



Reforming Davis-Dolwig:

Funding Recreation in The State Water Project

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AN LAO REPORT

EXECUTIVE SUMMARY

The Governor's 2009-10 budget proposes \$38.5 million in bond and special funds for fish and wildlife enhancements and recreation in the State Water Project (SWP). This funding is proposed in connection with the Davis-Dolwig Act, the state's 47-year-old state law which states the intent of the Legislature that such activities be included in the development of the statewide water system. The budget also proposes a number of statutory reforms to the act, in part to provide a dedicated funding source for its implementation. The recently enacted budget excludes the Governor's proposed funding and statutory reforms to Davis-Dolwig. The Legislature, however, may consider those issues in the coming months.

In this report we discuss policy and fiscal issues that arise from how the Davis-Dolwig Act is being currently interpreted and implemented by the Department of Water Resources (DWR), and make recommendations for legislative action. We find that the Governor's proposal does not address a number of major problems with the implementation of the act and that the administration's approach improperly limits the Legislature's oversight role. We recommend that the budget request be denied, and we offer the Legislature an alternative package of statutory reforms to the act.

Our review has found that DWR has interpreted the provisions of the Davis-Dolwig Act broadly and as a result has:

- Over-allocated SWP costs to recreation, thereby overstating the appropriate public funding share of SWP costs for recreation.
- Incurred operational costs of recreation facilities without legislative budgetary review.
- Allocated some regulatory compliance costs of SWP operations to Davis-Dolwig and the state, rather than including them in charges to SWP contractors (users of the water system).

As there is currently no state funding source for costs allocated to Davis-Dolwig by DWR, the SWP contractors, who pay most of the costs of SWP, have fronted the monies with the anticipation of repayment by the state. The lack of a state funding source for recreation has also resulted in a situation in which new revenue bonds for SWP construction have been placed on hold, delaying these construction projects.

To address the shortcomings both in the current implementation of Davis-Dolwig by DWR and in the Governor's proposal to reform the act, we recommend that:

- The Legislature amend the Davis-Dolwig Act to specify what are eligible costs under Davis-Dolwig (and hence to be paid for with state funds) and what costs are to be met by SWP contractors.

- The DWR evaluate whether SWP facilities mainly used for recreation can be divested from the SWP.
- The Legislature provide clear policy direction on the status of costs previously allocated by DWR to Davis-Dolwig and for which the money has been fronted by the SWP contractors.

THE DAVIS-DOLWIG ACT: ORIGINAL INTENT AND PRACTICAL IMPLEMENTATION

The State Water Project. The SWP is the state’s main water conveyance system—mostly from Northern California to parts of the San Francisco Bay Area, the Central Valley, and Southern California. Users of the water system (“SWP contractors”) fund most of SWP’s capital and operational costs through water user fees. The DWR is responsible for the overall operations of SWP. Other sources of funding for the project include federal funding (mainly for flood control), state general obligation bonds (mainly for environmen-

tal programs), and the General Fund combined with user fees (recreation and fish and wildlife programs). The project was initiated by legislation in 1959 under the Burns-Porter Act, with voters ratifying in November 1960 the \$1.75 billion bond for the project authorized in the act.

Figure 1 shows the location of a number of the recreation-related SWP reservoirs that we will reference in this report.

Davis-Dolwig Enacted in 1961. Chapter 867, Statutes of 1961 (AB 261, Davis)—the Davis-

Dolwig Act—states the broad intent of the Legislature that SWP facilities be constructed “in a manner consistent with the full utilization of their potential for the enhancement of fish and wildlife and to meet recreational needs.” The DWR is charged with implementing the act as part of planning for construction of SWP facilities. The Davis-Dolwig Act does not provide criteria specifying what kinds of recreation facilities or fish and wildlife enhancements are to be developed, nor does it require legislative review or approval of such facilities or enhancements

Figure 1
Selected Reservoirs in the State Water Project



that DWR chooses to develop in the course of implementing the law.

The Davis-Dolwig Act states that the cost of fish and wildlife enhancements and recreation is a *non-reimbursable cost* to SWP contractors. That is, under the act, DWR is *not* to include costs of fish and wildlife enhancements and recreation in charges levied on the SWP contractors. The act states the *intent* of the Legislature that such costs be paid for by an annual appropriation from the General Fund. The act, however, did not actually appropriate any General Fund monies to pay for Davis-Dolwig costs. Since one Legislature cannot bind another Legislature to a future action, and the State Constitution prohibits the Legislature from creating certain debts or liabilities without voter approval, we are advised that the intent language of Davis-Dolwig does not create a legal obligation for the General Fund to cover the costs of these fish and wildlife enhancements or recreation. It is up to the Legislature, at its complete discretion, whether to provide funding in accordance with the act.

How Davis-Dolwig Is Implemented by DWR. The DWR has been responsible for implementing Davis-Dolwig since 1961. State law, as we noted earlier, is silent on what specific projects and costs are eligible under Davis-Dolwig. Thus, DWR determines what share of the costs of SWP facilities relate to fish and wildlife enhancements and recreation and are Davis-Dolwig costs not subject to reimbursement by state water contractors. In practice, most Davis-Dolwig costs are related to recreation. Most fish and wildlife costs are classified as being related to “preservation” of these species, rather than the “enhancement” of fish and wildlife, and therefore are not usually attributed to Davis-Dolwig.

Most Davis-Dolwig Costs Are an Allocation of Total SWP Costs. There are two main costs

that DWR considers eligible Davis-Dolwig costs. First is the capital cost of the creation of recreation facilities when the SWP was constructed (such as the purchase of additional land for hiking trails and camping). The second is an allocation to recreation of the total annual budget of the overall SWP, based on an assessment of each facility’s value as a recreational asset. This is an indirect form of cost allocation, whereby a portion of the operation and capital cost at every SWP facility is allocated to recreation. These indirect recreation-related costs, on a statewide basis, average about 3 percent for operations and 6 percent for capital spending. As the capital costs for the creation of the recreation facilities have been paid off, the annual total cost that has been assigned to Davis-Dolwig by DWR in recent years is mainly comprised of this allocation of total SWP costs to recreation. In 2006-07, of a total of \$12 million of costs described as Davis-Dolwig costs by DWR, \$10.3 million were an allocation of total SWP costs.

Operation or Improvement of Recreation Facilities Generally Not a Davis-Dolwig Cost.

The direct costs to operate, maintain, and improve most recreation facilities in SWP are *not* included in DWR’s calculation of Davis-Dolwig costs. Recreation facilities in SWP are operated by a mix of federal (National Forest Service), state (Department of Parks and Recreation [DPR]), and local agencies (for example, Los Angeles County). Generally, the day-to-day costs of operations and maintenance (for example, operating campgrounds and stationing rangers at parks) are borne by the operating entity, such as DPR.

However, the DWR has chosen to pay some operating costs of recreation at two SWP facilities—Lake Oroville and Lake Perris. Since 1996, the DWR has paid some of the costs of campgrounds and park rangers at Lake Oroville

in Butte County that are provided by DPR. At Lake Perris in Riverside County, DWR has paid for some improvements to the recreation facilities (such as replenishing beach sand) since 2007. Both Lake Perris and Lake Oroville are State Recreation Areas (SRAs) and, as such, DPR funds provide the majority of funding support for the recreation operations at these sites. In 2006-07, of a total of \$12 million of costs described as Davis-Dolwig costs by DWR, about \$1.4 million related to the direct operating costs at Lake Oroville.

Some SWP Facilities Defined by DWR as Having Mainly a Recreation Purpose. There are a small number of facilities in SWP where DWR assigns more than 75 percent of costs to recreation, meaning that the main purpose of the facility is for recreation. In the extreme, a 100 percent allocation of costs to recreation at a particular facility means that the facility would not have been included in the SWP except for its use for recreation. Figure 2 shows DWR’s varying cost allocations to recreation, depending on the main purpose of the facility at issue.

DWR’s Decision-Making on Davis-Dolwig Done “Off Budget.” There has been no opportunity for legislative input into DWR decisions to allocate certain costs to Davis-Dolwig. That is, DWR alone determines what costs are to be charged to the SWP contractors and what costs are potentially to be borne by the state. That is largely because these and other budget decisions affecting the SWP are made largely outside of the annual legislative budget process.

Although the department must obtain authorization from the Legislature to create new staff positions, the allocation of SWP funds to support SWP operations and capital outlay expenditures is not subject to appropriation in the annual budget bill. Existing statute provides DWR with the authority to spend SWP funds without legislative approval for these purposes. As an example, DWR is moving ahead with a \$350 million capital improvement project to make seismic safety retrofits to the dam at Lake Perris without legislative oversight—even though a portion of costs will be allocated to Davis-Dolwig and could be

viewed as an obligation of the state. The SWP contractors have raised concerns with the portion of costs that they will be required to pay for Lake Perris, as they feel that there is limited water supply benefit and a more cost-effective alternative to the capital improvement project exists. Please see the box on the next page for further discussion of issues relating to Lake Perris.

Figure 2
Department of Water Resources Allocation of Costs to Recreation, by Facility Purpose

2006-07 Data

Main Purpose of State Water Project (SWP) Facility	Facilities in This Category	Allocation to Recreation of Total Facility Costs:	
		Capital	Operating
Water supply	Lake Oroville, San Luis, Aqueduct, most facilities south of the Delta	3 percent to 6 percent ^a	1 percent to 3 percent ^a
Mix of recreation, flood control, and water supply	Del Valle Dam and Lake Del Valle	48 percent ^a	45 percent ^a
Recreation	Frenchman Dam and Lake, Antelope Dam and Lake, Grizzly Valley Dam and Lake Davis	79 percent to 100 percent ^a	98 percent to 100 percent ^a
Average for the SWP		6 percent ^a	3 percent ^a

^a Allocation varies by facility.

LAKE PERRIS—WATER SUPPLY OR RECREATION?

Lake Perris is at the southern end of the State Water Project (SWP) distribution system in Riverside County. From that point, water is supplied to local contractors through locally operated conveyance systems. The Lake Perris State Recreation Area (SRA) is one of the most heavily used SRAs in Southern California. Recreation opportunities include swimming, boating, hiking, hunting, and fishing.

Perris Dam Requires Extensive Seismic Repairs. The dam at Lake Perris will require significant repairs in the coming years to address potential seismic safety risks. Until the dam is repaired, the water level in the lake has been reduced to 80 percent of capacity. The repairs to the dam would cost an estimated \$350 million.

Water Supply Benefit Questioned. Prior to 2008, Department of Water Resources (DWR) allocated 6 percent of capital costs and 3 percent of operating costs to recreation at Lake Perris. Beginning in 2008, DWR increased the allocation of Lake Perris' capital costs to recreation to 7 percent. The SWP contractors who receive water from Lake Perris, and hence pay the costs of distributing and storing water at the lake, dispute this allocation. In a recent study commissioned by one of the SWP contractors, the recreation benefit at Lake Perris was estimated to be in the range of 50 percent to 75 percent of the facility.

Decision to Repair the Dam Sits With DWR Alone. As SWP's budget is not subject to legislative budgetary oversight, the decision to repair the dam is one that is being made solely by DWR. Because of what they consider to be its limited water supply benefits, the SWP contractors, who would fund 93 percent of the planned repairs have expressed concern about the project. The SWP contractors estimate that constructing a new facility to supply the same amount of water as Lake Perris would cost \$65 million—substantially less than the costs to repair the Lake Perris Dam.

LAO FINDINGS AND ISSUES FOR LEGISLATIVE CONSIDERATION

Our review has found that DWR has interpreted the provisions of Davis-Dolwig broadly, given the lack of any requirement for legislative ratification of its actions in the budget process and the off-budget status of SWP. As a consequence, we have identified a number of problems relating to DWR's implementation of the act that impact SWP operations and contractors,

some with potential fiscal implications for the state. We discuss each of these issues below.

Over-Allocation of Total SWP Costs to Recreation. As noted above, the majority of the approximately \$10 million per year in Davis-Dolwig costs are based on an allocation by DWR of total SWP costs. This allocation, as we discussed earlier, represents DWR's assessment of the benefit

to the state's recreation facilities of the existence of SWP as a whole. However, these monies do not go directly for the construction or operation of recreation facilities (except as noted earlier). For this reason, we have concluded that DWR's allocation approach overstates the benefits to recreation from the operation of the SWP and therefore overstates the appropriate public funding share of SWP costs for recreation.

Some Operational Costs for Recreation Incurred Without Legislative Review. The DWR is continuing to incur new recreation costs at SWP facilities without identifying a state funding source to pay for them or considering legislative priorities for spending for recreation programs. For example, DWR has spent SWP funds for the recreation facilities at Lake Perris without any consideration of what may be higher-priority projects in other state parks or any legislative review of its spending for this purpose.

Regulatory Compliance Costs Are Being Allocated by DWR to Davis-Dolwig. In order to continue to operate the hydroelectric facility at Lake Oroville, DWR must renew its license from the Federal Energy Regulatory Commission (FERC). Part of the licensing requirements is the provision of additional recreation facilities. The DWR has allocated a portion of the added costs of these facilities to Davis-Dolwig and the state, rather than including them in charges to SWP contractors, even though these costs are the result of regulatory requirements that must be met to operate the hydroelectric plant. Currently, these regulatory-related costs for providing recreation at Lake Oroville amount to approximately \$1.5 million annually. However, DWR has estimated that these regulatory-related costs could increase to \$11.5 million per year, for a period of 50 years. The DWR has chosen to allocate these

costs to the state under Davis-Dolwig. Please see the text box on the next page for more details on the FERC relicensing process.

This approach raises significant policy concerns. In the past, the Legislature has stated its intent that regulatory compliance costs such as these are not appropriately funded by state funds, but rather should be paid by the regulated party—in this case, the SWP contractors.

New Revenue Bonds for SWP Construction Are on Hold. The DWR's approach to the implementation of Davis-Dolwig has led to another major problem—an inability for DWR to sell revenue bonds to finance current and future SWP projects. In the past, the DWR has relied on the issuance of revenue bonds to fund a number of SWP construction projects. The debt-retirement costs of these revenue bonds are generally paid off with revenues from charges to SWP contractors. Under DWR's cost allocation methodology, the SWP contractors were to be charged 94 percent of SWP total capital costs, with the remainder (6 percent) being allocated to the state as a Davis-Dolwig cost.

Until recently, the 6 percent Davis-Dolwig cost was "fronted" by SWP contractors, with the anticipation of repayment by the state. However, in 2006, a formal protest by a SWP contractor halted this practice. As a result, SWP contractors now can only be charged for their 94 percent of the cost of capital projects—the costs remaining once the 6 percent allocation to Davis-Dolwig has been taken into account.

In order to sell revenue bonds, DWR must show that it has a revenue source to cover 100 percent of the debt service, including the 6 percent share allocated to Davis-Dolwig. Because no source of funding has been dedicated to pay these costs, DWR is currently unable to

SWP RECREATION FACILITIES AND FERC RELICENSING

Hydroelectric Facilities Are Regulated by FERC. All hydro-electric facilities in the United States are regulated by the Federal Energy Regulatory Commission (FERC). Licenses are granted for 50 years and are granted based upon “settlement agreements” that direct the facility’s operations as well as the required mitigation steps at the site.

Recreation Provision Is a Key Requirement of FERC Licenses. As part of the settlement agreement, licensees are required to provide recreation facilities. The type, location, and quality of the recreation facilities to be provided are determined through consultation with stakeholders (for example, the local community). The FERC holds the licensee responsible for provision of the recreation facilities, and may rescind the license if they are not provided.

FERC Allows Licensees to Charge for Use of Recreation Facilities. Licensees are allowed to charge reasonable fees for the use of recreation facilities. Licensees are also allowed to subcontract for the provision of these facilities. However, FERC holds the licensee ultimately responsible for the provision of the recreation facilities described in the settlement agreement.

FERC and the State Water Project (SWP). There a number of facilities in the SWP that are regulated under FERC, including Lake Oroville—a site in the final stages of renewing a license for a further 50 years of operation. As part of the relicensing process, DWR has agreed to provide recreation facilities that will cost an estimated \$500 million over the 50 years of the license. The Department of Water Resources (DWR) plans to allocate these costs to Davis-Dolwig and hence to the state. There are other hydro-electric facilities in SWP, such as Castaic Lake, that will require license renewal and potentially additional recreation facilities. Under current practice, DWR would allocate these costs to Davis-Dolwig and hence to the state.

sell new revenue bonds, placing current and future SWP capital projects in jeopardy, or at least on hold. For example, the department has advised us that the seismic work at Lake Perris has been delayed.

SWP Contractors Have Fronted Monies for Davis-Dolwig Costs. Since 1961, DWR has allocated over \$464 million of SWP costs to Davis-Dolwig. Of this amount, \$107 million has been paid from a combination of tidelands oil revenue (\$90 million) and the General Fund (\$17 million). A further \$202 million in Davis-Dolwig costs fronted by SWP contractors was offset with monies owed by them to the state, which had fronted

the costs for SWP construction projects. The remaining \$155 million allocated by DWR for Davis-Dolwig recreation costs has been paid for, on an interim basis, by SWP contractors. (These costs were covered in the rates they paid over time.) Figure 3 shows how the costs allocated by DWR to Davis-Dolwig (without a state funding source) have grown over time.

Notably, the DWR did not submit any budget request to the Legislature for payment of Davis-Dolwig costs between 1996 and 2007. The Governor’s 2008-09 budget request did include \$3.9 million for Davis-Dolwig costs related to capital projects. However, this request was

rejected by the Legislature because of concerns that the administration had not provided a comprehensive solution to the implementation

problems related to the Davis-Dolwig Act. The Legislature did not want to approve an interim solution that only addressed certain portions of a greater funding problem.

OUR ASSESSMENT OF THE GOVERNOR'S PROPOSAL TO ADDRESS DAVIS-DOLWIG PROBLEMS

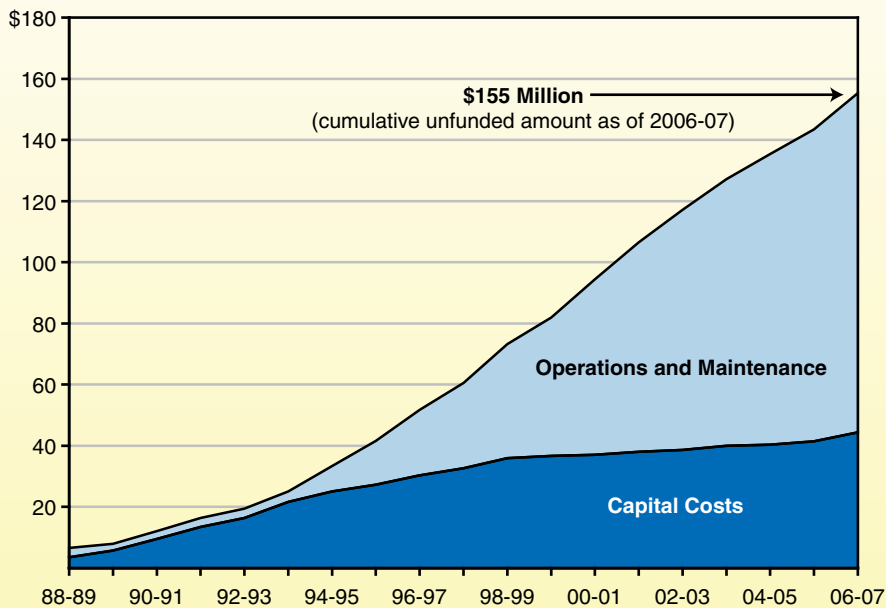
Governor's Proposal. The Governor's 2009-10 budget proposes to address some of the problems that have resulted from the way that DWR has been implementing Davis-Dolwig. Specifically, the budget attempts to address the problem with revenue bond issuance and the broader problem of the lack of a funding source for costs allocated to the state under Davis-Dolwig by DWR. The Governor's plan has three main components:

- An appropriation of \$31 million of Proposition 84 bond funds to pay a portion of the costs of nine SWP capital projects. These projects are not recreation facilities. Rather they are improvements to the SWP, such as an upgrade to SWP communication systems and an upgrade to the Santa Ana pipeline. The \$31 million represents DWR's allocation of a portion of the costs of these projects to recreation under Davis-Dolwig.

Figure 3

Unfunded Davis-Dolwig Costs Continue to Grow

(In Millions)



- A statutory change to provide an ongoing, annual appropriation of \$7.5 million from the Harbors and Watercraft Revolving Fund (mainly funded from boating-related fees and gas tax revenues) to DWR for Davis-Dolwig costs. Under the administration's proposed approach, the expenditure of these monies would not be subject to annual review and appropriation by the Legislature in the annual budget act.

- A statutory clarification to declare in statute that there is no obligation for contractors to be reimbursed from the state General Fund for costs previously allocated by DWR to the state under Davis-Dolwig.

We agree with the administration that it makes sense to resolve the problems stemming from the implementation of Davis-Dolwig. There are some benefits, at least in theory, to the administration's proposal, in that it provides a continuing funding source to pay for Davis-Dolwig costs that potentially would allow revenue bonds for construction projects to be sold. However, we have several concerns with the Governor's proposal, which we discuss below.

Some Fundamental Problems Not Addressed. The administration's proposal does not address most of the problems with the ongoing implementation of Davis-Dolwig by DWR that we have identified, and in our view, compounds some of the problems. Specifically, the budget proposal does not propose any statutory clarification of what is an eligible Davis-Dolwig cost. Accordingly, it fails to address what we consider to be an over-allocation of SWP project costs to recreation, the incurring of recreational operating costs by DWR outside of legislative review, and the inappropriate allocation of regulatory compliance costs to the state under Davis-Dolwig.

Proposed Expenditures Would Have Few Physical Recreation Benefits. As noted above, the \$38.5 million proposed in the budget to pay for costs related to Davis-Dolwig is to be used to fund the portion of SWP projects allocated by DWR to recreation. As such, very few physical recreation facilities (for example, campgrounds) would actually be provided with these funds. Under the administration's approach, there is

no guarantee of any physical recreation facilities being built with these state funds in future years. This could compound the problem of DWR's past over-allocation of Davis-Dolwig costs for recreation to the state.

Legislative Oversight Lacking. We are concerned about the proposal to provide ongoing appropriations of funding from the Harbors and Watercraft Revolving Fund without annual review of expenditure proposals by the Legislature. This approach means that there would continue to be insufficient oversight of the Davis-Dolwig commitments made by DWR and how funds are spent for these purposes. Under the administration's approach, DWR could continue to incur large new obligations for the state under Davis-Dolwig, and could use the funds it receives for these purposes in a manner that potentially conflicts with legislative priorities.

Dismissal of Historical Obligations Presents Policy Issues. As noted earlier, the administration proposes to clarify state law to state in effect that no historical state-funding obligation exists for Davis-Dolwig. This declaration in statute cites a provision in the Constitution that prohibits the creation of state debt without voter approval. The administration has advised us that it intends to rely on the proposed statutory language as the basis for its plan *not* to make any state payments at any time in the future with respect to costs that DWR has allocated to Davis-Dolwig since the mid-1990s.

Based on our discussions with staff at Legislative Counsel, the administration appears to be legally correct in its view that the Davis-Dolwig statute does not create a legally binding obligation of the General Fund. However, we think that any decision by the state to not recognize these unfunded Davis-Dolwig costs could have

significant legal and policy implications. We note that the SWP contractors have raised several objections to this course of action. From a policy perspective, the Legislature should consider how it wishes to balance equity to SWP contractors who have fronted these past costs with the state's very difficult fiscal situation.

Funding Source Has Structural Deficit. Our analysis indicates that there are technical problems with the Governor's proposal to use funding from the Harbors and Watercraft Revolving Fund to pay Davis-Dolwig costs. This fund would have a structural deficit (with expenditures exceeding revenues on an annual basis) if it were used for this purpose. In the budget year, the proposed \$7.5 million appropriation to DWR to pay Davis-Dolwig costs would leave the Harbors and Watercraft Revolving Fund with a fund balance of only \$796,000. If the Governor's proposal were adopted, the Department of Boating and Waterways estimates that expenditures from the fund on existing programs would need to be reduced beginning in 2010-11 to avoid a fund deficit, unless revenues to the fund were increased.

The administration proposal also complicates another component of the Governor's

budget plan. The Governor has proposed a loan of \$29 million to the General Fund from the Harbors and Watercraft Revolving Fund in the current year that was to be repaid by 2012-13. A commitment of \$7.5 million annually from the fund to pay Davis-Dolwig costs would accelerate the date when this loan would have to be repaid from the General Fund.

LAO Recommendations on the Budget Request. Because of the problems we have identified above with the administration's approach, we recommend that the Legislature deny the request for Davis-Dolwig funding in the budget year and reject the proposed statutory change to provide an ongoing appropriation from the Harbors and Watercraft Revolving Fund to pay Davis-Dolwig costs. We further recommend that the Legislature carefully evaluate the policy and legal implications for the state before adopting the administration's proposal to modify state law to declare that no historical state funding obligation exists for Davis-Dolwig costs. However, we recommend that the Legislature act now to address Davis-Dolwig issues. In the section that follows, we present an alternative to the Governor's proposal to address this issue.

LAO'S RECOMMENDED REFORM OF DAVIS-DOLWIG

We propose reforming the Davis-Dolwig Act to clarify the state's funding obligations while improving legislative oversight of spending related to recreation for the SWP. Our objective in developing these recommendations is to clearly define eligible Davis-Dolwig costs and funding responsibilities of the state (versus those of SWP contractors) for recreation at SWP facilities, and to provide legislative budgetary oversight of SWP expendi-

tures for recreation purposes. If our proposals were adopted as a package, the state would not incur any Davis-Dolwig costs in the budget year.

We have previously recommended that SWP be made subject to the Legislature's budgetary oversight—a recommendation that would improve the Legislature's oversight of Davis-Dolwig implementation. Please see the box on the next page for further discussion of this recommendation.

LAO RECOMMENDS BRINGING THE STATE WATER PROJECT “ON BUDGET”

In our *Analysis of the 2007-08 Budget Bill* (page B-129), and in our *2009-10 Budget Analysis Series: Resources and Environmental Protection* (page RES-49), we recommended bringing the State Water Project (SWP) on budget so that its expenditures be subject to ongoing legislative review and approval in the annual budget bill process. Currently, the allocation of SWP funds to support SWP operations and capital outlay expenditures is not subject to appropriation by the Legislature in the annual budget bill. The Legislature only reviews requests for new positions for the SWP.

SWP’s Budget Development Lacks Checks and Balances. We are concerned that the process the Department of Water Resources (DWR) follows to develop SWP budgets lacks checks and balances that would help ensure accountability. The only public review of the SWP spending plan takes place at legislative budget hearings, and then only in the context of specific requests for position authority. This relative lack of budgetary oversight also applies to SWP’s capital projects, although there is some limited oversight provided by the Department of Finance and the bonding agencies in cases in which the SWP issues revenue bonds to finance the construction of its projects.

SWP No Longer a Self-Contained Program. In the past, SWP operated as a discrete, self-contained program with sufficient fiscal oversight provided by SWP contractors (who pay most of the project’s costs). However, this situation has changed. We have found that not only is SWP integrally linked to other programs, but that its operation has created significant liabilities for other programs and funding sources, including the General Fund, without any legislative oversight. The DWR’s implementation of Davis-Dolwig is just one example of this.

Recommend SWP Be Brought On Budget. We therefore recommend the enactment of legislation that would make SWP subject in all respects to the annual legislative budget process in order to provide an appropriate level of legislative fiscal and policy oversight of SWP.

Figure 4 compares the Governor’s proposal to address the problems with the Davis-Dolwig Act with the LAO’s proposals, which are outlined below.

Specify What Costs Are Eligible for Davis-Dolwig. As current law does not specify what costs are eligible to be funded by the state under Davis-Dolwig, DWR has interpreted the act broadly, leading to what we view as the inclusion of inappropriate costs to the state under Davis-Dolwig. We propose several steps to address this situation:

- First, we recommend that Davis-Dolwig be amended to specify that only costs related to *construction of recreation facilities at new SWP facilities* are to be paid for by the state under Davis-Dolwig. The Legislature should specify that there is to be no allocation of total SWP costs to recreation. The recreation cost component of SWP capital projects would be removed, presumably allowing revenue bonds to be sold and construction to continue on pending SWP projects.

- Second, we recommend that the Legislature specify that SWP is no longer to incur operational and maintenance costs for state recreation areas, or use SWP funds for these purposes. These costs should be considered for funding alongside any other budget requests for the state park system, and be subject to legislative review and approval in the annual budget process. In particular, DWR should not incur any further costs related to the operation of the SRA at Lake Perris.
- Third, we also recommend that the Legislature specify that any SWP recreation facilities that are to be developed or improved under a regulatory requirement shall not be considered eligible state costs under Davis-Dolwig. This approach is consistent with legislative policy on how regulatory compliance costs are to

be funded. If this recreation spending is required by a federal, state, or local regulatory agency as a condition of approving the construction or operation of an SWP facility, these regulatory costs should be considered a project cost and paid for by SWP contractors.

If the Legislature decides to include recreation facilities at the time that the construction of new SWP facilities is authorized, we would concur with the current policy approach contained in Davis-Dolwig. In these circumstances, we believe it is reasonable that the costs for these recreation facilities not be charged to SWP contractors. The Legislature should amend the state law, however, to specify that no discretionary spending for such recreation facilities is to be incurred without prior legislative approval and a prior legislative budget appropriation to cover the entire cost of the project.

Figure 4

Governor’s Versus LAO’s Proposals for Davis-Dolwig Act Reform

Issue	Governor	LAO
<ul style="list-style-type: none"> • Addresses over-allocation of total State Water Project (SWP) costs to recreation? 	No proposal.	Limits Davis-Dolwig costs to construction of recreational facilities at new SWP facilities.
<ul style="list-style-type: none"> • Addresses Department of Water Resources (DWR) incurring some operational costs at recreational facilities, without legislative review? 	Limited legislative oversight (only for spending in excess of \$7.5 million per year).	Specifies that DWR cannot incur recreation operational costs. Requires an appropriation in the budget act for all recreation operational costs through budget of Department of Parks and Recreation.
<ul style="list-style-type: none"> • Prevents regulatory costs being passed to the state? 	No proposal.	Specifies that regulatory compliance costs are to be paid by the SWP contractors.
<ul style="list-style-type: none"> • Allows revenue bonds to be sold? 	Provides funding for costs allocated to recreation. Administration states that this will remove impediment to revenue bond issuance.	Removes the recreation component of cost allocation and hence the impediment to revenue bond issuance.

Figure 5 compares the way SWP recreation costs are currently being funded with how they would be funded under our proposal.

The DWR Should Evaluate Potential Divestment of SWP Facilities Mainly Used for Recreation. As we noted earlier, some SWP facilities have little or no water supply benefits. Recreation is their sole or primary benefit. In our view, this means it would be inappropriate for SWP contractors to subsidize the costs of operating these state recreation facilities on an ongoing basis.

Therefore, we recommend that the Legislature direct DWR to evaluate the potential to

divest SWP of these facilities and to shift them to other state, local, or federal agencies whose mission is to operate recreational facilities. The DWR should report to the Legislature by December 2009 with the findings from this evaluation, including a discussion of the costs and benefits and any legal impediments to such a divestment. The report should also provide a plan for such divestment, to the extent it is determined to be a legally and fiscally feasible course of action.

Recommend the Legislature Provide Clear Policy Direction on Status of Costs Previously Allocated by DWR to Davis-Dolwig. As dis-

Figure 5

Comparison of Funding for Recreation in the State Water Project (SWP): Current Practice Versus LAO Proposal

Cost Category	Funding Source	
	Current Practice	LAO Proposal
Operating Costs		
• Direct operating costs of recreation facilities	State funds (Department of Parks and Recreation [DPR]) or other state, local or federal entity's funds.	State funds (DPR) or other state, local, or federal entity's funds.
• Indirect recreation operating costs (allocation)	Monies fronted by SWP contractors. ^a	Not applicable—we recommend that there be no allocation of indirect costs to recreation.
• Recreation operations at Lake Perris	Monies fronted by SWP contractors. ^a	State funds (DPR).
• Recreation operations at Lake Oroville (regulatory costs)	Monies fronted by SWP contractors. ^a	SWP contractors.
Capital Costs		
• Capital improvements of recreation facilities	State funds (Department of Boating and Waterways or DPR) or other local or federal entity's funds.	State funds (Department of Boating and Waterways or DPR) or other local or federal entity's funds.
• Indirect recreation capital costs (allocation)	Monies fronted by SWP contractors. ^a	Not applicable—we recommend that there be no allocation of indirect costs to recreation.
• Recreation facilities required for regulatory compliance	Monies fronted by SWP contractors. ^a	SWP contractors.
• Discretionary recreation at new SWP facilities approved by the Legislature	Not applicable, as legislative approval currently not required.	State funds.

^a Costs allocated by the Department of Water Resources to the state under Davis-Dolwig (assumes state public funds will pay), but monies have been fronted by SWP contractors.

cussed above, the budget proposes to clarify in statute that no historical obligation exists for unfunded Davis-Dolwig costs. As we discussed earlier, this approach has significant legal and policy implications. We do concur with the concept that, after it has reviewed these issues, the Legislature should clarify in statute its posi-

tion regarding the payment of these unfunded costs. If the Legislature chooses to have the state assume some of the historical costs of recreation, it should direct the Department of Finance to develop an implementation plan by December 2009 to carry out the Legislature's policy direction in this area.

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This report was prepared by Caroline Godkin, and reviewed by Mark Newton. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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