

The 2014-15 Budget:

Resources and Environmental Protection



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LAO 

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EXECUTIVE SUMMARY

In this report, we assess many of the Governor's budget proposals in the resources and environmental protection area and recommend various changes. We provide a complete listing of our recommendations at the end of the report.

Total Expenditures Down by 16 Percent—Due to Drop in Bond Spending. The Governor's budget proposes a total of \$8.3 billion in expenditures from the General Fund, special funds, bond funds, and federal funds for resources and environmental protection programs in 2014-15. The proposed budget includes \$3.8 billion for the Department of Water Resources (DWR), \$1.5 billion for the Department of Resources Recycling and Recovery (CalRecycle), and \$1.4 billion for the Department of Forestry and Fire Protection (CalFire), as well as funding for many other departments. This proposed level of funding is a decrease of \$1.6 billion, or 16 percent, below estimated expenditures for the current year, almost entirely from lower bond funds.

Budget Includes Several Major Policy Proposals. The budget includes a cap-and-trade expenditure plan from the administration—totaling \$850 million in 2014-15. (We discuss this proposal in more detail in our report *The 2014-15 Budget: Cap-and-Trade Auction Revenue Expenditure Plan*.) The administration also proposes \$621 million from various fund sources to implement the first phase of its recently released Water Action Plan (WAP). This plan identifies a series of actions the administration believes the state should take over the next five years to address a range of water-related challenges, such as reduced water supply and poor water quality. For example, one WAP activity proposed in the Governor's budget is the transfer of the state's drinking water oversight program from the Department of Public Health (DPH) to the State Water Resources Control Board (SWRCB). Another important issue addressed in the Governor's budget is the roughly \$100 million annual structural deficit in the Beverage Container Recycling Fund (BCRF). The administration proposes to reduce or eliminate several programs currently funded by the BCRF in order to bring the fund into balance. We find that these proposals are generally reasonable approaches to addressing significant policy challenges. We also identify trade-offs in the administration's approach and offer recommendations to allow the Legislature to ensure that proposals are consistent with its priorities.

Opportunities for Legislative Oversight. The Governor's proposed budget raises several issues that we believe merit greater legislative oversight. For example, the budget includes one-time funding of \$43 million from the General Fund to address deferred maintenance at the Department of Parks and Recreation (DPR) and CalFire facilities. We find that while it makes fiscal sense to address deferred maintenance, there is uncertainty about what factors have contributed to the large amount of deferred maintenance in these departments, as well as how the state can best address maintenance needs on an ongoing basis. Similarly, the budget includes a total of \$4.6 million for the Department of Toxic Substances Control (DTSC) to implement changes designed to address several operational problems, including backlogs in updating hazardous waste permits. We find that the funding requested will not be sufficient to fix all of the issues identified on an ongoing basis. This finding raises questions about how the department will manage these problems in out years.

2014-15 BUDGET

OVERVIEW OF GOVERNOR’S BUDGET

Governor’s Budget Proposal

Total Spending Down by 16 Percent. The Governor’s budget for 2014-15 proposes a total of \$8.3 billion in expenditures from various fund sources—the General Fund, various special funds, bond funds, and federal funds—for programs administered by the Natural Resources and Environmental Protection Agencies. This level is a decrease of \$1.6 billion, or 16 percent, below estimated expenditures for the current year. The proposed reduction in spending is related to bond funds. Specifically, the budget proposes bond expenditures totaling about \$1.4 billion in 2014-15—a decrease of \$1.9 billion, or about 58 percent, below estimated bond expenditures in the current year.

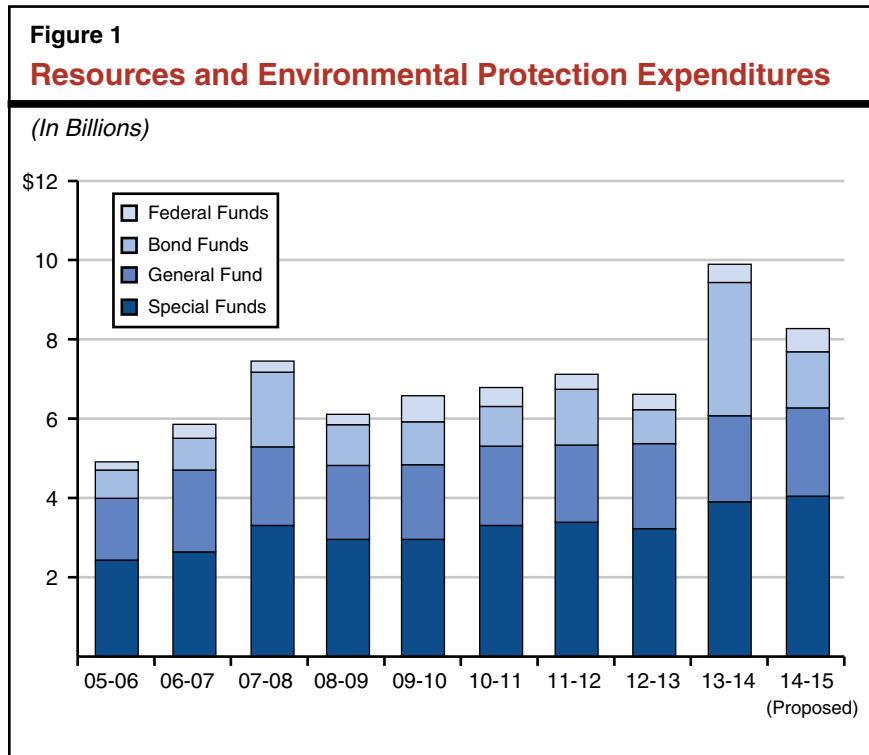
Multiple Funding Sources; Special Funds Predominate. The largest amount of state funding for resources and environmental protection programs in the budget year—about \$4 billion (or 49 percent)—would come from various special funds. This reflects an increase of \$142 million, or 4 percent, when compared to estimated special fund expenditures in the current year. The primary special funds that support resources and environmental protection programs include funds generated by beverage container recycling deposits and fees, an “insurance fund” for the cleanup of leaking underground storage tanks, the Fish

and Game Preservation Fund, and cap-and-trade auction revenues.

General Fund Spending Grows Slowly.

The Governor’s budget includes \$2.2 billion in expenditures from the General Fund (27 percent of total expenditures) in 2014-15 for resources and environmental protection programs. This is a net increase of \$54 million, or 2 percent, from 2013-14, reflecting both General Fund spending increases and decreases. The largest General Fund proposal in these programs is a proposed \$14 million increase for CalFire to increase fire protection services in Lake Tahoe, San Bernardino, and Riverside.

Overall Expenditure Trends. Figure 1 shows total expenditures for resources and environmental protection programs from all funding sources since 2005-06. As indicated in the figure, total spending generally has grown steadily between 2005-06 and 2013-14, averaging roughly a 9 percent



annual increase. The increase is mainly due to the availability of a greater amount of special fund revenues. The availability of bond funds also resulted in spikes in spending in certain fiscal years, such as in 2007-08 and 2013-14. As indicated above, the proposed reduction in total expenditures in 2014-15 primarily reflects a lower-than-expected level of bond expenditures.

Spending by Major Resources Programs

Figure 2 shows spending by selected fund sources for the state's major resources programs and departments—that is, programs within the

jurisdiction of the Natural Resources Agency. As the figure shows, total spending proposed for most resources programs is generally down in 2014-15, resulting from a reduction in bond fund expenditures. For example, the budget proposes a reduction of \$1.3 billion, or 63 percent, in bond spending for DWR.

Despite an overall decline in proposed bond spending for resources programs, the budget includes the appropriation of new bond funds in 2014-15 for both existing and new programs. For example, the budget proposes to spend \$473 million in bond funds from Proposition 84

Figure 2

Major Resources Budget Summary—Selected Funding Sources

(Dollars in Millions)

Department	Actual 2012-13	Estimated 2013-14	Proposed 2014-15	Change From 2013-14	
				Amount	Percent
Water Resources					
General Fund	\$91.6	\$100.2	\$100.9	\$0.7	0.7%
State Water Project funds	1,180.8	1,558.9	1,896.6	337.6	21.7
Bond funds	361.5	2,015.8	744.4	-1,271.4	-63.1
Electric Power Fund	937.8	988.6	956.4	-32.2	-3.3
Other funds	50.9	127.8	94.9	-32.9	-25.7
Totals	\$2,622.5	\$4,791.3	\$3,793.2	-\$998.1	-20.8%
Forestry and Fire Protection					
General Fund	\$859.2	\$721.9	\$777.6	\$55.8	7.7%
Other funds	469.0	538.5	663.0	124.5	23.1
Totals	\$1,328.2	\$1,260.3	\$1,440.6	\$180.3	14.3%
Parks and Recreation					
General Fund	\$110.3	\$117.6	\$115.9	-\$1.7	-1.4%
Parks and Recreation Fund	117.1	141.5	169.7	28.3	20.0
Bond funds	179.1	146.3	89.9	-56.4	-38.6
Other funds	157.7	312.6	279.2	-33.4	-10.7
Totals	\$564.3	\$718.1	\$654.8	-\$63.2	-8.8%
Fish and Wildlife					
General Fund	\$61.1	\$63.5	\$63.6	\$0.1	0.1%
Fish and Game Fund	92.3	115.8	113.3	-2.6	-2.2
Bond funds	27.1	91.9	16.6	-75.3	-81.9
Other funds	154.5	184.6	210.5	25.8	14.0
Totals	\$335.0	\$455.9	\$404.0	-\$52.0	-11.4%
Conservation					
General Fund	\$3.6	\$3.0	\$3.0	—	0.1%
Bond funds	25.3	48.6	2.4	-\$46.2	-95.0
Other funds	57.4	73.2	88.1	14.9	20.4
Totals	\$86.3	\$124.8	\$93.5	-\$31.3	-25.1%

for grants to local agencies for multibenefit water projects through the Integrated Regional Water Management (IRWM) program. The budget also proposes \$77 million in bond funds from Propositions 1E and 84 for flood control projects, planning, and emergency response activities. The only major resources department with an increase in total funding proposed in the Governor's budget is CalFire, which is proposed to receive an increase of \$180 million, 14 percent, over estimated current-year expenditures. This includes a \$14 million General Fund increase to expand its fire protection service area as described above, as well

as \$50 million from cap-and-trade auction revenues to implement several programs designed to reduce greenhouse gas (GHG) emission levels.

Spending by Major

Environmental Protection Programs

Similar to Figure 2, Figure 3 shows spending and fund source information for the major environmental protection programs—those within the jurisdiction of the California Environmental Protection Agency (CalEPA). The proposed budget for CalRecycle includes a \$31 million reduction in the BCRF from a proposal to

Figure 3

Major Environmental Protection Budget Summary—Selected Funding Sources

(Dollars in Millions)

Department	Actual 2012-13	Estimated 2013-14	Proposed 2014-15	Change From 2013-14	
				Amount	Percent
Resources Recycling and Recovery					
Beverage container recycling funds	\$1,216.3	\$1,193.5	\$1,143.2	-\$50.2	-4.2%
Other funds	244.2	282.8	328.5	45.7	16.1
Totals	\$1,460.5	\$1,476.3	\$1,471.8	-\$4.6	-0.3%
State Water Resources Control Board					
General Fund	\$14.5	\$15.0	\$22.6	\$7.6	50.9%
Underground Tank Cleanup	233.9	281.5	233.2	-48.3	-17.2
Waste Discharge Fund	100.5	109.9	116.0	6.1	5.6
Bond funds	33.1	144.6	187.1	42.5	29.4
Other funds	71.2	231.6	453.7	222.0	95.8
Totals	\$453.2	\$782.7	\$1,012.7	\$230.0	29.4%
Air Resources Board					
Motor Vehicle Account	\$113.7	\$121.5	\$128.1	\$6.6	5.4%
Air Pollution Control Fund	140.0	125.7	114.4	-11.3	-9.0
Greenhouse Gas Reduction Fund	—	31.3	204.7	173.3	553.5
Bond funds	19.0	135.9	240.0	104.1	76.6
Other funds	69.9	137.8	114.1	-23.7	-17.2
Totals	\$342.7	\$552.2	\$801.3	\$249.1	45.1%
Toxic Substances Control					
General Fund	\$21.4	\$21.8	\$21.2	-\$0.6	-2.6%
Hazardous Waste Control	44.7	52.1	55.7	3.6	7.0
Toxic Substances Control	43.6	43.7	44.1	0.3	0.8
Other funds	93.0	86.1	74.4	-11.7	-13.6
Totals	\$202.7	\$203.6	\$195.3	-\$8.3	-4.1%
Pesticide Regulation					
Pesticide Regulation Fund	\$71.8	\$79.3	\$80.2	\$0.9	1.2%
Other funds	6.6	3.1	3.1	—	0.3
Totals	\$78.4	\$82.4	\$83.3	\$0.9	1.2%

implement various financial reforms designed to fix an ongoing structural deficit in the fund. The budget also proposes to transfer responsibility for administering the state's drinking water regulation program from DPH to the SWRCB and shifts \$202 million (primarily in federal and various special funds) to the board for these activities. The proposed 2014-15 budget for the Air Resources

Board (ARB) includes (1) about \$200 million from cap-and-trade revenues (GHG Reduction Fund) to expand incentive programs designed to promote clean transportation, and (2) a \$240 million reappropriation of Proposition 1B funds to support local agencies' efforts to reduce emissions from goods movement sources, such as diesel trucks, trains, and ships.

CROSSCUTTING ISSUES

Hydraulic Fracturing and Other Well Stimulation—Implementation of SB 4

Background

Hydraulic fracturing and acid matrix stimulation are two types of well stimulation techniques used to increase the production of oil and gas. Typically, hydraulic fracturing relies on injecting a mixture of high-pressure water, sand, and chemicals deep into underground geologic formations. Acid matrix stimulation utilizes the injection of one or more acid mixtures into an underground geologic formation. Of the roughly 42,000 active wells in California, it is estimated that on average between 1,000 and 2,000 wells will likely undergo one or more of these types of well stimulation activities each year.

Chapter 313, Statutes of 2013 (SB 4, Pavley), commonly referred to as SB 4, requires the regulation of oil and gas well stimulation treatments such as hydraulic fracturing. The legislation requires, among other things, the development of regulations (which we discuss in more detail below), a permitting process, and public notification and disclosure of wells that will undergo hydraulic fracturing and acid matrix stimulation and the types of chemicals used for

these processes. The legislation also states that workload associated with its implementation can be funded by the Oil, Gas, and Geothermal Administrative Fund (OGGAF). The OGGAF is funded through a fee administered by the Division of Oil, Gas, and Geothermal Resources (DOGGR) within the Department of Conservation. The fee is designed to recover the division's costs to regulate oil and gas extraction in the state. The fee is currently assessed at \$0.14 per barrel of oil produced or 10,000 cubic feet of natural gas produced in the state.

Among its regulatory requirements, SB 4 requires DOGGR to adopt rules and regulations by January 2015 regarding the construction of wells and well casings, as well as the disclosure of the composition and disposal of well stimulation fluids. As part of the regulations, DOGGR must require well operators to apply for a permit prior to performing well stimulation activities, which must be posted on a publicly accessible portion of DOGGR's website. The regulations must also include provisions for random inspections by DOGGR during well stimulation activities. In addition, SB 4 requires DOGGR to provide a progress report to the Legislature by April 1, 2014.

Senate Bill 4 also requires that groundwater monitoring be performed in areas that have well stimulation activity, in order to detect if

groundwater is contaminated. Specifically, the legislation requires SWRCB to (1) provide guidance to DOGGR on the development of regulations for wells where groundwater could be affected, (2) develop criteria specifying requirements for groundwater monitoring in areas with well stimulation activities and a plan for monitoring groundwater based on those criteria by July 1, 2015, and (3) begin monitoring groundwater by January 1, 2016. Senate Bill 4 also requires well owners and operators to develop groundwater monitoring plans if they are in an area which is not monitored by SWRCB. In addition, SB 4 requires DOGGR to enter into formal agreements with multiple departments (including the ARB and DTSC), in order to delineate roles and responsibilities related to its implementation.

Governor's Budget

The Governor's budget includes proposals in three departments for workload related to the regulation of hydraulic and acid matrix fracturing. In total, the administration requests \$20.5 million from the OGGAF and 85 positions in 2014-15. Of this total, \$19.9 million and 80 positions are proposed to be ongoing. The Governor's budget reflects an increase of \$23 million in OGGAF revenue based on an assumed increase in the regulatory fee administered by DOGGR to pay for these additional costs. At the time of this analysis, it is uncertain how such a fee increase will be assessed. Specifically, the administration proposes adjustments for the following departments.

- **DOGGR.** The Governor's budget requests 60 permanent positions, 5 limited-term positions, and \$13 million in 2014-15 (\$9.2 million ongoing) for DOGGR to regulate well stimulation techniques. The bulk of these positions would be used for engineering and geological workload,

such as monitoring compliance with state regulations at extraction sites.

- **SWRCB.** The budget requests \$6.2 million and 14 positions in 2014-15 for SWRCB to develop the groundwater monitoring criteria and plan, as well as to evaluate compliance by well owners and operators who develop their own groundwater monitoring plans. It also includes funding for contracts to perform groundwater monitoring. The request for SWRCB would increase to \$9.4 million in 2015-16, which is primarily due to additional costs related to groundwater monitoring contracts.
- **ARB.** The Governor's budget requests six positions and \$1.3 million for ARB to develop regulations to control and mitigate GHG emissions, "criteria pollutants," and toxic air contaminants resulting from well stimulation.

The Governor also proposes budget trailer legislation to address what the administration describes as an inconsistency in SB 4 related to groundwater monitoring. Specifically, sections of SB 4 varied in whether it required SWRCB to "review" or "approve" groundwater monitoring plans developed by well owners and operators. The proposed legislation would specifically require SWRCB to review—rather than approve—monitoring plans. According to the administration, this change is necessary in order to clarify DOGGR's role as the lead state agency responsible for preparing environmental impact reports. Finally, the administration states that it may also propose budget trailer legislation to clarify how the fee increase will be assessed in order to generate the additional revenue reflected in the proposed budget to fund the requested proposals.

LAO Assessment

The Governor's proposals raise several issues for legislative consideration. First, as indicated above, while SB 4 states that monies from the OGGAF can be used for costs associated with the implementation of the bill, the administration has not yet determined how the fee increase will be assessed. The administration is currently considering two options, either (1) increasing the per barrel fee on all production in the state, or (2) assessing a fee increase just on those wells that undergo well stimulation. This is a policy choice on which SB 4 was silent, and there are trade-offs with each option. On the one hand, assessing the fee on all in-state production would spread the costs over many more parties, thus reducing the fee burden associated with regulating any single well. However, this would mean charging some oil producers for the costs associated with the regulation of an activity in which they are not engaged. On the other hand, if the fee increase were levied solely on those entities that are using well stimulation, it would be more expensive for those producers. Based on the cost proposals from the administration, we estimate that if the fee were only charged to those entities performing well stimulation each year, the average cost would be around \$10,000 to \$20,000 per well, though the exact amount paid by any individual driller or operator might vary depending on the number of wells which undergo well stimulation.

Second, it appears that the SWRCB request for contract funding in 2014-15 is premature. As indicated above, SWRCB is not required to complete the development of its criteria and monitoring plan until July 1, 2015. In addition, SWRCB cannot begin monitoring groundwater until the criteria and plan are developed. Thus, funding for groundwater monitoring is not needed until 2015-16.

Third, SWRCB's groundwater monitoring and other activities will vary based on a variety of factors, such as how many wells are stimulated, where the stimulated wells are located, and whether well operators/owners perform monitoring themselves. These factors will depend on the criteria and monitoring plan developed by SWRCB. Thus, while SWRCB will almost certainly have workload associated with monitoring and ensuring compliance by well owners and operators in 2015-16, the extent of that workload is unknown until the criteria and monitoring plan are developed. Thus, the number of positions needed to complete that workload in 2015-16 is currently unknown.

Fourth, while we agree with the administration's contention that current law regarding SWRCB's role in reviewing or approving monitoring plans is somewhat inconsistent, the proposed trailer bill language is a policy change that would affect which agency is responsible for approving groundwater plans, as well as who is the lead agency for preparing environmental impact reports. Therefore, the Legislature will want to make sure the proposal reflects its intentions for how groundwater monitoring is carried out.

Finally, the administration's proposal to provide ARB with positions and contract funding to develop regulations to control and mitigate GHG emissions, criteria pollutants, and toxic air contaminants related to well stimulation raises questions regarding legislative intent and workload justification. Senate Bill 4 only requires monitoring of air quality in areas where well stimulation occurs. The legislation does not explicitly direct ARB or any other agency to develop regulations to control or mitigate emissions resulting from well stimulation. Thus, it is unclear if the proposed funding and positions for ARB are consistent with the intent of SB 4. We also note that, under state and federal authority, local air districts currently

regulate emissions from wells. In fact, it appears that some air districts are already monitoring emissions that occur with well stimulation, potentially resulting in some duplication of effort between ARB and local boards. In addition, it is unclear why the Governor's budget is proposing to provide ARB with ongoing resources for activities that primarily constitute one-time workload in developing regulations.

LAO Recommendations

With regards to the administration's hydraulic fracturing request, we recommend that the Legislature:

- **Approve DOGGR Request.** The Governor's request for additional positions for DOGGR to implement SB 4 is justified on a workload basis. We therefore recommend that the Legislature approve 60 permanent positions, 5 limited-term positions, and \$13 million in 2014-15 (\$9.2 million ongoing) to regulate well stimulation techniques.
- **Ensure Proposals Are Consistent With Legislative Intent.** As described above, certain aspects of SB 4 are unclear. The Legislature will want to review these budget proposals to determine whether the administration's interpretations of the requirements in SB 4 are consistent with legislative policy intent. Specifically, the Legislature will want to determine (1) how the proposed fee increase should be assessed—on all oil producers in the state or just those using hydraulic or acid matrix fracturing techniques, (2) if SWRCB should review or approve well owners' groundwater monitoring plans, and (3) what activities it wants ARB and local air districts to perform in implementing

SB 4. The Legislature may want to approve legislation to clarify its intent in some of these cases. In addition, if the Legislature decides that ARB's role should be more limited than is proposed, we recommend ARB's proposal be reduced or rejected to reflect that role.

- **Reduce SWRCB Request.** We recommend that the Legislature deny the request to fund groundwater monitoring contracts (\$3.5 million in 2014-15 and \$7 million in 2015-16) and direct SWRCB to request funding in the 2015-16 budget once its criteria and monitoring plan are complete. In addition, we recommend that the Legislature approve SWRCB's request for 14 positions on a two-year limited-term basis. This would allow SWRCB and the Legislature to reevaluate the need for positions depending on actual workload data following the first year of implementation of the groundwater monitoring plans and other activities.

Deferred Maintenance

Background

Many state departments own and operate their own facilities and other types of infrastructure. Within the resources and environmental protection program area, DPR and CalFire have large amounts of property and physical assets. As shown in Figure 4 (see next page), this includes thousands of miles of trails and tens of thousands of campsites and other facilities spread over 1.6 million acres of park land, as well as nearly 300 fire stations, camps, and bases used to combat forest fires.

It is the responsibility of departments to maintain their infrastructure. Maintenance needs are driven by the number, age, types, and uses of

Figure 4

Department of Parks and Recreation and CalFire Key Assets Maintained

Holdings	Quantity
Department of Parks and Recreation	
Museum objects, archaeological specimens, and archival documents	More than 6,000,000
Acres of land	1,600,000
Campsites	14,421
Archeological sites	10,271
Picnic sites	7,647
Miles of nonmotorized trails	4,456
Historic buildings	3,375
Overnight noncamping facilities	709
Park units	280
Department of Forestry and Fire Protection (CalFire)	
Fire stations	228
Communications tower and vault sites	112
Lookouts	66
Conservation camps	39
Air and helitack bases	22

a department’s infrastructure. The maintenance needs for DPR and CalFire are significant because they have a large quantity of diverse assets, and many of their facilities were built a long time ago. For example, roughly three-fourths of CalFire’s facilities were built prior to 1950. In addition, many facilities were not designed for the amount and type of use required of them today. For example, the older park units operated by DPR were designed for far fewer visitors when they were constructed. Additionally, today’s parks accommodate recreational vehicles and many more group campers than the number for which they were designed. This contributes to deterioration and damage of many park properties and facilities, thereby necessitating more frequent repairs and modifications.

Frequently, preventive and routine facility maintenance does not occur as scheduled. When this happens, it is referred to as “deferred maintenance.” This typically happens due to a lack of funding or resources, the diversion of maintenance funding to other priorities, and

growth in maintenance costs. If maintenance is routinely delayed, a backlog of deferred maintenance forms and grows. Deferred maintenance is problematic because when repairs to key building and infrastructure components are delayed, facilities can eventually require more expensive investments, such as emergency repairs (when systems break down), capital improvements (such as major

rehabilitation), or replacement. Some facilities that are particularly overdue for repairs can even create liabilities for the state. As a result, while deferring annual maintenance avoids expenses in the short run, it often results in substantial costs in the long run. For more information on deferred maintenance and infrastructure, please see our recent report *The 2014-15 Budget: A Review of the 2014 California Five-Year Infrastructure Plan*.

Governor’s Budget

The Governor’s budget for 2014-15 proposes a total of \$43 million (one-time) from the General Fund for deferred maintenance in the natural resources program area. Specifically, the budget includes \$40 million for DPR and \$3 million for CalFire. By comparison, DPR estimates a \$1.2 billion backlog of deferred maintenance and CalFire estimates a backlog of \$27 million. (We note that the DPR estimated backlog in this report differs from that in the Governor’s infrastructure plan and reflects an updated estimate from the department.) Neither department has identified

the specific deferred maintenance projects they would complete with these additional funds. Instead, the Governor proposes budget control language requiring that the administration report to the Joint Legislative Budget Committee the list of deferred maintenance projects (DPR, CalFire, and other state departments) that will be funded 30 days prior to the allocation of funds. (We note that the Department of Fish and Wildlife [DFW] and the California Conservation Corps also expressed a deferred maintenance need of \$15 million and \$1 million, respectively. However, the Governor's proposal does not include deferred maintenance funding for these departments.)

LAO Assessment

Proposal Addresses Clear Problem, but Is Only Partial Solution. The proposed funding for deferred maintenance is reasonable given that the size of the backlog identified by CalFire and DPR is much larger than the funding proposed. However, we find that the proposal for one-time funding is only a partial solution. The \$43 million proposed in the Governor's budget would address only a small fraction—3.5 percent—of the estimated deferred maintenance backlog for CalFire and DPR. More significantly, deferred maintenance, particularly in DPR, appears to be a growing problem. For example, past analyses found that DPR's deferred maintenance backlogs were \$900 million in 2007-08. Therefore, while the proposed funding will reduce deferred maintenance in the short term, the backlog is likely to grow in the future without additional actions.

Unclear How Projects Will Be Prioritized by Departments. As indicated above, it is unclear what specific projects will be undertaken with the proposed funding. At the time of this analysis, DPR and CalFire reported that they were in the preliminary stages of developing their plans for

the use of their allocations and determining which projects they would complete. The departments have identified some general criteria that they would use to prioritize projects, such as safety and building integrity. This could include, for example, installation of smoke detectors, roof repairs, and fixing broken water treatment facilities. Based on our conversations with both DPR and CalFire, there appear to be many more projects that fit these criteria than can be completed with the proposed funding. It is, therefore, unclear how the departments would select among their higher priority projects when making funding decisions.

Proposal Does Not Address Underlying Problems. One-time money, such as the funding provided under the Governor's proposal, can be directed towards the most critical maintenance projects, but it is only a temporary fix if facilities are not maintained in subsequent years. Yet, the state does not currently have a strategy for either (1) reducing the deferred maintenance backlog beyond the budget year, or (2) maintaining parks and CalFire facilities at a sufficient level on an ongoing basis to avoid deferred maintenance in the future. A plan that extends beyond the budget year could ensure that existing assets are maintained in order to continue serving the public in the future. It could also reduce long-term maintenance costs by avoiding the need for unnecessary and expensive facilities investments such as emergency repairs or replacement.

We acknowledge, however, that developing a long-term strategy for eliminating deferred maintenance is difficult for several reasons. For example, it is often difficult to understand the scope of the problem in each department because there are no standard ways to define, track, or prioritize deferred maintenance. This is especially true in the natural resources program area due to the diversity of programs and maintenance needs. In addition, the specific causes for the deferred

maintenance backlog are not always clear. For example, facility and maintenance funding is not specifically identified in the Governor's budget, making it difficult to identify how well aligned resources are with actual need. It is also unknown the degree to which deferred maintenance backlogs have occurred because of decisions made by the departments, such as whether they have historically used their maintenance funding for other purposes when unexpected operational costs occurred. In addition, it is unclear whether the departments' funding for maintenance has increased to meet the additional demand of new or expanded facilities. For example, the number of state parks has grown from around 100 in 1950 to 280 today.

LAO Recommendations

Direct Department to Report on Funding Priorities. We recommend that the Legislature adopt the Governor's proposal, which provides some one-time funding for the most critical deferred maintenance projects. Additionally, we recommend that the Legislature require CalFire and DPR to report at budget subcommittee hearings this spring on the list of projects that they plan to fund and how they would prioritize competing maintenance needs. This would better enable the Legislature to ensure that the priorities identified by the departments align with legislative priorities. For example, the Legislature has sought opportunities for revenue enhancement at state parks in recent years and might prefer to prioritize DPR projects that could increase the amount of park fees collected.

Develop Longer-Term Approach to Fixing DPR's Facility Maintenance Problems. The administration's decision to address deferred maintenance is commendable. However, as discussed earlier, the state currently does not have a strategy for eliminating the remaining deferred

maintenance backlog or a plan to resolve the underlying problem by ensuring that departments are completing necessary routine and preventive maintenance on an ongoing basis. Addressing these issues is challenging, but longer-term planning can reduce future facilities costs and protect valuable state resources. The DPR currently has one of the largest identified deferred maintenance backlogs in the state, and it has been building for many years. Due to these factors, this department might serve as a useful "test case" in how the state can develop a long-term maintenance plan for departments. We recommend that the Legislature request that the administration report at budget hearings on what approach the state might take to develop such a plan. Ultimately, given the scale of the problem and the potential budget implications, it might make sense for there to be a collaborative approach involving not only DPR, but also the Department of Finance (DOF), our office, and other legislative staff.

In order to assist the Legislature and administration in identifying longer-term solutions to DPR's deferred maintenance problem, the state could analyze various factors including: DPR's annual maintenance budget and expenditures, how it tracks maintenance and calculates maintenance need, actual maintenance performed, and the causes of the ongoing backlog. The analysis might also consider whether it makes sense to provide guidelines to the departments on how to classify and track maintenance. The approach could determine the appropriate level of ongoing maintenance funding to maintain facilities at a reasonable level, and tie the estimates to industry benchmarks to the extent possible. While it is difficult to estimate a standard maintenance cost for some park assets given the wide variety of holdings, there are industry standards available for some park infrastructure, such as average maintenance cost per mile of trail or per campsite.

Based on this information, it might be possible to develop a more specific plan to address the deferred maintenance backlog for legislative review.

Water Action Plan

Background

In January 2014, the administration released the WAP, which identifies the state’s main water-related challenges. These include uncertain or scarce water supplies, declining groundwater supplies, poor water quality, declining native fish species, flood risk, and climate change. The WAP lays out more than 60 activities—categorized under ten broad goals—to begin addressing those challenges. Figure 5 lists some of those activities. Nearly all of the activities in the WAP have been recommended in numerous plans and reports issued in recent years by various state departments. These other plans and reports vary in terms of (1) their specific objectives, (2) which agency would be responsible for implementation, (3) the geographic area covered, and (4) the duration of the activities. When compiling the WAP, the administration asked departments to identify activities in those documents that they consider to be achievable in the next five years.

Governor’s Budget Proposal

As shown in Figure 6 (see next page), the Governor’s budget for 2014-15 proposes \$621 million (mostly bond funding) to begin implementing some aspects of the WAP. The administration indicates that for the first year of WAP implementation, it selected expenditures that it considered (1) actionable, (2) affordable, (3) supported by local agencies, (4) necessary to achieve implementation of the plan within five years, and (5) necessary for other activities in the plan to proceed. Below, we describe the most significant budget proposals.

IRWM. The budget proposes \$473 million in one-time bond funds for the IRWM program, which provides grants for water stakeholders within the same region to collaborate on projects that meet multiple water goals, such as improved quality, increased supply, and ecosystem restoration. (We discuss the IRWM proposal in more detail later in this report.)

Flood Protection. The budget proposes \$77 million in one-time bond funds for flood control planning and projects. Of this amount, \$26 million is for improvements to Folsom Dam and \$12 million is for the construction of a facility

Figure 5

Water Action Plan Includes Activities Intended to Meet Numerous Goals

Goal	Example of Activity
Make conservation a California way of life	Provide funding for conservation and efficiency
Increase regional self-reliance and IWM across all levels of government	Increase use of recycled water
Achieve co-equal goals for the Delta	Restore Delta aquatic and intertidal habitat
Protect and restore important ecosystems	Bring salmon back to the San Joaquin River
Manage and prepare for dry periods	Revise reservoir operations to respond to extreme conditions
Expand water storage capacity and improve groundwater management	Increase statewide groundwater replenishment
Provide safe water for all communities	Consolidate drinking water and water quality agencies
Increase flood protection	Improve access to emergency funds
Increase operational and regulatory efficiency	Improve and clarify coordination of state Bay-Delta actions
Identify sustainable and integrated financing opportunities	Develop water financing strategy

IWM = Integrated Water Management.

Figure 6

Budget Proposal for Water Action Plan Addresses Multiple Water Issues*(In Millions)*

Activity	Department	Amount	Fund Source
IRWM grants	DWR	\$473	Proposition 84 bond
Flood protection	DWR	77	Proposition 1E bond
Wetlands and watersheds restoration	DFW	30	Cap-and-trade auction revenues
Water quality grants for disadvantaged communities	SWRCB	11	Various special funds
State Water Project energy efficiency	DWR	10	Cap-and-trade auction revenues
Water use efficiency project grants	DWR	10	Cap-and-trade auction revenues
Groundwater monitoring and management	SWRCB, DWR	8	General Fund, Waste Discharge Permit Fund
Drinking Water Program transfer ^a	SWRCB	2	Propositions 50 and 84 bonds
Salton Sea restoration maintenance	DFW	— ^b	Salton Sea Restoration Fund
Total		\$621	

^a Included in Water Action Plan but proposed separately in budget.^b Proposal totals \$400,000.

IRWM = Integrated Regional Water Management; DWR = Department of Water Resources; DFW = Department of Fish and Wildlife; and SWRCB = State Water Resources Control Board.

that would enhance DWR's ability to respond to flood emergencies in the Sacramento-San Joaquin Delta (the Delta).

GHG Emission Reductions. The budget proposes \$50 million in cap-and-trade auction revenues for projects intended to reduce GHG emissions and provide water-related co-benefits, such as improved ecosystems. (Please see our report, *The 2014-15 Budget: Cap-and-Trade Auction Revenue Expenditure Plan*, for a more detailed discussion regarding these proposals.) The proposals include:

- **Ecosystem Restoration.** The budget includes \$30 million and 17 positions for DFW to restore wetlands and other watersheds in order to improve the ability of those lands to capture and store carbon from the atmosphere.
- **Water-Energy Efficiency.** The budget includes \$20 million for DWR for projects that would save energy and reduce water use, including \$10 million for upgrades to State Water Project (SWP) generators to increase hydroelectric generation and

\$10 million for grants to local agencies to reduce energy consumption associated with water use.

Groundwater Monitoring and Management.

The budget proposes a total of \$7.8 million for groundwater monitoring and management activities. The specific activities include:

- **Overdraft Management.** The budget includes \$1.9 million (General Fund) for ten positions at SWRCB to identify basins that are in danger of suffering permanent damage due to overdraft, which occurs when water withdrawals consistently exceed the water entering the basin. These positions would also develop management plans for those basins in which local agencies do not address the overdraft condition. The proposed funding would support management of one basin at the requested level of resources. The administration intends to propose budget trailer legislation to grant SWRCB the authority to develop these management plans.

- **Groundwater Elevation Monitoring.** The budget includes \$2.9 million from the General Fund for DWR to (1) meet a statutory requirement that the department monitor groundwater elevation in basins where no local agency performs such monitoring, and (2) develop an information technology (IT) system so that individuals who drill wells can submit well records online.
- **Groundwater Quality Monitoring.** The budget includes \$3 million from the Waste Discharge Permit Fund for SWRCB to monitor the water quality of groundwater used for public water supplies. This proposal would continue an existing monitoring program that was previously supported by bond funds.

Transfer of Drinking Water Regulation to SWRCB. The budget proposes to transfer drinking water regulation and financial assistance responsibilities from DPH to SWRCB. The budget includes a one-time increase of \$1.8 million for moving and IT costs. This proposal is budget-neutral on an ongoing basis. (We discuss this proposal in more detail later in this report.)

Governor Presents Legislature With Reasonable Approach

We find that the WAP generally offers the Legislature a reasonable blueprint for addressing many of the state's water challenges, as discussed below.

Generally Consistent With Legislative Priorities. Many of the activities in the WAP were derived from legislatively mandated plans or reports or were developed in response to legislative priorities. For example, the WAP includes several recommendations described in the legislatively

required Delta Plan, such as prioritizing improvements to Delta levees and restoring habitat in specific areas of the Delta. The WAP also states the administration's intent to establish a stable, long-term funding source to fund water systems in disadvantaged communities, including operations and maintenance. (Currently, the state operates some financial assistance programs supported by bond funds and federal funds, but these programs exclusively fund capital improvements.) The establishment of such a fund source is explicitly intended to meet the intent of Chapter 524, Statutes of 2012 (AB 685, Eng), which states that every human being has the right to safe, clean, affordable, and accessible water.

Reasonable Assumptions About Activities to Be Completed. In addition, it appears that progress could be made on all activities in the plan in the next five years. This is because the plan focuses primarily on efforts that could be undertaken administratively or with statutory changes, and does not assume that construction of significant new infrastructure will be completed during the plan's implementation. For example, the WAP identifies completing the development of the Bay Delta Conservation Plan (BDCP) as an activity to be accomplished in the next five years, but does not assume that the major infrastructure associated with it—a pair of tunnels under the Delta and 150,000 acres of habitat—will be completed in that time.

Budget Proposals Provide Useful Starting Point. The specific activities proposed in the Governor's budget for 2014-15 also appear to be generally reasonable first steps in implementing the WAP. The proposals have merit because they would take steps to address some of the state's water challenges. We also note that proposed activities can be accomplished in the budget year and primarily use existing fund sources.

Several Budget Proposals Initiate Positive Policy Changes. The budget includes two noteworthy proposals that, in our view, represent significant positive policy changes. First, we find that transferring the Drinking Water Program (DWP) from DPH to SWRCB could improve the efficiency and effectiveness of state water policy by allowing a single department to address interrelated water issues more comprehensively. For example, there could be a more coordinated focus on the sources of pollution and their effects on drinking water. It could also improve the administration of drinking water-related financial assistance and enhance accountability and transparency on drinking water issues.

Second, the Governor’s groundwater proposals appear to be consistent with recommendations that we have made in the past on groundwater management. Unlike most other western states, California currently does not monitor or permit groundwater use at the state level. In past reports, we have recommended that the Legislature establish “active management areas”—defined geographic areas where specific rules are established to govern the withdrawal and use of groundwater—in circumstances where the highest potential for groundwater overdraft exists. The proposal for SWRCB to identify and potentially regulate overdrafted basins could align with this recommendation. We note that the effectiveness of this proposal would depend on (1) the specific authority granted to the board, and (2) the availability of adequate groundwater quality and supply data to identify overdrafted basins.

Certain Priorities Could Be Addressed More in First Year

As discussed above, the WAP lists activities that the administration intends to complete in the next five years, and the administration has chosen to implement a subset of those activities in 2014-15.

While we generally find that the administration has put forward reasonable proposals for legislative consideration, it is important to note instances where the administration’s proposals do not fully address legislative priorities or current issues facing the state. As such, we identify below some selected areas where the Legislature may want to take additional actions. Depending on the specific actions taken, proposed resources may need to be redirected, or additional resources may need to be provided, relative to the Governor’s budget proposals.

Response to Current Drought. California is currently experiencing severe drought, with significant economic, environmental, public health, and water management effects. For example, DPH has identified 17 communities that may face severe water supply shortages as a result of the current drought. In addition, groundwater throughout the Central Valley has been rapidly depleted over the past two years due to increased reliance on this water source for irrigation and drinking water. Though the WAP discusses the need for the state to improve its ability to respond to periodic droughts, the Governor’s budget includes little to address the effects of the current drought. (The administration has, however, issued a drought declaration that includes some administrative actions, such as directing state agencies to reduce water use and beginning a statewide public information campaign to encourage water conservation.) For example, while the proposed IRWM funding might reduce the consequences of future droughts, the program would not alleviate the effects of water shortages during the current drought because of the time required to award grants and construct the funded projects. Furthermore, the effects of the SWRCB groundwater management proposal is likely to be of limited help in addressing the current drought because the proposed funding would only support activities in one basin.

To the extent the Legislature wants to take additional actions to address the current drought, there are a variety of options it could consider. Two such options include:

- ***Enable Water Transfers for Communities Facing Shortages.*** The Legislature could direct DWR to—as it has in past droughts—purchase water to transfer to urban and agricultural areas facing extreme shortages. The state could also offer emergency loans to fund water purchases by those areas. Small or disadvantaged communities are at particular risk of water shortages because of the funding challenges they face in developing new supplies. For example, the 17 communities identified by DPH as facing the potential for severe shortage range in size from 39 to 11,000 people.
- ***Expand Groundwater Management and Monitoring.*** Groundwater use increases significantly in dry years, increasing the risk of overdraft. Additional groundwater monitoring or management could allow the state to identify and prevent damage to basins during the current drought and to better target assistance to communities that rely on those basins. For example, the Legislature could fund the SWRCB groundwater management proposal at a higher level, which would allow the board to regulate additional basins in overdraft. We have recommended in the past that the state require local water districts to submit standardized groundwater use data, which could improve the state’s ability to identify overdraft conditions.

Delta Activities. In 2009, the Legislature passed legislation that identified the Delta as a priority and required the development of a Delta

Plan to address the decline of the Delta ecosystem and the decreasing reliability of water exports from the Delta. The legislation also required implementation of the Delta Plan to begin by January 1, 2012. Implementation has begun, but the level of funding proposed in the Governor’s budget for continued implementation of the Delta Plan in 2014-15 is limited. While the budget includes about \$19 million across various state agencies for Delta-related activities—mainly for responding to floods and for scientific activities—it does not include new spending on a variety of Delta activities described in the Delta Plan and the WAP. These activities include (1) levee maintenance and improvements, (2) ecosystem restoration, or (3) “near-term actions” that can be accomplished as other longer-term actions are carried out (such as increased efforts to eradicate invasive species).

To the extent the Legislature wants to address the challenges in the Delta to a greater degree than is proposed in the Governor’s budget, it could consider a variety of options, including:

- ***Establishing a Delta Levee Assessment District.*** Historically, the state has paid most of the costs to upgrade and maintain levees in the Delta, in part because they protect state infrastructure (such as highways) that run through the Delta and allow SWP and Central Valley Project to move water through the Delta. This maintenance has been supported by bond funds and the General Fund in the past. The Legislature could prioritize establishing a Delta Levee Assessment District, as included in the WAP. The district would charge entities that benefit from Delta levees (such as landowners in the Delta and water agencies that transport water across the Delta) for the cost of maintaining those levees, potentially increasing funding available for levee maintenance.

- Integrating DFW Wetland Restoration Proposal With Existing Delta Efforts.*** Research indicates that the restoration of certain Delta wetlands can reduce GHG emissions and improve the Delta ecosystem. The Legislature could direct DFW to focus cap-and-trade auction revenues proposed for restoration activities on those wetlands in the Delta that (1) produce the greatest GHG benefits and (2) are consistent with habitat restoration described in the Delta Plan or BDCP. At the time of this analysis, DFW had not identified a specific amount of cap-and-trade revenues it would spend on Delta restoration.
- Funding Additional Delta Plan Implementation, Including Near-Term Actions.*** The major activities included in the Delta Plan and BDCP (such as constructing the tunnels or restoring significant amounts of habitat) will require several years or more to complete. During that time, species in the Delta are expected to decline and threats to water supply reliability will continue. Thus, the Legislature may want to consider funding actions that can be completed in the interim to begin addressing those challenges. For example, the Legislature could increase funding for efforts to reduce the amount of aquatic invasive plants in the Delta, which could improve conditions for native fish. The Legislature could also direct state agencies to develop guidelines for how the acquisition and restoration of individual parcels can be coordinated at larger scales. Research indicates that restoring connected parcels of land and

considering how those pieces affect each other can ensure that ecosystem restoration benefits (such as improvements to fish populations) are achieved in the most cost-effective manner.

Conservation. While the WAP includes water conservation as one of its ten goals, the Governor's budget includes few specific proposals to achieve that goal. Yet, there are a variety of steps that could be taken now to significantly increase water conservation in the future. First, research demonstrates that the price of water and how water rates are structured can significantly increase water conservation by consumers. However, the WAP does not propose changes to how water is priced in the state. Second, as described in our publication *California's Water: An LAO Primer* (2008), the current water rights system can lead to inefficient uses of water. For example, Article X of the California Constitution requires that waste or unreasonable use of water be prevented. State regulatory agencies have interpreted this to require water users to consistently use their full allocation or forfeit the unused part, which can discourage conservation. (Water rights are granted in specific volumes for specific uses, such as irrigating crops.) The WAP does not propose any changes to the water rights system. Finally, the WAP identifies a goal of maintaining total urban water at 2000 levels through 2030, but the plan does not include goals or policies to significantly reduce agricultural water use, which accounts for roughly 80 percent of total water use in the state. While the Governor's budget includes funding for water use efficiency (\$10 million in DWR's water-energy proposal), such funds would most likely support urban water use efficiency projects.

If the Legislature wishes to address conservation to a greater degree than identified in the WAP or the Governor's budget, it could:

- **Require Changes to Water Pricing.** The Legislature could take steps to reduce demand for water by changing how water users are charged for water. For example, the Legislature could require that water agencies (1) charge higher rates for water in drought years, or (2) adopt “increasing block pricing,” which encourages conservation by charging water users lower per-gallon rates for essential water use (such as drinking, cooking, and bathing) but charges water users more per gallon above a certain threshold of water use deemed less necessary (such as for landscaping).
- **Refine Definition of “Reasonable Use.”** The Legislature could encourage conservation by making changes within the existing water rights system to account for the potential for water conservation in the definition of reasonable use. For example, where water is required for agricultural purposes, the water right could reflect the amount of water needed to grow a crop using available water efficiency technology.
- **Encourage Agricultural Conservation.** The Legislature could take steps to encourage agricultural water conservation, such as by setting goals for reductions in agricultural water use or funding agricultural water use efficiency measures.

Nitrate Contamination. Nitrates are the most common contaminant in groundwater that is not naturally occurring, and has been an area of recent legislative interest. Nitrate contamination of groundwater is common in many areas of the Central Valley and is generally caused by the application of fertilizers. In 2008, the Legislature required SWRCB to study the sources and extent of

nitrate contamination and offer recommendations on how to address its impacts. The SWRCB released a report with such recommendations in 2013. Despite wide recognition of this problem, neither the WAP nor the Governor’s budget specifically address nitrate contamination. If the Legislature wants to address nitrate contamination, it could take various actions, such as those recommended in the SWRCB report. These include:

- **Funding Nitrate Reduction Projects Through IRWM.** Currently, DWR uses numerous factors to award funding for IRWM projects through a competitive process. The Legislature could direct DWR to prioritize IRWM projects that would evaluate or treat nitrate problems.
- **Reevaluating Agricultural Waste Discharge Requirements.** As noted above, nearly all nitrate contamination is the result of agricultural activity. In many cases, SWRCB waives certain water quality regulations for agricultural operations. The Legislature could direct SWRCB to reevaluate the conditions under which waste discharge requirements are waived in order to reduce nitrates entering groundwater.
- **Funding Drinking Water System Operations and Maintenance.** According to SWRCB’s report, one of the factors that limits nitrate treatment is the limited financial capacity of small disadvantaged communities to operate and maintain their drinking water systems. In order to ensure that small disadvantaged communities have the capacity to operate and maintain such systems, the Legislature could establish a new fund source for that purpose. Options recommended by

SWRCB include a charge on fertilizer or a broader charge on all water use.

Strategy for Completing and Funding Remaining Activities Is Unclear

Plan for Completing Remaining Activities Needed. In the future, the Legislature is likely to be asked by the administration to appropriate funding or change statute to implement additional activities contained in the WAP. Without a description of the activities that the administration intends to accomplish and the years in which those activities will be undertaken, it is difficult for the Legislature to determine whether the administration's direction on water aligns with its priorities. Based on our conversations with the administration, it is currently developing a strategy for implementing the remainder of the activities in the WAP over the following four years. Such a strategy might include specific activities to be performed, the scope of those activities, the schedule of when each activity would be undertaken, and the specific outcomes anticipated.

Water Financing Strategy Needed. The administration expects to develop a water financing strategy that will identify how WAP activities will be funded in the future. Many of the activities in the WAP would require funding to complete. General obligation bonds have been a major source of funding for water activities since 1996, but these one-time funds are rapidly being exhausted. Of the nearly \$16 billion in bonds approved by voters for water programs since 2000, about 10 percent (\$1.7 billion) remains unappropriated. The Governor's budget proposes \$550 million in new bond fund appropriations for WAP activities in 2014-15. We note that there currently is an \$11.1 billion bond scheduled for the November 2014 ballot, but that the Legislature is considering changes to that bond. In the absence of a specific funding strategy that specifies how various funding

sources (such as bonds, user fees, or charges on polluters) should be used and which activities will be supported by those funding sources, it will be difficult for the Legislature to ensure that any future water bond measure provides the funding consistent with WAP priorities.

While the administration has not yet proposed a specific funding strategy to implement the WAP, the plan does identify a couple of financing proposals that, if implemented, could provide additional funding for water-related activities. The intent of these proposals is to shift more funding responsibilities to beneficiaries, which is generally consistent with recommendations that we have made in the past. Specifically, the WAP proposes to analyze the potential for additional user and polluter fees. This could include charging polluter fees on fertilizer sales with revenues used to reduce nitrate pollution. The structure of user and polluter fees and whether they are fees or taxes would determine the activities that could be supported by the fees.

The plan also includes several proposals that would change how the costs of some water activities are allocated among parties so that beneficiaries pay a higher share of project costs. First, as discussed above, the WAP proposes creating a Delta Levee Assessment District, which would assess a charge on those that benefit from Delta levees in order to upgrade and maintain those levees. Second, the WAP proposes to clarify the types of water-related taxes and fees that are affected by Proposition 218 (1996). Proposition 218 enabled property owners to stop increases on their water bills through a formal protest process, as well as required voter approval for rate increases to support flood control and stormwater management activities. Although the WAP identifies the administration's intent to address some of these issues, it does not propose specific changes. We note, however, that an initial public draft of the

WAP discussed the option of exempting flood management agencies from some of the voting requirements of Proposition 218, as is the case with water service providers.

LAO Recommendations

In view of the above, we offer some recommendations for the Legislature as it considers the WAP as a whole. These recommendations are intended to help ensure that the Legislature has sufficient information from the administration to assess long-term implementation of the plan. Later in this report, we make specific recommendations on certain budget proposals related to the plan.

Administration Should Provide

Implementation Strategy With 2015-16 Budget.

The administration indicates that it is developing a strategy for implementing the remainder of the WAP. We recommend the Legislature direct the administration to provide that implementation strategy no later than the release of the Governor's proposed budget for 2015-16. This strategy should include a schedule of activities that the administration proposes for each of the next four

budget years, the estimated costs of those activities, and the expected funding source. Having such a strategy would allow the Legislature to better understand how the goals of the WAP will be achieved and at what cost. The Legislature could then determine whether the strategy is consistent with its water priorities for the state.

Administration Should Report at Budget Hearings on Future Bond Funding for WAP Activities. In addition, as noted above, the Legislature is currently considering potential changes to the water bond scheduled for the November 2014 ballot. In order to ensure that the Legislature is able to make a fully informed decision as it considers those changes, the administration should report at budget subcommittee hearings this spring on the degree to which the bond currently scheduled for the ballot would fund specific aspects of the WAP. The administration could also identify any changes it would recommend to align the funding included in the water bond with the activities proposed in the WAP.

STATE WATER RESOURCES CONTROL BOARD

Transfer of Drinking Water Program

Background

The DPH Administers State DWP. The DPH administers and oversees various programs that address health issues, such as chronic disease prevention, communicable disease control, environmental health, and inspection of health facilities. The department's DWP regulates 7,900 public water systems, defined as privately or publicly owned water systems that serve more than 15 service connections or 25 people. The

DPH directly regulates some public water systems in California, including all systems with more than 200 service connections. It does so utilizing two field operations branches and 23 district offices throughout the state. In 31 counties, the department enters into agreements with "local primacy agencies," such as county health agencies, to regulate public water systems with fewer than 200 service connections.

The state spends about \$300 million annually on DWP's activities, which include the following:

- Regulating the quality of drinking water by (1) setting drinking water quality

standards, (2) inspecting public water systems, (3) issuing permits, and (4) taking enforcement actions when necessary.

- Responding to emergencies by providing technical assistance to damaged water systems, assessing drinking water contamination, and ensuring access to safe drinking water.
- Providing financial assistance to fund safe drinking water improvements to public water systems.
- Providing oversight, technical assistance, and training for local primacy agency personnel.

SWRCB Oversees State's Water Quality

Program. The SWRCB and the nine regional boards perform a variety of activities related to the state's water resources. These boards regulate the quality of the state's surface waters and groundwater by permitting waste discharges into the water and enforcing water quality standards. The boards also provide financial assistance to fund wastewater system improvements, underground storage tank cleanups, and other improvements to water quality. In addition, the state board administers the state's system of water rights.

Governor's Proposal

The *2014-15 Governor's Budget* proposes transferring DWP from DPH to SWRCB. Under the proposal, DWP's regulatory and technical assistance activities would be housed in a newly created Division of Drinking Water Quality (DDWQ) within SWRCB. The DDWQ would continue to utilize DWP's field operations branches and district offices and would retain existing DWP staff to carry out drinking water activities. The DDWQ, however, would report directly to SWRCB's state headquarters (to SWRCB's

executive director) under the proposed transfer.

The SWRCB's water quality regulatory function, by comparison, is generally carried out by the regional water boards (staff reports to regional board executive management), with the state board setting enforcement standards and priorities. Administration of financial assistance programs, including the Safe Drinking Water State Revolving Fund (SDWSRF), would be consolidated with SWRCB's existing Division of Financial Assistance, which administers SWRCB's similar state revolving fund program for wastewater treatment and other water quality improvements. The transfer would occur effective July 1, 2014.

Objectives of the Transfer. The administration intends for the transfer to achieve several objectives. First, it believes consolidating the state's drinking water and water quality programs would result in more integrated water quality management. It considers that consolidating responsibilities for drinking water oversight and regulation with SWRCB's water quality and water rights regulatory activities could allow a single department to address interrelated water issues more comprehensively. For example, there could be a more coordinated focus on the sources of water pollution and their effects on drinking water. In addition, there may be opportunities to coordinate permitting processes for entities that are currently regulated by both DWP and SWRCB.

The administration also believes this consolidation would improve the state's ability to provide financial assistance to small disadvantaged communities. A SWRCB-administered drinking water program may be more likely to have the expertise and administrative resources required to adequately run the program and get financial assistance out the door in a timely manner. For example, the SWRCB has significant expertise in financial management, including recent experience leveraging their revolving fund to increase the

amount of loans the fund is able to offer. This expertise could be extended to SDWSRF.

Finally, the administration believes the transfer would enhance accountability and transparency on drinking water issues because SWRCB's board structure with regular hearings provides a process for the public and stakeholders to offer comments on proposed rules or other issues. This could improve the ability of the public to hold decision-makers accountable for drinking water outcomes.

Implementation Details. In designing the structure of the proposed program transfer, the Governor had several important implementation choices regarding the reorganization.

- **Permitting and Enforcement.** As noted above, drinking water permitting and enforcement responsibilities would remain with district offices reporting to SWRCB's state headquarters. The agreements delegating authority to local primacy agencies in some counties would remain in place.
- **Rulemaking Process.** The DDWQ would develop drinking water quality standards using the same rulemaking process used by DWP, which requires formal review by DOF and the Office of Administrative Law, as well as a public comment period. The state board would ultimately adopt those limits through its hearing process.
- **Public Health Expertise.** The deputy director over DDWQ would be required to have specific public health expertise, including minimum amounts of experience in a public-health related field. In addition, all personnel currently employed by DWP would be transferred to DDWQ in order to maintain program expertise.

- **Emergency Response.** The DDWQ would retain a similar structure for responding to drinking water emergencies (such as a chemical spill affecting drinking water) as currently used by DWP. This involves having an on-call duty officer who triages emergency calls and communicates with the Office of Emergency Services as necessary. The director of DPH, as the State Public Health Officer, would retain authority to issue regionwide or statewide drinking water advisories, and to regulate the actions of and provide guidance to local health officers in the case of drinking water emergencies.

The administration has indicated that it plans to move DWP staff currently located in Sacramento into the CalEPA building in order to effectively consolidate the staff of SWRCB. The administration has indicated that moving DWP staff into the CalEPA building could displace some staff at other CalEPA departments. The administration plans to release a formal transition plan in February 2014, which should include further detail on the transfer of responsibilities and staff between the departments.

Budgetary Effects of Transfer. The proposed transfer would shift the total DWP budget of \$308 million—including \$43 million for state operations and \$265 million for local assistance (mostly bond and federal funding for grants)—from DPH to SWRCB in 2014-15. In addition, the budget includes a one-time increase of \$1.8 million in 2014-15 for moving expenses and IT consolidation. Accordingly, with the exception of modest one-time transition expenditures, the proposed transfer is essentially budget-neutral, meaning that it does not, on net, result in added costs or savings in the budget as a whole as proposed by the Governor.

LAO Comments

As described below, we find that the proposed transfer is likely to improve the effectiveness and efficiency of state water policy. We also comment on specific aspects of the transfer that warrant legislative consideration, including (1) the continuation of some potential enforcement concerns, (2) coordination between SWRCB and DPH in responding to emergencies and protecting public health, and (3) statutory changes to the administration of SDWSRF.

Transfer Is Likely to Improve Effectiveness and Efficiency of State Water Policy. We agree that the transfer should meet the broad objectives laid out by the Governor. In particular, we find that the transfer could allow for some efficiencies and increased administrative capacity relating to drinking water financial assistance. Previous LAO analyses have identified many of the same advantages of combining the state's drinking water and water quality programs within SWRCB. For example, some economies of scale may be realized by consolidating SWRCB's and DWP's financial assistance programs. Such a consolidation could allow staff to be shared across programs, allowing them to process additional grants and loans using the same resources. We also find that the transfer creates the potential for accelerated rulemakings related to drinking water. For example, SWRCB indicates that it intends to administratively update some eligibility requirements for SDWSRF grants and loans through its public hearing process. This process allows for public participation but typically is completed more quickly than the formal regulatory process that DPH has used in the past.

Past Concerns About DWP Enforcement Could Remain. In a 2010 audit of DWP, the U.S. Environmental Protection Agency (U.S. EPA) raised concerns regarding how consistently DPH district offices and the local primacy agencies enforced violations of drinking water regulations.

For example, the audit found that some districts chose not to issue some nonhealth related monitoring violations due to insufficient staffing. The U.S. EPA report also noted that the DWP has not issued a statewide enforcement policy. In conversations with DPH, it indicated that the DWP has relied on internal memos regarding enforcement policy to promote consistency rather than issue a statewide enforcement policy. It is unclear the degree to which the steps DPH has taken in response to the U.S. EPA audit have resulted in improved consistency and appropriate levels of enforcement across districts and local primacy agencies. Publicly available data on DWP enforcement activities are aggregated at a statewide level, not by district, thereby making it difficult to analyze the extent to which DWP enforcement improvements have been made in recent years.

Despite these previous concerns, the Governor's proposal would maintain the current approach to drinking water enforcement. The administration has not proposed creating a uniform statewide enforcement policy, and the administration's plan is to continue to rely on district offices and the existing local primacy agencies to enforce state regulations. In addition, the proposal explicitly rules out establishing mandatory minimum penalties (MMPs) for drinking water violations. The SWRCB has used MMPs for water quality violations since 2000, when the Legislature enacted legislation requiring MMPs for serious water quality violations in order to address concerns over the consistency and appropriateness of the level of SWRCB enforcement (carried out mostly by the regional boards). According to the most recent SWRCB enforcement report (from January 2013), MMPs have contributed to a reduction in water quality violations by acting as a deterrent.

Coordination With DPH Will Be Necessary. While the proposed transfer will mean that most drinking water responsibilities reside within

SWRCB, some related activities will remain with DPH. Therefore, it will be important that the two state entities establish effective ways to coordinate their efforts. This would allow for a continued public health perspective within the DWP and help ensure that public health objectives continue to be met. In particular, the SWRCB and DPH would need to coordinate on emergency response in cases of statewide drinking water emergencies. As described above, the director of DPH is the State Public Health Officer and would retain authority to issue regionwide or statewide drinking water advisories, as well as to regulate the actions of local health officers and provide guidance to local health officials. Under a local emergency, SWRCB district office duty officers and district engineers would handle the emergency response and would notify the deputy director of the DDWQ of the emergency. The SWRCB would then be responsible for determining when to notify the State Public Health Officer. The administration states that its forthcoming transition plan will include more detail on how drinking water emergencies will be handled and how DPH and SWRCB will coordinate when the authority of the State Public Health Officer is required.

In addition to collaborating with DPH under a drinking water emergency, SWRCB would need to collaborate with DPH on several programmatic activities. An interagency agreement would be required between SWRCB and DPH for the utilization of DPH's Drinking Water and Radiation Laboratory to analyze water samples submitted by district engineers for monitoring and compliance purposes. Additionally, the DWP is currently assessing what functions it coordinates with other DPH activities related to drinking water, such as identifying waterborne disease and providing health expertise to communities interested in fluoridating their drinking water. The departments indicate that a memorandum of understanding

might be required between the two state entities to continue the coordination of some of these activities.

Statutory Changes Could Improve Administration of SDWSRF. As described above, the Governor proposes to move administration of the financial assistance program for drinking water currently administered by DPH—including the SDWSRF—to SWRCB. In so doing, the administration has stated its intent to introduce statutory changes to allow greater flexibility in how the drinking water grants and loans are administered to be similar to the SWRCB's program. In particular, the administration would allow SWRCB to reduce the interest rates of loans issued through SDWSRF and would repeal existing state law that limits DPH's ability to fund projects that are ready to proceed but may be ranked as lower priority by district offices. If implemented, these changes could allow SWRCB to distribute financial assistance more quickly and would allow them to give loans to water systems in disadvantaged communities that may not qualify for loans with higher interest rates. The administration states its intent to provide these statutory changes following the release of the transition plan.

LAO Recommendations

As described below, we recommend that the Legislature: (1) approve the proposed transfer of DWP to SWRCB; (2) require the administration to report at budget hearings on the details of the transition plan and progress made by DPH and SWRCB on coordinating implementation of the transfer; and (3) require reports on the outcomes of the transfer, including its effects on permitting, enforcement, and emergency response.

Approve Transfer. We recommend that the Legislature approve the proposed transfer of DWP to SWRCB. In our view, the proposal has

the potential for significant improvements in the administration of the state's drinking water programs, particularly regarding the effectiveness of financial assistance programs, the integration of drinking water with other water policy issues, and the ability of the public to hold decision-makers accountable for drinking water outcomes through the SWRCB's board structure. In addition, we note that the transfer also is likely to have greater benefits than other options intended to achieve the objectives identified by the administration. For example, in a previous analysis, we found that transferring only SDWSRF activities to SWRCB could introduce significant coordination and regulatory challenges because financial assistance staff would reside in one department while staff with programmatic expertise and regulatory authority over drinking water issues would reside in a different state entity. We also evaluated the option of creating a stand-alone drinking water agency within CalEPA and found that transferring the DWP to a stand-alone entity would not allow for the economies of scale that could be provided by consolidating financial assistance programs and would hinder the new entity's ability to leverage SWRCB's expertise in distributing financial assistance. It likely would also result in an increase in state costs because such a department would require positions to perform the new department's various administrative functions.

Require Administration Report at Budget Hearings on Transition Plan. We recommend that the Legislature require DPH and SWRCB to report at budget hearings, providing an update on their progress in coordinating implementation of the transfer. This should include an overview of the transition plan and proposed statutory changes. This should also include providing the Legislature with more information on (1) the emergency response plan, including the protocol for coordination between SWRCB and DPH when

the State Public Health Officer authority is needed; (2) other areas of coordination that will be required between SWRCB and DPH; (3) the transfer of Sacramento-based DWP staff to the CalEPA building; and (4) proposed statutory changes to SDWSRF and other statutory changes deemed required to effectuate the transfer as proposed by the administration.

Require Reports on Outcomes of Transfer.

In order to ensure that the transfer successfully meets the Legislature's goals for drinking water, we recommend the Legislature adopt trailer bill language requiring SWRCB to report on the outcomes of the transfer in January of 2015 and 2016. This report should compare the performance of the program before and after the transition using quantifiable metrics for drinking water activities such as permitting, financial assistance, rulemaking, and enforcement. These metrics should include measures of the timeliness of grant approvals and the rate at which available state and federal funding is disbursed. This report should also include summary and trend data on enforcement actions by each district office and local primacy agency, including the number of monitoring and health-based violations, the enforcement actions taken, and whether the violations were corrected. Finally, the report should include information on coordination with DPH, including the number of responses to emergencies and how often DPH was notified of an emergency.

These reports would provide the Legislature with additional information to evaluate the effectiveness of the state's drinking water activities as administered by SWRCB, as well as determine if additional policy changes are needed in the future. For example, if concerns over enforcement continue even following the transfer, the Legislature could consider other options, such as requiring that MMPs be utilized to address drinking water violations.

DEPARTMENT OF WATER RESOURCES

The DWR protects and manages California's water resources. In this capacity, DWR plans for future water development and offers financial and technical assistance to local water agencies for water projects. In addition, the department maintains SWP, which is the nation's largest state-built water conveyance system. Finally, DWR performs public safety functions such as constructing, inspecting, and maintaining levees and dams.

The Governor's 2014-15 budget proposes a total of \$3.8 billion from various funds (mainly special funds) for support of the department. This is a net decrease of \$1 billion, or 21 percent, compared to projected current-year expenditures. This change primarily reflects reduced bond expenditures.

Integrated Regional Water Management

Background. The IRWM program is an effort to encourage greater regional collaboration in the management of water resources. Under the IRWM program, DWR awards competitive grants to coalitions of local agencies and partners to construct various types of projects aimed at achieving multiple water benefits in a region—such as increased water reliability and quality, flood control, and ecosystem restoration. For example, some IRWM projects improve water quality and reduce flooding by improving stormwater management.

Since 2002, voters have approved three bond measures—Propositions 50 (2002), 1E (2006), and 84 (2006)—providing a total of \$1.8 billion for IRWM projects. Proposition 84 provided \$1 billion to DWR to support IRWM grants. Of the total amount provided in Proposition 84, DWR has awarded \$387 million in grants. This includes

awarding \$205 million in 2011 and \$152 million in 2013 for a total of 60 implementation grants, as well as \$30 million in planning grants to help potential applicants develop and improve their IWRM plans. Proposition 84 also allocated \$100 million for other interregional projects and up to \$50 million for administrative costs.

Governor's Proposal. The Governor's budget proposes \$473 million to support a final round of implementation grants. This would fully appropriate the remaining IRWM funding from Proposition 84. The DWR expects to solicit proposals by November 2014 and to award funding by January 2015.

Size of Proposed Funding Could Reduce Overall Quality of Funded Projects. In previous funding rounds, DWR has funded most of the requests it received. Specifically, the \$357 million awarded for implementation grants by DWR represents 70 percent of the total amount requested in the first two rounds. There was a relatively modest amount—\$90 million—of projects that went unfunded in the most recent round. Yet, the Governor's proposal for 2014-15 would award three times the total amount awarded last year. Therefore, it is currently unclear whether there are a sufficient number of high-quality projects to support the amount requested by the administration. If there were not enough high-quality project proposals, DWR might have to choose between funding some projects with comparatively fewer benefits or not awarding all of the grant funding appropriated. The DWR did not establish minimum qualifying scores for past rounds of IRWM grants. Moreover, DWR funded some proposals in past rounds that it determined would not meet many statewide goals for water management or would provide uncertain levels of benefits.

Uncertain Whether Legislative Goals for Groundwater Monitoring Will Be Met. Chapter 1, Statutes of 2009, Seventh Extraordinary Session (SBX7 6, Steinberg), established a program to monitor groundwater elevation throughout the state by collecting standardized data from local agencies with groundwater management authority, including local water districts and counties. The legislation requires DWR to perform the monitoring in groundwater basins where no agency voluntarily provides this information and no monitoring wells exist that could provide the information. Chapter 1 also incentivizes local agencies to share groundwater data by making counties and certain local water agencies ineligible for state water grants (such as IRWM grants) or loans if DWR performs monitoring for them. Despite this requirement, DWR did not deny IRWM grants due to the failure of applicants to provide the state elevation monitoring data.

We would also note that there is some ambiguity in how DWR should interpret how these eligibility requirements apply to IRWM grants. This is because the groups that apply for these grants can include both entities that are performing monitoring and entities that are not. Based on our conversations with the department, it is unclear how strictly DWR will adhere to these requirements in the third round.

LAO Recommendations. In light of the above concerns, we recommend that the Legislature reduce the proposed appropriation from \$473 million to \$200 million, in order to more closely align the amount with past grant award levels and help ensure the funding of high-quality projects. The DWR could request appropriation of the remaining Proposition 84 funding for IRWM grants in future budget years. We also recommend that the Legislature require DWR to report at budget subcommittee hearings this spring on how it intends to apply the eligibility requirement

in Chapter 1 when awarding the third round of IRWM funds. This would allow the Legislature to determine whether DWR's interpretation is consistent with legislative intent.

Water and Energy Efficiency

Proposal. The Governor's budget proposes \$20 million from cap-and-trade auction revenues in 2014-15 and 2015-16 for water-energy efficiency programs, including \$10 million each year for upgrades to two hydroelectric generators on the SWP. The SWP is a large water storage and delivery system that provides water to homes and farmland throughout the state.

SWP Funds More Appropriate for Generator Upgrades. Currently, the vast majority of SWP expenditures are funded by payments from the water agencies ("water contractors") that receive water from the project because they are the direct beneficiaries of the project. The generating unit upgrades proposed by DWR would benefit water contractors by (1) reducing the amount of electricity purchased in order to operate the SWP; (2) reducing the cost SWP would have to pay to purchase allowances to comply with cap-and-trade regulations; and (3) reducing the water used to generate energy, making the water available for delivery to water contractors when needed. Thus, payments from those contractors may be a more appropriate source for funding these upgrades. Therefore, we would recommend the Legislature reject the proposed use of \$10 million in cap-and-trade auction revenues for this purpose. We note that denying this request does not prevent DWR from performing the upgrades using contractor funds if the department considers them to be necessary.

(For further information on the Governor's cap-and-trade proposals, see our report *The 2014-15 Budget: Cap-and-Trade Auction Revenue Expenditure Plan*.)

CALRECYCLE

CalRecycle regulates solid waste facilities (including landfills) and manages the recycling of various materials, such as beverage containers, electronic waste, tires, and used oil. The department also promotes waste diversion practices, such as source reduction, composting, and reuse.

The Governor’s budget proposes \$1.5 billion from various funds for support of CalRecycle in 2014-15. This is a reduction of \$4.6 million, or 0.3 percent, from current-year estimated expenditures. Major changes are (1) a \$31 million net decrease in expenditures for the Beverage Container Recycling Program (BCRP) resulting from reforms to address the program’s structural deficit, and (2) a \$30 million increase from the GHG Reduction Fund (cap-and-trade auction revenue) for loan and grant programs.

Beverage Container Recycling Fund Operating Deficit

Background

Overview of California Redemption Value (CRV) Program. The Division of Recycling (DOR) within CalRecycle administers the BCRP (commonly referred to as the “bottle bill program”). This program was established more than 25 years ago with the enactment of Chapter 1290, Statutes of 1986 (AB 2020, Margolin). The purpose of the program is to be a self-funding program

that encourages consumers to recycle beverage containers. The program accomplishes this goal by guaranteeing consumers a payment—referred to as the CRV—for each eligible container returned to a certified recycler. As shown in Figure 7, only certain beverage containers are part of the CRV program. Whether a particular container is part of the program depends on the material, content, and size of the container.

The BCRF—administered by DOR—is the funding source of the CRV program. As shown in Figure 8 (see next page), the program involves the flow of beverage containers and payments between several sets of parties, and generally operates as follows:

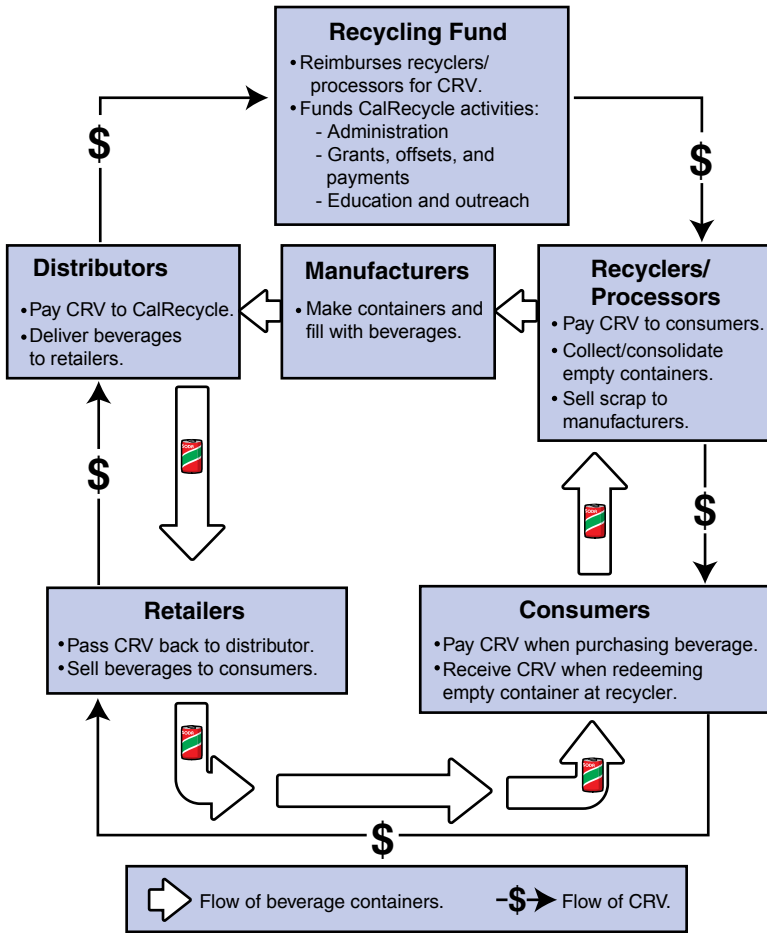
- **Distributors and Retailers.** For each beverage container subject to the CRV that distributors sell to retailers, they make redemption payments to the BCRF. The distributors typically recoup this cost in payments from retailers.
- **Retailers and Consumers.** Beverage retailers sell beverages directly to consumers, collecting the CRV from

Figure 7
Containers Covered Under the California Redemption Value (CRV) Program

	Covered in Program	Not Covered In Program
Container Type	Glass Plastic (all resin types) Aluminum Bimetal	Aseptic Foil pouches Styrofoam
Beverage Type	Soda Water Sports drinks Fruit juice Beer	Wine Distilled spirits Milk Vegetable juices Soy drinks
Container Size	Less than 24 ounces—5-cent CRV 24 to 64 ounces—10-cent CRV	64 ounces or more

Figure 8

How the CRV Program Works



CRV = California Redemption Value.

processors in exchange for the CRV, as well as the scrap value of the recycled material. Processors are then reimbursed from the BCRF for CRV. Then the processors sort, clean, and consolidate the recyclable materials and sell them to container manufacturers or other end users who make new bottles, cans, and other products from these materials.

Unredeemed Deposits Support Supplemental Programs. The CRV redemption rate—the percent of all CRV that is actually collected by consumers from recyclers—is less than 100 percent. This means that distributors pay more CRV into the BCRF than is claimed by consumers. In 2012-13, for example, the BCRF received roughly \$1.2 billion in deposits, but only about

consumers for each applicable beverage container sold.

- **Consumers and Recyclers.** When consumers redeem empty recyclable beverage containers, they recoup the cost of the CRV from the recycler. In this way, from the consumer’s perspective, the CRV can be viewed as a “deposit.”
- **Recyclers/Processors and Manufacturers.** Recyclers sell the recyclable materials to

\$1 billion was spent in redemption—an 88 percent redemption rate. State law requires that much of the unredeemed CRV be spent on specified recycling-related programs. In total, there are currently ten supplemental programs funded from the BCRF (including program administration), such as programs to subsidize glass and plastic recycling, subsidize supermarket recycling collection sites, and provide grants for market development and other recycling-related activities. These particular programs cost \$254 million in 2012-13.

Figure 9 lists all of the expenditures from the BCRF (including the supplemental programs), with a brief description and the amount spent in 2012-13.

High Redemption Rates and Supplemental Programs Create Shortfall in BCRF. Over time, redemption rates have increased and are now

higher than the target recycling rate defined in statute—80 percent. This leaves less money for the other BCRF expenditures discussed above. As a result of the combination of a higher redemption rate and the cost of supplemental programs, the BCRF has been operating under an annual structural deficit averaging about \$100 million

**Figure 9
Beverage Container Recycling Fund Expenditures and Revenues**

2012-13 (In Millions)

Description		Amount
California Redemption Value (CRV)	Consumers receive CRV when they redeem eligible containers at a recycling center.	\$1,032.3
Processing payments and offsets	Processing payments are intended to cover the difference between the cost of recycling and the scrap value of recycled materials. Processing fee offsets are currently provided to manufacturers.	67.4
Handling fees	Monthly payments made to recycling centers located in convenience zones near supermarkets.	40.4
Administrative fees	Statute provides administrative payments to participants to defray costs associated with program.	25.8
Plastic Market Development	Payments to processors and manufacturers for processing plastic bottles into a format for manufacturing and for manufacturing products with recycled plastic.	20.0
Local Conservation Corps (LCC)	Grants to LCC to be used for beverage container recycling and litter reduction programs.	19.5
Curbside Supplemental Payments	Payments to operators of single-family residential curbside recycling collection programs and neighborhood drop-off programs.	15.0
Payments to local governments	Payments to city and county governments for beverage container recycling and litter reduction activities.	10.5
Quality Incentive Payments	Provides payments to curbside programs or other certified entities for higher quality of materials collected through curbside programs.	10.0
Beverage Container Recycling Competitive Grants	Grants to governments, nonprofit entities, and private businesses for beverage container recycling programs.	1.5
Program administration	Costs to CalRecycle of running the Beverage Container Recycling Program.	43.9
Total Expenditures		\$1,286.2
CRV	Distributors pay CRV when they sell eligible containers.	\$1,167.9
Processing fees	Manufacturers pay processing fees for materials with a net recycling cost.	13.3
Total Revenue		\$1,181.1
Net (Structural Deficit)		-\$105.1

since 2008-09. For example, as shown above in Figure 9, the BCRF had a structural deficit of \$105 million in 2012-13. Based on current expenditure levels, the “break even” recycling rate—the rate at which there is enough unclaimed CRV to support all other program spending—is around 75 percent. Therefore, anytime the recycling rate is above 75 percent, the fund is operating in a deficit. According to CalRecycle’s estimates, the fund is currently forecast to run a deficit of \$110 million in 2014-15 absent any changes made to reduce expenditures or increase revenues. While the BCRF has had operating deficits on several occasions in the past, it was able to absorb the deficits from its large fund balance built up when the CRV redemption rate was low, as well as payments received from loans made to other funds. This balance is now nearly depleted, and the loans are mostly repaid. Thus, the fund no longer has a healthy reserve to help offset the impact of operating shortfalls. CalRecycle projects the BCRF balance to fall below the healthy reserve in September of 2015.

Under current law, if there are insufficient funds available in the BCRF to make all of the required CRV and supplemental payments, the department is required to reduce most supplemental program payments in equal proportions (commonly referred to as “proportional reductions”), in order to keep the fund in balance. The only payments from the fund that are not subject to the proportional reductions are the return of CRV to consumers, as well as program administration. Proportional reductions are problematic because they do not allow for discretion in spending based on priorities or other factors. For example, under proportional reductions, the department cannot prioritize programs that are most effective or central to the BCRP’s overall mission. Additionally, proportional reductions are very disruptive to program

participants. Since all payments are reduced equally and quickly, participants can experience a significant cut in funding without much warning to plan accordingly.

In 2009, CalRecycle had to implement proportional reductions to maintain the BCRF’s solvency. This included (1) reduced payments to recyclers of about 15 percent, (2) increased processing fees charged to beverage manufacturers totaling around \$50 million, and (3) elimination of most grant and market development program funding. Based on current revenue and expenditure projections, CalRecycle expects to implement proportional reductions in 2015-16.

Governor’s Budget

The Governor’s budget proposes ten programmatic changes that are expected to result in a net increase to the BCRF annual fund balance of \$72.3 million in 2014-15, growing to \$127 million when fully implemented in 2016-17. As shown in Figure 10, two changes raise revenue; four changes decrease expenditures; and four changes increase expenditures for fraud prevention, data collection, and expanded grant programs. The administration projects that these changes would eliminate the program’s structural deficit once fully implemented and avoid the need to implement proportional reductions.

We note that two BCRF-funded programs are not proposed for spending cuts or elimination: the Quality Incentive Payment program and the Plastic Market Development program. According to the administration, these two programs are central to the department’s recycling goals because they support recycling and the use of products made from recycled material. We describe in more detail below each of the programmatic changes proposed by the Governor and identified in Figure 10.

- ***Eliminate Processing Fee Offsets.*** Some container types—especially plastic and

glass—cost more to recycle than their material is worth in scrap value, making it unprofitable for recyclers to accept those containers. Consequently, state law previously required manufacturers to pay a “processing fee” into the BCRF that would be passed along in the form of “processing payments” to recyclers in order to encourage recyclers to take otherwise unprofitable materials (as well as to provide a fiscal incentive for manufacturers to use materials that are more cost-effective to recycle). These payments were calculated based on the difference between the cost to recycle the material and its scrap value. Subsequent legislation established “processing fee offsets,” which significantly reduce the amount of processing fees paid by manufacturers, thereby requiring CRV revenue to make up the difference. The administration proposes phasing out the processing fee offset over three years in order to have

manufactures cover the full net cost of recycling unprofitable materials. The administration estimates that this would result in savings to the BCRF of about \$67 million annually when fully implemented.

- **Diversify Local Conservation Corps (LCC)**

Funding. Each of the state’s 13 LCCs provides job training and academic instruction for at-risk youth, as well as operates a beverage container recycling program. As part of the recycling programs, the LCC receive supplemental funding from the BCRF for litter cleanup and recycling activities. The administration proposes expanding LCC programs to include oil, tires, and electronic waste activities, and diversifying LCC funding to reflect this change. Specifically, the proposal shifts \$15 million in program funding from the BCRF to other funds—\$2 million from the California Used Oil Recycling Fund, \$5 million from the California Tire Recycling Management Fund, and \$8 million from the Electronic Waste Recovery and Recycling Account. The LCCs would continue to receive \$6 million from the BCRF.

Figure 10
Impact of Governor’s Proposal on BCRF Fund Balance

(In Millions)

Change	2014-15	2015-16	2016-17
Increased Revenues			
Eliminate processing fee offsets	\$26.3	\$52.6	\$67.4
Diversify LCC funding	15.0	15.0	15.0
Subtotals, Revenues	(\$41.3)	(\$67.6)	(\$82.4)
Reduced Expenditures			
Eliminate Curbside Supplemental Payments	\$15.0	\$15.0	\$15.0
Restructure administrative fees	13.0	26.0	26.0
Eliminate local government payments	10.5	10.5	10.5
Restructure handling fees	7.0	7.0	7.0
Increased Expenditures			
Create a recycling enforcement grant program	-7.0	-7.0	-7.0
Expand Competitive Grant Program	-3.5	-3.5	-3.5
Public education and information	-2.5	-2.5	-2.5
Program administration	-1.5	-1.2	-1.2
Subtotals, Expenditures	(\$31.0)	(\$44.3)	(\$44.3)
Net Savings to BCRF Balance	\$72.3	\$111.9	\$126.7

BCRF = Beverage Container Recycling Fund and LCC = Local Conservation Corps.

- Eliminate Curbside Supplemental Payments.** Curbside recycling collection programs and neighborhood drop-off programs currently receive supplemental payments to support their operations. The administration proposes eliminating these supplemental payments because curbside programs make up only 8 percent of recycling. The administration also believes that curbside collection programs will likely continue even without the supplemental payment. This change is expected to result in \$15 million in annual savings.
- Restructure “Administrative Fees.”** Statute requires CalRecycle to provide administrative fees, which are payments to program participants intended to cover costs associated with their participation. These fees are provided to distributors (in the form of reduced CRV payments), as well as processors and recyclers. The administration proposes eliminating administrative fees paid to processors and recyclers because they believe that administrative costs will decline with the use of a new computer system being implemented, and these payments do not have a direct impact on recycling. Distributors will keep their administrative fees, but will have increased reporting requirements to provide additional data to CalRecycle. The administration estimates that this will result in \$25 million in annual savings.
- Eliminate Local Government Payments.** Currently, state law requires a \$10.5 million annual payment to incorporated city and county governments for beverage container recycling and litter reduction activities. This payment is distributed in proportion to the population residing in each jurisdiction. According to the administration, the CalRecycle has minimal oversight on the use of the funds, which makes it difficult for the department to direct funding to activities that promote its policy goals. Therefore, the administration proposes eliminating this payment, though it proposes redirecting the funds to two grant programs (described below). The elimination of the local government payments would result in a savings to the BCRF of \$10.5 million annually.
- Restructure Handling Fees.** Handling fees are monthly payments made from the BCRF to recycling centers located in “convenience zones”—typically within a one-half mile radius around supermarkets. These payments are intended to offset additional costs a recycler may incur as a result of their location, such as higher rent. The amount of handling fees paid to recyclers is based on volume of material recycled, which the administration believes is administratively burdensome for the department to calculate and susceptible to fraud. The administration proposes replacing the volume-based handling fee with a flat monthly payment of \$1,700 per site. The flat payment is lower than the current average of the volume-based fee, resulting in a savings to the BCRF of approximately \$7 million annually.
- Create Recycling Enforcement Grant.** The administration proposes to establish a new competitive grant program, which would provide funding for local enforcement agencies to perform activities targeted

toward detecting and deterring fraud. This program would increase expenditures from the BCRF by \$7 million annually.

- ***Expand Beverage Container Recycling Competitive Grants.*** This grant program provides funding for local recycling and litter reduction projects, such as projects to increase the recycling rates in schools, improve container collection in cities, or reduce litter at public events. The administration proposes increasing funding for this program by \$3.5 million, resulting in \$5 million in total funding for the program.
- ***Public Education and Information.*** The proposal includes \$2.5 million for public education in order to inform program participants and the public of recent and proposed changes to the BCRP.
- ***Program Administration.*** The proposal includes an additional 12 positions and \$1.5 million in funding for increased program administration workload resulting from the above changes, such as the establishment of a new grant program.

LAO Assessment

Proposal Is Reasonable Way to Eliminate Structural Deficit. We find that the Governor's proposal is a reasonable approach to addressing the BCRF structural deficit and avoiding the need for proportional reductions in 2015-16. For example, the proposal eliminates some program elements that are not as central to the mission of the CRV program, such as processing fee offsets. The Governor's proposal also reduces payments where there is little data on the program's impact on the overall beverage container recycling rate, such as curbside supplemental payments. We note, however, that there is some level of uncertainty

inherent in forecasting BCRF revenues and redemption rates. Therefore, it is possible that even if the Legislature were to adopt all of the Governor's proposed changes, there could be funding shortfalls in the future.

Proposal Could Have Small Impact on Recycling Rates. The proposed program changes would reduce some payments to participants, especially high-volume recyclers in convenience zones, curbside recyclers, and cities and counties currently receiving payments. Consequently, some recyclers and processors currently operating with a very small profit margin might shut down or operate fewer hours. However, these changes are a small portion of revenue for most participants, and they still receive other payments through the program. For example, while curbside collection programs would no longer receive curbside supplemental payments, they would still receive CRV and processing payments, and are eligible for several grant programs. This is in addition to revenue from their contract with the local government and scrap value of the materials they collect. Therefore, we expect that any impact on recycling to be small.

Future Recycling Rate Increases Can Cause Another Structural Deficit. We calculate that the proposed reforms would put the fund balance at the current break even redemption rate of approximately 88 percent. However, if the redemption rate were to increase past this point, it could result in another structural deficit in the future. If that were to occur, CalRecycle anticipates that additional programmatic changes (such as additional spending reductions) would be necessary to support a redemption rate higher than 88 percent. The department states that it expects the rate to stay close to the current rate. The department is currently required to issue quarterly reports on the status of the BCRF to allow the Legislature to monitor revenue and expenditure

trends. Figure 11 shows projected BCRF revenue and expenditures in 2016-17 under different redemption rate assumptions.

Few Outcome Metrics for Some Grant Programs.

Currently, there is little data available on the effectiveness of existing grant programs. The administration is not proposing outcome reporting on the new program proposed. While CalRecycle issues reports that include the number of grants, grant recipients, and grant statuses, these statistics do not indicate the overall effectiveness of the grant programs. Other CalRecycle grant programs, such as the Tire Enforcement Grant, by comparison, do track performance metrics such as the number of violation notices issued by grantees that resulted in collections.

LAO Recommendations

We recommend that the Legislature adopt the Governor’s proposal. As stated above, we find that the proposal is a reasonable way to ensure the fiscal solvency of the BCRF, which is currently operating with a large structural deficit. We would note, however, that each proposed reduction does come with some trade-offs and would result

Figure 11
Beverage Container Recycling Fund
Summary of Fiscal Impacts of Governor’s Proposal
Under Different Assumptions for Redemption Rates

(In Millions)

Redemption Rate	2016-17		
	85%	88%	91%
Total revenues (CRV payments less administrative fees)	\$1,131	\$1,131	\$1,131
CRV payments to consumers	-976	-1,010	-1,045
Funds Available for Programs	\$155	\$121	\$86
Program Expenditures	\$121	\$121	\$121
Net Surplus (+)/Deficit(-)	\$35	—	-\$34

in a recycling program participant—especially distributors and recyclers—bearing greater costs. Therefore, the Legislature will want to make sure that each of the changes is consistent with policy priorities.

Second, we recommend that the Legislature require the department to report annually on outcome metrics for all BCRF-funded grant programs to ensure that in the future the Legislature can determine whether these programs are an effective use of funds. These reports should include data related to effects of programs on recycling rates and cost-effectiveness. For example, the evaluation of enforcement grants should include the amount of collections and estimates of cost savings from reduced fraud. This would allow the Legislature to compare how effective the enforcement grants are relative to other enforcement options.

CALFIRE

CalFire, under the policy direction of the Board of Forestry and Fire Protection, provides fire protection services directly or through contracts for timberlands, rangelands, and brushlands

owned privately or by state or local agencies. These areas of CalFire responsibility are referred to as “state responsibility areas” (SRA) and represent approximately one-third of the acreage of the state.

In addition, CalFire 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 brushlands.

The Governor's budget proposes \$1.4 billion from various funds for support of CalFire in 2014-15. This is an increase of \$180 million, or 14 percent, from estimated current-year expenditures. This increase is due to various budget adjustments. For example, the budget reflects the allocation of \$50 million in cap-and-trade auction revenues for fire prevention activities and urban forestry. The budget also includes an increase of \$39 million in reimbursements from local and federal governments for firefighting services provided by CalFire. In addition, the budget proposes a \$56 million increase in General Fund support related to a shift in responsibilities from the federal government to CalFire, increased payments for employee compensation, and the annual adjustment to the emergency fund (e-fund). Chapter 8, Statutes of 2011 of the First Extraordinary Session (ABX1 29, Blumenfeld), authorized a fee on all habitable structures within the SRA. The revenue collected from this fee—projected to be \$76 million in 2014-15—is deposited in the SRA Fire Prevention Fund for fire prevention activities within the SRA.

SRA Protection Adjustment

Background. Fire protection efforts in California's wildlands involve firefighting resources at the state, federal, and local levels. The responsibilities for each level of government are set forth in law and policy directives. However, these responsibilities and the geographic areas of protection often overlap among governments. In order to reduce overlap and maximize the use of resources across jurisdictions, firefighting agencies generally rely on a complex series of agreements

that result in a multiagency wildland fire protection system. As shown in Figure 12 (see next page), state or federal agencies have primary responsibility for providing wildland fire protection for 79 million acres—almost 80 percent of all land—in California. Specifically, the state is currently responsible for wildland fire protection on approximately 31 million acres of wildlands (generally privately owned). Federal Responsibility Areas (FRA) are comprised of 48 million acres of land owned and administered by various federal agencies including the United States Forest Service (USFS), the Bureau of Land Management, the National Park Service, the Fish and Wildlife Service, and the Bureau of Indian Affairs.

Since the 1930s, state and federal agencies have entered into agreements that provide for interagency cooperation between these two levels of government. As part of this agreement, CalFire and its federal counterparts have determined in which areas it is most efficient for the state and federal governments to have resource protection responsibility. This includes, in some areas, CalFire having fire protection responsibilities of FRAs, while in other areas, the federal government has fire protection responsibilities in SRAs. Approximately four million acres of SRA are protected by the USFS for wildland fire prevention and suppression, and CalFire protects a similar amount of federal land. Once responsibility for protecting lands is determined, the agency accepting responsibility for the protection of that land assumes full financial responsibility for any firefighting costs associated with it. In addition, the agreement provides that each agency, to the extent possible, will fight fires consistent with the approach of the other agency had it been the one responsible.

Following the 2007 Angora Fire near Lake Tahoe, the agreement between CalFire and its federal counterparts was reexamined, and a statewide review by CalFire and USFS determined

that the USFS could no longer adequately protect some SRA it had previously covered. This determination was based on the following factors: (1) a large number of homes in wildland areas, (2) the likelihood of high-intensity wildfires, and (3) high property and resource values. In particular, the review identified areas around the Lake Tahoe basin, Idyllwild (Riverside County), and Big Bear Lake (San Bernardino County) as areas in which USFS could no longer offer adequate protection. CalFire and USFS reached a new agreement in 2013 that transfers primary fire protection responsibility

in these SRAs to CalFire. Consequently, the state resumed primary protection responsibility for 92,000 acres of high-risk, high-value SRA in 2013. For the past year, CalFire has utilized existing resources from other areas in order to cover these additional areas of responsibility.

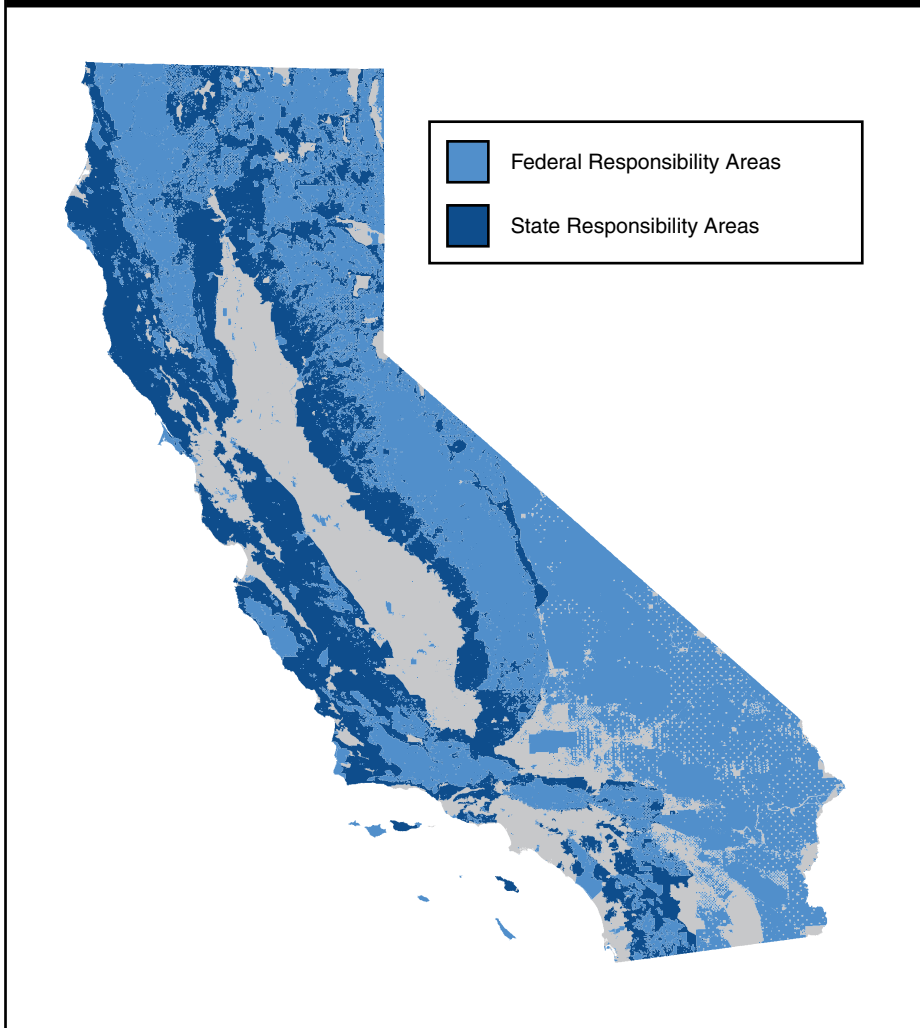
Governor’s Budget. The Governor’s budget proposes ongoing funding of \$14.2 million to support 62.5 permanent positions, in order to expand CalFire fire protection in the areas around Lake Tahoe, Idyllwild, and Big Bear

Lake. This includes (1) \$13.6 million from the General Fund to support 59.5 positions for fire suppression, and (2) \$670,000 from the SRA Fire Prevention Fund to support three positions for fire prevention activities within the SRAs. These resources will provide staffing for seven fire stations and one helitack base in these areas.

Proposed Expansions Likely to Have Additional Costs. The administration’s budget request is for the additional positions and operating costs necessary to provide fire prevention and protection services in these areas. The request, however, does

Figure 12

State and Federal Responsibility Areas for Wildland Fire Protection



not identify CalFire’s long-term facility needs in these areas or the potential costs for purchase or construction of new facilities.

More Changes to Interagency Agreement

Likely. Since the interagency agreement between CalFire and federal agencies was first established in the 1930s, the nature of the SRA and FRA have changed significantly. For instance, housing development has increased in many areas of SRA. Additionally, the responsibilities of CalFire and federal agencies have shifted. For example, CalFire is now required to provide certain fire prevention services to all inhabitants in SRA since those residents pay the SRA fee. The USFS, on the other hand, does not have the authority to conduct the same level of fire prevention activities as CalFire. In addition, the USFS and CalFire have different fire suppression and fire fuel management policies. The current interagency agreement with the federal government is set to expire in 2018. Based on our conversations with CalFire, as SRA land continues to be developed and fire suppression costs rise, federal agencies will want to shift more SRA fire protection responsibility to the state. This would result in additional costs to the state.

LAO Recommendations. It is consistent with CalFire’s mission to protect these three areas to California’s fire protection standards, and the proposal would provide the level of resources necessary for sufficient staffing according to the department’s methodology. Therefore, we recommend that the Legislature approve the Governor’s proposal. However, the Legislature should request additional information to understand the full magnitude regarding the fiscal impact of these changes, as well as potential changes in the future. Specifically, we further recommend that the Legislature require CalFire to report at budget hearings on the expected capital outlay costs associated with the proposal. In addition, we recommend that the Legislature

adopt budget trailer legislation requiring CalFire to report on other areas of SRA currently protected by federal agencies that are most likely to be transferred back to CalFire responsibility in the future. This report to the Legislature should be completed prior to renewing the interagency agreement. The report should identify the reasons why those areas are most likely to be shifted back to CalFire, the operational and capital costs associated with CalFire management of those areas, and any policy alternatives the state could consider other than taking back full responsibility (such as sharing of resources and facilities or different reimbursement policies).

Illegal Fireworks Management and Disposal

Background. Under state law, the Office of the State Fire Marshal (OSFM) within CalFire is responsible for the management and disposal of seized illegal fireworks. Fireworks may be declared illegal by federal, state, or local governments. Federal regulations designate some types of fireworks as illegal to be sold in the U.S. State law allows only certain fireworks legal under federal law—those designated as “safe and sane” by the OSFM—to be sold in California. Many local jurisdictions in California choose to ban the sale or use of any fireworks within their borders. Consequently, illegal fireworks seized by law enforcement agencies include those that are illegally made in or transported into the U.S., as well as fireworks that are legally purchased in one jurisdiction (including parts of California, in some cases) and brought into another jurisdiction where they are illegal.

Possession of fireworks illegal in California is usually a misdemeanor and is punishable by penalties ranging from \$500 to \$50,000, as well as possible incarceration, with the size of the penalty depending on the quantity of fireworks.

Law enforcement agencies, such as the California Highway Patrol and local police, are authorized to seize illegal fireworks. Local fire departments may also accept drop-offs of illegal fireworks. Once the fireworks are seized, state statute requires the OSFM to properly dispose of them. Because seized fireworks are considered hazardous waste and are explosive, proper disposal can be dangerous, labor intensive, and costly. Many of the fireworks must be shipped to an out-of-state disposal site, at a cost of roughly \$10 per pound. Fireworks that cannot be shipped because they are unpackaged or unstable are incinerated at a cost of about \$30,000 annually. The OSFM estimates that around 100,000 pounds of illegal fireworks are collected annually, and that it would cost approximately \$600,000 if the state were to dispose of all collected fireworks in the state each year.

Chapter 563, Statutes of 2007 (SB 839, Calderon), increased the penalty amounts to the levels described above in order to fund the disposal of seized fireworks. However, the revenue generated from these penalties has never been sufficient to cover more than a small fraction of the program's costs. The most penalty revenue collected in any given year was around \$30,000, and in some years, it has been as little as a few thousand dollars. It is unclear why the penalty revenue collected is so low. According to OSFM, the lack of ongoing funding for proper disposal has caused a backlog of illegal fireworks needing proper disposal. The OSFM estimated that there was a backlog of 250,000 pounds of fireworks as of August 2013. In 2012, a working group made up of various stakeholders was convened to address the issues surrounding seized illegal fireworks, including funding for disposal. However, the group did not issue a formal proposal. The Legislature approved one-time funding of \$500,000 from the General Fund in the current year to help address the backlog.

Governor's Budget. The Governor's budget proposes \$1.5 million in one-time funding from the Toxic Substances Control Account (TSCA) to properly dispose of the current backlog of seized fireworks. (The TSCA is used primarily by the DTSC for responses to hazardous waste releases and is funded mostly by a tax on businesses in industries that use, generate, or store hazardous materials or that use products manufactured with those materials.) The Governor also proposes to establish a 1.5 percent assessment on legal safe and sane fireworks sold in California to cover the ongoing costs of fireworks disposal. The administration estimates that the proposed assessment will generate \$1.2 million annually when fully implemented. Assessment revenues will be deposited into the existing Fire Marshall's Fireworks Enforcement and Disposal Fund to cover staffing and operation costs of the program.

New Assessment Has Trade-offs. We find that the new assessment proposed by the administration should raise more than a sufficient amount of revenue to address the ongoing costs of the program. In addition, the proposed assessment avoids the need to use other state resources—such as the General Fund or another special fund—on an ongoing basis. However, the structure of the assessment means that people purchasing fireworks legally would be required to pay the costs associated with the actions of those who break the law by purchasing or transporting illegal fireworks. Moreover, the assessment does not impose a cost on those who break the law and whose actions drive state costs. In addition, we note that the administration's proposed assessment is estimated to generate much more revenue—\$1.2 million—than estimated annual program costs—about \$600,000. While there is some uncertainty surrounding the revenue estimates because of limited data, this assessment could result in twice as much revenue as the program costs on an annual basis.

Other Funding Options Also Have Trade-Offs. In reviewing this proposal, we identified several alternative options for funding fireworks disposal.

- TSCA.** The Legislature could consider providing ongoing funding from TSCA. The Governor proposes using TSCA for one-time funding to address the existing backlog of seized fireworks, and we find it to be an appropriate use of this fund. Additionally, TSCA currently has a large reserve, projected at \$37 million—or 82 percent of revenues and transfers—in 2014-15. This financing mechanism avoids imposing an assessment on legal fireworks sales, and does not use money from the General Fund. However, creating additional ongoing commitments from TSCA would compete with current activities paid for by the fund. For example, TSCA is currently used to fund many other activities whose costs are projected to increase in the future, such as the cleanup of hazardous waste sites and the Safer Consumer Products program. Committing ongoing TSCA funding for fireworks disposal may reduce the state’s ability to perform these other activities in the future.
- General Fund.** To the extent that the Legislature determines that fireworks disposal has a benefit to the entire state, the General Fund is an appropriate funding option. This financing mechanism avoids an assessment on legal fireworks sales and does not place a financial burden on any special funds. However, it does divert resources from the General Fund on an ongoing basis, an option that the Legislature rejected in 2013-14. Notably, the General Fund is used to fund some costs associated with illegal activities, such as illegal drug lab cleanups.
- Local Governments—Share in Disposal Costs.** Local law enforcement agencies and residents benefit from the OSFM’s disposal of fireworks through reduced fire and safety risk. Moreover, local decisions—such as a county fireworks ban that increases the number of fireworks considered to be illegal—drive some of the OSFM’s costs. Therefore, a cost-sharing arrangement between state and local governments may be appropriate. This could be achieved, for example, by (1) requiring local governments to pay OSFM for a share of disposal costs, or (2) removing the statutory requirement that OSFM be responsible for the disposal of all seized fireworks, thereby leaving the responsibility and cost with local governments. Both options avoid an assessment on legal fireworks and do not divert state resources from special funds. However, they may both be considered state-reimbursable mandates. When the state mandates that a local government provide a new program or higher level of service, the California Constitution often requires the state to reimburse the local government. Since the state currently provides seized fireworks disposal, shifting the responsibilities or costs back to local governments could require a higher level of local service and therefore be a state-reimbursable mandate. Reimbursable mandates are paid from the General Fund. Therefore, if these actions were determined to be reimbursable mandates, this option could be costly to the General Fund. Moreover, the Legislature would have less oversight of the program

and control of the costs than if the program was operated by the state.

- ***Selling or Returning Fireworks to Manufacturers.*** One option the working group convened in 2012 considered was to allow enforcement agencies to sell or give fireworks that are legal in California or the U.S. back to manufacturers and retailers. Under this type of approach, fireworks companies would remove the fireworks from California and cover their costs by reselling the fireworks where they are legal. The benefit of this approach would be to reduce the cost of disposal, as well as generate some revenue that could be used, for example, to cover costs of disposing of fireworks illegal in the U.S. On the other hand, this approach would put government agencies in the position of selling illegal

materials, and once resold, much of this material could end up back in California.

LAO Recommendation. We find that the administration’s effort to develop a permanent funding source for fireworks disposal is a reasonable one. The Governor’s proposed approach provides one option, and there are others—as we discussed above—that could be considered. Each option, however, has trade-offs. In determining which financing mechanism is most consistent with current legislative priorities, the Legislature will need to make a policy decision about where it wants the costs of disposal to be borne. If the Legislature chooses to adopt the Governor’s proposal, we recommend lowering the assessment rate to 1 percent. This is enough to cover the estimated costs of the program and account for the uncertainty in this new revenue stream.

AIR RESOURCES BOARD

In California, air quality regulation is divided between ARB and 35 local air quality management districts. The local air districts manage the regulation of stationary sources of pollution (such as industrial facilities) and prepare local implementation plans to achieve compliance with the federal Clean Air Act. The ARB is responsible primarily for the regulation of mobile sources of pollution (such as automobiles) and for the review of local district programs and plans. The ARB also oversees the state’s cap-and-trade program designed to reduce GHG emissions. The Governor’s budget proposes \$801 million for ARB in 2014-15, a net increase of \$249 million (45 percent) over estimated expenditures in the current year. This increase largely reflects the appropriation of additional Proposition 1B funds for port modernization, as well as increased funding from cap-and-trade auction revenues for ARB’s clean vehicle programs.

Cap-and-Trade Market Surveillance

Background

Cap-and-Trade. The Global Warming Solutions Act of 2006 (Chapter 488, Statutes of 2006 [AB 32, Núñez/Pavley]), commonly referred to as AB 32, established the goal of reducing GHG emissions statewide to 1990 levels by 2020. In order to help achieve this goal, ARB adopted a regulation that establishes a cap-and-trade program that places a “cap” on the state’s aggregate GHG emissions. To implement the cap-and-trade program, ARB allocates carbon allowances equal to the cap. Each allowance equals one ton of carbon dioxide equivalent. The ARB provides some allowances for free, while making others available for purchase at auctions. Once the allowances have

been allocated, entities can then “trade” (buy and sell on the open market) the allowances in order to obtain enough to cover their total emissions for a given period of time.

The ARB is using a phased-in approach to implement the cap-and-trade program. The first compliance period started in 2013 with electricity generators and large industrial sources subject to the cap. Starting in January 2015, additional entities—notably fuel suppliers—will become subject to the cap, more than doubling the size of the program.

Oversight of Carbon Markets. The practice of auctioning, buying, and selling allowances creates a “carbon market.” This market actually consists of a number of distinct but interrelated markets, each regulated in different ways. First, emission allowances are introduced into the market via ARB’s quarterly auctions or through free allocations by the board. The ARB has established rules for these auctions. For example, ARB’s rules allow entities that are not subject to cap-and-trade regulations to participate in auctions as long as ARB has determined that they do not have a conflict of interest such as related to the implementation and oversight of the program.

Second, market participants can buy and sell allowances. In January 2014, ARB linked the state’s cap-and-trade market with Quebec’s cap-and-trade market, which allows allowances in each market to be traded for each other. The ARB has regulatory responsibility to oversee the direct trading of California’s cap-and-trade allowances. These trades must be approved by ARB and inputted into the Compliance and Tracking System Service. The ARB has contracted with a third-party company to provide assistance with tracking of trades and market monitoring.

A third carbon market component—the derivatives market—has developed out of the cap-and-trade program. A derivative is a

financial contract whose price is “derived from” an underlying asset (in this case, cap-and-trade allowances). Derivatives are primarily used for hedging risk and investment purposes. Derivative trades of cap-and-trade allowances can be conducted through operated exchanges, such as the Intercontinental Exchange. The U.S. Commodity Futures Trading Commission (CFTC) has oversight and enforcement authority of transactions that take place in the derivatives market.

Governor’s Proposal

The Governor’s budget proposes \$700,000 for ARB to support three new positions and contract funding to expand its market surveillance capabilities and implement its market monitoring plan. The additional staff would review trades of allowances to look for anomalies in trade patterns and coordinate with CFTC to incorporate more advanced methods of surveillance into ARB’s own oversight activities.

LAO Recommendations

Approve Positions Requested. As the state’s cap-and-trade program expands and ARB links California’s program with other countries, the cap-and-trade market will become larger and more complex. Over the life of the program, it is anticipated that the market for allowances will be valued in the billions of dollars—making it essential that ARB provide adequate oversight to the program in order to ensure its integrity. Thus, we find it is reasonable that ARB seek additional resources for this purpose and recommend that the Legislature approve the proposed three positions and \$700,000.

Additional Legislative Oversight Warranted. While ARB has taken some steps to help build its capacity to provide such oversight, which the proposed funding and positions would expand, the Legislature will want to ensure that the board is

providing an adequate level of oversight. The ARB is an air pollution regulatory body, and regulating and overseeing international commodity markets is not part of its core competency. In addition, since ARB's monitoring plan is confidential, the Legislature currently has little information regarding planned monitoring activities. It will be important for the Legislature to evaluate the safeguards that ARB is putting in place.

Therefore, we recommend that the Legislature direct ARB to report at budget hearings on its

current monitoring plan and how its approach to market oversight will be adequate given the size and complexity of the emerging market. In conducting this oversight, the budget committees may want to seek the participation of the relevant policy committees that deal with energy, as well as regulation of financial institutions. Depending on the outcome of these hearings, the Legislature could consider whether additional steps are necessary to provide ongoing oversight of the carbon market or ARB's market surveillance activities.

CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY (CAEATFA)

The CAEATFA is housed within the State Treasurer's Office and is tasked with the authority to provide financing assistance to entities that wish to develop and commercialize advanced transportation and alternative energy technologies intended to reduce air pollution and conserve energy. The CAEATFA consists of five members: the State Treasurer (who serves as the chairperson), the State Controller, the Director of the DOF, the Chairperson of the California Energy Commission (CEC), and the President of the California Public Utilities Commission (CPUC). The Governor's budget proposes a total of \$27.5 million for CAEATFA in 2014-15, a net increase of \$17.5 million over the estimated expenditures in the current year. The CAEATFA's programs are primarily funded through transfers from CEC.

Energy Efficiency Financing Pilot Program and PACE Loss Reserve

Background. The state is currently pursuing multiple approaches to assisting residential and commercial property owners to implement energy

efficiency upgrades (through rebate and incentive programs) and renewable energy installations (through California's Million Solar Roofs program). The state has three main programs to help property owners finance these types of projects. They are as follows:

- **On-Bill Financing.** Since 2010, all state investor-owned utilities (IOU) have provided upfront financing for commercial entities to install energy efficiency upgrades and renewable energy projects. Entities receiving financing repay with interest the IOUs over time through additional charges on their electricity bills.
- **Property Assessed Clean Energy (PACE) Loss Reserve.** Under state law, local governments may administer PACE programs to provide up-front financing for renewable and energy efficiency-related upgrades to properties. Through PACE, property owners who wish to install renewable energy-generating devices or make energy efficiency improvements to

their properties may borrow funds from the participating local government for those purposes. These loans are repaid by the property owner over 10 to 20 years via an assessment on the owner's property tax bill. The assessment remains on the property even if it is sold or transferred. Program participants anticipate that energy savings resulting from the retrofit will offset the cost of the property tax assessments. In 2010, the Federal Housing Finance Agency (FHFA) raised concerns that residential PACE financing could potentially create additional risk for federal mortgage enterprises (Freddie Mac and Fannie Mae) because when foreclosure occurs, the original lender must pay property taxes owed—including PACE assessments—before paying mortgage costs. In order to address FHFA's concerns and to encourage local government participation in this type of financing, the CAEATFA has set up a PACE loss reserve program in which the state will reimburse the original mortgage lender for the costs associated with PACE assessments during a foreclosure.

- ***CPUC Energy Efficiency Financing Pilot Program.*** In 2010, the CPUC hired a consulting team to identify financing approaches that would encourage greater adoption of energy efficiency upgrades. From this work, in 2012 the CPUC established a new financing pilot program to provide loan loss reserve and interest rate buy-downs for banks, in order to reduce their financial risk and provide greater incentive for them to provide financing for these types of projects. As part of its decision, CPUC selected

CAEATFA as the administrator for the pilot program.

Governor's Budget. The Governor's budget includes two proposals that would provide CAEATFA additional funding and positions for energy efficiency financing programs. First, the Governor requests a reappropriation of \$10 million that was initially appropriated in the 2013-14 budget for implementation of the PACE loss reserve program. The administration requests the reappropriation because enabling legislation was not passed until September 2013. Second, the budget includes an augmentation of \$3.2 million in 2014-15 and seven limited-term positions to administer the CPUC's energy efficiency financing pilot program.

Issues for Legislative Consideration. The administration's proposals are consistent with legislative intent to promote energy efficiency and renewable energy technology in California. However, based on the research we have reviewed, it is unclear how effective financing is at getting property owners to undertake projects that would not have otherwise occurred. Moreover, we note that with the addition of CPUC's new pilot program proposed to be administered by CAEATFA, there would now be three state financing programs with the same goal of increasing implementation of energy efficiency and renewable energy projects. Therefore, it is unclear to what extent these programs' overlapping missions could result in duplication of effort among programs.

LAO Recommendations. In order to better ensure that ratepayer funds are being used efficiently, we recommend that the Legislature approve budget trailer legislation that requires CPUC—in consultation with CAEATFA—to evaluate the effectiveness of each of the three financing programs, upon completion of the new CPUC pilot program. This evaluation should include information that allows the Legislature

to compare the cost and effectiveness of each approach, including information on (1) the number, type, and scale of energy efficiency upgrades and renewable energy installations funded; (2) the costs

of these projects compared to their benefits; and (3) the degree to which these programs overlap with each other for customers.

DEPARTMENT OF FISH AND WILDLIFE

The DFW administers programs and enforces laws pertaining to the fish, wildlife, and natural resources of the state. It protects and maintains habitat and manages about one million acres of ecological reserves, wildlife management areas, and fish hatcheries throughout the state. It also regulates hunting and fishing in conjunction with the Fish and Game Commission. The DFW is also the lead state agency for preventing and responding to oil spills.

The Governor's 2014-15 budget proposes a total of \$404 million from various funds (mainly special funds) for support of the department. This is a net decrease of \$52 million, or 11 percent, compared to projected current-year expenditures. This change primarily reflects reduced bond expenditures.

Oil Spill Prevention and Response Fee Increase

Background. The Office of Spill Prevention and Response (OSPR) within DFW is responsible for preventing, preparing for, and responding to oil spills. The OSPR activities include reviewing oil spill contingency plans, performing inspections and investigations, tracking spills, and directing spill response and cleanup efforts. The OSPR has statutory authority to regulate prevention of marine spills (through activities such as reviewing oil spill contingency plans and conducting drills). That authority, however, does not extend to inland prevention activities. Statute further designates OSPR as the primary agency responsible for responding to both inland and marine spills. Currently, OSPR responds to only about half of

inland spills because of funding limitations. The 2013-14 budget included \$44 million to support OSPR activities, including 190 positions.

The OSPR is principally funded by the Oil Spill Prevention Administrative Fund (OSPAF), which is supported by a fee of 6.5 cents on each barrel of oil brought into California over marine waters. (The State Lands Commission also receives some funding from OSPAF.) This fee is currently collected by the Board of Equalization from marine terminals and marine pipeline operators. The fee generates approximately \$38 million in revenues annually. In the current fiscal year, the state is projected to spend \$43 million from OSPAF, resulting in a structural deficit of about \$5 million. Under current law, the OSPAF fee will decrease to 5 cents on January 1, 2015.

In addition, the department supports a statewide system of facilities throughout the state, called the Oiled Wildlife Care Network (OWCN), to rapidly respond to and treat wildlife that have been affected by an oil spill. The OWCN is operated by the University of California but receives \$2 million in support annually from DFW, using interest from the Oil Spill Response Trust Fund (OSRTF). However, the interest from the OSRTF is no longer sufficient to fund OWCN as a result of a loan made to the General Fund and low interest rates.

Governor's Proposal. The Governor proposes statutory changes to maintain the OSPAF fee at 6.5 cents per barrel on an ongoing basis, as well as expand the fee to all oil entering California refineries, including oil transported by rail and

pipelines. The administration projects that the proposed fee increase would increase revenues by \$6.6 million in 2014-15 (\$12.3 million annually when fully implemented) compared to current-year revenues. The Governor's budget for 2014-15 proposes to increase ongoing spending by \$8.7 million, as follows:

- \$6.2 million and 38 permanent positions to support the proposed expansion of OSPR's activities to include inland prevention activities, as well as allow the office to respond to all inland spills. According to the administration, the proposed expansion is necessary because the amount of oil transported over land (by rail or pipeline) is expected to significantly increase in coming years.
- \$2.5 million to support the OWCN and change the program's fund source (from the OSRTF to the OSPAF). The proposed amount reflects an increase of \$500,000 for the program relative to the current-year funding level.

We note that even with the fee increase, expenditures from OSPAF are projected to exceed revenues in 2014-15 by \$7.1 million. While a fund surplus has been able to offset the structural deficit in past years, the projected fund balance would decrease to only \$1.8 million (4 percent of the total estimated revenue) in 2014-15 under the proposal. Thus, a relatively small difference between actual and estimated revenues in 2014-15 could put the fund into deficit. In future years, the department proposes to use some of the increased revenue to address the structural shortfall in OSPAF.

Fee Structure Not Tied to Spill Risk. One approach to apportioning the costs of a regulatory program is to charge regulated entities in proportion to the potential harm they impose on public resources (such as the environment). In

the case of OSPR's oil prevention and response programs, the potential harm is the risk associated with an oil spill. Currently, the OSPAF fee is charged to marine vessels and facilities based on the amount of oil they transport and thus only accounts for one aspect of oil spill risk. Other aspects of risk include the likelihood that a spill will happen (which can vary based on how the oil is transported), the type and chemical makeup of the oil, and the vulnerability of the ecosystem where the spill occurs. For example, an oil spill of a given size may have greater environmental consequences if it occurs in a smaller water body or in an ecosystem with high numbers of endangered species. Thus, the proposed fee structure is unlikely to charge regulated entities in proportion to the potential risk they pose.

LAO Recommendations. Given the potential environmental damage that can be caused by inland spills, as well as the projected increase in inland oil transportation, we find that the intent of expanding prevention activities to land is reasonable. Thus, we recommend that the Legislature approve the administration's proposal to expand the OSPAF fee to all oil entering California refineries to ensure that parties that transport oil inland (and therefore pose a spill risk) pay for some prevention and readiness activities.

As noted above, a flat fee per barrel does not fully capture all factors that affect spill risk. Thus, we recommend the Legislature amend the proposed budget trailer legislation to direct the department to develop a risk-based fee structure to cover the costs of its combined inland and marine oil spill prevention program. We also recommend that the legislation authorize the department to charge the fees to generate total revenue up to the amount authorized for oil spill prevention and response in the annual state budget.

In developing this structure, the department should consider several factors, including: (1) which

factors are most important for determining oil spill risk, including how oil spills affect different ecosystems; (2) how often the fee should be adjusted to account for changing risk; and (3) how to ensure that the fee structure is not administratively burdensome. Charging fees based on relative oil spill risk could help ensure that the state is reducing risk effectively, as well as helping to ensure that regulated entities are bearing an appropriate share of the costs of the program.

In addition, as noted above, this proposal would significantly reduce the balance in OSPAF, putting it at risk of a deficit. Thus, we recommend the Legislature fund the requested positions for OSPR's activities for a half year, resulting in a reduction of the appropriation by \$1.6 million in 2014-15. Based on current revenue estimates, this would result in a fund balance of 8 percent. We further recommend that the Legislature approve the requested funding for OWCN from OSPAF.

DEPARTMENT OF TOXIC SUBSTANCES CONTROL

The DTSC regulates hazardous waste management, cleans up or oversees the cleanup of contaminated hazardous waste sites, and promotes the reduction of hazardous waste generation. The department is funded from (1) fees paid by persons who generate, transport, store, treat, or dispose of hazardous wastes; (2) environmental fees levied on most corporations; (3) the General Fund; and (4) federal funds. The Governor's budget requests \$195 million from various funds for support of the DTSC in 2014-15. This is a decrease of \$8.3 million, or 4 percent, from estimated current-year expenditures.

Proposals to Reduce Backlogs and Improve Hazardous Waste Tracking

Background. The DTSC regulates hazardous waste management by issuing permits; tracking the generation, transportation, and disposal of hazardous waste; coordinating cleanup of contaminated sites; and seeking recovery of funds from parties responsible for contamination. Concerns have been raised in recent years regarding how DTSC has carried out these responsibilities. For example, due to a backlog in processing applications for hazardous waste

permit renewals, many facilities are operating on "continued permits." This means that these facilities have submitted permit renewal applications, but DTSC has not completed its review and approval process, which usually takes several years. While these particular facilities are allowed to continue operations under the terms of their original permit, these are frequently no longer based on up-to-date technologies, practices, and safeguards. Backlogs in continued permits are also problematic because it means that permit holders have not undergone recent assessments of their facilities to determine if they are releasing any hazardous wastes into the environment. These assessments are part of the permit approval process.

In early 2012, the department responded with its "Fixing the Foundation" initiative, which includes more than 30 different activities intended to improve its operations and restore public trust in the department. Activities include increasing cost recovery from those responsible for hazardous waste contamination, reducing permitting backlogs, strengthening enforcement, and improving the financial sustainability of its operating funds.

Governor's Budget. As shown in Figure 13, the Governor's budget includes four proposals designed

to address the above concerns and implement certain aspects of the department’s Fixing the Foundation initiative. These proposals include increased funding over the next two years. In total, the budget proposes \$4.6 million in 2014-15 and \$3.2 million in 2015-16 from the Hazardous Waste Control Account and the TSCA. Specifically, the request includes the following:

- **Cost Recovery.** The administration requests \$1.6 million and 14 two-year limited term positions to reduce a backlog of reimbursements owed to the department for hazardous waste clean-up activities. The administration estimates that this cost recovery backlog includes around \$26 million in unbilled or uncollected costs that are recoverable.
- **Hazardous Waste Permitting.** The administration requests \$1.2 million and eight two-year limited term positions for two sets of activities. First, the administration proposes to address the hazardous waste permit renewal backlog. There are currently 24 hazardous waste facilities with continued permits, which is expected to grow to 34 by 2017. Second, the administration proposes to update cost estimates associated with closing hazardous waste facilities in the future.

Cost estimates need to be updated to ensure that there are sufficient funds to pay for the decontamination and decommissioning of hazardous waste facilities.

- **Hazardous Waste Tracking System.** The budget includes \$1.3 million in one-time funding to rebuild the Hazardous Waste Tracking System, an IT system used by the department to track the generation, transportation, and disposal of hazardous waste. The current software used by DTSC was last updated in 2002 and is no longer supported by the developer. Additionally, the capabilities of the system no longer meet the current needs of DTSC and other regulatory agencies.
- **Hazardous Waste Manifest Error Correction.** The budget includes \$381,000 and 3.5 two-year limited term positions to correct existing errors in the hazardous waste manifest data. Hazardous waste manifests travel with hazardous waste from the point of generation, through transportation, to the final disposal facility. Each party in the chain of shipping (including the generator), signs and keeps one of the manifest copies, creating a

Figure 13

The Department of Toxic Substances Control Budget Proposals

(Dollars in Thousands)

Proposal	2014-15 Amount	Fund	Limited-Term Positions
Address cost recovery backlog	\$1,618	TSCA, HWCA	14.0
Address permit renewal backlog and update cost estimates	1,191	HWCA	8.0
Rebuild hazardous waste tracking system	1,364	HWCA	—
Correct errors in the hazardous waste manifest data	381	HWCA	3.5
Totals	\$4,554		25.5

TSCA = Toxic Substances Control Account and HWCA = Hazardous Waste Control Account.

tracking system for the hazardous waste. The manifests are used to verify that the hazardous waste was managed properly and arrived at its intended destination. They are also often used as evidence in criminal enforcement actions. However, according to the department, there are many errors in the system. These errors can occur for various reasons, including handlers of hazardous waste incorrectly, incompletely, or illegibly filling out the handwritten manifests, as well as DTSC staff making mistakes when entering the data into the electronic system. These errors create difficulties for monitoring hazardous waste and prevent DTSC from verifying that hazardous waste is being properly managed.

Proposals Would Address Important Issues. . .

The Governor's four proposals address documented concerns and would allow the department to make progress toward resolving some key issues, including low rates of cost recovery, inconsistent hazardous waste tracking, and permitting backlogs. Therefore, the administration's proposals present the Legislature with a reasonable approach to addressing these issues as part of the 2014-15 budget.

. . . However, Proposals Alone Will Not Fix All Issues on Ongoing Basis. While we find the administration's proposals to be reasonable, it is important to note they will not fully address the identified problems for the long run. For example, while two of these proposals address current backlogs, they rely on limited-term positions that will not address the underlying problems that caused the backlogs to form in the first place. In fact, the administration does not anticipate that

the permitting proposal will eliminate the entire backlog of permit renewals. Consequently, it is unclear whether the backlogs will begin to grow in the future after the limited-term positions expire. We would note, however, that the department reports that it is taking additional actions—such as internal administrative and process changes—that are aimed at addressing some of these problems.

Additionally, while the proposal to correct errors in the manifest data would be beneficial, it would not entirely fix the problems it seeks to address. This is because the proposal does not address the root causes of such errors (such as illegible handwriting or data entry mistakes), thus continuing to allow incorrect data to be entered into the system. We note, however, that many problems associated with the manifest system are due to the paper manifests currently required by the federal government. So, DTSC is limited in its ability to make certain changes in this area.

LAO Recommendation. We recommend approval of the Governor's proposals because they should enable the department to make progress in addressing operational deficiencies. We further recommend that the Legislature require the department to report at budget subcommittee hearings this spring on its progress in implementing the Fixing the Foundations initiative. Such a report should include (1) how these four proposals fit into the department's overall strategy, (2) the next steps to be taken—especially regarding aspects of the initiative not proposed for funding, and (3) how each of these steps will be the most cost-effective means of accomplishing all of the initiative's objectives. The department should also provide information on how it will prevent the growth of cost recovery and permitting backlogs in the future.

SUMMARY OF RECOMMENDATIONS

Issue	Governor's Proposal	LAO Recommendation
Crosscutting Issues		
Hydraulic fracturing and other well stimulation—SB 4 ^a	\$20.5 million and 85 positions in three departments—Department of Conservation (DOC), SWRCB, and ARB—to develop and implement regulations related to hydraulic and acid matrix fracturing.	(1) Approve DOC request; (2) ensure that administration's interpretation of current law is consistent with legislative intent, for example, regarding assessment of regulatory fees; and (3) deny SWRCB request for groundwater monitoring contracts.
Deferred maintenance	\$40 million for Department of Parks and Recreation (DPR) and \$3 million for CalFire—all from the General Fund—to address backlogs of deferred maintenance.	Require administration to report at budget hearings on how departments will prioritize projects. Consider using DPR as a "test case" to identify strategy for addressing deferred maintenance on an ongoing basis.
Water Action Plan (WAP)	Several budget proposals, totaling \$621 million, to begin implementation of the administration's recently released WAP.	Require administration to provide an implementation and financing strategy for the five years covered by the WAP.
State Water Resources Control Board (SWRCB)		
Transfer of drinking water program	Shift drinking water program—including \$308 million—from the Department of Public Health.	Approve transfer. Require administration to report at budget hearings on transition plan, and require reporting on outcomes of transfer.
Department of Water Resources (DWR)		
Integrated Regional Water Management (IRWM)	\$473 million (Proposition 84 funds) for IRWM grants.	Reduce appropriation to \$200 million to more closely align with past grant award levels. Also require DWR to report at budget hearings regarding consistency of implementation approach with legislative intent.
Water and energy efficiency	\$20 million from cap-and-trade auction revenues, including \$10 million to upgrade two State Water Project hydroelectric generators.	Reject use of \$10 million from cap-and-trade auction revenues for generator projects.
Department of Resources Recycling and Recovery (CalRecycle)		
Beverage Container Recycling Fund (BCRF) operating deficit	A series of programmatic changes to eliminate structural shortfall in BCRF.	Adopt proposals, and require department to report annually on outcome metrics for all BCRF-funded grant programs.

(Continued)

2014-15 BUDGET

Issue	Governor's Proposal	LAO Recommendation
Department of Forestry and Fire Protection (CalFire)		
State Responsibility Area adjustment	Increase \$14.2 million (primarily General Fund) to take over fire protection services from federal agencies in three areas.	Approve proposal. Require CalFire to report at budget hearings on future costs of proposal. Also require department to report on potential costs and alternatives associated with potential additional transfers of responsibility from federal agencies.
Illegal fireworks management and disposal	Create assessment on fireworks sales to fund costs to dispose of illegal fireworks. Also, one-time transfer of \$1.5 million from TSCA to properly dispose of current backlog of illegal fireworks.	Consider alternative options to determine preferred policy option for disposing of illegal fireworks. If the Governor's proposal is approved, reduce assessment to 1 percent.
Air Resources Board (ARB)		
Cap-and-trade market surveillance	\$700,000 to expand cap-and-trade market surveillance capabilities and implement market monitoring plan.	Approve positions, and direct board to report at budget hearings regarding its market surveillance strategy.
California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA)		
Energy financing pilot and PACE loss reserve	Reappropriate \$10 million for implementation of PACE loan loss reserve program, and provide \$3.2 million to administer energy efficiency financing pilot program.	Require CPUC—in consultation with CAEATFA—to evaluate the effectiveness of various financing programs.
Department of Fish and Wildlife (DFW)		
Oil Spill Prevention and Response fee increase	Expand current fee to all oil entering California refineries, including oil transported by rail and pipelines. Use additional funding to expand oil spill prevention and response activities by \$8.7 million.	Approve proposal, and direct DFW to develop a risk-based fee structure. Also, approve positions for half year, resulting in reduction of \$1.6 million in 2014-15.
Department of Toxic Substances Control		
Proposal to reduce backlogs and improve hazardous waste tracking	Implement four proposals totaling \$4.6 million from special funds to address (1) cost recovery backlog, (2) hazardous waste permit backlog, (3) an information technology system in need of updating, and (4) errors in hazardous waste tracking data.	Approve proposal, and require department to report at budget hearings regarding progress in implementing reforms designed to address various operational issues.
<p>^a Chapter 313, Statutes of 2013 (SB 4, Pavley). TSCA = Toxic Substances Control Account; PACE = Property Assessed Clean Energy; and CPUC = California Public Utilities Commission.</p>		

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