The 2015-16 Budget:

Resources and Environmental Protection

MAC TAYLOR • LEGISLATIVE ANALYST • FEBRUARY 2015

LAO

TABLE OF CONTENTS

The cover photo image was provided courtesy of the California Department of Water Resources.

EXECUTIVE SUMMARY

In this report, we assess many of the Governor's budget proposals in the resources and environmental protection area and recommend various changes. We provide a complete listing of our recommendations at the end of this report.

Budget Provides $9.3 Billion for Programs. The Governor's budget for 2015-16 proposes a total of $9.3 billion in expenditures from the General Fund, various special funds, bond funds, and federal funds for resources and environmental protection programs. This includes $4.4 billion for the Department of Water Resources, $1.8 billion for the Department of Forestry and Fire Protection (CalFire), $1.5 billion for the Department of Resources Recycling and Recovery, as well as funding for many other departments. This proposed level of spending is a decrease of $1.4 billion, or 13 percent, below estimated expenditures in the current year, mostly related to lower bond funds for resources programs.

Water Policies a Major Focus of Governor's Budget. The proposed budget includes three significant sets of water-related proposals. For each of these, we offer the Legislature recommendations designed to better ensure effective implementation of the proposals.

- ***Proposition 1E of 2006—Flood Protection.*** The Governor proposes to appropriate the remaining $1.1 billion in flood protection funds from Proposition 1E. In addition, the Governor is requesting that the funds be appropriated on a ten-year basis and with administrative flexibility to shift funds among state operations, local assistance, and capital outlay purposes. The administration makes this request because the proposition required all funds to be appropriated no later than July 2016. We find, however, that these provisions would significantly hamper the Legislature's traditional role of being able to prioritize projects and conduct oversight. We recommend appropriating Proposition 1E funds for specific projects in 2015-16 and 2016-17, and using pay-as-you-go in following years. This approach would allow some of the remaining Proposition 1E funds to support projects in the near term, reduce long term financing costs, and maintain the Legislature's traditional oversight role through the budget process.

- ***Proposition 1 of 2014—Water Bond.*** Proposition 1 authorizes $7.5 billion for various water-related purposes, such as water storage, watershed protection, and water quality improvements. The Governor's budget proposes $533 million of these funds for various programs in 2015-16. Please see our companion report *The 2015-16 Budget: Effectively Implementing the 2014 Water Bond* for our recommendations designed to ensure that cost-effective projects are funded and that such projects are adequately overseen and evaluated.

- ***Drought Funding.*** The Governor's budget includes $115 million—mostly from the General Fund—for a range of activities designed to reduce the impacts of the current drought. This includes funding for fire protection, emergency water supplies, and protection of vulnerable fish and wildlife. Since water conditions in 2015-16 will not be known until the end of

California's traditional rainy season later this spring, we withhold recommendation on these proposals until more information on water conditions is available.

Cap-and-Trade Auction Revenues Underestimated. The Governor's budget assumes that state revenues generated from auctioning carbon allowances in 2015-16 will total $1 billion. We find that actual revenues most likely will be significantly higher than estimated, perhaps by $1 billion or more. This underestimate has spending implications for two reasons. First, 60 percent of auction revenues are continuously appropriated to specific programs, such as high-speed rail and sustainable communities. So, a share of any higher revenues will automatically be directed to those programs. Second, the Legislature will have options for how to allocate the remaining 40 percent of any additional revenues. This could include expanding existing programs, funding new climate change programs, or reserving the funding for future years. In considering these options, the Legislature will want to take into account various factors and trade-offs, such as costs and the degree to which investments are likely to help the state reach its carbon emission goals.

Opportunities for Legislative Oversight. The Governor's budget raises several issues that we believe merit greater legislative oversight. We recommend the Legislature take steps to ensure that the proposals are likely to be cost-effective and consistent with its priorities.

- ***CalFire Helicopter Procurement.*** The budget includes language to allow CalFire to begin the procurement process to replace its helicopter fleet. Despite potential General Fund costs of a couple hundred million dollars, the department has not provided the Legislature with information regarding equipment, operating, or capital costs; design specifications; or procurement schedule. Consequently, we recommend that the Legislature withhold action on the request and require CalFire to provide this information at budget hearings. If it does not do so, we would recommend rejecting the proposed language.

- ***Air Resources Board (ARB) Southern California Consolidation Project.*** The budget for ARB includes $5.9 million in 2015-16 to develop design criteria for a new consolidated testing and research facility in Southern California. The project is estimated to cost a total of $366 million, but the board has not provided important details regarding (1) how it determined the facility's size, (2) other viable alternatives, and (3) the long term funding plan. Therefore, we recommend the Legislature direct the board to provide this information before making a decision on whether to move forward on the project.

- ***Environmental License Plate Fund (ELPF) Shortfall.*** The Governor proposes several changes—including delaying the implementation of new programs, funding shifts, and increased personalized license plate fees—to address a budget shortfall in the ELPF. We recommend the Legislature require the administration to provide additional information on ELPF-funded activities. Based on that information, the Legislature can make more informed decisions about what spending reductions or fee increases are most consistent with its priorities for the fund.

OVERVIEW OF GOVERNOR'S BUDGET

Governor's Budget Proposal

Total Spending Proposed of $9.3 Billion in 2015-16. The Governor's budget for 2015-16 proposes a total of $9.3 billion in expenditures from various fund sources—the General Fund, various special funds, bond funds, and federal funds—for programs administered by the Natural Resources and Environmental Protection Agencies. This level is a decrease of $1.4 billion, or 13 percent, below estimated expenditures for the current year. Most of the proposed reduction in spending is in the resources area. Specifically, the budget proposes $5.7 billion in 2015-16 for resources programs, a decrease of $1.3 billion (18 percent) from 2014-15. Proposed expenditures for environmental protection departments are $3.7 billion, a decrease of $100 million (3 percent) from 2014-15.

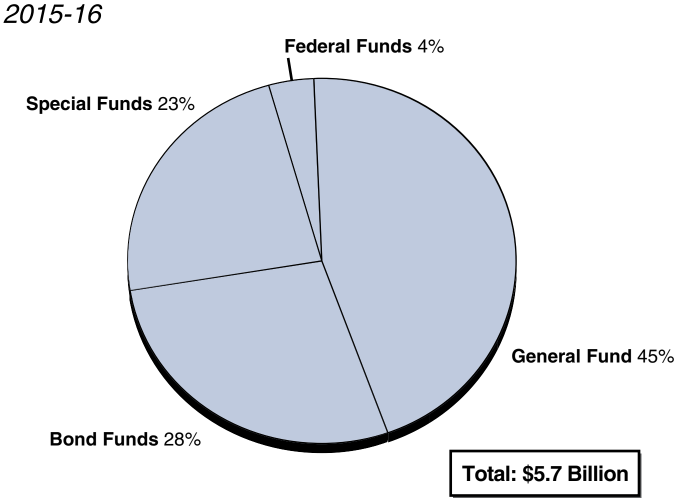
The reduction in proposed spending for resources and environmental protection programs is mostly related to spending from bond funds. Specifically, the budget proposes bond expenditures totaling about $1.9 billion in 2015-16—a decrease of $1.1 billion, or 36 percent, below estimated bond expenditures in the current year. Some of this decrease, however, is related to how bond funds are accounted for in the budget, making year-over-year comparisons difficult. In fact, the proposed budget includes substantial new investment of bond funds, particularly for flood protection and other water-related purposes, as described in more detail below. General Fund spending on resources and environmental protection programs is proposed to be $2.6 billion in 2015-16, a net increase of $50 million, or about 2 percent. This reflects increased expenditures for debt-service on general obligation bonds, partially offset by decreased General Fund spending in various departments.

Programs Rely on Varying Fund Sources. Departments within the Natural Resources and Environmental Protection Agencies vary significantly in which fund sources support their programs. As shown in Figure 1, resources programs are primarily dependent on the General Fund and bond funds (which are ultimately repaid from the General Fund in most of these cases). These two sources make up almost three-quarters of funding for these departments in 2015-16. Environmental protection departments, on the other hand, are primarily dependent on special funds, usually derived from fees. As shown in Figure 2 (see next page), the Governor's budget proposal assumes roughly 80 percent of funding for these departments will come from special funds next year.

Figure 1

Nearly Three-Quarters of Resources Funding From General Fund and Bonds

2015-16



Historical Expenditure Trend Reflects Various Fund Increases. Figure 3 shows total expenditures for resources and environmental protection programs since 2005-06. The proposed funding level in the current and budget years would represent a significant increase over prior years, increasing from $4.9 billion in 2005-06 to $9.3 billion in 2015-16. The total for 2015-16 includes more spending from bond funds by resources departments, a proposed increase of $2 billion compared to 2005-06. (We note, however, that the amount of bonds actually expended in 2015-16 will be less than appropriated because departments generally have multiple years to spend these funds.) This trend of increased bond spending largely reflects the passage by voters of bonds in 2006 (Propositions 1E and 84) and 2014 (Proposition 1), which provided a total of about $17 billion in bond authority for resources-related projects. In addition, General Fund spending in resources agencies is proposed to be $1.1 billion higher in the budget year compared to 2005-06, and spending from special funds by environmental protection departments is $1 billion higher over this period.

Figure 2

Roughly 80 Percent of Environmental Protection Spending From Special Funds

2015-16

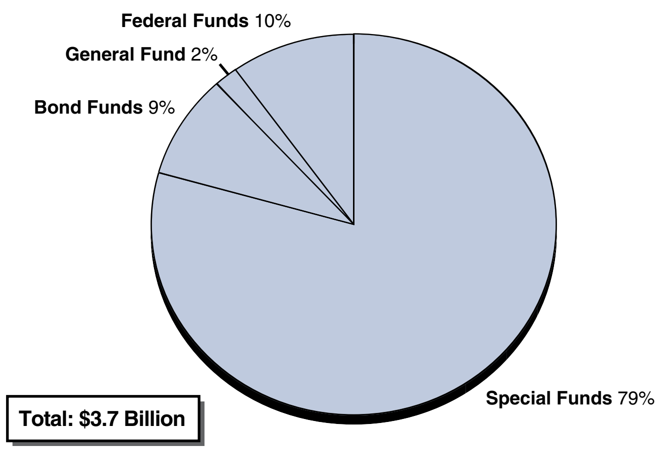
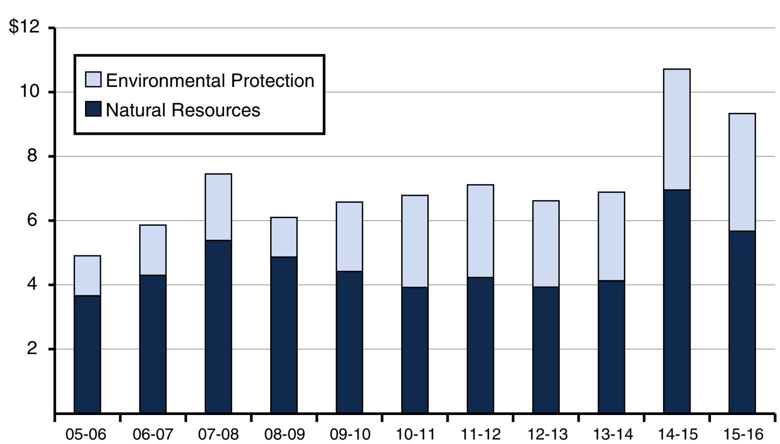


Figure 3

Resources and Environmental Protection Expenditures

(In Billions)



Spending by Major Resources Programs

Figure 4 shows spending by selected fund sources for the state's major resources programs and departments—that is, programs within the jurisdiction of the Natural Resources Agency. As the figure shows, total spending proposed for most resources programs is generally down in 2015-16, resulting from a reduction in bond fund expenditures. For example, the budget proposes a reduction of $738 million, or 36 percent, in bond spending for the Department of Water Resources (DWR).

Despite an overall decline in proposed bond spending for resources programs, the budget includes the appropriation of new bond funds in 2015-16 for both existing and new programs. In particular, the budget proposes to spend $1.3 billion in bond funds in DWR, including $1.1 billion in bond funding for flood protection projects from Proposition 1E (2006) and $87 million from the water bond approved by voters in November 2014 (Proposition 1).

Spending by Major Environmental Protection Programs

Similar to Figure 4, Figure 5 (see next page) shows spending and fund source information for the major environmental protection programs—those within the jurisdiction of the California Environmental Protection Agency. The proposed budget for the State Water Resources Control

Figure 4

Major Resources Budget Summary—Selected Funding Sources

(Dollars in Millions)

Department	Actual 2013-14	Estimated 2014-15	Proposed 2015-16	Change From 2014-15	
				Amount	Percent
Water Resources					
General Fund	$96.7	$124.5	$83.2	-$41.3	-33.2%
State Water Project funds	822.3	1,916.4	1,916.0	-0.4	—
Bond funds	701.5	2,041.3	1,303.6	-737.7	-36.1
Electric Power Fund	881.2	958.0	961.6	3.6	0.4
Other funds	52.3	147.2	138.1	-9.1	-6.2
Totals	**$2,554.0**	**$5,187.4**	**$4,402.5**	**-$784.9**	**-15.1%**
Forestry and Fire Protection					
General Fund	$773.1	$1,077.6	$1,086.6	$9.1	0.8%
Reimbursements	376.6	436.8	447.5	10.7	2.4
Other funds	103.5	256.6	237.0	-19.7	-7.7
Totals	**$1,253.2**	**$1,771.0**	**$1,771.1**	**$0.1**	**—**
Parks and Recreation					
General Fund	$117.6	$121.4	$115.9	-$5.5	-4.5%
Parks and Recreation Fund	136.5	173.2	176.5	3.3	1.9
Off-Highway Vehicle Trust Fund	82.8	160.1	92.5	-67.6	-42.2
Bond funds	114.2	108.4	22.5	-85.9	-79.2
Other funds	144.4	217.1	178.2	-38.9	-17.9
Totals	**$595.5**	**$780.2**	**$585.6**	**-$194.6**	**-24.9%**
Fish and Wildlife					
General Fund	$65.8	$97.2	$80.9	-$16.3	-16.8%
Fish and Game Fund	102.8	123.2	133.3	10.1	8.2
Bond funds	21.8	76.4	53.7	-22.7	-29.7
Other funds	167.3	253.8	250.0	-3.8	-1.5
Totals	**$357.7**	**$550.6**	**$517.9**	**-$32.7**	**-5.9%**
Energy Commission					
Electric Program Investment Charge	$5.3	$373.9	$128.5	-$245.4	-65.6%
ARFVTF	101.2	172.9	109.1	-63.8	-36.9
Other funds	135.6	239.3	185.6	-53.7	-22.4
Totals	**$242.1**	**$786.1**	**$423.2**	**-$362.9**	**-46.2%**

ARFVTF = Alternative and Renewable Fuel and Vehicle Technology Fund.

Board (SWRCB) includes a $164 million increase in Underground Storage Tank Cleanup Funds, which primarily reflects implementation of recent policy changes adopted by the Legislature to (1) increase fees on petroleum stored in underground tanks and (2) use the resulting revenues for new and existing programs related to cleaning up contamination from underground storage tanks. The largest decrease in funding for environmental protection departments is in proposed bond spending by the Air Resources Board (ARB), which reflects the funding of projects from Proposition 1B bond funds in 2014-15 designed to reduce emissions associated with transporting goods on trucks, trains, and cargo ships.

Figure 5

Major Environmental Protection Budget Summary—Selected Funding Sources

(Dollars in Millions)

Department	Actual 2013-14	Estimated 2014-15	Proposed 2015-16	Change From 2014-15	
				Amount	Percent
Resources Recycling and Recovery					
Beverage container recycling funds	$1,181.9	$1,189.3	$1,181.9	-$7.4	-0.6%
Electronic Waste Recovery	76.3	95.9	101.5	5.6	5.8
Other funds	174.2	254.9	248.3	-6.6	-2.6
Totals	**$1,432.4**	**$1,540.1**	**$1,531.7**	**-$8.4**	**-0.5%**
State Water Resources Control Board					
General Fund	$13.5	$42.3	$32.7	-$9.6	-22.7%
Underground Tank Cleanup	228.9	234.5	398.4	163.9	69.9
Bond funds	51.3	275.9	320.8	44.9	16.3
Waste Discharge Fund	109.0	122.0	120.2	-1.8	-1.5
Other funds	17.6	462.4	486.7	24.3	5.3
Totals	**$420.3**	**$1,137.1**	**$1,358.8**	**$221.7**	**19.5%**
Air Resources Board					
Greenhouse Gas Reduction Fund	$30.9	$209.2	$211.9	$2.7	1.3%
Motor Vehicle Account	121.1	131.6	134.1	2.5	1.9
Air Pollution Control Fund	118.4	116.4	117.5	1.1	0.9
Bond funds	104.2	245.0	0.1	-244.9	-100.0
Other funds	113.8	146.2	118.5	-27.7	-18.9
Totals	**$488.4**	**$848.4**	**$582.1**	**-$266.3**	**-31.4%**
Toxic Substances Control					
General Fund	$21.1	$27.3	$27.1	-$0.2	-0.7%
Hazardous Waste Control	52.1	58.9	60.0	1.1	1.9
Toxic Substances Control	43.8	45.9	48.9	3.0	6.5
Other funds	64.0	101.0	72.1	-28.9	-28.6
Totals	**$181.0**	**$233.1**	**$208.1**	**-$25.0**	**-10.7%**
Pesticide Regulation					
Pesticide Regulation Fund	$80.0	$84.7	$87.8	$3.1	3.7%
Other funds	3.1	3.0	3.1	0.1	3.3
Totals	**$83.1**	**$87.7**	**$90.9**	**$3.2**	**3.6%**

CROSSCUTTING ISSUES

Cap-and-Trade

Background

Assembly Bill 32. The Global Warming Solutions Act of 2006 (Chapter 488, Statutes of 2006 [AB 32, Núñez/Pavley]), commonly referred to as AB 32, established the goal of reducing greenhouse gas (GHG) emissions statewide to 1990 levels by 2020. Among other provisions, the legislation directed the ARB to develop a plan to achieve the maximum technologically feasible and cost-effective GHG emission reductions by 2020. This plan is commonly referred to as the AB 32 Scoping Plan. The Scoping Plan includes a wide variety of regulations and programs intended to reduce GHG emissions, including a cap-and-trade program.

Cap-and-Trade. The ARB adopted a cap-and-trade program that places a "cap" on aggregate GHG emissions from large GHG emitters (such as large industrial facilities, electricity suppliers, and transportation fuel suppliers), which are responsible for roughly 85 percent of the state's GHG emissions. (Uncapped sources include agriculture, forestry, and relatively small GHG emitters.) The cap declines over time, ultimately arriving at the target emission level in 2020. To implement the cap-and-trade program, ARB allocates a number of carbon allowances equal to the cap, and each allowance is essentially a permit to emit one ton of carbon dioxide (or the equivalent amount for other GHGs). The ARB provides some allowances for free, making others available for purchase at quarterly auctions. Large emitters must then obtain allowances equal to their total emissions in a given period of time. They can purchase the allowances at the auctions. Entities can also "trade" (buy and sell on the open market) the allowances in order to obtain enough to cover their total emissions for a given period of time.

The supply and demand of allowances in a trading market generally determine the price of an allowance. Parties that can reduce their emissions—for instance, by modifying their production processes—are likely to do so as long as it is cheaper than buying allowances at current prices. In theory, the level of overall emissions reductions is achieved at the lowest cost possible. This is because the allowance price provides an economic incentive to all regulated emitters to find the mix of emissions reductions and allowance purchases that minimize their costs.

Results From Past Auctions. The ARB has conducted nine cap-and-trade auctions between November 2012 and November 2014—generating a total of $970 million in state revenue. Beginning January 1, 2015, transportation fuel suppliers are required to obtain allowances for the GHG emissions associated with the combustion of the fuels they provide. In connection with this change, the number of state-auctioned allowances will increase significantly and, as a result, future auctions are expected to raise greater amounts of state revenue than in the past.

Prior Legislative Direction for Use of Revenue. Three statutes enacted in 2012 provide some requirements and direction on the use of cap-and-trade auction revenue.

- ***Chapter 39, Statutes of 2012 (SB 1018, Committee on Budget and Fiscal Review).*** Chapter 39 created the Greenhouse Gas Reduction Fund (GGRF), into which all auction revenue is to be deposited. The legislation requires that before departments can spend monies from the GGRF, they must prepare a record specifying: (1) how the expenditures will be used, (2) how the expenditures will further the purposes of AB 32, (3) how the expenditures will achieve GHG emission reductions, (4) how the department considered other non-GHG-related objectives, and (5) how the department will document the results of the expenditures.

- ***Chapter 807, Statutes of 2012 (AB 1532, Perez).*** Chapter 807 directed the Department of Finance (DOF) to develop and periodically update a three-year investment plan that identifies feasible and cost-effective GHG emission reduction investments. Chapter 807 requires that cap-and-trade auction revenues be used to reduce GHG emissions and, to the extent feasible, achieve co-benefits such as job creation, air quality improvements, and public health benefits. It also requires the DOF to submit an annual report to the Legislature by March 1 on the status and outcomes of GGRF-funded projects.

- ***Chapter 830, Statutes of 2012 (SB 535, de León).*** Chapter 830 requires that 25 percent of auction revenue be used to benefit disadvantaged communities. Chapter 830 also requires that 10 percent of auction revenue be invested in disadvantaged communities.

Expenditure Plan Adopted in 2014-15. The 2014-15 budget includes $832 million from the GGRF for various transportation, energy, and resources programs designed to reduce GHG emissions. At the time of this analysis, agencies are at varying stages of developing program guidelines, selecting projects, and expending funds. (For more detail on the types of programs that were funded in the 2014-15 budget, please see our report *The 2014-15 Budget: California Spending Plan*.)

Chapter 3, Statutes of 2014 (SB 862, Committee on Budget and Fiscal Review), also specifies how the state will allocate most cap-and-trade auction revenues in 2015-16 and beyond. For all future revenues, the legislation continuously appropriates (1) 25 percent for the state's high-speed rail project, (2) 20 percent for affordable housing and sustainable communities grants (with at least half of this amount for affordable housing), (3) 10 percent for intercity rail capital projects, and (4) 5 percent for low carbon transit operations. The remaining 40 percent would be available for annual appropriation by the Legislature. Chapter 3 also requires that an outstanding loan of $400 million from the GGRF to the General Fund be repaid to the high-speed rail project when needed by the project.

Legal Restrictions on the Use of Auction Revenues. There are several ongoing legal challenges to the different components of the cap-and-trade program. For example, in 2012, the California Chamber of Commerce filed a lawsuit against the ARB claiming that cap-and-trade auction revenues constitute illegal tax revenue. In November 2013, the superior court ruled that the "charges" from the auction have characteristics of a tax as well as a fee, but that, on balance, the charges constitute legal regulatory fees. This ruling has been appealed to the appellate court. It is also possible that even if ultimately determined to be a fee, the courts would put limits on how the revenues can be used, just as all other state fees have spending constraints. For example, the state may be required to use the revenues from the cap-and-trade auctions to mitigate GHG emissions. Final decisions from the appellate courts on these issues may take years.

Governor's Proposal

Continue Expenditure Plan Adopted as Part of 2014-15 Budget. The Governor's budget assumes the receipt of $650 million in state revenue from cap-and-trade auctions in 2014-15 and $1 billion in 2015-16. As shown in Figure 6, the Governor proposes 2015-16 expenditures that are consistent with the framework adopted as part of the 2014-15 budget. For example, the Governor's budget assumes that 60 percent of cap-and-trade revenues collected in 2015-16 would be continuously appropriated as follows: (1) $250 million for the state's high-speed rail project, (2) $200 million for the Affordable Housing and Sustainable Communities Program, (3) $100 million for the Transit and Intercity Rail Capital Program, and (4) $50 million for the Low Carbon Transit Operations Program. The remaining $400 million (40 percent)—which is not continuously appropriated—would be allocated to various programs in a manner that is identical to what was provided in the 2014-15 budget.

Additional Revenue Likely Available

Future Revenue Is Subject to Substantial Uncertainty. The amount of future auction revenue will depend on two basic factors: the number of state allowances purchased and the selling price of the allowances. Both of these factors are uncertain because they can be affected by many factors that are difficult to predict, including overall economic activity, covered entities' costs of emission reduction alternatives, market expectations about future allowance prices, industry expectations about future statutory or regulatory changes, and the degree to which other AB 32 policies reduce emissions.

Revenue Will Likely Be Significantly Higher Than the Budget Assumes. To illustrate the range of potential revenues in 2014-15 and 2015-16, Figure 7 provides revenue estimates under three different scenarios, as well as the level of revenue assumed in the Governor's budget. Each of our scenarios uses a different set of assumptions about the proportion of state allowances sold and the average price of allowances sold.

Figure 6

Governor's Proposed Cap-and-Trade Expenditures

(In Millions)

Program	2014-15	2015-16
High-speed rail	$250	$250[a]
Low carbon transportation	200	200
Affordable housing and sustainable communities	130	200[a]
Transit and intercity rail capital program	25	100[a]
Low-income weatherization and solar	75	75
Low carbon transit operations	25	50[a]
Sustainable forests and urban forestry	42	42
Wetlands and watershed restoration	25	25
Waste diversion	25	25
Energy efficiency for public buildings	20	20
Agricultural energy and operational efficiency	15	15
Totals	**$832**	**$1,002**

[a] Continously appropriated percentage of 2015-16 revenue.

Figure 7

Range of Estimated Annual Cap-and-Trade Revenue

(In Billions)

		LAO Scenarios		
	Governor's Budget	Low Revenue	Moderate Revenue	High Revenue
2014-15	$0.7	$1.3	$1.5	$2.8
2015-16	1.0	2.0	2.3	4.9
Totals	**$1.7**	**$3.3**	**$3.7**	**$7.7**

Based on our analysis of different factors (such as prior auctions and studies that projected future allowance prices), we consider the moderate-revenue scenario the most likely of the three scenarios presented. This scenario results in revenues totaling $3.7 billion in the current and budget years—assuming that nearly all allowances offered at state auctions are sold at the minimum price established by the state (between $12 and $13 in 2014-15 and 2015-16). The low-revenue scenario assumes a smaller portion—but still a majority—of allowances are purchased at the minimum price. The high-revenue scenario assumes all allowances are purchased at an average price of $25—roughly double the minimum price. The low- and high-revenue scenarios are plausible, but less likely. Under all three scenarios, state auction revenue will likely be significantly higher than what is assumed in the budget. There is also a chance that allowance prices could approach or exceed $50, in which case revenue would be significantly higher than the high-revenue scenario.

Certain Programs Would Automatically Receive Additional Funding. To the extent revenues exceed the amount assumed in the budget, those programs that are continuously appropriated specified percentages of auction revenue would receive more funding in 2015-16 than is identified in the Governor's budget. For example, under the moderate revenue scenario, the 60 percent of continuous appropriations in 2015-16 would be allocated as follows:

- $570 million for high-speed rail,
- $456 million for affordable housing and sustainable communities,
- $228 million for transit and intercity rail capital program,
- $114 million for low carbon transit operations.

Significant Additional Revenue Would Remain Unallocated. Under the Governor's proposal, any unanticipated revenue in 2014-15 above the $650 million assumed in the budget, as well as 40 percent of revenue above $1 billion collected in 2015-16, would remain unallocated. For example, an additional $800 million in 2014-15 revenue and $500 million in 2015-16 revenue would remain unallocated under the moderate revenue scenario discussed above.

Options for the Use Of Additional Revenue

The Legislature could use additional auction revenue—relative to what is assumed in the Governor's budget—in many different ways. Below, we discuss the following options: (1) waiting to spend funds until future years, (2) allocating funds to existing GGRF programs in 2015-16, and (3) allocating funds to other programs in 2015-16. We also discuss some potential advantages and disadvantages of each approach. The Legislature could adopt a combination of approaches based on its priorities.

Allocate Funds in Future Years. The Legislature could choose not to spend additional revenues in 2015-16, thereby making them available for spending in future years. By waiting until future years, the Legislature may have better information about the benefits of the various spending commitments made in 2014-15 that could help inform future spending decisions. For example, as mentioned above, the administration is required to provide the Legislature with annual reports on the status and outcomes of GGRF spending. This information could help the Legislature determine which programs are providing the greatest value. However, we caution the Legislature that it may be years before the current GGRF-funded projects are implemented and there is reliable information that can be used to adequately evaluate their effectiveness. In addition, if the Legislature elected to allocate the funds in future years, it would likely delay the benefits that could be achieved with these funds—such as GHG reductions, air quality improvements, and public health benefits.

Allocate Funds to Existing GGRF Programs in 2015-16. The Legislature could allocate additional funding in 2015-16 to programs that are currently receiving GGRF appropriations. One advantage to providing more funds to existing programs—instead of establishing new programs—is that agencies already have experience developing and administering these programs and, thus, there may be relatively little additional work needed to administer increased funding. Furthermore, the Legislature has already identified these programs as areas of priority. One potential concern with this approach, however, is that there may be diminishing returns to providing additional funding to these programs. For example, if agencies are currently allocating funds to projects with the greatest benefits per dollar spent, additional funding provided to these programs would likely be used to fund projects that provide fewer benefits per dollar spent. These additional projects may still be worth funding, but the Legislature should consider the *marginal* benefits of providing additional funds to these programs compared to other options.

Allocate Funds to Other Programs in 2015-16. The Legislature could fund additional programs that did not receive GGRF funds in 2014-15 and are not proposed to receive funding in 2015-16. We identified a few additional options in our report *The 2014-15 Budget: Cap-and-Trade Auction Revenue Expenditure Plan*. For example, the Legislature could use GGRF funds to support the development of energy storage technology. The Legislature has expressed its interest in this area and the integration of energy storage into the electricity grid. For example, the Legislature recently directed the California Public Utilities Commision (CPUC) to explore options for expanding the use of energy storage by the state's investor-owned utilities. Energy storage has the potential to support state efforts to increase the proportion of energy coming from renewable sources, such as solar.

Issues to Consider When Evaluating Spending Options

The Legislature should attempt to identify a cap-and-trade spending strategy that maximizes net benefits within the existing legal restrictions. The Legislature has identified a wide variety of goals it would like to achieve with the use of cap-and-trade auction revenues, including reducing GHG emissions, improving air quality and public health, and addressing inequities in disadvantaged communities. To the extent possible, the Legislature will want to have a clear understanding of how different spending options help achieve these benefits. When evaluating different spending options, we encourage the Legislature to evaluate the expected benefits relative to the benefits that would have otherwise occurred. Such a comparison is particularly important when evaluating spending options that affect GHG emissions from the capped economy. We discuss this issue in more detail below, as well as some potential strategies that may help target spending in ways that maximize *net* benefits—above and beyond what would have otherwise occurred.

Spending on Activities That Reduce GHG Emissions From the Capped Economy. As discussed above, the cap-and-trade program is designed to ensure California meets its 2020 GHG emission reduction targets at the least possible cost. When evaluating the benefits of spending on activities that affect GHG emissions from the capped economy—such as activities that reduce gasoline consumption, electricity consumption, or emissions from large industrial sources—the Legislature may want to consider the potential for the following effects:

- ***Might Not Affect Overall Emissions.*** The *cap* of the cap-and-trade program ensures total GHG emissions from the capped economy do not exceed a certain level. If the cap is limiting total GHGs, GHG reductions from one covered entity simply allows other covered entities to emit more GHGs. Therefore, spending cap-and-trade revenues on activities that reduce GHG emissions from the capped economy might not reduce overall GHG emissions. It may simply change the mix of emission reduction activities.

- ***Likely Leads to More Costly Emission Reduction Activities.*** In theory, by establishing a price on GHG emissions, the cap-and-trade program creates an economic incentive for producers and consumers to find the mix of least costly emission reductions. Spending cap-and-trade revenues on activities that reduce emissions from the capped economy likely leads to more costly emission reductions overall than simply relying on cap-and-trade. This is because it is unlikely that state expenditures would be directed at the least costly GHG emission reduction strategies. To the extent state expenditures are directed at emission reductions that are more costly than what would be achieved by the cap-and-trade program alone, the resulting mix of emission reductions would be more costly overall.

- ***Reduces Private Costs of Emission Reduction Activities.*** While spending on activities that reduce emissions in the capped sector might increase the overall cost of compliance—including public and private funds—it would reduce the *private* costs of compliance by subsidizing certain emission reduction activities. These reduced costs could be realized by either producers or consumers.

- ***Could Help Achieve Other Legislative Goals.*** Spending money on emission reduction activities in the capped economy could help achieve other legislative goals, such as improving air quality, improving public health, and addressing inequities in disadvantaged communities. However, similar to GHG reductions discussed above, the Legislature should evaluate how different spending options help address these benefits relative to what would have otherwise occurred. For example, spending on activities that reduce transportation emissions—both GHGs and local air pollutants—will help improve local air pollution where transportation emissions are reduced. However, those emission reductions might be at least partially offset by an increase in emissions somewhere else.

Targeting Spending to Achieve the Greatest Net Benefits. The Legislature will want to consider how to best target its spending in a way that achieves maximum *net* benefits, after considering some of the potential limitations associated with spending funds in the capped economy discussed above. Some of the strategies to target spending options with the greatest net benefits include:

- ***Spending in the Uncapped Economy.*** One strategy is to spend funds on activities that reduce emissions from the uncapped economy. In contrast to the capped economy, spending revenues on activities that reduce GHGs in the uncapped economy would not be offset by an increase in GHG emissions from other sources, thereby resulting in an overall reduction in emissions.

- ***Identifying Other Market Failures.*** Another strategy may be to fund GHG reduction activities that the private market fails to adequately provide, even under the incentives established by the cap-and-trade program. An example of this is energy efficiency. Some evidence suggests that the owners of existing apartment buildings might not invest in the optimal amount of energy efficiency. Since renters typically pay the energy bills, apartment building owners do not have much of a financial incentive to make energy efficiency investments that reduce utility bills. In theory, spending on energy efficiency could potentially provide low-cost GHG reductions that the private sector otherwise would not provide. However, the benefits and costs of such projects should be carefully evaluated to determine whether they provide clear net benefits.

- ***Prioritizing Other Legislative Goals.*** If spending on activities that reduce emissions from the capped economy have little or no impact on net GHGs, the Legislature may want to consider giving greater weight to some of its other goals—such as addressing concerns about disadvantaged communities or improving air pollution. However, given the legal restrictions discussed above, it should be aware of the potential legal risk associated with giving greater weight to non-GHG related criteria. We continue to recommend the Legislature consult with Legislative Counsel about the legality of different spending options.

- ***Offset Other Types of State Spending.*** The Legislature could use GGRF funds to offset spending from other sources of state funds, including special funds and General Fund. Using revenues to offset other state spending could free up state funds to be used for other legislative priorities. To the extent these other priorities provide significant benefits, this option would be worthy of consideration. For example, the Legislature could consider using the additional revenue to offset special fund spending—thereby freeing up such funds for alternate uses or allowing the Legislature to reduce the fees that are collected to support these programs. Similarly, using GGRF funds to offset General Fund expenditures would make additional General Fund dollars available for other legislative priorities. The current amount of potential General Fund offsets is unclear. However, in 2012, our office found only a handful of programs—totaling around $100 million—that could potentially meet the potential legal restrictions discussed above. (For more detail, please see our 2012 report *The 2012-13 Budget: Cap-and-Trade Auction Revenues.*)

2014 Water Bond

On November 4, 2014, voters approved Proposition 1, a $7.5 billion water bond measure primarily aimed at increasing the supply of clean, safe, and reliable water and restoring habitat. The Governor's budget proposes to appropriate $533 million from Proposition 1 in 2015-16 as shown in Figure 8 (see next page). In a recent report, we identify key principles for implementing Proposition 1 and use these principles as the basis for a series of recommendations aimed at assisting the Legislature to ensure that the bond is implemented effectively—meaning that funding is directed towards cost-effective projects and that such projects are adequately overseen and evaluated. (For more information on Proposition 1 and our recommendations, please see our report *The 2015-16 Budget: Effectively Implementing The 2014 Water Bond.)*

Drought Response

Background

Extended Drought Affecting California. California entered an extended drought beginning in 2011, including the third driest year on record in 2014. Water conditions for 2015 are currently unknown since the state typically receives nearly all of its precipitation between December and April each year. However, as of January 29, 2015, the snowpack in the Sierra Nevada Mountains—which is the source of most of the state's water in summer months—is currently at about one-fourth of average for the date.

Recent Expenditures on Drought. In response to the drought, the Legislature appropriated and the Governor approved a total of $839 million (mostly bond funds) for various drought-related activities in 2013-14 and 2014-15. Among other things, this amount included (1) $473 million to DWR for local water supply projects, (2) $66 million to the California Department of Forestry and Fire Protection (CalFire) for wildland fire suppression, (3) $41 million for the Department of Fish and Wildlife (DFW) to protect and monitor vulnerable fish and wildlife, and (4) $30 million for food assistance to drought-affected communities.

As of January 20, 2015, the administration had expended $234 million (27 percent) of the above $839 million. We note that the $473 million for local water supply projects is expected to be spent over multiple years as those projects are constructed.

Figure 8

Governor's 2015-16 Proposals for Proposition 1 Bond Funds

(In Millions)

Purpose	Proposed for 2015-16
Water Storage	**$3**
Water storage projects	$3
Watershed Protection and Restoration	**$178**
Conservancy restoration projects	$84
Enhanced stream flows	39
Watershed restoration benefiting state and Delta	37
Los Angeles River restoration	19
Urban watersheds	<1
Various state obligations and agreements	—
Groundwater Sustainability	**$22**
Groundwater sustainability plans and projects	$22
Groundwater cleanup projects	1
Regional Water Management	**$57**
Integrated Regional Water Management	$33
Water use efficiency	23
Stormwater management	1
Water Recycling and Desalination	**$137**
Water recycling and desalination	$137
Drinking Water Quality	**$136**
Drinking water for disadvantaged communities	$69
Wastewater treatment in small communities	66
Flood Protection	**—**
Delta flood protection	—
Statewide flood protection	—
Administration and Oversight[a]	**$1**
Administration	$1
Total	**$533**

[a] Bond does not provide specific allocation for bond administration and oversight. It allows the use of other allocations for this purpose.

Of this amount, DWR has awarded the first round of $221 million and plans to award the remaining funding in 2015-16.

Governor's Proposal

The Governor's budget proposes additional drought-related expenditures in 2015-16. In total, the Governor requests $115 million ($93.5 million General Fund) in one-time funds across five departments. These requests—along with the prior-year appropriations—are shown in Figure 9. Specifically, the Governor's budget provides drought-related funding in 2015-16 to the following departments:

- ***CalFire—$61.8 million.*** The budget includes $61.8 million for CalFire to continue expanded fire prevention and suppression activities, including employing seasonal firefighters longer during the fire season, increased vehicle repairs resulting from higher use, and contracts for additional firefighting aircraft. The request includes 373 temporary positions, mostly seasonal firefighters.
- ***SWRCB—$22.6 million.*** The SWRCB requests (1) $15.9 million for emergency drinking water supplies and (2) $6.7 million for emergency water rights activities (such as processing urgent changes to regulations and increasing enforcement efforts). The proposal includes 42.5 limited-term positions.

Figure 9

Drought Related Appropriations

(In Millions)

Purpose	Department	2013-14 Actual	2014-15 Actual	2015-16 Proposed
Increased fire suppression and prevention	Forestry and Fire Protection	—	$66.0	$61.8
Emergency drinking water supplies	Public Health/SWRCB	$15.0	—	15.9
Actions to protect fish and wildlife	Fish and Wildlife	2.3	38.8	14.6
Emergency water supply activities and education	Water Resources	1.0	18.1	11.6
Emergency regulations and enforcement	SWRCB	2.5	4.3	6.7
Drought response coordination and guidance	Office of Emergency Services	1.8	4.4	4.4
Food assistance	Social Services	25.3	5.0	—[a]
Grants for local water supply projects	Water Resources	472.5	—	—
Flood control projects	Water Resources	77.0	—	—
Housing assistance	HCD	21.0	—	—
Grants for projects that save water and energy	Water Resources	20.0	—	—
Groundwater cleanup and sustainable management	Water Resources/SWRCB	14.0	9.1	—
Drought response and water efficiency	California Conservation Corps	13.0	—	—
Grants for irrigation improvements to save water and energy	Food and Agriculture	10.0	—	—
SWP water-energy efficiency	Water Resources	10.0	—	—
Training for workers affected by drought	Employment Development	2.0	—	—
Water conservation in state facilities	General Services	—	5.4	—
Totals		**$687.4**	**$151.1**	**$115.0**

[a] Does not include a carryover of $7 million General Fund from prior years to 2015-16.

SWRCB = State Water Resources Control Board; HCD = Housing and Community Development; and SWP = State Water Project.

- ***DFW—$14.6 million.*** The budget proposes a total of $14.6 million to DFW for various activities. This amount includes (1) $3.3 million for emergency measures to protect fish and wildlife (such as rescuing and holding fish), (2) $3.2 million for enhanced monitoring of fish species in the Sacramento-San Joaquin Delta (Delta) and in other parts of the state, (3) $3.2 million for maintenance and upgrades of hatcheries to protect commercial salmon fisheries, and (4) $2 million to address effects on wildflife (such as mountain lions). The request includes 13 limited-term positions.

- ***DWR—$11.6 million.*** The DWR requests a total of $11.6 million for various activities. This amount includes (1) $3.8 million to coordinate the water supply and fish protection actions of multiple state agencies through DWR's Drought Management Operations Center, (2) $2.5 million to review local agencies' drought planning efforts and provide assistance where needed, and (3) $1.7 million to expedite water transfers.

- ***Office of Emergency Services (OES)—$4.4 million.*** The Governor's budget proposes $4.4 million for OES to continue coordinating state and local activities associated with the drought.

These activities are largely a continuation of activities funded in the current year, but at different funding levels. The largest proposed decrease in funding from 2014-15 to 2015-16 is a reduction of $24.2 million for DFW, primarily because much of the 2014-15 expenditures are associated with one-time equipment purchases. The largest increase in a proposed funding level is for SWRCB, mainly due to the $15 million in new funding for emergency drinking water supplies. The administration indicates that the proposed level of funding in 2015-16 is intended to address the needs that would arise if the state receives average precipitation, a level which would likely not significantly increase or decrease the intensity of the drought.

LAO Findings

Proposals Generally Reasonable Response to Problems Caused by Drought. Our review of the Governor's proposals finds that they generally address significant problems that have arisen during the drought. In addition, the administration appears to have learned some lessons from its previous drought-related activities that it has incorporated in its new proposals. For example, DFW recently identified impacts to protected wildlife species—such as mountain lions—in 2014-15 and requested $2 million to address those impacts in 2015-16.

Funding Required Will Depend on Future Hydrologic Conditions. The level of funding needed to respond to the drought will depend on future hydrologic conditions. As noted above, water conditions for 2015 will be determined by the amount of precipitation that falls in the next few months. Thus, the level of resources required is uncertain at this time. The administration indicates that it intends to reevaluate these budget needs with the May Revision, when more information on water conditions will be available.

Agencies Do Not Adequately Plan for Periodic Droughts. Droughts recur periodically in California and can be expected to recur in the future. Figure 10 shows this variation in water conditions. As shown in the figure, the state experienced drought years in 24 out of the past 50 years. The severity of drought years is affected by not only the precipitation that year, but also the dryness of previous years. (Statewide water conditions index values below -1 indicate drought years.) Given periodic droughts, it is important for state and local governments to have infrastructure and planning processes in place to manage these conditions, as they do for disasters. However, many state agencies and some local agencies do not have ongoing programs and procedures in place to deal with droughts, and as a result, their drought response activities funded in recent years have been implemented as emergency measures.

Responding to the drought on an emergency basis creates several issues, including:

- ***Use of General Fund Instead of More Appropriate Sources.*** An inability to fund activities from other sources that might be more appropriate. This is because some drought activities provide benefits to private parties but are being supported by the General Fund. For example, DFW was unable to secure funding from other sources in the short time available for the monitoring of endangered species in the Delta in 2014-15. Thus, it requested General Fund for this purpose as part of the Governor's May Revision to the 2014-15 budget, which was approved by the Legislature.

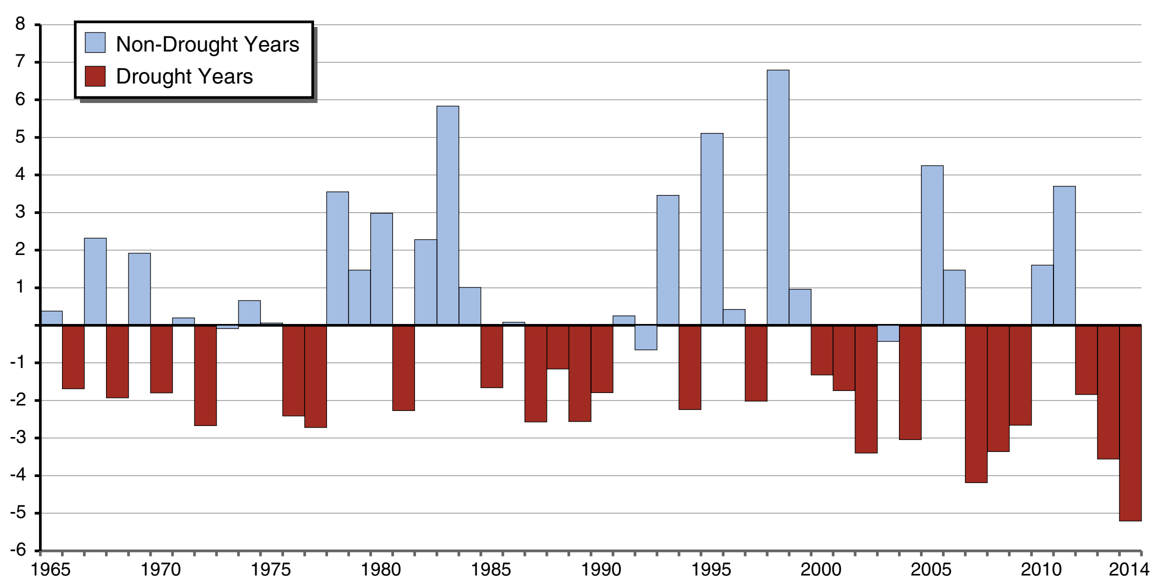
- ***Potentially Higher Costs for Routine Activities.*** Some activities may become more expensive during droughts. For example, drilling new wells in response to water supply shortages can be more expensive during droughts than at other times because of increased demand for well-drilling services.

- ***Delayed Progress on Other Activities.*** Several state agencies did not have time to hire new staff to respond to the drought and therefore redirected existing positions to meet drought needs. For example, DWR redirected 72 positions from various programs to carry out 2014-15

Figure 10

Droughts Recur Periodically in California

Statewide Index of Water Conditions



drought activities. According to DWR, this delayed various activities, including the development of the 2013 update to the California Water Plan.

Limited Ability to Learn From Past Drought Responses. State law requires OES—in cooperation with other relevant agencies—to develop an "after action report" following a declared disaster, such as droughts. This report describes potential improvements to the state's response to the emergency and a description of the actions planned to implement those improvements. However, the comprehensiveness of these reports can vary, and it is unclear whether past after action reports have been helpful in responding to the current drought.

LAO Recommendations

Withhold Recommendation on Drought Proposals. We withhold recommendation on the administration's drought proposals until the administration reevaluates drought response needs at the May Revision. This will allow the Legislature to evaluate the proposals when more complete information about water conditions is available.

Administration Should Identify Changes Needed to Improve Resilience. We also recommend the Legislature pass budget trailer legislation requiring that the after action report produced at the conclusion of this drought identify programmatic changes to California's water system that would improve the state's resilience to dry conditions. The report should also identify funding sources to support the recommended activities, including consideration of federal funds, State Water Project (SWP) funds, and water rights funds. The report should be provided to the Legislature to inform future drought-management policies.

Some examples of potential changes the administration and Legislature could consider include ongoing monitoring and enforcement of the water rights system, planning drought operations for SWP and the federal Central Valley Project in advance of dry conditions, and comprehensively reviewing the content of local agency drought plans to assess whether they provide a feasible response. In addition, we note that the administration's 2014 Water Action Plan includes a recommendation to streamline water transfers, in part to address droughts by making it easier for people to buy and sell water. To implement this, the Governor's 2015-16 budget includes a separate proposal of $1.4 million from the General Fund for DWR to continue its efforts to streamline water transfers through a "water transfer clearinghouse."

DEPARTMENT OF WATER RESOURCES

The DWR protects and manages California's water resources. In this capacity, DWR plans for future water development and offers financial and technical assistance to local water agencies for water projects. In addition, the department maintains the SWP, which is the nation's largest state-built water conveyance system. Finally, DWR performs public safety functions such as constructing, inspecting, and maintaining levees and dams.

The Governor's 2015-16 budget proposes a total of $4.4 billion from various funds (mainly special funds) for support of the department. This is a net decrease of $785 million, or 15 percent, compared to projected current-year expenditures. This change is primarily due to technical adjustments to bond expenditures.

Proposition 1E—Flood Protection

Background

Defining Flood Risk. According to a November 2013 report by DWR, California faces significant risk from flooding. The flood risk for a given area is determined by the amount of damage (such as damage to property and loss of life) that would be caused if a flood occurred, combined with the likelihood that a flood will occur. For example, an urban area along a river might have a relatively high flood risk—even if a flood is unlikely to occur—because the area has high property values and a large number of residents would be affected if flooding happened. In contrast, a rural area might have a lower flood risk—even if a flood is more likely to occur—because property values and populations in the area are lower.

State Role in Flood Protection. Historically, most flooding has occurred in the Central Valley. The state is the primary entity responsible for flood control in this area. The State Plan of Flood Control (SPFC) is the state's system of flood protection in the Central Valley. It includes about 1,600 miles of levees, as well as other flood control infrastructure, such as bypasses and weirs, which are used to divert water at times of high flow. Figure 11 (see next page) shows the location and extent of the SPFC.

Within the SPFC, the state funds the construction and repair of flood control infrastructure. Typically, the federal and local governments also provide funding for these projects. The state also provides grants to local governments to support local levee improvements and other activities. For most levee segments, the state has turned over the operations and maintenance to local governments (primarily local flood control districts). Even though some of these local agencies have failed to adequately maintain the levees in the past, the state has been found liable for such levee failures. Outside the SPFC, the state's role in flood management generally consists of providing financial assistance to local governments for flood control projects located throughout the state.

Voters Passed Proposition 1E. In November 2006, California voters approved the Disaster Preparedness and Flood Protection Bond Act of 2006 (Proposition 1E) in order to improve the condition of the state's levees. Proposition 1E authorized the sale of $4.1 billion in general obligation bonds for several broad categories of flood protection activities, such as improvements to the state's flood control system and the construction of bypasses. The measure requires (1) all funds to be appropriated by July 1, 2016, (2) the funds to be directed to projects that achieve maximum public benefits, and (3) the Governor to submit an annual flood prevention expenditure plan that includes the amount of matching federal and local funds.

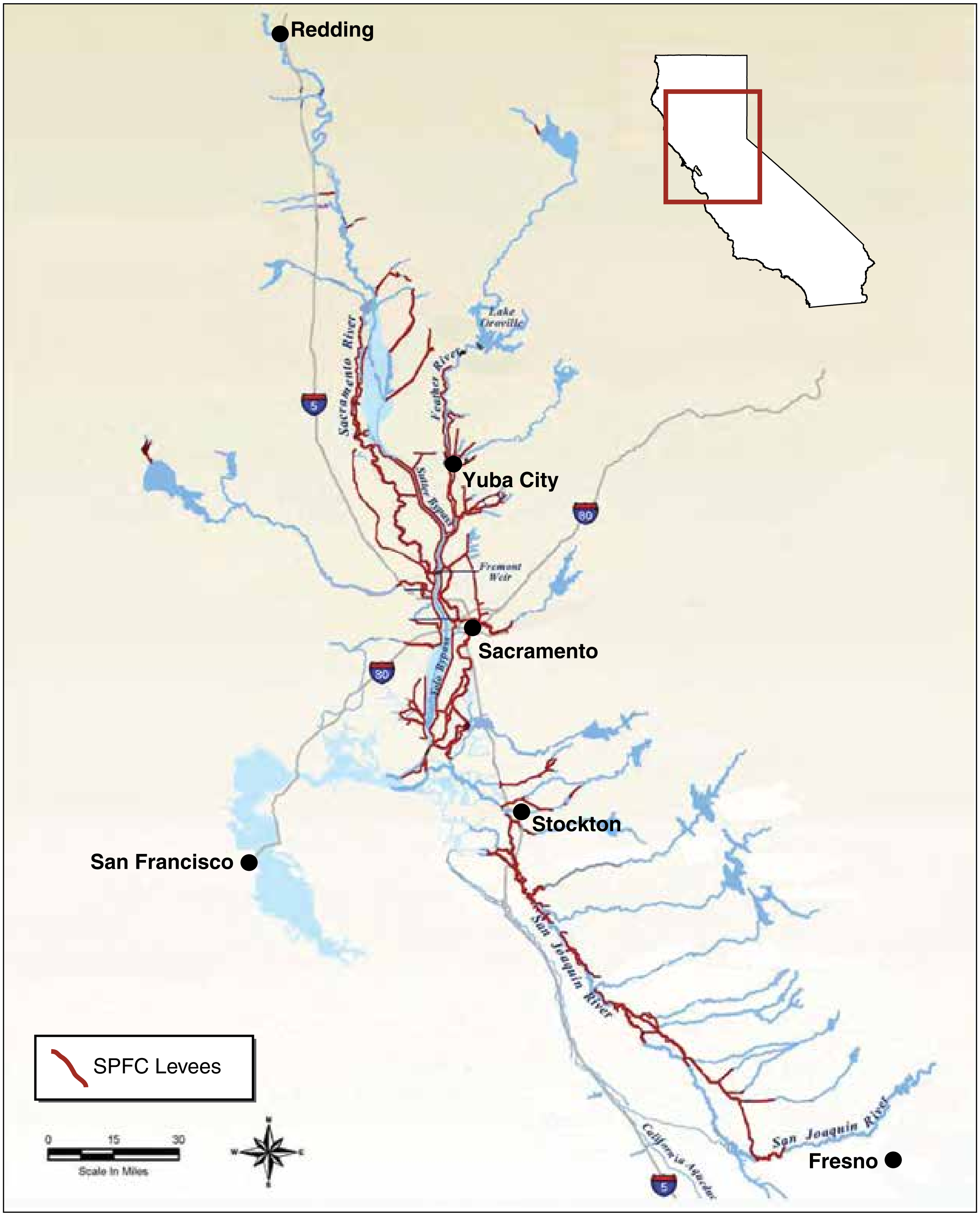
Central Valley Flood Protection Plan Developed. Subsequently, the Legislature passed the Central Valley Flood Protection Act of 2008 (Chapter 364, Statutes of 2007 [SB 5, Machado]). Chapter 364 required DWR to develop a plan—the Central Valley Flood Protection Plan (CVFPP)—for reducing the risk of flooding throughout the SPFC system, including recommended actions and projects. The CVFPP was developed by DWR in 2012 and identified a total flood control funding need of $14 billion to $17 billion.

State Flood Protection Activities. The state funds several types of flood protection activities. This includes three types of state-managed capital outlay projects:

- ***Urban Capital Outlay Projects.*** These projects protect urban areas, typically by improving levees. Projects in urban areas often provide large reductions in

Figure 11

State Plan of Flood Control (SPFC)



Modified from SPFC Descriptive Document (2010).

flood risk for the protected areas because the levees protect high value property and large populations. However, the way urban capital projects have historically been constructed often negatively affect fish habitat for several reasons, such as by reducing native vegetation. Consequently, such projects often require significant environmental mitigation. The federal government often provides most of the funding for these projects because they meet certain federal criteria for reducing flood risk in a cost-effective manner.

- ***Rural Capital Outlay Projects.*** These projects protect rural areas by repairing levees and making other improvements, such as flood-proofing structures or widening floodplains. The impact of rural flood projects on fish habitat depends on how they are designed. For example, some of these projects include "setback" levees, which are built further back from the bank of the river. This connects the river to its historical floodplain, which creates additional habitat and provides good food sources for fish and other species. Because these projects reduce risk in rural areas—which do not have high populations or property values—they often do not meet the federal government's cost-effectiveness criteria. Thus, the state typically pays over half the cost of these projects, with local governments paying the remainder.

- ***Systemwide Capital Outlay Projects.*** These projects include building or expanding existing bypasses (such as the Yolo Bypass near Davis). Bypasses significantly reduce the chance of flooding for large regions—including urban and rural areas—and improve environmental benefits for fish species that migrate through them. However, because some of the flood benefits accrue to rural areas, these projects may not reduce flood risk as cost-effectively as urban projects. The cost shares among state, federal, and local governments depend on the specific project.

The state also provides funding for other activities, including:

- ***Grants to Local Governments.*** The state provides grants to support a variety of flood protection activities at the local level. Specifically, the state funds a share of the costs associated with projects that are developed and led by local governments. This includes grant programs focused on reducing flood risk in small communities and supporting local levee maintenance.

- ***State Operations.*** The state also supports various state flood protection activities, such as updates to the CVFPP, analyses of flood risk, levee maintenance, and purchasing equipment and supplies needed to respond to flood emergencies.

Challenges to Expending Proposition 1E Funds. While the Legislature has appropriated most of the Proposition 1E funds for specific projects, only $1.9 billion of Proposition 1E funds had been expended or committed to projects as of June 2013 (the latest information available). According to DWR, this is because the state has faced some challenges in expending Proposition 1E funds. These challenges include difficulties in (1) securing funding for local and federal shares of certain flood protection projects; (2) identifying projects developed by local agencies that have gone through the required design stages and environmental reviews; and (3) securing other local, state, and federal permits needed to complete projects.

Governor's Proposal

The Governor's proposed budget for DWR includes $1.1 billion (nearly all from Proposition 1E) to support various flood control activities. As shown in Figure 12, this amount is primarily for capital outlay projects ($738 million), but also includes some funding for local assistance ($222 million) and state operations ($163 million). The proposal would appropriate all remaining Proposition 1E funding and would support 530 existing positions.

The Governor proposes to give DWR ten years to encumber the funds (commit to projects) and an additional two years to expend them. (This significantly exceeds the typical three-year appropriation for capital projects.) Unlike with prior appropriations, the proposal does not identify specific projects that would be funded. The proposal would also allow the department to transfer funds between state operations, local assistance, and capital outlay projects as it deems necessary. The administration has indicated that it will seek legislation to appropriate some funding prior to the passage of the *2015-16 Budget Act* with the intent to expedite flood projects. In future years, the administration also intends to submit an annual report detailing proposed expenditures for the year and progress on past programs.

Figure 12

2015-16 Proposed Proposition 1E Appropriations

(Dollars in Millions)

Purpose	Amount	Percent of Total
Capital Outlay Projects:	$738	66%
In Urban Areas	(320)[a]	(28)
Systemwide	(300)	(27)
In Rural Areas	(118)	(11)
Local Assistance	222	20
State Operations	163	15
Totals	**$1,123**	**100%**

[a] Includes $13.8 million from other bond funds and $52 million in reimbursement authority.

Proposal Raises Significant Concerns

Based on our analysis, we have identified several concerns with the Governor's Proposition 1E proposal. Specifically, the proposal (1) significantly reduces legislative involvement and oversight (particularly due to the proposed ten-year appropriation period and the lack of key information provided), (2) provides no opportunity for the Legislature to ensure that funded projects provide the best balancing of the numerous trade-offs inherent in selecting among different possible flood projects, and (3) does not address any of the underlying issues that have cost delays in completing flood protection projects in the past. Below, we discuss each of these concerns in more detail.

Significantly Reduces Legislative Involvement and Oversight. Under the proposal, the administration would be able to direct funding to currently unknown projects and shift funding away from currently planned projects without soliciting input from the Legislature or providing justification for its choices. Compared to the current budgeting practice, where the Legislature appropriates funds for specific projects in the annual budget act, the Governor's Proposition 1E proposal would significantly limit the Legislature's ability to direct funding to its priorities and oversee how those funds are spent. For example, the Legislature could have a particular interest in flood protection projects in certain areas, but it would not be able to ensure that funds were directed to those projects under the Governor's proposal.

These legislative constraints are particularly problematic because the administration's proposal lacks key information about what projects would be funded. As noted above, the proposal does not identify specific projects or even a list of potential projects that would be eligible for funding. The DWR states that it has lists of projects prioritized according to risk from flooding, but has not provided these lists for each type of activity to the Legislature. Moreover, the department has not indicated how it would prioritize among potential projects. (The DWR has provided our office with a list of potential rural levee improvements but has not confirmed that this lists all of the projects eligible for funding.) The administration also has not indicated how it decided to allocate the $1.1 billion among different types of flood protection activities. Without such information, it is impossible for the Legislature to determine whether the initial allocation of funds among the different types of activities or the specific projects that are expected to be selected are consistent with its priorities.

Provides No Opportunity for Legislature to Weigh Trade-Offs. As noted above, the CVFPP identified a total flood control funding need of $14 billion to $17 billion. Thus, Proposition 1E funding will only be sufficient to complete a small share of the recommended actions of the CVFPP. The state will have to make difficult choices about how to allocate limited dollars to projects and other activities. The choice of projects determines what outcomes are ultimately achieved by the investment of state dollars. Thus, the Legislature will want to weigh in on which projects and activities are funded in order to ensure that its highest priorities are achieved. However, the proposal does not provide the Legislature with such an opportunity. Reduction in flood risk is certainly one important factor to consider, but prioritizing among flood protection projects requires consideration of other factors and trade-offs, including:

- ***Ability to Obtain Cost Shares.*** As noted above, one obstacle to completing projects has been a lack of federal and local cost shares to fully fund projects. Given this challenge, for many projects the state will likely have to consider whether it is best to wait to secure those cost shares, even if it means delaying the completion date of projects. Alternatively, the state could consider using additional state funds to make up for unsecured local or federal shares.

- ***Environmental Benefits.*** As noted above, different flood protection projects provide various environmental benefits and harms. Environmental impacts are an important consideration for these types of projects, in part due to the potential additional costs associated with environmental mitigation.

- ***Achieving State-Level Benefits.*** According to the "beneficiary pays" principle, the costs of providing flood protection should be borne by those who benefit (such as local communities protected by levees). Therefore, state funds should be reserved for projects that provide public benefits for the state as a whole (such as environmental benefits). However, focusing state funds exclusively on projects that provide state-level public benefits could reduce the funding available for other priorities, such as reducing risk in high priority areas.

- ***Reducing Potential State Liability.*** The state could be found liable if levees fail. So, the state has an interest in funding levee improvements even where there are beneficiaries that could pay. However, this would likely reduce state funding available to support other projects.

- ***Funding State Operations Versus Projects.*** As currently reflected in the Governor's budget, 15 percent of the requested funds would support shorter-term, operational activities such as for state staffing, feasibility studies, and levee evaluations. Some of these activities may be reasonable, but without additional information on the activities that would be funded and the basis for selecting those activities, it is difficult for the Legislature to know whether they provide a greater benefit than funding additional projects.

Does Not Address Problems That Led to Delay. The administration's proposal for a ten-year appropriation (with two additional years to expend the funds) would allow the administration to spend funds potentially as late as 2027—21 years after the bond was initially passed and 11 years after the bond requires the funds to be appropriated. While lengthening the appropriation as proposed might allow the state to fully expend the bond funds, it does not directly address any of the problems that led to past delays. We would note that the department reports that it intends to take steps to address some challenges. For example, the department has begun work to establish a pilot program for securing necessary permits on a regional basis (instead of on a project basis). If successful, this could help streamline the permitting process for flood projects. However, other reasons for delay cited by the department, such as inability to obtain federal and local cost shares, remain unaddressed.

Legislature Has Several Options

Under the Governor's proposal, the Legislature would be forced to forgo its traditional oversight and appropriation authority in order to spend the remaining Proposition 1E funds for flood protection projects. However, the Legislature has other options available that could provide a better balance between continuing to fund flood protection projects and having legislative oversight. Below, we describe two such options for legislative consideration: (1) funding flood protection activities on a pay-as-you-go basis and (2) modifying the Governor's proposal to add control and accountability measures.

Option 1: Fund Flood Protection on Pay-As-You-Go Basis. One option the Legislature has is to reject the Governor's proposal and instead appropriate funds for flood protection activities on a pay-as-you-go basis. This means that expenditures would be paid for up front, instead of paid for through borrowing (as is done with bond financing). Funding flood control projects on a pay-as-you-go basis would allow the Legislature to exercise its traditional project approval and oversight roles through the budget process and to direct funds to its priorities. For example, the Legislature could target funding to specific projects in certain areas of concern or that meet other state goals.

In addition, pay-as-you-go funding of projects has the benefit of reducing long term General Fund spending. This is because selling bonds to finance projects requires the state to pay interest on those bonds from the General Fund. On the other hand, pay-as-you-go spending could increase costs in the near term compared to financing projects, which spreads the cost over many years. Of course, with a pay-as-you-go approach, the Legislature could choose a spending level for flood protection projects each year that balanced its flood protection goals with other legislative budget priorities.

Figure 13 illustrates how costs associated with funding $1.1 billion in projects could differ under three scenarios: (1) spending the full amount on a pay-as-you-go basis evenly over the next ten years, (2) spending the full amount on a pay-as-you-go basis evenly over the next 15 years, and (3) using general obligation bonds to finance the projects. We describe the trade-offs associated with these three scenarios below.

- ***10-Year Pay-As-You-Go.*** Under the 10-year pay-as-you-go scenario, projects would get built over the same time period as proposed by the Governor, and would cost $107 million annually over the decade. Total costs would be $1.1 billion.

- ***15-Year Pay-As-You-Go.*** Under the 15-year pay-as-you-go scenario, it would take a few additional years to spend the full $1.1 billion, but annual costs would only be about $70 million, same as the peak level of debt-service spending under the general obligation bond scenario. Total costs would be $1.1 billion.

- ***General Obligation Bonds.*** Under bond financing, as proposed by the Governor, the state would pay debt-service costs over a 40-year period (assuming it takes ten years to sell the bonds). Those costs would increase to about $70 million annually before declining at the end of this period. Because the state would be making debt-service payments for a much longer period of time using bonds, the state would pay a total of $2.2 billion from the General Fund.

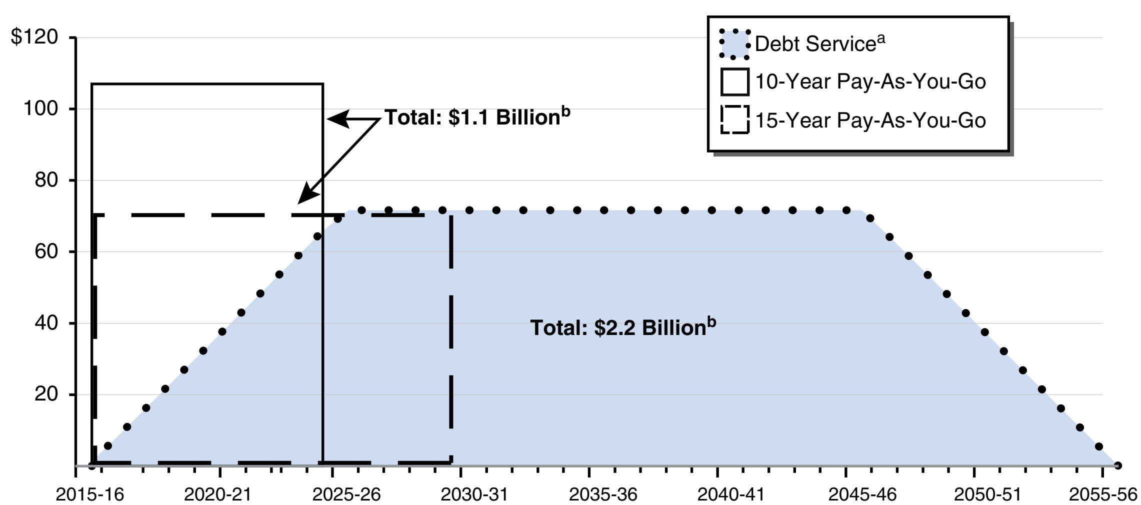
Importantly, the Legislature would also have options for pay-as-you-go funding sources including:

- ***General Fund.*** The state could support flood protection activities by spending General Fund, which supported most flood control expenditures prior to Proposition 1E. This is also the same fund source that would be used to make debt-service payments on the bonds authorized by Proposition 1E.

Figure 13

Pay-As-You-Go Financing Would Result in Lower Costs in the Long Term

Annual General Fund Payment (In Millions)



[a] This assumes the $1.07 billion in Proposition 1E bonds would be sold over a ten-year period.

[b] In nominal dollars.

- ***New Charge on Beneficiaries.*** The Legislature could establish a new charge on individuals that benefit from state flood protection projects. This charge could be paid for by the property owners in communities who are protected by the levees, as well as other communities that are out of the floodplain but who contribute to flood risk (such as by generating runoff related to development). This charge could be implemented through flood protection assessment districts that correspond to the major watersheds in the state. (We note that some areas within these watersheds already levy property tax assessments for flood protection purposes.)

Option 2: Modify Governor's Proposal to Add Control and Accountability Measures. If the Legislature wants to ensure that all Proposition 1E funds are appropriated in future years, one option it could consider is approving the Governor's requested appropriation but with additional measures designed to improve legislative oversight and control. It would provide more accountability than the Governor's proposal but less than under the current budget process. The control and accountability measures could include one or more of the following:

- ***Require Additional Information With Annual Expenditure Plan.*** In order to ensure that timely information is available on the specific projects that DWR intends to fund, the Legislature could require the administration to provide additional information along with the annual expenditure plan already required by the bond act and the new annual report in the Governor's proposal. This additional information could include (1) expenditures over the past year; (2) the specific projects proposed for funding; (3) the basis for selecting those projects, including an assessment of the net economic benefits and environmental benefits of the projects; and (4) how the projects would contribute to achieving quantified outcomes for the SPFC. Such a report would also allow the Legislature to determine whether the state's flood protection activities as a whole are meeting its priorities, which is difficult to achieve when reviewing individual proposals in isolation. We would note, however, that the administration has not submitted the bond-required report in recent years.

- ***Require Legislative Review of Projects Prior to Encumbering Funds.*** The Legislature could pass budget trailer legislation that prohibits DWR from encumbering funds prior to legislative review of projects selected by the administration to be funded. This would allow the Legislature to review whether the projects DWR selects are in line with its priorities. For example, the department could notify the Legislature about its selected projects as part of the Governor's January budget submittal, and the Legislature could have until June to review these projects, consistent with the current timeline. Under this approach, the DWR would notify the Legislature of its proposed projects, changes to previously authorized projects, and the rationale for the selection and design of the proposed projects.

- ***Prohibit Transfers to State Operations, Except for Levee Maintenance.*** The Legislature could modify the proposal to prohibit transfers to state operations, except for levee maintenance. This would limit how much funding could be shifted to state operations, which does not primarily fund projects (though it can fund levee maintenance). We recognize that it may be necessary to transfer funding authority between capital outlay and local assistance to be able to fund the most cost-effective projects. This is because the most cost-effective projects in the future could have either a state or local lead agency, which would require capital outlay or local assistance authority, respectively.

LAO Recommendations—A Combination of Fund Sources

We recommend the Legislature adopt a combination of the above options—fund specific projects with Proposition 1E funds in 2015-16 and 2016-17 and adopt a pay-as-you-go mechanism to fund projects beginning in 2017-18. This would allow some of the remaining Proposition 1E funds to support projects in the near term, reduce long term financing costs, and maintain the Legislature's traditional oversight role through the budget process.

Use Proposition 1E to Fund Identified Projects for Two More Years. The Legislature does not have to appropriate all remaining Proposition 1E funding this year as part of the 2015-16 budget. Proposition 1E allows funds to be appropriated until July 1, 2016. This means that the Legislature can appropriate bond funds in the 2016-17 budget, as long as the Legislature passes and the Governor signs the budget by July 1, 2016. The Legislature could also pass special legislation for this purpose prior to July 2016. Thus, we recommend the Legislature (1) reject the Governor's proposal for a ten-year appropriation of Proposition 1E funds and (2) require DWR to provide a list of specific projects to fund from Proposition 1E in the 2015-16 budget—at the time of the May Revision—and the 2016-17 budget. This would ensure the expenditure of additional Proposition 1E funds prior to the voter-approved expiration date. At the same time, it would allow the Legislature to ensure that funds are directed to its highest priorities and exercise oversight during the 2015-16 and 2016-17 budget processes.

Adopt Pay-As-You-Go Approach Beginning in 2017-18. We also recommend that the Legislature adopt a pay-as-you-go approach for funding additional flood protection projects beginning in 2017-18. Adopting a pay-as-you-go approach in the future would allow normal legislative oversight, while continuing to provide funding for flood protection projects. Such an approach could initially be somewhat more expensive in the near term than relying on general obligation bonds, but would be less expensive in the long run.

This approach could include a combination of General Fund and charges on beneficiaries. The General Fund could support activities with state-level public benefits (such as projects with significant environmental benefits), while the charges on beneficiaries could support activities where local communities receive the primary benefits (such as levee improvements). In addition, we note that the 2014 water bond (Proposition 1) includes $395 million for flood protection projects. This funding could be used to supplement the pay-as-you-go approach if additional funds are needed for projects.

Require Report on Obstacles to Completing Flood Protection Projects. As noted above, the administration's proposal does not address the challenges that have caused delays in completing flood protection projects. Thus, we recommend that DWR report at budget hearings this spring regarding key obstacles to identifying and completing projects. The department should also recommend strategies to address those obstacles, as well as ways to streamline flood protection project delivery. In so doing, DWR should identify for the Legislature where statutory changes are necessary to implement these improvements.

DEPARTMENT OF FISH AND WILDLIFE

The DFW administers programs and enforces laws pertaining to the fish, wildlife, and natural resources of the state. It protects and maintains habitat and manages about 1 million acres of ecological reserves, wildlife management areas, and fish hatcheries throughout the state. The department also regulates hunting and fishing in conjunction with the Fish and Game Commission.

The Governor's 2015-16 budget proposes a total of $518 million from various funds (mainly special funds) for support of the department. This is a net decrease of $33 million, or 6 percent, compared to projected current-year expenditures. This change primarily reflects reduced bond expenditures, as well as one-time drought-related expenditures from the General Fund in 2014-15.

Payment in Lieu of Taxes to Counties

Background. The DFW operates 111 wildlife management areas covering over 700,000 acres throughout the state. The areas are designed to protect natural ecosystems (such as wetlands) and improve habitat for fish and wildlife. These areas also often provide hunting, fishing, wildlife viewing, and outdoor education opportunities to visitors. They are typically located in rural areas.

According to the California Constitution, state lands (including wildlife management areas) are exempt from the property tax. However, state law specifies that DFW shall provide those counties containing wildlife management areas with payments from funds available to the department. These "payments in lieu of taxes" (PILT) are designed to offset lost property tax revenues that counties and other local governments would be able to collect on these properties if they were not state-owned. These PILT payments were made between 1957 and 2002 from the General Fund. Beginning in 2002-03, the state stopped providing PILT payments in the budget in order to achieve cost savings.

Governor's Proposal. The Governor proposes $644,000 to DFW from the General Fund to resume PILT payments in 2015-16. Under the Governor's proposal, the funding would be allocated to 36 counties containing wildlife management areas. (Local county assessors would then be responsible for allocating the funds they receive to the relevant local governments in their jurisdiction.) The Governor also proposes budget trailer legislation to articulate that the state is not required to make PILT payments to counties and that counties may not spend the payments on school districts. Figure 14 shows the amount each county would receive in PILT under the Governor's proposal.

The Governor's estimate of PILT includes funding for counties, cities, and special districts, but not school districts. According to the administration, state General Fund payments to school districts already take into consideration the amount of local property tax collected by the district. Therefore, providing PILT payments to school districts would be duplicative with existing state General Fund payments.

Policy Considerations in Providing PILT. We find that there are policy trade-offs that should be considered carefully by the Legislature in evaluating the Governor's proposal. On the one hand, providing PILT payments is in line with existing statutory direction and longstanding historical practice before 2002. In addition, some local governments might provide services on state wildlife management areas from which they do not receive property taxes. For example, some counties might incur costs to maintain local

Figure 14

Payments in Lieu of Taxes by County—Governor's Proposal

2015-16

County	Amount
Alpine	$31,739
Butte	39,603
Colusa	1,704
Del Norte	20,947
Fresno	5,569
Glenn	17,745
Humboldt	15,225
Imperial	3,728
Inyo	335
Lake	7,260
Lassen	19,087
Madera	623
Marin	11,644
Merced	27,536
Modoc	15,968
Mono	15,756
Monterey	3,597
Napa	45,390
Nevada	5,289
Placer	6
Plumas	1,903
Riverside	132,485
San Bernardino	3,129
San Diego	46,529
San Luis Obispo	14
Shasta	3,962
Sierra	41,288
Siskiyou	15,376
Solano	23,582
Sonoma	7,762
Stanislaus	200
Sutter	7,014
Tehama	2,548
Tulare	169
Yolo	50,385
Yuba	18,723
Total	**$643,820**
Average	$17,884

facilities on DFW wildlife management areas, and might step in to provide law enforcement services when necessary. However, the administration has not provided any detail on the extent to which this happens.

On the other hand, no other state department that we are aware of makes PILT payments to local jurisdictions for state-owned land. This includes other state properties for which local governments might provide some services, such as state buildings owned by the Department of General Services (DGS) and state parks. The administration has also argued that the lost property taxes can be particularly challenging for rural counties. While there is some variation, on average, PILT payments to these counties would be a fraction of a percent of their non-school property tax revenues.

Conclusion. The decision about whether to resume PILT payments to counties is ultimately a policy decision for the Legislature. In large part, this determination will be based on how the Legislature weighs the potential benefit to counties against other General Fund priorities, as well as the consideration of why PILT payments should be made for certain DFW lands but no other state properties.

CALIFORNIA NATURAL RESOURCES AGENCY

The California Natural Resources Agency (CNRA) through its various departments, boards, commissions, and conservancies is responsible for conservation, restoration, and management of California's natural and cultural resources. The Governor's budget requests $53 million from various funds for support of the CNRA in 2015-16. This is a decrease of about $6 million compared to estimated current year expenditures, largely due to decreased bond spending.

Environmental License Plate Fund

Background

The Environmental License Plate Fund (ELPF) was established in 1979 to fund various resources and environmental protection programs. The fund is primarily supported from the sale and renewal of personalized motor vehicle license plates, as well as a portion of fees on the sale and renewal of certain specialty plates (such as "Whale Tail" plates). Roughly 800,000 personalized license plates were issued or renewed in 2011-12. Existing state law restricts the use of ELPF monies to program administration and the following purposes:

- Control and abatement of air pollution.
- Acquisition, preservation, and restoration of natural areas or ecological reserves.
- Purchase of real property for park purposes.
- Environmental education.
- Protection of nongame species and threatened and endangered plants and animals.
- Protection, enhancement, and restoration of fish and wildlife habitat, and related water quality.
- Reduction of the effects of soil erosion and the discharge of sediment into the waters of the Lake Tahoe region.
- Scientific research on the impacts of climate change on California's natural resources and communities.

As shown in Figure 15, the state made $42 million in expenditures from the ELPF in 2013-14. The ELPF currently supports activities in 26 state departments, boards, conservancies, and commissions.

Administration Projects Significant Shortfall. The administration projects a shortfall in the ELPF of $4.9 million in the current year and $10.5 million in the budget year. These shortfalls are a result of several factors:

Figure 15

The Environmental License Plate Fund Is Used to Support Many Organizations

(In Thousands)

Department	2013-14
Fish and Wildlife	$15,173
Conservancies (ten)	9,484
Secretary of the Natural Resources Agency	4,824
Special Resources Programs	4,203
Parks and Recreation	3,185
Delta Protection Commission	1,006
Office of Environmental Health Hazard Assessment	875
Delta Stewardship Council	676
Water Resources	541
Pesticide Regulation	467
Forestry and Fire Protection	444
Education	406
California Conservation Corps	325
Wildlife Conservation Board	260
Other	197
Total	**$42,066**

- ***Lower-Than-Estimated Revenues.*** First, during the 2014-15 budget process, revenue for the current year was projected at $45 million. However, year-to-date revenue in 2014-15 has been lower than expected, and is now projected at $41 million. The Governor's budget assumes that revenue will remain at this lower level in 2015-16.

- ***Additional One-Time Spending.*** Second, the 2014-15 budget also provided funding for some programs not previously funded through ELPF. Specifically, the budget provided a total of $5 million over two years to the CNRA to fund the fourth climate change assessment, as well as $1.3 million on a one-time basis for Climate Ready Grants administered by the State Coastal Conservancy.

- ***Higher Ongoing Spending.*** Third, the administration cites increases in employee compensation and administrative costs as contributing to increased fund expenditures, resulting in an ongoing structural deficit.

Based on a review of recent ELPF expenditures and revenues, we estimate that there will be an underlying structural deficit of about $8 million annually beginning in 2015-16, even when excluding short-term expenditures for the climate change assessment and Climate Ready Grants. It is possible that this structural deficit would continue to grow in coming years. Employee compensation and administrative costs will likely continue to rise, whereas revenues to the fund have not grown in several years.

Governor's Proposal

The Governor's budget proposes various changes to address the above shortfalls in the ELPF, as summarized in Figure 16. First, the budget proposes to reduce expenditures from the fund by $4.9 million in 2014-15, mainly by postponing the climate change assessment and Climate Ready Grants by one year. (This delay results in increased costs to perform these activities in the subsequent years.) Second, the budget reflects net savings in 2015-16 of $11.5 million, mostly by shifting some expenditures for the Department of Parks and Recreation (DPR) and the DFW from the ELPF to other special funds—State Parks and Recreation Fund (SPRF) and Fish and Game Preservation Fund (FGPF), respectively. Third, the Governor's proposal includes a 5 percent savings target to departments receiving ELPF funds. Fourth, the

Figure 16

Addressing the Environmental License Plate Fund (ELPF) Shortfall in the Short Term

Positive (+)/Negative (-) Impact on ELPF Reserve (In Thousands)

Action	2014-15	2015-16	2016-17
Delay first year of climate change assessment	$2,500	-$2,500	—
Delay second year of climate change assessment	—	2,500	-$2,500
Delay Climate Ready Grants	1,300	-1,300	—
Shift DPR expenditures to SPRF	200	3,300	—
Shift DFW expenditures to FGPF	900	7,500	—
Provide savings targets to departments	—	1,000	—
Increase plate fee	—	1,000	2,000
Total Savings	**$4,900**	**$11,500**	**-$500**

DPR = Department of Parks and Recreation; SPRF = State Parks and Recreation Fund; DFW = Department of Fish and Wildlife; and FGPF = Fish and Game Preservation Fund.

administration proposes budget trailer legislation to increase the personalized license plate fees by about 5 percent. The administration projects this will generate additional revenue of $1 million in 2015-16 and $2 million annually thereafter.

LAO Assessment

Important Information Not Included With Governor's Budget. The Governor's budget does not include details of ELPF spending by program. While the administration provided some details on the programs funded by ELPF upon request, more detailed information on spending (such as identification of and funding levels for ELPF-supported programs and projects) is needed. In addition, providing this information in the Governor's annual budget proposal—as was done in the past—would be more timely and helpful for legislative decision making. The lack of detail regarding ELPF expenditures makes it difficult for the Legislature to evaluate the degree to which ELPF spending is being used for the most effective programs and is consistent with legislative priorities.

Governor's Proposal Offers One Reasonable Option to Address Shortfall. . . In the current year, the state has only limited options for addressing the ELPF shortfall. It would be difficult to raise much revenue with only a few months remaining in the fiscal year, and many departments would likely have difficulty implementing budget reductions without significantly affecting their programs. Most savings achieved by the administration's proposal are from delaying one-time spending until the next fiscal year. Therefore, this option is the least disruptive and achieves the needed savings to avoid a shortfall in 2014-15.

The proposal also provides a reasonable approach to addressing the shortfall in 2015-16 without major funding disruptions to supported programs. Yet, it has trade-offs. The costs of the budget-year shortfall would be borne mostly by special funds that support the activities of DPR and DFW. While these funds have sufficient balances to support this one-time shift without reducing the departments' activities, they would not be able to sustain the shifts. Additionally, the proposal only offers a solution through the budget year. A long term solution would still need to be found for 2016-17 and beyond.

. . .But There Are Other Alternatives Available. The Legislature has several choices regarding how to address the ELPF shortfall, both for the budget year and thereafter. For the budget year, the Legislature could choose from a variety of options: (1) reduce funding from the other programs supported by ELPF, (2) reduce or eliminate one-time spending, (3) increase the license plate fee beyond the level proposed by the Governor, or (4) backfill ELPF with other special funds. For example, if the Legislature did not want to use SPRF and FGPF to backfill ELPF, a cut of about 20 percent to all programs would achieve the same savings level in the budget year. Likewise, increasing the plate fee by more than the 5 percent proposed would reduce the need to cut spending in 2015-16 and beyond. We also note that many conservancies are getting large funding increases from Proposition 1 (2014 water bond), and may no longer need to rely as heavily on ELPF.

In the long term, the ongoing deficit—about $8 million annually—is smaller than the budget-year shortfall, and therefore may be addressed with less drastic action. The Legislature could reevaluate statutory priorities for the ELPF to ensure that activities of the highest priority continue to be funded. Narrowing the definition of some uses or eliminating uses would result in savings to the fund. A greater increase in the plate fee, as noted above, could also address the ongoing deficit.

LAO Recommendations

For the current year, we find that the Governor's proposal makes sense. For the budget year, the Governor provides a reasonable approach, but it is just one option to address the shortfall. There are others—as we discussed above—that could be considered. Each option, however, has trade-offs. Determining which option is most consistent with legislative priorities requires policy decisions about where the Legislature wants the spending reductions (or fee increases) to be borne.

To help the Legislature make decisions in the budget year, we recommend that the Legislature require the administration to provide detailed spending information by ELPF program at budget hearings. In addition, we recommend that the Legislature require the administration to include spending information for each program supported by the ELPF as part of the Governor's annual budget proposal. This basic information historically has been included as part of the proposed budget, and is necessary for the Legislature's budget process.

Finally, we recommend that the Legislature reevaluate ongoing spending priorities for the ELPF in statute to ensure the best use of this fund given the structural deficit. There are several options available. For example, uses of the fund could be placed in preference-based order in statute so that the Legislature's highest priorities are clear. This could involve creating "funding buckets" that receive revenue in a specified order as money is available, so that the highest priorities are protected from shortfalls and lower priorities are funded only when additional revenues are available. The Legislature could also narrow the statutory uses of the ELPF to more specific goals or programs and eliminate from statute those uses deemed no longer of high priority.

Marine Protected Area Monitoring

Background

The Marine Life Protection Act (MLPA) of 1999 aims to protect California's coastal environment by establishing a statewide network of marine protected areas (MPAs). The MPAs are separate geographic areas designed to protect or conserve marine life and habitat by restricting or prohibiting certain recreation activities and commercial fishing. The MLPA also requires MPA monitoring and adaptive management, a technique intended to improve the preservation and protection of natural resources over time by performing and learning from repeated research and data collection. Finally, the act calls for adequate enforcement of MPA restrictions.

Since enactment of the MLPA, the state has designated 124 MPAs in four regions along California's coast—North Coast, North Central Coast, Central Coast, and South Coast. The process of making these designations cost more than $30 million, paid for by the state and private philanthropic organizations. In 2010, the Fish and Game Commission adopted an MPA monitoring plan for the North Central Coast region. The plan identifies monitoring activities, cost estimates, and high-priority ecosystems among other things. Following the designation of MPAs, the Ocean Protection Council—an entity administered by CNRA—funded baseline ecosystem characterization studies against which future conditions could be compared. These studies cost $16 million and were funded from Proposition 84 (2006) bond funds.

Governor's Proposal

The Governor's budget for 2015-16 includes $2.5 million (one-time) from Proposition 84 bond funds to support the first round of post-baseline monitoring of ecosystems in the North Central Coast region. This funding would support this effort for a period of four to five years. The proposed funding is intended to prevent a gap in monitoring until the administration can identify an ongoing funding source to continue these activities in the long run.

LAO Assessment

Bond Funds Not Appropriate for Ongoing Operational Costs. We find that the proposed monitoring activities seem reasonable. The activities are consistent with the MLPA, and the proposed funding amount is actually somewhat less than the amount described in the monitoring plan adopted by the Fish and Game Commission in 2010. That plan included a range of activities and associated costs to conduct monitoring in the North Central Coast region, with the costs varying depending on the level of monitoring. The lowest cost option identified estimated total costs of $4 million ($1 million annually over four years).

As a general principle, however, bond funds should be used only for capital improvements or activities that provide benefits over many years to taxpayers who finance the bonds. The state should not conduct long term borrowing for day-to-day maintenance or operations costs. If bond proceeds were used for operations costs, it would mean that taxpayers in the future would be paying for today's activities. In addition, the state pays more in the long run when it relies on bond debt, about $1.30 (when adjusted for inflation) for each $1 borrowed. Therefore, covering operational expenses with bond funding is more expensive than using other funding sources. Since monitoring MPAs is an ongoing operational activity, bond funds are not an appropriate source of funding.

More Appropriate Funding Sources Are Available. We find that there are other funding sources that are better suited for funding an ongoing activity such as monitoring. The Marine Protected Areas Partnership Plan—developed by the Ocean Protection Council—identifies several potential state government funding sources for MPA monitoring. These sources are worthy of consideration, both to fund this round of monitoring and potentially to cover the costs of ongoing monitoring. We find the following sources to be the most viable:

- ***General Fund.*** If MLPA activities are of high priority to the Legislature, the General Fund is an appropriate funding source. We note that if the Legislature were to adopt the Governor's proposal of using Proposition 84 funds, the General Fund would eventually bear these costs with the added cost of interest. In the long run, it would be less expensive to fund the monitoring activity directly with the General Fund.

- ***ELPF.*** The monies in the ELPF must be spent to support specified conservation purposes, including several that are relevant to MLPA implementation. If MPA monitoring is a high priority for the Legislature, it is possible to use ELPF funds. However, as described above, the ELPF currently faces a shortfall in the budget year and an ongoing structural deficit. Therefore, using the ELPF for monitoring would probably have to displace activities currently supported by the fund.

- ***Use Fees.*** Establishing recreational user fees charged to access MPAs could raise revenue to pay for MPA monitoring. This would increase costs for those visiting MPAs, but it could make sense for them to pay for some of the program costs because they would benefit directly from the preservation of these areas.

LAO Recommendation

We find the proposed MPA monitoring activity and funding level to be reasonable. However, we recommend that the Legislature reject the Governor's proposal to use Proposition 84 bond funds for this purpose. Instead, we recommend that the Legislature choose a more appropriate funding source for an ongoing operational activity than bond funds. In determining the appropriate fund source, the Legislature should first consider who is most appropriate to bear these costs—for example, general taxpayers or users of these areas. Second, the Legislature should consider the competing demands for available funding sources and weigh the relative merits of using these funds for MPA monitoring versus other possible uses.

DEPARTMENT OF FORESTRY AND FIRE PROTECTION

CalFire, under the policy direction of the Board of Forestry and Fire Protection, provides fire protection services directly or through contracts for timberlands, rangelands, and brushlands owned privately or by state or local agencies. These areas of CalFire responsibility are referred to as "state responsibility areas" (SRA) and represent approximately one-third of the acreage of the state. In addition, CalFire regulates timber harvesting on forestland owned privately or by the state and provides a variety of resource management services for owners of forestlands, rangelands, and brushlands.

The Governor's budget proposes $1.8 billion from various funds for support of CalFire in 2015-16—about the same level as estimated current-year expenditures. This proposed amount includes $62 million from the General Fund and SRA Fire Prevention Fund for heightened fire conditions resulting from the current drought, which is similar to the drought-related funding provided to CalFire in 2014-15. In addition, the Governor proposes $2 million from the General Fund for deferred maintenance projects in CalFire.

Helicopter Replacement

Background. When fighting wildland fires, CalFire uses helicopters to quickly deliver fire crews and to perform water or retardant drops that slow the fires' spread. Helicopters are also used for other firefighting and fire prevention operations, medical evacuations, cargo transport, mapping, rescues, and other missions. The department currently has 12 helicopters that were acquired in 1990 through the Federal Excess Personal Property Program at no cost to the state. They were originally owned by the U.S. Army from 1963 to 1975 for troop and cargo transport. Once acquired by CalFire, these helicopters were modified for wildland firefighting at a cost of about $500,000 per aircraft.

Governor's Proposal. The proposed budget includes budget bill language stating that CalFire and the DGS shall work collaboratively on a procurement and its resulting contract for the replacement of CalFire's existing helicopter fleet. CalFire indicates that newer helicopters are available that have increased capabilities and are able to travel faster, operate at night, carry heavier payloads, and transport more people. Newer helicopters might also be more fuel-efficient and could require less maintenance. Additionally, current generation helicopters are compliant with the Federal Aviation Administration standards that have been updated since the current fleet was manufactured in the 1960s. The administration anticipates submitting a budget request for these costs in May 2016 as part of the 2016-17 budget.

Very Limited Information Provided. The Governor's proposal includes very little information on the proposed helicopter replacement. For example, CalFire has not provided cost estimates, a procurement schedule, or the desired specifications for the new helicopters. In addition, CalFire has not identified what additional support and capital outlay costs might be incurred to support this proposal. Such costs could include increased staffing, training, and modifications to current infrastructure (such as helicopter landing pads and hangars). Depending on the specific details of the procurement, the total procurement, support, and capital outlay costs could be in the range of a couple hundred million dollars. These costs would likely be supported from the General Fund.

Our office has requested the above information, but the department has not provided it, citing legal concerns. We find no compelling rationale for why CalFire should not provide the Legislature with the above information. Other departments have included this type of information when submitting budget requests related to large-scale procurements. For example, the California Highway Patrol (CHP) requested helicopters in 2013-14 and 2014-15, and was able to provide such information to the Legislature as part of the budget process.

Difficult for Legislature to Weigh Trade-Offs. The lack of information provided makes it difficult for the Legislature to weigh the relative trade-offs associated with the proposed helicopter replacement. While we agree that eventual replacement of CalFire's helicopter fleet is reasonable given the capabilities, maintenance needs, and age of the current fleet, we note that there is a wide range of factors that must be considered prior to replacing the department's fleet. Such factors include (1) the number of helicopters needed, (2) how the helicopters will be used, (3) the desired specifications of each helicopter (such as the size and speed), (4) the need for new facilities, and (5) the timeline for replacement. The Legislature will want to weigh the benefits and costs associated with each factor. For example, night vision capabilities allow helicopters to operate 24 hours a day, which could enable CalFire to respond and contain fires more quickly during nighttime hours. However, without knowing the cost of this capability, it is difficult for the Legislature to determine if helicopter night vision should be funded before other competing programs that it may deem to be of higher priority.

It is important for the Legislature to identify, its priorities for the new fleet *prior* to CalFire and DGS moving forward on this procurement. However, the proposed budget bill language would allow DGS and CalFire to enter a contract *prior* to legislative approval and without legislative oversight. While the Legislature would still be able to determine whether to appropriate or not appropriate money for helicopters in future budget processes, the price and specifications would already be set in the contract. Therefore, the department should provide sufficient information for the Legislature to make decisions regarding the procurement before adopting language allowing it to move forward.

LAO Recommendation. We recommend the Legislature withhold action on the proposed request and require CalFire to provide additional information at budget hearings regarding the proposed helicopter replacement, including desired specifications and possible alternatives; cost estimates for helicopters, staff training, personnel, and capital outlay; and the planned procurement schedule. If the department does not provide this information to the Legislature, we would recommend rejecting the proposed budget bill language. If, however, CalFire provides this information, our office will analyze it and make specific recommendations based on our analysis.

CALIFORNIA CONSERVATION CORPS

The California Conservation Corps (CCC) provides people between the ages of 18 and 23 work experience and educational opportunities. Program participants, referred to as corpsmembers, work on projects that conserve and improve the environment. They also provide assistance during natural disasters. Work projects are sponsored by various governmental and nongovernmental agencies that reimburse CCC for the work performed by corpsmembers. Corpsmembers often live in residential facilities that serve as a hub of CCC service delivery.

The Governor's 2015-16 budget proposes a total of $98 million for support of CCC. About half of these funds are from the General Fund with the remaining coming from a variety of special funds. The proposed amount reflects a net decrease of $16.9 million, or 17 percent, compared to projected current-year expenditures. This change primarily reflects reduced capital outlay expenditures.

Tahoe Base Center: Equipment Storage Facility

Background. The Tahoe Base Center is a residential and operational facility for corpsmembers. Completed in 2013, the center includes dorm rooms, a multipurpose kitchen building, and administrative offices. In addition, the CCC currently uses a total of 8,600 square feet of storage space at two facilities for various equipment used by corpsmembers at the center. This storage space includes 5,100 square feet of lease space and 3,500 square feet at a facility owned by CCC that was formerly a CHP field office.

Governor's Proposal. The Governor's budget proposes to establish a consolidated storage facility of 12,500 square feet to serve the Tahoe Base Center. This would be accomplished by acquiring and renovating the entire facility currently leased by the CCC. The Governor's budget includes $2.5 million in lease revenue bonds to fund the estimated cost of the project. We estimate that annual debt-service payments would be about $180,000. The administration provides several reasons for needing the proposed storage facility. First, the facility would provide additional storage space as is recommended in a warehouse prototype design developed by the DGS for new CCC facilities. This design is based on 10,700 square feet. Second, the proposed location is about a half mile closer to the Tahoe Base Center than the current CCC-owned storage facility. Third, CCC states that it has had to limit the frequency and times that it accesses this facility due to neighborhood complaints.

Proposal Raises Concerns. We find that the proposed project provides some benefits to CCC. However, it is unclear that the proposal provides a necessary and cost-effective approach for two reasons. First, CCC has not identified specific problems with the amount of storage space it currently has available or why its requires a 45 percent increase in storage capacity. Second, the proposal would result in substantially greater long term costs than the status quo. Lease costs—currently about $43,000 annually—are significantly lower than the $180,000 annual debt-service costs for the project. In addition, the estimated annual costs to operate and maintain the new facility (about $10,000) are greater than at the current facilities (about $6,000). We find that the proposed facility remains significantly more costly than the current storage facilities even when taking into account other factors, such as inflation and the sale of the CCC-owned facility. We also note that the proposed facility would be significantly more costly per square foot than the existing facilities.

LAO Recommendation. In view of the above concerns, we recommend that the Legislature reject the Governor's proposal to develop a consolidated storage facility for CCC in the Tahoe region.

DEPARTMENT OF CONSERVATION

The Department of Conservation (DOC) is charged with the development and management of the state's land, energy, and mineral resources. The department manages programs in the areas of (1) geology, seismology, and mineral resources; (2) oil, gas, and geothermal resources; and (3) agricultural and open-space land. The Governor's budget proposes $92 million for the DOC in 2015-16, a net decrease of $8 million (8 percent) below estimated expenditures in the current year. This decrease is driven primarily by the expiration of one-time funding provided for certain oil and gas regulatory activities.

Surface Mining Regulation

Background

Surface Mining and Reclamation Act. The Surface Mining and Reclamation Act of 1975 (the Act) establishes the state's regulations for surface mining operations. Under the Act, surface mining operators are required to have a mining permit, an approved reclamation plan, and secured financial assurances. (Financial assurances are used to pay for any mine reclamation costs in the event that a mine operator defaults on its obligation to reclaim the mine at the end of its useful life.) The Act is administered by the DOC's Office of Mine Reclamation (OMR) and the State Mining and Geology Board (SMGB), which is also located within DOC. However, local entities—such as cities and counties—typically operate as the lead agencies in regulating mines within their jurisdictions.

The SMGB is the policy advising and appeal body for the Act. Under the Act, the SMGB also generally assumes the role of the lead agency if the local entity is not adequately performing its duties under the Act. The OMR provides technical assistance to lead agencies and mine operators in the development of reclamation plans and financial assurances. The OMR also works with lead agencies to ensure that mining operations are conducted in accordance with their approved reclamation plans, as well as collects and analyzes data submitted by lead agencies and mine operators to monitor compliance.

Current Sources of Funding for Regulatory Activities. The DOC's regulatory activities related to the Act are currently supported by three special funds:

- ***Surface Mining and Reclamation Account (SMARA).*** The federal government provides states a portion of royalties collected from mining activities on federal land. Under state law, the first $2 million provided to California is deposited in the SMARA, to be used to administer the Act. The remaining federal mining revenues provided to California—estimated to be $93 million in 2015-16—are used to fund K-14 education.

- ***Bosco-Keene Renewable Resources Investment Fund (RRIF).*** The RRIF receives 30 percent—$1.2 million in 2015-16—of the royalties provided to the state from geothermal leases on federal lands. The remaining federal royalties go to local agencies (40 percent) and the California Energy Commission (30 percent), generally to support geothermal related activities, including exploration, research, and development activities.
- ***Mine Reclamation Account (MRA).*** The MRA receives revenue from two sources: (1) a $14 daily fee paid by mines in cities and counties where the SMGB acts as the lead agency and (2) annual regulatory fees paid by mine operators (reporting fees). Total annual revenue from the daily fee is about $180,000. For the reporting fees, DOC is required to adopt a fee schedule designed to cover its cost in carrying out the Act, including reclamation plan and financial assurance review, mine inspection, and enforcement. However, existing law establishes annual caps on reporting fees for both an individual mine operator (about $5,000 in 2014-15) and total reporting fee revenue (about $4.5 million in 2014-15). Individual mine reporting fees are based on the total value of the minerals extracted. Both caps are adjusted annually for inflation. In 2015-16 total mine reporting fee revenue is expected be $3.5 million, roughly $1 million less than the cap.

Funding for Regulatory Activities Is Structurally Imbalanced. Funding for the department's regulatory activities is structurally imbalanced. While revenues have remained relatively constant over the last few years, a variety of factors have increased costs, including increases in employee compensation and health costs and payments for general statewide administrative costs. Total revenues deposited into the three funds is projected to be about $6.8 million—roughly $2 million less than current costs. In recent years, this deficit was covered by reserves. The deficit is expected to continue, and potentially grow, in future years. Without any changes, these funds are projected to be insolvent in 2016-17.

Governor's Proposal

Increase SMARA Revenue to Address Structural Deficit. To address the structural deficit, the administration proposes to increase the amount of revenue deposited into the SMARA by tying the portion of the state's federal mining revenues that go to DOC to the SMARA appropriation in the annual state budget act. Effectively, the amount of federal mining royalties going to SMARA would be increased by the amount needed to make up the difference between costs and revenues—about $2 million 2015-16.

LAO Findings

Several Options for Addressing Structural Deficit. There are several options for addressing the program's structural deficit. We discuss some of the basic options below, as well as the major trade-offs associated with each option. The Legislature could adopt one of these options in isolation, or a combination of these approaches. Specifically, the Legislature could:

- ***Reduce Spending.*** The Legislature could reduce the total amount of funding provided to OMR. The effect of funding reductions would depend on how the reductions are implemented. For example, funding reductions for OMR could result in fewer site visits to mines to verify that reclamation plans and financial assurances meet minimum standards, among other things. This could put the state at greater risk of having mining operations cease without meaningful reclamation plans in place or the funds to implement them. Some of these potential effects could be minimized if OMR was able to identify ways to conduct its regulatory activities in a more cost-effective manner.

- ***Increase SMARA Revenue.*** As proposed by the Governor, the Legislature could increase the amount of federal mining royalties that go to SMARA. Absent this change, these revenues would be used to fund K-14 education. Therefore, this approach would reduce the amount of funding provided to school and community college districts below what would have otherwise occurred.

- ***Increase RRIF Revenue.*** The Legislature could increase the amount of federal geothermal lease revenue that goes to the RRIF. This option would reduce the amount of funding going to local governments and/or the California Energy Commission for various geothermal development activities.

- ***Increase MRA Revenue.*** The Legislature could increase the total amount of annual reporting fees collected from mine operators. This option would increase the amount of reporting fees paid by mine operators.

MRA Is Most Appropriate Funding Source to Address Deficit. In our view, state regulatory activities should generally be funded with revenues from fees paid by the regulated industry. The MRA is funded from reporting fees paid by mine operations and these funds must be used to administer the state's mining regulations, including reclamation plan and financial assurance review, mine inspection, and enforcement. Therefore, in our view, the mine reporting fees are the most appropriate funding source for funding the department's regulatory activities related to the Act.

Relying on MRA Would Require Raising Caps. Currently, nearly all mine operators are paying the maximum individual reporting fee. Therefore, in order to generate a significant amount of additional revenue, the Legislature would need to raise or eliminate the maximum individual reporting fee. However, the existing cap on *total* revenue would only allow the department to collect an additional $1 million in revenue—less than what is needed to fully address the $2 million deficit. If the Legislature wishes to use MRA funds to fully address the deficit, it would also need to increase or eliminate the cap on total reporting fee revenue. Increasing mine reporting fees to address the entire structural deficit would increase the total amount of fee revenue by more than 50 percent—almost all of which would likely be paid by mine operators who are currently paying the maximum individual reporting fee (currently $5,000). The effect on any individual mine operator would depend on two main factors: (1) how much the Legislature increased the cap and (2) the details of how the department adjusted the fee schedule for individual mine operators.

LAO Recommendation

Reject Governor's Proposal and Use MRA to Address Deficit. To address the structural deficit, we recommend that the Legislature reject the Governor's proposal to increase revenues to SMARA because we consider the MRA the more appropriate source of funding for addressing the deficit. We recommend the Legislature increase the level of mine reporting fees collected and deposited into the MRA. If the Legislature were to adopt such an approach, it would require a more than 50 percent increase in total mine reporting fee revenue. To generate enough revenue to fully address the deficit, the Legislature would need to: (1) raise (or eliminate) the cap on individual mine reporting fees and (2) raise to at least $5.5 million (or eliminate) the cap on total revenue collected from mine reporting fees. If the Legislature were concerned about the effects of an immediate increase of more than 50 percent on the financial viability of mine operators, it could consider phasing in the fee increases over a few years and temporarily increasing SMARA or RRIF revenue to maintain solvency.

The Legislature may also want to take the opportunity to examine more broadly how DOC's regulatory activities are funded. This includes considering the degree to which federal mining and geothermal revenues should continue to fund state mining regulatory activities versus exclusively relying on regulatory mine reporting fees. While exclusively relying on mine reporting fees would further increase the total amount of mine reporting fees paid, it would also free up federal mining and geothermal revenues for other state priorities.

DEPARTMENT OF RESOURCES RECYCLING AND RECOVERY

The Department of Resources Recycling and Recovery (CalRecycle) regulates solid waste facilities (including landfills) and manages the recycling of various materials, such as beverage containers, electronic waste, tires, and used oil. The department also promotes waste diversion practices, such as source reduction, composting, and reuse. The Governor's budget proposes $1.5 billion from various funds for support of CalRecycle in 2015-16. This is about the same level as current-year estimated expenditures.

Implementation of New Single-Use Carryout Bag Law

Background. Beginning July 1, 2015, Chapter 850, Statutes of 2014 (SB 270, Padilla), prohibits stores from providing single-use carryout plastic bags to customers. Stores may sell reusable grocery bags that are made by a certified reusable grocery bag producer and that meet specified requirements with regard to the bag's durability, material, labeling, heavy metal content, and recycled material content. Chapter 850 requires CalRecycle to perform several activities, including: (1) establish and maintain a system for certifications of reusable bags, (2) develop and maintain a web page to post the certifications and re-certifications, (3) develop a fee schedule to charge reusable bag manufacturers for the costs of reviewing proofs of certification, (4) establish the Reusable Grocery Bag Fund to deposit certification fees, (5) provide $2 million in loans from the Recycling Market Development Zone Loan Subaccount to manufacturers of reusable bags, and (6) submit a report to the Legislature by March 1, 2018 on the implementation of the law.

Governor's Proposal. The Governor's budget proposes $268,000 in 2015-16, $264,000 in 2017-18, and $180,000 ongoing from the Integrated Waste Management Account to support one limited-term and two ongoing positions, in order for CalRecycle to implement the provisions of Chapter 850.

Proposed Referendum. In January 2014, opponents of Chapter 850 submitted signatures to county election offices in an effort to qualify a voter referendum seeking to repeal the law. At the time this analysis was prepared, it was unclear whether the referendum would qualify, something that should be determined by early spring 2015. However, if enough signatures are found to be valid, most provisions of the law would be suspended until the outcome of the referendum was determined at the November 2016 statewide election. Therefore, should the referendum qualify for the ballot, CalRecycle would not require any of the resources requested until at least 2016-17, and should the voters reject the proposed law, it would not be implemented at all.

LAO Recommendation. We find that the requested resources are reasonable to implement the provisions of Chapter 850 should the referendum effort fail. However, we recommend that the Legislature reject the budget proposal if the Secretary of State determines that the referendum qualifies for the November 2016 ballot because the provisions of Chapter 850 would no longer be implemented in the budget year.

AIR RESOURCES BOARD

In California, air quality regulation is divided between the ARB and 35 local air quality management districts. The local air districts manage the regulation of stationary sources of pollution (such as industrial facilities) and prepare local implementation plans to achieve compliance with the federal Clean Air Act. The ARB is responsible primarily for the regulation of mobile sources of pollution (such as automobiles) and for the review of local district programs and plans. Historically, the ARB's regulations focused on emissions that affect local or regional air quality, such as particulate matter and ozone-forming emissions. More recently, the ARB also began overseeing the state's efforts to reduce GHG emissions. The Governor's budget proposes $582 million for ARB in 2015-16, a net decrease of $266 million (31 percent) compared to estimated expenditures in the current year. This year-over-year decrease is largely the result of a one-time $240 million appropriation of Proposition 1B bond funds for port modernization that was included in the 2014-15 budget.

Southern California Consolidation Project

Background

Mobile Source Regulations. Mobile sources, such as automobiles, are a large portion of the state's overall emissions. For example, 83 percent of statewide nitrogen oxide emissions—a major contributor to ground-level ozone—come from mobile sources. Under the federal Clean Air Act, California is authorized to adopt motor vehicle emissions standards that are more stringent than the federal standards. While California has made progress in reducing air pollution in recent years, it still faces significant air quality challenges. For example, the federal government has designated two of the state's air districts—the South Coast and the San Joaquin Valley—as the two areas with the highest ozone concentrations in the nation. These districts are required to achieve the most stringent federal ozone standards by 2031.

As part of ARB's mobile source regulatory activities, it administers emissions testing and research activities that are used for such things as developing regulations, researching new emission control technologies and vehicles, evaluating the effects of different fuels on engine emissions, and developing methods for measuring emissions.

Existing Southern California Testing and Research Facilities. Most of the ARB's mobile emission testing and research occurs at facilities in Southern California. The state-owned Haagen-Smit Laboratory (HSL), located in El Monte and built in 1971, is ARB's primary testing and research facility. The state also leases five buildings adjacent to the HSL for additional testing and office space. In addition, ARB currently conducts heavy-duty testing—such as testing of large diesel truck emissions—at the Metropolitan Transit Authority (MTA) facility about ten miles away in Los Angeles. The various testing facilities use specialized equipment, such as dynamometers (equipment used to simulate road conditions) and chambers specifically designed to measure emissions from vehicles and other engines (known as Sealed Housing for Evaporative Determinations, or SHEDs). Staff at these various facilities conduct vehicle testing, laboratory analysis, regulatory development, and enforcement activities.

Governor's Proposal

Consolidation of Existing Southern California Testing and Research Facilities. The administration proposes to consolidate and relocate the existing Southern California testing and research facilities. The exact location of the property for this project is unclear, but the administration indicates that it expects that the new facility would be located on a piece of state-owned land in Pomona. The ARB is considering various possible sites, including land owned by the California State University, Pomona and the site of the recently closed Lanterman Developmental Center. According to the administration, the existing Southern California facilities do not meet current and future emission testing needs. Some of the main concerns include:

- The MTA facility is too small to meet heavy-duty testing needs.
- The HSL property is too small and cannot be adapted to accommodate the equipment needed for current and future testing operations.
- Some of the equipment at the HSL has reached the end of its service life and will need to be replaced soon.
- The distance that staff have to travel between the MTA facility in Los Angeles and the El Monte facilities result in inefficiencies.

As shown in Figure 17, the administration is proposing to more than double the amount of

Figure 17

Size Comparison of Existing and Proposed Air Resources Board Testing and Research Facilities

Thousand Square Feet

	Existing Facilities	Proposed Facilities	Percent Change
Testing facilities	50	160	222%
Chemistry laboratory	17	48	177
Offices	55	73	32
Administrative services	10	18	84
Total Building Space	**132**	**299**	**127%**
Parking and outside facilities	58	311	440%
Total Space	**190**	**610**	**222%**

building space and triple the amount of total space (including parking). The new facility would include testing centers, a chemistry laboratory, offices, space for administrative services (such as receiving and shipping and storage areas) and a parking structure. The administration proposes to use a design-build procurement process for this project.

Requests $5.9 Million to Evaluate Site and Develop Performance Criteria. The administration requests a total of $5.9 million in 2015-16 to assess the suitability of a proposed new site ($200,000) and develop performance criteria ($5.7 million). The administration will use the performance criteria to develop documents that will then be used to solicit bids. Funding for these activities would be supported by $3.8 million from the Motor Vehicle Account (MVA), $1.2 million from the Air Pollution Control Fund (APCF), and $900,000 from the Vehicle Inspection Repair Fund (VIRF). These three funds are currently used to support the operations of the existing facilities. After the performance criteria have been approved by the Public Works Board, the administration plans to proceed to bid in mid-2016, award a contract in mid-2017, and complete the project by early 2020.

The total cost of this project is estimated to be $366 million. This amount includes (1) $5.9 million for site evaluation and development of performance criteria (as proposed in the Governor's budget), (2) $258 million in other planning and construction costs, and (3) $102 million for equipment. The administration indicates that it intends to use the same fund sources that are currently used to fund the operations of the existing facilities. The proposal does not identify future ongoing operating costs for the new facility.

LAO Assessment

Given the state's regulatory authority over mobile sources of emissions and continuing significant air quality challenges in certain parts of the state, a significant amount of mobile emission testing and research activities will likely continue into the future. In addition, given the current condition and size of ARB's existing facilities and equipment, at least a portion of the existing Southern California facilities will likely need to be renovated, upgraded, or replaced in the coming years. While the administration's proposal could potentially be the preferred approach to addressing ARB's future air quality regulatory needs, we find that the administration's proposal lacks several critical components. Specifically, the proposal lacks (1) a clear justification for the size and scope of the project, (2) a complete analysis of alternatives, and (3) a clear strategy for long term funding. In our view, at a minimum, the administration should address these issues before the Legislature considers approving such a project—particularly one of this size, scope, and cost. In addition, the administration has not provided an adequate justification for the $5.9 million cost estimate for site evaluation and developing performance criteria. We discuss each of these issues in more detail below.

No Clear Justification for the Size and Scope of the Project. While the administration identifies a wide variety of future testing and research activities that will be conducted as vehicles and fuels evolve, it has not provided a clear analysis of future workload that justifies the size and scope of the proposed project. For example, the administration's proposal includes three chassis dynamometers to conduct over 860 heavy-duty tests per year beginning in 2020. However, it is unclear how the administration arrived at an estimate of 860 tests. Furthermore, the proposed project is scheduled to be completed in 2020, but the administration does not provide estimates of the future workload and needs beyond 2020. As a result, it is difficult to evaluate whether the size and scope of the proposed project is appropriate.

Lack of Complete Analysis of Alternatives. To the extent possible, the Legislature should have a clear understanding of the advantages and disadvantages—including the net fiscal effects—of reasonable options prior to moving forward with capital outlay projects. While the ARB's proposal includes a limited discussion of some alternatives, in our view, the administration does not provide an adequate analysis of these alternatives. For example, at the time of this analysis, the administration had not provided an analysis of renovating the HSL and building or leasing a separate space that could accommodate additional testing needs.

No Clear Strategy for Long term Project Funding. In our view, prior to moving forward with a project, the Legislature should have a clear understanding of how the project will be funded in the long term. The administration has not provided a long term funding plan for this project. The $5.9 million to evaluate a potential site and develop performance criteria would be funded from the MVA, the APCF, and the VIRF. According to the administration, it also intends to rely on these three funds—in roughly the same proportion—to pay for the debt-service on the bonds that will be issued to fund the construction and equipment. If the bonds were repaid over a 25-year period at a 5 percent interest rate, the annual debt-service payments would be about $26 million. If the annual debt-service payments were divided in roughly the same proportion as the current funding amounts, the annual costs would be as follows: $17 million from the MVA, $5 million from the APCF, and $4 million from the VIRF. It is currently unclear whether these funds could support the additional costs in the long term. For example, the Governor's budget includes other proposals to use the MVA for capital outlay projects that would increase cost pressures on the fund. If the administration intends to use the three existing fund sources, it should provide (1) a description of how the project costs will affect the long term condition of these funds and (2) if the additional costs are found to jeopardize the solvency of the fund condition, what programmatic reductions or revenue increases would be needed to maintain solvency.

No Adequate Justification for $5.9 Million Cost Estimate. At the time of this analysis, the administration has not provided a detailed justification for the $5.9 million cost estimate for site evaluation and developing performance criteria. For example, the administration estimates that it will cost $1.1 million for project management activities. However, it is unclear how the administration developed such an estimate.

LAO Recommendation

Direct Administration to Provide Additional Information. In view of the above concerns, we recommend that the Legislature direct the administration to provide a more detailed analysis of the needed size and scope of the project, a more complete analysis of reasonable alternatives, more specific information about how the identified funds will support the long term project costs, and a more detailed justification for the $5.9 million cost estimate. Until the administration provides such information, we find that the proposal is premature.

Natural Gas Leakage

Background. Current law requires ARB to develop and maintain an inventory of GHG emissions. The GHG emission inventory is used to monitor California's progress in meeting the state's carbon emission reduction goals. Emission estimates rely on regional, state, and national data sources and facility-specific emissions data reported from large emitters.

Chapter 525, Statutes of 2014 (SB 1371, Leno), requires the CPUC, in consultation with ARB, to adopt rules and procedures governing the operation and maintenance of natural gas pipeline facilities in order to achieve two primary goals: (1) minimize safety concerns associated with leaks and (2) advance the state's goals of reducing GHGs. Among other things, these rules and procedures must:

- Provide for the maximum technologically feasible and cost-effective avoidance, reduction, and repair of leaks in gas pipelines.

- Establish procedures for the development of metrics to quantify and track the volume of emissions from leaking gas pipelines, which will then be incorporated into state emissions tracking systems, such as the ARB's GHG emission inventory.

- Require gas pipeline owners to report to CPUC and ARB an estimate of leaks from their pipelines—including data and methods used to estimate leakage—and periodically update this estimate.

The CPUC began a proceeding to develop these rules and procedures in January 2015.

Governor's Proposal. The ARB requests a total of $670,000 in 2015-16 from the Public Utilities Reimbursement Account to implement Chapter 525. This includes $370,000 annually for two positions, and a one-time allocation of $300,000 for contract funding to independently collect additional pipeline emission data and examine additional methods to estimate emissions. The requested positions would consult with the CPUC on its proceedings, analyze pipeline emission data, and help develop future regulations and policies related to pipeline emissions. (The Governor's budget provides $550,000 and four positions for CPUC to administer the proceeding and develop the rules and procedures.)

Inadequate Justification for ARB Resources. In our view, the administration has not adequately justified the need for additional ARB resources at this time. Our findings are based on the following factors:

- ***Chapter 525 Does Not Require ARB to Collect Additional Data.*** Chapter 525 requires CPUC, in consultation with ARB, to develop rules and procedures for utilities to measure and track pipeline emissions data, which will be provided to ARB to incorporate into its emissions inventory. It does not require ARB to collect additional data beyond what will be provided by the utilities.

- ***Premature to Request Resources to Analyze and Collect Additional Data.*** We find that the request for resources to collect and analyze emissions data is premature. The data that will be submitted by utilities should inform ARB's emissions inventory. If the ARB ultimately determines that the data—after it is submitted by the utilities—is insufficient for its purposes, it could then request additional resources for data collection. Additionally, it is unclear what the ongoing workload associated with analyzing utility data and incorporating it into the inventory is actually going to be until the new rules and procedures are finalized. Therefore, it is unclear what additional staff, if any, would be necessary for these purposes given that ARB currently has staff responsible for monitoring statewide GHG emissions.

- ***Need for Additional Position to Consult on Proceeding Is Unclear.*** While we recognize that assisting with CPUC will result in additional workload for the ARB, it is not clear that this additional workload will require one full-time position. Much of ARB's current activities involve coordination with other state agencies (including CPUC) on issues related to GHG emissions. We find that it would be reasonable for ARB to absorb this additional one-time workload with existing resources.

LAO Recommendation—Reject ARB Request. We recommend the Legislature reject the ARB request for funding and positions. The request for resources and positions to collect additional leakage data and analyze the new pipeline emissions data is premature. After the data is submitted, if the ARB determines that the data provided by utilities is inadequate or requires a significant additional analysis, the ARB can request additional resources at that time. In addition, it is not clear that the additional workload to assist CPUC on the proceeding requires additional position authority.

PUBLIC UTILITIES COMMISSION

The CPUC regulates privately owned electric, natural gas, telecommunications, water, railroad, rail transit, and passenger transportation companies. The CPUC's mission is to ensure that regulated utilities provide safe and reliable services at affordable rates. In addition to its regulatory activities, the CPUC also administers programs that provide subsidized utility services to certain underserved populations and support research and development activities. The Governor's budget proposes $1.5 billion for CPUC in 2015-16, a net increase of $192 million (14 percent) compared to estimated expenditures in the current year. This year-over-year increase is largely the result of increased costs for telecommunications programs for underserved populations.

Zero Based Budget (ZBB)

Background

Recent Legislative Concerns About CPUC's Operations. In recent years, several incidents and reviews led to legislative concerns about CPUC's operations. For example, in 2010, a gas transmission pipeline owned and operated by Pacific Gas and Electric (PG&E) ruptured in San Bruno, killing eight people and injuring many more. A federal investigation found that CPUC—the state entity responsible for regulating PG&E—failed to detect deficiencies in PG&E's pipeline management program. In addition, a December 2012 audit conducted by the Office of State Audits and Evaluations at the DOF identified significant weaknesses with CPUC's budget operations. Some of the deficiencies identified were ineffective assignment of budget duties, insufficient staff training, and inadequate fund balance reconciliations.

Legislature Requires CPUC to Provide ZBB. In response to these concerns, the Legislature approved budget-related legislation in 2013 (Chapter 356, Statutes of 2013 [SB 96, Committee on Budget and Fiscal Review]), which included a requirement that CPUC conduct a ZBB for all of its programs by January 10, 2015.

What Is a ZBB? Generally, the term ZBB refers to a system of budgetary review that requires analytical justification for each program or activity proposed in the budget. In contrast to typical budgeting practice, ZBB involves review and approval of part or all of an organization's budget, rather than just the incremental, year-over-year changes. In practice, ZBBs have evolved over time and currently take many different forms. Some of the different forms or alternatives used by governments include:

- ***Standard ZBBs.*** Under standard ZBBs, agencies are divided into decision units (such as a division). Each unit identifies many different "decision packages," each of which identifies a specific program or service level, as well as the level of funding needed to support that program or service level. For example, one decision package might identify the amount of funding necessary to provide a sufficient number of pipeline inspectors to meet minimum statutory or regulatory requirements. Other decision packages might identify funding necessary for additional inspectors to perform more frequent inspections. Each decision unit then ranks decision packages based on organizational priorities. A budget control agency, such as the DOF, then uses those rankings to develop a proposed budget. Generally, standard ZBBs are used to help clarify: (1) the minimum level of funding needed to continue to operate a program and (2) the trade-offs between additional funding levels and service levels. Standard ZBBs are very rare, primarily because they are extremely time-consuming.

- ***Zero Line-Item Budgeting.*** The method that most people envision when they think of ZBBs is zero line-item budgeting. Agencies are required to rebuild their budgets from the ground up, justifying each spending item, including a detailed analysis of the level of inputs (such as staff time) needed to produce a given level of output (such as frequency of inspections). It attempts to identify the minimum level of resources needed to provide a given service level. For example, a department might be required to analyze the minimum number of positions needed to process a given number of claims or inspect a certain distance of train tracks. Zero-line item budgets tend to focus on the minimum amount of resources needed to operate a program.

- ***Alternative Budgeting.*** Alternative budgeting is a simplified version of standard ZBBs that involves less time and effort. Agencies are directed to develop budget scenarios based on specific amounts relative to their existing funding levels (for example, 90 percent and 110 percent of existing funding). The agencies then analyze the effects each of those spending levels would have on their programs and levels of service. Relative to standard ZBBs and zero-line item budgeting, there is less emphasis on determining the minimum level of funding needed for the program to continue to operate. Rather, the emphasis is on clarifying the trade-offs between different funding levels and services.

- ***Periodic Agency Review.*** Periodic agency reviews are a planning method that is sometimes used as an alternative to ZBBs. Periodic agency reviews are conducted every several years and they are generally used when policy-makers want to examine the overall mission and level of services being provided by the agency. These typically include a comprehensive review of the agency's mission, legal requirements, organizational charts, and whether the agency's allocation of resources reflects its mission and priorities. The goal might be to eliminate programs or activities that are not central to the core mission of the agency.

In practice, there is often not a clear line that distinguishes these different forms of budgeting and planning. Governments might use a combination of these approaches. The method is generally driven by the types of questions being asked.

ZBBs Intended to Analyze Government Activities and Spending. Governments have different motivations for using ZBBs. For example, they may develop ZBBs with the goal of eliminating ineffective programs; reallocating resources from lower priority to higher priority activities; or simply fostering discussion of an agency's key challenges, mission, and priorities. While the goals and methods for ZBBs might differ, ZBBs generally share at least one common characteristic: an analysis of government activities, resources, and priorities that can inform decisions about how to allocate resources more effectively and efficiently.

CPUC Budget Report

Provides Description of Commission's Requirements, Activities, and Resources. In January 2015, the CPUC submitted a document to the Legislature entitled "Informational Zero-Based Budget to Provide Transparency Into Operations of the California Public Utilities Commission." This budget report describes: (1) CPUC's statutory requirements and regulatory authority, (2) the types of activities it conducts to fulfill its responsibilities, and (3) the current level of resources allocated to these different types of activities.

The report is generally organized by regulated industry, rather than by CPUC's different divisions. For example, the energy section of the report describes the requirements, activities, and resources related to the regulation of energy utilities (such as electricity and natural gas). This includes estimates of staff resources devoted to energy regulation activities that come from other divisions within the CPUC, including the Division of Administrative Law Judges and the Safety and Enforcement Division. The number of positions from each division that are assigned to a particular industry area is based on an estimate of the proportion of time those staff devote to activities related to that industry. For each industry area, the report also includes a further breakdown of staff by activity within each industry. For example, out of the 312 positions in the energy industry, 62 are assigned to work on issues related to electric power procurement and generation, including 12 assigned to work on renewable portfolio standard implementation. Figure 18 provides an overview of CPUC's authorized positions in 2014-15, by industry area.

Figure 18

CPUC Authorized Positions by Industry Area

2014-15

	Positions	Percent of Total
Energy	312	29%
Administration	207	19
Office of Ratepayer Advocates	162	15
Rail and transit	112	10
Communications (regulation)	82	8
Customer service	69	6
Transportation carriers	48	4
Water	41	4
Universal service communications programs	38	4
Totals	**1,071**	**100%**

CPUC = California Public Utilities Commission.

Overall, the report describes the total CPUC budget of $1.3 billion in 2014-15. Of this amount, about $1 billion (77 percent) is local assistance. These funds are spent for on programs for low-income residents, energy efficiency programs, and research programs. The remaining $307 million (23 percent) is used for state operations. Energy ($691 million) and telecommunications ($543 million) are the industry areas with the most funding. Most of the funding for the energy industry is related to the natural gas surcharge ($586 million)—revenue collected from natural gas users that is used to fund utility programs such as low-income assistance, energy efficiency, and research and development. Most of the funding for telecommunications ($526 million) is for local assistance and operating expenses associated with programs that provide subsidies for services to underserved populations and areas.

CPUC Findings. Based on the report, the CPUC makes several conclusions about its current activities and the level of resources allocated to these activities. Such conclusions include:

- Areas with significant levels of staff resources (such as safety activities, energy efficiency, and renewable portfolio standard efforts) "make sense" in light of state policy priorities.

- A relatively low number of staff were assigned to electricity and natural gas ratemaking activities. As a result, CPUC shifted resources to ratemaking activities from other program areas where it determined there would be no negative impact on program outcomes. (This resource shift is not reflected in the report.)

- The state might want to consider how shared responsibilities are allocated between agencies. For example, there might be opportunities to move some of its current regulatory responsibilities, including transportation licensing and enforcement activities and energy efficiency program oversight, to other state agencies.

LAO Assessment

Report Offers Insight Into Breadth of CPUC Responsibilities and Activities. The report generally answers the following questions:

- What are CPUC's legal requirements and responsibilities?

- What types of activities does the commission conduct to fulfill its responsibilities?

- How many resources are allocated to the different types of activities?

Given the breadth of responsibilities and activities within CPUC, such information can help the Legislature better understand what CPUC does and how many resources it has devoted to various activities. For example, someone interested in CPUC activities related to electric power procurement and generation—such as the state's renewable portfolio standard—could use the report to learn more about CPUC's regulatory authority and how many staff are assigned to different types of activities related to oversight of electric procurement and generation.

Report Lacks Analysis of Activities and Resources. Based on our understanding of the various types of ZBBs, the CPUC report is not a ZBB. As discussed above, a common goal of most ZBBs is to encourage government agencies to analyze their existing resources in an effort to determine whether resources could be deployed in a more efficient and cost-effective manner. While the report includes a *description* of current activities and resources, it lacks a comprehensive *analysis* of these activities and resources. The report does not provide an analysis of the minimum level of funding needed to achieve current service levels or an analysis of the degree to which having higher or lower funding levels would affect the amount or quality of services provided. Without such an analysis, the report provides relatively little information to inform the Legislature about potential changes to the level or distribution of resources provided to CPUC.

Basis for CPUC Findings Is Unclear. In the few instances where the CPUC concludes that existing resources are either adequate or inadequate, the basis for these findings is unclear. For example, the CPUC found that the number of staff working on ratemaking activities was too low and determined that resources needed to be shifted from other activities. However, the CPUC does not provide an analysis of the minimum amount of staff time needed to perform different ratemaking activities and, therefore, it is still unclear whether the current level of staffing for these activities is appropriate. Furthermore, to address the perceived staffing shortfall, the CPUC shifted resources from other program areas where it determined that resources could be spared without negative impacts on program outcomes. It is unclear how CPUC determined that such a shift would have no negative impact on program outcomes.

The basis for CPUC's finding that staffing levels for certain activities, such as energy efficiency and renewable portfolio standards, make sense in light of state public policy priorities is also unclear. First, the CPUC does not provide an analysis of the optimal level of resources needed to conduct the activities related to these programs. Second, while these activities may be state priorities, the Legislature may have other priorities that are of equal or greater priority. Without an analysis of the levels of resources needed to perform different activities, the report provides limited information that can be used to determine whether the existing resource allocations are appropriate or if an alternative level or distribution of resources could achieve greater benefits.

Issues for Legislative Consideration

The report includes a significant amount of descriptive information about CPUC's current operations and activities, but very little analysis of current resources and activities. The Legislature will need to determine what, if any, additional analysis it wants. The Legislature may want to consider some of the following issues when weighing its different options.

Be Clear About Goals and Expectations. Chapter 356 did not include detail about the Legislature's goals and expectations for the ZBB. If, going forward, the Legislature wants CPUC to provide additional information or analysis, it would be helpful to provide more specific guidance on its goals and expectations. Some potential goals include: (1) identifying the minimum level of funding needed to conduct current activities, (2) identifying different options for funding and service levels, or (3) determining whether CPUC's current activities and resources are in line with its core mission and priorities.

Goals and Expectations Should Drive Additional Direction to CPUC. If the Legislature determines that it would like additional analysis or information, its goals and expectations should help inform what *type* of additional analysis or information it needs. For example, the Legislature could provide the following types of direction:

- ***Identify Minimum Funding Levels Needed for Current Activities.*** If the Legislature is most interested in identifying the minimum level of funding needed for CPUC to maintain its current level of services, it could require something similar to a zero line-item budget. For example, for each activity conducted at the CPUC, the Legislature could require a detailed description of the workload associated with those activities and an estimate of the number of personnel staff hours needed to complete each activity. Such an analysis could be used to determine the minimum staffing levels needed for CPUC to perform its existing level of services.

- ***Identify Trade-Offs Between Funding Levels and Service Levels.*** If the Legislature wants to better understand the trade-offs associated with different funding levels, it could require something similar to an alternative budgeting analysis. For example, the Legislature could require the CPUC to develop a budget at four different funding levels—80 percent, 90 percent, 100 percent, and 110 percent of current funding. At each level of funding, the CPUC could describe the level of services that CPUC would provide. Service levels could be the proportion of underserved populations that obtain telephone service as a result of subsidies or the miles of rail track inspected each year.

- ***Identifying Whether Current Activities Support the Core Mission.*** If the Legislature is interested in examining how the agencies' current activities and resource allocations reflect its core mission, it could require something similar to a periodic agency review. For example, the Legislature could require the CPUC to assess the degree to which each activity or position supports its core mission and priorities. Such an analysis would not have a budgetary focus. However, it could help inform potential legislative actions to streamline government operations by reducing, eliminating, or transferring activities that are less aligned with the CPUC's core mission.

Weigh Expected Benefits and Costs. The Legislature will want to weigh the expected benefits and costs of requiring additional analyses of CPUC activities. In theory, the benefits of further analyses could be significant if it results in changes that improve efficiency or better aligns CPUC activities with its mission and legislative goals. In practice, however, the benefits would depend on the quality of the analysis produced. The quality of the analysis could be affected by many different factors, including the availability of reliable data and what entity is conducting the analysis, as discussed in more detail below.

Depending on the scope and type of analysis required, the costs of additional analysis also could be significant. To minimize some of these costs, the Legislature may want to consider requiring more focused analyses limited to specific parts of the CPUC that are of greatest interest or concern. For example, it could require a ZBB-type analysis for the energy area, which has the largest number of positions. It could also require an analysis of resources devoted to ratemaking activities—an area that the CPUC identified as being understaffed. This would allow the Legislature to evaluate the degree to which the CPUC's activities and resource allocations reflect legislative goals. The Legislature could then require further analyses of other areas of CPUC based on its interests, as well as its determination that the benefits of additional analyses were likely to outweigh the costs.

Consider Appropriate Entity to Conduct Analysis. If the Legislature determines it would like further analysis of CPUC activities, it should consider which entity is best suited to conduct the analysis. The appropriate entity will depend on many factors, including the type of analysis being conducted and the degree to which any potential entity is committed to conducting a critical analysis. If, for example, the Legislature is interested in better understanding how the CPUC can better prioritize its existing resources to achieve its core mission, the CPUC may share a similar goal and might be more likely to provide a meaningful analysis. On the other hand, if the CPUC is not committed to the same goals, then the analysis produced will likely have less value. For example, if the Legislature's goal is to reduce the CPUC's budget, then the CPUC is likely to have little incentive to provide a critical analysis of its workload and the minimum staffing levels needed. In that case, the Legislature could have an outside entity conduct the analysis.

SUMMARY OF RECOMMENDATIONS

Issue	Governor's Proposal	LAO Recommendation
Crosscutting Issues		
Cap-and-trade	Cap-and-trade auction revenue estimates of $650 million in 2014-15 and $1 billion in 2015-16. Expenditures for several programs consistent with the framework adopted in the 2014-15 budget.	Consider various options for allocating additional auction revenues, including reserving the funds for future years, expanding existing programs, or funding new programs. Spending strategy should attempt to maximize net benefits based on legislative priorities and certain other factors.
Drought response	Several proposals totaling $115 million in one-time funds across five departments for drought-related activities.	Withhold recommendation until better information on water conditions are known in Spring. Approve trailer bill legislation requiring administration to complete report on programmatic changes to water system that would improve state's drought resilience.
Department of Water Resources (DWR)		
Proposition 1E—Flood protection	$1.1 billion (nearly all from Proposition 1E) to support various flood control activities. Would appropriate all remaining Proposition 1E funds. Allows DWR ten years to expend funds and to shift funds between state operations, local assistance, and capital outlay projects.	Fund specific projects with Proposition 1E funds in 2015-16 and 2016-17 and adopt pay-as-you-go mechanism to fund projects beginning in 2017-18. Also, require report at budget hearings on key obstacles to timely completion of projects.
Department of Fish and Wildlife (DFW)		
Payment in lieu of taxes (PILT) to counties	$644,000 from the General Fund to resume PILT payments to local governments to offset lost property tax revenues that would otherwise be collected if wildlife management area properties were not state owned.	Weigh the potential benefit of PILT to counties against other General Fund priorities, as well as whether PILT payments should be made for certain DFW lands but no other state properties.
Natural Resources Agency		
Environmental Licence Plate Fund (ELPF) shortfall	Address ELPF deficit of $4.9 million in 2014-15 and $11.5 million in 2015-16, mainly by (1) postponing some one-time activites, (2) shifting some expenditures to other special funds, (3) setting a 5 percent savings target for departments, and (4) increasing the personalized license plate fee by about 5 percent.	Consider proposed approach and other options to address shortfall based on legislative priorities for where Legislature wants spending reductions or fee increases to be borne. Also require the administration to provide more detailed ELPF spending information at budget hearings and in future budgets. Reevaluate ongoing spending priorities for the ELPF in statute to ensure the best use of this fund given the structural deficit.
Marine protected area monitoring	$2.5 million (one-time) from Proposition 84 bond funds to support the first round of post-baseline monitoring of ecosystems in the North Central Coast region.	Reject Governor's proposal to use bond funds. Instead, choose a more appropriate funding source for an ongoing operational activity.

Department of Forestry and Fire Protection (CalFire)		
Helicopter replacement	Budget bill language allowing CalFire and the Department of General Services to begin the procurement process to replace CalFire's helicopter fleet.	Withhold action and require CalFire to provide information at budget hearings on desired specifications; cost estimates for helicopters, staff training, personnel, and capital outlay; and the planned procurement schedule. If not provided, we recommend rejecting the proposed language.
California Conservation Corps		
Tahoe Base Center: equipment storage facility	$2.5 million from lease revenue bonds to establish consolidated storage facility to serve the Tahoe Base Center.	Reject proposal because unclear that additional storage is needed, and would result in greater costs than continuing to use existing storage facilities.
Department of Conservation		
Surface mining regulation	Address a structural deficit by increasing by $2 million the amount of state revenue from federal mining royalties used to fund surface mining regulatory activities.	Reject Governor's proposal and increase mine reporting fees to address the structural deficit.
Department of Resources Recycling and Recovery (CalRecycle)		
Implementation of new single-use carryout bag law	$268,000 from the Integrated Waste Management Account for several activities related to recent law prohibiting stores from providing single-use plastic bags and requiring CalRecycle to certify reusable grocery bags.	Reject proposal if the Secretary of State determines that proposed referendum qualifies for ballot because most provisions would no longer be implemented in the budget year. If referendum does not qualify, we find that the requested resources are reasonable.
Air Resources Board (ARB)		
Southern California Consolidation Project	$5.9 million in 2015-16 from three special funds for site assessment and development of performance criteria for a new mobile emissions testing and research facility.	Direct the administration to provide: (1) detailed analysis of project's needed size and scope, (2) detailed analysis of reasonable alternatives, (3) long-term funding plan, and (4) justification for the $5.9 million cost estimate.
Natural gas leakage	$670,000 in 2015-16 from Public Utilities Reimbursement Account for activities related to recent law aimed at reducing and monitoring natural gas pipeline leakage.	Reject the ARB request because (1) resources requested to collect and analyze leakage data is premature, and (2) it is not clear that the additional workload to assist CPUC on the proceeding requires additional position.
California Public Utilities Commission (CPUC)		
Zero-based budget (ZBB)	CPUC report providing description of its requirements, activities, and resources.	Review report to better understand breadth of CPUC responsibilities and activities, but consider that it lacks analysis usually associated with ZBBs. If Legislature wants additional analysis of CPUC activities and resources, it should make clear its goals and expectations, consider the benefits and costs of additional analyses, and identify appropriate entity to conduct the analysis.

Contact Information

Ashley Ames	Natural Resources, Forestry, Recycling	319-8352	Ashley.Ames@lao.ca.gov
Ross Brown	Cap-and-Trade, Air Quality, Conservation, Utilities	319-8345	Ross.Brown@lao.ca.gov
Virginia Early	Wildlife, Conservation Corps	319-8309	Virginia.Early@lao.ca.gov
Anton Favorini-Csorba	Water	319-8336	Anton.Favorini-Csorba@lao.ca.gov

LAO Publications

This report was reviewed by Brian Brown. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

To request publications call (916) 445-4656. This report and others, as well as an e-mail subscription service, are available on the LAO's website at www.lao.ca.gov. The LAO is located at 925 L Street, Suite 1000, Sacramento, CA 95814.