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Fitch: Abatement Risk Manageable for California Following Tulare Flood

Fitch Ratings-New York/San Francisco-05 April 2023: California's decision to continue making lease payments on a recently abated project following the Tulare flood in March supports Fitch Ratings view that issuers will repay abatement lease debt, even if they technically have the option not to do so. Fitch does not apply additional notching from the Issuer Default Rating (IDR) when abatement risk is present.

The Treasurer of the State of California (AA/Stable) provided notice on March 30, 2023 on behalf of the State Public Works Board (SPWB) that due to flooding in Tulare, the California Department of Food and Agriculture (CDFA) does not currently have use and occupancy of a facility financed with Lease Revenue Bonds 2013 Series I (Various Capital Projects) (rated AA-). The initial damage occurred on March 16, 2023 and SPWB was notified on March 17, 2023. The obligation of the CDFA to pay rent under the facility lease between the CDFA and SPWB has been abated as there is substantial interference with the use and occupancy of the facility.

Fitch generally rates appropriation-backed bonds one notch below the obligor's IDR, reflecting the slightly higher degree of optionality associated with lease/appropriation payments compared to the IDR. Fitch believes the incentive and propensity to repay lease/appropriation debt is closely linked to an obligor's incentive and propensity to repay all debt. This reasoning applies to abatement leases which give obligors the right to withhold payments for abatement. Fitch assumes the issuer will repay such debt even if it technically has the option not to do so, whether through non-appropriation or abatement.

This is the case for the lease in question. The portion being abated is a modest portion of the overall lease financing and the SPWB has determined to use legally available funds for payment of approximately $165,000 due on May 1, without accessing the reserve fund that is available to this project. The Master Indenture Reserve Fund Requirement is currently more than $111 million. It is the SPWB's intention to continue to pay debt service from legally available funds during the period that the lease is abated.

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