A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

California Fiscal Focus

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Amid Economic Uncertainty, Controller Yee Echoes Governor's Restrained Budget Planning

As the governor's Department of Finance released its proposed 2018-19 budget, State Controller Betty T. Yee reported California's total revenues of $16.25 billion for December were $2.79 billion above June's budget expectations.

"I can sum up the governor's budget in one word: smart. The federal tax measure did not just stick it to California's individual taxpayers–it also likely will have a devastating impact on our state budget, which may mean less money for essential social services such as Medi-Cal, Medicare, and the children's health insurance program," said Controller Yee, the state's chief fiscal officer. "We are not going to know for months just how deep the wounds will be from the president's massive giveaway, so until we do, Governor Brown is once again wise in exercising caution with responsible short-term spending, boosting rainy day fund reserves, and paying down debt."

Personal income taxes (PIT) and corporation taxes, two of the "big three" sources of General Fund dollars, exceeded projections for the month. All three, including retail sales and use taxes, are ahead of fiscal year-to-date estimates. For the first half of the 2017-18 fiscal year, total revenues of $57.21 billion are higher than budget projections by 7.1 percent and 10.6 percent higher than the same period in 2016-17.

For December, PIT receipts, the state's largest revenue source, were $11.50 billion, or 25.0 percent above projections. While a portion of the variance may be due to taxpayer behavior, it is likely to be offset by reductions in future months' receipts. For the fiscal year, PIT receipts of $39.10 billion are higher than budget estimates by $2.28 billion or 6.2 percent.

Corporation taxes for December of $2.47 billion were $699.0 million or 39.6 percent higher than expected. For the fiscal year to date, total corporation tax receipts of $4.26 billion are $932.2 million, 28.0 percent, above assumptions in the 2017-18 Budget Act.

Sales tax receipts of $1.86 billion for December were $272.4 million lower than anticipated in the budget. However, for the fiscal year, sales tax receipts of $12.03 billion are $461.0 million or 4.0 percent above budget estimates.

For more details, read the cash report.

State Lands Commission Works to Address Port Climate Risk

In 2018 and all even-numbered years, Controller Yee serves as chair of the California State Lands Commission (SLC), which manages millions of acres of sovereign lands and resources—from the Klamath River in the north to the Tijuana Estuary in the south to Lake Tahoe and the Colorado River in the east. SLC also oversees California's ports and harbor districts.

If unaddressed, climate change and sea-level rise will have catastrophic consequences for these lands and resources held in trust on behalf of all Californians.

Experts predict climate-driven sea-level rise could elevate the water in coastal areas up to 10 feet in the next 70 years. This could eat up beachfront properties and overwhelm low-lying cities. Coastal communities that are susceptible to the highest tides are already seeing this. Known as king tides, today's highest tides are predicted to be average tides in the future.

Commissioners and SLC staff are working hard to facilitate sea-level rise preparedness, with an emphasis on protecting the public's right to access and enjoy these lands.

Moody's Investors Service incorporates climate change into its credit ratings for state and local bonds. Cities and counties know they must address risks from surging seas or intense storms. Local governments will need to think about where they build and anticipate what investments are needed in major adaptation and resilience projects.

The exact speed, rates, and magnitude of sea-level rise over the next century are unclear, but waiting for scientific certainty is not a safe or prudent option. The California Ocean Protection Council is updating the state's Sea-Level Rise Guidance to provide a science-based methodology to help state and local governments assess the risks associated with sea-level rise.

Jurisdictions can then incorporate that analysis into their planning, permitting, and investment decisions. California ports and harbor districts are among the state's primary economic and coastal resources and an essential element of the national maritime industry. The state has a vested interest in the long-term success of ports and harbor districts, as they are catalysts for comprehensive economic and job growth. SLC has a record of successfully partnering with them.

SLC has made climate change and sea-level rise considerations an integral feature of its decision-making process. California ports and harbor districts also are actively engaged in sea-level rise planning.

Ports and harbor districts that generate public trust revenues of more than $250,000 a year are required by California law to submit sea-level rise assessments to SLC by July 2019. These assessments must include a description of vulnerabilities of granted lands, an evaluation of those risks given different sea-level rise scenarios, information on the financial costs of impacts, and an outlined approach to adaptation for protection of the public's interests.

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Climate Action 100+ Carries Paris Momentum into 2018

The momentum of the 2015 Paris climate agreement continues to inspire global action to decrease carbon emissions, as Controller Yee saw at the One Planet Summit hosted by French President Macron in Paris last month. Yee attended on behalf of the California Public Employees' Retirement System (CalPERS) to introduce the Climate Action 100+ initiative, which will recruit investors to collectively engage targeted corporations to improve their climate impact disclosure and sustainability efforts.

As of the launch, 225 global investors with a combined $26.3 trillion in assets under management—including CalPERS and the California State Teachers' Retirement System (CalSTRS)—had already joined.

Participating investors will urge targeted companies to:

- Take action to reduce greenhouse gas emissions across their companies, including the production and delivery of goods and services, consistent with the Paris Agreement's goal of limiting global average temperature increase to below 2-degrees Celsius.
- Provide enhanced corporate disclosure in line with the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).
- Implement a strong governance framework that clearly articulates the board's accountability for and oversight of climate change risk and opportunity.

This effort was sparked by a carbon footprint analysis conducted by CalPERS in 2015 on its portfolio of more than 10,000 companies. The report showed that just 80 of the companies in which CalPERS invests are responsible for generating more than 50 percent of the portfolio's carbon emissions. Since many large investors own shares in the same companies, it made sense to team up to change how companies report and address their sustainability issues.

It is in the fiduciary interest of members that the funds actively work to ensure these corporations focus on long-term sustainability issues.

Climate Action 100+ is a global effort with a nonprofit organization from each continent responsible for recruiting investors and coordinating regional engagement efforts. Ceres, of which Yee is a board member, was chosen to lead the North American efforts.

Controller Yee believes engagement—especially when pursued collectively—sends a stronger message than divestment. Advocating for change by contacting corporate executives and their boards, as well as voting for shareholder proposals, requires a firm commitment to actively demanding change as owners.

Engagement also can benefit the sustained health of pension funds. When CalPERS and CalSTRS invest in a company, they do so with the intent to hold the shares indefinitely and use the investment earnings to pay their members' pensions. It is in the fiduciary interest of members that the funds actively work to ensure these corporations focus on long-term sustainability issues. For example, fossil fuel companies need to plan for their long-term viability as climate-related regulation and market changes force them to re-examine their business practices.

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Many SLC port partners are grappling with significant challenges related to sea-level rise because their lands and assets support water-dependent uses and activities often located in densely developed coastal regions. These factors constrain certain preferred adaptation strategies such as managed retreat and other natural infrastructure solutions.

Many of the facilities and infrastructure cannot feasibly be relocated away from the coast and instead must be protected in place. These facilities generally have a low "adaptive capacity," coupled with a risk of significant consequences if not protected, including structural damage and the creation of hazards.

It is time for California to prepare for the loss of sand, coastal shoreline, and the facilities along our coast. The state must invest in technologies to reduce greenhouse gas emissions and protect our communities.

The State Lands Commission will continue to work with local, state, and federal partners to ensure adaptation strategies are developed that recognize the importance of protecting California's ports and harbor districts. It is going to take creativity, flexibility, and significant funding to maintain California's ports in the face of rising sea levels.

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It appears to be working. The multi-year engagement efforts of CalSTRS, CalPERS, and other institutional investors led to important changes at three large fossil fuel corporations. At the annual Exxon Mobil shareholder meeting in May 2017, 62 percent of shareholders voted to support a climate change proposal calling on Exxon to evaluate and disclose the viability of its portfolio under the 2-degree scenario. The prior year, shareholders succeeded in the appointment of a climate-competent board member.

Chevron published risk management and scenario planning in its March 2017 report following shareholder engagement the prior year. Sixty-seven percent of shareholders passed a proposal last May requiring Occidental Petroleum to report on the business impacts of climate change.

Controller Yee will continue her work to advance responsible investment choices and looks forward to growing the partnership at the Ceres 2018 Investor Summit on Climate Change at the United Nations on January 31. The next major milestone in California climate risk planning will be the Governor's Climate Summit in September, which promises to bring additional international stakeholders together in the march toward meeting the Paris Agreement's goals.

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