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Fitch: CA Voter Initiatives Could Impact Budget and Credits.

Fitch Ratings-New York-31 October 2014: Voter initiatives in next week's election could have an impact on California's state budget, water credits and school districts, Fitch Ratings says. One initiative could impact water credits positively while a second could be positive for the state but negative for school districts.

California voters approval of Proposition 2 (The Rainy Day Budget Stabilization Fund Act) could help smooth the volatile tax revenues that have dogged the state budget in recent years. It would change the state's existing requirements for the Budget Stabilization Account (BSA), a rainy day fund, by requiring the state controller to make annual deposits based on set parameters. Fitch believes this is an important measure for the state. The enacted budget for fiscal 2015 assumes continued economic recovery and steady revenue gains while emphasizing the uncertainty inherent in California's volatile tax revenue system. That budget deposits \$1.6 billion to the rainy day fund, the first deposit since fiscal 2008.

Proposition 2 could also restrict the ability of local school districts to save for unanticipated needs, leaving K-12 schools more vulnerable to potential funding declines. In addition to smoothing contributions to the rainy day fund, Proposition 2 would create a new state-level reserve for schools and set restrictive funding preconditions likely to render deposits to that reserve infrequent. Deposits would trigger a statutory cap on local school reserves in subsequent years, potentially reducing local savings before substantial balances have accumulated at the state level. This could result in a 6% maximum reserve, well below the current 20% average for Fitch-rated districts. Proposition 2 would be positive for the state, but may reduce financial flexibility for schools in future downturns.

Another proposition, the Water Quality, Supply and Infrastructure Improvement Act of 2014 (Proposition 1), would be generally positive for the state's water credits in the long run as it would incentivize increased investment in capital projects that improve the long-term reliability of California water supplies. The \$7.454 billion bond is intended to fund state water supply infrastructure projects. It would also provide \$5.7 billion of matching funds to support local projects. It would have no positive impact on the drought or water credits in the short term and will not address the protracted debate around the controversial Bay Delta Conservation Plan.