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WORK MEETING MEMORANDUM

TO: Utah Water Quality Board
THROUGH: Erica Brown Gaddis, PhD
FROM: Ken Hoffman, P.E. and Skyler Davies, P.E.
SUBJECT: Follow-Up to Analysis of SRF Hardship Evaluation

1. INTRODUCTION

During the Water Quality Board work meeting held September 23, 2020, the Board discussed alternatives for determining community eligibility for hardship financing. In that meeting, the Board requested that staff develop a written policy clarifying the use of “other considerations” identified in rule. Additionally the Board has expressed concern that utilizing 1.4% of the median adjusted gross household income (MAGI) as a hardship threshold for sewer rates may not be sustainable from a fund management standpoint. **Staff’s report from the September meeting is attached.**

For this work meeting, staff identified alternatives that can be accomplished both within the framework of the current rule and those that would require a rule change. In all cases, staff attempted to establish a more systematic approach toward defining hardship eligibility and extent. Staff will present these ideas and seek the Board’s direction toward setting an equitable and consistent hardship policy.

2. BACKGROUND

The current rule establishes that for hardship consideration, sewer rates *should* (emphasis added) exceed 1.4% of Median Adjusted Gross Household Income (MAGHI). Additional considerations toward establishing the type and amount of assistance are provided but Rule does not specify subsidy levels nor does it specify how these additional considerations should be applied in making the subsidy determination.

a. CURRENT RULE

UAC R317-101-4(B) identifies multiple factors for consideration of hardship. These are summarized in the table below.

Table 1: Rule Required Considerations	
Rule Reference	Consideration
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
R317-101-4.B.1.	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.
R317-101-4.B.1.	Consideration will also be given to the applicant's unemployment data
R317-101-4.B.1.	Consideration will also be given to the applicant's population trends
R317-101-4.B.1.	Consideration will also be given to the applicant's level of contribution to the project
R317-101-4.B.2.	The estimated, average residential cost, as a percent of median adjusted gross household income, for the proposed project should be compared to the average user charge, as a percent of median adjusted gross household income, for recently constructed projects in the State of Utah;
R317-101-4.B.3.	Maximizing return on the security account while still allowing the project to proceed;
R317-101-4.B.4.	Local political conditions
R317-101-4.B.4.	Local economic conditions
R317-101-4.B.5.	Cost effectiveness evaluation of financing alternatives
R317-101-4.B.6.	Availability of funds in the security account
R317-101-4.B.7.	Environmental Need
R317-101-4.B.8.	Other data and criteria the Board may deem appropriate

b. Affordability of Sewer Service

The most comprehensive analyses of sewer service affordability have been published by EPA beginning with the 1997 *Combined Sewer Overflows – Guidance for Financial Capability Assessment and Schedule Development*. In this and successive reports, EPA established three ranges of Financial Impact - Low, Mid-Range, and High – in relation to community median household income or MHI (Table 2).

Table 2. Financial Impact Ranges from EPA	
Financial Impact	% MHI
Low	Less than 1.0 Percent of MHI
Mid-Range	1.0 – 2.0 Percent of MHI
High	Greater than 2.0 Percent of MHI

Although use of MHI as an indicator of hardship has its weaknesses, particularly with respect to addressing economically distressed populations, it has remained a key indicator of hardship throughout EPA’s guidance through the latest guidance of 2020.

The burden levels in Table 2 were set with combined sewer systems (Storm and Sanitary) in mind. In EPA’s guidance, these levels were set in the context of establishing reasonable project implementation schedules that would not over burden a community’s financial capability while accomplishing that project’s water quality objectives. These burden levels are not necessarily the same as those used in establishing financing terms and subsidy for most water quality projects.

While rule calls for the use of the median adjusted gross household income, staff has historically used the modified median adjusted gross income (modified MAGI) calculated annually by the State of Utah Tax Commission for the Divisions of Drinking Water and Water Quality. In comparison with the MHI, the Modified MAGI has an approximate ratio of 1.0 MHI to 1.4 Modified MAGI on a statewide basis. For example in 2018 the Statewide Modified MAGI was \$48,000 and the Statewide MHI was \$68,374. This means that Statewide MHI is approximately 1.4 times Statewide MAGI. Staff believes that this may explain how the 1.4% MAGI threshold was originally determined (in comparison to the EPA recommended 1% MHI).

c. ADDITIONAL AFFORDABILITY CRITERIA

The Affordability criteria in Utah's administrative rule were last modified to bring our rules into compliance with the changes made to the Federal Water Pollution Control Act (FWPCA) by the Water Resources Reform and Development Act (WRRDA). The act requires the following with respect to providing principal forgiveness/additional subsidization for a project.

(2) AFFORDABILITY CRITERIA.—

(A) ESTABLISHMENT.—

- (i) IN GENERAL.—Not later than September 30, 2015, and after providing notice and an opportunity for public comment, a State shall establish affordability criteria to assist in identifying municipalities that would experience a significant hardship raising the revenue necessary to finance a project or activity eligible for assistance under subsection (c)(1) if additional subsidization is not provided.
- (ii) CONTENTS.—The criteria under clause (i) shall be based on income and unemployment data, population trends, and other data determined relevant by the State, including whether the project or activity is to be carried out in an economically distressed area, as described in section 301 of the Public Works and Economic Development Act of 1965 (42 U.S.C. 3161).

(B) EXISTING CRITERIA.—If a State has previously established, after providing notice and an opportunity for public comment, affordability criteria that meet the requirements of subparagraph (A)—

- (i) the State may use the criteria for the purposes of this subsection; and
- (ii) those criteria shall be treated as affordability criteria established under this paragraph.

Furthermore, The FWPCA section 603(i)(2)(A) requires that criteria be based on:

- income;
- unemployment data;
- population trends; and
- other data determined relevant by the State.

The change in rule added language for the consideration of the items specified in WRRDA, but did not provide policy as to how these additional considerations would affect the funding recommendations.

d. CURRENT RULE IMPLEMENTATION

The Rule allows the Board discretion in determining the appropriate funding package. This discretion is intentional, and appropriate as there are often mitigating circumstances that the Board should take into account when determining the appropriate funding to authorize.

The current rule appropriately excludes advances for planning and design from exceeding an affordability threshold. This is because advances are intended to be rolled into the funding of the project once it is identified and funded, and the affordability would be evaluated at the time of project funding.

It is worth noting that information is available for MAGI for almost all cities and towns in Utah. It requires a greater effort to track down unemployment data, poverty rate data, and population trends. This may make any of the proposed alternatives more difficult to apply to smaller entities and districts.

Since Rule was updated last, the additional criteria and a few other criteria have been brought into the discussion in Board memos for specific projects. However, the only case staff was able to find where grant was recommended based on additional criteria and user rates did not exceed 1.4% of MAGI was Duchesne City. In this case Duchesne City was experiencing an extremely high unemployment rate at the time of application. There have been a few recent projects that considered other factors related to the recent EPA studies but in those cases, user rates necessary for the recommended funding exceeded 1.4% of MAGI by a significant amount, and the additional factors were brought as stronger justification for Hardship Grant consideration.

3. ALTERNATIVE FUNDING POLICIES

Included in this memo are four alternative funding policy proposals. Alternatives 1 and 2 provide two methods for determining a “Calculated Affordability Threshold MAGI.” In these alternatives we use the burden ranges set by EPA where sewer costs below 1.0% MHI are considered a low burden, 1.0% to 2.0% MHI a medium burden, and above 2.0% MHI a high burden. For our purposes, these ranges are converted to MAGI by multiplying by 1.4, leading to low, medium and high burden ranges of less than 1.4%, 1.4% to 2.8%, and greater than 2.8%, respectively. The halfway point of the medium burden range would be 2.1% of MAGI $((2.8+1.4)/2)$.

Alternative 1 approaches the hardship determination by starting at a high MAGI and decreasing Calculated Affordability Threshold MAGI based on the additional considerations (Table 1). For discussion purposes, 2.1% of MAGI will be used as the starting point in this alternative. Alternative 2 is very similar but takes the opposite approach by starting at 1.4% of MAGI and adding based on not meeting the additional consideration criteria.

Alternative 3 provides a different approach that utilizes matrices based on the EPA 1997 guidance and draft 2020 guidance. It is a more complex approach, but it provides a mechanism for incorporating all of the current considerations in rule (Table 1) and is more consistent with EPA’s recommended methodology.

Alternative 4 would be to reassess and change the 1.4 percent MAGI criterion.

Although not discussed in detail, the Board could also consider capping the percent of a project that may be funded by grant based on the level of burden. (e.g., low burden max 25% grant, medium burden max 50% grant, high burden greater than 50% grant). The board could also consider setting a maximum hardship grant amount for any project if they would like to, or a combination of the two.

Staff does not believe that any of these alternatives necessarily require a rule change. Regardless of the need for a rule change, once an alternative is chosen there will be a need for public outreach before instituting it in policy. All of these alternatives provide a reasonable process to consider additional factors beyond a single threshold.

It is anticipated that the chosen policy will be used as a Board directed policy for staff evaluation of projects. These alternatives provide measures that can be taken in evaluating upcoming projects with room to make changes in the future prior to making a more permanent rule change.

All of these alternatives are intended as being draft policies for guidance on Financial Assistance. Staff would like the Board to identify the alternative(s) that the Board would like Staff to further pursue solidifying the values and additional considerations, scoring brackets, weighting values, threshold values, and funding recommendation and any input on this is appreciated.

Staff can then take the guidance and prepare a final policy document to present to the Board in a future Water Quality Board meeting for adoption of the policy in the form of a 1-2 page policy guidance which could be placed on the Board website.

ALTERNATIVE 1: PROPOSED POLICY FOR STAFF EVALUATION OF WATER QUALITY PROJECTS

This policy establishes a systematic approach to be used by staff on evaluating community hardship conditions for the purpose of making financial assistance determinations and recommendations.

Step 1. A static cost model will be used to show various interest rates on loans and the corresponding user rate. The model will identify the interest rate at which a user rate exceeds 1.4% of MAGI. If rates can be maintained at or below 1.4% of MAGI with loan only, additional hardship evaluation will not be necessary unless extenuating circumstances exist.

Step 2. When the static cost model produces a required user rate that exceeds 1.4% of MAGI, with 0% interest rate, then an additional evaluation would be used to determine how much if any hardship grant should be considered for the project. Staff would evaluate funding packages that produce user rates up to a maximum of the “Calculated Affordability Threshold MAGI” or the rate set by a 0% interest loan with no Hardship Grant.

Table 3 below will be used in the calculation of the Maximum Calculated Affordability Threshold MAGI based on additional considerations. The maximum affordability threshold of 2.1 percent MAGI is an example for discussion purposes; as indicated above it is the midpoint of the medium burden range from EPA’s guidance.

Table 3. Maximum Calculated Affordability Threshold MAGI		
Maximum Affordability Threshold:		2.1% MAGI
Hardship Factors	Decrease in Hardship MAGI Threshold	Applied Decrease
Local Poverty Level > State Poverty Level	0.1	
Population Trend is Decreasing	0.1	
Local Unemployment > State Unemployment	0.1	
Demonstration of Environmental Need	0.1	
Applicant Contribution to the Project	0.1	
Low Impact to Available Grant Funds	0.2	
Project Addresses a Documented Public Health Crisis or verifiable public emergency.	0.2	
Calculated Affordability Threshold MAGI		

Step 3. The Calculated Affordability Threshold MAGI is determined from Table 3 by subtracting the potential decrease amount in column 2 from the maximum affordability threshold for each of the hardship factors (column 1) that apply.

Step 4. Additional static cost models would be run showing a range of funding options, including grant, that provide sewer rates between 1.4% of MAGI and the Calculated Affordability Threshold MAGI. The halfway point between 1.4% and the Calculated Affordability threshold could be considered the line between a Medium Burden and High Burden; low burden is below 1.4% of MAGI.

This policy would be used to inform the Board and to assist staff in providing consistent recommendations. It does not create requirements on the funding that could be offered by the Water Quality Board, as the Board makes the final decisions and may take other factors into consideration.

Additionally, in unusual circumstances this policy may be considered but not necessarily followed. These circumstances might include a documented public health crisis, emergency circumstances, low fund balances, projects smaller than \$100K, etc. Also for very large funding packages there generally are not sufficient grant funds to maintain an affordability level, and an interest rate on the loan is necessary to maintain the viability of the accounts.

ALTERNATIVE 2: PROPOSED POLICY FOR STAFF EVALUATION OF WATER QUALITY PROJECTS

This policy establishes a systematic approach to be used by staff on evaluating community hardship conditions for the purpose of making financial assistance determinations and recommendations. It is very similar to Alternative 1 above except that it builds up to a higher hardship threshold based on the absence of additional hardship considerations rather than down from a maximum threshold based on their presence.

Step 1. A static cost model will be used to show various interest rates on loans and the corresponding user rate. The model will identify the interest rate at which a user rate exceeds 1.4% of MAGI. If rates can be maintained at or below 1.4% of MAGI with loan only, additional hardship evaluation will not be necessary unless extenuating circumstances exist.

Step 2. In the event that the static cost model produces a required user rate that exceeds 1.4% of MAGI, even with 0% interest rate, then an additional evaluation would take place to determine how much if any hardship grant should be considered for the project. Staff would evaluate funding packages that produce user rates up to a maximum of Calculated Affordability Threshold MAGI or the rate set by a 0% interest loan with no Hardship Grant.

Step 3. The Calculated Affordability Threshold MAGI is determined from Table 4 by adding the potential increase amount in column 2 to the minimum affordability threshold for each of the additional hardship considerations (column 1) that apply.

Table 4. Minimum Calculated Affordability Threshold MAGI		
Minimum Affordability Threshold:		1.4% MAGI
Hardship Factors	Increase in MAGI hardship threshold	Applied Increase
Local Poverty Level < State Poverty Level	0.1	
Population Trend is Increasing	0.1	
Local Unemployment < State Unemployment	0.1	
Lack of Demonstration of Environmental Need	0.1	
Applicant Lack of Contribution to the Project	0.1	
% of available Grant Funds Needed for Project	0.1	
Hardship Grant Funds Availability < \$1,000,000	0.1	
Calculated Affordability Threshold Maximum	2.1% MAGI	

Step 4. Additional static cost models would be run showing a range of funding options, including grant, that provide MAGI's between 1.4% of MAGI and the Calculated Affordability Threshold MAGI. The halfway point between 1.4% and the Calculated Affordability threshold could be considered the line between a medium burden and high burden; low burden is below 1.4% of MAGI.

This policy would be used to inform the Board and to assist staff in providing consistent recommendations. It does not create requirements on the funding that could be offered by the Board, as the Board makes the final decisions and may take other factors into consideration.

Additionally, in unusual circumstances this policy may be considered but not necessarily followed. These circumstances would include a documented public health crisis, emergency circumstances, low fund balances, projects smaller than \$100K, etc. Also for very large funding packages there generally are not sufficient grant funds to maintain an affordability level, and an interest rate on the loan is necessary to maintain the viability of the accounts.

ALTERNATIVE 3: FINANCIAL INDICATOR ASSESSMENT ALTERNATIVE FOR STAFF EVALUATION OF WATER QUALITY PROJECTS

This policy establishes a systematic approach to be used by staff on evaluating community hardship conditions for the purpose of making financial assistance determinations and recommendations. Staff would characterize project funding results as high burden, medium burden, and low burden. Utah Administrative Code R317-101-4, *Loan, Credit Enhancement, Interest Buy-Down, and Hardship Grant Consideration Policy* requires the Board make a financial assistance determination based on the items summarized in Table 4. Table 4 includes a third column indicating how these individual considerations could be implemented into a new process and policy.

Table 4: Rule Required Considerations		
Rule Reference	Consideration	How we could address
R317-101-4.B.1.	<u>For loan consideration</u> , the estimated annual cost of sewer service to the average residential user should <u>not exceed 1.4%</u> of the median adjusted gross household income from the most recent available State Tax Commission records	Use Modified MAGI and put in Table 3 Matrix Ranking
R317-101-4.B.1.	<u>For hardship grant consideration</u> , exclusive of advances for planning and design, the estimated annual cost of sewer service for the average residential user <u>should exceed 1.4%</u> of the median adjusted gross household income from the most recent available State Tax Commission records.	
R317-101-4.B.1.	Consideration will also be given to the applicant's unemployment data	Unemployment rate compared with Statewide average
R317-101-4.B.1.	Consideration will also be given to the applicant's population trends	10 year population trend
R317-101-4.B.1.	Consideration will also be given to the applicant's level of contribution to the project	Percent of local contribution
R317-101-4.B.2.	The estimated, average residential cost, as a percent of median adjusted gross household income, for the proposed project should be compared to the average user charge, as a percent of median adjusted gross household income, for recently constructed projects in the State of Utah;	Compare with past Board Authorizations
R317-101-4.B.3.	maximizing return on the security account while still allowing the project to proceed;	Analyzed by staff independently in feasibility report
R317-101-4.B.4.	Local political conditions	
R317-101-4.B.4.	Local economic conditions	Poverty Rate
R317-101-4.B.5.	Cost effectiveness evaluation of financing alternatives	Analyzed by staff independently in feasibility report
R317-101-4.B.6.	Availability of funds in the security account	
R317-101-4.B.7.	Environmental Need	
R317-101-4.B.8.	Other data and criteria the Board may deem appropriate	

Items from Table 4 are translated into Table 5 for a Financial Assistance Indicator score to be calculated. Criteria for how a score would be calculated are only rough values and should have Board input.

Step 1. Each indicator would be assigned a score based off of measured parameters, then these scores could be multiplied by a weighting factor giving a weighted score. The sum of the weighted scores would be divided by the sum of the weighting factors giving a Financial Assistance Indicator from 1.0 to 3.0.

Indicator	Score Value			Score	Weighting	Weighted Score
	1	2	3			
Unemployment rate	less than State Average	X% more than State Average	X% more than State Average		3	
10 year population trend	Increase of more than X%	Between -X% and X% change	Decrease of more than X%		2	
Percent of local contribution	0% - 5% Local share	5-20% local share	Great than 20% local share		1	
Recent Project Comparisons	More than 20% less than recent projects	Between -20% and 20% change	More than 20% greater than recent projects		4	
Poverty Rate	less than State Average	X% more than State Average	X% more than State Average		3	
				Sum	13	
				Sum Score/Sum Weight Score		

Step 2. The financial assistance indicator score along with the Modified MAGI would be used to evaluate a project burden threshold as Low, Medium, or High burden using Table 6 below:

	Modified MAGI*		
Financial Assistance Indicator	Below 1.4%	1.4% to 2.1%	Above 2.1%
Above 2.5	Low Burden	Low Burden	Medium Burden
1.5 to 2.5	Low Burden	Medium Burden	High Burden
Below 1.5	Medium Burden	High Burden	High Burden

Step 3. The burden threshold could then be used to provide guidance to the Board and potential funding applicants using Table 7.

Low Burden	Projects in the Low Burden range <u>will not typically be recommended for grant.</u>
Medium Burden	Projects in the Medium Burden range may be recommended for a grant/loan mixture or additional interest rate reductions. Staff will not recommend greater than XX% grant OR XX% of the project, if funds are available and in accordance with R317-101-4.B.3. and .6., for the project.
High Burden	Projects in the High Burden range will be funded at a grant/loan mixture at the discretion of the Board. Staff will not recommend greater than XX% grant OR XX% of the project, if funds are available and in accordance with R317-101-4.B.3. and .6., for the project.

ALTERNATIVE 4: CHANGE THE 1.4% THRESHOLD IN RULE

During the September 2020 Board Meeting some Board members expressed desire for staff to recalculate the 1.4% threshold in rule. To begin, if the Board would prefer to change rule, staff recommends the Board consider moving away from Modified MAGI and toward MHI as that is the framework that was laid out in the EPA document “2020 Financial Capability Assessment for Clean Water Act Obligations” (2020 FCA). This is in part due to the uncertainty of the MHI to Modified MAGI ratio, which the statewide average may be 1.4 this ratio has a variability of approximately +/- 0.3. **Staff would recommend the Board evaluate financial capability rates between 1.0% to 2.0% of MHI, this would put communities into the mid-range financial impact based of EPA guidance.**

Further, the Board should keep in mind the 2020 FCA set out in that document was meant to determine a reasonable implementation schedule that would not over burden a community’s financial capability, rather than as a way of determining the appropriate funding for a project. In short, as we look into alternatives for financing a project the desired outcome is not necessarily to push a community into the high burden category before providing financial assistance. The goal should be instead to help maintain a reasonable burden while maintaining fund balances.

If the Board directs staff to pursue a rule change, staff will need to evaluate any change for compliance with State of Utah SB6004 *Regulatory Certainty Amendments*. The Board should be aware in accordance with SB6004, DEQ may have to report to the *Administrative Rules Review Committee as to whether the needs to act meets the requirements of Subsection (1)(c)* if the rule is enacted before July 2021. Last, for a rule change staff recommends outreach be conducted to the Publicly Owned Treatment Works community. This outreach could include any or all of a direct email, publishing the draft rule change to the Division’s public notice page, and/or taking comments over a 30 day public comment period.