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February 14, 2012

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PRESIDENT'S PROPOSED FEDERAL FISCAL YEAR 2013 BUDGET

Budget Overview

Yesterday, President Obama released his proposed $3.8 trillion budget for Federal Fiscal Year (FFY) 2013, which will begin on October 1, 2012. As estimated by the Office of Management and Budget (OMB), the Federal budget deficit would drop from $1.33 trillion in FFY 2012 to $901 billion in FFY 2013, $575 billion in FFY 2018, and $704 billion in FFY 2022. According to OMB, the President's budget proposals would reduce the budget deficit by more than $3 trillion below current law over ten years with roughly half of the savings coming from tax increases, which mainly would be imposed on wealthy individuals. The Federal deficit would be reduced by more than an estimated $4 trillion over ten years, counting the discretionary spending cuts enacted in the Budget Control Act (BCA) of 2011, which increased the Federal debt limit.

The President's proposed FFY 2013 Budget generally mirrors budget proposals from last year, including proposals from his American Jobs Act (AJA) initiative. His proposed budget would increase overall discretionary spending, which is set in appropriations legislation, from $1.043 trillion in FFY 2012 to $1.047 trillion in FFY 2013 -- the same levels as in the BCA.

We caution that our analysis of the impact of the President's proposed FFY 2013 Budget is based on the limited information that has been released by the Obama Administration as of date. While we expect more detailed budget information over the next few weeks, the Administration might not release detailed descriptions or draft legislative language for a number of proposals of County interest. It is noteworthy that the Administration did not release detailed descriptions of its blended Medicaid match rate and foster care incentive payment proposals even though they are carryover proposals from last year. Our ability to analyze the impact on the County also is limited because Federal departments have not yet announced FFY 2012 formula grant allocations -- a delay which is attributable to the fact that Congress did not complete action on FFY 2012 appropriations until late in December 2011.

With these caveats in mind, we believe that the net overall fiscal impact on the County of the President's FFY 2013 Budget, if enacted, would be relatively small. This is largely because, similar to last year, the President is proposing a relatively small reduction in overall mandatory spending and is proposing to fund most discretionary programs through which the County currently receives funding at or near FFY 2012 funding levels.

Mandatory spending programs, such as Medicaid, Title IV-E Foster Care and Adoption Assistance, Temporary Assistance for Needy Families (TANF), and Child Support Enforcement, currently account for over three-fourths of total Federal aid to state and local governments and for an even higher percentage of total Federal revenue received by the County. The President is proposing a relatively small reduction (1.3 percent) in overall Medicaid spending over the next ten years. No reductions are proposed to the TANF, Title IV-E, and Child Support Enforcement programs. Major discretionary programs which would be funded at or near their FFY 2012 levels include the Community Development Block Grant, Ryan White AIDS Emergency Assistance, Workforce Investment Act, and Older Americans Act programs.

Below is a discussion of major budget proposals of County interest.

Proposed Program Consolidations

Homeland Security Grants: The proposed budget would consolidate 16 existing programs in the Federal Emergency Management Agency's State and Local Programs account, which received a combined $1.112 billion in FFY 2012, into a new National Preparedness Grant Program (NPGP), which would be funded at $1.541 billion in FFY 2013. The consolidated programs include the State Homeland Security Grant Program, Urban Area Security Initiative Grant, and Port Security Grants. This new program would require state and local entities to tie investments to one of the 31 core capabilities included in the National Preparedness Goal, funding decisions to be guided by risk assessment levels, and measures of effectiveness to be included with proposed investments.

Under the NPGP, each state and territory would receive a base level of funding based on a population driven formula with the remainder of funds determined competitively, based on capabilities and the ability to complete projects within a two-year period of performance. While FFY 2013 funding for the NPGP would be higher than for the consolidated programs in FFY 2012, its funding level still would be significantly less than in FFY 2011 and previous years.

Public Housing Operating and Capital Funds: The proposed budget would consolidate the Public Housing Operating Fund and the Capital Fund into a single Public Housing subsidy stream. As a first step towards consolidation, the budget proposes a total of $6.59 billion in FFY 2013 to operate public housing programs and modernize its aging physical assets, which includes $4.52 billion in Public Housing Operating Funds (an increase of about 14 percent from its $3.96 billion FFY 2012 level) and $2.07 billion in Public Housing Capital Funds (an increase of about 10 percent from its $1.87 billion FFY 2012 level). In addition, the budget would provide public housing authorities with full flexibility to use their operating and capital funds for any eligible capital or operating expense. The County's Community Development Commission (CDC) supports the proposed funding increases, but is concerned that a single appropriated fund would be more vulnerable to future funding cuts.

Proposed Funding Reductions

The President is proposing a net reduction of an estimated $517.1 billion in mandatory spending over ten years, including an estimated $302.8 billion in Medicare savings and $55.7 billion in Medicaid savings. In percentage terms, the proposed ten-year Medicare and Medicaid budget savings are relatively small. They represent a roughly 4.3 percent reduction in total Medicare spending and 1.3 percent reduction in Medicaid spending. The Medicare budget proposals, in aggregate, would have relatively little impact on the County because most of them would not affect payments to providers and because the County receives relatively little Medicare revenue. Nearly one-half ($155.6 billion) of the Medicare savings would result from requiring drug manufacturers to provide Medicare with the same discounted drug prices which are provided under Medicaid.

Most of the estimated Medicaid savings ($48 billion) would result from the following three budget proposals, which also were proposed by the President last year:

1. **Single Blended Medicaid Match Rate:** Similar to last year, the President is proposing to replace the current patchwork of differing Federal match rates for Medicaid and the Children's Health Insurance Program with a single blended match rate specific to each state that automatically would increase if a recession forces enrollment and state costs rise. The single blended match rate would take

effect in FFY 2017, the first year in which the Federal match rate for newly eligible Medicaid recipients under health care reform no longer would be 100 percent. According to OMB estimates, the blended rate proposal would save the Federal government $17.9 billion over ten years. The estimated fiscal impact on California and the County cannot be determined because the Administration has not yet released a detailed proposal which can be used to estimate what California's new blended match rate would be in future years.

2. **Medicaid Disproportionate Share Hospital (DSH) Funding:** Under the Federal health care reform law, the Affordable Care Act (ACA), annual Medicaid DSH allotments to states were reduced for FFY 2014 through FFY 2020. Similar to last year, the President proposes to extend the Medicaid DSH reduction in subsequent years, which would save the Federal government more than $4 billion a year, including $8.3 billion in estimated savings within the next ten years. Under current law, Medicaid DSH allotments, otherwise, would revert back to pre-ACA levels, beginning in FFY 2021. The fiscal impact of this proposal on the County cannot be determined with any certainty at this time. This is because the fiscal impact on the County will depend on the new methodology which the Secretary of Health and Human Services must develop for implementing the DSH reductions and on the extent to which health care reform ultimately reduces the County's uncompensated care costs relative to other DSH hospitals in FFY 2021 and subsequent years.

3. **Medicaid Provider Taxes:** The President also again is proposing to limit the ability of states to use provider taxes to finance the non-Federal share of Medicaid costs by reducing the Medicaid provider tax threshold from 6 percent of a provider's total revenue in FFY 2014 to 4.5 percent in FFY 2015, 4 percent in FFY 2016, and 3.5 percent in subsequent years. The Administration estimates that this proposal would save the Federal government $21.8 billion over ten years. A reduction in the amount of Federal matching funds generated by provider taxes, in effect, shifts costs to states and could directly or indirectly result in cuts in Medicaid payments to providers.

Other proposed funding reductions include:

State Criminal Alien Assistance Program (SCAAP): The proposed budget would reduce SCAAP funding from $240 million in FFY 2012 to only $70 million in FFY 2013. Based on this funding level, the County would receive a SCAAP payment of slightly over $2.53 million, assuming that the County's percentage share of total SCAAP funding will be the same in FFY 2013 as in FFY 2011, which is the most recent year in which SCAAP funds were awarded. In comparison, the County received a SCAAP payment of $14.3 million when SCAAP was funded at $330 million in FFY 2010 and an all-time high SCAAP payment of $34.0 million in FFY 2002. Annual SCAAP funding levels have steadily declined since FFY 2009 when SCAAP was funded at $400 million.

Community Services Block Grant (CSBG): The proposed budget would reduce CSBG from about $677 million in FFY 2012 to $350 million in FFY 2013. Similar to last year's proposed budget, the Administration proposes to target the $350 million in funding to the highest performing Community Action Agencies through a competitive grant process. Assuming that the County receives the same percentage share of total funding as in FFY 2011, the County's CSBG formula grant funding would be reduced from roughly $6.7 million in FFY 2012 to approximately $3.5 million in FFY 2013.

Hospital Preparedness Program (HPP): Funding for the HPP would be reduced by nearly one-third from roughly $380 million in FFY 2012 to $255 million in FFY 2013. The County, which is one of only four local jurisdictions that receive direct HPP formula grants, received an HHP allocation of $11.07 million in FFY 2011 -- a larger allocation than received by all but eight states. The Administration proposes to change the HPP from a solely formula grant program to a program that includes a competitive grant component "to drive innovation among healthcare coalitions and a modest formula grant to states." This is likely to result in significantly less funding for the County and entities within the County.

Army Corps of Engineers: The proposed budget would reduce overall Army Corps of Engineers ("Corps") civil works funding by roughly 5.4 percent to $4.731 billion in FFY 2013. It includes $5,053,000 for operations and maintenance of the Los Angeles County Drainage Area and $900,000 for the California Coastal Sediment Master Plan, but does not request any funding for Marina del Rey dredging in FFY 2013.

However, the County's Department of Beaches and Harbors (DBH) indicates that on February 8, 2012, the Corps designated an additional $2.369 million in FFY 2012 funds for the Marina del Rey dredging in addition to the $3.107 million in dredging funds included in the Consolidated Appropriations Act of 2012, enacted in December 2011. In addition, DBH indicates that, when combined with residual Corps funding from FFYs 2010 and FFY 2011 and County funds approved by your Board on November 15, 2011, sufficient funds are available to implement a dredging of Marina del Rey in which contaminated sediment will be disposed at the Port of Long Beach and uncontaminated sediment at Redondo Beach to protect against future erosion. According to DBH, mobilization for the project will begin the week of February 13, 2012, and the dredging will begin on March 18, 2012, and be completed by mid-May 2012.

Proposed Funding Increases

Surface Transportation Program Reauthorization: The proposed budget calls for $476 billion over six years to reauthorize surface transportation programs and an additional $50 billion for transportation investments in FFY 2012, which the Administration also requested last year. According to OMB, this represents an increase of 80 percent above the level in the previous surface transportation reauthorization law, known as SAFETEA-LU. The increase would be funded from "peace dividend" savings from ramping down overseas military operations. Similar to last year, the President also proposes to create a new National Infrastructure Bank to leverage Federal and private investments in large-scale infrastructure projects of regional or national significance. Once again, he also proposes to permanently authorize ARRA's Transportation Investment Generating Economic Recovery ("TIGER") Program, which funds innovative multi-modal and multi-jurisdictional transportation projects.

Community Oriented Policing Stabilization Fund: As previously requested in the President's AJA proposal last September, the proposed budget requests $4 billion to support first responders and to hire and retain police officers with a preference for hiring post-9/11 veterans.

Foster Care Financing: Similar to last year, the proposed FFY 2013 Budget includes $2.5 billion over ten years for new foster care incentive payments aimed at preventing child abuse and keeping children safely in homes and out of long-term foster care placements. The Administration has not yet released a detailed description of how the financial incentive payments would be awarded.

Section 8 Tenant-Based Rental Assistance Administrative Fees: The proposed budget would increase Section 8 Tenant-Based Rental Assistance Administrative Fee funding by 16 percent from $1.35 billion in FFY 2012 to $1.57 billion in FFY 2013. The CDC indicates that the proposed 16 percent increase may result in approximately $3.5 million in additional funding to the County and would help offset some of the decreased funding to administrative fees enacted in FFY 2012.

Homeless Assistance Grants: The proposed budget would increase Homeless Assistance Grants funding by 17 percent from $1.90 billion in FFY 2012 to $2.23 billion in FY 2013, to maintain existing units and expand prevention, rapid re-housing, and permanent supportive housing. The Los Angeles Homeless Services Authority is the primary recipient of Homeless Assistance Grant funding within the County.

Byrne Justice Assistance Grant Funding: The proposed budget would increase formula grant funding for Byrne Justice Assistance Grants from $352 million in FFY 2012 to $413 million in FFY 2013, which still would be slightly below its FFY 2011 funding level of $422 million.

Other Proposals of County Interest

Interoperable Wireless Broadband Network: Similar to last year, the proposed budget assumes nearly $21 billion in revenue from auction spectrums to be used for deficit reduction. The budget also proposes $7 billion in funding to build an interoperable wireless broadband network for public safety use nationwide, and would allocate the D-Block spectrum for use by public safety agencies. This is important to the Los Angeles Regional Interoperable Communications System (LA-RICS) and first responders in the County.

Build America Bonds: The Administration is proposing to extend the Build America Bonds (BABs) Program for two years at a subsidy rate of 30 percent and permanently at a subsidy rate of 28 percent in subsequent years. Under the American Recovery and Reinvestment Act (ARRA), the program provided a tax credit (subsidy) of 35 percent in FFYs 2009 and 2010 that state and local governments could issue to finance capital projects in lieu of issuing traditional tax-exempt bonds. Similar to last year, the Administration also proposes to expand the allowable uses of BABs beyond the capital projects, which were allowed under the ARRA.

Base Realignment and Closure Rounds: The Administration is proposing two new Base Realignment and Closure (BRAC) rounds in 2013 and 2015 to help reduce overall defense spending to the reduced annual spending levels required by the BCA. Domestic and overseas bases with large numbers of military personnel will likely be a major focus if Congress approves these rounds. During the last BRAC round in 2005, it was speculated that Los Angeles Air Force Base (LAAFB) might be realigned. However, the base was determined to have a high military value and kept open. Its support of the mission at nearby Vandenberg Air Force Base and the presence of very few uniformed personnel at the base also were positive factors for retaining the LAAFB at its current location. Moreover, following the 2005 closure round, the Air Force approved a land swap at LAAFB which substantially downsized the footprint of the base and most likely will significantly reduce the cost savings that would be achieved from moving its functions elsewhere.

Veterans Job Corps Initiative: The budget proposes $1 billion over five years for an interagency effort, led by the Veterans Administration, to expand employment opportunities for veterans, particularly those returning from Iraq and Afghanistan. The Departments of Agriculture, Commerce, Interior, and the Army Corps of Engineers also would participate in this effort. The budget does not specify how this funding would be divided between the agencies.

Budget Outlook

The President's proposed FFY 2013 Budget includes many of the same budget proposals which were rejected by the Republican-controlled House last year when he offered them. It is all but certain that Congress will defer final action on FFY 2013 appropriations and many other major budget issues, such as the extension of the expiring Bush tax cuts, until after the November elections. In fact, the House is scheduled to be in session for only two weeks between August 4, 2012 and October 1, 2012, when FFY 2013 begins, and already has scheduled a "lame duck" session after the November elections. It also is noteworthy that, in each of the past three election years, Congress even enacted Continuing Resolutions to temporarily extend programs into the following year rather than completing appropriations during a lame duck session.

Before Congress begins action on FFY 2013 budget issues, it first must complete action on major legislation (H.R. 3630), which would extend the Social Security payroll tax reduction, emergency Unemployment Insurance benefits, and TANF, and which would maintain the current level of Medicare physician payment rates beyond February 29, 2012. H.R. 3630 also includes language which would allocate the D-Block spectrum to public safety and auction other spectrum to help reduce the Federal deficit and finance improvements in public safety interoperable communications. Conferees on the bill have made little progress to date on deciding how to finance these extensions without adding to the Federal deficit. Congress also is likely to temporarily extend surface transportation programs, which, otherwise, will expire on March 31, 2012, just as it has done since such programs originally were due to expire on September 30, 2009. The main stumbling block to enacting multi-year surface transportation reauthorization legislation has been the lack of agreement on how to adequately finance such programs without adding to the deficit.

House Republican leaders have indicated that they plan to begin action next month on an FFY 2013 Budget Resolution to guide Congressional action on budget-related legislation. It is expected that the House Republicans' budget resolution will call for far deeper spending cuts than proposed by the President. Senate Majority Leader Reid, however, has indicated that the Senate will not pass a budget resolution this year. As a result, similar to last year, Congress is unlikely to pass a budget resolution. For all of the reasons cited above, we expect another prolonged budget process with key Congressional budget decisions, such as on FFY 2013 appropriations and expiring Bush tax cuts, being postponed until after the November elections.

We will continue to keep you advised.

WTF:RA
MR:MT:OR:sb

c: All Department Heads
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