

May 22, 2009

California's Cash Flow Crisis

L E G I S L A T I V E A N A L Y S T ' S O F F I C E

Presented to:
Budget Conference Committee

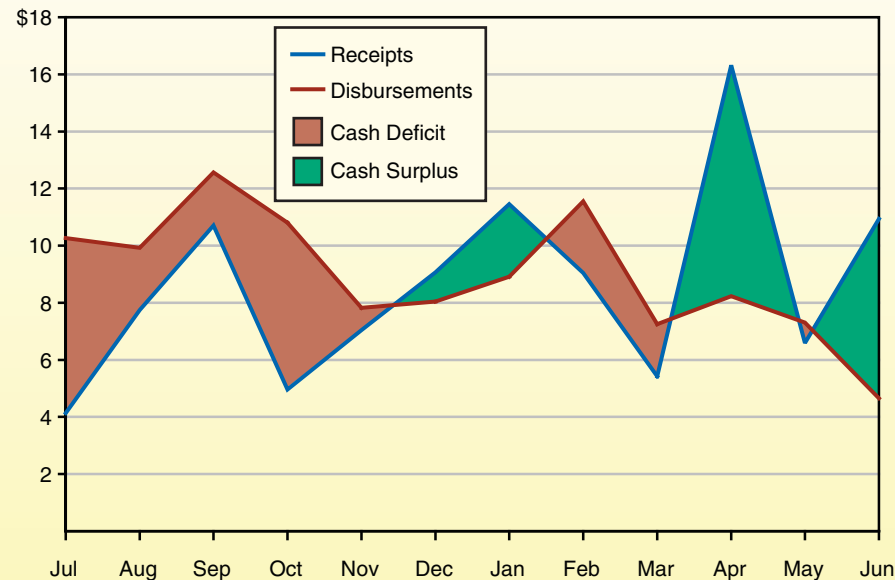


State Cash Flow: The Basics

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Cash Flow Deficits Mark the First Half Of the General Fund's Fiscal Year

2007-08 (In Billions)



State Cash Flows Are Uneven Through the Fiscal Year. The General Fund makes most of its expenditures in the first half of a typical fiscal year, as shown above. It collects most of its revenues in the second half of the fiscal year.



Cash-Flow Borrowing Required Every Year. The General Fund borrows from internal sources (hundreds of borrowable special funds) and external sources (short-term investors in revenue anticipation notes [RANs] or warrants [RAWs]). Available funds from these sources and any General Fund cash balances are known as the General Fund's "cash cushion."

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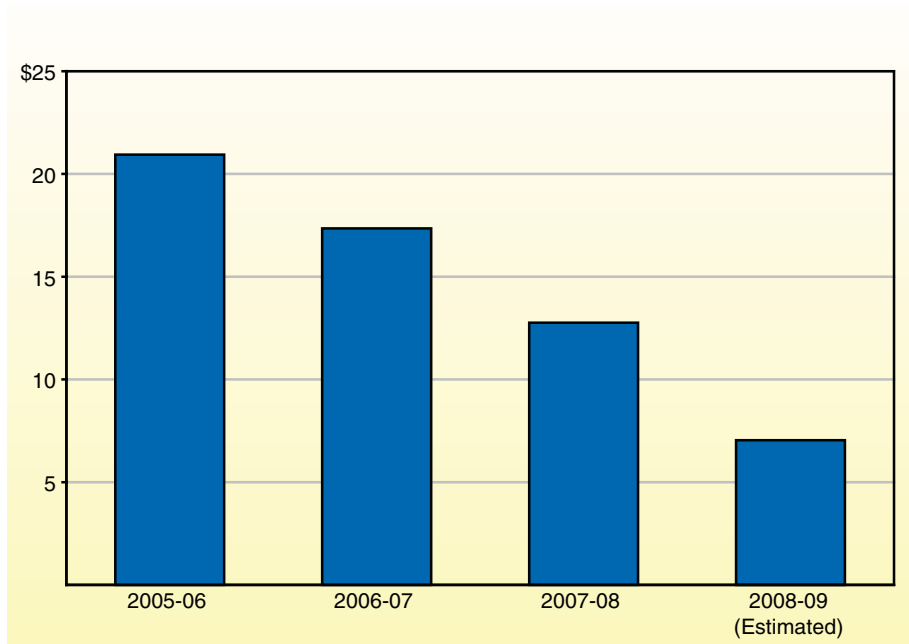
- A “Zero Cash Cushion” Means State Cannot Pay Bills on Time.*** If the cash cushion reaches zero, the state cannot pay all of its General Fund or special fund bills on time.

- Balancing Cash-Flow Needs Is Important.*** Failure of the state to pay certain bills on time (including payroll, vendor payments, and debt service) can lead to large penalties and interest. Payment delays can disrupt operations of local governments and vendors and affect individual Californians.

2008-09 Year-End Cash Cushion to be Much Lower Than in Prior Years

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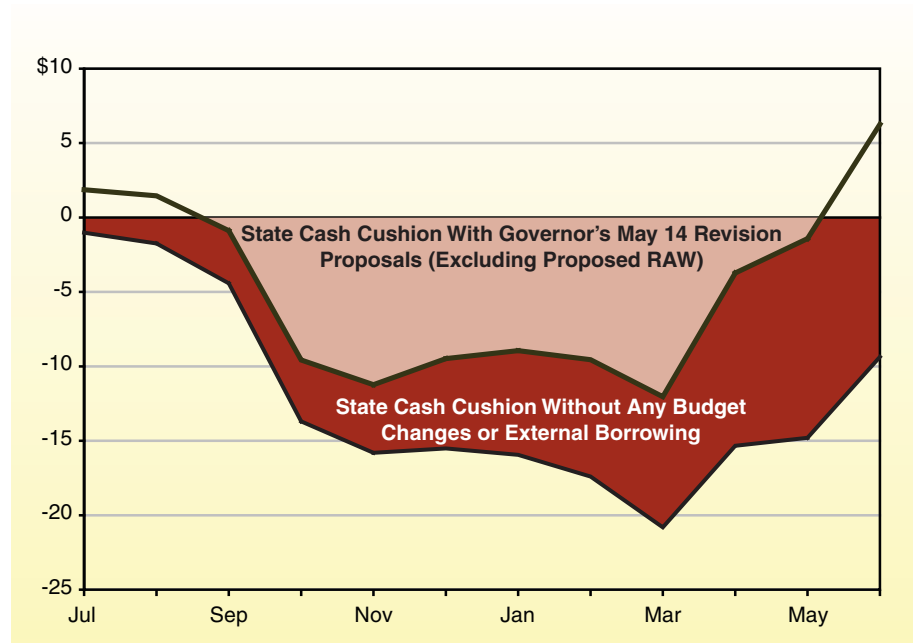
(In Billions)



Preliminary May 2009 Forecast: Huge Deficits in State's Cash Cushion During 2009-10

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(In Billions)



Borrowing Alone Probably Not Enough to Address This Problem

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- Even With \$10 Billion in RAWs or RANs, Additional Actions Would Be Needed.*** Even if the Legislature enacted the May Revision proposals, the state probably would have difficulty paying some bills on time even if it were able to secure \$10 billion of RAW or RAN borrowing during 2009-10.
- Payment Delays Will Be Required.*** It may be difficult to borrow \$10 billion of RAWs or RANs based on the state government's credit. Therefore, delaying billions of dollars of scheduled payments will almost certainly be required.
- Legislature Best Suited to Make These Decisions.*** If the Legislature does not act to delay payments, the Controller will have to use his power to do so. The Legislature, however, can—unlike the Controller in some instances—delay payments in ways that (1) provide greater advance warning to affected entities and (2) result in much less penalty and interest costs to the state.

LAO Recommendations

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- Reduce 2009-10 Short-Term Borrowing Need Below \$10 Billion.** By returning the budget to balance and adopting additional payment delays, the Legislature can reduce the state's 2009-10 external borrowing requirement below \$10 billion. Reducing the external borrowing requirement even lower may be necessary based on market conditions.
- No Choice but to Delay Some Payments.** There likely will be no choice but to delay to later during the 2009-10 fiscal year billions of dollars of state payments scheduled to be made to universities, school districts, counties, taxpayers awaiting refunds, vendors, service providers, and others.
- Mitigate Effects of Payment Delays on Local Governments and Others.** When adopting payment delays and budget reductions, the Legislature should adopt measures (1) to give local governmental entities and school districts increased flexibility and (2) to allow exemptions for the *most* financially distressed entities.
- Adopt a Trigger to "Turn Off" Payment Delays if Possible.** We recommend the Legislature allow the Pooled Money Investment Board to "trigger off" portions of the payment delays if the state cash situation allows during the fiscal year.
- Act Quickly.** The Legislature needs to act quickly to return the budget to balance and address cash-flow issues in order to allow the state to enter the short-term credit markets as soon as possible. Early action gives school districts, local governments, vendors, and others the chance to prepare for payment delays.