



Maryland

Department of
the Environment

**DRINKING WATER REVOLVING LOAN FUND
ANNUAL REPORT
STATE FISCAL YEAR 2019
(JULY 1, 2018 – JUNE 30, 2019)**

Prepared by
**MARYLAND WATER QUALITY FINANCING ADMINISTRATION
SEPTEMBER 2019**

**Larry Hogan
Governor**

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Lt. Governor**

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Secretary**

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Deputy Secretary**

**Annual Report
Maryland Water Quality Financing Administration
Drinking Water Revolving Loan Fund
State Fiscal Year 2019 (SFY 2019)
July 1, 2018 – June 30, 2019**

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State Fiscal Year 2019
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EXECUTIVE SUMMARY

This Annual Report (in lieu of a Biennial Report) has been prepared for submission to the United States Environmental Protection Agency (EPA) in compliance with the reporting requirements under the Safe Drinking Water Act (SDWA), and the Capitalization Grant Operating Agreement between the EPA and the Maryland Department of the Environment (MDE), amended as of April 2014, and February 2016. The report describes the operational and financial activities of the Maryland Drinking Water Revolving Loan Fund (DWRLF or DWSRF or Fund) for State Fiscal Year (SFY) 2018. This report covers the period July 1, 2018 through June 30, 2019 and provides the overall status of Maryland DWSRF program as of June 30, 2019. The programmatic activities under the DWSRF Set-asides (2%, 10% & 15%) are reported semi-annually to EPA separately and are included by reference as Appendix E.

The Maryland DWSRF was established by amendments to the Maryland Water Quality Financing Administration (MWQFA or Administration) Act, Title 9, Subtitle 16 of the Environmental Article, Annotated Code of Maryland consistent with the SDWA amendments. The primary purpose of the Fund is to make low interest rate loans, including additional subsidies in the form of grants/loan forgiveness to local governments and private entities for eligible drinking water infrastructure projects. Maryland's DWSRF finances capital improvements for drinking water sources, treatment, storage and distribution in compliance with the federal SDWA. The DWSRF supports the State's goals and objectives for public health protection, smart growth, and sustainability.

Since 1997, MDE has received approximately \$223 million from federal capitalization grants for "capital" projects, which along with state match, loan principal and interest repayments, and investment earnings has resulted in over \$469 million in loan and grant financing as of June 30, 2019. The following is a brief summary of the DWSRF capital program:

Drinking Water Revolving Loan Fund				
FY 2019 - Executive Summary				
DWSRF	As of 6/30/2019		As of 6/30/2018	
Total Assets	248,122,891		235,911,163	
Total Liabilities	48,977		49,754	
Total Net Assets	248,073,914		235,861,409	
Total Loans & Grants Executed	469,542,172		452,486,020	
Federal Grant Awards	299,246,706		278,898,706	
Awarded to Capital Projects	223,798,927		209,758,807	
Awarded to Set-asides	75,376,843		69,036,360	
Awarded to In-Kind (EPA)	70,936		103,539	
State Match Appropriated	54,544,000		50,474,400	
	FY 2019		FY 2018	
Capitalization Grant Award	20,348,000		13,987,000	
Allocated to Capital Projects	14,040,120		10,210,510	
Allocated to Set-asides	6,307,880		3,776,490	
State Match Appropriated	4,069,600		2,797,400	
Net New Loans & Grants (# Projects)	17,056,152	9	60,662,621	7
Weighted Average Loan Interest Rate	1.02%		0.79%	
Loan Principal Repayments	10,736,190		10,615,471	
Total Loan Interest Repayments (accrual)	1,764,868		1,489,435	
Investment Earnings (capital reserve a/c)	805,830		1,007,224	

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I. OVERVIEW

The Safe Drinking Water Act (SDWA) amendments of 1996 (Public Law 104-182) authorized a Drinking Water State Revolving Loan Fund (DWSRF) to assist eligible water system owners to finance the cost of infrastructure to achieve or maintain compliance with the SDWA requirements and to protect health objectives of the Act. In addition to authorizing the infrastructure fund, the Act also established a strong new emphasis on preventing contamination problems through source water protection and enhanced water system management. Central to this emphasis is the development of State prevention programs, including source water protection, capacity development and operator certification. The States have the option to use up to 31% of the annual Capitalization Grant for activities under the four set-asides, while the balance of the Capitalization Grant and the full State Match (20%) shall be allocated for DWSRF capital infrastructure loans as summarized below:

<u>Activity</u>	<u>% of Capitalization Grant</u>
Small System Technical Assistance	Up to 2%
DWSRF Administrative Expenses	Up to 4%
State Program Management	Up to 10%
Local Assistance and Other State Programs	<u>Up to 15%</u>
Subtotal	Up to 31%

DWSRF Project Fund (Capital Loans & Grants) Cumulatively, at least 69% annually plus the full 20% State match

As of June 30, 2019, the cumulative Federal capitalization grant allocation to capital project fund and set-asides is:

Capital Project Fund	\$223,798,927	
Setasides	\$ 75,376,843	
Set-asides In-kind (EPA)	<u>\$ 70,936</u>	
Total Federal Awards	\$299,246,706	Inception through June 30, 2019

(See Table 2 for more details)

In Maryland, the DWSRF Program is implemented within the Maryland Department of the Environment (MDE), with the Maryland Water Quality Financing Administration (MWQFA) responsible for administering the DWSRF Project Fund and its related 4% set-aside for DWSRF administration, and the Water and Science Administration's Water Supply Program (WSA/WSP) responsible for administering activities under the three set-asides (2%, 10% & 15%), along with the Maryland Public Water System Supervision (PWSS) Program.

The following report describes the DWSRF Capital Program activities (Project Fund and its operating 4% set-aside fund) for SFY 2019. The WSA/WSP activities under the three DWSRF set-asides (2%, 10% & 15%) are reported to EPA semi-annually and are included by reference as Appendix E.

II. SUMMARY OF DRINKING WATER REVOLVING LOAN (PROJECT) FUND ACTIVITIES

A. Intended Use Plans (IUP) and Capitalization Grants

Table 1, Status of Intended Use Plans, provides a summary of projects identified on all existing IUPs as of June 30, 2019. The existing IUPs identify DWSRF projects financing totaling \$469,542,172 of which \$407,898,561 were loans and \$61,643,611 were grants/loan forgiveness. During SFY 2019, net (after adjusting for prior year reversions) new DWSRF direct loans and grants executed totaled \$17,056,152 (9 agreements). The weighted average interest rate on direct loans was 1.02%. Table 1 also shows total sources of funds at approximately \$429 million with a 109% fund utilization rate as of June 30, 2019.

Table 2 provides a summary of the total Federal Capitalization Grant awards of \$299,246,706 as of June 30, 2019, of which \$223,798,927 is allocated to Capital projects, \$75,376,843 to set-asides, and the balance of \$70,936 to in-kind contributions. The total cumulative State Match appropriation is \$54,544,000 which is allocated to capital projects. During FY 2019, total federal funds drawn were \$13,844,906 of which \$10,210,510 was for capital projects and \$3,634,396 for set-asides. The State Match for capital projects is deposited into the fund concurrently as federal grant funds are drawn in proportion to the draw down percentage in the grant agreement (generally 78.49% federal, 21.51% state match, when no 4% admin set-aside is requested. Capital projects disbursements are first applied to the oldest open federal capitalization grant/state match and then to recycled funds once the grants are fully expended. The set-asides are drawn down at 100% federal funds against eligible expenditures using the oldest open grant first. The maximum binding commitment required based on total federal grant and state match is \$278,342,927, which was exceeded based on the total direct loans and grants achieved totaling \$469,542,172 as of June 30, 2019, netting a surplus of \$191,199,245. Table 2 also shows a summary of the DWSRF retained earnings of \$(13,119,186) as of June 30, 2019, as reported on the audited financial statements; this retained earnings excludes the \$59,215,624 in permitted or required grants/loan forgiveness disbursed (~19% of Federal cap grants), indicating most of the retained earnings have been expended as additional subsidies, thus slowing the growth rate of the overall fund perpetuity.

B. Financial Status

The MWQFA Annual Financial Statements and Independent Public Accountants Report for the period ending June 30, 2019 is included as Appendix A and the Annual Financial Report (Single Audit) for the same period is included as Appendix B to this Annual Report. As of June 30, 2019, the Balance Sheet shows Assets of \$248,122,891 and Liabilities of \$48,977 and Total Net Position of \$248,073,914.

Table 3 shows a summary of DWSRF loans made to borrowers and the receivable principal balance as of June 30, 2019. Of the total \$407,898,561 in loans (Base & ARRA), the principal outstanding as of June 30, 2019 was \$219,853,653. The above does not include \$61,643,611 awarded as permitted grants/loan forgiveness. Table 3 also provides a summary of the Borrower Credit Quality that shows 77% of the loan principal outstanding is associated with borrowers Rated "Baa" or higher (investment grade) by Moody's, while 23% of loans are with borrowers that are Not Rated by the Bond rating agencies. The MWQFA undertakes an annual financial review of non-rated borrowers to identify any as "credit watch." In addition, prior to loan closing, MWQFA reviews the financial status of all borrowers to ensure financial capacity that meets the MWQFA loan underwriting criteria.

Table 4 shows a summary of administrative expenses of the DWSRF program during SFY 2019, which totaled \$822,913 which was comprised of fees charged on loans (5% funds). The funds available for program expenses for SFY 2020 and beyond is estimated at \$1.82 million.

C. Minority/Women's Business Enterprise (M/WBE) Activity

M/WBE participation on new procurements approved by MDE during SFY 2019 will be provided in a separate report.

D. Follow-up Actions to Prior Year (SFY 2018) EPA Program Evaluation Report (PER)

The SFY 2018 EPA Program Evaluation Report (PER) included the following two recommendations:

- That MDE fill the positions of MWQFA Director and Program Administrator, vacant since September 30, 2017, with permanent replacements. *Both positions have been filled with permanent replacements.*
- That MDE expedite loans that are receiving additional subsidy; per EPA's 2013 memorandum, there is an expectation that the additional subsidy should be in executed loans within two years of the additional subsidy authority becoming available. *MDE works closely with borrowers to keep projects moving forward in as timely a manner as possible; however, some delays are inevitable, the causes of which are often beyond our control. Anticipated closing timeframes for projects with additional subsidy from FFY17 and earlier are provided in Table 1.*

E. Provisions of the Operating Agreement

The MWQFA has complied with the provisions of the Capitalization Grant Operating Agreement between the EPA and MDE, amended as of April 2014, and February 2016. The EPA during their annual DWSRF Program Evaluation will have an opportunity to affirm compliance with the Operating Agreement and Grant Agreements.

F. Project Benefit Reporting (PBR) & National Information Management System (NIMS) Database

The PBR and NIMS databases have been updated for all DWSRF projects financed during SFY 2019. The database reports are being incorporated here by reference and are not included as a hard copy in this Annual Report. Below are examples of public health benefits provided by some of DWSRF projects financed during SFY 2019:

Town Creek Water System Phase I - Phase I of this multi-phased project involves design and construction of waterlines, valves, fire hydrants, radio read water meters, and all necessary appurtenances to replace the existing aging and deteriorated water distribution system in the existing California area of St. Mary's County. The new system will correct water pressure and delivery problems and provide residents with safe and adequate drinking water.

Walkersville Water Treatment Plant - The proposed project entails the replacement of the Walkersville's water treatment plant, at existing capacity of 1.0 MGD, which will include ultrafiltration membranes followed by a reverse osmosis system for turbidity, nitrate and pathogen removal. The Town of Walkersville has a history of water contamination that cannot be adequately treated by its current water treatment plant. The proposed project will prevent any future contamination to the Town's drinking water system.

III. DWSRF GOALS AND ACCOMPLISHMENTS

The key goals identified in prior year Intended Use Plans and the achievements towards these goals are summarized below:

- To utilize the total financial resources of the Fund by providing low interest rate financing and other subsidies to eligible drinking water system owners while maintaining a perpetual source of capital funds for future projects.

Projects on the Intended Use Plan are selected in priority order based on readiness to construct except for meeting the green reserve requirements, if applicable. During SFY 2019, the DWSRF awarded \$17,561,923 in gross new financing, which included \$14,291,632 in loans and \$3,270,291 in grants/loan forgiveness. The loans were at a weighted average interest rate of 1.02%. For NIMS data reporting, the net new financing recorded was \$17,056,152, resulting from \$505,771 in financing reversions due to close-out of prior year projects that did not use their full funding allocation. Based on cumulative sources and uses of DWSRF funds as of June 30, 2019, the financing utilization rate is 109%. As of June 30, 2019, after accounting for cumulative grant/loan forgiveness disbursement of over \$59 million, the DWSRF capital fund had retained earnings of \$(13.1) million. The negative retained earnings resulted from DWSRF capital fund providing \$59,215,624 in permitted or required grants/loan forgiveness expended as additional subsidies, thus slowing the growth rate of the overall fund perpetuity.

- Ensure drinking water projects are constructed and maintained at a reasonable cost for the users of the system.

During SFY 2019, DWSRF awarded \$3.3 million in additional subsidy (grant/loan forgiveness) to Disadvantaged Communities. MDE DWSRF and state grant (FY 2019 budget: \$1.96 million) programs continue to co-fund projects with the U.S. Department of Agriculture (USDA) and Community Development Block Grant (CDBG) Program to keep user rates affordable. During SFY 2019, the MWQFA continued to use its financial model to assist communities in developing affordable user rates and in determining disadvantaged community status. This process involves meeting with other funding agencies to jointly discuss how best to fund projects.

Additional subsidy in the form of grant/loan forgiveness is provided to disadvantaged communities (DAC), not to exceed the cumulative federal statutory limit for each federal grant for both green and other projects. The DAC criteria is detailed in the annual IUP.

- Continue to provide at least 15% of DWSRF capital funds to assist small water systems.

During SFY 2019, \$13.4 million (78.6%) of the net financing (after closeout adjustments) was to five (5) small water system (debt-bearing population < 10,000). As of June 30, 2019, over \$131.7 million (28.06%) of total loans executed were made to small systems.

- As part of the credit/financial analysis of potential borrowers, MWQFA will continue to provide financial advisory services to system owners on the feasibility of their user rate structure and financial capacity to pay back a loan.

During SFY 2019 the MWQFA continued to use its financial model to assist communities in developing affordable user rates and in determining disadvantaged community status. This process involves meeting with other funding agencies to jointly discuss how best to fund projects particularly in disenfranchised communities.

- Continue to integrate and support the activities described in Maryland's water supply set-aside work-plan in support of the SDWA.

During FY 2019, nine (9) projects totaling ~\$17.1 million (100% of net financing) were to achieve or maintain compliance with requirements of the SDWA. MDE is committed to coordinate and

finance projects related to new rule development, enforcement and compliance, capacity development and other focus areas within the set-aside work-plan.