

INTRODUCTION

After two years dominated by COVID-19, the first months of 2022 brought a new set of challenges—elevated global inflation spurred by lingering supply-chain disruption and Russia's war in Ukraine that has sent fuel prices soaring. In addition, increasingly extreme weather due to climate change is leading to more severe heatwaves and drought conditions, worsening wildfires and a massive new strain on the state's electrical grid.

Despite these challenges, California continues to move forward. The state is creating more new jobs than any other state—more than 1 million in the last 12 months alone. California's continued success comes from the creativity and ingenuity of its people, years of smart public investments, and continued fiscal responsibility. General Fund revenues are estimated to be nearly \$55 billion higher than January, even after the temporary limitation of business tax credits was restored earlier this year. California's continued growth is rooted in our commitment to expand opportunity for all, especially those most affected by a rapidly changing economy.

The May Revision includes \$18.1 billion in direct relief to millions of Californians to help offset rising costs and projects that the minimum wage will be boosted for millions of workers. The May Revision adds to substantial investments to address homelessness and mental health and includes funding to make neighborhoods safer. It supports additional protection from the impacts of wildfire and drought, and bolsters the state's electrical grid to keep Californians safe. All while putting billions of dollars more into state reserves and paying down debts.

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The May Revision continues to reflect California values—defending women's right to choose, expanding access to health care for all Californians, and protecting the most vulnerable. It reshapes California public schools, expands access to the state's colleges and universities, and funds the roads, transit systems, broadband infrastructure, and clean energy grid to assure California's success for generations to come.

The Budget must continue to be prudent and the state must be prepared for an uncertain future. While the revenue forecast has been upgraded significantly due to recent cash trends, there is also increased economic uncertainty as the war, global supply chain disruptions, and record rates of inflation persist. The stock market has also declined in recent weeks since the budget forecast was finalized. To prepare for this uncertain future, the May Revision reflects \$37.1 billion in budgetary reserves and plans to prepay billions of dollars in state debts and make supplemental deposits into the Rainy Day Fund. The May Revision reflects \$49.2 billion in discretionary surplus, and the overall budget plan spends 94 percent of the discretionary surplus on one-time projects.

BROAD-BASED RELIEF

While wages have increased across the board, especially for high-income taxpayers, and corporate profits have surged, the COVID-19 Pandemic significantly destabilized families over the past two years. Persistent supply chain disruptions and labor market frictions have now driven inflation to its highest rates in 40 years, disproportionately affecting the ability of low- and middle-income households to cover every day needs.

Inflation is expected to exceed 7 percent in 2021-22, triggering an accelerated increase of the state's minimum wage for millions of workers to \$15.50 per hour regardless of employer size. To further address rising prices and return tax proceeds to Californians, a central component of the May Revision is a broad-based relief package. The package includes a \$400 rebate to households based on registered vehicles and a temporary reduction to the diesel sales tax rate that was proposed in March of this year.

The package also includes relief for families hardest hit by the pandemic, including funding for rental assistance, payments for outstanding utility arrearages built up during the pandemic, and covering all family fees for subsidized child care programs. The relief package also continues health care subsidies for the middle class if federal subsidies expire and includes retention bonus payments to approximately 600,000 workers in hospitals and nursing homes.

ADDRESSING IMPACTS OF EXTREME WEATHER

Climate change continues to drive extreme weather across the state, resulting in extreme heat events, severe drought, and worsening wildfires. These conditions are placing a massive new strain on the electrical grid, and new investments are needed to strengthen energy reliability. The Governor's Budget allocated \$22.5 billion over five years toward climate resilience and integrated climate, equity, and economic opportunity across the state's budget to mobilize a coordinated all-of-government response to the climate crisis. The May Revision complements these efforts and provides additional investments to combat the worsening drought, increase energy reliability, and enhance firefighting capabilities. The state is also investing in climate innovation, including lithium production to continue leading the world in climate solutions.

DROUGHT AND WATER RESILIENCE

This winter, a record-breaking lack of precipitation from January through mid-April pushed California into a third consecutive year of drought. Given the intensification of drought conditions since January, the May Revision allocates an additional \$1.6 billion, including the \$250 million set aside as a contingency in the Governor's Budget, to continue the state's drought response. These funds are allocated to immediate drought support, including efforts to encourage conservation. The May Revision also allocates funding to further long-term water resilience, including funding to augment loans to drinking water systems, increase water recycling, increase conservation within the agricultural sector, and expand habitat restoration. In addition, the May Revision also includes \$75 million to support grants of up to \$50,000 to farming and related businesses negatively impacted by the drought.

ENERGY

The May Revision allocates \$8 billion over five years to increase the state's energy system reliability and provide consumers with relief from rising electricity rates. This is in addition to the \$2 billion allocated in the Governor's Budget to provide incentives for long-duration-storage projects, renewable hydrogen, and industrial grid support and decarbonization projects. Recent supply chain disruptions, tariff issues, and other factors are negatively impacting the development of new clean energy installations in California, jeopardizing the timely development of projects needed for reliability. This is occurring as 6,000 megawatts of nuclear and gas-fired energy production are

scheduled to retire, and new extreme weather patterns are causing more stress on the state's energy grid. New wildfire hardening and transmission costs are placing additional upward pressure on electricity rates that are already rising significantly over the next few years. The May Revision investments are focused on creating strategic energy reserves to maintain reliability, accelerating clean energy projects and innovation, and providing relief to ratepayers.

WILDFIRES

The Governor's Budget proposed significant new enhancements to continue building forest and wildfire resilience statewide and expanded the state's wildfire response capacity. The May Revision builds on these efforts with additional funding to support expanded fire crews and air attack operations. The Administration also continues to work with firefighter associations on additional proposals that would appropriately staff CAL FIRE to meet the demands of wildland firefighting in a changing climate.

IMPROVING HEALTH CARE ACCESS AND AFFORDABILITY

California has advanced multiple measures in recent years to improve health care affordability and expand access. The Governor's Budget proposal to close the remaining gap in preventative coverage for individuals ages 26 to 49, regardless of immigration status will make California the first state to realize the goal of universal access to health coverage for all Californians. In the absence of the federal government extending the federal health insurance premium subsidies, the May Revision proposes \$304 million to re-instate state-supported Covered California premium subsidies for the middle class. The May Revision also includes \$100 million to develop and manufacture low-cost biosimilar insulin products to increase availability and affordability of insulin in the state.

While other states seek to limit women's ability to receive reproductive care, the May Revision adds \$57 million to the Governor's Budget proposals to expand access to reproductive healthcare services and improve clinical infrastructure and expand the workforce in reproductive healthcare services. The investments in the May Revision are focused on grants to reproductive health providers to provide abortion care and reproductive health education and information.

HOMELESSNESS AND MENTAL HEALTH

Last year, the state allocated a \$12 billion multi-year investment for local governments to build housing and provide critical supports and homelessness services. The Governor's Budget proposed an additional \$2 billion General Fund over two years to continue the state's efforts to address homelessness by investing in behavioral health housing and encampment cleanup grants. These investments are intended to serve as a bridge to other related efforts such as Homekey and California Advancing and Innovating Medi-Cal (CalAIM), which will redesign Medi-Cal to better serve Californians, including individuals experiencing homelessness, and provide long-term care. The May Revision includes an additional \$150 million to fund more Homekey projects and \$500 million for the development of interim housing designed to be built quickly, providing an additional type of housing to address homelessness.

The Administration has proposed a new court process to assist people living with untreated schizophrenia or other psychotic disorders. The May Revision includes \$64.7 million to fund state department and Judicial Branch costs associated with the new Community Assistance, Recovery and Empowerment (CARE) Court. The Administration continues to work with counties to estimate costs associated with this new court process. In addition, the Governor's Budget, as updated by the May Revision, made significant investments in community treatment and care for individuals suffering from mental illness who are deemed incompetent to stand trial. The Governor's Budget, as updated by the May Revision, also allocates opioid settlement funds, expands medication assisted treatment and expands community-based mobile crises services. All of these investments will better serve individuals experiencing mental illness and substance use disorders.

To support the implementation of these and other efforts, the Governor's Budget also included \$1.7 billion to invest in a multi-pronged effort to develop and train thousands of new care economy workers, including various mental health professionals and 25,000 new community health workers.

EDUCATION AND PARENTS AGENDA

The Budget includes total funding of \$128.3 billion for K-12 education. K-12 per-pupil funding totals \$16,991 Proposition 98 General Fund—its highest level ever—and \$22,850 per pupil when accounting for all funding sources. In addition to this funding,

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the May Revision includes an additional \$1.8 billion General Fund for K-12 school facilities, in addition to the \$2.1 billion General Fund included in the Governor's Budget.

The increased revenues in the May Revision result in \$19.6 billion Proposition 98 funds above the Governor's Budget for K-14 education, enabling further progress in reshaping California public schools to make them more student- and family-centered. To make this a reality, the May Revision includes more funding for community schools and universal high-quality school meals. It also accelerates full funding for extended learning opportunities that will provide families the opportunity for a 9-hour day filled with developmentally appropriate academics and enrichment, including six weeks during the summer. The COVID-19 Pandemic has strained school communities and the May Revision invests in an initiative to support K-12 schools with meaningful community engagement. The pandemic has also had a significant impact on average daily attendance at K-12 schools in the 2021-22 school year. The May Revision includes fiscal protections for schools that experienced significant attendance declines.

California continues to extend universal transitional kindergarten to all four-year-olds, and to expand the state's subsidized child care system. The May Revision proposes \$200 million to develop and repair existing child care infrastructure, especially in low-income communities, and extends family fee waivers and reimburses child care and state preschool providers based on contracted hours of care in lieu of attendance.

CHILDREN'S BEHAVIORAL HEALTH

The COVID-19 Pandemic left many people feeling isolated, especially children and youth. Last year the Budget Act allocated \$1.4 billion over multiple years to transform California's behavioral health system for all California children and youth. The May Revision includes an additional \$290 million over three years to address the most urgent needs and emergent issues in children's mental health. As the state continues to implement a new behavioral health system for children and youth, this proposal will support grants to deliver well-being and mindfulness programs, as well as parent support education programs. This proposal will also fund grants to support children and youth at increased risk of suicide and a youth suicide crisis response pilot. The funding will also establish a center for researching, evaluating, and applying innovative new technologies to improve youth mental health. This will enable California to maximize the positive impact of emerging technology on the social and emotional well-being of children and youth and minimize the harm these technologies cause by focusing on the use of emergent technologies to improve assessment, supports, and treatment, particularly as it is provided through the Children and Youth Behavioral Health Initiative.

EXPANDING OPPORTUNITY AND STRENGTHENING CALIFORNIA'S FUTURE

HIGHER EDUCATION

The Administration recently finalized five-year compacts with the University of California and California State University systems and a five-year roadmap with the California Community College system. These partnerships are designed to expand access, close equity gaps, and promote student success. They are focused on improving time-to-degree completion and reducing students' total cost of attendance. The compacts also focus on better connecting students to careers by strengthening occupational pathways that improve student economic mobility and better aligning student learning objectives to the state's workforce needs.

The May Revision makes new investments that will strengthen career pathways and support the next generation of inventions and innovations in California by making lasting infrastructure investments at the state's universities, including: \$500 million for a new Immunology and Immunotherapy Institute at UCLA that will bring together academics and researchers for collaborative research to maintain California's leading edge in biotechnology; \$80 million for a new San Diego State University, Brawley Center to further support education in the Lithium Valley; and \$67.5 million for a new engineering and computer science innovation hub at CSU, Fullerton.

INFRASTRUCTURE

The May Revision adds an additional \$17 billion in state funds to the \$20 billion allocated in the Governor's Budget to accelerate the transition to zero-emission vehicles, modernize the state's transportation system, spur clean energy innovation, advance the state's housing goals, reduce wildfire risk to communities, support drought resiliency and response, among other investments. The May Revision includes an additional \$1.1 billion for broadband, \$500 million for housing, \$500 million for active transportation, and \$650 million to expand efforts to build more housing for homeless individuals.

These unprecedented investments are on top of the \$13.9 billion in new federal formula funding from the Infrastructure Investment and Jobs Act that will support transportation, broadband and other infrastructure projects over the next five years. Every \$1 billion invested in infrastructure is expected to create approximately 13,000 good-paying jobs

in California. Combined, the state and federal infrastructure investments are projected to add 700,000 jobs.

SAFER COMMUNITIES

COVID-19

The state continues its science- and data-driven fight against COVID-19. The May Revision adds an additional \$1.1 billion to continue to implement the Administration's SMARTER plan, including additional funding to support school testing, increase vaccination rates, and expand and sustain efforts to protect public health at the border.

PUBLIC SAFETY

The May Revision makes additional investments to support public safety and protect victims of crimes and builds on the \$285 million General Fund in the Governor's Budget. The May Revision includes \$50 million in local law enforcement grants to support officer wellness. It also includes \$30 million for grants to assist minors who are victims of sex trafficking and to continue funding for the Internet Crimes Against Children Task Force Program. The May Revision invests in outreach to victims, including developing new and innovative ways to deliver services to victims. Additionally, it expands fentanyl drug interdiction efforts led by the California Military Department and establishes a new Fentanyl Enforcement Program at the Department of Justice.

BUDGET RESILIENCE AND LOOKING AHEAD

This May Revision reflects a significantly upgraded revenue forecast due to recent cash trends and improvement in key economic indicators. However, the forecast has become more uncertain given Russia's war on Ukraine, high rates of inflation, and anticipated actions by the Federal Reserve to raise interest rates. In addition, capital gains as a percent of the state's personal income are at levels last seen in 1999—just before the dot-com bust. Furthermore, the May Revision forecast was finalized before the recent declines in the stock market.

To prepare for this uncertain future, the May Revision continues building reserves, eliminating budgetary debt, reducing retirement liabilities, and focusing on one-time

spending over ongoing investments to maintain structurally balanced budgets over the long term.

Given the record high inflationary conditions facing the country, the May Revision includes an added inflation adjustment beginning in 2023-24 reflecting that state services are likely to cost more than currently estimated. The May Revision also continues to focus on allocating the vast majority of the discretionary surplus to one-time investments that can be adjusted in future years, if needed. The May Revision is projected to be structurally balanced in 2025-26, the last year in the multi-year forecast.

The May Revision reflects \$37.1 billion in budgetary reserves. These reserves include: \$23.3 billion in the Proposition 2 Budget Stabilization Account (Rainy Day Fund) for fiscal emergencies; \$9.5 billion in the Public School System Stabilization Account; \$900 million in the Safety Net Reserve; and \$3.4 billion in the state's operating reserve. The Rainy Day Fund is now at its constitutional maximum (10 percent of General Fund revenues) requiring \$476 million to be dedicated for infrastructure investments in 2022-23. Over the multi-year forecast period, the May Revision reflects \$4 billion in supplemental deposits into the Rainy Day Fund above what is constitutionally required.

To further build budget resiliency, the May Revision proposes a \$6.2 billion multi-year plan to prepay callable general obligation bonds, with a focus on variable rate bonds, and to shift lease revenue bond financed projects to cash. The May Revision also estimates supplemental payments to reduce state retirement liabilities of \$3.4 billion in 2022-23 and an additional \$7.6 billion projected over the next three years.

At the Governor's Budget, the State Appropriations Limit or "Gann Limit" was exceeded in the 2020-21 and 2021-22 fiscal years by a small margin. The May Revision does not exceed the limit. However, the limit may be exceeded in future years.

Committing to additional ongoing spending will make it much more difficult to meet all constitutional obligations, even if the economy grows faster than forecast, due to the State Appropriations Limit. Given the uncertain future, it remains essential for the state to focus mainly on one-time expenditures to maintain fiscal stability. Maintaining a balanced budget over the long-term will minimize disruptions to critical programs such as education and health care when revenues decline.