Oregon Department of Environmental Quality

Meeting Summary

Clean Water State Revolving Fund Rulemaking Advisory Committee Meeting 4

Wed., April 21, 2021, 9 a.m. to 12 p.m.
Virtual Meeting

List of Clean Water State Revolving Fund 2020 Rulemaking Advisory Committee Member Attendance (via video conference or phone)

- April Snell, Oregon Water Resources Congress
- Chris Thomas, The Freshwater Trust
- Eann Rains, Clackamas Soil and Water Conservation District
- Janna Graham, Business Oregon
- Karen Lewotsky, Oregon Environmental Council
- Desiree Sideroff, Craft3
- Jill Rolfe, Association of Oregon Counties
- RosAnna Noval, Rural Community Assistance Corp.
- Chris Bailey, City of Albany, representing League of Oregon Cities
- Tom Elliott, Oregon Department of Energy
- Absent: Charlotte Bentley, Community Program Director, USDA Rural Development

DEQ staff attendees (for all or part of the meeting)

Richard Whitman (DEQ Director), Justin Green (Water Quality Division Administrator), Lynn Barlow (CWSRF Program Manager), Trina Brown (Water Quality Administrative Specialist), Kathy Estes (CWSRF Senior Loan Specialist), Jennifer Kenny (CWSRF Program Analyst), Lee Ann Lawrence (CWSRF Program Coordinator, Rulemaking Lead), Michele Martin (Water Quality Project Manager, Meeting Facilitator), Chris Marko (CWSRF Program Analyst), and Oscar Orejel (CWSRF Loan Specialist).

Members of the public

Allison Daniel, Legislative Analyst for the Oregon State House Committee on Water

Handouts and presentation materials

- Agenda
- Draft Fiscal Impact Statement
- Previously proposed CDFI Lending Framework (October 2020)
- Lending to Community Development Financial Institutions – Part 4 (revised 4/20/2021)
- Presentation

Introduction and purpose

The purpose of the fourth and final meeting was to gather feedback and input from the Rulemaking Advisory Committee members and members of the public about DEQ's proposed Clean Water State Revolving Fund lending requirements as they relate to Community Development Financial Institutions that will be incorporated in Oregon Administrative Rules chapter 340, division 054.

Senate Bill 884 expanded the definition of an eligible CWSRF borrower to include nonprofit CDFIs for the specific purpose of lending to individual septic system owners for septic system repair, replacement, and connection to an available sewer system.

DEQ made adjustments to the draft rules based on public comments and input from the Environmental Quality Commission. Based on this input, DEQ began a re-scoping effort to the CDFI lending framework and restarted the public engagement process. The purpose of this meeting is for the committee members to review and provide additional input on updates to the CDFI lending framework.

Rulemaking process to date and next steps

DEQ reviewed the rulemaking process and schedule:

- Three previous committee meetings: January - August, 2020
- Public comment period: October 9, 2020, extended to December 18, 2020
- Public hearing: November 17, 2020
- Informational presentation to the Environmental Quality Commission: January 21, 2021

Next steps:

- Public comment period begins: May 1, 2021
- Public hearing/end of public comment: June 1, 2021
- DEQ will review public comments and determine any need to update the draft rules in preparation for rule adoption.
- Presentation to EQC for rule adoption: July 22 or 23, 2021

CWSRF staff are also working on the implementation plan for the proposed rules so that the CWSRF loan program is positioned to accept a CDFI loan application upon rule adoption.

Meeting #4 goals

The goals for the meeting were to review and provide input on DEQ's proposed:

1. Review the CDFI lending framework as originally proposed.
2. Review and provide input on DEQ's updated CDFI lending framework:
    - Tiered interest rates and principal forgiveness awards determined by sub-borrowers' household income and passed through to sub-borrowers
    - Risk management and creditworthiness measures
3. Review updated draft Fiscal Impact Statement

Lending to Community Development Financial Institutions: Proposed pass-through lending requirements

DEQ reviewed and discussed Attachment 1 – CDFI Lending Framework as proposed in October 2020 that details the requirements in the original draft rule. Then DEQ presented the new updates to the proposal.

DEQ outlined a new lending framework that includes 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.

Additionally, DEQ explained updates to certain CDFI lending parameters that were determined 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.

Summary of key discussion topics:

Craft3: The proposed changes to interest rates and principal forgiveness appear to be a disincentive for CDFIs to work with CWSRF. CWSRF is compliance driven to address state and federal rules. Craft3 will need to analyze how this can work to serve the needs of the target population and borrowing entities to cover costs.

Craft3 expressed concern about the tax implications of principal forgiveness on the sub-borrowers and the impact on sub-borrowers' ability to receive other public services. Deferred loans do not have this income issue in Craft3's experience.

Craft3 commented that DEQ change the asset to liability ratio because it wouldn't work for CDFIs which typically have a 4 or 5 to one ratio.

Regarding the breakdown of interest rates and principal forgiveness based on five income tiers is complicated, particularly for homeowners. Craft3 recommends DEQ allow CDFIs to determine sub-loan terms. The principal forgiveness percentage basis is difficult. DEQ should have three income tiers, not five.

The proposal is not quite there yet, it currently will not work for CDFIs. If the rule passed today, Craft3 would not be able to apply for the program. Contractors would have challenges with compliance with program requirements. Demand for clean water loans is increasing in part due to COVID and wildfire disasters. Craft3 appreciates all of DEQ's work so far.

Clackamas Soil and Water Conservation District: The proposed changes to the requirement that sub-loans must be fully amortized is a good change.

RCAC: DEQ's new proposal addresses some of the issues from the previous proposal. But, the affordability for low-income sub-borrowers is not as good as the higher income sub-borrowers. A higher income borrower would be paying three to four percent of their income and the lowest income sub-borrowers would be paying six percent. All of these numbers are above the 2.5 percent affordability threshold that EPA has used historically for drinking water and wastewater programs in the past, not sure if this has changed in 2021.

Oregon Environmental Council: OEC appreciates DEQ wanting to act in a fiscally responsible manner but is concerned by comments from CDFIs indicating they will not be able to apply for the program. OEC hopes the program can address the need for flexibility to address the CDFIs' unique aspects.

League of Oregon Cities: If intent of the program is for CDFIs to use this program and if CDFIs will not be able to use it, then that is a problem in terms of the rule change. LOC recommends looking into other options other than using municipal lending as basis for setting up the lending requirements.

Addressing the septic tank problems will significantly help address water quality in Oregon. This CWSRF approach is unique and challenging. DEQ needs to figure out how to make it work for CDFIs.

Oregon Department of Energy: DEQ did a stellar job with the proposals. There's been a lot of progress. Consider the need to revisit into the process as the key questions raised make sense. The Legislature should hear the potential impacts to get to where the State needs to be.

Oregon Water Resources Congress: Thanks to DEQ for bring this important matter to us. While it's important that DEQ gets this right for CDFIs, it's also important to balance the fiscal responsibility to ensure that the CWSRF loan program remains a viable tool for all CWSRF borrowers that have water quality needs.

DEQ responses:

- The taxable income will only be generated on the principal forgiveness for the given tax year for each year the sub-loan is in repayment. For low income sub-borrowers the taxation would be marginal given their tax rate. But, any additional taxable income that generated by principal forgiveness will still be low and will not dramatically offset the cost savings of the sub-loans.
- DEQ review the committee's suggestions. DEQ is trying to balance how much will be in rule so that we have adequate language in rule for clarity for CDFIs while not being so prescriptive to prevent adaptability.
- DEQ's presentation to EQC will likely include an explanation that the draft rules will be a first attempt at CDFI lending and that DEQ is learning how to operationalize this new type of lending and may need to make changes to the rules in the future.
- The updated draft rules posted to public notice will outline the rest of DEQ's responses to the committee's input.

Draft Fiscal Impact Statement

DEQ reviewed the draft fiscal impact statement. DEQ documented that there could be many fiscal and economic impacts from the proposed rule changes to DEQ's CWSRF, and they are categorized in the document into direct impacts (borrowers) and indirect impacts (secondary and third degree impacts). The proposed rules are not expected to have an impact on loans to other CWSRF borrowers and prior applicants.

DEQ asked the committee:

- Will the proposed CDFI lending requirements have a fiscal impact?
- To what extent will that impact be?
- Will the proposed CDFI lending requirements have a significant adverse impact on small businesses?
- What can DEQ do to reduce any adverse impact on small businesses?

The committee acknowledged there would be positive fiscal impacts but that there would not be any significant adverse impacts to small businesses. DEQ staff will incorporated the committee's responses to the three questions into the draft fiscal impact statement.

Public comment period

There were no comments from members of the public.

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.