

Fitch Rates \$2.2B California GOs 'A'; Outlook Stable

Written by Australian Business

NEW YORK--([BUSINESS WIRE](#))--Fitch Ratings assigns an 'A' rating to \$2.2 billion in general obligation (GO) bonds of the state of California, consisting of:

--\$707,705,000 various purpose GO bonds;

--\$600,000,000 various purpose GO refunding bonds;

--\$246,010,000 GO bonds (school facilities);

--\$450,000,000 GO bonds (mandatory put bonds);

--\$186,165,000 various purpose GO bonds (federally taxable).

The bonds will be sold via negotiated sale on October 22. The par amount for the refunding series is approximate and will be determined upon final sale.

Fitch also affirms the 'A' rating on approximately \$74 billion outstanding state GO bonds.

The Rating Outlook is Stable.

SECURITY

General obligations, for which the state pledges its full faith and credit, subject to the

prior application of moneys to the support of public education; funds for education represent approximately half of state spending.

KEY RATING DRIVERS

RECENT STATE UPGRADE BASED ON FISCAL MANAGEMENT IMPROVEMENT:

Institutionalized changes to fiscal management in recent years, combined with the ongoing economic and revenue recovery have enabled the state to materially improve its overall fiscal standing. Notable progress includes timely, more structurally sound budgets, spending restraint, and sizable reductions in budgetary debt. Fitch upgraded the state's GO rating to 'A', from 'A-', on Aug. 5.

WEALTHY, DIVERSE ECONOMY: The economy is wealthy and unmatched among U.S. states in its size and diversity. After severe, widespread recessionary conditions, growth has resumed, including in California's housing market.

MODERATE DEBT BURDEN: Tax-supported debt is moderate, although it has grown in the last decade for infrastructure needs and budgetary borrowing. Pension funded ratios have declined and contributions to the teacher system remain inadequate, but the state has instituted some benefit reforms.

CYCLICAL REVENUES AND CASH FLOWS: State finances are subject to periodic, severe budget and cash flow stress due to economic cyclicity, revenue volatility tied to personal income taxes, carried over structural imbalances, a lack of reserves, and institutional inflexibility. The state expanded its ability to manage cash flow weakness during the last downturn, and other progress made to date can be expected to make the effects of future downturns more manageable.

TANGIBLE STRUCTURAL PROGRESS: Deep recurring spending cuts in recent adopted budgets and a restrained approach to restoring past cuts have significantly lowered the state's structural imbalance. Nevertheless, the state carries a heavy burden of budgetary borrowing from the last two fiscal crises and its historical difficulty achieving and sustaining budgetary solutions poses an ongoing risk.

INITIATIVES LIMIT FLEXIBILITY: Voter initiatives have reduced the state's discretion to effectively manage budgetary challenges over time. However, more recent initiatives authorizing a simple legislative majority to approve spending and temporarily raising tax revenues have been instrumental in current fiscal progress.

RATING SENSITIVITIES

CONTINUED FISCAL DISCIPLINE: The rating is sensitive to the continuation of the state's recent fiscal discipline and its ability and willingness to continue addressing numerous fiscal challenges. Additional material progress on reducing budgetary borrowing, maintenance of structural balance and addressing key fiscal risks could result in rating improvement. Unexpected economic, revenue and cash flow weakness or a return to spending growth without regard to revenue volatility could pressure the rating.

CREDIT PROFILE

Fitch's recent upgrade of California's GO bond rating to 'A' from 'A-' was based on the institutional improvements made by the state in recent years, its disciplined approach to achieving and maintaining structural balance in recent budgets, and the consequent fiscal progress made to date by the state as it recovers from the severe budgetary and cash flow crisis of 2008-2009. Fitch believes that these gains provide the state with a greater capacity to address future fiscal and budgetary cyclicalities. However, California's credit standing is likely to remain lower than most states for the foreseeable future given the magnitude of the state's budgetary and financial challenges.

Notable fiscal management improvements since the fiscal crisis of 2008-2009 have included a voter-approved change that allows simple majority budget approval as well as various cash flow management tools. Successive years of timely budgets that achieved structural gains primarily through deep, recurring spending cuts have also positioned the state to make steady progress repaying past budgetary borrowing under the state's current forecast.

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The temporarily higher personal income tax (PIT) and sales tax rate changes approved by voters in November 2012, while exposing the state to sharper revenue volatility, provide it with a margin of cash and revenue flexibility to sustain recent progress and repay budgetary borrowing assuming the state continues to exercise spending restraint. The state forecasts reducing budgetary borrowing from \$26.9 billion as of June 30, 2013, to \$4.7 billion in fiscal 2017, as the temporary rates begin to expire.

Although California's fiscal situation has improved significantly, Fitch views the state as being a long way from a full recovery from the effects of two fiscal crises over a little more than a decade. Budgetary borrowing in the form of deferrals, internal loans and deficit bonds will remain a drag on current resources for several years even under optimistic scenarios. Despite the institutional reforms of recent years, unmet needs to address unemployment borrowing, underfunding of teacher pensions, and prisons represent material risks.

Additionally, the state's longstanding challenges to achieving and maintaining budgetary gains--often due to lawsuits, federal objections, or allowing spending to grow at a pace in excess of sustainable revenues--could continue to weigh on the state's finances. California has limited sources of flexibility to confront the inevitable future downturn, and the budget stabilization account, the state's rainy day fund, remains empty. However, key credit strengths include its massive, diverse economy and tax base and the strengths inherent in a state's broad powers.

For further information on California's GO rating, please see Fitch's rating action commentary from Aug. 5, 2013, 'Fitch Upgrades California GOs to 'A'; Outlook Revised to Stable', available at www.fitchratings.com.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 14, 2012);

--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. State Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033

Additional Disclosure

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