



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

NOV 26 2019

OFFICE OF WATER

MEMORANDUM

SUBJECT: Approval of Class Deviation from the Regulatory Prohibition on the Use of the Drinking Water State Revolving Fund to Purchase Water Rights

FROM: Anita Maria Thompkins, Director
Drinking Water Protection Division *Anita Maria Thompkins*

TO: Water Division Directors
Regions I-X

The Office of Grants and Debarment has approved a class deviation from the Drinking Water State Revolving Fund (DWSRF) regulatory prohibition at 40 CFR 35.3520(e)(2) (see attached memo). The class deviation allows for the use of DWSRF funds for the purchase of water rights, which supports meeting the public health protection objectives of the Safe Drinking Water Act.

For this class deviation, the purchase of 'water rights' is defined as the monetary value of the right to use water from a given source (e.g., a river, lake, aquifer) to supply drinking water to an existing population. The purchase of water rights could include, but is not limited to, the following: the payment for the transfer of water rights from one entity to another, the purchase of groundwater credits, the purchase of storage capacity in an existing raw water reservoir, or the purchase of newly created/newly available water rights.

A DWSRF project must meet the criteria outlined in the attached document, "*Policy and Technical Evaluation for a DWSRF Class Deviation for Purchase of Water Rights*" to be covered under this class deviation. States choosing to use this class deviation for assistance agreements involving water rights should notify their EPA Regional Project Officer of their intent. For the first project in each state requesting to use this class deviation, the EPA Regions must collaborate with EPA HQ on the review. This practice ensures national consistency and awareness.

For inquiries regarding this class deviation and to collaborate on the first assistance agreement in each state, please contact Kiri Anderer at Anderer.Kirsten@epa.gov or (202-564-3134).

Attachments

cc: Ronald Bergman, Associate Division Director, Drinking Water Protection Division
Felecia Fort, Acting Associate Division Director, Drinking Water Protection Division

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POLICY AND TECHNICAL EVALUATION
FOR A DWSRF CLASS DEVIATION FOR PURCHASE OF WATER RIGHTS

October 2019

The Office of Ground Water and Drinking Water (OGWDW) is considering a class deviation from the Drinking Water State Revolving Fund (DWSRF) regulatory prohibition at 40 CFR 35.3520(e)(2). The regulation prohibits the use of DWSRF funds for the purchase of “water rights, except if the water rights are owned by the system that is being purchased through consolidation as part of a capacity development strategy.” For this class deviation, the purchase of ‘water rights’ is defined as the monetary value of the right to use water from a given source (e.g., a river, lake, aquifer) to supply drinking water to an existing population.

The DWSRF was established by the 1996 amendments of the Safe Drinking Water Act (SDWA) as a financial assistance program to help drinking water systems and states to achieve the health protection objectives. In developing the regulation prohibiting the use of DWSRF funds to purchase water rights, the EPA had assumed that the primary purpose of such purchases would be to assist drinking water systems in preparation of future growth, which is prohibited by the SDWA.¹ As outlined below, there are several reasons to now consider a class deviation for the purchase of water rights.

Why Consider a Water Rights Class Deviation Now?

First, the primary purpose for the water rights deviation requests has not been for future growth. These requests were necessary for communities to provide existing residents with reliable, safe drinking water supplies. Communities have requested deviations because: 1) they often need to find a new, uncontaminated source of drinking water, 2) the current water supply is inadequate to meet the existing demand and therefore, the community needs a supply increase, or 3) changing hydrological conditions (e.g., drought) require communities to find additional sources to expand their supply portfolio.

Second, the EPA has seen increasing interest in deviation requests for water rights in recent years. In 2018, the EPA approved three deviation requests for water rights, and a fourth water rights deviation request is currently pending the outcome of this class deviation. The approved water rights purchases were necessary to replace existing contaminated supplies with a new source, whether drilling new wells or purchasing water from a neighboring community. The pending request is due to drought conditions and a lack of adequate supply to meet the demands of the existing population. More detail regarding current and future deviation requests is presented in the next section.

Third, approving a class deviation for current DWSRF prohibitions against water rights has the potential to expand the utility of the DWSRF to protect public health. Water rights have become important in western communities suffering from drought conditions and in the midwest due to aquifer contamination. Several states have available capacity to fund additional projects. Allowing state DWSRF programs to support projects with a water rights purchase component, for which the community might otherwise seek other funding for the whole project, provides states with a larger pool of projects to fund. Expanding eligibilities to include water rights will help reduce the amount of unspent Federal funds, or unliquidated

¹ 42 USC 300j-12(g)(3)(C)

obligations (ULOs), in accordance with the EPA's 2014 ULO Reduction Strategy.² The EPA DWSRF Team is educating and encouraging state DWSRF programs to increase their full fund utilization, which includes loan repayments, interest earnings, bond proceeds, and other fees, in addition to the Federal funds. A class deviation for water rights expands DWSRF eligibilities, promotes the effective use of DWSRF assistance, and ensures available funds are invested in drinking water infrastructure projects and protecting public health.

Previous Water Rights Deviation Request Approvals

Because the purchase of water rights is not explicitly made ineligible by the SDWA, the EPA may grant deviations from its own regulations regarding the use of DWSRF funds for water rights if the underlying focus on public health protection, which is integral to the SDWA, is maintained.³ Deviations from regulatory requirements not explicitly addressed in Federal law are at the discretion of the EPA. The decision must be fully informed by sufficient data and analysis, including assessment of reasonable, cost-effective alternatives that meet legitimate public health objectives. The information below provides an overview of approved deviation requests related to water rights in 2018:

- **Oshkosh, NE**: Oshkosh received a deviation for the purchase of a water transfer permit fee to withdraw water from new wells in a different aquifer. These new wells were needed because Oshkosh's existing wells were contaminated with uranium and arsenic.
- **Carson City, NV**: Carson City received a deviation to refinance water rights originally purchased with a Build America Bond, which are not receiving subsidy as originally anticipated. The water rights were needed so Carson City could connect with the nearby Town of Minden to provide uncontaminated water to Carson City residents.
- **Mores Creek, ID**: Mores Creek Rim Ranches Water District (the District) received a deviation for the purchase of water rights, which would allow the District to withdraw water from new shallow wells near Mores Creek. The District was struggling with arsenic-contaminated wells and aquifer depletion.

State Interest in Future Deviation Requests

In addition to the previously approved deviation requests for water rights, several states have either submitted deviation requests that are currently pending or have expressed interest in requesting a deviation in the near future. An overview of recent state interest related to water rights is presented below.

- **Arizona**: The EPA received a deviation request on February 4, 2019, for groundwater extinguishment credits (GWECs) for an otherwise eligible DWSRF project in Queen Creek, AZ. These water rights would allow Queen Creek to provide sufficient drinking water to existing residents, even during the current drought conditions. With increasing costs to purchase water from the Central Arizona Groundwater Replenishment District, Queen Creek analyzed a variety of alternatives including GWECs, treated wastewater effluent reuse, and/or surface water rights. While Queen Creek wants to add all three alternatives to their water resource portfolio, GWECs are cost-effective and immediately available. It may take several years to implement the other alternatives, and they need the additional water supply now. The request is currently pending the outcome of this class deviation. If the class

² Peter Grevatt to Water Division Directors (Regions I-X), memorandum, April 14, 2014. "Drinking Water State Revolving Fund (DWSRF) Unliquidated Obligations (ULO) Reduction Strategy".

³ 2 CFR 1500.3

deviation is not approved, the Queen Creek water rights deviation request will be sent forward separately.

- **Nebraska:** With the approval of the Oshkosh, NE water rights deviation request, the state expressed interest in submitting future water rights deviation requests. Oshkosh had a higher than normal cost to purchase their water transfer permit than is typically seen in the state. However, the state would like to assist these often small water systems with being able to finance this component of projects if needed.
- **Idaho:** After approval of the Mores Creek, ID water rights deviation request, the state may have additional DWSRF projects that require water rights deviations.
- **Oregon:** The state had an inquiry in June 2018 regarding a \$1.6 million water rights purchase. At that time, the state directed the project to another funding program.
- **Oklahoma:** The state has many projects with costs associated with purchasing water rights; therefore, the state expressed interest in a class deviation.
- **Colorado:** The CO DWSRF program sent the EPA DWSRF Team a list of more than 10 previous DWSRF projects, or projects currently seeking funding, that could benefit from a water rights deviation. Many of these projects would have pursued DWSRF funding for this purpose if it was eligible.

Water Rights Class Deviation Criteria

This class deviation for water rights covers the purchase of water rights for drinking water purposes, not the purchase of the water itself, as the latter is an ineligible DWSRF expense. For the purposes of this class deviation, the purchase of 'water rights' is defined as the monetary value of the right to use water from a given source (e.g., a river, lake, aquifer) for the purposes of drinking water supply for an existing population. This is typically a capital expense paid upfront to cover either a certain time period or may be for water rights in perpetuity.

A DWSRF project must meet the criteria below to be covered under this class deviation:

- The project directly addresses a compelling, imminent public health threat.
- The project is a cost-effective alternative.
- DWSRF funding is a significant factor to ensure that the project will proceed.
- The financial terms of the DWSRF assistance agreement are equal to or less than the "design life" of the project (e.g., a 15-year loan for 15-year water rights purchase).
- The main project purpose cannot be to prepare for future growth.

Projects covered by this class deviation may be standalone assistance agreements (i.e., the assistance agreement is solely for water rights) or may be part of a larger public health project. Permanent water rights are optimal; however, temporary water rights are covered by this class deviation if the assistance agreement terms do not exceed the time period for the water rights. The terms of any DWSRF-financed capital improvements that are constructed specifically to make use of a temporary water right must also be equal to or less than the "useful life" of the project (i.e., duration of water right purchase).

The purchase of water rights could include, but is not limited to, the following: the payment for the transfer of water rights from one entity to another, the purchase of groundwater credits, the purchase of storage capacity in an existing raw water reservoir, or the purchase of newly created/newly available water rights. The water right should be valued at an appropriate cost. The purchase transaction must follow all

applicable state legal processes related to water right transfer or assignment. Upon project completion, the subject water right should reflect the correct point of diversion or appropriation, reflect a place of use that includes the water system, and allow for drinking water supply use. The governance and ability to deliver the water to the water system should at least be in the planning stages, if not already in development.

Additionally, the purpose of the water rights purchase must be to make use of the water, not for investment purposes.

Process for Implementing Water Rights Class Deviation

States choosing to use this class deviation for assistance agreements involving water rights should notify their EPA Regional Project Officer of their intent. For the first project in each state requesting to use this class deviation, the EPA Regions must collaborate with EPA HQ on the review. This ensures national consistency and awareness. The EPA Regions may opt to collaborate or consult with EPA HQ on additional deviation requests if they choose.

For projects covered by this class deviation, documentation (in a memo or email format) should be kept in the project file highlighting how the project meets the above criteria. The EPA Regions should review this information when conducting their project file reviews as part of their annual state reviews.

Recommendation/Conclusion

OGWDW recommends that a class deviation from the DWSRF regulatory prohibition at 40 CFR 35.3520(e)(2) for the purchase of water rights be approved. In developing the regulation prohibiting the use of the DWSRF to purchase water rights, the EPA had assumed that the primary purpose of such purchases would be to assist drinking water systems in preparation of future growth, which is prohibited by the SDWA. However, in implementing the DWSRF program, the EPA has received several water rights deviation requests that met the health protection objectives of the SDWA and were not related to future population growth. These requests were necessary for communities to provide existing residents with reliable, safe drinking water supplies due to, for example, increased aquifer contamination and/or changes in hydrological conditions. The principal purpose of this class deviation for water rights is to provide a safe drinking water supply and improve public health protection for drinking water systems' existing populations. Moreover, the class deviation request is not designed to support population growth and thus is consistent with the SDWA.