

Date of Hearing: May 6, 2026

ASSEMBLY COMMITTEE ON APPROPRIATIONS

Buffy Wicks, Chair

AB 2777 (Committee on Environmental Safety and Toxic Materials) – As Amended March 26, 2026

Policy Committee: Environmental Safety and Toxic Materials Vote: 7 - 0

Urgency: No State Mandated Local Program: No Reimbursable: No

SUMMARY:

This bill makes various changes to the Clean Water State Revolving Fund (CWSRF) and makes a technical change to recently enacted legislation regarding recycled water.

Specifically, this bill, among other things:

- 1) States the intent of the Legislature (a) to provide the State Water Board with the authority to offer larger below-market rate loans that will help reinforce the long-term solvency of the CWSRF and support affordable recycled water, wastewater, and water quality infrastructure in California and (b) that when the State Water Board adopts amendments to the CWSRF policy to implement this bill, the board will collaborate with stakeholders and take steps to ensure projects receiving higher interest rates incur other benefits not offered to projects receiving the lowest offered rate.
- 2) Authorizes the State Water Board, for any financial assistance provided under the CWSRF, to assess fees for financial assistance services as permitted by federal law instead of an annual charge (that is currently authorized under existing law) and strikes an existing requirement prohibiting these fees or annual charges from exceeding 1% of the financial assistance balance computed according to the true interest cost method.
- 3) Strikes a provision in existing law stating that the financial assistance service rate applied by the State Water Board under the CWSRF shall remain unchanged for the duration of the financial assistance and shall not increase the financial assistance repayment amount, as specified.
- 4) Strikes a provision in existing law requiring the State Water Board to (a) set the total amount of revenue collected each year through the aforementioned annual charges at an amount that is as equal as practicable to the revenue levels set forth in the annual Budget Act and (b) conform the board's annual adjustment of its financial assistance service rate with the revenue levels set forth in the annual Budget Act.
- 5) Requires loans issued by the State Water Board under the CWSRF to be made at below market interest rates (as opposed to "at or below" market interest rates).
- 6) Strikes a provision in existing law, for loans issued by the State Water Board under the CWSRF, stating that, to the extent permitted by federal law, the combined interest and loan

service rate shall be set at a rate that does not exceed 50% of the interest rate paid by the state on the most recent sale of state general obligation bonds, as specified.

- 7) Defines, for purposes of SB 31 (McNerney), Chapter 736, Statutes of 2025, "incidental runoff" as unintended amounts (volume) of runoff, such as unintended, minimal overspray from sprinklers that escapes the area of intended use. Water leaving an intended use area is not considered incidental if it is part of the facility or system design, if it is due to excessive application, if it is due to intentional overflow or application, or if it is due to negligence.

FISCAL EFFECT:

- 1) By eliminating certain statutory limitations on interest rates and fees charged by the State Water Board for financial assistance offered through the CWSRF, this bill may result in an increase in the overall availability of funding in the CWSRF, which may be offset by larger loan amounts offered to eligible projects.

The CWSRF has significant financial assets, having financed over \$15 billion in wastewater and water recycling projects since 1988, and can finance projects from less than \$1 million to more than \$100 million.

Since the inception of the CWSRF, the Water Code has reenforced federal law requiring that CWSRF interest rates be "at or below market rates," effectively providing a subsidized interest rate for borrowers. The Water Code goes further to define the methodology for determining the CWSRF interest rate – specifically one-half of the recent General Obligation (GO) bond rate – effectively providing CWSRF borrowers at least a 50% subsidy on CWSRF lending rates compared to market rates. Since the interest earnings of the CWSRF may be used to make new loans, and the amount of interest earnings determines the lending capacity of the fund, with greater interest earnings resulting in greater lending capacity and vice-versa, the CWSRF interest rate is the primary variable in determining the annual lending capacity of the CWSRF. Under existing statute, State Water Board policy, and prevailing GO bond rates, the current annual lending capacity of the CWSRF is approximately \$600 million for eligible projects.

This bill strikes the express methodology for how the State Water Board must determine the interest rate for CWSRF loans and instead declares that the CWSRF interest rate must simply be "below market rate" and subject to any other federal rules. By striking the express interest rate methodology from statute, this bill gives the State Water Board the ability to establish a market rate definition and more flexible interest rates to, for example, provide larger loans where appropriate and maximize the lending capacity of the fund.

The State Water Board also has existing statutory authority to charge up to a 1% CWSRF administration "fee-in-lieu-of-interest" charge on the outstanding principal balance of a CWSRF loan and to deposit that charge in the CWSRF Administration Fund to cover the board's costs of administering the CWSRF program. Like an interest rate, the 1% annual charge is amortized over the loan repayment term and included with the borrower's principal and interest payment on their loan. However, the Water Code states that this 1% annual charge cannot increase the total annual payment due by the borrower when considering their principal and interest payment. Therefore, the 1% annual charge must supplement or be "in-lieu" of the borrower's interest payment, thereby not increasing the borrower's total loan repayment amount. The result is a portion of CWSRF loan interest earnings are repurposed

for CWSRF administrative funding, which then reduces the lending capacity of the program because of the loss in associated interest earnings to make new loans.

This bill strikes this 1% cap on CWSRF administration fees as well as the limitation that the fees be only annual charges that cannot increase the borrower's principal and interest repayment amount, effectively giving the State Water Board the authority to establish new fee methodologies to generate previously authorized administrative funding, while not adversely impacting the lending capacity of the CWSRF. The State Water Board notes that it could continue with the "fee-in-lieu-of-interest" methodology, subject to authority to establish higher interest rates to offset the loss in interest earnings, or it could deploy alternative fee methodologies.

- 2) Defining "incidental runoff" will result in minor and absorbable, if any, costs to the State Water Board (Waste Discharge Permit Fund and the Safe Drinking Water Account). As part of the Governor's budget for fiscal year 2026-27, the State Water Board is requesting \$1 million in ongoing funding for four permanent positions to permit and oversee the new types of water recycling uses authorized by SB 31. The State Water Board is also requesting \$500,000 annually between FY 2026-27 and FY 2028-29 from the Waste Discharge Permit Fund to fund two limited-term positions for developing necessary updates to water recycling regulations.

COMMENTS:

- 1) **Purpose.** According to the Environmental Safety and Toxic Materials (ESTM) Committee, this bill provides the State Water Board with flexibility when administering the CWSRF at no additional cost to water agencies, with the goal of stabilizing and potentially increasing the resources available within the CWSRF, and makes a technical clarification to SB 31 (dealing with water recycling).
- 2) **Background. *Clean Water State Revolving Fund.*** California's CWSRF program, which operates pursuant to an operating agreement between the State Water Board and the United States Environmental Protection Agency and offers low-cost financing for a variety of water quality projects, functions as an environmental infrastructure bank capitalized by federal and state funds. The CWSRF's capital and its earnings are used to provide financial assistance to a wide variety of water quality projects. States can target specific water quality problems, offer a variety of financing options, and customize terms to meet their water quality needs. Financing options include loans, refinancing debt, purchasing, or guaranteeing local debt, and purchasing bond insurance. The State Water Board offers interest rates that are below market rate, and the repayment period is generally the lesser of 30 years or the expected useful life of the financed asset. Since 2009, federal CWSRF appropriations and California law have, on a limited basis, also authorized grants, negative interest rates, and principal forgiveness through the CWSRF.

California's CWSRF has grown since financing its first project in 1989 and has executed more than \$14.7 billion in financial assistance agreements with over 500 unique recipients. The most common types of applications received are for wastewater treatment plants and sewer systems. Funding recipients are government entities, tribes, or non-profit organizations responsible for these projects. When the CWSRF loans out funds, the recipient pays back

both principal and interest. Currently the principal is deposited in the CWSRF and a portion of the interest is also deposited in the CWSRF.

Recycled Water Legislation. SB 31 clarified that the use of recycled water is authorized in various applications and under specified circumstances and provided that water discharged from a decorative body of water during a storm event is not an unauthorized discharge if recycled water was used to restore levels due to evaporation. Additionally, the bill authorized incidental amounts of spray, mist, or runoff to enter outdoor eating areas of parks and open spaces when irrigated with disinfected tertiary treated recycled water that complies with existing regulations governing the use of recycled water. However, according to the ESTM Committee, during implementation of SB 31, questions have arisen regarding the definition of incidental runoff.

To assist with the implementation of SB 31, this bill includes a definition of "incidental runoff" that exists in the California Code of Regulations (California Code of Regulations Title 23, Division 3, Chapter 3.5, Article 3, § 995).

- 3) **Support.** This bill is sponsored by the California Association of Sanitation Agencies (CASA) and WaterReuse California (WRCA) who assert, among other things, that the CWSRF is at risk of losing annual capitalization from the federal government, which would result in just interest circulating and annual loan totals going from \$600 million per year to perhaps \$200 million per year. The sponsors write, "With HUNDREDS OF BILLIONS of dollars of wastewater and recycled water projects planned in the state, more money needs to be infused into the program, not less." The sponsors contend this bill provides the State Water Board with "flexibility to stabilize the loan capacity over time by adjusting interest rates for large borrowers to account for the long-term solvency of the fund while maintaining appealing, below market-rate loan options for water infrastructure projects."

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