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Thursday  
November 5, 1998

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**Part II**

**Environmental  
Protection Agency**

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Final Guidelines for Implementation of  
the Drinking Water State Revolving Fund  
Program; Notice

**ENVIRONMENTAL PROTECTION  
AGENCY**

[FRL-6154-7]

**Final Guidelines for Implementation of  
the Drinking Water State Revolving  
Fund Program**

ACTION: Notice.

**SUMMARY:** The Environmental Protection Agency (EPA) has published the Final Guidelines for the Drinking Water State Revolving Fund (DWSRF) program. The DWSRF program was established by the Safe Drinking Water Act (SDWA) Amendments of 1996, which were signed by President Clinton on August 6, 1996. The SDWA authorizes \$9.6 billion for the DWSRF program and related programs under section 1452 from fiscal year 1994 through fiscal year 2003. For fiscal year 1997, EPA's budget includes \$1.275 billion for these programs. On a national level, the Office of Water is responsible for implementing the SDWA requirements, including the DWSRF program and related programs under section 1452. The document is being published today for the benefit and interest of the general public.

**DATES:** The Final Guidelines were distributed to all State agencies with responsibility for the DWSRF program on February 28, 1997.

**ADDRESSES:** Copies of the Final Guidelines for implementation of the DWSRF program are available from the Safe Drinking Water Act Hotline, telephone (800) 426-4791. Copies are also available from the Office of Water Resource Center (RC4100), U.S. EPA, 401 M Street, SW, Washington, DC 20460. The DWSRF Guidelines may also be obtained from the EPA Web Site at the URL address <http://www.epa.gov/OGWDW>.

**FOR FURTHER INFORMATION CONTACT:** The Safe Drinking Water Act Hotline, telephone (800) 426-4791. For technical inquiries, contact James Bourne, Drinking Water Implementation and Assistance Division, Office of Ground Water and Drinking Water, U.S. EPA, (4606), 401 M Street SW, Washington, DC 20460, telephone (202) 260-5557.

**SUPPLEMENTARY INFORMATION:** The Drinking Water State Revolving Fund (DWSRF) program was established as a new section 1452 of the Safe Drinking Water Act (SDWA), 33 U.S.C. 300j-12, by the SDWA Amendments of 1996, Pub. L. 104-182, which were signed by President Clinton on August 6, 1996. The DWSRF is a State loan program, to be capitalized in large part by Federal contributions. Loans from the DWSRF

must be made to protect public health and to achieve or maintain SDWA compliance. States have the flexibility to tailor DWSRF programs to address local needs as long as the programs meet the minimum Federal requirements in the law. States must describe how their programs will prioritize use of DWSRF funds and are required to develop a priority list of projects, subject to public review.

The SDWA amendments establish a strong emphasis on preventing contamination through source water protection and enhanced water system management. The amendments also emphasize the needs of small water systems. States may use portions of their DWSRF capitalization grants for programs that work toward attaining some of these goals and are required to reserve portions of their DWSRF loan funds for small water systems.

Interim guidance for the DWSRF program was released on October 4, 1996, to allow States to develop DWSRF programs so that capitalization grants could be awarded as soon as possible. A notice of availability of the interim guidance was published in the **Federal Register** on October 27, 1996, and announced a public comment period which ended on November 28, 1996. EPA subsequently held a series of public meetings with stakeholders to provide information about the program and to review the interim guidance. Comments received during the period of public comment and from attendees of public meetings were critical in developing the Final Guidelines for the program. After discussions with the Office of Management and Budget, the Final Guidelines for the program were released on February 28, 1997 and made widely available, including to all States, which are the recipients of capitalization grants under section 1452. The Guidelines were also made available to the general public at that time by placement on the Office of Ground Water and Drinking Water internet site. The Agency is publishing these guidelines for the benefit and interest of the public at large.

**Paperwork Reduction Act**

The information requirements for these Guidelines were submitted to the Office of Management and Budget (OMB) on March 14, 1997. OMB granted an emergency request for collecting information from State grant recipients on January 29, 1997 to allow for award of grants following release of the Final Guidelines. OMB approved the final requirements for collecting information from State grant recipients on June 30, 1997 and assigned OMB control number

2040-0185. The Information Collection Request is valid for a three year period. The estimated annual burden for EPA Headquarters and Regional review of applications, oversight of State programs and review of audits is 722 hours per State. The estimated annual burden per State for completing required capitalization grant applications, biennial reports and state audits is 3285 hours and the estimated annual burden for applicants to prepare applications for DWSRF assistance is 80 hours per community.

Dated: October 28, 1998.

**Cynthia C. Dougherty,**

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### Acknowledgements

We wish to thank the many individuals who contributed to development of the Drinking Water State Revolving Fund Program Guidelines. In particular, we thank those members of the DWSRF Guidance Advisory Group for their dedication and commitment in the development of the guidelines under a very tight time schedule. We also wish to thank those members of the public who contributed comments on the Interim Guidance.

### Introduction

The Safe Drinking Water Act (SDWA) Amendments of 1996 (Pub. L. 104-182) authorize a Drinking Water State Revolving Fund (DWSRF) to assist public water systems to finance the costs of infrastructure needed to achieve or maintain compliance with SDWA

requirements and to protect public health objectives of the Act. Section 1452 authorizes the Administrator of the U.S. Environmental Protection Agency (EPA) to award capitalization grants to States, which in turn can provide low cost loans and other types of assistance to eligible systems.

In addition to authorizing the infrastructure fund, the SDWA Amendments also establish a strong new emphasis on preventing contamination problems through source water protection and enhanced water systems management. That emphasis transforms the previous law from a largely after-the-fact regulatory oriented program into a statute that can provide for the sustainable use of water. Central to this emphasis is the development of State prevention programs, including source water protection, capacity development and operator certification. States may use a portion of their capitalization grants to fund these eligible activities. The success of these activities will act to safeguard the DWSRF funds that are provided for improving system compliance and public health protection and help determine whether the new law's potential as a preventive environmental statute is realized.

The DWSRF program will help ensure that the nation's drinking water supplies remain safe and affordable, that drinking water systems that receive funding will be properly operated and maintained, and that permanent institutions will exist in each State to provide financial support for drinking water needs for many years to come. Congress has placed particular emphasis on assisting smaller drinking water systems and those serving less affluent populations by providing greater funding flexibility for these systems under the DWSRF, to ensure that these systems have adequate technical, managerial, and financial resources to come into or maintain compliance and provide safe water.

Under the SDWA, a State may administer its DWSRF in combination with other State loan funds, including the wastewater SRF, hereafter known as the Clean Water State Revolving Fund (CWSRF). Beginning one year after a DWSRF program receives its first capitalization grant (Fund portion), a State may transfer up to a third of the amount of its subsequent DWSRF capitalization grant(s) to its CWSRF or an equivalent amount from its CWSRF capitalization grant to its DWSRF.

These two provisions linking the DWSRF and the CWSRF signal Congressional intent to implement and manage the two programs in a similar

manner. EPA also intends to administer the two programs in a consistent manner and to apply the principles developed for the existing CWSRF to the DWSRF program to the fullest extent possible. Like the CWSRF, the DWSRF is fundamentally a State program. Each State will have considerable flexibility to determine the design of its program and to direct funding toward its most pressing compliance and public health protection needs. Only minimal Federal requirements will be imposed.

This document provides a comprehensive description of the guidelines that will apply in the operation of the DWSRF program. In basic terms, the guidelines explain:

- What States must do to receive a DWSRF capitalization grant,
- What States may do with Federal capitalization grant funds,
- What States may do with funds the law intends for activities other than project construction (set-asides) and
- The roles of both the States and EPA in managing and administering the program.

The sources of these guidelines are the Statute itself, existing regulations and policies that apply in EPA grant programs, particularly those that apply in EPA general grant regulations (40 CFR part 31) and the CWSRF program, and the Administrator's authority to issue guidelines and regulations under SDWA. EPA will incorporate the guidelines by reference in each capitalization grant award as a grant condition. Where a specific statutory or regulatory provision is the basis for a requirement, that provision is cited. EPA will follow-up these guidelines with regulations.

The capitalization grants authorized under section 1452 for the DWSRF program are generally divided between two purposes: part of each capitalization grant is to be deposited into the DWSRF Fund for providing loans and other types of assistance for drinking water infrastructure projects; the other part is to be deposited into a set-aside account(s) for programs, projects and activities that do not receive assistance from the Fund. Throughout this document, the entire program authorized by section 1452 will be referred to as the DWSRF program, the loan account as the Fund and the account or accounts for other programs, projects and activities as the set-aside account.

### **I. Development of a Capitalization Grant Application/Agreement**

The capitalization grant agreement process begins when the State submits a capitalization grant application. A

capitalization grant cannot be awarded until after Federal funds have been appropriated for the DWSRF under section 1452 and then allotted by EPA. With its application, the State must also submit an Intended Use Plan (IUP), documentation on the institutional framework of its DWSRF program, and a proposed schedule for capitalization grant payments by the EPA.

In addition to the Fund, a State may use part of the capitalization grant to encourage the development of source water protection and State prevention programs and to enhance water systems management. All DWSRF funds will be awarded through the capitalization grant process. Before applying for a capitalization grant, a State must prepare an IUP that identifies how it intends to distribute the grant among the set-aside account(s) and the Fund and includes the list of projects expected to be funded.

A State may, however, prepare this IUP in two parts. The first part would present the State's overall framework for allocation of the grant among the set-asides and the Fund, but need not include the project priority list. The second part would be the IUP for the Fund only. This two-part process will allow a State to proceed with a partial capitalization grant application (e.g., a set-aside) before it completes all of the activities required to obtain a full capitalization grant.

The State must seek meaningful public review and comment on its funding decisions in the IUP. If a State applies for the project funds and set-aside funds separately, the State must seek public review on each separate component of the IUP.

In addition to identifying the distribution of funds, the capitalization grant application outlines the State's planned DWSRF program activities, provides assurances and specific proposals for meeting requirements of the SDWA and Federal general grant regulations, and serves as the basis for negotiations between the Regional Administrator (RA) and the State on the proposed payment schedule. The IUP and the payment schedule are then incorporated into the capitalization grant agreement, which also defines the State program and operating methods. Material in these documents that does not change from year-to-year may be incorporated by reference in subsequent grant agreements or in an operating agreement (OA), which remains in effect unless the RA and the State agree to amend it.

For DWSRF program grant applications, States must submit EPA's standard application for non-

construction grant assistance (EPA Form SF-424). States should submit grant applications no later than ninety days prior to the end of the period of funds availability. By so doing, EPA has adequate time to properly review the application and, as necessary, request additional information from the State. States that submit applications after this date run the risk of losing funds due to the provisions governing reallocation.

EPA Headquarters will concur on one State capitalization grant award in each Region and retains the flexibility to review additional capitalization grant applications. Headquarters may also review applications of States with more complex funding programs (e.g. leveraging). EPA Headquarters will work with the Regions to determine which State(s) will be reviewed.

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

The State must provide assurances in the capitalization grant application on how it will comply with the fifteen specifications discussed below for all DWSRF program funding (some apply only to the Fund). In some cases, the State must simply agree or certify in the grant application that it will comply with the specifications. In other cases, documentation on the procedures by which the State plans to ensure compliance with the specifications must be furnished. The State must include this documentation with its capitalization grant application or the Operating Agreement (OA) (see Table 1).

##### **1. Assurance That the State Has the Authority To Establish a Fund and To Operate the DWSRF Program In Accordance With the SDWA**

The State must establish a Fund and comply with section 1452 before it can receive a capitalization grant award (section 1452(a)(1)(B)).

With each capitalization grant application, the State's Attorney General (AG), or someone designated by the AG, must sign or concur in a certification that the authority establishing the DWSRF program and the powers it confers are consistent with State law and that the State may legally bind itself to the terms of the capitalization grant agreement. The AG must also provide written assurance that the DWSRF program will be administered by an instrumentality of the State that is authorized to (1) enter into capitalization grant agreements with the EPA, (2) accept capitalization grant awards made under section 1452(a)(1)(A) of the SDWA and (3) otherwise manage the Fund in

accordance with the requirements and the objectives of the SDWA.

Documentation supporting the AG's certification, such as copies of statutes, executive orders, or administrative orders, must be furnished with the application or reference must be made to documentation submitted with previous DWSRF capitalization grant applications. Where waiting for this certification would significantly delay awarding the first capitalization grant, the head or chief legal officer of the State agency primarily responsible for administering the DWSRF program may sign or concur in the certification at the time of the grant award. In this case the capitalization grant agreement will contain the condition requiring the State to submit the AG's or designee's concurrence within 120 days of the grant award. If the AG opinion is not received within the 120-day period, EPA will not process further payments until the certification is received.

If more than one State Agency is involved in the DWSRF program, the roles and responsibilities of each agency must be described in the application, and a copy of any Memoranda of Understanding or interagency agreement(s) that describes the roles and responsibilities between agencies, must be included with the application. However, the agency that is awarded the capitalization grant must remain accountable for the use of the funds provided in the grant agreement under EPA's general grant regulations (40 CFR 31.3).

A State may (as a convenience and to avoid unnecessary administrative costs) combine, in accordance with State law, the financial administration of the Fund with the financial administration of any other revolving fund established by the State if otherwise not prohibited by the law under which the Fund was established and if the State certifies that:

(A) All monies in the Fund, including capitalization grants, State match, bond proceeds, loan repayments and interest, must be separately accounted for and used solely for the purposes specified in section 1452(a); and

(B) The authority to establish assistance priorities and carry out oversight and related activities (other than financial administration) with respect to assistance remains with the State agency having primary responsibility for administration of the State's public water supply supervision program (primacy agency), after consultation with other appropriate State agencies (section 1452(g)(1)).

If a State is eligible to receive a capitalization grant but does not have primacy, the Governor shall determine

which State agency will have the authority to establish priorities for financial assistance from the State loan fund (section 1452(g)(1)(B)). Evidence of the Governor's determination must be furnished with the application.

#### 2. Assurance That the State Will Comply With State Statutes and Regulations

The State must agree to comply with all State statutes and regulations that are applicable to DWSRF funds, including Federal capitalization grant funds, State match, interest earnings, bond proceeds and repayments, and funds used for set-aside account activities.

#### 3. Assurance That the State Has the Technical Capability To Operate the Program

The State must provide documentation demonstrating that it has adequate personnel and resources to establish and manage the DWSRF program (for example, current and future staffing plan, background/qualifications statements, schedule for planned training).

#### 4. Assurance That the State Will Accept Capitalization Grant Funds in Accordance With a Payment Schedule

The State must agree to accept Federal grant payments in accordance with the negotiated payment schedule and use those payments for the activities of the DWSRF program under section 1452. As part of its capitalization grant application, the State must submit a proposed schedule of grant payments that is consistent with its proposed binding commitments outlined in its IUP, and its plan for expending set-aside funds. The payment schedule will become part of the capitalization grant agreement. The State will receive Federal funds in accordance with the provisions of the EPA-Automated Clearing House (formerly known as Letter-of-Credit). (See V.C. below)

#### 5. Assurance That the State Will Deposit All Capitalization Grant Funds in the Fund or Set-Aside Account

The State must agree to deposit the capitalization grant in the Fund except for those portions of the grant that the State intends to use for set-aside purposes authorized under the SDWA (section 1452(a)(1)(B)). The State must maintain an identifiable and separate account(s) for the portion, or portions, of the capitalization grant to be used for set-aside activities (see II.B.3. below).

Once funds are deposited into the Fund, such monies may be used only as authorized under section 1452(f). Under some circumstances, funds may be

moved after the award of the capitalization grant among authorized activities (see II.B).

#### 6. Assurance That the State Will Provide an Amount at Least Equal to 20 Percent of the Capitalization Grant (State Match) in the Fund

The State must agree to provide an amount into the Fund equaling at least 20 percent of the amount of each capitalization grant. Except for Federal payments made from Fiscal Year (FY) 1997 appropriations, the State match must be deposited into the Fund on or before the date that each Federal capitalization grant payment is made to the State (section 1452(e)). States have until September 30, 1999 to provide the State match for grant payments already received from FY 1997 appropriations. (See V.A. for additional details.)

The State may provide its match in a form that is similar to the form of the Federal payment. For example, the Federal payment is made in the form of an increase to the level of funds available to the State through the Automated Clearing House (ACH). The State may establish a similar mechanism to provide its match.

#### 7. Assurance That the State Will Deposit Net Bond Proceeds, Interest Earnings, and Repayments Into the Fund

The State must agree to credit net bond proceeds, interest earnings and repayments into the Fund. Fund assets may be used as a source of revenue or security for bonds, as long as the net proceeds of the sale of bonds will be deposited into the Fund (section 1452(f)(4)).

Loans for land acquisition and source water protection, made pursuant to section 1452(k)(1)(A) must be repaid. A State may deposit these repayments, including principal and interest, in the Fund, or the State may choose to deposit the repayments into a separate account dedicated to 1452(k)(1) activities. This separate account is subject to the same management oversight requirements as the Fund.

#### 8. Assurance That the State Will Match Capitalization Grant Funds the State Uses for 1452(g)(2) Set-Asides

The State may use up to 10% of its capitalization grant for 1452(g)(2) activities. The State must match use of these funds with an equivalent amount of state expenditures or provide documentation of in-kind services. A State cannot use any of the 20% match required under section 1452(e) to also match the 10% set-aside.

#### 9. Assurance That the State Will Use Generally Accepted Accounting Principles

The State must agree to establish fiscal controls and accounting systems, according to Generally Accepted Accounting Principles (GAAP) as promulgated by the Governmental Accounting Standards Board, that are sufficient to account for and report DWSRF Program activities. The accounting system used for the DWSRF Program must allow for proper measurement of (1) revenues earned by the DWSRF Program and other receipts, including, but not limited to, loan repayments, capitalization grants, interest earnings, State match deposits and bond proceeds; (2) expenses incurred by the DWSRF Program and other disbursements, including but not limited to, loan disbursements, repayment of DWSRF bonds, and other expenditures allowed under section 1452; (3) the assets, liabilities and capital contributions in the DWSRF Program; (4) the maintenance of the corpus of the Federal and State capital contributions made to the DWSRF Program; and (5) the DWSRF's performance in relation to its short- and long-term goals as identified in the previous IUP.

#### 10. Assurance That the State Will Have the Fund and Set-Aside Account Audited Annually in Accordance With Generally Accepted Government Auditing Standards

The State must agree to conduct an annual audit (with separate opinion for project funds) on the Fund and set-aside account activities funded in the DWSRF program. The contents of the annual audit are discussed in more detail under Part VI of these guidelines.

The State DWSRF program shall provide an audit on an annual basis. Such audits shall be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States.

The Administrator is relying on the annual audit of the DWSRF program to minimize the risk of waste, fraud and abuse and increase the chance that such occurrences will be detected and reported. As called for under GAGAS, audits should be designed to provide reasonable assurance of detecting material misstatements resulting from noncompliance with applicable laws, regulations, contracts and grant agreements and which have a direct and material effect on the determination of financial statement amounts and be developed in accordance with State

audit practices established in State law. If specific information comes to the auditor's attention that provides evidence concerning the existence of possible noncompliance, auditors should apply procedures specifically directed to ascertaining whether noncompliance has occurred.

#### 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)

The State must adopt policies and procedures to assure that borrowers have a dedicated source of revenue for the repayment of loans and must apply these policies and procedures to the portion of the loan that must be repaid. States must submit and receive EPA approval for the policies prior to the award of the first project loan. States must develop criteria to evaluate an applicant's financial ability to repay the loan, in addition to paying for operation and maintenance costs and other necessary expenses.

#### 12. Assurance That the State Will Commit and Expend Funds as Efficiently as Possible, and in an Expeditious and Timely Manner

The State must agree to commit and expend all funds allotted under Section 1452 "as efficiently as possible" (section 1452(g)(3)), and in a timely and expeditious manner. The State must enter into binding commitments with recipients of Fund assistance equal to the total amount of each grant payment and required State match deposited in the Fund within one year of the grant payment. States need to work with loan recipients to make sure that projects are funded and completed in a timely and expeditious manner. (See V.C.3. for additional details.)

#### 13. Assurance That funds Will Be Used in Accordance With the Intended Use Plan

The State must agree to expend DWSRF funds in accordance with an Intended Use Plan (section 1452(b)) that has undergone public review and comment. (See I.B. for additional details)

#### 14. Assurance That the State Will Provide EPA With a Biennial Report

The State must agree to complete and submit a Biennial Report on the uses of the DWSRF program. The scope of the report covers both the Fund and set-aside account activities. The contents of the Biennial Report are discussed in

more detail under Part VI of these guidelines.

States which jointly administer DWSRF and CWSRF programs, in accordance with section 1452(g)(1), may submit a report which covers both programs. If the State elects to prepare a joint report, it may either (1) submit a joint report in alternate years and an annual CWSRF report in the other years or (2) submit a joint report annually.

Even though the report covers both programs, financial information must be reported separately for each program. For example, the DWSRF and CWSRF should be reported in separate columns in audited balance sheets, income statements, and other financial statements.

#### 15. Assurance That the State Will Comply With All Federal Cross-Cutting Authorities

The State must agree to ensure that all applicable Federal cross-cutting authorities will be complied with. (See IV.A for additional details.)

#### B. Intended Use Plan

The central component of the capitalization grant application is an IUP (section 1452(b)), which describes how the State intends to use available DWSRF program funds for the year to meet the objectives of the SDWA and further the goal of protecting public health.

The State must prepare the IUP, and provide it to the public for review and comment prior to submitting it to the RA as part of its capitalization grant application. EPA expects that the public review and comment process that a State uses to discuss the IUP will be open and that it will provide the public with adequate opportunity to comment on how the State plans to use capitalization grant funds. States should also respond to substantial comments received. The State must include in the capitalization grant application a description of the public review process and how it responded to major comments and concerns.

For efficient planning and to maintain consistency in calculating set-asides, scheduling payments and other matters, each IUP must conform to the fiscal year adopted by the State for the DWSRF program (e.g., the State's fiscal year or the Federal fiscal year).

In the IUP, the State must describe how it will use all funds available to the capitalization grant, including funds that will be allocated to the set-asides. Specifically, the IUP must describe how all available funds, including capitalization grants, State match, loan repayments, interest earnings, bond

proceeds, and other monies deposited into the DWSRF program, are intended to be expended. States may, as an alternative, develop the IUP in a two part process, one part that identifies the distribution and uses of the funds among the various set-asides and the Fund and the other part dealing only with project funding in the Fund. The two-part process would allow a State to submit a capitalization grant application for a portion of the DWSRF program funds before they complete all of the specific funding decisions. In this situation, a State would have to conduct two rounds of public review and comment—one for the overall distribution of funds and specific details on particular set-aside uses and the other for the priority project list(s).

For example, assume that a State has decided to allocate 76% of its funds to the DWSRF Fund, 10% of its funds to the source water delineation set-aside, 4% for DWSRF administration, and 10% for the Public Water System Supervision (PWSS) program set-aside, but the State has not yet developed its project priority list(s). This State could seek public review and comment on the allocation of funds and submit a capitalization grant application for the 24% of funds that will be used for set-aside purposes. As with all grant applications, the State would have to include a detailed description of what the set-aside funds would be used for. The State would then, at a later date, develop the Fund component, including the project priority list, seek public review and comment on this list, and then submit an amendment to the capitalization grant application for the additional funds.

Because the Fund can only provide those types of assistance described in section 1452(f), funds that the State will use for set-aside activities must be placed in an account that is separate (outside) from the Fund account.

The State must prepare an IUP as long as the Fund account and/or set-aside account funds remain in operation, not just in those years in which the State submits an application for a Federal capitalization grant.

States must provide information regarding the IUP in a format and a manner that are consistent with the needs of the RA.

#### 1. Priority List of Projects, Including Description and Size of Community

In accordance with Section 1452(b), States must develop a list of projects that will receive funding in the first year after the grant award and a comprehensive priority list of eligible projects for funding in future years. In

determining the priority of funding, a States' "intended use plan shall provide, to the maximum extent practicable, that priority for the use of funds be given to projects that:

- i. Address the most serious risk to human health;
- ii. Are necessary to ensure compliance with the requirements of this Title [SDWA] (including requirements of filtration); and
- iii. Assist systems most in need, on a per household basis, according to State "affordability criteria" (section 1452(b)(3)).

Section 1452(a)(2) of the Act identifies eligible projects as those projects "which the Administrator has determined, through guidelines, will facilitate compliance with national primary drinking water regulations\* \* \* or otherwise significantly further the health protection objectives of this title."

Taken together, these two sections clearly signal Congressional intent that States *must give maximum priority* to projects needed for SDWA compliance, projects that provide the greatest protection to public health, and those projects which assist systems most in need on a per household basis. States *must develop* a priority list that reflects this intent and fund projects in this order, to the maximum extent practicable. The priority system must provide sufficient detail to permit the public and EPA to readily understand how the system has been established and the basis for ranking individual systems. A State that does not adhere to the above stated criteria must detail why they were unable to do so.

This is clearly different from the provisions in the CWSRF under which States can fund any project on the priority list regardless of its position on the list. To comply with this Congressional directive, EPA will annually review a States actions to see how closely the State adheres to the priority list.

Although "readiness to proceed" is not an appropriate factor in ranking projects based on their compliance and public health needs, EPA does recognize that States will need to consider this when deciding which projects to fund. This will be especially critical in the first two years, because many highly-ranked projects may not be ready to apply for assistance. Consequently, EPA will approve priority systems that take readiness to proceed into account only for the first two fiscal years.

The IUP list of projects to receive funding (project priority list) must include the name of the public water system, the priority assigned to the

project, and a description of the project (including the type of 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 IUP priority list must include the priority assigned to each project and, to the extent known, the expected funding schedule for each project (section 1452(b)(3)(B)). A State may combine these two lists into one list by identifying which projects on the single list will receive funding in that year.

The State must seek public review and comment on its IUP. The IUP project list may be amended during the year under provisions established in the IUP as long as the project has been previously identified through the public participation process. The IUP may also allow for the addition of projects on an emergency basis. Such projects would include those where some type of failure was unanticipated and requires immediate attention to protect public health.

A State may bypass a project on the priority project list if the State's bypass procedures have undergone public review and comment. These bypass procedures should clearly identify the conditions which would allow a project to be bypassed and the way the State will identify which projects would receive the bypassed funds. If a State elects to bypass a project for reasons other than fiscal capacity or readiness to proceed, the State must provide a justification for this bypass and, in each specific instance, describe why it was not practicable to fund projects that were ranked higher on the priority list than the funded project. In all such cases, the State must describe its efforts to adhere to the priority list, as required by the Act, "to the maximum extent practicable". States must work with bypassed projects to ensure that the project will be eligible for funding in the following fiscal year, to the maximum extent possible.

A State must annually use at least 15% of all funds credited to the Fund account to provide loan assistance to systems serving fewer than 10,000 persons (section 1452(a)(2)), to the extent that there are a sufficient number of eligible projects to fund. States must determine the amount to be used for this provision based on the level of available funds that the State expects to have for funding DWSRF projects during the period covered by the IUP. A State that does not use at least 15% of the available funds for small systems must describe in the next IUP the steps it is

taking to ensure that a sufficient number of projects are identified to meet this requirement in future years. States that exceed the prescribed percentage of assistance to these systems in one year may bank the excess toward future years.

## 2. Description of Criteria and Method Used for Distribution of Funds

The IUP must describe the criteria and method that the State will use to distribute all funds. This description shall include: (1) The process and rationale for distribution of funds between the Fund and the set-aside account, (2) the process for selection of systems to receive assistance, (3) the priority and allocation of assistance the State gives to different eligible categories of projects, (4) the rationale for providing different types of assistance and terms (e.g., length of repayment, interest rate), including a description of the financial planning process undertaken by the Fund, and (5) the impact of all funding decisions (e.g., set-aside, disadvantaged communities) on the long term financial health of the Fund.

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

The IUP must include a description of the financial status of the DWSRF Program. This description should detail: The total dollar amount in the Fund; the total dollar amount used as set-asides, including the level of funds banked; the types of projects to be funded; and the amount of the capitalization grants that will be used for disadvantaged community assistance. The IUP should include factors such as expected estimated loan demand, whether the State will leverage, and other factors that determine the short-term and long-term focus and health of the program.

## 4. Description of the short- and long-term goals of the DWSRF Program

The IUP must describe the short term goals of the DWSRF program, including how the capitalization grant funds will be utilized to ensure compliance and protect public health goals of the Act.

The IUP must also describe the objectives of the DWSRF program over the long-term, and how these objectives can be realized. These objectives include public health, compliance with the Act, assisting systems to ensure affordable water and maintaining the long-term viability of the Fund. The IUP should include a description of how the DWSRF program funds will be used to support other components of the State drinking water and ground water programs, including water system

restructuring, capacity building, operator certification, source water protection, and wellhead protection.

## 5. Description of amounts transferred between the DWSRF and the CWSRF

The Governor of a State may transfer up to 33% of the DWSRF capitalization grant to the CWSRF or an equivalent amount from the CWSRF to the Fund, starting a year after the State has received its first DWSRF capitalization grant (project funds), but no later than the beginning of FY 2002 (section 302 of Pub. L. 104-182). EPA will provide additional guidelines concerning these fund transfers at a later date.

## 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.

The IUP must identify what portion of the capitalization grant a State is electing to use for set-aside activities (e.g., section 1452(g)(2), section 1452(k)), and place those funds in a set-aside account. The set-aside account must be dedicated to supporting the other activities authorized in section 1452. The IUP must describe how the funds in the separate account(s) will be used and provide a schedule for their expected use. A State must describe how it intends to use the funds and the expected accomplishments that will result from use of the funds for a given purpose. For project set-aside funds, the State must describe, at a minimum, the process by which projects will be selected and how the funds will be distributed.

Recipients of 1452(k) land acquisition or source water protection loans are required to repay the loans in the same manner as loans from the Fund. The State may place the repayments in the Fund or it may set up a separate account to continue funding eligible 1452(k) loan activities. Subsequent loans from this separate account must meet the same requirements as loans from the Fund.

## 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

A State may provide additional loan subsidies, including forgiveness of principal, to disadvantaged communities receiving Fund loans (section 1452(d)). If the State establishes a disadvantaged community program it must describe in the IUP how the program will operate. Using the best

information available at the time of the IUP, this description must include: (1) A definition of disadvantaged community, (2) the total amount of the capitalization grant that may be used for providing additional subsidies, (3) to the maximum extent practicable, an identification of systems that will receive additional subsidies and the amount and (4) a description of affordability criteria that the State will use to determine the level of principal forgiveness.

The value of loan subsidies a Fund provides during the fiscal year adopted by the IUP under this provision cannot exceed 30 percent of the amount of the capitalization grant for that year (1452(d)(2)). Loan subsidies under this provision cannot be banked for future use.

## C. Capitalization Grant Agreement

The Capitalization Grant Agreement (CGA) is the principal instrument by which the State commits to manage its DWSRF program, and to ensure that it conforms with the requirements of the SDWA Amendments of 1996. The CGA contains, or incorporates by reference, the following parts of the agreement: the application; the IUP; the agreed upon payment schedule; certifications or other agreement requirements discussed in the first section; the operating agreement, if used, and other documentation required by the RA. In addition to these requirements, the CGA must also define the types of performance measures, reporting requirements, and oversight responsibilities that will be required to determine compliance with section 1452. Agreement is also needed on the contents of the Biennial Report, annual audit, and the EPA review. Table 1 describes how each of the following assurances and CGA requirements must be addressed.

The capitalization grant agreement must also describe the process a State will use to ensure that systems have the technical, financial, and management capacity to operate the system before receiving a loan. If a system in non-compliance is going to receive a loan, the State must describe how the system has changed or will change its operation over the long-term.

A State may also place into a separate, non-project administration account, loan application fees or other program fees or assessments that a DWSRF program collects from loan recipients to help offset the cost of running the DWSRF program. Because these fees and assessments would be considered program income under the Agency's general grant regulations (40 CFR 31.25),



the grant agreement must specify that they will be used for purposes directly related to the DWSRF program, that they will not be made available for other purposes and that they will be properly accounted for in the annual audit. The IUP must identify the amount of any fees that are placed in the non-project administration account and describe how they are used.

#### *D. Operating Agreement*

The framework and procedures of the DWSRF program that are not expected to change annually may be described in an Operating Agreement (OA) that can be included as part of the Capitalization Grant Agreement. The grant application and subsequent grant agreement may incorporate by reference relevant portions of the previous year's application. If there are proposed changes to the OA, the State will need to negotiate changes with the Region that may be necessary prior to submitting the next capitalization grant application.

The decision to prepare an OA does not entail additional program requirements, demonstrations or documentation. The OA simply describes the structure of the State's program, explains its goals and objectives, and includes review, overview, accounting, auditing and sanction provisions. Upon the successful completion of negotiations, the OA must be signed by the State signatory to the CGA and the Regional Administrator. On an annual basis, the OA must be supplemented with an Intended Use Plan that identifies the projects and activities that the State plans to support with financial assistance from the fund. Based on the OA and the Intended Use Plan, the Region will award a capitalization grant to the State. Regions and States that choose this alternative method of program implementation may find that it facilitates their program management capability.

## **II. Allotment/Use of Funds**

Section 1452(m) authorizes a total of \$9.6 billion for the DWSRF program from FY 1994 through FY 2003. This section describes allotment, reallocation, and withholding of these funds; national and State set-asides; and types of financial assistance available from the Fund.

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

#### 1. Allotment Formula

Funds available to States from FY 1997 appropriations will be allotted

according to the formula used for distributing Public Water System Supervision (PWSS) grants under section 1443 in FY 1995. Funds available to States from FY 1998 appropriations and beyond will be allotted according to a formula that reflects the needs identified in the most recent Needs Survey conducted pursuant to section 1452(h). In each case, the minimum proportional share established in the formula that each State will receive will be one percent of the funds available for allotment to all the States. The District of Columbia will also receive a one-percent share of available funds (section 1452(a)(1)(D)). The Virgin Islands and the Pacific Island territories will together receive an allotment of 0.33 percent (section 1452(j)).

#### 2. Period of Availability and Reallocation

Funds are available to the States during the fiscal year in which they are authorized and during the following fiscal year (section 1452(a)(1)(C)). The amount of any allotment not obligated to the State at the end of this period of availability will be reallocated among other States according to the original formula used to allot these funds (FY 1997 funds: PWSS formula; FY 1998 funds and beyond: appropriate Needs Survey). Any State that has not obligated all of the funds allotted to it in the period of availability shall not be eligible to participate in the reallocation of funds for that particular fiscal year. The Administrator may reserve up to 10 percent of the funds available for reallocation to provide additional assistance to Indian tribes (section 1452(a)(1)(E)).

#### 3. Withholding of Funds

a. The Administrator will withhold funds under the following provisions:

i. Capacity Development Authority—The Administrator will withhold 20 percent of a State's allotment unless the State has obtained the legal authority or other means to ensure that all new community water systems and new nontransient, noncommunity water systems commencing operation after October 1, 1999, demonstrate technical, managerial, and financial capacity with respect to each drinking water regulation in effect. This withholding provision becomes effective in FY 1999, which begins October 1, 1998. For any capitalization grant applications awarded after October 1, 1998, but before October 1, 1999 (FY 1999 funds), EPA will not obligate 20 percent of capitalization grant funds allotted to a State that does not have adequate

authority in place. If a State documents by September 30, 1999, that the authority is in place to ensure that new systems demonstrate adequate capacity, then EPA will award the unobligated FY 1999 funds. If a State does not have the authority in place by September 30, 1999, it will lose the 20 percent of FY 1999 funds that were not awarded originally. EPA will withhold 20 percent of each successive capitalization grant allotted to a State and the withheld funds will be reallocated. The withholding provision will cease to apply to federal funds appropriated starting the next fiscal year after a State obtains the required authority.

ii. Capacity Development Strategy—The Administrator will withhold funds from any States that are not developing and implementing a strategy to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity. The amount of a State's allotment under section 1452 that will be withheld on October 1 of each fiscal year is 10 percent of FY 2001 allotments, 15 percent of FY 2002 allotments, and 20 percent of each subsequent year's allotments. The determination of when the State meets the requirement will occur on October 1 of each year. States not meeting the requirement for that fiscal year's federal appropriation will lose funds to reallocation regardless of when the State submits the capitalization grant application. Funds will no longer be withheld once a State develops and implements its capacity development strategy. The withholding provision will cease to apply to federal funds appropriated starting the next fiscal year after a State obtains the required authority. EPA plans to issue separate guidelines for States to use in developing these strategies.

The total amount of funding that will be withheld if a State fails to meet the requirements of both of the capacity development provisions is 20 percent of the capitalization grant (section 1452(a)(1)(G)(i)).

iii. Operator Certification Program—The Administrator will withhold 20 percent of a State's funds unless the State has adopted and is implementing a program for certifying operators of community and nontransient, noncommunity public water systems. This withholding provision will begin two years after the Administrator publishes guidelines for certification of operators. The Administrator is required to publish guidelines no later than February 6, 1999. The withholding provision will cease to apply to federal funds appropriated the next fiscal year after a

State complies with the requirement (section 1452(a)(1)(G)(ii)).

**b. Reallotment of withheld funds.**

All funds withheld from a State because the State does not have the capacity development authority, does not develop and implement a capacity development strategy, and/or does not develop and implement an operator certification program, will be reallotted, using the same formula that was originally used to allot those funds. A State that has funds withheld for any one of these three activities is not eligible to receive reallotted funds for that activity. Thus, if a State does not develop an operator certification program but does have a capacity development strategy, the State would be eligible to receive a reallotment from withheld funds from States without capacity development programs but would not be eligible for reallotted funds under the operator certification provision. A State would also have to be eligible to receive reallotted funds in accordance with the reallotment provisions in section 1452(a)(1)(E) prior to being eligible to receive reallotted funds under the specified withholding provisions. This section limits reallotment to those States that have obligated all of their allotment during the period of availability.

**c. Loss of primacy.**

A State may not receive capitalization grant funds if the State had primary enforcement authority (primacy) for drinking water pursuant to section 1443 (section 1452(a)(1)(F)) on the date of enactment of the Safe Drinking Water Amendments of 1996 (August 6, 1996) and the State subsequently loses primacy. A State would not be eligible for future capitalization grants until primacy is restored. Wyoming and the District of Columbia did not have primacy prior to August 6, 1996. However, the law provides that they are eligible to receive DWSRF funds. The Administrator may reserve funds from the allotment of a State that loses primacy for use by EPA to administer primary enforcement responsibilities in that State. The balance of the funds not used by EPA to administer primacy will be reallotted to other States pursuant to section 1452(a)(1)(E).

**B. Set-asides From the National Appropriation and Ceilings on State Allotments**

Section 1452 authorizes numerous national set-sides from the appropriation for that section and allows States to use certain percentages of their allotment for various purposes other than project construction. Table 2 provides an overview of the available

set-asides. Table 3 presents a flow chart for calculating these set-asides and Table 4 gives a numerical example of the set-asides. States need to determine the level of funds necessary to evaluate short-term program needs to protect public health and prevent contamination versus the long-term need to maintain an adequate level of infrastructure to address system needs over the long-term.

**1. National Set-Asides**

The National set-asides are reserved from the funds annually appropriated by Congress to carry out section 1452. These set-asides are:

**a. Indian Tribes/Alaska Native Villages.** The Administrator may reserve (the Administrator will provide these funds) 1.5% from annually appropriated funds for grants to Indian Tribes and Alaska Native Villages (section 1452(i)). EPA will provide separate guidelines regarding the selection of projects, project management, and program oversight for these grants. Indian Tribes and Alaska Native Villages that have not otherwise received either grants or DWSRF assistance under 1452 for a specific project are eligible to receive grants under this provision.

**b. Health effects studies.** Section 1452 requires the Administrator to reserve \$10 million from annually appropriated funds to conduct health effects studies on drinking water contaminants (section 1452(n)).

**c. Unregulated contaminant monitoring.** Starting in FY 1998, section 1452 requires the Administrator to reserve \$2 million from annually appropriated funds (section 1452(o)) to pay for the costs of monitoring unregulated contaminants under section 1445(a)(2)(C).

**d. Small system technical assistance.** The Administrator may reserve up to 2% of the funds annually appropriated in FYs 1997–2003 to carry out the technical assistance provisions of section 1442(e) to the extent that the total amount of funding appropriated under section 1442 is not sufficient. The set-aside from section 1452(q) plus the appropriation in 1442(e) cannot exceed \$15 million per year (section 1452(q)).

**e. Operator training reimbursement.** The Administrator will reimburse States for the costs of training and certifying operators of drinking water systems serving 3,300 persons or fewer to meet the requirements of guidelines that the Administrator must publish by February 6, 1999 (section 1419(a) and (d)). The Congress has authorized to be appropriated \$30 million annually from FY 1997 through FY 2003 for these reimbursement costs (section

1419(d)(3)). If the appropriation is not sufficient to meet these requirements, the Administrator, prior to allocating funds to the States, shall reserve such sums from 1452(m) as are necessary to provide grants to States. Funds under this provision are set-aside prior to the allotment of funds to the States, and will be provided as a separate grant.

**2. Allotment for D.C. and Other Jurisdictions**

The Administrator shall reserve one percent of the funds allotted to the States for the District of Columbia. The administrator shall also reserve up to 0.33% of the total funds allotted to the States for grants to the Virgin Islands, the Commonwealth of the Northern Mariana Islands, American Samoa, and Guam (section 1452(j)). The funds will be allotted according to the formula for allotting PWSS grants under section 1443(a)(4), and may be used to fund projects eligible for assistance under section 1452(a)(2). EPA will provide separate guidelines regarding the management of these set-asides.

**3. State Set-aside Activities**

Section 1452 authorizes States to provide funding for certain set-aside activities, described below, provided that the amount of that funding does not exceed ceilings specified in the Statute. A State must describe in the IUP the amount of funds that it will use for these activities. A set-aside account must be set up to accept these funds. Before cash can be drawn down from the federal ACH, a State must provide a workplan to EPA describing how the funds will be expended.

When set-asides are used to fund program (non-project) activities, the State and EPA must negotiate a workplan indicating how funds will be spent. No cash draws will be authorized from the federal ACH until the workplan(s) have been approved by EPA. While EPA reserves the right to require additional information from the States, the workplan should at a minimum include:

- The funding amount in dollars and as a percentage of the State DWSRF allocation;
- The number of FTEs projected 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;
- The responsibilities of the agencies involved in implementing each set-aside;
- A description of the evaluation process to assess the success of work funded under each set-aside.

If a State does not expend all of its set-aside funds, a State may redirect the monies to the Fund, or it may redirect the funds to another set-aside activity as long as the maximum allowed for that activity has not been reached for the Fiscal Year from which the funds were derived. Set-aside funds may not be used to subsidize water system operation and maintenance expenses or for project activities eligible for funding from the Fund or those projects specifically not eligible for assistance from the Fund.

*a. DWSRF administrative expenses.* A State may use up to four percent of the funds allotted to it for the reasonable costs of administering the programs under section 1452 and providing technical assistance (section 1452(g)(2)). These costs may include such activities as issuing debt; DWSRF program start-up costs; audit costs; financial, management and legal consulting fees; development of IUP and priority ranking system; development of affordability criteria; and cost of support services provided by other State agencies.

Expenses incurred issuing bonds guaranteed by the Fund may be absorbed by the proceeds of the bonds and need not be charged against the four percent administrative costs allowance, if done so prior to depositing the proceeds into the Fund. The net proceeds of those issues must be deposited in the Fund.

Funds that a State chooses to use for administrative purposes cannot be deposited into the Fund. Instead, these funds must be deposited into a separate account, or with other non-project funds.

The State may charge an application fee to process, manage or review an application for Fund assistance. Such fees may be collected in an account outside the Fund and used to supplement administrative expenses. Monies in this non-project fee account must be dedicated to the administrative purposes associated with the DWSRF program. If fees are collected and deposited into the Fund account, they are subject to the stipulated uses of the Fund, which does not include the use of funds for administrative purposes.

States may recover reasonable costs associated with the development of the DWSRF program, if the costs were incurred between August 6, 1996, the date of enactment of the SDWA Amendments of 1996, and the date on which the first capitalization grant for a State was awarded. Documented reimbursement costs will be counted as part of the amount, up to four percent,

that a State can set aside for administrative purposes.

If the State does not obligate the entire four percent for administrative costs in one year, it can bank the excess balance and use it for administrative costs in later years.

*b. State program management.* A State may use up to a total of 10 percent of its allotment to:

- Administer the State PWSS program;
- Administer or provide technical assistance through source water protection programs, which includes the Class V portion of the Underground Injection Control Program;
- Develop and implement a capacity development strategy; and
- Develop and implement an operator certification program (section 1452(g)(2)).

The State must provide a dollar for dollar match (100 percent for up to 10 percent of the capitalization grant) for capitalization grant funds used for these purposes. This match is separate, and in addition to, the 20 percent match for the capitalization grant. At least one-half of the State match funds provided by the State must be in addition to the amount the State expended for the PWSS program in FY 1993 (see example on following page). Federal grant regulations preclude a State from using the same State funds to meet match requirements for two different programs. Thus, the same State dollar cannot be used to meet this match requirement and the match requirement in section 1443 of the SDWA (PWSS program grants), except that the FY 1993 match for the PWSS can offset up to one-half of the match required under section 1452 (g).

Funds used to administer or provide technical assistance for source water protection programs *shall not* be used for enforcement actions. States may credit toward the one-to-one match State dollars used for the PWSS program that are in excess of the current fiscal year State match required in section 1443. States may also credit current year expenditures on capacity development and operator certification programs toward the State's required match.

If the State does not obligate the entire 10 percent for these activities in any one year, it can bank the excess balance and use it for the same activities in later years.

*c. Small systems technical assistance.* A State may use up to two percent of its allotment to provide technical assistance to public water systems serving 10,000 people or fewer (section 1452(g)(2)). If the State does not use the entire 2 percent for these activities

against a given allotment, it can bank the excess balance and use it for the same activities in later years. If a State chooses to use funds under this set-aside, EPA encourages States to use available funds to support small system efforts to apply for DWSRF loans. A State may use these funds to support a technical assistance team or to contract with outside organizations to provide technical assistance.

*d. Local assistance and other State programs.* A State may fund several other categories of activities to assist development and/or implementation of local drinking water protection initiatives (section 1452(k)). A State may use up to 15% of the capitalization grant amount for specified uses below, with the stipulation that not more than 10% of the capitalization grant amount can be used for any one activity. A State is not allowed to bank any of these funds for use in future years, with the exception of the funds used for source water delineation and assessment.

Funds loaned out under this section (i and ii) must be repaid in 20 years after completion of a project. States may place repayments in the project fund or set up a new, separate dedicated account(s) for 1452(k)(1) activities. Assistance from this separate account(s) may continue to be used for any eligible 1452(k)(1) activity.

**State Program Management Match Example**

Assume a State will receive a \$10 million capitalization grant, and it would like to use 10% of the funds for this set-aside, which is \$1 million. The State must match it with \$1 million in State funds. According to the Statute, a State may receive credit for certain expenditures in FY 1993 and the current year being discussed, in lieu of having to match entirely with new appropriations. One important reminder is that at least one-half of the funds must be in addition to the amount expended by the State for the PWSS program in FY 1993.

	FY 1993	FY 1997
PWSS grant .....	\$900,000	\$1,200,000
State match for PWSS match	300,000	400,000
Additional State funds .....	200,000	300,000

*Determination of State Credit*

In lieu of providing funds for part or all of this match provision, many States may be able to credit current funds that a State is using for its PWSS program or other eligible funding. The Statute allows a State to use funds expended for

the PWSS program that are above and beyond the required PWSS State match, for both the current year (\$300,000 for FY 1997 in this example) and in FY 1993 (\$200,000 here). In addition, a State may credit the funds that the State is using for the State PWSS match portion in FY 1993 only (\$300,000). Thus, in this example, you first look at the \$300,000 from FY 1997, since the Statute requires that at least 50% of the total match come from the current year (FY 1997 in this example). The State could then potentially use up to \$500,000 (\$200,000 + \$300,000) from FY 1993. However, in this example, the State would be limited to the use of \$300,000 credit in FY 1993, due to the limitation of having only \$300,000 of credit available in FY 1997. Thus, the State could use a total of \$600,000 without providing new appropriations or other in-kind services. If the State wants to use the remaining \$400,000 (\$1 million less \$600,000 already matched) in eligible set-aside funds, the State would need to provide an additional \$200,000 or an equivalent amount of in-kind services. This additional \$200,000 in FY 1997 would allow the State to use the additional \$200,000 of unused credit from FY 1993. Thus, the State could take advantage of the full 10% set-aside with only a small amount of new funding or other in-kind contributions. In-kind services could include funds that the State currently expends on operator certification or capacity development programs. The State could also choose to simply use only \$600,000 if no additional funding could be secured.

#### Second Example

Using the above example, if the State provided no funding for the PWSS program above the \$400,000 State match in FY 1997, the allowable credit for FY 1997 would be zero. Thus, the State could not receive credit for FY 1993 allowable credits without providing State contributions in addition to the PWSS State match in FY 1997. This is due to the requirement that at least one-half of the funds be in addition to funding since 1993. For each new dollar the State provides, up to \$500,000, the State could match it with eligible credits from the FY 1993 expenditures described in the example above. Thus, in order to use the full \$1 million set-aside in this example, a State would have to provide \$500,000 in new funding or in-kind services.

#### Third Example

Again using the above example, if the State provides \$600,000 for the PWSS program above the State match

requirement in FY 1997 (versus \$300,000 as stated above), the State could use the \$600,000 from FY 1997 and use \$400,000 from FY 1993 as credit for the State match. In this example, the State would not have to provide any additional match in cash to take full advantage of this set-aside.

i. Assistance to a public water system to acquire land or a conservation easement for source water protection purposes:

A State may provide assistance, only in the form of a loan, to a public water system to acquire land or a conservation easement from a willing party for the purpose of protecting the system's source water(s) and ensuring compliance with national drinking water regulations.

If a State elects to use this set-aside, the State shall develop a priority setting process, or use an established priority setting process that meets the same goals, to decide what land or easements can be purchased. The process must include a requirement that public water systems demonstrate how the land or easements to be purchased will directly promote public health protection and/or compliance with national drinking water regulations. The State must seek public review and comment on this process. Furthermore, the State must identify specific parcels of land or easements purchased in the Biennial Report.

ii. Assistance to a community water system to implement voluntary, incentive-based source water quality protection measures:

A State may make a loan to assist a community water system implement voluntary, incentive-based source water protection measures in areas delineated under a source water assessment program described in section 1453 and for source water petitions. Only community (as opposed to noncommunity) water systems are eligible for this assistance. A State may establish a source water petition program and receive petitions from owners/operators or local governments requesting State assistance in the development of a voluntary, incentive-based partnership among systems, local governments, and others likely to be affected by the management measures. Only pathogenic organisms, chemicals in source water at levels above a drinking water standard, or chemicals that are not reliably and consistently below the drinking water standard can be identified as contaminants in a petition.

If a State elects to use this set-aside, the State must develop a list of systems that will receive loans, giving priority to

projects that promote compliance and public health protection, and then seek public review and comment on this list.

iii. Provide funding to delineate and assess source water protection areas:

A State may use up to 10 percent of its FY 1997 capitalization grant to delineate and/or assess source water protection areas for public water systems in accordance with section 1453. Assessments include the identification of potential sources of contamination within the delineated areas. These assessment activities, which primacy States are required to undertake, are limited to the identification of contaminants regulated under the SDWA, or unregulated contaminants, selected by the State, at its discretion, when the State determines that they may pose a threat to public health. Funds set aside for this purpose shall be obligated by the State within four fiscal years after the State receives the grant from which the funds are set-aside.

Funds are available from the capitalization grant only for FY 1996 and FY 1997 to delineate and assess source water protection areas in accordance with section 1453.<sup>1</sup> Since there are no FY 1996 funds available for the DWSRF program, FY 1997 is the only year when funds will be available for this important activity. *EPA encourages States to determine the level of activity necessary to delineate and assess their source water protection areas, and determine the level of funding necessary to complete these activities. If needed, States should take up to 10 percent of fiscal year capitalization grant allowed by law.* EPA will review the State's determination as part of the capitalization grant application review.

iv. To support the establishment and implementation of wellhead protection programs:

The State may make expenditures from the set-aside account to establish and implement wellhead protection

<sup>1</sup> States may use funds from this set-aside for the development of Total Maximum Daily Loads (TMDL's) in limited circumstances. The State must establish a policy of allowing use of set-aside funds to develop TMDL's only if a clear cause and effect relationship can demonstrate that development of the TMDL is essential to public health protection and continuing compliance with national primary drinking water regulations. Funding TMDL's through source water set-asides is only eligible if it will prevent or reduce source water contamination or enhance the efficiency of the drinking water treatment process. In this context, TMDL activity should be weighed against other source water assessment and delineation priority activities. State source water assessment programs submitted to EPA that propose to include TMDL activity shall ensure that the development of TMDL's does not delay the completion of the source water assessments.

programs (WHP) under section 1428. Funds can be used to establish a WHP program, which a State must then submit to the EPA Region for approval. The WHP activities to be funded must be identified in the IUP.

v. To provide funding to a Public Water System to implement a technical or financial assistance under the capacity development strategy:

A State may provide assistance to a public water system as part of a capacity development strategy under section 1420(c).

e. *Movement of funds between the Fund and set-aside account after award of capitalization grant.* If provided for in the IUP, a State may move funds among set-aside activities or from the set-aside account(s) to the Fund after receiving an approved amendment to the capitalization grant. Once payments have been made (according to the schedule outlined in the capitalization grant award), the project funds will be considered part of the Fund and may only be used for the authorized purposes.

f. *Transfer of funds.* Section 302 of the SDWA Amendments of 1996 allows a State to transfer up to 33% of the capitalization grant made to a State under section 1452(m) to the CWSRF or an equivalent amount from the CWSRF to the DWSRF. This transfer is at the Governor's discretion and cannot occur until at least a year after the State has received its first DWSRF capitalization grant. EPA plans to issue guidelines at a later date concerning this transfer provision.

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

A Fund may make loans for project construction, purchase or refinance local debt obligations, guarantee or purchase insurance for local debt issues, provide revenue for or secure State bonds if the proceeds of the bonds are deposited in the Fund, and earn interest on Fund accounts (section 1452(f)).

#### 1. Loans

A Fund may make loans with interest rates that are less than or equal to the market interest rate, including zero percent loans. The State is responsible for identifying in the IUP the method it will use to determine the "prevailing" market interest rate at the time a particular loan is executed with an assistance recipient. As part of its capitalization grant application, the State should outline its policy with respect to interest rate terms for various potential categories of assistance recipients.

A State may issue separate loans for planning, design, and construction costs. If the State had made prior loans to a recipient, the Fund may "roll over" the separate loans into a subsequent loan for construction. A State may also provide "incremental" assistance to finance a multi-year construction activity (e.g., for particularly large, expensive projects).

a. *Repayment of loan.* Assistance recipients (borrowers) must begin repayment of the loan(s), as provided in the loan agreement, not later than one year after completion of the project. A project is considered complete when the operations are initiated or are capable of being initiated. Recipients must complete loan repayment not later than 20 years after the completion of the project. However, States which establish a disadvantaged community loan program pursuant to section 1452(d) may provide loans to qualified recipients for up to 30 years, as long as the period of the loan does not exceed the expected design life of the project.

b. *Dedicated repayment source.* Each loan recipient (except for disadvantaged subsidy portion) must establish a dedicated source of revenue (or in the case of a privately owned system, demonstrate that there is adequate security) for repayment of the principal and interest due on the loan which is consistent with local ordinances and State laws. In most cases, this will be a pledge of revenues from user charges, while for privately owned systems, it could include the pledge of accounts receivable and proceeds therefrom.

c. *Financial security of privately-owned systems.* Eligible water systems that are privately owned must demonstrate that there is adequate security to assure repayment of the loan. In some cases a State may determine that it is appropriate to require such systems to provide credit enhancements, to pledge a variety of collateral, and/or to provide other types of security, such as corporate or personal guarantees.

d. *Financial, technical, and managerial capability analysis.* The State shall review the overall financial capability of the recipient to repay the loan as well as technical and managerial capability of the assistance recipient to maintain compliance with the SDWA (section 1452(a)(3)(A)(i)). Findings of the financial capability analysis may be used to determine the terms of assistance for applicants. The State may not provide assistance to any system that does not have the technical, managerial or financial capability to ensure compliance with the SDWA or is in significant non-compliance with any

drinking water standard or variance. However, if assistance will ensure compliance or if the system's owner or operator agrees to take appropriate measures to ensure that the system has the necessary capability, the State may provide assistance.

e. *Disadvantaged communities.* A Fund may provide additional loan subsidies (e.g., principal forgiveness, negative interest rate loans) to benefit communities meeting the definition of "disadvantaged" or which the State expects to become disadvantaged as a result of the project. A "disadvantaged community" is one in which the entire service area of a public water system meets affordability criteria established by the State after public review and comment (section 1452(d)). The Administrator shall publish information, within 18 months after enactment of the SDWA amendments, to assist States in developing affordability criteria. EPA will undertake this effort in consultation with States and the Rural Utilities Service.

The State should take its affordability criteria into account when deciding the level of subsidy a disadvantaged community will receive, in order to make the loan affordable. Where capability of the system is an issue, the State must ensure that, prior to necessary funding and any other actions, the system has adequate financial, technical and managerial capability to maintain compliance.

The value of subsidies that a Fund provides during a particular fiscal year's capitalization grant cannot exceed 30 percent of the amount of the capitalization grant for that year (1452(d)(2)). Subsidies under this provision cannot be banked for future use.

f. *Project funding for small systems.* The Statute requires that a State use a *minimum* of 15 percent of all dollars credited to the Fund to provide loan assistance to small systems that serve fewer than 10,000 persons. The 15 percent minimum is based on the level of DWSRF funds that the State expects to have available for funding in the fiscal year addressed by the IUP.

#### 2. Buy or Refinance Existing Debt Obligations

A Fund may buy or refinance debt obligations of municipal, intermunicipal or interstate agencies, where the initial debt was incurred and construction started after July 1, 1993 (section 1452(f)(2)). Private systems are not eligible for refinancing under section 1452(f)(2). Refinancing may entail purchasing existing municipal debt such that the proceeds of the transaction

may be used to call the bonds. This provision is intended to encourage projects to proceed using their own means of financing in advance of the availability of Fund assistance, by offering the prospect of project refinancing at better financial terms at a later date.

Projects incurring debt and initiating construction between July 1, 1993 and the effective date of a State capitalization grant must meet the eligibility requirements of section 1452 to be eligible for refinancing. Where the original debt for a project was in the form of a multi-purpose bond incurred for purposes in addition to eligible purposes under section 1452, a Fund may provide refinancing only for eligible purposes, not for the entire debt.

If a State has credited repayments of loans made under a pre-existing State loan program as part of its State match (see V.A.), the State cannot also refinance the projects under the DWSRF. If the State has already counted certain projects toward its State match which it now wants to refinance, the State must provide replacement funds for the amounts previously credited as match.

The State should seek the advice of bond counsel or tax attorneys to ensure that these refinances do not conflict with Federal law.

### 3. Guarantee or Purchase Insurance for Local Debt Obligations

A Fund may provide assistance to improve the marketability of local debt obligations or to reduce interest rates to attract potential buyers of the bonds and loans (section 1452(f)(3)). These credit enhancements may take the form of guarantees or purchases of insurance, which are available from a number of insurance companies. Assistance of this type is limited to local debt obligations that are undertaken to finance projects eligible for assistance under section 1452.

### 4. A Source of Revenue or Security for Payment of Fund Debt Obligations

The State may use assets deposited in the Fund to "leverage" (i.e., increase) the total amount of funds available within the Fund (section 1452(f)(4)). Leveraging is accomplished by using Fund assets as a source of revenue or security for the payment of the principal and interest on revenue or general obligation bonds issued by the State. The net proceeds of the sale of the bonds secured by the Fund must be deposited into the Fund.

The security may be provided by any of the assets of the Fund, including an existing Fund balance and future

revenues from loan repayments. The State may also choose to borrow against the repayment stream from outstanding loans made from an initial set of capitalization grants (or part of the capitalization grant or State match), thus increasing the financial resources of the Fund much sooner than would otherwise be possible. Bonds may be issued by an instrumentality of the State, including the State agency responsible for administering the Fund.

Note that the use of a capitalization grant to leverage does not, in and of itself, satisfy any requirements on the use of DWSRF funds. The proceeds of the bond issue must ultimately be used for providing loans and other assistance to satisfy the requirements of section 1452.

For the purposes of this section, "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 fees, financial advisor fees, rating agency fees, printing of disclosure documents/bond certificates, trustee banks' fees, various forms of credit enhancement and enhancement and other costs that may be incurred by a State agency incidental to the bond issuance).

Funds in a CWSRF cannot secure bonds issued for DWSRF assisted projects, and vice-versa, where there is the potential that assets in one Fund could be used for a purpose not authorized by the law establishing that Fund. Funds in a CWSRF cannot be used to cure a default on a project receiving DWSRF assistance because it is not an authorized type of assistance, nor is the project eligible, under title VI of the Clean Water Act. However, States may propose other leveraging methods relying on one or both Fund's assets where the potential for using those assets for an unauthorized purpose does not exist. For example, a State may use the authority to reserve one program's capitalization grant funds under section 302 of the SDWA Amendments to further secure a bond issued for one or both SRF programs. Such leveraging methods must be reviewed by the Regional Office and by EPA Headquarters before they can be implemented by the State.

### 5. Earn Interest on Fund Accounts

Sections 1452(c) and 1452(f)(5) authorize the State to earn interest on Fund accounts prior to disbursement of assistance (e.g., on reserve accounts used as security or guarantees). Dollars deposited must not remain in the Fund primarily to earn interest. States and municipalities should obtain the legal

opinion of a bond counsel or tax attorney with respect to using the Fund to earn interest on the proceeds of a tax-exempt issue.

There are limits to the type of investments that a State can make with Fund accounts. Funds not required for current obligation or expenditure must be invested in interest bearing obligations (section 1452(c)). The authority to earn interest does not include investment methods that earn dividends or yields other than interest. Most States have laws that restrict the eligible investments of these fund accounts. Furthermore, if a State engages in a leveraged program, there may be restrictions on eligible investments in the trust indenture securing the bonds. In certain cases, the Federal tax code may limit the investments a leveraged program can make with fund accounts.

## III. Eligible Systems and Projects

### A. Eligible Systems

Drinking water systems that are eligible for Fund assistance are community water systems, both privately and publicly owned, and nonprofit noncommunity water systems. Federally-owned systems are not eligible to receive Fund assistance (section 1452(a)(2)).

Fund managers should seek tax advice if they plan to issue bonds, to ensure that the requirements of the Private Activity Use Rule are met, particularly with regard to funding eligible private systems.

Drinking water systems that have components of their systems in more than one State are eligible to receive funding after consultation with the regulatory agencies involved.

### B. Eligible Projects

#### 1. Compliance and Public Health

A DWSRF may provide assistance only for expenditures (not including monitoring, operation, and maintenance expenditures) of a type or category which will facilitate compliance with national primary drinking water regulations applicable to the system under section 1412 or otherwise significantly further the health protection objectives of the Act (section 1452(a)(2)).

Projects to address SDWA health standards that have been exceeded or to prevent future violations of the rules are eligible for funding. These include projects to maintain compliance with existing regulations for contaminants with acute health effects (i.e., the Surface Water Treatment Rule, the Total Coliform Rule, and nitrate standard) and

regulations for contaminants with chronic health effects (i.e., Lead and Copper Rule, Phases I, II, and V rules, and safety standards for total trihalomethanes, arsenic, barium, cadmium, chromium, fluoride, mercury, selenium, combined radium-226, -228, and gross alpha particle activity).

Projects to replace aging infrastructure are also eligible if they are needed to maintain compliance or further the public health protection goals of the Act. Examples of these include projects to:

- Rehabilitate or develop sources (excluding reservoirs, dams, dam rehabilitation and water rights) to replace contaminated sources;
- Install or upgrade treatment facilities if, in the State's opinion, the project would improve the quality of drinking water to comply with primary or secondary standards;
- Install or upgrade storage facilities, including finished water reservoirs, to prevent microbiological contaminants from entering the water system; and
- Install or replace transmission and distribution pipes to prevent contamination caused by leaks or breaks in the pipe, or improve water pressure to safe levels.

Projects to consolidate water supplies—for example, when individual homes or other public water supplies have a water supply that is contaminated, or the system is unable to maintain compliance for financial or managerial reasons—are eligible for DWSRF assistance.

The purchase of a portion of another system's capacity is eligible for a loan, if it is the most cost-effective solution.

#### 2. Loan Assistance to Systems That Meet the Definition in Section 1401(b)

Certain entities that deliver water through constructed conveyances, other than piped water systems, are not currently considered public water supplies. The SDWA Amendments would classify such systems as public water systems unless they comply with provisions of 1401(b).

These systems are eligible for section 1452 funds for the purposes specified in 1401(b).

#### 3. Land Acquisition

Land is eligible only if it is integral to a project that is needed to meet or maintain compliance and further public health protection. In this instance, land that is integral to a project is only the land needed to locate eligible treatment or distribution projects. In addition, the acquisition has to be from a willing seller. Land that is necessary for source

water protection may be eligible to receive a loan under section 1452(k).

The cost of complying with the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (the Uniform Act) is an eligible cost to be included in a DWSRF program loan. (See section on cross-cutters for a more detailed discussion of the Uniform Act.)

#### 4. Planning and Design of a Drinking Water Project

A Fund may provide assistance for the costs of project planning, design and other related costs. The provision of assistance for design and planning costs does not guarantee a system that the DWSRF program will provide funding for the construction of the project. The State may choose to combine the loan for planning and design with a construction loan.

Costs to municipalities for preparing environmental assessment reports may be included as part of the costs of planning a project. 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

A Fund may provide assistance to an eligible public water system to consolidate with other public water system(s) only if the assistance will ensure that the system returns to and maintains compliance with SDWA requirements (section 1452(a)(3)(B)).

If the system does not have the technical, managerial, and/or financial capability to ensure compliance, or is in significant noncompliance, the system may receive assistance only if (1) the assistance will ensure compliance, or (2) the owner or operator of the system agrees to undertake appropriate changes in operations. These changes include consolidation or management changes that will ensure that the system has the technical, managerial, and financial capability to ensure and maintain compliance with SDWA requirements. Costs associated with consolidation, such as legal fees and water buy-in fees, are eligible for funding.

A State should establish criteria or guidelines to help assess what types of operational or management changes may be appropriate for a water system. Further, a State should define when a system would be a good candidate for physical consolidation to solve a compliance or long-term financial issue, or when a system could consolidate by

other means, such as through management consolidation.

#### C. Projects Not Eligible for Funding

The Fund cannot provide funding assistance for the following projects and activities:

- Dams, or rehabilitation of dams;
- Water rights, except if the water rights are owned by a system that is being purchased through consolidation as part of a capacity development strategy;
- Reservoirs, except for finished water reservoirs and those reservoirs that are part of the treatment process and are located on the property where the treatment facility is located;
- Laboratory fees for monitoring;
- Operation and maintenance expenses;
- Projects needed mainly for fire protection;
- Projects for systems that lack adequate technical, managerial and financial capability, unless assistance will ensure compliance;
- Projects for systems in significant noncompliance, unless funding will ensure compliance;
- Projects primarily intended to serve future growth.

#### 1. Lack of Technical, Managerial and Financial Capability

A Fund may not provide any type of assistance to a system that lacks the technical, managerial or financial capability to maintain SDWA compliance, unless the owner or operator of the system agrees to undertake feasible and appropriate changes in operation or if the use of the financial assistance from the DWSRF will ensure compliance over the long-term (section 1452(a)(3)(B)(i)). The State shall develop a capacity program to evaluate each system to be funded to ensure it has adequate capacity to receive funding.

#### 2. Significant Noncompliance

A Fund may not provide assistance to any system that is in significant noncompliance with any national drinking water regulation or variance unless the State conducts a review and determines that the project will enable the system to return to compliance and the system will maintain an adequate level of technical, managerial and financial capability to maintain compliance (section 1452(a)(3)(B)(ii)).

#### 3. Growth

A Fund cannot provide assistance to finance the expansion of any drinking water system solely in anticipation of future population growth (section



1452(g)(3)(C)). However, assistance may be provided to address population growth expected to occur over the useful life of the facility to be funded. In determining whether or not a project is eligible for assistance, the State must determine the primary purpose of the project. If the primary purpose is to supply or attract growth, the project is not eligible to receive DWSRF funds. If the primary purpose is to solve a compliance or public health problem, the entire project, including the portion necessary to accommodate a reasonable amount of growth over its useful life, is eligible. In reviewing the proposed project, the State should review the basis for, and reasonableness of, the population projections.

A State must also consider the extent of current risk to public health in establishing funding priorities. Consequently, if a project includes substantial growth, it must be placed at the lower end of the priority list. It would be contrary to the intent of Congress, as reflected in the "anticipation of growth" provision, to fund a project with the prospect of a substantial amount of growth ahead of a project where a significant portion is attributable to rectifying a current health threat.

#### *D. Compliance Without DWSRF Funding*

The inability or failure of any public water system to receive assistance from a Fund or any other funding agency, shall not alter the obligation of a drinking water system to comply in a timely manner with all applicable drinking water standards and requirements of section 1452 (section 1452(l)).

### **IV. State/Project Level Authorities**

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

There are a number of Federal laws, executive orders and government-wide policies that apply by their own terms to projects and activities receiving Federal financial assistance, regardless of whether the statute authorizing the assistance makes them applicable. These "cross-cutting Federal authorities" (cross-cutters) include environmental laws such as the National Historic Preservation Act and the Wild and Scenic Rivers Act, and social and economic policy authorities such as Executive Orders on Equal Employment Opportunity and government-wide debarment and suspension rules.

A few cross-cutters apply by their own terms only to the State as the grant recipient (e.g., Drug-Free Workplace

Act, Pub. L. 100-692 section 5152 *et seq.*), because the authorities explicitly limit their application to grant recipients. In general, however, the cross-cutters will apply to projects and activities receiving assistance from the Fund.

The Fund may consist of funds from several sources: Federal grant dollars, State match amounts, loan repayments, and, perhaps, bond proceeds. It is therefore difficult to identify which projects are receiving Federal financial assistance and are thus, subject to the cross-cutters. Consequently, the cross-cutters will apply to an amount of funds equaling the amount of the Federal grant. Requirements imposed by the cross-cutters must be met by projects whose cumulative DWSRF funding is equivalent to the amount of the capitalization grant ("equivalency projects").

The concept of equivalency was developed for the CWSRF program, although in that program it had an additional feature. In the CWSRF program, equivalency projects were subject to a number of specific requirements listed in the Clean Water Act (section 602(b)(6)), as well as the cross-cutters. In the DWSRF program, the concept of equivalency is only used to describe which projects must comply with cross-cutters and which must undergo a tier one environmental review (see IV.B.)

Projects funded with DWSRF monies in amounts greater than the capitalization grant are not subject to these requirements, but States that apply cross-cutters to projects whose cumulative funding is greater than the amount of the Federal capitalization grant may bank this excess to meet future requirements.

All programs, projects and activities undertaken by the DWSRF program, including those undertaken as non-equivalency projects, are subject to Federal anti-discrimination laws, including the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973 and the Age Discrimination Act of 1975.

Because of the similarities between the DWSRF and CWSRF programs, and because the State plays a more substantial role in these two programs than in other Federal assistance programs (particularly in its relationship with assistance recipients), the method for applying cross-cutters in the DWSRF program will be the same as that used in the CWSRF program. The Agency will remain ultimately responsible for ensuring that assistance recipients comply with the cross-cutters, but will carry out this

responsibility mainly through its annual oversight and approval roles. Day-to-day responsibility for overseeing funding recipients' implementation of the cross-cutters will fall upon the State. For example, where a cross-cutter requires consultation with another Federal agency, such as the U.S. Fish and Wildlife Service, the State will take this action initially. If a compliance issue cannot be resolved for a particular project through that consultation, then the State must seek the Regional Office's assistance in settling the matter. The most recent list of cross-cutters that apply is attached in Appendix A.

#### *B. Environmental Reviews*

The environmental review principles developed for the CWSRF program will provide the basis for the development of a State environmental review process (SERP) in the DWSRF program. The SERP that applies to Fund equivalency projects must be the same as the process for CWSRF equivalency projects. Non-equivalency projects must also undergo an environmental review, but the State may elect to apply an alternative SERP to these projects.

##### **1. Equivalency Projects**

Equivalency projects are reviewed under a SERP that is functionally equivalent to the review followed by the Agency under the National Environmental Policy Act (NEPA). The State may elect to apply the procedures at 40 CFR part 6, subpart E and related subparts, or apply its own "NEPA-like" SERP for conducting environmental reviews developed for the CWSRF program. For equivalency projects, a SERP must contain the elements described below.

*Legal foundation:* The State must have the legal authority to conduct environmental reviews of construction projects receiving Fund assistance. The legal authority and supporting documentation must specify:

- The mechanisms to implement mitigation measures to ensure that a project is environmentally sound;
- The legal remedies available to the public to challenge environmental review determinations and enforcement actions;
- The State agency that is primarily responsible for conducting environmental reviews; and
- The extent to which environmental review responsibilities will be delegated to local recipients and will be subject to oversight by the primary State agency.

*Interdisciplinary approach:* The State must employ an interdisciplinary approach for identifying and mitigating adverse environmental effects



including, but not limited to, those associated with cross-cutting Federal environmental authorities.

**Decision documentation:** The State must fully document the information, processes and premises that influence its decisions to:

- Proceed with a project contained in a finding of no significant impact (FNSI) following documentation in an environmental assessment (EA);
- Proceed or not proceed with a project contained in a record of decision (ROD) following preparation of a full environmental impact statement (EIS);
- Reaffirm or modify a decision contained in a previously issued categorical exclusion (CE), EA/FNSI or EIS/ROD following a mandatory 5 year environmental reevaluation of a proposed project; and
- If a State elects to implement processes for either partitioning an environmental review or CE from environmental review, the State must similarly document these processes in its proposed SERP.

**Public Notice and Participation:** The State must provide public notice when a CE is issued or rescinded, a FNSI is issued but before it becomes effective, a decision issued 5 years earlier is reaffirmed or revised, and prior to initiating an EIS. Except with respect to a public notice of a categorical exclusion or reaffirmation of a previous decision, a formal public comment period must be provided during which no action on a project will be allowed.

A public hearing or meeting must be held for all projects except for those having little or no environmental effect.

**Alternatives Consideration:** The State must have evaluation criteria and processes which allow for:

- Comparative evaluation among alternatives, including the beneficial and adverse consequences on the existing environment, the future environment and individual sensitive environmental issues that are identified by project management or through public participation; and
- Devising appropriate near-term and long-range measures to avoid, minimize or mitigate adverse impacts.

#### 2. Non-equivalency projects.

The State may elect to apply an alternative SERP to non-equivalency construction projects assisted by the Fund, provided that the process:

- Is supported by a legal foundation which establishes the State's authority to review construction projects;
- Responds to other environmental objectives of the State;
- Provides for comparative evaluations among alternatives and accounts for beneficial and adverse

consequences to the existing and future environment;

- Adequately documents the information, processes and premises that influence an environmental determination; and
- Provides for notice to the public of proposed projects and for the opportunity to comment on alternatives and to examine environmental review documents. For projects determined by the State to be controversial, a public hearing must be held.

#### 3. EPA approval and Review Process

The RA must review and approve any State "NEPA-like" and alternative procedures to ensure that the requirements for both equivalency and non-equivalency projects have been met. The RA will conduct these reviews on the basis of the criteria for evaluating NEPA-like reviews contained in appendix B to these guidelines. Because these criteria are also used in the CWSRF program (appendix A to the CWSRF regulations), a State may simply adopt those for the DWSRF program. Significant changes to State environmental review procedures must be approved by the RA. The approved SERP may be incorporated in the State's operating agreement, if it elects to prepare one. (See I.D. above)

States should establish administrative procedures for monitoring, collecting and summarizing environmental review information and provide documentation of these activities in the Biennial Report. EPA's annual review will include a review of a sample of DWSRF projects to verify the application and the adequacy of the SERP.

### V. Funding Process

#### A. 20 Percent State Match

Except for FY 1997 funds, States must deposit the 20% State match into the Fund on the date of or before receiving payments under the capitalization grant. In general, State match deposits must be in cash. When a State opts to use a "letter of credit" mechanism for its State match, payments to this letter of credit account must be made proportionally on the same schedule as the payments of Federal funds (as outlined elsewhere in these guidelines) in the capitalization grant. Monies from this State match letter of credit must be drawn into the Fund as monies are drawn on the Federal letter of credit (known as the automated clearinghouse account (ACH)).

When cash is drawn from the Federal ACH for the set-aside account only, the State may deposit its proportional share into the Fund in the form of a note

receivable rather than actual cash. The note(s) must be converted to cash prior to the time when cash is drawn from the federal ACH to the project fund, in order to meet the State match requirement.

For grant payments made to the State from funds appropriated in FY 1997, the State may defer deposit of its matching amount to no later than September 30, 1999. This flexibility is provided to States which may need additional time to secure State funding for the required matching amount. Note that even if the State defers deposit of its matching amounts, it must identify the source of its matching funds in the capitalization grant application and agree to provide the State match for grant payments already received from the FY 1997 appropriations by September 30, 1999. Thus, States will have to match the funds that have been received as payments or are drawn down in cash, in order to reach the proportional match requirement of 20%, before additional funds can be expended from the federal ACH.

States may acquire the matching amount from a variety of sources, including legislative appropriations, proceeds from State issued bonds, revenues from State taxes or assessments, and funds maintained in other State accounts. Bonds issued by the State to derive the match may be retired from the interest payments made to the Fund on loans awarded by the Fund if the net proceeds from the State issued bonds are deposited in the fund. Loan repayments including principal and interest of a loan must be repaid to the Fund; with only the interest portion of repayments and interest earnings of the Fund as a source of funds to retire State bond issues that provide the State match. This flexibility to retire State debt should not be used to the extent that it endangers the long term financial goals and objectives, and financial condition of the DWSRF program, as described in the IUP. If the State provides a match in excess of the required amount, the excess balance may be banked toward match requirements associated with subsequent capitalization grants.

The State may already manage a dedicated revolving fund which provides assistance for activities consistent with section 1452(a)(2) of the SDWA. The State may credit toward its match requirement State monies deposited into this dedicated fund between July 1, 1993 and prior to the receipt of a capitalization grant under section 1452(a) of the SDWA if:

- (1) The monies were deposited in an SRF that subsequently received a capitalization grant and, if the deposit

was expended, it was expended in accordance with section 1452 of the SDWA;

(2) The monies were deposited in a separate fund that has not received a capitalization grant, they were expended in accordance with section 1452 of the SDWA and an amount equal to all repayments of principal and payments of interest from these loans will be deposited in the Federally capitalized fund; or

(3) The monies were deposited in a separate fund and used as a reserve consistent with section 1452 and an amount equal to the reserve is transferred to the Federally capitalized fund as its function is satisfied.

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

The State must agree to deposit into the set-aside account where the 1452(g)(2) funds will be deposited, a dollar for dollar match, up to 10 percent of the capitalization grant. States may acquire the matching amounts from a variety of sources, in particular, PWSS funding credits discussed in II.B.3.b. If additional funds are required, a State may use legislative appropriation or other State funds.

#### *C. Federal Funding Process*

##### 1. General

A State will receive each capitalization grant payment in the form of an increase to the ceiling of funds available through a separate Fund account set up in the EPA-Automated Clearing House (EPA-ACH). Cash will be transferred to the State from the U.S. Treasury on a reimbursement basis, after the assistance recipient has billed the DWSRF program for work completed and the DWSRF program requests reimbursement from EPA. The State then reimburses project assistance recipients for costs incurred—a process known as the disbursement from the DWSRF.

##### 2. Schedule of Payments

A State must include a payment schedule in its capitalization grant agreement that is based on its projection of binding commitments (see below) and use of set-asides in the State's Intended Use Plan. Increases in the ceiling of funds available in the EPA-ACH will be made in accordance with the schedule of payments. All payments will be made by the earlier of 8 quarters from the date of a capitalization grant award or 12 quarters from the date of allotment. The schedule of payments applies to all funds in the capitalization grant, including those funds that are used for set-aside activities.

##### 3. Binding Commitments

In order to demonstrate continuing progress in project (both Fund and set-aside projects) initiation, and to further the intent of Congress to "commit(s) and expend(s) funds \* \* \* as efficiently as possible\* \* \*" (section 1452(g)(3)(A)), the State must agree to enter into binding commitments to provide financial assistance under the DWSRF program with assistance recipients. A binding commitment is a legal obligation by the State to a recipient of assistance that defines the terms for DWSRF assistance. The binding commitment should include a description of the project to receive financial assistance, the expected terms of the assistance, and expected date of project initiation and project completion.

Binding commitments must be made in an amount equal to the amount of each grant payment that is deposited into the Fund and State match within one year after the receipt of each grant payment.

The State must continue to make progress in providing Fund assistance by entering into binding commitments equaling the amount of the grant payment and State match within one year after it receives a grant payment. To facilitate compliance with this requirement, the State may wish to plan for binding commitments equal to the federal capitalization grant less the non-project set-asides plus the State match (Federal funds only for the FY 1997 funds). Then, if some projects are unable to proceed for unforeseen reasons, the State will still be able to comply with the requirement. The State may make binding commitments for more than the required amount, and bank the "excess" balance towards the binding commitment requirements of subsequent grant payments.

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.

##### 4. Cash Draw

The ACH process is structured so that neither the DWSRF program nor the assistance recipients will be required to provide interim financing on financial transactions of the DWSRF program. Transfer procedures have been established to ensure that cash will be in the DWSRF program account within two days after the Agency receives a valid request for cash draw from the State. To effect this two day transfer, the Agency will only subject requests to

account verification. The Agency will not review DWSRF program documents (e.g., construction status of projects, adequacy of voucher documentation) as part of the cash draw process.

Cash draws from the DWSRF-ACH are limited by the ceiling available in the DWSRF-ACH. However, in the event of an imminent default (e.g., debt service payments to bondholders and resulting need for a cash draw from a DWSRF-ACH for use as a security or guarantee), the Agency can amend the grant agreement and payment schedule to allow the State to draw cash immediately, up to the total amount of the DWSRF-ACH committed to the guarantee or security. The DWSRF or the assistance recipient must first incur a cost in order for cash to be drawn against the DWSRF-ACH. The State may draw cash from the DWSRF-ACH for the proportionate Federal share of eligible costs at the time those costs have been incurred.

The following subsections describe the cash draw rules that apply to the different types of assistance a Fund can provide.

##### a. Projects

###### *i. Loans*

The State may draw cash from the DWSRF-ACH when the Fund receives a request from a loan recipient, based on incurred costs, including pre-building and building costs.

###### *ii. Refinance or Purchase of Municipal Debt*

For completed construction, cash draws will be made at a rate no greater than equal amounts over the maximum number of quarters that capitalization grant payments are made, and up to the portion of the DWSRF-ACH committed to the refinancing or purchase of the local debt. Cash draws for incurred building costs will generally be treated as refinanced costs. With the approval of the RA, the State may draw cash immediately when it is prepared to refinance for up to five percent of each fiscal year's capitalization grant or two million dollars, whichever is greater, to refinance or purchase local debt.

For projects or portions of projects that have not been constructed, the State may draw cash based on incurred construction costs according to the rule for loans.

For the purchase of incremental disbursement bonds from local governments, cash draws will be based on a schedule that coincides with the rate at which construction related costs are expected to be incurred for the project.

### iii. Purchase of Insurance

The State may draw cash to purchase insurance as premiums are due.

### iv. Guarantees and Security for Bonds

In the event of an imminent default in debt service payments on a guaranteed or secured debt, the State can draw cash immediately up to the total amount of the DWSRF-ACH that is dedicated to the guarantee or security. If a balance remains after the default is covered, the State must negotiate a revised schedule for the remaining amount dedicated to the guarantee or security.

In the absence of default, the State can draw cash up to the amount of the DWSRF-ACH dedicated for the guarantee or security based on actual construction cost. The amount of the cash draw would be the actual construction costs multiplied by the Federal share of the reserve multiplied by the ratio of the reserve to either the amount guaranteed or the proceeds of the bond issue.

In addition, in the case of a security, the State can identify a group of projects whose value equals approximately the total of that portion of the DWSRF-ACH and the State match dedicated as a security. The State can then draw cash based on the incurred construction costs of the selected projects only, multiplied by the ratio of the Federal portion of the security to the entire security.

Where the cash draw rules discussed immediately above would significantly frustrate a State's program, the Agency may permit an exception to these cash draw rules and provide for a more accelerated cash draw, where the State can demonstrate that:

- There are eligible projects ready to proceed in the immediate future with enough costs to justify the amount of the secured bond issue;
- The absence of cash on an accelerated basis will substantially delay these projects;
- If accelerated cash draws are allowed, the Fund will provide substantially more assistance; and
- The long term viability of the State program to meet water quality needs will be protected.

When the ACH is used for securing State issued bonds, cash draws cannot be made at a rate greater than equal amounts over the maximum number of quarters that payments can be made. Exceptions to this limitation are in cases of default and where cash draws are based on construction costs for all projects.

### b. Set-Asides

States may draw down federal funds for set-aside use without the need to

provide a State match in the form of cash (see V.A.). The one exception is the required one-for-one match, where a State elects to use up to 10 percent of the funds to be used for 1452(g)(2)(A-D). A State must provide the match prior to or at the time the State requests the federal funds, which is the same as the requirement for the 20 percent State match.

## VI. Reporting/Review Responsibilities

Each State must submit a Biennial Report to the Administrator on the State's activities which receive funding under section 1452.

The Administrator has determined that the Agency shall conduct reviews of the DWSRF program on an annual basis. The Annual Review is necessary to carry out the Agency's Federal fiduciary responsibilities and to assure that States are implementing the program as efficiently as possible (section 1452(g)(3)(A)). Specific elements of the Agency's Annual Review are outlined below.

Several other programs may receive funding from the State's allotment, including operator certification, small systems technical assistance, source water protection, and wellhead protection. Agency review of these other programs shall generally be conducted separately in accordance with procedures described in program specific guidelines. The Agency may develop additional guidelines to reflect new components for the other eligible programs receiving funds pursuant to section 1452.

### A. State Responsibilities

#### 1. Biennial Report

The State should submit its Biennial Report to the RA according to the schedule established in the grant agreement.

The Biennial Report should contain detailed information on how the State has met the goals and objectives of the previous two fiscal years as stated in the IUP and grant agreement. The Report should provide information on loan recipients, loan amounts, loan terms, project categories of eligible cost, and similar details on other forms of assistance. This information should be provided in a format and a manner that is consistent with the needs of the Regional Office. The Report should also describe the extent to which the existing DWSRF program financial operating policies, alone or in combination with other State financial assistance programs, will provide for the long term fiscal health of the Fund, attain and maintain compliance with the Safe

Drinking Water Act, and carry out other provisions specified in the legislation.

The State must submit a detailed financial report as part of the Biennial Report. At a minimum, the financial report shall include the financial statements and footnotes required under GAAP to present fairly the financial condition and results of operations.

In addition, the State must establish in its DWSRF program Biennial Report that it has:

- Reviewed all DWSRF funded projects in accordance with the approved State Environmental Review Procedures;
- Deposited its match (cash or State ACH) on or before the date on which each grant payment was made;
- Made binding commitments to provide assistance equal to the Federal capitalization grant less set-asides funds plus the State match funds within one year after receiving the grant payment, except for FY 1997 (100%);
- Managed the DWSRF program in a fiscally prudent manner and adopted policies and processes which promote the long-term financial health of the Fund(s);
- Complied with Agency grant regulations (40 CFR part 31) and specific conditions of the grant;
- Complied with Federal cross-cutting authorities that apply to the State as a Federal grantee and those which flow through to assistance recipients;
- Provided assistance only to eligible water systems and for eligible purposes under these guidelines; and
- Funded only the highest priority projects listed on the IUP, according to their priority and readiness to proceed, and have documented any procedures for by-passing priority projects on the IUP.

The State must provide, in the Biennial Report, all information necessary to demonstrate that the State remains eligible to receive its full allotment of funds provided under section 1452(m). Information on the other eligible programs provided in the State's biennial DWSRF program report shall not replace reporting requirements of other Agency program-specific guidelines. At its option, the State may wish to incorporate by reference or attach copies of the most recent copies of other reports to the Agency describing progress under the other eligible programs.

#### 2. Annual Audit

The State must conduct an annual audit of the Fund, to be prepared by the State or an independent auditor in accordance with the standards of the

General Accounting Office (otherwise known as Generally Accepted Government Auditing Standards). Set-aside monies used for projects, in particular monies loaned out under section 1452(k)(1)(A), must also be covered by a separate audit. Programmatic set-asides may be covered by the Single Audit Act.

The audits must provide an auditor's opinion on the DWSRF financial statements, a report on internal controls and a report on compliance with laws and regulations. The audits may be conducted in conjunction with audits conducted under the Single Audit Act. However, a State's Single Audit report alone will not meet the DWSRF audit requirement.

Those set-asides that are not directly related to the revolving fund should be audited under the guidelines of the Single Audit Act, including OMB Circular A-133 and OMB's Compliance Supplement for Single Audits of State and Local Governments.

### 3. Information Management System

In conjunction with the States, the Agency shall develop and implement an information management system which includes regularly updated data on funds available and assistance provided by the DWSRF program. To the extent practical, this system will be coordinated with the implementation of a similar effort in the CWSRF program. Once developed, States will be required to provide information for the information system. The Agency will use this information to assess the program on a national basis and to monitor State progress in years in which Biennial Reports are not required. In particular, the Regional Offices will use the information to assist in conduct of the annual reviews.

#### B. EPA Responsibilities

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

EPA will conduct annual reviews of each DWSRF program to assess the success of each program in meeting the objectives of section 1452. The purposes of the Annual Review are to (1) assess the success of the State's performance of activities identified in the IUP, the State's Biennial Report, the Operating Agreement (if used), and the DWSRF program information management system, (2) determine how the DWSRF is achieving the intent of section 1452 and the overall goals and objectives of the SDWA as amended, (3) determine compliance with the capitalization grant agreement, and (4) assess the financial status of the Fund. The time period for conduct of Agency Annual Reviews is

not connected to the period of award of Federal capitalization grants (i.e., Annual Reviews will continue even after Federal appropriations are no longer available).

EPA will complete an Annual Review of the IUP and the Biennial Report covering the same fiscal year according to the schedule established in the grant agreement (generally within 60 days of receipt of the Biennial Report in the year it is due, and approximately the same date on the year the Biennial Report is not due). After reasonable notice by EPA, the State or loan recipient shall make available to the EPA such records as the EPA reasonably requires to review and determine State compliance with the requirements of section 1452 of the SDWA as amended in 1996. EPA may conduct on-site visits as needed to provide adequate programmatic review. During years in which a State Biennial Report is not required, the Region will, to the extent practicable, obtain information necessary to conduct its Annual Review from the DWSRF Information System. If necessary, the Region will request the State to clarify information in the system or provide additional information. Requests for such supplemental information shall be kept to a minimum necessary for conduct of the Annual Review.

Upon completion of its Annual Review, the Region will prepare a Program Evaluation Report (PER). The Region shall submit the draft PER to the State for review and comment prior to preparing the final PER.

Identification and resolution of issues need not be limited to the Annual Review process. As the Region becomes aware of issues in DWSRF program operations, the Region shall consult with the State as appropriate. EPA will review the adequacy of State program management procedures and compliance with procedures as described in the State's capitalization grant application and Operating Agreement (if used).

The following is a list of review topics which may be included as part of the Annual Review:

#### *Compliance/General Program Management*

- Compliance with capitalization grant conditions and EPA grant regulations;
- Compliance with the State assurances incorporated in the capitalization grant agreement(s);
- Consistency of DWSRF program operations with the State's short and long term goals and objectives as reflected in the DWSRF capitalization

grant application(s) and grant agreements;

- Coordination between the DWSRF program and other State drinking water program management activities (e.g., source water protection, wellhead protection, capacity development, assistance to small systems);

- Compliance with requirements of section 1452 (e.g., eligibility of recipients, types of projects, and types of financial assistance provided);

- Program administration costs; adequacy of staffing; and

- Adequacy of State in filing timely "UCC Financing Statements" to ensure security on loans to private systems.

#### *Pace of Program*

- Status of binding commitments and progress in initiating and completing projects;

- Compliance with projections of Federal outlays and adequacy of efforts to manage outlays, both for the current year as well as the period covered by the Annual Review; and

- Size of uncommitted fund balance.

#### *Project Level Management*

- Compliance with cross-cutting Federal authorities;

- Adequacy of State environmental review procedures (including consideration of mitigation, consultation with appropriate State and Federal environmental officials, and adequacy of project documentation);

- Adequacy of State procedures for reviewing assistance applicants' financial (financial capability and credit analysis), managerial and technical capabilities;

- Adequacy of State procedures to review proposed dedicated repayment sources and financial security demonstrations;

- Adequacy of loan agreements (e.g., inclusion of assistance terms; accounting, audit, and record keeping procedures; default management provisions; and compliance with applicable State and Federal requirements);

- Adequacy of on-going State oversight of the financial, managerial and technical capability of assistance recipients and appropriateness of State actions to resolve areas of concern.

- Consistency of assistance recipients with IUP (e.g., names of recipients, assistance amounts, terms of assistance); and

- Adequacy of construction management oversight (e.g., change orders, compliance with applicable labor laws, adherence to schedule, record keeping).

### Financial Management

- Adequacy of State financial management system (including documentation relating to Federal cash draws, deposit of State matching funds, posting of repayments and interest earnings);
  - Timeliness of flow of funds to assistance recipients;
  - Adequacy of financial statement of the DWSRF program;
  - Adequacy of fund balance to meet financial responsibilities (e.g., current operating expenses, debt service payments, funding of reserves, long-term financial assistance needs);
    - Comparison of actual expenditures to budget;
    - Adequacy of State internal controls to prevent waste, fraud and abuse (e.g., processing of payments, financial accounting);
    - Adequacy of loan portfolio management (including billing and collections, aging of accounts, actions to prevent payment default);
      - Repayment record, including defaults and potential for defaults;
      - Mix and relative risk of financial assistance types (e.g., various interest rates, guarantees, refinancings, disadvantaged community assistance);
      - Adequacy and reasonableness of State fund investment practices;
      - Appropriateness of State policies and strategies with respect to impacts on the long-term financial viability of the DWSRF program;
      - Reasonableness of the disadvantaged community program and consistency of its implementation with the approved program; and
      - Adequacy of the State's cash flow analysis, review of financial trends, and long term forecasting of project assistance needs.

### 2. Evaluation

The Administrator shall prepare an evaluation of the effectiveness of the DWSRF programs' operations through FY 2003 (section 1452(r)).

### 3. Compliance Assurance

The Administrator will develop guidelines necessary to assure effective program management and to prevent waste, fraud, and abuse (section 1452(g)(3)). The Agency will assist the State in achieving and maintaining compliance with program objectives and requirements. There may be cases, however, when technical support may be insufficient or where a State may be reluctant or unable to correct identified problems. This section of the guidelines outlines procedures and potential actions which may be necessary in cases of non-compliance.

If the annual review or audit reveals that the State has not complied with its capitalization grant agreement or other requirements under section 1452, or if the State does not manage the DWSRF program in a financially sound manner (e.g., allows consistent and substantial failures of loan repayments), the Agency may take action under the enforcement provisions of the general grant regulations at 40 CFR 31.43.

Before taking such action the Agency will issue a notice of non-compliance with the capitalization grant agreement and prescribe appropriate corrective action. The State's corrective action must remedy the specific instance of non-compliance and adjust program management to avoid non-compliance in the future.

If within 60 days of receipt of the non-compliance notice, a State fails to take the necessary actions to obtain the results required by the EPA, or provide an acceptable plan to achieve the results required, the Agency may suspend payments to the DWSRF until the State has taken acceptable actions (40 CFR 31.43(a)(3)). Once the State has taken the corrective action deemed necessary and adequate by the Agency, the withheld payments shall be released and scheduled payments shall recommence.

If the State fails to take the necessary corrective action deemed adequate by the Agency within twelve months of receipt of the original notice, any suspended payments may be deobligated and reallocated to other States. All future payments may be withheld from a State (40 CFR 31.43(a)(4)), and reallocated, until such time that adequate corrective action is taken and the Administrator certifies that the State is back in compliance.

### 4. Dispute Resolution

Any State applicant or recipient that has been adversely affected by an Agency action or omission may request a review of such action or omission. The procedures are codified in the Agency's general grant regulations at 40 CFR part 31, subpart F.

## VII. Appendices

### A. Federal Cross-Cutters

#### Environmental Authorities

- Archeological and Historic Preservation Act of 1974, Pub. L. 86-523, as amended.
- Clean Air Act, Pub. L. 84-159, as amended.
- Coastal Barrier Resources Act, Pub. L. 97-348.
- Coastal Zone Management Act, Pub. L. 92-583, as amended.

- Endangered Species Act, Pub. L. 93-205, as amended.
- Environmental Justice, Executive Order 12898.
- Floodplain Management, Executive Order 11988 as amended by Executive Order 12148.
- Protection of Wetlands, Executive Order 11990.
- Farmland Protection Policy Act, Pub. L. 97-98.
- Fish and Wildlife Coordination Act, Pub. L. 85-624, as amended.
- National Historic Preservation Act of 1966, Pub. L. 89-665, as amended.
- Safe Drinking Water Act, Pub. L. 93-523, as amended.
- Wild and Scenic Rivers Act, Pub. L. 90-542, as amended.

#### Economic and Miscellaneous Authorities

- Demonstration Cities and Metropolitan Development Act of 1966, Pub. L. 89-754, as amended, Executive Order 12372.
- Procurement Prohibitions under Section 306 of the Clean Air Act and Section 508 of the Clean Water Act, including Executive Order 11738, Administration of the Clean Air Act and the Federal Water Pollution Control Act with Respect to Federal Contracts, Grants, or Loans.
- Uniform Relocation and Real Property Acquisition Policies Act, Pub. L. 91-646, as amended.
- Debarment and Suspension, Executive Order 12549.

#### Social Policy Authorities

- Age Discrimination Act of 1975, Pub. L. 94-135.
- Title VI of the Civil Rights Act of 1964, Pub. L. 88-352.<sup>2</sup>
- Section 13 of the Federal Water Pollution Control Act Amendments of 1972, Pub. L. 92-500 (the Clean Water Act).
- Section 504 of the Rehabilitation Act of 1973, Pub. L. 93-112 (including Executive Orders 11914 and 11250).
- The Drug-Free Workplace Act of 1988, Pub. L. 100-690 (applies only to the capitalization grant recipient).
- Equal Employment Opportunity, Executive Order 11246.
- Women's and Minority Business Enterprise, Executive Orders 11625, 12138 and 12432.
- Section 129 of the Small Business Administration Reauthorization and Amendment Act of 1988, Pub. L. 100-590.
- Anti-Lobbying Provisions (40 CFR Part 30) (applies only to capitalization grant recipients).

<sup>2</sup>The Civil Rights Act and related anti-discrimination statutes apply to all the operations of the SRF program.

### B. Criteria for Evaluating a State's Proposed NEPA-Like Process

The following criteria will be used by the RA to evaluate a proposed SERP:

(A) *Legal foundation.* Adequate documentation of the legal authority, including legislation, regulations or executive orders and/or Attorney General certification that authority exists.

(B) *Interdisciplinary approach.* The availability of expertise, either in-house or otherwise, accessible to the State Agency.

(C) *Decision documentation.* A description of a documentation process adequate to explain the basis for decisions to the public.

(D) *Public notice and participation.*

(1) A description of the process, including routes of publication (e.g., local newspapers and project mailing list), and use of established State legal notification systems for notices of intent, and criteria for determining whether a public hearing is required.

(2) The adequacy of a rationale where the comment period differs from that under NEPA and is inconsistent with other State review periods.

(E) *Consider alternatives.* The extent to which the SERP will adequately consider:

(1) Designation of a study area comparable to the final system;

(2) A range of feasible alternatives, including the no action alternative;

(3) Direct and indirect impacts;

(4) Present and future conditions;

(5) Land use and other social parameters including recreation and open-space considerations;

(6) Consistency with population projections used to develop State implementation plans under the Clean Air Act;

(7) Cumulative impacts including anticipated community growth (residential, commercial, institutional and industrial) within the project study area; and

(8) Other anticipated public works projects including coordination with such projects.

### C. Definitions

*Administrative Expenses*—Costs incurred in managing and operating the SRF program. A State may use up to 4% of its allotment for program administration expenses.

*Annual Review*—EPA's assessment of the success of a State DWSRF program.

*Appropriations*—Statutory authority that, after apportionment by OMB, allows Federal agencies to obligate funds and make payments from the Treasury for specified purposes.

*Assurances*—Certifications or pledges by the State that it will meet the requirements of the SDWA and other requirements of the program.

*Automated Clearing House*—A Federal payment mechanism that transfers cash to States and other recipients of Federal assistance using electronic transfers from the Treasury through the Federal Reserve System.

*Biennial Report*—The State's SRF Report to EPA which contains information on how the State has met the goals and objectives of the previous two fiscal years as stated in the Intended Use Plan and grant agreement.

*Bank/Banking*—Crediting amounts (contributed by the State to SRF eligible projects or activities) to the SRF in excess of amounts required towards meeting certain requirements of future capitalization grants.

*Binding Commitment*—A legal obligation by the State to a local recipient that defines the terms and the timing for assistance under the SRF.

*Capitalization Grant*—The assistance agreement by which EPA obligates to award funds allotted to a State for purposes of capitalizing that State's revolving fund and funds for other purposes authorized in section 1452.

*Capitalization Grant Application*—An application for Federal assistance submitted by a State, which in addition to the application form includes an Intended Use Plan, proposed payment schedule, and operating agreement or other documents describing how the State intends to operate its SRF.

*Certification/Certify*—Documentation signed by the responsible party that specific requirements or standards have been or will be met.

*Community Water System*—A public water system that: (a) Serves at least 15 service connections used by year-round residents of the area served by the system; or (b) regularly serves at least 25 year-round residents.

*Cross-Cutting Authorities*—Federal laws and authorities that apply by their own terms to projects or activities receiving Federal assistance.

*Debt Obligation*—A legal obligation or liability to pay something to someone else.

*Default*—Failure to meet a financial obligation such as a loan payment.

*Disadvantaged Community*—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.

*Disbursement*—The transfer of cash from the SRF to the assistance recipient.

*Disbursement Schedule*—A quarterly schedule of estimated disbursements from the SRF.

*Eligible System*—Community water systems, both privately or publicly owned, and nonprofit noncommunity water systems.

*Environmental Review*—An environmental review process conducted by States that complies with 40 CFR Part 6, Subpart E or an alternative "NEPA-like" State environmental review.

*Equivalency Projects*—Projects that must total the amount equal to the Federal capitalization grants and must comply with environmental review requirements and Federal cross-cutting authorities.

*Financial Health/Integrity*—The ability of the DWSRF to address SDWA needs and to be continually available to meet future needs.

*Guarantee*—A promise to provide municipal bondholders with full and timely payment of principal and interest on the municipal debt obligation to the limit of the guarantee, in the event of default by the municipality.

*Intended Use Plan*—A document prepared each year by the State, which identifies the intended uses of the funds in the SRF and describes how those uses support the goals of the SRF.

*Leveraging*—The use of the capitalization grant as the security for the sale of State bonds. Leveraging does not include State financing arrangements in which repayment streams, rather than capitalization grant or ACH are used as the primary security for the bond issue.

*Loan*—An agreement between the DWSRF and the local recipient through which the SRF provides funds for eligible assistance and the recipient promises to repay the principle sum back to the SRF over a period not to exceed 20 years, except for disadvantaged communities that may receive a loan for up to 30 years (that does not exceed the life of the project), at an interest rate established at or below market interest rates (may be interest free).

*Net Bond Proceeds*—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).

*Noncommunity Water System*—A public water system that is not a community system.

**Noncompliance**—Failure to satisfy the terms of the capitalization grant agreement, including unmet assurances, invalid certifications, or failure to manage the DWSRF in a financially sound manner.

**Nonprimacy States**—States that do not exercise primary enforcement responsibility for public water systems.

**Operating Agreement**—An optional document in which the State may establish the basic framework and procedures of the DWSRF that are not expected to change annually.

**Payment/Payment Schedule**—A payment is an action by EPA to increase

the amount of funds available for cash draw in the Automated Clearing House. A payment is not a transfer of cash to the State, but only an authorization making funds available for transfer to the State when a cash draw request is submitted. A payment schedule, indicating the timing and size of the payments to be made, will be agreed upon by EPA and the State based on the State's projection of binding commitments.

**Refinancing**—Purchase of a previously executed debt obligation

where initial debt was incurred and construction initiated after July 1, 1993.

**Set-Aside**—Use of allotted State funds for a range of specific SDWA related activities identified in section 1452, to encourage source water protection and other State drinking water program activities.

**State Match**—Funds equaling at least 20% of the amount of the capitalization grants which the State must deposit into the Fund. The State must also provide a 10% match if the State uses the 1452(g)(2) set-aside.

TABLE 1.—STATE REQUIREMENTS FOR THE CAPITALIZATION GRANT AGREEMENT

Requirement	How addressed
CG Application:	
Part 31 Assurances (Grant Conditions) .....	Agree to.
Established SRF & Instrumentality .....	Document (AG certif.).
Comply with State Statutes/Regulations .....	Agree to.
Technical Capability To Manage Program .....	Document.
Review Technical, Financial & Managerial Capability of Assistance Recipients .....	Agree to.
Intended Use Plan (IUP):	
(1) List of Projects .....	Propose.
(2) By-pass Procedures .....	Describe, if applicable.
(3) DWSRF Goals .....	Describe.
(4) Activities To Be Supported .....	Describe.
(5) Disadvantaged Communities .....	Describe, if applicable.
(6) Assurances and Proposals:	
—Environmental Review .....	Document/certify.
—Federal Cross-Cutters .....	Agree to.
—120% Binding Commitments .....	Agree to.
—Timely Expenditure .....	Agree to.
(7) Criteria & Method for Distributing Funds .....	Describe.
Payment Schedule/Schedule of Estimated DWSRF Disbursements .....	Agree to and Propose.
Other Activities To Be Supported by Set-Asides .....	Intended Use Plan.
Transfer of Funds To/From CWSRF .....	Describe.
Grant Agreement:	
Accept Grant payments .....	Certify.
Deposit Funds in DWSRF Fund .....	Certify.
Deposit State Match:	
—Source of the Match .....	Identify.
—Deposit of Match .....	Certify.*
120% Binding Commitments .....	Agree to.
Information Management System .....	Agree to.
Use State Laws & Procedures .....	Agree to.
Use GAAP (Generally Accepted Accounting Principles) .....	Agree to.
Use GAGAS (Generally Accepted Government Auditing Standards) .....	Agree to.
Recipient Accounting .....	Agree to.
Biennial Report .....	Agree to.
Annual Audit .....	Agree to.
Environmental Review** .....	Agree to.
Program Oversight .....	Agree to.
All changes to the agreement or OA require a formal grant amendment.	

\* For payments from FY 1997 appropriations, the State must agree to provide the certification no later than September 30, 1999, of the availability of its match and provide the State match for grant payments already received from the FY 1997 appropriations. A State that fails to certify by that date may not receive further grant payments until the match is deposited.

\*\* States required to certify environmental review process.

TABLE 2.—SET-ASIDES AND FUNDING CEILINGS IN THE DRINKING WATER SRF PROGRAM

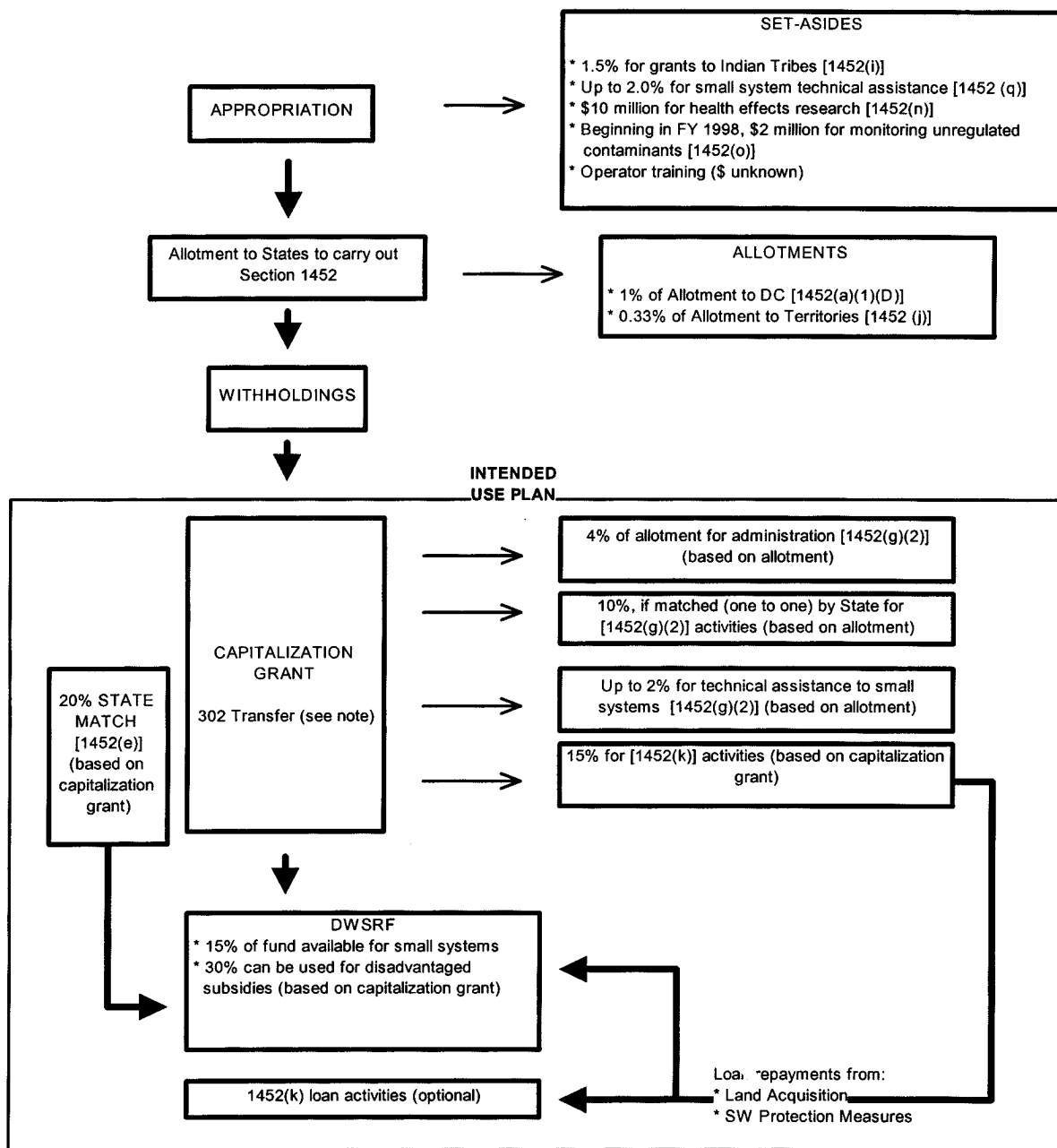
Before Allotment to States	
<b>Programmatic</b>	
\$10 Million .....	Health effects research.
\$2 Million .....	Unregulated contaminant monitoring (starting in FY 1998).
Up to 2% .....	Technical assistance to small systems (optional) Capped at \$15 Million when combined with funds appropriated under Section 1442.
Undecided .....	Reimbursement of operator training expenses projects.

TABLE 2.—SET-ASIDES AND FUNDING CEILINGS IN THE DRINKING WATER SRF PROGRAM—Continued

<b>Projects</b>	
1.5% .....	Indian Tribes/Alaska Native Villages.
<b>Based on Allotment to States</b>	
<b>Projects</b>	
1.0% .....	District of Columbia.
0.33% .....	Virgin Islands, Territories.
<b>After Allotment to States</b>	
<b>Programmatic</b>	
Up to 4% .....	Administration of DWSRF program and technical assistance.
Up to 2% .....	Technical assistance to small systems.
Up to 10% .....	Assistance to State programs (PWSS, SWP, capacity development, operator certification.)
Up to 15% .....	Combination of the following: **
	<ul style="list-style-type: none"> <li>• Loans for public water systems to acquire land or conservation easements.</li> <li>• Loans for community water systems to implement SWP measures or to implement recommendations in SW petitions.</li> <li>• Technical and financial assistance to public water systems for capacity development.</li> <li>• Expenditures to delineate or assess SWP areas.</li> <li>• Expenditures to establish and implement wellhead protection programs.</li> </ul>
	**Each activity separately can receive no more than 10% of the capitalization grant amount.
<b>Projects</b>	
Up to 30% .....	Loan subsidies for disadvantaged communities.
<b>Based on Fund Amount</b>	
<b>Projects</b>	
Minimum 15% .....	Loans toward small systems (population <10,000) under Section 1452.

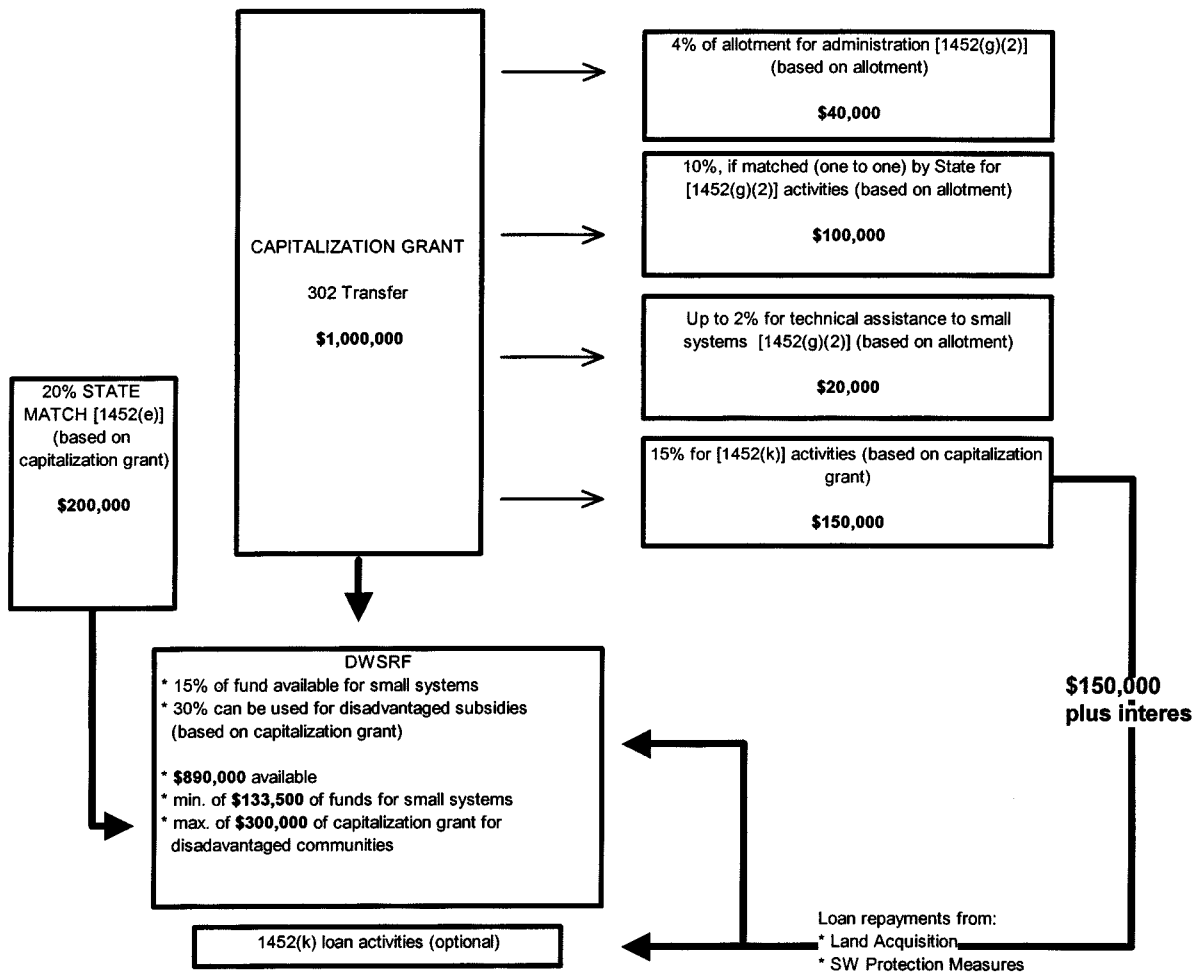


**Table 3 - DWSRF Set-Asides**



**Note:** The Governor of a State may transfer up to 33% of the DWSRF capitalization grant amount to the CWSRF or an equivalent amount may be transferred from the CWSRF to the DWSRF, to be used for eligible Fund activities. If Clean Water funds are used for DWSRF set-asides, the maximum amount of funds available for these purposes is the amount stated in Section 1452.

**Table 4 - Set-aside Example**



**Note:** The Governor of a State may transfer up to 33% of the DWSRF capitalization grant amount to the CWSRF or an equivalent amount may be transferred from the CWSRF to the DWSRF, to be used for eligible Fund activities. If Clean Water funds are used for DWSRF set-asides, the maximum amount of funds available for these purposes is the amount stated in Section 1452.