

February 24, 2009

The Delta Vision and Bay Delta Conservation Plan: Financing Issues

LEGISLATIVE ANALYST'S OFFICE

Presented to:

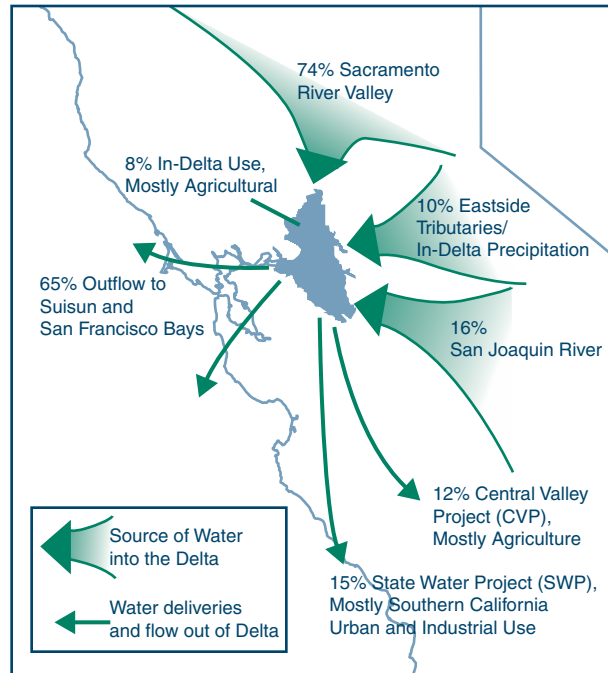
Senate Natural Resources and Water Committee

Hon. Fran Pavley, Chair





Delta Is at the Heart of The California Water System



- ☑
Water flowing through the Delta is the main source of supply for two major California water delivery projects, the State Water Project (SWP) and the federal Central Valley Project (CVP). From these projects, a majority of Californians rely on water flowing through the Delta for all or part of their drinking water. In addition, approximately one-third of the state's cropland uses water flowing through the Delta.



Funding Water Infrastructure— Choice of Financing Mechanism



Choice of Financing Mechanism— Two Key Issues Are:

- The basic ***financial approach*** to use.
- The ***source of funds*** to ultimately pay for the acquisition or use of facilities, regardless of the financial approach used.



Three Financing Approaches. Generally speaking, there are three main approaches available for public agencies to finance the acquisition and/or use of capital infrastructure. These approaches include:

- ***Pay-As-You-Go.*** With this approach, infrastructure projects are paid for directly from current revenues. Typically, a portion of a local water project is financed using a pay-as-you-go financing mechanism. The state has also used a pay-as-you-go approach for capital investment in some flood control projects.
- ***Renting and Leasing.*** This can sometimes be feasible where privately owned infrastructure (such as a privately owned desalination or wastewater treatment plant) is available for public use. In these cases, the governmental entity makes rent or lease payments to the private owner of the particular infrastructure. Somewhat rare in the water world, this approach may be increasingly used by public agencies as private investment in water infrastructure increases.
- ***Bond Financing.*** By far the most common form of infrastructure financing, this approach typically involves the governmental entity borrowing money to be paid off over time to build or acquire long-lived capital facilities that generate services over many years.



Funding Water Infrastructure— Choice of Financing Mechanism *(Continued)*

- Sources of Funding.** Regarding sources of funding to ultimately pay for infrastructure, these can include both general and selective taxes, user fees, the sales of other physical assets or income streams, and a variety of other alternatives.
- “Beneficiary Pays” Funding Principle.** One approach of allocating a project’s costs among funding sources is the beneficiary pays funding principle. On a number of occasions, the Legislature and state water program administrators have stated their intent that the costs of state water programs and projects should be paid by those who benefit from them. A water program or project may benefit a clearly defined subset of the state’s population (for example, individual water users receiving deliveries from a water project), the public as a whole (for example, from fish and wildlife habitat enhancements), or reflect a combination of private and public benefits.
- Current examples of the application of the beneficiary pays principle are found in most water programs, including, for example, the financing of:

 - Flood Control Projects.
 - The SWP.
 - Water quality and water rights regulation.



Funding Water Infrastructure— Choice of Financing Mechanism *(Continued)*

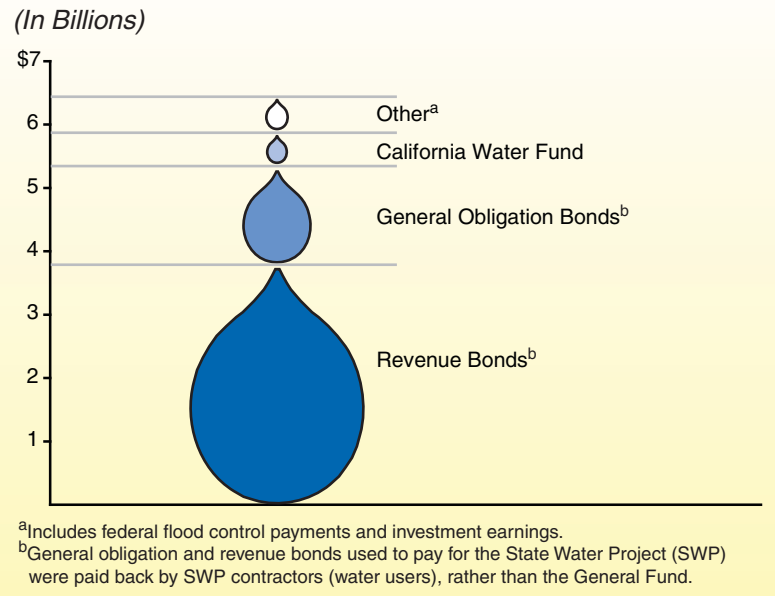
- Bonds Are the Major State Financing Approach for Water Infrastructure.*** The state has traditionally used two major types of bonds to finance water infrastructure. The key difference between the two types of bonds is the source of funds to pay back this debt.

General Fund-Supported Bonds	Revenue Bonds
<ul style="list-style-type: none"> • These are paid off from the state's General Fund, which is largely supported by tax revenues. The majority of these are General Obligation (GO) bonds. These bonds must be approved by the voters and their repayment is guaranteed by state's general taxing power. <p>In the case of the State Water Project (SWP), however, GO bonds were paid back mainly by user fees, while remaining guaranteed by the state's general taxing power.</p> <ul style="list-style-type: none"> • The second types are lease-revenue bonds, which are authorized by the Legislature. These are paid off from lease payments (primarily financed from the General Fund) made by state agencies using the facilities they finance. These bonds do not require voter approval and are not guaranteed. As a result, they have somewhat higher interest costs than GO bonds. 	<ul style="list-style-type: none"> • These also finance capital projects but are not supported by the General Fund. Rather, they are paid off from a designated revenue stream—usually generated by the projects they finance—such as water user assessments. These bonds also do not require voter approval.



Funding Water Infrastructure— A Case Study

State Water Project: Mainly Bond Financed, Paid Back by Users



- From 1952 to 2007, funding to build the SWP** totaled about \$6.4 billion, mainly from revenue bonds and General Obligation bonds.

- When the revenue and General Obligation bonds are paid off**, it is estimated that those entities who receive the water from the SWP (“contractors”) will have paid for about 96 percent of the cost of building the project. The remainder is paid by the state, to cover fish, wildlife, and recreation enhancements associated with SWP, and the federal government, primarily for flood control benefits.



Resources Bonds Status Report

Resources General Obligation Bonds, 1996 to Present					
<i>(In Millions)</i>					
Bond	Year	Total Authorization	Previous Appropriations^a	Proposed Appropriations^b	Balance (July 2010)
Proposition 204 ^c	1996	\$870	\$827	\$22	\$21
Proposition 12	2000	2,100	2,072	10	18
Proposition 13 ^c	2000	2,095	1,892	87	116
Proposition 40	2002	2,600	2,574	14	12
Proposition 50	2002	3,440	3,381	10	49
Proposition 1B ^d	2006	1,200	735	254	212
Proposition 1C ^e	2006	200	7	11	182
Proposition 1E	2006	4,090	1,514	563	2,013
Proposition 84	2006	5,388	2,949	795	1,644
Totals		\$21,983	\$15,953	\$1,764	\$4,266

^a Includes funds previously appropriated, statewide bond costs, future-year obligations, and reversions.
^b As proposed in the 2009-10 Governor's Budget.
^c \$125 million was transferred from Proposition 204 to Proposition 13 accounts.
^d Primarily a transportation bond, this includes sections that have funds for air quality.
^e Primarily a housing bond, this includes funds dedicated for housing-related parks.

Resources General Obligation Bonds, 1996 to Present^a by Program Area				
<i>(In Millions)</i>				
	Allocation	Previous Appropriations^b	Proposed Appropriations^c	Balance (July 2010)
Parks and recreation				
State parks	\$1,094	\$913	\$71	\$110
Local parks	2,412	1,838	206	369
Historic and cultural resources	240	236	1	3
Nature education	100	6	94	—
Subtotals	(\$3,846)	(\$2,993)	(\$371)	(\$481)
Water quality	\$3,647	\$2,582	\$138	\$927
Water management	6,843	4,063	638	2,142
Conservation, restoration, and land acquisition	4,711	3,972	312	427
CalFed/Delta related	1,686	1,557	52	77
Air quality	1,250	784	254	212
Totals	\$21,983	\$15,953	\$1,764	\$4,266

^a Includes Propositions 204, 12, 13, 40, 50, 1B, 1C, 1E, and 84.
^b Includes funds previously appropriated, statewide bond costs, future-year obligations, and reversions.
^c As proposed in the 2009-10 Governor's Budget.



Issues for Legislative Consideration



In the following pages, we discuss a number of issues for the Legislature to consider regarding the financing of Delta-related programs and projects. These include:

- Beneficiary pays application requires legislative definition.
- Evaluation of CALFED Bay-Delta Program's 2009-10 budget proposals should be based on clear criteria.
- Problems abound with the "off-budget" status of SWP.
- Gaps in cost-benefit and economic analyses exist in administration's approach to addressing the Delta conveyance issue.



Applying the Beneficiary Pays Principle to Delta Financing Issues

- No Legislative Definition of Beneficiary Pays Principle.*** While the Legislature on a number of occasions has stated its intent to apply the beneficiary pays funding principle in the context of financing the CALFED program, it has not provided a statutory definition that delineates the public versus private beneficiaries of program activities so as to guide the role of public funding of Delta-related investments.
- CALFED Program Has Struggled to Develop a Long-Term Financing Plan.*** Continuous debate among CALFED program stakeholders regarding the allocation of the program's costs to program beneficiaries has resulted in the lack of a long-term financing plan for the program and very likely an over-allocation of the program's costs to state public funds.
- Recommend Statutory Guidance on Beneficiary Pays Application for Financing CALFED/Delta Vision Investments.*** Statutory guidance as to what state public funds will and will not pay for would helpfully guide the development of the Bay Delta Conservation Plan and provide a basis for cost-sharing agreements for Delta capital projects that will allow the state to move forward in solving Delta problems. For example, statute could specify that for ecosystem restoration activities, a private benefit—to be funded with non-state funds—occurs when the activity is required as mitigation under existing regulatory requirements. A public benefit—to be paid for with state public funds—occurs when habitat is enhanced beyond required mitigation. Legislation to guide the application of the beneficiary pays principle in CALFED financing was introduced previously in the 2005 session—SB 113 (Machado).



Evaluating CALFED 2009-10 Budget Proposals

- Budget Reflects \$157 Million of New CALFED Spending Proposals.*** Of the \$315 million of state-funded CALFED expenditures proposed for 2009-10, \$157 million reflects new spending for which budget change proposals have been submitted for legislative review.
- Approach for Evaluating CALFED Budget Proposals.*** We recommend that the Legislature evaluate CALFED budget proposals based on a number of criteria, including clear objectives, established funding priorities, and use of the beneficiary pays funding principle. Specifically, we recommend that budget proposals:

 - Not prejudice or bias the outcome of various ongoing Delta-related planning efforts, including the Delta Vision, Bay Delta Conservation Plan (BDCP), and Delta Risk Management Strategy processes.
 - Be focused so as to provide timely information that serves to inform various Delta-related planning efforts.
 - Tie to clear objectives and established funding priorities for the program.
 - Reflect the application of the beneficiary pays funding principle, as adopted in the long-term plan for the CALFED program and by the Delta Vision Blue Ribbon Task Force.
 - Minimize growth of the CALFED program until the Legislature's policy for the Delta is established, redirecting funding from lower- to higher-priority activities as necessary to minimize expenditure growth.
 - Reserve General Fund expenditures only for those activities, such as program oversight, for which an alternative eligible funding source is not available.



Budget Status of SWP

The SWP's Off-Budget Status Problematic. Currently, SWP—budgeted at about \$1.2 billion for 2009-10—is off budget, meaning that the funds to support SWP operations and capital outlay are not appropriated in the annual budget bill. This budget status has substantially constrained the Legislature's oversight role and has been problematic for several reasons:

- The Legislature does not have information to fully evaluate SWP's requests for position authority that must be approved by the Legislature. (The 2009-10 Governor's budget requested 195 new SWP positions, on top of the current-year total of 1,509 positions.)
- The SWP's budget development process lacks checks and balances to ensure accountability, triggering increasing billing protests from SWP water contractors that fund SWP.
- The SWP's operations have created significant liabilities for other programs and funding sources, including the General Fund, without any legislative oversight.
- Although SWP contributes both to the causes of, and the potential solutions to, water-related problems in the Delta, the SWP's off-budget status results in the Legislature being unable to evaluate the entire water system and address the state's water policy issues in a comprehensive way. For example, the Department of Water Resources, in its implementation of the Davis-Dolwig Act, has allocated substantial SWP recreation-related costs to the General Fund, outside of the budget process and without any legislative review or approval.

We Recommend That SWP Be Brought "On Budget" to Enhance Legislative Oversight.



Addressing the Conveyance Issue Through The BDCP Process

- ☑ ***Conveyance Through the Delta Must Be Addressed—and Soon.*** The Delta Vision and various other Delta-related state planning efforts have found that an alternative to the current business-as-usual conveyance approach—in which water is conveyed solely through the Delta—must be selected if the state’s environmental and economic objectives for the Delta are to be met. We have recommended previously that the Legislature enact legislation establishing its policy for the Delta, with the choice of a Delta conveyance alternative being a key component of such policy.

- ☑ ***Administration is Proceeding on the Conveyance Issue Through the BDCP Process.*** In addition to the alternative of ending water exports from the Delta to the south altogether, there are two basic alternatives to the current through-Delta conveyance system that have been evaluated—(1) an isolated peripheral facility such as a canal or pipeline isolated from the Delta and (2) combining through-Delta conveyance with an isolated peripheral facility (“dual conveyance”). The Delta Vision Blue Ribbon Task Force and the Delta Vision (Cabinet) Committee recommend the dual-conveyance approach. The administration is proceeding with BDCP—a conservation planning and environmental permitting process authorized under state and federal endangered species law—as its framework for evaluating various alternative conveyance approaches. The BDCP is proceeding on the basis that dual conveyance is the preferred alternative.



Addressing the Conveyance Issue Through the BDCP Process *(Continued)*



The BDCP Analysis Too Narrowly Focused to Fully Inform Legislature on Conveyance Issue; Broader, More Comprehensive Cost-Benefit and Economic Analyses Required.

Since the BDCP process is essentially a regulatory process intended to result in permit issuance for SWP operations, its focus is not as broad as one that considers and balances issues from a statewide perspective. As such, the process does not appear to be giving adequate consideration to the economic impact of the chosen conveyance solution on third parties (such as Delta farmers) or to the fiscal impact of the various alternatives on state finances. To address the broader information requirements of the Legislature, we recommend that the Delta Vision Committee report to the Legislature with a more comprehensive analysis of the costs, benefits, risks, and inherent policy tradeoffs in connection with each conveyance alternative being evaluated by the administration.