



## Economic Development Analysis Governor's May Revise FY 26-27 Budget

The California Association for Local Economic Development (CALED) is the voice of economic development practitioners and stakeholders. With over 1,100 members, CALED is one of the largest economic development associations in the country. We are pleased to share this economic development analysis of Governor Newsom's May Revise to the proposed FY 2026-2027 budget.

Inevitably, the exuberant AI-fueled stock market party will have to end. But, for now, cash -- primarily derived from capital gains paid by wealthy taxpayers -- continues to surge into state coffers. An additional \$16.3 billion since January enabled the Governor to propose a two-year balanced budget that allocates more to schools, maintains spending on most state programs, and responds to the ongoing (\$20-\$30 billion) structural deficit with a combination of tax increases and cuts to Medi-Cal.

The Governor said his proposal would balance the budget through July 2028, and cut the structural deficit going-forward in half. He concluded his presentation to the press, showing a final slide, and stating: *"So look, if there is nothing else you remember...please remember this: California's structural deficit, on the basis of the proposal we are making to the Legislature, through July 2028, is zero."*

The good news for local economic developers is that no cuts have been proposed for economic development programs. The Governor's prior proposals -- including the five-year extension of the CalCompetes program -- remain in place. In addition, the Governor proposes to reduce from \$800 to \$400 the state tax applied to new businesses created in 2027-2029.

- Link to May Revise document is here: <https://ebudget.ca.gov/budget/m/2026-27/BudgetSummary>
- The initial analysis by the Legislative Analyst's Office is <https://lao.ca.gov/Budget?year=2026&subjectArea=May>

### Governor's Proposal

The key outlines of the Governor's two-year budget proposal are as follows:

- Temporary Reserve: Set aside \$9.74 billion in a state surplus holding account to use for the FY 2027-28 Budget (year two).
- Tax Increases:
  - Establish a cap of \$5 million, or 50 percent of tax liability, on corporate tax credits, yielding the state \$1.7 billion annually when fully implemented.
  - Expand the sales tax to apply to (non-streaming) digital prewritten software purchases, yielding the state \$900 million annually, and \$1.1 billion annually for local governments.
  - Renew the Managed Care Organization Tax, yielding the state between \$2.3 and \$1.7 billion annually.
- Medi-Cal Cuts: Implement several cuts impacting Medi-Cal recipients to produce over \$1 billion in annual cost savings for the state:
  - Increase the monthly premium for adults with unsatisfactory immigration status from \$30 to \$50, yielding \$427 million in state savings in FY 2027-28, and an estimated \$314 million in out years.
  - Reinstate the prior Medi-Cal asset test for senior and disabled recipients, yielding nearly \$500 million annually in savings.
  - Make numerous other changes to Medi-Cal services to incur additional state savings.
- Increased Education Expenditures: The Governor proposes allocating the new \$6.4 billion influx of additional educational revenue for various priorities: \$2 billion more for special education, \$2.8 billion

more for teacher training and retention, \$428 million for literacy coaches, \$485 million for community schools, offering a 4.81 percent “Super COLA” increase for school districts, providing a five percent increase to UC and CSU systems, and mandating all schools and community colleges to provide 14 weeks of disability leave for pregnancies.

### **Economic Development/Expanded Local Revenue:**

The economic development proposals in the Governor’s January Budget continue, including the proposed five-year extension of the Cal-Competes program. The May Revise builds upon those with several that promote economic opportunities, and one that will boost local discretionary revenues:

- Reducing Cost of Establishing a New Business: The Governor proposes to bolster new business formation by cutting in half the state tax that new businesses (limited liability companies, limited partnerships, and limited liability partnerships) formed in 2027, 2028, or 2029, must pay in their first year in operation from \$800 to \$400.
- Incentivizing Remanufacturing of Recycled Products: \$75 million is proposed to be allocated over three years from the Beverage Container Recycling Fund to expand in-state remanufacturing of recycled products.
- Sales Tax Revenue Boost: It is not often that a Governor’s May Revise includes a proposal that would boost local government discretionary revenues by \$1.1 billion annually. Unlike the income tax or other state revenue sources, a proposed expansion of the applicability of the sales tax also benefits local governments. In his press conference, the Governor stated that the proposal to expand the sales tax to downloads of prewritten digital software (non-streaming) also includes Software as Service (SaaS). The Governor stated the proposal promotes equity between the way that brick and mortar vs. online purchases are treated, mirrors the practices of 35 other states, and mostly applies to business-to-business transactions.

**Restricting Application of Local Fees to State-Funded Affordable Housing:** The Governor is proposing two restrictions on applying city/county development impact fees on state-funded affordable housing projects subject to a Notice of Funding Availability (NOFA) issued after July 1, 2027:

- Prohibits Applying Impact Fees Where City/County is an “Applicant.” Provides that an affordable housing project (subject to a state project-specific funding award) is ineligible for funding if a city, county, or city and county is an applicant, lead applicant or co-applicant for a project in an affordable multifamily rental or ownership development program and has imposed a (very broadly defined) local development fee. This requirement does not apply to formula based or block grants allocations to cities and counties. With this new punitive condition, it is unclear why a local government would consider being an “applicant” in the future, or how the state expects the project-related impacts to be addressed with no funding.
- Fee Elimination/Reduction as New Competitive Eligibility Criteria: Requires state housing entities within the Housing and Homelessness Agency to “consider, to the extent feasible,” any “quantifiable in-kind local contributions,” (defined as fee reductions and eliminations) when awarding competitive multifamily affordable housing funding for new construction projects. Requires these entities to determine the “relative weight” of proposed local contributions in scoring or evaluating applications to “encourage” local agencies to reduce, limit, or defer local impact fees on state-funded affordable housing. Prohibits fee waivers/reductions already granted to the project under Density Bonus Law from counting under this provision. This proposal also may lead to some undesirable outcomes. The “race to the bottom” competitive criteria, may dissuade agencies which lack the resources to pay for the impacts of these projects, from applying. Further, it is unclear why, going forward, a city or county would agree to a fee reduction/waiver under Density Bonus Law, to then be later penalized under this proposal.

State policy makers should pause and consider the potential longer term impacts of these cost-shifting proposals when it comes seeking voter support for future state affordable housing bonds, as voters become aware that state-funded affordable projects no longer pay their fair share to offset local infrastructure and other community impacts.

## Disaster Recovery

The Governor proposes a \$100 million Disaster Rebuilding Fund to expand access to construction and renovation financing for disaster-impacted homeowners. This investment will be used to reduce borrowing costs and facilitate access to private financing through a combination of a loan loss guarantee program and an interest rate buydown program, facilitated by philanthropic contributions, non-profits, and lenders who have committed to participate in the fund.

## Other Housing

When it comes to affordable housing, there are no new major funding proposals, and the Governor's May Revision made no mention of a possible housing bond. Instead, the Governor proposes several limited expenditures:

- Infill Infrastructure: \$7 million is reappropriated to the Infill Infrastructure Grant Program.
- State Agency Coordination: In furtherance of the Governor's goal to improve coordination between state housing agencies, the May Revision proposes transferring positions, including communications capacity for the California Housing and Homeless Agency (CHHA), information technology and administrative support for the Department of Housing and Community Development, and leadership for the Housing Development and Finance Committee. Additionally, the Governor proposes six new positions for the Civil Rights Department to reduce wait times and facilitate settlements.

## Homelessness

The Governor's proposal maintains previous allocations of \$1 billion for Round 6 to the Homelessness Housing, Assistance and Prevention (HHAP) funding, and up to \$500 million for Round 7 contingent upon enhanced accountability and performance requirements.

- Enhanced Conditions for New HHAP Funding: The Governor announced that future eligibility for HHAP funding will be conditioned upon housing element compliance, encampment management, Prohousing policy adoption, and matching local funds (which could be satisfied by granting fee waivers under the proposed new policy).
- New Resources for State Highway Cleanup: The Governor is proposing to continue efforts to clean up encampments along state highways with an additional \$40 million allocated to the Clean California program, and \$6.2 million for two years to sustain efforts addressing homelessness and encampments on the state highway right-of-way.

As in past years, the effort to boost homeless funding will need to come from legislators negotiating amendments to the Governor's Budget.

## Cannabis

- Allocations: \$414.1 million is estimated to be available for cannabis fund allocations in 2026-27 as follows:
  - Education, prevention, and treatment of youth substance use disorders and school retention—60 percent (\$248.5 million)
  - Clean-up, remediation, and enforcement of environmental impacts created by illegal cannabis cultivation—20 percent (\$82.8 million)
  - Public safety-related activities—20 percent (\$82.8 million)
- Industrial Hemp: \$8.4 million General Fund is proposed to offset lower than expected fee revenues in recent years for the implementation of the Industrial Hemp Program.

## Other Items

- New Fees for CEQA Submittals to State Clearinghouse: Authorizes the Governor's Office of Land Use and Climate Innovation to assess a fee on California Environmental Quality Act (CEQA) documents submitted to the state. This fee authority is intended to support the modernization of the Clearinghouse's functions and streamline the environmental review process for all public agencies.

- Organized Retail Crime: \$2.2 million is allocated to the Department of Justice to resolve 27 organized retail criminal enterprise cases stemming from the original funding provided in 2022-23.
- State Parks:
  - \$3.6 million is allocated for operations at the new Fort Ord Dunes State Park campground.
  - \$125 million is allocated to purchase the 161-acre Golden Gate Fields property, so it can be converted to a park.
- State Tax Conformity for Contributions to Trump Accounts: The May Revision proposes to conform to federal tax treatment for deposits made into “Trump Accounts,” which are tax advantaged savings/retirement accounts which may be established for children under 18.
- Supporting Media Engagement: \$10 million is proposed to be allocated annually to the California Civic Media Program, a public-private partnership, to support the work of California’s newsrooms.
- Museum of Tolerance: \$12 million is allocated to support the Museum of Tolerance, which supports educational programs that challenge visitors to confront bigotry, antisemitism, and hate, and encourages a deeper understanding of the Holocaust within both historical and contemporary contexts. This funding will enable the Museum to complete critical infrastructure improvements and create a second Mobile Museum of Tolerance, focused on serving schools and communities in Central and Northern California.
- Nonprofit Security: \$40 million is allocated to support physical security enhancements to nonprofit organizations that have historically been targets of hate-motivated violence.

**Next Steps:**

The Legislature must send the Governor a budget by June 15, and the Governor must sign one by July 1. These deliberations are compounded by tensions and uncertainties over federal policy and budgetary decisions, and the vagaries of the stock market. As always, CALED will monitor activities and keep its member updated on developments.

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