Memorandum

January 25, 2018

TO: Infrastructure Finance Authority Board
FROM: Chris Cummings, Assistant Director
SUBJ: Safe Drinking Water Revolving Loan Fund Program Modification

Requested Action

☐ Informational Only ☐ For Board Input ☒ For Board Action (see Recommended Motion)

Introduction

During this agenda item, the IFA Board will consider adoption of recommended modifications to the Safe Drinking Water Revolving Loan Fund (SDWRLF) program.

Background

The SDWRLF program is a federal-state partnership to help ensure safe drinking water by providing financial support to water systems. The program is jointly implemented by the Oregon Health Authority Drinking Water Services (OHA-DWS) and Business Oregon. The agencies work together to approve projects, administer the revolving loans and undertake related activities.

Since 1997, the state of Oregon has received an annual capitalization grant from the United States Environmental Protection Agency (EPA). Most of this grant (69%) is used to capitalize the state's SDWRLF. A portion of funds (31%) are used for program set-asides including technical assistance, program management, source water protection, and state agency administrative expenses. This grant requires a 20 percent match from the state which is met by Special Public Works Fund pass through moneys (Water Fund). Set-asides are managed by OHA-DWS whereas funded drinking water projects and the revolving loan fund are managed by Business Oregon.

The SDWRLF provides loans with below market interest rates to eligible water systems to plan, design, and construct drinking water infrastructure improvements. Subsidy in the form of principal forgiveness is also offered. The purpose of this memorandum is to present recommended SDWRLF program modifications to the IFA Board for consideration. Recommended modifications include changes to subsidy (principal forgiveness), loan term length, and loan interest length offerings.

Discussion

Subsidy (Principal Forgiveness)

Since 2010, for each annual EPA capitalization grant, a provision has been in place that requires a minimum amount of subsidy (i.e. loan principal forgiveness) be awarded as well as a maximum amount that cannot be exceeded. This subsidy allocation is tracked in a federal database and is subject to an annual EPA audit. Loan principal forgiveness is offered for all eligible projects, projects that address a health/compliance issue, and projects for communities that will have challenges with water rate affordability when loan repayment occurs. Additionally, principal forgiveness is offered to address program specific labor standards compliance (Davis Bacon) as well as project management assistance.

During the annual EPA audit, a measure of program performance is Oregon's ability to commit as much of the available loan funds as possible. To address this performance measure Business Oregon took an assertive approach by providing up to 60% of project cost in loan principal forgiveness with up to $1,030,000 awarded for each project. This effort was a success and culminated in $47.9 million in loan contracts executed during State Fiscal Year 2017, which was the second most in SDWRLF program history.

A careful review of existing principal forgiveness awards and likely awards for projects moving forward showed that the current award pace and principal forgiveness approach has the potential to result in loan principal forgiveness awards in excess of EPA capitalization grant limitations. In making this determination Business Oregon worked closely with EPA to verify the maximum amount of principal forgiveness allowed as well as verify that Oregon's federal tracking procedures conform to best practices. The need to avoid subsidy over-allocation necessitates a reduction in the amount of loan principal forgiveness offered.

The recommended modified approach is to provide up to 50% of project cost in principal forgiveness with up to $530,000 awarded for each project. Furthermore, when a funding recipient seeks an amendment to increase the award amount, awarding of additional loan principal forgiveness will not be the standard approach moving forward. In addition to reduced principal forgiveness offerings, Business Oregon will monitor cumulative principal forgiveness awards to ensure over-allocation does not occur.

Loan Term Length

The standard loan term length for the SDWRLF is 20 years. For those communities designated as "disadvantaged" a 30 year loan term length is offered. The EPA allows the states to develop the criteria for disadvantaged designation. The criteria used by Oregon involved analysis of water rate affordability. To calculate the affordability rate the community's Median Household Income (MHI) is multiplied by 1.25% and divided by 12. The affordability rate is then compared to the average monthly residential water charge taking into account future loan repayment for the proposed project. For communities with a MHI below that state average, if repayment of a loan for project implementation would result in community water rates in excess of the affordability rate, then the community was determined to be disadvantaged and would be offered a 30 year loan term length. For those communities with a MHI above the state average, the criteria was different, with 150% of affordability rate serving to trigger disadvantaged status and associated 30 year loan term length availability.

An opportunity to provide a greater number of communities the option of up to 30 year loan term length was sought. Business Oregon consulted with EPA on potential criteria that could be used to designate a water system as disadvantaged. The recommended modified criteria takes into account all water systems that would be faced with rates in excess of what is affordable, economically distressed counties, and the impacts of governor declared emergencies such as declared drought. In all cases loan term length may not exceed the expected useful life of the improvements funded in the project.

Loan Interest Rate
To calculate interest rates for the SDWRLF, at the time of award Business Oregon compares the 20-Bond Index rate from both the prior quarter as well as the prior month to determine which is lower. 80% of the lower rate is calculated and is used as the standard rate for the SDWRLF. In cases where communities have a MHI less than the state average, an interest rate as low as 1% is offered if the project would result in water rates in excess of the calculated affordability rate.

In past years, the effort to increase demand resulted in “incentive” interest rates being offered for communities with MHI greater than the state average. This led to these communities frequently qualifying for interest rates of 60% of the 20-Bond Index rate. In cases when rates would be significantly increased by the project (150% of affordability rate) those communities with MHI greater than the state average are offered interest rates as low as 1%. The recommended modified criteria for communities with a MHI above the state average is use of the standard rate (80% of 20-Bond Index). For communities with a MHI less than the state average the loan interest rate offerings would be unchanged.

Recommended Program Modifications
Recommended program modification include:

1. Reduce principal forgiveness offerings from a maximum of 1,030,000 to a maximum of $530,000;
2. Increase 30 year loan term length availability for communities by considering affordability, economically distressed counties, and governor declared emergency; and
3. Update the loan interest rate approach for communities with a MHI greater than the state average by offering the standard rate (80% of 20-Bond Index) to those communities.

Recommended Motion
Move to adopt program modifications including reduced principal forgiveness offerings, increased 30 year loan term length availability for communities, and an updated loan interest rate offering for communities with a MHI greater than the state average.

Attachments: Proposed SDWRLF Financing Options 2018