Overview

Many sewer system owners and operators are facing a need for significant capital repairs, upgrades, and expansions to abate chronic sanitary sewer overflows, or SSOs. The challenge to permittees is finding low-cost funding methods that fairly distribute costs among sewer system users. This fact sheet presents various funding options and discusses how each applies to SSO projects.

Most funding mechanisms are designed to allow the permittee, or sewer system utility, to obtain and administer the funds. Some methods allow the utility's client community to obtain or help secure funding with financial reserves. Throughout this fact sheet, "permittee" refers to the sanitary sewer system owner or operator holding the NPDES permit, and "community" refers to the local government or governments served by the permitted sewer system.

Many permittees rely on revenue bonds or State Revolving Loan (SRF) funds for capital improvement project costs. Alternatives to these revenue sources exist and may be available to fund SSO abatement. It is hoped that permittees will review the options in this fact sheet for ideas as they develop their SSO abatement construction and financing schedules.

Types of Capital Funding Options

Capital projects for SSO abatement include a large variety of sewer collection system improvements, such as line rehabilitation or replacement, pump and lift station improvements, interceptor upgrades, etc. Capital funding options can be grouped into the categories of:

- Bonds
- Loans
- Grants
- Other Capital Funding Options
Not all options may be available to every permittee. For example, a permittee with limited borrowing history might have difficulty obtaining long-term bond financing. Also, not all States provide separate grant or loan assistance programs. It is important to note that under many lending program definitions, infiltration and inflow reduction methods (such as line cleaning, manhole cover replacement, or downspout disconnection programs) are not considered capital projects. Any such limitations will be noted in the individual funding method discussions.

**How to Use This Fact Sheet**

As you begin to plan your capital improvement project, tour this website and read about each of the funding options described. You will get a sense of those that may be available to your system or community, and those that will not. Use the information provided in this fact sheet, and information you may learn from related links provided herein, to develop your capital improvement financing plan.
Special Reserves

Many permittees establish special reserve funds for capital equipment repair and replacement. Generally, a portion of user fee revenues and interest earnings on idle funds are placed in a separate account for this purpose. Some communities use these reserves to fund SSO abatement projects.

Benefits:

- Funds are immediately available for use.
- Reserve funds avoid many administrative costs involved in issuing bonds, obtaining loans, and/or paying interest.

Limitations:

- Reserve funds should not be used for rehabilitation or replacement of capital facilities if they were established to cover operations and maintenance costs.
- The funding level is limited compared to other capital funding sources.

Pay-As-You-Go

Many communities prefer not to be in debt. These communities use a pay-as-you go approach by collecting annual taxes, water/sewer fees, and other revenues in advance of the project construction.

Benefits:

- Pay-as-you-go financing avoids long-term debt.
- Financing costs, such as interest and debt issuance administrative costs, are eliminated.

Limitations:

- SSO abatement projects may involve large initial capital investment.
- Regulatory compliance deadlines may accelerate implementation of abatement projects, leaving too little time for revenues to accrue.
FINANCING CAPITAL IMPROVEMENTS FOR SSO ABATEMENT:

Links to Funding Resource Sites

Bonds

State Bond Banks
An example of a bond bank in California can be seen by visiting:

- http://www.ebondpool.com/

Loans

State Revolving Fund Contact Information:


Rural Utilities Service Contacts:

- Go to http://www.usda.gov/rus/water/states/usamap.htm, and click on your state on the map.

CoBank Contacts:

- CoBank's Communication and Energy Division Rural Utilities Service is headquartered in Denver, CO, with additional banking centers located in St. Paul, MN, Atlanta, GA, and Louisville, KY. For more information on CoBank loans and contacts, go to: http://www.cobank.com/About_CoBank/Contact_Us.htm
Grants

**Rural Utilities Service Grants:**

- Additional information can be obtained at RUS state offices. For information, go the following link and click on your state to find state contact information: [http://www.usda.gov/rus/water/states/usamap.htm](http://www.usda.gov/rus/water/states/usamap.htm).

**Community Development Block Grants:**

- For more information on the CDBG program, visit HUD's website at: [http://www.hud.gov/offices/cpd/communitydevelopment/programs/](http://www.hud.gov/offices/cpd/communitydevelopment/programs/).
Environmental Finance Center Network

The EFCN is the only university-based organization that creates innovative solutions to help manage the cost of environmental protection. Addressing the difficult "how-to-pay" issues, the EFCN provides a wide range of planning, funding identification, and technology transfer services. Additional information and local contacts are available at:

- [http://www.epa.gov/efinpage/efcn.htm](http://www.epa.gov/efinpage/efcn.htm)

Rural Community Assistance Program

RCAP provides technical and management planning assistance to small rural communities with populations under 10,000. They also provide subsized technical training to eligible communities. Information can be found at:

FINANCING CAPITAL IMPROVEMENTS FOR SSO ABATEMENT

Bonds Lend Stability and Flexibility to Capital Improvement Programs

Bonds are promissory notes sold by local governments or utilities to raise funds for large construction projects. Bond interest rates are usually higher than federal or state-sponsored low interest loans, but lower than commercial loan rates. In general, bonds issued by permittees with more stable socioeconomic conditions and successful debt management track records will be more attractive to buyers than those with weaker circumstances. This will affect the bond interest rate. The rate can often be lowered if the permittee provides assurance of continued payment in the event of a revenue shortfall, through:

- Bond insurance
- Establishment of a municipal or utility debt service reserve fund
- State or Federal Government guarantees or assurances

Bonds offer the most flexibility in financing SSO abatement projects. They are usually structured with 20-year retirement schedules and can be used to fund some non-capital projects (such as manhole inspection and repair programs) that must be accomplished in a short period of time.

**General Obligation Bonds**

General obligation (GO) bonds can be issued by a municipal or county government to fund capital projects of the jurisdiction. They are secured by the jurisdiction's general taxing power. In the case of an SSO abatement project, the municipality would issue a GO bond on behalf of the permittee. If planned revenues, such as property and/or income taxes, fall short of the amount needed to meet payments, the jurisdiction may raise taxes to generate the needed revenue.

**Benefits:**

- The taxing power makes GO bonds the most secure form of local debt, so they often attract lower interest rates.
- The permittee does not need separate bonding authority or advanced financial management capabilities.
- This form of financing is flexible enough to cover some traditionally non-capital budget items needed for SSO abatement.
Limitations:

- Many communities need voter approval to issue GO bonds.
- There is often a statutory limit on total GO debt, or on GO debt as a percent of property value.
- The general public may be paying for projects that benefit only a portion of the community.

Revenue Bonds

Revenue bonds are sometimes referred to as water/sewer bonds. They are issued by the permittee and are backed by user fees or service charges paid by system users. Interest and principal repayment schedules are structured in the same manner as GO bonds.

Benefits:

- Revenue bonds can be used by a large majority of permittees that need to address SSOs.
- User fees are more equitable than property taxes, because system users, rather than the general public, pay for the service.
- Revenue bonds are often not affected by local debt limits or voter approval requirements.
- Revenue bond financing is flexible enough to cover some traditionally non-capital budget items needed for SSO abatement.

Limitations:

- Interest rates on revenue bonds are usually higher than GO bonds.
- The permittee must establish legal authority to issue debt.
- The permittee must have advanced financial management expertise and adequate cash reserves in case user fees fall short of the amount needed to meet bond payments.

Moral Obligation Bonds

A moral obligation (MO) bond is a revenue bond with an additional nonbinding pledge from the community to cover bond payments in the event of revenue shortfalls. A revenue shortfall would be reported to the local government, which would then appropriate the amount needed to repay the bondholder. The participating local government is not legally required to make up the shortfall.

Benefits:

- The financial backing of the community can result in lower revenue bond interest rates.
- The bond market is more open to revenue bonds with MO pledges, so the bond is more saleable.
- MO pledges usually do not count against the issuing government's debt limitations.
- MO bond financing is flexible enough to cover some traditionally non-capital budget items needed for SSO abatement.

Limitations:

• The MO pledge may require voter approval.
• Because the pledge is not legally binding, interest rates will be slightly higher than GO bond rates.

**Double-Barreled Bonds**

A double-barreled (DB) bond is a revenue bond that has a legally binding "full faith and credit" pledge issued by the permittee's community government.

**Benefits:**

• This is the most secure type of bond from the investor's standpoint, so it receives the lowest interest rates.
• DB bonds are easiest to sell because the market is receptive to them.

**Limitations:**

• DB bonds do count against the pledging community's debt limitation.
• Some governments have additional restrictions on the use of DB bonds.

**State Bond Banks**

A bond bank is a state-created financial entity that issues pooled bonds for participating communities. By grouping individual bond offerings, the bond bank increases the security of the bond issue, resulting in a higher bond rating and a lower interest rate. These funds are for communities with smaller projects that likely would not generate saleable bonds in the open market.

**Benefits:**

• Bond banks offer lower interest and issuance costs.
• Bond banks can assist communities with smaller projects.

**Limitations:**

• Generally, bond banks do not benefit larger communities or larger projects.
• Bond banks have underwriting and administrative fees.
• Bond banks may not cover some I/I reduction projects that are not considered traditional capital improvements.
For More Information

**Municipal Bond Rating Information**

To learn more about the municipal bond rating system, visit Moody's Investor's Service web site:


**State Bond Banks**

An example of a bond bank in California can be seen by visiting:

- [http://www.ebondpool.com/](http://www.ebondpool.com/)
FINANCING CAPITAL IMPROVEMENTS FOR SSO ABATEMENT:

**Low-Interest Loans Can Help Communities Bridge Funding Gaps**

State, association, and commercial loans are available to many permittees for funding SSO capital improvement projects. Many of these loan programs can offer creditworthy small- to mid-size communities no-interest or low-interest loans, effectively increasing the amount of money available for projects. Loans usually have shorter repayment schedules than bonds. Loan size is usually capped to allow the program to fund as many permittees as possible. Many programs exclude some types of non-capital I/I reduction activities.

Permittee creditworthiness is assessed according to:

- Current level of debt
- Source of funds to repay debt
- Past experience in obtaining and repaying loans
- Current socioeconomic conditions
- Management capabilities

The primary loan programs include:

- State Revolving Fund (SRF)
- Other state loan funds
- Rural Utilities Service
- CoBank
- Commercial lending institutions

**SRF Loans**

The SRF is a federally-subsidized program that is managed at the state level. All 50 states and Puerto Rico have SRF programs that provide funding for eligible wastewater treatment, nonpoint source, and estuary projects. Each state determines how its program will be administered, including water quality improvement priorities, interest rate, maximum loan amount, qualification requirements, and loan terms and conditions. SRF programs can offer zero to market rate interest loans, guarantees of repayment, bond insurance, and refinancing of existing debt under certain conditions. The District of Columbia and U.S. territories do not have SRF programs.
Benefits:

- Most state SRF programs offer no- and/or low-interest rates (0 - 3.5%).
- SRF program staff are skilled at helping applicants identify other sources of funding.

Limitations:

- SRF loans are not for non-capital I/I reduction activities.
- SRF loans may be limited in amount and number.
- In many states, SRF loan applications are solicited and reviewed on an annual or semi-annual basis. This requires significant advance planning by the permittee.

**Other State Loan Programs**

Many states have other loan programs that offer assistance to permittees for the construction of wastewater treatment facilities. The programs differ in size and requirements, but in most cases, SSO control-oriented projects are eligible for funding. To learn whether your state has non-SRF loan funds available, contact your state permitting authority.

Benefits:

- Many state loan programs exist specifically to serve the water pollution control needs of permittees and the communities they serve. They are highly service-oriented and strive to meet the needs of communities within the state, particularly those that may have difficulty obtaining financing on their own.
- Interest rates are often low.
- Repayment periods may be longer and requirements may be less stringent than in the SRF program.

Limitations:

- If state resources are limited, loan programs may restrict the available number and/or amount of loans.

**Rural Utilities Loan Service Program**

The U.S. Department of Agriculture Rural Utilities Loan Service (RUS) provides loans for communities with populations under 10,000 that are unable to obtain needed funds from commercial sources at reasonable rates.

RUS offers loans at three different interest rates, depending on the household income of the service area. The three rates are:

- **Poverty rate** - 4.5%, as of February 1, 2001. This rate applies when the primary purpose of the loan is to upgrade or build facilities to meet health and sanitary standards and the median household income is below the national poverty line, or less than 80% of the state median income.
- **Market rate** - This rate is set quarterly, based on the average bond
index over a four-week period at the beginning of the quarter. The market rate applies to communities where the median household income is equal to, or greater than, the state median household income.

- **Intermediate rate** - the poverty rate, plus one-half the difference between the poverty rate and the market rate, not to exceed 7%. It applies to projects in communities where median household income is between 80% and 99% of the state median household income. RUS also offers loan guarantees to help small communities obtain commercial funding.

State RUS offices can provide detailed information and assistance.

**Benefits:**

- RUS offers lower interest rates than commercial loans or bonds. Repayment terms may be longer than 20 years, up to a maximum of 40 years, not to exceed the useful life of the facility being financed.

**Limitations:**

- Only available to communities with less than 10,000 population.
- Permittees that do not qualify for lower rate categories may find better rates through SRF or other state loan programs.

**CoBank Loans**

CoBank, or the National Bank of Cooperatives, was formed in 1989 through consolidation of 11 of the nation's 13 Banks for Cooperatives. CoBank is part of the Farm Credit System and is a government-sponsored enterprise. It can obtain low-cost capital, which it then lends out to its members. Water utility, telecommunication, and power projects are funded through CoBank's Communication and Energy Division.

**Benefits:**

- Because it is a cooperative financial institution, CoBank can offer competitive interest rates.
- Loans normally mature in 10 years, but may be written for up to 35 years.
- Because CoBank is a cooperative, its earnings are distributed to its customer-owners.
- CoBank offers flexible financing to cover non-capital I/I projects.

**Limitations:**

- Water and wastewater loan candidates are evaluated strictly on the basis of creditworthiness.
- Only communities with populations under 20,000 are served by CoBank loans.
- Other programs for small communities may offer lower loan rates.
Commercial lending institutions may provide funds for SSO control-related projects. Although commercial loans are widely available, they are used by very few permittees for capital projects. This is because lower-interest financing is available through bond issues or state loan programs.

Benefits:

- The application process can be faster for a commercial loan.
- There are no set limits on the amount of commercial loans.
- The loan terms, interest rate, and repayment period can be negotiated for each loan.

Limitations:

- Commercial loans generally have higher interest rates than other loans or bonds.
- Commercial loans can be difficult to obtain without adequate collateral.

For More Information

**State Revolving Fund Contact Information:**

- [http://www.epa.gov/safewater/dwsrf/index.html](http://www.epa.gov/safewater/dwsrf/index.html)

**Rural Utilities Service Contacts:**

- Go to [http://www.usda.gov/rus/water/states/usamap.htm](http://www.usda.gov/rus/water/states/usamap.htm), and click on your state on the map.

**CoBank Contacts:**

- CoBank's Communication and Energy Division Rural Utilities Service is located in Denver, CO, with additional banking centers in St. Paul, MN, Atlanta, GA, and Louisville, KY. For more information on CoBank loans and contacts, go to: [http://www.cobank.com/About_CoBank/Contact_Us.htm](http://www.cobank.com/About_CoBank/Contact_Us.htm)
FINANCING CAPITAL IMPROVEMENTS FOR SSO ABATEMENT:

Public Works Grant Programs

Grants, which were used extensively by the federal government to fund wastewater treatment programs during the 1970s and 1980s, will play a limited role in future SSO control funding. The federal government has shifted much of its funding assistance to the SRF program and support of other local funding programs.

At most, grants should be considered a component of an overall funding strategy.

Benefits:

- Grants do not have to be repaid.

Limitations:

- Most grants are too small to fund an entire project.
- The cost of administering grants is higher due to complex and lengthy application processes.
- Many grants have stipulations on how the money must be used.
- Because they are usually awarded competitively, grants are an inherently unreliable source of funding.

Currently available grant programs include:

- RUS Grants
- Economic Development Administrative Grants
- Community Development Block Grants
- State Grant Programs

**RUS Grants**

RUS offers grants for the construction of environmental infrastructure facilities for small and economically disadvantaged communities. The grants can cover up to 75% of the project cost. Historically, RUS has focused on funding wastewater treatment facilities.

**Economic Development Administration Grants**

The U.S. Department of Commerce Economic Development Administration (EDA) awards grants to economically disadvantaged communities for the
construction of public works. These grants are intended to promote long-term economic development and contribute to private-sector job creation and retention. Usually, EDA grants cover 50% of project costs, but can offer up to 80% assistance for severely distressed communities.

**Community Development Block Grants**

The U.S. Department of Housing and Urban Development (HUD) administers the Community Development Block Grant/Small Cities Program. This program assists communities with projects located in low- to moderate-income areas. States administer the program and determine the selection criteria for grand awards. Wastewater systems are among the types of projects eligible for assistance. Grants typically cover 50% of project costs, but can cover up to 80% in areas undergoing significant economic distress.

**State Grant Programs**

Many states offer grant programs. These programs vary significantly in funding level and restrictions. Many are offered only to small communities. For example, California provides state grant assistance to communities with populations of less than 3,500. The maximum grant available through this program is $2.0 million.

**For More Information**

**Economic Development Administration Grants:**

- Information on EDA grants can be obtained online at: [http://www.doc.gov/eda/html/1h_grantreq.htm](http://www.doc.gov/eda/html/1h_grantreq.htm). This page provides a basic description of the EDA grant process and links to national, regional, and state contacts.

**Community Development Block Grants:**

- For more information on the CDBG program, visit HUD's website at: [http://www.hud.gov/offices/cpd/communitydevelopment/programs/](http://www.hud.gov/offices/cpd/communitydevelopment/programs/).