December 7, 2015

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 15-0088, Amendment No. 1) that would authorize $4.9 billion in general obligation bonds for water programs and projects.

BACKGROUND

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

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

In order to address these challenges, California has built various water-related projects. Some projects use natural rivers—as well as pipelines, pumping stations, and canals—to deliver water throughout the state. These projects also include dams and other types of water storage to hold

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

Roles of Various Governments in Water System. The state, federal, and local governments play important roles in providing clean and reliable water supplies. Most spending on water programs in the state is done at the local level, such as by water districts, cities, and counties. In recent years, local governments have spent approximately $26 billion per year to supply water and to treat wastewater. About 80 percent of this spending is paid for by individuals as ratepayers of water and sewer bills. In addition, local governments pay for projects using other sources, including state funds, federal funds, and local taxes. While most people get their water from these public water agencies, about one-sixth of Californians get their water from private water companies.

The state runs programs to (1) conserve, store, and transport water around the state; (2) protect water quality; (3) provide flood control; and (4) protect fish and wildlife habitat. The state provides support for these programs through direct spending, as well as grants and loans to local governments, nonprofit organizations, and privately-owned water companies. (The federal government runs similar programs.) Funding for these state programs usually comes from bonds and fees.

PROPOSAL

This measure provides $4.9 billion in general obligation bonds for various water-related programs and projects. The state repays these bonds, with interest, using the state's General Fund. (The General Fund is the state's main operating account, which pays for education, prisons, health care, and other services.)

Uses of Funds

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

Watershed Improvement for Water Supply and Water Quality Enhancement ($1.9 Billion). The measure provides funding to protect, restore, and improve the health of watersheds. For a project to be eligible for this funding, the project generally must have water supply or quality benefits, or ecosystem benefits relating to rivers, streams, forests, meadows, wetlands, or other water-related resources. Specifically, the measure allocates funds for:

- ***Protection and Restoration of Watersheds on Conservancies ($765 Million).*** The measure includes $765 million to protect, conserve, and restore natural resources in areas overseen by state conservancies.

Figure 1

Uses of Bond Funds

(In Millions)

	Amount
Watershed improvement for water supply and water quality enhancement	$1,885
Water recycling and desalination	800
Capture and use of urban runoff and stormwater	600
Flood management for improved water supply	400
Water for wildlife	350
Water conservation through turf removal and water system leak reduction	300
Groundwater sustainability and storage	230
Safe drinking water	200
Land and water management for water supply improvement	100
California Conservation Corps for water-related projects	30
Water measurement	25
Total	**$4,920**

- ***River Parkways ($340 Million).*** The measure includes $340 million for projects to restore, protect, and develop river parkways pursuant to the California Rivers Parkways Act of 2004.
- ***Protection and Restoration of Watersheds, Woodlands, and Wildlife Habitat ($240 Million).*** The measure provides the state's Wildlife Conservation Board with $240 million for the protection, acquisition, and restoration of the watersheds of certain rivers, oak woodlands, rangelands, and fish and wildlife habitat.
- ***Protection and Restoration of Watersheds Within State Parks ($150 Million).*** The measure provides $150 million for the restoration of watersheds within state parks, as well as to improve the water supply and wastewater treatment systems in state parks.
- ***Coastal Protection and Restoration ($100 Million).*** The measure provides $100 million for projects to reduce the amount of pollutants that flow to beaches, bays, and coastal estuaries. This amount also includes funding to protect coastal and near-shore ocean resources from the impacts of rising sea levels, storm surges, ocean acidification, and related hazards.
- ***Protection and Restoration of the Sacramento and San Joaquin River Watersheds ($90 Million).*** The measure includes $90 million for the protection and restoration of the watersheds of the Sacramento River, San Joaquin River, and the Sacramento-San Joaquin Delta. This amount also includes funds for the American River Parkway Plan.

- ***Watershed Restoration on Agricultural and Forest Lands ($60 Million).*** The measure provides the Department of Conservation with $60 million for watershed restoration on agricultural lands, rangelands, and forested lands.
- ***Quantification Settlement Agreement ($50 Million).*** The measure provides $50 million for projects—including restoration activities at the Salton Sea—related to the implementation of a 2003 agreement among several public agencies regarding the use of Colorado River water.
- ***Urban Streams Restoration ($50 Million).*** The measure provides $50 million for the Urban Streams Restoration Program, which provides grants for projects such as stream cleanups, riverbank stabilization, and flood protection activities.
- ***Urban Forestry Projects ($20 Million).*** This measure provides $20 million for urban forestry projects that improve water quality or water supplies.
- ***Delta Wastewater Treatment Projects ($15 Million).*** The measure provides $15 million to the Delta Protection Council for wastewater treatment projects designed to improve water quality in the Sacramento-San Joaquin Delta.
- ***Delta Science Program ($5 Million).*** The measure provides $5 million for the Delta Science Program that was established to develop scientific information on issues critical for managing the Delta system.

Water Recycling and Desalination ($800 Million). The measure provides $400 million for wastewater recycling projects and $400 million for projects that remove salt from groundwater and other water supplies. Allowable projects include water treatment, storage, distribution, and multi-benefit projects.

Capture and Use of Urban Runoff and Stormwater ($600 Million). The measure provides $600 million for multi-benefit projects identified and prioritized in Stormwater Resource Plans, which are developed by public agencies to prioritize potential stormwater and dry weather runoff capture projects.

Flood Management for Improved Water Supply ($400 Million). The measure provides funding in three flood-management related areas: (1) $200 million for flood management, wetlands restoration, and other projects in the San Francisco Bay Area; (2) $100 million to improve existing floodways, bypasses, and other flood control facilities in the Central Valley; and (3) $100 million to repair or reoperate reservoirs to increase water storage and provide recreational and habitat benefits.

Water for Wildlife ($350 Million). The measure provides: (1) $100 million to acquire water from willing sellers to improve conditions for fish and wildlife; (2) $100 million to support coastal and Central Valley salmon and steelhead fisheries restoration projects; (3) $100 million to support migratory bird habitat acquisition and restoration projects; and (4) $50 million to improve water supply and water quality conditions for fish and wildlife on private lands.

Water Conservation Through Turf Removal and Water System Leak Reduction ($300 Million). The measure provides $300 million for two programs: (1) a turf removal rebate

program to encourage public and private property owners to convert to drought tolerant landscaping, and (2) a leak reduction program for water agencies to reduce leaks in their water distribution systems and their customers' water systems.

Groundwater Sustainability and Storage ($230 Million). The measure provides $180 million for projects and programs that support sustainable groundwater management and $50 million for local agencies to develop groundwater sustainability plans.

Safe Drinking Water ($200 Million). The measure provides $200 million for projects to improve water quality for disadvantaged communities and provide them with clean, safe, affordable, and reliable drinking water.

Land and Water Management for Water Supply Improvement ($100 Million). The measure provides $100 million to improve the quality of rangelands, wildlands, wetlands, and other areas for the purposes of increasing groundwater recharge and water supply from those lands, as well as improving water quality for the environment.

California Conservation Corps—Water-Related Projects ($30 Million). The measure provides $30 million to the California Conservation Corps for projects to protect and restore watershed lands and improve water quality, water supply reliability, and watershed health.

Water Measurement ($25 Million). The measure provides $25 million for (1) the purchase and installation of water measuring equipment to better measure streamflow and water diversions, and (2) the acquisition of information systems, technologies, and data to improve water management.

Other Provisions

State Oversight and Administrative Costs. The measure continuously appropriates the funds from bond sales to more than a dozen different state government entities such as departments, agencies, boards, and conservancies. Up to 5 percent of the bond funds could be used to pay for administrative costs incurred by these entities to implement the measure. These entities, in turn, would pass through most of the funds authorized under the measure to local government agencies in the form of grants. In addition to making grants to local government agencies, state government entities would spend some of the funds on projects and programs administered at the state level.

Local Matching Fund Requirements. The measure generally requires local government agencies to provide at least one dollar in local government funds for each dollar of grant funding received (known as a matching requirement). However, the measure largely allows the matching requirement to be reduced or eliminated in certain cases, such as for grants that benefit economically distressed areas.

Maintain Annual Transfer of Funds to the Habitat Conservation Fund. Under current law, the State Controller annually transfers 10 percent of the funds (about $6.2 million) from a certain subaccount within the Cigarette and Tobacco Products Surtax Fund to the Habitat Conservation Fund. The statute authorizing this annual transfer is due to sunset on July 1, 2020. This measure eliminates the sunset and continues the transfer beyond July 1, 2020.

Direct Cap-and-Trade Revenues for Certain Water-Related Projects. The state's cap-and-trade program requires some entities, such as electricity generators, to purchase permits (referred to as "allowances") to emit greenhouse gases. As a result of the program, the Department of Water Resources (DWR) and the Metropolitan Water District (MWD) of Southern California have higher electricity costs to operate their water delivery systems. The measure continuously appropriates to the DWR and MWD a portion of state revenue generated from the sale of allowances. The amount appropriated would be equal to each agency's additional electricity costs associated with the cap-and-trade program, which could be in the low tens of millions of dollars annually for the duration of the program. This amount could be higher or lower depending on factors such as amount of energy purchased and allowance prices. The agencies would be required to spend the funds on such things as water conservation and efficiency programs.

FISCAL EFFECTS

Fiscal Effects on State Government. This measure would allow the state to borrow up to $4.9 billion by selling additional general obligation bonds to investors, who would be repaid with interest using the state's general tax revenues. The cost to the state of issuing these bonds would depend on various factors such as the interest rates in effect at the time they are sold, the timing of the bond sales, and the time period over which they are repaid. We assume that (1) the interest rate for bonds would average just over 5 percent, (2) they would be sold over the next ten years, and (3) all bonds would be issued for a 30-year term. Based on these assumptions, the cost to taxpayers to repay the bonds would average about $250 million annually over the next 40 years or $9.8 billion to pay off both principal ($4.9 billion) and interest ($4.9 billion). Annual debt service would ramp up in the initial few years, peak at about $330 million per year, and ramp down in the final few years.

Fiscal Effects on Local Governments. The availability of state bond funds for local water projects would affect how much local governments, primarily water agencies, spend on water projects. In many cases, the availability of state bonds could reduce local spending. For example, this would occur in cases where state bond funds replaced monies that local governments would have spent on projects anyway. Local savings would also occur in cases where the availability of state bond funds allowed local governments to build projects that reduced operating costs, such as by increasing efficiency or using a new water source that allows them to purchase less water.

In total, we estimate that this measure would result in savings to local governments on water-related projects. These savings would likely average between a few tens of millions of dollars and over $100 million annually over the next few decades.

However, in some cases, state bond funds could increase spending on water projects by local governments. For example, the availability of bond funds might encourage some local governments to build additional or substantially larger projects than they would otherwise. These projects could also be more expensive to operate.

An individual local government might use these savings in various ways. For example, it might use the savings to build other new facilities or for maintenance and repair of existing facilities. In other cases, a government might use the savings to keep water rates lower than they

otherwise would be by delaying or reducing future rate increases. Since the amount of statewide savings in any given year is likely to be small relative to the overall amount spent by local governments on water, any effect on rates would likely be small for most ratepayers.

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

- State General Fund costs of $9.8 billion to pay off principal ($4.9 billion) and interest ($4.9 billion) on bonds over a 40-year period. Annual payments would average $250 million. Annual payments would be relatively low in the initial and final few years and somewhat higher in the intervening years.
- Savings to local governments on water-related projects that would likely average between a few tens of millions of dollars and over $100 million annually over the next few decades.

Sincerely,

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Mac Taylor
Legislative Analyst

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Michael Cohen
Director of Finance