

Rulemaking Advisory Committee Agenda

Meeting #2

Wednesday, Feb. 26, 2020

DEQ Headquarters

9:00 a.m.

700 NE Multnomah, Room 601

Portland, Oregon 97232

Conference Line: 888-278-0296

Access Code: 8040259

This package contains the following documents:

- Meeting Agenda
- CDFI Lending Part 2
- Advisory Committee Meeting 2 PowerPoint Presentation

Note for Readers:

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State of Oregon
Department of
Environmental
Quality

CWSRF

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www.oregon.gov/DEQ

*DEQ is a leader in
restoring, maintaining and
enhancing the quality of
Oregon's air, land and
water.*

- | Time | Topic |
|-------------|---|
| 9:00 a.m. | Welcome and logistics |
| 9:10 a.m. | Follow up from Advisory Committee Meeting #1 <ul style="list-style-type: none"> • Review meeting summary and status of action items • Review legislative intent <p>Meeting #2 goals:</p> <ul style="list-style-type: none"> • Provide an overview of how CDFIs operate • Clarify known pass-through lending requirements • Explore public and private lending to inform CWSRF loan fund impacts • Solicit input on private lending considerations |
| 9:30 a.m. | Overview and Q&A: Septic system issues and DEQ program in Oregon |
| 9:50 a.m. | Presentation and Discussion: CDFI Lending –Part 2 <ul style="list-style-type: none"> • CDFI overview • Proposed pass-through lending requirements |
| 10:15 a.m. | Break |
| 10:25 a.m. | Presentation and Discussion: CDFI lending –Part 2 <ul style="list-style-type: none"> • Comparisons: public vs. private lending <ul style="list-style-type: none"> ○ General requirements ○ Financial statements and ratio analysis ○ Business and financial management ○ Security/Default remedy • Third party financial consultant – review the four deliverables in the CDFI Lending –Part 2 document |
| 11:30 a.m. | Public Comment period. Public is allotted three minutes per person. Meeting continues if no or few comments. |
| 12:00 p.m. | Adjourn Meeting |

Alternative formats

DEQ can provide documents in an alternate format or in a language other than English upon request. Call DEQ at 800-452-4011 or email deqinfo@deq.state.or.us.



State of Oregon Department of Environmental Quality
Clean Water State Revolving Fund
2020 Rulemaking
Lending to Community Development Financial Institutions – Part 2

Contact: Lee Ann Lawrence
503-229-5622

Background

There are 456,000 septic systems in Oregon and some 30 percent of Oregon households rely on septic systems. As many as 10 percent of these systems fail each year according to various estimates. This causes groundwater and surface water pollution that can damage the environment and public health. Not all homeowners or small businesses have the financial resources to make repairs that can cost as much as \$25,000.

Community Development Financial Institutions, known as CDFIs, can provide the financing to address a failing septic system when the owners cannot access the necessary financing within the traditional banking system. [Senate Bill 884](#), which passed in the 2019 Oregon Legislative Session, requires DEQ to establish pass-through lending procedures and requirements for CDFIs that will lend to septic system owners for repairing and replacing failing on-site septic systems or to connect failing on-site septic systems to an available sewer.

DEQ will accomplish this by adopting a new rule in [OAR chapter 340, division 054](#) and by amending existing rules. DEQ's Clean Water State Revolving Fund is the implementing program for the new rule. This document describes the known and potential loan requirements for pass-through lending to CDFIs.

Eligible borrower – 2019 Oregon Revised Statute

Senate Bill 884 amended Oregon Revised Statutes [468.423](#) and [468.425](#) to include the following language:

- 468.423(5) “**Qualified institution**” means a nonprofit organization registered to operate in the State of Oregon that is certified as a community development financial institution by the Community Development Financial Institution Fund at the United States Department of the Treasury.”
- 468.425(2) To aid and encourage **qualified institutions** to assist in the protection or maintenance of water quality in the waters of this state by financing projects to repair or replace failing on-site septic systems or to replace failing on-site septic systems with connections to an available sewer

DEQ will amend rules to include certified nonprofit CDFIs as eligible borrowers for repairing and replacing failing on-site septic systems and to connect failing on-site septic systems to an available sewer. Amendments and new rules will include loan requirements, interest rates calculations, loan terms, and loan securities.

Community development financial institutions

U.S. Treasury eligibility requirements

To be eligible for CDFI certification, an organization must meet the following criteria:

- Be a legally existing entity
- Have a primary mission of promoting community development
- Be a financing entity
- Serve and maintain accountability to one or more defined target markets
- Maintain accountability to a defined market
- Be a non-governmental entity at the time of application (with the exception of Tribal governmental entities)

Organizations eligible for CDFI certification:

While all CDFIs have a primary mission of serving low-income individuals and communities, they can take several forms, including:

- Banks: For-profit corporations providing capital to rebuild economically distressed communities through targeted lending and investments
- Venture Capital Funds: Organizations providing equity and debt-with-equity services to businesses in distressed communities
- Credit Unions: Member-owned nonprofit cooperatives promoting savings, affordable loans, and other financial services*
- Loan Funds: Typically, nonprofit organizations providing financing and technical assistance to small businesses, microenterprises, affordable housing developers, and community service organizations*

*Credit Unions and Loan Funds with nonprofit status are the “qualified institutions” DEQ is considering as eligible CWSRF loan recipients.

How CDFIs work:

Many certified CDFIs offer loans that are more financially favorable and flexible than loans from traditional commercial lenders. In accordance with their mission, certified CDFIs also provide educational services like business planning, credit counselling, and homebuyer classes to help their borrowers use credit effectively.

CDFIs access capital to finance their own lending and grant programs through many public and private sources such as the U.S. Department of Treasury CDFI Fund, the Bank Enterprise Award Program, corporations, and private foundations. CDFIs use these investments to address the financing gaps unmet by mainstream banking.

Proposed pass-through lending requirements

Loan application requirements

- Current CDFI certification through US Department of Treasury
- Environmental review: DEQ will determine what level of environmental review is required
- Audited financial statements

- Projected cash flow statement
- Demonstrated readiness to implement or continue the lending program by providing details of current and past loan portfolio, a proposed plan for developing a lending program with outreach parameters, or an established pipeline of potential borrowers
- Project planning document: DEQ will determine what documentation will be sufficient
- Land Use Compatibility Statement

Federal requirements that must pass to the sub loans

33 U.S.C. § 1383 (2020) Water pollution control revolving loan funds

(d) Types of assistance

Except as otherwise limited by State law, a water pollution control revolving fund of a State under this section may be used only—

(1) to make loans, on the condition that—

(A) such loans are made at or below market interest rates, including interest free loans, at terms not to exceed the lesser of 30 years and the projected useful life (as determined by the State) of the project to be financed with proceeds of the loan;

(B) annual principal and interest payments will commence not later than one year after completion of any project and loans will be fully amortized upon the expiration of the term of the loan

Interest rate calculation and term length

DEQ updates the CWSRF interest rates quarterly on the [program's website](#) based on the procedures outlined in OAR [340-054-0065\(4\)](#). DEQ uses the 20-year federal bond buyer index as the metric for determining municipal loan interest rates. The 20-year bond is a common debt instrument for municipal borrowers across the nation. The federal bond index rates are a representation of nationwide surveys for traders of municipal General Obligation bonds. The Federal Reserve publishes this rate weekly.

DEQ uses a quarterly average of the weekly rate, the “base rate,” and then discounts it according to community demographic. This is how DEQ assures our borrowers receive “below-market” pricing.

DEQ will need guidelines for rate and term for CDFIs:

- DEQ will identify the appropriate index as a metric for setting interest rates for CDFI lending, particularly for CDFIs that have statewide or multi-county lending programs.
- DEQ will consider interest rate calculations for the CDFI's sub loans to ensure they are also below-market rate.
- The loan term should never exceed useful life and the term length of the sub loans should match the pass-through loan.

Loan repayment/project completion

DEQ will:

- Define “project completion” for lending to a CDFI to identify a timeframe for loan repayment to DEQ.
- Consider batching groups of sub loans and deem them complete on an annual basis or quarterly basis to trigger the loan repayment period. This approach will save time and administrative costs for both a CDFI and DEQ. It also will help ensure timely loan repayment to DEQ.

Public and private lending comparisons and considerations: Risk management and creditworthiness

Underwriting is the basic way that lenders determine creditworthiness and manage risk. Borrowers must meet certain prerequisites such as those required by federal law. Other items may allow for compensating factors. For instance, a borrower may have limited cash flow but has debt that is nearing pay off. DEQ may make an allowance and include the dollars the future payment represent in determining the potential borrower's creditworthiness.

While the following comparisons are not exhaustive, the column on the left outlines how the DEQ currently reviews potential borrower's credit and the right column shows similar measures that may be more aligned with underwriting a private entity.

For discussion with the Rulemaking Advisory Committee for each section below:

- *Do these measures seem appropriate to manage risk and evaluate creditworthiness?*
- *What loan securities should DEQ consider?*
- *What guaranties might a CDFI make that's comparable to public lending?*
- *Should DEQ consider credit rating and a minimum loan loss reserve?*
- *How much weight should DEQ put on ratios?*
- *What are additional considerations DEQ should consider?*

Comparison of Current Public vs. Possible Private Lending Criteria	
Public Lending	Private Lending
Current CWSRF Public Entity Borrower Requirements	Under consideration: Community Development Financial Institution Requirements
General Basic requirements DEQ would expect from all borrowers.	
Clear water quality benefit	 Same
Facility plan, project plan and budget, outreach to stakeholders, possible education of rate payers	Lending program fully established or plan to establish lending program with an outreach plan
Financial Statements and Ratio Analysis These measures evaluate creditworthiness and solvency.	
Three years audited financial statements	Three years audited financial statements

Break even at a minimum	Made a profit after taxes for at least 2 years
Current ratio of at least 1.50 to 1	Current ratio of at least 1.75:1
Debt service coverage ratio 105% with fully funded reserve	Debt service coverage ratio of at least 125%
Debt to equity no more than 3:1	Debt to equity no more than 2:1
	The proportion of sub loan lending that is forgivable
Business and Financial Management These parameters help evaluate how the borrower manages its business and demonstrates the ability and willingness to repay.	
Asset management	Asset management, manage funds effectively
Management of enterprise funds	Credit history, banking relationships
Improved or deteriorated overall financial position	Financial trends over time
User rate schedule to increase for new debt service	Plan to increase income to cover debt service or increase available capital
Revenue sufficient to cover operations, maintenance and repair of the capital project	Income sufficient to manage expenses
Opinion of legal counsel for statutory sufficiency to borrow, and sometimes to lend	Determination of legal capacity to borrow and lend
Security/Default Remedy These measures establish the obligation to pay and consequences of non-payment.	
Pledge to repay - governing body borrowing resolution	Borrowing resolution of board, LLC members, etc.
Revenue obligation - sewer, stormwater, etc.	General obligation of the entity
Debt service reserve	Debt service reserve for CWSRF loan
	Loan loss reserve for sub loans
Power to intercept state funds	same
	Fail safe security measure such as a line of credit in case of default

Third-Party financial advisor

DEQ needs to establish underwriting guidelines for lending to CDFIs. DEQ's current underwriting guidelines used for public entities will be insufficient to determine risk and mitigation strategy for private borrowers. A third-party financial consulting firm will help develop new underwriting guidelines related to perfecting a lien and assuring the ability to collect in the case of default. The Department of Justice will advise DEQ to ensure that any new guidelines do not exceed our statutory authority. More specifically, the contractor will perform the following:

1. Contractor will review existing underwriting and collateral policy and procedure. Contractor will provide consulting services to verify and augment language for strength and reasonableness of proposed underwriting guidelines specific to lending to non-governmental entities generally, and CDFIs specifically.
2. Contractor will provide consulting services for proposed security/collateral to be included into underwriting guidelines and future loan agreements, including review of borrower and sub loan borrower creditworthiness as it relates to collateral sufficiency.
3. Contractor will determine appropriate methodology to assess strength of pledged revenue source and appropriate collateral.
4. Contractor will develop a cash flow model for CDFI borrower and sub loan borrowers including modeling potential defaults and remedy. Contractor will train appropriate Agency staff on cash flow model.

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Advisory committee meeting #2

Clean Water State Revolving Fund

Feb. 26, 2020

DEQ

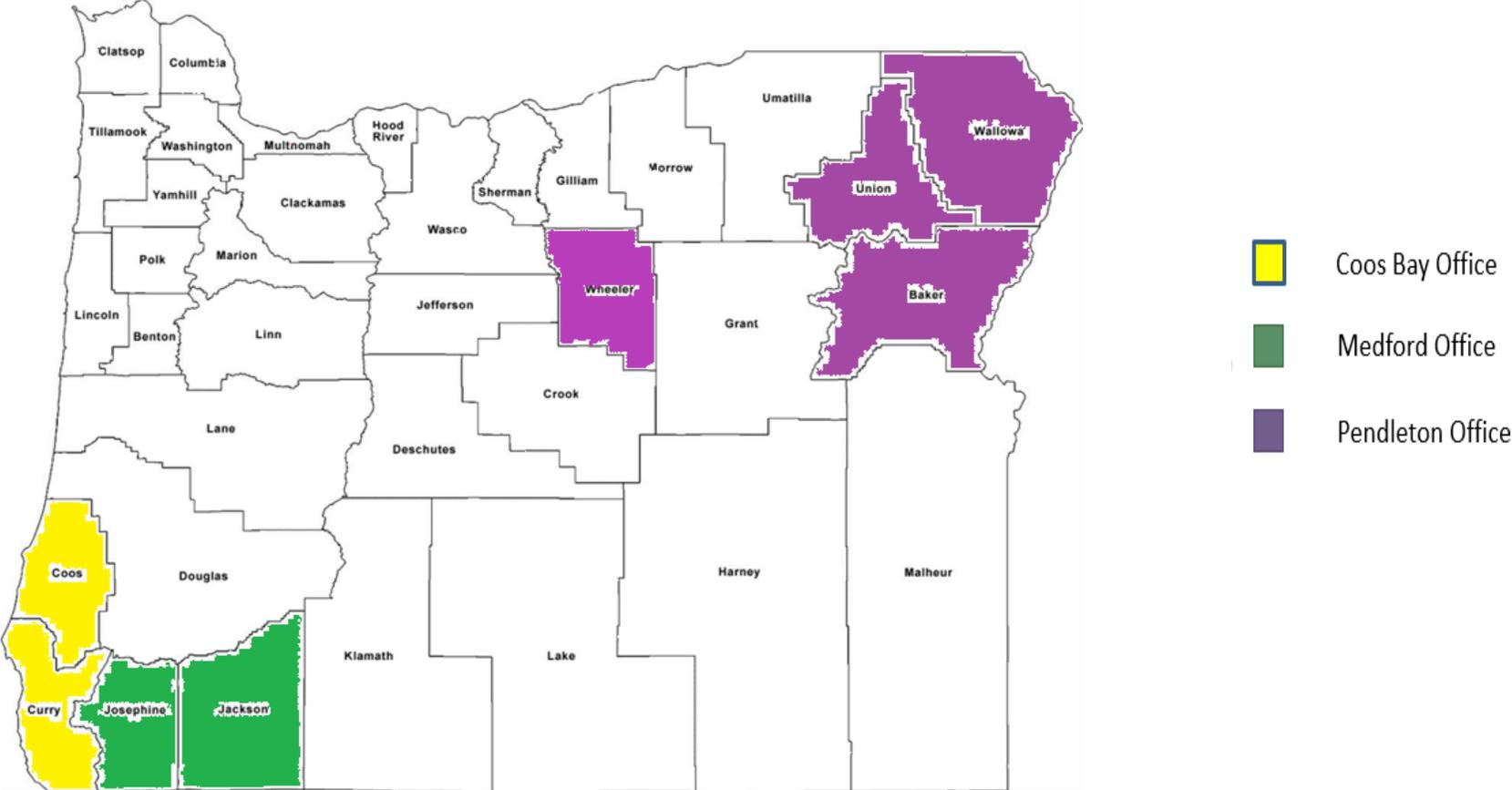
700 NE Multnomah St

Portland, OR

Presentation overview

- Septic system issues in Oregon
- CDFI overview
- Proposed pass-through lending requirements
- Public vs. public lending comparisons

The state of septic systems in Oregon



The state of septic systems in Oregon

Residential Onsite Permits – (About 350,000)

- Prescriptive rules
- Permit in place until modified, terminated or system fails
- Most have **no** maintenance, monitoring or reporting requirements
- No DEQ/County inspections

Large Onsite (WPCF) Permits – (684)

- Descriptive rules
- 10 year duration
- Flow and effluent limits
- Most have maintenance, monitoring and reporting requirements
- Inspected periodically (3-5 years)

The state of septic systems in Oregon

2018 Statewide residential onsite data

- 1,894 Construction-installation permits issued
- 2,219 Repair permits issued
- 159 loans through onsite loan program ('17-'18)

The state of septic systems in Oregon

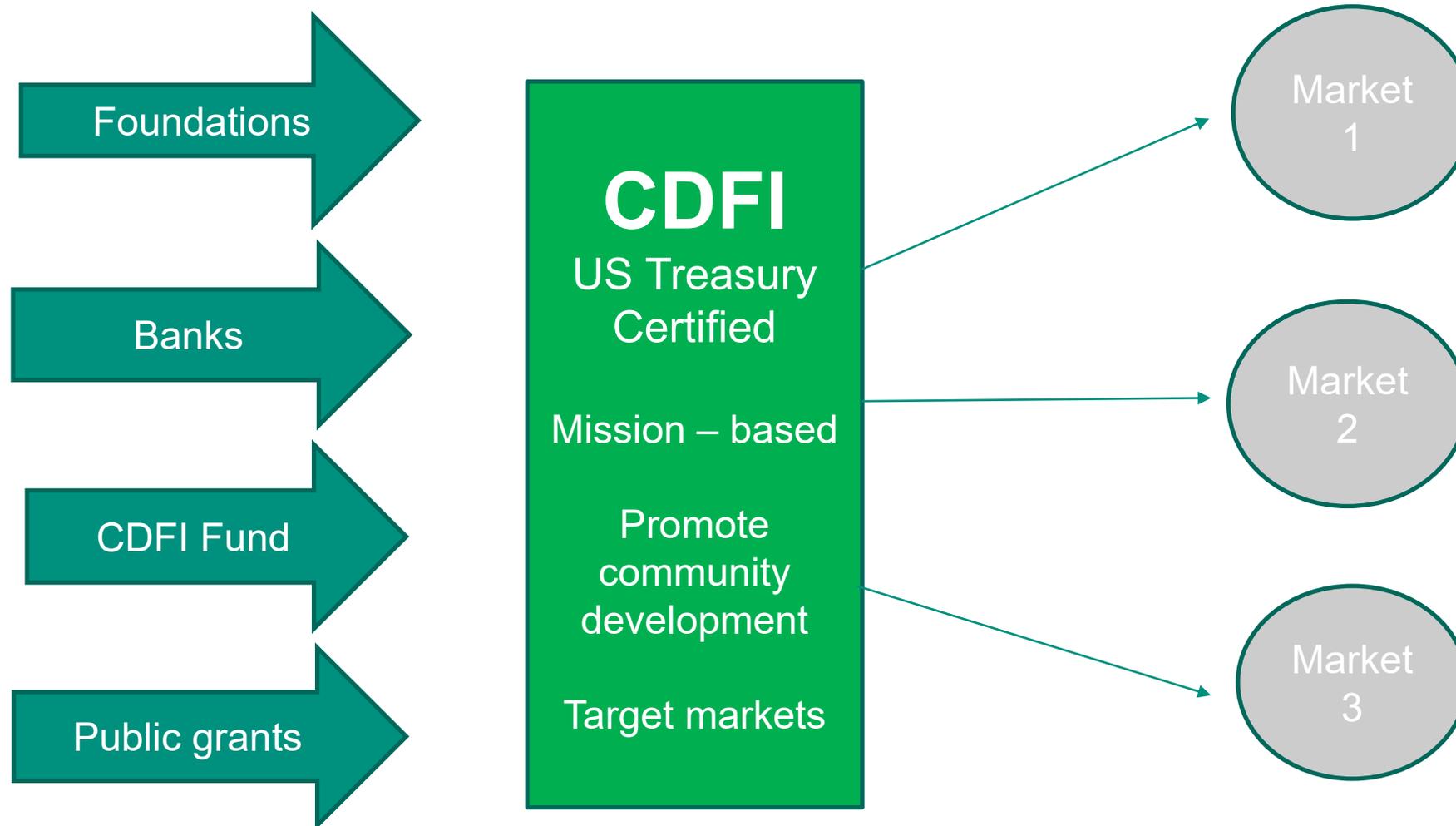
2018 Annual Discharge Monitoring Reports

Large Onsite (WPCF) Permits

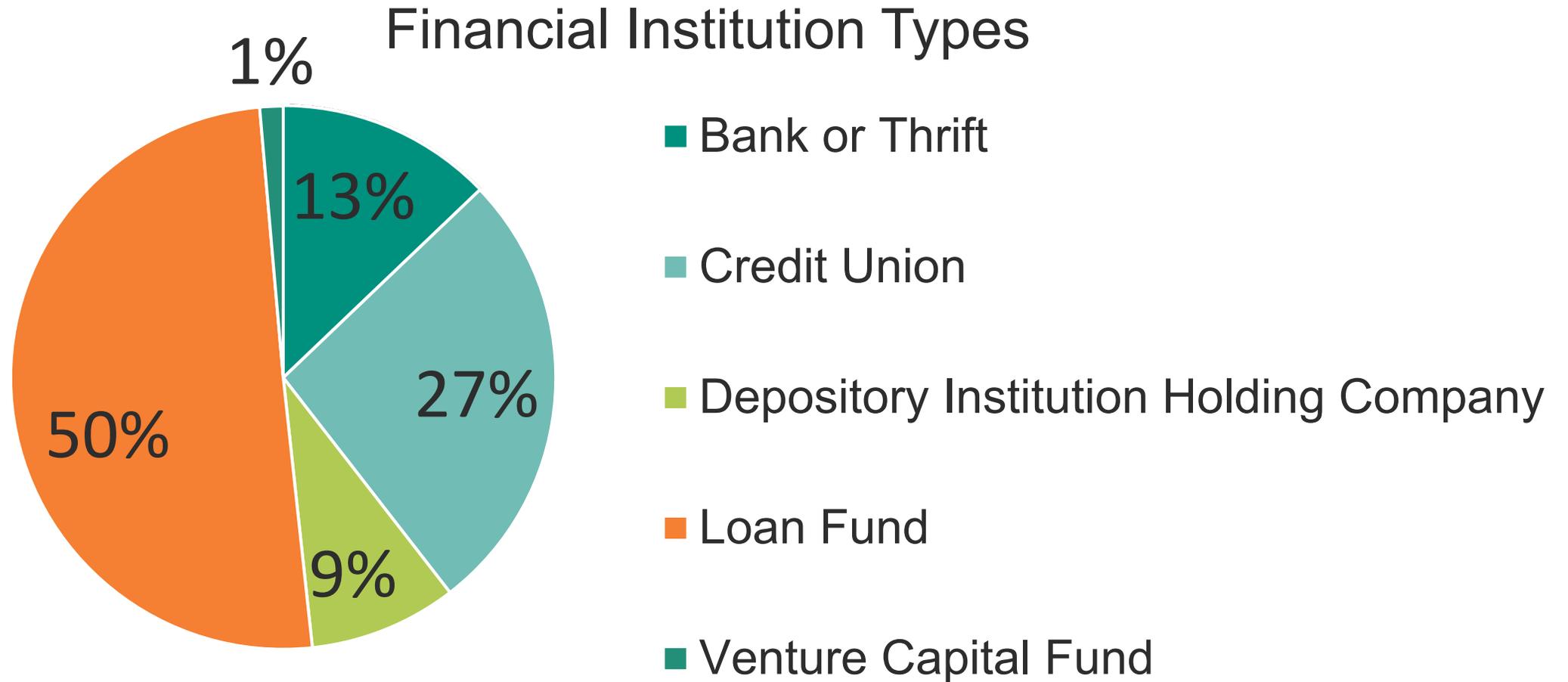
326 Violations

	WR	NWR	ER	Totals
No DMR Submitted	90	47	5	142
Flow Exceeded Violation	37	12	2	51
Permit Effluent Limit Exceeded Violation	46	30	3	79
Both Flow and Permit Limit Exceeded Violation	48	6	0	54

How does a CDFI work?



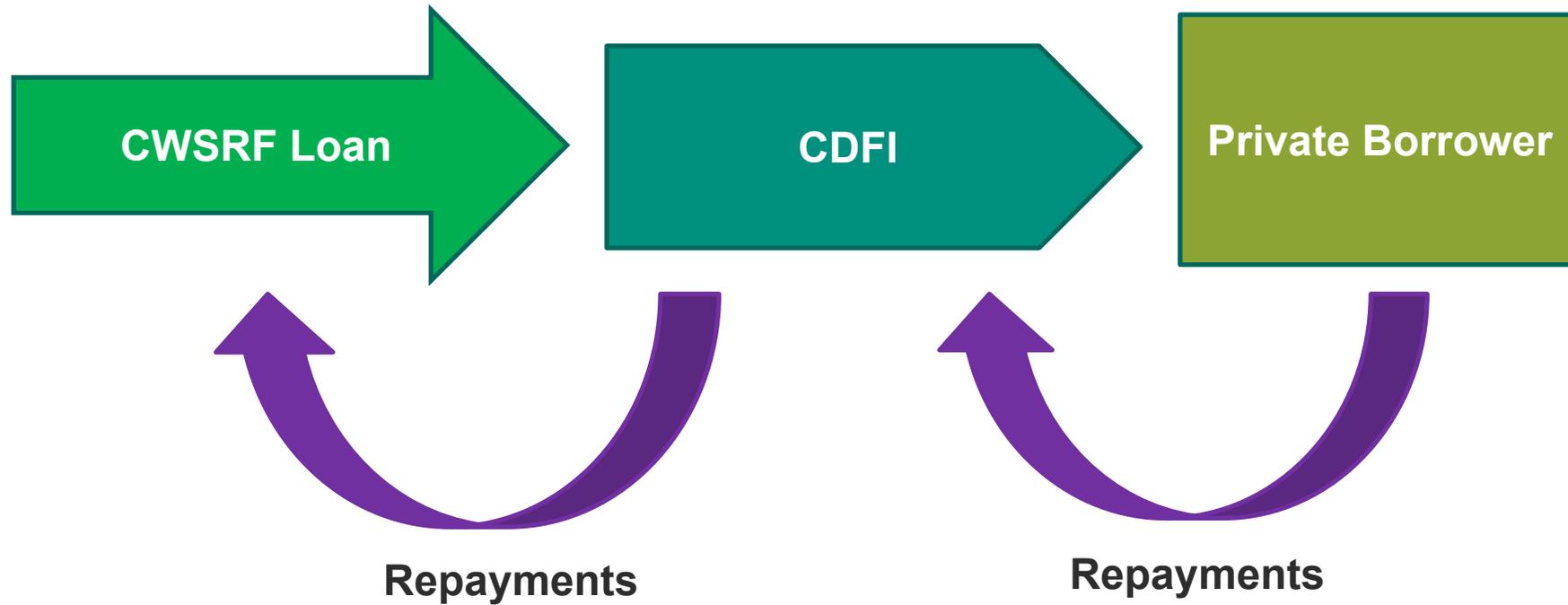
Types of CDFIs



CDFIs in Oregon

- Albina Opportunity Corporation
- Craft 3
- Habitat for Humanity
- Innovative Changes
- Point West Credit Union
- Portland Housing Center

Pass-through lending: How this could work



Proposed pass-through lending requirements

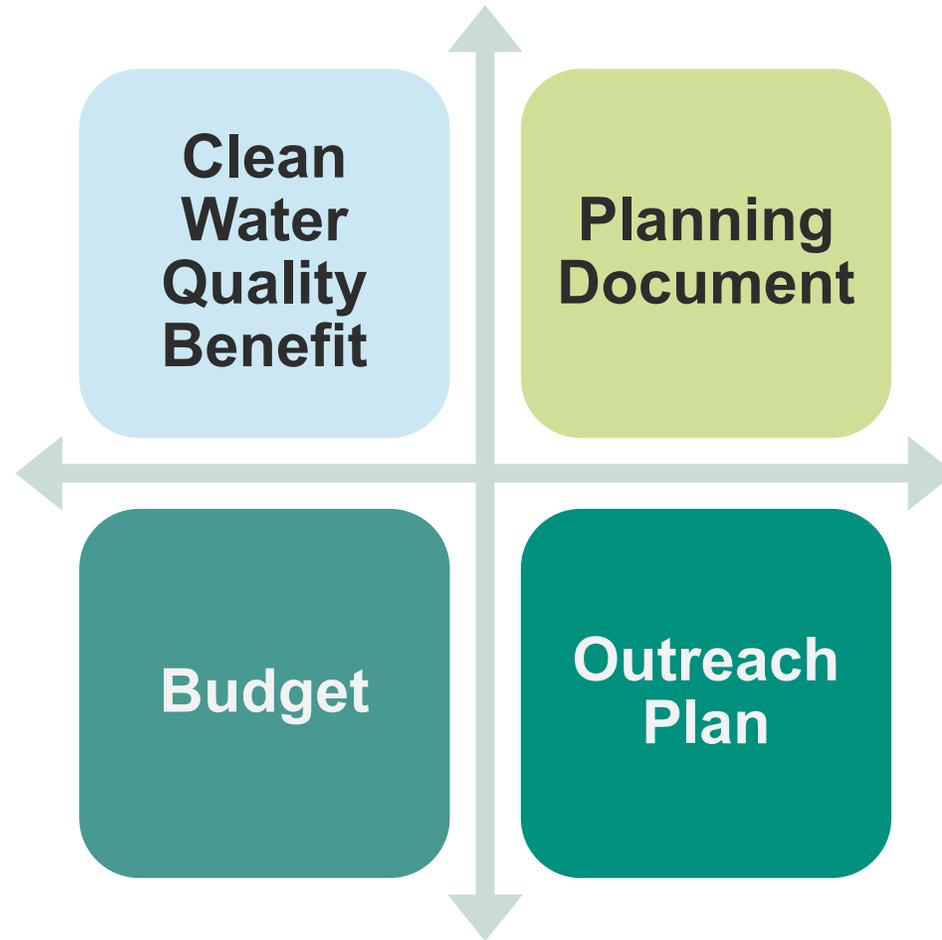
- Land Use Compatibility Statement
- Interest rates – below-market rate
- Loan Term – cannot exceed useful life of the asset
- Project Completion – triggers repayment
- Principal Forgiveness

10 minute break

Public and private lending

Comparisons and considerations

General requirements



Financial statements

Financial statement - Financial statements are written records that convey the business activities and the financial performance of a company.

They are often audited by government agencies, accountants, firms, etc. to ensure accuracy and for tax, financing, or investing purposes. Financial statements include:

Balance Sheet- Provides overview of companies assets, liabilities and stockholders equity as a snapshot in time

Income Statement- Provides overview of revenues, expenses, net income. Covers a range of time (ex. monthly, quarterly, yearly)

Cash Flow Statement- Measures how well a company's operation is running, where it money is coming in and how money is being spent

Financial statements

Current underwriting questions	Potential alternate questions for a CDFI
What portion, if any, of the municipality's financial assets are restricted?	What portion of the funds are restricted?
What portion of the net debt is funded by the annual tax levy or user fees?	What portion of funds are unrestricted?
Has the municipality's overall financial position improved or deteriorated?	What are the financial trends over time?
Were the municipality's current year revenues sufficient to pay for current year services?	Was income sufficient to meet expenses?

Ratio analysis

Break Even Point - the production level at which total revenues equal total expenses

Current Ratio - a liquidity ratio that measures a company's ability to pay short-term obligations or those due within one year

Ratio Analysis - a quantitative method of gaining insight into a company's liquidity, operational efficiency, and profitability by comparing information contained in its financial statements.

Debt to Equity Ratio - a measure of the degree to which a company is financing its operations through debt versus wholly-owned funds

Debt to Service Coverage Ratio - a measurement of the cash flow available to pay current debt obligations

Ratio analysis

Current underwriting questions	Potential alternate questions for a CDFI
What portion of the municipality's debt limit does the net debt represent?	What is the debt income ratio?
Are the municipality's financial assets liquid and current?	Same
What is the term of the existing debt?	Same

Business and financial management

Asset management - a systematic process of deploying, operating, maintaining, upgrading, and disposing of assets cost-effectively

Credit history

Determination of legal capacity to borrow and lend

Improved or deteriorated overall financial position

Manage funds effectively

Plan to increase income/user rates to cover debt service or increase available capital

Business and financial management

Current underwriting questions	Potential alternate questions for a CDFI
Is there a debt management plan in place?	Same
Will projected future revenues be sufficient to pay the net debt?	What is the plan to increase revenues, or to collect sub-debt?
What was the cost of providing services to the community?	What was the cost of providing services to borrowers?
What is the term of the existing debt?	Same

Security

These measures establish the obligation to pay and consequence of non-payment

Pledge to Repay - pledge to repay a specified amount of money with interest

Borrower Resolution - legal document containing information about the parties who may borrow money from financial institutions

Revenue/general obligation - Are there enough revenue/funds to cover general obligations? (debt service, expenses, etc.)

Default remedy

These measures establish the obligation to pay and consequence of non-payment

- What measures have been put in place in case of default events?

Debt service/Loan loss reserves - an expense set aside as an allowance for uncollected loans and loan payments

Power to intercept state funds/Fail safe security measure

-Line of credit in case of default

Security and default remedy

Current underwriting questions	Potential alternate questions for a CDFI
What is the extent of investments in capital assets, including roads and other infrastructure?	Are there any capitals assets?
Are debt service/loan loss reserves set up?	Same
What is expectation of significant growth or decline in reserves?	What is the CDFI plan to increase income to cover debt service?