latimes.com
experience
PARIS, FRANCE!

Wednesday, April 25, 2001

State's Bond Rating Downgraded to A+

▪ Finance: Reduction of 2 notches puts it among states with the lowest credit ratings. Move could cost California hundreds of millions in borrowing fees.

By LIZ PULLIAM WESTON, MIGUEL BUSTILLO, Times Staff Writers

A major credit rating agency downgraded $25 billion of California bonds Tuesday in a move that could add hundreds of millions of dollars to the state's borrowing costs and saddles California with one of the lowest state credit ratings in the nation.

Standard & Poor's Corp. cut California's bond rating by two notches, from AA to A-plus, citing "the mounting and uncertain cost . . . of the current electrical power crisis," which has forced the state to spend billions on electricity to keep the lights on.

S&P, one of three major rating agencies monitoring California's financial health, said a further downgrade could occur if the state fails to follow through on plans to issue at least $10 billion in revenue bonds to help pay off energy-related debts.

"S&P is saying, 'We don't have any faith that what you say you're going to do, you're going to do,' " said Zane Mann, publisher of the California Municipal Bond Advisor, a newsletter that tracks government debt.

Wall Street is concerned by delays surrounding the electricity bond issue, but lawmakers hope to pass legislation this week to put the bond issue on a fast track and speed up return of the money to the state's general fund.

Credit ratings help determine how much states and other borrowers have to pay when issuing bonds. The lower the rating, the higher the interest rate the state must pay to entice investors to buy.

The state Treasurer's Office concluded in a preliminary estimate that as a result of the downgrade, California could have to pay $190 million to $570 million more on the $12 billion in general obligation bonds the state has authorized to pay for ongoing expenses such as school and road-building projects, but has yet to issue.

State revenue bonds should not be affected by the downgrade, the officials said. However, some bond experts disagree.

California's energy crisis already has driven down prices of a wide range of the state's bonds, from general obligation issues that depend on the state's ability to repay to small issues by school districts and cities that could be hurt by rising

electricity prices. Bond traders said S&P's downgrade probably would cause prices to fall further.

"All California bond holders are going to lose value in their bonds because the state's credit has been downgraded," said John Fitzgerald, managing partner of Seidler-Fitzgerald, a Los Angeles municipal debt underwriter.

The downgrade most affects investors who want to sell their bonds now, before the issues mature. Investors who hold onto their bonds are still almost certain to get the face value when their securities reach maturity, because the state is unlikely to miss any interest payments or otherwise default on its bonds, traders said.

S&P analysts said the state's continuing surplus and "deep and diverse" economy helped prevent a further downgrade.

Still, the downgrade places California below most other states on S&P's rating scale and on par with Hawaii. Among states rated by S&P, only Louisiana has a lower rating, at A-minus, according to Bloomberg News.

In addition, the two other major credit rating agencies have indicated they may downgrade California's bonds. Fitch Inc. said last week that it was contemplating such a move, and Moody's Investors Service earlier this month changed its outlook on California bonds to "negative" from "stable."

Some politicians Tuesday accused S&P of overreacting.

"It's just unfair, premature and inappropriate for them to do that. We do have reserves, we do have good revenue projections, we do have a plan to get us out of this," said Assemblyman Gil Cedillo (D-Los Angeles).

In a statement, Gov. Gray Davis said California's economy "is still fundamentally strong, period. We expect that in 2001 we will continue to lead the nation in economic growth and job creation."

State Treasurer Phil Angelides has been pleading with lawmakers to pass legislation to speed up repayment of $5 billion drained from the state's general fund to buy electricity this year. That figure is expected to reach $15 billion by year's end, according to the governor.

The consequences of a downgrade are profound, Angelides said, noting that it took California years to overcome the downgrades spurred by the recession of the early 1990s.

"It is critical that the Legislature act immediately to clearly establish our legal authority to sell bonds and replenish the state's general fund," Angelides said.

California began buying massive quantities of electricity in January because the state's three major investor-owned utilities could no longer afford to do so. Since then, the state has been purchasing roughly one-third of the electricity the utilities need to service their customers, according to state officials.

Under a plan approved by the Legislature and signed into law by Davis, the general fund is supposed to be reimbursed for the power purchases with what is expected to be the largest municipal bond issue in U.S. history. The bond issue is to be repaid by utility ratepayers through a monthly charge on their electricity bills.

However, obstacles that threaten timely repayment of the fund are causing consternation among Wall Street analysts about California's financial status.

The bankruptcy filing of Pacific Gas & Electric Co., the state's largest investor-owned utility, has thwarted the state's plan to restore the utilities to financial health.

But it is a dispute over the state's formula for repaying the bonds that has raised the most concern among state officials. The state and the utilities are at odds over how much of consumers' electricity payments should go to reimburse the state for its power purchases.

The state's two major utilities, Pacific Gas & Electric and Southern California Edison, have challenged the Public Utilities Commission's plan for splitting up the money--a legal move that threatens to delay issuance of the bonds. The firms contend the allotment granted to the state is too generous and could make it

contend the allotment granted to the state is too generous and could make it harder for them to recover from the energy crisis.

Hoping to sidestep the controversy, Angelides is urging state lawmakers to pass an emergency measure this week that sets the bond amount and the amount the state will receive from utility payments. The revenue bond was initially expected to be $10 billion, but the Davis administration has since proposed a $12.4-billion issue.

* * *

Times staff writers James Flanigan, Jenifer Warren and Julie Tamaki contributed to this report.

* * *

S&P's California Rating History

California's credit rating from Standard & Poor's Corp. plunged from AAA--the highest possible rating--in 1991 to a low of A by 1994, as the state suffered through the recession of the early '90s. The rating began to rise again in 1996 as the state recovered, but it has not reached AAA again. S&P's ratings of California general obligation debt since 1991:

* Downgraded from AAA to AA: December 1991
* Downgraded from AA to A-plus: July 1992
* Downgraded from A-plus to A: July 1994
* Upgraded from A to A-plus: July 1996
* Upgraded from A-plus to AA-minus: August 1999
* Upgraded from AA-minus to AA: September 2000
* Downgraded from AA to A-plus: April 2001

* * *

What Bond Ratings Mean

Investors use a state's bond rating to help judge the level of interest they should demand on state bonds to compensate for the relative risk of the securities. Here are general descriptions of S&P bond ratings:

* AAA: Highest quality
* AA: High quality
* A: Upper-medium grade
* BBB: Medium grade
* BB: Predominantly speculative (junk bonds)

Sources: Standard & Poor's Corp., Barron's Dictionary of Finance and Investment Terms

* * *

Comparing California

The state's general credit rating was cut to A-plus from AA by rating firm Standard & Poor's Corp., which cited the "mounting and uncertain cost" of the power crisis. The move, which will raise the state's cost of borrowing, drops California to a rating shared by just two other states.

S & P's State Ratings

* States rated AAA: 10, including Delaware, Michigan, North Carolina and Utah.
* States rated AA: 27, including Alabama, Illinois, New York and Washington.
* States rated A: 3, California (A-plus), Hawaii (A-plus) and Louisiana (A-minus).

Note: 10 states aren't rated by S&P, including Colorado, Iowa and Nebraska.

Source: Bloomberg News