
Implementing SL 2020-79 – Reform of Water and Wastewater Public Enterprises

Introduction

On July 1, 2020, Session Law (SL) 2020-79, “An Act to Improve the Viability of the Water and Wastewater Systems of Certain Units of Local Government...” was signed by the Governor. SL 2020-79 requires review of local government units to determine if they are distressed due to issues in their water / wastewater enterprise fund and provides for a new Viable Utility Reserve (VUR) fund, with the goal of facilitating comprehensive, long-term solutions through a process framework and grant funding. The review of local government units is a joint process of both the Local Government Commission (Commission) and the State Water Infrastructure Authority (Authority). The Authority makes projects eligible for funding from the VUR fund. The Department of Environmental Quality (DEQ), through the Division of Water Infrastructure (Division), administers the grants made from the VUR; however, the Department may not award a grant from the VUR fund unless the Commission approves the grant award and terms. Accordingly, both the Authority and the Commission must approve the use of VUR grant funds.

The Commission was created by the General Assembly in 1931 after the funds invested in banks by many local governments had been lost in the 1929 stock market crash. The Commission is a nine-member body that provides assistance to local governments and public authorities. The Department of State Treasurer (DST) State and Local Government Finance Division (SLGFD) serves as staff to the Commission and supports over 1,300 local government units by monitoring and analyzing their fiscal health and accounting practices, in addition other activities.

The nine-member Authority was created by the General Assembly in 2013 to assess and make recommendations about the state’s water and wastewater infrastructure needs and the funding programs available to the state’s local governments. The General Assembly also established the Division at the same time and consolidated the major water and wastewater infrastructure funding programs in the Division. Division staff support the Authority in carrying out its assigned duties. One specific duty of the Authority is to develop a troubled system protocol which resulted in SL 2020-79.

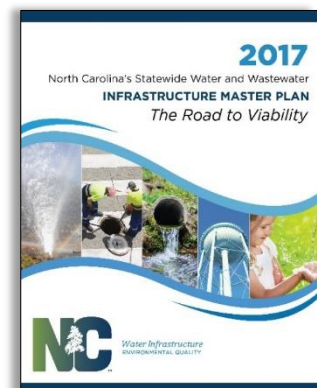
The Secretary of the Commission is an ex officio member of the Authority representing the Commission, so the two entities have been working together since the Authority was created.

Working Toward Viability

In 2017, the Authority developed “*North Carolina’s Statewide Water and Wastewater Infrastructure Master Plan: The Road to Viability*” (Master Plan). The Master Plan reflects the Authority’s emphasis on utility viability and three utility management best practice areas.



Infrastructure Management: Utilities are operated most effectively and efficiently by taking proactive approaches to enable the right investments to be made in the right projects at the right time, taking into consideration lifecycle costs and risk management.





Organizational Management: Elected officials or utility boards that understand the long-term nature of water infrastructure and establish rates to support the financial needs are critical for viable utilities. In addition, utilities must have management in place that understands the complexities of operating water and wastewater systems.



Financial Management: Viable utilities function as self-sufficient business enterprises. Revenue must be generated to fund infrastructure construction, maintenance, operations, renewal/replacement, and reserves for unexpected events without long-term reliance on grant funds.

The Master Plan concepts and the Master Plan vision have been used as the basis for proposed distressed unit criteria for implementation of SL 2020-79, along with education and action plan procedures for distressed units.

In 2018, DEQ published *“Challenges Facing Small Water and Wastewater Utilities: Four Systems Facing Viability Challenges.”* The paper provided an overview of four systems DEQ has worked closely with, to illustrate the difficulties smaller utilities may face in operating as viable entities. While these systems reflect issues that may exist in many rural systems across the state, each unit is unique and requires a tailored solution. The issues highlighted in the paper include:

- Many systems face revenue pressures from declining populations, lower water usage per customer, and loss of large industrial / commercial connections.
- At the same time, the cost of infrastructure continues to increase. In many smaller systems, customers are responsible for more infrastructure on a per person basis than those in larger systems.
- Small systems often have difficulty recruiting and maintaining staff experienced in issues such as treatment technology, condition assessment, long-term financial planning, risk assessment, and managing construction projects. Without qualified utility managers, the task of understanding these complex issues is the responsibility of town management, elected officials, or operations staff.

Since 2018, the Commission has assumed financial control of two of the four units highlighted in the paper (the Town of Eureka and Cliffside Sanitary District). The Town of Bethel is merging its utility system with the Greenville Utilities Commission (GUC); this merger is made possible with significant grant funding to resolve critical infrastructure and financial issues associated with the Town’s water and sewer system.

Well before SL 2020-79 was ratified, the Authority recognized that many systems needed assistance to move toward viability, and recommended changes to the existing water infrastructure grant programs to the General Assembly, which were subsequently approved. These changes became effective in 2015 and included basing the amount of construction project grants on affordability criteria and offering two new types of grants – Asset Inventory &

Master Plan Vision

A viable system functions as a long-term, self-sufficient business enterprise, establishes organizational excellence, and provides appropriate levels of infrastructure maintenance, operation, and reinvestment that allow the utility to provide reliable water services now, and in the future.

Assessment (AIA) grants and Merger/Regionalization Feasibility (MRF) grants. Recently, the Authority has increased the prioritization of projects that establish viable utilities in all funding programs under its purview.

In 2019, through financial support from DEQ, the University of North Carolina Environmental Finance Center (EFC) published two guidance documents for utilities – “*Crafting Interlocal Water and Wastewater Agreements*” and “*Consolidation of Water and Wastewater Systems: Options and Considerations*.” These documents are essential resources for communities seeking long-term solutions under SL 2020-79.

Preliminary Process to Implement SL 2020-79

SL 2020-79 authorizes a process aimed at developing permanent solutions for distressed water and/or wastewater utilities and provides for grant funding to accomplish the solutions. The initial appropriation of only \$9 million for the VUR fund supports just the beginning of this process. The Authority has recommended that the General Assembly provide a secure, reliable, on-going, and increased source of funding, which is needed for the long-term success of the new program.

There are three primary elements to implementation:

1. Designating distressed units including developing distressed criteria
2. Distressed unit requirements
 - a. Education
 - b. Action plans
3. Funding for actions

Designating Distressed Units Including Developing Distressed Criteria

The assessment of local government units (units) is provided in § 159G-45. The Authority and Commission are to jointly develop criteria and then, using that criteria, identify units as “distressed.” Under § 159G-45.(a) the criteria must include the following:

- (1) Whether the public water or wastewater system serves less than 10,000 customers.
- (2) Whether the public water or wastewater system has an established, operational, and adequately funded program for its repair, maintenance, and management.
- (3) Whether the annual debt service is disproportionate to the public water or wastewater system's annual revenue.
- (4) Whether the local government unit has appropriated funds from its utility or public service enterprise fund in accordance with § 159-13(b)(14) in two or more of the preceding five fiscal years

§ 159G-20.(4a)

Distressed unit. – A public water system or wastewater system operated by a local government unit exhibiting signs of failure to identify or address those financial or operating needs necessary to enable that system to become or to remain a local government unit generating sufficient revenues to adequately fund management and operations, personnel, appropriate levels of maintenance, and reinvestment that facilitate the provision of reliable water or wastewater services.

without maintaining a reserve fund sufficient to provide for operating expenses, capital outlay, and debt service.

- (5) Whether the local government unit has appropriated funds to supplement the operating expenses, capital outlay, or debt service on outstanding utility or enterprise bonds or notes in excess of the user fees collected in two or more of the preceding five fiscal years.

A distressed criteria model is being developed jointly by DEQ and DST staff, which includes the five required criteria and additional criteria needed to better delineate distressed units. The model will be used to determine the specific units that must participate in the educational activities and take certain actions.

The criteria are based on readily available data, and there will be cases where the data do not accurately reflect the system's level of risk. In some cases, a unit may need to be elevated into the distressed category when the data do not reflect actual levels of needed capital investment, operations and maintenance, organizational capacity, etc. In other cases, data may indicate a distressed level but not accurately reflect the actual soundness of the unit (e.g., inaccurate data, changes made in the system not yet reflected in the data, bulk customers, etc.). ***Note that a few units are already in such a known critical condition that they may need to be designated as distressed as soon as possible.***

Distressed Unit Requirements

Once a unit is designated as distressed, § 159G-45.(b) requires certain actions by the unit (and therefore certain actions by DEQ and DST staff). There are two broad categories of actions – education and action plans, which will move forward concurrently; actions in both categories will start with basic requirements and then become more involved depending on the unit's specific situation.

Distressed Unit Requirements – Education

Under § 159G-45.(b), distressed units must participate in a training and educational program approved by the Authority and the Commission. Attendance is mandatory for any governing board members and staff whose participation is required by the Authority and Commission. The scope of training and education, and its method of delivery, shall be at the discretion of the Authority and Commission. Education is envisioned to include three aspects:

1. **Initial orientation meeting** to discuss why the system is categorized as distressed, utility-specific data compared to benchmarks, and potential paths forward. In some cases, this may be the only educational requirement depending on long-term plans (e.g., the system may be willing to merge with another already viable utility).
2. **One-day overview** of the SL 2020-79 requirements, the need for organizational capacity, infrastructure issues, and the financial aspects of water enterprises. Division staff are already developing this overview program, which is designed to complement items that will need to be addressed by the action plans (e.g., understanding rates, performance measures, etc.).
3. **Detailed education requirements** as needed. There could also be requirements for staff of the unit to develop more capacity utilizing formal courses that are already available. For example, if the unit has a need for more financial knowledge, the finance officer may be required to take

a course at a local community college. Or if the unit needs more operations capacity, staff may be required to obtain operator certifications.

Distressed Unit Requirements – Action Plans

Under § 159G-45.(b), a unit must conduct certain basic studies and develop both short-term and long-term action plans. The statutes require:

1. An **asset assessment and rate study** as directed and approved by the Authority and Commission. DEQ has worked with HDR Engineering to develop specific requirements for asset assessment, including operations and maintenance needs, to ensure consistency and completeness whether the work is contracted by the unit or administered by DEQ or DST. Based on the assessment work, a preliminary rate study can be performed. It may not be possible for the unit to implement rates needed for full sustainability (e.g., the rates may be unaffordably high) and additional rate studies may be needed for alternative solutions such as decentralizing or consolidating with another utility.
2. A **short-term plan** for infrastructure repair, maintenance, and management which must be within the ability of the unit to implement with some potential assistance such as immediate funding from the VUR, assistance by technical assistance organizations, etc. The unit may need to implement a short-term rate increase. Additional operations and maintenance activities may be needed, some of which may be beyond the ability of the unit to perform and therefore would need to be outsourced.
3. A **long-term infrastructure and financial plan** that ensures the utility will be viable. Long-term solutions may include mergers and regionalization for many systems. If a long-term plan includes consolidation and construction activities, these plans may take several years to implement, allowing time to develop a process to consider and agree on an approach between multiple units, and work through the details of an interlocal agreement or the structure of a new utility once an approach is agreed upon.

Town of Bethel Example

The Town of Bethel is a distressed unit that operates both a water and sewer system. Wastewater is treated by Greenville Utilities Commission (GUC) via an interconnection. In 2017, GUC conducted an assessment, partially funded by a MRF grant from the Authority. This provided enough information to identify some basic construction needs and allowed the two entities to discuss a merger on a more informed basis. In 2020, project funding in the amount of \$4.5 million was awarded which provided assurance that the infrastructure could be brought up to acceptable levels. Merger agreements are now being developed and construction will begin soon after the agreements are in place, estimated to be in 2021.

Funding for Actions

Once designated as distressed, there are several actions the unit must take. Depending on the unit's financial situation and scope of issues, funding through the VUR may be possible. Some units may have a sufficient customer base combined with rate increases to pay for the needed

actions. Many of the water infrastructure funding programs can also be utilized in these cases (e.g., subsidized loans from a state revolving fund). However, many units will need grant funding through the VUR program. The VUR can provide grants to implement many aspects of the action plans such as:

1. Public water or wastewater infrastructure to provide regional service
2. Rehabilitate existing public water or wastewater infrastructure
3. Decentralize an existing public system into smaller viable parts
4. Fund a study of
 - a. Rates
 - b. Asset inventory and assessment
 - c. Merger and regionalization options
5. Fund other options deemed feasible
6. Provide emergency grants for operating deficits

Pursuant § 159G-35.(c), grants from the VUR are awarded based on criteria jointly developed by the Commission and the Authority. This would mirror the current process of the Authority making a project eligible for a loan from the Division and the Commission then approving the loan (debt).

Pursuant to § 159G-39(e), when grants are made, DEQ and the Commission may, in their discretion, impose specific performance measures for these grants to ensure the long-term viability of the utility. These performance measures could include requirements such as exceeding the financial benchmarks used to determine that a unit is distressed, maintaining certain staffing levels (e.g., a utility manager), documenting operation and maintenance, benchmarking, etc. Performance measures would not be needed if the distressed unit consolidated their system with a known viable utility, like the Town of Bethel consolidating its utilities with the Greenville Utilities Commission.