

# RESOURCES



65 YEARS OF SERVICE

2007-08 Analysis



# MAJOR ISSUES

## *Resources*

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### **Big Influx of Bond Funds: State Should Proceed Carefully**

- The budget proposes over \$2.3 billion in bond funding for various resources programs, most of which comes from two resources bonds approved by voters in November 2006. The state would spend substantially higher bond amounts than in the current year, particularly for flood management.
- To ensure the effective and efficient implementation of the new bonds, we recommend that the Legislature set funding priorities to guide new programs created by the bonds; establish appropriate cost-sharing arrangements; ensure related programs are coordinated; and exercise oversight by holding hearings, establishing reporting requirements, and controlling administrative costs (see page B-17).



### **Oversight of State Water Project and Flood Management Spending Crucial**

- We recommend that funding for the State Water Project (SWP) be brought “on budget,” as SWP’s current off-budget status makes it difficult for the Legislature to comprehensively address the state’s water policy issues. Legislative oversight of the \$725 million in flood management budget proposals would be enhanced by establishing an oversight process for capital outlay project management and requiring reporting on capital outlay expenditures (see pages B-129 and B-117).



### **Climate Change Proposals Veer Off Statutory Roadmap**

- The budget proposes \$36 million across several state agencies to implement 2006 legislation that sets objectives and

provides a roadmap for reducing greenhouse gas emissions in the state.

- The Governor's climate change budget proposals circumvent legislative direction, by moving prematurely to implement a market-based regulatory mechanism and assigning a role to the Cal-EPA Secretary that goes beyond coordination. There also is no long-term plan for funding these proposals, a concern since most of the proposed funding sources will run out in the next budget year (see page B-50).



### **Wildland Firefighting Expenditures Continue to Rise Significantly**

- The fire protection budget of the state's forestry department (mostly funded from the state General Fund) continues to rise significantly. This reflects changing forest conditions fueling fire risk, increasing housing development at the wildland-urban boundary, and increasing labor costs.
- We make a number of recommendations to control the rising costs, including clarifying state and local roles for providing emergency services, modifying the criteria by which land is designated a state responsibility for fire protection, and enacting a fee on private landowners to partially cover the state's costs in providing fire protection services that benefit them (see page B-77).



### **Budget Fails to Address State Parks Maintenance Requirements**

- Despite a growing backlog in deferred maintenance at state parks—currently over \$900 million—the budget provides no funding to address the problem. There is also a significant funding shortfall related to ongoing maintenance at state parks.
- To address these problems, we recommend using \$160 million of Proposition 84 bond funds allocated to state park restoration and rehabilitation for deferred maintenance, and augmenting the department's ongoing maintenance budget by \$15 million, funded from fees (see page B-102).

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# OVERVIEW

## *Resources*

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**T**he budget proposes slightly lower state expenditures (from all funds) for resources and environmental protection programs in 2007-08 compared to the estimated current-year level. Most of this reduction reflects the elimination of a number of one-time General Fund expenditures that occurred in the current year. The budget also proposes significantly higher bond expenditures for the budget year, reflecting the infusion of available bond funds from two resources-related measures approved by the voters at the November 2006 election. The Governor has also proposed a \$4 billion water management bond measure to be submitted for voter approval in 2008.

## EXPENDITURE PROPOSALS AND TRENDS

Expenditures for resources and environmental protection programs from the General Fund, various special funds, and bond funds are proposed to total \$7 billion in 2007-08, which is 4.9 percent of all state-funded expenditures proposed for the budget year. This level is a decrease of \$253 million, or 3.5 percent, below estimated expenditures for the current year.

*Decrease Largely Reflects Reduction in General Fund Expenditures.* The proposed reduction in state-funded expenditures for resources and environmental protection programs mostly reflects a \$695 million (31 percent) decrease in General Fund expenditures in a number of program areas. This General Fund reduction is largely due to two sets of factors. First, is the elimination of a number of one-time General Fund expenditures that occurred in the current year, including for state parks deferred maintenance, repairs of critical levee erosion sites, local flood control subventions, and fish and wildlife programs. Second, the Governor proposes to use bond funds to reimburse the General Fund, in the budget year, for \$200 million of flood control expenditures made in the current and previous years. (As

discussed next, this decrease in General Fund expenditures is partially offset by an increase in expenditures from bonds.)

***Spending From Bond Funds Up Significantly.*** On the other hand, the budget reflects an increase in bond expenditures for various purposes. Between 1996 and 2006, the state's voters have approved about \$20.6 billion of resources bonds. Of this total, \$11.1 billion comes from five measures approved between 1996 and 2002, of which about \$1.3 billion remains available for appropriation for new projects in the budget year. The balance of approved bonds—\$9.5 billion—comes from two measures approved by voters this past November: Proposition 1E (\$4.1 billion for flood control) and Proposition 84 (\$5.4 billion for various resources purposes).

The budget proposes bond expenditures totaling \$2.4 billion in 2007-08—an increase of \$341 million, or 17 percent, over estimated bond expenditures in the current year. A majority of the proposed bond expenditures are from the two recent measures—\$1.1 billion is proposed from Proposition 84 and \$624 million from Proposition 1E. Accounting for the proposed budget-year expenditures, the 1996 through 2002 bond funds will be substantially depleted at the end of the budget year, with about \$700 million available for appropriation for new projects in future years.

The Governor has also proposed a \$4 billion water management bond to be submitted for voter approval in 2008. (This bond proposal has been introduced this session as SB 59 [Cogdill].) We discuss the status of current bond funds, issues concerning the November bonds, as well as the Governor's proposed bond measure in greater detail in the "Resources Bonds" write-up in the Crosscutting Issues section of this chapter.

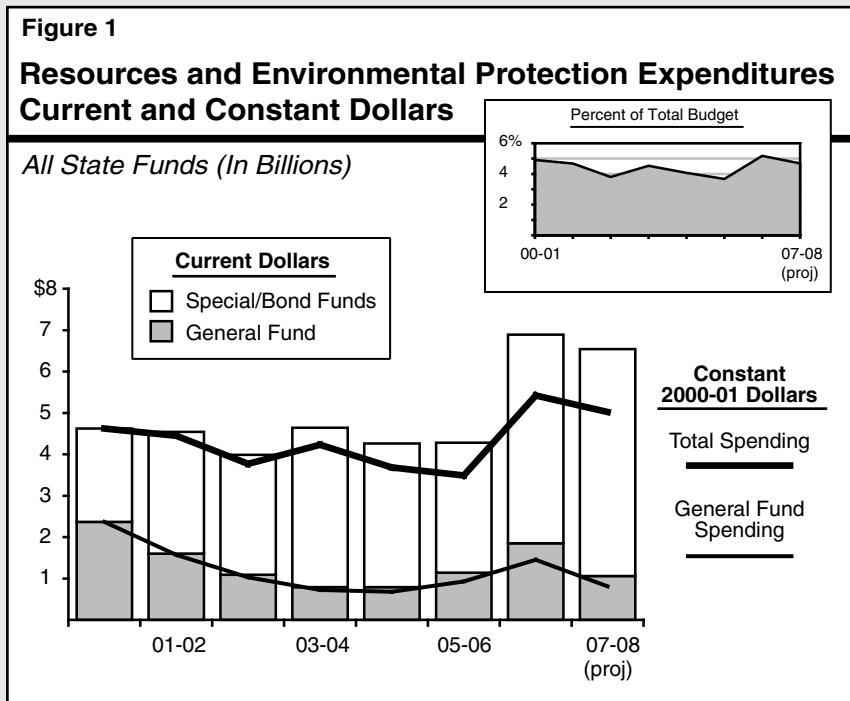
***Spending From Special Funds Up Slightly.*** The budget proposes special fund expenditures that are \$101 million, or 3.4 percent, above the current-year level. Most of this increase reflects an increase in incentive payments to recycling industries under the Department of Conservation's (DOC's) beverage container recycling program, pursuant to various statutes enacted over the last few years.

***Funding Sources.*** The largest proportion of state funding for resources and environmental protection programs—about \$3.1 billion (or 44 percent)—will come from various special funds. These special funds include the Environmental License Plate Fund, Fish and Game Preservation Fund, funds generated by beverage container recycling deposits and fees, an "insurance fund" for the cleanup of leaking underground storage tanks, and a relatively new electronic waste recycling fee. Of the remaining expenditures, \$2.4 billion will come from bond funds (34 percent of total expenditures) and \$1.5 billion will come from the General Fund (22 percent of total expenditures).



**Expenditure Trends.** Figure 1 shows that state expenditures for resources and environmental protection programs increased by about \$1.9 billion since 2000-01, representing an average annual increase of about 5 percent. The increase between 2000-01 and 2007-08 reflects an increase in special fund and bond expenditures. On the other hand, the budget proposes General Fund expenditures for 2007-08 that are substantially below 2000-01 spending—a decrease of \$1.3 billion.

When adjusted for inflation, total state expenditures for resources and environmental protection programs have been relatively stable—an average annual increase of about 1 percent. When adjusted for inflation, the decline in General Fund expenditures is even more pronounced—an average annual decrease of about 14 percent. General Fund expenditures for resources and environmental protection programs peaked in 2000-01, declined from 2001-02 through 2004-05 due to the state’s weakened fiscal condition, but ticked up in 2005-06 and subsequent years.



## SPENDING BY MAJOR PROGRAM

*Cost Drivers for Resources Programs.* For a number of resources departments, the expenditure levels are driven mainly by the availability of bond funds for purposes of fulfilling their statutory missions. This would include departments whose main activity is the acquisition of land for restoration and conservation purposes as well as departments who administer grant and loan programs for various resources activities.

For other departments that rely heavily on fees, their expenditure levels are affected by the amount of fees collected.

Some resources departments own and operate public facilities, such as state parks and boating facilities. The number and nature of such facilities drive operations and maintenance expenditures for these departments.

In addition, the state's resources programs include a number of regulatory programs. The cost drivers for these programs include the number and complexity of regulatory standards that are required to be enforced and the related composition of the entities which are regulated.

Finally, some resources activities have a public safety purpose, and the cost drivers include emergency response costs that can vary substantially from year to year. These activities include the California Department of Forestry and Fire Protection's (CDFFP's) emergency fire suppression activities and the emergency flood response actions of the Department of Water Resources (DWR).

*Cost Drivers for Environmental Protection Programs.* A core activity of departments and boards under the California Environmental Protection Agency (Cal-EPA) is the administration of regulatory programs that implement federal and state environmental quality standards. These regulatory programs generally involve permitting, inspection, and enforcement activities. The main cost drivers for environmental protection programs are the number and complexity of environmental standards that are required to be enforced, which dictate the extent of the parties regulated by the departments and therefore the regulatory workload.

In addition, a number of Cal-EPA departments administer grant and loan programs. The expenditure level for grant and loan programs, and the staffing requirements to implement them, are driven largely by the availability of bond funds or fee-based special funds to support them.

*Budget's Spending Proposals.* Figure 2 shows spending for major resources programs—that is, those programs within the jurisdiction of the Secretary for Resources and the Resources Agency.

## Figure 2 Resources Budget Summary Selected Funding Sources

(Dollars in Millions)

Department	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Change From 2006-07	
				Amount	Percent
<b>Resources Secretary</b>					
Bond funds	\$5.8	\$148.3	\$47.7	-\$100.6	-67.8%
Other funds	4.2	17.0	25.6	8.6	50.6
<b>Totals</b>	<b>\$10.0</b>	<b>\$165.3</b>	<b>\$73.3</b>	<b>-\$92.0</b>	<b>-55.7%</b>
<b>Conservation</b>					
General Fund	\$4.9	\$4.6	\$4.7	\$0.1	2.2%
Recycling funds	828.4	972.4	1,177.6	205.2	21.1
Other funds	46.4	72.0	82.5	10.5	14.6
<b>Totals</b>	<b>\$879.7</b>	<b>\$1,049.0</b>	<b>\$1,264.8</b>	<b>\$215.8</b>	<b>20.6%</b>
<b>Forestry and Fire Protection</b>					
General Fund	\$544.4	\$625.8	\$654.9	\$29.1	4.7%
Other funds	310.2	346.0	652.6	306.6	88.6
<b>Totals</b>	<b>\$854.6</b>	<b>\$971.8</b>	<b>\$1,307.5</b>	<b>\$335.7</b>	<b>34.5%</b>
<b>Fish and Game</b>					
General Fund	\$39.1	\$133.1	\$78.6	-\$54.5	-41.0%
Fish and Game Fund	87.8	57.8	85.9	28.1	48.6
Bond funds	26.2	133.6	84.0	-49.6	-37.1
Other funds	117.0	186.5	198.5	10.0	5.4
<b>Totals</b>	<b>\$270.1</b>	<b>\$511.0</b>	<b>\$447.0</b>	<b>-\$64.0</b>	<b>-12.5%</b>
<b>Parks and Recreation</b>					
General Fund	\$101.4	\$231.6	\$150.4	-\$81.2	-35.1%
Parks and Recreation Fund	120.7	121.2	121.2	—	—
Bond funds	185.7	139.3	69.4	-69.9	-50.2
Other funds	121.7	236.7	152.8	-83.9	-35.5
<b>Totals</b>	<b>\$529.5</b>	<b>\$728.8</b>	<b>\$493.8</b>	<b>-\$235.0</b>	<b>-32.2%</b>
<b>Water Resources</b>					
General Fund	\$338.7	\$688.1	\$5.1	-\$683.0	-99.3%
State Water Project funds	1,199.3	940.2	959.3	19.1	2.0
Bond funds	130.5	398.0	1,378.6	989.6	248.6
Electric Power Fund	6,028.5	5,789.9	5,577.2	-212.7	-3.7
Other funds	29.1	73.5	73.5	—	—
<b>Totals</b>	<b>\$7,726.1</b>	<b>\$7,889.7</b>	<b>\$7,993.7</b>	<b>\$104.0</b>	<b>1.3%</b>

Figure 3 shows similar information for major *environmental protection* programs—those programs within the jurisdiction of the Secretary for Environmental Protection and Cal-EPA.

<b>Figure 3</b>					
<b>Environmental Protection Budget Summary</b>					
<b>Selected Funding Sources</b>					
<i>(Dollars in Millions)</i>					
Department/Board	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Change From 2006-07	
				Amount	Percent
<b>Air Resources</b>					
General Fund	\$2.2	\$2.3	\$3.4	\$1.1	47.8%
Motor Vehicle Account	99.5	156.4	105.1	-51.3	-32.8
Air Pollution Control Fund	136.2	130.8	154.9	24.1	18.4
Other funds	29.3	34.5	131.2	96.7	280.3
<b>Totals</b>	<b>\$267.2</b>	<b>\$324.0</b>	<b>\$394.6</b>	<b>\$70.6</b>	<b>21.8%</b>
<b>Waste Management</b>					
Integrated Waste Account	\$43.7	\$50.8	\$50.6	-\$0.2	-0.4%
Electronic Recycling Account	46.6	67.7	69.6	1.9	2.8
Other funds	61.6	80.6	78.9	-1.7	-2.1
<b>Totals</b>	<b>\$151.9</b>	<b>\$199.1</b>	<b>\$199.1</b>	<b>—</b>	<b>—</b>
<b>Pesticide Regulation</b>					
Pesticide Regulation Fund	\$57.4	\$62.3	\$65.4	\$3.1	5.0%
Other funds	3.3	3.6	3.5	-0.1	-2.8
<b>Totals</b>	<b>\$60.7</b>	<b>\$65.9</b>	<b>\$68.9</b>	<b>\$3.0</b>	<b>4.6%</b>
<b>Water Resources Control</b>					
General Fund	\$29.7	\$39.1	\$39.1	—	—
Underground Tank Cleanup	272.3	274.0	278.8	\$4.8	1.8%
Bond funds	151.3	367.6	255.0	-112.6	-30.6
Waste Discharge Fund	58.7	67.7	67.8	0.1	0.2
Other funds	104.1	193.0	193.8	0.8	0.4
<b>Totals</b>	<b>\$616.1</b>	<b>\$941.4</b>	<b>\$834.5</b>	<b>-\$106.9</b>	<b>-11.4%</b>
<b>Toxic Substances Control</b>					
General Fund	\$18.3	\$32.5	\$25.3	-\$7.2	-22.2%
Hazardous Waste Control	47.8	52.4	50.9	-1.5	-2.9
Toxic Substances Control	37.4	36.4	46.7	10.3	28.3
Other funds	42.7	63.6	61.3	-2.3	-3.6
<b>Totals</b>	<b>\$146.2</b>	<b>\$184.9</b>	<b>\$184.2</b>	<b>-\$0.7</b>	<b>-0.4%</b>
<b>Environmental Health Hazard Assessment</b>					
General Fund	\$8.3	\$8.8	\$8.9	\$0.1	1.1%
Other funds	6.4	8.3	8.6	0.3	3.6
<b>Totals</b>	<b>\$14.7</b>	<b>\$17.1</b>	<b>\$17.5</b>	<b>\$0.4</b>	<b>2.3%</b>

**Spending for Resources Programs.** Figure 2 shows the General Fund will provide just over 50 percent (\$655 million) of CDFFP's total expenditures for 2007-08. The General Fund will account for much less in the support of other resources departments. For instance, for DOC, the General Fund will constitute less than 1 percent (\$4.7 million) of its budget-year expenditures. In the case of the Department of Fish and Game (DFG) and the Department of Parks and Recreation (DPR), the General Fund will pay about 18 percent (\$79 million) and 30 percent (\$150 million) of the respective departments' expenditures. The DWR's expenditure total is skewed by the almost \$5.6 billion budgeted under DWR for energy contracts entered into on behalf of investor-owned utilities. If these energy-related expenditures are excluded from DWR's total, the General Fund still pays for only about 8 percent (\$205 million) of DWR's expenditures. (Figure 2 reflects DWR's General Fund expenditures at \$5 million, as the Governor's budget display shows the department's General Fund expenditure total as being reduced by the proposed \$200 million bond-funded reimbursement to the General Fund for flood control expenditures incurred before bond passage.)

Figure 2 also shows that compared to current-year expenditures, the budget proposes an overall spending reduction in some resources departments, while proposing an overall spending increase in others. Specifically, for the Secretary, DFG, and DPR, the reduction reflects a decrease in spending from the 1996 through 2002 resources bond funds, partially offset by spending from Proposition 84 bond funds. Also, in the case of DFG and DPR, the reduction reflects the elimination of one-time General Fund expenditures that occurred in the current year.

The budget's proposed increase in total spending in CDFFP (34.5 percent) largely reflects an increase of \$317 million in capital outlay expenditures (funded mainly from lease-revenue bonds). For DOC, the proposed increase in spending (20.6 percent) mostly reflects an increase in incentive payments to recycling industries.

Finally, while the figure shows relatively stable spending overall in DWR (a modest 1.3 percent spending increase), the proposed mix of funding sources and program activities for DWR in the budget year differ substantially from the current year. Specifically, the budget proposes a major reduction of General Fund spending (as noted previously, mainly reflecting the elimination of one-time flood control expenditures that occurred in the current year), and a substantial increase in expenditures overall for flood control, largely due to the major infusion of Propositions 1E and 84 bond funds for this purpose.

**Spending for Environmental Protection Programs.** As Figure 3 shows, the budget proposes relatively stable spending for a majority of

environmental protection departments. The one area with significant proposed overall increase (21.8 percent) is the Air Resources Board (ARB). This reflects (1) \$96.5 million in spending from Proposition 1B (the transportation bond) funds for grants to replace and retrofit high-polluting school buses and (2) an increase of \$24.4 million from special funds for climate change-related program implementation. On the other hand, the one area with a significant proposed reduction (11.4 percent) is the State Water Resources Control Board, mostly reflecting a decrease in spending from Propositions 40 and 50 bond funds, partially offset by new spending from Proposition 84 bond funds.

## MAJOR BUDGET CHANGES

Figure 4 presents the major budget changes in resources and environmental protection programs.

As shown in Figure 4, the budget proposes a number of bond fund and special fund increases throughout resources and environmental protection departments.

Bond-funded proposals of particular note include (1) \$97.5 million for an ARB grant program for the replacement and retrofit of high-polluting school buses; (2) \$13.9 million for the Secretary for Resources (to disburse to DFG and DWR) to support the implementation of a settlement agreement among the federal government, water users, and environmental interests related to the restoration of the San Joaquin River; and (3) \$598 million from recently passed bonds for flood control programs and projects carried out in the budget year. (As mentioned earlier, the budget also proposes to use \$200 million in Proposition 1E bond funds to reimburse the General Fund for flood control expenditures incurred before bond passage.)

As regards special fund proposals, the budget also proposes \$24.4 million in ARB to implement Chapter 488, Statutes of 2006 (AB 32, Núñez)—the Global Warming Solutions Act of 2006. The Governor's budget proposes this funding—which is in addition to \$11.4 million proposed in several other state departments for AB 32 implementation—to be used to develop a mandatory emissions reporting system, a market-based emissions trading system, and a plan on how to achieve statutory emission reduction targets. The budget also proposes: (1) \$6 million (Motor Vehicle Account) as matching funds for hydrogen fueling stations under the Governor's Hydrogen Highway Initiative and (2) \$24.8 million in funds received by the state from an energy crisis-related settlement entered into with the Williams Energy Company to provide financial assistance to schools for energy conservation projects.

**Figure 4****Resources and Environmental Protection Programs  
Proposed Major Changes for 2007-08****Air Resources**

- + \$96.5 million (bond funds) for Lower Emission School Bus Program
- + \$24.4 million (special funds) to implement greenhouse gas emission reduction legislation
- + \$6 million (Motor Vehicle Account) to continue Governor's Hydrogen Highway Initiative

**Energy Resources**

- + \$24.8 million in electricity contract settlement funds for energy conservation projects at schools

**Parks and Recreation**

- \$80 million (General Fund) for state parks deferred maintenance

**Secretary for Resources**

- + \$13.9 million (bond funds) for San Joaquin River restoration

**Water Resources**

- + \$598 million in Propositions 1E/84 bond funds for various flood control programs
- + \$200 million in Proposition 1E bond funds for transfer to General Fund, as reimbursement for previous flood control expenditures
- + \$47.3 million (General Fund) to continue lining of the All-American Canal

Finally, as shown in the figure, the budget proposes to create General Fund savings in the state parks deferred maintenance program. The budget proposes to do this by transferring back (“reverting”) to the General Fund \$160 million—of the \$250 million General Fund appropriation in the *2006 Budget Act* for deferred maintenance—the amount projected to remain unspent at the end of the current year. (The current-year budget assumes that the \$250 million would be spent as follows: \$90 million in 2006-07, and \$80 million in each of 2007-08 and 2008-09.) Although the Governor notes in his *Budget Summary* document that bond funds are available as a replacement funding source, the budget does not propose bond funding for state parks deferred maintenance in the budget year.



# CROSSCUTTING ISSUES

*Resources*

## RESOURCES BONDS

The state uses a number of bond funds to support the departments, conservancies, boards, and programs under the Resources and California Environmental Protection Agencies that regulate and manage the state's natural resources. Of the \$7 billion in state-funded expenditures for resources and environmental protection programs proposed for 2007-08, about \$2.4 billion (34 percent) is proposed to come from bond funds. This amount is about \$341 million more than estimated bond expenditures in the current year, reflecting the influx of a total of \$9.5 billion of available funds from the Propositions 1E and 84 resources bond measures approved by the voters in November 2006. These two bonds provide a major one-time infusion of state funds for flood management; safe drinking water, water quality, and water supply; natural resource protection; and park improvements. The Governor has also proposed a \$4 billion water management general obligation (GO) bond measure to be submitted for voter approval in 2008.

In the sections that follow, we provide a brief status report on the fund condition of various pre-2006 resources bond funds, highlight key programs funded by Propositions 1E and 84 and summarize the Governor's budget proposals for these two bonds, identify issues and offer recommendations that the Legislature should consider to ensure the effective and efficient implementation of Propositions 1E and 84, and describe the Governor's proposed 2008 bond measure.

## PRE-2006 RESOURCES BONDS

*The budget proposes expenditures in 2007-08 of around \$600 million from the five resources bonds approved by the voters since 1996. The proposed expenditures would leave a balance of about \$700 million for new projects beyond the budget year. Most bond funds for park projects, land acquisition, and restoration have been appropriated, with the funds remaining being mainly for water quality and safe drinking water projects, integrated regional water management, and ecosystem restoration and other water-related projects under the CALFED Bay-Delta Program.*

**Five Resources Bonds Approved Between 1996 and 2002.** Between 1996 and 2002 (the last year, prior to November 2006, that voters approved resources-related GO bonds), voters had authorized \$11.1 billion in five GO bonds for various resources purposes. Funding from these bonds was allocated as follows:

- \$3.2 billion for a broad array of land acquisition and restoration projects, including ecosystem restoration, agricultural land preservation, urban forestry, and river parkway projects.
- \$2.7 billion for state and local park projects and for historical and cultural resources preservation.
- \$2 billion for various water quality purposes, including wastewater treatment, watershed protection, clean beaches, and safe drinking water infrastructure upgrades.
- \$1.7 billion for various water management purposes, including water supply, flood control, desalination, water recycling, water conservation, and water system security. Of this total amount, about \$400 million is allocated specifically for flood control.
- \$1.5 billion for CALFED, a federal-state consortium of over 20 agencies created to address interrelated water quality, water supply, fish and wildlife habitat, and flood protection issues in the Delta region of the state.
- \$50 million for grants to improve air quality in state and local parks.

**Budget Proposal.** The budget proposes expenditures totaling about \$530 million in 2007-08 from the five, 1996 through 2002, resources bonds. The budget projects a balance of at least \$700 million from the five bonds for new projects beyond the budget year. Of this remaining balance, most of the funding is available for water quality, safe drinking water, integrated regional water management, and ecosystem and other water-related proj-

ects under CALFED. Virtually no funding remains for state and local parks and little funding remains for land acquisition and restoration projects.

## MAJOR PROVISIONS OF PROPOSITIONS 1E AND 84

**Proposition 1E.** Proposition 1E authorizes the state to sell about \$4.1 billion in GO bonds for various flood management purposes. Figure 1 summarizes the purposes for which the bond money would be available for expenditure by the Department of Water Resources (DWR) and for grants to local agencies. In order to spend these bond funds, the measure requires the Legislature to appropriate them in the annual budget act or other legislation.

<b>Figure 1</b>	
<b>Proposition 1E</b>	
<b>Uses of Bond Funds</b>	
<i>(In Millions)</i>	
	<b>Amounts</b>
State Central Valley flood control system repairs and improvements; Delta levee repairs and maintenance.	\$3,000
Flood control subventions (local projects outside the Central Valley).	500
Stormwater flood management (grants for projects outside the Central Valley).	300
Flood protection corridors and bypasses; floodplain mapping.	290
<b>Total</b>	<b>\$4,090</b>

Proposition 1E also requires the Secretary for Resources to (1) provide for an independent audit of bond fund expenditures to ensure that all moneys are expended in accordance with the measure and (2) publish annually a list of all program and project expenditures funded from the bond.

Companion legislation to the flood control bond measure—Chapter 31, Statutes of 2006 (AB 1039, Nuñez)—was enacted to streamline the environmental review and permitting process for flood control projects funded from the bond in order to facilitate timely project delivery. Specifically, Chapter 31 includes an exemption from the California Environmental Quality Act for the repair of specified critical levees of the Sacramento River Flood Control Project. Chapter 31 also requires a consolidated environmental permitting process for levee repair projects funded from

the bond, to reduce or eliminate unnecessary duplication, overlap, and paperwork associated with the multiple permits required.

**Proposition 84.** Proposition 84 authorizes the state to sell about \$5.4 billion in GO bonds for safe drinking water, water quality, and water supply; flood control; natural resource protection; and park improvements. Figure 2 summarizes the purposes for which the bond money would be available for expenditure by various state agencies and for loans and grants, primarily to local agencies and nonprofit organizations. In order to spend most of these bond funds, the measure requires the Legislature to appropriate them in the annual budget act or other legislation. Specifically, only \$620 million in funding (\$315 million allocated to the Wildlife Conservation Board [WCB] for forest conservation and wildlife habitat projects and \$305 million allocated to DWR for floodplain mapping and flood control projects) is “continuously appropriated,” meaning that a legislative appropriation is not required before funds can be spent.

Proposition 84 also requires the Secretary for Resources to (1) provide for an independent audit of bond fund expenditures to ensure that all monies are expended in accordance with the measure and (2) publish annually a list of all program and project expenditures funded from the bond.

## GOVERNOR’S BUDGET PROPOSAL FOR PROPOSITIONS 1E AND 84

**Proposition 1E.** The Governor’s budget proposes \$624 million in expenditures from Proposition 1E in 2007-08, about 15 percent of total funding authorized in the measure. (No expenditures are proposed for 2006-07.) All of the funding for 2007-08 is proposed for appropriation in the budget bill. The Governor’s budget document was not accompanied by any proposed statutory language to implement the measure. The Governor’s budget proposal is summarized in Figure 3 (see page 22).

**Proposition 84.** From Proposition 84, the Governor’s budget proposes \$60 million in expenditures in 2006-07 (\$25 million for wildlife habitat protection and \$35 million for forest conservation) and about \$1.1 billion in expenditures in 2007-08, representing about 22 percent of total funding authorized in the measure. Most of the funding is proposed for appropriation in the budget bill, with the exception of \$121 million of expenditures in WCB for forest conservation and wildlife habitat projects (in 2006-07 and 2007-08 combined) and \$93 million of expenditures in DWR for floodplain mapping and flood control projects (in 2007-08). No statutory language has been proposed by the Governor to implement the measure. The Governor’s budget proposal for 2007-08 is summarized in Figure 4 (see page 23).

**Figure 2**  
**Proposition 84**  
**Uses of Bond Funds**

*(In Millions)*

<b>Water Quality</b>	<b>\$1,525</b>
• Integrated regional water management.	1,000
• Safe drinking water.	380
• Delta and agriculture water quality.	145
<b>Protection of Rivers, Lakes, and Streams</b>	<b>\$928</b>
• Regional conservancies.	279
• Other projects—public access, river parkways, urban stream restoration, California Conservation Corps.	189
• Delta and coastal fisheries restoration.	180
• Restoration of the San Joaquin River.	100
• Restoration projects related to the Colorado River.	90
• Stormwater pollution prevention.	90
<b>Flood Control</b>	<b>\$800</b>
• State flood control projects—evaluation, system improvements, flood corridor program.	315
• Flood control projects in the Delta.	275
• Local flood control subventions (outside the Central Valley flood control system).	180
• Floodplain mapping and assistance for local land use planning.	30
<b>Sustainable Communities and Climate Change Reduction</b>	<b>\$580</b>
• Local and regional parks.	400
• Urban water and energy conservation projects.	90
• Incentives for conservation in local planning.	90
<b>Protection of Beaches, Bays, and Coastal Waters</b>	<b>\$540</b>
• Protection of various coastal areas and watersheds.	360
• Clean Beaches Program.	90
• California Ocean Protection Trust Fund—marine resources, sustainable fisheries, and marine wildlife conservation.	90
<b>Parks and Natural Education Facilities</b>	<b>\$500</b>
• State park system—acquisition, development, and restoration.	400
• Nature education and research facilities.	100
<b>Forest and Wildlife Conservation</b>	<b>\$450</b>
• Wildlife habitat protection.	225
• Forest conservation.	180
• Protection of ranches, farms, and oak woodlands.	45
<b>Statewide Water Planning</b>	<b>\$65</b>
• Planning for future water needs, water conveyance systems, and flood control projects.	65
<b>Total</b>	<b>\$5,388</b>

**Figure 3****Governor's Budget Proposed Expenditures  
Proposition 1E—Flood Control***(In Millions)*

	<b>2007-08</b>
State Central Valley flood control; Delta levees	\$520 <sup>a</sup>
Flood control subventions	—
Stormwater flood management	102
Flood protection corridors and bypasses; floodplain mapping	2
<b>Total</b>	<b>\$624</b>

<sup>a</sup> Includes \$200 million "payback" to the General Fund for projects funded prior to bond passage.

*Flood Control Expenditures Have a Local Assistance Focus.* It is important to note that of the roughly \$600 million total of proposed flood control expenditures from Propositions 1E and 84 in 2007-08 (excluding the \$200 million transfer to the General Fund from Proposition 1E), about two-thirds (\$401 million) is proposed for local assistance. This local assistance includes flood control subventions (payment of the state share of costs of locally sponsored, federally authorized projects), grants for projects to improve flood protection in urban Central Valley areas, support for local maintenance and improvements of Delta levees, grants for new flood control feasibility studies and levee evaluations, and programs to improve floodway corridors. According to DWR, this local assistance (as opposed to state capital outlay) focus of the expenditures reflects the relatively greater resource capacity at this time of local flood control agencies, particularly urban ones, to deliver projects.

## **PROPOSITIONS 1E AND 84 IMPLEMENTATION: ISSUES FOR LEGISLATIVE CONSIDERATION**

In order to realize the full benefits of the infusion of bond funding provided by Propositions 1E and 84, it is important that the projects and programs funded are cost-effective in achieving the desired results of the measures. In this section, we highlight a number of issues for the Legislature to consider as it evaluates the Governor's budget proposals for these bond funds. We further recommend a number of legislative actions to provide for the effective and timely implementation of bond programs, consistent with legislative priorities. Our recommendations are summarized in Figure 5 (see page 24).

**Figure 4****Governor's Budget Proposed Expenditures  
Proposition 84—Resources***(In Millions)*

	<b>2007-08</b>
<b>Water Quality</b>	
Integrated regional water management	\$156
Safe drinking water	76
Delta and agriculture water quality	31
<b>Protection of Rivers, Lakes, and Streams</b>	
Regional conservancies	\$105
Other projects	9
Delta and coastal fisheries restoration	60
San Joaquin River	14
Colorado River	41
Stormwater pollution prevention	15
<b>Flood Control</b>	
State flood control projects	\$93
Delta flood control projects	58
Local flood control subventions	100
Floodplain mapping	25
<b>Sustainable Communities and Climate Change Reduction</b>	
Local and regional parks	\$1
Urban greening	11
Incentives for conservation planning	18
<b>Protection of Beaches, Bays, and Coastal Waters</b>	
Coastal areas and watersheds	\$93
Clean Beaches Program	9
Ocean Protection Trust Fund	29
<b>Parks and Natural Education Facilities</b>	
State park system	\$25
Nature education and research facilities	—
<b>Forest and Wildlife Conservation</b>	
Wildlife habitat protection	\$50
Forest conservation	35
Protection of ranches, farms, and oak woodlands	33
<b>Statewide Water Planning</b>	
Future planning	\$15
<b>Total</b>	<b>\$1,102</b>

**Figure 5****Recommendations to Improve Propositions 1E and 84 Implementation**

- ✓ **Defining Funding Eligibility**
  - Provide legislative direction for various new programs funded by Proposition 84.
  - Declare private water companies as eligible recipients of Proposition 84 funds.
  - Define project funding eligibility for flood control programs.
- ✓ **Establishing State-Local Cost Sharing**
  - Establish local matching requirement, along with any exemptions, for all flood control programs funded from the two bonds.
- ✓ **Being Advised of Federal Funding**
  - Request administration to advise Legislature at budget hearings of anticipated federal funding for flood control and the San Joaquin River restoration.
- ✓ **Considering Streamlining Measures to Improve Project Delivery**
  - Request administration to advise Legislature of statutory action that could be taken to improve timeliness of project delivery.
- ✓ **Coordinating Local Parks Programs**
  - Designate Department of Parks and Recreation as primary administrator for Propositions 1C and 84 local park funds.
- ✓ **Appropriating Bond Funds**
  - Appropriate all funds through budget bill.
- ✓ **Additional Oversight Measures**
  - Ensure, during course of budget review, that bond funds are proposed for capital outlay-related purposes.
  - Provide controls on charging administrative costs to bond proceeds.
  - Require reporting of bond fund information in Governor's budget.
  - Hold joint legislative hearings on bond implementation.



## Funding Eligibility

*Defining Funding Eligibility for New Proposition 84 Programs.* Proposition 84 contains provisions that create substantially new programs, with very general guidance as to the types of projects eligible for funding. The Legislature should provide direction for these programs in order to ensure that these expenditures are consistent with legislative priorities. (We discuss the need for implementing legislation for a number of bond crosscutting issues—such as administrative costs and cost-sharing requirements—later in this section.) The relevant bond provisions for new programs for which the Legislature should provide direction are as follows:

- ***\$90 Million for Urban Greening Projects; \$90 Million for Conservation Planning Incentives.*** In both cases, the measure does not specify an implementing agency and provides only very general guidance as to the eligible uses of the funds. The Legislature should enact legislation to designate implementing agencies and establish program goals and criteria for awarding grants and funding specific projects under these two new programs. We recommend that the Legislature designate the Secretary for Resources as the lead agency for these two programs. This is because the funds, depending on the nature of the conservation project to be funded—such as water conservation, energy conservation, and urban forestry projects—would be potentially administered by one of several different resources departments within the agency. While the Secretary for Resources would be the lead agency, we recommend that the budget bill place the expenditure authority for the funds in the department most closely related to the particular area of conservation addressed by the funding.

We note that as regards the funding for conservation planning incentives, the Governor's budget proposal includes \$6.4 million to the Department of Conservation (DOC) for the development and implementation of the "Green Cities Partnership Initiative." Of this amount, \$400,000 is for DOC staff and \$6 million is for grants to local agencies for the development of planning documents that incorporate the characteristics of a "sustainable California community." The concept of a sustainable California community is not defined in the budget proposal, apart from the very broad definition of "environmental and economic soundness." As it is unclear what criteria DOC will use in awarding the grants, we recommend that the Legislature withhold action on this particular budget request, pending a report at budget hearings from DOC on its policy interpretation of sustainable California community and the criteria upon which it anticipates basing its selection of grants.

This will give the Legislature an opportunity to provide any policy direction it deems appropriate in implementing legislation.

- ***\$90 Million for Matching Grants to Local Agencies for Stormwater Pollution Prevention.*** The Legislature should enact legislation to define the matching requirements and establish criteria for awarding grants. While Proposition 84 requires that there be a local match, it does not specify what it should be. We think that a nonstate cost share of 50 percent of the cost of projects funded from these grants would be in keeping with matching requirements for similar grant programs.
- ***\$60 Million for Loans and Grants for Groundwater Contamination Prevention.*** The measure directs the Department of Health Services—now the Department of Public Health (DPH)—to require repayment of grant-funded costs that are subsequently recovered from parties responsible for the contamination. The Legislature should enact legislation to establish criteria for awarding the loans and grants for the groundwater contamination prevention program. Similarly, the Legislature should provide guidance on how the provision concerning payments from responsible parties would be enforced. Regarding the latter, the legislation should define responsible parties (for example, are any polluters exempt from the definition?). The legislation should also clarify the respective roles of DPH and the environmental regulatory agencies (including the Department of Toxic Substances Control and the State Water Resources Control Board) in taking enforcement action against responsible parties to recover costs resulting from their contamination.

***Addressing Funding Eligibility of Private Water Companies.*** Proposition 84 does not specify whether or not private water companies (which serve a significant portion of the state's residents) are eligible for grants and loans for water quality and water supply projects. We recommend that the Legislature declare its policy position on this issue in legislation to implement Proposition 84. We think that the public purpose stated in Proposition 84 of providing a safe and reliable supply of water to all of the state's residents and businesses would be furthered by including private entities as eligible recipients of bond funds for this purpose. (For more discussion of this issue please see our report, *Proposition 50 Resources Bond: Funding Eligibility of Private Water Companies*, May 2004.)

***Defining Project Funding Eligibility for Flood Control Programs.*** Propositions 1E and 84 together provide \$4.9 billion for flood control projects and programs. Both of these measures provide funding for a very broad array of projects and programs, leaving considerable discretion to

the administration as to the particular flood management activities funded from the bonds. For example, Proposition 1E provides \$3 billion for repairs and improvements to the state Central Valley flood control system and for Delta levee repairs and maintenance, without specifying the funding allocation between these two broad purposes. As another example, Proposition 84 provides \$275 million for a broad array of flood control activities, without specifying whether the flood control projects eligible for funding must be part of the state Central Valley system or whether funding is available for any project in the state. In view of the above, we recommend the enactment of legislation for each of the bonds establishing the Legislature's priorities for allocating funds for flood management activities.

We also recommend that the Legislature include as a priority, expenditures that serve to reduce the state's potential fiscal liability stemming from flood events. As we noted in *The 2005-06 Budget: Perspectives and Issues (P&I)* (page 223), a number of recent court decisions, including the decision in *Paterno v. State of California*, expose the state to major liability for flood-related damages.

We think there are a number of ways to address the state's potential fiscal exposure from flood events. First, the Legislature could improve the connection between local land use planning and flood risk. This could be done, for example, by conditioning bond funding to local agencies on improved flood control planning at the local level. In this regard, we have previously recommended that the Legislature tie flood control subvention funding to flood risk, so that local agencies that approve risky development would be ineligible for flood control subventions funding. (Please see our *2005-06 P&I* [page 231].)

Second, in light of the *Paterno* decision, expenditures that correct design deficiencies in the state Central Valley flood control system would also serve to reduce the state's fiscal exposure from flood events. Addressing such design deficiencies should be a priority when considering the allocation of bond funds.

Finally, the court in *Paterno* found the state liable for flood-related damages partly on the basis that the state lacked a reasonable flood control "plan" for the state flood control system. Accordingly, developing such a plan would be another key way to reduce the state's fiscal exposure. Plan development is an authorized use of the flood control bond funds.

***Identifying Administration's Selection Criteria for Initial Flood Control Proposals.*** As we discussed in *The 2005-06 P&I* (page 220), there is much evidence that the state's aging flood control infrastructure contains sections that have lost substantial capacity to carry the flow of water for which they were designed. However, the state lacks comprehensive information on the structural integrity and the channel carrying capacity of the

projects making up the state Central Valley flood control system. The state is only now embarking on a comprehensive systemwide evaluation, given the availability of bond funds allocated for this purpose. The evaluation involves exploration, lab testing, and technical analysis for each of the 1,600 miles of levees in the state flood control system. Once complete—DWR anticipates the evaluation will take about four years—the evaluation will provide information essential for setting priorities for the state’s flood management expenditures in future years.

Pending completion of the comprehensive evaluation, the department proposes moving forward with substantial funding of various flood control projects in the budget year. In order to assist the Legislature in its evaluation of these proposals, we recommend that the administration advise the Legislature during the budget process on the criteria it used to select the flood control projects and programs proposed for funding in 2007-08. This will give the Legislature a basis for evaluating whether the proposed flood control expenditures are a reasonable use of funds and consistent with legislative priorities for the interim while the comprehensive evaluation is in progress.

Please see our “Department of Water Resources” write-up in this chapter for a more detailed discussion of the Governor’s flood management-related budget proposals, including bond-funded proposals. In this write-up, we discuss an overall need for legislative oversight of the proposed flood-related capital projects.

## **State-Local Cost Sharing**

*Establishing State-Local Cost Sharing for Flood Control Projects.* As previously noted, Propositions 1E and 84 together provide \$4.9 billion for flood control projects and programs. Funds will be allocated as grants directly to local agencies for local flood control projects, as well as for the state share of expenditures for projects that have a direct local benefit. However, with specified exceptions, there is no local matching requirement for these bond funds. (The exceptions are: [1] federally authorized flood control projects, [2] the Delta levees subventions program, and [3] the \$300 million stormwater flood management grant program.)

The Governor’s budget proposes close to \$250 million of flood control expenditures in 2007-08 without a mandatory local matching requirement. While DWR has indicated that it will seek a voluntary local match for these expenditures, it does not plan on requiring it.

As a general rule, we think local matching requirements are appropriate for state bond-funded flood control projects for two reasons. First, as these projects provide direct benefits to local communities, including

public safety and economic benefits, it is appropriate for these communities to share in the costs of these projects on the basis of the “beneficiary pays” principle. Second, because the funding requirements to address flood control issues statewide far exceed the funding allocated in the bonds for this purpose, a requirement for local matching funds would allow the state funds to go further and facilitate a greater number of projects.

We recognize that the appropriate matching requirement may vary by flood control program, and that there may be policy reasons for exempting certain local agencies from a matching requirement (for example, on the basis of economic hardship). We therefore recommend the enactment of legislation that establishes a local matching requirement, along with any exemptions, for all flood control programs funded from the two bonds. In so doing, the Legislature should also consider whether any existing cost-sharing requirements in law that would otherwise apply to projects from these two measures continue to be appropriate.

## **Federal Funding**

*Being Advised of Federal Funding Uncertainty.* There is considerable uncertainty about the amount and the timing of federal funding potentially available to supplement bond expenditures proposed in the Governor’s budget. This uncertainty primarily involves federal funds for (1) federally authorized flood control projects and (2) the San Joaquin River restoration project. As discussed below, we think that it is important for the Legislature to be advised by the administration of the likelihood of federal funding in both of these areas.

For federally authorized flood control projects with a federal-state-local cost share, the state has traditionally secured the federal funding contribution before making state expenditures. Because of the not-before-seen magnitude of state bonds for flood control projects, it is unlikely that the state will have secured a federal funding commitment in all cases before a project expenditure triggers a federal cost share. Proposition 1E appears to recognize this, in that the measure requires the Governor to “secure the maximum feasible amount of federal matching funds...to the extent that this does not prohibit timely implementation of (the bond-funded program).” To assist the Legislature in its evaluation of the Governor’s flood-related bond expenditure proposals, we recommend that the Legislature be advised by DWR during the course of budget hearings of the potential for federal matching funds, the administration’s efforts to seek these funds, and the reasonable likely amount and timing of the federal funding.

Regarding the San Joaquin River restoration, there is a recent lawsuit settlement that provides for a funding contribution from the federal gov-

ernment and specified water agencies for various restoration activities on the San Joaquin River. (While the state was not a party to the lawsuit, the state has signed a memorandum of understanding with the federal government pledging cooperation and financial assistance in implementing the settlement agreement.) The total cost of the restoration effort has been projected to be upwards of \$600 million to \$700 million. Proposition 84 provides \$100 million toward implementing the San Joaquin River restoration settlement, and the Governor's budget proposes \$13.9 million from this allocation for expenditure in 2007-08. However, federal funding for the restoration effort (which requires Congressional action) remains highly uncertain. A bill providing a \$250 million federal appropriation for the restoration effort failed to pass this past Congressional session. We recommend that the appropriate administration agencies (DWR, the Department of Fish and Game, and the Secretary for Resources) advise the Legislature at budget hearings on the merits of proceeding with the proposed state expenditures in the context of such federal funding uncertainty. On the basis of such information, the Legislature can evaluate the budget proposal.

Please see our "Funding the San Joaquin River Restoration Settlement" write-up in the Crosscutting Issues section of this chapter for a more detailed discussion of this issue.

## **Streamlining Measures**

*Considering Streamlining Measures to Improve Project Delivery.* As previously noted, the Legislature enacted Chapter 31—companion legislation to the flood bond measure—to streamline the environmental review and permitting processes for levee repair projects in order to improve delivery of these projects. We recommend that the various implementing agencies, identified in the two bond measures, advise the Legislature of other statutory action that might be taken to significantly improve the timeliness of project delivery.

## **Coordination**

*Coordinating Similar Local Parks Programs Across Bonds.* We think there are actions that the Legislature should take to ensure that the implementation of similar programs found in different bond measures is coordinated in order to avoid duplication of administrative effort, unnecessary costs, and a potential loss of program effectiveness. In this regard, it is important that the local parks programs funded from Proposition 84 and those funded from Proposition 1C (the housing bond) be coordinated.

Proposition 84 includes \$400 million for grants for local and regional parks. These funds will be administered by DPR which, for many years,

has had an established process to implement bond-funded grants and loan programs for local and regional parks. Proposition 1C includes up to \$400 million for local parks. Of this total, \$200 million is broadly available for housing-related parks grants in urban, suburban, and rural areas, and up to an additional \$200 million is for grants for park creation, development, or rehabilitation to encourage infill development. In contrast to Proposition 84, Proposition 1C does not designate an agency to administer the park-related funding. The Governor's budget proposes that the Proposition 1C park-related funding be administered by the Department of Housing and Community Development (HCD), and all of the local assistance bond funding for this purpose is placed under HCD's budget. However, the budget also proposes three new positions in DPR to help implement the Proposition 1C park programs.

Both Propositions 84 and 1C explicitly provide that the Legislature may establish conditions and criteria governing the allocation of the park funds. As the Legislature further defines the two park-related programs under Proposition 1C in implementing legislation, it should consider which state entity is best suited to administer these funds. As we also note in the section of this report on the housing bond, we think that designating DPR as the primary administrator of all bond funding for local parks (including Proposition 1C and 84 money) would likely result in lower overall state administrative costs, more consistent project evaluation, and better coordinated project selection, than if two agencies (DPR and HCD) administer separate grant programs for substantially similar purposes. In addition, we would expect there to be substantial overlap in the universe of potential grantees of the two bond funds. Running separate programs in different agencies for each of the two bond funds would serve to complicate the grant process for grantees and likely add to the time and costs incurred by them in the application process.

For a more detailed discussion of this issue, please see our "Department Parks and Recreation" write-up in this chapter, and our "Housing and Community Development" write-up in the General Government chapter of this *Analysis*.

## Appropriations

***Appropriating Bond Funds.*** As noted above, all funds in Proposition 1E and most funds in Proposition 84—except for \$620 million—are required by these measures to be appropriated by the Legislature. We note, however, that a continuous appropriation in a bond measure does not preclude the Legislature from appropriating these funds in the annual budget act in lieu of the continuous appropriation, as a way of increasing its legislative oversight of the expenditure of these funds. We therefore

recommend that the Legislature include the Governor's proposed expenditures from the continuously appropriated funds in the annual budget bill, enabling review of these expenditures through the legislative budget process.

## Oversight Measures

*Ensuring That the Bond Funds Are Used for Capital Outlay Purposes.* Current law (Section 16727 of the Government Code) essentially provides that GO bonds are to be used for capital purposes. Without this control, the door would be opened to debt financing of noncapital expenditures, such as the costs of day-to-day program operations. This is in contrast to the legitimate use of bond proceeds to fund the reasonable administrative costs connected with a bond-related capital project or program. (We discuss the issue of bond-funded program administrative costs more generally in the next section.) In order to ensure that bond funds are not proposed for purposes that are clearly not related to capital outlay, we recommend that the Legislature review the Governor's budget proposals with the Government Code provision in mind.

*Ensuring Oversight of Program Administrative Costs.* Generally, administrative costs related to bond-funded programs are for general administrative purposes, such as accounting and processing grant applications. These costs include staff salaries, benefits, equipment, and other operating expenses. To the extent that various administrative costs are charged to bond proceeds, there will be less funding available for specific capital projects and local assistance grants.

Both Propositions 1E and 84 leave considerable room for budgetary discretion in defining administrative costs. While Proposition 84 addresses the issue of administrative costs, it does so simply by capping administrative costs at 5 percent of funds allocated to any "program." The measure does not provide either a definition of program or a definition of what is included in administrative costs. As regards Proposition 1E, it does not impose any limits on administrative costs.

Given the potentially substantial impact of program administrative costs on the amount of bond funds ultimately available for projects, we think it is important that the Legislature exercise effective oversight of these costs. For Proposition 84, we recommend that the Legislature enact legislation to define program for purposes of the 5 percent administrative cost cap and provide a definition of what is included in administrative costs. As a general guideline, we believe that only departmental costs directly attributable to bond-related projects (for example, costs to administratively track bond fund expenditures) should be borne by bond funds. For Proposition 1E, we also recommend legislation be enacted to provide



parameters for charging administrative costs against bond proceeds. For example, as we have previously recommended in the context of the Proposition 40 resources bond (please see our report, *Enhancing Implementation and Oversight: Proposition 40 Resources Bond*, May 7, 2002), we suggest a cap of up to 5 percent of an appropriation for administrative costs related to Proposition 1E grant programs.

Our recommendations to control bond-funded administrative costs are consistent with recent legislative policy on this issue. Specifically, Chapter 831, Statutes of 2006 (AB 3003, La Malfa), limits DWR's administrative expenses to 5 percent of GO bonds approved after January 2007.

***Requiring Reporting of Bond Fund Information in Governor's Budget.*** As noted above, both Propositions 1E and 84 require independent audits and an annual reporting of bond expenditures. In order to exercise oversight of bond programs, the Legislature needs both clear and accurate information about expenditures and periodic updates on the fund balances remaining for the various programs and projects funded by bond measures. Therefore, we recommend the enactment of legislation that requires the balances of each of the funding "pots" of the two bond measures be displayed annually in the Governor's budget document. This will promote accountability and will facilitate the monitoring of fund balances for use in current and future budget appropriations.

***Holding Joint Legislative Hearings.*** Finally, we recommend that the policy and budget subcommittees of the Legislature hold periodic joint hearings in which DWR and the other key implementing entities of Propositions 1E and 84 bond funds report on the use of bond funds and the timeliness of project delivery and program implementation. This would provide the Legislature with an opportunity to monitor the progress of the bond programs in the aggregate, and assess whether the programs are being carried out effectively to meet the measures' objectives. This approach would also give the Legislature an opportunity to assess the extent to which bond expenditures are coordinated both among the various implementing departments and with similar programs funded from other fund sources. Finally, this would allow the Legislature to be apprised of the Governor's overall expenditure priorities from each of these bond measures.

## **Conclusion**

The passage of Propositions 1E and 84 provides the state with the opportunity to tackle major flood management issues, provide the state's residents and businesses with safe and reliable water supplies, protect the state's natural resources, and make needed park improvements. However, it is important that the bond funds are used to promote the bond programs'

objectives in an efficient and cost-effective manner. In this section, we have recommended actions that will help the state meet these goals.

## **\$4 BILLION WATER MANAGEMENT BOND PROPOSED FOR 2008**

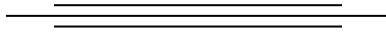
*As part of his ten-year Strategic Growth Plan, the Governor has proposed a \$4 billion water-related general obligation bond to be submitted for voter approval in 2008.*

As part of his ten-year Strategic Growth Plan to address the state's infrastructure needs, the Governor has proposed a \$4 billion water management GO bond to be submitted to the voters in 2008. Senate Bill 59 (Cogdill) contains this bond measure. The allocation of the \$4 billion among projects and programs to be funded by the measure is as follows:

- **Surface Water Storage—\$2 Billion.** This funding is for the "state's cost share" in the design, acquisition, and construction of two surface water projects currently being studied by DWR under CALFED—Sites Reservoir (Colusa and Glenn Counties) and Temperance Flat Reservoir (Fresno and Madera Counties). If these specified surface water projects are deemed infeasible by DWR, then the funding is available for alternate surface water projects that are included in the CALFED "Record of Decision." The proposed measure also provides that the state's cost share is not to exceed 50 percent of total project costs. The nonstate share of costs would be funded from up to \$2 billion in DWR-issued revenue bonds that would be secured by contract payments from water suppliers benefiting from the new storage.
- **Groundwater Storage—\$500 Million.** This funding is for grants for the planning, design, and construction of locally managed groundwater storage and "conjunctive use" (combined use of surface and groundwater systems) projects.
- **Delta Resource Conservation—\$500 Million.** This funding is to develop and implement a conservation plan for the Bay-Delta region, including projects that enhance and sustain fish populations.
- **Delta Sustainability—\$300 Million.** This funding is to implement a strategic plan currently under development for sustainable management of the Delta's multiple uses, resources, and ecosystem.

- **Resource Stewardship and Ecosystem Restoration—\$250 Million.** This funding is for various restoration projects, including restoration of the San Joaquin River system, the Sacramento River corridor, and the Salton Sea.
- **Delta Water Quality—\$200 Million.** This funding is to implement the water quality component of CALFED.
- **Water Use Efficiency—\$200 Million.** This funding is for competitive grants for agricultural and urban water use efficiency projects.

**Policy Issues for Legislative Consideration.** The Governor's bond proposal raises important policy issues for the Legislature to consider. Foremost among these is the issue of the appropriate ratio for a sharing of costs between the state and the nonstate entities who benefit directly from surface storage water projects that are proposed for bond funding. Such projects have traditionally been funded mostly by the water user beneficiaries. The Governor's proposal, while still including a significant funding contribution from the direct project beneficiaries, incorporates a relatively greater role for public funding of these projects.



## CALFED BAY-DELTA PROGRAM

*The CALFED Bay-Delta Program (CALFED), a consortium of 12 state and 13 federal agencies, was created to address a number of interrelated water problems in the state's Bay-Delta region. In the sections that follow, we provide a history of CALFED, including its recent reorganization, discuss financing issues and the use of performance measures, summarize the Governor's budget proposal, and raise a number of issues with particular budget proposals.*

### BACKGROUND

*What Is CALFED?* Pursuant to a federal-state accord signed in 1994, CALFED was administratively created as a consortium of state and federal agencies that have regulatory authority over water and resource management responsibilities in the Bay-Delta region. The CALFED program now encompasses 12 state and 13 federal agencies. The objectives of the program are to:

- Provide good water quality for all uses.
- Improve fish and wildlife habitat.
- Reduce the gap between water supplies and projected demand.
- Reduce the risks from deteriorating levees.

After five years of planning, CALFED began to implement programs and construct projects in 2000. The program's implementation—which is anticipated to last 30 years—is guided by the "Record of Decision" (ROD). The ROD represents the approval of the lead CALFED agencies of the final environmental review documents for the CALFED "plan." Among other things, the ROD lays out the roles and responsibilities of each participating agency, sets goals for the program and the types of projects to be pursued, and sets milestones for achieving program outcomes. The ROD also addresses how CALFED should be financed, providing that "a fundamental philosophy of the CALFED Program is that costs should, to the extent possible, be paid by the beneficiaries of the program actions."

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The ROD, however, provides few details as to how this principle would be implemented.

***CALFED Governance: The Early Years Through 2005-06.*** The program's organizational structure evolved administratively in the mid-1990s, as it was not spelled out in state statute. The initial organizational structure was very loosely configured. Early on, the program was housed within the Department of Water Resources (DWR), with an executive director. For a number of years, the staffing and their related funding arrangements for the program were complicated, with staff coming largely from employees loaned to DWR and temporary hires. In the late 1990s, the Legislature for the first time approved funding explicitly for CALFED program staff. At that time, CALFED staff (around 50 positions) was focused mainly on planning, although there was some implementation of projects taking place in the various state agencies participating in the program, including DWR, the Department of Fish and Game (DFG), and the Secretary for Resources.

After the signing of the ROD, the program shifted from being a relatively small program focused on planning to a much larger program focused on implementation. The implementation phase of the program requires decisions to be made regarding the type, location, timing, and financing of specific projects. A number of important policy decisions are also made, both in terms of developing project criteria as well as setting expenditure priorities within and among the program's several activity areas. It was in this context that the Legislature, for the first time, statutorily established a governance structure for CALFED in 2002. (The governance structure has since changed, as discussed later.)

Chapter 812, Statutes of 2002 (SB 1653, Costa), created a new state agency in the Resources Agency—the California Bay-Delta Authority (CBDA)—to oversee the overall CALFED program, as well as to directly implement the CALFED science program. Chapter 812 assigned responsibility for implementing the program's other elements (such as water quality, ecosystem restoration, and water storage) among a number of other state agencies. For example, the State Water Resources Control Board (SWRCB) is designated as the implementing agency for the water quality element. While the CBDA reviewed and approved the annual work plans and expenditure plans of the implementing agencies, Chapter 812 explicitly provided that “nothing [in the legislation] limits or interferes with the final decision making authority of the implementing agencies.”

The CBDA's 24-member board, led by a Governor-appointed chair, includes 12 representatives from state and federal agencies, 7 public members (5 appointed by the Governor, and 2 by the Legislature), 4 nonvoting members of the Legislature, and 1 representative from a public advisory

committee. Through the end of 2005-06, CBDA had a Governor-appointed director, who oversaw a staff of about 70 positions.

***Independent Reviews of CALFED Found Many Problems.*** At the request of the Governor, four independent management, fiscal, and program reviews of CALFED were conducted in the summer and fall of 2005. These reviews were conducted by the Little Hoover Commission, the Department of Finance, and KPMG (a private consultancy firm). These reviews found common agreement that the then-current governance structure was not working well, state priorities for CALFED were not clear, and meaningful performance measures for the program were lacking.

The CALFED governance structure was reviewed by the Little Hoover Commission. The commission summed up the CALFED organizational structure as “convoluted,” with two major problems: the lack of clear assignment of authority among the many participating entities and fuzzy lines of accountability. Regarding the first problem, the Commission noted that CBDA is an authority without authority, in that the CBDA board has no actual authority over the implementing agencies, making it very difficult for CBDA to fulfill the management function it has been given. Additionally, among the implementing agencies, it is not clear who is in charge of CALFED implementation.

Regarding the second problem of accountability, the Commission found that there were many positions of authority within the program, including the CBDA executive director, the CBDA board, the heads of the many implementing departments, and the Secretary for Resources. The bottom line of the Commission’s findings was that the program as it was then structured lacked a leader to move the program forward and who could be held accountable to the Governor and Legislature for the program’s performance.

## **CALFED REORGANIZED IN 2006**

*The Legislature reorganized the CALFED governance structure in 2006, in an effort to clarify lines of accountability within the program and hold the program accountable for its performance. The reorganization included the transfer of all of California Bay-Delta Authority’s positions (totaling 71) to the Secretary for Resources and five other CALFED implementing agencies. Most of these transferred positions are filled.*

***Governance Structure Revised.*** During the course of budget hearings on the 2006-07 budget, the Legislature took action to address problems with CALFED’s governance structure as identified in the various independent reviews. The Legislature approved a budget trailer bill and made a

number of adjustments to the CALFED budget. The main components of the reorganization are as follows:

- ***CBDA Defunded.*** All of the positions at CBDA (totaling 71 positions) were transferred to the Secretary for Resources and five other CALFED implementing agencies, and CBDA was defunded as a state agency. The board of CBDA continues to exist, however, and staff support to the board is provided by the Secretary for Resources.
- ***Secretary for Resources in Charge and Accountable for Program Performance.*** The Secretary for Resources (receiving 32 positions) became the single main “point of accountability” for CALFED. (The previous confusion as to the Secretary’s authority versus the CBDA director’s authority has been removed.) In addition to being given the programmatic responsibility for the CALFED science program, the Secretary was given clear responsibility for the overall program planning, performance, and tracking.
- ***Forestry Department Serves Administrative Support Function.*** The California Department of Forestry and Fire Protection (receiving 19 positions) was given the traditional administrative support functions (such as human resources, contracting, information technology, and accounting) to assist the Secretary in carrying out its duties under the reorganized structure.
- ***Implementing Agencies Do the Implementation.*** The remaining 20 CBDA positions—those doing programmatic rather than oversight or coordination work at CBDA—were transferred to the respective CALFED implementing agencies (DWR, SWRCB, or DFG) responsible under current law for the particular program at issue. For example, positions at CBDA involved in ecosystem restoration program implementation were transferred to DFG.

***Most Transferred Positions Filled.*** As of the time this analysis was written, 67 of the 71 positions that were transferred from CBDA to other agencies are filled, with active recruitment being conducted for the balance.

## **CALFED FINANCING: STILL NO PROGRESS ON IMPLEMENTING “BENEFICIARY PAYS”**

*In spite of legislative direction, CALFED has made little progress in implementing the “beneficiary pays” principle in funding its programs. The CALFED does not currently have a long-term financing plan. It will need to await the conclusion of a number of ongoing planning efforts, including the Delta Vision process, to be guided on long-term financing issues.*

**Legislative Direction Regarding CALFED Financing.** Neither the CALFED governance legislation nor any other legislation lays out a comprehensive framework for how CALFED should be financed over the long term. However, the Legislature on a number of occasions has stated its intent that CALFED financing should in part rely upon user fees for funding its programs. For example, budget language in the 1999-00 and 2000-01 *Budget Acts* states that beneficiaries of surface water storage projects that proceed to construction should reimburse all prior planning expenditures made from the General Fund. Similarly, in the *Supplemental Report of the 2002 Budget Act*, the Legislature directed CALFED to draft a financing plan for potential surface storage facilities consistent with the beneficiary pays principle. Finally, the 2003-04 *Budget Act* includes a statement of legislative intent that CBDA submit a broad-based user fee proposal for inclusion in the 2004-05 *Governor's Budget*, consistent with the beneficiary pays principle specified in the ROD. However, such a fee proposal was not submitted to the Legislature.

**State Funds Have Contributed Most to CALFED.** Although the ROD envisioned CALFED being financed over time by roughly equal contributions of federal, state, and local/user funding, and the ROD endorsed the concept of the beneficiary pays, the state has been the major funding source for the program's first seven years, providing about \$2.3 billion, or close to 50 percent, of funding.

Almost all of the state funds supporting CALFED have been taxpayer-supported "general-purpose" funds, namely monies from the General Fund and bond funds. Apart from a relatively small contribution from the State Water Project and Central Valley Project contractor revenues, no user fees have supported the program. The local funding support for the program, while significant, largely reflects a local match for state bond funds, mainly for water use efficiency projects.

**January 2005 Long-Term Financing Plan—Neither Viable Nor Complete.** Although the ROD in 2000 called for the development of a CALFED finance plan, it was not until January 2005 that a long-term finance plan, adopted by CBDA, was submitted for legislative review at budget hearings. This plan, however, was not considered to be viable or complete. Much concern was raised in the Legislature that the plan's \$8.1 billion ten-year funding target was unrealistic, given that it assumed high levels of highly uncertain federal funding (21 percent of the total funding was assumed from this source) and unspecified sources of new state funds (19 percent of total funding was assumed from these sources). In fact, almost 80 percent of the \$8.1 billion funding target was proposed to be met from new sources of revenue that would need to be identified. Second, while the finance plan included the concept of new fee revenues from water users, it did not include specific proposals for these new fees. Therefore, the finance plan



provided little substance on how the beneficiary pays principle would actually be implemented, in spite of legislative intent that the program proceed in this direction.

**April 2006 Action Plan—Only Near-term Funding Plan; Relies on “Voluntary” Water User Contributions.** In the following year during the course of hearings on the 2006-07 budget, CALFED released a “10-Year Action Plan,” outlining a number of proposed changes to CALFED’s governance, program and fiscal management, and strategic planning processes. (The plan’s governance proposals predated the legislative reorganization of CALFED.) On the financing plan front, two items are of note. First, the action plan did not include a long-term financing plan, but rather a “near-term” funding plan for 2005-06 through 2007-08. This was largely a plan to draw down existing bond funds available for CALFED programs. Second, instead of incorporating a water user fee component as directed previously by the Legislature, the near-term funding plan included the concept of water users who, in negotiated agreements with CALFED, would voluntarily contribute monies to CALFED based on their perceived benefits from the program. As we noted in our *Analysis of the 2006-07 Budget Bill* (see page B-28), we concluded that such a proposal appeared more in line with a “willingness to pay,” as opposed to a true beneficiary pays funding principle as previously articulated by the Legislature.

**No New Developments.** There have been no new developments within the administration this year relative to a long-term finance plan, and the budget includes no new proposals to implement the beneficiary pays principle. (In fact, as discussed below, the budget proposes to use bond funds to support an activity that had been receiving funding from voluntary water user contributions because those contributions will have run out.)

**Long-Term Finance Plan Development Will Await Conclusion of Various Planning Efforts.** According to CALFED, it is currently involved in a number of planning efforts that fundamentally will define the future for CALFED programmatically, thereby determining both CALFED’s financing requirements and its program beneficiaries over the long term. Given this, it would be premature for CALFED to develop a long-term financing plan when it does not yet know what programs and projects will be financed over this period. On the other hand, the timing of these planning efforts does not provide a justification for the lack of action on the beneficiary pays front.

The multiple, ongoing planning efforts include the following:

- **“Stage One” Assessment.** Pursuant to ROD requirements, CALFED is required to oversee an independent, technical review of the program’s performance (relative to project milestones found in the ROD) over its first seven years, to help guide the remainder

of what is anticipated to be a 30-year program. Specifically, the review will assess the current state of the Delta ecosystem and evaluate how well CALFED has achieved the program's water quality objectives. The CALFED expects to release a public draft of the Stage One report in June.

- ***Delta Risk Management Strategy ("DRMS")***. Chapter 573, Statutes of 2005 (AB 1200, Laird), requires DWR to evaluate the potential impacts of levee failures in the Delta (from risks such as earthquakes and climate change) and further requires DWR and DFG to evaluate options for protecting various benefits provided by the levees. The departments are to report to the Governor and Legislature by January 1, 2008, with the results of their evaluation.
- ***Delta Vision***. Chapter 535, Statutes of 2006 (SB 1574, Kuehl), and Chapter 77, Statutes of 2006, (AB 1803, Committee on Budget), require the Secretary for Resources to develop a strategic vision for a "sustainable" Delta, including sustainable ecosystems, land use patterns, transportation uses, water supply uses, utility uses, recreation uses, and flood management strategies. The plan, referred to as the "Delta Vision," is to be submitted to the Governor and Legislature by December 31, 2008.

## PERFORMANCE MEASURES

*The CALFED is currently working with the various implementing agencies to develop a select group of performance measures based on the broad program objectives in the CALFED Record of Decision. We recommend the adoption of supplemental report language requiring the Secretary for Resources to report on the chosen measures and to state legislative intent that future-year budget proposals provide how the proposal affects any relevant performance measure.*

***CALFED Is Developing Performance Measures.*** As noted earlier, the statutory reorganization of CALFED placed a program performance review function in the Secretary for Resources. Over the next several months, CALFED scientific staff will continue working with the various implementing agencies to develop a select group of performance measures tied to each of the four overriding objectives of CALFED. Program staff expect to have a preliminary set of measures developed by this June.

***Legislature Should Review Measures and Create Tie to Budget Process.*** There is much precedent for the Legislature to require programs to have performance measures as a means of holding them accountable. However, experience has shown that a mere direction from the Legislature that

a program have measures typically results in measures being developed by the program that are input-oriented and do not assist the Legislature in its oversight function of program accomplishments (outcomes). We think the Legislature can benefit when performance measures are designed to reflect legislative priorities and expected outcomes from the program. Accordingly, we think that the Legislature should be given the opportunity to evaluate the measures that the administration proposes to use to see whether the measures reflect legislative priorities for the program. One such measure might be the extent to which the program has improved water quality in the Delta.

Second, we think that one of the benefits of performance measures is the potential to inform, and thus increase the effectiveness, of future decision making. We think that one way of establishing this link with decision making is to create a tie with the budget process. To this end, we recommend that any CALFED budget proposal submitted to the Legislature, beginning with the 2008-09 budget, be required to indicate how the budget change would impact any applicable performance measure.

To facilitate legislative review of the performance measures and to link performance measures with the budget process, we recommend adoption of the following supplemental report language:

Item 540-001-0001. Secretary for Resources. In conjunction with the submittal of the *2008-09 Governor's Budget*, the Secretary for Resources shall submit to the Legislature a report on performance measures currently being used, and proposed for use, to evaluate the CALFED Bay-Delta Program (CALFED). It is the intent of the Legislature that CALFED-related budget change proposals for 2008-09 and future budget years show how the proposed budget change would impact any applicable performance measure.

## GOVERNOR'S BUDGET PROPOSAL

*The budget proposes \$473.6 million of state funds across eight state agencies for CALFED in 2007-08, essentially the same level as in the current year.*

*Expenditure Summary.* Figure 1 (see next page) shows the breakdown of CALFED expenditures in the current year and as proposed for 2007-08, among the program's 12 elements.

*Current-Year Expenditures.* As shown in the figure, the budget estimates CALFED-related expenditures from state funds of \$475.6 million in 2006-07. Of this amount, \$26.7 million is from the General Fund, with the balance mainly from Proposition 50 bond funds (\$276.5 million), Proposition 13 bond funds (\$107.1 million), and State Water Project funds (\$43.9 million).

<b>Figure 1</b>		
<b>CALFED Expenditures—State Funds Only</b>		
<i>(In Millions)</i>		
<b>Expenditures by Program Element</b>	<b>2006-07</b>	<b>2007-08</b>
Ecosystem restoration	\$124.6	\$127.0
Environmental Water Account	74.6	2.8
Water use efficiency	59.4	52.1
Delta vision	1.4	1.9
Watershed management	17.7	2.4
Drinking water quality	20.8	122.6
Levees	18.9	64.0
Water storage	10.3	9.8
Water conveyance	91.1	58.7
Science	39.3	24.1
Water supply reliability	9.4	—
CALFED program management	8.1	8.2
<b>Totals</b>	<b>\$475.6</b>	<b>\$473.6</b>
<b>Expenditures by Department</b>		
Water Resources	\$338.1	\$257.4
State Water Resources Control Board	10.8	0.7
Secretary for Resources	35.8	14.2
Fish and Game	84.4	109.6
Conservation	0.3	1.5
Forestry and Fire Protection	1.7	1.6
San Francisco Bay Conservation	0.1	0.1
Health Services (Public Health)	4.4	88.7
<b>Totals</b>	<b>\$475.6</b>	<b>\$473.6</b>
<b>Expenditures by Fund Source</b>		
Proposition 50	\$276.5	\$222.6
Proposition 84	—	148.3
Proposition 13	107.1	32.5
Proposition 204	18.3	1.7
General Fund	26.7	16.6
State Water Project funds	43.9	49.6
Other state funds	3.1	2.3
<b>Totals</b>	<b>\$475.6</b>	<b>\$473.6</b>

For the current year, the largest state expenditures are for the ecosystem restoration (\$124.6 million), water conveyance (\$91.1 million), environmental water account (\$74.6 million), and water use efficiency (\$59.4 million) programs.

***Budget Proposes Virtually No Change in State Funds for 2007-08.*** As shown in Figure 1, the budget proposes \$473.6 million of state funds for various departments to carry out CALFED in 2007-08, essentially no change from the current year. Of the proposed expenditures, \$16.6 million is proposed from the General Fund, with the balance mainly from Proposition 50 bond funds (\$222.6 million), Proposition 84 bond funds (\$148.3 million), and State Water Project funds (\$49.6 million).

As Figure 1 indicates, CALFED expenditures are spread among eight agencies. The largest expenditures are found in DWR (\$257.4 million), DFG (\$109.6 million), and the Department of Public Health (\$88.7 million). The largest state expenditures are proposed for ecosystem restoration (\$127 million), water quality (\$122.6 million), levee system integrity (\$64 million), and water conveyance (\$58.7 million) programs.

## ISSUES FOR LEGISLATIVE CONSIDERATION

We now turn to a discussion of a number of issues for the Legislature to consider related to particular budget proposals for the program.

### **South Delta Improvements Program Proposal Premature**

***The budget proposes \$31.4 million in capital outlay funding from Propositions 13 and 50 bond funds for the South Delta Improvements Program. We recommend the Legislature deny the proposal as it is premature. (Reduce Item 3860-301-6026 by \$14.4 million and Item 3860-301-6031 by \$17 million.)***

***South Delta Improvements Program.*** The budget requests \$14.4 million from Proposition 13 funds and \$17 million in Proposition 50 funds for final design, staff support, and construction costs for the South Delta Improvements Program (SDIP). The objectives of the SDIP are to improve water supply reliability for the State Water Project (SWP) through project capital improvements, and to increase SWP's capacity to make water deliveries. The proposal recognizes additional out-year costs of \$18.9 million from Proposition 50 bond funds.

***Legislative Direction.*** While the 2006-07 Budget Act appropriated \$41.6 million of bond funds for SDIP, it included language prohibiting the expenditure of the funds until the Secretary of Resources submitted a specified report to Legislature. The Secretary is required to report on actions that it will take, other than study, to stabilize the ecosystem in the Delta and to address an identified decline in organisms that live in water above the bottom, commonly referred to as pelagic organism decline (POD). The intent of the language was to put on hold the development

of SDIP until the impacts of pumping from the Delta on POD could be addressed.

***Budget Request Premature on Several Counts.*** We find that the budget request is premature on a number of counts, and therefore recommend denying the request.

First, at the time this analysis was prepared, the legislatively required report had not been submitted to the Legislature. On this basis alone, the budget request should be denied, as it is premature to provide funding before the Legislature is given information it thought important to have before authorizing the program to go forward.

Second, we think that the budget request should also be denied because cost-sharing agreements with the federal government and SWP contractors who benefit directly from the program have not been secured. In fact, the budget documentation submitted to the Legislature states that such cost sharing is the “preferred” way to fund the program, and that it would be “unacceptable” for the state to be the sole funding entity. However, the department has not received funding commitments from either the federal government or SWP contractors. Until such funding commitments are secured, it would be premature to appropriate state funds as requested.

Finally, we note that the federal Fish and Wildlife Service has recently put on hold its permitting for SDIP, citing problems with declines in fish populations in the South Delta area. This creates substantial uncertainty as to whether the project can proceed, providing yet another grounds for the budget request being considered premature.

In view of the above, we recommend a reduction of \$31.4 million for SDIP.

### **CALFED Surface Storage Proposals Need Matching Funds**

***The budget proposes \$9.8 million in bond funds for the Department of Water Resources, under CALFED, to continue feasibility studies for surface water storage projects. We find that the CALFED surface storage program has reached a point where these feasibility studies cannot practically move forward unless nonstate entities—parties who would benefit from the projects being studied—step up to the plate and share in the costs of studying and developing these projects. We recommend denying the budget request, given the lack of matching local or federal funding. (Reduce Item 3860-001-6031 by \$3.8 million and Item 3860-001-6051 by \$6 million.)***

**Surface Water Storage Feasibility Studies.** As shown in Figure 2, over \$62 million of state funds will have been spent under the CALFED program on surface water storage studies through the end of the current year. Some of these studies relate to a project at a specific location (such as Los Vaqueros Reservoir Expansion), while others relate to potential projects throughout a region (such as Upper San Joaquin River Storage).

**Figure 2**

### Summary of CALFED Expenditures on Surface Storage Studies

August 2000 Through 2007-08  
(In Millions)

	Estimated August 2000 Through 2006-07		Proposed 2007-08
	State Expenditures	Federal Expenditures	State Budget <sup>a</sup>
Common Assumptions <sup>b</sup>	\$5.4	\$5.8	\$0.5
Shasta Lake Enlargement <sup>c</sup>	0.4	14.5	—
North-of-Delta Offstream Storage (Sites Reservoir)	30.8	5.5	4.7
In-Delta Storage Investigations <sup>c</sup>	9.3	0.7	—
Los Vaqueros Reservoir	13.5	13.2	1.8
Upper San Joaquin River Storage Investigations (Temperance Flat)	3.2	15.7	2.8
<b>Totals</b>	<b>\$62.6</b>	<b>\$55.4</b>	<b>\$9.8</b>

<sup>a</sup> State funds only. Federal government proposal for budget year not available.

<sup>b</sup> Refers to development of a common analytical framework to guide state and federal agencies across feasibility studies.

<sup>c</sup> State funding for Shasta Lake Enlargement and In-Delta Storage Investigations was denied in 2005-06 and subsequent budget acts.

**Budget Proposal.** The budget proposes a total of \$9.8 million in bond funds (\$3.8 million from Proposition 50 and \$6 million from Proposition 84) to continue various surface storage studies, as summarized in Figure 2.

**State Funding Should Continue Only if Funding Partners Come on Board.** Our review finds that, for the most part, the preliminary feasibility study work for these projects is complete, and for the studies to practically move into the more costly final stage of investigation and into project

development, local and/or federal funding partners (entities who benefit from and would have an interest in funding the project) must be on board to share in these costs with the state. This is consistent with legislative direction in the *2006-07 Budget Act* regarding funding for the Los Vaqueros Reservoir Expansion. Specifically, the Legislature prohibited state funds being spent for this project until regional funding sources were secured to fund the continued investigation and planning of the project. (We note that while Contra Costa citizens voted in 2004 to support continued studies of the expansion project, local funding has yet to be committed.)

***Recommend Denying Budget Request.*** Given the lack of funding from nonstate funding sources to move the storage studies proposed for funding in the budget year forward, we therefore recommend denying the budget request.

### **Budget Relies on Bond Funds to Continue Planning Effort That Benefits Delta Water Exporters**

*The budget proposes \$1.7 million of Proposition 84 bond funds to continue funding a conservation planning effort that benefits Delta water exporters, as funding contributions from water users for this effort will have run out in the middle of the budget year. We recommend denying the budget request, because water user contributions are the more appropriate funding source. (Reduce Item 3600-001-6051 by \$1.7 million.)*

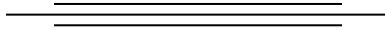
***Budget Proposal.*** The DFG's budget for CALFED includes \$1.7 million in Proposition 84 bond funds and continuation of 16 existing positions for the development of a Natural Communities Conservation Plan (NCCP) for the Delta. An NCCP is a regulatory tool used to comply with the California Endangered Species Act. Essentially, the development and implementation of an NCCP allows project proponents (in this case, Delta water exporters relying on the Delta pumps for water deliveries) to "take" (incidentally harm) endangered species, provided that the overall health of the ecosystem is protected. The budget request represents the first year of a \$20 million, six-year plan for spending Proposition 84 funds to develop the conservation plan. The budget proposal also includes shifting the fund source for 16 existing positions from user contributions to bond funds. (In the current year, funding for these positions is provided by SWP contractors, but this funding support, voluntarily agreed to by the SWP contractors, will expire in December 2007.)

***Water Users Should Pay for NCCP Development and Implementation.*** When the proposal for developing an NCCP for the Delta was first presented to the Legislature at hearings on the 2006-07 budget, the administration indicated that water users (primarily SWP contractors) would pay



for such an NCCP. Because the water users are the primary beneficiaries of water diversions from the Delta and must comply with the California Endangered Species Act, it is appropriate that they pay for such an NCCP. The recovery of state costs to develop and implement NCCPs from fees is also authorized in state law.

***Recommend Denying Budget Request.*** While Proposition 84 authorizes *up to* \$20 million for the development of an NCCP for the Delta, we think that the availability of bond funds does not relieve the water users from the responsibility for paying for projects that benefit them. We therefore recommend denying the budget request on the basis of the proposed funding source, but would recommend its approval if the water user contribution were to be reinstated.



## IMPLEMENTATION OF “AB 32”—GLOBAL WARMING SOLUTIONS ACT OF 2006

*The budget proposes \$35.8 million across several state agencies to begin implementation of the Global Warming Solutions Act of 2006 (commonly known as “AB 32”), which focuses on reducing California’s greenhouse gas (GHG) emissions. In this analysis, we describe the Governor’s budget proposal and discuss cases where the proposal appears in conflict with legislative direction as expressed in AB 32. We then make recommendations to assist the Legislature in overseeing development and implementation of the state’s regulation of GHG emissions in order to better align the budget proposal with AB 32 and to address long-term funding issues.*

### **California a Significant Emitter of Gases Contributing to Climate Change**

*California’s GHG Emissions and Climate Change.* Greenhouse gases are those that trap solar heat within the earth’s atmosphere, thereby warming the earth’s temperature. While both natural phenomenon (mainly water evaporation) and human activity (principally burning fossil fuels) produce GHGs, increasing concern has been placed on concentrations of GHGs resulting from human activities and their relation to increases in average global temperatures.

California is a significant emitter of GHGs. As a populous state with a robust economy, California is the second largest emitter of GHGs in the United States and one of the largest emitters of GHGs in the world, when compared to other countries’ emissions. For more information on California GHG emissions, please see our discussion of the “Governor’s Climate Change Initiative” in our *Analysis of the 2006-07 Budget Bill*.

## The Global Warming Solutions Act of 2006 (AB 32)

*Passage of AB 32 commits the state to reducing, by 2020, California's greenhouse gas (GHG) emissions to 1990 levels. The act charges the Air Resources Board (ARB) with monitoring and regulating the state's sources of GHGs and establishes a timeline by which ARB is to complete various specified actions.*

*Act Declares State's Interest in Limiting Global Warming.* Last year, the Legislature enacted Chapter 488, Statutes of 2006 (AB 32, Nuñez)—The Global Warming Solutions Act of 2006. The act states that global warming poses a threat to California's economy, public health, natural resources, and environment, and states the necessity of federal and international action to effectively combat global warming. However, the act also notes that California's early efforts to reduce GHG emissions can encourage similar actions by other states, the federal government, and the other countries and position California's economy to benefit from future efforts to limit GHG emissions in other jurisdictions.

*ARB in Charge of State's Multiagency Emissions Reduction Efforts.* The act charges ARB as the sole state agency responsible for monitoring and regulating sources of GHG emissions and gives ARB a role in coordinating with other state agencies and stakeholders in implementing AB 32. The ARB is to require and monitor comprehensive reporting of statewide GHG emissions, determine the state's GHG emissions levels in 1990, and adopt regulations to reduce statewide GHG emissions, by the year 2020, to what they were in 1990.

The act also calls for the Climate Action Team—the multiagency body established in 2005 by executive order and led by the Secretary for Environmental Protection—to continue its coordination of overall climate policy.

*Emissions Reduction Goal and Timelines.* The act lays out the broad goal of reducing statewide GHG emissions. In addition, the act establishes a timeline by which ARB is to have taken specific actions, as shown in Figure 1 (see page 53).

*GHG Emissions Reduction Measures Must Satisfy Extensive, Specific Criteria.* The act also lays out numerous, detailed criteria that any GHG emissions reduction measure must satisfy in order for ARB to adopt it. The act states that ARB's regulations should achieve maximum technologically feasible and cost-effective reductions, and that they should be complementary and nonduplicative. The act also states that ARB's regulation of GHG emissions should achieve the following specific goals:

- Minimize costs.
- Maximize benefits.
- Encourage early action.
- Not disproportionately affect low-income communities.
- Credit early, voluntary GHG emission reductions.
- Complement federal and state air quality efforts.
- Consider indirect benefits of GHG reduction regulations (such as air pollution reductions, energy source diversification, and other economic, environmental, and public health benefits).
- Minimize administrative burden.
- Minimize displacement of California GHG emissions to out-of-state sources (a phenomenon known as “leakage”).
- Consider the significance of the regulated sources’ contribution to statewide emissions of GHGs.

In addition, GHG emission reductions are to be real, permanent, quantifiable, verifiable, and enforceable by the state. To the extent feasible, program activities, such as providing financial incentives for GHG emissions reduction, are to direct investment to the most disadvantaged communities.

***Market-Based Mechanisms Permissible, but Must Meet Additional Criteria.*** The act allows, but does not require, ARB to adopt “market-based compliance mechanisms” as part of its regulations to be adopted by January 1, 2011. (Market-based compliance mechanisms, in very general terms, refer to flexible regulatory programs in which government sets a market signal, such as a price per unit of emission to be paid by regulated entities, and then allows regulated sources to set their own emission levels in response to that signal.)

However, the act allows ARB to include such market mechanisms in its regulations only if (1) the regulations meet the criteria applicable to all GHG emission regulations, as described above, and (2) ARB takes a number of significant actions in its evaluation and design of such mechanisms, namely:

- Considering the potential for these mechanisms to result in adverse emissions effects on communities already harmed by air pollution.

**Figure 1****Global Warming Solutions Act of 2006 (AB 32)  
Timeline of Required Actions**

Date	Action	Responsible State Entity
By 6/30/07	<ul style="list-style-type: none"> <li>Publicize greenhouse gas (GHG) “early action measures” that can be implemented prior to the other Air Resources Board (ARB) emissions reduction measures and regulations that will become operative beginning on January 1, 2012.</li> </ul>	ARB
By 7/01/07	<ul style="list-style-type: none"> <li>Convene environmental justice committee, comprised of representatives of communities most significantly exposed to air pollutants, including communities with minority and/or low-income populations.</li> </ul>	ARB
No date specified	<ul style="list-style-type: none"> <li>Appoint an Economic and Technology Advancement Advisory Committee to advise on investment in and implementation of technological research and development.</li> </ul>	ARB
By 1/01/08	<ul style="list-style-type: none"> <li>Determine statewide GHG emissions level in 1990.</li> <li>Approve 1990-equivalent statewide GHG emissions limit, to be achieved in 2020.</li> <li>Adopt regulations to require reporting and verification of statewide GHG emissions and to monitor and enforce compliance.</li> </ul>	ARB
By 1/01/09	<ul style="list-style-type: none"> <li>Prepare and approve “scoping plan” to achieve maximum technologically feasible and cost-effective GHG emissions reductions by 2020. Plan will make recommendations on direct emission reduction measures, alternative compliance mechanisms, market-based mechanisms, and incentives.</li> </ul>	ARB, in consultation with CPUC <sup>a</sup> , CEC <sup>b</sup> , and other relevant state agencies
By 1/01/10	<ul style="list-style-type: none"> <li>Adopt regulations, enforceable by January 1, 2010, to implement “early action measures”.</li> </ul>	ARB
By 1/01/11	<ul style="list-style-type: none"> <li>Adopt regulations on GHG emission limits and reduction measures, to become effective on January 1, 2012.</li> </ul>	ARB
a	California Public Utilities Commission.	
b	State Energy Resources Conservation and Development Commission.	

- Designing any market-based mechanism to prevent an increase in emissions of toxic air contaminants or other air pollutants regulated by the state.
- Maximizing additional environmental and economic benefits to the state.

### Governor's Budget Proposal

*The budget proposes \$35.8 million and 151 positions across several state agencies to begin implementation of AB 32.*

The budget proposes \$35.8 million from various special and bond funds and 151 positions across a number of state agencies to implement AB 32. Figure 2 lists the proposed expenditures, number of positions, and funding sources, on an agency-by-agency basis. Figure 3 lists the same information, on an activity-by-activity basis.

**Figure 2**

### 2007-08 Proposed Budget for AB 32, by Agency

*(Dollars in Thousands)*

Agency	Expenditures	Positions	Fund Source
Air Resources Board	\$24,358	123	Air Pollution Control Fund (includes \$15.2 million loan from Motor Vehicle Account)
Department of General Services	3,398	5	Service Revolving Fund
Department of Water Resources	2,000	5	Proposition 84 Bond
Forestry and Fire Protection	1,500	—	Proposition 84 Bond
Secretary for Environmental Protection	1,390	5	Air Pollution Control Fund
California Public Utilities Commission	1,272	3	Public Utilities Reimbursement Account
California Energy Commission	1,110	6	Energy Resources Program Account
Integrated Waste Management Board	618	1	Integrated Waste Management Account
Department of Food and Agriculture	(331)	2	Reimbursement from Secretary for Environmental Protection
Department of Toxic Substances Control	115	1	Hazardous Waste Control Account
<b>Totals</b>	<b>\$35,761</b>	<b>151</b>	

**Figure 3****2007-08 Proposed Activity for AB 32 Implementation***(Dollars in Thousands)*

<b>Activity and Agencies Involved</b>	<b>Expenditures</b>	<b>Positions</b>
<b>Emissions Reduction Measures and Regulations (including alternative and market-based compliance mechanisms)</b>	<b>\$19,170</b>	<b>78</b>
Air Resources Board	\$13,272	64
Department of General Services	3,398	5
Department of Forestry and Fire Protection	1,500	—
California Energy Commission	610	6
Public Utilities Commission	272	3
Integrated Waste Management Board	118	—
<b>Scientific and Economic Analysis</b>	<b>\$7,726</b>	<b>14</b>
Air Resources Board	\$2,780	5
Department of Water Resources	2,000	5
Public Utilities Commission	1,000	—
California Energy Commission	500	—
Integrated Waste Management Board	500	1
Secretary for Environmental Protection	500	—
Department of Food and Agriculture	(331) <sup>a</sup>	2
Department of Toxic Substances Control	115	1
<b>Program Oversight and Coordination</b>	<b>\$3,940</b>	<b>28</b>
Air Resources Board	\$3,050	23
Secretary for Environmental Protection	890	5
<b>Emissions Inventory and Reporting</b>	<b>\$3,444</b>	<b>19</b>
Air Resources Board	\$3,444	19
<b>Emissions Reduction Scoping Plan</b>	<b>\$1,812</b>	<b>12</b>
Air Resources Board	\$1,812	12
<b>Totals</b>	<b>\$35,761</b>	<b>151</b>

<sup>a</sup> Reimbursement from Secretary for Environmental Protection.

*Budget Includes Additional Funding for Climate Change-Related Activities.* While the administration has indicated that \$35.8 million is the total of proposed expenditures for AB 32 implementation, we note that the budget includes other expenditures for climate change-related activities

that were approved as ongoing expenditures in prior-year budgets. These include at least the following:

- **\$3.15 million (\$2.65 million Motor Vehicle Account, \$500,000 Air Pollution Control Fund), 15.5 Positions.** For ARB for regulatory development and research activities related to the Governor's Climate Change Initiative.
- **\$981,000 (\$666,000 Air Pollution Control Fund, \$180,000 Motor Vehicle Account, \$135,000 General Fund), Two Positions.** For the Secretary for Environmental Protection to fund coordination, oversight, outreach, and analysis related to the Governor's Climate Change Initiative.
- **\$539,000 (Public Utilities Reimbursement Account), Six Positions.** For the California Public Utilities Commission (CPUC) for research activities related to the Governor's Climate Change Initiative.

### **Secretary's Proposal Goes Beyond Coordination**

*In passing AB 32, the Legislature placed the Air Resources Board in charge of implementation of the act while recognizing that the Secretary for Environmental Protection would have a coordination role in terms of the state's overall climate change policy. We find that the budget proposal expands the Secretary's role beyond coordination to include activities such as planning, monitoring, technical analysis, and oversight, many of which are clearly programmatic activities. Therefore, we recommend denying the budget request for the Secretary. (Reduce Item 0555-001-0115 by \$1.4 million.)*

*Secretary's Budget Request Proposes \$1.4 Million, Five Positions.* Citing an increased workload resulting from the state's expanding GHG emissions reduction activities, the Secretary requests \$1.4 million from the Air Pollution Control Fund (APCF) for five new positions and \$700,000 in external contracts related to AB 32.

*Secretary's Proposal Goes Beyond Coordination.* According to the budget proposal, funding would allow the Secretary to plan, coordinate, monitor, analyze, and oversee GHG emissions reduction activities at various state departments and agencies. We believe that these activities, as described in the proposal, would go beyond coordination, particularly given the types of positions being requested. Specifically, of the five positions requested, three are Air Pollution Specialists, which are highly technical staff typical of those employed by ARB for monitoring and regulating sources of air pollution. A fourth position is for a similarly technical Air Resources Supervisor who would oversee the other three technical posi-



tions. The fifth position would help the Secretary with public education and outreach. In addition, the proposal requests \$700,000 to pay for external contracts for such activities as analysis of related job growth, technology exports, and other economic effects.

***Legislature Charged ARB With State's GHG Emissions Reductions Policy-Making Authority.*** The budget proposal, in effect, attempts to establish a policy-making role for the Secretary in implementing AB 32—a role that the administration proposed when the Legislature was considering AB 32. In the final version of AB 32, the Legislature eliminated the Secretary's policy-making role from the bill and, for purposes of implementing the act, it limited the Secretary's role to coordination and specifically assigned policy-related decision-making authority to ARB.

***Recommend Denial of Secretary's Funding Request.*** The budget proposal does not justify the need for the requested technical positions and contracted services based on its role in coordinating the state's GHG emission reduction activities. We find that the highly technical positions would be more effectively employed at an entity, such as ARB, that directly undertakes technical monitoring and regulation of GHGs and has established *programs* and technical expertise in the subject area. Similarly, we believe that technical and economic analysis is better performed by or contracted through an entity such as ARB. Finally, we believe it is already within the Secretary's day-to-day duties to coordinate public participation and outreach and think that such activities could be performed with existing resources. Therefore, we recommend denying the Secretary's \$1.4 million funding request, and associated positions.

## **CPUC Funding Proposal Premature and Contrary to Legislative Direction**

***The budget proposal includes \$1.3 million for the California Public Utilities Commission (CPUC) to implement a cap on greenhouse gases and to conduct climate change-related research. The CPUC has also stated its intent to establish a "cap-and-trade" market mechanism for utilities. We recommend denying the CPUC's funding request since it is premature until the Air Resources Board conducts a number of statutorily directed actions. (Reduce Item 8660-001-0462 by \$1.3 million.)***

***CPUC Proposes Funding for Climate Change-Related Proceedings and Research.*** The budget proposes \$1.3 million and three positions for CPUC to conduct climate change-related proceedings. Of that funding, \$1 million is for consulting contracts to model GHG emission cap scenarios and to establish a protocol for development and measurement of GHG emissions reductions in the power sector. These positions are in addition

to six positions the Legislature authorized in the current year to research climate change at the CPUC.

*CPUC Signaled Its Intent to Establish Cap-and-Trade Market Mechanisms and Baseline for GHG Measurements.* During a recent commission hearing on climate change, the commission publicly stated its intent to establish a cap-and-trade market mechanism on emissions for investor-owned utilities (currently regulated by the commission) and publicly owned utilities (currently not regulated by the commission). The commission also stated its intent to conduct a proceeding to determine the base year for the cap-and-trade program. (In cap-and-trade programs that have been established elsewhere, the government sets a limit on, or “caps”, emissions, issues a limited number of emissions allowances, and allows regulated sources to buy and sell, or “trade”, those emissions allowances.)

*CPUC Funding Proposal Premature, Contrary to Legislative Direction.* We find CPUC’s intention to hold climate change-related proceedings, and in particular its intention to move ahead with a very specific market mechanism, contrary to the intent of AB 32. This is because the act charges ARB with identifying and establishing GHG emission reduction measures, and with determining whether those measures will include market-based mechanisms. The act also clearly established a GHG emissions base year of 1990, making the CPUC’s determination of a baseline unnecessary.

*Recommend Denial of CPUC’s Funding Request.* Given that the CPUC’s budget request inappropriately moves ahead of the statutorily directed effort at ARB, we recommend that the Legislature deny the request for \$1.3 million for CPUC. We also recommend adoption of the following budget bill language to prohibit CPUC from spending resources to develop and/or implement market mechanisms:

Item 8660-001-0462. Of the funding appropriated in this or any other item, no funds may be expended by the commission in connection with the implementation of market mechanisms as a greenhouse gas (GHG) emission reduction strategy until the Air Resources Board has completed its statutorily required statewide GHG emissions reduction plan, has included these mechanisms in the plan, and has directed the commission to begin to implement them.

## **Market-Based Measures Should Be Carefully Considered Prior to Their Inclusion in Climate Change Regulations**

*The budget proposal assumes the inclusion of market-based mechanisms in the Air Resources Board (ARB) regulations and provides funding for their implementation. We note that market-based measures represent a relatively new approach in California to regulate emissions*

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*and involve significant policy choices in which the Legislature should be involved. Therefore, we recommend that 24 positions at ARB for development and implementation of market-based measures be made three-year limited term. We also recommend the adoption of budget bill language prohibiting implementation of market-based measures, pending legislative review of ARB's evaluation of such measures.*

***ARB's Proposal Assumes Implementation of Market-Based Mechanisms.*** The budget proposal assumes the inclusion of market-based measures in the state's GHG emissions reduction regulations. For example, for 24 of its requested 123 permanent positions, ARB's proposal describes tasks involving, in part, the *implementation* of market-based mechanisms. In addition, ARB's proposal specifies the anticipated use of one particular type of market-based mechanism, known as cap-and-trade. However, when the administration was asked what evaluation led it to assume the inclusion of market-based measures in the state's GHG emissions reduction efforts, the administration could cite only a bibliography of academic publications and the prevalence of market-based measures as part of GHG emissions reduction programs in other jurisdictions.

***Use of Market-Based Measures Represents a Relatively New Regulatory Approach With Significant Policy Implications.*** Economic theory establishes the theoretical rationale for the use of market-based mechanisms to reduce GHG emissions—the potential for greater cost-effectiveness through flexible regulatory compliance. Many jurisdictions (including the United Kingdom, the European Union, and Japan) have chosen or are considering to employ market-based mechanisms in their attempts to reduce GHG emissions, with some success. We therefore think that there is merit to considering the potential for market-based mechanisms as a component of the state's GHG emission reduction strategies.

However, the inclusion of market-based mechanisms as part of California's GHG emissions reduction efforts deserves careful legislative consideration. To date, no California environmental regulatory agency has employed market-based mechanisms statewide. In addition, experience with market-based GHG emissions reduction systems in other jurisdictions is limited, the outcomes are difficult to assess and, in some instances, those outcomes have unfavorably affected environmental quality.

The use of market-based mechanisms to control GHG emissions in California involves important policy choices and inherent tradeoffs in which we believe the Legislature should be involved. While all market-based systems have in common some degree of flexibility being granted to regulated sources and the establishment of cost signals, there is substantial variation among potential market-based systems. For example, that variation can include such fundamental issues as whether government chooses

to set the quantity of allowable emission (as in a trading program) or to set the “price” of emissions (as under a fee-for-emitting program); whether such a program will generate revenue and, if so, how to distribute that revenue; and what sectors or entities will bear the costs imposed by such a program.

In addition, ARB’s budget proposal mentions designing a market-based mechanism to accommodate possible linkages between California’s market-based GHG emissions reduction program and similar programs operating or that may come to operate in other states, regions, and countries. We believe the Legislature should be made aware of and carefully consider any such system before California joins its regulatory efforts to those of jurisdictions over which the state has no authority. Given the major policy implications, any linkages with other jurisdictions should be ratified in a policy bill.

***Act Requires Evaluation of Market-Based Measures Before Their Inclusion in ARB Regulations.*** As described earlier, the act specifies evaluations that ARB must complete before it includes market-based mechanisms in its GHG emissions regulations. As ARB has yet to conduct these evaluations, the Legislature therefore lacks information that it thought important to an assessment of any proposed market-based regulatory system to control GHG emissions. In addition, it is premature to authorize funding and positions to implement a very specific market mechanism (namely, cap-and-trade), until these evaluations have been conducted.

***Positions Associated With Market-Based Mechanisms Should Be Limited Term.*** As described above, the administration proposes 24 *permanent*, full-time positions associated with market-based mechanisms to reduce California’s GHG emissions. We recommend two changes to this aspect of the administration’s proposal. First, we recommend that the Legislature approve the 24 positions for a three-year, limited term only. We think this three-year period will give ARB staff sufficient time to develop and evaluate various market-based mechanisms, but prevent it from undertaking implementation activities, consistent with our recommendation below. These evaluations can form the basis of legislative consideration of whether to include market-based mechanisms in the state’s GHG emission reduction regulations.

***Specify Funding Is Not to Pay For Implementation of Market-Based Mechanisms.*** Second, to ensure that funds are not used for ARB staff to work on implementing market-based mechanisms until ARB has presented the findings of its evaluation of those mechanisms, we recommend the adoption of the following budget bill language:

Item 3900-001-0115. Of the funding appropriated in this or any other item, no funds may be expended by the Air Resources Board for the

implementation of market mechanisms as a greenhouse gas (GHG) emissions reduction strategy until the board has completed its evaluation of these mechanisms as required by Chapter 488, Statutes of 2006 (AB 32, Nuñez) and submitted its findings and recommendations for its evaluation in a report to the Legislature for its review.

## **Funding for Budget Proposal Unsustainable**

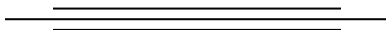
*Funding for the proposal relies mostly on special funds, some of which face substantial future pressures and based on our review cannot support the state's greenhouse gas (GHG) emissions reduction program, even as early as 2008-09, without significant fee increases. The budget proposal does not include any new fees, even though AB 32 provides the Air Resources Board with the authority to assess fees for purposes of implementing the act. We recommend that the administration report at budget hearings on its long-term funding plan for the state's GHG emission reduction activities. We also recommend the adoption of supplemental report language to require such a long-term funding plan be presented in conjunction with submittal of the 2008-09 Governor's Budget.*

**GHG Emission Reduction Program Funding Unsustainable; Long-Term Funding Plan Unknown.** The budget proposal funds the state's GHG emission reduction activities mostly from existing fee-supported fund sources—the APCF being the largest source (\$25.7 million). The budget does not rely on any increases of existing fees, nor does it propose any new fees, even though AB 32 provides ARB with the authority to assess fees for purposes of implementing the act. In fact, in the case of funding proposed from APCF, the budget relies on drawing down substantial fund balances carried over from previous years, along with a \$15.2 million loan to APCF from the Motor Vehicle Account—an account with the potential for major future-year pressures—to provide the funding budgeted for 2007-08. This level of funding would not be available from APCF in 2008-09, unless significant fee increases or APCF-funded program reductions in other areas were made.

**Require Administration to Report on Its Long-Term Funding Plan.** The budget's funding proposal for AB 32 implementation is clearly not sustainable. However, when asked, the administration was unable to specify its long-term funding plan for the state's GHG emissions reduction activities or whether such a plan would include use of ARB's statutory authority to assess new fees. This lack of planning is particularly problematic given that the activities described in the budget proposal represent only the initial development stages of the state's GHG reduction programs. The programs that result from this initial ramp up activity could involve costs well beyond the \$35.8 million included in this year's budget proposal.

We believe it important that the Legislature, in evaluating the administration's proposal, be informed of the administration's long-term plan to fund the state's GHG emissions reduction programs. Therefore, we recommend that the administration report at budget hearings on its long-term funding plan, including its estimate of future-year costs of the state's GHG emissions reduction programs, how these future-year costs would be funded, and whether the administration anticipates either increasing existing fees and/or creating new fees to support the identified funding requirements. To ensure that the Legislature is advised of the administration's long-term funding plans for these programs when it evaluates next year's budget, we recommend the adoption of the following supplemental report language:

Item 3900-001-0115. The Air Resources Board shall submit a report to the Legislature, in conjunction with the submittal of the *2008-09 Governor's Budget*, on its long-term funding plan to fund the state's greenhouse gas emissions reduction programs, including its estimate of future-year costs of these programs, how these future-year costs would be funded, and whether the administration proposes either increasing existing fees and/or creating new fees to support the identified funding requirements.



## FUNDING THE SAN JOAQUIN RIVER RESTORATION SETTLEMENT

*The budget proposes about \$14 million in bond funds to support the implementation of a lawsuit settlement to restore portions of the San Joaquin River. We recommend the Legislature delete funding for restoration activities in the budget year and await secure funding commitments from the responsible parties before committing state funds. If the administration wishes to move forward with restoration activities, it should sponsor a policy bill to ratify the agreement it has made with the responsible parties, thereby allowing the Legislature the opportunity to fully consider the appropriate role for the state in the restoration. (Reduce Item 0540-001-6051 by \$13,869,000, reduce Department of Fish and Game reimbursements by \$1,185,000, reduce Department of Water Resources reimbursements by \$12,684,000, reduce Item 3860-001-6027 by \$265,000.)*

**San Joaquin River Lawsuit Settlement.** Friant Dam is located on the San Joaquin River in Fresno County and is used to store water—primarily for agriculture. In 1988 the Natural Resources Defense Council sued the federal Bureau of Reclamation (the operator of Friant Dam) and the Friant Water Users Association (FUWA), alleging that the operation of Friant Dam violates the state’s Fish and Game Code with respect to historic fish populations in the river. In August 2006, the parties reached a settlement agreement, the goal of which is to “restore and maintain fish populations” in the San Joaquin River below Friant Dam. The settlement specifies actions that will be taken to restore the San Joaquin River over the next 20 years. Under the agreement, the federal government will provide funds to restore the river, while FUWA agreed to actions that will increase flows in the river. While the total cost of the restoration is unknown, early estimates indicate that the total cost could be over \$700 million over the next 20 years. The settlement agreement recognizes that Congressional action is necessary to authorize the federal funding contribution.

**State’s Role in the Restoration.** Proposition 84, passed by the voters in November 2006, includes \$100 million allocated to the Secretary for

Resources for the restoration of the San Joaquin River, for the purpose of implementing a court settlement to restore flows and the salmon population to the river. While the state is not a party to the lawsuit, the Department of Fish and Game (DFG), the Department of Water Resources (DWR), the Resources Agency, and the California Environmental Protection Agency have entered into a memorandum of understanding (MOU) with the settling parties regarding the state's role in the restoration. The MOU has been incorporated into the settlement agreement.

Pursuant to the MOU, the administration is proposing to spend \$100 million of Proposition 84 funds over the next five years on restoration activities. Proposition 84 funds are proposed for land and easement purchases, channel improvements, and research projects. Two specific priority areas identified by the administration are the creation of a bypass around Mendota Pool (which would prevent fish from passing through Mendota Dam) and isolating an existing gravel pit located along the San Joaquin River in Fresno (to prevent migrating salmon from becoming trapped in the gravel pit during high river flows).

**Budget Proposal.** The budget proposes about \$13.9 million of Proposition 84 bond funds to the Secretary for Resources for purposes of implementing the lawsuit settlement. (These funds would be used by the secretary to reimburse DFG [\$1.2 million] and DWR [\$12.7 million] for carrying out the actual restoration activities.) In addition, the budget proposes \$265,000 of Proposition 13 bond funds in DWR for San Joaquin River restoration activities. The funds proposed in the budget will begin the restoration activities described above.

**Legislative Prerogative to Ensure Proposition 84 Funds Are Spent Wisely.** Proposition 84 provides that before funds can be spent for the San Joaquin River restoration settlement, they must be appropriated by Legislature. While the administration's MOU references the availability of Proposition 84 funds for purposes of the settlement, the MOU cannot obligate the Legislature to take a particular action in exercising its appropriation authority. In exercising its authority, the Legislature should ensure not only that the proposed expenditures are consistent with the bond measure, but also that funds are spent wisely and effectively.

**Need Stronger Assurances That Responsible Parties Will Pay.** While there is a state interest in restoring the San Joaquin River and also preserving the use of river water for agriculture, it is important to note that the state is not directly responsible for the condition of the San Joaquin River that led to the lawsuit. Under the "polluter pays" principle, the responsible parties—in this case the federal government and the water users—should bear the primary responsibility for the restoration of the river. The state



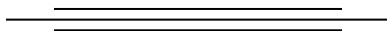
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should not take actions that potentially diminish the legal obligations of the responsible parties to restore the damage they have caused.

Based on our review, we conclude that the funding contribution from the responsible parties is subject to significant uncertainty. The settlement agreement, for example, provides that any party to the lawsuit can void the settlement if federal legislation to implement the settlement is not enacted by December 31, 2006. While such federal legislation (authorizing \$250 million in appropriations) was introduced this past fall, it failed to pass. This brings into question whether either the federal government or the water users will meet their obligations under the settlement agreement. While such legislation may be forthcoming in the new session of Congress, we recommend that the state wait until the required federal appropriations are made before appropriating state funds. If the state were to appropriate funds to begin the restoration process in advance of federal funding being secured, it may reduce the urgency for the federal government to provide funding as required in the settlement. For example, while the CALFED Bay-Delta program was intended to be an equal partnership among the state, the federal government, and local water users, the federal government has substantially lagged the state in its funding contribution, as the state has provided more than its share of costs.

We therefore recommend that the Legislature delete the requested state funding for restoration activities in the budget year. This will allow the Legislature to ensure that these Proposition 84 funds (which can only be used for the San Joaquin restoration), when appropriated, are targeted effectively and that the responsible parties have provided their required contributions.

***Legislature Should Have an Opportunity to Evaluate the State's Role in the Restoration.*** While Proposition 84 allocates funds for the restoration of the San Joaquin River and the administration has signed an MOU with the responsible parties, the Legislature has never been given an opportunity to evaluate the state's appropriate role in the restoration. Because the restoration effort is likely to require significant state contributions over the next several decades, we think the Legislature should have the opportunity to deliberate on the appropriate role for the state in the restoration. If the administration wishes to move forward with restoration activities, it should sponsor a policy bill to ratify the MOU. This would allow the Legislature to fully evaluate the commitment the administration is proposing, as well as allowing the Legislature to determine the overall parameters of state involvement in the restoration.



## ELIMINATION OF ENERGY-RELATED AGENCIES

### **Budget Proposes to Eliminate Energy Agencies**

*The budget proposes budget bill and trailer bill language eliminating two energy-related agencies, the California Consumer Power and Conservation Financing Authority (CPA) and the Electricity Oversight Board (EOB), with no plan to shift their authority to other agencies. Below we provide a brief history of CPA and EOB and energy agency organization in the state, and raise issues for the Legislature to consider, particularly relative to the proposed elimination of EOB.*

In conjunction with his budget proposal, the Governor has proposed eliminating five of California's boards and commissions, of which two are energy-related, on the basis that they are "no longer needed." The proposal is in part based on the work of the California Performance Review, which identified a number of opportunities to streamline and reorganize state government organization. The Governor has proposed budget bill and trailer bill language to eliminate two energy-related agencies—CPA and EOB. In both cases, the proposed language to eliminate the agencies contains no plan to shift authority from these entities to other energy-related agencies.

### **Current Energy Agency Organization**

*There are multiple state agencies involved in implementing and overseeing the state's energy-related responsibilities, including the California Consumer Power and Conservation Financing Authority (CPA) and the Electricity Oversight Board (EOB). While CPA is currently inactive, EOB is currently fully operational.*

At least seven state governmental entities are involved in implementing, overseeing, and managing the state's energy-related policies and responsibilities. These include the Energy Resources Conservation and Development Commission (CEC); California Public Utilities Commission

(CPUC); EOB; CPA; California Energy Resources Scheduling (CERS) division within the Department of Water Resources; the Division of Oil, Gas, and Geothermal Resources within the Department of Conservation; and the California Independent System Operator (ISO).

**History of EOB.** The EOB was created by Chapter 854, Statutes of 1996 (AB 1890, Brulte), which deregulated California's wholesale electricity industry. The board was created to oversee ISO, which manages the transmission grid serving most of California, and the Power Exchange (PX), which for a time was the marketplace in which all electricity in the state was bought and sold. The EOB was also given very broad authority over ensuring reliability of the state's supply of electricity.

Central to the original role of EOB was oversight of the activities of ISO and PX and determining the composition of the governing boards of these two organizations. However, among the many developments associated with the 2001 energy crisis was the bankruptcy of the PX in March 2001, and the replacement of the EOB-appointed ISO stakeholder board with a board of gubernatorial appointees. Thus, EOB no longer carries out these original duties. However, subsequent legislation has given it authorization to conduct certain other activities. These include the following:

- **Petition the Federal Energy Regulatory Commission (FERC) on Specific Transmission Matters.** Chapter 1040, Statutes of 2000 (SB 1388, Peace), requires EOB to petition FERC to allow the recovery of certain expenses of investor owned utilities relating to the replacement and expansion of the state's electricity transmission grid.
- **Communicate ISO's Rule Changes to FERC.** Chapter 1x, Statutes of 2001 (AB 5x, Keeley), requires EOB to direct ISO to amend its bylaws in response to FERC decisions, and to communicate this action to FERC.
- **Investigate Any Matter Related to the Wholesale Electricity Market.** Chapter 766, Statutes of 2001 (SB 47, Bowen), gives EOB broad powers to investigate and initiate proceedings at FERC in response to market manipulation by electricity market participants.

As a result of these statutory responsibilities, EOB's primary duty at this time is to act as a market monitor, overseeing the state's electricity market and initiating proceedings at FERC in response to market manipulation. The EOB has been a participant in over 400 proceedings at FERC and has been a litigant in over 100 cases in the federal courts of appeal. Through 2005-06, EOB has been a party to settlements of over \$1 billion for various overcharges.

The EOB currently has a staff of 23 positions and a budget of \$4.1 million, the majority of which comes from the fee-funded Public Utilities Commission Reimbursement Account. The EOB's governing board currently has not met since March 2003. Since that time, EOB staff has reported directly to the Governor's office.

**History of CPA.** The CPA was created by Chapter 10x, Statutes of 2001 (SB 6x, Burton), to assure a reliable supply of power to Californians at reasonable rates, including planning for a prudent energy reserve. The CPA was also created to encourage energy efficiency, conservation, and the use of renewable resources. Chapter 10x authorized CPA to issue up to \$5 billion in revenue bonds to finance these activities, and prohibits the authority from approving any new program or project after January 1, 2007, unless statutory authorization has been granted for such activity.

The CPA exercised only a small portion (\$28 million) of its bonding authority, and its administrative operations ceased in October 2004, at which time it only had one operational program—the Demand Reserves Partnership Program. Under this program, CPA provided electricity at peak times to CERS, by paying other large electricity users to reduce their electricity use during these peak demand times. The Demand Reserves Program has been transferred to Pacific Gas & Electric, under the direction of CPUC. While funding for this program has passed through CPA's budget through the current year, this program is scheduled to expire on June 30, 2007.

### **Elimination of CPA Warranted**

*The budget proposes to statutorily eliminate the California Consumer Power and Conservation Financing Authority (CPA) and transfer any remaining CPA funds to the Energy Commission for repayment of loans. We think this proposal is warranted and recommend its approval.*

**Budget Proposes Elimination of CPA.** As noted, CPA has long ceased its administrative operations, and the remaining program which it has been funding is scheduled to expire on June 30, 2007. The CPA has no other current or future activities authorized by statute. Consistent with the de facto termination of CPA under current law as of January 1, 2007, the budget proposes to formally eliminate CPA in statute and transfer remaining funds in the amount of \$2.5 million to CEC to repay loans made to CPA in 2002 and 2003. We recommend approval of the Governor's proposal.

## Proposal to Eliminate EOB Raises Issues

*The Governor's proposal to eliminate the Electricity Oversight Board (EOB) is incomplete in that it does not address which entity will assume EOB's current duties and its pending legal-related workload. We recommend the administration report at budget hearings with a plan for assigning EOB's duties and legal workload to other state agencies. With the administration's plan in hand, the Legislature will then need to make its own determination as to the appropriate assignment of these duties and workload.*

*Administration Lacks Plan to Shift EOB Duties.* While the Governor's budget proposes EOB expenditures of \$4.1 million in 2007-08 (essentially the same as the current-year level), the *Governor's Budget Summary* states the administration's intention to eliminate EOB. The proposed budget bill contains language (Control Section 4.26) that would give the Director of Finance the authority to reduce appropriations made in the bill to EOB to reflect savings from eliminating the board. We note, however, that the proposed trailer bill language to eliminate EOB does not specify how current workload and authority at the board would be transferred to other agencies. Rather, the proposed statutory language simply eliminates any references to the board in statute, and gives the Governor power to designate a successor for all of EOB's duties and authority including legal matters.

*Energy Agency Reorganization Concept Has Merit, but Governor's Proposal Falls Short.* We have previously raised the issue of reorganizing the state's energy agencies in light of the current multiplicity of energy agencies, some of which have overlapping functions (see, for example, *The 2006-07 Budget: Perspectives & Issues*, page 199). While there may be merits in consolidating EOB's functions in another energy entity, the Governor's proposal is incomplete in that it does not address the energy-related activities in several other state entities, nor does it provide a plan on which state agency would be assuming EOB's current duties and workload. The issue of which state entity would assume EOB's duties is particularly relevant given that moving EOB's electricity market monitoring duties into certain other energy agencies raises potential conflicts of interest. The FERC requires that entities that monitor the electricity market be independent from any market participant or interest. Some of the state's energy entities—such as CEC and CERS—could be considered market participants. Additionally, EOB is currently involved in a number of FERC proceedings and litigation as noted above. The Governor's proposal is silent on who would be assuming EOB's role in these cases to ensure that the cases continue to be pursued aggressively on behalf of the state's ratepayers.

We think it is important to note that, unlike CPA, EOB is currently fully operational and has ongoing workload, which, absent the Governor's proposal or another plan to reorganize the state's energy entities, would carry on into the budget and future years. The EOB's current workload includes involvement in about 240 cases pending at FERC. The EOB legal workload also includes over 100 items of appeal in United States Court of Appeals. These cases, largely, are pursuing settlements for electricity price overcharges during the energy crisis, on behalf of the state's electricity ratepayers.

*Assumption of Duties Should Be Evaluated and Determined by Legislature.* The Legislature has previously proposed a plan to eliminate EOB. Senate Bill 920 (Bowen), enrolled in 2004 and vetoed, proposed to eliminate the board and provided a plan for the assumption of EOB's pending legal cases—these cases were to be transferred to the Attorney General. Other EOB duties were to be assigned to a successor agency by the Governor. In contrast, the Governor's proposal does not specify who will handle EOB's caseload before FERC. We think that it is an important policy matter for the Legislature to evaluate how EOB's duties, and its current legal workload, should be assumed by other entities. To that end, we recommend the Legislature withhold action on the EOB budget, and require the administration to present at budget hearings a plan to assign EOB's duties and pending legal workload to other state agencies. The Legislature will then need to make its own determination on these issues. We further recommend the Legislature deny budget bill language allowing the Department of Finance to reduce appropriations to the board, pending legislative determination of a more complete plan for the assumption of EOB duties and workload.

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# DEPARTMENTAL ISSUES

*Resources*

## ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION (3360)

The Energy Resources Conservation and Development Commission (commonly referred to as the California Energy Commission, or CEC) is responsible for forecasting energy supply and demand, developing and implementing energy conservation measures, conducting energy-related research and development programs, and siting major power plants.

***Proposed Funding.*** The budget proposes expenditures of \$417.3 million from various state and federal funds in 2007-08. This is \$92.3 million, or 19 percent, less than current-year estimated expenditures. This decrease is mainly due to a decrease of \$77 million in expenditures from the Renewable Resource Trust Fund (RRTF) for lower estimated renewable energy production incentive payments. The budget also proposes increases of \$1.1 million and 4.8 positions to implement the Global Warming Solutions Act; \$994,000 to implement both the Million Solar Roofs Initiative and New Solar Homes Partnership; and a \$24.8 million transfer from the Ratepayer Relief Fund to implement a new program to support energy conservation projects at schools using funds from the Williams Energy settlement.

## **Proposed Use of Williams Energy Settlement Funds Contrary to Legislative Intent**

*The budget proposes to use funds from the Williams Energy settlement for a new program of grants and loans to schools for solar power. The Legislature previously stated its intent in policy legislation (that was vetoed) that these funds are to be used to maximize energy efficiency in schools without specifying a technology, thus giving schools flexibility in how to achieve efficiencies. We recommend that the Legislature deny the Governor's proposal, and instead provide the funding in a policy bill directing the use of settlement funds. (Eliminate transfer Item 3360-011-3061 for \$24,796,000.)*

**Electricity Contract Settlement Agreements.** During the energy crisis of 2001, the Department of Water Resources (DWR) entered into a number of longer-term contracts to purchase electricity to serve the customers of the state's three largest investor owned utilities (IOUs). The majority of these contracts were signed at relatively high prices. As a result of litigation, the state renegotiated its contract with Williams Energy and settled other claims against that company, resulting in an allocation of cash and assets to the state. Among other purposes, the settlement directed that \$69 million in cash be used to retrofit schools and other public buildings with renewable energy and energy efficiency projects.

**Legislative Opportunity to Direct Use of Settlement Funds.** In our *Analysis of the 2003-04 Budget Bill* (page B-64), we recommended that the Legislature consider uses for the settlement funds, including funds already received by the state and potential future settlement funds related to the energy contracts. Under then current law, the Attorney General had the authority to direct the expenditure of settlement funds that are provided to the state, unless the Legislature provided other direction in statute. Chapter 228, Statutes of 2003 (AB 1756, Committee on Budget), was enacted to *prospectively* direct that settlement funds (from settlements entered into after August 2003) be appropriated by the Legislature for the benefit of ratepayers to (1) finance energy litigation expenses by the state, (2) reduce rates for customers in the affected service areas, and (3) reduce debt on bonds related to DWR energy purchases. The allocation of the Williams Energy settlement funds is not governed by this legislation, given that the settlement was entered into before the legislation took effect. However, as discussed below, the Legislature has stated its intent on the use of these funds.

**Legislature Has Previously Directed Use of Williams Energy Settlement Funds.** In keeping with the original settlement agreement, the Legislature passed AB 2756 (Levine) which created a plan to expend Williams Energy settlement funds for energy efficiency retrofits of public



schools and buildings. The legislation directed CEC, upon legislative appropriation, to provide grants to K-12 public schools and public universities or community colleges, based on specific criteria and expectations, for various energy conservation projects. The bill did not specify a specific energy technology, but rather allowed the schools to select the most effective energy efficiency projects to be submitted for grant consideration. The legislation was vetoed by the Governor in 2006.

**Budget Proposal.** The budget proposes to use \$24.8 million of Williams Energy settlement funds to fund a new photovoltaic (PV) energy efficiency program for public K-12 schools. This is achieved by transferring funds from the Ratepayer Relief Fund to the continuously appropriated Energy Conservation Assistance Account. Of this amount, \$1.1 million is for program administration (four positions) and the balance of \$23.7 million is for grants, loans, and technical support contracts. The proposal assumes that loans under this program could be repaid by using the monies saved by energy efficiencies.

**Concerns With Budget Proposal.** The proposed use of the Williams Energy settlement funds is inconsistent with prior legislative intent (as indicated in AB 2756) on a number of counts. First, the budget proposal specifies a single energy efficiency technology—PV—as a necessary criterion for grants and loans under the program. However, the budget already proposes multiple ongoing solar programs at CEC and the California Public Utilities Commission (CPUC) for the New Solar Homes Partnership; the Solar Initiative; and implementation of Chapter 132, Statutes of 2006 (SB 1, Murray), that serve to promote this technology. Consistent with legislative intent in AB 2756, we think that settlement funds should be awarded for a broader array of energy efficiency upgrades, beyond those that are PV in nature. Examples of other types of energy efficiencies are retrofitting heating and cooling systems, replacing lighting fixtures, improving insulation, and using alternative building materials. Second, the budget proposal includes using settlement funds for loans. This again contrasts with AB 2756, which provided funding only for grants in keeping with legislative policy that the electricity settlement fund should be used for purposes of ratepayer relief. Loans to ratepayers may not serve the purpose of ratepayer relief as effectively as grants.

**Recommend Legislature Direct the Use of Settlement Funds Through Policy Bill.** To ensure legislative oversight and consistency with legislative intent for the use of the Williams Energy settlement funds, we recommend that the budget request be denied and instead recommend the enactment of legislation directing the use of Williams Energy settlement funds (in accordance with the settlement agreement), such as was done in AB 2756. The bill could include an appropriation to allow for expenditure of the funds. Consistent with prior legislative intent, we recommend that the

legislation provide for the maximum feasible use of grants with matching funds to afford ratepayer relief, and allow for an array of energy efficiency projects to be eligible for grants.

### **Improving Renewable Energy Program Effectiveness**

*The commission has experienced difficulty in getting renewable energy program funds out the door, as reflected in a projected fund balance of \$142 million in the Renewable Resources Trust Fund at the end of the budget year. To ensure that the state gets back on track to meeting statutory renewable energy goals, we recommend that the Legislature hold joint policy and budget hearings to review the state's progress in meeting these goals and to consider statutory changes that may be needed to improve program effectiveness.*

**Renewables Portfolio Standard (RPS).** Under current law, IOUs and other energy providers are required to obtain 20 percent of their delivered power from renewable sources (such as wind, small hydroelectric, and PV) by 2010. In furtherance of this statutory target, the commission administers a renewable energy program funded by RRTF. The RRTF receives its funding from a surcharge on consumers' energy bills. The program provides incentives for the production and purchase of renewable energy. One component of the program is the provision of "supplemental energy payments" (SEPs) to renewable energy producers to cover above-market costs of producing renewable energy relative to nonrenewable sources. This program component is designed to make renewable energy more price-competitive for IOUs when IOUs seek energy contracts.

**Getting the State Back on Track to Meeting Renewable Energy Goals.** The CEC as well as CPUC have indicated that the state is not on target to reach the 20 percent RPS goal by 2010 unless corrective action is taken. The CEC has recently completed an update to its statutorily required Integrated Energy Policy Report (IEPR) that includes recommendations for a number of midcourse changes to the renewable energy program, some of which may require statutory changes. Among the recommended changes are changes to the SEP process, to address concerns that renewable energy producers have had difficulty securing financing for their projects, even with the potential of their receiving SEP production incentives. This has led to fewer SEP claims, allowing RRTF to build up a substantial fund balance—projected to be \$142 million at the end of the budget year.

**Recommend Joint Hearings on RPS Progress and Potential Program Changes.** We think that the recommendations in the IEPR for changes in the renewable energy program to put the state back on track to meeting the 2010 goals merit legislative consideration. The Legislature should require the commission to report at hearings on its proposals to increase

the effective use of RRTF, thereby reducing the fund balance. We therefore recommend joint policy and budget hearings on the state's progress in meeting the RPS goals, the commission's proposals for improving program effectiveness or adjusting fee levels, and any recommendations from the commission for statutory changes to implement their proposed program changes.

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## DEPARTMENT OF FORESTRY AND FIRE PROTECTION (3540)

The California Department of Forestry and Fire Protection (CDFFP), under the policy direction of the Board of Forestry, provides fire protection services directly or through contracts for timberlands, rangelands, and watershed lands owned privately or by state or local agencies. These areas of department responsibility are referred to as “state responsibility areas” (SRA). In addition, the department regulates timber harvesting on forestland owned privately or by the state and provides a variety of resource management services for owners of forestlands, rangelands, and watershed lands.

The budget requests about \$1.3 billion for the department in 2007-08, including support and capital outlay expenditures. Of this amount, 94 percent is for fire protection, 5 percent is for resource management, and 1 percent is for State Fire Marshal activities and administration.

The total proposal represents an increase of \$336 million over estimated current-year expenditures. This largely reflects an increase of \$317 million (mostly lease-revenue bonds) for capital outlay projects and \$31 million (mostly General Fund) for various employee compensation increases, including changes to the Unit 8 memorandum of understanding (MOU), partially offset by reductions in prior-year one-time expenditures.

The General Fund will provide the largest portion of the department’s funding for state operations and capital outlay—\$655 million (about 50 percent). The remaining funds will come from lease-revenue bonds (\$340 million), reimbursements (\$248 million), federal funds (\$26 million), and various other state funds, including bond funds.

In addition to the department’s base fire protection budget, the budget proposal includes \$82 million from the General Fund for emergency fire suppression. As in the current year, the budget bill contains language that authorizes the Director of Finance to augment the budget for emergency fire suppression by an amount necessary to fund these costs. (The costs of

wildland firefighting can vary substantially from year to year, making it difficult to accurately budget for emergency fire suppression. The budgeted General Fund amount for emergency fire protection is roughly \$13 million less than the ten-year average for such costs.)

## **State's Wildland Firefighting Costs Continue to Escalate**

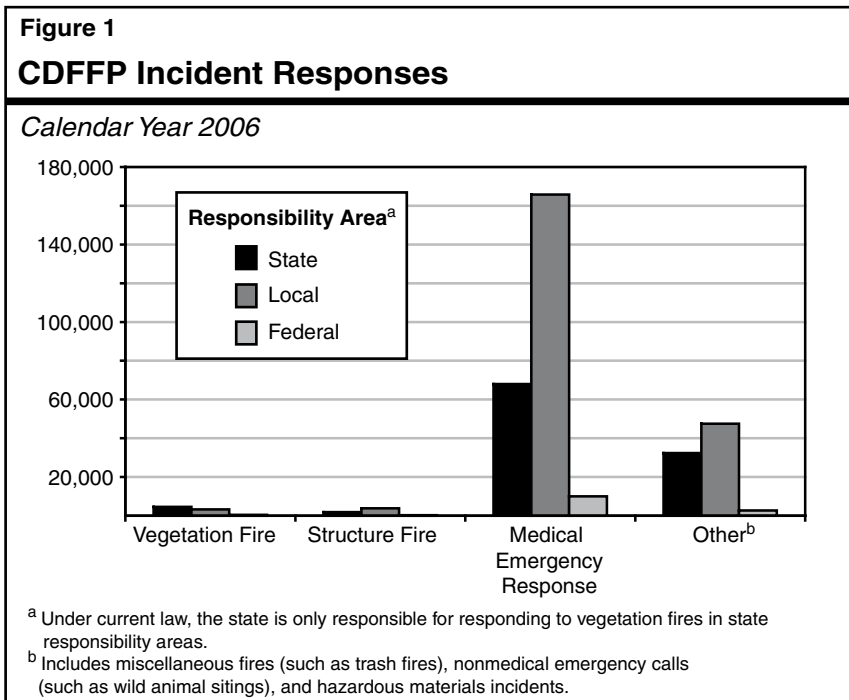
*The state's costs to provide wildland fire protection have increased substantially in recent years. Growing costs are due, in part, to changes in fire conditions in wildland areas, increasing development in wildland areas, and rising labor costs. In order to control rising costs, we recommend the Legislature clarify the roles of the state and local government for emergency services in state responsibility areas (SRA). We also recommend the Legislature enact a fire protection fee levied on private landowners in SRA, so that the beneficiaries of state fire protection pay a portion of its cost. Finally, we recommend the Legislature consider modifying the current criteria for designating SRA, such that local governments take more responsibility for fire protection on lands where locally-approved development is occurring.*

**State's Responsibility for Wildland Firefighting.** The state is responsible for wildland firefighting in SRA. These SRA are primarily *privately-owned* timberlands, rangelands, and watersheds. Lands owned by the federal government or incorporated within existing city limits are excluded from SRA. Also, if the density of houses is greater than three units per acre, the Board of Forestry generally removes these lands from SRA and local governments become responsible for fire protection. Existing law *requires* the department to provide wildland fire protection on SRA. The law *allows* the department to provide other emergency services—such as structure fire protection or medical emergency response—in SRA when resources are available and it is within the department's budget. State law does not explicitly require local governments to provide nonwildland fire protection within SRA, although in practice local governments generally have assumed this responsibility, as structure fire protection and emergency services are generally considered local responsibilities. In addition to state and local responsibility areas, the federal government owns a large amount of land in the state—including national forests and other federal lands. On these lands, the federal government is responsible for fire protection.

Cooperation among the department, federal fire agencies, and local fire agencies is governed by a series of agreements among the various parties. These agreements specify how and when various agencies will provide assistance to one another, whether or not such assistance will require reimbursement to the assisting agency, and the terms of such reimbursements. For a detailed discussion of the various fire protection agreements

and recommendations to improve this system, please see our report: *A Primer: California's Wildland Fire Protection System*, April 2005.

As shown in Figure 1, in calendar year 2006, the department responded to more than 340,000 separate incidents—including vegetation fires, structure fires, and emergency medical incidents. (The figure shows the number of responses by the department, the type of incident, and in which *area of responsibility* the incident occurred, even though the department responded. As mentioned above, the state is only *responsible* for vegetation fires in SRA, though the department *may* respond to other incidents if it has resources available.) Approximately 70 percent of the department's responses were for medical emergencies, while only 1 percent of total calls were for vegetation fires in SRA (about 4,500 incidents). Also, roughly 65 percent of department responses were to incidents outside of SRA in local responsibility areas. On the other hand, the federal government and local agencies also respond to incidents in SRA. In 2006, federal fire agencies responded to roughly 750 vegetation fires in SRA, while local governments responded to about 5,500 vegetation fires in SRA.

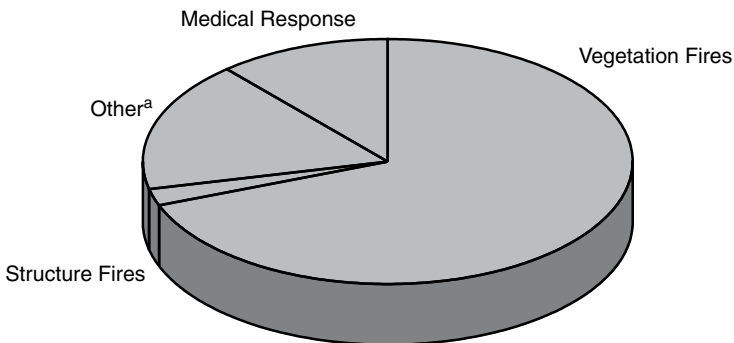


While the sheer number of the department's *responses* (almost 98 percent) are to incidents beyond its primary mission of wildland fire protection, the department spends the majority of its *time* responding to vegetation fires. As shown in Figure 2, the department spent approximately 70 percent of its emergency response time in 2006 on vegetation fires. The department does not distinguish between state and nonstate responsibility activities when recording time spent, so it is difficult to determine how much of this time was spent responding to fires that are either a local or federal responsibility. However, the majority of vegetation fire responses (55 percent) were in SRA. We also note that, in general, the state is reimbursed for responses to incidents that are either a federal or local responsibility after either the first 12 or 24 hours of response. This means that for *significant* fires outside of SRA, the state is generally reimbursed for its costs.

Figure 2

### CDDFP Time Spent Per Incident Type

Calendar Year 2006

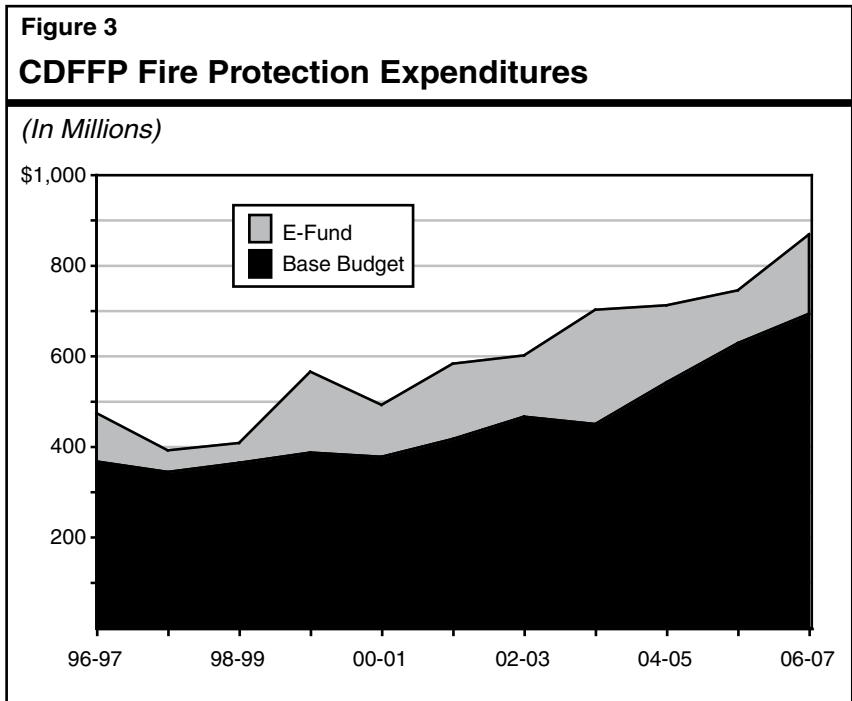


<sup>a</sup> Includes miscellaneous fires (such as trash fires), nonmedical emergency calls (such as wild animal sightings), and hazardous materials incidents.

**Continually Increasing Costs of State Fire Protection.** The department's fire protection budget is divided into baseline fire protection and emergency expenditures. The baseline budget includes normal day-to-day costs, such as salaries and benefits for employees, the costs of operating facilities, and other regular firefighting costs. The budget also includes

funding for the Emergency Fund (E-Fund) which is used to pay for costs of fire protection beyond budgeted expenditures, such as overtime or special equipment rentals. The E-Fund expenditures are typically associated with large wildland fires that vary considerably in number and severity year to year. It is difficult to predict the costs of responding to these fires, so the department is given a separate General Fund appropriation for this purpose—generally based on the ten-year average expenditure for emergency fire suppression—and the Director of Finance is given the authority to augment this appropriation as needed, provided certain reporting requirements are satisfied.

As shown in Figure 3, the department's budget for fire protection has increased significantly over the last decade. Actual fire protection expenditures (including E-Fund) in 1996-97 were \$475 million. In the current year, the department estimates total fire protection expenditures (including E-Fund expenditures beyond the budget appropriation) will be \$869 million—an 83 percent increase over the last decade, or an average increase of just over 8 percent per year. As discussed below, there are many reasons why the state's expenditures for fire protection have grown so substantially over the last decade.





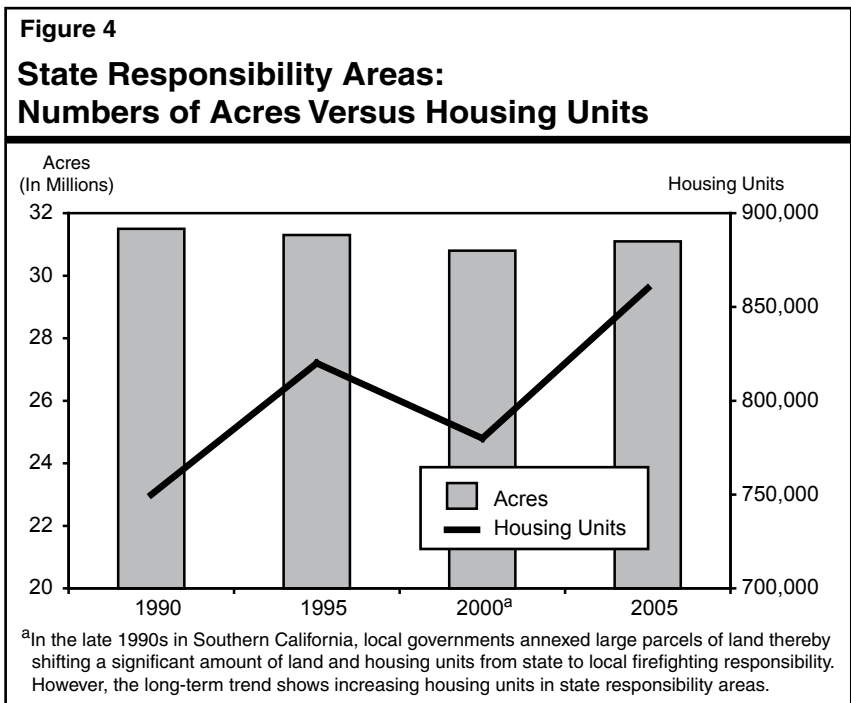
**Increasing Workload.** There are several factors that have either increased or complicated the department's fire protection workload, thereby increasing the department's expenditures:

- **Changes in Wildland Fuel Conditions.** Fire suppression activities over the last century have left much of the state's wildlands filled with fallen trees, standing dead trees, and heavy undergrowth. As these fuels have built up, the risk of catastrophic fires has grown. In addition, several years of drought followed by insect infestations in Southern California and the Sierras have killed many trees, increasing the risk of large, dangerous fires in these regions of the state.
- **Increasing Development in the Wildland Urban Interface.** Over the last several decades, the state has experienced significant housing development at the boundary between wildlands and urban areas, known as the wildland urban interface. In particular, significant development has occurred in the Sierra Nevada foothills and the interior ranges of Southern California. As can be seen in Figure 4, while the total acreage in SRA has remained stable over the last 15 years, the number of housing units in SRA has increased by 15 percent over this period—despite changes in SRA designations which have moved fire protection responsibility for significant numbers of houses from SRA to local responsibility areas. As development increases in previously undeveloped—and often fire prone—areas, fire protection costs increase for several reasons. First, the presence of more people increases the incidence of wildland fires, as fires from human caused activities spread to wildland areas. Second, protecting people and homes often requires greater fire suppression effort than would typically be used on forests or rangelands. Finally, the presence of people and structures can sometimes limit the techniques used for fire prevention or suppression. For example, the use of prescribed burning to reduce available fuel loads or the use of aircraft to suppress fires may be limited by the presence of homes in a formerly wildland area. The inability to use these kinds of fire suppression tactics increases the need for more labor-intensive firefighting methods to protect people and homes.

**Increasing Labor Costs.** Firefighting is a labor-intensive activity. Labor costs account for a significant portion—roughly 50 percent—of the department's costs for wildland fire protection. Any increases in compensation per employee, as well as in the number of employees and hours of overtime worked, can substantially impact expenditures for wildland fire protection. In the current year, the department's fire protection budget includes more than 4,000 full-time, year-round positions and more than

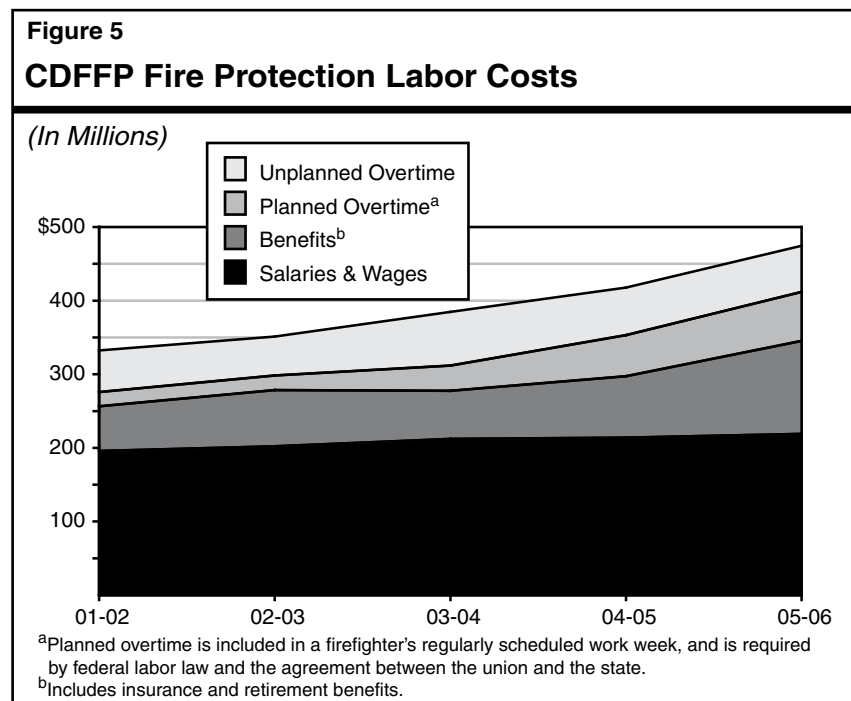
950 full-time equivalent positions for seasonal firefighters. As can be seen in Figure 5, total labor costs for fire protection have increased substantially in recent years—a 30 percent increase from 2001-02 through 2005-06.

In addition to an increase in the number of positions, total labor costs have increased due to wage and benefit increases that are based on terms included in the MOU between the firefighters' union and the state. (Wage increases for firefighters have been generally similar to the compensation increases received by most state employees.) The increasing total costs for benefits also reflects the generally increasing cost for firefighter-related insurance and health benefits, which are, in part, driven by the physical nature of firefighting.



Total labor costs have also increased in recent years due to changes in how overtime is calculated and compensated. Compensation for “planned overtime” (which is part of a firefighter’s regularly scheduled work week) is determined by both federal labor law and the MOU. Between 2001-02 and 2005-06, the cost of planned overtime increased by 71 percent. (Increased costs for planned overtime reflect both increases in the total number of firefighters earning overtime and incremental increases in the pay rate for overtime hours, which were part of the MOU.) Previously, in areas outside

of Southern California, firefighters accrued paid overtime only during fire season. A provision of the 2001 MOU requires that all firefighters earn year-round planned overtime as of July 2006. In the current and budget year, this will increase compensation costs by approximately \$36 million annually, since firefighters will now earn increased wages for planned overtime hours.



**Legislative Options for Controlling State Costs for Wildland Firefighting.** The department's labor costs on a per-employee basis are generally driven by the existing MOU with the firefighters' bargaining unit. Unless the Legislature wishes to reopen this recently ratified agreement, the department's per-employee labor costs are generally fixed. However, as discussed in the following sections, we think that there are several actions that the Legislature can take to control state costs for fire protection by providing for a more appropriate sharing of (1) the costs of fire protection between the state and the beneficiaries of the state's services and (2) the responsibility for fire protection between the state and local governments.

**Clarifying State Versus Local Responsibilities.** Under current law, the department is not responsible for life or structure protection in SRA.

However, statute is *not explicit* that local governments *are* responsible for these services. In general, local governments have assumed responsibility for life and structure protection in SRA. However, the presence of department fire stations and personnel in SRA may provide a disincentive for local governments to budget for and provide adequate emergency response capability. We recommend that the Legislature clarify in statute that the state is not *fiscally* responsible for life or structure protection in SRA. We think that this clarification regarding fiscal responsibility would both encourage local governments to account for the firefighting-related costs of their land use decisions that impact SRA and to more realistically assess and budget for their own needs for emergency services. While we recommend clarifying that the state is not *fiscally* responsible for life and structure protection in SRA, we do not recommend limiting the department's authority to cooperate with local governments through mutual aid agreements, which dispatch the closest available resources to an incident. Our recommended clarification addresses the issue of fiscal responsibility, regardless of who actually provides the service in question.

***Reenacting a Fire Protection Fee in SRA.*** In 2003-04, the Legislature enacted legislation establishing a fire protection fee to be levied on private landowners in SRA. This fee was to be assessed on these landowners as a flat fee of \$35 per parcel. However, subsequent legislation the following year rescinded the fee, before any fee revenues were collected. Concerns were raised that a flat fee did not fairly reflect the benefits of fire protection enjoyed by property owners paying the fee. (For instance, owners of small parcels would pay the same fee as owners of large parcels, even though protecting large parcels may cost much more than protecting small parcels.) We think that these concerns can be addressed by restructuring the fee, as discussed later.

We believe that it is appropriate for the beneficiaries of state fire protection to contribute to the cost of such protection. Because the department's fire protection provides both public benefits (the protection of watersheds, for example) and private benefits (the protection of timber lands and houses in SRA) it is appropriate that private beneficiaries contribute to the state's cost of doing so. Therefore, we recommend the enactment of legislation to reinstate fire protection fees on private property owners in SRA, so that the private beneficiaries of the state's fire protection pay a portion of the state's costs. Specifically, we recommend that the fee be set so that the total cost of fire protection in SRA be split evenly between the state's General Fund and fee payers. For example, evenly splitting the cost of fire protection between user fees and the General Fund in the budget year would reduce the costs to the General Fund by \$426 million. (However, because it will likely take a year or more to adopt the necessary regulations and

collect these fee revenues, we do not recommend the Legislature budget for such revenues until 2008-09.)

There are several options for structuring fire protection fees—including per parcel fees, per acre fees, or fees based on risk. Also, fees could be assessed on selected parcels—such as parcels with housing units—either independently or in combination with fees on all parcels in SRA. In order to address the fairness concerns raised about the previously enacted fee, we recommend the Legislature adopt a per-acre fee, as the benefits of fire protection are generally proportionate to land area. Assessing a per-acre fee would be administratively simple, since county assessors have such information available and have processes in place for collecting such fees. In addition, we recommend that the legislation enacting the fee also provide for an assessment on parcels with structures and/or a development fee on new house construction in SRA. Enacting such an additional assessment/fee would capture some of the increased costs of fire protection associated with increasing development in SRA. It may also encourage more “fire smart” development decisions at the local level, given the clear fiscal consequences to future homeowners of development that creates a fire risk.

***Legislature Should Review the Standards for SRA Designation.***

The Board of Forestry has been delegated the authority, under the Public Resources Code, to designate the boundaries of SRA lands. Under statute, SRA includes (1) lands which are forested and are producing or capable of producing forest products; (2) watersheds that provide water for irrigation, domestic, or industrial use; and (3) lands that are principally used for grazing. One of the criteria used by the board to determine whether lands should remain in SRA or revert to local responsibility is the density of development. Generally, lands are reverted to local responsibility if housing density exceeds three buildings per acre. In many areas of the state, particularly the Sierra foothills and inland Southern California, development is occurring at much lower densities than three units per acre. While development of housing at densities lower than three units per acre may not look particularly urban, the presence of significant numbers of houses—even at relatively low densities—can significantly increase both the risk of wildland fires and their consequences.

While local agencies have the authority to make land use decisions, including the decision of whether to allow development in fire-prone areas, the state largely faces the consequences of such decisions—such as increased risk of wildfire and increased costs to fight wildfires in proximity to development. Changing the criteria for reverting SRA to local responsibility may reduce the number of structures in SRA and also encourage local planning agencies to give more consideration to the dangers of wildland fire when making decisions regarding new development.

There are a number of changes to the criteria for SRA designation that the Legislature could evaluate for potential adoption in a policy bill:

- ***Alter the Existing Density Criteria.*** As was mentioned above, there is significant development occurring in SRA, much of it at densities lower than three units per acre. Under current board policy, such development does not trigger a shift in fire protection responsibility for these areas to local governments. However, in many cases development at relatively low density is nevertheless changing the nature of SRA lands—from timber, rangeland, or watersheds lands—to more residential land uses. It may be appropriate to change the existing density criteria, such that new and existing development at lower densities in SRA will trigger a shift in fire protection responsibility for these lands from the state to local governments.
- ***Pay More Consideration to Actual and Potential Land Uses in Developing Areas.*** Under existing statute, SRA is defined as forest lands, lands that protect watersheds, and rangelands. While the board has tended to focus on the density of development as a primary criteria for shifting lands from SRA to local responsibility, the Legislature should consider requiring that more focus be put on whether the lands are being *actively* used for timber production or grazing, or if they still provide real watershed protection benefits. There may be areas of the state where changing rural economics, recent development, or likely future development has taken formerly productive timber and rangelands out of active production. (For instance, developers may purchase formerly active timber or rangelands for future development and take these lands out of production.) In these cases, it may be appropriate for local government to take responsibility for these areas as they are likely to be developed in the future.

### **Legislature Should Limit Expansion of Department's Capital Outlay Project Management**

*The department has not established a sufficient track record managing existing capital outlay projects and has not provided required information on its capital outlay project management process to the Legislature. Therefore, we recommend revision of the proposed budget language delegating project management authority to the department so that the Department of General Services would manage one of the five projects currently proposed for management by the department.*

***Department Facilities.*** As the state's wildland firefighting agency, the department is responsible for fire protection on more than 31 million acres

of predominantly privately owned lands. In order to provide fire protection over such a large area, the department operates an extensive system of fire stations (228), conservation camps (39), helitack and air attack bases (22), and other facilities. The bulk of the department's infrastructure was constructed in the 1940s, 1950s, and 1960s. The department estimates that 87 percent of its fire stations are more than 50 years old and 72 percent of its conservation camps are more than 40 years old. The age of so many of these existing facilities means that often they are outmoded for modern firefighting needs and subject to increasing maintenance costs. In the latest *California Five-Year Infrastructure Plan* (2006), the department identified a five-year capital need of \$1.4 billion, primarily to replace or relocate existing facilities. Because of budget constraints and delays in ongoing capital outlay projects, the department has identified a backlog of about 300 capital outlay projects.

***Department Management of Capital Outlay Projects.*** Under current law, capital outlay projects of most state departments are managed by the Department of General Services (DGS). Unifying project management within DGS allows for economies of scale by consolidating specialized services, such as architectural, engineering, and project management services in one department. Currently, DGS is managing 46 capital outlay projects for the department. However, in recent years, the Legislature has granted the department the authority to manage some of its own capital outlay projects. This authority was granted to the department because of concerns with the pace of DGS's project delivery and a large backlog of projects. From 2002-03 through 2005-06, the department was granted authority to manage six major capital outlay projects and eight minor capital outlay projects.

In the *2006-07 Budget Act*, the department was given authority to manage 11 fire station replacement projects, complete two ongoing fire station replacement projects, and manage a small portion of the department's fire academy renovation. The total capital outlay funding provided by the *2006-07 Budget Act* for management by the department is \$23.6 million. In order to increase the department's capacity to manage these new projects, the current-year budget also provided the department the authority to add 15 positions to its capital outlay staff over two years, doubling the size of the department's staff responsible for capital outlay projects.

***Capital Outlay Budget Proposal.*** The budget requests new appropriations for capital outlay projects of \$15 million in General Fund and \$147 million in lease-revenue bond funding. Of the ten new capital outlay projects proposed in the budget, the department proposes to manage five projects, including four fire station replacement projects and one unit headquarters replacement. (The department is not requesting additional positions to manage these new projects; they will be managed by existing

staff.) See Figure 6 for a list of new, major capital outlay projects proposed in the 2007-08 budget.

**Figure 6**

**California Department of Forestry and Fire Protection  
New Major Capital Outlay Projects<sup>a</sup>**

*2007-08  
(In Thousands)*

<b>Project</b>	<b>Phases<sup>b</sup></b>	<b>Fund Source</b>	<b>Budget-Year Cost</b>
<b>To Be Managed by California Department Of Forestry and Fire Protection</b>			
Red Bluff/Tehama Glenn Unit Headquarters Replacement	P,W,C	Lease-revenue bonds	\$23,577
Paso Robles Fire Station Replacement	P,W,C	Lease-revenue bonds	8,286
Fawn Lodge Fire Station Replacement	P,W,C	Lease-revenue bonds	6,664
Westwood Fire Station Replacement	P,W,C	Lease-revenue bonds	5,654
Las Posadas Fire Station Replacement	P,W,C	Lease-revenue bonds	4,784
<b>To Be Managed by Department of General Services</b>			
Growlersberg Conservation Camp Remodel	P,W,C	Lease-revenue bonds	\$47,565
Ishi Conservation Camp Replacement	P,W,C	Lease-revenue bonds	32,250
Bieber Fire Station/Helitack Base Relocation	A,P,W,C	Lease-revenue bonds	18,565
Pine Mountain Fire Station Relocation	A	General Fund	562
Bear Valley Fire Station/Helitack Base Water System Replacement	A	General Fund	533

<sup>a</sup> Excludes funding requests for ongoing projects and minor capital outlay projects.  
<sup>b</sup> A = Acquisition; P = Preliminary Plans; W = Working Drawings; C = Construction.

*The Legislature Does Not Have Enough Information to Evaluate Department's Project Management Ability.* The Legislature has granted the department the authority to manage some of its own capital outlay projects on a pilot basis, to evaluate whether the department can deliver capital outlay projects more quickly and within the approved budget than has been the case in recent years with DGS-managed projects. In order to evaluate whether the department has improved on the delivery of capital outlay projects, the department must have completed enough projects for a comparison to be made with DGS. Essentially, the Legislature must



have sufficient information about project outcomes for both DGS-managed and department-managed projects to make a comparison. To date, the department has only completed its management of one major capital outlay project (Lassen Lodge Fire Station relocation).

Unlike DGS and other state departments with project management authority, the department has not been filing quarterly capital outlay reports on its project management activity with the Department of Finance, as is required under state administrative procedure. Additionally, the *Supplemental Report of the 2006 Budget Act* requires the department to report to the Legislature by January 10, 2007, on actions that it and DGS are taking or will take to improve DGS's management of the department's projects. At the time this analysis was prepared, this report had not been submitted to the Legislature. All of this information will be necessary for the Legislature to determine whether the department should continue to manage its own capital outlay projects.

***Legislature Should Limit Department's New Capital Outlay Project Management to Fire Station Replacement Projects.*** Because the department does not yet have a track record of completing capital outlay projects and because important information about the capital outlay process and the department's ongoing projects have not yet been provided to the Legislature, it would be premature to expand the scope of the department's capital outlay project management at this time. In particular, since the department has not yet developed a track record of managing fire station replacements (fairly prototypical projects) it would be premature to expand the department's project management authority to larger, more complicated projects, such as the Red Bluff/Tehama Glenn Unit Headquarters replacement project. We therefore recommend revising the proposed budget language in order to exclude the Red Bluff/Tehama Glenn Unit Headquarters replacement project from the list of projects to be managed by the department. This particular project would instead be managed by DGS. Our revised budget bill language would retain the authority for the department to manage the four fire station replacement projects, as proposed by the budget.

## **Energy Commission Should Direct Public Funding Support for Energy Development Projects**

*The department, in cooperation with the California Tahoe Conservancy, proposes to spend \$5.1 million (mostly Proposition 84 funds) on activities to reduce the risk of wildfire in the Lake Tahoe Basin. Included in the proposal is \$4.1 million for grants to support the construction of new energy plants which would use trees, shrubs, and other forest waste for fuel. We recommend the Legislature delete this*

*portion of the budget proposal, as the California Energy Commission is better suited to evaluate and support such projects and has existing resources to do so. The proposal also includes \$296,000 for support of department personnel to oversee fuel reduction projects. We recommend the Legislature delete this portion of the request, as this is not an appropriate use of bond funds. (Reduce Item 3540-101-6051 by \$4.1 million and reduce Item 3540-001-6029 by \$296,000.)*

**Budget Proposal.** The budget proposes \$5.1 million in Proposition 40 and Proposition 84 funds to be spent by the department and the California Tahoe Conservancy for projects to reduce the hazards of large wildfires in the Lake Tahoe area. The department and the conservancy propose to use about \$1 million for support staff to implement fuels reduction (removal of dead and fallen trees and excessive undergrowth) and biomass use programs (burning these removed fuels to generate energy). The bulk of the request (\$4.1 million, Proposition 84 funds) is proposed for grants to local governments to support projects using biomass waste to generate heat and/or electricity. Specifically, the department proposes to grant (1) \$3.5 million to a local public agency for the development of a biomass facility in the Lake Tahoe basin that would use recovered biomass from forest thinning projects to generate electricity, (2) \$400,000 to support a cogeneration facility that would use recovered biomass to heat local school buildings, and (3) \$200,000 to support a Placer County program to subsidize the use of biomass for electricity generation.

**Energy Support Programs Should Be Implemented by the Energy Commission.** The department has provided forest resource management services for decades. It is appropriate that the department be directly involved in fuel reduction efforts in the Tahoe basin. However, the department does not have expertise with respect to the other aspect of the budget request—providing support for significant energy generation projects. Given the complexity of the design and development of any power plant, it takes significant expertise to evaluate proposals to receive public funding for such projects. On the other hand, the California Energy Resources Conservation and Development Commission (Energy Commission) has considerable expertise providing financial support to renewable energy projects and has several ongoing programs that do so. For example, the Public Interest Energy Research (PIER) Program provides state funds for research, development, and demonstration projects that provide environmental and economic benefits through increased energy efficiency, increased reliability, and reduced costs for energy in the state. (The proposed grant projects may be eligible for PIER funds as demonstration projects.) In the budget year, the Energy Commission proposes to spend \$70 million from the PIER fund on various new and ongoing projects. The

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Energy Commission also has programs that subsidize renewable energy generation projects by providing production incentive payments.

We believe that the Energy Commission should be the lead agency for supporting renewable energy projects, including biomass utilization projects, based on its longstanding technical expertise and established programs in this subject area. Therefore we recommend the Legislature delete the proposed funding of \$4.1 million from Proposition 84 for these biomass utilization projects. Given the significant, existing resources at the Energy Commission potentially available to support such projects, we believe the commission should evaluate whether the proposed projects should be supported from existing funds, in the context of other funding priorities.

***Bond Funds Not an Appropriate Fund Source for Regulatory Activities.*** The department proposes to use \$296,000 in Proposition 40 bond funds to support two limited-term foresters. These new positions would support the department's fuel reduction proposal by enforcing the Forest Practice Act (as it relates to fuel reduction activities) and implementing other forestry-related activities. We believe these activities are regulatory in nature and should be funded out of the department's base budget, rather than using bond funds. We therefore recommend denial of this component of the budget request.

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## STATE LANDS COMMISSION (3560)

The State Lands Commission is responsible for managing lands owned by the state, including lands that the state has received from the federal government. These lands total more than four million acres and include tide and submerged lands, swamp and overflow lands, the beds of navigable waterways, and state school lands.

For 2007-08, the budget proposes \$28.6 million for the support of the commission. This amount is financed from various funds, including the Oil Spill Prevention and Administration Fund (\$10.9 million), the General Fund (\$10.2 million), and other special funds and reimbursements. The proposed budget is \$282,000 less than estimated current-year expenditures. The budget includes \$1.2 million (General Fund) for the continuing remediation of a toxic, state-owned site in Contra Costa County.

### **Again No Progress in Commission's Management of School Land Bank Fund**

*The School Land Bank Fund is projected to have a fund balance of \$65 million by the close of the budget year. Because the State Lands Commission has been unable to reinvest monies in the fund over the past several years, we recommend the adoption of trailer bill language to transfer either all, or a portion of, the balance of the fund to the Teachers' Retirement Fund (TRF) and require that the proceeds of any future land sales be directly deposited in the TRF for management and investment by the California State Teachers' Retirement System (CalSTRS). Such actions are consistent with legislative intent that school lands be managed to benefit CalSTRS.*

*The School Land Bank Fund (SLBF).* The federal government has given the state significant amounts of land to be used to help support public education in the state. While these lands are referred to as "school lands," they generally have not been used for building new schools. (In fact, most of these lands are located in sparsely populated areas of the Southeastern

part of the state.) The commission is charged under state law with *managing* these lands in a way that benefits CalSTRS. To this end, the commission leases some of these lands for commercial purposes, and the revenues from these leases are deposited in TRF, which is managed by CalSTRS. In 2006, the commission managed approximately 470,000 acres where the state owns full title to the land and an additional 790,000 acres where the state owns the underground mineral rights, but another party owns the surface rights. In 2005-06, lease revenues to TRF were \$5.4 million.

Under the School Land Bank Act of 1984, the commission may also sell lands and use the proceeds to purchase other properties in order to consolidate the lands into contiguous holdings. The purpose of this law is to allow the commission to sell isolated or unproductive lands, and acquire lands that are more easily and profitably managed for the benefit of CalSTRS. Proceeds from land sales are deposited in SLBF and are to be used to purchase other revenue-generating lands.

***Commission Has Made No Progress in Managing and Reducing the SLBF Fund Balance.*** While the commission has sold school lands and deposited the proceeds in SLBF, over the past several years the commission has not invested these sales proceeds in new revenue-generating lands. Rather, the sales proceeds remain in SLBF, perpetually increasing the fund balance and depriving TRF of potential lease revenues. In 1996-97, the SLBF fund balance was less than \$20 million. By the end of the budget year, the fund balance is projected to be over \$65 million.

During hearings held on the 1996-97, 2001-02, and 2006-07 budgets, the Legislature examined the commission's management of SLBF and its inability to reinvest sales proceeds in new, revenue-generating lands. (Please see our *2006-07 Analysis of the Budget Bill*, page B-62, for additional discussion of this issue.) In the years since 2001-02, the commission has invested no funds from SLBF and the budget proposal includes no plans to do so in the budget year. Allowing the balance of SLBF to continue to grow, without any reinvestment of land sales proceeds, is contrary to the legislative intent expressed in the School Land Bank Fund Act that these lands be "managed and enhanced" as a revenue-generating resource for TRF. In fact, the only revenue that the proceeds from previous sales have generated—interest earned on the money in SLBF—is not transferred to TRF, but simply adds to the fund balance.

***Potential State Fiscal Liabilities From School Lands.*** The commission has indicated that there may be hazards on existing school lands, such as from previous mining operations or relating to prior military use of these lands for training, that may require remediation—potentially at state expense. To date, the commission has not developed a full inventory of all potential hazards or estimated the potential costs to remedy

such hazards. However, the commission has inventoried the abandoned mine remnants on school lands and was appropriated \$2 million in the current-year budget to remediate the most critical hazards on lands with these features. The commission has indicated that these funds should be sufficient to remediate the known mine-related hazards.

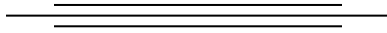
In addition to the known hazards relating to abandoned mines, the commission has indicated that a significant amount of school lands may have “unexploded ordinance” (explosive weapons such as bombs and artillery shells that did not explode when used during past military training and still pose a risk of detonation). While the extent of these hazards is not yet known, we note that the federal government is liable for the mitigation of such hazards and has an ongoing program to do so.

In the *Supplemental Report of the 2006 Budget Act*, the Legislature directed the commission to report to the Legislature with a plan for addressing hazards on school lands, by January 2008.

***Some Portion of the Fund Balance Should Be Transferred to TRF.*** Given that the commission continues to be unable to reinvest proceeds from land sales such that the SLBF balance continues to grow, we recommend that the Legislature take action to ensure that SLBF is managed to benefit the Legislature’s intended beneficiaries of the fund. While the commission has been unable to reinvest SLBF monies, we think that CalSTRS has significant investment expertise and could invest these monies in ways that will maximize the benefit to TRF. Because the Commission has indicated that there may be financial liabilities to the state from existing hazards on school lands, the Legislature may wish to retain some funds in SLBF for future remediation efforts. Therefore, we recommend the Legislature take one of the following actions:

- Adopt trailer bill language to transfer \$45 million from SLBF to TRF. This will leave a projected fund balance in SLBF of approximately \$20 million for future remediation efforts, should they become necessary.
- Alternatively, adopt trailer bill language to transfer the total balance of SLBF to TRF (approximately \$65 million). The trailer bill language should include the condition that if future state financial liabilities from school lands exceed the funding capacity of SLBF, funds can be transferred back from TRF to SLBF for remediation efforts. Such a future transfer—not to exceed the amount of the proposed transfer from SLBF to TRF—would occur only if there is a demonstrated need for these funds and documentation showing that all potential nonstate funding sources to pay for the remediation have been reasonably pursued.

We also recommend that any adopted trailer bill language require that the proceeds of future land sales be directly deposited in TRF for investment by CalSTRS. By adopting either of the above options, the Legislature can ensure that the ultimate beneficiary of school lands proceeds—CalSTRS—can invest those funds directly for the benefit of teachers.



## DEPARTMENT OF FISH AND GAME (3600)

The Department of Fish and Game is responsible for promoting and regulating hunting and fishing for game species, and for promoting resource protection for all California native plants, fish, and wildlife. The Fish and Game Commission sets policies to guide the department in its activities. The department currently manages about one million acres including ecological reserves, wildlife management areas, hatcheries, and public access throughout the state.

The budget proposes total expenditures of \$447 million from various sources, a decrease of about \$64 million below estimated current-year expenditures. Most of this decrease reflects a reduction in available Proposition 40 bond funds and the elimination of various one-time General Fund expenditures (totaling about \$70 million) that occurred in the current year. Of the total proposed expenditures, \$86 million comes from the Fish and Game Preservation Fund (FGPF) (19 percent), \$79 million from the General Fund (18 percent), \$69 million from federal funds (16 percent), \$67 million from Proposition 84 bond funds (15 percent), and the rest from reimbursements and other special and bond funds.

Several of the programmatic changes in the department's budget relate to expenditure of Proposition 84 funds, including for the CALFED Bay-Delta ecosystem restoration program (\$47 million) and anadromous fish management (\$11 million). Other changes include \$4.5 million for increased environmental review and \$2.9 million for management of department lands.

### **Department's Fiscal Management Improving; Budget Transparency Still Needs Work**

*The department has a history of fiscal management problems, particularly with respect to the Fish and Game Preservation Fund (FGPF). While the department has made progress in complying with legislative requirements for improved fiscal management and budget*



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*transparency, we have identified opportunities to further improve the clarity and the accuracy of FGPF fund condition statements. We also recommend a reduction in the expenditure authority of one FGPF account, to better align revenues and expenditures and create a prudent fund reserve. (Reduce Item 3600-001-0200 by \$528,000.)*

**History of Fiscal Problems Within FGPF.** The FGPF provides the largest source of ongoing support for the department's activities. The FGPF receives revenues from hunting and fishing licenses and taxes, commercial fishing permits and fees, and environmental review fees paid by project proponents. However, many of the fund's revenue sources show a long-term decline, largely due to declining participation in hunting and fishing activities in the state. In addition, over time the department's mandated activities have increased. In many cases, increased mandates either did not come with a new funding source or were not accompanied by increases in existing funding sources, such as license fees, to fund them. The FGPF is divided into a "nondedicated" account—for which revenues can be spent on a variety of department-funded activities—and 27 "dedicated accounts"—for which revenues can only be spent on specified activities.

For many years, the department has had problems with fiscal management, particularly with respect to the management of FGPF. (See our *Analysis of the 2006-07 Budget Bill* for a description of some of the department's past problems.) Over the years, the department has shifted funds from one account to another within FGPF, in order to address revenue shortfalls in certain accounts. This caused revenues dedicated by statute for specific uses to be used for other purposes. Also, these fund shifts created negative fund balances in several accounts within FGPF, even though the fund as a whole had a positive fund balance.

**Legislative Actions to Address Fiscal Problems.** In the *2006-07 Budget Act*, the Legislature provided \$19.9 million from the General Fund (one-time) to address past deficits within FGPF. The Legislature also provided an ongoing General Fund shift of \$5.9 million, so that certain activities previously funded from FGPF are now funded from the department's General Fund budget. Included in the \$5.9 million (ongoing) General Fund shift is \$1.2 million to offset lost revenue due to the federal closure of the commercial salmon fishing season. While the closure of commercial salmon fishing is not necessarily permanent, it is unknown if and when this commercial fishing will resume. The Legislature found that while fee revenues from salmon fishing were not likely to be collected in the foreseeable future, the management and restoration activities previously funded with license and other fee revenues should continue.

In addition to providing additional General Fund monies to address past and ongoing fiscal problems, the Legislature required, through trailer

bill language, that the department make certain improvements in its fiscal disclosures, to ensure that past fiscal mismanagement and opaque budgeting would not continue. Specifically, Chapter 77, Statutes of 2006 (AB 1803, Committee on Budget), requires that the department:

- Include in the budget proposal a fund condition statement for FGPF that includes information on revenues and expenditures for the fund, including both the nondedicated account and the dedicated accounts.
- Provide a fund condition statement similar to the fund condition statement included in the 2003-04 budget proposal.
- Post on its Web site, on or before January 10<sup>th</sup> of each year, fund condition statements for each subaccount within FGPF.

*Department's Actions to Follow Legislative Requirements.* We find the department has generally complied with the requirements of Chapter 77. The Governor's budget document includes fund condition statements for both the nondedicated and dedicated accounts of FGPF, reflecting the format of the 2003-04 budget proposal. (We note that the department has subsequently made corrections to the online version of the fund condition statements.) The department has posted on its Web site separate fund condition statements for each of the accounts within FGPF.

*Department Is in Compliance with Legislative Mandates, but Additional Steps Needed for Full Budget Transparency.* We find that the department has made a good-faith effort to comply with the requirements of Chapter 77 and to provide additional information to allow legislative oversight of its management of FGPF. However, based on our review, we find that there are ways that the FGPF fund condition statements could be presented more clearly. For example, in the current year, the Legislature provided a one-time General Fund transfer of \$19.9 million to pay off past deficits within the fund. In the fund condition statements, however, this transfer is not explicitly shown as a separate line-item transfer, but rather it is embedded within the revenue line for the various subaccounts, without any acknowledgement that there was a General Fund transfer. In other words, while the statements are factually correct, they do not clearly explain the Legislature's actions or their impact on FGPF's account balance. For instance, displaying the \$19.9 million transfer as part of the fund's revenues may give the false impression that revenues from fees have increased.

We recommend the department report at budget hearings on potential revisions to its fund condition statements that would more clearly and accurately reflect the condition of the fund. We will work with the department on potential ways to increase transparency.

***Legislature Should Consider Transferring Ongoing General Fund Replacement Support Directly Into FGPF.*** In the 2006-07 Budget Act, the Legislature provided \$5.9 million in ongoing General Fund support for program expenditures previously supported from FGPF. While these funds will be used to support program activities previously funded from FGPF, the actual expenditures will come from the department's General Fund budget item. In order to improve budget transparency, we recommend the adoption of budget bill language transferring General Fund monies to the various accounts within FGPF. This will allow interested parties to see where the Legislature has augmented FGPF revenues with General Fund. In addition, transferring these funds into the specific accounts within FGPF will ensure that the funds are spent on specific program activities as intended by the Legislature.

***Department Has Overestimated Certain Revenue Projections.*** Based on our review, we find that the department has failed to reduce projected fee revenues relating to salmon fishing in several FGPF subaccounts. As was mentioned above, the federal government has closed commercial salmon fishing indefinitely off the California coast. While the department was given an ongoing General Fund augmentation intended to offset lost revenues in the budget year, its revenue projections do not seem to take into account reduced salmon fishing and its impacts on department revenues. Specifically, we find that revenue projections for the following four accounts are too high: the Commercial Salmon Stamp Account, by \$62,000; the Commercial Augmented Salmon Stamp Account, by \$210,000; the Commercial Salmon Vessel Permit Account, by \$48,000; and the non-dedicated account, by about \$900,000. We recommend the department prepare updated fund condition statements for these four accounts that more accurately reflect projected revenues, taking into account the closure of the commercial salmon fishing season. We also recommend the department report at budget hearings on its long-term plans for managing these four accounts, since we project that the revenue adjustments will put the three dedicated accounts in deficit beginning in 2008-09, absent corrective action.

Finally, the department projects a zero fund balance in the Upland Game Bird Account at the end of the budget year, due to declining revenues. In fact, proposed expenditures exceed projected resources by \$436,000. The department plans to rely on unspecified program savings of \$436,000 to ensure that this subaccount does not go into deficit. Instead, we recommend reducing budget authority for this account by \$528,000, to reflect the declining revenue projections and to provide a prudent year-end projected reserve in the account of \$92,000 (5 percent of expenditures).

## **One-Time Funds for Marine Life Management Inadvertently Remain in Budget**

*The department's budget request inadvertently includes \$2 million in General Fund for Marine Life Management Act implementation, which was provided as one-time funding in the current year. We recommend the Legislature reduce the department's General Fund request by this amount. (Reduce Item 3600-001-0001 by \$2 million.)*

*Department's General Fund Budget Includes One-Time Funding From 2006-07 Budget Act.* In the 2006-07 Budget Act, the Legislature provided \$10 million in one-time General Fund monies for activities associated with the Marine Life Management Act and the Marine Life Protection Act. Of these funds, \$8 million went to the Coastal Conservancy and \$2 million went to the department. The department has indicated that this \$2 million augmentation was inadvertently included in the department's 2007-08 budget request.

*Reduce Department's General Fund Budget by \$2 million.* We recommend the Legislature reduce the department's General Fund budget appropriation by \$2 million to reflect the one-time nature of the appropriation provided in the 2006-07 Budget Act.

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## DEPARTMENT OF PARKS AND RECREATION (3790)

The Department of Parks and Recreation acquires, develops, and manages the natural, cultural, and recreational resources in the state park system and the off-highway vehicle trail system. In addition, the department administers state and federal grants to local entities that help provide parks and open-space areas throughout the state.

The state park system consists of 278 units, including 31 units administered by local and regional agencies. The system contains approximately 1.5 million acres, which includes 4,100 miles of trails, 300 miles of coastline, 970 miles of lake and river frontage, and about 14,800 campsites. The state park system includes parks and attractions that require entrance or use fees and other parks, beaches, and attractions that are free to enter. Almost 80 million visitors traveled to state parks in 2005, including more than 50 million visitors to free day-use sites.

The budget proposes \$494 million in total expenditures for the department in 2007-08. This is an overall decrease of about \$235 million below current-year estimates. This decrease reflects the elimination of a one-time expenditure of \$90 million for state parks deferred maintenance that occurred in the current year, reduced federal funding (a decrease of \$40 million), and a reduction of \$91 million in capital outlay expenditures funded from bond funds and special funds.

The budget proposes \$382 million in departmental support, \$44 million in local assistance, and \$67 million in capital outlay expenditures. Of total departmental spending, \$150 million comes from the General Fund, \$121 million comes from the State Parks and Recreation Fund (primarily fee revenues), \$69 million comes from bond funds, and \$60 million comes from the Off-Highway Vehicle Trust Fund. Major budget proposals include the reversion of \$160 million to the General Fund (the unspent balance of a \$250 million appropriation for state parks deferred maintenance in 2006-07), \$5.2 million in bond funds for state park system planning and administration, \$5 million (General Fund) in local assistance for the Simon

Wiesenthal Center, and \$4.1 million (General Fund) for hazardous material remediation at Empire Mine State Historic Park.

## **BUDGET FAILS TO ADDRESS STATE PARKS DEFERRED MAINTENANCE BACKLOG**

*Despite a growing backlog of deferred maintenance projects in state parks—totaling over \$900 million—the budget proposes essentially no funding for this purpose in the budget year. In fact, the budget proposes to revert \$160 million of funding appropriated in the current year for deferred maintenance back to the General Fund. To address this issue, we recommend that the Legislature (1) appropriate \$160 million from Proposition 84 bond funds, and adopt related budget bill language, to backfill the General Fund reversion; (2) withhold approval of request for staffing to administer existing appropriation for deferred maintenance; (3) adopt supplemental report language requiring the department to develop a strategy to use outside funding sources to help fund deferred maintenance projects; and (4) augment the department’s support budget by \$15 million and adopt budget bill language directing the department to raise fees by a similar amount, in order to fund ongoing maintenance in the state park system. (Increase Item 3790-001-6051 by \$160 million and increase Item 3790-001-0392 by \$15 million.)*

### **Growing Deferred Maintenance Problem**

The state park system includes 278 units, of which almost 250 are directly managed by the department. These park facilities vary from state beaches to historic parks to off-highway vehicle recreation areas. The department estimates that almost 80 million people visited the system in 2005. The size and breadth of the state park system, heavy usage by the public, and the fact that so much of the system’s infrastructure is exposed to the elements means that the department has a significant obligation to perform maintenance activities.

Based on its internal facility management program, the department estimates that the cost to maintain the system at its current capacity is approximately \$117 million per year. However, the department’s maintenance budget (funded primarily by the General Fund and park fee revenues) is approximately \$67 million per year—yielding a maintenance shortfall of \$50 million per year. Over many years, the difference between ongoing maintenance needs and available funds has created a backlog of deferred maintenance projects. Typically, these projects encompass the replacement or rehabilitation of an existing asset that has not been adequately

maintained. The department currently estimates that the deferred maintenance backlog is over \$900 million. Given the current shortfall between the department's maintenance budget and its estimated maintenance requirements, this backlog will likely continue to grow over time unless corrective action is taken.

### **Past Funding for Deferred Maintenance Projects**

While the backlog of deferred maintenance projects has grown substantially in past years, the department has never had a dedicated source of funding for these projects. (In past years, the Legislature has periodically appropriated one-time General Fund money or bond funds for deferred maintenance.) While a small amount of general obligation (GO) bond funds has been used for deferred maintenance, generally bond funds allocated to the state park system have been used for acquisition, expansion, and development of the system, rather than repairs. Of the resources-related GO bonds passed by the voters prior to 2006, almost all of the funding for state parks has been exhausted. In the *2006-07 Budget Act*, the Legislature appropriated \$250 million from the General Fund for deferred maintenance projects in the state park system. Funds from this appropriation are available to be spent through 2011-12.

### **Budget Proposal**

The budget proposes to revert \$160 million of the prior \$250 million General Fund appropriation for deferred maintenance—the amount projected to remain unspent at the end of the current year. While the *Governor's Budget Summary* indicates that there are available bond funds as a replacement funding source for deferred maintenance projects, the budget includes no bond funding for deferred maintenance.

The budget proposal also includes a request for 41 new positions and 16 redirected positions to manage projects funded from the General Fund appropriation for deferred maintenance in the current year. As these positions were not provided in the 2006-07 budget, the department created them administratively during the current year, and is now seeking to make these positions permanent. While the budget shows that the bulk of the appropriation (the portion not proposed for reversion) will be spent in the current year, most of these projects will take several years to complete, and hence the department is requesting permanent positions, funded out of the 2006-07 General Fund appropriation, to manage these projects to completion.

## **Proposition 84 as a Potential Funding Source**

In November 2006, the voters approved Proposition 84, which provides \$5.4 billion for various resources-related projects, including \$400 million for the state park system. (See the “Resources Bonds” write-up in the “Crosscutting Issues” section of this chapter for more discussion of resources bonds.) Proposition 84 provides this funding for “development, acquisition, interpretation, restoration and rehabilitation of the state park system and its natural, historical, and visitor serving resources.” Based on discussions with Legislative Counsel, it appears that many deferred maintenance projects are an eligible use of these bond funds as they fit within “restoration and rehabilitation”—provided that the requirements of the state’s GO bond law are met. The governing bond law, Government Code Section 16727, states that GO bond funds may only be used for the construction or acquisition of “capital assets” which are defined as “tangible physical property with a useful life of 15 years or more” and include “major maintenance, reconstruction, demolition for the purposes of reconstruction of facilities, and retrofitting work that is ordinarily done no more often than once every 5 to 15 years or expenditures that continue or enhance the useful life of the capital asset.”

The department has indicated that it does not intend to make future requests for Proposition 84 funds for deferred maintenance projects, as it considers maintenance projects generally ineligible for bond funding. While we differ on this point, we note that restoration and rehabilitation are only two of several allowable uses of Proposition 84 state park funds. It is a policy choice for the Legislature under its appropriation authority to allocate the \$400 million among the eligible uses. We also note that even if the Legislature appropriated all the available Proposition 84 state parks bond funds to deferred maintenance projects, these funds would not even pay for one-half of the estimated backlog.

## **Recommendations for Addressing Deferred and Ongoing Maintenance**

Given the magnitude of the deferred maintenance backlog and the legislative intent to significantly reduce this backlog as reflected in the current-year budget, we believe that it is important for the state to address both the existing deferred maintenance backlog and the underlying availability of funds for ongoing maintenance. To this end, we recommend the Legislature take the following steps:

***Appropriate \$160 Million in Proposition 84 Funds for Deferred Maintenance.*** Since there will be many competing uses for these funds—such as the acquisition of new parks and upgrading and expanding visitor attractions—it would not be appropriate to use all the available funds



allocated to state parks for deferred maintenance. However, we believe that maintaining the existing system in good condition by working down the deferred maintenance backlog should be a priority when appropriating bond funds. We believe that the Legislature can fulfill its previously stated intent to reduce the deferred maintenance backlog by appropriating \$160 million in Proposition 84 funds to offset the proposed General Fund reversion of the same amount. Consistent with previous legislative intent, we recommend the adoption of budget bill language authorizing the expenditure of these funds through 2012-13.

***Adopt Budget Bill Language Specifying That Bond Funds Be Used According to GO Bond Law.*** Based on the requirements of Proposition 84 and GO bond law, we believe that these bond funds can be appropriately used for deferred maintenance projects that generally have a useful life of more than 15 years. Pursuant to information provided by the department, we believe that there are many such projects included in the deferred maintenance backlog for which bond funds are an appropriate fund source. To ensure that bond funds are used for appropriate projects, we recommend the adoption of the following budget bill language under Item 3790-001-6051:

Of the funds appropriated in this item, \$160 million shall be available for expenditure for deferred maintenance projects that comply with the requirements of Government Code Section 16727 and shall be available for encumbrance until June 30, 2013.

***Withhold Approval of Requested Positions Pending Additional Information.*** The department has requested a significant number of *permanent* positions (41 new positions and 16 redirected positions) to be funded from the existing General Fund appropriation for deferred maintenance made in the current year. These positions would provide staff support for projects funded from the \$90 million of the existing appropriation that the administration has not proposed for reversion. As projects are completed over the next few years, the department indicates that the number of filled positions will be reduced through attrition. The information provided by the department did not provide sufficiently detailed information to fully evaluate the need for the proposed positions. Therefore, we recommend the department report at budget hearings on the workload requirements associated with the projects to be funded from the existing appropriation. Additionally, the department should address whether there are potential efficiencies from using outside services—for example the Department of General Services—to provide specialized expertise, such as architectural services, rather than adding permanent staff in the department.

We do not believe it is necessary to add permanent positions in order to spend funds with a limited duration. Therefore, if the Legislature decides to approve the department's staffing request, we would recommend that

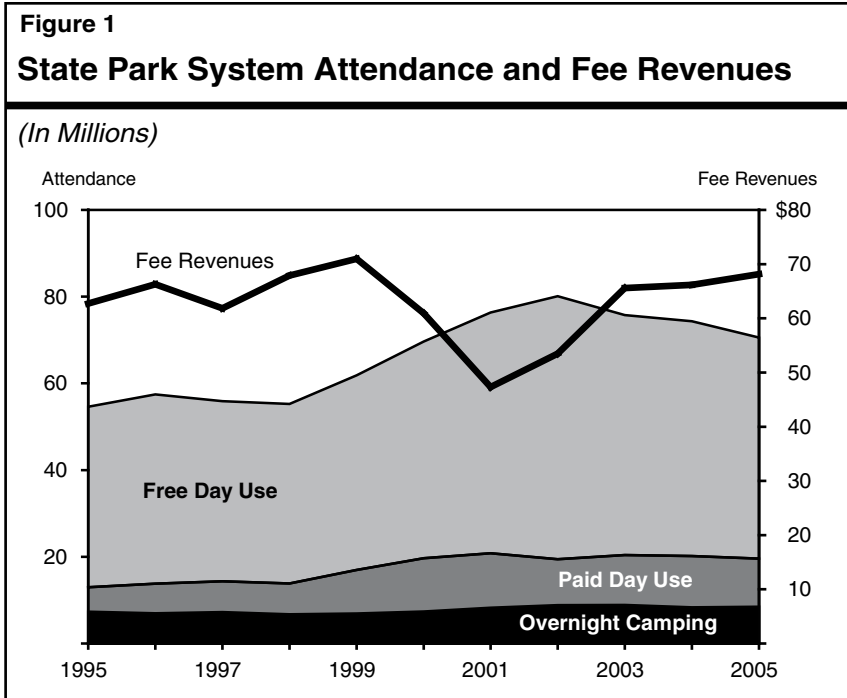
any positions granted be 3-year limited-term positions, as the department indicates that it will take three years to fully expend the existing appropriation. While we do not recommend adding new positions in connection with the \$160 million in bond funds we recommend for appropriation in the budget year, the department can address any related staffing requirements at budget hearings.

***Require the Department to Report on Other Options to Fund Deferred Maintenance.*** The department has had success working with outside groups to provide private funding for projects in state parks. However, we are not aware of a department-wide strategy to use private funding to support deferred maintenance projects. We recommend that the Legislature adopt the following supplemental report language requiring the department to devise a plan to maximize private donations and other new funding mechanisms to support deferred maintenance projects:

On or before January 10, 2008, the department shall provide a report to the Legislature which presents the department's plan to supplement state funds for deferred maintenance projects with private funds and other nonstate sources of revenue.

***Direct an Increase in Park Fees to Fund Ongoing Maintenance.*** While the department faces a growing deferred maintenance problem—in part because its annual maintenance budget does not meet its estimated maintenance requirements—fee revenues collected by the department have remained relatively flat in recent years. In the late 1990s, the state dramatically reduced park fees. Beginning around 2002, fees were subsequently increased, but not to the previous level. Therefore, while paid attendance at state parks has consistently increased over time, fee revenues collected by the department are less now than they were in the late 1990s, as shown in Figure 1. From 1995 to 2005 (the last full year for which data are available), paid attendance in the state park system increased by 7.5 million visits. Over this period, however, total fee revenues collected increased by only \$5.4 million. Total fee revenues actually declined by \$0.75 per paid visit over this period (in nominal dollars). If one adjusts for inflation, fee revenues were almost \$2 less per paid visit in 2005 than in 1995.

In the budget year, the department projects park fee revenues of approximately \$75 million. Some of these funds are used for ongoing maintenance, but none are used for deferred maintenance. In order to slow the growth in the deferred maintenance backlog, we recommend that the Legislature take action to provide increased funding for the department's *ongoing* maintenance requirements. Specifically, we recommend that the Legislature increase the department's expenditure authority from the State Parks and Recreation Fund by \$15 million and adopt budget bill language directing the department to raise its fees by a similar amount, to be used solely for ongoing maintenance activities. While this increase will not cover



the entire ongoing maintenance shortfall (\$50 million per year), it does represent a 20 percent increase in currently projected fee revenues.

In the past, concerns have been raised about the effects of proposed fee increases on attendance at the state park system. We find that while park system attendance varies over time, paid attendance to the system does not seem to be very sensitive to changes in park fees, as shown in Figure 1. We also note that park fees represent only a portion of the total potential cost of attending a state park—including the costs for gasoline, lodging, food, and recreational equipment. Based on these factors, and the historically low park fees currently being charged, we believe that the department can raise fees without significantly reducing attendance. As it has done in the past, the department should target fee increases to park units that have very high demand and can sustain increased fees without significantly reducing visitation. We believe that if the department is given flexibility to implement this proposed fee increase, it should be able to target increases to avoid or at least minimize reductions in attendance—particularly with respect to low income visitors. (We also note that the department’s Golden Bear Pass provides discounted fees for certain low-income park visitors.) Based on the above, we recommend the adoption of the following budget bill language under Item 3790-001-0392:

This item includes a \$15 million augmentation to be used solely for ongoing maintenance activities in the state park system, to be generated by an increase in state park fee revenues of an equal amount. The department shall endeavor to target fee increases in a manner that minimizes the impact on state parks attendance.

## **ADMINISTRATION OF BOND FUNDS FOR LOCAL PARKS SHOULD BE CONSOLIDATED**

*The administration proposes to appropriate Proposition 84 local park funds to the Department of Parks and Recreation (DPR), while appropriating Proposition 1C local park funds to the Department of Housing and Community Development. We recommend the enactment of legislation to consolidate the administration of all local park bond funds in DPR. We also recommend the enactment of legislation specifying what portion of the \$850 million of Proposition 1C funds, set aside for infill housing development, should be allocated to local parks. Finally, we recommend the department report at budget hearings on its plan to spend Proposition 84 local park funds. (Reduce Item 2240-101-6071 by \$30 million; reduce Item 2240-001-6071 by \$685,000; reduce reimbursements in Item 3790 by \$350,000; increase Item 3790-101-6071 by \$30 million.)*

**Past Spending on Local and Regional Parks.** The department has a great deal of experience administering grant programs that allocate funds to local and regional parks. Over the last decade, the department has administered approximately \$1.7 billion in bond-funded grants for local and regional parks. Essentially all of the funds for local and regional parks allocated in resources bonds approved prior to 2006 have been spent.

**New Bond Funds for Local and Regional Parks.** In November 2006, the voters approved a series of GO bonds to provide funding to support and expand the state's infrastructure. Of these bonds, Proposition 84 provides \$400 million for local and regional parks, to be administered by the department. In addition, Proposition 1C (the housing bond) provides \$200 million for housing-related local and regional park grants and *up to* \$200 million for park grants to encourage infill housing development. (Proposition 1C authorizes a total of \$850 million for infill housing grants that can be allocated for a number of purposes, including park creation, water, sewer, and other infrastructure development, without allocating a specific amount of funding to each of the various eligible uses.) While Proposition 1C does not identify an implementing department for these funds, the administration is proposing that the Department of Housing and Community Development (HCD) administer the park-related grant programs.

**Budget Proposal for Local Parks Funds.** For the department, the budget proposes \$1.4 million in Proposition 84 funds (and ten positions) for planning, developing grant guidelines, and other administrative functions. The budget proposal does not include any grant funds for local parks in 2007-08, and in fact, the administration indicates that the department will not make any Proposition 84-funded local park grants until 2009-10. In HCD, the budget proposes to spend \$30.7 million (\$30 million in local assistance and \$685,000 in state administrative costs) for housing-related local and regional parks. Also, the budget proposes to spend \$101.3 million (\$100 million in local assistance and \$1.3 million in state administrative costs) for regional planning, housing, and infill incentives, of which local parks are an allowed use. The budget proposal is not specific as to what portion of the \$100 million would be allocated for local parks. In addition to adding staff within HCD, the budget proposes to add reimbursement-funded staff at the department to assist HCD in program development and administration.

**Recommend Legislature Appropriate All Parks-Related Bond Funding to Department.** We think that the Legislature should consolidate parks-related bond programs in Propositions 1C and 84 within the department, and we therefore recommend the enactment of legislation designating the department as the implementing agency for the Proposition 1C park-related funds. We make this recommendation because the department has a history of administering these kinds of grant programs and it has staff expertise and existing guidelines and procedures for selecting projects and administering grants. Consolidating these programs in a single department would avoid duplicating administrative costs, allow for more consistent project evaluation and selection, and minimize the time and effort spent on grant applications by local agencies. Accordingly, we recommend reducing HCD's local assistance appropriation from Proposition 1C by \$30 million and increasing the department's local assistance appropriation by a similar amount. We further recommend reducing HCD's state operations appropriation from Proposition 1C by \$685,000 and reducing the department's state operations appropriation from reimbursements by \$350,000. (Please see the "General Government" chapter of the *Analysis* for our recommendation regarding HCD.) Because the department has an existing local assistance program and proposes to add staff to spend Proposition 84 local park funds, we consider the department's additional staffing requirements to implement Proposition 1C park funds to be minimal.

**Recommend Legislature Specify Allocation of Proposition 1C Park Funds.** While Proposition 1C provides up to \$200 million for parks amongst other infill-related uses (totaling \$850 million), the measure is not specific about the precise amount that should be spent on parks. We recommend the enactment of legislation specifying what portion of the \$850 million

allocation is to be spent on parks, and would therefore be available for appropriation to the department. Annual funding would then be appropriated through the budget.

***Recommend Department Report at Budget Hearings on Ways to Speed Up Grant Delivery.*** Finally, as previously mentioned, the administration indicates that the department will not begin making grants from Proposition 84 local park funds until 2009-10. With the depletion of pre-2006 bond funds for local parks, there is virtually no funding for local parks from resources bonds proposed in 2007-08. It is important that bond funds for local assistance projects be granted according to well-designed guidelines and procedures, in order to ensure that the bond funds are spent wisely. However, given the department's history of implementing local park grants and the existence of procedural guidelines for doing so, we are concerned about the projected pace of Proposition 84 grant delivery. We recommend the department report at budget hearings on any reasons why a grant solicitation could not be made in the budget year to start the flow of funds earlier, and any planned revisions to their long-term expenditure plan for Proposition 84 local parks funds.

## **STATE PARKS AND RECREATION FUND RESERVE DEPLETED**

***The budget proposes an expenditure level from the State Parks and Recreation Fund which would leave virtually no reserve at the close of the budget year. We recommend the department report at budget hearings on its plans to secure a prudent year-end reserve.***

***Fund Supported by User Fees.*** The State Parks and Recreation Fund (SPRF) is the department's primary special fund supporting state park operations. In the budget year, it is second only to the General Fund in providing support for department operations. The two primary revenue sources for this fund are fee revenues—including park admission fees, camping fees, and other fees charged to state park visitors—and an annual transfer from the Motor Vehicle Account. The budget projects total revenues of \$118 million (including \$75 million in fee revenues) and expenditures of \$121 million. After taking into account prior-year balances carried into the budget year, the department's projections indicate that the fund will have virtually no reserve at the end of the budget year—only \$56,000 (less than one-tenth of one percent of expenditures).

***Parks and Recreation Fund Reserve Depleted.*** Leaving virtually no year-end reserve in SPRF, as projected in the budget proposal, is problematic. Without a reserve, the department lacks a cushion against revenue fluctuations and a source of funding should unforeseen expenses arise during the budget year. (As a general rule of thumb, we have recom-

mended that fee-funded special funds should ideally have a reserve of at least 3 percent to 5 percent of expenditures.) We note that fee revenues generated by the state park system have varied in past years and can be difficult to predict accurately. Because the state park system relies on tourism revenues—primarily outdoor-oriented tourism—attendance can vary based on unpredictable factors such as weather. In 2004-05, actual fee revenues were 96 percent of estimates, while in 2005-06 actual fee revenues were 91 percent of estimates. If fee revenues were to decline or unforeseen expenditures were to arise in the budget year, the department would be forced to reduce programs and/or increase fees to address these unanticipated events.

***Recommend Department Report at Budget Hearings on Its Plan to Provide a Sufficient Reserve.*** Given the problems that we have identified with the lack of a budgeted fund reserve, we recommend the department report at budget hearings on its plan to achieve a prudent reserve in SPRF. In considering the amount of the reserve, the department should take into account its experience with revenue fluctuations and unanticipated expenses over the past several years. Given the preceding discussion of the department's ongoing maintenance shortfall, the department should consider opportunities to *both* reduce expenditures *and* increase fee revenues.

## CONCESSION AND OPERATING AGREEMENT PROPOSALS

*The budget includes proposals for three concession agreements and two operating agreements requiring legislative approval. While we find three of the five proposals warranted, we recommend the Legislature withhold approval for two of the proposals, pending delivery of a final economic feasibility for one and the determination of all the agreement terms for the other.*

Under current law, the Legislature is required to review and approve any proposed or amended concession contract that involves a total investment or annual gross sales over \$500,000. Concessions are private businesses operating under contract in state parks to provide services such as food that are not normally provided by the state. The Legislature is also required to approve most types of operating agreements, in which one governmental entity operates and maintains another entity's facility. In some cases the department contracts with local government agencies to operate state park facilities while in other cases the department agrees to operate federal or local facilities. In past years, the Legislature has provided the required approvals in the supplemental report of the budget act.

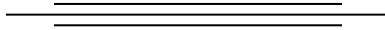
As shown in Figure 2, the department has included three concession proposals and two operating agreement proposals in the budget that require legislative approval. While we find three of the proposals warranted, we recommend that the Legislature withhold its approval on two of the proposals that lack sufficient detail, as discussed below.

<b>Figure 2</b>			
<b>Department of Parks and Recreation</b>			
<b>Concession and Operating Agreement Proposals</b>			
	<b>Term (In Years)</b>	<b>Minimum Rent To State</b>	<b>Minimum Capital Investment</b>
<b>State Park Concession Proposals</b>			
<b>Old Town San Diego State Historic Park</b>			
• Interpretive retail concession	Up to 10	\$30,000 or 10% of sales <sup>a</sup>	\$175,000
<b>Lake Valley State Recreation Area</b>			
• Golf course, restaurant, and winter recreation	10 to 20	\$108,000 or 10% of most sales, plus 29% of certain other sales <sup>a</sup>	\$1.6 million, plus 5% of sales per year
<b>California Citrus State Historic Park</b>			
• Wealthy growers mansion concession	20	2% to 5% of sales	Unknown
<b>Operating Agreements</b>			
Folsom Lake, Millerton Lake, San Luis Reservoir, and Salton Sea State Recreation Areas	Up to 50		
Kings Beach State Recreation Area	Unknown		
<sup>a</sup> Whichever is higher.			

*Two of Five Proposals Lack Sufficient Detail.* The department has not yet completed the final economic feasibility study for the California Citrus State Historic Park concession proposal. Without this information, the Legislature is not able to determine whether this proposal is in the



state's interest. In addition, while the department proposes to extend the existing operating agreement for Kings Beach State Recreation Area, the terms of the agreement—in particular the length of the agreement—have not been finalized. It would be premature for the Legislature to approve these two proposals before all the pertinent information is available for consideration. Therefore, we recommend the Legislature withhold approval of (1) the California Citrus State Historic Park concession proposal, until the department has provided a final economic feasibility study and (2) the Kings Beach operating agreement proposal, until the terms of the agreement have been finalized and the Legislature has been notified of them.



## SIERRA NEVADA CONSERVANCY (3855)

The Sierra Nevada Conservancy was established by statute in 2004. The purpose of the conservancy is to undertake projects and make grants and loans for various public purposes in the Sierra Nevada Mountains, including increasing tourism and recreation; protecting cultural, archaeological, and historical resources; reducing the risk of natural disasters; and protecting and improving water and air quality.

The budget proposes for 2007-08 total expenditures for the conservancy of \$21.6 million from three sources—Proposition 84 bond funds (\$17.5 million), the Environmental License Plate Fund (\$3.9 million), and reimbursements (\$200,000). This is an increase of \$17.6 million, or 440 percent, above estimated expenditures in the current year. This increase reflects the infusion of bond funds allocated to the conservancy in a recently passed bond measure (Proposition 84). Staffing for the conservancy is proposed at 25.5 positions for 2007-08.

### **Conservancy Has Yet to Develop Guidelines for New Grant Program**

*The budget proposes \$17.5 million from Proposition 84 bond funds for a new grant program—\$17 million for local assistance grants and \$500,000 for five support staff to administer the grants. We recommend the Legislature withhold action on the budget request, pending submittal by the conservancy at budget hearings of details on the guidelines and criteria by which the conservancy will award the grants.*

**Background.** Chapter 726, Statutes of 2004 (AB 2600, Leslie), established the Sierra Nevada Conservancy. The mission of the conservancy is to preserve and restore significant natural, cultural, archaeological, recreational, and working landscape resources (farms, ranches, and forests) in the Sierra Nevada Mountains. The conservancy's jurisdiction covers 25 million acres and is divided into six subregions. In 2005, the conservancy began its start-up activities which, in 2006, resulted in it selecting an executive director, moving into its headquarters, and hiring staff.

The conservancy's initial focus in its first two years was undertaking and facilitating a strategic program planning process involving meetings and workshops within each of the subregions, with the purpose of formulating strategic program objectives and priorities within that subregion. Chapter 726 requires these activities in order to encourage local involvement and participation in the conservancy's activities.

***Budget Proposes Proposition 84 Bond Funds for Local Assistance Grants.*** Proposition 84 provides \$54 million to the conservancy, broadly for the protection and restoration of rivers, lakes, and streams, their watersheds, and associated land, water, and other natural resources within the geographic jurisdiction of the conservancy. The budget for 2007-08 proposes \$17 million in Proposition 84 bond monies to fund local assistance grants, as well as \$500,000 to fund staff to support the grant program. The conservancy anticipates awarding the grants over a three-year period that will begin in 2007-08. Administration of the grant program, including oversight of grant recipient projects, will continue through 2014-15.

***Conservancy Has Yet to Adopt Specific Criteria by Which to Award Local Assistance Grants.*** At the time this analysis was prepared, the conservancy had not yet adopted guidelines that set program objectives and priorities and criteria for awarding grants under the new grant program. According to conservancy staff, such guidelines are in draft form and will be considered by the conservancy's board at its upcoming meeting in February.

***Recommend Legislature Withhold Action on Budget Request.*** Absent the guidelines for the new grant program, the Legislature is unable to assess the extent to which the conservancy's local assistance program is in keeping with statutory objectives for the conservancy and consistent with legislative priorities for resource activities in the Sierra-Nevada region. For this reason, we recommend that the Legislature withhold action on this budget item pending submittal by the conservancy at budget hearings of details on the guidelines, as adopted by the board, that set program priorities and criteria for awarding grants under the new grant program. This will provide the Legislature with information that it needs to evaluate this budget request.

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## DEPARTMENT OF WATER RESOURCES (3860)

The Department of Water Resources (DWR) protects and manages California's water resources. In this capacity, the department maintains the State Water Project (SWP), which is the nation's largest state-built water conveyance system, providing water to 23 million Californians and 755,000 acres of agriculture. The department also maintains public safety and prevents damage through flood control operations, supervision of dams, and water projects. The department is also a major implementing agency for the CALFED Bay-Delta Program (CALFED), which is charged with putting in place a long-term solution to water supply reliability, water quality, flood control, and fish and wildlife problems in the San Francisco Bay/Sacramento-San Joaquin Delta Estuary (the "Delta").

Additionally, the department's California Energy Resources Scheduling (CERS) division manages billions of dollars of long-term electricity contracts. The CERS division was created in 2001 during the state's energy crisis to procure electricity on behalf of the state's three largest investor owned utilities (IOUs). The CERS division continues to be financially responsible for the long-term contracts entered into by the department. (Funding for the contracts comes from ratepayer-supported bonds.) However, IOUs manage the receipt and delivery of the energy procured by the contracts.

**Proposed Funding.** The budget proposes total expenditures of about \$8 billion in 2007-08 (including capital outlay), an increase of \$104 million, or 1.3 percent above estimated expenditures in the current year. Although this is a net increase, the proposed DWR budget reflects both major spending increases and decreases. The department's General Fund expenditures (\$5 million) are much lower in the budget year, reflecting the elimination of one-time expenditures for flood control that occurred in the current year. On the other hand, much higher spending from bond funds (\$990 million) is proposed in the budget year, largely reflecting the availability of Propositions 1E and 84 bond funds for flood control and other water management projects. In addition, because of price increases

in natural gas, the CERS budget proposes increases of \$760 million in the current year and \$546 million in the budget year to accommodate bond operating reserve requirements.

Major budget proposals include increases of \$8.4 million (mostly General Fund) and 35 personnel-years for state operations of flood management and local assistance, as part of a three-year program initiated in the 2005-06 budget; \$82 million (\$47.3 million General Fund and \$34.7 million bond funds) for the lining of the All-American and Coachella Canals and related projects; \$597.8 million (Propositions 1E and 84 bond funds) for flood control investments including capital outlay; and \$364.6 million from various bond funds for integrated regional water management, mostly local assistance.

The budget total includes \$331.8 million for capital outlay projects, of which \$122.3 million is for SWP (the costs of which are reimbursed from SWP contractors), \$31.4 million (Proposition 13 and Proposition 50 bond funds) for CALFED water conveyance projects, and \$178.2 million for flood control (\$135.2 million Proposition 1E, \$30 million General Fund, and \$12.9 million reimbursements). The budget also proposes to use \$200 million of Proposition 1E bond funds to reimburse the General Fund for flood control expenditures made from an emergency appropriation (Chapter 34, Statutes of 2006 [AB 142, Nuñez]) prior to bond passage.

In the following pages, we review the department's efforts and the budget's proposals to address the state's flood management problems, present an opportunity to create General Fund savings, make recommendations on reforming the department's capital outlay process, and discuss bringing SWP on budget to enhance legislative oversight.

## FLOOD MANAGEMENT ISSUES

### **New Bonds Provide Influx of Funding to Department**

*Propositions 1E and 84—approved by voters in November 2006—together allocate up to \$6.4 billion of bond funds to the department, of which \$4.9 billion is for flood control.*

Two major bonds related to water passed in November 2006. Proposition 1E, the Disaster Preparedness and Flood Prevention Bond Act of 2006, authorizes the state to sell a total of \$4.1 billion in general obligation bonds for various flood management programs. Proposition 84, the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006, authorizes the state to sell \$5.4 billion for safe drinking water, water quality, and water supply; flood control; natural resource protection; and park improvements. Figure 1 (see next page) shows

that under the terms of the measures the department is allocated all of the Proposition 1E funds (\$4.1 billion) and up to \$2.3 billion of Proposition 84 funds, of which \$800 million is specifically allocated for flood control.

**Figure 1**

### **Department of Water Resources Propositions 1E and 84 Bond Funding Eligibility**

*(In Millions)*

#### **Bond Program**

<b>Proposition 1E</b>	<b>\$4,090</b>
<ul style="list-style-type: none"> <li>• State Central Valley flood control system repairs and improvements; Delta levee repairs and maintenance. (3,000)</li> <li>• Flood control subventions (local projects outside the Central Valley). (500)</li> <li>• Stormwater flood management (grants for projects outside the Central Valley). (300)</li> <li>• Flood protection corridors and bypasses; floodplain mapping. (290)</li> </ul>	
<b>Proposition 84</b>	<b>\$2,280</b>
<b>Water Quality</b>	
<ul style="list-style-type: none"> <li>• Integrated regional water management. (1,000)</li> <li>• Delta and agriculture water quality.<sup>a</sup> (145)</li> </ul>	
<b>Protection of Rivers, Lakes, and Streams</b>	
<ul style="list-style-type: none"> <li>• Restoration projects related to the Colorado River.<sup>b</sup> (90)</li> </ul>	
<b>Flood Control</b>	
<ul style="list-style-type: none"> <li>• State flood control projects—evaluation, system improvements, flood corridor program. (315)</li> <li>• Flood control projects in the Delta. (275)</li> <li>• Local flood control subventions (outside the Central Valley flood control system). (180)</li> <li>• Floodplain mapping and assistance for local land use planning. (30)</li> </ul>	
<b>Sustainable Communities and Climate Change Reduction</b>	
<ul style="list-style-type: none"> <li>• Urban water and energy conservation projects.<sup>b</sup> (90)</li> <li>• Incentives for conservation in local planning.<sup>b</sup> (90)</li> </ul>	
<b>Statewide Water Planning</b>	
<ul style="list-style-type: none"> <li>• Planning for future water needs, water conveyance systems, and flood control projects. (65)</li> </ul>	

<sup>a</sup> Joint eligibility with State Water Resources Control Board.

<sup>b</sup> Joint eligibility with various other state agencies.

## Funding History and Budget Proposal

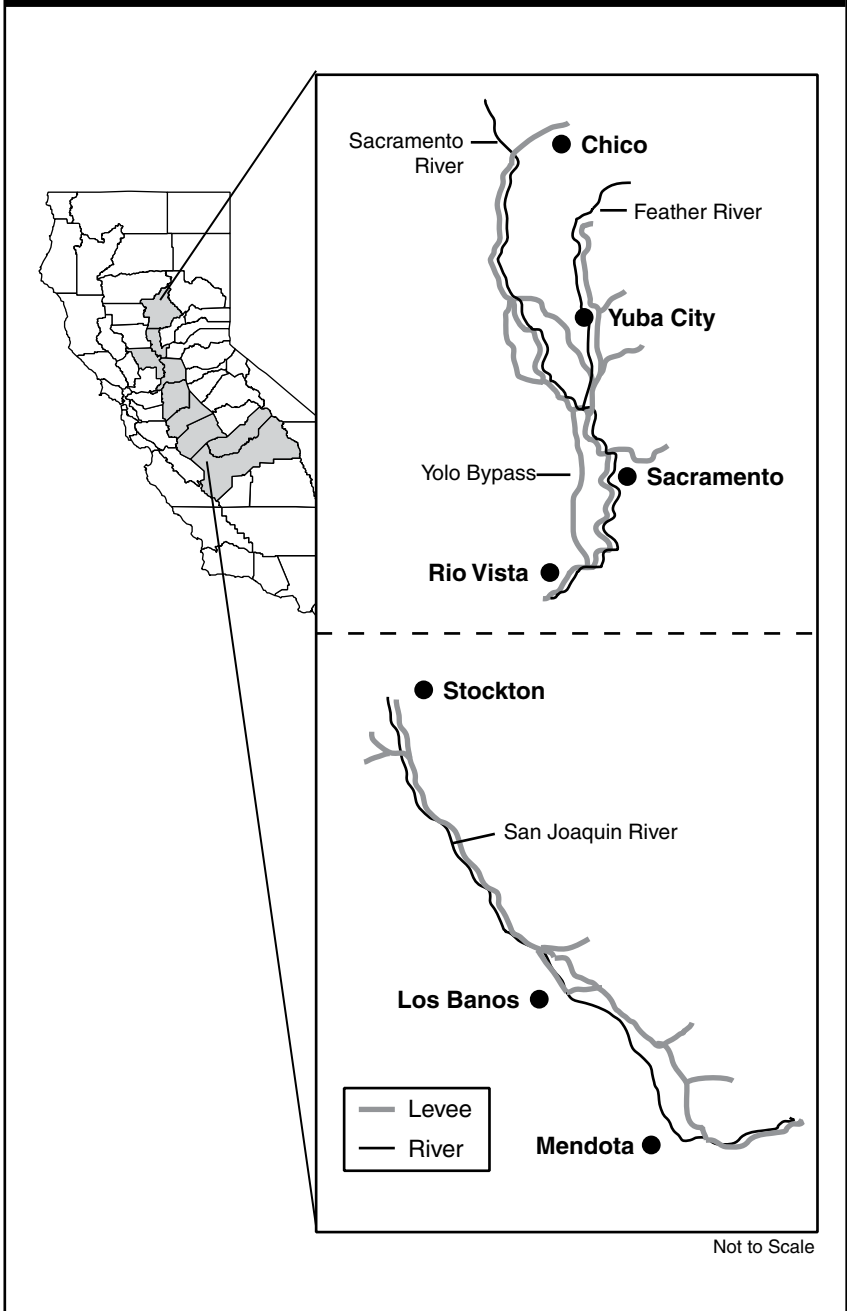
*The budget proposes an increase of \$12.5 million (mostly bond funds and General Fund) in 2007-08 for flood management-related state operations. The budget also proposes \$147.1 million in bond funds and reimbursements for flood control capital outlay. In this section, we give a historical perspective of flood management funding and describe the proposed budget increases.*

**State's Role in Flood Management.** In the Central Valley, the state is the nonfederal sponsor of federally authorized flood control projects. For these projects, the state provides capital outlay funds for the construction and repair of flood control structures such as levees, with a federal and local cost share. For approximately 80 percent of the 1,600 miles of federally authorized levees in the Central Valley, the state has turned over the operations and maintenance to local reclamation districts, although the state retains ultimate responsibility for the levees and the system as a whole. The state oversees the operations and maintenance efforts of the local districts in the Central Valley system and provides floodplain management services by designating floodways and providing assistance to local agencies through floodplain mapping and other technical assistance. The department also serves as the lead state agency for predicting and responding to floods. Figure 2 (see next page) shows a map of the Central Valley flood control system.

Outside the Central Valley flood control system, the state's role in flood management is generally limited to providing local assistance funds to local governments for flood control projects. In the Delta region, for example, the state has no oversight role with respect to local levee construction or maintenance (a majority of Delta levees—about 700 miles are located outside the state system). While the state has provided subventions for levee rehabilitation in the past, the state has no formal role in assessing the structural integrity of these levees. However, because a significant portion of the state's population depends on water supplies that come from the Delta, there is a strong state interest in the continued operation of the Delta levee system.

**Funding for Flood Management Has Varied Substantially Over Time.** Figure 3 (see page 121) illustrates the state's funding of flood management activities since 2001-02. As can be seen, not only has the overall level of funding available for flood management varied considerably in recent years, but what has been funded (for example, local assistance versus state operations) and the breakdown of funding sources (for example, General Fund versus bonds) has also varied year to year.

**Figure 2**  
**Central Valley Flood Control System**





**Figure 3**  
**Department of Water Resources**  
**Flood Management Funding**

(In Millions)

Fund Source	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
General Fund	\$92.4	\$25.0	\$29.2	\$14.9	\$541.3 <sup>a</sup>	\$192.1	\$91.5
State Operations	(19.1)	(17.6)	(14.5)	(14.9)	(524.3)	(43.7)	(78.5)
Local Assistance	(47.7)	(1.1)	(11.0)	—	—	(115.0)	(13.0)
Capital Outlay	(25.6)	(6.3)	(3.6)	—	(17.0)	(33.4)	—
Proposition 13 bond funds	15.6	28.2	14.7	22.5	36.0	3.0	2.5
Proposition 50 bond funds	—	2.3	21.4	21.4	18.8	2.0	—
Proposition 84 bond funds	—	—	—	—	—	—	175.0
Proposition 1E bond funds	—	—	—	—	—	—	422.2
Other funds <sup>b</sup>	12.3	6.9	6.7	6.8	11.6	18.0	34.1
<b>Totals</b>	<b>\$120.3</b>	<b>\$62.4</b>	<b>\$72.0</b>	<b>\$65.6</b>	<b>\$607.7</b>	<b>\$215.1</b>	<b>\$725.3</b>

<sup>a</sup> Includes \$500 million from continuous appropriation in Chapter 34, Statutes of 2006 (AB 142, Nuñez).

<sup>b</sup> Includes federal funds and reimbursements.

*Department Currently in Second Year of Multiyear Flood Management Funding Plan.* The department has indicated that there are substantial unmet funding requirements in the state's flood control system. This is due to an aging system of flood control infrastructure, deferred maintenance, increasing development in floodplains (often behind sub-standard levees), and limited resources for flood management in recent years. Starting in the 2005-06 budget, the department proposed a number of increases in flood management baseline funding to take effect over a three-year period. These increases are proposed from various sources, including the General Fund, bond funds, and special funds.

*Budget Proposal.* The budget proposes \$462.6 million in Propositions 84 and 1E bond funds for flood management state operations and local assistance. Most of these funds are for local assistance, including flood control subventions, and grants for projects to improve flood protection in urban Central Valley areas and Delta levee maintenance and improvements. The state operations funding is to develop a California Flood Plan, evaluate floodplains, and provide technical assistance for grant programs. In addition, the budget also includes \$135.2 million in Proposition 1E bond funds as well as \$11.9 million in reimbursements for flood management-related capital outlay projects in the Central Valley. (Please see our "Resources Bonds" write-up in the "Crosscutting Issues" section of this

chapter for a detailed discussion of the bond-funded component of the budget proposal.)

Finally, as discussed earlier, 2007-08 is the third year of a three-year budget plan to improve flood management-related state operations. The budget proposes increases of \$3 million in one-time funds and \$9.5 million in ongoing funds (mainly General Fund) for this purpose. The major components of these increases as well as capital outlay expenditures proposed for the budget year are summarized in Figure 4 and discussed below.

<b>Figure 4</b>		
<b>Department of Water Resources Flood Management: Selected Spending Increases</b>		
<i>(In Millions)</i>		
	<b>Ongoing Expenditures</b>	<b>One-Time Expenditures</b>
<b>State Operations Program Increases—Year Three of Three-Year Budget Plan</b>		
Flood project maintenance	\$3.2	—
Floodplain management	3.1	—
Emergency response	3.2	\$0.5
Flood protection programs	—	2.5
Flood-fighting equipment	—	0.5
<b>Capital Outlay</b>		
Central Valley flood control system projects	—	\$47.1
Systemwide levee evaluations and repairs	—	100.0
<b>Totals</b>	<b>\$9.5</b>	<b>\$150.6</b>

Proposed flood management capital outlay increases include:

- *Central Valley Flood Control System—Systemwide Levee Evaluations and Repairs—\$100 Million (One-Time Proposition 1E Bond Funds)*. These funds would be used to begin conducting a systemwide evaluation of the state's levees and repair erosion sites where deficiencies are found.
- *Continuing Capital Outlay Projects—\$47.1 Million (\$35.2 Million Bond Funds, \$11.9 Million Reimbursements)*. There are several continuing Central Valley flood control system capital outlay projects in the budget. These projects, while funded by the General

Fund in past years, are proposed to be funded entirely by bond funds (and reimbursements) in the budget year. These projects include, for example, the Folsom Dam Modifications Project and the American River (Common Features) Project.

Proposed increases for flood management state operations that are part of the three-year budget plan include:

- ***Flood Project Maintenance—\$3.2 Million (\$1.7 Million General Fund, \$1.5 Million Reimbursement Authority)***. These augmentations are proposed for Maintenance Area Formation in areas where locals are not maintaining the state system, and for channel vegetation maintenance, mostly by the California Conservation Corps. The proposal also includes \$1.5 million in reimbursement authority to implement a beneficiary pays system of payment from locals benefiting from the projects.
- ***Floodplain Management—\$3.1 Million***. These augmentations are proposed to improve DWR's ability to inform local governments about potential flood risks through increased floodplain mapping. The proposal also increases resources for enforcing violations of the Reclamation Board's designated floodway standards, creates a floodplain administrator for state buildings and a Community Rating System program to assist local communities reduce their insurance rates through proactive community flood activities.
- ***Emergency Response—\$3.2 Million (\$445,000 One-Time)***. These augmentations are proposed to improve DWR's ability to predict and respond to flood events. Under the proposal, for example, the department would improve reservoir operations coordination and expand the flood emergency training program.
- ***Flood Protection Programs—\$2.5 Million (One-Time Proposition 13 Bond Funding)***. This request will complete the Flood Protection Corridor Program, which funds nonstructural flood management projects that include wildlife habitat enhancement and/or agricultural land preservation.
- ***Flood-Fighting Equipment—\$465,000 (One-Time AB 142 funds)***. This request will purchase equipment for use in flood emergencies.

Finally, we note that the budget proposes to use \$200 million of Proposition 1E funds to reimburse the General Fund for flood control expenditures that were incurred prior to bond passage. We discuss this "payback" proposal in more detail later.

## **Priorities and Oversight Needed for Capital Outlay Projects**

*While we recommend the Legislature approve the baseline augmentations for flood management state operations and local assistance, we recommend the Legislature withhold action on all flood-related capital outlay projects until the department (1) submits a required Proposition 1E expenditure plan, (2) reports at budget hearings on its priorities and criteria for selecting flood-control capital outlay projects, and (3) provides a plan for independent review and oversight of capital outlay projects. We further recommend the enactment of legislation requiring the department to regularly report on its capital outlay projects.*

**Baseline Augmentations for State Operations and Local Assistance Warranted.** As we discussed in our *2005-06 Budget: Perspectives and Issues (P&I)* (see page 217), the state faces a crisis in flood management. We have previously recommended that the Legislature adopt the department's three-year flood management plan as a prudent initial step to begin addressing the state's obligation to provide adequate flood control. The proposed flood management state operations and local assistance augmentations fit within the 3-year plan, and we therefore recommend approval.

**Systematic Approach Needed for Bond-Funded Capital Outlay Projects.** However, we believe the influx of new bond funds gives the department the opportunity to use a systematic approach to complete improvements and repairs to the Central Valley flood control system. We believe that a systematic approach would be furthered by a number of recommendations we have made in our January 2007 publication, *Implementing the 2006 Bond Package: Increasing Effectiveness Through Legislative Oversight*. Specifically, in that report, we make a number of recommendations related to the department's proposed expenditures from Propositions 84 and 1E bond funds for flood control.

**Proposition 1E Expenditure Plan Late, Priorities Unclear.** Proposition 1E required the department to submit a bond expenditure plan annually with the Governor's budget. The plan is required to describe in detail the (1) proposed expenditures of bond funds, (2) the amount of federal and local funds obtained to support disaster preparedness and flood prevention projects to match state expenditures, and (3) an investment strategy to meet long-term flood protection needs and minimize state taxpayer liabilities from flooding. We think this plan is crucial to the Legislature's evaluation of both bond-funded flood proposals as well as related state operations and local assistance expenditures. At the time this analysis was prepared, the plan had not been submitted. Without the required expenditure plan for Proposition 1E, it is difficult for the Legislature to evaluate individual projects proposed for funding, as it is

difficult to determine how these projects fit into the overall program of improving the flood control system. Further, expending funds without a prioritization plan with clear criteria to guide the selection of projects to be funded could cause increased flood risk in some areas. For example, if funding were used to upgrade one part of the system, such as a levee in one county, and no funding were provided to upgrade a levee on the opposite side of the river, in another county, the area not upgraded potentially would be subject to increased flooding risk.

We therefore recommend that the department submit the plan prior to budget hearings and report at hearings on it. We further recommend that the Legislature withhold action on all flood-related capital outlay projects until it has had the opportunity to review the expenditure plan and be advised of the department's criteria for selecting projects for funding.

***The Legislature Should Consider Its Priorities for Flood Management Proposals.*** The Legislature has an opportunity to give the department guidance on expenditure priorities for the state flood control system. We make a number of recommendations in our "Resources Bonds" write-up in the "Crosscutting Issues" section of this chapter regarding cost-sharing, project funding eligibility, and federal funding. We recommend the Legislature hold joint policy and budget hearings to review its expenditure priorities for flood management funding, particularly related to Proposition 1E.

***Structure for Capital Outlay Project Management Oversight Lacking.*** In the past, the department has had few direct capital outlay projects that did not also include partnering with the federal government as the lead agency. This partnering provided independent management oversight for capital outlay projects. For example, projects were reviewed by the Army Corps of Engineers, or its designee, at various stages to ensure the public interest was protected with regard to cost overruns, contract management, and project bidding. As we discuss in our "Resources Bonds" write-up, federal funding for flood control projects is highly uncertain. As a consequence, given the known critical deficiencies in the system, there are pressures for the department to move forward on projects without the traditional federal involvement. Thus, when proceeding in this manner, the federal project management oversight process is no longer present.

The department has indicated that, absent the federal oversight process, the state Reclamation Board, by default, would provide an oversight function for capital outlay projects. However, as the Reclamation Board is staffed by DWR, it may not provide the needed independence to review all of the capital projects that lack a federal partner. While this may not have been an issue in the past, we think the new bond funds, plus the increased state liability for flood control, makes providing independent project

oversight a needed step for flood-related capital projects. We therefore recommend that the department report at budget hearings on its plan to provide independent review and oversight of capital outlay projects.

***DWR Should Report Regularly on Capital Outlay Projects.*** Most state departments are required to report quarterly on capital outlay projects to the Department of Finance, pursuant to the State Administration Manual (SAM), Section 6864. The Department of General Services also reports quarterly to the Legislature on all major projects under its purview. The department is currently exempt from this reporting requirement for its flood control capital projects. As the department plans to move ahead with projects without the federal government as the lead agency, we think that such periodic reporting would further oversight of the department's capital outlay program. Such reports could provide the Legislature with information on project scope, timing and changes to projects, overall funding patterns, and cost-sharing proposals. The department's current information technology (IT) management system is capable of monitoring capital outlay projects and providing relevant reports, with specifics such as timeline, budget, and expenditures. Therefore, we recommend the enactment of legislation requiring the department to report semi-annually on flood control-related capital outlay projects in a manner similar to the SAM requirement (specifically Section 6864, Capital Outlay Project Reporting) using their existing internal IT system. This will provide the Legislature with timely and up-to-date information on the department's capital outlay expenditures, allowing for timely action to address issues that arise for projects in progress.

### **AB 142 Spending Needs Scrutiny; Opportunity for General Fund Savings**

*The Legislature appropriated \$500 million from the General Fund in 2006 legislation (AB 142) to evaluate, repair, and improve the flood control system. The budget proposes to use \$200 million of Proposition 1E bond funds to pay back the General Fund for AB 142 expenditures incurred before the bond's passage. The "payback" proposal may raise legal issues, and we think that there is another option to create General Fund savings. We recommend the Legislature hold joint budget and policy hearings on AB 142 spending.*

***The AB 142 Appropriation.*** Chapter 34—commonly referred to as AB 142—provided an urgency appropriation of \$500 million from the General Fund for flood preparedness and repair of critical levees. The bill continuously appropriated the funding to the department for levee evaluation, repair, and flood control improvements. The bill followed an executive order by the Governor declaring a State of Emergency based on

findings of degradations within the California levee system by the federal Army Corps of Engineers.

Pursuant to the *Supplemental Report of the 2006 Budget Act*, the department is required to report quarterly on the expenditure of AB 142 funds. Figure 5 shows how AB 142 funds have been spent/committed through November 30, 2006, broken down between cash-out-the-door expenditures and contract commitments (encumbered, but not spent, funds).

<b>Figure 5</b>		
<b>Department of Water Resources</b>		
<b>AB 142 Spending Through November 30, 2006</b>		
<i>(In Millions)</i>		
<b>Activity</b>	<b>Cash-Out-the-Door Expenditures</b>	<b>Contract Commitments (Encumbered Funds)</b>
Emergency levee erosion repair project	\$146.7	\$45.0
Federal levee rehabilitation assistance	13.7	1.5
American River Common Features	2.1	—
Levee evaluation programs	0.1	35.0
Flood maintenance	2.1	—
Flood fight materials	—	0.8
<b>Totals</b>	<b>\$164.7</b>	<b>\$82.3</b>

**Proposed Payback to General Fund.** As mentioned previously, the budget proposes to use \$200 million in Proposition 1E bond funds in the budget year to repay the General Fund for expenditures from the AB 142 appropriation that were incurred prior to the passage of the bond.

**Legal Issues.** According to the administration, since AB 142 and Proposition 1E each provide funds for similar types of flood management projects, it is an eligible use of Proposition 1E bond funds to reimburse the General Fund for AB 142-funded expenditures that were incurred before bond passage. We are concerned about the policy implications of using bond funds to reimburse another fund source for expenditures made *prior* to bond passage. In addition, the administration's proposal raises legal issues. We recommend that the Legislature seek the advice of Legislative Counsel regarding this proposal.

***Other Issues and Option to Consider.*** In addition to the legal issue, we think there are other issues for the Legislature to consider regarding this proposal. First, even if the payback proposal passes legal muster and the Legislature wishes to proceed with it, it appears that the amount of the payback is too high. Specifically, as shown in Figure 5, \$164.7 million, rather than \$200 million, was spent from AB 142 funds through the end of November. In light of this, we recommend that the department advise the Legislature at budget hearings on the maximum potential amount of the payback.

Second, in addition to, or in lieu of, the payback proposal, the Legislature should consider the opportunity to create General Fund savings by “reverting” (transferring back) to the General Fund the unspent balance of the AB 142 appropriation—currently estimated to be about \$335 million. Proposition 1E funds could be used as a replacement funding source *prospectively* for future expenditures that would otherwise be funded from the AB 142 appropriation.

***Required Reports Late and Lacking Details.*** As mentioned above, the department is required to report quarterly on expenditures using the AB 142 continuous appropriation. These reports have generally been submitted late. The most recent report was due on January 1, 2007, and at the time this analysis was prepared, had yet to be submitted. In addition, the reports that have been submitted have generally lacked sufficient detail to evaluate the expenditure of funds. For example, the department has not consistently included details on land acquisitions in the expenditure reports, nor has it provided information on the level of flood risk faced by projects it decided to fund. In other words, the expenditure reports provide insufficient information to discern the basis for the department’s selection of projects for AB 142 funds.

***Recommend Enhanced Legislative Oversight of AB 142 Spending.*** While we recommend the department submit the overdue quarterly report, we think that the Legislature’s oversight of AB 142 spending would be significantly enhanced by holding joint policy and budget hearings, possibly in conjunction with overall flood management hearings. We think that this evaluation would help the Legislature determine how it wishes to direct future expenditures for flood management, including Proposition 1E spending.



## STATE WATER PROJECT SHOULD BE BROUGHT “ON BUDGET”

*The budget requests 78 new positions for the State Water Project (SWP). Given that funding for SWP is “off budget” and not subject to legislative appropriation in the budget bill, there is little information presented with the request to justify this staffing level. Further, given SWP’s increasing fiscal and programmatic ties to other state on-budget programs, such as the CALFED Bay-Delta Program, we recommend the enactment of legislation to bring SWP expenditures on budget in order to facilitate legislative oversight of state water issues.*

**SWP Background.** 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. The project was initiated with a voter-approved bond (Proposition 1) in November 1960. The project is mainly funded by water users (“SWP contractors”) of the system. However, there are other significant sources of funding. Specifically, the federal government provides a share of the costs for flood control projects related to SWP, the General Fund and user fees pay for recreation and fish and wildlife programs, and state general obligation bond funds have funded related environmental programs such as CALFED.

**SWP Staffing Request.** The budget requests 78 new positions for SWP. These include (1) 42 capital outlay positions to improve and expand water conveyance capabilities of the system; (2) 10 positions to provide legal and billing staff for an increasing amount of billing protests experienced by the department on behalf of SWP contractors; (3) 7 positions for CALFED-related programs; and (4) 19 positions for other projects, including environmental review, drinking water quality, water transfers, and Oroville hydroelectric facility staffing. These positions require legislative approval, and are therefore presented to the Legislature for review. However, the expenditure authority for these positions is “off budget,” as is expenditure authority for all SWP operations and capital outlay. Off budget means that (1) funds to support these positions, as well as all other functions of the SWP, are not appropriated in the annual budget bill, and (2) the department is not required to submit funding requests in conjunction with position requests. Consequently, the Legislature does not have information to fully evaluate these position requests in the context of the SWP’s total existing staffing of about 1,450 positions.

**After Nearly 50 Years, the Role of SWP Has Changed.** We think that the role of SWP in the state is substantially different today than in 1960 when it was established, thereby justifying a change in its budget status. While in past years SWP operated more or less as a discrete, self-con-

tained program, with fiscal oversight provided by SWP contractors who pay most of the project's costs, the SWP of today is much more integrally connected to other major "on budget" state programs. In particular, there is a growing recognition of SWP's role in contributing both to the causes of, and the potential solutions to, water-related problems in the Delta. The state has a number of ongoing programs to address Delta issues, including CALFED. (Please see our "CALFED Bay-Delta Program" write-up in the "Crosscutting Issues" section of this chapter.) The SWP often directly benefits from these programs (such as those improving water quality and water conveyance), contributes funding to them, and may even play a programmatic role in them, but this is done off budget and therefore outside of legislative budgetary oversight. Similarly, SWP contractors are beneficiaries of the state-funded improvements underway in the state system of flood control. Without SWP being on budget, the Legislature is unable to evaluate the entire water system and address the state's water policy issues, including Delta issues, in a comprehensive way.

***Recommend SWP Be Brought on Budget.*** The Legislature has faced the issue of whether to bring large off-budget programs on budget in the past. For example, the state's transportation program was brought on budget in the 1970s. As previously noted, the role of SWP has changed, making it increasingly difficult for the Legislature to comprehensively address the state's water policy issues in light of SWP's off-budget status. Therefore, we recommend the enactment of legislation to bring SWP expenditures on budget in order to facilitate legislative oversight of state water issues.

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## CALIFORNIA INTEGRATED WASTE MANAGEMENT BOARD (3910)

The California Integrated Waste Management Board (CIWMB), in conjunction with local agencies, is responsible for promoting waste management practices aimed at reducing the amount of waste that is disposed in landfills. The CIWMB administers various programs that promote waste reduction and recycling, with particular programs for tires, used oil, and electronics. The board also regulates landfills through a permitting, inspection, and enforcement program that is mainly enforced by local enforcement agencies that are certified by the board. In addition, CIWMB oversees the cleanup of abandoned solid waste sites.

The budget proposes expenditures of \$199.1 million from various funds (primarily special funds) for support of CIWMB, which is essentially the same amount as estimated expenditures in 2006-07.

### **Waste Tire Diversion Rates Need Improvement**

*The California Integrated Waste Management Board administers the waste tire recycling management program to reduce the landfill disposal and stockpiling of whole tires. Even though 10.2 million (25 percent) of waste tires annually generated in the state are not diverted to productive end uses, the budget does not propose any program changes to address this issue. We recommend the adoption of supplemental report language to require the board to report on options, and related statutory changes, that it would recommend to increase the diversion rate.*

**Waste Tire Recycling Management Program Created in 1990.** The CIWMB administers the state's Waste Tire Recycling Management Program. The program was statutorily created in 1990 to reduce the landfill disposal and stockpiling of whole tires through the establishment of a statewide tire recycling program. The CIWMB administers the program to encourage the diversion of waste tires from the state's landfills through a number of activities, including:

- Conducting/funding research into new technologies that increase the useful lifespan of tires.
- Conducting/funding research into waste tire product development and applications.
- Assessing market demand for waste tire products.
- Undertaking, on its own and in conjunction with state and local public agencies, waste tire demonstration projects.
- Providing marketing, grants, and technical assistance to business and to state and local public end users of waste-tire products.
- Developing waste tire engineering curriculum for use at universities and in continuing education for professionals.

**Waste Tire Diversion Up.** In 1990, at the program's inception, the state diverted 34 percent of waste tires from landfills to other productive end uses. As of 2005 (the last year for which data are available), the rate of waste tire diversion was 75 percent, or 30.6 million tires diverted out of 40.8 million tires generated.

Waste tires are diverted for a number of productive end uses, such as crumb rubber—wire-free tire shreds of varying sizes—and rubberized asphalt concrete (RAC)—paving material that is a blend of crumb rubber, asphalt, and other materials. Figure 1 shows the various productive end uses of waste tires in California.

**Waste Tire Piles Down.** At the program's inception, there were many large, preexisting piles of illegally stored waste tires throughout the state. The board reports that between 1994 and 2002, it identified 894 illegal tire sites that collectively held 6.1 million waste tires.

Through the board's enforcement efforts, it has been able to bring about the cleanup and/or proper storage of waste tires at nearly all of the 894 illegal tire sites, including the Tracy and Westley tire piles—sites of large, long-burning tire fires that occurred in the late 1990s. In recent years, the board has contracted with the California Highway Patrol for use of its helicopters to identify remote tire piles. Nonetheless, the board newly identifies fewer large, illegal tire piles every year.

Believing it has largely resolved the problem of existing piles of illegally stored tires, the board now focuses its enforcement efforts on preventing the reappearance of such tire piles. Currently, the board's primary enforcement activities include permitting and inspection of storage facilities and tracking the transport of waste tires. The board's enforcement efforts are carried out by its own staff, as well as by local government agencies that receive enforcement grants from the board.

**Figure 1****End Uses of Waste Tires Diverted From Landfills in 2005**

End Use	Tires Diverted (In Millions)	Percentage of Diverted Tires
Burnt as fuel for cement production <sup>a</sup>	7.4	23.1%
Daily cover at landfills	4.7	14.6
Retread	4.4	13.7
Crumb rubber	3.2	10.0
Other uses	3.2	10.0
Exported	2.3	7.2
Rubberized asphalt concrete	2.0	6.2
Civil engineering projects	2.0	6.2
Burnt for power generation <sup>a</sup>	1.7	5.3
Reuse	1.2	3.7
<b>Totals<sup>b</sup></b>	<b>30.1</b>	<b>100%</b>

<sup>a</sup> Statute prohibits the board from supporting (such as by financial or technical assistance) diversion uses that result in the combustion of waste tires.

<sup>b</sup> Total tires diverted has been adjusted downward by 2 million to reflect 2 million tires imported into the state for disposal each year.

***Tire Fee Structure Has Varied Over Time.*** The waste tire recycling program is supported entirely by fees. The amount of the fee, as well as its point of collection, has varied over time. Currently, the fee is \$1.75 per tire, collected when the tire is purchased. Of that amount, 75 cents is deposited in the Air Pollution Control Fund (APCF) to fund local air district programs to mitigate or remediate air pollution caused by tires, including waste tire pile fires. The balance of the fee—\$1.00—is deposited into the California Tire Recycling Management Fund (CTRMF) to fund CIWMB's waste tire activities.

***Legislature Retains Higher Fee.*** The CIWMB's portion of the fee was statutorily set to decrease from \$1.00 to 75 cents on December 31, 2006. However, at hearings on the 2006-07 budget, the Legislature revised statute so that CIWMB's portion of the fee remains at \$1.00. In retaining the higher fee, the Legislature recognized an opportunity for the board to expand efforts to divert the roughly 10.2 million waste tires disposed of in California landfills each year. However, the Legislature did not give specific direction regarding which board activities to increase waste tire diversion it wanted CIWMB to expand.

**Legislature Has Given Direction on Use of Tire Fee Funds.** In recent years, the Legislature has provided specific direction to the board as to the use of the tire fee revenues to promote the diversion of waste tires from landfills. Such direction includes:

- **The RAC Grant Program for Local Public Works (Chapter 671, Statutes of 2002 [SB 1436, Kuehl]).** Authorized CIWMB to implement a program to award grants to local government entities for funding of public works projects that use RAC. The measure specified the size of eligible projects and the amount and proportion of crumb rubber that a project would need to use to be eligible for the grants, as well as the permissible amounts of the grants (between \$6,250 and \$50,000). The RAC grant program was to expire January 1, 2007. However, subsequent legislation (Chapter 300, Statutes of 2006 [SB 1346, Simitian]) extended the program to January 1, 2011, revised eligibility requirements to include greater minimum usage of RAC, and increased the maximum grant amount to \$250,000.
- **Replacement Tire Efficiency Program (Chapter 645, Statutes of 2003 [AB 844, Nation]).** Requires the California Energy Commission (CEC), in consultation with CIWMB, to adopt by July 1, 2007, and implement by July 1, 2008, efficiency standards for replacement tires based on CEC testing. The CIWMB funded the first phase of the program with \$400,000 from the CTRMF. The CEC proposes to fund continued development of the efficiency standards with \$500,000 from the Energy Resources Program Account as part of the 2007-08 budget.
- **Use of Crumb Rubber in California Department of Transportation (Caltrans) Paving Projects (Chapter 709, Statutes of 2005 [AB 338, Levine]).** Required CIWMB and Caltrans to jointly develop procedures for using crumb rubber and other tire-derived products in Caltrans projects. The statute also requires Caltrans to use, between 2007 and 2013, asphalt paving materials that contain increasing amounts of crumb rubber, given periodic demonstration of the material's relative cost effectiveness.

**Budget Proposal.** The budget proposes a total of about \$39.3 million from CTRMF for the board's waste tire recycling program in 2007-08—roughly the same as estimated expenditures in the current year. The \$39.3 million is proposed largely for market development and research, permitting, enforcement, clean up, and remediation.

**Persistently Large Waste Tire Fee Fund Balance.** The CTRMF, which funds the board's waste tire management activities, has carried a persistently large balance for several years, as shown in Figure 2. (The fund

balance does not reflect a roughly \$17 million loan made from CTRMF to the General Fund in 2003-04, which has yet to be paid back.)

<b>Figure 2</b>	
<b>Persistently Large Tire Recycling Management Fund Balance</b>	
<i>(In Millions)</i>	
<b>Years</b>	<b>Balance</b>
2003-04	\$12.5
2004-05	23.0
2005-06	35.8
2006-07	30.6
2007-08	25.6

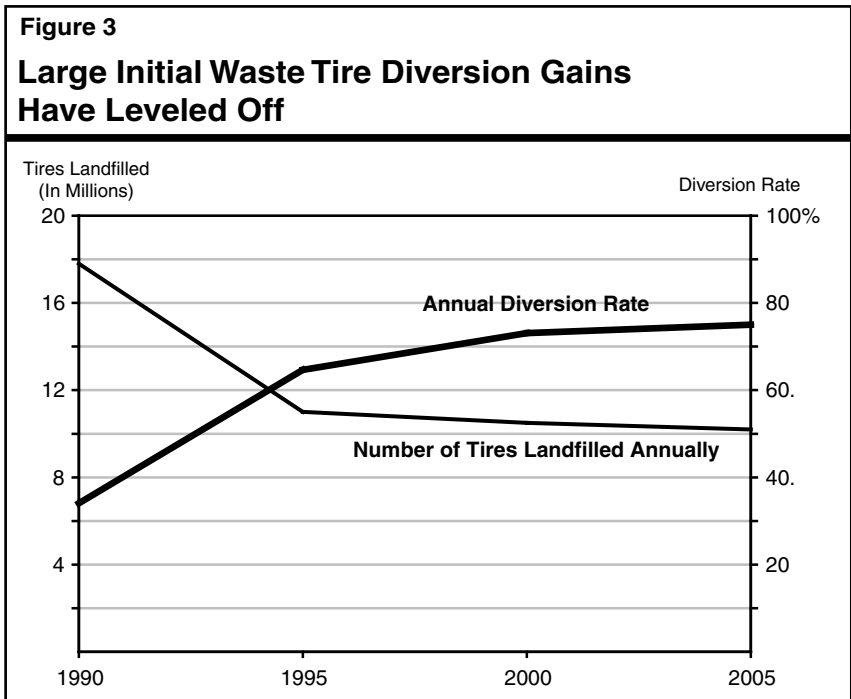
Although the fund balances have built up to substantial levels, the board's program expenditures have remained relatively stable over the last several years. The 2007-08 budget proposal for the tire program does not reflect any significant program changes or initiatives. Absent such program enhancements and initiatives, it is likely that the fund balance would stay at relatively high levels in the future.

***Options to Increase Tire Diversion and Address High Fund Balance.*** While CIWMB currently undertakes a variety of efforts to encourage the diversion of waste tires from landfills to productive end uses, the amount and proportion of waste tires that are not diverted from landfills is still large (10.2 million, or about 25 percent of waste tires generated annually). The waste tire program appears to be in a "holding pattern." As Figure 3 (see next page) shows, despite large initial gains in waste tire diversion, in recent years, both the diversion rate and the number of waste tires deposited into the state's landfills each year have remained relatively constant.

We believe that the large fund balance presents the board with the opportunity to increase the waste tire diversion rate. In recent years, the Legislature has taken the lead by giving statutory direction on the use of the tire fund in an effort to increase the diversion rate.

We think that there are opportunities to draw down the CTRMF balance by enhancing program activities and thereby increase the diversion rate. For example, the board could increase expenditures on its activities designed to encourage the productive end use of waste tires, such as:

- **Research Efforts and Demonstration Projects.** Continue to fund CEC's research into replacement tire efficiency, or expand its testing and certification of new tire-derived products. Similarly, CIWMB could expand its sponsorship of demonstration projects that use tire-derived materials for civil engineering projects.
- **Marketing and Outreach.** Continue and expand efforts to communicate to end users the viability and long-term cost effectiveness of tire-derived products and to provide technical assistance to them.



**Recommend CIWMB Report on Options to Increase Waste Tire Diversion Rates.** We think that the board is best positioned to identify those additional efforts most likely to increase the number of waste tires diverted from the state's landfills, as well as to advise the Legislature of the policy choices that may be inherent in such efforts warranting legislative evaluation. Therefore, we recommend the adoption of the following supplemental report language:

Item 3910-001-0226. The California Integrated Waste Management Board shall submit a report to the Legislature by July 10, 2008, that identifies the following:



- A history of revenues, expenditures, and balances of the California Tire Recycling Management Fund since its inception, and projection of such information for 2008-09 and the subsequent two fiscal years.
- A history of waste tire diversion rates and end uses, and projection of such rates and uses for 2007 and the subsequent three years.
- Identification and assessment of the costs and effectiveness of options to increase the rate of diversion of waste tires from disposal in landfills.
- Any statutory changes that would assist the board's efforts to increase the diversion rate.

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## STATE WATER RESOURCES CONTROL BOARD (3940)

The State Water Resources Control Board (state board or SWRCB), in conjunction with nine semiautonomous regional boards, regulates water quality in the state. The regional boards—which are funded by the state board and are under the state board’s oversight—implement water quality programs in accordance with policies, plans, and standards developed by the state board.

The state board carries out its water quality responsibilities by (1) establishing wastewater discharge policies and standards; (2) implementing programs to ensure that the waters of the state are not contaminated by underground or aboveground tanks; and (3) administering state and federal loans and grants to local governments for the construction of wastewater treatment, water reclamation, and storm drainage facilities. Waste discharge permits are issued and enforced mainly by the regional boards, although the state board issues some permits and initiates enforcement actions when deemed necessary.

The state board also administers water rights in the state. It does this by issuing and reviewing permits and licenses to applicants who wish to take water from the state’s streams, rivers, and lakes.

**Proposed Funding.** The budget proposes expenditures of \$834.5 million from various funds for support of the state and regional boards in 2007-08. This amount is a decrease of \$106.9 million, or about 13 percent, below estimated current-year expenditures. Most of this decrease reflects a reduction in bond-funded expenditures, mainly for loans and grants for local water quality and water recycling projects funded from pre-2006 bond funds. Despite this overall spending reduction, the budget does propose some increases in program funding. These proposals include \$111.4 million in Proposition 84 bond funds to implement various water quality programs, \$3.1 million (special funds) to accelerate brownfield cleanups,

and \$3.5 million (various funds) for cleanup operations and maintenance at Leviathan Mine in Alpine County. The budget also proposes to backfill the fee-funded Water Rights Fund with \$2.7 million from the General Fund.

## INFORMATION TECHNOLOGY (IT) AT THE WATER BOARDS: AN ASSESSMENT

*The Importance of IT at the State and Regional Water Boards.* Like any modern organization, the state and the nine regional water boards rely upon IT for many of their core business functions. The SWRCB IT systems serve a variety of purposes, including administrative functions, permitting and enforcement systems, water quality monitoring, and providing public access to water quality and enforcement data (through the Internet). The boards are constantly revising, updating, and adding to their IT systems. As seen in Figure 1, at least five separate IT projects are currently in progress, with one-time development costs projected to total about \$3.7 million for these projects.

On numerous occasions, the Legislature has stressed the fundamental role that management of data—including permitting, enforcement, and water quality—at the boards plays in assisting the board to carry out its mission. This is critical to informing the board's decision making and the public-at-large and in effectively targeting resources to program areas most in need.

**Figure 1**

### Major Water Board Information Technology (IT) Projects in Progress

(In Thousands)

IT Project	Design and Development (One-Time) Costs	Projected Annual (Ongoing) Maintenance Costs
Stormwater Annual Report Module	\$350.0	\$35.0
Stormwater Multiple Application Reporting and Tracking Module	125.0	50.0
Sanitary Sewer Overflow Spill Module	100.0	—
Ambient Surface Water and Groundwater Module	1,300.0	118.0
Geotracker (2 phases)	1,834.5	163.2
<b>Totals</b>	<b>\$3,709.5</b>	<b>\$316.2</b>

**Analyst's Approach.** In the following sections, we highlight the challenges facing the water boards in the area of IT and recommend steps that should be taken for improvement. In conducting our review, we examined current and proposed IT projects at the water boards related to water quality. We reviewed in depth one IT project—the California Integrated Water Quality System (CIWQS).

Based on our review, we find that there are significant problems in the way SWRCB has informed the Legislature of its new IT projects and in the way new projects have been rolled out to the regional boards. We make a number of recommendations to increase legislative oversight of the IT programs at SWRCB. Further, we recommend the Legislature withhold funding for future new projects until an updated IT strategic plan is in place.

### **IT Strategic Plan Needs Update; Legislative Oversight Critical**

*We recommend the adoption of budget bill language (1) requiring the board to conduct a needs assessment of its information technology (IT) programs in order to update its IT strategic plan, (2) prohibiting expenditures for new IT projects until the plan is updated and submitted to the Legislature, and (3) requiring the board to submit an IT implementation plan as part of the submittal of the annual Governor's budget.*

**IT Strategic Plan Needs Update.** Every state department is required to have a strategic plan to guide its IT activity, known as an Agency Information Management Strategy (AIMS) report. The purpose of this strategic plan is to ensure that departments have a clear direction with respect to IT, including identification of priorities. Along with its use internally to state departments, the plan is submitted to the Department of Finance to assist in its review of the budget. The board has indicated that its AIMS is outdated, and that a new IT plan is needed. Furthermore, as we discuss later, the board has changed its IT strategy, and a revised AIMS report must be prepared when there is a significant change in IT strategy. This plan is particularly important at SWRCB because, as the board adopts IT systems pursuant to the plan, the nine regional boards are then required to use these IT systems to accomplish their goals.

Because the board's IT strategic plan is outdated, we find that the board's basis for adopting new IT projects is unclear and the Legislature has no basis on which to review how new IT projects fit into the board's overall IT strategy. Based on this, we recommend the adoption of budget bill language requiring the board to update its AIMS report and prohibiting expenditures for new IT projects until the report is updated and submitted for legislative review. We recommend:

Item 3940-001-0001. No money appropriated in this item or any other items appropriating funds to the State Water Resources Control Board, can be used for new information technology projects until the board's Agency Information Management Strategy is updated to reflect the board's current information technology strategy and submitted to the Joint Legislative Budget Committee no sooner than 30 days prior to any spending on information technology projects.

***Development of IT System Outside Budget Process Circumvents Legislative Oversight.*** In past years, the Legislature, through the budget process, has reviewed IT proposals from the water boards. Most notably, a proposal for an upgrade to the core permitting and enforcement database was presented at hearings on the 2002-03 budget, but was rejected by the Legislature for funding based on the design of the system. Shortly thereafter, the board developed a contract with the federal government, wherein a system similar to the one rejected by the Legislature would be designed by the board under federal contract with certain development costs to be paid directly by the federal government. In other words, the board proceeded with an IT project that the Legislature rejected by going outside the budget process. In subsequent years, the board administratively directed program funds to continue the project, making legislative review difficult.

The original purpose of this IT system—referred to as CIWQS—was solely to automate federal permitting for pollution discharges. (The state is delegated responsibility for issuing and enforcing federal water quality permits.) The project, however, has expanded significantly over time. Based on our review, we have identified total costs of about \$4.6 million to develop and maintain CIWQS at the state board, of which only \$1.7 million has been paid for by the federal government, as shown in Figure 2 (see next page). Ongoing maintenance and operation costs are being paid by the state from special funds (mainly fees) as part of the board's permitting and enforcement activities. Based on our review, we estimate \$738,000 would be used to maintain the system in the budget year.

***Budget for IT Difficult to Evaluate.*** The overall budget for IT projects at SWRCB is difficult to evaluate, as most IT costs are assessed to individual regulatory programs and are not consolidated for budget display purposes as a "program" themselves. We think that legislative oversight of the board's IT projects would be significantly enhanced if the board were required to submit an IT implementation plan in conjunction with the submittal of the annual Governor's budget. This plan should include information on ongoing and proposed IT projects, one-time design and development costs, and ongoing maintenance costs. We therefore recommend the adoption of budget bill language requiring the board to submit an IT implementation plan as part of the submittal of the annual Governor's budget.

**Figure 2**  
**CIWQS Project Development and Operations Funding**

(In Thousands)

	System Development		System Operations and Maintenance <sup>a</sup>		Four-Year Totals
	2003-04	2004-05	2005-06	2006-07	
Federal funding <sup>b</sup>	\$85.3	\$1,590.0	—	—	\$1,675.3
State funding (special funds)	890.2	585.4	\$738.0	\$738.0	2,951.6
<b>Totals</b>	<b>\$975.5</b>	<b>\$2,175.4</b>	<b>\$738.0</b>	<b>\$738.0</b>	<b>\$4,626.9</b>

<sup>a</sup> Ongoing costs.  
<sup>b</sup> Federal direct spending.  
 CIWQS = California Integrated Water Quality System.

### Scope Change of IT Project Leads to Data Entry Backlog at Regional Boards

*We find that the rollout of the California Integrated Water Quality System (CIWQS) to the regional boards has led to a backlog of data entry related to permits, enforcement, and water quality monitoring. This has led to outdated, incomplete, and therefore potentially misleading water quality data both on the boards' publicly accessible Internet site and for its internal enforcement and permitting staff use at the regional board level. We recommend the board report at budget hearings on the extent of the backlog and its plans to reduce it in the budget year.*

As mentioned previously, the original scope of the CIWQS project was to automate the federal permitting process. However, the state board has expanded the scope of CIWQS by beginning to link various other existing data management programs, including those used by regional boards, to the CIWQS system. For example, data entry related to state water quality permits issued at the regional board level must now tie into CIWQS. Moreover, the board has a number of new IT projects under development, each of which is specifically designed to link with CIWQS and will generally require the regional boards to change the way they conduct data entry.

While some regional boards have integrated well with the new scope of the program, others have struggled. For example, one regional board halted all data entry into the new system for six months because it was unsure of how the system would be used in the future. This board still uses a duplicate paper-trail system in addition to the new automated system for day-to-day activities, which is inefficient and adds unnecessarily to costs.

The ongoing expansion of the scope of CIWQS exacerbates backlogs in data entry that have developed at the regional board level, particularly related to permitting, enforcement, and water quality monitoring data. Because of backlogs in data entry that would otherwise provide regional board staff with a picture of the state of water quality in their areas, they may not be targeting their resources as effectively as possible. This data backlog is also problematic because it creates the potential for the public to be misled as it uses the Internet to seek water quality-related information. For example, where backlogs occur with only partial data being put on the Internet, it would not be clear to the public that the information they are viewing contains gaps or is outdated. At the time this *Analysis* was prepared, the state board was unable to quantify the extent of the data entry backlog, although board staff concur that it is a problem at some of the regional boards. We therefore recommend that the board report at budget hearings on the extent of the backlog and its plans to reduce it in the budget year.

### **Legislature Should Be Apprised of External Review Findings**

*Problems with the California Integrated Water Quality System have been brought to the state board's attention and the board has requested an external review of the project. We recommend the Legislature direct the board to submit this external review in an unabridged version to the Legislature at the same time it is presented to the board.*

Users of CIWQS, including regional boards, regulated entities, and the public have raised concerns to the state board about CIWQS, prompting the board to request an external review of this IT project to be completed in May 2007 by external program experts. We think the Legislature should receive an unabridged version of this review, and we therefore recommend that the board present the Legislature with the review at the same time as it is presented to the state board. This assessment would help the Legislature evaluate CIWQS and associated major IT projects at the board and assess the corrective actions the board is taking to address the identified problems with its IT programs.

## **WATER RIGHTS FEE FUNDING UNCERTAIN**

*A recent court decision has called into question the constitutionality of the board's water rights fee, thus making fee funding for this program uncertain. Consequently, we recommend that the Legislature withhold action on the board's water rights program budget, pending an update from the board at budget hearings on the status of litigation on the water rights fees.*

***Water Rights Program Overview.*** The SWRCB's water rights program is responsible for (1) issuing new water rights for water bodies that have not been fully "allocated" to water rights holders, (2) approving changes to existing water rights (this may be to facilitate a water transfer), and (3) conducting ongoing enforcement and compliance monitoring of water rights under its jurisdiction. The board's enforcement authority applies only to water rights established after 1914.

Legislation was enacted in 2004 to require the water rights program to be fully funded from fees. The board adopted regulations to establish a new fee structure in response to this legislative direction.

***Fee Litigation.*** The board's water rights fee structure was challenged in court on the basis that the fees were an unconstitutional tax. While upheld at the lower court level, an appellate court has recently ruled against the state. At the time this *Analysis* was prepared, the board was considering its options, including seeking a rehearing or appealing to the Supreme Court.

***Budget Proposes Significant Reliance on Fees.*** The budget proposes expenditures of \$11.1 million for the water rights program, including \$6.9 million from the fee-funded Water Rights Program Fund. The budget also proposes to continue a \$2.7 million backfill from the General Fund that was made on a one-time basis in the current year resulting in total General Fund support of about \$3.9 million.

***Recommend Board Report on Status of Litigation.*** We recommend that the Legislature withhold action on this budget request as well as on the overall water rights program budget, pending an update from SWRCB at budget hearings on the status of litigation on the water rights fees.

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## OFFICE OF ENVIRONMENTAL HEALTH HAZARD ASSESSMENT (3980)

The Office of Environmental Health Hazard Assessment (OEHHA) identifies and quantifies the health risks of chemicals in the environment. It provides these assessments, along with its recommendations for pollutant standards and health and safety regulations, to the boards and departments in the California Environmental Protection Agency (Cal-EPA) and to other state and local agencies.

The budget requests total funding of \$17.5 million for support of OEHHA in 2007-08, an increase of \$387,000 (2 percent) above estimated current-year expenditures.

### **PUBLIC HEALTH GOALS AND DRINKING WATER REGULATION**

*The Office of Environmental Health Hazard Assessment (OEHHA) develops and periodically updates scientifically derived, health-based public health goals (PHGs) for drinking water contaminants regulated by the Department of Public Health.*

*The General Fund has funded the entirety of OEHHA's PHG-related work since the program's inception. We recommend shifting support for the PHG program from the General Fund to the fee-funded Safe Drinking Water Account. As OEHHA has consistently lagged statutory deadlines to develop and update PHGs, we further recommend that OEHHA report to the budget subcommittees prior to budget hearings on the required resources to complete its statutorily defined responsibilities in a timelier manner.*

## **Background: Safe Drinking Water Regulation**

*Roles of OEHHA and Department of Public Health (DPH).* In California, two state entities—OEHHA and the newly constituted DPH, formerly part of the Department of Health Services—are responsible for assuring that the state’s drinking water is safe, pure, and potable. The OEHHA scientifically assesses the risks to human health posed by contaminants that may be found in the state’s public drinking water systems and are regulated or proposed to be regulated under DPH’s safe drinking water regulatory program (discussed below). Based on that scientific assessment, OEHHA adopts contaminant-specific goals, known as PHGs, that specify, based solely on public health considerations, the maximum levels of concentration at which various contaminants can be found in drinking water without adversely affecting human health. Statute specifies that OEHHA is to set each PHG at a level that protects the public from both acute adverse health effects and chronic disease. Statute further directs OEHHA to consider possible combined and interactive effects of exposure to two or more contaminants, as well as the effect of contaminants upon specified subgroups, including infants, children, pregnant women, and elderly persons, and persons suffering from serious illness.

The DPH manages the risk to human health identified in OEHHA’s PHGs (which are advisory) by setting primary drinking water standards (also known as “maximum contaminant levels” or “MCLs”). Statute requires DPH to set its MCL for each regulated contaminant as close as is technologically and economically feasible to the corresponding PHG. In this way, OEHHA’s PHGs form the scientific basis of DPH’s regulation of drinking water to ensure public health and safety. (Until PHGs are developed for a regulated contaminant, DPH is guided by a federal requirement that the state set safe drinking water standards at least as stringent as any federal standards for that contaminant.) The MCLs specify the maximum level of each contaminant allowable in the state’s public drinking water systems that are regulated by DPH.

Public drinking water systems, which can be either publicly or privately owned, are those systems that regularly supply drinking water to at least 25 people or 15 service connections. In California, there are over 7,000 public drinking water systems, each of which is regulated and permitted by DPH. These systems include both groundwater systems and surface water systems and supply drinking water to the majority of Californians.

*Statutory Timelines for OEHHA’s PHG Development and Review.* Statute enacted in 1996 (and amended in 1999) provides a timeline for OEHHA to develop (and “publish”) PHGs for each drinking water contaminant regulated by DPH and to periodically review the PHGs, once developed. Specifically, OEHHA is required to have developed 25 PHGs

by January 1, 1998, an additional 25 PHGs by January 1, 1999, and PHGs for all remaining drinking water contaminants for which DPH had adopted an MCL by December 31, 2001. (In 1996, DPH regulated 84 drinking water contaminants for which a PHG was to be developed.) Statute also requires OEHHA to have developed a PHG at the same time DPH proposes the adoption of an MCL for any newly regulated contaminant. In addition, statute requires OEHHA to review each established PHG every five years, and to revise the PHG as necessary, based on the availability of new scientific data.

## **Recommend Shift to Fee-Based Funding**

*The General Fund has been the only source of funding for the Office of Environmental Health Hazard Assessment's public health goal program. In keeping with the "beneficiary pays" principle, we recommend shifting funding for this program to a fee-based funding source—the Safe Drinking Water Account. (Reduce Item 3980-001-0001 by \$1.84 million and create new Item 3980-001-0306 for \$1.84 million.)*

**General Fund Has Been Program's Only Source of Funding.** Unlike most other regulatory-related programs within the California Environmental Protection Agency, OEHHA's PHG program receives no funding from regulatory fees. Rather, the program has been funded entirely from the General Fund since its inception in 1997-98, at which time the program's budget was \$835,000. For 2007-08, the budget proposes \$1.84 million from the General Fund for OEHHA's PHG program

**The Beneficiary Pays Principle.** We think that funding for OEHHA's PHG program should be guided by the "beneficiary pays" principle. According to this principle, those who benefit from the use of public resources are responsible for paying the cost imposed on society to regulate that use.

We think that public drinking water systems regulated by DPH benefit directly from OEHHA's PHG activities. This is because OEHHA's development of PHGs benefits the operators of public drinking water systems, in that the PHG program provides a basis in science for the drinking water standards adopted by DPH and prevents the standards from being more stringent than is necessary to protect public health. As such, the PHG program benefits the regulated public drinking water systems and, therefore, should be funded through fees assessed on these systems.

**Recommend Shift of OEHHA's PHG Program Funding to Fee-Based Support.** Accordingly, we recommend that OEHHA's PHG program be funded through existing regulatory program fees paid by operators of DPH-regulated public drinking water systems. (Currently, DPH collects

permit fees from these operators and deposits them in the Safe Drinking Water Account [SDWA].) We recommend permanently shifting all funding for OEHHA's PHG activity from the General Fund to SDWA, creating savings of \$1.84 million to the General Fund in the budget year. We note that, in light of a substantial balance projected to remain in SDWA at the end of the budget year (about \$6.6 million), the adoption of our recommendation is unlikely to require an increase in DPH's regulatory fees that support SDWA in either the budget year or the subsequent few years at current funding levels for the PHG program.

### OEHHA Lags Statutory Timelines for PHG Activity

*The Office of Environmental Health Hazard Assessment's (OEHHA's) development and update of the public health goals (PHGs) has persistently lagged statutory timelines. The Department of Public Health depends upon OEHHA's timely development/update of PHGs for its regulation of public drinking water systems. We recommend that OEHHA report to the budget subcommittee of each house, prior to budget hearings, on the funding that would be required to enable OEHHA to complete its PHG activity according to statutory timelines.*

*Development of PHGs Persistently Lags Statutory Schedule.* As mentioned above, statute sets a schedule by which OEHHA is to have developed PHGs for regulated drinking water contaminants. Figure 1 compares the timing of OEHHA's development of PHGs to the schedule laid out in statute.

**Figure 1**

### OEHHA's Development of PHGs Persistently Lags Statutory Schedule

	<b>Statutory Requirement</b> Cumulative Number of PHGs to Be Developed, By Specified Date	<b>OEHHA's Progress</b> Actual Cumulative Number of PHGs Developed by OEHHA	<b>Backlog</b> Number of PHGs Behind Statutory Schedule
By January 1, 1998	25	24	(1)
By January 1, 1999	50	24	(26)
By December 31, 2001	85	56	(29)
As of December 31, 2006	89 <sup>a</sup>	78	(11)

<sup>a</sup> Includes PHGs for four contaminants regulated or proposed for regulation by the Department of Health Services (now the Department of Public Health) after 2001.

As the figure shows, OEHHA's development of PHGs has consistently lagged the statutory schedule. That lag continues today. While there were 84 contaminants requiring PHGs at the time of the 1996 PHG legislation, DPH has since proposed regulating an additional five contaminants (including one for which DPH adopted an MCL in 2001), increasing to 89 the total number of contaminants for which OEHHA is to adopt PHGs. As of now, OEHHA has not developed the required PHGs for 11 contaminants (including at least six that are part of the original group of 84 regulated contaminants).

***Updating of Previously Developed PHGs Also Behind Schedule.***

As noted earlier, statute requires OEHHA not only to develop PHGs, but also to periodically update them by reviewing its developed PHGs at least every five years and to revise them as necessary, based on new scientific data. Despite the statutory requirement, OEHHA has reviewed only 7 of the 56 PHGs it developed more than five years ago. Consequently, OEHHA is behind the statutory schedule for review of 49 of its existing PHGs. As those PHGs that OEHHA developed more recently become at least five years old, it is likely that OEHHA will fall even further behind in its review of existing PHGs.

***DPH Regulation of Drinking Water Dependent on OEHHA's Development and Update of PHGs.*** The OEHHA's development of PHGs ensures the adequacy of the state's regulation of public drinking water to protect human health. The DPH relies on PHGs to define the concentrations of contaminants that may safely be found in drinking water supplies. Absent up-to-date PHGs, DPH lacks a scientific basis for its regulation of public drinking water at levels more stringent than federal drinking water standards.

***Review of Funding Adequacy Required.*** As OEHHA's PHG program serves a significant public health function of statewide benefit, it is therefore important for the program to be adequately funded. The OEHHA's persistent failure to meet statutory schedules for the development and review of PHGs is potentially a reflection of inadequate funding levels. However, when asked, OEHHA was unable to provide estimates of the resources it would need to meet its statutory PHG obligations in a timely manner. We think that this estimate is important information for the Legislature to have as it evaluates OEHHA's proposed budget.

***Recommend OEHHA Advise Legislature on PHG Funding Requirements.*** In order to provide the Legislature with the information it needs to evaluate the budget proposed for OEHHA's PHG program, we recommend that OEHHA report to the budget subcommittee of each house, prior to budget hearings, on the funding that would be required in 2007-08 and

future years to enable OEHHA to address the following workload within the timeframes specified:

- Develop/publish PHGs for the six regulated contaminants remaining from the 1996 list of 84 contaminants, within one year.
- Complete reviews of the 49 PHGs developed more than five years ago, within two years. (The OEHHA should give priority to those developed PHGs that seem most likely in need of revision, based on new scientific data.)
- Complete review of PHGs developed since 2001 within five years of development, and every five years thereafter.
- As required by statute, develop/publish a PHG at the same time DPH, in the future, proposes the adoption of a primary drinking water standard for a newly regulated contaminant.

The report should also include OEHHA's estimates of the time it would take to address the above-noted workload (without the specified timeframes) at the current funding level of the PHG program. The report will allow the Legislature to determine whether revisions to OEHHA's budget are appropriate so that the office can meet its statutory responsibilities for the PHG program in a timelier manner. Finally, should the Legislature, based on the report, determine that funding for the PHG program should be increased, we recommend that this increase be funded from SDWA.

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## PUBLIC UTILITIES COMMISSION (8660)

The California Public Utilities Commission (CPUC) is responsible for the regulation of privately owned “public utilities,” such as gas, electric, telephone, and railroad corporations, as well certain passenger and household goods carriers. The CPUC’s primary objective is to ensure adequate facilities and services for the public at equitable and reasonable rates. The CPUC also promotes energy conservation through its various regulatory decisions.

**Proposed Funding.** The budget proposes CPUC expenditures of \$1.3 billion in 2007-08, mostly from various special funds. This is a decrease of \$4.8 million from the current year due, in part, to the elimination of a one-time expenditure in the Teleconnect Program that occurred in the current year. The budget also proposes \$1.3 million and 2.9 positions to implement the CPUC’s greenhouse gas emissions reduction efforts (please see our analysis of “Implementation of “AB 32”—Global Warming Solutions Act of 2006” in the Crosscutting Issues section of this chapter); \$2.5 million and 2.9 positions to implement the Million Solar Roofs Initiative and the California Solar Initiative; \$950,000 and 10.3 positions to implement the Digital Infrastructure and Video Competition Act; and a number of administratively created new programs as discussed later.

### **Administratively Created New Programs Raise Multiple Concerns**

*The budget proposes funding for two new programs created administratively—one related to electricity market design and the other establishing a utility infrastructure security branch. The programs collectively total \$908,000 in special and federal funds, and five new positions. We think that it is premature to fund both of these programs until the Legislature evaluates their policy merits and authorizes them in statute. In addition, the proposal for a critical utility infrastructure security branch has unclear objectives and highly uncertain funding. We recommend that the Legislature deny both requests. (Reduce Item 8660-001-0462 by \$408,000 and Item 8660-001-0890 by \$500,000.)*

**Electricity Market Design Proposal.** The budget requests one-time funding of \$307,000, mostly for consulting services to design a “wholesale capacity market” for electricity, and \$101,000 (ongoing funds) for one new position to evaluate and plan for the electricity market, both at the wholesale and retail levels. A capacity market is a type of market framework where wholesale generators sell their excess capacity to other generators who have unmet supply requirements. In 2005, the CPUC commissioned a white paper investigating capacity market design, which largely favored the establishment of this type of market.

**Legislature Should Direct Energy Agencies on Market Design.** While the electricity market has seen increased stability recently, the Legislature continues to evaluate issues, such as whether consumers should have “direct access” to the energy provider of their choice, the resolution of which could result in changes to the market structure in future years.

While there may be merit to the idea of a capacity market design, we believe that market design is a policy issue that should be evaluated by the Legislature. In evaluating market mechanisms, the Legislature would be in a position to consider the role of *all* state energy agencies and all types of energy providers, not just those under the regulatory jurisdiction of CPUC.

We think it is premature and beyond the jurisdiction of CPUC to begin investigation and evaluation of a market design without further statutory direction from the Legislature. We therefore recommend the Legislature deny the budget request.

**Critical Utility Infrastructure Security Branch Proposal.** The budget proposes \$500,000 (federal funds) and four positions for a new Critical Utility Infrastructure Security branch at CPUC. The proposed branch would coordinate state activities for disaster preparedness, response, and recovery for utilities under a federal Department of Homeland Security program. Other state agencies eligible to participate in this federal effort include all state and local law enforcement authorities, the Office of Homeland Security, the Office of Emergency Services, and the Governor’s Emergency Operations Executive Council. There are no other state regulatory agencies included in the proposal.

Based on our review of the commission’s proposal, we found the proposed duties of the new branch are often very broad, typically vague, and lacking a clear purpose. The commission has stated that municipal utilities, currently not regulated by CPUC, would be included in this program. The inclusion of municipal utilities is an expansion of authority for the commission.



We also find that the federal funding proposed to support this new program is highly uncertain. According to the commission, there is no certainty that federal funds will be allocated to this effort, and those federal funds the commission has identified as potentially available may require matching state funds. Given the uncertainty of federal funding, the lack of clear duties, and an apparent expansion of the commission's jurisdiction without statutory authorization—we recommend the Legislature deny the request.

### **High Fund Balance in Universal Service Telephone Program Fund Allows for Ratepayer Relief**

*The California High-Cost Fund-B Administrative Committee Fund—one of the commission's six universal service telephone program funds—has a projected fund balance of \$333.5 million at the end of the budget year. This fund balance has remained high for several years. We recommend that the commission report at budget hearings on (1) a plan to phase out and eliminate the telephone surcharge and (2) when it intends to submit a report on the statutorily required review of the program. Pending receipt of the report, we recommend that the Legislature withhold action on the program's budget.*

**High-Cost Fund-B Program Established in 1996.** In October 1996, the commission established a program to provide subsidies to larger telephone companies serving high cost areas. The purpose of the program was to reduce the disparity in rates charged by these telephone companies. The program is referred to as the California High-Cost Fund-B Administrative Committee Fund (CHCF-B) Program.

The subsidies have been paid to such service carriers as the currently named Frontier, Verizon, and SureWest, among others. Though it is difficult to evaluate how the subsidies have been used due to a lack of reporting by the commission, the program expenditures continue to serve such areas as Malibu, Roseville, and Elk Grove. While some of the geographic area covered under the program may have been difficult to reach and therefore were considered a higher cost area in 1996, these areas today may no longer be difficult to serve with new technologies. The authorizing legislation that established CHCF-B sunsets January 1, 2009, at which time the subsidies would be discontinued.

**Surcharge Rate Has Varied, Substantial Fund Balances Have Developed.** The CHCF-B is funded by a surcharge on telephone bills collected by telecommunications carriers. Customers who have services (such as "call waiting" or "caller ID") on their phones pay this charge on their bill. The budgeted surcharge rate—which is set administratively by the commission by resolution—has varied significantly from a high of 3.8 percent

on the cost of services in 1999 to a low of 1.4 percent in 2002. Currently, the rate is 2 percent.

Revenues and expenditures have varied widely as a result of these rate changes. In the first eight years of the program, over \$3 billion in subsidies were paid to carriers, mostly four companies, to provide affordable rates in hard-to-service areas. In recent years, a substantial fund balance has developed in the program, as revenues have consistently exceeded expenditures. While the budget projects a \$333.5 million balance in the fund at the end of the budget year, the balance would actually be much higher were it not for a \$250 million loan to the General Fund made from the fund in 2002. (There is no specified repayment date for this loan.)

***Fund Condition and Impending Sunset of Program Allows for Ratepayer Relief.*** We think that the magnitude of the fund balance projected to remain in CHCF-B at the end of the budget year, combined with the impending sunset of the CHCF-B program in 2009, affords the commission an opportunity to eliminate the surcharge that supports the fund for the remainder of the program's life. We therefore recommend that the commission present a plan to the Legislature at budget hearings to phase out by January 1, 2008, the telephone bill surcharge that supports the fund.

***Statutorily Required Review of Program Long Overdue.*** Chapter 847, Statutes of 2004 (SB 1276, Bowen), required CPUC to conduct a review of the CHCF-B program by January 1, 2006. The review requirement was prompted by concerns of the commission's Office of Ratepayer Advocates about the program's cost-effectiveness. Specifically, the review was required to (1) adjust subsidy payments to carriers to reflect updated operating costs and (2) evaluate whether subsidy levels could be reduced while still meeting the goals of the program. This review has not been completed and thus it is difficult for the Legislature to evaluate the appropriateness of the proposed expenditures for subsidies. We recommend CPUC report at budget hearings on when it intends to deliver this report. Pending receipt of the report, we recommend the Legislature withhold action on the overall program budget.

## **Climate Change Proposal Contrary to Legislative Direction**

In our analysis of "Implementation of "AB 32"—Global Warming Solutions Act of 2006" in the "Crosscutting Issues" section of this chapter, we address a CPUC request to establish a "cap-and-trade" market mechanism for utilities as a greenhouse gas emission reduction strategy. We find the proposal moves ahead of the statutorily directed effort at the California Air Resources Board, and recommend the Legislature deny the budget request.

# FINDINGS AND RECOMMENDATIONS

## *Resources*

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### Crosscutting Issues

#### *Resources Bonds*

- B-18     ■     **Pre-2006 Resources Bond Fund Conditions.** The budget proposes about \$530 million of program expenditures from the five resources-related general obligation (GO) bonds approved by the voters between 1996 and 2002. Funds for park projects and land acquisition and restoration have essentially been depleted.
- B-19     ■     **Major Provisions of Propositions 1E and 84.** Proposition 1E authorizes the state to sell \$4.1 billion in GO bonds for various flood management purposes. Proposition 84 authorizes the state to sell \$5.4 billion in GO bonds for safe drinking water, water quality, and flood control; natural resource protection; and park improvements.
- B-20     ■     **Governor’s Budget Proposes Over \$1.7 Billion From Propositions 1E and 84.** The budget proposes \$624 million of Proposition 1E expenditures and \$1.1 billion of Proposition 84 expenditures in 2007-08.
- B-22     ■     **Issues for Legislative Consideration.** The Legislature should consider a number of issues when evaluating the Governor’s budget proposals to ensure the effective and efficient implementation of Propositions 1E and 84. These issues concern

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retaining legislative oversight of bond expenditures, defining funding eligibility, ensuring that administrative costs are reasonable, addressing issues of state-local cost sharing and federal funding, and coordinating similar programs across bonds.

- B-34 ■ **New Water Management Bond Proposed.** As part of his Strategic Growth Plan, the Governor has proposed a \$4 billion water management GO bond to be submitted for voter approval in 2008.

***CALFED Bay-Delta Program (CALFED)***

- B-38 ■ **CALFED Reorganization.** The CALFED was significantly reorganized by the Legislature in 2006, in an effort to improve accountability for the program's performance.
- B-39 ■ **Little Progress in Implementing Beneficiary Pays Principle.** The budget does not include any proposals to implement the beneficiary pays funding principle.
- B-42 ■ **Performance Measures Should Tie to Budget.** Recommend adoption of supplemental report language requiring report on chosen performance measures and to tie performance measures to budget.
- B-45 ■ **South Delta Improvements Program Funding Premature. Reduce Item 3860-301-6026 by \$14.4 Million. Reduce Item 3860-301-6031 by \$17 Million.** Recommend the Legislature deny the funding proposal as it is premature, due to lack of submittal of legislatively required report, lack of secured cost-sharing arrangements, and recent concerns raised by federal wildlife agencies that create uncertainty about program's future.

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- B-46 ■ **CALFED Surface Storage Feasibility Studies Lack Needed Matching Funds to Move Forward. Reduce Item 3860-001-6031 by \$3.8 Million. Reduce Item 3860-001-6051 by \$6 Million.** The CALFED surface storage program has reached a point where feasibility studies cannot move forward until funding partners have been secured to move the studies into the final investigation stage and project development. Recommend denying the budget request, pending the commitment of local and/or federal funding to complete the studies.
- B-48 ■ **Planning Effort Benefiting Water Exporters Should Be Paid by Them. Reduce item 3600-001-6051 by \$1.7 Million.** Recommend denial of budget request to use Proposition 84 bond funds to pay to develop a Natural Communities Conservation Plan for the Delta, as plan directly benefits Delta water exporters and should be paid by them.

***Implementation of “AB 32”—Global Warming Solutions Act of 2006***

- B-51 ■ **The Global Warming Solutions Act of 2006.** The act charges the Air Resources Board (ARB) with monitoring and regulating the state’s sources of greenhouse gas (GHG) emissions to limit them, by 2020, to 1990 levels.
- B-54 ■ **Governor’s Budget Proposal.** Budget proposes \$35.8 million (mostly special funds) and 151 positions at various departments to implement the act.
- B-56 ■ **Secretary’s Request Goes Beyond Coordination. Reduce Item 0555-001-0115 by \$1.4 million.** Recommend deletion of \$1.4 million from the Air Pollution Control Fund because request expands Secretary’s role beyond coordination to include technical staffing and contracted services of a programmatic nature.

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- B-57     ■     **California Public Utilities Commission Funding Proposal Premature, Contrary to Legislative Direction. Reduce Item 8660-001-0462 by \$1.3 million.** Recommend denial of \$1.3 million to conduct climate change-related proceedings and research as it moves ahead of the statutorily directed efforts at ARB.
- B-58     ■     **Make ARB's Positions Related to Market-Based Mechanisms Limited Term.** Recommend 24 positions requested for ARB related to market-based mechanisms be for a three-year limited term. Further recommend adoption of budget bill language prohibiting funding for implementation of market mechanisms until the board has evaluated them and submitted a report for legislative review.
- B-61     ■     **Funding Proposal Is Not Sustainable.** Recommend administration report at budget hearings on its long-term funding plans for state's GHG emissions reduction activities. Further recommend adoption of supplemental report language requiring long-term funding plan to be submitted in conjunction with the *2008-09 Governor's Budget*.

***Funding the San Joaquin River Restoration Settlement***

- B-63     ■     **State Should Withhold Funding for San Joaquin River Restoration Until Other Funding Sources Are Secure. Reduce Item 0540-001-6051 by \$13,869,000. Reduce Department of Fish and Game Reimbursements by \$1,185,000. Reduce Department of Water Resources Reimbursements by \$12,684,000. Reduce Item 3860-001-6027 by \$265,000.** Recommend the Legislature delete funding for restoration activities in the budget year and await secure funding commitments from the responsible parties in a lawsuit settlement before committing state funds. If the administration wishes to proceed with the memorandum of understanding it has signed with the settling parties, it should sponsor a policy bill

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to ratify the agreement, allowing the Legislature to consider the appropriate role for the state in the restoration.

**Elimination of Energy-Related Agencies**

- B-68 ■ **Elimination of California Consumer Power and Conservation Financing Authority (CPA) Appropriate.** Recommend Legislature approve elimination of CPA and transfer of remaining funds to the Energy Commission to repay loans.
- B-69 ■ **Electricity Oversight Board (EOB) Elimination Needs Legislative Direction.** Recommend administration present, at budget hearings, its plan for assigning the board's duties and workload to other state agencies. Recommend deletion of budget bill language authorizing the Director of Finance to reduce EOB's appropriations, pending legislative determination of the assignment of EOB duties and workload.

**Energy Resources Conservation and Development Commission**

- B-72 ■ **Legislature Should Direct Use of Williams Energy Settlement Funds Through Policy Bill. Eliminate Transfer Item 3360-011-3061 for \$24,796,000.** Recommend the Legislature (1) deny the Governor's proposal because it does not follow previous legislative intent and (2) enact legislation that directs the use of the settlement funds and contains an appropriation for such use.
- B-74 ■ **Statutory Changes to Renewables Program May Be Needed.** Recommend the Legislature hold joint policy and budget hearings to review the state's progress in meeting the Renewables Portfolio Standard, and to consider the commission's proposals to improve the effectiveness of its renewable energy program, some of which may require statutory changes.

**Analysis****Page****Department of Forestry and Fire Protection**

- B-77 ■ **State's Wildland Firefighting Costs Continue to Increase.** State's cost for wildland fire protection continues to increase, reflecting increasing development in and around wildland areas and increasing labor costs. Recommend enactment of legislation clarifying the state's fiscal responsibility for fire protection in state responsibility areas (SRA). Also, recommend adoption of fire protection fees to partially offset state costs for fire protection. Further recommend Legislature consider revising criteria for designating SRA boundaries.
- B-86 ■ **Expansion of Department's Capital Outlay Project Management Should Be Limited.** Recommend revision to proposed budget bill language by deleting department's authority to manage the Red Bluff/Tehama Glenn Unit Headquarters replacement project.
- B-89 ■ **Energy Commission Should Direct Public Funding Support for Energy Projects. Reduce Item 3540-101-6051 by \$4.1 Million and Reduce Item 3540-001-6029 by \$296,000.** Recommend deletion of Proposition 84 funds proposed for support of biomass utilization projects, as support for such energy-generating facilities should be evaluated by California Energy Commission. Recommend deletion of bond funding for regulatory activities.

**State Lands Commission**

- B-92 ■ **Again No Progress in Commission's Management of School Land Bank Fund.** We recommend the adoption of trailer bill language to transfer either all or a portion of the fund balance and proceeds from future land sales to the Teachers' Retirement Fund.



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**Analysis****Page****Department of Fish and Game**

- B-96     ■     **Department’s Fiscal Management Improving; Budget Transparency Still Needs Work. Reduce Item 3600-001-0200 by \$528,000.** Recommend the department report at budget hearings on potential revisions to its fund condition statements. Also recommend reduction of \$528,000 to provide a prudent balance in one specific Fish and Game Preservation Fund account.
- B-100    ■     **One-Time Funds for Marine Life Management Inadvertently Remain in Budget. Reduce Item 3600-001-0001 by \$2 Million.** Recommend deletion of one-time funds from current year that inadvertently remain in budget.

**Department of Parks and Recreation**

- B-102    ■     **Budget Fails to Address Growing State Parks Deferred Maintenance Backlog. Increase Item 3790-001-6051 by \$160 Million. Increase Item 3790-001-0392 by \$15 Million.** Recommend the Legislature appropriate \$160 million from Proposition 84 bond funds for deferred maintenance to backfill a proposed General Fund reversion and adopt budget bill language ensuring consistency with general obligation bond law. Recommend Legislature withhold approval of requested positions to administer existing funding for deferred maintenance. Recommend adoption of supplemental report language requiring the department to develop a plan to maximize the use of nonstate funding sources to fund deferred maintenance projects. Recommend the Legislature augment the department’s maintenance budget by \$15 million per year and adopt budget bill language directing the department to raise park fees by a similar amount.

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- B-108 ■ **Administration of Bond Funds for Local Parks Should Be Consolidated. Reduce Item 2240-101-6071 by \$30 Million; Reduce Item 2240-001-6071 by \$685,000; Reduce Reimbursements in Item 3790 by \$350,000; Increase Item 3790-101-6071 by \$30 Million.** Recommend enactment of legislation to (1) consolidate Propositions 1C and 84 bond-funded local park programs in the department and (2) specify allocation of Proposition 1C funds for local parks. Recommend the department report at budget hearings on its plan to spend Proposition 84 local park funds.
- B-110 ■ **State Parks and Recreation Fund Reserve Imprudent.** Recommend department report at budget hearings on its plan to provide a reasonable year-end reserve, considering both potential expenditure reductions and revenue increases.
- B-111 ■ **Concession and Operating Agreement Proposals.** Recommend Legislature withhold approval of two of the five concession and operating agreement proposals, pending delivery of a final economic feasibility study and determination of final agreement terms.

**Sierra Nevada Conservancy**

- B-114 ■ **Conservancy Has Yet to Adopt Guidelines for Awarding of Grants.** Recommend Legislature withhold action on budget request for \$17.5 million for new bond-funded grant program until conservancy submits information at budget hearings that details guidelines by which grant funds will be awarded.

**Department of Water Resources**

- B-117 ■ **New Bonds Provide Funding Influx.** Propositions 1E and 84 together allocate \$6.4 billion to the department, of which \$4.9 billion is for flood control.

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- B-119    ■    **Budget Proposal.** The budget proposes increases totaling \$12.5 million for flood management state operations, and \$147.1 million in bond funds and reimbursements for flood control capital outlay.
- B-124    ■    **Flood-Related Capital Outlay Legislative Oversight.** Recommend Legislature withhold action on flood-related capital outlay projects until department (1) submits required Proposition 1E expenditure plan, (2) reports on its prioritization method for selecting projects, and (3) provides a plan for independent review and oversight of capital outlay projects. Further, recommend enactment of legislation requiring regular, periodic reporting on flood control-related capital outlay projects.
- B-126    ■    **AB 142 Spending Needs Scrutiny; Opportunity for General Fund Savings.** Unspent funds from a \$500 million General Fund appropriation for flood control in 2006 (AB 142) offer opportunity for General Fund savings. Recommend Legislature hold joint policy and budget hearings to review AB 142 spending to date.
- B-129    ■    **Recommend State Water Project (SWP) Be Brought “On Budget.”** The SWP’s “off-budget” status for all expenditures complicates legislative evaluation of budget request for 78 new positions. Recommend the enactment of legislation to bring SWP on budget to facilitate legislative oversight of the state’s water issues.

**California Integrated Waste Management Board**

- B-131    ■    **Legislature Needs Board’s Assistance to Identify Ways to Increase Waste Tire Diversion.** Recommend adoption of supplemental report language requiring board to report on options available to increase the rate of diversion of waste tires from landfills.

**Analysis****Page****State Water Resources Control Board (SWRCB)**

- B-139 ■ **Information Technology (IT) Projects Need Legislative Oversight.** We make a number of recommendations to improve legislative oversight, including the adoption of budget bill language halting funding for new IT projects, requiring annual reporting of an IT implementation plan, and requiring the board to update its IT strategic plan. We also recommend that the board report at budget hearings on data backlogs at the regional boards and submit the findings of an IT-related external review to the Legislature.
- B-143 ■ **Water Rights Fee Funding Uncertain.** Recommend Legislature withhold action on the budget for the water rights program pending an update from SWRCB at budget hearings on the status of litigation on the water rights fees.

**Office of Environmental Health Hazard Assessment**

- B-145 ■ **Office Has Important Role in State's Safe Drinking Water Regulation.** The Office of Environmental Health Hazard Assessment (OEHHA) develops public health goals (PHGs)—a scientific assessment of the risks to human health posed by contaminants that may be found in the state's public drinking water systems. The Department of Public Health regulates those contaminants through its drinking water program using the PHGs as the scientific basis for its regulatory standards.
- B-147 ■ **Shift Support for Public Health Goal (PHG) Program to Fee Funding. Reduce Item 3980-001-0001 by \$1.84 million. Create New Item 3980-001-0306 for \$1.84 million.** Recommend replacing General Fund monies with monies from fee-funded Safe Drinking Water Account, as an application of the beneficiary pays principle.

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- B-148 ■ **Office Persistently Fails to Meet Statutory Timeframes for PHG Activity.** Recommend OEHHA report prior to budget hearings on resources needed to meet statutory obligations in a timelier manner.

**Public Utilities Commission**

- B-151 ■ **Administratively Created New Programs Raise Multiple Concerns. (Reduce Item 8660-001-0462 by \$408,000 and Item 8660-001-0890 by \$500,000.)** Recommend deletion of funding for electricity market design and utility infrastructure security branch proposals. We think that it is premature to fund both of these programs until the Legislature evaluates their policy merits and authorizes them in statute. In addition, the proposal for a critical utility infrastructure security branch has unclear duties and highly uncertain funding.
- B-153 ■ **High Fund Balance in Universal Service Telephone Program Fund Allows for Ratepayer Relief.** The California High-Cost Fund-B Administrative Committee Fund—a universal service telephone program fund—has a projected fund balance of \$333.5 million at the end of the budget year. Recommend that the commission present a plan to the Legislature at budget hearings to phase out and eliminate the telephone bill surcharge that supports the fund by January 1, 2008. Further recommend that the Legislature withhold action on the overall budget for the program, and require the commission to report at hearings on when it intends to submit a report on long overdue statutorily required review of the program.
- B-154 ■ **Climate Change Proposal Contrary to Legislative Direction.** In our analysis of “Implementation of “AB 32”—Global Warming Solutions Act of 2006”, we address a California Public Utilities Commission request to establish a “cap-and-trade” market mechanism for utilities as a greenhouse gas

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emission reduction strategy. We find the proposal moves ahead of the statutorily directed effort at the California Air Resources Board, and recommend the Legislature deny the budget request.



