

SL 2020-79 Viable Utility Reserve Distressed Criteria Summary

Criteria	Points	Threshold Value	Description	Formula	Data Source
Service Population	1	< 10,000	Identifies smaller systems (less than 10,000 people served).		Varied
Transfers Out	1		Point scored when money is transferred out of the system's dedicated utility fund in 2 or more of last 5 years if the system also has a negative surplus and low debt service coverage ratio. (This indicates that money generated by the utilities is not being put back into the system for improvements).		Calculated from LGC data
Transfers In	1		Indicates that the system is not generating enough money to cover expenses. Point scored when money is transferred into the primary water/sewer fund from other sources in 2 or more of the last 5 years.		Calculated from LGC data
Debt Service Coverage Ratio (DSCR)	1	< 1.1	Measures unit's ability to cover loan payments by looking at revenue, expenses, and loan payments (principal and interest).	(Operating revenues - operating expenses excluding depreciation) / (principal + interest payments)	Calculated from LGC data
DW Compliance	1		Point scored for maximum contaminant level (MCL) and treatment technology violations.		NC DEQ-DWR
WW / CS Compliance	1		Point scored for limit violations and inspection violations for wastewater treatment operations, and sanitary sewer overflows (SSOs) violations and systems with the highest SSOs per mile of collection system.		NC DEQ-DWR
Flow Moratorium	4		Points scored when the system is under a moratorium preventing service expansion due to inability to treat wastewater or because the system has reached 90% of permitted capacity.		NC DEQ-DWR
Revenue Outlook	4		Reflects service unit's ability to generate income in the future. Points scored when the system has high rates AND declining population.		EFC rates, population source varies
Affordability	1	4 or more Indicators	Identifies economically disadvantaged communities by comparing the service area's population change rate, poverty rate, median household income, unemployment rate, and total appraised value of property to established state benchmarks. Point scored if 4 or 5 of these indicators are worse than the state benchmark.		Developed by DWI/SWIA
Rates	1	>\$100 Combined >\$50 DW >\$60 WW	Point scored when rates are already high. Indicates that the system is unlikely to be able to increase rates to improve revenue.	2019 inside rate for 5,000 gallons used	EFC
DW Pop / Mile	1	< 100	Evaluates population density. Lower density areas tend to face more service challenges.	Population/Miles of drinking water pipe	LWSP (see above for population)
Sewer Pop / Mile	1	< 100	Evaluates population density. Lower density areas tend to face more service challenges. Note that there is a significant lack of data on miles of sewer line for small systems.	Service Population/ Miles of sewer pipe	NC DEQ-DWR

Criteria	Points	Threshold Value	Description	Formula	Data Source
UAL Control - W/S only	3	1 or 2 risk level	Points scored for systems that have been identified as medium (2) or high risk (1) of accounting internal control issues associated with water and/or sewer systems based on annual audits.		LGC
Surplus (deficit) w/ Debt	2	$\leq \$0$	Identifies systems that are not generating enough revenue to cover expenses, asset depreciation, and debt payments.	Operating Revenues - ((Operating Expenses - Depreciation) + Long-term Debt Service)	Calculated from LGC data
No Debt DSCR Test	1	1.1	Similar to the DSCR calculated above but includes \$1 million "test" project if system has no debt to evaluate the ability to finance a relatively simple project.		Calculated from LGC data
% Depreciated	1	>50%	Evaluates the financial impact of depreciation of water and sewer assets as they age.		Calculated from LGC data
Operating Margin	1	<0	Point scored if the system is not generating enough revenue to cover operating expenses.	(Operating Revenue - Operating Expenses) / Operating Revenue Includes depreciation	Calculated from LGC data
Quick Ratio	1	< 1.1	Evaluates a system's ability to meet short-term financial obligations with cash or easily accessible funds.	Current assets (excluding inventories and prepaids) / current liabilities	Calculated from LGC data
Receivables Ratio	1	≥ 2.0	Measures how timely the system is collecting money from customers. Point scored for 3 year average exceeding ratio or for increasing ratio over 2 years showing declining trend of bill payment.	Days Receivables / billing period Days receivables = Net Customer Accounts Receivable / Charges for services / 365	Calculated from LGC data

List of Acronyms

CS = Collection System

DEQ = Department of Environmental Quality

DSCR = Debt Service Coverage Ratio

DW = Drinking Water

DWI = Division of Water Infrastructure

DWR = Division of Water Resources

EFC = UNC Environmental Finance Center

LGC = Local Government Commission

LWSR = Local Water Supply Plan

MCL = Maximum Contaminant Level

SSO = Sanitary Sewer Overflow

SWIA = State Water Infrastructure Authority

WW = Wastewater (sewer)

UAL = Unit Assistant List generated by LGC to identify communities that may have problems with accounting procedures identified through audits

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

Introduction

The nine-member State Water Infrastructure Authority (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 of Water Infrastructure (Division) and consolidated the major water and wastewater infrastructure funding programs in the Division within the Department of Environmental Quality (DEQ). The enabling legislation is NC General Statute 159G. Division staff support the Authority in carrying out its assigned duties.

The Local Government Commission (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 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.

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. The SL 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. DEQ, through the 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.

Background

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.



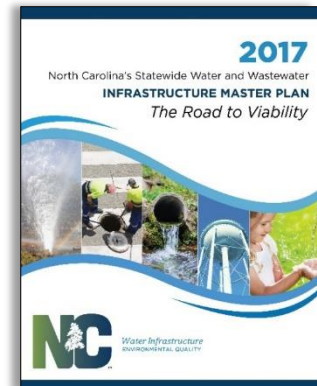
Infrastructure Management: Utilities are operated most effectively and efficiently by taking proactive approaches to enable the right investments to be made in the right projects at the right time, taking into consideration lifecycle costs and risk management.



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.



These Master Plan concepts and the Master Plan vision are used as a basis for developing the distressed unit criteria, educational components, and action plans under SL 2020-79.

To illustrate the difficulties smaller utilities may face in operating as a viable entity, DEQ published *“Challenges Facing Small Water and Wastewater Utilities: Four Systems Facing Viability Challenges”* in 2018. This paper provided an overview of four systems DEQ had worked closely with and had become familiar with their individual situations. 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 this 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.

Note that two of the four units highlighted in this paper have since been taken over by the Commission. One other, 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 2016 and included basing the amount of construction project grants on affordability criteria and offering two new types of grants – Asset Inventory & 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.

DEQ also supported work at the University of North Carolina Environmental Finance Center (EFC) to develop educational materials for utilities. Through this financial support, the EFC published two guidance documents – *“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.

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.

Implementing SL 2020-79

SL 2020-79 authorizes a process that will result in 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:

- Local Government Unit assessment
- Education requirements
- Implementing action plans

The assessment of local government units (units) is provided in § 159G-45. There are two general processes – developing criteria and then, using that criteria, identifying units as “distressed.”

A. Developing Distressed Criteria

The Authority and Commission are charged with first developing criteria to determine which specific units meet the definition of distressed (§ 159G-20.(4a)). The Authority and Commission are to jointly develop criteria under § 159G-45.(a) which 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 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.

§ 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.

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 data that are readily available 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 critical condition that they may need to be designated as distressed as soon as possible.**

Early Designation as Distressed

Regardless of the model development, there are a few units that are in critical situations and may need to be designated as distressed before the criteria is finalized based on actions already taken by the Commission

B. Distressed Unit Actions

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. These two categories will essentially take place simultaneously and both will start with basic requirements and then become more involved depending on the unit's specific situation.

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.

The first aspect of the educational requirement will be an initial orientation meeting to discuss why the system is categorized as distressed, utility-specific data compared to benchmarks, and discussion of potential paths forward for the specific utility. 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).

The second aspect will be a 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.). The overview will also examine first steps that the system could take to begin moving toward viability.

The third aspect will be more detailed education requirements for board members and staff. There could also be requirements for staff 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.

Develop and Implement 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:

- 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.
- 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.
- A long-term infrastructure and financial plan that ensures the utility will be viable.
 - Long-term solutions will likely include mergers and regionalization for many systems. Resources already in place include EFC guidance documents on interlocal agreements and utility structures available under NC law.
 - 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.
 - Once agreements are in place, then construction contracts for interconnections and/or bringing some infrastructure up to acceptable levels may be entered into.

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.

C. 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. The criteria will be used by the Authority to make awards under § 159G-39.

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 meeting the financial benchmarks used to determine that a unit is distressed, maintaining certain staffing levels (e.g., a utility manager), document 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.

**State Water Infrastructure Authority
Viable Utility Reserve Committee
October 7, 2020 Meeting**

Agenda Item F – Recommendations from Committee to Authority

Division of Water Infrastructure Staff Report

Background

Session Law 2020-79 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. As part of the Session Law, if a unit is determined to be distressed, it must conduct an asset assessment and rate study as directed and approved by the Authority and the Local Government Commission.

Among other activities, VUR funds can be used to:

- Conduct the asset inventory and assessment to inventory the existing public water or wastewater system, or both, and to document the condition of the inventoried infrastructure
- Conduct a rate study to determine a rate structure to ensure the public water system or wastewater system will generate sufficient revenue to adequately fund management and operations, personnel, appropriate levels of maintenance, and reinvestment that facilitate the provision of reliable water or wastewater services
- Study merger and regionalization options

After the Authority and the Local Government Commission determine units that are distressed, these initial studies would be among the first work tasks to be undertaken. Staff has prepared the following cost estimates of the initial work tasks that would need to be completed for units that may be initially identified as distressed.

Initial Distressed Units, Initial Work Tasks and Estimated Costs

The Authority and the Local Government Commission may initially identify several units as distressed. The Town of Eureka and the Cliffside Sanitary District have already been taken over by the Local Government Commission and are likely to be designated as distressed. The Town of Bethel is a distressed unit that is in the process of developing a merger agreement with the Greenville Utilities Commission, resulting from an earlier Merger/Regionalization Feasibility grant awarded by the Authority. On Sept. 1, 2020, the Local Government Commission passed the following: “Resolution Giving Notice and Warning to the Town of Kingstown, Pursuant to G.S. 159-181(c), regarding the Town’s Failure to Comply with the Budget and Fiscal Control Requirements of Chapter 159 of the General Statutes of North Carolina”, which indicates that the unit is distressed.

Unit: Town of Eureka			
Other Units likely to be Involved in Solution: Fremont, Pikeville, Goldsboro, Wayne County			
Other Units that likely need Evaluation: Fremont, Pikeville			
Unit	Service Provided	Initial Work Tasks	Estimated Cost
Eureka	Sewer only	Sewer Asset Assessment	\$75,000
Fremont	Water and Sewer	Water and Sewer Asset Assessment	\$200,000
Pikeville	Water and Sewer	Water and Sewer Asset Assessment	\$120,000
All		Water and Sewer Merger/Regionalization Study	\$100,000
Total			\$495,000

Unit: Cliffside Sanitary District			
Other Units likely to be Involved in Solution: Likely no other units			
Other Units that likely need Evaluation: None			
Unit	Service Provided	Initial Work Tasks	Estimated Cost
Cliffside Sanitary District	Sewer only	Sewer Asset Assessment	\$150,000
		Alternatives Analysis	\$150,000
Total			\$300,000

Unit: Town of Bethel			
Other Units likely to be Involved in Solution: Greenville Utilities Commission			
Other Units that likely need Evaluation: None			
Unit	Service Provided	Initial Work Tasks	Estimated Cost
Town of Bethel	Water and Sewer	Preliminary Rates Analysis	\$50,000
		Merger Agreement Review	\$50,000
Total			\$100,000

Unit: Town of Kingstown			
Other Units likely to be Involved in Solution: Polkville, Lawndale, Fallston, Cleveland County Water, Shelby			
Other Units that likely need Evaluation: Polkville, Lawndale, Fallston			
Note: Merger/Regionalization Feasibility Study completed in May 2019			
Unit	Service Provided	Initial Work Tasks	Estimated Cost
Kingstown	Sewer only	Sewer Asset Assessment	\$150,000
Polkville	Water and Sewer	Water and Sewer Asset Assessment	\$90,000
Lawndale	Water and Sewer	Water and Sewer Asset Assessment	\$100,000
Fallston	Water and Sewer	Water and Sewer Asset Assessment	\$150,000
Total			\$490,000

Rate Studies for all Units		
Unit	Other Units Likely to be Involved in Solution	Estimated Cost
Eureka	Fremont, Pikeville, Goldsboro, Wayne County	\$100,000
Cliffside Sanitary District	None	\$100,000
Bethel	Greenville Utilities Commission	\$100,000
Kingstown	Polkville, Lawndale, Fallston, Cleveland County Water, Shelby	\$100,000
Total		\$400,000

Summary of Estimated Costs for Initial Work Tasks	
Unit	Estimated Cost
Town of Eureka	\$495,000
Cliffside Sanitary District	\$300,000
Town of Bethel	\$100,000
Town of Kingstown	\$490,000
Rate Studies for All	\$400,000
Total	\$1,785,000

Staff Recommendation

Staff recommends that the Committee recommend the following actions to the Authority at its meeting on October 14, 2020:

1. The Authority should identify the following units as distressed:
 - Town of Eureka
 - Cliffside Sanitary District
 - Town of Bethel
 - Town of Kingstown
2. The Authority should approve the expenditure of Viable Utility Reserve funds, up to \$1,785,000, for the initial work tasks shown in the tables above with the stipulation that staff report back to the Authority on how much is spent for which tasks for each unit.

Special Joint Meeting of the Local Government Commission and the State Water Infrastructure Authority

October 14, 2020

Meeting Via WebEx

The public may listen to the meeting at the following link:

XXX

The State Government Ethics Act (North Carolina General Statute Chapter 138A) mandates that the Chair inquire as to whether there is any known conflict of interest or potential conflict of interest with respect to any matters before the Commission and Authority today. If any member knows of a conflict of interest or potential conflict of interest, please identify the conflict at the time the conflict becomes apparent.

The times indicated for each Agenda Item are merely for guidance. The Commission and Authority will proceed through the Agenda until completed.

AGENDA

The Honorable Dale R. Folwell, State Treasurer, Presiding

2:00 A. Call to Order – Treasurer Folwell

1. Welcome
2. Reminder of Conflict of Interest and Compliance with State Government Ethics Act
3. Please set electronic devices to off or vibrate
4. Attendance Roll Call – Treasurer Folwell and Kim Colson, Chair, State Water Infrastructure Authority

2:05 B. Commission and Authority Members Introductions

2:15 C. Session Law 2020-79 Overview

2:30 D. Potential Distressed Criteria

2:45 E. Process Overview

3:00 F. Near-Term Action Items

3:15 G. Remarks by Local Government Commission Members and State Water Infrastructure Authority Members

3:30 H. Adjourn

Reminder to All Authority Members: Members having a question about a conflict of interest or potential conflict should consult with the Chair or with legal counsel.

Reminder to Authority Members Appointed by the Governor: Executive Order 34 mandates that in transacting Commission business each person appointed by the Governor shall act always in the best interest of the public without regard for his or her financial interests. To this end, each appointee must recuse himself or herself from voting on any matter on which the appointee has a financial interest.
