



February 2, 2016

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative (A.G. File No. 15-0116, Amendment No. 1) that would amend the state Constitution to create an alternative process for local governments to assess fees for flood control, stormwater management, water, and sewer services.

BACKGROUND

Local Government Agencies Provide Most Water-Related Services. Most spending on water programs in the state is done at the local level by local government agencies such as special districts, cities, and counties. These local government agencies provide four major water-related services:

- **Water Service.** Local agencies utilize infrastructure—such as pipes, reservoirs, and water treatment plants—to provide drinking water to households and businesses, as well as to supply water for agricultural purposes—such as irrigation.
- **Sewer Service.** Local governments are responsible for providing sewer services, which include infrastructure and programs to dispose of and treat dry weather runoff, sewage, or wastewater.
- **Flood Control.** Flood control activities include the construction and maintenance of levies and other structures to manage floodwater in order to reduce the risk of flooding of public or private property.
- **Stormwater Management.** Stormwater runoff is generated by rain and snowmelt that flows over land, paved streets, and parking lots, and does not soak into the ground. This runoff picks up pollutants, such as chemicals and oils, that can harm rivers, streams, lakes, and coastal waters. Stormwater management includes infrastructure, projects, and services designed to treat stormwater in order to protect public health and safety and conserve water.

Local Governments Rely on Various Funding Options for Water-Related Services. Local governments pay for water-related projects and services using several revenue sources, including state funds; federal funds; and local taxes, fees, and assessments. We discuss a few of these local funding sources below.

- ***Property-Related Fees.*** A fee is a charge imposed on an individual or business for a service provided directly to that individual or business. The amount of the fee may not exceed the cost to government to provide the service. Under Proposition 218 (1996), property-related fees, such as for water and sewer services, are limited and cannot exceed the *proportional* cost of providing the service to the specific parcel being charged. About 80 percent of local costs for water and sewer services is paid for as fees by individuals as ratepayers of water and sewer bills.
- ***Property Assessments.*** Local governments levy assessments in order to fund improvements that benefit property. Under Proposition 218, improvements funded with assessments must provide a direct benefit to property owners, and the amount each property owner pays must (1) reflect the cost incurred by the local government to provide the benefit and (2) be allocated to each property in proportion to the benefit it receives from the improvement. Flood control services are sometimes funded in part through property assessments.
- ***Special Taxes.*** A tax is called a “special” tax if its revenues are used for specific purposes. Special taxes are sometimes used to fund water-related services.

Processes for Approving Local Property-Related Fees, Assessments, and Special Taxes. Property-related fee increases generally must be approved by a majority vote of the property owners subject to the fee or by a two-thirds vote of the electorate living in the affected area. However, fee increases for sewer and water services are not subject to a public vote. Instead, fee increases for sewer and water services are subject to a public hearing, and if a majority of the affected parcel owners protest, then the fee increase is rejected. Fee increases for flood control and stormwater services are subject to the same vote requirement as most property-related fees, as they are not included in the sewer and water service exemption. To impose a new property assessment, a local government must secure the approval of a weighted majority of affected property owners, with each property owner’s vote weighted in proportion to the amount of the assessment he or she would pay. A special tax requires a two-thirds vote of the electorate for approval.

Recent Court Decision Regarding Tiered Rates. There are various rate structures that are used by the roughly 430 local government agencies that provide an estimated 90 percent of the water delivered in California. One of the most common is a tiered rate. Under a tiered rate, the price for a unit of water changes according to the level of use and tiers can be structured to promote water conservation. In a recent court decision, an appellate court ruled that one city’s tiered rate violated the proportionality requirements for property-related fees. In this case, the city failed to demonstrate that its rate tiers corresponded to the actual cost of providing service on a parcel basis at a given level of usage.

Lifeline Programs. Lifeline programs are programs that reduce the water and sewer service rates charged to low-income households in order to provide them with more affordable services. In order to backfill the revenue decreases from the lower lifeline rates, local government agencies generally either charge higher rates to other households or use other sources of funding.

PROPOSAL

This measure makes several changes to the state Constitution related to how local governments can charge for providing water, stormwater, flood control, and sewer services.

Establishes an Alternative Process for Increasing Water-Related Fees. This measure establishes an alternative process to impose, increase, or extend fees (or certain other charges) for water-related services. The measure prohibits this process from being used for an ad valorem tax (based on property value), a special tax, or an assessment. Under the new process, a local government agency would have to mail notices to all fee payers with information on the amount of the fee and how the fee increase would be calculated, as well as a description of the services, facilities, and improvements that would be funded with the increased revenues. Local government agencies would be required to conduct a public hearing on the proposed fee at least 45 days after mailing the notice. If written protests against the fee are given to the agency by a majority of fee payers, then the agency cannot impose the fee. While this process is largely similar to what currently is required for water and sewer fees, the measure would allow stormwater and flood control fees to follow this process as well. Currently local governments must receive voter approval to levy property-related fees for stormwater and flood control.

Requires Use of Fair or Reasonable Relationship to Costs. The measure requires that the manner in which the increased costs to provide a water-related service are allocated to a fee payer must bear a *fair or reasonable* relationship—a change from the *proportional* requirement under existing law—to the fee payer’s burden or the benefit the payer receives from these services. The local agency would bear the burden of proof in demonstrating that this standard has been met.

Provides Greater Rate-Setting Flexibility. Under the measure, local government agencies could utilize the new fee-setting process to establish rate structures—such as tiered rates—for allocating the cost of water-related services in ways designed to encourage water conservation and discourage excessive use. (As noted earlier, a recent appellate court decision has created uncertainty about how tiered rates must be structured in order to meet the proportionality requirement under existing law.) Local government agencies could also use the new process to establish lifeline programs to reduce fees for lower-income ratepayers, provided that the fee increases are reasonable.

Establishes Requirements for Fiscal Accountability. Any local government agency that uses the measure’s alternative funding method for water-related services would be required to have an independent audit of the receipt and expenditure of the revenues derived from the fee or charge.

FISCAL EFFECTS

Increased Stormwater and Flood Control Revenues and Costs. The measure provides a new process for raising fee revenues to fund flood control and stormwater projects. For these types of projects, the new process would make it easier for local governments to raise revenues, compared to the approval threshold for assessments, special taxes, and property-related fees.

The amount of additional local revenues generated would depend on future actions by local governing boards and voters. Given the estimated statewide need for flood control and stormwater management projects—estimated to be between \$1.3 billion and \$1.8 billion annually—the effect of lower approval threshold for funding for projects could be major. To the extent local agencies utilize the new process, over time, we estimate that it could increase local government revenues and spending by the low hundreds of millions of dollars up to more than \$1 billion annually compared with what otherwise would have occurred. These increased revenues would be used for increased flood control and stormwater services.

Other Potential Fiscal Impacts. The measure changes the requirement for a property-related fee or charge from one where it shall not exceed the *proportional* costs of the service to one where the fee or charge shall bear a *fair or reasonable* relationship to the benefits the fee payer receives. It also allows for the use of greater rate-setting flexibility, including the use of alternative rate structures to promote water conservation. To the extent local government agencies use the flexibility—particularly those providing water and sewer services—it could result in changes in how payers use these services. To the extent this occurs, it would affect local government agencies' costs and revenues.

Summary of Fiscal Effect. The measure would have the following fiscal effect:

- Increased local government revenues and spending for flood control services and stormwater management in the range of low hundreds of millions of dollars up to more than \$1 billion annually, depending on future actions by local governing boards and voters.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
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