

**California Clean Water and Drinking Water
State Revolving Fund Program Evaluation Report for SFY Ending 2023
September 24, 2024**

I. Executive Summary

EPA conducted its annual review of the California State Water Resources Control Board (SWRCB) Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund (DWSRF) programs in accordance with EPA's SRF annual review guidance. Based upon the file and program reviews and on-site interviews, EPA concludes that the State of California has administered the programs in compliance with the capitalization grant agreements. All financing executed by the SWRCB assisted wastewater and water systems to maintain or bring them into compliance with federal and state clean water and drinking water requirements.

The SRF programs in California demonstrated strong performance in SFY 2023. In the first year of implementing the supplemental sources of funding provided by the Bipartisan Infrastructure Law (BIL), SWRCB achieved among the highest fund utilizations in the country and executed \$600.8 million in CWSRF assistance and \$74.2 million in DWSRF assistance.

II. Introduction

In accordance with the Safe Drinking Water Act and the Clean Water Act, EPA provides funds to states to capitalize their DWSRF and CWSRF programs, respectively. EPA is required to conduct an annual oversight review of each state's DWSRF and CWSRF program as required by 40 CFR §35.3165(c) and 40 CFR 35.3570(c), respectively. The purpose of the annual review process is to assess the cumulative program effectiveness, fiscal health, compliance with the statutes and regulations, operating agreement, and grant conditions governing the State's DWSRF and CWSRF programs.

SWRCB is responsible for administering the California DWSRF and CWSRF programs. SWRCB provides low interest loans to offset the financial burden of planning, designing, and constructing water and wastewater infrastructure. SWRCB also sets aside some of the DWSRF funds to supplement the Public Water System Supervision (PWSS) program and to provide technical assistance to water systems.

To provide EPA with information on the progress and many accomplishments of the California SRF programs for the review period ending June 30, 2023, the SWRCB submitted to EPA draft versions of the California DWSRF Annual Reports and the California CWSRF Annual Reports on April 24, 2024, and final versions on July 29, 2024. This Program Evaluation Report (PER) documents EPA's observations, recommendations and requested and/or required follow-up action items for the period of review.

On May 15 through 17, 2024, EPA conducted an on-site annual review of DWSRF and CWSRF program activities. During this time, staff from EPA Region 9 conducted in-person interviews with SWRCB staff and management to discuss various aspects of the DWSRF and CWSRF programs. To ensure that the annual review addressed all major review elements for both programs, EPA staff completed the *SRF Annual Program and Financial Review Checklist, Attachment A*. On June 11, 2024, EPA held an exit meeting with SWRCB staff and managers to discuss observations and recommendations taken from the annual review.

Following the annual review, EPA prepares a PER. The PER covers all program activities from program inception to the present, with major emphasis on the activities performed during the last state fiscal year. As noted, this PER evaluates activities performed during state fiscal year 2023, or July 1, 2022 through

June 30, 2023, otherwise referred to as the review period. This PER highlights observations from the review and identifies recommendations and follow-up actions to be addressed as soon as feasible.

III. Background and Scope

The California DWSRF uses federal capitalization grants, state match funds, loan repayments, and interest earnings to make loans for construction of drinking water treatment facilities and support several Safe Drinking Water Act programs. As reported in the SRF Data System, also referred to as the National Information Management System (NIMS), SWRCB has received \$3.1 billion¹ from EPA in DWSRF capitalization grants since the inception of the program. Together with the state match and American Recovery and Reinvestment Act (ARRA) funds, the total state-federal investment is \$3.7 billion². Since the inception of the program, SWRCB has closed 574³ DWSRF assistance agreements totaling \$4.69 billion⁴ according to NIMS as of June 30, 2023.

The California CWSRF uses federal capitalization grants, state match funds, loan repayments, bond proceeds and interest earnings to make loans for construction of wastewater treatment facilities, the implementation of nonpoint source water quality control projects, and the development and implementation of estuary enhancement projects. As reported in NIMS, SWRCB has received \$4.015 billion⁵ from EPA in CWSRF capitalization grants since the inception of the program, including ARRA and special appropriation grant funds. Together with the state match, the total state-federal investment is \$4.8 billion⁶. Since the inception of the program, SWRCB has closed 994⁷ CWSRF assistance agreements totaling \$14.76 billion⁸ according to NIMS as of June 30, 2023.

The scope of the annual review includes consideration of the legal, managerial, technical, financial, and operational capabilities of SWRCB to manage the Clean Water (CW) and Drinking Water (DW) SRF programs. EPA Region 9 used the *2023 SRF Annual Review Guidance, the SRF Program Review Checklist, the Project File Review Checklist*, data collected in NIMS and the additional financial metrics required by the Government Accountability Office (GAO) to ensure that all major elements of the program were reviewed and discussed with SWRCB management and staff. In response to the Improper Payments Elimination and Recovery Act of 2012, the Office of Management and Budget through the EPA Office of the Chief Financial Officer directed that the SRFs be subjected to testing of a random selection of SRF transactions to develop a national estimate of improper payments from these programs. For this review, EPA Headquarters selected 11 DWSRF and six CWSRF program cash draws to test for the state fiscal year ending June 30, 2023. The transactions selected reflected all appropriations for which the State made draws during the review period.

The California DWSRF and CWSRF programs are required to maintain the following program and financial elements, which EPA assessed during its review. Elements noted with an asterisk are discussed in Sections IV and VI and may include recommendations or action items for SWRCB. The other elements were found to be acceptable and do not require further response from the State:

Required Program Management Elements

- Annual/Biennial Reports and Intended Use Plans*

¹ NIMS, Line 3

² Sum of NIMS Lines 3 and 35

³ NIMS, Line 136

⁴ NIMS, Line 130

⁵ NIMS, Line 57

⁶ Sum of NIMS Lines 57 and 91

⁷ NIMS, Line 117

⁸ NIMS, Line 110

- Staff Capacity*
- State Match
- Compliance with Federal Requirements and Grant Conditions (i.e., Cross-Cutting Authorities, American Iron and Steel (AIS), Davis-Bacon, Additional Subsidization, Green Project Reserve)
- Project File Reviews
 - Funding Eligibility
 - Compliance with DBE Requirements
 - Compliance with Environmental Review Requirements
- Reporting*
- Additional Subsidization*
- Operating Agreement
- Binding Commitment Requirements
- Small Systems Reserve (DW)
- Set-Asides (DW)*
- Programmatic Risks*

Required Financial Management Elements

- Timely and Expeditious Use of Funds
- Compliance with Audit Requirements
- Assistance Terms
- Use of Fees
- Assessment of Financial Capability and Loan Security
- Financial Indicators and Performance*
- Financial Oversight and Management
- Cash Draw Transactions and Improper Payments
- Other Financial Elements*

IV. California DWSRF and CWSRF Program and Financial Management: Observations and Follow-up

EPA's review assessed program, financial and project management practices as they relate to the State's ability to effectively administer DWSRF and CWSRF program activities. This section presents EPA's specific observations and requested follow-up items to be incorporated into future operations, Annual Reports, or management of the program. As necessary, EPA will continue to meet regularly with the State to discuss these and other issues related to the California DWSRF and CWSRF.

A. Program Management

1. CWSRF and DWSRF Annual Reports

The Annual Reports should be provided to EPA within 90 days from the close of the state fiscal year. Drafts of the SWRCB's CW and DW SRF Annual Reports for SFY 2023 were submitted to EPA on April 24, 2024. Final versions of the Annual Reports were provided on July 29th, 2024, 9 months from the expected date.

EPA acknowledges and appreciates the State's efforts to provide EPA with project and cash draw transaction information for EPA's review in advance of finalizing the Annual Reports. EPA also recognizes that the sources of delay are attributed, in part, to the State's receipt of the audited financial

statements in December 2023 in addition to time SWRCB staff took to restructure and reformat the content of the Annual Reports that will streamline the reports' preparation for future years. EPA appreciates the SWRCB's efforts to meet the SRF program reporting requirements and acknowledges that SWRCB has substantially reduced the amount of time taken to deliver the Annual Reports to EPA from previous years. It is EPA's expectation that these efforts will position the SWRCB to meet the SRF reporting requirements in alignment with the established schedule during the next state fiscal year reporting cycle. As with this year's Annual Reports, EPA recognizes that SWRCB may not have information needed for the Annual Reports from the audited financial statements until the beginning of December of the audit year.

Required Follow-Up Item: In the event of delays in submitting the SFY 2024 California SRF Annual Reports to EPA, please notify EPA Region 9 in advance of the October due date and send EPA drafts of the Annual Reports in the event of delayed submission by November 2024.

2. Compliance with Federal Requirements and Grant Conditions

CWSRF & DWSRF Project File Review – The purpose of project file reviews is to determine whether the State and assistance recipients are following all applicable statutory, regulatory, and policy requirements, as well as capitalization grant terms and conditions. Project file reviews for the SFY 2023 EPA Annual Review for California were conducted remotely in advance of the on-site interviews. This year, EPA reviewed three CWSRF project files and three DWSRF project files representing projects funded by the base SRF and BIL capitalization grant awards. Equivalency projects and projects receiving additional subsidization benefiting disadvantaged communities were included in project selection. EPA did not identify any issues during project file review. The project file review checklists for each of the projects listed below can be found in **Attachment B**.

- a) **CWSRF** - EPA's review of CWSRF project files found the projects to be eligible and compliant with the program requirements.

Recipient	Project	Assistance Amount	Agreement Date	Project Category
Elsinore Valley Municipal Water District	Diamond Regional Sewer Lift Station and Dual Force Mains	\$36,540,937	December 5, 2022	FFY22 CW base equivalency project
City of Sunnyvale	Secondary Treatment and Dewatering Facilities	\$287,800,000	January 3, 2023	FFY22 CW BIL General Supplemental equivalency project
City of Arcata	Arcata Wastewater Treatment Facility Upgrades Project	\$64,306,616 as 100% principal forgiveness	February 24, 2023	Project benefitting a DAC receiving additional subsidy

- b) **DWSRF** - EPA's review of DWSRF project files found the projects to be eligible and in compliance with the program requirements.

Recipient	Project	Assistance Amount	Agreement Date	Project Category
-----------	---------	-------------------	----------------	------------------

Keyes Community Services District	Construction of TCP Treatment Improvements at Well #7, #8, #9, and #10	\$10,410,000 with \$4,164,000 in principal forgiveness	October 31, 2022	Project benefitting a DAC receiving additional subsidy
City of Santa Ana	Well 32 Nitrate Treatment and Rehabilitation	\$5,290,000	January 17, 2023	FFY22 DW base equivalency project
West Valley Water District	Oliver P. Roemer Water Filtration Facility Expansion Project (RWFF Project)	\$46,665,000	August 8, 2023	FFY22 DW BIL General Supplemental equivalency project

Recommendation: None. EPA appreciates SWRCB's continued efforts to standardize the file structure and organization of project files.

3. CWSRF and DWSRF Staff Capacity

During the review period, the SWRCB filled open vacancies within the Loans and Grants Branch and Admin Branch created through a re-organization implemented the prior year. The teams supporting the SRF programs grew to over 88 staff and management positions in SFY 2023. The number of staff supporting engineering and field inspection activities increased by almost 18 (from 20.9 to 38.8), environmental review by over 4 staff (from 4.1 to 8.5), and 9 new management positions were filled (from 11.7 to 21.2). The Loans and Grants Branch also established and staffed a dedicated unit for lead service line inventory and replacement projects. EPA congratulates the SWRCB for proactively managing staff resources to support the SRF programs. This commitment to ensuring adequate staff resources positions the State to manage the continued high demand in the base SRF programs and implement the programs established by the Bipartisan Infrastructure Law.

Recommendation: EPA encourages SWRCB to continue filling vacancies as needed to accommodate the high administrative and technical workloads associated with the SRFs.

4. State Match

State match requirements for the federal fiscal year (FFY) 2023 grants were as follows:

FFY	Grant	Award Amount	Match	Match Amount
23	CWSRF Base SRF	\$53,649,000	20%	\$10,729,800
23	CWSRF BIL General Supplemental	\$149,075,000	10%	\$14,907,500
23	CWSRF BIL Emerging Contaminants	\$15,208,000	0%	\$0
23	DWSRF Base SRF	\$53,272,000	20%	\$10,654,400
23	DWSRF BIL General Supplemental	\$227,150,000	10%	\$22,715,000
23	DWSRF BIL Emerging Contaminants	\$82,428,000	0%	\$0
23	DWSRF BIL Lead Service Line	\$28,650,000	0%	\$0

The above match requirements for the State's Clean Water and Drinking Water base SRF and BIL General Supplemental capitalization grants have been met. The source of state match for both programs in

SFY 2023 were General Fund appropriations. As documented in Note 6 of the audited financial statements, SWRCB had excess state match disbursed to cover CW match requirements for both the base and BIL General Supplemental grants before the grants were awarded and the first federal draws were made. For DW, Note 6 of the audited financial statements showed \$0 in excess state match to be applied to the FFY 2022 grants as of June 30, 2023. SWRCB's Division of Financial Assistance (DFA) provided supplemental disbursement logs from the State's Loans and Grants Tracking System (LGTS) to demonstrate that 100% of state match for the DW grants was disbursed prior to drawing from the federal funds.

Recommendation: None.

5. Reporting

SRF Data System Reporting

Reporting for assistance agreements for the review period in the SRF Data System, previously PBR and CBR, is complete. All 19 funded assistance agreements under CW in SFY 2023 totaling \$600.8 million were entered. For DW, all 14 assistance agreements totaling \$74.2 million are in the system.

Over the course of the review, EPA learned that the CWSRF program issued a revenue bond during the review period that was missing from the NIMS data. California Infrastructure and Economic Development Bank, Clean Water State Revolving Fund Revenue Bonds, Series 2023 was issued on January 31, 2023 for \$545.3 million at a premium of \$57.2 million and cost of issuance of \$2.48 million. The Series 2023 bond was issued for the purpose of making financial assistance available to recipients for eligible projects, as reported in the State's CW Annual Report. The State subsequently reported the bond sale to the SRF Data System in May 2024.

Requested Follow-Up Item: EPA asks that SWRCB ensure that all financial information is entered into the SRF Data System in a timely manner. In particular, any leveraging activities should be reported within the quarter of their occurrence given these activities' impact on EPA's calculation of financial metrics for the state fiscal year.

FFATA

FFATA requirements are considered met when assistance agreements exceeding \$30,000 and non-exempted activities funded through the DWSRF set-asides are reported to www.frs.gov in an amount equivalent to the full capitalization grant.⁹ The following amounts were reported in FFATA for grants awarded in FFY 2022:

Grant	Grant Amount	Sub-Awardees Reported	Total Amount of Subawards	Future Reporting Required*
FFY22 CW Base SRF	\$82,753,000	Elsinore Valley Municipal Water District, City of Sunnyvale	\$82,753,000	None, reporting complete.
FFY22 CW BIL General Supplemental	\$127,290,000	City of Sunnyvale	\$127,290,000	None, reporting complete.

⁹ As noted in the November 7, 2023, memorandum, "Clarification of Federal Funding Accountability and Transparency Act Reporting Requirements in the State Revolving Fund Programs", many typical set-aside activities are exempt from FFATA subaward reporting. As such, the total dollar amount of DWSRF FFATA subaward reporting will likely be less than the total dollar amount of the DWSRF capitalization grant.

FFY22 DW Base SRF	\$61,819,000	City of Santa Ana, San Juan Water District	\$9,285,000	\$52,534,000
FFY22 DW BIL General Supplemental	\$158,733,000	Los Angeles Department of Water and Power, West Valley Water District	\$56,239,000	\$102,494,000
FFY22 DW BIL Emerging Contaminants	\$73,336,000	No subawards reported.	\$0	\$73,336,000
FFY22 DW BIL Lead Service Line Replacement	\$250,107,000	No subawards reported.	\$0	\$250,107,000

*Amounts specified for DW grants do not subtract set-aside expenses that may decrease the total amount reported to fhrs.gov.

SWRCB has fulfilled the FFATA requirements for the CW Base SRF and CW BIL General Supplemental FFY 2022 grants. Additional projects will need to be reported to meet equivalency requirements for the DW Base SRF and DW BIL General Supplemental grants for FFY 2022, in the amounts of \$52,534,000 and \$102,494,000, respectively. No FFATA reports were submitted for the FFY 2022 DW BIL Emerging Contaminants (EC) and BIL Lead Service Line Replacement (LSLR) grants. As discussed in EPA's November 2023 State Revolving Fund Equivalency Handbook:

“If the final assistance agreement amounts are lower than the capitalization grant amount, the state should identify additional assistance agreements to make up the shortfall. It is acceptable for new assistance agreements to be signed in a later year than the original equivalency group to make up a shortfall; the SRF program should just note in the IUP and Annual/Biennial Report which assistance agreement(s) have been selected to compensate for a shortfall in prior year equivalency projects.”

Required Follow-Up Item: To meet equivalency and FFATA reporting requirements, SWRCB must report additional projects in FFATA for the FFY 2022 DW Base SRF, BIL General Supplemental, BIL Emerging Contaminants, and BIL Lead Service Line Replacement grants after additional assistance agreements are identified.

6. Additional Subsidization

Additional subsidization should be committed in executed assistance agreements within the first year and disbursements should ideally be issued within two years of the grant award. The additional subsidization requirement is considered met when the minimum subsidy required has been disbursed.¹⁰ SWCRB provided detailed commitment and disbursement information on additional subsidy in the SFY 2022-2023 Annual Reports. Information from the Annual Reports for the grants that had not disbursed the minimum additional subsidy required prior to the review are reflected in the tables below.

- a. DWSRF: As of June 30, 2023, the minimum additional subsidy required has not been fully disbursed for the FFY 2020 and 2021 base DW grants. The minimum has been fully disbursed for the FFY 2022 base DW grant. The minimum additional subsidy has not

¹⁰ Consistent with the closeout requirements of 2 CFR 200 and 1500 and EPA Order 5700.6A2, Policy on Compliance, Review and Monitoring, the capitalization grant may be closed out before the state meets the required minimum additional subsidization requirement (i.e., before those funds have been disbursed to projects). This is noted in the November 4, 2021, memorandum, “Policy Change Regarding Additional Subsidization and Closeout of SRF Capitalization Grants”.

been committed nor disbursed for the FFY 2022 DW BIL General Supplemental, Emerging Contaminants, or Lead Service Line Replacement grants.

Grant	Minimum	Maximum	Committed as of June 30, 2023	Disbursed as of June 30, 2023
2020 DW	\$19,426,800	\$47,595,660	\$14,906,926	\$18,914,590
2021 DW	\$19,409,400	\$47,553,030	\$43,261,030	\$16,392,569
2022 DW	\$16,072,940	\$30,291,310	\$12,489,631	\$23,326,798
2022 DW BIL General Supplemental	\$77,779,170	\$77,779,170	\$37,011,455	\$0
2022 DW BIL Emerging Contaminants	\$73,336,000	\$73,336,000	\$20,461,287	\$0
2022 DW BIL Lead Service Line Replacement	\$122,552,430	\$122,552,430	\$0	\$0

- b. CWSRF: As of June 30, 2023, the minimum additional subsidy required has been committed and disbursed for the FFY 2019, 2020, 2021, and 2022 base CW grants. Minimum additional subsidy has not been committed nor disbursed for the FFY 2022 CW BIL General Supplemental grant.

Grant	Minimum	Maximum	Committed as of June 30, 2023	Disbursed as of June 30, 2023
2019 CW	\$11,363,700	\$45,454,800	\$45,454,800	\$22,973,359
2020 CW	\$11,365,300	\$45,461,200	\$45,461,200	\$17,994,823
2021 CW	\$11,363,700	\$45,454,800	\$45,454,800	\$27,171,171
2022 CW	\$16,550,600	\$33,101,200	\$25,307,022	\$23,343,087
2022 CW BIL General Supplemental	\$62,372,100	\$62,372,100	\$2,133,000	\$0

Required Follow-Up Item: EPA requests that SWRCB disburse the minimum additional subsidy required in a timely manner for the FFY 2020 and 2021 base DW grants, targeting December 2024 to complete disbursements. For the FFY 2022 DW and CW BIL General Supplemental grants, EPA asks that SWRCB commit the minimum additional subsidy required by June 2025. For the DW BIL Emerging Contaminants and Lead Service Line Replacement grants where the minimum additional subsidy is 100% and 49%, respectively, SWRCB should target making commitments by June 2025.

7. Green Project Reserve (CW):

The Green Project Reserve (GPR) provision for the 2022 Appropriations Bills states that to the extent that there are sufficient eligible project applications, at least 10 percent of the capitalization grant shall be used for projects or components of projects that address energy efficiency, water efficiency, green infrastructure, or are environmentally innovative projects. The GPR requirement for a given year's appropriation is met when the minimum GPR funds required are committed in executed assistance agreements. The GPR requirement totaled \$21,004,300 for the FFY 2022 CW Base SRF and BIL General Supplemental grants. As documented in the Annual Report, \$56,289,067 in GPR funding was assigned to executed agreements for three projects funded by the Base CW grant.

Recommendation: None. EPA congratulates the State for exceeding the GPR requirement for SFY 2023.

8. Small Systems 15% Requirement (DW):

Federal rules require that at least 15 percent of available DWSRF funding be provided to public water systems that serve less than 10,000 people, to the extent that projects for these systems are eligible and ready to proceed to a funding agreement. The calculation is based on all monies the state plans to make available for assistance agreements as described in the State's IUP sources and uses table. In years where a state exceeds this requirement, the DWSRF regulations at 40 CFR 35.3525(a)(5) authorize states to "bank" this requirement.

SWRCB's Annual Report notes that the State provided \$54,845,792 in planning and construction assistance to small water systems in SFY 2022-2023.¹¹ This amount is 7.5% of total assistance planned in SFY 2022-23 based on estimated sources totaling \$734,788,196, as calculating by taking the sum of all sources provided in the SFY 2022-2023 IUP's Appendix C Fiscal Impact Summary table. In considering why the State was not able to meet the 15% requirement for the review period, EPA notes that the DWSRF program provided a lower level of assistance than what was originally planned in the SFY 2022-2023 IUP. SWRCB issued \$74.2 million in DW assistance in SFY 2023 instead of the \$300 million in sustainable lending capacity identified for the base and BIL General Supplemental funding sources. Many of the SFY 2022-2023 IUP Fundable List projects were executed in the first or second quarter of SFY 2024. Of the actual assistance provided in SFY 2023, 74% of total funding benefited small systems.

EPA appreciates SWRCB's work to make funding available to small water systems and understands that there are many reasons why a state may not be able to meet the 15% in executing agreements. As California already prioritizes small systems by automatically placing projects serving small DACs with complete applications on the Fundable List, EPA expects the state to exceed this requirement in future years when funding levels are closer to those targeted in the IUP.

Recommendation: None. EPA supports SWRCB's ongoing work to prioritize and provide technical assistance to small systems in preparation for funding such that the 15% requirement can be reached in future years.

9. DW Set-Aside Unliquidated Obligations (ULOs)

Approximately 10.2% of awarded base DW set-aside funds were ULOs at the end of the review period (July 1, 2023). Nationally, this figure was 6.1%. EPA recognizes SWRCB's efforts to reduce set-aside ULOs and notes that the State has already made progress in making reductions, down to 6.5% as of June 1, 2024. In FFY 2024, EPA began tracking set-aside ULO separately for the BIL grants. As of June 1, 2024, 90% of awarded BIL set-aside funds were ULO, slightly higher than the 88% average nationally. During the on-site interviews, DFA relayed the State's plans to address growing set-aside ULOs from BIL grants by working in conjunction with the Division of Drinking Water to assess needs and move any unused funds back to the loan fund for each respective BIL grant.

¹¹ SWRCB DWSRF Annual Report for State Fiscal Year 2022-2023, Table 4. FY22-23 DWSRF Construction & Planning Financing Summary. The amount of assistance listed in the Annual Report provided to small systems is within range of the small systems assistance reported to the SRF Data System (NIMS lines 137, 138, 139), which totaled \$52,465,792.

For the base grants, SWRCB is actively working with EPA to reduce ULOs by requesting the transfer of funds from the set-asides to the loan fund. One such request was completed for the FFY 2020 base DW grant in April 2024, after which the state drew down the grant in its entirety. EPA expects a forthcoming request will be processed for the FFY 2019 base DWSRF grant shortly. NIMS data on the cumulative set-aside spending rate is discussed in detail in Financial Management section.

Requested Follow-Up Item: EPA asks SWRCB to keep diligent on reducing ULOs. EPA supports SWRCB's plans to move remaining set-asides to the loan fund for the FFY 2019 DW base grant and requests the necessary paperwork be submitted to EPA no later than September 2024.

10. ASADRA

On June 6, 2019, the "Additional Supplemental Appropriations for Disaster Relief Act, 2019" (ASADRA) was signed into law. California was allotted \$41,903,000 to its DWSRF in FFY 2020 and \$183,000 to its CWSRF in FFY 2021 to carry out the goals of the ASADRA capitalization grant. California subsequently transferred its \$183,000 CWSRF allocation to the DWSRF program, in order to maximize funds available to address extensive wildfire damage experienced by public water systems throughout the State. Through the reallocation process in FFY 2021, California was awarded \$4,253,000 in additional funding. To date, SWRCB has not executed assistance agreements using ASADRA funds.

During the annual review, EPA and SWRCB discussed the State's ongoing work with prospective recipients for ASADRA funding. The State relayed that it is entering the final stages of executing an assistance agreement with an applicant that would commit half of the state's total \$51,974,515 in ASADRA funding. It is important to note that the ASADRA grant's budget period ends on June 30, 2027, and that the State may seek reimbursement up to 90 days after the grant closes. Unless it was granted an extension, any funds remaining after 90 days following the project period's end would be de-obligated and returned to EPA. If necessary to ensure full expenditure of the funds, SWRCB may request that EPA extend the grant period beyond the limitations in Grants Policy Issuance 11-01, "Amended Grants Policy Issuance (GPI) 11-01 – Managing Unliquidated Obligations and Ensuring Progress under EPA Assistance Agreements" in 2026.

Required Follow-Up Item: EPA asks SWRCB to commit the majority of ASADRA funds as soon as possible, and no later than June 2025.

11. Programmatic Risks

EPA's annual review included an insightful discussion with SWRCB regarding the potential programmatic risks facing the programs, and the State's plans to avoid or mitigate risks where possible. One area of concern is slow demand for lead service line replacement funding in spite of considerable funds available, in excess of \$250 million alone from the FFY 2022 BIL LSLR capitalization grant. Although California has achieved among the highest fund utilization rates in the country in SFY 2023, SWRCB executed no funding agreements in SFY 2023 for either the BIL LSLR or BIL EC funds.

SWRCB's pipeline for EC projects exceeds \$400 million and the State expects several projects to be signed in SFY 2025. With regard to lead, the State has taken proactive steps to attract applicants. During the review period, DFA established a dedicated team to administer both EC and LSLR funds and conducted lead-specific marketing and outreach, including holding public Board workshops to gather

feedback on use of the funds. SWRCB additionally worked with EPA to set up a contracting vehicle for communities seeking assistance to conduct lead service line inventories in advance of the October 16, 2024, Lead and Copper Rule Revision deadline for public water systems. As of the writing of this PER, at least 50 communities have submitted preliminary requests for inventory assistance. EPA and the State anticipate more LSLR projects will be identified as communities complete their inventories, and demand for the funds will rise.

Required Follow-Up Item: SWRCB should report on its progress in executing BIL LSLR and BIL EC assistance agreements by completing its quarterly assistance agreement-level reporting to the SRF Data System.

B. Financial Management

1. CWSRF & DWSRF Timely and Expeditious Use of Funds

A state must agree to commit and expend all funds as efficiently as possible and in an expeditious and timely manner. Timely and expeditious use of the funds is critical to maximize the effectiveness of SRF assets and meet the public health needs of the state per 40 CFR § 35.3550(l). Both of California's SRF programs have done an exceptional job in monitoring the SRFs' cash balances and predicting and planning for the funds' ability to commit to new projects. In doing so the SWRCB can reliably commit over 100% of its available DW and CW funds through executed funding agreements.

To ensure the timely and expeditious use of the funds, EPA SRF program policy encourages states to limit the number of open CW and DW SRF grants to two for each base or BIL program. During the review period, the State quickly and completely drew down two of its older (FFY 2020 and 2021) base CW grants. California has one open CW base grant with only 2% of funds unobligated as of the writing of this PER. CA's FFY 2022 CW BIL General Supplemental grant has 63% funds remaining. The State has three open DW base grants relevant to the review period (FFY 2019, 2021 and 2022). California completed a request to EPA to move remaining set-aside funds to the loan fund for the FFY 2020 base grant and was able to draw remaining funds in April 2024. The State is working on a similar request for the FFY 2019 base DW grant. The FFY 2021 grant only has 1% of funds remaining, and the FFY 2022 base grant has 19% of funds remaining. The FFY 2022 DW BIL General Supplemental has 59% of funds unobligated. However, 100% of the FFY 2022 BIL LSLR and BIL EC grants are unobligated. For these two funding sources established by BIL, EPA has observed a high percentage of unliquidated obligations across the country as states stand up new programs to conduct outreach and work with applicants to develop projects supported by these narrower eligibilities.

EPA acknowledges the State's efforts to reduce the number of open base SRF grants and congratulates the SWRCB for closing out three older grants (FFY 2020 and FFY 2021 base CW, FFY 2020 base DW) in the last year. EPA understands that SWRCB must first prioritize and liquidate state match funds provided by the General Fund, as well as revenue bond proceeds with shorter spending requirements. However, with the additional grants the State is administering specific to the BIL appropriations, the number of open grants is growing. Therefore, it is critical for the State to continue to draw the federal funds in a timely manner.

Requested Follow-Up Item: SWRCB should reduce the number of open grants for each base and BIL program to two. In particular, the State should prioritize draw down on all grants pre-dating 2022 (DW base grants FS-98934919 and FS-98934921) and use First-In-First-Out (FIFO) principles to expend the FFY 2022 base and BIL grants.

2. Financial Indicators and Performance

Several SRF financial performance indicators are generated through NIMS and are used annually by EPA to measure the progress of the SRF programs. These financial indicators, in addition to audited financial statements and the recommended GAO indicators, serve as tools to help understand and assess state programs. EPA has reviewed these financial indicators to evaluate SWRCB's performance in SFY 2023 as compared to the last four years and national averages. In general, these indicators are used as a suite and not individually. EPA considers all the indicators together to gain a comprehensive picture of the State's program. The PER addresses the following mandatory financial indicators and any other indicators where follow-up is necessary.

a) CWSRF

NIMS Financial Indicators

- **Fund Utilization Rate:** This indicator shows how quickly funds are committed to finance CWSRF projects. This is one of the most significant metrics EPA utilizes to evaluate the effectiveness with which the CWSRF is being managed. The table below shows California's performance against the national average. Please note that historical values will have changed slightly from prior PER's as a result of data clean-up efforts in NIMS.

EPA's initial NIMS reporting showed that California maintained the same 123% fund utilization rate in SFY 2023 that it achieved in SFY 2022. Over the course of the annual review, it came to EPA's attention that a January 2023 revenue bond issued for the CWSRF program in the amount of \$600 million was missing from the NIMS data, and therefore was not included in California's financial indicator calculations. Factoring in the bond sale, the state's CW cumulative fund utilization rate for SFY 2023 is 117.2%, again far exceeding the national average of 99%. This high pace reflects the SWRCB's use of cash flow modeling to inform lending capacity decisions and anticipate disbursement needs at any given time. It also indicates a strong and steady project pipeline supported by adequate staffing to ensure that applications are processed.

Table 1.

CWSRF Fund Utilization (NIMS Line 309, Cumulative)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National (%)	97	97	97	99	99
California (%)	113.5	112.3	110	122.9	117.2*

*Initial result of 123.1% reported in NIMS recalculated to reflect January 2023 bond issued for \$600 million.

Recommendation: None. EPA congratulates the State's CWSRF program for again achieving one of the highest paces of any state in the country in 2023.

- **Cumulative Disbursement as a Percent of Executed Loans:** While the fund utilization indicator reflects the California CWSRF's ability to commit funds to projects, disbursement as a percent of assistance provided reflects how quickly the California CWSRF disburses the committed funds (i.e., federal cap grants, state match, and repayments) to active projects. Full

fund utilization coupled with timely disbursement indicates a well-functioning SRF program. These taken together maximize environmental benefits and protect public health.

This metric increased slightly for CA CW in SFY 2023 by a percentage point, from 74.6% to 75.8%. Of \$14.76 billion in cumulative assistance provided, 75.8% of executed agreements have been disbursed. As shown in Table 2, California CWSRF disbursements as a percent of executed loans has historically been below the national average.

Table 2.

CWSRF Disbursements as a Percent of Assistance Provided (NIMS Line 311, Cumulative)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National (%)	89	90	89	89	88
California (%)	78.8	80.2	81.7	74.6	75.8

While this indicator may suggest low performance when compared nationally, it should be noted that the national average reflects data for leveraged and non-leveraged states. During the on-site interviews, SWRCB noted that in most cases, the Division of Financial Assistance executes assistance agreements with recipients prior to projects going out to bid. Construction typically begins within 6 months of loan signing. The lag between loan execution and when a project's first claims are submitted is likely a factor contributing to this metric's results. However, the primary driver for the lower percentage is the State's very high cumulative assistance provided. SWRCB has advance committed funds in excess of \$2 billion since inception of the program. CA CW's ratio of cash-to-average annual disbursements (discussed in the next section) further indicates that SWRCB is efficiently disbursing funds and managing cash flows.

Recommendation: None.

GAO Financial Indicators

- ***Undisbursed Funds to Average Disbursement (Years to Disburse):*** This indicator looks at all undisbursed funds that a state has and divides it by the prior three-year average annual disbursement figure. It is a leading indicator to gauge how effectively SRF funds are revolving through the program and approximates the number of years it would take to fully disburse any undisbursed funds based on the state's typical annual disbursement. A high number indicates a state has significant cash on hand and may not be revolving funds in a timely manner. A memorandum issued by EPA Headquarters on January 31, 2024, titled "Maximizing Water Quality and Public Health Benefits by Ensuring Expeditious and Timely Use of All State Revolving Fund Resources" identified 2 years as adequate performance for this indicator.

California's CWSRF undisbursed funds to average disbursements ratio has historically been below the national average, as shown in Table 3. Compared nationally, California's CWSRF has kept less cash on hand than other states.

Table 3.

CWSRF Undisbursed Funds to Average Disbursements (Years to Disburse) (NIMS Line 311.1)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National	3.1	2.9	3.0	2.9	3.2
California	1.6	1.6	1.9	1.6	2.5*

*Initial result of 1.4 reported in NIMS is recalculated to reflect January 2023 bond issued for \$600 million.

EPA’s initial NIMS data showed that California’s disbursement ratio decreased to 1.4 years of cash on hand in SFY 2023. As with fund utilization, EPA Region 9 recalculated this metric to account for the \$600 million revenue bond issued for the CWSRF program in January 2023. In increasing the total cumulative funds available through the bond sale, the State’s CW undisbursed funds to average disbursements ratio for SFY 2023 was recalculated to be 2.5 years. This result is below the national average, and within range of the 2-year target identified in the recent “timely and expeditious” memo. EPA expects this metric to trend closer to the 2-year mark or lower as the projects funded in SFY 2022 (close to \$2 billion in assistance) begin submitting a higher volume of reimbursement claims for construction activities.

Recommendation: EPA commends SWRCB for maintaining a low ratio of undisbursed funds to average disbursements. SWRCB should continue to monitor this metric to ensure the timely submittal and processing of disbursement requests.

- **Total Net:** This indicator seeks to gauge if an SRF program is growing. Programs with little to no Total Net are not growing and funds are not revolving. The five-year trend for this metric is shown in Table 4.

Table 4.

CWSRF Total Net	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
California	\$213,262,502	\$556,811,296	\$352,216,838	\$412,585,600	\$114,740,003

California’s CWSRF program had a total net of \$114.7 million in SFY 2023, a significant decrease from SFY 2022. The large reduction is attributed to \$290 million less in annual principal repayments the program received from recipients, coupled with \$5 million more in principal repaid on revenue bonds (\$92.8 million in SFY 2023 compared to \$87.4 million in SFY 2022). In discussing this metric with SWRCB, the higher total nets observed in 2020 through 2022 reflect years when the State experienced substantial early pre-payments during the historically low interest rate environment observed throughout the Covid-19 pandemic. The total nets seen in 2019 and 2023 indicate more typical, lower pre-payment conditions with annual principal repayments closer to the \$200-300 million range. EPA will continue to monitor this indicator as the State leverages to ensure it stays above \$0.

Recommendation: As in past years, the SWRCB should continue to monitor this indicator to ensure that the fund corpus is not at risk by leveraging activities.

- **Net Interest Margin:** This indicator measures net earnings the SRF is generating from its total assets through loans and investments, after accounting for the interest expenses associated with match and leveraged bonds. Simply stated, it is a measurement comparing the net interest income generated from the SRF loans, with the outgoing interest it pays to bondholders. This indicator seeks to gauge if an SRF program is growing through interest earnings. A negative percentage indicates that what it costs a state to leverage is more than what it is earning in interest to pay for the expense.

Discussions about net interest margin stemming from the previous year's annual review led EPA Region 9 to calculate this metric three ways: 1) as it has traditionally, using NIMS data in addition to Total Assets provided by the State's audited financial statements, 2) on a cash basis using the Statements of Cash Flows from the audited financials in addition to Total Assets, and 3) using numbers based on accruals as provided by the Statements of Revenues, Expenses and Changes in Net Position from the audited financials. The results from calculating net interest margin using these three approaches is shown in Table 5.

Table 5.

CWSRF Net Interest Margin, as calculated using:	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
NIMS	-0.110%	-0.043%	-0.145%	-0.083%	-0.149%
Statements of Cash Flows	0.185%	0.196%	-0.009%	0.019%	-0.080%
Statements of Revenues, Expenses, and Changes in Net Position	0.875%	0.800%	0.592%	0.497%	0.588%

California's net interest margin for the CWSRF program in SFY 2023 is either positive or negative depending on which approach is used. It is very slightly negative: -0.149% using NIMS data or -0.08% using cash-basis equation terms. It is positive, 0.59%, when the numbers are based on accruals. EPA and SWRCB discussed the merits of each approach:

- The NIMS data does not include construction period interest (CPI), otherwise known as capitalized interest. CPI is the interest earned during the non-repayment period and is accrued each year. It is rolled into the principal balance of the loan and is repaid over the loan term after the recipient starts repayment.
- The Statement of Cash Flows accounts for CPI as cash received from interest on loans. However, Total Assets are only provided on an accruals' basis of accounting, not a cash-basis.
- Financial numbers provided by the Statements of Revenues, Expenses, and Changes in Net Position, including Total Assets, are all calculated using the same accruals basis of accounting. These numbers also account for CPI.

Regardless of the approach used, the net interest margin results in SFY 2023 skew close to zero percent. This suggests that based on the various inputs feeding into the calculations, interest earnings are hovering very close to the State's interest expenses from leveraging

activities. If interest earnings remain low and the state leverages aggressively into the future, the net interest margin figure could drop (further) into the negative. Over time, this may indicate impacts on the long-term health of the fund.

Recommendation: As the net interest margin results are very close to zero, SWRCB should monitor this indicator to ensure that its CWSRF leveraging interest expenses do not exceed the fund’s interest earnings by a large margin.

b) DWSRF

NIMS Financial Indicators

- **Fund Utilization Rate:** This indicator shows how quickly funds are committed to finance DWSRF projects. This is one of the most significant metrics EPA utilizes to evaluate the effectiveness with which the DWSRF is being managed. The table below shows California’s performance against the national average. Please note that historical values may have changed slightly from prior PER’s as a result of data clean-up efforts in NIMS.

California’s DWSRF program had a pace in of 110% in SFY 2023, as shown in Table 6. California’s fund utilization rate is well above the national average and above 100%. This indicates that the SWRCB is anticipating funds received and planning for their use prior to having them deposited. SWRCB has demonstrated a commendable capacity to properly manage the flow of funds over the life of the program.

Table 6.

DWSRF Fund Utilization (NIMS Line 419, Cumulative)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National (%)	96	96	96	98	95
California (%)	112.5	109.8	107.7	126.2	109.7

Recommendation: None. EPA congratulates the State’s DWSRF program for again achieving one of the highest paces of any state in the country in SFY 2023.

- **Disbursements as a Percentage of Assistance Provided – Based on Cumulative Activity:** While the fund utilization indicator reflects the California DWSRF’s ability to commit funds to projects, disbursement as a percent of assistance provided reflects how quickly the California DWSRF disburses the committed funds (i.e., federal cap grants, state match, and repayments) to active projects. Full fund utilization coupled with timely disbursement indicates a well-functioning SRF program. These taken together maximize environmental benefits and protect public health.

This metric increased for CA DW by over 3% in SFY 2023, from 72.4% to 75.8%. Of \$4.7 billion in cumulative assistance provided, 75.8% of executed agreements have disbursed. As shown in Table 7, California DWSRF disbursements as a percent of executed loans has historically been below the national average.

Table 7.

DWSRF Disbursements as a Percent of Assistance Provided (NIMS Line 420, Cumulative)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National (%)	87.5	87.6	86.8	85.4	85
California (%)	78.2	82.9	84.4	72.4	75.8

While this indicator may suggest low performance when compared nationally, it should be noted that the national average reflects data for leveraged and non-leveraged states. During the on-site interviews, SWRCB noted that in most cases, the Division of Financial Assistance executes assistance agreements prior to projects going out to bid. The expectation is that construction begins within 6 months of loan signing. The lag between loan execution and when a project's first claims are submitted is likely a factor contributing to this metric's results. However, the primary driver behind the lower number is the State's high cumulative assistance provided. The drop in this metric from SFY 2021 and SFY 2022 was due to the state's commitment of over \$900 million in assistance in a single year. As of SFY 2023, SWRCB has cumulatively advance committed funds in excess of \$415 million. EPA expects this figure to improve as recipients that signed assistance agreements in SFY 2022 submit disbursement requests. However, this metric may decline as projects for the BIL EC and LSLR funds are committed and the figure for Cumulative Assistance Provided increases. Given the State's higher cash-to-average disbursements ratio in the DWSRF program, EPA suggests monitoring this metric.

Recommendation: SWRCB should monitor this metric for progress as commitments and disbursements are made for emerging contaminants and lead service line replacement projects.

- **Set-Aside Spending Rate:** This indicator gauges the pace at which a state is spending its set-aside funds. The five-year trend for this metric is shown in Table 8.

Table 8.

DWSRF Set-Aside Spending Rate (NIMS Line 424, Cumulative)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National (%)	91.3	90.7	90.9	91.5	84.5
California (%)	92.2	92.2	91.7	91.7	71.9

In SFY 2023, California's DWSRF set-aside spending rate was 72%, down 20% from SFY 2022. Cumulative set-aside expenses were higher during the review period than the prior year (\$346.2 million compared to \$319.6 million). However, the total dollar amount of set-asides awarded increased significantly – by over \$132.5 million – due to the new BIL capitalization grants. This increase in set-asides awarded caused the overall spending rate to drop significantly. Set-asides awarded for the BIL grants totalled \$118 million. EPA approximates that if BIL grant set-asides were excluded from the calculation, the set-aside spending rate would be closer to 95% assuming no expenditures were made from BIL set-asides during the review period. EPA acknowledges the additional time it has taken for states to staff and administer the BIL funds, as reflected in lower set-aside spending thus far.

Recommendation: EPA suggests that SWRCB track set-aside spending, specifically with regard to BIL set-asides supporting emerging contaminants and lead service line replacement projects.

EPA expects this metric to improve as staff begin expending set-asides to provide administrative and technical assistance to applicants for these new programs.

GAO Financial Indicators

- **Undisbursed Funds to Average Disbursement (Years to Disburse):** This indicator looks at all undisbursed funds that a state has and divides it by the prior three-year average annual disbursement figure. It is a leading indicator to gauge how effectively SRF funds are revolving through the program and approximates the number of years it would take to fully disburse any undisbursed funds based on the state’s typical annual disbursement. A high number indicates a state has significant cash on hand and may not be revolving funds in a timely manner. A memorandum issued by EPA Headquarters on January 31, 2024, titled “Maximizing Water Quality and Public Health Benefits by Ensuring Expeditious and Timely Use of All State Revolving Fund Resources” identified 2 years as adequate performance for this indicator.

California’s DWSRF undisbursed funds to average disbursements ratio has historically been below the national average, as shown in Table 9. Compared nationally, California’s DWSRF has kept less cash on hand than other states.

Table 9.

DWSRF Undisbursed Funds to Average Disbursements (Years to Disburse) (NIMS Line 420.1)	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
National	2.8	2.7	2.7	2.9	3.7
California	1.4	1.1	1.3	1.2	3

California DWSRF’s disbursement ratio increased by a factor of 0.8 from 1.2 in SFY 2022 to 3 years of cash on hand in SFY 2023. The national average increased by the same amount between the two years. This metric’s increase for California was directly due to the sharp increase in Cumulative Funds Available resulting from the introduction of the BIL capitalization grants. Between the additional capitalization from the first year of BIL grants and other incoming funds (e.g., repayments and interest earnings), the increase in California’s Cumulative Funds Available between 2023 and 2022 was over \$643 million. The DWSRF program’s annual disbursement improved by over \$15 million during the year in review. However, the three-year average used to calculate the ratio decreased due to a higher disbursement year (2020) falling out of the average’s calculation. Subtracting out the BIL capitalization grant amounts and assuming all other inputs being equal, this ratio would be closer to 1.1 in the absence of the BIL grants. EPA expects this ratio to decrease and trend closer to the goal of 2 years once the DWSRF program commits emerging contaminant and lead service line replacement projects and claims for such projects begin disbursement.

Although California’s DWSRF is successfully managing its cash supply per the GAO metric for the base program, the State should track this metric to ensure it is not building up cash from uncommitted EC and LSLR funds. If the disbursement ratio does not improve in subsequent years, this metric may suggest that either the state is not committing adequate

projects for the BIL funds or there is an inadequate number of DWSRF loans submitting claims for reimbursement in a timely manner.

Recommendation: As with disbursements as a percent of assistance provided, SWRCB should monitor the cash-to-disbursement ratio for progress as commitments and disbursements are made for emerging contaminants and lead service line replacement projects.

- **Total Net:** This indicator seeks to gauge if an SRF program is growing. Programs with little to no Total Net are not growing and funds are not revolving. The five-year trend for this metric is shown in Table 10.

Table 10.

DWSRF Total Net	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
California	\$82,063,938	\$122,367,646.68	\$173,893,585.62	\$113,152,624	\$125,710,583

California's DWSRF program had a total net of \$125.7 million in SFY 2023, an increase of \$12 million from SFY 2022 and in range with the average total net the program has experienced over the last four years. The increase from SFY 2022 is due to slightly higher interest earnings on investments and interest payments from recipients while leverage bond principal and interest expenses remained essentially level from the last year. Albeit slow, total net for the DWSRF program is growing. EPA will monitor this indicator to ensure it stays above \$0.

Recommendation: If the State chooses to leverage for the DWSRF program in the near future, SWRCB should monitor this indicator to ensure it remains positive.

- **Net Interest Margin:** This indicator measures net earnings the SRF is generating from its total assets through loans and investments, after accounting for the interest expenses associated with match and leveraged bonds. Simply stated, it is a measurement comparing the net interest income generated from the SRF loans, with the outgoing interest it pays to bondholders. This indicator seeks to gauge if an SRF program is growing through interest earnings. A negative percentage indicates that what it costs a state to leverage is more than what it is earning in interest to pay for the expense.

Discussions about net interest margin stemming from the previous year's annual review led EPA Region 9 to calculate this metric three ways: 1) as it has traditionally, using NIMS data in addition to Total Assets provided by the State's audited financial statements, 2) on a cash basis using the Statements of Cash Flows from the audited financials in addition to Total Assets, and 3) using numbers based on accruals as provided by the Statements of Revenues, Expenses and Changes in Net Position from the audited financials. The results from calculating net interest margin using these three approaches is shown in in Table 11.

Table 11.

DWSRF Net Interest Margin, as calculated using:	SFY 2019	SFY 2020	SFY 2021	SFY 2022	SFY 2023
--	---------------------	---------------------	---------------------	---------------------	---------------------

NIMS	1.13%	1.28%	1.11%	1.14%	1.22%
Statements of Cash Flows	1.16%	1.37%	1.11%	1.11%	1.24%
Statements of Revenues, Expenses, and Changes in Net Position	1.33%	1.37%	1.17%	1.18%	1.30%

California's net interest margin for the DWSRF program in SFY 2023 is over 1.2% regardless of the approach used for the calculation, representing an increase from SFY 2022. As the DWSRF program has not recently issued revenue bonds as has been done in the CWSRF program, EPA expects this metric to hold steady unless the State leverages in the future.

Recommendation: None at this time. EPA recommends monitoring this metric if the DWSRF program decides to leverage in the near term.

3. **CWSRF & DWSRF Cash Transactions & Improper Payments** –

Cash draws from the U.S. Treasury for SRF expenses must be based on eligible incurred project or set-aside costs. Any inconsistency between the eligible incurred costs or amount drawn is considered an improper payment. As part of EPA's oversight of the CWSRF and DWSRF programs, EPA reviews state cash draws to protect against waste, fraud, and abuse, and to minimize and document improper payments. To comply with the Improper Payments Elimination and Recovery Act 2012 and implementing requirements established by the Office of Management and Budget, EPA is required to test several state CWSRF and DWSRF funded transactions annually.

In FFY 2024, EPA updated the SRF transaction testing process. The cash draws were selected using a statistical sample approach similar to the procedure approved by the Office of the Chief Financial Officer in 2017. EPA Headquarters ran the draw selection protocol and provided the list to EPA regional staff. EPA Headquarters conducted all transaction testing and completed Transaction Testing Worksheets. California had 11 draws for the DWSRF program totaling \$35,677,821.18 and 6 draws for the CWSRF program totaling \$19,337,034. As of the release of this PER, transaction testing was completed September 19, 2024. EPA Headquarters sent an email to the Region identifying two (2) improper payments under the DWSRF program and one (1) improper payment found under the CWSRF program. EPA Region 9 worked with State for review and confirmation, as well as to identify resolutions for these findings (listed below). EPA Region 9 has included the final transaction testing worksheets for the State as documentation of FFY 2023 Transaction Testing.

Required Follow-Up Item: SWRCB staff has agreed to the following findings and resolutions for the improper payments found during FFY 2023 Transaction Testing:

DWSRF

Findings: Overpayment in the amount of \$1.06 found for both DW_23AS1465410 and DW_23AS1465391.

Resolution: It has been discussed and confirmed with the State that from incorrectly rounding and transcribing dollar amounts, an underpayment of \$1 was made to the borrower associated with the respective invoices. The State plans

on resolving the matter in the next round of invoicing, estimated to be February 1, 2025, where they intend to have the recipient claim this total to resolve the underpayment. EPA HQ has confirmed and has updated their records to reflect this determination.

CWSRF

Findings: Overpayment in the amount of \$0.90 for CW_23AS1469432.

Resolution: The State confirmed this finding. The State informed EPA Region 9 of their plans on resolving the matter in the next round of invoicing, estimated to be December 1, 2024, by offsetting the next reimbursement with the specified amount to resolve the overpayment.

Recommendation: In response to questions that SWRCB staff raised regarding cash draw documentation needs, EPA would like to reiterate that EPA only requires prime contractor invoices for EPA's transaction testing purposes. Sub-contractor invoices may be requested if issues are noted in the documentation provided at the prime contractor level. To reduce the volume of invoicing that is collected, the State could consider asking recipients to provide invoices from the prime contractor and first sub-contractor level.

4. CWSRF and DWSRF Compliance with Audit Requirements

The auditor noted that the financial statements for both SRFs were in conformance with GAAP and no material weaknesses were identified.

Recommendation: None. EPA congratulates the State's SRFs for achieving a clean audit.

5. Financial Risks

EPA's annual review included an insightful discussion with SWRCB regarding the financial risks the State anticipates and its work to avoid and mitigate risks where possible. SWRCB has sufficient controls and procedures in place in its revenue bond program to monitor its pledge pool for deficiencies and maintain good standing as leveraging needs rise. The financial risks the State foresees are broader in nature. An ongoing concern is the uncertain level of future federal capitalization for the SRFs with Congressionally-directed spending for community grants, which has continued to reduce the annual SRF base appropriations. Funding provided by the BIL grants has supplemented these reductions in the last two years – however, the additional capital from BIL is set to end in FFY 2026. In its last PER evaluating the State's performance during SFYs 2021 and 2022, EPA raised concerns over the California SRF programs' limited ability to raise interest rates, given current state statute prohibiting the SRF programs from charging rates on assistance in excess of half of the State General Obligation Bond rate. EPA continues to emphasize the need to keep stakeholders engaged on the financial implications of the interest rate law over the program's capacity, given its limiting impact on the State's ability to raise more funds to meet growing demand.

Another factor affecting funding that the California SRFs are planning for stems from the State's close to full commitment of state sources of principal forgiveness. These sources – a \$1.1 billion appropriation from the General Fund, as well as legacy General Obligation Bond measures, notably Proposition 1 and Proposition 68 – have provided consistent and substantial funds as principal forgiveness for drinking water, wastewater, PFAS and water recycling projects. Over the last several years, SWRCB has been able

to serve the infrastructure needs of small, DAC communities with less challenges due to these state funds being available. Now substantially committed, the State anticipates it will have less capacity to provide 100% principal forgiveness and may need to shift to 0% or low interest loans in the coming years.

To prepare for the potential of less state and federal funds being available, California's DWSRF program is considering collecting administrative and small community grant fees in the near future. Fee revenue may be used to offset reductions in set-aside funds if lower federal capitalization continues to impact the base DWSRF program. Given the State's limited ability to charge interest rates above half of the State General Obligation Bond rate and its considerable use of the DW grant set-asides to pay for administrative costs and provide technical assistance to small, DAC communities, EPA commends SWRCB for exploring the use of fees as a source of revenue that would safeguard and continue to support these important activities into the future. EPA recognizes the State's work to prepare for a variety of scenarios through its annual capacity analysis and applauds SWRCB for communicating regularly with stakeholders through the Stakeholder Advisory Group about how different outcomes could impact the programs.

Recommendation: EPA commends SWRCB's efforts to plan for the future and supports the State's ongoing work to inform stakeholders of the dynamic financial risks facing the program.

V. Status of Requested Follow-Up Items from Prior PERs

The purpose of a PER is to document findings, observations, and recommendations. PERs also serve to track and monitor the ongoing performance of SRF programs by acting as a reference point for which progress and follow-up on prior findings and recommendations can be checked and verified. Below is a summary of the status of requested follow-up items from the last PER dated December 18, 2023, titled "California Clean Water and Drinking Water State Revolving Fund Program Evaluation Report for SFYs Ending 2021 and 2022."

SWRCB completed the requested follow-up actions that EPA identified with regards to 1) notifying EPA of its delayed submission of the SFY 2023 Annual Reports, 2) documenting set-aside reserve authority in its Annual Reports, 3) completing a minor correction to the FFATA report in ffrs.gov for the FFY 2021 DW grant. California provided helpful information during the on-site interviews for this review regarding the additional subsidization tables in the Annual Reports, clarifying that the tables show cumulative commitments and disbursements made on a rolling basis, rather than on an individual per-grant basis. This clarification addresses the requested follow-up item identified for item 4) disbursing minimum additional subsidy requirements. With regard to 5) draw down and of older base SRF grants to meet timely and expeditious requirements, the state completed a set-asides transfer request for the FFY 2020 base DW grant in April 2024. SWRCB shared its perspective on the CWSRF negative net interest margin result for item 6) during the on-site interviews this year, as detailed in the Financial Management portion of this PER.

EPA thanks SWRCB for responding to the above-mentioned follow-up items from the last PER. EPA is working with the state on two remaining action items: 1) a set-asides transfer request for the FFY 2019 DW grant to be completed in SFY 2025, and 2) making corrections to the populations served for two projects funding during the last review period (SFPUC Mountain Tunnel Project and the Stanislaus Water Supply Project for the Cities of Turlock and Ceres) in the SRF Data System.

VI. Summary of Key Recommendations and Follow-Up Items

In light of EPA's review of SWRCB's SRF program performance and activities conducted during SFY 2023, we are providing the following recommendations and requested follow-up items. The items identified in this PER are generally intended to address isolated and minor deficiencies, small one-time errors, or suggest best practices and efficiencies that would strengthen the programs. Findings, by contrast, are meant to address major, significant issues that place the state at risk for non-compliance or misuse of funds. EPA made no findings for the review period. EPA has identified the following recommendations and required/requested follow-up items for SWRCB to address accordingly.

Required Follow-Up Items:

1. **Annual Reports:** In the event of delays in submitting the SFY 2024 California SRF Annual Reports to EPA, please notify EPA Region 9 in advance of the October due date and send EPA drafts of the Annual Reports in the event of delayed submission by November 2024.
2. **FFATA:** To meet equivalency and FFATA reporting requirements, SWRCB must report additional projects in FFATA for the FFY 2022 DW Base SRF, BIL General Supplemental, BIL Emerging Contaminants, and BIL Lead Service Line Replacement grants after additional assistance agreements are identified.
3. **Minimum additional subsidization:** EPA requests that SWRCB disburse the minimum additional subsidy required in a timely manner for the FFY 2020 and 2021 base DW grants, targeting December 2024 to complete disbursements. For the FFY 2022 DW and CW BIL General Supplemental grants, EPA asks that SWRCB commit the minimum additional subsidy required by June 2025. For the DW BIL Emerging Contaminants and Lead Service Line Replacement grants where the minimum additional subsidy is 100% and 49%, respectively, SWRCB should target making commitments by June 2025.
4. **ASADRA:** EPA asks SWRCB to commit the majority of ASADRA funds as soon as possible, and no later than June 2025.
5. **Tracking progress in BIL EC and LSLR commitments:** SWRCB should report on its progress in executing BIL LSLR and BIL EC assistance agreements by completing its quarterly assistance agreement-level reporting to the SRF Data System.

Requested Follow-Up Items:

6. **NIMS reporting:** EPA asks that SWRCB ensure that all financial information is entered into the SRF Data System in a timely manner. Any leveraging activities should be reported within the quarter of their occurrence given these activities' impact on EPA's calculation of financial metrics for the state fiscal year.
7. **Set-aside ULOs:** EPA asks SWRCB to keep diligent on reducing ULOs. EPA supports SWRCB's plans to move remaining set-asides to the loan fund for the FFY 2019 DW base grant and requests the necessary paperwork be submitted to EPA no later than September 2024.
8. **Reducing open grants:** SWRCB should reduce the number of open grants for each base and BIL program to two. In particular, the State should prioritize draw down on all grants pre-dating 2022 (DW base grants FS-98934919 and FS-98934921) and use First-In-First-Out (FIFO) principles to expend the FFY 2022 base and BIL grants.

Recommendations:

9. **Staff capacity:** EPA encourages SWRCB to continue filling vacancies as needed to accommodate the high administrative and technical workloads associated with the SRFs.

10. **CW financial indicators:** SWRCB should continue to monitor the CW cash-to-disbursement ratio, CW total net, and CW net interest margin. The latter two metrics should be tracked to ensure that leveraging activities do not impact the long-term health of the fund.
11. **DW financial indicators:** SWRCB should monitor its DW disbursements as a percent of assistance provided, cash-to-disbursement ratio, and set-aside spending rate for progress as commitments and disbursements are made for emerging contaminants and lead service line replacement projects.
12. **Financial risks:** EPA commends SWRCB's efforts to plan for the future and supports the State's ongoing work to inform stakeholders of the dynamic financial risks facing the program.

VII. Annual Review Participants

SWRCB: Heather Bell, Amanda Benitez, Bridget Binning, Brian Cary, Bridget Chase, Kim Dinh, Mike Downey, Joe Escobar, Matthew Francis, Jean Fung, Christine Gordon, Anne Hartridge, Lisa Hong, Ahmad Kashkoli, Keisha Kelley, Lisa Machado, David Maurer, Lindsay McLaggan, Lance Reese, Dat Tran, Uyen Trinh-Le, Denise Walker, Stephanie White, Matt Wilson, Josh Ziese

EPA: Hector Aguirre, Elizabeth Borowiec, Juanita Licata, Nina Odunlami, Mimi Soo-Hoo

VIII. Attachments

- Attachment A: Annual Review Checklist
- Attachment B: CWSRF & DWSRF Project File Checklists