State of Oregon Department of Environmental Quality

Lending to Community Development Financial Institutions – Part 4

Clean Water State Revolving Fund 2020 Rulemaking

Advisory Committee Meeting #4 - ***Revised Apr. 20, 2021***

Background

There are more than 456,000 septic systems in Oregon. Thirty percent of Oregon households rely on septic systems. As many as 10 percent of these systems fail each year according to various estimates. Septic system failures cause groundwater and surface water pollution that can endanger 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.

In 2019, the Oregon legislature adopted Senate Bill 884 to help Community Development Financial Institutions, known as CDFIs, to address septic system financing challenges through access to the Clean Water State Revolving Fund loan program. The bill requires DEQ to establish pass-through lending procedures and requirements for CDFIs that will lend to septic system owners, using CWSRF capital, for repairing and replacing failing on-site septic systems or connecting to an available sewer system.

DEQ will implement this new law by adopting a new rule in OAR chapter 340, division 054 and by amending existing rules.

During the three rulemaking advisory committee meetings in 2020, DEQ shared known requirements and considerations and proposed a CDFI lending framework. Since the last rulemaking advisory committee meeting, DEQ has evaluated input from the committee, the public, the Oregon Department of Justice, a contracted third party financial consultant, PFM, and the Environmental Quality Commission to prepare an update to the proposed draft rules.

Rulemaking Advisory Committee meeting #4 purpose

DEQ received substantial public comments from Craft3 and Aeris, Insight on the draft rules that asked DEQ to adjust certain loan terms, security pledges, reserves, credit worthiness parameters, the base interest rate and the prohibition on long-term sub-loan deferments.

DEQ presented an informational overview of the CDFI lending objectives and framework to the EQC on Jan. 21, 2021. The EQC supported the framework and wanted to see an effort to develop a proposal that ensures that the most economically disadvantaged sub-borrowers would benefit directly from DEQ's subsidization and lower-cost capital through the CDFIs' loans.

After careful review of the public comments and the EQC's input, DEQ decided to revisit the draft rules and made changes to the original requirements for the CDFI lending framework for the advisory committee's consideration.

Proposed updates to the CDFI lending framework

The following proposal outlines a tiered interest rate and principal forgiveness award to the CDFI and its sub-borrowers based on the household income of the sub-borrower.

DEQ will:

- Offer CDFIs tiered interest rates and principal forgiveness awards based on the CDFIs' sub-borrowers' household income (five income tiers)
- Require a CDFI to structure interest rates based on its sub-borrowers' household income
- Require a CDFI to pass-through 100% its principal forgiveness award to its sub-borrowers according to the sub-borrowers' household income

DEQ determined the US Census median household income data to be the best household income data source.

US Census median household income data for Oregon

- US Census: Oregon Median Household Income (2.6 people) = $67,058
- 75 percent median household income $50,294
- 50 percent median household income $33,529
- 25 percent median household income $16,765

The lending scenarios below are based on these assumptions:

- A $1 million DEQ loan per CDFI per year
- Interest rate 3.25 (prime rate)
- 15-year term
- 37 sub loans at $27,000 each

Lending Parameters	median household income & above	100 - 75% median household income	75% - 50% median household income	*50% - 25% median household income	25% & below median household income
DEQ principal forgiveness (% of loan)	Zero PF	Zero PF	25% PF	50% PF	50% PF
DEQ rate (% of prime rate)	prime	75% prime 2.44%	50% prime 1.62%	50% prime 1.62%	25% prime .813%
CDFI rate on sub-loans (DEQ rate +2% max)	5.25%	4.44%	3.63%	3.63%	2.81%
CDFIs' Costs and Proceeds					
Cost of CWSRF loan over term	1,336,105	1,258,396	891,253	599,581	558,941
P&I proceeds from sub-loan portfolio	1,445,533	1,351,655	1,369,920	1,296,568	1,225,695
Net proceeds after allowing for 3% loss	1,402,167	1,311,105	1,257,671	1,257,671	1,188,924
Total proceeds on sub-loan portfolio	66,062	52,709	366,418	658,090	629,983
Annual proceeds from sub-loan portfolio (profit/program income)	**4,404**	**3,514**	**24,428**	**43,873**	**41,999**
Sub-loan monthly payment	**217**	**203**	**206**	**195**	**184**
Principal forgiveness applied to the sub-loans					
CDFI principal forgiveness (percent of sub-loans)	Zero PF	Zero PF	**25% PF**	**50% PF**	**50% PF**
Cost of CWSRF loan over term			891,253	599,581	558,941
P&I proceeds to CDFI with PF applied to sub-loans			972,426	648,284	612,848
Net proceeds to CDFI after 3% loss			943,253	628,835	594,463
Total proceed on Sub loans with PF applied			(52,000)	(29,254)	(35,522)
Profit (Loss) to CDFI over term of sub loans			**(3,467)**	**(1,950)**	**(2,368)**
Sub-loan monthly payment			**146**	**97**	**92**

* Represents DEQ's original CDFI lending framework

CDFIs receiving other State of Oregon funding

CDFIs that receive State of Oregon grants or budget allocations to use as capital to make sub-loans to sub-borrowers for the purpose of repair, replacement or connection to an available sewer will not receive any additional subsidization in a CWSRF loan and must use the state funding to pass-through a certain percentage of principal forgiveness to sub-borrowers based on household income.

However, if a CDFI that receives State of Oregon grants or budget allocations for the sole purpose of covering the operational costs of a septic loan program (known as an 'operating grant'), and does not use the state monies as capital for making the sub-loans, the CDFI may be eligible for the principal forgiveness in a CWSRF loan.

Proposed updates to risk management and creditworthiness

In addition to the newly proposed tiered interest rates and principal forgiveness and pass-through requirements as outlined above, the following CDFI lending requirements reflect updates to the CDFI lending framework originally proposed in the draft rules that were posted to public comment from Oct. 9, 2020 to Dec. 18, 2020. See the original CDFI lending framework in Attachment 1. DEQ made these updates based on public comments and EQC considerations:

Revision: • **Maximum loan amount –** $2M per CDFI, per year • **Total CDFI lending limit per state fiscal year –** $10M in aggregate
Update: DEQ increased the annual CWSRF loan limit to any CDFI from $1M to $2M. DEQ increased the total aggregated CWSRF loan reserved for CDFI lending from $5M to $10M.

Revision: **Fully amortized CDFI loan and sub-loan** – CDFI loans must be fully amortized with equal installment payments. DEQ will not require that sub-loans be fully amortized with equal installment payments and will not prohibit sub-loan deferrals.
Update: The original proposal prohibited loan deferrals because fully amortized loans of equal installment payments is a best lending practice and ensures timely repayments within the useful life of the asset. Regularly scheduled sub-loan repayments allow a CDFI to lend that money again which will maximize the environmental benefit sustainably overtime. DEQ determined that its policy is to ensure CDFI is making payments to DEQ. DEQ will allow CDFI to work out details with sub-borrower.

Revision: **Security position –** DEQ will not require a first priority position in rule.
Update: DEQ determined that its security position will not be defined in rule. An alternative is that security position could be negotiated when developing a loan agreement on a case-by-case basis.

Revision: **Asset to liability ratio** (also known as current ratio) **–** DEQ will determine a level appropriate to the CDFI.
Update: DEQ will determine a level appropriate to the CDFI rather than setting the ratio in rule.

Debt service coverage ratio (also known as net income to debt service ratio) **–** A measurement of the cash flow available to pay current debt obligations.
Update: CWSRF will allow a 1.05:1 ratio, instead of 1.25:1 as originally proposed, which is the same as the debt service coverage ratio for municipalities. The same as with municipalities, a CDFI must have a fully funded debt service reserve to qualify for this lower DSCR percentage. DEQ will look for a $1.05 of cash for every dollar of debt service after expenses.

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.