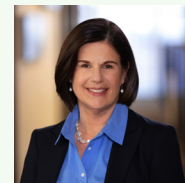


STATE OF CALIFORNIA: PRUDENT POLICIES AND HEALTHY RESERVES COUNTER REVENUE VOLATILITY

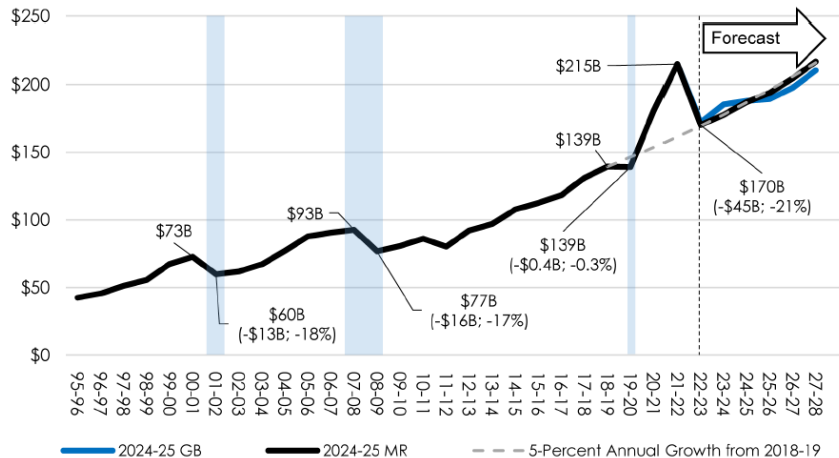
Tax revenue performance in the State of California is particularly susceptible to economic cycles given its highly progressive rate structure coupled with industry concentrations, including the technology sector. Although the state is accustomed to periods of revenue variability, the experience following the pandemic has been unlike any period in history. Positively, prudent fiscal practices, many of which were instituted following the Great Recession, supported the set aside of significant windfalls and will be used in combination with spending cuts and other measures to support the restoration of fiscal balance in future years.



SHEILA R. MAY, CFA

*Principal
Director, Municipal Bond Research*

Big Three Revenues (\$Billions)



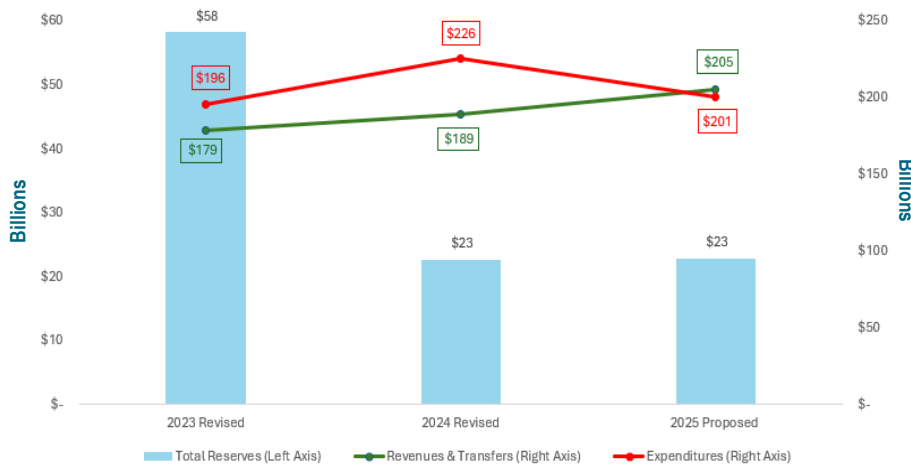
Projected revenue figures exclude the impact of tax policy proposals and solutions.
Shaded bars indicate previous US recessions.
Source: California Department of Finance, 2024-25 May Revision Forecast.

California witnessed consecutive years of unprecedented revenue growth in the years following the health crisis with the Big Three Revenues, personal income, sales, and corporate income taxes expanding by 55% from fiscal 2020 through fiscal 2022. In fiscal 2022, General Fund revenues and transfers totaled a record \$232.5 billion, with the trio accounting for \$215.3 billion, or 92.5%, of the fund's

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total collections that year. More specifically, personal income taxes contributed \$137.1 billion to the tally, including \$29.7 billion of capital gains taxes. Tax receipts returned to more normalized levels starting in fiscal 2023. Despite registering a 21% decline that year, the primary taxes remained above pre-pandemic levels and posted an annualized growth rate of 5% since fiscal 2019.

General Fund Budget Summary (FYE 6/30) – May 2024



Source: California Legislative Analyst's Office

These tremendous funding swings have presented challenges for budget forecasters. For fiscal 2023 and the recently completed fiscal 2024, spending levels were predicated on revenue expectations that failed to materialize. 2024 was a particularly difficult year for finance officers as filing extensions following statewide winter storms delayed tax receipts by more than six months, well after the spending plan was set. The state's response during this period has been to suspend one-time investments and instead allocate accumulated balances and reserves toward core programs, including education and health services. For fiscal 2025, the state has brought spending back in line with revenue expectations while maintaining reasonable levels of reserves at nearly 11.5% of expenses.

California has taken several steps over the past decade to enhance operating flexibility while acknowledging the volatile nature of its primary tax resource. Proposition 2, approved by voters in November 2014, requires the transfer of excess capital gains taxes above a specified threshold to the equal funding of

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budget reserves and the repayment of state debts, including pension liabilities. The statute has been instrumental in reducing the state's reliance on an unpredictable revenue stream for general operations, while diverting the funds to build reserves and reduce long-term obligations. The mandate has proven so instrumental to fiscal stability that Governor Newsom is proposing even larger transfers of surplus collections in future years.

We are confident in the state's ability to manage its inherent revenue variability given the fiscal guardrails in place and expect forecasting will improve as economic conditions continue to normalize. Our comfort with the state's credit profile is further supported by the breadth and depth of its economy, representing the fifth largest in the world. California GO is currently rated Aa2 / AA- / AA and is the fourth largest holding in our GW&K Municipal Bond Strategy (2.5%) and the largest in the Index (4.3%).

DISCLOSURES:

All material has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy of, nor liability for, decisions based on such information. This represents the views and opinions of GW&K and does not constitute investment advice, nor should it be considered predictive of any future market performance.

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www.gwkinvest.com

Boston Headquarters
222 Berkeley Street
Boston, Massachusetts 02116
617.236.8900

Other Locations
New York, New York
Winter Park, Florida