Report on Drinking Water Loans to Hardship Municipalities

Report Submitted Pursuant to Act No. 72 of 2019, Sec. E. 700.2
Loans to Hardship Municipalities for Public Water System Improvements
From the Vermont Environmental Protection Agency (EPA)
Drinking Water State Revolving Fund

Submitted to the
Senate Committees on Institutions and on Appropriations
House Committees on Corrections and Institutions and on Appropriations

Submitted by the
Department of Environmental Conservation
Agency of Natural Resources

January 15, 2020

This report is provided pursuant to Act 72 of 2019 (referred to as the "Big Bill"), which requires the Agency of Natural Resources to present information on a newly established designation known as "hardship municipality." This designation was created for the purpose of providing additional subsidy to loans for critically needed improvements to small municipally owned public water systems with high annual user costs. The new term is defined in statute at 24 VSA § 4752(20). Act 72 also added § 4769 to 24 V.S.A., which includes specific provisions that apply to loans awarded for hardship municipality projects. The term "hardship municipality" is defined as follows:

A municipality served by a municipally owned public community water system[1] that:

- has a residential population of 250 or less;
- has an annual household user cost that exceeds $1,000.00 or 1.5% of the median household income (MHI) after construction of the water supply improvements project as determined by the Secretary of the Agency of Natural Resources (the Secretary): and
- requires improvements to address an imminent public health hazard or a substantial threat to public health as determined by the Secretary.

Under the newly added section § 4769 to 24 V.S.A., the Department of Environmental Conservation (DEC) may award a loan to a "hardship municipality" that includes loan subsidy of up to $200,000.00 in the form of 100% principal forgiveness with no interest or administrative fee. These loans are capitalized from the Vermont Environmental Protection Agency (EPA) Drinking Water State Revolving Fund (DWSRF) and do not require the municipality to pass a bond up to the amount to be forgiven. Additionally, the loan may include provisions for waiving the reimbursement method that would otherwise be required under 24 V.S.A. § 4755(b). The waiver allows disbursements to be made upon receipt by the Department of Environmental Conservation of eligible project invoices without prior payment by the municipality, further reducing the cost of project financing by minimizing or eliminating short-term borrowing. Lastly, the authority to provide loan forgiveness is subject to the availability of such subsidy, which is set each year by the terms of the annual federal capitalization grant that governs use of the DWSRF.

The new provisions were targeted to help small municipal public community water systems that would have difficulty raising the capital needed to pay for system improvements to avert an imminent public health hazard. Some examples include a major line break threatening contamination of the distribution system, a failing water source that cannot meet system demand, catastrophic failure of system storage, etc.

[1] Public Community Water System is defined in 10 V.S.A. § 1671 as a water system that serves at least 15 service connections used by year-round residents or regularly serves at least 25 year-round residents.

The required elements to be included in this report are outlined below, which is followed by a discussion of each.

- projected demand for "hardship municipality" loans;
- municipal eligibility;
- long term impact on availability of loan subsidy for systems that do not qualify as "hardship municipalities"; and
- a recommendation on options for prioritizing projects.

Projected Demand for "Hardship Municipality" Loans and Municipal Eligibility

At the time of enactment of the legislation, it was anticipated that at least one system would pursue this funding soon after the funding became available due to an emerging threat to an exposed water main at a river crossing. It is expected that as awareness of this new funding approach grows, additional eligible systems will likely apply for this funding. Projects to be funded are included on an annual project priority list, assigned points, and ranked accordingly. If a project emerges between annual adoption cycles, it can be added to and ranked atop the list if it qualifies as an emergency project per DWSRF program guidelines. Emergency designation pre-dates the new legislation and therefore applies to all eligible public water systems, not just "hardship municipalities".

The DWSRF was established in 1997 and since that time, the program has typically encountered no more than one emergency designated project per funding cycle. However, due to various adverse factors that threaten the integrity of public water systems such as aging infrastructure, increasing frequency of high intensity storms, and emerging manmade contaminants such as PFAS, the program could experience increasing numbers of emergency projects in the future. Subsidized loans for "hardship municipalities" may serve as a key source of funding for those communities.

At a minimum, to qualify as a "hardship municipality", the water system must meet the statutory definition of a public community water system, serve a population of 250 or less, and be municipally owned. At present, 48 municipally owned public community water systems meet this population threshold, which are arrayed from smallest to largest in Table 1 below. This list can change over time as population fluctuates or system ownership changes from private to municipal, which is the case for many fire districts. An example is St. George Fire District #1 which formed circa 1998, transferring ownership from private to municipal.

Additionally, to qualify, projects must address an imminent public health hazard or a substantial threat to public health and the system must have high annual user rates. The statute establishes high annual user rates as greater than $1,000 or 1.5% of the median household income of residents served. These rates are high when compared to the target rate established in statute[2] of 1.0% of a municipality's median household income.

[2] 24 V.S.A. § 4763c(b)(2) establishes a target annual household user cost of one percent of median household income.

Table 1 – Municipal Public Community Water Systems Serving a Population of 250 or Less

Water System Name	Municipality	Population
RUTLAND TOWN FIRE DISTRICT 11	RUTLAND TOWN	29
ELMORE WATER DISTRICT	ELMORE	32
ST GEORGE FIRE DISTRICT 1	ST. GEORGE	42
WHEELOCK FIRE DISTRICT 1	WHEELOCK	50
WESTFORD FIRE DISTRICT 1	WESTFORD	50
BLOOMFIELD WATER SYSTEM	BLOOMFIELD	50
SHEFFIELD FIRE DISTRICT 1	SHEFFIELD	50
RICHMOND FIRE DISTRICT 1	RICHMOND	56
POWNAL FIRE DISTRICT 3	POWNAL	60
GREENSBORO BEND FIRE DISTRICT #2	GREENSBORO	71
ST GEORGE FIRE DISTRICT #2	ST. GEORGE	72
FAIRFAX FIRE DISTRICT 1	FAIRFAX	80
WATERVILLE FIRE DISTRICT 1	WATERVILLE	84
STOWE FIRE DISTRICT 2 GOLD BROOK CIRCLE	STOWE	86
ALBURGH FIRE DISTRICT 1	ALBURG	87
BRANDON FIRE DISTRICT 2	BRANDON	98
LYN HAVEN FIRE DISTRICT 1	LYNDON	100
CUTTINGSVILLE FIRE DISTRICT	SHREWSBURY	108
RUTLAND TOWN FIRE DISTRICT 5	RUTLAND TOWN	110
HUNTINGTON FIRE DISTRICT 1	HUNTINGTON	120
WESTFIELD FIRE DISTRICT 1	WESTFIELD	120
STOWE FIRE DISTRICT 4	STOWE	120
FAIRFIELD FIRE DISTRICT 2	FAIRFIELD	126
RYEGATE FIRE DISTRICT 2	RYEGATE	131
RUTLAND TOWN FIRE DISTRICT 4	RUTLAND TOWN	136
GUILDHALL WATER SYSTEM	GUILDHALL	136
RUTLAND TOWN FIRE DISTRICT 6	RUTLAND TOWN	137
PASSUMPSIC FIRE DISTRICT 1	BARNET	140
BURKE FIRE DISTRICT 1	BURKE	142
AQUA HAVEN	EAST HAVEN	150
MORRISTOWN CORNER WATER CORP	MORRISTOWN	150
PEACHAM FIRE DISTRICT 1	PEACHAM	150

Water System Name	Municipality	Population
SOUTH ALBURGH FIRE DISTRICT 2	ALBURG	150
WASHINGTON FIRE DISTRICT	WASHINGTON	170
MCINDOE FALLS FIRE DISTRICT 3	BARNET	176
EAST FAIRFIELD FIRE DISTRICT 1	FAIRFIELD	184
EAST BERKSHIRE FIRE DISTRICT 1	BERKSHIRE	184
SUTTON WATER SYSTEM	SUTTON	185
JERICHO FIRE DISTRICT 1	JERICHO	190
EAST DORSET FIRE DISTRICT 1	DORSET	192
EAST CALAIS FIRE DISTRICT 1	CALAIS	200
IRASBURG FIRE DISTRICT #1	IRASBURG	200
ALBANY WATER SYSTEM	ALBANY	200
BARNET FIRE DISTRICT 2	BARNET	205
WILLISTON FIRE DISTRICT 1	WILLISTON	212
LUNENBURG FIRE DISTRICT 1	LUNENBURG	250
CABOT TOWN WATER SYSTEM	CABOT	250
SOUTH BURLINGTON FIRE DISTRICT	SOUTH BURLINGTON	250

An initial assessment was conducted to determine which of the 48 systems have high rates, i.e. exceeding the threshold rates of $1,000 or 1.5% of the median household income. To establish the baseline rates, a survey was prepared and sent out during summer 2019 to all 48 systems, with 37 of those systems having responded. Table 2 below summarizes the results of the survey and shows that at least 10 of the 48 systems have high user rates, with a range of $240 to $1,200. The range expressed as a percentage of local MHI is 0.42% to 2.09%. Rates that exceed the threshold values of either $1,000 or 1.5% of MHI are highlighted in the table. By comparison, the median rate is $700 and 1.15%, respectively. The rates for the other 11 systems remain unknown at this time since data has not yet been received from those systems, and therefore, the information is left blank in the corresponding cells.

Based on the information received and assuming all 11 systems for whom rate information has not been collected, the maximum number of systems that currently could potentially qualify for hardship funding is 21. Though it should be noted that some systems currently below the critical user rate thresholds of $1,000 or 1.5% of MHI could experience higher rates in the future and therefore potentially qualify in the future.

Table 2 – System User Rates

Water System Name	User Rate	User Rate Expressed as a % of MHI
RUTLAND TOWN FIRE DISTRICT 11		
ELMORE WATER DISTRICT	$750	0.96%
ST GEORGE FIRE DISTRICT 1	$900	1.54%
WHEELOCK FIRE DISTRICT 1	$450	0.74%
WESTFORD FIRE DISTRICT 1	$920	1.02%
BLOOMFIELD WATER SYSTEM	$425	1.04%
SHEFFIELD FIRE DISTRICT 1		
RICHMOND FIRE DISTRICT 1		
POWNAL FIRE DISTRICT 3	$800	1.35%
GREENSBORO BEND FIRE DISTRICT #2		
ST GEORGE FIRE DISTRICT #2	$960	1.65%
FAIRFAX FIRE DISTRICT 1		
WATERVILLE FIRE DISTRICT 1	$400	0.60%
STOWE FIRE DISTRICT 2 GOLD BROOK CIRCLE	$1,000	1.83%
ALBURGH FIRE DISTRICT 1	$1,084	1.95%
BRANDON FIRE DISTRICT 2	$340	0.65%
LYN HAVEN FIRE DISTRICT 1	$720	1.74%
CUTTINGSVILLE FIRE DISTRICT	$450	0.66%
RUTLAND TOWN FIRE DISTRICT 5	$800	1.40%
HUNTINGTON FIRE DISTRICT 1	$700	0.95%
WESTFIELD FIRE DISTRICT 1	$480	1.15%
STOWE FIRE DISTRICT 4	$930	1.70%
FAIRFIELD FIRE DISTRICT 2		
RYEGATE FIRE DISTRICT 2	$700	1.27%
RUTLAND TOWN FIRE DISTRICT 4	$735	1.28%
GUILDHALL WATER SYSTEM		
RUTLAND TOWN FIRE DISTRICT 6	$1,200	2.09%
PASSUMPSIC FIRE DISTRICT 1	$440	1.11%
BURKE FIRE DISTRICT 1	$600	0.99%
AQUA HAVEN	$400	1.00%
MORRISTOWN CORNER WATER CORP	$500	1.05%
PEACHAM FIRE DISTRICT 1	$800	1.38%

Water System Name	User Rate	User Rate Expressed as a % of MHI
SOUTH ALBURGH FIRE DISTRICT 2	$1,148	2.06%
WASHINGTON FIRE DISTRICT	$240	0.42%
MCINDOE FALLS FIRE DISTRICT 3	$340	0.58%
EAST FAIRFIELD FIRE DISTRICT 1	$416	0.50%
EAST BERKSHIRE FIRE DISTRICT 1	$720	1.35%
SUTTON WATER SYSTEM	$600	1.03%
JERICHO FIRE DISTRICT 1	$920	0.94%
EAST DORSET FIRE DISTRICT 1		
EAST CALAIS FIRE DISTRICT 1	$552	0.85%
IRASBURG FIRE DISTRICT #1	$420	1.18%
ALBANY WATER SYSTEM		
BARNET FIRE DISTRICT 2	$1,000	1.58%
WILLISTON FIRE DISTRICT 1		
LUNENBURG FIRE DISTRICT 1	$523	1.45%
CABOT TOWN WATER SYSTEM	$570	1.88%
SOUTH BURLINGTON FIRE DISTRICT		

Long Term Impact on Availability of Loan Subsidy for Systems that do not Qualify for Hardship Funding

Assuming a worst-case scenario where all 21 systems qualify and concurrently face imminent system failure, and the cost per system is $200,000, the total demand on the DWSRF would be $4,200,000. However, this is unrealistic on several accounts: first, it is unlikely that all or even a majority of the 11 systems for which data is lacking are above the threshold rates to qualify; second, it is highly improbable that all qualifying municipalities would experience emergencies requiring capital funding, let alone concurrently; and third, the actual need per system could be less than $200,000.

As of this writing the DWSRF program is working with one of the above municipalities and has not yet received additional requests. Therefore, a more realistic, though conservative, assumption would be to plan for up to three eligible systems per funding cycle in need of emergency improvements. Assuming each loan was awarded for the maximum $200,000 of hardship funding, a total of $600,000 in loan subsidy would be provided. This amount is currently within the available subsidy allocation on an annual funding cycle basis.

The amount of subsidy available for projects funded by the DWSRF is established on an annual basis and governed by federal law. The federal requirements that control the amount of subsidy have varied over the years. Beginning in 1997 with the inception of the DWSRF and continuing to this day, loan subsidy can be provided in the form of principal forgiveness or negative interest rates. From 1997

through 2008 (i.e. prior to enactment of the *American Recovery and Reinvestment Act of 2009*), subsidy was limited to systems meeting each state's definition of "Disadvantaged Community" with an upper limit on the amount of subsidy set at 30% of each year's capitalization grant. For example, in federal FY2000, Vermont was awarded a DWSRF capitalization grant of $7,757,000 with a maximum subsidy allowed of $2,327,100.

Beginning with the *American Recovery and Reinvestment Act grant (ARRA)*, the provisions governing the amount and eligibility of subsidy changed, including a new requirement establishing a minimum amount of subsidy that must be provided. Table 3 below summarizes the floor and ceiling for subsidy from the initial grant awarded in FFY1997 to the most recently awarded FFY2019 grant. As noted above, eligibility for subsidy also underwent changes since 2009.

The ARRA grant was the first DWSRF federal award that provided what is referred to as additional subsidy, meaning subsidy that can be provided in addition to the 30% limit previously established for disadvantaged systems and available to systems other than those that are defined as disadvantaged. The form of allowable subsidy also changed in that a third option was made available to states, allowing for the award grants in lieu of loans. However, because of additional federal administrative requirements applicable to grants, Vermont has opted to limit the form of subsidy to loans with negative interest and/or principal forgiveness.

With the most recent federal capitalization grant, FFY19, a further provision was applied to subsidy specifying that at least 6% must go to disadvantaged systems, or $660,240, while at least 20% must be provided as "additional subsidy," or $2,200,800. This latter amount is the allocation available for systems that do not necessarily meet the definition of disadvantaged and thus available for hardship funding as well as other state designated purposes. Therefore, assuming $600,000 is provided to "hardship municipalities" annually, and the current funding levels and provisions continue, $1,600,800 would be available each year for other projects that are neither hardship nor disadvantaged.

Table 3 – DWSRF Loan Subsidy by Federal Grant

FFY Grant	Grant Amount	Minimum Required	Maximum Allowed
1997	12,558,800	0	3,767,640
1998	7,121,300	0	2,136,390
1999	7,463,800	0	2,239,140
2000	7,757,000	0	2,327,100
2001	7,789,100	0	2,336,730
2002	8,052,500	0	2,415,750
2003	8,004,100	0	2,401,230
2004	8,303,100	0	2,490,930
2005	8,285,500	0	2,485,650
2006	8,229,300	0	2,468,790
2007	8,229,000	0	2,468,700

FFY Grant	Grant Amount	Minimum Required	Maximum Allowed
2008	8,146,000	0	2,443,800
2009	8,146,000	0	2,443,800
2009 *	19,500,000	9,750,000	19,500,000
2010	13,573,000	4,071,900	13,573,000
2011	9,420,800	2,826,240	9,420,800
2012	8,975,000	1,795,000	2,692,500
2013	8,421,000	1,684,200	2,526,300
2014	8,845,000	1,769,000	2,653,500
2015	8,787,000	1,757,400	2,636,100
2016	8,312,000	1,662,400	4,156,000
2017	8,241,000	1,648,200	4,120,500
2018	11,107,000	2,221,400	5,553,500
2019	11,004,000	2,861,040	6,052,200
Total	224,271,300	32,046,780	105,310,050

* Denotes ARRA Grant

Recommendation on Options for Prioritizing Projects for Hardship Funding

Three approaches to prioritizing projects for receiving hardship funding were considered:

1. Assign by type severity and type of system failure, i.e. distribution, storage, source, treatment;

2. Establish an annual limit on the number of projects that can qualify; or

3. Use the current priority point ranking system and establish an allocation each year in the annual Intended Use Plan.

The third option is recommended and is consistent with the current process for assigning priority points for emergency projects. Also, establishing an annual dollar limit will provide more clarity at the start of each funding cycle how much will be available for this purpose. As explained above, the amount of subsidy can vary from year to year, which will have a bearing on the amount allocated for hardship funding.