

## GUIDANCE FOR WATER SYSTEMS ON MEETING ELIGIBILITY CRITERIA RELATED TO WATER RATE STRUCTURES

Effective July 1 2009, drinking water systems applying for state infrastructure loans or grants for extension of waterlines or expansion of water treatment capacity must demonstrate that the water system has a rate structure that is:

“adequate to pay the cost of maintaining, repairing, and operating the system, including reserves for payment of principal and interest on indebtedness incurred for maintenance or improvement of the water system during periods of normal use and periods of reduced water use due to implementation of water conservation measures.”

G.S. 143-355.4(b)(1)

The statute directed funding agencies to apply guidelines developed by the State Water Infrastructure Commission in determining the adequacy of the water rate structure to support operation and maintenance of the system.

The State Water Infrastructure Commission contracted with the Environmental Finance Center at the UNC School of Government to do a study of water rate structures and to recommend guidelines for implementation of the new requirement.

Funding agencies will determine whether a rate structure meets the first part of this criteria (adequacy of the rate structure to cover the cost of maintaining, repairing and operating the system, including debt service) based on the following questions:

- a. Do system operating revenues cover operating expenditures (excluding principal and interest on debt)?

If the answer is “no”, the rate structure does not meet the statutory criteria and the water system will not be eligible for state infrastructure funds. If the answer is “yes”, go to the next question.

- b. Do system operating revenues also cover principal and interest payments on indebtedness? If the answer is “yes”, the rate structure meets the first criteria set out in the statute. If the answer is no, the rate structure may still meet this criteria if there are circumstances that make the current year unusual and the system can demonstrate that it will cover operating expenses and principal and interest on an ongoing basis in the future. Circumstances that may be considered include:

- The utility has significant capital reserves due to impact fees or special assessments that are not included in the calculation of operating revenues.

- The utility has large reserves and is holding rates low to avoid over-charging customers and to draw down the reserves.
- The utility is in a start-up phase and has significant up front expenditures and debt service, but a small customer base.
- The utility is providing water infrastructure or utility service as an economic development incentive and is temporarily using money from the general fund to subsidize the capital improvements.
- The utility has lost a major customer and a major source of revenue.
- The utility has a debt service reserve and has sufficient funds from which to transfer an amount equal to principal and interest.
- The utility is in receipt of a transfer from the General Fund for sales tax formerly restricted for water/sewer capital outlay or debt service; though no longer legally restricted some municipalities have chosen to continue the designation of a percentage of sales tax revenue for water/sewer capital outlay or debt service.
- The utility has investment earnings on debt proceed available to fund debt service or has capitalized interest that was part of capital financing.

If the utility has a revenue gap because it is in start-up, has lost a major customer or has made recent outlays as an economic development incentive, it can meet the criteria by submitting a financial plan demonstrating that operating revenues will meet or exceed the combined costs of operation (including repair and maintenance) and debt service within 3 years.

NOTE: Funding agencies will use the information on system revenues, expenditures and debt service provided on Local Government Commission Form LGC-108C. For combined water and sewer systems, funding agencies will apply the criteria set out in G.S. 143-355.4(b)(1) to the combined system.