



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

APR 14 2014

OFFICE OF WATER

MEMORANDUM

SUBJECT: Drinking Water State Revolving Fund (DWSRF) Unliquidated Obligations (ULO) Reduction Strategy

FROM: Peter Grevatt, Director
Office of Ground Water and Drinking Water

TO: Water Division Directors
Regions I-X

This memorandum presents a national strategy to reduce unliquidated obligations (ULO) under the Drinking Water State Revolving Fund (DWSRF). DWSRF ULO are unspent funds from grants provided to states by the Environmental Protection Agency to assist drinking water systems in financing needed infrastructure improvements. States may also use a portion of their DWSRF grant funds as set asides for other important public health protection purposes including helping water systems, particularly small systems, strengthen their technical, managerial and financial capacity; implementing state Public Water System Supervision (PWSS) programs; and providing support for source water protection. The DWSRF ULO reduction strategy is directed to the timely expenditure of federal funds for these activities and supports our broader collective goal of maximizing the use of all DWSRF resources to advance investment in the reliable delivery of safe drinking water to the American people.

The strategy focuses on two key objectives: 1) liquidation of past years' grant funds and 2) maintenance of lower levels of ULO in future years. These objectives are framed within the expectation that states will work towards operating their DWSRFs to have ULO at the lowest practical level while recognizing the varying institutional and financial circumstances of each state. The objectives are accompanied by a set of practices to assist states and to encourage them to operate the best infrastructure financing programs they are able within their respective institutional frameworks. These objectives and practices are described in further detail below. The strategy's overall approach is further reinforced by the "best practices" identified by both the Council of Infrastructure Financing Authorities (CIFA) and the Association of State Drinking Water Administrators (ASDWA).

The strategy evolved from a series of consultations with states, CIFA, ASDWA, and you and your Regional DWSRF and PWSS staffs. The strategy's objectives and practices have received positive feedback from CIFA's and ASDWA's boards of directors, reflecting the continuing strong emphasis that these organizations place on sound DWSRF funds management. I appreciate your thoughtful input and perspectives and your acknowledgement of the multiple aspects of DWSRF funds utilization that need to be addressed collaboratively now and into the future of the program to ensure timely, expeditious and efficient use of these federal dollars. The strategy also builds on my memorandum to you of September 12, 2013, which describes flexibilities that states have under DWSRF regulations to help in addressing certain aspects of ULO, including use of federal funds on a first-in first-out (FIFO) basis; bypass procedures for projects not yet ready to proceed; funds use equivalence for additional subsidy and green projects; and funds reserve authority for DWSRF set asides. These flexibilities are already used by many states and will enable others to accelerate their efforts to spend their DWSRF grant funds.

I want to express my appreciation for your support and that of your staffs in the development and early implementation of key aspects of this strategy. An important step that all Regions took working with states in 2013 was to award all DWSRF state grants in the fiscal year of appropriation. The state associations have also endorsed this step. We will need to continue on this foundation of prompt grant awards in 2014 and future years. Your continued engagement on these issues will be essential to assure the full, timely use of these funds to address high priority public health protection needs of water systems within each state.

Strategic Objectives

The strategy aims to reduce DWSRF ULO for both loan and set aside funds to lower yet practical levels, targeted to occur within financially manageable timeframes as indicated by the experience of states with low ULO, while respecting that there will be differences among states. This aim is reflected in the strategy's objectives:

- (1) Full utilization of funds from previous DWSRF grants (FY 2013 and prior years' funds) by the end of September 2016.

These grant funds may be referred to as "legacy ULO" as they will have been available for a significant period of time by the end of fiscal year 2016. These loan and set aside funds are a focus of immediate concern and attention. I encourage you to focus most intensively on states with higher ULO while ensuring that others remain on their paths to meet or continue to stay within this objective.

- (2) Complete draw down of funds from future years' grants within two years from the date of grant award.

This objective addresses the maintenance of lower ULO in the future to support timely, expeditious and efficient use of DWSRF grant funds for both loan and set aside assistance. The purpose is to prevent accumulation of grant funds and minimize the number of open grants. States that are meeting or exceeding this objective are encouraged to continue to do so. Regions are asked to work closely with all other states to reduce carriage of ULO and manage within the objective.¹

Practices

The strategy focuses on fundamental DWSRF program management practices, with heightened emphasis on approaches that can help reduce ULO. Many states are already successfully using these "best practices" to support sound funds management and timely public health protection. I am asking you to join me in working with states to adopt the following practices, directed toward the strategic objectives, where needed:

- (1) **Focus on Ready-To-Proceed Projects.** Proactive efforts by states to help get projects ready to proceed to financing and to ensure that construction of funded projects is initiated on schedule represent an investment in protecting the health of our communities. States have options available through the use of either DWSRF loan funds or set aside funds, or both, to work with water systems at each phase, from project conception through planning and design, to ensure that priority infrastructure projects are ready to proceed to construction. State financial assistance for project planning and design can offer opportunities for water systems, especially small systems, in preparing projects for construction. States are strongly advised to ensure that construction funding for projects on the fundable list is not awarded until projects are ready to begin construction. If DWSRF funds are provided up front for planning and design, those funds should be awarded separately from funds for construction, unless the project is assured to proceed to construction within the near term; for example, in the same program year.

¹ Some states, particularly with respect to set aside funds, may face challenges that could constrain their efforts. In such instances, states in collaboration with Regions should carefully consider, wherever possible, alternative approaches for using the funds in the timeliest manner possible to achieve their intended public health protection purposes. Additional time to use set aside funds is envisioned not to extend beyond twelve months.

- (2) **Develop a Robust List of Fundable Projects.** A robust fundable list contains projects of cumulative value that sufficiently exceeds the amount a state expects to provide in assistance in the period covered by its Intended Use Plan (IUP). Projects on the fundable list should be immediately ready, or be poised to be ready, to enter into assistance agreements. A well-developed fundable list affords a state the option to bypass projects not ready for financing due to unanticipated issues. Incorporation of bypass procedures into IUPs enables states to efficiently advance ready projects, while appropriate use of these procedures facilitates project timeliness and expeditious funds use for responding to priority public health needs. Solicitations by states of water system projects needing capital investment to protect public health underpin the development of the comprehensive project lists from which fundable lists are drawn and are an important early step; states' efforts to ensure that water systems within their jurisdictions are well-informed of the financing opportunities available through the DWSRF are key to support this process.
- (3) **Forecast Financing Capacity through Use of Cash Flow or Similar Analysis.** Understanding the relationships between future incoming funds, projected disbursements and future project needs is a powerful tool that states can use to optimize the productivity of all of their DWSRF funds. Incoming funds include the federal capitalization grant and state match, as well as principal and interest payments on loans, leveraged bond proceeds and fees. Cash flow modelling allows a state to determine the amount of assistance its program can prudently provide in a given year and can help a state assess the impacts of current year financing decisions on future years' financing capacity. Particularly when used in conjunction with a robust list of fundable projects that are ready to proceed, cash flow analysis can help states to maximize the pace of project funding where supported by sound financial management principles. It can also assist states in moving funds more quickly to reimburse project expenditures, supporting expeditious draw on federal and other sources of funds. I ask that you encourage states not using cash flow analysis to participate in training offered by my office to facilitate their understanding of the techniques and conditions that support this approach and that you work with them to determine how its use might enhance their ability to finance needed drinking water infrastructure.
- (4) **Manage Set Aside Accounts to Reflect the Pace of Funds Use.** Set aside funds are a hallmark of state flexibility under the DWSRF program and are taken by states for a variety of purposes, such as technical assistance, PWSS program management and source water protection, as well as for planning and design grants for project readiness. In taking set asides, states have options that they can exercise to support effective use of

these funds while minimizing ULO. States that have long-term projects funded with set aside funds can reserve the authority to take funds from a future grant, in lieu of the current grant, to support these multi-year projects. States may reserve the authority for the two percent, four percent and ten percent set asides. Once authority has been reserved it does not expire and may be exercised by the state against any future capitalization grant. Other approaches that may be useful to a state in managing set aside accounts include adjusting the amounts taken from one year to the next to reflect actual pace of spending; and transferring accumulated unused set aside funds to the loan fund.

- (5) **Draw Down Federal Funds and State Match First.** States have several sources within their drinking water revolving funds from which to draw funds for reimbursement of project expenditures. Please encourage states to draw federal capitalization grant funds and state match funds before using other funds, to the extent possible, to cover these reimbursements and reduce ULO. This approach of prioritizing federal and state match draw down can be informed and facilitated by cash flow analysis.
- (6) **Accelerate Federal Cash Draws through Prompt Invoicing.** To help manage ULO, please encourage states to work with assistance recipients to achieve submission of invoices as promptly as possible (such as monthly, as indicated by national association “best practices”) and to expedite review of project payment requests to effect timely cash draws of federal capitalization grant funds.

These practices are dynamic and interactive. My staff will continue to work with staff in the Regions and states and state associations to promote these practices, drawing on the experience of states in reducing and maintaining low ULO as well as ongoing efforts by CIFA and ASDWA to advance cash flow approaches and set-aside management.

Strategy Implementation

This strategy is for immediate implementation. I advocate that you confer closely with states in your Region to put these practices in place as needed to support ULO reductions and to position states as much as possible to achieve the strategy’s objectives, recognizing that states present a wide range of circumstances and starting points relative to the objectives and in utilizing the supporting practices. For states that currently meet or exceed the objectives, it will be important to ensure that these achievements are maintained. For others, your dedicated efforts to assist in developing a sound and sustainable path to meet the objectives will be critical. For those states that are most challenged, it is particularly important for both the Region and the state to

understand any factors that may impede meeting the objectives, while working to attain the lowest ULO balances possible.

To further assist you, I will make my staff available to consult with your staff and any state officials that you identify as needing information or technical assistance. My staff has been tracking ULO and will continue to provide this information to your staff on a monthly basis to facilitate your frequent evaluation of each state's progress and assist you in identifying where further assistance to states is needed. I will continue to evaluate our collective efforts and will seek your input should we need to reinforce this strategy to achieve its purpose of significantly lowering ULO levels.

My office is committed to support you and the states. My staff recently conducted a webinar in collaboration with state and regional presenters on cash flow analysis as a recommended tool to support timely, expeditious and efficient use of funds. Additional webinars and materials are planned that will further address this and other financial management aspects of the DWSRF program. As you work in consultation with states to understand their individual circumstances, you may identify other needs and opportunities for overcoming hurdles to reducing ULO. I am available upon your request to discuss ways in which my office might be able to assist. There may also be opportunities for states to support each other through transfer of knowledge from direct experience and use of best practices. I would be happy to communicate with states' national organizations to assist in brokering these kinds of state-to-state relationships.

Programmatic mechanisms are also available to you and may be useful in working with states to attain ULO reductions. These include specifying state DWSRF grant budget and performance periods, and grant conditions, if needed; state changes in Intended Use Plans; and, if appropriate, state modifications to DWSRF operating agreements which might be useful in documenting state-administered financial processes. While EPA's grants policy allows up to seven years for full expenditure of open grants, the DWSRF regulations call for the expenditure of all funds as efficiently as possible, in an expeditious and timely manner. Implementation of this strategy across the national DWSRF program will promote a focus on expeditious liquidation of grant funds to ensure that appropriated dollars are being used to address critical public health needs in a timely manner.

You may also find it helpful to track the pace of states' implementation of the above-described strategic objectives, as well as use of the practices, as you evaluate whether the strategy's objectives are being achieved in your Region. I will be doing so on a regular basis to support collaboration with you on achieving progress in ULO reduction. Together we need to carefully evaluate the efforts of each state in ULO reduction. I look to you to actively ascertain that a state is making or has made sufficient progress towards sound management of its DWSRF funds and, if warranted, to take appropriate action to ensure proper and timely funds use.

I want to thank each of you and also convey my appreciation to CIFA, ASDWA and their respective board members for sharing insights and expertise in the development of this strategy. I look forward to working with you and the states to ensure the timely use of DWSRF funds for public health protection. Please contact me or have your staff contact Chuck Job, Chief, Infrastructure Branch, at (202) 564-3941 or job.charles@epa.gov at any time with questions or to share ideas to advance this important initiative.