

Invest what you can – borrow what you have to

In the November issue of *The Kansas Lifeline*, we wrote about the Kansas Public Water Supply Loan Fund (KPWSLF). In this issue, we will discuss the mechanics of the Kansas Public Water Supply Loan Fund. The KPWSLF is a state revolving fund (SRF) program designed to provide financial assistance in the form of loans to Kansas municipalities at below market interest rates for the construction of public water supply system infrastructure. The interest rate for the KPWSLF is set at 80% of the previous three months average of the Bond Buyer 20 General Obligation Bond Index. We intend to review that Index in our next article. The State can offer a

“below” market interest rate due to the National Drinking Water State Revolving Loan Fund (DWSRF) program. The DWSRF program allows the U.S. Environmental Protection Agency (EPA) to award capitalization grants to states.



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To begin, let's review the Kansas Public Water Supply Loan Fund program and the kinds of projects that it supports. For example, a city or water district might apply for a loan to fund a water line improvement project. Projects that are needed solely for future growth or fire protection can not be considered for funding.

A potential applicant might ask, “My water district needs new water lines; how can we get funding to replace them?” Another frequently asked question is, “How would my water district establish loan eligibility?”

First, for a municipality to be eligible for a loan, it must adopt and implement a Water Conservation Plan. This plan must follow the guidelines developed by the Kansas Water Office and can be found on their Web site: www.kwo.org/Reports%20&%20Publications/conservation_guidelines.htm.

Once a water conservation plan is approved, the applicant city or water district completes and presents a “project submittal form”

and provided a loan application form. An application is considered complete when all of the following materials are submitted to KDHE (Note: all forms mentioned are available at the KDHE Web site: www.kdheks.gov/pws/loan/loanfund.htm.)

Kansas Public Water Supply Loan Fund (KPWSLF) Application Materials Checklist:

1. Completed loan application
2. Resolution designating authorized representative of applicant, for the city or RWD
3. Record of minutes of public meeting, for city or RWD
4. Notice of public meeting for the applicant
5. Two copies of the applicant's last three years of audited

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to the Kansas Department of Health and Environment (KDHE). An applicant can attempt to do this on its own or retain the assistance of an engineer, financial advisor or the Kansas Rural Water Finance Authority which is under contract to provide these services.

After KDHE receives the project submittal form they place the applicant's submission in a rank ordered list. Applicants that submit projects will be notified by KDHE when funding is available,

financial statements (A loan application can be made even if applicant does not have three years of audited financial statements. However, if a loan is granted it is necessary to start auditing financial records.)

6. Environmental review comments (This involves making project explanations to a variety of agencies and providing notice of intent to construct and opportunity for agency review.)

7. Project location map
8. Documented water rate
9. Project engineering study
10. Completed EPA form for civil rights and other compliance

The next step is to complete the Loan Application. This is a user-friendly document designed so that the applicant can easily complete it. After the applicant has completed the application, KDHE performs an environmental assessment and financial capacity analysis. Since Kansas began operating the Drinking Water Loan Fund, KDHE has contracted with the Kansas Rural Water Finance Authority (KRWFA) to perform the financial capacity analysis of all applicants to the program. This report analyzes the financial capabilities of the municipality to repay the loan.

Once the environmental assessment and financial capacity analysis are approved, KDHE will then draft a loan agreement. A standard loan agreement is for a 20-year repayment schedule that begins either one year after project completion or two years after the first disbursement, whichever comes first. There is a loan origination fee of .25% of the loan amount, which can also be borrowed from the KPWSLF.

Municipalities with taxing authority (cities or some public wholesale water supply districts) are required to either pledge that authority as a safeguard against loss of water system revenues, or pledge system revenues only and purchase a bond insurance policy. Municipalities with no taxing authority (RWDs) are required to maintain a debt service coverage ratio of 125% with a 10% reserve account, or maintain a 140% debt service coverage ratio without a reserve account. The borrower can choose to obtain the 10%

reserve account from the KPWSLF.

Before loan disbursements can be made, items on the following checklist must be submitted to KDHE :

1. A signed loan agreement
2. A resolution (RWD) or an ordinance (city) must be passed, authorizing the execution of a loan agreement. Minutes of the meeting in which it was passed must also be submitted.
3. A form of opinion of municipality's counsel

All rural water districts and some cities are required to enter into a Financial Integrity Assurance Contract (FIAC) with the Kansas Rural Water Finance Authority as a condition of receiving a loan. The FIAC has a one-time fee of 1% of the loan and can be borrowed from the KPWSLF. The municipality must submit an annual budget,

quarterly financial and management reports to KRWFA under this contract. The intent of the FIAC is to make professional financial and management assistance available to the recipient, to assure debt obligations are satisfied and to identify problems in operations so they can be corrected before they lead to financial problems.

The Kansas Public Water Supply Loan Fund is a uniquely structured program that provides below-market rate loans to publicly-owned public water systems in Kansas. If an applicant needs help getting started with the KPWSLF, I encourage contacting any one of these three entities: the Kansas Rural Water Finance Authority, through the KRWA; Ranson Financial Consultants, L.L.C. by calling John Haas or M.E. Yeager; or KDHE by calling William Carr or Dave Waldo.



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The Markets are Moving by John Haas

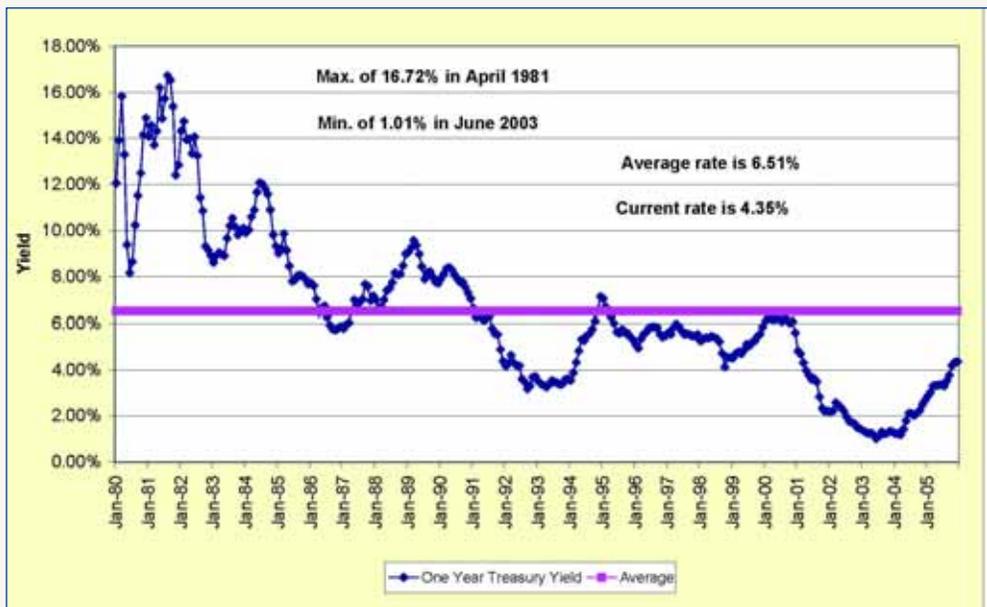
As was predicted interest rates for all three of indexes that we follow: the One Year Treasury Bill, the Bond Buyer Index of Municipal Bonds, and the interest rate charged by the Kansas Public Water Supply Loan Fund, have increased since the November 2005 issue of *The Kansas Lifeline*. Many factors have contributed to this increase in interest rates including: 1) the cost of the barrel of oil – about \$70;

2) the Federal Reserve continues to increase the discount rate – about 5.50%; and, 3) the red ink in the Federal budget continues to grow – I do not have enough zeros on my key board. Some point to an improving economy as the cause for higher interest rates, but don't ask workers at Ford or General Motors about their opinion on the current economic status.

Investing Your Money

Since November 2005 also, the yield (or implied interest rate) on the One Year T-Bill has risen from 3.73% to 4.35%, an increase of 62 basis points. This means a local unit of government should be receiving a significantly higher return on its investments when compared to the previous quarter. The average yield on the One Year T-Bill since 1980, however, declined from 6.53% to 6.51% (a quirk of statistics). As you can see on Chart A: "One Year Treasury Yield – Historic and Average Rates," the yield on the One Year T-Bill continues to climb to its historic average. With Mr. Greenspan leaving the Federal Reserve there is uncertainty as to whether or not the Fed will continue to raise short-term interest rates. I predict that they will continue to increase until they hit the 5% level at about this time next year.

Chart A: One Year Treasury Yield - Historic and Average

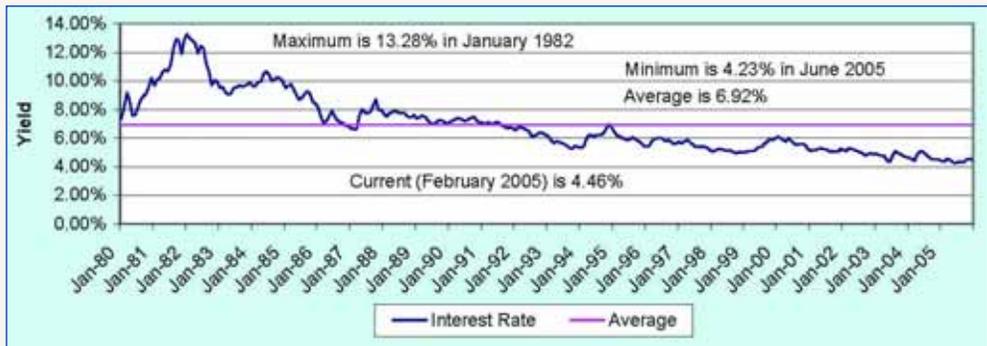


Borrowing Money

The interest rate as reflected by the Bond Buyer Index of Municipal Bonds has also increased since my article in November. Previously, this interest rate was 4.23%. Currently, the interest rate is 4.46%, an increase of 23 basis points. The effect? The average annual borrowing cost for a \$1,000,000 tax-exempt bond issue amortized over 20 years increased by approximately \$1,525.

Chart B: the "Bond Buyer Index of Municipal Bonds – 1980 to Current," demonstrates that borrowing costs are still significantly less than the average since 1980. Given that increase in yield for the One Year T-Bill is more than the increase in the Bond Buyer Index of

Chart B: Bond Buyer Index of 40 Bonds



Municipal Bonds, 62 versus 23 basis points, I would take this to mean that either the economy is not gaining steam or long-term interest rates are too low relative to short term interest rates. I do

not think that the economy is gaining much steam and predict that long-term rates may be up to 5% by this time next year. The bottom line, they will either stay at the current level or decline again.

The Kansas Public Water Supply Loan Fund (KPWSLF)

Following the lead of the Bond Buyer index the interest rate for the KPWSLF increased from 3.42% to 3.60% or 18 basis points. The increase in interest rate for the KPWSLF was less than the Bond Buyer Index (23 basis points) due to the KPWSLF being subsidized by a grant from the national Drinking Water State Revolving Fund (DWSRF) program. Due to this increase in interest rates the average annual debt service on a \$1,000,000 loan for 20 years increased from \$69,852 to \$71,000; an annual difference of \$1,147. Chart C: "Historical Interest Rates – Public Water Supply Loan Fund" demonstrates that the interest rate for this program has continued to increase from a historic low in September 2005. I predict this interest rate will continue to "creep" up for another 12 months, but will not reach the 5% level.

Chart C: Kansas Public Water Supply Interest Rates: Historic and Average



Final Thoughts

My predictions are less reliable than weather forecasts, but it will be fun to see how they turn out. Even though rates are on the rise, they are still below historic levels. My best advice: "Invest what you can – borrow what you have to."

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