

**STATE WATER RESOURCES CONTROL BOARD
BOARD MEETING SESSION – DIVISION OF FINANCIAL ASSISTANCE
OCTOBER 5, 2016**

ITEM 2

SUBJECT

CONSIDERATION OF A RESOLUTION AUTHORIZING THE EXECUTIVE DIRECTOR OR DESIGNEE TO EXECUTE AN AGREEMENT WITH THE CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (I-BANK) FOR UP TO \$70 MILLION IN SAFE DRINKING WATER STATE REVOLVING FUND (DWSRF) MATCHING FUNDS

DISCUSSION

The DWSRF provides low-interest loans and grants to public water systems (PWS) for planning and construction of drinking water projects throughout California. It is capitalized by annual grants (capitalization grants) from the United States Environmental Protection Agency (U.S. EPA). In addition to capitalizing the DWSRF's loan and grant activities, the capitalization grants also fund the administration of the DWSRF and various technical assistance to small water systems, as well as the public water system supervision (PWSS) and regulatory activities of the Division of Drinking Water (DDW).

As a condition of the capitalization grants, states must provide matching funds equal to 20 percent of each grant (State Match). Also, U.S. EPA's recent Un-Liquidated Obligation (ULO) Reduction Strategy, dated April 14, 2014, generally requires the State Water Resources Control Board (State Water Board) to liquidate the 2015 and subsequent DWSRF capitalization grants within two years of award. The associated State Match for such capitalization grants must also liquidate at a proportional rate.

Past State Match for the DWSRF has been provided by general fund appropriations, proceeds from the sale of general obligation bonds (Propositions 13, 50, and 84), and in 2013 and 2014, a similar short-term financing with the I-Bank. These sources have provided sufficient funds to fully match the 1997 through the 2014 capitalization grants. Recently, funding provided by Chapter 5 Section 79724 of Proposition 1 (Prop 1 Drinking Water) has been allocated as State Match for the DWSRF through the expenditure of Prop 1 Drinking Water principal forgiveness funds through the DWSRF for small disadvantaged communities. The current Prop 1 Drinking Water appropriation has provided sufficient funds to fully match the 2015 and 2016 DWSRF capitalization grants as well as future DWSRF capitalization grants.

However, the Prop 1 Drinking Water State Match funding, which has been allocated for the 2015 and 2016 DWSRF capitalization grants, is currently not projected to disburse at a sufficient rate to ensure the timely liquidation of such capitalization grants in accordance with U.S. EPA's ULO Reduction Strategy. While it is anticipated that the Prop 1 Drinking Water State Match funds will eventually liquidate at a sufficient rate to ensure the timely disbursement of future DWSRF capitalization grants, DWSRF cash flow projections are now requiring a supplemental State Match funding source for at least the 2015 and 2016 DWSRF capitalization grants that will liquidate at a sufficient rate to ensure the State Water Board's long-term compliance with USEPA's ULO Reduction Strategy.

The DWSRF does not have any current general fund appropriations or other general obligation bond authorizations that can provide additional matching funds and which will disburse at a sufficient rate. The immediate options for obtaining State Match funds that will liquidate at a sufficient rate under the DWSRF is a short-term financing with the I-Bank or the sale of revenue bonds on the municipal bond market.

Division staff proposes a new short term financing between the I-Bank and the DWSRF for up to \$70 million in principal, interest, and fees. The transaction with the I-Bank will be a short-term obligation secured and repaid from past interest earnings currently held by the DWSRF. While \$70 million is greater than the State Match required for the 2015 and 2016 DWSRF capitalization grants, staff is seeking to maximize available State Match funding sources, including Prop 1 Drinking Water as well as eventual local match financing, to position the DWSRF for long-term sustainability. The obligation will have a one week maturity following closing, with no pre-payment penalty. The obligation will bear interest at the I-Bank's standard rate. All fees and costs will be rolled into the financing, and paid concurrent with the obligation repayment. The exact fees and interest charges cannot be determined at this time, but are expected to be slightly greater than the fees and interest charges on the 2014 I-Bank financing (approximately \$5,000.) Using interest earnings to obtain matching funds is an eligible use of interest earnings under state and federal law.

The proposed transaction with the I-Bank must be completed in late October or November of 2016 to ensure the timely liquidation of the 2015 and 2016 DWSRF capitalization grants in accordance with U.S. EPA's ULO Reduction Strategy.

POLICY ISSUE

Should the State Water Board authorize the Executive Director or his designee to execute a short-term financing with the I-Bank to obtain up to \$70 million in State Match funds for the DWSRF?

FISCAL IMPACT

The proposed financing with the I-Bank will not significantly affect the finances of the DWSRF. There is currently approximately \$77 million in interest earnings held in the DWSRF available for this transaction. Even with the conversion of these earnings to State Match funds, they will still be available in perpetuity for financing drinking water projects. Also, due to the short-term nature of the financing and the reliability of using an existing cash balance as a source of repayment, there is essentially no risk of default on the proposed transaction.

The transaction costs will not significantly affect the DWSRF. Due to the short-term nature of the obligation as well as the I-Bank's unique role as a public agency specifically formed to provide this special type financing, the fees and transaction costs are minimal and far below the costs associated with a bond market transaction. The staff costs associated with the transaction are also minimal, and will be absorbed as part of the normal administrative costs of the program.

If the State Water Board does not engage in this transaction then California will be at high risk of becoming non-compliant with U.S. EPA's ULO reduction strategy. Absent another supplemental State Match funding source, the State Water Board would risk not liquidating the 2015 DWSRF capitalization grant by September of 2017 and U.S. EPA could threaten to withhold future DWSRF capitalization grants until the State Water Board's return to compliance. A loss or delay of future DWSRF capitalization grants would jeopardize subsidized infrastructure financing for California's PWS, including principal forgiveness for small disadvantaged communities. A loss of future DWSRF capitalization grants would also jeopardize funding for State personnel and operational costs to administer the DWSRF as well as DDW's administration of its PWSS program.

REGIONAL BOARD/DIVISION OF DRINKING WATER IMPACT

A DWSRF State Match financing with the I-Bank will allow the State Water Board to fully draw at least the 2015 and 2016 DWSRF capitalization grants without risk of non-compliance with U.S. EPA's ULO Reduction Strategy. This will allow the DWSRF to provide low-interest loans and principal forgiveness to PWSs, thereby supporting the efforts of DDW to implement the requirements of the Safe Drinking Water Act. In addition, the State Water Board will be able to fully use these funds for technical assistance to PWS by DDW and funding for DDW's PWSS and regulatory oversight.

HUMAN RIGHT TO WATER ANALYSIS

Staff has considered Section 106.3 of the Water Code (added by Assembly Bill 685 (Stats. 2012, ch. 524)). This proposed action supports the Human Right to Water because it will assist disadvantaged communities with obtaining safe drinking water by reducing their financing costs and providing technical assistance needed to obtain financing for safe drinking water projects.

STAFF RECOMMENDATION

The State Water Board should authorize the Executive Director or his designee to execute a short-term financing agreement with the I-Bank to provide up to \$70 million in matching funds for the DWSRF.

DRAFT

STATE WATER RESOURCES CONTROL BOARD RESOLUTION NO. 2016-

AUTHORIZING THE EXECUTIVE DIRECTOR OR DESIGNEE TO EXECUTE AN AGREEMENT WITH THE CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK (I-BANK) FOR UP TO \$70 MILLION IN SAFE DRINKING WATER STATE REVOLVING FUND (DWSRF) MATCHING FUNDS

WHEREAS:

1. The DWSRF and capitalization grants from the United State Environmental Protection Agency (U.S. EPA) are used by the State Water Resources Control Board (State Water Board) to provide low-interest loans and grants and technical assistance to public water systems, as well as subsidize the Division of Drinking Water's public water system supervision program;
2. As a condition of DWSRF capitalization grants from the U.S. EPA, the recipient state entity must provide matching funds equal to 20 percent of each capitalization grant;
3. The U.S. EPA has implemented a national Un-liquidated Obligation (ULO) Reduction strategy whereby States are generally required to liquidate their DWSRF capitalization grants within two years of award of such capitalization grants;
4. Chapter 5 Section 79724 of Proposition 1 has been allocated as match for the 2015 and 2016 SDWSRF capitalization grants;
5. The DSWRF needs additional supplemental matching funds for at least the 2015 and 2016 DWSRF capitalization grants that will disburse at a sufficient rate to ensure the State Water Board's compliance with U.S. EPA's ULO Reduction Strategy;
6. The State Water Board has no current general fund appropriations or general obligation bond authorizations that can provide additional supplemental matching funds, which will disburse at a sufficient rate to ensure the State Water Board's compliance with U.S. EPA's ULO Reduction Strategy;
7. The State Water Board seeks to maximize all available funding sources for match funds to position the DWSRF for long-term sustainability;
8. The State Water Board may use interest earnings of the DWSRF, as allowed by state and federal law, to secure and repay a bond to obtain matching funds;
9. The California Department of Public Health and the State Water Board obtained matching funds from the I-Bank using this type of transaction in 2013 and 2014, respectively; and
10. The DWSRF currently contains sufficient interest earnings to secure and repay a short-term obligation from the I-Bank to obtain up to \$70 million in matching funds for the 2015 and 2016 DWSRF capitalization grants, as well as future DWSRF capitalization grants, pursuant to the authority provided by Health and Safety Code Section 116760.40(a)(15).

D R A F T

THEREFORE BE IT RESOLVED THAT:

The State Water Board authorizes the Executive Director or his designee to execute a short-term financing agreement with the I-Bank to obtain up to \$70 million in matching funds for the DWSRF.

CERTIFICATION

The undersigned Clerk to the Board does hereby certify that the foregoing is a full, true, and correct copy of a resolution duly and regularly adopted at a meeting of the State Water Resources Control Board held on October 5, 2016.

Jeanine Townsend
Clerk to the Board