BIL Lead Service Line Replacement Incentives

Due to the health risks associated with lead service lines and current lack of progress in attracting systems to the PENNVEST program to obtain low-interest loans for lead service line replacement projects, a modification to the affordability analysis associated with drinking water systems with lead line replacement projects seeks to promote these projects in the neighborhoods that can least afford the cost to replace the necessary piping. As described above, in order to target limited grant funds for the neediest systems, PENNVEST looks at the impact the potential grant will have on the resulting residential user fees. This tends to eliminate the largest systems from grant consideration, as project costs can be shared by a greater number of households spreading the cost impact across the entire system. However, the larger systems are also often those with the greatest lead service line replacement needs.

For those systems with lead service line replacement needs that have adequately mapped and designated high need areas or reach an action level under the Revised Lead and Copper Rule, PENNVEST will consider the rate impact on those specific areas or neighborhoods within the larger system in lieu of overall system users. This would provide a more realistic picture of the consequence of the capital improvement on the specific community impacted and allow for these types of projects to be eligible for additional subsidy, thus expediting correction and addressing the public health and environmental hazard.

In some cases, PENNVEST may offer only part of the funding that an applicant requests, particularly if there is a much greater demand for funding than can be met. This can occur when the resulting user rate is below the affordable rate. In such cases, typically 50 percent of the needed funding is offered, and the borrower is expected to obtain the other 50 percent from some other source (e.g. a bank or a bond issue). The resulting user rate that is calculated and compared with the affordable rate includes the debt service on this other borrowing.

The latest tool available to applicants is Loan Guaranty. In cases where the program can only offer partial or no direct loan funding, PENNVEST has the option of providing a loan guaranty. In these cases, the community/system would be able to take advantage of private sector borrowing to complete its funding package, using PENNVEST and its bond rating as security, reducing the overall cost of borrowing.

Loan and Grant Offering Determination for Systems

Both public and private entities may apply directly to PENNVEST and are subject to the same ranking and review criteria as other DWSRF projects.
For Private-for-Profit projects, tax returns and personal financial statements of the system owner are utilized to evaluate availability of operating revenue and cash flow analysis to cover debt service on a loan. A three-prong approach to this review is used:

1. If the average gross revenues for the most recent three years are equal to or greater than $1 million, the funding is offered as a loan. If the average gross revenues for the most recent three years is less than $1 million, but the average cash flow before taxes is greater than $100,000 and this average net cash flow exceeds the projected PENNVEST debt service, the

funding is offered as a loan.

2. When average gross revenues for the most recent three years is less than $1 million and the average cash flow before taxes is less than $100,000 but the PENNVEST debt service is less than 15% of the consolidated personal cash flow of entities' owners, the funding offered is loan.

3. Should the entity not meet any of the above criteria – funding offer is grant or principle forgiveness loan.

For Not-for-Profit sponsored projects, PENNVEST evaluates the capacity of the entity through tax returns, financial statements, or other information as necessary. The intent is to reach through to owners/benefactors to evaluate capacity to cover debt service.

For Public (Municipal) sponsored projects, PENNVEST evaluates the ability to handle debt through audited financial statements, DCED reports or other information such as related to the general fund or sewer fund revenues, as may be necessary. When a county or regional governmental unit is sponsoring a funding request, the capacity evaluation is based upon the municipality where the facilities/improvements are being constructed. Both cash flow and cash available are evaluated in the following manner:

Test 1: Is the unrestricted cash and investments equal to or exceed last year's cash operating expenses (including cash paid for debt service) plus the amount of the requested PENNVEST funding?

Test 2: Is the average cash flow before debt service for the last three years equal to or greater than two (2) times the total projected debt service (existing plus new PENNVEST loan)?

- If they pass both tests, the funding is offered as a loan.
- If they pass one test but fail the other the funding offer is ½ loan, ½ grant or principle forgiveness loan.
- If they fail both tests the funding offer is all grant or principle forgiveness loan.

How Pennsylvania Defines a Disadvantaged System

PENNVEST utilizes a financial capability analysis that compares various community specific demographic data to similarly situated communities across the Commonwealth to determine a percent of the community's adjusted median household income (MHI) that should be available to pay for water service. The amount that should be available to pay for water service by residential customers will range from 0.5 to 1.25 percent of the community's adjusted MHI dependent upon the specific socio-economic factors that are provided by the Pennsylvania DCED. This process aids in an equitable distribution of residential user rates.

Should the estimated resulting residential user rates be higher than similar systems, even after PENNVEST has provided the most favorable funding package available, based upon criteria set forth in the PENNVEST Act and regulations and further described in this document under the section "Priority and Allocation of Assistance," these systems would be considered "disadvantaged" for the purpose of term extension from the normal 20 years to a term of up to, but not to exceed, 30 years repayment of principal and interest. Systems qualifying for term extensions must exceed the user rate(s) found in similar systems according to the PENNVEST financial capability model. The terms will be extended to a point that will allow the residential user rate to fall to a level equal to similar systems' cost of water service, as determined by the demographic analysis and financial capability analysis.

In considering projects where there are no immediate users, such as some green infrastructure, the above-described methodology will be modified. In such cases, PENNVEST will look to the applicant's financial capability to repay a loan. If there is no reasonable expectation that this capability will be present, then PENNVEST could determine that the applicant fits the definition of a disadvantaged system.

Additionally, any community identified as disadvantaged using the Council on Environmental Quality (CEQ) Climate and Economic Justice Screening Tool or located in a Pennsylvania defined Environmental Justice Area will be considered a disadvantaged system for purposes of applications relating to design and engineering projects with the financial capability analysis being performed on the service area impacted by the proposed project instead of system wide.

Cash Flow Model

Pennsylvania uses a complex cash flow model that will allow for optimal funding decisions to be made. The cash flow model will provide loan portfolio activity analysis for the multiple funding scenarios. The model has recently been completely redone to accommodate changes in software and program requirements.

Loan Repayment

Pennsylvania requires repayment to commence shortly after final inspection following construction completion. Generally, repayment is done on a monthly basis. The Board may defer principal payment for up to five years in certain financially or economically distressed communities in order to maintain the fund. This procedure ensures available cash flow for continuous use of the fund. It would not, however, result in no payments being made within one year of completion of construction since some payment would always be required, even in the most extreme circumstances.

Automated Clearinghouse (ACH)

Pennsylvania utilizes a state ACH program to electronically debit borrowers for debt service on their loans. The participation in the ACH program is a loan requirement. The ACH program ensures the receipt of loan repayments on a timely basis. Additionally, PENNVEST offers the option to use the ACH program to electronically deposit disbursements to a loan recipient's account.

Leveraging of Funds