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RE: **Governor Newsom FY 23-24 State Budget Update – May Revise**

The following is a topline summary of the Newsom Administration's revision of the Fiscal Year 2023-24 (FY 23-24) State Budget highlighting specific areas of interest to the City of Rancho Palos Verdes. If there are other areas or line items of interest expressed by Council or department heads, please do not hesitate to reach out to our team to ask questions or to request additional information.

MAY REVISE: BUDGET UPDATE SUMMARY

On May 12, Governor Newsom held a news conference to announce the release of the Administration's revised State Budget plan for FY 23-24. The Governor presented the revised Budget projections and took questions from reporters on broad aspects of the Budget but declined to go into detail on some items, leaving that for members of his team. Total spending for FY 23-24 is now projected at $306 billion. While the Governor indicated that the Administration is not forecasting a recession, under a moderate recession scenario state General Fund revenues could shrink up to $100 billion below May Revise projections through FY 26-27.

As indicated in the Governor's January Budget proposal, state revenues in FY 23-24 have decreased from FY 22-23. The deficit is now projected at $31.5 billion, which is an increase of $9 billion over the $22.5 billion projected in January. Contributing factors include declines in capital gains taxes, population loss, high inflation, recent mass layoffs, and the impacts from the COVID-19 pandemic. Delays in tax collection create additional uncertainties. The Administration announced earlier this year that the Franchise Tax Board would be extending the deadline to file and pay income taxes for individuals and businesses impacted by the 2022-2023 winter storms to October 16, 2023. State Budget estimates of the impacts of these delays are $42 billion. Additional budgetary corrections may be necessary if the amounts collected in October are significantly below current estimates.

During his press conference, the Governor addressed the Administration's plan to deal with the projected deficit. The Governor announced that there will be no additional trigger reductions. However, the Budget maintains most of the $3.9 billion in trigger reductions included in the January proposal. The Administration has outlined the following options to help close the shortfall:

- $1.1 billion additional reduction in spending across the 2021-22 through 2023-24 fiscal years. Combined with the $5.7 billion in reductions and pullbacks and a $57 million adjustment, the May Revise includes total solutions in this category of $6.7 billion.
- $695 million spending delay across the multi-year without reducing the total amount of funding through the same period. Combined with the delays proposed in January of $7.4 billion, $8.1 billion in spending delays is spread across multiple years. Major items in this category include $295 million moved into the out-years for the Foreclosure Intervention Housing Prevention Program (while maintaining $205 million in the current year and Budget year).
- $3.3 billion in shifts of spending commitments from the General Fund to other funds. Combined with fund shifts of $4.3 billion and a $90 million adjustment, there is a total of $7.5 billion in shifts to other funds. Major items in this category include $1.1 billion in Climate related investments shifted to a proposed Climate Bond, $1.1 billion in college student housing projects with Bonds that would need to be approved by voters, $635 million in Zero Emission Vehicle investments shifted to the Greenhouse Gas Reduction Fund, and $1 billion in reversions from programs such as middle class tax refunds and utility bill support for low-income residents.
- $3.7 billion in revenue and borrowing, which consist primarily of an additional $2.5 billion from the Managed Care Organization tax and $1.2 billion in additional borrowing from special funds. Combined with the Governor's Budget amount of $1.2 billion, there is a total of $4.9 billion in new revenue or borrowing.
- $450 million withdrawal from the Safety Net Reserve to offset costs associated with Medi-Cal and CalWorks. This represents half of the funds available in the reserve, leaving a balance of $450 million.

As previously mentioned, during his presentation the Governor highlighted his work with the Legislature on two bond proposals, which would, in part, offset state General Fund commitments:

- A Behavioral Health Bond, of an unknown amount, which would include proposed changes to the Mental Health Services Act, Prop. 63 of 2004. The Mental Health Services Act (MHSA) currently generates approximately $3 billion annually that is allocated to counties to support various mental health programs. The Governor is proposing to authorize funding for increasing behavioral-related housing by 6,000 units, including housing for homeless veterans, and assisting those with substance abuse. In a related move, the Governor is also proposing to swap $500 million in MHSA funds to backfill a proposed General Fund deferral of $250 million to the Behavioral Health Bridge Housing Program, along with an additional $250 million in budgetary savings.
- A Climate Resilience Bond, of an unknown amount, which would include a swap-out from the General Fund to the Bond of $1.1 billion of funds dedicated to various climate resilience programs. The Governor said that the Bond would also "allow us do even more in this space than was proposed in January." With this statement, it appears that the Bond could also propose to offset some or all of the $6 billion in proposed reductions to these programs listed in the Governor's January budget, which reduced (from $54 to $48 billion) the commitments made to these programs.

While shifting state General Fund commitments to bonds may be an attempt to maintain momentum on various priorities during a deficit, the additional interest costs are significant. The May Revise states: "When the state borrows to pay for infrastructure, roughly one out of every two dollars spent on infrastructure investments pays long-term interest costs, rather than construction costs."

The Governor also did not discuss two other bond related items:

- A school bond mentioned in the Infrastructure section of the May Revise: "Given the ongoing need to construct and/or renovate educational facilities, the Legislature and Administration will need to engage in a conversation regarding the potential placement of a general obligation bond supporting the construction and/or modernization of education facilities on a future ballot for consideration by the voters."
- The two proposed housing bonds pending in the Legislature, AB 1657 (Wicks) for $10 billion, and SB 834 (Portantino) for $25 billion. Housing advocates and local governments cite the lack of adequate funding as the key barrier to affordable housing production.

The Governor's May Revision of the FY 23-24 Budget proposal can be found **HERE**.

MAY REVISE BY THE NUMBERS

Total Budget: $306 billion	• $224 billion general fund • $35.6 billion in reserves • $450 million in Safety Net Reserves • $22.25 billion in rainy day fund
Total Deficit: $31.5 billion	• $9 billion increase in deficit from the January Budget proposal

TIMING AND NEXT STEPS

This is the first time since taking office that Governor Newsom has had to navigate such a steep revenue decline. This growing deficit will set the stage for lengthy and spirited negotiations between legislative leadership, advocates, and the Administration over proposed cuts and competing priorities – perhaps more pronounced in the next year than this year's, depending on where the delayed tax receipts come in this October.

Snapshot: Timing For the State's Budget Adoption:

- Now that the Governor has released his revised proposal, Budget subcommittees of each house will meet and confer over specific items germane to their respective policy areas. Each House will move to adopt its version of the State Budget leading into final negotiations with the Governor.
- Prior to the Democratic supermajority in both houses, the Assembly and Senate would convene a Budget conference committee to resolve differences in their respective spending plans. However, it is now more commonplace that the Administration and legislative leadership negotiate a deal privately.
- June 15. The Legislature must vote on a balanced Budget package to send to the Governor by June 15th to adhere to the constitutional deadline.
- July 1. The Governor then has until July 1 to sign the Budget deal, which is the start of the new fiscal year, and may line-item veto specific appropriations.

It is important to note that the constitutional deadline does not apply to Budget Trailer Bills (BTBs), which are bills that 'trail' behind the main Budget bill for purposes of augmentation. BTBs are typically germane to one specific policy category. However, it is commonplace that a general Budget trailer bill also referred to as a "Budget Bill Jr'" is introduced which amends many sections of the adopted Budget. There can be several iterations of a Budget Bill Jr in any given budget year. Due to both the state and federal extension of the tax filing deadline, it is likely that we will see subsequent budgetary actions in the coming months and perhaps augmentations as late as January of 2024.

AREAS OF INTEREST TO LOCAL GOVERNMENT

While this Budget reflects just over $306 billion in spending, the Governor was clear that he has had direct conversations with Legislative leadership about exercising restraint with respect to policies that require funding outside of the adopted Budget. For local government this has the potential of cutting both ways. On the one hand, policies that have an adverse impact on local governments' operations or their legal or legislative authority may be vetoed based on budgetary constraints that come with mandating a new duty or local program. On the other hand, this means less potential funding for local earmarks as well as the potential that the Legislature will try to create mandated programs which are unfunded. With this in mind, RPPG has identified the following areas of general interest to local agencies in the following categories:

1. **Housing and Homelessness**
2. **Natural Resources**
3. **Transportation**
4. **Energy**
5. **Economic Development**
6. **Public Safety**

Housing and Homelessness

While the May Revise offered several minor funding adjustments – a proposed finding swap to a homeless program, and a new deferral and reversion to existing housing programs – the focus of the Governor's comments at his press conference was on holding local agencies accountable to demonstrate results using the funds that have been, and are proposed to be, allocated.

"Accountability, accountability, it's all about accountability, and that extends to housing affordability…", the Governor said, and promised that details would be revealed in a Budget trailer bill. During his presentation, and in responses to questions from the press, he praised the work of the Department of Housing and Community Development's Housing Accountability Unit and the Attorney General, insisted that 2.5 million units was a "legally binding" requirement, promised more lawsuits against local governments would soon be filed, and declared that it was time to "clean up these damn encampments." He dismissed press questions about local government requests for ongoing homeless funding and stated that no Governor has focused or spent more in an effort to address the problem.

While not addressed in the press conference or in the policy sections, information included in the Economic Outlook portion of the May Revise reveals that the state has reduced its projected housing needs, stating that, *"As California population growth slows and projections of future growth decreases, California is now estimated to need around 148,000 housing units permitted annually (down from the Department of Housing and Community Development's 2018 estimate of 180,000) to keep pace with projected population growth."* The May Revise also projects current housing production for 2023 at 109,000 units which will climb to 129,000 units annually by 2026.

In the press conference, the Governor also made two other announcements with potential impacts on the housing policy discussion:

- He is working with the Legislature on a Behavioral Health Bond, which would include modernization of the Mental Health Services Act, Prop. 63 or 2004, which provides funding to counties for mental health programs. The adjustments would include authorizing funding to be used for increasing behavioral-related housing by 6,000 units, including housing for homeless veterans, and assisting those with substance abuse.
- He will soon unveil a permitting and procurement reform legislative package aimed at accelerating "shovel ready" infrastructure projects (clean energy, roads, bridges, public transit, water storage and conveyance, and faster internet), funded by over $180 billion in federal and state funds over the next decade. The proposals, which may affect housing as well, are projected to cut timelines by three years, save hundreds of millions, and reduce paperwork by hundreds of thousands of pages.

Housing: In January, the Governor proposed various reductions to previously approved housing funding totaling $600 million. These reductions are subject to potential restoration based upon a 2024 budgetary trigger as follows:

- $200 million (out of a total of $500 million) approved for the Dream for All homeownership assistance program for FY 23-24 at the California Housing Finance Agency.
- $100 million (out of a total of $350 million) allocated in the FY 2022-23 Budget to the CalHome program, which provides local agencies and nonprofits grants to assist low- and very-low-income first-time homebuyers with housing assistance, counseling, and technical assistance.
- $50 million allocated to the California Housing Finance Agency for an Accessory Dwelling Unit program.
- $250 million to seismically retrofit "soft story" multifamily housing, where the first floor of the structure, due to garages and other features, is vulnerable to collapse.

In the May Revise, the Governor proposed the following additional deferral and reversion:

- Defer $345 million, out of an original $500 million included in the 2021 Budget Act, for the Foreclosure Intervention Housing Prevention Program, which provides funds to various non-profit organizations to acquire foreclosed property and operate as affordable housing. The May Revise proposed to defer the allocation of these funds over four fiscal years: $50 million in 2023-24, $100 million in 2024-25, $100 million in 2025-26, and $95 million in 2026-27.
- Revert $17.5 million in unexpended funding from a $25 million allocation in the 2000 Budget Act for the Downtown Rebound Program, which provides funding for adaptive reuse of commercial and industrial structures to residential housing.

Accompanying language in the Housing section of the May Revise continues to focus on local governments activities and obligations related to housing: *"For these investments and laws to work, local governments must do their part—not just to comply with their state housing obligations, but to accelerate their efforts to enable the development of equitable and affordable housing in their communities. California continues to set requirements for local governments to meet their obligation to plan for and develop housing. The state remains committed to providing technical assistance to communities throughout the state, enabling them to leverage available tools to accelerate and streamline housing development. The state also continues to find ways to accelerate housing development by providing financing and enforcing state housing laws."*

Homelessness: The May Revise maintains homeless funding allocations levels proposed in the Governor's Budget for the following programs:

- $400 million for a third round of Encampment Resolution Grants.
- $1 billion for a fifth round of Homeless Housing, Assistance and Prevention (HHAP) grants. The Administration maintains its intent to focus HHAP funds on highest priority needs, especially reducing unsheltered homelessness, and to pursue statutory changes to prioritize spending on activities such as encampment resolution, Homekey operating sustainability, and Community Assistance, Recovery and Empowerment (CARE) Act housing support.

Related language in the May Revise states that the Administration is continuing to engage the Legislature in discussions about enhancing local accountability around homeless services and enhancing regional coordination on homelessness strategies.

In addition, the May Revise proposes a funding swap that may be controversial with counties. It proposes to shift $500 million one-time from the Mental Health Services Fund (funds which are allocated to counties from Prop. 63 for mental health services) in 2023-24, in lieu of a General Fund allocation, to the Behavioral Health Bridge Housing Program. This program is managed by the Department of Health Care Services (DHCS) and offers support to homeless individuals through various "bridge" housing settings, including tiny homes, interim housing, rental assistance models, and assisted living settings.

Besides achieving some General Fund savings, this proposed funding swap offsets a proposal in the Governor's January Budget to delay $250 million General Fund to 2024-25, thus maintaining the $1.5 billion funded in the 2022 Budget Act for this program. When questioned about this proposal by the press, the Governor offered a series of arguments supporting the use of these mental health funds for housing, including stating that, "[H]ousing is foundational…look what's happening on the streets, look at the crisis…I have zero interest in the status quo ante….". He further noted that, "…change is uncomfortable, and change has its enemies…we are not interested in failing more efficiently any longer."

For a recap of all housing and homeless related funding allocated by the state in recent years, including the housing and homeless funding proposed in the Governor's January Budget, please see this recent summary prepared by the Office of Legislative Analyst:
https://www.lao.ca.gov/handouts/socservices/2023/State-Housing-Spending-022823.pdf

Natural Resources

The May Revise continues to invest in countering carbon pollution and growing the green economy, maintaining much of the prior year's proposed investments in the Climate Budget. However, as previously mentioned, in his press conference the Governor doubled down on his commitment to back a Climate Bond this year and has integrated those efforts into his Budget plan. As such, the May Revise proposes to shift funds from programs to integrate into the Bond funding.

Maintains January Level Investments in Climate Budget

Last year, the Budget proposed $54 billion in Climate Investments. The January proposal brought the level of investment to $48 billion, which has been retained in the May Revision with some funding shifted. The top-level investments retained as proposed in the State's Climate Package are as follows:

- Retains $8.5 billion in overall water funding (97% retained), with all proposed investments aligning with the State's Water Resilience Portfolio and California's Water Strategy for Adapting to a Hotter Drier Future that were released last August.
- Retains $2.7 billion over a three-year period to continue to address the catastrophic wildfire crisis – over 1,200 projects have been funded to date (either completed or are currently in progress).

  - The Wildfire and Forest Resiliency Task Force will be issuing a release on their progress in the coming weeks.
- Retains most of the heat and community resilience package, including:
  - $50 million for urban greening and nature-based solution projects
  - $100 million for heat related vulnerabilities
  - $80 million for the CalFire Urban Forestry Project
  - $110 million for Office of Planning and Research (OPR) Community Resilience Program
  - $120 million for OPR Regional Resilience Program
- Maintains 89% of last year's investment with very minimal change from January's Budget for nature-based solutions, including access to open space.
  - The State's "Outdoors for All" initiative will be released in the coming days
- Retains January's proposed investment in Coastal Resilience (which is 60% of the prior year's proposed funding).

New Investments – Flood Protection and Disaster Relief

The May Revise does propose an additional investment of $290 million to enhance flood protection and disaster relief efforts throughout the state. This is on top of the $202 million additional flood protection funding from the January Proposal and is in response to the multiple atmospheric rivers experienced earlier this year and in anticipation of potential flooding as the snow melts later this season. This includes:

- $125 million in the Flood Control Account
- $75 million for the Flood Control Subvention Program (this is a local match fund for major U.S. Army Corps of Engineers' State Plan of Flood Control Projects)
- $25 million for Small Agricultural Business Relief Grants
- $25 million in the Disaster Response Emergency Operations Account

Shifts Funding to Proposed Climate Bond

The Governor refrained from providing details at the press conference on the proposed Bond that would incorporate $1.1 billion of proposed fund shifts, including keeping the proposed final amount of a Bond quiet. However, the Budget detail notes specific shifts to the Bond include:

- $270 million for Water Recycling
- $160 for Community Resilience Centers
- $100 million for Transformative Climate Communities
- $100 million for Regional Resilience Program
- $100 million for Urban Greening
- $86.6 million for Statewide Parks Program
- $60 million for Sustainable Groundwater Management Act Implementation
- $50 million for Dam Safety and Flood Management
- $20 million for Multi-Benefit Land Repurposing

The Governor did note that the Administration, legislative leadership, and legislative leaders on these specific issues continue to finalize negotiations to bring a Climate Bond to the voters to ensure continued investment in the state's aggressive climate goals.

<u>Transportation</u>

The May Revise states that it will maintain $12.8 billion in transportation investments to allow the state to include statutory changes to expedite infrastructure projects that advance California's Climate, equity, and economic goals and maximize the state's share of federal infrastructure spending while maintaining appropriate environmental review.

The summary document, however, contains somewhat confusing language mentioning a $2.85 billion General Fund reduction in proposed transportation expenditures, which is partially offset by $650 million of new state transportation funds, for a net reduction of $2.2 billion. This reflects an additional fund shift of $150 million as compared to the Governor's Budget. What is not clear, however, is what exactly this language is referring to. RPPG staff will be following up with Administration officials to clarify.

Specific transportation funding amounts listed in the May Revise include:

- $5.65 billion for high-priority transit and rail infrastructure projects that will improve rail and transit connectivity between state and local/regional services that are designed to reduce traffic congestion and greenhouse gas production.
- $1.4 billion for Active Transportation Program projects, the Highways to Boulevards Pilot Program, and bicycle and pedestrian safety projects.
- $1.2 billion for projects that improve goods movement on rail and roadways at port terminals, including rail yard expansions, new bridges, and zero-emission modernization projects.
- $350 million for grade separation projects that support critical safety improvements and expedite the movement of traffic and rail by separating the vehicle roadway from the rail tracks.

State Highway Operations and Protection Program

Caltrans will continue delivering over $20 billion worth of <u>planned</u> state highway repair and rehabilitation projects over the next five years.

State Transportation and Improvement Program (STIP)

Caltrans and local partners will invest over $3 billion in projects that support the implementation of regional Sustainable Community Strategies.

Transit

Transit agencies struggling to rebound from the impacts of the COVID-19 pandemic requested the Administration and legislature for $5.15 billion in funding to support transit capital and operation. The May Revise does not include funding for transit agencies and immediately after his press conference legislative leaders stated that will be a point of contention. If passed without amendments, Newsom's revised budget would leave transit agencies facing a $6-8 billion deficit over the next 5 years.

Zero Emission Vehicles (ZEV)

The May Revise maintains $8.9 billion in investments to the state's ZEV agenda—ranging from cleaning up short-haul trucks and school buses to accelerating equitable electrification of passenger vehicles—coupled with infrastructure and incentives for in-state manufacturing. This includes targeted investments in disadvantaged and low-income communities by increasing access to the benefits of clean transportation and by continuing to decarbonize California's transportation sector and improving public health. The May Revise shifts $635 million General Fund ($500 million in 2023-24) over three years to the Greenhouse Gas Reduction Fund.

<u>Energy</u>

The Governor's Budget maintained $7 billion of last year's $7.9 billion investment in a clean energy agenda including investments in areas such as building decarbonization, transmission development, and long duration energy storage. The May Revise proposes a one-time investment of $1 billion for programs and projects included in the Clean Energy Reliability Investment Plan pursuant to SB 846 (Dodd) in 2022. This plan provides justification and recommendations for clean energy investments that accelerate the deployment of clean energy resources, support demand response, assist ratepayers, and increase energy reliability. The plan takes into account California's anticipated supply and demand needs for near-term and mid-term reliability, advancement of the state's policies towards 100 percent zero-carbon and renewable energy resources by 2045, and the state's greenhouse gas emissions reduction targets for the electricity sector. The final commission report was recently released and can be found here.
RPPG Note: The May Revise reverts an additional $149.4 million in California Emergency Relief Funds in 2022-23 to the General Fund, based on updated savings figures from the California Arrearage Payment Program due to actual applications received and approved for funding. This program addressed residential utility arrearages accrued during the COVID-19 Pandemic through December 31, 2022.

Economic Development

The May Revise continues to support the proposals in the Governor's January Budget to:

- Extend the existing film and television tax credit by five years at $330 million annually.
- Offer additional incentives for semiconductor manufacturing, including $120 million in targeted California Competes Grants, and removing geographic limitations associated with the existing New Employment Credit.

In addition, the May Revise proposes the following:

- Allocate $23.5 million federal funds, to be spent over 5 years, for the Office of the Small Business Advocate to provide technical assistance to small businesses, including businesses owned by socially and economically disadvantaged individuals, applying for State Small Business Credit Initiative capital programs.
- Make other statutory changes to extend the sunset date on several programs administered by the Office of the Small Business Advocate to allow additional time for grant awards and program closeout activities.
- Allocate $25 million one-time General Fund (for a total of $100 million) to the California Small Agricultural Business Drought Relief Grant Program to provide direct assistance to eligible businesses affected by recent storms.
- Reduce $50 million in funding that was previously allocated to the California Small Business COVID-19 Relief Grant Program, given that there will be an additional amount remaining after all grants have been awarded.
- Restore $30 million for workforce training for women in the construction sector, and another $49.8 million for public heath workforce training, which were proposed to be deferred in the Governor's January Budget.
- Reallocate $250 million to the City of Fresno, out of $300 million originally proposed in the Governor's Budget to be allocated to small counties with high rates of unemployment and poverty. The reallocated funds would be used to support the City of Fresno's Public Infrastructure Plan to invest in the downtown area. This plan includes projects to build parking structures, develop green space, improve walkability, and build water infrastructure.

Local agencies should closely review the Governor's permitting and procurement reform package when it is released for potential applicability to local projects and review the contents of the proposed Climate Bond for potential opportunities.

Public Safety

The May Revise includes $1.3 billion in funding, of which $491.6 million is from the General Fund, to support the Department of Justice (DOJ) to enhance public safety, including $269 million to address the fentanyl crisis. Those DOJ fund adjustments of local agency interest include:

- 10 million one-time funding to provide security assistance to nonprofit organizations at risk of hate-motivated violence, which includes the Asian American Pacific Islander, LGBTQ+, Black, Latinx, and Jewish communities. Security enhancement projects include reinforced doors and gates, high-intensity lighting and alarms, and other security-related improvements.
- $25 million for the Local Law Enforcement Gun Buyback Grant Program at the Board of State and Community Corrections.
- $112.9 million savings for Proposition 47.
- $9.3 million for county probation departments to supervise the temporary increase of individuals on Post Release Community Supervision as a result of Proposition 57 credit earning opportunities.
- $400 million budgetary loan from the Litigation Deposit Fund to the General Fund in 2023-24 to assist in closing the projected statewide budgetary shortfall and to ensure the submission of a balanced budget plan. This proposal also includes statutory changes to authorize this budgetary loan from idle resources not required for currently projected operational or programmatic purposes.
- $1.9 million ($702,000 General Fund and $1.2 million various Special Funds) in 2023-24, increasing to $4 million ($1.5 million General Fund and $2.5 million various Special Funds) in 2026-27 and ongoing to collect, store, and process electronic discovery information related to litigation.
- $6.4 million in the Dealers Record of Sale Account in 2023-24 and $1.5 million ongoing to continue the Project Approval Lifecycle process and address ongoing workload pertaining to the Firearms Information Technology System Modernization Project. The May Revise includes an additional $1.1 million ongoing to update cost estimates to continue the Project Approval Lifecycle process and for additional workload pertaining to the Project.
- $1.7 million in ongoing General Fund to process workload and provide system support and maintenance to implement Chapter 541, Statutes of 2017 (SB 384), which established a tiered system for sexual offenders and specifies registration timelines and criteria for each tier.
- $141.3 million in the Opioid Settlements Fund over four years for the Department of Health Care Services to support the Naloxone Distribution Project, for a total of $220.3 million over four years. Additionally, the May Revision includes $30 million one-time Opioid Settlements Fund in 2023-24 to support the development of a lower cost, generic version of a naloxone nasal spray product through the CalRx Naloxone Access Initiative at the Department of Health Care Access and Information.

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