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California Preps \$2.2 Billion Bond Sale, Biggest in Two Years.

- **State's credit is viewed 'strongest it has been in decades'**
- **Size and market tone may lead to higher yields for buyers**

The last time California sold such a large amount of general-obligation bonds, wildfires were scorching thousands of acres and its budget was balanced in part by deferring payments and plumbing reserves.

But now, roughly two years later, the Golden State is selling \$2.2 billion of debt under much more stable circumstances. Governor Gavin Newsom is projecting a \$45.7 billion operating surplus for the next fiscal year. And while California remains mired in drought, revenue from its highest earners has boosted the state's coffers as they continue to defy expectations in the pandemic's uneven recovery.

"They've really been a nice case study of all the various aspects that go into fiscal discipline and maintaining that over multiple years," said Ty Schoback, a senior municipal research analyst for Columbia Threadneedle Investments, ahead of the Wednesday offering. "Their tax collections have really been off the chart. It provided the governor with a bucket of funds that it would be difficult to screw up even if they tried."

In fact, the state could see a credit-rating increase, CreditSights municipal analyst John Ceffalio said. Moody's Investors Service and Fitch Ratings both rate the state's general-obligation debt at the third-highest rank, Aa2 and AA respectively with stable outlooks, while S&P Global Ratings' AA- is a step lower with a positive outlook.

California "is the strongest it has been in decades," said Ceffalio, saying it likely deserves the second-highest rank of AA+. "The state has socked away a lot of money in its rainy-day funds. It's reduced debts over the last 10 years."

Propping up Wall Street's confidence in California — the world's fifth-largest economy if it were a nation — are the state's lucrative business sectors including technology, as well as a progressive tax system that has led it to notch surpluses. The state's wealthiest residents have reaped the benefits of rising stock prices and stable employment, even as many lower-income workers lost their jobs in the pandemic.

As the coronavirus outbreak roiled U.S. states in early 2020, California girded for a \$54 billion two-year deficit, deferring payments to schools, borrowing from internal funds and cutting employee compensation. But by January 2021, Newsom heralded a sharp turnaround in presenting a budget with a \$15 billion surplus that later expanded to a record \$75.7 billion, on top of \$27 billion in federal stimulus funds.

The next fiscal year's budget again posted a sizable surplus, with \$20.6 billion available for discretionary purposes. Yet revenue collections show cash is rolling in even more than expected — 15% — year to date. That raises the possibility that the windfall may grow by May, when Newsom, a

first-term Democrat running for re-election, updates his spending plan.

Credit profile aside, the state may still have to offer more in compensation for next week's deal, given its large size and the market, which is seeing some volatility and uncertainty, said Debra Crovicz, a portfolio manager at Chilton Investment Company LLC. California 10-year bonds are yielding 1.79%, or 16 basis points over benchmark munis, data compiled by Bloomberg show.

Traders are bracing for interest-rate hikes this month, investors have pulled money from municipal-bond mutual funds for six out of the past seven weeks, and the market's posting a 3.2% loss year to date, according to Bloomberg index data.

"There's a lot of bonds," she said. "It has to be priced cheap relative to where spreads were in the past and relative to Treasuries in order to get that deal done."

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