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Agenda

February 18, 2026

9:00 a.m. – 1021 O Street, Room 1200

Informational Hearing Review of California's Reserve Policy: Looking to the Future

I. History of California's Reserves and Recommendations for Reform

Ann Hollingshead, Principal Fiscal & Policy Analyst
Legislative Analyst's Office

Carolyn Chu, Chief Deputy Legislative Analyst
Legislative Analyst's Office

Lisa Mierczynski, Assistant Program Budget Manager
Department of Finance

Irena Asmundson, Economist
Founder and CEO Practical Idealism Economics, LLC

Scott Graves, Budget Director
California Budget and Policy Center

III. Public Comment

Informational Hearing
Review of California's Reserve Policy: Looking to the Future

Hearing Background:

Budget Stabilization Account.

The Budget Stabilization Account (BSA) was created in 2004 with the passage of Proposition 58. Proposition 58 allowed for the Governor to deposit up to three percent of General Fund revenues into the BSA reserve each year, until the BSA reached five percent of General Fund Revenues (roughly \$8 billion when the BSA was passed). A majority vote of the Legislature was required to withdraw funds from the BSA. While deposits were made into the BSA, the balance was quickly used when the state entered the Great Recession in 2008.

Proposition 2 - Rainy Day Fund:

Coming out of the Great Recession, the Legislature put a constitutional amendment on the ballot (Resolution Chapter 1, Statutes of 2013-14 Second Extraordinary Session, J. Pérez). The resulting Proposition 2 was passed by voters in 2014. Proposition 2 changed the rules around the BSA in a few keyways as follows:

- Required an annual set aside of 1.5 percent of estimated General Fund revenues.
 - For 15 years – from 2015-16 to 2029-30 – half of these funds are required to be deposited into the BSA as reserves, and the other half would be used to reduce other state liabilities – such as school debt, pension or retirement liabilities, and other debt.
- Required the state to set aside a portion of capital gains revenues that exceed eight percent of General Fund taxes – of these, half are used for reserves and half are used to pay down debts as defined.
- Increased the maximum deposit to 10 percent of General Fund Revenues. Mandatory deposits that exceed the cap must be used for infrastructure spending, although discretionary deposits can be made above the maximum into the reserve.
- Created a reserve within Proposition 98 for K-14 education, the Public School System Stabilization Account. Deposits and withdrawals into and from this account are made according to specified formulas and provide relief within Proposition 98, but do not impact the General Fund condition in any given year.

- Withdrawals from the BSA can be made if the Governor declares a budget emergency (a defined fiscal emergency with certain conditions, or the occurrence of a natural or man-made disaster).

Current Use of Reserves:

At the highest point, entering 2024-25, the BSA had \$22.6 billion in reserves. However, over the last two fiscal years, the state has withdrawn approximately \$12.2 billion from the BSA and suspended deposits into the BSA for the 2024-25 and 2025-26 fiscal years in order to balance the budget.

The 2026-27 Governor’s Budget proposes to suspend a \$2.8 billion “true-up” deposit into the BSA in 2025-26, but reflects a BSA deposit in 2026-27 of approximately \$3 billion and a minor "true-up" for fiscal year 2024-25, ending 2026-27 with \$14.4 billion in the BSA.

2025-26 and 2026-27 General Fund Summary (Dollars in Millions)		
	Revised <u>2025-26</u>	Proposed <u>2026-27</u>
PRIOR YEAR BALANCE	\$55,951	\$53,451
Revenues and transfers	\$235,162	\$227,385
TOTAL RESOURCES AVAILABLE	\$291,113	\$280,836
Non-Proposition 98 Expenditures	\$155,749	\$158,453
Proposition 98 Expenditures	\$81,913	\$89,877
TOTAL EXPENDITURES	\$237,662	\$248,330
FUND BALANCE		
Encumbrances	\$27,998	\$27,998
Special Fund for Economic Uncertainties	\$25,453	\$4,508
Public School System Stabilization Account	\$4,509	\$4,102
Safety Net Reserve	\$0	\$0
Budget Stabilization Account	\$11,327	\$14,350

(Source: Department of Finance)

State Appropriations Limit (SAL) Interactions with the BSA:

In 1979, voters passed Proposition 4 which added Article XIII B to the State Constitution and established an appropriations limit on the state (SAL) and most types of local governments. The appropriations limits later were amended by Proposition 98, passed in 1988, and Proposition 111, passed in 1990. The purpose of the appropriations limits is to keep real (inflation adjusted) per-person government spending under 1978-79 levels.

While the SAL constrained state spending in the 80's and 90's, there was consistently plenty of room under the limit in the early 2000's, until roughly 2021 when growing revenues resulted in state spending getting close to the limit.

The state has some options for creating room under the cap, however if revenues exceed the cap, any excess revenues over two years are required to be equally divided between taxpayer rebates and education spending.

Under Proposition 4, reserve deposits are counted in the year they are made (instead of the year they are withdrawn). While Proposition 2 requires the state to set aside minimum amounts in the BSA each year, Proposition 4 treats these deposits like other state appropriations.

Recent BSA Reform Proposals:

While the BSA has worked as intended over the past several years, state revenues have grown more unpredictable over recent years, and discussions have begun on how to strengthen California's tools for handling changes in revenues.

Department of Finance:

In their 2025-26 Governor's Budget Summary, the Department of Finance proposed to increase the mandatory deposit level in the BSA from the current 10 percent to 20 percent of General Fund revenues and exempt deposits into the BSA from the State Appropriations Limit.

At the time, the Department of Finance noted in their summary document that the state has effectively been constrained in its ability to set even more revenue aside during upswings because of the interaction between Proposition 2's cap on mandatory deposits of 10 percent of General Fund revenues and Proposition 4's State Appropriations Limit. The Administration notes this has impeded the state's ability to make additional deposits that would have created even greater budget resiliency by building the state's reserves to a level sufficient to address the recent revenue corrections that the state experienced.

Legislature:

Similar to the Administration, the Legislature's Budget Plan in 2025-26 proposed a Constitutional Amendment to improve the Rainy Day Fund and make other responsible budgeting improvements, including the following:

- Increase the size of the Rainy Day Fund from 10 percent of the General Fund to 25 percent of the General Fund.
- Increase deposits into the Rainy Day Fund.
- Exclude deposits into the Rainy Day Fund and other statutory reserves (excluding the Special Fund for Economic Uncertainties) from the State Appropriations Limit calculation.

Legislative Analyst’s Office:

The Legislative Analyst Office (LAO) released a report “*Rethinking California’s Reserve Policy*” in April of 2025. A copy of the report is included as an attachment to this hearing agenda. In their report the LAO recommends that the Legislature raise the BSA cap to 50 percent of General Fund taxes, using a scheduled, phased-in increase: 20 percent to take effect immediately after the next statewide election, 25 percent in 2030, and increasing by 5 percent every five years until the cap reaches a maximum of 50 percent in 2055. In addition, the LAO makes recommendations for depositing more into the BSA each year, and other changes, such as exempting deposits from SAL.

A two-thirds vote of both houses of the Legislature is required to place a constitutional amendment on the ballot. While the concepts above were introduced for consideration in the 2025-26 budget discussion, ultimately no constitutional amendment was passed.

Suggested Questions:

- Has the BSA worked as intended over the past few years? What lessons should the state learn from recent budgets and the use of the BSA?
- What debts has the BSA been used to pay overtime? Is this a successful way for the state to pay off debt? Should the state re-evaluate and add to the type of debt eligible for Proposition 2 purposes?
- What is the “right” level of reserves and how do we determine that with the volatility of revenues increasing? How should the state be thinking about using new revenues, i.e. the increases in General Fund that were not anticipated when we passed the 2025-26 Budget Act?
- In a period of structural deficits and federal uncertainty, how can the state make progress on building up a reserve?