Bond Case Briefs

Municipal Finance Law Since 1971

Fitch: New Lead and Copper Rule to Raise Costs for Water Utilities

Fitch Ratings-Austin/New York-19 January 2021: The Environmental Protection Agency's (EPA) new Lead and Copper Rule (LCR) is not expected to impact utility credit quality over the near-term, but it could have a material effect on certain water utilities' capex and credit profiles over the medium- to long-term, particularly for those utilities that serve communities with a large proportion of older homes and buildings that will likely require greater lead service line (LSL) remediation, Fitch Ratings says. The LCR is expected to raise near-term operational costs for all utilities and negatively affect capital budgets in the longer term as LSLs are identified and replaced.

Overall, the EPA expects annual costs to implement the LCR to be as much as $839 million, up to 80% more than the prior rule, with most of these costs borne by the water utilities. The increased costs of monitoring, outreach and LSL replacement may crowd out other operating costs and infrastructure projects and could lead to higher rate increases than currently anticipated by utilities, heightening concerns in the industry over service cost affordability.

Utilities will face increased operational costs under the LCR with requirements for identifying LSLs and increased water testing and outreach. If lead is detected in excess of the trigger threshold of 10 parts per billion (ppb), a utility will need to review water treatment, implement corrosion control measures and/or replace LSLs. Smaller utility systems serving fewer than 10,000 people are granted more flexibility with regard to these measures in their implementation of the LCR.

Under the new rule, utilities have three years in which to inventory LSLs, which will provide more visibility on which systems will bear greater costs for replacement. The EPA estimates that there are 6.3 million to 9.3 million homes across the country with LSLs and millions of other buildings with lead solder and/or faucets with lead. Older homes and other buildings in areas with relatively higher levels of poverty have been identified by the Government Accountability Office (GAO) in its December 2020 drinking water report as more likely to have lead pipes. Those systems serving older and poorer residences will face a greater capital burden of replacing LSLs but may also have the least flexibility to absorb increased capital costs.

After LSLs have been inventoried, the LCR requires an annual LSL replacement rate of 3% versus 7% under the old rule for communities exceeding the 15 ppb federal action level. While the required percentage replacement rate of LSLs is lower, the new LCR closes loopholes from the previous rule that led to much lower replacement rates. Further, the new rule requires full replacement of LSLs, including both the utility and privately-owned portion of the line, to count toward the replacement rate, whereas the prior rule included partial and other types of replacement in the calculation. As a result of the changes being implemented, the EPA expects annual investment in LSLs replacements to be as much as 70x higher under the new rule than the prior one.

The rule becomes effective 60 days following its publication in the Federal Register. President-Elect Joseph Biden's administration will have the opportunity to decide whether it will allow the final rule to go into effect or if it will propose a new rule. States may pass more stringent lead water level

regulations than those in the new LCR.

Contact:

Douglas Scott
Managing Director, Head of US Water and Sewer Ratings
+1 512 215 3725
Fitch Ratings, Inc.
111 Congress Ave., Suite 2010
Austin, TX 78701

Sarah Repucci
Senior Director, Fitch Wire
+1 212 908-0726

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com