



State Revolving Fund Loan Program

an Indiana Finance Authority Environmental Program

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Interested Persons:

Re: Prepayment of SRF Loans

Many communities have contacted the SRF Program to inquire about the process to prepay their outstanding SRF loans as they reach their optional redemption dates. This letter is intended to communicate the SRF Program's observations related to prepayments already made and/or proposed to be made.

First, while the SRF Program is not aware of each community's underlying circumstances, it is thought that many contemplate funding their SRF prepayments with new refunding bonds ("Local Refunding Bonds") issued at the local level in order to enjoy debt service savings. As a general matter, SRF has historically sought to assist Indiana communities to reduce utility costs as much as possible, including accepting prepayments ("Prepaid Loan Amounts"), even though prepayments, when such reach certain levels in the aggregate, can cause mismatches within the cash flows of the SRF Program ("SRF Cash Flow Needs"). A priority of the SRF Program is to assure it remains on solid financial grounds (including assuring it adequately provides for its regularly scheduled debt service payments on all outstanding Indiana Finance Authority ("IFA") bonds). The SRF Program has a firm grasp on this part of the prepayment dynamic and is confident that the SRF resource will continue to provide needed funding to Indiana communities for their wastewater and drinking water infrastructure needs.

Second, SRF Program staff wants to be sure all participants understand how SRF loans are funded and how prepayments are applied in the context the SRF Program, so that those facts may be used by a prepaying local community in their Internal Revenue Code ("IRC") local refunding analysis associated with prepayments. As was set out in each original local bond transcript (related to any SRF loan being prepaid), the SRF Program acquired the local bond (SRF loan) as a "purpose investment" from the proceeds of pooled financing bonds issued by the IFA (or its predecessor issuer, the Indiana Bond Bank), the interest on which was excludible for federal income tax purposes under IRC §103 ("Original IFA Bonds"). As you may or may not know, the IFA has previously issued refunding bonds to advance refund all Original IFA Bonds. Finally, the IFA's bond counsel has advised SRF Program staff that IFA SRF bonds constitute a "conduit financing issue" under Treas. Reg. §1.150-1(d)(2)(iii) and Local Refunding Bonds constitute a "conduit refunding issue" under that same Treas. Reg. and, as such, depending upon how the IFA applies Prepaid Loan Amounts, the Local Refunding Bonds could be viewed as a second advance refunding under IRC §149(d)(6). While this does not affect any IFA bonds, the Local communities should consult their own tax advisors and bond counsel regarding the affect, if any, on their



Local Refunding Bonds. The SRF Program does not provide legal and/or tax advice to local SRF communities.

While the SRF Program has not made any commitments regarding how Prepaid Loan Amounts will be applied by it, the SRF Program generally looks to apply Prepaid Loan Amounts as follows:

1. To pay debt service on IFA pool financing bonds that are due within 90 days after a prepayment is received (or if known to be earlier, the issue date of a related Local Refunding Bonds);
2. To pay costs of administering the SRF Program (without regard to when that payment may occur);
3. To fund new forgivable SRF loans (without regard to when such loan draws may occur), which forgivable SRF loans are not expected by SRF to be repaid and are not expected to be available to pay IFA pool financing bonds;
4. To make loan disbursements to fund new SRF loans within 6 months after a prepayment is received (or if known to be earlier, the issue date of a related Local Refunding Bonds).

Again, the SRF Program makes no commitment to take the preceding steps and also notes that its ability to do so is limited by the volume and timing of prepayments received. Further, the SRF Program will also observe as its first priority assuring it meets the SRF Program Cash Flow Needs, notwithstanding how some aspect of that course of action may affect Local Refunding Bonds under the IRC or otherwise.

Finally, to allow the SRF Program to better understand and manage the various details surrounding prepayments, effective immediately, the SRF Program will require the following:

- A. Formal Notice of Prepayment. Over the past several months, the SRF Program has allowed very informal notice of a planned refunding. In one way, informal notice provided a “heads-up” from any local community at an early stage that it was considering (and/or expecting) to prepay an SRF loan by issuing Local Refunding Bonds. That is a positive aspect, and the SRF Program appreciates early contact on a go-forward basis. However, in addition to informal notice, the SRF Program will now also require prepayments to follow traditional, formal bond redemption practices (including formal notices) that are consistent with the formal terms specified in the Bonds. Conditional notices are not viewed as consistent with Bond forms; once a notice is given, prepayments will be treated as committed obligations. Accordingly, the SRF Program would generally expect formal redemption notices to be given in advance of the issuance of Local Refunding Bonds; however, if your local wastewater refunding will close within 90 days prior to February 1, 2014 (or any August 1 or February 1 thereafter), or if your local drinking water refunding will close within 90 days prior August 1, 2013 (or any February 1 or August 1 thereafter), then please contact the SRF Program as an exception may be allowed so that a particular Prepaid Loan Amount can to be timely applied by the SRF Program as set out in #1 above.
- B. Other SRF Loans. Pursuant to the terms of each SRF Program loan, the SRF Program retains the right to deposit the full loan amount into a local construction account (either on a new closing date or after closing for any loans closed initially using a draw mode). Once a local construction account is funded, interest begins to accrue on the SRF loan. To the extent normal new loan draws (as set out in #3 and #4 above) do not utilize all Prepaid Loan Amounts quickly enough,

the SRF Program will likely fully fund several of its undrawn loans (by making a deposit into local construction accounts); this will *first* be done for any existing SRF loans related to a prepaying community and *second* will be considered for use for any SRF communities that have an undrawn loan balance.

- C. Additional Information Requested. Following the SRF Program's receipt of any prepayment, the SRF Program will contact the local financial advisor seeking further details such as (i) when the Local Refunding Bonds were issued and (ii) the amount of funds (non-bond proceeds) applied to the prepayment. Please promptly respond as this will allow us to more accurately take any of the above-described actions, should the SRF Program determine, in its discretion, to do them.

It has been the past practice of the SRF Program to assist Indiana communities in keeping borrowing costs down and the SRF Program staff looks forward to continuing that practice with respect to future prepayment requests. Please contact me if you have any questions.

Sincerely,



William Harkins