

Funding Principles for Building a Water Bond

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Senate Governance and Finance Committee
Hon. Lois Wolk, Chair
and
Senate Natural Resources and Water Committee
Hon. Fran Pavely, Chair





Legislative Considerations for Funding Water Activities

- Define the Scope of Activities That Receive State Funding**
- Reduce Demand for State Funding**
- Identify State Funding Sources and Mechanisms**



Define the Scope of Water Activities That Receive State Funding

- State Funds Used for Certain Activities.*** Historically, the state has used public funds for water-related activities, including:
 - Providing services that would not otherwise be provided privately (for example, due to market failures).
 - Subsidizing activities to address ability-to-pay issues.
 - Administering a program at the state level because of economies of scale or other efficiencies available to the state.
 - Water-related activities with a significant public purpose such as planning and management of the statewide water system, broadening access to necessary water services, ecosystem improvements, management of water-related risks and major public emergencies, and water system changes that improve recreational opportunities.

- Use State Funds for Activities That Provide State-Level Benefits.*** Any program or project may have both public benefits and private, or nonstate, benefits. We recommend that state funds be used to fund the portion of water-related activities that have a state-level public benefit, while considering what levels of government, such as local government, are best suited to provide other public benefits.



Reduce the Demand for State Funding

- ☑ ***Reduce the Demand for Water Infrastructure.*** The Legislature could reduce demand for water infrastructure by enacting policies that increase utilization of existing infrastructure, encourage less costly alternatives, or improve efficiency. Examples in water policy could include:
 - Adjusting how reservoirs are operated in order to meet different priorities.
 - Encouraging the efficient use of water with rate structures or state-level targets.
 - Restricting development in floodplains.

- ☑ ***Ensure That Beneficiaries and Polluters Pay.*** Defining the “beneficiary pays” and “polluter pays” principles in statute could help to ensure that private beneficiaries of a water activity pay their appropriate share of costs and that new funding streams are available to fund only the state public-benefit component of an activity.



Identify Funding Sources for Water-Related Activities

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A Portfolio of Funding Mechanisms and Sources. Once the Legislature has considered the scope of state support for water-related activities and considered reducing demand for state funding, it will need to decide on a mix of state funding mechanisms and funding sources. These include bond funds versus pay-as-you-go and special funds versus general purpose funds. No single source will meet all state needs, so the Legislature should consider what mechanism and source is best suited to each particular activity. The figure below shows examples of the range of possibilities based on current uses of these funds.

Funding Mechanisms and Sources for Water-Related Activities		
	General Purpose Funds	Special Funds
Bond/Debt	General Obligation Bond Delta Habitat Enhancement	Revenue Bond State Water Project Financing
Pay-as-You-Go	General Fund Flood Relief	Regulatory Fee Water Quality Regulation

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Spectrum of Funding Mechanisms and Sources. While presented as discrete choices, funding mechanisms and sources fall along a spectrum based on considerations listed below, such as how closely the charge ties to the benefits derived or the perceived difficulty of identifying beneficiaries.



Funding Mechanism: Bond Versus Pay-as-You-Go

- Uses of Bond Funding.*** Bond funds are best used for large, discrete capital projects that would ordinarily not be able to be supported by ongoing funding mechanisms and that meet a need over several decades. For instance, construction of the State Water Project has been funded by bonds repaid with revenues from the contractors that receive water from the project.

- Uses of Pay-as-You-Go Funding.*** Pay-as-you-go funding is best suited for ongoing costs that are likely to occur repeatedly over many years. These costs could include programs that perform ongoing monitoring or maintenance, as well as programs that involve construction of numerous small-scale capital projects year after year. For example, in the past some Delta levee repair and replacement programs have been funded by pay-as-you-go mechanisms.



Funding Source: Special Funds Versus General Purpose Funds

- Uses of Special Funds.*** Special funds are best used where there are clear beneficiaries or polluters and where there is a clear nexus between the payers and the project or program, as in the case of regulatory programs or infrastructure that benefits a well-delineated group of people. For example, the State Water Resources Control Board levies a fee on dischargers that funds their water quality regulation programs, and special districts at the local level charge water users for the cost of operating their water systems.

- Uses of General Purpose Funds.*** General purpose funds are best suited to programs or projects that are not reasonably attributed to a specific set of polluters or beneficiaries. This may occur because of administrative or technical challenges to identifying polluters or beneficiaries. General purpose funds could also be used where there is a current overriding public interest in making exceptions to the beneficiary or polluter pays principles. For example, aid to flooded areas has been provided from the General Fund.



Steps to Designing a Water Bond

- Determine Relative Priority of Water Infrastructure.*** Generally speaking, balancing the size and content of a water bond against other uses of state funds is important.
- Define Eligible Uses.*** We recommend that the Legislature specifically consider what water-related activities are best funded by bonds repaid from state general purpose revenues, keeping in mind that there are other funding mechanisms and sources that could be used, as well as ways to reduce demands for state funds.
- Provide Legislative Flexibility.*** Targeting general purposes in the bond rather than small allocations to individual agencies and narrowly defined projects or purposes would allow the Legislature more flexibility to direct funding to its priorities. Making bond funds available upon appropriation by the Legislature also ensures that the Legislature can direct funding to its priorities.
- Consider Alternative Repayment Sources.*** The debt-service costs of the bond are expected to be repaid by the General Fund, but the Legislature should consider alternatives such as beneficiary or polluter pays.