

**Attachment F**

**Staff Report for Rule 205  
(including comments and responses)**

**SACRAMENTO METROPOLITAN  
AIR QUALITY MANAGEMENT DISTRICT**

**STAFF REPORT**

**RULE 205 – COMMUNITY BANK AND PRIORITY RESERVE BANK**

**May 14, 2013**

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## **INTRODUCTION**

Rule 205, COMMUNITY BANK AND PRIORITY RESERVE BANK, sets the requirements for administering loans of emission reduction credits (ERCs) from the Community Bank and the Priority Reserve Bank (District ERC bank). Generally, there are two primary reasons why a business might need ERCs. ERCs are required for some larger emissions sources to mitigate emissions increases. ERCs are also an alternative compliance option for business that might need additional time, or for various reasons want relief from specified requirements in the District's Regulation 4. Businesses may choose to purchase ERCs from businesses that have banked emission reduction credits, or request a loan from the District ERC bank.

The Priority Reserve Bank is for use by essential public services or for use or reuse of a military base. The Community Bank is for use by other public and private entities. Borrowers pay base fees based on the amount and duration of the loan and an administrative fee to process the loan. The base loan rates established for each pollutant are the same as the ERC transaction costs from recent private ERC transactions. Revenue from the base loan fees is used to fund new emission reduction projects including the District's wood stove incentive program. The base loan fees are not used to cover Staff's time to select and implement the emission reduction projects.

In addition to the base loan fee, a borrower of ERCs must pay an annual renewal fee for each active loan. Annual renewal fees fund the cost of Staff's time to implement this program and obtain replacement emission reduction credits. The renewal fee has not been changed for 10 years and is \$903. An analysis of program costs shows that this fee does not recover the program costs. Staff is proposing three options to increase the annual renewal fee.

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## **BACKGROUND**

Loans of ERCs may be requested by stationary sources in order to comply with emission requirements set in specific prohibitory rules, emission offset requirements pursuant to Rule 202, NEW SOURCE REVIEW, a conformity determination pursuant to Rule 104, GENERAL CONFORMITY, or for use as mitigation under the California Environmental Quality Act or functionally equivalent program.

Rule 205 requires any source that requests a loan to pay a base loan fee and an administrative fee to process the loan request. For active loans with a term greater than one year, Rule 205 requires the source to pay an annual renewal fee. Below is a summary of each fee.

- The Base loan fee is determined by the amount of credits loaned, the time period of the loan, and the base loan rate that has been approved by the Board of Directors. The base loan fees are used to fund emission reduction projects, which reduce emissions and generate ERCs to be deposited back into the Community Bank. Currently, the base loan fees are used as incentive funds for the District's Woodstove and Wood Fireplace Change Out Incentive Program (Change Out Program). This fee is not used to cover Staff's time to select and implement the emission reduction projects.

- The administrative processing fee is established in Section 315 of Rule 301, PERMIT FEES – STATIONARY SOURCE, and is used to recover the cost of Staff's time to process a new loan request.
- The annual renewal fee is established in Section 313 of Rule 205 at \$903 per active loan and is used to recover the cost of Staff's time to renew and update ERC loans and to select, implement, and bank the replacement emission reductions to sustain the bank for future business needs. Currently, this fee is used to recover Staff's time to implement the Change Out Program.

Rule 205 has not been amended since 2003. Section 313 requires the Air Pollution Control Officer, in March of each year, to submit to the Board a cost analysis which contains a recommendation for the new annual renewal fee. The annual renewal fee may increase or decrease based on Staff's cost to renew and update the ERC loans annually and to implement emission reduction projects. The Board may approve a new annual renewal fee. The following table summarizes the past renewal fees that have been reviewed and approved by the Board of Directors.

Board Hearing Date	Annual Renewal Fee
9/5/96	\$1,000
3/5/98	\$766
3/25/99	\$856
3/23/00	\$859
4/26/01	\$903
3/25/04	\$903
3/24/05	\$1,649

The District practice has been to amend Rule 205 before implementing the new Board-approved annual renewal fee. In recent years, other high priority rulemaking work and reduction in rule development staff have prevented updating the renewal fee since 2005 and amending Rule 205.

Staff has performed a cost analysis for fiscal year (FY) 13/14 and is proposing to amend Rule 205 to increase the annual renewal fee to fully recover the cost of Staff's time to renew and update the ERC loans annually and to implement emission reduction projects.

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## **COST ANALYSIS**

For FY13/14, annual loan renewal fee revenues support implementation of the Change Out Program. This program provides incentives for the replacement of an uncertified wood stove, wood stove insert or fireplace to any person who lives in Sacramento County. The incentive amount is partially funded by the base loan fees. All new wood stoves and inserts must meet the U.S. EPA certification standards for new wood burning appliances or use gaseous (natural

gas or propane) or pellet fuels. For this program, Staff reviews the Change Out Program applications, issues vouchers that reserve incentive money, and reimburses the retailers the value of the vouchers after the change outs have been properly completed. This program also includes an auditing component where Staff verifies that the participants (retailers/contractors, recycling companies, and applicants) are complying with the terms and expectations of the Change Out Program. To date, the program has replaced over 5,000 old wood burning devices.

The program cost associated with renewing and updating ERC loans and implementing the Change Out Program in FY13/14 is projected to be \$126,943. A portion of the cost is funded by land use mitigation fees<sup>1</sup>. Revenue from the current annual renewal fee is insufficient to cover the remaining portion of the costs and must be supplemented with stationary source fund balance if the rule is not amended. The proposed amendments would fully cover the remaining portion of the costs (i.e., not funded by land use mitigation fees) with either the annual renewal fee (Options 1 and 2) or a combination of annual renewal fee and fees from the permit program established in Rule 301, Permit Fees – Stationary Source (Option 3). Each option is discussed in detail in the “Proposed Amendments” section. The annual renewal fee for each proposed option was determined by dividing the cost allocated to sources with ERC loans by the anticipated number of active loans to be processed and renewed for FY13/14, or 50 ERC loans. The calculated annual renewal fee for FY13/14 for each option is shown below.

<b>Fee Calculation</b>	<b>Option 1 or 2</b>	<b>Option 3</b>
Total Change Out and District ERC Bank program costs (FY13/14)	\$126,943	\$126,943
Portion of the cost supported by land use mitigation fees	(\$22,690)	(\$22,690)
District ERC Bank program cost projected for FY13/14	\$104,253	\$104,253
Cost allocated to sources with ERC loans	\$104,253	\$52,127
Cost allocated to all permit holders	\$0	\$52,127
Number of ERC loan renewals in FY13/14	50	50
Calculated annual renewal fee (per active loan)	\$2,085	\$1,043

The cost analysis for a new annual renewal fee for FY13/14 was calculated to be \$2,085 per loan for Options 1 and 2 and \$1,043 for Option 3. The District must fully cost recover the program cost or face the possibility of lacking credits available in the future or even ending this program.

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<sup>1</sup> CEQA mitigation fees are received when project developers choose to pay fees in lieu of reducing emissions on site when emissions from land use projects exceed the air quality significance thresholds. The CEQA mitigation fees are passed through the District to fund new innovative projects that will result in emission reductions. Mitigation fees provided 51% of the incentive funds for the Change Out Program. The emission reductions achieved from the use of mitigation fees are used to meet prior emission reduction commitments and cannot be banked. For now, that fund also supports the cost to implement the program.

**PROPOSED AMENDMENTS**

The significant proposed amendments for Rule 205 are summarized below. For a detailed list of changes, see Appendix A.

Staff is proposing several options to fully recover the cost to implement the program and to ensure credits are available in the future for all permit holders. Each option is discussed below and proposes to increase the annual ERC loan renewal fee in Section 313.

Option 1: This option proposes to increase the annual renewal fee to \$2,085 per active loan effective upon adoption of the amendments to this rule. This option allocates all of the remaining cost to the sources who are borrowing emission reduction credits from the District ERC bank. These sources elect to use this program voluntarily and are receiving the benefit. Sources opting to use this program have quicker access to the needed ERCs through the District ERC bank instead of acquiring them from the open market. In addition, the cost to use ERCs from the District may be much lower than those acquired on the market because sources pay a prorated fee based on the time period of the loan. The availability of this program prevents delays in facility expansions and helps sources stay in compliance through the alternative compliance option. Currently, there are 14 businesses that are utilizing this program, with a total of 50 active loans.

Option 2: This option is the same as Option 1 except it phases in the annual fee increase over a three-year period. This option will allow the sources who have taken ERC loans additional time to manage their budgets to prepare for a fee increase. Because the fees in the first two years do not fully recover the program cost, the shortfalls will be covered by the existing stationary source fund balance. The proposed annual renewal fee over the three-year period and the shortfall in the first two years are shown in the following table:

<b>Effective Date</b>	<b>Date of rule adoption – 1 day before 1 year after date of rule adoption</b>	<b>1 year after date of rule adoption – 1 day before 2 years after date of rule adoption</b>	<b>After 2 years after date of rule adoption</b>
Annual Renewal Fee	\$1,297	\$1,691	\$2,085
Program Shortfall	\$39,403	\$19,703	\$3

Option 3: This option allocates half of the remaining cost to the sources who are borrowing emission reduction credits from the District ERC bank. The other half of the cost will be allocated to all permit holders. A viable District ERC bank is a benefit to all permit holders because it provides the opportunity for any permitted source to access the District ERC bank in the future for their business expansion or alternative compliance needs. Currently, there are 14 businesses that have ERC loans from the District ERC bank. The number of sources using the District ERC bank may increase in the future when businesses need ERCs to offset their emission increases or to comply with new, lower emission limits as an alternative to traditional rule compliance. For this option, the

proposed annual renewal fee is \$1,043. If this option is adopted, the proposed fee increases not associated with the hourly rates in Rule 301 – Permit Fees – Stationary Source must be increased by no more than 0.6% to cover the remaining cost of the program. See the staff report for the Proposed Amendments to Rule 107 – Alternative Compliance, Rule 301 – Permit Fees – Stationary Source and Rule 306 – Air Toxics Fees for more information.

Staff is proposing to eliminate the provision requiring the APCO to submit a cost analysis and renewal fee recommendation to the Board in March of each year (Section 313). As discussed previously, it is already the District's practice to amend Rule 205 before implementing a new renewal fee. As such, this provision is unnecessary. In the future, if the APCO determines that a change to the renewal is needed, the change will be implemented through a rule amendment process, except for CPI adjustments, as discussed in the following paragraph.

Staff is proposing to give the APCO the authority to adjust the fee relative to any change in the California Consumer Price Index (CPI). This fee adjustment will allow the annual renewal fees to keep pace with increases in program costs due to inflation. This provision will be similar to the provision established in Rule 301. CPI increases apply to only the annual renewal fee, and the fee can be CPI-adjusted only when the adjustment is proposed as part of the annual District budget and approved by the Board of Directors.

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## **COST IMPACTS**

Section 40703 of the California Health and Safety Code requires that the District consider and make public its findings relating to the cost effectiveness of implementing an emission control measure. The proposed amendments to Rule 205 will not require any additional emission control equipment or emission reductions at existing stationary sources. These rule amendments are administrative. Therefore, an analysis of cost impacts is not required.

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## **EMISSION IMPACTS**

The proposed amendments to Rule 205 are administrative and do not affect emissions.

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## **SOCIOECONOMIC IMPACTS ANALYSIS**

California Health and Safety Code Section 40728.5 requires a district to perform an assessment of socioeconomic impacts before adopting, amending, or repealing a rule that will significantly affect air quality or emission limitations. The District Board is required to actively consider the socioeconomic impact of the proposal and make a good faith effort to minimize adverse socioeconomic impacts. The proposed amendments to Rule 205 are administrative in nature. The amendments do not affect emissions limitations or air quality, nor do they interfere with the

District's attainment plan. Therefore, Section 40728.5 of the Health and Safety Code does not apply.

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## **ENVIRONMENTAL REVIEW AND COMPLIANCE**

Staff finds that the amendments to Rule 205 are exempt from the California Environmental Quality Act (CEQA). Public Resources Code Section 21080(b)(8) and Section 15273(a)(1) of the State CEQA Guidelines provide that the establishment or modification of fees is not subject to CEQA. To claim this exemption, the District must find that the amendments are for the purpose of meeting operating expenses. Amendments to Rule 205 will increase the annual renewal fee to recover the cost to implement the ERC program.

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## **PUBLIC COMMENTS**

Staff held a public workshop to discuss the proposed amendments on April 11, 2013. A public notice was published in the "Our Region" section of the Sacramento Bee, and sent via e-mail and U.S. mail, if requested, to affected sources and other interested parties, and was posted on the District website on March 20, 2013. The draft rule and staff report were made available for public review at that time.

Staff received comments and questions concerning the proposed changes to the annual renewal fee at the workshop and received written comments from sources who borrow emission reduction credits from the District ERC bank. All comments and responses are included in Appendix B.

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## **TABLE OF FINDINGS**

The California Health and Safety Code (HSC), Division 26, Air Resources, requires local districts to comply with a rule adoption protocol as set forth in Section 40727 of the Code. This section has been revised through legislative mandate to contain six findings that the District must make when developing, amending, or repealing a rule. These findings, effective January 1, 1992, and their definitions are listed in following table.

**RULE 205 – REQUIRED FINDINGS**

FINDING	FINDING DETERMINATION
<b>Authority:</b> The District must find that a provision of law or of a state or federal regulation permits or requires the District to adopt, amend, or repeal the rule.	The District is authorized to amend Rule 205 by Health & Safety Code Sections 40001, 40702, 40709, 40709.5, 40709.7, 40711, and 41080. [Health & Safety Code Section 40727 (b)(2)].
<b>Necessity:</b> The District must find that the rulemaking demonstrates a need exists for the rule, or for its amendment or repeal.	The District needs to amend Rule 205 to recover the program costs to renew and update ERC loans and implement the Change Out Program. The proposed amendments also allow give the Air Pollution Control Officer the authority to adjust the fee relative to any increase in the Consumer Price Index. [Health & Safety Code Section 40727(b)(1)].
<b>Clarity:</b> The District must find that the rule is written or displayed so that its meaning can be easily understood by the persons directly affected by it.	Staff has reviewed the proposed rule and determined that it can easily be understood by the affected parties. In addition, the record contains no evidence that people directly affected by the rule cannot understand the rule. [Health & Safety Code Section 40727(b)(3)].
<b>Consistency:</b> The rule is in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or state or federal regulations.	The District has found that the proposed rule does not conflict with and is not contradictory to, existing statutes, court decisions, or state or federal regulations. [Health & Safety Code Section 40727(b)(4)].
<b>Non-duplication:</b> The District must find that either: (1) The rule does not impose the same requirements as an existing state or federal regulation; or (2) that the duplicative requirements are necessary or proper to execute the powers and duties granted to, and imposed upon the District.	The proposed rule does not duplicate any state or federal laws or regulations. [Health & Safety Code Section 40727(b)(5)].
<b>Reference:</b> The District must refer to any statute, court decision, or other provision of law that the District implements, interprets, or makes specific by adopting, amending, or repealing the rule.	Health & Safety Code Sections 40709, 40709.5, and 40709.7. [Health & Safety Code Section 40727(b)(6)].
<b>Additional Informational Requirements (Health &amp; Safety Code Section 40727.2):</b> In complying with Health & Safety Code Section 40727.2, the District must identify all federal requirements and District rules that apply to the same equipment or source type as the proposed rule or amendments.	The proposed amendments to Rule 205 are administrative and do not impose new or more stringent emission limits or standards, monitoring, reporting, or recordkeeping requirements. Therefore, a written analysis of federal regulations and other District rules is not required. [Health & Safety Code Section 40727.2(g)].

**Appendix A**

**SUMMARY OF PROPOSED AMENDMENTS**

**Rule 205 – Community Bank and Priority Reserve Bank**

<b>EXISTING SECTION</b>	<b>NEW SECTION</b>	<b>CHANGES</b>
102.4	Same	Subsection a: Corrected Rule 411 title. Subsection b and c: Removed language referring to compliance timelines after March 1997 because this rule language is no longer relevant. Subsection g: Corrected Rule 459 title. Subsection j and k: Moved the rules to be in numerical order.
102.5	Same	Subsection b and d: Corrected the titles for the referenced CFR sections. Subsection e: Grammatical correction.
102 – Note Section	Same	Updated note at the end of the section. Removed all rules that have been SIP approved. Rule 460 has not been SIP approved.
200	Same	Corrected Rule 204 title.
N/A	202	Added definition of “Borrower” to specify any person who has been granted a loan of emission reduction credits.
202-214	203-215	Sections renumbered.
302.3	Same	Updated section reference.
303.3	Same	Updated section reference.
313	313.1	Replaced “any person who requests to withdraw” with “A borrower of” for clarification. Amended annual renewal fee for each active loan. Removed the requirement for the APCO to submit a cost analysis and a recommendation for a new annual loan renewal fee to the Board in March of each year.
313	313.2	Added provision that authorizes the Air Pollution Control officer to adjust the annual renewal fee on an annual basis. The proposed rate by the change in the California CPI. for the Air Pollution Control Officer to recommend a new fee when a cost analysis shows that a change in the fee is necessary.
403	Same	Replaced “loan requestor” with “borrower” for clarity.

**APPENDIX B  
COMMENTS AND RESPONSES**

**PUBLIC WORKSHOP FOR RULES 301, 107, 205, AND 306**

April 11, 2013

**Attendee:**

David Green, DMEA  
Rene Toledo, SMUD  
Michael Anderson, Sacramento County MSADWMR (Kiefer Landfill)  
William Brunson, Apple Inc.  
Yolanda Grigsby, Sacramento Area Sewer District  
Steve Nebozuk, Sacramento Regional County Sanitation District  
Jason Chu, SYAR Industries Inc.  
Erica Gonzalez, Aerojet  
Philip Meyer, City of Sacramento  
Becky Wood, Teichert

**Questions/Comments:**

Note: A combined workshop was held for proposed amendments to Rule 301, Rule 107, Rule 205 and Rule 306. Only comments pertaining to the proposed amendments to Rule 205 are shown below. Other comments made during the public workshop period will be added in the Staff Report for Rule 301, Rule 107 and Rule 306.

Comment #1: If the Board adopts the fee increase, when will it take effect?

Response: The proposed amendments will be effective on the date of adoption. Staff plans to bring the proposed changes to be considered for adoption at the May 23, 2013 Board hearing.

Comment #2: The proposed increase in the annual renewal fee for ERC loans is very large. Why is this increase proposed to occur all in the first year as opposed to spreading the increase over multiple years?

Response: Staff originally proposed an increase in the annual renewal fee to begin recovering the full cost in the first year. This option avoids the use of fund balance to cover the shortfall as would occur if the increase were phased in. This program provides a large benefit to sources that take advantage of the opportunity to borrow ERCs from the District bank. Sources opting to use this program have quicker access to the needed ERCs through the District bank than through the open market. In addition, sources borrowing ERCs for a term less than 30 years pay only a prorated cost of the market value of the ERCs. The availability of this program prevents delays in facility expansions and helps sources stay in compliance through the alternative compliance option. This program is also a voluntary program that is unique to our District; no other districts offer this service to their permitted sources.

After considering the comments received and the importance of this program to all potential users, Staff is proposing additional options to be considered by the Board. Option 1 is Staff's

original proposal, which is a full increase in the annual renewal fee in the first year. This option allocates the entire cost of the District ERC bank to all sources who are borrowing ERCs. Option 2 will phase in the fee increases over a period of three years, as suggested by the commenter. Option 3 distributes half of the cost to the source who are borrowing ERCs and half to all permit holders. The proposed annual renewal fee for this option is half of the proposed fee for Option 1.

### **Written Comments Received After the Public Workshop**

Chelsea Westerberg, Aerojet (4/11/2013):

Comment #3: The proposed Rule 205 amendments will increase the annual renewal fee from \$903 per year to \$2,556 per year, a 283% increase. Aerojet does not agree with the drastic rate increase that is planned to take place all in one year. Aerojet is proposing that SMAQMD consider one of three options for gradual increases in fee to achieve the desired goal which would be consistent with the proposed increases for the other rules. The requested gradual increases would allow Aerojet more time to reallocate money and balance our budget internally to cover these costs. Option 1 is to increase the fee by 36.5% in FY13/14, 26.7% in FY14/15, 21% in FY15/16, 17.5% in in FY16/17, and 16% in FY17/18. Option 2 is to increase the fee by 46% in FY13/14, 31% in FY14/15, 24% in FY15/16, and 20% in FY16/17. Option 3 is to increase the fee by 61% in FY13/14, 38% in FY14/15, and 28% in FY15/16.

Response: Staff used updated program cost projections to calculate the annual renewal fee. The proposed annual renewal fee changed from \$2,556 to \$2,085. The full fee increase in the first year is considered Option 1. Staff has considered the commenter's three options for gradual fee increases and developed Option 2, which increases the fee over a three-year period. Staff used the three-year period because the District will consume the least amount of the existing and critically low stationary source fund balance. See response to Comment #2.

Tim Israel, County of Sacramento, Department of Waste Management and Recycling:

Comment #4: The current and proposed annual renewal fee structure does not take the size of the loan into account. DWMR's loan of 0.09 tons for the Kiefer gasoline dispenser will incur the same fees as the 7.72 tons for the site's flares and engines. DWMR suggests that SMAQMD consider a tiered approach for small, medium, and large sized loans. This approach is utilized for local permit fees.

Response: The amount of the ERC loans does not affect the amount of Staff time to maintain and update the District ERC bank and to implement the emission reduction projects to create replacement credits. As such, the time associated with each loan is the same, and Staff does not consider it appropriate to use different renewal fees for different sizes of loans.

Comment #5: The staff report does not clearly address how the initial loan fees fit into the budget for this program. DWMR requests that SMAQMD staff evaluate the impact of base loan fees on the projected revenues and consider adjusting the proposed fees.

Response: The fees are explained in the "Background" section of this staff report. Rule 205 has three types of fees: the base loan fee, the administrative processing fee, and the annual renewal fee. The base loan fee is used to fund emission reduction projects; it is not used to recover Staff's cost to implement the emission reduction projects. Currently, the revenues from the base loan fee are used as incentive funds for the District's Change Out Program. The administrative processing fee is used to recover the cost of Staff's time to process a new loan request. The annual renewal fee is used to recover Staff's cost to maintain the ERC bank and to implement emission reduction projects. Currently, this fee is used to cover Staff time to implement the District's Change Out Program. The revenues from the base loan fees will not affect the cost analysis for the proposed annual renewal fee. No adjustments were made to the proposed annual renewal fee based on this comment.

Comment #6: The proposed fee increases are retroactive to our original agreements to the ERC loans. We cannot recover the original loan fees if we decide that the new annual fees are too costly. Would the SMAQMD consider prorated refunds for loans that have suddenly become cost prohibitive?

Response: No. The Terms and Conditions (no. 3) of the ERC loans state, "...once an ERC loan is approved, the District will not refund any fees paid for unused portions of ERC loans". Therefore, Staff will not provide prorated refunds for the unused portions.

In addition to an annual renewal fee increase in the first year, Staff is proposing two other options for the Board's consideration and adoption. Option 2 phases in the fee increase over three years. Option 3 allocates half of the cost of the District ERC program to all permit holders, which reduces the annual renewal fee proposed in Option 1 by half. See response to Comment #2.