County of San Mateo

Inter-Departmental Correspondence

Department: COUNTY EXECUTIVE
File #: 24-099 Board Meeting Date: 2/13/2024

Special Notice / Hearing: None
Vote Required: Majority

To: Honorable Board of Supervisors

From: Michael P. Callagy, County Executive
Connie Juarez-Diroll, Chief Legislative Officer

Subject: State and Federal Legislative Update #1-Analysis of the Governor's Fiscal Year (FY) 2024-25 State Budget Proposal and 2024 State and Federal Legislative Sessions

RECOMMENDATION:
Recommendation to:

A) Accept this analysis of the Governor's FY 2024-25 State Budget Proposal; and

B) Accept an informational report on the 2024 State and Federal Legislative sessions.

BACKGROUND:
On January 10, 2024, Governor Newsom released his initial budget proposal for the 2024-25 fiscal year, a $291.5 billion ($208 billion General Fund (GF)) spending plan. The Governor's Budget forecasts that GF revenues will be $44 billion lower compared to the FY 2023-2024 budget, and California will be facing an estimated budget gap of $37.86 billion in the 2024-25 fiscal year, differing significantly from the Legislative Analyst's Office (LAO)'s projected $68 billion budget deficit announced in December. The Administration notes that the shortfall is due to two main factors: 1) a significant decline in the stock market in 2022 that impacted revenues, and 2) the substantial delay in receiving critical income tax collections when stock market trends impacted high earners. To close the budget gap, Governor Newsom proposes a combination of borrowing from budgetary reserves, funding delays, reductions to internal special funds, budget shifts, deferrals, and limited revenue generation.

The proposal is optimistic about 2024 fiscal conditions and projects that California's economy will grow in 2024 based on recent stock market gains and as markets anticipate interest rate cuts. While the Governor's budget proposal is cautiously optimistic, there are significant risks to the forecast, including rebounding of inflation levels, sustained high-interest rates, and global economic uncertainty, any of which could impact the economic outlook.

The Governor's Budget includes the following strategies to stabilize the anticipated deficit:

- **Budget Reserves.** A withdrawal of $12.2 billion from the State's Budget Stabilization Account, commonly referred to as the rainy-day fund, and $900 million from the Safety Net Reserve.

- **Additional Revenue/Borrowing.** Borrowing from internal revenue sources such as the Tax Cuts and Jobs Act Net Operating Loss limitation ($300 million) and increasing the Managed Care Organization (MCO) tax for Medi-Cal ($3.8 billion), which would require early action by the Legislature and approval from the federal government.

- **Delays/Funding.** Spreads $5.1 billion in appropriations scheduled for FY 24-25 across a three year period beginning in 2025-26 under various programs, including:
  - Developmental service provider rate reforms ($613 million)
  - Preschool, transitional and full-day kindergarten facilities grants ($550 million)
  - Behavioral health bridge housing program ($235 million)
  - Transit and intercity rail ($1 billion)

- **Shifts**. Moves $3.4 billion in GF expenditures in FY 22-23 and 23-24 to other funds from the following programs:
  - Greenhouse Gas Reduction Fund ($1.8 billion)
  - State debt repayment for retirement contributions ($1.3 billion)
  - Unemployment insurance interest payments ($100 million)

- **Deferrals.** Uses accounting deferrals for specific payroll obligations to state ($1.6 billion), UC, and CSU employees ($499 million) to FY 25-26. The Governor also proposed deferring any new, discretionary spending decisions, including consideration of resource requests associated with recently chaptered legislation, until this spring.

The County Executive Office's Intergovernmental and Public Affairs Unit provides your Board with monthly updates on state and federal legislative and budget activity during the ongoing sessions, which resumed on January 3, 2024, and January 9, 2024, respectively.

DISCUSSION:

The Governor's Budget includes some notable reductions in the following areas impacting San Mateo County:

In-lieu Vehicle Licensing Fee (VLF)

Excludes reimbursement for the County's FY 22-23 VLF shortfall of $70 million, $41 million of which is the County's allocation. Historically, the State has made counties and cities whole by reimbursing VLF shortfalls through the State budget. This ensures that all local governments receive their full in-lieu VLF payment as required by law.

Under the 2004 budget compromise, the State permanently reduced the annual VLF rate, which significantly decreased counties and cities' revenues, and shifted property taxes away from local governments to pay the State's school funding obligations and address the State's budget deficit. In exchange, the State guaranteed counties and cities an "in-lieu" VLF payment for the lost revenues. This ongoing in-lieu VLF obligation is adjusted annually based on property value growth. In San Mateo County, the direct funding sources identified in the statute are insufficient to cover the full amount of the in-lieu VLF payment, causing a funding shortfall. The shortfall specifically arises because there are insufficient Educational Revenue Augmentation Funds (ERAF) and property taxes of the few non-basic aid schools in San Mateo County to cover the State's full payment obligation. While the State backfills school districts so they do not suffer any revenue losses, these shortfalls will cause significant financial harm to San Mateo County and its 20 cities.

Housing
A total of $1.2 billion in revisions, delays, and program eliminations are made to various housing programs. Notably, the Governor's budget cuts $450 million in funding for the state's Infill Infrastructure Grant Program and the Multifamily Housing Program. The County's Department of Housing currently has 11 affordable housing projects in the development pipeline between the two programs, representing 943 units requiring $91.9 million in funding from the programs to begin construction. In addition, $300 million in revisions to the Regional Early Action Planning Grant program would limit the planning and development funds available to advance the implementation of housing goals and climate commitments.

Human Services
The January proposal also includes $275 million in cuts to CalWORKs administration and services. These reductions would take effect during the current year, posing challenges for counties that have already spent their allocations and need to adjust personnel and client services.

Health
While the Governor's proposal maintains most health program allocations, it does propose to delay $140.4 million to the Behavioral Health Continuum Infrastructure program. In order to provide new revenue, the Budget also includes an increase to the Managed Care Organization (MCO) Tax on health insurance plans to support Medi-Cal. The County anticipates that there will be an increase in Medi-Cal enrollees due to the elimination of the "asset test" as part of Medi-Cal eligibility effective January 1, 2024, and due to the expansion of Medi-Cal, which no longer factors immigration status into eligibility. The net impact of these changes remains unknown for County Health programs.

Climate
Lastly, $2.9 billion in various environmental programs were revised in the proposed budget, including clean energy reliability investments ($400 million), active transportation grants ($200 million), building decarbonization ($283 million), and coastal protection and adaptation ($171.1 million) programs.
The Senate and Assembly Budget Committees have completed their initial overview of the Governor's proposed spending plan. Subcommittee hearings will begin soon and continue through May. The final budget is due to the Governor by June 15 and must be signed into law by July 1, 2024.

The attached table outlines the impacts the Governor's FY 2024-25 proposed State Budget would have on select County programs and services. The County Executive's Office (CEO) and departments will continue to closely monitor state budget discussions in the coming months and advocate for the interests of the County and residents. The CEO will also continue to keep your Board updated regarding discussions in Sacramento and our advocacy actions throughout the process.

EQUITY IMPACT:
The County's 2024 Legislative program supports policies that further or enhance equity goals in addressing the needs of underserved, disadvantaged, or marginalized residents.

<u>FISCAL IMPACT</u>:
Unknown. Countywide, $70 million due to the exclusion in FY 2022-23 VLF shortfall funding to reimburse the County and its cities, $41.49 million is the County's allocation.

2024 Legislative Update #1:

State Update
On January 3, 2024, the California Legislature reconvened to begin the second year of its two-year session. Bills introduced in 2023 that had yet to be passed by the house in which they were introduced had to be acted upon and passed out of their house of origin by January 31, 2024, to remain eligible. Legislators have until February 17, 2024, to introduce new legislation for this year.

AB 817 (Pacheco), which would allow county boards and commissions that serve in an advisory capacity to teleconference without meeting the in-person quorum requirements of the Brown Act, was recently passed by the Assembly. It will be referred to Senate policy committees for approval.

Federal Update

On January 18, 2024, one day ahead of a partial federal government shutdown, the House and Senate passed a short-term Continuing Resolution (CR) funding bill that would extend the federal government's spending authority until March. Similar to the CR that was signed into law late last year, lawmakers staggered the new deadlines as follows:

Extends the agencies funded under the below bills through March 1:
- Agriculture-FDA
- Energy and Water
- Military Construction-Veterans Affairs
- Transportation-Housing and Urban Development

Extends agencies funded under the below bills through March 8:
- Commerce-Justice-Science
- Labor-HHS-Education
- Defense
- Financial Services
- Homeland Security
- Interior-Environment
- Legislative Branch
- State-Foreign Operations

This is the third CR since the new fiscal year began on October 1, 2023.

Looking ahead, Senate and House Leadership have agreed to a $1.66 trillion discretionary spending cap for the FY24 funding bills. The lead House and Senate appropriators are now negotiating how to split this amount among the 12 annual funding bills. Passage of the new CR and the new deadlines will give the parties more time to try and negotiate a final government spending package.