



3/18/14 Board Meeting Item 3
Near-Term Recycled Water Projects
Deadline: 3/13/14 by 12:00 noon

WESTERN RECYCLED WATER COALITION

A Collaborative Approach to Developing Sustainable Water Supplies

March 13, 2014

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Felicia Marcus, Chair, and Members
State Water Resources Control Board
1001 I Street
Sacramento, CA 95814



Via email: commentletters@waterboards.ca.gov

SUBJECT: Resolution to Provide Financial Incentives in Response to the Governor's Drought Proclamation for Near-Term Recycled Water Projects—Agenda item #3, Board Meeting of March 18, 2014

Chair Marcus and Members, State Water Resources Control Board:

The California Association of Sanitation Agencies, WaterReuse California and the Western Recycled Water Coalition are pleased to provide comments on the proposed resolution to provide funding incentives for the Clean Water State Revolving Fund (CWSRF) program specifically directed to incentivize/accelerate near term recycled water projects. Our organizations greatly appreciate the time and efforts CWSRF program staff have devoted to working with us to develop favorable financial terms that can directly translate into new water supplies for California.

From our discussions with Board members and staff, we believe that we all share the goal to provide CWSRF terms that will “jump start” recycled water projects in the near term. We are generally supportive of the proposed resolution, and offer our suggestions to make this financing tool even more attractive to local agencies.

The lower the interest rate and longer the repayment term, the more projects can move forward.

The terms proposed by the staff are designed to balance the need to move forward now with shovel ready projects while protecting the corpus of the SCWSRF through interest payments. As we all know, however, this is an unusual time, and we respectfully ask the Board to consider opening up a limited offering at even lower interest rates to get closer to the 50% grant partnership that has been available in the past.

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Historically, to make new recycled water projects economically viable from an agency policy maker's perspective, 50% of combined Federal and State grant funding is needed, with the remainder funded locally, either through up-front payment and/or debt financing. Unfortunately, no Title 16 projects have cleared Congress in the last three years, and State grant funds through Propositions 13 and 50 have been exhausted. Only Proposition 84 funds remain, and these are extremely limited and difficult to secure. The lack of this Federal and State grant funding is what led to the idea of no, to very low, interest CWSRF loans to ensure that agencies are willing and able to push new recycled water projects forward in the greater interest of the State of California in addressing not only near-term, but future cyclical drought cycles as well as new demands as the state continues to grow.

In addition, while we support the 30-year repayment term proposed by staff and previously approved by the Board, there are some projects with very long term benefits that we believe may warrant a 40-year repayment term. It is our understanding that CWSRF program staff has asked the Environmental Protection Agency (EPA) to consider allowing loan terms up to 40-years, and that the EPA staff has not been supportive. We ask that the Board support program staff's efforts to move forward with 40-year SRF loan durations in appropriate circumstances. We will work with the CWSRF staff to seek EPA concurrence. The following table shows the "grant equivalencies" at different interest rates for both 30-year and 40-year loans.

| Interest Rate | 30-Year Loan Equivalency | 40-Year Loan Equivalency |
|----------------------|---------------------------------|---------------------------------|
| 2.1% | 26% | 32% |
| 1.0% | 37% | 44% |
| 0.5% | 41% | 49% |
| 0.25% | 44% | 52% |
| 0.0% | 46% | 54% |

The Proposed Application Deadlines May be Overly Limiting.

Staff has identified up to \$400 million of CWSRF funding that could be available in a first phase very-low interest timeframe of about eight and one-half months, and an additional \$200 million that could be available at a higher interest rate for an additional year. Given that it takes substantial time to produce and submit "complete applications" (unless that criteria is relaxed), the initial window seems potentially short, as the application process takes at least six months and the CWSRF program has an internal goal of nine months to complete the entire process for a given application. We are also concerned that due to the short initial window, CWSRF program staff may receive more applications that can reasonably be processed in the targeted timeframe in addition to applications for other types of CWSRF funded projects. We ask the Board to reconsider these timelines either to lengthen the application submittal deadlines, or accept complete applications eligible for the very low interest rate funding until the \$400 million total funding level is reached. This may result in more projects being economically viable and would likely smooth the loan review and processing workload for staff.

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Flexibility with Regard to Other Loan Terms and Conditions is Also Key to Incentivizing Projects.

In addition to low interest loan considerations, there are several other factors our organizations have discussed with staff that can serve as barriers to projects seeking CWSRF funding. These include: (1) current requirements that CWSRF loans be senior lien debt; (2) levelized loan amortization schedules; and (3) potential re-funding of existing 20-year CWSRF loans and “bridge” loans with new 30-year CWSRF loans. We understand that these terms and conditions are within the discretion of program staff, and ask that the Board indicate its support for exercising flexibility in these areas. Each is addressed briefly below.

Senior Lien Loans

The perspective that there is lower risk to the CWSRF program if loans are required to be senior lien debt is understood. However, there should be consideration of the overall credit-worthiness of a given agency rather than a strict standard that new CWSRF loans be senior to other agency debt. The current CWSRF Policy provides for the ability to issue subordinated CWSRF loans, but additional parameters would be helpful. Being constrained to senior lien can have substantial financial impacts to the borrowing agency. For example, senior lien debt typically carries higher debt service coverage requirements than subordinated debt. Higher coverage ratios can constrain an agency’s overall borrowing capacity, or they can result in rate increases and/or operating cost cut-backs simply to meet a specified coverage level. Raising rates or reducing customer service levels for this purpose is not a good financial practice.

Levelized Re-payment Schedules

Typically CWSRF loans are amortized over the repayment period so that annual debt service payments are the same. Many agencies have issued bonded debt over the years that may create peaks and troughs in their overall debt service payments as older loans are retired and new debt is added. It is desirable from an agency’s perspective to keep its overall debt service load consistent over time, as this also mitigates the need for customer rates to spike or be somewhat erratic over time. Although, in general, the practice of CWSRF loans being amortized on a levelized basis is very reasonable, it would be helpful if agencies had the ability to request and justify “customized” schedules based on their unique circumstances.

Re-funding of Existing 20-year CWSRF Loans or Bridge-Loans with 30-year CWSRF Loans

The recent change to offer CWSRF loans with 30-year versus 20-year payment terms is very positive for agencies taking on new CWSRF debt. It aligns with bonded debt loan terms, and helps smooth cash flows over a longer period, which is beneficial to ratepayers and often better matches the useful life of an asset to the repayment period. Many agencies have current 20-year CWSRF loans that would benefit from being refunded with the longer term loans. In addition, some agencies need to borrow on the open market using “bridge loans” to initiate a needed

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project while awaiting approval of a CWSRF loan. Again, the ability to refinance these kinds of loans would prove useful to these agencies.

We appreciate the State Water Board moving forward to incentivize new recycled water projects and your efforts to continue to evolve and improve the overall CWSRF program. Our comments are offered in the spirit of our mutual objective of meeting the ambitious recycled water goals set forth in Board policy and provide reliable, sustainable and drought proof water supplies for California.

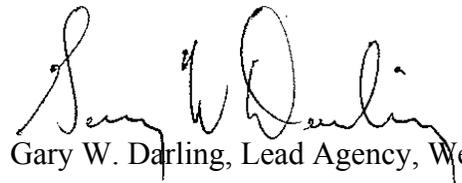
Sincerely,



Roberta L. Larson, Executive Director, California Association of Sanitation Agencies



David W. Smith, Managing Director, WateReuse California



Gary W. Darling, Lead Agency, Western Recycled Water Coalition