



State of Utah

GARY R. HERBERT  
*Governor*

SPENCER J. COX  
*Lieutenant Governor*

Department of  
Environmental Quality

L. Scott Baird  
*Executive Director*

DIVISION OF WATER QUALITY  
Erica Brown Gaddis, PhD  
*Director*

**Water Quality Board**  
Jennifer Grant, Chair  
Gregg A. Galecki, Vice Chair  
Steven K. Earley  
Brandon Gordon  
Michael D. Luers  
L. Scott Baird  
Emily Niehaus  
James Webb  
Dr. James VanDerslice  
Dr. Erica Brown Gaddis  
*Executive Secretary*

**MEMORANDUM**

**TO:** Utah Water Quality Board

**THROUGH:** Erica Brown Gaddis, PhD

**FROM:** Skyler Davies, P.E.

**DATE:** September 23, 2020

**SUBJECT:** Analysis of SRF Hardship Evaluation

**Background**

The purpose of this memo is to assist the Water Quality Board (Board) with evaluating alternative mechanisms by which community hardship determinations could be made for the purpose of financing decisions. The Board has requested that staff provide new policy options to the existing single metric of 1.4% of Median Adjusted Gross Income (MAGI).

In recent years there have been several attempts at the national level to address concerns that utilities are facing in balancing regulatory compliance with managing utilities at rates that are not beyond the financial capabilities of the households they serve. These studies can be used to inform the process of developing hardship criteria as it relates to funding.

The EPA is currently seeking public comment on the proposed “2020 Financial Capability Assessment for Clean Water Act Obligations” located at the following link:  
[https://www.epa.gov/sites/production/files/2020-09/documents/epa\\_proposed\\_2020\\_financial\\_capability\\_guidance\\_september\\_2020.pdf](https://www.epa.gov/sites/production/files/2020-09/documents/epa_proposed_2020_financial_capability_guidance_september_2020.pdf)

Page 4 of that document provides a summary that explains the purpose of the policy and briefly speaks to the use of two alternatives for assessing financial capability. The first alternative is the use of a residential indicator (i.e. a percent of MHI or in our case MAGI) and a financial capability indicator. The second alternative uses dynamic financial and rate models that evaluate the impacts of debt service on customer bills. Both of these methods also suggest looking at the

lower quintile of a community and to consider other utility costs such as drinking water and stormwater costs when considering affordability. This document is discussed in more detail in the “Alternative Approaches” section below.

An additional resource is the April 17, 2019 report “Developing a New Framework for Household Affordability and Financial Capability Assessment in the Water Sector” that was prepared for the American Water Works Association, the National Association of Clean Water Agencies, and the Water Environment Federation found at the following link:

<https://www.awwa.org/Portals/0/AWWA/Government/DevelopingNewFrameworkForAffordabilityReport.pdf>

The predecessor to these two documents, and what seems to be the reason for their creation is a report created by the National Academy of Public Administration (NAPA) for the EPA in 2017 in a report “Developing a New Framework for Community Affordability of Clean Water Services” (the “NAPA Report”), located at the following link: [https://www.nacwa.org/docs/default-source/conferences-events/Hot-Topics-in-Clean-Water-Law-Webinar/2017-11-15napa\\_report.pdf?sfvrsn=2](https://www.nacwa.org/docs/default-source/conferences-events/Hot-Topics-in-Clean-Water-Law-Webinar/2017-11-15napa_report.pdf?sfvrsn=2)

### **Utah’s Current Rule and Practice**

The Current Rule that informs the Boards decision making process is contained in R317-101-4(B)(1):

“for loan consideration, the estimated annual cost of sewer service to the average residential user should not exceed 1.4% of the median adjusted gross household income from the most recent available State Tax Commission records. Consideration will also be given to the applicant's unemployment data, population trends, and the applicant's level of contribution to the project. For hardship grant consideration, exclusive of advances for planning and design, the estimated annual cost of sewer service for the average residential user should exceed 1.4% of the median adjusted gross household income from the most recent available State Tax Commission records. The Board will also consider the applicant's level of contribution to the project.”

This rule allows the 1.4% of MAGI to be a starting point for hardship consideration as it indicates that for loans the average residential user rate *should* not exceed 1.4% of MAGI, and for grant to be considered the cost of sewer service for the average residential user *should* exceed 1.4% of MAGI. The “should” aspect of the rule provides inherent flexibility for the Board to take other factors into consideration. Staff understands the Board’s desire to provide a more consistent approach to consideration of other factors and possibly to adjust the existing 1.4% MAGI threshold.

Staff currently uses the 1.4% MAGI criterion as a threshold criterion for hardship. In general, if a project will result in a sewer bill of 1.4% or higher, staff recommends that the Board set the loan interest rate at 0% and consider using grant funds for the project costs that would result in sewer bills being greater than 1.4%.

Other considerations have been used on both sides of the 1.4% dividing line:

1. Both Logan and Provo received loan authorizations with interest rates greater than 0% when their projects will result in sewer bills greater than 1.4%. These were large loans and the decision to charge interest was based on the need to preserve (and contribute to) the hardship grant fund.
2. Duchesne City received a grant authorization (in addition to loan) when their project did not result in a sewer bill greater than 1%. Special consideration was given to the City's project cost based on the community's 18% rate of unemployment at the time of the loan.
3. For the recent Millville and Lewiston projects, staff used a more detailed analysis of hardship, based on the 2019 AWWA et al. guidance referenced above. This is explained in more detail below.

## **Alternative Approaches**

### Proposed 2020 Financial Capability Assessment Guidance

EPA released the *Proposed 2020 Financial Capability Assessment Guidance* (2020 FCA) on August 28, 2020. This guidance, which is open to public comment now, incorporates aspects of the strategies recommended previously and addresses concerns over weakness and limitations of the previous strategies, particularly with respect to addressing affordability problems associated with disadvantaged communities and utilities with restricted financial capacity.

The proposed 2020 FCA is intended to provide options and flexibilities to communities and offers templates and calculations that local authorities can use when assessing their financial capability to implement control measures needed to meet Clean Water Act (CWA) obligations. As noted above, it identifies two alternative approaches for assessing a community's financial capability. The first alternative is the existing 1997 FCA methodology with expanded consideration of costs, poverty, and impacts on the population in the service area with incomes in the lowest quintile. The second alternative is the development of a dynamic financial and rate model that looks at the impacts of rate increases over time on utility customers, including those with incomes in the lowest quintile.

Staff used an alternative approach (for assessing a community's financial capability) similar to EPA's first alternative in our evaluation of Millville and Lewiston Cities' financial assistance packages that were heard by the board on March 25, 2020. These analyses used three of the four criteria that are discussed in EPA's proposal:

- Residential Indicator (RI), as measured by median household income (MHI) or alternatively Utah's MAGI;
- Household Burden Indicator (HBI) = 20%-ile household income (LQI)
- Poverty prevalence indicator (PPI) = % population below 200% of fed poverty level

In considering these indicators, EPA established a range for the RI and a matrix that combines the HBI and PPI to express the economic burden of water service, ranging from low to very high.. Together, this approach allows us to view community hardship levels both broadly, across the whole community, and more specifically at the lowest income level.

The fourth criterion that was not used in these analyses was the Financial Capability Indicator (FCI), which uses socioeconomic, debt, and financial indicators used to benchmark a community's financial strength. This indicator requires an in depth analysis of a city's finances and practices and includes the use of a bond rating, debt as a percent of property value, property tax revenue as a percent of property value, and property tax collection rate, as well as MHI and unemployment rates, used in other indicators. The cost to obtain a bond rating for a smaller city as well as the lack of availability of some of the other information would make this a more difficult indicator to calculate for smaller municipalities.

In most cases where the perceived hardship (based on MAGI) occurs, communities are small (like Lewiston) or new infrastructure is being proposed, like Millville where septic tanks are being replaced with a community sewerage system.

#### Options for Discussion

1. Maintain the current status quo.
2. Increase the threshold from 1.4% to some new level. One option would be to match the drinking water requirement of 1.75%
3. Offer a tiered approach as identified above. For example an option would be the 1.4% threshold would trigger additional evaluation rather than becoming the point at which grant is recommended. In other words the Board could create a policy that essentially says:
  - a. If the 1.4% threshold is not exceeded with loan, staff provides the simple static cost model to indicate that, and grant would not be considered at that point.

- b. If the 1.4% is exceeded then a more detailed analysis would be warranted, taking into consideration other factors. This analysis could take into account factors such as unemployment data, poverty level, population trends, etc.

Using this methodology the 1.4% would only be used to determine whether to reduce interest rates on loans. A higher level of hardship may then need to be demonstrated before a grant is considered.

4. Abandon MAGI and go to a completely new process that uses metrics as described in recent EPA guidance.
5. Move toward a one-water approach accounting for wastewater, storm water, and drinking water fees in the hardship analysis.

### **Considerations for Discussion**

Some items to be considered in evaluating a change to the current structure:

- Changing the 1.4% threshold requires a rule change and is within the authority of the Board. An alternative would be for staff to prepare a more formal policy that the Board could adopt for consideration of factors beyond the 1.4% threshold.
- Changes to this rule affect not only hardship grant criteria but also the criteria for authorizing principal forgiveness associated with federal loans. (see Water Resources Reform and Development Act of 2014 Title V(A) Section 5003) [https://www.epa.gov/sites/production/files/2015-04/documents/water\\_resources\\_reform\\_and\\_development\\_act\\_guidance.pdf](https://www.epa.gov/sites/production/files/2015-04/documents/water_resources_reform_and_development_act_guidance.pdf)
- Changes to the Board's affordability analysis also affect the Permanent Community Impact Board (CIB) policy. Staff creates feasibility reports for CIB and identifies affordability for funding a water quality project based on the same criteria used for the Water Quality Board.
- The EPA affordability framework is primarily directed to regulatory decision making (thresholds for offering compliance schedules as a form of regulatory relief) rather than SRF funding. However, the most recent draft of the EPA affordability framework provides guidelines that could be taken into consideration in creating a financing policy.
- The EPA guidance provides ranges over which hardship conditions are considered. In assessing these ranges the board should consider the differences between financing affordable water quality projects and providing economic relief for water quality compliance.

- The EPA method may require additional time to evaluate applications as much more information needs to be gathered in preparing the Board memo. Also, these data may be more difficult to find for rural cities and districts.
- Flexibility for setting loan terms is important to EPA and the Division. How can the Board preserve flexibility while establishing a more robust hardship criteria framework?
- Utilizing MAGI may not be the perfect solution, but it is what has been used for a long time for DWQ and is currently also used by the Division of Drinking Water (1.75% of MAGI) for determining affordability. Therefore, if significant changes are made public outreach will be needed to convey the changes.

## **Conclusions**

In conclusion there are many ways for hardship to be evaluated, all of which have pros and cons associated with the methodology. At this point Staff seeks the Boards input on which option or options to pursue further. As has been presented above there are many things that need to be considered before proceeding. The goal of the work meeting is to narrow the focus to a smaller range, and to better understand the desired direction of the Board. This may require either creating a policy/guidance document that works within our current rule, or it may require initiating rule making to significantly modify the existing rule.