Financial Capability Assessments and Schedule Development for meeting CWA objectives

NJ Workshop: Reinvesting in Our Water Infrastructure Through CSO LTCPs
January 8, 2015
Key Points

• EPA considers Financial Capability Assessments (FCAs) when developing compliance schedules
  • FCAs are NOT used to lower existing regulatory or permit standards.

• EPA does not have one set formula for municipal Financial Capability Assessments

• Municipal FCAs have and continue to evolve
  • 1997 Guidance provides starting point
  • 2014 Framework recognizes programs and encourages continued improvement
Compliance Schedules

• 40 CFR 122.47 – Schedules for compliance shall require compliance as soon as possible.

• Considerations for Municipal Schedules
  • Protection of sensitive areas
  • Use impairment
  • Financial capability
  • Grant and loan availability
  • Previous and current sewer fees and rate structures
  • Other viable funding mechanisms and sources of financing
Why Consider Financial Capability?

• CWA obligations can create financial impacts on municipalities.

• Municipalities, States and EPA must be partners in moving forward in an affordable way.

• Financial impacts can be reduced by providing more time to comply.

• An FCA allows for an INFORMED DISCUSSION on timing (schedules) for reaching CWA objectives.
CSO Policy and Financial Capability Assessment Guidance

• CSO Policy issued in 1994
  • Policy negotiated by CSO municipal organizations, environmental groups, EPA and State NPDES authorities and others.
  • CSO Policy lists seven financial capability criteria to consider when developing construction schedule.

• “CSO-Guidance for Financial Capability Assessment and Schedule Development” issued in 1997
  • Provides detail to applying criteria identified in CSO Policy
Purpose of 1997 Guidance

• Allows individual without municipal financial assessment experience to assess financial capability and negotiate reasonable CSO/SSO controls and schedules.
  • Assessment process reflects approach taken by bond rating agencies to assess overall financial conditions and credit capacity.

• Encourages municipalities to submit additional information to document unique financial conditions.
Assessment in 1997 Guidance

• Financial Capability Assessment Approach
  • Two-Phase Approach
    • Residential Indicator
      • Household cost impact
    • Permittee Financial Capability Indicators (6)
      • Aim is to “evaluate the debt, socioeconomic, and financial conditions that affect a permittee’s financial capability to implement the CSO controls”
      • Community ability to pay
  • A matrix approach is used to boil the indicators down to a single implementation schedule determination
Residential Indicator

- Average cost per household for Clean Water Act obligations as percentage of local median household income

<table>
<thead>
<tr>
<th>Financial Impact</th>
<th>Residential Indicator (CPH as % MHI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Less than 1.0 Percent of MHI</td>
</tr>
<tr>
<td>Mid-Range</td>
<td>1. - 2.0 Percent of MHI</td>
</tr>
<tr>
<td>High</td>
<td>Greater than 2.0 Percent of MHI</td>
</tr>
</tbody>
</table>
Permittee Financial Capability Indicators

• Debt indicators
  • Reflect the community’s current debt burden and ability to issue more debt
    1. Bond ratings (see handout with list of S&P and Moody’s indicators)
    2. Overall net debt as % of full market property value

• Socioeconomic indicators
  • Reflect the general economic condition of residential users in the permittee’s service area relative to national averages
    3. Unemployment rate
    4. Median household income

• Financial management indicators
  • Reflect the permittee’s ability to manage financial operations
    5. Property tax revenue collected as % of property tax assessed
    6. Property tax revenues as % of full market property value
Combining the Permittee Financial Indicators

- Strong, mid-range and weak benchmark ranges are defined for the 6 indicators:

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Strong</th>
<th>Mid-Range</th>
<th>Weak</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Rating</td>
<td>AAA-A (S&amp;P) or Aaa-A (Moody’s)</td>
<td>BBB (S&amp;P) Baa (Moody’s)</td>
<td>BB-D (S&amp;P) Ba-C (Moody’s)</td>
</tr>
<tr>
<td>Overall Net Debt as a Percent of Full Market Property Value</td>
<td>Below 2%</td>
<td>2% - 5%</td>
<td>Above 5%</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>More than 1 Percentage Point Below the National Average</td>
<td>± 1 Percentage Point of National Average</td>
<td>More than 1 Percentage Point Above the National Average</td>
</tr>
<tr>
<td>Median Household Income</td>
<td>More than 25% Above Adjusted National MHI</td>
<td>±25% of Adjusted National MHI</td>
<td>More than 25% Below Adjusted National MHI</td>
</tr>
<tr>
<td>Property Tax Revenues as a Percent of Full Market Property Value</td>
<td>Below 2%</td>
<td>2% - 4%</td>
<td>Above 4%</td>
</tr>
<tr>
<td>Property Tax Collection Rate</td>
<td>Above 98%</td>
<td>94% - 98%</td>
<td>Below 94%</td>
</tr>
</tbody>
</table>
Combining the 6 indicators into a single financial capability judgment

• Then assign 1 point for each weak indicator, 2 for each mid-range and 3 for each high indicator

• Average the community’s points across the indicators
# Initial Burden Assessment

<table>
<thead>
<tr>
<th>Permittee Financial Capability Indicators Score (Socioeconomic, Debt and Financial Indicators)</th>
<th>Residential Indicator (Cost Per Household as a % of MHI)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Weak</strong> (Below 1.5)</td>
<td>Low (Below 10%)</td>
</tr>
<tr>
<td></td>
<td>Medium Burden</td>
</tr>
<tr>
<td><strong>Mid-Range</strong> (Between 1.5 and 2.5)</td>
<td>Low Burden</td>
</tr>
<tr>
<td><strong>Strong</strong> (Above 2.5)</td>
<td>Low Burden</td>
</tr>
</tbody>
</table>
Discussions with Conference of Mayors

• Discussion of how the financial capability of a community should be considered in developed schedules.
  • Prioritizing Investments
    • Will consider both stormwater and wastewater costs
  • Low Income Households
    • EPA encourages communities to establish lower rates or subsides for low income households
    • Permittee may submit supplemental information
  • Role of MHI - 2% MHI is only guidance
  • Community Specific Factors
2014 Framework: Informing the Dialogue

2014 Financial Capability Assessment Framework

• Elements

• Encourages additional Information
Elements

• 1997 Guidance assessment provides a common basis.
• 2% MHI is not a rigid threshold.
• EPA will consider all CWA costs, including stormwater costs, in the residential indicator.
• EPA will consider SDWA obligations as part of financial capability indicators.
• Communities should assure that CWA obligations that are addressed as costs will be implemented.
Additional Information

Related to Residential Impacts
• Income distributions
• Rate structures with differential rates for low income customers
• Poverty rates and trends in service area

Related to Financial Strength
• Population trends and projections
• Unemployment data
• Rate or revenue models