

Joint AWWA / NACWA / WEF Webinar

Review of EPA's 2022 Proposed Financial Capability Assessment Guidance

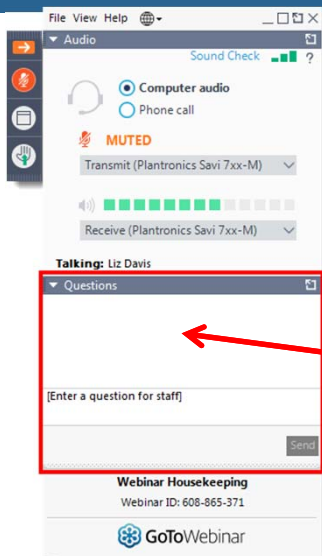
- Utility Association Review

AWWA / NACWA / WEF
April 8 , 2022

1

1

How to Participate Today



• Audio Modes

- Listen using Mic & Speakers
- Or, select "Use Telephone" and dial the conference (please remember long distance phone charges apply).

Submit your questions using the Questions pane.

- A recording will be available for replay shortly after this webcast.

2

Review Sponsors - Consultants

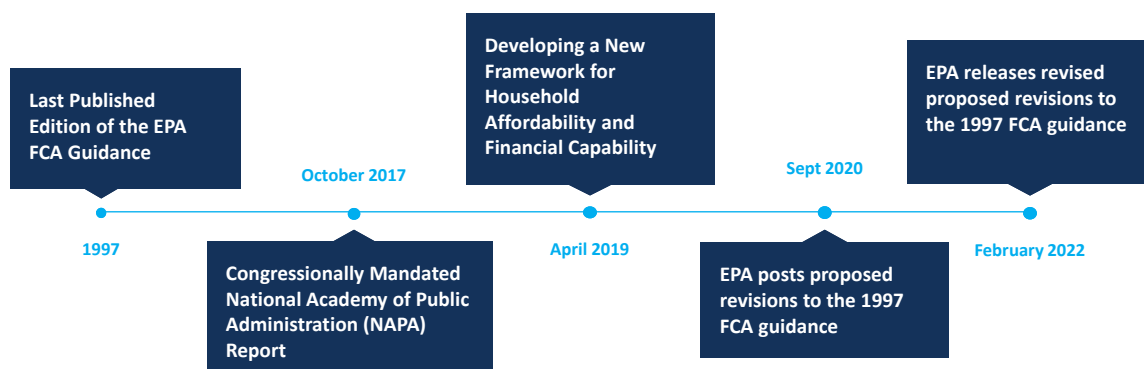


- Galardi Rothstein Group - Eric Rothstein
- Raftelis - John Mastracchio

3

3

FCA Revision Timeline



4

4

Existing 1995/1997 EPA FCA Methodology

Residential Indicator:

$$RI = \frac{\text{Residential Cost}}{\text{Median Household Income}} \times 100$$

Financial Impact	RI
Low	< 1.0% of MHI
Mid-Range	1.0 - 2.0% of MHI
High	> 2.0% of MHI

Financial Capability Indicators:

Debt Indicators

- Bond Rating
- Overall Net Debt as % of Full Market Property Value

Socioeconomic Indicators

- Unemployment Rate
- Median Household Income

Financial Management Indicators

- Property Tax Collection Rate
- Property Tax Revenue as % of Full Market Property Value

5

5

Existing EPA FCA Methodology

Financial Capability Indicator Score	Residential Indicator		
	Low (Below 1%)	Medium (1%-2%)	High (Above 2%)
Weak (Below 1.5)	Medium Burden	High Burden	High Burden
Mid-Range (1.5 - 2.5)	Low Burden	Medium Burden	High Burden
Strong (Above 2.5)	Low Burden	Low Burden	Medium Burden

Financial Capability – General Schedule Boundaries

- Low Burden- Normal Engineering Construction
- Medium Burden - Up to 10 Years
- High Burden - Up to 15 – 20 Years

6

6

NAPA Report Critique of the Existing EPA FCA Methodology

Residential Indicator

1. Not focused on the most economically vulnerable users
2. Incomplete water cost measure
3. Basis for the 2% threshold is unknown and subjective
4. Provides only a snapshot and ignores critical trends

Financial Capability Indicators

1. Measures are for local government, not necessarily relevant to the utility
2. Bond ratings do not exist for smaller utilities
3. Measures highly correlated
4. Measures are static

7

7

NAPA Panel Recommendations for Revised FCA

- ✓ Focuses on households that are most economically vulnerable rather than MHI
- ✓ Include all water costs
- ✓ Identify the size of the vulnerable users relative to the total rate payer base
- ✓ Avoid arbitrary normative thresholds to determine relative burdens

8

8

NAPA Panel Recommendations for Revised FCA

- ✓ The Financial Capability Indicators should focus on the utility supplying clean water service
- ✓ Expand the socioeconomic components to include trends in socioeconomic conditions.
- ✓ Establish guidelines for developing flexibilities that allow compliance within a timeline that correlates with integrated planning activities.

9

9

New 2022 EPA Proposed FCA Methodology

Alt 1: RI and FCI Unchanged from the Existing FCA Methodology

Residential Indicator:

$$RI = \frac{\text{Residential Cost}}{\text{Median Household Income}} \times 100$$

Financial Impact	RI
Low	< 1.0% of MHI
Mid-Range	1.0 - 2.0% of MHI
High	> 2.0% of MHI

Financial Capability Indicators:

Debt Indicators

- Bond Rating
- Overall Net Debt as % of Full Market Property Value

Socioeconomic Indicators

- Unemployment Rate
- Median Household Income

Financial Management Indicators

- Property Tax Collection Rate
- Property Tax Revenue as % of Full Market Property Value

10

10

New 2022 EPA Proposed FCA Methodology						
Alt 1: Lowest Quintile Poverty Indicator Score						
Proposed Option 1						
Indicator (Census Data Code)	Strong (Score = 3)	Mid-Range (Score = 2)	Weak (Score = 1)	Weight	Actual Value	Score
LQPI #1 Upper Limit of Lowest Quintile Income (B19080)	More than 25% above national LQI	±25% of national LQI	More than 25% below national LQI	50%		
LQPI #2 Percentage of Population with Income Below 200% of Federal Poverty Level (S1701)	More than 25% below national value	±25% of national value	More than 25% above national value	10%		
LQPI #3 Percentage of Population Receiving Food Stamps/SNAP Benefits (S2201)	More than 25% below national value	±25% of national value	More than 25% above national value	10%		
LQPI #4 Percentage of Vacant Households (B25002)	More than 25% below national value	±25% of national value	More than 25% above national value	10%		
LQPI #5 Trend in Household Growth (B25002)	>1%	0%-1%	<0%	10%		
LQPI #6 Percentage of Unemployed Population 16 and Over in Civilian Labor Force (DP03)	More than 25% below national value	±25% of national value	More than 25% above national value	10%		
Score for LQPI #1						
Average Score for LQPI #2 to #6 (Sum of 2 through 6 divided by 5)						
Initial Lowest Quintile Poverty Indicator Score (Sum of two lines above divided by 2)						
Initial Lowest Quintile Poverty Indicator Benchmarks Low Impact (Above 2.5) Medium Impact (1.5 to 2.5) High Impact (Below 1.5)						

11

New 2022 EPA Proposed FCA Methodology

Alt 1: Lowest Quintile Poverty Indicator Score

Proposed Option 2

Step 1: Determine Lowest Quintile Income Indicator Score

Score	Lowest Quintile Income Indicator
Weak	More than 25% below National LQI
Mid-Range	±25% of National LQI
Strong	More than 25% above National LQI

Proposed Option 2, Step 2: Determine Poverty Indicator Score using template below.

Indicator (Census Data Code)	Strong (Score = 3)	Mid-Range (Score = 2)	Weak (Score = 1)	Actual Value	Score
PI #1 Percentage of Population with Income Below 200% of Federal Poverty Level (S1701)	More than 25% below national value	±25% of national value	More than 25% above national value		
PI #2 Percentage of Population Receiving Food Stamps/SNAP Benefits (S2201)	More than 25% below national value	±25% of national value	More than 25% above national value		
PI #3 Percentage of Vacant Households (B25002)	More than 25% below national value	±25% of national value	More than 25% above national value		
PI #4 Trend in Household Growth (B25002)	>1%	0%-1%	<0%		
PI #5 Percentage of Unemployed Population 16 and Over in Civilian Labor Force (DP03)	More than 25% below national value	±25% of national value	More than 25% above national value		
Poverty Indicator Score (Sum of lines above divided by 5)					
Poverty Indicator Benchmarks Strong (Above 2.5) Mid-Range (1.5 to 2.5) Weak (Below 1.5)					

12

12

12

New 2022 EPA Proposed FCA Methodology

Alt 1: Expanded Financial Capability Assessment Matrix

FCA Score (RI and FCI)	Final Lowest Quintile Poverty Indicator Score		
	Low Impact	Medium Impact	High Impact
Low Impact	Low Impact	Low Impact	Medium Impact
Medium Impact	Low Impact	Medium Impact	High Impact
High Impact	Medium Impact	High Impact	High Impact

If the LQPI Score is “Medium” or “High”, a financial alternatives analysis is required to be completed, and then a Final LQPI score is prepared.

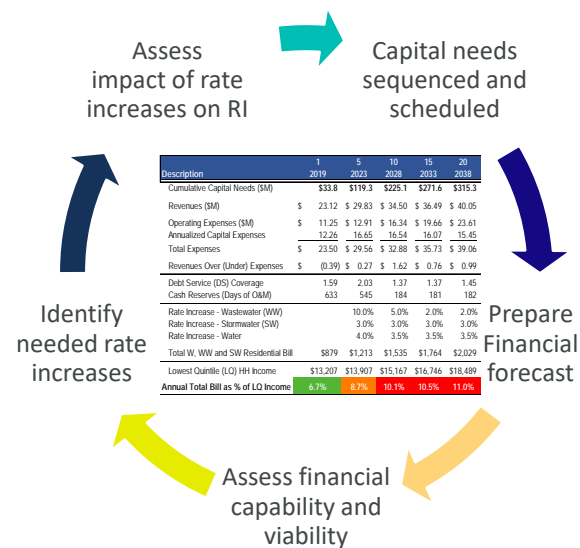
Expanded FCA Matrix Result	Recommended Implementation Schedule Benchmarks
Low Impact	Normal Engineering/Construction Schedule
Medium Impact	Total schedule up to 15 years
High Impact	Total schedule up to 20 years (schedule up to 25 years based on negotiation with EPA and state NPDES authorities)

13

13

New 2022 EPA Proposed FCA Methodology

Alt 2: Financial and Rate Models



14

14

New 2022 EPA Proposed FCA Methodology

Alt 2: Financial and Rate Models

- EPA recommends including a projected Residential Indicator (but not a LQRI) as part of the financial projection.
- EPA does not recommend use of financial and rate model analysis under Alternative 2 in lieu of Alternative 1 for Water Quality Decisions
- Drinking water costs can be included under Alternative 2

15

15

New 2022 EPA Proposed FCA Methodology

Financial Alternatives Evaluation

- For communities demonstrating a “medium” or “high” initial LQPI Score, the permittee needs to complete a checklist and implement feasibility financial alternatives to minimize burden on residential ratepayers.
- Document the steps it will take to implement all feasible options

16

16

New 2022 EPA Proposed FCA Methodology

Financial Alternatives Evaluation

1. EPA requires “feasible” steps to be implemented, whether or not prohibited by state law.
2. The use of “feasible” steps must be evaluated from multiple perspectives, not solely from an affordability lens.
3. Encouraging utilities not to follow cost-based rate-making standards introduces added litigation risk for utilities.
4. Some alternatives proposed by EPA will result in increased burden, not lowering the burden on low-income customers
5. Requires a level of complexity that is not warranted in the FCA guidance

17

17

New 2022 EPA Proposed FCA Methodology

Financial Alternatives Evaluation Impacts Final Scoring

1. Financing Options for Capital Costs
 - E.g., Has the community considered extended financing on loans?
2. Rate Design
 - E.g., Have you considered a wealth-based approach?
3. Ratepayer Support Options
 - E.g., Has the community looked into setting up a Customer Assistance Program?
4. Financial and Utility Management
 - E.g., Are all rate revenues or other user charges applied to fund the utility's purposes?

18

18

Review Report - Organization

- INTRODUCTION AND CONTEXT
- MAJOR CHANGES BETWEEN PROPOSED 2020 AND PROPOSED 2022 GUIDANCE
- MAJOR CONCERNS, MISSED OPPORTUNITIES, POTENTIAL IMPLICATIONS
- DETAILED REVIEW OF 2022 PROPOSED FCA GUIDANCE PROCEDURES
- FINANCIAL ALTERNATIVES ANALYSIS – APPENDIX C
- EPA REQUESTS FOR PUBLIC COMMENT & PROPOSED RESPONSES

19

19

Major Findings / Concerns

- Fails to consider prospective compliance funding **impacts** on low-income customers
 - Reference to Lowest Quintile Income amplifies review of prevalence of poverty
- Calls for a Financial Alternatives Analysis for consideration of extended compliance schedules or WQS variances.
- Retains Alternative #2 enabling use of cash flow forecasting to evaluate impacts on customers' bills.
 - Not recommended for economic impact analysis supporting WQS variance requests or UAAs
- Reiterates defined scheduling benchmarks, most notably 20 years for High Burden communities
 - (or up to 25 years based on additional considerations)

20

20

Major Changes: January 2021 –February 2022

- **Consideration of Lowest Quintile Households and Poverty Indicators**
- **Addition of Financial Alternatives Analysis**
 - (1) Financing Options for Capital Costs, (2) Rate Design, (3) Ratepayer Support Options for Lower Income Residential Customers, and (4) Financial and Utility Management
- **Modification of Scheduling Benchmarks**

21

21

Major Concerns

- Fails to address the well documented methodological problems with the original 1997 guidance matrix
 - Cost per household calculation
 - reference to the problematic Median Household Income measure,
 - use of a flawed index of equally weighted Financial Capability Indicator measures
- Insists on continued submittal of the 1997 guidance's FCA matrix – a generation removed from the CSO policy – without modification for evidenced nonsensical results
- Fails to a consider prospective compliance funding impacts on low-income customers
- Does not address prevailing legal or logistical constraints on the prescribed Financial Alternatives nor how EPA will gauge a particular level of burden determination.
- Reiterates defined scheduling benchmarks rather than referencing useful lives of assets, longer-term financing periods, or recognizing that many 25+ year periods have been approved.

22

22

Missed Opportunities

- To finally discontinue the use of highly criticized and discredited median income cost burden measure and to address other flaws of the 1997 guidance
- To stop perpetuating an approach that ignores the realities of most retail – wholesale relationships
- To revise the financial capability indicators that are largely general obligation measures
- To prompt a meaningful discussion of community burden assessments based on actual compliance funding impacts on households and to promote collaborative engagement of community organizations
- To encourage and include meaningful partnering with the utility community to address the prevailing constraints on their freedom to act to address low-income affordability,
- To reference the use of an Integrated Planning Framework to achieve greatest benefit for the costs incurred, rather than perpetuating a siloed approach.

23

23

Potential Implications

- Employ the flexibilities that characterize Alternative #2: Financial and Rate Models to advocate for compliance schedules that limit economic burdens.
- Seek to work collaboratively with EPA on readily available means for utilities to demonstrate that selected financial alternatives are or are not legal or practical
- Seek to clarify/address (potentially through legal challenge) the boundaries of EPA's regulatory purview as it pertains to utility management and rate setting
- Work collaboratively with EPA and other stakeholders to establish federal legislation and/or rulemaking that could reduce barriers to implementation of selected Financial Alternatives.
- Work to define circumstances under which EPA's Proposed 2022 FCA guidance is deemed to be inapplicable, enabling consideration of alternative metrics / approaches
- Develop CD negotiation recommendations (and sample language) that call for institution of economic re-opener provisions

24

24

EPA Questions / Public Comment

1. Should the Final 2022 FCA incorporate a single new metric—LQPI—that considers lowest quintile income and poverty elements together? Or should the Final 2022 FCA incorporate two new metrics (a lowest quintile income indicator and a poverty indicator) to be calculated separately and combined in a matrix?
2. EPA is seeking additional examples or case studies of funding and financing considerations to add to Appendix C.
3. EPA is seeking feedback on the current proposed scheduling benchmarks of 20 years for “high” Expanded FCA Matrix impacts, or 25 years for unusually high impacts. If commentors propose different benchmarks, EPA is requesting examples to support the basis for such benchmarks.

25

25

Questions and Answers

26

26