



Office of Water (4101)

STATE ACTIVITY UPDATE

EPA 816-N-00-003B
January 2000

New York's Short-Term Cross-Investment Structure

*Under a short-term
cross-investment
structure a state may
invest funds
from one SRF
program to cure a
default in the other*

A number of states, including New York, Michigan, and Colorado, have already issued bonds to leverage their Drinking Water State Revolving Fund (DWSRF) programs. Recent reports indicate that up to fifteen states are already leveraging or are planning to leverage their DWSRF programs. In designing their leveraged program structures several states have explored the use of pooled bond security enhancements that are new to the State Revolving Fund program: *cross-collateralization* and *short-term cross-investment*. These security enhancements allow the resources of one SRF to be used to secure the repayment of leverage bonds of the other program.

Cross-collateralization was authorized by the Departments of Veteran Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act of 1999 (PL 105-276). Short-term cross-investment is allowed under the "permitted investment provisions" of the Clean Water Act and the Safe Drinking Water Act. To date, New Jersey has received approval for a cross-collateralization structure and New York and Michigan have received approval for short-term cross-investment structures.

Under a short-term cross-investment structure a state may use available funds from one SRF program to help cure a default in the other. For example,

in New York's program, if a borrower fails to repay a Clean Water State Revolving Fund (CWSRF) or DWSRF loan, the first source to cover the default is the individual program debt service reserve. With a short-term cross-investment structure, when the debt service reserve and other reserve funds are depleted, the second revolving fund can "invest" funds to cure the deficiency. The investment is made by the borrowing SRF selling a bond to the investing SRF program. The investment is permitted under Section 603(d)(6) of the CWA and Section 1452(f)(5) of the SDWA. The authority for borrowing funds for cross-investment is found in Section 603(d)(4) of the CWA and Section 1452(f)(4) of the SDWA. The bond must be a short-term investment so that the lending SRF is repaid after the borrowing SRF recovers from loan defaults.

A cross-investment structure provides additional security to bond holders and reduces the cost of borrowing to SRF programs. As the newer program, the DWSRF program will benefit from the existing coverage levels, diversification and credit quality of the CWSRF program. These benefits are accomplished even though the chances of a cross-investment actually occurring are remote due to the extraordinary level of debt service reserves (often 50 percent of bond size) found in many leveraged SRF programs. This report describes New York's short-term cross-investment structure.



New York's Combined Financing Program

The New York Environmental Facilities Corporation (NYEFC) has amended its existing Master Trust Agreement (MTA) and Master Financing Indenture (MFI) to implement a common financing approach for both CWSRF and DWSRF loans. Under this approach CWSRF and DWSRF loans will be financed under a joint bond issue. However, from an accounting standpoint the programs will remain segregated. Loans for each program will be recorded on separate balance sheets. The CWSRF and DWSRF will also have their own separate reserve accounts to make up for any borrower default in debt service.

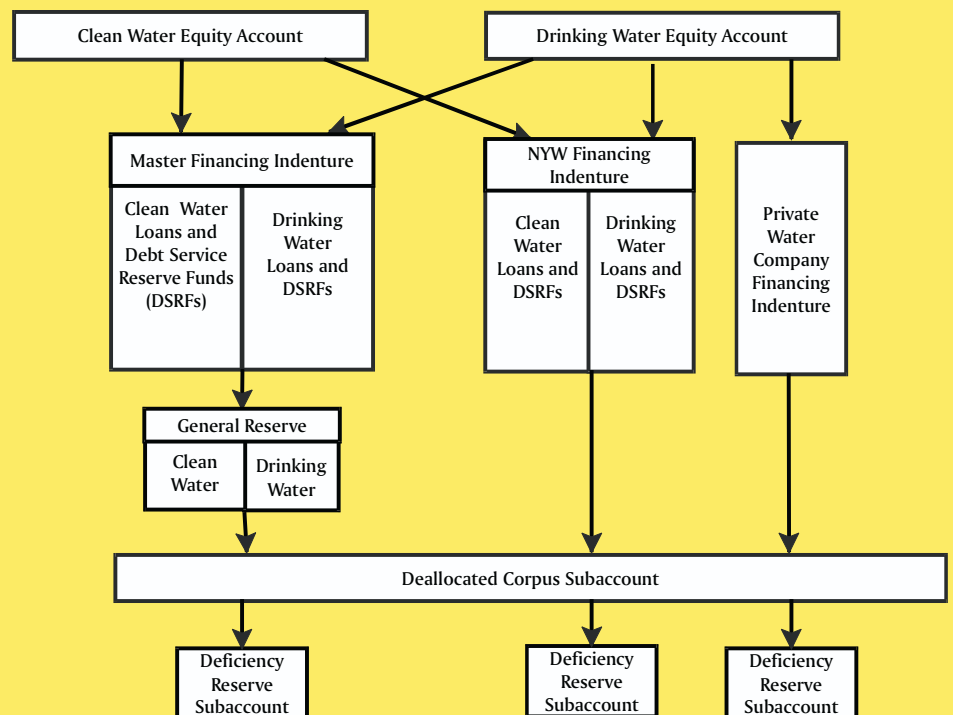
In most cases, borrowers will be financed under the MFI. However, borrowers large enough to justify separate financing, such as the New York City Municipal Water Finance Authority (NYW), and private companies that do

not meet certain credit standards will be financed under separate indentures (See Exhibit 1).

The NYEFC common financing program offers many economic and programmatic advantages. Clean Water and Drinking Water loans will be pooled together into the same bond issue, lowering issuance costs. For example, New York will issue two series of bonds (rather than four) to accommodate different borrower payment date requirements. The DWSRF program will benefit from the CWSRF AAA bond rating, allowing for greater leveraging capacity. Finally, although the programs will remain legally separate and distinct, the newly amended financing program allows for a cross-investment from a “free-up” of reserve dollars of one program to cure a deficiency in the other program.

The NYEFC common financing program offers many economic and programmatic advantages

Exhibit 1
New York Master Trust Agreement



Flow of Funds under New York's MFI

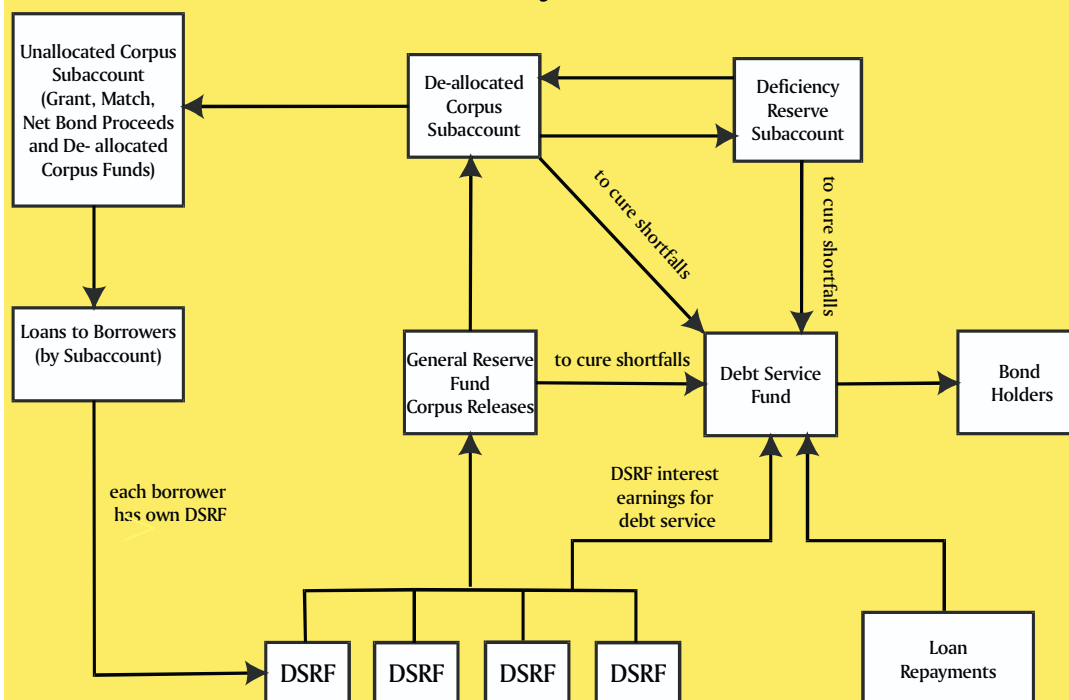
Under the MFI, both CWSRF and DWSRF projects are funded from revenue bond proceeds. SRF capitalization grants, state match and deallocated funds are used to fund SRF reserves (Exhibit 2). As construction progresses, funds are released to the borrower and deposited into individual Debt Service Reserve Funds (DSRFs). DSRFs are funded in an amount equal to either one-third or one-half of the loan amount. The interest earnings on these individual DSRFs are released into the Debt Service Fund to subsidize loan repayments or, if necessary, to cure any shortfalls. As repayments on loans are made, reserve funds are released from the DSRF into the General Reserve Fund. Released CWSRF and DWSRF funds are kept in separate subaccounts. The General Reserve Fund will be maintained at an amount that is equal to any deficiency in the borrowers' individual DSRFs.

Remaining funds are then released from the General Reserve into the Deallocated Corpus Subaccount. Funds can be moved from this account into the Deficiency Reserve Subaccount to cover deficiencies under the MTA or be recycled into the Unallocated Corpus Subaccount for any authorized purpose of the SRF.

If reserve funds within a program are unavailable to meet debt service payments, funds from the other SRF will be invested to cure the deficiency. However, any movement of dollars between the CWSRF and DWSRF would be recorded on the respective balance sheets as a temporary investment and recorded as an asset on one SRFs balance sheet and as an asset with an offsetting liability on the other SRFs balance sheet. Investments will be repaid with the first available SRF resources.

If reserve funds within a program are unavailable to meet debt service payments, funds from the other SRF will be invested to cure the deficiency

Exhibit 2
New York's Flow of Funds in the MFI



Priority Use of Account Funds to Cure Deficiencies

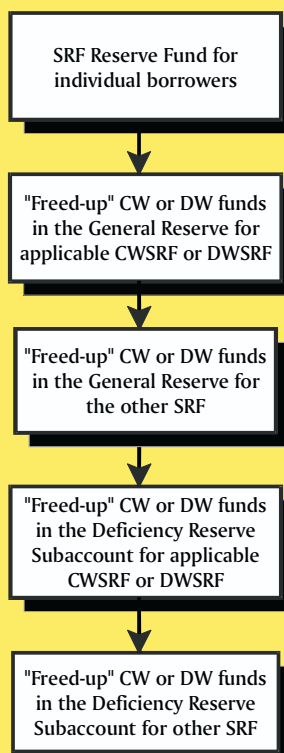
The order of accounts used to cure a borrower default under the MFI is shown in Exhibit 3. In the event of a default, the first draw would be on the individual SRF Debt Service Reserve Funds. Once depleted, the next source of funds to cover a default would be from the General Reserve Subaccount for the applicable CWSRF or DWSRF. The next account to be drawn upon would be the General Reserve Subaccount from the other SRF. This is first instance where cross-investment will take place. If needed, funds could be drawn from the applicable CWSRF or DWSRF moneys in the Deficiency Reserve Subaccount. Finally, funds would be borrowed as a cross-investment from the Deficiency Reserve Subaccount of the other

SRF. The cross-investments would be in the form of a short-term bond.

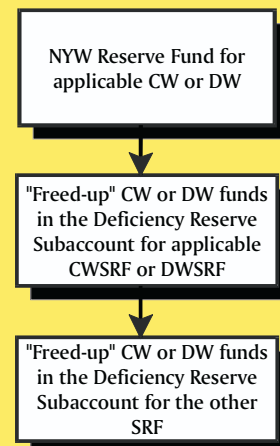
The order of accounts to cure a default under the NYW Indenture is similar. First, funds would be drawn from the applicable CWSRF or DWSRF NYW Reserve. Then funds would be drawn from the applicable CWSRF or DWSRF portion of the Deficiency Reserve Subaccount. Finally, funds would be borrowed from the other SRFs portion of the Deficiency Reserve Subaccount as a short-term cross-investment.

Exhibit 3 Priority Use of Account Funds to Cure Deficiencies

Within the MFI



Within the NYW Indenture



Summary of Key Features

New York's structure is designed to be appealing to bond rating agencies and investors. The State's approach enhances the security structure of New York's CWSRF and DWSRF leveraging bonds while complying with federal CWSRF and DWSRF program requirements. The following are key features of New York's cross investment structure:

- The CWSRF and DWSRF accounts remain separate.
- Only 'freed-up' dollars from reserve funds will be used for short-term cross-investments.
- Cash draws will not be made for cross-investment purposes.
- Cross-investments will not be used for state match.
- The structure allows short-term cross-investment in either direction between the State's CWSRF and DWSRF programs.
- Investments are temporary, short-term bonds that will be repaid with the first available SRF resources.
- Any investment between the CWSRF and DWSRF will be recorded on the SRF balance sheets.
- The State's approach is detailed in the operating agreements for the DWSRF and CWSRF between the Region and the State.
- Funds will not be held in one SRF in anticipation of potential future short-term cross-investment needs.

States interested in further information on short-term cross-investment should contact their EPA Regional Office SRF Coordinator. For information on New York's cross-investment structure contact the state representative below.

State Contact:
James Gebhardt
NYS Environmental Facilities
Corporation
50 Wold Road
Albany, NY 12205
Tel: (518) 457-0886



This report was prepared by
EPA Headquarters