



City of Arts & Innovation

Finance Committee

TO: FINANCE COMMITTEE MEMBERS **DATE: JUNE 11, 2025**
FROM: FINANCE DEPARTMENT **WARDS: ALL**
SUBJECT: FISCAL YEAR 2025/26 STATE GOVERNOR'S MAY REVISION OVERVIEW

ISSUE:

Receive and file a report on the Fiscal Year 2025/26 State Governor's May Revision.

RECOMMENDATIONS:

That the Finance Committee receive and file a report on the Fiscal Year 2025/26 State Governor's May Revision.

BACKGROUND:

The State constitution and related Government Codes require that the Governor submit a proposed budget to the Legislature annually by January 10, provide an update to the proposed budget by May 14 of each year, and that the Legislature pass a budget bill by June 15.

DISCUSSION:

Governor Newsom released the Fiscal Year 2025/26 State Governor's Budget proposal on January 10, 2025, and the May Revision to the State Budget on May 14, 2025.

Overall, the proposed FY 2025-26 State Governor's May Revision projects an estimated shortfall of \$12 billion (5.8%) to balance the budget and to provide for a prudent discretionary reserve. This is due to a combination of factors including a \$5.2 billion revenue downgrade through FY 2025-26, combined with higher anticipated costs, primarily in Medi-Cal Expenditures.

The Budget includes \$321.9 billion in total expenditures of which \$226.4 billion are from the State General Fund. This represents a \$6.9 billion (3 percent) decrease in proposed General Fund expenditures compared to the revised FY 2024/25 level of expenditures.

2025-26 Total State Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	\$8,195	\$4,555	\$376	\$13,126
Business, Consumer Services & Housing	491	1,320	522	2,333
Transportation	724	17,144	97	17,965
Natural Resources	3,836	3,457	2,472	9,766
Environmental Protection	121	3,865	372	4,357
Health and Human Services	85,362	44,891	450	130,703
Corrections and Rehabilitation	13,406	4,087	-	17,493
K-12 Education	80,344	105	1,517	81,966
Higher Education	23,058	176	551	23,785
Labor and Workforce Development	946	1,143	-	2,089
Government Operations	2,698	180	12	2,890
General Government:				
Non-Agency Departments	1,285	2,096	171	3,552
Tax Relief/Local Government	556	3,727	-	4,283
Statewide Expenditures	5,354	2,232	1	7,587
Total	\$226,376	\$88,978	\$6,541	\$321,895

Note: Numbers may not add due to rounding.

2025-26 Revenue Sources

(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2024-25
Personal Income Tax	\$125,977	\$3,634	\$129,611	\$130
Sales and Use Tax	34,862	15,770	50,632	1,629
Corporation Tax	35,613	-	35,613	-5,683
Highway Users Taxes	-	9,571	9,571	60
Insurance Tax	4,359	-	4,359	282
Alcoholic Beverage Taxes and Fees	421	-	421	4
Cigarette Tax	35	1,131	1,166	-47
Motor Vehicle Fees	46	12,826	12,872	331
Other	6,145	47,078	53,223	-5,911
Subtotal	\$207,458	\$90,010	\$297,468	-\$9,205
Transfer from the Budget Stabilization Account/Rainy Day Fund	7,100	-7,100	-	-
Total	\$214,558	\$82,910	\$297,468	-\$9,205

Note: Numbers may not add due to rounding.

While the May Revision does not forecast a traditional recession, it does reflect changing national conditions that economists consider to be a “growth recession”—marked by a substantial slowdown in Gross Domestic Product growth combined with lower job growth and higher unemployment. Higher tariffs are the principal driver of this shift to a “growth recession” outlook, and are reflected in the downward revision of key economic factors in the May Revision forecast. The biggest downside risk for the May Revision forecast continues to be federal policy uncertainty.

The May Revision proposes \$12 billion in solutions in FY 2025/26 to close the General Fund deficit including:

- \$5 billion in reductions in FY 2025/26, growing to \$14.8B by FY 2028/29, mostly in Healthcare/Human Services Programs.
- \$5.3 billion in revenue reforms/borrowing/loans, mostly coming from Medi-Cal rate increases, and loans from the Medical Providers Interim Payment Fund.
- \$1.7 billion in fund shifts, mostly from the General Fund to the Greenhouse Gas Reduction Fund.

The May Revision also:

- includes \$456.1 million in commitments that would be triggered on in 2027-28, contingent upon sufficient resources to support these commitments.
- maintains the planned withdrawal of approximately \$7.1 billion from reserves that was included in the Governor's January budget. Accounting for withdrawals, the Budget reflects total reserve balances of approximately \$15.7 billion at the end of 2025-26.

Below are proposals and information included in the FY 2025/26 State Governor's May Revision that may be of most relevance to the City's finances and policies:

Budget Reserves and Gann Limit Reforms

The Governor's May Budget Revision continues proposed reforms to laws identified in January related to state's budget reserves and Gann Limit. Specifically, it proposes to increase the cap on deposits to state reserves from 10 percent to 20 percent, and to exclude transfers to reserves from the Gann Limit expenditure calculation. These reforms would also require voter approval through a state ballot initiative.

These proposed reforms could provide a policy window to also address local Gann limit issues. For example, currently local government transfers to reserves also count towards the Gann limit and extending the reserve transfer exclusion to local governments can also help alleviate Gann Limit expenditure caps.

Housing and Homelessness

The May Revision includes ongoing funding to support the reorganization of the Business, Consumer Services, and Housing Agency, which includes resources for the new California Housing and Homelessness Agency and the creation of the Housing Development and Finance Committee (HDFC). The new HDFC will administer multifamily affordable housing programs and is intended to streamline the administration and oversight of housing funding across the state, improving efficiency and reducing the administrative burden for housing developers.

The Governor is proposing a legislative package to reduce red tape, align permitting timelines, and unlock faster, smarter housing development. The proposal streamlines Coastal Commission approvals to match the timelines of other permitting agencies, prioritizes infill and transit-oriented development to reduce toxic pollution and vehicle miles traveled, and support for incorporating pending legislation that would reform CEQA for infill housing and other development projects, along with a housing and infrastructure bond.

The May Revision includes the elimination of \$31.7 million unexpended in the General Fund that was previously appropriated for the Infill Infrastructure Grant Catalytic Program, the Commercial Property Pilot Program, and the 2021 Infill Infrastructure Grant Program.

The May Revision also includes \$200 million in Proposition 35 funds over two years for Flexible Housing Pool rental assistance and housing supports to help individuals with significant behavioral health conditions who are experiencing, or at risk of, homelessness, enter and maintain stable long-term housing.

Climate

The May Revision proposes an extension of the Cap-and-Trade program, with a renaming to the Cap-and-Invest program. The Administration signaled that it intends to work with the Legislature to design an expenditure plan that invests the program's proceeds in transformative climate projects. The May Revision proposes a shift of \$1.54 billion from the General Fund to the Greenhouse Gas Reduction Fund to support CAL FIRE's fire prevention, fire control, and resource management activities on an ongoing basis. The May Revision also proposes that at least \$1 billion annually should be provided for the High-Speed Rail Project. This reprioritization of Cap and Trade funds may result in less funding being available for other discretionary programs that benefit local agencies.

The May Revision also continues the first year of a multi-year expenditure plan to implement the \$10 billion Climate Bond (Proposition 4) authorized by voters in November. This funding will provide additional grant opportunities that entities including local government can apply to in addressing climate issues.

Sales Tax and Economic Forecast Assumptions

The state sales tax forecast is \$2 million lower in 2023-24, \$405 million lower in 2024-25, and \$259 million lower in 2025-26. Sales tax revenues are downgraded due to lower-than-anticipated taxable sales in the second half of 2024. In addition, taxable sales are projected to grow slower due to a weaker economic outlook and lower business investment offsetting some near-term positive impacts on nominal consumer spending due to inflation.

The May Revision notes that all major CPI components are projected to experience higher inflation in 2025 and 2026 as a result of the broad and elevated tariffs. While new vehicles and apparel have the greatest projected inflationary impacts, tariffs are projected to significantly raise inflation in most categories including household furnishings, food, medical care, recreation, and other goods.

Overall, California personal income growth is expected to slow from 6.5 percent in 2024 to 4 percent and 4.1 percent in 2025 and 2026, respectively (compared to 4.2 percent and 4.6 percent in the Governor's Budget) due to general weakening economic conditions. Notably, wages and salaries are downgraded by \$36.2 billion per year or 1.8 percent.

High interest rates continue to hamper residential construction activity, which is also now projected to be further slowed by tariffs, leading to a significantly downgraded housing permits forecast. The decline in permitting has been driven by multi-family permitting, which is disproportionately impacted by high interest rates. The forecast for permitted units is downgraded by 14,000 units or 12 percent on average through the forecast window due to low actuals since

Governor's Budget, higher projected interest rates, tariff-induced material cost increases, and potential labor supply issues.

STRATEGIC PLAN ALIGNMENT:

The reporting and presentation of the state budget supports **Strategic Priority 5 – High Performing Government** and **Goal 5.3** - Enhance communication and collaboration with community members to improve transparency, build public trust and encourage shared decision making.

Reporting on the state budget aligns with each of the five Cross-Cutting Threads as follows:

1. **Community Trust** – Presentation of state budget impacts provides a transparent view and communication of state finances and policies that can potentially impact the City in a forum that accommodates community engagement.
2. **Equity** – The report is available to all members of the public via the City website, and the presentation of the report in a public forum accommodates community engagement from all members of the public.
3. **Fiscal Responsibility** – The report demonstrates the City's commitment to monitoring state budget and programs that can impact the City to support responsible management of the City's financial resources.
4. **Innovation** – The report provides information that can lead to future action by the City to seek funding or policy changes to benefit the City which demonstrate innovative management of City finances.
5. **Sustainability & Resiliency** – The report and insights on potential impacts to the City identified by staff demonstrate the City's commitment to the long-term fiscal health of the City and the preservation of City services.

FISCAL IMPACT:

There is no fiscal impact associated with this report.

Prepared by:	Sergio Aguilar, Deputy Finance Director
Approved by:	Kristie Thomas, Finance Director/Assistant Chief Financial Officer
Certified as to availability of funds:	Kristie Thomas, Finance Director/Assistant Chief Financial Officer
Approved by:	Edward Enriquez, Assistant City Manager/Chief Financial Officer/Treasurer
Approved as to form:	Rebecca McKee-Reimbold, Interim City Attorney