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Fitch: Proposed Fund Balance May Pressure CA School Districts.

Fitch Ratings-New York-25 June 2014: A number of California school districts could see their credit quality weaken if a fund balance cap included in the fiscal 2015 budget becomes effective, Fitch Ratings says. Gov. Jerry Brown signed the education trailer bill to the budget last week that contains the cap. It will only become effective if the state's rainy day reserve (which includes a school funding reserve) constitutional amendment is approved by voters in November. If approved, it is not expected to be implemented until after fiscal 2018.

Even before the cap is triggered, Fitch expects some increased pressure by stakeholders to draw down reserves in anticipation of the cap being applied, which may result in some credit quality deterioration.

If applied, the cap would limit most school districts' assigned and unassigned general fund balances to 6% of expenditures. The current minimum is 3% of expenditures. The 6% cap would be well below the median Fitch-rated California school district balance of 20% and we view it as low, given the volatile history of California's K-12 funding system. Fitch believes that could also result in liquidity pressures.

There are potential mitigants to these risks. The school funding reserve ought to dampen funding volatility somewhat, reducing the concern about lower fund balances. Both budgetary and cash flow concerns could be mitigated by district's ability to maintain reserves outside the general fund to which the cap would not apply. Finally, districts may apply for exemptions from the cap if they provide a reason for needing additional funding, such as for capital or other long-term needs.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

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