



Governor's 2026-27 Budget Proposal

Prepared by Jennifer Baker, CABE Legislative Advocate

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The Governor released his 2026-27 budget proposal today, which includes an overall budget of close to \$349 billion, including \$248.3 billion in General Fund expenditures, \$23 billion in reserves, and \$125.5 billion for Proposition 98. The budget projects a modest shortfall of close to \$3 billion, much lower than the projected shortfall of close to \$18 billion as projected by the Legislative Analyst's Office. The Rainy Day Fund will receive a \$3 billion deposit for 2026-27, reflecting a catch-up covering two fiscal years of payment suspensions. This fund will additionally receive a small "true-up" for 2024-25 reflecting these changes. As a result, the projected 2026-27 balance will be \$14.4 billion. The overall reserve includes \$4.5 billion in the Special Fund for Economic Uncertainties, as well as \$4.1 billion in the Public School System Stabilization Account, creating overall reserves for 26-27 of approximately \$23 billion.

While a balanced budget proposal is presented for 2026-27, a \$22 billion shortfall is projected for 2027-28, with an additional two years of shortfalls projected. The Governor has stated the May Revision will include an updated fiscal plan that would address these projected shortfalls, along with providing budget reserves, and will address the continued increase in ongoing baseline costs, which are continuing to increase above projections.

Economic Influences

The increased revenue benefitting the state is predicated upon AI share prices and their impact on personal income tax revenues, which may not continue at the same levels in the future.

H.R. 1, which was passed in 2025, is projected to result in \$1.4 billion of additional General Fund costs in 2026-27. \$1.1 billion of these additional costs are a result of the increases to Medi-Cal as a result of Medicaid cuts. An additional \$300 million in increase CalFresh costs, which provides food for over three million homes, is included in these overall costs.

Debt Financing: As of December 1, 2025, \$72.1 billion in authorized General Obligation bonds and approximately \$9.2 billion in lease revenue bonds remain outstanding. Debt service on these bonds is expected to increase to \$4.1 billion by 2027-28, assuming that only limited new lease revenue bonds are authorized.

The state budget forecast includes a tariff rate of close to 17 percent over the budget forecast window, as compared with the previous May Revision, which projected 27 percent. The overall U.S. and California economy has generally improved, leaving the budget projection with a moderately upgraded Gross Domestic Product and personal income growth, as well as with lower inflation. The labor market is cooling off, and a more moderate economy may be on the horizon.

GDP: The budget forecasts the U.S. real GDP will grow by two percent in 2025 and 2.2 percent in 2026, which is higher than the previous forecast. The average annual GDP growth projection for 2027-2030 is 1.7 percent. U.S. headline Consumer Price Index inflation has been revised down to 2.8 percent for 2025-27. The Budget forecast

assumes the Federal Reserve will pause interest rate cuts until June 2026 with inflation projected to stay at a consistent level in early 2026.

Job Growth: California job growth has not been strong, with four months of consecutive losses and a total of seven months of job losses in 2025. Job growth in the state has been primarily in private education and health services. Future job growth between 2025 and 2030 is expected to decline by 0.2 percentage points due to a slowing labor market. Despite this, wage growth increased by 5.2 percent year-over-year during the first half of 2025. Wage growth is projected to average 4.3 percent from 2026 to 2030.

Personal Income Growth: Personal income increased by 5.6 percent year-over-year during the first half of 2025. This growth is projected to average 4.6 percent from 2026 to 2030.

Risks: Federal policies, particularly surrounding international trade and immigration are projected to be the most significant risks to the baseline forecast. Equity markets have performed strongly in the past but may undergo a correction. The overall budget forecast assumed moderate economic growth.

Revenues

General Fund agency cash receipts through November exceeded the 2025 Budget Act forecast by \$9.1 billion (primarily due to AI personal income tax gains). The stock market has risen close to 19 percent higher than projected at the third quarter of 2025, which has resulted in higher cash receipts. Economic data has also been stronger than projected, leading to an upgrade in the economic outlook and personal income growth. General Fund revenue is expected to be 6.7 percent higher than assumed in the 2025 Budget Act.

Big Three Revenues: These revenues are projected to be \$40 billion higher over the budget window as a result of a \$16.4 billion upward revision to the personal income tax forecast, a \$24.6 billion upward revision to the corporation tax forecast, and a \$1.1 billion downward revision to the sales tax forecast.

Personal income tax forecasts are being upgraded by \$36.7 billion, with corporation tax forecasts upgraded by \$1.7 billion. Projected growth is lowered in 2026, resulting in revenues shifting to a 5.3 percent trendline by 2029-30. The budget projects capital gains realizations to increase to eight percent in 2025 and one percent in 2026. Withholding growth is expected to moderate to four percent in 2026 and 4.3 percent in 2027.

Education

Proposition 98: The Proposition 98 Guarantee for 2026-27 is calculated at \$125.5 billion, with previous fiscal years revised to \$121.4 billion in 2025-26, and \$123.8 billion in 2024-25. The cumulative increases over these years total \$21.7 billion. The mandatory maintenance factor payment for 2024-25 is \$7.8 billion, leaving a total balance of \$584.6 million for 2026-27. The budget proposal includes fully repaying the existing settle-up balance of \$1.9 billion created in 2024-25. Due to economic uncertainty, the budget proposes to create a \$5.6 billion settle-up in 2025-26, bringing the Proposition 98 Guarantee funded level for 2025-26 to \$115.9 billion, instead of \$121.4, which is the calculated amount. There may be adjustments to these numbers in the May Revision.

Proposition 98 remains in Test 1 for 2024-25, 2025-26, and 2026-27, utilizing close to 40 percent of General Fund revenues. Total TK-12 funding includes \$149.1 billion, with \$88.7 billion General Fund and \$60.4 billion from other funds. Per pupil funding totals \$20,427 Proposition 98 General Fund, and \$27,418 per pupil from all other funding sources. The Public School System Stabilization Account, also known as the Proposition 98 Rainy Day Fund would receive a deposit of \$3.8 billion in 2024-25, a deposit of \$424.3 million in 2025-26, along with a mandatory withdrawal of \$407.1 million in 2026-27. Further, a discretionary deposit of \$240 million in 2025-26

is proposed, which would bring the three-year total balance to \$4.1 billion. These totals trigger the ten percent cap on school district reserves for 2025-26 and 2026-27.

Local Control Funding Formula: The LCFF includes a 2.41 percent cost-of-living adjustment, which results in an increase of approximately \$2 billion in funding. Previous deferrals of \$1.9 billion are proposed to be fully repaid in 2026-27. An additional ongoing increase of \$30.7 million Proposition 98 General Fund is included for a 20 percent increase in LCFF for Necessary Small Schools, who are disproportionately impacted by enrollment reductions.

Master Plan: The budget proposal would implement the 2002 Master Plan recommendation to shift oversight authority of the California Department of Education, which provides support to local education agencies (LEAs), to the State Board of Education. The Superintendent of Public Instruction would be responsible for the coordination and alignment among the bodies creating policy from early childhood education through postsecondary education. Additional details will be provided in the budget trailer bill language, which will be released in early February.

Community Schools: The budget proposal includes \$1 billion ongoing Proposition 98 General Fund to expand community schools to additional school sites with large student concentrations from low-income families, English learners, and students in foster care.

Special Education: A proposed increase of \$509 million ongoing Proposition 98 General Fund is included in the budget proposal to increase special education base rates, allowing for full equalization of special education rates statewide.

Career Education: College and career pathways for high school students, including dual enrollment and dual credit programs, are proposed to receive \$100 million one-time Proposition 98 General Fund. Prioritizing the creation and expansion of dual enrollment and pathways programs is to be achieved through the \$2.8 billion Student Support and Discretionary Block Grant.

Expanded Learning Opportunities Program: \$62.4 million ongoing Proposition 98 General Fund is proposed to provide a guaranteed \$1,800 per pupil for Tier 2 LEAs, which would bring total ongoing program funding to \$4.7 billion Proposition 98 General Fund.

Teacher Preparation: The Budget includes \$250 million one-time Proposition 98 General Fund for the continuation of educator residency programs through 2029-30.

Student Support and Professional Development Discretionary Block Grant: \$2.8 billion one-time Proposition General is proposed to provide LEAs with fiscal support to manage attendance and enrollment declines. These funds would additionally support professional development for teachers on the English Language Arts/English Language Development Framework and the Literacy Roadmap, the Mathematics Framework, teacher recruitment and retention strategies, and professional development for TK teachers and site administrators on appropriate TK instruction, as well as career pathways and dual enrollment expansion consistent with the Master Plan for Career Education.

Charter Schools: New requirements for charter schools regarding the use of public funds, fraud and malfeasance, and improved accountability and oversight will be included in the budget, as well as the utilization of verified data in the renewal process until 2028.

Facilities: \$1.5 billion in Proposition 2 bond funds are proposed for school construction projects in 2026-27.

Significant adjustments include:

- Learning Recovery Emergency Block Grant: \$757.3 million one-time Proposition 98 General Fund, reflecting the final payment;
- Home-to-School Transportation: \$322 million one-time and \$239.2 million ongoing Proposition 98 General Fund;
- Cost-of-Living Adjustments: \$228.2 million ongoing Proposition 98 General Fund reflecting a 2.41 percent COLA for specified categorical programs and the LCFF Equity Multiplier;
- Kitchen Infrastructure and training: \$100 million one-time Proposition 98 General Fund for specialized kitchen equipment, infrastructure, and training to support more freshly prepared meals with locally grown ingredients;
- Reading Difficulties Risk Screening: \$40 million one-time Proposition 98 General Fund for continued implementation. Statutory changes will be proposed to clarify the appropriate administration of the screeners for ensured consistency and the quality of results;
- L.A. County School Wildfire Recovery: \$22.9 million one-time Proposition 98 General Fund to assist impacted LEAs to recover from the 2025 wildfires;
- Universal and Targeted Assistance: \$13.3 million in additional ongoing Proposition 98 General Fund, totaling \$131.9 million for county offices of education to provide support to school districts and charter schools, including those that utilize differentiated assistance. Statutory changes will also be included that allow for updated performance criteria;
- Fiscal Crisis and Management Assistance Team: \$994,000 in additional ongoing Proposition 98 General Fund for increased workload;
- California School Information System: \$966,000 in additional ongoing Proposition 98 General Fund;
- Curriculum-Embedded Performance Tasks for Science: \$890,000 ongoing Proposition 98 General Fund;
- K-12 High Speed Network: \$629,000 in additional ongoing Proposition 98 General Fund;
- County Offices of Education LCFF: Ongoing decrease of \$15.6 million Proposition 98 General Fund reflecting ADA changes, as well as a COLA;
- School Nutrition Programs: Ongoing decrease of \$67.9 million Proposition 98 General Fund to support the Universal School Meals program, reflecting a reduction of estimates in 2025-26;
- Local Property Tax Adjustments: Decrease of \$18 million Proposition 98 General Fund for school districts and county offices of education in 2025-26, and a decrease of \$1.4 billion ongoing Proposition 98 General Fund in 2026-27 resulting from increased offsetting property taxes;
- Holocaust and Genocide Education Grant Program: The May Revision is expected to include up to \$10 million one-time Proposition 98 General Fund to provide LEAs with grants for instructional materials, professional development, and related costs.

Higher Education

The Budget proposes a total of \$50.4 billion (\$31.4 billion General Fund and local property tax, and \$19 billion in other funding) for the University of California, California State University, and California Community Colleges, as well as the California Student Aid Commission.

University of California: \$5.3 billion General Fund is proposed, as well as an increase of \$254.3 million ongoing General Fund, reflecting a five-percent base increase. This total includes the final payment for the multi-year compact. An additional increase of \$96.3 million ongoing General Fund, representing the partial funding of the fourth year of the compact payment in the 2025 Budget Act is additionally proposed. However, \$240.8 million of the 2025 Budget Act deferral is proposed to be repaid in 2027-28. The budget includes a deferral of \$31 million to offset revenue reductions associated with 902 nonresident undergraduate students. Further, the budget continues a one-time three-percent base deferral of \$129.7, shifting the repayment to 2027-28. To

mitigate cash flow complexities, the UC would be provided with budget language allowing them to utilize a loan in 2026-27.

California State University: \$5.6 billion in General Fund is provided, including an increase of \$264.8 million ongoing General Fund, representing a five-percent base increase, which concludes the final payment of the multi-year compact. Additional base funding is increased, totaling \$100.9 million ongoing General Fund for partial payment of the fourth-year compact payment included in the 2025 Budget Act. Further, the budget continues a one-time deferral of \$252.3 million, shifting the repayment to 2027-28. They would continue to receive a three-percent base decrease of \$143.8 million included in the 2025 Budget Act, shifting the repayment to 2027-28. To mitigate cash flow complexities, the CSU would be provided with budget language allowing them to utilize a loan in 2026-27.

California Community Colleges: The budget proposal includes \$15.4 billion in General Fund and property taxes. A one-time increase of \$408.3 million is provided to fully repay deferrals. An increase of \$240.6 million Proposition 98 General Fund is provided for a 2.41 percent COLA for Student-Centered Funding Formula (SCFF) apportionments, as well as \$31.9 million Proposition 98 General Fund for 0.5 percent enrollment growth. An increase of \$55.3 million Proposition 98 General Fund is provided for additional enrollment growth of one percent in 2025-26. A total of 1.5 percent growth is expected in 2026-27.

Significant adjustments include:

- SCFF Adjustments: One-time increase of \$88.7 million Proposition 98 General Fund;
- Proposition 98 Rainy Day Fund: One-time withdrawal of \$44.5 million to support SCFF costs in 2026-27;
- Facilities: One-time increase of \$736.9 million Proposition 2 bond funds to finance ten new projects and 29 continuing projects;
- Deferred Maintenance: One-time increase of \$120.7 million;
- Student Support Block Grant: One-time increase of \$100 million Proposition 98 General Fund;
- Common Cloud Data Platform: Increase of \$41 million Proposition 98 General Fund, \$5 million of which is ongoing;
- Calbright College: Increase of \$38.1 million Proposition 98 General Fund for base operations;
- Credit for Prior Learning: Increase of \$37 million Proposition 98 General Fund, \$2 million of which is ongoing;
- Categorical Program COLA: Increase of \$30.6 million Proposition 98 General Fund for a 2.41 percent COLA;
- California Healthy School Food Pathways Program: Increase of \$14.3 million Proposition 98 General Fund;
- Apprenticeship Related and Supplemental Instruction Costs Backfill: One-time increase of \$13.4 million Proposition 98 General Fund to backfill costs in 2024-25 and 2025-26;
- Local Property Tax Adjustments: Decrease of \$346.4 million Proposition 98 General Fund.