JOHN CHIANG
California State Controller

June 2, 2010

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

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

The Honorable John A. Pérez
Speaker of the Assembly
State Capitol, Room 219
Sacramento, CA 95814

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

The Honorable Martin Garrick
Assembly Republican Leader
State Capitol, Room 3104
Sacramento, CA 95814

Dear Governor and Legislative Leaders:

As State Controller, I am responsible for keeping you informed of California's cash condition and any threats that may prevent the State from meeting its payment obligations in a timely manner.

Based on the May Revision revenue and spending estimates provided by the Department of Finance, and including the actual cash receipts and expenditures my office tracks, California appears to have sufficient resources to meet all of its payment obligations and maintain a prudent cash cushion to address unanticipated developments through the month of August. A timely and credible budget will provide us with enough time to secure a conventional cash flow borrowing necessary to smooth the timing differences between when the State receives its revenues and makes its expenditures (see the blue line in the attached schedule).

It is important to understand that the State's positive cash position during the opening months of the new fiscal year does not indicate the State's cash flow is beginning to rebound along with the general economy. Rather, the State's ability to meet its payment obligations during the next three months is entirely owed to two factors:

- Legislation (ABx8 5 and ABx8 14) enacted earlier this spring that allowed the deferral of approximately $4.7 billion of payments to K-12 education, higher education, and local governments; and
- The continued reliance on borrowing as much as $20 billion from special funds. These special funds, which were established to address critical public needs such as

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controlling air pollution, and preventing oil spills and lead poisoning in children, can only be tapped to the extent that the borrowing does not affect the statutory purpose of the fund.

Even with the payment deferrals that hurt schools and local governments and the excessive leveraging of special funds, a protracted budget stalemate or the passage of a "get-out-of-town budget" relying on accounting gimmicks and unrealistic solutions will create cash shortfalls starting in October (see orange line). Because the State cannot begin conserving cash on the same day that it runs out of cash, my office will be forced to begin aggressive cash management measures, such as issuing IOUs, well in advance of any projected shortfall.

As you know, the State began issuing IOUs for only the second time since the Great Depression just ten short months ago. Not only were thousands of already-struggling Californians forced to shoulder the brunt of California's liquidity crisis, the State's credit rating toppled close to non-investment grade, or "junk status." Nearly a year later, we are still trying to recover from that shameful chapter in California's history and the residual scars can be found in the millions of dollars in extra debt service that we are paying to finance our borrowing needs. At a time when California is preparing for an economic upturn, your leadership is needed now more than ever to ensure that an honestly-balanced budget is reached in a timely manner to protect the State from another fiscal meltdown.

While there should be debate regarding the role tax increases and spending cuts are to play in this budget, there is no debate that the worst thing you can do is nothing. Political paralysis cannot be an option. Consider the following:

- Cash solutions need time in order to be realized. For example, reductions in payments that are scheduled for later in the year cannot help the cash shortage we face in the near term;
- Inaction compromises the ability to implement the necessary programmatic changes in time to achieve the full year benefit of your 2010-11 solutions;
- Cash receipts continue to be volatile and difficult to predict. For example, 2009-10 receipts through April 30, 2010, were $1.3 billion below the estimates included in the Governor's January Budget, and General Fund receipts were $3.6 billion below April estimates; and
- If I am forced to implement emergency cash management measures, I must act before the State's treasury is depleted. Depending on several factors, including how much cash needs to be conserved and the market conditions for borrowing, I will have to act weeks in advance of the projected date that the State goes into the red.

Although I will issue an update of the State's cash outlook next week, when the actual receipts and disbursement data for May will be available, the cash report for June is critical to our cash flow planning. June has become the leading month for revenue receipts, with more than 13% of all Fiscal Year 2009-10 General Fund revenues projected to be received in this month.

I do not envy the difficult choices you face in the weeks ahead. However, my staff and I are at your service for any technical expertise or assistance we can provide.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

Attachment

cc: The Honorable Bill Lockyer, State Treasurer
Members of the California State Legislature
Ana Matosantos, Department of Finance Director
Mac Taylor, Legislative Analyst