

State Water Infrastructure Authority
December 8, 2021 Meeting
Agenda Item N
Potential use of CWSRF for Funding Onsite Wastewater Systems

Division of Water Infrastructure Staff Report

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, 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 in North Carolina could be made available to repair and/or replace 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.

This staff report summarizes the results and recommendations provided by Northbridge Environmental Management on the potential expansion of NC CWSRF funds to support on-site wastewater infrastructure replacement and repair.

Background

There are more than four million occupied homes in North Carolina and approximately fifty percent of them use on-site wastewater treatment systems (on-site systems) to collect, treat, and disperse their wastewater. This dependence on on-site systems in the state has remained relatively constant for more than twenty years. On-site systems are projected to be used in ever-increasing numbers as a part of the permanent wastewater treatment infrastructure in communities due to population growth, development pressure, and the high cost of centralized wastewater treatment systems. North Carolina had the third-highest number of homes served by septic systems in the 1990 Census, and the National Environmental Services Center 2015 Assessment Report indicated that North Carolina had the highest number of new on-site system installations across the United States. Approximately 194,497 on-site systems were installed or repaired from 2010 to 2019.

Like centralized sewer systems, on-site systems also require routine operation and maintenance to keep them functioning properly. System failure poses a significant threat to public health, surface water, and groundwater quality. About thirty percent (59,076) of the on-site system installations from 2010 to 2017 were done to repair failing systems. The on-site system failure rate in North Carolina is reported to be between six and 10 percent based on recent surveys.

Some homeowners cannot repair a failing on-site system due to financial constraints. Few funding programs or mechanisms are currently available in North Carolina to assist homeowners in repairing or replacing failing systems. The U.S. Department of Agriculture (USDA) 502 Loan Program and 504 Repair Program have been successfully used to a limited extent. The USDA funds in North Carolina are currently administered by the Southeast Rural Community Assistance Program, Inc (SERCAP).

The CWSRF is utilized in some states as a more sustainable, long-term solution to support on-site system repairs for individuals and small communities. To date, North Carolina's CWSRF funds have not been used for on-site systems. The North Carolina CWSRF Intended Use Plan lists replacement and repair of failing septic systems as a priority item, and GS 159G-23 requires DWI to consider public necessity in prioritization of projects. GS 159G-23 includes replacing failing septic tanks with a wastewater collection system as a public necessity project, however, it does not list repair or replacement of failing septic tanks.

Potential Pilot Program – Pass-Through Lending

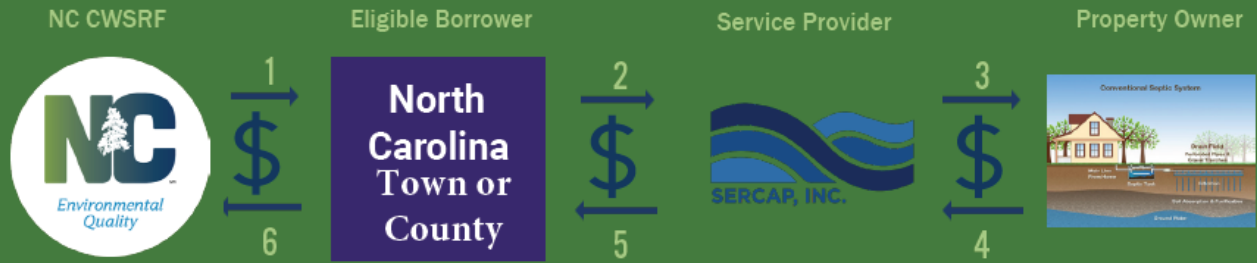
A common funding mechanism used by other states supporting on-site systems with CWSRF funds is to use a pass-through funding model. In pass-through programs, an eligible CWSRF recipient serves as a bridge connecting CWSRF funding to the loan recipient. The recipient agrees to requirements of the SRF loan and use 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 administrative burden falls mostly with the CWSRF recipient. The recipient will be responsible for the administration requirements for the CWSRF loan, including the payment request from the Division and repayment of the loan to the Division. The recipient is also responsible for approval and administration of pass-through loans for the on-site wastewater projects, and collection of the on-site 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. This process is shown below, showing SERCAP as an example service provider.

PROPOSED FLOW OF FUNDS: DOUBLE PASS-THROUGH



The Town or County is the Eligible SRF Borrower. This partnership allows the County or Town to pass CWSRF funds through a Service Provider (ex. SERCAP) who will perform outreach, perform credit review, set terms and make loans directly to property owners. Homeowners then repay individual loans to SERCAP, who repays the Town or County, which in turn repays the SRF loan to the State.

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.

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 NPDES and Non-discharge 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 County with SRF application Oversight of DWTS Pilot project Oversee design approval, installations, permitting and compliance for systems under Health Department jurisdiction Support County 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 septic system (local health department) Select and manage septic system contractor Obtain permits and project approvals Authorize disbursements Repayment of loan

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

- Clear delineation of project service area for providing funds (Town's EJ, or County limits)
- Process to ensure both the recipient and project are eligible for funding.
- 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
- Maximum interest rate on pass-through loans

A CWSRF on-site wastewater funding pilot program could establish funding limits or project prioritization to ensure funds are used to support failed or failing systems, and to better ensure that funds reach property owners with limited financial capacity, and/or are in economically disadvantaged communities. The recipient may also further limit eligibility or awards based on the on-site system applicant's ability to repay their loan.

When making loans to individual homeowners, the process undertaken by pass-through recipients in other states follows a traditional commercial banking approach. Northbridge has developed a simple affordability calculator that utilizes the debt-to-income ratio as the ATP indicator and is based on **disposable income** to gauge the maximum loan amount that a residential applicant may reasonably qualify for. This calculator may be utilized by the recipient or service provider as part of the credit review analysis for individual applicants seeking funding assistance.

Potential for Additional Subsidy of a CWSRF On-site Wastewater Funding Program

The CWSRF program has the potential to provide on-site wastewater systems owners an additional funding source with preferred interest rates. However, the additional administrative costs by the recipient and potential service provider plus the risk of delinquent repayment, may make a pass-through loan program undesirable to many potential recipients. Additional subsidy to the program for consideration include:

1. **Reduced interest rates:** The program could offer reduced interest rates based on affordability criteria. The recipient would document that all recipients of the pass-through loan would meet pre-established affordability criteria to qualify the loan for a reduced or zero percent interest rate. The recipient could charge a slightly higher interest rate to help cover administrative costs.
2. **Principal Forgiveness:** The program could provide principal forgiveness to the loan based on affordability criteria. The current SRF program has a scarcity of available principal forgiveness. Use of principal forgiveness to support on-site projects would further limit available grant funds for more typical CWSRF projects.
3. **Wastewater Reserve grant:** The Wastewater Reserve could 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. Use of the Wastewater State Reserve to support on-site projects would further limit available grant funds for more typical projects.

Potential Next Steps

- Develop Pilot Program Funding process
 - Recipient requirements and expectations
 - Local Government Commission (LGC) expectations
 - Project eligibility requirements
 - Disbursement requirements
 - Timing
 - Documentation
 - Recipient repayment schedule.
- Update CWSRF Intended Use Plan (IUP) to include the Pilot Program with limited funding allotment. The IUP would reserve a set amount of CWSRF funding for the Pilot Program and allow for recipients to apply for the funds. The IUP would also establish recipient requirements, project eligibility and loan terms.
 - April 2022: SWIA scheduled to approve Priority Rating Systems to go to public review (PRS is part of CWSRF IUP and both documents will go out for review).
 - July 2022: SWIA scheduled to approve updated priority rating systems (
 - September 2022: EAP application for 2022 Capitalization Grant scheduled to be submitted a head of Fall funding round.
- Fall 2022 funding round - Pilot Program funding.