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UPDATE

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New Jersey's Cross-Collateralization Structure

To date, New Jersey is the only program to receive approval for a cross-collateralization structure and issue bonds with the structure in effect



Cross-collateralization between the Clean Water State Revolving Fund (CWSRF) and Drinking Water State Revolving Fund (DWSRF) programs was authorized by the Departments of Veteran Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (Public Law 105-276). The act allows funds from one SRF program to be used to secure the other SRF program against default. For states that leverage their SRF programs, the DWSRF will benefit from existing CWSRF credit quality, diversification and coverage levels. To date, New Jersey is the only program to both receive approval for a cross-collateralization structure and issue bonds with the structure in effect.

Under a cross-collateralization structure, states may combine assets of the CWSRF and DWSRF programs as security for bond issues ". . . provided that revenues from the bonds are allocated . . . in the same portion as the funds are used as security for the bonds . . . ." (Public Law 105-276). EPA has released two examples that illustrate how proportionality may be maintained in the draft Transfer/Cross-Collateralization Policy.

First, a state can achieve proportionality at the debt service reserve level. For example, if the debt service reserve is the primary security and 65 percent of the funds in the reserve are CWSRF funds and 35 percent are DWSRF funds, then 65 percent of the bond proceeds must be allocated to CWSRF purposes and 35 percent must be allocated to DWSRF purposes.

Second, a state may also achieve proportionality by requiring that loan repayments on loans made from the CWSRF are pledged, as the primary security, only to the CWSRF bonds (or portion of a joint bond issue) and loan repayments on loans made from the DWSRF are pledged, as the primary security, only to the DWSRF bonds (or portion of a joint bond issue). For example, if $50 million in bonds are issued for CWSRF project loans and $25 million in bonds are issued for DWSRF project loans, then $50 million of repayments must be pledged as security from CWSRF project loans and $25 million in repayments must be pledged as security for DWSRF project loans. The second option may not be used if the state provides principal forgiveness subsidies for disadvantaged communities funded with bond proceeds from the DWSRF program because the DWSRF security would be disproportionate to the security provided by the CWSRF program.

Cross-collateralization provides additional security to bondholders, thereby improving the bond ratings and reducing the cost of borrowing to the CWSRF/DWSRF programs. New Jersey's DWSRF program is now able to benefit from the CWSRF programs Aaa/AAA/AAA ratings, reserves and security structure. This update describes the New Jersey cross-collateralization structure.

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Overview of New Jersey's Cross-Collateralization Structure

The New Jersey Environmental Infrastructure Trust manages the financial functions of both the CWSRF and DWSRF programs. The Trust has focused on making programmatic improvements that build on the principle of pooling loan financings to strengthen the rating of its bonds beyond that of the individual credit ratings of borrowers. In 1998 New Jersey jointly issued $56.6 million in bonds to leverage both the CWSRF and the DWSRF.

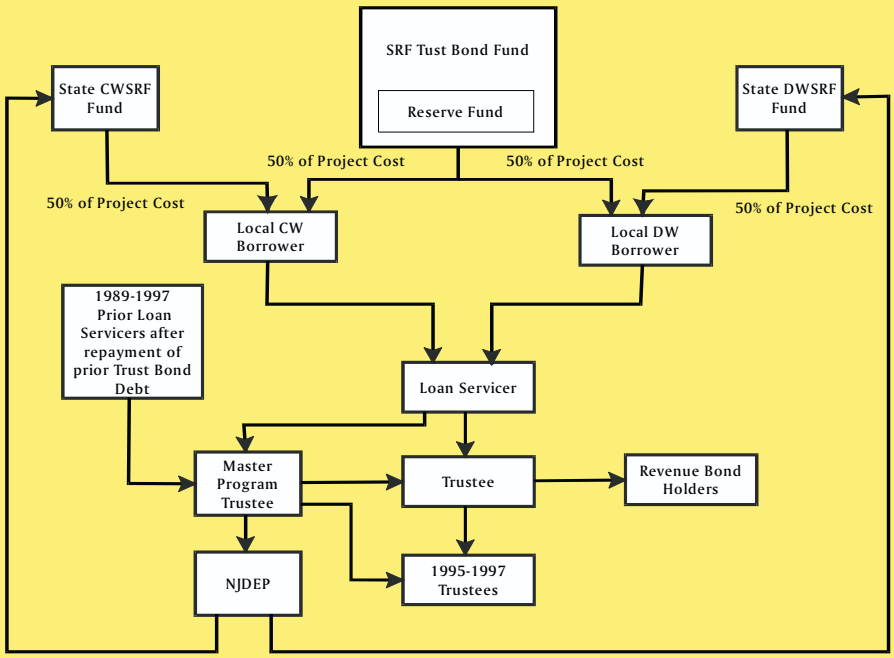
Exhibit 1 displays the flow of funds for New Jersey's cross-collateralization of the Clean Water and Drinking Water Financing Program.

A borrower receives half of its financing in the form of an interest bearing loan from the Trust Bond Fund, which is financed with revenue bond proceeds. The second half of a borrower's financing is in the form of a zero interest loan from the State CWSRF or DWSRF Fund that is financed by capitalization grants, state match funds and loan repayments. The borrowers make repayments through a bank, which acts as the Loan Servicer that directs the repayments to first cover debt service payments on Trust Revenue Bonds, then directs the remaining portion of the payment to the Master Program Trustee account. This account acts as another level of security to cover defaults in debt service payments on other bonds issued from 1995 to the present. Funds can be held by the Master Program Trustee for up to one year. Once the funds are released, the New Jersey Department of Environmental Protection separates the Clean Water and Drinking Water repayments and earnings and recycles them back into the appropriate fund for any authorized purpose of the CWSRF/ DWSRF.

Each CWSRF/DWSRF project loan is funded with 50% revenue bond proceeds and 50% interest free equity funds.



Exhibit 1
New Jersey Cross-collateralization
Clean Water & Drinking Water Financing Program



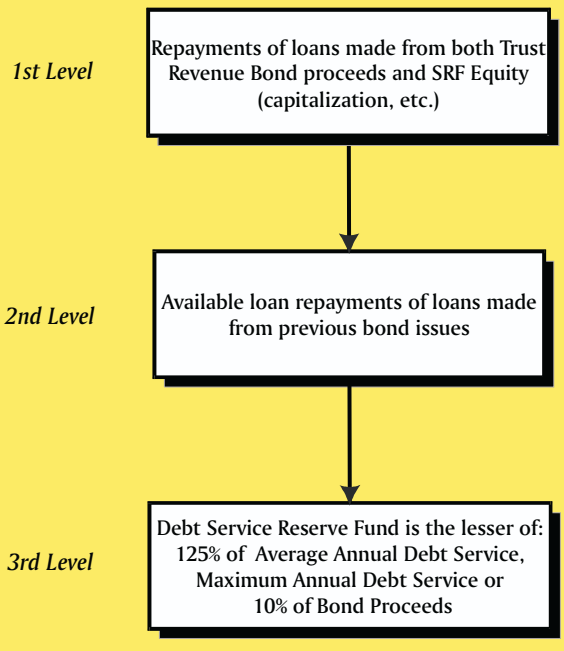
Levels of Security for New Jersey's Cross-Collateralization Program

New Jersey uses cash-flow leveraging in its program. The program structure provides outstanding level of debt service coverage for the Program's revenue bonds. Fitch IBCA reports that annual cash flow coverage ranges between a ratio of 1.5 and 3.2. The leverage structure is designed to maintain proportionality for cross-collateralization by pledging loan repayments as the first level of security for bonds in the same proportion reflected in the joint DWSRF and CWSRF bond issue.

New Jersey funds projects with one-half Trust revenue bond proceeds and one-half SRF capitalization funds. The Trust and NJDEP devised a three-tiered system for the repayment of its bonds. The primary level calls for repayment of both the Trust and SRF loan to the Loan Servicer Bank which immediately transfers funds required for repayments to bondholders (Exhibit 2). The second level of security is created when the Loan Servicer transfers all the remaining funds to a Master Program Trustee. The Master Program Trustee holds these funds for up to one year, during which they are made available to make up any deficiency in bonds issued 1995 and after. The debt service coverage associated with this security is also very strong, ranging-between a ratio of 3 and 6 times annual debt service. The final level of security is the debt service reserve fund which is capitalized at the lesser of: 125 percent of average annual debt service, the maximum annual debt service or 10 percent of bond proceeds.

Fitch IBCA reports that annual cash flow coverage ranges between a ratio of 1.5 and 3.2

Exhibit 2
Security Structure of New Jersey's Cross-collateralization Program





Summary of Key Features

New Jersey's structure is designed to be appealing to bond rating agencies and investors. The State's approach enhances the security structure of New Jersey's combined CWSRF and DWSRF bonds while complying with federal CWSRF and DWSRF program requirements. The following are key features of New Jersey's cross-collateralization structure:

- The Attorney General's certification will document the State's authority to cross-collateralize the SRF program
- The debt service for the DWSRF and CWSRF will be accounted for separately
- Repayments on CWSRF program loans will be paid to the CWSRF
- Repayments on DWSRF program loans will be paid to the DWSRF
- Separate records and financial statements are kept for each program
- Because New Jersey is pledging repayments in order to meet the proportionality requirements for cross-collateralization, NJDEP will not implement the SDWA 1452(d) disadvantaged community "principle forgiveness" provision
- Interest earnings within the Debt Service Reserve Fund will be distributed to the appropriate borrower
- A borrower is only eligible to draw on their allocable share of the Debt Service Reserve Fund
- Both DWSRF and CWSRF programs will maintain a 50/50 relationship between Fund and Trust Loans

States interested in further information on cross-collateralization should contact their EPA Regional Office SRF Coordinator. For information on the New Jersey program contact the state representative below.

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