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Fitch: Tax on California Water Another Pressure on Monthly Bills.

Fitch Ratings-San Francisco-25 August 2017: A proposed state-wide tax on California water bills would generate funds for water projects in disadvantaged communities. According to Fitch Ratings, the tax would set a precedent in the state and add to the upward pressure on water bills.

Households would initially pay 95 cents per month and commercial customers up to \$10 per month. Fertilizer sellers and dairy producers would also pay fees to support the program. The bill, if passed, would generate an estimated \$2 billion over 15 years for both long-term and emergency projects for utilities to meet safe-drinking-water standards.

The proposed tax is just one of a long list of forces pushing California water bills higher. Water rates have increased state-wide, in some cases significantly, in recent years due to conservation-related demand declines resulting from the state's five-year drought. Many utilities implemented rate increases or alternative rate structures to mitigate significant declines in financial margins in fiscals 2015 and 2016. In addition, the proposed California Water Fix (the Fix), a plan to convey water through two tunnels under the Sacramento-San Joaquin Delta (the Delta) to improve water reliability and the health of the Delta ecosystem, could add several dollars per month to the bills of many southern California residents. The estimated \$16.3 billion in project costs would be borne by the utilities' ratepayers, including State Water Project (SWP) and Central Valley Project (CVP) members.

California water utilities have enjoyed solid rate flexibility, but Fitch believes the margin of that flexibility is decreasing and will likely be tested in the years ahead. The proposed bill is unlikely to tip the balance in the near term but adds to the pressure incrementally. Ratepayers have thus far shown a willingness and ability to absorb higher rates and most California utilities have ratepayer bases able to bear the estimated increases. However, some agencies have water bills that already exceed Fitch's affordability threshold (combined water and sewer utility bill equal to or higher than 2% of median household income) and would become more pressured if additional costs such as those related to the tax and the Fix are implemented.

The fate of the bill (Senate Bill 623) is uncertain as it would require a two-thirds vote of the state legislature. The bill's goal of addressing safe drinking water in in disadvantaged communities enjoys broad support among lawmakers and interest groups, but stakeholders continue to debate the merits of the bill's funding mechanism (the tax on water bills). Agriculture and dairy industries as well as environmental groups support the bill because it would begin to address longstanding concerns about rural groundwater. Water districts and the Association of California Water Agencies oppose it. Water agencies have expressed concerns about the precedent of taxing water, which has been exempted from state sales taxes as is food and some other basic necessities.