

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY ENVIRONMENTAL FINANCIAL ADVISORY BOARD

Coordination of USEPA/SRF and USDA/RUS Water and Sewer Loan Assistance

Purpose of Paper

This paper examines important programs overseen by the United States Environmental Protection Agency (USEPA) and the United States Department of Agriculture (USDA) that provide financial assistance to small rural communities to pay for water related environmental infrastructure. The programs examined include:

- the USEPA Clean Water and Drinking Water State Revolving Loan Fund Programs; and
- the USDA Rural Utility Service Water and Environment Programs.

The paper looks at the purposes of these programs and presents the eligibilities, amounts, and types of assistance that they provide. The paper also looks at the issue of coordination between the programs and considers whether improved coordination would result in better, more efficient environmental and public health protection. The paper includes recommendations and next steps for USEPA to consider regarding the future interaction of these important federal assistance programs.

Introduction

Both the USDA Rural Utilities Service (RUS) Water and Environment Programs (WEPs) and the USEPA-funded, state-run Clean Water and Drinking Water State Revolving Funds (SRFs) have successfully financed important numbers of water infrastructure projects in rural America. The RUS programs provide communities with a mix of loan and grant assistance for water and waste disposal projects, while the USEPA-funded SRFs make loans to communities for wastewater and drinking water projects.

RUS WEPs target loans and grants to small, lower income, rural communities with populations under 10,000. While the state-run SRFs are not limited to this target group, many of the environmental and public health threats that the SRFs seek to eliminate occur in this same target group. As a result, it is not uncommon for both funding entities to consider offers of financial assistance to the same communities.

Given the extent of the financial need in many rural areas and the difficulty of meeting that need, this overlap is fortunate. Many smaller communities, affected by diseconomies of scale, experience compliance and capacity problems. This makes these small communities an important target group for SRF program managers as well.

Funding Comparison

Both the RUS WEPs and the EPA-funded SRF programs are important sources of federal assistance for small communities. A comparison of the financial resources of these programs demonstrates significant differences in how the Congress provides resources to them. For example, the RUS WEPs had \$714,360,000 of budget authority for federal fiscal year 2001. This funding amount included \$594,265,000 designated for direct grants to communities and \$120,095,000 designated as loan subsidy. This loan subsidy amount was projected to create \$883,701,251 in direct project loans. Loan repayments are returned to the United States Treasury.

The funding mechanism for the SRF programs is quite different. During federal fiscal year 2001, USEPA made capitalization grants to the State Revolving Funds of \$825,000,000 for Drinking Water and \$1,350,000,000 for Clean Water. These amounts were combined with other SRF assets, including state matching funds, leveraging, funds from prior federal capitalization grants, loan repayments and interest earnings. Using all of these combined assets, the Drinking Water SRFs were able to make \$1,315,100,000 of loans and the Clean Water SRFs were able to make \$3,846,300,000 of loans during the period July 1, 2000 to June 30, 2001. Loan repayments are made to the state SRFs.

It should be noted that 22% of the DWSRF loans were made to communities under 3,300 and 12% of the CWSRF to communities under 3,500 (USEPA uses 3,500 for CWSRF).

While funding for the RUS WEPs is smaller than the funds allocated to the two SRFs, its significance is quite large when one considers that they are targeted to serve the smallest, lowest-income communities where needs have proved to be so great and so intractable. In fact, RUS WEPs funding of communities with a population of less than 3,300 is significantly higher than funding by the SRFs.

Subsidy Comparison

While both the RUS WEPs and the EPA-funded SRF programs promote water infrastructure improvements by providing subsidized loans, the subsidy mechanisms used by the programs are quite different. As a result, the user costs can vary significantly depending on which program provides the loan subsidy. Virtually all RUS funding packages include some amount of loan. In order to make projects affordable, however, RUS also offers grants to many eligible communities, in combination with their loans.

At the time of the review, the RUS loan interest rate for poverty level communities was 4.5% nationwide. An RUS funding package can range from 100% market rate loan (at the time of review, this rate was 5.5%) all the way to a maximum of 75% grant and 25% poverty rate loan for some projects. However, most RUS loan/grant packages do not include 75% grants, because there is insufficient grant money available. Forty-year loan terms are common for RUS projects.

Factors affecting the cost of money in the Clean Water and Drinking Water SRFs are the rate of subsidy offered and the length of loan terms. Most SRF loan terms have been set at 20 years although loans made by some Drinking Water SRFs can now extend to 30 years. Unlike the RUS programs, state SRF programs have the flexibility to set interest rates based on the state priorities as outlined in their Intended Use Plans. In some states, the SRF interest rate has been set as low as 0%. Principal forgiveness is also available for hardship communities participating in the Drinking Water SRF Program. On the other end of the scale, the average weighted interest rates offered by SRFs in some states are set at or close to market interest rates.

Coordination Efforts

In most states throughout the nation there have been efforts at coordination between the EPA-funded SRFs and USDA RUS WEPs. At the national level, a 1997 Memorandum of Understanding between EPA, USDA and HUD provided high-level official encouragement for such coordination; however the results have been uneven at the state level.

Coordination efforts have produced active cooperation in some states and resulted in sharing of project priority lists, regular co-funding of projects and interim funding of RUS loans by SRF loans. However, there are other states where coordination has not worked as well. Although there are a number of factors that impact effective coordination, SRF interest rates, which vary considerably among the states, may be the most important factor.

In at least some states, the managers of the RUS programs and the SRF programs have found themselves competing at times for the same projects. It is also not uncommon for communities to apply to both programs in an effort to find the lowest cost. This can result in a duplication of administrative effort and in some instances, a loss by the state RUS programs of a portion of its federal water subsidy. In some cases, in an effort to further reduce user costs, loans from the SRF program are used to refinance loans from RUS, occasionally within just a few months after the RUS loan is completed. In at least one Northeastern state, SRF funds went to projects that could have been funded by the RUS, while state RUS funds were returned unspent, even though other state project priorities remained unfunded.

Important Coordination Issues

A variety of factors influence coordination, but the cost of money is certainly among the most important. In some states RUS WEPs funding is generally more affordable for small communities to use. In these cases the SRF programs have difficulty competing with the RUS. In other states, however, the opposite is true, and the RUS 4.5% loans, even when combined with grants, cannot compete with a SRF loan carrying a very low rate of interest. In some cases, lower rate SRF loans are being used to refinance the loan portion of RUS grant/loan packages in an effort to raise subsidy to a level where the user rates become more affordable.

The affordability of water and sewer rates is also at the center of issues affecting coordination among infrastructure funding programs. If a consensus on affordability could be

developed between the RUS programs and the SRF programs, it would be easier to speak about desirable interest rates and partial grants for communities in particular environmental and economic circumstances.

Finally, RUS programs have a long history of capacity development and offer significant resources to communities. They represent an important partner to EPA in overcoming capacity problems in small and low income communities. Better coordination could increase the value of this partnership.

Program Goals: Differences and Opportunities

EPA's goal is health protection while USDA's is rural development, resulting in different program priorities and restrictions. For example, SRF funds may not be readily available for system extensions intended to create economic development. There is still significant overlap however, in the objectives of the two agencies. For instance, the capacity of rural communities and their leaders to effectively plan and manage their water infrastructure over the long term is essential to achieving the goals of both agencies.

In addition to the RUS focus on some of the most difficult systems, RUS also brings an important integrated development focus to their funding efforts in many states. This is, in part, because the RUS WEP represent only a fraction of the USDA Rural Development programs available to small communities. USDA Rural Development programs also include a variety of home ownership and multi-family housing programs, community facilities loans and a business and industry grants program.

Because the RUS is one of a variety of community development programs offered by USDA, it is in a position to support community capacity development in a way that is just not possible for USEPA or the state primacy agencies. This is important because many rural water systems are in communities difficult to serve, economically non-viable, and geographically isolated. RUS programs may offer the best potential for creating economic and social capacity in some of these communities. Fostering a supportive working relationship with federal programs like RUS could be a means for USEPA and the states to achieve their own compliance and health goals.

Recommendations Regarding EPA and USDA Cooperation

1. EFAB recommends that USEPA pursue a national-level commitment from USDA/RUS to achieve closer coordination between the SRF Programs and the RUS Water and Environmental Programs.
2. EFAB recommends that USEPA invite USDA/RUS input on integrating small community water infrastructure funding into the broader planning and development concerns of rural areas. This would help to assure that the SRF program promotes other USEPA and community goals, such as smart growth, economic development and the building of strong, capable communities.

3. EFAB recommends that USEPA work with USDA/RUS on setting WEP interest rates that mesh with SRF interest rates to achieve greater affordability for communities with the most need.
4. To foster more efficient coordination between these two major federal water and wastewater loan programs EFAB recommends that USEPA include one or more experts from the state based RUS programs as members or expert witnesses to the EFAB board.

Additional Steps

- A next step could be to seek case studies of RUS-SRF coordination from a number of states where this coordination has been either especially positive or particularly difficult. There may be states where coordination was at one time poor but has now improved; these should be included.
- EFAB could seek a partner to survey SRF and RUS program managers in all fifty states to learn more about their perceptions of the need for improved coordination. This survey could be used to request input on measures that would strengthen collaboration.
- EFAB could encourage SRF and RUS program managers to discuss and review their respective affordability standards with an eye to looking at how affordability can best be expressed and achieved. EFAB could offer to participate in these discussions.