

EPA Environmental Financial Advisory Board

February 11-13, 2020

Draft Proposed Charges for EFAB Discussion (as of 2/6/2020)

Stormwater Credit Trading 101: Advice for Permit Writers and their Permittees

Problem Statement

As many cities in the United States continue to experience growth, the increase in stormwater runoff associated with impermeable surfaces has presented challenges for many municipal water utilities trying to keep pace with increasingly stringent Clean Water Act (CWA) permitting requirements.

To address these challenges, municipalities across the United States are implementing strict stormwater management requirements for new and existing properties throughout their jurisdictions. These requirements mandate a certain volume of stormwater be managed on those properties. The goal of these programs is to reduce the volume of stormwater entering existing storm- and wastewater infrastructure, which improves overall water quality at the point of discharge from municipal sewer systems.

While in some cases the costs of stormwater best management practices (BMPs) can be high, one of the key obstacles facing building owners is the opportunity costs related to siting BMPs. For example, roof space for high value amenities such as pools, bars, and decks, or underground space for parking can be limited if that same space is used instead for BMPs. Further, the optimal location of a BMP from a watershed benefit standpoint might not be where development is occurring. As such, cities and states throughout the country are exploring the development of innovative market-based mechanisms that would allow private sector developers to finance offsite projects with the sale of credits, which are used by property owners to meet their regulatory obligations under new stormwater management standards. Similar to cap and trade markets for carbon dioxide emissions, the advent of a credit against these standards creates a marketplace that drives competition and ultimately provides the lowest-cost solutions to stormwater mitigation, thereby reducing costs of compliance.

EFAB Mission Fit

EFAB's mission is to explore ways to lower costs and increase investments in environmental protection. Environmental markets are often designed to achieve both facets of this mission. Stormwater credit trading is a new and exciting tool that CWA permittees might want to have at their disposal. With thoughtful market design, it may be possible for those communities to drive low cost compliance, incentivize and increase economic development by offering private developers an alternative compliance pathway, and drive investment in environmental services to traditionally underserved/underinvested neighborhoods. EFAB may be able to provide guidance and advice on how to structure these markets so that they can achieve these goals.

EPA Mission Fit

EPA's mission is to protect the environment through the enforcement of the nation's environmental regulations, scientific research, and public education. Often this means working with communities to determine the best pathways to achieve compliance in a cost-effective manner. In a February 6, 2019 memo¹ Assistant Administrator Ross reiterated EPA's support for market-based water quality programs, including water quality trading and offsets, and encouraged regional offices to find opportunities to promote market-based programs within its regulatory mandates.

Type of EFAB Engagement

EFAB could assist EPA through a written report that would provide guidance to permit writers and their permittees on how to implement stormwater credit trading. This may include market design, incentives design, market administration, among others.

¹ <https://www.epa.gov/sites/production/files/2019-02/documents/trading-policy-memo-2019.pdf>

Environmental Finance Advisory Board

Addressing Affordability Challenges to Equitable Water Service Delivery

As water service rates have risen faster than inflation and income growth, addressing water affordability has become a central policy issue. This focus has prompted a number of studies and research efforts that offer alternative measures of household burdens, delineate geographical distributions of water service cost burdens, and outline potential revisions to methods for assessing community financial capabilities (including EPA's ongoing review of its 1997 methodology guidance).

In the last two decades, EFAB has developed two related charges that addressed: (1) potential rate design (and complimentary customer account management) options to address water affordability,¹ and (2) how the EPA's Water Infrastructure and Resiliency Center could assist local governments with affordability challenges.² In subsequent years, particularly after the Flint Water Crisis and various reports on water access challenges in the United States,³ the water service sector is redefining its services in terms that challenge historical pricing through measures of billable volumes and customer account management practices. This more explicit recognition of the importance of water affordability to fulfill the water sector's public health protection responsibilities has complementary implications for regulatory, financial, and technical support initiatives.

Problem/Question Statement

This proposed EFAB charge is to develop recommendations for how EPA's enforcement practices and financial and technical assistance programs may be modified to enhance and amplify the ongoing refinement of water service definitions that highlight the importance of assuring water affordability and access. These refinements recognize that water services are more than management of drops measured through water meters and impervious area measures. They more explicitly recognize the public health protection value conveyed, and the attendant imperatives to assure access and affordability. The charge is to address how EPA can help ensure that the costs of compliance with environmental regulations do not impose inequitable burdens on economically disadvantaged households while also advancing water quality improvement and utility system reinvestment. The charge is to gauge the extent to which EPA-sponsored financial and technical assistance programs may be modified to address community access and affordability challenges to render more equitable outcomes.

EFAB Mission Fit

The charge is oriented toward providing recommendations related to EPA's approaches to enforcement of environmental regulations that may have acute impacts on community financial capabilities and household affordability, and on how EPA could modify its financial and technical assistance programs to enhance support to communities with affordability and access challenges.

EPA Mission Fit

The proposed charge is intended to provide recommendations primarily to enhance existing EPA programs and practices established to serve EPA's mission.

Type of EFAB Engagement

- EFAB workgroup written report
- EFAB-sponsored workshop

¹ *Affordable Rate Design for Households*, EFAB report dated February 2006.

² *Household Affordability Challenges in the Water Sector*, EFAB report submitted February 26, 2016.

³ *Closing the Water Access Gap in the United States: A National Action Plan*, Dig Deep and US Water Alliance, 2019.

Risky Environmental Business: Impact on Cost of Capital for Utilities

EFAB members: J. Beecher, T. Chapman, E. Crooks, R. Weiss

Problem/Question Statement

Capital and insurance markets are increasingly recognizing environmental factors in their assessment of risk profiles and credit quality. The relevant risks factors are also expanding in the context of complex systems encompassing both the natural and built environments. Risk relates to interrelated aspects of utility operations, including reliability, resilience and regulatory compliance. In addition, there is growing recognition that environmental risks, including those associated with natural or humanmade disasters, are affecting the cost of capital. Managing and mitigating risk is a priority of utility managers. Environmental, resource, and economic regulators are increasingly risk aware.

The following key questions are of interest:

- What risk factors (including environmental risks) are affecting utilities and how are they being addressed? Examples of risk impacts include cost (increased capital or operations scope, reporting and administrative effort, etc.), schedule (delays due to required environmental permits/approvals), and increased uncertainty about project viability (affecting cost of capital and increasing contingencies).
- How can utilities more effectively manage risk, and which tools are most cost-effective for which risks?
- Which categories of risk have been the most challenging for utilities to manage effectively, and why?
- How are utility credit ratings and insurance products affected by risk?
- How is changing risk affecting utility capital costs and revenue requirements?
- How does utility ownership affect risk management?
- For the private sector, how are risks shifted between shareholders and ratepayers?
- How does risk-bearing relate to issues of environmental justice?
- What practices and products can utilities use to manage or mitigate risk?
- How are various types of risks disclosed and reported?
- What tools are available for evaluating risk, including scorecards?

EFAB Mission Fit. Risk is a natural topic for the EFAB due to its implications for the financial health and viability of utilities. EFAB members have considerable expertise in how financial markets perceive and process risk, and how this in turn affects utilities.

EPA Mission Fit. EPA's interest in risk relates its roles as the nation's environmental health regulator but also as a source of capital financing. Better risk management has implications for the financial health of utilities and thus public health over the long term.

Type of EFAB engagement. We recommend an EFAB consultation at a public meeting or an EFAB-sponsored educational workshop with a written summary. We view this topic as an opportunity to share knowledge about financial risk and its implications with stakeholders in the environmental policy community.

Attracting Private Investment to Opportunity Zones: A Role for EPA

EPA Efforts in Opportunity Zones

In December 2018, the White House Opportunity and Revitalization Council (WHORC) was established by Executive Order 13853 to implement administrative reforms and initiatives to target, streamline, and coordinate Federal resources in economically distressed communities. EPA is a member of the Council and is included in two separate work streams: Safe Neighborhoods and Economic Development. In addition to tax incentives for development in designated Opportunity Zones (OZ) provided by the Tax Cuts and Jobs Act of 2017, a new feature on grants.gov beginning in March 2020 will enable applicants to search for available grants/programs across the federal government that benefit OZs. This will benefit OZ stakeholders by increasing general awareness of federal programs with OZ benefits.

Problem/Question Statement: Maximizing the Impact of EPA Investment in Distressed Communities

The OZ initiative creates incentives for equity investments in real estate and infrastructure projects as well as new or expanded businesses located in the designated OZs. It is principally an economic development initiative that is designed to support the revitalization of communities to address chronic and acute problems that result from economic decline. Many of these problems relate to the environment and human health.

Our experience with community-focused programs suggests that economic investments from the private sector are far more likely and attractive when environmental quality is maintained at healthy levels. Potential environmental liability and uncertainty about environmental quality can also discourage private sector investment in a community. We believe that additional environmental infrastructure and improvement is a necessary condition for attractive private sector investment in many communities, even with OZ incentives.

Investing in distressed communities is not new for EPA. The agency has historically provided support to communities through mechanisms that have included grants, tools, training, education, and technical assistance. Despite these efforts and investments, EPA cannot always determine, in advance, whether its limited resources will be effectively leveraged to make a measurable environmental and public health improvement for these communities.

The EPA would appreciate any strategic advice from the EFAB on ways to encourage private investment in OZs. Specific questions include:

- 1) First, which specific federal/EPA incentives (monetary or otherwise) are most likely to increase public/private investment in OZs?
- 2) Looking at existing EPA incentives, including funding programs such as environmental justice, or brownfields grants which incentives, programs or approaches are better suited to achieve desired community outcomes while reducing risk, liability and/or

regulatory uncertainty for investors in OZs?

- 3) Does the EFAB have recommendations on readily implementable adjustments to existing Agency programs to make them more effective in reducing risk, liability and/or regulatory uncertainty? Are there more complicated adjustments that should be also considered by the Agency?
- 4) What regulatory/liability/risk data could be provided to allow investors to compare OZs and determine which OZ might be a best fit for their investment?
- 5) Does the EFAB have any recommendations on how we share information and resources in a way that would ensure that the programmatic resources we leverage for OZ purposes lead to improvements in local health and environmental outcomes for the existing community.

EPA Mission Fit:

The EPA Office of Policy (OP), located in the Office of the Administrator, is the primary policy arm of EPA. Among other duties, OP is responsible for coordinating all of EPA's Opportunity Zone (OZ) work across the agency. OP has extensive experience in working in economically distressed communities across the country to support locally led, community-driven strategies that improve economic development and environmental and human health outcomes. OP uses this expertise in coordinating across EPA programs and in collaboration with other federal agencies to assist communities' efforts to ensure that public and private sector investments support community goals.

Type of EFAB Engagement: to be determined