



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

APR 14 2014

OFFICE OF
WATER

MEMORANDUM

SUBJECT: Financing Terms Greater than 20 Years in the Drinking Water State Revolving Funds

FROM: Peter Grevatt
Director, Office of Ground Water and Drinking Water

TO: Water Division Directors
Regions 1-10

This memorandum addresses financing terms of greater than twenty years in Drinking Water State Revolving Funds (DWSRF) for the purchase and repayment of debt obligations that provide funds for municipal drinking water infrastructure. The Safe Drinking Water Act (SDWA) specifically authorizes State Revolving Funds (SRFs) to provide loans for drinking water protection purposes with repayment terms up to 20 years. (SDWA § 1452(f)(1)(B) and (f)(3)) Loan terms of up to 30 years are specifically allowed through financial assistance to eligible water systems of communities designated as “disadvantaged” based on a state’s affordability criteria. (SDWA § 1452(d)) The Safe Drinking Water Act also provides authority for DWSRFs to provide, under certain circumstances, other types of financing, none of which limit repayment terms. (SDWA § 1452(a)(2)) Although in the past the DWSRF has not allowed extended financing except for loans to disadvantaged communities, the program has received a legal opinion from EPA’s Office of General Counsel that provides support for an interpretation of SDWA that would allow financing for a period of greater than twenty (20) years with respect to the purchase of municipal debt obligations. The DWSRF has determined that under certain circumstances, Regions may approve proposals for financing, except with respect to initial loans, for periods that exceed terms of over twenty (20) years. The criteria under which such financing is allowed are set forth below.

Existing Provision for Extended Term Loans for Disadvantaged Communities

SDWA already provides for extended term financing for up to 30 years through loans for eligible water systems to communities designated by states as “disadvantaged” under state criteria. A ‘disadvantaged community’ means the service area of a public water system that meets affordability criteria established after public review and comment by the State in which the public water system is located. A State may take an amount equal to no more than 30 percent of the amount of a particular fiscal year’s capitalization grant to provide loan subsidies to disadvantaged communities (40 CFR 35.3520(2)), such as loans which include principal

forgiveness and negative interest rate loans (40 CFR 35.3525(b)(2)). SDWA 1452 (f)(1) allows DWSRFs to provide for extended term loans to disadvantaged communities provided that the loan terminates not later than the date that is 30 years after the date of project completion and does not exceed the expected design life of the project.

Under appropriations acts, DWSRF programs are also required to provide an equivalent annual amount of a capitalization grant of between 20 and 30 percent as additional subsidy in their financial assistance for eligible water systems which states identify to receive subsidy. For an individual project, this additional assistance may be part of an assistance agreement that combines this subsidy amount with an extended term loan for a disadvantaged community receiving DWSRF financial assistance.

Criteria for Extended Term Financing through Purchase of Municipal Debt Obligations

Extended Term Financing can be a valuable tool for states to address the current growing need for investment in drinking water infrastructure. If managed strategically, Extended Term Financing may result in a significant increase in the volume of lending by a state's DWSRF program. Extending the terms of assistance reduces a water system's annual repayments, making projects more affordable for communities. Increasing project affordability may, in turn, lead to an increase in projects funded as well as the speed at which communities may seek and accept funding for projects, which would have a direct benefit to public health.

Section 1452 (f) of the Safe Drinking Water Act lists the types of assistance that may be provided by a Drinking Water State Revolving Fund. Notably, the other types of financing in SDWA do not carry the same restrictions that apply to loans. Specifically, SDWA 1452(f)(2), (3) and (4) identify other types of assistance authority: "to buy or refinance the debt obligation of a municipality or an intermunicipal or interstate agency within the State at an interest rate that is less than or equal to the market interest rate in any case in which a debt obligation is incurred after July 1, 1993"; "guarantee or purchase insurance for a local obligation"; or "as a source of revenue or security for the payment of principal and interest on revenue or general obligation funds." Because of the absence of the limitations in the law that are contained with respect to loans relative to the other types of assistance, considerable flexibility exists in how DWSRF assistance might be provided through purchase of municipal debt obligations.

Regional Water Management Division Directors have the discretion to approve Extended Term Financing proposals, provided the proposed programs abide by the criteria and terms listed below. If a program does not meet the discretionary criteria listed below, the proposal may only be approved by the Director of the Drinking Water Protection Division in EPA Headquarters, or at a higher level.

The following criteria expected to be met in proposals to EPA for Extended Term Financing are:

1. Extended term financing may only apply when a state's DWSRF buys or refinances debt obligations from municipalities and intermunicipal and interstate agencies pursuant to section 1452(f)(2) of the Safe Drinking Water Act. This requirement is based on EPA's interpretation that the term "buy" as used in Section 1452(f)(2) is intended to mean the purchase of a bond by

the DWSRF issued by the municipality or intermunicipal/interstate agency directly to the DWSRF. In addition, EPA interprets the term “refinance” as used in Section 1452(f)(2) to mean the purchase of a debt obligation by the DWSRF (either a bond or direct loan) that had been previously issued by the municipality and is currently held by a third party.

2. Extended Term Financing is only available to borrowers with a dedicated source of revenue or security for bond repayment. A state’s DWSRF program is to demonstrate that the community has will have established a dedicated source of revenue for bond repayments (e.g., a general obligation or revenue obligation pledge to guarantee their repayments), or provide some form of security which will guarantee bond repayment in the event of a default (e.g., property lien, etc.).

3. All principal and interest received from bond payments must be deposited into a state’s DWSRF.

4. This Extended Term Financing may be used in combination with additional subsidization if appropriated by Congress, as a useful supplement in financial assistance to address drinking water infrastructure needs of eligible water systems.

5. State DWSRF programs need to demonstrate that the future lending capacity of the fund is not significantly impacted by offering Extended Term Financing through the purchase or refinance of debt obligations. A State is to demonstrate that expected repayments from the fundable list on which these extended term financing projects are listed does not decrease by more than 10% annually over the next 5 years, as compared to the condition under which those projects would have received 20-year term loans at a comparable rate.

The following criterion may be waived by EPA Headquarters:

6. Extended Term Financing cannot exceed the lesser of the useful life of the underlying asset or 30 years.

If the above terms are met, Regions may approve these programs. Any waivers for the discretionary requirements can be issued only by the Office of Water. EPA Headquarters review will be based upon a more stringent review of criterion #5, to ensure the long-term revolving nature of the fund is protected if the application is approved.

Regions should work with states that wish to adopt Extended Term Financing programs to make any needed changes to their grant agreement(s) and updates to their Intended Use Plan and Operating Agreements to reference the availability of the new financing agreements.

If you have questions on the implementation of this memorandum and the criteria for approving extended term financing, please contact Chuck Job, Chief, Infrastructure Branch, at (202) 564-3941, or the Drinking Water Protection Division at (202) 564-3751.