INTRODUCTION

California's economy remains larger than all but four nations with an annual gross domestic product (GDP) of nearly $3 trillion in 2018. The May Revision protects the hard-won recovery and is centered on making necessary investments for a more effective government, promoting affordability and opportunity, and supporting justice and dignity for all Californians.

Data for 2018 reflect that the growth in California's GDP continues to outpace the nation as a whole. However, this growth is taking place against a backdrop of increasing risks: the International Monetary Fund recently projected that 70 percent of the world's economy would see a slowing of growth in 2019 and the Federal Reserve also projects slower U.S. growth. Federal tax reform has not resulted in increased wages for workers. Total wages and salaries in 2018 grew at almost one-half the rate of growth during the last period of low unemployment (2000).

The May Revision recognizes these risks and the inextricable linkage between fiscal prudence and the state's ability to promote affordability and economic opportunity. Accordingly, it simultaneously expands the Governor's commitment to budget resiliency and increases support for California's most vulnerable populations and working families.

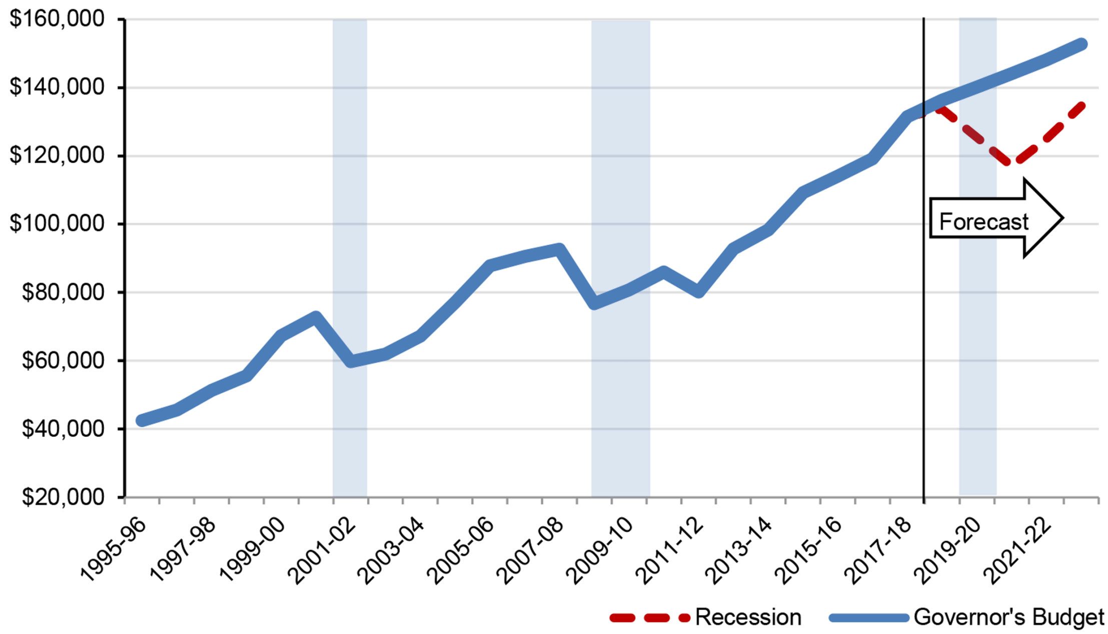
The May Revision projects short-term revenues of $3.2 billion above the Governor's Budget. However, most of the increased revenues are constitutionally obligated to reserves, debt repayment, and schools. Therefore, the budget surplus remains relatively unchanged. Despite the short-term gains, slower economic growth leads to a lower forecast in out-year revenues—$1.6 billion lower in 2022-23 compared to the forecast in January.

Strong Foundation, Intensified Risks

The state has built a strong fiscal foundation by paying down debts and liabilities and building up reserves that will help manage the effects of an economic downturn. However, growing uncertainty related to the global political and economic climate, federal policies, rising costs, and the length of the current economic expansion require that the Budget be prudent.

The May Revision forecast recognizes slower growth in the economy, but does not predict a recession. However, the state must be prepared for the possibility that even a moderate recession could result in revenue declines of nearly $70 billion and a budget deficit of $40 billion over three years.

Revenue Could Drop by Nearly $70 Billion in a Recession
(Dollars in Millions)



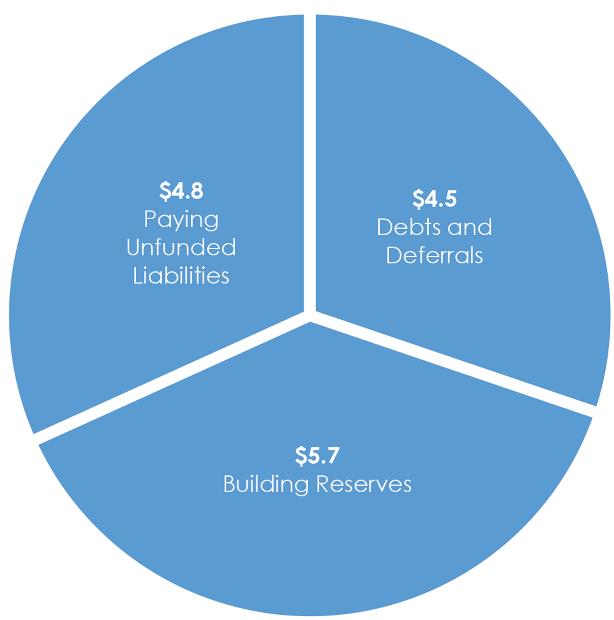
Given the slowing economic forecast and the intensified risks, the May Revision continues to save and prepare for uncertain times ahead. To maintain structural balance in each year over the forecast period, the May Revision proposes to sunset certain program expansions at the end of December 31, 2021. This includes programs in which the growth of expenditures continues to outpace long-term revenue growth, and where the Administration is committed to reforms that bend the cost curve.

Building Budget Resiliency and Paying Down Unfunded Retirement Liabilities

The May Revision allocates $15 billion to building budgetary resiliency and paying down the state's unfunded liabilities—$1.4 billion higher than proposed in January. This includes $4.5 billion to eliminate debts and reverse deferrals, $5.7 billion to build reserves, and $4.8 billion to pay down unfunded retirement liabilities. In the first two of these three categories, the May Revision reflects the following changes:

- Eliminate Debts and Reverse Deferrals—The revised total now includes a portion of the Proposition 98 settle-up that was not reflected in the Budget. This marks the first time in over a decade that all budgetary debts are completely paid off.
- Build Reserves—An additional $1.2 billion deposit into the Rainy Day Fund brings the reserve to $16.5 billion in 2019-20. The Rainy Day Fund is now expected to reach its constitutional cap of 10 percent of General Fund Revenues in 2020-21—two years earlier than predicted in January. By the end of 2022-23, the Rainy Day Fund balance is projected to be $18.7 billion. In addition, for the first time, $389 million in Proposition 98 funding is reserved in the Public School System Stabilization Account. This transfer is required by Proposition 2.

Building a Strong Foundation: $15 Billion
(Dollars in Billions)



2019-20 May Revision

Effective Government

Building budget resiliency promotes a more effective government that can withstand downturns in the economy, as well as natural and human-caused emergencies and disasters.

The May Revision also includes critical investments needed to sustain and improve California's emergency readiness, response, and recovery capabilities. This includes funding to protect vulnerable populations and public safety related to power interruptions planned by utilities during the upcoming fire season.

Maintaining a balanced budget and increasing budget resiliency is non-negotiable and a predicate for expanding programs.

Affordability and Opportunity

The Governor's Budget made major investments to address the fact that far too many Californians simply cannot pay basic bills, afford health care, find an affordable place to live, or provide opportunities for their children to thrive from cradle-to-career. The May Revision maintains and expands these investments. However, based on lower growth in out-year revenues, to maintain a structurally balanced budget, more of these investments are now proposed to be temporary allowing for review of these investments in the future.

The May Revision continues to expand the Earned Income Tax Credit (EITC) and includes an additional $210 million. The Cal-EITC: A Cost-of-Living Refund will help low-income families with young children by expanding the additional credit proposed in January from $500 to $1,000. The May Revision also provides for monthly advanced payments contingent on a federal waiver to ensure participants do not lose federal benefits. This increased tax refund will help economically distressed families with the costs of food, rent, and child care.

The Administration continues to work on several strategies to improve affordability and access to health care, including addressing the rising cost of prescription drugs, increasing health insurance subsidies so that more middle-class Californians can afford health coverage through Covered California, and moving closer to universal coverage by expanding full-scope Medi-Cal coverage eligibility to young adults ages 19 through 25 regardless of immigration status.

The Administration continues to work with local governments and stakeholders to address the housing crisis head-on, including identifying excess state property that can be used for housing development. The May Revision updates the Governor's January housing proposal to focus on accelerating housing development and leveraging private investment from newly formed Opportunity Funds. The May Revision also doubles the General Fund support to legal aid resources to help renters fight back against rent gouging and other unfair practices.

The May Revision prioritizes cradle-to-career opportunities by recognizing the crucial investments needed to support young children and their parents. These investments include increasing training for doctors so they can identify and treat issues related to childhood trauma, and additional funding for expanded investments in childcare. The Budget established the goal to expand California's Paid Family Leave program so newborns can be cared for by a parent or close relative for the first six months of the child's life. The May Revision reflects a down payment towards this goal by expanding paid family leave for each parent from six to eight weeks. This expansion adds an additional month of paid leave for two-parent families, allowing up to a combined four months of leave after the birth or adoption of their child.

The May Revision further expands funding for K-12 schools by providing approximately $5,000 more per pupil than eight years ago, including greater investments to assist students with the greatest needs. The Governor's Budget reflected a significant increase in funding for special education and the May Revision further increases the ongoing funding by over $300 million compared to the Governor's Budget. The May Revision makes significant investments in the recruitment and retention of qualified teachers by revamping teacher training and providing targeted loan repayments.

Colleges and universities remain engines of economic mobility. The May Revision maintains funding for two free years of community college tuition for first-time full-time students, and provides significant increases for the California State University and the University of California to prevent tuition increases in the budget year.

Justice and Dignity

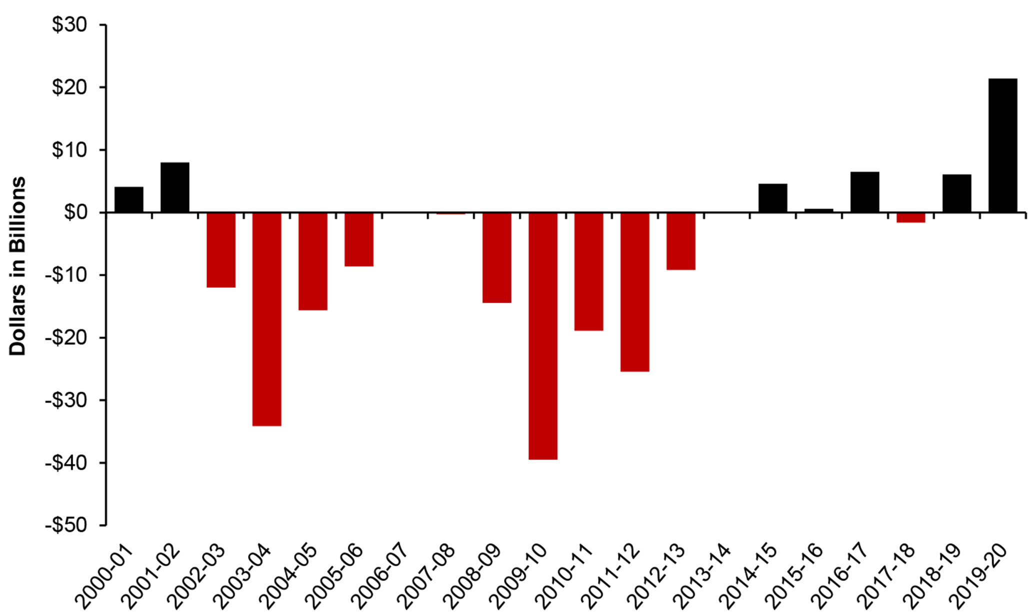
California is facing a homelessness epidemic across the state. This crisis is exacerbated by a health care system that does not adequately serve individuals with mental illness. The May Revision invests an additional $150 million for a total of $650 million one-time to support local governments on the frontline combating this epidemic. The May Revision also includes additional funding to expand the whole person care pilot projects to additional counties and makes a major investment in workforce, education, and training of mental health professionals. In total, the May Revision includes $1 billion to prevent and mitigate the homelessness epidemic.

The May Revision increases access to justice by providing funding for 25 new judgeships and expanded language access services in the courts. The May Revision also includes an overhaul of the substance use disorder programs in prison, including integrating medically assisted treatment and reentry services as appropriate. The May Revision also expands reentry beds to continue progress in closing gaps and supporting all Californians in having access to justice and dignity.

A Strong Foundation is Fundamental to a California for All

Maintaining the fiscal health of the state is an ongoing challenge given its volatile revenue base and limited spending flexibility. The Budget demands constant attention to stay in balance. Vigilance is especially needed this year given the length of the current economic expansion and federal uncertainty. The May Revision takes a careful approach by allocating $15 billion toward building more budget resiliency through paying off debts and deferrals, building reserves, and paying down unfunded liabilities. It makes strategic investments, mainly one-time, to expand affordability and opportunity, strengthen the state's readiness and emergency response, and promote access to justice and dignity. Building a strong foundation now is the best way the state can prepare for the future and continue to build a California for all.

Balanced Budgets Have Been Quickly Followed by Huge Deficits[1/]



[1/] Budget shortfalls or surplus, measured by the annual Governor's Budget.