

State of Minnesota MN Public Facilities Authority

**Proposed Amendments to Rules Governing
the Minnesota Public Facilities Authority Drinking
Water Revolving Fund and the Water Pollution
Control Revolving Fund**

**STATEMENT OF NEED
AND REASONABLENESS**

**Minnesota Rules, Chapter 7380,
Part 7380.0100 through 7380.0480**

I. INTRODUCTION

This document explains the need for and reasonableness of the proposed amendments to the MN Public Facilities Authority (Authority) rules governing the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund. It summarizes the evidence and arguments that the Authority's Board is relying upon to justify the proposed amendments. It has been prepared to satisfy the requirements of Minnesota Statutes, section 14.131 and Minnesota Rules 1400.2070.

The proposed amendments serve to address two primary changes to the rules. The first change is to modify the methodology and criteria for determining interest rates and terms on the loans. The result will be to strengthen the financial viability of the Funds by setting loan rates that more closely parallel bond market fluctuations and provide municipalities more flexibility in structuring their repayment schedules. The demand for the Authority's financing outpaces the Authority's legal ability to fund projects. A restructuring of the interest rate subsidy will allow more projects to be funded in the future. The second change is to bring uniformity and administrative efficiencies to the Drinking Water and Water Pollution Control Revolving Funds, which are administered similarly under the provisions of federal and state laws.

The effective date of the amended rules will be July 1, 2007 which will coincide with the development of the 2008 Intended Use Plan. All eligible borrowers on the 2007 Intended Use Plan will be allowed to complete the funding process under the existing rules which were in place when the 2007 Intended Use Plan was approved on August 22, 2006.

A. MN Public Facilities Authority Program Rules and Background

The Authority, established under Minn. Stat. 446A in 1987, is governed by a board consisting of six state agency commissioners representing the Departments of Employment and Economic Development, Health, Agriculture, Finance, Transportation and the Pollution Control Agency. The Commissioner of Employment and Economic Development chairs the Authority's board and is responsible for providing administrative support.

The Authority is responsible for financing projects and managing investments and transactions for three revolving funds and other programs that provide financial assistance to local

units of government for infrastructure needs, primarily drinking water and wastewater. Specific programs include the Drinking Water Revolving Fund, Water Pollution Control Revolving Fund, Transportation Revolving Loan Fund, Wastewater Infrastructure Funding Program, County Credit Enhancement Program, Total Maximum Daily Load (TMDL) Program, Small Community Wastewater Treatment Program, Phosphorous Grant Program, and Methamphetamine Laboratory Cleanup Revolving Account.

The Authority finances projects using a combination of federal and state funds, revolving fund revenues, and revenue bond proceeds. Loans to local units of government are secured by a general obligation note or revenue pledge from the local government unit. The issuance and management of bonds are subject to complex federal tax regulations, securities laws and regulations, and covenants to bond holders in addition to federal and state requirements. Under MN Statutes 446A.12, the Authority is authorized to issue up to \$1.50 billion in revenue bonds to finance projects. From 1989 through 2005, the Authority has financed \$1,992,987,093 in loans.

The proposed amendments address the Drinking Water and Water Pollution Control Revolving Funds. The U.S. Environmental Protection Agency (EPA) provides annual capitalization grants to the Authority for these two Funds. The State is required to provide a 20% match. Federal law requires that the assets of the Funds be maintained in perpetuity. Proactive management and diligent oversight are required to sustain the growth of the Funds and maintain the Authority's AAA/AAA/Aaa credit rating. The proposed amendments are a result of the ongoing review and analysis of program rules and policies required to meet the challenges of future infrastructure financing needs in Minnesota and maintain the Funds' viability.

The federal Safe Drinking Water Act Amendments of 1996 authorized the Drinking Water State Revolving Fund program to provide funds to states to finance drinking water projects and activities to protect public health and achieve or maintain compliance with the Safe Drinking Water Act. The Act authorizes the U.S. Environmental Protection Agency to award annual capitalization grants to each state to capitalize a state revolving fund, which the state can use to provide loans and other assistance to public water systems. In 1994, the Minnesota Legislature established the Drinking Water Revolving Fund under Minnesota Statutes 446A.081 to receive federal capitalization grants and state matching funds. Funds may be used for planning, design, and construction of publicly-owned municipal and regional drinking water supply systems, privately-owned municipal and regional drinking water supply systems, and other entities authorized by the act for projects that have been certified by the Minnesota Department of Health, and approved by the Authority.

The federal Clean Water Act authorizes the Water Pollution Control Revolving Fund program to provide funds to states to finance water pollution control projects. Under the Act, the U.S. Environmental Protection Agency awards annual capitalization grants to each state to capitalize a state revolving fund, which the state can then use to provide loans for point source (primarily wastewater but MPCA permitted storm water infrastructure) and nonpoint source water pollution control projects. In 1987, the Minnesota Legislature established the Water Pollution Control Revolving Fund under Minnesota Statutes 446A.072 to receive federal capitalization grants and state matching funds. Funds may be used for the planning, design and construction of municipal wastewater treatment systems certified by the Pollution Control Agency and approved by the

Authority to assure progress toward municipal compliance, or implementation of nonpoint source management controls.

B. Development of Proposed Amendments; Public Comment

On August 30, 2004, the Authority published a public notice in the State Register requesting comments on possible revisions to Minnesota Rule, Chapter 7380.0100 through 7380.0480. The Notice in the State Register requested that comments be submitted by November 1, 2004. Seven comments were received in response to the Notice. All written and oral comments were reviewed and considered during the development of the proposed rules.

In addition to publishing the Notice in the State Register, a notice of publication was posted on the MN Department of Employment and Economic Development's website. A cover letter along with the Notice was distributed to a mailing list that included all cities in Minnesota, the Metropolitan Council, all Sanitary Sewer Districts, the MN Department of Health's list of non-municipal public drinking water suppliers, legislators, various state and federal agencies, local government associations, and mayors and city clerks or administrators of every city in Minnesota. The Notice was electronically mailed to the League of Minnesota Cities, Minnesota Association of Townships and the Association of Minnesota Counties who included the information in their publications. An electronic mailing was also sent to all consultants and engineers listed on the Authority's e-mail list.

C. Alternative Format

Upon request, this Statement of Need and Reasonableness can be made available in an alternative format, such as large print, Braille, or cassette tape. To make the request, contact Nancy Johnson at the Minnesota Public Facilities Authority, Minnesota Department of Employment and Economic Development, 1st National Bank Building, 332 Minnesota Street, E200, St. Paul, Minnesota 55101-1351. The phone is 651-297-1677, fax is 651-296-8833, and the e-mail address is *Nancy.LC.Johnson@state.mn.us*. The toll free number is 1-800-657-3858. TTY users may call the Department at 651-296-3900 or 1-800-657-3973.

II. STATUTORY AUTHORITY

The Authority and Department's statutory authority to adopt the amendments to the rules is set forth in Minnesota Statutes 446A.07, Subdivision 10 for the Water Pollution Control Revolving Fund; and, Minnesota Statutes 446A.081, Subdivision 11 for the Drinking Water Revolving Fund. Minnesota Statutes 446A.11, Subdivision 1 and 2 specifically authorizes the Authority to adopt rules to implement the purpose and programs under Chapter 446A. Under these statutes, the Authority has the necessary statutory authority to adopt the proposed rules.

III. REGULATORY ANALYSIS

A. Regulatory Analysis of Factors Required by Minnesota Statutes, section 14.131.

Minnesota Statutes, section 14.131, sets out six factors for a regulatory analysis that must be included in the SONAR. Paragraphs (1) through (7) list these factors and the Authority's response to each item.

(1). A description of the classes of persons who probably will be affected by the proposed rule, including classes that will bear the costs of the proposed rule and classes that will benefit from the proposed rule.

- The classes of affected persons that will be impacted by and bear the costs of the proposed amendments include governmental entities such as cities, townships, counties, sanitary sewer districts, water districts and other non-governmental drinking water providers who choose to borrow money from the Authority for infrastructure projects. This will be discussed in detail in the Rule-by-Rule Analysis section of the SONAR.

-Those that will benefit from the proposed amendments are eligible applicants (same group as borrowers). This will be discussed in detail in the Rule-by-Rule Analysis of the SONAR.

(2). The probable costs to the Department and to any other Agency of the implementation and enforcement of the proposed rule and any anticipated effect on state revenues.

-There are no additional costs to the Authority or other agencies as a result of the proposed amendments nor does the Authority anticipate there will be any effect on state revenue.

(3). A determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule.

-There are no other methods available for achieving the purposes of the proposed rule amendments.

(4). A description of any alternative methods for achieving the purpose of the proposed amendments that were seriously considered by the Authority and the reasons why they were rejected in favor of the proposed rule.

-A variety of methods were considered within the constraints of state and federal law and municipal bond market practices. The proposed methodology improves the Authority's ability to balance the need to provide below market rate financing with the Authority's fiduciary responsibility for preserving, in perpetuity, the Funds' lending capacity.

(5). The probable costs of complying with the proposed rule, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals.

-The Authority is one of several financing sources providing infrastructure financing to eligible applicants throughout Minnesota and no entity is required to participate in the Authority's programs. For those entities that wish to apply, the cost to comply with the proposed rules (i.e., the cost to prepare an application to the Authority for financing) will not change with the proposed rule amendments.

-The proposed rules provide uniformity between programs and changing market conditions when setting below market interest rate subsidies for all borrowers. This may result in some borrowers paying a slightly higher rate while others, especially those with limited affordability, may receive a lower rate.

(6). The probable costs or consequences of not adopting the proposed rule, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of government units, businesses or individuals.

-Fewer low interest loans will be made, resulting in more systems with violations or higher water and sewer user rates for those not receiving low interest loans.

(7). An assessment of any differences between the proposed rule and existing federal regulations and a specific analysis of the need for and reasonableness of each difference.

-The proposed rule complies with all applicable federal regulations.

B. Performance-Based Rules

The Authority does not have regulatory powers. The regulatory aspect of the Drinking Water and the Water Pollution Control Revolving Funds lies with the MN Department of Health and the Minnesota Pollution Control Agency, respectively.

The Authority's program evaluation standards and performance indicators are outlined in federal laws and regulations governing the Drinking Water Revolving Loan Fund and the Water Pollution Control Revolving Fund and are reviewed annually by the U.S. Environmental Protection Agency, Region V, Chicago office.

C. Additional Notice

Minnesota Statute 13.441 and 14.23 require that the SONAR contain a description of the Authority's efforts to provide additional notice to persons who may be affected by the proposed rules or explain why these efforts were not made.

The Authority will be mailing the proposed rule and Dual Notice of Intent to Adopt to those individuals that have registered to be placed on the Department's rulemaking mailing list under Minnesota Statutes, section 14.14, subdivision 1a. The Authority will also give notice to the Legislature per Minnesota Statutes, section 14.116 and the Legislative Reference Library as required by Minnesota Statute 14.131 and 14.23.

The Additional Notice Plan, for which prior approval from the Office of the Administrative Hearings (OAH) will be requested, includes mailing a copy of the Dual Notice with a cover letter from the Executive Director of the Authority inviting public comment. The Dual Notice will be sent, by United States mail on the Friday, preceding the Monday that it will appear in the State Register, to the following:

- A. Interested persons and organization requesting information in response to the Request for Comment published August 30, 2004;
- B. Mayors of all Minnesota Cities;
- C. All Minnesota County Board Chairpersons;
- D. Sanitary Sewer Districts;
- E. Non-municipal public drinking water suppliers;
- F. Metropolitan Council;
- G. Regional Development Commissions;
- H. Initiative Foundations;
- I. MN Department of Health;

- J. MN Pollution Control Agency;
- K. DEED Small Cities Development Program;
- L. U.S. Environmental Protection Agency, Region V; and
- M. U.S. Department of Agriculture, Rural Development Office.

In addition to providing a hardcopy mailing of the Dual Notice to the above parties, the Authority will provide an electronic message containing the Dual Notice and cover letter to the following interested persons and organizations:

- A. League of Minnesota Cities;
- B. Minnesota Association of Townships;
- C. Association of Minnesota Counties;
- D. Association of Metropolitan Municipalities;
- E. Minnesota Association of Small Cities;
- F. Coalition of Greater MN Cities;
- G. Metro Inter-County Association;
- H. The Authority's electronic consultant and engineer list; and
- I. Other related associations or organizations not specifically listed.

The Dual Notice, which must be approved by the OAH prior to publication in the State Register, will contain: 1) a description of the proposed rule amendments; 2) a link to the Department's web page where copies of the proposed rules, SONAR and Dual Notice will be located; 3) information on how to obtain a hard copy of the proposed rules, SONAR and Dual Notice; and 4) information on how to submit comments on the proposed rules.

D. Consultation with the MN Department of Finance on Local Government Impact

Minnesota Statute 14.131 requires that the Authority must consult with the Commissioner of Finance to help evaluate the fiscal impact and fiscal benefits of the proposed rule on units of local government. The Executive Budget Officer for the MN Department of Finance was e-mailed, on August 26, 2004, the Request for Comment and cover letter as well as the Governor's Preliminary Notice. On September 3, 2004, the Executive Budget Officer requested, by telephone, that we send the SONAR and Dual Notice of Intent to Adopt, when available. The Authority will include any response received from the Commissioner of Finance in the rulemaking record.

E. Cost of Complying for Small Business or City

As required by Minnesota Statutes, section 14.127, the Authority has considered whether the cost of complying with the proposed rules in the first year after the rules take effect will exceed \$25,000 for any small business or small city. The Department has determined that the cost of complying with the proposed rules in the first year after the rules take effect will not exceed \$25,000 for any small business or small city. The cost to apply to the Authority for financing will not change with the proposed rule amendments. The Authority has made this determination based on the probable costs of complying with the proposed rules, as described in III. Regulatory Analysis, item (5) of this SONAR.

IV. LIST OF WITNESSES

In the event a public hearing is held on these proposed rule amendments, the Authority plans to have the following staff available to testify at the hearings on the need and reasonableness of the rules. The witnesses will be available to answer questions about the development and content of the rules. The witnesses are as follows:

Terry Kuhlman, Executive Director, MN Public Facilities Authority, will discuss the proposed rule amendments in general, the reasons for modification of subsidies and the methodology used to set interest rates for the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund, as well as the history of the rule making process.

Jeff Freeman, Assistant Director, MN Public Facilities Authority, will discuss the proposed rule amendments in general, the history of the rule making process, the program requirements and application process. Mr. Freeman will also be available to discuss the process used to set interest rates for the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund.

Steve Walter, Financial Officer, MN Public Facilities Authority, will be available to discuss the proposed rule amendments specifically related to changes in the methodology used to set interest rates, the added flexibility applicants will have in structuring the debt service payments and current bond market practices.

V. RULE-BY-RULE ANALYSIS OF NEED AND REASONABLENESS

7380.0100 DEFINITIONS.

7380.0100 Subpart 1. Scope

7380.0100 Subpart 2. Meetings

7380.0100 Subpart 3. Statute.

Part 7380.0100 is proposed to be repealed. It is a reasonable change because the definition of meetings is defined in Minnesota Statute 13D, Minnesota Open Meeting Law and, therefore, not necessary to duplicate the information. Minnesota Statute section 471.705 is now Minnesota Statute 13D.

7380.0110 REGULAR MEETINGS.

Part 7380.0110 is proposed to be repealed because the requirements concerning regular meetings under 7380.0110 are defined in Minnesota Statutes 13D, section 4, subdivision 1, Minnesota Open Meeting law and do not require duplication in the rules. Minnesota Statute section 471.705, subdivision 1c is now Minnesota Statute 13D.04, subdivision 1.

7380.0120 SPECIAL MEETINGS.

Part 7380.0120 is proposed to be repealed. It is necessary and reasonable to repeal this part because the requirements for holding special meetings are defined in Minnesota Statutes 13D.04, subdivision 2 and do not require duplication in the rules.

7380.0130 AGENDA.

Part 7380.0130 is proposed to be repealed. The rule language in part 7380.0130 is defined in Minnesota Statute 13D.06, subdivision 6 and does not require duplication in the rules. It is reasonable to repeal this rule.

7380.0245 PURPOSE.

This part has been repealed and renumbered and will appear after part 7380.0250. The new number is part 7380.0252. It is necessary to make this change because the Drinking Water Revolving Fund and Water Pollution Control Revolving Fund definitions will be merged and need to precede part 7380.0245, which is the purpose section for Drinking Water only.

7380.0250 DEFINITIONS.

The proposed changes to Definitions are necessary and reasonable in order to merge and streamline the rules for the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund. The definitions listed under the Water Pollution Control Revolving Fund rules, in part 7380.0410, will be repealed.

7380.0250 Subpart 1. Scope.

The Authority is proposing to add the Scope definition from part 7380.0410, the Water Pollution Control Revolving Fund rules to subpart 1. The federal Safe Drinking Water Act is deleted under the current scope language and referenced under subpart 2 of this part. Minnesota Statutes 446A.081 is identified under part 7380.0252. Definitions cited in Minnesota Statutes 446A are incorporated by reference.

7380.0250 Subpart. 2. Act

The proposed changes to this definition incorporate the federal acts and laws applicable to the Water Pollution Control Revolving Fund, which was defined in part 7380.0410, subpart 2, and is proposed for repeal.

7380.0250 Subpart. 3. Applicant.

The proposed changes to the definition of applicant include reorganizing and merging the Water Pollution Control Revolving Fund language from part 7380.0410, subpart 4 with this definition. The new language in subpart 3 was moved from the drinking water definition of applicant because there are two revolving funds now included within this definition.

7380.0250 Subpart. 4. Application.

Several changes are proposed for this definition in order to provide clarity and readability. The first change clarifies that the Authority provides the application forms to the applicant. The deletion of the sentence on lines 22-25 on page 2 is reasonable because the language is moved to part 7380.0260, subpart 4 where required application information is addressed under the changes to that part. The last sentence is deleted as private data issues are covered under Minnesota Statutes, section 13.02, subdivision 12, and nonpublic data as defined in Minnesota Statute, section 13.02, subdivision 9.

7380.0250 Subpart 5a. Base discount.

This term is needed to describe the primary ways that the Authority will provide an interest rate subsidy on loans from the Drinking Water Revolving Fund and Water Pollution Control Revolving Fund loans. It is reasonable that the base discount be set annually by the Authority through its

adoption of the intended use plans because the size of the base discount impacts the number and total dollar volume of loans the Authority can make while protecting the long term capacity of the Funds, and the intended use plans are public documents through which the Authority describes how it is managing the Funds.

7380.0250 Subpart. 6a. Bond yield scale-authority bonds.

Bond yield scale-authority bonds is a new definition that is proposed to be added to the rules and would describe the scale of rates on Authority bonds that may be used in the process of determining the interest rate on a loan. The scale would be comprised of the yield to maturity on bonds sold by the Authority. It is necessary and reasonable to include this definition because the Authority is proposing to change the method used for setting interest rates, as discussed under part 7380.0272 and part 7380.0442.

7380.0250 Subpart. 6b. Bond yield scale-market index.

Bond yield scale-market index is a new definition that is proposed to be added to the rules and would describe the scale of rates from a nationally recognized daily index of tax-exempt municipal bonds that may be used in the process of determining the interest rate on a loan. The scale is based on consolidated data from marketplace transactions and is widely used in the municipal finance industry as a gauge of municipal bond rates. It is necessary and reasonable to include this definition because the Authority is proposing to change the method used for setting interest rates, as discussed under part 7380.0272 and part 7380.0442.

7380.0250 Subpart. 7. Borrower.

The language that is proposed for deletion in this definition appears under the definition of applicant, subpart 3. The language in subpart 7 is necessary and reasonable because it will describe the transition from an applicant to a borrower.

7380.0250 Subpart. 8. CD.

This definition is proposed to be repealed. It is reasonable to delete this definition because the Authority has never provided a financing transaction in the form of a linked deposit loan that required a certificate of deposit. This will be discussed further under part 7380.0275.

7380.0250 Subpart. 8a. Debt security.

This change proposes to add a new definition that provides a shorthand reference for the various types of collateral provided to the Authority. This term would be used where multiple types of collateral are listed in the rules. This change is necessary and reasonable in order to simplify and streamline the rule language.

7380.0250 Subpart. 9. Debt service account.

The proposed change to this definition replaces the term general obligation bond with the term “debt security” which is consistent with the new definition of debt security.

7380.0250 Subpart. 10. Dedicated sources of revenue.

The changes proposed would clarify that dedicated sources of revenue may include a pledge other than a general obligation or revenue bond as stated in the proposed debt security definition. The definition applies to both the Drinking Water Revolving Fund and the Water Pollution Control

Revolving Fund, therefore, the reference to Minnesota Statutes, section 446A.081, subdivision 8; paragraph (d) would be deleted because it refers specifically to the Drinking Water Revolving Fund.

7380.0250 Subpart. 10a. Default.

This proposed new definition would be added because the Authority is required by the Act to ensure that all borrowers comply with loan terms and conditions. The term default is used to describe both a financial and technical default. This language provides a mechanism for enforcement of the covenants and therefore it is necessary and reasonable to include the definition of default.

A financial default is failure to make scheduled debt service payments by the due date to the Authority. A technical default includes noncompliance with the terms of the loan agreement and may include a failure to submit required reports or information.

7380.0250 Subpart. 11. Department.

This definition is proposed to be repealed because the Department of Health would be written out in the rules.

7380.0250 Subpart. 12. Eligible costs.

The proposed change to eligible costs combines the definitions from the Water Pollution Control Revolving Fund rules, part 7380.0410, and the Drinking Water Revolving Fund eligible costs. Parts of the proposed changes simply provide clarity and are not substantive changes.

Eligible project costs must be certified by the Department of Health or the Pollution Control Agency prior to receiving funds from the Authority and the new language clarifies their respective roles in the review process for eligible costs.

The words “provision of the capitalization grant, and the Authority’s basic bond resolution and series bond resolution” are deleted as these requirements are specified in the loan agreement.

The following list of eligible costs would be re-lettered due to the deletion of item J.

7380.0250 Subpart. 12 Item A.

The modifications to this definition are being proposed to include the Water Pollution Control Revolving Fund definition of acquisition as defined under part 7380.0410, subpart 7, item A.

7380.0250 Subpart. 12 Item I.

This proposed change would clarify that the eligible costs listed do not apply to the Authority, only the borrower.

7380.0250 Subpart. 12 Item K.

This proposed change is a technical correction because neither the federal Safe Water Drinking Act nor the federal Water Pollution Control Act specifies a reimbursement cap for contingency costs, only that the costs are eligible.

7380.0250 Subpart. 12 Item L.

This change proposes the addition of the phrase “including capitalized interest” which will clarify that the cost of interest charges on the loan, that would be due and payable before the system revenues are fully available to pay them, can be added to the loan principal, as an eligible cost.

7380.0250 Subpart. 13. Emergency project.

This change proposes to repeal the definition of an emergency project because the term is proposed to be removed from part 7380.0255, subpart 1, item C.

7380.0250 Subpart. 15. Financial capability.

This definition is proposed to be changed to eliminate the distinction between a municipal borrower, item A, and a private borrower, item B. The term “municipal borrower” is changed to “applicant” because the Authority is analyzing the applicant’s financial capacity and has not yet approved a loan. The list of items used by the Authority to evaluate financial capability are reordered, reworded and expanded for clarification purposes.

7380.0250 Subpart. 17. Fund.

This definition would be changed to include the Water Pollution Control Revolving Fund definition from part 7380.0410, subpart 9. The rule citations for each program would be added to the definition.

7380.0250 Subpart. 18. General obligation bond.

This definition is proposed to be changed and shortened for simplicity and readability.

7380.0250 Subpart 20. Linked-deposit loan.

This definition is proposed for repeal because the term is proposed to be removed from part 7380.0265, subpart 3.

7380.0250 Subpart 20a. Loan

This proposed definition is new and represents the transaction whereby the Authority would purchase debt security from the borrower. The term is being defined to add readability and applies to all the Authority’s loan transactions.

7380.0250 Subpart 21. Loan agreement.

This proposed change will clarify and broaden the definition of eligible borrowers under the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund.

7380.0250 Subpart 21a. Loan closing.

This proposed definition is new and is added to describe what must be completed prior to the borrower receiving disbursements from the Authority.

7380.0250 Subpart 21b. Municipal drinking water system.

This definition was formerly defined as water supply system, under subpart 33 of part 7380.0250, and is proposed for repeal. The addition of subpart 21b proposes to rename this definition due to the merger of the Water Pollution Control Revolving Fund definitions with the Drinking Water Revolving Fund definitions.

7380.0250 Subpart 21c. Municipal storm water system.

This proposed definition is new and is added to provide a description of a municipal storm water system for the Water Pollution Control Revolving Fund.

7380.0250 Subpart 21d. Municipal wastewater system.

This proposed definition is new and is added to provide a description of a municipal wastewater system and appurtenances for the Water Pollution Control Revolving Fund.

7380.0250 Subpart 22. Municipal bond index.

This definition is proposed to be repealed due to obsolescence.

7380.0250 Subpart 23. Official statement .

The proposed changes are being made for clarity and readability. The term “bond offering” would replace “issue” and is more descriptive of the document offered by the issuer. The phrase “in the case of the Authority” would be deleted as unnecessary language.

7380.0250 Subpart 24. Participation loan.

The proposed changes to this definition clarify the Authority’s maximum obligation regarding the purchase of a loan with a financial institution, for an eligible borrower. This will be discussed under part 7380.0265, subpart 3. Participation loans are only utilized under the Drinking Water Revolving Fund.

7380.0250 Subpart 25. Poverty level

This definition is proposed for repeal because the Authority is recommending that the poverty level discount for a municipality be eliminated. This will be discussed under part 7380.0272.

7380.0250 Subpart 25a. Project

This definition is proposed to be added and describes the activities that constitute a project whether the project is a drinking water, storm water or wastewater system.

7380.0250 Subpart 27. Quarterly set rate.

This definition is proposed for repeal because the Authority is recommending the elimination of the quarterly set rate for establishing interest rates on loans. This will be discussed under part 7380.0272.

7380.0250 Subpart 27a. Project service area

The Authority is proposing to add this definition because the term defines a project’s service area as either a municipality’s entire service area or a geographic area separate from or a part of a municipality.

7380.0250. Subpart 27b. Residential system cost.

The new definition of residential system cost is proposed to address drinking water, storm water or wastewater projects utilizing either the Drinking Water Revolving Fund or Water Pollution Control Revolving Fund. The definition adds the costs associated with building the project as part of the system costs that will be charged to residential users in the project service area. The proposed change deletes the list of fees or assessments that can legally be charged to pay for the system costs because applicants will identify, in the complete application, the source of revenues that will be used to pay debt service on the project.

7380.0250 Subpart 28. Revenue bond

The proposed addition of the term “or note” is consistent with the definition in subpart 18. The term “one or more” is added because there may be multiple sources of revenue charged or assessed to users to pay for the system costs.

7380.0250 Subpart 28a. Significant storm water contributor.

This proposed definition is added to define a significant storm water contributor. It is reasonable and necessary to add this definition in order to determine if a municipality needs to enter into an agreement with a storm water contributor in order for a borrower to receive interest rate discounts under part 7380.0442, subpart 3, item C.

7380.0250 Subpart 28b. Significant storm water contributor agreement.

This definition is proposed to be added to define the specific information to be included in a written agreement between a borrower and a significant storm water contributor. It is necessary and reasonable for the Authority to require a secured, written guarantee from the significant storm water contributor in the event the contributor should curtail or cease operation in a municipality.

7380.0250 Subpart 28c. Significant wastewater contributor.

This proposed change moves the definition from part 7380.0410, subpart 20, as a result of the proposed reorganization and consolidation of the Water Pollution Control Revolving Fund definitions with the Drinking Water Revolving Fund definitions.

7380.0250 Subpart 28d. Significant wastewater contributor agreement.

The Authority is proposing to add a new definition that requires specific information to be included in a written agreement between a borrower and a significant wastewater contributor. It is necessary and reasonable for the Authority to require a secured, written guarantee from the significant wastewater contributor in the event the significant wastewater contributor should curtail or cease operation in a municipality.

7380.0250 Subpart 29. Significant water user.

The definition of significant water user is proposed for modification to clarify and simplify the definition.

7380.0250 Subpart 29a. Significant water user agreement.

The Authority is proposing to add a new definition that requires specific information to be included in a written agreement between a borrower and a significant water user. It is necessary and reasonable for the Authority to require a secured, written guarantee from the significant water user in the event the significant water user should curtail or cease operation in a municipality.

7380.0250 Subpart 30. True interest cost.

This definition is proposed to be repealed because the term will no longer be used in the calculation of the interest rates.

7380.0250 Subpart 31. Water service area.

This definition is proposed to be repealed and replaced with the definition of project service area, subpart 27a, which addresses both the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund.

7380.0250 Subpart 32. Water service charge.

This definition is proposed to be repealed. It would be replaced by the definition of residential system cost described under subpart 27b, which is used for both the Drinking Water Revolving Fund and Water Pollution Control Revolving Fund, including a municipal storm water system.

7380.0250 Subpart 33. Water supply system

This definition is proposed to be repealed. The proposed new definition is municipal drinking water system and renumbered subpart 21b. The language is exactly the same but with the addition of the phrase, “regardless of whether a private, public, or nonprofit system”. It is necessary and reasonable to add the new language regarding private, public or nonprofit systems because each is eligible for funding under the Drinking Water Revolving Fund.

7380.0252 PURPOSE.

This purpose section for the Drinking Water Revolving Fund was renumbered to follow the combined definitions, which now include both the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund. No substantive changes were made to the purpose section except to update the terminology and delete the language that describes how the Authority raises funding for the program which is contained in the Minnesota Statute establishing and governing the program.

7380.0255 INTENDED USE PLAN.

7380.0255 Subpart 1. Adoption of intended use plan.

The Authority is proposing to modify and add new language to subpart 1.

7380.0255 Subpart 1, Item A

The first modification would include the addition of item A, which would describe a certain category of projects informally known as carryover projects. These are projects that are listed in the fundable range on the prior year’s intended use plan that have submitted a complete loan application to the Authority and received certification from the Department of Health, but have not received an actual loan award prior to the Authority’s preparation of the new intended use plan. This may happen due to the time needed for a municipality to complete the construction bidding process, because the Authority does not award a loan until the municipality submits the as-bid project costs. Due to the time and money invested by the municipality to get a project to this point, it is reasonable to create a separate category for these projects so their situation can be considered when determining the fundable range in subpart 3.

7380.0255 Subpart 1, Item B.

Item B is proposed for modification in two ways to improve clarity. First, to help distinguish between this set of projects and the projects in item A the word “new” was inserted to indicate this category is for projects that are newly meeting the eligibility requirements in subpart 2, as opposed to the projects in item A that previously met the eligibility requirements for placement on the prior year’s intended use plan. Second, the general language “expected to be funded in the fiscal year” was changed to more specifically reference the fundable range, which is further explained in the revisions to subpart 3

7380.0255 Subpart 1, Item C.

Item C would be revised to delete an unused provision and insert new language that relates to interest rate determinations in part 7380.0272. The reference to reserving an amount in the intended use plan for emergency projects, a tool that has not been used to date, has been deleted. Given the demand for Drinking Water Revolving Funds and that, in the vast majority of cases, planning for infrastructure projects begins well in advance when the project is expected to be ready for construction, it is the Authority's experience that reserving funds for emergencies would be an inefficient use of funds. When emergencies have come up, the Authority has provided guidance to cities on how they can get temporary financing to do the necessary work in such a way that it can later be refinanced through the Drinking Water Revolving Fund. This allows a municipality to access funds and gets the work done much more quickly and efficiently.

The new language proposed in item C states that the intended use plan will identify the base discounts that will be used when calculating the interest rate for loans under part 7380.0272, subpart 3A. Under state and federal law, the Authority must make Drinking Water Revolving Fund loans at below market interest rates, but the Authority is also required to maintain the assets of the fund in perpetuity to provide an ongoing source of financing to help municipalities meet their drinking water infrastructure needs. Therefore, the Authority must balance the interest rate discounts it provides to current projects with its fiduciary responsibility to preserve lending capacity for future needs. The responsibility of balancing current and future needs makes it necessary and reasonable for the Authority to annually set the base discount for loans, and to publish the base discounts in the intended use plan, which is a public document used to inform interested parties about the management of the Drinking Water Revolving Fund.

7380.0255, Subpart 1, Item D.

Item D is new language that is being proposed to identify other eligible activities allowed under the Act.

7380.0255 Subpart 2. Eligibility

This proposed change modifies item A to clarify that the reference to department is the Department of Health. In item B, the last item required to be part of a request for placement on the intended use plan is deleted. The monthly drawdown of loan proceeds is typically not very accurate at this point in the process and is not necessary for preparing the intended use plan.

7380.0255 Subpart. 3. Fundable range .

This change proposed to modify subpart 3 to clarify how the intended use plan identifies fundable projects. The word "eligible" was inserted at the beginning to emphasize that projects must meet the eligibility requirements of subpart 2 to be listed and the department reference was clarified to state the Department of Health. The second sentence was modified to indicate the Authority determines the amount available for loans each year, and based on that determination and the project priorities set by the Health Department, a fundable range of projects is established in the intended use plan. These changes are reasonable because they better describe how the process works and formalize the term "fundable range," which is commonly used and well understood by municipalities and consultants working with the program.

The one substantive change in subpart 3 is where there are two categories of projects in the intended use plan fundable range, with the projects in subpart 1A (i.e., “carryover” projects) listed first and the new projects listed secondly. This is necessary because there could be situations where a project that was in the intended use plan fundable range one year, was not listed in fundable range in the following year due to a higher level of demand and/or more limited availability of funds. Municipalities need to have some assurance that if they get their project on the intended use plan, submit a loan application, and get all technical and environmental approvals necessary for project certification by the Department of Health, that the loan funds will be available when the municipality bids the project and the loan agreement is executed. It is reasonable that these “carryover” projects be listed first in the fundable range because it would be unfair and detrimental to good project planning if a municipality that invests the time and money to get its project to this point could not count on the loan funds being available once the bidding process was complete.

7380.0255 Subpart 4. Bypass procedure.

This change proposes to repeal subpart 4. The procedure has not been used, nor do we anticipate a future need. In order to maximize the use of Drinking Water Revolving Fund loan funds to assist as many projects as possible, the Authority assumes that not all the eligible projects will actually proceed to the point of receiving a loan when it determines the fundable range in subpart 3. In other words, projects that may otherwise be added through the bypass procedure are instead put in the intended use plan fundable range right from the beginning. In a situation where additional projects could be added beyond that, the intended use plan amendment process in subpart 5 is a more open process to do so. Therefore, it is reasonable to delete this subpart.

7380.0255 Subpart 5. Amendments to the intended use plan.

The proposed changes to subpart 5 are being made to provide clarity. No substantive changes are being made.

7380.0260 APPLICATIONS.

7380.0260 Subpart 1. Timing.

The proposed changes clarify which projects may submit an application. These changes are necessary and reasonable in order to be compatible with part 7380.0255. The bypass procedure was repealed under part 7380.0255, subpart 4.

7380.0260 Subpart 1. Item A.

This proposed change is necessary and reasonable in order to make the definition more readable.

7380.0260 Subpart 1. Item B.

This proposed change is necessary and reasonable in order to make the definition more readable and to identify the department as the Department of Health.

7380.0260 Subpart 2. Financial information.

This proposed change would repeal subpart 2. The information regarding private data is found under Minnesota Statutes, section 13.02, subdivision 12, and nonpublic data as defined in Minnesota Statutes, section 13.02, subdivision 9.

7380.0260 Subpart 3. Municipal profile.

This proposed change would repeal subpart 3 because data requested in the municipal profile is available in other formats and sources. In addition, data on an applicant's financial capability is requested in the application process and is further specified in subpart 4, item B, which has been expanded.

7380.0260 Subpart 4. Complete applications.

The proposed changes to subpart 4 improve readability and clarify what a completed application must contain.

7380.0260 Subpart 4. Item B.

This proposed change expands the type of data that is analyzed by the Authority to determine the creditworthiness of the applicant. It is necessary and reasonable to make this change in order for the Authority to make an informed determination as to the applicant's capacity to comply with the terms and conditions of the loan including the ability of the applicant to repay the loan.

7380.0260 Subpart 4. Item C.

This proposed change is necessary and reasonable to simplify the definition, eliminate unnecessary language and re-letter item C as item D.

7380.0260 Subpart 4. Item D.

This proposed change would add new language that describes the information that must be submitted to the Authority by the borrower in order demonstrate compliance with laws and regulations governing the fund. The proposed change also re-letters item D as item C.

7380.0260 Subpart 5. Incomplete applications.

This rule is proposed to be repealed because the timeframes and methods for notification of an incomplete application are obsolete. Incomplete applications are addressed in subpart 7, Rejection of an application.

7380.0260 Subpart 6. Evaluation of applications .

This proposed rule change is necessary and reasonable because it clarifies that projects and not applications are certified by the Department of Health; increases readability by using debt security as a defined term that includes all types of security that may be issued by an applicant; and identifies the department as the Department of Health.

7380.0260 Subpart 7. Rejection of an application.

This proposed change modifies subpart 7 to add language allowing the executive director on behalf of the Authority to reject applications. This change is necessary and reasonable to clarify the executive director's responsibility for the administrative functions of the Authority, including rejection of incomplete applications.

7380.0260 Subpart 7. Item A.

This proposed rule change is necessary and reasonable because it identifies the department as the Department of Health.

7380.0260 Subpart 7. Item C.

This proposed rule change is necessary and reasonable because an application may be rejected if the applicant cannot demonstrate that they have established the resources required to make timely debt service payments and to keep the proposed facility in good working order.

7380.0260 Subpart 7. Item E.

The proposed change to item E clarifies and expands the language when the Authority may reject an application if the applicant cannot demonstrate that they have the financial capability to make debt service payments when due.

7380.0260 Subpart 7. Item F.

This proposed change is reasonable and necessary because it increases readability by using debt security as a defined term that includes all types of security that may be issued by an applicant.

7380.0260 Subpart 7. Item G

This proposed change is necessary because the Authority is required by the Act to:

1) ensure all applicants and borrowers demonstrate technical, financial and managerial capability with respect to their project(s); and, 2) maintain the fund into perpetuity, including protecting the Authority bond rating and ability to obtain additional U.S. Environmental Protection Agency funding in the future. This change is reasonable because it provides a mechanism to enforce the requirements of the Act and it protects the integrity of the fund by not allowing subsequent transactions when a borrower fails to correct a default condition of a previously funded transaction.

7380.0265 LOAN TERMS AND CONDITIONS.

7380.0265. Subpart 1. In general.

There are several changes proposed for subpart 1. Some of the proposed changes streamline and clarify the rule while others are substantive changes that solidify the primacy of the loan agreement documents. The following changes are all found on page 19 of the proposed rules.

Lines 1 to 4 clarify that not all projects listed on the intended use plan are within the fundable range as described in part 7380.0255, subpart 3.

Lines 4 and 5 delete the reference to emergency projects for reasons given in part 7380.0255, subpart 1.D.

Lines 7 through 9 relate to other financial assistance and are deleted because other forms of assistance are addressed under part 7380.0285. The requirement for certified projects is addressed in part 7380.0260.

Lines 9 through 15 broadly incorporate applicable federal requirements and Minnesota Rules in addition to identifying the Act, state statutes and applicable legal documents that govern the terms and conditions of the loan agreement issued by the Authority.

Line 12 is a renumbering of the rule citation.

Lines 18 through 21 are added to clarify that the provisions of the loan agreement prevail when in conflict with the borrower's bond documents. It is necessary and reasonable to add this language because it ensures conformity with all applicable laws and regulations.

Lines 21 through 24 are deleted because this language is no longer relevant based on the proposed rule change.

7380.0265 Subpart 2. Borrowers providing general obligation or revenue bonds.

The proposed modifications to subpart 2 are for grammatical clarity and to replace the existing language in item F with new language.

7380.0265 Subpart 2. Item A.

The proposed changes to item A provide clarification on what constitutes the term of a loan and states that the term of the loan cannot exceed the design life of the project, which is a prudent financial lending practice.

7380.0265 Subpart 2. Item E.

The proposed modifications to item E provide uniformity between the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund by having debt service schedules consistent with standard municipal bonding practices. Since the security is a municipal bond, this change reflects a typical municipal bond debt service structure. The proposed modification will eliminate the interest free period on the loans.

This change is reasonable because market conditions and tax considerations have changed since the Drinking Water Revolving Fund was created and modeled after the Water Pollution Control Revolving Fund. When the Water Pollution Control Revolving Fund program was created, municipalities were able to issue twenty-year debt to pay construction costs and invest the bond proceeds at short-term yields that exceeded the tax-exempt bond yield. Small issuers were able to keep their arbitrage profits rather than rebate the earnings that exceeded the bond yield. To compete in that market, the Authority offered an interest free period to its borrowers. Due to unpredictable changes in the market the Authority can no longer afford the risk and earning losses provided by offering interest free period therefore it is necessary to make this change which is consistent with municipal bonding practices.

7380.0265 Subpart 2. Item F.

The proposed modifications to item F include the deletion of the existing language requiring a significant water user to enter into an agreement with a borrower. This language was modified and moved to part 7380.0272, subpart 3, item C.

The proposed new language is added to notify the borrower that pursuant to the provision of Rule 15c2-12 promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended, the Authority has agreed in its Master Continuing Disclosure Agreement for the benefit of the Beneficial Owners of its bonds: (i) to enter into a Borrower Continuing Disclosure Agreement with each obligated person as defined in rule 15c2-12, and, (ii) to cause each obligated person to provide continuing disclosure. The addition of this language is

necessary and reasonable in order to provide current and accurate information to the Authority and its bondholders.

7380.0265 Subpart 3. Borrowers not providing general obligation or revenue bonds.

There are several proposed changes to subpart 3. The Authority is proposing to delete linked deposit loans. The Authority has never received a request for this type of financing, which is a cumbersome and complex financing tool.

The Authority is retaining the participation loan but reducing the maximum loan amount from \$250,000 to \$50,000 per loan. This change is reasonable because projects would typically be smaller and inquiries about the participation loan program have been for projects under \$100,000. The Authority anticipates limited requests for these small loans and therefore it would be prudent to reduce the maximum loan amount. If a project were larger, the Authority would work with the local government to suggest other financing options or make the project a part of the public system. Changes to the participation loan are also addressed under part 7380.0275.

The participation loan program provides a mechanism for non-municipal borrowers to access the Drinking Water Revolving Fund by partnering with a borrower's financial institution to provide needed financing for a project while sharing the risk with the Authority. The Authority is proposing to make the program similar to other successful lending programs, such as the Minnesota Tourism Loan Program.

7380.0265 Subpart 3. Item A

The proposed changes would clarify and streamline the language. The use of the term "project" provides simplicity and clarity because it is a defined term under part 7380.0250, subpart 25a. There are no substantive changes being proposed.

7380.0265 Subpart 3. Item D

This change proposes to delete linked deposit loans for reasons cited under subpart 3. In contrast, participation loans are a simpler financing transaction for borrowers and the Authority and allow a mechanism for non-municipal borrowers to access the Authority's fund. The term proportional would be added before security interest to acknowledge that the security for a loan would be prorated between the Authority and financial institution based on the level of financing provided by each lender.

7380.0270 INTEREST RATE DETERMINATIONS FOR BORROWERS PROVIDING GENERAL OBLIGATION OR REVENUE BONDS.

The Authority proposes to move portions of this language to other parts within the rules and repeal part 7380.0270.

7380.0272 INTEREST RATE DETERMINATIONS.

The proposed new part 7380.0272 addresses how interest rates are determined and applied to Authority Drinking Water Revolving Fund loans, except for participation loans, which are covered under part 7380.0275. The proposed changes are necessary in order to achieve the following:

- ? Reduce market risk for both the Authority and borrowers by using current market rates at the time loan agreements are made rather than relying on a rate that is adjusted only once each quarter.
- ? Further reduce market risk for both the Authority and borrowers by creating, in the rules, the ability to react to market swings to protect the Authority and borrowers from temporary market conditions that may otherwise cause loan rates to be either damaging to the Authority's long-term lending capacity or non-competitive to the borrowers.
- ? Match the rate on a loan with the structure of the principal redemption schedule as is done in the municipal marketplace. Currently the loan rate is independent of the loan structure. Authority loans are structured with level debt service for the term of the loan unless the borrower requests a different principal maturity schedule, which the Authority must approve. The rate on a loan should reflect these differences because of the time-value of money.

7380.0272 Subpart 1. In general.

These changes are necessary in order to expand the capacity of the Fund and mirror municipal marketplace practices. In order to achieve the Authority's goals of reducing market-timing risks and to match the loan rate to the loan repayment structure, it is reasonable to add this language because it identifies parameters used to determine how the rate of interest will be set for a loan, in that:

- ? loan rates will be based on current market rates in effect at the time the loan agreement is processed, rather than based on a rate (the quarterly set rate) that was in effect at the time the application was received, which may be many months outdated.
- ? loan rates will take into account the structure of the loan repayment schedule; to the extent loan repayments are more heavily weighted toward the early or late years of the loan, the loan rate will likewise be weighted toward the market rates for that time frame.

7380.0272 Subpart 1, Item A.

This new language is proposing to change the manner in which interest rates are set. The current application process requires that a complete application be submitted to the Authority, that the project be certified by the Department of Health and that as-bid costs are submitted to the Authority prior to finalizing the financing for the project. Under the existing rules the loan agreement could be processed many months after setting the rate.

The new language establishes the timeframe for locking in the interest rate for a borrower. Under the proposed language, the interest rate will be set when the last of the three items required is received by the Authority and the borrower has submitted a formal request to the Authority to proceed with the loan agreement. This will make the loan agreement processing coincident with the rate setting.

7380.0272 Subpart 1, Item B.

The language in item B is necessary because the Authority proposes to change the timing for interest rate determination. This language is reasonable because it clearly defines the information that must be received by the Authority prior to the applicant formally requesting that the Authority proceed with the loan agreement.

7380.0272 Subpart 1, Item C.

The proposed language in item C appeared under part 7380.0270, subpart 1, item A, which has been repealed, however, the Authority proposes to include this language under part 7380.0272.

7380.0272 Subpart 1, Item D.

This new language is necessary in order to address the arbitrage issues that could impact the tax-exempt status of the Authority's bonds and the cost associated with the arbitrage rebate calculation the Authority undertakes. Arbitrage restrictions prohibit the Authority from earning a higher yield on bond proceeds or debt service funds than the arbitrage yield on the Authority's bond(s) that partially or fully fund a loan. It is reasonable to make this change.

7380.0272 Subpart 2. Bond yield scale

The Authority is proposing to change how interest rates are calculated. The Authority has used the bond index in the Wall Street Journal, which was the average interest rate on municipal bonds that matured in 20 years. It is necessary and reasonable to change this procedure because this is not a good reflection of the yield curve and what the true interest cost would be over a 20-year period. By using a bond yield scale, the Authority can offer rates that are more reflective of the market.

7380.0272 Subpart 2, Item A.

For borrowers that provide a tax-exempt general obligation bond, the Authority will use the AAA bond scale. Tax-exempt securities are more valuable in the secondary bond market and thus deserve the lower rate.

7380.0272 Subpart 2, Item B.

This new language is proposed because some borrowers prefer to provide a taxable general obligation bond for a variety of reasons. Since this type of security is less valuable in the secondary market it is reasonable for the Authority to charge a slightly higher rate of interest by using the AA bond scale.

7380.0272 Subpart 2, Item C.

For borrowers that provide a tax-exempt revenue bond, the Authority intends to use the AAA bond scale. This type of security is more valuable in the secondary bond market and thus deserves the lower rate.

7380.0272 Subpart 2, Item D.

This new language is proposed because several borrowers prefer to provide a taxable revenue bond for a variety of reasons. Since this type of security is less valuable in the secondary market, it is reasonable for the Authority to charge a slightly higher rate of interest by using the AA bond scale.

7380.0272 Subpart 3. Interest rate discounts

This new language is reasonable and necessary because it set the parameters for application of the discounts in items A, B and C.

7380.0272 Subpart 3, Item A.

The Authority is proposing to replace the existing method with the new method under part 7380.0255, subpart 1, item c.

7380.0272 Subpart 3, Item B.

The new language in subpart 3, item B proposes to provide additional discounts to borrowers with populations of less than 2,500 and for loan amounts up to \$20,000 per household. For projects where costs are in excess of \$20,000 per household, a blended interest rate would be applied because the costs in excess of \$20,000 would not receive additional discounts, just the base discount.

Generally borrowers with a population less than 2,500 have limited financial capacity and less economy of scale than larger municipalities thereby requiring discounts that would keep a system affordable. The \$20,000 limit on subsidies is reasonable because it reserves available resources for more cost effective projects. These changes are necessary in order to protect the viability of the Fund and expand the Fund's capacity to assist more borrowers. The proposed changes are consistent with the changes being made in the Water Pollution Control Revolving Fund rules.

Sub-item 1 moves the median household discount from the old part 7380.0270, subpart 3, A, which is being repealed to part 7380.0272, subpart 3, B (1).

Sub-item 2 was moved from part 7380.0270, subpart 4, A through C, which is being repealed, to part 7380.0272, subpart 3, item 2, (a) through (e). The information was reorganized and reworded for clarity and modified to expand the range of discount levels available but only to small borrowers with populations less than 2,500 and up to \$20,000 per household.

7380.0272 Subpart 3, Item C.

The Authority would not provide the discounts in items A or B for a borrower that has a non-residential, significant water user that has caused the need for the project or whose water intake after project completion will exceed 50% of the total gallons annually unless there is a secured, written guarantee provided through a significant water user agreement. This change is necessary and reasonable as the risk for this type of project is much higher because there is typically a single, non-residential user paying a higher share of the project cost as opposed to spreading the cost of the project over the entire project service area.

7380.0272 Subpart 4. Demographic

The language proposed under subpart 4 was moved from part 7380.0270, subpart 1, item D, which is being repealed.

7380.0275 INTEREST RATE DETERMINATIONS FOR PARTICIPTION LOANS.

The Authority is proposing to delete the linked deposit funding mechanism and would rename the heading to reflect the change.

7380.0275 Subpart 1. Participation loans.

The proposed modifications to subpart 1 eliminates all language related to the linked-deposit loan. The change would also combine subparts 1 and 3 and repeal subpart 2.

The Authority is proposing new language that would establish a fixed 2% interest rate on the participation share of the loan and allow a financial institution to retain half the interest collected for fees related to the loan. By providing a participation loan, the financial institution's risk is minimized

and they may be more willing to provide needed financing for higher risk loans. In turn, the financial institution would be responsible for completing the credit review and financial analysis on the project, as well as the collection of the debt service payment. These loans are typically higher risk and would most likely require additional oversight by the financial institution for the term of the loan. A 2% interest rate would provide a lower blended rate to the borrower resulting in a savings of interest expense over the term of the loan. The model for the participation loan program is the Tourism Loan Program, which is administered by the Department of Employment and Economic Development. The Tourism Loan Program has a set interest rate of 2% for their participation share of the loan with a financial institution. This program has been very successful.

7380.0275 Subpart 2. Linked deposit loans

The Authority proposes to repeal subpart 2 as discussed in part 7380.0265, subpart 3.

7380.0275 Subpart 3. Disbursements.

The proposed change renames subpart 3. The proposed language is necessary because it describes how the Authority will provide disbursements to the financial institutions once the project has been completed. This language is reasonable because these are small loans and a single disbursement at the completion of the project provides for administrative efficiencies for both the Authority and the financial institution.

7380.0277 MARKET CONSIDERATIONS.

7380.0277 Subpart 1. Market adjustments.

This language is necessary to create a mechanism for the Authority to set a temporary market adjustment discount. This would be applied to rate determinations under part 7380.0272. Without such a mechanism, it is possible that conditions could cause the rates offered on Authority loans to be non-competitive with market rates available to borrowers.

Market rates are subject to constant change, and the change may be significant even over short time periods. If market rates fall significantly after an Authority bond sale, then borrowers may, because of rates, choose to forgo Authority financing. The Authority may wish to encourage continued borrowing under these conditions by implementing this additional discount.

It is reasonable to create this mechanism because federal regulations and program purpose require the rate on Drinking Water loans to be below market-rate. It is reasonable that the adjustment be implemented and applied in a manner consistent with the application of the base discount. This discount would however be temporary because its purpose is to allow for Authority reaction to changing market conditions.

7380.0277 Subpart 2. Suspension of loans.

7380.0277 Subpart 2, Item A.

The new language in item A is proposed in order to provide a mechanism for the executive director to respond to volatile market conditions until the Authority meeting can be scheduled. The executive director would be authorized to suspend making loans until the Authority can re-evaluate the circumstances or market conditions and make a reasonable adjustment.

7380.0277 Subpart 2, Item B .

The new language in item B is proposed because it is reasonable and necessary that the Authority would have the ability to resume making loans under existing criteria or to reset the criteria depending on market conditions and risk to the bondholders.

67380.0280 SUPPLEMENTAL ASSISTANCE FOR DISADVANTAGED COMMUNITIES.

7380.0280 Subpart 1. In general .

The proposed changes to subpart 1 clarifies that the total amount of principal forgiveness to all borrowers cannot exceed 10% of the federal capitalization grants available, which may include more than one year's allocation .

7380.0280 Subpart 2. Disadvantaged community criteria.

The proposed change to subpart 2 would delete borrower and insert applicant because the process for determining eligibility for supplemental assistance is reviewed during the application phase.

7380.0280 Subpart 2, Item A.

The word applicant is proposed to replace borrower for the reasons identified under subpart 2 and the Department of Health is written out in the body of the Drinking Water Revolving Fund rules because the definition of department is repealed.

7380.0280 Subpart 2, Item B.

The word "proposed" would be deleted because the Authority evaluates costs based on project completion. The definition of water service charge is repealed and would be replaced with a new definition titled residential system cost. The change is being made to put emphasis on completed projects rather than proposed projects.

7380.0280 Subpart 2, Item C.

The Authority is proposing to delete item C because applicants typically evaluate other financing programs in an effort to reduce the costs to the users of the drinking water system. The Authority works with applicants to identify funding programs and coordinates with program staff. Requiring applicants to submit applications to other financing programs is costly and not necessarily economical for applicants.

7380.0280 Subpart 3. Amount of supplemental assistance.

The proposed changes to subpart 3 are necessary and reasonable in order to update the terminology to include proposed new definitions and to clarify that the supplemental assistance provided will be based on the as-bid costs of the project.

7380.0295 RELEASE OF FUNDS.

7380.0295 Subpart 1. In general .

The proposed changes to this subpart are reasonable because they simplify the language describing the process for releasing funds to a borrower and eliminate the language found in MN Statute 446A.081, subdivision 10.

7380.0295 Subpart 1, Item A.

The proposed new language in item A was added to clarify that loans must be closed prior to disbursing funds to a borrower. The debt security from the borrower must be delivered to and accepted by the Authority. Loan closing and debt security are proposed definitions included under part 7380.0250.

7380.0295 Subpart 1, Item B.

The proposed changes to item B require the borrower to submit documentation of incurred, eligible cost on forms provided by the Authority which is reasonable and follows standard operating procedures for government financial programs.

380.0295 Subpart 2. Adverse change.

This change is proposed to update the terminology.

7380.0295 Subpart 3. Withholding, disallowance, or termination of disbursements.

7380.0295, Subpart 3, Item A.

There are several changes proposed for item A. Under item A, department would no longer be defined in part 7380.0250 but rather written out as the Department of Health throughout the Drinking Water Revolving Fund rules. The word “or” was eliminated under item 1 because items 3 and 4 are proposed for inclusion in subpart 3, item A. Items 3 and 4 are proposed for inclusion because there have been circumstances where a borrower failed to provide the Authority with adequate documentation of expenditures or did not submit required compliance reports on time. The addition of items 3 and 4 would give the Authority the ability to withhold or disallow costs to borrowers who are not complying with the requirements of the program.

7380.0295, Subpart 3, Item B.

The proposed change in item B simply clarifies that if a condition has not been corrected in the specified time frame the disallowed disbursements may be terminated as well. This change is reasonable and is consistent with the language in the first sentence of item B.

7380.0296 PENALTIES FOR DEFAULT.

The Authority is proposing to delete the original heading and language under part 7380.0296. A new default definition is proposed under part 7380.0250, subpart 10, item A, and identifies the condition for either a payment default or technical default. The new heading and language more accurately address both the payment and technical defaults and is divided into two subparts to address either type of default.

7380.0296. Subpart 1. Penalty for late payment.

Subpart 1 is new language proposed to be added which would clearly state that a borrower has five business days, after payment due date; to remedy the nonpayment or the borrower will be charged additional interest on the unpaid principal amount due. The proposed late payment penalty for the unpaid principal is reasonable and necessary because it encourages timely payment and conforms to market practices. Timely payments are critical to maintaining the Authority’s high credit rating.

7380.0296. Subpart 2. Penalty for material noncompliance.

Subpart 2 contains the updated and streamlined language that is in the original rule under part 7380.0296. The language has been renamed and modified in order to clarify the process. There are no substantive changes to the language.

7380.0297 REPORTS, DISCLOSURE, AND AUDITS.

7380.0297, Subpart 3. Audits.

The proposed changes to subpart 3 are necessary in order to clearly delineate the timeframe for submitting audits to the Authority and to state that compliance with applicable government auditing standards is required.

7380.0297 Subpart 4. Waiver of audit requirements

This proposed addition to part 7380.0297 is necessary because it allows borrowers, with loan balances under \$300,000, who have completed their disbursements, to request a waiver of the independent audit which would be a cost savings for the borrower. Subpart 4 requires a borrower to submit a written request to the Authority, and pending a favorable review of the borrower's financial condition, payment history and submittal of required reports, it is reasonable that a waiver may be provided to the borrower. However, the Authority may revoke the waiver should the financial condition of the borrower change in a manner that would impact the repayment of the Authority's loan.

The borrower must comply with the reporting requirements mandated by the Office of the State Auditor and annually submit that information to the Authority in lieu of an independent audit.

7380.0400 PURPOSE.

Part 7380.0400 is proposed for modification in order to streamline, clarify and update the information all in keeping with the format proposed in the Drinking Water Revolving Fund purpose section found under part 7380.0252.

7380.0410 DEFINITIONS

Part 7380.0410 is proposed for repeal because the definitions for the Water Pollution Control Revolving Fund have been merged, with the exception of those that are obsolete, with the Drinking Water Revolving Fund definitions, under part 7380.0250.

7380.0420 PROCEDURES FOR FINANCIAL ASSISTANCE APPLICATIONS PROCESSING.

Part 7380.0420 is proposed for repeal and the new part 7380.0422 Intended Use Plan will replace part 7380.0420 in an effort to be consistent, where applicable, with the Drinking Water Revolving Fund.

7380.0422 INTENDED USE PLAN

The proposed changes to this part are necessary in order to clarify the process and reflect the revised Minnesota Statutes. The new title is "Intended Use Plan" and will conform to the revised Drinking Water Revolving Fund rule, where applicable, and incorporate changes in Minnesota Statute that now require the Authority to develop the intended use plan.

7380.0422 Subpart 1. Adoption of the intended use plan

The proposed new language is necessary because the intended use plan that was previously the Pollution Control Agency's responsibility, is now the responsibility of the Authority under Minnesota Statute 446A.07, subdivision 4.

7380.0422 Subpart 1, Item A.

Item A is added to describe a certain category of projects informally known as carryover projects. These are projects that are listed in fundable range on the prior year's intended use plan, submit a complete loan application to the Authority and receive certification by the Pollution Control Agency, but do not receive an actual loan award prior to the Authority's preparation of the new intended use plan. This may typically happen due to the time needed for a municipality to complete the construction bidding process, because the Authority does not award a loan until the municipality submits its as-bid project costs. Due to the time and money invested by the municipality to get a project to this point, it is reasonable to create a separate category for these projects so their situation can be considered when determining the fundable range in subpart 3.

7380.0422 Subpart 1, Item B.

Item B makes clear that the IUP will include newly eligible projects in fundable range, and references the eligibility requirements in subpart 2 and the fundable range determination in subpart 3. This will help distinguish between this set of projects and the projects in item A.

7380.0422 Subpart 1, Item C.

Item C states that the intended use plan will identify the base discount that will be used when calculating the interest rate for all loans under Part 7380.0270, subpart 3A. Under state and federal law, the Authority must make loans at below market interest rates, but the Authority is also required to maintain the assets of the Fund into perpetuity to provide an ongoing source of financing to help municipalities meet their wastewater infrastructure needs. Therefore, the Authority must balance the interest rate discount it provides to current projects with its fiduciary responsibility to preserve lending capacity for future needs. The responsibility of balancing current and future needs makes it necessary and reasonable for the Authority to annually set the base discount for loans, and to publish the base discount in the intended use plan which is a public document used to inform interested parties about the management of the Fund.

7380.0422 Subpart 1, Item D.

Federal law permits other eligible activities to also be funded through the revolving fund. Item D makes clear that these other activities will be identified in the intended use plan and will be consistent with the limits in the Act and in Minnesota Statutes.

7380.0422 Subpart 2. Eligibility .

The new language is necessary to reflect the change in Minnesota Statute 446A.07, subdivision 4, that requires the Authority to annually prepare and submit to the U.S. Environmental Protection Agency an Intended Use Plan.

7380.0422 Subpart 2, Item A and B.

This language is proposed for several reasons. The language is necessary in order to reflect the change in MN Statute 446A.07, subdivision 4, which requires the Authority to annually prepare and

submit to the U.S. Environmental Protection Agency an intended use plan. Prior to the change in statute, the Pollution Control Agency was responsible for preparing the intended use plan for the Water Pollution Control Revolving Fund. It is reasonable for the new language to conform to the Drinking Water Revolving Fund language found under part 7380.0255, subpart 2.

7380.0422 Subpart 3. Fundable range.

The new language is proposed in order to clarify how the intended use plan identifies eligible projects from the project priority list maintained by the Pollution Control Agency and describe the process to be followed should the total loan amounts from eligible applicants exceed the funds available from the Authority. The intended use plan was previously the Pollution Control Agency's responsibility but is now the responsibility of the Authority, which makes it necessary to revise the rule language to reflect the process.

7380.0422 Subpart 4. Amendments to intended use plan.

The proposed subpart and language are added to the Water Pollution Control Revolving Fund rules in order to address amendments to the intended use plan. The addition of this subpart is necessary and reasonable in order to formalize the amendment rule under the Water Pollution Control Revolving Fund and so the process will conform to the Drinking Water Revolving Fund rules.

7380.0425 APPLICATIONS.

Part 7380.0425 is proposed new language to the Water Pollution Control Revolving Fund rules in order to have uniformity between this program and the Drinking Water Revolving Fund rules because the process is similar for both programs. The addition of subpart 1 through subpart 4 and the modifications to subpart 5 are necessary and reasonable in an effort to clarify, update and bring uniformity to the process for both programs.

7380.0425 Subpart 1 Timing.

These proposed changes are reasonable and necessary because only projects within the fundable range can access the loan funds and are subject to the deadline for submitting required materials. The intended use plan is an annual document and any project within the fundable range that does not submit the required documents within the deadline must reapply to a subsequent intended use plan.

7380.0425 Subpart 1, Item A.

The proposed new language is reasonable and necessary because the intended use plan is an annual document and any project within the fundable range that wants to proceed with a project must submit an application to the Authority.

7380.0425 Subpart 1, Item B.

The addition of item B is necessary and reasonable because it states that the plans and specifications must be provided to the Pollution Control Agency and the language follows a similar format for the drinking water revolving loan fund rules.

7380.0425 Subpart 2. Completed application

The new language in subpart 2 replicates the language in the Drinking Water Revolving Fund rules and identifies the items that must be contained in an application in order for the Authority to make a determination on the applicant's loan request.

7380.0425 Subpart 2, Item A-D

The proposed language identifies the information to be submitted by applicants for the Authority's review in order for the Authority to make an informed determination as to the applicant's capacity to complete the project and comply with the terms and conditions of the loan including payment of debt service. The language is necessary because it lists the documentation required for a complete application. It is reasonable for the Authority to request the information in order to ensure the applicant meets all program requirements and to make an informed decision on the applicant's financing request.

7380.0425 Subpart 3. Evaluation of applications.

The addition of the language in the new subpart 3 replicates the language in the Drinking Water Revolving Fund rules and was modified for the Water Pollution Control Revolving Fund rules. It is necessary and reasonable that the same language be incorporated into the Water Pollution Control Revolving Fund rules because the application review process is the same, except for the application for the federal and state laws and regulations.

7380.0425 Subpart 4. Rejection of an application.

The proposed language in subpart 4 addresses the reasons for rejecting an application and conforms, where applicable, to the language proposed under the Drinking Water Revolving Fund. The language in subpart 4, item A-G clearly establishes the reasons why the Authority or the Executive Director would reject an application for funding. The new language is necessary because it informs the applicant of the reasons for rejection. It is reasonable for the Authority to have the ability to reject an application to protect the assets of the Fund.

7380.0425 Subpart 4, Item A.

This language is added to clearly state if the Pollution Control Agency does not provide a certification for the project, the application will be rejected. The Pollution Control Agency is required under MN Rule 7077.0281 to provide a certification to the Authority in order for the project to receive a loan.

7380.0425 Subpart 4, Item B.

It is necessary and reasonable that the Authority receive a complete application in order to make a fully informed decision.

7380.0425 Subpart 4, Item C.

It is necessary to add this language because the applicant is responsible for ensuring that revenues are adequate to not only pay the debt service on the loan but also operate and maintain the facility in a reasonable manner.

7380.0425 Subpart 4, Item D.

It is reasonable to add the language because an application may be rejected if an applicant cannot demonstrate that they have the institutional capacity to undertake the project and manage the system for the term of the loan.

7380.0425 Subpart 4, Item E.

The language is necessary because it enables the Authority to reject an applicant that has not clearly demonstrated financial capacity.

7380.0425 Subpart 4, Item F.

The proposed new language is necessary in order to enable the Authority to reject an application if the applicant fails to document an ability to comply with the applicable state and federal requirements.

7380.0425 Subpart 4, Item G.

This proposed language is added because the Authority is required by the Act to: 1) ensure all applicants and borrowers demonstrate technical, financial and managerial capability with respect to their project(s) and, 2) maintain the fund into perpetuity, including protecting the Authority bond rating and ability to obtain additional U.S. Environmental Protection Agency funding in the future. This change is reasonable because it provides a mechanism to enforce the requirements of the Act and it protects the integrity of the fund by not allowing subsequent transactions when a borrower fails to correct a default condition of a previously funded transaction.

7380.0430 LOAN TERMS AND CONDITIONS

In order to achieve uniformity between the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund, it is necessary to reorganize and rename this part in order to follow the same format as the Drinking Water Revolving Fund proposed rules.

7380.0430 Subpart 1. In general.

It is necessary and reasonable to delete the existing rule language under subpart 1 because the intended use plan, previously the Pollution Control Agency's responsibility, is now the responsibility of the Authority.

The proposed language is necessary because projects listed in the fundable range on the intended use plan are based on estimated availability of funds including state and federal appropriations, loan repayments, and Authority bond proceeds. Not all projects listed on the intended use plan are within the fundable range as further described in part 7380.0422, subpart 3. The language also incorporates applicable federal and state requirements that govern the terms and conditions of the loan agreement issued by the Authority. It also states that provisions of the loan agreement prevail when in conflict with the borrower's bond documents. This is necessary because it ensures conformity with all applicable laws and regulation.

7380.0430 Subpart 2. Borrowers pledging general obligation or revenue bonds.

This proposed new language is necessary and reasonable to ensure that bond documents are prepared by nationally recognized bond counsel that meet the professional qualifications required for a listing in the Bond Buyer's Municipal Marketplace Directory. Items A to G are proposed to be added because it is necessary to clearly identify the loan conditions as well as the borrower's responsibilities for the term of the loan.

7380.0430 Subpart 2, Item A.

The language proposed for deletion has been modified and incorporated into subpart 1 with the exception of the language on other forms of financial assistance, which has been moved to part 7380.0450. The proposed language was necessary to clarify that loans are limited to no more than 20

years and cannot exceed the design life of the financed project. The language regarding segmented or phased projects was deleted from old subpart 3 and moved to subpart 2, item A.

7380.0430 Subpart 2, Item B.

The new language proposed in B was moved from old subpart 4 of this part and reworded to conform to the Drinking Water Revolving Fund rules. The language proposed for deletion is not necessary because loans provided by the Authority for all eligible activities are subject to the same requirements, terms and conditions as identified elsewhere in this part.

7380.0430 Subpart 2, Item C.

The proposed language in item C was moved from old subpart 4 of this part and reworded to conform to the Drinking Water Revolving Fund rules.

7380.0430 Subpart 2, Item D

The new language is proposed because the Authority, as part of the application process, reviews information provided by the applicant to determine that a potential borrower has the technical, managerial and financial capacity to ensure adequate operation of a system for the term of the loan. This language also conforms to the existing rule language in the Drinking Water Revolving Fund.

The deleted language was slightly reworded and moved to item A of this subpart.

7380.0430 Subpart 2, Item E

The proposed changes combine the old subparts 4 and 5 and bring uniformity between the Funds by having consistent debt service schedules. Since the security is a municipal bond, this change simplifies the payment process by reflecting a typical municipal bond debt service structure.

The proposed change also eliminates the interest free period on the loans. Interest will be charged only on the funds that are disbursed to the borrower. When the Water Pollution Control Revolving Fund program was created it was easy for municipalities to issue twenty-year debt to pay construction cost and invest the bond proceeds at short-term yields that exceeded the tax-exempt bond yield. Small issuers were able to keep their arbitrage profits rather than rebate the earnings that exceeded the bond yield. To compete in that market the Authority offered an interest free period. Today the yield difference between short-term investments can be two percent less than the arbitrage yield on municipal tax-exempt bonds, which is called negative arbitrage. By charging interest only on the funds cities draw down and spend, borrowers receive the substantial benefit of avoiding negative arbitrage. The Authority simply cannot continue to provide an interest free period for borrowers while it is unable to invest bond proceeds at yields close to the yield on its bonds. The loss of interest earnings is too great to maintain over the long term.

With the exception of the language on significant wastewater contributors and alternative payment schedules, the deleted language was reworded, separated and moved to items B and C of this part. The language on significant wastewater contributors was modified slightly and moved to part 7380.0442 Interest Rate Determination, subpart 3, item C. The language on alternative payment schedules is proposed for deletion because the Authority will no longer allow for modified payment schedules.

7380.0430 Subpart 2, Item F.

The proposed addition of this paragraph is to notify the borrower that pursuant to the provision of Rule 15c2-12 promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended, the Authority has agreed in its Master Continuing Disclosure Agreement for the benefit of the Beneficial Owners of its bonds: (i) to enter into a Borrower Continuing Disclosure Agreement with each obligated person as defined in rule 15c2-12, and, (ii) to cause each obligated person to provide continuing disclosure.

7380.0440 INTEREST RATE DETERMINATIONS.

Part 7380.0440 is being repealed and rewritten under part 7380.0442.

7380.0442 INTEREST RATE DETERMINATIONS.

This part of the rules addresses how interest rates are determined and applied to the Authority's Water Pollution Control Revolving Fund loans. The proposed changes are necessary in order to achieve the following goals:

- ? Reduce market risk for both the Authority and borrowers by using current market rates at the time loan agreements are made rather than relying on a rate that is adjusted only once each quarter.
- ? Further reduce market risk for both the Authority and borrowers by creating, in the rules, the ability to react to market swings to protect the Authority and borrowers from temporary market conditions that may otherwise cause loan rates to be either damaging to the Authority's long-term lending capacity or non-competitive to the borrowers.
- ? Match the rate on a loan with the structure of the principal redemption schedule, as is done in the municipal marketplace. Currently the loan rate is independent of the loan structure. Authority loans are structured with level debt service for the term of the loan unless the borrower requests a different principal maturity schedule, which the Authority must approve. The rate on a loan should reflect these differences because of the time-value of money.

7380.0442 Subpart 1. In general.

These changes are necessary in order to expand the capacity of the Fund and mirror municipal marketplace practices. In order to achieve the Authority's goals of reducing market-timing risks and to match the loan rate to the loan repayment structure, it is reasonable to add this language because it identifies parameters used to determine how the rate of interest will be set for a loan, in that:

- ? loan rates will be based on current market rates in effect at the time the loan agreement is processed, rather than based on a rate (the quarterly set rate) that was in effect at the time the application was received, which may be many months outdated.
- ? loan rates will take into account the structure of the loan repayment schedule; to the extent loan repayments are more heavily weighted toward the early or late years of the loan, the loan rate will likewise be weighted toward the market rates for that time frame.

7380.0442 Subpart 1, Item A.

This new language is proposing to change the manner in which interest rates are set. The current application process requires that a complete application be submitted to the Authority, that the project be certified by the Pollution Control Agency and that as-bid costs are submitted to the Authority prior to finalizing the financing for the project. Under the existing rules the loan agreement could be processed many months after setting the rate.

The new language establishes the timeframe for locking in the interest rate for a borrower. Under the proposed language, the interest rate will be set when the last of the three items required is received by the Authority and the borrower has submitted a formal request to the Authority to proceed with the loan agreement. This will make the loan agreement processing coincident with the rate setting.

7380.0442 Subpart 1, Item B.

The language in item B is necessary because the Authority proposes to change the timing for interest rate determination. This language is reasonable because it clearly defines the information that must be received by the Authority prior to the applicant formally requesting that the Authority proceed with the loan agreement.

7380.0442 Subpart 1, Item C.

The proposed language in item C appeared under part 7380.0440, subpart 1 which has been repealed, however, the Authority proposes to include this language under part 7380.0442.

7380.0442 Subpart 1, Item D.

This new language is necessary in order to address the arbitrage issues that could impact the tax-exempt status of the Authority's bonds and the cost associated with the arbitrage rebate calculation the Authority undertakes. Arbitrage restrictions prohibit the Authority from earning a higher yield on bond proceeds or debt service funds than the arbitrage yield on the Authority's bond(s) that partially or fully fund a loan. It is reasonable to make this change.

7380.0442 Subpart 2. Bond yield scale

The Authority is proposing to change how interest rates are calculated. The Authority has used a bond index in the Wall Street Journal, which was the average interest rate on municipal bonds that matured in 20 years. It is necessary and reasonable to change this procedure because this is not a good reflection of the yield curve and what the true interest cost would be over a 20-year period. By using a bond-yield scale, the Authority can offer rates that are more reflective of the market.

7380.0442 Subpart 2, Item A.

For borrowers that provide a tax-exempt general obligation bond, the Authority will use the AAA bond scale. Tax-exempt securities are more valuable in the secondary bond market and thus deserve the lower rate.

7380.0442 Subpart 2, Item B.

This new language is proposed because some borrowers prefer to provide a taxable general obligation bond for a variety of reasons. Since this type of security is less valuable in the secondary market it is reasonable for the Authority to charge a slightly higher rate of interest by using the AA bond scale. This is reasonable given the value and liquidity of the security offered.

7380.0442 Subpart 3. Interest rate discounts

This new language is reasonable and necessary because it set the parameters for application of the discounts in items A, B and C.

7380.0442 Subpart 3, Item A.

The Authority proposes to replace the existing method with the new method in part 7380.0422, subpart 1, item C.

7380.0442 Subpart 3, Item B.

The new language in subpart 3, item B proposes to provide additional discounts to borrowers with populations of less than 2,500 and for loan amounts up to \$20,000 per household. For projects where costs are in excess of \$20,000 per household, a blended interest rate would be applied because the costs in excess of \$20,000 would not receive additional discounts, just the base discount. The \$20,000 cap on subsidies is reasonable because it reserves available resources for more cost effective projects and limits incentives to design and build high cost systems.

Generally borrowers with a population of less than 2,500 have limited financial capacity and less economy of scale than larger municipalities thereby requiring discounts that would keep a system affordable. These changes are necessary in order to protect the viability of the Fund and expand the Fund's capacity to assist more borrowers. The proposed changes are consistent with the changes being made in the Drinking Water Revolving Fund rules.

Sub-item 1 moves the median household discount from the old part 7380.0440, subpart 5, A, which is being repealed to part 7380.0442, subpart 3, B (1).

Sub-item 2 was moved from part 7380.0440, subpart 4, A through C, which is being repealed, to part 7380.0442, subpart 3, item 2, (a) through (e). The information was reorganized and reworded for clarity and modified to expand the range of discount levels available but only to small borrowers with populations less than 2,500 and up to \$20,000 per household.

7380.0442 Subpart 3, Item C.

When a significant wastewater contributor is involved in a project, the Authority is proposing to apply the discounts in items A and B only when a secured, written guarantee is provided through a significant wastewater contributor agreement. This change is necessary due to the higher credit risk for this type of project when there is a single, non-residential user paying a major share of the project cost as opposed to spreading the cost of the project over the entire project service area. To obtain the available interest rate subsidies, it is reasonable for the Authority to require an agreement between the significant wastewater contributor and the borrower to assure debt service revenues will be available to repay the Authority.

7380.0442 Subpart 4. Demographic.

The language proposed under subpart 4 was moved from part 7380.0440, subpart 4, item D, which is being repealed.

7380.0445 MARKET CONSIDERATIONS.

7380.0445 Subpart 1. Market considerations.

This language is necessary to create a mechanism for the Authority to set a temporary market adjustment discount. This would be applied to rate determinations under part 7380.0442. Without such a mechanism, it is possible that conditions could cause the rates offered on Authority loans to be non-competitive with market rates available to borrowers.

Market rates are subject to constant change, and the change may be significant even over short time periods. If market rates fall significantly after an Authority bond sale, then borrowers may, because of rates, choose to forgo Authority financing. The Authority may wish to encourage continued borrowing under these conditions by implementing this additional discount.

It is reasonable to create this mechanism because federal regulations and program purpose require the rate on Water Pollution Control Revolving Fund loans to be below market-rate. It is reasonable that the adjustment be implemented and applied in a manner consistent with the application of the base discount. This discount would however be temporary because its purpose is to allow for Authority reaction to changing market conditions.

7380.0445 Subpart 2. Suspension of loans.

7380.0445 Subpart 2, Item A.

The new language in item A is proposed in order to provide a mechanism for the executive director to respond to emergencies until an Authority board meeting can be scheduled. The executive director would be authorized to suspend making loans until the Authority can re-evaluate the circumstances or market conditions and make a reasonable adjustment.

7380.0445 Subpart 2, Item B.

The new language in item B is proposed for inclusion because it is reasonable and necessary that the Authority would have the ability to resume making loans under existing criteria or to reset the criteria depending on market conditions and risk to the bondholders.

7380.0450 OTHER FINANCIAL ASSISTANCE.

The language proposed for deletion is stated in MN Statute 446A.07, Subdivision 8, which governs the Water Pollution Control Revolving Fund and does not need to be restated in the rules. The Authority has never received a request for other forms of financial assistance but wants to remain flexible in exploring options that may be more cost effective for applicants. The Authority will examine these options on a case-by-case basis when requests are received.

7380.0460 FEES.

The language is proposed to be modified to conform with the Drinking Water Revolving Fund language found in part 7380.0290.

7380.0470 RELEASE OF FUNDS.

7380.0470 Subpart 1. In general .

The proposed changes to this subpart are being made to clarify the process for releasing funds to a borrower and to eliminate language found in MN Statute 446A.081, subdivision 10.

7380.0470 Subpart 1, Item A.

The proposed new language in item A was added to state that the loan has to be closed prior to disbursing funds to a borrower which means the debt security from the borrower must be delivered to and accepted by the Authority. Loan closing and debt security are proposed definitions included under part 7380.0250 Definitions.

7380.0470 Subpart 1, Item B.

The proposed change to item B simply requires the borrower to submit documentation of incurred, eligible costs on forms provided by the Authority which is a standard operating procedure for governmental financial programs.

7380.0470 Subpart 2. Adverse change.

The proposed changes include changing municipality to borrower, which indicates that funds have been approved for a project, changing the word funding to financial assistance, and generally updating the terminology.

7380.0470 Subpart 3. Withholding, disallowance or termination of disbursements.

7380.0470 Subpart 3, Item A.

The proposed changes and additions to this subpart will provide uniformity between the Water Pollution Control Revolving Fund and the Drinking Water Revolving Fund. Under item A (1), “commissioner” would no longer be defined in part 7380.0250 but rather written out as the Pollution Control Agency throughout the Water Pollution Control Revolving Fund. The word “or” was eliminated under item 1 because items 3 and 4 are proposed for inclusion in subpart 3, item A. Items 3 and 4 are proposed for inclusion because there have been circumstances where a borrower failed to provide the Authority with adequate documentation of expenditures or did not submit required compliance reports on time. The addition of items 3 and 4 would give the Authority the ability to withhold or disallow costs to borrowers who are not complying with the requirements of the program.

7380.0470 Subpart 3, Item B.

The proposed modification and expansion of paragraph B replicates the current language found in the Drinking Water Revolving Fund rules and provides consequences for borrowers who do not comply with the written notice issued by the Authority. It is necessary and reasonable to make these changes in order to ensure compliance and to bring uniformity to the administration of the rules.

7380.0475 PENALTIES FOR DEFAULT.

It is necessary to add this new language to the Water Pollution Revolving Fund rules in order to identify the condition for either a payment default or technical default, which is defined under part 7380.0250, subpart 10, item A, Default. The current rule does not address default conditions and therefore it is reasonable to add the language to be consistent with the Drinking Water Revolving Fund.

7380.0475. Subpart 1. Penalty for late payment.

Subpart 1 is new language proposed to be added which would clearly state that the borrower has five business days, after the payment due date, to remedy the nonpayment or the borrower will be charged additional interest on the unpaid amount due. This simplifies the penalties and process for curing the default. The proposed late payment penalty for the unpaid amount is reasonable and necessary

because it encourages timely payments and conforms to market practices. Timely payments are critical to maintaining the Authority's high credit rating.

7380.0475. Subpart 2. Penalty for material noncompliance.

Subpart 2 is new language that is proposed to be added which would clearly state to a borrower the procedure for returning to material compliance or define the penalties if a borrower does not return to compliance. This proposed language is consistent to the language in the Drinking Water Revolving Fund and provides uniformity and consistency in addressing this issue.

7380.0480 REPORTS, DISCLOSURE AND AUDITS.

7380.0480. Subpart 1. Reports.

Subpart 1 is proposed to be modified to conform to the Drinking Water Revolving Fund language found in part 7380.0297, subpart 1.

7380.0480. Subpart 1a. Disclosure.

It is necessary and reasonable to bring uniformity to the Drinking Water Revolving Fund and the Water Pollution Control Revolving Fund, therefore, subpart 2 is proposed to be added using the same language as found under Part 7380.0297. subpart 2.

7380.0480. Subpart 2. Audits.

The proposed language updates and clarifies the federal audit requirements. This language conforms to the Drinking Water Revolving Fund rule.

7380.0470. Subpart 4. Waiver of audit requirements.

The proposed language is necessary because it allows borrowers, with loan balances under \$300,000, who have completed their disbursements, to request a waiver of the independent audit which would be a cost savings for the borrower. Subpart 4 requires a borrower to submit a written request to the Authority, and pending a favorable review of the borrower's financial condition, payment history and submittal of required reports, it is reasonable that a waiver may be provided to the borrower. However, the Authority may revoke the waiver should the financial condition of the borrower change in a manner that may impact the repayment of the Authority's loan.

The borrower must comply with the reporting requirements mandated by the Office of the State Auditor and annually submit that information to the Authority in lieu of an independent audit.

VI. CONCLUSION

Based on the foregoing, the proposed rules are both needed and reasonable.

Signed on January 30, 2007 by Dan McElroy, Chair, MN Public Facilities Authority