

# State of Connecticut



## State Revolving Fund Programs: **DRINKING WATER FUND**

*Supporting the Planning, Design and Construction of Water Quality Projects*

### **2004 Annual Report**

# State of Connecticut

## DRINKING WATER FUND



Keeping Connecticut Healthy

**J. Robert Galvin, M.D., M.P.H.**  
**Commissioner**  
**Department of Public Health**



**Arthur J. Rocque, Jr.**  
**Commissioner**  
**Department of Environmental Protection**

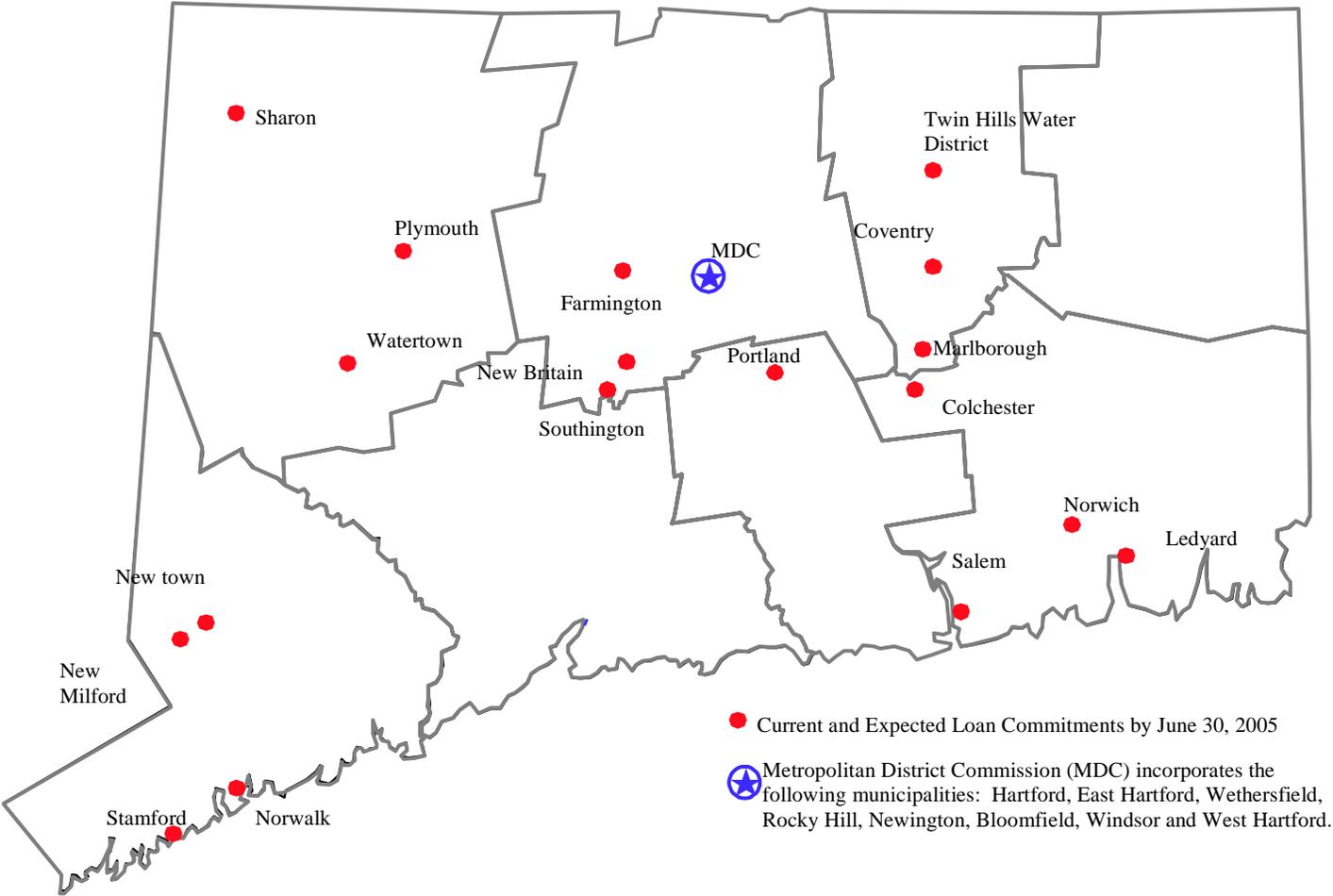


**Denise L. Nappier**  
**State Treasurer**



**Donald W. Downes**  
**Chairperson**  
**Department of Public Utilities Control**

# Location of Drinking Water Projects



This is the seventh Annual Report on the Drinking Water State Revolving Fund Loan Program (DWF). It has been prepared by the State Treasurer's Office, Debt Management Division and the Department of Public Health (DPH) with assistance from the Department of Environmental Protection (DEP) to comply with the requirements of Connecticut General Statutes Section 22a-475 (h). These agencies are responsible for both the accuracy of the data and the completeness and fairness of this presentation.

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## INTRODUCTION

The State of Connecticut State Revolving Fund Programs include the Clean Water Fund (CWF) and the Drinking Water Fund (DWF) and provide low-cost financing to achieve and facilitate compliance with federal and state water quality. The Connecticut General Statutes, Section 22a-475 to 22a-483 authorizes the State to establish and operate the State Revolving Fund programs and to apply for and receive Federal funds. Both programs required that each state create a revolving fund in order to accomplish the program mandates and initiatives of the Act and to accept federal capitalization grants and state provided matching funds equal to 20% of the federal capitalization grants. a Information on the Clean Water Fund is provided in a separate annual report.

The 1996 Amendments to the Safe Drinking Water Act (SDWA) authorize the United States Environmental Protection Agency (EPA) to offer state capitalization grants for the DWF. There is an annual federal authorization of \$1 billion for the DWSRF through 2003. The current authorizations was extended to FY2004.

The State of Connecticut created its Drinking Water State Revolving Fund Program within the Connecticut General Statutes 22a-475 to 22a-483, the authorizing statutes of the Clean Water Fund. This action was consistent with the goals of the federal Drinking Water program which was modeled after the state revolving fund program within the Clean Water Act.

The Department of Public Health (DPH) is the State's primacy agency for drinking water. Within the parameters set by the EPA guidelines, the State of Connecticut exercises considerable flexibility in the type of planning, design and construction projects that the DWF will fund. The major concern is the protection of public health and compliance with Federal and State drinking water mandates. The only limitations on project funding are exclusions for increased capacity and other non-eligible project purposes as described in the DWSRF guidance document, available from the Department of Public Health.

This report includes a review of the Drinking Water Fund and its history, revenue bond program, operations during the year ending June 30, 2004, projections of future project funding and management initiatives for fiscal year 2005.

As a recipient of more than \$500,000 in federal financial assistance, the State must comply with the federal Single Audit Act of 1984 and have adequate internal controls in place to ensure and document compliance with applicable laws and regulations. The audited statements for fiscal year ending June 30, 2004 have been prepared by the firm of Seward and Monde CPAs, with headquarters in New Haven Connecticut. The audits disclosed no internal control weaknesses or violation of laws or regulations. The audited statements for the DWF are included in this report and are available separately from Seward and Monde and the State Treasurer's Office.

The enclosed financial information is accurate and is reported in a manner that presents the financial position and results of operations of the State of Connecticut Drinking Water Fund. The audits disclosed no internal control weaknesses or violation of laws or regulation.

Copies of the Annual Reports are available at the State Treasurer's Office during regular business hours, or on-line, through the Treasurer's website at [www/state.ct.us/ott](http://www/state.ct.us/ott).

## Drinking Water Program at-a-Glance

(Fiscal Year 1997-2004\*)

Total Capitalization Grants	\$75.9 million
Percentage of Total Grants Reserved for Set-Aside Activities	31%
Total Revenue Bonds Issued for Project Financing	\$851.9 million *
Total Amount Project Funding	\$56.6 million
Minimum Perpetuity Requirement per the Federal Grant	\$67.3 million**
Total Assets as of Fiscal, Year End June 30, 2004	\$112.8 million
Total Loans Made to Systems	22 loans
Total Loan Made to Small/Medium	13 loans
Percentage of Total Loans Awarded to Small/Medium Systems	59%

\*FFY 2004 Funds are pending.

\* includes amounts for Drinking Water Fund Program and does not include any amounts to become available for payment of debt service or for the purchase or redemption of bonds during the next succeeding fiscal year

\*\*this number represents the capitalization grant less set asides plus required match however this number should not be used to represent amounts needed to sustain the Fund in perpetuity

## **HISTORY**

Department of Public Utilities Control and the State Treasurer's Office to successfully use the Fund to provide financial assistance to public and private borrowers for the construction, rehabilitation, expansion or improvement of water systems. Total cumulative project funding of \$56 million as further detailed in Appendix XII.

The State demonstrates its continuing commitment to the program in several ways. A generous portion of the federal grant is set-aside to provide critical services to water providers and the State has coordinated funding sources to maximize the financing available.

The set-aside categories and eligible activities are as follows:

<b><u>Set-Asides</u></b>	<b><u>Max. %</u></b>
<b>Administration &amp; Technical Assistance</b>	<b>4%</b>
Administer the DWSRF program and provide technical assistance to public water systems.	
<b>Small Systems Technical Assistance</b>	<b>2%</b>
Technical assistance to small systems.	
<b>State Program Management</b>	<b>10%</b>
Administer the state Public Water Supply Supervision Program. Provide technical assistance through source water protection programs. Develop and implement a capacity development strategy or an operator certification program.	
<b>Local Assistance and Other State Programs</b>	<b>15%</b>
Delineate and assess source water protection areas. Provide loans to systems to acquire land or conservation easements. Provide loans to systems to assist in voluntary, incentive-based source water protection measures. Make expenditures to establish and implement wellhead protection programs. Provide assistance to systems as part of a capacity development strategy. No more than 10% per activity per capitalization grant.	

## **PROGRAM MANAGEMENT**

In accordance with the State Act, through its Drinking Water Fund, the State makes loans to borrowers to provide capital for various State and Federally mandated drinking water projects. Pursuant to the Resolution, loans are defined as any loan made by the State to a borrower pursuant to a loan agreement and any other financial support provided by the State to a borrower including, without limitation, a guarantee or credit support.

The Department Of Public Health (DPH) is the state agency responsible for enforcement of and compliance with, State and federal laws, rules and regulations pertaining to drinking water and its use in the State. The Clean Water Act, Connecticut General Statutes 22a-475 to 22a-483, inclusive, as amended, gives DPH certain statutory responsibilities with respect to the DWSRF. DPH works with the Department of Environmental Protection, the Department of Public Utilities Control and the State Treasurer's Office and coordinates the activities of the DWF.

The State agencies involved in the program have worked together with the Office of Policy and Management (OPM) to address the drinking water needs of the State since 1995. The process has been implemented with a great deal of consideration for existing regulations and procedures. The DWF Interagency Memorandum of Understanding (MOU) creates an interagency committee and details the roles and responsibilities of each agency. The following is a brief overview of State agency participation.

### **Department of Public Health**

The DPH is the state agency that carries out the public health policy of the state, including the use and protection of the State's drinking water resources. The Safe Drinking Water Act gives the DPH certain statutory responsibilities with respect to the DWSRF. The DPH is also responsible for enforcement of, and compliance with, state and federal laws, rules and regulations pertaining to drinking water and its use in the state.

The DPH determines future needs and sets priorities. Based on approved state and federal appropriations, DPH prepares an annual Project Priority List identifying drinking water projects that are eligible for assistance from the DWSRF. The financing obligations with the DWSRF borrowers are signed by the DPH and the DEP. DPH establishes a compliance schedule for each step of the project, including planning, design and construction. Lastly, DPH reports the details of these and other program activities to the EPA every year.

Each year the DPH submits a capitalization grant application to the U.S. Environmental Protection Agency (EPA) to capture the State of Connecticut's DWSRF allocation. Applications for funding from EPA include funds for set-aside activities as well as project funds. Set-asides are funds allocated for a range of specific activities such as encouraging source water protection and supporting other state drinking water program activities which includes: DWSRF program administration, drinking water program management, technical assistance for small water systems and the purchase of land for additional source protection. The Intended Use Plan, a document required by the EPA for grant submission, describes the State's intended uses for set-aside and project funds.

As the primacy agency, DPH maintains a list of approximately 1249 public water systems [Community & Non-Community (non-profit)] in Connecticut that are eligible for funding. The Depart-

ment has emphasized the importance of reach these potential applicants through the implementation of its public outreach initiatives simultaneously with the development of the DWSRF program. Each year outreach includes mailings, statewide informational meetings, open forums, conference presentations, correspondence, telephone inquiries and meetings held at the request of interested parties.

### **Department of Environmental Protection**

The DEP is the state agency that carries out the environmental policy of the state for conserving, improving and protecting the State's natural resources and environment and mitigating water, land and air pollution. The Clean Water Act, Connecticut General Statutes 22a-475 to 22a-483, inclusive, as amended, gives DEP certain statutory responsibilities with respect to the DWSRF.

The Department's DWSRF responsibilities are similar to its CWF responsibilities. DEP monitors the financial elements of a project from the design and planning phase to construction. In addition to assisting in the determination of project eligibility, DEP reviews all project information to ensure compliance with project schedules and budgets. DEP also enters into financing obligations with borrowers and approves disbursement requests for all eligible costs incurred. DEP will initiate cash draw requests based on requisitions from borrowers and provides that information to both DPH and the Treasurer's Office. DEP maintains the financial project tracking system with the assistance of DPH.

### **Department of Public Utilities Control**

The Department of Public Utilities Control (DPUC) is the state agency that carries out the public policy and enforces the regulations of the state with regard to all its utilities including privately owned public water systems.

DPUC approves all rate change requests from privately owned public water systems. DPUC reviews the capital budget requests and adjudicates over the enforcement of state laws. In addition, DPUC monitors and approves financing obligations for privately owned public water systems before any disbursements can be made. For the DWSRF program, DPUC meets its statutory responsibilities with regard to privately held water companies.. As a result, DPUC plays a role in the management of the Fund and is a member of the Interagency Committee.

The DPUC has no role in the DWSRF process for municipalities and small public water systems that have under 50 connections.

### **State Treasurer's Office**

The State Treasurer is primarily responsible for receiving and disbursing all money belonging to the state, superintending the collection of state taxes, the investment of state funds, administering certain state trust funds and managing state property.

The State Bond Commission delegates to the Treasurer the authority and responsibility for determining the State's financing plans including the terms and conditions of issuing state general obligation and revenue bonds.

The Treasurer's Office has responsibilities for the fund's financing program and various financial components of the DWF. In addition to participation on the Interagency Committee, the financial administrator within the Treasurer's Office also:

- administers DWSRF financing program which includes the issuance of bonds
- administers the lending process including the review of any credit-related documents submitted by the loan applicant, evaluation the prospective and current borrowers' financial condition; and oversight of project loans outstanding;
- coordination of tax documentation necessary to finance the projects;
- maintains the program's dual entry accounting system developed and maintained by the State Treasurer's Office
- documents changes in the interest rates and;
- coordinates of the independent federal audit, the audit by the State Auditors of Public Accounts, and the preparation of the annual reports to the Governor and to the EPA.

The program management goals and objectives of State Treasurer's Office relating to the Drinking Water Fund are to:

- Develop the Fund's capacity to provide low-cost financing for eligible projects, as simply and effectively as possible;
- Fund loan amounts to the maximum extent possible;
- Review the funds available each year to projects with the highest priority;
- Assist in the coordination of DWF activities with priority state and federal enforcement activities;
- Provide effective financial management to ensure integrity of the Drinking Water Fund; and
- Maintain both the federal tax-exempt status and the high credit ratings of all the program's publicly issued debt.

The Financial Administrator and DPH prepare an annual report detailing the activities of the SRF Programs. The report is submitted to the Governor and to the EPA by September 30 each year.

## **PROGRAM FUNDING**

The main features of Connecticut's DWSRF program – the ranking system, the project funding, the maximization of set-aside and the leveraging plan discussed in this section and allow DPH to meet the public health and compliance goals of the DWSRF while simultaneously preserving the integrity and perpetuity of the Fund.

### **Sources and Uses of Funds**

The funding for the DWF comes from federal capitalization grants, revenue bond proceeds for drinking water projects, and state general obligation bond proceeds. Federal capitalization grants and state match have been primarily used to secure program bonds and interest subsidy to borrowers. These amounts are held by the Trustee. Similar to the CWF leveraged program, federal funds are drawn monthly from a Federal Capitalization Grant in proportion to the rate of spending on certain projects. State bond authorizations are used to provide the required state match.

Under the DWF leveraged program revenue bonds are the funding source for all loans financed by the federal account. The State intends to fund future loans to DWF borrowers from the proceeds of bonds.

### **Federal Capitalization Grants**

Federal drinking water capitalization grants for federal fiscal years 1997 through 2003 in the amount of \$75.9 million have been awarded by the EPA to the State. The largest grant to date was for \$21 million in 1997. Since that time, Connecticut has applied for and received grants each year as detailed in Appendix I.

Under the SDWA, in order to receive federal drinking water capitalization grants, the State must provide matching funds in a ratio of at least 20% of federal drinking water capitalization grants. State contributions include required State matching funds and other amounts contributed by the State to the Drinking Water Program above the amount required by the SDWA. Connecticut has made State contributions in the form of taxable State general obligation bonds deposited in the DWF to meet the required amount of State matching funds for Federal Drinking Water Capitalization Grants awarded to date.

The federal drinking water capitalization grants and state contributions have been used to make loans, fund reserves, make direct loans to private borrowers, to pay administrative costs and other set-aside activities. Connecticut Short-Term Investment Fund (STIF) and guaranteed investment contracts with AAA providers.

Connecticut is allowed to earmark a maximum of 31% of the Federal allocation for each fiscal year for all set-aside activities.

## **State Authorizations: Grant Match**

The state has provided, or expects to provide, sufficient amounts of funds in the DWSRF to meet the required state matching funds for current and future federal capitalization grants. Information on the amount of federal grants and the required state matching funds for the DWSRF can be found in Appendix I.

## **Revenue Bonding Program**

The State enters into loan agreements with each borrower in the program including municipalities, public water systems and private water systems. The State then uses revenue bonds to fund the project loans. Bond proceeds are disbursed on an as needed basis to borrowers with executed loan agreements, as such borrowers incur project costs. Borrowers, in addition to those listed in the appendices, may receive funding. In all cases funding is subject to State Bond Commission approval.

This leveraged financing allows the Fund to maximize the available project funding. The revenue bond proceeds can be two times the amount of the available capitalization grants and the state match contributions. This strategy also allows the state to provide loans with a low interest rate at favorable 20-year terms to all of the municipalities with water quality issues.

## **Cross-Collateralization**

Both the DWF and the CWF make loans from the proceeds of the bonds. Loan repayments from both SRF Programs are deposited to the State Revolving Fund General Revenue Bond Program and available to pay all bonds whether the loans were made under the DWF or the CWF. The cross-collateralization of the SRF Programs has been structured in accordance with the EPA regulations, interpretations and guidance (collectively, the “Federal Environmental Law”) and the Resolution, as amended and supplemented.

## **Revenue Bonding Program**

Since 1991, twelve series of revenue bonds, referred to as the Program Bonds, have been issued. These bonds have provided \$960 million in project funding for the SRF programs and \$445 million to refund bonds. These revenue bonds are the funding source for loans made by the federal account and are liabilities solely of the Fund. Bond proceeds equal to \$64 million of the \$225 million issued in 2001 and 2003 were used to fund Drinking Water projects.

## **Program Bonds**

Since the issuance of the 2003 Bonds, the State has three types of outstanding Program Bonds including: (1) Bonds issued under the new General Bond Resolution; (2) revenue bonds issued under a general bond resolution adopted December 7, 1990 (the “1990 Resolution”) which are secured by specific pledged Municipal Obligations, as defined therein, and other pledged funds described therein and (3) subordinated refunding bonds issued under a Subordinate Bond Resolution

adopted on February 23, 1996 (the “Subordinate Resolution”) which are secured by surplus revenues released from the 1990 Resolution. Bonds issued and outstanding under the 1990 Resolution (the “1990 Resolution Bonds”) and bonds issued under the Subordinate Resolution (“Subordinate Bonds”) are sometimes referred to as the “Prior Bonds.” The following information describes the 2003A Bonds. Appendix VII provides additional information about the Program Bonds.

This section of the annual report provides information concerning the 2003 Bonds which are three series of bonds in the par amount of \$355,245,000 issued on July 10, 2003, just after the beginning of the fiscal year. Series A and Series B are fixed rate bonds and Series C are auction rate securities. All three series were again rated triple A, unsecured, by the three major bond rating agencies.

## **Bond Sale**

The 2003 bond offering included \$118,085,000 State Revolving Fund General Revenue Bonds, 2003 Series A (the “2003A Bonds”), \$115,785,000 State Revolving Fund Refunding General Revenue Bonds, 2003 Series B (the “2003B Bonds”) and \$121,375,000 State Revolving Fund Refunding General Revenue Bonds (Auction Rate Securities) 2003 Series C (the “2003C Bonds”). The 2003 Bonds represent the first three series of Bonds issued by the State pursuant to its SRF Program General Revenue Bond Resolution adopted by the State Bond Commission on December 17, 2002 (the “General Bond Resolution”) This was the largest bond sale for the program.

One objective of the sale was to implement a new bond resolution with a general revenue security structure in order to maximize the capacity of the financing program, simplify administration and lower the need for state subsidies. Rather than pledging large reserves, under the revenue bond Resolution, the State will apply all moneys in the Revolving Fund available under the General Bond Resolution (“Available Moneys”) to the timely payment of the Bonds.

A portion of assets of the Revolving Fund remains pledged to the Prior Bonds. The 1990 Resolution Bonds are secured under the 1990 Resolution by pledged assets, including Loans made to Borrowers from bond proceeds and other funds, a 50% debt service reserve fund and an interest subsidy fund, which was funded with State General Obligation Bonds.

The proceeds of the bonds were used as follows:

- 1) 2003A Bonds were issued to make loans to Borrowers under the SRF Programs pursuant to the General Bond Resolution and to pay costs of issuance of the 2003A Bonds. The new issue resulted in an additional \$35,000,000 in funding for drinking water projects.
  
- 2) the 2003B Bonds and Series 2003C Bonds were issued to refund portions of various series of 1990 Resolution Bonds previously issued by the State to make loans under the SRF Programs pursuant to the 1990 Resolution and to pay the respective issuance costs of the 2003B Bonds and 2003C Bonds. The transaction included \$282.8 million in refunding bonds and cash defeasance which resulted in a savings of \$13.7 million.

The State achieved a true interest cost of 3.06639%, the lowest interest rate ever achieved for program.

As more fully described in Appendix VIII, the 2003 Bonds are special obligations of the State payable solely from all moneys in the Revolving Fund legally available for application to payments due under the Resolution, as defined below (“Available Moneys”).

## **Fixed Rate Bonds and ARS Bonds**

The 2003A Bonds and 2003B Bonds were issued as fixed rate securities (the “Fixed Rate Bonds”) in minimum denominations of \$5,000 or any integral multiple thereof. The 2003A Bonds and the 2003B Bonds bear interest from July 1, 2003, payable on April 1 and October 1 of each year.

The 2003C Bonds were issued as auction rate securities (the “ARS Bonds”) in minimum denominations of \$25,000 and integral multiples thereof in two subseries, consisting of \$55,000,000 2003 Series C-1 and \$66,375,000 2003 Series C-2 and bear interest at an ARS Rate for its respective ARS Period. The ARS Bonds bear interest from the date of issuance thereof to and including the last day of the Initial Periods at the interest rate (the “ARS Rate”) determined pursuant to the Auction Procedures. All or a portion of the ARS Bonds may be converted, at the option of the State and subject to certain conditions and restrictions as set forth in the Resolution to Bonds bearing interest at Fixed Rates as described herein, in which case the ARS Bonds converted are subject to mandatory tender on the date fixed for conversion (the “Conversion Date”) at a price equal to 100% of the principal amount thereof plus accrued interest, if any, to the Conversion Date. The ARS Bonds are subject to redemption prior to maturity under certain circumstances as described herein.

In connection with the issuance of the 2003C Bonds, the State entered into an interest rate swap agreement or agreements with Goldman Sachs Mitsui Marine Derivative Products, L.P. (the “Counterparty”) for the purpose of converting its variable rate exposure to a fixed rate (the “Interest Rate Swap”). The Interest Rate Swap has a notional amount equal to the par amount of the 2003C Bonds and an effective date equal to the date of delivery of the 2003C Bonds. Under the terms of the Interest Rate Swap, the State pays a fixed rate payment to the Counterparty and receive a variable rate payment. Additional information about the SWAP is provided in Appendix IX.

## **Bond Debt Service**

The repayment of the revenue bonds comes from loan payments, interest earnings on reserves and an interest subsidy contribution which comes from the State. During 2004, loan interest repayments were \$1.37 million. While all loan repayments are available for the repayment of the bonds, a portion of loan repayments are retained in the debt service fund as a cash flow cushion in conformance with rating agency default coverage guidelines. The debt service schedule for all bonds outstanding is provided in financial statements.

Debt service on the subordinated refunding bonds issued in 1996 and 1999 is paid after funds are released from the 1990 indenture. As of July 30, 2004, the subordinated debt service fund has been fully funded.

## **Ratings**

The bonds are rated at the highest available credit rating from all three rating agencies, AAA from Fitch, Aaa from Moody’s Investors’ Services and AAA from Standard & Poors’ Investors’ Services, a division of the McGraw-Hill Companies, Inc. The Subordinate bonds are rated AAA from Fitch Aa1 from Moody’s Investors’ Services and AA+ from Standard & Poors’ Investors’ Services.

Each rating reflects only the views of the respective rating agency, and an explanation of the significance of the rating may be obtained from the rating agency. There is no assurance that ratings

will continue for any given period of time and they may be revised or withdrawn entirely by rating agency if in the judgement of the agency circumstances so warrant.

### **Investment of Funds**

The State currently invests a significant portion of the funds and accounts created under the 1990 Resolution in investment agreements with financial institutions. The 1990 Resolution requires that investment agreements be with, or be guaranteed by, institutions with ratings at least equal to the rating on the 1990 Resolution Bonds given by Standard & Poor's and Moody's Investors Service or any rating service recognized by the State banking commissioner. Certain moneys currently held in the Debt Service Reserve Fund under the 1990 Resolution are invested pursuant to investments agreements, collateralized with securities issued or guaranteed by the U.S. Government or agencies or instrumentalities thereof whose market value is at least 100% of the funds invested.

Upon the issuance of the 2003 bonds, certain of these long-term investments were released from the pledge of the 1990 Resolution and became unencumbered assets.

These agreements are subject to early termination upon certain events. In addition, agreements may be subject to certain other risks, including the bankruptcy or insolvency of the party with which funds have been invested under such agreements or which has guaranteed such agreements.

The State reserves the right to adopt one or more other general bond resolutions and reserves the right to issue notes and any other obligations so long as the same are not a prior charge or lien on Available Moneys. The Resolution provides that additional bonds may include a pledge of borrower obligations that are pledged to one or more series of bonds pursuant to a supplemental resolution. No additional bonds will be issued under the 1990 Resolution or the Subordinate Resolution.

As shown in Appendix X, the 1990 Bond debt service reserves equal at least 50% of all outstanding 1990 bonds. A support fund was established by the general revenue resolution for debt service. There are no reserves on subordinate bonds, which were issued only for refunding purposes.

## PROJECT FINANCING

Financing tools available through the DWF include: low-interest rates on loans at one half of market rate with a 20 year repayment period; refinancing of local debt; and additional assistance as needed with use of set aside money. All projects are selected for financial assistance based on a priority list system created and managed by the DPH. A priority ranking system reinforces the long-term goals and reflects the Department's philosophy of encouraging public health protection through the distribution of safe and adequate drinking water.

### Priority List

The priority list system is a key component of the management of the DWF. With it, management ensures that funding is available for projects that have the most pressing needs, while reserving funds for other projects. To ensure that DWF funds are used where they are needed most, the ranking system also incorporates procedures for emergencies.

Each year the State develops a list of projects that will receive funding in the year after the grant award and maintains a comprehensive priority list of eligible projects for funding in future years. Eligible participants are public water systems (PWS) that have 15 or more service connections or regularly serves at least 25 people, 60 or more days a year. PWS are subdivided by regulation into two categories; community and non-community. Community systems serve water to residential populations, whereas non-community systems serve water to non-residential populations. Priority for the use of funds will be designated to those PWS projects that address one or more of the following:

- Water quality violations
- Water quantity violations
- Acquisitions and transfers
- Infrastructure Upgrades
- Protective measures covering sources of supply and distribution systems
- Affordability

These ranking criteria award points for situations in which water quality impairments, water quantity deficiencies, or water system imperfections may increase risk to public health and/or result in non-compliance. Points awarded for the acquisition of an existing public water system and upgrades emphasize the importance of supporting projects that achieve long-term solutions to existing water quality deficiencies. Affordability points are given to projects located in communities where the median household income (MHI) is less than 80% of the State's average MHI.

The highest points are assigned to projects that are designed to bring systems into compliance with quality and quantity regulations of the Connecticut Public Health Code. In each fiscal year, the Commissioner of the DPH approves project loans to recipients in the order of the Priority List of eligible projects to the extent of funds available. Each recipient may apply for and receive a project loan in the amount equal to 100% of the eligible project cost. The Drinking Water Division continually updates its computer-based application to track programmatic information for all DWF loan

applications. The DPH may bypass a project on the Priority List if the selected project is not ready to proceed.

Based on FFY 2004 Priority List, projects earmarked for funding include approximately 17.9% of the available project fund for systems serving under 1,000 population, 12.9% for systems serving between 1,001 and 10,000 population and 69.2% for systems serving populations greater than 10,001.

There was concern with the 2003 survey that security-related planning documents, such as a vulnerability assessment, might compromise the security of a system. It was determined that either the state or the system can either summarize the documentation in a way that does not identify the location/equipment/facility associated with the project or not submit the security documentation . The systems surveyed were:

- Bethel Water Department
- Bristol Water Department
- BHC- Main System
- BHC – Stamford
- CT. American Water Company – Mystic Valley Div. Crystal Water Company
- CTWC – Northern Region – Western System
- CTWC – Shoreline Region – Guilford
- CTWC – Gallup Water Service, Inc.
- Danbury Water Department
- Groton Utilities
- Heritage Village Water Company
- CT. American Water Company – Greenwich
- Kensington Fire District
- Town of Manchester – Water Department
- Metropolitan District Commission
- New Britain Water Department
- New London Dept. of Public Utilities
- Norwalk First Taxing District
- Regional Water Authority
- Second Taxing District
- Torrington Water Company
- Unionville Water Company
- Wallingford Water Department
- Waterbury Water Department
- Winsted Water Works

## **Financial Terms of Loans**

The DWF provides loans for water projects in six categories based on the criteria described below. The DWF has no grant program. Once a project is deemed eligible for funding, an evaluation of the applicant's capabilities is performed using a DPUC approved Economic Viability Model. The purpose of this evaluation is to ascertain if the applicant's system can support the DWF loan.

Loan terms are attractive, especially to small systems, while lending procedures include safeguards structured to minimize unforeseen losses to the Fund. Under the DWF, 100% of eligible drinking water projects are funded with loans that are structured to be an attractive source of funding for Connecticut's water providers. To stimulate water providers to carry out essential improvements in a timely fashion, financing is offered with interest rates based on a tiered schedule of rates for DWF loans based on the State's costs of debt financing. The rate applicable for a specific project is based on the credit-worthiness, financial and legal status of the recipient. The authority to determine the rate was delegated by the State Bond Commission to the State Treasurer. All loans made to eligible drinking water projects bear an interest rate no greater than one-half of the market rate determined on the date of each State general obligation bond issue. Once a project is approved by the State Bond Commission and the rate is set at closing, it is fixed until the loan is repaid. Loans must be repaid over a period not to exceed 20 years from the completion date of the project. The State may adjust these terms based on the financial viability of the borrower. Currently, the State has not offered principal forgiveness or extended loan terms beyond 20 years.

There are several steps in the application process, as described in Appendix VI.

## **Portfolio Credit Quality**

The analysis and review of the borrower's financial condition prior to awarding a project loan is essential to the long-term viability of the Fund and is required by the state regulations.

All applicants must submit documentation as proof of their ability to repay the debt and their technical and financial management capabilities. The required documentation may include, but is not limited to, financial statements, tax returns, a current operating budget, a projected budget including the proposed debt. Most importantly, applicants must document their ability to charge rates for services and collect from their customers. Applicants may also be asked to provide information explaining the alternatives to the proposed project as well as the benefit of the project to customers.

In addition to a project-specific review including an engineering report or a feasibility study, the State reviews the capital cost repayment analysis for the project and any increases in taxes or user fees. The State also requests information on any existing or future contractual agreements.

The closed loans for the program during state fiscal year 2004 are detailed in Appendix III.

## Needs Survey

DPH ascertained the number of potential projects and estimated loan demand for the DWF. In January 1997, public water systems that responded to a DPH questionnaire provided information on 228 possible projects with a total estimated cost of \$159.3 million. Systems serving populations more than 1,000 reported projects estimated at \$141.8 million. Systems serving populations fewer than or equal to 1,000 reported projects estimated at \$17.5 million. Based on the data in both the 1995 and 1999 Needs Surveys, the State concluded that substantial demand exists among the public water systems for DWF financial assistance.

Connecticut participated in the EPA's 1999 Drinking Water Infrastructure Needs Survey. Before the study, based on the estimated projects per year previously discussed, Connecticut's total 20 year need was \$1.01 billion. Distribution (including transmission) and treatment represent the two highest categories with the former accounting for 57% of the need and the latter 23%.

The EPA 1999 Drinking Water Infrastructure Needs Survey findings were published in February 2001 and evidenced a \$340 million decrease in the need for DWF financial assistance to \$670 million.

Connecticut is participating in the latest Drinking Water Infrastructure Needs Survey begun in 2003. A different method was used and surveys were mailed to 28 randomly selected public water systems. These systems varied in size of population served and water source (ground and surface). Most of the recent respondents to the survey did so after realizing that their input may assist the state in obtaining additional funds for infrastructure improvements to its water systems. Fourteen systems answered the survey for a 50% response rate. The DPH plans to publish the results by 2005. Connecticut intends to continue funding a wide range of drinking water projects using careful consideration of a potential recipient's technical, managerial and financial capabilities.

# SET-ASIDE MANAGEMENT

The set asides are important components of the implementation of the program. The set asides give the State extensive flexibility to explore and take advantage of multiple options associated with each set aside available under the federal capitalization grant regulations.

## Set aside Status

Each year Connecticut has taken the maximum allowable set aside of 31% of each federal capitalization grant. The following descriptions include the set-aside categories, percentages of the federal capitalization grant taken and the use of the funds:

### **Administration (4%)**

These funds are used in various aspects of administering the DWF. Funds are earmarked for the Departments of Public Health (DPH), Environmental Protection (DEP) and the Treasurer's Office. Some of the duties performed are:

- Review and approve Eligibility and Full Loan Applications.
- Process Loan Agreements including loan closings.
- Review and approve project cost.
- Determine if the applicants possessed adequate financial, technical and managerial capabilities to ensure long-term compliance with applicable State and Federal regulations.
- Receive and process payment requests.
- Prepare and submit funding request to the State Bond Commission.
- Conduct inter-agency meetings on the status and ways to improve the DWF Program.
- Assist in the preparation of the Capitalization Grant and various DWF reports.
- Meet with applicants as needed.

### **Operator Certification Program – 15% Local Assistance and Other State Programs Set aside**

The Operator Certification Program (OCP) was established as a separate program within the Drinking Water Division in January 2003. At that time changes were adopted regarding Small Water System Operator qualifications. These changes were recommended during EPA's review of the DWF.

There were 932 systems eligible for Conditional Operators status in Connecticut's regulations or "grandfathering" at the time of program submittal. The OCP reviewed 659 applications for conditional operator certification and approved 569 during the application period. The OCP rejected 90 applications for reasons such as ineligibility or compliance history. The deadline for Conditional Operator applications was July 26, 2002 and no further applications are being accepted. A total of 390 systems have Conditional Operators status as of June 30, 2004.

The OCP is in the process of migrating operator certification data into the Safe Drinking Water Information System (SDWIS) and the department's licensure database. When this process is complete, the OCP will utilize these databases to perform its day to day functions.

An OCP staff person attends monthly meetings of the Connecticut Section-American Water Works Association Operator Certification Committee. This committee serves as an advisory group to the OCP and provides input on many areas including regulation development, exams, and program administration. The OCP holds meetings twice per year with trainers that review exam results and provide input on various certification issues. The OCP also receives periodic input from the Association of Boards of Certification (ABC) and the New England Water Works Association's Operator Certification Committee.

The OCP discussed changes to operator certification requirements at four meetings with the Drinking Water Advisory Council and the Small Town Drinking Water Advisory Council. These groups provided input to the Division on a number of issues but will no longer meet since funding is not available. Primary stakeholder input will be provided by the Operator Certification Committee with additional input from trainers, operators, and water systems.

Staff has presented information on Operator Certification to various industry groups such as water system owners and operators, and well drillers.

The program is continually reviewed as part of the requirements described under "Stakeholder Involvement". As a result of these reviews, three of the examinations were revised, the training approval guidance was revised, additional information was added to the operator certification web page, and the use of new ABC sequential examinations was evaluated. In addition, comments were incorporated into the draft of the Operator Certification Handbook, the revised operator certification brochure and the DPH's position on background checks for operators.

The OCP now has four full time staff persons. A new engineer position was filled to handle some of the items related to cross connection control. Although the position is open at this time, work has been submitted to refill the position. In addition, the OCP's clerical staff person was replaced by a person from within the department as part of the state layoff process. Management also plants to create a new position for a training program.

### **Wellhead Protection - 15% Set aside Funds**

These funds are designated for source water protection activities.

The amounts for each set aside and the spending to date is detailed in Appendix I.

## CONDITION OF THE FUND

The DWF provides numerous opportunities for strengthening water supply mechanisms that will ultimately result in improvements to safe and adequate supplies of drinking water for Connecticut residents. The condition of the DWF continues to be strong primarily because of its effective management and the placement of the DWF within the financial structure of the CWF. This guarantees that the DWF will benefit from the same management and financial planning mechanisms that have marked the success of the CWF program.

The DWF has been developed over the past eight years and the State has established management goals for the SRF program as part of its statewide public health initiative. The following goals are part of the Operating Agreement between the state and the federal EPA.

### Financial Goals

- Approve and disburse loans in accordance with the annual Intended Use Plan and the Project Priority list.
- Efficiently manage the use of the DWF funds and enter into project funding agreements or contracts with recipients that are consistent with the program .
- Performing annual review of DWF fiscal elements as required by EPA.

### Program Goals

- Perform technical review of DWF projects.
- Approve requests for funding from the applicants on the DWF priority list.
- Monitor projects pending oversight and contract compliance.
- Implement and maintain the DWF Standard Operating Procedures Manual.
- Draft DWF State regulations.
- Complete the annual review of DWF programmatic elements as required by EPA.

Eight years have been spent developing the program to provide Connecticut's water providers with access to funding. On-going discussions about the following issues will shape the program in the coming years:

- The amount of administrative and program set-asides allowed by the EPA and the discretion the state will exercise in the use of those dollars.
- The EPA's program guidelines and regulations and their impact on the implementation of the program at the state level.
- The Priority List of eligible projects, the amount of money available for projects and the number of potential loans.
- The assessment of needs within the State.

- The development of mechanisms to assist water providers on small projects.

## **Program Accomplishments**

Major initiatives and accomplishments during the year were primarily the result of activities in the following areas:

### **Projects and 4% Administrative Set-Aside**

Three project loans were executed for the towns of Bloomfield (Metropolitan District Commission), Farmington/Unionville (Unionville Water Company) and Watertown (Watertown Fire District) for \$4.4 million.

Nine projects were completed including New Britain Water Department's new Water Treatment Plant with a total cost of over \$50,000,000, more than 2/3 funded by DWF monies. The New Britain had its Ribbon Cutting Ceremony on July 7, 2004. The projects were completed in Bloomfield & West Hartford (Metropolitan District Commission), Farmington/Unionville (Unionville Water Company), Newtown (Newtown High School), New Britain (City of New Britain), Sharon (Sharon Sewer & Water) and Watertown (Watertown Fire District) at a total cost of almost \$35 million.

### **Small Systems Technical Assistance 2% Set-Aside**

The major emphasis of this set-aside is to provide assistance to small public water systems serving fewer than 1,000. During this reporting year, emphasis will be placed on security and emergency response for public water systems. Staff supported by this set-aside played a lead role in the four security workshops that were held statewide and produced a brochure "Is Your Public Water System Secure?". Approximately 600 individuals attended the workshops with 295 representing public water systems.

### **15% Local State Set-Aside**

#### ***Source Water Protection (SWP) Program Unit***

Since the completion of the SWP assessment reports in Connecticut on April 28, 2003, a drinking water source protection program has been developed in order to utilize assessment information to further public health protection. A letter from former DPH Commissioner Garcia dated April 29, 2003 announced the completion of the Connecticut SWP Assessments and set a future direction to move from assessment to protection. The following are accomplishments during state fiscal year 2004 consistent with the Strategic Plan:

- Developed a Drinking Water Source Protection Functional Unit (timeframe July 1, 2003 – June 30, 2004) – With the SWP assessments as the basis, a Drinking Water Source Protection Unit was originally formed in 2002. Following the completion of SWP assessment reports in April 2003, the Drinking Water Source Protection Unit reformatted its mission. The new mission was developed based upon utilization of the SWP assessment report information:

*Promote, enhance and protect public health by proactively providing source protection for all existing and future public drinking water sources of supply in Connecticut.*

- Redeveloped the budget and budget work plan. Funding for the Source Water Assessment Program ended in May 2003 with the 100 percent completion of the SWP assessment reports. Since May 1, 2003, four full time staff of the Drinking Water Division has been funded by the wellhead protection set-aside to support the implementation of drinking water source protection. This staff specifically supports the source water protection unit's implementation of the 5 year Drinking Water Source Protection Strategic Plan.
- Developed Initial 5 year Strategic Plan for Source Water Protection (SWP) (timeframe August 2003 – June 30, 2004) – A strategic plan for the movement from assessment to protection was developed. First drafted in August 2003, this plan was in a final draft form in November 2003. The action items within the plan set the course for the Source Water Protection Unit within the Drinking Water Division. This plan has been shared with all stakeholders in numerous forums and presentations across the state. Both EPA Region I and EPA Headquarters have endorsed the plan's goals and objectives. The goals and objectives are closely linked to EPA's five-year strategic planning goals for drinking water source protection. Met specifically with staff of both Region I and HQ to outline details contained within the plan. The Strategic Plan for Drinking Water Source Protection in Connecticut is posted on the DPH web site. This plan is a living document that will be continuously updated and enhanced. The plan will be updated at least on an annual basis, and will continue to guide the SWP Unit in meeting the stated goals and objectives.
- Developed and continued to enhance the Drinking Water Geographical Information System (DWGIS) (timeframe July 1, 2003 – June 30, 2004) – The Drinking Water Geographical Information System (DWGIS) was developed by the SWP Unit working with ERSI, Inc. This project started in February 2003 and was complete and available to all staff on May 1, 2003. This new GIS based system links the SWP assessments reports and GIS information into one intranet application available to the entire staff of Drinking Water Division. The DWGIS system requires direct oversight by an experienced GIS staff person on a continuous basis. Since the DWGIS was developed on a fast track, testing and debugging the system has taken place during the first few months of actual system use. A three-hour training course for staff on the use of the DWGIS was accomplished, as well as numerous one-on-one training sessions. An operations and maintenance manual has been drafted and an internal DWGIS tech group has been formed in order to keep DWGIS in optimum working condition. The manual also addresses the need for continuous maintenance of the DWGIS data layers.
- Participated on GWPC/EPA HQ Pilot Project for SWP Measures Reporting. During July 2003 through February 2004 the SWP Unit staff participated as a member of a Pilot Project for the Groundwater Protection Council and EPA Headquarters to review technical methods of electronic transfer of source water protection measures data. Connecticut was one of three states chosen specifically to work through the entire data transfer process. The SWP Unit's data transfer to EPA Headquarters was successful.
- Participated on EPA Headquarters SWP Measures Workgroup. Continue to participate as a member of the National Source Water Measures Workgroup. Initiated in the winter of 2003/2004, this group has held numerous conference calls to discuss, comment and guide EPA concerning the measurement of drinking water source protection actions and activities. This group will assist in setting the national direction on measuring the reduction of risk to public health due to source water protection actions. Provided a presentation at the Association of

State Drinking Water Administrator's winter meeting in Washington D.C. concerning Connecticut's emphasis on using the SWP assessment information and existing source water protection laws, to formulate a new program to emphasize drinking water source protection.

- Redeveloped the drinking water source protection stakeholders group. Utilizing the SWP technical and citizen advisory group members as a base, a Drinking Water Source Protection Stakeholders group was developed. Forty-five stakeholder groups have volunteered to be members, out of seventy groups initially contacted. One stakeholder group meeting was held in April 2004. At this meeting, the results of the SWP assessment reports were summarized with an outline of the 5 year strategic plan presented.
- Redeveloped the requirements of RSCA 19-13-B102(b). Reviewed thirty three land use survey reports as required to be produced under RSCA 19-13-B102(b). Initiated a new strategy to link SWP assessment reports, the new water supply plan source water protection evaluation regulations, the enforcement strategy, and violation identification. Initiated discussions with the CT Section AWWA Source Water Protection Committee concerning the need to link processes and requirements.
- Developed an enforcement initiative. Utilizing public health source protection laws that have existed since the early 1900s, the SWP Unit developed an enforcement initiative concerning the protection of drinking water quality for all sources of public drinking water. A draft on-site Notice of Violation (NOV) report was prepared for field inspection and same-day notice of violations. This on-site NOV will become part of a formal process, linking an on-site inspection to compliance with existing source water protection laws and regulations. This process will continue to develop with a formal standard operating procedure planned. Initial discussions have taken place with the necessary regulatory agencies and other stakeholders in order for the DPH to receive appropriate and timely notice.
- Presented drinking water source protection at numerous forums/meetings. Presented the new drinking water source protection mission and strategic plan concepts at numerous forums/meetings throughout state fiscal year 2004. Groups presented to include: Clean Water Action, Association of State Drinking Water Administrators, Atlantic State Rural Water Association (ASRWA) , Regional Planning Organization Executive Directors, Regional Planning Organization individual meetings, CT Section American Water Works Association, DPH Stakeholders Group, various chief elected officials, Water Utility Land Coalition Seminar, and the Pomperaug River Watershed group.
- Initiated linkages between SWP and source water protection to various stakeholder processes and regulations. Initiated discussions with numerous stakeholder groups within state and regional agencies. Including a review of the seventy DEP pesticide use permits and ongoing discussions of the existing Memorandum of Understanding for aquatic pesticide use within drinking water supplies, initial discussions with the DECD, DOA, DPS, DOT, NEMO program, Soil Conservation Service, a review of procedures concerning spill reporting and notification to DPH with DEP's UST/LUST and oil and chemical spill response programs, a review of procedures and ongoing discussions concerning the transfer of data and GIS layers between DEP and DPH, and a review and ongoing discussion with the DEP Storm Water enforcement unit in order to link actions and enforcement processes.
- Developed a program to review and provide education on SWP assessment information with ASRWA. Met with the ASRWA to discuss future collaboration on projects concerning drinking water

source protection. A program was developed that has Atlantic State Rural Water Association (ASRWA) field verifying the most highly susceptible small community bedrock well sources of supply. Also initiated a discussion concerning a possible agriculture initiative to work with the newly hired ASRWA staff to utilize the SWP assessment reports.

- Initiated an education strategy focused on local decision makers. Planned for and initiated the development of an outreach strategy to focus local decision makers on SWP areas and review potential effects of proposed development. This initiative focuses on education of local responsibilities public water supply protection local responsibilities, and state agency interaction.

Other activities and accomplishments during the reporting year included:

- Participation as a member of the NEIWPC Source Water Committee.
- Participation on an interagency advisory group coordinated by DEP concerning aquifer protection land use regulations
- Review of standard operating procedures for both water company land reviews and recreational land use permitting
- Redevelopment the SWP Unit's web site
- Participation in the review of the Interim Standard Operating Procedure for the secure transfer of DWGIS source water area data layer
- Continued development of regulations for an evaluation of drinking water source protection measures
- Initiated the development of an education strategy concerning the SWP assessment reports and drinking water source protection
- Redeveloped a standard review process for local proposed development projects
- Drafted new process for siting of proposed wells

### ***Operator Certification Program***

- Obtained approval of amendment of the Expense Reimbursement Grant (ERG, \$ 2.2+ million) for the Drinking Water Division staff to provide operator training
- Achieved 99% system compliance with operator certification requirements, with 72 systems achieving compliance as a result of formal and informal enforcement in FY 2004
- Incorporated security elements (training, background check position)
- Added many outreach items to web page (majority of the program's publicly distributed documents are available on web)
- Increased outreach work (presentations, articles, committee participation)
- Developed internal process improvements including project and task databases, mailing document center, Standard Operating Procedures (SOP) for staff, and phone call tracking spreadsheet
- Created operator renewal training course database
- Modified the training approval guidance document to strengthen training approval criteria
- Completed review for the first year of renewal applications that required training credits
- Developed a process to issue Continuing Education Units (CEUs) for Drinking Water Division courses
- Gave various presentations on certification and security at various state, regional national forums
- Developed a process to issue Continuing Education Units (CEUs) for DPH courses

The DPH and Interagency Committee continues to develop goals for all facets of the DWF program. The Interagency Committee intends to commit the remainder of the unspent federal grant funds to other current grant periods and for the leveraged bond financing program.

Generally, the Department seeks to encourage use of set-asides to promote source protection efforts integral to Connecticut's nationally recognized multiple barrier approach to protection of public supplies. Additionally, the Department plans to use these funds to foster greater appreciation of

## 2005 Program Initiatives

drinking water among the general public and the regulated community. Both of these intended uses address proactive and preventive measures endorsed by Congress in its authorization of SDWA. Major activities during the year will be focused in the following areas:

### Source Water Protection

A partial list of activities the Source Water Protection Unit will be involved in during SFY 2005 include:

- Review PWS submissions pertaining to source water protection methods, and water conservation information for compliance with the Public Health Code Section 19-13-B102(i)10(J) and CGS 25-32k.
- Continue to deliver the SWP Town Leader Books by providing periodic information and new or revised assessment reports.
- Continue to update the SWP Town Leader Books by providing periodic information and new or revised assessment reports.
- Continue to work with all stakeholders and make the necessary linkage to other programs. This would include all relevant state, regional and local agencies.
- Continue to update assessment information through linkages with individual and regional water supply plans, watershed inspection reports, outreach and partnerships with various groups, updated GIS data from the DEP, and with Consumer Confidence Reports (CCR).
- Meet with the Department of Public Safety (DPS) Division of Homeland Security to review the DPH assessment process and discuss information contained in the assessments.
- Collaborate with the DPS Division of Homeland Security to determine the level of security required for DPH source water assessment reports and sensitive GIS information.
- Working with other state agencies, develop a process to disseminate, in a secure manner, drinking water source information for legitimate purposes
- Continue to work with the public water systems concerning security of sensitive GIS information.
- Work with the DEP to gain access to and maintain critical information concerning known spills, contamination events, UIC wells, and UST's.
- Continue to represent the DPH at statewide GIS committees.

- Develop an ongoing outreach component that is geared towards local municipal planners and land-use boards that educates land use commissioners concerning local responsibilities under CGS Sections 8-2, 8-23, 8-3i, 22a-42f, and 25-32f.
- Review of water-company lands permits applications to meet statutory review deadline.
- Review and respond to annual public water system inspection reports.
- Integrate source water assessment information into individual and regional water supply plans.
- Continue to work proactively with public water systems, Connecticut Water Works Association, and the CT Section Source Water Protection and Water Conservation Committees.
- Continue to proactively work with the States of New York, Rhode Island, and Massachusetts concerning source water protection for border sources of supply.
- Continue to support the CT Section Association of Water Works Administrators water conservation committee through membership and the distribution informational materials.

### **Operator Certification Program**

Administrative funds and other set-asides will be used to :

- Convert to use of departmental licensing database and SDWIS for operator and facility data.
- Pursue security issues (application questions, background check guidance).
- Complete revision of Operator Certification Handbook.
- Add additional items to web site and assess items on CT Licensing Information Center (CLIC) site.
- Revise regulations for certification of backflow personnel, cross connection control, and operator certification items.
- Finalize procedures for disciplinary actions against certified operators.
- Administrative funds and other set-asides not obligated in any fiscal year are being reserved for future years.

### **Administrative and Other Set-Asides**

During FY2005, management will also focus on training and staff development.

Prior to requesting the disbursement of its federal funds, DPH will submit work plans to EPA detailing specifics about set-aside utilization.

## **Project Funds**

As indicated in Appendix V, there are 13 pending projects for 2005. These projects are consistent with the goals of the DWF and commitments are expected to be executed during the year.

## **Long Term Projections**

The latest Long-Term Projections of Project Funding are being reviewed. Connecticut participated in the EPA sponsored 1995 Drinking Water Infrastructure Needs Survey and is included in the EPA's federally mandated 1999 National Needs Survey. A new report is expected to be available in 2005. There are significant needs throughout the State for capital improvement financing.





# FINANCIAL STATEMENTS

## State Account (6867) - Unaudited Balance Sheet

(in thousands)	Fiscal Year Ended June 30, 2004	Fiscal Year Ended June 30, 2003
<b>ASSETS</b>		
Cash and equivalents	-	-
Interest receivable— Loans	-	-
Cost of Issuance	0	85
<b>Total assets</b>	<b>0</b>	<b>85</b>
<hr/>		
<b>FUND BALANCE:</b>		
Prior fund balance	85	103
Net Income/(Loss)	(85)	(18)
<b>Current fund balance</b>	<b>0</b>	<b>85</b>
<hr/>		
<b>Total fund balance</b>	<b>0</b>	<b>85</b>
<hr/>		

# State Account (6867)- Unaudited

## Statement of Revenue and Expenses and the Statement of Change in Fund Balance

(in thousands)	Fiscal Year Ended June 30, 2003	Fiscal Year Ended June 30, 2003
<b>REVENUE:</b>		
Interest on Loans	0	0
Interest Income	1	1
	1	1
<b>EXPENSES:</b>		
Cost of issuance expense	222	19
	222	19
Income before Operating transfers	(221)	(206)
<b>Operating transfers:</b>		
Other operating transfers	136	0
Total Operating Transfers	0	0
Net Income after Transfers:	(85)	(18)
<b>Fund Balance</b>		
Beginning of the year	85	103
End of the year	0	85

## **Notes to the Financial Statements**

These are the internally prepared statements for the State account.

The State does not provide grants for this program.

The State has not provided interest subsidy payments for the bonds issued for the benefit of this program.



# **AUDITED FINANCIAL STATEMENTS**

*STATE OF CONNECTICUT CLEAN WATER FUND -*

*DRINKING WATER FEDERAL REVOLVING*

*LOAN ACCOUNT (STATE REVOLVING FUND)*

*AUDITED FINANCIAL STATEMENTS*

**JUNE 30, 2004 AND 2003**

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The audited statements provided on the following pages have been prepared by the auditors, Seward & Monde, CPAs of North Haven, CT. for the DWSRF as of June 30, 2004. These statements are also available in a separate report dated September 17, 2004 from the auditors.



**STATE OF CONNECTICUT CLEAN WATER FUND –  
DRINKING WATER FEDERAL REVOLVING  
LOAN ACCOUNT (STATE REVOLVING FUND)  
JUNE 30, 2004 and 2003**

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**SEWARD AND MONDE**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**296 STATE STREET**  
**NORTH HAVEN, CONNECTICUT 06473**

## **INDEPENDENT AUDITORS' REPORT**

Ms. Denise L. Nappier, Treasurer  
Mr. J. Robert Galvin, M.D., Commissioner,  
Department of Public Health  
Mr. Arthur J. Rocque, Jr., Commissioner,  
Department of Environmental Protection,  
State of Connecticut

We have audited the accompanying financial statements of the State of Connecticut Clean Water Fund – Drinking Water Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut) as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the SRF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Clean Water Fund - Drinking Water Federal Revolving Loan Account and do not purport to, and do not, present fairly the financial statements of the State of Connecticut, as of June 30, 2004 and 2003, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of Connecticut Clean Water Fund – Drinking Water Federal Revolving Loan Account - SRF as of June 30, 2004 and 2003, and the changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 3, 2004 on our consideration of the State of Connecticut Clean Water Fund – Drinking Water Federal Revolving Loan Account - SRF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

### **Seward and Monde**

North Haven, Connecticut

September 3, 2004

overview and analysis of the activities of the State of Connecticut Drinking Water Fund for the fiscal year ended June 30, 2004. We encourage readers to rutsanding and a more than double amount of loans where repayments have begun and interest income from loans growing by 30.7%. The reduction in operating losses was also the result of lower legal and other costs.

STATE OF CONNECTICUT  
OFFICE OF THE TREASURER  
STATE OF CONNECTICUT  
DRINKING WATER FUND  
FISCAL YEAR ENDED JUNE 30, 2004

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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Management of the State of Connecticut Drinking Water Fund in the Office of the Treasurer provides this *Management's Discussion and Analysis* of the Drinking Water Fund. This is a narrative overview and analysis of the activities of the State of Connecticut Drinking Water Fund for the fiscal year ended June 30, 2004. We encourage readers to read it in conjunction with the Fund's financial statements that follow.

The Drinking Water Fund will implement Governmental Accounting Standards Board (GASB) Statement No. 40 as required during the fiscal year ending June 30, 2005.

## Financial Highlights

*Changes in Net Assets* - The Fund net assets at the end of the year were \$57,979,060 (including assets of \$112,862,336 and liabilities of \$54,883,276) compared to \$61,278,617 (including assets of \$92,125,431 and liabilities of \$30,846,814) in fiscal year 2003. The Fund net assets decreased by \$3,299,557 or 5.4% reflecting the issuance of bonds, the proceeds of which were used to fund additional loans and the use of cash to defease a portion of the outstanding bonds. The statements also show \$45,079,533 in restricted fund net assets which is \$6,436,605 or 16.7% above the 2003 balance.

*Net Operating Loss* - The Fund's operating loss decreased 71.3% or \$723,462 to \$291,638 due to a 24.4% increase in loans outstanding and a more than double amount of loans where repayments have begun and interest income from loans growing by 30.7%. The reduction in operating losses was also the result of lower legal and other costs.

*Statement of Cash Flows* - The Statement of Cash Flows shows a negative change in cash for the year of \$921,299.

*Debt Outstanding* - The Fund's total debt significantly increased to \$51.1 million from \$29.6 million due primarily to the issuance of bonds. Principal payments of \$1,332,487 came due during the year.

*Loans Receivable* - Total loans receivable increased by \$10,401,147 from \$42,594,323 to \$52,995,470 as the Fund financed its loans with revenue bond proceeds and cash from the federal capitalization grants.

*Capitalization Grants* - During the year, drawdowns were \$5,898,420 compared to \$16,139,486 in fiscal year 2003 as capitalization grants were drawn from the EPA to support the funding of drinking water projects. The Department of Public Health is in the process of applying for the 2004 grant. At June 30, 2004, \$44,758,031 of \$67,596,000 in cumulative federal drinking water capitalization grant awards have been drawn.

## Overview of the Financial Statements

The Drinking Water Fund financial statements are reported by the Office of the Treasurer in conjunction with the Department of Public Health (DPH) and the Department of Environmental Protection (DEP). The Treasurer is accountable for the detailed financial information of the Fund.

The Drinking Water Fund is part of the Clean Water Fund Revenue Bond Program which is an AAA/Aaa/AAA rated (Standard & Poor's/Moody's Investors Service/FITCH, respectively) enterprise fund. The Drinking Water Fund within the Clean Water Fund is included in the activities of the State of Connecticut's Fund Financial Statements. In the State of Connecticut, a fund is a fiscal and accounting entity with a self-balancing set of accounts that the State of Connecticut uses to keep track of specific sources of funding and spending for a particular purpose. The Fund Financial Statements report additional and detailed information about the activities of the Fund (rather than the State as a whole which can be found in the State's Government-wide Financial Statements). The primary focus of these statements is to ensure and demonstrate compliance with finance related laws and regulations and are presented by the State of Connecticut in three categories, Governmental Funds, Proprietary Funds, and Fiduciary Funds.

Proprietary Funds focus on the determination of the change in fund net assets, financial position, and cash flows for governmental activities that operate similar to a commercial enterprise. Proprietary funds use the accrual basis of accounting. The statements consist of enterprise funds, one of which is the State of Connecticut Clean Water Fund including the Drinking Water Fund, and internal service funds.

The Balance Sheets, Statements of Revenues, Expenses and Changes in Fund Net Assets, and Statements of Cash Flows provide information about the activities of the Fund as a whole and present a longer-term view of the Fund's finances.

The Balance Sheets include all the assets and liabilities of the Fund using the accrual basis of accounting. There have been no significant changes in our processes, procedures, and recognition of revenue and expenses and valuation of assets because of our compliance with GASB 34.

Fund Net Assets of the Drinking Water Fund are categorized as follows:

Restricted - include net assets that have been restricted in use in accordance with the terms of an award, agreement or by State law.

Unrestricted - include all net assets not restricted and available for any program purpose.

In the Statements of Revenues, Expenses and Changes in Fund Net Assets we divide the activity of the Fund into two categories: 1. Operating Activities, including the Drinking Water Loan Program; and 2. Nonoperating Activities, including Investment of the Funds and the Revenue Bond Program. For the Drinking Water Loan Program activities, these statements tell how the loans were financed in the short term as well as what remains for future spending. For the investment of the Funds, these statements tell how interest income is generated and describe the long term structure of our investments. For the Revenue Bond Program activities, these statements tell how the bonds were paid in the short term as well as what remains to be repaid in the future. Fund financial statements also provide information about activities of the Fund as a recipient of federal capitalization grants. Where necessary, interest income and expenses may be allocated between the Clean Water Fund and the Drinking Water Fund.

## Operating Activities

## The Drinking Water Loan Program

Loans are for project funding and consist of construction loans or interim funding obligations (IFOs) which accrue interest during construction and the long-term permanent financing obligations (PLOs) which are signed after the projects are completed. The PLOs have 20 year repayment terms and can be prepaid at any time. There are no state grants available to participants in this program.

Construction loans in progress totaled \$65,242 representing a decrease of \$21,561,536 from 2003 primarily due to cyclical fluctuations in project starts as fewer projects were started during the year. Completed projects totaled \$52,930,228 which was \$31,962,683 higher than in 2003. There are no delinquent loans in the Drinking Water Loan Program. Further detail about the loans can be found in the notes to the financial statements.

## Loan Service

The Fund is provided loan servicing by the Trustee. Repayments on all loans made by the DPH and DEP since 1998 are paid to the State through US Bank.

## Non-Operating Activities

### Investment of Funds

The federal capitalization grants and State matching funds are used to provide leveraged financing for eligible projects in the State and to provide reserves as a source of payment for the senior debt obligations issued to fund Loans under the SRF Programs. Federal capitalization grants used to meet the Debt Service Reserve Fund Requirement are held by the Trustee in the form of either (a) cash or (b) permitted investments. State Contributions used to meet the Debt Service Reserve Fund Requirement are held by the Trustee in the form of (a) cash or (b) permitted investments that may include State general obligation bonds.

The State currently invests a significant portion of the funds and accounts created under the General Bond Resolution in investment agreements with financial institutions. The investment agreements are with, or guaranteed by, institutions with ratings at least equal to the rating on the Bonds given by Standard & Poor's and Moody's Investors Service. Certain monies currently held in the Debt Service Reserve Fund are invested pursuant to investment agreements, collateralized with securities issued or guaranteed by the U.S. Government or agencies or instrumentalities thereof whose market value is at least 100% of the funds invested. Such agreements are subject to early termination upon certain events. In addition, such agreements may be subject to certain other risks, including the bankruptcy or insolvency of the party with which such funds have been invested under such agreements or which has guaranteed such agreements.

## The Bond Program

Long-term debt obligations of the Fund consist of special obligations of the State which are payable from the revenues or monies pledged to the Fund as provided in the Indenture and the State Act. Further detail about outstanding bonds can be found in the notes to the financial statements.

2004 Advisors are:

Bond Counsel- Nixon Peabody LLP and Hardwick Law Firm

Financial Advisors- Lamont Financial Service and P.G Corbin

General Counsel – Attorney General of the State of Connecticut

Auditor- Seward & Monde

## Description of Program Bonds

The Connecticut Clean Water Fund, like other state revolving funds (SRFs), has issued bonds backed by the pledge of specific assets including loans, reserve funds and other program assets. While these credits have been increasingly well received in the market and several, including Connecticut, have AAA ratings, the pledge of specific assets results in millions of dollars of lost earnings on the program's large reserve funds.

During the fiscal year 2004, the State of Connecticut Clean Water Fund issued \$355,245,000 State Revolving Fund General Revenue Bonds. The offering brought the total amount of bonds sold by the program during its 16 year history to \$870,000,000. With its largest bond sale ever the Connecticut SRF Programs restructured the credit, and surpassed the \$1.5 billion mark in total project funding, while achieving the lowest interest rates ever obtained for its bonding program.

The following is a description of the new general revenue bonds and the benefits to the State and the program with the implementation of the General Revenue Bond structure.

The State issued the bonds in three series. The first series had a true interest cost of 3.06639% and consisted of bonds to fund \$125,000,000 of new wastewater and drinking water projects. The State allocated the proceeds between the Drinking Water Fund and the Clean Water Fund with \$33,063,800 allocated to the Drinking Water Fund and \$85,021,200 allocated to the Clean Water Fund. There were two series of refunding bonds with \$115,785,000 of the refunding bonds issued as traditional fixed rate bonds, and \$121,375,000 of the refunding bonds issued as auction rate bonds. The refunding portion of the transaction achieved present value savings of \$13.7 million, or 5.03% of refunded bond par. The State allocated \$7,572,339 of the fixed rate Refunding Bonds to the Drinking Water Fund. The refunding bonds issued as auction rate bonds were only allocated to the Clean Water Fund. The Clean Water Fund used innovative strategies to achieve these results.

The General Revenue Bonds are secured by the contractual obligation of the Clean and Drinking Water Funds to use any available monies in the SRF to pay the bonds, rather than being secured by pledged assets. This means that the General Revenue Bond structure differs significantly from the previous SRF structure because most program assets remain unencumbered. Based in large part on the demonstrated success of the Clean and Drinking Water Funds' management and the Fund's significant assets, the General Revenue Bonds achieved the highest possible ratings, Aaa/AAA/AAA by Moody's Investors Service, Standard and Poor's Ratings Services, and Fitch, Inc., respectively. In essence, the creditworthiness of the General Revenue Bonds is based on the federal and state requirements governing the SRF program, its significant assets and on the quality of the Clean and Drinking Water Funds' management. This marked the 5th time that the Bonds achieved this highest possible rating.

Since the only restrictions on the use of the unencumbered assets are the federal and state requirements governing the SRF program, the Clean and Drinking Water Funds will have greatly enhanced flexibility to improve, modify and expand the program in the future. The Funds also retain the investment returns on investments created since the beginning of the program on most of its program equity. As a result, the debt service savings realized from the financing and the additional earnings that can be retained by the Clean and Drinking Water Funds under the General Revenue Bond approach will help to make the Funds more independent and to reduce the need for additional contributions from the State in the future.

It is no small detail that the Funds' accounting requirements are dramatically simplified under the new approach and will become more straightforward as the senior and subordinate bonds are repaid. This will enable greater focus on making more diverse financing structures available to the borrowers, the implementation of a guarantee program to reduce the administrative burden on small water providers, further incentive to establish loan only program with favorable rates for projects initiated by the municipalities and more automation in our project management, accounting, loan servicing and loan portfolio management processes. Furthermore, these and other advancement can be achieved without an additional burden on the State.

## SUMMARIZED FINANCIAL STATEMENTS

	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease)</u>
<b>Operating Revenues</b>	\$ 1,216,304	\$ 930,839	\$ 285,465
<b>Federal Capitalization Grants</b>	5,898,420	16,139,486	( 10,241,066)
<b>Interest on Investments</b>	1,631,325	1,818,158	( 186,833)
<b>Operating Expenses</b>	1,507,942	1,945,939	( 437,997)
<b>Interest Expense</b>	1,906,285	1,398,371	507,914
<b>Change in Fund Net Assets</b>	( 3,299,557)	22,425,056	( 25,724,613)

### *ECONOMIC CONDITIONS AND OUTLOOK*

Fiscal year 2004 began with economic indicators reflecting mixed results. While Connecticut has not been immune to fluctuations in economic conditions during the year, generally the State has experienced some improvements in income levels despite the impact from job losses primarily due to the modest recovery from the economic recession. Further adjustments in the economy reflected both domestic and international events. The cost of war, market volatility, high costs of fuel and medical care, lack of security and job losses have all contributed to low consumer confidence.

The major impact of the economic outlook continues to be the possible reduction in state support for the program and slow-down in the initiation of drinking water projects. The SRF Programs have implemented a new financing structure in order to maximize the use of state funding and meet the water quality needs of the State. The Fund will continue to monitor planning activities and will assist municipalities in determining the most effective and cost efficient ways to meet their water quality needs. In addition, DPH is continuing to be proactive in identifying needs, setting priorities and working with municipalities to plan compliance with federal water quality laws.

### *REQUIRED SUPPLEMENTARY INFORMATION*

The Drinking Water Fund does not separately report required supplementary information that contains budgetary comparison schedules, or schedules presenting infrastructure assets, and required supplementary pension fund information. This information is recorded by the State of Connecticut and as such, compliance with GASB Statement 34 is not applicable.

Following the financial statements, the Notes to the Financial Statements provide additional supplementary information that further explains and supports the information in the financial statements. The Notes provide additional information that is essential to a full understanding of the data provided in the Drinking Water Fund's financial statements.

~~CONTACTING THE DRINKING WATER FUND FINANCIAL~~  
**STATE OF CONNECTICUT - CLEAN WATER FUND -**  
**DRINKING WATER FEDERAL REVOLVING LOAN ACCOUNT**  
*ADMINISTRATOR IN THE OFFICE OF THE TREASURER*  
**(STATE REVOLVING FUND)**  
**BALANCE SHEETS**  
**June 30, 2004 and 2003**

	2004	2003
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 223,554	\$ 1,144,853
Interest receivable - investments	330,100	282,709
Interest receivable - loans	105,864	364,691
Grant receivable	449,850	-
Loans receivable	3,773,468	22,724,735
Total current assets	4,882,836	24,516,988
Noncurrent assets:		
Loans receivable	49,222,002	19,869,588
Revolving fund	12,839,336	-
Deferred loss on early retirement of bonds	967,769	-
Restricted assets:		
Loan fund	13,486,329	-
Debt service reserve fund	22,802,940	23,609,209
Debt service fund	2,987,693	24,129,646
Support fund	5,673,431	-
Total restricted assets	44,950,393	47,738,855
Total noncurrent assets	107,979,500	67,608,443
Total assets	\$ 112,862,336	\$ 92,125,431
<b>LIABILITIES</b>		
Current liabilities:		
Interest payable on revenue bonds	\$ 521,764	\$ 349,593
Revenue bonds payable	1,226,051	1,199,397
Refunding bonds payable	286,779	-
Deferred grant revenue	-	437,170
Total current liabilities	2,034,594	1,986,160
Noncurrent liabilities:		
Premium on revenue bonds	3,277,113	445,304
Revenue bonds payable	42,419,098	28,415,350
Refunding bonds payable	7,152,471	-
Total noncurrent liabilities	52,848,682	28,860,654
Total liabilities	54,883,276	30,846,814
<b>FUND NET ASSETS</b>		
Unrestricted	12,899,527	22,635,689
Restricted for loans	45,079,533	38,642,928
Total fund net assets	57,979,060	61,278,617
Total liabilities and fund net assets	\$ 112,862,336	\$ 92,125,431

See notes to financial statements.

**STATE OF CONNECTICUT CLEAN WATER FUND -  
DRINKING WATER FEDERAL REVOLVING LOAN ACCOUNT  
(STATE REVOLVING FUND)**

This financial report is designed to provide a general overview of the Drinking Water Fund's finances. Questions about this report or requests for additional information should be addressed to:

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS  
For the years ended June 30, 2004 and 2003**

	<u>2004</u>	<u>2003</u>
<b>OPERATING REVENUES</b>		
Interest on loans	\$ 1,216,304	\$ 930,839
<b>OPERATING EXPENSES</b>		
Salaries	966,461	846,838
Employee benefits	433,056	340,514
Other	108,425	758,587
Total operating expenses	<u>1,507,942</u>	<u>1,945,939</u>
Operating loss	<u>( 291,638)</u>	<u>( 1,015,100)</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Interest on investments	1,631,325	1,818,158
Amortization of bond premium	460,458	23,033
Interest expense	<u>( 1,906,285)</u>	<u>( 1,398,371)</u>
Total nonoperating revenues (expenses)	<u>185,498</u>	<u>442,820</u>
Income (loss) before federal capitalization grants and transfers	<u>( 106,140)</u>	<u>( 572,280)</u>
<b>FEDERAL CAPITALIZATION GRANTS</b>		
Project funds	4,040,617	13,731,753
Set-aside activities	<u>1,857,803</u>	<u>2,407,733</u>
Total federal capitalization grants	<u>5,898,420</u>	<u>16,139,486</u>
<b>OPERATING TRANSFERS</b>	<u>( 9,091,837)</u>	<u>6,857,850</u>
Change in fund net assets	<u>( 3,299,557)</u>	<u>22,425,056</u>
<b>FUND NET ASSETS, beginning</b>	<u>61,278,617</u>	<u>38,853,561</u>
<b>FUND NET ASSETS, ending</b>	<u>\$ 57,979,060</u>	<u>\$ 61,278,617</u>

See notes to financial statements.

**STATE OF CONNECTICUT CLEAN WATER FUND -  
 DRINKING WATER FEDERAL REVOLVING LOAN ACCOUNT  
 (STATE REVOLVING FUND)  
 STATEMENTS OF CASH FLOWS  
 For the years ended June 30, 2004 and 2003**

	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Interest received on loans	\$ 1,370,031	\$ 854,084
Loan originations	( 11,607,632)	( 17,328,022)
Principal paid on loans receivable	1,311,585	1,488,373
Payments to employees	( 1,399,517)	( 1,187,352)
Other payments	( 108,425)	( 758,587)
Net cash used by operating activities	( 10,433,958)	( 16,931,504)
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Federal capitalization grants	5,011,400	16,482,847
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Repayment of revenue bonds payable	( 1,199,398)	-
Repayment of refunding bonds payable	( 133,089)	-
Proceeds from revenue bonds payable	33,063,800	-
Proceeds from refunding bonds payable	7,572,339	-
Premium received on revenue and refunding bonds	3,292,267	-
Payment to refunded revenue bond escrow agent	( 18,879,694)	-
Interest paid on revenue bonds	( 1,656,189)	( 1,398,371)
Operating transfers	( 9,091,837)	6,844,347
Net cash provided by noncapital financing activities	12,968,199	5,445,976
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest received on investments	1,583,934	2,893,465
Increase in revolving fund	( 12,839,336)	-
(Increase) decrease in restricted assets	2,788,462	( 6,805,037)
Net cash used by investing activities	( 8,466,940)	( 3,911,572)
Net increase (decrease) in cash and cash equivalents	( 921,299)	1,085,747
<b>CASH AND CASH EQUIVALENTS</b> , beginning	1,144,853	59,106
<b>CASH AND CASH EQUIVALENTS</b> , ending	\$ 223,554	\$ 1,144,853
<b>RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES</b>		
Operating loss	(\$ 291,638)	(\$ 1,015,100)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Changes in assets and liabilities:		
(Increase) decrease in interest receivable - loans	258,827	( 76,755)
Increase in loans receivable	( 10,401,147)	( 15,839,649)
Net cash used by operating activities	(\$ 10,433,958)	(\$ 16,931,504)

See notes to financial statements.

Hartford, CT 06106-1773  
Telephone (860) 702-3134  
[www.state.ct.us/ott](http://www.state.ct.us/ott)

Questions about the Drinking Water Fund and water quality in Connecticut should be addressed to:

Connecticut Department of Public Health  
450 Capitol Avenue  
Hartford, CT 06106  
Telephone (860) 509-7333  
[www.state.ct.us/dph](http://www.state.ct.us/dph)

## **1 - NATURE OF ORGANIZATION**

The State of Connecticut Clean Water Fund - Drinking Water Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut), established in 1998 pursuant to Connecticut General Statutes Section 22a-475 to 22a-483, provides assistance to the public water systems in Connecticut to finance the costs of infrastructure needed to achieve or maintain compliance with the Safe Drinking Water Act (SDWA). The SRF is funded through revenue bonds and federal grants as established under the SDWA, which requires the State of Connecticut (State) to match federal funds to the extent of 20% of federal funds received.

## **2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies of the SRF conform to U.S. generally accepted accounting principles as applicable to government enterprises. The following is a summary of the SRF's significant accounting policies:

### Basis of Accounting

The financial statements are prepared using the accrual basis of accounting and the flow of economic resources as specified by the Governmental Accounting Standards Board's (GASB) requirements for an enterprise fund. Under GASB Statement No. 20, *Accounting and Reporting for Proprietary funds and other Governmental Entities that Use Proprietary Fund Accounting*, the SRF has elected to apply all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements.

### Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

### Operating and Nonoperating Revenues and Expenses

The SRF's principal operation consists of making low interest loans to public water systems in Connecticut. Operat-

ing revenue consists of interest earned on those loans. Operating expenses consist of personnel and other expenses incurred in the initial approval, disbursement and ongoing servicing of those loans through maturity.

Nonoperating revenues include interest earned on investments and nonoperating expenses include interest expense on revenue and refunding bonds.

#### Revenue Recognition

Federal capitalization grants are reported as nonoperating revenue and are recognized as federal funds are loaned to public water systems and as the SRF expenditures for administration are made.

#### Cash and Cash Equivalents

For purposes of the statements of cash flows, the SRF considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. However, the SRF's policy is to exclude restricted assets from cash and cash equivalents for purposes of the statements of cash flows due to the limitations imposed on their use by the Clean Water Fund Revenue Bond Program General Bond Resolutions, adopted by the State Bond Commission on December 15, 2000 as amended and supplemented and on December 17, 2002 (collectively, the "Resolution"). The SRF had no cash equivalents as of June 30, 2003 and 2002, except as reflected in Note 6.

#### Investments

The SRF's policy is to present all investments at fair value except for money market investments and investment contracts, which the SRF has elected to report at amortized cost. The fair value of investments traded on public markets is determined using quoted market prices. The fair value of state general obligation bonds, which are not traded on a public market, is estimated using matrix pricing. The cost of the state general obligation bonds approximates their estimated fair value.

There were no material investment gains or losses for the years ended June 30, 2004 and 2003.

#### Loans, Allowance for Loan Losses and Credit Risk

The SRF makes loans to public water systems in the State of Connecticut to finance the costs of infrastructure needed to achieve or maintain compliance with the SDWA. Interest rates on the loans range from 2.1% to 4.68% and interest income is recognized as it is earned. The loans are secured by the full faith and credit or revenue pledges of the public water systems, or both. No allowance for loan losses is considered necessary based on management's evaluation of the collectibility of the loans. The evaluation takes into consideration such factors as changes in the size of the public water system loans, overall quality, review of specific problem loans, and current economic conditions and trends that may affect the borrowers' ability to pay.

#### Restricted Assets

Restricted assets consist of investments, which are segregated into funds and accounts in accordance with the Resolution as previously described plus amounts determined to be prudent by management. The Resolution restricts investments to: a) the State Treasurer's Short-Term Investment Fund, b) Tax Exempt Proceeds Fund of the State, c) interest bearing time deposits held by the trustee, a member bank of the Federal Reserve System, or a bank which is insured by the Federal Deposit Insurance Corporation and d) Investment Obligations as defined in the Resolution.

#### Bond Premiums/Deferred Loss

The premiums on the revenue bonds are being amortized over the term of the bonds on a straight-line basis, which yields results equivalent to the interest method. The deferred loss on early retirement of bonds (Note 8) is being

amortized using the outstanding bond method, which yields results equivalent to the interest method.

Revenue Bonds

The following funds and accounts have been established in accordance with the Resolution adopted December 15, 2000:

<u>Fund / Account</u>	<u>Description and Use</u>
Revenue Fund	Receives all pledged receipts including loan repayments from the municipalities.
a. Pledged Receipts Account	Out-flows include amounts transferred to the interest and principal accounts of the debt service fund for payment of current debt service.
b. Earnings Account	Receives all earnings on funds and investments in all funds and accounts. Out-flows include amounts transferred to the interest and principal accounts of the debt service fund for payment of current debt service.
Loan Fund	Received proceeds from the sale of revenue bonds as specified and determined by the Resolution. Funds expended for purposes of the State Revolving Fund program, including the financing of loans to municipalities.
Debt Service Reserve Fund	Required to be funded in an amount equal to 50% of all outstanding bonds. The reserve is funded by federal capitalization grant payments drawn under the federal letter of credit and state general obligation bonds. Investment income is transferred to the revenue fund for debt service payments. Used for payment of principal and interest in the event of deficiencies in the revenue accounts.
Debt Service Fund	Receives amounts from the revenue fund accounts sufficient to pay the interest
a. Interest Account	portion due on each interest payment date. Pays interest on outstanding bonds.
b. Principal Account	Receives amounts from the revenue fund accounts sufficient to pay the principal or current sinking fund installments. Pays principal on outstanding bonds.
c. Redemption Account	Receives amounts from the interest and principal accounts for the redemption of bonds. Used for redemption of bonds.
d. Capitalized Interest Account	Receives any capitalized interest received by the trustee. Amounts in the account are transferred for payment of capitalized interest on outstanding bonds.

- |                                 |   |
|---------------------------------|---|
| e. Interest Subsidy Fund        | Established outside of the state revolving fund, principal and investment income is transferred to the revenue fund, then to the debt service fund for payment of debt service. Provides payment of principal and interest in the event of a deficiency in the debt service reserve fund. |
| f. Administrative Fund: Cost of | Established outside the SRF, receives a portion of the revenue bond proceeds.   |
| g. Issuance Account             | Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds.   |
| h. Rebate Fund                  | Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required.   |

The following funds and accounts have been established in accordance with the Resolution adopted December 17, 2002:

Fund/Account	Description and Use
Revolving Fund	The Revolving Fund from which the Bonds are repaid consists of amounts in the water pollution control federal revolving loan account and drinking water federal revolving loan account. The State will maintain the Revolving Fund in accordance with the Federal Act.
Loan Fund	Received proceeds from the sale of revenue bonds as specified and determined by the Resolution. Funds expended for purposes of financing loans to borrowers under the State Revolving Fund program and if other monies are not available, payment of principal and interest on bonds.
Debt Service Fund	Receives amount from the Revolving Fund, Support Fund and Loan Fund sufficient to pay the debt service on the bonds. Pays principal and interest on outstanding bonds.
Support Fund	The Support Fund, and accounts therein, shall be funded in the amounts and in the manner set forth in a Supplemental Resolution. Monies in the Support Fund shall be transferred to the Debt Service Fund to pay the interest, principal and Sinking Fund Installments and Redemption Price due on bonds, in accordance with the schedule set forth in the applicable Supplemental Resolution.
Administrative Fund: Cost of Issuance Account	Established outside the SRF, receives a portion of the revenue bonds proceeds. Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds.
Rebate Fund	Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required.

#### Fund Net Assets – Restricted for Loans

The fund net assets reserved for loans represents amounts accumulated from federal drawdowns, less set-aside activity expenses not exceeding 31% of the federal grant, transfers from the State representing the 20% match on federal funds and interest earned on public water system loans.

#### Reclassifications

Certain 2003 amounts have been reclassified to conform to the 2004 presentation.

### **3 - CASH DEPOSITS AND INVESTMENTS**

Governmental Accounting Standards Board Statement No. 3 requires governmental entities to categorize their cash deposits and investments into three levels of risk. Category 1 includes amounts which are insured or registered in the SRF's name or its agent in the SRF's name. Category 2 includes amounts which are uninsured or unregistered for which collateral or securities are held by a counterparty's trust department or agent in the name of the SRF. Category 3 includes amounts in which the deposits or securities are uninsured or unregistered for which collateral or securities are held by the counterparty or its trust department, but not in the name of the SRF.

#### Cash Deposits

For purposes of this disclosure, cash deposits include cash held by the State Comptroller and money market funds which are included in restricted assets. As of June 30, 2004 the institution balance was \$16,690,066 and the carrying amount of the SRF's deposits total \$16,697,576, of which \$16,474,022 is included in restricted assets. For purposes of GASB No. 3, the SRF's deposits of \$16,690,066 are considered Category 1, registered in the SRF's name. As of June 30, 2003 both the insti-

tution balance and carrying amount of the SRF's deposits total \$25,278,566, of which \$24,133,713 is included in restricted assets. For purposes of GASB No. 3, the SRF's deposits of \$25,278,566 are considered Category 1, registered in the SRF's name.

Investments

Investments consist of State General Obligation Bonds and various investment contracts which for purposes of GASB No. 3 are considered Category 1, registered in the SRF's name.

**4 - LOANS RECEIVABLE**

The SRF loans funds to qualified public water systems. Principal and interest payments on loans are payable over a 20 year period in equal monthly installments commencing one month after the scheduled completion date, or in a single annual installment representing the first year's principal and interest not later than one year after the scheduled completion date and thereafter in monthly installments. Loans receivable by type are as follows as of June 30:

	<u>2004</u>	<u>2003</u>
Construction in process	\$ 65,242	\$ 21,626,778
Completed projects	<u>52,930,228</u>	<u>20,967,545</u>
	<u>\$ 52,995,470</u>	<u>\$ 42,594,323</u>

Aggregate maturities of loans receivable in subsequent years for completed projects are as follows:

<u>Year ending June 30</u>	
2005	\$ 3,572,122
2006	2,769,988
2007	2,785,229
2008	2,800,941
2009	2,817,140
Thereafter	<u>38,184,808</u>
	<u>\$ 52,930,228</u>

**5 - FEDERAL LETTER OF CREDIT**

The following represents a summary of the funds available under the U.S. Environmental Protection Agency's letter of credit as of June 30:

	<u>2004</u>	<u>2003</u>
Awarded	\$ 67,596,000	\$ 59,591,900
Requested	<u>44,758,031</u>	<u>38,811,901</u>
Available federal letter of credit	<u>\$ 22,837,969</u>	<u>\$ 20,779,999</u>

## **6 - RESTRICTED ASSETS**

Restricted assets as of June 30 are comprised of the following:

	<u>2004</u>	<u>2003</u>
Cash equivalents:		
Money market funds	\$ 16,474,022	\$ 24,133,713
Investments:		
Investment Contracts	18,498,824	13,206,446
State General Obligation Bonds	<u>9,977,547</u>	<u>10,398,696</u>
	<u>\$ 44,950,393</u>	<u>\$ 47,738,855</u>

## **7 - RELATED PARTY TRANSACTIONS**

The SRF is one fund of many within the State of Connecticut financial reporting structure and as a result, certain transactions including operating transfers, loans receivable and allocation of expenses among funds are under the direction of management.

### Allocation of Expenditures

Fringe benefit costs which are incurred at the State level are applied as a percentage of salaries to all State governmental units, including the SRF. For the years ended June 30, 2004 and 2003, the basic rates were 45.82% and 40.21%, respectively, of the SRF wages and the amounts charged aggregated \$433,056 and \$340,514, respectively.

### Investments

The SRF holds State General Obligation Bonds as presented in Note 6.

## **8 - BONDS PAYABLE**

A summary of changes in bonds payable during the year ended June 30, 2004 is as follows:

	<u>Balance June 30, 2003</u>	<u>Additional Borrowings</u>	<u>Principal Paydown</u>	<u>Advance Refunding</u>	<u>Balance June 30, 2004</u>
Revenue bonds payable	\$ 29,614,747	\$ 33,063,800	\$ 1,199,398	\$17,834,000	\$ 43,645,149
Refunding bonds payable	<u>-</u>	<u>7,572,339</u>	<u>133,089</u>	<u>-</u>	<u>7,439,250</u>
	<u>\$ 29,614,747</u>	<u>\$ 40,636,139</u>	<u>\$ 1,332,487</u>	<u>\$17,834,000</u>	<u>\$51,084,399</u>

### Revenue Bonds

The State of Connecticut issued Clean Water Fund, Revenue Bonds 2001 series, dated May 24, 2001. The proceeds of these bonds are to be used to provide funds to make loans to Connecticut municipalities and public water systems, for use in connection with the financing or refinancing of waste water and drinking water treatment projects. These bonds are payable solely from funds pledged pursuant to the General Bond Resolution adopted December 15, 2000. In accordance with the State Clean Water Fund Revenue Bonds, 2001 Series Plan of Finance, the State allocated the proceeds between the SRF and the State of Connecticut Clean Water Fund - State Revolving Fund ("Clean Water Fund") (collectively, "The Obligated Group") with \$29,614,747 allocated to the SRF and \$70,385,253 allocated to the Clean Water Fund. The Clean Water Fund (an enterprise fund of the State of Connecticut) was also established pursuant to Connecticut General Statutes Section 22a-475 to 22a-483, and provides assistance to municipalities and public water systems of Connecticut for the planning, design and construction of water quality projects. Debt service on the 2001 series bonds is to be paid from pledged receipts, earnings on investments held in the debt service reserve funds and maturing principal and interest on investments held in the interest subsidy funds. "Pledged receipts" means payments of principal and interest on municipal obligations, including both timely and delinquent payments with late charges, if any, and includes any fees and charges, fines and penalties collected or held by the State. Pledged receipts include the repayments of loans made by the Obligated Group, including all loans previously funded as well as future loans. Although amounts attributable to the Obligated Group will be tracked separately for federal reporting purposes, all pledged receipts will secure all bonds of the Clean Water Fund Revenue Bond Program. The SDWA and the initial Resolution permit the pledging of assets of both the SRF and the Clean Water Fund SRF to secure these revenue bonds.

The State of Connecticut issued Clean Water Fund Revenue Bonds 2003 series dated July 10, 2003. In accordance with the State Clean Water Fund Revenue Bonds, 2003 Series Plan of Finance, the State allocated the proceeds of 2003 series between the SRF and the Clean Water Fund with \$33,063,800 allocated to the SRF and \$85,021,200 allocated to the Clean Water Fund. Debt service on the 2003 series bonds is to be paid from any available monies in the SRF and the Clean Water Fund. The State has pledged amounts in the loan fund, the support fund and the debt service fund pursuant to the General Bond Resolution dated December 17, 2002.

The SRF's revenue bonds payable are serial bonds, of which \$43,645,149 and \$29,614,747 was outstanding as of June 30, 2004 and 2003, respectively. The serial bonds mature on October 1, 2022 with interest rates ranging from 2.0% to 5.0%.

### Refunding Bonds - 2003 Series

On July 10, 2003 the State of Connecticut issued \$115,785,000 of Clean Water Fund Refunding Bonds, 2003 Series B with interest rates of 2.0% to 5.9% to advance refund Clean Water Fund 2001 Series Revenue Bonds (Refunded Bonds) with a principal balance totaling \$17,834,000 and interest rates of 4.0% to 5.5%. The State allocated \$7,572,339 of the 2003 Series B Refunding Bonds to the SRF. The Refunded Bonds were to mature at various dates through October 1, 2022.

The net proceeds of the 2003 Series B Refunding Bonds of \$18,879,694 were used to purchase U.S. Government securities and those securities were placed in an irrevocable trust with an escrow agent to provide debt service payments until the Refunded Bonds are called on various dates through October 1, 2011. The advance refunding met the requirements of an in-substance defeasance and, accordingly, the Refunded Bonds with a principal balance of \$17,834,000 were removed from the SRF's balance sheet. As of June 30, 2004, the outstanding principal balance of the Refunded Bonds was \$17,834,000.

The difference of \$1,045,694 between the book value of the Refunded Bonds and the amount deposited to the irrevocable trust to fund their debt service represents a loss which has been deferred and is being recognized as an adjustment of interest expense

over the life of the 2003 Series B Refunding Bonds using the outstanding bond method. Amortization of the deferred loss for the year ended June 30, 2004 totaled \$77,925.

Bond Maturities

Requirements at June 30, 2004 to retire the SRF's revenue and refunding bonds are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 1,512,830	\$ 2,058,951
2006	1,838,888	1,999,929
2007	3,209,474	1,924,110
2008	2,970,958	1,836,423
2009	3,176,655	1,748,530
2010-2014	14,254,645	7,131,087
2015-2019	11,194,749	4,153,145
2020-2024	10,581,200	1,731,665
2025-2026	<u>2,345,000</u>	<u>86,927</u>
	<u>\$ 51,084,399</u>	<u>\$ 22,670,767</u>

**9 - FUND NET ASSETS**

The following represents an analysis of fund net assets for the years ended June 30, 2004 and 2003.

	<u>Unrestricted</u>	<u>Restricted for Loans</u>	<u>Total</u>
Balance at June 30, 2002	\$ 18,101,122	\$ 20,752,439	\$ 38,853,561
Change in fund net assets	<u>4,534,567</u>	<u>17,890,489</u>	<u>22,425,056</u>
Balance at June 30, 2003	22,635,689	38,642,928	61,278,617
Change in fund net assets	<u>( 9,736,162)</u>	<u>6,436,605</u>	<u>( 3,299,557)</u>
Balance at June 30, 2004	<u>\$ 12,899,527</u>	<u>\$ 45,079,533</u>	<u>\$ 57,979,060</u>

**10 - OPERATING TRANSFERS**

Operating transfers consist of the following for the years ended June 30:

	<u>2004</u>	<u>2003</u>
Operating expenses transfer	(\$ 349,859)	(\$ 461,792)
Transfers related to bond offerings	( 8,195,382)	7,319,642
Debt service payment to Clean Water Fund	( 546,596)	-
	<u>(\$ 9,091,837)</u>	<u>\$ 6,857,850</u>

## **11 - LOAN FUNDING COMMITMENTS**

The operating agreements for the federal capitalization grants require that the SRF enter into binding commitments with local government units within one year of the receipt of each federal grant payment to provide assistance in an amount equal to 120% (including 20% state matching grants) of each federal capitalization grant.

The following represents a summary of loan commitments at June 30:

	<u>2004</u>	<u>2003</u>
Total funds committed to public water systems	\$ 100,958,799	\$ 100,735,838
Loan amount outstanding to public water systems	<u>52,995,470</u>	<u>42,594,323</u>
Loan commitments outstanding	<u>\$ 47,963,329</u>	<u>\$ 58,141,515</u>

## **12 - RISK MANAGEMENT**

The State of Connecticut is responsible for risk management of the SRF activities through the use of commercial and self-insurance.

**SEWARD AND MONDE**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**296 STATE STREET**  
**NORTH HAVEN, CONNECTICUT 06473**

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS  
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Ms. Denise L. Nappier, Treasurer

Mr. J. Robert Galvin, M.D., Commissioner,  
Department of Public Health

Mr. Arthur J. Rocque, Jr., Commissioner,  
Department of Environmental Protection,

## State of Connecticut

We have audited the financial statements of the State of Connecticut Clean Water Fund - Drinking Water Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut) as of and for the year ended June 30, 2004, and have issued our report thereon dated September 3, 2004. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### COMPLIANCE

As part of obtaining reasonable assurance about whether the SRF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the SRF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily

disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the management of the SRF and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

## Seward and Monde

North Haven, Connecticut

September 3, 2004

**SEWARD AND MONDE**  
**CERTIFIED PUBLIC ACCOUNTANTS**  
**296 STATE STREET**  
**NORTH HAVEN, CONNECTICUT 06473**

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM, ON INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133, AND  
ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Ms. Denise L. Nappier, Treasurer

Mr. J. Robert Galvin, M.D., Commissioner,  
Department of Public Health

Mr. Arthur J. Rocque, Jr., Commissioner,  
Department of Environmental Protection,

State of Connecticut

## COMPLIANCE

We have audited the compliance of the State of Connecticut Clean Water Fund - Drinking Water Federal Revolving Loan Account (State Revolving Fund) (SRF) (an enterprise fund of the State of Connecticut) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2004. The SRF's major federal program is identified in the summary of auditors' results section of the accompanying schedule of federal findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of the SRF's management. Our responsibility is to express an opinion on the SRF's compliance based on our audit.

We conducted our audit of compliance in accordance with U.S. generally accepted accounting standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the SRF's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the SRF's compliance with those requirements.

In our opinion, the SRF complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2004.

## INTERNAL CONTROL OVER COMPLIANCE

The management of the SRF is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the SRF's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

## SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

We have audited the financial statements of the SRF as of and for the year ended June 30, 2004, and have issued our report thereon dated September 3, 2004. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the management of the SRF and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

## **Seward and Monde**

North Haven, Connecticut

September 3, 2004

STATE OF CONNECTICUT CLEAN WATER FUND - DRINKING WATER

FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the year ended June 30, 2004

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<u>Federal Grantor; Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>
ENVIRONMENTAL PROTECTION AGENCY		
Direct:		
Capitalization Grants for Drinking Water State Revolving Fund	66.468	<u>\$ 5,898,420</u>

See notes to schedule.

STATE of CONNECTICUT CLEAN WATER FUND - DRINKING WATER  
 FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)  
 NOTES to SCHEDULE of EXPENDITURES of FEDERAL AWARDS  
 For the year ended June 30, 2004

**A - ACCOUNTING BASIS**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the State of Connecticut Clean Water Fund - Drinking Water Federal Revolving Loan Account (State Revolving Fund) and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the financial statements.

Revenues are recognized to the extent of expenditures. Expenditures have been recognized to the extent that administrative costs have been incurred by the SRF and charged to the grant and federal funds have been loaned to municipalities during the year.

**B - MUNICIPAL LOANS**

The balance of outstanding loans to public water systems totaled \$52,995,470 as of June 30, 2004.

STATE of CONNECTICUT CLEAN WATER FUND - DRINKING WATER  
 FEDERAL REVOLVING LOAN ACCOUNT (STATE REVOLVING FUND)  
 SCHEDULE of FEDERAL FINDINGS and QUESTIONED COSTS  
 For the year ended June 30, 2004





# APPENDICES

## Appendix I: Federal Capitalization Grant

Federal Fiscal Year	Total Federal Grant	Program Set Asides	Federal Project Funds
1997	\$21,408,200	\$6,636,542	\$14,771,658
1998	\$7,121,300	\$2,207,603	\$4,913,697
1999	\$7,463,800	\$2,313,778	\$5,150,022
2000	\$7,757,000	\$2,404,670	\$5,352,330
2001	\$7,789,100	\$2,414,621	\$5,374,479
2002	\$8,052,500	\$2,496,275	\$5,556,479
2003	\$8,004,100	\$2,421,271	\$5,522,829
2004	\$8,303,100	\$2,573,961	\$5,729,139

## State and Federal Funds Available for DWSRF Projects\*

Federal	Federal	State 20% Match	Total
1997	\$14,771,658	\$4,281,640	\$19,053,298
1998	\$4,913,697	\$1,424,260	\$ 6,337,957
1999	\$5,150,022	\$1,492,760	\$ 6,642,782
2000	\$5,352,330	\$1,551,400	\$6,943,730
2001	\$5,374,479	\$1,557,820	\$6,932,299
2002	\$5,556,479	\$1,610,500	\$7,166,979
2003	\$5,522,829	\$1,600,820	\$7,123,649
2004	\$5,729,139	\$1,660,620	\$7,389,759
*Does not include leveraged funds			

## Federal Capitalization Grants

		21076	21081	21085	21088	
	3105-6868-999	0000-4001-991	0000-4001-992	0000-4001-993	0000-4001-994	Totals
1997 Award	14,771,658.00	856,328.00	2,140,820.00	428,164.00	3,211,230.00	21,408,200.00
Drawn thru 6/30/04	14,771,658.00	856,328.00	2,140,820.00	428,164.00	3,211,230.00	21,408,200.00
Balance	-	-	-	-	-	-
1998 Award	4,913,697.00	284,852.00	712,130.00	142,426.00	1,068,195.00	7,121,300.00
Drawn thru 6/30/04	4,913,697.00	284,852.00	712,130.00	142,426.00	413,162.00	6,466,267.00
Balance	-	-	-	-	655,033.00	655,033.00
1999 Award	5,150,022.00	298,552.00	746,380.00	149,276.00	1,119,570.00	7,463,800.00
Drawn thru 6/30/04	5,150,022.00	298,552.00	138,395.00	149,276.00	-	5,736,245.00
Balance	-	-	607,985.00	-	1,119,570.00	1,727,555.00
2000 Award	5,352,330.00	310,280.00	775,700.00	155,140.00	1,163,550.00	7,757,000.00
Drawn thru 6/30/04	5,352,330.00	310,280.00	-	155,140.00	-	5,817,750.00
Balance	-	-	775,700.00	-	1,163,550.00	1,939,250.00
2001 Award	5,374,479.00	311,564.00	778,910.00	155,782.00	1,168,365.00	7,789,100.00
Drawn thru 6/30/04	5,000,709.00	79,624.00	-	155,782.00	-	5,236,115.00
Balance	373,770.00	231,940.00	778,910.00	-	1,168,365.00	2,552,985.00
2002 Award	5,556,225.00	322,100.00	805,250.00	161,050.00	1,207,875.00	8,052,500.00
Drawn thru 6/30/04	-	-	-	93,454.00	-	93,454.00
Balance	5,556,225.00	322,100.00	805,250.00	67,596.00	1,207,875.00	7,959,046.00
Total Awarded to date	41,118,411.00	2,383,676.00	5,959,190.00	1,191,838.00	8,938,785.00	59,591,900.00
Drawn thru 6/30/04	35,188,416.00	1,829,636.00	2,991,345.00	1,124,242.00	3,624,392.00	44,758,031.00
Total Balance	5,929,995.00	554,040.00	2,967,845.00	67,596.00	5,314,393.00	14,833,869.00

## Appendix II: Credit Quality— Financial Assistance by Bond Rating

Borrower	A& Above	Not Rated	Total Loans
<b>PUBLIC</b>			
Colchester	1,350,000.00		1,350,000.00
Cromwell F.D	4,611,000.00		4,611,000.00
MDC	15,557,029.69		15,557,029.69
Ledyard WPCA	1,026,500.00		1,026,500.00
New Britain	35,044,767.83		35,044,767.83
Newtown	966,000.00		966,000.00
Norwalk W.D.	21,000,000.00		21,000,000.00
Norwich	1,693,207.27		1,693,207.27
Portland	2,017,747.03		2,017,747.03
Sharon	2,336,501.02		2,336,501.02
Southington W.D	9,947,753.00		9,947,753.00
Watertown Fire District	1,128,982.23		1,128,982.23
<b>Private</b>			
Aquarion Water(BHC)		350,706.81	350,706.81
Chippanydale Water Assn.		21,500.00	21,500.00
Cook Willow		617,729.71	617,729.71
Crystal Lake		328,427.72	328,427.72
Harrybrook Park Condo		190,318.56	190,318.56
Hillside Water Corp		140,863.01	140,863.01
Ledgewood Water System		500,000.00	500,000.00
Twin Hills		165,454.36	165,454.36
Unionville		1,559,810.67	1,559,810.67
Woodlake Taxing District		404,500.00	404,500.00
	<b>96,679,488.07</b>	<b>4,279,310.84</b>	<b>100,958,798.91</b>
<b>Percent of Totals</b>	95.76%	4.24%	100%

## Closed Loans—Fiscal Year 2004

Closing Date	Borrower	Project No	SCD	IFO/ PLO	I/20th			Capitalized		New PLO Amount	New IFO Amount
					Principal Payment	Accrued Interest Paid	Additional Interest Amount	Interest Amount			
8/22/2003	MDC	200105-C	7/30/2003	IFO	\$2,343,735.00						\$2,343,735.00
9/30/2003	Watertown F.D	200104-C	12/321/03	IFO	\$435,500.00						\$435,500.00
9/30/2003	Watertown F.D	9803-DC-D1	3/31/2003	PLO	\$717,731.37			\$15,699.09		\$717,731.37	
10/31/2003	Newtown	200101-C	6/30/2003	PLO	\$516,000.00		2,898.82	\$4,154.97		\$516,000.00	
11/26/2003	Crystal Lake	9711-C-D2	11/30/2003	IFO	\$45,000.00						\$45,000.00
12/11/2003	MDC	200105-C	7/30/2003	PLO	\$2,343,735.00			\$10,027.25		\$2,343,735.00	
12/30/2003	MDC	9704-DC-D1	6/30/2003	PLO	\$2,225,346.41			\$50,607.21		\$2,225,346.41	
12/30/2003	MDC	9709-C-D1	6/30/2003	PLO	\$956,990.32			\$9,521.79		\$956,990.32	
3/31/2004	New Britain	2000A-DC	10/1/2003	PLO	\$24,000,000.00	\$1,200,000.00	\$704,424.86			\$24,000,000.00	
5/28/2004	Crystal Lake	9711-C-D1	11/30/2003	PLO	\$129,945.18		\$6,963.41			\$129,945.18	
6/4/2004	Unionville	200103-C	5/15/2003	PLO	\$1,646,970.16	\$82,348.51				\$1,646,970.16	
6/30/2004	Sharon	2000d-DC	12/31/2003	PLO	\$438,153.49	\$21,907.67				\$438,153.49	
6/30/2004	Watertown F.D	200104-C	12/31/2003	PLO	\$435,500.00	\$21,775.00	\$7,510.25			\$435,500.00	
	<b>Totals</b>						<b>\$721,797.34</b>	<b>\$105,100.47</b>	<b>\$0.00</b>	<b>\$33,410,371.93</b>	<b>\$2,824,235.00</b>

Total New IFO Loans 3  
 Total Dollar Value on New IFO Loans 2,824,235.00  
 Total Dollar Value on PLO Loans \$33,410,371.93

Key: SCD—Scheduled Completion Date (based on loan agreement). IFO—Interim Funding Obligations  
 PLO—Permanent Loan Obligation

## Appendix III: Funded Loan Listing Fiscal Year 2004

Loan	Total IFO/PLO AS OF 06/30/04	Undrawn Loan Commitments	Additional Loan	
			Commitments Through 06/30/05	Total Commit- ments
Aquarion Water(BHC)	350,706.81			350,706.81
Chippanydale Water Assn.			21,500.00	21,500.00
Colchester			1,350,000.00	1,350,000.00
Cook Willow	616,757.22	972.49		617,729.71
Cromwell F.D			4,611,000.00	4,611,000.00
Crystal Lake	328,427.72			328,427.72
Harrybrook Park Condo	190,318.56			190,318.56
Hillside Water Corp	140,863.01			140,863.01
Ledgewood Water System			500,000.00	500,000.00
Ledyard WPCA			1,026,500.00	1,026,500.00
MDC	7,042,029.69		8,515,000.00	15,557,029.69
New Britain	35,044,767.83			35,044,767.83
Newtown	516,000.00		450,000.00	966,000.00
Norwalk W.D			21,000,000.00	21,000,000.00
Norwich	1,693,207.27			1,693,207.27
Portland	2,017,747.03			2,017,747.03
Sharon	2,336,501.02			2,336,501.02
Southington W.D			9,947,753.00	9,947,753.00
Twin Hills	165,454.36			165,454.36
Unionville	1,559,810.67			1,559,810.67
Watertown Fire District	1,128,982.23			1,128,982.23
Woodlake Taxing District			404,500.00	404,500.00
<b>Totals</b>	<b>53,131,573.42</b>	<b>972.49</b>	<b>47,826,253.00</b>	<b>100,958,798.91</b>

## Appendix IV: Pending Projects

Applicant	Town of Project	Requested Funding	FFY Priority List
Southington Water Department	Southington	\$5,304,500	2002/2003
Southington Water Department	Southington	\$4,643,030	2002/03
Woodlake Tax District	Woodbury	\$404,500	2003
Ledyard WPCA – Highland System	Ledyard	\$1,026,500	2003
Town of Newtown – Middlegate Elementary School	Newtown	\$450,000	2003
Town of Colchester - Courtyard	Colchester	\$350,000	2003
South Norwalk Electric & Water	Norwalk	21,000,000	2003/04
Ledgewood Condominium Water System	Brookfield	\$500,000	2004
Cromwell Fire District	Cromwell	\$4,611,000	2004
Colchester Sewer & Water	Colchester	\$1,000,000	2004
Metropolitan District Commission	West Hartford / Bloomfield	\$1,800,000	2004

## Proposed Eligible Projects Potentially To Be Funded In FY 2004

Applicant	Location	Anticipated Loan
Chippanydale Water Assn.	Bristol	\$21,500
Metropolitan District Comsn.	Bloomfield	\$1,565,000
Metropolitan District Comsn.		\$1,880,000
Metropolitan District Comsn.	West Hartford	\$375,000
Metropolitan District Comsn.	Bloomfield	\$300,000
Metropolitan District Comsn.	Bloomfield	\$345,000
Metropolitan District Comsn.	Bloomfield	\$650,000
Metropolitan District Comsn.		\$600,000
Metropolitan District Comsn.	West Hartford	\$1,000,000

## Appendix V: FFY 2004 PRIORITY LIST OF PROJECTS

APPLICANT	ID#	DESCRIPTION	AMOUNT
TOWN OF DURHAM	PDC 2004 0380021a	ADDRESS WATER QUALITY & INFRA-	\$750,000
LEDYARD WPCA - HIGHLAND	PDC 2003 0727031a	INTERCONNECT WITH ELEMENTARY	\$1,026,500
TOWN OF NEWTOWN- PUBLIC	DC 2003 0970422a	INTERCONNECT MIDDLE SCHL WITH	\$500,000
LEDGEWOOD CONDOMINIUM	2004 0181431a	WATER SYSTEM RENOVATIONS	\$500,000
HARTLAND ELEMENTARY	PDC 2004 0650102a	SYSTEM UPGRADE INCL WELL RE-	\$144,500
EAST HAMPTON WATER &	PDC 2003 0429031a	MAIN EXT. SYSTEM UPGRADE INTERCON-	\$385,000
TOWN OF COLCHESTER -	PDC 2003 0280011a	INTERCONNECTION TO COLCHESTER	\$350,000
CROMWELL FIRE DISTRICT	2004 0330011a	CAPITAL IMPROVEMENTS	\$4,611,000
TOWN OF LEDYARD WPCA	PDC 2004 0720031a	CONSTRUCT WATER TOWER	\$1,195,000
WOODLAKE TAX DISTRICT	PDC 20031680031a	LAND PURCHASE/CONSTRUCT WELL	\$404,500
COLCHESTER SEWER & WA-	C 2004 0280111a	TAINTOR HILL ROAD TREATMENT PLANT	\$1,000,000
SECOND TAXING DISTRICT	2004 1030021a	FILTRATION PLANT UPGRADE	\$21,500,000
METROPOLITAN DISTRICT	C 2004 0640011h	ASSESSABLE WATER PROGRAM	\$1,800,000
CTWC-SHORELINE REGION -	DC 2004 1050752a	REPLACE SEASONAL WATER SUPPLY	\$1,616,808
CHIPPANYDALE WATER ASSO-	PDC 2004 0176021a	UPGRADE PUMPING FACILITY	\$21,500
METROPOLITAN DISTRICT	C 2004 0640011f	ELECTRICAL UPGRADES RESERVIOR 6	\$1,565,000
METROPOLITAN DISTRICT	C 2004 0640011a	SECURITY RELATED IMPROVEMENTS TO	\$1,880,000
METROPOLITAN DISTRICT	C 2004 0640011d	CHEMICAL FEED SYSTEM	\$375,000
METROPOLITAN DISTRICT	C 2004 0640011e	FILTER EXPANSION	\$300,000
CITY OF DANBURY	2004 0340011a	WEST LAKE WATER TREATMENT PLANT	\$227,500
CITY OF DANBURY	2004 0340011b	DISTRIBUTN SYSTM PIPE CLEANING AND	\$600,000
CITY OF DANBURY	2004 0340011c	DISTRIBUTN SYSTM HYDRAULIC MODEL &	\$250,000
CITY OF DANBURY	2004 0340011d	REPLACEMENT WATER MAINS-FIELD &	\$568,000
CITY OF DANBURY	2004 0340011e	REPLACEMENT WATER MAINS-	\$180,000
CITY OF DANBURY	2004 0340011f	WEST SIDE HIGH SERVICE STORAGE	\$2,500,000
CITY OF DANBURY	2004 0340011g	MARGERIE HIGH SERVICE STORAGE	\$2,500,000
METROPOLITAN DISTRICT	C 2004 0640011b	ROOF REPAIRS AT VARIOUS WATR	\$345,000
METROPOLITAN DISTRICT	C 2004 0640011c	SIMSBURY ROAD WATER PUMP STATION	\$650,000
METROPOLITAN DISTRICT	C 2003 0460011ca	UPGRADE SOUTH MILL PUMP STATION	\$600,000
METROPOLITAN DISTRICT	C 2003 0460011cd	REPLACE WATERMAIN	\$1,000,000
PIERCE MEMORIAL BAPTIST	C 2003 0190101a	INTERCONNECT WITH TOWN WATER	\$60,000
LYME ACADEMY OF FINE ARTS	PDC 2004 1059043a	UPGRADE CURRENT WELLS & WATER	\$599,062
METROPOLITAN DISTRICT	C 2004 0640011g	VARIOUS SYSTEM IMPROVEMENTS	\$1,000,000
		TOTAL REQUEST BY SIZE	\$51,004,370

TOTAL REQUEST

SOUTHINGTON WATER DE-	2003 1310011ca	WATER MAIN EXTENSION	\$5,304,500
SOUTHINGTON WATER DE-	2003 1310011a	WELLHEAD PROTECTION PROJECT	\$4,643,030

\* for Federal Fiscal Year 2004

## Appendix VI: Application Process

To qualify for funding, the project must be listed on DPH's Project Priority List. Once a project is placed on the Project Priority List, the potential loan recipient applies for financial assistance for the specific project. The application must pass four levels of approval:

- Evaluation and Enforcement (DPH): The proposed project must address the needs cited by the Department and comply with regulatory and statutory requirements for the project.
- Project Administration (DEP): All project costs included in the application must be eligible for funding in accordance with State and Federal Regulations.
- Environmental Review (DPH): Based on information received from the borrowers, DPH prepares an environmental assessment of all activities to be undertaken in order to insure that the project is consistent with the State Plan of Conservation and Development. The assessment report is submitted to the Physical Resource Planning Section of OPM for final concurrence.
- Credit Review (Treasurer's Office, DPUC and the Interagency Committee): The applicant must be creditworthy, and the DWSRF underwriting standards must be met. The Treasurer's office reviews the financial information submitted with each application. The Interagency Committee determines whether, and on what general terms and conditions, financial assistance will be provided. The loan agreements are written to permit eventual financing through a revenue bonding program.

At each level of approval, modifications can be made to address any concerns. Upon receipt of the signed commitment letter from the borrower, the State Bond Commission approves the project funding. Once all approvals are in place and after completion of an overall review of the Project Loan Agreement and the other loan documents, a closing is scheduled with the Treasurer's Office. The Project Loan Agreement is then executed and signed first by the borrower, then by the DPH Commissioner and the DEP Commissioner. The State Attorney General also reviews and signs the documents.

Loan funds are disbursed on a first-come, first-served basis as project costs are incurred. Under the terms of the loan, the specific amounts disbursed to any borrower will depend upon the actual progress of construction.

Project audit requirements are subject to the provisions of the Single Audit Act Chapter 55b of the Connecticut General Statutes. Once disbursement is complete, the interim loan is converted to a Project Loan Obligation (PLO). The borrower is billed according to the terms of the PLO. Generally, all borrowers make monthly principal and interest payments. The DPH and its staff of engineers assist each borrower through the process as each department completes its work.

## Appendix VII: Summary of Project Grant and Loan Agreements

In accordance with the State's Clean Water Fund and Drinking Water program, as required by the Connecticut General Statutes 22a-475-483, the mechanism by which financial assistance is provided to the municipality is the Project Loan Agreement, between the municipality and the State. Under each loan agreement, the State agrees to make loans for eligible project costs incurred by the Municipality, upon the terms and in the maximum amount specified. Funds are disbursed to a municipality to pay eligible Project costs which have been incurred by the municipality, and the amount of a Municipality loan is equal only to the aggregate of such disbursed amounts. Thus the municipality is obligated to repay only that amount which it actually draws down for the payment of project costs.

Additionally, each loan agreement specifies a scheduled completion date. Amortization of each loan is required to begin one year from the project's scheduled completion date and the final maturity of each Loan is twenty years from the scheduled completion date.

Each loan is secured by a municipal obligation for which each municipality pledges its full faith and credit and/or a dedicated source of revenue. In 1996, the first loan agreement secured only with a dedicated source of revenue was closed.

Principal and interest payments on loans are payable (1) in equal monthly installments commencing one month after the scheduled completion date, or (ii) in a single annual installment representing the first years principal and interest not later than one year after the scheduled completion date and thereafter in monthly installments.

Loans made under loan agreements entered into prior to July 1, 1989 are repayable in annual installments. Borrowers may elect to make level debt service payments or level principal payments. Municipalities may prepay their loans at any time prior to maturity and there is no penalty for prepayment of loans.

Below is a summary of the details covered by the Project Loan Agreement.

### 1.Loan Provisions

*Loan Clauses [Section 4.1] and [Sections 4.3 and 4.5]*

*Prepayment by Municipality [Section 4.6]*

*Disbursement of Loan Proceeds [Sections 4.4 and 7.5]*

*Reimbursement of the State [Section 4.5]*

*Remedies [Section 9.2]*

### 2.The Project

*Construction and Maintenance of the Project [Sections 7.1 and 7.3]*

*3.Compliance with Law [Section 6.8]*

*4.Tax Compliance [Section 7.7]*

*5.Modifications and Amendments [Section 10.10]*

## Appendix VIII: Summary of the General Bond Resolution

There are three Program Resolutions under which bonds are outstanding. The flow of funds, security provisions and the accounts held by trustee under each resolution is discussed in this appendix.

### Summary

Bond Resolution	Security	Name	Accounts Restricted/Unrestricted
Revolving Fund (2003 Bonds)	Available Money, Assets of the Fund	Loan Fund	R
		Debt Service Fund	R
		Support Fund	R
		Sr. Sinking Fund	R
		Revolving Fund	U
1990 Bonds (1991-2001 series)	Revenue, Loans DSF and DSRF	Loan Fund	R
		Debt Service Fund	R
		Debt Service Reserve Fund	R
Subordinate Bonds (1996 and 1999 series)	Subordinate Lien on Revenue, Loans	Debt Service Fund	R

### 1990 Bonds

Revenues generated under the 1990 Resolution include repayments of pledged Loans, earnings on the debt service reserve fund and principal and interest on assets in the interest subsidy fund. The interest subsidy fund was sized in an amount that when added to loan repayments and expected earnings on invested funds would produce pledged revenues at least equal to debt service on the Prior Bonds. The debt service reserve fund was originally funded with a combination of federal capitalization grants invested in guaranteed investment contracts, and State Contributions in the form of State General Obligation Bonds. As principal of such Prior Bonds is repaid, a pro rata portion of the debt service reserve fund is released. Subordinate Bonds are secured by surplus revenues in excess of the amount required to pay the 1990 Resolution Bonds and by the maturing principal of State General Obligation Bonds deposited in the debt service reserve fund. Surplus revenues in excess of the amount required to pay the Prior Bonds can be released from the 1990 Resolution at the discretion of the State. Such released surplus revenues and amounts released from the debt service reserve fund will be Available Moneys.

The following is the flow of funds created under the General Bond Resolution: now general referred to as the 1990 Bond Resolution:

The Trustee deposits all pledged loan repayments into the Pledged Receipts Account which is in the Revenue Fund. The Trustee deposits all earnings on funds and investments (except for earn-

ings on amounts held within the Debt Service Reserve Fund) into the Earnings Account. Upon deposit, amounts in the Pledged Receipts Account and the Earnings Account are immediately transferred to the Debt Service Fund for the payment of principal of and interest on the Bonds to the extent required to meet the Debt Service payments due from January 2 through the next succeeding January 1. The order of priority is as follows: 1) first to the Interest Account for the payment of interest, 2) then to the Principal Account for the payment of principal and Sinking Fund Installments, if any. 3) Then to the extent funds in the Pledged Receipts Account are available therefor they will be transferred to the Debt Service Reserve Fund in the amount necessary to restore the Debt Service Reserve Fund to the Debt Service Reserve Fund Requirement.

The payment of debt service on the Bonds when due is made from the Debt Service Fund. Earnings on amounts in the Federal Letter of Credit and Undesignated Accounts are deposited into the Debt Service Fund Earnings Account and applied to pay Debt Service on the Bonds prior to the application of other Pledged Receipts and revenues for such purpose. Whenever the funds in the Debt Service Fund are insufficient to pay the interest, principal on outstanding bonds, the Trustee will apply amounts from the following Funds to the extent necessary to make good the deficiency in the following order of priority:

(a) In the event of deficiencies in the Interest Account, after all transfers from the Revenue Fund have been made pursuant to the General Bond Resolution, funds will be transferred: first, from the Debt Service Reserve Fund; second, from the Interest Subsidy Fund; and third, from the Principal Account of the Debt Service Fund.

(b) In the event of deficiencies in the Principal Account, after all transfers from the Revenue Fund have been made pursuant to the General Bond Resolution, and there are on deposit in the Interest Account of the Debt Service Fund amounts sufficient to pay the next interest payment coming due, funds will be transferred: first, from the Debt Service Reserve Fund; and second, from the Interest Subsidy Fund

All proceeds of the Bonds are deposited into the Loan Fund and expended only for the purposes of the SRF program, including the financing of Loans to municipalities.

Upon the delivery of a cash flow sufficiency certificate from the Fund Administrator, the State will withdraw these funds free and clear of the lien of the General Bond Resolution. Although these funds may be used for any SRF purpose, the State is required to apply such excess funds first to pay debt service on the Subordinate Refunding Bonds.

The Trustee will pay out of the Redemption Account of the Debt Service Fund on each Redemption date (as set forth in a Series Resolution) for any Bonds for which there has not been made Sinking Fund Installments, the amounts required for the payment of such Redemption Price on the Redemption Date.

The Debt Service Reserve Fund is required to be funded in an amount equal to 50% of all Outstanding Bonds. The State chose to fund the DSRF with 1) federal capitalization grant payments made pursuant to federal capitalization grant agreements, 2) State general obligation bonds and, 3) other amounts provided by the State and received by the Trustee for deposit therein.

The Interest Subsidy Fund has been established outside of the SRF, and will be funded in an amount equal to the aggregate debt service payable on Outstanding Bonds minus (a) earnings on investments held in the Debt Service Reserve Fund, (b) repayments of Municipal Obligations, (c) amounts on deposit in the Revenue Fund at the beginning of the applicable period and (d) earnings on certain funds or on such amounts expected to be transferred or received during the applicable period. Funds in the Interest Subsidy Fund will be used to pay the interest, principal, and Sinking Fund Installments due on Bonds, as provided in the General Bond Resolution. The Interest Subsidy Fund will be funded from maturing principal and interest on state general obligation

bonds held in such fund.

This is accomplished with the following funds created under the Resolution:

General Bond Resolution			
Fund Type	Description & Use	Held By	Invested
Revenue Fund	Receives all pledged receipts including loan repayments from the municipalities. Out flows include amounts transferred to the interest and principal accounts of the debt service fund for payment of current debt service.	Trustee	Yes - AIG
a. Pledged Receipts Account			
b. Earnings Account	Receives all earnings on funds and investments in all funds and accounts. Out flows include amounts transferred to the interest and principal accounts of the debt service fund for payment of current debt service.	Trustee	Yes - AIG
Loan Fund	Received proceeds from the sale of revenue bonds as specified and determined by the Resolution. Funds expensed for purposes of the State Revolving Fund program, including the financing of loans to municipalities.	State	Yes
Debt Service Reserve Fund	Required to be funded in an amount equal to 50% of all outstanding bonds. The reserve is funded by federal capitalization grant payments drawn under the federal letter of credit and state general obligation bonds. Investment income is transferred to the revenue fund for debt service payments. Used for payment of principal and interest in the event of deficiencies in the revenue accounts.	Trustee	Yes - AIG
Debt Service Fund	Receives amounts from the revenue fund accounts sufficient to pay the interest portion due on each interest payment date. Pays interest on outstanding bonds	Trustee	Yes - AIG
a. Interest Account			
b. Principal Account			
c. Redemption Account			
d. Capitalized Interest Account	Receives any capitalized interest received by the trustee. Amounts in the account are transferred for payment of capitalized interest on outstanding bonds	Trustee	Yes - SSB
Interest Subsidy Fund	Established outside of the state revolving fund, principal and investment income is transferred to the revenue fund, then to the debt service fund for payment of debt service. Provides payment of principal and interest in the event of a deficiency in the debt service reserve fund.	Trustee	Yes - SSB
Administrative Fund: Cost of Issuance Account	Established outside the SRF, receives a portion of the revenue bond proceeds. Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds	Trustee	Yes - SSB
Rebate Fund	Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required	Trustee	Yes - SSB

## General Revenue Revolving Fund

The General Revenue Bond Resolution was approved by the State Bond Commission December 17, 2002. The 2003 Series A, B & C are the first bonds issued under this Resolution. Under the Resolution, the Revolving Fund is the repository for all Available Moneys that have not been transferred to another fund.

Not later than one business day before any Payment Date, the State is required to transfer amounts (that is, the Debt Service Portion) to the Debt Service Fund in an amount sufficient to pay the debt service due on that Payment Date.

The Revolving Fund is operated in a manner similar to a general fund for the Clean Water and Drinking Water programs and although the other amounts in the Revolving Fund are available to pay debt service on the Bonds, these amounts are: 1) not pledged to the Bonds, 2) are not necessary or expected to be used for the payment of debt service on the Bonds, and 3) are available for any purposes allowed under the Act, including to make loans to Borrowers and to subsidize loans made to Borrowers.

There is no reasonable assurance that amounts held in such funds would be available to pay debt service on the Bonds if the State were to encounter financial difficulties.

This is accomplished with the following funds created under the Resolution:

General Revenue Bond Resolution Fund Type	Description & Use	Held By	Invested
<b>Revolving Fund.</b>	The Revolving Fund from which the Bonds are repaid consists of amounts in the water pollution control federal revolving loan account and drinking water federal revolving loan account. The State will maintain the Revolving Fund in accordance with the Federal Act. Not later than one Business Day prior to any Payment Date, the State shall transfer to the Debt Service Fund any amounts necessary, together with any amounts on deposit therein, sufficient to pay principal of, redemption premium, if any, and interest on Bonds coming due on such Payment Date and any amounts payable from the Debt Service Fund related to Other Financial Assistance and Related Program Obligations.	Trustee	Yes - AIG
<b>Bond Proceeds Fund. .</b>	The proceeds of the 2003A Bonds were deposited into the Bond Proceeds Fund as specified and determined by the Supplemental Resolution. Moneys in the Bond Proceeds Fund are expended only for the purposes of the Wastewater Program or the Drinking Water Program, including the financing of Loans to Borrowers, and to the extent that other moneys are not available, for payments of principal of and interest on the Bonds when due and to redeem Bonds at the direction of the	Trustee	Yes - AIG
<b>Debt Service Fund.</b>	Amounts deposited in the Debt Service Fund may include accrued interest and capitalized interest, if any, and amounts transferred from the Revolving Fund, the Support Fund and the Bond Proceeds Fund. Amounts on deposit in the Debt Service Fund will be used for the payment of debt service on the Bonds when due and amounts due on Other Financial Assistance and Related Program Obligations.	State	Yes
<b>Support Fund</b>	The Support Fund, and accounts therein, shall be funded in the amounts and in the manner set forth in a Supplemental Resolution. Moneys in the Support Fund shall be transferred to the Debt Service Fund to pay the interest, principal and Sinking Fund Installments and Redemption Price due on Bonds, in accordance with the schedule set forth in the applicable Supplemental Resolution.	Trustee	Yes - AIG
Administrative Fund: Cost of Issuance Account	Established outside the SRF, receives a portion of the revenue bond proceeds. Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds	Trustee	Yes - SSB
Rebate Fund	Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required	Trustee	Yes - SSB

## Subordinate Refunding Bond Resolution

Under the Resolution, the refunding bonds are subordinate to the 1990 Bonds and principal and interest are paid from a dedicated account which is filled before December 1st of each year.

The subordinate bond debt service is funded in advance as described below:

Each July 16th the next 12 month's debt service on the 1999 Sub Bonds is moved into the 1999 Sub Bond DSF (which means the following January 15 and July 15 debt service). For the 96 Sub Bonds a deposit to the DSF is made each July 2nd for the following January 1 and July 1 payments.

This is accomplished with the following funds created under the Resolution:

Subordinate Refunding Bond Resolution Fund Type	Description & Use	Held By	Invested
<b><i>Debt Service Fund.</i></b>	Amounts deposited in the Debt Service Fund may include accrued interest and capitalized interest, if any, and amounts transferred from the Revolving Fund, the Support Fund and the Bond Proceeds Fund. Amounts on deposit in the Debt Service Fund will be used for the payment of debt service on the Bonds when due and amounts due on Other Financial Assistance and Related Program Obligations.	State	Yes
Administrative Fund: Cost of Issuance Account	Established outside the SRF, receives a portion of the revenue bond proceeds. Investment income is transferred to the revenue fund for debt service payments. Used to pay issuance cost on revenue bonds	Trustee	Yes - SSB
Rebate Fund	Receives any earnings required to be rebated to the United States pursuant to the Tax Regulatory Agreement. Used for IRS obligations as required	Trustee	Yes - SSB

## Appendix IX: Revenue Bond Investment Information—SWAP

The table below provides estimated values and summary information for two swap agreements entered into by the State of Connecticut Clean Water Fund (“The State”) and Goldman Sachs Mitsui Marine Derivative Products (“GSMMDP”). The swaps were initiated to lock-in a fixed rate for the State Revolving Fund General Revenue Bonds, 2003 Series C issue, which is comprised of auction rate securities.

The State secured a fixed payment rate of 3.0299% with Swap A in return for receiving a floating payment rate of (1-month LIBOR x 67%). Swap A includes an option for the State to terminate the agreement effective October 1, 2013 and semiannually thereafter. The notional amount of the swap mirrors the amortization schedule of the 2003 Series C bonds (see table below).

The floating rates on the 2003 Series C bonds are expected to trade based on the tax-exempt BMA index, which has historically averaged around 67% of LIBOR. However, there is a risk that the BMA index could equal more than 67% of LIBOR creating a mismatch between floating receipts from the swap agreement and floating interest payments under the 2003 Series C bonds. This situation generally happens when interest rates are low and is called basis risk. To hedge this risk, the State entered into Swap B with GSMMDP.

Swap B pays the State a floating rate equaling the lesser of 33% of LIBOR or [58% of LIBOR plus 0.39%] minus 67% of LIBOR, subject to a 0% minimum. The State makes fixed payments to GSMMDP with an interest rate of 0.149%. Swap B matures on October 1, 2013 and contains no termination option. The combined effect of the swaps is that the State receives a higher percentage of LIBOR when LIBOR rates are below 4.33% (to a maximum of 100% of LIBOR) and a lower percentage of LIBOR when rates are higher (to a minimum of 67% of LIBOR). The creation of this structure (“Collar”) approximates the relationship between the BMA and the taxable LIBOR index, thereby reducing basis risk.

The estimated valuations are included in the audited financial statements. Due to the unique nature of the option, any estimates are theoretical and are not indicative of any future value of the SWAP. No guarantee of value is implied.

## **Appendix X: Investment of Funds**

The State may invest funds under the Resolution in Investment Obligations.

The State currently invests a significant portion of the funds and accounts created under the General Bond Resolution in investment agreements with financial institutions. The General Bond Resolution requires that such investment agreements be with, or be guaranteed by, institutions with ratings at least equal to the rating on the Bonds given by Standard & Poor's and Moody's Investor Service or any rating service recognized by the State banking commissioner, provided that such institutions will have a rating from Standard & Poor's and Moody's Investors Service at least equal to the rating on the Bonds. Certain funds currently held in the Debt Service Reserve Fund are invested pursuant to investment agreements, collateralized with securities issued or guaranteed by the U.S. Government or agencies or instrumentalities thereof whose market value is at least 100% of the funds invested. Currently the Fund has guaranteed investment contracts with the following entities: AIG, Societe Generale, CDC Funding Group.

		DEBT SERVICE RESERVE**				
BOND SERIES	REVENUE AMOUNT*	GENERAL			INTEREST SUBSIDY	
		FEDERAL	OBLIGATION BONDS	DIRECT LOAN REPAYMENTS	DSR 'FREE UP'	(GO BONDS)
CWSRF	CWSRF	CWSRF	CWSRF	CWSRF	CWSRF	CWSRF
1991	100,000,000	37,126,619	12,873,381	0	0	19,690,000
1992	105,000,000	25,155,089	26,144,911	1,200,000	0	6,715,000
1993	50,000,000	23,600,217	0	1,399,783	0	7,200,000
1994	75,000,000	32,222,500	0	2,900,000	2,377,500	5,100,000
1996A	80,000,000	18,064,373	5,000,000	7,183,127	9,752,500	3,290,000
1997	110,000,000	20,415,930	19,000,000	4,016,570	11,567,500	5,200,000
1999A	125,000,000	25,088,408	18,000,000	5,309,093	14,022,500	4,875,000
2001	70,385,254	6,992,627		5,000,000	23,270,000	3,567,085
2002	0	0	0	0	0	0
2003	90,000,00	0	0	0	0	0
SUBTOTAL	715,385,254	188,665,763	81,018,292	27,088,573	60,990,000	55,637,085
DWSRF	DWSRF	DWSRF	DWSRF	DWSRF	DWSRF	DWSRF
2001	29,614,746	9,408,000	10,398,696	0	0	0
2002	0	0	0	0	0	0
2003	35,000,000		3,320,000			
TOTAL	745,000,000	198,073,763	94,736,292	27,088,573	60,990,000	55,637,085
		*may include premium and excludes refunding bonds				
		**includes restricted accounts except Loan Fund and Debt Service Fund				

## Appendix XI: Cumulative Projects Funded by the Drinking Water Fund

#	APPLICANT	ID	TOWN	BRIEF DESCRIPTION	PLO AMOUNT
1	TWIN HILLS TAXING DISTRICT	C 97 0340131a	COVENTRY	DISTRIBUTION & SOURCE IMPROVEMENTS	\$207,420.86
2	SHARON SEWER & WATER	DC 97 1250011b	SHARON	WATER MAIN REPLACEMENT (REFINANCE)	\$1,084,010.00
3	SHARON SEWER & WATER	DC 97 1250011a	SHARON	PUMP STATION	\$210,000.00
4	MDC (b)	C 970640011b	WEST HARTFORD	SYSTEM REPAIRS & UP-GRADES	\$3,086,188.44
5	MDC(a)	C 97 0640011a	BLOOMFIELD	VARIOUS IMPROVEMENTS	\$1,163,888.62
6	NEW BRITAIN	PDC 98 0890011a	NEW BRITAIN	NEW WATER TREATMENT PLANT - PHASE I	\$12,682,987.00
7	NORWICH	DC 97 1040011a	NORWICH	REPLACE ASBESTOS PIPE WITH DUCTILE IRON PIPE	\$1,898,651.36
8	MDC(C)	C 97 0640011c	BLOOMFIELD/ HARTFORD/ W. HARTFORD	WATER MAIN REPLACEMENT	\$861,978.47
9	WATERTOWN FIRE DISTRICT	DC 98 1530011a	WATERTOWN	NEW DISTRIBUTION PUMP STATION	\$717,731.37
10	CRYSTAL LAKE CONDOS	C 97 1210021/31a	SALEM	CONSTRUCT NEW WATER SYSTEM	\$359,902.19
11	HARRYBROOKE PARK CONDO	PDC 97 0960131a	NEW MILFORD	INTERCONNECT WITH UNITED WATER COMPANY	\$231,327.45
12	BHC - STAMFORD (AQUARION)	PDC 97 1350011a	STAMFORD	UPGRADE PUMP STATION	\$391,038.00
13	COOK WILLOW REALTY	DC 97 1110111a	PLYMOUTH	INTERCONNECT WITH CONNECTICUT WATER COMPANY	\$639,018.00
14	HILLSIDE WATER	PDC 00 0790021a	MARLBOROUGH	WATER MAIN & DISTRIBUTION IMPROVEMENTS	\$149,052.00
15	SHARON SEWER & WATER	DC 98 1250011a	SHARON	INTAKE & PIPELINE UPGRADE, WATER FILTRATION TREATMENT PLANT, STORAGE	\$1,100,000.00
16	TOWN OF PORTLAND	C 97 1180081a	PORTLAND	INTERCONNECT WITH METROPOLITAN DISTRICT COMMSN	\$2,500,000.00
17	NEW BRITAIN PHASE II	PDC 98 0890011a	NEW BRITAIN	NEW WATER TREATMENT PLANT - PHASE II	\$24,000,000.00
18	SHARON SEWER & WATER	DC 01 1250011a	SHARON	WATER MAIN REPLACEMENT	\$438,153.49
19	TOWN OF NEWTOWN (H.S)	C 02 0970442a	NEWTOWN	CONNECTION TO TOWN WATER	\$516,000.00
20	MDC(x)	C 01 0640011x	BLOOMFIELD	CONSTRUCTION OF WATER MAINS	\$2,343,735.00
21	WATERTOWN FIRE DISTRICT	DC 98 1530011b	WATERTOWN	UPGRADE CHEMICAL FEED EQUIPMENT	\$435,500.00
22	UNIONVILLE WATER COMPANY	C 97 0520011b	FARMINGTON	INTERCONNECT WITH METROPOLITAN DISTRICT COMMSN	\$1,646,970.16
	<b>TOTAL</b>				<b>\$56,663,552.41</b>

## Appendix XII: Ratio Analysis

### FINANCIAL RATIO

	FY 2001	FY 2002	FY 2003	FY 2004
(1) CURRENT RATIO:				
<b>Current Assets:</b>				
Cash & Equivalents	\$13,458	\$59,106	\$1,144,853	\$13,062,890
Int/recvble Investments	\$108,202	\$999,576	\$282,709	\$330,100
Due from other state fund	\$0	\$24,775	\$0	\$0
Grant Receivable	\$0	\$0	\$0	\$449,850
Loans Receivable current portion	\$17,252,271	\$8,081,678	\$22,724,735	\$3,773,468
Loan Fund	\$14,141,641	\$6,261,027	\$0	\$13,486,329
Debt Service Fund	\$13,284,668	\$18,383,265	\$24,129,646	\$2,987,693
Free-up from reserve fund	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Total Current Assets	\$44,800,240	\$33,809,427	\$48,281,943	\$34,090,330
<b>Current Liabilities:</b>				
Revenue bond interest payable	\$116,531	\$349,593	\$349,593	\$521,764
Due to other state fund	\$0	\$13,503	\$0	\$0
Deferred grant revenue	\$10,061	\$118,585	\$437,170	\$0
Revenue bonds payable(current)	<u>\$0</u>	<u>\$0</u>	<u>\$1,199,397</u>	<u>\$1,512,830</u>
Total Current Liabilities	\$126,592	\$481,681	\$1,986,160	\$2,034,594
CA/CL	353.89%	70.19%	24.31%	16.76%
(2) ASSET/LIABILITY RATIO				
<b>Long term assets:</b>				
Interest Receivable	\$213,641	\$287,936	\$364,691	\$105,864
Loans recble-less current portion	\$1,535,637	\$18,672,996	\$19,869,588	\$49,222,002
Reserve fund(less free-up)	\$16,285,500	\$16,289,526	\$23,609,209	\$28,476,371
Short term assets convertible:				
Federal Cap grant	<u>\$13,156,284</u>	<u>\$6,730,236</u>	<u>\$16,527,779</u>	<u>\$4,966,468</u>
Total	\$31,191,062	\$41,980,694	\$60,371,267	\$82,770,705
<b>Long Term Debt:</b>				
Rev bonds pyble-less current portion	\$29,614,747	\$29,614,747	\$28,415,350	\$49,571,569
Deferred grant revenue	\$10,061	\$118,585	\$0	\$0
Premium on revenue bonds	<u>\$491,370</u>	<u>\$468,337</u>	<u>\$445,304</u>	<u>\$3,277,113</u>
Total	\$30,116,178	\$30,201,669	\$28,860,654	\$52,848,682
A/L	1.04%	1.39%	2.09%	1.57%
(3) EQUITY GROWTH				
Cumulative Captilization Grants	\$43,750,300	\$51,539,400	\$59,591,900	\$67,596,000
State Match Contribution	\$2,573,420	\$3,919,467	\$7,147,364	\$7,955,487
Overmatch Contribution	\$7,824,580	\$0	\$0	\$0
Retained Earnings	<u>\$32,602,309</u>	<u>\$38,495,120</u>	<u>\$61,278,617</u>	<u>\$57,979,060</u>
Total Equity	\$86,750,609	\$93,953,987	\$128,017,881	\$133,530,547
Equity/Cap grant	1.98%	1.82%	2.15%	1.98%
(4) BINDING COMMITMENT				
Binding Cmtments or closings	\$18,787,908	\$26,754,674	\$42,594,323	\$52,995,470
Cap Grants	\$43,750,300	\$51,539,400	\$59,591,900	\$67,596,000
Binding Commitment Ratio	0.43%	0.52%	0.71%	0.78%
(5) PROJECT COMPLETION				
Projects Completion	\$5,911,328	\$20,017,177	\$20,967,545	\$49,222,002
Cap Grants	\$43,750,300	\$51,539,400	\$59,591,900	\$67,596,000
Project Completion Ratio	0.14%	0.39%	0.35%	0.78%
(6) DEFAULT RATIOS				
(7) QUALITY OF INVESTMENTS				
Total Loans	\$18,787,908	\$26,754,674	\$42,594,323	\$52,995,470
Total Assets	\$62,835,018	\$69,059,885	\$92,125,431	\$112,862,336
TL/TA	0.30%	0.39%	0.46%	0.47%

