



JOHN CHIANG
California State Controller

May 29, 2009

The Honorable Arnold Schwarzenegger
Governor of California
State Capitol Building
Sacramento, CA 95814

The Honorable Darrell Steinberg
President Pro Tempore
State Capitol, Room 205
Sacramento, CA 95814

The Honorable Karen Bass
Speaker of the Assembly
State Capitol, Room 219
Sacramento, CA 95814

The Honorable Dennis Hollingsworth
California State Senate
State Capitol, Room 305
Sacramento, CA 95814

The Honorable Sam Blakeslee
California State Assembly
State Capitol, Room 4117
Sacramento, CA 95814

Dear Governor and Members:

As State Controller, it is my obligation to keep you apprised of the State's cash condition and alert you to the risks that threaten the State's ability to meet its payment obligations. Last Friday, I presented to the Budget Conference Committee a description of the critical status of the State's cash position. At that hearing, I outlined the costly and limited nature of the State's borrowing and cash management options and urged the adoption of a truly balanced budget as the only responsible approach to resolving the State's cash crisis.

Based on the May Revision revenue and expenditure estimates provided to us late last week by the Department of Finance and taking into account the actual cash receipts and expenditures my office tracks, it is clear the health of the State's treasury has significantly deteriorated since the adoption of the 2009-10 Budget Act a mere three months ago. Our latest projections show that beginning on July 29, California will not have the cash needed to meet all of its payment obligations. On that date, the State will be in the red by \$317.1 million; two days later, on July 31, our cash deficit increases to a negative \$1.02 billion.

As the attached chart demonstrates, the State's cash problems will only grow in severity in the subsequent months without Legislative action. The State will reach its lowest cash balance in April 2010, when we will fall short of meeting our payment obligations by nearly \$22 billion. That is more than *four times* the \$5.1 billion cash deficit we faced this past spring. But the painful options we used in February to ensure we had sufficient cash to make education and debt service payments required by the Constitution, federal law and court rulings – including delays in tax refunds and vendor payments and shutting down 5,300 public works projects – will not come close to providing an adequate solution in the coming months.

While there are 61 days between today and July 29, the time available to align the State's spending with its revenues is far less. There are three reasons:

- (a) Cash solutions need time in order to be realized. For example, reductions in payments that occur later in the fiscal year cannot help the cash shortage we face in the beginning of the fiscal year.
- (b) As a precautionary measure, I am preparing to sell Revenue Anticipation Warrants (RAWs) to address part of the cash shortage. While I would prefer to avoid them altogether, prudence demands contingency planning. To complete the borrowing needed by July 29, my office will have to meet with credit rating agencies and launch a major investor outreach effort in mid-June. Without credible budget and cash flow solutions in place, the rating agencies and potential investors who will be evaluating the credit risk of these securities will be highly skeptical about investing in California. It is also worth mentioning that the passage of Senate Bill 116 is a necessary component to a successful sale. Legislative inaction to remedy the budgetary imbalance can compromise the success of this sale or further increase what is expected to be the largest financing costs in the State's history.
- (c) The State's chronic inability to resolve its structural budget deficit, the fact that the State has not had a positive cash balance since July 12, 2007, and has had to borrow internally from special funds, and the collapse of the global credit markets all have significantly limited the State's ability to borrow from Wall Street. Simply-stated, the State will not be able to borrow its way out of this crisis. Tough decisions cannot be avoided.

Because of these reasons, **I strongly urge you to take action no later than June 15th.**

Failure to immediately address the budget deficit and cash shortage will severely damage our already fragile fiscal position. A protracted stalemate would do immeasurable harm to our economy by potentially extending a recession that many economists predict will bottom out by early 2010. Inaction would create an even greater fiscal hardship for Californians, especially those businesses that provide goods to the State and those vulnerable individuals who depend on public health and social services. The ability of the State to discharge its most fundamental duties of protecting its citizens, educating its youth, and safeguarding its natural resources will be compromised.

May 29, 2009

Page 3

Please recognize that only you, the Legislature and the Governor, can prevent the fiscal catastrophe that we face. You have a narrow window to address the State's budget and cash challenges, and I respectfully urge you to take prompt action. My office is at your service for any assistance we can provide.

Sincerely,

Original signed by,

JOHN CHIANG
California State Controller

cc: All Legislators
Enclosure(s)