California Credit Update [01-16-2025]

RSW would like to express our heartfelt sympathy for everyone affected by the wildfires. Considering the horrific events, please review this note for our thoughts on issuer creditworthiness:

- Total property damages are estimated to range from $120 - $150 billion, between 3 - 4% of state GDP.
- RSW has limited exposure to the impacted areas.
- California will need to issue billions in new debt to fund redevelopment and to bolster its claim-paying insurance fund.
- Although the situation remains fluid, currently our team has no concerns regarding defaults in the region.
- With the above being said, there is one California issuer that RSW lends monies to that demanded our attention: Los Angeles Department of Water and Power ("LADWP"). While a strong essential service provider covering large diverse population centers ordinarily would not be of concern, current events dictated action. Specifically, the following:
    - On Monday January 13, Fitch released a statement without taking any credit actions affirming the resiliency of the impacted tax base and the extensive utility customer base resources.
    - On Tuesday January 14, Standard and Poor's took aggressive action lowering the credit ratings on Los Angeles Power bonds from "AA-" to "A" and the water bonds from "AA+" to "AA-", with negative outlooks assigned to both authorities. As of Wednesday January 15, Moody's has not commented on the Los Angeles fires.
    - Despite being a large essential service provider, the credit rating downgrades, and related concerns are being driven by lawsuits filed against LADWP (with more forthcoming). The following is from S&P's Press release: "The downgrade on the power system's bonds reflects our view that, although the utility's infrastructure has so far not been implicated as the cause of the ongoing wildfires, the increasing frequency and severity of highly destructive wildfires within LADWP's service territory and recent spread into more urban areas highlights the utility's potential vulnerability to financial liability claims that could **eclipse** its liquidity and insurance coverage".

- The yield differential between these issuers and those in areas not impacted by the fires has been widening and stands at approximately 75 basis points.
- As always, RSW's decision to invest/hold bonds is always driven by fundamental credit research. Unfortunately, the credit analysis for LADWP has morphed from fundamental research to handicapping the probability, culpability and any resultant legal damages to the entity.
- At this juncture, no one can be certain of how the issues mentioned above will resolve themselves. We have aggressively reduced our risk and will continue to complete the process, as market liquidity becomes available. Simply put, whether the issuer descends into financial ruin or is unscathed by the lawsuits comes down to betting on heads or tails. Accepting this sort of "coin-flip" risk is simply not in concert with RSW's mandate and investment philosophy.

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