

State Water Resources Control Board
Division of Financial Assistance
Drinking Water State Revolving Fund

Credit/Financial Review Guidelines

The Credit/Financial Review Guidelines (Guidelines) are designed to streamline a loan applicant's credit/financial review and shorten the loan approval process. These Guidelines describe the general credit/financial review process and the customary provisions the State Water Board includes in its Drinking Water State Revolving Fund loan agreements. Requests to deviate from these Guidelines may significantly delay financing approval or may result in financing not being approved. Note that the process will deviate for private entity applicants, as described in Section C below.

As discussed in the body of the Policy, the Division of Financial Assistance (DFA) will review an applicant's credit/financial capacity prior to recommending financing approval and will require credit/financial terms and conditions as part of the financing. Applicants must review the application instructions and the main body of the Policy in addition to this Credit Appendix. Credit/financial review factors will be discussed below, as will standard credit and financial terms and conditions. As indicated in Section B below, most financing agreements will contain rate covenants and additional debt restrictions set forth in this Appendix, as applicable, though DFA may require additional conditions or may modify these conditions depending on security and other credit considerations. Please refer to the end of this Appendix for defined terms.

- A. Credit Analysis – Qualification for Financing. DFA will evaluate the proposed security for the financing using materials submitted by the applicant, as well as materials available online. DFA will review the applicant's finances, including revenues, debts, operations and maintenance costs, and other credit materials.
1. Security. Most applicants pledge Net Revenues as security for a repayable financing, though other forms of proposed security may be considered (e.g.,

assessments, special taxes, general fund obligations, property taxes, or special surcharges).¹

2. Other debt. DFA will evaluate all of the applicant's material debt. It is DFA's expectation that applicants secure their long-term debt with Net Revenues, rather than gross Revenues.
3. Senior tier. If the applicant has pledged its Net Revenues to other material debt, the State Water Board expects the proposed DWSRF debt obligation to be on parity with the applicant's senior/first tier lien debt obligations, unless DFA determines that credit considerations compel a lower lien status.
4. Credit assumptions. In addition to the credit process set forth in the main body of the Policy, DFA will use the following assumptions in determining eligibility for the financing:
 - a. Adopted increases - Net Revenue projections may be adjusted to reflect any approved/adopted rate or fee increase that will be pledged as security for the financing or that will be used to operate and maintain the system and project.
 - b. Rate stabilization funds - Balances of or transfers from a rate stabilization fund are not included in the calculation of Net Revenues for funding eligibility/qualification.
 - c. Sub-enterprises – If the applicant has established a sub-enterprise, the revenues associated with that sub-enterprise may be excluded from the overall Revenues calculation if such amounts are paid or to be paid from some other source as set forth in a long-term agreement and such funding/revenue source is identified. Any associated revenue(s) would also be excluded from the calculation of Net Revenues.

¹ Any alternative security source must receive conceptual approval by DFA shortly after submittal of the application. Generally, DFA will require that any elections, approvals, or adoptions must be completed prior to the issuance of the financing agreement. The applicant is encouraged to discuss alternative forms of security with DFA earlier, rather than later.

5. Coverage calculation. DFA will generally use the following coverage calculation tests for repayable and non-repayable deals, respectively, unless DFA determines that credit considerations compel the use of a different test.
- a. For repayable deals: In the most recent three (3) fiscal years from the time DFA performs its credit analysis, unless credit considerations support an alternative qualification process, Net Revenues must be at least the sum total of (a) 1.2 times the total senior (D^{senior}) and parity (D^{parity}) Maximum Annual Debt Service payable from Net Revenues and (b) 1.0 times the subordinate ($D^{\text{subordinate}}$) Maximum Annual Debt Service payable from Net Revenues, as reflected in the following formula: $\text{Net Revenues of System} \geq [1.2 (D^{\text{senior}} + D^{\text{parity}}) + 1.0 (D^{\text{subordinate}})]$
 - b. For non-repayable deals: The Applicant must be in compliance with material debt obligations, including any coverage tests, if any, and with all State Water Board funding agreements to which it is a party, if any, including compliance with any and all financial covenants.
6. Other credit/financial factors. In addition to meeting the qualification requirements of the coverage calculation above, DFA may consider additional factors, including but not limited to the following:
- a. Market history
 - b. Social economic trends
 - c. Historical Debt Service coverage
 - d. Financial and management stability
 - e. Prior CWSRF or DWSRF financings
 - f. Percentage of second homes within service area
 - g. Concentration of significant ratepayers
7. Tax Certificate. Generally, all applicants that are public entities, who receive repayable financing, will be expected to agree to and comply with the State Water Board's standard Tax Certificate. The current version of the Tax Certificate can be found as Exhibit F in the posted standard DWSRF template on DFA's website. The final Tax Certificate that appears in an applicant's financing agreement may differ from the version posted on DFA's website.

B. DWSRF Financing Conditions

The executed DWSRF financing agreement will contain credit and financial conditions. Generally, agreements will contain rate covenants and additional debt restrictions as set forth below, as applicable, though DFA may require additional conditions or may modify these conditions depending on the security and other credit/financial considerations:

1. Rate covenant. The financing agreement will contain a covenant substantially similar to the covenant below:
 - a. For repayable deals: The Recipient must, to the extent permitted by law, fix, prescribe and collect rates, fees and charges for the System during each Fiscal Year which are reasonable, fair, and nondiscriminatory and which will be sufficient to generate Revenues in the amounts necessary to cover Operations and Maintenance Costs, and must ensure that Net Revenues are equal to the sum of (i) at least 120% of the Maximum Annual Debt Service with respect to all outstanding System Obligations senior to and on parity with the Obligation and (ii) at least 100% of the Maximum Annual Debt Service with respect to all outstanding System Obligations subordinate to the Obligation, so long as System Obligations other than this Obligation are outstanding. Upon defeasance of all System Obligations other than this Obligation, this ratio must be at least 120%, except where System Obligations are defeased pursuant to refunding obligations.
 - b. For non-repayable deals: The Recipient must, to the extent permitted by law, fix, prescribe and collect rates, fees and charges for the System during each Fiscal Year which are reasonable, fair, and nondiscriminatory and which will be sufficient to generate Revenues in the amounts necessary to cover Operations and Maintenance Costs, and must ensure that Net Revenues are in an amount necessary to meet its obligations under this Agreement. The Recipient may make adjustments from time to time in such fees and charges and may make such classification thereof as it deems necessary, but shall not reduce the rates, fees and charges then in effect unless the Net Revenues from such reduced rates, fees, and

charges will at all times be sufficient to meet the requirements of this section.

2. Additional debt. For repayable deals, the financing agreement will contain a restriction on additional debt substantially similar to the following:
 - a. Additional senior debt: The Recipient's future debt may not be senior to this Obligation, except where the new senior obligation refunds or refinances existing senior debt at better terms and does not extend the repayment period of the existing senior debt.
 - b. Additional parity or subordinate: The Recipient may issue additional parity or subordinate debt only if all of the following conditions are met:
 - i. Net Revenues, not including any transfers from a rate stabilization fund that would otherwise be considered Revenues, but including any approved/adopted rate or fee increase that will be pledged as security for the financing, in the most recent Fiscal Year meet the ratio for rate covenants with respect to any outstanding and proposed additional obligations;
 - ii. The Recipient is in compliance with any reserve fund requirement.
3. Liens. The financing agreement will generally contain a condition substantially similar to the following: A Recipient must not make any pledge of or place any lien on the project or project assets, except upon consent of the Division.
4. Assumptions/Definitions. The financing agreement will contain assumptions with respect to ongoing coverage calculations, including the definitions at the end of this Appendix.

C. Private Entity Applicants

Generally, applicants that are private entities will be expected to have and maintain revenues sufficient to produce coverage ratios substantially equivalent to the rate covenants described above in sections A and B. For repayable financing, applicants that are private entities will generally be required to grant security interests in accordance with the Uniform Commercial Code (UCC) and execute UCC filings, collateral agency agreements, fiscal services agreements, deposit account control agreements, and/or deposit account maintenance

agreements. DFA will evaluate the proposed collateral for compliance with the Board's federal obligations. An applicant will be required to provide deliverables necessary for the Board to perfect its security.

D. Special Credit Provisions

1. Assessments. An applicant proposing an assessment-backed financing in compliance with Article XIII of the California Constitution will be expected to provide a joint pledge of enterprise revenues, as well. Except upon consent of the Deputy Director, the assessments securing the DWSRF financing may not be used to secure any other financing. Only assessments that have been duly adopted by an applicant's governing body prior to the issuance of a financing agreement will be considered by DFA when it evaluates an applicant's eligibility for DWSRF financing. The value for each assessed parcel can be either the assessed value supported by the county's tax assessor's roll or a complete appraisal report prepared by an independent appraiser with a designation of Member, Appraisal Institute (MIA) from the Appraisal Institute. The applicant must demonstrate that the district-wide value-to-lien ratio for developed parcels is at least 3:1. The individual value-to-lien ratio of no more than 20% of the assessed developed parcels may be less than 3:1. The district-wide and individual value-to-lien ratio for undeveloped parcels or parcels that have been vacant for more than 9 months must be at least 9:1. The top ten taxpayers' aggregate assessment or special tax obligation may not exceed 50% of total assessment or special taxes. No single taxpayer's obligation may exceed 15% of the total assessment or special taxes. Property tax delinquencies and defaults within the district must not be materially above the countywide average.
2. Joint Powers Authorities. A joint powers authority's credit will be evaluated based both on its own financial information, as well as the financial information of its member agencies. DFA will generally require a pledge of Net Revenues from the joint powers authority's member entities, in addition to a pledge of Net Revenues from the joint powers authority, unless credit considerations support a pledge of solely the joint powers authority's Net Revenues. In addition to other credit conditions that it may deem appropriate, DFA may require restrictions on

member agency debt that parallel the standard credit conditions set forth in this Appendix.

3. Water Infrastructure Finance and Innovation Act (WIFIA). An applicant proposing to co-fund a project with a loan from the WIFIA program should notify DFA as soon as possible to ensure credit conditions are met. Early coordination is important because a DWSRF financing agreement may include more stringent financial, environmental, or technical requirements than a WIFIA financing agreement.

CREDIT DEFINITIONS

Unless otherwise approved by DFA, the following credit definitions will be included in all DWSRF financing agreements with public entities and may be included or modified where DFA deems appropriate in private entity financing:

“Days” means calendar days unless otherwise expressly indicated.

“Debt Service” means, as of any date, with respect to outstanding System Obligations and, in the case of the additional debt tests in Exhibit B of this Agreement, any System Obligations that are proposed to be outstanding, the aggregate amount of principal and interest scheduled to become due (either at maturity or by mandatory redemption), together with any Charge In Lieu of Interest on this Obligation or other System Obligations to the State Water Board, calculated with the following assumptions:

- a. Principal payments (unless a different subdivision of this definition applies for purposes of determining principal maturities or amortization) are made in accordance with any amortization schedule published for such principal, including any minimum sinking fund payments;
- b. Interest on a variable rate System Obligation that is not subject to a swap agreement and that is issued or will be issued as a tax-exempt obligation under federal law, is the average of the SIFMA Municipal Swap Index, or its successor index, during the 24 months preceding the date of such calculation;
- c. Interest on a variable rate System Obligation that is not subject to a swap agreement and that is issued or will be issued as a taxable obligation under federal law, is the average of SOFR, or its successor index, during the 24 months preceding the date of such calculation;
- d. Interest on a variable rate System Obligation that is subject to a swap agreement is the fixed swap rate or cap strike rate, as appropriate, if the variable rate has been swapped to a fixed rate or capped pursuant to an interest rate cap agreement or similar agreement;

- e. Interest on a fixed rate System Obligation that is subject to a swap agreement such that all or a portion of the interest has been swapped to a variable rate shall be treated as variable rate debt under subdivisions (b) or (c) of this definition of Debt Service;
- f. Payments of principal and interest on a System Obligation are excluded from the calculation of Debt Service to the extent such payments are to be paid from amounts then currently on deposit with a trustee or other fiduciary and restricted for the defeasance of such System Obligations;
- g. If 25% or more of the principal of a System Obligation is not due until its final stated maturity, then principal and interest on that System Obligation may be projected to amortize over the lesser of 30 years or the Useful Life of the financed asset, and interest may be calculated according to subdivisions (b)-(e) of this definition of Debt Service, as appropriate.

“Enterprise Fund” means the enterprise fund of the Recipient in which Revenues are deposited.

“Event of Default” means the occurrence of any of the following events:

- a) Failure by the Recipient to make any payment required to be paid pursuant to this Agreement, including Payments;
- b) A representation or warranty made by or on behalf of the Recipient in this Agreement or in any document furnished by or on behalf of the Recipient to the State Water Board pursuant to this Agreement shall prove to have been inaccurate, misleading or incomplete in any material respect;
- c) A material adverse change in the condition of the Recipient, the Revenues, or the System, which the Division reasonably determines would materially impair the Recipient’s ability to satisfy its obligations under this Agreement.
- d) Failure by the Recipient to comply with the additional debt test or reserve fund requirement, if any, in Exhibit B or Exhibit D of this Agreement;
- e) Failure to operate the System or the Project without the Division’s approval;

- f) Failure by the Recipient to observe and perform any covenant, condition, or provision in this Agreement, which failure shall continue for a period of time, to be determined by the Division;
- g) The occurrence of a material breach or event of default under any System Obligation or Material Obligation that results in the acceleration of principal or interest or otherwise requires immediate prepayment, repurchase or redemption;
- h) Initiation of proceedings seeking arrangement, rearrangement, reorganization, or any other relief under any applicable bankruptcy, insolvency, or other similar law; the appointment of or taking possession of the Recipient's property by a receiver, liquidator, assignee, trustee, custodian, conservator, or similar official; the Recipient's entering into a general assignment for the benefit of creditors; the initiation of resolutions or proceedings to terminate the Recipient's existence, or any action in furtherance of any of the foregoing;
- i) A determination pursuant to Gov. Code section 11137 that the Recipient has violated any provision in Article 9.5 of Chapter 1 of Part 1 of Division 3 of Title 2 of the Government Code;
- j) The occurrence of a material breach or event of default under any of the following agreements [], which agreements provide for payments to the Recipient for the payment of Debt Service; or
- k) Loss of the Recipient's rights, licenses, permits, or privileges necessary for the operation of the System or the Project, or the occurrence of any material restraint on the Recipient's enterprise by a government agency or court order.

"Fiscal Year" means the period of twelve (12) months terminating on June 30 of any year, or any other annual period selected and designated by the Recipient as its Fiscal Year in accordance with applicable law.

"Maximum Annual Debt Service" means the maximum amount of Debt Service due on System Obligations in a Fiscal Year during the period commencing with the Fiscal Year for which such calculation is made and within the next five years in which Debt Service for any System Obligations will become due.

"Net Revenues" means, for any Fiscal Year, all Revenues received by the Recipient less the Operations and Maintenance Costs for such Fiscal Year.

"Obligation" means the obligation of the Recipient to make Payments (including Additional Payments) as provided herein, as evidenced by the execution of this Agreement, proceeds of such obligations being used to fund the Project as specified in the Project Description in Exhibit A and Exhibit B and in the documents thereby incorporated by reference.

"Operations and Maintenance Costs" means the reasonable and necessary costs paid or incurred by the Recipient for maintaining and operating the System, determined in accordance with GAAP, including all reasonable expenses of management and repair and all other expenses necessary to maintain and preserve the System in good repair and working order, and including all reasonable and necessary administrative costs of the Recipient that are charged directly or apportioned to the operation of the System, such as salaries and wages of employees, overhead, taxes (if any), the cost of permits, licenses, and charges to operate the System and insurance premiums; but excluding, in all cases depreciation, replacement, and obsolescence charges or reserves therefor and amortization of intangibles.

"Revenues" means, for each Fiscal Year, all gross income and revenue received or receivable by the Recipient from the ownership or operation of the System, determined in accordance with GAAP, including

- (i) all rates, fees, and charges (including connection fees and charges) as received by the Recipient for the services of the System, and
- (ii) all other income and revenue howsoever derived by the Recipient from the ownership or operation of the System or arising from the System, including all income from
 - a. the deposit or investment of any money in the Enterprise Fund or any rate stabilization fund of the Recipient or held on the Recipient's behalf,
 - b. any refundable deposits made to establish credit, and
 - c. advances or contributions in aid of construction.

For the avoidance of doubt, refundable deposits and advances or contributions are not included in the definition of Revenues.

For drinking water financing agreements: "System" means all drinking water collection, transport, treatment, storage, and delivery facilities, including land and easements thereof, owned by the Recipient, including the Project, and all other properties, structures, or works

hereafter acquired and constructed by the Recipient and determined to be a part of the System, together with all additions, betterments, extensions, or improvements to such facilities, properties, structures, or works, or any part thereof hereafter acquired and constructed.

For recycled water financing agreements: "System" means all wastewater, water recycling, and/or potable water collection, pumping, transport, treatment, storage, and/or disposal facilities, including land and easements thereof, owned by the Recipient, including the Project, and all other properties, structures or works hereafter acquired and constructed by the Recipient and determined to be a part of the System, together with all additions, betterments, extensions or improvements to such facilities, properties, structures, or works, or any part thereof hereafter acquired and constructed.

"Year" means calendar year unless otherwise expressly indicated.