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Funding Public Benefits Of Water Investments

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Natural Resources and Water Committee

Hon. Fran Pavley, Chair

Overview of Presentation

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- ☑ **Public Funding Demands in the Water Area**
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The Public Purposes of Water-Related Investments

☑ ***Water-Related Activities With a Public-Purpose Component.*** Water-related activities that have a significant public-purpose component can be consolidated into the following five main categories:

- Planning and efficient management of the statewide water system.
- Broadening access to necessary water services.
- Ecosystem improvements.
- Management of water-related risks and major public emergencies.
- Water system changes that improve recreational opportunities.

☑ ***Statutory Definitions Should Guide Use of State Funds.*** We recommend that the Legislature define what activities, from its policy perspective, are appropriately supported—in full or in part—with state public funding and which are not. To ensure that private beneficiaries of a water activity pay their appropriate share of costs, the Legislature should consider providing statutory definitions of:

- The "beneficiary pays" principle.
- The "polluter pays" principle.
- Private/nonstate benefits (with specific examples).

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Public Funding Demands in the Water Area

☑ ***Current Funding Sources.*** The five broad categories of public-purpose water activities referenced earlier are currently taking place to some degree, generally using monies from the General Fund or general obligation bonds. In the water area, there is not a funding mechanism that parallels the "public goods charge" that is currently assessed on energy ratepayers.

☑ ***Unmet Funding Demands.*** The California Research Bureau has assisted us in listing a number of water-related funding demands that could potentially tap a new state public funding mechanism. Some portion of the following program areas' unmet water investment capital demands would be appropriately funded from state public funds:

- Drinking water infrastructure: $39 billion (over a period of 20 years).
- Wastewater infrastructure: $29.9 billion (over a period of 20 years).
- Flood infrastructure: $26 billion (over a period of 20 years).
- Delta ecosystem restoration: $3.6 billion, plus $46 million/year over 50 years in ongoing demands for Bay Delta Conservation Plan implementation.

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Other States' Funding Mechanisms and Previous California Proposal

☑ ***Other States' Funding Mechanisms.*** State governments across the country have employed a variety of broad-based mechanisms to pay for the public benefit portion of water-related activities. These mechanisms are generally one of three types:

- ***General Assessments Not Tied to Water Use.*** These include cases where some *portion* of the revenues from general taxes (such as property or general sales taxes), charges on specific goods or services (such as cigarette taxes), or natural resource severance charges (such as assessments on oil or mining severance) are *dedicated* to water-related projects and programs.

- ***Assessments Directly Tied to Water Use.*** These include annual charges on water-rights holders, volumetric water use charges (such as on retail water sales or groundwater withdrawals), and flat charges on water system users (such as charges on wastewater connections or water utilities).

- ***Property-Related Assessments, Indirectly Tied to Water Use.*** These include assessments on the amount of irrigated acreage or tied to property valuation.

☑ ***Previous California Proposal.*** As part of his 2006 Strategic Growth Plan Initiative, the Governor proposed the enactment of a new "water resources capacity charge" to be imposed on every retail water supplier in the state. (The Governor's proposal was introduced as AB 1839 [Laird] and SB 1166 [Aanestad].) The charge was based on the number and type of water connections in each retail supplier's service area and it varied from zero to $10 per month per connection. Of the $500 million in estimated annual revenues collected from the new charge, 50 percent were to be deposited into a state investment account, with the balance deposited into 11 regional accounts. The regional account monies were to be administered by the state (the Department of Water Resources), with project applicants for grant funding required to show consistency with an integrated regional water management plan.

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LAO-Preferred Funding Option

☑ ***Evaluative Criteria.*** We evaluated options for a new funding source using three main criteria:

- Ease of enactment and implementation.
- Breadth of assessment base and tie to water use.
- Ability to provide a stable, reliable, ongoing source of funding.

☑ ***California-Specific Challenges.*** The feasibility of the funding options evaluated were significantly impacted by two fundamental facts of water governance in California:

- There is a lack of comprehensive data on statewide water use, resulting from large amounts of water use being unregulated by the state.
- There is a diverse universe of state and local water agencies, with varying jurisdictions and administrative capabilities.

☑ ***Placing Assessment at Water Retailer Level Makes Practical Sense.*** We find that an assessment levied on water retailers and administered by the state Board of Equalization is the most feasible funding option for a public-benefit-type charge in California. It is relatively easy for water retailers to provide the data necessary to impose assessments tied to the use of water.

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LAO-Preferred Funding Option *(Continued)*

☑ ***Different Assessment Bases Required for Nonagricultural Versus Agricultural Water Uses.*** The vast majority of urban (commercial/residential) water use in the state would be captured by an assessment that is tied to the *volume of water that a retailer supplies to nonagricultural water users*. Therefore, we consider this to be the most feasible assessment base for nonagricultural users. However, agricultural water use is more difficult to assess directly because of data gaps. This reflects the fact that a significant amount of agricultural water use is supplied by groundwater resources that are "off the grid" (that is, not supplied by a water retailer). To address this issue, we recommend that agricultural water use be captured by an assessment on water retailers based on the *total area of irrigated acreage of agricultural customers of water retailers* (even though some of those customers' acreage may be irrigated using sources other than the retailer). This relatively simple assessment approach provides a reasonable proxy for measurement of agricultural water use and would serve to capture the vast majority of agricultural water use in the state.

☑ ***Setting the Level of the Assessments Raises Policy Issues.*** In addition to determining the total amount of revenues intended to be raised from the new assessments, the Legislature would need to address a number of policy issues that help guide the specific level of the two categories of assessments. These include:

- Mitigating disproportionate burdens on smaller water retailers.
- Mitigating impacts on low-income ("lifeline") customers.
- Determining the process for future adjustments to assessment levels.
- Accounting for constitutional constraints on local government water retailers' revenue-raising ability.

LAO-Preferred Funding Option *(Continued)*

- ***The Appropriation and Administration of the New State Funds.*** The Legislature would have to consider a number of important questions regarding the appropriation and administration of the new state funds, including:
  - How should assessment funding be appropriated?
  - How would budget proposals across multiple state agencies be coordinated?
  - Who should be eligible for assessment funding?
  - In what forms should the funding be provided?
  - What process should state agencies follow in allocating the assessment funding?
  - Should there be cost-sharing requirements placed on funding recipients?