of the loans' closing.

Although we found that PENNVEST adequately performed monitoring activities for the items above through April 30, 2022, certain activities were not completed due to the timing of the Acid Mine Drainage (AMD) remediation included in the Lyme Timber NPS projects. As part of the defined projects under the funding agreements, Lyme Timber was required to invest \$750,000 of its own funds to remediate the impact of AMD polluting streams at three sites within one tract of land it planned to purchase. Monitoring activities related to the AMD remediation work involve DEP inspections of the designed pollution control measures after installation; however, because work at the three sites was still in progress, no DEP inspections had been conducted as of October 2022. The agreements indicate that Lyme Timber will begin AMD remediation work in 2022 and complete the work by 2024.

Based on our review, it appears that PENNVEST has adequately monitored the Lyme Timber NPS projects through April 30, 2022.

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Finding 1 – Undefined terms in the PENNVEST Act resulted in PENNVEST broadly interpreting eligibility criteria and awarding \$50 million in low-interest loans for the Lyme Timber Projects.

As noted in the *Audit Procedures and Results* section, we selected and reviewed 7 of the 14 Nonpoint Source (NPS) Management Program projects that the Pennsylvania Infrastructure Investment Authority's (PENNVEST) Board of Directors (Board) approved during the audit period July 1, 2017, through June 30, 2018. We verified that all seven NPS projects were eligible. However, we determined that PENNVEST management used its administrative discretion to very broadly interpret certain undefined terms in Act 16 of 1988, the Pennsylvania Infrastructure Investment Authority Act (PENNVEST Act), to conclude that the two projects approved for Lyme Emporium Highlands II, LLC, an affiliate of The Lyme Timber Company LP (Lyme Timber), were eligible for PENNVEST financial assistance.²⁸ For simplicity, we will refer to both Lyme Timber projects as one project in this finding, which includes two separate loan funding agreements totaling **\$50 million**.

The concern about the Lyme Timber project being eligible for PENNVEST financial assistance was publicly discussed in a Pennsylvania House of Representatives committee meeting in March 2018. Specifically, much of the debate preceding the adoption of the House resolution requesting this audit hinged on the fact that the PENNVEST Act's definition of "Project" stipulates that an NPS project must be "... *all or part of any facility or system*..." to be eligible for project financing. The Act, however, fails to specifically define these terms or prohibit certain types of projects.²⁹ Under Section 1903(a) of the Statutory Construction Act (SC Act), "[w]ords and phrases" not defined in a statute that are not "technical words and phrases" are to be construed according to "their **common and approved usage**."³⁰ A "facility" or "system" could be "generally understood to be something that is built or engineered to work as a unit to accomplish a particular or common purpose authorized under the PENNVEST Act."³¹

²⁸ 35 P.S. § 751.1 *et seq.* (Act 16 of 1988, as amended).

²⁹ Pursuant to the PENNVEST Act, the definition of "Project" is as follows, in part: "[t]he eligible costs associated with the acquisition, construction, improvement, expansion, extension, repair, rehabilitation or security measures of **all or part of any facility or system**, whether publicly or privately owned: (1) for the collection, treatment or disposal of wastewater, including industrial waste; (2) for the supply, treatment, storage or distribution of drinking water; (3) for the control of pollution associated with storm water, which may include, but need not be limited to, the transport, storage and the infiltration of storm water; or (4) for the best management practices to address **pollution**, including **innovative techniques** developed to comply with...The Clean Streams Law, **or** identified in the county-prepared watershed plans pursuant to...the Storm Water Management Act, **or** as identified in Pennsylvania's Nonpoint Source Management Program Update, as required under section 319(b) of the Federal Water Pollution Control Act..." (Emphases added.) See 35 P.S. § 751.3, Definition of "Project" Subsection (4) in particular. As discussed in this finding, the terms "facility" and "system" are not defined in the PENNVEST Act.

³⁰ 1 Pa.C.S. § 1903(a). (Emphasis added.)

³¹ Pennsylvania House of Representatives Memorandum to Representative Donna Oberlander, Caucus Secretary, House Republican Caucus, and Representative Martin Causer, Chairman, House Committee on Agriculture, from Jim Mann, Deputy Chief Counsel (now Senior Deputy CC), House Republican Caucus, June 15, 2018.

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While the terms “facility” and “system” have been part of the definition of “Project” since the PENNVEST Act’s enactment, these vital terms were not defined or further clarified despite several amendments to the statute.³² We believe the common usage of the terms “facility” and “system” can be relied upon for most types of PENNVEST NPS projects. Examples of typical NPS projects include construction of a storm sewer inlet, installation of permeable pavement, retrofitting/replacing storm catch basins, and purchasing farmland identified as the source of pollutants released into the local watershed due to farming practices. **These projects are designed to address known pollution problems within a specifically defined facility or system** to improve water quality, and clearly comply with eligibility requirements in the PENNVEST Act.³³

The Lyme Timber project, however, was an **atypical** NPS project. Its primary purpose was to use PENNVEST loan funds to help finance the purchase of 37,205 acres of Pennsylvania timberlands where Lyme Timber planned to conduct timbering operations that would conserve the forests and protect the water quality of local streams from **potential pollution that could result from land development or changes in land usage**.³⁴ The Lyme Timber project did not significantly address known threats to water quality.³⁵

As previously stated, the concern with Lyme Timber receiving PENNVEST financial assistance stems from the definition of “Project” in the PENNVEST Act, which stipulates that an NPS project must be “... *all or part of any facility or system*...” to be eligible for project financing. For the Lyme Timber project however, the facility or system associated with the purchase of forest acreage is not clear, considering the *common and approved usage* of those terms in accordance with the SC Act.

According to PENNVEST management, the “system”, as it relates to the Lyme Timber project, pertains to “the geographic area where an eligible PENNVEST project can be implemented or constructed.” Specifically, it includes the 37,205 acres of land purchased using the PENNVEST funds. This very broad interpretation of the word “system,” as compared to the common usage of

³² The definition of “Project” was amended by Act 149 of 1992, Act 51 of 2005, and Act 16 of 2013, but the terms “facility” and “system” were not amended **nor** defined. See 35 P.S. § 751.3 *et seq.*

³³ 35 P.S. § 751.1 *et seq.* (Act 16 of 1988, as amended).

³⁴ Lyme Timber purchased more than 60,000 acres in total; however, PENNVEST funds were only used to purchase 37,205 acres for which the company planned to sell Working Forest Conservation Easements (WFCE) to prevent land development and changes to land usage. PENNVEST could declare the loans in default if Lyme Timber sold or subdivided the land during the 20-year loan terms.

³⁵ Although not part of its original plans, Lyme Timber agreed to commit up to \$750,000 to fund Acid Mine Drainage (AMD) remediation at three sites within the Sterling Run tract in exchange for the loans. While the AMD remediation component is more typical of NPS projects, committing up to \$750,000 for the work was a small fraction of the \$50 million loaned to finance the Lyme Timber project (less than two percent).

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the term noted above, was PENNVEST's rationale to conclude that the Lyme Timber project was eligible for the NPS loans using its administrative discretion.³⁶

While we agree that PENNVEST is able to use its administrative discretion to interpret the statutes it is charged with implementing, we question the broadness of PENNVEST's interpretation of the word "system" to constitute a "geographic area where an eligible project can be implemented or constructed." Based on that definition, it appears that project eligibility is practically limitless, which potentially renders the other limiting criteria for projects meaningless. We caution against this practice for future projects, as it may cause the public to question the limits that exist to ensure projects comply with the legislative intent of the PENNVEST Act, as well as the consistent application of management's interpretations.

Without legislative changes to define "facility" or "system", which are not currently defined in the act, we believe the eligibility of certain PENNVEST-approved NPS projects will continue to be questioned as PENNVEST uses its discretionary authority to very broadly interpret those terms. PENNVEST must award loans/grants to eligible projects according to the PENNVEST Act, and consistently interpret undefined terms, when necessary, but PENNVEST must also be cognizant of how potential litigation may result in courts determining the validity of its discretionary interpretations of the PENNVEST Act.

Recommendations for Finding 1

We recommend that PENNVEST work with the General Assembly to obtain its approval of amendments to the PENNVEST Act as follows:

1. Work collaboratively to amend **Section 751.3 (relating to Definitions)** of the PENNVEST Act to add comprehensive definitions of the terms "facility" and "system" that more clearly convey the legislative intent of the provision to offer funding assistance for NPS projects.³⁷
2. Consider adding a provision to the PENNVEST Act specifically prohibiting certain types of projects, such as NPS projects funded by PENNVEST, without meeting certain enumerated explicit conditions.

³⁶ "[A]n administrative agency's interpretation of a statute that the agency is charged to implement is entitled to 'strong deference' [i.e., broad discretion] unless it is clearly erroneous." *Moonlite Café, Inc. v. Dep't of Health*, 23 A.3d 1111, 1115 (Pa. Cmwlth. 2011) (citing *Borough of Ellwood City v. Pa. Labor Relations Bd.*, 998 A.2d 589, 594 (Pa. 2010); *Bethenergy Mines, Inc. v. Dep't of Env'tl. Prot.*, 676 A.2d 711, 715-16 (Pa. Cmwlth. 1996).

³⁷ 35 P.S. § 751.3.

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We recommend that PENNVEST management:

3. Sufficiently document and maintain for reference the basis for determining the eligibility of a project prior to Board approval when circumstances require management to interpret terms not specifically defined in the PENNVEST Act.

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Finding 2 – PENNVEST’s process for Board approval of NPS project funding offers appears automatic, by overly relying on management to determine eligibility and make recommendations.

House Resolution 948 of 2018 requested the Department of the Auditor General to audit the eligibility of Nonpoint Source (NPS) Management Program projects that had been approved by the Pennsylvania Infrastructure Investment Authority’s (PENNVEST) Board of Directors (Board).³⁸ We addressed eligibility in the *Audit Procedures and Results* section and our concerns regarding eligibility in *Finding 1* of this report. We also included within Objective 1 the need to evaluate PENNVEST’s process of approving loans and grants for NPS projects because the resolution also indirectly questioned why certain NPS projects received Board approval. Based on a hearing held by the Pennsylvania House of Representatives Agricultural and Rural Affairs Committee (Committee), the NPS projects in question were two related projects for Lyme Emporium Highlands II, LLC, an affiliate of The Lyme Timber Company LP (Lyme Timber).³⁹ These projects were **atypical** NPS projects as discussed in *Finding 1*. As a result, the focus of this finding, in part, relates to these two projects, but it also leads to a broader discussion about the Board and its responsibilities.

The Board unanimously approved two PENNVEST loans for the Lyme Timber NPS projects in October 2017 and January 2018.⁴⁰ However, questions regarding these projects surfaced after Board approval. Consequently, the Committee held an informational hearing in March 2018 to raise its concerns and obtain answers from the parties involved. The Board also questioned PENNVEST management at the April 2018 quarterly meeting.⁴¹ Two of the questions/concerns related to the following:

- Eligibility of the projects and
- Whether loaning \$50 million to Lyme Timber was the best use of public money to benefit the Commonwealth and the environment.

³⁸ See *Appendix B* to read House Resolution 948 of 2018, P.N.3585, session 2018, adopted on June 21, 2018, in its entirety.

³⁹ Ibid.

⁴⁰ Based on the October 18, 2017, PENNVEST Board meeting minutes, the Board postponed a vote on the Lyme Timber NPS project after a Board member sought more time to allow a state senator to evaluate the project, which is within the senator’s legislative district. The Board held a special meeting on October 27, 2017, and unanimously approved a loan offer of \$25,450,115, approximately half of the \$50 million Lyme Timber requested on its project application. Lyme Timber applied for the remainder of the funds after splitting the project into two projects. The PENNVEST Board unanimously approved a loan offer of \$24,549,885, for the second Lyme Timber project on January 31, 2018, which brought the total of both loans to \$50 million.

⁴¹ See *Appendix D* for a detailed timeline related to Lyme Timber’s application and receipt of PENNVEST loan funding for the Lyme Timber projects.

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These post-approval questions/discussions, especially by the Board itself, call into question whether the Board adequately vetted or evaluated the Lyme Timber projects prior to approving financial assistance. Based on the October 27, 2017, Board meeting minutes, only one question was asked in regard to whether Lyme Timber had other funding options, and no questions were asked during the January 31, 2018, meeting. Therefore, it appears the issues noted above were never publicly vetted or debated, which casts doubt on the sufficiency of PENNVEST's NPS project approval process. We consider these questions extremely relevant and appropriate. Indeed, it is surprising that they were not raised during Board meetings before the projects were approved.

PENNVEST management and staff review and process NPS project applications to send to the Board for approval. PENNVEST management determines project eligibility as part of its process and prepares Board Summary Reviews of eligible projects for Board members to review as described in the *Introduction and Background* section.⁴² Management acknowledged that only eligible projects are submitted for Board approval. Board Summary Reviews, however, do not present a rationale explaining why the project was deemed eligible. As such, Board members rely solely on PENNVEST management to determine project eligibility. Board members should clearly understand how management determined that each project is eligible to receive a PENNVEST funding offer, so it is considered before the Board approves funding offers. Requiring PENNVEST management to document its rationale for NPS project eligibility in the Board Summary Reviews would eliminate Board members' assumption of eligibility, may generate constructive debate, and would support the Board's decisions as well as ensuring that only quality projects that meet the legislative intent of the Act are funded.

In addition, according to PENNVEST's 2021-2022 Annual Report, since 2015-16, the Board has approved funding offers for every applicant that satisfied the following three criteria:⁴³

1. A complete application package was submitted for an **eligible project** prior to the cut-off date for Board consideration.
2. The Pennsylvania Department of Environmental Protection (DEP) determined the application and project design to be technically complete.
3. The project was ready to start construction in a timely fashion.

This acknowledgement, coupled with the Board's over-reliance on management to determine project eligibility and incomplete description of the Lyme Timber projects' assessment results from DEP fosters the appearance that automatic approvals may have occurred for the Lyme

⁴² See *Appendix E* for the Lyme Timber NPS project Board Summary Review PENNVEST management prepared for the Board meeting on October 18, 2017.

⁴³ PENNVEST Annual Report for 2021-2022, page 13 <https://www.pennvest.pa.gov/about-us/Pages/Publications.aspx> (accessed January 25, 2023).

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Timber projects.⁴⁴ The Board should adequately scrutinize, deliberate, and discuss every eligible NPS project prior to approving a funding offer.

The Board has the responsibility to approve or reject financial assistance for NPS projects at its discretion.⁴⁵ As a best business practice in the interest of taxpayers, PENNVEST management and the Board should consider whether each eligible project is a prudent use of public funds before approving a funding offer regardless of having funds available. This best practice addresses the second post-approval concern noted above in relation to the two Lyme Timber projects.

Documenting the bases of the Board's approvals of NPS project funding offers provides credibility for its decision-making and shows the best use of taxpayer funds was considered during the review and approval process. The Board Summary Review information prepared by PENNVEST management plays a critically important role in the process and must accurately reflect the assessment information provided by DEP and the Pennsylvania Department of Community and Economic Development's (DCED). As part of our review of the Lyme Timber projects, we identified certain comments from DEP were omitted from the Lyme Timber's Board Summary Reviews.

PENNVEST Failed to Include Comments from DEP's Assessments of the Lyme Timber NPS Projects in its Board Summary Reviews⁴⁶

We compared the information PENNVEST management presented in both Lyme Timber Board Summary Reviews with information from DEP's technical review of the projects, DCED's assessments, and other related documentation. As shown in the Board Summary Review column of the table below, Board members received the alpha descriptors, rather than the numeric scores from the DEP and DCED assessments of the Lyme Timber projects. For example, a DEP score of "0" for Water Quality equates to "No Impact" on the Board Summary Review. We found that the assessment results presented in Lyme Timber's Board Summary Reviews accurately reflected DEP's and DCED's review scores, as follows:

⁴⁴ Although PENNVEST ranks projects based on scoring, PENNVEST's ability to fund all projects that met these criteria rendered the project ranking irrelevant. See PENNVEST's NPS project scoring process in *Appendix C*.

⁴⁵ The Board has the authority to provide financial assistance under Subsection 8 (and Subsection 18) of Section 751.6 (relating to Powers and duties of authority) of the PENNVEST Act, and conversely, the Board can reject such financial assistance at its discretion despite the availability of funding.

⁴⁶ The October 2017 Board Summary Review document can be found in *Appendix E*.

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Board Summary Reviews Versus DEP/DCED Review Scores

Rating Factor (Possible Points)	Lyme Timber Project					
	Funding Request-1 (October 2017)			Funding Request-2 (January 2018)		
	Board Summary Review*	DEP Review Score	DCED Review Score	Board Summary Review*	DEP Review Score	DCED Review Score
Water Quality (0-30)	NI	0	-	NI	0	-
Planning (0-30)	NI	0	-	M	13	-
Benefit-to-Cost (1-30)	L	1	-	L	1	-
Public Safety (0-5)	NI	0	-	NI	0	-
Compliance (0-10)	NSDI	0	-	NSDI	0	-
Economic Development (5,10,15)	M	-	10	M	-	10
Total (6-120)	-	1	10	-	14	10

*- PENNVEST management explained that DEP and DCED scores are converted to alpha descriptors for the Board Summary Reviews as historically requested by Board members. Alpha descriptors: NI- No Impact; L- Low; M- Medium; H- High; and NSDI- No Significant Detrimental Impact.

Source: Developed by Department of the Auditor General staff from PENNVEST Board Summary Reviews and DEP and DCED NPS Project Rating Forms for the Lyme Timber projects.

During our review of the NPS project scoring process, PENNVEST management pointed out that DEP's and DCED's project assessment scoring used to rank the eligible projects is irrelevant when funding is available for all of the projects. While we agree that all eligible projects that could be funded should be presented to the Board for consideration, we want to emphasize that it does not negate the Board's responsibility to weigh the merits of each project before approving funding offers. For example, the Board should determine whether approving projects that received low assessment scores, such as the Lyme Timber projects, is the best use of PENNVEST funds, even though funding is available. If the available project funds had been insufficient to offer funding assistance for every NPS project sent to the Board for the October 2017 and January 2018 meetings, the Lyme Timber projects would probably not have been provided to the Board for consideration because the low scores ranked these projects at the bottom of the list.⁴⁷

Although the alpha descriptors accurately reflect DEP's and DCED's scores, we found that Lyme Timber's Board Summary Reviews did not include DEP's review comments to explain

⁴⁷ See the *Audit Procedures and Results* section of this report for a table listing other NPS project scores.

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DEP's low-scoring assessment results. The additional information would have provided Board members with a better understanding of the project scoring and impact of the NPS projects, especially related to water quality benefits. Several comments from DEP's assessment that we believe would have been appropriate to provide the Board members for consideration include the following:

- Water Quality Rating: *Only a very small part of the project is related to the stream's impairment. This project will protect water quality but will not have a direct and substantial water quality benefit.* (Score: 0 points)
- Planning Rating (October 2017 Funding Request): *No prior experience with similar funding requirements. This project is not part of any WQ [Water Quality] plans.* (Score: 0 points)
- Benefit-to-Cost Rating: *The project will potentially protect water quality. A small portion could possibly improve water quality. The cost is very high for a NPS project.* (Score: 1 point)

We found instead that PENNVEST management used strongly favorable project descriptions in Lyme Timber's Board Summary Reviews regarding water quality benefits and benefit-to-cost of the NPS projects. For example, in contrast to DEP's comments above, the Board Summary Reviews described the project's water quality benefit as, "...[doing] the most for water quality protection since these are the originating waters for all larger downstream water bodies...".⁴⁸ They also described the benefit-to-cost as, "[t]here is no more effective, or cost-effective way to keep streams protected than protecting the forests around them."⁴⁹ PENNVEST took these descriptions verbatim from an email sent by the Pennsylvania Department of Conservation and Natural Resources (DCNR) to express DCNR's interest in the proposed land acquisitions Lyme Timber hoped to partially finance using the PENNVEST funds.⁵⁰

For comparison, we reviewed the NPS project descriptions PENNVEST management used in the Board Summary Reviews for five other NPS projects approved during the fiscal year ended June

⁴⁸ PENNVEST Board Summary Review, Lyme Pennsylvania Headwaters/Sterling Run Conservation and Restoration, Project ID: 12006031708-CN, October 18, 2017. *See Appendix E.*

⁴⁹ PENNVEST Board Summary Review, Lyme Pennsylvania Headwaters/Sterling Run Conservation and Restoration, Phase Two, Project ID: 12006041710-CN, January 31, 2018.

⁵⁰ As described in the *Introduction and Background* section, Lyme Timber initially contacted DCNR to obtain funding for its projects through sales of Working Forest Conservation Easements (WFCE) to DCNR. Although DCNR desired to purchase WFCEs for the lands Lyme Timber planned to purchase, it lacked available funds to purchase WFCEs. DCNR then facilitated discussions between Lyme Timber and PENNVEST to determine if Lyme Timber would be eligible for PENNVEST financial assistance to purchase the lands. As the process moved forward and Lyme Timber prepared to submit a PENNVEST application, DCNR helped Lyme Timber identify water quality improvement projects to incorporate into the application and provided PENNVEST an email summary of DCNR's interest in Lyme Timber's land acquisitions, which would be funded partially with the PENNVEST loan funds. PENNVEST used some of the descriptions from DCNR's email verbatim as the project descriptions on the Lyme Timber Board Summary Reviews.

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30, 2018.⁵¹ Contrary to the Lyme Timber projects, PENNVEST included descriptions similar to DEP's comments from its technical reviews of the projects. We believe that it is important to provide accurate information with respect to DEP and DCED project review assessments, so Board members have a complete understanding of the projects and extent of the benefits expected for the commonwealth before they approve PENNVEST funding offers.

Recommendations for Finding 2

We recommend that the PENNVEST Board:

1. Diligently review every NPS project PENNVEST management submits with a recommended funding offer for Board approval.
2. Require PENNVEST management to revise the Board Summary Review to include how each NPS project qualifies as eligible for the funding offer being recommended.

We recommend that PENNVEST management:

3. Provide sufficient information to its Board about NPS projects recommended to receive PENNVEST funding offers so Board members have a complete understanding of the projects, how they align with PENNVEST's mission, and comply with the PENNVEST Act before voting to approve funding offers.
4. Ensure the Board Summary Reviews present accurate information contained in the DEP and DCED assessments for each NPS project it recommends.

⁵¹ See the *Audit Procedures and Results* section for a description of our review of the NPS projects approved during the fiscal year ended June 30, 2018.

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Pennsylvania Infrastructure Investment Authority's Response and Auditor's Conclusion

We provided copies of our draft audit findings and related recommendations to the Pennsylvania Infrastructure Investment Authority (PENNVEST) for its review. On the pages that follow, we included PENNVEST's response in its entirety. Following the agency's response is our auditor's conclusion.

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Audit Response from the Pennsylvania Infrastructure Investment Authority

AGENCY RESPONSE OF THE PENNSYLVANIA INFRASTRUCTURE INVESTMENT AUTHORITY

TO

THE DEPARTMENT OF THE AUDITOR GENERAL'S DRAFT PERFORMANCE AUDIT REPORT

Pennsylvania Infrastructure Investment Authority

Nonpoint Source Management Program Projects

MARCH 2, 2023

This Agency Response serves as the Pennsylvania Infrastructure Investment Authority's ("PENNVEST") formal response and rebuttal to the Department of Auditor General's ("Department") Draft Performance Audit Report dated March 2, 2023. By Initial Information Request No.1, September 1, 2021, the Department initiated a Performance Audit to, generally, evaluate the PENNVEST Nonpoint Source ("NPS") Management Program. The Department's performance audit arose from a resolution by the Pennsylvania House of Representatives "Requesting the Auditor General to conduct a financial audit of the nonpoint source program projects approved by the Pennsylvania Infrastructure Investment Authority."¹ After fifteen (15) total Information Requests and nearly eighteen (18) months of investigating, the Department issued its Draft Performance Audit Report. The Department's stated objectives for the performance audit were: 1) to evaluate PENNVEST's process for determining eligibility of NPS projects; and, 2) to evaluate PENNVEST's monitoring activities related to two loans made to Lyme Emporium Highlands II, LLC, an affiliate of The Lyme Timber Company LP ("Lyme Timber").²

In its Draft Performance Audit Report, the Department conclusively states that it "verified that all seven³ NPS projects (including the two Lyme Timber projects) were eligible."⁴ The Department also conclusively states in its Draft Performance Audit Report that PENNVEST adequately

¹ H. Res. 948 of 2018, Jun. 21, 2018.

² The Department concluded that PENNVEST adequately monitored the Lyme Timber projects. COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 7.

³ The Department reviewed seven (7) NPS projects including the two Lyme Timber projects in its general review of PENNVEST's NPS Management Program. See COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 12.

⁴ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 17 at ¶1.

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monitored the Lyme Timber Projects.⁵ PENNVEST agrees with the Department's conclusions in both these instances. The Lyme Timber projects and all 7 of the NPS projects are eligible for funding under the applicable statutes, regulations, policies and procedures and the Lyme Timber projects have been adequately monitored by PENNVEST as required by the terms of their funding.

PENNVEST administers the two Federal state revolving loan funds (SRFs) in Pennsylvania and one nonfederal revolving loan fund. The default rate on over \$11.2B of PENNVEST funding awards is under .33%. PENNVEST is a national leader in its innovation, management and oversight of the SRFs. PENNVEST's leadership has again been recognized with the Lyme Timber projects receiving the Pisces award in 2019 from U.S. EPA for innovation and use of the SRF. The PENNVEST program has been structured to eliminate political and personal bias. Projects are considered based upon priority ranking, loan and grant awards are based upon financial need and interest rates are set by our statute.

Despite having concluded that the objectives to the audit were satisfied, no NPS project was ineligible for funding and the Lyme Timber projects were and are adequately monitored, the Department has provided a Draft Audit Performance Report which includes two findings: 1) that undefined terms in the PENNVEST Act resulted in a broad interpretation of eligibility related to the Lyme Timber projects;⁶ and, 2) that PENNVEST's Board approval process appears automatic and overly reliant on staff recommendations.⁷

PENNVEST disagrees with the Department's findings for all reasons articulated below:
(The order of discussion below follows the order set forth in the Department's Draft Performance Report)

Agency Response to Audit Procedures and Results

On Page 12 of the Audit Report, the Department states as follows:

We further reviewed the sufficiency of information PENNVEST management shared with its Board members before it approved the recommended funding offers for the seven selected NPS projects. We found that management did not provide the rationale used to determine projects eligibility in the documents sent to the Board. Therefore, members rely solely on PENNVEST management to properly determine project eligibility. It is important that the rationale be included with the project information, so Board members understand how NPS projects are eligible for funding. This may have prevented questions raised about eligibility of the Lyme Timber projects after the Board had approved funding offers and given the appearance of automatic approval by the Board.

COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE
PA. INFRASTRUCTURE INV. AUTH. 12.

⁵ See *supra* at fn. 2.

⁶ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 17 at ¶1.

⁷ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 31-35.

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PENNVEST staff has identified inaccuracies with the statement above which must be addressed:

- 1) The determination of project eligibility is a job duty that has been delegated by the Board to staff by resolution approved by the Board on June 8, 1988 and the agency's Bylaws. Project eligibility is strictly governed by a) applicable federal statutes, b) applicable federal regulations, c) U.S. EPA-approved federal policies and guidance, d) the PENNVEST Act, d) the PENNVEST regulations, e) PENNVEST Board-approved program guidance and f) PENNVEST's operational policies and procedures. In addition, the Board has approved ranking criteria specific to each project type, which are incorporated into the operational policies and procedures applied by staff in processing all funding applications.
- 2) Staff only take projects that are being recommended for approval to the PENNVEST Board for consideration. Staff does not recommend ineligible projects for consideration by the Board.
- 3) Over the past thirty-five years, staff and the Board have worked together to fine tune the information the Board members have found relevant to allow them to timely and efficiently review each project coming before the Board for consideration. As the Board requests changes to the Board Summary Review, staff responds making either changes to individual project summaries or by creating new reports that convey the information our Board members find relevant to their review of the matters on which they are being asked to vote or the projects they are being asked to approve.

Your assessment that the Board members rely on PENNVEST staff to determine eligibility is correct. As staff, that is our job, as assigned by our governing body. The determination of project eligibility is an operational matter, not a governance matter, and by industry standard is properly handled at the operational level.

The Department concludes that it is important to include the rationale for determining project eligibility in the summary of information provided to the Board on each NPS project application. Although industry-standard best practices allow the Board to delegate operational matters like determining project eligibility to staff and do not require the Board to review every decision made by staff, PENNVEST staff will discuss the Department's recommendation with the Board.

Agency Response to Finding 1

In Finding 1, the Department makes the assumption that the failure to define "facility" or "system" as it relates to nonpoint source projects funded by PENNVEST was an oversight by the Legislature and that the **common and approved usage** of the terms "facility" or "system" can only be "generally understood to be something that is built or engineered to work as a unit to accomplish a particular or common purpose authorized by the PENNVEST Act".⁸ The definition of "facility" or "system" adopted by the Department was posited in a memorandum issued by Jim Mann,

⁸ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 15 at ¶12.

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Deputy Chief Counsel (now Senior Deputy CC) for the House Republican Caucus, to Representative Donna Oberlander on June 15, 2018.⁹ The Department goes on to cite public discussion in a Pennsylvania House of Representatives committee meeting in March 2018 purportedly around the definition of Project, the meaning of “facility” or “system” and the resulting impact on the eligibility of the Lyme Timber projects.¹⁰ The Department concludes that in order to determine the Lyme Timber projects were eligible under the definition of Project in Section 751.3 of the PENNVEST Act¹¹, PENNVEST had to stretch and use its administrative discretion very broadly to interpret the definition of “facility” or “system”,¹² to make the Lyme Timber projects fit within the definition of Project under Section 751.3.¹³

Simply put, PENNVEST disagrees. PENNVEST did not stretch the definition, or broadly interpret “facility” or “system”, in an effort to make the Lyme Timber projects eligible. Rather, the Legislature explicitly directed PENNVEST to fund such best management practices in 2013 in order to fully utilize the Clean Water State Revolving Fund (“CWSRF”) in the manner most needed in the Commonwealth to best impact water quality in our ecosystem, and the agency was carrying out its duties as instructed by the Legislature and the PENNVEST Board to fund the same.

PENNVEST functions as a bank, not the environmental arm of the Commonwealth or the Legislature. PENNVEST is not the arbiter of what is an appropriate environmental best management practice with a water quality impact on the Commonwealth’s “ecosystem” warranting inclusion in Pennsylvania’s Nonpoint Source Management Program Update. Nor does PENNVEST enact legislation. PENNVEST funds eligible projects, in accordance with the parameters of legislation, regulation and guidelines. The agency follows the direction and intent of the Legislature at the time of enactment of the legislation and the direction of the DEP in working toward the implementation of projects identified by the Commonwealth, and approved by the U.S. EPA, on the Nonpoint Source Management Plan Update.

Agency Position: The PENNVEST Act was amended by Act 16 of 2013 to clearly and precisely define eligible projects to include any and all BMPs addressing pollution that are identified in Pennsylvania’s Nonpoint Source Management Program Update, commonly known as Pennsylvania’s Nonpoint Source Management Plan. Each BMP identified in Pennsylvania’s Nonpoint Source Management Plan has a water quality impact on the Commonwealth’s “ecosystem”.

⁹ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 15 at fn 30.

¹⁰ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 15 at ¶2.

¹¹ 35 P.S. § 751.3 (Act 16 of 1988).

¹² COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 15 at ¶2; *Id.* at 16, ¶4; *Id.* at 17 ¶1; *Id.* at 17 ¶2.

¹³ *Ibid.*

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Background

The Act 16 of 2013 amendments revised the definition of Project under the PENNVEST Act to include:

The eligible costs associated with the acquisition, construction, improvement, expansion, extension, repair, rehabilitation or security measures of all or part of any facility or system, whether publically or privately owned:

...

(4) for the best management practices to address pollution, including innovative techniques developed to comply with the act of June 22, 1937 (P.L. 1987, No. 394), known as the Clean Streams Law, or identified in the county-prepared watershed plans pursuant to the act of October 4, 1978 (P.L. 864, No. 167), known as the Stormwater Management Act, or as identified in Pennsylvania's Nonpoint Source Management Program Update, as required under section 319(b) of the Federal Water Pollution Control Act (62 Stat. 1155, 33 U.S.C. § 1329 (b)).

35 P.S. § 751.3 (emphasis added).

In addition, Act 16 of 2013 added the following language to Section 751.10, relating to Financial Assistance:

(b.2) Nonpoint source management program projects. – A project that is consistent with Pennsylvania's Nonpoint Source Management Program Update, as required under section 319(b) of the Federal Water Pollution Control Act (62 Stat. 1155, 33 U.S.C. § 1329 (b)), that has a water quality benefit as determined by the department, shall be eligible for funding.

35 P.S. § 751.10.

Under Pennsylvania law, legislative intent must be derived from the plain language of a statute or regulation. Where there is ambiguity or where the language is subject to differing interpretations, we must look to the intention of the legislators who enacted the statute. While PENNVEST believes that the plain language outlined above clearly indicates that PENNVEST's non-point source program operates appropriately, we will, for the sake of this Audit, provide additional support for our position. To further determine the Legislature's intent in enacting Act 16 of 2013, we must look to the intent of the 2013 General Assembly, not a memorandum drafted by the Deputy Chief Counsel of the House Republican Caucus in 2018.

To best understand the relevant legislative intent, it is helpful to understand the history of the definition of a PENNVEST-eligible project and what precipitated the passage of the Act 16 of 2013 amendments. The Pennsylvania General Assembly established the Pennsylvania Infrastructure Investment Authority under Act 16 of 1988 (the "PENNVEST Act")¹⁴ to assist in financing projects to protect the health and safety of the citizens of the Commonwealth of

¹⁴ 35 P.S. § 751.1 *et seq.* (Act 16 of 1988, as amended).

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Pennsylvania and to promote economic development.¹⁵ PENNVEST has been tasked with financing projects as defined in Section 751.3 of the PENNVEST Act.¹⁶ The definition of project was amended in 1992 to allow PENNVEST to finance stormwater projects.¹⁷ The definition of project was further amended in 2013 to allow PENNVEST to finance best management practices to address pollution, including innovative techniques developed to comply with the Clean Streams Law, the Storm Water Management Act, or as identified in Pennsylvania's Nonpoint Source Management Program Update under section 319(b) of the Federal Water Pollution Control Act.¹⁸

The PENNVEST senior leadership team has been with the agency for most, if not all, of the agency's thirty-five year existence, and participated directly (along with DEP) in the review of the draft legislation for Act 16 of 2013, providing comment and input, the initial implementation of the changes brought about by Act 16 of 2013, and the continued implementation of the Act 16 of 2013 amendments over the last ten years. It is also critical to understand PENNVEST's close connection with DEP as the Commonwealth's environmental arm, and the U.S. EPA who administers the federal funding under section 319(b) of the Federal Water Pollution Control Act (62 Stat. 1155, 33 U.S.C. § 1329 (b)) and approves each State's Nonpoint Source Management Plan. PENNVEST staff is in continuous interaction with the DEP and the U.S. EPA to understand ever-changing funding requirements and opportunities for the states, evolving project eligibilities under the nation's State Revolving Fund Programs and the funding priorities of the U.S. EPA and the Commonwealth to align the financing priorities and eligibilities for our clean water initiatives in Pennsylvania. Staff participates monthly, if not weekly, in training opportunities with U.S. EPA to stay abreast of ever-changing nuances related to the State Revolving Fund Programs.

As an agency, PENNVEST has had two very prominent goals over the years, which came to the forefront at the time Act 16 of 2013 was passed. First, the Commonwealth through DEP, its environmental arm, and PENNVEST, its bank, should be in a position to take advantage of all funding available to the it under U.S. EPA's Clean Water and Drinking Water State Revolving Fund Programs, to ensure that Pennsylvania is not disadvantaged compared to other states. Second, nonpoint source projects are a critical component to improving the Commonwealth's water quality, albeit more difficult to implement since they are not directly regulated like point sources of pollution and the nonpoint source BMPs are most often not structural. Recognizing that nonpoint source pollution is the leading remaining cause of water quality problems,¹⁹ it follows that the successful implementation of these projects has the biggest impact on improving water quality in the Commonwealth of Pennsylvania.

In his December 24, 2012 Memorandum to the Pennsylvania Senate, Senator Donald C. White, the primary sponsor of Act 16 of 2013, referred to the need to expand the capability of PENNVEST to fund nonpoint source remediation projects to more effectively utilize federal monies provided by the Clean Water State Revolving Fund.²⁰ Senator White goes on to explain that under the Clean

¹⁵ 35 P.S. § 751.2(7) (Act 16 of 1988).

¹⁶ 35 P.S. § 751.3 (Act 16 of 1988).

¹⁷ The definition of Project was amended by Act 149 of 1992. *See* 35 P.S. § 751.3 *et seq.*

¹⁸ The definition of Project was amended by Act 16 of 2013. *See* 35 P.S. § 751.3 *et seq.*

¹⁹ <https://www.epa.gov/nps/basic-information-about-nonpoint-source-nps-pollution> (accessed Feb. 22, 2023).

²⁰ PA. SEN. DONALD C. WHITE, MEMORANDUM TO ALL SENATE MEMBERS, Dec. 24, 2012.

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Water State Revolving Fund, PENNVEST is allowed to fund certain nonpoint source projects as developed under Section 319 of the Clean Water Act, and that pursuant to the Clean Water Act, each state develops its own Section 319 Plan, subject to the approval of the United State Environmental Protection Agency.²¹ Senator White emphasizes that “To effectively utilize the CWSRF for implementation of the Section 319 plan, we must change our current legislation[.]”, and that the proposed changes will allow PENNVEST to fund the nonpoint source activities that are identified under the Commonwealth’s Section 319 plan.²² The 319 plan and the heretofore Nonpoint Source Management Plan Update, are the same plan.

Rules of Statutory Construction

With the factual background in mind, we turn to the Department’s interpretation of PENNVEST’s enabling legislation and why that interpretation must fail as being inconsistent with the plain language of the statute, in conflict with the legislative intent and in opposite to the interpretation compelled by the rules of statutory construction.

The Department opines that the Legislature’s failure to specifically define the terms “*facility*” or “*system*” as it relates to the nonpoint source projects creates confusion as to whether PENNVEST has the authority to fund all nonpoint project source projects identified in Pennsylvania’s Nonpoint Source Management Plan, and calls into question the Board’s unanimous approval of both Lyme Timber funding applications.²³

As it relates to the Department’s Audit Finding Number 1, there are two options for interpreting the Act 16 of 2013 amendments to the PENNVEST Act: 1) the words “*facility*” or “*system*” restrict or limit PENNVEST’s authority to fund nonpoint sources projects, or 2) the words “*facility*” or “*system*” do not restrict or limit PENNVEST’s authority to fund nonpoint source projects.

While the Department cites the common and approved usage rule of statutory construction²⁴, it fails to consider the actual common definition of “*facility*” or “*system*” as those terms relate to nonpoint source best management practices the Legislature intended PENNVEST to incentivize as a result of the Act 16 of 2013 amendments.

1. Words Clear and Free from Ambiguity

The rules of statutory construction provide that, “When the words of a statute are clear and free from ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its intent.”²⁵ It is PENNVEST’s position that the language of Section 751.10(b.2) of the PENNVEST Act could not be more clear, a project that is consistent with Pennsylvania’s Nonpoint Source Management

²¹ Ibid.

²² Ibid.

²³ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 17 at ¶2.

²⁴ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 15 at ¶2.

²⁵ 1 Pa.C.S.A. § 1921(b) (Act 290 of 1972).

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Plan, that has a water quality benefit (as determined by DEP), shall be eligible for funding.²⁶ PENNVEST fails to see how any reasonable party could interpret this language to omit any project that is consistent with the 319 Plan. Of note, the 319 Plan expressly includes forestry/silviculture projects.

2. Words Shall be Construed According to Their Common and Approved Usage

Even assuming that the language contained in Section 751.10(b.2) of the PENNVEST Act is unclear, the common and approved usage of the term “system” is consistent with and supports the agency’s authority to fund all nonpoint project source projects identified in Pennsylvania’s Nonpoint Source Management Plan.

It appears Mr. Mann’s June 15, 2018 memorandum relied solely on a definition of “facility” when he stated that a facility or system can be “generally understood to be something that is built or engineered to work as a unit to accomplish a particular or common purpose authorized by the PENNEVST Act”.

Merriam-Webster defines “facility” as “something that is built, installed or established to serve a particular purpose”.²⁷ ²⁸ Merriam Webster defines “system” as, “a regularly interacting or interdependent group of items forming a unified whole”, or a “group of related natural objects or forces, such as a river system”.²⁹ Mr. Mann appears to conclude, and the Department appears to assert, that only manmade permanent construction can constitute a “facility” or “system” under the PENNVEST Act. PENNVEST disagrees.

As explained to the Department in PENNVEST’s Responses submitted to Audit Inquiry Request numbers 9 and 12, dated January 28, 2022 and February 24, 2022 respectively, an ecosystem is an example of a “*system*”³⁰. PENNVEST, the DEP and EPA have consistently treated natural environmental and green infrastructure as eligible projects being part of our ecosystem in Pennsylvania. For purposes of the Lyme Timber projects, an ecosystem consisting of hundreds of acres of plant and animal life and the groundwater and tributaries on the land fall squarely under the definition PENNVEST is directed to apply under the expanded definition of Project in Act 16 of 2013. An “Ecosystem” is defined by Merriam Webster to include, “the complex of a community of organisms and its environment functioning as an ecological unit”.³¹ It is important to emphasize the definition of Project includes all or part of any “*facility*” *or* “*system*” intending these to be two different things. Mr. Mann and the Department’s adoption of his position seem to only consider the structural definition of facility.

²⁶ 35 P.S. § 751.10(b.2) (Act 16 of 1988, as amended by Act 16 of 2013).

²⁷ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 15 at ¶2.

²⁸ <https://www.merriam-webster.com/dictionary/facility> (accessed Feb. 24, 2023).

²⁹ <https://www.merriam-webster.com/dictionary/system> (accessed Feb. 22, 2023).

³⁰ See PA. INFRASTRUCTURE INV. AUTH., RESPONSES TO THE COMMONWEALTH OF PA. DEP’T OF AUDITOR GEN., PERFORMANCE AUDIT INFO. REQ. NO. 9, Jan. 28, 2022; see COMMONWEALTH OF PA. DEP’T OF AUDITOR GEN., PERFORMANCE AUDIT INFO. REQ. NO. 12, QUESTION 9(C), Feb. 24, 2022.

³¹ <https://www.merriam-webster.com/dictionary/ecosystem> (accessed Feb. 22, 2023).

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The Department states that the system being benefitted by the implementation of the PENNVEST-funded best management practices is unclear.³² We disagree. The best management practices being implemented on the Lyme Timber forest land will benefit the local waterways, as confirmed by DEP, and together with the interrelated parts of the related forces of water work together to form “all or part of any system” (in this case part of the overall ecosystem) in the geographic area.

3. *Give Effect to All Provisions*

Under 1 Pa. C.S.A. § 1921(a), “The object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly.” This provision goes on to state that “Every statute shall be construed, if possible, to give effect to all its provisions (emphasis added).”³³ By interpreting “all or part of any system” as set forth in subsection B above, we are able to give full force and effect to Section 751.10(b.2) of the PENNVEST Act, allowing PENNVEST to fund all nonpoint project source projects identified in Pennsylvania’s Nonpoint Source Management Plan. If, on the other hand, we adopt Mr. Mann’s definition of “system”, we will be limiting PENNVEST’s ability to fund nonpoint source projects to those projects that are being performed on “something that is built or engineered to work as a unit”, which implies that PENNVEST is only authorized to fund best management practices which are structural in nature. The interpretation of “facility” or “system” that has been relied upon by the Department as the basis for Finding 1 does not allow PENNVEST to give full effect to the plain language in Section 751.10(b.2) of the PENNVEST Act.

4. *Irreconcilable Clauses*

Even if the Department found that the definition of Project under Section 751.3 of the PENNVEST Act and Section 751.10(b.2) of the PENNVEST Act were irreconcilable, meaning the former placed some restriction on PENNVEST’s authority to fund nonpoint sources projects, and the latter did not, Section 1934 of the rules of statutory construction provides that, “whenever, in the same statute, several clauses are irreconcilable, the clause last in order of date or position shall prevail.”³⁴ This rule of statutory construction would also bode in favor of PENNVEST having the statutory authority to fund all nonpoint project source projects identified in Pennsylvania’s Nonpoint Source Management Plan update as stated clearly and precisely in Section 751.10(b.2) of the PENNVEST Act.

5. *Legislative Intent Controls*

The rules of statutory construction go on to state that

When the words of the statute are not explicit, the intention of the General Assembly may be ascertained by considering, among other matters:

- (1) The occasion and necessity for the statute.
- (2) The circumstances under which it was enacted.

...

³² COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 16 at ¶3.

³³ 1 Pa.C.S.A. § 1921(a) (Act 290 of 1972).

³⁴ 1 Pa.C.S.A. § 1934 (Act 290 of 1972).

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(4) The object to be attained.

....

(6) The consequences of a particular interpretation. [. . .]

1 Pa.C.S.A. § 193

Finally, the rules of statutory construction provide that”

In ascertaining the intention of the General Assembly in the enactment of statute, the follow presumptions, among others, may be used:

- (1) That the General Assembly does not intend a result that is absurd, impossible of execution or unreasonable.
- (2) That the General Assembly intends the entire statute to be effective and certain.

...

(5) That the General Assembly intends to favor the public interest as against any private interest.³⁵

1 Pa.C.S.A. § 1922.

As stated in the *Background* section, the clear intent of the Act 16 of 2013 amendments was to take full advantage of all funding available to Pennsylvania under the Clean Water State Revolving Fund to perform best management practices under an EPA-approved Nonpoint Source Management Plan.³⁶

To conclude that the words “*all or part of any facility or system*” limits PENNVEST’s authority to fund only best management practices that are structural in nature, would significantly restrict the Commonwealth’s ability to finance and incentivize the projects set forth in Pennsylvania’s Nonpoint Source Management Plan Update, effectively limiting the Commonwealth’s ability to: a) target much needed pollution reduction efforts coming from nonpoint sources; and, b) maximize/exploit the use of available federal funds authorized for such uses, essentially turning those funds away from Pennsylvania to other states who would welcome the windfall. It cannot be ignored that PENNVEST’s authority to fund all nonpoint project source projects identified on Pennsylvania’s Nonpoint Source Management Plan, or the definition “*all or part of any facility or system*” have not been called into question in the ten years since Act 16 of 2013 was passed. As indicated in 1 Pa. C.S.A. § 1922 (5), PENNVEST would suggest that we favor the public interest in maximizing the improvement of water quality in the Commonwealth in interpreting the intent of the Act 16 of 2013 amendments.³⁷

³⁵ 1 Pa.C.S.A. § 1922 (Act 290 of 1972).

³⁶ PA. SEN. DONALD C. WHITE, MEMORANDUM TO ALL SENATE MEMBERS, Dec. 24, 2012.

³⁷ 1 Pa.C.S.A. § 1922(5) (Act 290 of 1972).

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PENNVEST must address a misrepresentation of PENNVEST's funding criteria. On page 16 of its findings, the Department seems to imply that PENNVEST nonpoint source funding is limited to projects "designed to address known pollution problems." As examples of nonpoint source projects that address known pollution problems, the Department states that "typical NPS projects include construction of a storm sewer inlet, installation of permeable pavement, retrofitting/replacing storm catch basins, and purchasing farmland[.]" The Department further states that "The Lyme Timber project, however was an atypical NPS project" before concluding that "The Lyme Timber project did not significantly address known threats to water quality."³⁸

Not only do these statements misrepresent PENNVEST's mission and eligibility criteria, they reveal a fundamental lack of understanding by the Department regarding the differences between stormwater management, nonpoint source projects, and best management practices intended to address nonpoint source project needs. PENNVEST's mission, within the constraints of its enabling statute, is to fund projects with a demonstrable **water quality impact** on the health and wellbeing of Commonwealth residents. Significant portions of PENNVEST's funding goes to preventative infrastructure upgrades that do not address a known threat, to new construction that is intended only to produce financial benefits, or to provide for other benefits that cannot be tied to a known threat. In short, the Department devotes significant energy to painting the Lyme Timber project as a novel project that represents an impermissible expansion of PENNVEST eligibility, only at the end to state they recognize the Lyme Projects as eligible.

Based on the foregoing, PENNVEST believes that the Legislature enacted Act 16 of 2013 to amend the PENNVEST Act to clearly, precisely and definitively provide PENNVEST with the full authority to fund all nonpoint project source projects identified on Pennsylvania's Nonpoint Source Management Plan, that have a water quality impact, as required by the PENNVEST Act, and that any request from PENNVEST to the Legislature to specifically prohibit certain types of projects, without meeting certain enumerated explicit conditions not already contained in the PENNVEST Act, would be a serious detriment to the Commonwealth's efforts to remediate the leading remaining cause of water quality problems in Pennsylvania.³⁹ Notwithstanding the foregoing, PENNVEST staff will present the response of this Draft Performance Audit Report to the PENNVEST Board for their input and consideration of the need for a statutory amendment.

With regard to the Department's recommendation that PENNVEST sufficiently document and maintain for reference the basis for determining the eligibility of a project prior to Board approval "when circumstances require management to interpret terms not specifically defined in the PENNVEST Act"⁴⁰, PENNVEST staff is of the opinion that the PENNVEST Act and the PENNVEST regulations provide a clear and succinct definition of project eligibility, which is reviewed and approved for each project prior to a funding application being recommended to the

³⁸ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 16 at ¶2

³⁹ <https://www.epa.gov/nps/basic-information-about-nonpoint-source-nps-pollution> (accessed Feb. 22, 2023).

⁴⁰ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 17 at ¶4.

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PENNVEST Board for approval at each quarterly PENNVEST Board meeting. However, this issue will be addressed more fully in the agency's response to Finding 2 below.

Agency Response to Finding 2

The Department's second Finding can be addressed in two parts: the PENNVEST Board's approval of funding applications appears to be automatic, without the requisite review and deliberation required by governance best practices, and PENNVEST failed to include certain pieces of information from DEP's review of the Lyme Timber applications in its recommendation to the Board. We will address each part in turn.

Part I

Agency Position: The Department's conclusion that "PENNVEST's process for Board approval of NPS projects appears automatic, by overly relying on management to determine eligibility and make recommendations" is not substantiated by the facts and fails to take into account industry-standard governance practices.

The Department, relying almost exclusively on the Board's approval of the Lyme Timber projects, suggests that PENNVEST's approval process for NPS projects is insufficient.⁴¹ We will address the following issues in response to the Department's finding: 1) the PENNVEST Board properly reviewed the applications pursuant to all applicable laws, regulations, policies, and procedures; 2) the Lyme Timber projects were publically vetted and debated; 3) the Board properly delegated much of PENNVEST's operational responsibility to staff, who extensively review projects; 4) the Department improperly insinuates that the Lyme Timber projects were not the "best use of public money"; 5) the Department's opinion that the Lyme Timber projects were "atypical".

1. The PENNVEST Board adequately reviewed, vetted, evaluated, considered and debated the Lyme Timber funding applications.

First, the Department claims that the PENNVEST Board failed to adequately review, vet, evaluate, consider, or debate the Lyme Timber funding applications. The Department advances an argument that implies that, because questions regarding the Lyme Timber projects surfaced after Board approval of the projects,⁴² and because only one question was asked by the Board with regard to the Lyme Timber projects before the Board voted unanimously to approve the first Lyme Timber application on October 27, 2017, with no questions being asked by the Board before it voted unanimously to approve the second Lyme Timber application in January 2018, the Board failed to properly review the projects.⁴³

The Department recognizes in a footnote, but fails to include in its analysis that on October 18, 2017, after discussion on the first Lyme Timber application, the PENNVEST Board agreed to

⁴¹ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶3.

⁴² COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶2.

⁴³ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶3.

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postpone its vote on the first Lyme Timber application so Senator Scarnati could have adequate time to evaluate the project and its potential benefits for the district.⁴⁴ Representative Oberlander also expressed concerns with the project, including the amount of the loan and the limit on further development in the area.⁴⁵

After the October 18, 2017 Board meeting, PENNVEST Board members asked for additional information relative to the Project and took nine days to consider the projects and ask questions of PENNVEST staff, resulting in staff's preparation and distribution of a supplemental Board packet providing all additional information requested by the Board as it relates to the Lyme Timber project and fully vetting all questions and concerns raised with regard to the first Lyme Timber application. Only after all questions were fully answered did PENNVEST schedule a special Board meeting specifically to discuss and consider the first Lyme Timber application, which after discussion was approved unanimously by the PENNVEST Board.

The first Lyme Timber application withstood a high level of scrutiny by the Board. Only a handful of times in the history of the agency has the Board asked staff to postpone voting on a project so that additional consideration of the benefits of the project could be reviewed and evaluated. Contrary to the Department's conclusion that the Board's nonpoint source project approval process is insufficient, that the Board over relies on PENNVEST staff to determine eligibility, and that the PENNVEST Board automatically approves all projects without adequate scrutiny, deliberation or discussion⁴⁶, the facts suggests just the opposite, that the PENNVEST Board had a very lengthy, productive and healthy discussion and deliberation with regard to the Lyme Timber applications, a true testament that the PENNVEST Board's governance model is working exactly as it should. A healthy Board of Directors should challenge staff and their fellow Board members. Board members are not expected to always agree on whether a project should be approved or denied. Each member of the PENNVEST Board of Directors has their own unique perspective, goals and priorities. That is precisely why the PENNVEST Act requires the affirmative vote of **seven** Board members to approve a motion or resolution,⁴⁷ because it is anticipated that Board members will have different opinions on the benefits of a project and the priorities of the agency. The Department reviewed 14 of the 3,249 projects approved by the PENNVEST Board with a focus on the two Lyme Timber projects. This is not a representative sample of the voting patterns of the Board.⁴⁸ Contrary to the Department's opinion, PENNVEST Board members do oppose motions to approve certain projects, and those motions pass only if the Board is able to obtain the requisite number of votes required by the Act.⁴⁹

For example, at the October 2022 PENNVEST Board Meeting, board members, PENNVEST staff, and representatives from Cranberry-Venango county General Authority held lengthy discussions

⁴⁴ PENNVEST, BOARD MEETING MINUTES, Oct. 18, 2017.

⁴⁵ *Ibid.*

⁴⁶ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶3; *Id.* at 19, ¶3.

⁴⁷ 35 P.S. § 751.4(d) (Act 16 of 1988).

⁴⁸ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶3 *Id.* at 3, ¶2.

⁴⁹ *Ibid.*

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regarding questions and concerns posed by Representative Struzzi regarding the project. Ultimately, Representative Struzzi elected not to vote in favor of the project. At PENNVEST's July 7, 2019 Board Meeting, Representative Oberlander's alternate expressed concerns regarding an application from Old Lycoming Township for funding for a nonpoint source project. Representative Oberlander's alternate read a statement into the record regarding Representative Oberlander's reservations regarding the project, but ultimately voted in favor of funding the NPS project. Again, this is part of a healthy governance model and proof that the PENNVEST Board is functioning as intended.

The Department mentions that Board members raised questions about the Lyme Timber projects at the April 18, 2018 PENNVEST Board meeting. It should be noted that Representative Oberlander asked for additional time to discuss the Lyme Timber projects and Mr. Cohn and Senator White supported her request for further conversation. It should be noted that no motions were made in response to her request. It should also be noted that the other 9 board members did not in any way question the Board's approval or the Lyme Timber projects or the eligibility of the best management practices being funded by PENNVEST, other than to ask about the status of the project and the timeline for the completion of settlement on the PENNVEST funding offer.⁵⁰

PENNVEST has explained to the Department that PENNVEST has had a sufficient level of funding available to fund all projects that were approved by the Board since 2015. In other words, demand for PENNVEST funding has not exceeded supply and no applicants have been turned away because we did not have sufficient available funds. The Department contorts this into a conclusion that because the Board has approved all eligible funding applications since 2015, the Board does not actually review the information contained in the Board packets with regard to individual projects. Rather they suggest this information gives the appearance the Board is automatically approving projects without adequate scrutiny, deliberation and discussion.⁵¹ This is an unfair assessment and not substantiated by fact. The Board's history of having members vote in opposition to projects also suggests the Department has drawn an unfair and unsubstantiated conclusion.

Furthermore, in this audit, the Department fails to take into account that as part of operational practice and procedure, prior to being presented to the PENNVEST Board for consideration, all project applications have undergone extensive planning, review, modification and preparation to ensure that each project is a) eligible, b) construction-ready, c) has a verified water quality benefit, d) has an adequate funding source to repay any PENNVEST loan associated with the proposed funding package e) PENNVEST has sufficient funds to cover the completion of the project and f) the project sponsor has the managerial, technical and financial capability to undertake the project. Given the breadth of preparation each project has to undergo under the direction of PENNVEST staff, DEP and our independent underwriter, it is reasonable that the Board, having delegated such duties to staff, expects and relies on PENNVEST staff to ensure the project is eligible under a)

⁵⁰ PENNVEST, BOARD MEETING MINUTES, Apr. 18, 2018.

⁵¹ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶3; Id. at 19, ¶3.

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applicable federal statutes, b) applicable federal regulations, c) U.S. EPA-approved federal policies and guidance, d) the PENNVEST Act, d) the PENNVEST regulations, e) PENNVEST Board-approved program guidance and f) PENNVEST's operational policies and procedures. Given this, it is plausible, where the proposed projects align with all individual Board member priorities that Board members would be inclined to approve all such eligible projects to achieve the mission of the agency. The Board establishes and approves the parameters for programs implemented by PENNVEST that are not otherwise established by law or funding source. The PENNVEST staff implements the Board's direction in accordance with law, funding sources and mission. As indicated in PENNVEST's financial statements, the PENNVEST default rate on over \$11.2B in funding awards is less than 0.33% to date. Simply stated, it is wrong to conclude that the Board approves all projects automatically without properly reviewing, vetting or debating the information presented to them in the Board packets. In fact, the Department's conclusion that the Board is overly reliant and automatically approves all projects presented to the Board by staff is inconsistent with how the initial Lyme application was considered by the Board and is unsubstantiated by the facts.

Based on the facts, and a documented and public record of strong consideration of the Lyme Timber applications by the PENNVEST Board, it is PENNVEST's position that the Board more than adequately reviewed, vetted, evaluated, considered and debated the Lyme Timber applications, and after adequate consideration, obtained more than the requisite number of votes under the PENNVEST Act to formally and officially unanimously approve the first and second Lyme Timber applications.

2. The Lyme Timber funding applications were publically vetted and debated.

The Department also suggests that issues relating to the Lyme Timber applications were not "publically" vetted or debated.⁵² All PENNVEST Board meetings, including the Special Board Meeting held on October 27, 2018, called specifically to consider the first Lyme Timber application. Further, PENNVEST provided appropriate notice in accordance with the Sunshine Act and conducted meetings that were open to the public and included ample opportunity for public comment. The Board asked for additional information to respond to some questions and concerns after the October 18, 2017 Board meeting. That information was compiled and provided to all Board members before the October 27, 2017 Board meeting. That no Board member wished to further discuss or debate the additional information that they requested at the meeting on October 27, 2017 does not mean that the project was not adequately reviewed, vetted, evaluated, considered and debated by each Board member. Rather, it suggests that the project was fully vetted leaving no further questions at that time.

3. The PENNVEST Board should be able to rely on staff to perform administrative and operational functions, like determining whether each project brought before the Board is eligible under the statutes, regulations, guidance and policies that govern PENNVEST's funding program.

⁵² COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶3.

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The Department subjectively opines that, “Board members should clearly understand how management determined that each project is eligible to receive a PENNVEST funding offer so it is considered before the Board approves funding offers.”⁵³ The Department goes on to instruct that “[t]he Board should adequately scrutinize, deliberate and discuss every eligible NPS project prior to approving a funding offer.”⁵⁴ This blurs the line of governance and operational functions. The Board is authorized to delegate administrative and operational matters to staff and has done so by resolution and the adoption of agency bylaws.⁵⁵ From a governance perspective, the PENNVEST Board ought to be able to rely on PENNVEST staff, including but not limited to, PENNVEST’s Chief Counsel, to verify the eligibility of a project, which was done twice on each application and again in a separate writing for the Lyme Timber projects.⁵⁶ To suggest that the Board should understand how each project is eligible for funding inherently requires each Board member to review and verify the eligibility for each project, would seem to create an overly burdensome and unnecessary duplication of efforts. The job of the PENNVEST Board is to govern from a strategic perspective, not to run the day to day operations of the agency. The Department provides no evidence or reference to governance policy which would suggest otherwise, so PENNVEST is unable to respond to its source of information or guidance.

4. *The Department improperly insinuates that the award of a \$50M loan to Lyme Timber was not a prudent use of available PENNVEST funds and improperly implies that the PENNVEST Board does not sufficiently evaluate nonpoint source funding applications, including the Lyme Timber applications.*

The Department opines, “As a best business practice in the interest of taxpayers, PENNVEST management and the Board should consider whether each eligible project is a prudent use of state funds before approving a funding offer regardless of having funds available.”⁵⁷ This assertion again demonstrates a fundamental misunderstanding of PENNVEST’s operations, programs and sources of funding. The Lyme Timber projects were funded by federal revolving funds, not state or federal tax payer funds as the Department implies. The two awards to Lyme Timber were approved by the Board in the form of loans with the highest interest rate then-allowed under the PENNVEST Act for loan awards in the project area. Again, these are loans, they are the debt of Lyme Timber. There is no state action. Lyme Timber is obligated to repay the full amortized dollar amount with interest to the Clean Water State Revolving Fund.

The completion of the Lyme Timber projects will:

- Provide for enhanced stream protection,
- Protect the drinking water supply for 12,500 residents,
- Ensure that 37,205 acres of land will be forested and sustainably managed, **in perpetuity**,

⁵³ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 19 at ¶1.

⁵⁴ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 19 at ¶2.

⁵⁵ PENNVEST BOARD RES., Jun. 8, 1988. See also generally PENNVEST BYLAWS.

⁵⁶ PENNVEST CHIEF COUNSEL JAYNE B. BLAKE, MEMORANDUM TO PENNVEST EXECUTIVE DIRECTOR BRIAN T. JOHNSON, Apr. 2, 2018.

⁵⁷ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 19 at ¶3.

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- Commit 9,500 acres to a working forest conservation easement,
- Create over 100 jobs,
- Complete \$750,000 in acid mine drainage remediation work over three sites,
- Provide public access to private lands for recreational purposes,
- Assist PENNVEST with meeting its “Green Infrastructure” requirements with U.S. EPA, and
- Provide \$5M in interest earnings that will be returned to the CWSRF program to be used as future loan or grant funding sources for other eligible projects with a water quality benefit.

In addition to the environmental benefits achieved by the implementation of the best management practices under the Lyme Timber projects, one critical factor has been overlooked by the Department. The Lyme Timber projects were funded using 100% Clean Water State Revolving Fund, Non-Equivalency loan funds, requiring full repayment of all proceeds, in addition to generating a 1% interest rate of return to the Clean Water State Revolving Fund over the life of the loans. PENNVEST did not pass over one single funding application in order to fund these projects. It did not reduce grant funding to a single project in order to fund these projects. PENNVEST put federal revolving loan dollars to work to show U.S. EPA that we have the ability to get funds working for eligible projects and that Pennsylvania’s federal funding sources are being put to work protecting future appropriations from being reduced because of our failure to utilize the available funds in a timely fashion. And finally, the Lyme Timber projects will generate \$5M in interest earnings that will be returned to the CWSRF program to be used as future loan or grant funding sources for other eligible projects with a water quality benefit. As PENNVEST has explained to the Department, to let these funds go unused for eligible loan awards could give the U.S. EPA leverage to allocate future funds to other states and to change our allocation formula. To do as the Department has suggested would arguably be fiscally irresponsible and a detriment to the program by reducing our cash flow by \$5M and jeopardizing our program pace requirements with the U.S. EPA.

5. The Nature of Nonpoint Source Projects

The Department states that the Lyme Timber projects were “**atypical**”.⁵⁸ PENNVEST does not agree with this mischaracterization. All NPS projects are, by nature, “atypical” compared to the agencies traditional wastewater, drinking water or structural storm water book of business. For reasons discussed in the Agency’s response to Finding 1, there was much benefit to be gained by the Commonwealth to amend the definition of Project under Act 16 of 2013 to make best management practices under Pennsylvania’s Nonpoint Source Management Plan eligible projects.

PENNVEST is authorized under Section 751.3 of the PENNVEST Act to fund “[t]he eligible costs associated with . . . best management practices to address pollution . . . as identified in Pennsylvania’s Nonpoint Source Management Program Update, as required under section 319(b) of the Federal Water Pollution Control Act (62 Stat. 1155, 33 U.S.C. § 1329 (b)).” What is overlooked in the Department’s analysis is that the best management practices included in

⁵⁸ COMMONWEALTH OF PA., DEP’T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 18 at ¶1.

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Pennsylvania's Nonpoint Source Management Plan are fully vetted by Pennsylvania **AND** reviewed and approved by U.S. EPA. The treatment of acid mine drainage and the protection of riparian forest buffers and forest stewardship plans are expressly **included** in Pennsylvania's 2014 Nonpoint Source Management Plan rendering this type of work, by statute, eligible and, put another way, **typical** for NPS projects.⁵⁹

PENNVEST would agree that it is unusual to find a private entity that is willing to perform acid mine drainage abatement, commit privately-owned land to conservation easements, and grant the public access to private property for recreational purposes, all of which Lyme Timber did with the projects being funded by the PENNVEST loans. The purpose behind the U.S. EPA Nonpoint Source Program is to encourage exactly the activity that was completed under the Lyme Timber projects.

In fact, as a testament to the eligibility, validity, efficacy and impact of the Lyme Timber projects, Pennsylvania was awarded the **2019 U.S. EPA's George F. Ames Pisces Exceptional Project Award** for the Lyme Timber projects.⁶⁰

Part II

Agency Position: PENNVEST included comments from DEP's assessment of the Lyme Timber applications in a consistent manner with other nonpoint source projects. The Department improperly suggests that if the Board saw all of DEP's comments to the Lyme Timber funding applications that it would have considered the Lyme Timber loans not a prudent use of PENNVEST funds.

1. *The Department improperly suggests that if the Board saw all of DEP's comments to the Lyme Timber funding applications that it would have considered the Lyme Timber loans not a prudent use of PENNVEST funds.*

The Department agrees that all projects that are eligible for funding by PENNVEST should be presented to the PENNVEST Board for consideration.⁶¹ The Department again implies that the PENNVEST Board does not weigh the merits of each project before approving funding offers, nor does the Board make an active determination that projects receiving low scores, like the Lyme Timber applications, are a good use of PENNVEST funds.⁶² The Department presents no evidence to substantiate these claims, other than the statements made by the Department and refuted by PENNVEST in Part I of the agency's response to Finding 2. The Department correctly states that a DEP Review Score of 1, and an overall ranking score of 11, made the first Lyme Timber application the lowest ranked project in the October 17, 2017 funding round. The Department also correctly states that if PENNVEST did not have almost \$25M in Clean Water State Revolving

⁵⁹ COMMONWEALTH OF PA. DEP'T OF AUDITOR GEN., PERFORMANCE AUDIT INFO. REQ. NO. 9, QUESTION 12, Feb. 24, 2022.

⁶⁰ https://www.epa.gov/sites/default/files/2019-11/documents/pisces_2019_compendium.pdf (Accessed Feb. 23, 2023).

⁶¹ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 21 at ¶1.

⁶² Ibid.

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Funds available for that Board meeting, that the first Lyme Timber project would not have been funded, giving deference to projects which received higher ranking points.⁶³

While the Department's statements are true, PENNVEST did have \$25M in available funds that were not being requested by other funding applicants at the October 17, 2017 Board meeting. The Board's action to approve the first and the second Lyme Timber funding applications, with a verified water quality impact, albeit not as much of a water quality impact as the other projects, allowed the Board to put \$50M of federal revolving fund dollars to work, every dollar of which Lyme Timber is required to repay with anticipated interest earnings of approximately \$5M. If the options before the Board in October 2017 were to put \$25M to work, earning interest, or have those funds sit idle not promoting clean water benefits and not earning interest, it is reasonable and logical to conclude that the Board opted for the more fiscally responsible choice. Again, there is no evidence to the contrary, and the decision made by the Board employs common sense.

The Department may not have an appreciation for the fact that unlike other traditional funding programs, PENNVEST is not a program where limited funds are provided to the agency and the Board has the discretion to allocate those funds based on individual priorities. The PENNVEST business model is established by statute and regulation, and has been developed and matured over the past thirty-five years through much deliberation and debate between the Board and staff, to develop a revolving loan fund program for the financing of clean water projects based on an affordability analysis. The business model is a well-oiled machine, free of political persuasion, which staff credits for the successful long-term sustainability of the program.

2. PENNVEST is not able to verify the Department's allegations that the DEP comments for Lyme Timber were treated differently than other nonpoint source projects.

The Department states that its review of the Board Summary Reviews of the Lyme Timber projects showed that DEP determined the project had a water quality benefit, but gave the project only 1 point, citing the high cost of the project, which was not included by PENNVEST on the Board Summary Review.⁶⁴

PENNVEST staff reviews the information collected with regard to a project and condenses the information into the format requested by the Board to facilitate its review of recommended projects, so the Department is correct that the Board on that particular summary may not see every comment made by DEP or DCED with regard to the project. (It should be noted that the Board members were provided more detailed information relating to the Lyme Timber project as part of the supplemental Board packet provided to the Board at its request prior to the Special Board meeting on October 27, 2017 to consider prior to the award of funding for the first Lyme Timber application).

The Department also notes that it compared the Board Summary Reviews for the other five projects reviewed by the Department and found the descriptions on those Board Summary Reviews more closely resembled DEP's comments.

⁶³ Ibid.

⁶⁴ COMMONWEALTH OF PA., DEP'T OF AUDITOR GEN., (DRAFT) PERF. AUDIT REP. OF THE PA. INFRASTRUCTURE INV. AUTH. 21 at ¶¶ 2-3.

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PENNVEST's review of the 14 nonpoint source projects approved by the Board in FYE June 30, 2018, shows that 5 were noted as high cost by DEP (2 Lyme Timber applications, York County Rail Trail Authority, and 2 Chester City Stormwater Authority applications), 1 was noted as a medium-high cost (Armstrong County Conservation District), and 4 were noted as medium cost (Chester County Conservation District, Homestead Borough, Armstrong Township, Lycoming County and Coal Township), and 1 had a general comment of "very low water quality benefit relative to cost" (Tri-Municipal Park), so many of the nonpoint projects in that funding round contained very similar comments to the Lyme Timber project with regard to cost, most of which were not included on the Board Summary Review (with the exception of York County Rail Trail Authority).

While it appears that the Board Summary Review description for the Lyme Timber projects was consistent with the descriptions used by PENNVEST staff for all other nonpoint source projects, staff will review the information being presented with the Board and see if any additional clarifications can be made that would be helpful to the Board in their review of funding recommendations.

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Auditor's Conclusion to the Pennsylvania Infrastructure Investment Authority's Response

The Department of the Auditor General's auditors note that the Pennsylvania Infrastructure Investment Authority's (PENNVEST) management clearly and correctly states at the beginning of its response that we verified that all seven of the Nonpoint Source (NPS) Management Program projects reviewed, including the two Lyme Timber projects, were eligible for the funding its Board of Directors (Board) approved during the 2017-18 fiscal year, and that PENNVEST adequately monitored the Lyme Timber projects. PENNVEST agrees with our conclusions, however, it disputes that it had weaknesses in its NPS project review and approval process that we were plainly and accurately able to present in our findings.

In response to **Finding 1**, PENNVEST acknowledges that the terms "facility" or "system" are not defined in the PENNVEST Act but disputes that it broadly interpreted these terms to determine the Lyme Timber projects eligible. Management states that amendments to the PENNVEST Act in 2013 clearly and precisely define eligible NPS projects. We disagree, however, that eligible NPS projects are clearly defined, as evidenced by the numerous questions raised by legislative members and the public within six months after the Board approved the second Lyme Timber project loan. These concerns led to the informational hearing conducted by the Pennsylvania House of Representatives' (HR) Agriculture and Rural Affairs Committee, and unanimous adoption of HR Resolution 948 that requested this audit. The undefined terms caused confusion and concern over the eligibility of the Lyme Timber projects.

It is also important to note that despite PENNVEST management's description of its agency as a "bank", it is actually a statutorily-created commonwealth-affiliated entity that was established as a body corporate and politic and is constituted as an instrumentality of the Commonwealth with a public and essential governmental function that must follow requirements that go well beyond acting in the capacity of a bank.⁵² Further, management argues that the Board delegated its authority to management many years ago (1988), when it is clear that the PENNVEST Board's fiduciary duties can never be delegated to the entity's management and its staff.

Additionally, PENNVEST questions our characterization of the Lyme Timber projects as *atypical* NPS projects and contends that certain statements in the finding reveal our lack of understanding of its mission and projects. Again, we disagree because management erroneously equates our conclusion that the Lyme Timber projects were unlike every other NPS project that we reviewed with an improper expansion of eligibility criteria that would make those projects ineligible.⁵³ As management admits several times throughout its response, we in fact concluded that the Lyme Timber projects were eligible.

⁵² 35 P.S. § 751.4(a).

⁵³ Interestingly, while the first project may have been eligible, it was determined by the state Department of Environmental Protection (DEP) to have a very low score assessment of just "1" of a possible "105".

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We believe, however, that our recommendations to amend the PENNVEST Act to more clearly convey the legislative intent of the provision to offer funding assistance for NPS projects, and for PENNVEST management to sufficiently document and maintain for reference the basis for determining the eligibility of a project prior to Board approval would alleviate similar confusion and questions in the future regarding NPS project eligibility. Therefore, our finding conclusions and recommendations remain as stated.

Regarding **Finding 2**, PENNVEST argues that its process for Board approval of NPS project funding offers is appropriate and questions our determination supported by ample evidence that the process appears automatic, by overly relying on management to determine eligibility and make recommendations. We disagree because PENNVEST management inaccurately states our conclusions as we presented in the finding. Concerns noted in our finding regarding the information provided on the Board Summary Reviews sent to Board members, lack of questions about the Lyme Timber projects prior to approval at the board meetings, and the Board's historical record of approving every NPS project recommended by PENNVEST management since 2015-16 foster the *appearance* of insufficient reviews and automatic approvals by the Board. We reaffirm our conclusion that Board members should be provided management's rationale used to determine project eligibility. This does not require Board members to re-perform eligibility determinations, as PENNVEST asserts, nor does it blur the lines of governance and operations.

As noted earlier, the Board may delegate required operational tasks to management, but that does not relinquish the Board from its fiduciary responsibilities outlined in the PENNVEST Act. We also reiterate the need for management to provide balanced information to its Board, so members have a more complete understanding of the project, including potential benefits and concerns, prior to awarding a funding offer. This includes DEP's reviewer comments to explain the scores assessed. We do agree with PENNVEST's comment that the Lyme Timber projects were funded by federal revolving funds, not state or federal taxpayer funds. We, therefore, revised our initial statement to reflect that the Lyme Timber projects were funded by 'public funds' for clarity. Otherwise, our finding conclusions and recommendations remain as stated to improve PENNVEST's process for approving NPS project loans and grants.

Regardless of PENNVEST's disagreement with our findings, we are encouraged that management intends to seek its Board's opinion on the need to amend the language in the PENNVEST Act, and review the information provided to Board members to determine if clarifications or additional information would be helpful as the Board considers approval of projects to fund.

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Appendix A

Objectives, Scope, Methodology, and Data Reliability

The Department of the Auditor General (Department) conducted this performance audit of the Pennsylvania Infrastructure Investment Authority (PENNVEST) in order to provide an independent assessment of PENNVEST's process for awarding financial assistance for Nonpoint Source (NPS) Management Program Projects and to ensure entities comply with established loan/grant agreements.

We conducted this audit under the authority provided to the Department in Section 751.12 (Audits) of the PENNVEST Act of 1988, pursuant to Pennsylvania House of Representatives Resolution No. 948 adopted during the 2018 legislative session, and Sections 402 and 403 of The Fiscal Code.⁵⁴ The audit was performed in accordance with generally accepted *Government Auditing Standards* (GAS), issued by the Comptroller General of the United States.⁵⁵ Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our audit objectives.

Objectives

1. Evaluate PENNVEST's process for determining applicant/project eligibility and approval for loans and grants provided for Nonpoint Source Management Program Projects. [*See Audit Procedures and Results, Findings 1 and 2*]
2. Evaluate PENNVEST's monitoring activities related to the loans awarded to LFF IV Timber Holding LLC (d.b.a. Lyme Timber) to ensure compliance with the respective loan agreements. [*See Audit Procedures and Results*]

Scope

Our performance audit had two objectives. The first audit objective covered the period July 1, 2017, through June 30, 2018, and the second objective covered the period July 1, 2017, through April 30, 2022, with updates through October 21, 2022.

PENNVEST management is responsible for establishing and maintaining effective internal controls, also referred to as management controls, to provide reasonable assurance of compliance

⁵⁴ 35 P.S. § 751.12 (Act 16 of 1988) amended; House Resolution No. 948, PN 3586 (June 21, 2018); 72 P.S. §§ 402, 403.

⁵⁵ U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision Technical Update April 2021.

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with applicable laws and regulations, contracts, grant agreements, and administrative policies and procedures. In conducting our audit, we obtained an understanding of PENNVEST's internal controls, including information systems controls.

Standards for Internal Control in the Federal Government (also known as and hereafter referred to as the Green Book), issued by the Comptroller General of the United States, provides a framework for management to establish and maintain an effective internal control system.⁵⁶ We used the framework included in the Green Book to assess PENNVEST's internal control system.

The Green Book's standards are organized into five components of internal control. In an effective system of internal control, these five components work together in an integrated manner to help an entity achieve its objectives. The five components contain 17 related principles, listed in the table below, which are the requirements an entity should follow in establishing an effective system of internal control.

We determined that all internal control components were significant to both objectives. The table below represents a summary of the level of our internal control assessment in regard to both objectives for effectiveness of design (D); implementation (I); or operating effectiveness (OE), that we performed for each principle. It also includes our conclusions with any issues found, and if those issues are included in a finding.⁵⁷

Component		Principle	Level of Assessment	Objective	Conclusion
Control Environment	1	The oversight body and management should demonstrate a commitment to integrity and ethical values.	D	1, 2	No issues noted
	2	The oversight body should oversee the entity's internal control system.	D	1, 2	No issues noted
	3	Management should establish an organizational structure, assign	D	1, 2	No issues noted

⁵⁶ Even though the Green Book was written for the federal government, it explicitly states that it may also be adopted by state, local, and quasi-government entities, as well as not-for-profit organizations, as a framework for establishing and maintaining an effective internal control system.

⁵⁷ The Green Book, Sections OV3.05 and 3.06, states the following regarding the level of assessment of internal controls. Evaluating the design of internal control includes determining if controls individually and in combination with other controls are capable of achieving an objective and addressing related risks. Evaluating implementation includes determining if the control exists and if the entity has placed the control into operation. Evaluating operating effectiveness includes determining if controls were applied at relevant times during the audit period, the consistency with which they were applied, and by whom or by what means they were applied.

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Component		Principle	Level of Assessment	Objective	Conclusion
		responsibility, and delegate authority to achieve the entity's objectives.			
	4	Management should demonstrate a commitment to recruit, develop, and retain competent individuals.	D	1, 2	No issues noted
	5	Management should evaluate performance and hold individuals accountable for their internal control responsibilities.	D	1, 2	No issues noted
Risk Assessment	6	Management should define objectives clearly to enable the identification of risks and define risk tolerances.	D	1, 2	No issues noted
	7	Management should identify, analyze, and respond to risks related to achieving the defined objectives.	D	1, 2	No issues noted
	8	Management should consider the potential for fraud when identifying, analyzing, and responding to risks.	D	1, 2	No issues noted
	9	Management should identify, analyze, and respond to significant changes that could impact the internal control system.	D	1, 2	No issues noted
Control Activities	10	Management should design control activities to achieve objectives and respond to risks.	D, I, OE	1	Finding 2
			D, I, OE	2	No issues noted
	11	Management should design the entity's information system and related control activities to achieve	D	1, 2	No issues noted

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Component		Principle	Level of Assessment	Objective	Conclusion
		objectives and respond to risks.			
	12	Management should implement control activities through policies.	D, I, OE	1	Finding 2
			D, I, OE	2	No issues noted
Information and Communication	13	Management should use quality information to achieve the entity's objectives.	D, I, OE	1	Finding 2
			D, I, OE	2	No issues noted
	14	Management should internally communicate the necessary quality information to achieve the entity's objectives.	D, I, OE	1	Finding 2
			D, I, OE	2	No issues noted
	15	Management should externally communicate the necessary quality information to achieve the entity's objectives.	D	1, 2	No issues noted
Monitoring	16	Management should establish and operate monitoring activities to monitor the internal control system and evaluate results.	D	1, 2	No issues noted
	17	Management should remediate identified internal control deficiencies on a timely basis.	D	1, 2	No issues noted

Generally accepted *Government Auditing Standards* require that we consider information systems controls "...to obtain sufficient, appropriate evidence to support the audit findings and conclusions."⁵⁸ This process further involves determining whether the data that supports the audit objectives is reliable. In addition, Publication GAO-20-283G, *Assessing Data Reliability*, provides guidance for evaluating data using various tests of sufficiency and appropriateness when the data is integral to the audit objective(s).⁵⁹ See our assessment in the *Data Reliability* section that follows.

⁵⁸ U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision. Paragraph 8.59 through 8.67.

⁵⁹ U.S. Government Accountability Office. *Assessing Data Reliability*, December 2019.

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Our procedures to assess the design, implementation, and/or operating effectiveness are discussed in the *Methodology* section that follows. Deficiencies in internal controls we identified during the conduct of our audit and determined to be significant within the context of our audit objectives are summarized in the conclusion section below and described in detail within the respective audit findings in this report. See the table above for descriptions of each of the principle numbers included in the conclusions below.

Conclusion for Objective 1:

Our assessment of PENNVEST management's internal controls did not find any issues for Principles 1-9, 11, and 15-17; however, we did identify issues with management's controls regarding Principles 10 and 12-14. These issues included the following: (1) management does not include its rationale for determining project eligibility with the information provided to its Board of Directors' (Board) about each NPS project in preparation for the votes to approve funding offers; and (2) did not fully disclose certain aspects of the Pennsylvania Department of Environmental Protection's (DEP) technical reviews for both Lyme Timber projects. Management included DEP's scoring, but not the reviewer comments to explain the low scores awarded. See further details in *Finding 2*.

Conclusion for Objective 2:

Our assessment of PENNVEST management's internal controls did not find any issues associated with the 17 Principles as to design, implementation, and/or operating effectiveness as noted in the table above.

Methodology

The following procedures were performed to address both audit objectives, unless otherwise noted. Items selected for testing within this audit were based on auditor's professional judgment. The results of our testing, therefore, cannot be projected to, and are not representative of, the corresponding population.

- Reviewed Pennsylvania House of Representatives Resolution 948 of 2018.⁶⁰
- Obtained an understanding of PENNVEST's overall organizational structure and purpose, as well as at the functional level where the Board approves NPS projects, from

⁶⁰ House Resolution No. 948, PN 3586 (adopted on June 21, 2018) ("A Resolution requesting the Auditor General to conduct a financial audit of nonpoint source program projects approved by the Pennsylvania Infrastructure Investment Authority"), see *Appendix B* of this report.

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our review of PENNVEST's organizational chart and information published on its website, and from interviews with management. [All Principles]

- Reviewed PENNVEST's Internal Control Self-Assessments for the fiscal years ended June 30, 2021, 2020, 2019, and 2018, completed in accordance with Management Directive 325.12 (amended) to determine what controls PENNVEST designed to address each of the 17 principles within the five components of internal control to establish an effective system of internal control. [All Principles]
- Reviewed the meeting minutes from PENNVEST's Board of Director's quarterly meetings from July 2017 to April 2021. [Principles 10, 12]
- Identified the following laws, regulations, and PENNVEST policies and procedures relevant to the process for determining applicant/project eligibility and approval for loans and grants provided for NPS projects: [Principles 3, 6, 7, 9, 10, 11, 12, 13, 14, 15, 16]
 - Pennsylvania Infrastructure Investment Authority Act (Act 16 of 1988) as amended⁶¹
 - Title 25 – Environmental Protection, Part VII- PENNVEST, Chapter 963 – PENNVEST Assistance
 - Title 25 – Environmental Protection, Part VII – PENNVEST, Chapter 965 – Clean Water State Revolving Fund
 - Federal Clean Water Act⁶²
 - Commonwealth of Pennsylvania, Nonpoint Source Management Plan, 2014 Update
 - Ranking Framework for PENNVEST Non-Point Source Projects – Bureau of Clean Water, Division of Technical and Financial Assistance, DEP, April 1, 2016⁶³
 - PENNVEST project application process policies and procedures
 - PENNVEST project monitoring policies and procedures
 - Master Consent Agreements for PENNVEST NPS loans made to a Lyme Timber Company affiliate

⁶¹ 35 P.S. § 751.1 *et seq* (Act 16 of 1988, amended).

⁶² 33 U.S.C. § 1251 *et seq.* (1972). The basis of the Clean Water Act was enacted in 1948 and was called the Federal Water Pollution Control Act. The Act was significantly reorganized and expanded in 1972 and became known as the Clean Water Act. Further amendments to the Act.

⁶³ See *Appendix C*.

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Objective 1:

- Interviewed PENNVEST management to understand and assess the internal controls in place regarding PENNVEST's review and approval procedures for NPS project applications for financing assistance. [All Principles]
- Reviewed and relied on the results of the evaluation of information technology (IT) general controls at PENNVEST performed by the Pennsylvania Auditor General Bureau of Information Technology Audit in conjunction with the commonwealth's Single Audit for the fiscal year ended June 30, 2018. [Principle 11]
- Reviewed the NPS project scoring and ranking procedures to determine how the DEP, Pennsylvania Department of Community and Economic Development (DCED), and PENNVEST review, score, and rank NPS projects. [Principles 6, 7, 10, 12, 13, 14]
- Obtained a list of all 14 NPS projects PENNVEST's Board approved during the period of July 1, 2017, through June 30, 2018. Based on our assessment of risk, we judgmentally selected 7 of the 14 NPS projects to conduct a detailed review.
- Performed a detailed review of the seven selected NPS projects to determine if PENNVEST accurately documented its process to determine applicant/project eligibility and recommend loan/grant approval. Specifically, we reviewed project applications, loan funding agreements, and other supporting documents such as the initial consultation meeting notes, project ranking and review documents prepared by DEP, DCED, and PENNVEST, financial reviews, Board Summary Reviews, emails, and other documents. [Principles 10, 12, 13, 14]
- Reviewed the DCNR Secretary's and PENNVEST Executive Director's responses to the House Agricultural and Rural Affairs Committee informational meeting held on March 26, 2018.
- Reviewed the Pennsylvania House of Representatives Republican Caucus Chief Counsel's summary of opinion regarding the use of PENNVEST funds for the Lyme Timber land purchases.
- Reviewed correspondences related to the Lyme Timber projects between PENNVEST, DEP, Pennsylvania Department of Conservation and Natural Resources (DCNR) and Lyme Timber.

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Objective 2:

- Interviewed PENNVEST personnel to understand the process used to develop the Lyme Timber loan agreements. This involved a discussion of PENNVEST's monitoring procedures for the Lyme Timber projects, as well as the projects' status. [Principles 3, 6, 7, 10, 12, 13, 14]
- Obtained the master consent agreements for both Lyme Timber loans to identify the terms of the agreements that PENNVEST should monitor to ensure compliance with the loan agreements.
- Reviewed PENNVEST's monitoring activities to determine if Lyme Timber adequately complied with the respective loan agreement requirements. Specifically, we determined that PENNVEST ensured Lyme Timber: [Principles 10, 12, 13, 14]
 - Provided financial statements annually to PENNVEST to ensure Lyme Timber has adequate cash flows to cover the debt service over the next fiscal year.
 - Obtained an appraisal(s) of the lands purchased with PENNVEST funds at least every three years since the closing date of the loan and the appraisals reflected a current fair market value of not less than \$55 million.
 - Provided two irrevocable bank letters of credit in the amount of \$4 million each to PENNVEST as part of the collateral requirements.
 - Conveyed a 9,152-acre Working Forest Conservation Easement (WFCE) to DCNR.
 - Made monthly loan payments according to the loan agreement terms.
 - Enrolled in and certified by the Sustainable Forestry Initiative or the Forest Stewardship Council Program.
 - Repaid the interim financing from another entity needed to fund the preclosing for the lands purchased after it received the PENNVEST funds.
 - Worked toward completion of acid mine drainage remediation projects at three sites located on the lands purchased.

Data Reliability

Generally accepted *Government Auditing Standards* require us to assess the sufficiency and appropriateness of computer-processed information that we used to support our conclusions and/or recommendations. The assessment of the sufficiency and appropriateness of computer-processed information includes the considerations regarding the completeness and accuracy of the data for the intended purposes.⁶⁴

⁶⁴ U.S. Government Accountability Office. *Government Auditing Standards*. 2018 Revision. Paragraph 8.98.

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For our first audit objective, we obtained an understanding of the system PENNVEST used to accept, review, and approve NPS project applications and supporting documents. This included performing certain tests of the design and effectiveness of IT general controls. From this system, PENNVEST provided a list of NPS projects awarded during the period of July 1, 2017, through June 30, 2018. We agreed this information to Board meeting minutes that document the projects approved during the quarterly meetings, confirming the list was complete. We selected 7 of the 14 projects for further testing, as described in the *Methodology* section above, including agreeing projects to source documentation. [Principle 11]

We also obtained a management representation letter from PENNVEST management asserting that this computer-processed information provided for the audit was accurate, complete, and free from falsifications.

Based on the data reliability procedures performed, we found no limitations for using the data files obtained for our intended purposes. In accordance with generally accepted *Government Auditing Standards*, we concluded that the PENNVEST data was sufficiently reliable for the purposes of this engagement.

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Appendix B	Pennsylvania House of Representatives Resolution No. 948 of the Legislative Session of 2017-2018
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The Pennsylvania House of Representatives Agriculture and Rural Affairs Committee raised concerns at a public informational meeting on March 26, 2018, about the eligibility of a Nonpoint Source program project approved for loan financing by the Pennsylvania Infrastructure Investment Authority (PENNVEST). Specifically, PENNVEST approved financing to an affiliate of the Lyme Timber Company, Lyme Emporium Highlands II, LLC (Lyme Timber), for the purchase of timberlands. These concerns were raised two months after the PENNVEST Board of Directors (Board) approved a second loan to finance the Lyme Timber project. Legislators also questioned whether providing public funds to assist a private company with the purchase of tens of thousands of acres of timberlands was the best use of Clean Water State Revolving Fund monies. As shown below, the Pennsylvania House of Representatives unanimously adopted House Resolution No. 948 on June 21, 2018, which requested the Auditor General to conduct an audit of Nonpoint Source program projects approved by the PENNVEST Board.

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**Pennsylvania Infrastructure Investment Authority
Nonpoint Source Management Program Projects**

PRINTER'S NO. 3586

THE GENERAL ASSEMBLY OF PENNSYLVANIA

HOUSE RESOLUTION

No. 948 Session of
2018

INTRODUCED BY CAUSER, JAMES, BLOOM, BOBACK, CUTLER, DIAMOND,
GODSHALL, KEEFER, M. K. KELLER, KLUNK, LAWRENCE, MILLARD,
MOUL, NEILSON, PICKETT, RAPP, RYAN, THOMAS, WARD, WATSON,
ZIMMERMAN AND GILLEN, MAY 31, 2018

REFERRED TO COMMITTEE ON AGRICULTURE AND RURAL AFFAIRS,
MAY 31, 2018

A RESOLUTION

1 Requesting the Auditor General to conduct a financial audit of
2 nonpoint source program projects approved by the Pennsylvania
3 Infrastructure Investment Authority.
4 WHEREAS, The Pennsylvania Infrastructure Investment Authority
5 is an instrumentality of the Commonwealth created by section 4
6 of the act of March 1, 1988 (P.L.82, No.16), known as the
7 Pennsylvania Infrastructure Investment Authority Act; and
8 WHEREAS, It is the mission of the authority to provide
9 affordable financing to implement or improve sewer, storm water
10 and drinking water projects throughout this Commonwealth; and
11 WHEREAS, Section 10(b.2) of the Pennsylvania Infrastructure
12 Investment Authority Act and 25 Pa. Code Ch. 963 (relating to
13 Pennsylvania Infrastructure Investment Authority assistance)
14 authorize the use of funding from the Clean Water State
15 Revolving Loan Fund Program for nonpoint source projects, as
16 long as the use of funding is in conformance with Federal law
17 and additional State-established parameters; and

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1 WHEREAS, The definition of "project" in section 3 of the
2 Pennsylvania Infrastructure Investment Authority Act includes
3 best management practices which are identified in
4 Pennsylvania's Nonpoint Source Management Program Update, as it
5 relates to section 319(b) of the Federal Water Pollution Control
6 Act (62 Stat. 1155, 33 U.S.C. § 1329(b)), as long as the best
7 management practices are part of a facility or system; and

8 WHEREAS, The board of directors of the authority has approved
9 approximately 118 nonpoint source program projects; and

10 WHEREAS, There is some uncertainty as to the eligibility of
11 some of the approved nonpoint source program projects, arising
12 from whether the transactions are actually projects under the
13 Pennsylvania Infrastructure Investment Authority Act; therefore
14 be it

15 RESOLVED, That the House of Representatives request the
16 Department of the Auditor General to conduct a financial audit
17 of all nonpoint source program projects approved by the board of
18 directors of the Pennsylvania Infrastructure Investment
19 Authority and to submit a report of the audit to the Chief Clerk
20 of the House of Representatives; and be it further

21 RESOLVED, That a copy of this resolution be transmitted to
22 the department.

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Appendix C

Pennsylvania Infrastructure Investment Authority Rating Process for Nonpoint Source Project Applications

The Pennsylvania Infrastructure Investment Authority (PENNVEST), along with the Pennsylvania Department of Environmental Protection (DEP) and the Pennsylvania Department of Community and Economic Development (DCED), developed and implemented a project rating system to rank and prioritize projects from applicants seeking financial assistance through the Clean Water State Revolving Fund, which includes Nonpoint Source (NPS) management program projects.⁶⁵

DEP, acting as a technical consultant for PENNVEST, uses the methodology outlined below to rate eligible NPS projects submitted to PENNVEST. DEP staff add scores and comments to a project rating form after evaluating projects using the five rating factors below. DEP provides the results through secured access to PENNVEST's NPS project review system.

DEP Rating Factors for NPS Project Reviews

1. WATER QUALITY (0-30 points)

Projects will be rated in one of the following categories based on the quality of the receiving stream:

- A. Receiving stream is listed as impaired on the Section 303(d) List.⁶⁶ (30 points)
- B. Receiving stream is designated high quality (HQ) or exceptional value (EV). (20 points)
- C. Receiving stream is impaired but not listed on 303(d) List. (10 points)

2. COMPLIANCE (0-10 points)

- A. Ten points will be awarded if the project will improve compliance with existing laws, rules, or regulations, when no compliance order, decree or agreement has been issued, and there is no deadline date specified in regulation.
- B. Five points will be awarded if the project will comply with a compliance order, decree or agreement, or a deadline specified in regulation, or there is an approved

⁶⁵ The DEP ranking system described above was developed using the Ranking Framework for PENNVEST Non-Point Source Projects, prepared by DEP's Bureau of Clean Water, Division of Technical and Financial Assistance, April 1, 2016.

⁶⁶ Pennsylvania Integrated Water Quality and Assessment Report (Section 303(d) List).

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total maximum daily load which requires reductions in pollutant(s) to be controlled by the project.

3. PLANNING (0-30 Points)

Projects will be rated by the accumulation of up to 30 points from the following categories:

A. Capability to Manage (5 points)

- a. Five points will be awarded if the applicant can demonstrate prior experience with PENNVEST application process.
- b. Three points will be awarded if the applicant can demonstrate prior experience with Growing Greener, NRCS, or another relevant state or federal funding program.

B. Planning Coordination (25 points)

- a. Fifteen points will be awarded to projects that are part of a DEP approved 319 Watershed Implementation Plan, or the project is contained in a Municipal Separate Storm Sewer System (MS4), Pollution Reduction Plan or Total Maximum Daily Load strategy or plan that is either submitted with an MS4 notice of intent or permit application or is in response to an issued MS4 permit.
- b. Eight points will be awarded to projects that are comprised of accepted best management practices that are endorsed by the County Conservation District, a local planning office, or watershed group.
- c. Two points will be awarded if the project is located in an environmental justice community as determined by the Office of Environmental Justice.

4. BENEFIT-TO-COST (1-30 points)

The Benefit-to-Cost rating is a function of the project's water quality benefit relative to total cost:

- A. High water quality benefit relative to cost. (21-30 points)
- B. Medium water quality benefit relative to cost. (11-20 points)
- C. Low water quality benefit relative to cost. (1-10 points)

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5. **SAFETY (0-5 points)**

Projects which provide public health and safety benefits will be rated in one of the following categories:

- A. Projects that eliminate a critical ongoing safety or health hazard. (5 points)
- B. Projects that eliminate a chronic safety or health hazard. (3 points)
- C. Projects that eliminate a potential safety or health hazard. (1 point)

Additional Rating Factors for NPS Project Reviews

In addition to DEP's review and scoring procedures, PENNVEST relies on DCED to review NPS project applications and score projects based on the reasonableness of the economic impact the applicant expects, as noted on the applications. PENNVEST staff may also add points based on specific factors noted below.⁶⁷ PENNVEST compiles all the scores, calculates the projects' overall/final scores, and ranks them accordingly. This ranked list is used to allocate available funds for the highest ranked projects. The list is irrelevant when PENNVEST has sufficient funds to approve every project on the list, which has occurred every year since 2015-16.⁶⁸

A maximum of 70 points may be added to DEP's score for each NPS project as shown below:

- (a) ***Economic Development*** – DCED provides this ranking based on:
 - (1) **High (20 points)** – The project has a direct link to job creation or preservation and private investment.
 - (2) **Medium (10 points)** – An indirect link to job creation or preservation and private investment exists.
 - (3) **Low (5 points)** – Project implementation.
- (b) ***Distressed Community*** – DCED evaluates communities across the Commonwealth for financial well-being. Communities on the Distressed Communities list are identified in order to have access for consideration for assistance from various state agencies in order to get the communities back to normal status. If the project is in a community that is considered distressed, **10 points** are added to the project.

⁶⁷ Ranking Framework for PENNVEST Non-Point Source Projects, prepared by DEP's Bureau of Clean Water, Division of Technical and Financial Assistance, April 1, 2016, page 3.

⁶⁸ PENNVEST Annual Report for 2021-2022, page 13. <https://www.pennvest.pa.gov/about-us/Pages/Publications.aspx> (accessed January 25, 2023).

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- (c) ***Infill*** – PENNVEST adds **10 points** to those projects that serve a city, borough or township of the first class. Redevelopment of existing population centers is a priority.
- (d) ***Brownfield*** – PENNVEST adds **15 points** to those projects that serve a designated Brownfield site as identified by DEP.
- (e) ***Community Action Team (CAT) Projects*** – DCED adds **10 points** to those projects that are in a CAT community. The CAT community system is an effort to focus financial and technical resources to specific communities identified by the CAT Team.
- (f) ***Comprehensive Planning*** – DCED adds **5 points** to those projects that are within communities with a comprehensive plan, where the community plan is consistent with the adopted county comprehensive plan.

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Appendix D

Timeline: Lyme Timber NPS Project Loans Approved by PENNVEST

This appendix provides a detailed timeline regarding the two Pennsylvania Infrastructure Investment Authority (PENNVEST) Nonpoint Source (NPS) project loans executed with an affiliate of The Lyme Timber Company (Lyme Timber) totaling \$50 million for the purchase of timberlands in northwest Pennsylvania. The timeline highlights pre-loan communications, loan applications and approvals, and post-approval actions.

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Spring to July 2017		Nov. 2017 to Jan. 2018	
Aug. to Oct. 2017		March to July 2018	
<i>Pre-loan communications</i>	<i>Loan 1</i>	<i>Loan 2</i>	<i>Post-approval actions</i>
<p>Spring 2017 – Lyme Timber asked the PA Department of Conservation and Natural Resources (DCNR) if the agency would want to purchase working forest conservation easements (WFCE) from timberlands it planned to buy. DCNR indicated that it was interested in acquiring WFCEs but did not have funds available to do so in the near future. DCNR assisted with discussions between Lyme Timber and PENNVEST.</p> <p>June 2, 2017 – Lyme Timber met with DCNR and PENNVEST staff to discuss its timberland purchase plans and the possibility of financial assistance through PENNVEST.</p> <p>June 19, 2017 – PENNVEST, PA Department of Environmental Protection (DEP) and Lyme Timber officials met to discuss a</p>	<p>August 10, 2017 – Lyme Timber submitted an NPS project application seeking a \$50 million PENNVEST loan to help it purchase 23 large tracts of forestland totaling 60,103 acres in seven counties.</p> <p>August 11, 2017 to October 11, 2017 – PENNVEST, DEP, and PA Department of Economic and Community Development (DCED) staff reviewed the Lyme Timber application and scored the project while a third-party consultant determined Lyme's financial capability to manage a loan. PENNVEST deemed the project eligible and recommended the Board offer a \$25,450,115 million loan to ensure it could also fund other projects that fiscal year.</p> <p>October 18, 2017 – At its quarterly meeting, the</p>	<p>November 1, 2017 – Lyme Timber submitted a second application to PENNVEST seeking \$24,549,885 to purchase 11 large tracts of forestland totaling 28,054 acres.</p> <p>November 2, 2017 to January 23, 2018 – PENNVEST, DEP, and DCED staff reviewed and scored Lyme Timber's second application while a third-party consultant determined Lyme's financial capability to manage a second loan. PENNVEST staff recommended the Board approve a loan offer of \$24,549,885.</p> <p>January 31, 2018 – At its quarterly meeting, the PENNVEST Board unanimously approved a loan offer of \$24,549,885 to Lyme Timber, bringing the total of both loans to the \$50 million</p>	<p>March 26, 2018 – During a PA House Agricultural and Rural Affairs Committee meeting, members raised questions about project eligibility and whether using public loans to help a private company buy timberland was a fitting use of Clean Water State Revolving Fund monies in terms of the benefits for the public and environment.</p> <p>April 3, 2018 – PENNVEST provided a requested memo to the House Committee outlining the determination of eligibility and interest rates and stating that no traditional projects were rejected because of the Lyme project being funded.</p> <p>April 25, 2018 – PENNVEST's Executive Director provided a requested summary to the Board describing details of the project's eligibility, interest</p>

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<p>potential PENNVEST NPS project loan.</p> <p>July 11, 2017 – PENNVEST contacted the U.S. Environmental Protection Agency (EPA), Office of Infrastructure and Assistance, with preliminary details of the Lyme Timber proposal. EPA informally responded that the project appeared to be eligible for funding based on the protection/conservation of high-quality streams, a determination EPA later formalized in February 2018.</p>	<p>PENNVEST Board postponed consideration of the Lyme proposal after a Board member sought more time to allow a state senator to evaluate the project and its potential benefits.</p> <p>October 19, 2017 to October 25, 2017 – Lyme Timber informed PENNVEST that it needed to revise what was indicated in its original application after learning that PENNVEST planned to offer only approximately half of the financing amount requested. Lyme Timber advised PENNVEST that it might apply for a second NPS loan.</p> <p>October 27, 2017 – The PENNVEST Board held a special meeting via teleconference to consider the Lyme Timber proposal and unanimously approved a loan offer of \$25,450,115.</p>	<p>the company initially sought.</p>	<p>rate, and loan term determinations, as well as answers to other questions Board members raised.</p> <p>June 15, 2018 – A memo from the PA House Republican Caucus legal counsel asserted that the loans to Lyme Timber were not permissible under the PENNVEST Act because the projects did not appear to involve a facility or system.</p> <p>June 21, 2018 – PA House of Representatives adopted Resolution No. 948 asking the Auditor General to conduct a financial audit of nonpoint source program projects approved by PENNVEST.</p> <p>July 31, 2018 – Loan funding agreements were executed, and Lyme Timber conveyed a 9,152-acre tract of land to DCNR as a WFCE.</p>
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Pennsylvania Infrastructure Investment Authority Nonpoint Source Management Program Projects

Appendix E

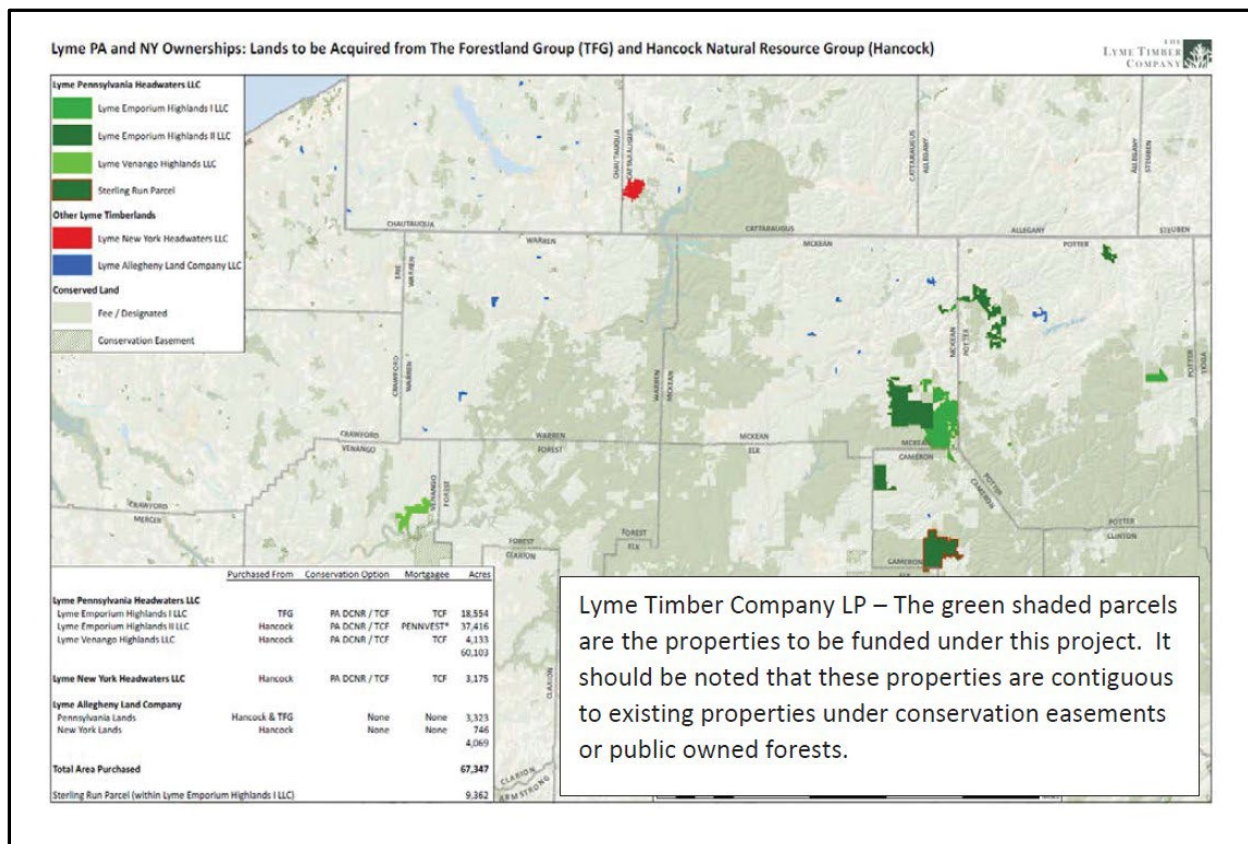
Pennsylvania Infrastructure Investment Authority Board Summary Review, October 2017 – Lyme Timber Project

This appendix contains the Lyme Timber NPS project Board Summary Review that the Pennsylvania Infrastructure Investment Authority (PENNVEST) management prepared for its Board of Directors (Board) in October 2017. Board members received it approximately one week prior to the quarterly board meeting when a vote to approve the NPS project funding offer was scheduled. Management included Lyme Timber's map as page one of the four-page Board Summary Review, showing the tracts of land Lyme Timber affiliates planned to purchase. The two boxes along the left edge of the map indicate which parcels will be purchased by various Lyme Timber affiliates. The box in the bottom left corner identifies Lyme Emporium Highlands II, LLC, as one of three affiliates making up Lyme Pennsylvania Headwaters, LLC, and the borrower of the PENNVEST funds. PENNVEST is listed as the 'Mortgagee' for 37,416 acres to be purchased by Lyme Emporium Highlands II, LLC, approximately 62 percent of the more than 60,000 acres described in the project description on page two of the Board Summary Review.

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Board Summary Review – Lyme Timber NPS Project **(October 2017)**



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Pennsylvania Infrastructure Investment Authority Board Summary Review				Approval Date: 10/18/2017	
SUMMARY					
Project Name: Lyme Pennsylvania Headwaters/ Sterling Run Conservation and Restoration					
Project ID: 12006031708-CN		Funding Request Type: Non-point Source			
County(s)	Service Area Population	Service Connections	Senate District(s)	House of Reps District(s)	
Cameron	NA	NA	Scarnati, Joseph B.	Causer, Martin T.	
Legal Entity Name: Lyme Timber Company LP		Contact's Name: [REDACTED]			
Address: [REDACTED]		Address: [REDACTED]			
Telephone: [REDACTED]		Telephone: [REDACTED]			
Organization Type: Private Investor Owner		Year Incorporated: 2008		PUC Regulated: No	
TECHNICAL					
Project Description: Lyme Timber Company plans to purchase 23 large tracts of privately owned forest land, totaling 60,102 acres in Cameron, Clinton, Elk, Jefferson, McKean, Potter and Venango Counties, putting over 15%, or 9,362 acres of that land immediately into working forest conservation easement. In addition, Lyme Timber will offer conservation easement option rights to purchase future working forest conservation easements and invest \$550,000 in Acid Mine Drainage restoration projects within the Sterling Run property, which is located within the Chesapeake Bay watershed.					
Water Quality	Economic Development	Planning	Benefit-to-Cost	Public Safety	Compliance
NI	M	NI	L	NI	NSDI
Proposed Construction Schedule:		Start Date: 12/31/2017		Completion Date: 12/31/2018	
FINANCIAL/LEGAL					
Est. Total Project Cost: \$141,138,000.00		Legal Review:		Recommended	
Proposed Method of Financing Remainder of Project Costs:		Est. Annual Avg. Residential User Rate:		\$0.00	
Non-Repayment		Advance Funding Loan Amounts:			
Other Loans: N/A		Loan:		\$0.00	
Other Sources: Other Loan \$14,000,000.00		Non-Repayment:		\$0.00	
Local Contribution \$77,138,000.00					
Other Sources \$24,549,885.00					
Amount of Project Cost To Be Obtained Through Other Sources:		\$115,687,885.00			
Collateral (Hard)		The note of Lyme Pennsylvania Headwaters, LLC and an irrevocable bank letter of credit.			
STAFF RECOMMENDATION					
PENNVEST Recommendation:		<X> Approved <> Defer <> Disapprove			
Loan Amount: \$25,450,115.00		Term of Loan:		240	
Non-Repayment: \$0.00		Interest Only Period and First 5 Yrs of Amort:		1.000%	
		Yrs 6 to Maturity Amort:		1.000%	
Total PENNVEST Funding:		\$25,450,115.00			
SIGNATURE: 		DATE: 10/11/2017 12:00:00 AM			
Brian T. Johnson, Acting Executive Director for PENNVEST					

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Pennsylvania Infrastructure Investment Authority Nonpoint Source Management Program Projects

PROJECT NAME: Lyme Pennsylvania Headwaters/ Sterling Run Conservation and Restoration

APPLICANT: Lyme Timber Company LP

TOTAL PROJECT COST: \$141,138,000.00

ESTIMATED NUMBER OF CONSTRUCTION RELATED JOBS CREATED: 50

NUMBER OF THESE JOBS TO EMPLOY PA RESIDENTS: 50

PROBLEM TO BE SOLVED BY PROJECT:

Large scale commercial timberlands are being sold and subdivided at an unprecedented rate. These smaller parcels are more likely to be converted to uses other than large scale sustainable forest management resulting in increased runoff from development.

PROJECT DESCRIPTION:

Lyme Timber Company plans to purchase 23 large tracts of privately owned forest land, totaling 60,102 acres in Cameron, Clinton, Elk, Jefferson, McKean, Potter and Venango Counties, putting over 15%, or 9,362 acres of that land immediately into working forest conservation easement. In addition, Lyme Timber will offer conservation easement option rights to purchase future working forest conservation easements and invest \$550,000 in Acid Mine Drainage restoration projects within the Sterling Run property, which is located within the Chesapeake Bay watershed.

Lyme Timber Company is a 40-year-old timberland investment manager with working forest conservation easements and other conservation assets in 14 different states. The grant equivalent of the PENNVEST loan subsidy is \$9,597,033.

MAJOR BENEFITS OF THE PROJECT:

WATER QUALITY: Purchasing and protecting headwater streams, as proposed here, does the most for water quality protection since these are the originating waters for all larger downstream water bodies, whether they drain into the Chesapeake Bay, the Delaware Bay, or the Allegheny/Monongahela/Ohio river system. Many of the streams included in these parcels are Exceptional Value and High Quality status already, requiring no further restoration work. The proposal includes plans to address water quality in at least one large parcel afflicted by acid mine drainage, so protection will be coupled with restoration.

PLANNING: This project is a collaborative effort by PENNVEST, Department of Conservation Natural Resources (DCNR) and private industry to provide a more effective, or cost effective way to keep streams protected by protecting the forests around them. Conservation easements in this case provide a long-term water quality benefit, a complimentary economic and community benefit, and improve overall forest management through forest certification. In addition, working with the Cameron County Conservation District, Lyme Timber Company has agreed to construct \$550,000 in Acid Mine Drainage projects already designed by the Conservation District within the Sterling Run property.

BENEFIT TO COST: This project offers many environmental benefits. A working forest conservation easement will protect streams and other headwaters by protecting those waters from increased runoff, development pressures and changing land use regulations. There is no more effective, or cost-effective way to keep streams protected than protecting the forests around them. By using the conservation easement model, these acres remain in private hands, albeit with important conservation restrictions and no additional development. The particular parcels included here take advantage of existing seller opportunities but also happen to be located in the "conservation gap" area between DCNR's large state forest holdings in north-central Pennsylvania and the large and contiguous Allegheny National Forest to the west. A conservation "land bridge" between these two-large public conservation land holdings would create many advantages to migratory wildlife, stream systems, and the "wilderness" feel many visitors and PA residents can't find elsewhere.

ECONOMIC DEVELOPMENT: Permanent protection of these lands as protected working forests, combined with stream restoration activities and sustainable timber harvesting, will create over 50 new forestry jobs over the next several years and a private investment of \$91,000,000.

PLANNING COMMENTS:

This project is consistent with land use planning and farmland preservation efforts.

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Pennsylvania Infrastructure Investment Authority Nonpoint Source Management Program Projects

MEMORANDUM
PENNVEST NON POINT SOURCE
FINANCIAL CAPABILITY

RE: LYME PENNSYLVANIA HEADWATERS, LLC
PROJ. ID #: 12006031708-CN

Total Project Cost - \$141,138,000
PENNVEST Funding Request - \$ 50,000,000

Interest Rate:
Years 1-5 1.000%
Years 6-20 1.000%
Term 20 Years

TO: Pennsylvania Infrastructure Investment Authority (PENNVEST)

FROM: RKL LLP
Financial Consultant

DATE: September 18, 2017

DESCRIPTION OF APPLICANT: Limited Partnership

DESCRIPTION OF PROJECT: Forest conservation and reclamation and maintenance of riparian buffers for enhanced water quality

☒ The Above applicant appears to have the ability to repay the proposed PENNVEST loans of \$50,000,000 Based on the following criteria established by PENNVEST:

☐ The applicant has average Gross revenue that exceeds PENNVEST's Threshold for loan funding

☐ The applicant entity has average net cash flow for the last three years that exceeds PENNVEST's threshold for loan funding

☒ The owners of the applicant entity and affiliates have consolidated cash flow from other sources adequate to repay the PENNVEST funding that exceeds PENNVEST's threshold for loan funding.

☐ The applicant does not appear to have sufficient repayment resources to repay the PENNVEST loan based on the financial statements provided with the PENNVEST application and the criteria established by PENNVEST:

Conditions for loan approval:

1. The general obligation of Lyme Pennsylvania Headwaters, LLC, (a newly formed company).
2. The pledge of an irrevocable bank letter of credit for the outstanding balance of the PENNVEST loan on a declining basis.
3. The annual audited financial statements or Federal income tax returns of Lyme Pennsylvania Headwaters, LLC for the term of the PENNVEST loan.

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Appendix F

Distribution List

This report was distributed to the following Commonwealth officials:

The Honorable Josh Shapiro
Governor

Mr. Brion Johnson

Executive Director
Pennsylvania Infrastructure Investment
Authority

Mr. Robert Boos

Deputy Executive Director for Project
Management
Pennsylvania Infrastructure Investment
Authority

The Honorable Scott Martin

Senate Majority Appropriations Chairman
Pennsylvania Senate

The Honorable Vincent Hughes

Senate Minority Appropriations Chairman
Pennsylvania Senate

The Honorable Jordan Harris

House Majority Appropriations Chairman
Pennsylvania House of Representatives

The Honorable Seth Grove

House Minority Appropriations Chairman
Pennsylvania House of Representatives

The Honorable Eddie Day Pashinski

House Majority Agriculture & Rural Affairs
Chairman
Pennsylvania House of Representatives

The Honorable Dan Moul

House Minority Agriculture & Rural Affairs
Chairman
Pennsylvania House of Representatives

The Honorable Elder Vogel, Jr.

Senate Majority Agriculture & Rural Affairs
Chairman
Pennsylvania Senate

The Honorable Judy Schwank

Senate Minority Agriculture & Rural Affairs
Chairman
Pennsylvania Senate

The Honorable Kim Ward

President Pro-Tempore
Pennsylvania Senate

The Honorable Joanna McClinton

Speaker of the House
Pennsylvania House of Representatives

The Honorable Matt Bradford

House Majority Leader
Pennsylvania House of Representatives

The Honorable Bryan Cutler

House Minority Leader
Pennsylvania House of Representatives

The Honorable Joe Pittman

Senate Majority Leader
Pennsylvania Senate

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The Honorable Jay Costa

Senate Minority Leader
Pennsylvania Senate

The Honorable Uri Monson

Secretary of the Budget
Office of the Budget

The Honorable Stacy Garrity

State Treasurer
Pennsylvania Treasury Department

The Honorable Michelle A. Henry

Acting Attorney General
Office of the Attorney General

The Honorable Neil Weaver

Secretary of Administration
Office of Administration

Mr. William Canfield

Director
Bureau of Audits
Office of Comptroller Operations

Ms. Mary Spila

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