



## Report to City Council

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**TO:** Mayor and City Council

**FROM:** Brian Mohan, Assistant City Manager (Administration)  
Launa Jimenez, Chief Financial Officer

**AGENDA DATE:** June 18, 2024

**TITLE:** STATE BUDGET AND ECONOMIC UPDATE (REPORT OF: CITY MANAGER)

**TITLE SUMMARY:** State Budget and Economic Update

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### **Recommendation(s)**

That the City Council:

1. Receive and file this State Budget and Economic Update.

### **SUMMARY**

This report discusses the current State budget deficit and the Governors and Legislatures plan to balance the State budget, which includes the use of reserves, spending cuts, delays, deferrals and funding shifts. Based on their published plan in the Governors May budget revisions, this report will also discuss the potential impact to our local budget as well as the various economic pressures that will impact our budget going into the second year of our current budget cycle; Fiscal Year 2024-25.

### **DISCUSSION**

#### **State Budget Update**

On Friday, May 10, Governor Newsom released his 2024-25 State Budget May Revise, ahead of the May 14 statutory deadline. The May Revise reflects an update to the Governor's Proposed Budget in January 2024, which reflects changes to tax returns, inflationary pressures, and federal monetary policy that could result in additional spending cuts or the restorations of spending programs.

In his presentation, the Governor estimates **a remaining \$27.6 billion deficit this year as well as ongoing deficits of around \$30 billion per year beginning in 2025**. The total deficit has fallen following the enactment of the “Early Action” budget package the Legislature and Administration worked on to solve \$17 billion of the total shortfall. The Early Action budget package included cuts to undisbursed one-time spending programs across the previous three budgets. The revised spending proposal totals **\$288 billion** [summary](#) totaled just 49 pages, which contrasts significantly with the previous budget summary packets that included hundreds of pages of details.

Throughout the presentation, the Governor attributed the shortfall to the state’s “volatile” progressive tax structure that largely relies on the financial performance of high-income earners. Earlier this year, during the Governor’s January Proposed Budget, the Governor attributed the shortfall to the substantial decline in the stock market that drove down revenues in 2022 and the unprecedented delay in critical income tax collections. Additionally, the 2023 Budget Act experienced a budget shortfall of approximately \$32 billion, which became exacerbated by the IRS’s tax filing and payment delay, which generated a budget without an accurate depiction of revenues. Once additional tax receipts for 2022 were received in late November 2023, the 2022 revenues were lower than projected when the 2023 Budget Act was adopted. Similar to the 2023-24 budget cycle, the FY 2024-25 continues the deficit trend with a total shortfall of \$37.9 billion.

While the May Revise summary released on May 10 includes various spending reductions and deferrals, it is important to note that the budget situation will continue to evolve over the next month and a half as the Legislature engages in negotiations with the Administration on spending priorities.

### **Budget Balancing Tactic**

As mentioned, in recognizing the importance of addressing the shortfall ahead of schedule, the Legislative passed an Early Action Budget Package in April that reduced the size of the budget shortfall by approximately \$17.3 billion ([AB 106](#)). This package was comprised primarily of solutions included in the Governor’s Budget and also accounted for the use of \$12.2 billion from the Budget Stabilization Account (BSA).

Subtracting the savings of \$17.3 billion from the Early Action Budget Package from the stated total budget deficit of \$37.9 billion, there remained a \$20.6 billion deficit to resolve in the coming budget year. The May Revise estimates an additional \$7.0 billion reduction in revenues, which sums up the new problem to resolve in the budget to \$27.6 billion.

Jan 10 Budget Deficit Estimate	\$37.9 billion
Early Action Budget Package	- \$17.3 billion
May Revise Deficit Adjustment	\$7.0 billion
<b>Total State Budget Deficit</b>	<b>\$27.6 billion</b>

The May Revise takes into account the budget solutions proposed in the January 10 budget (including those proposals that were and were not included in the Early Action

Budget Package), adds the additional revenue reductions to the problem, and then proposes the additional solutions necessary to close the entire gap. Below is a summary of both the Jan 10 solutions and May Revise solutions necessary to close the entire estimated budget deficit. Detailed breakdowns follow.

	<b>Jan 10 Budget Solutions</b>	<b>Additional May Revise Solution and Adjustments</b>
Reserves	\$13.1 billion	- \$8.9 billion
Reductions	\$8.5 billion	\$10.7 billion
Revenue/Borrowing	\$5.7 billion	\$2.0 billion
Delays	\$5.1 billion	\$520 million
Fund Shifts	\$3.4 billion	\$3.9 billion
Deferrals	\$2.1 billion	
<b>Total</b>	<b>\$37.9 billion</b>	<b>\$8.2 billion</b>

### Reserves

The May Revise maintains the Governor’s Budget withdrawal of approximately \$12.2 billion from the BSA, as well as \$900 million from the Safety Net Reserve. However, the May Revise spreads the use of the BSA withdrawal over two fiscal years, utilizing \$3.3 billion in the 2024-25 fiscal year and \$8.9 billion in the 2025-26 fiscal year. This action will assist in balancing the budget through the 2025-26 fiscal year.

### Reductions

The May Revise reduces funding for various items in addition to the reductions made in the Governor’s Budget. Significant solutions in this category include:

- *Middle Class Scholarship Program*—Reduce \$510 million ongoing General Fund support for the Middle Class Scholarship program. Combined with a technical adjustment, \$100 million ongoing support for this program would remain.
- *California Preschool, Transitional Kindergarten and Full-Day Kindergarten Facilities Grant Program*—Pull back a planned 2025-26 General Fund investment of \$550 million that would have supported the California Preschool, Transitional Kindergarten, and Full-Day Kindergarten Program. Such an investment could be considered for inclusion in education facilities bond proposals being contemplated by the Legislature.
- *Children and Youth Behavioral Health Initiative*—A reduction of one-time \$72.3 million General Fund in 2023-24, \$348.6 million General Fund in 2024-25, and \$5 million General Fund in 2025-26 for school-linked health partnerships and capacity grants for higher education institutions, behavioral health services and supports platform, evidence-based and community-defined grants, public education and change campaign, and youth suicide reporting and crisis response pilot.
- *California Department of Corrections and Rehabilitation Housing Unit Deactivations*—An ongoing reduction of \$80.6 million General Fund to reflect the

deactivation of 46 housing units across 13 prisons, totaling approximately 4,600 beds.

- *Ongoing Reductions to State Operations*—A reduction to state operations by approximately 7.95 percent beginning in 2024-25 to nearly all department budgets. The planned reduction involves all categories, including personnel, operating costs, and contracting. The Department of Finance will work with agencies and departments in the fall on the appropriate budget reductions.

### Revenue/Internal Borrowing

The May Revise includes additional and adjusted support from revenue sources and borrows internally from special funds. Significant solutions in this category include:

- *Net Operating Loss (NOL) Suspension and Limit Credit to \$5 Million*—The Governor’s Budget NOL suspension proposal is modified to begin in 2025-26 and include an opportunity to trigger the suspension off if revenues improve, resulting in \$900 million revenue gain (\$558 million net of Proposition 98) in 2024-25 and \$5.5 billion (\$3.4 billion net of Proposition 98) in 2025-26.
- *Additional Managed Care Organization (MCO) Tax (Medicare Revenue)*—Increase the MCO Tax to achieve additional net state benefit of \$689.9 million in 2024-25, \$950 million in 2025-26, and \$1.3 billion in 2026-27 by including health plan Medicare revenue in the total revenue limit calculation, which increases the allowable size of the tax.

### Delays and Pauses

The May Revise minimizes the use of delays to avoid both increased future obligations and potential shortfalls, and some delays proposed in the Governor’s Budget have been changed to reductions. There are limited exceptions in which funding is spread over a multiyear period. These include:

- *Broadband Last Mile*—Delay \$200 million from 2025-26 to 2027-28.
- *Child Care Slot Expansion Pause at Current Level*—Approximately 119,000 slots have been added; a pause at the current level until fiscal conditions allow for resuming the expansion will result in a revenue gain of \$489 million in 2024-25 and \$951 million in 2025-26.

### Fund Shifts

The May Revise shifts certain expenditures from the General Fund to other funds in addition to those shifted in the Governor’s Budget. Significant solutions in this category include:

- *Capitol Annex Projects*—Shift \$450 million in 2024-25 and \$250 million in 2025-26 from cash to bonds.
- *Cap and Trade Fund Shifts*—A number of General Fund commitments are shifted

into the Greenhouse Gas Reduction Fund, with a focus on equity programs, priorities to help meet climate goals, and programs that support greenhouse gas reductions for a total shift of \$1.7 billion in 2024-25.

## **PROPOSED SPENDING: HOUSING**

Similar to the tenor of the Governor’s January budget proposal, the May Revise does not include any new funding for housing programs and instead maintains spending cuts and deferrals. It should be noted that with the passage of Proposition 1, funding will eventually be disseminated to local government channels for the development of specific low-income and permanent supportive housing solutions, however, the budget does not create opportunities for housing development above those low income/homeless categories. A breakdown of proposed spending for core housing accounts includes:

### Regional Early Action Planning Grants 2.0 (REAP 2.0)

The Governor’s Budget proposal proposes a reversion of \$300 million General Fund for REAP 2.0.

### Multifamily Housing Program

The January budget proposal included a \$250 million reversion of previously allocated General Funds for the Multifamily Housing Program, which proposes to leave \$75 million in 2023-24 for this purpose. The current proposal includes an additional \$75 million elimination of remaining funds for the 2023-24 cycle of the program.

### Adaptive Reuse Program

The May Revise proposes reducing \$127.5 million in 2023-24, which will eliminate the program.

### Foreclosure Intervention Housing Preservation Program

The January Budget proposal included a reduction of \$247.5 million in General Funds for the Foreclosure Intervention Housing Preservation Program over the next three years (\$85 million in 2024-25, \$100 million in 2025-26, and \$62.5 million in 2026-27). The May Revise calls for eliminating the remaining \$236.5 million in addition to the \$237.5 million proposed in the Governor’s Budget, which would result in the elimination of the program.

Other contentious funding cuts, including those proposed for the Regional Early Action Planning (REAP) 2.0 program, are noticeably absent from the May Revise proposal documents. This suggests that the program is still under discussion and will be formalized in subsequent iterations of the budget.

## **PROPOSED SPENDING: HEALTH AND HUMAN SERVICES**

The Governor’s May Revise to the budget includes cuts, reductions, and pauses for key health care and social services programs. Details on many of these programs were limited.

### ***Department of Health Care Services***

### Medi-Cal to All Income-Eligible Californians

Reducing \$94.7 million ongoing by eliminating the In-Home Supportive Services (IHSS) undocumented expansion coverage for all ages.

### Behavioral Health Continuum

The May Revise eliminates \$450.7 million one-time from the last round of the Behavioral Health Continuum Infrastructure Program and reduces \$132.5 million in 2024-25 and \$207.5 million in 2025-26 for the Behavioral Health Bridge Housing Program.

### Managed Care Organization Tax

The May Revise proposes an amendment to the MCO Tax to include health plan Medicare revenue in the total revenue limit calculation, which increases the allowable size of the tax resulting in an additional net state benefit of \$689.9 million in 2024-25, \$950 million in 2025-26, and \$1.3 billion in 2026-27. Overall, the May Revise includes an additional \$9.7 billion in MCO Tax funds over multiple years to support the Medi-Cal program.

## ***Department of Social Services***

### CalWORKS Program

The CalWORKs program, California's version of the federal Temporary Assistance for Needy Families (TANF) program, provides temporary cash assistance to low-income families with children to meet basic needs. The Budget proposes a reduction of \$47.1 million ongoing for the CalWORKs Home Visiting Program and as well as a reduction of \$126.6 million ongoing for the CalWORKs Mental Health and Substance Abuse Services.

## **PROPOSED SPENDING: PUBLIC SAFETY**

While the Governor did not provide much detail in his May Revise address, his most notable line with regard to public safety policy was, "We are holding the line on unprecedented investments in crime prevention and retail theft." Those retail theft investment specifics were not disclosed.

With regard to maintaining public safety dollars, the Governor noted that he was maintaining the funding commitment for 1,000 new CHP officers funded in recent budgets.

Other specific reductions in public safety spending outlined in the May Revise include:

### Trial Court Operations: Ongoing General Fund Reduction

Reducing \$97 million ongoing consistent with the statewide ongoing reduction to state operations.

### Department of Justice Law Enforcement and Legal Services Reductions

Reducing \$10 million ongoing for the Division of Law Enforcement and \$5 million ongoing for the Division of Legal Services.

## ***California Department of Corrections and Rehabilitation***

### Housing Unit Deactivations

Reducing \$80.6 million ongoing to reflect the deactivation of 46 housing units across 13 prisons, totaling approximately 4,600 beds.

### Peace Officer Training Reduction (Block Training and Northern California Women's Training Facility)

Reducing \$8.5 million in 2023-24, \$13.8 million in 2024-25, and \$22.6 million ongoing to reflect a reduction in annual training for correctional officers from 48 hours to 40 hours, and a discontinuation of the use of the California Reality Based Training Center.

## ***Board of State and Community Corrections***

### Medication Assisted Treatment Grants

Reducing \$10.5 million in 2023-24 for competitive grants to counties to use for various purposes relating to the treatment of substance use disorders and the provision of medication-assisted treatment.

### Post Release Community Supervision

Reducing \$4.4 million one-time in 2024-25 to eliminate funding provided to county probation departments for the temporary increase in the number of offenders released from prison to Post Release Community Supervision pursuant to Proposition 57, the Public Safety and Rehabilitation Act of 2016.

### Adult Reentry Grant

Reducing \$54.1 million in 2023-24 and \$57 million one-time in out years that was proposed to be delayed in the Governor's Budget. The Governor's Budget included an additional reduction of \$7.8 million in 2022-23. The Adult Reentry Grant provides competitive funds to community-based organizations to deliver reentry services to assist formerly incarcerated individuals reentering communities.

## **PROPOSED SPENDING: TRANSPORTATION**

Last year, the Legislature and Governor Newsom made commitments from the state's General Fund to address impending transit operations funding shortfalls that would result in service and workforce cuts and that would undermine transit agencies' recovery from the pandemic. Specifically, the Budget Act of 2023-24 included \$2 billion for California transit agencies and a promise of \$3.1 billion in additional funding over Fiscal Years 2024-25 to 2027-28 to support transit operations and capital project delivery. As part of this agreement, the state created new reporting requirements on regional transportation planning agencies and transit agencies that will govern access to, and use of, this new state funding.

To address the projected budget shortfall, the Jan 10 budget proposed General Fund solutions to achieve a balanced budget. These include \$296 million of General Fund reductions, \$791 million in fund shifts, and \$3.2 billion in delays across various programs.

On top of these solutions, the May Revise adds the following:

#### Active Transportation Program

Reducing \$300 million in 2025-26 and \$99 million in 2026-27 for funds appropriated for active transportation grants.

#### Transit

Shifting \$555.1 million from the General Fund to the Greenhouse Gas Reduction Fund above what was proposed in the Governor's Budget, for a total of \$1.3 billion in proposed fund shifts for transit. These fund shifts are not expected to have any program impact and the May Revise maintains the Formula Transit and Intercity Rail Capital Program (\$4 billion) and the Zero Emission Transit Capital Program (\$1.1 billion) funding levels. The May Revise also reduces \$148 million not used for awarded projects from the Competitive Transit and Intercity Rail Capital Program and maintains 96 percent of the Competitive Transit and Intercity Rail Capital Program (\$3.5 billion of the originally planned \$3.65 billion).

### **LOOKING FORWARD**

Looking forward, negotiations between the Governor and the Legislature will continue within the next month and a half. Budget Committees in both houses will resume hearings with consideration given to the proposals incorporated into the May Revise. The next statutory budget deadline is the Legislature's passage of a balanced budget by June 15, which will occur after the writing of this staff report. After the June 15 statutory deadline, the Governor should approve a final 2024-25 spending plan before the new budget year begins on July 1.

While the Budget Act must pass by June 15, the state's spending will see numerous amendments and additional details emerge through the introduction of 'Budget Trailer Bills' and "Budget Bill Jrs." which provide implementing language, details on core (and often contentious) accounts, and amendments to the overall structure of the preliminary Budget Act.

### **State Budget Local Impact to Moreno Valley**

As discussed above, the city will be directly and/or indirectly impacted by the state reductions in spending:

- Youth spending – The City receives roughly \$9M from the state to fund the city-run after school programs. These programs serve over 3,600/day.
- Affordable Housing – There will be less funding available to partner with affordable housing developers, which will continue to exacerbate the affordable housing issue as there are not enough affordable or market rate units to reduce the current high housing values.
- Behavioral Health – This may jeopardize our regional behavioral health efforts and specifically our two RUHS mobile crisis teams.
- Public Safety, Corrections & Post Release Community Supervision – With the closure of 4,600 prison beds there can be an increase of the current state practice



of the early release program, which causes criminals to be in the local jurisdictions such as Moreno Valley. This causes increased public safety calls and costs.

- Transportation – There will be less funding available for regional projects, which will reduce the amount of grant funds available for local projects.

## **Economic Update**

Statewide revenues continue to trend downward. Sales and use tax receipts for fourth quarter 2023 were 2.5% lower than the same quarter one year ago. The fourth quarter is notably the highest sales tax generating quarter of the year and exhibited diminished year-over-year returns as consumers are skeptical of the economy. Fuel and service stations contributed a similar downturn, as lower fuel prices reduced receipts from gas stations and petroleum providers. This decline also impacted the general consumer goods category as those retailers selling fuel experienced a similar drop.

During this holiday shopping period, general consumer goods experienced lackluster sales as results pulled back 3.4%. Most sectors saw reductions with home furnishings, women's apparel, shoe and electronic-appliance stores being the most significant. Returns also marked the fourth consecutive quarter showing comparable declines. Similar to the anticipated trend of new vehicles, consumer spending may be sluggish in the near term.

Even though revenue from most major sectors slowed, restaurant sales remained steady with a modest gain of 1.0%. Results from casual dining establishments grew during the early winter period as patrons enjoyed indoor dining. However, following the greater trend of consumers looking for value, fine dining eateries experienced lower receipts. The industry is currently reacting to the implementation of AB 1228, a new law that increased minimum wages for 'fast food restaurants', on April 1, 2024. In order to deal with these increases, many businesses have had to increase prices and/or reduce their labor force in order to curb costs.

The above trends are also affecting us locally as we realized an overall decline of 4.9% for the same period as well as overall declines over the last four quarters. Based on our sales tax consultants, HdL, who are the foremost experts statewide, they are estimating a \$2.5 million reduction in the second year of our current budgetary cycle, which begins July 1, 2024 and ends June 30, 2025. Staff and I will be monitoring this very close as new quarterly sales tax data is realized in the next few months as we may need to reduce the estimated revenues accordingly and discuss what equivalent cuts will be made in our expenditure categories.

## **FISCAL IMPACT**

As discussed above, the City of Moreno Valley, as well as the other local jurisdictions in the State, continue to see the State budget their fiscal deficits on the back of local governments. This has continued for decades now. With the direct and/or indirect reductions above the sand, the HdL estimates a shortfall of \$2.5 million of sales tax

revenue related to the economic softening over the last four quarters; the city will need to address budgetary reductions next fiscal year.

## **PREPARATION OF STAFF REPORT**

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## **CITY COUNCIL GOALS**

**Advocacy:** Develop cooperative intergovernmental relationships and be a forceful advocate of City policies, objectives, and goals to appropriate external governments, agencies and corporations.

**Community Image, Neighborhood Pride and Cleanliness:** Promote a sense of community pride and foster an excellent image about our City by developing and executing programs which will result in quality development, enhanced neighborhood preservation efforts, including home rehabilitation and neighborhood restoration.

**Positive Environment:** Create a positive environment for the development of Moreno Valley's future.

**Public Facilities and Capital Projects:** Ensure that needed public facilities, roadway improvements, and other infrastructure improvements are constructed and maintained.

**Public Safety:** Provide a safe and secure environment for people and property in the community, control the number and severity of fire and hazardous material incidents, and provide protection for citizens who live, work and visit the City of Moreno Valley.

**Revenue Diversification and Preservation:** Develop a variety of City revenue sources and policies to create a stable revenue base and fiscal policies to support essential City services, regardless of economic climate.

## **CITY COUNCIL STRATEGIC PRIORITIES**

- 1. Economic Development**
- 2. Public Safety**
- 3. Library**
- 4. Infrastructure**
- 5. Beautification, Community Engagement, and Quality of Life**
- 6. Youth Programs**



### Report Approval Details

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This report and all of its attachments were approved and signed as outlined below:

Natalia Lopez

**No Signature - Task assigned to Launa Jimenez was completed by workflow administrator Patty Rodriguez**

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