

LAO

September 5, 2017

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 17-0010, Amendment No.1) that would authorize \$8.9 billion in general obligation bonds for various water-related programs and projects.

Background

Sources of Water in California. Rivers originating in the Sierra Nevada Mountains and other mountain ranges in Northern California are filled mainly by rainfall and snowmelt and provide most of the state's water supply. Water available underground (referred to as groundwater) supplies roughly a third of the state's water use and is more heavily relied on in dry years. A small share of the state's water supply also comes from other sources, such as capturing rainwater, reusing wastewater (water recycling), and removing the salt from ocean water (desalination).

Meeting the State's Water Needs. There are many demands on the state's water supply, and meeting these demands presents several key challenges. First, water is not always naturally available where it is needed, such as for the farms of the Central Valley and the population centers in the San Francisco Bay Area and Southern California. Second, the amount of water available can change widely from year to year. So, when less water is available in dry years, it can be difficult to meet the demand for water throughout the state. These demands include providing water for growing crops, drinking, and maintaining natural habitats—such as rivers and wetlands—for endangered species as is required under state and federal laws. However, in very wet years the state can experience floods, particularly in the Central Valley. Third, water is sometimes polluted making it unsuitable for drinking, irrigating crops, or maintaining natural habitats.

In order to address these challenges, California has built various water-related projects. Projects use natural rivers—as well as pipelines, pumping stations, and canals—to deliver water throughout the state. In particular, the state's water system is designed to deliver water from Northern California—where it is more plentiful—to other regions of the state. Water-related

Legislative Analyst's Office
California Legislature
Mac Taylor • Legislative Analyst
925 L Street, Suite 1000 • Sacramento CA 95814
(916) 445-4656 • FAX 324-4281

RECEIVED

SEP 05 2017

INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

projects in the state also include dams and other types of water storage to hold water for when it is needed. Other projects to meet the state's water challenges include water treatment plants to remove pollutants from drinking water and wastewater, systems to clean up runoff from storms, and levees to prevent floods. The state also has taken a variety of actions to improve natural habitats and water quality. These include restoring watersheds (an area of land that drains into a body of water) by thinning forests and reintroducing native plants. The state has also provided water to rivers when needed by fish.

Roles of Various Governments in Water System. Government agencies spend roughly \$30 billion annually in the water sector, including to provide clean and reliable water for urban and agricultural uses, treat wastewater, and manage floods. Over three-quarters of this spending is done at the local level, such as by water districts, cities, and counties. About 80 percent of this local spending is paid for by individuals as ratepayers of water and sewer bills. Other local funding sources include state funds, federal funds, and local taxes. The state and federal governments also play important roles in the state's water system, such as by operating key water supply infrastructure that moves water around the state, as well as by setting and enforcing water quality standards.

State Activities and Funding. The state runs programs to (1) conserve, store, and transport water around the state; (2) protect water quality; (3) provide flood control; and (4) protect fish and wildlife habitat. The state provides support for these programs through direct spending, as well as grants and loans to local governments, nonprofit organizations, and privately owned water companies. Funding for these state programs usually comes from bonds and fees. Since 2000, voters have approved about \$27 billion in general obligation bonds for various environmental purposes, including water. The state repays these bonds, with interest, using the state's General Fund. (The General Fund is the state's main operating account, which also pays for education, prisons, health care, and other services.)

Proposal

This measure provides \$8.9 billion in general obligation bonds for various water-related programs and projects.

Uses of Funds

As shown in Figure 1, the measure provides bond funding for various water-related uses that fall into seven categories, which are described below in more detail.

Figure 1	
Proposed Use of Bond Funds	
<i>(In Millions)</i>	
Category	Amount
Water Supply and Quality	\$3,030
Water recycling and desalination	800
Drinking water and wastewater systems	750
Urban runoff and stormwater	550
Flood management and water supply	500
Water conservation	365
Water measurement and information	60
Integrated Regional Water Management planning	5
Watershed and Fisheries Restoration	\$2,895
Watershed improvements	2,355
Central Valley fisheries restoration	400
Land management for water supply	100
Watershed improvements by Conservation Corps	40
Habitat Protection	\$940
Fish and wildlife habitat	930
Sacramento regional projects	10
Water Conveyance	\$855
Groundwater Sustainability and Storage	\$685
SF Bay Area Surface Water Storage	\$250
Oroville Dam Flood Control	\$222
Total	\$8,877

Water Supply and Quality (\$3 Billion). The measure provides a total of \$3 billion to increase the supply and improve the quality of water for human uses in the residential, commercial and industrial, and agricultural sectors. By allocating funding for the following purposes, the measure seeks to clean up and develop water supplies, make water use more efficient, and reduce the demand for water:

- ***Water Recycling and Desalination (\$800 Million).*** The measure provides \$400 million for wastewater recycling projects and \$400 million for projects that remove salt from groundwater and other water supplies.
- ***Drinking Water and Wastewater Systems (\$750 Million).*** The measure includes funding to provide disadvantaged communities with clean, safe, affordable, and reliable drinking water, including \$500 million for projects to improve water system infrastructure and \$250 million for wastewater treatment projects.
- ***Urban Runoff and Stormwater (\$550 Million).*** The measure provides funding for projects to capture and use stormwater runoff and dry weather runoff, including diverting such runoff from storm drains and putting it to use.

- ***Flood Management and Water Supply (\$500 Million)***. The measure provides funding in three flood-management related areas: (1) \$200 million to improve existing floodways, bypasses, and other flood control facilities in the Central Valley; (2) \$200 million for flood management, wetlands restoration, and other projects in the San Francisco Bay Area; and (3) \$100 million to repair or reoperate reservoirs to increase water storage and provide recreational and habitat benefits.
- ***Water Conservation (\$365 Million)***. The measure provides funding for various efforts to reduce water use, including programs to convert turf to more drought-tolerant landscapes, detect and reduce leaks in public water distribution systems, encourage water efficiencies in the agricultural sector, and develop technologies that save both water and energy.
- ***Water Measurement and Information (\$60 Million)***. The measure provides funding for various efforts to improve the state's ability to collect and maintain data related to water management, including development of water measuring equipment and information systems, and research to be conducted by specific public universities.
- ***Integrated Regional Water Management Planning (\$5 Million)***. The measure includes funding to maintain and continue existing regional water management planning efforts.

Watershed and Fisheries Restoration (\$2.9 Billion). The measure provides a total of \$2.9 billion to protect, restore, and improve the health of watersheds, fisheries, and lands that provide water supplies. Specifically, the measure allocates funding for:

- ***Watershed Improvements (\$2.4 Billion)***. The measure provides a number of allocations to specific agencies for restoring and improving the health of watershed lands. To be eligible for this funding, a project generally must have water supply or quality benefits (including improving forest health and reducing fire danger), increase flood protection, or protect or restore riparian or aquatic resources.
- ***Central Valley Fisheries Restoration (\$400 Million)***. The measure provides funding for efforts to restore Central Valley populations of native fish and fisheries habitat, with the goal of increasing self-sustaining populations of native fish.
- ***Land Management for Water Supply (\$100 Million)***. The measure provides funding for projects that improve the quality of rangelands, wildlands, wetlands, and other areas for the purposes of increasing groundwater recharge and water supply from those lands, as well as improving water quality for the environment.
- ***Watershed Improvements by Conservation Corps (\$40 Million)***. The measure funds the California Conservation Corps for projects to protect and restore watershed lands and improve water quality, water supply reliability, and watershed health.

Habitat Protection (\$940 Million). The measure provides a total of \$940 million to improve habitat conditions for fish, wildlife, and migratory birds, including:

- ***Fish and Wildlife Habitat (\$930 Million)***. The measure provides funding for various efforts, including acquiring land for conservation, improving habitat conditions on wildlife refuges and private lands (including by acquiring water from willing sellers), and restoring fisheries for coastal and Central Valley salmon and steelhead.
- ***Sacramento Regional Projects (\$10 million)***. The measure provides funding for projects to improve water supply and the environment in the Sacramento region, including to improve flow and temperature conditions and habitat in the lower American River.

Water Conveyance (\$855 Million). The measure provides (1) \$750 million for the Friant Water Authority to make capital improvements (including to increase water conveyance capacity to and in the Madera and Friant-Kern canals), (2) \$100 million for conveyance projects related to a legal settlement to restore native fish in the San Joaquin River, and (3) \$5 million to plan for a new diversion of water from the Sacramento River to the North Bay Aqueduct. The measure explicitly prohibits any funding from the bond to be expended on water conveyance facilities in the Sacramento-San Joaquin Delta.

Groundwater Sustainability and Storage (\$685 Million). The measure provides funding for projects and programs that support sustainable groundwater management—including projects to recharge groundwater basins—and to establish a state-level groundwater technical assistance program to serve disadvantaged communities.

San Francisco Bay Area Surface Water Storage (\$250 Million). The measure provides funding for a group of eight water agencies in the Bay Area to develop new facilities that extend the regional benefits of existing surface water storage, such as by building new connections to existing water supplies. The funds may not be used to build new surface storage or expand existing reservoirs.

Oroville Dam Flood Control (\$222 Million). The measure provides \$200 million for the repair and reconstruction of the spillways at the Oroville Dam, which were damaged in 2017. It also provides \$22 million to undertake sediment removal, flood control, and emergency preparedness activities downstream from the dam.

Other Provisions

Funding Allocations and Administrative Costs. The measure continuously appropriates the funds from bond sales to more than a dozen different state departments, agencies, boards, and conservancies. As such, the Legislature would not appropriate funds through the annual state budget. Instead, the executive branch—the Governor and administering entities—would decide how to allocate funds for most program categories. Up to 5 percent of the bond funds could be used to pay for administrative costs incurred by these entities to implement the measure. These entities, in turn, would pass through much of the funds authorized under the measure to local government agencies, Indian tribes, nonprofit agencies, and private water companies in the form of grants. For many of the programs funded under this measure, funds would be prioritized for disadvantaged communities. In addition to making grants, state government entities would spend some of the funds on projects and programs administered at the state level.

Local Cost-Sharing Requirements. For many of the programs funded under this measure, grantees would be required to provide at least one dollar in local funds for each dollar of grant funding received. However, the measure allows this local cost-share requirement to be reduced or eliminated in certain cases, such as for grants that benefit economically distressed areas.

Maintain Annual Transfer of Funds to the Habitat Conservation Fund. Under current law, the State Controller annually transfers 10 percent of the funds (about \$6 million per year in recent years) from a certain subaccount within the Cigarette and Tobacco Products Surtax Fund to the Habitat Conservation Fund, which supports acquisition and preservation of wildlife habitat. The statute authorizing this annual transfer is due to sunset on July 1, 2020. This measure eliminates the sunset and continues the transfer beyond July 1, 2020. As such, under the measure these funds would continue to be dedicated for their current purpose, rather than becoming available for other purposes.

Direct Cap-and-Trade Revenues for Certain Water-Related Projects. The state's cap-and-trade program requires some entities, such as electricity generators, to purchase permits (referred to as "allowances") to emit greenhouse gases. As a result of the program, some water agencies have higher electricity costs to operate their water delivery systems. This measure continuously appropriates a portion of state revenue generated from the sale of allowances to four entities—the state Department of Water Resources, the Metropolitan Water District of Southern California, the Contra Costa Water District, and the San Luis and Delta Mendota Water Authority. The amount appropriated would be equal to each entity's additional electricity costs associated with the cap-and-trade program, which could be in the tens of millions of dollars annually. This amount could be higher or lower depending on factors such as amount of energy purchased and allowance prices. The agencies would be required to spend the funds on such things as consumer water conservation programs. As such, under the measure these funds would no longer be available for the Legislature to appropriate for other purposes.

Fiscal Effects

Fiscal Effects on State Government. This measure would allow the state to borrow up to \$8.9 billion by selling additional general obligation bonds to investors, who would be repaid with interest using the state's general tax revenues. The cost to the state of repaying these bonds would depend on various factors such as the interest rates in effect at the time they are sold, the timing of bond sales, and the time period over which they are repaid. We assume that (1) the interest rate for bonds would average 5 percent, (2) they would be sold over the next ten years, and (3) all bonds would be issued for a 30-year term. Based on these assumptions, the cost to taxpayers to repay the bonds would average \$433 million annually over the next 40 years—totaling \$17.3 billion to pay off both principal (\$8.9 billion) and interest (\$8.4 billion). Annual debt service costs would ramp up in the initial few years, peak at about \$580 million per year, and ramp down in the final few years.

Fiscal Effects on Local Governments. Much of the bond funding would be available for local government water-related projects. The availability of state bond funds for local projects would affect how much local governments spend on these projects. In many cases, the availability of state bonds could reduce local spending. For example, this would occur in cases

where the state bond funds replaced monies that local governments would have spent on projects anyway. Local savings would also occur in cases where the availability of state bond funds allowed local governments to build projects that reduced operating costs, such as by increasing efficiency or using a new water source that allows them to purchase less water.

However, in some cases, state bond funds could increase total spending on projects by local governments. For example, the availability of bond funds might encourage some local governments to build additional or substantially larger projects than they would otherwise. Funded projects could also increase future operating costs, such as for new desalination facilities.

The net fiscal effect on individual local governments would vary depending on the specific projects they undertake, what grants or loans they receive because of this bond, and the amount of the local cost-share requirement. These costs or savings could affect rates charged to customers, such as on water bills. However, the annual net effect on local governments statewide is likely to be small relative to the overall amount spent by local governments. Therefore, any effect on rates would likely be small for most ratepayers.

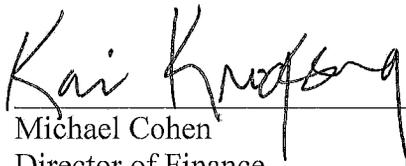
Summary of Fiscal Effects. This measure would have the following fiscal effects:

- State costs of \$17.3 billion to pay off principal (\$8.9 billion) and interest (\$8.4 billion) on bonds over a 40-year period. Annual payments would average \$433 million. Annual payments would be lower than this average in the initial and final few years, and somewhat higher in the intervening years.
- Varying fiscal effects on individual local governments depending on specific projects undertaken, amount of grants and loans received, and amount of local cost-share required.

Sincerely,



for
Mac Taylor
Legislative Analyst



for
Michael Cohen
Director of Finance