

---

This content is from the eCFR and is authoritative but unofficial.

---

**Title 40 —Protection of Environment**  
**Chapter I —Environmental Protection Agency**  
**Subchapter B —Grants and Other Federal Assistance**  
**Part 35 —State and Local Assistance**

**Authority:** 42 U.S.C. 7401 *et seq.*; 33 U.S.C. 1251 *et seq.*; 42 U.S.C. 300f *et seq.*; 42 U.S.C. 6901 *et seq.*; 7 U.S.C. 136 *et seq.*; 15 U.S.C. 2601 *et seq.*; 42 U.S.C. 13101 *et seq.*; Pub. L. 104-134, 110 Stat. 1321, 1321-299 (1996); Pub. L. 105-65, 111 Stat. 1344, 1373 (1997), 2 CFR 200.

**Subpart L Drinking Water State Revolving Funds**

- § 35.3500 Purpose, policy, and applicability.
- § 35.3505 Definitions.
- § 35.3510 Establishment of the DWSRF program.
- § 35.3515 Allotment and withholdings of funds.
- § 35.3520 Systems, projects, and project-related costs eligible for assistance from the Fund.
- § 35.3525 Authorized types of assistance from the Fund.
- § 35.3530 Limitations on uses of the Fund.
- § 35.3535 Authorized set-aside activities.
- § 35.3540 Requirements for funding set-aside activities.
- § 35.3545 Capitalization grant agreement.
- § 35.3550 Specific capitalization grant agreement requirements.
- § 35.3555 Intended Use Plan (IUP).
- § 35.3560 General payment and cash draw rules.
- § 35.3565 Specific cash draw rules for authorized types of assistance from the Fund.
- § 35.3570 Reports and audits.
- § 35.3575 Application of Federal cross-cutting authorities (cross-cutters).
- § 35.3580 Environmental review requirements.
- § 35.3585 Compliance assurance procedures.

**Appendix A to Subpart L of Part 35**

Criteria for Evaluating a State's Proposed NEPA-Like Process

**Subpart L—Drinking Water State Revolving Funds**

**Authority:** Section 1452 of the Safe Drinking Water Act, as amended, 42 U.S.C. 300j-12.

**Source:** 65 FR 48299, Aug. 7, 2000, unless otherwise noted.

## § 35.3500 Purpose, policy, and applicability.

- (a) This subpart codifies and implements requirements for the national Drinking Water State Revolving Fund program under section 1452 of the Safe Drinking Water Act, as amended in 1996. It applies to States (*i.e.*, each of the 50 States and the Commonwealth of Puerto Rico) which receive capitalization grants and are authorized to establish a Fund under section 1452. The purpose of this subpart is to ensure that each State's program is designed and operated in such a manner as to further the public health protection objectives of the Safe Drinking Water Act, promote the efficient use of all funds, and ensure that the Fund corpus is available in perpetuity for providing financial assistance to public water systems.
- (b) This subpart supplements section 1452 of the Safe Drinking Water Act by codifying statutory and program requirements that were published in the Final Guidelines for the Drinking Water State Revolving Fund program (EPA 816-R-97-005) signed by the Assistant Administrator for Water on February 28, 1997, as well as in subsequent policies. This subpart also supplements EPA general assistance regulations in 2 CFR parts 200 and 1500 which contain administrative requirements that apply to governmental recipients of Environmental Protection Agency (EPA) grants and subgrants. EPA will not impose additional major program requirements without providing an opportunity for affected parties to comment.
- (c) EPA intends to implement the national Drinking Water State Revolving Fund program in a manner that preserves for States a high degree of flexibility to operate their programs in accordance with each State's unique needs and circumstances. To the maximum extent practicable, EPA also intends to administer the financial aspects of the national Drinking Water State Revolving Fund program in a manner that is consistent with the policies and procedures of the national Clean Water State Revolving Fund program established under Title VI of the Clean Water Act, as amended, 33 U.S.C. 1381-1387.

[65 FR 48299, Aug. 7, 2000, as amended at 79 FR 76057, Dec. 19, 2014]

## § 35.3505 Definitions.

The following definitions apply to terms used in this subpart:

**Act.** The Safe Drinking Water Act (Public Law 93-523), as amended in 1996 (Public Law 104-182). 42 U.S.C. 300f *et seq.*

**Administrator.** The Administrator of the EPA or an authorized representative.

**Allotment.** Amount available to a State from funds appropriated by Congress to carry out section 1452 of the Act.

**Automated Clearing House (ACH).** A Federal payment mechanism that transfers cash to recipients of Federal assistance using electronic transfers from the Treasury through the Federal Reserve System.

**Binding commitment.** A legal obligation by the State to an assistance recipient that defines the terms for assistance from the Fund.

**Capitalization grant.** An award by EPA of funds to a State for purposes of capitalizing that State's Fund and for other purposes authorized in section 1452 of the Act.

**Cash draw.** The transfer of cash from the Treasury through the ACH to the DWSRF program. Upon a State's request for a cash draw, the Treasury will transfer funds to the DWSRF program account established in the State's bank.

**CWSRF program.** Each State's clean water state revolving fund program authorized under Title VI of the Clean Water Act, as amended, 33 U.S.C. 1381-1387.

**Disadvantaged community.** The entire service area of a public water system that meets affordability criteria established by the State after public review and comment.

**Disbursement.** The transfer of cash from the DWSRF program account established in the State's bank to an assistance recipient.

**DWSRF program.** Each State's drinking water state revolving fund program authorized under section 1452 of the Act, as amended, 42 U.S.C. 300j-12. This term includes the Fund and set-asides.

**Fund.** A revolving account into which a State deposits DWSRF program funds (e.g., capitalization grants, State match, repayments, net bond proceeds, interest earnings, etc.) for the purposes of providing loans and other types of assistance for drinking water infrastructure projects.

**Intended Use Plan (IUP).** A document prepared annually by a State, after public review and comment, which identifies intended uses of all DWSRF program funds and describes how those uses support the overall goals of the DWSRF program.

**Net bond proceeds.** The funds raised from the sale of the bonds minus issuance costs (e.g., the underwriting discount, underwriter's legal counsel fees, bond counsel fee, and other costs incidental to the bond issuance).

**Payment.** An action taken by EPA to increase the amount of funds available for cash draw through the ACH. A payment is not a transfer of cash to the State, but an authorization by EPA to make capitalization grant funds available for transfer to a State after the State submits a cash draw request.

**Public water system.** A system as defined in 40 CFR 141.2. A public water system is either a "community water system" or a "noncommunity water system" as defined in 40 CFR 141.2.

**Regional Administrator (RA).** The Administrator of the appropriate Regional Office of the EPA or an authorized representative of the Regional Administrator.

**Set-asides.** State and local activities identified in sections 1452(g)(2) and (k) of the Act for which a portion of a capitalization grant may be used.

**Small system.** A public water system that regularly serves 10,000 or fewer persons.

**State.** Each of the 50 States and the Commonwealth of Puerto Rico, which receive capitalization grants and are authorized to establish a Fund under section 1452 of the Act.

### § 35.3510 Establishment of the DWSRF program.

- (a) **General.** To be eligible to receive a capitalization grant, a State must establish a Fund and comply with the other requirements of section 1452 of the Act and this subpart.
- (b) **Administration.** Capitalization grants must be awarded to an agency of the State that is authorized to enter into capitalization grant agreements with EPA, accept capitalization grant awards made under section 1452 of the Act, and otherwise manage the Fund in accordance with the requirements and objectives of the Act and this subpart. The State agency that is awarded the capitalization grant (*i.e.*, grantee) is accountable for the use of the funds provided in the capitalization grant agreement under 2 CFR part 200 and the EPA general assistance regulations in 2 CFR part 1500.

- (1) The authority to establish assistance priorities and to carry out oversight and related activities of the DWSRF program, other than financial administration of the Fund, must reside with the State agency having primary responsibility for administration of the State's public water system supervision (PWSS) program (*i.e.*, primacy) after consultation with other appropriate State agencies.
  - (2) If a State is eligible to receive a capitalization grant but does not have primacy, the Governor will determine which State agency will have the authority to establish priorities for financial assistance from the Fund. Evidence of the Governor's determination must be included with the capitalization grant application.
  - (3) If more than one State agency participates in implementation of the DWSRF program, the roles and responsibilities of each agency must be described in a Memorandum of Understanding or interagency agreement.
- (c) **Combined financial administration.** A State may combine the financial administration of the Fund with the financial administration of any other revolving fund established by the State if otherwise not prohibited by State law under which the Fund was established. A State must assure that all monies in the Fund, including capitalization grants, State match, net bond proceeds, loan repayments, and interest are separately accounted for and used solely for the purposes specified in section 1452 of the Act and this subpart. Funds available from the administration and technical assistance set-aside may not be used for combined financial administration of any other revolving fund.
- (d) **Use of funds.**
- (1) Assistance provided to a public water system from the DWSRF program may be used only for expenditures that will facilitate compliance with national primary drinking water regulations applicable under section 1412 or otherwise significantly further the public health protection objectives of the Act.
  - (2) The inability or failure of any public water system to receive assistance from the DWSRF program, or any delay in obtaining assistance, does not alter the obligation of the system to comply in a timely manner with all applicable drinking water standards and requirements of section 1452 of the Act.

[65 FR 48299, Aug. 7, 2000, as amended at 79 FR 76057, Dec. 19, 2014]

## § 35.3515 Allotment and withholdings of funds.

- (a) **Allotment —**
- (1) **General.** Each State will receive a minimum of one percent of the funds available for allotment to all of the States.
  - (2) **Allotment formula.** Funds available to States from fiscal year 1998 appropriations and subsequent appropriations are allotted according to a formula that reflects the infrastructure needs of public water systems identified in the most recent Needs Survey submitted in accordance with section 1452(h) of the Act.
  - (3) **Period of availability.** Funds are available for obligation to States during the fiscal year in which they are authorized and during the following fiscal year. The amount of any allotment not obligated to a State by EPA at the end of this period of availability will be reallocated to eligible States based on the formula originally used to allot these funds, except that the Administrator may reserve up to 10

percent of any funds available for reallocation to provide additional assistance to Indian Tribes. In order to be eligible to receive reallocated funds, a State must have been obligated all funds it is eligible to receive from EPA during the period of availability.

(4) **Loss of primacy.** The following provisions do not apply to any State that did not have primacy as of August 6, 1996:

- (i) A State may not receive a capitalization grant from allotments that have been made if the State had primacy and subsequently loses primacy.
- (ii) For a State that loses primacy, the Administrator may reserve funds from the State's allotment for use by EPA to administer primacy in that State. The balance of the funds not used by EPA to administer primacy will be reallocated to the other States.
- (iii) A State will be eligible for future allotments from funds appropriated in the next fiscal year after primacy is restored.

(b) **Withholdings** —

(1) **General.** EPA will withhold funds under each of the following provisions:

- (i) **Capacity development authority.** EPA will withhold 20 percent of a State's allotment from any State that has not obtained the legal authority or other means to ensure that all new community water systems and new nontransient, noncommunity water systems commencing operations after October 1, 1999, demonstrate technical, financial, and managerial capacity with respect to each national primary drinking water regulation in effect, or likely to be in effect, on the date of commencement of operations. The determination of withholding will be based on an assessment of the status of the State program as of October 1 of the fiscal year for which the funds were allotted.
- (ii) **Capacity development strategy.** EPA will withhold funds from any State unless the State is developing and implementing a strategy to assist public water systems in acquiring and maintaining technical, financial, and managerial capacity. The amount of a State's allotment that will be withheld is 10 percent for fiscal year 2001, 15 percent for fiscal year 2002, and 20 percent for each subsequent fiscal year. The determination of withholding will be based on an assessment of the status of the State strategy as of October 1 of the fiscal year for which the funds were allotted. Decisions of a State regarding any particular public water system as part of a capacity development strategy are not subject to review by EPA and may not serve as a basis for withholding funds.
- (iii) **Operator certification program.** Beginning on February 5, 2001, EPA will withhold 20 percent of a State's allotment unless the State has adopted and is implementing a program for certifying operators of community and nontransient, noncommunity public water systems that meets the requirements of section 1419 of the Act. The determination of withholding will be based on an assessment of the status of the State program for each fiscal year.

(2) **Maximum withholdings.** The maximum amount of funds that will be withheld if a State fails to meet the requirements of both the capacity development authority and the capacity development strategy provisions is 20 percent of the allotment in any fiscal year. The maximum amount of funds that will be withheld if a State fails to meet the requirements of the operator certification program provision and either the capacity development authority provision or the capacity development strategy provision is 40 percent of the allotment in any fiscal year.

- (3) **Reallocation of withheld funds.** The Administrator will reallocate withheld funds to eligible States based on the formula originally used to allocate these funds. In order to be eligible to receive reallocated funds under the withholding provisions, a State must have been obligated all funds it is eligible to receive from EPA during the period of availability. A State that has funds withheld under any one of the withholding provisions in paragraphs (b)(1)(i) through (b)(1)(iii) of this section is not eligible to receive reallocated funds made available by that provision.
- (4) **Termination of withholdings.** A withholding will cease to apply to funds appropriated in the next fiscal year after a State complies with the specific provision under which funds were withheld.

### § 35.3520 Systems, projects, and project-related costs eligible for assistance from the Fund.

- (a) **Eligible systems.** Assistance from the Fund may only be provided to:
  - (1) Privately-owned and publicly-owned community water systems and non-profit noncommunity water systems.
  - (2) Projects that will result in the creation of a community water system in accordance with paragraph (b)(2)(vi) of this section.
  - (3) Systems referred to in section 1401(4)(B) of the Act for the purposes of point of entry or central treatment under section 1401(4)(B)(i)(III).
- (b) **Eligible projects —**
  - (1) **General.** Projects that address present or prevent future violations of health-based drinking water standards are eligible for assistance. These include projects needed to maintain compliance with existing national primary drinking water regulations for contaminants with acute and chronic health effects. Projects to replace aging infrastructure are eligible for assistance if they are needed to maintain compliance or further the public health protection objectives of the Act.
  - (2) Only the following project categories are eligible for assistance from the Fund:
    - (i) **Treatment.** Examples of projects include installation or upgrade of facilities to improve the quality of drinking water to comply with primary or secondary standards and point of entry or central treatment under section 1401(4)(B)(i)(III) of the Act.
    - (ii) **Transmission and distribution.** Examples of projects include installation or replacement of transmission and distribution pipes to improve water pressure to safe levels or to prevent contamination caused by leaks or breaks in the pipes.
    - (iii) **Source.** Examples of projects include rehabilitation of wells or development of eligible sources to replace contaminated sources.
    - (iv) **Storage.** Examples of projects include installation or upgrade of eligible storage facilities, including finished water reservoirs, to prevent microbiological contaminants from entering a public water system.
    - (v) **Consolidation.** Eligible projects are those needed to consolidate water supplies where, for example, a supply has become contaminated or a system is unable to maintain compliance for technical, financial, or managerial reasons.
    - (vi) **Creation of new systems.** Eligible projects are those that, upon completion, will create a community water system to address existing public health problems with serious risks caused by unsafe drinking water provided by individual wells or surface water sources. Eligible projects

are also those that create a new regional community water system by consolidating existing systems that have technical, financial, or managerial difficulties. Projects to address existing public health problems associated with individual wells or surface water sources must be limited in scope to the specific geographic area affected by contamination. Projects that create new regional community water systems by consolidating existing systems must be limited in scope to the service area of the systems being consolidated. A project must be a cost-effective solution to addressing the problem. A State must ensure that the applicant has given sufficient public notice to potentially affected parties and has considered alternative solutions to addressing the problem. Capacity to serve future population growth cannot be a substantial portion of a project.

(c) **Eligible project-related costs.** In addition to costs needed for the project itself, the following project-related costs are eligible for assistance from the Fund:

- (1) Costs for planning and design and associated pre-project costs. A State that makes a loan for only planning and design is not required to provide assistance for completion of the project.
- (2) Costs for the acquisition of land only if needed for the purposes of locating eligible project components. The land must be acquired from a willing seller.
- (3) Costs for restructuring systems that are in significant noncompliance with any national primary drinking water regulation or variance or that lack the technical, financial, and managerial capability to ensure compliance with the requirements of the Act, unless the systems are ineligible under paragraph (d)(2) or (d)(3) of this section.

(d) **Ineligible systems.** Assistance from the Fund may not be provided to:

- (1) Federally-owned public water systems and for-profit noncommunity water systems.
- (2) Systems that lack the technical, financial, and managerial capability to ensure compliance with the requirements of the Act, unless the assistance will ensure compliance and the owners or operators of the systems agree to undertake feasible and appropriate changes in operations to ensure compliance over the long-term.
- (3) Systems that are in significant noncompliance with any national primary drinking water regulation or variance, unless:
  - (i) The purpose of the assistance is to address the cause of the significant noncompliance and will ensure that the systems return to compliance; or
  - (ii) The purpose of the assistance is unrelated to the cause of the significant noncompliance and the systems are on enforcement schedules (for maximum contaminant level and treatment technique violations) or have compliance plans (for monitoring and reporting violations) to return to compliance.

(e) **Ineligible projects.** The following projects are ineligible for assistance from the Fund:

- (1) Dams or rehabilitation of dams.
- (2) Water rights, except if the water rights are owned by a system that is being purchased through consolidation as part of a capacity development strategy.
- (3) Reservoirs or rehabilitation of reservoirs, except for finished water reservoirs and those reservoirs that are part of the treatment process and are on the property where the treatment facility is located.

- (4) Projects needed primarily for fire protection.
- (5) Projects needed primarily to serve future population growth. Projects must be sized only to accommodate a reasonable amount of population growth expected to occur over the useful life of the facility.
- (6) Projects that have received assistance from the national set-aside for Indian Tribes and Alaska Native Villages under section 1452(i) of the Act.
- (f) **Ineligible project-related costs.** The following project-related costs are ineligible for assistance from the Fund:
  - (1) Laboratory fees for routine compliance monitoring.
  - (2) Operation and maintenance expenses.

### § 35.3525 Authorized types of assistance from the Fund.

A State may only provide the following types of assistance from the Fund:

- (a) **Loans.**
  - (1) A State may make loans at or below the market interest rate, including zero interest rate loans. Loans may be awarded only if:
    - (i) An assistance recipient begins annual repayment of principal and interest no later than one year after project completion. A project is completed when operations are initiated or are capable of being initiated.
    - (ii) A recipient completes loan repayment no later than 20 years after project completion except as provided in paragraph (b)(3) of this section.
    - (iii) A recipient establishes a dedicated source of revenue for repayment of the loan which is consistent with local ordinances and State laws or, for privately-owned systems, a recipient demonstrates that there is adequate security to assure repayment of the loan.
  - (2) A State may include eligible project reimbursement costs within loans if:
    - (i) A system received approval, authorization to proceed, or any similar action by a State prior to initiation of project construction and the construction costs were incurred after such State action; and
    - (ii) The project met all of the requirements of this subpart and was on the State's fundable list, developed using a priority system approved by EPA. A project on the comprehensive list which is funded when a project on the fundable list is bypassed using the State's bypass procedures in accordance with § 35.3555(c)(2)(ii) may be eligible for reimbursement of costs incurred after the system has been informed that it will receive funding.
  - (3) A State may include eligible planning and design and other associated pre-project costs within loans regardless of when the costs were incurred.
  - (4) All payments of principal and interest on each loan must be credited to the Fund.

- (5) Of the total amount available for assistance from the Fund each year, a State must make at least 15 percent available solely for providing loan assistance to small systems, to the extent such funds can be obligated for eligible projects. A State that provides assistance in an amount that is greater than 15 percent of the available funds in one year may credit the excess toward the 15 percent requirement in future years.
- (6) A State may provide incremental assistance for a project (e.g., for a particularly large, expensive project) over a period of years.

(b) ***Assistance to disadvantaged communities.***

- (1) A State may provide loan subsidies (e.g., loans which include principal forgiveness, negative interest rate loans) to benefit communities meeting the State's definition of "disadvantaged" or which the State expects to become "disadvantaged" as a result of the project. Loan subsidies in the form of reduced interest rate loans that are at or above zero percent do not fall under the 30 percent allowance described in paragraph (b)(2) of this section.
- (2) A State may take an amount equal to no more than 30 percent of the amount of a particular fiscal year's capitalization grant to provide loan subsidies to disadvantaged communities. If a State does not take the entire 30 percent allowance associated with a particular fiscal year's capitalization grant, it cannot reserve the authority to take the remaining balance of the allowance from future capitalization grants. In addition, a State must:
  - (i) Indicate in the Intended Use Plan (IUP) the amount of the allowance it is taking for loan subsidies;
  - (ii) Commit capitalization grant and required State match dollars taken for loan subsidies in accordance with the binding commitment requirements in § 35.3550(e); and
  - (iii) Commit any other dollars (e.g., principal and interest repayments, investment earnings) taken for loan subsidies to projects over the same time period during which binding commitments are made for the capitalization grant from which the allowance was taken.
- (3) A State may extend the term for a loan to a disadvantaged community, provided that a recipient completes loan repayment no later than 30 years after project completion and the term of the loan does not exceed the expected design life of the project.

(c) ***Refinance or purchase of local debt obligations —***

- (1) ***General.*** A State may buy or refinance local debt obligations of municipal, intermunicipal, or interstate agencies where the debt obligation was incurred and the project was initiated after July 1, 1993. Projects must have met the eligibility requirements under section 1452 of the Act and this subpart to be eligible for refinancing. Privately-owned systems are not eligible for refinancing.
- (2) ***Multi-purpose debt.*** If the original debt for a project was in the form of a multi-purpose bond incurred for purposes in addition to eligible purposes under section 1452 of the Act and this subpart, a State may provide refinancing only for the eligible portion of the debt, not the entire debt.
- (3) ***Refinancing and State match.*** If a State has credited repayments of loans made under a pre-existing State loan program as part of its State match, the State cannot also refinance the projects under the DWSRF program. If the State has already counted certain projects toward its State match which it now wants to refinance, the State must provide replacement funds for the amounts previously credited as match.

- (d) **Purchase insurance or guarantee for local debt obligations.** A State may provide assistance by purchasing insurance or guaranteeing a local debt obligation to improve credit market access or to reduce interest rates. Assistance of this type is limited to local debt obligations that are undertaken to finance projects eligible for assistance under section 1452 of the Act and this subpart.
- (e) **Revenue or security for Fund debt obligations (leveraging).** A State may use Fund assets as a source of revenue or security for the payment of principal and interest on revenue or general obligation bonds issued by the State in order to increase the total amount of funds available for providing assistance. The net proceeds of the sale of the bonds must be deposited into the Fund and must be used for providing loans and other assistance to finance projects eligible under section 1452 of the Act and this subpart.

### § 35.3530 Limitations on uses of the Fund.

- (a) **Earn interest.** A State may earn interest on monies deposited into the Fund prior to disbursement of assistance (e.g., on reserve accounts used as security or guarantees). Monies deposited must not remain in the Fund primarily to earn interest. Amounts not required for current obligation or expenditure must be invested in interest bearing obligations.
- (b) **Program administration.** A State may not use monies deposited into the Fund to cover its program administration costs. In addition to using the funds available from the administration and technical assistance set-aside under § 35.3535(b), a State may use the following methods to cover its program administration and other program costs.
  - (1) A State may use the proceeds of bonds guaranteed by the Fund to absorb expenses incurred issuing the bonds. The net proceeds of the bonds must be deposited into the Fund.
  - (2) A State may assess fees on an assistance recipient which are paid directly by the recipient and are not included as principal in a loan as allowed in paragraph (b)(3) of this section. These fees, which include interest earned on fees, must be deposited into the Fund or into an account outside of the Fund. If the fees are deposited into the Fund, they are subject to the authorized uses of the Fund. If the fees are deposited into an account outside of the Fund, they must be used for program administration, other purposes for which capitalization grants can be awarded under section 1452, State match under sections 1452(e) and (g)(2) of the Act, or combined financial administration of the DWSRF program and CWSRF program Funds where the programs are administered by the same State agency.
  - (3) A State may assess fees on an assistance recipient which are included as principal in a loan. These fees, which include interest earned on fees, must be deposited into the Fund or into an account outside of the Fund. If the fees are deposited into the Fund, they are subject to the authorized uses of the Fund. If the fees are deposited into an account outside of the Fund, they must be used for program administration or other purposes for which capitalization grants can be awarded under section 1452. Fees included as principal in a loan cannot be used for State match under sections 1452(e) and (g)(2) of the Act or combined financial administration of the DWSRF program and CWSRF program Funds. Additionally, fees included as principal in a loan:
    - (i) Cannot be assessed on a disadvantaged community which receives a loan subsidy provided from the 30 percent allowance in § 35.3525(b)(2);
    - (ii) Cannot cause the effective rate of a loan (which includes both interest and fees) to exceed the market rate; and

- (iii) Cannot be assessed if the effective rate of a loan could reasonably be expected to cause a system to fail to meet the technical, financial, and managerial capability requirements under section 1452 of the Act.

(c) **Transfers.** The Governor of a State, or a State official acting pursuant to authorization from the Governor, may transfer an amount equal to 33 percent of a fiscal year's DWSRF program capitalization grant to the CWSRF program or an equivalent amount from the CWSRF program to the DWSRF program. The following conditions apply:

(1) When a State initially decides to transfer funds:

- (i) The State's Attorney General, or someone designated by the Attorney General, must sign or concur in a certification for the DWSRF program and the CWSRF program that State law permits the State to transfer funds; and
- (ii) The Operating Agreements or other parts of the capitalization grant agreements for the DWSRF program and the CWSRF program must be amended to detail the method the State will use to transfer funds.

(2) A State may not use the transfer provision to acquire State match for either program or use transferred funds to secure or repay State match bonds.

(3) Funds may be transferred after one year has elapsed since a State established its Fund (*i.e.*, one year after the State has received its first DWSRF program capitalization grant for projects), and may include an amount equal to the allowance associated with its fiscal year 1997 capitalization grant.

(4) A State may reserve the authority to transfer funds in future years.

(5) Funds may be transferred on a net basis between the DWSRF program and CWSRF program, provided that the 33 percent transfer allowance associated with DWSRF program capitalization grants received is not exceeded.

(6) Funds may not be transferred or reserved after September 30, 2001.

(d) **Cross-collateralization.** A State may combine the Fund assets of the DWSRF program and CWSRF program as security for bond issues to enhance the lending capacity of one or both of the programs. The following conditions apply:

(1) When a State initially decides to cross-collateralize:

- (i) The State's Attorney General, or someone designated by the Attorney General, must sign or concur in a certification for the DWSRF program and the CWSRF program that State law permits the State to cross-collateralize the Fund assets of the DWSRF program and CWSRF program; and
- (ii) The Operating Agreements or other parts of the capitalization grant agreements for the DWSRF program and the CWSRF program must be amended to detail the method the State will use to cross-collateralize.

(2) The proceeds generated by the issuance of bonds must be allocated to the purposes of the DWSRF program and CWSRF program in the same proportion as the assets from the Funds that are used as security for the bonds. A State must demonstrate at the time of bond issuance that the

proportionality requirements have been or will be met. If a default should occur, and the Fund assets from one program are used for debt service in the other program to cure the default, the security would no longer need to be proportional.

- (3) A State may not combine the Fund assets of the DWSRF program and the CWSRF program as security for bond issues to acquire State match for either program or use the assets of one program to secure match bonds for the other program.
- (4) The debt service reserves for the DWSRF program and the CWSRF program must be accounted for separately.
- (5) Loan repayments must be made to the respective program from which the loan was made.

### § 35.3535 Authorized set-aside activities.

(a) **General.**

- (1) A State may use a portion of its capitalization grants for the set-aside categories described in paragraphs (b) through (e) of this section, provided that the amount of set-aside funding does not exceed the ceilings specified in this section.
- (2) A State may not use set-aside funds for those projects or project-related costs listed in § 35.3520(b), (c), (e), and (f), with the following exceptions:
  - (i) Project planning and design costs for small systems; and
  - (ii) Costs for restructuring a system as part of a capacity development strategy.

(b) **Administration and technical assistance.** A State may use up to 4 percent of its allotment to cover the reasonable costs of administering the DWSRF program and to provide technical assistance to public water systems.

(c) **Small systems technical assistance.** A State may use up to 2 percent of its allotment to provide technical assistance to small systems. A State may use these funds for activities such as supporting a State technical assistance team or contracting with outside organizations or other parties to provide technical assistance to small systems.

(d) **State program management.** A State may use up to 10 percent of its allotment for State program management activities.

- (1) This set-aside may only be used for the following activities:
  - (i) To administer the State PWSS program;
  - (ii) To administer or provide technical assistance through source water protection programs (including a Class V Underground Injection Control Program), except for enforcement actions;
  - (iii) To develop and implement a capacity development strategy; and
  - (iv) To develop and implement an operator certification program.
- (2) Match requirement. A State must provide a dollar for dollar match for expenditures made under this set-aside.
  - (i) The match must be provided at the time of the capitalization grant award or in the same year that funds for this set-aside are expected to be expended in accordance with a workplan approved by EPA.

- (ii) A State is authorized to use the amount of State funds it expended on its PWSS program in fiscal year 1993 (including PWSS match) as a credit toward meeting its match requirement. The value of this credit can be up to, but not greater than, 50 percent of the amount of match that is required. After determining the value of the credit that it is eligible to receive, a State must provide the additional funds necessary to meet the remainder of the match requirement. The source of these additional funds can be State funds (excluding PWSS match) or documented in-kind services.

(e) **Local assistance and other State programs.** A State may use up to 15 percent of its capitalization grant to assist in the development and implementation of local drinking water protection initiatives and other State programs. No more than 10 percent of the capitalization grant amount can be used for any one authorized activity.

(1) This set-aside may only be used for the following activities:

- (i) A State may provide assistance only in the form of loans to community water systems and non-profit noncommunity water systems to acquire land or conservation easements from willing sellers or grantors. A system must demonstrate how the purchase of land or easements will protect the source water of the system from contamination and ensure compliance with national primary drinking water regulations. A State must develop a priority setting process for determining what parcels of land or easements to purchase or use an established priority setting process that meets the same goals. A State must seek public review and comment on its priority setting process and must identify the systems that received loans and include a description of the specific parcels of land or easements purchased in the Biennial Report.
- (ii) A State may provide assistance only in the form of loans to community water systems to assist in implementing voluntary, incentive-based source water protection measures in areas delineated under a source water assessment program under section 1453 of the Act and for source water petitions under section 1454 of the Act. A State must develop a list of systems that may receive loans, giving priority to activities that facilitate compliance with national primary drinking water regulations applicable to the systems or otherwise significantly further the health protection objectives of the Act. A State must seek public review and comment on its priority setting process and its list of systems that may receive loans.
- (iii) A State may make expenditures to establish and implement wellhead protection programs under section 1428 of the Act.
- (iv) A State may provide assistance, including technical and financial assistance, to public water systems as part of a capacity development strategy under section 1420(c) of the Act.
- (v) A State may make expenditures from its fiscal year 1997 capitalization grant to delineate and assess source water protection areas for public water systems under section 1453 of the Act. Assessments include the identification of potential sources of contamination within the delineated areas. These assessment activities are limited to the identification of contaminants regulated under the Act or unregulated contaminants that a State determines may pose a threat to public health. A State must obligate funds within 4 years of receiving its fiscal year 1997 capitalization grant.

(2) A State may make loans under this set-aside only if an assistance recipient begins annual repayment of principal and interest no later than one year after completion of the activity and completes loan repayment no later than 20 years after completion of the activity. A State must deposit repayments

into the Fund or into a separate account dedicated for this set-aside. The separate account is subject to the same management oversight requirements as the Fund. Amounts deposited into the Fund are subject to the authorized uses of the Fund.

### § 35.3540 Requirements for funding set-aside activities.

- (a) **General.** If a State makes a grant or enters into a cooperative agreement with an assistance recipient to conduct set-aside activities, the recipient must comply with 2 CFR part 200 and the EPA general assistance regulations in 2 CFR part 1500.
- (b) **Set-aside accounts.** A State must maintain separate and identifiable accounts for the portion of its capitalization grant to be used for set-aside activities.
- (c) **Workplans —**
  - (1) **General.** A State must submit detailed annual or multi-year workplans to EPA for approval describing how set-aside funds will be expended. For the administration and technical assistance set-aside under § 35.3535(b), the State is only required to submit a workplan describing how it will expend funds needed to provide technical assistance to public water systems. In order to ensure that funds are expended efficiently, multi-year workplan terms negotiated with EPA must be less than four years, unless a longer term is approved by EPA.
  - (2) **Submitting workplans.** A State must submit workplans in accordance with a schedule negotiated with EPA. If a schedule has not been negotiated, the State must submit workplans no later than 90 days after the capitalization grant award. If a State does not meet the deadline for submitting its workplans, the set-aside funds that were required to be described in the workplans must be transferred to the Fund to be used for projects.
  - (3) **Content.** Workplans must at a minimum include:
    - (i) The annual funding amount in dollars and as a percentage of the State allotment or capitalization grant;
    - (ii) The projected number of work years needed for implementing each set-aside activity;
    - (iii) The goals and objectives, outputs, and deliverables for each set-aside activity;
    - (iv) A schedule for completing activities under each set-aside activity;
    - (v) Identification and responsibilities of the agencies involved in implementing each set-aside activity, including activities proposed to be conducted by a third party; and
    - (vi) A description of the evaluation process to assess the success of work funded under each set-aside activity.
  - (4) **Amending workplans.** If a State changes the scope of work from what was originally described in its workplans, it must amend the workplans and submit them to EPA for approval.
- (d) **Reserving set-aside funds.**
  - (1) A State may reserve set-aside funds from a capitalization grant and expend them over a period of time, provided that the State identifies the amount of funds reserved in the IUP and describes the use of the funds in workplans approved by EPA. For the administration and technical assistance set-aside under § 35.3535(b), the State is only required to submit a workplan to reserve funds needed to provide technical assistance to public water systems.

- (2) With the exception of the local assistance and other State programs set-aside under § 35.3535(e), a State may reserve the authority to take from future capitalization grants those set-aside funds that it has not included in workplans. The State must identify in the IUP the amount of authority reserved from a capitalization grant for future use.

(e) ***Fund and set-aside account transfers.***

- (1) A State may transfer funds among set-aside categories described in § 35.3535(b) through (e) and among activities within these categories, provided that set-aside ceilings are not exceeded.
- (2) A State may transfer funds between the Fund and set-asides, provided that set-aside ceilings are not exceeded. Set-aside funds may be transferred at any time to the Fund. If a State has taken payment for the set-aside funds to be transferred to the Fund, it must make binding commitments for these funds within one year of the transfer. Monies intended for the Fund may be transferred to set-asides only if the State has not yet taken a payment that includes those funds to be transferred in accordance with the payment schedule negotiated with EPA.
- (3) The capitalization grant agreement must be amended prior to any transfer among the set-aside categories or any transfer between the Fund and set-asides.

[65 FR 48299, Aug. 7, 2000, as amended at 79 FR 76057, Dec. 19, 2014]

**§ 35.3545 Capitalization grant agreement.**

- (a) **General.** A State must submit a capitalization grant application to EPA in order to receive a capitalization grant award. Approval of an application results in EPA and the State entering into a capitalization grant agreement which is the principal instrument by which the State commits to manage the DWSRF program in accordance with the requirements of section 1452 of the Act and this subpart.
- (b) **Content.** In addition to the items listed in paragraphs (c) through (f) of this section, the capitalization grant agreement must contain or incorporate by reference the Application for Federal Assistance (EPA Form 424) and other related forms, IUP, negotiated payment schedule, State environmental review process (SERP), demonstrations of the specific capitalization grant agreement requirements listed in § 35.3550, and other documentation required by the Regional Administrator (RA). The capitalization grant agreement must also define the types of performance measures, reporting requirements, and oversight responsibilities that will be required to determine compliance with section 1452 of the Act.
- (c) **Operating agreement.** At the option of a State, the framework and procedures of the DWSRF program that are not expected to change annually may be described in an Operating Agreement. The Operating Agreement may be amended if the State negotiates the changes with EPA.
- (d) **Attorney General certification.** With the capitalization grant application, the State's Attorney General, or someone designated by the Attorney General, must sign or concur in a certification that:
  - (1) The authority establishing the DWSRF program and the powers it confers are consistent with State law;
  - (2) The State may legally bind itself to the proposed terms of the capitalization grant agreement; and
  - (3) An agency of the State is authorized to enter into capitalization grant agreements with EPA, accept capitalization grant awards made under section 1452 of the Act, and otherwise manage the Fund in accordance with the requirements and objectives of the Act and this subpart.

- (e) **Roles and responsibilities of agencies.** If more than one State agency participates in the implementation of the DWSRF program, the State must describe the roles and responsibilities of each agency in the capitalization grant application and include a Memorandum of Understanding or interagency agreement describing these roles and responsibilities.
- (f) **Process for evaluating capability and compliance.** A State must include in the capitalization grant application a description of the following:
  - (1) The process it will use to assess the technical, financial, and managerial capability of all systems requesting assistance to ensure that the systems are in compliance with the requirements of the Act.
  - (2) If a State provides assistance to systems that lack technical, financial, and managerial capability, the process it will use to ensure that the systems undertake feasible and appropriate changes in operations to comply with the requirements of the Act over the long-term.
  - (3) If a State provides assistance to systems in significant noncompliance with any national primary drinking water regulation or variance, the process it will use to ensure that the systems return to compliance.

### § 35.3550 Specific capitalization grant agreement requirements.

- (a) **General.** A State must agree to comply with this subpart, 2 CFR part 200, the EPA general assistance regulations in 2 CFR part 1500 and the specific conditions of the grant. A State must also agree to the following requirements and, in some cases, provide documentation as part of the capitalization grant application.
- (b) **Comply with State statutes and regulations.** A State must agree to comply with all State statutes and regulations that are applicable to DWSRF program funds including capitalization grant funds, State match, interest earnings, net bond proceeds, repayments, and funds used for set-aside activities.
- (c) **Demonstrate technical capability.** A State must agree to provide documentation demonstrating that it has adequate personnel and resources to establish and manage the DWSRF program.
- (d) **Accept payments.** A State must agree to accept capitalization grant payments in accordance with a payment schedule negotiated between EPA and the State.
- (e) **Make binding commitments.** A State must agree to enter into binding commitments with assistance recipients to provide assistance from the Fund.
  - (1) Binding commitments must be made in an amount equal to the amount of each capitalization grant payment and accompanying State match that is deposited into the Fund and must be made within one year after the receipt of each grant payment.
  - (2) A State may make binding commitments for more than the required amount and credit the excess towards the binding commitment requirements of subsequent grant payments.
  - (3) If a State is concerned about its ability to comply with the binding commitment requirement, it must notify the RA and propose a revised payment schedule for future grant payments.
- (f) **Deposit of funds.** A State must agree to promptly deposit DWSRF program funds into appropriate accounts.
  - (1) A State must agree to deposit the portion of the capitalization grant to be used for projects into the Fund.

- (2) A State must agree to maintain separate and identifiable accounts for the portion of the capitalization grant to be used for set-aside activities.
  - (3) A State must agree to deposit net bond proceeds, interest earnings, and repayments into the Fund.
  - (4) A State must agree to deposit any fees, which include interest earned on fees, into the Fund or into separate and identifiable accounts.
- (g) **Provide State match.** A State must agree to deposit into the Fund an amount from State monies that equals at least 20 percent of each capitalization grant payment.
- (1) A State must identify the source of State match in the capitalization grant application.
  - (2) A State must deposit the match into the Fund on or before the date that a State receives each payment for the capitalization grant, except when a State chooses to use a letter of credit (LOC) mechanism or similar financial arrangement for the State match. Under this mechanism, payments to this LOC account must be made proportionally on the same schedule as the payments for the capitalization grant. Cash from this State match LOC account must be drawn into the Fund as cash is drawn into the Fund through the Automated Clearing House (ACH).
  - (3) A State may issue general obligation or revenue bonds to derive the State match. The net proceeds from the bonds issued by a State to derive the match must be deposited into the Fund and the bonds may only be retired using the interest portion of loan repayments and interest earnings of the Fund. Loan principal must not be used to retire State match bonds.
  - (4) If the State deposited State monies in a dedicated revolving fund after July 1, 1993, and prior to receiving a capitalization grant, the State may credit these monies toward the match requirement if:
    - (i) The monies were deposited in a separate revolving fund that subsequently became the Fund after receiving a capitalization grant and they were expended in accordance with section 1452 of the Act;
    - (ii) The monies were deposited in a separate revolving fund that has not received a capitalization grant, they were expended in accordance with section 1452 of the Act, and an amount equal to all repayments of principal and payments of interest from loans will be deposited into the Fund; or
    - (iii) The monies were deposited in a separate revolving fund and used as a reserve for a leveraged program consistent with section 1452 of the Act and an amount equal to the reserve is transferred to the Fund as the reserve's function is satisfied.
  - (5) If a State provides a match in excess of the required amount, the excess balance may be credited towards match requirements associated with subsequent capitalization grants.
- (h) **Provide match for State program management set-aside.** A State must agree to provide a dollar for dollar match for expenditures made under the State program management set-aside in accordance with § 35.3535(d)(2). This match is separate from the 20 percent State match requirement for the capitalization grant in paragraph (g) of this section and must be identified as an eligible credit, deposited into set-aside accounts, or documented as in-kind services.

- (i) **Use generally accepted accounting principles.** A State must agree to ensure that the State and public water systems receiving assistance will use accounting, audit, and fiscal procedures conforming to Generally Accepted Accounting Principles (GAAP) as promulgated by the Governmental Accounting Standards Board or, in the case of privately-owned systems, the Financial Accounting Standards Board. The accounting system used for the DWSRF program must allow for proper measurement of:
  - (1) Revenues earned and other receipts, including but not limited to, loan repayments, capitalization grants, interest earnings, State match deposits, and net bond proceeds;
  - (2) Expenses incurred and other disbursements, including but not limited to, loan disbursements, repayment of bonds, and other expenditures allowed under section 1452 of the Act; and
  - (3) Assets, liabilities, capital contributions, and retained earnings.
- (j) **Conduct audits.** In accordance with § 35.3570(b), a State must agree to comply with the provisions of the Single Audit Act Amendments of 1996. A State may voluntarily agree to conduct annual independent audits.
- (k) **Dedicated repayment source.** A State must agree to adopt policies and procedures to assure that assistance recipients have a dedicated source of revenue for repayment of loans, or in the case of privately-owned systems, assure that recipients demonstrate that there is adequate security to assure repayment of loans.
- (l) **Efficient expenditure.** A State must agree to commit and expend all funds as efficiently as possible and in an expeditious and timely manner.
- (m) **Use funds in accordance with IUP.** A State must agree to use all funds in accordance with an IUP that was prepared after providing for public review and comment.
- (n) **Biennial report.** A State must agree to complete and submit a Biennial Report that describes how it has met the goals and objectives of the previous two fiscal years as stated in the IUPs and capitalization grant agreements. The State must submit this report to the RA according to the schedule established in the capitalization grant agreement.
- (o) **Comply with cross-cutters.** A State must agree to comply with all applicable Federal cross-cutting authorities.
- (p) **Comply with provisions to avoid withholdings.** A State must agree to demonstrate how it is complying with the requirements of capacity development authority, capacity development strategy, and operator certification program provisions in order to avoid withholdings of funds under § 35.3515(b)(1)(i) through (b)(1)(iii).

[65 FR 48299, Aug. 7, 2000, as amended at 79 FR 76057, Dec. 19, 2014]

### § 35.3555 Intended Use Plan (IUP).

- (a) **General.** A State must prepare an annual IUP which describes how it intends to use DWSRF program funds to support the overall goals of the DWSRF program and contains the information outlined in paragraph (c) of this section. In those years in which a State submits a capitalization grant application, EPA must receive an IUP prior to the award of the capitalization grant. A State must prepare an annual IUP as long as the Fund or set-aside accounts remain in operation. The IUP must conform to the fiscal year adopted by the State for the DWSRF program (e.g., the State's fiscal year or the Federal fiscal year).

- (b) **Public review requirements.** A State must seek meaningful public review and comment during the development of the IUP. A State must include a description of the public review process and an explanation of how it responded to major comments and concerns. If a State prepares separate IUPs (one for Fund monies and one for set-aside monies), the State must seek public review and comment during the development of each IUP.
- (c) **Content.** Information in the IUP must be provided in a format and manner that is consistent with the needs of the RA.
  - (1) **Priority system.** The IUP must include a priority system for ranking individual projects for funding that provides sufficient detail for the public and EPA to readily understand the criteria used for ranking. The priority system must provide, to the maximum extent practicable, that priority for the use of funds will be given to projects that: address the most serious risk to human health; are necessary to ensure compliance with the requirements of the Act (including requirements for filtration); and assist systems most in need, on a per household basis, according to State affordability criteria. A State that does not adhere to the three criteria must demonstrate why it is unable to do so.
  - (2) **Priority lists of projects.** All projects, with the exception of projects funded on an emergency basis, must be ranked using a State's priority system and go through a public review process prior to receiving assistance.
    - (i) The IUP must contain a fundable list of projects that are expected to receive assistance from available funds designated for use in the current IUP and a comprehensive list of projects that are expected to receive assistance in the future. The fundable list of projects must include: the name of the public water system; the priority assigned to the project; a description of the project; the expected terms of financial assistance based on the best information available at the time the IUP is developed; and the population of the system's service area at the time of the loan application. The comprehensive list must include, at a minimum, the priority assigned to each project and, to the extent known, the expected funding schedule for each project. A State may combine the fundable and comprehensive lists into one list, provided that projects which are expected to receive assistance from available funds designated for use in the current IUP are identified.
    - (ii) The IUP may include procedures which would allow a State to bypass projects on the fundable list. The procedures must clearly identify the conditions which would allow a project to be bypassed and the method for identifying which projects would receive funding. If a bypass occurs, a State must fund the highest ranked project on the comprehensive list that is ready to proceed. If a State elects to bypass a project for reasons other than readiness to proceed, the State must explain why the project was bypassed in the Biennial Report and during the annual review. To the maximum extent practicable, a State must work with bypassed projects to ensure that they will be prepared to receive funding in future years.
    - (iii) The IUP may allow for the funding of projects which require immediate attention to protect public health on an emergency basis, provided that a State defines what conditions constitute an emergency and identifies the projects in the Biennial Report and during the annual review.
    - (iv) The IUP must demonstrate how a State will meet the requirement of providing loan assistance to small systems as described in § 35.3525(a)(5). A State that is unable to comply with this requirement must describe the steps it is taking to ensure that a sufficient number of projects are identified to meet this requirement in future years.

- (3) **Distribution of funds.** The IUP must describe the criteria and methods that a State will use to distribute all funds including:
  - (i) The process and rationale for distribution of funds between the Fund and set-aside accounts;
  - (ii) The process for selection of systems to receive assistance;
  - (iii) The rationale for providing different types of assistance and terms, including the method used to determine the market rate and the interest rate;
  - (iv) The types, rates, and uses of fees assessed on assistance recipients; and
  - (v) A description of the financial planning process undertaken for the Fund and the impact of funding decisions on the long-term financial health of the Fund.
- (4) **Financial status.** The IUP must describe the sources and uses of DWSRF program funds including: the total dollar amount in the Fund; the total dollar amount available for loans, including loans to small systems; the amount of loan subsidies that may be made available to disadvantaged communities from the 30 percent allowance in § 35.3525(b)(2); the total dollar amount in set-aside accounts, including the amount of funds or authority reserved; and the total dollar amount in fee accounts.
- (5) **Short- and long-term goals.** The IUP must describe the short-term and long-term goals it has developed to support the overall goals of the DWSRF program of ensuring public health protection, complying with the Act, ensuring affordable drinking water, and maintaining the long-term financial health of the Fund.
- (6) **Set-aside activities.**
  - (i) The IUP must identify the amount of funds a State is electing to use for set-aside activities. A State must also describe how it intends to use these funds, provide a general schedule for their use, and describe the expected accomplishments that will result from their use.
  - (ii) For loans made in accordance with the local assistance and other State programs set-aside under § 35.3535(e)(1)(i) and (e)(1)(ii), the IUP must, at a minimum, describe the process by which recipients will be selected and how funds will be distributed among them.
- (7) **Disadvantaged community assistance.** The IUP must describe how a State's disadvantaged community program will operate including:
  - (i) The State's definition of what constitutes a disadvantaged community;
  - (ii) A description of affordability criteria used to determine the amount of disadvantaged assistance;
  - (iii) The amount and type of loan subsidies that may be made available to disadvantaged communities from the 30 percent allowance in § 35.3525(b)(2); and
  - (iv) To the maximum extent practicable, an identification of projects that will receive disadvantaged assistance and the respective amounts.
- (8) **Transfer process.** If a State decides to transfer funds between the DWSRF program and CWSRF program, the IUPs for the DWSRF program and the CWSRF program must describe the process including:
  - (i) The total amount and type of funds being transferred during the period covered by the IUP;

- (ii) The total amount of authority being reserved for future transfer, including the authority reserved from previous years; and
  - (iii) The impact of the transfer on the amount of funds available to finance projects and set-asides and the long-term impact on the Fund.
- (9) **Cross-collateralization process.** If a State decides to cross-collateralize Fund assets of the DWSRF program and CWSRF program, the IUPs for the DWSRF program and the CWSRF program must describe the process including:
  - (i) The type of monies which will be used as security;
  - (ii) How monies will be used in the event of a default; and
  - (iii) Whether or not monies used for a default in the other program will be repaid, and if they will not be repaid, what will be the cumulative impact on the Funds.
- (d) **Amending the IUP.** The priority lists of projects may be amended during the year under provisions established in the IUP as long as additions or other substantive changes to the lists, except projects funded on an emergency basis, go through a public review process. A State may change the use of funds from what was originally described in the IUP as long as substantive changes go through a public review process.

#### § 35.3560 General payment and cash draw rules.

- (a) **Payment schedule.** A State will receive each capitalization grant payment in the form of an increase to the ceiling of funds available through the ACH, made in accordance with a payment schedule negotiated between EPA and the State. A payment schedule that is based on a State's projection of binding commitments and use of set-aside funds as stated in the IUP must be included in the capitalization grant agreement. Changes to the payment schedule must be made through an amendment to the grant agreement.
- (b) **Timing of payments.** All payments to a State will be made by the earlier of 8 quarters after the capitalization grant is awarded or 12 quarters after funds are allotted to a State.
- (c) **Funds available for cash draw.** Cash draws will be available only up to the amount of payments that have been made to a State.
- (d) **Estimated cash draw schedule.** On a schedule negotiated with EPA, a State must provide EPA with a quarterly schedule of estimated cash draws for the Federal fiscal year. The State must notify EPA when significant changes from the estimated cash draw schedule are anticipated. This schedule must be developed to conform with the procedures applicable to cash draws and must have sufficient detail to allow EPA and the State to jointly develop and maintain a forecast of cash draws.
- (e) **Cash draw for set-asides.** A State may draw cash through the ACH for the full amount of costs incurred for set-aside expenditures based on EPA approved workplans. A State may draw cash in advance to ensure funds are available to meet State payroll expenses. However, cash should be drawn no sooner than necessary to meet immediate payroll disbursement needs.
- (f) **Cash draw for Fund.** A State may draw cash through the ACH for the proportionate Federal share of eligible incurred project costs. A State need not have disbursed funds for incurred project costs prior to drawing cash. A State may not draw cash for a particular project until the State has executed a loan agreement for that project.

(g) **Calculation of proportionate Federal share —**

- (1) **General.** The proportionate Federal share is equal to the Federal monies intended for the Fund (capitalization grant minus set-asides) divided by the total amount of monies intended for the Fund (capitalization grant minus set-asides plus required State match). A State may calculate the proportionate Federal share on a rolling average basis or on a grant by grant basis.
- (2) **State overmatch.**
  - (i) The proportionate Federal share does not change if a State is providing funds in excess of the required State match.
  - (ii) Federal monies may be drawn at a rate that is greater than that determined by the proportionate Federal share calculation when a State is given credit toward its match amount as a result of funding projects in prior years (but after July 1, 1993), or for crediting excess match in the Fund in prior years and disbursing these amounts prior to drawing cash. If the entire amount of a State's required match has been disbursed in advance, the proportionate Federal share of cash draws would be 100 percent.

**§ 35.3565 Specific cash draw rules for authorized types of assistance from the Fund.**

A State may draw cash for the authorized types of assistance from the Fund described in § 35.3525 according to the following rules:

(a) **Loans —**

- (1) **Eligible project costs.** A State may draw cash based on the proportionate Federal share of incurred project costs. In the case of incurred planning and design and associated pre-project costs, cash may be drawn immediately upon execution of the loan agreement.
- (2) **Eligible project reimbursement costs.** A State may draw cash to reimburse assistance recipients for eligible project costs at a rate no greater than equal amounts over the maximum number of quarters that capitalization grant payments are made. A State may immediately draw cash for up to 5 percent of each fiscal year's capitalization grant or 2 million dollars, whichever is greater, to reimburse project costs.

(b) **Refinance or purchase of local debt obligations —**

- (1) **Completed projects.** A State may draw cash up to the portion of the capitalization grant committed to the refinancing or purchase of local debt obligations of municipal, intermunicipal, or interstate agencies at a rate no greater than equal amounts over the maximum number of quarters that capitalization grant payments are made. A State may immediately draw cash for up to 5 percent of each fiscal year's capitalization grant or 2 million dollars, whichever is greater, to refinance or purchase local debt.
- (2) **Portions of projects not completed.** A State may draw cash based on the proportionate Federal share of incurred project costs according to the rule for loans in paragraph (a)(1) of this section.
- (3) **Purchase of incremental disbursement bonds from local governments.** A State may draw cash based on a schedule that coincides with the rate at which costs are expected to be incurred for the project.

- (c) **Purchase insurance for local debt obligations.** A State may draw cash for the proportionate Federal share of insurance premiums as they are due.

(d) **Guarantee for local debt obligations** —

- (1) **In the event of default.** In the event of imminent default in debt service payments on a guaranteed local debt, a State may draw cash immediately up to the total amount of the capitalization grant that is dedicated for the guarantee. If a balance remains after the default is satisfied, the State must negotiate a revised cash draw schedule for the remaining amount dedicated for the guarantee.
- (2) **In the absence of default.** A State may draw cash up to the amount of the capitalization grant dedicated for the guarantee based on actual incurred project costs. The amount of the cash draw would be based on the proportionate Federal share of incurred project costs multiplied by the ratio of the guarantee reserve to the amount guaranteed.

(e) **Revenue or security for Fund debt obligations (leveraging)** —

- (1) **In the event of default.** In the event of imminent default in debt service payments on a secured debt, a State may draw cash immediately up to the total amount of the capitalization grant that is dedicated for the security. If a balance remains after the default is satisfied, the State must negotiate a revised schedule for the remaining amount dedicated for the security.
- (2) **In the absence of default.** A State may draw cash up to the amount of the capitalization grant dedicated for the security using either of the following methods:
  - (i) **All projects method.** A State may draw cash based on the incurred project costs multiplied by the ratio of the Federal portion of the reserve to the total reserve multiplied by the ratio of the total reserve to the net bond proceeds.
  - (ii) **Group of projects method.** A State may identify a group of projects whose cost is approximately equal to the total of that portion of the capitalization grant and the State match dedicated as a security. The State may then draw cash based on the incurred costs of the selected projects only, multiplied by the ratio of the Federal portion of the security to the entire security.
- (3) **Aggressive leveraging.** Where the cash draw rules in paragraphs (e)(1) and (e)(2) of this section would significantly frustrate a State's leveraged program, EPA may permit an exception to these cash draw rules and provide for a more accelerated cash draw. A State must demonstrate that:
  - (i) There are eligible projects ready to proceed in the immediate future with enough costs to justify the amount of the secured bond issue;
  - (ii) The absence of cash on an accelerated basis will substantially delay these projects;
  - (iii) The Fund will provide substantially more assistance if accelerated cash draws are allowed; and
  - (iv) The long-term viability of the State program to meet drinking water needs will be protected.

(f) **Loans to privately-owned systems.** In cases where State monies cannot be used to provide loans to privately-owned systems, a State may draw 100 percent Federal monies for costs incurred by privately-owned systems. When Federal monies are drawn for incurred costs, the State must deposit or have previously deposited into the Fund the required match associated with the amount of cash drawn. Every 18 months, the State must submit documentation showing that it has met its proportionate Federal share within the last 6 months. If a State is unable to document that it has met its proportionate Federal share, State match deposited into the Fund must be expended before Federal monies are drawn for costs incurred by publicly-owned systems until the State meets its proportionate Federal share.

## § 35.3570 Reports and audits.

### (a) *Biennial report* —

- (1) **General.** A State must submit a Biennial Report to the RA describing how it has met the goals and objectives of the previous two fiscal years as stated in the IUPs and capitalization grant agreements, including the most recent audit of the Fund and the entire State allotment. The State must submit this report to the RA according to the schedule established in the capitalization grant agreement. Information provided in the Biennial Report on other EPA programs eligible for assistance from the DWSRF program may not replace the reporting requirements for those other programs.
- (2) **Financial report.** As part of the Biennial Report, a State must present the financial status of the DWSRF program, including the total dollar amount in fee accounts. This report must, at a minimum, include the financial statements and footnotes required under GAAP to present fairly the financial condition and results of operations.
- (3) **Matters to establish in the biennial report.** A State must establish in the Biennial Report that it has complied with section 1452 of the Act and this subpart. In particular, the Biennial Report must demonstrate that a State has:
  - (i) Managed the DWSRF program in a fiscally prudent manner and adopted policies and processes which promote the long-term financial health of the Fund;
  - (ii) Deposited its match (cash or State LOC) into the Fund in accordance with the requirements of § 35.3550(g);
  - (iii) Made binding commitments with assistance recipients to provide assistance from the Fund consistent with the requirements of § 35.3550(e);
  - (iv) Funded only the highest priority projects listed in the IUP and documented why priority projects were bypassed in accordance with § 35.3555(c)(2);
  - (v) Provided assistance only to eligible public water systems and for eligible projects and project-related costs under § 35.3520;
  - (vi) Provided assistance only for eligible set-aside activities under § 35.3535 and conducted activities consistent with workplans and other requirements of § 35.3535 and § 35.3540;
  - (vii) Provided loan assistance to small systems consistent with the requirements of § 35.3525(a)(5) and § 35.3555(c)(2)(iv);
  - (viii) Provided assistance to disadvantaged communities consistent with the requirements of § 35.3525(b) and § 35.3555(c)(7);
  - (ix) Used fees for eligible purposes under § 35.3530(b)(2) and (b)(3) and assessed fees included as principal in a loan in accordance with the limitations in § 35.3530(b)(3)(i) through (b)(3)(iii);
  - (x) Adopted and implemented procedures consistent with the requirements of § 35.3530(c) and § 35.3555(c)(8) if funds were transferred between the DWSRF program and CWSRF program;
  - (xi) Adopted and implemented procedures consistent with the requirements of § 35.3530(d) and § 35.3555(c)(9) if Fund assets of the DWSRF program and CWSRF program were cross-collateralized;

- (xii) Reviewed all DWSRF program funded projects and activities for compliance with Federal cross-cutting authorities that apply to the State as a grant recipient and those which apply to assistance recipients in accordance with § 35.3575;
- (xiii) Reviewed all DWSRF program funded projects and activities in accordance with approved State environmental review procedures under § 35.3580; and
- (xiv) Complied with 2 CFR part 200, the EPA general assistance regulations in 2 CFR part 1500 and the specific conditions of the grant.

- (4) **Joint report.** A State which jointly administers the DWSRF program and the CWSRF program may submit a report that addresses both programs. However, programmatic and financial information for each program must be identified separately.

(b) **Audit.**

- (1) A State must comply with the provisions of the Single Audit Act Amendments of 1996, 31 U.S.C. 7501-7, 2 CFR part 200 and the Office of Management and Budget's Compliance Supplement.
- (2) A State may voluntarily agree to conduct annual independent audits which provide an auditor's opinion on the DWSRF program financial statements, reports on internal controls, and reports on compliance with section 1452 of the Act, applicable regulations, and general grant requirements. The agreement to conduct voluntary independent audits should be documented in the Operating Agreement or in another part of the capitalization grant agreement.
- (3) Those States that do not conduct independent audits will be subject to periodic audits by the EPA Office of Inspector General.

(c) **Annual review —**

- (1) **Purpose.** The purpose of the annual review is to assess the success of the State's performance of activities identified in the IUP, Biennial Report (in years when it is submitted), and Operating Agreement (if used) and to determine compliance with the capitalization grant agreement, requirements of section 1452 of the Act, and this subpart. The RA will complete the annual review according to the schedule established in the capitalization grant agreement.
- (2) **Records access.** After reasonable notice by the RA, the State or assistance recipient must make available such records as the RA reasonably considers pertinent to review and determine State compliance with the capitalization grant agreement and requirements of section 1452 of the Act and this subpart. The RA may conduct on-site visits as deemed necessary to perform the annual review.

(d) **Information management system —**

- (1) **Purpose.** The purpose of the information management system is to assess the DWSRF programs, to monitor State progress in years in which Biennial Reports are not submitted, and to assist in conducting annual reviews.
- (2) **Reporting.** A State must annually submit information to EPA on the amount of funds available and assistance provided by the DWSRF program.

[65 FR 48299, Aug. 7, 2000, as amended at 79 FR 76057, Dec. 19, 2014]

### § 35.3575 Application of Federal cross-cutting authorities (cross-cutters).

- (a) **General.** A number of Federal laws, executive orders, and government-wide policies apply by their own terms to projects and activities receiving Federal financial assistance, regardless of whether the statute authorizing the assistance makes them applicable. A few cross-cutters apply by their own terms only to the State as the grant recipient because the authorities explicitly limit their application to grant recipients.
- (b) **Application of cross-cutter requirements.** Except as provided in paragraphs (c) and (d) of this section and in § 35.3580, cross-cutter requirements apply in the following manner:
  - (1) All projects for which a State provides assistance in amounts up to the amount of the capitalization grant deposited into the Fund must comply with the requirements of the cross-cutters. Activities for which a State provides assistance from capitalization grant funds deposited into set-aside accounts must comply with the requirements of the cross-cutters, to the extent that the requirements of the cross-cutters are applicable.
  - (2) Projects and activities for which a State provides assistance in amounts that are greater than the amount of the capitalization grant deposited into the Fund or set-aside accounts are not subject to the requirements of the cross-cutters.
  - (3) A State that elects to impose the requirements of the cross-cutters on projects and activities for which it provides assistance in amounts that are greater than the amount of the capitalization grant deposited into the Fund or set-aside accounts may credit this excess to meet future cross-cutter requirements on assistance provided from the respective accounts.
- (c) **Federal anti-discrimination law requirements.** All programs, projects, and activities for which a State provides assistance are subject to the following Federal anti-discrimination laws: Civil Rights Act of 1964, as amended, 42 U.S.C. 2000d et seq.; section 504 of the Rehabilitation Act of 1973, as amended, 29 U.S.C. 794; and the Age Discrimination Act of 1975, as amended, 42 U.S.C. 6102.
- (d) [Reserved]
- (e) **Complying with cross-cutters.** A State is responsible for ensuring that assistance recipients comply with the requirements of cross-cutters, including initiating any required consultations with State or Federal agencies responsible for individual cross-cutters. A State must inform EPA when consultation or coordination with other Federal agencies is necessary to resolve issues regarding compliance with cross-cutter requirements.

[65 FR 48299, Aug. 7, 2000, as amended at 73 FR 15922, Mar. 26, 2008]

### § 35.3580 Environmental review requirements.

- (a) **General.** With the exception of activities identified in paragraph (b) of this section, a State must conduct environmental reviews of the potential environmental impacts of projects and activities receiving assistance.
- (b) **Activities excluded from environmental reviews.** A State must conduct environmental reviews of source water protection activities under § 35.3535, unless the activities solely involve administration (e.g., personnel, equipment, travel) or technical assistance. A State is not required to conduct environmental reviews of all the other eligible set-aside activities under § 35.3535 because EPA has determined that, due to their nature, they do not individually, cumulatively over time, or in conjunction with other actions have a

significant effect on the quality of the human environment. A State does not need to include provisions in its SERP for excluding these activities. Activities excluded from environmental reviews remain subject to other applicable Federal cross-cutting authorities under § 35.3575.

(c) **Tier I environmental reviews.** All projects that are assisted by the State in amounts up to the amount of the capitalization grant deposited into the Fund must be reviewed in accordance with a SERP that is functionally equivalent to the review undertaken by EPA under the National Environmental Policy Act (NEPA). With the exception of activities excluded from environmental reviews in paragraph (b) of this section, activities for which a State provides assistance from capitalization grant funds deposited into set-aside accounts must also be reviewed in accordance with a SERP that is functionally equivalent to the review undertaken by EPA under the NEPA. A State may elect to apply the procedures at 40 CFR part 6 and related subparts or apply its own "NEPA-like" SERP for conducting environmental reviews, provided that the following elements are met:

- (1) **Legal foundation.** A State must have the legal authority to conduct environmental reviews of projects and activities receiving assistance. The legal authority and supporting documentation must specify:
  - (i) The mechanisms to implement mitigation measures to ensure that a project or activity is environmentally sound;
  - (ii) The legal remedies available to the public to challenge environmental review determinations and enforcement actions;
  - (iii) The State agency that is primarily responsible for conducting environmental reviews; and
  - (iv) The extent to which environmental review responsibilities will be delegated to local recipients and will be subject to oversight by the primary State agency.
- (2) **Interdisciplinary approach.** A State must employ an interdisciplinary approach for identifying and mitigating adverse environmental effects including, but not limited to, those associated with other cross-cutting Federal environmental authorities.
- (3) **Decision documentation.** A State must fully document the information, processes, and premises that influence its decisions to:
  - (i) Proceed with a project or activity contained in a finding of no significant impact (FNSI) following documentation in an environmental assessment (EA);
  - (ii) Proceed or not proceed with a project or activity contained in a record of decision (ROD) following preparation of a full environmental impact statement (EIS);
  - (iii) Reaffirm or modify a decision contained in a previously issued categorical exclusion (CE), EA/ FNSI or EIS/ROD following a mandatory 5 year environmental reevaluation of a proposed project or activity; and
  - (iv) If a State elects to implement processes for either partitioning an environmental review or categorically excluding projects or activities from environmental review, the State must similarly document these processes in its proposed SERP.
- (4) **Public notice and participation.** A State must provide public notice when: a CE is issued or rescinded; a FNSI is issued but before it becomes effective; a decision that is issued 5 years earlier is reaffirmed or revised; and prior to initiating an EIS. Except with respect to a public notice of a CE or

reaffirmation of a previous decision, a formal public comment period must be provided during which no action on a project or activity will be allowed. A public hearing or meeting must be held for all projects and activities except for those having little or no environmental effect.

(5) **Alternatives consideration.** A State must have evaluation criteria and processes which allow for:

- (i) Comparative evaluation among alternatives, including the beneficial and adverse consequences on the existing environment, the future environment, and individual sensitive environmental issues that are identified by project management or through public participation; and
- (ii) Devising appropriate near-term and long-range measures to avoid, minimize, or mitigate adverse impacts.

(d) **Tier II environmental reviews.** A State may elect to apply an alternative SERP to all projects and activities (except those activities excluded from environmental reviews in paragraph (b) of this section) for which a State provides assistance in amounts that are greater than the amount of the capitalization grant deposited into the Fund or set-aside accounts, provided that the process:

- (1) Is supported by a legal foundation which establishes the State's authority to review projects and activities;
- (2) Responds to other environmental objectives of the State;
- (3) Provides for comparative evaluations among alternatives and accounts for beneficial and adverse consequences to the existing and future environment;
- (4) Adequately documents the information, processes, and premises that influence an environmental determination; and
- (5) Provides for notice to the public of proposed projects and activities and for the opportunity to comment on alternatives and to examine environmental review documents. For projects or activities determined by the State to be controversial, a public hearing must be held.

(e) **Categorical exclusions (CEs).** A State may identify categories of actions which do not individually, cumulatively over time, or in conjunction with other actions have a significant effect on the quality of the human environment and which the State will exclude from the substantive environmental review requirements of its SERP. Any procedures under this paragraph must provide for extraordinary circumstances in which a normally excluded action may have a significant environmental effect.

(f) **Environmental reviews for refinanced projects or reimbursed project costs.** A State must conduct an environmental review which considers the impacts of a project based on conditions of the site prior to initiation of the project. Failure to comply with the environmental review requirements cannot be justified on the grounds that costs have already been incurred, impacts have already been caused, or contractual obligations have been made prior to the binding commitment.

(g) **EPA approval process.** The RA must review and approve any State "NEPA-like" and alternative procedures to ensure that the requirements for Tier I and Tier II environmental reviews have been met. The RA will conduct these reviews on the basis of the criteria for evaluating NEPA-like reviews contained in Appendix A to this subpart.

(h) **Modifications to approved SERPs.** Significant changes to State environmental review procedures must be approved by the RA.

## § 35.3585 Compliance assurance procedures.

- (a) **Causes.** The RA may take action under this section and the remedies of noncompliance of 2 CFR 200.339 through 200.343, if a determination is made that a State has not complied with its capitalization grant agreement, other requirements under section 1452 of the Act, this subpart, 2 CFR parts 200 and 1500, or has not managed the DWSRF program in a financially sound manner (e.g., allows consistent and substantial failures of loan repayments).
- (b) **RA's course of action.** For cause under paragraph (a) of this section, the RA will issue a notice of non-compliance and may prescribe appropriate corrective action. A State's corrective action must remedy the specific instance of non-compliance and adjust program management to avoid non-compliance in the future.
- (c) **Consequences for failure to comply.**
  - (1) If within 60 days of receipt of the non-compliance notice a State fails to take the necessary actions to obtain the results required by the RA or fails to provide an acceptable plan to achieve the results required, the RA may suspend payments until the State has taken acceptable actions. Once a State has taken the corrective action deemed necessary and adequate by the RA, the suspended payments will be released and scheduled payments will recommence.
  - (2) If a State fails to take the necessary corrective action deemed adequate by the RA within 12 months of receipt of the original notice, any suspended payments will be deobligated and reallocated to eligible States. Once a payment has been made for the Fund, that payment and cash draws from that payment will not be subject to withholding. All future payments will be withheld from a State and reallocated until such time that adequate corrective action is taken and the RA determines that the State is back in compliance.
- (d) **Dispute resolution.** A State or an assistance recipient that has been adversely affected by an action or omission by EPA may request a review of the action or omission under 2 CFR part 1500, subpart E.

[65 FR 48299, Aug. 7, 2000, as amended at 79 FR 76058, Dec. 19, 2014; 87 FR 30400, May 19, 2022]

## Appendix A to Subpart L of Part 35—Criteria for Evaluating a State's Proposed NEPA-Like Process

The following criteria will be used by the RA to evaluate a proposed SERP:

- (A) **Legal foundation.** Adequate documentation of the legal authority, including legislation, regulations or executive orders and/or Attorney General certification that authority exists.
- (B) **Interdisciplinary approach.** The availability of expertise, either in-house or otherwise, accessible to the State agency.
- (C) **Decision documentation.** A description of a documentation process adequate to explain the basis for decisions to the public.
- (D) **Public notice and participation.** A description of the process, including routes of publication (e.g., local newspapers and project mailing list), and use of established State legal notification systems for notices of intent, and criteria for determining whether a public hearing is required. The adequacy of a rationale where the comment period differs from that under NEPA and is inconsistent with other State review periods.

(E) ***Alternatives consideration.*** The extent to which the SERP will adequately consider:

- (1) Designation of a study area comparable to the final system;
- (2) A range of feasible alternatives, including the no action alternative;
- (3) Direct and indirect impacts;
- (4) Present and future conditions;
- (5) Land use and other social parameters including relevant recreation and open-space considerations;
- (6) Consistency with population projections used to develop State implementation plans under the Clean Air Act;
- (7) Cumulative impacts including anticipated community growth (residential, commercial, institutional, and industrial) within the project study area; and
- (8) Other anticipated public works projects including coordination with such projects.