

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

Honorable Carol M. Browner
Administrator
United States Environmental Protection Agency
401 M Street, SW
Washington, D.C. 20460

Dear Administrator Browner:

When you addressed the Board on the Administration's proposed Better America Bonds initiative at its March meeting, a question arose about possible linkages between the initiative and the Clean Water and Drinking Water State Revolving Funds (SRFs). You asked the Board at that time for a paper on how the SRFs might help the proposed initiative. To meet your request, we set up an ad hoc workgroup which reviewed the topic and developed the enclosed paper, "*Ways the State Revolving Funds Could Assist the Better America Bonds Initiative.*"

The Board's ad hoc workgroup included Sonia Toledo, Terry Agriss, Stephen Mahfood, Michael Finnegan, George Brewster, and Bill Jarocki. In addition, we want to acknowledge the Office of Water for their thoughtful comments and suggestions. While developing the paper, we received feedback from them which improved and informed our efforts. The Board, as always, is solely responsible for the final product.

Finally, in response to your request for suggestions on ways to improve the Better America Bonds proposal, the Board is in the last stages of developing some tax-related recommendations which could improve implementation prospects. We will be sending you a short letter report in this regard within the next two weeks.

Sincerely,

Robert O. Lenna
Chair
Environmental Financial
Advisory Board

John C. Wise
Executive Director
Environmental Financial
Advisory Board

Enclosure

cc: J. Charles Fox, Assistant Administrator for Water

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***WAYS THE STATE REVOLVING FUNDS PROGRAMS COULD ASSIST THE
BETTER AMERICA BONDS INITIATIVE***

This paper outlines a number of ways that the United States Environmental Protection Agency's Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund (DWSRF) programs might assist the Administration's proposed Better America Bonds initiative. The CWSRFs and DWSRFs work closely with the Agency and have considerable experience with bonds. In addition, they have expanded, or are gradually expanding, into many of the eligibilities contemplated in the Better America Bond initiative. This paper represents an initial assessment and as events move forward, the Board is available to provide further recommendations and assistance, as needed.

First, for the SRFs to effectively participate in, and advance the purposes of the Better America Bonds program, it would make sense to provide the SRFs with the same set of project eligibilities. The SRFs share some, but not all, of the eligibilities planned for the Better America Bonds program (i.e., nonpoint source and brownfields clean-up). Attached at the end of this paper is a list provided by the Office of Water that shows examples of both eligible and ineligible activities under the CWSRF. By allowing the SRFs' funds to be eligible for the same qualified uses as Better America Bonds, more resources could be directed to these worthy environmental purposes. Such eligibility changes would, however, require congressional action.

Second, as experienced issuers of tax-exempt bonds and established State environmental financing entities, the CWSRFs and DWSRFs could provide important assistance to the Better America Bonds initiative even with existing eligibility limitations. Not only might they be potential issuers of Better America Bonds, but they could also do more. At first look, it seems likely to the Board that the SRFs' greatest contribution would lie with helping smaller local and tribal governments. Examples of SRF assistance could include the following.

1. State Revolving Funds (SRFs) could apply for Better America Bond allocation authority from EPA to sell bonds to help finance loans to municipalities for projects that satisfy the qualified uses and other requirements of both programs. For multiple projects, SRFs might aggregate loan funds on behalf of one or more other governmental entities. While the purpose of the CWSRFs is to finance water quality improvement projects, clearly there are land purchase situations where the water quality interests are so directly impacted as to be eligible costs. For example, the purchase of the Howard Ranch in California involving the State's CWSRF.
2. SRFs might seek allocation authority for bond issues to create pools of loan funds for several projects to be identified or still under development. In many cases, the SRFs' credit ratings would be higher than those of individual participants in the pools (particularly for many small communities), thus allowing the bonds to be sold closer to par, at par, or even at a premium. SRF

loans to pool participants could also be part of co-financing deals with other lenders.

3. SRFs might also consider arranging guaranties and/or bond insurance on behalf of qualified borrowers/Better America Bonds issuers undertaking eligible projects. These borrowers/issuers could pay premiums for such insurance, as appropriate, to the SRF.

Smaller issuers in particular may face serious problems with lower credit ratings which could cause their issues of Better America Bonds to be sold at significant discounts from par. These bonds would have to be paid off at par at maturity thus increasing their cost. With SRFs providing backstop credit enhancements (thus raising their creditworthiness for the particular projects), this situation would be less likely and the small communities might be able to issue bonds at par.

4. The DWSRFs might also be interested in Better America Bonds from the stand-point of helping fund source water protection projects that ensure compliance with the Safe Drinking Water Act. The DWSRF set-aside account for source water protection could be particularly useful in supporting eligible Better America Bond projects.

DWSRFs have similar financial authorities and could use many of the same techniques as the CWSRFs. DWSRFs also might make direct loans to private parties. Perhaps DWSRFs could work with governments with Better America Bond authority to issue bonds and make the proceeds available to individuals, non-governmental organizations (NGOs), corporate landowners, or prospective landowners to buy green space subject to conservation easements. CWSRFs may be able to do something similar by making bond proceeds available via NGOs.

5. In contemplating these potential forms of financial assistance, the Board recognizes and agrees with the Office of Water that the SRFs also possess considerable administrative, managerial, technical, and financial expertise which might be made available to eligible issuers of Better America Bonds. It seems reasonable that since this expertise exists in these State agencies, tapping it makes a lot of sense. However, the Board also recognizes that additional duties for the SRFs will entail additional costs and may require additional resources.

There may be other possible roles for the SRFs in participating in the proposed Better America Bond program and helping it meet its objectives. However, it seems likely at first look that the greatest potential would lie with assisting in the areas discussed above.

Examples of Eligible Activities Under the CWSRF

Nonpoint Source (§319) and Estuary (§320) Projects

(Public and private ownership eligible) (Must be on approved NPS or Estuary Plan)

- Agricultural crop land BMPs
 - no-till equipment
- Agricultural animal BMPs
 - manure containment pond
- Silviculture
 - forestry
- Groundwater protection
 - wetlands
 - buffers to protect drinking water
- Brownfields
 - pollutant assessments
 - abatement of water quality problems
- Landfills
 - capping, liners, monitoring wells
- Septic tanks
- Estuary
 - fish passage
- Stream and river bank restoration
- Sourcewater protection

Point Source

(Must be publicly owned)

- Planning and design
- Wastewater treatment facilities
- Collector and interceptor sewers
- Correction of combined sewer overflows
- Sludge handling facilities
- Infiltration/Inflow correction
- Storm sewers
- Land that is an integral part of the treatment process
- Reserve capacity
- Acid mine drainage correction
- Concentrated Animal Feeding Operations

Ineligible Activities Under CWSRF

1. Land for point source projects that is not an integral part of the treatment system.
2. Operation and maintenance costs.
3. Any privately-owned point source listed above.