

SLO COUNTY’S STATE WATER: A TAXPAYER BURDEN AND A GENERAL FUND BOON?

USE OF SAN LUIS OBISPO COUNTY FUNDS RECEIVED FROM STATE WATER PROJECT PROPERTY TAX AND WATER SALES

SUMMARY

The California State Department of Water Resources (DWR) owns and operates the State Water Project (SWP). In 1963, the San Luis Obispo (SLO) County’s Flood Control and Water Conservation District (Flood Control District or District) entered into a contract with the DWR for a 25,000-acre-feet per year (AFY) allocation (i.e., share) of State Water. Accordingly, SLO County levied an annual SWP property tax on assessable property within the County to pay for this allocation of water from the SWP. The County indicated it uses this tax revenue “solely to make the contractual payments required by the DWR agreement¹ . . .”

Many of the County’s largest water agencies (i.e., City of SLO, City of Arroyo Grande, City of Paso Robles, Nipomo Community Services District, and others) chose not to subscribe to State Water. The County found commitments for about 5,000 AFY of State Water. This left the County responsible to pay for about 20,000 AFY of SWP allocation. Property taxes assessed to all County property owners continue to pay for this water. The County continues to market the excess water.

In its investigation, the 2021 – 2022 SLO County Grand Jury learned the following:

¹ County of San Luis Obispo, Property Tax Rates, Bonds Levied, Tax Rates by Fund & TRA, 2020 – 2021, James W. Hamilton, page 1, Explanation of Tax Rates, State Water Project.,

- SLO County sold about 5,000 AFY of its SWP allocation to water agencies within the County, relieving property taxpayers from having to pay for this portion of the SWP allocation.
- The County subsequently sold about 5,000 more AFY of its SWP allocation to many of the same water agencies as a “Drought Buffer”. These sales further reduced the property taxpayer obligation for State Water to about 15,000 AFY.
- In 2008 and again in 2013, the County approved water sales to agencies outside the County. These one-time, multi-year sales agreements generated a combined revenue of approximately \$6.8 M. Of the \$6.8 M, \$500,000 was placed in reserves for the subcontractors.
- The County deposited these SWP Contract revenues into the District Zone General Fund 0643 instead of depositing them into the State Water Contract Tax Fund 0646 which would have reduced the property tax burden on County property taxpayers. The overall reserve balance in the District Zone General Fund 0643 is \$10,987,326 as of June 30, 2021.
- Recent changes to the SWP Contract make the County’s State Water allocation more marketable. The County is actively negotiating new “exchange agreements” with water agencies inside and outside the County. This would generate new water sales and/or transfer some of the County’s excess water allocation, potentially raising State Water Contract Tax Fund revenues, which would possibly reduce the County’s State Water property tax rate.
- County administrative charges to the State Water Contract Tax Fund 0646 have increased from \$35K to \$190K in past 18 years.
- SWP charges to County property owners have continued to increase with the \$1.9M average annual property tax collected during the past 10 years (2012 - 2021) being twice that of the \$826K average tax during the prior 15 years (1995 - 2011).

Background and Introduction to the Report

This Grand Jury investigation began with a focus on how SLO County complies with the Sustainable Groundwater Management Act (SGMA). The Jury was interested in gaining a better

understanding of the resource expenditures stemming from the various efforts to comply with the State-mandated Act. However, the Grand Jury later decided to change the focus of its investigation into how the County managed and accounted for its SWP Contract funds. The County accounts for SWP revenue using the financial management software (SAP) and SWP Property Tax Fund numbers shown in Table 1.

Table 1 – SLO County SAP and Property Tax Fund Numbers

Fund Name	SAP Fund Number	Fund Number
County Flood Control General (aka District Zone General Fund)	1300000000	0643
State Water Contract Tax Fund	2300500000	0646
State Water Project Fund	2300501000	N/A

The State Water Contract Tax Fund 0646 includes property tax revenues and drought buffer contract revenues to pay for a portion of the contract with DWR for the SWP. The State Water Project Fund includes revenues for sales of water to subcontractors and payments for a portion of the contract with DWR for the SWP. This fund incurs costs for water supply delivery and treatment, which are fully reimbursed by the agencies that participate in the project. Both funds account for costs associated with managing water contracts. These costs include evaluating and responding to SWP contract amendments, contract term and financing, and participating in State led projects associated with State Water delivery.

Methodology

The Grand Jury sent an information request to the SLO County Public Works Department (Public Works) about how the County complies with SGMA. Public Works provided an eight-page response letter with 152 pages of attached documents and hyperlinks to additional references. It

became evident early on that SGMA compliance is a costly effort to organize public and water agencies around studying and managing groundwater basins with results that will be measured in decades, not years.

The Grand Jury included questions in its information request regarding the County's use of its SWP revenues. Exploring the answers to these questions became the focus of the Grand Jury's investigation. Grand Jury members reviewed numerous contracts, accounting documents, and reports provided by the County to learn more about how the County managed and accounted for its SWP revenues.

The Grand Jury learned that Public Works acts as the Flood Control District to administer the SWP Contract for SLO County. The District is governed by the SLO County Board of Supervisors. The District manages County water resources issues and conducts water resources studies, among various other tasks.

The Grand Jury interviewed three senior Public Works staff members and a senior person at the County Auditor Controller Treasurer Tax Collector (ACTTC). Each interviewee provided additional material in follow-up to their interview.

Discussion

District's SWP Contract with the DWR

In 1963, SLO County entered into a contract with the DWR to acquire 25,000 acre-feet per year (1 AFY = 326,000 gallons / year) of water allocation through the Central Coast Branch of the SWP (see Figure 1). In the late 1980s and early 1990s, in preparing to build the Coastal Branch of the SWP, the County attempted to find subcontractors (water agencies and cities within the County) to purchase some of the County's SWP allocation. The subcontractors would pay for their portion of the cost to treat and transmit State Water from the California Aqueduct turnout in the Central

Valley into the County and to their individual water systems. Subcontractors would also pay for their portion of the County's water obligation that property taxes had been paying.

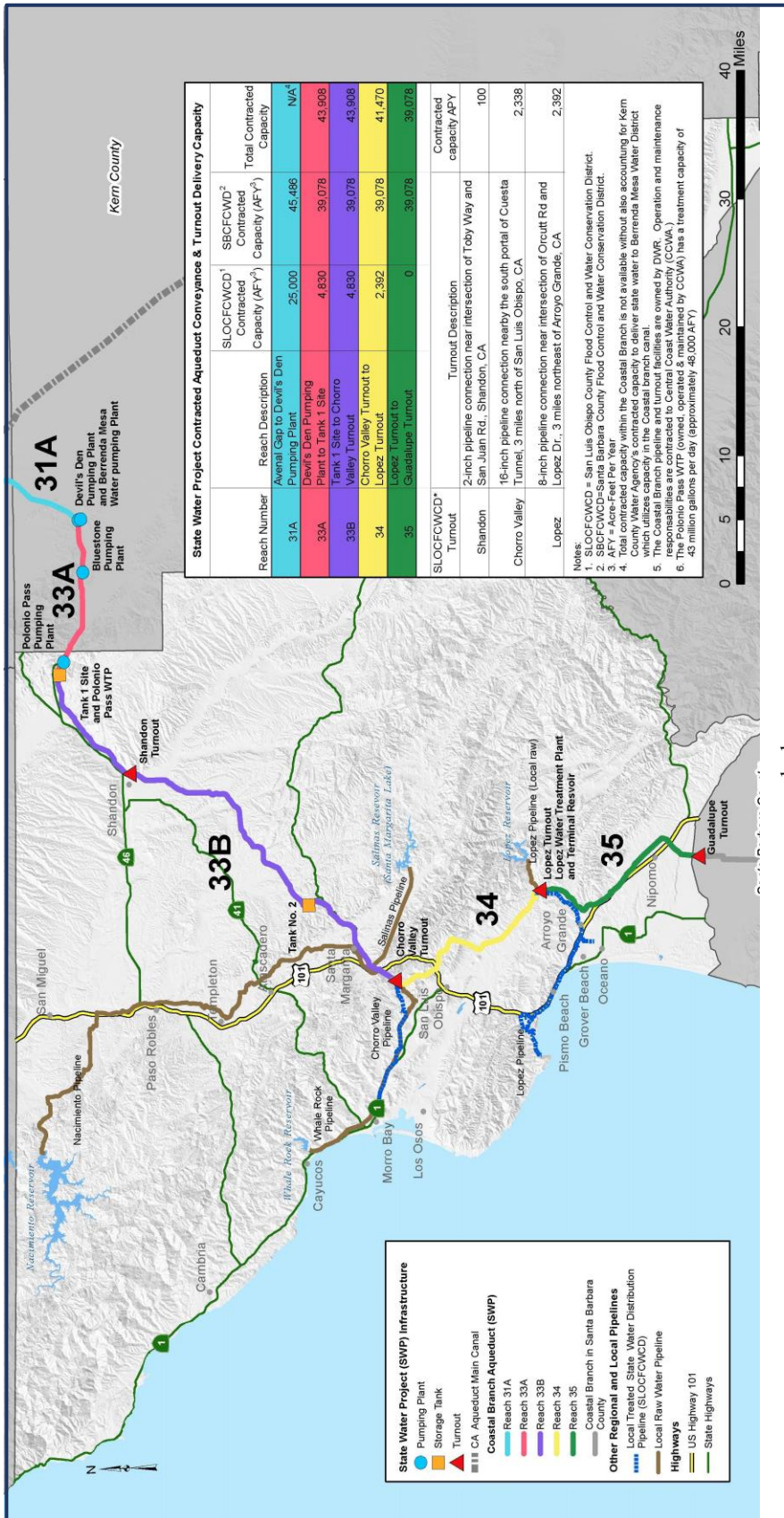
State Water deliveries through the Coastal Branch in California began around 1993, and subcontractors thereafter paid for their share of SWP charges. Since the County did not have subscribers for all the water, the County chose not to incur additional costs and thus did not participate in the construction of the Coastal Branch of the SWP. Therefore, the County's remaining allocation of State Water (about 20,000 AFY) is typically undeliverable into the County.

Annual SWP Property Tax

SLO County established a property tax specifically to pay for its obligation for State Water. The SWP and this associated property tax were established prior to the 1978 Jarvis-Gann Property Tax Initiative (Proposition 13). Therefore, the SWP tax is a special tax that stands outside the 1% maximum Jarvis tax rate increase on real property. The County sets the rate of the SWP-associated property tax each year based on the charges from the DWR, and other County-imposed fees. Since the 1988 - 1999 tax years, the rate has been as high as \$10.90 per \$100,000 assessed property value and as low as \$2.30 per \$100,000 assessed value. Between 2000 and 2010, the SLO County SWP property tax assessment rate averaged \$2.20 per \$100,000 of assessed value. For the past 10 years (2012 - 2021), the rate averaged \$3.90 per \$100,000. The assessed value of property in the County increased from \$22.1B in 2000 - 2001 to \$62.5B in 2020 - 2021.

In fiscal year 2003 - 2004, the County began charging the SWP property tax account a \$35,000 "administration and accounting" fee. In fiscal year 2019 - 2020, it was \$125,000. In fiscal year 2021 - 2022, the fee is projected to be \$187,000; a five-fold increase over its initial rate.

Figure 1 - State Water Project Central Coast Branch



SLO County Water Sales

The County's undeliverable State Water allocation does have monetary value. The County sold some of the SWP allocations to existing subcontractors as "drought buffer" (see Attachment 1). Subcontractors purchased (i.e., assumed financial responsibility for) about 5,000 more AFY of the County's SWP allocation under this program. The County deposited revenues from sale of this water into its State Water Contract Tax Fund 0646. This lowered the amount of SWP allocation property taxpayers are responsible for to about 15,000 AFY annually.

In 2008 and 2013, the SLO County Board of Supervisors approved water sales to agencies outside the County. These one-time, multi-year sales agreements generated about \$6.8M in revenue. The County deposited revenues from the sale of this water into the County Flood Control District's "Zone General Fund reserves" Fund 0643, rather than lessening the property tax burden on those who paid for this water.

In the "Financial Considerations" section of the July 22, 2008, Public Works Staff Report², staff states the 2008 water sales, "Total revenues for the Flood Control District . . . could be as much as approximately \$900,000 . . ." This is the only mention in the Staff Report about proceeds from the water sales. Sales under this Agreement totaled \$1.9M from 2008 to 2010 and were deposited in the District's Zone General Fund 0643.

Public Works' June 18, 2013, Agenda Item³ transmitting its June 18, 2013, Public Works Staff Report to the SLO County Board of Supervisors stated, "Total revenues for the Flood Control District in 2013 could be as much as \$1.3M." Sales under this Agreement generated \$4.9M in 2013 to 2014 and were deposited in the District's Zone General Fund 0643.

² Water Resources Engineer, SLO County Department of Public Works, July 22, 2008, report to SLO County Board of Supervisors, "Approval of Water Transfer Agreements with the California Department of State Water Resources (DWR), the Santa Barbara County Flood Control and Water Conservation District (SBC), the Central Coast Water Authority (CCWA) and Local State Water Subcontractors Authorizing the Emergency Transfer of State Water in 2008 and 2009."

³ SLO County Public Works Department, June 18, 2013, Agenda Item Transmittal to the SLO County Board of Supervisors, "Request approval of resolutions authorizing the Public Works Director to execute Multi-Year Water Pool Program Agreements with the California Department of State Water Resources (DWR) and to determine the extent to which the County shall participate in the Program. All Districts."

Neither of the aforementioned Public Works Staff Reports discussed allowable uses for revenues generated from the sales of property tax-purchased water. It is clear the Board of Supervisors approved the sale of water and deposit of these funds in the Zone General Fund. It does not appear staff or the Board considered possible restrictions on these funds.

In response to Grand Jury questioning, Senior County's Tax Collector staff acknowledged that the County use of State Water Contract revenues is legitimately open to legal interpretation and deserves to be reconsidered prior to future tax rate determinations.

In March 2021, DWR adopted the 18th amendment of the SWP Contract with SLO County and its other 28 SWP contractors. This "Water Management Tools" amendment gives SWP contractors greater flexibility in how they manage their allocations. These recent changes make the County's undeliverable water allocation more marketable. SLO County is actively negotiating new agreements to sell and/or exchange its SWP allocation purchased with SLO County property tax revenues.

ACKNOWLEDGEMENT

County Public Works staff and the County Tax Collector's Office were forthcoming and timely with all information and interview requests.

FINDINGS

F1. The County established a County-wide special (standalone) property tax specifically to pay for its 1963 contractual obligation to the DWR for a 25,000 AFY allocation of water from the SWP.

F2. Since 1993, nearly 40% of the SWP allocation has been assigned (i.e., sold) to subcontractors, leaving County property taxpayers responsible to pay for 15,173 AFY of State Water.

F3. The County sold \$6.3 M worth of this property tax-funded allocation and has not credited the County's State Water Contract Tax Fund 0646 with those proceeds. The County deposited these proceeds into its District Zone General Fund 0643 which is governed by the County Board of Supervisors.

F4. Based on the Board approved budgets, administrative charges to the State Water Contract Tax Fund 0646 have gone from \$35,000 in 2003/2004 tax year, to \$124,756 in the 2019/2020 tax year. Budgeted administrative charge for 2021/2022 is \$187,000 - a five-fold increase over the 2003/2004 charge.

F5. Property tax revenues collected to pay for State Water obligations continue to increase.

F6. The County's Tax Collector's Office acknowledged the County's use of State Water Contract revenues is open to legal interpretation and deserves to be reconsidered prior to future tax rate determinations.

RECOMMENDATIONS

R1. The County, working with its Tax Collector, needs to obtain expert legal interpretation for the use of revenue derived from the sale of property tax-purchased State Water, past and future.

R2. The County must ensure that only reasonable administrative charges attributable to the collection of taxes and payment of State Water Contract expenses be charged to the State Water Contract Tax Fund 0646. The County should clearly explain and justify the recent significant increases in "Administration and Accounting" charges to the State Water Contract Tax Fund 0646.

R3. The County should ensure that all funds derived from past and future sales and/or exchanges of the County SWP allotment be credited to the State Water Contract Tax Fund 0646 and reduce the financial tax burden placed on property owners.

R4. When the State Water Contract revenue exceeds the taxpayer burden, the County could use the balance to explore water resource projects with County-wide benefits.

REQUIRED RESPONSES

Response to R1 is required from the County Board of Supervisors, County Counsel, and County Tax Collector.

Response to R2 is required from the County Board of Supervisors and the County Public Works Department.

Response to R3 is required from the County Board of Supervisors.

Response to R4 is required from the County Board of Supervisors, the County Tax Collector, and the County Public Works Department.

AGENCY RESPONSE REQUIREMENTS

The Penal Code Section 933.05 that specifies the format and methodology for agency responses is listed below. All agency respondents are required to respond to all findings and recommendations in the following manner:

- If the respondent disagrees wholly or partially with an item, the respondent must elaborate on the portion of the item that they disagree with and provide an explanation.
- If a respondent notes that an item will be implemented in the future, the response must include a timeframe for implementation.
- If a respondent notes that an item requires further analysis, the agency must include in the response an explanation of and the scope of what will be studied, and the timeframe needed for the study. The timeframe for follow-up from the agency cannot exceed six months.
- If the item will not be implemented or is not reasonable, the respondent is required to provide a detailed explanation.

933.05. Findings and Recommendations

- (a) For purposes of subdivision (b) of Section 933, as to each grand jury finding, the responding person or entity shall indicate one of the following:
- (1) The respondent agrees with the finding.
 - (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons, therefore.
- (b) For purposes of subdivision (b) of Section 933, as to each grand jury recommendation, the responding person or entity shall report one of the following actions:
- (1) The recommendation has been implemented, with a summary regarding the implemented action.
 - (2) The recommendation has not yet been implemented, but will be implemented in the future, with a timeframe for implementation.

- (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.
- (4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation, therefore.

Presiding Judge	Grand Jury
Presiding Judge Craig van Rooyen Superior Court of California 1035 Palm Street Room 355 San Luis Obispo, CA 93408	San Luis Obispo County Grand Jury P.O. Box 4910 San Luis Obispo, CA 93403

Attachment 1 - SLO County's State Water Subcontractors and Water Allocations

SUBCONTRACTOR	Water Service Amount (AFY)	Drought Buffer Amount (AFY)	Total Water Amounts (AFY)
County Service Area 16 (Shandon)	100	0	100
City of Morro Bay	1,313	2,290	3,603
CA Men's Colony	400	400	800
County Operations Center	425	425	850
Cuesta College	200	200	400
City of Pismo Beach	1,240	1,240	2,480
Oceano Community Services District	750	750	1,500
San Miguelito Mutual Water Company	275	275	550
Avila Beach Community Services District	100	100	200
Avila Valley Mutual Water Company	20	20	40
San Luis Coastal Unified School District	7	7	14
Subcontractor Total =	4,830	5,707	10,537
Unsubscribed "Excess Allocation" =			14,463
District's Total Contract Allocation =			25,000