

COUNCIL OF ECONOMIC ADVISORS

MINUTES

Thursday, June 27, 2002

2:00 - 4:30 p.m.

State Capitol, Room 223

Salt Lake City, UT 84114

MEMBERS PRESENT:

ASHDOWN, Neil	GOPB Deputy Director
GOCHNOUR, Natalie	Governor's Office
BARBER, Brad	Barber Consulting
JEX, Douglas	DCED
KROES, Steve	Utah Foundation
MACDONALD, Doug	State Tax Commission
ROVIG, Lance	GOPB

MEMBERS NOT PRESENT:

BURKS, Jeff	Energy & Resource Planning
GODFREY, Bruce	Utah State University
WOLCOTT, Andrea	Federal Reserve Bank of SF
MATTHEWS, Kelly	Wells Fargo
THREDGOLD, Jeff	Thredgold Economic Assoc.
NELSON, Ray	BYU

OTHERS PRESENT:

GILMORE, Doug	Franson-Noble Engineer.
ROBERTSON, Scott	Lewis, Young, Robertson & Burningham
SUMMERS, Lyle	DNR-Water Resources
OVARD, David	Jordon Valley Water
STRONG, Dennis	DNR-Water Resources
CRISPIN, Jan	BEBR
ROBSON, Jim	DWS
WOOD, Jim	BEBR
KATAYAMA, Leslee	State Tax Commission
PETERSON, Cary	UDAF
PARKER, Randy	UDAF
THOEN, Erica	Utah Rivers Council
HOUSTON, Janice	Utah Foundation
TURNER, Jan T.	UASO
ESPINOZA, Yvette	JVWCD
HOWE, Bryan	OLRGC
HOOTON, LeRoy W, Jr.	SLC Public Utilities
LEWIS, Jim	SLC Public Utilities
BLATTENBERGER, Gail	U of U
CRANDALL, John	George K. Baum & Co.
ECKHOFF, David	PSOMAS
DONNER, Peter	GOPB
VERMA, Neena	GOPB
SPENDLOVE, Robert	GOPB
DICARO, Sophia	GOPB
WALTERS, Clara	GOPB

Call to Order/Introductions/Approval of Minutes

Neil called the meeting to order and began by giving a short tribute about Thayne Robson and his accomplishments.

The topic of the meeting was "Water Financing." He read through the Agenda and said questions could be asked at the end of each presentation.

Water Rights in Utah - Jerry Olds - State Engineer, Department of Natural Resources

Mr. Olds began by giving a presentation on the foundation of Utah water laws. Utah's water laws are based on the Doctrine of Prior Appropriation or a procedure for rights to water. It says those who came first and settled the state should have their water rights protected from those who came later.

As states were admitted into the Union, Congress recognized each state's water rights law contained in their constitution. The basic element of Utah's water rights law said, "All water in the state is property of the public and beneficial use shall be the basis, the measure and the limit of all rights to the use of water in the state."

The major elements of a water right are: Priority date, quantity of water (flow or volume amount), source of supply, point of diversion (where it is located), uses (irrigation, domestic, stock water, mining, municipal), period of its use and the place of its use. A water right stays with the land and changes hands when ownership of the land is changed.

Water right laws were established in 1903, prior to that, filing for use of surface water was called a "Diligence Claim." By 1935, the state had expanded water rights to include underground water. After 1935, anyone applying for a ground-water right had to apply with the state engineer. Also, throughout the state many "decreed rights" have been established to define various water rights on major river systems. These rights were established about 1900 through the 1930s and cover how river water rights are divided to make water use equitable.

Today the only way to establish a water right is through an application. Appropriate applications are: temporary, permanent, and fixed-time. "Change" (permanent or temporary) and "Exchange" (exchanging water from one area for water in another area) are types of applications, with "Change" applications being the most common type in use.

To file for a water right, one must fill out an application form, advertise for 2 consecutive weeks in a local paper and allow a 20 day protest period. If a protest is lodged then a hearing is scheduled so each side can supply information they want the state engineer to consider. Following that, a decision is made whether to approve or reject the application. If it is approved, there is a specific amount of time given to develop the water in order to show the water was put to use and terms and conditions set down were followed. All decisions can be appealed to the district court.

In approving applications, there is a number of criteria that must be plugged in. If it's an application to appropriate, a determination must be made if there is unused water in the source, whether it is ground water or surface water, that it will not impair existing rights, and the project is physically and economically feasible and not monopolistic. It must also be in the public's interest and won't affect the natural stream environment or public recreation.

The majority of water use applications received are "Change Applications" and consist mostly of agricultural, such as: livestock and irrigation. Many areas of the state are closed to new applications for appropriation. To meet the present water requirements, an existing water right must be changed. Under change applications, the point of diversion may be changed, the place of issue, the nature of the use of application, and the period of its use. The application cannot impair existing rights without compensation, change the priority date of the underlying right, nor the priority of change.

The Division of Water Rights' duties consist of: water right applications, distributing and measuring water, dam safety, stream channel alterations and maintaining records of all water rights within the state at the "Office of Public Record" on line. Adjudications under state district courts or updating titles within a water drainage area are also part of the responsibilities; along with regulating well drillers, geothermal activities, and a water use program that obtains data and information pertaining to water use throughout the state. The division is broken up into 7 regions within the state. Most of the heavily populated areas are closed to new water appropriations or development.

State and federal water right issues are determined through state and federal laws, usage, protection through the Endangered Species Act, Wild & Scenic Rivers Act and agency regulations. In 1908, the federal government put "reserve water rights" in place for reservations and in 1963 it was expanded to include national parks, forest service lands, and public land.

Because much of the state is closed to new water rights applications, challenges to current and future water use consist mainly of changing existing water rights to meet the needs of the state. The Division of Water Rights will also be working on surface and ground water management, reserved water right claims, and water use from the Colorado River Basin. Because of litigation decisions, among others, the Division requires good sources of data to help with management of the issues. Currently, Water Resources has in place an up-to-date data collection system that will fulfill those needs.

Questions:

- ▶ *Can closed applications be changed at any time?*
Ans: Before Water Resources makes a decision to close an area, they look at hydrology, how much water there is and how many applications there are on file. It depends on those criteria, whether a change can be made, but there are many places within the state that will remain closed.

- ▶ *Is there enough water in the Agricultural community to accommodate population growth along the Wasatch Front without adding more supply or be converted from agricultural to municipal?*
Ans: The quantity and quality of water must be addressed. At this time communities are in the process of obtaining water rights through the "change" process, however, in the future, lack of water will become an issue and water will need to be acquired.

Property Tax on Water - Janice Houston - Utah Foundation

Janice reported on the history of water development in the state and how it differs from other states in the West.

History: The "First in Time, First in Right" Western Water Doctrine was in place before documentation of water rights came into being. From 1870 to 1900, Utah saw growth in efforts to develop water for profit. In 1880, the Utah Legislature passed an act to allow land owners

to sell land, but retain the water rights. In 1894, Congress passed the Enabling Act for Utah. The Federal Government gave the State 500,000 acres of land to be sold or developed for water use.

Early in the state's history, the Utah Constitution Convention discussed how to resolve the water rights issues and Article VII came out of it, which basically said: "All water rights in place at that time would be adhered to and new ones would be added." In 1902, the Reclamation Act was passed by Congress. It essentially said, "Western migration was in the best interest of the U.S. so taxpayers would help assist in developing water." Utah set up the ALRFC (Arid Land Reclamation Fund Commission); a group sent to Washington to lobby for water projects to come to Utah. Because it was state sponsored, Utah was more successful than other states in procuring water projects from the federal government.

In 1903, Utah passed water rights legislation to set up a process of how to go forward with water management and create funding mechanisms to pay for projects the ALRFC would bring to the state and this is what we operate under today.

During the 1930s, because of drought conditions, New Deal and public works projects were set up along with two more funding mechanisms. The new mechanisms were: the Metropolitan Water District Act and the Water Conservancy District Act; both of which gave more ways to fund water development.

Water rights today. Our history has been one of government and public institution involvement. It has reinforced the idea that water in Utah is a "public good" as opposed to a "private commodity" and public good defined means all citizens must have access to water at the lowest cost possible.

Property and sales taxes fund water and also operate within general revenues of water districts. Property taxes account for a significant portion of water districts' revenue strengths, however, financing for water development projects relies mainly on revenue bonds which are backed by water sales only. If a district wants to develop another water resource, they must pass revenue bonds to do it and those bonds are linked only to the price they charge for the water. The bonds are not linked to the value of the property or how much the district is bringing in on property taxes. Property taxes make up a significant portion of many of water districts' revenue strengths.

Sales Tax Revenue. In 1996, the legislature passed an allocation of 1/8 of 1 cent of the sales tax revenue for water and transportation. Of the 1/8 cent, transportation received half and water the other half. There was 1/16th of a cent going to water development. A percent goes to the Jordan Valley Conservancy District for water right adjudication. The other funds are for various entities. To ensure small areas or municipalities update their water systems, or if they must make heavy investments in capital, the funds are available. If they can't go to the private market, there is a revolving loan fund they can tap into for that purpose.

Water consumption, pricing and conservation in Utah. The following information is from

1995 data and considered typical water use in the West. In Utah, irrigation makes up 79% of total withdraws (pulled out of ground water or surface water supplies). Livestock makes up 2.4%, Residential/Domestic is 7.8%, Commercial 2.7%, Industrial 2.3%, Mining 3.7%, Thermo-electric is 1.2% and Public Use and Losses make up .6% (leakage). The largest water users in the West are agriculture interests. In looking at the East, Mid-West or West Coast, they also have a similar mix, but their largest water user is not agriculture, it's thermo-electric generation. In every state there will be one predominate water user, agriculture or thermo-electric.

Water that comes through municipal and industrial pipe systems is composed of: 68.4% for residences, 23.1% commercial, 3.4% industrial and 5% public use and losses. The industrial and commercial in Utah usually have their own water-well systems so they don't tap into the municipal supply.

Concerns about consumption and pricing: The Governor's Council of Economic Advisors believed the water situation in Utah was enough of a concern to pass a resolution regarding water consumption and supply in Utah. Listed below are bullet points drafted into the resolution:

- Utah currently has high per capita water use and low water rates
- Based on present demand and pricing practices, population and economic growth will continue to put pressure on the state's water supply
- The most accessible and least costly sources of water have already been developed
- Federal funds for new water development are dwindling & will continue to decline, if not disappear
- Future water development will almost assuredly be funded from state and local revenue sources

The burden of water development will shift back to state and local entities and will be a shift from the early part of the century where western development was considered a federal priority. Because it's no longer considered a federal priority, we as taxpayers, in the State of Utah, will be called upon to carry a higher burden for water development.

Water Pricing: The average municipal water pricing in the western states is \$1.63 per thousand gallons of water. Utah's pricing is \$1.15 per thousand gallons and the national average is \$1.96.

Property Tax Revenue: Utah is unique in the West, as property tax revenue to water districts go into the general operating funds of the districts. In other states, if a property tax is levied, it is reserved for development purposes.

To go forward regarding water in the state, we need to keep the following points in mind.

- Utah water development has a unique history
- Because of that history, water is paid for from a variety of sources, including billing and property taxes
- Water prices in Utah are some of the lowest in the West and Utah is the second highest

- per capita consumer
- Water prices are moderately inelastic, if quality is not an issue, then consumers do not usually respond to price increases in the short run
 - If pricing was successful in causing consumers to conserve water, residential water accounts for only 7.8 percent of the total water used in the state, and could only have a nominal effect on overall water use

Questions:

- ▶ When did you gather the pricing information used in average cost of water?
Ans: 1998
- ▶ Do you have any figures of water use outside vs inside use for Salt Lake County?
Ans: No complete figures, but most of the water used by a household is on a lawn.
- ▶ Concerning consumption in the state, are the public “use and losses” different or the same thing?
Ans: They are the same. It’s called residuals and means leakage from pipes, etc. Utah has the lowest residuals in the nation and the consumption per capita has gone down again.

Removing Property Tax from Water: David Ovard - Jordan Valley Water Conservancy District

Jordan Valley Water Conservancy District is the largest municipal water district in the state and serves Salt Lake County, outside Salt Lake City surface area, including all the high growth areas.

The Division of Water Resources has thought there is enough water for the valley, but another aspect of that to consider is, there are all types of legal, institutional and political problems to keep that from happening. The water might be there, but the infrastructure has not been developed to move the water anywhere.

There are always two elements of water supply: volume and infrastructure. Infrastructure causes the most problems, because it’s very expensive to develop the water and move it or even to put it to use and divert it to agricultural water as many of the counties envision.

Mr. Ovard read a statement to the Council. “The Metropolitan Water District Act passed in 1935 and the Water Sur Tax in 1941 were both in response to the drought of the 1930's, to develop water supplies and they were successful in doing so. Consider the following reservoirs along the Wasatch Front today; where would we be without them: Deer Creek, Jordanelle, East Canyon, Echo Wanship, and Pineview to name a few, along with other small reservoirs. During the period from 1941, about the year Deer Creek Dam was completed, to the present, the population of the state has increased from about 550,000 people to 2.2 million. That is a 400% increase. Over the next 30 years the state’s population is projected to increase only 70%, while that doesn’t compare with the 400% increase over the previous 60 years, the

amount of new people represents 1.5 million.

It is easier to relate to population projections in terms of educational needs and growth, but for some unknown reason people think water just happens. Part of the problem is water facilities are at remote places, far from population centers and not exciting, challenging or demanding. The public always seem to have an adequate amount of water. Now, however, we are in the 4th year of drought and throughout the state we are being shown there is a limit to our current water supply.

He proposed the question, “What will we do in thirty years for water for an additional 1.5 million people or even ten years until our next drought cycle?” We are now preaching water conservation. Utah is the second driest state in the nation in terms of precipitation. Water districts are leading the way in water conservation, while water conservation is very important, it’s not the total answer for providing 1.5 million new Utahns water.”

Property taxes have been a large part of water districts in developing our current water supplies. It takes billions of dollars of infrastructure to deliver water to the residents of Utah. Another important element in property taxes for water is ability and reliability. Our state is subject to great fluctuations of weather and it can go from flooding to drought in a matter of months. These cycles are certain but unpredictable. Water infrastructure is built with long term debt. Investors demand a predictable revenue stream in order to make money. Long term debt supported by property taxes, even if a modest amount will achieve non-property tax in debt.

The state legislature has made a big deal out of the need for diversity in its revenue sources, sort of like a 3 legged stool. Water districts need a 3 legged stool too.

Someone needs to develop a future water supply in Utah, if not the water districts, then who? The elimination of property taxes for water development will severely hamper this effort. Some environmental groups are calling for elimination of property taxes. People know without water, economic growth will shut down. What they can’t do by lobbying they are doing much more quietly by removing the resources of growth.

It’s certain without property taxes the cost of water will raise in Utah, making it more difficult to build infrastructure. The current system has worked well to provide water for many people since 1930. Who’s going to provide water for the next 1.5 million people? The people calling for change in water development don’t have an answer.

Questions:

- ▶ Have there been any projects that have run out of money or bonds that were defaulted on because there wasn’t a property tax base helping to pay off the bonds?

Ans: As a result of the depression, bonds were defaulted on by water districts, but they were for federal projects and were not backed by property taxes. This is one reason why the federal government requires property tax as part of the bond. There is a history of bond default in Utah. Millard County, around Delta was bonded heavily in

the 1920s, during the drought of the 1930s everyone defaulted.

- ▶ Are most bonds revenue bonds?

Ans: Yes, but earlier bonds were General Obligation Bonds, but all are revenue bonds now. There has to be an election when using “G.O.” bonds.

- ▶ Is there any sense of what portion of property tax goes to operations vs development?

Ans: In the Jordan Valley District the capital budget is about \$17 million to \$20 million per year and property tax is \$8 million and the O & M are \$20 to \$25 million per year. Most of the property taxes for water development in the state are assessed by the large districts and are generally associated with water development.

- ▶ Would you use a bracket pricing structure?

Ans: JVWD will look at every issue, property tax and long range conservation. There are entities in the valley that have conservation pricing in place. For example: Salt Lake and Sandy have a seasonal rate, while Kearns has a tiered rate that other groups are looking at.

- ▶ Why are rates going up?

Ans: Utah water rates are half the national average. New projects are all more expensive. There's cost pressure on rates, because new water has to be developed along with conservation. Federal water quality regulations also increase costs.

Property Tax and Water Finance in Utah - Peter Donner - GOPB

Peter began with a chart from 1995 that shows water use in Utah by category. About 80% of water use was for crops. The standard was 1 million gallons per day, so M&I used about 500 mgd, mining used 167 mgd, ranching 108 mgd, farming 3,533 mgd or about 80%, and other 55 mgd.

The practical economics of water is that about 75% of Utah's water is used to irrigate crops. Crop production is 0.4% of Utah's GSP and Utah uses 75% of its water to produce 0.4% of GSP. Water will not be a binding constraint to economic growth during the next 50 years.

Agricultural use of water in the Greater Wasatch Front Counties in 1995 showed the greatest users were Box Elder, Juab, Morgan, Summit, and Wasatch. Agriculture water has quality issues, even for horticulture uses.

Going on to water rate costs for the states showed Utah has the lowest rates, but the highest usage nation-wide. Crops make up much of that use, with corn, fruit, hay and vegetables being the main crops produced in Utah.

The economic theory and water use says the larger you are, the cheaper water is. There are increasing returns from the more you use the higher the price charged. Second, is water a public good, which says water systems that produce culinary water are public goods, because

we all consume it. Finally, water is second best as far as pricing is concerned compared to gasoline prices as well as other commodities in the state.

Property Tax revenues by the types of government during 1999 showed that schools used about 55% or \$732 Million, of the total \$1.35 Billion taxes collected. Second to that were counties which used 24% or \$256 Million.

The flow of water delivery in the Salt Lake Valley comes first from streams and aquifers and is called "raw water". From there it goes to the wholesalers such as Jordan Valley Water Conservancy District, who in turn process it and sell it to the retailers (cities, etc.). They in turn deliver the water to homes and businesses.

The sources of revenue for the wholesale water systems during 1999 showed a total revenue of \$149 Million collected. Of that, property taxes accounted for 35% or \$52 million, private water charges were 33% or \$49 million, Federal 20% or \$29 million, and other 13% or \$19 million.

During 1999, the five largest wholesale water districts collecting property tax revenue were: Central Utah Water Conservancy District, Jordan Valley Water Conservancy District, the Municipal Water District of Salt Lake, Washington Water Conservancy District, and Weber Basin Water Conservancy District.

The distribution of Property Tax for water between wholesale and retail water utilities during 1999 consisted of \$52 million or 90% for wholesale and \$6 million or 10% for retail. The total property tax for water was \$98 million.

The sources of revenue in the Retail Water System during 1999 was Water Rates at \$164 million, Property Taxes at \$6 million, Impact Fees at \$22 million, Connection Fees at \$15 million, and State Loan Funds at \$29 million.

The Property Taxes per customer in the five largest retail water systems during 1999 were: Granger-Hunter (26,000 at \$50 per connection) and Ogden Water (23,000 at \$23 per connection). Salt Lake City (82,000), Sandy Water (26,000) and Orem Water (20,000) did not have connection costs.

Sources of revenue for the water systems were: Water Charges \$256 million, Property Taxes \$58 Million, Federal \$26 Million, State \$29 Million, and Other \$19 Million, with a total revenue of \$390 Million.

A seven year average of charges, as a percent of expenditures for water utilities in Western States from 1993 to 1999 showed Utah having 72% compared to Montana at 111%. All the Western States had 72% or higher.

Some of the issues of removing the property tax for water involve the financial solvency of Central, Washington, Metro, and others. The transitional funding for all water districts,

increased debt-service cost and less ability to issue debt, and finally, the legal exposure from a tax covenant in revenue bonds.

Questions:

- ▶ What would happen to the price of water if revenue was held constant and property tax was eliminated as a source of revenue? How much would the average person's bill increase? There are so many non-property tax paying entities in some districts.

Ans: All non property tax paying entities would end up applying a higher rate for water than those in SLC. The average resident's bill would not raise by 30% because the portion is smaller relative to what the large entities (i.e. U of U) is paying, given their usage.

People who use water would actually pay for what they use and there would be less infrastructure development because of conservation of those who pay for what they use.

Summation:

The meeting covered all aspects of removing water from property tax and the present distribution costs involved within the different water districts. Because of the diverse districts and problems each face, the prospect of changing water from property taxes to pay-for-use, will be a long and complicated process. The Central Utah Project was brought up many times as something which changes the equation for the districts, along with non-profit entities that use large amounts of water. Finally, the Legislature was mentioned as being a major player in making any changes.