

COMMONWEALTH OF PENNSYLVANIA

**PA INFRASTRUCTURE INVESTMENT AUTHORITY
and
PA DEPARTMENT OF ENVIRONMENTAL PROTECTION**

DRINKING WATER STATE REVOLVING FUND

INTENDED USE PLAN

FY 2008

July 2008

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**Drinking Water State Revolving Fund
FY 2008
Intended Use Plan**

I. Introduction

Pennsylvania herewith submits its Intended Use Plan (IUP) for use of all Drinking Water State Revolving Fund (DWSRF) funds awarded or available through the 2008 appropriation, under the Safe Drinking Water Act (the Act). This consists of all awarded grant funds through the FFY 2008 appropriation, appropriate state match funds, and principal/interest/investment income.

Also attached to this IUP is the FY08 EPA approved workplan for the use of the Set-Aside funds as provided for in the 1996 Amendments to the Federal Safe Drinking Water Act. This includes the 2% Set-Aside for Technical Assistance to Small Systems, the 10% Set-Aside for Assistance to State Programs and the 15% Set-Aside for Other Authorized Activities. This workplan captures how the state will be utilizing all the funds set-aside from these three categories in previous grants. The state also proposes to set-aside additional funds from the FY08 grant for this purpose.

The State has developed a comprehensive Cash Flow Projection Model to determine the optimal annual project approval funding. This Model incorporates both state and federal loan funding, as well as state grant availability.

Act 68 of 1999, commonly known as Growing Greener Grants, has provided additional grant funding to water, sewer, and storm water projects in Pennsylvania. These grants are being used to help communities improve infrastructure throughout the Commonwealth. Funding is also being made available to watershed groups and others to protect and restore watersheds, reclaim abandoned mines, and plug abandoned oil and gas wells which will improve the quality of Pennsylvania's water.

The DWSRF program is an essential component of the Commonwealth's efforts to protect and improve the quality of life of the citizens of Pennsylvania by helping to protect the water environment, promoting community revitalization, and supporting economic development. To this end, the Pennsylvania Infrastructure Investment Authority (PIIA) and the Department of Environmental Protection (DEP) work closely together and with other state and federal agencies to identify opportunities for funding specific projects and to coordinate funding efforts. These efforts are instrumental in achieving the requirements of the federal Safe Drinking Water Act.

II. List of Projects

A. Projects to be Funded

Under this FY 2008 IUP, Pennsylvania intends to fund 12 drinking water projects with a total dollar value of approximately \$30.3 million as shown in Chart 1. In addition, the state intends to utilize FY 2008 set-aside amounts of \$548,740 for the 2%, Technical Assistance Fund; \$2,743,700 for the 10%, Assistance to State Programs Fund and \$4,115,550 for the 15%, Other Authorized Activities Fund. This is in addition to the \$1,097,480 that will be used in the 4%, Administrative Fund. In addition the FY08 Set-Aside Workplan calls for the use of the FY 2005 2% reserved amount of \$533,620. We reserve the authority to take the 2% and 10% set-asides that have been reserved in the past from future grants. A summary of the amount of funds in reserve by grant is as follows:

Grant	2% -- Technical Assistance	10% -- Assistance to State Programs
2005	Added to FY08 application	\$2,668,100
2006	\$554,370	\$2,771,850
2007	\$554,380	\$2,771,900

B. Project Descriptions

Each project is reviewed by the regional DEP staff for cost-effectiveness, including the sizing of proposed facilities. Approved projects must be designed to meet only existing needs and future needs based on reasonably expected growth. Where project cost estimates include excess capacity for service beyond normal growth, project approval is based solely on that portion of the project needed to eliminate the Public Health or Compliance concerns for the existing and reasonably expected future customers. Although the project sponsor may receive a DEP permit to construct whatever size facility it deems appropriate and which meets DEP design standards, the awarding of PENNVEST DWSRF funding is limited to those costs, which meet these criteria.

Where a project includes fire hydrants, these are in all cases a cost-effective addition, which is incidental to the project purpose.

All DWSRF projects are ranked and funded based upon the rating criteria agreed upon by Pennsylvania and EPA. Some projects may obtain an updated rating based upon information provided by the project sponsor at the time of application. Pennsylvania has state funds that may be used for drinking water projects based upon criteria developed with the original state-funded revolving loan program. If

a project is included on the original IUP as DWSRF-eligible, and the review and ranking process concludes that it is not DWSRF-eligible, it will be bypassed and potentially funded through non-DWSRF funding sources. Other DWSRF-eligible and ranked projects would move onto the IUP to fill any resulting gaps.

A brief description of each project on the IUP list is included following the list.

C. Bypass Procedure

In the event that projects identified for funding on the IUP list are unable to proceed, these projects will be bypassed, and other projects from the comprehensive priority list will be funded, based on, among others, criteria identified in Section 10(b) of Act 16, and Section 963.9 of the PIIA regulations and readiness to proceed, as well as emergency needs for funding.

A project may be bypassed if the PIIA determines that funding the project from the DWSRF will supplant other funds available to finance all, or a portion of, the total costs of a project; or only a portion of the amount requested when the applicant can, based upon its ability to pay, obtain other affordable financing for the remainder of the project.

A project may also be bypassed for funding when another project, that was ranked lower on the Project Priority List (PPL) based on preliminary information or that is added to the PPL, subsequently moves ahead of it based upon new or revised ranking information.

The current PPL may show bypassed projects. Bypassed projects are (1) those that will be funded from other sources (e.g. transfer amounts, repayments), to maximize effective use of the federal funds, and (2) those that have been given a preliminary priority rating but have not yet submitted applications for funding. It should also be noted that there may be projects that have submitted applications for funding, but have not yet obtained the necessary permits and approvals, and have not yet been given a priority rating. Projects that have not been placed on the IUP and/or PPL lists because there is not yet a cost estimate or priority rating available will be subject to the same eligibility and funding considerations as other projects that are listed.

D. IUP and PPL Amendment Process

Annually, as part of the DWSRF Annual Report, DEP/PENNVEST will submit to EPA one PPL and one IUP/fundable list for EPA's approval of all projects that have been approved for funding during the prior year for EPA review and approval. This post approval amendment process will allow for the multiple PENNVEST board meetings and amendments throughout the year and is based on the experience that has been developed over the years. Additionally, a brief description of the environmental or public health concerns and descriptions of all

new projects will be included. EPA will review and approve these revisions as part of its annual review process.

Should a project be approved by PENNVEST and included on the IUP/PPL that subsequently is found to not be an eligible project, it will be removed from the fund and any funds that have been expended will be reimbursed to the fund.

III. Criteria and Method Used for Distribution of Funds

Loan repayments and investment earnings have been included in Funds Used.

A. Process for Selection of Systems to Receive Financial Assistance

To determine the drinking water projects that are included in the IUP list, the PPL was developed based upon projects currently requesting funding from the State Revolving Fund. Projects that need funding within the next twelve to eighteen months were also identified.

Projects appearing on the IUP list and the FY 2009/10 PPL were ranked in accordance with the criteria noted herein. However, some ratings have not been finalized and may be modified during further review prior to project funding.

The type and amount of financial assistance was determined for each project. The sources and spending limits have been identified and the SRF funds have been allocated accordingly.

B. Rationale for Providing Different Types of Assistance and Terms

Pennsylvania's financial assistance policy is based upon the communities' ability to repay loans. PIIA will charge interest on all DWSRF loans in accordance with Section 963.15 of the PIIA regulations described in the following:

1. The minimum interest rate allowable for any loan is one percent. The maximum interest rates are determined by comparing the unemployment rate of the county in which the project is located to the statewide average unemployment rate. The figures used for unemployment rate comparison are the rates from the previous calendar year as reported by the Pennsylvania Department of Labor and Industry. Projects that serve multiple counties use the highest county unemployment rate in the calculations. Projects that are located within an area that has a separate unemployment rate monitored and reported by the Pennsylvania Department of Labor use the unemployment rate for that area (municipality) in the calculations to determine financial assistance. If the county unemployment rate exceeds the statewide average by 40 percent or more, the maximum interest rate allowable is one percent for the first five years of the term and 25 percent of the interest rate the Commonwealth must pay for bonds it has issued to finance the program for

the remainder of the term.

2. For projects located in counties where the unemployment rate exceeds the statewide average rate by less than 40 percent, the maximum interest rate is 30 percent of the state bond issue rate for the first five years of the term, and 60 percent of the state bond issue rate for the remainder of the term. Projects in counties that have an unemployment rate below the statewide average receive maximum interest rates equal to 60 percent of the bond issue rate and 75 percent of the bond issue rate for the first five years and the remainder of the term respectively.
3. Interest rates may be set lower than the maximum if the PIIA Board determines that the community is so financially distressed that repayment of the loan is unlikely if the project were financed at the county interest rate maximums. If the Board determines that the community may not be able to repay the loan even if it were offered at one percent for the entire term, the Board may offer the system a supplemental grant, using Commonwealth funds.
4. Reduced interest rates and limited supplemental grants allow many systems to undertake needed water facility improvements/construction that would not be feasible otherwise. These projects protect the public health and safety of residents and allow system viability while utilizing SRF support.
5. The financial planning undertaken for the fund includes the use of the PIIA affordability analysis to determine loan terms and repayments. In addition to a review of individual loans, a complex cash-flow model encompassing the entire portfolio will be used to project future fund capacity. This model will allow PIIA to determine the availability of future funding based on individual loan repayments, as well as additional fund inputs (i.e. future grant allocations). An annual budget is calculated, projecting funding levels within the DWSRF.

C. Priority and Allocation of Assistance

The criteria used to prioritize projects are described in the “Priority Ranking Scale” (Attachment 3). This scale was developed from the existing criteria used to rank projects under the PIIA program and modified to incorporate the requirements and limitations of the DWSRF program. The existing ranking criteria were derived from the PIIA Act (35 P.S. Sections 751.1 et seq., specifically Section 10 (a) and (b)) and the PIIA regulations (25 PA Code Section 963.9). The affordability component of the Priority Ranking Scale was removed from DEP review and placed with PENNVEST in 2001 with the approval of EPA Region 3. The current priority rating criteria are explained in Attachment 3.

Pennsylvania applies the criteria described above to develop the technical ranking

of each project. The project is then evaluated considering the debt service and operation and maintenance costs and how they impact the resulting residential user rate. This financial analysis (Affordability) will determine the amount of SRF assistance and the loan component interest rate(s).

Pennsylvania utilizes a financial capability analysis (PACNIF) to determine the financing offer to applicants. This capability analysis takes into consideration 15 variables based upon the communities' annual financial statements submitted to the Department of Community and Economic Development. These variables include financial, burden/effort/capacity and socio/economic factors. Consideration is provided for, but not limited to:

Change in fund equity; Cash Position; Debt Service; Fixed costs; Real estate market value; Change in earned income tax; Change in assessed valuation; Per capita debt; Percent of the population below the poverty income level; Change in population; Percent of the population over age 65; Per capita income.

These socio-economic factors are weighted with the adjusted 2000 Median Household Income (MHI) to determine the percent of the MHI that should be available for payment of water service. This will be expressed as a percentage between one and two percent and is what we believe to be the range of what other similar systems are paying for water service. Where a particular project will fall within the one to two percent is dependent upon the socio-economic factors discussed above and the adjusted MHI.

Once a "target" user rate has been determined, the project and operation and maintenance costs are factored against the available users and a resulting user rate developed. Should the resulting user rate be higher than what is determined that similar systems are paying, the interest rate is adjusted down to as low as one percent per annum and the repayment term can be extended to as long as 30 years, if necessary, to bring the user rates to within acceptable levels. This will constitute Pennsylvania's Disadvantaged Community Program, which is more fully described later in this document.

Should the resulting user rates be lower than what similar systems are paying, PIIA may opt to fund only a portion of the project so as not to subsidize what would otherwise be considered low rates.

Pennsylvania also recognizes and intends to comply with the 15 percent funding requirement for small systems as described in Section 1452(a)(2) of the Act. Pennsylvania expects to be able to make use of the available funding in areas where it has the most impact and promote an equitable distribution of user rates utilizing this approach.

D. Non-Project Activities to be Funded out of the DWSRF

1. Administrative

As identified in the capitalization grant application, PIIA and DEP intend to use four percent of the FY 2008 federal grant for administrative support. Based on a federal allotment of approximately \$32.9 million, (\$27.4 million from the FY08 allocation and \$5.5 million in unused Expense Reimbursement Grant funds) this amounts to approximately \$1.3 million for managing and operating the DWSRF.

2. Program Support

Section I of this IUP identifies the set-aside amounts to be utilized for program support. This includes use of the FY05 and FY08 2% Technical Assistance, the FY08 10% Support for State Programs and the FY08 15% Other Authorized Activities program support functions.

IV. The Impact of Funding Decisions

A. Set-Asides

Sections 1452(g) and 1452(k) of the Act provide that certain percentages of Pennsylvania's allotment under Section 1452 may be set aside for various uses other than project funding. Attached to this IUP is the FY08 EPA approved workplan for the use of these Set-Aside funds. This workplan captures how the state will be utilizing all the funds set-aside from these three categories. The 4% Administrative Set-Aside also goes to the Program Fund.

B. Disadvantaged Communities

Based on the definition of Pennsylvania's intended use of this program (see Section VIII), the financial impact to the fund corpus will be a delay in receiving loan principal and interest repayments. This program use does not diminish nor reduce the corpus of the fund. The actual federal investment will remain the same over the long term of the DWSRF program.

C. Cash Flow Model

Pennsylvania uses a complex cash flow model that will allow for optimal funding decisions to be made. The cash flow model will provide loan portfolio activity analysis for the multiple funding scenarios.

D. Interest Rate

The Pennsylvania DWSRF loan program is required by state law to make loans with a minimum interest rate of one percent. This requirement insures the growth

of the DWSRF fund in future years.

E. Loan Repayment

Pennsylvania requires repayment to commence shortly after final inspection following construction completion. Generally, repayment is done on a monthly basis. The Board may defer principal payment for up to five years in certain financially or economically distressed communities in order to maintain the fund. This procedure ensures available cash flow for continuous use of the fund. It would not, however, result in no payments being made within one year of completion of construction since some payment would always be required, even in the most extreme circumstances.

F. Automated Clearinghouse (ACH)

Pennsylvania utilizes the ACH program to electronically debit borrowers for debt service on their loans. The participation in the ACH program is a loan requirement. The ACH program insures the receipt of loan repayments on a timely basis.

G. Loan Portfolio Management

Pennsylvania uses a comprehensive Loan Monitoring Program (LMP) for loan portfolio management. The LMP includes risk definition, monthly and annual payment review, annual financial statement review and ongoing management analysis. The LMP is a pro-active management tool to protect the integrity of the loan portfolio.

V. Financial Status

Pennsylvania agrees to submit to EPA a Financial Status Report (SF-269) within 90 days after the end of each state fiscal year during the term of the capitalization grant agreement.

The 2008 Sources and Uses section of the IUP represents the funding levels for the eligible program activities for all funds to date. The full 27 percent (27%) of previously awarded Set Aside funds will continue to be used for the set-asides administered by DEP. Pennsylvania also intends to set aside the 27% of the FY 2008 funds for Safe Drinking Water activities authorized under Section 1452(k) and the FY2005 2% set-aside funds previously reserved. Four percent (4%) will be used for administrative purposes.

Pennsylvanians use of the disadvantaged community assistance will consist of extended terms of the loan. Pennsylvania does not plan to leverage at this time. Pennsylvania reserves the right to review all program activities on an annual

basis.

VI. FY 2008 SRF PAMs

A. Indicators

1. Number of DWSRF projects that have initiated operations (cumulative). SDW-6 We project that eight projects will initiate operations.
2. Number of DWSRF projects whose purpose is to achieve compliance with drinking water standards. SDW-7 We project 10 projects will achieve compliance with the drinking water standards.

B. Outputs and Outcomes

1. Program Integration – the DWSRF program works to coordinate funding opportunities with other state and federal programs, as well as, to incorporate it into the state and federal drinking water priority systems. Where possible this will be shown in the Annual Report. We project 10 binding commitments/closed loans for the fiscal year.
2. Compliance with current and future drinking water requirements – SDW-7 – the DWSRF program works with the DEP technical personnel to provide financial assistance for municipalities, municipal authorities, and private water companies to meet the compliance requirements. This will be shown through the NIMS compliance reporting.
3. Funds utilization rate – we project to be 92 percent.
4. IUP Set Aside Work Plan - We project to complete set-aside activities in accordance with the timeline established in the EPA approved FY08 Set-Aside Workplan.

VII. Goals of the DWSRF Program in Pennsylvania

A. Long-Term Goals

1. To have all public water systems in Pennsylvania achieve compliance with drinking water standards through coordination and integration with the state Public Water Supply Supervision Program. Based on the 2003 Drinking Water Needs Survey, state needs for public water systems are currently estimated at \$10.9 billion.
2. To protect and enhance the quality of life of present and future Pennsylvanians by providing safe and adequate supplies of potable water through coordination and integration with the Public Water Supply Supervision Program. Eligibility for DWSRF funds will

allow many drinking water systems currently not eligible for financial assistance to provide improved drinking water quality and service to existing customers by correcting problems with source water quality and quantity, treatment, storage, and distribution. Emphasis will be placed on projects designed to correct deficiencies that pose a threat to public health.

3. To administer the DWSRF to issue loans, loan guarantees, or insurance to applicants, at fees commensurate with risk, such that the revolving nature of the DWSRF is assured in perpetuity.
4. To assist communities with financial difficulties in meeting required drinking water standards. Low interest loans for the eligible project costs will be available to assist these communities. Other types of assistance are available to improve the marketability of local debt instruments. The goal is to provide, without replacing other funds reasonably available, the type and amount of assistance necessary to make the project affordable, consistent with the long-term health of the DWSRF.
5. Support and implement infrastructure sustainability initiatives to protect public health and the environment; including, but not limited to; the Public Water Supply Supervision Program, the Drinking Water Capability Enhancement Program, the Operator Certification Program, the EPA Special Appropriations Program and the state Growing Greener Programs.
6. To ensure the technical integrity of the DWSRF through adequate and effective program management and project planning, design, and construction management.
7. To maintain an adequate data management system to track and monitor all DWSRF project and program information.
8. To ensure proper accounting, audit, and fiscal procedures conforming to generally accepted government accounting standards.
9. To review annually the DWSRF program funding for long-term use and viability by using the PENNVEST Cash Flow Model.

B. Short-Term Goals

1. To obtain maximum capitalization of the DWSRF in the shortest time possible so that the funding needs of communities with inadequate drinking water facilities can be addressed.

2. To maximize the use of Growing Greener grants funds and DWSRF loan money to assist distressed communities and other systems in providing adequate water service.
3. To assure that projects under construction will initiate operations on schedule, provide loans only for uncompleted portions of projects rather than refinancing completed portions.
4. To improve the coordination of DWSRF financial assistance, planning, permitting, and enforcement activities among DEP, PIIA and other agencies, including the Public Utility Commission.
5. To continue outreach efforts to systems across the Commonwealth. This outreach is structured to inform systems of the availability of funds, the application procedures and federal requirements.
6. To continue coordination efforts with other funding sources. This coordination takes the form of regional and statewide meetings with representatives responsible for the administration of funds from EPA, the U.S. Department of Agriculture, Community Development Block Grants, Appalachian Regional Commission, Economic Development Financing Authority, the U. S. Army Corps of Engineers, local banks, bond counsel organizations and various state funding sources.
7. The DEP will negotiate the Disadvantaged Business Enterprise (DBE) firm fair share objective with the EPA Region 3 office for the federal fiscal year 2008 capitalization grant award. Each DWSRF project Borrower receives a copy of DEP's DBE guidance document, and they are informed that they must take the six affirmative steps to solicit M/WBE firms for participation in project work. DEP will continue to collect data on proposed and actual use of DBE firms by Borrowers on DWSRF loan projects and submit semi-annual reports to Region 3 on DBE firm procurement actions. DEP will revise the DBE guidance document to insure compliance with new EPA regulations promulgated in May 2008.
8. Support the Governor's Sustainable Infrastructure Initiative by providing data, information and staff support to the Water Sustainable Infrastructure Task Force being formed by Executive Order to complete an analysis of financing needs.
9. Complete the Pennsylvania Gap Study to identify the gap between available funding resources and financial infrastructure need and merge the results of this study with the 2007 Drinking Water

Needs Survey to further enhance the estimation of total infrastructure financing need in the Commonwealth.

10. Develop and deliver a combination of classroom and web-based training courses to promote Asset Management. Create an Asset Management Specialty Team as part of DEP's Outreach Assistance Provider Program to assist system personnel with the implementation of an asset management framework.

VIII. Transfer Amounts

On June 17, 2008, EPA approved the transfer of \$20,000,000 from the DWSRF to the CWSRF in accordance with EPA guidance and regulations and Pennsylvania's Operating Agreement. Pennsylvania continues to reserve the authority to transfer additional funds as appropriate at some time in the future, up to the maximum of 33% of the 2008 capitalization grants, respectively, between the DWSRF and the CWSRF. This transfer, in addition to the transfer of the maximum amount between the CWSRF and the DWSRF for all prior grants and any future transfers between funds, will assist in meeting the demand for CW and DWSRF funding. The effect of these transfers on the fund will be minimal. No additional transfers are anticipated at this time.

IX. Description of How Pennsylvania Will Define a Disadvantaged System

PIIA utilizes a financial capability analysis that compares various community specific demographic data to similarly situated communities across the Commonwealth to determine a percent of the community's adjusted Median Household Income (MHI) that should be available to pay for water service. The amount that should be available to pay for water service by residential customers will range from one to two percent of the community's adjusted MHI dependent upon the specific socio-economic factors that are provided by the Pennsylvania Department of Community and Economic Development. This process aids in an equitable distribution of residential user rates.

Should the estimated resulting residential user rates be higher than similar systems, even after PIIA has provided the most favorable funding package available, based upon criteria set forth in the PIIA act and regulations and further described in this document under III.C., "Priority and Allocation of Assistance," these systems would be considered "disadvantaged" for the purpose of term extension from the normal 20 years to a term of up to, but not to exceed, 30 years repayment of principal and interest. Systems qualifying for term extensions must exceed the user rate(s) found in similar systems according to the PIIA financial capability model. The terms will be extended to a point that will allow the residential user rate to fall to a level equal to similar systems' cost of water service, as determined by the demographic analysis and financial capability analysis.

X. Assurance of Recipient Capability

All DWSRF applicants will be evaluated for compliance with technical, financial, and managerial capability requirements. Applicants considered to lack capability will be evaluated for anticipated capability as a result of DWSRF assistance. Evaluation of applicants will be performed according to criteria developed by DEP as described in Attachment 4. Determination of compliance subsequent to DWSRF assistance will be accomplished through currently established procedures for routine evaluation of system performance (routine monitoring and comprehensive performance evaluations) and according to EPA guidance.

XI. Public Review and Comment

On July 5, 2008, a notice was published in the Pennsylvania Bulletin regarding a public meeting scheduled for July 14, 2008 in Harrisburg, PA on the FY 2008 CW and DWSRF IUPs. The IUP list of projects is attached.

The PIIA Board schedules four project review and approval meetings each state fiscal year. The Board meets in January, April, July, and October to review and approve funding for projects. These projects are subject to the provisions included in the public comment periods for the IUP and PPL. Copies of the IUP and the PPL are available upon request from the DEP, Division of Technical and Financial Assistance or through the DEP website, at the following link:

<http://www.depweb.state.pa.us/watersupply/cwp/view.asp?a=1263&Q=449900&watersupplyNav=|30198>

A public meeting will be held on July 14, 2008. Written comments will also be accepted until close of business on July 14, 2008.

A summary of the public participation activities for the FY 2008 IUP and capitalization grant application is attached along with the summary of comments solicited from the county planning agencies in accordance with Executive Order 12372.