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Drinking Water State Revolving Loan Fund – Loan Management Policies

These Policies are adopted on [August 24, 2023] by the Board of Directors of the New Mexico Finance Authority (“Finance Authority” or “NMFA”), a public body politic and corporate, separate and apart from the State of New Mexico constituting a governmental instrumentality, created by the New Mexico Finance Authority Act, Section 6-21-1 et. seq., NMSA 1978.

I. PURPOSE

A. Purpose Statement

The New Mexico Drinking Water State Revolving Loan Fund Act (the “Act”) was created to provide local authorities with low-cost financial assistance in the construction and rehabilitation of necessary drinking water facilities through the creation of a self-sustaining revolving loan program so as to improve and protect drinking water quality and public health. The Act is based on the Safe Drinking Water Act (“SDWA”), originally passed in 1974 and amended in 1986, 1996, 2018, and 2021 with the passage of the Bipartisan Infrastructure Law (“BIL”). Pursuant to the Act, NMFA is partnered with the New Mexico Environment Department (“NMED”) in the operation of the Drinking Water State Revolving Loan Fund (“DWSRLF”). These Loan Management Policies set forth the criteria by which the NMFA may make DWSRLF loans to qualified entities.

B. Objectives

The goal of these Loan Management Policies is to provide guidance to NMFA staff and borrowers regarding acceptable levels of risk, pricing and securitization of individual loans, and structuring enhancements within the DWSRLF program.

C. Implementation

These Loan Management Policies shall be implemented by the New Mexico Finance Authority Board and may, at times, be waived by the Board if the Board determines that a

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deviation from its adopted policies is necessary. Such waiver will be reflected in the minutes of the meeting at which the waiver is considered and must not conflict with federal regulations and the approved State’s Environmental Review Process document.

II. DEFINITIONS

- A. **“Additional Bonds Test”** – Calculation to determine if a borrower’s revenues meet levels required by the NMFA to incur additional debt against a financed facility.
- B. **“Additional Subsidy”**– Principal Forgiveness provided under the DWSRLF program and as allowed under state law.
- C. **“Bipartisan Infrastructure Law” (Pub. L. 117-58) (BIL)** also known as the “Infrastructure Investment and Jobs Act” (IIJA) - A once-in-a-generation investment in our nation’s infrastructure and competitiveness to rebuild America’s roads, bridges, and rails, expand access to clean drinking water, ensure every American has access to high-speed internet, tackle the climate crisis, advance environmental justice, and invest in disadvantaged communities.
- D. **“BIL Lead Service Line Replacement Program” (LSLR)** – A BIL funded program to remove lead service lines from water systems. Eligible projects include the identification, planning, design, and replacement of lead service lines, corrosion control optimization, lead testing and education, and interim/emergency protocols.
- E. **“BIL Emerging Contaminants Program” (EC)** – A BIL funded program for projects that reduce exposure to perfluoroalkyl and polyfluoroalkyl substances (PFAS) and other emerging contaminants on EPA’s Contaminant Candidate Lists (CCL1-CCL5).
- F. **“Build America Buy America Act” (BABA)** – An Act that strengthens Made in America laws and bolsters America’s industrial base, protects national security, and supports high-paying jobs. None of the funds made available for a federal financial assistance program for infrastructure may be obligated for a project unless all of the iron, steel, manufactured products, and construction materials used in the project are produced in the United States.

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- G. “Capitalization Grant”** – An award of funds by the United States Environmental Protection Agency (EPA) to a State for the purpose of capitalizing and administering the DWSRLF, as authorized in Section 1452 of the Safe Drinking Water Act.
- H. “Comprehensive Priority List”** – The list of prioritized water system projects using the criteria enacted by the NMED and listed in the Intended Use Plan.
- I. “Cost of Issuance”** – A 1% fee added to loan draws, as permitted by federal regulations, to cover the cost of legal services, construction monitoring, and engineering and environmental review.
- J. “Disadvantaged Entities”** – An applicant whose MHI is greater than 75% but less than 100% of the National MHI, based on the most recent 5-year average of MHI from census data or through a survey acceptable to NMFA.
- K. “EPA”** – United States Environmental Protection Agency.
- L. “EPA equivalency”** – The total dollar amount of projects funded by the Capitalization Grant that meet specific federal requirements.
- M. “Federal Regulations”** – The collection of rules under which the DWSRLF is governed. Specifically, these include but are not limited to, 40 CFR 9 and 35, the Interim Final Rule, and the Safe Drinking Water Act, Section 1452.
- N. “Financial Capacity”** – A water system’s ability to maintain sufficient financial resources to allow the system to maintain compliance with federal and state laws.
- O. “Fundable Priority List”** – The list of projects that have demonstrated Technical Capacity, Managerial Capacity, and Financial Capacity, are ready to proceed and eligible to receive financial assistance from the DWSRLF.
- P. “Green Projects”** – Means green infrastructure, water conservation, energy efficiency improvements, or other environmentally innovative activities.
- Q. “Intended Use Plan” or “IUP”** – The annual document prepared by both the NMED and NMFA which identifies the intended uses of the Capitalization Grant, and describes how those uses support the overall goals of the program.

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- R. **“Interim Period”** – The construction period of a DWSRLF loan during which only interest and fees are charged to the borrower on requisitioned amounts.
- S. **“Maximum Annual Debt Service” or “MADS”** – The amount of debt service for the year in which the greatest amount of debt service payments are required.
- T. **“Managerial Capacity”** – A water system’s ability to maintain system operations, as determined by NMED.
- U. **“Median Household Income”** – The median of the combined incomes for persons living within one household, used by the NMFA to determine if a community qualifies as Disadvantaged under this Policy.
- V. **“Minimum Coverage Requirement”** – The minimum ratio of revenue available to service the debt-to-debt service required on a loan.
- W. **“Parity Lien”** – A lien with the same priority for payment from Pledged Revenues or other security.
- X. **“Pledged Revenue”** – The revenue generated by the borrower pledged to the NMFA from which the borrower will fund repayment of the loan.
- Y. **“Principal Forgiveness”** – Same as **“Subsidy;”** the amount of principal that does not require repayment.
- Z. **“Public Water System”** – A public water system that provides water for human consumption through pipes or other constructed conveyances to at least 15 service connections or serves an average of at least 25 people for at least 60 days a year. A public water system may be publicly or privately owned.
- AA. **“Regionalized Community”** – The residents of an area benefiting from the water system improvements to be financed with the proceeds of the loan.
- BB. **“Safe Drinking Water Act” (SDWA)** – The principal federal law in the United States intended to ensure safe drinking water for the public. Pursuant to the Act, the Environmental Protection Agency (EPA) is required to set standards for drinking water quality and oversee all states, localities, and water suppliers that implement the standards.

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CC. **“Senior Lien”** – Lien with higher priority for payment from Pledged Revenues or other security.

DD. **“Severely Disadvantaged Entities”** – An applicant with an MHI 75% or less of the National MHI, based on the most recent 5-year average of MHI from census data or through a survey acceptable to NMFA.

EE. **“State Environmental Review Process” or “SERP”** – The necessary components of an environmental information document prepared by the applicant, and the steps necessary for NMFA to make a determination regarding any potential environmental impacts of a proposed project.

FF. **“Technical Capacity”** – The adequacy of operation, and physical infrastructure of a water system, including the water source, treatment, storage and distribution system, which allows the public water system to achieve and maintain compliance with federal and state laws.

III. ROLES AND RESPONSIBILITIES

A. New Mexico Environment Department’s Drinking Water Bureau is responsible for the determination and promulgation of a Fundable Priority List that:

1. Meets the federal regulations.
2. Gives priority to projects that cure imminent health and safety concerns.
3. Designates projects that qualify as Green projects.
4. Encourages sustainable and resilient drinking water systems.
5. For the BIL LSLR Program, ensures projects meet BIL LSLR project requirements.
6. For the BIL EC Program, ensures projects meet BIL EC project requirements.

B. Public Programs Staff shall be responsible for:

1. Coordinating with the Applicants appearing on the Fundable Priority List to complete and submit applications for financial assistance from the DWSRLF.

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2. Determining an Applicant’s Disadvantaged Entity status.
3. Determining the amount of additional subsidy, if any, that an applicant is eligible to receive pursuant to these Loan Management Policies.
4. Determining a project’s compliance with the SERP and federal conditions.
5. Determining borrower concentration within the DWSRLF loan portfolio.
6. Monitoring project construction and compliance with applicable federal regulations.

C. Lending Department Staff shall be responsible for:

1. Underwriting, structuring and presenting for approval DWSRLF loans that meet the requirements outlined in these policies.
2. Administration and monitoring of permanent DWSRLF loans.

D. Credit Department Staff shall be responsible for:

1. Confirming underwriting at approval and at the point the construction loan converts to a permanent loan.
2. Administration and monitoring of permanent DWSRLF loans.

IV. GENERAL CONSIDERATIONS

A. Project Eligibility. Each project funded by the DWSRLF must meet the following federal regulations.

1. Projects funded by the DWSRLF must demonstrate Managerial Capacity, Technical Capacity and Financial Capacity to undertake the proposed water project and must appear on the Fundable Priority List.
2. Compliance with the State Environmental Review Process: Projects funded with DWSRLF funds may be used only for a project whose environmental effects were assessed pursuant to NMFA’s State Environmental Review Process approved by the EPA. This review process ensures that adequate

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notice to the public has been made regarding the environmental findings prior to providing financing.

Loans will not be made until after NMFA has published its environmental determinations and adequate notice has been provided to the public.

3. For BIL LSLR projects, confirmation from NMED that the project is eligible as a BIL LSLR project and conforms to EPA Rules for such projects.
 4. For BIL EC projects, confirmation from NMED that the project is eligible as a BIL EC project and conforms to EPA Rules for such projects.
- B. Green Project Reserve:** Consistent with the goals of the EPA, the NMFA and NMED may set-aside portions of its loan funds for projects that qualify as Green projects.
- C. Concentration:** The NMFA will limit the DWSRLF funds so that no single loan comprises more than 25% of the outstanding loan portfolio.
- D. Cost of Issuance:** In order to satisfy legal services, construction monitoring, and engineering and environmental review associated with the DWSRLF loans, the NMFA will incorporate into the principal amount of the loan a cost of issuance fee totaling 1% of the project costs, excluding disadvantaged BIL EC projects, which will be collected on a per-draw basis, to the extent permitted by federal regulations. In accordance with federal regulations, fees collected will be held outside of the DWSRLF and used only for purposes allowed by law.

V. LOAN STRUCTURING AND RISK MITIGATION

- A. Loan Structure:** All DWSRLF loans will be structured with an Interim Period of two years, or as otherwise approved by the NMFA Board, during which only interest and administrative fees will be paid on the amounts drawn.
1. Following the expiration of the Interim Period, or the certification of the last draw, whichever comes first, the loan will be converted to a permanent loan and a final debt service schedule will be provided to the borrower. The loan conversion to a permanent loan must occur within one year of initiation of the system's operation.

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2. The permanent loan will be structured with an amortization of up to 30 years payable monthly.
 3. The NMFA Board may approve a loan to have a longer Interim Period if the project’s construction estimates indicate a longer construction phase is necessary.
 4. All DWSRLF loans shall be pre-payable by the borrower at the conclusion of the interim period without penalty.
- B.** In order to mitigate risk in the DWSRLF while maintaining a diverse pool of borrowers, the NMFA will take the following steps in structuring a transaction:
1. Lien: Generally, NMFA secures its loans on a Parity Lien with any other lenders. The NMFA may agree to accept a security pledge that is subordinate to the payment of another lender if the identified Pledged Revenue has a strong, positive historical trend and the overall coverage adheres to the Minimum Coverage Requirements and Additional Bonds Test requirements.
 2. Loan Repayment: Monthly receipt of loan payments from borrowers provides the NMFA with early indication of potential loan defaults. Generally, when a monthly revenue stream is available, the NMFA will require its loans to be paid monthly. The NMFA may allow borrowers to pay semi-annually; provided, the requesting entity has demonstrated ability to meet prior debt obligations and has sufficient staffing to manage timely loan payments.
 3. All loans will be structured utilizing an executed intercept agreement if the NMFA is statutorily allowed to intercept the Pledged Revenue. The NMFA may agree to hold an executed intercept agreement in abeyance while the borrower makes monthly principal and interest payments on its loan under the following conditions:
 - a. If the borrower fails to make the agreed upon payments in a timely manner, the NMFA will immediately begin to intercept the Pledged

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Revenues pursuant to the intercept agreement for the duration of the loan.

- b. This “contingent” or “suspended” intercept arrangement may be offered only to borrowers that have demonstrated ability to meet prior debt obligations and have sufficient staffing to manage timely loan payments.

C. For BIL EC Projects:

1. Loan Structure: All BIL EC project loans will be structured with an Interim Period of two years, or as otherwise approved by the NMFA Board, the project costs of which will be reimbursed. At the completion of the Interim Period and completion of the plan and design, EC survey and/or construction, project costs will be 100% forgiven.
 - a. Following the expiration of the Interim Period, or the certification of the last draw, whichever comes first, the loan will be converted to a permanent loan and a final debt service schedule will be provided to the borrower. The loan conversion to a permanent loan must occur within one year of initiation of the system’s operation.
 - b. The NMFA Board may approve a loan to have a longer Interim Period if the BIL EC project’s construction estimates indicate a longer construction phase is necessary.

VI. DISADVANTAGED COMMUNITY ASSISTANCE AND ADDITIONAL SUBSIDY

A. Base Program, BIL General Supplemental and BIL LSLR Construction Projects

1. Affordability Criteria. Capitalization Grant recipients are required to define Affordability Criteria and to provide additional assistance to Disadvantaged Communities. Pursuant to public comment, NMFA defines affordability based upon MHI of the applicant and provides for two levels of Disadvantaged entity status:

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a. Disadvantaged Entities – to be considered a Disadvantaged entity, the applicant’s MHI must be greater than 75% but less than 100% of the National MHI, based on the most recent 5-year average of MHI from census data or through a survey acceptable to NMFA.

b. Severely Disadvantaged Entities - to be considered a Severely Disadvantaged entity, the applicant’s MHI must be 75% or less of the National MHI, based on the most recent 5-year average of MHI from census data or through a survey acceptable to NMFA.

c. Applications for Regionalization projects may use the MHI of the community proposed for incorporation into the applicant’s water system service area for purposes of determining Disadvantaged entity status. These applications will be limited in scope to project elements related to the provision of water to the Regionalized Community and all assets funded by the loan must be owned and maintained by the borrower.

2. Disadvantaged Community Assistance. Capitalization Grant recipients are required to provide additional subsidy to its borrowers. NMFA provides additional subsidy in the form of loans with principal forgiveness, with the percentage of the principal forgiven determined by the NMFA Board of Directors at loan approval. The principal not forgiven will be structured and priced as provided otherwise in these Loan Management Policies.

3. The amount of additional subsidy provided will be promulgated each year in the State’s Intended Use Plan and is subject to federal appropriation. Pursuant to the Safe Drinking Water Act, DWSRLF base capitalization grant recipients must provide at least 12% - 35% of the base capitalization grant amount as additional subsidy for state-defined Disadvantaged Communities. From time to time, Congress or EPA may require capitalization grant recipients to provide additional subsidy to its loan recipients.

Pursuant to the BIL, States must provide 49% of the general supplemental capitalization grant amount as additional subsidy for state-defined Disadvantaged Communities.

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4. No single applicant may receive more than 25% of the total additional subsidy available for disadvantaged communities in any given year. Any additional funds required to complete the proposed project will be financed at the terms offered to non-disadvantaged communities. This limitation may be waived if there is not sufficient ready demand among disadvantaged communities.

5. Determination of additional subsidy for DWSRLF Base program, BIL General Supplemental, and BIL LSLR construction projects: The NMFA will provide additional subsidization in the form of principal forgiveness for projects using the following guidelines:

- a. Borrowers subject to federal construction requirements (Davis Bacon Wage Act; American Iron and Steel; Buy America, Build America Act, etc.) will be offered a 25% subsidy. Loans for Planning and Design only will not receive this subsidy.
- b. NMFA will provide additional subsidy to Disadvantaged Entities who meet affordability criteria based on the Median Household Income (MHI) of the applicant. NMFA provides two levels of disadvantaged entity status:
 - i. Disadvantaged Entities are provided 25% principal forgiveness;
 - ii. Severely Disadvantaged Entities are provided with an additional 25% principal forgiveness; and
- c. Certified “Green Projects” will be provided with an additional 25% of principal forgiveness.
- d. Entities that meet Disadvantaged or Severely Disadvantaged criteria may be provided up to 90% principal forgiveness dependent on the availability of additional subsidy, for regionalization projects related to the provision of water to a regionalized community when all assets funded by the loan will be owned and maintained by the borrower.

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e. Private non-profit and private for-profit systems are not eligible for subsidy due to the New Mexico anti-donation clause (Art IX, Sec. 14).

B. BIL LSLR Program for non-construction projects (i.e., lead service line surveys and plan and design projects)

For BIL LSLR projects, States must provide 49% of the capitalization grant amount as additional subsidization in the form of principal forgiveness or grants. This additional subsidization must be provided to eligible DWSRLF assistance recipients that meet the State’s disadvantaged community criteria as described in SDWA §1452(d).

1. Affordability Criteria. Capitalization Grant recipients are required to define Affordability Criteria and to provide additional assistance to Disadvantaged Communities. Pursuant to public comment, NMFA defines affordability based upon MHI of the applicant and provides for two levels of Disadvantaged Entity status:
 - a. Disadvantaged Entities – to be considered a Disadvantaged Entity, the applicant’s MHI must be greater than 75% but less than 100% of the National MHI, based on the most recent 5-year average of MHI from census data or through a survey acceptable to NMFA.
 - b. Severely Disadvantaged Entities – to be considered a Severely Disadvantaged Entity, the applicant’s MHI must be 75% or less of the National MHI, based on the most recent 5-year average of MHI from census data or through a survey acceptable to NMFA.
2. Disadvantaged Community Assistance. Capitalization Grant recipients are required to provide additional subsidy to its borrowers. NMFA provides additional subsidy in the form of loans with principal forgiveness, with the percentage of the principal forgiven determined by the NMFA Board at loan approval. The principal not forgiven will be structured and priced as provided otherwise in these Loan Management Policies.

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3. No single applicant may receive more than 25% of the total additional subsidy available for disadvantaged communities in any given year. Any additional funds required to complete the proposed project will be financed at the terms offered to non-disadvantaged communities. This limitation may be waived if there is not sufficient ready demand among disadvantaged communities.

4. Determination of additional subsidy. The NMFA will provide additional subsidization in the form of principal forgiveness for projects using the following guidelines, the BIL LSLR Program will also allow for population served for non-construction projects:
 - a. NMFA will provide additional subsidy to Disadvantaged Entities who meet affordability criteria based on the MHI of the applicant. NMFA provides two levels of disadvantaged entity status:
 - i. Disadvantaged Entities are provided 30% principal forgiveness;

 - ii. Severely Disadvantaged Entities are provided 60% principal forgiveness;

 - iii. Disadvantaged Entities and Severely Disadvantaged Entities that serve a population of under 1,000 are provided an additional 25% principal forgiveness.

C. BIL EC Program

BIL EC Program capitalization grant amounts, net of set-asides taken, are provided additional subsidization in the form of principal forgiveness. Pursuant to the provisions of the SDWA, at least 25% of the funds must be provided to eligible recipients that meet the State’s disadvantaged community criteria as described in SDWA §1452(d) or to public water systems serving fewer than 25,000 persons. NMFA will apply the affordability criteria as defined in these policies to determine disadvantaged entity status for the BIL EC Program.

1. No single applicant may receive more than 25% of the total additional subsidy available for disadvantaged communities in any given year. Any additional funds required to complete the proposed project will be financed

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at the terms offered to non-disadvantaged communities. This limitation may be waived if there is not sufficient ready demand.

2. The NMFA will offer BIL EC projects additional subsidization in the form of 100% principal forgiveness in the ranked order of the fundable priority list as provided by the NMED Drinking Water Bureau based on the ranking system in the IUP.
3. BIL EC projects may be co-funded with Emerging Contaminants funding from NMED. All water systems meeting the definition of a Public Water System as defined by the EPA are eligible for this program in accordance with the SDWA. Public Water Systems may be publicly or privately owned.

VII. INTEREST RATES (NOT APPLICABLE TO BIL EC PROJECTS)

- A. To help offset costs associated with federal loan program compliance and to provide incentive for a system to undertake critical water-quality projects, the NMFA provides DWSRLF borrowers with low-cost, fixed interest rates.
 1. Public Non-Disadvantaged systems, including those incorporated under the Sanitary Projects Act, will be offered an interest rate of 0.01%, plus a 0.25% administrative fee paid to NMFA for loan servicing.
 2. Public water systems that meet Disadvantaged Entity or Severely Disadvantaged Entity criteria will be offered an interest rate of 0%, plus an administrative fee of 0.25% paid to NMFA for loan servicing.
 3. Private, non-profit systems will be offered an interest rate of 3%, which is inclusive of a 0.25% administrative fee paid to NMFA for loan servicing.
 4. Private, for-profit systems that meet the federal definition of “Public Water Supply System” will be offered an interest rate of 4%, which is inclusive of a 0.25% administrative fee paid to NMFA for loan servicing.

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VIII. UNDERWRITING CRITERIA (NOT APPLICABLE TO BIL EC PROJECTS)

A. Debt Service Coverage. The NMFA structures DWSRLF loans to allow for some decline of the Pledged Revenue without affecting the borrower’s ability to pay debt service. Based upon certain factors such as revenue stability and management history, the NMFA may require higher Minimum Coverage Requirements and Additional Bonds Tests, as determined by the NMFA Board of Directors.

1. Historical Revenues. The NMFA will structure its DWSRLF loans so that at a minimum, historical revenues will exceed the Maximum Annual Debt Service (MADS) due during the life of the loan by the following Minimum Coverage Requirements:

a. Gross Receipts Tax	115% of MADS (1.15x)
b. Mil Levy	115% of MADS (1.15x)
c. Net System Revenues	120% of MADS (1.20x)
d. General Obligations	100% of Annual Debt Service (1x)
e. For profit systems	135% of MADS (1.35x)

2. Projected Revenues. The NMFA may consider estimated or projected revenues to determine Minimum Coverage Requirements if a three-year historical average is either not available or if circumstances have changed significantly within the last three years that would justify the forecasting of revenue growth to satisfy the Minimum Coverage Requirements. For example, an entity may have imposed increases in its user rates that are not reflected in financial statements. Under these circumstances, the NMFA will structure its loans so, at a minimum, the borrower’s projected revenues will exceed the MADS due during the life of the loan by the following Minimum Coverage Requirements:

a. Receipts Tax	125% of MADS (1.25x)
b. Mil Levy	125% of MADS (1.25x)
c. Net System Revenues	130% of MADS (1.30x)

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5. The project financed by the original loan must have been used for a purpose consistent with the eligible purposes defined by federal regulation and must have complied with all applicable state and federal regulations.

B. Private entities are not eligible for loan refinancing.

X. REFERENCES

A. Statutes, Regulations and Rules:

1. Safe Drinking Water Act – [Title XIV of the Public Health Service Act] [Section 1452 – State Revolving Loan Funds], as amended and supplemented from time to time
2. Drinking Water State Revolving Funds - [CFR Title 40 Chapter I Subchapter B Part 35 Subpart L], as amended and supplemented from time to time
3. EPA’s Interim Final Rule for the DWSRF - [CFR Title 40 Parts 9 and 35, FRL–6846–5, RIN 2040–AD20], as amended and supplemented from time to time
4. Office of Management and Budget’s *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (known as the “Uniform Guidance”) - 2 C.F.R. Part 200 - Requirements for Pass-Through Entities, as amended and supplemented from time to time
5. New Mexico Drinking Water State Revolving Loan Fund Act - [6-21A-1 to 6-21A-9 NMSA 1978] Laws 1997, Chapter 144, Section 1, as amended and supplemented from time to time
6. Bipartisan Infrastructure Law (BIL) (Pub. L. 117-58), as amended and supplemented from time to time

B. Policies or Program Documents

1. Memorandum of Understanding – the agreement between the NMFA and the NMED (DWB) to carry out the provisions of the Drinking Water State Revolving Loan Fund Act, as amended and supplemented from time to time

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2. Memorandum of Agreement – the agreement between the NMFA and the NMED Construction Programs Bureau to perform engineering and construction oversight, as amended and supplemented from time to time