STATE REVOLVING FUNDS

Improved Financial Indicators Could Strengthen EPA Oversight

Why GAO Did This Study

EPA estimates that more than $680 billion is needed to repair and replace water and wastewater infrastructure nationwide over the next 20 years. Under the Clean Water Act and Safe Drinking Water Act, the federal government contributes some funding to states through EPA's Clean Water and Drinking Water SRF programs. States use this funding to make low- or no-interest loans to communities to build water and wastewater infrastructure, in addition to other assistance. These loans are repaid with interest, and these funds are then used for future loans. EPA reviews and oversees state SRF programs.

GAO was asked to examine the sustainability of SRF funds. This report examines (1) factors that affect selected states’ abilities to sustain their SRF funds, (2) selected states’ actions to enhance their SRF funds and views about sustaining the funds, and (3) steps that EPA takes to review states’ abilities to sustain their SRF funds as part of its oversight. GAO analyzed EPA and state financial data and interviewed EPA officials, nine experts, and officials in 21 states. Experts were selected from an EPA financial advisory board. States were selected for program size, region, and type of fund management.

What GAO Found

Multiple factors can limit states’ abilities to sustain their Clean Water and Drinking Water state revolving funds (SRF), according to Environmental Protection Agency (EPA) officials, nine experts, and officials in the 21 states GAO reviewed. Under the Clean Water Act and the Safe Drinking Water Act, as amended, states are to create and maintain revolving funds to be eligible for federal grants. To sustain their SRF funds into the future, states earn revenues—such as from interest on invested funds—that enable them to continue to lend funds. Yet, factors can permanently remove money from the funds or diminish the states’ abilities to earn funds. For example, states provide subsidies from SRF funds to communities and charge below-market interest rates on loans, removing funds, and earning less revenue than would otherwise be available to make future loans.

Officials in most of the 21 states GAO reviewed said that they have taken actions to enhance the financial management of their SRF programs, but that they generally cannot sustain their SRF funds without continued federal grants or changes to their programs, such as decreasing SRF program assistance or increasing revenue. Selected states’ actions were aimed at three general areas: (1) raising SRF revenue directly, such as by charging higher administrative fees to borrowers; (2) increasing loan volume, which increases loans but does not necessarily increase revenue; and (3) improving financial planning, which can increase the number of loans, interest earned, or both.

As part of EPA’s oversight responsibilities, EPA regional offices annually review states’ financial performance by collecting financial information and indicators, including some information related to states’ abilities to sustain their SRF funds. Leading financial management practices include indicators to evaluate an entity’s growth and sustainable lending capacity. EPA’s financial indicators include sustainability indicators that show the growth of the SRF programs relative to federal and state investments, which are only part of total net assets. They do not reflect the states’ abilities to sustain their SRF funds through growth of total net assets, consistent with leading financial management practices. EPA has identified financial measures, in its guidance for states, that show states’ overall financial management of SRF funds and the growth of those funds. However, they are not part of EPA’s financial indicators for regional offices to use when reviewing state SRF funds’ financial performance. EPA officials said that having regions use such measures could be helpful, and that they developed a standard operating procedure in 2014 that encourages regions to use different financial measures when reviewing state programs, but the agency has not yet updated its financial indicators guidance. Including one or more of the financial measures for identifying the growth of states’ SRF programs in its financial indicators guidance for regional office reviews can help EPA better gauge the financial performance and growth of states’ SRF funds. Further, state programs develop projections of their future lending capacity, but EPA does not use these projections as indicators. By using past performance to develop projections of SRF funds’ future lending capacity, consistent with leading financial management practices, EPA can better assess state programs’ sustainability. EPA officials said that future-looking indicators could be helpful for understanding the financial sustainability of SRF funds, and that they would consider incorporating such indicators.

What GAO Recommends

GAO recommends that EPA update its financial indicators guidance to include one or more financial measures and develop projections of states’ SRF programs’ future lending capacity. EPA agreed with the recommendations and said that it would form a state-EPA work group and take action on the indicators in fiscal year 2016.

View GAO-15-567. For more information, contact J. Alfredo Gomez at (202) 512-3841 or gomezj@gao.gov.