

**UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
ENVIRONMENTAL FINANCIAL ADVISORY BOARD**

September 28, 2001

Honorable Christine Todd Whitman  
Administrator  
U. S. Environmental Protection Agency  
Washington, D.C. 20460-0001

Dear Administrator Whitman:

We are pleased to provide you the latest report of the Environmental Financial Advisory Board (EFAB), *Arbitrage Relief Would Increase Funds Available to Meet Critical Water and Sewer Funding Needs.* Its principal author is Sonia Toledo, Managing Director, Public Finance Department, Lehman Brothers. Ms. Toledo is chair of EFAB's Public Finance Workgroup.

Recent environmental financing studies have found that the nation faces significant and growing water and wastewater infrastructure costs. State and local governments shoulder by far the largest portion of this infrastructure burden. EFAB believes the federal government should explore ways to help these governments address this funding challenge. One way would be to remove federal restrictions to the efficient management, investment and operations of federally-funded drinking water and wastewater infrastructure programs.

In that regard, the enclosed report examines the idea of removing Internal Revenue Code arbitrage restrictions on the federal and state dollars used to fund the Clean Water and Drinking Water State Revolving Funds. Arbitrage is the difference between the interest rates at which bond proceeds are borrowed and the interest rates at which they are invested. Generally, the Internal Revenue Code requires that arbitrage earned on the investment of tax-exempt bond proceeds be rebated to the federal government.

Freedom from arbitrage restrictions would have a significant, positive impact on funding for these public-purpose State Revolving Funds. Further, since federal statute controls the use of monies held in the Funds, any arbitrage earnings could only be used for authorized environmental purposes. From a federal budget perspective, the change would make additional funding available immediately without a corresponding immediate budgetary impact. Of course, federal receipts of arbitrage rebate payments from the State Revolving Funds would fall over time.

In a broader sense, we believe that the consideration of tax and financial issues such as the Internal Revenue Code's arbitrage rebate restrictions have long been, and continue to be, of considerable importance to EPA and its programs. In this regard, we suggest that you consider naming a senior Agency headquarters official with financial expertise as a permanent liaison with the Department of the Treasury. Such an individual could meet regularly with Treasury and Internal Revenue Service officials to communicate and represent EPA's interests across all of its environmental programs.

We hope that you will find the report and our suggestions constructive and useful. The Board is prepared to discuss its findings and recommendations, and to take any follow-up actions that are consistent with its charter. If you or your staff have questions regarding the report, or would like to arrange a meeting, please let us know. We greatly appreciate the continuing opportunity to serve the Agency.

Sincerely,

/s/

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Robert O. Lenna  
Chair

/s/

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A. Stanley Meiburg  
Executive Director

Enclosure

cc: Linda Fisher, Deputy Administrator  
Tracy Mehan, Assistant Administrator for Water  
Michael W. S. Ryan, Deputy Chief Financial Officer  
Joseph L. Dillon, Comptroller