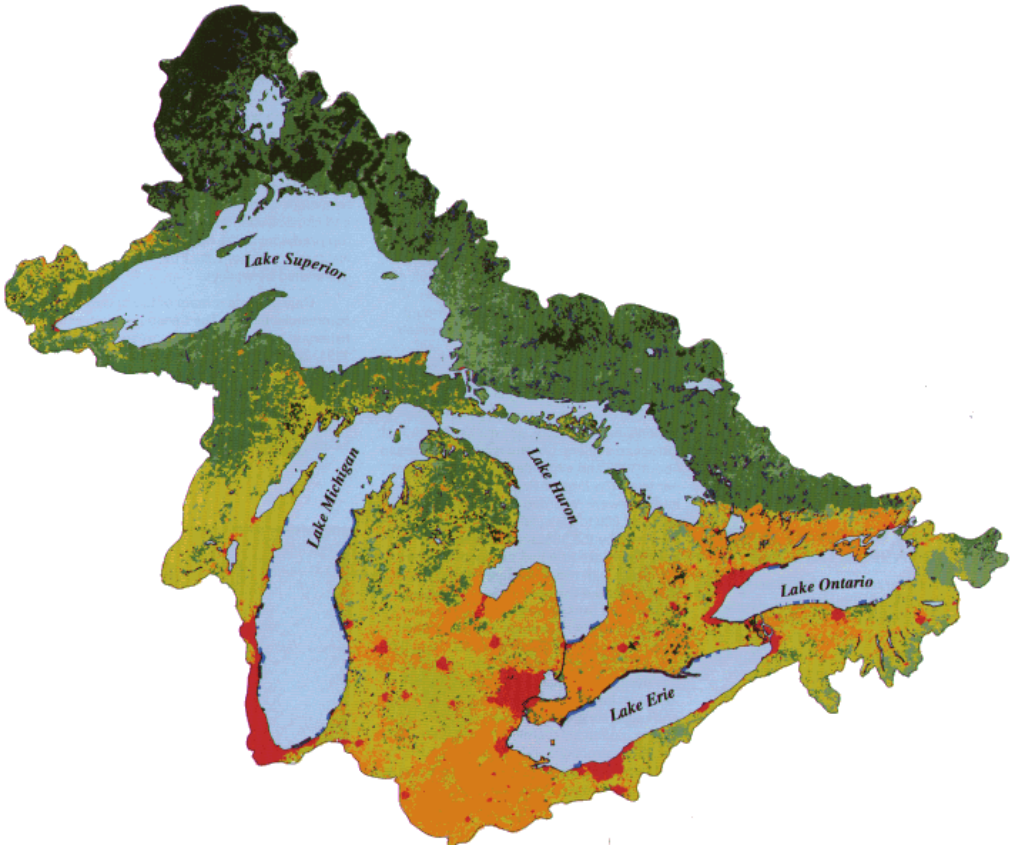
Proposal:

Two New and Innovative Financing Programs to Restore The Health of The Great Lakes
April 2008



"It must be remembered that there is nothing more difficult to plan, more doubtful of success, nor more dangerous to manage, than the creation of a new system. For the initiator has the enmity of all who would profit by the preservation of the old institutions and merely lukewarm defenders in those who would gain by the new ones."

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Participants

David A. Rogers, Esq.
Emmett M. Kelly, Esq.
Partners
Bricker & Eckler LLP
100 S. Third Street
Columbus, OH 43215
(614) 227-2367
drogers@bricker.com

Timothy P. Long
Michael R. DiPerna
Managing Directors
Robert W. Baird & Co.
10 W. Broad St., 25th Floor
Columbus, OH 43215
(614) 629-6951
tlong@rwbaird.com

Jeffery Trinca
Jennifer L. Latourette
Vice Presidents
The Implementation Group
101 Constitution Ave., NW
Suite 600 W
Washington, DC 20001
(202) 638-2950

Jeffrey M. Reutter, Ph.D.
The Ohio State University
OH. Sea Grant & Stone Lab.
1314 Kinnear Rd.
Columbus, OH 43212-1194
(614) 292-8949

Jane E. Montgomery, Esq.
Sean T. Maloney, Esq.
Schiff Hardin LLP
6600 Sears Tower
Chicago, IL 60606
(312) 258-5508

Gary L. Failor
Gary L. Failor, LLC
2198 Falls Oval
Westlake, OH 44145
(216) 952-4914

Keith Kolb
Managing Director
Robert W. Baird & Co.
777 E. Wisconsin Ave.,
17th Fl.
Milwaukee, WI 53202
(414) 765-3921

Ronald M. Shankman
Aramas Financial, LLC
471 Glenview Court
Westerville, OH 43081
(614-580-0256

Jerry J. Arkebauer
President
Arkebauer & Associates, LLC
7715 Gillcrest Rd.
Sylvania, OH 43560
(419) 480-9656

Tom Gavin
Managing Director
Robert W. Baird & Co.
300 E. 5th Ave., Suite 200
Naperville, IL 60563
(630) 778-9178

Stephen Szanto
Senior Vice President
Cabrera Capital Markets
Fifth Third Center
600 Superior Ave., Suite 910
Cleveland, OH 44114
(216) 344-7906

Glenn S. Krassen, Esq.
Partner
Bricker & Eckler LLP
1375 E. 9th Street, Suite 1500
Cleveland, OH 44114
(216) 523-5469

Summary of Two New and Innovative Financing Programs to Restore The Health of The Great Lakes

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SUMMARY

The severe problems facing the Great Lakes watershed are national in scope since the lakes represent 95% of the country's supply of fresh surface water and 20% of the world's supply. The health of nearly 30 million residents in eight states is directly tied to the health of the Great Lakes watershed. Solving the growing environmental human health concerns facing the Great Lakes watershed and the other important watershed's in the U.S. will require increased participation by the federal government. This report describes a new national program to restore this country's watersheds and two new financing programs that will be needed to make the restoration program a reality. See Sections IV and V for a discussion of basic questions involving both programs.

SECTION I

Strategies to Accelerate Restoration of the Great Lakes and Other Important U.S Watersheds

We are recommending creation of a new national program to establish "Watershed Restoration Zones" (WRZ) (creation of zones for specific purposes is a tool Congress has used before) to restore damaged watersheds and we are recommending that the program be implemented through the U.S. EPA in 1-3 pilot watersheds. We have developed very simple, straight-forward, and logical criteria to select pilot WRZs, and we believe these criteria will allow the Great Lakes watershed to be ranked number one when pilot WRZs are selected. The same criteria will be used to prioritize individual improvement projects within the Great Lakes region.

To finance restoration activities within WRZs **we are recommending the implementation of two nationwide financing programs:**

The first program will use **federal tax credit bonds,** to be issued by the individual states and implemented through the U.S. EPA, to finance critical water and wastewater projects.

The second program will encourage each of the Great Lakes States, and other interested states throughout the U.S., to create **individual bond fund programs** to help finance important water and sewer improvements within their respective states.

If fully implemented, these two programs could more than ***double the available funding*** for the Great Lakes and other important U.S. watershed restoration projects. These additional resources will dramatically accelerate the restoration of such watersheds. These two strategies have been used before within the U.S. public finance industry, but not in tandem, and have not been available for these types of projects. This combination represents a powerful new financing mechanism that can help restore these important watersheds, including the Great Lakes, at a faster pace than existing financing.

After an extensive review of existing federal and state programs, the following, in combination, represents the recommended federal and state financing programs:

- **Federal Tax Credit Bonds:** Authorize a new type of "federal tax credit bonds" to be issued by each state within a selected "watershed restoration zone (WRZ)". The federal tax credit program would eliminate interest costs on bonds issued for critical water and wastewater projects within any "WRZs" throughout the U.S., including the Great Lakes; and

- **State Bond Fund Programs:** Assist any state within the U.S., including the Great Lakes States, in creating a "Watershed Renewal Bond Fund Program" which would issue the "federal tax credit bonds" and other "tax-exempt bonds" for restoring the respective watersheds.

  The bond fund program would provide state, local and water and sewer authorities another vehicle to issue tax-exempt and taxable bonds for qualified projects without having to pledge their full faith and credit to such bonds. The program would be rated by the national rating agencies and therefore would provide those borrowers access to the capital markets and competitive interest rates. The program would not be governed by existing federal rules that currently govern many existing resources, so the program could be more flexible and could finance a wider spectrum of projects.

It is expected that the Administration of these programs, which would supplement existing State Revolving Fund Programs ("SRFs"), would be managed by each state's existing SRF staff. However, these decisions will be decided by the individual states.

While both programs are designed to be implemented within any state or watershed restoration zone, our report speaks to the restoration of the Great Lakes.

SECTION II
Challenges Facing the Great Lakes and the U.S.

When the spotlight is focused on the Great Lakes, it is obvious the problems affecting the Great Lakes are real. The multitude of industrial pollutants, farm and road runoff, and even air pollutants are having detrimental effects on the Great Lakes ecosystem. In 2005, the Great Lakes Regional Collaboration, a White House-backed group convened by the U.S. EPA, estimated that the cost of cleaning up the Great Lakes watershed could reach $20 billion. The vast majority of what goes into the Great Lakes never leaves.

Many of the 30 million residents who live within the Great Lakes watershed contribute to the degradation of the Great Lakes every time they flush their toilets. In 2004, more than 8 billion gallons of raw sewage was discharged into Lake Erie and waterways that feed the Lake, according to the Ohio Public Interest Group. The primary cause of this problem is the fact that the Great Lakes region has nearly half of the nation's 828 combined sewer systems ("CSOs").

U.S. Representatives Mark Kirk and Dan Lipinski, both of Illinois, have introduced legislation to quadruple fines to up to $100,000 a day for cities sending sewage water into the Great Lakes beginning in 2027. In the meantime billions and billions of gallons of raw sewage may enter the Great Lakes.

Here are a few statistics on the broader challenges facing the entire nation:

- According to the U.S. EPA, 772 communities throughout the U.S. serving 40 million people have inadequate wastewater and sewage facilities.
- By 2030, the cost of maintaining the average drinking water utility will increase by 350% as these facilities continue to age.
- $1.2 trillion needed for water and wastewater utilities over the next 20 years.
- More than 450,000 miles of water and waste water pipes need replacing.
- However, federal funding for water and wastewater projects was reduced by almost 20% from 2004 ($1.31 billion) to 2007 ($1.06 billion).

SECTION III

Existing Federal, State and Local Resources Are Not Adequate

The Federal Clean Water Act required communities with such CSOs to meet the following nine specific minimum criteria by 1997.

- Proper operation and maintenance of collection systems,
- Maximizing use of the collection system for storage,
- Modifying pretreatment systems to avoid overflows,
- Maximizing flow to the publicly owned treatment works for treatment,
- Elimination of dry weather overflows,
- Controlling solid and floatable materials in CSOs,
- Preventing pollution,
- Improving communications with the public about overflows, and
- Preparing long-term plans for reducing overflows by upgrading infrastructure.

Unfortunately, about 62% of the communities failed to meet the nine criteria, most citing lack of money as the biggest reason restricting progress.

Methods of funding the costs of water and wastewater system improvements have changed during the last four decades.

- In the 1970's the U.S. EPA provided construction grants to cover 75% of the costs of water and wastewater improvements. The required 25% local match generally was met through local governmental bonds to be repaid through user fees.

- In the 1980's, direct grants were reduced by 45% and the SRFs were established under the Clean Water Act to provide low-cost financing for water and wastewater projects.

Congress is considering wastewater needs for the 21st century. A Senate Sub-Committee held a hearing on this topic on Sept. 19, 2007. In the House, the Subcommittee on Water Resources and Environment held hearings in October, 2007 on "Progress Towards Improving Water Quality in the Great Lakes" and the "Raw Sewage Overflow Community Right-to-Know Act".

One Example of Inadequate Resources:

While the city of Indianapolis is not within the Great Lakes Watershed, the example below is considered a good example of the CSO problems facing the U.S. and the Great Lakes States. The Q and A shown below was posted on the website of the City of Indianapolis.

City of Indianapolis

Combined sewers use the same collection system for moving storm water and raw sewage to treatment plants. When the systems overflow during rainstorms, contaminated water is dumped untreated into lakes, rivers and streams. The Ohio Public Interest Group estimated in 2004 that more than 8 billion gallons of sewage was discharged into Lake Erie and waterways that feed the Lake.

The City of Indianapolis recently financed major improvements to its sewer facilities. The city posted a series of frequently asked questions on the internet to help residents understand the benefits and the costs of the project. This situation underscores the problem facing governmental entities today in an effort to fix the existing water and sewer infrastructure. Here are a few of the Questions and Answers related to the project:

Question #1: How much will my sewer rates increase?

Answer #1: Your sanitary sewer rate increase will be phased in over the next three years. The average homeowner using 5,400 gallons per month will see his monthly bill increase from $9.59 today to $12.38 in 2006, $15.17 in 2007 and $17.96 in 2008. New or increased fees also are proposed on new developments and new connections to the sewer system.

Question #2: Will these be the last rate increases needed to pay for the city's plan?

Answer #2: No. Regular sewer rate increases will be required every year for the next 20 years to finance the projects required by the state and federal governments.

Question #3: Will the long-term solution completely eliminate all raw sewage overflows?

Answer #3: No. At the end of 20 years, overflows will be reduced dramatically from today's 45-80 storms each year down to 0-10 storms. Actual frequency will depend on the weather, but only the largest storms will still cause some overflows. Also, overflows will occur when streams are flowing fast and people are not likely to be exposed to raw sewage. The city's goal is to develop an affordable plan that will focus dollars on projects that will do the most to improve water quality and protect public health.

SECTION IV
Strategy #1 - Federal Tax Credit Bonds

What is a "Tax Credit Bond"?

It is a type of bond that is authorized by Congress and is issued by a political subdivision of a state. Bondholders of such bonds receive no direct interest payments. Instead, the bondholder receives a direct credit off their federal income taxes equal to the amount of interest that would otherwise be paid.

What is the Primary Purpose of the Tax Credit Bonds?

The benefit of the program is to improve the water quality and ecosystem of federally-designated Watershed Restoration Zones, including the Great Lakes. The interest on the Bonds will be subsidized by federal tax credits. Through this program, the ability to improve the water quality and restore the ecosystem of the Great Lakes will be greatly accelerated.

Has Congress Ever Authorized Federal Tax Credit Bonds?

Congress has previously authorized federal tax credit bonds. Currently, the eligible activities for tax credit bonds are limited to: (i) qualified zone academy bonds (QZAB's); (ii) clean renewable energy bonds (CREBs); and (iii) qualified projects within the Gulf States devastated by Hurricane Katrina.

To date, Congress has authorized approximately $16.6 billion of tax credit bonds for these purposes. Congress has recently considered expanding the use of tax credit bonds for rural development, construction of new public schools, transportation related infrastructure projects, and other uses.

What financial costs are required to make this work?

Lost tax revenue to the federal government based upon the federal tax credit associated with such bonds.

How well have the other Federal Tax Credit Programs worked?

QZABs have worked well. CREBS are gaining in popularity as the green energy sector develops; the final $400 million (out of $1,200,000,000) in allocation was just awarded**.**

From Congress' perspective what is new or better about this Program?

Using tax credit bonds for environmental projects would be a new approach. It is arguably better than grants because you finally give states something after years of declining grant funding, but still require private sector participation. Part of the "value" is political. The tax credit program could be provided as a response to a bi-partisan request by the 3 or 4 largest watersheds in the country. This support should be easy to find, since the cost of fixing the required water and sewer infrastructure is a critical issue to many communities throughout the U.S.

What are the best arguments against Tax Credit Bonds?

Many people would prefer to increase federal and state grants to restore the Great Lakes ecosystem, and we should clearly continue to seek such funding. However, the state of the economy and the budget process make additional grants unlikely. Therefore, we have developed a strategy that we believe is much more likely to be successful.

Opponents might suggest that tax credits are inefficient and grants provide more control. In reality, tax credit bonds provide almost twice as much project capital as other bonds and, unlike grants, combine participation in the public and private sectors in the solution by requiring private investment in the bonds and requiring that the projects be approved and fully funded before federal funding (tax credits) are provided.

What is the history of the Federal Tax Credit Bond in drinking water and wastewater infrastructure?

There has been some discussion within the State SRF community, but nothing concrete has materialized. By creating a national program with pilot watersheds, we hope to be able to gain national support while controlling annual expenditures.

Why would Federal Tax Credit Bonds be better than Federal Grants?

We would not suggest that tax credit bonds are better than grants. However, tax credit bonds are more likely to become a reality because: (i) costs of the program can be controlled by the creation of pilot WRZs; (ii) tax credit bonds require the participation of both private bond investors as well as the federal government; (iii) the federal tax credit is only provided to those projects that have been approved and are ready to be constructed; and (iv) the tax credit effects the federal budget the life of the bond issue (15 to 30 years) versus a one-time upfront cost.

If Congress approves the Tax Credit Program, what must the States do?

The states must authorize issuance of such bonds by a state agency. Then the states' SRFs could issue a survey to their cities and sewer districts for interest in participating. They must identify the mechanism to review, evaluate, and rank applications so that the highest impact projects receive the first funding.

Has model Legislation been drafted?

Not yet – it would be part of the actual lobbying effort. We would be willing to assist with this process.

How Would Local Governments Obtain the Ability to issue Tax Credit Bonds?

Local municipalities within the Great Lakes States are expected to apply to the respective state for authorization. Each state will have its own application based upon the federal allocation of tax credits to each Great Lake State.

Who is likely to want this Program?

Since tax credit bonds can more than double the amount of infrastructure improvements for each $1 of rate increase, municipalities, sewer districts, elected officials and rate payers should support the program. In addition, the Governors, legislatures and SRFs of the Great Lakes States and anyone seeking to restore the Great Lakes ecosystem should also want to support this program.

Who Can Purchase Tax Credit Bonds?

Existing tax credit bonds, as well as the proposed tax credit bonds, are able to be purchased by banks, insurance companies, other financial institutions, and qualified individuals.

What are the Primary Benefits To Borrowers?

With tax credit bonds, the borrower does not pay any interest, and is obligated to repay only the principal of the bonds. Therefore, with this savings, the borrower could finance almost twice the amount of infrastructure costs.

How is the Tax Credit Determined?

Instead of receiving periodic interest payments, bondholders are entitled to claim an annual federal tax credit against their federal income taxes equal to the imputed interest component on the tax credit bonds. The interest rate on existing federal tax credit bonds equals 110% of the interest rate on comparable U.S. Treasury bonds. Therefore, the federal tax credit pays the interest component related to such bonds.

What is the Proposed Limit of Tax Credit Bonds?

It is hoped that Congress would authorize at least $12 billion of federal tax credit bonds for projects aimed at cleaning up our nation's major water ecosystems. It is expected that the tax credits would be authorized over five years within three qualified zones throughout the U.S., including the Great Lakes watershed. If three zones were initially created, approximately $4 billion would be available for restoring the Great lakes watershed.

How Do Tax Credit Bonds Provide Additional Resources?

Consider a Great Lakes community with 31,380 households that is facing significant costs to improve its wastewater collection and treatment systems. Assume the users of the system would accept a maximum annual increase in user charges of $100 per household, or $3,138,000 a year to improve its water and waste water improvements.

Under a traditional tax-exempt bond transaction, such user charges would be sufficient to pay the debt service on $50,000,000 of bonds at an estimated 4.75% tax exempt rate over a 30-year term. Under a federal tax credit bond transaction, the same user charges would be sufficient to leverage approximately $93,000,000 of tax credit bonds over the same term. The reason is that there are no interest costs on the tax credit bonds.

How much funding will this provide to the Great Lakes region?

This will depend entirely on the amount of tax credit bonds that are authorized by Congress. We believe $2 billion to $10 billion is possible. Since funding needs by the Great Lakes are estimated to be $20 billion, the tax credit program will provide between 10% and 50% of the total need. However, our plan is to allow continued funding to WRZs that are meeting expectations and performing well, so Congress could authorize more over time.

Where Should The New Tax Credit Zones Be Located?

This program should begin with pilot Watershed Restoration Zones in different regions of the country. For example, pilot projects could be targeted within three major watershed regions. Given its national significance, it is expected that the Great Lakes region would be one of the pilot Watershed Restoration Zones.

How Should Pilot Projects be Selected for the Initial Watershed Restoration Zone?

The five criteria shown below are recommended to be used to evaluate and rank each potential Watershed Restoration Zone:

- Impact on Human Health: Priority should be given to projects that provide: (i) Safe drinking water; (ii) Elimination of combined sewer overflows; (iii) Elimination of Harmful Algae Blooms; (iv) Elimination of Beach Closures; (v) Elimination of pharmaceuticals in drinking water and from sewage effluents; (vi) Swimming, SCUBA Diving and Boating Safety; and (vii) Seafood Safety.

- Economic Health of the Watershed: Regions with high unemployment, low median income, and low rate of business growth should be given priority.

- Age and Condition of the Infrastructure: Regions with aging and failing infrastructure and not meeting the nine minimum criteria of the U.S. EPA for CSOs should be given priority.

- Population within the Watershed: Regions with a greater population and where human impact is high should be given priority.

- Meeting Ecosystem Management Objectives in the Watershed: Priority should be given to projects that restore the aquatic ecosystem and contribute to ecosystem management goals and objectives within the watershed.

In addition, these five criteria could be used by the states within each Watershed Restoration Zone to rank projects applying for authorization to issued tax credit bonds.

SECTION V

Strategy #2 - Great Lakes Renewal Bond Fund Program

What is the Purpose of the Bond Fund Program?

The purpose of the Great Lakes Renewal Bond Fund Program (the "Program") is to provide low cost, flexible and long-term fixed rate financing of qualified projects which will help restore the ecosystem of the Great Lakes. The Program will be able to offer low cost financing through the issuance of both federal tax credit bonds and tax-exempt bonds. The Program will offer immediate access to the capital markets based upon the expected "AA-" bond rating from the national rating agencies. This will translate into some of the lowest rates - - best leverage - - available to municipal borrowers in the capital markets.

What is a "bond fund"?

It is a programmatic credit vehicle that is separate and distinct from the political subdivision that actually issues the bonds through the "bond fund". A "bond fund" is another name for a pooled security bond program that allows bonds to be issued and loans to be made on a project-by-project basis. It starts with a program reserve (usually supplied by the state) and then that state (or an agency) issues bonds where all participants repayments cross-collateralize each other.

How does the State Bond Program relate to Federal Tax Credit Bonds?

The new state bond funds can issue tax-exempt bonds or the proposed "taxable federal tax credit bonds". It is two programs that can work together. However, the tax credit bonds could be issued within the bond fund program (if the state creates a bond fund program) or individually (if the state elects not to create a bond fund program).

Can one program work without the other?

Yes, but the synergies of the combined programs would show Congress that the Great Lakes States are ahead of the game and committed to using the proposed new tax credit bonds; i.e., it provides leverage that can be used when seeking to participate in the new Watershed Restoration Zone pilot program to be created by Congress.

What would be the Primary Benefits to Borrowers?

The Bond Fund Program would provide significant benefits to the borrowers, including:

- Provide loans for up to 30 years;
- Finance up to 100% of eligible project costs;
- No interest costs related to the federal tax credit bonds;
- Provide low interest costs for projects financed with tax-exempt bonds, due to the high investment grade rating of the Program;
- Expand the number of qualified projects by issuing bonds that are not subject to the typical federal water and wastewater guidelines;
- Guidelines can be flexible to meet needs of each Borrower;
- Each Project is financed by a separate bond issue, but all Bonds become part of the pooled security of the Program;
- Reduce the time needed to finance projects; and
- Reduce bond issuance costs by using standard documents.

Would the State Bond Fund Program be helpful to strong Borrowers like big cities and sewer districts?

The state bond fund programs pool credits and provide real credit strength without bond insurance or other credit enhancement (which is very important in today's market) and without using the full faith and credit of the municipality or sewer district. The program is likely to be more flexible than existing programs since no direct federal funding will be used to create the bond fund program.

Do Other Similar Programs Exist in the U.S.?

Many governmental entities throughout the Great Lakes States have created bond fund programs, including the following:

Issuer/ Administrator	Rating	Created	Borrowers
Minneapolis Community Development Agency	"A-"	1983	Private/Public
City of Milwaukee, Wisconsin	"A-"	1986	Private/Public
Toledo-Lucas County Port Authority	"BBB+"	1988	Private/Public
State of Ohio - Department of Development	"AA-"	1989	Private/Public
Cleveland-Cuyahoga County Port Authority	"BBB+"	1996	Private/Public
Summit County Port Authority (Akron, Ohio)	"BBB+"	2003	Private/Public
Dayton-Montgomery County Port Authority	"BBB+"	2003	Private/Public
State of Ohio - Department of Transportation	"AA-"	2006	Public
Columbus Regional Finance Authority (Ohio)	“BBB+”	2007	Private/Public

What has been the default history of the existing Bond Funds?

There have been no draws against any of the Program Reserves of the above Programs. The few defaults that have occurred have been resolved without using such Program Reserves. However, this Program will be even less likely to incur defaults since all borrowers are expected to be political subdivisions and governmental agencies.

Who would issue the Bonds?

It would be expected that each Great Lake State would use the SRF and its executive staff to issue the Bonds and manage the Program. Each state could consider using any available state issuing authorities.

How does this proposal relate to the Great Lakes Regional Collaboration?

The criteria used to rank Watershed Restoration Zones and individual projects within WRZs were based upon the concerns and needs of the Collaboration. Furthermore, the kinds of projects we anticipate being able to support are exactly the kinds of projects recommended by the Collaboration. This program could be one of the tools in the arsenal used by the Collaboration to restore the Great Lakes ecosystem.

What are Qualified Projects?

Proceeds from the issuance of bonds within the Program will be used to restore the ecosystem of the Great Lakes through the acquisition of land, construction or renovation of real property and structures, acquisition or renovation of systems and equipment, and to finance related soft costs, including interest and financing costs.

While the emphasis will be to finance needed Great Lakes water and wastewater infrastructure projects, if any state so desired the tax-exempt bonds issued within the Bond Fund Program could be extended to other tax-exempt qualified projects including non-point source pollution control projects.

What will be the Typical Size of each Bond issue?

It is expected that the principal amount of each Bond issue would generally range between $3,000,000 and $25,000,000. Larger projects may be permitted based upon the size of the Fund's loan portfolio and if the borrower meets certain credit standards.

What would be the Term and Interest Rates of the Bonds?

The Program would issue Bonds and make direct loans to each borrower. The terms of each loan would be as follows:

Term of Loans - Up to 30 years based upon useful life of the assets financed.

Fixed Interest Rate - The interest rate will be fixed for the term of the issue based upon tax-exempt or taxable bond rates at the time the bonds are sold.

- The interest rate on bonds would be based upon the expected "AA-" rating of the Program.
- The borrower would not pay any interest associated with any tax credit bonds issued within the Program.

Does the Borrower need to Issue Notes to finance Construction?

No, the Bonds can be used for both construction and permanent financing. By avoiding issuing Notes, the Borrowers can lock in fixed rates at the time they commence construction. In addition, the Borrowers can avoid the issuance costs associated with two series of bonds vs. one.

What are the Acceptable Credit Standards for each Borrower?

Qualified Borrowers of the Bond Program will include cities, counties, villages, state agencies, boards, or commissions, regional transit boards and port authorities, and other governmental entities. Such borrowers must also meet certain minimum credit standards, as set forth below:

- Ability to repay;
- Management of project;
- Need/Public benefit;
- Collateral or repayment sources;
- Approved bids for construction of the project; and
- Status of project in relation to actual construction startup.

What is the Security for the Bonds?

The state may consider any of the following as security for each proposed Bond issue:

- Pledge of the borrower's full, faith and credit;
- Moral obligation to annually appropriate debt service as part of the annual budget of the Borrower;
- Guarantees from borrowing political subdivision or other related entities;
- Senior pledge of certain identified revenue streams such as water or wastewater charges, sales taxes, license fees, property taxes, grants, non-tax revenues, other fees, or other revenues available to support the Bonds; and
- Other credit enhancement as deemed necessary.

Could the Program Issue Both Tax-Exempt Bonds and Tax Credit Bonds?

Tax-Exempt Bonds - The Program would be able to issue tax-exempt Bonds, subject to federal tax law. The interest on these Bonds will be exempt from both federal and state income taxes (with certain restrictions).

Tax Credit Bonds - It would be expected that the Tax Credit Bonds described herein would also be issued within the Program.

How would the Program be Secured?

In order to obtain the appropriate bond rating for the Program, several different structures could be used. Set forth below are a few options that should be acceptable to the rating agencies:

Moral Obligation/Program Reserve: The state could provide a "moral" obligation to make payments on any Bonds that default within the Program. This type of state support would not affect the debt capacity of the state. In addition, the state would fund a fixed Program reserve equal to approximately $10 million. The size of the Program Reserve would depend upon the size of the portfolio of each Program.

Minimum Debt Service Coverage Test: The state could pledge an acceptable stream of revenues that would equal approximately 10% of the debt service payments on the Bonds issued within the Program. In addition, certain limits would be placed on issuing bonds for any borrower that does not have an existing rating from a national rating agency of “A” or higher. The Program would also apply certain limits to any one Borrower (i.e. typically no Borrower could exceed 10% of the outstanding bonds within the Program).

Would the Bonds be Rated?

Each Bond will be submitted for a rating prior to the Bonds being sold. However, the rating is based upon the Program's the level of reserves and the portfolio of loans and is expected to be AA-.

If a Borrower defaults, how are the Bondholders paid?

If a Borrower defaults on a semi-annual payment, the Program reserves would enable the Trustee to make principal and interest payments to Bondholders as scheduled.

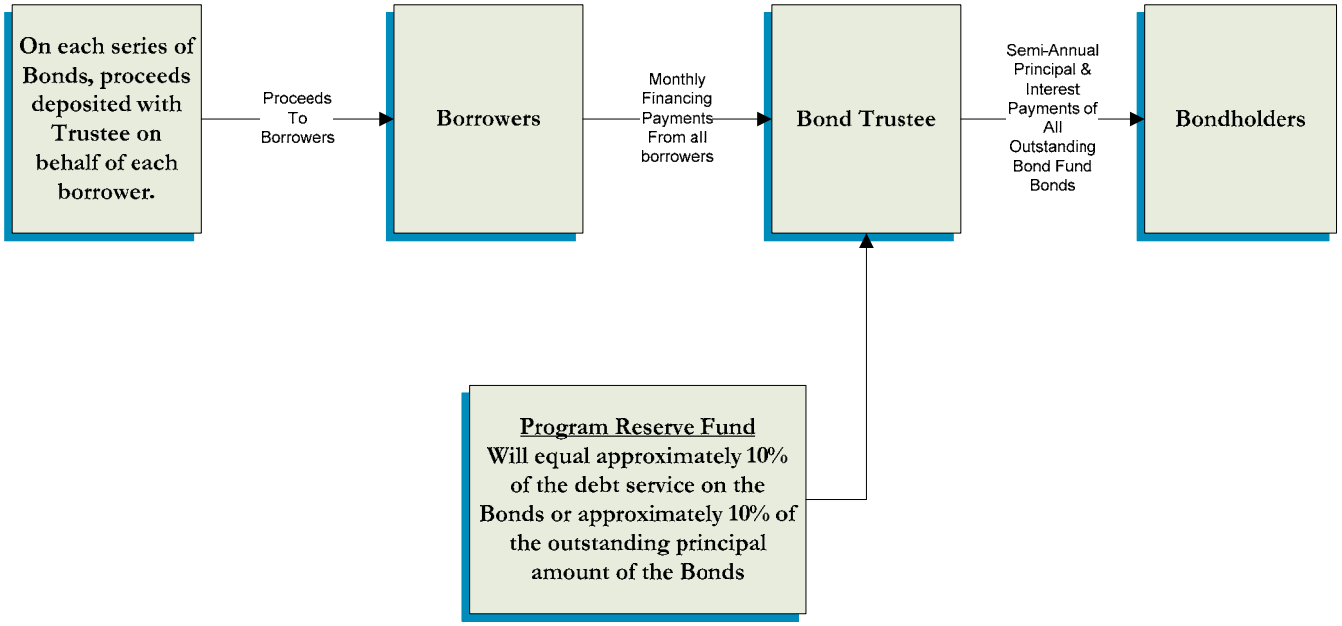
Who Would Disburse the Proceeds of the Bonds and Make Payments to Bondholders?

The state would engage a major commercial bank as the Trustee for the Program and for all Bonds issued within the Program. At the closing of each Bond issue the proceeds would be held by the Trustee and disbursed according to the disbursement agreement with the Program. Borrowers would make semiannual interest and principal payments to the Trustee and the Trustee would make the semiannual payments to the Bondholders.

Is the financial services sector likely to support this Program?

Yes, because it is a new program working in conjunction with existing funding mechanisms. The big winners will be everyone living in the Great Lakes region, including those who drink the water, eat the fish, and enjoy the Great Lakes.

What is the Typical Flow of Funds Within the Program?



What Existing Bond Fund Program is most similar to the Proposed Program?

The recently created **Ohio Department of Transportation Bond Fund Program** is the most similar to the proposed Great Lakes Renewal Bond Fund Program.

Mission: The overall mission of the ODOT Bond Program is to serve the connectivity of Ohio's transportation system such as corridor completion, infrastructure enhancements and economic development in order to better compete in global economy and improve quality of life. The Program was created to enhance the number of transportation projects that can be completed within the state that otherwise would not have been considered for traditional grant funds in the past or are not ranked on the State Transportation Improvement Program.

Purpose**:** Established by the Ohio Department of Transportation (ODOT) in 2006, the Program was created to assist Ohio political subdivisions access to the national capital markets. The Program's lower financing costs, based upon its "AA-" rating, is passed along to qualified borrowers with no annual ODOT fees.

Issuance of Bonds: Bonds are issued on a project-by-project basis and bond proceeds are lent to borrowers by ODOT.

Eligible Borrowers: Ohio political subdivisions including cities, counties, townships, villages, port authorities and metropolitan planning organizations.

Loan Amounts/Terms**:** Loan amount range from $1,500,000 to $10,000,000 for up to 30 years.

Existing Bond Rating: "AA-" by Standard & Poor's.

Eligible Projects: Include road construction and repair, bridges, rail, transit and airport infrastructure, parking structures, docks and wharfs as well as other transportation enhancement projects.

Prior Project Financings: To date, two projects have been financed in the Bond Program totaling over $12 million in bond proceeds.

Time Frame to Complete Each Financing: 60 to 90 days from receipt of application.

Year Program Commenced: 2006

SECTION VI
Conclusion

Clearly the current available resources are not sufficient to pay for the estimated $20 billion of improvements needed to restore the health of the Great Lakes.

Traditional ways of meeting the need are not adequate. Federal dollars flowing to SRF Programs already have been reduced by about 20% and future reductions are expected.

This Report has presented the case for authorizing federal tax credit bonds and the establishment of a Bond Fund Program within each Great Lakes State. Collectively, these efforts would jump start water and wastewater infrastructure improvements throughout the Great Lakes region.

Also included in this Report is a proposed roadmap to engage the legislative process to implement the federal tax credit program.

The participants in this Report believe that the recommendations presented here offer a real chance of success to accelerate the restoration of the Great Lakes Watershed. However, the recommendations can not succeed without the support and political will of the decision makers within the Great Lakes States.

SECTION VII
Next Steps

We would recommend distributing the Report to each of the Great Lakes' SRFs for their review and comment. We are available to discuss this report with the GLPF staff, GLPF Board or a select number of SRFs. We would also be interested in working on the next phase of the program by working to promote the programs and assisting with legislation. If approved, we could assist with implementing the programs at the state and federal level.

APPENDIX A
State Revolving Loan Funds

The fundamental financing concepts embedded in the SRFs programs make them an invaluable tool for local governments to finance infrastructure needs at below market interest rates. Utilizing tools available in the municipal market place and the expertise of various investment bankers, financial advisors and bond counsel, SRFs have been and continue to play a major role in meeting the needs of infrastructure financing.

Bond rating agencies emphasize the financial strength of the SRFs in the Great Lakes area by rating most bonds issued under the programs AAA. The SRF Programs originated in 1988 utilizing primarily grants provided by the federal government under the Clean Water Act. Most SRFs have increased their loan volume by leveraging these grants, as well as loan repayments.

The SRFs in the Great Lakes States use one of two financing models, either a Reserve Model or a Cash Flow Model.

Under the Reserve Fund Model, states place all federal grant dollars received into a Reserve Fund. Those dollars, and the significant interest earnings on the Reserve Fund, are available to cure a default. The massive size of the Reserve Fund results in significantly higher bond ratings, and lower interest rates to the governmental borrowers. Illinois, Indiana, Michigan, Minnesota, New York, and Wisconsin use the Reserve Fund Model.

Under a Cash Flow Model, the federal grant dollars create a revolving loan program and are lent to various communities together with proceeds from the issuance of bonds. The debt repayments by borrowers then are loaned to other communities. Ohio and Pennsylvania use the Cash Flow Model.

Some states have developed smaller programs which could be considered hybrids since they combine elements of a Reserve Fund Model and a Cash Flow Model, Regardless of the model employed, these programs have a finite capacity. Some states already are restricting the maximum size of a loan.

As a part of the research for this Report, representatives of each of the SRFs within the Great Lakes States were contacted for information about their Programs. Among the eight Programs are some similarities and some differences.

Generally, each SRF has been successful in funding water and wastewater projects within their state. Again, Appendix A shows the amount of water and wastewater loans each state has made.

It is beneficial to review all of the SRF programs to see how they operate, highlighting some of the program differences and similarities.

Beyond the significant contributions made by these SRFs, some Great Lakes States have initiated other programs to help fund water and waste water projects. These programs include:

- Hardship programs to help disadvantaged communities;
- Erosion control programs along the Great Lakes coastline;
- Grant programs to help reduce the cost to local governments for water and wastewater projects;
- Programs to fund various non-point source projects in the Great Lakes watershed; and
- Programs to fund emergency assistance for areas hit by natural disasters such as tornadoes and floods.

ILLINOIS FINANCE AUTHORITY

Geoff Andres, *Finance Manager*
Marcia Wilhite, *Chief Bureau of Water,* Illinois EPA

The Illinois Environmental Protection Agency operates the Illinois SRF, with the program having been leveraged twice with revenue bonds issued by the Illinois Finance Authority. The Illinois programs use the Reserve Model and to date have met loan demand, with the assistance of revenue bond issues in 2002 and 2004, based on applications received. The time it takes to process and complete loans sometimes has been complicated by a relatively small staff and by attrition within the staff. During a typical year, the Fund will loan $135 million to $145 million for wastewater and $35 million to $45 million for drinking water projects. The Metropolitan Water Reclamation District of Greater Chicago is allocated approximately 50% of wastewater SRF funds annually, including a recent loan for $52 million. The average loan interest rate for the programs is less than 3.0%, with the minimum rate of 2.5% offered for the past five consecutive years. Most loans have a term of 20 years.

Illinois has instituted the Unsewered Communities Grant Program as a companion to the Water Pollution Control Loan Program financed through the Illinois SRF. The program provides grants up to 70% to fund wastewater projects in incorporated communities without public wastewater systems.

Future demand for Illinois is estimated to be $11.9 billion.

INDIANA FINANCE AUTHORITY

Matt Martin, *Program Manager*

The Indiana Finance Authority operates Indiana's State Revolving Fund (SRF) Loan Programs. The Indiana Programs use the Reserve Fund Model, and to date have met the demand for loans. The Indiana SRF Loan Programs use a matrix to determine interest rates for the projects to be funded, with Median Household Income (MHI) and user charges as the two main components of the matrix. The City of Indianapolis typically has used approximately 20% of the total amount loaned by the SRF. The average interest rate is 3.30% and the typical term is 20 years.

Overall, the Indiana SRF Loan Programs have received $690 million in federal grants and has loaned out approximately $2 billion to Indiana Participants. Today, the SRF Programs have approximately $1.82 billion in Program Bonds outstanding.

Future demand in Indiana is estimated to be $7.2 billion.

MICHIGAN BOND AUTHORITY

Janet Hunter Moore, *Executive Director*

The Michigan Department of Environmental Quality and the Michigan Municipal Bond Authority jointly operate the Michigan SRF Program using the Reserve Fund Model. The Program has received $1.3 billion of federal grants and has loaned more than $2.7 billion. The Michigan Program expects to loan $560 million in 2007 and about $500 million in 2008. Many municipalities in Michigan do not use the SRF which could help account for the fact that to date all loan applicants have been funded. The largest borrower for the Michigan Program is the City of Detroit which is borrowing $157 million in 2007. However, Detroit faces over $580 million in future water and wastewater projects.

The Program's current interest rate is set at 1.625% with typical terms of 20 years.

Combined Sewer Overflow projects represent the largest future project demand. The cities of Detroit, Dearborn, Lansing and Port Huron all face significant CSO projects. One key problem that Michigan faces in its Program is higher than average user charges. Water and wastewater rates continue to climb to pay for only a portion of the additional work that must be done.

Michigan has added the S2 Grant Program funded by the State of Michigan at $1.0 billion. Of this amount, $900 million is allocated to the Michigan State Revolving Fund Program, with the remaining $100 million going to specific projects, including private use, septic and storm water projects. The S2 Program also has brought new governmental borrowers to Michigan's SRF.

Future demand for Michigan is estimated to be $4.1 billion.

MINNESOTA PUBLIC FACILITIES AUTHORITY

Terry Kuhlman, *Executive Director*

The Minnesota Public Facilities Authority operates the Minnesota SRF Program which uses the Reserve Fund Model. As of June 30, 2006, Minnesota had received $607 million in wastewater and water capitalization funds which have been leveraged to provide more than $1.958 billion in loans. The Minnesota program receives between $250 million and $300 million in loan applications a year and funds approximately $180 million annually. Minneapolis – St. Paul uses about $50 to $100 million a year. Loans carry an interest rate of 2% and a term of 20 years.

Minnesota also has funded another state Program with other state moneys for a 0% loan program with loans maturing in 40 years. Payments on the state funded program can be deferred to start one year after the SRF loan is repaid. The state funded program monies can also be used to match USDA Rural Development grants for small communities. Other uses of the state program include: a) 75% grants up to $500,000 for phosphorus reduction treatment, b) 50% grants up to $3 million for projects to address Total Maximum Daily Load (TMDL) discharge limits and c) loans or grants for communities to install publicly owned individual wastewater treatment or cluster systems. An example of a Great Lake City that is facing major wastewater and water project financing is the City of Duluth which is on Lake Superior. Duluth is currently under findings and orders from U.S. EPA to upgrade its facilities. In response, Duluth is building large reservoirs with project financing from the State Loan Program. Other cities in Minnesota face a similar problem.

Future demand for Minnesota is estimated to be $2.3 billion.

NEW YORK ENVIRONMENTAL FINANCE CORP.

Jim Gebhardt, *Finance Manager*

The New York Environmental Finance Corporation (NYEFC) administers the New York SRF Program which uses the Reserve Fund Model. NYEFC is the largest SRF in the country and has received federal grants totaling $2.6 billion for wastewater and $500 million for water. By aggressively leveraging these monies, NYEFC has loaned more than $10.2 billion. Interest earnings from the Reserve Fund are used to subsidize the Program's interest rate. In a typical year, NYEFC loans $120 million for wastewater projects and $36 million for water projects. NYEFC reviews local government's median household income to determine the interest rate on the loan. Interest rates under this program could be as low as 0%. In addition, NYEFC uses interest earnings on the Reserve Fund to set the subsidy level on each loan.

Since its borrowing requirements are so great, NYEFC has a separate program for NY City, the largest borrower of the Program using about 50% of the total amount loaned annually.

The NYEFC is currently considering new loan programs specifically related to its statutory "guarantee authority". Under current Drinking Water programs, most loans specify a maximum term of 20 years. NYEFC is reviewing an extension of the term to 30 years with guarantees from the state to support the last 10 years of the loan.

Future demand in New York is estimated to be $20.4 billion

OHIO WATER DEVELOPMENT AUTHORITY

Steve Grossman, *Executive Director*

The Ohio Environmental Protection Agency and the Ohio Water Development Authority (OWDA) jointly operate the Ohio SRF Program which uses the Cash Flow Model.

Through a Memorandum of Understanding, OWDA provides the financial management and Ohio EPA acts as the program manager for Ohio's SRF.

From its start in 1968, it has made more than 2,000 loans totaling about $5.0 billion. The two largest borrowers in the Ohio Program have been the City of Columbus and North East Ohio Regional Sewer District which serves the greater Cleveland area. Together, they have borrowed over $2.5 billion from the Program.

Ohio's Program has provided over $1.2 billion in loans to communities along Lake Erie and in the Lake Erie watersheds. The Program has a hardship rate available to local governments that meet certain economic tests, while the overall Program interest rate is approximately 3.75% with typical terms of 20 years.

The Ohio experience was the model for the U.S. EPA when it decided 20 years ago to provide federal capitalization for State Revolving Funds. EPA suggested that other states follow the OWDA program when establishing their own SRFs. The progressiveness of the Great Lakes again set the pattern for the nation.

Ohio, through its Ohio Water Development Authority, has initiated an erosion control program along Lake Erie. Property owners can borrow at reduced interest rates through a county administered program, with OWDA providing the funding source for the loans.

OWDA and the Ohio EPA have combined to implement, under the SRF Program, two successful non-point source programs. Under a Linked Deposit Program, loans are made primarily to farmers for non-point source projects. OWDA works with local banks to provide low cost funding. The state acquires a Certificate of Deposit from each bank paying the state an interest rate 3% below market. The bank in turn, loans the money backed by the CD to a farmer for the projects at an interest rate 3% below the market rate that the farmer would have paid "but for" the Linked Deposit Program.

Another non-point source program has been implemented by Ohio EPA. It finances qualified non-point source projects by funding the projects through reduced interest rates on related point source loans.

Future demand in Ohio is estimated to be $8.7 billion.

PENNSYLVANIA INFRASTRUCTURE INVESTMENT AUTHORITY

Paulo Marchetti, *Executive Director*

The Pennsylvania SRF Program is administered by the Pennsylvania Infrastructure Investment Authority (Pennvest). Pennvest uses the Cash Flow Model and considers itself a lender of last resort. In 2006, Pennvest received $568 million in applications, and made $276 million in loans and approximately $65 million in grants.

Pennvest has created its own terms and conditions, such as a maximum loan for a project in one municipality of $11 million, and a maximum loan for a project in more than one municipality of $20 million. Pennvest will fund up to $350,000 for planning and design costs and interest rates on the loans vary from 1% to 3.2% depending on the user charges in he community. Most project loans have an interest rate of 2% with many of them having terms of 30 years. Because of its maximum loan size limitation, Pennvest funds primarily smaller projects. Pittsburgh and Philadelphia have borrowed under the Program, but have not received a large share of the SRF money. If loan demand continues to exceed supply, Pennvest has indicated it may consider changing its Program to provide additional leveraging, with a focus on the revitalization of older established communities.

Future demand in Pennsylvania is estimated to be $8.1 billion.

WISCONSIN DEPARMENT OF NATURAL RESOURCES

Michael Wolff, *Financial Administrator*

The Wisconsin SRF Program is operated jointly by the Wisconsin Departments of Natural Resources and Administration and uses a hybrid model incorporating aspects of both the Reserve Model and the Cash Flow Model. The Program is the lender of first resort in the state. Water and wastewater projects for compliance maintenance represent 74% of the total loans. Historically, financing under the Program has been 90% for wastewater projects and 10% water projects, with total Loan volume averaging $180 million annually. As of June 30, 2006, the Wisconsin Program has received approximately $865 million in federal grants, and the state of Wisconsin has authorized $736 million in additional capital contributions from the state. Total loans completed to date are $2.9 billion with a weighted average interest rate of 2.8% and a term of 20 years.

Wisconsin's Program operates like a bond bank. Bonds are issued by the local governments and purchased by the Program. The Program estimates a need for approximately $900 million over the next three years and it anticipates being able to fund all requests.

Wisconsin operates a loan program parallel to the Federal SRF which provides subsidized loans and grants to qualifying communities. Loan rates vary from 0% to 70% of the state's cost of funds. The two portfolios are roughly equal in size.

It also is recognized that there are other programs designed to assist small communities meet their water and wastewater program needs. For example, the U. S. Department of Agriculture has a Water and Waste Disposal Loan and Grant Program. Some states use Federal Small Cities Community Development Block Grants to provide financial assistance. In neither case do these programs meet 100% of the costs.

Future demand in Wisconsin is estimated to be $3.3 billion.

GREAT LAKES SRF PROGRAM – PRIOR PROJECTS*

STATE	WATER LOANS	WASTEWATER LOANS	TOTAL*
ILLINOIS	$375	$1,870	$42,245
INDIANA	238	1,641	1,879
MICHIGAN	401	2,322	2,723
MINNESOTA	310	1,648	1,958
NEW YORK	1,641	8,647	10,288
OHIO	474	3,539	4,013
PENNYSLVANIA	329	1,411	1,739
WISCONSIN	191	1,247	1,438
TOTAL	**$3,959**	**$22,325**	**$26,283**

*Source: U.S. EPA Annual National Study of SRF Programs, 2006. Dollars in millions.

GREAT LAKES SRF PROGRAM – FUTURE DEMAND*

STATE	EXPECTED DEMAND NEXT 20 YEARS
ILLINOIS	$11,888
INDIANA	7,222
MICHIGAN	4,092
MINNESOTA	2,319
NEW YORK	20,422
OHIO	8,722
PENNSYLVANIA	8,060
WISCONSIN	3,338
TOTAL	**$66,063**

*Source: U.S. EPA Annual National Study of SRF Programs, 2006. Dollars in millions

APPENDIX B

Legislative Plan

The governors of the Great Lakes States should work through the Council of Great Lakes Governors, in conjunction with the Great Lakes Commission, to begin discussing a legislative plan.

While those organizational steps are being taken, the offices of Great Lakes Senators and Representatives (the Great Lakes Congressional Task Force) also should be contacted to explain the Program to them, seek their support and endorsement, and to determine if they have an appropriations request submission deadline for Fiscal Year 2009. A specific request should be made through these Congressional representatives to support the program.

On February 4, 2008, the President transmitted his Fiscal Year 2009 budget to Congress.

APRIL 2008

It is imperative to have introductory meetings with staff of relevant authorizing Committees to introduce them to the Program and to request support for the Program. Of particular interest should be:

- **House Ways and Means Committee:** Meetings should be held with the Majority and Minority Committee staff, with Tax Staff/Legislative Director/Chief of Staff in office of Chairman Rangel and Ranking Member McCrery, and geographically relevant Representatives (i.e. Levin, Tubbs Jones, Emanuel, Kind, Camp, Ramstad, English, Weller, Reynolds, Ryan)

- **Senate Finance Committee:** Meetings should be held with Majority and Minority Committee staff, with Tax Staff/Legislative Director/Chief of Staff in office of Chairman Baucus and Ranking Member Grassley, and geographically relevant Senators (i.e. Schumer, Stabenow)

- **Possibly House Transportation and Infrastructure Committee—Water Resources and Environment Subcommittee:** Meetings could be held with Majority and Minority Committee staff, Water Resources Staff/Legislative Director/Chief of Staff in office of Chairwoman E.B. Johnson and Ranking Member Baker, and geographically relevant Members (Higgins, Kagen, Miller (MI)

- **Possibly Senate Environment and Public Works Committee:** Meetings could be scheduled with Majority and Minority Committee staff, Chairwoman Boxer and

Ranking Member Inhofe, and geographically relevant Senators (i.e. Clinton, Klobuchar, Voinovich).

Typically, the House drafts and passes its own FY 09 budget during this month.

The House Appropriations Committee uses the budget resolution as a guide to determine its spending allocations for each of its appropriations bills.

The House Appropriations Committee deadline for earmark requests in FY 08 was mid-March in 2007, and a similar deadline is anticipated in FY 09.

The Program should develop a specific appropriations request; the Symbiotic Entity should have meetings in the offices of relevant appropriators and submit the request to Great Lakes lawmakers during early March prior to each office's earmark deadlines.

The Authorizing Committees have a less cyclical schedule than the Appropriations Committees. The Senate Finance and the House Ways and Means Committees will be working on various pieces of legislation throughout the year. Actions can be tracked by watching the Committee's hearings and mark-ups of legislation. The Symbiotic Entity should keep in touch with the Staff contacts it makes on all of the Committees and in the offices of Great Lakes Senators and Representatives to keep updated on the action and to continue pressing for the Program's priorities throughout the legislative process.

Typically, the Senate drafts and passes its own FY 09 budget this month. The Senate Appropriations Committee uses the budget resolution as a guide to determine its spending allocations for each of its appropriations bills.

The Senate Appropriations Committee typically has a deadline during April for earmarks requests in FY 08.

Efforts must continue by the Symbiotic Entity to meet with all appropriate Committees, Senator, Representatives, and Staffs to explain the Program and its benefits.

MAY 2008

The House Appropriations Committee begins to mark-up FY 09 Appropriations bills, and the House Floor consideration begins of FY 09 appropriations bills.

Meetings with appropriate contacts must continue.

JUNE 2008

The House Floor consideration of FY 09 Appropriations bills concludes, with a goal typically to complete all Floor votes prior to the July 4th recess.

The Senate Appropriations Committee begins to mark-up its FY 09 Appropriations bills.

The Symbiotic Entity should schedule meetings with the Office of Management and Budget (OMB) to discuss priorities for the FY 2010 Presidential budget. The Administration begins vetting proposals and drafting its budget for the upcoming fiscal year during the summer. In addition, Great Lakes lawmakers should be asked to contact OMB through letters, phone calls or meetings to encourage OMB to include the Program's priorities in the upcoming FY 2010 budget.

JULY 2008

The Senate Appropriations Committee concludes its mark-up of FY 09 appropriations bills and the Senate Floor begins consideration of its FY 09 Appropriations bills with a goal typically to complete floor votes on appropriations bills prior to August recess. This goal is rarely achieved.

Meetings should **c**ontinue with Office of Management and Budget (OMB) to discuss priorities for the FY 2010 Presidential budget.

AUGUST 2008

Congress is in recess.
Meetings should continue with Staff and OMB.

SEPTEMBER 2008

The Senate Floor usually concludes consideration of FY 09 appropriations bills this month, and the Senate adopts its version of the appropriation bills. Since it always contains differences from the House version, both bills are sent to a Conference Committee where negotiations begin over compromises. Conference Committee reports are considered and voted on this month.

Often appropriations bills are not completed before the Sept. 30 end of the fiscal year and a continuing resolution is needed to keep the government running while Congress continues its work.

OCTOBER 2008

Conferences continue and progress can be seen as some appropriations bills are completed.

NOVEMBER 2008

Usually conference negotiations are still ongoing this month and the work continues until all FY 09 appropriations bills are completed.

While this outlines shows a typical roadmap through Congress, the Symbiotic Entity must be alert, and nimble enough, to act and react throughout 2008 in real time as specific opportunities present themselves to push forward the elements and priorities of the Program.