

Reclamation Manual

Directives and Standards

Criteria for Determining the Federal Cost-Share when a Participating Municipality has a Population Greater than 50,000 people

1. Background.

- A. The Rural Water Supply Program is aimed at assisting rural areas, including small rural communities, in meeting their domestic water supply needs. However, in some cases participation in a rural water project by a community with a population greater than 50,000 people (urban community) may provide economies of scale that would make the project much more affordable and expand project benefits. It makes sense to encourage an urban community to participate in planning and completing appraisal and feasibility studies and ultimately becoming a partner in providing a water supply for a rural area, which will ultimately reduce costs to the Federal government.
- B. However, it should also be recognized that the Program is a rural water program. So, while an urban community should be able to derive some benefit from participating as a result of lowering overall costs compared to a strictly rural system, they are not entitled to the same level of program assistance as the rural areas for which the program is targeted. In addition, if the urban community is determined eligible to participate in the program because of the significant economic efficiencies that result, the Federal government must be able to share in those efficiencies as well.
- C. A simple approach is needed in order to objectively determine a reasonable Federal cost-share in cases where there is a significant urban component that strengthens a proposed rural water project. The approach must be simple to implement because study cost-share requirements must be determined prior to obtaining detailed information that usually only becomes available through the study itself. Ideally, the costs paid by a participating urban community would be determined by the economies of scale associated with their participation. However, this information will not be available prior to the feasibility study.
- D. The criteria/methodology presented below can be used to determine whether cost-share for feasibility studies should be allowed for urban communities that are participating in a rural water study. This methodology applies only to study-related costs and not the costs associated with construction or operation, maintenance, and replacement of a project.

2. **Criteria for Determining Federal Cost-Share When There Is Urban Community Involvement.** The following criteria will be used to determine project participant and Federal cost-sharing levels.

- A. The same methodology for determining financial hardship as proposed for rural communities can be applied to participating urban areas to determine if the urban area meets the financial hardship criteria. If the urban community meets the criteria for

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financial hardship and urban community participation improves the viability of the project, then a maximum 50 percent Federal cost would be provided.

- B. Extreme cases where the population is entirely urban or rural.
 - (1) In an extreme case where the proposed study population is an urban community (greater than 50,000 people), then the Federal cost-share would be 0 percent and the community would not participate in the rural water program.
 - (2) In the other extreme case (where all of the communities in the study area meet the rural definition), then the Federal cost-share would be 50 percent or higher if it meets the hardship criteria.

- C. If there is no financial hardship and the extreme cases do not apply, then a simple method for determining the level of Federal cost-sharing for the urban portion of study costs is needed. Assuming urban community participation provides economies of scale for the project, some level of Federal cost sharing is warranted for the urban portion of costs. The Federal cost-share will be determined by the financial resources available to the participating urban communities.
 - (1) A broad measure of financial strength is credit ratings. These ratings are provided by services such as Moody's Investors Service, Standard and Poor's, and Fitch Ratings. These ratings are based on assessed payment risk. The rating characteristics for each of the three rating services are provided in table 1.

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Table 1 – Rating characteristics

Rating	Rating characteristics
Fitch AAA AA A BBB BB B CCC CC C	Highest credit quality, very strong capacity for payment. Very high credit quality, expectation of very low default risk. High credit quality, may be more vulnerable to adverse economic conditions. Good credit quality, adequate capacity for payment but somewhat vulnerable. Speculative, elevated vulnerability to default risk. Highly speculative, material default risk is present. Substantial credit risk, default is a real possibility. Very high levels of credit risk, default of some kind appears probable. Exceptionally high levels of credit risk, default is imminent.
Moody's Aaa Aa A Baa Ba B Caa Ca C	Highest quality, minimal credit risk. High quality, very low credit risk. Upper-medium grade, subject to low credit risk. Moderate credit risk, may possess some speculative characteristics. Speculative elements and subject to substantial credit risk. Speculative and subject to high credit risk. Judged to be of poor standing and very high credit risk. Highly speculative and likely in or very near default. Lowest rated class, typically in default and little chance of recovering investment.
Standard & Poor's AAA AA A BBB BB B CCC CC C	Obligor's capacity to meet financial commitments is extremely strong. Obligor's capacity to meet financial commitments is very strong. More susceptible to adverse changes in economic conditions than AAA or AA. Adequate obligator capacity, but susceptible to economic downturn. Speculative characteristics, vulnerable to adverse economic conditions. Speculative characteristics, vulnerable to adverse economic conditions. Speculative characteristics, vulnerable to nonpayment. Speculative characteristics, highly vulnerable to nonpayment. Speculative characteristics, highly vulnerable to nonpayment.

- (2) There are additional Fitch ratings below C which indicate default. In addition, there are modifiers such as + and – for Fitch and Standard and Poor's and 1, 2, and 3 for Moody's to denote relative status within the major categories. It should be noted that the same rating does not necessarily mean absolute equality of credit quality. The same rating indicates a similar position for creditworthiness.

- (3) The potential range of Federal cost-share for the urban portion is a minimum of 0 percent and a maximum of 50 percent. The 50 percent Federal cost-share is applied to the urban community that is in the weakest financial position and the 0 percent Federal cost-share is applied to the urban community that is in the strongest position and has readily available resources. The Federal cost-share is based on credit ratings are shown in table 2.

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Table 2 – Federal cost-share corresponding with credit ratings

Credit Rating	Federal Cost-share
Fitch	
AAA (highest quality)	0%
AA, A (high quality, low risk)	17%
BBB (good quality, moderate risk)	34%
BB,B, CCC, CC (speculative)	50%
Moody's	
Aaa (highest quality)	0%
Aa, A (high quality, low risk)	17%
Baa (good quality, moderate risk)	34%
Ba, B, Caa, Ca, C (speculative)	50%
Standard and Poor's	
AAA (highest quality)	0%
AA, A (high quality, low risk)	17%
BBB (good quality, moderate risk)	34%
BB, B, CCC, CC, C (speculative)	50%

- (4) The Federal cost-shares shown in table 2 are divided into general categories of very low risk, low risk, moderate risk, and speculative investments as indicators of financial strength. The participating urban community can use the credit service rating of their choice since each rating is based on very similar criteria.
- (a) If involvement of an urban community increases study costs and the incremental increase in cost can be estimated, then the Federal cost-share as determined in Paragraph 2.C.(3) above for the urban portion to be applied to that incremental cost. Increased costs could be due to a larger number of issues and water users involved with the urban community.
- (b) Examples of Federal cost-share calculations. The examples assume urban participation creates significant economies of scale.
- (5) The proportion of the proposed project population that meets the rural criteria (“rural”) and the proportion of the population that lives in communities with 50,000 or more people (“urban”) in the project area can be used as a starting point to determine the Federal cost-share of a combined rural and urban feasibility study. The 50 percent Federal cost-share is applied to the rural portion of study costs as measured by population served and the Federal cost-share applied to the urban portion of study costs is determined by an evaluation of the urban community’s credit rating. The maximum Federal cost-share for the urban portion is 50 percent and the minimum cost-share is 0 percent. The example

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assumes a 17 percent Federal cost-share based on a AA Fitch rating. How the project sponsors decide to allocate the non-Federal share is entirely up to them. Tables 3, 4, and 5 show examples of determining the Federal cost-share.

Table 3 - Example: a \$100,000 study that would cost the same regardless of urban community involvement and urban community has a AA Fitch rating.

Percentage of rural population	Urban portion of total cost	Rural portion of total cost	Federal cost-share provided	Federal cost-share as a percentage of total cost
25% Rural	\$75,000	\$25,000	\$25,250 (\$12,750 + \$12,500)	25.25%
50% Rural	\$50,000	\$50,000	\$33,500 (\$8,500 + \$25,000)	33.50%
60% Rural	\$40,000	\$60,000	\$36,800 (\$6,800 + \$30,000)	36.80%
75% Rural	\$25,000	\$75,000	\$41,750 (\$4,250 + \$37,500)	41.75%
All Rural	\$0	\$100,000	\$50,000 (\$0 + \$50,000)	50.00%

Table 4 - Example: a \$120,000 study that would have cost \$100,000 if only rural communities were involved and urban community has a AA Fitch rating.

Percentage of rural population	Urban portion of total cost	Rural portion of total cost	Federal cost-share	Federal cost-share provided as percentage of total cost
25% Rural	\$95,000	\$25,000	\$28,650 (\$16,150 + \$12,500)	23.88%
50% Rural	\$70,000	\$50,000	\$36,900 (\$11,900 + \$25,000)	30.75%
60% Rural	\$60,000	\$60,000	\$40,200 (\$10,200 + \$30,000)	33.50%
75% Rural	\$45,000	\$75,000	\$45,150 (\$7,650 + \$37,500)	37.63%

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Table 5 - Example: a \$100,000 study that would cost the same regardless of urban community involvement, the rural area has a financial hardship that will allow 60 percent Federal cost-share, and the urban community has a AA Fitch rating.

Percentage of rural population	Urban portion of total cost	Rural portion of total cost	Federal cost-share	Federal cost-share provided as percentage of total cost
25% Rural	\$75,000	\$25,000	\$27,750 (\$12,750 +	27.75%
50% Rural	\$50,000	\$50,000	\$15,000)	38.50%
60% Rural	\$40,000	\$60,000	\$38,500 (\$8,500 +	42.80%
75% Rural	\$25,000	\$75,000	\$30,000)	49.25%
All Rural	\$0	\$100,000	\$42,800 (\$6,800 +	60.00%
			\$36,000)	
			\$49,250 (\$4,250 +	
			\$45,000)	
			\$60,000 (\$0 + \$60,000)	