Two Paths to Lower Interest Rates

by Susan Hall, Kansas City, MO, Water Services Department and Ellen G. Miller, Ellen Miller Group, Lenexa, KS

Crystal ball alert for small drinking water systems: capital improvements are coming your way. Check all that apply:
- System age is 30-something (or even older).
- Customers want more… and want it yesterday.
- Safe Drinking Water Act (SDWA) Amendments of 1996 will require system replacements, enhancements, and/or new facilities.

Even if you checked just one, it’s time to revisit your capital improvements “wish list.” Many small systems, originally funded by Farmer’s Home Administration (now Rural Utilities Service) loans or grants, have been operating for several decades. For other systems, customers—especially newcomers from cities or suburbs—demand better water pressure, water quantity, fire protection, and economic development opportunities. And don’t forget escalating state and federal regulatory requirements.

Keep Borrowing Costs Low

Unfortunately, the need for widespread capital improvements to drinking water facilities collides with U.S. taxpayers’ mood. Taxpayers want to keep taxes and user fees as low as possible. What does

Funding Program Explained
RUS Begins Streamlined Application Process

by Natalie Eddy
NDWC Contributing Writer

Editor’s Note: The Rural Utilities Service (RUS) recently issued new regulations for its water and wastewater loan and grant program. In light of these changes, the following article revisits the funding program, explaining eligibility requirements, application procedures, and information that small communities might need before approaching RUS for funds.

The U.S. Department of Agriculture’s (USDA) Rural Utilities Service (RUS) has streamlined its application process for water and waste disposal loans and grants, making them more accessible to the neediest small communities. RUS is one of the largest public funding sources for rural water and sewer systems, providing grants and low-interest loans for rural areas, cities, and towns with populations of less than 10,000.

During the 1997 fiscal year, RUS processed $797 million in loans and $506 million in grants, according to Larry Bowman, chief of the operations branch for RUS water programs. Although the 1998 appropriations bill had not been signed at presstime, Bowman said the upcoming year’s program levels will be similar to last year.

Bowman said changes in the regulations were a natural progression in the loan/grant program. “Our overall interest was in streamlining the

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Build It and They Will Come?
Infrastructure Spending Linked to Job Growth

Do you ever feel like your investment in drinking water or sewer facilities is just money going down the drain?

Think again.

Local infrastructure spending may be the key to attracting new businesses and jobs, according to an article in the August 12, 1997, Wall Street Journal (“Infrastructure Dollars Pay Big Dividends”).

The article cites statistics to show that regions of the country with higher than average infrastructure spending—on roads, sewers, airports, and the like—also saw higher than average growth in jobs.

And even though other factors no doubt came into play, there’s clearly a link between infrastructure investment and job growth, according to the article. “More and more state and local economic-development agencies are recognizing that unless they are prepared to invest in more infrastructure spending they will be left behind in the jobs race.”

The article points to Ohio as one example of a state that has consciously made this link by tying infrastructure spending to economic development.

The state has been able to attract businesses and jobs by coordinating state and local investments in water-line connections, new roads to rural areas, and utilities.

Elsewhere, an economic-development official in Florida says that companies are also concerned about “livability issues,” once they know that their business needs will be met.

The article concedes that there are still plenty of problems with the country’s aging infrastructure.

However, it also includes the observation that “because of heated competition between states for corporate plant and office relocations, more and more regions have better roads, sewers and transportation systems.”

RUS Loan Rates Explained; Two of Three Decrease This Quarter

After holding steady for three quarters, two of three interest rates for Rural Utilities Service (RUS) water and wastewater loans have decreased this quarter.

RUS interest rates are issued quarterly at three different levels: the poverty line rate, the intermediate rate, and the market rate. The rate applied to a particular project depends on community income and the type of project being funded.

To qualify for the poverty line rate, two criteria must be met. First, the loan must primarily be used for facilities required to meet health and sanitary standards. Secondly, the median household income of the area being served must be below 80 percent of the state’s nonmetropolitan median income or fall below the federal poverty level. (Median household income is determined by lining up all household incomes from highest to lowest. The median income is at the middle of the list. The nonmetropolitan median income figure varies from state to state, while the federal poverty level is set at $16,050 for 1997).

To qualify for the intermediate rate, the service area’s median household income cannot exceed 100 percent of the state’s nonmetropolitan median income.

The market rate is applied to projects that don’t qualify for the poverty or intermediate rates. The market rate is based on the average of the Bond Buyer index.

The rates for the first quarter of fiscal year 1998, which applies to all loans issued from October 1 through December 31, 1997, are:

- poverty line rate: 4.5 percent (unchanged from the previous quarter);
- intermediate rate: 4.875 percent (down .125 from the previous quarter); and
- market rate: 5.375 percent (down .125 from the previous quarter).

RUS loans are administered through local or state Rural Development offices, which can provide specific information about RUS loans and applications.

For the phone number of your state Rural Development office, contact the National Drinking Water Clearinghouse at (800) 624-8301 or (304) 293-4191.
Federal Agencies Seek Funding Cooperation

Three federal agencies have stated their intent to better coordinate efforts when working together to fund drinking water and wastewater activities.

The three agencies—the U.S. Department of Agriculture’s Rural Utilities Service (RUS), the U.S. Environmental Protection Agency (EPA), and the U.S. Department of Housing and Urban Development (HUD)—are the largest providers of federal funding for water and wastewater projects, particularly in small and rural communities.

RUS provides loans and grants for projects in lower income and rural communities serving up to 10,000 people. (See article beginning on page 1.)

EPA provides federal capitalization grants to states for revolving loan programs. For nearly a decade, EPA has provided funding for the clean water state revolving fund to support wastewater, agricultural and urban runoff, stormwater, and related water quality projects. More recently, the Safe Drinking Water Act of 1996 created the new drinking water state revolving fund (DWSRF). (See DWSRF summary, page 11.)

HUD makes block grants to states under the Community Development Block Grant (CDBG) program for smaller communities (those not eligible to receive CDBG funds directly from HUD). CDBG funds can be used for water and wastewater projects, individual hook-ups, planning, and technical assistance, as long as these activities meet a national objective—usually benefiting low- and moderate-income people.

In a joint memorandum released this spring, officials with the three agencies spelled out their plans to increase cooperation at the federal, state, and local levels to help foster more efficient use of funds and reduce administrative inefficiencies. The cooperative effort pertains to all projects, but a special emphasis is placed on projects involving small communities.

The memorandum reinforces efforts already begun by many states to better assist their small, rural communities with water and wastewater needs, according to John Sidor, executive director of the Council of State Community Development Agencies.

“Our hope is that this [memorandum] will become the catalyst that will encourage Congress and the three federal agencies to institute a single set of regulations when any of these sources are used to fund a single project,” Sidor added.

Some of the specific actions the agencies agreed to take at the state level include:

• cooperate in preparing the consolidated, operating, intended use, and strategic plans required by the three agencies;
• work to coordinate funding cycles and take other steps to remove barriers when more than one agency is involved in the same project;
• when possible, meet on a regular basis to discuss projects that need funding; and
• prepare a single environmental review document that is acceptable to all three agencies.

The agencies appointed the following headquarters staff to provide national leadership:

Larry Bowman, RUS; Jamie Bourne and Richard Kuhlman, EPA; and Stephen Rhodeside, HUD.

Previous issues of Water Sense have summarized efforts by a number of states to coordinate infrastructure funding. The articles include “State Groups Coordinate Funding, Resources” in the Spring 1997 Water Sense and “‘One-Stop Shops’ Help Small Communities” in the Summer 1995 Water Sense. These back issues can be obtained from the National Drinking Water Clearinghouse (NDWC) by calling (800) 624-8301. A shipping and handling charge will apply.

Commissions Can Regulate Drinking Water Utilities

Fourty-five states have commissions, such as a public utility commission, to regulate investor-owned water utilities, according to Janice Beecher, director of regulatory studies at Indiana University’s Center for Urban Policy and the Environment. Some of these commissions also regulate homeowners’ associations, water districts, or other nonprivate systems as well.
process. The regulations hadn’t been looked at in a holistic way for a few years,” said Bowman. “A small working group of USDA Rural Development field staff led the effort to revise the regulations. Input was solicited from other parties as the drafting process continued.”

Bowman hopes the new regulations, issued on June 19, will make the entire process a little bit easier. Although all potential applicants are affected by the changes, he said some will not notice a big difference because many parts of the program remain unchanged.

What’s been changed?

One of the most significant changes is the formula used to select projects for funding. Bowman said it has been revised slightly to direct the funds to low-income, small communities that need to correct health problems.

“By doing this, we hope to direct grant funds to the communities that need them most,” said Bowman.

The regulations retain the maximum grant at 75 percent of eligible project costs for the lowest income, most needy communities. However, the maximum grant consideration for most of the grant-eligible communities has been reduced from 55 to 45 percent, he said.

To receive consideration for the 75 percent grant, the service area’s median income must be below the federal poverty level—currently set at $16,050—or below 80 percent of the state nonmetropolitan median household income. In addition, the project must be necessary to alleviate a health or sanitary problem.

To qualify for the 45 percent grant consideration, a community’s median household income must be below the state’s nonmetropolitan median income.

For example, if a state’s median income is $30,000, the service area’s median income must be below 80 percent of that, or $24,000, to potentially qualify for a 75 percent grant. Bowman said most of the grant-eligible communities fall into this category, adding that some of the higher income communities may not qualify for any grant funding. “We almost always make a loan with a grant, but we wouldn’t necessarily make a grant with a loan,” he explained.

“The new regulations continue the policies of limiting grant consideration to the amount necessary to achieve reasonable user rates, and prohibiting grants to communities where the median household income is above the states’ nonmetropolitan median household income,” said Bowman.

Bowman said reasonable user rates are defined by what similar communities charge for similar services.

In addition, to qualify for a grant, an applicant must need the funding because they lack the resources to complete a planned project on their own.

Another change in the regulations is the elimination of the formal preapplication as part of the application process. Bowman believes that removing it will help shorten the application process. He added that the regulations allow a potential applicant to get an eligibility determination from the agency prior to filing a formal application.

A preliminary engineering report will be required earlier in the application process. Previously, the preliminary engineering report was required at a later stage within the full application. “We believe moving this up makes sense because with a clear picture of what the applicant wants to build, we can help them move right along with the process. We can say ‘yes’ or ‘no’ sooner,” said Bowman.

Bowman added that the simplified language in the program regulations would allow communities to better identify for themselves what information they need to submit or what criteria they need to meet to qualify for funding.

The new regulations contain changes required by the 1996 Farm Bill, such as a requirement for the applicant to notify constituents of its intent to apply for the funding within 60 days of the application. Gary Morgan, RUS director of engineering and environmental staff, said this can usually be done via a nonlegal advertisement in a local newspaper.

There are also new guidelines for employing consulting engineers. If a different engineering firm is to be contracted for the planning design and the construction design, then a formal request for a proposal to solicit invitations is necessary. Morgan explained the process is similar to bidding, but instead the applicant requests qualifications from consulting engineers and makes a decision based on those qualifications.

Who is eligible?

To be eligible, a system must be owned and operated by a local government, Indian Tribe, cooperative, or nonprofit organization and must serve fewer than 10,000 people. Funds are available to public bodies, such as municipalities, water authorities, water sewer districts, nonprofit corporations, and recognized Indian tribes.

Continued on next page
RUS cannot provide funding to privately-owned systems operated for profit.

Another important factor is that RUS only lends to communities unable to obtain funding on their own from commercial lending institutions at reasonable rates and terms.

In addition, the applicant must have the authority to construct, operate, and maintain the facility and must be legally able to secure and repay a loan.

**How can RUS funds be used?**

RUS program financing can be used for most costs relating to the building or expansion of a water or wastewater project. These costs can include construction, legal expenses, and engineering costs. “We can do drinking water, sanitary sewers, solid waste disposal, and storm drainage,” said Bowman.

The funding may account for most, or even all, of an applicant’s needed funding. However, many times when an applicant applies for partial funding through RUS, the rest of the money needed is acquired through other government programs.

Bowman said in most cases an approved applicant receives a combination of a loan and a small grant. Interest rates for RUS loans are set quarterly at three levels: poverty line rate, intermediate rate, and market rate. (See box on page 2 for additional information about interest rates.)

**How the Process Begins**

All RUS water and waste disposal loans and grants are processed and approved in the field by state and local district Rural Development offices. From start to finish, Morgan said the entire loan/grant process usually takes nine to 18 months to complete.

Prior to the new regulations, communities planning to apply for RUS funding would submit a preapplication form. The purpose of this form

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was to determine if the community met the population, median income, and other eligibility requirements mentioned earlier.

Previously, the preapplication process took approximately 45 days to complete, and after that a formal application had to be filed. Now applicants are able to get eligibility determination from the agency prior to filing formal paperwork. Just how applicants get this eligibility determination can vary from state to state—in some cases this may be done through a letter, a meeting, or other methods.

Morgan said the first thing for prospective applicants to do is to contact their state RUS office. “Each state has some flexibility in determining what kind of information they would like to see before the application is submitted,” said Morgan. “They can give potential applicants a quick read to eligibility or what additional item may be needed. Many times this can be done in a phone call.

“Most of our program managers are familiar enough with communities in the states. They could tell them what kind of information they might need to see or tell them where else they should go for help.”

Bowman added, “We would encourage communities to get to know us. Most of the time the first step is a phone call, but we are also willing to meet with communities and help them think a project through.

“The more we learn about the community’s situation, the better able we are to help them.”

The types of things RUS needs to know during that initial contact include a description of the project, rough cost estimates, and health and environmental concerns. More specific information would be helpful if available, such as median household income of the community or service area, current and projected user rates, and size of the community.

A Single Application Is Required

The next step will be to file the formal application. “Basic information items—such as median income level—that used to be contained in the preapplication are now folded into the application process,” said Morgan.

“According to the new regulations, RUS will have 45 days to review the application. Following the review, we will give an applicant some indication of what action we can take. They may get an approval, or sometimes because of lack of funds, they may be placed on a waiting list, which is prioritized based on different factors, such as health and safety, size of the community, and income levels.”

If there are sufficient funds for a project, a letter of conditions is prepared and delivered to the applicant. This letter sets out the conditions on which a loan and/or grant will be approved and the conditions that must be met prior to closing the loan or grant and actually advancing funds.

The applicant then can proceed to develop design drawings and advertise bids.

Most loan recipients need to obtain interim financing to cover the cost of construction until the RUS funds are released, according to Morgan. “For the most part, the applicants are able to secure a short-term loan from local lending institutions, based on a commitment from us. They use the interim financing for construction.

“When those funds are expended, we close the loan and use the loan funds to pay continued on next page

Before You Phone . . .

Some Tips For RUS Applicants

Under recently issued regulations, potential applicants for Rural Utilities Service water and wastewater funding no longer need to complete a formal preapplication. Instead, they can usually get an eligibility determination from their state or local Rural Development office. This can start with a phone call.

Some information that might be requested at this early stage includes:

• description of the proposed project,
• rough cost estimate of the project,
• health or environmental problems facing the current system,
• median household income of the community or service area,
• current and projected user rates,
• population of the community,
• number of residential users,
• number of commercial users, and
• amount of water used.

Once this eligibility determination is made, and if funding is available, eligible applicants would be encouraged to file a formal application. $
Changes Should Help Applicants, RUS
Morgan believes the new regulations will be helpful to both applicants and field officers.
“There is always a little confusion as you go through changes. Once our program managers master the changes, it will be easier for us and the applicants,” he said.

He added that RUS will continue to process applications and preapplications already on hand.

Although Bowman also expects the new regulations to help expedite the process, he added that there are many existing applications to work through. “We still have a backlog in applications. We have over $2.5 billion in loan applications and a little over $1 billion in grant applications. Working through this may be our most difficult task,” he said.

Two major reasons for delays in loan and grant processing are the “lack of dollars” and “applicants who are not quite sure what they need to build,” Bowman said.

He added, “We are constantly working with other potential funding sources, such as Community Development Block Grants (CDBG), state revolving loan funds, and private sources of credit in an effort to get more projects built with the available dollars.”

In addition, Bowman said RUS works with applicants “to help them plan and develop their project into something that is fundable.”

Ways to Improve Your Chances
Given the high demand for limited resources, Bowman offers this advice for communities seeking RUS funding for water or wastewater projects:

• Contact Rural Development field staff early during the development phase of a proposed project.
• Recognize that competition for RUS funding resources is high and seek cost-effective alternatives.
• Realize grants are hard to secure, and even tougher under the new regulations that reduced the maximum grant amount for most grant-eligible communities.
• Be amenable to a low-interest, long-term loan, remembering that the goal is to complete the project as an investment in the community’s future.
• Be ready to set reasonable water rates consistent with the 1990s.

States Implementing New Regulations
Glenn Walden, RUS program director for Florida, said his state has implemented the changes and trained area office staff on the new regulations. “It’s really too early to gauge how well it will be received by the prospective applicants. The new regulations have been organized well and a lot of policies have been updated,” said Walden.

“Based on preliminary discussions with consulting engineers, they’ve [applicants] been receptive. There has not been an indication of a great deal of reduction in the overall paperwork required. We did eliminate the preapplication process, but most of the information from that has been incorporated into the new application process. However, the flow of application processing should be enhanced with the new regulations.”

Dorman Otte, program director for rural utilities and community facilities in Iowa, said the change in regulations, particularly the elimination of the preapplication, has allowed them to formally merge their funding program with that of two other state agencies.

He added that they are currently developing a common application form for RUS, the CDBG program, and the state Department of Natural Resources (state revolving loans).

“We have had an excellent relationship with these funding sources, particularly the CDBG program, over the past 13 years,” said Otte. “This will allow us to forge a more efficient approach in terms of financing. The new regulations enable us to develop a common application for all three agencies, making it easier and more efficient for applicants and reducing red tape for all three agencies.”

For more information on the new regulations or application requirements, contact your state or local Rural Development office. You may also contact Bowman at (202) 720-9628 or Morgan at (202) 720-8328. To obtain the number for your state Rural Development office, contact the National Drinking Water Clearinghouse at (800) 624-8301 or (304) 293-4191. Staff listings also may be found on the RUS Web site at http://www.usda.gov/rus/water/.
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this mean for small systems?

- Know your financing options, from federal funding sources (see the Spring ’97 Water Sense) to state and local lenders.
- Consider innovative arrangements with other systems to get access to lower interest rates, which lowers the cost to borrow money for capital improvements. Two ways for small systems to do this are the new drinking water state revolving fund (DWSRF) and wholesale water contracts.

New Federal Funds Available

The SDWA Amendments of 1996 included new money for states and small systems. For fiscal year 1997, this funding source—the DWSRF—provided $1.3 billion in “seed money” to states via U.S. Environmental Protection Agency (EPA) grants. Small systems must receive some DWSRF loans or the state will lose some of its EPA grant. States may set aside certain percentages from their EPA grant for items such as administration and technical assistance. The three main requirements for DWSRF loans are that they: (1) help systems come into or maintain compliance with SDWA; (2) protect public health; and (3) keep rates/user fees affordable. Although these funds cannot be used for such activities as fire protection or economic development, they still provide a new source of funding for projects that address public health risks. (See related article, page 11.)

And find out how much money is available. All states must contribute at least a 20 percent match to their EPA grants, but some states are contributing far more so that they can make the most of the federal funds. Learn the ratio of federal-to-state dollars in your state. For example, Kansas has chosen an aggressive 4:1 leveraging ratio, meaning that four state-procured dollars are matched with every federal dollar. Kansas has submitted its application for EPA funds and expects to start its DWSRF in the near future.

For fiscal year 1997, after deducting set-asides, Kansas plans to put more than $11 million from the EPA grant into its Kansas Public Water Supply Loan Fund. State dollars will bring the total in this fund up to $52.5 million. Leveraging means more loans can be made to systems throughout the state.

To help as many systems as possible while attracting investors to the loan fund, Kansas is constructing a bond pool that will include both rated and non-rated systems. Entities that have neither taxing powers nor the ability to get bond insurance, but want to be part of the pool, must sign a special contract. That contract becomes part of the loan agreement and obligates the water system to open its books to the Kansas Development Finance Authority (KDFA), which manages the financial aspects of the loan fund. In return, KDFA takes care of all financial and other reports for the system.

“We have taken great pains to make sure that small water utilities are included in our program,” said William Caton, KDFA President.

Partnering to Keep State Government Small. Two other organizations are working with KDFA to jointly administer the loan fund, which is the funding source from which the state’s DWSRF loans will be made. The Kansas Department of Health and Environment (KDHE) is the primacy agency for the state’s drinking water program, with responsibility for deciding which systems are eligible for DWSRF loans.

“We’ll make loans at 80 percent of market rate, with all recipients paying the same rate,” said David F. Waldo, Chief, Public Water Supply Section in KDHE’s Bureau of Water. In other words, because of the loan fund’s pooling concept, even small, unrated systems can get below-market interest rates. Normally, the most attractive rates can only be obtained by larger, highly rated systems.

The third partner in the loan fund is the Kansas Rural Water Finance Authority (KRWFA), a non-profit corporation formed in 1988. It is...
under contract with KDFA to (1) conduct financial analyses for all prospective DWSRF borrowers and (2) manage the contracts of the non-rated rural water districts and towns identified as needing management and reporting assistance.

“The three-way partnership is unique,” Caton concluded. “Kansas does not need to hire expertise at the state level when we have an organization [KRWFA] that has the mission, organization and track record [to help our DWSRF borrowers]. It’s a good way not to create more government.”

Wholesale Contracts: Another Option

Hoopla about the DWSRF has blinded some to a basic fact: no matter how aggressively a state leverages its federal grant, those funds still won’t provide enough loan money to meet all state needs.

So what’s a small system to do? Revisit the wholesale water contract, wherein one system buys and distributes water already treated by another system. Benefits include:

- dependable quantity of water that meets state and federal quality requirements;
- mutually agreed-upon business contract;
- local control;
- predictable rates and/or maximum allowed increases; and
- last, but definitely not least, the opportunity to partner with the supplier for financing.

Partnering for Lower Interest Rates. One way small systems can get lower interest rates for financing expansions or upgrades is to work with a potential or current water supplier to get legal language, usually through votes or bond issues, that permits the supplier to help others. This legal language allows voters in the supplier’s district—which is often a larger municipality with a good credit rating and lower borrowing costs—to OK the use of their revenue dollars to help supply water to smaller, outlying communities.

Successful 1996 ballot language in Kansas City, Missouri, permitted using part of a $150 million water system capital improvement bond to fund “. . . improvements to insure adequate and dependable service to our suburban wholesale customers.” That enabling language grew out of expanded relationships between the Kansas City Water Services Department and neighboring counties, municipalities, and public water supply districts.

As a result of the ballot language, some of Kansas City’s $150 million bond proceeds can be used to lay water mains, build storage tanks, or fund other activities to extend water service to communities outside of the city. The outlying communities purchasing water from the city repay these costs through water rates. These rates will cover both the cost of water and their share of the improvements. However, the rates normally will be noticeably lower than if the community had to borrow money itself because the city’s good credit rating results in lower borrowing costs. Moreover, Kansas City’s Water Services Department has excess water treatment capacity, so it can achieve “economies of scale.” That is, as it treats more water, the cost per 1,000 gallons tends to go down, benefitting all customers.

“We need a reliable supply [of drinking water] that will increase growth out here,” said John Moodie, President of the Ray County Public Water Supply District (PWSD) No. 1, northeast of the Kansas City metro area. It has 750 meters

Step-by-Step in Kansas

To receive drinking water state revolving funds (DWSRF), each state must submit its criteria for selecting priority projects for funding to the U.S. Environmental Protection Agency (EPA). The main steps that Kansas proposed for systems to get funding are:

1. The municipality or rural water district submits a project description (but not an engineering report), including problems addressed and preliminary cost estimates.
2. Project descriptions are ranked by the primacy agency, the Kansas Department of Health and Environment (KDHE). Top ranking criteria include water quality issues such as compliance with the Safe Drinking Water Act, regionalization of systems, reliability, and state median versus applicant household income levels.
3. Highly ranked systems are sent an official application package.
4. The system completes its official application (including engineering/environmental impact reports and financial analysis through Kansas Rural Water Finance Authority), requesting review and clearance from federal and state agencies.
5. If appropriate based on agencies’ review, KDHE issues a Finding of No Significant Impact (FONSI) on the environment, permitting the loan to be made.
6. Presuming the applicant holds public meetings and satisfies all other requirements, it should be able to receive DWSRF funding within a few months.
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serving about 2,625 people. “I see great growth in this area. Every year EPA puts more stringent testing requirements on water treatment. The small treatment plant will be uneconomical.”

Ray County PWSD No. 1 is currently paying $4.82/1,000 gallons from another wholesale water supplier. Recently, Kansas City gave the PWSD cost estimates to supply wholesale water and to build a water main that would serve the district.

“Assuming that the preliminary costs from Kansas City hold, the cost of water plus amortization of construction would save us 77 cents per 1,000 gallons,” Moodie noted. Any rate increases would be based on cost-of-service analyses.

Leveraging county investments. Nearby Clay County is also interested in buying water from Kansas City to supply the regional airport and support plans for industrial development.

County Administrator Gary Panethiere sees two benefits to getting Kansas City’s water through a wholesale contract. One is a dependable supply of water for growth, housing, and business expansion.

The other benefit is the low cost for both the water and the capital expansion to bring it. “Kansas City quoted some rates they had supplied other jurisdictions; they were 25–50 percent lower than we’re experiencing,” Panethiere said. “Of course, it would depend on the final rate. But this is a public-public cooperative agreement that, if finalized, will be win-win for all parties.”

Expanding to outlying areas. With legal language in place that allows the use of bond funds to help suburban wholesale customers, Kansas City began telling the outlying communities about possible wholesale water options.

Just a water tank? Maybe not—at least for small communities buying treated water through wholesale contracts. Having your own tank for reserves may lead to cheaper rates from the supplier, who can pump water during less expensive “off hours.”

In summer 1997, Kansas City Water Services Department held a series of meetings with Missouri and Kansas public water systems. The topic: Kansas City’s master plan for expansion and possible interest in connecting outlying communities to Kansas City’s supply via new mains. As of September, about eight entities—including public water supply districts, municipalities, and counties—have signed up to pursue serious study of connecting to Kansas City’s supply. What happens next?

“We’re in the process of hiring a consultant to look at the players, the best way to run the main and the specific costs for each one,” said Frank Pogge, Deputy Director of the Water Services Department. Once the consultant’s figures are mostly accepted, it would be time to start negotiating contracts between the city and the new buyers of wholesale water.

“A portion of the $150 million bond issue was designated for improvements to insure adequate and dependable service to our suburban wholesale customers,” Pogge stated. “The revenue generated by wholesale customers is a key to expanding our customer base and reducing the need for future water rate increases for all our customers.”

According to financial advisor Roger S. Edgar, carefully crafted bond issues or ballot statements can benefit two or more parties. Of course, special and legal counsel is needed to assure conformity with state laws concerning purpose, tax/fee assessments, and spending.

“There is an art to constructing language that will provide the necessary specificity and reasonable flexibility” for two parties working together legally on a mutually needed project, commented Edgar, executive vice president and manager, Midwest Public Finance, for George K. Baum & Company, Kansas City.

“If the needs [for a possible project] are pronounced but common, there is often much creativity about how to jointly proceed,” he noted. One proven example is the interlocal cooperative agreement, a legal document permitting two or more entities to work together. Whatever the device that’s used, he said, the goal is a long-term business relationship that reflects mutual trust and confidence between the supplier and buyer of wholesale water.$
**The ABCs of the Drinking Water SRF**

*Editor’s Note: The first article on page 1 includes discussions of how Kansas plans to handle its new drinking water state revolving fund. The following overview summarizes major features of this federal program.*

**About the DWSRF**

The drinking water state revolving fund (DWSRF) was created by the Safe Drinking Water Act (SDWA) Amendments of 1996 to help water utilities finance costs of complying with SDWA requirements and protecting public health.

The U.S. Environmental Protection Agency (EPA) awards federal grants to states to establish revolving loan programs. After contributing at least a 20 percent match, a state can make loans from this fund to eligible community water systems. As these loans are repaid, the funds can be loaned again to other systems.

Often these loans can offer low interest rates or other favorable terms, particularly for communities defined as “disadvantaged” by the state.

Nearly $1.3 billion was made available for distribution to states in fiscal year 1997. States have until September 30, 1998, to apply for these DWSRF funds. Another $725 million is available for fiscal year 1998.

Many states are still in the process of setting up their programs. As of October 15, 1997, all but three states had received legislative authority to operate a program, and 18 states had received a DWSRF capitalization grant from EPA.

**Becoming Eligible**

DWSRF funding priority must be given to projects that help ensure:

- SDWA compliance,
- public health protection, and
- affordability of rates/user fees.

A community water system that expects to receive DWSRF funds has to first get on its state’s priority list of projects for funding. Ranking methods for these lists vary by state, so communities should contact their state’s program administrators to find out how to get on the list.

Any community that will receive a DWSRF loan must show that it has—or will have—the capability to comply with SDWA requirements.

Types of projects eligible for funding include:

- system consolidation or restructuring,
- installation or upgrades of treatment facilities, storage facilities, or distribution systems,
- source improvement, and
- planning and design activities.

Types of activities not eligible for funding include construction and rehabilitation of dams, operating expenses, and projects intended primarily to serve future growth.

Private systems are eligible for DWSRF funding, unless state law precludes it.

**Considerations for Small Systems**

The law has provisions to help small systems, including the requirement that at least 15 percent of the loan fund be used for systems serving fewer than 10,000 people, to the extent that there are projects available for funding. States may also use up to 30 percent of the grant to provide loan subsidies to “disadvantaged” communities, which may include small systems.

States can also set aside a portion of their EPA grant for activities that will help protect water supplies and ensure compliance with the SDWA. Set asides that may assist small systems include:

- up to 2 percent for technical assistance, and
- up to 15 percent for source water protection, wellhead protection, and capacity development activities.

**Demonstrating Capacity**

The SDWA clearly emphasizes that the DWSRF cannot be used to fund new systems doomed to fail, or prop up existing systems that will not survive.

To help systems, especially small ones, meet this requirement, states must set up programs to ensure that all new systems demonstrate they have the technical, financial, and management capacity to operate over the long term. States that do not have capacity development programs in place by October 1998 may lose up to 20 percent of their DWSRF grant from EPA.

To learn more about specific requirements in your state, contact your state’s DWSRF program administrator. For the number of your state contact, call the National Drinking Water Clearinghouse at (800) 624-8301 or (304) 293-4191.

**Guidelines Available**

Detailed information about the drinking water state revolving fund (DWSRF) is provided in a guidance document produced by the U.S. Environmental Protection Agency (EPA). This February 1997 publication, Drinking Water State Revolving Fund Program Guidelines, explains how states can obtain federal grants to start their DWSRF programs and what they may do with those funds.

Aimed primarily at state-level administrators, this 55-page document also describes eligible uses and projects, set-aside allowances, and provisions for small systems. The document can be obtained at no cost from EPA’s Safe Drinking Water Hotline at (800) 426-4791. The guidelines are also available online from EPA’s Web site. Access http://www.epa.gov/ogwdw, and click on the DWSRF link.
Leasing Helps Make Equipment Affordable

by Jeremy Canody
NDWC Contributing Writer

Many small communities, when faced with having to purchase new municipal equipment and technology, find that budgetary constraints and a lack of available funds often prevent outright cash purchases.

When funds are limited, it’s particularly difficult for small water and wastewater utilities to purchase equipment needed to attain compliance with environmental regulations or to buy heavy operating equipment that may be used only occasionally.

Outright purchases of equipment and technology can drain municipal budgets, decrease reserve and emergency funds, and often cannot be made without extensive voter and committee approval.

When faced with this common dilemma, some small communities are leasing the equipment and technology they need for their everyday and seasonal projects. An increasing number of financial institutions offer flexible leasing and renting programs that can help communities eliminate the need for large, upfront lump-sum cash outlays.

What is a municipal lease?

Municipal lease agreements—usually known as lease/purchase agreements—serve as an alternative to cash purchases or the issuance of long-term municipal bonds. Rather than paying cash upfront, the customer obtains the use of equipment by making principal and interest payments for an agreed-upon payment period (monthly, quarterly, semi-annually, or annually) with a minimum purchase option ($1) at the end of the lease term.

According to Ken Parker, vice president of Laurel Mountain Leasing in Ligonier, Pennsylvania, a true municipal lease/purchase agreement is a tax-exempt, non-debt source of capital funding for equipment that is essential to a municipality’s operations. (Parker is also a volunteer firefighter who presents municipal lease training seminars around the country for fire departments and various councils of government.)

Parker explained that when municipalities establish a lease/purchase agreement, the payments on the equipment are treated as a current business expense rather than debt.

This is because the lease contract includes a non-appropriation clause that allows the municipality to cancel the contract without penalty, but only if they are broke and funds are not available in subsequent years’ budgets. Essentially, the lease is a series of one-year terms, and renewable unless it is cancelled according to the provisions noted above.

Since the lease/purchase contract is not considered debt, the community can avoid the delay and expense of getting taxpayer approval and issuing bonds, said Parker. However, leasing should not be used as an alternative for voter-rejected financings, according to the Association of Government Leasing and Finance, a nonprofit membership organization for companies involved in municipal leasing.

Equipment acquired through lease/purchase arrangements must still go out for bid, like any other major equipment purchase, added Parker. And the municipality’s governing body, such as a town council or water board, must still vote to approve the lease payments at its public meetings.

The interest on a municipal lease is exempt from federal income taxes, and in some jurisdictions it is also exempt from state or local taxes. Since the leasing institution (lessor) does not have to pay taxes on the interest it collects, it can afford to charge a lower interest rate to the leasing municipality (lessee).

For an entity to become eligible for a tax-exempt municipal lease, Parker added, it must be a political subdivision with power of eminent domain or the power to tax, issue bonds, or police its citizens. These entities are defined under Section 103 of the Internal Revenue Tax Code as amended in 1986. These generally includes states, cities, townships, villages, counties, school boards, universities, and other qualifying agencies and authorities, Parker said.

Lease/purchase agreements can be structured various ways to meet customers’ unique equipment and cash flow needs. For instance, a master lease allows multiple purchases from multiple vendors over long periods of time. Equipment can be upgraded or new equipment can be added during the term of this lease without negotiating a new contract. A single transaction lease, on the Continued on next page
other hand, will simply cover a one-time purchase of one piece (or several pieces) of equipment.

Various lease payment options may allow a municipality to make payments during certain times of the year, defer the first payment, or establish some other customized payment schedule best suited to the community’s needs and availability of funds.

What can be leased?

Anything that is deemed essential-use equipment—necessary for an entity’s ongoing operations—can be leased, Parker said.

Some examples include trucks and other transportation equipment, waste hauling and recycling equipment, construction equipment, road graders and pavers, emergency vehicles, and even computers and communications equipment.

Water and wastewater facilities, in particular, can lease solid- and liquid-waste equipment, pump stations, transfer stations, water testing equipment, computers for monitoring or record keeping, and even entire treatment systems.

The community of Conemaugh Township, Pennsylvania (pop. 9,800), began leasing its road maintenance, municipal waste, and sewer service equipment after officials discovered that buying these items would drain all the money they had in the bank. Prior to leasing, the community was depleting its capital by purchasing its equipment. Township Supervisor Al Zuccolotta said that when the town began drawing more and more money from the bank, they feared they would have to increase taxes to make up for the debt. However, after establishing a municipal lease agreement, the community was able to acquire such items as street sweepers and landfill equipment without the huge costs involved with an outright purchase or bond issue. The town has even been able to lower its taxes during the three-year time period that they have been leasing.

“Why use your own money when you can use someone else’s?” Zuccolotta said.

Why lease?

Parker said concern about finances is the most common reason municipalities lease. He offered the following list of leasing benefits:

- **Low cost financing**—The tax-free characteristics of municipal leases and increasing competition among leasing institutions can result in interest rates substantially lower than the commercial market. The amount leased, the type of lease, and the term are all determining factors for the interest rate of a lease. Parker advises customers to be aware of these differing rates and shop for the lowest ones.
- **Improved cash flow**—Leasing provides 100 percent financing with no major cash outlays. Payments can be tailored to the convenience of the customer.
- **More equipment and better facilities**—Leasing may help communities with limited resources afford facility and equipment upgrades to keep up with costly technological advances.
- **Fixed rate financing**—Payments remain the same over the term of the lease, no matter how much interest rates may fluctuate.
- **Speed and control over the process of the lease**—No referendum or bond election is required, and funds are available in a matter of days. The customer controls the choice of equipment, its delivery, and the payment plan.

How do you weigh the options?

Before deciding which lease option is best—or even whether or not to lease—potential leasing customers need to consider their budget, revenue stream, the projected useful life of the equipment, desire for ownership, and potential obsolescence of the equipment, particularly computers and technology.

Prospective customers also need to compare the costs and benefits of leasing against costs to acquire equipment through other means.

Issuing bonds takes time and costs money for legal fees, brokerage costs, and related expenses. “You need to evaluate the total cost outlay of bonds versus a lease,” said Parker. In some cases, the lease costs may be less, while in other cases, the bond issue may be more economical.

A similar evaluation must be made when comparing long-term lease payments to a large cash outlay that may deplete a municipality’s operating budget for the year.

“If you spend all your money on one piece of equipment, is there anything left to cover your operations?” asks Parker. If the municipality can afford the equipment, it may be less expensive to buy it outright. However, for some entities, the regularly scheduled lease payments may offer a more practical way to obtain equipment while leaving enough in the operating budget to cover other expenses.

Parker also noted that even though some entities have enough cash to buy equipment outright, they may find that they can invest that money to get a higher rate of return than they’re paying on the lease.

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Leasing Helps Make Equipment Affordable

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For some, leasing may not even be an option; not every entity that applies for a lease will qualify. For example, those with bad credit, bankruptcy problems, or loan defaults could have problems obtaining a municipal lease.

There are certain times when an entity may want to avoid leasing altogether: when there is political turmoil; when the use is non-essential; if the equipment is needed only for a particular job (in this case an entity may want to consider renting—see box below); if the term of the lease is excessive to the value of the asset; or if an entity can simply afford to buy the equipment they need without any setbacks.

Who offers leasing?

There are numerous companies, including some banks and independent leasing companies, that provide leasing services to qualifying entities. Leasing companies contract with hundreds of vendors across the country to offer a variety of equipment and technology.

Parker said credit decisions are generally made within 24–48 hours after a customer’s credit information is received. He said after all documents are signed, accepted, and forwarded to the interested parties, the lessor will pay the vendor for the equipment and the lease will commence. In most cases, the customer then has the title to the equipment from the beginning of the lease term.

Parker advises all entities considering municipal leasing to know exactly what they are signing before doing so. “Talk to your attorney and/or financial advisor and make sure you have sample copies of all the legal documentation before you take action,” Parker said. He further explained that the municipal lease process, although somewhat easy to access, can be very confusing to someone who doesn’t fully understand leasing requirements and terminology. A municipality’s advisors should be able to help evaluate the options.

If you are interested in leasing, discuss your options with your governing authorities and then contact the various leasing institutions for assistance. For more information on municipal leasing and referrals, you may also contact Ken Parker at (800) 214-4606 or (412) 238-4949. To find out more about municipal leasing on the Internet, do a “municipal leasing” word search on your favorite search engine. Additional information is also available on the Association for Governmental Leasing and Finance Web site at http://www.financenet.gov/financenet/state/aglf/aglf.htm.

When To Consider Renting Versus Leasing

In some cases, leasing may not be the most practical answer to a community’s need to acquire municipal equipment and technology. Entities that don’t want to make the commitment to an outright municipal lease/purchase agreement may want to consider renting.

The main difference between leasing and renting is that leasing involves ownership—it’s essentially a long-term purchase arrangement. Renting is usually short-term and involves payment for usage only; the renter does not end up owning the equipment.

Items that are frequently rented by municipal entities include dump trucks, loaders, backhoes, pumps, cranes, and other big-ticket items.

Reasons why an entity may choose to rent instead of buy or lease include:

• the equipment must be obtained immediately,
• the equipment may be needed only once,
• specialty equipment is needed, and
• the expected useful life of the equipment is shorter than the term of a lease.

Many municipal entities like the idea that the equipment they rent costs money only while it is being used. Renting becomes a practical alternative to buying equipment that remains idle when not in use and requires costly and time-consuming maintenance.

Rental centers are located in or near virtually every small town and large city across the country. Much like leasing institutions, rental agencies also offer competitive rates. Municipalities considering renting should first compare rates of several rental agencies to get the best price.

For more information on municipal renting, contact your nearest rental agency and ask what they can do for you.
An estimated $139.5 billion is needed to meet municipal wastewater treatment capital needs over the next 20 years, according to a U.S. Environmental Protection Agency (EPA) survey.

This figure is included in EPA’s 1996 Clean Water Needs Survey, which estimates the cost for completing various water quality infrastructure projects, many of which are eligible for funding from the clean water state revolving fund (SRF). The needs survey includes costs for publicly owned municipal wastewater collection and treatment facilities and for such activities as stormwater, combined sewer overflows, nonpoint source pollution projects, and estuary management projects.

The total needs identified in the 1996 survey are $15.5 billion less than the $155 billion in needs identified in the 1992 survey. “This reflects, in part, progress made in meeting the nation’s water quality infrastructure needs,” according to the report.

An estimated $3 billion is available from the clean water SRF for fiscal year 1998. Since the SRF program began in 1988, $20 billion has been loaned for various water quality projects.

Small Community Needs

Water quality program needs for small communities represent nearly $14 billion of the survey’s total needs estimate, according to the report.

GAO Reports Increased SRF Lending Activity

A recent study of the clean water state revolving fund (SRF) operation in nine states reflects an increase in the amount of lending to communities.

Federal “seed money” distributed by the U.S. Environmental Protection Agency is combined with a state match to provide a lending pool in each state. State officials then use the pools to provide low-interest loans for community wastewater projects and related needs. As the loans are repaid, funding becomes available for additional loans.

The December 1996 report, conducted by the U.S. General Accounting Office (GAO), looked at the SRF programs in Arizona, Florida, Illinois, Louisiana, Maryland, Missouri, Oregon, Pennsylvania, and Texas. Each of these states reported an increase in the amount of SRF funding they lent in fiscal year 1996 over lending volume in 1995. The most dramatic increase was in Arizona, with an increase from $50 million in 1995 to $99 million in 1996. The percentage of SRF funds lent by the nine states at the end of 1996 ranged from 60 to 99 percent.

The report followed Congressional staff concerns about “unliquidated balances”—or the amount of available SRF funding not loaned to communities.

The states cited several factors they saw as limiting their ability to lend more SRF funds. These included concerns that the SRF program would not be reauthorized at the federal level, potential increases in costs because of prevailing-wage and other federal requirements, and restrictions on funding use.

To order a free copy of the report, contact the GAO at (202) 512-6000 or write to P.O. Box 6015, Gaithersburg, MD 20884-6015. Request document GAO/RCED-97-19. The report may also be viewed and downloaded from the GAO’s Internet Web site at http://www.gao.gov/AINdexFY97/abstracts/rc97019.htm. $
New NDWC Products Catalog Is Available

The National Drinking Water Clearinghouse (NDWC) has just published a new version of its products catalog, which describes nearly 200 free or low-cost products that address small community drinking water issues.

Available at no charge, the Drinking Water Products Catalog lists items that detail drinking water system finances, management, regulations, operations and maintenance, public education, and the health effects of contaminants. The guide contains a brief explanation of each product, lists the organization that developed it, the year it was developed, the cost, and a product number. An index by key word is provided for easy reference.

Products listed include those from the National Rural Water Association, the U.S. Environmental Protection Agency, NDWC, the National Small Flows Clearinghouse, health departments, and universities, among others.

To request a hard copy of the catalog, call the NDWC at (800) 624-8301 or (304) 293-4191. You also may request a copy via e-mail at ndwc_orders@ndwc.wvu.edu. An electronic version of the guide may be accessed on NDWC's Web site at http://www.ndwc.wvu.edu.

Report Offers Lessons for Designing SRFs

A recent report examines the Pennsylvania Infrastructure Investment Authority (PENNVEST) loan program and offers lessons that may help other states trying to establish their own state revolving loan funds. PENNVEST is a large-scale loan fund addressing the capital needs of investor-owned and municipal water utilities in Pennsylvania.

“With the passage of the 1996 amendments to the Safe Drinking Water Act, the lessons learned through the PENNVEST experience are especially important for regulatory commissions and officials in other states seeking to design and administer an effective revolving fund,” according to the May 1997 report, issued by the National Regulatory Research Institute (NRRI).

Some lessons focus on the importance of having expedited rate reviews, continued training and certification of system operators, coordination with other funding sources, and advance loans for the weakest systems.

The report also suggests that state matching funds should be larger than the minimum required and that an effective loan program should be combined with a multi-agency “tool bag” approach.

The 36-page report, Lessons From PENNVEST Applicable to the Design of a State Safe Drinking Water Revolving Loan Fund, can be purchased from NRRI by calling (614) 292-9404. The cost is $23.95.