Controller *John Chiang*

California State Controller's Office

December 2009 Summary Analysis | Volume 3, Issue 12

Statement of General Fund Cash Receipts and Disbursements

State Finances in November 2009

⇒ The State's November 2009 General Fund revenues were relatively close to projections. Compared to the estimates in the Amended 2009-10 Budget Act enacted on July 28, 2009, total General Fund revenues were down $40.8 million (-0.7%). Corporate taxes came in $70.2 million above estimates, and sales taxes beat estimates by $32.7 million (1.0%). Personal income tax revenues were $270 million below (-12.8%) projections.

⇒ Compared to November 2008, General Fund revenue in November 2009 was down $33.3 million (-0.6%). The total for the three largest taxes was below 2008 levels by $12.8 million (-0.2%). Personal income taxes came in $304 million below (-14.1%) last November and corporate taxes were down by $117 million. Sales taxes were up by $408 million (13.5%) from last year.

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Budget vs. Cash

The State's budget is a financial plan based on estimated revenues and expenditures for the State's fiscal year, which runs from July 1 through June 30.

Cash refers to what is actually in the State Treasury on a day-to-day and month-to-month basis.

Monitoring the amount of cash available to meet California's financial obligations is the core responsibility of the State Controller's office. On average, the Controller's office issues 182,000 payments every day.

The State Controller's Office is responsible for accounting for all State revenues and receipts and for making disbursements from the State's General Fund. The Controller also is required to issue a report on the State's actual cash balance by the 10th of each month.

As a supplement to the monthly Statement of General Fund Cash Receipts and Disbursements, the Controller issues this Summary Analysis for California policymakers and taxpayers to provide context for viewing the most current financial information on the State's fiscal condition.

This Summary Analysis covers actual receipts and disbursements for November 2009 and year to date for the first five months of Fiscal Year 2009-10. Data are shown for total cash receipts and disbursements, the three largest categories of revenues, and the two largest categories of expenditures.

This report compares actual receipts against historical figures from 2008. A statement of estimated cash flows for the Amended 2009-10 Budget Act enacted on July 28, 2009, is used as an estimate for a basis of comparison.

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Tax Revenue Fiscal Year to Date

⇒ Compared to the Amended 2009-10 Budget Act, General Fund revenues in November were below the year-to-date estimate by $835 million (-2.8%).

⇒ Corporate taxes were above the year-to-date estimates by $163 million (8.0%). Income taxes were down $1.44 billion (-9.3%), and sales taxes were short by $355 million (-3.2%). Because the Amended 2009-10 Budget Act estimates contained actual revenue through the budget's enactment on July 28, 2009, this deterioration occurred between the months of August and November.

⇒ Compared to this date in November 2008, revenues were down $2.33 billion (-7.4%). This was primarily driven by personal income taxes, which came in $2.63 billion below (-15.8%) last year's figures, and corporate taxes, which were $293 million under (-11.8%) the same point in 2008.

⇒ Year-to-date collections for the three major taxes were down $2.20 billion (-7.5%). Retail sales taxes were up $724 million (7.1%) from last year's total at the end of November 2008.

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Budget Provision for Lower-Than-Expected Revenues

The Amended 2009-2010 Budget Act, in the "other receipts" category of its monthly cash flows, included $3 billion for potential revenue deterioration.

What The Numbers Tell Us

Despite strong growth in the nation's real Gross Domestic Product last quarter, the National Bureau of Economic Research (NBER) has yet to signal the end of this recession. But many indicators, especially in California, show the economy reaching its bottom.

Home prices, while still below last October, were up slightly in October 2009. Home sales continue to increase across the state as first-time home buyers move to take advantage of federal incentive programs aimed at boosting purchases. Residential building permits have also been on the rise in recent months, which should help to mitigate further losses in a construction industry that has suffered greatly since the collapse of the housing market in 2006.

Along with consumer activity, which leveled off in the third quarter, we begin to see these changes feed into the State's cash position. Although California's General Fund revenues deteriorated in November, its net cash position is roughly $611 million above the estimate contained in the Amended 2009-10 Budget Act. Most of this improvement is due to an additional $1 billion in revenue anticipation notes (RANs), but some revenue sources saw improvement as well. The most obvious is the State's sales tax revenues, which have increased on a year-over-year basis for three months in a row. State expenditures are also $400 million lower than anticipated at this time in the Amended Budget Act, although we will not know for months whether that represents true savings in program costs.

Unfortunately, it is not quite time to pop the champagne corks. Despite some positive signs, the state's unemployment rate is still at 12.5% — the highest on record in more than three decades. Nearly 1.029 million nonfarm jobs have been lost since employment peaked in July 2007. In addition, these positive cash movements were largely helped by government intervention into the markets and a marked slowdown in the pace of the economic decline.

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Summary of Net Cash Position as of November 30, 2009

⇒ Through November, the State had total receipts of $29.7 billion (Table 1) and disbursements of $42.3 billion (Table 2).

⇒ The State ended last fiscal year with a deficit of $11.9 billion, so the combined current year deficit stands at $24.4 billion (Table 3). Those deficits are being covered with $15.6 billion of internal borrowing and $8.8 billion in external borrowing.

⇒ Of the largest expenditures, $31.5 billion went to local assistance and $9.9 billion went to State operations (See Table 2).

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Borrowable Resources

State law authorizes the General Fund to internally borrow on a short-term basis from specific funds, as needed.

Payroll Withholding Taxes

"Payroll Withholdings" are income taxes that employers send directly to the State on their employees' behalf. Those amounts are withheld from paychecks during every pay period throughout the calendar year.

Revenue Anticipation Notes

Traditionally, the State bridges cash gaps by borrowing money in the private market through Revenue Anticipation Notes (RANs). RANs are repaid by the end of the fiscal year.

Non-Revenue Receipts

Non-revenue receipts typically are transfers to the General Fund from other State funds.

Table 1: General Fund Receipts, July 1, 2009 - November 30, 2009 (in Millions)*

Revenue Source	Actual Receipts to Date	Amended 2009-2010 Budget Act Estimate	Actual Over (Under) Estimate
Corporation Tax	$2,199	$2,036	$163
Personal Income Tax	$14,019	$15,460	($1,441)
Retail Sales and Use Tax	$10,860	$11,214	($355)
Other Revenues	$2,109	$1,321	$798
Total General Fund Revenue	$29,187	$30,021	($835)
Non-Revenue	$553	$556	($3)
Total General Fund Receipts	$29,740	$30,578	($838)

***Note:** Some totals on charts may not add up, due to rounding.*

Table 2: General Fund Disbursements, July 1, 2009-November 30, 2009 (in Millions)

Recipient	Actual Disburse-ments	Amended 2009-10 Budget Act Estimate	Actual Over (Under) Estimate
Local Assistance	$31,517	$31,308	$209
State Operations	$9,852	$10,553	($701)
Other	$907	$807	$100
Total Disbursements	$42,276	$42,667	($392)

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⇒ Local assistance payments were $209 million higher (0.7%) than the Amended 2009-10 Budget Act and State operations were $701 million below (-6.6%) those estimates.

How to Subscribe to this Publication

This Statement of General Fund Cash Receipts and Disbursements for November 2009 is available on the State Controller's Web site at www.sco.ca.gov.

To have the monthly financial statement and summary analysis e-mailed to you directly, sign up at: http://www.sco.ca.gov/ard_monthly_cash_email.html

Table 3: General Fund Cash Balance As of November 30, 2009 (in Millions)

	Actual Cash Balance	Amended 2009-2010 Budget Act Estimate	Actual Over (Under) Estimate
Beginning Cash Balance July 1, 2009	($11,908)	($11,908)	$0
Receipts Over (Under) Disbursements to Date	($12,536)	($12,090)	($446)
Cash Balance November 30, 2009	($24,444)	($23,998)	($446)

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California Economic Snapshot		
New Auto Registrations (Fiscal Year to Date)	**230,734** Through August 2008	**166,567** Through August 2009
Median Home Price (for Single Family Homes)	**$278,000** In October 2008	**$257,000** In October 2009
Single Family Home Sales	**42,293** In October 2008	**41,280** In October 2009
Foreclosures Initiated (Notices of Default)	**94,240** In 3rd Quarter 2008	**111,689** In 3rd Quarter 2009
Total State Employment (Seasonally Adjusted)	**14,886,700** In October 2008	**14,199,000** In October 2009
Newly Permitted Residential Units (Seasonally Adjusted Annual Rate)	**52,922** In October 2008	**35,246** In October 2009
Data Sources: DataQuick, California Employment Development Department, Construction Industry Research Board, State Department of Finance		

Featured Articles on California's Economy

The opinions in these articles are presented in the spirit of spurring discussion and reflect those of the authors and not necessarily the Controller or his office. This month's report includes an article by Christopher Thornberg, Ph.D, Founding Principal, Beacon Economics, and Chair, State Controller John Chiang's Council of Economic Advisors .

Are We There Yet?
What do recent statistics tell us about the economy?

By Christopher Thornberg, Ph.D
Founding Principal, Beacon Economics
Chair, State Controller John Chiang's Council of Economic Advisors

The United States: It's the Consumer, Dummy!

It has been a rough year. The U.S. economy contracted 3.8% between the second quarter of 2008 through the second quarter of 2009. Unemployment is now 10.2% and the U.S. continues to shed payroll jobs. However, a cursory glance at some basic statistics could indicate a rebounding US economy.

Growth in the third quarter came in at 2.8%, the stock markets are up 50% from the bottom and home prices are rising in 16 of the 20 markets being tracked by the Case-Shiller price indexes. But are things really so rosy?

The unfortunate answer is no. Growth in the third quarter was not due to improving fundamentals but instead due to massive government intervention in the economy. While this has served to reduce the symptoms of the problems in the short run, they are also slowing the healing process the nation needs to work through in order to finally pull out of this nasty business cycle.

Consider the banking sector. Earlier this year the Financial Accounting Standards Board rules were changed at the behest of Congress (after some

serious back room lobbying efforts on the part of the financial industry) to give banks tremendous leeway in how they value troubled loans. This functionally killed the Public-Private Investment Program (PPIP) that was designed to help clear the banks of bad assets and help restore normalcy in the lending markets. It also leaves investors more in the dark than ever about the real value of their holdings. Of greater concern is the consumer. While many pundits describe this recession as driven by financial market problems, in fact the larger issue has been the American consumer. The sharp

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pullback in spending that began in Q3-08 capped a 15-year spending spree that pushed savings rates down from 7% of disposable income to 1%. Over the same period, debt levels climbed from 75% to 120% of income. For the U.S. economy to return to normal growth the consumer must save more (spend less) and deleverage.

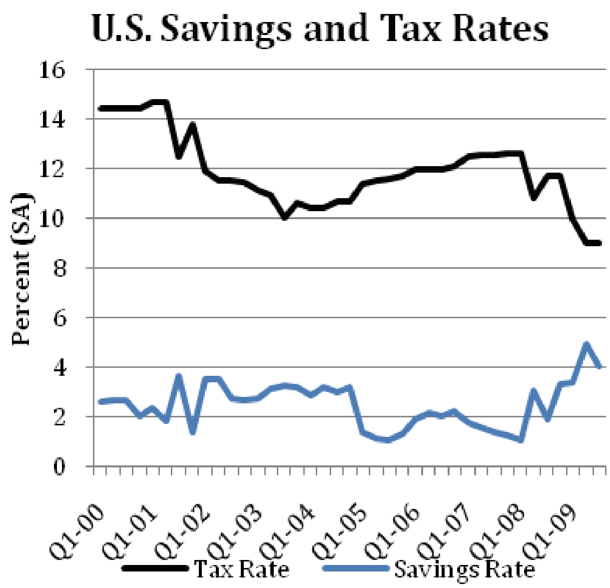
Unfortunately the federal government seems largely unwilling to allow consumers to return to appropriate levels of borrowing and spending. Instead they are using tax rebates to spur on purchases of homes and cars. The Federal Reserve continues to keep mortgage rates artificially low and the FHA continues to insure mortgages for borrowers with poor credit and a paltry amount down — the new subprime disaster in the wings with the U.S. taxpayer, rather than bond buyers, as the loser when the losses inevitably start to mount.

As for the increase in the savings rate seen this year — it, too, is an illusion created by the tremendous decline in the U.S. tax rate, driven in turn by stimulus tax cuts, rebate checks and a tax system that allows capital losses to be written off against income levels. In fact, the U.S. consumer used a record proportion of their income in Q3 to fund the surge in spending that stabilized the economy.

Add it all up and it is clear that the U.S. economy has a ways to go before things are truly stabilized and we can begin to grow again in earnest. When this will occur depends critically on whether policy makers will finally stop their quixotic efforts to pump up the already over-extended consumer. We hope it occurs before inflation kicks in and federal debt finally reaches a debilitating level.

California: Housing on the Mend?

The Golden State has always been a boom or bust place, thankfully more boom than bust in the long run. Yet the last housing cycle dominates anything seen in the past. Median prices in the state grew from $210,000 in 2001 to $510,000 in 2007, a 16.5% annual pace. What is more amazing is how



many local economic forecasters and real estate 'experts' denied that the state's markets were in a bubble.

As we now know, it was a bubble pumped up by the alternative lending markets. By our estimate, 30% of this liquidity landed in California's housing markets. When the flow finally halted in 2007, prices began to crash back to earth. They reached 2001 levels earlier this year.

In accordance with national trends, there were some positive signs seen in the state's housing market in recent months. An increase in demand, falling rates of foreclosures and record low interest rates have caused prices to bounce back — double digits in the Bay Area, 8% to 9% in San Diego and Orange County and a few percent in the Los Angeles / Inland Empire region. Builders are suddenly scrambling to repurchase land they had been offloading at a record pace not even a year ago.

Similar to the Q3 U.S. growth rate, this bounce in the housing market is largely driven by government intervention, rather than by improving fundamentals. One such intervention was the recently-extended tax credit for homebuyers. The point of a tax credit is to pull buyers into the market

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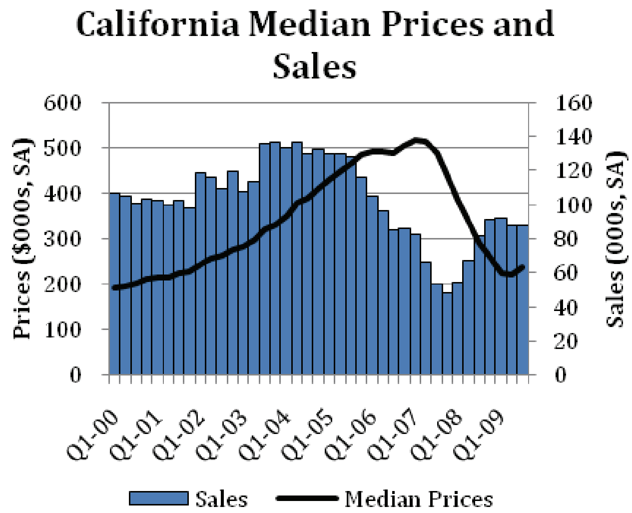
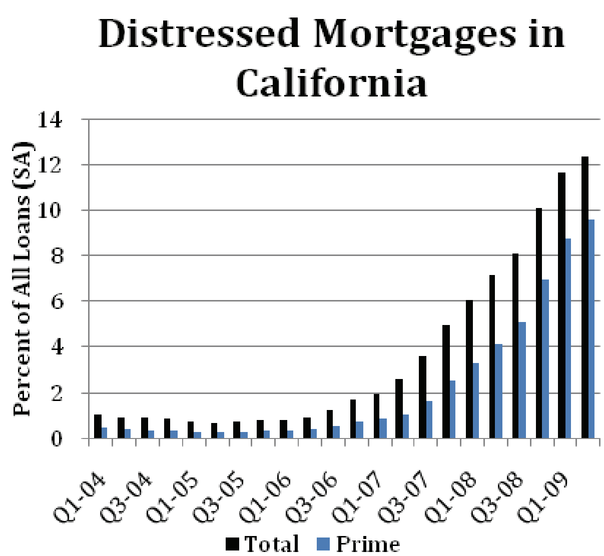
even though they fear potential losses on the value of their recent purchase — the losses from falling prices are fully or partially made up for by the fact that they get the mortgage deduction. But such a plan works only if the tax credit is coming to an end — as witnessed by the surge in sales in the two months prior to the previous deadline. By extending the program Congress has more or less ended the value of it.



Mortgage rates are at record low levels due to Federal Reserve policy of quantitative easing — printing money to buy debt issued by the GSE's — Fannie Mae and Freddie Mac. This will necessarily come to an end when the Fed is finally forced to absorb some of this liquidity to prevent inflation. If not, it will be even worse, as those who remember the 15% mortgage rates of the early 1980s can attest to.



But most important to the recent stability in the market is the blockage in the foreclosure process. The decline in the number of bank-owned units is not a function of fewer problem mortgages, but rather a legislative lengthening of the foreclosure process. State level moratoriums, Federal Homeowner Assistance Plan programs, and changes in how banks deal with distressed loans have all served to reduce the current supply of homes being put on the market now.

Data from the Mortgage Bankers Association paint a grim picture. As of the second quarter of this year, 15% of all mortgages in the state were in serious trouble — either 60 or more days behind on payment or somewhere in the foreclosure process. This isn't just subprime product either — prime mortgages are also in deep trouble. This represents somewhere between 400,000 and 600,000 units, most of which will eventually have to be foreclosed on and resold.

On top of the already grim numbers, it is clear that more resets in coming years will put more owners into default, adding to the stock. When this mass of units inevitably moves through the system and into the market, it will more than satiate the excess demand for product. This isn't to say prices will fall much more — they are already back into a sustainable long-run level. But the current bounce will not be sustained.

The only good news for our housing markets is that we are not saddled with an excess supply of units the way that Nevada, Arizona and Florida are. Even though new building permits are still at record low levels, California has not built enough housing units to meet population growth since the early nineties, particularly for lower priced units. This shortage has been driven by regulatory costs and prohibitive zoning rules, leaving the state with one of the worst crowded housing situations in the nation — even now. We only hope that when construction does begin again in earnest we focus on supplying this underserved portion of the market.