

I. INTRODUCTION

A. Background

In California, the responsibility for regulating public water systems and overseeing the safety of drinking water rests with the Department of Health Services (Department). The Department has been designated as the “primacy agency” by the United States Environmental Protection Agency (USEPA) for purposes of implementing and enforcing the federal Safe Drinking Water Act (SDWA). The Department regulates 8,600 public water systems located throughout the State. To assist in this effort, the Department contracts with 35 of the 58 counties in the State for enforcement of the State drinking water requirements for public water systems serving less than 200 service connections.

Many California water systems are having difficulty in complying with the numerous new drinking water standards and requirements due to the lack of sufficient financial resources. In addition to the compliance needs, systems also face the need to improve their source water capacity and treatment plants, replace old or inadequate pipelines and equipment, and improve their managerial and technical capability. The magnitude of these needs is reflected in the Drinking Water Infrastructure Needs Survey conducted by the USEPA in 1995. The initial survey indicated that California water systems would require approximately \$18.8 billion to make these necessary improvements. California participated in the USEPA’s 1999 effort to update the original needs survey. The 1999 Drinking Water Infrastructure Needs Survey found \$17.5 billion in estimated need in California. The 1999 Survey provides the basis for California’s future federal SRF funding allocation

In response to the national need, Congress in 1996 adopted amendments to the federal SDWA that included funding to provide financial assistance to public water systems. This financial assistance is in the form of Capitalization Grants to states to establish drinking water state revolving funds (DWSRF) to be used to provide low interest loans and other assistance to public water systems. These funds may be used to finance the costs of infrastructure improvements needed to achieve or maintain compliance with the SDWA requirements. In order to receive these funds, states must have statutory authority and must provide a state match equal to 20 percent of the federal Capitalization Grants, which have been authorized through the year 2003.

The initial grant allotments to states for the 2002 fiscal year have been made. The amount of \$82,460,900 has been reserved for allotment to California for the fiscal year 2002.

The federal law provides that a portion of the federal funds may be used for specified activities in addition to providing financial assistance to public water systems for infrastructure improvements. These activities include: (1) administration of the DWSRF financial assistance program, (2) technical assistance to small water systems, (3) source water assessment and protection, and (4) water system capacity development. Federal and state statutes mandate source water assessment and protection, and capacity development. Collectively, funding for these “set-aside” programs may utilize up to 31 percent of the federal Capitalization Grant. In order to provide as much funding to public water systems infrastructure improvements as possible, the Department does not intend to divert the total amount of authorized funds into these activities. As described in Section IV, the Department intends to utilize only 8.4 percent of the

2002 funds for set aside activities not directly providing funding for water system projects. The 2002 IUP includes a 5 percent set aside for Source Water Protection (SWP) project loans. The remaining 86.6 percent of federal funds, plus all state matching funds will be used for DWSRF project funding.

To receive funding approval from the USEPA, the State is required to submit a Capitalization Grant application and an Intended Use Plan (IUP). Federal guidelines require that the IUP include a description of how the program is structured, the planned use of the funds, the criteria, and methods to be used for distribution of the funds, the goals for the program, and a specific project priority list (PPL). The California IUP described in this document is being submitted in compliance with those requirements.

B. Statutory Authority

In order to be eligible to receive the federal funds, the California Legislature adopted SB 1307 (Chapter 734, statutes of 1997), which was signed by the Governor on October 6, 1997. This law provides the statutory authority to create the California DWSRF and designates the Department as the state agency responsible for administration of the DWSRF. With only minor differences, the state statute parallels the federal law and requirements. Therefore, the federal law and the USEPA SRF program guidelines generally govern the conduct of the program. The specific provisions of SB 1307 are set forth in sections 116760.20 through 116762.60 of the California Health and Safety Code (H & S Code). To aid in implementation of this authority, the Department has adopted SRF program regulations, which are set forth in sections 63000 through 63058 of the California Code of Regulations. A copy of these regulations, including regulations for implementation of the Source Water Protection Project (SWPP) loan program is attached as Appendix A.

C. Program Structure

The California DWSRF program is administered and directed by the Department. Department staff conducts many of the activities associated with implementation of the DWSRF program, however the Department contracts with other State and local agencies and independent contractors for specific activities. Through an interagency agreement (contract) the California Department of Water Resources (DWR), provides assistance in administering the local financial assistance portion of the DWSRF program. DWR (1) conducts the financial review of project applications, (2) determines the ability of the applicant to repay the loan, (3) determines the amount of loan subsidy, if any, and (4) establishes the terms and conditions of loan contracts. In this context, DWR prepares notices of application acceptance as authorized by DHS, prepares draft and final funding agreements (loan contracts), and executes funding agreements as authorized by DHS. During project construction, DWR processes and reviews claims submitted by funding recipients, and concurs in authorization of disbursements to funded projects. DWR maintains a record of disbursements on loans, and prepares semiannual billing notice information for DHS. The Department selected DWR to provide financial expertise on funding applications because of their extensive experience and expertise in carrying out similar activities under previous drinking water bond acts and other water related financial assistance programs. The interagency agreement between the Department and DWR extends through 2004. A copy of the interagency agreement between the two departments is included as Appendix B.

The Department contracted with the Bureau of State Audits (BSA) to conduct the federally mandated annual audit for the first three operational years of the California DWSRF program. During 2001, Department staff consulted with USEPA and reviewed the DWSRF processes in other states with respect to conformance with the federal annual audit requirement. As a result of the evaluation of mechanisms for meeting federal audit requirements, the Department is seeking a new external contractor to conduct the annual independent audit for program years 2001 through 2003.

The DWSRF program is managed by the chief of the Drinking Water State Revolving Fund and Small Water System section within the Department's Division of Drinking Water and Environmental Management. The section chief serves as the program manager, and provides direction and coordination of various aspects of the DWSRF program and assurance of compliance with federal cross-cutters. The section chief/program manager is also responsible for assuring statewide consistency in the implementation of the program. The ranking of projects on the priority list and the management of individual projects (technical review of applications, approval of plans and specifications, construction inspections, etc.) is the responsibility of the Department's drinking water field district offices. The relationship of the various DWSRF program activities and responsibilities is illustrated in Figure 1.

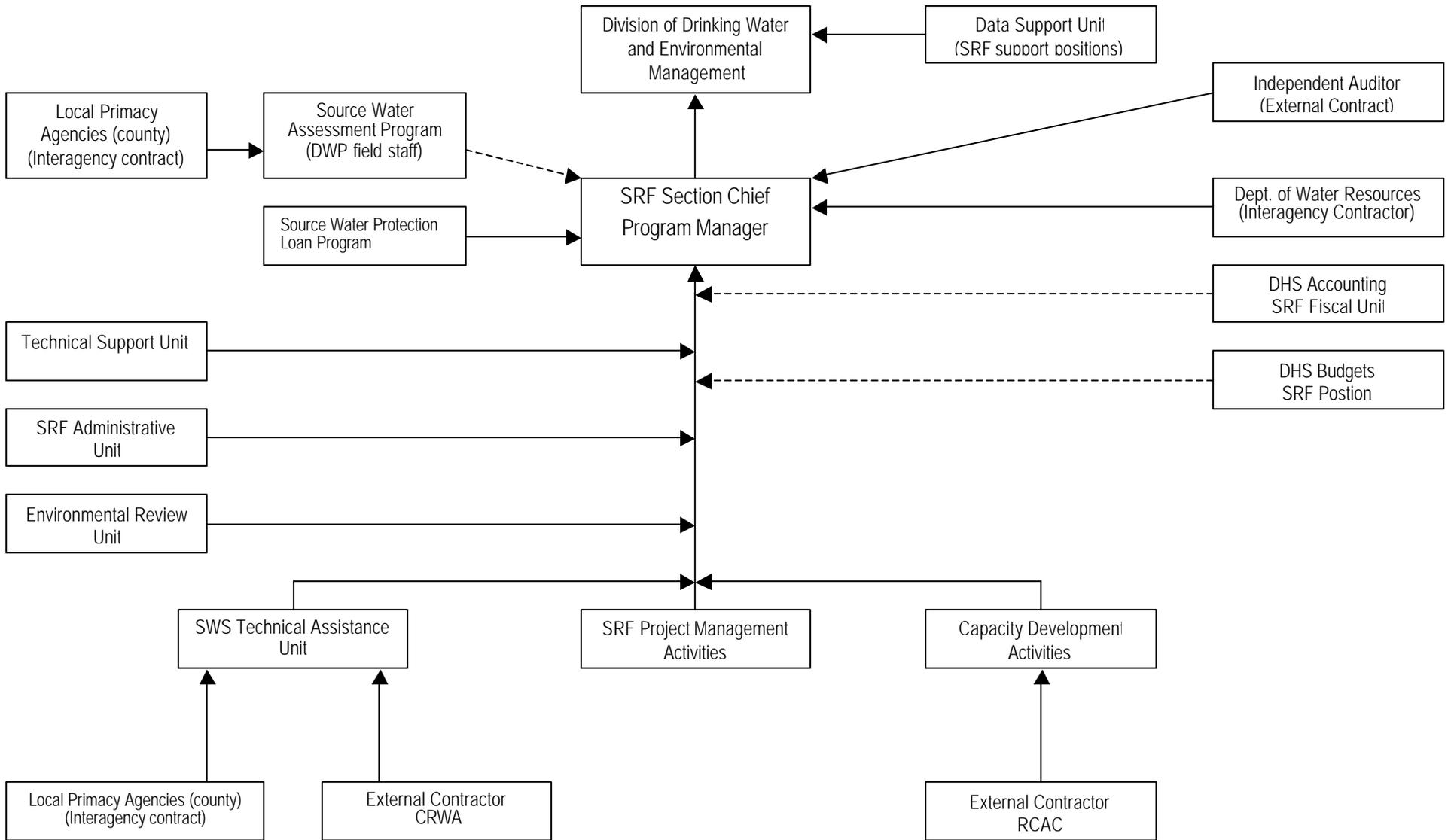
II. DRINKING WATER STATE REVOLVING FUND PROGRAM GOALS

The SDWA Amendments of 1996 (Public Law 104-182) enacted in the summer of 1996, authorized the creation of a DWSRF. While the Clean Water SRF has been in place to fund wastewater treatment for some time, this was the first time Congress provided a DWSRF for public water systems infrastructure needs and other drinking water programs. The DWSRF was authorized in response to many factors, some of which were the amount of public water system infrastructure need demonstrated nationally by the 1995 USEPA Needs Survey and the new SDWA requirements set forth in the amendments.

The DWSRF program goals set forth below reflect both federal and state legislative intent to provide funding to correct public water system deficiencies based upon a prioritized funding system. The California DWSRF funding system utilizes a comprehensive multi-year PPL (See Section VI, Project Priority List), whereby (1) public water system projects addressing public health risk problems, (2) public water system projects needed to comply with the SDWA, and (3) projects assisting public water systems most in need on a per household affordability basis, receive higher funding priority than other eligible public water system projects.

In general, the DWSRF provides the 8,600 public water systems in California the opportunity to utilize subsidized funding to correct infrastructure problems, to assess and protect source water, and to improve technical, managerial and financial capability (TMF). The DWSRF additionally benefits over 8,100 small water systems (water systems serving a population of fewer than 10,000) by providing technical assistance in most aspects of public water system operations and management.

Figure 1 Drinking Water SRF Program Activities and Responsibilities



A. Long Term Goals

1. Ensure that public water systems provide an adequate, reliable supply of safe, clean drinking water.

The DWSRF loan program advances this basic goal of the Department by providing an ongoing source of funds for future infrastructure improvements. The project ranking process ensures that program resources and funds are applied to the most significant public health and compliance problems.

2. Fund projects on the comprehensive, multi-year Project Priority List

The Department will continue to use the priority list process to direct DWSRF loan funds to those projects that meet high priority needs. The Project Priority List developed by the Department for the Capitalization Grant will be revised at least biennially, to include new projects. Projects by-passed will not automatically be removed from the list; rather by-passed projects will be eligible for funding in subsequent years at the same time as new projects in the same category.

3. Ensure the revolving nature of the DWSRF loan fund

The DWSRF loan fund can provide a cost effective funding mechanism to assist public water systems in achieving and maintaining compliance with the SDWA. The Department will monitor the fund to ensure that it remains financially viable over the long term as an ongoing source of water system funding. As repayments or de-obligated funds become available, they will allow the issuance of new loans even in the event that further federal Capitalization Grants cease.

4. Ensure that all public water systems achieve and maintain compliance with the SDWA

In furtherance of the Department's overall goal of safe and reliable drinking water, the Department utilizes the resources of the DWSRF loan fund and set aside programs to help ensure that all public water system have the TMF capacity to operate in compliance with the SDWA. Important elements of this include enhancing the technical knowledge of small water system personnel in complying with regulatory requirements, and enhancing the technical knowledge of small water system operators in water treatment.

5. Reduce Cost of Drinking Water

Reduce the per-household cost of protecting public health and delivering safe drinking water by using the SWAP results to develop public water system drinking water monitoring plans based on the conditions surrounding the source water and, providing affordable financing for the construction of technically sound drinking water infrastructure and source water protection projects.

6. Encourage Consolidation

Encourage the consolidation and/or regionalization of small public water systems that lack the capability or potential to be operated and maintained in a cost effective manner. By facilitating consolidation, the resultant systems can benefit from the economy of scale available to larger water systems.

B. Short Term Goals

1. Maintain an efficient and effective Safe Drinking Water SRF program for the State of California through planned evaluation and revision of the program.

The Department has developed the DWSRF program based on its own experience regulating public water systems, on the knowledge and experience of the drinking water industry and based on the public input received. The Department also meets regularly with the USEPA Region IX staff to discuss its DWSRF program development activities.

2. Continue Implementation of the DWSRF program

Each DWSRF Grant application requires identification of a source of state matching funds. The 20 percent state fund match is provided from sale of general obligation bonds authorized by Proposition 13, The Safe Drinking Water, Clean Water, Watershed Protection, and Water Reliability Bond Act, and from similar bond acts authorized by the Legislature and Governor, subject to approval of the electorate. Proposition 13 authorized the sale of \$1.97 billion in general obligation bonds for water related projects, including \$70 million for the Safe Drinking Water SRF loan program. Alternate funding would be sought from the Legislature in the absence of continued Bond support for the DWSRF program..

3. Maintain a Project Priority List (PPL) and an Intended Use Plan (IUP)

The Department notifies every eligible public water system in the state of the annual opportunity to submit a preapplication for incorporation into the DWSRF project priority list. The staff in the Department's district offices evaluates each project and places it in the appropriate health risk category. Bonus points are assigned based on the criteria developed by the Department (see Section VI Project Priority List). Regional Engineers and other departmental staff review the PPL before its publication to ensure that the rating of the projects is consistent. The ranked pre-applications are integrated into the compiled PPL. In 2001, the Department provided all public water systems with the opportunity to submit additional projects or update the information on projects already listed. Approximately 200 new or revised DWSRF preapplications were received during the 2001 preapplication period. The Department held a public hearing in January 2002 on the draft Updated Project Priority List (Updated PPL) for the Drinking Water SRF and adopted the 2002 updated listing effective April 2002. In addition, the Department has invited community water systems and certain non-profit non-community water systems to submit preapplications for the SWPP loan program priority list. The Department evaluated and ranked the proposed SWP projects, established a draft SWP project priority list (SWP-PPL), and

included this list in the public hearing on the proposed list. The SWP-PPL was adopted effective April 14, 2000. In 2001, the Department again invited eligible public water systems to submit additional projects or update the information on projects already listed. Preapplications for eight new source water protection projects were received during the 2001 preapplication period. The Department held a public hearing in January 2002 on the draft Updated SWP-PPL and adopted the 2002 updated listing effective April 2002.

4. Determine the fundable portion of the Project Priority List and invite eligible public water systems to apply for funding

An important goal of the DWSRF program is to fund those projects that are in high priority categories. As discussed in Section VI, Project Priority List, the categories A through G are high priority categories. These categories contain projects to mitigate a current risk to public health or to correct a violation of the SDWA. The Department invites applications from eligible projects on the fundable list on an annual basis beginning in Spring 2002. If the responses to the Statement of Interest are not sufficient to enable the program to obligate the available funds, the need for an additional cycle of invitations will be evaluated. (Target completion – Invitations to be mailed by April 2002)

5. Continue implementation of the set-aside programs

As mentioned earlier in this Section, and discussed in detail in Section IV, Set-Aside Activities, the Department utilizes portions of the Capitalization Grant to fund technical assistance and capacity development programs. The Department implements these programs both by providing direct assistance to water systems, and by supporting local health department (LHD) staff and outside providers to assist smaller water systems in meeting TMF operations goals, and aid to these systems in applying for SRF loan funds. The Department will complete updated workplans for each set-aside activity. (Target completion – submit annual draft update of workplans by June 2002)

6. Continue implementation of the SWPP loan program.

Implement the SWPP regulation revision; and make funding commitments for at least \$4 million. (Target completion – issue commitments by Sept 2002)

7. Solicit and contract with independent auditor.

Solicit through an RFP process, and contract with, an independent contractor for auditing services in order to conform with federal requirements for annual audit of the DWSRF program. (Target completion – issue contract by July 30, 2002)

8. Complete deployment of the DWSRF MARS data management system.

The Data Systems Support Unit (DSSU) is developing a comprehensive data management system to meet the DWSRF and related long term data tracking needs of the drinking water program. DSSU, with the support of external contractor programmers is completing testing and

deployment of the DWSRF MARS data management system (phase 1) so that it is available to all field offices, DWR, and DWSRF program and fiscal support staff. In consultation with the SDWSRF staff, DSSU will establish and implement a management reports process to improve DWSRF project tracking and facilitate program oversight and funds tracking. (Target completion date – June 2003).

III. INTENDED USE OF DWSRF FINANCIAL ASSISTANCE FUNDS

The Introduction to USEPA’s DWSRF Program Guidelines states:

“The Safe Drinking Water Act (SDWA) Amendments of 1996 (Pub. L. 104-182) authorizes a Drinking Water State Revolving Fund (DWSRF) to assist public water systems to finance the costs of infrastructure needed to achieve or maintain compliance with SDWA requirements and to protect public health objectives of the Act. Section 1452 authorizes the Administrator of the U.S. Environmental Protection Agency to award Capitalization Grants to the States, which in turn can provide low cost loans and other types of assistance to eligible systems.”

A. State Matching Funds

The State of California will obtain the required 20 percent State match by the sale of State General Obligation bonds authorized by Proposition 13, and from similar bond acts authorized by the Legislature and Governor, subject to approval of the electorate. Proposition 13 authorized the sale of \$1.97 billion in general obligation bonds for water related projects, including \$70 million for the Safe Drinking Water SRF loan program. A total of \$ 16,492,180 is earmarked to provide for the state match for the FFY 2002 DWSRF grant award. The state funds will be made available, as payment is required for invoices related to project funding agreements entered in to from the FFY 2002 federal grant. Alternate funding would be sought from the Legislature in the absence of continued bond support for the DWSRF program. Consistent with federal requirements, all state matching funds are allocated to the DWSRF loan fund.

B. Proposed Uses

The federal allocation to the State of California is \$82,460,900 in 2002. From the FFY 2002 Capitalization Grant, the Department plans to set-aside \$3,298,436 (4 percent) for Administration, \$ 1,649,218 (2 percent) for Small Water Systems Technical Assistance, \$2,000,000 (approximately 2.4 percent) for Capacity Development, and \$ 4,123,045 (5 percent) for the Source Water Protection Project loan program. Including the current \$16,492,180 state match to meet the 20 percent federal/state match requirement, this will leave a DWSRF loan fund of \$87,882,381 to be used for local project funding. The DWSRF loan funds will be obligated to specific projects within 8 quarters of receipt of the federal grant award resulting from this IUP. In addition, during 2002-03 an estimated \$3.5 million in repayments (either principal or interest) made to the DWSRF from previous loan recipients will become available for re-obligation. The Department anticipates re-obligating funds within eighteen months of payment receipt, or as soon as aggregate repayments are sufficient to fund a reachable project. A

series of worksheets providing details of each DWSRF grant award follow to present more details. A graphic chart is provided to illustrate current year funding resources.

Table 1.

2002 Funds

Federal Capitalization Grant	\$ 82,460,900
Set aside programs	
Administration (4 percent)	(\$ 3,298,436)
Source Water Protection	
Loan Fund (5 percent)	(\$ 4,123,045)
Small Water Systems Technical	
Assistance (2 percent)	(\$ 1,649,218)
Capacity Development	
(approx. 2.4 percent)	(\$ 2,000,000)
Balance of Federal grant funds to DWSRF Loan Fund	\$ 71,390,201
2002 State Match (20 percent)	<u>\$ 16,492,180</u>
DWSRF Local Assistance (Loan) Funding	\$ 87,882,381
DWSRF Loan fund including SWPP	\$ 92,005,426
Estimated repayments (principal and interest)	\$ 3,500,000

Separate accounts have been established for financial support and accounting of the following set-aside programs:

1. Administration

The federal and state statutes allow the Department to set aside up to 4 percent of the total annual federal Capitalization Grant to support the costs of the administration of the DWSRF program. The Department plans to continue to set aside the entire 4 percent allowed for the administration costs of this complex program. Any funds available at the end of the FY02/03 will be banked for use in future years and to ensure the availability of sufficient funds to administer the program in perpetuity. Specific activities supported by the Administration set aside are outlined in Section IV, Set-Aside Activities. Portions of these activities are implemented through Interagency Agreements with DWR and an independent auditor contractor. The Department has

**Financial Status of DSWRF
State Fiscal Year 1998-99
California DWSRF Implementation July 1998-September 1999**
(California DWSRF Program Year 1)

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS	TOTAL
I. DWSRF Loan Account	\$ 63,270,653	\$ 15,136,520	N/A	\$0	\$1,500,000	\$ 78,407,173
Large systems						
Standard Loans	\$26,306,564	\$6,293,436				\$32,600,000
Disadvantaged Communities						
0% Loan	\$23,764,672	\$5,685,328				\$29,450,000
Principle Forgiveness (grant)	\$0	\$0				\$0
Large systems subtotal	\$50,071,235	\$11,978,765				\$62,050,000
Small Systems						
Standard Loans	\$9,552,004	\$2,285,169				\$11,837,173
Disadvantaged Communities						
0% Loan	\$1,702,664	\$407,336				\$2,110,000
Principle Forgiveness (grant)	\$1,944,749	\$465,251				\$2,410,000
Small Systems Subtotal	\$13,199,418	\$3,157,755				\$16,357,173
Loan Account Subtotal	\$63,270,653	\$15,136,520			\$1,500,000	\$78,407,173
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$ 1,513,652					\$ 1,513,652
State Program Management	\$0					\$0
Capacity Development#	\$ 302,730	#				\$ 302,730
Local Assistance	\$0					\$0
Source Water Assessment Program	\$ 7,568,260					\$ 7,568,260
Source Water Protection Loan Program	\$0					\$0
Set aside Subtotal	\$ 9,384,642					\$ 9,384,642
III. DWSRF Administration Account						
4% Set aside	\$ 3,027,304					\$ 3,027,304
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$ 3,027,304					\$ 3,027,304
TOTAL	\$75,682,600	\$15,136,520	N/A	N/A	\$1,500,000	\$90,819,120

1:1 match from PWSS grant overmatch: 1993 PWSS grant and 1998 PWSS grant (\$151,365 each)

**Repayments/earnings is an estimate only; actual repayments/earnings may be higher

*** Total excluding repayments and interest earnings

Financial Status of DSWRF
State Fiscal Year 1999-2000
California DWSRF Implementation July 1999-September 2000
California DWSRF Program Year 2

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS	TOTAL
I. DWSRF Loan Account	\$ 72,173,000	\$ 15,421,620	N/A	\$0	\$1,500,000	\$ 89,094,620
Large systems						
Standard Loans	\$55,506,090	\$11,860,305				\$68,520,000
Disadvantaged Communities						\$0
0% Loan	\$0	\$0				\$0
Principle Forgiveness (grant)	\$0	\$0				\$0
Large systems subtotal	\$55,506,090	\$11,860,305				\$68,520,000
Small Systems						
Standard Loans	\$396,935	\$84,815				\$490,000
Disadvantaged Communities						
0% Loan	\$12,835,273	\$2,742,587				\$15,844,620
Principle Forgiveness (grant)	\$2,219,596	\$474,274				\$2,740,000
Small Systems Subtotal	\$15,451,803	\$3,301,676				\$19,074,620
Loan Account Subtotal	\$70,957,893	\$15,161,981			\$1,500,000	\$87,594,620
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$ 1,542,164					\$ 1,542,164
State Program Management	\$0					\$0
Capacity Development#	\$ 308,433					\$ 308,433
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$0					\$0
Set aside Subtotal	\$ 1,850,597					\$ 1,850,597
III. DWSRF Administration Account						
4% Set aside	\$ 3,084,328					\$ 3,084,328
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$ 3,084,328					\$ 3,084,328
TOTAL	\$77,107,925	\$15,421,620	N/A	N/A	\$1,500,000	\$92,529,545

1:1 match from PWSS grant overmatch: 1993 PWSS grant and 1999 PWSS grant (\$154,217 each)

**Repayments/earnings is an estimate only; actual repayments/earnings may be higher

*** Total excluding repayments and interest earnings

**Financial Status DWSRF
State Fiscal Year 2000-01
California DWSRF Implementation July 2000-September 2001
California DWSRF Program Year 3**

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS**	TOTAL***
I. DWSRF Loan Account	\$71,603,596	\$16,163,340	N/A	\$0	\$500,000	\$87,766,936
Large systems						
Standard Loans	\$58,428,534	\$13,175,062				\$ 71,603,596
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Large systems subtotal	\$57,469,828	\$12,958,883				\$70,428,711
Small Systems(15% target)						
Standard Loans	\$11,104,944	\$2,504,056				\$13,609,000
Disadvantaged Communities						
0% Loan	\$1,395,360	\$314,640				\$1,710,000
Principle Forgiveness (grant)	\$1,647,688	\$371,537				\$2,019,225
Small Systems Subtotal	\$14,147,992	\$3,190,233				\$17,338,225
Loan Account Subtotal	\$71,617,820	\$16,149,116			\$500,000	\$87,766,936
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$1,616,334					\$1,616,334
State Program Management	\$0					\$0
Capacity Development#	\$323,267					\$323,267
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$4,040,835					\$4,040,835
Set aside Subtotal	\$5,980,436					\$5,980,436
III. DWSRF Administration Account						
4% Set aside	\$3,232,668					\$3,232,668
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$3,232,668					\$3,232,668
TOTAL	\$80,816,700	\$16,163,340	N/A	N/A	\$500,000	\$96,980,040

1:1 match from PWSS grant overmatch: 1993 PWSS grant and 2000 PWSS grant (\$161,633 each)

**Repayments/earnings is an estimate only; actual repayments/earnings may be higher

*** Total excluding repayments and interest earnings

Financial Plan DWSRF
State Fiscal Year 2000-01 Grant Application No.2
California DWSRF Implementation October 2000-September 2002
California DWSRF Program Grant 4

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS**	TOTAL ***
I. DWSRF Loan Account	\$79,793,445	\$16,798,620	N/A	\$0	\$500,000	\$96,592,065
Large systems						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Large systems subtotal	\$67,824,428	\$14,278,827				\$82,103,255
Small Systems(15% target)						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Small Systems Subtotal	\$11,969,017	\$2,519,793				\$14,488,810
Loan Account Subtotal	\$79,793,445	\$16,798,620			\$500,000	\$96,592,065
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$0					\$0
State Program Management	\$0					\$0
Capacity Development	\$0					\$0
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$4,199,655					\$4,199,655
Set aside Subtotal	\$0					\$4,199,655
III. DWSRF Administration Account						
4% Set aside	\$0					
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$0					\$0
TOTAL	\$83,993,100	\$16,798,620	N/A	N/A	\$500,000	\$100,791,720

\$00.000 shaded areas indicate target allocation of loan funds

**Repayments/earnings is an estimate; actual repayments/earnings may be higher

***Total excludes repayments/earnings estimate

Financial Plan DWSRF
State Fiscal Year 2001-03
California DWSRF Implementation July 2001-September 2003
California DWSRF Program Grant 5

ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS**	TOTAL***
I. DWSRF Loan Account	\$73,062,600	\$16,686,000	N/A	\$0		\$89,748,600
Large systems						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Large systems subtotal	\$62,103,210	\$14,183,100				\$76,286,310
Small Systems(15% target)						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Small Systems Subtotal	\$10,959,390	\$2,502,900				\$13,462,290
Loan Account Subtotal	\$73,062,600	\$16,686,000				\$89,748,600
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$1,686,800					\$1,686,800
State Program Management	\$0					\$0
Capacity Development#	\$2,000,000	#				\$2,000,000
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$4,217,000					\$4,217,000
Set aside Subtotal	\$7,903,800					\$7,903,800
III. DWSRF Administration Account						
4% Set aside	\$3,373,600					\$3,381,016
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$3,373,600					\$3,373,600
TOTAL I	\$84,340,000	\$16,868,000	N/A	N/A		\$101,208,000

1:1 match from PWSS grant overmatch: 1993 PWSS grant and 2001 PWSS grant (\$1,000,000 each)

\$00.000 shaded areas indicate target allocation of loan funds

***Total excludes repayments/earnings estimate

**Repayments/earnings is an estimate; actual repayments/earnings may be higher

Proposed Financial Plan DWSRF
State Fiscal Year 2002-04
California DWSRF Implementation January 2003 - December 2004
California DWSRF Program Grant 6

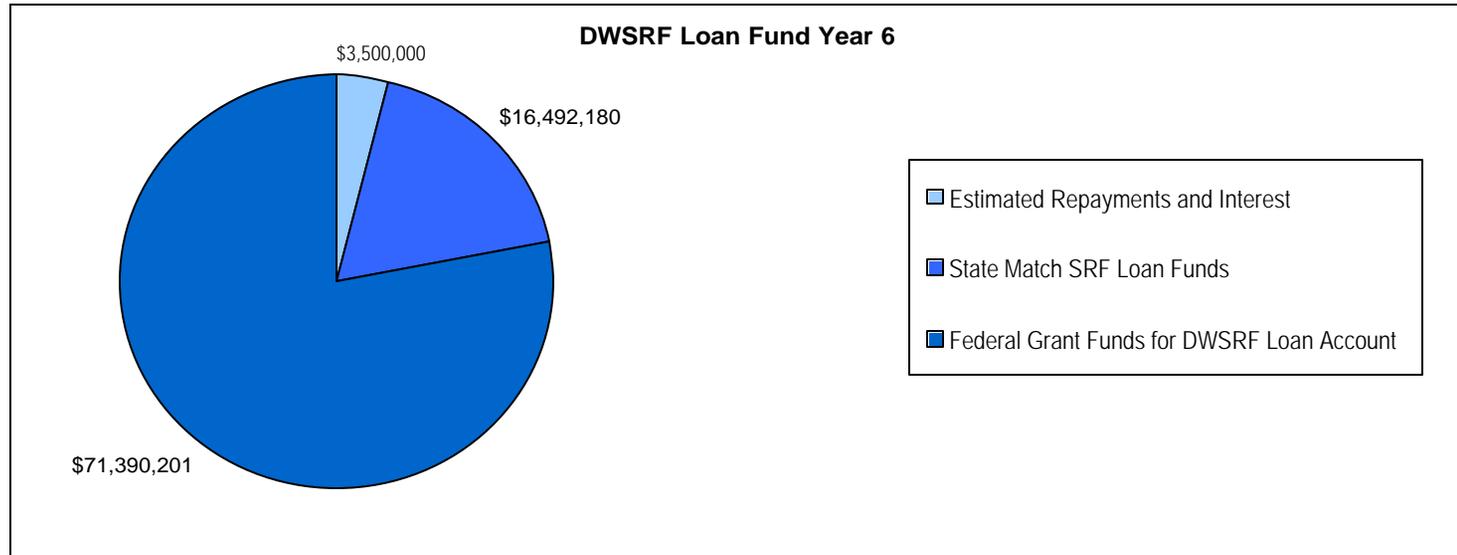
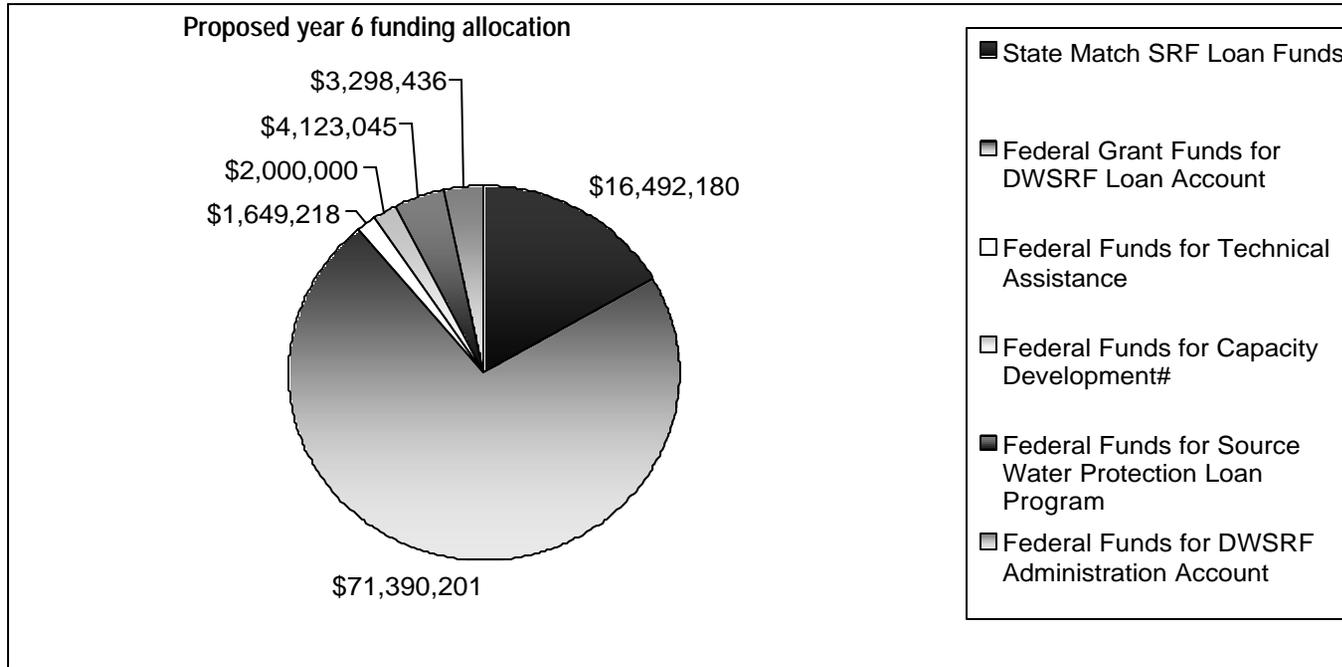
ACCOUNT	FEDERAL FUNDING	STATE MATCH	LEVERAGING	OTHER STATE PROGRAMS	REPAYMENTS & EARNINGS**	TOTAL***
I. DWSRF Loan Account	\$71,390,201	\$16,492,180	N/A			\$87,882,381
Large systems						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Large systems subtotal	\$60,681,671	\$14,018,353				\$74,700,024
Small Systems(15% target)						
Standard Loans						
Disadvantaged Communities						
0% Loan						
Principle Forgiveness (grant)						
Small Systems Subtotal	\$10,708,530	\$2,473,827				\$13,182,357
Loan Account Subtotal						\$0
II. Set Aside Accounts		\$0	N/A	N/A	N/A	
Technical Assistance	\$1,649,218					\$1,649,218
State Program Management	\$0					\$0
Capacity Development#	\$2,000,000	#				\$2,000,000
Local Assistance	\$0					\$0
Source Water Assessment Program	\$0					\$0
Source Water Protection Loan Program	\$4,123,045					\$4,123,045
Set aside Subtotal	\$7,772,263					\$7,772,263
III. DWSRF Administration Account						
4% Set aside	\$3,298,436					\$3,298,436
Fees	N/A	NA	N/A	N/A	N/A	
Subtotal	\$3,298,436					\$3,298,436
TOTAL	\$82,460,900	\$16,492,180	N/A	N/A		\$98,953,080

1:1 match from PWSS grant overmatch: 1993 PWSS grant and 2002 PWSS grant (\$1,000,000 each)

\$00.000 shaded areas indicate target allocation of loan funds

***Total **excludes** repayments/earnings estimate

SDWSRF FFY 2002 Funding Charts



a three-year agreement with DWR for support on financial aspects of the application evaluation and funding commitment, claims, and reimbursement processes. The Department contracted with a new independent audit firm. for external auditing services in 2002.

2. Small Water Systems Technical Assistance

The SDWA authorizes states to set aside up to 2 percent of the total annual federal Capitalization Grant to provide technical assistance to small water systems (those with populations of less than 10,000). As over 8,100 of California's 8,600 water systems fall into this category the Department intends to utilize the entire portion of the Capitalization Grant allowed for this activity. The process developed by the Department to provide technical assistance to California's small water systems is outlined in Section IV, Set-Aside Activities.

3. Capacity Development

The SDWA encourages states to develop a "capacity development strategy" and sets specific goals and deadlines which states must meet in order to remain eligible to receive both the funds for the capacity development set-aside and to preserve the full Capitalization Grant award in future years. The Department intends to allocate \$2 million (approximately 2.4 percent) of the 2002 federal Capitalization Grant to support capacity development activities. The Department's capacity development strategy is set forth in Section IV, Set-Aside Activities.

These funds will be used to continue the capacity development strategy and the assessment of existing public water systems. The funding for these activities, therefore, will be derived under the authorization set forth in Section 1452(g)(2) of the federal SDWA. In addition, external contractors will be utilized to improve the TMF capabilities of public water systems. The Department plans to provide the 1:1 match through current PWSS overmatch and previous years' credit.

4. Source Water Protection Fund

The Department intends to allocate 5 percent of the 2002 federal Capitalization Grant to support loans for Source Water Protection Projects (SWPPs). The funding for these loans will be derived under the authorization set forth in Section 1452(k) of the federal SDWA. The Department will implement the SWPP loan program. USEPA approved the Department's Source Water Assessment and Protection Program (dated January 1999) as of April 26, 1999. Repayment of SWPP loans will be directed to the Safe Drinking Water SRF for re-obligation to SDWSRF projects. This SWPP program will enable community water systems to implement projects directly related to protecting vulnerable water sources from contamination, and can include project funds for land or easement acquisition by community and non-profit non-community water systems. Project proposals cannot address problems for which other sources of funding already exist, such as leaking underground storage tanks.

SWPP projects may involve planning, design, and construction strategies, but may also involve public education, land acquisition, and conservation easements. The type of projects that may be eligible for funding include source water protection measures such as destruction of abandoned

wells; hazardous waste collection programs; upgrade or abatement of septic systems; public education; water quality monitoring at critical points in protection areas; fencing out cattle and other animals from intakes, tributaries or reservoir boundaries; restricting public access to critical areas in protection areas; evaluations of agricultural practices and education on best management practices; installation of signs at boundaries of zones or protection areas; land acquisition; conservation easements; and structures to divert contaminated runoff from the source.

C. Eligibility for Funding

The California Legislature followed USEPA's DWSRF program guidelines when it established the criteria for public water system eligibility for financial assistance.

1. Eligible Systems

Community water systems, both privately and publicly owned, and non-profit noncommunity water systems are eligible for DWSRF financial assistance. Systems providing water for human consumption through constructed conveyances that have become subject to the SDWA due to the change in the federal definition of a public water system in the 1996 SDWA are also eligible for DWSRF funding. Federally owned water systems are not eligible for DWSRF financial assistance from the State of California. While public water systems located on Indian reservations over which the Department has no jurisdiction are not eligible for DWSRF financial assistance from the State of California, Indian Tribes are eligible pursuant to SDWA Section 1452(i) for grant funding from the USEPA for public water system improvement projects.

All of the 8,600 plus public water systems in California are sent information, preapplication, and instructions annually during the open preapplication period in June, when the Department begins the cycle to update the listing. The process of establishing the Project Priority List is described in more detail in Section VI, Project Priority List. As a result of the Department's dissemination and outreach, approximately 3,500 pre-applications from over 1,600 public water systems were received for the initial listing in 1998, and approximately 200 additional projects are added to the list during each annual preapplication period.

The DWSRF may not provide any type of assistance to a system that lacks the TMF capability to maintain SDWA compliance, unless the owner or operator of the system agrees to undertake feasible and appropriate changes in operation, and if the use of the financial assistance from the DWSRF will ensure compliance over the long-term (SDWA Section 1452(a)(3)(B)(i)). The Department conducts capacity assessment as part of the SDWSRF application process to evaluate each system to be funded to ensure it has adequate capacity or has made a commitment to address any capacity gaps.

The SDWSRF may not provide assistance to any system that is in significant noncompliance with any national drinking water regulation or variance unless the State conducts a review and determines that the project will enable the system to return to compliance and the system will maintain an adequate level of TMF capability to maintain compliance (SDWA Section 1452(a)(3)(B)(ii)).

2. Eligible Projects

All eligible projects must facilitate compliance with national or State primary drinking water regulations or further the health protection objectives of the SDWA. There are six types of projects eligible to be funded from the DWSRF loan program. These are listed and briefly described below:

- a. *Compliance and Public Health* - Projects to address SDWA health standards that have been exceeded or to prevent future violations of the rules.
- b. *Projects to Replace Aging Infrastructure* - These include projects to 1) rehabilitate or develop sources; 2) install or upgrade treatment facilities; 3) install or upgrade storage facilities; and 4) install or replace transmission and distribution pipes to prevent contamination caused by leaks, or improve water pressure to safe levels.
- c. *Projects to Provide Treatment Under Section 1401(4)(B) of the SDWA* - Loan assistance to systems affected by the change in the definition of a public water system to include “constructed conveyances” such as canals or other open ditches and certain piped irrigation districts described in SDWA Section 1401(4)(B) for treatment pursuant to SDWA Section 1401(4)(B).
- d. *Land Acquisition* - The acquisition of land is eligible only if it is integral to a project that is needed to meet or maintain compliance or further the public health protection of the SDWA. Land acquisition is only considered eligible if the land is needed as a site for eligible treatment or distribution projects.
- e. *Planning and Design of a Drinking Water Project* - Financial assistance may be given for the costs of project planning, design and other related costs of a Drinking Water project. The cost to applicants of preparing environmental assessment reports may also be included as part of the cost of planning a project. At the Department’s discretion, loans given for this purpose may be combined with a later construction loan.
- f. *Consolidation* - Financial assistance may be given to cover the costs of consolidating a public water system, which is in noncompliance with the SDWA or that lacks the necessary technical, financial and managerial capacity to maintain compliance with the SDWA, with another water system that is in compliance to ensure that compliance with the SDWA is achieved and maintained. The Department is making changes to the DWSRF program regulations to remove administrative barriers to funding consolidation projects (See Appendix A)
- g. *Water system security, water conservation, energy conservation*-- In addition to the above, the SDWSRF may provide loan funds to funded projects to address water system security. The SDWSRF also encourages water systems to

incorporate water and energy conservation measures in the development of their project.)

3. Growth

Federal and state statutes require that DWSRF funds may not be used for projects whose primary purpose is to provide for or attract growth. Both federal and state requirements do allow an eligible project whose primary purpose is not to address growth, to include a “reasonable” amount of growth that would occur during the useful life of the project. California H & S Code Section 116760.20(j) defines “reasonable growth” as not exceeding 10 percent over the design capacity needed to serve the existing water demand. The primary purpose of a proposed project, as well as the amount of project growth is determined during the departmental review and evaluation of the full project application. DWSRF funding for projects that exceed the 10 percent growth limitation is limited to that amount necessary to comply with the reasonable growth definition. A public water system proposing a project that exceeds this growth limitation will need to identify an alternative source of funding to cover the additional cost associated with excessive project component capacity if the system plans to enter into a DWSRF loan agreement.

D. Types of Financial Assistance Available

In accordance with State and federal statutes and USEPA guidance, several types of financial assistance are offered to eligible project applicants. In order to provide some flexibility for applicants, maintain DWSRF fund long-term viability, and fund as many high priority projects as possible, the Department has developed various terms, limitations, and conditions for use of the funds. These criteria are spelled out in the Departments SRF regulations. Funding assistance of any type will be offered only to projects that are within the fundable portion of the Project Priority List. To the extent feasible, the Department will coordinate SRF funding with funding from other State and Federal sources. Applicants are encouraged to make maximum utilization of more appropriate funding sources. Available DWSRF financing options are discussed below.

1. Normal Construction Loans

Normal construction loans comprise the majority of the project financing made available, and cover planning, design, acquisition, and construction costs. All of the federal rules and criteria apply to these loans for systems with more than 1000 services. In addition, pursuant to state law, the following terms and conditions apply:

- The maximum length of the loan is 20 years or the useful life of the project, whichever is shorter (H&S Code Section 116761.22)
- The applicable interest rate is 50 percent of the average interest rate paid by the State on general obligation bonds issued in the prior calendar year (H&S Code Section 116761.65).
- The maximum amount of loan financing to be awarded to a single project during any one fiscal year is \$20,000,000 (subject to provisions of CCR Section 63012).

- In addition to the maximum loan amount per project described above, no public water system with multiple projects shall receive a total amount of loans in excess of \$30,000,000 in any one fiscal year (subject to provisions of CCR Section 63012).

2. Planning Loans

Normally, project planning and preliminary engineering costs are included in a design and construction loan and reimbursed to the applicant. However, in a few cases, some smaller systems may not be able to fund the preliminary planning needed to proceed with a full design and construction loan application. In such cases, an applicant may apply for a planning loan. Receiving a planning loan, however, does not commit the Department to future funding of the project and does not guarantee that a subsequent construction loan will be awarded. Projects receiving a planning loan will retain their place on the priority list and will need to compete with other projects for available funding at the time construction is desired.

Planning loans are subject to the following terms and conditions:

- Funds may be used only for feasibility studies, project planning (including environmental documentation), and preliminary engineering. The funds may not be used for detailed design, equipment, acquisition, or construction.
- The project must be within the fundable portion of the priority list.
- The maximum length of the loan is 5 years. The loan repayments may be combined with a construction loan should one be subsequently awarded. [H&S Code Section 116761.50 (b)(5)]
- The applicable interest rate is 50 percent of the average interest rate paid by the state on general obligation bonds issued in the prior calendar year
- The maximum planning loan amount for any single project shall not exceed \$100,000 per project (CCR Section 63011)
- Forgiveness of principal is not available for planning studies.
- Planning projects will be considered completed when the final draft planning report is approved by the Department (CCR Section 63011).

3. Disadvantaged Communities

As provided for by state and federal statutes, disadvantaged communities (see discussion under Section V.) may be eligible for additional financial assistance in the form of lower interest rates, extended repayment periods, or forgiveness of principal (subsidy). The loan terms and conditions will be as follows:

- The applicant must be a public agency (CCR Section 63020).
- The loan repayment period will be 20 years, or the useful life of the project constructed, whichever is shorter, except that a disadvantaged system may, if necessary, receive a construction loan of up to 30 years as long as this doesn't exceed the expected useful life of the project.
- The loan repayment period will be 5 years for a planning loan (H&S Code 116761.50)
- The applicable interest rate for both planning loans and construction loans will be zero percent. [H&S Code Section 116761.65 (b)]
- The maximum amount of additional financial subsidy to be awarded to a single public water system in any one fiscal year shall not exceed \$1,000,000. (CCR Section 63021)
- The maximum amount of principal forgiveness per project is 80 percent for categories A through G, 65 percent for projects in categories H through L, and 50 percent for projects in categories M through O (CCR Section 63021).
- In addition to the \$1,000,000 maximum total, forgiveness of principal will not be awarded in excess of \$10,000 per service connection. (CCR Section 630210)

4. Refinancing of Projects

Recently completed projects where the initial debt was incurred and construction started after July 1, 1993, are eligible for refinancing (CCR Section 63000.80) under the following conditions:

- The project must be on the current PPL and fall within the fundable portion of the list.
- The project when constructed complied with all federal DWSRF criteria pertaining to new projects. The refinancing procedures as specified in the USEPA guidelines will apply.
- Only publicly owned public water systems are eligible.
- The loan maximums and other terms described in subsection III.D.1 (Normal construction loans) shall also apply to refinancing projects.
- Refinancing will be limited to the existing balance of outstanding municipal debt.
- Only projects in categories A through G are eligible (deficiencies in meeting critical public health standards); refinancing also depends on the availability of funds compared with requests for funding.

5. Local Match Projects

State statutes allow a local agency to pay the required state match (20 percent) in lieu of the state and in return receive a zero interest rate loan. In accordance with USEPA requirements, the Department requires full payback to the State of the loan amount (a combination of state and federal funds). Thus far no SRF loan applicant has pursued providing a local match nor has interest been expressed in doing so. The Department will impose additional terms and conditions on any local match project consistent with the statutory and regulatory requirement in CCR Sections 63000.49 and 63014; H&S Code 116761.65.

E. Application of Federal Cross-Cutters

There are numerous federal laws and executive orders that apply by their terms to projects receiving Federal financial assistance, even though that assistance may be administered by the State. Examples of these include the National Historic Preservation Act, Wild and Scenic Rivers Act, Equal Employment Opportunity executive orders, Minority- and Women-owned Business Enterprise (MBE/WBE), and the Endangered Species Act. As the administering agency of California's DWSRF, the Department has the responsibility to assure that applicants adhere to the requirements of these crosscutting laws and orders. The Department established a central unit of specialists in environmental review to assure compliance with the various environmental and historic/archaeological cross-cutting federal requirements. The Department also maintains a technical staff providing coordination of MBE/WBE and other non-environmental cross cutters.

Projects supported with funds directly made available by USEPA capitalization grants (i.e., projects funded in amounts equaling the grant), sometimes known as "equivalency projects," must fulfill the Federal crosscutting requirements. The Department retains the discretion to determine which projects are treated as non-equivalency projects. The Department designates projects of smaller systems as non-equivalency since smaller systems more often lack the expertise necessary to comply with the more demanding federal equivalency requirements. The Department establishes a cutoff based on the size range and project funding requests anticipated in the funding year pool of DWSRF projects that will be invited to complete the application process. In the initial two years of the program, the non-equivalency funds (equal to the amount of funding from the State match) were used for systems serving less than 1000 service connections (including non-community water systems). Systems receiving SDWSRF funding of \$500,000 or more are required to conform with applicable federal cross cutters regardless of the size of the system..

Non-equivalency projects are required to undergo a tier two environmental review, as explained in a later section. Applications sent to water systems seeking funding for projects determined to be non-equivalency projects will explain in detail the requirements applicable to those projects. When projects whose cumulative funding exceeds the amount of the Federal capitalization grant are treated as equivalency projects, the excess will be banked for use in future years.

It should be noted that all projects and activities funded with DWSRF funds are subject to federal anti-discrimination laws, including title VI of the Civil Rights Act of 1964, section 504 of the

Rehabilitation Act of 1973, and the Age Discrimination Act of 1975. The Department includes standard provisions concerning these cross cutting laws in all funding agreements and service contracts.

IV. SET-ASIDE ACTIVITIES

The federal SDWA provides for a variety of activities to be funded from the DWSRF using “set-aside” funds to be deposited into separate accounts. While federal statute allows as much as 31 percent of the federal Capitalization Grant to be directed to set-asides activities, the Department plans to utilize only 8.4 percent of the 2002 funds are being requested for set-aside programs not directly funding water system projects. Should any set-aside funds not be needed, the remainder will be returned to the DWSRF local financing fund. The Department plans to fund (1) DWSRF administration costs (4 percent), (2) small water system technical assistance program (2 percent), and (3) water system capacity development program (approximately 2.4 percent) from the available federal funds. In addition, 5 percent of the 2002 federal Capitalization Grant will be set aside for SWPP loans for (1) projects involving source protection through acquisition of land or conservation easements and. (2) projects involving implementation of source water protection measures. Following is a brief description of each of the proposed set-aside program elements.

A. Program Administration Element

The full cost of administering the Fund, including the development of the priority list, the review and processing of applications from local agencies, management and oversight of individual projects, management of contracts with cooperating agencies, all accounting and legal costs are funded by this set-aside. The Department does not anticipate instituting any type of loan fee as long as capitalization grants continue to be available. Therefore, there should be no State administrative cost to a local agency to apply for and secure funding from this program. Public water systems will not be billed for time expended in reviewing and processing applications, although this is allowed by state statute (H&S Code Section 116565).

The administration set-aside funding is used to support staff within the Department and to cover the costs of the interagency agreements with DWR and the external audit contract. The administrative set-aside supports a number of staff in the SDWSRF headquarters office, including those providing environmental review, capacity development program oversight, technical assistance program management, and administrative support of SDWSRF contracts, fiscal, and program management and personnel needs. DHS utilizes a detailed time-accounting system to track hours devoted by staff to the DWSRF program elements. This time accounting system forms the basis for personnel costs drawn from the set asides for DWSRF administration, technical assistance and capacity development.

The initial, three-year agreement between the Department and DWR was renegotiated during 2000. Under this agreement, DWR provides fiscal oversight of SRF loans and grants for the Department’s DWSRF and SWPP projects. The Department contracts annually for audit services to fulfill the federal program audit requirement.

A portion of the Administration set aside is used to fund positions of the DWSRF Fiscal Support Team in the Accounting Section of the Department's Administration functional area. The senior accounting officer and the accounting technician handle Department responsibilities for loan claims payments, including federal ACH draws, accounting of the various functional subaccounts through which the various set-asides are tracked, and semi-annual billing for interest and principal to funding recipients. The DWSRF Fiscal Support Team coordinates closely with the DWSRF program manager, and with DWR. The Fiscal Support Team provides the point of contact with the State Controller's Office, and may consult on matters related to the sale of State bonds providing state matching funds.

USEPA has established the Drinking Water National Information Management System (DWNIMS) database for maintaining information on DWSRF funding and assistance. Pursuant to USEPA's Final Guidelines for the DWSRF Program (February 1997), the Department provides information to the DWNIMS on a semiannual basis. USEPA uses this data to assess the program on a national basis and to monitor state progress. USEPA's regional offices use the information to assist in conducting their annual review of the state program to assess state compliance with the annual grant agreement, including compliance with special federal requirements and limitations on use of SRF funds, including recipient and project eligibility and the type of assistance provided, and assess the state's progress in specific tasks identified in the IUP,

The Department utilizes SRF administrative funds to support several data management positions and activities, which in turn support the California's DWSRF program. These data management resources are directed to development of a database for tracking information related to the state DWSRF priority list, the funding process, and project construction. This database, referred to as the Management Accounting and Reporting System (MARS) database, will be phased in to encompass all data tracking functions of the drinking water program. The initial emphasis of MARS has been capturing data needed for management of the DWSRF program. The system aides program staff in tracking projects designated as subject to compliance with cross cutting federal authorities, the progress of applications toward receipt of funding, and the progress to completion of the project. The information in the database enables staff to determine whether the pace of the program will meet achieve funding goals for targeted recipients such as small systems and disadvantaged communities. The information is also used when making projections for quarterly payment and cash draw schedules. Rollout of MARS is being made available to field offices through a wide area network to allow accurate and timely access to project information both in field offices and headquarters units.

B. Small Water System Technical Assistance Program Element

California has over 8,100 small public water systems (systems serving a population of less than 10,000). As has been well documented over the years, many of these small systems lack the technical capability to be able to comply with the numerous and technically complex requirements of the SDWA. Although the Department assisted by the local primacy agencies (LPAs), has attempted to assist these small systems, the resources to do so have been extremely limited. Recognizing this condition exists nationally, Congress has provided that up to 2 percent of the federal Capitalization Grant could be used to provide additional technical assistance to

small systems. Since the need of the small systems substantially exceeds the allowable 2 percent, the Department intends to apply for the maximum amount available. The Department uses these funds to provide additional in-house technical staff and to contract with LPAs and outside contractors to provide a variety of technical services to small systems in need.

The primary goals of the small system technical assistance program are: (1) reducing the instances of noncompliance with drinking water standards and requirements; (2) establishing and assuring safe and dependable water supplies; (3) improving the operational capability of the systems; and (4) establishing or improving the financial, technical, and managerial capability of the systems. This program is directed at those systems serving a population of less than 10,000, with much of the emphasis given to community water systems serving less than 200 service connections.

The specific work activities to be conducted during FY 2002-2003 will be determined by the Department assisted by LPAs and interested third parties. One of the areas of priority, however, will be to assist small systems in the preparation of applications for DWSRF funding. Preparing these applications, particularly the environmental documentation and preliminary engineering needed, is beyond the technical and financial capability of many systems. The Department, with the help of LPAs and third party contractors will provide some of this assistance.

In addition to the above, the small system technical assistance program will focus on the following activities:

- Source water capacity and demand evaluations
- Correction of existing or pending violations and other operational problems
- Treatment of source water
- Development of distribution system operational plans
- Operator training (workshops, training materials etc.)

C. Water System Capacity Development Program Element

Many systems have difficulty in understanding and complying with technically complex drinking water requirements. The term “capacity” collectively refers to three necessary components of effective water system operation, the technical, managerial, and financial (TMF) capacity or capability of the system available for ongoing system operation. A system needs the financial wherewithal to adjust and make improvements, the technical knowledge to effectively understand and operate the physical aspects of the system, and the managerial capability to plan and administer overall water system operations. The capacity development set-aside element of the state program reviews and updates of TMF criteria, the mechanisms for assessing a water system’s adequacy in these three operational areas, and the use of these TMF assessment tools. By assisting systems to recognize and address their TMF deficiencies, the capacity development

program seeks to improve the systems' operational programs to assure that acceptable levels of operation can be met and sustained.

This program is being implemented in phases. Phase I was development of the actual acceptable performance criteria for TMF elements in order to prevent the formation of new water systems that do not meet the established criteria. In Phase II, the state program focused on assessing existing public water systems in light of the criteria, to determine where improvements were needed, and to identify program assistance priorities. Phase III is to provide assistance to those systems most in need of help to meet TMF criteria for reliable long-term water system operation. Phase II and III have been outlined in the multiyear workplan for that set aside element.

A major activity was undertaken to develop a comprehensive state capacity program involving major program elements (i.e. permits for new systems, inspections, operator certifications, training, financial assistance, master planning, technical workshops and assistance). To assist in accomplishing this, the Department sought public participation and established an advisory group of persons and entities interested in the capacity development program. The Department completed its first draft comprehensive program strategy in May 2000, which was subjected to public workshops and hearings. After receiving public input, the DHS complete TMF strategy was submitted to USEPA, reviewed and accepted as of September 8, 2000.

Since 1998, the Department has had the statutory authority (H&S Code Section 116540(a)) to prevent the formation of a new public water system that does not comply with the capacity criteria. This provision is implemented through the issuance (or denial) of a domestic water supply permit that must be issued by the Department before a public water system can be formed or operated. A review of the permit review and issuance process is ongoing and a progress report was provided to USEPA in 2002.

During FY 2002, the additional Department staff, with the assistance of third party contractors will begin the assessment of existing public water systems for compliance with the adopted capacity criteria. For the most part, this assessment will be conducted in conjunction with the annual public water system inspection conducted by the Department, but separated from mandated regulatory and billing obligations. Training will be provided to Department, third-party, and LPA staff as necessary. To conduct the capacity development activities during FY 2002-03 the Department is requesting a set-aside of \$2,000,000 from the 2002 Capitalization Grant.

The Department has met the requirement that the necessary legal requirements for treatment and distribution system operator certification through the emergency adoption of Operator Certification regulations which became effective January 1, 2001. The final version of these regulations became effective August 13, 2001.

V. DISADVANTAGED COMMUNITIES

California statutes and regulations provide additional financial assistance to “disadvantaged communities” if such communities cannot afford to repay the full amount of the loan needed to fund the proposed project. The interest rate to disadvantaged communities is set at zero percent (H&S Code Section 116761.65). The assistance may include extending the repayment period to 30 years (but not to exceed the design life) as allowed in the federal act. In addition, for water systems owned by a public agency and serving a disadvantaged community, State law allows forgiveness of up to 80 percent of the loan principal. The entire service area of the public water system must meet the criteria for a disadvantaged community in order for the system to be eligible for consideration for these special financial assistance measures. The provisions of State law allow for assistance so that the resultant water rate to the average residential user is no higher than 1.5 percent of the median household income (MHI) for the community.

Meeting the criteria of a disadvantaged community is the first step in receiving additional financial assistance. Merely meeting the criteria, however, does not guarantee that additional assistance beyond a zero interest loan will be provided. The offer of additional assistance will be dependent upon the disadvantaged community’s ability to repay a loan. Thus, factors such as household income levels, current and projected monthly consumer water charges, and the cost of the proposed project become determining factors when setting the interest rate on SDWSRF loans.

The determination as to whether a disadvantaged community qualifies for additional financial assistance will not be made until DWR completes its evaluation of the revenue program, project costs, and other financial information contained in the full project application. Therefore, while a public water system may be able to determine in advance whether or not they qualify as a disadvantaged community, they will not know if additional financial assistance will be provided (subject to the limitations described in Section III.D.3.) until the full application process is completed. A diagram of the SDWSRF project funding process is provided in Figure 2. The process and steps for making determination of financial need is shown in Figure 3.

The Department assists economically disadvantaged communities in resolving serious drinking water problems consistent with legislative direction. However, the excessive awarding of subsidies would undermine the primary objective of the program, which is to establish a long-term self-sustaining revolving loan fund. Funds given out in the form of subsidy (loan forgiveness) are not returned to the fund in the form of repayments, and so reduce the future ability to fund DWSRF projects. The Department has balanced these two objectives to meet the overall need of the program. An ongoing and viable loan program is in the best interest of both financially stable and economically disadvantaged communities.

The Department’s success in maintaining an appropriate balance between normal direct loans and additional financial assistance will be monitored closely and will be reported to the USEPA in future IUPs.

VI. PROJECT PRIORITY LIST

In accordance with federal requirements, all potential recipients for DWSRF funding must have had their projects included on a statewide Project Priority List. The Department developed and adopted a 2000 Updated Project Priority List which was finalized in April 2002 and which will be used for obligating funds from the federal allocation addressed by 2002 IUP. The Department has developed a priority list of SWPP projects, which will serve as the basis for funding SWP loans under the 5 percent set aside in this IUP for that purpose (See III.B.4. SWP Fund). Operationally, the Department merges projects that are on an existing priority list with new applications when establishing an updated project priority list. This eliminates the need for many applicants to resubmit applications each list revision cycle. The Updated Project Priority List to be used for the 2002 allocation is attached as Appendix C.

Placement of a project on the priority list does not guarantee that a project will be funded. However, only those projects that are included on the priority list will be considered for possible funding. Projects may only be added to a priority list during the annual public hearing and adoption process.

Pursuant to state statutory authority, the Department may revise the ranking of a project on an existing priority list at any time if information affecting the ranking of that project becomes available that was not available at the time the list was adopted.

A. SRF Project Priority Ranking Criteria

1. Health Risk and Safe Drinking Water Act Compliance Categories

As required by federal and state law, water system projects are offered SRF funding based on a Project Priority List developed by the Department. In establishing the priority list, the Department ranks projects in order of the degree of health risk associated with the problem that the proposed project is intended to solve. Thus, the projects solving the most serious health risk and SDWA compliance problems receive the highest ranking. When ranking projects, within a category the Department places smaller systems higher on the list within the category than larger systems, and, within each category, places systems with lower MHI ahead of non-disadvantaged systems.

The Department has had considerable experience in developing Project Priority Lists using the above criteria (with the exception of “affordability”) in implementing several previous drinking water financial assistance programs. Based on this experience, the Department determined that a category system whereby projects fall into designated categories provides the most feasible and practical way to rank proposed projects. The categories established for the DWSRF program are consistent with USEPA’s criteria and are similar to those categories used during the previous state funding programs. These categories group water quality, quantity, and reliability problems that have a similar degree of health risk. The Department has developed similar ranking criteria for the SWP-PPL projects.

FINANCIAL NEED DETERMINATION FLOWCHART

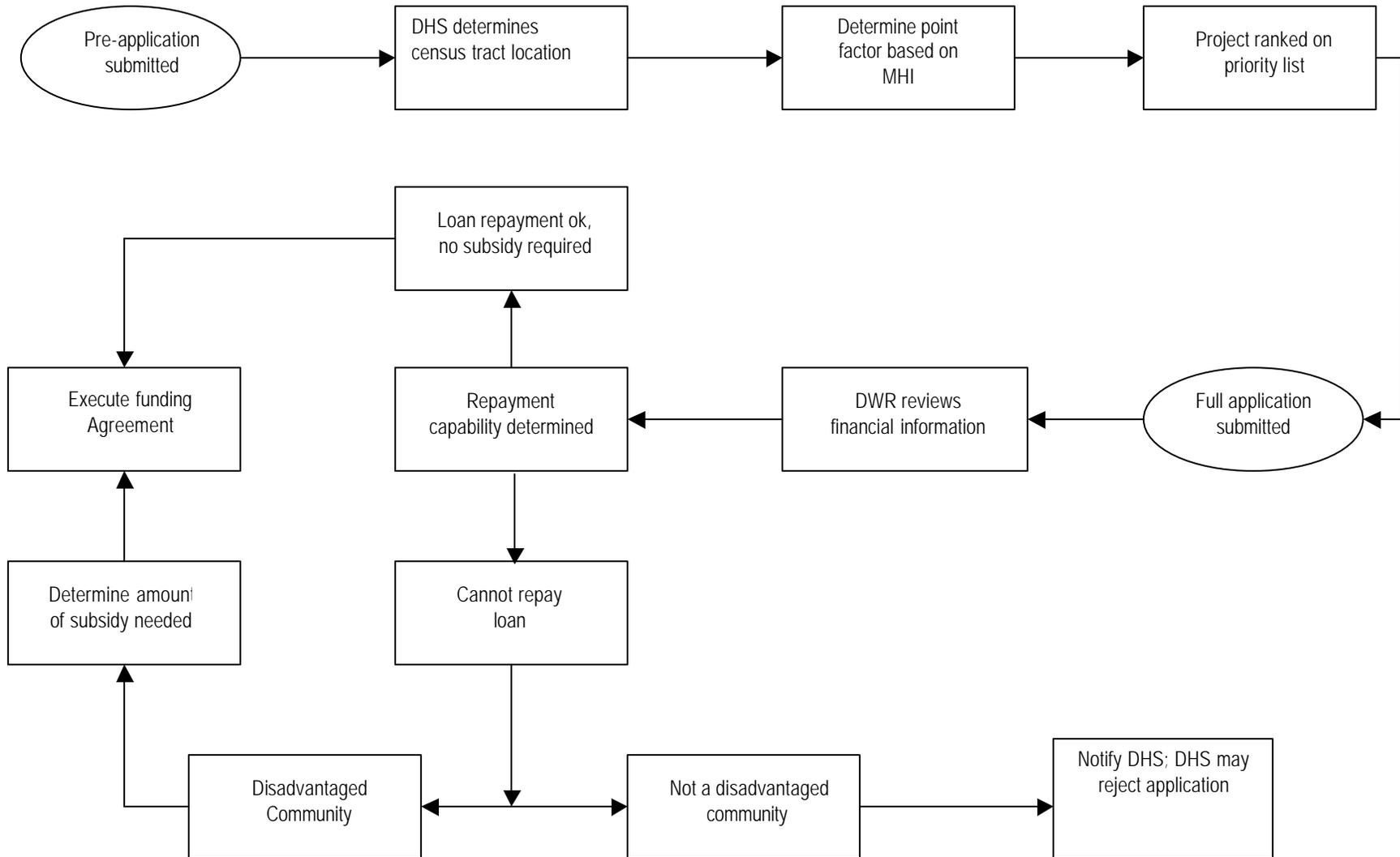


Figure 3

The categories that have been established by the Department are briefly summarized below (a more detailed description of the categories is included in Appendix D):

<u>Category</u>	<u>Description</u>
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- | | |
|----|--|
| A. | Water systems with deficiencies that have resulted in documented waterborne disease outbreaks or water systems under court order to correct SDWA violations and/or water outage problems |
| B. | Water systems that have sources contaminated with coliform bacteria (fecal, <i>E. coli</i> , or total coliforms) resulting in repeated violation of the total coliforms MCL. |
| C. | Water systems which have a surface water supply that is not filtered or well sources that are subject to fecal or <i>E. coli</i> contamination. |
| D. | Water systems that have surface water sources with treatment deficiencies that violate the Surface Water Treatment Rule (SWTR). |
| E. | Water systems with water outages or significant water quantity problems caused by insufficient source water capacity or insufficient water delivery capability to supply current demand. |
| F. | Water systems that (1) distribute water containing nitrates/nitrites in excess of the MCL, or (2) water systems have ongoing violation of the Total Coliform Rule as a result of distribution system problems. |
| G. | Water systems that distribute water containing chemical or radiological contamination exceeding a primary MCL other than nitrate/nitrite. |
| H. | Water systems with uncovered distribution reservoirs or water systems with low-head transmission mains. |
| I. | Water systems that meet existing Surface Water Treatment Regulation but not the California Cryptosporidium Action Plan. |
| J. | Water systems that have violations of the Water Works Standards that could result in entry of wastewater into the water supply or distribution system. |
| K. | Water systems that operate disinfection facilities that do not comply with the Water Works Standards or other State regulations. |
| L. | Water systems that (1) are under a compliance order due to ongoing distribution of water exceeding the iron or manganese secondary standard; or (2) violate a Department published action level in the water distributed to consumers, or (3) rely on standby groundwater sources that are contaminated in excess of a primary MCL for a chemical or radiological contaminant. |

- M. Water systems that do not meet the Water Works Standards other than those components already covered by the above listed categories; or projects to correct an ongoing TMF (system reliability) deficiency not covered by the above categories.
- N. Water systems in violation of a secondary water quality standard (other those included in the above categories) in the water delivered to consumers.
- O. All water system deficiencies which cause a risk to the water safety or quality, or the reliability of water delivery system, that are not covered in any of the above categories.

In general, the Department considers priority categories A through G to be high priority, categories H through K to be medium priority and categories L through O to be low priority.

2. Bonus Ranking Points

Bonus points are used in ranking projects within a category. The addition of bonus points will not move a project from one category to another. This point is stressed more than once in this document to emphasize that the category in which a project is placed is much more important, for funding concerns, than is the assignment of bonus points. To the extent feasible, when a group of systems is invited to complete the application process for SRF funding, all the systems within that category seeking funding that year are invited.

a. Affordability

The Department factors in affordability using a system similar to that used by the State of New York. This method compares the median household income (MHI) level of the community served by the proposed project to the statewide median household income level. Communities that are below the statewide average median household income level receive additional ranking consideration. This gives poorer communities a higher ranking within a category than communities with higher income levels do. Additional affordability ranking points will be granted as follows:

<u>MHI of Service Area</u>	<u>Ranking Points</u>
Greater than the statewide MHI	0
90% - 100% of statewide MHI	5
80% - 89% of statewide MHI	10
70% - 79% of statewide MHI	15
60% - 69% of statewide MHI	20
less than 60% of statewide MHI	25

b. Consolidation

For purposes of ranking projects within a category, any project that includes consolidation of separate existing water systems will receive additional ranking points. Twenty points will be awarded for a physical consolidation of two or more systems and 10 points will be awarded for

new consolidation of ownership and/or management (no physical consolidation) of two or more systems. The purpose of assigning consolidation points is to promote reliability, efficiency, and economy of scale that can be achieved with larger water systems while discouraging the proliferation of numerous separate small systems with their inherent inefficiencies and limitations, consistent with H&S Code Section 116760.10(g). The Department adopted changes to the DWSRF regulations to facilitate funding of consolidation projects which became effective September 5, 2002. (See Appendix A).

3. Type of System

Because there is a relatively higher health risk associated with persons who drink the same water each day over a period of time (accumulated exposure), community and nontransient noncommunity water systems are ranked above transient noncommunity systems within a category.

4. Population

Award of additional points for affordability and consolidation affects the ranking of a project within a category, but does not result in a project being elevated to a higher category. All projects within a category that have the same number of ranking points are ranked in ascending order based on the population served by the water system with smaller populations ranked above higher populations. This allows smaller communities that have a more difficult time obtaining financing an opportunity to compete with much larger systems for available state financing.

The California enabling legislation emphasizes that that the degree of health risk, compliance with the SDWA, and affordability are the primary criteria for ranking projects. The ranking criteria described in this section accomplish this. California law also indicates that the amount of growth included in a proposed project should be considered. To the extent this can be determined at this very preliminary stage of the process, the Department considers this element. The primary growth evaluation, however, is made during the review of the full project application when this information becomes available. The Department determines actual funding priority at that time.

B. Source Water Protection Program Project Ranking Criteria

1. Protection of Water Source from Contaminants Posing a Health Risk

The following categories are used for ranking SWPP projects:

Category Description

- A. Source water protection projects that address microbial contaminants associated with potential contaminating activities (PCAs) located in Zone A of a SWP area for a ground water source, or located in Zone A or B of a SWP area for a surface water source if zones have been established.
- B. Source water protection projects that address nitrate associated with PCAs located in Zone A for a ground water source.
- C. Source water protection projects that address nitrate associated with PCAs located in Zones B5, B10 and/or a recharge area for a ground water source.
- D. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs located in Zones A and/or B5 for a ground water source, or located in Zones A and/or B for a surface water source if zones have been established.
- E. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs in Zone B10 of a ground water source.
- F. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs in the watershed of a surface water source.
- G. Source water protection projects that address disinfection byproducts and/or chemicals associated with PCAs in the recharge area of a ground water source.
- H. Source water protection projects that address microbial contaminants associated with PCAs located in Zone B5 and/or B10 for a ground water source, in the recharge area of a ground water source, or in the watershed of a surface water source.
- I. Source water protection projects that address microbial contaminants, nitrate, or disinfection byproducts and/or chemicals associated with PCAs in the buffer zone of a ground water source, if a buffer zone has been established.

2. Bonus Points

SWPP projects will be ranked within a category based on the total number of bonus points awarded by the Department using the following criteria. These criteria provide higher priority to systems in which actual water contamination is known to have occurred and that contamination has shown movement toward the system's water source. The criteria also award points within a

category based on actions, which the water system has undertaken on its own to establish a source water protection plan, thereby reflecting a readiness to proceed.

- A water system with a source water assessment completed in accordance with the California Source Water Assessment and Protection Program will be awarded 4 bonus points.
- A water system that has organized a local task force or work group to develop and implement a source water protection program will be awarded 2 bonus points.
- A water system that has developed a source water protection program that identifies possible management measures will be awarded 2 bonus points.
- If the contamination from the PCA(s) that the project proposes to address has been released and the direction of movement is toward the drinking water source, the water system will be awarded 3 bonus points.

3. System type and size criteria

Projects in the same category that have the same number of bonus points will be ranked in accordance with the following:

- Community and non-transient non-community water system projects will be ranked above transient noncommunity water system projects.
- Projects that are proposed by the same type of water system will be ranked in ascending order (smaller populations above higher populations) by the number of persons served.

C. Process for Adoption of Priority List

The ranking of projects on the Project Priority List is based on the submission of a pre-application by public water systems. The pre-application is a relatively simple one-page form that must be filled out and submitted by any water system wishing to have a project included on the priority list. A copy of the pre-application form used by the Department is included as Appendix E. A copy of the SWPP preapplication is included as Appendix F. In preparing the 2002 updated listing, a copy of the SRF and SWPP preapplication forms were sent to all public water systems in California. Since there is no obligation on the part of the water system, all water systems were encouraged to submit pre-applications for any projects for which they might want to consider the use of DWSRF funding in the near future. Water systems are not limited in the number of projects they submit. In fact, systems were encouraged to submit separate pre-applications for each separate water problem faced by the system. During development of the initial (1997) listing the Department received nearly 3500 pre-applications. During the development of the annual updates in 1999 and 2000, new or updated preapplications were received from approximately 200 systems each submission period. The 2002 Updated PPL included these preapplications and projects from the 1997 listing, for a total of 3700 projects on the 2002 Project Priority List.

Following receipt of the pre-applications, the Department's district field staff reviewed each project and the project was ranked into the appropriate category. Any bonus points were also assigned and the applicant was informed of the category ranking. This information is entered into a statewide database from which the statewide Project Priority List is developed. A flow chart depicting the pre-application review process is shown in Figure 4.

In addition to individual water system notification, two public hearings were held, one in Sacramento and one in the Los Angeles area. Public comments were taken on the draft 2002 Update of the SRF Project Priority List, and the SWPP PPL as well as the SWPP priority ranking criteria. The Updated SDWSRF PPL for 2002 and the initial SWPP PPL were then adopted. This 2002 Updated SRF Project Priority List is included as Appendix C. The SWPP PPL is included as Appendix G.

D. Use of the Project Priority List

As indicated earlier, the Project Priority List forms the basis for determining which projects will receive funding. To the extent feasible, projects will be funded in descending order of their placement on the priority list. However, due to the federal deadlines on obligation of the available funds, projects that are not ready to proceed may be by-passed for that particular funding cycle. Any project that is by-passed will retain its position on the priority list and be eligible for the next funding cycle.

Following adoption of the priority list, the Department will determine which projects have indicated an immediate "readiness to proceed." Readiness to proceed means an ability and willingness to enter into and sign a loan commitment by the deadlines established by the Department for that funding year. The projects that are ready to proceed will be separated into large water system (serving 10,000 or more persons) and small water system (serving less than 10,000 persons) lists. Based on the amount of funding available, the Department will determine which portion of the Project Priority List will constitute the "fundable" portion of the list for that particular funding cycle.

While the fundable project list will include small and large systems and will not exceed the amount of funds available in the loan fund, the Department will identify a number of large systems that together equal 200 percent of the funds available for large systems for that year. This group of large systems will constitute the working list of large systems. The purpose of this working list of large systems is to ensure that there are enough projects ready to proceed at the time the Department initiates the funding by-pass procedures.

Similarly, the Department will identify a number of small systems that together equal 200 percent of the funds available for small systems for that year. A higher percentage goal is used for small systems due to the anticipated higher drop out rate for small systems. This group of small systems will constitute the working group of small systems. The purpose of this list is to ensure that there are enough projects ready to proceed at the time the Department initiates the funding by-pass procedures.

All projects in the working list of large and small systems will be invited to submit a full application for funding from the 2002 funds. The SDWSRF fundable project list for 2002 funding

PRE-APPLICATION REVIEW AND RANKING PROCESS

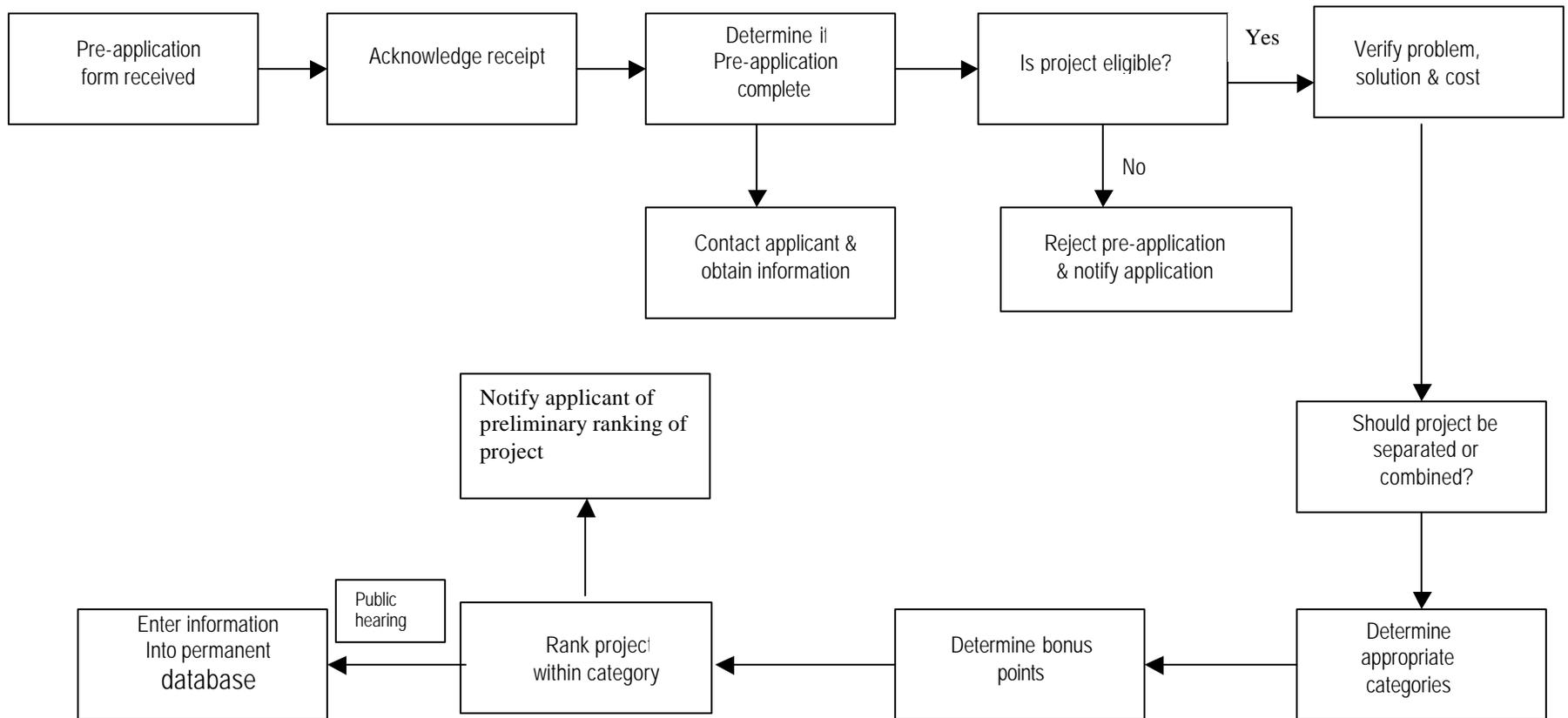


Figure 4

is attached in Appendix H. Applications received from large and small systems in the working list, but not in the fundable project list, are processed as received but funding commitments is not be made until after the by-pass procedures have been initiated, and will be made in order of priority in the Multi-Year Project Priority List. The by-pass procedures occur at multiple times and points in the process. Accordingly, the working list as well as the fundable list will be adjusted periodically based on the by-pass results. A revised fundable list will be submitted to USEPA as revisions are made.

As required by the federal guidelines, the Department will annually establish a small water system funding reserve. The purpose of the small system reserve is to assure that small systems do not have to compete with large water systems for available funds and thus would have more time to develop and submit applications without fear of losing funds to larger systems that may be ready to proceed at an earlier date. The amount of the annual small system reserve will be a minimum of 15 percent of the total funding available for financing projects.

E. Project By-Pass Procedures

As indicated, it may be necessary from time to time for the Department to by-pass a project on the priority list in order to fund a lower ranked project. This is essential to meet the federal funding obligation deadlines and avoid loss of funds. Projects will be by-passed only under one or more of the following conditions:

1. The applicant indicates on the pre-application form that they do not desire or will not be able to receive funding in the current funding year. This project will be by-passed automatically for the current year.
2. Upon receiving an invitation from the Department to submit a full application, the applicant notifies the Department that they do not wish to submit an application at this time or that they cannot meet the application submittal deadline.
3. The applicant fails to submit the full application by the deadline established by the Department.
4. A full application is rejected by the Department and a revised application cannot or will not be resubmitted within the deadlines established by the Department.
5. The Department determines (and has notified the applicant) that the applicant does not (or will not) meet the TMF capacity requirements and is thus ineligible.
6. The water system is in “significant noncompliance”, and it is determined that the project will not return the system to compliance with the SDWA.
7. Upon receiving a letter of loan commitment from the Department, the applicant fails to sign and return the letter by the deadline established by the Department.

8. The applicant fails to submit plans and specifications for the project by the deadline established by the Department and the initial loan offer is withdrawn.
9. The applicant has reached the \$30 million annual per applicant loan cap. All other projects for the applicant that would exceed the \$30 million cap will be by-passed.

Applicants whose projects are, or will be, by-passed are notified. Any project that is by-passed will retain its position on the current priority list and will be eligible for potential funding in the following fiscal year.

VII. PUBLIC PARTICIPATION

The DWSRF guidelines provided by the USEPA require that states, seek meaningful public review and comment on its funding decisions in the IUP. The Department has, from the earliest days of planning for its DWSRF program, involved numerous groups and individuals in the development of the ranking criteria and program components. This section provides a summary of the Department's efforts to involve the public in the development of the DWSRF program.

A. DWSRF Program Development

Since, early in 1997 the Department has met monthly with the "DWSRF Interest Group." Members of this group represent water associations, state and federal agencies, and other stakeholders who have an interest in the development of the DWSRF. The members of this group reviewed early drafts of the pre-application form, ranking criteria, Project Priority List and the IUP. Each member of the group commented on behalf of their own organizations or individual concerns rather than as a team. Thus, each was able to make the Department aware of the needs and concerns of their own constituency groups. A list of the members of the DWSRF Interest Group has been previously submitted to the USEPA.

B. Project Priority List and the Intended Use Plan

Announcement of the draft versions of each year's IUP and each Project Priority List are sent to each public water system in the state, as well as county health departments. Additionally, copies of the IUP and the Project Priority List are available to all interested parties on the Department's internet web site. A public hearing is held on the draft IUP and Project priority Lists, and written and oral comments are accepted prior to finalization of these documents.

C. Source Water Assessment and Protection (SWAP)

The comprehensive description of California's SWAP is contained in the Department's Drinking Water Source Assessment and Protection Program report, dated January 1999, which has been submitted previously. The public participation outlined in that document is expected to continue. The Department generally meets annually with the Policy Advisory Committee and the Technical Advisory Committee to receive updates on SWAP activities and to provide input on the future course of these activities. The Data Advisory Committee, which provides input to the source water assessment program automation tools development meets regularly with

representatives of the Department and the contractors at UC Davis developing the data tools. In addition to these formal meeting. DHS representatives also have opportunities to receive input from the water community when making presentations and participating on professional committees at meetings of groups such as the Groundwater Resources Association, the California Environmental Health Association, and the Association of California Water Agencies, and the CALFED Bay-Delta project.

D. Small Water System Technical Assistance

The small water system technical assistance (SWS-TA) program strategy was developed with the assistance of interested groups such as California Rural Water Association, Rural Community Assistance Corporation, Community Development Block Grant program, California Conference of Directors of Environmental Health (CCDEH), local environmental health agencies, Self-Help Enterprises, American Water Works Association and others. Workshops were conducted throughout the state during 1997 in an effort to involve small water systems in the DWSRF.

E. Capacity Development

During 1999, the Department has provided key policy documents to an external group of interested parties, the SRF TAC, in order that these stakeholders may advise the Department on both capacity development and technical assistance activities during the development of this program. This advisory group has met on several occasions. Input from the DWSRF Interest Group, CCDEH, the LPAs and other committees and a task force group has been central to the program development process.

In addition to the committees and public meetings described above, Department staff has also made numerous presentations at various meetings and conferences that described the SRF program and solicited input. .

The Department worked extensively with the regulated community and the public in enactment of the necessary statutory changes to conform with federal water operator certification requirements. The Department has also consulted and worked extensively water systems, water operators, testing and training organizations, and other states in development and implementation of operator certification program changes, including extensive regulatory changes. The Department now certifies both treatment and distribution system operators.