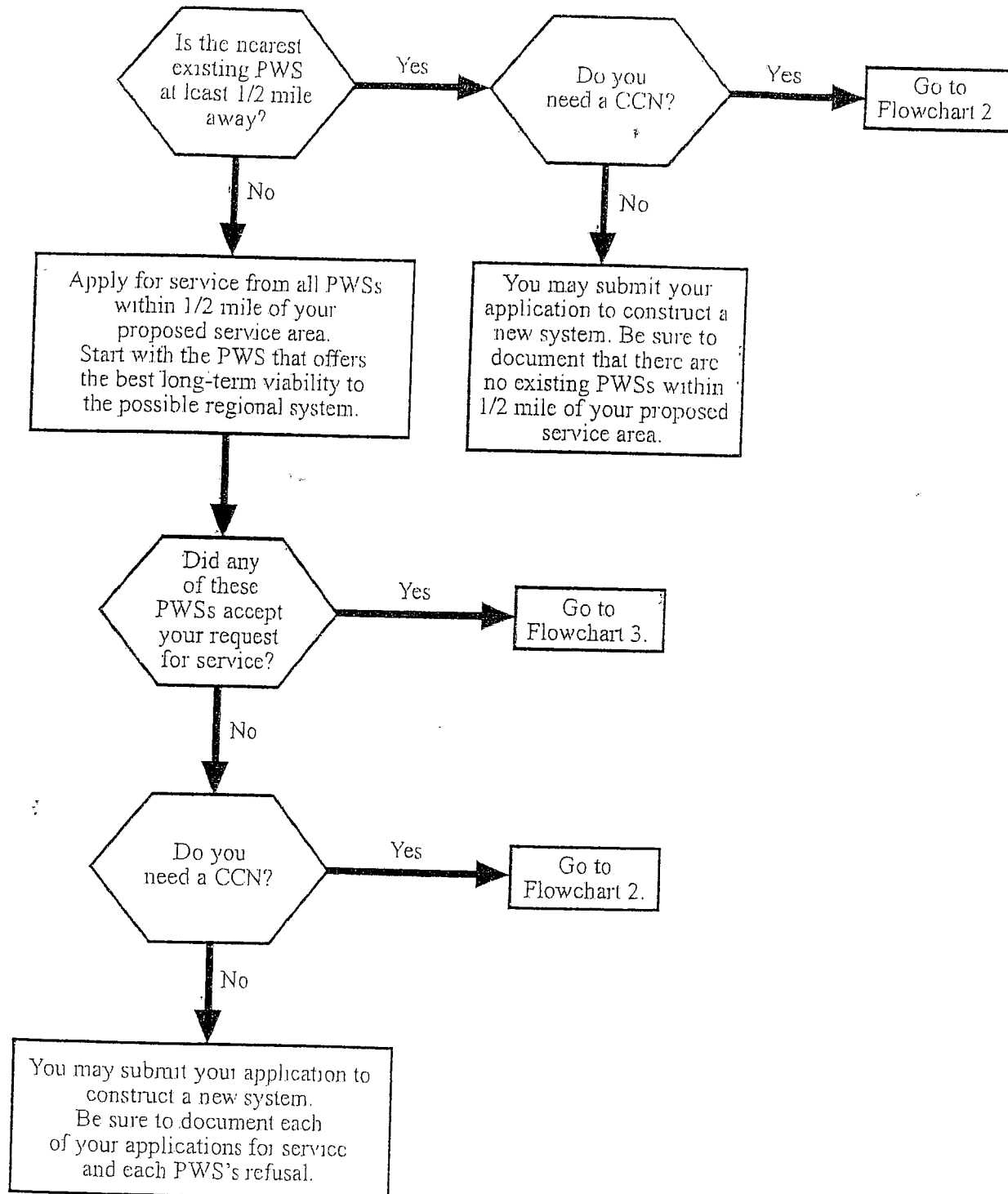


Flowchart 1.
Is forming a regional PWS feasible?



If there is more than one existing system, we recommend that you consider establishing regional service with the existing system that will provide the best long-term viability.

You must document that you have made every reasonable attempt to request service from all the nearby systems and the appropriate department of each system. If you do not receive a response within a reasonable amount of time, you are responsible for following up.

Was your request for service approved?

If your request was approved, you must work with that system to form a regional system unless you can demonstrate that regionalization is not feasible through Exception 3 below.

If your request was not approved and you do not need a new CCN (see box, page 11, upper left), you may submit your plans, specifications, and, if required, business plan for a stand-alone system. However, you must provide us a copy of the application requesting service and all correspondence from all the existing systems when you submit these materials.

Exception 3: Costs, affordability, and capabilities

Can you successfully demonstrate that an exception should be granted based on costs, affordability, and the capabilities of the existing system?

To analyze the feasibility of regionalization, you must consider the interplay of these interrelated factors:

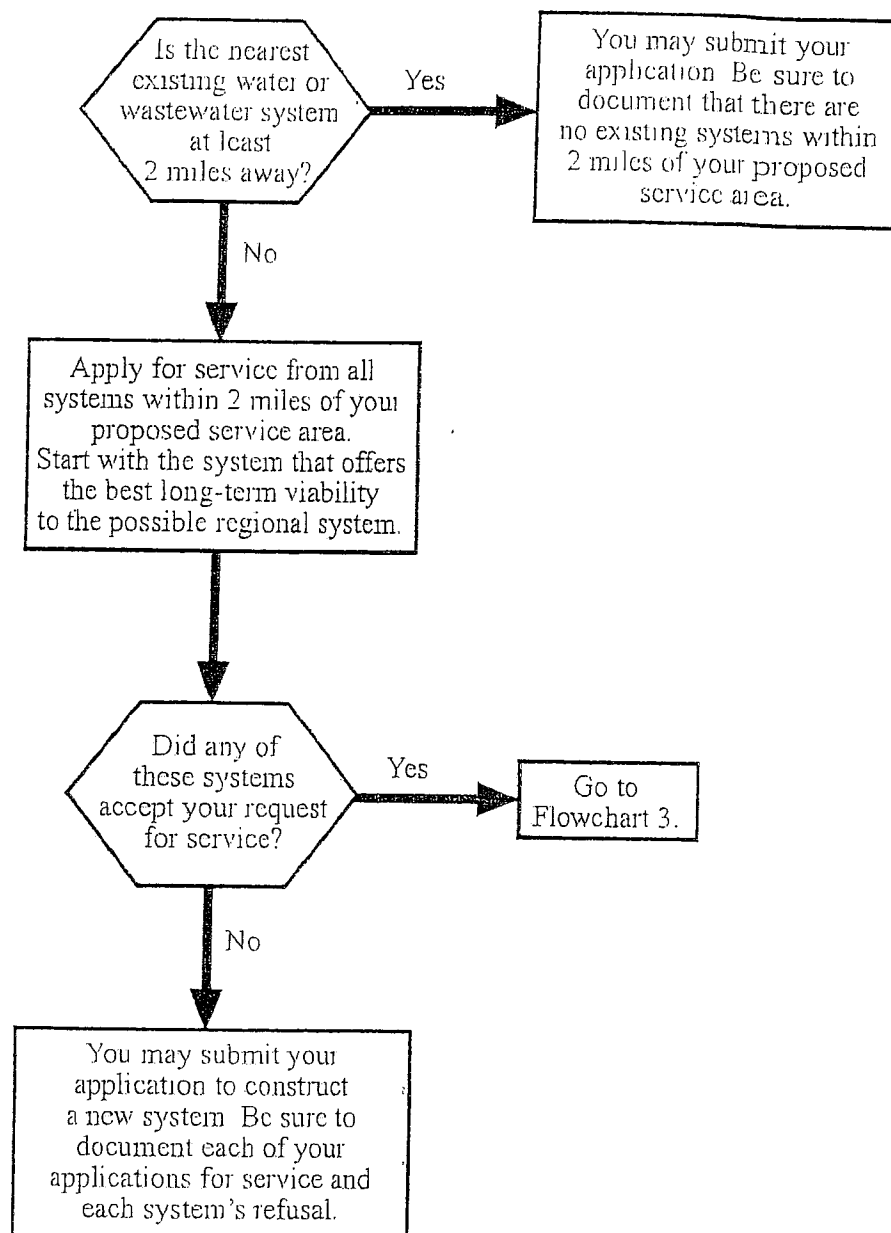
- ratio of the costs of regionalization compared to the projected value of the development at buildout;
- affordability of the rates; and
- financial, managerial, and technical capabilities of the existing system.

These factors are used as a screening process. You qualify for this exception even if you meet only one of these factors.

If you qualify for this exception, you may submit your plans, specifications, and, if required, business plan for a stand-alone system. However, you must also give us the supporting documentation. Before you submit these materials, see the box at the upper left of page 11 to find out whether you also need a CCN.

For a more detailed explanation of how to analyze these factors, see "Appendix A Analyzing Costs, Affordability, and Capabilities of the Existing System" on page 17.

Flowchart 2.
Is forming a regional system feasible when you need a CCN?



New Water and Wastewater CCNs

If you are applying for a new CCN, you must evaluate the feasibility of regionalization before you submit your CCN application and accompanying documents to us.

Our regionalization policy for these new CCNs is just like our policy for new PWSs except for these two points:

- You must expand your search for nearby water or wastewater systems to 2 miles from the boundary of your proposed service area.
- You do not have to consider the exceptions in order. In other words, you do not have to apply for service from a nearby system if you can demonstrate that costs, affordability, and the capabilities of that system would make regionalization infeasible anyway.

Flowchart 2 on the facing page gives an overview of this process.

Exception 1: No systems within 2 miles

Is an existing PWS or wastewater treatment system within 2 miles of your proposed CCN boundary?

If the nearest system is within 2 miles of your proposed boundary, see whether *either* Exception 2 below or Exception 3 on page 16 applies to you.

If the nearest system is more than 2 miles away, you may submit your CCN application and related materials to us.

You are not *required* to consider regionalization. However, we *recommend*

that you consider the feasibility of establishing regional service with another system, even if you must look more than 2 miles away.

Note: If more than one existing system is within 2 miles of your proposed boundary, we recommend that you consider establishing regional service with the existing system that will provide the best long-term viability.

Exception 2: Your request for service has been denied

Have you requested service from all of these systems?

If you have requested service, see “Was your request approved?” below.

If you have not requested service from a nearby system, then you must either request service from that system or demonstrate that regionalization is not feasible through Exception 3 on page 16.

Was your request approved?

If the nearby system approved your request for service, see Exception 3 below

If the nearby system rejected your request for service, you may proceed to submit your plans, specifications, business plan, and CCN application. However, you must provide us a copy of the application requesting service and all correspondence from the existing system when you submit these materials

Exception 3: Costs, affordability, and capabilities

Can you successfully demonstrate that an exception should be granted based on costs, affordability, and the capabilities of the existing system?

As with a new PWS, to analyze the feasibility of regionalization, you must consider the interplay of these interrelated factors:

- ratio of the costs of regionalization compared to the projected value of the development at buildout;
- affordability of the rates; and
- financial, managerial, and technical capabilities of the existing system.

These factors are used as a screening process. You qualify for this exception even if you meet only one of these factors.

If you qualify for this exception, you may submit your plans, specifications, and, if required, business plan for a stand-alone system. However, you must also give us the supporting documentation.

For a more detailed explanation of how to analyze these factors, see "Appendix A: Analyzing Costs, Affordability, and Capabilities of the Existing System" on page 17.

If You Qualify for None of These Exceptions

If you do not qualify for any one of these exceptions, you should seriously consider regionalization.

However, if you decide to pursue your CCN application, you will have an opportunity to try to demonstrate to the staff that your CCN application should be approved. If your application is protested and an evidentiary hearing is held, you will have an opportunity to demonstrate to the administrative law judge (and ultimately the TCEQ commissioners) that your CCN application should be approved

Appendix A

Analyzing Costs, Affordability, and Capabilities of the Existing System

Use this information along with Flowchart 3 on page 18 to determine whether an exception should be granted based on costs, affordability of rates, or the capabilities of the existing system.

This appendix discusses whether an exception based on the following interrelated factors should be granted:

- Factor 1:** Ratio of the costs of regionalization compared to the projected value of the development at buildout
- Factor 2:** Affordability of rates
- Factor 3:** Financial, managerial, and technical capabilities of the existing system

These factors are used as a screening process. You qualify for this exception even if you meet only one of these factors.

In the following discussion, we do not intend to limit the factors that you may want to raise to support an exception. If you bring to our attention factors not mentioned in this appendix, we will also consider those factors, as appropriate.

Factor 1: Compare Costs to Your Development's Projected Value

The ratio of the costs of regionalization compared to the projected value of the development refers to the comparison of the costs of regionalization to obtain service from an existing system versus the estimated value of the project at full buildout.

The cost of regionalization includes the up-front costs associated with obtaining service from an existing system and the incremental construction costs associated with any delays in construction.

```

graph TD
    subgraph Factor1 [Factor 1: Costs]
        Q1{{Is the cost of regionalization greater than 10 percent of the projected value of your planned development?}}
        A1[Yes] --> Q2{{Is the cost of regionalization greater than the cost of a stand-alone system?}}
        A1_N[No] --> Q3{{Would the rates of the regional system be affordable?}}
    end
    
    subgraph Factor2 [Factor 2: Affordability]
        Q3
        A2[Yes] --> Q4{{Does the existing system have adequate financial, technical, and managerial capabilities?}}
        A2_N[No] --> Q5{{Would the rates for your stand-alone system be lower?}}
    end
    
    subgraph Factor3 [Factor 3: Capabilities]
        Q4
        A3[Yes] --> Q6{{Do you need a CCN?}}
        A3_N[No] --> Q5
    end
    
    Q2 -- Yes --> Q6
    Q2 -- No --> Q7{{Have you completed Flowchart 2?}}
    
    Q5 -- Yes --> Q6
    Q5 -- No --> Q8{{Have you completed Flowchart 2?}}
    
    Q6 -- Yes --> EndBox[You may submit your application to construct a new system. Be sure to include all the supporting information you developed as you completed these steps.]
    Q6 -- No --> Box1[Consider forming a regional system. If you apply to construct your own system, our staff will not approve your application.]
    Q7 -- Yes --> EndBox
    Q7 -- No --> Box2[Go to Flowchart 2]
    Q8 -- Yes --> EndBox
    Q8 -- No --> Box2

```

Factor 1: Costs

- Decision: Is the cost of regionalization greater than 10 percent of the projected value of your planned development?
- If **No**: Proceed to Factor 2.
- If **Yes**: Decision: Is the cost of regionalization greater than the cost of a stand-alone system?
 - If **Yes**: Proceed to "Do you need a CCN?"
 - If **No**: Decision: Have you completed Flowchart 2?
 - If **Yes**: Proceed to final submission box.
 - If **No**: Go to Flowchart 2.

Factor 2: Affordability

- Decision: Would the rates of the regional system be affordable?
- If **No**: Decision: Would the rates for your stand-alone system be lower?
 - If **Yes**: Proceed to "Do you need a CCN?"
 - If **No**: Decision: Have you completed Flowchart 2?
 - If **Yes**: Proceed to final submission box.
 - If **No**: Go to Flowchart 2.
- If **Yes**: Proceed to Factor 3.

Factor 3: Capabilities

- Decision: Does the existing system have adequate financial, technical, and managerial capabilities?
- If **No**: Proceed to "Would the rates for your stand-alone system be lower?"
- If **Yes**: Decision: Do you need a CCN?
 - If **Yes**: Proceed to final submission box.
 - If **No**: Consider forming a regional system. If you apply to construct your own system, our staff will not approve your application.

Final Outcomes:

- Submission Box:** You may submit your application to construct a new system. Be sure to include all the supporting information you developed as you completed these steps.
- Approval Denial:** Consider forming a regional system. If you apply to construct your own system, our staff will not approve your application.
- Next Step:** Go to Flowchart 2.

The projected value of the development includes the estimated value of all lots, homes, commercial and industrial improvements, developed reserves, and undeveloped land at buildout, assuming the installation of a stand-alone system.

To propose an exception based on the high costs of regionalization, you must meet both of these criteria:

Criterion 1: The costs of regionalization are greater than 10 percent of the projected value of the development.

Criterion 2: The costs of regionalization are greater than the cost of a stand-alone system.

Determining Costs of Regionalization

Up-Front Costs Associated with Obtaining Service

When an existing water or sewer utility extends new service, this utility service provider can charge connection fees to the person requesting the service, regardless of whether the person is a residential customer or a developer who needs multiple services for a proposed new subdivision.

Examples of these connection fees include:

tap fees—the costs of tapping the main line and installing the tap, service line, meter, and meter box to provide utility service to the customer's property line.

deposit—a bond-type arrangement that can be applied to unpaid charges. This sometimes takes the form of a membership fee that a new customer may be required to pay the utility service provider.

system development charges (also commonly referred to as *impact fees*, *system capacity charges*, *system buy-in charges*, and *system investment fee front-end charges*)—any fee that is charged by the utility service provider to provide funds to finance capital improvements necessary to serve a new customer. System development charges are designed to generate contributions from customers for financing major system construction. The theory is that these charges allow growth to pay for itself. The magnitude of the charges may range from several hundred to many thousands of dollars. There are two primary methods used to determine the amount of these charges: the system buy-in method and the incremental-cost pricing method.

system buy-in method—the fee is related to the equity embedded in existing or new systems required to serve new customers and is based on the premise that new customers are entitled to water at the same prices charged to existing customers

incremental-cost pricing method—the fee is related to the change in total cost resulting from a change in capacity of existing or future systems required to serve the new customer (including related operating costs) and is based on calculating the addition to total cost resulting from the incremental cost of capacity (= increase in capacity divided by increase in output, for a specific time period).

extension fees—the costs of the line extensions or capacity in existing lines that will be used to transport utility service to the new customer. The costs of extension fees may include any related engineering fees and the cost of financing the extension as applicable.

Table 2 provides information concerning the different types of utility service providers in the state and the jurisdiction we have over their connection fees in case a dispute or question arises with another utility service provider.

Table 2. Does the TCEQ Have Jurisdiction over Your Connection Fees?

Type of Utility	Tap Fee?	Deposit?	System Development Charge?	Extension Fee?
Investor-owned utility	yes	yes	yes	yes
Water supply corporation	no	no	in some cases ¹	in some cases ¹
Water district	no	no	no ²	no
City or county	no	no	no	no

¹ Developers or new customers can appeal the costs for a new connection from a nonprofit water supply corporation

² The TCEQ sets impact fees for water districts only if the impact fee is more than three times the district's tap fee

We set cost-based connection fees for utilities over which we have the related jurisdiction. System development charges and extension fees have the most impact on new development. In the past, many service providers have taken on debt to fund infrastructure for growth; however, in the last twenty years or so there has been a large increase in the number of water and sewer service providers that charge system development charges and extension fees to cover new infrastructure needs. Water and sewer service providers now tend to require developers to pay for the infrastructure instead of taking on additional debt that would increase customer rates or taxes.

These connection fees are start-up costs that should be covered in the lot sales. You may find that these fees are greater than the short-term cost to install a small system that would serve only the new proposed subdivision. However, you should also consider the long-term costs and obligations associated with operating the system when you make your decision.

Depending on the service provider's extension policy, you may be able to recover some, if not all, of these costs through the following methods. You must factor any money you can recover through these methods into your cost calculations.

- **Line extension refund contract**—allows reimbursement to the developer of the full cost of the main extension from user charge revenues generated from customers which are served from the main extension (time limited).
- **Contribution of the cost of the size of the main** required to serve the developer's subdivision, with the service provider paying the costs for any up-sizing of the main extension which may be required to serve anticipated future customer growth in the area beyond that in the developer's current needs.
- **Up-sizing costs refunded to the developer** by establishing a "benefit area." As additional customers or subdivisions in this benefit area connect to the main extension, the original developer can be reimbursed for the prorated share of the up-sizing costs attributable to the additional connections.

Time Frame for Receiving Service

A neighboring service provider may be willing to provide service to your development, but may not be able to do so immediately. You may consider the economic impact of such a delay in providing service.

For example, the existing service provider may have to increase system capacity to be able to meet the demands of your new system, may need to obtain necessary financing, or may already have a prioritized schedule for construction or providing service to other applicants.

Delays in obtaining service may result in delays in certain phases of your construction, depending on the projected construction schedule. To the extent that there are delays in construction, there is likely to be an increase in the overall cost of your project. If such a delay affects your development, you must demonstrate how the delays in construction will result in

additional project costs. These costs would then be compared to the estimated projected value of the project at full buildout.

Impact on Sales

As the cost of regionalization increases, it is necessary to look at the impact on the development in an area. These costs may be passed on to existing customers and property owners through increases in lot prices, water and wastewater rates, ad valorem taxes, or all three.

Determining Projected Value of Development

The projected value of the development includes the estimated value at buildout of all lots, homes, commercial and industrial improvements, developed reserves, and undeveloped land, assuming the installation of a stand-alone system.

Use present-day unit values to determine the current value of all existing property and the value that will be added by future improvements to the property. The development should include all property to be served by the proposed new system.

Factor 2: Consider Affordability of Rates

The issue of rate affordability considers the consumers' ability to pay. Even if your rates are reasonable according to your costs, your customers won't be able to support the cost of the water if those cost-based rates are unaffordable. To propose an exception to regionalization due to unaffordable rates from the existing provider, you must meet *both* Criterion 1 and Criterion 2 discussed below. However, our staff may review additional factors in determining rate affordability.

Criterion 1: Rates resulting from regionalization are not affordable

To determine whether rates are unaffordable, we must calculate a "household cost factor" as set forth in a TWDB rule [31 TAC §371.24(b)]. If regionalization results in rates with a household cost factor greater than 1 percent for water service or a combined household cost factor greater than 2 percent for water and sewer service, then the rates resulting from regionalization may not be affordable.

The consumption level used in the rate calculation is based on per capita indoor water use.

The household cost factor (for areas charged for water service only) and the combined household cost factor (for areas charged for both water and sewer services) are calculated as follows:

Household cost factor (if charging for water services *only*)

If you are charging for water services only, follow these five steps to calculate the household cost factor:

1. Calculate the average monthly household usage:

average number of persons per household \times 2,325 gallons = average monthly household usage

2. Calculate a monthly bill based on this usage and your rate structure.
3. Multiply this monthly bill by 12 to get the average yearly water bill.
4. Multiply the adjusted median household income (AMHI) for your area for 2000 by the Texas consumer price index (CPI) for last year. Divide this value by the Texas CPI for 2000 to get a current value for the AMHI:

$$\frac{(\text{AMHI for 2000}) \times (\text{last year's Texas CPI})}{\text{Texas CPI for 2000}} = \text{current AMHI}$$

5. Add the average yearly water bill to the average cost of any taxes, surcharges, or other fees you plan to use to subsidize your system. Divide this value by the current AMHI to get the household cost factor:

$$\frac{\text{average yearly water bill} + \text{average other fees}}{\text{current AMHI}} = \text{household cost factor}$$

Combined household cost factor (if charging for *both* water and sewer service)

If you are charging for both water and sewer service, follow these steps to calculate the household cost factor:

1. Calculate the average yearly water bill and the AMHI as shown under "Household cost factor" above.

2. Calculate the average monthly household usage:

average number of persons per household \times 1,279 gallons = average monthly household usage

3. Calculate a monthly bill based on this usage and your rate structure.
4. Multiply this monthly bill by 12 to get the average yearly sewer bill.

5 Add the average yearly water bill to the average yearly sewer bill and any taxes, surcharges, and other fees you plan to use to subsidize your system. Divide this total by the AMHI of the area to be served.

$$\frac{\text{avg yearly water bill} + \text{avg yearly sewer bill} + \text{other fees}}{\text{current AMHI}} = \text{household cost factor}$$

Criterion 2: Rates of a stand-alone system would be lower than the (unaffordable) rates of a regionalized system

Under this criterion, you must calculate the rates that will be necessary to fully recover the costs of the proposed new water or sewer system. If the rates of the proposed system are higher than the current rates of the existing provider, we will presume that the rates of the existing provider are affordable. Under these circumstances, we will not consider your case to be an exception to this policy (even if the household cost factor shows the rates of the existing provider are unaffordable).

To demonstrate that this exception exists, you must show that the rates of the proposed new system are affordable *and* that the rates of the regionalized system are not affordable (see Criterion 1 on page 22).

Factor 3: Consider Capabilities of Existing System

An analysis of financial, managerial, and technical capabilities refers to whether the existing system has the financial resources to fund improvements that provide the service over the long term, the managerial resources to support operations and plan for emergencies, and the technical expertise to provide consistent service in compliance with our rules.

Here we list factors to consider in determining financial, managerial, and technical capabilities of the existing system. We will also consider other factors as appropriate.

Features That Can Indicate Financial Capability

- Rates are reviewed on a regular basis.
- Rate structure is appropriate to customer base.
- Debt coverage ratio is adequate.
- System is current on debt payments.
- All fees to regulatory agencies and laboratories paid on a timely basis.
- System has appropriate insurance coverage.
- Annual audit is conducted (if system is a public entity or water supply corporation).
- System has operating reserve accounts or access to funds as needed.

- System has adequate working capital ratio.
- System has a high rate of collection of customer accounts.
- System has written policies for collection and termination of service.
- Collection policies are enforced.
- System has low number of disconnects due to failure to pay bill

Features That Can Indicate Managerial Capability

- System is aware of type of organization it is and has legal authority to operate.
- System has an operating budget.
- System has written operating policies.
- Customers have access to water system personnel at all times in case of emergency.
- Records are maintained and updated on a regular basis.
- Budget is used to determine rates.
- System has adequate water supply.
- System has written emergency plans.
- System has conveyable title to water-producing assets.
- Governing board is able to conduct meetings and make decisions (that is, a quorum is usually present, and there is a majority vote for most major operating decisions).
- Every connection is metered.
- Customers are billed on consistent billing cycles based on meter readings.
- System owners or board has current CCN (if required).
- System has an approved drought contingency plan.
- System has an employee handbook or policies.

Features That Can Indicate Technical Capability

- Licensed operator is on site or available to operate the system.
- All operators are licensed.
- Operators have the appropriate certifications for the size of the system.
- System staff can identify oldest piece of equipment and the most vulnerable part of the system.
- Process control and preventive maintenance are performed and documented.
- System calculates unaccounted-for water and does not have excessive amounts.
- System does not have a history of noncompliance with regulatory requirements.

Appendix B

Statutory and Regulatory Authority

This policy implements portions of Senate Bill 1 (1997) and is intended to assist our Utilities and Districts program staff and the regulated community with the implementation of the regionalization requirements in Title 30 Texas Administrative Code (30 TAC) Chapters 290 and 291. Regionalization was one of the key goals of Senate Bill 1 (1997) in order to optimize the use of existing financial, managerial, and technical resources. In addition, this policy is based on the following statutory provisions.

General Statutory Authority

The Texas Health and Safety Code, Chapter 341, Subchapter C, requires that public drinking water be free from deleterious matter and comply with the standards established by the TCEQ or the United States Environmental Protection Agency. The TCEQ may adopt and enforce rules to implement the federal Safe Drinking Water Act (42 U.S.C. Section 300f et seq.).

The Texas Water Code Chapter 13 establishes a comprehensive regulatory system that is adequate to the task of regulating retail public utilities to ensure that rates, operations, and services are just and reasonable to the consumers and to the retail public utilities.

Specific Authority

Public Water Systems

Section 341.0315(a)–(d) of the Texas Health and Safety Code, relating to public drinking water supply system requirements, requires that:

- (a) To preserve the public health, safety, and welfare, the commission shall ensure that public drinking water supply systems:
 - (1) supply safe drinking water in adequate quantities,
 - (2) are financially stable; and
 - (3) are technically sound
- (b) The commission shall encourage and promote the development and use of regional and areawide drinking water supply systems
- (c) Each public drinking water supply system shall provide an adequate and safe drinking water supply. The supply must meet the requirements of Section 341.031 and commission rules.

- (d) The commission shall consider compliance history in determining issuance of new permits, renewal permits, and permit amendments for a public drinking water system.

Texas Health and Safety Code § 341.035 requires that before constructing a new system a person submit plans and specifications and, with certain exceptions, a business plan that demonstrates that the owner or operator of the proposed system has available the financial, managerial, and technical capability to ensure future operation of the system in accordance with applicable laws and rules. The TCEQ may order the prospective owner or operator of the system to provide adequate financial assurance of ability to operate the system in accordance with applicable laws and rules, in the form of a bond or as specified by the commission, unless the executive director finds that the business plan demonstrates adequate financial capability.

Title 30 TAC § 290.39 ensures that regionalization and area-wide options are fully considered; ensures the inclusion of all data essential for comprehensive consideration of the contemplated project, or improvements, additions, alterations or changes; establishes minimum standardized public health design criteria in compliance with existing state statutes and in accordance with good public health engineering practices; and requires that minimum acceptable financial, managerial, technical and operating practices are specified to ensure that systems are properly operated to produce and distribute safe, potable water.

Water and Sewer CCNs

Texas Water Code § 13.241 requires that an applicant for a CCN demonstrate that it possesses the financial, managerial, and technical capability to provide continuous and adequate service and also requires that an applicant for a new CCN for a physically separate water or sewer system demonstrate that regionalization or consolidation with another retail public utility is not economically feasible.

Texas Water Code § 13.246 specifies the factors to be considered by the commission concerning CCN notice and hearing and CCN issuance or refusal.

Texas Water Code § 13.253 requires that a CCN holder located in an affected county that has not been able to provide continuous and adequate service obtain service from another consenting utility service provider. Title 30 TAC § 291.102(a) provides that the TCEQ must ensure that an applicant possesses financial, managerial, and technical capability to provide continuous and adequate service.

Title 30 TAC § 291.102(b) requires that where a new CCN is being issued for an area which would require construction of a physically separate water or sewer system, the applicant must demonstrate that regionalization or consolidation with another retail public utility is not economically feasible

Title 30 TAC § 291.102(c) requires that the TCEQ consider the following in considering whether to grant a CCN:

- (1) the adequacy of service currently provided to the requested area;
- (2) the need for additional service in the requested area;
- (3) the effect of the granting of a certificate on the recipient of the certificate and on any retail public utility of the same kind already serving the proximate area,
- (4) the ability of the applicant to provide adequate service,
- (5) the feasibility of obtaining service from an adjacent retail public utility;
- (6) the financial stability of the applicant, including, if applicable, the adequacy of the applicant's debt-equity ratio;
- (7) environmental integrity; and
- (8) the probable improvement in service or lowering of cost to consumers in that area.