Reviewing EPA’s New Affordability Framework

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Communities and regulators recently received new direction in their efforts to work towards shared goals of clean water in ways that are affordable for citizens and also sustainable. On November 24, EPA released a Financial Capability Assessment Framework (FCA Framework), which supplements its 1997 Guidance on the same subject. This framework is intended to further the aims of the Guidance to “aid all parties in negotiating reasonable and effective schedules for implementing Clean Water Act requirements” and provide “the flexibility to take into account local considerations” that affect financial capability.

Local government organizations, in their initial press release about the FCA Framework, have “welcomed it as a ‘good first step’ in bringing national water quality goals and local resource constraints in better balance.” They also expressed hope for further progress in addressing the affordability limits of their residents, especially those with lower incomes.

The FCA Framework is not going to satisfy everyone; in the document, EPA recognizes that it needs to “continue to look for ways to improve” it. Nonetheless, as we begin to work with this new framework, an initial review of its strengths and weaknesses can help communities and regulators have a more productive dialogue on affordability.

STRENGTHS

Once again, EPA acknowledges that state and local government partners face “difficult economic challenges with limited resources and financial capability.” Further, EPA affirms that “long-term approaches to meeting CWA objectives should be sustainable and within a local government or authority’s financial capability.”

Given the context in which the word is used here, “sustainable” must mean financially sustainable. In other words, whatever communities are expected to do, it must not impose a financial burden that cannot be sustained in the long-term. Sustainable must also mean that clean water enforcement programs do not threaten or undermine a local government’s responsibility to meet its other health, safety, and welfare obligations. This is a very positive aspect of the FCA Framework.

The first item in EPA’s list of five key elements clarifies that permittees have “the option of submitting additional information” that “can result in schedules that are different than the schedules suggested by the baseline analysis” in the 1997 FCA Guidance. The tone here is far more positive than the one many communities have experienced in consent decree negotiations.

The second element, “financial capability is on a continuum,” improves the usefulness of EPA’s Financial Capability Matrix (below left). In effect, EPA is characterizing its application of the matrix as being more along the lines of the second chart (below right).
Nearly a decade ago, when one permittee suggested this interpretation during its consent decree negotiations, EPA disagreed, so this element of the framework is a departure from the previous stance and a definite improvement. Furthermore, EPA concludes this second element by assuring local officials that “additional information submitted by the community may affect the length of the schedule regardless of where the community is on the [financial capability] continuum” (emphasis added). It is very encouraging that EPA is directly connecting supplemental community information to project prioritization and schedule determination.

The third element, “EPA will consider all CWA costs,” falls into the category of “half a loaf is better than none.” While local government organizations have expressed, in their press release, some disappointment and concern that EPA has yet to “fully embrace consideration of all public water costs” within the calculation of household burden, this element builds upon EPA’s June 2012 Integrated Planning Framework by offering further recognition of the fact that the financing of all clean water improvements ultimately comes from the same system users.

Another strength of the Framework can be found in its listing of “Examples of Information Related to Residential Impacts.” Of particular note here are the references to considering breakdowns of both income distribution and residential indicator by income quintile, geography, or other categories. Even modest rate increases can impose extreme hardship for households with low or moderate incomes. These households are often concentrated particular communities within an urban area or in particular demographic groups such as seniors or single-parent households. Presentation of such information by a permittee is extremely important in creating a more accurate and complete picture of residential impacts.

EPA’s identification of information about payment problems – measured through delinquencies and disconnections – is another example of valuable information that communities should use in assessing their financial conditions. While this item is included in EPA’s list of examples related to financial strength (of the permittee), it can also serve as verification of the severity of sewer cost impacts on residents.

**WEAKNESSES**

Although certain elements of the new FCA Framework are encouraging and most welcome, it also contains some serious shortcomings. The aspect that produces the greatest disappointment is EPA’s continued reluctance to more directly confront the obvious flaws in the existing 1997 Guidance. Commenters on the Draft FCA Framework strongly encouraged EPA to take such action.
In its response to EPA’s request for a review of the draft document, EPA’s own Environmental Finance Advisory Board (EFAB) detailed its reasons for recommending that EPA use this project “as an opportunity to make revisions to the 1997 Guidance.” Recognizing EPA’s reluctance to take such an action at this time, NACWA (National Association of Clean Water Agencies) suggested two compromise approaches in its July 2014 comments on a draft of the FCA Framework. First, NACWA proposed that the Framework “be messaged not as a mere supplement to the 1997 Guidance, but instead as the Agency’s most current thinking on affordability” and that “the principles in the new Framework should be the primary guide for all assessments going forward.” Second, NACWA encouraged EPA to clearly communicate that “utilities and communities can use other financial capability assessment approaches,” provided they also supply regulators with the data required for doing an assessment according to the 1997 methodology. EPA’s decision not to be more responsive to these stakeholders is a significant missed opportunity.

Several specific points in the FCA Framework are also problematic.

- Despite extensive criticism of median household income (MHI) as the central metric of the 1997 Guidance, EPA retains its reliance on this indicator despite recommendations from EFAB and many others. Furthermore, there is a problem with the way the FCA Framework described anything below 2% of MHI as falling into the medium burden category. In fact, this does not accurately represent the existing Financial Capability Matrix, which shows that weak communities reach a heavy burden at 1% of MHI.

- Although overreliance on MHI may be the most common criticism of EPA’s approach, the most damaging aspect may be reflected in the framework’s assertion that “EPA does not view or use the Financial Capability Matrix as a rigid metric that points to a given schedule length or threshold over which the costs are unaffordable.” This framework offered EPA an opportunity to recognize that, at some point, a program can be unaffordable. Not acknowledging such an economic reality is a serious deficiency.

- The separation of clean water costs from drinking water costs is another shortcoming. Despite EPA’s efforts to make distinctions between the two, any standard that measures financial capability only in terms of CWA activities amounts to “robbing Peter to pay Paul” and conflicts with EPA’s aim of achieving long-term sustainable solutions. Additionally, when its debt indicator only considers general obligation debt (and not revenue debt) associated with drinking water systems, EPA is refusing to face the full burden of these costs.

- A number of other financial capability indicators also were ignored or poorly addressed in the FCA Framework. There is no mention of debt indicators, and even though EFAB provided considerable feedback on this topic, the distortions created by heavy reliance on bond ratings remain. Similarly, despite an abundance of evidence about diversification in local tax structures, this framework appears to retain the 1997 Guidance’s sole focus on property tax.

One other notable weakness is the appearance of a new term – “atypical” – in describing a permittee’s economic circumstances. Although this word is not used in the 1997 Guidance, its introduction here could be used to justify closing some of the doors opened by other parts of the FCA Framework. Information about a community’s economic distress does not become irrelevant just because other
communities are similarly distressed. In addition, the call for permittees to make comparisons to the situations of other communities is unduly burdensome and unnecessary.

MOVING FORWARD

Now that EPA has provided this new FCA Framework, how are we to proceed?

For permittees, the task is to take full advantage of the positive aspects of this framework. Items cited here as strengths of the document offer opportunities to build more complete descriptions of community financial capability and household affordability. In addition, the second half of the FCA Framework identifies a range of information that is relevant to the process. The metrics presented by EPA are described as examples that are “not a complete list.” Communities should therefore make extensive use of the types of information cited by EFAB in its September 2014 Analysis and Recommendations on Draft Financial Capability Assessment Framework.

For local government and clean water associations, the priority will be to continue to point out the problems in the 1997 Guidance that remain unaddressed and press EPA to fix them. While the discussions with EPA over the past two years have resulted in this new FCA Framework, which provides greater clarity and some movement from the Agency, the work needs to continue so that the promise of sustainability for all communities and affordability for vulnerable populations is fulfilled.

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