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SUBJECT MATTER HEARINGS

Water Management Funding

Background and Issue Paper¹

California enjoys a long history of water management infrastructure development. In the 1870s, the State authorized the first water districts, in order to promote cooperative development of water facilities, starting in the San Joaquin Valley. In 1933, the Legislature took the historic step of authorizing the State Central Valley Project, consisting of Shasta Dam, Friant Dam, and various canals. The State plan included financing with revenue bonds, with project costs repaid by water and power users. During the Depression, however, the State could not afford to build the project. The Federal Government took over the project in 1935, under the auspices of the Bureau of Reclamation, which now oversees the Central Valley Project – its largest project.

In 1959, the Legislature authorized the State Water Project (SWP). The project was principally financed by a \$1.75 billion general obligation bond, state revenue bonds, loans from a state tideland oil revenue account, and power revenues. The costs of the project are principally repaid by the SWP water contractors. The State pays for recreation and fisheries enhancements upon approval by the Legislature, but these costs are a relatively small percentage of the total.

Focus on Delta. In the late 1970's, the Legislature approved the Peripheral Canal as an addition to the State Water Project, but the voters rejected the project in a 1982 referendum. Shortly thereafter, Governor Deukmejian proposed the Through-Delta Plan as an alternate to the Peripheral Canal in the mid-1980s, but the Governor dropped his bill. In 1984, the Legislature authorized Los Banos Grandes Reservoir as an addition to the SWP, but the reservoir was never constructed.

After the demise of the Peripheral Canal and the Through-Delta Plan, the Legislature and the voters (by initiative) made another fundamental policy change: using state General Fund bonds to pay for local water projects – with no requirement for subsequent reimbursement by local agencies that benefit from such projects. Such projects included local water conveyance projects, drinking water quality improvements, watershed improvements, fishery improvements, and reservoir studies.

¹ This paper was prepared collaboratively, with substantial assistance from staff from Republican Caucus, Senate and Assembly Budget Committees, and Assembly Committee on Environmental Safety and Toxic Materials. Committee staff edited such contributions, except for material noted as "Prepared by Republican Caucus Staff." The LAO also has prepared a paper on the Governor's water funding proposal, and parts of that paper have been included in this paper where relevant to particular issues.

During the 1987-92 drought, Delta water conflicts escalated. USEPA declared the 1978 Delta water quality plan invalid. Two fish species edged toward extinction, leading to greater federal regulation under the Endangered Species Act. Delta exports were reduced to protect the fishery. In 1992, the Congress amended the federal Central Valley Project Act to provide more water for fish and wildlife, thus reducing water available for its water contractors. The State and the Federal Government battled over control of the Delta. .

In the midst of all this conflict, environmentalists, urban water agencies, and agricultural water agencies began discussing how to resolve the conflict – the so-called “three way process.” Separately, the various federal agencies began coordinating their Delta efforts, in what became known as “Club Fed.” In 1994, Club Fed began working with the State to resolve the conflict over Delta water quality standards and fishery needs, leading to the landmark 1994 "Bay-Delta Accord," which created consensus water quality standards. The State and the Federal Government then created the “CALFED Bay-Delta Program” which was a cooperative, multi-agency coordination effort to address the Delta's long-term needs.

For the next five years, the two governments worked together to develop a joint Environmental Impact Report/Statement to address the Delta's needs. In an August 2000 "Record of Decision" (ROD), they adopted four coequal objectives for improving the Delta – water supply reliability, ecosystem restoration, water quality and levee system stability. The ROD's most important decision was to use the existing conveyance system for Delta water exports – through the Delta – with reconsideration of that decision set for 2007.

In recent years, CALFED has encountered rough water. The fiscal conditions of both the State and the Federal Government deteriorated, leading to less funding than was proposed in the CALFED ROD. At this point, State bond funding approved in 1996, 2000 and 2002, is running out. Despite years of work, CALFED failed to develop a consensus as to how and who should pay for CALFED programs. Stakeholders and public officials continued debating how to pay for the Delta's needs. Last year, legislative budget committees reduced the CALFED budget and the Governor responded with a comprehensive fiscal, programmatic and governance review of the entire CALFED Program. At the same time, the Department of Fish and Game reported a substantial decline in the health of the Delta ecosystem, which has affected the progress of Delta water supply reliability projects. Now that the Governor's reviews have been completed, the Legislature still has the responsibility to address how best to reorganize CALFED to accomplish its four objectives for improving Delta conditions.

I. Financial Summary of Bond Proposals Re: Water Management

(in millions, unless otherwise indicated)

Governor's Bond Proposal: AB 1839		
INTEGRATED REGIONAL WATER MGMT	TOTAL \$2B	TOTAL \$4.5B
Regional Water Mgmt	\$1,000	\$2,000
North Coast	(45)	(90)
San Francisco Bay	(147)	(294)
Central Coast	(61)	(122)
Los Angeles-Ventura	(220)	(440)
Santa Ana River	(121)	(242)
San Diego	(98)	(196)
Sacramento River	(81)	(162)
San Joaquin River	(66)	(132)
Tulare Lake	(68)	(136)
Lahontan	(48.5)	(97)
Colorado River Basin	(44.5)	(89)
Statewide Water Mgmt	\$1,000	\$2,500
Protect & Improve Water Quality	(250)	(500)
Water Storage Development	(250)	
Water Resources & Quality Science & Technology	(300)	(500)
Resource Stewardship & Ecosystem Restoration	(200)	(500)
State Share of Water Storage Projects Under CALFED		(1,000)

SB 153 (Chesbro) – September 2, 2005	
Clean Water and Coastal Protection	TOTAL: \$875
State Coastal Conservancy: protection of land and water	(250)
- local coastal watershed projects – not less than \$15 million	
Clean Beaches, Water Quality, Integrated Regional Water Management	(410)
- SWRCB Clean Beaches: \$100 million	
- DWR Integrated Regional Water Management \$200 million	
- SWRCB Mercury Contamination Cleanup \$100 million	
- DHS Emergency Actions, Clean Water in Low-Income Communities: \$10 million	
California River Parkways	(50)
Ocean Protection Trust Fund, scientific data, sustainable fisheries	(100)
DWR Urban Stream Restoration Projects	(25)
SWRCB New River Cleanup and Remediation	(40)

Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2004 (Proposed Initiative)	
Safe Drinking Water	\$240
Small Community Drinking Water System Improvement Grants	(180)
Emergency Safe Drinking Water Projects	(10)
Safe Drinking Water Revolving Fund	(50)
Integrated Regional Water Management	\$1 billion
Water Quality	\$435
Clean Water Revolving Fund	(50)
Groundwater pollution prevention	(60)
Delta water quality projects	(130)
Agricultural wastewater cleanup	(15)
Stormwater pollution prevention	(90)
Clean Beaches program	(90)
Resources Stewardship (Partial List)	\$370
Bay-Delta NCCP	(20)
Coastal Salmon and Steelhead restoration	(45)
CalFed ERP	(115)
Colorado River QSA implementation	(36)
Lower Colorado MSCP	(7)
Salton Sea restoration	(47)
San Joaquin River	(100)
Statewide Water Planning and Design	\$65
<ul style="list-style-type: none"> • Evaluation of climate change impacts on flood and water systems Surface storage planning and feasibility (CALFED) • Flood protection improvement • Integration of flood control and water supply systems 	

II. Broad Executive Discretion

Historically, the process of funding water programs through State bonds has involved both the executive and legislative branch. Bond proposals were developed either through the Legislature, with the Governor signing bond bills, or by initiative, where the Legislature holds a hearing. The Legislature's bond bills gave at least some general direction as to how the bond funding should be directed. Once the water bond passed, the Legislature retained its authority to make annual appropriations that provide further direction as to how State agencies should spend bond funding. Then the Legislature provides oversight as to that bond funding, particularly in making further annual appropriations. This Governor's bond proposal sets a different course.

LAO Comment: *Key Policy Decisions to Be Made Administratively.* As mentioned above, much of the funding in the bill is tied to the concept of integrated regional water management planning—a fundamental concept that is to be defined in regulations to be adopted by DWR. As another example of the bill's deference to future policy-laden administrative action, the bill provides that the California Water Commission can propose changes to the fee schedule of the water resources capacity charge. These changes will become effective unless overturned by legislative enactment of a statute within 60 days after receipt of the commission's recommendation to make the changes. As yet another example, the 2010 bond act provides that the \$640 million of funds for Delta special flood control projects are to be guided by the "Delta risk management strategy"—a strategy that has yet to be developed by the administration.

A. Continuous Appropriation

Proposed Continuous Bond Appropriations	
2006:	\$2.25 billion
2010:	\$200 million

Background. The Constitution of California separates the powers of state government into three main branches. Under this system, the legislature makes the laws, the executive executes the laws, and the judiciary interprets the laws. The State Constitution provides that persons charged with exercise of one power may not exercise either of the others except for specific exemptions provided in the State Constitution. This provides for separation of powers among the branches of government.

One of the fundamental checks on the Executive branch of government is the legislative branch's power to appropriate funds. In the budget process, the role of the Governor is to develop and propose a budget and the role of the Legislature is to review the proposed budget, amend where necessary, and appropriate the funds to implement the budget. Programs funded by continuous appropriations do not go through the normal budget process, which limits the Legislature's ability to review and amend expenditures proposed from continuous appropriations.

Government Code Section 13340 provides that continuously appropriated funds may not be encumbered unless the Legislature, by statute, specifies that the funds are appropriated for encumbrance. Besides a few exemptions provided by this section, all funds must be appropriated through the budget process unless there is a specific statutory authorization to do otherwise. Recent bond measures have allowed continuous appropriations of limited, specified amounts of funding. For example, Proposition 50 provided \$750 million in continuous appropriations to the Wildlife Conservation Board for land acquisitions.

LAO Comment: *Continuous Appropriations Authority.* The bill provides that almost \$2.5 billion of bond funds and \$2.5 billion (estimated) of revenues in the California Water Resources Investment Fund are continuously appropriated to DWR. This reduces legislative input and review of projects to be funded. Of particular note is that most of the continuous appropriations authority is provided to brand new programs that do not have established funding eligibility guidelines and administrative processes in place. (The one exception being the \$450 million total of continuous appropriations in the two bonds for flood control subventions.)

Governor's Bond. The Governor proposes continuous appropriation of \$2.25 billion of the 2006 water bond. The 2010 bond provides an explicit continuous appropriation only for \$200 million in flood control subventions. The Governor also proposes continuous appropriation of all funds generated by the proposed Water Resources Investment Fund fee.

Committee Questions:

1. Why does the Governor's water bond proposal contain programs that would be continuously appropriated?
2. Is it the Administration's position that using continuous appropriations ensures funding for projects through their completion?
3. How has the Legislature set policy and direction for these new programs, considering DWR has not yet developed any regulations for integrated regional water management plans?

Administration Comments:

The Administration believes that two categories of funding are worthy of consideration for continuous appropriations: flood subventions and integrated regional water management plan (IRWMP) development and implementation. Regarding flood subventions, the Administration notes that flood subvention funds have been continuously appropriated in the past (including within Proposition 13 of 2000) and is necessary to avoid unnecessary delays. Regarding integrated regional water planning, the Administration believes that all potential obstacles to the development of IRWMPs should be minimized and that the legislature has played a significant role in developing the concept of integrated regional water management planning. The Administration notes that DWR will develop regulations to guide IRWMP development.

The Legislature passed SB 1672, the Integrated Regional Water Management Planning Act of 2002, as well as implementing legislation for Proposition 50 which provided the Administration's initial definition of integrated regional water management. Further, the Administration engaged in public discussion through the development of the California Water Plan and implementing regulations for Proposition 50.

B. Broad Allocation Categories

Background: Past water bonds have provided direction, often specifically, as to how individual amounts of money should be spent. The Burns-Porter Act, adopted by voters in 1960, paid for the State Water Project, which was defined as to specific facilities, beneficiaries and water resources. Proposition 13 (AB 1584, Ch. 725), adopted in 2000, allocated money for the developing CALFED Bay-Delta Program and for specific local water projects. In 2002, Proposition 50, an initiative bond, allocated funds to categories of projects "for appropriation by the Legislature." These categories, however, focused on specific types of projects, which provided the Legislature with both direction and flexibility in their appropriation decisions. For example, Prop. 50 allocated \$40 million "to the California Tahoe Conservancy for acquisition

from willing sellers, restoration, and protection of land and water resources to improve water quality in Lake Tahoe."

The challenge in specifying bond fund allocations in the bond language is providing a balance of specificity and flexibility. Allocations require enough specificity to give adequate direction and set priorities among competing purposes. But the Legislature and the Governor still need enough flexibility in its appropriations to make annual judgments as to program effectiveness and then adjust program direction as conditions change. This flexibility allows the Legislature to exercise oversight over bond funding during the appropriation process, as well as adjust funding as conditions change.

LAO Comment: *Many Programs Have Very Broad Funding Parameters, Not a Sense of Funding Priorities.* There are a number of programs funded under the bond acts and the California Water Resources Investment Act that have extremely broad funding parameters and where the statutory language does not give a sense for funding priorities within the program area. In particular, these include provisions allocating a total of \$1.5 billion for "science and technology" and for "resource stewardship and ecosystem restoration" in the two bond acts and the provisions related to expenditures from the "State Investment Account" in the California Water Resources Investment Fund (estimated to total \$2.5 billion over ten years).

Governor's bond, in contrast, transfers \$2 billion to the Integrated Regional Water Management Account, with a continuous appropriation, in the 2006 bond. It then allocates \$1 billion for regional water management projects, with specific allocations to regions. Then the bond proposal lists five broad categories of projects that can compete for this funding, but provides no further direction as to priorities or allocation among these categories of projects. This structure provides the Executive Branch with broad discretion and little direction as to the kinds of projects ultimately funded. This broad discretion is balanced with "preferences" for proposals that promote certain policy goals. *See, pages 22-23 of AB 1839.* The preferences include:

- Integration of region-wide water management
- Integration of water management and land-use planning
- Resolution of significant regional or inter-regional water resource conflicts
- Attainment of one or more CALFED objectives
- Promotion of statewide water management priorities, which are undefined
- Promotion of water supply or quality needs for disadvantaged communities
- Provision of multiple benefits
- Readiness to implement

The 2006 bond proposal allocates an additional \$1 billion to the Statewide Water Management Account (*See pp 25-27 of AB 1839.*), with:

- \$250 million for water quality
- \$250 million for water storage
- \$300 million for water technology
- \$200 million for resource stewardship

Within these categories, there are similar listings of the kinds of eligible projects, but with no priorities or other specific allocation among the categories of projects, other than \$20 million for "costs incurred" for enhancement of fish and wildlife or public recreation by the SWP.

Committee Questions:

1. How does the bond proposal establish policy priorities for funding?
2. Why does the bond proposal fail to provide greater specificity as to allocations?
3. Why does the Administration believe it should have such broad discretion in allocating bond funding among competing water resource priorities?

Administration Comments:

The overall priorities were established in the California Water Plan update, Bulletin 160-05. Further priorities will be established by each region. There is no prioritization of funding because strategies will vary from region to region based on needs and available options. The Administration proposes that State agencies coordinate to develop priorities and that the resulting budgets subject to the budget process. The Administration would like to work with the Legislature to achieve an approach that secures greater specificity for statewide funding allocations which maintaining flexibility to adjust to evolving priorities.

The regulations that will guide implementation of integrated regional water management planning will build from prior legislation, the California Water Plan, guidelines to implement Proposition 50, and existing or new statutes. Regional plans that meet these regulations should receive funding.

The Administration stated that it would consider adding clarity to the purpose of allocations, as well as establishing subaccounts to further define allocation categories. This may include specific funding levels for wastewater recycling, CALFED implementation, water quality projects for disadvantaged communities, etc.

Witness Comments:

The City of Fresno supports the proposed bond.

The East Bay Municipal Utilities District raises concerns that the bond provides little direction as to how bond funds will be spent, instead leaving this determination to DWR.

C. Concentration of Authority and Responsibility

Background: Past water bonds have allocated funding to a broad array of agencies for implementation. DWR often has received the bulk of water funding, but other State agencies with responsibilities and expertise related to water resources also have received funding. In the Delta, the California Bay-Delta Authority coordinates among all agencies with responsibilities in the Delta. The Department of Fish and Game (DFG) addresses fishery issues. The SWRCB and the Department of Health Services address water quality issues.

Such dispersion of implementation authority and responsibility creates both opportunities and challenges. It allows the agencies to share the burden of effectively expending large sums of bond funding. It also allows each agency to use its particular expertise in a policy area to judge how best to achieve the State's objectives in investing such sums. Diffusion of responsibility, however, also diminishes accountability, making it difficult to hold one agency or official responsible for program implementation. Moreover, some agencies have shown greater effectiveness at implementing programs than other agencies, particularly regulatory agencies that lack the programmatic expertise to implement a program in a timely and effective manner.

LAO Comment: *Unclear Fit Within Existing Related Programs in Departments Outside of DWR.* The two bond acts and the California Water Resources Investment Act give DWR the responsibility for allocating all of the funding from these acts. In some cases, DWR is charged with allocating funds for program activities that are mainly the responsibility of other departments (such is the case with the ecosystem restoration program). More generally, it is unclear how the programs funded by these acts tie to the multiagency CALFED Bay-Delta Program, a program with similar objectives.

Governor's bond allocates the entire bond funding to DWR, but requires DWR to "consult" with other agencies. These DWR allocations include responsibility for "resource stewardship and ecosystem restoration," including agricultural land conservation easements and habitat conservation planning. These responsibilities are not DWR's primary responsibility, and more properly belong with other agencies, particularly DFG. The definition of consultation, however, is not provided. It is unclear, for example, whether other agency opposition to proposed DWR spending decisions would have any legal effect or consequence.

Committee Questions:

1. Why does DWR receive the entire financial allocation for all bond-funded programs, including programs traditionally managed by other agencies?
2. How will other agencies be able to affect DWR's decisions when DWR consults with them? Will consultation assure sufficient coordination of such complex water programs?
3. Does the DWR allocation for "resource stewardship and ecosystem restoration" mean that such funding will be limited to environmental mitigation for water projects?
4. Will interagency consultation provide for the level of "coordination" that the California Bay-Delta Authority has provided for Delta issues?
5. Would funding for development of the "Mitigation Bank" project in the Project Levee and Facilities Repairs Subaccount be allocated from the "resource stewardship and ecosystem restoration" section of either bond act?

Administration Comments:

DWR will collaborate with other State agencies in a variety of ways, which include engaging appropriate State agencies in: 1) Updates to the California Water Plan; 2) Other public processes, such as the CALFED Bay-Delta program, to determine priorities for expenditure of statewide funds; 3) Developing regulations to guide development of Integrated Regional Water Management Plans and funding recommendations; and 4) The Governor's Water Policy Council.

The bond proposal is not intended to allocate all of the funding to DWR, but to ensure sufficient coordination among state agencies on water management issues. After this coordination, the resulting budgets will be subject to the normal budget process. Allocating funding to numerous agencies will reinforce existing "silos" and reduce flexibility.

The Administration intends that the projects funded by the Governor's proposal that fall within the direct purview of CALFED should be subject to formal approval of the California Bay-Delta Authority or its successor. Other actions will be coordinated with the California Bay-Delta Authority or its successor.

Witness Comments:

The Kern County Water Agency states that additional clarification is required to determine what type of consultation is required between DWR and other State agencies.

D. Compliance With Future Policy

Background: Allocations of bond funding often reflect adoption of various policies that the executive and legislative branches have forged together. Such policies may be fully developed, or the policy may reflect certain direction for developing such policy. Proposition 13, for example, allocated substantial funding for the CALFED Bay-Delta Program, including projects to be funded after completion of an EIS/EIR in cooperation with the Federal Government. While the CALFED EIS/EIR had not been completed by that point, the Legislature did adopt a policy direction for the spending by: 1) specifying projects *in the Delta*; 2) requiring completion of the EIR/EIR; 3) specifying that CALFED "will achieve balanced solutions in all identified problem areas, including the ecosystem, water quality, water supply, and system integrity." While bond funding allocations may be made before the related policy is final, the Legislature provides at least some general policy direction in bond language, policy bills, or subsequent appropriations.

Over the last decade, California water policy has changed significantly, as often reflected in the California Water Plan, which is otherwise known as DWR Bulletin 160. Much of California water policy debate has focused on the Sacramento-San Joaquin Delta. In 1994, the State began working collaboratively with the Federal Government in shaping Delta policy, which indirectly changed statewide water policy due to Southern California's reliance on the Delta. In the last year, DWR has proposed taking some new directions in its *draft* California Water Plan, which emphasizes integrated regional water planning. These new directions, however, have not been adopted or fully delineated by the State – or embraced by the regions asked to implement them.

Governor's bond requires that funding be expended consistent with policies that are either unspecified or yet-to-be-developed. In the flood management section, the bond proposal requires consistency with the "Delta Risk Management Strategy," which is not expected before 2008. In the water management section, the bond proposal requires that the \$6.5 billion in both the 2006 and 2010 bonds be spent "to implement integrated regional water management and statewide water management priorities as described in the California Water Plan, *as updated*." (Emphasis added.) Considering the vast changes in that plan over the last decade, it is unclear the nature of the plan a decade from now, making the "priorities" uncertain. Finally, the bond proposal requires DWR to develop regulations defining "integrated regional water management plans."

Committee Questions:

1. What are the "statewide water management priorities" referenced in AB 1839, and how will those priorities be "updated" over the life of these bonds?
2. How does protection of the Delta fit into regional management and statewide priorities, or is it now just part of another region? Is CALFED still a statewide priority?
3. How will the Legislature participate in setting statewide priorities and policies in the future? Does the Administration propose any parameters for these future decisions?

Administration Comments:

CALFED committed to completing a Delta Risk Management Strategy (DRMS) and the bond commits the Administration to completing the DRMS by December 2008. The results of the DRMS will be reported to the Legislature. The Legislature will have the opportunity to review the DRMS priorities and consider funding or modifying those priorities through the annual budget process. The California Water Plan Update 2005 was released in draft form in April 2005 and final form in December 2005. There were no substantive changes from the draft to the final version that would affect the Governor's bond proposals. The Administration proposes that references to future updates of the California Water Plan be limited to: 1) Consideration by the

California Water Commission in recommended rate changes; and 2) Consideration by DWR, in coordination with other agencies, in establishing priorities for expenditures of Statewide Water Management Program funds provided in the proposed 2010 bond.

CALFED is a statewide priority, but the Delta was not included as a separate region due to its unique nature as the intersection of the state's two major river systems. Statewide funds are expected to play an important role in addressing Delta needs. Funding proposals for statewide water priorities will be vetted by the Legislature in the normal budget process.

Witness Comments:

The Natural Resources Defense Council recommends that the legislature retain the flexibility to design future bonds to best meet future water-related needs.

The Bay Institute believes that future expenditures should be contingent on the completion of the management documents referenced in the bond.

The East Bay Municipal Utilities District raises concerns about providing broad latitude to DWR to determine which projects are funded.

III. Fiscal Issues

As with any bond proposal, substantial fiscal issues arise. The Legislative Analyst's Office and others have identified the issues discussed below, as well as other issues discussed in their paper analyzing the Governor's bond proposal related to flood and water infrastructure.

A. Bond Funds for Non-Capital Assets

Background. Section 16727 of the Government Code requires the expenditure of general obligation bond proceeds be for the construction or acquisition of capital assets. Capital assets are defined by the law as tangible physical property with an expected useful life of 15 years or more. However, the law also allows up to 10 percent of the bond proceeds to be used to fund capital assets with an expected useful life of only 10 to 15 years. Furthermore, the law explicitly allows for the purchase of equipment and the funding of activities directly related to construction or acquisition of capital assets, including planning, the preparation of environmental impact reports, and mitigation expenses. This section of law limits the types of expenditures that can be supported from the proceeds of general obligation bonds.

In the past, some bond funds have paid for limited non-capital assets, by explicitly exempting the bond from application of Section 16727. A blanket exemption to this law was made in Proposition 13 (Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Fund, 2000). Bond funds have been expended for non-capital assets when the bond explicitly provides for what activities the bond funds can support. For example, bond funds were explicitly allowed for groundwater monitoring activities in Proposition 50.

The critical policy issue here is when should the State pay for continuing agency operations with borrowed money. Traditionally, bond funding supports capital projects, so future taxpayers who enjoy the benefits of those projects pay for their creation. The same logic does not apply to current State agency operations that do not benefit future generations.

LAO Comments: *Using Bond Funds for Noncapital Purposes.* As noted in the figure on page 2, a large portion of the funding under the two bond acts is allocated in provisions that are stated to be “notwithstanding Government Code section 16727.” This Government Code section essentially provides that general obligation bonds are to be used for capital purposes. In some cases it is clear why the “notwithstanding” provision is needed—such as to allow bond funds to be used for floodplain mapping. However, the notwithstanding provision applies to the whole water management component of the two bond acts, totaling \$6.5 billion. It is unclear why the notwithstanding provision is made to apply so broadly; this opens the door to expensive debt financing of noncapital expenditures if controls are not put in place to limit this practice.

Governor’s Bond. The Governor’s water bond exempts \$6.6 billion of the total \$9 billion in bonds proposed from Government Code Section 16727. This means that a vast majority of the bond funds could be expended on various non-capital projects.

Committee Questions:

1. What is the Administration’s rationale for exempting the entire water management bond fund from the restrictions under Government Code Section 16727?

2. What non-capital activities is the Administration proposing for the water management bond funds?

Administration Comments:

The Administration proposed removing the language exempting bond-funded activities from Government Code Section 16727. Some water management strategies eligible for funding may include non-capital funds. Examples include water conservation, watershed management, and environmental restoration programs, and the development of integrated regional water management plans.

B. Eligibility of Private Entities for Bond Funding

Background: Statewide, drinking water is generally supplied through three types of water systems: 1) public agencies (such as local water districts); 2) private, not-for-profit mutual water companies (entities whose shareholders are the landowners served by the water system); and: 3) private, for-profit corporations. Private water companies provided water to approximately 23 percent of the state's population. Private, not-for-profit mutual water companies set their own rates and private, for profit water corporations are regulated by the California Public Utilities Commission (CPUC). The Department of Health Services regulates drinking water quality for all publicly and privately owned water systems with 15 or more service connections.

Past resources bond measures restricted the allocation of grants and loans to public agencies and non-profit organizations. However, Proposition 50 was silent on the subject and private water companies have been allowed to receive loans and grants from Proposition 50 bond funds.

The State Constitution precludes the Legislature from making a gift of public funds to a private person or corporate entity (Section 6 of Article XVI of the California Constitution). However, according to Legislative Counsel, the allocation of public funds to private entities would not result in an unlawful gift of public funds as long as the funds are expended for a public purpose.

LAO Comment: *Eligibility of Private Entities for Funding.* The two bonds acts and the California Water Resources Investment Act all provide that entities eligible to apply for water management grant funding include investor-owned utilities and incorporated mutual water companies. While this raises tax issues and legal issues (the latter related to the constitutional provision that precludes the Legislature from making a gift of public funds to a private person or corporate entity), the major issue for legislative consideration is a policy one.

Governor's Bond. The Governor's water bond and the California Water Resources Investment Act all provide that entities eligible to apply for water management grant funding include private not-for profit mutual water companies and private for profit corporations. The bond also includes language to address the issue of gifting public funds to private companies by restricting the funds made available by the bond of the California Water Resources Investment Act for the benefit of the ratepayers and not the investors. This would be regulated by the CPUC.

Committee Questions:

1. Would capital assets procured by private companies with public funds be considered private or public property?
2. Does the CPUC have an adequate regulatory system in place to ensure that public money is only benefiting ratepayers and not investors?

Administration Comments:

Precedent for state bond funded loans to investor-owned utilities was set with the Safe Drinking Water Bond Law of 1976. The California Public Utilities Commission (CPUC) has developed a rate-setting procedure for authorizing a rate increase to repay these loans, and excludes the value of the improvements from the owner's equity and general rate base. The CPUC must also provide comments to DWR on the utility's ability to finance the project from other sources and to repay the proposed loan. The CPUC has continued with this role through other bonds and the Safe Drinking Water State Revolving Fund Program. The CPUC is currently in a rulemaking process to establish rules for the receipt and use of state funds received by all classes of regulated utilities. This rulemaking will cover the current bond proposals.

Witness Comments:

The California Water Association requests that investor-owned utilities be eligible for bond funds.

The Natural Resources Defense Council recommends adding a requirement that fees collected by investor-backed utilities lead to public benefits.

C. Creation/Use of Sub-accounts

Background: The creation of “accounts” and “subaccounts” for each program specific allocation in a bond began with Proposition 204, a water bond approved by voters in 1996. That bond act created one fund, five accounts, and 17 subaccounts. This pattern continued with Proposition 13, another water bond approved by the electorate in March 2000. That bond act created two funds, six accounts and 26 subaccounts. These past water bonds have created 11 new accounts and 43 subaccounts, just for water bond funding. It should be noted that the general practice, particularly with the parks and natural resources bonds, is to create a single bond fund (per bond) from which all allocations are made. Nor did Proposition 50, an initiative water bond approved in 2002, include such accounts.

Creating such numerous accounts and subaccounts produces benefits and costs. On the one hand, creating an account and/or a subaccount for each bond allocation may allow for easier tracking and accounting of appropriations and expenditures. . These accounts and subaccounts also may prevent a recipient department from over expending its allocation.

On the other hand, such a structure makes for a more costly administration of the bond—particularly from a State budgeting and accounting perspective. For the previous water bond acts, each subaccount and in many cases each account is treated for budget and accounting purposes as a single, stand alone fund. Thus, it is treated like another other state special fund—its own fund code, its own line item, etc. One bond recipient department estimates its costs to be up to \$100,000 per special fund annually to administer and manage the fund pursuant to standard budget and accounting practices.

The swelling of such accounts also makes it difficult for the public (or even legislative staff) to determine the financial status of so many accounts. In the past, in order to create a less voluminous budget and hold down printing costs, the Administration chose to no longer reflect bond fund conditions in any specificity. One option to ensure transparency when reporting on bond expenditures would be to require the Administration to provide a fund condition for each bond by allocation in the Governor’s Budget. This mandate could be included in the bond itself.

Given the advent of “E-Budget,” then the Administration should reinstate its practice of providing this critical bond information through automated reporting.

Governor’s bond proposes creation of one fund, two accounts and eight subaccounts. Thus, with the previous water bond accounts, the total would grow to 13 accounts and 51 subaccounts for water bonds alone.

Committee Question:

1. Why does this bond proposal require so many accounts and subaccounts?

Administration Comments:

Regional subaccounts are established to insure the equitable distribution of bond funds to all regions of the State, including rural areas with smaller populations.

D. Limits on Administrative Costs *(Prepared by Republican Caucus Staff)*

Background: In previous bond proposals, the department responsible for the administration of programs, depending of the statutory language governing the authorization, has been able to recover the costs of administration. This is often in addition to the authorization of the Department of Finance to recover the costs of issuing bonds. Typically, in code sections authorizing a department cost-recovery funds, a limitation of 5% of bond funds is the maximum amount dedicated to such purposes.

According to information provided by the Department of Water Resources and the CALFED Program even in code sections where no provision is made for administrative cost recovery has been made, program funding has been reduced by the administering agency for those costs. The table below shows that DWR has impounded bond funds allocated to programs at a rate anywhere from 5% to 10.4% of appropriated funds, for the purposes of state operations.

**DWR Utilization of Bond Funds
for Departmental Budgets**

DWR State Operations

W.C. Section 79045 (a)	(\$30 Million - 7%):	\$ 2,192,778
W.C. Section 79068.6	(\$70 Million - 6%):	\$ 4,250,000
W.C. Section 79055 (a)	(\$45 Million - 5%):	\$ 2,250,000
W.C. Section 79035	(\$70 Million - 5%):	\$ 3,500,000
W.C. Section 79033 (a)	(\$2.5 Million - 5%):	\$ 125,000
W.C. Section 79551	(\$70 Million - 10.4%):	\$ 7,300,000
Total:		\$ 19,617,778

The “Total” amount withheld for “State Operations” averages 6.4% of funding allocated by the referenced code sections.

LAO Comment: *Administrative Costs.* Unlike a number of previous resources bond measures, the two bond acts in the bill do not provide any parameters or caps on bond-funded administrative costs to administer the grant programs funded by the bonds.

The Governor's Bond contains no cap on the amount of funding that may be allocated to DWR, the Board of Equalization, or the California Water Commission for the purposes of administration or for state operations of any program authorized by either the 2006 or the 2010 bond acts.

Committee Question:

1. Since 5% of the proposed \$9 billion bond package could equal \$45 million per budget year, in addition to any cost recovery authorized and associated with the Water Resources Investment Fund, shouldn't there be specific language addressing the maximum amount allocated to DWR State Operations, if any?

Administration Comment:

The Administration agrees that a cap should be implemented for administration in grant programs and will work with the Legislature to develop appropriate language.

E. Water Resource Investment Fund

Governor's bond proposes the Water Resource Investment Act as part of his water bond proposal. The stated goal of this act is to address the water-related needs of a growing state by applying an integrated regional water management approach and providing a new stable source of funding to address these state and local needs. The program will be funded by a new water resources capacity charge imposed on every retail water supplier in the state, based on the actual number and types of water connections in each supplier's service area. The bill provides a schedule of the capacity charges, varying from \$0 to \$10 per connection, depending on the type of water connection. The fee would initially raise about \$380 million annually and is projected to raise \$5 billion over the next 10 years to help fund the Governor's Strategic Growth Plan.

The revenues in the investment fund are to be allocated as follows:

- 50 percent would be allocated to 11 regional investment accounts. Each regional investment account would receive a base allocation of \$35 million and then additional revenues would be allocated on a pro rata basis reflecting the amount of the capacity charge revenues collected in each region. These funds are proposed to be continuously appropriated to the regions, but are to be expended only on projects consistent with an integrated regional water management plan adopted by the Department of Water Resources. These funds can be used as the local match for the construction of surface storage.
- 50 percent would be allocated to a state investment account. Moneys in this account are to be expended upon appropriation by the Legislature based on a very broad set of priorities, including support for priority regional projects and water infrastructure of statewide significance.

Future adjustments to the fee would be controlled by the California Water Commission, also created in the Act. Every five years the Commission would make recommendation to the legislature every five years as to the appropriate level of the fee. These recommendations would then become effective within 60 days unless the Legislature takes action otherwise.

LAO Comment: *Imposing, and Structuring, the Water Resources Capacity Charge.* The decision to impose a water resources capacity charge—which the bill declares to *not* be a tax—and the choice of a particular structure for this charge, involve major policy choices. The particular structure for this charge in the bill is a fixed charge based on category of user (such as

single-family residential) that does not vary depending on the amount of water use by users within that category. While such a structure would make collection of the charge administratively easy, it would not serve to promote water conservation behavior, which is a potential policy objective in structuring a fee on water users.

1. Beneficiary Pays

The beneficiary pays principle requires that costs, to the extent possible, be paid by the beneficiaries of the program actions. The beneficiary pays principle is not new. Historically, all of the state's major water projects have been paid for with funds from the local water agencies that benefited from the water projects. For example, the state authorized the State Water Project in the 1960's and it was the responsibility of local water agencies to sign contracts with the state to guarantee full cost recovery for the water and power costs of the project. It was not until the 1980's when the state started authorizing state general obligation bonds to help pay for water-related infrastructure that state and local funding responsibilities started to be blurred.

Furthermore, the CALFED Record of Decision (ROD) stated that a fundamental philosophy of the CALFED Program is that costs should to the extent possible, be paid by the beneficiaries of the program actions. The Bay-Delta Authority issued a Finance Plan in 2004 that attempted to implement the beneficiary pays principle for some programs. However, this plan was not approved and has not been implemented to date and state funds have supported the majority of the CALFED program since 2000.

Chapter 8 of Proposition 50 (Water Security, Clean Drinking Water, Coastal and Beach Protection Act, 2002) allocated \$500 million to initiate a new Integrated Regional Water Management program. This program requires local water agencies to work together collectively to solve regional water problems. These grants only required a 10 percent funding match from the locals for construction of the projects. This program has provided incentives for regional cooperation, but has also further blurred the state and local role in funding water infrastructure improvements. A regional approach to water management is likely to improve water use efficiency in some regions, but this sort of approach is not appropriate for all parts of the state.

Committee Questions:

1. Please provide the Administration's rationale for a 50/50 split in the allocation of fee funding to locals and the State? Was this split made based on a determination of beneficiary pays?
2. What about regions of the state where regional water management does not make sense? Will these regions not receive any funding from the new fee even though they pay into the fund?

Administration Comments:

The Governor's proposal is consistent with most commonly held definitions of "beneficiaries pay." The Administration does not see the value in further attempting to define the term. The Administration proposed amending the proposal to a 70/30 split between regional and statewide funds. The Administration selected a connection fee, rather than a fee based on water use because such a fee is easier to administer, can be easily passed on to consumers, and requires urban water users to provide the majority of funding when the majority of investments are needed in urban areas.

The Administration does not foresee any regions of the state that cannot benefit from integrated regional water management. This has been evidenced by the coalitions that have formed to respond to the funding opportunities in Proposition 50.

Witness Comments:

The Natural Resources Defense Council (NRDC) recommends the creation of a fee based on water use that would apply to all water users. Delta farmers may be credited for their investments in levee stability. NRDC recommends including a "beneficiary pays" financing package. Further, NRDC recommends that the Environmental Water Account be funded through water fees on Delta water diverters.

The Municipal Water District of Orange County opposes the Water Resources Investment Fund and requests that it be removed from the legislation.

The Bay Institute recommends a volumetric fee, rather than a per-connection charge.

The Marin Municipal Water District opposes the connection fee and believes it violates beneficiary pays principles, is an inequitable and regressive tax, and would be dedicated to programs that are poorly defined.

The East Bay Municipal Utility District (EBMUD) raises numerous concerns about the proposed water use fee. EBMUD's concerns include: 1. the lack of connection between amount of water usage and fee levels; 2. the lack of definition on how fees will be spent and the role of DWR in determining future expenditures; 3. the ability of the CWC to raise fees without legislative action; 4. the subsidization of large residential customers, as well as agricultural, commercial and industrial customers by small residential customers; 5. the lack of connection between beneficiaries and suppliers of the fees; and 6. the eligibility of investor-owned utilities to receive funds from the fees.

The Los Angeles Department of Water and Power (LADWP) notes that the proposed fees would equate to an 11.4% rate increase for LADWP residential ratepayers.

The Kern County Water Agency recommends encouraging local agencies to apply for federal funds in order to maximize the federal match for water management projects, and states that many retail agencies in its area do not support a Water Resources Investment Fund that is funded by fees on rate payers. Use of the state portion of the fee may be inequitable.

The Western Municipal Water District opposes the Water Resources Investment Fund as proposed.

The City of San Diego raised numerous concerns regarding the water connection fee, including, fairness, impacts on the City's ability to raise its own fees.

The Sonoma County Water Agency recommends refining the definition of retail water suppliers, applying the fee to all water users, providing incentives for water reuse, and basing the fee on water usage.

The Regional Council of Rural Counties and California State Association of Counties raises numerous concerns about the Water Resources Investment Fund, including the: 1. Lack of cap on fee increases; 2. Ability of the California Water Commission to raise fees; 3. Lack of protection against redirection of fund revenues; 4. Definition of "applicant;" and 5. Need for funding for relocation of residences previously subject to flooding.

2. Allocation of Fee Revenues (Prepared by Republican Caucus Staff)

Background: One of the Governor’s specific proposals for the funding of ongoing water projects in California is the creation of the California Water Resources Investment Fund. Contained within the 2006 bond act language is the imposition of a Water Resources Capacity Charge to be collected by water retailers on water users in California. This proposed levy is projected by DWR to raise \$5 billion from homeowners and businesses in the state over the ten year life of the combined bond acts (2006 & 2010).

The revenue allocation formula requires all funds collected by the State Board of Equalization (BOE) to be deposited into the “General Account.” From there, the Controller’s Office **continuously appropriates** 50% of the revenues to the State Investment Account and 50% to the 11 regional accounts, on a pro-rata basis [Pro-rata is defined as the percentage of contribution to the General Account will dictate the percentage of funds placed in the affiliated regional account.]

Of the 50% placed in the State Investment Account, all BOE, DWR, and the California Water Commission expenses will be taken from this appropriation. The funds that remain are to be divided between a 35% commitment of funds to provide funding for priority regional projects (presumably 11 such projects) and projects of “statewide significance.”

For discussion purposes, the proposed distribution of the anticipated first year revenues (\$380 million) would appear to follow this model:

Total Projected Revenue: \$380 million

- a. 11 Regional Accounts = \$190 million [Divided by 11 regions, this would result in deposits to each regional account of \$17.3 million.]
- b. State Investment Account = \$190 million.
 - i. Minus 15% or \$28.5 million (5% for each allowable state agency) [*No exact figure is currently stated in the measure, so staff has used the 5% historical DWR figure for illustrative purposes.*]
 - ii. Minus 5% or \$9.5 million for the statutorily required “reserve” which would leave a balance of \$152 million. (*No exact figure is currently stated in the measure, so staff has used the 5% historical DWR figure for illustrative purposes.*)

On this hypothetical basis, \$53.2 million (the 35% mandatory allocation) would be subtracted to fund the “priority regional projects” (divided equally between the 11 regions means \$4.8 million would be available for each priority regional project). This would leave \$98.8 million for projects of “statewide significance” annually.

The current language allowing all accounts to accumulate interest earnings appears to be well thought out. Prior to the distribution of any funding from the regional investment accounts, the statutory language requires:

- DWR to establish and implement a plan to monitor and track integrated regional water management plan implementation and performance to demonstrate achievements associated with the expenditures from the investment fund;
- DWR must adopt regulations for the preparation of integrated regional water management plans and to review those regulations and the resulting plans with a wide variety of other state agencies;

- DWR must verify that integrated regional water management plans comply with *the yet to be developed regulations*;
- DWR must ensure that projects funded from a regional investment account are consistent with an integrated regional water management plan; and
- Requires DWR to establish a process to allocate funds on a competitive basis for each of the regional investment accounts – among all proposals meeting *the yet to be developed regulations*.

It should be noted that from the time Proposition 13, created the *Flood Protection Corridor Program*, in March of 2000, until DWR filed the Flood Protection Corridor Program Regulations approved by the Office of Administrative Law, more than three years had past (DWR filed the approved regulations with the Secretary of State on August 19, 2003.)

The Governor's Bond creates the California Water Resources Investment Fund (WRIF) and establishes a schedule for assessment of a water resources capacity charge that retail water suppliers in California must pay. The proposed assessment is estimated to provide \$380 million in the first year and ultimately \$5 billion over the lifespan of the two bond acts.

Committee Questions:

1. Will state agencies involved with the administrative elements of the WRIF be allowed to charge expenses and costs during the time when regulatory requirements are being developed?
2. Has DWR conducted any specific or detailed analysis involving the proportional benefit to specific retail water suppliers across the State and if not why not, given that a charge or “fee” should proportion the amount of the levy to any benefits conferred upon fee payers?
3. The programmatic definition of an “Applicant” contained in the Integrated Regional Water Management Program allows a broad range of entities, including “*A nonprofit organization qualified under Section 501(c)(3) of the United States Internal Revenue Code.*” Do these definitions ultimately mean that while retail water suppliers are the “source” of the WRIF, organizations such as the Nature Conservancy or other environmental organizations are allowed to compete for project funding authorized under the WRIF?

Administration Comments:

The Administration considers program development, including development of regulations and guidelines, to be administrative activities. The proposal creates incentives for regional planning that considers a broad variety of issues and solutions. The proposal does not prescribe specific projects to local and regional entities. Each fee payer will benefit from the regional and statewide programs. Applicants do not compete against each other. Non-profit organizations would be allowed access to funding if their proposal is included and prioritized in a regional plan, and they have the expertise to carry out the proposal and the support of participants in the region.

Witness Comments:

The Natural Resources Defense Council recommends that, prior to initiating a new fee, adequate detail should be provided regarding the expenditure of funds generated by the fee. The bond should include distinguish between public and private benefits. Eligible expenditures for new funds should include water quality improvements, ecosystem restoration, science programs, and enforcement.

The City of San Diego raises concerns about fee allocations and the regional distribution of fee revenues.

3. Tax vs. Fee

The primary purpose of a tax is to obtain general revenue for the government, while the primary purpose of a fee is to cover the reasonable costs of providing services or regulation for which the fee is charged. Taxes require approval by two-thirds of the Legislature to enact and fees require approval only of a majority of the Legislature.

The court case often cited as providing a distinction between fees and taxes is *Sinclair Paint Company v. State Board of Equalization*. This case found that a special tax excludes “any fee which does not exceed the reasonable cost of providing the service or regulatory activity for which the fee is charged and which is not levied for general revenue purposes.” The decision also finds that charges allocated to the payer that bear a reasonable relationship to the payer’s burdens or benefits conferred by improvements, are not ‘special taxes’ under article XIII A of the State Constitution. “In general, taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted.”

The *Sinclair Paint* decision also described a two-part test to distinguish a fee from a tax. This test requires the government to prove: (1) the estimated costs of the service or regulatory activity, and (2) the basis for determining the manner in which the costs are apportioned, so that charges allocated to the payer bear a reasonable relationship to the payer’s burdens or benefits from the regulatory activity.

Governor's proposal: The water resources capacity charge would be levied on retail water suppliers in the state based upon the number and types of water connection in each supplier's area. The individual water agencies would then be responsible for assessing the fee on their customers as they see fit. Fee revenue collected by state would be split evenly between regional projects and statewide projects consistent with Integrated Regional Water Management plans.

There is a question as to whether this fee establishes clear nexus between fees paid and services received, which would put into question whether the proposed fee is actually a fee or a tax. (Staff is awaiting a Legislative Counsel opinion on the issue.). This distinction is important in determining what vote requirement would be necessary to make future adjustments to the fee. The proposal currently requires a two-thirds vote of the Legislature since this is the requirement for approving general obligation bonds for the ballot.

Committee Questions:

1. As a stand-alone proposal, does the Administration believe that this constitutes a fee or a tax?
2. Historically, the *Sinclair* decision has been justified additional fees in order to mitigate damages or harm from past, present, or future activities. Is it the Administration’s position that *Sinclair* should now be used as rationale for imposition of fees to generate revenue?
3. Typically, a fee is justified by some service provided to the fee payer, along with the application of the element of proportionality relative to fee. Has the Administration undertaken an examination or analysis of the proportionality of the water connection fee, as it relates to the availability of funding for a fee payer’s regional projects?

Administration Comments:

The Administration believes that the capacity charge is a fee that is authorized by the state and not subject to Proposition 218. The fee should not be viewed narrowly as just the conferral of new benefits to the user, but also the need to address the impacts of current water use. Further, strict proportionality is not required; the interests of reasonableness and practicality allow considerable latitude in connecting the amount of the fee to the fee payer's activity. A fee based on water use is a reasonable and practical basis for a statewide fee.

Witness Comments:

The Kern County Water Agency suggests that the fee may be a tax.

The East Bay Municipal Utility District (EBMUD) believes that the fee is actually a retail water tax, and that the surcharge would be 300 times higher for single-family residential customers than agricultural customers. EBMUD is concerned that the fee could be raised and diverted into programs other than infrastructure.

4. Delegation Fee/Tax Authority to the California Water Commission

One of the fundamental checks on the Executive branch of government is the Legislative branch's power to impose fees and levy taxes. A review of state law finds that there are a limited number of cases where the Executive branch is allowed to adjust fees or taxes. In most cases the adjustment is only allowed to ensure they raise the amount of funds that has been appropriated by the Legislature.

The California Water Commission is an advisory commission that reports to the director of the Department of Water Resources. Statute requires the commission to approve the department's regulations, and hold hearings and make recommendations regarding State Water Project development. The commission has not been active in this role over the past several years. Most recently the commission has had a limited role in lobbying on behalf of the state for federal appropriations. The current commission does not have the authority to set or adjust fee or tax rates. The Governor proposed eliminating this commission as part of the California Performance Review in 2005.

Committee Questions:

1. Why does the Governor's water bond propose to delegate to the California Water Commission the responsibility to change the rates for the California Water Resources Investment Fund, unless the Legislature acts within 60 days to deny the change?
2. If the California Water Commission chooses to increase the fees associated with the WRIF and thereby requiring the Legislature to draft, debate, and pass an urgency measure in order to stop the increase within 60 days, does the Administration believe that it has effectively "inverted" the requirement for 2/3's approval of funding measures?

Administration Comments:

The Administration believes the fee proposal properly balances legislative oversight with administrative flexibility to address emergencies and provides examples of similar fee structures to show that giving the executive branch fee authority is not unprecedented. The Administration proposed capping fee increases at 5% in any fiscal year and requiring a two-thirds vote of the legislature for fee increases. The Administration also stated that it would investigate a larger range of connection charges, and adding language to clarify the definition of a water connection.

5. Overlap with Bond Programs

Background: While the two bond acts provide a total of \$3 billion for integrated regional water management grants, the California Water Resources Investment Act also provides and estimated \$2.5 billion over ten years (from water resources capacity charge revenues) for essentially the same category of projects. From the proposal, it is unclear how these different funding sources will interrelate to meet the proposed objectives of the funds. Additionally, the justification for funding integrated regional water management projects from both and the capacity charge revenues, and for funding at the magnitude of \$5.5 billion, is unclear.

LAO Comment: *Similar Programs and Projects Funded From Bonds and Water Resources Capacity Charge.* While the two bond acts provide a total of \$3 billion for integrated regional water management grants, the California Water Resources Investment Act also provides an estimated \$2.5 billion over ten years (from water resources capacity charge revenues) for essentially the same category of projects. The justification for funding integrated regional water management projects from both bonds and the capacity charge revenues, and for funding at the magnitude of \$5.5 billion, is unclear.

Committee Questions:

1. Does the administration have a plan for how expenditures from the bond and the new fee will be prioritized?
2. Is there any intention to distinguish between bond-funded projects and fee-funded projects?
3. Is the fee intended to, in any way, provide a source for repaying the bonds?

Administration Comments:

Both bond funds and fee revenues will be prioritized based on integrated regional water management plans. DWR regulations will set minimum criteria for these plans. The proposal contains similar requirements, preferences, and priorities for both the bond and fee funds. Fee revenues will not be used to repay the bonds, but will provide additional funding for regional projects and statewide activities.

<p>Proposed Statewide Water Management Bond Funding 2006: \$1 billion 2010: \$2.5 billion</p>
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IV. Statewide Water Management

The Governor's bond proposal for water management purports to address "integrated regional water management and statewide water management priorities." These *statewide* priorities, however, are not clear, considering the proposal's emphasis on *regional* management and its broad description of potential projects.

A. Connection to the Delta

Background: Since the 1950's, virtually all debate over California water policy has converged on the Delta, in one way or another. In the 1990's, the State struggled with the expanded role of the Federal Government in the Delta, due to the federal Endangered Species Act. As a result, the CALFED Bay-Delta Program addressed the water needs of regions that covered most of the state. Even recent debate regarding the Colorado River connected to the Delta, based on the effect of reduced Colorado River deliveries on Southern California demands for Delta water.

Recent water bonds have included funding for the Delta, with the last two designating funding specifically directed at the CALFED Bay-Delta Program. The importance of the Delta to statewide water management priorities has become common wisdom. The Association of California Water Agencies (ACWA), for example, identified improvement of Delta conveyance as the first priority action in its 2005 publication entitled "No Time To Waste: A Blueprint for California Water." As reflected in the Governor's recent programmatic review of the CALFED program, CALFED and the Delta still demand urgent resolution of the challenges facing the State. The four CALFED objectives – water supply reliability, ecosystem restoration, water quality and levee system integrity – have all suffered difficulty in the last year, calling for additional funding for the Delta's needs.

Governor's bond proposes funding allocations for Delta levees, but nothing specifically for any of the other three Delta objectives (*i.e.* water, ecosystem, quality). The bond's "preferences" for funding regional proposals include "attainment of one or more" of the CALFED objectives. In addition, the Statewide Water Management Program includes \$1.25 billion for surface storage proposals arising out of CALFED and an unspecified allowance for the resource stewardship and ecosystem restoration funding to go to Delta needs.

Committee Questions:

1. What assurances does this bond proposal offer to fund the needs of the Delta?
2. How will the regional water projects be linked to the Delta, particularly in reducing other regions' reliance on Delta waters?
3. How does this proposal reflect a high priority for addressing the Delta's urgent needs?

Administration Comments:

The Delta is an area of statewide water management significance. Significant funding for improvements to reduce water management conflicts in the Delta would be available from statewide funds. Regions that benefit from diversions and exports from the Delta may invest their regional funding in Delta projects that improve water supply reliability and water quality. Investments in water use efficiency may decrease demands on the Delta. A future study will guide priorities for Delta water management.

B. What Are “Statewide Water Management Priorities?”

Background: Since the SWP first started delivering water from the Delta to Southern California, there has been some tension in defining regional versus statewide interests in California water policy. The CALFED Bay-Delta Program's Record of Decision adopted a strategy based on implementing the Program's projects at the regional level. That strategy assumed the theory that, by each region improving its own self-sufficiency, demands on the Delta would decline. Therefore, the statewide interests in the Delta would be addressed by regional actions, but that statewide interest would remain an important factor in making State water policy decisions. The 2005 draft California Water Plan adopted a similar approach for addressing California's water needs, with an emphasis on integrated regional water management. It is unclear, however, whether the State's assumption that addressing each region's needs would address the statewide interest in water management has proven true. The line between the regional interest and the statewide interest has blurred.

Governor's bond proposes spending \$6.5 billion on “integrated regional water management and statewide water management priorities.” It creates a “Statewide Investment Account” to draw on the revenues from the proposed capacity charges for addressing statewide interests, including:

- payment of Board of Equalization costs for collecting the capacity charge
- State matching funds for federal drinking water funding
- "priority regional projects"
- emergency funding for remediation of groundwater contamination
- "water infrastructure of statewide significance"
- other statewide programs significant to "integrated water management"

Initiative bond includes \$65 million in funds for the following:

- a. Evaluation of climate change impacts on flood and water systems
- b. Surface storage planning and feasibility (CALFED)
- c. Flood protection improvement
- d. Integration of flood control and water supply systems

Committee Questions:

1. Why do regional projects reflect statewide interests?
2. How does funding for cleanup of groundwater basins, which landowners and local communities generally claim as a local-only resource, support statewide interests?

Administration Comments:

Because the State has a responsibility to oversee and encourage good resource management, it is in the State's broader interest to ensure that regional programs are successful in meeting their water management obligations. The funds are intended to allow a response to conditions that impact or threaten drinking water supplies, not to fully restore a groundwater basin or clean up a major plume of contamination.

Proposed Regional Water Management Funding 2006: \$1 billion 2010: \$2 billion

V. Integrated Regional Water Management

Integrated regional water management is a comparatively new concept in California water management. In the mid-1990's, Metropolitan Water District of Southern California began developing an "Integrated Resources Plan" (IRP) for its region. In the previous decade, MWD had begun developing its "Local Projects" program, which helped support its member agency projects that encouraged self-sufficiency, such as water recycling. The IRP moved MWD away from its historic model of acting only as a delivery agent for SWP and Colorado River water. It emphasized balance among the many kinds of Southern California water resources. While CALFED adopted this regional model, many regions do not enjoy a regional governance structure that would support an integrated regional water management plan similar to MWD's IRP. The Governor's bond proposal therefore breaks new ground in promoting such plans throughout California.

A. Regional Water Governance: Who?

Background: Unlike the State's reliance on Councils of Governments (COGs) for developing regional transportation plans, the State generally has not established regional water management structures. Instead, local water agencies have formed regional agencies of some sort (*i.e.* JPA, metropolitan) – when they discover common interests. ACWA includes 447 public water agencies, most of them serving individual communities, particularly those with agricultural needs. Water agencies reflect great diversity, of supply, demand, type of use (ag/urban), staffing, and size.

Some regions have made more progress on regional water management than others. These "regions" may be based on watersheds, counties, or metropolitan areas. The regional agency may have any number of authorities, ranging from mere "coordination" to operation of regional water infrastructure. What works in one region may not serve the needs of other regions. It is not unusual for conflicts to arise within a region when there is competition for limited resources (financial or hydrological). Moreover, surface water management may have no connection to groundwater management, which some regions continue to resist.

Governor's bond does not create any regional water management structures, but is intended to provide financial incentives for their creation. The proposal also is unclear in defining regions. It allocates specific funding to 11 regions: North Coast, San Francisco Bay, Central Coast, LA/Ventura, Santa Ana River, San Diego, Sacramento River, San Joaquin River, Tulare Lake, Lahontan, and Colorado River Basin. It also identifies hydrologic regions, which are not identical to the listed regions. For example, the bond specifies that the South Coast Hydrologic Region shall be split into three parts and the north and south Lahontan regions will be combined, but these regions are not necessarily consistent with the listed regions.

Committee Questions:

1. How does the bond proposal apply existing regional water management structures? Los Angeles and Ventura, for example, are in different basins and MWD, which includes parts of both counties, includes other basins.
2. How will the regions be able to submit proposals without any regional water governance?
3. Does the bond proposal anticipate that the State will create some form of regional water governance? Will COGs be used? How will the regions be defined?

4. How can "disadvantaged communities" and small water agencies afford to participate in regional water management?
5. How will DWR's regulations defining integrated regional water management plan affect the development of regional water governance?

Administration Comments:

The bond allows only one proposal per region, and requires that applicants must have submitted either an urban or agricultural water management plan. The intent of these requirements is to stimulate regional coordination and cooperation. Existing water management structures can be utilized under the terms of the proposal. Some legal or institutional arrangement will probably be needed to develop integrated regional water management plans; however, formal regional governance may not be needed. The proposal does not include a process to establish regional governance, and the Administration does not propose to require a plan on the scale of the funding regions. Smaller regions may apply for funds in competition with others in the region.

B. Development of Integrated Regional Water Management Plans: What?

Background: Few regions today have integrated regional water management plans. Southern California has made the most progress because of its long history of regional water cooperation through MWD. For many regions, water agencies only recently have begun the long dialogue about how to resolve water challenges with their neighbors. Some regions, however, have made progress toward developing regional plans, including smaller areas like Yolo County.

The State only recently has proposed development of and greater State reliance on regional plans for water management. In the last decade, the Legislature passed laws requiring urban water management plans, by individual urban water agencies. In 2000, CALFED adopted a regional strategy. In 2002, Proposition 50 included funding for regional plans, which has provided substantial incentives for water agencies to start talking to each other. DWR has issued grants for several regions in the last few years. Just last year, DWR issued a draft of the latest California Water Plan, which proposed substantial reliance on regional water plans.

LAO Comment: *Integrated Regional Water Management to Guide Funding Allocations.*

Much of the funding in the two bond acts and from the new California Water Resources Investment Fund is to be allocated on a regional basis to projects that are consistent with "integrated regional water management plans." The bill leaves it to DWR to adopt regulations to provide definition for the specific development and content of these plans, although the bill does provide some general parameters.

Governor's bond includes \$3 billion in bond funds for integrated regional water management projects. (A portion of the proposed water resource investment fund also would go toward such projects.) It requires DWR to adopt "regulations for the preparation of integrated regional water management plans," which shall include consideration of all resource management strategies in Bulletin 160-05, performance measures, an integrated, multi-benefit approach, and standards for developing regional priorities. It also requires that agencies participating in the regional proposal submit agricultural and urban water management plans. If regions seek support for groundwater storage projects, then they must adopt a groundwater management plan.

SB 153 (Chesbro) proposes \$200 million for integrated regional water management.

Initiative bond includes \$1 billion in grant funds, divided regionally in a manner similar to the Governor's proposal. Unlike the Governor's proposal, the IRWM program in the initiative is based closely on the existing Prop 50 Chapter 8 program as interpreted by the current DWR guidelines.

Committee Questions:

1. Does DWR have a model for regional water management plans (e.g. MWD's IRP) that will help shape its regulations for developing regional plans?
2. Have some regions already begun development of regional water plans? If so, did you define the regions to encompass those areas that are already working together?

Administration Comments:

DWR would start with the existing guidelines and draw on lessons learned in the development of plans in response to Proposition 50 to develop the new requirements. Some regions have begun to develop integrated regional water management plans.

The Administration stated that it would consider clarifying and defining subregions and accepting subregional plans for integrated regional water management planning and implementation.

Witness Comments:

The East Bay Municipal Utilities District raises concerns that the bond fails to provide performance standards for what integrated regional water management projects are intended to accomplish.

The Inland Empire Utilities Agency states that there are many important ongoing local water conservation, supply, and quality programs and requests that the bond utilize some of the integrated regional management funding be used to support competitive grants for water recycling, groundwater management, watershed management, desalinization, and conservation.

The Sonoma County Water Agency recommends utilizing existing guidelines for integrated regional water management planning. The agency also recommends allowing priorities for integrated water management to be determined locally.

The Regional Council of Rural Counties and California State Association of Counties raise concerns about the amount of time necessary to develop integrated regional water management plans, and the size and boundaries of proposed regions. They also cite the need for technical assistance and funding specifically for updating local General Plans.

Yolo County supports funding for IRWM programs and indicates that the county will complete its IRWM plan will be completed by December 2006.

C. Equity Issues

Adopting a regional strategy for addressing statewide interests inherently raises issues of equity, due to the diversity of economics, hydrology and water use, both among and within regions. While these issues may be inevitable, there may be ways to address such issues that eliminate or, at least, minimize any injustice.

1. Inter-Regional

Background: The diversity in water management is perhaps most obvious when considering inter-regional differences. Today, Southern California and the Bay Area are almost exclusively urban, with the last vestiges of agriculture quickly disappearing. In contrast, the Central Valley – with some significant exceptions – uses its water for agriculture. The water falls in the north and is used in the south. The robust technology economies – with higher incomes and housing prices – lie in the urban regions, while agriculture – which has suffered in recent years – lies in or adjacent to our rural communities. The ability and willingness to pay the full value of water also creates a divide between regions.

Urban regions will pay the bulk of the connection charge/fee under the Water Resources Investment Fund, but it is unclear whether they will receive the same proportion of benefits, despite the allocation of a portion of fee revenues back to the regions that paid them. The City of Los Angeles, for example, estimates that it will pay nearly \$36 million annually. The average monthly customer bill will rise by \$3 to \$29.26, an 11.4% increase. The City's representatives assert that the fee is regressive. In addition, they have questioned whether the fee revenues will support the kind of urban water use conservation that they have funded on their own for the last few decades, considering that the flat connection charge provides no incentive for conservation because the fee is not based on volume of use.

Governor's bond distinguishes between regions, making different funding allocations and raising different amounts of funds from the proposed capacity charge. Because the capacity charge is based on water connections and not volume of water used, urban water agencies will pay the lion's share of the charges but agricultural agencies will continue to use the lion's share of the State's water resources. The proposal attempts to address this apparent inequity by returning fee revenues to the regions in proportion to their fee revenue generation.

Committee Questions:

1. How will the capacity charge relate to water use?
2. How will the proposal address inter-regional inequities?
3. How were the bond funding allocations determined?

Administration Comments:

The capacity charge will not be tied to the volume of water used, but is based strictly on the number of water connections. Any proposal to base fees on the volume of water used would require the development of a complex statewide water use reporting, accounting, and verification process. The proposal allocates portions of available funds to every region of the state and utilizes the statewide program as a backstop for unmet regional needs. Funding allocations for regional accounts were based on a formula that divides 1/3 of the funds equally among the eleven regions, and 2/3 of the funds proportional to population.

Witness Comments:

The Kern County Water Agency states that the use of hydrologic basins may be inappropriate for integrated regional water management planning.

Assemblymember Lori Saldana expressed concerns about the definition of "region" in the Governor's proposal.

The East Bay Municipal Utilities District believes the regional approach is problematic because many utilities have systems that span multiple regions.

2. Environmental Justice

Background: Historically, there has been unequal enforcement of environmental, civil rights, and public laws; differential exposure of minority and low-income populations to health risks in the home, school, neighborhood, and workplace; and, faulty assumptions by government agencies and private entities in calculating and assessing risks to minority and low-income populations. In addition, discriminatory zoning and land use practices and exclusionary policies and practices have limited participation by minority and low-income residents in governmental processes.

Today, California law requires "the fair treatment of people of all races, cultures and income with respect to development, adoption and implementation of environmental laws, regulations and policies". (Government Code Section 65040.12) However, a recent Environmental Working Group report found that according to US EPA, state and local agency data that many Californians are exposed to contaminants in their drinking water above health-based limits. Among the most impacted communities are low-income communities and communities of color.

Also it should be noted that bonds are often viewed as 'a regressive tax', by many members of the environmental justice movement. They generally feel that bonds and other fee type mechanisms often place an unfair burden on low-income communities and communities of color.

The Governor's Bond provides funds for a variety of water management projects. While the language does include a definition of 'disadvantaged community', it is based only on median income level and does not take into account other factors often associated with negatively impacted communities. It also does not spell out a process that will allow citizens, including those in areas with existing environmental justice concerns, to participate in the decisions necessary to implement this bond. This poses a risk in California's quest for environmental justice.

The proposed capacity charge also may lead to inequitable outcomes. It is generally regressive because it charges the same amount, regardless of income. So, low-income homeowners with a modest house will pay the same as wealthy owners of mansions. In addition, large agricultural landowners will not pay much more, despite their more substantial water use. While the charge proposal allows water agencies to obtain a reduction in total charges by exempting customers with lifeline rates, there is no indication how many agencies have such lifeline rates. Moreover, the small, rural agencies serving low-income communities are least likely to be able to afford to determine who should have a lifeline rate.

Committee Questions:

1. How do we ensure an adequate public participation process in developing water infrastructure?
2. How will the regional water management approach assist with getting funds to the areas that need assistance most? It is often the low income areas and areas with other challenges that do not have the resources to undergo efforts to regionalize.
3. Can we ensure that this bond will not be regressive, and place the burden for repayment on the citizens of California that can least afford it?

Administration Comments:

The proposal includes minimum requirements for integrated regional water management plans and contains several mechanisms to promote the participation of disadvantaged communities. The proposal provides a preference for proposals that address water supply and quality needs for disadvantaged communities, and contains provisions to reduce the cost share requirement for projects proposed for disadvantaged communities. The Administration stated that it would consider redefining "disadvantaged communities." The Water Resources Investment Fund excludes fees for households on lifeline rates.

Witness Comments:

Clean Water Action recommends inclusion of a statewide life line.

The Regional Council of Rural Counties and California State Association of Counties request that the definition of "disadvantaged community" be revised.

The Environmental Justice Coalition for Water (EJCW) recommends focusing on current infrastructure needs and utilizing a broader definition of disadvantaged communities. Further, EJCW recommends that DWR solicit input from disadvantaged communities for integrated regional water management planning projects, and remove the matching fund requirement for project applicants meeting the criteria for disadvantaged communities.

3. Indian Tribes

Background: In recent years, attention to the water resource needs of California Indian tribes has increased. For historical reasons, California has more than 100 federally recognized Indian tribes. California's Native American Heritage Commission recognizes additional tribes. There is great diversity among the tribes as to interest and concern about water issues, with some tribes enjoying a direct connection (either physically or culturally) to California's water resources.

In the CALFED Record of Decision, the Federal Government – and the State – made a commitment to assess CALFED impacts on tribal government rights and concerns. They also committed to consult with affected federally recognized tribes on a "government-to-government" basis. The most controversial tribal water issue relates to the expansion of the Federal Government's Lake Shasta, and its effect on the Winnemem Wintu tribe, which the Federal Government does not recognize. To the extent that the State funds construction or improvement of additional water infrastructure, there may be a need to address the effects on California's Indian heritage.

Governor's bond does not address how water infrastructure will affect Indian tribes.

Committee Question:

1. Should any water infrastructure bond include provisions that require consultation with Indian tribes identified by the Native American Heritage Commission, consistent with the provisions of SB 18 (Chapter 905, Statutes of 2004)?

Administration Comments:

The Administration would like to work with the Legislature to develop appropriate consultation procedures and requirements.

VI. Water Issues

Proposed Funding for Water Quality 2006: \$250 million 2010: \$500 million

A. Water Quality

Background: A Harris Interactive poll published in October 2005 found that Americans rank water pollution as the number one environmental concern facing the country, topping global warming, ozone depletion, and air pollution. (The Harris Poll 2005) This is a legitimate concern given numerous studies show that a majority of California is exposed to contaminants in their drinking water on a regular basis. For example, a recent report by the Environmental Working Group (EWG) found that, according to state and local water district records, 145 contaminants were found in the tap water from 1998 to 2003.

There are distinct communities and small water systems that do not have safe clean drinking water which complies with state and federal drinking water requirements. These systems need to be upgraded to remove a wide array of contaminants that pose significant health risks including arsenic, perchlorate, nitrates, nitrites, and tetrachloroethylene.

In its most recent national Water Quality Inventory, US EPA found that 45% of lakes and 39% of streams and rivers are "impaired," making them unsafe for drinking, fishing, or even swimming in some cases. (EPA 2000). Source protection, mitigation for polluted runoff from farms, and urban and sprawl areas, which collectively account for 60 percent of water pollution is woefully insufficient. By failing to keep our rivers and reservoirs clean, water utilities must have treatment capacity and capabilities to decontaminate water that is polluted with industrial chemicals, factory farm waste, sewage, pesticides, fertilizer, and sediment.

Governor's bond includes \$9 billion for a variety of water management issues, including water quality. It allocates \$750 million to water quality. The current broad language in the bills authorizes this money for these activities, but specifics are lacking.

Initiative bond contains funding for the following water quality programs:

a. Clean Water Revolving Fund	\$50 million
b. Groundwater pollution prevention	\$60 million
c. Delta water quality projects	\$130 million
d. Agricultural wastewater cleanup	\$15 million
e. Stormwater pollution prevention	\$90 million
f. Clean Beaches program	\$90 million

In addition, the initiative bond includes a total of \$240 million for safe drinking water projects, divided as follows: \$180 million for small community drinking water system improvement grants, an additional \$10 million for emergency safe drinking water projects and \$50 million for the Safe Drinking Water Revolving Fund.

Committee Questions:

1. Are the criteria for funding projects adequate to ensure that the highest priority water quality issues are addressed?
2. How do we ensure that existing water quality issues are addressed with a portion of these funds? The focus on flood control in the bond seems to shift attention away from the serious existing water quality problems. There are numerous small low-income communities in the

state who simply cannot afford to upgrade to adequate drinking water treatment systems or who cannot afford a sewer system to treat their sewage.

3. Does the bond address the need to protect current water supplies? With so many water supplies already compromised, efforts to reestablish the quality of those supplies as well as protect additional supplies are critical.

Administration Comments:

The water management portions of the bond and fee program focus on both water supply reliability and protecting and improving water quality. The Administration stated that it would consider clarifying that wastewater treatment and stormwater management is a component of integrated regional water management planning.

Witness Comments:

Rural Communities Assistance supports the Department of Health Services assistance program and recommends an increased focus on drinking water safety.

Assemblywoman Pavley recommends placing increased emphasis on water quality, granting money to local governments to meet their Clean Water Act standards and convert septic to sewer systems, and funding stormwater runoff clean-up programs.

The California Association of Sanitation Agencies recommends that the bond include funds for wastewater infrastructure projects and including funds for the State Revolving Loan Fund. The Association recommends including the language in AB 1783 (Nunez).

The Environmental Justice Coalition for Water recommends including: \$200 million for the infrastructure rehabilitation program; \$30 million for urban water conservation; \$500 million for small community safe drinking water; \$10 million for contaminant treatment research and technology; and \$50 million for the small community wastewater grant program.

B. Water Use Efficiency: Conservation and Recycling

Background: The last two decades have seen a growing emphasis on water use efficiency, including greater use of water conservation and recycling. A 1992 federal law required Central Valley Project water agencies to adopt water conservation plans. As water has become more expensive, local water agencies have made aggressive efforts to use their limited water resources more efficiently. For many years, the SWRCB has administered a grant program that supports water recycling projects. The 2000 CALFED Record of Decision supported substantial investment in water use efficiency projects. As a result, a 2005 report noted that Southern California today uses less water overall than in 1970. ("Water for Growth," Pacific Policy Institute of California, 2005)

Governor's bond includes water conservation and recycling among the projects that may be funded through integrated regional water management programs, although there is no specific allocation for such programs.

Committee Questions

1. Does the Governor's proposal explicitly promote water use efficiency and recycling?
2. Should a particular amount of funding be allocated for conservation and recycling?
3. Why is there no funding for the SWRCB's existing water recycling program?

Administration Comments:

The proposal is based on the California Water Plan, which is based in part on water use efficiency. The statewide program includes funding to advance water conservation technologies. The Administration is considering earmarking the \$300 million for science and technology into subaccounts: \$50-100 million for desalinization; \$25-50 million for water conservation; and \$30 million for statewide groundwater monitoring. The proposal does not specifically include funds for water recycling projects, but the Administration is considering a specific earmark for water recycling.

Witness Comments:

The California Section of the WaterReuse Association recommends revisiting the recommendations of the 2002 Recycled Water Task Force to recycle 1,000,000 acre-feet of water by the year 2010. The Association notes that an existing State Water Resources Control Board program has identified 70 water recycling projects that could provide 355,000 acre-feet of recycled water for an investment of \$350 million.

Proposed Funding for Storage
 2006: \$250 million
 2010: \$1 billion

C. Water Storage

Background: Most of California’s surface water storage facilities were built by either the Federal Government or local agencies. In the last decade, Contra Costa Water District and the Metropolitan Water District have built significant reservoirs with their own resources. In contrast, the Legislature has approved only three State water storage projects:

Project	Year	Status	Costs Paid By:
Central Valley Project	1933	Built by Federal Government	Water users
State Water Project	1959	Built by State	Water users
Los Banos Grandes	1984	Approved but never built	Water users

In each case, the State has required water users to pay for these state-authorized facilities. The State, however, has provided funds for fish/wildlife/recreation enhancements – after the demonstration of the enhancements.

In the last 25 years, state and local agencies increasingly have turned to groundwater for storage. The most cost-effective surface water reservoir sites were constructed long ago. Certain groundwater basins have offered attractive alternatives in terms of cost, availability and environmental costs/benefits. The most prominent groundwater storage project is the Kern County Water Bank, operated by Kern County Water Agency. This project started as a State-sponsored element of the SWP, called the Kern Fan Project. In recent years, the State, through the CALFED Bay-Delta Program, has supported a variety of local efforts to develop groundwater storage projects. DWR estimates that these projects will produce 300-350,000 acre-feet of storage, or enough water for approximately 600,000 homes. Addressing water storage issues therefore requires broader analysis of the costs and benefits of various kinds of water storage that will best meet the needs of a growing state.

D. Surface Storage: Part II *(Prepared by Republican Caucus Staff)*

Background: The CALFED Record of Decision (ROD) has identified five potential surface storage reservoirs that are being investigated by the California Department of Water Resources, U.S. Bureau of Reclamation, and local water interests. The five surface storage investigations are:

- Shasta Lake Water Resources Investigation (SLWRI)
- North-of-the-Delta Off-stream Storage (NODOS)
- In-Delta Storage Project (IDS)
- Los Vaqueros Reservoir Expansion (LVE)
- Upper San Joaquin River Basin Storage Investigation (USJRBSI)

In DWR's Bulletin 160-05, April 2005 Draft Release, the estimated capital cost for developing the individual surface storage projects identified in the CALFED ROD could range from \$180 million for the smallest Shasta Lake Expansion, to \$2.4 billion for Sites Reservoir with the most extensive conveyance facilities; the least expensive configuration of Sites Reservoir is estimated to be about half as much as the most expensive.

According to draft release, the provision of "sufficient and stable" State and Federal funding are critical to successful completion of the feasibility and environmental studies for the five projects. The draft release also states that, "*Given the estimated funding shortfall, one or more of the studies, of lesser determined priority, may have to be delayed or even terminated unless they are provided specific financial support.*"

In the draft release, DWR, Reclamation, and CALFED estimated funding necessary to complete the five investigations at \$64.3 million. The draft release also estimated that \$29.2 million remained available from Proposition 50 bond proceeds to support surface storage investigations. Purportedly, the Federal budget for 2005 and the President's proposed budget for 2006, amount to approximately \$13.5 million, leaving an unmet need of \$21.6 million.

Figures contained in the DWR's draft release show that we would need to offset "*...an additional 3.6 million acre-feet of urban and environmental water demand per year with a combination of management strategies to reduce demand, improve system efficiency, and redistribute and augment supplies.*" It is significant that the draft release calls for "management strategies" that don't include the creation of new sources of supply as an integral part of planning for the anticipated population growth facing California.

Members should also have an historic framework to understand the current discussions involving the issue of surface storage. During the negotiations surrounding the content of Proposition 204 in 1996, funding for surface storage was integral to those discussions and it ultimately was offered that funds for those types of projects were to be added to the "next bond package."

Since that time, four additional bonds totaling more than \$10 billion have been placed before voters for a wide range of water related purposes. None have included funding for construction of surface storage projects. Notably, the five bond packages have included more than \$3.5 billion (approximately 30% of bond funding), dedicated to water supply, water pollution, water conservation, and water reclamation/recycling programs. At the same time, surface storage "studies" have received \$50 million (approximately 1/2 of 1% of bond funding).

The Governor's Bond allocates \$1.25 billion for the purpose of water storage development and surface storage construction (2006 - \$250 million to support development of water storage and 2010 - \$1 billion to fund a state cost share for construction of one or more of the surface storage projects being investigated by DWR under the CALFED Bay-Delta Program.)

Committee Questions

1. If, according to the Bulletin 160-05 draft release only \$21.6 million is needed to complete surface storage investigations, why does the 2006 bond act require allocation of \$250 million?
2. The Bulletin 160-05 draft release would seem to indicate that potential costs for surface storage construction will exceed \$3 billion for at least two facilities, so will \$1 billion be sufficient to cover the “public benefit” costs of their construction?
3. Why is funding for construction placed in the 2010 bond act and not the 2006?

Administration Comments:

The proposal includes funds for design of storage facilities, not merely planning and environmental documentation. The final total costs of any surface storage facility will depend on the selected configuration. The Administration expects that \$1 billion will provide for adequate funding for the public benefit share of selected surface storage projects.

The CALFED 2000 Record of Decision commits to assessing five surface storage projects and that two of those projects, North-of-the-Delta Offstream Storage and Upper San Joaquin River Basin Storage, appear to offer the broadest array of benefits. The Governor's proposal is intended to provide a basis for establishing a public interest in the surface storage facilities under study and defining the types of public benefits that bond funding could support. The information will allow DWR to proceed with feasibility studies, cost-sharing determinations, and environmental documentation. The Administration does not intend to restrict the role of the legislature in final approval of the projects and will work with the legislature to include the appropriate mechanism.

The Administration is proposing to combine the surface storage funds, which currently include \$250 million in 2006 and \$1 billion in 2010, into the 2006 bond. Of the \$1.25 billion total for surface storage in the 2006 proposal, \$250 million would be available immediately, upon appropriation by the Legislature. The remaining \$1 billion would not be available until 2010 and would be conditioned on: 1) Completion of feasibility studies, environmental review, and permitting; 2) Finalized cost-share arrangements that define cost and benefit distributions; and 3) Review and approval by the legislature. The Legislature would retain the ability to reprogram surface storage funds in the event that proposed surface storage facilities are not approved.

The Administration will also consider allocating specified funding for groundwater storage.

Witness Comments:

The Natural Resources Defense Council recommends deleting funds for new water storage facilities until the facilities have proven to be environmentally and economically feasible.

The Kern County Water Agency recommends state involvement in surface storage, but not in groundwater storage.

Plumas County states that the surface storage provisions of the proposed bonds are problematic.

The Regional Council of Rural Counties and California State Association of Counties support the Governor's proposed change to include \$1.25 billion in surface storage funding in 2006.

Friends of the River opposes new surface storage construction, including Sites Reservoir and the site at Temperance Flat.

The Planning and Conservation League recommends separating flood management from water management into two separate bonds.

The Friant Water Users Authority states that groundwater storage is not feasible and requests funds for the Temperance Flat project. The Authority recommends maintaining the existing funds for surface storage and including an additional \$1 billion for surface storage in 2006.

The Mayor of Orange Cove requests that the Temperance Flat project be funded.

The Bay Institute recommends including solely funds for surface storage investigations.

E. Ecosystem Restoration and Multiple Benefits

Background: Prior to 1990, California's major water projects were managed primarily for water supply, with little effort or resources dedicated to related issues, such as ecosystem health or water quality. However, in the early 1990's, a significant shift took place in the management of California's water resources. That shift happened as a result of changing public needs, public awareness, court rulings and listings under the ESA of species such as the winter run Chinook salmon and the Delta smelt. This new paradigm emerged for another reason. Water managers and decision-makers recognized that programs designed to restore healthy ecosystems can indirectly reduce regulatory burdens on water projects, strengthening water supply reliability. Similar realizations regarding water quality have contributed to a movement toward balanced funding for water policy and natural resources management.

In 1992, Congress passed the Central Valley Project Improvement Act, which established ecosystem health as a co-equal objective of the federal Central Valley Project. The CVPIA dedicated a block of water to ecosystem restoration and established a federal restoration fund, funded by contributions from CVP water and power customers.

The CALFED process also reflected this new approach. The four co-equal objectives of the CALFED Program are water supply reliability, water quality, ecosystem restorations and levee system integrity. Through the CALFED Program, agencies have created separate water supply and ecosystem restoration programs, but agency coordination has increased dramatically. Water projects and fishery agencies no longer see themselves as adversaries, but rather as collaborators seeking to balance the management of water project operations, water supply projects and restoration programs to achieve multiple benefits. The Legislature codified this balanced approach in the California Bay-Delta Authority Act.

Increasingly, during this time, water bonds such as Propositions 204, 13 and 50, as well as the state budget, emphasized multiple objectives, agency coordination and balanced funding for all relevant agencies. These bonds included funding for DWR, DFG, State conservancies, State Parks, the SWRCB and DHS. Congress also adopted this balanced approach in the projects and funding authorized by the CALFED Bay-Delta Authorization Act of 2004. Both the state and federal CALFED authorizing acts include multiple objectives, separately funded water supply and ecosystem programs, agency coordination and a requirement for a balanced program.

Governor's Bond allocates \$700 million (\$200/2006; \$500/2010) for "resource stewardship and ecosystem restoration," but all to DWR. It also allows for similar projects to be funded through integrated regional water plans. It therefore appears that all these programs are designed with water supply as the primary objective. While DWR is required to consult with DFG, it is unclear whether DFG would receive funding for its duties in protecting the public trust. The proposed bonds and fees do not include funding specifically available to DFG or other agencies involved in ecosystem protection and restoration. This approach reflects a significant departure from the trend over the past 15 years toward coordinated but separate water supply and restoration programs, and balanced funding for all relevant agencies.

Initiative bond includes significantly more funds for the state's ecosystem restoration obligations related to water supply, including:

Bay-Delta NCCP	\$20 million
Coastal Salmon and Steelhead restoration	\$45 million
CalFed ERP	\$115 million
Colorado River QSA implementation	\$36 million
Lower Colorado MSCP	\$7 million
Salton Sea restoration	\$47 million
San Joaquin River	\$100 million

In addition, the initiative contains funds for other watershed and river restoration programs including Lake Tahoe, Sierra Nevada Conservancy, River Parkway Program, LA River, Santa Ana River, SF Bay, San Joaquin River Parkway, Santa Monica Bay, San Diego Bay, and others.

Committee Questions:

1. Would the current funding proposal enable DFG to achieve the ecosystem restoration milestones in the CALFED ROD?
2. Can you demonstrate how the current proposal would enable the CALFED Bay-Delta Program to remain in balance, as required by state and federal law?
3. Does the Administration propose to achieve the \$150 million per year in ecosystem restoration funding that is required by the existing Delta assurances for water users?
4. Does this proposal provide the Department of Fish and Game with the resources it needs to respond to and reverse the decline of the Delta ecosystem?
5. What is the Administration's proposal for funding the Environmental Water Account?

Administration Comments:

The Administration is considering earmarking stewardship and restoration funds for specified activities: San Joaquin River restoration, the Delta, habitat conservation planning, and the Salton Sea. Further, the Administration is considering adding a special regional purpose overlay for specified project areas, which would include funds for the Delta and upper watershed management.

A Statement of Principles supported by 18 CALFED participants sets forth \$60 million of water user contributions that will be in addition to public money set aside in the proposed bonds. The Statement of Principles will also ensure that CALFED remains balanced. The \$150 million per year was a four-year target in the CALFED Record of Decision and has already been met. DFG needs will be met by a combination of bond funds and \$4 million per year of water user funds. The Environmental Water Account (EWA) is still under development by state and federal

agencies. Until the long-term EWA is established, the Administration believes that the EWA should be funded with public monies.

Witness Comments:

Tulare Basin Wildlife Partners recommended that a specified list of Tulare Basin regional land and water conservation and planning projects be included in the bond.

The Natural Resources Defense Council (NRDC) recommends that the bond include adequate resources for environmental protection and restoration, and recommends including the \$35 million annually in new water user fees to support ecosystem restoration, as required by the CALFED Record of Decision. NRDC also recommends including adequate funds to protect and restore drinking water quality and ecosystem water quality.

The Sonoma County Water Agency recommends increased funds for natural resource protection, including: \$45 million for salmon and steelhead restoration projects undertaken by the Department of Fish and Game; \$135 million for the State Coastal Conservancy; \$108 million for the San Francisco Bay Conservancy; and \$90 million for the Ocean Protection Trust Fund.

The Sierra Fund recommends including directed funding for Sierra Nevada conservation, including an earmark of \$100 million for the Sierra Nevada Conservancy.

The California Waterfowl Association recommends inserting the provisions of SB 153 into the water bond. The Association also recommends funding Central Valley and Tulare Basin habitat projects, as well as Central Valley Project Improvement Act water for national wildlife refuges.

The California Association of Councils of Governments states that open space acquisitions and other projects should follow the regional blueprints developed by Council of Governments.

The Bay Institute believes that the proposed bond provides inadequate funding for ecosystem restoration, and recommends increasing funds for restoration, including funds for the CALFED Environmental Restoration Program.

The Friant Water Users Authority recommends including \$200 million for San Joaquin River restoration.

The Sonoma County Water Agency recommends increased funding for fisheries restoration, as well as funding for state conservancies and the Ocean Protection Trust Fund.

F. Watershed Management

Background: In the last two decades, California water policy increasingly has emphasized the importance of addressing water problems with a watershed-wide approach. A 1986 appellate court decision ruled that the SWRCB was required to consider the impact on the Delta from water users throughout the Central Valley watershed – not just the state and federal water projects. In legislation, regulation and implementation, water resource experts have relied on watershed-wide solutions to resolve the State’s most difficult water challenges – in water quality, water supply, flood management, or ecosystem health.

In 2002, Proposition 50 funded an Integrated Regional Water Management Program (IRWMP), to encourage local agencies involved in water supply, ground water management, and flood issues to prepare “integrated” plans. While “habitat protection and improvement” and other strategic broad-based needs are included on the list of water management issues to be addressed by these plans, water supply projects may dominate the IRWMP funding priorities because well-funded water agencies have the most resources to affect this integration process.

The statute and regulations adopted to implement IRWMP are silent regarding the definition of “integration.” Historically, “integration” has been narrowly interpreted by some water planners to mean simply coordinating the work of federal, state and local entities and to coordinate construction of water supply, treatment, and groundwater management projects. Some communities, however, have integrated planning for the purpose of watershed partnerships to create cooperative agreements between agencies and communities that link multiple projects to multiple benefits, including water supply, quality and habitat.

Governor’s bond includes "watershed management" among the types of projects under the resource stewardship category, which are eligible for funding as part of an integrated regional water management plan. It also includes a preference for projects that either resolve significant conflicts within a region or provide multiple benefits.

Committee Questions:

1. How can we ensure that regional water management plans improve water resource management throughout the watershed.
2. How can we better facilitate partnerships between communities and public agencies?
3. How will the regions address water management issues throughout the watershed?
4. How do the proposed preferences promote better watershed management?
5. How can we ensure full public participation in management of our watersheds?

Administration Comments:

The proposal establishes minimum requirements for integrated regional water management plans, which includes watershed management. Involving stakeholders, and providing planning tools and technical assistance will ensure that regions are comprehensive in their planning. DWR will develop regulations for integrated regional water management plans what will include requirements for public outreach and participation.

Witness Comments:

The Natural Resources Defense Council recommends establishing an integrated regional flood management plan that incorporates ecosystem restoration for the Delta, San Joaquin River, and Sacramento River watersheds. Further, NRDC recommends establishing a deadline for the completion of this plan and a requirement that bond expenditures be consistent with the plan.

The California Watershed Coalition recommends that the Resources Agency conduct a statewide watershed grants program and that the Integrated Regional Water Management Program be revised to include multi-agency objectives and watershed planning and management. The Coalition recommends that the bond include \$600 million for an Integrated Watershed Management Program to be administered by the Department of Fish and Game, Department of Water Resources, and Regional Water Quality Control Boards.

The Natural Resources Defense Council recommends allowing disadvantaged communities to submit proposals for integrated regional water management plans.

The Regional Council of Rural Counties and California State Association of Counties recommend a greater focus on watershed management within the bonds.