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COMMENTS

Comments on the New Jersey Department of Environmental Protection's Proposed Drinking Water State Revolving Fund and Clean Water State Revolving Fund Intended Use Plans for State Fiscal Year 2025

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Listed below are questions and recommendations from New Jersey Future on the New Jersey Department of Environmental Protection's Proposed Drinking Water State Revolving Fund (DWSRF) and Clean Water State Revolving Fund (CWSRF) Intended Use Plans (IUPs) for State Fiscal Year (SFY) 2025.

We highly value your willingness to consider these ideas and our ongoing dialogue with Department staff on how to refine this important document.

Policy Issues

The comments below relate to New Jersey Future's recent study, "Improving a Program That Works: Recommendations to the New Jersey Water Bank for Advancing Equity."

Disadvantaged Communities - Revised Definition of Affordability

It is heartening to learn that the New Jersey Department of Environmental Protection (NJDEP or Department) is actively considering refinements to its existing Affordability Criteria, potentially incorporating a tool such as the Department of Community Affairs' Municipal Revitalization Index (MRI), which considers a variety of local factors beyond median household income (MHI) yet provides a single score for ranking the relative wealth of communities. While the poorest localities are likely to appear on NJDEP's current Affordability Criteria and the MRI (and other similar tools), the results at the other end of the spectrum can differ significantly. That is, approximately 20% of localities that currently qualify as disadvantaged communities (DACs) under NJDEP's Affordability Criteria *would not qualify* under MRI, while a similar segment of towns that are not presently considered DACs *would* qualify under MRI.

Though it is a useful tool when complemented by other indicators, MHI has serious limitations in measuring municipal distress. For instance, MHI does not measure the local commercial tax base, property wealth, personal financial assets, water affordability (i.e., ability to pay), local economic trends (i.e., gradual economic decline), and income fluctuations across different neighborhoods.

In addition to the MRI tool, New Jersey's Affordability Criteria could also incorporate a user cost analysis that considers the rate increase likely to be required to implement a major capital project. For example, PENNVEST's financial capability analysis compares various community-specific demographic data (e.g., population in poverty, population change) to similarly situated communities across Pennsylvania to determine the portion of the community's adjusted MHI that should be available to pay for water service. For residential customers, that "targeted percentage" ranges from 1% to 2% of the community's MHI. If, after considering the applicable funding package offered by PENNVEST, the estimated residential user rates remain higher than similar systems and there is no reasonable expectation that the applicant can repay a loan, that system would be considered "disadvantaged." For design and engineering, the analysis would be performed on the service area affected by the project rather than system-wide. The financial terms would be extended to a point that allows the residential user rate to fall to a level equal to similar systems' cost of water service. This may include an extension of the term of the loan.[1] (See PENNVEST Clean Water and Drinking Water Disadvantaged Community and Affordability Criteria on the American Rivers website for a detailed overview.)

Another source document to consider is "A New Jersey Affordability Methodology and Assessment for Drinking Water and Sewer Utility Costs," a study by Rutgers University professor Daniel Van Abs for Jersey Water Works. Importantly, this 2021 study examines how disposable income impacts household stress when paying water and sewer bills.

While the perfect tool does not exist for measuring local wealth, a more accurate picture can be derived by shifting from a system that primarily relies on a single indicator to one that incorporates many factors.

Additional Subsidization

While the federal Bipartisan Infrastructure Law (BIL) and American Rescue Plan Act (ARPA) programs provided a significant increase in support for water infrastructure, it is generally accepted that the amount of principal forgiveness (PF) is far short of the need in most states,

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[1] *See also, " Affordability Assessment Tool for Federal Water Mandates", American Water Works Association, 2013, particularly EPA's Two-level Affordability Screening Analysis for Wastewater and Combined Sewer Overflow (CSO) Controls (page 4).*

including New Jersey. Has NJDEP considered setting aside a modest portion of the annual SRF loan repayments to increase PF for critical projects in DACs?

While loan repayments sustain the SRF program over time, a modest redirection to expand PF would be permissible so long as cash needs are managed to ensure the program's viability in perpetuity. A modest redirection of funds is highly unlikely to upset that requirement. As a case in point, redirecting 10% of the $152 million loan repayments noted in New Jersey's SFY25 IUP would increase PF by $15 million annually. In addition, future repayments of the estimated $500 million in new federal BIL loans issued through FY2026 will easily offset the impact of this initiative and help sustain an expanded level of project loans.

Tiering

It is encouraging to see NJDEP introduce the concept of tiering the distribution of PF to DACs in the FY25 IUPs; however, we strongly suggest that that effort be revisited to target a greater share of the benefit to the most needy communities. The SFY25 IUPs include only two tiers, capturing communities with affordability scores ranging from 66 to 80, and below 65. Other states, such as Wisconsin, have ranked the need for PF based on multiple factors beyond just MHI (e.g., poverty, joblessness, population trends) and use those scores to distribute PF on a sliding scale that is much more extensive, thus driving more of the funds to the most distressed localities. See Principal Forgiveness Wisconsin DNR and Recommendation 5 of New Jersey Future's study.

Expand 0% Loans

We noted and support the planned liberalization of the mix of loans (i.e., NJDEP vs NJIB) that support the SFY25 IUPs funding packages; however, we encourage the Department to consider greater use of 0% interest loans, at least for DAC projects. During New Jersey Future's study of SRF equity, several stakeholders indicated that such an initiative would likely spark an increase in applications for SRF funding. While this measure would probably reduce the number of total projects that can be funded, it could be a very valuable tool in motivating fiscally distressed communities. The success of the SRF program is not measured merely by the sheer number of projects funded but also by its ability to advance vital environmental improvements in communities that cannot do it alone. To test the concept, NJDEP could develop a pilot program focusing on DACs.

Creditworthiness

While creditworthiness policies are necessary to ensure the fiscal integrity of the SRF over the long term, the Department is encouraged to explore additional measures to help localities with poor credit ratings access SRF funding. Success in overcoming credit barriers is part of the stated purpose of the SRF program, and that may include loan guarantees, purchase of insurance for local obligations (i.e., to improve credit market access or reduce interest rates), and loan security provisions (e.g., reserve requirements and collateral). Also, some states maintain both a direct loan portfolio and a leveraged loan portfolio, with the stronger credits included in the leveraged portfolio. This helps ensure weaker credits with a higher likelihood of default, late payment, or restructuring do not negatively impact the SRF bond rating. Finally, enacting statutory changes and expanding State financial support for credit enhancement may represent the only way that high-priority, environmentally-sensitive projects will advance in fiscally-strapped communities.

Clean Water Violations
As part of New Jersey Future's report, the Environmental Policy Innovation Center model found that DWSRF awards are somewhat connected to Maximum Contamination Level violations, particularly for small-sized water utilities. The more drinking water violations, the higher the chance of receiving an award from the Water Bank. However, there does not seem to be a similar connection with the CWSRF. While this could have been a limitation of the analysis, we encourage NJDEP to prioritize cumulative water pollution impacts in the CWSRF and affordability concerns to ensure that DACs with water quality issues get the resources they need.

Technical Comments

Principal Forgiveness (PF) - Lead Service Line Replacements (LSLR)
In the "Summary of Funding Package Details" chart within the DWSRF IUP, a footnote associated with the PF Cap per Applicant for the High-Rank Affordability Projects and Lead Service Line Replacement programs reads, "PF caps for affordability and CSO Abatement Affordability are tiered by affordability score." Does NJDEP plan to tier the distribution of PF for LSLR projects?

Principal Forgiveness - $51m Carryforward into SFY25
The Lead Service Line Replacement section (page 19) of the DWSRF IUP notes the following:

> *"In addition to the SFY25 BIL LSLR PF, approximately $51 (million) of PF carried over from SFY24 will be used for LSLR PF in SFY25."*

Why did the $51m rollover from SFY24 into SFY25, and what programs was it from?

Sources/Uses Chart
Consistent with past IUPs, the SFY25 version of the plan continues to reflect a sizable amount of "Funds Available from Prior Years" (e.g., $323m in the DWSRF alone) as well as a significantly higher amount of funding available than planned spending. Has NJDEP considered adding an explanatory footnote to help readers understand this?