



THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA

Office of the General Manager



October 6, 2014

Ms. Jeanine Townsend, Clerk to the Board
State Water Resources Control Board
1001 "I" Street, 24th Floor
Sacramento, CA 95814

Comment Letter – October 21, 2014 Board Meeting – DWSRF Policy Handbook

The Metropolitan Water District of Southern California is pleased to submit comments on the State Water Resources Control Board's proposed Policy for Implementing the Drinking Water State Revolving Fund (hereafter referred to as the DWSRF Policy Handbook). The primary purpose of the DWSRF is to assist public water systems in financing the cost of drinking water infrastructure projects needed to achieve or maintain compliance with Safe Drinking Water Act (SDWA) requirements and to further the public health objectives of the SDWA. As a regional water wholesaler, Metropolitan is dedicated to providing clean and reliable drinking water to approximately 18.4 million people throughout 26 cities and water districts in Southern California. Metropolitan's service area covers portions of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura counties. To fulfill our mission, Metropolitan owns and operates the Colorado River Aqueduct and five large drinking water treatment plants ranging in size from 220 to 750 million gallons per day in rated capacity. Currently, Metropolitan is applying for approximately \$14 million in DWSRF loans to help finance enhanced bromate control improvements at the Henry J. Mills and F. E. Weymouth Water Treatment Plants. Metropolitan is continuing to identify eligible projects for DWSRF monies.

After careful review of the DWSRF Policy Handbook, Metropolitan respectfully submits the comments. These comments focus on ensuring the fiscal sustainability of the DWSRF program, and expressing Metropolitan's desire to apply for DWSRF funding in the future; however, certain provisions in the proposed DWSRF Policy Handbook may limit Metropolitan's ability to do so.

General Comments

Metropolitan has the following general comments regarding the proposed DWSRF Policy Handbook:

1. Metropolitan supports discontinuing the use of pre-applications, the "Project Priority List" (currently consisting of > 5,000 projects), and the invitation process in selecting

and approving projects for funding under the DWSRF. Metropolitan also supports the consolidation of the Priority System categories from A-O to A-F (pgs. 7-9 of the DWSRF Policy Handbook). Metropolitan believes that these changes will streamline the DWSRF application process and allow water systems with eligible projects in any category, including those not traditionally invited (e.g. pipe replacements, backup wells, iron/manganese treatment systems), to apply for financing.

2. Metropolitan is concerned with the long-term financial sustainability of the DWSRF, as proposed in the DWSRF Policy Handbook. This concern is rooted in two issues. The first issue is compliance with new or upcoming regulations. The second issue is the potential for an increased incidence of projects that would qualify for loan forgiveness criteria (pg. 12). Both of these issues are discussed briefly below.

New and Upcoming Regulatory Compliance—Metropolitan is concerned that the increased utilization of the DWSRF to help comply with new and upcoming drinking water regulations may place an added strain on the fund. One example is the cost of compliance of the recently adopted Maximum Contaminant Level (MCL) of 0.010 parts per million for hexavalent chromium. In a letter dated October 11, 2013, Metropolitan expressed a concern to the California Department of Public Health (CDPH) that the then draft MCL for hexavalent chromium underestimated the cost of compliance. While CDPH estimated that the total annualized treatment cost of compliance with the proposed MCL would be approximately \$156 million, affecting approximately 311 water systems, an independent review sponsored by the drinking water community projected that the actual total annualized cost would be up to \$616 million based on 1,027 affected water systems¹ and other system-specific costs not accounted for in the initial statement of reasons. The water community's independent review suggested that the total capital costs were \$4.1 billion. As such, Metropolitan is concerned that the large costs associated with new and upcoming drinking water regulations will place a significant strain on the DWSRF's limited pool of funds, and for a time, would shift funding to Category A and away from a more robust funding portfolio.

Loan Forgiveness – While Metropolitan recognizes the need to provide small and disadvantaged water systems with the ability to have access to all appropriate loan and grant funds, Metropolitan is concerned that many of these communities may have difficulty in paying back the DWSRF loans and instead may utilize the DWSRF Policy Handbook's debt forgiveness provisions (pg. 12). The DWSRF Policy Handbook specifically states that applications from disadvantaged and severely disadvantaged communities will receive priority over other projects within the same category (see Other Factors, pg. 9). Metropolitan is concerned that if a disproportionate number of DWSRF

¹ Further analysis suggested that the MCL would impact 863 water systems.

applicants cannot pay back their loans, then the future viability of the DWSRF may be in jeopardy. This would be contrary to the programs stated intent “to provide financial assistance in perpetuity using federal and state funds” (Introduction, pg. 1) (emphasis added).

Metropolitan recommends that the Board conduct a financial analysis of the added costs for regulatory compliance (e.g., hexavalent chromium MCL), as well as varying degrees of loan defaults for small and disadvantaged communities, on the DWSRF. Metropolitan believes that careful consideration needs to be given to the long term viability of the DWSRF, as it balances existing water system needs with those of future regulations.

3. Due in part to Metropolitan’s bond resolutions, Metropolitan is not able to fully meet several of the financial requirements found in the DWSRF Policy Handbook (pgs. 25-30). For example, for the lien status of loans, Metropolitan would request that any DWSRF loans are subordinate to Metropolitan’s revenue debt and that any covenants or requirements are consistent with those established in Metropolitan’s bond indentures. In addition, many of the proposed administrative and procedural requirements are more onerous and/or time consuming than Metropolitan’s current procedures for funding capital improvement projects from pay-as-you-go funds or Metropolitan bond proceeds. While the interest rate on the DWSRF loans is attractive, the apparent additional administrative requirements of these loans may make them less attractive to Metropolitan.

Specific Comments

In light of Metropolitan’s desire to apply for future DWSRF loans, but considering Metropolitan’s bond resolution and credit considerations, Metropolitan submits the following specific comments regarding the proposed DWSRF Policy Handbook:

1. Match Financing (pg. 11): This section would benefit from clarification of the percentage of DWSRF loan funding from federal and state sources. The following sentence is confusing:

“The state must contribute capital into the DWSRF equal to twenty percent (20%) of the federal capital contributions (i.e., Capitalization Grants).”

Metropolitan is unclear over how the 20% state obligation for match financing works in this context. Metropolitan understands that for match financing, the loan recipient would provide the 20% match financing in lieu of the state, with the DWSRF loan comprising the remaining 80% of the project financing.

2. Reserve and Coverage (pg. 25): *As currently drafted, Metropolitan would need to request an exception from the proposed financial security reserve and coverage provisions.* Metropolitan can make deposits into a bond fund, but Metropolitan does not set up a separate reserve accounts for parity obligations (pg. 25 subsection a). In addition, Metropolitan’s bond resolutions establish coverage requirement for debt service payments and therefore, the DWSRF Handbook would need to accept a recipients

existing coverage requirements, in lieu of those proposed (pg. 25, subsection b).
Metropolitan's suggested modification to page 25 subsection b is as follows:

- b. The recipient must comply with coverage covenants in existing material debt or with DWSRF coverage requirements. Where net revenues are pledged, the recipient's net revenues at completion of construction pledged to pay all senior debts relying on the PRF must be at least 1.2 times the highest year's senior debt service, and the net revenues pledged to pay all debts must be at least 1.0 times the highest year's aggregate debt service. Where assessments are pledged, other appropriate covenants and conditions may be imposed."
3. Additional Debt (pg. 26): *As currently drafted, to participate in the DWSRF, Metropolitan would need to request an exception from the proposed financial security additional debt provisions.* Metropolitan has no authority to incur debt with a senior lien to Metropolitan's existing water revenue bonds. Metropolitan's existing DWSRF loan is subordinate to Metropolitan's water revenue bonds and Metropolitan's applications for future funding also request DWSRF loans to be subordinate.
4. Compliance with Federal and State Statutes and Authorities (pg. 34): *Metropolitan requests that the Board create an appendix that lists and briefly describes all the pertinent federal and state statutes that would be included in a DWSRF financing agreement.* The appendix can be posted online, such that the Board can update the list as requirements are either added or dropped, and provide links to guidance documents, if any.
5. Davis Bacon (pg. 35): *Metropolitan requests clarification of who is responsible for compliance monitoring under the Davis-Bacon Act fair wages provisions.* If the state does not use California Proposition 84 funds for the SRF loans, will the California Department of Industrial Relations' Compliance Monitoring Unit provide the labor compliance monitoring?

Metropolitan appreciates this opportunity to provide input toward finalizing the Board's proposed DWSRF Policy Handbook. We support the Board's goals of protecting public health and looking for ways to increase funding to water utilities throughout the state, as well as within our service area. If you have any questions, please contact me at 213-217-7121.

Sincerely,



Gary Breaux
Assistant General Manager and Chief Financial Officer