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## Caution and Fiscal Restraint Dominate Governor's Revised Budget Proposal *No Affordable Housing Funding Proposed; Cap and Trade Outcome Pending*

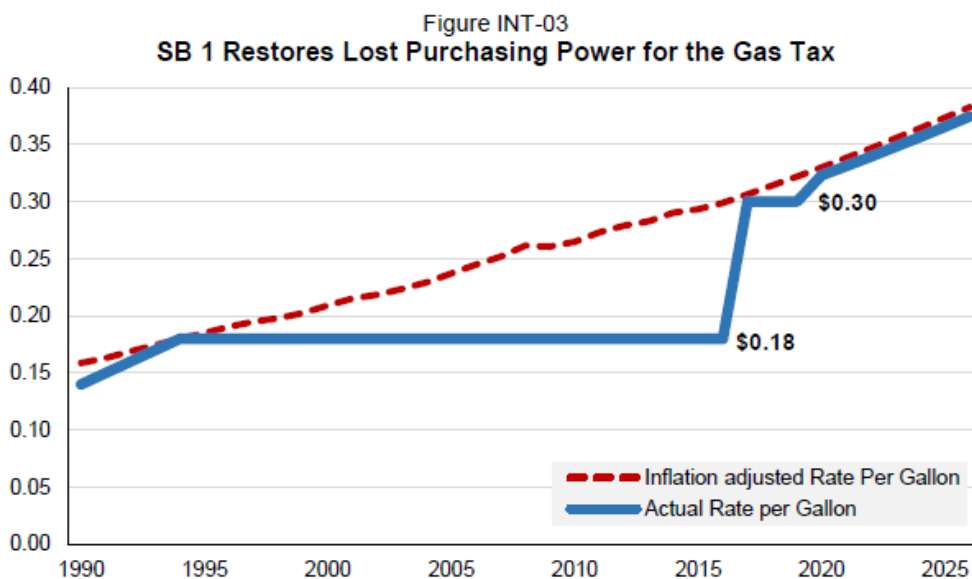
Gov. Jerry Brown held a press conference this morning to unveil his [revised FY 2017-18 budget proposal](#). Despite improved state revenue projections since January, Governor Brown continued to urge fiscal restraint, and cautioned that the next recession is long overdue. Concerns also continue over potential changes to federal policies, with an estimated loss of \$4.3 billion annually by 2020, and \$18.6 billion by 2027, should the House Republican's replacement of the Affordable Health Care Act be enacted.

"Cuts are coming," warned Governor Brown.

The May Revise budget proposes \$183.4 billion in total spending, which includes \$124 billion for the state's General Fund. By the end of FY 2017-18, the Rainy Day Reserve Fund is projected to have a balance of \$8.5 billion, equivalent to 66 percent of the constitutional target.

No proposed funding for affordable housing is included in the proposal, or any mention of the policy issues. In response to a reporter's question, the Governor says he wants reforms that will lower the cost of construction and increase efficiency before he considers state investment, but also expressed doubts that a package would come together. Neither of the brief statements on the budget by Senate Pro Tem Kevin de León (D-Los Angeles) nor Assembly Speaker Anthony Rendon (D-Lakewood) mentioned housing.

A major component of the Governor's May Revise document focused on projected allocations from recently enacted SB 1, the Road Repair and Accountability Act of 2017, to address deferred street, road and highway maintenance. The chart below, from that document, illustrates how the revenues from that measure return the gas tax's purchasing power to 1994 levels.



In response to the state's growing unfunded pension liabilities, the Governor is proposing a \$6 billion additional payment to CalPERS funded by a loan mechanism developed with the State Treasurer. Under this mechanism, the state would borrow from state funds currently earning low interest rates in the Treasurer's Surplus Money Investment Fund then repay the loan over time. The state projects this loan will save the state \$11 billion over 20 years.

Nothing new was included in the May Revision on Cap-and-Trade. Since January, the Governor has urged the Legislature to reauthorize the program with a two-thirds vote. When questioned by a reporter on timing, the Governor was non-committal, while stressing the benefits of a solution and not ruling out the possibility of obtaining votes from Republican legislators.

Projected allocations for K-14 education increased by \$1.1 billion due to the requirements of Proposition 98. Funds for higher education are also included, however, \$50 million was withheld from the University of California (UC) budget until the recent recommendations from the State Auditor and other UC proposals are implemented.

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

### **Transportation Funding**

On April 28, the Governor signed SB 1 (Beall), a historic transportation funding plan of \$54 billion over the next decade. The Governor's May Revision includes the first \$2.8 billion in FY 17-18 appropriations for:

- "Fix-it-first" investments for local streets and roads, bridges, and the state highway system.
- Trade corridor investments, including funding to implement a sustainable freight strategy.
- State-local match funds for high-priority transportation projects.
- Passenger rail and public transit modernization/improvements.

Funds are allocated under the Road Maintenance and Rehabilitation Account as follows:

#### Local allocations

- \$445 million for local streets and roads (divided equally between cities and counties).
  - For cities, the amount in FY 17-18 is \$222 million distributed to cities on a per capita basis (population based).
- \$330 million for the Transit and Intercity Rail Program (TIRCP).
- \$305 million for the State Transit Assistance program (STA).
- \$200 million for the State-Local Partnership Program (SLPP).
- \$100 million for the Active Transportation Program (ATP).
- \$25 million for Local Planning Grants.

#### State allocations

- \$445 million for the State Highway Operations and Protection Program (SHOPP).
- \$400 million for bridges and culverts.
- \$250 million for congested corridors.
- \$200 million for trade corridor enhancement.
- \$54 million for the Department of Parks and Recreation.
- \$25 million for Freeway Service Patrol.
- \$17 million for the Department of Food and Agriculture.
- \$7 million for transportation research at the CSU and UC.
- \$5 million for the Workforce Development Board.
- \$4 million for administration (including the State Controller's Office, the California Transportation Commission (CTC), and \$3.8 million for DMV).

The \$2.8 billion in FY 2017-18 is generated from:

- \$727 million from the tiered Transportation Improvement Fee (\$25-\$175 depending on value of the vehicle).

- \$1.25 billion from restoring gas tax purchasing power to 1994 levels (12 cent increase in the base gasoline excise tax).
- \$600 million from the diesel sales and excise tax increases (11 cent increase in the diesel excise tax and an additional 4 percent in the diesel sales tax).
- \$235 million from general fund loan repayments.

In addition to providing transportation funding for local streets and roads, bridges, the state highway system, transit, active transportation, trade corridors, congestion management, self-help municipalities, intercity rail, transportation research, and freeway patrols, the measure also included a series of reforms, such as:

- Creation of the Office of Transportation Inspector General, whom would have audit and investigatory oversight authority over Caltrans.
- Establishment of the State Highway Performance Plan to create measurable targets for improvements and reporting requirements to the CTC and Legislature.
- Creation of the Advanced Mitigation Program to get early permitting approval for transportation projects to help prevent delays and strategically mitigate environmental impacts.
- Additional CTC oversight for each phase of the State's project delivery.
- Constitutional protection in ACA 5 (Frazier), which would go before the voters in the June, 2018, general statewide election to ensure the revenues are dedicated to transportation.

For local streets and roads, it's important to note that the \$445 million in direct subventions to cities and counties in FY 2017-18 is reflective of partial year funding for the first year of the transportation deal. In the first full fiscal year (FY 20 18-19) \$1.1 billion will be allocated for local streets and roads, divided equally between cities and counties. An additional \$75 million split between cities and counties will be made available for loan repayments.

An additional detailed explanation of the transportation funding deal and city-by-city local streets and roads estimates is [available online](#) for FY's 2016-17, 2017-18 and 2018-19.

## Housing

Unfortunately, like the January budget proposal, the May Revise does not include a meaningful funding proposal for affordable housing. The only mention of housing is contained in sections reporting various economic data, which projects housing supply to remain lower than needed to accommodate population growth through 2018. Curiously, however, in numerical tables that compare national economic trends versus California, housing permit issuance data reveals that California is actually recovering faster than the nation as a whole. Between 2012 through 2016, the level of housing permits issued nationwide grew from 830,000 to 1.19 million, an increase of 31 percent. In California, however, over the same period, housing permits grew from 59,000 to 100,000, an increase of 41 percent. While California debates its housing policies, such national trends may reflect larger economic undercurrents affecting housing production since the recession.

The Governor's January budget outlined his desired reform 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.

### Transitional Housing

The 2016 Budget allocated \$25 million for the Community Based Transitional Housing Program, which encourages cities and counties to support transitional housing that provides treatment and reentry programming to offenders released from the criminal justice system, and to any other persons who the applicant city or county believes may benefit. The applicant must partner with a private entity, either for-profit or nonprofit, to operate the transitional housing facility and provide a slate of statutorily prescribed services. While there has been interest in this program, its regulations were viewed as overly cumbersome.

The May Revision broadens the purposes for which cities and counties may use their program funds based on feedback from many potential applicants.

The proposed statutory changes do the following:

- Allow cities and counties to provide a portion of their program funds to the facility operator, if the facility operator agrees to use those funds for facility operations and services to residents. There is no limit on the amount the city or county may provide the facility operator.
- Allow cities and counties to use program funds for other purposes that their governing boards determine are in furtherance of the program's goals as long as the proposed uses are specified in the application.

### **California Department of Corrections and Rehabilitation (CDCR)**

The May Revision provides total funding of \$11.4 billion; \$11.1 billion General Fund and \$308 million from other sources.

Since January, changes in the adult inmate and parolee population have resulted in decreases of \$29.4 million General Fund in FY 2016-17; and further decreases of \$21.3 million General Fund in FY 2017-18. As of May 3, the prison population was at 135.0 percent of capacity, below the court-ordered population cap of 137.5 percent — this is attributable to population reduction measures and new bed and programming space. The average daily inmate population projections are for an increase of 260 inmates for a total of 129,275 in FY 2016-17, and a decrease of 466 inmates to 127,693 in 2017-18. The May Revision includes \$34.9 million for rehabilitation of CDCR roof structures due to record rainfall

Average daily parolee population projections are projected to increase from 44,445 in FY 2016-17 to 47,274 in FY 2017-18.

### Proposition 57 and 47 Implementation:

While policy debates continue over these two propositions which result in inmates being released earlier than otherwise and altering the prior definitions of crimes, the implementation of these measures continue to reduce the state's prison population and the influx of new inmates into the prison system.

- Population Reduction: The Governor's January Budget assumed an average daily inmate population reduction of 1,959 inmates in FY 2017-18. The May Revision, however, reflects accelerated implementation dates proposed in emergency regulations and increases the projected population reduction to 2,675 in FY 2017-18, growing to 11,500 in 2020-21. If these figures hold, it will CDCR to remove all inmates from one of the two remaining out-of-state facilities in FY 2017-18, and the second facility beginning in January 2018. The net savings from these changes is projected to grow to \$186 million in FY 2020-21.
- Timing:
  - November, 2016: Juvenile Justice provisions (assigning judges responsibility to decide whether minors should be charged as adults) went into effect immediately upon the passage of Proposition 57.
  - May 1: implementation of Good Conduct Credits began.
  - July 1: new parole consideration process for non-violent offenders (requiring inmates to serve 100 percent of their base sentence, but no time for sentencing enhancements before being eligible to appear before the Board of Parole Hearings).

- August 1: Milestone Completion, Rehabilitative Achievement, and Educational Merit Credits (time off for active efforts to participate in and complete rehabilitation and educational programs) begins.
- Funding: \$6.7 million is allocated for implementation, including \$1 million augmentation for more case records staff to review and process inmate records related to new credit earning structure and parole process.

Proposition 47

This initiative's re-classification of certain felony offenses to misdemeanors is expected to reduce adult inmate population by 4,425 in FY 2016-17, based on avoided new admissions to state correctional facilities. This change is expected to yield a savings of \$45.6 million in FY 2017-18.

Post Release Community Supervision

May Revise includes \$15.4 million General Fund for county probation departments to supervise increased offenders released with a condition of Post Release Community Supervision. This is an increase of \$4.4 million over the amount allocated in the Governor's January Budget based on Prop. 57's accelerated implementation dates.

**Cannabis Regulation**

The Governor's January Budget appropriated \$52.2 million for cannabis regulation. The May Revise appropriates an additional \$43.2 million for cannabis programs across all state entities, for a total of \$95.4 million.

Funded activities include:

- Initial development of regulations.
- Development of licensing and track-and-trace programs.
- Development of standards for pesticide use in cannabis cultivation.
- Programs to protect instream flows from water diversion.
- Studying health risks associated with cannabis use.

Individual agency allocations are as follows:

- \$11.3 million to Bureau of Cannabis Control within Dept. of Consumer Affairs for regulation and licensing.
- \$4.6 million to Office of Manufactured Cannabis Safety within Dept. of Public Health.
- \$5.0 million to Department of Health Care Services for a public information program, including education and prevention.
- \$13.7 million to Department of Fish and Wildlife for water quality and instream flows;
- \$7.2 million to the State Water Resources Control Board for the Cannabis Cultivation Waste Discharge Regulatory program.
- \$700,000 to the Department of Pesticide Regulation for cannabis pesticide regulation and enforcement.
- \$1.1 million to the Board of Equalization for tax collection.
- \$8.6 million to the Department of Food and Agriculture for cultivation licensing.

Funding Adjustments are being made as follows:

- Department of Fish and Wildlife: \$17.2 million from multiple fund sources for 63 positions supporting regulatory programs in the Dept. of Food and Agriculture and the State Water Resources Control Board.
- State Water Resources Control Board: \$9.8 million from multiple fund sources for 65 positions statewide water quality permit and related regulations.
- Department of Pesticide Regulation: \$1.3 million for the Cannabis Control Fund to develop guidelines for pesticide use on cannabis.
- Cannabis Control Appeals Panel: \$1 million for 8 positions for the panel's operations;
- Bureau of Cannabis Control: \$664,000 and 5 positions for environmental impact review activities.
- Department of Public Health: \$9.3 million for the Cannabis Control Fund to implement cannabis manufacturer regulations.
- Department of Food and Agriculture \$3.9 million for the Cannabis Control Fund for environmental impact review activities.

## Cap-and-Trade

Governor Brown did not propose any revisions to his January proposal on Cap-and-Trade, indicating he is holding firm on his proposal to reauthorize the Cap-and-Trade system with a two-thirds vote of the Legislature. The two-thirds vote is widely seen as insulation against current and future legal challenges to the system. While some 60 percent of the revenue auctions will be spent based on continuous appropriation, the Governor proposes to make appropriation of the remaining 40 percent of auction revenues be contingent on the vote to reauthorize the Cap-and-Trade system.

When asked during his press conference, Governor Brown indicated he believes there is a good chance the Legislature will reauthorize this system because 50 percent of the revenues go to disadvantaged communities. The Governor further articulated the importance of this system to the credibility of the state's Climate Action Plan, and a willingness to work with lawmakers on proposals to restructure the program and potentially use Cap-and-Trade revenues for air quality priorities in addition to reducing greenhouse gases (GHGs).

## Public Utilities Commission: Transfer of Responsibilities

According to the Governor's May Revision Budget Summary, transportation functions currently regulated by the Public Utilities Commission (PUC) will be transferred to various other departments starting July 1, 2018, as follows:

- Private carriers of passengers (limousines, party buses, shuttles, etc.) — transferred to the DMV.
- Household goods carriers (residential or office moving companies) — transferred to the Department of Consumer Affairs' Bureau of Electronics and Appliance Repair, Home Furnishings and Thermal Insulation.
- For-hire vessels (ferry services) — transferred to the Department of Parks and Recreation's Division of Boating and Waterways.
- Commercial air operators (flight schools, sightseeing services, chartered intrastate flights) — transferred to cities and counties.

In addition to these transfers the PUC will see an increase of \$636,000 to strengthen their Transportation Enforcement Branch. It is unclear at this time if any of these transfers of budget increases will impact regulations over the transportation network company industries, such as Uber and Lyft.

## Drought Response Concluding Activities

The May Revision decreases the projection needed for drought response activities from \$178.7 million to \$62.9 million. This \$115.8 million decrease is due to end of the statewide drought. Funding resources included in the May Revision are intended to conclude activities that began during the drought, and the Administration expects the state to transition to prioritizing activities associated with climate change. Major proposed appropriations include the following:

### Protecting Water Supplies and Water Conservation

- \$5 million to Department of Water Resources (DWR) for emergency drinking water for assistance for small communities in the Central Valley with dry private domestic wells;
- \$600,000 to the State Water Resources Control Board (Water Board) to conclude water curtailment compliance and enforcement; and
- \$1 million to DWR for the Save Our Water Campaign.

### Emergency Response

- \$41.7 million to Department of Forestry and Fire Protection (CAL FIRE) to address fire protection needs due to continuing tree mortality. An unprecedented bark beetle outbreak is estimated to have killed 100 million trees.
- \$42.3 million to CAL FIRE for expanded firefighting capabilities and extended fire season.
- \$6.5 million to the Office of Emergency Services (OES) for emergency water tank activities including periodic refills and tank storage and sanitation to the nine counties that

continue to experience effects from the drought (a reduction from January due to drought conclusion).

- \$2 million to OES for local agencies to remove dead or dying trees.

#### Protecting Fish and Wildlife

- \$2.6 million to the Department of Fish and Wildlife for at-risk fish monitoring including protection of fish and wildlife affected by future drought and climate change.
- \$3.5 million for Delta Smelt Resiliency Strategy implementation.
- \$21 million from water bond funds for the Sacramento-San Joaquin Delta and San Francisco Bay Watershed from Prop. 13 over five years to DWR for scientific, engineering, and construction to support salmon habitat restoration. Five positions within the Department of Fish and Wildlife for expert staff, as the negotiations continue with water districts and environmental groups on voluntary agreements to protecting drinking water and habitats for numerous species

#### Enhancing Dam Safety and Flood Control

The Governor proposes enactment of a comprehensive dam safety and emergency flood response package including legislation requiring updated emergency action plans, updated inundation maps, and granting enforcement authority to DWR. Funding proposals include:

- \$387.1 million Prop. 1 to accelerate flood control projects over the next two fiscal years, including projects in the Central Valley, the Sacramento-San Joaquin Delta, and other parts of the state with significant flood risk.
- \$3.5 million to DWR to carry out dam safety activities.
- \$1.8 million to OES to carry out dam safety activities.
- \$3 million to the DWR to conduct evaluation of appurtenance structures such as spillways, gates, outlets.

#### Making Water Conservation A Way of Life

The Administration has proposed a trailer bill and funding in the May Revision to support his long-term water conservation proposal called, "Making Water Conservation A Way of Life". Also pending in the Legislature are policy bills designed to implement the Administration's plan, an alternative proposal developed by local water agencies, as well as a handful of other proposals for water conservation. The May Revision proposes five positions in the State Water Resources Control Board from existing funding to implement the proposed legislation.

#### Department of Parks and Recreation

SB 1, the transportation funding package, includes \$54.3 million in additional funding for the parks. The May Revision proposes the following allocations:

- \$31.5 million increase to repair state parks system infrastructure.
- \$1.5 million to establish a pilot project to provide transportation to parks from urban areas and schools.
- \$1 million increase to support off-highway vehicle recreation including increased law enforcement, environmental monitoring and maintenance grants.
- \$1 million increase for the Abandoned Watercraft Abatement grant program.
- \$1 million increase to establish recruitment and training program for hard-to-fill classifications including park rangers, lifeguards, maintenance workers, administrators and managers.
- \$18 million increase for the Jurupa Area Recreation and Park District.

#### Beverage Container Recycling Program

While the January budget proposal contained a reform proposal for this 30-year old program, the May Revision does not contain additional details. CalRecycle held a series of stakeholder workshops in the early part of 2017 and stakeholders continue to await additional details. At stake for cities is funding that supports local recycling programs.

#### Economic Development: Small Business Assistance

An additional \$2 million is allocated to the Governor's Office of Business and Economic Development to match federal funds that are available to the California Small Business Development Center for efforts to support small businesses. Funds will be made available through a one-time competitive grant program, with emphasis on high poverty areas of California.

### **Governor's Office of Emergency Services**

The May Revision proposes \$500,000 from the Anti-Terrorism Fund for the California NonProfit Security Grant Program, assisting nonprofit organization at high risk of terrorist attack:

- Target hardening.
- Physical security enhancements.
- Public/private coordination and collaboration in emergency preparedness (includes state and local agencies and nonprofits).

### **State Retirement Cost (CalPERS) Investment**

The May Revision includes a onetime \$6 billion supplemental payment to CalPERS through a loan from the Surplus Money Investment Fund. In an effort to mitigate the significant impacts resulting from the lowering of discount rate, this proposed one-time payment to CALPERS is projected to save the state \$11 billion over the next two decades. This action would effectively double the state's annual payment for this year as they are projected to pay approximately \$5.8 billion (\$3.4 billion general fund dollars). This proposal to address the state's rapidly growing unfunded pension liabilities is a step in the right direction.

While the details of this proposal emerge, it is likely that many cities facing challenges with pension obligations may not have the surplus reserves to avail themselves of such options.

### **Public Employees Relations Board**

Allocates \$750,000 to PERB, which administers and enforces public sector collective bargaining laws, to support permanent positions, cover the costs of "fact finding fees" and relocate an office in Southern California.

### **California Department of Justice Litigation**

\$6.5 million GF and 31 positions is allocated to the Department of Justice to address new legal workload related to various federal actions taken since January 2017 impacting public safety, health care, the environment, consumer affairs, and general constitutional issues. This increased workload is expected to continue.

### **Courts**

The May Revision allocates a total of \$3.6 billion for the state's court system. This figure includes:

- Trial Courts: \$2.7 billion.
- Courts of Appeal: \$234 million.
- Supreme Court: \$48.6 million.
- Judicial Council: \$140.3 million.
- Judicial Branch Facility Program: \$440.9 million.
- Habeas Corpus Resource Center: \$15.8 million.
- Court Construction Projects: \$2.2 million.

\$75 million will be allocated in FY 2016-17, and \$55 million in FY 2017-18, to backfill the shortfall in the Trial Court Trust Fund revenues resulting from lower filing fees and criminal assessments. Also included is a \$1.2 million loan over two years to implement a statewide electronic filing program for court pleadings. The cost recovery fee charged to users will fund the loan repayment.

The Governor's January Budget included language deleting provisions from statute related to placing holds on driver's licenses for failure to pay fines and penalties. The Judicial Council has advocated for a need to address the resulting loss in revenue for court operations, but no amount



has been specified. The May Revise contains no solutions on this point, but dialogue between the Administration and the Courts.

\$2.2 million is included for two courthouse construction projects:

- \$664,000 for demolition of existing structures on the site of the Siskiyou County Courthouse, including lead and asbestos abatement and clearing of debris.
- \$1.6 million to complete a data center at the Alameda County Hall of Justice
- Re-appropriation of \$16 million to support design phase of the Sacramento County Criminal Courthouse.

### **Child Care**

In January, Governor Brown proposed to pause until FY 2018-19 child care provider rate increases and 2,959 additional full-day state preschool slots that were agreed to in FY 2016-17. Since the May Revise assumes modestly improved revenue growth over January, the Administration has reversed this proposal. The scheduled increases in reimbursement rates for child care providers and expanded preschool slots would result in a \$500 million increase for child care providers in the current fiscal year through FY 2018-19.

### **Next Steps:**

The League will continue to review the Governor's Budget May Revise and keep city officials informed of any new developments. The Legislature is required by the Constitution to send the Governor a budget by June 15 to be signed and take effect by July 1.