



MEMO

January 9, 2026

To: Members of the Board of Directors

From: Darrell E. Johnson, Chief Executive Officer

A handwritten signature in blue ink, appearing to read "Darrell Johnson", written over the printed name.

Subject: **Governor's Fiscal Year 2026-2027 State Budget Proposal**

This morning, Governor Gavin Newsom released his fiscal year (FY) 2026-27 State Budget proposal to the Legislature. The Governor's proposal projects a balanced budget for FY 2026-27, with General Fund revenues estimated at approximately \$227.4 billion and expenditures of approximately \$248.3 billion, supported by total reserves of approximately \$23 billion. While the Administration indicates the budget is balanced on a budgetary basis, it emphasizes that significant uncertainty remains and signals that additional detail and potential adjustments will be addressed in the May Revision.

While the Governor's Budget is balanced in FY 2026-27 and includes a discretionary reserve of approximately \$4.5 billion, the Administration projects a budget deficit of roughly \$22 billion in FY 2027-28, with additional shortfalls projected in the two years that follow. The Administration notes that this proposal reflects an initial framework and that the May Revision will include a revised plan intended to balance the budget in FYs 2026-27 and 2027-28, while maintaining adequate budget reserves.

The Governor's economic outlook does not currently project a recession but underscores several risks that could negatively impact revenues over the budget window. These risks include continued stock market volatility, uncertainty in capital gains and personal income tax collections, inflationary pressures, labor market conditions, and potential federal policy actions. To maintain fiscal stability, the proposed budget includes limited new discretionary spending and focuses on preserving existing commitments and maintaining reserves.

Climate Bond

The Governor's proposed budget continues to advance implementation of Proposition 4, the Climate Bond approved by voters in 2024, which provides funding for a broad range of climate resilience, natural resources, and climate adaptation investments statewide. As part of this effort, the budget proposes

\$107 million for coastal resilience to protect coastal communities from sea level rise, flooding, erosion, and habitat loss.

Cap-and-Invest Program

The Governor's budget reflects recent statutory changes that extend and rebrand the State's Cap-and-Trade program as the Cap-and-Invest program through 2045. The budget incorporates a new tiered structure for the Greenhouse Gas Reduction Fund (GGRF) intended to prioritize statutory commitments and provide greater predictability for program funding.

The chart below summarizes the proposed Cap-and-Invest expenditure plan, including the new tiered structure and the allocation of auction proceeds across major program categories, including outyear projections.

2026-27 Cap-and-Invest Expenditure Plan

(Dollars in Millions)

Tier	Program	2026-27	2027-28	2028-29	2029-30
Tier 1 Appropriations	Manufacturing Tax Credit	\$159	\$163	\$168	\$174
	State Operations	\$120	\$124	\$127	\$131
	State Responsibility Area Fee Backfill	\$88	\$88	\$88	\$88
	Legislative Counsel Climate Bureau	\$3	\$3	\$3	\$3
Tier 2 Appropriations	High Speed Rail Authority	\$1,000	\$1,000	\$1,000	\$1,000
	\$1 billion reserved for discretionary appropriations:				
	- CAL FIRE General Fund Shift ^{1/}	\$750	\$500	\$500	\$0
	- SB 840 Commitments	\$250	\$0	\$0	\$0
	- Remaining Amount Available for Tier 2 Discretionary Funding	\$0	\$500	\$500	\$1,000
Tier 3 Appropriations^{2/}	Affordable Housing	\$396	\$435	\$475	\$516
	Transit and Intercity Rail Capital Program	\$283	\$311	\$339	\$369
	Community Air Protection	\$177	\$194	\$212	\$231
	Sustainable Communities and Agricultural Land Conservation	\$170	\$186	\$204	\$221
	Low Carbon Transit Operations Program	\$141	\$155	\$170	\$184
	Healthy and Resilient Forests	\$141	\$155	\$170	\$184
	Safe & Affordable Drinking Water Program	\$92	\$101	\$110	\$120

^{1/} Remaining \$500 million for the CAL FIRE General Fund shift in 2026-27 is funded with additional discretionary funding from interest earnings.

^{2/} Tier 3 funding is based on auction proceeds estimates which are based on recent auction results. This scenario is presented as an example only and should not be considered as a market price forecast.

While the proposed Cap-and-Invest expenditure plan reflects the Administration's updated revenue assumptions and program priorities, the projected funding levels are lower than the amounts contemplated under SB 840 (Chapter 121, Statutes of 2025). Under SB 840, the Transit and Intercity Rail Capital Program was to receive \$400 million annually and the Low Carbon Transportation Program was to receive \$200 million annually. These updated estimates indicate more conservative Cap-and-Invest revenue projections.

In addition, the proposed expenditure plan does not reflect previously identified Zero-Emission Transit Capital Program (ZETCP) funding commitments for FY 2026-27 and FY 2027-28. Under prior assumptions, statewide ZETCP funding was expected to total \$230 million in FY 2026-27 and \$460 million in

FY 2027-28, supported by GGRF revenues. Based on these prior funding assumptions, Orange County had anticipated receiving approximately \$38 million to support investments such as zero-emission buses, charging and fueling infrastructure, and on-site energy improvements, including rooftop solar.

The absence of these previously anticipated ZETCP funding levels introduces additional uncertainty for transit agencies' near-term capital planning and will require further clarification as the budget process continues, particularly through the May Revision and subsequent legislative deliberations.

As part of the Cap-and-Invest expenditure plan, the Governor also proposes the modernization of the Affordable Housing and Sustainable Communities Program, splitting the proceeds between affordable housing and sustainable communities, with the latter focusing on regional priorities related to land use, housing and transportation. The budget also proposes shifting up to \$560 million annually in Cap-and-Invest proceeds to the Housing Development and Finance Committee. This change is intended to streamline administration, better leverage complementary housing subsidies, and accelerate delivery of climate-aligned affordable housing.

State Transit Assistance (STA)

The budget estimates approximately \$717.9 million in STA funding for FY 2026-27, a decrease from the \$801.4 million in FY 2025-26. Orange County is expected to receive approximately \$38.8 million in STA funding in FY 2026-27, an estimated decrease from last year's amount of approximately \$43.3 million. In addition, the budget continues to include funding for the SB 1 (Chapter 5, Statutes of 2017) State of Good Repair program, estimating \$140.7 million being available in FY 2025-26, with about \$7.6 million being available for Orange County. The budget also includes funding for the Low Carbon Transit Operations Program in FY 2026-27, estimated to be \$141.7 million statewide, down from \$237.6 million this year. Orange County will receive about \$7.7 million if the estimate holds for FY 2026-27. Since these amounts are based on actual revenue receipts and Cap-and-Invest auction proceeds, these initial estimates are subject to change.

Bay Area Transit Loan

The Governor's proposed budget continues to propose a Bay Area transit loan intended to support near-term transit operations in the Bay Area. However, unlike proposals from the FY 2025-26 budget cycle that focused on a general fund backed loan, this proposal would allow funding to loan funding from STA via the Metropolitan Transportation Commission to meet cash flow challenges.

It is currently unclear if this loan would impact statewide STA or only the Bay Area shares.

Staff will continue to analyze the Governor's budget proposal and evaluate potential impacts to OCTA programs and funding as additional detail becomes available. An update on the proposed budget will be presented at the Legislative and Communications Committee meeting on February 19, 2026. For additional information, please visit <http://www.ebudget.ca.gov/>.

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c: Executive Staff