

Municipal Credit > Investment Grade



State of California

Updated: Oct 31, 2015

Trade Idea:

- ▶ Buy state of California general obligation bonds.

Investment Rationale:

- ▶ **Security:** The bonds are general obligations to which the state of California pledges its full faith and credit. Debt service is second in line of priority payments only behind K-12 and higher education funding.
- ▶ **Large, diverse, and dynamic economy.** The state has the eighth largest economy in the world. Real GDP= \$2.3 trillion (2014).
- ▶ **California's tax receipts increased significantly in 2015 and 2015 as economic recovery materialized, and at the same time, the state employed conservative budgeting practices and institutional changes that facilitated a substantial improvement in its financial position.**
- ▶ **As of the 2015 Budget Act, the state has passed an on-time budget for five years in a row. This is largely due to Proposition 25 (2010) which allows the legislature to pass a budget by simple majority rather than two-thirds super majority.**
- ▶ **During the recession, California borrowed and deferred payments in order to balance its budget and fund operations. Due to this, the general fund balance remains negative on a GAAP basis but continues to improve as the state has reduced budgetary borrowing and continues to pay down these deferred payments.**
- ▶ **California voters passed Proposition 2 in 2014 which will strengthen the state's budget stabilization fund. This is a key development as the state's revenue is volatile and typically correlates to overall economic conditions.**
- ▶ **The state is highly levered. Additionally, its two pension plans, CalPERS and CalSTRS, have a combined unfunded liability of \$116 billion as of FYE14. Funded ratios will continue to improve due to implemented contribution increases. The state's unfunded OPEB liability is also elevated at \$72 billion but the FY16 budget establishes a trust to begin pre-funding this liability.**

Recommendation(s):

View	Trade Horizon	Credit	Moody's/S&P /Fitch Ratings	Internal Rating	Cusip	Maturity	Par Amount of Selected Maturity	Last Trade to AAA Curve	Next Expected Issuance
Buy	12 Months	State of California	Aa3/AA-/A+	A+/Stable	13063BP63	2/1/2038	250,000,000	+30	\$3.3 billion new money in FY16