



M e m o r a n d u m

Date: June 22, 1999

To: BDAC Members

From: Lester A. Snow

Subject: CALFED Draft Finance Plan

Summary

At the May BDAC meeting the topic of CALFED finance was deferred until the July meeting at which time BDAC will have had an opportunity to review the Draft Finance Plan released later this month. The CALFED Draft Finance Plan is included in the Implementation Plan Technical Appendix of Draft EIS/R. Please read the Draft Finance Plan in preparation for the BDAC meeting. Attachment 1 contains the Executive Summary of the Draft Finance Plan.

In developing the financial strategies and cost-sharing for the many aspects of the CALFED Program, CALFED is following several basic steps:

1. Identifying the priority actions for implementation
2. Developing cost estimates for priority actions
3. Reviewing the funding and cost-sharing formulas in existing laws and agreements
4. Identifying program/project benefits and beneficiaries
5. Identifying finance issues and options to be discussed by BDAC and CALFED Policy Group
6. Recommending cost allocation procedures and cost-sharing strategies for each program element and, in some cases, individual projects.

The Draft Finance Plan includes information on all the above steps except #6. The draft plan lays out background information on program benefits and beneficiaries, describes finance issues that need to be addressed, lays out possible financing options and evaluate different funding sources (see Attachment 2). CALFED will be working with BDAC to develop final finance recommendations.

CALFED Agencies

California The Resources Agency
Department of Fish and Game
Department of Water Resources
California Environmental Protection Agency
State Water Resources Control Board
Department of Food and Agriculture

Federal Environmental Protection Agency
Department of the Interior
Fish and Wildlife Service
Bureau of Reclamation
U.S. Geological Survey
Bureau of Land Management
U.S. Army Corps of Engineers

Department of Agriculture
Natural Resources Conservation Service
U.S. Forest Service
Department of Commerce
National Marine Fisheries Service
Western Area Power Administration

Discussion Questions

The Draft Finance Plan contains numerous "issues/questions" that need to be addressed in order to finalize a Finance Plan for CALFED. The following issues/questions are posed for discussion with BDAC.

1. When is it in the public interest to use public funding for CALFED programs and actions?
2. Is a broad-based Bay-Delta system diversion fee an appropriate funding source for the CALFED program?

If so, which CALFED programs or actions should receive revenues from a diversion fee? How should the fee be structured?

Stage 1 Financing and Cost Estimates

CALFED has identified actions and cost estimates for Stage 1 (7 year) and Stage 1a (Year 2000 and 2001). To initiate implementation of the CALFED program at the time of the ROD (and for some actions implementation may begin prior to the ROD), CALFED is identifying a variety of funding sources. Currently CALFED is participating in the Governor's Infrastructure Commission which was established to provide advice on infrastructure financing needs. The Natural Resources Subcommittee of the Commission is reviewing bond revenue funding needs for water and ecosystem projects. Later this summer the Commission will make a recommendation to the Governor on bond issues for next year. Staff will provide an update on the Infrastructure Commission at the meeting.

Attachments 3 and 4 are tables from the Draft Finance Plan and provide estimates for Stage 1 and Stage 1a program costs.

5.0 FINANCING PLAN

Executive Summary

With the signing of the Record of Decision, scheduled for June 2000, CALFED will need to have a financing plan in place to begin implementation. In fact, early implementation of portions of the Program will begin in 1999 with existing funding sources. To be prepared for program implementation, a finance plan is needed to guide state and federal administration and legislative discussions regarding new bonds, new fees, and proposed budget appropriations.

This draft lays the initial framework for developing a CALFED Finance Plan. The Plan provides background, definitions, description of Program benefits, description of possible funding sources, financing options, and issues to resolve to finalize a Finance Plan. CALFED will work to complete the Finance Plan in 1999, but no later than the time of the ROD.

The Finance Plan for implementing the CALFED Bay-Delta Program is a critical component of the Program because of the assurance needed by member agencies and stakeholders that a serious and concerted effort will be made to secure funding for all components over the life of the Program. In developing financial strategies and cost-sharing for the many aspects of the CALFED Program, CALFED is following several basic steps:

- Identifying the priority actions for implementation
- Developing cost estimates for priority actions
- Identifying the funding and cost-sharing formulas in existing laws and agreements
- Identifying program/project benefits and beneficiaries
- Identifying finance issues that affect the successful implementation of the Program
- By the time of the ROD, CALFED will recommend cost allocation procedures and cost-sharing strategies for each program element and in some cases for individual projects.

A fundamental philosophy of the CALFED Program is that costs should, to the extent possible, be paid by the beneficiaries of the Program actions. There are reasons, other than equity and fairness, that the beneficiaries pay principle be applied to CALFED and other water resources programs. Having beneficiaries pay for public programs encourages them to more carefully review their water and power needs and the costs of proposed programs (including mitigation costs) in relation to the benefits they receive. Such a policy also encourages examination of a

fuller range of alternatives, including locally funded measures, in order to assure that public funds are spent in the most cost-effective way to meet Program goals.

Definitions. There are several terms that require definition to provide clarity in the chapter: (a) initial funding shares (which may or may not correspond to final funding shares); (b) cost allocation - the distribution of costs to project purposes and beneficiaries; (c) cost shares (formulas typically used for sharing the costs allocated to each project purpose); (d) proposed cost shares - the shares that would be recommended for use by the CALFED Program; and (e) effective cost shares (the percentage that each beneficiary group ultimately pays). The effective cost shares differ from the proposed cost shares if repayment terms are at below-market rates.

Historical Financing. CALFED's finance strategy must be considered within the current and historical context of state and federal water resources financing. Historically, federal water projects have been financed with appropriations and, in some cases, repayment was provided by beneficiaries at below market rates of interest (or no interest). This resulted in historically low levels of effective cost-sharing. Since the 1980's, federal water resources agencies have been requiring higher levels of non-federal cost-sharing, through higher levels of up-front cost-sharing and other means. In the CVP, the Central Valley Project Improvement Act of 1992 enacted tiered water rates, Mitigation and Restoration payments, and other fees to be deposited into a Restoration Fund to be used for environmental purposes. Financing for the State Water Project relies principally on general obligation bonds and revenue bonds repaid by water and power users, which provides high levels of effective cost-sharing. In general, there has been a shift in federal and state water financing toward higher levels of repayment and higher effective cost shares by local entities.

Program Benefits/Beneficiaries. At this time, because many of the actions have not yet been specified, (e.g., water use efficiency actions, storage sites), the specific benefits cannot be identified or measured, and Program costs cannot be allocated. In other cases, such as ecosystem restoration, benefits can be identified but not easily measured. However, to initiate the finance discussions, and lay the framework for a CALFED finance strategy, this chapter identifies expected benefits and beneficiaries at the program level. For actions where benefits can be measured, the program or project costs will be allocated among the benefit categories. In the Final Finance Plan a specific cost allocation procedure will be identified. For those program elements where benefits cannot be easily measured (ecosystem, water quality, watershed programs) CALFED will need to identify a procedure for estimating and allocating costs. After the benefits analysis and cost allocation, CALFED may propose cost shares that differ from existing state and federal cost-sharing formulas or may use the cost-sharing formulas in existing programs. Final decisions on cost-sharing will be made by the state and federal legislatures.

The benefits from each program element (both near-term and expected future benefits), as well as cost-sharing issues and potential cost-sharing options are described in this chapter. In general, these options differ financially (the extent to which they require higher levels of repayment from beneficiaries), or institutionally (in terms of what mechanism they rely on to secure repayment,

ranging from existing programs, up-front cost-sharing, recovery through water rates, or recovery through other user charges). Some of these options address user fees targeted at the beneficiaries of a particular program (e.g., directly linked to a group of benefitting water districts, such as Delta diverters).

Financing Mechanisms. This chapter compares several different financing mechanisms, all of which have been used to date and are expected to be used in the future, including state and federal appropriations, state general obligation bonds, state water and power revenue bonds (tied to SWP water and power rates), private financing, and a broad-based user fee (e.g., the Mitigation and Restoration payments imposed by the CVPIA). The advantages and disadvantages of these various funding sources and financing mechanisms are described.

CALFED and CALFED stakeholders have discussed the use of a broad-based Bay-Delta system diversion fee, particularly to finance some of the programs or actions with broad-based public benefits, such as the Ecosystem Restoration Program (such a fee is discussed, for example, in the 1996 report *Maintaining Momentum on California Water Issues: Business Leaders' Findings - Financing Options for Water-Related Infrastructure in California* produced by the California Business Roundtable, the California Chamber of Commerce, the California Farm Bureau Federation, and the California Manufacturers Association). The basic concept is a fee that would apply to all diverters, or all major diverters of water from tributaries that flow into the Delta as well as exporters of Delta water. This chapter explores how such a broad-based diversion fee could be structured and what revenues could be expected for fees similar to those established in the CVPIA. The crediting of contributions to date would be an integral part of implementing any broad-based diversion fee.

Potential CALFED Funding Sources Advantages and Disadvantages		
Option	Advantages	Disadvantages
General obligation bonds	<ul style="list-style-type: none"> --Can achieve substantial up-front funding, but distribute the financial burden over time. --Focuses stakeholders and the public on next Program phase. 	<ul style="list-style-type: none"> --Can be limited to physical infrastructure and facilities --Requires legislative and voter approval. --Would require repeated approval over 30-year period. --Cannot be used for ongoing costs such as land management costs, monitoring and assessment.
Water and power revenue bonds	<ul style="list-style-type: none"> --Can provide immediate sources of funding if linked to revenue-generating facilities. --Less burden on state budgets than general obligation bonds. Does not require voter or legislative approval. --Linking beneficiaries to program elements in SWP rates is consistent with beneficiary pay. 	<ul style="list-style-type: none"> --Can be limited to physical infrastructure and facilities. --Works well for private benefits (water deliveries and power), but hasn't been used to cover program elements with broad public benefits.
State appropriations	<ul style="list-style-type: none"> --Provides immediate sources of funding. --Focuses stakeholders and the public on next Program phase. --Allows annual legislative review. 	<ul style="list-style-type: none"> --A more direct financial burden than bonds. --Competition with other state program elements. --Requires annual approval which reduces assurances of long term funding. --Would require repeated approval over 30-year period.
Federal appropriations	<ul style="list-style-type: none"> --Provides immediate sources of funding. --Focuses high-level state and federal attention on the Program. --Allows annual Congressional review. 	<ul style="list-style-type: none"> --Competition with other federal priorities. --Requires annual approval which reduces assurances of long term funding. --Would require repeated approval over 30-year period.
Private financing	<ul style="list-style-type: none"> --Can be more immediate than funding from public sources. --Some contributions have been made to solve regional problems, as well as local problems. 	<ul style="list-style-type: none"> --Is generally focused on local needs.
Broad-based diversion fee	<ul style="list-style-type: none"> --Dependable and ongoing source of revenues (may fit with program elements for ongoing funding needs). --Tied to diversion impacts on the Delta. --A broader-based fee would provide consistency and fairness with CVP users, who currently pay such fees. --Supported by stakeholder groups - Business Roundtable, etc. 	<ul style="list-style-type: none"> --Since revenues come in annually, the funding available initially is less than with bonding or appropriations.

Estimated CALFED Stage 1 Costs ¹ (\$ in millions)	
Program Area	Total Cost
Ecosystem Restoration ²	\$910
Water Use Efficiency/Recycling	\$2,000
Water Transfers ³	\$6
Watershed Management	\$210
Water Quality	\$250
Levees	\$264
Storage ⁴	\$370
Conveyance ⁵	\$913
Monitoring ⁶	\$246
TOTAL	\$5,169

Notes:

¹ Preliminary; current year dollars based on staff estimates. Total costs assume contributions from State, Federal, and User/Private funding.

² Total cost could be paid for by Prop. 204 (State), Federal Bay-Delta appropriation and CVPIA water and energy funds (Federal), and CVPIA Restoration Fund (User).

³ No major capital investments are necessary for this program.

⁴ Includes South of Delta groundwater and North of Delta groundwater (\$300 million), Integrated Storage Investigation and related planning and feasibility work (\$70 million).

⁵ Includes South Delta Improvements (\$671 million), North Delta Improvements (\$220 million), conveyance studies (\$22 million).

⁶ Assumes monitoring and assessment costs are 5% of total program costs.

Estimated CALFED Stage 1a Costs ¹ (\$ in millions)			
Program Area	Year 2000	Year 2001	Total Cost
Ecosystem Restoration	\$136	\$137	\$274
Water Use Efficiency/Recycling	\$50	\$100	\$150
Water Transfers ²	\$2	\$2	\$4
Watershed Management	\$30	\$30	\$60
Water Quality	\$17	\$21	\$38
Levees	\$33	\$26	\$59
Storage	\$20	\$23	\$43
Conveyance	\$20	\$51	\$71
Monitoring ³	\$15	\$19	\$34
TOTAL	\$323	\$409	\$732

Notes:

¹ Preliminary; current year dollars based on staff estimates. Costs derived from actions listed on Table 3.1 of this appendix.

² No major capital investments are necessary for this program.

³ Assumes monitoring and assessment costs are 5% of total program costs.