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Understanding the State's Role in Funding Water Projects

PRESENTED TO:

Assembly Committee on Water, Parks, and Wildlife
Hon. Diane Papan, Chair

Assembly Committee on Local Government
Hon. Juan Carrillo, Chair



LEGISLATIVE ANALYST'S OFFICE

State's Funding Requirements

State Has Various Legal and Financial Responsibilities. Most of what the state funds stems from a specific legal requirement where it has liability, must meet the terms of a contract or settlement agreement, or must fulfill a statutory or regulatory requirement.

- ***Legal Liability.***
  - State Plan of Flood Control (*Paterno v. State of California*).
- ***Contractual or Settlement Agreement Obligations.***
  - State Water Project (most of the cost passed through to contractors).
  - Healthy Rivers and Landscapes Program (also known as voluntary agreements) within the updated Bay-Delta Plan.
  - Salton Sea (Quantification Settlement Agreement).
- ***Statutory Requirements.***
  - Debt service on natural resources bonds.
  - Flood Control Subventions Program (state contribution toward nonfederal cost share of local projects).
  - Delta Levees Maintenance Subventions Program (state provides up to 75 percent of total cost for local projects).
  - State Revolving Funds (SRFs) to support local water projects (federal grants requiring a state match).
- ***Regulatory Requirements.***
  - State and federal endangered species requirements such as those affecting State Water Project operations.
  - Ensuring safety of state-owned dams.

State Funding Sources

The state has several main sources of funding for water-related projects and activities.

General Obligation Bonds. Since 2000, voters have approved nearly $41 billion in nine general obligation (GO) bonds to pay for different types of water, natural resources, and environmental protection projects.

Natural Resources General Obligation Bonds Approved by Voters Since 2000
(In Millions)

Proposition	Date	Primary Purposes	Amount[a]
12	March 2000	Parks and habitat protection	$2,100
13	March 2000	Water supply and flood protection	1,884
40	March 2002	Habitat protection, water quality, and parks	2,597
50	November 2002	Coastal protection, Delta, water supply and quality	3,345
1E	November 2006	Flood protection	3,990
84	November 2006	Water quality, habitat protection, flood protection, and parks	5,266
1	November 2014	Water supply, habitat protection, and water quality	7,465
68	June 2018	Habitat protection, parks, and flood protection	4,100
4	November 2024	Climate resilience	10,000
		Total	**$40,747**

[a] Reflects amounts authorized by voters as adjusted by Propositions 1 and 68.

State Funding Sources

(Continued)

Recent Bonds Included $14.1 Billion for Water-Related Activities. Propositions 1, 68, and 4 funded numerous types of activities, including water storage, flood management, and watershed and ecosystem protection and restoration.

Recent Bond Funding for Water-Related Activities

(In Millions)

	Proposition 1 (2014)	Proposition 68 (2018)	Proposition 4 (2024)	Totals
Watershed and ecosystem protection and restoration	$1,496	$1,497	$655	$3,648
Drinking water quality	520	220	610	1,350
Groundwater management and land repurposing	900	400	586	1,886
Flood management	395	460	550	1,405
Dam safety	—	—	480	480
Water recycling and desalination	725	80	449	1,254
Water storage, regional conveyance repairs	2,700	—	150	2,850
Stormwater management	200	100	110	410
Integrated Regional Water Management	510	—	100	610
Water use efficiency	100	20	75	195
Water data management and climate education	—	—	35	35
Totals	**$7,546**	**$2,777**	**$3,800**	**$14,123**

General Fund. The state uses the General Fund in times of surplus or to meet funding requirements when other sources of funding are not eligible or readily available. For example, reflecting recent temporary budget surpluses, climate budget packages from 2020-21 through 2025-26 provided a total of $6.5 billion for water and drought resilience, with nearly 90 percent from the General Fund.

Greenhouse Gas Reduction Fund (GGRF). GGRF provided $130 million annually for the state's Safe and Affordable Funding for Equity and Resilience (SAFER) drinking water program from 2020-21 through 2025-26. However, recent changes to the cap-and-invest program are expected to decrease GGRF revenues overall, making future funding for the program somewhat uncertain, and they no longer guarantee a full $130 million for SAFER. In 2026-27, the budget includes a total of $71 million from GGRF for SAFER.

Federal Funds Administered by the State

The State Also Administers Federal Grants for Water Infrastructure. For example:

- The State Water Resources Control Board administers SRF grants from the U.S. Environmental Protection Agency, which are used to provide low-interest and forgivable loans to local agencies for drinking water and wastewater capital projects.
- The Department of Water Resources collaborates with the U.S. Army Corps of Engineers on flood management projects (and provides the state match).
- The California Governor's Office of Emergency Services administers hazard mitigation and recovery funding from the Federal Emergency Management Agency, which might be directed for flood-related activities.

Key Challenges

Bonds Typically Used for Larger Projects That Provide Long-Term Benefits… Bonds typically fund large infrastructure projects. Since infrastructure typically provides services over many years, it is reasonable for both current and future taxpayers to help pay for it through multiple years of bond debt service. Additionally, the large costs of major projects can be difficult to pay for all at once.

…However, They Typically Cannot Pay for Ongoing Operations and Maintenance (O&M). While bond funds can support planning, design, and construction of infrastructure projects, because they provide one-time funding they are not an appropriate source to support ongoing O&M for the projects once completed. This can create a need to find other sources of funding to support O&M.

Bonds Are an Expensive Way to Fund Projects. The state pays more in the long run when it relies on bonds to support water-related activities because of the added interest costs. For each $1 borrowed, the state generally pays about $1.30 in debt service (when adjusted for inflation). The 2026-27 budget includes roughly $1.6 billion from the General Fund to repay resources-related GO bond debt.

Only About $1.6 Billion in Bond Funds Remains Available for Appropriation. Less than 1 percent of funding for water-related activities remains available from Propositions 1 and 68 (about $75 million in total). Of Proposition 4 funds for drinking water and drought resilience, about $1.5 billion (40 percent) has not yet been appropriated.

Federal Funds for Drinking Water and Wastewater Declining. The federal Infrastructure Investment and Jobs Act (IIJA) provided a significant increase in funding for the Drinking Water and Clean Water SRFs from 2022 through 2026. This included a general augmentation as well as special funding to address emerging contaminants and lead service line replacement. Given the IIJA funds are exhausted, the state will see a large drop-off in funding beginning in the current federal fiscal year (going from an estimated $715 million to potentially less than $100 million). In addition, Congress's use of SRF funds for earmarks means less base funding for standard water projects that have historically depended on these funds.

Key Challenges

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State General Fund Outlook Is Tenuous. Our office last updated our revenue outlook in August and will release another update in November with our annual Fiscal Outlook. The strength in recent income tax collections probably is not sustainable. It is largely tied to an overheated stock market, which is now showing several classic signs of a financial bubble. Historically, these kinds of speculative episodes have ended in dramatic reversals. As such, we advise against treating the current level of revenue as a sustainable foundation for multiyear budgeting. Instead, the state should be prepared for revenues to be tens of billions of dollars lower within one or two years.