Appendix H
Approved Deviation Request

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

SEP 26 1997

OFFICE OF ADMINISTRATION AND RESOURCES MANAGEMENT

MEMORANDUM

SUBJECT: Class Deviation from Sections of 40 CFR Part 35, Subpart O

FROM: Gary M. Katz, Director
Grants Administration Division (3903R)

THRU: Harvey G. Pippen, Jr., Director
Office of Grants and Debarment

TO: Timothy Fields, Jr.
Acting Assistant Administrator for
Solid Waste and Emergency Response

This is to inform you that I have approved a class deviation for recipients of EPA's Brownfields Cleanup Revolving Loan Fund (BCRLF) Demonstration Pilot Cooperative Agreements. Because of your expressed interest in the Brownfields Initiative, I am providing you with a copy of this approval.

OGC has advised we do have legal authority to use CERCLA funds for revolving loans and has both reviewed and approved this deviation.

Attachment

cc: Al Pesachowitz

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OFFICE OF ADMINISTRATION AND RESOURCES MANAGEMENT

MEMORANDUM

SUBJECT: Class Deviation from Sections of 40 CFR Part 35, Subpart O

FROM: Gary M. Katz, Director
Grants Administration Division (3903R)

TO: Linda Garczynski, Director
Outreach/Special Project Staff
Office of Solid Waste and Emergency Response

This is in response to your August 29, 1997, request for a class deviation from certain specific requirements of the regulations included in 40 CFR Part 35, Subpart O under EPA's Brownfields Cleanup Revolving Loan Fund (BCRLF) Demonstration Pilots.

Action

I am approving a deviation from those portions of 40 CFR 35.6105(a), (incorporated by reference at 40 CFR 35.6205(a)) which requires the recipient to submit with its application site-specific information.

Background

EPA's Brownfields Economic Redevelopment Initiative is designed to empower states, local governments, communities, and other stakeholders in economic redevelopment to work together in a timely manner to prevent, assess, safely cleanup and sustainably reuse brownfields. As part of this initiative, EPA will award Brownfields Cleanup Revolving Loan Fund (BCRLF) Demonstration Pilots to the states, cities, towns, counties, territories, and Indian tribes to test BCRLF and facilitate coordinated public and private cleanup efforts.

For the 1997 fiscal year (FY97), only entities that have been awarded National or Regional brownfields assessment pilots prior to October 1995 will be eligible to apply to EPA's BCRLF demonstration pilots. The Agency will initiate follow-up cleanup grants of up to $350,000 each to capitalize revolving loan funds for 29 pilot recipients who completed the initial brownfield pilot stage

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The BCRLF demonstration pilot cooperative agreements will be funded under §104(d)(1) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended (CERCLA).

Conclusion

Exploring such a pilot as the BCRLF was not envisioned at the time 40 CFR Part 35 Subpart O was promulgated. To allow the states to demonstrate, on a pilot basis, their ability to meet their stated objectives, a deviation is needed from those portions of 40 CFR 35.6105(a), as referenced in 40 CFR 35.6205(a) and (c), which require the recipient to submit with its applications site-specific information because site identification will not occur at the application phase of the cooperative agreement. OSWER states it is not reasonable for EPA to require recipients to identify specific sites in cooperative agreement applications since one purpose of the program is to empower states and local governments to work with other stakeholders in economic redevelopment to identify sites that warrant cleanups under the BCRLF pilot program. Cooperative agreement recipients will submit all site-specific information required under 40 CFR 35.6105(a) to EPA once a site is identified and the information becomes available.

You also requested a deviation from 40 CFR 35.6205(d) to allow EPA to waive the state cost share assurance for removal costs on behalf of a political subdivision for the BCRLF pilot cooperative agreements. The Office of General Counsel (OGC) has provided clarification of CERCLA cost share requirements in the case of removal cooperative agreements. OGC has advised us that no deviation is required from this provision because such assurance is only required when a fund-financed remedial action is undertaken. Thus, because the BCRLF demonstration pilot cooperative agreements are to be limited to removal actions, a deviation covering remedial actions is unnecessary.

All other requirements of 40 CFR Part 35, Subpart O will apply to the BCRLF pilot cooperative agreements.

Appendix I
BCRLF Financial Scenarios

This appendix presents the results of four hypothetical alternative loan fund structures that vary based on differences in key design elements. While it is impossible to show all potential fund structures, it is intended that these four structures will show the impact of differences in key components on the fund corpus and loaning potential. The components of each fund's structure which will likely have the most significant impact include:

- *Additional capitalization* -- the BCRLF pilot program encourages (although does not require) non-federal contributions to the capitalization of the fund;
- *Loan term* -- the BCRLF pilot program does not establish any requirements on the length of loans, but each cooperative agreement recipient is expected to use sound judgement when establishing loan durations;
- *Interest rate charged on loans* -- the BCRLF pilot program only requires that rates be set at between 0 percent and the prevailing market rate; and
- *Fees charged to loan applicants* -- the BCRLF pilot program does not establish any guidelines on the level of such fees.

For demonstration purposes, each of the four components described above will be altered in the four example fund structures presented in this appendix. In addition to these components, numerous decisions will need to be made by fund managers that also will affect the fund's structure and lending capacity. Other structural components that will affect the fund corpus and loaning potential include provision for administrative costs, interest earned on loan balances, and method / timing of disbursement to borrowers.

For illustrative purposes, the funds have been named based on their distinguishing characteristics, as follows:

- *"Bank-like" Fund* -- characterized by non-subsidized interest rates, relatively high loan processing fees, and short loan terms.
- *"Subsidy" Fund* -- characterized by highly subsidized interest rates, no loan fees, and long loan terms.
- *"Average" Fund* -- characterized by moderately subsidized interest rates, moderate loan fees, and medium-length loan terms.
- *"Additional Capitalization Average" Fund* -- characterized by the same interest rates, loan fees and loan terms as the "Average" Fund, but with additional non-federal capitalization.

"BANK-LIKE" FUND

The "Bank-like" Fund charges interest rates of 6 percent and 2 percent loan fees. The average term of a loan from the "Bank-like" Fund is two years. Such short loan durations facilitate quick repayment and relending of funds. The structure of the "Bank-like" Fund makes borrowing costs higher, but enables assistance to be given to a larger number of projects. As a result, the leverage ratio of total loaned funds to federally awarded dollars is high (e.g., in year 10 as structured here, 5.79).

"Bank-like" Fund Inputs			**Value**
Award amount ($)			$350,000
Non-federal capitalization			$0
Interest rate on loans			6.0%
Loan fees (upfront)			2.0%
Average term (years)			2
"Bank-like" Fund Outputs	**Nominal**	**PV ($ Year 1)**	**Leverage Ratio ($Loans : Fed$)**
$ Value Loans, Year 3	$696,062	$662,412	1.89
$ Value Loans, Year 5	$1,193,550	$1,091,992	3.12
$ Value Loans, Year 10	$2,431,247	$2,025,065	5.79
$ Value Loans, Year 15	$3,656,309	$2,784,006	7.95
Cash Balance, Year 15	$136,712	$75,911	
Value of Outstanding Payment Stream (Per 15 on)	$197,414	$106,104	

"SUBSIDY" FUND

In contrast to the "Bank-like" Fund, the "Subsidy" Fund charges loans a highly subsidized interest rate of 2 percent and no loan fees. In addition, the "Subsidy" Fund spreads repayment out over a much longer loan term, an average of 8 years in this example. Borrowing costs are thus kept very low and loan terms are attractive. Due to the long loan terms and subsidies, however, fewer loans will be made (i.e., fewer projects assisted) over a given time. The leverage ratio in year 10 of the "Subsidy" Fund as structured here is only 2.10 loaned dollars per dollar of federal award.

"Subsidy" Fund Inputs			**Value**
Award amount ($)			$350,000
Non-federal capitalization			$0
Interest rate on loans			2.0%
Loan fees (upfront)			0.0%
Average term (years)			8
"Subsidy" Fund Outputs	**Nominal**	**PV ($ Year 1)**	**Leverage Ratio ($Loans : Fed$)**
$ Value Loans, Year 3	$365,216	$353,718	1.01
$ Value Loans, Year 5	$486,263	$458,214	1.31
$ Value Loans, Year 10	$853,226	$733,818	2.10
$ Value Loans, Year 15	$1,209,020	$953,938	2.73
Cash Balance, Year 15	$40,896	$22,708	
Value of Outstanding Payment Stream (Per 15 on)	$293,886	$146,394	

“AVERAGE” FUND

It is anticipated that many BCRLF pilot loan funds will be structured in a manner that they fall in between the two extremes of “Bank-like” and “Subsidy”. Such funds will be able to provide low cost loans to borrowers while maintaining a viable fund that recycles loans in a timely manner enabling the assistance of many projects. An “Average” Fund example has been provided here to demonstrate one of the many ways such a fund could be structured. This structure in no way is meant to represent the ideal fund structure. The actual structure for each fund will be determined by the needs of the borrowers and capacity of the fund to supplement borrowing subsidies with additional matching capitalization.

As structured here, the “Average” Fund charges an interest rate of 4 percent and loan fees of 1 percent. This interest rate is somewhat subsidized (depending upon borrowers’ alternate sources and prevailing market rates), giving borrowers reduced cost loans, but not drastically impeding the ability of the fund to recoup lending costs. The average loan term is 5 years, which is short enough to recycle funds in a timely fashion, while at the same time giving the borrower a reasonable time frame for repayment. As a result, the leverage ratio of loaned funds to federally awarded dollars is moderate (e.g., in year 10 as structured here, 2.91).

“Average” Fund Inputs			**Value**
Award amount ($)			$350,000
Non-federal capitalization			$0
Interest rate on loans			4.0%
Loan fees (upfront)			1.0%
Average term (years)			5
“Average” Fund Outputs	**Nominal**	**PV ($ Year 1)**	**Leverage Ratio ($Loans : Fed$)**
$ Value Loans, Year 3	$437,733	$420,957	1.20
$ Value Loans, Year 5	$637,985	$593,416	1.70
$ Value Loans, Year 10	$1,203,292	$1,020,119	2.91
$ Value Loans, Year 15	$1,759,606	$1,364,762	3.90
Cash Balance, Year 15	$63,664	$35,350	
Value of Outstanding Pay ment Stream (Per 15 on)	$278,295	$143,931	

“ADDITIONAL CAPITALIZATION AVERAGE” FUND

BCRLF programs have the opportunity to add non-federal funds to the funds received from US EPA capitalization awards. The “Average” Fund could, for instance, contribute $300,000 of additional non-federal capitalization. This additional capitalization would enable the “Average Fund” to have a high leverage ratio very similar to that of the “Bank-like” Fund which did not have additional capitalization, despite the “Average” Fund’s lower borrowing costs and longer loan terms. The leverage ratio of loaned funds to federally awarded dollars is substantially higher than without such funds (e.g., in year 10 as structured here, 5.77).

"Additional Capitalization Average" Fund Inputs			**Value**
Award amount ($)			$350,000
Non-federal capitalization			$300,000
Interest rate on loans			4.0%
Loan fees (upfront)			1.0%
Average term (years)			5
"Additional Capitalization Average" Fund Outputs	**Nominal**	**PV ($ Year 1)**	**Leverage Ratio ($Loans : Fed$)**
$ Value Loans, Year 3	$871,014	$839,949	2.40
$ Value Loans, Year 5	$1,270,583	$1,184,062	3.38
$ Value Loans, Year 10	$2,377,263	$2,019,489	5.77
$ Value Loans, Year 15	$3,468,608	$2,695,567	7.70
Cash Balance, Year 15	$124,893	$69,348	
Value of Outstanding Payment Stream (Per 15 on)	$546,152	$282,459	

COMPARISON OF THE FOUR STRUCTURES

The following chart compares the cumulative loans made under each of the four alternative fund structures. Values are given in year 1 dollars for year 3, year 5, year 10, and year 15 of the program.

ASSUMPTIONS

All the example fund structures are based on the following assumptions:

- Once at least $25,000 in repaid principal is available to re-lend, new loans are made;
- Interest rate earned on balances of repaid principal is 4 percent;
- 100 percent of interest (on loans and fund balances) and fees and 10 percent of initial award are used for administrative costs (this is less than the limits set by the program of up to 100 percent of interest earned and fees, up to 15 percent of initial award, and up to 10 percent of principal repayments);
- All principal is returned to fund for re-lending;
- For simplicity, scenarios assume no default or delay in loan payments;
- All loans are made at the beginning of the year;
- Three-year drawdown of federal funds (50 percent, 30 percent, and 20 percent, respectively);
- Repayment commences at the end of the year, for that year;
- Loans are made for 30 years and then stop; and
- Repayment schedule is semi-annual.

Cumulative Dollars Loaned (Year 1 Dollars)
Comparison of Four Fund Structure Examples