

State Water Infrastructure Authority
March 9, 2022 Meeting
Agenda Item H
Potential use of CWSRF for Funding Onsite Wastewater Systems

Division of Water Infrastructure Staff Report

Background

In May 2020, the Onsite Water Protection Branch (OSWPB) of the Department of Health and Human Services, with the support of DEQ's Division of Water Infrastructure (Division), applied for and received EPA funding for a consultant (Northbridge Environmental Management) to develop a protocol and further explore how funding from the Clean Water State Revolving Fund (CWSRF) in North Carolina could be made available to repair and/or replace malfunctioning onsite and decentralized wastewater systems, especially in the rural areas with lower socioeconomic levels and small towns and communities with slow demographic changes and geographically dispersed populations. The results of the evaluation support the use of a pass-through funding program. A pilot program to work with single recipients in one or two counties to help establish a full-scale funding mechanism for NC was recommended.

In the December 2021 Authority meeting, staff summarized the results and recommendations provided by Northbridge Environmental Management on the potential expansion of CWSRF funds to support onsite wastewater infrastructure replacement and repair and received support from the Authority to continue development of a pilot program.

The pilot development team has continued to have conversations with a potential pilot recipient, Halifax County, and potential recipient service provider (Southeast Rural Community Assistance Project, Inc.) to discuss program expectations and identify potential obstacles in all parties coming into an agreement.

This staff report provides an update on potential funding program enhancements to establish a Decentralized Wastewater Treatment System Pilot Program (Pilot) within the CWSRF program.

Potential Pilot Program – Pass-Through Lending

A common funding mechanism used by other states supporting onsite systems with CWSRF funds is to use a pass-through funding model. In pass-through programs, an eligible CWSRF recipient serves as a bridge connecting CWSRF funding to the loan recipient. The recipient agrees to requirements of the SRF loan and uses the CWSRF funds to provide loans to individual homeowners.

Pass-through funding closely mirrors the traditional CWSRF loan approach from the state's perspective, and all requirements for disbursement and repayment of the CWSRF remain with the recipient. Payments from the Division will occur on a reimbursement model, and a repayment schedule will be established as funds are disbursed. From the perspective of property owners, the CWSRF is virtually invisible, and the program will appear much like that of procuring a personal loan from any typical commercial lender.

The funding recipient will be responsible for the administration requirements for the CWSRF loan. The recipient is responsible for approval and administration of pass-through loans for the on-site wastewater projects, and collection of the onsite wastewater project loan repayments.

The recipient could enter into an agreement with a third-party service provider to provide oversight of the individual homeowner loans and ensure that program requirements are met. The service provider could help with characterizing project needs, assessing funding applications based on project eligibility and priority, reviewing and approving reimbursement at the project level, coordinating and tracking repayment at the project level, and any other services as agreed to by the recipient. The use of a third-party service provider is called a Double Pass-Through and is the most likely process to be used in North Carolina. The table below provides a general overview of the roles that each of the critical partners play in a conduit lending scenario for funding projects. This is what may be reasonably expected in a typical pass-through lending situation.

Table 1. Pass-Through Loan Roles and Responsibilities				
NC CWSRF Program	OSWP Branch/Local Health Department	Pass-Through Entity (Recipient)	Recipient or Service Provider	Property Owners
<ul style="list-style-type: none"> • Review and Approve Pilot Program funding application for completeness • Make recommendations to SWIA for funding • Coordinate with permitting programs on Pilot program awareness and outreach • Develop SRF financial agreements and other legal instruments • Process disbursements and repayments 	<ul style="list-style-type: none"> • Collaborating with CWSRF Program to develop and evaluate Pilot • Education and outreach for Pilot program campaign • Assist recipient with SRF application • Oversight of DWTS Pilot project • Oversee design approval, installations, permitting and compliance for systems under Health Department jurisdiction • Support recipient with project reporting by pass-through entity 	<ul style="list-style-type: none"> • SRF loan application • Repayment of SRF loan • Oversee Service Provider 	<ul style="list-style-type: none"> • Review homeowner funding applications and ensure eligibility requirements are met. • Administration and performance of project • Project reporting • Process loan repayments from Property Owners • Reimburse the Pass-Through Entity for all principal and interest costs incurred under the CWSRF loan agreement • Education and Outreach 	<ul style="list-style-type: none"> • Provide verification of a failing or malfunctioning septic system (local health department) • Select and manage septic system contractor • Obtain permits and project approvals • Authorize disbursements • Repayment of loan

Potential of Additional Subsidy

Discussion with the Pilot program development team have identified the risk of individual homeowner loan default and the need to cover program administration costs the largest remaining

hurdles to establishing a Pilot program. From a Division CWSRF perspective, the recipient of the loan is responsible for all loan repayments regardless of whether or not the pass-through recipients make repayments, so it will be the recipient's responsibility to assure pass-through loan recipients (homeowners) are credit-worthy and will have the ability to repay their loan. However, there is a potential for the CWSRF program to provide additional subsidy based on existing affordability criteria and program allowances to reduce the financial burden on the recipient in the event a few of pass-through loan recipients do not make repayments and to provide funds to support the Pilot administrative costs.

Existing affordability criteria identify project eligibility for both targeted interest rates and principal forgiveness based on project and community data. The Pilot program will be working on an individual homeowner level and not a community level, so it is recommended that if reduced interest rates or Principal Forgiveness is available, that affordability be evaluated at the homeowner level. It is also recommended that the recipient establish in the project application that all pass-through recipients will be considered disadvantaged and meet affordability criteria for the Pilot program. Establishing pass-through recipient eligibility based on affordability would be all that is needed for the recipient to receive reduced interest rate and/or Principal Forgiveness of the loan.

The Wastewater Reserve could also provide additional grant funds to a recipient to help offset administrative costs. Similar to Principal Forgiveness, available funds are limited compared to the demand for grant funds. However, use of the Wastewater State Reserve to support onsite projects would limit grant funds available to more typical infrastructure projects.

Updates to Division Intended Use Plan for CWSRF administration.

The Division's current Intended Use Plan (IUP) for the CWSRF program would require a potential partner for the Pilot program to apply for consideration using the existing Priority Rating System and compete for available funds. The State Water Infrastructure Authority (Authority) has the ability with CWSRF funds to consider additional information provided in an application and adjust project priority order. However, The Division intends to adjust the IUP to call out the Pilot program more clearly. Updates to the IUP could potentially include any or all the following items:

- Set aside of CWSRF funds to be made available for eligible applicants (Recommend no more than \$1,000,000 for the 2022 IUP)
- Establish project type eligibility (recommend limiting funding to failed or malfunctioning decentralized wastewater systems including onsite wastewater, single family non-discharge systems, or single-family discharge facilities)
- Establish pass-through recipient eligibility (recommend limiting pass-through recipient eligibility based on documented household income, or other affordability indicators).
- Establish additional subsidy different than those provided to other CWSRF recipients (recommend 0% interest rate CWSRF loan, consider Principal forgiveness based on intended service areas)

Application for Funding

To ensure that CWSRF funds are used appropriately, the following items would be addressed in the funding application and may be included as loan requirements for the recipients:

- Clear delineation of project intended service area for offering CWSRF funds (examples: Town's Extraterritorial Jurisdiction or County limits);
- Description of process to ensure both the recipient and project are eligible for funding;
- Description of process to ensure funds are available to all eligible recipients;
- Process to ensure reimbursement requests are eligible for repayment;
- Process to ensure payments are requested and processed in a timely manner; and/or
- Memorandum of Understanding on expectation of the Pilot program signed by the applicant, Division, DHHS onsite wastewater representative, and recipient service provider (if applicable).

Next Steps

The Division is seeking input from the Authority on the development of the Pilot program prior to updating the Division's Priority Rating System and IUP for public review. It is anticipated that the Division will recommend that the Authority to take an updated Priority Rating System to public review during the April 2022 Authority meeting, recommend for approval a final Priority Rating System to the Authority in July 2022, and open the Pilot program to applicants as early as the Fall 2022 funding round.