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Governor Unveils Proposed FY 2017-18 Budget with \$1.6 Billion Deficit Projected *Proposal Includes \$4.3 Billion for Transportation but No New Funding for Affordable Housing*

Volatility and prudence were the words of the day during Gov. Jerry Brown's annual January budget release press conference in Sacramento this morning. Similar to recent years, the Governor repeatedly cautioned about the dangers of overspending and the pending recession that will likely follow the last eight years of economic expansion. His words were stronger this year because after four years of balanced budgets with small budget surpluses, this one projects a \$1.6 billion deficit for the fiscal year that starts July 1. The [proposed FY 2017-18 budget](#) he unveiled includes \$122.5 billion General Fund and \$179.5 billion total spending.

State revenues are still growing and projected to grow in FY 2017-18 according to the Governor's budget proposal. However, the trajectory of that growth is declining and the budget lays out some tough choices to rein in spending in the face of the deficit and lower growth.

The proposed budget includes \$3.2 billion in budget solutions. The unappropriated \$400 million in the FY 2016-17 budget — set aside to be exchanged for approval of the by right proposal — is counted as savings. The state will also hold back from transferring \$300 million to modernize state buildings in FY 2017-18. The Proposition 98 constitutional guarantee for K-14 funding will be at its minimum. The Middle Class Scholarship program will not be extended to new students, rate increases for child care will not occur and a number of other spending proposals will not be funded.

California faced a \$27 billion deficit when Governor Brown assumed his third term of office in January 2011. The coming year's deficit is dramatically smaller, however, the Governor is worried that it can quickly grow if it is not immediately addressed. In the midst of the dire warnings, he showed his softer side in calling on the Legislature to "Save some biscuits for a rainy day" in honor of his beloved recently deceased First Dog Sutter Brown. To that end, the Governor stressed the importance of the state's Rainy Day Fund, which is projected to reach \$7.9 billion in FY 2017-18.

Several factors make state budgeting in California challenging. Although the state has the most progressive tax structure in the nation, that in turn results in more volatility because of the reliance on capital gains. Income, sales and corporation taxes comprise the "big three" revenue sources for California.

This year there is more uncertainty resulting from the impacts of unknown changes to be made by the incoming Trump Administration. The Governor's budget did not account for how the new president's policies will impact California, but he did say that his May Revise could be based on very different numbers depending on what happens between now and then. He used this portion of his remarks as another opportunity to remind the Legislature that California must be fiscally prudent and wise this year.

The Governor's proposed budget does reflect several of the League's [2017 strategic goals](#). He reiterated his commitment to transportation funding by including a 10 year, almost \$43 billion transportation infrastructure investment plan. The funding goes to the entire system, state and local and transit. The [Fix Our Roads Coalition](#), of which the League is a member, [issued a statement](#) early Tuesday afternoon commending the Governor for his continued engagement in crafting a sustainable transportation funding package while reinforcing the need for at least \$6 billion annually to stop the deterioration of the system.

California's affordable housing crisis and homelessness were both also addressed. Governor Brown spoke about the need to reduce the per unit affordable housing construction cost, currently averaging \$322,000 per unit. However, the League is disappointed that the Governor chose to emphasize the need to streamline the process and adjust requirements at the local level rather than provide much needed funding. The budget contains no new funding for affordable housing, and principles presented by the Governor for any funding negotiations include "No Impact to the General Fund."

On a positive note, the League-supported [No Place Like Home](#) program will be funded in FY 2017-18 to construct and rehabilitate permanent supportive housing for California's most chronically homeless mentally ill.

The Governor focused on the Cap-and-Trade program and wants to withhold any additional allocations until after the Legislature stabilizes the fund through a two-thirds vote. Early auctions generated significantly more revenues than those held in May and August of last year, which total produced approximately \$18 million. The last auction in November 2016 produced \$364 million.

Details on these and other budget areas of importance to cities are outlined below.

Transportation Funding

While the regular and special session on transportation funding came to a close last year without resolution, the Governor's new transportation funding proposal provides an increase to \$43 billion over the next 10 years.

Of the \$4.3 billion in new funding for transportation in FY 2017-18, \$1.16 billion goes to local streets and roads for maintenance and rehabilitation. Additionally, the Governor's proposal includes the following annual investments in the coming 10 years:

- \$100 million for the Active Transportation Program.
- \$25 million for sustainable (SB 375) transportation grants.
- \$270 million for Corridor Mobility Improvements on congested commute corridors.
- \$25 million for the freeway service patrol program.
- \$400 million for the Transit and Intercity Rail Capital Program.
- \$1.8 billion for highway repairs and maintenance on the state highway system.
- \$250 million for the state's major trade corridors.

These investments will be supported through the following revenue sources:

- \$2.1 billion Road Improvement Charge from \$65 fee on all vehicles, including electric and hybrid.
- \$1.1 billion from eliminating the annual adjustments to the gasoline excise tax and resetting the tax to the FY 2013-14 rate of 21.5 cents, adjusted annually for inflation.
- \$425 million from an 11 cent increase to the diesel excise tax, adjusted annually for inflation.
- \$500 million in additional cap and trade proceeds.
- \$100 million in Caltrans efficiencies.
- \$706 million in loan repayments.

The Governor's budget transportation proposal represents a smaller package than existing legislative proposals in AB 1 (Frazier) and SB 1 (Beall), which generate \$6 billion annually upon full implementation. With a commitment from this Legislature and Administration, the benefits of a comprehensive transportation funding proposal will far exceed the costs for Californians. These modest increases will help ease the costs drivers are already paying, an average of \$762 annually, to fix their vehicles due to poor road conditions.

The Governor's budget proposal assumes adoption of the proposal. Local streets and roads will continue to deteriorate without a new funding package.

Housing

The League was very disappointed to see that the Governor did not include a meaningful funding proposal for affordable housing. The Governor took it a step further in his proposal and clearly stated that the General Fund was completely off the table as a possible source of funding to help spur housing production, including affordable housing. Governor Brown also eliminated the \$400 million set aside in the 2016-17 Budget Act for affordable housing in exchange for approval of the by right proposal. The funds have not been appropriated because the Legislature has not acted on his proposal.

Instead of bringing forward a balanced proposal that comprises significant permanent housing funding and appropriate project streamlining, the Governor unveiled a list of housing policy principles that largely focus on “reforms” at the local level. These “reforms” could dramatically limit plan review, public input, impact fees, and tie housing production to unrelated infrastructure funding, such as much needed transportation dollars.

The Governor’s Housing Policy Principles are as follows:

- **Streamline Housing Construction.** Reduce local barriers to limit delays and duplicative reviews, maximize the impact of all public investments, and temper rents through housing supply increases.
- **Lower Per-Unit Costs.** Reduce permit and construction policies that drive up unit costs.
- **Production Incentives.** Those jurisdictions that meet or exceed housing goals, including affordable housing, should be rewarded with funding and other regulatory benefits. Those jurisdictions that do not build enough to increase production should be encouraged by tying housing construction to other infrastructure-related investments.
- **Accountability and Enforcement.** Compliance with existing laws such as the housing element should be strengthened.
- **No Impact to the General Fund.** No new costs, or cost pressures, can be added to the state’s General Fund, if new funding commitments are to be considered. Any permanent source of funding should be connected to these other reforms.

Curiously, given all of the recent debate in the Capitol about what has led to the rise in home prices, the Governor’s “reform” principles make no mention of CEQA, prevailing wage, high land costs, market conditions, or a number of other factors that put pressure on housing costs.

Homelessness

The only new funding for housing or homelessness comes from the No Place Like Home Program, which allocates \$262 million for permanent supportive housing for persons who are eligible for services under Prop. 63 (2004) and are homeless, chronically homeless, or at risk of chronic homelessness. Grant guidelines are still being developed by the Department of Housing and Community Development, and grant approvals are not expected until 2018.

Workforce Development

The January Budget Proposal includes:

- \$248 million to expand career technical education courses through the Strong Workforce Program at California community colleges.
- \$500 million for the Adult Education Block Grant Program to support programs that assist adult learners with courses to complete high school diplomas, general education equivalent, and English as a Second Language courses.
- \$68 million for apprenticeship programs that offer a clear pathway to obtain classroom instruction and on-the-job training skills leading to gainful employment.
- A policy statement linking the importance of local libraries to workforce development. The state librarian will work with stakeholders to integrate libraries into the state’s workforce strategy.

Cap-and-Trade

Governor Brown proposes legislation authorizing the state Air Resources Board (ARB) to administer Cap-and-Trade auctions beyond 2020. This proposal is meant to address volatility in auction revenues in 2016, which many speculate are the result of legal challenges to the validity

of the program beyond 2020. Governor Brown also announced that any appropriation of Cap-and-Trade funds is contingent on passage of the proposed legislation to extend the Cap-and-Trade authority.

Should this proposal receive the two-thirds it needs in both the Senate and Assembly, the budget proposes the following \$2.2 billion Cap-and-Trade Expenditure Plan:

Continuous Appropriation (60 percent of annual auction proceeds)

- \$375 million for the High-Speed Rail Project.
- \$75 million for Low Carbon Transit Operations.
- \$150 million for the Transit and Intercity Rail Capital Program.
- \$300 million for the Affordable Housing and Sustainable Communities Program.

One-time Appropriation (40 percent of annual auction proceeds)

- \$500 million to the Transportation Agency for Transit and Intercity Rail Capital Program and to Caltrans for Active Transportation (See Transportation Funding section above).
- \$363 million for ARB's Low Carbon Transportation Program to provide incentives for low carbon freight and passenger transportation, including rebates for zero emission cars, vouchers for hybrid trucks and zero-emission trucks and other uses.
- \$142 million for the Strategic Growth Council to administer the Transformational Climate Communities Program as well as to provide technical assistance.
- \$95 million cumulatively to ARB for black carbon woodsmoke, to CalRecycle for waste diversion, and to the Department of Food and Agriculture for dairy digesters.
- \$127.5 million cumulatively to CALFIRE for healthy forests and urban forestry programs, to the Department of Food and Agriculture for Climate Smart Agriculture — Healthy Soils, and to the Natural Resources Agency for urban greening.
- \$27.5 million cumulatively to the Department of Community Services and Development for energy efficiency upgrades and weatherization and to the Department of Food and Agriculture for the State Water Efficiency and Enhancement Program.

Should the Governor's proposal not be approved, programs that receive a continuous appropriation will go forward but with significantly less funding. The programs that received one-time appropriations would not be funded in FY 2017-18.

Beverage Container Recycling Program Reform

In his budget, the Governor highlights the 30-year old Beverage Container Recycling Program as ripe for reform. Depending on the proposed reforms, cities could potentially lose funding that supported recycling programs at the local level. The League will monitor this issue closely as discussions develop.

Environmental Quality

Emergency Drought Response

The Governor's budget proposes an additional \$178.7 million in one-time funding to provide immediate responses to the drought. This budget assumes drought conditions continue, although the administration will continue to monitor drought conditions and make any necessary changes in the May revision to the January budget proposal. Appropriations are proposed in the categories below.

Protecting water supplies and water conservation:

- \$5 million to the Department of Water Resources (DWR) for local assistance to small communities for emergency drinking water.
- \$5.3 million to the State Water Resources Control Board (SWRCB) for water rights management.
- \$7 million to the DWR for drought management and response.
- \$2 million to the DWR for the Save Our Water campaign.

Emergency response for fire protection and tree mortality:

- \$91 million to CALFIRE for enhanced fire protection, including continuation of increase firefighter surge capacity, extended fire season, surge helicopter pilots, California Conservation Corps fire suppression crews, increased vehicle maintenance, and exclusive use of large and very large air tankers.
- \$52.7 million to the Office of Emergency Services (OES) for the California Disaster Assistance Act.
- \$4 million to OES for the State Operations Center.

Protecting Fish and Wildlife:

- \$8.2 million to the Department of Fish and Wildlife (DFW) for emergency fish rescues and monitoring.
- \$3.5 million to the DWR for implementation of the Delta Smelt Resiliency Strategy including aquatic weed control, adaptive food management and distribution, and wetlands flood and drain operations.

California Water Action Plan

The Governor proposes several funding increases to further the goals of the 2014 California Water Action Plan. The proposed allocations below assume drought conditions in the state continue.

- \$248 million (Prop. 1 funding) to DWR for integrated regional water management projects that are regionally driven multi-benefit projects that help meet long-term water needs.
- \$1 million (Waste Discharge Permit Funds) and five new positions for the SWRCB, in coordination with the Department of Food and Agriculture, to address contamination of groundwater basins from agricultural practices.
- \$1.9 million (Prop. 1 funding) increase to DFW for the Water Investment Storage Program for initial outreach and technical review of the ecosystem benefits of the water storage project proposals submitted to the California Water Commission.
- \$2.3 million increase (Water Rights Fund) for five new positions at the SWRCB and \$1.5 million in contract funds to enforce reporting requirements and protect local groundwater resources beginning in July 1, 2017. The proposal targets high or medium-priority groundwater basins that fail to form local governance structures, as required by the Sustainable Groundwater Management Act (SGMA).

Department of Fish and Wildlife

For the Fish and Game Preservation Fund to fully support the commercial fishing program, the budget proposes an increase of \$12.3 million from commercial fish landing fees and redirecting \$10.6 million on a one-time basis from the Lifetime License Account.

Department of Parks and Recreation

In recent years, the Department of Parks and Recreation has undertaken reform and innovation efforts, although the administration notes that the Department has long-term structural shortfalls. The budget proposes a one-time increase of \$12.6 million from the State Parks and Recreation Fund and \$4 million from the Environmental License Plate Fund to maintain existing service levels at state parks.

Local Public Safety

The Governor's Budget Proposal includes:

- \$114.9 million for Community Corrections Performance Incentive Grants: Continued from previous years to fund county efforts to reduce the number of felony probationers going to state prison.
- \$11 million for Post-Release Community Supervision: For county probation departments supervising temporary increase in offenders resulting from Prop. 57 and court-ordered population control measures.
- Policy changes to reduce the number of programs supported by State Penalty Fund due to declining revenues in recent years.

- The following programs will no longer be supported by the fund: California Gang Reduction, Intervention and Prevention Program (GRIP) with Board of State and Community Corrections; Internet Crimes Against Children Task Forces, OES; Local Public Prosecutors and Public Defenders Training Program, OES; and, Motorcyclist Safety Program, California Highway Patrol (training, education and outreach activities).
- Funds will continue to be available to the following programs: Driver Training Program; Peace Officer Standards and Training; Standards and Training for Corrections; Victim Witness and Assistance Programs; Restitution Fund; CA Witness Relocation and Protection Program; Traumatic Brain Injury Program; and Fish and Game Prevention Program.
- A repeal of the Drivers License Suspension Program: Eliminates provisions in law providing for suspending a person's drivers license for failure to pay fines/penalties.

Corrections: Proposition 57 Implementation

Prop. 57 (2016) is estimated to reduce average daily adult inmate population by 2,000 in FY 2017-18, and by a total of 9,500 by FY 2020-21. It facilitates removal of all out-of-state inmates in one of the two remaining prison facilities in FY 2017-18. The Governor's proposal promises to provide substance abuse treatment at all state correctional facilities by the end of the year. The proposal anticipates savings of \$22.4 million in FY 2017-18 with a net savings of \$140 million by FY 2020-21.

Specific provisions of the Governor's Budget Proposal include:

Parole Process — Eligibility for Non-Violent Offenders

The budget provides for non-violent second strikers to go before the Board of Parole Hearings, which will evaluate their threat to public safety. An estimated 5,000 inmates will qualify, only eligible after serving 50 percent of the longest possible term for their sentence. In practice, this will affect approximately 500 – 600 inmates. It also increases and standardizes good-time credit earnings.

Inmates who are not eligible include:

- Violent inmates (defined by Penal Code Sec. 667.5).
- Third Strikers.
- Inmates with sentence enhancements violent acts.
- Inmates with in-custody infractions for drugs/gang-related behavior.

Milestones and Mentors

Milestone credits are good-time credits for specified activities. The goal is to award enhanced milestone credits for earned academic and vocational achievements including accredited high school courses, vocational programs certified by the trades, and an AA or BA Degree.

The Offender Mentor Program (approximately 400 programs throughout the program) will require that inmates go through courses and tests to get credits.

While rehabilitation programs are traditionally open only to non-violent inmates, the Governor proposes to open them to all inmates regardless of committed offense in FY 2017-18. This has been shown to be an effective anti-recidivism tool. The California Department of Corrections and Rehabilitation (CDCR) has found that inmates are 31.2 percent less likely to re-offend if they complete an in-prison substance abuse disorder treatment program. Under the proposal, substance abuse program will be available at all prisons by the end of the year.

Funding for Inmate Rehabilitation and Re-Entry

The budget includes \$440 million to division or rehabilitative programs, which represents an increase from \$300 million in FY 2012-13. Support for in-custody rehabilitative programming will include: cognitive behavioral therapy, re-entry/transition programs, Long Term Offender Program,

Offender Mentor Certification Program, and self-help programs. Participation will be incentivized by grants of up to one month off prison sentence for completion of 208 program hours.

Division of Juvenile Justice

There is an anticipated increase of 72 wards due to Prop. 57's shift of authority regarding charging minors as adults from district attorneys to judges. The budget includes \$4.9 million to reactivate two Department of Juvenile Justice living units to accommodate this expected population increase. In addition, juvenile prosecutions in adult court expected to decline and average daily inmate population on the adult side expected to decline by 81 in FY 2017-18. Counties are expected to experience related increased costs as probation departments will provide greater assistance in juvenile court proceedings and County probation departments will pay the state \$24,000 per year per ward for certain juvenile commitments.

Other Programs

The Budget Proposal also includes funding for the following programs:

- Because 80 percent of lifers released on parole need or request transitional housing, CDCR is developing a 300-bed program for six months of transitional housing.
- Continued funding for Drug and Contraband Interdiction.
- Continued funding for Segregated Housing Unit Conversion at Pelican Bay.
- Funding for 647 beds in community re-entry facilities. This is an increase of 187 beds over current levels.
- Funding for the California Leadership Academy, aimed at reducing recidivism among 18 – 25 year old inmates.

Cannabis Regulation

Generally, the Administration has decided on a single regulatory structure for both medical and recreational marijuana. However, it has not yet committed to whether that structure will look more like Prop. 64, or the Medical Marijuana Regulation and Safety Act, which the League supported. Another unknown factor is how the federal government may change enforcement of existing federal law.

For now, the Administration plans to move forward with Prop. 64 implementation and has proposed \$52.2 million in FY 2017-18 for cannabis regulation, processing of licenses, and enforcement. As revenues from the tax included in Prop. 64 will not be collected until 2018, this appropriation is structured as a loan from the General Fund, to be repaid in FY 2018-19.

Specific appropriations in this area include:

- Department of Consumer Affairs (lead agency): \$22.5 million to Bureau of Medical Cannabis Regulation for regulation of transportation, sale, storage and distribution of cannabis.
- Department of Food and Agriculture: \$23.4 million for administrative oversight, promulgation of regulations, issuance of cultivation licenses.
- Department of Public Health: \$1 million for licensing and regulation of manufacturing facilities.
- Board of Equalization: \$5.3 million for educating businesses on new tax requirements and updating information technology systems.
- Department of Health Care Services: \$5 million for public information program specified in Prop. 64.

State Retiree Health and Pension Costs

The budget includes \$5.3 billion dollars (\$2.8 billion General Fund) specifically for state employee contributions. The Department of Finance (DOF) attributes the increased contributions to several factors including a maturing fund and increased life expectancy combined with significantly lower than expected investment returns. These factors, in part, contributed to the recent decision made by the CalPERS board to lower its assumed rate of return (discount rate) [from 7.5 percent down to 7 percent](#) effective immediately for the state — with a one year delay for local agencies. The

immediate action will result in a modest contribution increase of \$172 million (\$105 million General Fund) in FY 2017-18 year. Given the phased-in approach adopted by the CalPERS board, the true impacts of a 7 percent rate will not impact the state's budget until the FY 2023-24, when state contributions are projected to reach \$9.7 Billion (\$5.6 billion General Fund). The Governor called the recent move by the Board "another major step [in reducing costs]".

The Governor did not announce any plans to seek a legislative remedy to further tackle the state's rapidly growing unfunded pension and retiree healthcare liability. However, he did not close the door on seeking a legislative approach this year. "This will continue to be a lively topic this year ... we will continue to take advantage of other opportunities as they come up".

Public Utilities Commission (PUC) Reform

The Governor's budget proposal includes a commitment from the Administration to continue to work on some of the PUC reforms that were enacted last year, including a directive for the Administration to work with the PUC to develop a reorganization plan to transfer regulatory oversight over transportation network companies and charter party carrier vehicles (shuttles, limousines, etc.) to departments within the California Transportation Agency.

Census Address Program

The budget includes \$7 million for the Local Update of Census Address Program. The program will provide grants ranging from \$7,500 to \$125,000 to cities and counties to encourage their voluntary participation in efforts to ensure the accuracy of the Census Bureau's Master List of addresses.

Redevelopment Dissolution

The Governor's proposed budget summary reports that since FY 2011-12 and projected through FY 2017-18, redevelopment dissolution will have returned a total of \$8.6 billion in property taxes to K-14 schools. This consequently allows the state to reduce its General Fund expenditures under Prop. 98 education funding requirements by a similar amount.

The cumulative total received by counties, special districts and cities over this same period is projected to be \$6.32 billion. Cities are anticipated to receive \$733 million over FY 2016-17 and FY 2017-18. The Administration makes no new proposals in this area for FY 2016-17.

Special Needs Housing

While the Governor's budget does not include additional funding for the Community Based Transitional Housing Program, the Department of Finance reminded local governments on a budget conference call that grant applications are currently open. This program was created in the 2016-17 Budget Act, and seeks to encourage local communities to support housing that provides treatment and reentry programming to individuals who will benefit from those services. To date, zero grant applications have been received. More information and grant applications are available on the [DOF's](#) website.

Next Steps

The Department of Finance will begin releasing draft trailer bill language in the next month that will include details of the proposal. The Assembly and Senate Budget committees will also begin hearings to review program-specific details. In May the Governor will release his revised budget proposal for the coming fiscal year that must be passed by June 15 to take effect July 1.