

New York State
ENVIRONMENTAL FACILITIES CORPORATION

MATTHEW J. DRISCOLL, President and CEO

March 4, 2013

Mr. George Ames
Chief, State Revolving Funds Branch
U.S. Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
EPA East (4204M)
Washington, D.C. 20460

Dear Mr. Ames,

In the fall of 2010, representatives of the New York State Environmental Facilities Corporation (EFC) and the New York State Energy and Research Development Authority (NYSERDA) met with you and other EPA representatives regarding NYSEDA's Green Jobs Green New York Program (Program). Through its Program, NYSEDA provides low interest loans to finance energy efficiency improvements in residential, small business, not-for-profit, and multifamily buildings to meet the State's energy reduction and greenhouse gas mitigation goals. Loans are limited by amount to include only eligible cost effective improvements based on the anticipated energy costs savings. The residential energy efficiency improvement projects (Residential Energy Conservation Projects) consist of building shell measures, high efficiency heating and cooling measures, energy star appliances and lighting measures. The program was funded with auction proceeds from the Regional Greenhouse Gas Initiative (RGGI), of which about \$50 million was allocated to establish a revolving loan fund to issue loans.

NYSERDA's Program has gained popularity and continues to succeed. Since the launch of the program in November 2010 and through January 2013, NYSEDA has issued 2,451 loans (totaling \$23.28 million) to finance Residential Energy Conservation Projects that it expects to finance through the secondary markets. NYSEDA estimates that over the anticipated life of the improvements, the anticipated electric savings for these projects will be 28.2 GWh; the anticipated gas savings will be 1,804,618 MMBtu; and the anticipated home heating oil savings will be 939,400 MMBtu. Total estimated emission reductions over the life of the improvements are 158 tons of NOx, 133 tons of SO₂, and 193,323 tons of CO₂.

During our meeting, we discussed NYSEDA's hope and expectation that it would exhaust its allocation of RGGI proceeds for its Program before the loans were repaid and that it would need to recapitalize the Program through a bond issuance securitizing its loan portfolio of Residential Energy Conservation Projects. We discussed the potential for New York State's Clean Water and Drinking Water Revolving Funds to support NYSEDA's Program through use of the SRF's investment authority under the Clean Water Act and the Safe Drinking Water Act. We appreciated EPA's support for our proposal at the time; however, today we have an additional related but different question.

Burning fossil fuel to generate heat and electricity in NYS contributes to atmospheric deposition of air pollutants into NYS water bodies. NY's Nonpoint Source Management Program (NY NPS Program) identifies atmospheric deposition from fossil fuel combustion as a significant source of water quality impairment and calls for additional controls over, and reductions in atmospheric deposition of such air pollutants into NY's waters. We believe an adequate relationship exists between the environmental benefits of NYSERDA's Residential Energy Conservation Projects and the remedial action called for in NY's NPS Program regarding atmospheric deposition such that EFC's provision of CWSRF financial assistance can be characterized fairly as assisting in the implementation of NY's NPS Program. We believe this relationship, when coupled with the SRF operating flexibility intended to be afforded to the States, the increasing emphasis on creative use of the CWSRF and the increasing concern about the water quality impacts of atmospheric deposition justifies qualifying such a project under the CWSRF.

We propose to qualify NYSERDA's portfolio of Residential Energy Conservation Projects as an eligible Section 319 project qualified for financial assistance by the CWSRF under Section 603(c)(2) of the Clean Water Act and the implementing federal guidelines governing the Clean Water State Revolving Fund (CWSRF).

Our intent is to provide what EFC terms "market rate" financing to NYSERDA either by EFC issuing SRF bonds in the capital markets and using the proceeds to purchase NYSERDA bonds backed by NYSERDA's loan portfolio, or by NYSERDA issuing its own bonds supported by an SRF guaranty with the same SRF security that would have been provided had EFC been the bond issuer. In either structure, we would not allocate any current or future CWSRF IUP funds to the project, except on a contingent basis, if loan collections and other funds available for repayment of the bonds were insufficient to ensure timely payment of principal and interest on the NYSERDA bonds. The NYSERDA bonds would be over-collateralized with anticipated loan cash flows in excess of the principal and interest due on the bonds. NYSERDA will also establish a \$9 million loan loss or debt service reserve funded by a grant from the U.S. Department of Energy Better Buildings program intended to facilitate leveraged financing of Residential Energy Conservation Projects. Such reserves will be available to meet bond payments prior to drawing upon the SRF guaranty to limit the CWSRF's risk. The proposed NYSERDA bond issuance entails a contingent SRF commitment of approximately \$18-24 million. We intend to limit our initial total exposure to such non-traditional projects to \$100 million which is less than 1% of SRF assets.

The discussion below is in two parts. In Part I, we discuss the CWSRF requirements under Section 319 of the Clean Water Act, the implementing regulations and the other pronouncements of EPA on the topic of atmospheric deposition. In Part II, we identify the location of NYSERDA's Residential Energy Conservation Projects and the proximity of such locations to NYS's 2012 Section 303(d) List of Impaired Waters and to other water bodies threatened by the impacts of atmospheric deposition.

PART I – Atmospheric Deposition and the Clean Water State Revolving Fund

Section 603(c)(2) of the Clean Water Act provides that a State's water pollution control revolving fund may be used to provide financial assistance for the implementation of a management program established under Section 319 of the Clean Water Act.

Atmospheric deposition and the subcategory of acid rain are identified in the NY NPS Program as the most frequently occurring cause of water quality impairment in the State. While lakes and ponds in the Adirondack Mountains are the predominant receptors identified, atmospheric deposition in general is identified as affecting water bodies in other parts of the State as well. The NY NPS Program indicates that atmospheric pollution may contribute substantially to the nitrogen enrichment to Long Island Sound and further indicates that acid rain largely originates from pollutants emitted into the air when fossil fuel is burned. The primary pollutants are sulfur oxides which combine with water to form sulfuric acid, and nitrogen oxides which combine with water to form nitric acid. Airborne pollutants cause water quality problems when they fall on impervious urban areas adding to the pollution of storm water runoff. As stated in the NY NPS Program:

“Acid rain has been listed as the primary source of impairment on 397 waterbodies within the Black, St. Lawrence, Lake Champlain, Upper Hudson and Mohawk basins. In southeastern New York, atmospheric pollution, falling directly onto Long Island Sound's surface and entering indirectly from the Sound's watershed, may contribute as much as 14.3% of the nitrogen enrichment to Long Island Sound (nitrogen enrichment is the cause of severe summertime hypoxia problems in the Sound). Many other waterbodies are affected by acid rain as a secondary source although the PWL lists only 22. For example, waterbodies within the Catskill Park and in higher elevations in southeastern New York are affected by acid rain. Atmospheric deposition has been shown to be a significant source of pollutants in urban areas as well as Adirondack lakes.”

Finally, for implementation, the NY NPS Program emphasizes that “As the scientific and regulatory community clarify the need for further reductions and the most cost effective mechanisms, it will be an absolute necessity to take an holistic viewpoint of all the control programs” dealing with the sources of atmospheric deposition.

Congress' intent to empower States to use their CWSRF flexibly to achieve water quality goals traces back to the very creation of the fund and is clear in the legislative history. Almost a decade later in 1996, EPA repeated that sentiment in issuing its SRF Funding Framework – Policy and Guidance. The Framework set national policy for States seeking to use their CWSRF to fund innovative non-traditional projects where the connection to water quality improvements is critical, but more difficult to demonstrate. Recognizing the increase in States' interest and innovation in addressing and funding projects to address nonpoint sources of pollution, EPA defined a non-traditional project as “one for which the primary purpose is other than water quality but which has an additional purpose which is clearly related to the improvement or protection of water quality” EPA confirmed that States could use the CWSRF to fund non-traditional projects related to water quality. CWSRF funding smokestack scrubbers to reduce air pollution was identified as such a project, an implicit acknowledgment of the CWSRF's authority to confront the impact of atmospheric deposition on water quality.

More recently, EPA has expressed support for States addressing the water quality impacts of atmospheric deposition through the CWSRF. In its 2007 draft white paper, “The Clean Water State Revolving Fund Program: Tapping the Untapped Potential”, EPA staff

acknowledged that where there is a causal link between manmade air pollution and water quality, projects to prevent the emission of air pollutants are eligible under the CWSRF.

The paper specifically addressed the Section 319 classification in the context of atmospheric deposition stating:

“Since the location of the contamination is not related to a particular source of mercury or nitrogen, but to all sources, deposition is a nonpoint source of pollution for water quality purposes.”

If the cost of installing mercury or nitrogen *reducing* technologies at public or private sources is eligible, then the cost of mercury or nitrogen *eliminating* technologies such as energy conservation projects which reduce the burning of fossil fuel and the production of electricity should be no less eligible.

In 2009, the State-EPA Nutrient Innovations Task Force issued “An Urgent Call to Action” identifying nutrient-related pollution as significantly impacting drinking water supplies, aquatic life and recreational water quality and presenting a compelling reason for more urgent and effective action. Deposition of NO_x compounds released to the air during fossil fuel combustion contributes significant inputs of additional nitrogen to land and surface water, according to the report. While the report noted that EPA lacked the authority to regulate air emissions under the Clean Water Act, we believe the flexible use of the CWSRF should be included in any list of incentive-based tools as alternatives to regulatory tools.

In 2011, EPA’s Acting Assistant Administrator issued “Working in Partnership with States to Address Phosphorous and Nitrogen Pollution through Use of a Framework for State Nutrient Reductions” urging EPA’s Regions to place new emphasis on working with states to make greater progress in accelerating the reduction of nitrogen loadings to the nation’s waters. While acknowledging that EPA possessed multiple regulatory tools, the memo stated that EPA’s resources “can best be employed by catalyzing and supporting action by states that want to protect their waters from nitrogen and phosphorous pollution.” The memo reiterated a common theme: “States need room to innovate and respond to local water quality needs, so a one-size-fits-all solution to nitrogen and phosphorous pollution is neither desirable nor necessary.” Energy demand reduction generally and NYSERDA’s Residential Energy Conservation Projects specifically are not the sole manner by which NYS intends to address atmospheric deposition of pollutants to water bodies. But, these projects are part of a successful and effective program and warrant the limited CWSRF support we propose. We take particular note of programs where participation is voluntary and which produce water quality benefits without federal appropriations, without local municipal borrowing and without regulatory compulsion.

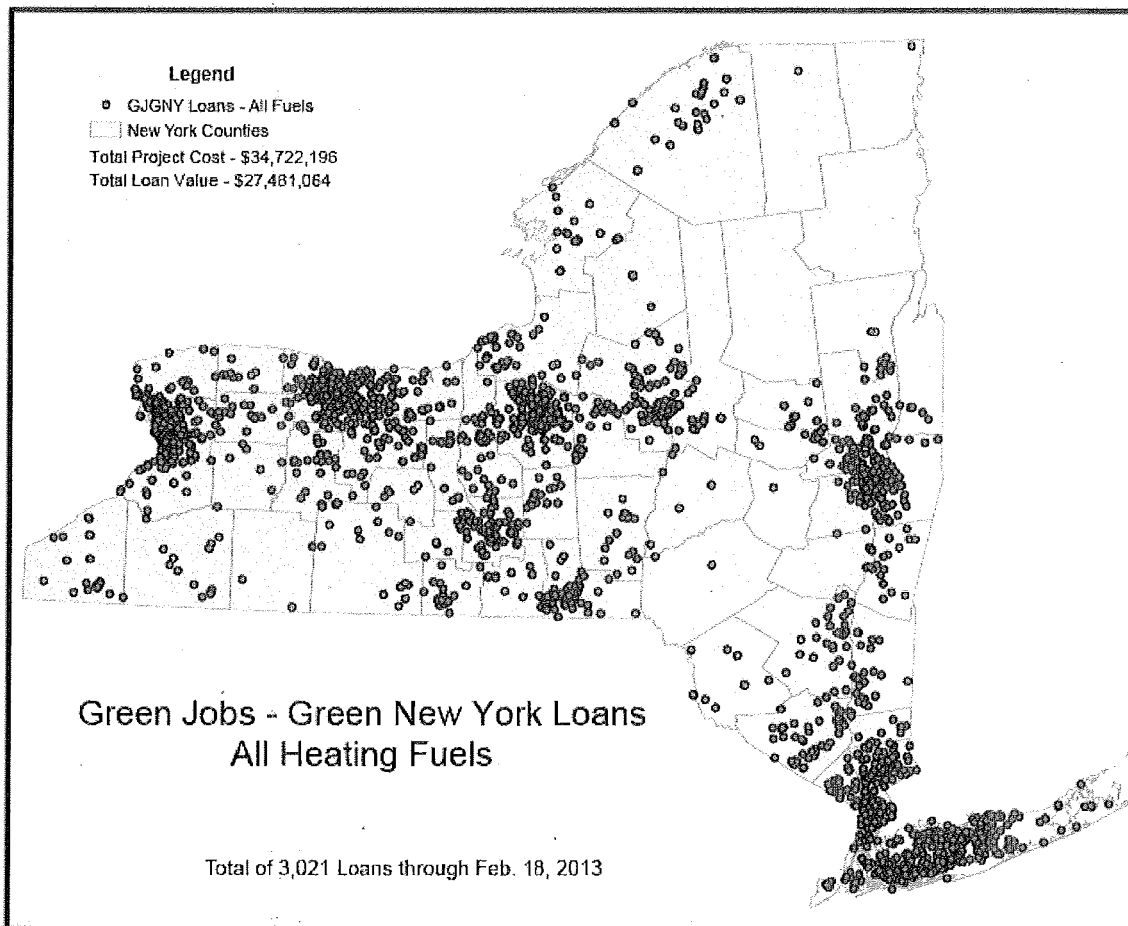
EPA’s Environmental Finance Advisory Board has long urged EPA to (a) expand CWSRF lending for non-point source projects, (b) review all of its funding programs which have a nexus to air emissions with a view to, wherever possible, using them as an incentive to encourage states to promote emission reduction activities and (c) advocate and encourage states to create financing mechanisms to address the reduction of greenhouse gas emissions and other air and non-point source water pollution problems. We believe our proposal is consistent with each of these recommendations.

Most recently, in draft guidance issued in November 2012 on NPS Program and Grants Guidelines for States and Territories, EPA again acknowledged atmospheric deposition as a source of nonpoint pollution and stated “EPA believes that the CWSRF is particularly well suited to assisting in the implementation of NPS projects requiring capital investment. States are encouraged to increase their use of these financial resources to help implement [watershed based plans] and other NPS projects.”

PART II – Residential Energy Conservation Projects and Atmospheric Deposition

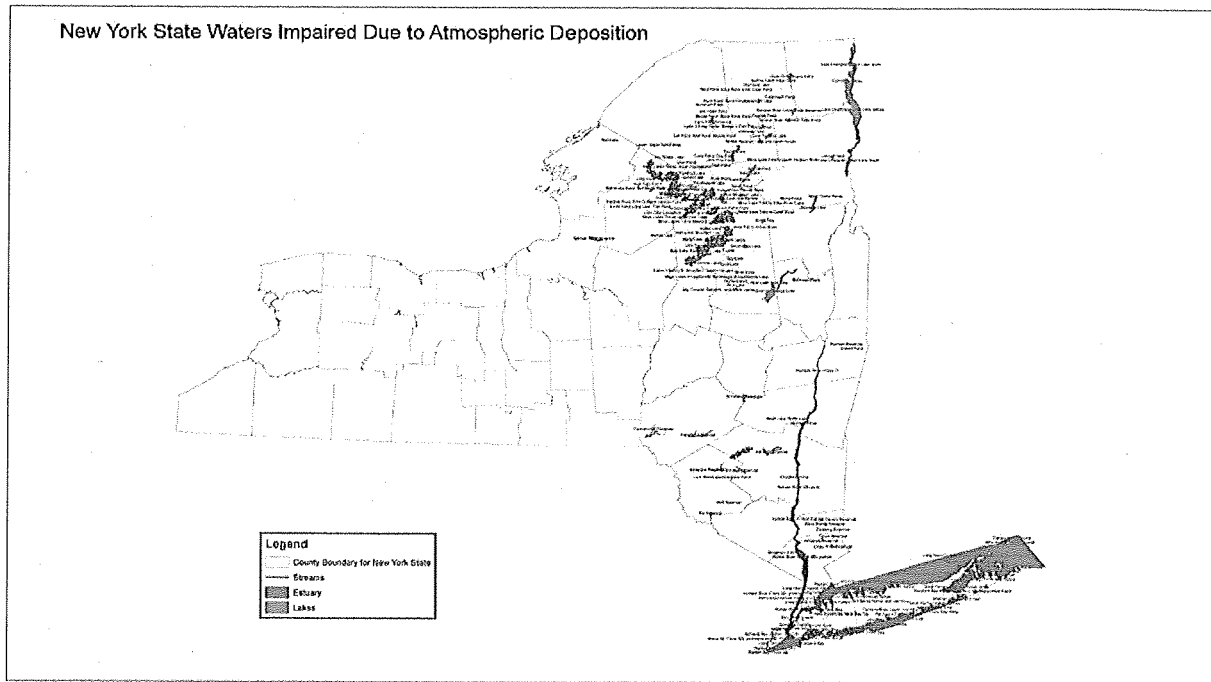
While the primary purpose of NYSERDA’s Residential Energy Conservation Projects is to meet the State’s energy reduction and greenhouse gas mitigation goals, reduced air emissions due to reduced energy consumption, primarily through reduced on-site combustion of fossil fuels for space and water heating needs, and secondarily from reduced electricity use, clearly have a positive effect on water quality, as these air emissions would otherwise have resulted in negative impacts such as nitrogen or sulfur deposition in regional water bodies or the watersheds that serve them. These impacts can occur across a wide geographic area, including sulfur and nitrogen deposition in the Great Lakes, Chesapeake Bay and Long Island Sound watersheds, and acid deposition in Adirondack water bodies.

NYSERDA’s Green Jobs/Green New York Residential Energy Conservation Projects are located across NYS. The map below provides an overview of the general locations of such projects.



As evident from the map, NYSERDA's Residential Energy Conservation Projects are generally clustered in four areas of concentrated population: southeastern New York surrounding Long Island Sound, the Hudson River Valley including the capital district, central New York in the vicinity of Oneida Lake and the Finger Lakes and western New York in proximity to Lake Ontario and Lake Erie. As stated above, the projects consist of building shell measures such as insulation and air sealing upgrades, high efficiency heating and cooling measures such as boiler and furnace conversions and upgrades, energy star appliances and lighting measures.

The map below is based on the Final New York State 2012 Section 303(d) list of Impaired Waters Requiring a TMDL/Other Strategy and reflects those New York State water bodies which have been further identified as impaired due to atmospheric deposition.



As evident by comparing both maps, there is close geographic proximity between NYSERDA's Residential Energy Conservation Projects in southeastern New York and the Hudson Valley and impaired water bodies on Long Island, including Long Island Sound and along the Hudson River. While NYSERDA's Residential Energy Conservation Projects in central and western New York do not appear in close proximity to water bodies on NY's Section 303(d) list, such projects are in close proximity to other significant water bodies which are subject to the impacts of atmospheric deposition. The Finger Lakes and Oneida Lake in central New York and the Great Lakes bordering Rochester and Buffalo are substantial water bodies critical to NY's environment and economy. Such water bodies are subject to the impacts of atmospheric deposition to their surface waters. Moreover, atmospheric deposition within these population centers aggravates the water quality impacts of urban storm water runoff which is a documented water quality problem in these regions. New York State's 2010 Water Quality Report issued under Section 305(b) of the Clean Water Act identifies over 30% of our waters as either impaired or impacted by atmospheric deposition or acid rain.

In conclusion, we believe an adequate relationship exists between the environmental benefits of NYSERDA's Residential Energy Conservation Projects and the remedial action called for in NY's NPS Program regarding atmospheric deposition such that EFC's provision of CWSRF financial assistance can be characterized fairly as assisting in the implementation of NY's NPS Program. We believe this relationship, when coupled with the SRF operating flexibility intended to be afforded to the States, the increasing emphasis on creative use of the CWSRF and the increasing concern about the water quality impacts of atmospheric deposition justifies qualifying such a project under the CWSRF and providing the limited support we propose. We request EPA's views on the adequacy of such relationship for purposes of determining whether CWSRF financial assistance can be provided in these circumstances for the implementation of NY's NPS Program under Section 603(c)(2) of the Clean Water Act.

We very much appreciate your willingness to consider our proposal. Both the EFC and NYSERDA teams are available to discuss questions or concerns with follow-up calls or in person. We would like to proceed with the transaction in April and accordingly, would like an indication of your position before the end of the month.

Sincerely,



James Devine
Senior Vice President and
General Counsel

JRL/CDP

c: Matthew J. Driscoll, President, NYSEFC
Tracey Hitchen Boyd, NYSEFC
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