

**DRINKING WATER STATE REVOLVING FUND (DWSRF)  
PROGRAM**

**QUESTIONS AND ANSWERS**



**MAY 2001**

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NOTE: In this document, the entire program authorized by section 1452 will be referred to as the **DWSRF**, the loan amount as the “**Fund**” and the account or accounts for other programs, projects and activities as the “**set-asides**”. Set I of the Q&A’s were released in June 1998. Set II of the Q&A’s are indicated by a “II” after the question.

## **INTRODUCTION**

### **I. DEVELOPMENT OF A CAPITALIZATION GRANT APPLICATION/AGREEMENT**

I.1) Can a State include "contingency funds" as a separate line item in its capitalization grant application?

A: No. All costs must be accounted for by a projected binding commitment for a specific type of project assistance. If allowed by the State program, however, reasonable contingency funds may be included in the estimated project cost covered by individual binding commitments.

#### **A. Items Necessary To Establish a Loan Fund That Complies with Federal Requirements**

I.A) Must the State comply with 40 CFR Part 31 regulations?

A: Yes. However, Part 31 requirements do not pass through to recipients of loan assistance from the Fund, because loans are not considered a grant for the purposes of Part 31. If a State makes a grant or enters into a cooperative agreement with an assistance recipient to conduct set-aside activities, the recipient must comply with Part 31, as appropriate.

#### **1. Assurance that the State has the authority to establish a Fund and to operate the DWSRF program in accordance with the SDWA**

I.A.1.1) Can the DWSRF establish additional requirements for recipients beyond what is designated in section 1452?

A: Yes, provided the additional provisions do not conflict with the Safe Drinking Water Act (SDWA) requirements, capitalization grant agreement, or other applicable Federal rules and regulations.

I.A.1.2) What action can be taken if enabling legislation for the DWSRF includes provisions which are inconsistent with section 1452?

A: The appropriate action will depend upon a number of factors. In general, one of the following actions may be necessary to address an inconsistency between a State's DWSRF enabling legislation and section 1452:

- o If the legislation authorizes something that is not consistent with section 1452 but it is not mandatory, a special condition can be placed on the capitalization grant.
- o If the legislation is silent about something that is required under section 1452, it can be handled in State rules, the Operating Agreement, or the grant agreement.
- o If the legislation prohibits something that section 1452 requires or if the legislation requires something that section 1452 prohibits, legislation to revise the State law is necessary prior to capitalization grant award.

I.A.1.3) If more than one State agency will be involved in management of the DWSRF program, what documentation should be included as part of the capitalization grant application to describe the division of responsibilities among the agencies?

A: Memoranda of Understanding (MOUs) or similar interagency agreements should be included as part of the capitalization grant application. If the State uses an Operating Agreement, the MOUs should be attached to the Operating Agreement. The MOUs should clearly delineate the division of management responsibilities among the agencies.

I.A.1.4) Must DWSRF enabling legislation include provisions for providing assistance for all possible uses of section 1452?

A: No. States, however, are encouraged to include provisions in enabling legislation to engage in all activities authorized by section 1452. Such broad authorizing legislation will minimize the need to seek additional legislative action in the future.

I.A.1.5) Are State regulations required to implement the DWSRF?

A: No, unless required by the State to implement its program. Policies, procedures, guidelines, etc. are acceptable, provided they give the State sufficient authority to operate its DWSRF. The State's Attorney General certification should address the authority of the State instrumentality to implement the program.

I.A.1.6) Can Indian Tribes and Alaska Native Villages receive capitalization grants to establish DWSRFs?

A: No, only States are currently authorized to establish DWSRFs.

**2. Assurance that the State will comply with State statutes and regulations**

I.A.2.1) How will the RA determine if a State is following its own laws and procedures regarding commitment and expenditure of funds?

A: A State must certify in its application that it will follow its own laws and procedures applicable to the commitment and expenditure of funds. The Region will also determine whether the State is meeting that certification during the Annual Review and Annual Audit.

I.A.2.2) What is the role of the State in protecting the DWSRF from waste, fraud, and abuse?

A: As a recipient of Federal assistance under 40 CFR Part 31, the State assumes the primary responsibility for safeguarding the DWSRF funds. If a State determines that DWSRF resources might be subject to waste, fraud, or abuse, the State must follow procedures similar to those EPA would follow at 40 CFR 31.43.

I.A.2.3) How should DWSRF records be maintained?

A: The State must maintain DWSRF records in accordance with 40 CFR Part 31 and State laws and procedures.

**3. Assurance that the State has the technical capability to operate the program**

**4. Assurance that the State will accept capitalization grant funds in accordance with a payment schedule**

**5. Assurance that the State will deposit all capitalization grant funds in the Fund or Set-Aside Account**



**6. Assurance that the State will provide an amount at least equal to 20 percent of the capitalization grant (State match) in the Fund**

I.A.6.1) Must the State have the State match at the time it enters into the capitalization grant agreement?

A: No, however, at the time of award, the State must show that it has the financial and legal capability to satisfy the match on or before the date of each capitalization grant payment. For grant payments made to the State from fiscal year 97 appropriations, the State may defer deposit of its 20% State match until September 30, 1999.

I.A.6.2) Can a State use funds received under other Federal programs to meet the 20% State match requirement?

A: Only if allowed by the laws and procedures of those programs.

I.A.6.3) Does the State match requirement apply to the total amount of the capitalization grant?

A: Yes. The State match must be calculated on the basis of the entire amount of the capitalization grant which includes both Fund and set-aside monies.

I.A.6.4) What requirements must be met to qualify loan and repayment amounts from "pre-existing" State loan programs as a source of State match?

A: For loans made from State funds after July 1, 1993, but before the award of the capitalization grant, the amount of outstanding principal can be credited in full toward the State match if the projects were expended in accordance with section 1452. As the State receives repayments of principal which it claimed credit for, those funds must be made directly to the Fund. Interest can only be counted toward State match as repayments are received and deposited into the Fund. (The repayment stream from these loans cannot also be counted because that would be double counting.)

For loans prior to July 1, 1993, repayment amounts can be counted toward State match; only credit may be given as the repayments are received and deposited into the Fund.

I.A.6.5) May another State agency loan the DWSRF funds to provide for the DWSRF State match?

A: No. However, another State agency may be authorized to undertake financial transactions with or on behalf of another State agency as a normal part of its operations (e.g., a State operated bank). This may include providing funds to the DWSRF through debt offerings if the debt is in the form of a revenue or general obligation bond or a bond anticipation note. These forms of debt can be paid back from interest earned by the DWSRF. In addition, another State agency may act as trustee on behalf of the grantee for bonds issued to generate the State match.

7. **Assurance that the State will deposit net bond proceeds, interest earnings, and repayments into the Fund**
8. **Assurance that the State will match capitalization grant funds the State uses for 1452(g)(2) set-asides**
9. **Assurance that the State will use Generally Accepted Accounting Principles**

I.A.9.1) Do State DWSRF accounting practices need to indicate if funds from more than one DWSRF capitalization grant are used to fund specific projects?

A: No. There are no requirements for such accounting arising from the SDWA. Once capitalization grant funds are deposited into a DWSRF, a DWSRF does not need to track funds by grant at the project level. As part of its Biennial Report, a DWSRF must list those projects which were funded by an amount equal to the Federal grant payments. However, such a listing need not identify which grant was the source of funding.

I.A.9.2) Do DWSRF accounting/auditing practices need to track State match funds?

A: Yes. For auditing purposes, States must be able to account for the source and amount of State match funds attributable to specific capitalization grants.

10. **Assurance that the State will have the Fund and set-aside account audited annually in accordance with Generally Accepted Government Auditing Standards**

**11. Assurance that the State will adopt policies and procedures to assure that borrowers have a dedicated source of revenue for repayments (or in the case of a privately owned system, demonstrate that there is adequate security)**

**12. Assurance that the State will commit and expend funds as efficiently as possible, and in an expeditious and timely manner**

I.A.12.1) Can a State ever withdraw State funds deposited into the Fund?

A: No. Once State funds are deposited into the Fund, they can only be withdrawn to provide authorized types of assistance established by section 1452(f). Except, consistent with section 302 of the SDWA, State funds deposited into the DWSRF may be transferred to the CWSRF.

I.A.12.2) What does "commit and expend funds as efficiently as possible and in an expeditious and timely manner" mean?

A: States should move responsibly to commit DWSRF monies to assistance recipients as quickly and efficiently as possible to facilitate the financing of eligible activities and, where applicable, to initiate construction with a minimum of delay. In the case of leveraged funds, Federal tax laws may require the imposition of tax or arbitrage liabilities for unnecessary delays in expending DWSRF monies resulting from tax-exempt bonds.

I.A.12.3) When are detailed plans and specifications required for projects receiving DWSRF assistance?

A: The timing is at the discretion of the DWSRF, in accordance with State procedures.

I.A.12.4) Does a State have to commit to maintaining a Fund balance at a specified level?

A: No. The DWSRF operating procedures, however, should reflect the intent to administer Fund balances "in perpetuity" for the purposes outlined in section 1452(c) of the SDWA. The DWSRF should maintain the Fund balance in such a manner as to allow achievement of the short- and long-term goals as identified in the Intended Use Plan (IUP).

**13. Assurance that funds will be used in accordance with the IUP**

**14. Assurance that the State will provide EPA with a Biennial Report**

**15. Assurance that the State will comply with all Federal cross-cutting authorities**

**B. Intended Use Plan**

I.B.1) When does the requirement for preparation of IUPs end?

A: The State must prepare and submit an IUP in conjunction with each capitalization grant application. After the end of the availability of Federal capitalization grants, the State must continue to prepare and have public review of annual IUPs as long as the Fund is in existence.

I.B.2) What does "public comment and review" mean in relation to the preparation of an IUP?

A: "Public comment and review" means that a State must provide a meaningful opportunity for the public to review and comment on the State's IUP in accordance with State public participation requirements. The State must, as part of the capitalization grant application, provide EPA with a summary of its public participation process and also describe how it addressed major comments received from the public comment process.

I.B.3) Are States required to conduct a public hearing/meeting as part of the development of the IUP?

A: No. A State must, however, provide public notice and an opportunity for public comment and review. The State must, as part of the capitalization grant application, provide EPA with a summary of its public participation process and also describe how it addressed major comments received from the public comment process.

I.B.4) What level of detail is required with respect to public review and comment? (II)

A: The 1996 SDWA Amendments place an increased emphasis on public involvement and education in all aspects of the drinking water program, including the DWSRF. States are required to provide a meaningful process for public review and comment on the priority system used to rank projects and use of funds, including set-asides. Furthermore, a State must, as part of the capitalization grant application, provide EPA with a summary of its public participation process and also describe how it addressed major comments received from the public comment process.

I.B.5) If a State has a public review statute that clearly establishes the process that the State must undertake, will EPA require more than what is found in State law? (II)

A: No, as long as the State process for public review allows for a meaningful opportunity for the public to review and comment on the intended uses of all project and set-aside funds.

I.B.6) In conducting public outreach, is it sufficient to mail the IUP to all eligible systems prior to the public hearing? (II)

A: No. For example, a State can look beyond its traditional list of notice recipients and include those groups that are concerned about adverse health effects of drinking water supplies, including environmental and public health related groups. A State can also consider the use of non-traditional means to reach the public, including use of the Internet.

I.B.7) If a State's priority system has already gone out for public review, is it subject to additional review when the IUP goes out for public comment? (II)

A: No. While the IUP must include the priority system to permit the public and EPA to readily understand the basis for ranking systems, if the priority system has already undergone review and comment, the State may indicate in the IUP that it will not take additional comment on it.

## **1. Priority list of projects, including description and size of community**

I.B.1.1) Must refinanced projects be listed on a State's current DWSRF project priority list to qualify for DWSRF assistance?

A: Yes.

I.B.1.2) What parameters can be used in the development of the priority system? (II)

A: Congress included specific language in section 1452(b)(3)(A) of the SDWA requiring that States develop a priority system that gives priority, to the maximum extent practicable, to projects that address the most serious risk to human health, are needed to ensure SDWA compliance, and assist systems most in need, on a per household basis, according to State affordability criteria. EPA's interpretation of this provision is that a State must base its entire system on these three criteria. A State that does not adhere to the three criteria must demonstrate why it is unable to do so. States may provide a small number of bonus points to encourage systems to meet other SDWA objectives such as consolidation, source water protection, financial planning, proper operation of the system, and water conservation. Bonus points should not be sufficiently large so as to

elevate a low priority compliance or public health project over a high priority project.

I.B.1.3) Can a State develop its priority system using compliance and public health as its primary factors, and use affordability as a tie breaker? (II)

A: No. Section 1452(b)(3)(A) of the SDWA mandates that a State include all three criteria (public health, compliance, and affordability) in its priority system, to the maximum extent practicable. While each of the three criteria do not have to be weighted equally, they must be included as primary factors.

I.B.1.4) Can population be included in the priority system? (II)

A: Yes. However, a factor that considers population should receive a substantially smaller weighting than factors addressing the three statutory criteria of public health, compliance, and affordability.

I.B.1.5) How can readiness to proceed be used in the priority system? (II)

A: States were only allowed to include points for readiness to proceed in the priority ranking criteria for fiscal years 1997 and 1998. After September 30, 1998, readiness to proceed can only be considered in developing the list of fundable projects or as a bypass procedure.

I.B.1.6) What lists of projects are required to be included in an IUP? (II)

A: The SDWA requires that the IUP contain a list of projects that are expected to receive assistance (i.e., fundable list) and a list of projects that are eligible to receive assistance in the future (i.e., comprehensive list). The fundable list of projects must include: the name of the public water system; the priority assigned to the project; a description of the project; the expected terms of financial assistance based on the best information available at the time the IUP is developed; and the population of the system's service area at the time of the loan application. The comprehensive list must include, at a minimum, the priority assigned to each project and, to the extent known, the expected funding schedule for each project.

I.B.1.7) Can the fundable and comprehensive project priority lists be in a separate document from the IUP that describes how project funds will be spent? (II)

A: No. The SDWA requires that the IUP include a list of projects expected to receive assistance (i.e., fundable list) and a list of projects eligible to receive assistance in the future (i.e., comprehensive list).

Congress intended that States include the priority lists in the IUP to ensure that the public would have access to the list of eligible projects.

I.B.1.8) Can a State develop only one list that serves as both a comprehensive and fundable list? (II)

A: Yes. States may use one list, as long as the State clearly identifies those projects which are expected to receive assistance (i.e., those projects on the fundable list). When selecting projects, the State must start at the top of the combined list and identify the highest priority projects that the State expects to fund. Projects on the list that have been funded using prior year or other sources of funds should be identified as having already received funding.

I.B.1.9) For projects that have been identified as fundable (on either a separate or combined list), can a State start funding projects from any place on the fundable list? (II)

A: Yes. Once a State has developed a separate fundable list of projects expected to receive assistance based on its priority ranking system (or indicated which projects on the combined list are expected to receive assistance) any of those projects may be funded. It is not, for example, necessary to wait until project #1 has been funded to execute a loan with project #2 on the fundable list.

I.B.1.10) How can readiness to proceed be used in developing the fundable list of projects? (II)

A: A State should evaluate a project's readiness to proceed when developing the list of projects to be funded in an IUP. The fundable list should be comprised of the highest priority projects from the comprehensive list that are ready to proceed. States are encouraged to provide technical assistance to high priority projects that are not ready to proceed to help the systems take any necessary steps to prepare to receive assistance.

I.B.1.11) If a system with a project on the fundable list does not apply for a loan, can a State bypass that project? (II)

A: Yes. A State may bypass the project and fund the highest priority project on the comprehensive list that is ready to proceed. A State should allow a system a reasonable length of time to apply for assistance prior to being bypassed. Some States have specified individual deadlines for each project while others have specified the same deadline for every project. States should determine the time frame that they will use and describe this time frame in the bypass procedures that are outlined in the IUP.

I.B.1.12) Can a State bypass a project on the fundable list if the system has not demonstrated that it has technical, financial, or managerial capacity? (II)

A: Yes. A State may determine, when the final analysis has been completed, that the system does not meet the State's minimum requirements for technical, financial, or managerial capacity. If this occurs, the State cannot provide the system a loan, unless the assistance will ensure adequate capacity and the owner or operator agrees to undertake feasible and appropriate changes in operations that will ensure adequate capacity. The State may wish to provide technical assistance to the system through the set-asides to help them achieve capacity.

I.B.1.13) Can a State bypass projects on the fundable list to finance projects needed due to an emergency? (II)

A: Yes. A State may bypass projects on the fundable list to provide assistance to emergency projects which require immediate attention to protect public health if the State has described the process it will use to do so in the IUP. These bypass procedures will allow the project to forgo the priority ranking process. Emergency projects that were not on the priority list prior to receipt of funding must be identified during the Annual Review and included in the Biennial Report.

I.B.1.14) Does an emergency project have to meet requirements for technical, financial, and managerial capacity, environmental review, and other cross-cutting Federal authorities? (II)

A: Yes. An emergency project must meet other program requirements of State and Federal law. A State does have flexibility to identify an emergency project as a tier two (e.g., non-equivalency) project, which may reduce the number of requirements it would have to meet. It may also be possible to modify the environmental review procedures in emergency situations. The Agency's own regulations (40 CFR Part 6.106) provides a process for handling emergencies, and a State could include similar provisions in its State Environmental Review Process.

I.B.1.15) Can a State bypass a small project for a larger project to ensure a higher bond rating? (II)

A: No.

**2. Description of criteria and method used for distribution of funds**

**3. Description of the financial status of the DWSRF Program**



4. **Description of the short- and long-term goals of the DWSRF Program**
5. **Description of amounts transferred between the DWSRF and the CWSRF**
6. **Description of the set-aside activities, and percentage of funds, that will be funded from the DWSRF capitalization grant, including DWSRF administrative expenses allowance, PWSS program support, technical assistance, etc.**
7. **Description of how a State disadvantaged community program will define a disadvantaged system and the amount of DWSRF funds that will be used for this type of loan assistance**

### **C. Capitalization Grant Agreement**

I.C.1) Since changes in Operating Agreements affect all capitalization grants awarded under that agreement, would the new requirements affect previously awarded loans (i.e., are requirements retroactive)?

A: Changes in Operating Agreements are intended to be applied to future DWSRF assistance agreements unless the Agency is statutorily directed to apply changes retroactively or the Region and State agree to implement a new provision retroactively.

I.C.2) Can a capitalization grant award be amended to increase the amount of the grant?

A: Yes, as long as the IUP is amended to reflect the revised grant amount.

I.C.3) Do project/budget periods of capitalization grants need to conform to the Federal fiscal year?

A: No. The State may choose which fiscal year will apply to the Fund. The project/budget period of a capitalization grant should reflect the start date as the date of award and the end date as the last date that the State expects to draw funds from the grant.

### **D. Operating Agreement**

I.D.1) May Operating Agreements have a specified termination date?

A: Yes, if mutually agreeable to the State and the Region at the time of negotiation of the capitalization grant agreement.

I.D.2) Can the Operating Agreement be changed without a formal grant amendment? (II)

A: Yes, if the State negotiates the changes with the Region.

## **II. ALLOTMENT/USE OF FUNDS**

### **A. Allotment/Reallotment/Withholding of Funds**

#### **1. Allotment formula**

#### **2. Period of availability and reallotment**

II.A.2.1) When is a grant “obligated” for purposes of section 1452(a)(1)(E)?

A: A capitalization grant is obligated on the date EPA awards the grant.

II.A.2.2) How long does a State have to receive a capitalization grant for a given appropriation? (II)

A: A State has two fiscal years in which to receive a capitalization grant for each annual allotment of funds to the State. This two year period covers all capitalization grant funds, for both the Fund and set-asides. In order to allow adequate time for EPA to review the application, a State should submit its final application to the Region no later than June 30 of the second year of the two year period.

#### **3. Withholding of Funds**

##### **a. The Administrator will withhold funds**

II.A.3.a.1) What is the maximum amount of funds that can be withheld if a State fails to meet capacity development and/or operator certification provisions? (II)

A: The maximum that can be withheld from a State that fails to meet both the capacity development provisions (one or both) and the operator certification provision is 40% of the allotment. The maximum that can be withheld from a State that fails to meet both of the capacity development provisions is 20%. The maximum that can be withheld from a State that fails to meet the operator certification requirement is 20%.

##### **b. Reallotment of Withheld Funds**

II.A.3.b.1) What must a State do in order to be eligible to receive reallocated funds under the DWSRF program?

A: To be eligible to receive reallocations under section 1452(a)(1) of the SDWA, at the end of the two year period of availability for a particular allotment, a State must have received a capitalization grant award(s), equal to its full allotment of DWSRF funds. In order for the DWSRF to receive any reallocated funds, the State must describe the use of reallocated funds in an IUP, as part of a capitalization grant application. The capitalization grant award must be received prior to the expiration of the availability of the reallocated funds to that State.

**c. Loss of Primacy**

**B. Set-asides From The National Appropriation And Ceilings on State Allotments**

**1. National set-asides**

**a. Indian Tribes/Alaska Native Villages**

II.B.1.a.1) Can Indian Tribes and Alaska Native Villages receive assistance from DWSRFs?

A: Yes, Indian Tribes and Alaska Native Villages are eligible to receive assistance from DWSRFs. However, a project which receives a grant from the national set-aside for tribal assistance is not eligible to receive DWSRF assistance.

**b. Health Effects Studies**

**c. Unregulated Contaminant Monitoring**

**d. Small System Technical Assistance**

**e. Operator Training Reimbursement**

**2. Allotment for D.C. and other jurisdictions**

**3. State set-aside activities**

II.B.3.1) What are the minimum workplan requirements for the set-asides? (II)

A: At a minimum, the workplan should include: the funding amount in dollars and as a percentage of the State DWSRF allocation; the projected number of work years needed for implementing each set-aside; the goals and objectives, outputs, and deliverables for each set-aside; a schedule for completing activities under each set-aside; an identification and the responsibilities of the agencies involved in implementing each set-aside, including activities proposed to be conducted by a third party; and a description of the evaluation process to assess the success of work funded under each set-aside. Additional requirements for workplans addressing source water delineation and assessments are described on pages 2-31 through 2-32 in the Final *State Source Water Assessment and Protection Programs Guidance* (EPA-816-R-97-009, August 1997).

II.B.3.2) Do set-aside workplans have to undergo public review and comment?  
(II)

A: No. Workplans are not subject to public review and comment. However, if a State chooses to provide loans under section 1452(k) of the SDWA, the State must seek public comment on its priority setting process for selecting projects to fund. This can be done by including the proposed priority setting process with the description of the intended uses of set-asides which must undergo public review as part of the IUP.

II.B.3.3) Can a Performance Partnership Agreement (PPA) or Performance Partnership Grant (PPG) substitute for the minimum workplan requirements for the set-aside activities? (II)

A: No. Funds expended under the DWSRF are specifically excluded from a PPG. However, if set-aside funds are used to support activities in a program where the State has described its current activities in a workplan for a PPG or in a PPA that serves as a workplan (e.g., Public Water System Supervision (PWSS) Program), the State may build upon information it has already developed.

**a. DWSRF administrative expenses**

II.B.3.a.1) How can a State demonstrate that it has not exceeded the 4% limit for expenditure of set-aside funds for administrative expenses?

A: As part of its Biennial Report, the State must specifically identify administrative expenditures. This will facilitate the Annual Review and audit, including review of compliance with the 4% limitation.

II.B.3.a.2) Can a State be reimbursed from a Federally capitalized DWSRF, for administrative costs associated with the development of the DWSRF incurred prior to the award of a capitalization grant?

A: Yes, costs incurred prior to the award of a capitalization grant to establish a DWSRF can be reimbursed if such costs were incurred after August 6, 1996 (enactment date of SDWA Amendments of 1996), and before the date of the first capitalization grant award for project funds. The State must provide documentation of incurred costs.

II.B.3.a.3) Can a State use the 4% administration set-aside to fund anything beyond administration of the Fund? (II)

A: Yes. Section 1452(g)(2) of the SDWA allows a State to use up to 4% of the funds allotted to it to cover the reasonable costs of administering the DWSRF, which includes administration of the Fund, and to provide technical assistance to public water systems.

II.B.3.a.4) Do the minimum workplan requirements apply to the 4% administration set-aside? (II)

A: A State is not required to submit a workplan for the portion of the 4% administration set-aside funds that will be used for administration of the DWSRF. The State is only required to briefly describe, in the IUP, how these funds will be used. However, if the State intends to use a portion of the 4% set-aside funds to provide technical assistance to public water systems, the State must submit a workplan that meets the minimum requirements.

**b. State program management**

II.B.3.b.1) When does a State need to match expenditures it makes under the 10% State program management set-aside - at the time of the award or in the year that the funds are expended? (II)

A: A State has the flexibility to describe the method it will use to match set-aside funds at the time of application or at the time of negotiation of workplans. A State may provide the match at the time of the capitalization grant award or in the same year that funds are expended in accordance with an approved workplan.

II.B.3.b.2) What must a State demonstrate to gain in-kind credit for eligible PWSS expenses in order to meet the 1:1 match that is required for the 10% State program management set-aside? (II)

A: There are three different points at which a State will demonstrate how it will meet the 1:1 match for the 10% State program management set-aside required under section 1452(g)(2). Within the IUP, the State should provide a table to show how the State intends to meet the matching requirement, including using in-kind credit for PWSS expenses. During the Annual Review and within the Biennial Report, the State should provide documentation (e.g., financial status reports, workplans, and budgets) to show the Region how it met the match for the year being reviewed, including its basis for taking in-kind credit for PWSS expenses.

II.B.3.b.3) Can States include funds expended on source water protection activities as in-kind services to help meet the 1:1 matching requirement for the 10% State program management set-aside? (II)

A: Yes, eligible in-kind services may include funds expended on source water protection activities, with some restrictions. Specifically, State expenditures on only the following source water protection activities are eligible in-kind services: wellhead protection activities; source water delineation and assessments; watershed regulations or compliance initiatives aimed directly at source water protection of drinking water sources; drinking water source protection partnerships; and expenditures made on a class V UIC program.

**c. Small systems technical assistance**

II.B.3.c.1) Can a State provide technical assistance to systems with a population of 10,000 or less in the form of a loan? (II)

A: No, the intention of this set-aside is for the State (or an agent of the State) to provide technical assistance to small systems and not to provide a loan to the system. A State may use these funds for activities such as supporting a State technical assistance team or contracting with outside organizations or other parties to provide technical assistance to small systems.

**d. Local assistance and other State programs**

II.B.3.d.1) Can a State use 1452(k) set-aside funds for land acquisition for the purposes of source water protection without identifying specific parcels of land in the IUP? (II)

A: Yes. A State can set aside up to 10% for land acquisition without identifying specific assistance recipients in its IUP/capitalization grant application. However, a State must identify the specific assistance recipients and include a description of the parcels of land or easements purchased in its Biennial Report.

II.B.3.d.2) The SDWA requires a State to obligate the delineation and assessment funds within four years. When does this four year period begin and do the funds have to be spent within four years? (II)

A: The four year period for obligating the delineation and assessment funds begins on the date of award of the fiscal year 1997 capitalization grant which includes the set-aside. Thus, a State has four years to obligate the funds starting on the date it received its fiscal year 1997 grant. Obligation, in this case, does not mean that funds must be spent, but that funds must be committed. It is possible that the actual period of time over which these funds are expended could exceed four years. However, the State cannot expend funds later than the time by which it is required under section 1453 of the SDWA to have the assessments completed (e.g., May 2003 with an EPA extension).

II.B.3.d.3) Does capacity development assistance to a system have to go directly to the public water system or can it be provided through a third party? (II)

A: It may be provided through a third party.

II.B.3.d.4) Can funds that are set aside for wellhead protection be used to perform assessments? (II)

A: Yes, States may use wellhead protection funds to complete assessments for ground water sources. Unlike the delineation and assessment set-aside, funding for this set-aside is available beyond the fiscal year 1997 appropriation and will allow the State to continue to fund assessment activities for ground water sources.

**e. Movement of funds after capitalization grant award between the Fund and set-aside account**

II.B.3.e.1) Can a State reallocate use of funds from the Fund to set-aside accounts after award of a capitalization grant? (II)

A: Yes. However, a State may only transfer those funds for which it has not yet taken a payment intended for the Fund according to the payment schedule negotiated with EPA. Transfers must not cause the State to exceed the maximum amount of funding allowed for each set-aside.

II.B.3.e.2) What are the public review requirements if a State changes the distribution of funds among set-asides or between the Fund and set-asides? (II)

A: If a State chooses to reallocate funds prior to public review of the IUP, no additional notification is required provided that the new use of funds is described in the IUP released to the public. If a State reallocates funds after the IUP public review period and/or grant award, it must revise the IUP and seek public comment.

II.B.3.e.3) What changes must be made to the grant agreement if a State changes the distribution of funds among set-asides or between the Fund and set-asides? (II)

A: If a State chooses to reallocate funds after the grant award, it must submit materials to the Region to allow EPA to amend the grant agreement to show how funds will be redirected. Transfers must not cause the State to exceed the maximum amount of funding allowed for each set-aside. If applicable, the State may also need to submit a revised payment schedule. If the intended use of set-aside funds is changed, a State must submit revised workplans for EPA approval.

**f. Transfer of funds**

**C. Types of Financial Assistance That the Fund May Provide**

II.C.1) Can a SDWA section 1452 project (or a portion of a project) constructed with DWSRF assistance be sold to a private concern (privatized), for example, a sale-leaseback transaction?

A: Yes, if provided for under the State program.

II.C.2) Are services to start operation of an eligible facility eligible for assistance?



A: Yes, if these costs are associated with the construction of a project.

II.C.3) May States use an "allowance" table similar to that used in the CWSRF or Construction Grants program (see 40 CFR, Part 35, Subpart I, Appendix B) to determine allowable costs for non-building activities (e.g., planning, design, and construction engineering activities)?

A: Yes, at the option of the State.

II.C.4) May an assistance recipient pledge its facility or the revenue stream from its facility financed with DWSRF assistance as collateral for a private loan for subsequent expansion or improvements?

A: Yes, however subsequent debt obligations must not reduce the ability of the assistance recipient to meet its repayment obligations to the DWSRF and the assistance recipient must maintain the debt service coverage used to collateralize the DWSRF loan. Underwriting practices for subsequent debt obligations may provide bondholders of both DWSRF and non-DWSRF obligations with equal, parity claims to revenues of the system. The administrator of the DWSRF should examine the credit tests which an assistance recipient would have to meet before issuing further obligations on a parity with existing DWSRF loans.

II.C.5) May an assistance recipient lease, to a private operator, a facility constructed with DWSRF assistance?

A: Yes, subject to the terms of its DWSRF assistance agreement with the State. The State and the assistance recipient should carefully review possible tax implications prior to approving lease arrangements.

II.C.6) Can DWSRF assistance be provided to buy a treatment facility which was privately financed and/or operated?

A: Yes, but the cash draw rules for refinancing apply whether or not the privately financed facility has outstanding indebtedness.

II.C.7) Can DWSRF assistance be provided for purposes of constructing sludge handling facilities as part of a drinking water facility?

A. Yes.

II.C.8) If a State provides overmatch and deposits these funds into the Fund, can these funds be used to provide assistance to projects which might not meet all section 1452 requirements?

A: No. Once funds from any source are deposited into the Fund account, the funds are subject to applicable provisions of section 1452.

II.C.9) Can facilities with existing debt obligations participate in the DWSRF program?

A: Yes. Existing debt obligations need not pose a problem to qualify for DWSRF assistance. Each DWSRF should set its own criteria for determining a recipient's ability to repay loans, including consideration of existing debt obligations. An acceptable loan agreement could provide that the DWSRF take a "subordinated" position to other debts of a loan recipient (e.g., the recipients user charge revenues may already be pledged as repayment for an existing bond issue for previous construction; revenues should be sufficient to retire both bond issues; in case of default, however, repayment of the pre-existing debt instrument takes precedence). However, to minimize any cash flow problems in collecting repayments from a loan recipient that this may cause, prior to providing a loan, a State should ensure that: recipients demonstrate both their ability to make timely repayments to satisfy loan requirements and to provide "security" or collateral to ensure that the Fund receives payments when due.

### **1. Loans**

II.C.1.1) Can States provide "incremental" assistance to finance a multi-year construction activity?

A: Yes.

II.C.1.2) For "second round" (and later) loans, may DWSRFs enter into loan agreements with repayment periods longer than 20 years?

A: No. The limitation on 20 year repayment periods applies to all loans made by the DWSRF except for loans to disadvantaged communities, which may have repayment terms up to 30 years. Loans can be made for less than 20 years.

II.C.1.3) The SDWA requires that loans be made at or below "market rate". Who is responsible for determining the market rate?

A: The State is responsible for determining the market rate. The method for determining the market rate should be described in the Operating Agreement.

II.C.1.4) Can a DWSRF enter into a loan agreement with variable interest rates?

A: Yes. The DWSRF may charge different rates of interest during the term of the loan. It may be desirable to allow limited interest deferral. For

example, the DWSRF could charge a 0% rate of interest for the first five years of a loan, 5% per year for the second five years, and a market interest rate (prevailing at the time of the loan agreement) for the duration of the loan.

II.C.1.5) Is there a minimum "return rate" required to maintain the "perpetuity" of the Fund?

A: No. The State should, however, consider the long-term impact of loans issued with returns below the long-term expected rate of inflation.

II.C.1.6) May separate loans be made for planning and/or design costs?

A: Yes, at the option of the State. The initiation of repayment for such loans should begin consistent with the definition for project completion described in the State's capitalization grant application. At the option of the State, separate loans for planning and/or design may be "rolled over" into a subsequent loan for construction.

II.C.1.7) Can a State phase funding for a large project over several years instead of committing all of the necessary funds to the project in one year? (II)

A: Yes. A State may provide incremental project funding (e.g., for a particularly large, expensive project) over a period of years. A State may include a provision in its priority system to indicate that funding for subsequent phases will be considered a top priority for subsequent years. For example, a State could phase funding to a system which intended to replace 10 miles of distribution lines if the system knew it would only be able to do 5 miles over the next two years. The system would receive priority for funding when it was prepared to replace the remaining distribution lines. If the phased project is actually separate projects, the projects should be ranked separately and each funded according to its priority ranking.

#### **a. Repayment of Loan**

II.C.1.a.1) What determines when a project is complete and when repayments begin?

A: A project is considered complete when operations are initiated or are capable of being initiated. Repayments must begin no later than 1 year after completing the project. For project planning or design projects, the initiation of repayment should begin consistent with the definition for project completion described in the State's capitalization grant application.

II.C.1.a.2) May a State provide an interest rate discount to assistance recipients (regular and disadvantaged) for accelerated repayment?

A: Yes, at the option of the State.

II.C.1.a.3) Can loan repayment schedules be established which include "balloon" payments (e.g., final payments of principal and interest falling due in later years of the debt obligation which are substantially larger than preceding payments)?

A: Yes, but States considering the use of balloon payments in their loan agreements should be aware of possible implications such as: (1) the ability of the community to repay a balloon payment (potential default), (2) a possible reduction in State's ability to leverage, and (3) the reduced payment stream in early years which will reduce the DWSRF's ability to provide further assistance. If proposed as part of a DWSRF program, this form of repayment should be addressed in the IUP including a discussion of possible impacts on the long-term health of the Fund. Before approving a capitalization grant, EPA will review the State's evaluation of the potential effects of use of balloon payments. In any case, repayments cannot exceed 20 years (i.e., cannot modify the repayment schedule during the life of the loan to exceed 20 years), except for loans provided to those systems that meet the States definition of a disadvantaged community (maximum 30 year repayment period).

#### **b. Dedicated repayment source**

II.C.1.b.1) May a State charge delinquent fees for late payments or defaults?

A: Yes, but under the Agency's grant regulations at 40 CFR 31.25 fees may be considered program income and will be treated according to those rules.

II.C.1.b.2) Does the dedicated source of revenue (public) or adequate security (private) requirement apply to forms of DWSRF assistance other than loans?

A: No.

II.C.1.b.3) Who evaluates the sufficiency of the dedicated source of revenue (public) or adequate security (private)?

A: The State, as part of the process of reviewing/negotiating a loan agreement with a recipient. As part of the Annual Review process, EPA will review State procedures for assuring the adequacy of dedicated repayment sources.

**c. Financial security of privately-owned systems**

**d. Financial, technical, and managerial capability analysis**

II.C.1.d.1) What is the responsibility of the DWSRF if a loan recipient fails to comply (defaults) with the repayment terms of the loan agreement?

A: The DWSRF is responsible for protecting the financial integrity of the Fund. Prior to executing loan agreements, the DWSRF must assess the technical, managerial and financial capability of the assistance recipient to repay the loan. For private systems, States must ensure that the private system demonstrates adequate security to repay the loan. To safeguard against the possibility of default, the State should include procedures in loan agreements which address the dedicated repayment source requirement for publicly owned systems. In addition, the State should have the power to ensure repayment. For example, if a recipient is unable to collect sufficient revenues through its dedicated repayment source (i.e., user charge), the DWSRF should have the ability to require the recipient to revise its drinking water service charge to generate sufficient funds to meet the repayment schedule in the loan agreement or take whatever other steps are necessary to raise the necessary funds. Revenues should be sufficient to cover not only general operating costs (including routine repairs and replacements), but also major replacements and debt service. In some cases, States may have the authority to take title to the facility and operate it directly.

II.C.1.d.2) What level of review of the recipient's ability to repay DWSRF loans is required?

A: As part of the capitalization grant application process, the State must agree to require a dedicated source of revenue or adequate security (privates) for all DWSRF loans. The specific procedures a State uses to determine whether an assistance recipient has the ability to repay a loan are at the discretion of the State, but should be established to protect the financial integrity of the Fund. State procedures should be described in the capitalization agreement or in the Operating Agreement. As part of the Annual Review

process, the Regions can review the activities of the Fund to ensure that there has not been a failure to repay loans.

**e. Disadvantaged communities**

II.C.1.e.1) Can a loan recipient under the set-asides receive the benefits of disadvantaged assistance? (II)

A: No. The flexibility to use DWSRF monies to provide additional loan subsidies or extended loan terms to disadvantaged systems applies only to assistance provided to systems from the Fund. A State may be able to provide additional subsidy to recipients of set-aside funding if it uses a source of funding outside the DWSRF.

II.C.1.e.2) Is a State limited to providing assistance in the form of principal forgiveness or negative interest rate loans for disadvantaged community assistance loans made from the Fund? (II)

A: No. A State may define the means by which it will provide disadvantaged assistance to systems meeting the State's definition. Such assistance can take the form of principal forgiveness, negative interest rate loans, a lower interest rate than that applied to non-disadvantaged systems (e.g. 3% vs. 5%), or an extended repayment term of 30 years. The 30% limitation on use of the capitalization grant to provide disadvantaged assistance is determined by the level of principal forgiveness and/or subsidy provided by negative interest rate loans. Loan subsidies in the form of reduced interest rate loans that are at or above zero percent are not counted against the 30% limitation.

**f. Project funding for small systems**

II.C.1.f.1) The SDWA requires that States annually make available a minimum of 15% of DWSRF funds to provide loan assistance to small systems serving fewer than 10,000. Does the 15% requirement apply only to Federal funds associated with the capitalization grant, or does it apply to all funds in the Fund, including net proceeds from a leveraged program? (II)

A: The SDWA requires that at least 15% of the amount credited to the Fund in any fiscal year be made available for assistance to small systems under 10,000, to the extent funds can be obligated for eligible projects. Therefore, the percentage is based on all monies that a State expects to be available for loans as described in

a State's IUP. This includes the capitalization grant, State match, bond proceeds, repayments, and interest earnings.

II.C.1.f.2) How long does the requirement to provide 15% of DWSRF funds to small systems need to be met? (II)

A: Because the 15% provision is tied to the Fund, not the capitalization grant, it will remain in effect as long as the Fund is in operation.

II.C.1.f.3) What happens if a State is unable to meet the 15% requirement for small systems? (II)

A: The SDWA allows for this possibility by indicating that States must meet this 15% requirement to the extent that funds can be obligated for eligible small system projects. A State that is not able to find a sufficient number of small system projects to meet the minimum 15% requirement will need to explain in its IUP why the requirement was not met and what it is doing to ensure that this requirement is met in future years (e.g., marketing, outreach, technical assistance). The State should report the actual percentage expended on small systems in the Biennial Report, in order to evaluate the success of the program.

II.C.1.f.4) If two systems, both serving populations less than 10,000, are interested in loans to consolidate with each other, can the loan to combine the systems be counted toward meeting the 15% requirement? (II)

A: Yes.

II.C.1.f.5) If a system serving a population greater than 10,000 is going to receive a loan to physically consolidate a system under 10,000, can that loan be counted toward meeting the 15% requirement? (II)

A: Yes, but only the costs associated with consolidating the small system can be counted.

## **2. Buy or refinance existing debt obligations**

II.C.2.1) If a State has credited repayments of loans made under a pre-existing State loan program as part of its State match, can these projects be refinanced under the DWSRF?

A: The State cannot count future payments of prior loans as credit towards meeting its State match requirement and also refinance the projects under

the DWSRF. If the State has already counted future payments from certain projects towards its State match, and now wants to refinance these projects, the State must provide replacement funds for the amounts previously credited as match.

### **3. Guarantee or purchase insurance for local debt obligations**

II.C.3.1) Is the DWSRF responsible for loans it has guaranteed? (i.e., if an assistance recipient defaulted on a loan, would the State have to repay the loan or portion thereof?)

A: Yes, but only up to the amount under the terms of the guarantee agreement. The State is responsible for ensuring the financial health of the Fund. To safeguard against the possibility of default, the State must have procedures which require an assistance recipient to demonstrate its ability to repay the local debt obligation, before the DWSRF provides the guarantee. In addition, the State should have the power to recover funds adequate to remedy the default (e.g., by attaching State financial assistance payments to the recipient or requiring the recipient to revise its service charge to generate funds sufficient to meet the repayment schedule).

II.C.3.2) May a DWSRF provide assistance to a recipient which results in deposit of the funds into a DWSRF security account?

A: Yes, if the DWSRF capitalizes a debt service reserve in the DWSRF and uses it to guarantee a local debt. However, the debt has to be for purposes consistent with section 1452.

### **4. A source of revenue or security for payment of Fund debt obligations**

II.C.4.1) A DWSRF may be used as a source of revenue or security for the payment of principal and interest on revenue or general obligation bonds issued by the State if the "net proceeds" of the sale of such bonds are deposited in the DWSRF. What is the definition of "net proceeds"?

A: For purposes here, "net proceeds" is defined as the funds raised from the sale of the bonds minus issuance costs (e.g., the underwriting discount, underwriter's legal counsel fees, bond counsel fee, financial advisor fee, rating agency fees, printing of disclosure documents/bond certificates, trustee banks' fees, various forms of credit enhancement and other costs that may be incurred by a State agency incidental to the bond issuance).

II.C.4.2) How can loan repayments be credited to the DWSRF if they are pledged to repayment of DWSRF bond issues?



A: The repayments are to be first deposited into the DWSRF and then paid to the pledged issue.

II.C.4.3) Can the State use funds in the DWSRF as a security for the issuance of State bonds used to provide the State match?

A: Yes. If the net proceeds of the bond issue were deposited into the DWSRF and the amount of the security subject to being paid out is limited to an amount equal to the interest earnings of the Fund.

II.C.4.4) Can the State use funds in the Federal Automated Clearing House (ACH) to guarantee the repayment of a State bond issue used to provide the State match?

A: No, only interest earnings of the Fund may be used to capitalize a guarantee reserve for the State match.

II.C.4.5) May States use DWSRF funds to make rebate payments of arbitrage earnings and penalties, if applicable, to the U.S. Treasury?

A: Yes, the proceeds of a bond issue secured by DWSRF funds may be used to make rebate payments, but only if the net proceeds of the bond issue were deposited in the DWSRF in accordance with section 1452(f)(4). Moreover, in the case of State bonds issued for the purpose of providing the State match, the rebate payment must come from funds attributable to the interest portion of repayments on DWSRF loans or interest earnings of the DWSRF.

## **5. Earn interest on Fund accounts**

II.C.5.1) Can a DWSRF make loans the principal purpose of which is to establish a local interest earning fund from which the recipient will use the interest earned to reduce the cost of funding its projects?

A: No, except as allowed in 1452(p) of the SDWA. This is not an allowable use of the Fund as outlined in section 1452(f). However, if allowed by State law and approved by the Region, a recipient may invest incidental idle construction funds obtained from a DWSRF loan and use the interest to reduce the cost of its project.

## **III. ELIGIBLE SYSTEMS AND PROJECTS**

### **A. Eligible Systems**

III.A.1) Can DWSRF assistance be provided to purchase a system?

A: Yes, if the project or activity is eligible for assistance under section 1452 of the SDWA, and ranks high enough on the State priority list to receive funding.

III.A.2) What is the definition of a non-profit system? (II)

A: To be considered non-profit, a water system must have a Federal tax exempt status identification number.

## **B. Eligible Projects**

### **1. Compliance and Public Health**

III.B.1.1) If a State has adopted an MCL for a contaminant for which EPA has not yet set a standard, or if the State has a stricter standard for an EPA regulated contaminant, are the costs associated with compliance with the State standard eligible for funding? (II)

A: Yes. A State may include, as eligible for funding from the DWSRF, costs for compliance with any contaminant standard that a State includes in its law or regulations. Costs are eligible even if EPA does not regulate the contaminant or if EPA has a less stringent standard for that contaminant as long as the standard is required to meet the compliance or public health objectives of the State.

III.B.1.2) If a project consolidates a number of systems, but only some of them qualify for priority points, is the project eligible? (II)

A: Yes.

### **2. Loan assistance to systems that meet the definition in section 1401(4)(B)**

### **3. Land acquisition**

III.B.3.1) Can a State use monies from the Fund to finance the purchase of land or conservation easements for source water protection? (II)

A: No, purchase of land for source water protection is only eligible under the 1452(k) set-aside. Acquisition of land using the Fund is only eligible if the land is needed for the purposes of locating eligible project components. The land must be acquired from a willing seller.

III.B.3.2) Can the Fund finance purchase of land needed for source water protection efforts on a proposed well? (II)

A: No. While the monies in the Fund can be used to purchase a parcel of land needed to site a well, the purchase of land for source water protection purposes is only eligible for funding from the land acquisition set-aside under section 1452(k).

III.B.3.3) To what extent is land “integral to a project” eligible? (II)

A: The purchase of land from the Fund is an eligible activity if the land is “integral” to the project. In this context, integral includes land necessary to locate a treatment facility, locate a transmission line, locate a storage tank or pump station, and site a new well.

**4. Planning and design of a drinking water project**

III.B.4.1) Can a turnkey (design/build) project receive DWSRF assistance?

A: Yes, if the project or activity is eligible for assistance under section 1452 of the SDWA.

III.B.4.2) Are environmental review costs allowable?

A: Yes. Costs to assistance recipients for preparing environmental assessment reports (including EISs prepared by "third party" consultants hired by loan recipients and approved by the State DWSRF agency) may be included as part of the assistance amount. Costs incurred by the State in reviewing the environmental assessments are considered DWSRF administrative costs.

**5. Restructuring of systems that are in noncompliance or that lack the technical, managerial and financial capability to maintain the system**

**C. Projects not eligible for funding**

**1. Lack of technical, managerial and financial capability**

**2. Significant noncompliance**

**3. Growth**

**D. Compliance without DWSRF funding**

## **IV. STATE/PROJECT LEVEL AUTHORITIES**

### **A. Cross-cutting Federal Authorities**

IV.A.1) Can a section 1452 project not meeting the equivalency requirements receive DWSRF assistance prior to a section 1452 project meeting the equivalency requirements?

A: Yes, as long as the State will be able to demonstrate in the Biennial Report that the equivalency requirement (i.e., projects funded in an amount equal to the capitalization grant) has been met or that progress is being made toward meeting the requirement.

### **B. Environmental Reviews**

IV.B.1) Must the DWSRF establish a two-tier environmental review process?

A: No. The State does not have to establish two distinct sets of laws, regulations or procedures (e.g., one set for equivalency [tier one] and another for non-equivalency projects [tier two]). States have the option to either employ different levels of environmental review stringency to these two tiers or to apply a NEPA-like review to all construction projects funded with DWSRF monies.

IV.B.2) Can States adopt environmental determinations previously issued by EPA or another Federal agency as part of the required NEPA-like review process?

A: Yes, if: (a) the State process allows for the utilization of the Federal determination, including any associated mitigation measures and (b) either the determination is less than five years old or the State has reaffirmed the determination through an approved process updating previously issued determinations over five years old.

IV.B.3) Can the DWSRF instrumentality hire other entities (such as other State agencies, universities, or consulting firms) to do the environmental reviews on projects including EISs?

A: Yes. However, the required determinations must be signed and distributed for review by the State agency identified in the State's approved capitalization grant application.

IV.B.4) Should all alternatives considered in the planning phase beyond the selected "preferred alternative" be subjected to a State-level interdisciplinary review?

A: Yes. The State should have the interdisciplinary expertise for reviewing the preliminary alternatives to identify and evaluate all environmental concerns to

ensure the selection of the preferred alternative which avoids, minimizes, or mitigates undesirable project impacts.

IV.B.5) If an environmental review was not conducted on a project expected to receive DWSRF refinancing assistance, what steps must be taken to comply with the SERP requirements?

A: If the local debt was incurred on or after February 28, 1997, (date of issuance of the DWSRF Final Guidance), an environmental review must have been completed in accordance with the SERP (i.e., NEPA-like for equivalency projects or an approved alternative process for non-equivalency projects). If the local debt was incurred before February 28, 1997 (DWSRF) and the project being refinanced is a non-equivalency project, a tier two environmental review is necessary. If local debt is incurred prior to February 28, 1997 and the project is an equivalency project, prior to issuance of the binding commitment, the State must subject the project to an "after the fact" NEPA-like review. In both of the above instances, the review process must consider the impacts of the project based on the pre-building site conditions. Compliance with the SERP cannot be justified on the grounds that costs have already been incurred, environmental impacts have already been caused, or contractual obligations were made prior to the binding commitment.

**1. Equivalency projects** (i.e., projects funded in an amount equal to the capitalization grant)

IV.B.1.1) What is the State's responsibility under the DWSRF environmental review requirements?

A: The State will be responsible for the development and, after EPA approval, implementation of environmental review procedures. This includes, but is not limited to, documenting, making determinations on, and providing for public comment on environmental issues associated with construction projects receiving DWSRF assistance and ensuring implementation of mitigation measures. States may adopt the CWSRF procedures for use in the DWSRF program.

**2. Non-equivalency projects** (i.e., projects funded in an amount greater than the capitalization grant)

**3. EPA Approval and Review Process**

IV.B.3.1) What is EPA's responsibility under the DWSRF environmental review requirements?

A: EPA's responsibility will include approving proposed State processes and revisions to them, conducting annual oversight, providing technical assistance when requested, providing guidance regarding compliance with the provisions of the other cross-cutting Federal authorities, and, when necessary, consulting with other Federal agencies under the cross-cutting authorities.

## **V. FUNDING PROCESS**

### **A. 20 Percent State Match**

V.A.1) Can costs incurred in development of the DWSRF instrumentality or specific portions of the capitalization grant application be counted against State match?

A: No. State match funds must be deposited into the Fund and can only be used for eligible Fund activities described in section 1452(a) of the SDWA.

### **B. State Match for the 1452(g)(2) Set-aside**

### **C. Federal Funding Process**

#### **1. General**

#### **2. Schedule of payments**

V.C.2.1) Can the negotiated payment schedule be amended once it is part of the capitalization grant agreement?

A: Yes, as long as the last payment is received no later than the earlier of 8 quarters after the date such funds were obligated by the State or 12 quarters after the date such funds were allotted to the State. Only those payments on the schedule that haven't been made can be changed on an amended payment schedule.

V.C.2.2) In determining the payment schedule, what date is used to determine the availability of the allotment?

A: The date of the Advice of Allowance which makes funds available from the EPA Comptroller.

#### **3. Binding commitments**

V.C.3.1) Is there a minimum repayment term for a loan to count towards satisfying the binding commitments requirement?

A: No.

V.C.3.2) What actions should a State take if it feels it may not be able to meet the requirement for binding commitments within 1 year after receiving a grant payment (increase in the ACH ceiling)?

A: If a State is concerned about its ability to comply with the binding commitment requirement, it should notify the RA before it fails to fulfill its responsibility, and propose a revised payment schedule. (The payment schedule is based on the estimated schedule for entering into binding commitments).

V.C.3.3) Can funds used for administrative costs and other set-asides be counted towards the binding commitment requirement?

A: No. Binding commitments equal to the amount of the Federal grant deposited into the Fund and the State match must be entered into with eligible projects within one year after the receipt of each grant payment.

V.C.3.4) Can a State include reasonable "contingency funds" for projects when establishing a projected and/or actual amount of a binding commitment?

A: Yes. If provided for under the State program, a contingency cost may be included in the estimated project cost covered by the binding commitment.

V.C.3.5) Can a binding commitment for a loan or other DWSRF assistance be made from more than one capitalization grant?

A: Yes.

#### **4. Cash Draw**

V.C.4.1) Prior to requesting a cash draw from the ACH, what should be the extent of State review of a disbursement request from a DWSRF assistance recipient?

A: The State has responsibility for determining appropriate review of disbursement requests.

V.C.4.2) How will payments be made to the ACH?

A: The process for making payments to the ACH are explained in detail in the *Guide to Using EPA's Automated Clearing House for the DWSRF Program* (EPA-832-B98-003, September 1998).

V.C.4.3) A DWSRF identifies a group of projects in order to maintain proportionality (i.e., disbursements from Federal payments and State funds). If one of these projects becomes delayed to the extent that it cannot be used to meet proportionality (e.g., construction is shutdown), can the DWSRF substitute another project for purposes of cash draw?

A: Yes, unless cash has been drawn for the project for which substitution is intended. If, however, a project for which cash has been drawn is significantly delayed, then, subject to a non-monetary grant amendment, the Region and State may negotiate the substitution of another project provided that outlay commitments are not negatively impacted.

V.C.4.4) What are incremental disbursement bonds?

A: In some States, State law or constitutions restrict local bond indebtedness. Incremental disbursement bonds (or similar techniques) allow communities to issue debt on a periodic basis prior to incurring construction costs or as project costs are incurred. These bonds are generally issued by local communities and purchased by State entities which supply the needed funds.

V.C.4.5) If a State uses the group of projects method to ensure proportionality, may it switch to the all projects method after a payment and cash draw has been made?

A: Yes, a State may change to the all projects method if it demonstrates, to the satisfaction of the Regional Administrator, that project(s) in the group are significantly delayed and the delay will cause an adverse impact on the Fund.

To accomplish the change, the amount of cash drawn that would have been allowed if the all projects method was initially employed must be calculated. Once the cash draw method is changed, additional cash draws may only be made if the cumulative amount that would have been allowed under the initial all project methods is greater than the draws that have actually been made. (In other words, any additional draws may not cause the cumulative total of actual draws to exceed the amount allowed using the initial all projects method). Upon Regional Office approval, the State may, if necessary, substitute projects designated for purposes of cash draw tracking.

- a. Projects**
- b. Set-asides**



V.C.4.b.1) When drawing down Federal funds for set-asides, do States have to draw down a proportional amount of the required 20% State match? (II)

A: No, a State may draw down 100% Federal funds for costs incurred conducting set-aside activities. Proportionality is calculated based on cash draws from the Fund. For more information about calculating proportionality, see the *Guide to Using EPA's Automated Clearing House for the DWSRF Program* (EPA-832-B98-003, September 1998).

## **VI. REPORTING/REVIEW RESPONSIBILITIES**

### **A. State Responsibilities**

VI.A.1) How long into the future will Federal DWSRF reporting requirements apply?

A: The reporting requirements under section 1452(g)(4) are not tied to the award of capitalization grants and thus, will continue as long as the funds are in existence. However, the appropriate level of State reporting to EPA after the award of the last capitalization grant has not yet been determined, but it is expected to be less since several requirements will no longer apply.

VI.A.2) How long does the DWSRF need to keep records relating to: (1) capitalization grants (e.g., development of IUP, negotiation of payment schedules, grant application and agreement materials) and (2) DWSRF assistance (e.g., applications, completed review checklists, environmental review materials, documentation related to compliance with equivalency requirements and other Federal authorities, repayment records)?

A: Records relating to the DWSRF must be maintained in accordance with 40 CFR 31 and State laws and procedures and be readily available for auditors' use.

#### **1. Biennial Report**

VI.A.1.1) Do uses of DWSRF funds have to be accounted for separately (e.g., meeting equivalency)?

A: Yes, the Biennial Report will need to show which projects satisfy the various requirements (including the costs related to each project). The Biennial Report must also describe set-aside accounts separately.

#### **2. Annual Audit**

VI.A.2.1) When States conduct audits under the DWSRF program, can the costs of such audits be paid for with DWSRF funds?

A: Yes. The State can use administrative funds from the set-aside account to pay for the cost of an audit.

VI.A.2.2) Does the EPA's Inspector General have access to State and loan recipient records?

A: Yes. Section 6(a)(1) of the Inspector General Act of 1978 authorizes the EPA's Inspector General to have access to all records, reports, documents, papers or other materials that are available to the Administrator. The Office of Inspector General intends to perform selective audits on the efficiency, effectiveness, and compliance with DWSRF program regulations, and will require access to the records of State agencies and loan recipients in the course of these audits.

VI.A.2.3) Do the requirements of the Single Audit Act apply to the Fund? (II)

A: Yes. However, EPA is concerned that audits performed under the Single Audit Act may not provide adequate financial detail on a program that has a significant level of authorized funding. EPA is encouraging States to enter into voluntary agreements to conduct an annual independent audit of all program funds. Those States that do not undertake a more comprehensive audit will be periodically audited by the EPA Office of the Inspector General.

VI.A.2.4) Are funds used for set-aside activities subject to requirements of the Single Audit Act? (II)

A: Yes. As part of the DWSRF program, monies expended for set-aside activities are covered by the Single Audit Act. However, as with the Fund, EPA encourages States to conduct annual independent audits of set-aside funds.

### **3. Information Management System**

#### **B. EPA Responsibilities**

##### **1. Annual Review of DWSRF Program**

VI.B.1.1) How long into the future will EPA review requirements apply?

A: Some review requirement will continue as long as the DWSRF is in operation. The level of review beyond the period covered by capitalization grants has not yet been determined.

VI.B.1.2) What is the EPA Headquarters role in the Annual Review?

A: The conduct of Annual Reviews is a Regional Office responsibility. Headquarters will oversee Regional Office implementation of DWSRF activities.

VI.B.1.3) Can there be a review of a State's DWSRF program operations during the year?

A: Yes. EPA plans to conduct reviews of State performance through the review of the Biennial Report, and through conduct of the Annual Review and audit process. However, if significant issues arise during the course of the year (e.g., allegation of waste, fraud, abuse, or major problems with the operation of the DWSRF program), EPA will conduct necessary reviews or audits.

VI.B.1.4) Will EPA get involved in review of project specific issues?

A: EPA may review project specific issues as part of its Annual Review of the State program. In its Annual Review, EPA will examine the management and operations of the DWSRF as identified in the State's Biennial Report and IUPs. To determine the adequacy of a State's technical reviews of designated equivalency projects, EPA may review certain documents of selected projects as provided in the Operating Agreement. The purpose of this sampling would not be to review the judgment of the State with regard to specific project-level decisions, but to evaluate whether the State review was effective and consistent with its procedures. The State has lead responsibility for resolving project specific issues. If questions of waste, fraud or abuse arise, however, EPA may require project level review in some cases. In conducting its audits, the Office of Inspector General may find it necessary to review recipient records. In addition, in some cases, at the request of the State or another Federal agency, EPA may participate in the review or resolution of some issues related to compliance with cross-cutting Federal authorities.

## **2. Evaluation**

## **3. Compliance Assurance**

VI.B.3.1) Can the award of a capitalization grant be "held up" pending review of a previous grant's Biennial Report or Annual Audit?

A: Yes. However, if the RA is satisfied with the State's conduct of its DWSRF program at the time of application for a subsequent year's capitalization grant, the subsequent year's capitalization grant can be awarded prior to the completion of the Annual Review and Annual Audit.

#### **4. Dispute Resolution**

### **VII. APPENDICES**

- A. Federal Cross-Cutters**
- B. Criteria for evaluating a State's proposed NEPA-like process**
- C. Definitions**