CHART K-6
HISTORY OF CALIFORNIA
GENERAL OBLIGATION BOND RATINGS
(1980 TO 2004)

The following reflects the years in which the State of California's bond ratings were changed, including a summary of the rating agency rationale for the changes:

1980 **Moody's** downgraded from Aaa to Aa, and **S&P** from AAA to AA+. Actions were attributed to uncertainty over impact of Proposition 13 and the Gann spending limit on state finances in light of the national economic slowdown.

1983 **S&P** downgraded to AA. Action coincided with California's first issuance of revenue anticipation notes (RANs) in January 1983, which were issued to, in part, redeem $400 million in warrants issued in November 1982. California had been placed on CreditWatch by **S&P** in October 1982, as a result of cash shortages which led to the issuance of the warrants.

1985 **S&P** upgraded to AA+ due to improved financial performance and cash position.

1986 **S&P** upgraded to AAA due to "strong outlook for economic base, strong financial management, commitments to addressing pension liabilities, and a strong financial base with good prospects for maintenance of prudent reserves."

1989 **Moody's** upgraded to Aaa, citing restoration of adequate fund balance in the reserve for economic uncertainty and the state's economic strength and diversity.

1991/92 Ratings lowered by **all three agencies** due to state's fiscal condition and heavy reliance on external borrowing.

1994 **S&P** lowered to A, citing the state's continuing deferral of substantial portions of its estimated $3.8 billion accumulated deficit, including off-book "loans" to schools; continuing structural budgetary constraints including Proposition 98's funding guarantee for K-14 education; overly optimistic expectations of federal aid to balance the 1994-95 budget and the 1995-96 cash flow projections; and its reliance upon a blunt trigger mechanism to reduce spending if the assumptions prove to be inflated.

Moody's lowered to A1, citing the state's heavy reliance on the short-term note market to finance its cash imbalances, and the likelihood that this exposure will persist for at least two years. Moreover, the constraints imposed by voter initiative and the political environment are likely to cause fiscal stress to persist after the accumulated deficit is finally extinguished, given an expected backdrop of only moderate economic growth and growing demographic pressures. **Fitch** lowered rating to A.

1996 **Fitch** upgraded to A+, citing the elimination of the deficit, an improved cash position, and good prospects for growth. Still there are long-term problems from the restrictions imposed by restructuring initiatives, including mandating of strict property tax limits and the share of the budget which must be devoted to education as well as uncertainties which necessarily accompany an economy in transition.

S&P upgraded to A+, citing broad economic improvement, the stabilization of aerospace employment, improved liquidity position, including the end of borrowing across fiscal years, and more realistic budget assumptions. S&P also cites structural budget impediments, such as mandated school funding levels, tough new mandatory sentencing laws, and a two-thirds legislative vote for budget passage, as contributors to the single A+ rating. S&P indicated that absent significant structural change in budgetary constraints, it is unlikely to further raise the state rating.

1997 **Fitch** upgraded to AA-, citing California's improving economy and favorable outlook.

1998 **Moody's** upgraded to Aa3. The upgrade reflects the State's continuing economic recovery, coupled with a number of actions taken in the recent legislative budget session to improve the State's credit condition, including the rebuilding of cash and budget reserves. In addition, five-year financial projections indicate long-term budget balance can be maintained even under assumptions of slowing economic growth.

1999 **S&P** upgraded to AA-. The upgrade reflects California's strong economic performance and a return to structural fiscal balance as demonstrated by: a positive GAAP General Fund balance for fiscal year 1997-98, a continued positive budgetary basis fund balance at the end of fiscal year 1998-99 and conservative budgeting in the adoption of the 1999-00 Budget.

2000 **Fitch** upgraded to AA. The upgrade takes into account the fundamental strengths of California, buttressed by the sustained favorable economy and financial operations. The General Fund had a substantial balance at June 30, 1999, and revenues to date this year are well above estimates, pointing to another successful year. The proposed budget for 2000-01 is based on conservative expectations and includes a good level of reserves.

Moody's upgraded to Aa2. The upgrade reflects the strength and diversity of an economy that continues to exceed consensus growth expectations and comfortably outpaces the nation in terms of personal income and employment growth. The upgrade also reflects the State's increased fiscal conservatism.

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S&P upgraded to AA. The upgrade was due to the State's substantially improved General Fund balances; new history of conservative fiscal budgeting; and prospect that it will now budget financial reserves on an on-going basis.

2001 **S&P** lowered to A+, citing the mounting and uncertain cost to the State of the current electrical power crisis, as well as its likely long-term detrimental effect on California's economy.

Moody's lowered to Aa3, citing increased financial risks associated with the continuing energy crisis, as well as those related to trends in the broader US and California economies.
Moody's lowered to A1, citing an expectation that the State's General Fund and liquidity position will weaken substantially over the next eighteen months.

2002 **S&P** lowered to A, citing the $34.8 billion budget gap, including a larger than anticipated 2002-03 deficit.

Fitch lowered to A, citing the $34.8 billion budget gap, which includes a steep, unprecedented drop in personal income tax receipts.

2003 **Moody's** lowered to A2, citing the magnitude of the imbalance between the California's revenues and expenditures, and the expectation California will not be able to sufficiently address the imbalance in the upcoming fiscal year – given the inherent obstacles to reaching consensus on solutions to the problem.

S&P lowered to BBB, citing the lack of progress in adopting a budget. In addition, the political turmoil surrounding the recall diminishes the likelihood of structural budget reform.

Moody's lowered to A3, citing the large size of the structural budget gap and the view that the State will have substantial difficulties closing the gap.

Moody's lowered to Baa1, citing the recent action to cut the Vehicle License Fee and continuing inability to reach political consensus on solutions to the budget and financial problems.

Fitch lowered to BBB, citing California's widening budget gap, the intention to increase the amount to be raised from deficit funding and the magnitude of measures necessary to restore balance, which may become mandated, underlie the rating downgrade.

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2004 **Moody's** upgraded to A3, citing an established trend of recovery in the state's economy and tax revenues, as well as an improved state budgetary and liquidity outlook.

S&P upgraded to A and removed the rating from CreditWatch, citing the easing of immediate liquidity pressure on the State following the sale of the $11.3 billion Economic Recovery Bonds, the State's recent economic improvement, and an enacted fiscal 2004-05 state budget that is still reliant on substantial amounts of long-term borrowing to achieve balance.

Fitch upgraded to A-, citing the State's financial improvement with the successful issuance of economic recovery bonds, improving economic indicators, and revenues matching estimates.

2005 **Moody's and Fitch** upgraded the state to A2 and A respectfully citing a continuing favorable trend of recovery in the state's economy and tax revenues, better than expected financial performance in fiscal 2005, and a moderately improved outlook for 2006 and beyond.