



**MINNESOTA**

**PUBLIC FACILITIES AUTHORITY**

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# Estimated Funding Needs Report

Report to the Legislative Capital Investment and  
Environmental and Natural Resource Finance Committees

In Accordance with Minnesota Statutes, Section 446A.076

February 1, 2023

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**Minnesota Public Facilities Authority  
2023 Estimated Funding Needs Report**

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*Note (as required by Minnesota Statutes, section 3.197): Preparation of this report required an estimated 90 hours of staff time for a total cost of \$6,363.*

## **Introduction**

Nearly 600 Minnesota municipalities own and operate wastewater systems and over 700 own and operate drinking water systems, all of which are essential to protect public health and the environment. Maintaining these systems is a major responsibility for local governments. Challenges include replacing and rehabilitating aging infrastructure and upgrading treatment facilities to meet current water quality standards. The Minnesota Public Facilities Authority (PFA) helps municipalities construct projects to meet their water infrastructure needs through several loan and grant programs.

The PFA's largest programs are the Clean Water and Drinking Water Revolving Funds. Since inception in 1990, these revolving loan funds have provided \$4.4 billion in low interest loans to municipalities throughout the State, with below-market interest rates that are saving communities over \$900 million in interest costs.

The PFA also administers two large grant programs that provide additional assistance to help municipalities address their water infrastructure needs: the Water Infrastructure Funding (WIF) program and the Point Source Implementation Grant (PSIG) program. As required by Minnesota Statutes, Section 446A.076, this report identifies estimated funding needs under these grant programs. In many cases, the estimated grant amounts in this report are based on preliminary project information and have not been finalized.

## **Water Infrastructure Funding (WIF) Program**

The Water Infrastructure Funding (WIF) program is established in Minnesota Statutes, Section 446A.072. The purpose of the WIF grant program is to help cities build projects to replace aging and obsolete water systems that would otherwise be unaffordable. Without this assistance, municipal water systems in small and disadvantaged communities would be at increased risk of major system failure.

The PFA awards WIF grants in conjunction with loans from its Clean Water and Drinking Water Revolving Fund (CWRF and DWRF) programs and project funding from the U.S. Department of Agriculture's (USDA) Rural Development grant and loan program. Municipalities seeking WIF grants must have their projects listed on project priority lists (PPLs) developed by the Minnesota Pollution Control Agency (MPCA) for wastewater projects, and the Minnesota Department of Health (MDH) for drinking water projects. The PPLs rank projects that are expected to proceed with construction within a five-year period according to environmental and public health factors. The WIF program does not have a separate application process. Projects are evaluated for grant eligibility as part of the application process for PFA loans or USDA Rural Development funding.

WIF grants are awarded to eligible projects based on their priority rank on the MPCA or MDH project priority lists and their readiness to proceed. Under Minnesota Statutes, section

446A.072, subdivision 3(d), each fiscal year the PFA reserves available funds for eligible projects when they are certified by the MPCA or MDH, or when the project receives a funding commitment from USDA Rural Development. Funds are reserved in an amount based on the project cost estimate when the project is certified or the as-bid cost, whichever is less. Grants are not awarded until as-bid construction are submitted and all application information is verified. If a project's as-bid costs would result in a grant award larger than the amount reserved, the PFA will award the higher amount if sufficient funds are available.

#### WIF Affordability Criteria

WIF affordability criteria are established in Minnesota Statutes, section 446A.072, subdivision 5a. The criteria are based on the average system costs per household as a percentage of median household income of the project service area. For most projects that serve the entire municipality and whose costs are spread over all system users, the total system users and median household income of the municipality are used. For projects serving a smaller service area and that rely on special assessments on specific benefitting properties, affordability is calculated based on those users and the median household income of that service area. While the WIF program is potentially available to all cities, WIF grant recipients tend to be smaller communities that typically have higher costs per household than larger cities.

For projects receiving PFA loans, the average annual system cost per household is determined by taking the annual operation and maintenance cost of the wastewater or drinking water system, plus existing annual debt service costs from prior capital improvements, plus new debt service for the proposed project for the maximum allowable loan term, divided by the number of users. Existing debt service is calculated based on a ten-year average to fairly reflect long-term debt costs. The total number of users is based on a calculation of equivalent residential units (ERUs) in order to capture both residential and non-residential users.

When the average annual system cost per household, including the cost of the new project, exceeds 1.4 percent of median household income for wastewater projects, or 1.2 percent for drinking water projects, the project is eligible to receive a WIF grant to offset a portion of the PFA loan. The amount of the grant is equal to 80 percent of the amount needed to reduce the average residential system cost to the 1.4 percent or 1.2 percent threshold, up to a maximum grant of 80% of eligible project cost or \$5,000,000. The WIF program provides assistance only for project costs necessary to address existing needs, not growth. The WIF eligible project cost is determined by multiplying the total project cost by the Essential Project Component percentage calculated by MPCA or MDH, which represents the portion of the project needed to meet existing needs.

Similar to the PFA process, small rural communities (generally under 1,000 population) with median household incomes below the non-metro state average may apply to USDA Rural Development for wastewater and drinking water grants and loans. Projects that are eligible to receive a USDA Rural Development grant based on the Rural Development affordability criteria may receive a WIF matching grant for up to 65% of the total grant need determined by USDA

Rural Development. This state-federal partnership allows state WIF funds to assist more projects, makes it easier for small communities to access funding, reduces state administrative expenses, and helps USDA Rural Development maximize the federal funds allocated for Minnesota communities.

Whether a WIF grant is awarded in conjunction with a PFA loan or as a match to USDA Rural Development funding, the maximum grant is \$5,000,000 per project or \$20,000 per connection, whichever is less, unless specifically approved by law.

#### System Replacement Fund Requirement

Under the provisions of Minnesota Statutes, section 446A.072, subdivision 12, WIF recipients must establish a system replacement fund and annually deposit \$.050 per 1000 gallons of flow to be used for future projects for rehabilitation, expansion, or replacement of the wastewater or drinking water system. The funds are held by the municipality and must remain in a dedicated system replacement account for the life of the corresponding PFA or USDA-RD loan, unless use of the funds is approved by the PFA for eligible capital improvements. WIF recipients submit an annual certification to the PFA documenting their system replacement fund deposits and balances. A recipient is not required to maintain a replacement fund balance greater than the amount of the WIF grant received.

#### Estimated WIF Needs

Table 1 on pages 9-10 (drinking water projects) and Table 2 on pages 11-12 (wastewater projects) identify potential WIF eligible projects on the respective 2023 Project Priority Lists. The top of each table shows the funds from prior appropriations that were available at the start of the fiscal year. Grey shading indicates projects since the beginning of FY 2023 where WIF grants have already been awarded or where estimated grant funds are reserved (as described above). Unshaded amounts indicate estimated grants based on preliminary project information that have not yet been reserved. Estimated grants (shaded and unshaded) may change and new projects may be added to the list as project costs change and as final application information is received and verified.

The tables also show potential projects to receive federal principal forgiveness funds, which are a portion of the annual federal funding for the state revolving loan programs. Under federal law, principal forgiveness funds can be awarded as grants to reduce project costs that would otherwise be included in the loan principal. Under state statutes, federal principal forgiveness funds can be awarded based on the same affordability criteria as WIF grants. State statutes also allow principal forgiveness funds to be used to assist green infrastructure projects, for non-municipal community drinking water systems, and for projects to replace drinking water lead service lines.

Projects in each table are divided into categories based on their priority ranking and their readiness to proceed, beginning with carryover projects that received technical approval and certification from the MPCA or MDH (or a USDA Rural Development funding commitment) in a prior year, followed by new projects proposals on the current Intended Use Plan and potential future year projects. Each table indicates with a dotted line how far down the project list the available funds will reach.

New WIF appropriations are needed to meet estimated WIF grant needs for some of the 2022 carryover projects and for potential new WIF eligible projects. The list of potential 2023 WIF eligible projects may grow as projects on the 2023 Intended Use Plan submit formal loan applications and additional project information is received. The final category in each table are other projects on the 2023 Project Priority Lists that are seeking funding for construction in future years where preliminary information indicates a potential WIF need.

Total estimated unfunded WIF needs for all identified eligible projects on the 2023 Project Priority Lists are \$154 million for drinking water and \$114 million for wastewater. Additional eligible projects will likely be identified as project reviews proceed.

### **Point Source Implementation Grants (PSIG) Program**

The Point Source Implementation Grant (PSIG) program is established in Minnesota Statutes, Section 446A.073. The PSIG program provides grants to help cities upgrade treatment facilities to improve water quality by reducing the discharge of specific pollutants. PSIG grants are provided for 80% of eligible project costs up to \$7 million. Only those projects and project components that are directly related to meeting the specific pollutant requirement are eligible.

Each July the PFA accepts PSIG applications from cities and other local governments for projects that they believe to be eligible for PSIG grants and for which they plan to proceed with construction in the upcoming year. PSIG grants are not awarded until projects are approved and certified by the Minnesota Pollution Control Agency (MPCA) and the city submits as-bid costs to the PFA. Grant funds are reserved for projects that receive MPCA approval and certification by the end of each fiscal year (June 30).

#### **Estimated PSIG Needs**

Table 3 on pages 13-14 identifies potential PSIG projects on the 2023 Project Priority List, starting with Carryover Projects (certified prior to June 30, 2022) in priority order, followed by FY 2023 PSIG applications in priority order. The MPCA has not yet confirmed PSIG project eligibility and eligible costs for FY 2023 applications. In most cases, the PSIG eligible costs and estimated grant amounts for these projects are determined by the applicant and may change following MPCA review.

The PSIG table shows the total funds available from prior appropriations at the start of the fiscal year. Grey shading indicates projects since the beginning of FY 2023 where PSIG grants have already been awarded or where estimated grant funds are reserved. Unshaded amounts indicate estimated grants based on preliminary project information that have not yet been reserved. Estimated grants (shaded and unshaded) may change as project costs change and as project information is received and verified. A dotted line indicates how far down the list the available funds will reach. The total unfunded (below the dotted line) PSIG grant need is currently estimated at approximately \$131 million. New PSIG applications will again be accepted in July 2023.

### **Estimated Average Annual Wastewater Residential Costs**

For wastewater projects with identified WIF or PSIG grant needs, Minnesota Statutes, Section 446A.076 also requires this report to show average annual residential wastewater treatment rates with and without the estimated WIF and PSIG grants, and to compare those costs to the Twin Cities metropolitan area average as determined by the Metropolitan Council.

To compare one community to another, the financial impact to residential users (rates) is determined by calculating the average annual system cost per household for operation and maintenance, existing debt service, and new project debt service. This is the same formula specified in MS 446A.072 to determine per household costs for WIF eligibility. Only new project costs can be offset by PFA grants and loans. Operation and maintenance and existing debt service are fixed costs that cannot be reduced by PFA project funding.

Table 4 on pages 15-19 shows estimated project funding and estimated average annual residential system costs for potential wastewater WIF and PSIG projects. Fixed (non-project) costs are shown along with estimated new project debt service costs with and without PFA WIF and PSIG grants. Estimated new project debt service assumes current PFA or USDA-RD loan rates and terms. For purposes of the report, it is assumed that the estimated PFA or USDA-RD loan amount for each project would be increased by the amount of the WIF and/or PSIG grants under the “Without PFA Grants” scenario.

The table shows the Twin Cities metropolitan area weighted average annual retail charge per household is \$377 based on the most recent Metropolitan Council survey done in 2020. For comparison purposes, the report statute directs this amount be multiplied by 3 which equals \$1,131.

In general, smaller communities typically have higher residential costs than larger cities because they have fewer users over which to spread system costs. In addition, there are many other factors that can vary significantly from one community to another which can make it difficult to compare user costs. These can include the age and condition of the collection and treatment system components, the type and size of non-residential (business and industrial) users, the type

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of treatment facilities, the geography, geology, and hydrology of the area, and discharge permit requirements based on the condition and classification of receiving waters. Also, cities often phase system improvements over multiple years, making snapshot comparisons difficult. Finally, projects in unsewered communities involve construction of both a new sewer collection system and treatment facility, making these projects significantly more expensive than improvements to existing systems.