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California GO Debt Rating Raised To 'AA-' And Removed From CreditWatch Upon Budget Enactment.

SAN FRANCISCO (Standard & Poor's) July 2, 2015–Standard & Poor's Ratings Services removed from CreditWatch and raised its rating on California's general obligation (GO) debt to 'AA-' from 'A+'. Standard & Poor's has also raised its rating on the state's general fund annual appropriation-secured debt to 'A+' from 'A'. The outlook on both ratings is stable.

"The rating action follows enactment of California's 2015-2016 budget, which, in our view, marks another step forward in the state's journey toward improved fiscal sustainability," said Standard & Poor's credit analyst Gabriel Petek. Seeing the potential for this, in May we placed our 'A+' GO rating on the state on CreditWatch with positive implications, pending the outcome of budget negotiations that were underway at the time. In June, lawmakers reached agreement on a budget package that is just $61 million (0.05%) above what the governor had proposed. The spending plan is built upon the Department of Finance's (DOF) revenue forecast and leaves the state with budget reserves totaling $4.6 billion, or 4% of expenditures, which we consider good. In addition, the budget pays down $1.85 billion in various general fund debt-like obligations, most of which had been incurred during prior years to finance budget deficits.

"Lawmakers' adoption of the DOF revenue forecast as part of the final budget agreement was significant, in our view," added Mr. Petek. "Had the legislature adopted the higher Legislative Analyst's Office's revenue forecast, lawmakers could have, in effect, generated capacity for new discretionary spending commitments while projecting that operating balance would be maintained. However, by diverging from — and surpassing — the DOF's forecast, primarily by projecting higher capital gains-related tax revenue, the Legislative Analyst's Office's forecast rests on more favorable performance of a volatile revenue stream."

In the end and as they have in recent years, lawmakers agreed on a restrained approach to setting fiscal policy instead of budgeting to a more aggressive set of assumptions. The result is favorable to credit quality, not least because it enables the DOF to project that general fund operations will generate modest surpluses for at least three years. But the projected operating surpluses are narrow and largely spoken for by transfers to the rainy day fund.