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ENVIRONMENTAL PROTECTION AGENCY

[EPA–HQ–OW–2020-0426; FRL–10019-61–OW]

2021 Financial Capability Assessment Guidance for Clean Water Act Obligations

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice.

SUMMARY: As part of the Environmental Protection Agency (EPA)'s commitment to implementing Clean Water Act (CWA) objectives in a sustainable manner, EPA continues to enhance our understanding of the issues surrounding financial capability assessments (FCA). Consistent themes have emerged during discussions with stakeholders, such as the benefit of expanding on the flexibility available under the 1997 FCA Guidance and ensuring a consistent approach for implementing these flexibilities. The 2021 FCA Guidance (2021 FCA) embraces these stakeholder priorities and provides tools to more easily articulate local financial circumstances, while advancing the mutual goal to protect water quality. The 2021 FCA directly incorporates relevant portions of the 1997 FCA Guidance and the 2014 FCA Framework as Appendices A through C. Going forward, the 2021 FCA replaces the 1997 FCA Guidance and

will be used to evaluate a community's capability to fund CWA control measures in both the permitting and enforcement context. The 2021 FCA reflects EPA's consideration of public comments received in response to its September 18, 2020 *Federal Register* publication. Additionally, EPA intends to apply the options and flexibilities from Appendix D of the 2021 FCA to the consideration of economic impacts to public entities for supporting revisions to designated uses, water quality standard (WQS) variances, and antidegradation reviews for WQS. The contents of this guidance document do not have the force and effect of law and are not meant to bind the public in any way. This document is intended only to provide clarity to the public regarding existing requirements under the law or agency policies.

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SUPPLEMENTARY INFORMATION:

I. Purpose of the 2021 Financial Capability Assessment Guidance

EPA announced a proposed FCA Guidance and requested public comment on September 18, 2020 (85 FR 58352). The final 2021 FCA is available at https://www.regulations.gov/, Docket ID No. EPA-HQ-OW-2020-0426. The 2021 FCA advances the ability of communities to more

accurately demonstrate the financial burdens they face and increases the transparency of EPA's considerations as it endeavors to consistently apply FCA methodologies across the country. The 2021 FCA will allow communities to easily submit information that may indicate the entire community's capability to fund CWA projects/programs. Specifically, the 2021 FCA includes templates and calculations that communities can use when submitting information for consideration regarding low-income households, poverty prevalence within a service area, drinking water costs, financial models or studies, and other relevant information. The templates and calculations include references that direct the community to the applicable publicly available data sources.

The 2021 FCA sets forth two alternative general approaches for assessing a community's financial capability to carry out CWA control measures. The first alternative consists of four critical metrics, the Residential Indicator (RI) and Financial Capability Indicator (FCI) from the 1997 FCA Guidance, and two new critical metrics, the Lowest Quintile Residential Indicator (LQRI) and Poverty Indicator (PI) that expand consideration of costs, poverty, and impacts on the population in the service area with incomes in the lowest quintile. The first alternative may be employed by the community or by EPA for the community, as it involves use of publicly available information. Communities with lower cost control measures or an ability to self-finance the cost of CWA controls may wish to employ the first alternative due to its simplicity.

The second alternative is the calculation of the Poverty Indicator score and 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. Communities with more expensive CWA obligations may choose to employ the second alternative, given its

more sophisticated evaluation of financial capability over time. However, if a community chooses the second alternative, it must conduct the analysis itself as it involves information known only to the community.

For use in the first alternative, relevant portions of the 1997 FCA Guidance and the 2014 FCA Framework are included as Appendices to the final 2021 FCA. While the structure of the included 1997 FCA Guidance worksheets remains for the first alternative, the 2021 FCA also includes standardized instructions and practice tips for how to define and submit certain additional costs into the portion of the RI calculation that looks at total CWA costs per household as a percent of median household income (MHI). EPA intends to consider not only MHI when calculating the impact of costs on a community's households but also will consider impacts to households in the lowest quintile. MHI represents the mid-point of income in a geographical area determined by the American Community Survey (ACS). Median is used to express a "middle" value in a set of data. This "middle" value is also known as the central tendency. Median is determined by ranking the data from largest to smallest, and then identifying the middle so that there are an equal number of data values larger and smaller than the middle point. The median is generally used for skewed distributions and is typically used to derive at central tendency since it is not largely affected by outlier values. However, EPA recognizes that many communities have many customers that represent either end of the income spectrum. Some communities have a range of incomes but also have contiguous areas of population that have difficulty paying for their water services. For some communities, these challenges can be shown by looking at the community's Lowest Quintile Income (LQI) along with its MHI. As such, EPA has incorporated

LQI into the LQRI, a critical metric for calculating the impact of costs on a community's households.

Based on stakeholder feedback, EPA is basing its Alternative 1 metrics on data that is available in the ACS. The ACS is conducted every year by the U.S. Census Bureau to provide up-to-date information about the social and economic conditions of communities. The annual updates include key socio-demographic information and can be provided to a fine level of geographic granularity with historic continuity. The ACS can produce data showing the quintiles of household income (each quintile defines the household income range for 20% of a community's households). Use of LQRI as an FCA critical metric meets the following criteria proposed by the National Academy of Public Administration (NAPA):[1]

- Readily available from publicly available data sources;
- Clearly defined and understood;
- Simple, direct, and consistent;
- Valid and reliable measures, according to conventional research standards; and
- Applicable for comparative analyses among permittees.

The 2021 FCA can help to ensure that local challenges related to low-income households are better reflected in CWA implementation schedules. The types of data provided in Alternative 1 of the 2021 FCA are not exhaustive; and consistent with previous policy, EPA will consider any

[1] NAPA issued a report titled ''Developing a New Framework for Community Affordability of Clean Water Services'' in October 2017.

relevant financial or demographic information presented that illustrates the unique or atypical circumstances faced by a community.

II. Overview of the 2021 FCA Guidance

Consideration of financial capability requires certain information. Alternative 1 of the 2021 FCA recommends analyzing both the first phase (Residential Indicator or RI) and the second phase (Financial Capability Indicator or FCI) of the two-phased approach in the 1997 FCA Guidance as critical metrics and adds two new critical metrics: LQRI and the PI. These four critical metrics would be calculated by EPA or the community and would be considered equally. It should be emphasized that these four recommended critical metrics might not present the most complete picture of a community's financial capability to fund its CWA requirements. However, these metrics do provide a common basis for financial burden discussions among the community, the state or tribe, and EPA. Since flexibility is an important aspect of the CWA, communities are encouraged to submit any additional documentation (other metrics) for consideration that would create a more accurate and complete picture of their financial capability. Alternative 2 of the 2021 FCA recommends analyzing a financial and rate model in addition to calculating the Poverty Indicator Score.

The 2021 FCA also includes Other Metrics with Standardized Instructions, as well as Other Metrics with Submission of Information to be Determined by the Community. Significant consideration will be given to drinking water costs as well as the cost of meeting CWA obligations. Consideration of other metrics is permitted under either Alternative 1 or 2 and may support an extended implementation schedule. However, EPA does not anticipate establishing

implementation schedules that would exceed the useful life of the selected CWA control measures.[2]

Alternative 1: Recommended Critical Metrics with Established Thresholds and Instructions

- Residential Indicator – cost per household as a percentage of MHI
- Financial Capability Indicator – six socioeconomic, debt, and financial indicators used to benchmark a community's financial strength
- Lowest Quintile Residential Indicator – cost per low-income household as a percentage of the LQI
- Poverty Indicator – five poverty indicators used to benchmark the prevalence of poverty throughout the service area

Alternative 2: Recommended Critical Metrics

- Financial and Rate Models
- Poverty Indicator

Other Metrics with Standardized Instructions

- Drinking Water Costs
- Potential Bill Impact Relative to Household Size
- Customer Assistance Programs

[2] Based on EPA's experience with Clean Water Act programs, the projected useful life of wastewater infrastructure assets for the purpose of financing is typically 30-40 years. Additionally, Clean Water State Revolving Loan Funds terms are typically limited to the "lesser of 30 years and the projected useful life (as determined by the State) of the project to be financed with the proceeds of the loan." See 33 U.S.C. 1383(d)(1)(A).

- Asset Management Costs
- Stormwater Management Costs

Examples of Other Metrics with Submission Information Determined by the Community

- Unemployment Rates
- Debt Service Coverage Ratio
- Debt to Income Ratio
- Percent Population Decline, or Other Population Trends
- Locality Specific Information on Household Size, Including the Size of Households with Incomes in The Lowest Quintile
- State or Local Legal Restrictions or Limitations on Property Taxes, Other Revenue Streams, or Debt Levels
- Other Metrics as Determined by the Community

Schedule Development

- Public Health and Environmental Considerations: Discharges to Sensitive Areas; Use Impairment; Public Health; Environmental Justice
- Alternative 1 Schedule Development
- Alternative 2 Schedule Development

The 2021 FCA is available at: https://www.regulations.gov/, Docket ID No. EPA-HQ-OW-2020-0426.

Additionally, going forward, EPA intends to apply the options and flexibilities from Appendix D of the 2021 FCA to the consideration of economic impacts to public entities for

supporting revisions to designated uses, WQS variances, and antidegradation reviews for WQS. EPA intends that the recommended expanded matrix for WQS decisions in Appendix D, along with the electronic spreadsheet tools for the public sector at https://www.epa.gov/wqs-tech/spreadsheet-tools-evaluate-economic-impacts-public-sector,[3] would replace the worksheets and calculations for the public sector sections of the 1995 *Interim Economic Guidance for Water Quality Standards*. This replacement would then guide states and authorized tribes in determining the degree of economic impact for use in WQS decisions including revisions to designated uses, WQS variances, and antidegradation reviews.

III. Summary of Public Comments

During the 30-day public comment period, EPA received 70 public comments from a wide range of stakeholders (states, municipalities, environmental organizations, non-governmental organizations (NGOs), consulting firms, and private citizens).

- Many commenters expressed support for the proposed FCA and its extension for use in WQS decisions.
- A few commenters stated that the proposed FCA is a "considerable improvement over the 1997 FCA" and "EPA should move forward expeditiously in finalizing this guidance, while keeping the door open for additional adjustments and compliments in the future."
- Many commenters supported the addition of the Lowest Quintile Residential Indicator within Alternative 1.

[3] These electronic spreadsheet tools for the public sector encompass the data inputs and calculations of the 1995 *Interim Economic Guidance for Water Quality Standards*.

- Many commenters supported the addition of the Poverty Indicator within Alternative 1.
- Many commenters supported the flexibility to utilize financial and rate models under Alternative 2.
- Many commenters supported the flexibility to choose between Alternative 1 and Alternative 2.
- Some commenters supported the inclusion of standardized instructions for considering costs associated with drinking water projects, asset management, stormwater projects, and customer assistance programs.
- A few commenters requested that the 2021 FCA Guidance replace the 1997 FCA Guidance.
- Some commenters expressed concern that Clean Water Act implementation schedules for environmental justice (low income and minority) communities would be extended under the 2021 FCA. In addition, some commenters raised concerns about the impact of WQS decisions based on application of the 2021 FCA to areas with potential environmental justice concerns.
- One commenter recommended that the FCA include a discussion of green infrastructure.
- Some commenters requested additional rationale for the Residential Indicator and Lowest Quintile Residential Indicator benchmarks.
- Some commenters requested additional instructions for calculating the Residential Indicator and Lowest Quintile Residential Indicator.
- One commenter noted that scaling lowest quintile costs when calculating Lowest Quantile Residential Indicator may not be appropriate if low volume households receive the same bill as high-volume households.

- A few commenters requested additional standardized instructions for the use of financial and rate models under Alternative 2.
- One commenter suggested that local data, when available, should be used in lieu of national data under Alternative 2.
- A few commenters requested clarification of how the 1% and 2% benchmarks in Alternative 1 apply when Clean Water Act costs and drinking water costs are both considered.
- A few commenters requested additional clarification regarding how EPA will evaluate useful life.
- Some commenters expressed concern about the application of the 2021 FCA Guidance to water quality standards decisions.
- A few commenters requested that Alternative 2 also apply to water quality standards decisions.
- A few commenters requested that additional resources regarding funding opportunities be added to Section IX (Resources).
- Five commenters requested that EPA withdraw the proposed FCA Guidance.

IV. Summary of Revisions to Final 2021 FCA Guidance

- The final 2021 FCA Guidance was revised to explain that going forward the 2021 FCA replaces the 1997 FCA Guidance and will be used to evaluate a community's capability to fund CWA control measures in both the permitting and enforcement context.

- The final 2021 FCA Guidance was revised to explain that the Agency's expectation is that communities will develop plans and schedules to achieve compliance with the Clean Water Act as soon as practicable, and financial capability is only one of the factors considered when developing these schedules, in addition to environmental and public health considerations (e.g., environmental justice). Appendix D, for use with WQS decisions, also includes a statement that explains that opportunities to mitigate impacts of water quality standards decisions to areas with potential environmental justice concerns should be considered.
- The final 2021 FCA Guidance was revised to include a statement explaining that communities can utilize integrated planning and green infrastructure to achieve Clean Water Act compliance in a timely, flexible, and cost-effective manner.
- The final 2021 FCA Guidance was revised to include a statement describing the underlying data that was relied upon to establish the Residential Indicator and Lowest Quintile Residential Indicator benchmarks.
- The final 2021 FCA Guidance was revised to include additional "practice tips" for calculating Residential Indicator and Lowest Quintile Residential Indicator for MS4 Systems, Regional Systems, Retail/Wholesale Customers, Stormwater Costs, payments in lieu of taxes (PILOT), and Census Tract Reference maps.
- The final 2021 FCA Guidance was revised to clarify that scaling lowest quintile costs may not be appropriate in all instances.
- The final 2021 FCA Guidance was revised to include additional standardized instructions and additional requirements for submission of supporting documentation for the use of financial and rate models under Alternative 2.

- The final 2021 FCA Guidance was revised to explain that the use of local data is encouraged, when available, under both Alternative 1 and Alternative 2.
- The final 2021 FCA Guidance was revised to clarify that the 1% and 2% benchmarks in Alternative 1 apply only to Clean Water Act costs (e.g., wastewater, stormwater, asset management costs, CAP costs), and drinking water costs can be considered as an "other metric" that may support an extended schedule for implementing control measures. The final FCA does not adopt benchmarks for drinking water costs. EPA's 1998 guidance titled "Developing Affordability Criteria for Drinking Water Systems" contains a 2.5% MHI benchmark. However, EPA does not have a record basis for applying this benchmark to Clean Water Act financial capability assessments. The 1998 guidance is implemented by EPA's Office of Water, Office of Ground Water and Drinking Water and is used to grant variances for compliance technology to small drinking water systems.
- The final 2021 FCA Guidance was revised to explain that EPA does not anticipate establishing implementation schedules that will exceed the useful life of the selected CWA control measures.
- The final 2021 FCA Guidance was revised to explain that Alternative 2 can be used to supplement Alternative 1 for Water Quality Standards decisions.
- The final 2021 FCA Guidance was revised to include additional resources regarding available federal and state funding for Clean Water Act projects.

Dated:

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