

Drinking Water State Revolving Fund Program Operations Manual

Provisional Edition



United States Environmental
Protection Agency

The Office of Ground Water
and Drinking Water

Infrastructure Branch

Drinking Water State Revolving Fund

Program Operations Manual

Provisional Edition

United States Environmental Protection Agency

The Office of Ground Water and Drinking Water

Infrastructure Branch

Table of Contents

Chapter 1 - Introduction

1.1.	Statutory Background	2
1.2	DWSRF Regulations	3
1.3	Program Oversight	3

Chapter 2 – Steps in the Federal DWSRF Funding Process

2.1	The President’s Budget Request	6
2.2	Congressional Appropriations	6
2.3	OMB Apportionment	8
2.4	Allotment to States	8

Chapter 3 – Steps in the Federal DWSRF Project Funding Cycle

3.1	State Develops the Federal Capitalization Grant Application	10
3.2	EPA Review of the Capitalization Grant Application	15
3.3	Withholding DWSRF Funds Available	16
3.4	State Agrees to Provide Matching Funds	19
3.5	State Leveraging Activities to Increase Funds Available	21
3.6	Fund Transfers (Between the DWSRF and CWSRF Programs)	24
3.7	Federal Funding Process	26
3.8	Special Program Assistance Requirements	27
3.9	Cooperation and Coordination with other Programs	28
3.10	Project Application Process	30
3.11	Detailed State Loan Application Review	37
3.12	Project Approval and General Loan Closing Procedures	43
3.13	Construction Activities and Loan Disbursement	48
3.14	Project Completion and Close-Out	52

Chapter 4 – Funding through the DWSRF Set-Asides

4.1	Four Types of Set-Asides	53
4.2	Key Requirements and Recommendations	55

Chapter 5 – State Follow-Up Activities

5.1	State Develops the DWSRF Annual/Biennial Report	58
5.2	State Completes and Submits the DWSRF Annual Audit to EPA	60
5.3	Submitting Annual Set-Aside Performance Status Reports	63
5.4	Reporting for DWNIMS	64

Chapter 6 – EPA Oversight Activities

6.1	State and EPA Annual Review Process	66
6.2	EPA Regional Review Process	67

Chapter 7 – Revisiting the Program Structure

7.1	Assessing Implications of Fund Management Decisions	69
-----	---	----

Acronyms

ACH	Automated Clearing House
AG	Attorney General
ASAP	Automated Standard Application for Payments
CE	Categorical Exclusion
CFR	Code of Federal Regulations
CWSRF	Clean Water State Revolving Fund
DWNIMS	Drinking Water National Information Management System
DWSRF	Drinking Water State Revolving Fund
EA	Environmental Assessment
EIS	Environmental Impact Statement
EPA	Environmental Protection Agency
FCTR	Federal Cash Transaction Report
FSR	Financial Status Report
FTE	Fulltime Equivalence
FY	Fiscal Year
GAAP	Generally Accepted Accounting Procedures
GAGAS	Generally Accepted Auditing Standards
GAO	Government Accountability Office
GO	General Obligation
IUP	Intended Use Plan
MBE	Minority Business Enterprise
NEPA	National Environmental Policy Act
OA	Operating Agreement
OIG	Office of Inspector General
OMB	Office of Management and Budget
PAM	Program Activity Measure
PART	Program Assessment Rating Tool
PER	Program Evaluation Report
PPL	Project Priority List
PWS	Public Water System
PWSS	Public Water System Supervision
SDWA	Safe Drinking Water Act
SERP	State Environmental Review Process
SRF	State Revolving Fund
SWP	Source Water Protection
TFM	Technical, Financial, and Managerial
WBE	Women's Business Enterprise

CHAPTER 1

Introduction

KEY POINTS IN CHAPTER 1

- Created through the 1996 Amendments to SDWA, the DWSRF program is a multifaceted tool for states to use in achieving public health protection.
- DWSRF programs must follow all requirements as set forth under the DWSRF Interim Final Rule, the DWSRF Program Guidelines, and EPA's general grant regulations at 40 CFR Part 31.
- EPA, the Office of Management and Budget, the Government Accountability Office, and Congress conduct varying levels of DWSRF oversight activities to ensure compliance and effective program management.

1.1 Statutory Background

1.1.1 Development of the Safe Drinking Water Act

Congress passed the Safe Drinking Water Act (SDWA) in 1974 and amended it in 1986 and 1996 to protect public health by regulating the nation's public drinking water supply. Under SDWA authority, the United States Environmental Protection Agency (EPA) establishes national health-based standards for drinking water that protect against a wide range of contaminants, and it provides national leadership in implementing a suite of programs designed to protect water supplies and ensure the sound operation of water systems. Drinking water standards set either enforceable maximum levels of individual contaminants in drinking water or required ways to treat water to remove contaminants. EPA, state governments, and water systems work together to make sure that these standards are met.

1.1.2

The Role of the Drinking Water State Revolving Fund (DWSRF)

The 1996 Amendments to SDWA, Section 1452, created the DWSRF program. The DWSRF is a multifaceted tool for states to use in achieving the public health protection objectives of SDWA. States operate their own DWSRF programs and receive annual capitalization grants from EPA which they use to support low-interest loans and other types of assistance to public water systems. Additional provisions also allow state DWSRF programs to target extra assistance to those communities with the greatest economic need. (See Section 3.8.1 for additional information on providing assistance to small and disadvantaged communities.)

The state agency that establishes DWSRF assistance priorities and carries out program oversight activities is the same state agency that also administers the Public Water System Supervision (PWSS) program. The PWSS program carries out many key activities, including developing and maintaining drinking water regulations, tracking compliance information, and ensuring that all public water systems follow state regulations. States may entrust day-to-day operations and financial management of their DWSRF program to another agency such as a finance authority as long as priority setting and program oversight responsibilities remain with the PWSS program.

Examples of Key PWSS Program Activities:

- Developing state drinking water regulations;
- Maintaining an inventory of public water systems;
- Conducting sanitary surveys of public water systems;
- Providing technical assistance to PWS operators; and
- Ensuring all systems comply with state requirements.

DWSRF Priorities

DWSRF funds are used to ensure:

- Public health protection,
- Compliance with drinking water standards, and
- Affordable access to drinking water.

The 1996 Amendments extended the safe drinking water framework of public health, compliance, and affordability to encompass Source Water Protection (SWP), operator training, technical assistance, and public education. The DWSRF program design reflects this source-to-tap approach. States can set aside a portion of their capitalization grants to fund activities that improve the management of water systems and establish or expand programs that protect sources of drinking water. Some DWSRF funds can also be used to help states support the implementation of PWSS program activities. DWSRF funding for these purposes is contingent upon efforts to improve and maintain system capacity. Although DWSRF set-aside funds may be used to administer the state PWSS program, there is a federal limitation on the use of set-aside funds for enforcement activities.

1.2 DWSRF Regulations

1.2.1 DWSRF Interim Final Rule

Issued in August 2000, the DWSRF Interim Final Rule codifies the DWSRF Program Final Guidelines (1997) and explains various program requirements, including: steps to receiving a capitalization grant; what states may do with capitalization grant funds intended for infrastructure projects; what states may do with funds intended for set-aside activities; and the roles of the states and EPA in managing and administering the DWSRF program. The rule gives states significant flexibility to design their DWSRF programs and to direct funding toward their most pressing compliance and public health-related needs.

EPA attempted to include all major program requirements, including items required by SDWA and those EPA considers necessary for effective program management. The rule modifies and adds to the Final Guidelines based on policies that evolved during the first

few years of DWSRF implementation and from comments provided on a first draft of the rule by a work-group of State Revolving Fund practitioners.

1.2.2 General Grant Regulations

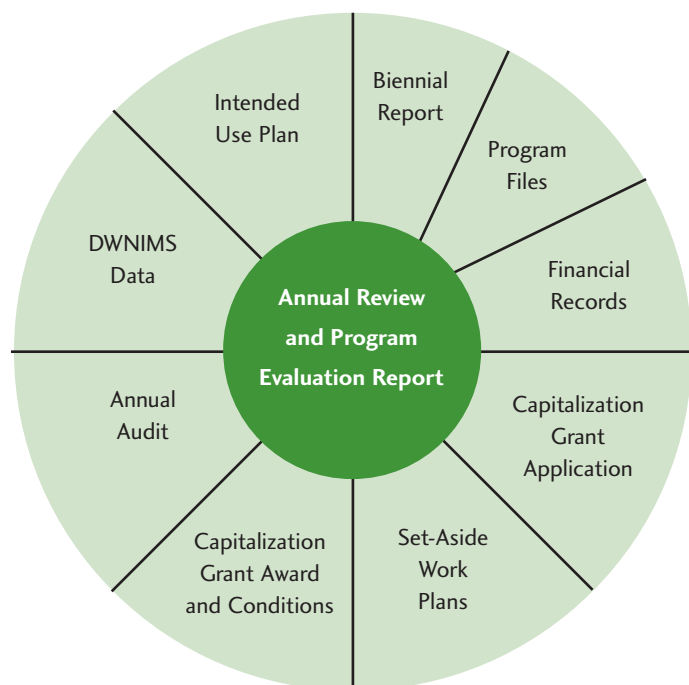
The Interim Final Rule supplements EPA's general grant regulations at 40 CFR Part 31 which contain administrative requirements that apply to governmental recipients of EPA grants and subgrants. With the exception of requirements for the participation of minority and women's business enterprises¹, EPA's general grant regulations at 40 CFR Part 31 do not apply to recipients of loans and other types of assistance from a state DWSRF program Fund. Instead, these general grant regulations apply to state agency recipients of DWSRF capitalization grants. These general grant regulations describe the planning activities and forms required to apply for a grant, the acceptable financial administration of grant funds, the appropriate methods for changes and subawards, the monitoring of program activities, reporting requirements, records retention, enforcement procedures, and post-grant requirements. Guidelines for conducting audits are also included.

1.3 Program Oversight

1.3.1 DWSRF Circle of Accountability

EPA DWSRF program conditions and reporting requirements provide EPA with a summary of individual state program activities. Information used by EPA includes the Intended Use Plan, the Biennial Report, program files, financial records, the capitalization grant application, set-aside work plans, capitalization grant award conditions, the annual audit, and reports provided through the Drinking Water National Information Management System (DWNIMS). This information, in combination with Annual Reviews of state programs and the development of state Program Evaluation Reports (PERs), provides EPA insight into state use of funds and helps guide management and administration decisions.

¹ Each DWSRF program is required to develop a fair share goal for the participation of minority and women's business enterprises in receiving DWSRF project assistance. Just as the DWSRF program is required to make progress in meeting these fair share goals, SRF loan recipients of assistance in an amount equal to the capitalization grant are also required to follow a standard procedure to ensure compliance in this area. (Please see Section 3.11.3 for more information.)



DWSRF Circle of Accountability

Additionally, Congress and multiple agencies oversee DWSRF program operations in order to ensure efficiency, effective implementation, and management in order to best serve the public interest. These different oversight components act to further increase accountability by conducting audits and investigations of DWSRF program policies and administration. These oversight activities are then used to guide funding decisions and program management policies.

1.3.2

EPA Office of Inspector General

The EPA Office of Inspector General (OIG) is an independent office within the EPA. It consists of analysts, auditors, and investigators, among others. Its purpose is to help the EPA and its programs, including the DWSRF, operate more efficiently and to detect and prevent waste, fraud, and abuse. To accomplish this, it performs audits, evaluations, and investigations. It also provides public liaison and hotline services to review public complaints about EPA programs and activities.

EPA Office of Inspector General

- Helps EPA programs operate more efficiently
- Performs audits, evaluations, and investigations
- Evaluates possible cases of waste, fraud, and abuse

1.3.3

Office of Management and Budget

The Office of Management and Budget (OMB) oversees the preparation of the federal budget and supervises its administration in Executive Branch agencies, including the EPA. OMB evaluates the effectiveness of programs, policies, and procedures of these agencies, including the DWSRF, with the goals of improving administrative management, developing better performance measures and coordinating mechanisms, and reducing unnecessary burdens on the public.

Office of Management and Budget

- Oversees the administration of the federal budget
- Evaluates the effectiveness of programs
- Leads the development of government policy

1.3.4

Government Accountability Office

The Government Accountability Office (GAO) helps Congress oversee federal programs and operations, including the DWSRF, in order to ensure that they are serving the public interest. The agency consists of analysts, auditors, lawyers, economists, information technology specialists, and many others with the purpose of enhancing the economy, efficiency, credibility, and effectiveness of the federal government. In accordance with this purpose, GAO conducts financial audits, program reviews, legal support, and policy analyses, and investigations. For example, in 2001, GAO released a report to Congress entitled, Water Infrastructure: Information on Federal and State Financial Assistance to provide information on assistance from state and federal agencies for drinking water and wastewater capital improvements since 1991.

Government Accountability Office

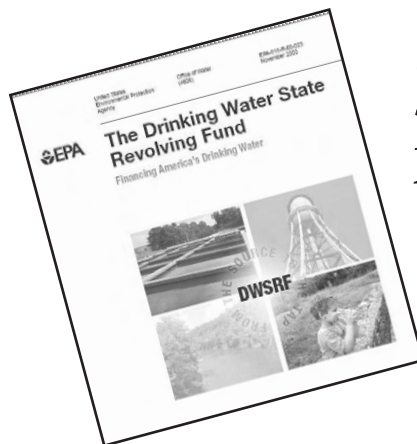
- Assists Congress in overseeing federal programs
- Conducts financial audits, program reviews, policy analyses, and investigations

1.3.5 Congress

Congress oversees EPA's administration of the DWSRF to review and monitor the Agency's performance, program success, and effects of policy implementation under SDWA. The goal is to determine whether the laws and the programs created by Congress are implemented and carried out in accordance with the intent of Congress.

The Senate Environment and Public Works Committee (Subcommittee on Fisheries, Wildlife, and Water) and the House Energy and Commerce Committee (Subcommittee on Environment and Hazardous Materials) are the authorizing committees for SDWA and thus monitor the impact of the legislation they initiate. The Senate Appropriation Subcommittee on Interior and related Agencies and the House Appropriations Subcommittee on Interior, Environment, and Related Agencies develop the annual legislation appropriating funds to EPA for DWSRF capitalization grants each year. They are interested in how the money is spent.

Every three to five years, the authorizing committees are obligated to review and study how EPA administers SDWA, including its application, administration, execution, and effectiveness. This includes the organization and operation of EPA. It also includes the impact of tax policies on SDWA and the DWSRF programs in particular. The appropriations committees examine the DWSRF annually, but not in the same detail as the authorizing committees.



The Drinking Water State Revolving Fund: Financing America's Drinking Water

The Congressional committees, and sometimes individual Representatives and Senators, will request reports and other information from EPA that describe program performance. For example, in 2003, EPA issued The Drinking Water State Revolving Fund Program: Financing America's Drinking Water from the Source to the Tap, Report to Congress. Such reports and additional information help Congress ensure that EPA can effectively manage and carry out program objectives, help judge whether executive policies reflect the public interest, and build a knowledge base for future legislation.

Congress

- Oversees EPA's administration of the DWSRF
- Reviews and monitors the Agency's performance
- Every three to five years, the authorizing committees are obligated to review and study how EPA administers SDWA

KEY RESPONSIBILITIES: CHAPTER ONE

DWSRF Regulations and Program Oversight

EPA

- EPA, OMB, GAO, and Congress are charged with overseeing DWSRF program operations in order to ensure compliance, efficiency, and effective implementation of program activities.

State Program Office

- The state agency that establishes DWSRF assistance priorities and carries out program oversight activities must be the same agency that also administers the PWSS program. This agency is termed the primacy agency.
- All DWSRF programs are subject to certain program conditions and reporting requirements as set forth under the DWSRF Interim Final Rule, the DWSRF Program Guidelines, and EPA's general grant regulations at 40 CFR Part 31. For example the program office is charged with developing the Intended Use Plan, the DWSRF Annual/Biennial Report, and annual program audit.

Steps in the Federal DWSRF Funding Process

KEY POINTS IN CHAPTER 2

- To help guide budget decisions OMB uses PART to assess the purpose, management, and performance of individual programs, including the DWSRF.
- House and Senate Budget Committees hold hearings to discuss the President's Budget and gather expert testimony from federal agencies, including EPA.
- The passage of an appropriations bill and its signing into law permits a federal agency to make payments from the federal Treasury for specified program purposes, including the DWSRF.
- EPA allots DWSRF funds to states according to a formula that reflects proportional drinking water infrastructure needs.

2.1 The President's Budget Request

2.1.1 Development of the President's Budget

Each year, the President's Budget request is received by Congress on or before the first Monday in February. This schedule is set according to requirements under the Congressional Budget Act of 1974. The President's Budget contains details on the Administration's policies and funding priorities for the upcoming fiscal year. The Budget includes information on spending estimates by category, revenue and borrowing levels, and input from the various federal agencies. (For more information and access to the annual federal budget and related information, see <http://www.whitehouse.gov/omb/budget/>.)

To help guide budget decisions, OMB uses the Program Assessment Rating Tool (PART). PART is a series of questions that seek to assess the purpose, management, strategic planning, and performance of individual pro-

grams, including the DWSRF. Programs must demonstrate that their purpose is clear, that they are results-oriented, that they are well managed, and that they achieve intended results. The purpose of PART is to improve the performance and management of federal programs. Its evaluation of program effectiveness also plays a role during the development of the President's Budget by providing relevant information for allocating limited funds to programs that can best demonstrate success. Possible ratings include "effective," "moderately effective," "adequate," "ineffective," and "results not demonstrated." The DWSRF has received a rating of "adequate." (For detailed information on the PART process, see <http://www.whitehouse.gov/omb/part/>.)

The Purpose of OMB's Part Analysis . . . to improve the performance and management of federal programs

According to the President's Budget, the DWSRF falls under Budget Function 300, also known as funding for Natural Resources and the Environment. This budget category encompasses several funding areas, including the development and maintenance of our national water resources and the management of our drinking water and wastewater infrastructure systems.

2.2 Congressional Appropriation

2.2.1 Congress Presents the Final Budget Resolution

After the President's Budget request is submitted to Congress, both the House and Senate Budget Committees hold hearings to discuss the budget and gather expert testimony and advice from the various fed-

eral agencies, including EPA. For example, in May of 2005, the EPA Administrator appeared before the Senate Appropriations Committee to discuss the President's Budget for FY2006.² During this process, individual Members of the Budget Committees can offer amendments and make other suggestions for change before a final version of the budget is presented. According to the Budget Act, Congress is required to present a final version of the House and Senate budget resolutions – termed the concurrent resolution – by April 15th of each year. This deadline is rarely met in practice. This budget sets an overall framework for all appropriations bills considered before Congress. (For more information on this topic, see <http://www.house.gov/budget/> and <http://budget.senate.gov/>.)

2.2.2 Congress Considers Multiple Appropriations Bills

Annually, Congress considers multiple appropriations bills. It is important to note that annual appropriations bills will change from year-to-year. For 2006, the House included eleven appropriations bills. The Drinking Water SRF is included under the Interior and Environment appropriations bill. Others included: Agriculture; Defense; Science, State, Justice, and Commerce; Energy and Water; Foreign Operations; Homeland Security; Interior and Environment; Labor, Health and Human Services, and Education; Legislative Branch; Military Quality of Life and Veterans Affairs; and Transportation, Treasury, HUD, Judiciary, and the District of Columbia.

Similarly, the Senate included the Drinking Water SRF program under the Interior appropriations bill. Other bills in 2006 included: Agriculture; Commerce, Justice, and Science; Defense; the District of Columbia; Energy and Water; State/Foreign Operations; Homeland Security; Interior; Labor, Health and Human Services, and Education; Legislative Branch; Military and Veterans Affairs; and Transportation, Treasury, Judiciary, and HUD.

The passage of an appropriations bill and its signing into law by the President permits a federal agency to make

payments from the Federal Treasury for incurred obligations and other specified purposes. Appropriations provide a formal approval for the expenditure of public funds for a specified purpose over a set period of time.

2.2.3 Congress Approves Individual Appropriations Bills

Appropriations bills are considered by both the House and Senate Appropriations Committees. Individual bills are divided among each Committee's respective subcommittees depending on the specific area of federal funding. Each subcommittee works to develop their individual appropriations bill according to the original Presidential Budget request, new priorities, and the previous appropriations bills. After each subcommittee develops their final recommendation, all appropriations bills are amended as necessary and approved by the full House and Senate Appropriations Committees. (For a listing of current membership on subcommittees charged with consideration of program appropriations for the national DWSRF program, see the House and Senate Appropriations websites at <http://appropriations.house.gov/> and <http://appropriations.senate.gov/>.)

Following approval of their respective appropriations bills, the House and Senate each appoint conferees (i.e., negotiators) to reconcile differences between their respective versions of these appropriations bills. House and Senate conferees group to form an ad hoc panel known as the Conference Committee to develop one version for each appropriations bill that can receive support from at least half of the appointed conferees and can pass both the House and the Senate by a majority vote. (For more information on the appropriations bills approval process and to track individual bills, visit <http://thomas.loc.gov/>. This website provides legislative information from the Library of Congress.)

2.2.4 Rescission

Congress may apply a rescission (an across the board reduction to an appropriation) before final passage of that appropriation. This practice has been common in recent years. Rescissions are a tool the appropriations committees use to keep the total amount of appropriations within agreed upon spending caps. After a final

² For access to EPA testimony statements before the House and Senate Committees, see <http://www.epa.gov/ocirpage/hearings/index.htm>.

appropriations bill is approved, readjustments to the bill are still possible under certain circumstances.

Authorized under the authority of the Budget Act of 1974, the President may request readjustments to the previously appropriated budget amounts through the introduction of a rescission bill. A rescission bill specifies the exact amount of change to all or part of a previously appropriated amount. If the President's rescission bill is not passed by Congress within forty-five days, funds must be released according to the original appropriated amounts. For example, in an attempt to offset costs associated with Hurricane Katrina, a rescission bill was introduced for FY2006 that withdrew funds previously appropriated, including funds previously appropriated to EPA. The proposal rescinded \$166 million from the EPA State and Tribal Assistance Grants program.

2.3

OMB Apportionment

2.3.1

Purpose

Based on appropriations bills signed into law by the President, OMB develops an apportionment spending plan. An apportionment plan is intended to achieve the most effective and economical use of funds made available by a federal appropriation. The process of apportioning distributes funds appropriated for specific purposes by time period of availability and proper oversight agency.

2.4

Allotment to States

2.4.1

National Set-Asides

Before funds appropriated for the DWSRF are allotted to states, EPA is required to reserve some of the funds for specific national-level set-asides. Indian Tribes and Alaska Native Villages can receive grants valued up to 1.5 percent of annually appropriated funds. EPA may also reserve up to two percent of appropriated funds for small system technical assistance.

In addition, EPA reserves \$2 million for the monitoring of unregulated drinking water contaminants. From FY1999 to FY2003, EPA reserved funds to provide

grants to states for reimbursement of the costs of training and certifying operators of drinking water systems serving 3,300 persons or fewer (known as the Operator Certification Expense Reimbursement Grant Program and authorized under the provisions of Section 1419 of SDWA, as amended). Separate EPA guidelines govern the management of these national-level set-asides.

National Set-Asides

- 1.5 percent for grants to Indian Tribes and Alaska Native Villages
- Up to two percent for small system technical assistance
- \$10 million for health effects research
- \$2 million for monitoring unregulated contaminants
- Cost reimbursement for operator training certification

2.4.2

Basis of Allotment

After national set-asides are reserved from the full federal appropriation, remaining funds are allotted to state DWSRF programs, the District of Columbia, and the Pacific Island Territories to carry out Section 1452 of SDWA.

EPA allots federal DWSRF funds to the states according to a formula that reflects their proportional share of needs identified in the most recent Drinking Water Infrastructure Needs Survey. Drinking Water Infrastructure Needs Surveys are due to Congress every four years starting from the January 1997 survey. Of note, state costs for participation in the Needs Survey may be charged to the four percent DWSRF administration set-aside. (See Section 4.1.1 for more information on the four percent DWSRF administration set-aside.) No state or Puerto Rico receives less than one percent of the total funds available for allotment to all the states (withholding notwithstanding).

In addition to funds allotted for individual state programs, the District of Columbia receives a one percent share of total allotted funds, while the Virgin Islands and the Pacific Island Territories together receive an allotment of 0.33 percent.

Funds are available to states during the fiscal year in which they are authorized and during the following fiscal year. Any amount not obligated at the end of this period is reallocated (according to the same formula) to

all remaining states that have already obligated their funds. EPA may reserve up to ten percent of the funds available for reallocation to provide additional assistance to Indian tribes.

General Steps in the Federal Funding Process

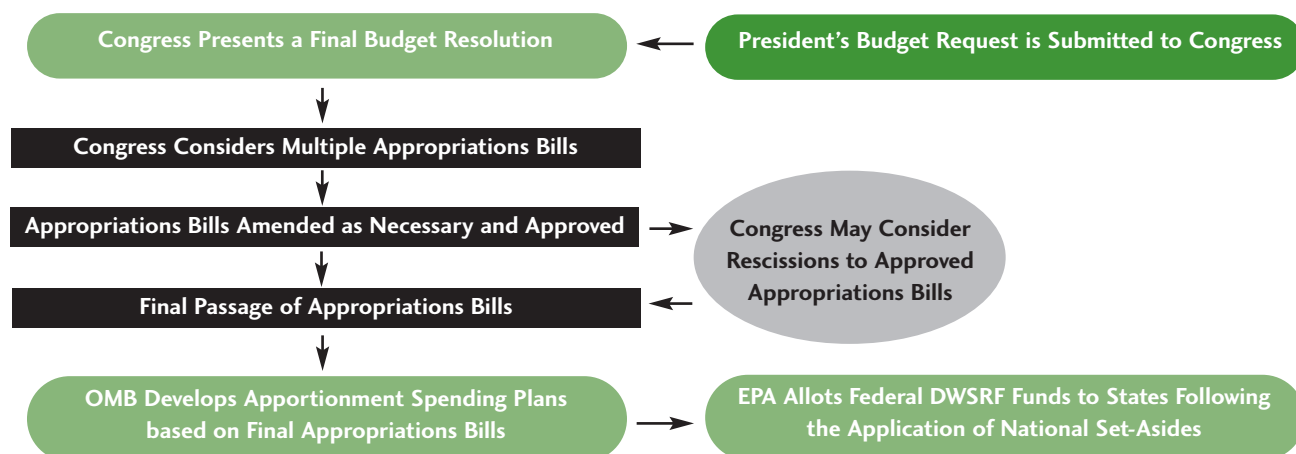


Figure: General steps in the federal funding process from the President's budget request to EPA allotment of funds to the individual DWSRF programs.

KEY RESPONSIBILITIES: CHAPTER TWO

Steps in the Federal DWSRF Funding Process

EPA

- For every program assessed through the PART process, OMB and associated federal agencies develop plans to improve performance and management over time. All assessed programs are held accountable to the recommendations contained within these plans, including the national DWSRF program and EPA.
- After the President's Budget request is submitted to Congress, both the House and Senate Budget Committees hold hearings to discuss the budget and gather expert testimony from the various federal agencies, including EPA.
- Before funds appropriated for the DWSRF are allotted to states, EPA is required to reserve some of the funds for specific national-level set-asides.
- EPA allots federal DWSRF funds to the states according to a formula that reflects their proportional share of needs identified in the most recent Drinking Water Infrastructure Needs Survey.

State Program Office

- EPA allots federal DWSRF funds to the states according to a formula that reflects their proportional share of drinking water needs. Funds are available to the states during the fiscal year in which they are authorized and during the following fiscal year. Any amount not obligated at the end of this period is reallocated to all remaining states that have already obligated their funds.

Steps in the DWSRF Project Funding Cycle

KEY POINTS IN CHAPTER 3

- In order for a state to receive the DWSRF funds allotted to it, the state must submit a complete capitalization grant application.
- The IUP is the focal point of the capitalization grant application. It lays out how the DWSRF program will employ all of its available funds.
- EPA will withhold a portion of a DWSRF's capitalization grant if certain SDWA requirements are not met.
- States must provide a match to the Fund equal to or greater than twenty percent of the capitalization grant.
- States can “leverage” capitalization funds to provide a higher level of assistance in the near term.
- A state may transfer an amount equal to thirty-three percent of the DWSRF capitalization grant between the CWSRF to the DWSRF programs.
- Programs must follow formal requirements for making loans and approving project applications.
- Programs must adhere to certain project requirements and formal construction oversight procedures.

3.1 State Develops the Federal Capitalization Grant Application

In order for a state to receive the DWSRF funds allotted to it, the state must apply for a grant of the funds. This capitalization grant application must conform to general federal grant regulations (40 CFR Part 31 – Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments); 40 CFR Part 35, Subpart L – Drinking Water State Revolving

Funds; EPA's Interim Final Rule for the DWSRF; and Section 1452 of SDWA, as amended. (For more information on EPA grantee requirements, including required EPA grantee forms, visit the EPA Office of Grants and Debarment at <http://www.epa.gov/ogd>.)

Components of the formal capitalization grant application include:

- EPA Form 424, “Application for Federal Assistance,” and related forms,
- The state's Annual Intended Use Plan (IUP), including the state's Project Priority List, and
- State Attorney General certification that the authorities establishing the DWSRF are consistent with state law and that the state may legally bind itself to the terms of the capitalization grant agreement

Some states submit set-aside work plans along with their capitalization grant application, but they are not required for the capitalization grant application. If not submitted with the capitalization grant application, they are submitted based on a schedule negotiated with EPA. (For more information about set-aside work plan requirements, see Section 3.1.5.)

Capitalization Grant Application . . . states should submit grant applications no later than ninety days prior to the end of the period of funds availability.

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

3.1.1 Operating Agreements

An Operating Agreement (OA) is an optional document that describes the objectives, structure, and procedures of a DWSRF program that remain the same from year-to-year. An OA outlines how the State Revolving Fund (SRF) will conduct business and comply with the basic tenets of the program, including schedules for review by and reporting to EPA. Almost all DWSRF programs function under an OA.

The OA stands in for several portions of the capitalization grant application and agreement. It can include most of the assurances and requirements, as noted above. EPA and the state must agree to the OA provisions and to any changes therein. Changes can occur without a formal grant amendment, and the state and EPA can give the OA a termination date. With an OA in place, subsequent capitalization grant applications will mainly consist of the IUP.

3.1.2 Compliance with Federal Regulations

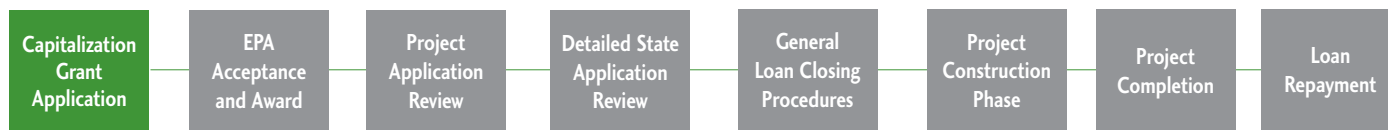
Administering Agency Authority and Responsibility. The state attorney general must certify and document that the state and administering agency(ies) can enter into a capitalization grant agreement, accept funds from the EPA, and operate the DWSRF program in accordance with SDWA. The agency that prioritizes assistance and oversees DWSRF operations must also be the primacy agency for the state's PWSS program. Documentation of the roles and responsibilities for each administering agency must be included with the application. The state must demonstrate that it has the personnel and resources to manage the DWSRF program. Also necessary are assurances for compliance with all state statutes and regulations regarding DWSRF funds and for compliance with applicable federal crosscutters (See Section 3.11.3 for more information on federal crosscutters).

“The agency that prioritizes assistance and oversees DWSRF operations must also be the primacy agency for the state’s PWSS program.”

Funds Management. Each DWSRF program must agree to the negotiated payment schedule and to the legislative requirements for use of the funds. The capitalization grant must be deposited into the Fund and in separate accounts for set-aside activities, as detailed in the application. A twenty percent match to the capitalization grant and a one hundred percent match for the State Program Management set-aside are required.³ (See Section 3.4 for more information on DWSRF set-asides and matching funds.) Interest earnings, loan repayments (except for loan repayments through the DWSRF set-asides for land acquisition and SWP activities – see Section 4.2.1), and, where applicable, net bond proceeds must be credited to the Fund. In turn, the Fund can be used for new loans or security for SRF-issued bonds. States must also provide assurances that fiscal controls and accounting systems will be consistent with the Generally Accepted Accounting Principles (GAAP) and that yearly Fund and set-aside account audits will conform to the Generally Accepted Governmental Auditing Standards (GAGAS).

Use of DWSRF funds must follow the program's IUP, as submitted with the capitalization grant application, and established DWSRF set-aside work plans (see Section 3.1.5 for more information on developing DWSRF set-aside work plans). States also need to have evaluation systems and policies in place that assure each borrower's ability to repay their loans. Timely and expeditious use of funds (i.e., committing and expending funds quickly and efficiently) is an additional requirement. Every other year, each DWSRF program must submit a Biennial Report to EPA detailing the uses of the Fund and set-aside accounts, including audited financial statements. Although the reporting

³ The one-hundred percent match for expenditures through the State Program Management set-aside may be met through cash, in-kind services, and program credits according to formal policies (see Section 3.4 for more information.)



requirement calls for biennial reports, many states have decided that it is necessary and appropriate to generate annual reports for submission to EPA and for internal reporting purposes. For example, several states generate annual reports because they are required by the state legislature.

3.1.3

General Content of the Intended Use Plan

The IUP is the focal point of the capitalization grant application and agreement. It lays out how the DWSRF program will employ all of its available funds, including:

- federal capitalization grants,
- state matching funds,
- loan repayments,
- Fund interest earnings,
- loan fees, and
- bond proceeds deposited into the Fund

States may submit a two-part IUP, one part for set-asides and another for the Fund itself. The whole or each part must undergo public review to meet the requirements set forth through the DWSRF Interim Final Rule. The DWSRF program must describe the review process and its response to major comments and concerns. An IUP is required as long as the Fund or set-aside accounts remain in operation, irrespective of continued federal funding. Changes to the use of funds from what is stated in the IUP are permitted, but substantive changes must undergo public review. IUPs are approved by the State's EPA Region.

Intended Use Plan (IUP)

Required contents include:

- Short and long-term program goals
- Summary of the DWSRF accounts
- Set-aside and disadvantaged community budgeting
- Project priority list and ranking methodology
- Discussion of the public review process

Program Goals. The state must present short- and long-term goals for their DWSRF program. The short-term

goals should address the upcoming year's activities and the long-term goals should communicate how the state is maximizing program effectiveness and how program objectives support national goals set forth through SDWA.

According to EPA's Strategic Plan, the Agency is dedicated to protecting human health by reducing exposure to contaminants in drinking water, including protecting source waters. According to the most recent EPA Strategic Plan (September, 2006 proposal), the following draft strategic targets are highlighted:

- By 2011, ninety percent of community water systems will provide drinking water that meets all applicable health-based drinking water standards throughout the year. (2005 baseline: Eighty-nine percent)
- By 2011, eighty-six percent of the population in Indian country served by community water systems will receive drinking water that meets all applicable health-based drinking water standards throughout the year. (2005 baseline: Eighty-six percent)
- By 2011, minimized risk to public health through SWP will be achieved for fifty percent of community water systems and for an associated sixty-two percent of the population served by community water systems. (2005 baseline: Twenty percent of community water systems; twenty-eight percent of population)
- By 2015, in coordination with other federal agencies, reduce by fifty percent the number of homes on tribal lands lacking access to safe drinking water. (2003 baseline: Indian Health Service data indicate that twelve percent of homes on tribal lands lack access to safe drinking water)

Through goals and objectives developed by national DWSRF programs, states have the opportunity and responsibility to contribute to meeting the national goals of EPA's Strategic Plan. As described through this plan, EPA's National Water Program is responsible

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

for assessing the performance of individual programs, including the DWSRF, and EPA regions on a continuing basis to ensure progress in meeting national objectives. DWSRF programs are encouraged to continue positive efforts to support advancement in meeting national measures of program accountability.

Status Update. The IUP must also provide a summary of DWSRF program account balances, the amounts available for loans, set-aside activities, and subsidies to disadvantaged communities. This information must include details for all fund activities and the total amounts collected through fee accounts. For fees placed in separate, non-project accounts to pay for program administration, the state must certify that these funds will be used only for DWSRF purposes and will be properly audited.

It is also important that the state document estimated loan demand, forecasted leveraging, and other factors that affect financial planning. Transfers to or from the CWSRF or cross-collateralization with the CWSRF should be described. (See Section 3.5 and 3.6 for additional information on cross-collateralization and SRF fund transfers.)

DWSRF Set-Asides. In addition to accounting for DWSRF set-aside funds, the IUP must also describe how these funds will be used, including a general schedule and expected achievements. Additional details, such as goals and objectives, schedule of deliverables, and specific evaluation criteria for each set-aside are further defined through set-aside work plans. According to national program policy, set-aside work plans are submitted based on a schedule negotiated with EPA. If no schedule exists, work plans must be submitted no later than ninety days after the capitalization grant award.

If a state wishes to reserve the authority to take set-aside funds from future capitalization grants, they must include the amount reserved in the annual IUP. States may reserve the authority for all set-asides except the fifteen percent local assistance and other state programs

set-aside. (For more information on developing set-aside work plans, refer to Section 3.1.5.)

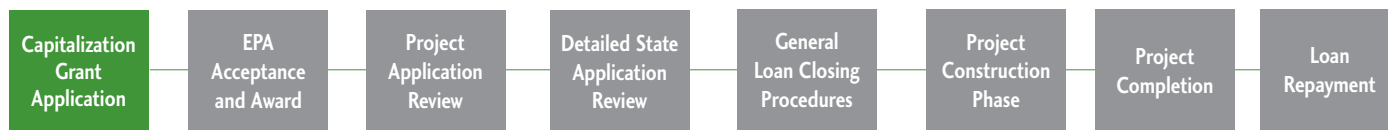
Disadvantaged Community Assistance. States may also adopt a disadvantaged community program to provide additional subsidies to disadvantaged communities in the form of “negative interest rate loans” or “loan principal forgiveness.” Both of these approaches will reduce the amount of the original loan principal. IUP documentation for a state’s disadvantaged community assistance programs also requires well thought out estimates of the types and amounts of disadvantaged assistance for specific projects. A state with such a program must also include a definition of a disadvantaged community and a description of affordability criteria that will determine the level of principal forgiveness. Total loan subsidies for this program cannot be greater than 30 percent of the same year’s capitalization grant and cannot be banked for use in coming years.

Prioritization and Distribution Methods. DWSRF programs must state their methods and criteria for distributing all available funds through their IUP. States must also describe their overall financial planning process and note the impact of financial decisions on the long-term financial health of the Fund.

Questions answered through the IUP may include:

- What is the reasoning behind allocating some assistance to set-asides?
- What are the established criteria and methods for distributing funds?
- What criteria determine the terms of assistance, including repayment period and interest rates?

DWSRF programs must present their priority systems for ranking projects in such a way that is clear to the public. To the maximum extent practicable, systems must be structured to prioritize projects that address the most serious risk to public health, that enable compliance with SDWA, and that have the greatest needs according to state affordability criteria for the cost of drinking water per household.



3.1.4

Purpose and Format of the Project Priority Lists

Any project to be funded must appear on a state DWSRF comprehensive priority list which is made available for public review. DWSRF programs must assign every project a priority and expected funding schedule. Water system name and service area population must also accompany each fundable project. In addition, a project description and expected loan terms for each proposed assistance agreement must be listed. Once fundable projects have been identified, they are to be funded in priority order.

Deviations from the priority list are subject to certain program requirements including adherence to established bypass procedures. Any changes to the original funding order, according to program bypass procedures, must be explained in the Biennial Report and during the annual review process. States may bypass projects if they are not ready to proceed and for other documented reasons. The highest ranked project on the priority list that is ready to proceed should always receive next consideration. State staff should work to prepare these projects for future funding through the DWSRF program.

EPA strongly encourages states to develop a list of projects most likely to receive funding in the coming year as a supporting table which will help to offer perspective and context to the comprehensive project priority list.

If emergency projects approach the DWSRF for immediate funding, state programs may fund these activities according to previously established emergency funding procedures. Emergency projects are those defined as projects that require immediate attention to protect public health or other state-defined emergency situations. All procedures for identifying and accepting an emergency project for DWSRF program assistance must be detailed in the IUP.



Along with the priority lists, DWSRF programs must show how they will provide at least fifteen percent of assistance to small systems (less than 10,000 people), according to SDWA requirements. If there is insufficient demand, the state must describe how it will meet this requirement in the future. A DWSRF program that spends more than fifteen percent on small system assistance can bank any excess toward future compliance.

3.1.5

General Content of the DWSRF Set-Aside Work Plans

In order to draw federal dollars into its set-aside accounts to support program activities, a DWSRF program must first illustrate how it will spend these funds according to a formal plan. States must submit detailed annual or multi-year work plans that list the total dollar amount and percentage of the DWSRF capitalization grant to be used for set-aside activities. For each set-aside, states must include specific goals and objectives, a schedule of outputs and deliverables, and a description of evaluation criteria for each activity. A description of specific roles and responsibilities, including third party contractors, and projected fulltime equivalences (FTEs) for implementation must be documented. EPA must approve a state's set-aside work plan before funds are released for these purposes.

DWSRF programs must submit their work plans on a schedule established with EPA, or no more than ninety days after the capitalization grant award. If a state misses its deadline, the set-aside funds in question are

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

transferred back to the Fund for allowable program uses. Multi-year work plans are an option, but they must be negotiated with EPA and funds must be expended within four years. When implementing a multi-year work plan, states are required to organize budget details by individual year.

Under the four percent administration and technical assistance set-aside, a state is only required to submit a work plan if providing funds for technical assistance to public water systems. In this event, only the portion used for technical assistance must be described within the work plan.

If a state wishes to reserve the authority to take set-aside funds from future capitalization grants, they do not have to submit a work plan. Instead, states may reserve the authority by including this amount in the annual IUP. States may reserve the authority to take an equivalent amount from a future capitalization grant for all set-asides except the fifteen percent local assistance and other state programs set-aside.

3.1.6 Public Participation and Marketing

Public Participation. The 1996 Amendments to the Safe Drinking Water Act created a public involvement requirement that applies to the DWSRF program. As part of the IUP development process, state programs must seek “meaningful” public review and comment for several elements of the IUP:

- The short and long-term goals of the program
- The priority system used to rank projects
- The priority lists of projects, including both the fundable and the comprehensive list
- The financial status of the program
- A description of the amounts of funds that the program will use for set-aside activities and the intended use of those funds

While the requirement does not specify what would constitute meaningful public review, programs typically meet the requirement if they allow adequate time for

public comment and adequate time for the State to address and respond to major comments. Examples of state activities to involve the public include:

- Distributing the IUP to a wide audience
- Holding public meetings/hearings or participating in conferences
- Publishing newsletters or newspaper notices
- Mailing program information to interested parties
- Developing Internet websites
- Producing public service announcements for radio or television
- Establishing advisory groups to develop and review policies

Marketing. In order to spread awareness of the DWSRF and encourage applicants to apply for funding, some state programs issue newsletters, send mailings, hold public meetings/conferences, and develop internet websites, among other activities. These activities are important for attracting new customers, particularly those in small and rural communities with significant needs and minimal resources.

3.2 EPA Review of the Capitalization Grant Application

3.2.1 Review of the State Capitalization Grant Application

As states develop their capitalization grant application, they work, as appropriate, with EPA regional staff to determine IUP format, establish or change OAs, set deadlines for set-aside work plans, and negotiate payment schedules. EPA notifies states of any new requirements, if applicable.

Once a DWSRF program submits its capitalization grant application, EPA reviews it to ensure that it meets the requirements of SDWA, EPA grant regulations, and the DWSRF program regulations. DWSRF staff at EPA work with the grants administration staff to



General Steps in Award of State Capitalization Grant

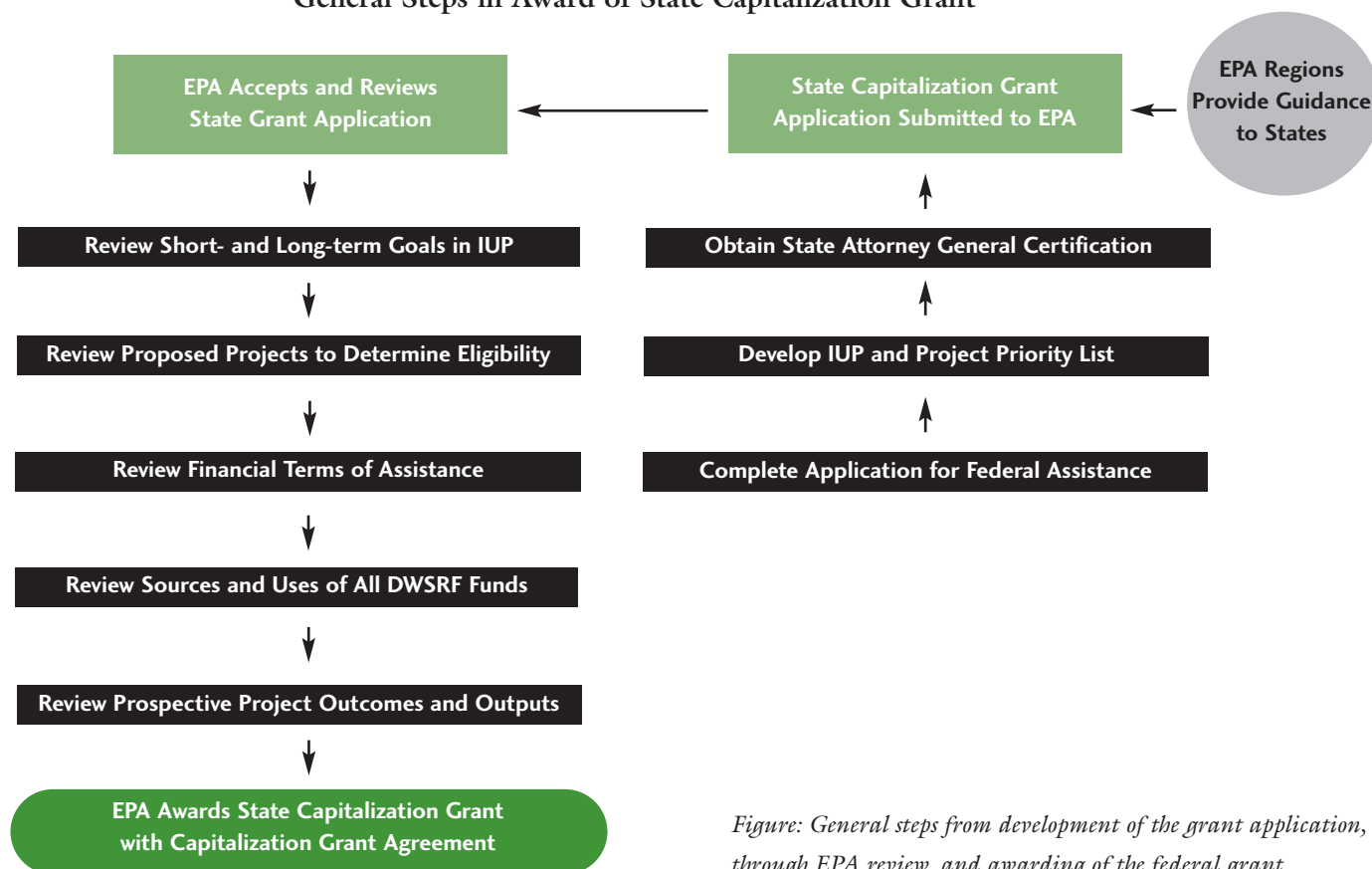


Figure: General steps from development of the grant application, through EPA review, and awarding of the federal grant.

approve the application and to prepare the state recipient for the grant award. Every year, these offices review the IUP to determine that the capitalization grant is issued for eligible program activities, as authorized through SDWA. Additional review items include ensuring that the budget is sufficiently detailed, that outputs and outcomes are sufficiently detailed, and that the program has outlined an appropriate plan for expeditious and timely use of all available funds.

3.2.2

EPA Award of the State Capitalization Grant

The capitalization grant is awarded to the state following EPA approval of the grant application. This initiates a capitalization grant agreement. According to a formal payment schedule established between EPA and the grantee, EPA authorizes the state DWSRF program to draw down federal grant funds for authorized program activities and loan disbursements. (For more informa-

tion on formal cash draw procedures through the DWSRF program, see Section 3.12.4.)

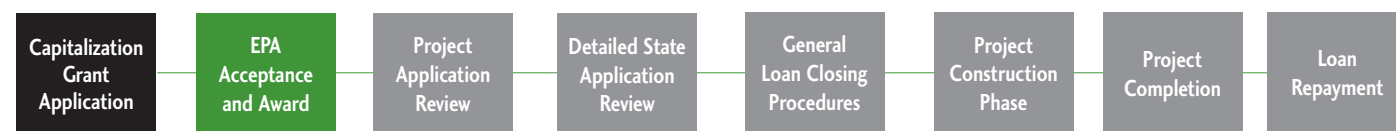
3.3

Withholding DWSRF Funds Available

3.3.1

Specific Criteria

Capacity and Authority Withholdings. EPA will withhold a portion of a DWSRF's capitalization grant if certain SDWA capacity development requirements are not met. Twenty percent of funds will be withheld from states that do not have the legal authority or other means to ensure that community and nontransient, noncommunity water systems that began operations after October 1, 1999, demonstrate technical, managerial, and financial capacity for each drinking water regulation. Twenty percent withholding will also occur for states that are not implementing a capacity development strategy, including adherence to all federal reporting require-



ments, to help systems gain capacity. (These two withholding provisions are not additive. A maximum of only twenty percent may be withheld for either of these two violations.) An additional twenty percent may also be withheld if the state has not adopted and is not implementing a water system operator certification program.

Loss of Primacy. If a state loses primacy (i.e., primary enforcement authority) under SDWA, EPA will withhold that state's entire DWSRF capitalization grant. EPA may use these funds to administer primacy in that state. The balance of funds not used by EPA to administer primacy will be reallocated to other compliant state DWSRF programs. A state will be eligible for future allotments from funds appropriated in the next fiscal year after primacy is restored.

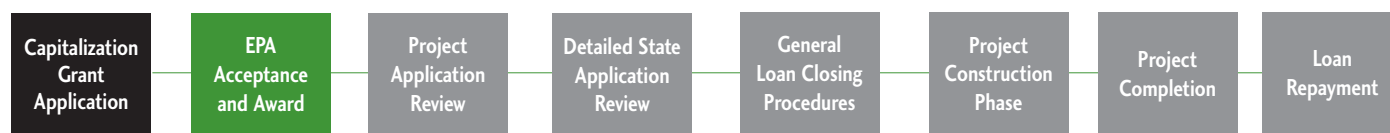
Reasons for Withholding Capitalization Grant Funds

- No implemented capacity development strategy or authority to ensure systems demonstrate TFM capacity: maximum twenty percent withholding
- No implemented operator certification program: maximum twenty percent withholding
- Loss of primacy: one-hundred percent withholding

3.3.2

Reallotment of Withheld Funds

Withholding associated with failure to: 1) implement a capacity development strategy, 2) establish authority ensuring systems demonstrate TFM capacity, or 3) implement an operator certification program will be reallocated to those states that can show current compliance with those requirements. Redistribution occurs according to the original allotment formula for all funds in question. Only states that have obligated all of their allotment for that period of availability are eligible to receive these additional monies. The receiving state must describe how it will spend the funds in its current IUP. Reallotment of loss-of-primacy DWSRF funds that are not reserved by EPA occurs in a similar manner.



KEY RESPONSIBILITIES: CHAPTER THREE: 3.1-3.3

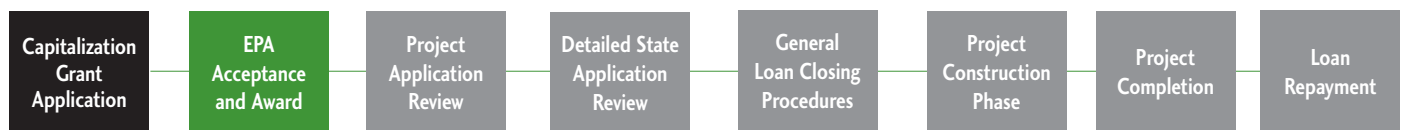
Development/Acceptance of the Federal Capitalization Grant Application/Withholding of DWSRF Funds Available

EPA

- Work with each state DWSRF program to make necessary changes to the OA and to negotiate a payment schedule for the capitalization grant.
- Review the capitalization grant application materials, IUP, and set-aside work plans to ensure that funds will go to eligible projects and that the DWSRF will be managed according to federal requirements.
- Award the DWSRF capitalization grant.
- Determine annually if a withholding is necessary. Withhold the proper amount of DWSRF capitalization grant funds if a state has not met its capacity development or operator certification program requirements.
- Withhold all funds if a state loses primacy; employ some of these allotted funds to administer primacy in that state; and reallocate remaining funds to other compliant state DWSRF programs.
- Reallocate withheld allotted funds to other, compliant DWSRF programs according to the current allotment formula.

State Program Office

- Prepare, subject to public review, and submit to EPA an IUP that describes the use of all DWSRF funds and establishes a priority list of fundable projects in the upcoming fiscal year.
- Complete and submit a capitalization grant application to EPA including the funding application, payment schedule, IUP, and other required documentation, which may involve a revised OA that defines program structure and operations.
- Develop work plans for EPA that detail how DWSRF set-aside funds will be managed and employed within ninety days of the grant award, or according to the agreed to schedule between the state program and EPA regional office.
- Coordinate with state PWSS and capacity development programs to remain aware of possible withholdings.
- If relevant, state how the DWSRF will spend reallocated funds in the IUP.



3.4 State Agrees to Provide Matching Funds

3.4.1 Federal Requirements for State Match of the Fund

States must provide a match to the Fund equal to or greater than twenty percent of the entire capitalization grant. The state must demonstrate that it has the financial and legal ability to satisfy this match on or before the date of each grant payment. It is important to note that other state agencies may not make a loan to the DWSRF to provide the match; however, they may assist the DWSRF in acquiring matching funds through an external debt offering.

A state can issue bonds to provide its match. Revenue bonds may be issued directly by a DWSRF with bonding authority or through other existing state mechanisms. General Obligation (GO) bonds can also be repaid with DWSRF revenues. Review of a state match bond proposal is an important part of the grant award process. As opposed to bonds for leveraging, bond issues to fund state match must be repaid only with interest earnings. In addition to the regional review, EPA headquarters must approve a state's first-ever state match bond issue but not subsequent issues with the same structure.

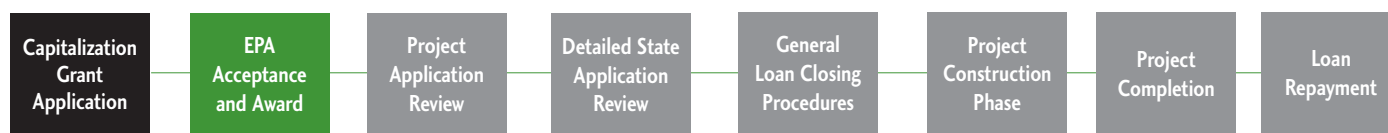
State Match Requirements . . . Each state must provide a twenty percent match for each capitalization grant payment and a one-to-one match to all grant monies reserved under the program management set-aside.

3.4.2 State Match to the Ten Percent Program Management Set-Aside

In addition to the twenty percent match for the Fund, DWSRF programs must provide a one-to-one match for any amount of the capitalization grant, up to ten percent, reserved for the State Program Management set-aside (see Section 4.1.3 for more information on this match requirement). Under the DWSRF regulations, programs are allowed the option of using credit from state expenditures (match and overmatch) provided to the PWSS program during FY1993. This credit may account for up to fifty percent of the match required under this set-aside. Regulations also allow these amounts provided by the state to the PWSS program during FY1993 to serve as a perpetual credit.

Additional match can be in the form of new cash, credit for in-kind services, or credit for PWSS overmatch (only) in the current fiscal year. Cash contributions may come from state appropriations or income generated through program fees. State funds provided for the State Program Management set-aside match requirement may not also be used to satisfy the match requirements under the PWSS program or vice versa. In-kind services may include state funds used for program management activities that are directly related to the eligible uses of the Program Management set-aside, an example of which is employee salaries.

States are required to identify the source of match for the State Program Management set-aside in their capitalization grant applications, as well as provide documentation of the actual source of match in their Annual/Biennial Reports.



KEY RESPONSIBILITIES: CHAPTER THREE: 3.4

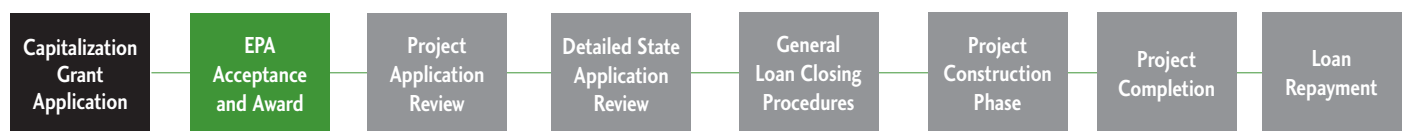
State Agrees to Provide Matching Funds

EPA

- Ensure that the state will be able to provide the twenty percent capitalization grant match in accordance with federal requirements, including restrictions on DWSRF bond issuance to raise state match.
- Review the documentation for the one-to-one match before authorizing use of the State Program Management set-aside.

State Program Office

- As part of the DWSRF capitalization grant application, demonstrate the ability to provide a match of twenty percent for each capitalization grant payment. Ensure timely deposit of this match according to a formally established payment schedule.
- Document a one-to-one match for any State Program Management set-aside funds requested.



3.5 State Leveraging Activities to Increase Funds Available

3.5.1 Overview of the Leveraging Planning Process

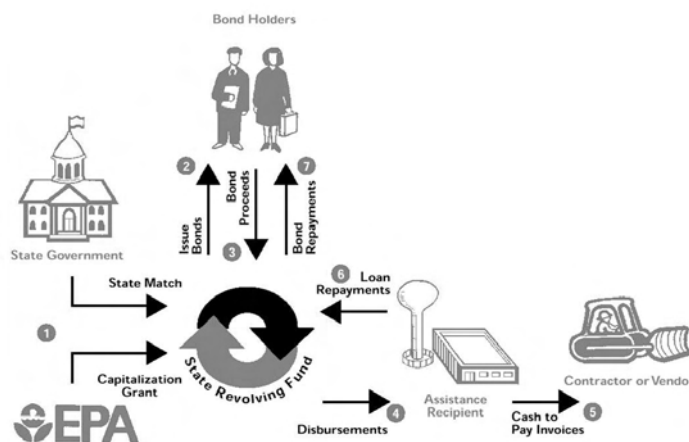
States can “leverage” capitalization funds, using them as security for bond issues that allow DWSRF programs to provide a higher level of assistance in the near term. DWSRF bonds are highly regarded by the market, keeping states’ interest in leveraging high. Several basic types of leveraging are in use. No two state approaches, however, are identical.

If a state is considering leveraging, its DWSRF program should examine its financial assistance needs, both the demand for assistance and the timing of these needs, and the role of other funding mechanisms, including local financing. Financial modeling not only allows program administrators to compare the supply of funding versus this demand, but also shows the impact of leveraged program structures versus a non-leveraged program. Even if leveraging looks like a good option financially, state political acceptability, state policy considerations, relationships among state agencies, and the ability to administer a leveraged program might be significant obstacles. DWSRF programs should consult with EPA when conducting leveraging planning, as regional staff members have experience reviewing other leveraging programs.

Leveraging Considerations

- Demand for DWSRF financing
- Timing of infrastructure needs
- Role of other funding mechanisms
- Long-term impact on the Fund
- Political acceptance
- Program management capacity

When a DWSRF program decides to leverage, it first has to establish the responsibilities of state agencies and plan any needed modifications to SRF enabling legislation, SRF procedures, or state regulations. This is also the time to formally initiate contact with the financial community and to inform EPA and client communities of its plans.



Basic Leveraging Structure

Next, the DWSRF assembles a financial team including state personnel, bond counsel, underwriters, a trustee, and a financial advisor. This team designs the leveraging structure and considers the level of state credit support, loan participants, the type of bond indenture, and the type of cash flow/account structure. Preliminary communications with those who will review the state’s approach, including credit rating agencies and EPA, occur during this development process.

EPA regional DWSRF staff review any leveraging plan to be sure that it will protect the long-term financial health of the Fund and that its structure respects the federal program requirements. Specifically, the net bond proceeds must be deposited into the Fund.

While no two states have exactly the same leveraging account structure, a review of state programs shows that there are two basic forms of leveraging in use in DWSRF programs: reserve fund leveraging and cash flow leveraging.

For reserve fund leveraging, the capitalization grant drawn from the federal treasury is deposited into a debt service reserve fund as security and a source of earnings and bond funds are used to make loans for eligible projects. In cash flow leveraging federal grant funds are lent out along with bond funds. EPA reviews the leverage structure for compliance with federal requirements.

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

As the program is developed, the state works with finance industry professionals to develop the trust indenture, bond resolution, legal opinion form, and bond certificates. They also write the preliminary official statement, bond purchase agreement, and agreement among underwriters. The DWSRF program executes loan agreements and interagency agreements. At this point, the bond issue is ready to present to the rating agencies and advertise to the market. After all these steps are complete, the bonds are priced, printed, and issued. Proceeds from the bond sale are deposited into the Fund and managed by the trustee.

3.5.2

SRF Cross-Collateralization Procedures

Cross-collateralization allows funds from one state SRF program to be used to secure the other SRF program from revenue shortfalls. By supporting DWSRF bonds with the very strong cash flows of the CWSRF program, states receive stronger bond ratings that translate into lower interest rates on their bonds and cost savings to DWSRF borrowers. In the case of a state where few of the DWSRF borrowers have strong credit histories, cross-collateralization can make access to the bond market possible.

A state must take several steps to include cross-collateralization in its SRF Programs. First, the capitalization grant agreements for both programs must be amended and receive an opinion from the Attorney General (AG) certifying that state law permits cross-collateralization. In addition, the OA and IUP in both programs must be amended to detail how cross-collateralization will be implemented. In particular, the IUPs for both programs must detail which funds will be used as security, how monies will be used in the event of a default, and whether or not monies used for a default in the other program will be repaid. If it will not be repaid, an explanation of the cumulative impact on the Funds is also required. State programs are also required to submit any amended IUPs for public review and comment.

DWSRF/CWSRF Cross-Collateralization . . . *State DW or CWSRF bond issues can be used to support the other SRF program if revenues from the bonds are allocated to the respective funds in the same portion as they are used for security for the bonds.*

All proceeds generated by the issuance of bonds must be allocated to the respective CWSRF and DWSRF Funds in the same portion as they are used for security for the bonds. States must demonstrate at the time of bond issuance that the proportionality requirements have been or will be met. If a default should occur, and Fund assets from one SRF program are used for debt service in the other SRF program, the security would no longer need to be proportional. States may not combine the assets of the SRF programs as security for bond issues to acquire state match for either program. States are also prohibited from using the assets of one SRF program to secure match bonds for the other SRF program. Finally, the debt service reserves for the DWSRF and CWSRF programs must remain accounted for separately and loan repayments must be made to the respective program from which the loan was made.

It is important to note that cross-collateralization does not effect the calculation of set-asides, the four percent administrative ceiling, or binding commitments; however, payments and cash draw proportionality may be affected if there are defaults.

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

KEY RESPONSIBILITIES: CHAPTER THREE: 3.5

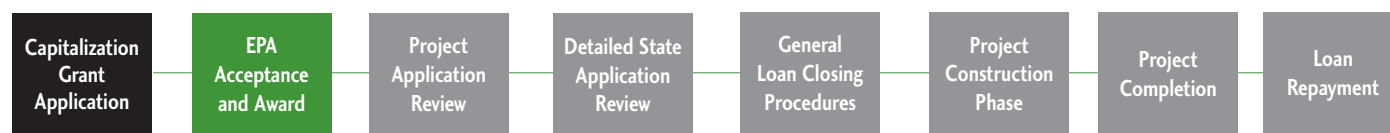
State Leveraging Activities to Increase Funds Available

EPA

- Review a DWSRF program's assistance needs and proposed leveraging structure to ensure that leveraging will sustain the financial health of the program.
- Examine a state's cross-collateralization plans with regard to their compliance with all DWSRF regulations.

State Program Office

- If drinking water infrastructure funding demand is outpacing a DWSRF's ability to provide financing, consider leveraging DWSRF funds.
- Assemble a team of program and financial advisors to design a leveraging structure and to plan for and implement a bond issue.
- Consider cross-collateralization as a way to better secure a bond issuance. This may result in a lower interest rate and better loan terms to borrowers.
- Obtain EPA approval before implementing proposed leveraging structure.



3.6 Fund Transfers (Between the DWSRF and CWSRF Programs)

3.6.1 Specific Criteria

To provide flexibility to use one SRF to support the other in meeting state funding needs, the 1996 SDWA Amendments (Section 302) allowed the transfer of funds between a state's DWSRF and CWSRF program. Although this initial authorization ended on September 30th, 2001, Congress extended transfer authority on an ongoing basis through annual EPA appropriations bills. This transfer provision was later made permanent with the 2006 appropriations.

According to DWSRF and CWSRF transfer provisions, a state may transfer an amount equal to thirty-three percent of the DWSRF capitalization grant to the CWSRF or an equivalent amount from the CWSRF to the DWSRF. When electing to approve a transfer between SRF programs, the IUPs and OAs in both programs should cover the approach and details for SRF fund transfers. Information on how these transfers will affect payment schedules, cash draw proportionality, and binding commitments should also be included. Follow-up reporting through the state Annual/Biennial Report should include information on total recorded SRF transfer activity.

DWSRF/CWSRF Fund Transfers . . .

A state may transfer an amount equal to thirty-three percent of the CWSRF capitalization grant to the CWSRF or an equivalent amount from the CWSRF to the DWSRF.

Before transferring funds, the state's AG, or someone designated by the AG, must certify that state law permits such a transfer between the CWSRF and DWSRF programs. The OA and relevant portions of the Capitalization Grant Agreement must also be amended for both programs to detail the specific method the state will use to transfer the funds. States may transfer any monies that are in the Fund, including federal capitalization grant dollars, state dollars, repayments, and investment earnings. DWSRF programs may elect to reserve the authority to transfer funds in one year, but not actually transfer those funds until some later time. This approach can help with planning. Funds must be used for project or set-aside activities during the time period prior to when the actual transfer occurs. If sunset provisions for transfers allow, a state could address key priorities by accounting for transfers on a net basis such that it can "loan" funds to its sister program that would "repay" them with an equivalent transfer at a later date. Because a transfer occurs after award of a capitalization grant, it does not affect the calculation of state match, set-asides, or administration funding levels.

Funds transferred into the DWSRF are considered to be part of the "available funds credited to the Fund," and as such, they are subject to the fifteen percent small systems provision. Also, DWSRF programs must account for whether the transferred amount consists of federal dollars to which federal requirements such as payment schedules and crosscutters will apply.

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

KEY RESPONSIBILITIES: CHAPTER THREE: 3.6

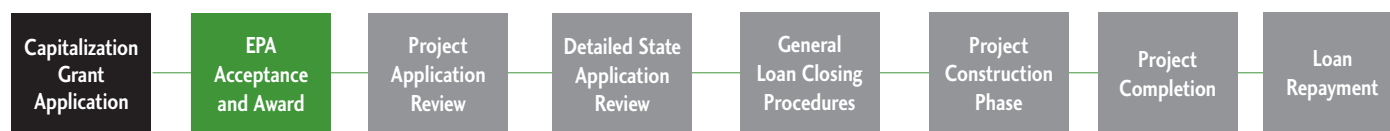
Fund Transfers

EPA

- Review any DWSRF/CWSRF fund transfers in the IUP to ensure that they do not exceed the transfer ceiling.
- Ensure the DWSRF program follows all other requirements for transferred funds, including application of federal crosscutters and meeting the small systems minimal funding requirement.
- Ensure state programs have the necessary authority to transfer funds between SRFs (e.g., through state AG certification and appropriate language included in the IUP).

State Program Office

- Obtain necessary authority (e.g., state AG certification) to transfer funds between SRF programs.
- Describe transfer procedures for SRF funds within the OA.
- Document planned transfer activity to or from the CWSRF program in the IUP.
- Provide follow-up reporting on all recorded SRF transfer activity within the Annual/Biennial Report.
- Ensure compliance with all federal requirements for transferred funds, including application of federal crosscutters and providing a minimum level of assistance to small systems.



3.7 Federal Funding Process

3.7.1

Disbursement from the DWSRF

State programs receive each capitalization grant payment in the form of an increase in the ceiling of funds available through the EPA Automated Clearing House (EPA-ACH). Funds are transferred to the state from the U.S. Treasury on a reimbursement basis, after assistance recipients have billed the DWSRF program for work completed and the DWSRF program requests. After the funds are transferred, the State reimburses the assistance recipients for costs incurred. This process is known as the disbursement from the DWSRF.

3.7.2

Binding Commitment Requirements

Following a Set Payment Schedule. DWSRF programs are required to follow a formal schedule when accepting capitalization grant payments. These schedules are negotiated between individual DWSRF programs and EPA. A separate schedule is developed for each capitalization grant and made final through a formal capitalization grant agreement. Schedules are based on each program's estimated plan for entering into future binding commitments and expenditures through the DWSRF set-aside accounts. Both EPA and DWSRF programs agree to follow these schedules when funding SRF activities.

It is important to highlight that individual grant payments are not actual transfers of cash, but instead represent increases to the Automated Standard Application for Payments (ASAP) funding ceiling available for SRF loan disbursements or set-aside expenditures. Increases in the funds made available track the established payment schedule.

SRF assistance programs are required to accept all grant payments within the earlier of eight quarters from the capitalization grant award or within twelve quarters from the allotment of federal funds. For example,

under the 8 quarter rule, if payments began in January of 2000, they would end in December of 2001. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3560(a) and (b))

Capitalization Grant Payments

Programs **MUST** accept all capitalization grant payments the earlier of:

- Eight quarters after the grant award, or
- Twelve quarters after the allotment

Establishing Binding Commitments. After DWSRF programs accept a federal capitalization grant payment they are required to enter into binding commitments for eligible projects within one year. Binding commitments must equal the total amount of each grant payment, net all set-aside deposits, plus state match. A binding commitment represents a legal obligation between a DWSRF program and an assistance recipient. Such agreements detail all relevant terms of assistance, including interest rates, payment schedules, and repayment terms. In many states, a binding commitment is a closed loan; in some states a binding commitment letter is used. If binding commitment letters are used, EPA monitors the time period between their issuance and loan closing to assure that funds are being used expeditiously. If a program enters into binding commitments for an amount greater than the total amount required, the program may credit any excess toward future binding commitment requirements.

Binding Commitments

Binding commitments **MUST** equal:

- Federal payments (net set-aside deposits) PLUS state match (within one year of payment date)

EPA uses information about binding commitments to calculate program pace (i.e., executed loan agreements as

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

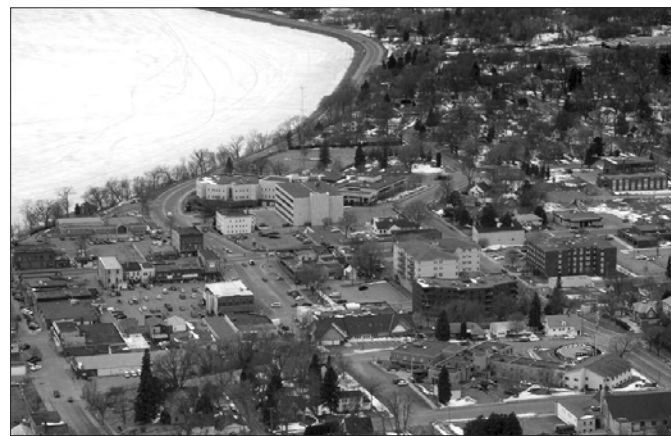
a percentage of total funds available). Total binding commitments (as reported to EPA) are based solely on final loan agreements, rather than interim loan agreements.

If the binding commitment requirement is not met, EPA may withhold future grant payments and require modification of the payment schedule prior to releasing additional grant payments. If an individual program is concerned that it will not meet the minimum binding commitment requirements, program staff should establish and propose a revised binding commitment schedule to the EPA Regional Administrator. Any amendments to the payment schedule affect only future payments. Although a program may revise its payment schedule, all remaining payments must be received as originally required (i.e., within the earlier of eight quarters of the grant award or twelve quarters from allotment). (Reference: 2000 DWSRF Interim Final Rule, Section 35.3550(c))

3.8 Special Program Assistance Requirements

3.8.1 Providing Special Program Assistance

Assistance to Small Communities. All state DWSRF programs are required to provide, to the extent possible, a minimum of fifteen percent of funds available annually for loans to small systems. Small systems are defined as those that serve fewer than 10,000 persons. Total available funds include capitalization grants deposited to the Fund, state match, interest earnings, loan repayments, and bond proceeds. States must consider all of these sources in a given fiscal year to calculate the required level of assistance for small systems. Direct assistance to small systems, as well as the portion dedicated to the consolidation of a small system with another facility, qualifies toward this requirement. Programs must detail the total amounts anticipated for small system assistance within the IUP and report on the actual use of funds within the Biennial Report.



If a program anticipates that it will be unable to fulfill the fifteen percent minimum obligation in the upcoming year, an explanation accounting for the inability to meet this requirement must be included in the annual IUP as well as a discussion about program activities that will ensure the minimum requirement is met in future years. Activities may include providing technical assistance to small systems, implementing a new marketing strategy, or conducting other types of outreach efforts.

Small System Assistance. . . programs must provide a minimum of fifteen percent of all available loan assistance to small systems

States are required to meet this fifteen percent minimum level of funding to small systems for as long as the program is in operation. This fifteen percent minimum requirement is not tied to the award of a capitalization grant, but represents a permanent program condition. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3525(a)(5))

Assistance to Disadvantaged Communities. DWSRF programs are given the flexibility to provide additional loan subsidies to disadvantaged communities. Each state has the flexibility to establish its own definition of “disadvantaged communities.” To make loans affordable for disadvantaged recipients, programs may offer

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

subsidies including reduced interest rates, negative interest rates, and extended loan repayment terms (up to thirty years). Alternatively, they may provide a certain level of principal forgiveness. Programs may provide these types of subsidies to recipients that currently meet affordability criteria established by the state or will meet these criteria as a direct result of receiving DWSRF loan assistance.



When providing assistance to disadvantaged communities, programs are limited to a maximum of thirty percent of each capitalization grant deposited to the Fund for providing loan principal forgiveness subsidies and negative interest rates. If a state provides less than the maximum of thirty percent of each capitalization grant for principal forgiveness or negative interest rates, the remaining amounts may not be banked for future use.

Programs providing disadvantaged assistance are responsible for developing affordability criteria to define these types of communities. A “disadvantaged community” represents the entire service area of a public water system that meets such affordability criteria. If desired, EPA will provide additional information and assistance to those programs developing these types of affordability determinations. Before programs may implement their system for defining disadvantaged communities, proposed criteria must first undergo a formal public review and comment period. EPA reviews and approves a state’s disadvantaged community assistance program as part of the annual IUP review process.

Disadvantaged Community Assistance

- Disadvantaged community assistance (i.e., in the form of negative interest rates or principal forgiveness) may not exceed thirty percent of each capitalization grant.

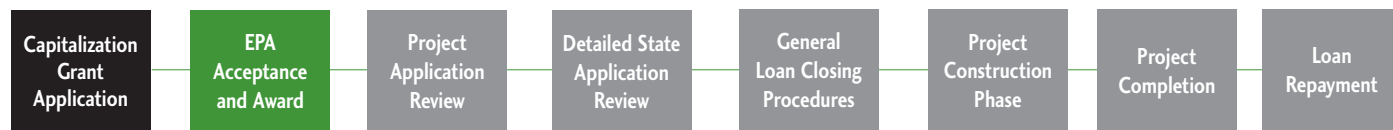
All subsidy amounts are approved and committed according to the same schedule established for overall binding commitments. In other words, all binding commitments, including commitments for disadvantaged community assistance, must be made within one year of receipt of the associated capitalization grant payment. Programs are required to identify all projects receiving this type of assistance, the overall level of subsidy, and the criteria used for awarding assistance to these systems within their annual IUP. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3520(b))

3.9 Cooperation and Coordination with other Programs

3.9.1 Enhancing Cooperation and Coordination

In addition to the DWSRF, there are many other complementary federal and state assistance programs. Navigating these funding sources can be time-consuming and difficult, particularly for small and rural communities that often have significant needs and minimal resources. Throughout the steps of the DWSRF funding process, cooperation and coordination with other assistance programs at the state and federal levels simplifies the funding process and enhances guidance for potential borrowers.

Many states have taken steps to implement coordinated funding strategies to target specific needs, benefiting those seeking assistance as well as those providing assistance. These efforts enhance communication between agencies and reduce administrative work, maximizing resources and the benefits achieved. States use a variety of approaches to coordinate funding between assistance programs, including:



- One-stop meetings or screenings. Some states hold meetings that involve multiple agencies coming together to provide all relevant information for project assistance, including information about funding sources, eligibility criteria, the application process, etc.
- Technical assistance. Assistance is often provided for small and rural communities that are unfamiliar with the funding and application process of the DWSRF.
- Coordinating documents. These documents, such as memoranda of understanding and agreements, serve as formal commitments to enhance cooperation and coordination among state and federal agencies.
- Joint environmental reviews. Some programs streamline the environmental review process by accepting environmental reviews for other programs whenever there is joint funding or providing common environmental review procedures.
- Regular project review meetings. Some states hold meetings that discuss applicants and issues, such as readiness for construction and environmental review status.
- Funding fairs or events. These events provide information about the multitude of funding options available to those seeking assistance.
- Internet websites. Many states have created websites that provide information about assistance options and program requirements. Two examples include searchable databases of funding sources and self-assessment tools that allow utilities to determine the sources of funding for which they are eligible.
- Uniform applications. In some cases, a single application may be available for multiple funding programs.

KEY RESPONSIBILITIES: CHAPTER THREE: 3.7-3.9

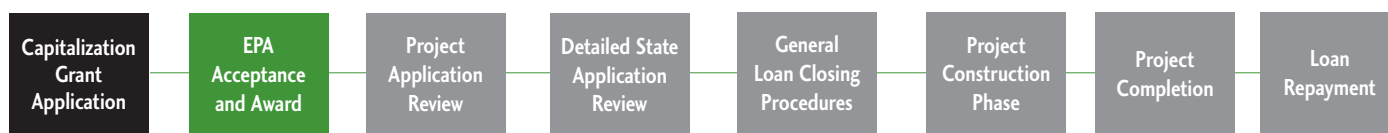
Federal Funding Process/Program Requirements for Making Loans/Cooperation and Coordination with other Programs

EPA

- Negotiate with the DWSRF program to develop a formal schedule of capitalization grant payments.
- Ensure programs are funding a minimum of fifteen percent of all available loan assistance to small communities or have a formal plan to meet these requirements in the future.
- Approve state proposals for developing a disadvantaged community assistance program.
- Ensure state programs do not exceed the maximum of thirty percent of each capitalization grant for eligible disadvantaged community assistance.

State Program Office

- Accept all grant payments within the earlier of eight quarters of the grant award or twelve quarters of the allotment of federal funds.
- Enter into binding commitments within one year after receiving each capitalization grant payment. Binding commitments must equal total grant payments deposited to the Fund plus associated state match.
- Provide a minimum of fifteen percent of available loan assistance annually to small communities. If unable to provide this level of assistance, provide a detailed explanation within the IUP to explain why the program is unable to meet this requirement and how the program plans to meet this requirement in the future.
- Provide no more than thirty percent of each capitalization grant for disadvantaged community assistance in the form of negative interest rates or principal forgiveness according to approved affordability criteria.



3.10 Project Application Process

3.10.1 Developing the Project Priority Lists

Timing of the Intended Use Plan. DWSRF programs are required annually to develop a formal IUP.

Development of the IUP is a permanent requirement and an IUP must be completed even if the program is not receiving a capitalization grant. Annual IUPs describe how programs intend to allocate all available funds in a timely and expeditious manner, provide information on amounts reserved for project assistance, and detail amounts reserved for DWSRF set-asides. Projects highlighted for assistance in the upcoming fiscal year are presented in project priority lists. State programs are also required to provide well-defined outputs and outcomes as part of their capitalization grant application; however DWSRF programs will often include this type of information within their IUPs as well.

Fundable Project Lists

Details must include:

- Name of the public water system
- Priority assigned to the project
- Project description
- Expected terms of assistance
- Service population

DWSRF programs typically include their IUP with the capitalization grant application; however, some states will submit their IUPs to EPA for review prior to submitting the grant application. Although timing may differ between state programs, annual IUPs must be submitted no later than when the capitalization grant application is submitted to EPA for approval. EPA will not review a capitalization grant application without an accompanying IUP.

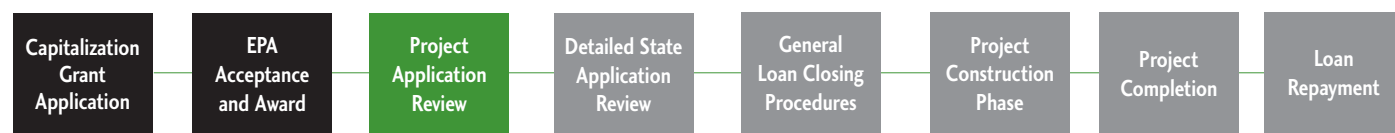
Developing the Project Priority Lists. Two lists of priority projects are included in the annual IUP. These lists

include the comprehensive project list and the fundable project list. The comprehensive list includes all projects that are eligible for program assistance and have submitted a pre-application for priority listing. From the comprehensive list, programs develop a fundable list of projects that are expected to receive assistance in the upcoming year. State programs will often evaluate a project that is not able to receive funding during the upcoming year for possible technical or financial trouble areas. In some cases, state programs will offer technical assistance to these systems to ensure they are capable of receiving funding during the next project cycle.

When developing the fundable and comprehensive priority lists, state programs must include additional information to define each project listed as eligible to receive SRF assistance. Additional details as part of the fundable project list include the name of the public water system, the priority assigned to the project, a description of the project, expected terms of assistance based on current information available, and the population of the service area at the time of loan application. Remaining projects on the comprehensive list must include information on the priority assigned and, if available, the expected funding schedule.

Preapplications are often collected to gather this type of information. Programs may use preapplications to gather basic project eligibility information before requesting a detailed application at a later date.

Adhering to the Priority Ranking System. Project priority lists are arranged based on a program's priority ranking system. All programs must include the details of their priority ranking system criteria within the annual IUP. Both the IUP and the priority ranking system are subject to public review and comment. All priority systems are required to focus funding on projects that: 1) address the most serious risk to human health; 2) are necessary to ensure compliance with the requirements of SDWA; and 3) assist systems most in need, on a per household basis. A state that does not adhere to these requirements must explain why it is unable to do so in its IUP.



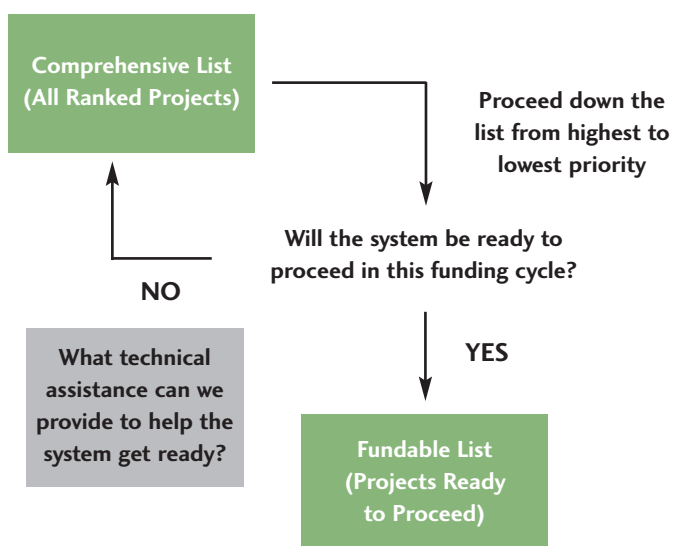
Priority Ranking Systems

Priority projects must:

- Address the most serious risk to human health
- Ensure compliance with all SDWA requirements
- Assist systems most in need

Submitting Priority Lists for Review. In most cases, the project priority lists are included with the annual IUP or as part of the capitalization grant application. In cases where a state has not yet completed its project priority lists, the IUP may be developed as part of a two-part process. In these cases, programs may develop the IUP without the project priority lists and only include information on the use of the DWSRF set-aside funds. Public review and comment are still required for this IUP before submitting with the capitalization grant application. When the priority lists are complete, programs generate this additional information to detail the use of the SRF funds for loan assistance. After an additional round of public review and comment, programs would submit this new information as part of an amendment to the original capitalization grant application. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3555(a), (b), and (c))

General DWSRF Priority Setting Process



3.10.2

Description of Eligible Applicant Types

General Eligibility. DWSRF programs may provide assistance to all publicly- and privately-owned community water systems or nonprofit noncommunity water systems. For a nonprofit system to be eligible for SRF funding, it must have a federal tax exempt status identification number. Nonprofit systems may include school systems, day care centers, churches, or retreat centers. Systems that are federally-owned or recognized as for-profit noncommunity water systems are not eligible for assistance through the Fund.

DWSRF Assistance Recipients

Eligible applicants include:

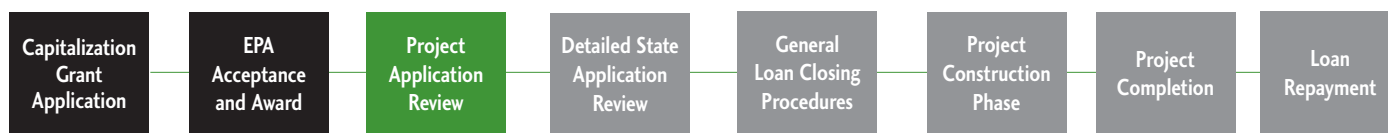
- Publicly-owned community water systems
- Privately-owned community water systems
- Nonprofit noncommunity water systems

Ineligible Applicants. All borrowers receiving program assistance must demonstrate full technical, managerial, and financial capacity and full compliance with all national primary drinking water regulations or variances. If an applicant does not demonstrate full compliance in all of these areas, it may not be eligible for DWSRF assistance. In such cases, assistance is only offered to those recipients that agree to undertake appropriate operational changes to ensure future compliance or agree to use assistance offered to address the specific cause(s) of noncompliance. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3520(a) and (d))

3.10.3

Description of Eligible Project Activities

General Project Categories. DWSRF assistance is provided for projects that address a current violation or will prevent a future violation of health-based drinking water standards.



Eligible project categories include:

- Consolidation of drinking water supplies,
- Creation of new systems,
- Costs for maintaining drinking water sources,
- Storage capacity costs,
- Transmission and distribution costs,
- Drinking water treatment costs, and
- Drinking water security measures

Additional project types not explicitly defined through the categories listed above may still be eligible for assistance through the Fund. Questions related to the eligibility of individual project types are answered by EPA on a case-by-base basis. Sample activities for each eligible project category are described below:

Consolidation of Supplies. Consolidation projects refer to the consolidation of drinking water supplies when supplies are either contaminated or when a system can no longer maintain compliance due to a lack of proper technical, financial, or managerial capacity.

Creation of New Systems. DWSRF programs may fund the development of new systems to address current public health concerns or consolidate existing systems that face technical, financial, or managerial capacity challenges. Projects that authorize the creation of a new system are limited to the specific geographic area affected by contamination. Projects to consolidate multiple facilities are limited to the current service areas for each drinking water system. For all consolidation projects, applicants must ensure that consolidated systems will maintain compliance with all SDWA requirements.

When funding these types of projects, programs must show that applicants have provided sufficient public notice, considered alternative solutions, and are implementing the most appropriate and cost-effective solutions.

Drinking Water Sources. Eligible costs include the rehabilitation of existing drinking water sources and the development of new sources to replace those that are

contaminated. Sample projects may include dredging activities near intake facilities, the replacement of contaminated wells, or the construction of new wells to meet current demands.

Storage Capacity. DWSRF programs may provide assistance for the upgrade or installation of finished drinking water storage facilities to prevent possible contamination. Activities can include the development of a finished drinking water reservoir, recoating or repair of an existing storage tank, or the replacement of onsite sludge ponds.



Transmission and Distribution. Costs for transmission and distribution include the installation or replacement of transmission pipes and distribution networks to improve water pressure or for the prevention of possible contamination caused by leaks or breaks in the system. Projects can include the construction of new water lines, the installation of new elevated tanks or storage reservoirs, or the construction of a new drinking water booster and pump station.

As with all projects funded through the DWSRF program, it is important to note that projects may only be sized to accommodate a reasonable amount of growth expected over the life of the associated facility. Growth may not be a substantial portion of any project.

Treatment Costs. Treatment costs include expenses related to the installation, replacement, or upgrade of treatment facilities to improve drinking water quality or to comply with primary and secondary drinking water

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

standards. Individual projects can include the installation of new nitrate treatment facilities, improved filtration methods for surface water, or construction improvements for chlorine storage techniques.



Security Measures. DWSRF programs may also provide assistance for drinking water security measures. These may include assistance for the development of vulnerability assessments or for the development of contingency and emergency response plans. Other types of security components may also be included within the scope of a larger infrastructure project. Sample security measures include:

- Facility fencing,
- Security cameras and lighting,
- Motion detectors,
- Redundancy (systems and power),
- Securing chemical and fuel storage areas,
- Lab equipment,
- Enhanced filtration/disinfection (for biological agents),
- Enhanced treatment (for chemical agents),
- Backflow prevention devices in distribution system, and
- Covering for finished water reservoirs

Additional protection for drinking water sources may be funded through the DWSRF set-asides. Specific activities may include fencing and security cameras for drinking water sources or the development of source water vulnerability assessments and emergency response plans.

It is important to note that certain security measures related to operations and maintenance costs are not eligible for assistance through the DWSRF program. Such ineligible activities may include assistance for the hiring of security guards, the purchase of disinfection chemicals, or funding for monitoring costs.

Eligible Project-Related Costs. The DWSRF may also fund some types of additional costs necessary to fully implement an eligible project.

These additional costs must fall within one of the following categories:

- Costs for land acquisition that are integral to project implementation,
- Costs related to project planning, design, and other pre-project costs, and
- Costs related to system restructuring activities

(Reference: 2000 DWSRF Interim Final Rule, Section 35.3520(b) and (c))



3.10.4

Ineligible Project Types

Several distinct categories of funding are ineligible for assistance through the DWSRF program. According to formal regulations, programs are not permitted to provide assistance in the following project areas: 1) the development or rehabilitation of dams; 2) the purchase of water rights (except when water rights are transferred as part of a system consolidation effort); 3) the building or rehabilitation of reservoirs (except for finished water reservoirs and reservoirs essential to the treatment process); 4) projects primarily developed for fire protection; 5) projects developed primarily to accommodate future population growth; and 6) projects that have received assistance through the Indian Tribes and Alaska Native Villages national set-aside.

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

In addition to these general categories of ineligible projects through the DWSRF program, states may not provide assistance for certain ineligible project-related costs, including laboratory fees related to routine compliance monitoring or for any type of operation and maintenance costs. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3520(e))

Ineligible DWSRF Project Assistance

Projects Ineligible for Assistance:

- Installation/rehabilitation of dams
- Purchase of water rights
- Development/rehabilitation of reservoirs
- Projects primarily for fire protection
- Projects primarily for future growth
- Indian Tribes/Alaska Native Villages national set-aside recipients

Ineligible Project-Related Costs:

- Routine compliance monitoring laboratory fees
- Operation and maintenance expenses

3.10.5

Description of Eligible Assistance Structures

DWSRF programs may provide assistance in a variety of forms. In addition to assistance to eligible recipients in the form of a loan, programs may also provide assistance through the purchase of local debt, the purchase of debt insurance, or to secure SRF debt obligations when leveraging. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3525)

Assistance through a DWSRF Loan. DWSRF loans are provided for individual projects or for a group of multiple projects to an individual recipient. Programs may also combine a previous planning and design loan obligation for an individual recipient with a newly-issued loan for project construction. Program recipients may also apply for a series of loans for a particularly large or expensive project. In this case, programs may issue multiple loans over the course of several years for one project. These types of projects are often called “phased projects.”

DWSRF Assistance Structures

Program assistance through:

- DWSRF Loans
- Refinance or Purchase of Local Debt
- Insurance or Guarantee for Local Debt
- SRF-Issued Bond Security

Refinance or Purchase of Local Debt. DWSRF programs also have the option to purchase or refinance local debt obligations. Programs may purchase local debt through a direct purchase of municipal bonds issued for project construction. Program regulations require that all projects where debt was incurred must have a construction initiation date after July 1, 1993. In the case where a local government issues a multipurpose bond, only the portion used for the DWSRF eligible project may receive assistance through the program. Privately-owned systems are not eligible for refinancing.

Insurance or Guarantee for Local Debt. In an effort to improve the credit market access for a local community or to assist in reducing borrowing interest rates, the DWSRF may provide assistance through the purchase of local debt insurance or a debt guarantee. Programs may only provide assistance for debt incurred to implement a DWSRF-eligible project. In the case of default following a DWSRF issued guarantee, the program would be responsible for repaying the local debt obligation. It is imperative that DWSRF programs review the creditworthiness of the guarantee recipient and ensure acceptable coverage for the local debt obligation.

Security for DWSRF Issued Bonds. In addition to direct assistance for program recipients, DWSRFs have the capability to issue program debt. Program debt is issued in the form of SRF bonds. When issuing bonds to increase the level of funds available for program loans and other types of assistance, DWSRF programs must explore options to secure program-issued debt. In many cases, programs will use fund assets (e.g., the federal capitalization grant, loan repayments, or interest earnings) to secure SRF issued bonds. Security is pro-

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

vided on future loan principal and interest repayments to the bond holders. All bond proceeds, net issuance costs, must be deposited directly to the Fund to finance additional DWSRF project assistance.

For more information on SRF leveraging activities, refer to Section 3.5: State Leveraging Activities to Increase Funds Available of this handbook.

3.10.6 Additional Uses of SRF Funds

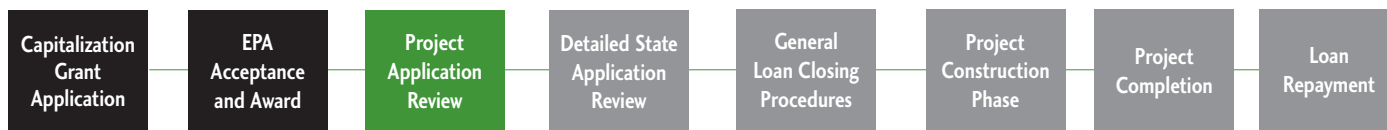
In addition to assistance in the form of a loan, purchase of local debt or debt insurance, and to secure SRF debt

obligations when leveraging, DWSRF programs may also use funds for additional purposes. Additional uses include the right to reserve a portion of funds for administration and set-aside expenditures and the right to earn interest on idle funds. It is important to note, however, that all monies deposited into the Fund may not remain there primarily to earn interest.

For more information on reserving funds for administration and other types of set-aside expenditures, refer to Section 4.1: Four Types of Set-Asides for more information.

DWSRF Assistance Options and Structure

DWSRF Loans	Refinance or Purchase of Local Debt	Insurance or Guarantee for Local Debt	SRF Issued Bond Security	Other
- Loans for individual projects - Loans for multiple projects - Combining previous planning and design loan obligations with newly issued loans - Series of loans for phased projects	- Refinance debt for lower interest rate - Direct purchase of municipal bonds at loan closing	- Purchase insurance for municipal debt - Guarantee holders of local debt that repayment will continue if municipality or public water system defaults	Security provided on future loan principal and interest repayments to bond holders	- Earn interest on funds - Administration activities and set-aside expenditures - Guarantee debt obligations when leveraging



KEY RESPONSIBILITIES: CHAPTER THREE: 3.10

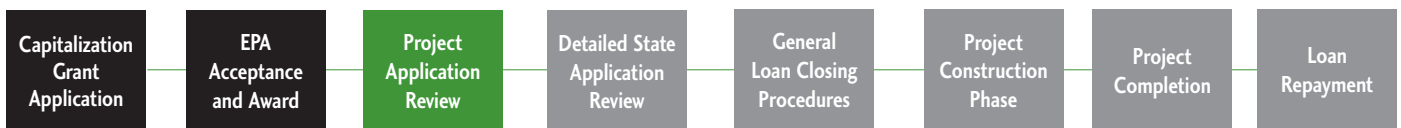
Project Application Process

EPA

- Review and approve annual IUPs and PPLs to assure that projects and recipients are eligible.

State Program Office

- DWSRF programs are required to develop a formal IUP annually for the life of the program.
- Programs must include two priority lists with each IUP. These lists include the comprehensive project list and the fundable project list.
- All programs must include the details of their priority ranking system within the annual IUP.
- All priority systems must place priority on projects that address the most serious risk to human health, that are necessary to ensure compliance with the requirements of SDWA, and that assist systems most in need.



3.11 Detailed State Loan Application Review

To conduct a fully detailed application review, programs must receive additional documentation to ensure that applicants have proper project planning and design. Additional application material will ensure that a project complies with all DWSRF program requirements for eligible reimbursable costs and that the system meets all technical, financial, and managerial capacity determinations. Throughout the detailed application process, the program may request additional material from the applicant. State programs will often use a checklist to keep track of what material is received and what additional material is necessary to complete the application.

3.11.1 Technical, Financial, and Managerial Review (TFM)

All program recipients must pass a full TFM review. In addition to demonstrating that the system can maintain compliance based on technical and managerial activities, they must also demonstrate an acceptable level of financial management, including the ability to repay the DWSRF loan and maintain acceptable facility operations. If a system does not have adequate TFM capacity, they may only qualify for assistance if the assistance will target a specific area of noncompliance or if the system agrees to develop a formal plan to make the appropriate changes necessary to improve compliance. In some cases, it may be determined that the project is not ready to proceed. In those instances, the program should provide appropriate technical assistance to resolve identified TFM issues.

“All program recipients must undergo a full TFM review before receiving assistance.”

3.11.2 Environmental Review Procedures

General Requirements. All projects receiving assistance through the Fund must pass an environmental review to evaluate possible negative environmental outcomes as a direct result of project assistance. Programs must conduct this review on all projects receiving direct Fund assistance, all refinanced or reimbursed projects, and all SWP activities through the DWSRF set-asides unless the activities solely involve administration (e.g., personnel, equipment, or travel) or technical assistance. States are not required to conduct environmental reviews for all other set-aside activities as EPA has determined that, due to their nature, they do not individually, cumulatively over time, or in conjunction with other actions have a significant effect on the environment.

Programs must follow environmental review procedures as required by the DWSRF program regulations. States may employ a State Environmental Review Process (SERP) that is similar to the process proposed through the National Environmental Policy Act (NEPA). These procedures are often called NEPA-like. Projects whose cumulative funding is equal to the amount of the federal capitalization grant are subject to the SERP or NEPA-like review. For all other projects, those in an amount greater than the amount of the federal capitalization grant, states have the option to use an alternative SERP which they must propose and have approved by EPA. In the absence of an approved alternative process, all projects are subject to a NEPA-like review.

For all environmental reviews, programs must fully document all information collected, procedures followed, and the reasons listed for all decisions. For example, a state may determine a finding of no significant impact following an Environmental Assessment (EA) or may recommend that the project not proceed following the preparation of a full Environmental Impact Statement (EIS). Programs must document all decisions.

EPA Review Procedures. All state environmental review procedures, both a NEPA-like SERP and an alternative

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

SERP, must undergo a review and receive approval from EPA. The same criteria for both types of environmental review approaches are used in the CWSRF and DWSRF programs. Once these processes are approved, programs may incorporate this information into their OAs. Any changes to the State Environmental Review Procedures must receive approval from EPA prior to implementation.

Categorical Exclusions. In some cases, projects may not require a full environmental review. These types of projects may fall under the particular definition of a Categorical Exclusion (CE). These projects include activities that are known to not cause a significant environmental impact. Such activities may include the replacement of existing transmission lines, the implementation of a wellhead protection program through the DWSRF set-asides, or a loan issued for planning and design. Only actions that do not individually, cumulatively over time, or in conjunction with other actions have a significant impact on the quality of the human environment, may qualify as a CE.

3.11.3

Federal Crosscutting Authorities

Defining Federal Crosscutting Authorities. Federal crosscutting authorities represent a general category of federal laws, governmental policies, and executive orders that broadly influence the activities of individual citizens, private businesses, and public entities. These authorities influence actions in areas of environmental protection, protection of civil rights, and the protection of open and fair competition in business practices, just to name a few. Federal crosscutting authorities also affect how federal assistance dollars are spent; in particular, restricting how they may be used according to existing federal law or policy. Because DWSRF programs are capitalized by federal assistance grants, Congress requires DWSRF programs to apply federal crosscutting authorities to certain DWSRF program activities.

General Requirements. Although EPA is ultimately responsible for compliance with federal crosscutting authorities as they apply to state DWSRF programs, individual state DWSRF programs are required to ensure SRF loan recipients also comply with these same crosscutting authorities. Congress recognizes that the DWSRF program is comprised of several types of funds that may include federal grant dollars, state matching funds, loan repayments, interest earnings, and bond proceeds. When a borrower receives loan assistance from the Fund, it is receiving a mixture of these funding sources. As it is sometimes impossible to determine the exact source of funds for each assistance agreement, Congress requires SRF programs to apply federal crosscutters to a state-selected number of projects with total funding that is equal to the amount of each capitalization grant deposited to the Fund. States that elect to impose the requirements of federal crosscutting authorities to projects and activities in amounts that are more than the amount of the capitalization grant may credit this excess to meet future crosscutting requirements. It is important to note that states may only use this compliance credit within the account that generated the credit. For example, a state cannot use a credit gained from excess compliance through set-aside account activities to meet future crosscutting requirements for projects funded through the DWSRF Fund.

Crosscutting Authorities . . .

“Crosscutting authorities apply to projects and activities whose total funding is equal to or greater than the amount of each capitalization grant.”

Application to DWSRF Set-Asides. In addition to applying general crosscutting requirements on the use of DWSRF funds for loan assistance, programs are required to apply federal crosscutting authorities to all DWSRF set-aside assistance activities. Although all set-aside activities are generally subject to federal crosscut-

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

Applicable Crosscutters During Relevant Stages of Project Implementation

Planning and Design	Procurement	Construction
• Civil Rights Act of 1964 • Section 504 of the Rehabilitation Act of 1973 • Age Discrimination Act of 1975 • Prohibition Against Sex Discrimination Under the Federal Water Pollution Control Act • Equal Employment Opportunity • National Environmental Protection Act • National Historic Preservation Act • Archeological and Historic Preservation Act • Coastal Zone Management Act of 1972 • Clean Air Act • Endangered Species Act • Protection and Enhancement of the Cultural Environment • Floodplain Management • Protection of Wetlands • Farmland Protection Policy Act • Fish and Wildlife Coordination Act • Safe Drinking Water Act • Wild and Scenic Rivers Act • Coastal Barriers Resource Act • Demonstration Cities and Metropolitan Development Act • Lobbying Disclosure	• Civil Rights Act of 1964 • Section 504 of the Rehabilitation Act of 1973 • Age Discrimination Act of 1975 • Prohibition Against Sex Discrimination Under the Federal Water Pollution Control Act • Equal Employment Opportunity • Women's and Minority Business Enterprise • Preservation of Open Competition and Government Contractors' Labor Relations on Federally Funded Constructed Projects • Debarment and Suspension • Prohibitions Relating to Violators of the Clean Air Act and the Clean Water Act with Respect to Federal Contracts, Grants, or Loan	• Civil Rights Act of 1964 • Section 504 of the Rehabilitation Act of 1973 • Age Discrimination Act of 1975 • Prohibition Against Sex Discrimination Under the Federal Water Pollution Control Act • Equal Employment Opportunity • Women's and Minority Business Enterprise • Uniform Relocation Assistance and Real Property Acquisition Act

Table: Application of federal crosscutters from project planning and design, through procurement, to project construction and completion.



ter requirements, in many cases, these authorities are not implicated. For example, administrative costs would not require the application of environmentally-based federal crosscutters such as NEPA or the Endangered Species Act. In these cases, federal crosscutters would apply only when and if appropriate.

Following the Crosscutter Handbook. To assist state programs in complying with federal crosscutting requirements, EPA developed the “Cross-Cutting Federal Authorities” handbook in October of 2003. This handbook lists all current federal authorities that apply to SRF program recipients, including:

- Environmental authorities (such as the Coastal Zone Management Act and the Endangered Species Act),
- Social policy authorities (including the Civil Rights Act and Equal Employment Opportunity requirements), and
- Economic or other miscellaneous authorities (including the Demonstration Cities and Metropolitan Development Act and the Preservation of Open Competition and Government Neutrality Act)

For each federal authority listed in this handbook, EPA provides a background discussion and a detailed description of its specific applicability to the SRF program. The handbook is written for both the CWSRF and DWSRF programs.

Although this handbook represented an exhaustive resource of all federal crosscutting authorities applicable to the SRF program at the time of its original publication, programs are responsible for complying with any new federal authorities that may also affect the use of federal assistance dollars. EPA and individual DWSRF programs must recognize that the current list of federal crosscutters is subject to change.

Anti-Discrimination Law Requirements. In general, federal crosscutters are applied only to projects in an amount equal to the federal capitalization grant and for

project assistance provided through the DWSRF set-asides; however, programs are required to apply general anti-discrimination law requirements to all projects universally, regardless of the source of SRF funds.

Currently, these crosscutters include the Civil Rights Act of 1964, Section 504 of the Rehabilitation Act of 1973, and the Age Discrimination Act of 1975.

Minority and Women’s Business Enterprise (MBE/WBE) Requirements. Each DWSRF program is required to consult the EPA Regional Administrator to develop a fair share goal for the participation of MBE/WBEs in receiving DWSRF project assistance. These goals are based on the presence of MBE/WBEs within the relevant market area for DWSRF project assistance. Just as the DWSRF program is required to make progress in meeting fair share goals for MBE/WBEs, SRF loan recipients of assistance in an amount equal to the capitalization grant are also required to follow a standard procedure to ensure compliance in this area. State programs must ensure that such program recipients follow the six affirmative steps when awarding contracts using program assistance. In addition, all contractors in such cases are required to use these same procedures when awarding subcontract agreements. (Reference: 2000 DWSRF Interim Final Rule, Section 35.3575 (a-c))

3.11.4

Financial Analysis and Loan Repayment

Financial Assessment of Program Recipients. Prior to awarding a loan for project assistance, DWSRF programs must perform an assessment of all potential borrowers to ensure creditworthiness. This process is often conducted by state program staff; however, some programs will conduct these reviews with the assistance of local financial institutions, such as banks, or with the help of outside contractors. EPA must review and approve a program’s process for conducting financial assessments and identifying acceptable repayment sources and private security means.



Each program borrower must demonstrate adequate revenue or security to repay an SRF loan. The processes for public and private borrowers differ, although the justification for the review is the same. The evaluation of creditworthiness is used to ensure both public and private borrowers maintain sound financial management and possess the ability to repay an SRF loan.

“All borrowers are required to demonstrate adequate security for loan repayment.”

Public Borrowers: Approving a Dedicated Repayment Source. When working with public borrowers, program staff may review audited financial statements and discuss types of revenue sources the entity may dedicate to the repayment of an SRF loan. For example, revenue sources may include a pledge of additional revenues collected through user fees. Public systems must also demonstrate the appropriate ability to collect revenue according to state law and/or local ordinances.

Private Borrowers: Establishing Adequate Security. Working with private borrowers often requires more creativity on the part of program staff in determining creditworthiness and financial capability for loan repayment. Private borrowers may include privately-owned community or nonprofit noncommunity water systems. When working with private borrowers, SRF programs are required to ensure the recipient of SRF assistance has adequate security for an SRF loan. For example, program staff may review income tax statements when audited financials are not available.

When adequate security cannot be easily established (e.g., through company assets or other revenue sources), SRF programs may require unique collateral arrangements or may explore other options in credit enhancement for the applicant. SRFs have used several types of collateral arrangements, including the establish-

ment of a debt payment reserve or requiring the purchase of insurance to guaranty loan repayment. In some cases, SRF programs have approved both corporate and personal guarantees of the loan recipient.



KEY RESPONSIBILITIES: CHAPTER THREE: 3.11

Detailed State Application Review

EPA

- All state environmental review procedures, both a NEPA-like SERP and an alternative SERP must undergo a review and receive approval from EPA.
- Although EPA is ultimately responsible for compliance with federal crosscutting authorities as they apply to state DWSRF programs, individual programs are required to ensure SRF loan recipients also comply with these authorities.
- EPA must review and approve a program's process for conducting financial assessments and identifying acceptable repayment sources.

State Program Office

- State programs must ensure all program recipients pass a full TFM review.
- Programs must conduct an environmental review on all projects receiving direct Fund assistance, all refinanced or reimbursed projects, and all SWP activities through the DWSRF set-asides unless the activities solely involve administration (e.g., personnel, equipment, or travel) or technical assistance.
- Programs must apply federal crosscutters to projects and activities in an amount equal to the amount of each capitalization grant deposited to the Fund. In addition, federal crosscutters must be applied to all DWSRF set-aside activities.
- Programs are required to apply general anti-discrimination law requirements to all projects, regardless of the source of SRF funds.
- Each DWSRF program is required to consult the EPA Regional Administrator to develop a fair share goal for the participation of minority- and women-owned businesses in receiving DWSRF project assistance. State programs must also ensure SRF program recipients of assistance, in an amount equal to the capitalization grant, must follow the six affirmative steps when awarding subcontract assistance.
- Prior to awarding a loan for project assistance, DWSRF programs must perform an assessment of all potential borrowers to ensure creditworthiness and identify source of repayment and, if applicable, security provisions.



3.12 Project Approval and General Loan Closing Procedures

3.12.1 Funding the Highest Priority Projects

Funding in Priority Order. DWSRF programs are required to fund projects in strict priority order according to the comprehensive and fundable project priority lists. Projects are initially ranked based on an approved project priority ranking system to develop a list of all projects eligible for funding through the DWSRF program. Based on this comprehensive list, a final fundable list of projects is developed based on projects that are ready to proceed during the current funding cycle. Programs are required to offer loan assistance according to the ranking of the final fundable project priority list. (For more information on the development and requirements for the DWSRF program priority lists, see Section 3.1.4 of this manual.)

“... DWSRF programs are required to fund projects in strict priority order based on approved project priority lists.”

3.12.2 Following Formal Project Bypass Procedures

General Requirements. Although programs are required to fund projects in strict priority order, deviations from the project priority lists are allowable under certain circumstances. Projects on the fundable list can be bypassed upon written notice to the loan applicant if the project is not ready to proceed or another project is in need of emergency program assistance. All programs are required to document their unique procedures for bypassing projects within their IUP. Procedures must include specific conditions that allow for a project to be bypassed and the method used to identify which projects would receive funding instead. In all circumstances,

except when bypassing a project on an emergency basis, programs must fund the next highest ranked project on their unique fundable list.

Funding Projects on an Emergency Basis. Programs are allowed the flexibility to provide funding assistance on an emergency basis. Emergency projects are those defined as projects that require immediate attention to protect public health or other state-defined emergency situations. All procedures for identifying and accepting an emergency project for DWSRF program assistance must be detailed in the IUP. Emergency projects may originate from the project priority lists; however, programs are also able to fund projects that do not previously appear on these approved project lists. Programs are required to list all projects receiving this type of assistance in their Biennial Reports and discuss the funding for these recipients during the annual program review. The way in which individual programs will define what constitutes an emergency funding situation will vary. For example, a state may define a situation for emergency financing only for water supply systems in need of emergency repairs and when no other funding source is available. These types of determinations are made by the state primacy agency.

All projects, including the projects funded on an emergency basis, are subject to existing TFM capacity requirements, as well as applicable environmental review and crosscutter procedures. Some states may choose to identify emergency projects as those in an amount greater than the amount of the federal capitalization grant. In this way, projects may be defined as those projects receiving assistance in an amount equivalent to state match, loan repayments, or interest earnings to limit the applicable environmental and crosscutter review requirements. (For more information on crosscutter requirements applicable to projects whose cumulative funding is equal to the federal capitalization grant, see Section 3.11.3 of this manual.)

Additional Criteria for Bypassing Projects. States may also develop additional criteria for bypassing projects for reasons other than readiness to proceed or accommodations for emergency situations. In cases where a state program bypasses a project for reasons other than readi-



ness to proceed, programs must document these occurrences in their Biennial Report and provide an explanation during the annual review. Examples of additional bypass allowances include failure to adhere to a particular application schedule or preset deadlines on the part of the applicant, withdrawal of the application by the potential borrower, or reaching a state-determined limit on annual loan assistance provided to a single borrower through the Fund.

Project Bypass Procedures

Projects on the priority list may be bypassed if:

1. The system does not meet the state's minimum requirements for technical, financial, or managerial capacity,
2. The project is not ready to proceed, or
3. Another project is in need of emergency assistance.

3.12.3

Establishing Loan Terms

DWSRF programs have the flexibility to offer a wide variety of assistance types and establish unique borrowing provisions for loan agreements through the Fund. Programs have the ability to set unique interest rates, offer various repayment terms, and assess fees on program borrowers. These types of decisions may affect the growth or ability of the SRF Fund to provide future project assistance and require a sound approach to financial planning. States are encouraged to have a long-term financial plan to evaluate expected impacts of funding decisions on the overall health of the Fund. Programs will often balance decisions and adjust loan terms to provide a beneficial subsidy to the borrowing community and to ensure the continued health of the SRF Fund. For example, a lower interest rate may provide a greater incentive to the individual borrower in the near time, but it will reduce the future income available to the program for additional loans.

“ . . . SRF programs are encouraged to have a long-term financial plan to evaluate expected impacts of funding decisions on the overall health of the Fund . . . ”

Setting the Loan Interest Rate. Programs are given considerable authority in setting interest rates as appropriate for their individual program and by borrower type. According to regulations, programs may set borrowing rates between zero and the current market interest rate for all loans. If providing disadvantaged community assistance, programs may also provide a negative interest rate; however, the subsidies provided in these cases are limited to no more than thirty percent of the annual amount of the capitalization grant deposited to the Fund. (See Section 3.8.1 for more information on disadvantaged community assistance.)

SRF Loan Rates:

- General loan rates must remain between zero and the current market rate.
- As an extra subsidy, disadvantaged communities may receive a negative interest rate loan.

The responsibility for establishing the effective market rate lies with the state program office. For example, a state may use the Bond Buyer 20-Bond GO Index to define the current market interest rate when establishing its effective SRF interest rate for current loans. Any method used to define the current market rate must be defined in the annual IUP. In addition, EPA recommends that state programs describe their unique method in a formal program OA.

When considering rates for loan recipients, programs should not set effective interest rates at a level that may cause the recipient to fail to meet any technical, financial, or managerial capability requirements. In addition, when assessing fees, the DWSRF program must ensure the effective loan rate (i.e., the loan interest rate, plus

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

assessed borrowing fees) does not exceed the current market rate. Please see Determination of Fees below for more information.

Setting the Repayment Schedule. In addition to establishing loan interest rates for individual borrowers, states must establish a formal loan repayment schedule in the final loan agreement. Requirements state that loan repayments to the SRF program must start within one year of project initiation of operations or when the project is capable of being initiated. In cases where a possible delay in project completion is expected, programs may require the borrower to begin repayment within one year of the estimated date of completion. Programs must receive loan repayments on at least an annual basis, although some programs may require repayments on a semi-annual or more frequent schedule.

After the loan repayment period begins, program borrowers must complete all repayments within twenty years for standard loans but may extend the term to thirty years (as determined by individual DWSRF program) for loans to disadvantaged communities. When providing an extended repayment period to a disadvantaged community, programs must ensure the loan repayment period does not exceed the expected design life of the project. Programs may consider how a longer or delayed repayment period may decrease the capacity of the Fund in providing additional assistance. (See Section 3.8.1 for more information on disadvantaged community assistance through the DWSRF program.)

SRF Loan Repayments

- Repayments must begin within one year of initiation of operations.
- Repayments must be complete within twenty years from the first loan repayment date (thirty years for a disadvantaged community).

Setting Repayment Levels. Loan repayments are not required to equal any particular amount (e.g., one-twentieth of the total repayment amount per year). Although not generally in use, programs may authorize a “balloon repayment” or escalating repayment schedules for SRF loans. In these cases, the borrower is required to provide higher annual repayment amounts in later years in contrast to lower repayment amounts in the earlier years. Similarly, programs may also allow borrowers to provide interest-only payments for a set period of time, with higher annual repayment amounts in later years. For all programs that wish to include interest-only or “balloon repayment” options, the IUP must contain a discussion of the method for calculating this repayment schedule. Programs should recognize the potential negative effects, including an increase in the possibility of borrower default during the later years of loan repayment or the decreased capacity of the Fund to provide program assistance in the current years.

Determination of Fees. In addition to establishing loan repayment terms and interest rates, programs are given the authority to assess additional fees on program borrowers. These charges may include fees assessed annually (e.g., loan maintenance fees) or an assessment of a one-time fee during the loan closing process. Fees may be used for several purposes. Two uses include additional project assistance through the Fund or for DWSRF program administration activities. Programs must document all planned and actual fee activity in the IUP and Biennial Report.

SRF Programs May Assess Fees:

- Annually (e.g., for SRF loan maintenance), or
- During the loan closing process

Programs may require loan recipients to pay fees directly or allow the recipient to include these charges as part of the loan principal amount. The method of assessing and collecting fees will determine how and for what

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

purposes programs may use SRF fee revenue. In all cases, fees and interest on fees must return to the Fund or must be deposited to an account outside the Fund. Specific uses of fees are subject to several, additional program requirements. These requirements are discussed further below.

Fees Paid by the Assistance Recipient. Fees paid directly by the assistance recipient and deposited to the Fund may be used for all eligible Fund activities, including additional project assistance. Fees deposited to an account outside the SRF Fund may be used for the purposes of program administration, for combined financial administration of both the CWSRF and DWSRF programs when operated by the same agency, for state match, and for other allowable SDWA, Section 1452 activities, including activities through the DWSRF set-asides.

Fees Included as a Portion of the Loan Principal. Fees included as a portion of loan principal may return directly to the program Fund or may be deposited to a separate account outside the Fund. Fee revenue deposited to the DWSRF Fund account is eligible for all Fund activities, while fee revenue deposited to a separate account is eligible for program administration activities and for other allowable SDWA, Section 1452 activities, including activities through the DWSRF set-asides. It is important to note that these fees may not be used for state match or for the combined financial administration of the DWSRF and CWSRF programs. In addition, disadvantaged community borrowers may not include assessed fees as part of the loan principal amount. When assessing fees, the DWSRF program must ensure the effective loan rate (i.e., the loan interest rate, plus assessed borrowing fees) does not exceed the current market rate and is not reasonably expected to cause a system to fail TFM capability requirements.

3.12.4 Developing the Formal Loan Agreement

Following the establishment and mutual acceptance of all loan terms, the SRF program drafts a formal project

loan agreement. This agreement contains all requirements of assistance from the SRF program, including the loan interest rate, the loan repayment term, and any applicable loan origination or annual fees. Both the program recipient and the DWSRF program office must sign this agreement to ensure all terms are legally binding. A signed loan agreement becomes the formal contract between program borrower and the DWSRF program office.

According to a final project loan agreement, project assistance is only provided after the formal loan agreement is finalized and signed by both parties. According to this contract, the DWSRF assistance recipient promises to complete the project according to schedule and approved specifications, while the DWSRF program office agrees to provide funding assistance on a reimbursable cost basis or approved alternative method.

⁴ Unless funds are being used to correct for a noncompliance issue.

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

KEY RESPONSIBILITIES: CHAPTER THREE: 3.12

Project Approval and General Loan Closing Procedures

EPA

- EPA is responsible for oversight to ensure state programs are complying with applicable federal requirements throughout the project approval and loan closing processes.

State Program Office

- DWSRF programs are required to fund projects in strict priority order according to the comprehensive and fundable project priority lists.
- All programs are required to document their unique procedures for bypassing projects within their IUP.
- All procedures for identifying and accepting an emergency project for DWSRF program assistance must be detailed in the IUP.
- States are encouraged to have a long-term financial plan to evaluate expected impacts of funding decisions on the overall health of the Fund.
- Programs must document all planned and actual fee activity in the IUP and Biennial Report. In all cases, fees and interest on fees must return to the Fund or must be deposited to an account outside the Fund.
- Project assistance is only provided after a formal loan agreement is finalized and signed by both parties.



3.13 Construction Activities and Loan Disbursement

3.13.1 Project Performance Certification

State programs require all project borrowers to designate a certified project engineer to provide continuous oversight and verification that the project is constructed according to design specifications. Periodic engineering reports are collected by the SRF program to verify progress according to the original construction schedule agreed to in the final loan agreement. Additionally, the borrower-designated engineer typically accompanies the state project engineer during formal onsite construction inspections.

If a system fails to adhere to the original project completion schedule, fails to meet ongoing compliance under SDWA, or fails to show appropriate technical, financial, or managerial capacity, state programs are required to enforce remediation requirements. To ensure that assistance recipients take the steps necessary to maintain compliance, programs may require the adoption of a formal Corrective Action Plan or require a revision to the original construction schedule.

3.13.2 Project Inspections

DWSRF programs use formal onsite inspections of the project site to verify that construction activities are completed in a timely manner, as detailed in the original loan agreement, and according to the original design specifications. Although there are no formal requirements on how often a state program must complete formal project inspections, programs are required to ensure assistance recipients are using DWSRF funding for eligible purposes and to lend additional verification for all disbursement requests.

The frequency and complexity of formal project inspections vary state to state. Some state programs conduct



monthly project inspections, while others complete only two inspections of the project site – one after fifty percent of the funds have been released to the borrower and another after construction is complete and before the last cash draw is completed for all

remaining reimbursable costs. State programs typically use in-house project engineers to complete inspections. In some cases, primacy agencies may work with external field offices or, in cases of limited staff resources, with local county health departments to complete interim project inspections.

Onsite Construction Inspections

General activities conducted during a construction inspection include:

- 1) Adequacy of engineering supervision,
- 2) Oversight by water system,
- 3) Availability of construction drawings,
- 4) Compliance with the construction schedule,
- 5) Availability of accounting records,
- 6) Actual payment requests versus payment schedules, and
- 7) Use of appropriate construction practices

3.13.3 Approving Requests for Reimbursement

DWSRF programs are required to verify all loan payments and construction reimbursements are for eligible program costs only. The general process for approving an SRF loan disbursement at the state-level requires an initial review of all invoices and accompanying documentation. After the program checks to ensure the disbursement request is for an active borrower, an

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

active project, and that the borrower is not in significant noncompliance⁴, the program staff must verify the funds requested are within the limits set according to the loan agreement. If the level of detail contained within an individual disbursement request is insufficient to allow state staff to verify the release of SRF funds, programs may request the applicant to submit additional documentation.

Often, SRF programs involve technical staff directly involved in construction inspections to help verify individual disbursement requests. Technical staff can provide additional information on program-approved change orders, work completed since prior inspection, and knowledge of any observed deficiencies. This information can help SRF program staff to accurately approve individual requests for reimbursement.

EPA Oversight of Fund Disbursements. During the annual review process, EPA is required to ensure each state maintains an appropriate level of control over all SRF Fund disbursements. During onsite visits, EPA will select a sampling of project level cash draws for review. EPA uses this information to verify that the state is following all requirements, including formal rules for cash draw, and conducting an appropriate level of technical and administrative oversight to verify disbursement requests. Should EPA discover any occurrence of an improper payment, either through an onsite sample or as identified in the annual program audit, the state must identify all steps taken (or planned to be taken) to correct for any such identified inaccuracy.

3.13.4 Formal Cash Draw Procedures for Loan Disbursements

Calculating the Proportionate Federal Share. The state DWSRF programs are comprised of both state and federal funds. When a loan disbursement request is submitted to the SRF program, both state funds and federal funds may be used to honor the request. By law, state programs are only authorized to draw the appropriate proportional federal share of all eligible incurred project costs from the Federal Treasury. Cash draws of federal funds may only occur for those projects with executed loan agreements. The calculation of the federal propor-

tional share is described in detail through the “Guide to Using EPA’s Automated Clearing House for the Drinking Water State Revolving Fund Program” (EPA-832-B98-003). The newest system for accessing federal funds is the ASAP system, or the Automated Standard Application for Payments. The proportionality rules and processes described for accessing funds through the federal cash draw system are similar under ASAP to those under the Automated Clearing House system.

“. . . By law, state programs are only authorized to draw the proportional federal share of all eligible costs from the Federal Treasury.”

Establishing the Cash Draw Ratios. In general, cash draw ratios are established at the time of the capitalization grant award. Establishing formal cash draw ratios ensures both federal and state funds are readily available as costs are incurred. Formal steps involved during the cash disbursement process include: approving the formal disbursement request based on an allowable costs determination; calculating the proportionate federal share for all verified disbursements; and following an approved funds disbursement mechanism (e.g., the ASAP process).

Below is a sample calculation to determine the appropriate federal cash draw ratio for project disbursements.

In general, the *cash draw ratio for federal funds* is equivalent to:

\$ Federal Share of Project Costs / \$ Total Project Disbursement

Where the *federal share* is equivalent to:

**The Capitalization Grant –
Set-Asides +/- SRF Transfers**

Capitalization
Grant
Application

EPA
Acceptance
and Award

Project
Application
Review

Detailed State
Application
Review

General
Loan Closing
Procedures

Project
Construction
Phase

Project
Completion

Loan
Repayment

For example, if a DWSRF program takes the maximum thirty-one percent of federal funds for set-asides, the federal cash draw ratio in this example would be 77.5%. (See specific calculations used to illustrate this example below.)

Given Information:

Capitalization Grant = \$100

State Match = \$20

Set-Asides Reserved = 31%

Determining the Federal Cash Draw Ratio:

\$ Federal Share of Project Costs = \$69
[\$100 (Capitalization Grant) - \$31 (Set-Asides)]

\$ Total Project Disbursement = \$89
[\$69 (Federal Share) + \$20 (State Match)]

In this example, the *cash draw ratio for federal funds* is equivalent to 77.5%

[\$69 (\$Federal Share of Project Costs) / \$89 (\$Total Project Disbursement)] = 0.775

Federal Cash Draw through the DWSRF Set-Asides.

Unique to the DWSRF set-aside accounts, cash draw ratios are set to one-hundred percent – as one-hundred percent of the funds used for expenditures through these accounts are federal funds. One exception is the DWSRF State Program Management set-aside as programs may use state funds to satisfy the state one-to-one match requirement. (For more information on the match requirement through the State Program Management set-aside, see Section 4.1.3 of this handbook.)



KEY RESPONSIBILITIES: CHAPTER THREE: 3.13

Construction Activities and Loan Disbursement

EPA

- During the annual review process, EPA is required to ensure each state maintains an appropriate level of control over all SRF Fund disbursements.
- In general, cash draw ratios are established at the time of the capitalization grant award. EPA must provide proper oversight to ensure the state DWSRF program is in compliance with federal cash draw proportionality requirements.

State Program Office

- State programs require all project borrowers to designate a certified project engineer to provide continuous oversight throughout the project construction process.
- If a system fails to adhere to the original project completion schedule, fails to meet ongoing compliance under SDWA, or fails to show appropriate technical, financial, or managerial capacity, state programs are required to enforce remediation requirements.
- DWSRF programs are required to verify all projects receiving assistance from the Fund are using these monies for eligible purposes.
- By law, state programs are only authorized to draw the appropriate proportional federal share of all eligible incurred project costs from the Federal Treasury.



3.14 Project Completion and Close-Out

3.14.1 Final Construction Inspection

After project construction is complete and before final reimbursement funds are released to the program borrower, a final construction inspection must be completed. This final inspection is carried out to ensure project funds have been used for eligible purposes and the project is complete according to original plans and specifications and all state approved change orders. Typically a state program staff engineer will complete this final onsite inspection in combination with the borrower-designated project engineer.

Releasing Final Project Funds. Following a final construction review, the loan recipient is provided with all remaining project disbursements according to approved project disbursement requests. In many cases, state DWSRF programs will hold five percent or ten percent of remaining loan funds pending final inspection. In other cases, programs will only hold the amount of the final disbursement request before signing off that the project is complete according to all requirements. The purpose of withholding some funds before final verifica-

tion is to encourage timely completion of the project and initiation of operations.

3.14.2 General Timing and Requirements for Loan Repayment

Initiating Loan Repayments. After a project is complete and has initiated operations, the loan recipient is required to begin repayments within one year. All borrower repayments must return to the Fund (both principal and interest amounts), and all repayments must return within twenty years.

KEY RESPONSIBILITIES: CHAPTER THREE: 3.14 Project Completion and Close-Out

EPA

- EPA is responsible for oversight to ensure state programs are complying with applicable federal requirements throughout the project completion and close-out processes.

State Program Office

- After project construction is complete and before final reimbursement funds are released to the program borrower, a final construction inspection must be completed.
- After a project is complete and has initiated operations, the loan recipient is required to begin repayments within one year.



Funding through the DWSRF Set-Asides

KEY POINTS IN CHAPTER 4

- DWSRF programs may provide direct program assistance in the form of grants, technical assistance to small systems, and other types of expenditures through set-asides.
- Four types of set-asides have been authorized by Congress, administration, technical assistance to small systems, state program management, and local assistance and support for other state programs.
- All set-aside activities must coordinate with the overall goals of the DWSRF.
- State programs must follow specific requirements to plan and account for expenditures related to DWSRF set-aside activities.

4.1 Four Types of Set-Asides

DWSRF programs are uniquely structured to allow states the option of providing direct program assistance in the form of grants, technical assistance to small systems, and other types of expenditures through a separate mechanism known as the DWSRF set-asides.

Four types of set-asides have been authorized by Congress and these include:

- DWSRF program administration,
- Technical assistance to small systems,
- State program management support, and
- Local assistance and support for other state programs

After a state receives its capitalization grant, a certain portion may be moved to these separate accounts for additional uses of the program funds. In general, assistance through the DWSRF set-asides is provided in the

form of grants to drinking water systems, technical assistance through the program staff office and third party contracts, and for program administration activities, including salary requirements for DWSRF program staff. Additional requirements and restrictions on the uses of these funds are described in further detail below.

4.1.1

Administration and Technical Assistance

States may reserve up to four percent of each capitalization grant for administrative expenses and for technical assistance. To date, all fifty-one SRF programs are reserving funds for use under this set-aside. Eligible expenses include all types of administrative expenses necessary to implement the state DWSRF loan program, including administration of the set-asides. Sample activities may include loan portfolio management, technical reviews of preliminary engineering reports, the preparation of the annual capitalization grant application, and holding meetings with potential borrowers to discuss the status of a loan application.

In addition to reserving funds under this set-aside for program administration activities, the DWSRF may provide direct technical assistance to the borrowing community. Only a handful of states have provided technical assistance through the four percent administration set-aside to date. These include Arkansas, Virginia, New Mexico, Oregon, and South Carolina. Programs may use these resources to develop multimedia products or to provide direct technical assistance to borrowers, for example, through face-to-face meetings. Examples include the development of printed materials, public service announcements, video tapes, or other media to provide information on water conservation activities and to provide direct assistance to applicants to ensure the detailed application is complete and accurate.

4.1.2

Small System Technical Assistance

In many cases, small systems may not be able or eligible to apply for loan assistance through the DWSRF Fund due to lack of technical, financial, or managerial capacity. In these cases, small systems may benefit from extra technical assistance provided through the DWSRF set-asides to achieve the compliance level required for an SRF loan. State programs may reserve up to two percent of each capitalization grant for direct assistance to small systems. Assistance activities can include the completion of an engineering feasibility study to highlight operational areas for improvement, additional assistance in completing an environmental review and developing cost estimates during the planning process, or may include direct assistance in completing an application for DWSRF funds. Technical assistance through this set-aside can be provided directly by SRF program staff or a third party contractor to carryout assistance activities.

4.1.3

State Program Management

State DWSRF programs are given the additional authority to provide assistance for other drinking water-related activities under the State Program Management set-aside. Programs may reserve up to ten percent of the federal capitalization grant for several types of activities including 1) administrative assistance to the PWSS program; 2) technical assistance for SWP activities; 3) assistance for capacity development initiatives; and 4) support for state operator certification programs. Nationally, programs have reserved approximately five percent of the allowable ten percent maximum through this set-aside for these and other types of activities.

Individual project examples eligible through this set-aside are many, and states continue to strive for innovative uses of these funds. Programs use assistance through this set-aside to complement existing programs and to provide training programs or other types of direct assistance. Sample project activities include the use of set-aside funds for project inspections, sanitary surveys, and development of new training manuals or exams for drinking water system operators.

One-to-One Match Requirement. For all funds reserved through the State Program Management set-aside, state programs must provide a direct match at the time of the

grant or as funds are expended. Although states are required to provide a direct one-to-one match for federal funds under this set-aside, several options are available that allow programs to specify in-kind services or credit in lieu of new cash. Under the DWSRF regulations, programs are allowed the option of using a credit from state expenditures (match and overmatch) provided to the PWSS program during FY1993. This credit may account for up to fifty percent of the match required under this set-aside. Regulations also allow these amounts provided by the state to the PWSS program during FY1993 to serve as a perpetual credit.

For example, if a state plans to expend \$1 million through this set-aside over the next fiscal year, and they have a perpetual credit for PWSS expenditures during FY1993 of \$600,000, they may only use \$500,000 as the maximum credit allowable. Again, states may only use up to fifty percent of the FY1993 expenditures for the PWSS programs as a credit toward the current match requirement. In this example, the state program must provide an additional \$500,000 in direct match. Additional match can be in the form of new cash, credit for in-kind services, or credit for PWSS overmatch (only) in the current fiscal year.

It is possible for a state to provide match in the form of credit for PWSS expenditures and in-kind services without providing any additional match in the form of direct cash match. It is important to note that the use of in-kind services encompasses any type of eligible state activity used to support the implementation of this set-aside, an example of which is employee salaries.

Questions on the eligibility of potential in-kind services are answered by EPA on a case-by-case basis. All forms of match must be approved by EPA through a detailed set-aside work plan (see Section 4.2.2 for more information on developing set-aside work plans) before eligible for use by the state for State Program Management expenditures.

4.1.4

Local Assistance and Other State Programs

The Local Assistance and Other State Programs set-aside allows additional types of DWSRF project assistance as compared to the types of assistance through the four percent, two percent, and ten percent DWSRF set-aside accounts. In general, DWSRF set-aside assis-

tance is provided in the form of grants to drinking water systems, and for technical assistance or other types of programmatic support expenditures. Through the Local Assistance and Other State Programs set-aside, states may also provide loan assistance for certain SWP activities. In particular, states may provide loans for implementation activities related to state source water assessments. These loans may be used for SWP land acquisition and other types of incentive-based SWP protection measures. If a state decides to provide these types of loan assistance options, it must develop an EPA-approved priority setting process similar to that created for the Fund (see Section 3.10.1 for more information on priority setting). All loan repayments under this set-aside must return either to the set-aside account for future loans or to the Fund for DWSRF binding commitments or other eligible uses of the Fund.

In addition to loan assistance through the Loan Assistance and Other State Programs Set-aside, states may provide direct assistance in the form of a grant or technical support activities in the following areas: 1) SWP area delineation and assessment⁵; 2) support for wellhead protection programs; and 3) technical or financial assistance related to a capacity development strategy

for eligible drinking water systems, including small systems. Example activities eligible through this set-aside may include the development of local SWP ordinances and implementation of public education programs to highlight the importance of wellhead protection.

States are limited to a maximum of fifteen percent of each capitalization grant for these types of activities, and may use no more than ten percent of each grant for any one project category through this set-aside. For example, states may provide no more than ten percent for SWP land acquisition loans or direct support for wellhead protection programs.

4.2 Key Requirements and Recommendations

4.2.1 Account Management

Maintaining Separate Accounts. The state grantee has primary responsibility for proper maintenance of a sepa-

⁵ Support for source water delineations and assessments were eligible using set-aside funds from the FY1997 capitalization grant only. All state programs have used funds for these purposes.

DWSRF Set-Aside Reference Chart

Amount	Statutory Citation	Purpose	Required Match	Can Authority Be Reserved
4%	1452(g)(2)	DWSRF Administration & Technical Assistance to PWSs	None	Yes
2%	1452(g)(2)	Small Systems Technical Assistance Technical Assistance to PWSs Serving<10,000 Persons	None	Yes
10%	1452(g)(2)	State Program Management: 1. Administer the State PWSS Program 2. Administer or Provide Source Water Technical Assistance 3. Develop & Implement a Capacity Development Strategy 4. To Develop & Implement an Operator Certification Program	1:1	Yes
15%	1452(k)	Local Assistance & Other State Programs: No more than 10% of Capitalization Grant Amount Can Be Used for Any One Activity 1. Loans to Acquire Land or Conservation Easements for Protection of Source Waters 2. Loans to Provide Funding to Implement Voluntary, Incentive-Based Source Water Quality Protection Measures 3. Assistance to PWS as Part of Capacity Development Strategy 4. For 1996 & 1997 Only, Assistance to Delineate or Assess Source Water Protection Areas 5. Assistance to Establish & Implement Wellhead Protection Programs Under Section 1428	None	No

rate and identifiable DWSRF Fund account. If providing assistance through DWSRF set-asides, programs must maintain separate and identifiable accounts for both Fund activities and set-aside expenditures. If loan repayments for project assistance through the fifteen percent Local Assistance and Other State Programs set-aside are deposited back to the set-aside accounts, oversight of these accounts must meet the same management requirements as implemented for the Fund.

Coordinating Goals. All set-aside activities must coordinate with the overall goals of the DWSRF. Set-aside activities are eligible through the program to support the overall mission of SDWA in accordance with the requirements for assistance through the Fund. In addition, all set-aside activities are subject to requirements for federal crosscutters and environmental review procedures; however, in most cases these requirements will not pertain to set-aside activities. (See Sections 3.11.2 and 3.11.3 for more information on environmental review and federal crosscutter requirements.)

4.2.2

Reporting Requirements

Basic Reporting Requirements. State programs must follow specific requirements to plan and account for expenditures related to DWSRF set-aside activities. According to the basic requirements for the program, the level of funds and general descriptions of planned activities for DWSRF set-asides must be included in the IUP. Detailed descriptions and budget information are included in formal set-aside work plans. Follow-up reporting on the actual use of DWSRF set-aside expenditures, in comparison to planned activities, is included in the Annual/Biennial report or a separate set-aside activity update. Other types of reporting, at the request of the Region or initiative of the state, can supplement, but not substitute for these required reporting activities.

Set-Aside Work Plans. Detailed requirements for set-aside work plans are included in the final DWSRF program regulations. According to these original requirements, all set-aside work plans must include six specific sections of information. These sections include: 1) a thorough description of planned activities and identification of the goals and objectives for each set-aside; 2) an identification of roles and responsibilities for all imple-

menting parties; 3) the annual and cumulative funding amount and percent of the capitalization grant reserved for each activity; 4) expected outputs, outcomes, and deliverables; 5) projected work years to completion and a schedule of deliverables; and 6) a description of how the state will evaluate success. Regions may request additional information or specify certain formats for work plans. For example, states may be requested to briefly discuss the relationship of work identified in the current work plan with ongoing work in prior year work plans and work plans associated with the PWSS, security, and operator training grants. In addition, a region may request information from a state on what steps a state may take to expedite work if large unexpended balances of set-aside funds have accumulated.

Set-aside work plans are due in accordance with schedules identified by EPA Regional staff. EPA must approve all work plans and work plan amendments. States must prepare a work plan for all set-asides, except the four percent administration set-aside. No work plan is required for administrative activities, unless the four percent set-aside is also used for technical assistance. In this case, a work plan would only be required for the portion of funds used for technical assistance.

“ . . . all set-aside work plans are due within ninety days of the capitalization grant award, unless a shorter schedule is approved . . . ”

Acceptable Formats. Set-aside work plans come in a variety of formats. Plans may be developed according to an individual grant, on an annual basis (even if the state does not receive a grant in the current year), or according to a multi-year format. Regulations limit multi-year work plans to no more than four years. Planning over the course of multiple years is helpful if funded activities are expected to take several years to complete with the use of multiple capitalization grants and other funding.

In addition to different reporting schedules, states may develop work plans based on each individual set-side by creating a separate set-aside work plan for the two per-

cent, four percent, ten percent, and fifteen percent set-asides, or by developing individual work plans by category of funding. For example, a state may develop a separate work plan for Capacity Development and another for Operation Certification or SWP activities.

Annual/Biennial Reports and Set-Aside Activity Reports. State programs must report on set-aside use through the Annual/Biennial Report or another type of set-aside activity report (also called a Set-Aside Performance

Report), as agreed upon with the EPA Region.

Information reported through these documents allows the states and others to compare the planned use of SRF funds for set-aside activities with actual expenditures of funds for project assistance. Funding information reported through the set-aside activity reports or Annual/Biennial Reports should reconcile with the previous year's IUP and work plans. Any discrepancies should be explained within these documents.

KEY RESPONSIBILITIES: CHAPTER FOUR

Funding Through the DWSRF Set-Asides

EPA

- Several options are available that allow programs to specify certain in-kind services in lieu of new cash to satisfy the one-to-one match requirement under the State Program Management set-aside. Questions on the eligibility of potential in-kind services are answered by EPA on a case-by-case basis.
- EPA must approve all set-aside work plans and work plan amendments.
- As agreed upon with the EPA Region, state programs must report on set-aside use through the Annual/Biennial Report or additional set-aside activity report.
- EPA will negotiate with the program office on corrective action measures, if necessary, to reduce large balances of unexpended set-aside funds.

State Program Office

- No work plan is required for administrative activities, unless the four percent set-aside is also used for technical assistance.
- For funds reserved through the State Program Management set-aside, state programs must provide a direct match at the time of the grant or as funds are expended.
- Through the Local Assistance and Other State Programs set-aside, states may also provide loan assistance for certain SWP activities. If a state decides to provide loan assistance, it must develop an appropriate priority setting process. All loan repayments must return either to the set-aside account for future loans or to the Fund.
- States are limited to a maximum of fifteen percent of each capitalization grant for activities funded through the Local Assistance and Other State Programs set-aside and may use no more than ten percent of each grant for any one project category.
- If providing assistance through DWSRF set-asides, programs must maintain separate and identifiable accounts for Fund activities and set-aside expenditures.
- All set-aside work plans are due within ninety days of the capitalization grant award, unless a shorter schedule is required by the EPA regional office.
- State programs must report on set-aside use through the Annual/Biennial Report or another type of set-aside activity report as agreed to with the Regional Office.

State Follow-Up Activities

KEY POINTS IN CHAPTER 5

- The Annual/Biennial Report documents the actual activity of the DWSRF program for the prior year or two years.
- Program audits perform a comprehensive check of DWSRF operations. These include the loan Fund, set-aside accounts, and administrative or fee accounts.
- Under the Single Audit Act, all nonfederal entities that expend more than \$500,000 of federal dollars in any fiscal year are required to conduct a Single Audit.
- State programs must report on set-aside use through an annual set-aside performance status report or the state DWSRF Annual/Biennial Report.
- DWNIMS is used to compile a comprehensive and consistent set of data quantifying SRF activity.

5.1

State Develops the DWSRF Annual/Biennial Report

5.1.1

Purpose

Each DWSRF program must submit a Biennial Report to its EPA regional office detailing the state's performance and its compliance with DWSRF regulations and capitalization grant requirements. Many states, especially those where management of the CWSRF and DWSRF is coordinated, choose to report annually instead of biennially. The report may also be submitted as a combined CWSRF and DWSRF report. In this case, all CWSRF and DWSRF financial activities must be clearly and separately reported.

5.1.2

Key Requirements and Recommendations

The Annual/Biennial Report documents the actual activity of the DWSRF program for the prior year or two years. It describes the program's progress toward short-term and long-term goals as described in the IUP. States are also required to address progress toward agreed upon outputs and outcomes as defined in their IUP, including satisfactory explanations, as necessary, as to why specific outputs and outcomes were not achieved.

Reporting also includes detailing the timely and expeditious use of funds, binding commitments and loans executed, and all types of assistance provided. Specifically, the state must demonstrate that it has provided funding to projects consistent with the project priority lists and that it adhered to its project bypass process. In addition to the accompanying DWNIMS reports (see Section 5.4 for more information on DWNIMS); the Annual/Biennial Report should include financial statements and an overall assessment of the financial health of the DWSRF program. A region may specify a particular format for the report, including financial tables. It should also cross-reference the independent audit report (see Section 5.2 for more information on SRF program audit procedures).

In addition to demonstrating compliance, the report needs to show which projects satisfy the various federal and state requirements, differentiating between costs paid out of the capitalization grant and state match and those paid by other monies, including repayments and interest earnings, in the Fund. The DWSRF program should demonstrate compliance with the specific assurances as stated within the IUP. Most importantly, all costs incurred must be eligible under SDWA. The Annual/Biennial Report must also report on the status of the set-aside accounts separately. One EPA grant

condition requires that each DWSRF program illustrate the public health benefits for its activities and progress in achieving outputs and outcomes.

In addition to these regular components, the report should also follow-up on previous PER findings and evaluate any other program changes. Taking a long-

term view is important for EPA, the financial community, state legislators, and others, as this is a public document. Reporting requirements will continue to exist as long as the DWSRF program operates, however they are expected to be reduced after the award of the last capitalization grant, as several program requirements will no longer apply.

KEY RESPONSIBILITIES: CHAPTER FIVE: 5.1

State Develops the DWSRF Annual/Biennial Report

EPA

- Set a schedule for receipt of the Annual/Biennial Report with each state DWSRF program, and notify the state of any changes to reporting requirements.
- If desired, the regional office may specify a preferred Annual/Biennial Report format.

State Program Office

- Submit an Annual/Biennial Report to EPA detailing DWSRF program activity over the past year(s), including project funding commitments, financial statements, progress in achieving outcomes and outputs, resolution of prior year PER issues, and expected program changes.
- In the Annual/Biennial Report, demonstrate compliance with the DWSRF regulations and capitalization grant requirements.

5.2 State Completes and Submits the DWSRF Annual Audit to EPA

5.2.1 Purpose

Program financial audits help to ensure that DWSRFs operate within the law, comply with federal requirements, use appropriate accounting and fiscal procedures, and minimize the risk of waste, fraud, and abuse. EPA uses audited financial statements to determine if the program is operating as intended, and to gather information necessary to report to Congress. Prior period audit reports are reviewed by the Region as a confirmation of previously reported financial information and information reported through the Annual and Biennial Reports. Any identified inconsistencies should be addressed and resolved.

States that conduct audits under the DWSRF program can use administrative funds from the four percent set-aside account to pay for them.

5.2.2 Key Requirements and Recommendations

Annual Program Audits. Independent financial audits of State DWSRF program accounts are conducted by nearly every state program.

Program audits perform a comprehensive check of DWSRF operations rather than individual capitalization grants. These include the loan Fund, set-aside accounts, and administrative or fee accounts. Auditors first express an opinion regarding the fairness of the financial statements and determine whether the state has used accounting and fiscal procedures that conform

Sample Financial Statement

Financial Information for a Sample State's DWSRF

(Millions of Dollars)

	2004	2005	2006
Cash Flows			
Operating Activities			
Interest Received on Loans	1.8	1.6	1.9
Loan Principal Repayments	3.4	3.7	4.5
Total Loan Disbursements (incl. amounts forgiven)	(13.0)	(14.0)	(18.7)
Transfers - Other SRF Funds	0.0	0.0	0.0
Federal Capitalization Grants - Cash Draws	12.7	13.5	18.0
State Match Deposits - Excluding Bonds Paid by SRF	2.7	5.1	2.8
Additional State Contributions	0.0	0.0	0.0
Net Cash Provided by Operating Activities	7.5	9.9	8.4
Noncapital Financing Activities			
Gross Leverage Bond Proceeds	0.0	0.0	0.0
Leverage Bond Proceeds (Gross less Issuance Expense)	0.0	0.0	0.0
Interest Paid on Leveraged and State Match Bonds	0.0	0.0	0.0
Net Refunding Bonds and Funds Used for Refunding	0.0	0.0	0.0
State Match Bond Proceeds (Gross less Issuance Expense)	0.0	0.0	0.0
Repayment of Leveraged Bond Principal	0.0	0.0	0.0
Repayment of State Match Bond Principal	0.0	0.0	0.0
Net Cash Provided by Noncapital Financing Activities	0.0	0.0	0.0
Investing Activities			
Interest Received on Short-term Investments	0.4	0.4	0.5
Interest Received on Debt Service Reserves	0.0	0.0	0.0
Deposits to Debt Service Reserve for Match Bonds	0.0	0.0	0.0
Deposits to Debt Service Reserve for Leverage Bonds	0.0	0.0	0.0
Net Cash Provided by Investing Activities	0.4	0.4	0.5
Net Increase (Decrease) in Cash and Cash Equivalents	7.9	10.3	8.9
Beginning Balance - Cash and Cash Equivalents	27.0	34.9	45.2
Ending Balance - Cash and Cash Equivalents	34.9	45.2	54.1
Ending Balance - Undrawn Federal ACH Balance	15.9	12.1	8.2

to GAAP and that allow for the proper measurement of the flow of funds into and out of the DWSRF accounts.

They then review the balance sheet accounting for all the DWSRF assets, liabilities, and net assets in order to report on the internal controls related to the financial statements. This is part of a broader check to ensure that the state has appropriate internal controls and accounting procedures to prevent waste, fraud, and abuse.

Next, the auditors express an opinion as to whether the state has complied, in all material respects, with laws, regulations, and provisions of the SRF capitalization grants and other applicable federal laws and bond indentures. The audit will detail the state's cash management practices and note whether the DWSRF is earning a reasonable rate of return on invested funds. The audit should document any identified erroneous payments, cash draws, disbursements, and the steps taken (or planned) to correct such occurrences.

States must submit completed audit reports and management letters to EPA for review and for use during the state annual review process. The EPA Region uses these audit reports, which are hopefully complete by the time of the Annual Review, to evaluate program management.

The Single Audit. Under the Single Audit Act and OMB Circular No. A-133, states are required to conduct an annual audit, known as the Single Audit. The Circular implements the Single Audit Act amendments of 1996 and requires all nonfederal entities that expend more than \$500,000 of federal dollars in any fiscal year to conduct a Single Audit.

In addition to the DWSRF program financial audit, loan recipients that expend more than \$500,000 of federal assistance in a single fiscal year must also conduct an audit under the Single Audit Act. States must ensure all DWSRF program recipients that meet these criteria are conducting Single Audits, adhere to GAAP accounting requirements, and work to resolve any issues identified through the audit process.

Information derived from the Single Audit can subsequently be used for financial audits of the DWSRF pro-

gram. Set-asides used for programmatic purposes may also be covered by the Single Audit.

Format of the Single Audit Report. The Single Audit report may be contained within one combined report or several separate reports.

In general, the Single Audit report will contain the following information:

- An opinion on whether the financial statements are fairly presented in accordance with GAAP,
- Status of internal controls relative to the financial statements and major programs,
 - Assessment of recipient compliance with laws, regulations, and terms of federal assistance awards, and

Schedule of findings and questioned costs.

Although the Single Audit alone is not traditionally used to fulfill DWSRF audit requirements, for those states that do not conduct an annual independent audit and do not have a recent EPA OIG Audit available, EPA regional offices will need to pull as much information as possible from the Single Audit report to verify program compliance.

(For more information concerning SRF audits, see the U.S. EPA Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs, September 2002.)

KEY RESPONSIBILITIES: CHAPTER FIVE: 5.2**State Completes and Submits the DWSRF Annual Audit to EPA****EPA**

- Review the most recent independent audit, OIG audit, or Single Audit for each DWSRF program to determine compliance and proper financial management and to check for consistency with the state's previous reporting.
- Ensure that the state has received and reviewed single audits from the designated DWSRF loan recipients.

State Program Office

- Arrange for an independent audit or Single Audit of program operations to document compliance with all necessary authorities, internal controls on financial transactions and reporting, and GAAP.
- Work with the auditor to conduct the audit and to discuss/resolve findings.
- Submit the auditor's report, including audited financial statements, to EPA for review.
- Collect Single Audits from loan recipients covered by the Single Audit Act. Follow-up on audit findings if related to the recipient's ability to repay the loan.

5.3 Submitting Annual Set-Aside Performance Status Reports

5.3.1 Purpose and Requirements

Annual set-aside performance status reports (also known as set-aside activity reports) may be developed to provide an annual update and description of activities conducted and funds expended under each individual set-aside account. These reports are optional, unless required by the Region; however, a state program must report on set-aside use either through this type of report or the state DWSRF Annual or Biennial Report. This documentation allows the states and others to compare the

planned use of SRF set-aside funds with actual expenditures. (See Section 4.2.2 for more information on set-aside planning and reporting requirements.)

The set-aside status reports should also include a discussion of planned versus actual expenditures of set-aside funds. If there is a balance of unexpended funds which exceeds the amount expected based on planned schedules in the approved work plans, the state should identify measures it will take to reduce the excess amount. Such measures could include steps to expedite planned work, identification of additional tasks (e.g., revised work plans), transfer of funds to the other set-aside categories (if ceilings are not already reached), and transfer of excess amounts to the infrastructure Fund.

KEY RESPONSIBILITIES: CHAPTER FIVE: 5.3 Submitting Annual Set-Aside Performance Status Reports

EPA

- EPA must ensure proper oversight of state DWSRF set-aside reporting activities. State programs are required to report on set-aside use either through an annual set-aside performance status report or through the DWSRF Annual/Biennial Report.

State Program Office

- State programs must report on set-aside use through an annual set-aside performance status report or the state DWSRF Annual/Biennial Report.

5.4 Reporting for the Drinking Water National Information Management System (DWNIMS)

5.4.1

Purpose and Requirements

The DWNIMS is used to compile a comprehensive and consistent set of data quantifying SRF activity. DWNIMS data can be used to provide credible reports and analysis of program activity; monitor progress in meeting program goals and objectives; and to support efforts in financial planning. Information collected through the DWNIMS system include details on project assistance by category (e.g., system compliance with SDWA), assistance by population served, information on awards and expenditures through the DWSRF set-asides, and information on the DWSRF financial indicators. States use the DWNIMS data to track program progress over time.

DWNIMS data reports are also used by regions during the Annual Review process to assess the financial health of the program and to report on program activity measures.

Program Activity Measures (PAMs). According to federal requirements, EPA program offices are required to link DWSRF capitalization grants to EPA's Strategic Plan. Regional offices work with states to ensure well-defined outputs and outcomes are addressed within capitalization work plans. In relation to national reportable outputs and outcomes, four PAMs are identified for the DWSRF program. These include:

- Annual percentage of assistance agreements to bring entities into compliance,
- Fund utilization rate [cumulative loan agreement dollars compared to cumulative funds available for projects],
- Return on federal investment [cumulative dollar amount of assistance disbursements to projects divided by cumulative federal outlays for projects], and
- Cumulative number of project completions

5.4.2

General Schedule

The DWNIMS reports program data from July 1, 1997 through June 30th of the current year. Data is collected from Excel spreadsheets or through the internet (at <http://www.dwsrf.net>) at the State's option.

EPA began work to develop DWNIMS during the late 1990s. A pilot effort was launched in six states including Kansas, Maine, Maryland, Ohio, Oregon, and Virginia. A final version of the system was initiated in 2000 by EPA. The new system contained data collection requirements for over four-hundred data elements for each state program. Today, all states report information for the uses of their DWSRF funds to DWNIMS. The DWSRF data reporting period ends annually on June 30th and final numbers are submitted to EPA through an established website by a September deadline. States may report only information for the most recent fiscal year and are requested to submit any changes or corrections to the prior year only.

5.4.3

Use of the DWSRF Financial Indicators

There are seven financial indicators calculated through DWNIMS. These figures help to give EPA and the states a means to track program progress and explore initial assessments of overall program health. Information is collected for the following types of DWSRF indicators:

- Return on federal investment,
- Assistance provided as a percent of funds available,
- Disbursements as a percent of assistance provided,
- Additional assistance provided due to leveraging,
- Net return/loss after repaying match bonds and forgiving principal,
- Net return on contributed capital, and
- Set-aside spending rate

Programs use these indicators to develop various assumptions on program health and to assist during the financial planning process for the program. EPA also uses these indicators to help prepare the DWSRF PART response for OMB. As described earlier in Section 2.1.1 of this handbook, PART is a series of questions

that seek to assess the purpose, management, and performance of individual programs, including the DWSRF. Programs must demonstrate that their purpose is clear, that they are results-oriented, that they are well managed, and that they achieve intended results.

Program effectiveness, as evaluated through the PART process, also plays a role during the development of the President's Budget by providing relevant information for allocating limited funds to programs that can best demonstrate success.

KEY RESPONSIBILITIES: CHAPTER FIVE: 5.4

Reporting for the Drinking Water National Information Management System (DWNIMS)

EPA

- EPA must ensure states report timely and accurate information through the DWNIMS data system.

State Program Office

- The DWSRF data reporting period ends annually on June 30th, and final numbers are submitted to EPA through an established website by a September deadline.
- States may report only information through DWNIMS for the most recent fiscal year and are requested to submit any changes or corrections to the prior year only.

EPA Oversight Activities

KEY POINTS IN CHAPTER 6

- The annual review is central to EPA's oversight of the DWSRF program and thus encompasses all aspects of a state's operations.
- EPA's general responsibilities for the annual review begin with an assessment of the state's progress and performance in achieving goals and objectives identified in the IUP.
- In addition to the annual reviews of state DWSRF programs, EPA Headquarters also conducts oversight reviews of each individual regional office.

6.1

State and EPA Annual Review Process

6.1.1

Purpose

The main purposes of an annual review are to evaluate the DWSRF program's financial and operational health and check its compliance with relevant statutes, regulations, and grant conditions. The review focuses on the DWSRF's activity over the previous year and includes actions and agreements that affect the program. EPA regional staff generally conducts part of the review at the state offices and use the visit as an opportunity to assess the state's capacity to run its program. Opening and exit interviews, as well as specific meetings to discuss new requirements and initiatives, are a valuable means of improving DWSRF management in the short- and long-term.

6.1.2

EPA Responsibilities

The annual review is central to EPA's oversight of the DWSRF program and thus encompasses all aspects of a state's operations. The 2004 Annual Review Guidance for Clean Water and Drinking Water State Revolving Fund (SRF) Programs provides a comprehensive discussion of core review elements and a checklist for EPA regional staff to complete during the review and submit to EPA Headquarters with their PER. Beyond these core components, regions may emphasize certain elements of the DWSRF program based on situational knowledge and past reviews. To help ensure that the state and EPA are on the same page, regions are encouraged to share a draft of the PER with the state and to discuss findings and proposed action items clearly.

EPA's general responsibilities for the annual review begin with an assessment of the state's progress and performance in achieving goals and objectives as identified in the IUP and reported through the state's Annual/Biennial Report. EPA also reviews a selection of programmatic and financial project files, often onsite at the state program offices, to determine program compliance with federal requirements, adequacy of environmental reviews, and eligibility of program recipients and assistance activities.

Specific review activities are used to ensure:

- Program operation is in accordance with established OA (if applicable),
- Program is achieving the intent of Section 1452 and other pertinent sections of SDWA,
- Program coordinates with other water quality and drinking water programs in the state, as appropriate,
- Program is in compliance with Part 31 of the general grant regulations and the provisions of the capitalization grant agreements, and
- Assistance activities are eligible through the DWSRF program

General Steps in Annual Review Process from State Perspective

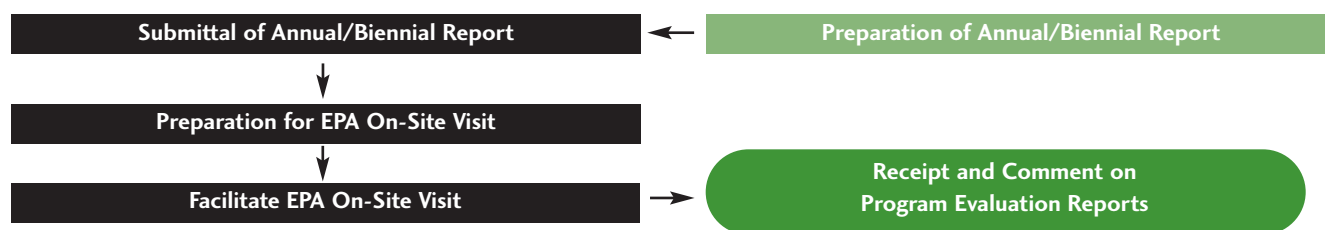


Figure: General steps in the annual review process from a state perspective from submittal of annual/biennial report to state receipt and comment on Program Evaluation Report.

Additional focus areas include EPA’s annual review of the financial status and performance of the Fund and set-aside accounts. Financial review of the Fund includes assurance of state match, assessment of binding commitment requirements, use of appropriate cash draw procedures, compliance with audit requirements, use of appropriate assistance terms and fees, and proper assessment of borrower creditworthiness. EPA also confirms that the state is completing all Federal Cash Transaction Reports (FCTRs) and Financial Status Reports (FSRs) as required by the EPA Office of Grants and Debarment. EPA’s review of the DWSRF set-aside accounts includes an evaluation of work completed as defined through the set-aside work plans, assessment of adherence to federal requirements, and evaluation of overall set-aside expenditure rates.

In addition to EPA’s review of financial and programmatic requirements for the DWSRF program, the EPA regional review team will perform an examination and follow up on any open audit findings and check the status of any prior year PER recommendations. Finally, EPA may note state progress and initiatives with regard to the public health benefits of the program and look for opportunities to improve overall management of DWSRF programs, including marketing efforts, information systems, and strategic planning.

6.2 EPA Regional Review Process

6.2.1 Purpose

In addition to the annual reviews of state DWSRF programs conducted by EPA regional offices, EPA Headquarters also conducts periodic oversight reviews of

each individual regional office. These reviews focus on ensuring EPA regional staff is conducting an appropriate level of management oversight for each state DWSRF program in their jurisdiction. These reviews take into consideration how the EPA regional office tracks state program activities, ensures proper use of federal funds, and conducts annual DWSRF program reviews.

EPA Headquarters works with the region to discuss each state program individually with a highlight on program performance and successful public health protection.

Additional topics of review include:

- PER follow-up,
- Review of audit findings,
- Financial management of the program,
- Set-aside utilization,
- Program pace,
- Terms and conditions of assistance,
- IUP goals,
- Priority list development and actual projects funded,
- Coordination between the State DWSRF and PWSS program,
- Reporting through DWNIMS, and
- Status of required work plans and other reports

The EPA Headquarters review team provides oversight responsibilities to ten EPA regional offices. In turn, these regional offices oversee all fifty-one state DWSRF programs. This unique national perspective helps EPA Headquarters better assist the EPA regional offices. EPA Headquarters often provides valuable solutions and recommendations that help improve program assistance and oversight activities. On average, the EPA Headquarters review team visits approximately five EPA regions per year.

KEY RESPONSIBILITIES: CHAPTER SIX

EPA Oversight Activities

EPA

- Conduct the annual review of each DWSRF program to assess performance and to ensure compliance with SDWA, the DWSRF regulations, the grant management post-award monitoring requirements, and applicable bond indentures.
- Assess the financial health and management capacity of each DWSRF, working with the state to improve program operations.
- Document and work to resolve any findings of noncompliance or concerns about DWSRF program management.
- Participate in EPA Headquarters reviews of each EPA regional office to discuss DWSRF program performance and compliance.

State Program Office

- Submit the Annual/Biennial report and supporting documents to EPA in accordance with the agreed-upon schedule.
- Provide project files, documented procedures, and staff time to facilitate EPA's annual review.
- Comment on EPA's draft PER and work with regional staff to finalize this document.

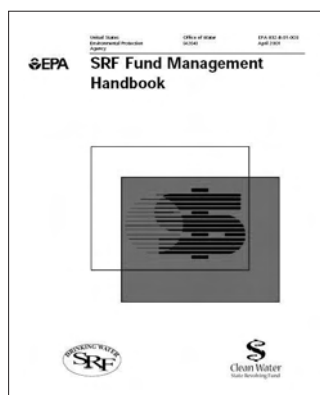
Revisiting the Program Structure

KEY POINTS IN CHAPTER 7

- To assess SRF financial performance, EPA has provided tools to assist state programs in conducting SRF strategic planning, including the SRF Fund Management Handbook.
- Financial planning activities help the SRF reevaluate program goals and set lending terms for future assistance.
- The SRF planning model helps states make the best planning decisions for their Drinking Water SRFs.

7.1 Assessing Implications of Fund Management Decisions

7.1.1 The SRF Fund Management Handbook



To assess SRF financial performance, EPA has provided tools to assist state programs in conducting SRF strategic planning. For example, the SRF Fund Management Handbook, released by EPA in 2001, provides a “how to” guide for SRF managers to conduct SRF strategic financial planning activities.

The handbook is organized into three sections including Strategic Management, Fund Management Issues, and Analytic Tools and Techniques.

The Basic SRF Fund Management Model described through this document provides information on strategic planning, program management, and program evaluation. Key objectives for sound fund management include a goal to fund projects with greatest public health benefits. The Fund Management Manual further describes how to manage the Fund effectively in order to provide the maximum amount of assistance over the long-term while maintaining the overall purchasing power of the fund. Financial considerations discussed through this document include the use of various types of loan terms, the proper management of investment returns, the best use of Fund resources, and an exploration of options in loan portfolio management approaches. Financial planning activities help the SRF reevaluate program goals and set lending terms for future assistance.

7.1.2 SRF Loan Portfolio Analysis

Proper loan portfolio analysis requires a direct understanding of the financial conditions for each borrower. For example, DWSRF programs with loan portfolios that have a large proportion of financially weaker borrowers may consider off-setting factors that increase the assurance of repayment. Such factors may include additional security for loan repayment beyond pledges of revenues from user charges, such as pledging the full faith and credit of a community. Loan portfolios should also be evaluated with respect to loan terms that may affect the ability of borrowers to make repayments in the future. For instance, programs should be careful to consider how the use of “balloon” and interest-only repayment options may affect the overall health of the Fund.

Assessing the financial condition of the DWSRF loan portfolio can serve a number of purposes. Proper evaluation of the loan portfolio, for example, can serve to

assess the likelihood that all outstanding loans will be repaid on time. Any identified risks or potential default rates should be incorporated during the financial planning process. Assessing the loan portfolio can also be used to provide feedback on a program's financial capability review process. Analysis of the loan portfolio can help to determine if DWSRF program procedures are adequate to appropriately categorize the financial condition of borrowers.

For additional, more detailed, information on loan portfolio management and analysis, please refer to EPA's 2001 SRF Fund Management Handbook.

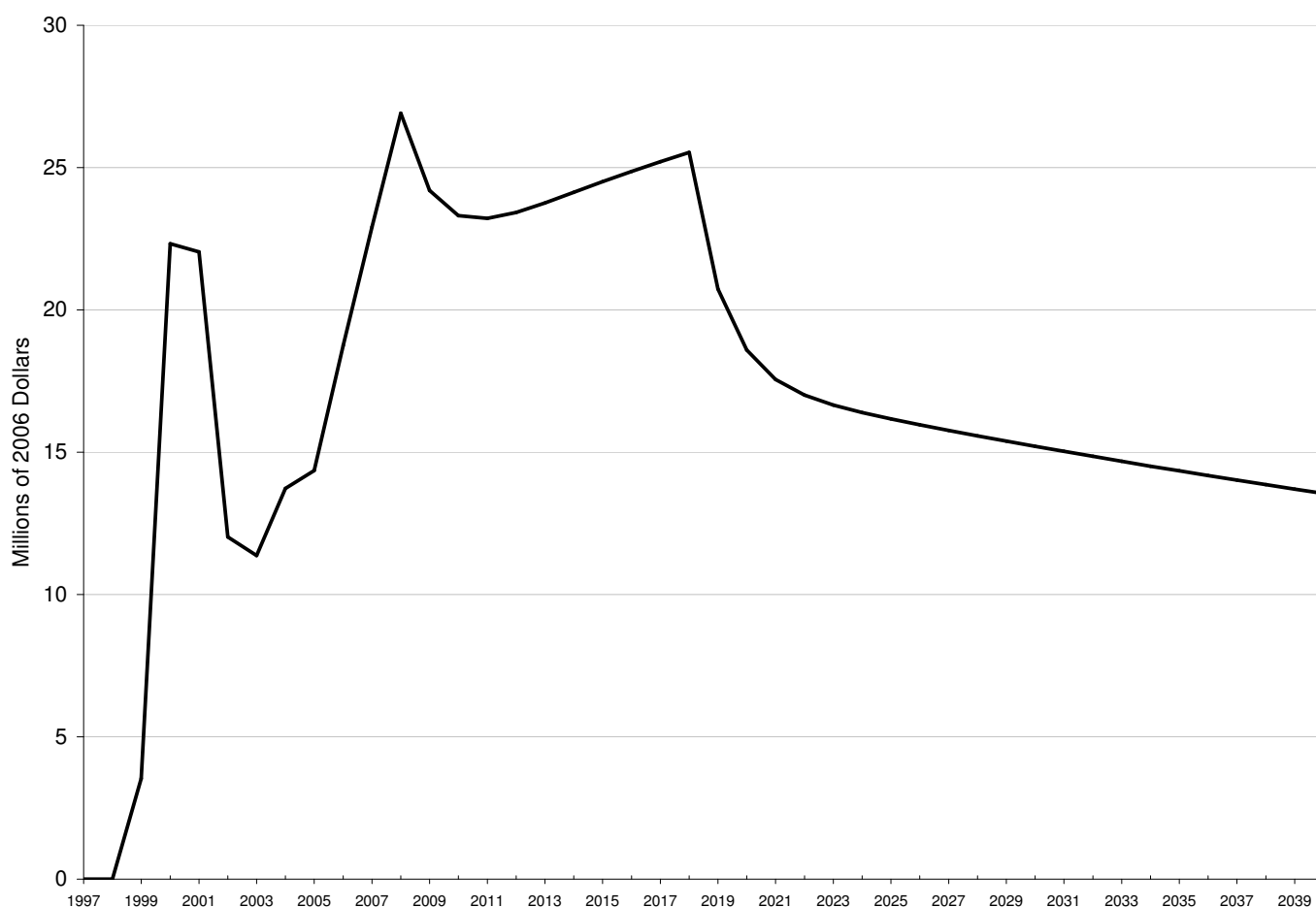
7.1.3 Use of the SRF Planning Models

The SRF Financial Planning Model was developed by EPA to assist states in assessing both short- and long-term

effects of Fund management decisions. The SRF planning model helps states make the best planning decisions for their Drinking Water SRFs. For example, the model allows state staff to produce output in both reports and graphs to illustrate the effects of various scenarios on the ability of the SRF to provide assistance in the present and future. These outputs include sources and uses of funds, pro-forma-financial statements, and graphs showing annual project commitments and disbursements.

The SRF Financial Planning Model allows states to assess the impact of many variables including changes to the loan interest rate, investment returns, Fund utilization rates, the use of leveraging, alternate levels of set-aside expenditures, and changes to the level of disadvantaged community subsidy provided.

Annual Project Disbursements for a Sample State's DWSRF



KEY RESPONSIBILITIES: CHAPTER SEVEN

Revisiting the Program Structure

EPA

- To help states assess SRF financial performance, EPA provides tools to assist state programs in conducting SRF strategic planning.

State Program Office

- States use the SRF Financial Planning Model to help assess both short- and long-term effects of Fund management decisions. Financial planning activities help states make the best management decisions for their Drinking Water SRFs.

APPENDIX A

REFERENCES

Cross-Cutting Federal Authorities: A Handbook on
Their Application in the Clean Water and Drinking
Water State Revolving Fund Programs

Unavailable Online

EPA DWSRF Homepage

- Program Guidance
- Fact Sheets and Reports
- Tribal and Territorial Programs
- Program Data
- Related Programs
- Contact Information

<http://www.epa.gov/safewater/dwsrf.html>

Federal Budget

<http://www.whitehouse.gov/omb/budget/>

Federal Legislative Information

<http://thomas.loc.gov/>

House Budget Committee

<http://www.house.gov/>

House Committee on Appropriations

<http://appropriations.house.gov/>

PART Process

<http://www.whitehouse.gov/omb/part/>

Senate Budget Committee

<http://budget.senate.gov/>

Senate Committee on Appropriations

<http://appropriations.senate.gov/>

SRF Fund Management Handbook

See EPA DWSRF Homepage

The Drinking Water State Revolving Fund Program:
Financing America's Drinking Water from the Source
to the Tap, Report to Congress

See EPA DWSRF Homepage

Water Infrastructure: Information on Federal and
State Financial Assistance

www.gao.gov/new.items/d02134.pdf

This Page
Does Not Print.

EPA DISCLAIMER: This document is intended to be purely informational and is based on SDWA provisions, EPA regulations, guidance, and established policy effective at the time of publication. It does not substitute for the applicable provisions of statutes, and regulations, guidance, etc., nor is it a regulation itself. Thus, it does not impose legally-binding requirements on EPA, States, or the regulated community.



EPA-816-B-06-007

October 2006

Printed on Recycled Paper

Office of Ground Water and Drinking Water (4601)
1200 Pennsylvania Avenue, NW
Washington, DC 20460