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Assembly California Legislature



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July 11, 2016

The Honorable Freddie Rodriguez
Chair, Joint Legislative Audit Committee
P.O. Box 942849, Room 6025,
Sacramento, CA 94249-0052

RE: AUDIT REQUEST TO EXAMINE HOW THE CALIFORNIA DEPARTMENT OF WATER RESOURCES FUNDS CALIFORNIA WATERFIX ACTIVITIES

Dear Chair Rodriguez:

With this letter, we respectfully request that the Joint Legislative Audit Committee approve an audit, whose scope is described below, of the California WaterFix Project, specifically its funding, the sources of funds already spent on its planning and preparation by the Department of Water Resources, and the spending itself.

BACKGROUND

The California WaterFix Project has its roots in planning of the Bay Delta Conservation Plan (BDCP) starting in 2006.¹ At that time, water contractors, the Department of Water Resource, the Bureau of Reclamation, fishery agencies², and various non-governmental organizations were among those signing on to the BDCP. Signatories to the Planning Agreement sought to plan for “covered activities” that included “conveyance elements” of the SWP and the federal CVP as well as the projects’ maintenance and facility improvements. The Planning Agreement also stated that the parties “agree they will work together to bring available funding to the planning effort.”

At present, California WaterFix is a project whose every phase lacks a transparent funding plan.

Its funding needs are substantial. Estimates in BDCP’s 2014 environmental review presented the project’s capitalized cost (including construction and annual operating and maintenance) at about \$16 billion. This estimate did not include debt service requirements, which other analysts estimated at an additional \$40 billion to \$60 billion.

¹ As defined in Exhibit A of the original BDCP Planning Agreement (U.S. Bureau of Reclamation et al 2006), water contractors included MWD, SCVWD, KCWA, Zone 7, WWD, and San Luis & Delta Mendota Water Authority (which as a joint powers authority under the California Government Code includes among its members SCVWD and WWD).

² Fishery Agencies included the California Department of Fish and Game, United States Fish and Wildlife Service, and the National Marine Fisheries Service.



To date, approximately \$248 million has been spent to develop the Draft BDCP and its successor project, California WaterFix. These funds were used to conduct environmental review of the proposed project and its alternatives, host numerous public outreach activities, and undertake preliminary engineering and design of the proposed conveyance facilities.

According to the BDCP web site, funding for this work has been provided to the California Department of Water Resources by state and federal water contractors that receive water from the State Water Project (SWP), the Central Valley Project (CVP), or both. The contractors include Alameda County Flood Control and Water Conservation District, Zone 7, Metropolitan Water District of Southern California (MWD), Kern County Water Agency (KCWA), San Luis & Delta-Mendota Water Authority, Santa Clara Valley Water District, and Westlands Water District.³

These water contractors are expected to be the major beneficiaries of the construction, operation, and maintenance of the proposed California WaterFix project, and as beneficiaries they are expected to pay for the project's costs.

However, of the \$248 million spent to date, MWD's General Manager stated that MWD's share was \$63 million, or about 25 percent. In the fall of 2014, KCWA officials were informed in late 2014 that the Agency's share of BDCP was approximately 12.7 percent of the total BDCP budget.

These shares of key water contractors' costs of the Tunnels project indicate that they are investing significant amounts of ratepayer and possibly local taxpayer funds to support continued planning and design of the California WaterFix project.

Since 2006, neither the Bay Delta Conservation Plan nor the California WaterFix Project has had any action authorized by the California State Legislature or the United States Congress.⁴ No coherent funding plan has been put forward by any party to the project's planning agreements that clearly describes California WaterFix funding over the long-term. Planning for the BDCP previously and now California WaterFix has been made possible in part from bonded debt issued by major water contractors (or their joint powers authority coalitions) supporting the project, or by one of their joint powers authorities.

To date, neither state nor federal water contractors have committed to any specific financing plan for California WaterFix. Until state or federal contractors commit to funding their share of project costs, their counterpart cannot commit to funding either, as they could be left with expense. Nonetheless in May 2014, DWR director Mark Cowin announced the formation of a new unit within DWR called the Design and Construction Enterprise (DCE), and retained Hallmark Group to manage design engineering for this

³ Accessible at <http://baydeltaconservationplan.com/Library/BDCPLibrary/YourQuestionsAnswered.aspx>.

⁴ The California Water Action Plan update for 2016 acknowledges the absence of financing for California WaterFix, stating, "State and federal agencies will complete environmental review documents, secure permits for construction and operation from state and federal biological agencies, secure all necessary permits from other state and federal agencies, finalize a financing plan, and complete the design of California WaterFix facilities." The 2015 Implementation report on the California Water Action Plan included only two mentions of California WaterFix and neither reference had any relationship to its financing or funding. Accessible at http://resources.ca.gov/california_water_action_plan/.

unit. DCE planning documents mention a Conveyance Project Coordinating Agency. It is unclear how this agency is or will be funded without a finance plan.

State water contractor commitments to financing California WaterFix are crucial. According to a recent DWR revenue bond prospectus, their water service contracts with DWR provide that

[DWR's] costs, including interest, of providing the facilities of the State Water Project, including the Water System Projects, are payable by the Contractors whether or not water is delivered. If a Contractor defaults under its Water Supply Contract, the Department may, upon six months' notice, suspend water deliveries to that Contractor. During such period, the Contractor remains obligated to make all payments required by the Water Supply Contract. If a Contractor fails or is unable to raise sufficient funds by other means to make Water Supply Contract payments, the Contractor is required by the Water Supply Contract to levy a tax or assessment sufficient for such purpose....If any affected Contractor defaults on payments under certain of [various] amendments [to account for recent construction works in the State Water Project], the shortfall may be collected from non-defaulting affected Contractors, subject to certain limitations.

These contractual requirements place a great deal of fiscal pressure on state water contractors to make these payments. Not only do they have obligations to DWR to make payments, but most, if not all, have bond financing for local systems they operate as well. We are concerned their state obligations will weaken the ability of retail and wholesale water contractors to afford their local obligations under California Water Code Section 85021 to reduce their reliance on Delta sources of water through investment in "improved regional supplies, conservation, and water use efficiency."⁵ Ensuring they meet their bond obligations helps ensure they have good ratings should they wish to issue new bonds or refinance prior issues. Their ability to levy and adjust water rates (upward or downward) is critical to the state water contractors' ability to secure their water service contracts, and which in turn provide the necessary security to DWR to meet its obligations to bond holders.

AUDIT REQUEST

We respectfully request that the Joint Legislative Audit Committee authorize the State Auditor to examine and report to the Legislature and the general public on the following questions, covering the most recent five years, relating to the proposed California WaterFix project:

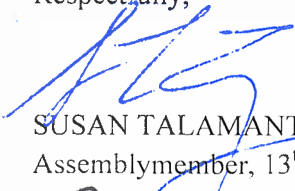
- 1) Specifically, how has the Department of Water Resources collaborated with water contractors in order to organize and fund the planning and design of the Bay Delta Conservation Plan (BDCP) and now the proposed California WaterFix Project?
 - a) What has been DWR's role in financing?
 - b) Has any General Fund money been allocated for the planning and design of the Waterfix?
 - c) What shares have all water entities paid to date since 2006, and for what purposes?

⁵ Water Code Section 85021 states in full: "The policy of the State of California is to reduce reliance on the Delta in meeting California's future water supply needs through a statewide strategy of investing in improved regional supplies, conservation, and water use efficiency. Each region that depends on water from the Delta watershed shall improve its regional self-reliance for water through investment in water use efficiency, water recycling, advanced water technologies, local and regional water supply projects, and improved regional coordination of local and regional water supply efforts."

- 2) Which funding sources, including debt, have DWR, the water contractors, and their joint water authorities used and how much funding have they raised, by source?
 - a) Which contractors and authorities, if any, used debt financing for California WaterFix and BDCP planning and design activities, in what amounts, when, and how was any debt issuance they used secured?
 - b) If debt was used, which entity issued debt and what was the contractor's relationship to it?
- 3) How did the DWR determine it could contract with Hallmark Group for "design and construction enterprise" services, including the bid process selected and the department's rationale for selecting Hallmark Group?
 - a) What is the Conveyance Project Coordinating Agency; who are its members; and when was it chartered?
 - b) What sources and amounts funded the Conveyance Project Coordinating Agency?

Thank you for considering this audit request concerning state agencies' involvement with the Bay Delta Conservation Plan and California WaterFix funding and financing activities.

Respectfully,



SUSAN TALAMANTES EGGMAN
Assemblymember, 13th District


CATHARINE BAKER
Assemblymember, 16th District

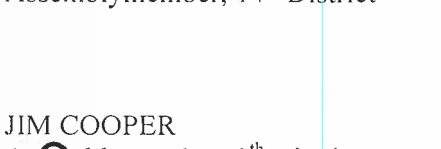

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