CITY OF
LONG BEACH

Memorandum

Date: December 9, 2022

To: Thomas B. Modica, City Manager T.M.

From: Kevin Riper, Director of Financial Management KR

For: Mayor and Members of the City Council

Subject: **Revenue Implications of SB 1137 - Health and Safety Setbacks Around New and Reworked Existing Oil Wells**

Recently enacted Senate Bill (SB) 1137 establishes a 3,200-foot health and safety zone around new and reworked existing oil wells and prohibits drilling of new wells and improvements to existing wells within that radius. The legislation was introduced in the final two weeks of the session as a gut-and-amend, and it passed with very little opportunity to engage in the development of the proposal. The City of Long Beach (City) sent a letter to the authors and to Governor Newsom outlining the concerns and potential impacts of the legislation on the City's actions to safely manage the environmental risk of subsidence; reserve funding for oil well abandonment; and funding a variety of climate, health, and youth programs in Long Beach.

Despite the truncated legislative process at the very end of the session, this legislation will have significant ramifications for oil operations throughout the state. In Long Beach, the City was already in the process of planning a transition away from oil production as early as 2035, but the legislation will greatly expedite this transition. While the City fully supports the intent of the legislation to advance health equity and mitigate the impacts of climate change—and Long Beach has been a leader in this field—SB 1137 presents major fiscal challenges for the City's efforts to fund oil well abandonment, as well as critical local programs and projects in the Tidelands.

The Energy Resources Department and the State's Geologic Energy Management Division (CalGEM) estimate that the legislation's required 1.15-square-mile health and safety setbacks will apply to about half of the City's oil wells, and accelerate the elimination of oil production before the previously projected year, which was 2035.This impact is due to a projected doubling of the rate of annual decline in oil production in the City. Until now, the Energy Resources Department has assumed a long-term, natural decline of 6 percent per year in oil production. Under SB 1137, that decline is assumed to double, to 12 percent per year.

SB 1137 is slated to go into effect January 1, 2023. However, the effective date of SB 1137 is uncertain due to an initiative petition drive by the oil industry to place a Statewide proposition before the voters in March 2024 that would overturn SB 1137. If SB 1137 ultimately stands, it will significantly reduce revenue in the City's Tideland Operating Fund; and cause smaller revenue reductions in the Uplands Oil Revenue Fund, which is part of the General Fund Group; and elsewhere in the General Fund, beginning in the second year that SB 1137 is in effect.

A October 25, 2021 memorandum from the Energy Resources and Financial Management Departments foreshadowed this possibility, accurately predicting that, "Any actions by the State to reduce or stop oil production before 2035 may also have an additional adverse impact on City oil production over time and may result in less time to adjust to lower oil revenue…."

Estimated Tideland Operating Fund Impacts

The price of Wilmington Crude oil produced in Long Beach has averaged about $70 per barrel (bbl) over the last 17 years, so the Energy Resources Department has evaluated the revenue impacts of SB 1137 on the Tideland Operating Fund under two different future oil-price scenarios: (i) the City's usual, deliberately conservative assumption of $55/bbl for a commodity famous for wild swings in price; and (ii) a $65/bbl assumption that is closer to historical actuals.

The tables below show the resulting revenue reductions for the Tideland Operating Fund, in millions of dollars, with parentheses denoting a revenue loss after SB 1137, compared to revenue before SB 1137.

Oil price/bbl	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
$55	**-0-**	**($9.9m)**	**($11.1m)**	**($12.9m)**	**($13.9m)**	**($13.6m)**
OR						
$65	**-0-**	**($6.1m)**	**($7.8m)**	**($9.9m)**	**($11.7m)**	**($13.1m)**

Under either oil-price assumption, the financial implications of the projected loss in revenue to the Tideland Operating Fund are obvious: (i) less money to spend on annual operating expenses in the Tidelands; and/or (ii) less money available to pay debt service on the long-term municipal bonds that would need to be sold to finance capital projects in the Tidelands, such as the Belmont Beach and Aquatic Center, structural improvements to the Convention and Entertainment Center, and water circulation pumps for Alamitos Bay.

Estimated Uplands Oil Revenue Fund (part of the General Fund Group) Impacts

Oil price/bbl	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
$55	-0-	($0.9m)	($1.6m)	($2.1m)	($2.6m)	($2.9m)
OR						
$65	-0-	($0.5m)	($1.2m)	($1.8m)	($2.3m)	($2.7m)

Estimated General Fund (other than Uplands Oil Revenue Fund) Impacts

The General Fund receives revenue related to the production of oil in several other ways.

Sales and Use Tax (Bradley-Burns 1 percent) and Transactions and Use Tax (Measure A 1 percent): several sales tax generators in the City are involved in oil production. To the extent that SB 1137 reduces the production of oil, sales in Long Beach will be reduced, and so will the sales taxes paid. Other sales tax generators in the City sell petroleum-based products at retail, and to the extent that SB 1137's reduction in locally produced oil also affects those firms, their sales in Long Beach will similarly be reduced, and so will the sales taxes they generate. Both factors are included in the revenue estimates for sales tax loss on the next page.

Property Tax: Oil production companies pay property taxes on the assessed value of their land and improvements (structures, equipment). To the extent that SB 1137 eventually reduces the market value of their property below the assessed value, the City -- and all other taxing jurisdictions – will receive less property tax revenue from oil production companies than currently received. However, at least for those oil production properties that have remained under the same ownership, 40-plus years of Proposition 13 being in effect almost certainly means that today's market value of oil-production properties is much higher than today's assessed value on which property tax bills are calculated. Therefore, it is likely that these oil-production properties have a long way to fall in market value before their property tax bills actually go down, and thus before the City – and all other taxing jurisdictions – experience any loss in property tax revenue. As a result, the table below assumes zero reduction in property tax revenue over the forecast horizon. Eventually, the value of the oil-production properties will drop as oil is no longer able to be extracted from them, at which time the property tax revenue they generate will drop sharply. That is likely to occur beyond the timeframe of this analysis.

Utility Users Tax: Oil production companies use substantial amounts of electricity, which generates utility users tax revenue for the City. To the extent that SB 1137 causes them to produce less oil, they will use less electricity, which will reduce utility users tax revenue.

Measure US and Prop H Oil Barrel Production Tax: City revenue generated from the business license tax on oil production depends on the number of barrels of oil produced. As SB 1137 restricts oil production, revenue from Measure US and Prop H will decrease.

The table below lists General Fund revenue loss projections by the Energy Resources Department (utility users tax and Measure US/Prop H business license tax) and the Financial Management Department (sales tax and property tax). These projections are less sensitive to the assumed price of oil than the other revenue estimates shown above. Therefore, these projections are all based on an oil-price assumption of $55/bbl.

Rev. Source	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Sales tax	-0-	($0.7m)	($0.9m)	($1.2m)	($1.2m)	($1.2m)
Property tax	-0-	-0-	-0-	-0-	-0-	-0-
Util users tax	-0-	($0.3m)	($0.5m)	($0.7m)	($1.0m)	($1.2m)
Measure US	-0-	($0.3m)	($0.3m)	($0.2m)	($0.2m)	($0.2m)
Subtotal	-0-	($1.3m)	($1.7m)	($2.1m)	($2.4m)	($2.6m)
Add: Uplands Rev. Fund	-0-	($0.9m)	($1.6m)	($2.1m)	($2.6m)	($2.9m)
Total, General Fund	**-0-**	**($2.2m)**	**($3.3m)**	**($4.2m)**	**($5.0m)**	**($5.5m)**

The revenue loss projections for both the Tideland Operating Fund and the General Fund are subject to many assumptions, and actual results could well differ noticeably from these estimates.

Oil Well Abandonment Costs

The total cost to abandon, eventually, the City's oil wells is currently estimated at $1.2 billion, allocated to the various owners as follows:

State	$ 939.7 million
City	$ 154.0 million
Townlot	$ 68.7 million
CRC	$ 61.4 million
TOTAL	$ 1,223.8 million

Existing reserves for those oil abandonment costs are as follows:

State	$ 300.0 million, or 32 percent of State's liability
City	$ 70.0 million, or 45 percent of City's liability
Townlot	$ unknown, but assume zero
CRC	$ 61.4 million bond, or 100 percent of CRC's liability
TOTAL	$ 431.4 million, or 35 percent of total liability

Therefore, the City still needs to set aside an additional $84 million to fully fund its own oil well abandonment liability. At the previously projected abandonment liability reserve of $8.75 million per year (consisting of $7.125 million in the Tideland Operating Fund plus $1.625 million in the Uplands Oil Revenue Fund), it would take another 10 years to fully fund the City's liability. As the oil revenue continues to decline, the abandonment reserve will become a larger percentage of the total oil revenue.

Under SB 1137, with Tideland and Uplands revenue losses of more than $15 million annually by Year 4, there will not be enough remaining revenue to support current operating expenses, existing and planned debt service on Tidelands municipal bonds, and oil-well abandonment liability set asides. It is conceivable that the General Fund may have to plug that liability gap in the late 2020s or early 2030s.

Total Financial Impact (Tidelands Fund and General Fund)

For just the first five years affected by SB 1137 as shown above, the total revenue loss to the City is projected at $81.6 million assuming $55/bbl oil price, or $67.2 million assuming $65/bbl. Add to that the City's remaining unfunded liability for oil well abandonment costs at the end of those five years ($40.25 million) for which the historical revenue source will be literally drying up, and the total negative financial impact of SB 1137 on the City over just the first five years is estimated at $122 million ($55/bbl assumption), or $107 million ($65/bbl assumption).

If you have any questions, please do not hesitate to contact Kevin Riper at (562) 570-6427 or Kevin.Riper@longbeach.gov.

CC: CHARLES PARKIN, CITY ATTORNEY
DOUGLAS P. HAUBERT, CITY PROSECUTOR
LAURA L. DOUD, CITY AUDITOR
LINDA F. TATUM, ASSISTANT CITY MANAGER
TERESA CHANDLER, DEPUTY CITY MANAGER
KATY NOMURA, DEPUTY CITY MANAGER
APRIL WALKER, ADMINISTRATIVE DEPUTY CITY MANAGER
KEVIN LEE, CHIEF PUBLIC AFFAIRS OFFICER
MONIQUE DE LA GARZA, CITY CLERK
DEPARTMENT HEADS