DEPARTMENT OF FINANCE
OFFICE OF THE DIRECTOR

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April 10, 2020

Honorable Holly Mitchell, Chair
Joint Legislative Budget Committee
Senate Budget and Fiscal Review Committee

Honorable Phil Ting, Chair
Assembly Budget Committee

Honorable Anthony Portantino, Chair
Senate Appropriations Committee

Honorable Lorena Gonzalez, Chair
Assembly Appropriations Committee

COVID-19—Interim Fiscal Update

As the Legislature assesses the extraordinary impacts of the COVID-19 pandemic on the state's fiscal condition, the Department of Finance provides the following interim fiscal update. Finance will continue to refine the information in this letter, as well as the state's revenue and expenditure estimates, as it develops the May Revision.

Economic Forecast and Revenues

The need to implement stay-at-home measures in California to protect public health and safety, combined with the effects of the COVID-19 pandemic on the national and world economies, have dramatically affected the state's economy. The economic disruption from the pandemic is expected to result in a recession and have significant negative effects on state revenues; concurrently, the drop in the stock market may cause further revenue declines.

This impact is expected to be immediate, affecting fiscal year 2019-20, and will continue in to fiscal year 2020-21 and additional years depending on the pace of recovery of local, state and national economies.

To give some perspective, Finance modeled a moderate recession scenario for the Governor's Budget, when it was released in January of this year, in which unemployment was projected to peak at 9.1 percent in the second quarter of 2021, compared to 6.9 percent and 12.3 percent for the 2001 and 2009 recessions, respectively. Due to the scope of the COVID-19 pandemic, unemployment could peak at a level higher than the Great Recession.

Expenditures

Fortunately, California begins this fiscal downturn in far better shape than in prior downturns because of our significant budget reserves and a cash cushion. Over the past several years, the state has paid off all of its past budgetary borrowing (the "wall of debt"), and has committed billions of dollars to paying down other liabilities. This, along with the maintenance of a structurally balanced budget in the last several years, has also made the state's fiscal condition more resilient.

Given the magnitude of this crisis, however, difficult decisions lie ahead. Accordingly, on March 24, Finance issued a Budget Letter (BL 20-08) informing all state departments that Finance is reevaluating all budget changes within the context of a workload budget, defined generally as the budget year costs of currently authorized services. In addition, resource constraints will likely force a further prioritization and reduction of expenditures.

At the same time, the state has been faced with implementing a massive public health response to the COVID-19 pandemic. This effort is critical to protecting the health of Californians and preparing the state's health care infrastructure for a surge of patients who will be infected and need to be hospitalized for life-saving supports. The cascading impacts of the public health response on the economy have also required historic intervention.

The state's response requires significant upfront emergency expenditures beyond the $1 billion allocated in Chapter 2, Statutes of 2020. For cash flow purposes, an additional $6 billion in response-related expenditures is projected in 2020. This funding is being used to secure personal protective equipment and critical medical supplies to expand the surge capacity of hospitals and medical facilities, as well as to support the state's efforts to protect public health and safety and reduce the spread of COVID-19. The state expects a majority of these expenditures will be reimbursed by the federal government. Given the scale of economic dislocation and other impacts of the public health orders, the Administration also expects increased expenditures due to higher caseloads in Medi-Cal, CalWORKs, and other health and human services programs.

Federal Stimulus

Congress has enacted three COVID-19 relief packages to date. The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), signed into law on March 27, includes $2.2 trillion in federal stimulus for the nation. Direct payments provided to approximately two-thirds of California families, the additional $600 per week added to unemployment checks, and expanded food benefits are all critical to supporting Californians during the crisis. The additional funding for small businesses through the Small Business Administration is also necessary to avoid long-term impacts on the state's economy.

Additional federal funding for schools, colleges and universities, child care, hospitals, housing, homelessness, and others will also provide critical support for both increased demand on programs and extraordinary expenditures related to delivering programs in different ways under the state's public health orders.

The federal stimulus will also provide at least $8.4 billion in direct assistance for the state's COVID-19-related expenditures and up to $6.9 billion for direct assistance to local governments. This funding is critical to support needed expenditures as the state and local governments work to keep Californians safe and reduce the spread of COVID-19. The Administration has directed all state agencies and departments to put procedures in place to draw down all available federal assistance and allocate these funds expeditiously.

Finally, on March 22, California secured a Presidential Major Disaster Declaration which makes federal funding available to the state for emergency protective measures, including direct federal assistance and reimbursement of state costs through the Federal Emergency Management Agency (FEMA). FEMA is expected to reimburse the state for approximately 75 percent of direct expenditures, and has committed to advancing up to 50 percent of the federal share of certain expenditures. Under this cost sharing arrangement, the federal government will fund approximately $5.25 billion of the $7 billion the state currently plans for expenditure.

A significant increase in federal funding will be needed beyond what has been provided for states and local governments to maintain critical programs and services. The Governor recently sent a letter (copy attached) to Speaker of the House Nancy Pelosi requesting significant funding from Congress—$1 trillion in direct and flexible relief for *all* states and local governments in recognition of the profound challenges ahead.

Cash Flow

The state's cash position was strong entering fiscal year 2019-20, but has been impacted by the COVID-19 pandemic. Current projections indicate that the state will have sufficient cash and internal borrowable resources available through the end of the current fiscal year despite the rapidly changing conditions related to the COVID-19 pandemic.

The State Controller's Office has updated these projections to reflect the delay in the deadlines for filing and payment of the primary General Fund tax revenue sources (personal income tax, corporate income tax and sales tax) to July 15, 2020, and assumes the state will receive approximately $19.8 billion in revenue from April through June of 2020—roughly 39 percent of the estimated receipts for this period reflected in the Governor's January Budget.

The following other significant assumptions are also reflected in these preliminary cash projections:

- The state will receive an $8.4 billion allocation of federal funding pursuant to the federal CARES Act in May 2020; and
- The state will spend roughly $7 billion in emergency COVID-19 response-related expenditures in 2020. The updated cash flow projections conservatively do not reflect additional federal reimbursements in 2019-20 other than the $500 million already received by the state.

Based on these assumptions, the cash flow projections indicate that as of June 30, 2020, the state will have approximately $8.7 billion in available cash and unused internal borrowable resources.

The fast-moving and fluid nature of the state's fiscal condition during this crisis require a range of cash management tools. Accordingly, the Governor authorized the State Controller to open and transfer funds to an account known as the General Cash Revolving Fund. Establishing this fund is a precautionary measure that would allow the

state to issue Revenue Anticipation Warrants, also called "RAWs", which are external cash borrowings that extend beyond a single fiscal year. The State Controller's Office, however, does not anticipate issuing RAWs this year because of the projected available cash and unused internal borrowable resources.

Conclusion

The May Revision that the Administration will submit to the Legislature by the statutory deadline will reflect the extraordinary impacts of the COVID-19 pandemic on the state's fiscal condition. As this letter demonstrates, the state faces daunting challenges and difficult decisions in the weeks and months ahead. The Administration will continue to work with the Legislature during this unprecedented crisis to maintain a balanced budget that promotes opportunity, and supports an equitable economic recovery.

KEELY MARTIN BOSLER
Director, Department of Finance

Attachment

cc: Honorable Jim Nielsen, Vice Chair, Senate Budget and Fiscal Review Committee
Honorable Jay Obernolte, Vice Chair, Assembly Budget Committee
Gabriel Petek, Legislative Analyst (3)
Joe Stephenshaw, Staff Director, Senate Budget and Fiscal Review Committee
Kirk Feely, Budget Fiscal Director, Senate Republican Fiscal Office
Christopher W. Woods, Senate President pro Tempore's Office (2)
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Mark McKenzie, Staff Director, Senate Appropriations Committee
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