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Paying for Water in California

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Summary

California's water system provides many vital services: supplying clean water for homes, farms, and other businesses; protecting the quality of rivers, lakes, and beaches; preventing loss of life and property from devastating floods; and safeguarding the health and habitat of fish and other wildlife. By some accounts, our water system is in a deep financial crisis, with failing marks for essential infrastructure and with vast unmet spending needs. However, this system is both large—with annual expenditures exceeding \$30 billion—and multifaceted, so it is important to take a closer look to identify the specific financial problems. To this end, we examine how well California is meeting various water management goals and identify areas where lack of funding is a key obstacle to success. This closer examination reveals a more nuanced picture of fiscal health for California's water system and pinpoints areas requiring urgent policy attention.

Contrary to many media reports, California's water supply and wastewater providers, which together account for over 85 percent of total spending, are performing reasonably well—providing safe, reliable levels of service and preparing for future needs. These utilities are almost entirely locally funded, and to date they have generally been able to raise rates to comply with new treatment requirements and replace aging infrastructure. However, they do face financial challenges. Rising regulatory standards carry new costs, and the water supply shipped through the Sacramento–San Joaquin Delta remains at risk because of the system's ecological decline and its seismically vulnerable levees. Yet from the perspective of fiscal health, a bigger concern is the potential for Proposition 218 (1996) to stymie local agencies' ability to pursue the modern water management techniques needed to maintain reliable water service in the face of population growth, climate change, and increasing water scarcity. Proposition 218's rigid requirement that fees must be specifically linked to the services for each property jeopardizes the implementation of conservation-oriented programs and the development of nontraditional sources of water supply. This requirement also limits water utilities' ability to provide "lifeline" discounts to low-income households, an important equity-oriented feature of most energy billing systems.

We find even more debilitating structural funding gaps in five other areas: small, rural water systems; flood protection; stormwater pollution; aquatic ecosystem management; and integrated water management. For small, rural drinking water systems with contaminated groundwater wells, the shortfall in funding is hard to bridge because prospective solutions have high costs per household and many households in these communities have limited means. In the four other areas, the key challenge is a legal environment for water funding that is out of sync with modern water management objectives. Again, Proposition 218 poses problems, requiring voter approval for fees and assessments for "property-related" flood protection and stormwater management. Moreover, anything not qualifying as a fee is a tax, and earmarked "special" taxes require a two-thirds supermajority of local voters since the passage of Proposition 13 in 1978. Proposition 26, a new constitutional reform passed in 2010, restricts the definition of other, non-property-related fees, potentially further hampering fundraising for stormwater management and ecosystem improvement. Crucially, these legal strictures make it harder to support a more integrated water management system—a necessary approach for effectively meeting the state's water system goals during times of water scarcity and climate change.

The overall funding gap in these five areas is on the order of \$2 billion to \$3 billion annually: \$30 million to \$160 million to provide safe drinking water in small, disadvantaged rural communities; \$800 million to \$1 billion for floods; \$500 million to \$800 million for stormwater management; \$400 million to \$700 million for

ecosystem support for endangered species; and \$200 million to \$300 million for integrated water management. Although filling this gap may seem daunting—particularly to cash-strapped program managers—it is not large relative to the sums California is already spending on water services. In other words, this is a fixable problem.

Since the early 2000s, the state has worked to fill some of the gap with general obligation (GO) bond funds, to the tune of about \$1 billion annually. But these funds, which are reimbursed with general fund tax dollars, are running out, and it seems likely that California will be on a leaner bond diet in the years ahead.

California will need a broader mix of funding to pay for the state water system. State GO bonds are less desirable for most purposes than are targeted funding sources (such as surcharges on water, chemicals, road use, and hydropower), especially those that tap contributions from the individuals and communities who share responsibility for the problems or who benefit most from this spending. Likewise, broader taxes (e.g., parcel taxes or sales tax increments) are suitable for some purposes.

To fill the existing funding gaps, and to prevent new ones from forming, California will have to better align its funding laws with the goals of modern water management. The legislature will need to pass new special taxes and regulatory fees to tap a broader mix of funding sources. And alongside any new state GO bonds, California voters will also need to approve a suite of constitutional reforms to address the unintended consequences of Propositions 218, 26, and 13 for local governments' ability to manage water responsibly. These reforms would maintain the salutary aspects of these laws, such as their high standards of transparency and accountability, while enabling more efficient, equitable, and sustainable water management. In particular, they should provide a more flexible definition of fees, remove the local voter approval requirements for fees and assessments for flood protection and stormwater management (comparable to water and wastewater fees), and lower the local voter threshold for special taxes to a simple majority (comparable to fiscal measures in statewide elections and local general taxes). Local water agencies, for their part, should provide transparent, well-explained records of their rate decisions.

It will also be important to mind the funding gap by comparing the value of proposed spending with its costs. For instance, some proposed flood management investments do not appear to pass a cost-benefit test, and some ecosystem and stormwater investments provide little real benefit. To be sure we are using funds most effectively, California's water management agencies at all levels—local, regional, state, and federal—should aim to develop more coordinated, integrated approaches to management and regulatory oversight, drawing on scientific and technical analysis to support sound and balanced decisions.

Relative to current spending of over \$30 billion per year on this vital sector, Californians need to raise an additional 7 to 10 percent—or \$150 to \$230 per household annually—to fill critical gaps. Although this is a fixable problem, it will not happen without a bold, concerted effort on the part of California's state and local leaders, who must convince California's residents to support the necessary changes with their votes and their pocketbooks.

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