



Memorandum

TO: TRANSPORTATION AND
ENVIRONMENT COMMITTEE

FROM: Hans F. Larsen
Leslye Corsiglia
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SUBJECT: CAP-AND-TRADE PROGRAM

DATE: July 31, 2012

Approved	Ed Shikada	Date	08/06/12
	/s/		

RECOMMENDATION

- a) Accept status report on the California Cap-and-Trade Program to reduce greenhouse gas emissions.
- b) Provide input to staff on guiding principles for legislative advocacy and investment strategies.

BACKGROUND

In 2006, the State enacted AB 32, the Global Warming Solutions Act of 2006, which set the State's 2020 greenhouse gas (GHG) emissions reduction goals into law. This legislation established a comprehensive program of regulatory and market mechanisms to achieve real, quantifiable, cost-effective reductions of greenhouse gases. It makes the California Air Resources Board (ARB) responsible for monitoring and reducing GHG emissions and directed ARB to begin developing discrete early actions to reduce greenhouse gases while also preparing a scoping plan to identify how best to reach the 2020 limit.

The AB 32 Scoping Plan was approved on December 12, 2008 and provides direction to reduce greenhouse gases in California to 1990 levels by the year 2020. The law's mandate is to achieve an 80 percent GHG reduction from 1990 levels by 2050. The scoping plan also indicates how these emission reductions will be achieved from significant greenhouse gas sources via regulations, market mechanisms and other actions. ARB's Scoping Plan identifies a Cap-and-Trade program for pollution credits as one of the strategies that will be used to reduce GHG emissions. The development of the Cap-and-Trade program included a multi-year stakeholder process and consideration of potential impacts on disproportionately impacted communities.

Under Cap-and-Trade, an overall limit on GHG emissions from "capped" sectors will be established, and polluters that are subject to the cap will be able to trade permits (allowances) to emit GHGs. Under state regulations, one allowance is equal to one ton of the total carbon dioxide equivalent (CO_{2e}) emissions. Producers of about 80 percent of the State's GHG emissions, consisting of stationary large polluters such as refineries and factories creating over

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25 metric tons per year, are subject to the cap. Transportation fuel, natural gas and other fuel sectors will be subject to the cap starting in 2015. The remaining 20 percent of emissions derive from smaller entities, such as agriculture and forestry and are referred to as the "uncapped" sectors. Capped polluters can purchase credits from the State or from other facilities that pollute less than their allocation.

With that guidance, the California Air Resources Board (ARB) included language in its scoping plan that supported development of a Cap-and-Trade program. ARB will conduct a trial auction in August 2012 and the first official auction in November 2012, with additional auctions following in February and May of 2013. Through regulation, ARB has set a floor price of \$10 per ton and a ceiling of \$50 per ton. Initial estimates on auction proceeds going to the State to be derived from the November auction alone start at \$1 billion. ARB plans to sell 66 million allowances in FY 2012-13, with estimated proceeds generated of up to \$3 billion.

Uses of Auction Proceeds

Consistent with Governor Brown's budget request, the Assembly and Senate budget subcommittees have each adopted language that would dedicate at least \$500 million of the November auction proceeds towards eligible General Fund expenditures in order to help reduce the State's budget deficit. Uses for the remainder of the proceeds have not yet been identified, but according to ARB staff, the Governor's goals are for proceeds to:

- Maximize economic and environmental benefits
- Enhance air quality
- Benefit the most disadvantaged communities.

The Governor's programmatic priorities are reportedly to fund programs for clean and efficient energy, low carbon infrastructure and transportation, and natural resources protection.

Further, there are legal requirements for the use of the auction proceeds. According to the Senate and the Assembly's Legislative Counsel, revenues generated from the allowances are considered mitigation fee revenue subject to a legal nexus test. Legislative Counsel reviewed the Cap-and-Trade Program to determine if it would be impacted by Proposition 26. A finding was made that since the Cap-and-Trade Program was included in AB 32 and was passed by the Legislature prior to Proposition 26 taking effect, proceeds from the auction would not be considered taxes but would be mitigation fees requiring a nexus. Therefore, such revenue may only be used to mitigate GHG emissions or the harms caused by GHG emissions.

City's Green Vision

Following the State's passage of AB 32, on October 7, 2007, the San José City Council adopted the City's Green Vision, which outlines 10 ambitious goals for economic development, environmental leadership, and an enhanced quality of life for San José residents and businesses. Since then, the Green Vision has helped guide staff's efforts in a broad spectrum of areas including economic development, energy, green buildings, water, waste, sustainable growth, streetlights, trees, and trails. This in turn has led to the formation of multiple strategic

partnerships and a significant influx of grant funding that has helped advance Green Vision goals even in this time of extremely limited City funding for the initiative.

Other Governing Plans: General Plan, Housing Investment Plan and Economic Development Strategy

The *Envision San José 2040 General Plan* was approved in November 2011 after four years of extensive planning and input from the community. It includes land use policies that will help to transform strategic and historically underutilized Growth Areas into higher-density, mixed-use "Urban Villages" which can accommodate employment and housing growth and reduce the environmental impacts of that growth by promoting transit use and walkability. This land use strategy, in combination with progressive economic and environmental policies, will guide the City's growth to be sustainable over time.

San José's current *Five-Year Housing Investment Plan 2007-2012* calls for the production, maintenance, and preservation of affordable housing units for residents with a range of incomes, with a focus on building apartments near transit and on the use of green building technologies.

In addition, the *San José Economic Development Strategy 2010-2015* articulates the need to develop more walkable, vibrant, mixed-use communities located near transit as a way to attract top talent and grow jobs as the population increases. The *Strategy* also includes plans to aggressively implement the Green Vision and CleanTech Strategy, with a focus on attracting and growing businesses that are developing GHG-reducing technologies.

ANALYSIS

Legislation

During the current Legislative Session there have been several bills introduced that would establish the allocation of Cap-and-Trade revenues for the State General Fund and create a process for developing an expenditure plan and the allocation of non-General Fund revenues until next year for inclusion in the FY 2013-14 State budget.

The two primary Cap-and-Trade bills pending in the Legislature are:

- **AB 1532 (Perez)** - Creates the Greenhouse Gas Reduction Account for Cap-and-Trade revenue and requires funds to be spent on measures and programs that reduce GHG, including low-carbon transportation and sustainable infrastructure development, including transportation and housing. Requires the ARB to adopt guidelines related to the allowable uses of cap and trade revenue. Requires ARB to develop and adopt three investment plans for the following time periods: 2013-14, 2015-17 and 2018-2020. Requires submittal of an investment plan to the Legislature at least 30 days prior to the adoption of an investment plan. Requires the Governor to recommend appropriations of Cap-and-Trade revenue as part of the annual budget submission that are consistent with ARB's adopted plan. Requires submittal of an annual report to the Legislature on the use of funds.

- SB 1572 (Pavley) - Establishes the Greenhouse Gas Reduction Fund within the Air Pollution Control Fund and requires that all moneys collected be deposited in the fund. Specifies the lesser of half of the money in the Fund for 2012-14 or \$250 million would be available for allocation in the following manner: 20 percent for sustainable land use and transportation; 4.8 percent for goods movement; 2 percent for low-emission school bus program; 12 percent for clean vehicle rebate program; 36 percent for K-12 energy projects; 8 percent for public university projects that reduce greenhouse gas emissions; 12 percent for PUC program; 4 percent for residential efficiency; 1.6 percent for agriculture energy program.

The deadline for bills to move out of committee is August 17th and the last day of session is August 31st. If the Legislature is to pass Cap-and-Trade legislation this session they would need to meet these deadlines. Any future bill positions that would be recommended by staff would be taken to the Rules and Open Government Committee.

New Funding Opportunities to Support the City's Green Vision and Other Goals

Through the upcoming Cap-and-Trade auctions, San José has the opportunity to secure needed revenues that will assist it with meeting the goals of Assembly Bill 32 both in the short-term and in the long-term. Over time, the auctions are anticipated to generate funding into the billions annually for the State. It is estimated that the first auction in November will raise between \$1 and \$3 billion in fiscal year 2012. In future years, it is probable that the auctions may generate \$3 billion and \$14 billion annually. Most of the revenues will be raised after 2015 when the transportation, natural gas and other fuel sectors are included in the auctions.

These revenues will spur short-term investment in innovative technologies and support projects that will not only drive a reduction in emissions but also provide a boost to the economy through the generation of new jobs and economic development. Equally as important, the revenues will also support long-term investments that foster sustainable mobility and land development.

Alignment with the City's Priorities

Revenues from Cap-and-Trade represent a significant opportunity to align potential funding sources with several of the City's existing goals around job creation, transportation, housing, and a reduced environmental footprint.

The Cap-and-Trade program objectives fit well with the Green Vision's strategic framework, as revenues could constitute a new financing mechanism to implement the Vision's goals of reducing GHGs by promoting use of public transit, green buildings, using clean energy, and reducing energy consumption in the City. Proceeds potentially could also help to finance emerging technologies that reduce GHGs consistent with the City's *Economic Development Strategy*, and could create construction jobs for projects like High Speed Rail. Cap-and-Trade proceeds could assist with the implementation of *Envision 2040*, which facilitates significant job growth and seeks to promote San José's mixed-use development near transit in order to create more walkable communities.

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Further, Cap-and-Trade proceeds could be an important source to fund construction of new affordable homes in places close to transit, to support energy-efficient retrofits for existing buildings, and to help prevent displacement of lower-income families to locations that are farther away from transit and jobs. Recent analysis has shown the importance of locating low-income housing near transit in order to reduce GHGs. Finding new funding for affordable housing programs is particularly important given the State's elimination of redevelopment funding in February 2012, as San José now receives very little ongoing funding to produce, maintain and preserve affordable rental units. The City's \$40 million per year in redevelopment proceeds was not enough to meet market demand, and federal sources for housing also have dropped precipitously in the past few years. Given the current weak economy and steep increases in local rents, the need for affordable units has increased significantly yet unfunded state mandates for housing production continue to exist—so identification of new funding for housing is particularly pressing at this time.

Potential Investment Strategy

Staff has developed a strategy, based on Green Vision goals and the City's other strategic priorities, as a way to help determine priority funding areas. This strategy provides a framework that will enable the City to engage in discussions related to the Cap-and-Trade Program and to pursue funding when auction revenues become available. These strategies include:

- Support of funding for low-emission transportation investments, including High Speed Rail, and other significant regional mass transit projects like the extension of BART to Downtown San José, Bus Rapid Transit (BRT), bikeways, and alternative fuel vehicles.
- Support of funding for emerging clean technologies that reduce greenhouse gas emissions.
- Support of funding for affordable housing located near transit, including new construction and green rehabilitation, as well as preservation of affordable housing in gentrifying areas to minimize out-migration and limit VMTs.
- Support of funding for green building incentives, construction of green buildings and green rehabilitation.
- Support of energy efficiency investments that provide improvements to existing buildings and provide conversion of street lights to adaptive LED lights.
- Support of renewable energy systems including distributed solar and other emission lowering investments that include; water pollution control upgrades, water pumping, composing-waste to energy, and recycling programs
- Support of programs that provide for urban tree planting.
- Support of funding mechanisms that include a mix of competitive awards from the State as well as funds that could be awarded directly to larger local jurisdictions.

As the State develops its allocation program, having an investment strategy will create potential opportunities for the City as it implements *Envision 2040* and the *Green Vision*.

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Also of note are the several agencies and organizations that are taking advocacy positions on Cap-and-Trade. The Metropolitan Transportation Commission (MTC) is supportive of cap-and-trade and is recommending that 40 percent of revenues generated through the Cap-and-Trade auctions should be returned to Metropolitan Planning Organizations (MPOs) since transportation comprises roughly 40 percent of the State's share of GHG. Other groups, including SPUR, are advocating that funding from the auctions should be used to offset costs associated with High Speed Rail. Transform is advocating that some funding to go to High-Speed Rail and some go to affordable housing. Housing advocates, including the Nonprofit Housing Association of Northern California and California Housing Partnership Corporation, have been active supporting the allocation of some auction proceeds to affordable housing construction near transit, to green rehabilitation of existing affordable housing, and to displacement prevention.

EVALUATION AND FOLLOW-UP

Staff will return to the City Council in the fall with a recommended set of guidelines and principles incorporating feedback and direction provided by the T&E Committee, and will bring requests to support legislative guiding principles and specific bills to the Rules Committee and to the City Council.

COORDINATION

This Memorandum has been coordinated with the City Attorney's Office, the Office of Inter-Governmental Relations, Department of Planning, Building and Code Enforcement, Office of Economic Development, and the City's Sacramento Legislative Office.

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