AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 3 RESOURCES AND TRANSPORTATION

ASSEMBLYMEMBER RICHARD BLOOM, CHAIR

WEDNESDAY, MARCH 19, 2014
9:00 A.M. - STATE CAPITOL ROOM 447

ITEMS TO BE HEARD

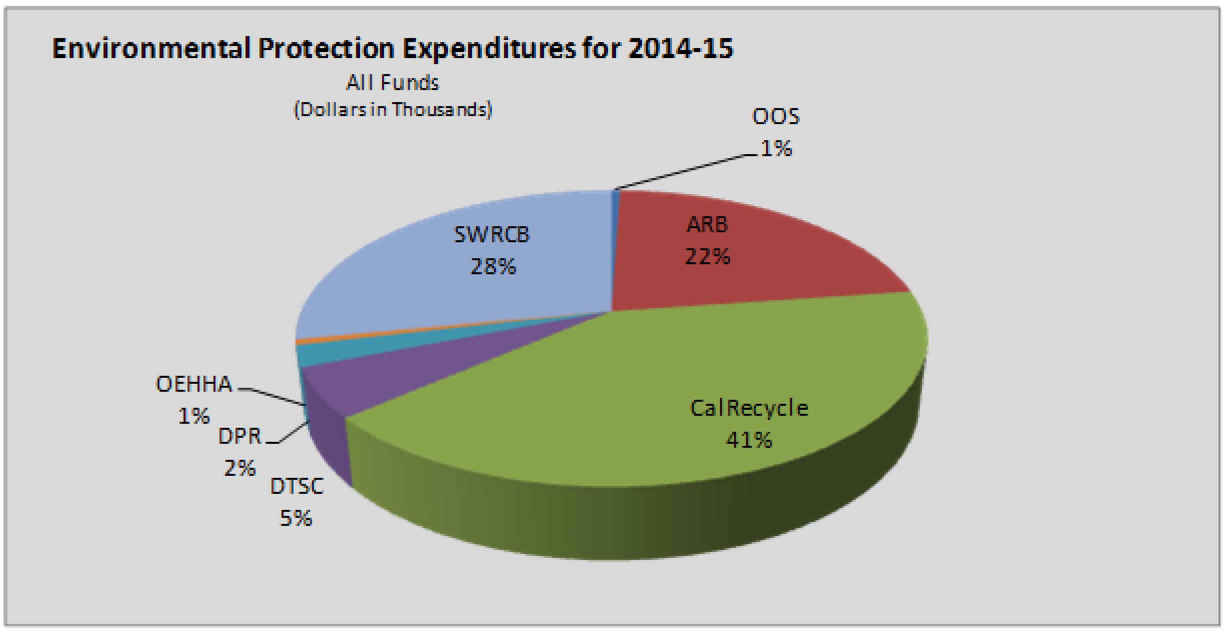
ITEM	DESCRIPTION	
0555	SECRETARY FOR ENVIRONMENTAL PROTECTION AGENCY – BUDGET OVERVIEW	1
VARIOUS	CAP-AND-TRADE EXPENDITURE PLAN	2

ITEMS TO BE HEARD

SECRETARY FOR ENVIRONMENTAL PROTECTION AGENCY – BUDGET OVERVIEW

California Environmental Protection Agency programs restore and protect environmental quality, and protect public health. The Secretary coordinates the State's environmental regulatory programs and ensures fair and consistent enforcement of environmental law, which safeguards the State's residents and promote the state's economic vitality.

The Governor's Budget proposes $3.6 billion ($54 million General Fund, $3.5 billion other funds) and 5,490.2 positions for the California Environmental Protection Agency (Cal/EPA) boards, departments, and offices. Secretary Matt Rodiquez will give an overview of the Environmental Protection Agency's budget.



CAP-AND-TRADE EXPENDITURE PLAN

The Governor's Budget proposes to invest $850 million of cap-and-trade auction proceeds to support existing and pilot programs that will "promote GHG reductions and meet SB 535 goals." This amount includes the repayment of $100 million that was loaned to the General Fund in 2013-14.

PANELISTS

- Department of Finance, Matt Almy, Assistant Program Budget Manager
- California Air Resources Board, Mary Nichols, Chairman
- California State Transportation Agency, Brian Kelly, Secretary
- Legislative Analyst's Office, Tiffany Roberts, Senior Fiscal & Policy Analyst – Energy and Climate Change

BACKGROUND

The goal of the State's climate plan is to reduce greenhouse gas (GHG) emissions to 1990 levels by 2020. The cap-and-trade program is a key element in this plan. It sets a statewide limit or cap on the sources of GHGs and establishes a financial incentive for long‑term investments in cleaner fuels and more efficient energy use. Currently, GHG emissions from electricity and large industrial sources are subject to the cap. As part of its program, the California Air Resources Board (ARB) will allocate free allowances to the State's large industrial emitters as well as the State's electric utilities in order to reduce the economic impact of the cap-and-trade program. Based on the draft update to the AB 32 Scoping Plan, the cap-and-trade program will be responsible for approximately 30 percent of the required GHG emission reductions to meet the AB 32's 2020 goal.

The ARB has conducted six auctions since November 2012 of GHG emission allowances as part of the market-based compliance mechanism. These auctions resulted in approximately $663 million in proceeds to the state. The state plans to conduct quarterly auctions in 2014.

California's cap–and–trade program is expected to raise billions of dollars in auction revenues from 2012 through 2020. The actual amount of revenue that will be raised is difficult to predict, particularly because of the uncertainty about future allowance prices and the number of allowances that may be sold. Using ARB's floor and ceiling prices for allowances, and assuming that ARB provides 60 percent of all allowance for free, the total cap–and–trade revenues from all auctions through 2020 could range from $12 billion to $45 billion. According to the Legislative Analyst's Office (LAO), several economists who have evaluated California's cap–and–trade program have estimated that, over the life of the program, average allowance price may be in the $15 to $20 range. If this were to occur, total revenue for the program through 2020 could be roughly $15 billion.

SB 1018 (Budget and Fiscal Review), Chapter 39, Statutes of 2012, directed all monies collected by ARB from the auction to be deposited into the Greenhouse Gas Reduction Fund. AB 1532 (Pérez), Chapter 807, Statutes of 2012, directed the Department of Finance (DOF) to provide a three-year investment plan for auction proceeds in the May Revision, 2013. Further, SB 535 (De Leon), Chapter 830, Statutes of 2012, requires the investment plan to allocate a minimum of 25 percent of the available monies in the fund to projects that provide benefits to identified disadvantaged communities and a minimum of 10 percent of the available monies in the fund to projects located within identified disadvantaged communities.

Cap-and-Trade Expenditure Plan
(Dollars in Millions)

Activity	Department	Amount
High-Speed Rail (HSR)	High–Speed Rail Authority (HSRA)	$250
Low–Carbon Transportation	ARB	200
Sustainable Communities Grants	Strategic Growth Council (SGC)	100
Low–Income Home Energy Assistance Program	Department of Community Services and Development (CSD)	80
Intercity Rail Grants	Caltrans	50
Fire Prevention and Urban Forestry	Department of Forestry and Fire Protection (CalFIRE)	50
Wetlands Restoration	Department of Fish and Wildlife (DFW)	30
Waste Diversion	Department of Resources Recycling and Recovery (CalRecycle)	30
Energy Efficiency Upgrades In State Buildings	Department of General Services (DGS)	20
Reducing Agricultural Waste	Department of Food and Agriculture (CDFA)	20
Water Use Efficiency	Department of Water Resources (DWR)	20
Total		**$850**

The Governor's cap-and-trade expenditure plan aims to address "both near-term emission reductions and projects that support California's longer-term climate targets." The plan incorporates the categories of funding included in AB 1532, but further evaluation is needed to determine how effectively it meets the SB 535 goal of investment in identified disadvantaged communities. A more detailed accounting of cap-and-trade proposals follows:

- **High‐Speed Rail** — $250 million for the state high-speed rail (HSR) project. Funding will support construction of the initial operating section. This includes $58.6 million to continue environmental planning of the Phase 1 project extending from San Francisco to Anaheim, and $191.4 million for right-of-way acquisition and construction of the initial construction segment extending from Madera to near Bakersfield. The proposal anticipates a reduction of 4.3 million metric tons of CO_2 equivalents by 2030, with an additional one million CO_2 annually thereafter. Trailer bill language proposes that beginning in 2015-16, 33 percent of all GGRF revenues be continuously appropriated to the HSRA for the state's HSR project. Further, it specifies that the remaining $400 million General Fund loan be directed to HSRA.

- **Low-Carbon Transportation** — $200 million to ARB for grants to accelerate the transition to low carbon freight and passenger transportation, with a priority for disadvantaged communities. The ARB administers existing programs that provide rebates for zero‐emission cars and vouchers for hybrid and zero‐emission trucks and buses. This proposal will respond to increasing demand for these incentives, as well as provide incentives for the pre‐commercial demonstration of advanced freight technology to move cargo in California, which will benefit communities near freight hubs. The budget also proposes to spend $30 million from current-year proceeds for low-carbon transportation projects. This would reverse a $30 million loan from the Vehicle Inspection and Repair Fund approved in the current-year mainly for electric vehicle rebate programs.

- **Sustainable Communities Grants** — $100 million ($1 million state operations and $99 million local assistance) to support regions in the implementation of the sustainable communities strategies required by SB 375 (Steinberg), Chapter 728, Statutes of 2008, and to provide similar support to other areas with GHG reduction policies, but not subject to SB 375 requirements. The Strategic Growth Council (SGC) will coordinate this program with programmatic work performed by a multi-agency team of departments, including the Department of Transportation, the California Transportation Commission, the Department of Housing and Community Development, and the Natural Resources Agency. Funds will be directed toward projects that reduce GHG emissions by increasing transit ridership, active transportation (walking/biking), affordable housing near transit stations, preservation of agricultural land, and local planning that promotes infill development and reduces the number of vehicle miles traveled. The stated Program goal is that at least 50 percent of the total funds benefit disadvantaged communities. The proposal includes shifting the Strategic Growth Council from the Natural Resources Agency to the Governor's Office of Planning and Research.

- **Low-Income Home Energy Assistance Program** — $80 million ($75 million local assistance and $5 million state operations) to the Department of Community Services and Development to assist in the installation of energy efficiency and renewable energy projects in low-income dwellings within disadvantaged communities. Weatherization measures typically include weather-stripping, insulation, caulking, water heater blankets, refrigerator replacement, electric water heater repair/replacement, and heating and cooling system repair/replacement. Renewable energy measures include installation of solar water heater systems and photovoltaic systems. This proposal will serve a mix of single- and multi-family dwellings, leveraging existing federal Low Income Home Energy Assistance Program and Weatherization Assistance Program funds, workforce development agency funding, utility-funded incentives, and other similar resources. The proposal includes specific outcomes and accountability metrics for number of homes weatherized and number of homes receiving solar technologies.

- **Intercity Rail Grants** — $50 million to Caltrans to administer a competitive grant program for existing rail operators for capital improvements to integrate rail systems, including those located in disadvantaged communities, and provide connectivity to the high-speed rail system.

- **Fire Prevention and Urban Forestry**— $50 million to CalFIRE to support urban forests in disadvantaged communities and forest health restoration and reforestation projects that reduce wildfire risk and increase carbon sequestration. This proposal seeks to enhance forest health and reduce fuel loads in light of climate change impacting wildfire intensity and damage across the landscape.

- **Wetlands Restoration**— $30 million ($4.2 million state operations, $25.8 million local assistance) to the Department of Fish and Wildlife (DFW) for wetland restoration. Projects include planning and implementation of: the Sacramento-San Joaquin Delta and coastal restoration projects that integrate GHG reduction, flood protection, habitat restoration, and climate change readiness; mountain meadows restoration in the Cascade and Sierra Nevada mountain ranges including groundwater storage, stream flow stability, water supply and habitat restoration; and wetland restoration and water efficiency projects on state-owned and administered lands. This proposal includes metrics for measurement of reduction of GHGs through carbon update, measured in carbon per acre. These types of projects are also identified in the Water Action Plan as integral to developing a more sustainable water management system statewide.

- **Waste Diversion** — $30 million to CalRecycle to provide financial incentives for capital investments that expand waste management infrastructure, with a priority in disadvantaged communities. Investment in new or expanded clean composting and anaerobic digestion facilities is necessary to divert more materials from landfills, a significant source of methane emissions. These programs also support the state's 75 percent solid waste recycling goal. The majority of funding ($20 million per year) will be used for grants and loans for in-state development of infrastructure to process organic materials and recyclable commodities into new value-added products. An additional $10 million per year will be used to establish a new GHG revolving loan fund to provide financial assistance through low-interest loans for recycling market development zones. This proposal includes metrics for measurement of GHG reduction and a specific target of 1-2 million metric tons of GHG reduction by the end of 2014-15.

- **Energy Efficiency Upgrades in State Buildings** — $20 million to DGS to implement Executive Order B-18-12 that requires state agencies to reduce GHG emissions by 10 percent by 2015 and 20 percent by 2020. Funds will assist state agencies in the construction of zero net energy state buildings, reduction of grid-based energy purchases at state-owned buildings, and the use of clean, on-site power generation, such as fuel cells, solar photovoltaic, solar thermal, and wind power generation. The proposal includes metrics for installation of megawatts (MW) of clean energy (solar and wind, for example) and for the conversion of buildings to zero net energy.

- **Reducing Agricultural Waste —** $20 million to CDFA to support projects that reduce GHG emissions from the agriculture sector by capturing GHGs, harnessing GHGs as a renewable bioenergy source, improving agricultural practices and promoting low carbon fuels, agricultural energy, and operational efficiency. This proposal will support: the design and construction of dairy digester systems; research and technical assistance on reducing nitrous oxide emissions, nitrification inhibitors, water and nitrogen movement in the environment, evaluation of water and nitrogen management practices; and the development of fuel quality specifications and standards for renewable and zero emissions systems, such as biofuels produced from dairy digesters and other agricultural waste. This proposal anticipates the reduction of between 15,000 and 21,600 metric tons of CO_2 through the dairy digester program.

- **Water Use Efficiency** — $20 million to DWR for water and infrastructure efficiency projects that also result in energy savings. This proposal will provide additional funding for grants that support water use efficiency projects, such as leak loss detection and repair projects that have a demonstrated ability to reduce GHG emissions, with consideration given to projects that help address critical water supply needs of disadvantaged communities. The proposal will also support efficiency upgrades at two State Water Project facilities, Thermalitio and Hyatt. This expenditure was included in SB 103, the urgency drought relief legislation, which passed by the Legislature on February 27, 2014.

LAO Comments. *In order to minimize the negative economic impact of cap–and–trade, it is important that auction revenues be invested in a way that maximizes GHG emission reductions for a given level of spending. In reviewing the Governor's proposed expenditure plan for cap–and–trade auction revenue, we find that there is significant uncertainty regarding the degree to which each investment proposed for funding will achieve GHG reductions. This uncertainty is the result of several factors, including there being only limited data and analysis provided by the administration, as well as the fact that the level of emission reductions achieved would depend* *on the specific projects funded by departments. Consequently, it is very difficult for the Legislature to have assurance that the specific package of programs proposed by the administration would achieve the greatest reduction per dollar invested possible, or whether a different set of programs might yield better outcomes in a more cost–effective manner.*

Given these concerns, we recommend that the Legislature direct ARB to develop metrics for departments to use in order to prospectively evaluate the potential GHG emission benefits of proposed projects, as well as direct the board to establish a set of guidelines for how departments should incorporate these metrics into their decision–making processes. Having such metrics to use as part of departments' decision–making processes when determining how program funding will be spent would provide greater certainty regarding the potential GHG emission reductions of projects being considered for funding.

Spending on Longer-Term Projects. Questions have been raised about whether it is legally permissible to use cap-and-trade auction revenues for longer-term projects, such as HSR, where GHG emissions reductions would not be realized until after 2020. Based on discussions with the Attorney General's Office, staff understood the following arguments regarding the litigation risk of potential expenditures:

> AB 32 clearly states that greenhouse gas emission reductions be maintained and continued beyond 2020 (Health & Safety. Code, § 38551, subd. (b)); therefore, expenditures on long-term projects can further the regulatory purposes of AB 32. Given that the economy and population of California are expected to expand post-2020, additional reductions in greenhouse gas emissions will be needed going forward simply to maintain the 2020 level. Further, if we are to be in a position to continue to reduce emissions as contemplated by AB 32, we must invest in longer-term infrastructure projects today, recognizing that their greenhouse gas emissions benefits will not be immediate.
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> For any longer-term project, it will be important to document that greenhouse gas emission reductions will be achieved, even if those reductions will not be immediate. In the case of high speed rail, for example, there is a solid record by ARB recognizing the greenhouse gas emission reductions potential of this infrastructure project. (See for example 2008 Climate Change Scoping Plan, at p. 56; 2013 Proposed First Update to the Climate Change Scoping Plan, at p. 63.) In addition, the Investment Plan, required by AB 1532, identifies the state's near-term and long-term greenhouse gas emission reduction priorities. Programs proposed for expenditure in the Investment Plan help achieve both the state's near-term and long-term statewide greenhouse gas emissions goal. Proposed expenditures for longer-term reductions, including high speed rail, are appropriate because they advance the state's long-term, statutorily directed objective to maintain and continue reductions in greenhouse gas emissions beyond 2020.

STAFF COMMENTS

As noted by the LAO, there appears to be "*significant uncertainty regarding the degree to which each investment proposed for funding will achieve GHG reductions."* The lack of data makes it difficult for the Legislature to determine how much of a reduction some of these activities are likely to achieve. Further, estimating potential outcomes would provide important information to allow the Legislature to make informed decisions on how to achieve the greatest return on investment.

To help maximize GHG emissions reductions, departments directed to allocate funding need the proper tools to assess the GHG reduction potential of the various proposals. Under the Governor's proposal, each department (11 departments and boards) would be responsible for developing its own criteria to determine how to spend its GGRF allocation -- most of which have no experience evaluating GHG emissions reduction programs.

While ARB is tasked with assisting departments in developing metrics to evaluate program outcomes in the first year, there is no plan to provide metrics to departments to guide front-end investment decision-making. While back-end evaluations are important, having the information prior to the appropriation of funds seems prudent.

Thus, staff recommends directing ARB to develop metrics for departments to use to evaluate the potential GHG emission benefits of proposed projects. While this requirement could delay getting funding “out the door” at first, it would be worthwhile if the result is that the state could better ensure that the most beneficial projects are being funded.

Finally, the Legislature may also wish to consider directing the administration to establish GHG reduction goals for each program funded by auction revenues. This would allow departments and the Legislature to evaluate the effectiveness of these programs relative to what was expected at the time of legislative approval.

The Assembly intends to further discuss the various components of the Governor’s Cap-and-Trade proposal in the budget discussions of the appropriate departments.

Staff Recommendation: Hold Open