

**STATE WATER RESOURCES CONTROL BOARD
WORKSHOP SESSION – DIVISION OF FINANCIAL ASSISTANCE
JULY 17, 2007**

ITEM 7

SUBJECT

PROPOSED AMENDMENT TO THE POLICY FOR IMPLEMENTING THE STATE REVOLVING FUND (SRF) FOR CONSTRUCTION OF WASTEWATER TREATMENT FACILITIES

DISCUSSION

The Division of Financial Assistance (Division) administers the SRF Loan Program to provide low-interest loans for construction of wastewater treatment and water recycling facilities, implementation of non-point source (NPS) projects and programs, and development and execution of estuary comprehensive conservation and management plans.

The *Policy for Implementing the State Revolving Fund for Construction of Wastewater Treatment Facilities* (SRF Policy) was originally adopted by the State Water Resources Control Board (State Water Board) on August 18, 1988, and last amended on September 22, 2005. Under the SRF Policy, Section XVIII. B, projects are assessed a one-tenth (0.1) of one percent penalty on the daily outstanding loan balance for the period of time that either a Project Performance Report and Certification or Corrective Action Report are late. A Project Performance Report and Certification or Corrective Action Report must be submitted within 15 months of the Initiation of Operation (I/O) date.

Between August 2002 and May 2006, six agencies failed to Certify or submit Corrective Action Reports for ten SRF projects, within 15 months of the IO dates, as required by the SRF Policy. Based on the existing Policy, the six affected agencies owe \$58,668,856 in penalties. All of these projects have since met the requirements of the SRF Policy by submitting the required Certifications or Corrective Action Reports. All agencies have made all required loan repayments in a timely manner, with no evidence to suggest that the agencies intended to purposely ignore the SRF Loan Program requirements. Failure of the agencies to Certify the projects did not adversely affect water quality.

At the September 6, 2006, Board Meeting, the State Water Board considered a Resolution to waive the penalties for the ten projects. Division staff recommended waiving the penalties because the application of the penalties appeared unfairly punitive.

The State Water Board did not waive the penalties at its September 6, 2006, Board Meeting. The Board directed Division staff to re-examine the penalty provision and recommend a penalty that is consistent with the circumstances associated with each project and reasonably reflects the need for the Project Performance Report and Certification or Corrective Action Report. Division staff drafted an Announcement and posted it on the State Water Board website and sent the Announcement to interested parties on May 1, 2007 and provided 30 days for review and comments. In the Announcement, Division staff evaluated seven options for revising the penalty provision of the SRF Policy.

The Division reviewed the following amendment options (options are listed from most desirable to least desirable):

OPTION 1 – *Retain a portion of the loan balance until the appropriate report is submitted.*

The State Water Board's *Small Community Wastewater Grant Program Guidelines* (SCWG Guidelines), Section X. (l), has a provision to retain two and one-half percent (2.5%) of the grant until all deliverables relating to the SCWG Project have been submitted and approved by the Division. This provision could be applied to the SRF Loan Program as well. Currently the SRF Policy similarly requires that the applicant cannot receive more than 90 percent of the SRF Loan funds until a Final Revenue Program is submitted and approved by the Division.

Pros: Retaining two and one-half percent (2.5%) of the total loan balance will help ensure that projects are implemented in accordance with the signed contracts and that all the reporting requirements will be met. This option will make the SRF Policy consistent with the current SCWG Guidelines and more reasonable than the existing SRF Policy requirement. This option is also similar to retention requirements in many construction contracts. It is also similar to the existing SRF Policy requirement that an applicant must submit and receive approval of a Final Revenue Program before it can receive more than 90 percent of its loan funds.

Cons: This option may create a shortage of cash for the applicant at the end of the Project because the applicant will have to wait from 12 (twelve) to fifteen (15) months before receiving disbursement of the last 2.5 percent of its loan. As a result, some agencies may have to look elsewhere for funds to bridge the gap. This could, in some instances, decrease the overall benefit of the SRF's reduced interest rate.

OPTION 2 – *Stop processing any pending or future applications for new loans or grants. If applicable, withhold payments on any existing loans and grants that the agency may have with the State Water Board, until the Certification requirements are met.*

Pros: Agencies that receive loans or grants from the State Water Board are interested in receiving timely payments or having their applications reviewed quickly. Withholding payments or suspending processing should motivate applicants to promptly submit any reports required by the SRF Policy.

Cons: This option can be used effectively when agencies have other loans or grants with the Division, or are applying for additional loans or grants. This option does not provide any leverage with agencies that do not intend to apply for other loans or grants, or do not have existing loans or grants.

OPTION 3 – *Implement an administrative procedure or use existing statutory authority to bring recipients into compliance.*

The Division would go through a series of steps to bring recipients into compliance. First the Division would remind recipients of their obligation to submit one of the required reports. A follow-up letter would then be sent to the recipient giving it a reasonable deadline within which to submit one of the required reports. The follow-up letter could include a provision that if the recipient does not submit one of the required reports by the deadline, the Division will use other legal means to remedy breach of the agreement terms. This could include seeking termination and full repayment of the loan or using the State Water Board's authority under California Water Code §§13267 and 13268 of the California Water Code to gain compliance.

Pros: This is an administrative approach that is consistent with the overall manner in which the SRF Program is implemented. The Division's experience is that most recipients are willing to submit the required reports, but that some agencies overlook this requirement at the end of their projects. When reminded, most agencies willingly submit the overdue reports. The threat of having the loan recalled being subject to California Water Code § 13267 is probably sufficient to motivate those few agencies that continue to be tardy with their reports. It is unlikely that the Division would have to recall loans or impose civil liabilities, and this contingency would only be used as a last resort. If the Division recalled a loan due to a recipient's failure to submit one of the required reports, it would increase the funds available to loan to other SRF projects. If the State Water Board imposed civil liabilities, these funds would be deposited into the Cleanup and Abatement Account.

Cons: This option could deprive an agency of funds it may need for other projects.

OPTION 4 – *Lower the penalty rate from one-tenth (0.1) of one percent per day to ten (10) percent per year on the remaining loan balance, equating to 0.0274 percent per day.*

This option would assess a lower fixed penalty rate based on an annual percentage of the outstanding loan amount. This would lower the rate to 0.0274 percent per day.

Pros: This revised rate would reduce the penalties assessed on the ten projects that did not comply with the SRF reporting requirement by 73 percent, from \$58,668,856 to \$16,073,659. This revised penalty rate is more reasonable and significantly lowers the interest penalty.

Cons: Assessment of a penalty of ten (10) percent per year on the remaining loan balance exceeds the statutory authority regarding interest amounts on SRF loans. Further, both rates are disproportionate to the consequences of an agency not submitting the required report. The resulting penalties from either of these rates may be considered unlawful.

OPTION 5 – *Revise the penalty rate to be similar to other Water Code penalties for reporting violations in Waste Discharge Requirements.*

The Porter-Cologne Water Quality Control Act (Porter-Cologne), Division 7, Chapter 5.5, Section 13385 (h)(1), assesses mandatory penalties of three thousand dollars (\$3,000) for each serious violation and each complete period of 30 days following the deadline as defined in Section 13385.1. The SRF Policy could be revised to be similar to the Water Code in assessing the same amount of penalties on projects that do not submit the Project Performance Report and Certification, or Corrective Action Report on time.

Pros: This option simplifies the penalty assessment by making it consistent with Porter-Cologne, and assesses the same level of penalties against all projects regardless of the outstanding loan balance. Penalties would be more reasonable – on the order of thousands of dollars instead of millions of dollars.

Cons: Assessing a mandatory penalty of three thousand dollars (\$3,000) for not submitting the required report exceeds the statutory authority of the SRF Loan Program. This penalty may be disproportionate to the violation. Furthermore, the resulting penalty may be considered unlawful.

OPTION 6 – *Completely eliminate the penalty from the SRF Policy.*

This option would modify the SRF Policy to eliminate the penalty provision. Division staff would rely on applicants' good faith efforts.

Pros: This option is used by other states. Three other states (Florida, Oregon, and Ohio) were contacted by Division staff to determine the level of monetary penalties for projects that have not complied with the Project Performance Report and Certification, or Corrective Action Report requirements. None of the states contacted have any monetary penalty in place for projects that do not submit a Project Performance Report and Certification, or Corrective Action Report in a timely manner. The only state that reported having compliance problems was Ohio. According to staff with Ohio's SRF program, they use administrative means such as letters and in-office meetings to persuade applicants to comply.

Cons: No penalty amounts would accrue to SRF account. Total elimination of the penalty removes the Division's leverage. The Division believes it is appropriate to have a means of ensuring that loan recipients evaluate the operation of their projects and certify to the Division that they are functioning correctly. It is important that the Division be able to document the successful operation of the SRF projects that the Water Board funds.

OPTION 7 – No Action – leave the SRF Policy as is.

The current penalty rate, one-tenth (0.1) of one percent per day, assessed on the daily outstanding loan balance, for the period of time that the Project Performance Report and Certification, or Corrective Action Report, are late was added to the SRF Policy on January 21, 1993. The penalty was adopted because staff encountered difficulty getting the required reports submitted and the penalty helps induce applicants to submit one of the required reports.

Pros: Based on the existing SRF Policy, the six affected agencies must pay \$58,668,856 in penalties. This could increase funds that can be used to provide loans to other agencies that are in need of implementing various types of water quality improvement projects. This option will not require a change to the SRF Policy.

Cons: The current level of SRF penalty exceeds the State Water Board's statutory authority, does not accurately reflect the need for the reports, and may be unlawful.

The purpose of the SRF Loan Program is to provide low interest funds to agencies for construction of wastewater treatment facilities to improve water quality. If the Water Board enforced this excessive penalty, it would divert funds for water quality protection from one agency to other agencies.

The State Water Board received a number of comments on the proposed recommended options. Almost every entity was in favor of some combination of options 1, 2 and 3. Option 1 was opposed by three entities, favored by three entities, and one entity favored it at a reduced level. All said that options 4-7 should be eliminated from further consideration.

The Division recommends implementing a combination of options 1, 2, and 3, and waiving the penalties incurred for late submittal of Project Performance Certifications or Corrective Action Reports as applicable on the following ten SRF loans.

- City of Sacramento, SRF Project No. C-06-4441-120;
- North San Mateo County Sanitation District, SRF Project No. C-06-4801-110;
- Santa Ana Watershed Project Authority, SRF Project Nos. C-06-4452-110, -120, -130, and -140;
- City of Escondido, SRF Project Nos. C-06-4156-110, -310;
- City of Alameda, SRF Project No. C-06-4007-610; and,
- Vallejo Sanitation and Flood Control District, SRF Project No. C-06-4790-110.

The Division recommends waiving the penalties because the penalties may be unlawful, all agencies have since met the requirement, and there was no water quality impact or financial impact to the SRF Loan Program.

Exhibit A includes all proposed changes to the SRF policy.

POLICY ISSUE

Should the State Water Board amend Section XVIII. B and Appendix J of the SRF Policy to eliminate the penalty assessment of one-tenth (0.1) of one percent per day for not complying with the reporting requirements and replace it with a combination of options 1, 2, and 3?

Should the State Water Board waive the penalties for late submittal of Project Performance Certifications or Corrective Action Reports applicable on the following ten SRF loans?

- City of Sacramento, SRF Project No. C-06-4441-120;
- North San Mateo County Sanitation District, SRF Project No. C-06-4801-110;
- Santa Ana Watershed Project Authority, SRF Project Nos. C-06-4452-110, -120, -130, and -140;
- City of Escondido, SRF Project Nos. C-06-4156-110, -310;
- City of Alameda, SRF Project No. C-06-4007-610; and,
- Vallejo Sanitation and Flood Control District, SRF Project No. C-06-4790-110.

FISCAL IMPACT

Adoption of this resolution will result in the State Water Board not collecting \$58,668,856 in interest penalties as calculated under the current Policy. The SRF budget has never been augmented by interest penalties, and interest penalties are not part of the normal revenue for the SRF program. In addition, implementing the new policy measures will require a marginal increase in administrative costs; these will be absorbed with the current budget authorization.

REGIONAL WATER BOARD IMPACT

None.

STAFF RECOMMENDATION

Division staff recommends that the State Water Board amend Section XVIII. B and Appendix J of the SRF Policy to eliminate the penalty assessment of one-tenth (0.1) of one percent per day for not complying with the reporting requirements and replace it with a combination of options 1, 2, and 3. Proposed changes to the SRF policy are included in Exhibit A.

The Division staff also recommends waiving the penalties incurred for late submittal of Project Performance Certifications or Corrective Action Reports as applicable on the following ten SRF loans.

- City of Sacramento, SRF Project No. C-06-4441-120;
- North San Mateo County Sanitation District, SRF Project No. C-06-4801-110;
- Santa Ana Watershed Project Authority, SRF Project Nos. C-06-4452-110, -120, -130, and -140;
- City of Escondido, SRF Project Nos. C-06-4156-110, -310;
- City of Alameda, SRF Project No. C-06-4007-610; and,
- Vallejo Sanitation and Flood Control District, SRF Project No. C-06-4790-110.

**STATE WATER RESOURCES CONTROL BOARD
RESOLUTION NO. 2007-**

**PROPOSED AMENDMENT TO THE POLICY FOR IMPLEMENTING THE STATE REVOLVING
FUND (SRF) FOR CONSTRUCTION OF WASTEWATER TREATMENT FACILITIES**

WHEREAS:

1. The State Water Resources Control Board (State Water Board) adopted the *Policy for Implementing the State Revolving Fund for Construction of Wastewater Treatment Facilities* (SRF Policy) on August 18, 1988, and last amended it on September 22, 2005;
2. The SRF Loan Program provides low-interest loan funding to finance projects intended to improve the quality of the State's waters;
3. The current SRF Policy assesses a one-tenth (0.1) of one percent penalty on the daily outstanding loan balance for the period of time that either a Project Performance Report and Certification or Corrective Action Report are late;
4. Ten SRF projects assessed this penalty have since met the reporting requirements and have made all loan repayments in a timely manner, with no evidence to suggest that the agencies intended to purposely ignore the SRF Loan Program requirements;
5. At the September 6, 2006, Board Meeting, the State Water Board considered a resolution to waive the penalties for the ten SRF projects. The Board did not waive the penalties, but directed Division staff to re-examine the penalty provision and make further recommendations;
6. Division staff evaluated seven options for revising the penalty provision and proposed changes to the SRF Policy;
7. Interested and affected parties were notified on May 1, 2007 of the proposed Amendments and given 30 days to comment on the proposed changes to the SRF Policy.

THEREFORE BE IT RESOLVED THAT:

The State Water Board:

1. Approves the Amendments to the SRF Policy outlined in Exhibit A; and

2. Waives the penalties assessed under the existing SRF Policy on the following ten projects for late submittal of the Project Performance Certification or Corrective Action Plan Reports:

- City of Sacramento, SRF Project No. C-06-4441-120;
- North San Mateo County Sanitation District, SRF Project No. C-06-4801-110;
- Santa Ana Watershed Project Authority, SRF Project Nos. C-06-4452-110, -120, -130, and -140;
- City of Escondido, SRF Project Nos. C-06-4156-110, -310;
- City of Alameda, SRF Project No. C-06-4007-610; and,
- Vallejo Sanitation and Flood Control District, SRF Project No. C-06-4790-110.

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 July 17, 2007.

Song Her
Clerk to the Board

EXHIBIT A
PROPOSED AMENDMENTS TO THE SRF POLICY
(STRIKEOUT MEANS DELETE, UNDERLINE IS NEW TEXT)

The following changes will be made to Section I, Introduction:

This is the ~~seventh~~ **eighth** amendment to the SRF Policy originally adopted by the State Water Resources Control Board (SWRCB) on August 18, 1988.

The Following Changes will be made to Section II: Purpose and Objective

The primary purpose of the SRF Loan Program is to implement the Clean Water Act (CWA) and various State laws including the Clean Water Bond Law of 1984, the Safe, Clean, Reliable Water Supply Act (1996 Bond Law), the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act (2000 Bond Law), **Water Quality/Flood/Resource Protection/Park Bonds (Proposition 84)**, and any subsequent bond laws, by assisting in the financing of wastewater treatment facilities necessary to prevent water pollution, recycle water, correct nonpoint source and storm drainage pollution problems, and provide for estuary enhancement, and thereby protect and promote the health, safety, and welfare of the inhabitants of the State.

The following changes are proposed for Section XVIII.B: Project Performance Report and Certification:

B. Project Performance Report and Certification

One year after initiation of operation, the recipient is required to certify that the project meets the project performance standards and must submit a project performance certification report. The project performance certification report should summarize the data collected during the one-year project performance period and discuss the project's current and future ability to meet the project performance standards. The project performance certification report should also address any items noted as deficient in the final project inspection report. The Division will approve the certification of the project, if appropriate, at the end of the one-year certification period. A detailed outline of the Project Performance Report requirements for various types of projects can be obtained from the ~~Operations Unit~~ **Division**.

If the project cannot be affirmatively certified, the recipient must prepare a corrective action report, which analyzes the project's inability to meet the project performance standards. The corrective action report must include an estimate of the nature, scope and cost of the corrective action, and a time schedule for meeting the project performance standards. The time schedule must include an estimated date by which the loan recipient will certify the project and submit a project performance certification report. The Division will conduct follow-up inspections, as necessary, to monitor the recipient's progress towards meeting the project performance standards. The cost of the corrective action is not eligible for loan assistance.

The Division shall retain two and one-half percent (2.5%) of the total loan balance until submittal of a project performance certification report, including a signed certificate of performance, or a corrective action report. If the recipient does not submit a project performance certification report which includes a signed certificate of performance, or a corrective action plan **report**, within fifteen (15) months of the initiation of operation date, **the Division will also stop processing any pending or future applications for new loans or grants and withhold payments on any existing loans and grants that the agency may have with the State Water Board until the project performance certification report, or corrective action report, are submitted** an interest penalty of one-tenth of one (0.1) percent per day, will be assessed on the outstanding loan balance due. The interest penalty will begin on the first day after expiration of the appropriate deadline.

The Division may use any legal means to obtain the project performance report and certificate or corrective action report from the recipient.

Further information on Project Performance Certification is included in Appendix J.

The following changes are proposed for page 4 of Appendix J: Project Certification:

Project Certification

The Division shall retain two and one-half percent (2.5%) of the total loan balance until submittal of a project performance certification report, including a signed certificate of performance, or a corrective action report. If the recipient does not submit a project performance certification report which includes a signed certificate of performance, or a corrective action report, within fifteen (15) months of the initiation of operation date, **the Division will also stop processing any pending or future applications for new loans or grants and withhold payments on any existing loans and grants that the agency may have with the State Water Board until Certification requirements are met, and may use any legal means to obtain the Project Performance Report and Certificate of Corrective Action Report from the recipient.** an interest penalty of one-tenth of one (0.1) percent per day will be assessed on the outstanding loan balance due. The interest penalty will begin on the first day after expiration of the appropriate deadline.

After the Division has reviewed and approved the Project Performance Certification Report, the recipient will be notified that the project is being recommended for close out. If a Corrective Action Plan is submitted the Division will conduct follow-up inspections as necessary to monitor the applicant's progress towards meeting the Project Performance Standards. When the project can be certified, the recipient prepares a Project Performance Certification Report for Division approval.

Additional information on Project Performance Certification may be obtained from the Division's Operations Unit by calling (916) 227-4564 **341-5700**.