

ENVIRONMENTAL PROTECTION AGENCY

ASSISTANCE LISTING 66.468 CAPITALIZATION GRANTS FOR DRINKING WATER STATE REVOLVING FUNDS

ASSISTANCE LISTING 66.483 DISASTER RELIEF APPROPRIATIONS ACT (DRAA) HURRICANE SANDY CAPITALIZATION GRANTS FOR DRINKING WATER STATE REVOLVING FUNDS

I. PROGRAM OBJECTIVES

Capitalization grants are awarded to states to create and maintain Drinking Water State Revolving Funds (DWSRF) programs. States can use capitalization grant funds to establish a revolving loan fund (DWSRF) to assist public water systems finance the costs of infrastructure needed to achieve or maintain compliance with Safe Drinking Water Act (SDWA) requirements and protect the public health objectives of the Act.

II. PROGRAM PROCEDURES

The DWSRF program is established in each state by capitalization grants from the Environmental Protection Agency (EPA) and state match equaling 20 percent of the EPA capitalization grants.

EPA implements the DWSRF program in a manner that preserves flexibility for states in operating their program in accordance with their unique needs and circumstances. States have the flexibility to set aside some of their capitalization grants for other related activities. States may also transfer an amount up to 33 percent of its DWSRF capitalization grant to the Clean Water State Revolving Fund (CWSRF) (Assistance Listing 66.458) or an equivalent amount from the CWSRF to the DWSRF program. A state may transfer capitalization grant dollars, state match, investment earnings, or principal and interest repayments.

Capitalization grant agreements include (1) an application; (2) an Intended Use Plan (IUP), which describes how the state intends to use funds made available to it, including a list of proposed projects eligible for financing and a description of the financial status of the program; (3) a proposed payment schedule; (4) certain certifications and demonstrations which can be included in an optional operating agreement; and (5) workplans containing a least a general description of the use of set-aside funds.

The state must annually provide an IUP which describes how the state will use available DWSRF program funds for the year to meet the objectives of the SDWA and further the goal of protecting public health. The IUP explains how all of the funds available to the DWSRF program (including bond proceeds, interest earnings, loan repayments, federal capitalization grants, state match, etc.) will be expended.

The Disaster Relief Appropriations Act (Pub. L. No. 113-2) provided funds for awards to the states of New York and New Jersey for drinking water facilities impacted by Hurricane Sandy. EPA awarded these funds under Assistance Listing 66.483. Those funds are subject to all of the

compliance requirements that apply to Assistance Listing 66.468 except as indicated in III, “Compliance Requirements,” in this program supplement.

On June 6, 2019, Pub. L. No. 116-20, the “Additional Supplemental Appropriations for Disaster Relief Act, 2019,” or ASADRA, was signed into law. The law provided funds to Alabama, Alaska, California, Georgia, Florida, North Carolina, and South Carolina DWSRF programs for drinking water facilities impacted by Hurricanes Florence and Michael, Typhoon Yutu, and calendar year 2018 wildfires and earthquakes.

Source of Governing Requirements

This program is authorized under Section 1452 of the Public Health Service Act (Title XIV), commonly known as the SDWA (42 USC 300j-12) and the Disaster Relief Appropriations Act, 2013 (Pub. L. No. 113-2). The implementing regulations for the program can be found at 40 CFR Part 35, Subpart L.

Availability of Other Program Information

Other general information about the program is available on the EPA Drinking Water State Revolving Fund home page (<https://www.epa.gov/dwsrf>).

III. COMPLIANCE REQUIREMENTS

In developing the audit procedures to test compliance with the requirements for this federal program, the auditor must determine, from the following summary (also included in Part 2, “Matrix of Compliance Requirements”), which of the 12 types of compliance requirements have been identified as subject to the audit (noted with a “Y” in the summary matrix below), and then determine which of the compliance requirements that are subject to the audit are likely to have a direct and material effect on the federal program at the auditee. For each such compliance requirement subject to the audit, the auditor must use Part 3 (which includes generic details about each compliance requirement other than Special Tests and Provisions) and this program supplement (which includes any program-specific requirements) to perform the audit. When a compliance requirement is shown in the summary below as “N,” it has been identified as not being subject to the audit. Auditors are not expected to test requirements that have been noted with an “N.” See the Safe Harbor Status discussion in Part 1 for additional information.

A	B	C	E	F	G	H	I	J	L	M	N
Activities Allowed or Unallowed	Allowable Costs/Cost Principles	Cash Management	Eligibility	Equipment/Real Property Management	Matching, Level of Effort, Earmarking	Period Of Performance	Procurement Suspension & Debarment	Program Income	Reporting	Subrecipient Monitoring	Special Tests and Provisions
Y	Y	Y	N	N	Y	Y	Y	N	N	N	N

A. Activities Allowed or Unallowed

1. *Activities Allowed*

- a. A state DWSRF program may provide the following financial assistance to publicly or privately owned community water systems and nonprofit non-community water systems for eligible drinking water infrastructure projects (40 CFR sections 35.3520 and 35.3525):
 - (1) Making loans for eligible projects (40 CFR section 35.3520(b).
 - (2) Purchasing or refinancing existing debt obligations of municipal, intermunicipal and interstate agencies entered into on or after July 1, 1993. Purchase of local debt would have the expectation that the seller would repay the debt at the agreed upon terms.
 - (3) Guarantee of or purchasing insurance for local debt obligations.
 - (4) Providing a source of revenue or security for DWSRF debt obligations, provided that the net proceeds of the sale of such debt obligations are deposited in the DWSRF.
 - (5) Funds awarded (all manner of assistance, both a loan or grant to a local entity) under Assistance Listing 66.483 may be used only for projects to reduce flood damage risk and vulnerability or to enhance resiliency to rapid hydrologic change or a natural disaster (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31).
- b. A state may set aside DWSRF funds for the following designated activities (40 CFR section 35.3535):
 - (1) Administrative expenses (including technical assistance).
 - (2) Technical assistance to small water systems that regularly serve 10,000 or fewer persons (40 CFR section 35.3505).

- (3) State program management.
- (4) Local assistance and other state programs.

2. *Activities Unallowed*

As per 40 CFR 35.3520(d) through (f), a state DWSRF program may not provide assistance for:

- a. Dams or reservoirs, water rights, laboratory fees for monitoring, system operation and maintenance, or projects that are primarily fire protection. Water rights are listed as ineligible in DWSRF regulations, but a class deviation for water rights was signed in November of 2019. “Deviation from 40 CFR section 35.3520(e)(2)” [DWSRF Class Deviation for Water Rights--Dec 2019 \(epa.gov\)](#). This allows the use of DWSRF funds for Water rights if it addresses a public health objective of the Safe Drinking Water Act. EPA has the authority to allow deviations from EPA regulations that are not disallowed by law. In this case the Safe Drinking Water Act.
- b. Expansion projects pursued solely in anticipation of future growth.

B. Allowable Cost/Cost Principals

The cost principles of 2 CFR 200 Subpart E are applicable as appropriate, to this award. If the state does not have a previously established indirect cost rate, the state will prepare and submit its indirect cost rate proposal in accordance with 2 CFR 200 Appendix VII.

For DWSRF programmatic eligibilities, state DWSRF programs are required to follow 40 CFR 35.3520 for assistance eligibilities from the loan fund and 40 CFR 35.3535 for DWSRF set-aside eligibilities.

C. Cash Management

The state may draw cash through the Automated Standard Application for Payments (ASAP) system for (40 CFR sections 35.3560 and 35.3565):

1. *Loans* – when the DWSRF receives a request from a loan recipient, based on incurred costs, including pre-building and building costs.
2. *Refinance or Purchase of Municipal Debt* – generally, at a rate not greater than equal amounts over the maximum number of quarters that payments can be made, and up to the amount committed to the refinancing or purchase of the local debt. A state may immediately draw cash for up to the greater of \$2 million or 5 percent of each fiscal year’s capitalization grant to refinance costs.
3. *Purchase of Insurance* – when insurance premiums are due.

4. *Guarantees and Security for Bonds* – immediately, in the event of imminent default in debt service payments on the guaranteed/secured debt; otherwise, up to the amount dedicated for the guarantee or security based on actual construction cost.
5. *Set-Asides* – generally, on an incurred cost basis after workplans have been approved by EPA (40 CFR section 35.3560(e)).

G. Matching, Level of Effort, Earmarking

1. Matching

- a. States are required to deposit into the DWSRF from state monies an amount equal to 20 percent of each grant payment. The match is required to be made on or before the time that EPA funds are drawn. When a letter of credit (LOC) mechanism or similar financial arrangement is used for the state match, payments to the LOC account must be made proportionally on the same schedule as payments for the capitalization grant. Monies from this state match LOC must be drawn into the DWSRF as monies are drawn on the federal automated clearinghouse account. A state may issue general obligation or revenue bonds to derive the state match. If the state provides a match in excess of the required amount, the excess balance may be banked toward subsequent match requirements (40 CFR section 35.3550(g)).

2. Level of Effort

Not Applicable

3. Earmarking

- a. The allotment can be earmarked for set-aside activities as follows:
 - (1) *Administrative Expenses* – Not to exceed the higher of 4 percent of the allotment, \$400,000, or one-fifth of a percent of the fund's annual net position.
 - (2) *Technical Assistance to Small Systems* – Not to exceed 2 percent of the cumulative allotment (40 CFR section 35.3535(c)).
 - (3) *State Program Management* – Not to exceed 10 percent of the cumulative allotment (40 CFR section 35.3535(d)). The cumulative allotment amount will be in state records as their total grants awarded. EPA will have a record of this as well.
 - (4) *Local Assistance and Other State Programs* – Not to exceed 15 percent of the capitalization grant and no more than 10 percent of

the grant is used on any one of the defined activities (40 CFR section 35.3535(e)).

- b. For 2018 and previous grants, state cannot use more than 30 percent of any particular fiscal year’s capitalization grant to provide subsidies in the form of principal forgiveness or negative interest rate loans to communities meeting the state’s definition of disadvantaged, or communities the state expects to become disadvantaged as a result of the project (40 CFR section 35.3525(b)). Starting with the 2019 grants, states are required to use between 6 percent and 35 percent of their grant for disadvantaged assistance subsidy, as per the amendments from the American Water Infrastructure Act of 2018.
- c. EPA’s DWSRF appropriations include the following requirements:
 - (1) The Disaster Relief Appropriations Act (Pub. L. No. 113-2, Division A, Title X, 127 Stat. 31), FY 2019 appropriation and the FY 2020 appropriation each have requirements to provide subsidy in amounts found in the table below. This subsidy can be provided in the form of grants, principal forgiveness, or negative interest.

Disaster Relief Funds	FY 2019 Funds	FY 2020 and FY 2021 Funds
Not less than 20 percent and not more than 30 percent of the capitalization amount.	“20 percent of the capitalization grant amount mandatory additional subsidy, available to all DWSRF-eligible recipients, and an additional 6-35 percent additional subsidy available only to state-defined disadvantaged communities.”	“14 percent of the capitalization grant amount mandatory additional subsidy, available to all DWSRF-eligible recipients, and an additional 6-35 percent additional subsidy available only to state-defined disadvantaged communities. Additionally, the Water Infrastructure Fund Transfer Act (WIFTA) allows states, until 10/5/2020, to transfer up to 5 percent of their cumulative allotment of CWSRF capitalization grants to the DWSRF for threats to public health as a result of heightened exposure to lead. These funds are to be provided as subsidy in the form of principal forgiveness, grants, or negative interest.” For the ASADRA funds, states are required to use between 20 percent and 30 percent as subsidy in the

Disaster Relief Funds	FY 2019 Funds	FY 2020 and FY 2021 Funds
		form of principal forgiveness, grants, or negative interest.

- (2) The decision to maintain a category of projects for green infrastructure, water and energy efficiency, and other environmentally innovative activities is at the state's discretion (Pub. L. No. 113-76, Pub. L. No. 113-235, and Pub. L. No. 114-113).

H. Period of Performance

- Grant payments from a capitalization grant, which increase the ceiling of funds from which a state may draw cash for eligible costs, shall begin no earlier than the quarter in which the grant is awarded, and generally end no later than eight quarters after the grant is awarded, not to exceed twelve quarters from the date of allotment of grant funds to the states. States must enter into binding commitments for an amount equal to each capitalization grant payment and accompanying state match that is deposited into the Fund within one year after the receipt of each grant payment. This does not apply to funds drawn for set-aside activities. States disburse, or liquidate, grant funds for projects in accordance with construction schedules. Funds are disbursed for set-aside activities in accordance with costs being incurred under approved workplans (40 CFR sections 35.3550(e) and 35.3560).
- Funds made available for disaster relief activities under Assistance Listing 66.483 are available until expended (Pub. L. No 113-2, Division A, Title X, 127 Stat. 31).

IV. OTHER INFORMATION

The audit focus is on a state's DWSRF program rather than individual capitalization grants awarded to states by EPA.

Subrecipients

DWSRF amounts are awarded by EPA to states as grants. The states then make subawards in the form of loans to their subrecipients. Therefore, in determining the amount of federal funds expended to be reported on the Schedule of Expenditures of Federal Awards (SEFA), subrecipients receiving DWSRF loans should include project expenditures incurred under these loans during the audit period as provided in 2 CFR section 200.502(a). These are subawards—not direct federal loans—and, therefore, neither 2 CFR sections 200.502(b) nor (d) apply when calculating the amount of federal funds expended.

It also is important to appropriately identify these DWSRF loans as subawards because of the impact on which federal agency is the cognizant or oversight agency. When completing the Form SF-SAC (also referred to as the Data Collection Form), the subrecipient should indicate that a

DWSRF loan received from the state is not a direct award by showing an “N” in Part III, Item 6(h).

Equivalency

To achieve consistency in meeting program requirements and eliminate the possibility of over-reporting information under the Federal Funding Accountability and Transparency Act (FFATA), state DWSRF programs must use the same group of loans for the purpose of meeting federal cross-cutting, single audit, procurement, and Transparency Act reporting requirements (as per 40 CFR 35.3575). Equivalency projects/loans are funded with an amount equal to the capitalization grant. DWSRF set-aside activities are also considered federal expenditures. Auditors should be mindful that set-aside spending will not always trigger FFATA reporting based on the thresholds for reporting under the law. In addition, for states using the loan authority under the set-aside funds, it is possible those expenditures are repayment dollars from previous loans and should not be considered federal funds. Auditors should consult with the state to make that determination.

While any of the sources of funds in the DWSRF may be used for equivalency projects/loans, it should be understood that these funds would be considered federal funds once they are deemed equivalency dollars and that all disbursements for equivalency projects/loans must be entered into the SEFA. The SEFA should reflect equivalency dollars rather than actual cash draws from the Treasury to the state. Additionally, the SEFA will differ from the SF-425 form.