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MEMORANDUM

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**To:** Mayor Libby Schaaf  
Council President Lynette Gibson McElhaney and Members of the City Council

**From:** Townsend Public Affairs, Inc.

**Date:** May 17, 2016

**Subject:** Ongoing update of the 2016-2017 State & Federal Budgets

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The purpose of this memo from Townsend Public Affairs, Inc. (TPA) is to provide the City of Oakland with updates regarding Governor Brown's Proposed Budget for 2016-17, released on January 7, 2016, and President Obama's Budget, released on February 9, 2016.

**State**

On the morning of Friday the 13th, the Governor presented his highly anticipated revised budget proposal in a press conference. In his opening statement, Governor Brown shared that California has done remarkably well and that the State is moving toward a balanced budget. However, "like anything else," he posits that this momentum cannot last, and the surging tide of revenue is beginning to turn. Rather than spend money on new programs, the Governor asserts that the State must continue to put money away in anticipation of inevitable economic downturns. With the current recovery period lasting two years longer than average for periods of expansion, the Governor referenced the classic fable, "the Ant and the Grasshopper," as a lesson in preparing for the worst during times of prosperity.

The Governor's May Revise also cites lower than expected revenue projections as a key reason for his conservative approach on the budget, as well as the unpredictability of capital gains taxes as a main source of uncertainty with state revenue. According to the Governor, this is due to the globalizing economy and the redistribution of wealth. According to the CA Legislative Analyst Office, the reason for this volatility stems from the ebb and flow of the markets, as the share of California's personal income tax (PIT) paid from the 1 percent of PIT returns with the most income is driven by rises and falls in stock and other asset prices. In order to counteract this, the State has taxed those with the highest incomes at an increased rate. Currently, the top 1% of earners pays half of the State's income taxes. Despite these increased taxes, the nature of income taxes lends itself to increased economic uncertainty.

Additionally, the Governor's budget accounts for the potential of lost revenue in the event that Prop 30 taxes are not extended. This November, the state's voters will be given the choice whether to extend the Proposition 30 income tax rates on high earners for another 12 years. If unsuccessful, by 2019-20, the annual shortfall between spending and revenues is forecast to be over \$4 billion.

In total, the May Revise proposes \$122.2 billion in General Fund expenditures, which is approximately \$450 million less than was proposed in the Governor's January budget. The May Revise also anticipates that the State will collect nearly \$1.9 billion less in revenue than was included in the January Budget proposal, reflecting poor April income tax receipts and more

sluggish sales tax receipts than expected. The majority of the revenue loss is addressed in the May Revise through lowered required budget reserves (reduction of budget reserves by \$1.6 billion).

The May Revise does continue to advocate for several of the initiatives that the Governor put forth in his January Budget. Most notably, the May Revise still advocates for funding from the Governor's comprehensive transportation infrastructure funding plan, as well as a comprehensive spending plan for \$3.1 billion in Cap and Trade funding. Both of these proposals will need review by the Legislature and are likely to be significantly altered before they are sent to the Governor for his consideration. Based on the politics within the Legislature, it is more likely that a comprehensive Cap and Trade funding proposal will be included as part of the budget. However, a transportation funding proposal is unlikely to come together over the next month in time to be included as part of the budget, given that it would require voting on new taxes in an election year. Given the potential for new and/or renewed funding from both a potential transportation plan and cap and trade fund disbursement, we will follow closely for potential fiscal opportunities and impacts for the city of Oakland. While the May Revise does not contain any significant new programs, and has an emphasis on fiscal restraint, the Governor did put forth some new proposals today worth noting.

**Funding for Homelessness Solutions:** The Governor's May Revise endorses the plan put forth by Senate President Pro Tem Kevin DeLeon for a \$2 billion bond (from a portion of future Prop 63 revenue) which would enable HCD to develop and administer homelessness and affordable housing programs through a Mental Health Services Act-Supportive Housing Program and Tenant-Based Rental Assistance Program, with a particular focus on chronic homelessness. The May Revise proposes first year funding from the bond proceeds of \$267 million. Given Oakland's current increase in housing costs and growing homeless population, we will follow this item closely, and assess the fiscal impacts and opportunities afforded by its potential passing.

**Reducing Barriers to Development:** In an effort to reduce the costs of and barriers for housing development by accelerating the time that it takes to build, the Administration is proposing trailer bill language that would require ministerial "by-right" land use entitlement provisions for multifamily infill housing developments that include an affordable housing component. Under the proposal, a local government could not require a conditional use permit, planned unit development permit or other discretionary review or approval for qualifying developments, provided they are consistent with general plan and zoning requirements and are subject to mitigating measures to address environmental harm, where appropriate. Under the proposal, a qualifying project would be one that contains at least a 10% affordability component, if located in a transit priority area, or otherwise must have a 20% affordability component if in an urban area. While the LAO sees this as a solution to expediting the development process at the local level, many believe that such a measure would take power away from local municipalities. As such, this component of the budget can have huge implications for Oakland, especially with respect to how the city conducts its efforts to build and secure housing at affordable and market rate levels. As such, we will follow closely and provide updates on the bill's progress.

**Transportation:** The May Revise reflects the availability of federal funds for trade corridor improvements over the next five years. The federal Fixing America's Surface Transportation Act provides California with \$582 million over the next five years for highway, transit, safety and rail programs, as well as the ability to compete for a portion of the \$900 million available for Nationally Significant Freight and Highway (FASTLANE) Projects. The May Revise contains language that would make state and federal resources available for the 40% match that is required for these federal programs. The California Transportation Commission will allocate half of the funding to corridor-based projects proposed by local agencies and half to projects of statewide significance proposed by Caltrans. As such, this component could drastically influence the ability of local transportation authorities and municipalities to access federal funds. Given Oakland's prominence

along the region's transportation and freight corridors, this can have huge implications for potential transportation projects near and within Oakland city limits. We will follow this closely.

The Legislature will now kick into high gear, with numerous Budget Committee hearings scheduled to discuss the components of the Governor's revised budget. Over the coming weeks, the Senate and Assembly will holding numerous hearings to consider the Governor's proposals, as well as to develop proposals of their own. This process will culminate with a budget conference committee between the Senate and Assembly to hash out the final details of the budget, as well as a number of closed door meetings between the Governor and Legislative Leadership. The Legislature will ultimately approve the budget and a series of trailer bills on June 15<sup>th</sup> in order to meet their constitutional obligation. From now through June 15<sup>th</sup>, we will continue to follow these discussions, as well as revisions to trailer bills, and keep you updated over the coming weeks as the Legislature and Administration finalize the budget.

### **Federal**

A little more than 30 legislative days remain before this year's extended summer recess. The Senate Armed Service Committee passed a \$602 billion defense reauthorization bill that is \$8 billion less than the House's version, setting-up a fight between the chambers on how to fund the controversial Overseas Contingency Operations (OCO) fund, also known as the "war fund." The House recommends less money for the OCO. Both chambers include language that requires women to register for the draft, and establishes a commission to review the future of the draft.

### ***Senate Appropriations***

The Senate passed a \$37.5 billion Energy & Water appropriations bill, and Majority Leader Mitch McConnell (R-KY) has already successfully queued-up a "minibus" spending bill that includes the Military Construction & Veterans Affairs, and Transportation-HUD. The bill is also expected to serve as the funding vehicle to address the Zika crisis. The Senate Appropriations Committee is expected to meet next week to markup the FY 2017 Agriculture appropriations bill, as well as the FY 2017 Legislative Branch appropriations bill.

### ***House Appropriations***

Speaker Ryan is making another effort to pass a budget resolution, having seemingly closed-in on a strategy that may appease hardline conservatives: passing the budget as a joint resolution and thereby, in the event of Senate passage, requiring the President to sign or veto the measure. Under this approach, the House would cut \$170 billion in spending—an estimated \$23 billion of which would come from the Food Stamp program.

The House has passed a package of bills aimed at the nation's growing heroin and prescription drug addiction. The legislation authorizes \$103 million in grants per year, from Fiscal Year 2017-Fiscal Year 2021, to prevent and treat opioid addiction. The authorization falls far short of the Obama Administration's request for \$1.1 billion in new funding to address the opioid crisis, and the legislation would still be required to receive an appropriation from Congress.

### ***Looking Ahead...***

Along with appropriations bills, the Senate may begin negotiations with the House regarding opioid legislation. The House is expected to introduce a standalone Zika bill that would provide funding through Fiscal Year 2017. The House Appropriations Committee will markup the Defense spending bill, the Commerce-Justice-Science and the Transportation appropriations bills. The House will also tackle its \$610 billion Defense Authorization bill—over 350 floor amendments have been filed, so expect to see debate on hot button issues like women registering for the draft, and cutting National Security Council staff. As such, we will follow each house's appropriations process, and how their outcomes can have fiscal impacts on cities like Oakland.