



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
WATER

February 9, 1999

MEMORANDUM

SUBJECT: Management of Set-asides for the Drinking Water State Revolving Fund (DWSRF) Program

FROM: Connie Bosma, Chief
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Office of Ground Water and Drinking Water

TO: DWSRF Regional Coordinators
Regions I-X

The Drinking Water State Revolving Fund (DWSRF) program gives States the option of using up to 31% of their capitalization grants to fund activities that protect sources of drinking water and enhance water systems management. The Final Guidelines released for the program allowed States to “bank” certain set-aside funds that it could not use in the current year for use in future years to give States flexibility in implementing set-aside programs. The intent was that States would “bank” the ability to use the funds in the future, but use them to fund projects in the interim. However, several early capitalization grant applications indicated that States were reserving a high percentage of set-asides with the intention of using only a small percentage in the short-term leaving the remaining funds as undrawn reserves.

Because EPA was concerned that reserved set-aside funds would sit idle while needed infrastructure projects went unfunded, a policy was developed and released to Regions and States last spring to describe how set-aside funds should be managed in the DWSRF program. The policy was changed in response to the comments that were received and in response to discussions held with Regional staff and members of the State/EPA State Revolving Fund work group.

The interim final policy, which is attached, allows States to leave funds as undrawn reserves if the use of the funds is described in an EPA approved workplan. A State may also reserve the right to take funds for which it cannot currently specify a use from future capitalization grants. States can submit annual or multiyear workplans in accordance with schedules identified by

Regional staff to describe how funds will be used. The length of workplans is generally limited to four years and must be updated if the State significantly changes planned activities or budgets.

This policy will become effective on March 15, 1999 unless we receive any comments that are show-stopping. The final policy will be issued shortly thereafter. Please send any comments you may have to Veronica Blette.

Please see that Drinking Water State Revolving Fund staff in the States receive this policy memorandum. If you or your staff have any questions, please contact me at (202) 260-5529 or Veronica Blette at (202) 260-3980.

Attachment

Policy: Management of Set-asides in the Drinking Water State Revolving Fund (DWSRF) program

Background

States have the authority to use up to 31% of a DWSRF capitalization grant for various activities intended to protect sources of drinking water and enhance the management of water systems. This paper outlines how states may manage use of funds reserved for set-aside activities under section 1452(g)(2)(B) and 1452(k) of the Safe Drinking Water Act. Section 1452(g)(2)(B) allows states to reserve a portion of the allotment for activities which include a 4% set-aside for administration of the program and technical assistance, a 2% set-aside for technical assistance to small systems, and a 10% set-aside for state program management activities. The 10% set-aside must be matched 1:1 by the state. The 1452(k) set-aside allows states to take up to 15% of the capitalization grant for various activities addressing source water protection and capacity development.

This policy was developed in response to recognition on the part of EPA that some states were reserving a high percentage of the capitalization grant for set-aside uses when they did not yet have a specific plan for how the funds would be used in the immediate future. EPA was concerned that this practice would allow funds to sit idle while needed infrastructure projects went unfunded. An issue paper with a proposal was developed and released to EPA regional offices and states for comment. Comments were taken into consideration in development of this interim final policy.

Two attachments to this document provide examples for states and/or regions to use in implementing the policy. Attachment 1 presents two spreadsheet methods of tracking set-aside funds and Attachment 2 presents two methods of reporting set-aside information in the Intended Use Plan. Both attachments are intended as examples. Regions and states are encouraged to develop and share alternative methods for tracking and reporting information.

Policy

Every year states must describe how they will spend all available funds in an Intended Use Plan (IUP). This includes all monies in the Fund as well as those funds that are being applied for in the current capitalization grant application. After award of a capitalization grant, federal funds are made available to states through the Automated Clearinghouse (ACH). The ACH is a federal funds transfer system used to deposit funds into a grant recipient's account. States take payments from the ACH to increase the amount of funds (i.e. ceiling) available for cash draw through an established schedule. In the IUP, a state must identify the level of funds it will deposit in the Fund to use for infrastructure projects and the level of funds it is reserving from the current year's grant to conduct set-aside activities.

When a state reserves set-aside funds, it can direct the funds two different ways. First, a state can specify the amount of 1452(g)(2)(B) and 1452(k) set-aside funds it will take from the current year's grant. The use of these **specified funds** must be described in an EPA-approved workplan. The funds remain in the ACH until the state draws the cash to pay for incurred costs. The state can also earmark 1452(g)(2)(B) set-aside funds that it intends to use at a later time and for which a workplan has not been prepared. These **unspecified funds** are deposited into the Fund and directed toward infrastructure projects in the short-term. The state retains the authority to reclaim the funds from a future capitalization grant. The funds are converted into specified funds when the state indicates in an IUP that it will use them and describes their use in an EPA approved workplan. There is no limit on the amount of funds a state can reserve and leave

as unspecified for use, beyond that allowed by law (i.e. caps on set-asides). However, the amount of funds to be designated as unspecified must be described in the IUP and, as such, is subject to public review and comment. It is important to note that when states reserve unspecified funds, they reserve the dollar amount of funds, not the actual percentage. This is because the dollar amount associated with a percentage could change from year to year due to variations in the amount of the capitalization grant.

Example

- In year 1, State A reserves \$3.1 million of its \$10 million cap grant for set-aside use. It describes how it will use \$1.1 million of the funds in a workplan covering four years. The state designates the remaining \$2.0 million as unspecified funds and reserves the authority to take them from a future grant. The state deposits the \$2.0 million in the Fund to finance infrastructure projects.
- In year 3, State A gets a cap grant for \$10 million. It reserves \$1.5 million in specified funds from the current grant for set-asides and reclaims the \$2.0 million of unspecified funds from year 1 by exercising the authority to pull the funds from the grant. The state presents this in the IUP and describes the use of all the funds (\$3.5 million) in a workplan.
- Note that the practical effect of the state exercising its authority to reclaim unspecified funds is that 35% of the year 3 grant has been directed toward set-aside activities. However, if looked at cumulatively, only 23% of the two grants together has been directed to set-asides.

An annual or multiyear workplan must be submitted to EPA for approval prior to expending any set-aside funds. States cannot incur expenses and be reimbursed for activities unless the activities are described in a workplan which has received EPA approval. The intent of allowing a multiyear workplan is to give states flexibility to conduct work that cannot be completed within a year. The expectation is that funds will be put to use throughout the term of the workplan, not simply reserved for future use. Multiyear workplans should be detailed enough to identify activities, milestones, and expenditures throughout the term of the workplan so that progress can be assessed throughout the period covered by the plan. States must provide amendments to the workplan if activities or budgets are significantly changed from the original workplan.

The SDWA and DWSRF Guidelines require that funds be spent in an efficient, timely, and expeditious manner. Therefore, if a Region does not already require a state to submit a workplan to describe the use of specified set-aside funds concurrently with the application or according to an established annual schedule, the state must submit the workplan no later than 90 days after the grant award. If a state has not submitted a workplan within the established timeframe, any funds reserved for set-asides must be transferred to the Fund and used for infrastructure projects. In an additional effort to ensure that monies are used in a timely manner, the length of workplans is limited to four years after award of the grant. A state may, however, exceed the four year limitation if it can provide a justification and an adequate level of detail to satisfy the Region. However, the goal for states should be to expend set-aside funds reserved from a specific capitalization grant within four years, a timeframe similar to that needed for completion of many infrastructure projects.

Regions may choose to include a grant condition that will describe the actions a state must take with respect to workplans. A Region may require that a state provide an updated workplan annually. An example of a grant condition used in one region follows:

Workplans for each set-aside for which grant assistance is provided, excluding the 4% administrative set-aside [unless technical assistance is provided], shall be submitted annually. The workplan contents will follow the Final DWSRF Guidelines, and shall include information regarding the budget for the upcoming year, funds [reserved] for future years, costs incurred to date and the use of funds carried forward from previous years. The annual workplans will be submitted by July 1 of each year. Payments may be deferred and cash draws prohibited until the workplans are approved by EPA. A performance status report for each set-aside activity will be submitted no later than 90 days after the end of each Federal Fiscal Year [or State Fiscal Year, if used].

This grant condition requires an annual workplan even though the state submitted a multi-year workplan with the application. The requirement for a performance report comes from 40 CFR 31.40 and 31.41 which describe the reporting requirements for states receiving grants.

When describing the financial status of the DWSRF program in the IUP and Biennial Report, the state must describe the amount of specified and unspecified funds and the cumulative amount of unspecified funds it has reserved for future use. Grant assistance agreements will only show the amount of specified funds that will be included for use within a workplan. EPA will check the level of reserved set-asides (both specified and unspecified) during the Annual Review in order to determine if the state is using the funds efficiently.

Exceptions and Limitations

- (1) Exception for administration of the DWSRF program. States may reserve funds from the 4% set-aside for administering the DWSRF program by holding the funds in the ACH until they are needed or by reserving the authority to take funds not required in the short-term from a future cap grant. While states are not generally required to describe use of funds from the 4% set-aside to conduct administration of the DWSRF program in a detailed workplan, the state should provide the Region with an overview of the activities it will conduct. If funds from the 4% set-aside are used to provide technical assistance, the state must provide EPA with a workplan for the technical assistance portion of the funds.
- (2) Limitation for 1452(k) set-aside funds. Section 1452(k) of the SDWA requires that “for each fiscal year, the total amount of assistance provided and expenditures made...may not exceed 15% of the amount of the capitalization grant received that year”. This contrasts with the set-asides outlined in section 1452(g)(2)(B) for which states may exceed the set-aside ceilings when reclaiming unspecified funds as long as the cumulative percentage that has been reserved remains at or below the statutory limit. However, due to differences in the statutory language, a state cannot exceed the 15% limit on the 1452(k) set-aside for any grant.

Therefore, a state cannot set aside funds pursuant to 1452(k) that have an unspecified designation. All funds reserved for 1452(k) activities are considered specified funds and must be described in an annual or multiyear workplan which receives EPA approval. Funds remain in the ACH until the state draws them to cover costs. If a state cannot identify specific activities to be funded by the section 1452(k) set-aside, it cannot reserve the funds.

Funds for the source water delineation and assessment activity eligible under this set-aside could **only** be reserved from the FY97 appropriation and must be obligated within four years of the award. The use of the funds must be specified for use in a workplan which is updated as the state develops its

source water assessment program. All activities must be completed, and funds expended, by November 2001, although EPA may grant a state an extension through May 2003.

- (3) Exception for awarded FY97/98 grants. Due to the delay in implementation of measures to address the management of set-asides, there are a couple of exceptions for FY97 and FY98 grants awarded prior to the release of the final policy.
- (A) If a state did not announce its intent to reserve all allowable set-asides in its FY97 and FY98 IUPs, it may amend 97/98 grant agreements to increase the level of set-asides. An intention to do this must be made available to the public, by inclusion in the next IUP developed by the state or by separate public notice. If the state increases the amount of specified set-aside funds, it must amend existing workplans to describe their use, and if necessary, make appropriate changes to the fundable list of projects.
- (B) If a state reserved set-asides in a FY97/98 application, but did not specify the use of the funds in a workplan, the funds are considered unspecified. The state may choose to either move the monies into the Fund to finance projects or may specify a use for the set-asides by including them in a workplan or working with the Region to amend existing workplans.

Attachment 1: Tracking Set-Asides

States and regions are encouraged to develop a system to track the level of reserved set-aside funds. We have provided two spreadsheets (in Lotus and Excel formats) as examples of how a state or region can track the management of specified and unspecified funds. Excerpts from each spreadsheet are included below. The first example is an abbreviated version which only tracks funds and does not calculate percentages, while the second takes the user through the process step by step.

Example 1.

The state enters the amount of funds it is taking from the current grant for set-asides in the first column (specified and unspecified). This is the amount the Region will review to determine if the state is within the statutory limits for the set-asides. In the second column, the state indicates the level of funds it will include in workplans. This includes funds from the current grant and amounts reserved as unspecified from earlier grants that the state now wishes to use. The third column holds the automatically calculated amount of total unspecified funds that the state will be able to take from future capitalization grants. It is equal to the cumulative unspecified funds from the previous year plus the new money the state is reserving minus the amount that they are specifying in workplans. Each year, the state can look to the total unspecified amount it had from the previous year before making a decision about how much of the current year's authority should be reserved.

Grant/Use	FY1997 - \$17,640,900			FY1998 - \$7,121,300		
	new setasides from current grant	specified in workplans	total unspecified =credit (calculated)	new setasides	specified	total unspecified =credit (calculated)
Admin	\$705,636	\$705,636	\$0	\$284,852	\$284,852	\$0
TA	\$352,818	\$147,182	\$205,636	\$142,426	\$348,062	\$0
SPM	\$1,764,090	\$1,200,000	\$564,090	\$712,130	\$775,000	\$501,220
LA	\$2,646,135	\$2,646,135	\$0	\$800,000	\$800,000	\$0

Example 2.

- In Block A the state enters the total dollar amount of set-asides it is reserving from a particular year's capitalization grant (for both specified and unspecified uses).
- In Block B the state indicates the amount of those new funds for which it will specify a use by inclusion in a workplan.
- The remaining funds, designated as new unspecified, are automatically calculated and shown in Block E. These funds are deposited into the Fund and used to finance projects.
- Block F tracks the total amount of unspecified funds that the state has directed to the Fund.
- When the state determines that it has a need for funds it has previously designated as unspecified, it can reclaim them from the total available (shown in Block F) by taking them from the most recent capitalization grant and describing their use in a workplan (Block C). When the state reclaims unspecified funds, the amount in Block F is diminished by that amount.
- The total amount of set-asides which will be included in a workplan, including new specified and reclaimed unspecified funds, is calculated and shown in Block D. These are the amounts that would be reflected in the assistance agreement or grant amendments.

The effect of reclaiming unspecified funds may be that the state exceeds the normal threshold for that set-aside. For example, in the spreadsheet, the percentage of total specified funds from the FY1998 grant for the administrative set-aside is 6.9% because the state has reclaimed some of the unspecified funds it reserved in the FY1997 grant application. Due to differences in the way the statute is written, this is not the case for section 1452(k) set-asides which must always be identified as specified funds described in a workplan, and the amount of which cannot exceed 15% of any particular capitalization grant.

The column on the far right (see spreadsheet) shows the cumulative amount of funds that have been reserved by the state for set-aside activities and the percentage of the grants that have been used for set-asides. The running percentage of the grants should always be equal to or less than the statutory limit for the specific set-aside.

		FY 1997		FY 1998	
Grant Award		--	\$17,640,900	--	\$7,121,300
New set-asides reserved		%	\$	%	\$
A	admin	4.0%	\$705,636	4.0%	\$284,852
	tech asst	2.0%	\$352,818	2.0%	\$142,426
	state prg mgt	10.0%	\$1,764,090	10.0%	\$712,130
	local asst	15.0%	\$2,646,135	11.2%	\$800,000
New specified funds					
B	admin	4.0%	\$705,636	4.0%	\$284,852
	tech asst	0.8%	\$147,182	2.0%	\$142,426
	state prg mgt	6.8%	\$1,200,000	7.0%	\$500,000
	local asst	15.0%	\$2,646,135	11.2%	\$800,000
Reclaimed specified funds from available unspecified					
C	admin	--	\$0	--	\$0
	tech asst	--	\$0	--	\$205,636
	state prg mgt	--	\$0	--	\$275,000
	local asst	NA	NA	NA	NA
Total specified (calculated)					
D	admin	4.0%	\$705,636	4.0%	\$284,852
	tech asst	0.8%	\$147,182	4.9%	\$348,062
	state prg mgt	6.8%	\$1,200,000	10.9%	\$775,000
	local asst	15.0%	\$2,646,135	11.2%	\$800,000
New unspecified (calculated)					
E	admin	0.0%	\$0	0.0%	\$0
	tech asst	1.2%	\$205,636	0.0%	\$0
	state prg mgt	3.2%	\$564,090	3.0%	\$212,130
	local asst	NA	NA	NA	NA
Available unspecified (calculated)					
F	admin	--	\$0	--	\$0
	tech asst	--	\$205,636	--	\$0
	state prg mgt	--	\$564,090	--	\$501,220
	local asst	NA	NA	NA	NA
Amount to Loan Fund		73%	\$12,941,947	69%	\$4,913,386

Attachment 2: Draft language for IUP

As seen in the section above, the tracking of set-asides can be a challenge. States have some flexibility in determining the level of detail they wish to use to describe management of set-asides in the IUP provided to the public. The policy requires that states inform the public of the amount of specified and unspecified set-asides from the current grant, and the cumulative amount of unspecified funds that is available for a state to reserve from any particular grant.

We have included two examples of how a state could present information within the IUP. Both use the numbers from the accompanying spreadsheets. One consideration is, if a state choose a simpler presentation of set-aside management in the IUP, it may have to provide EPA with a more detailed representation within the capitalization grant application so that the Agency can ensure that states are not exceeding ceilings on the use of set-asides. Although the examples make use of tables, there is no requirement that they be used. A state should use whatever format it believes will be of greatest ease to the reader.

Example 1.

The first example is a simple table that shows the amount of the current grant that the state is taking to fund set-asides. This includes both new specified funds and funds that the state is reclaiming from reserved authority from previous grants. The second column shows the amount of the current grant authority that the state is reserving the right to take from future grants, and the final column shows the total amount of credit that the state has accumulated.

Year 1 language. New Water is reserving \$5,468,679 of this year's \$17.6 M grant to fund set-aside activities (see table below). A workplan will be submitted to EPA to describe how \$4,698,953 will be used to fund these activities, which are further described in the next section. The remaining \$769,726 will be used to finance drinking water projects this year. We will retain the ability to take these monies from a future capitalization grant to fund set-aside activities in the future.

Set-aside category	\$ Amount reserved from current grant to fund set-asides	\$ Reserved credit for future years	\$ Total available credit
Admin	\$705,636	\$0	\$0
Tech Asst.	\$147,182	\$205,636	\$205,636
St. Prg. Mgt	\$1,200,000	\$564,090	\$564,090
Local Assist.	\$2,646,135	NA	NA
Total	\$4,698,953	\$769,726	\$769,726

Year 2 language. New Water is reserving \$2,420,044 of this year's \$7.1 M grant to fund set-aside activities (see table below). The state will use \$1,727,278 from the current grant and will reclaim \$480,636 of credit from previous years to fund activities that will be included in the workplan submitted to EPA for approval. The activities that will be funded with the full \$2,207,917 included in the workplan are further described in the next section. The remaining \$212,130 will be used to finance drinking water projects this year. We will retain the ability to take these monies from a future capitalization grant to fund on-going activities in the future.

Set-aside category	\$ Amount reserved from current grant to fund set-asides	Reserved credit for future years	\$ Total available credit
Admin	\$284,852	\$0	\$0

Tech Asst.	\$348,062	\$0	\$0
St. Prg. Mgt	\$775,000	\$212,130	\$501,220
Local Assist.	\$800,000	NA	NA
Total	\$2,207,914	\$212,130	\$501,220

Year 3 language. New Water is reserving \$1,501,200 of this year's \$7.6 M grant for set-aside activities (see table below). The state will use \$1,155,000 from the current grant and will reclaim \$226,200 of credit from previous years to fund activities that will be included in the workplan submitted to EPA for approval. The activities that will be funded with the \$1,381,200 are further described in the next section. The remaining \$120,000 will be used to finance drinking water projects this year. We will retain the ability to take these monies from a future capitalization grant to fund on-going activities in the future.

Set-aside category	\$ Amount reserved from current grant to fund set-asides	\$ Reserved credit for future years	\$ Total available credit
Admin	\$305,000	\$0	\$0
Tech Asst.	\$150,000	\$0	\$0
St. Prg. Mgt	\$426,200	\$120,000	\$395,020
Local Assist.	\$500,000	NA	NA
Total	\$1,381,200	\$120,000	\$395,020

Example 2.

The second example provides a greater level of detail, which is more representative of what the Region would need to evaluate the grant application. Note that the percentage in the table is based on the percent of specified and unspecified set-aside funds being taken from the current capitalization grant. It does not include funds associated with reclaimed credit from earlier grants.

Year 1 language. New Water is reserving \$5,468,679 of this year's \$17.6 M grant to fund set-aside activities (see table below). A workplan will be submitted to EPA to describe how \$4,698,953 will be used to fund these activities, which are further described in the next section. The remaining \$769,726 will be used to finance drinking water projects this year. We will retain the ability to take these monies from a future capitalization grant to fund set-aside activities in the future. The state is currently developing a comprehensive source water protection plan to protect drinking water sources in the state and will need money to fund activities supporting this program in two to three years. We also expect to need additional funds to provide technical assistance to small systems to help them implement consumer confidence reports which will be required in the fall of 1999.

Set-aside category	% set-aside	Total amount reserved from current grant	Reclaimed credit from old grants	Cumulative amount in workplans	Amount of current grant reserved for future use	Total available credit
	%	\$	\$	\$	\$	\$
Admin	4.0	\$705,636	\$0	\$705,636	\$0	\$0
Tech Asst.	2.0	\$352,818	\$0	\$147,182	\$205,636	\$205,636
St. Prg. Mgt	10.0	\$1,764,090	\$0	\$1,200,000	\$564,090	\$564,090
Local Assist.	15.0	\$2,646,135	NA	\$2,646,135	NA	NA
Total	31.0	\$5,468,679	\$0	\$4,698,953	\$769,726	\$769,726

Year 2 language. New Water is reserving \$2,420,044 of this year's \$7.1 M grant to fund set-aside activities (see table below). The state will reserve \$1,939,408 from the current grant and will reclaim \$480,636 of credit from previous years to fund activities that will be included in the workplan submitted to EPA for approval. The activities that will be funded with the full \$2,207,917 included in the workplan are further described in the next section. The remaining \$212,130 will be used to finance drinking water projects this year. We will retain the ability to take these monies from a future capitalization grant to fund on-going activities in the future.

Set-aside category	% set-aside	Total amount reserved from current grant	Reclaimed credit from old grants	Cumulative amount in workplans	Amount of current grant reserved for future use	Total available credit
	%	\$	\$	\$	\$	\$
Admin	4.0	\$284,852	\$0	\$284,852	\$0	\$0
Tech Asst.	2.0	\$142,426	\$205,636	\$348,062	\$0	\$0
St. Prg. Mgt	10.0	\$712,130	\$275,000	\$775,000	\$212,130	\$501,220
Local Assist.	11.2	\$800,000	NA	\$800,000	NA	NA
Total	27.2	\$1,939,408	\$480,636	\$2,207,914	\$212,130	\$501,220

Year 3 language. New Water is reserving \$1,501,200 of this year's \$7.6 M grant for set-aside activities (see table below). The state will use \$1,275,000 from the current grant and will reclaim \$226,200 of credit from previous years to fund activities that will be included in the workplan submitted to EPA for approval. The activities that will be funded with the \$1,381,200 are further described in the next section. The remaining \$120,000 will be used to finance drinking water projects this year. We will retain the ability to take these monies from a future capitalization grant to fund on-going activities in the future.

Set-aside category	% set-aside	Total amount reserved from current grant	Reclaimed credit from old grants	Cumulative amount in workplans	Amount of current grant reserved for future use	Total available credit
	%	\$	\$	\$	\$	\$
Admin	4.0	\$305,000	\$0	\$305,000	\$0	\$0
Tech Asst.	2.0	\$150,000	\$0	\$150,000	\$0	\$0
St. Prg. Mgt	4.2	\$320,000	\$226,200	\$426,200	\$120,000	\$395,020
Local Assist.	6.6	\$500,000	NA	\$500,000	NA	NA
Total	16.8	\$1,275,000	\$226,200	\$1,381,200	\$120,000	\$395,020