Los Angeles County, California

General Government
Full Rating Report

Ratings

Issuer Default Rating	AA
New Issue	
2016-17 Tax and Revenue Anticipation Notes	F1+
Outstanding Debt	
Certificates of Participation	AA–
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds (LAC-CAL Equipment Program)	AA–
Los Angeles County Public Works Financing Authority Lease Revenue Bonds	AA–
Sonnenblick-Del Rio El Monte Asset Leasing Corporation Senior Certificates of Participation[a]	AA–
Sonnenblick-Del Rio West Los Angeles Leasing Corporation Senior Certificates of Participation[a]	AA–

[a]Upgraded from 'A+' on June 6, 2016.

Rating Outlook

Stable

Analysts

Alan Gibson
+1 415 732-7577
alan.gibson@fitchratings.com

Amy Laskey
+1 212 908-0568
amy.laskey@fitchratings.com

New Issue Details

Sale Information: $800,000,000 2016-17 Tax and Revenue Anticipation Notes, to be sold via negotiation on June 8.

Security: Payable from unrestricted general fund revenue attributable to fiscal 2017.

Purpose: To smooth out lumpy fiscal 2017 general fund receipts that support ongoing general county operations.

Final Maturity: June 30, 2017. Not subject to redemption prior to final maturity.

Key Rating Drivers

Economic Resource Base: With a population exceeding 10 million, the county is more populous than most U.S. states. The county's huge, diversified economy represents approximately a quarter of California's total economy.

Revenue Framework: 'a' factor assessment. The county's independent legal ability to raise revenues is limited by state law. There is also some revenue exposure to state and federal reimbursement delays. However, growth prospects for the economy and revenues are solid, and the county's revenues have demonstrated limited volatility, reflecting the size and maturity of the economy and tax base (which has a large Proposition 13 cushion).

Expenditure Framework: 'aa' factor assessment. The county demonstrated strong expenditure control during the recession and continues to enjoy considerable expenditure flexibility, although its general fund remains exposed to subsidization of Department of Health Services (DHS) operations. Fitch Ratings expects expenditure growth to be roughly in line with revenue growth. Carrying costs will increase as the county pays down its manageable unfunded pension liability and other post-employment benefits (OPEB) obligations (still significant despite recent OPEB reform).

Long-Term Liability Burden: 'aa' factor assessment. The county's combined long-term liability (overall debt and pension obligations) as a percentage of total personal income is on the lower end of the moderate range. Overlapping debt makes up about three-quarters of this total.

Operating Performance: 'aaa' factor assessment. Using strong expenditure controls, the county consistently maintains structural balance before transfers out to DHS. This, plus solid reserve funding levels, leaves the county very well positioned to address cyclical downturns. The county has demonstrated an ongoing commitment to bolster its financial cushion during the recent economic recovery, aided in part by DHS's improved financial position.

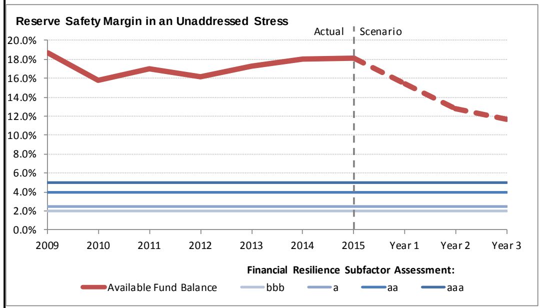
Rating Sensitivities

Solid Financial Profile: The rating is sensitive to fundamental changes in the county's financial operations and strong budget management.

Manageable General Fund Support for DHS: An unexpected need for greater general fund support of DHS operations that reduces the county's general fund balance cushion and overall financial flexibility could pressure the rating.

Los Angeles County (CA)

Scenario Analysis v. 1.08 2016/05/17



Analyst Interpretation of Scenario Results:

The county maintained strong general fund balances throughout the most recent recession, despite its general fund exposure to DHS. The county's solid reserves, manageable carrying costs, proven capacity to manage personnel expenditures, and limited debt plans cumulatively offset its limited revenue-raising capacity. The county is well positioned to address cyclical downturns. The county has demonstrated an ongoing commitment to bolster its financial cushion during the recent economic recovery, aided in part by DHS's improved financial position. While this scenario is based on total general fund revenues (including federal and state pass-through funding), the county's reserve targets are based on discretionary revenues.

Scenario Parameters: Using strong expenditure controls, the county consistently	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.1%	3.5%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Total Revenues	13,537,750	13,485,442	13,568,254	13,825,979	14,606,938	15,208,018	15,454,733	15,300,186	15,618,612	16,171,584
% Change in Revenues	-	(0.4%)	0.6%	1.9%	5.6%	4.1%	1.6%	(1.0%)	2.1%	3.5%
Total Expenditures	13,134,525	13,239,768	13,554,044	13,619,386	14,013,588	14,790,147	15,237,807	15,542,563	15,853,414	16,170,483
% Change in Expenditures	-	0.8%	2.4%	0.5%	2.9%	5.5%	3.0%	2.0%	2.0%	2.0%
Transfers In and Other Sources	300,905	363,487	475,230	484,995	508,087	468,614	393,023	389,093	397,191	411,253
Transfers Out and Other Uses	911,752	780,168	762,808	772,080	863,738	663,327	522,934	533,393	544,061	554,942
Net Transfers	(610,847)	(416,681)	(287,578)	(287,085)	(355,651)	(194,713)	(129,911)	(144,300)	(146,870)	(143,689)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(207,622)	(171,007)	(273,368)	(80,492)	237,699	223,158	87,015	(386,677)	(381,673)	(142,588)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(1.5%)	(1.2%)	(1.9%)	(0.6%)	1.6%	1.4%	0.6%	(2.4%)	(2.3%)	(0.9%)
Unrestricted/Unreserved Fund Balance (General Fund)	2,626,967	2,211,383	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745	2,475,068	2,093,395	1,950,807
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	2,626,967	2,211,383	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745	2,475,068	2,093,395	1,950,807
Combined Available Fund Bal. (% of Expend. and Transfers Out)	18.7%	15.8%	17.0%	16.2%	17.2%	18.1%	18.2%	15.4%	12.8%	11.7%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

Rating History — Notes

Rating	Action	Outlook/ Watch	Date
F1+	Assigned	—	6/6/16

Rating History — IDR

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	6/6/16
AA	Upgraded	Stable	2/23/16
AA–	Affirmed	Positive	6/1/15
AA–	Affirmed	Positive	12/24/14
AA–	Affirmed	Stable	6/2/14
AA–	Affirmed	Stable	5/31/13
AA–	Affirmed	Stable	9/27/12
AA–	Affirmed	Stable	6/6/12
AA–	Affirmed	Stable	2/22/12
AA–	Affirmed	Stable	11/15/11
AA–	Assigned	Stable	6/9/11

Rating History — Standard Lease Obligations

Rating	Action	Outlook/ Watch	Date
AA–	Affirmed	Stable	6/6/16
AA–	Upgraded	Stable	2/23/16
A+	Affirmed	Positive	7/22/15
A+	Affirmed	Positive	6/1/15
A+	Affirmed	Positive	12/24/14
A+	Affirmed	Stable	6/2/14
A+	Revised	Stable	4/30/10
A	Upgraded	—	5/23/00
A–	Downgraded	—	6/21/95
A+	Assigned	—	1/14/93

Rating History — Nonstandard Certificates of Participation

Rating	Action	Outlook/ Watch	Date
AA–	Upgraded	Stable	6/6/16
A+	Upgraded	Stable	2/23/16
A	Affirmed	Positive	6/1/15
A	Affirmed	Positive	12/24/14
A	Affirmed	Stable	6/2/14
A	Revised	Stable	4/30/10
A–	Upgraded	Stable	1/16/04
BBB+	Assigned	—	6/14/99

Related Criteria

Rating U.S. Public Finance Short-Term Debt (November 2015)

U.S. Tax-Supported Rating Criteria (April 2016)

Credit Profile

Los Angeles County is a major economy and manufacturing center, and incorporates a port and an airport that are among the busiest in the world. Taxable assessed valuation (TAV) has grown strongly in the past four years to an all-time high of $1.3 trillion, after very small recessionary declines, reflecting the county's highly developed and mature nature and large Proposition 13 cushion. A further 5% TAV increase is expected in fiscal 2017. While the county's median house price has yet to return to its prior peak (2007), house prices and numbers of residential building permits have been rising, while notices of default are at a 10-year low.

Despite these strong economic and tax base characteristics, the unemployment rate is typically higher than the nation's. Wealth indicators are below the state's and mixed relative to the nation, reflecting some highly urbanized and low-income areas.

The 'AA' Issuer Default Rating (IDR) reflects the county's strong but cyclical economic underpinnings, exceptionally strong gap-closing capacity despite limits on revenue raising, and moderate liability levels. A demonstrated ability to cut spending and a sound financial cushion offset the county's exposure to both state and local economic cyclicality and DHS operations and related federal and state funding decisions.

The 'F1+' short-term rating on the notes corresponds to the county's IDR. The combination of pledged revenues and court-verified borrowable resources provides very strong debt service coverage for the notes. Full note principal and interest set-asides occur well in advance of note maturity.

The 'AA–' rating for all the county's rated certificates of participation and lease revenue bonds is one notch below the IDR, reflecting the appropriation requirement for debt service payment.

Revenue Framework

The majority of general fund revenues come from state and federal funding for social services (almost half of total revenues, although this amount fluctuates significantly through the economic cycle due to caseloads, reimbursement timing and state budget issues), property taxes (23% of the fiscal 2017 general fund budget) and charges for services (20%).

Since fiscal 2011, there has been good growth in key discretionary revenues. This suggests that future growth should at least mirror economic trends. The fiscal 2017 budget assumes 5% property tax revenue growth and 4% sales tax revenue growth.

The county has very limited independent revenue-raising capacity, particularly due to Propositions 13 and 218 requiring voter approval for tax increases. Revenue-raising ability is largely limited to licenses, permits, fines and charges for service.

Expenditure Framework

Over half of fiscal 2015 general fund expenditures were on public safety (34%) and health and social services (19%), which is typical for county governments. Public works is another large line item at about 37%.

The pace of spending growth absent policy actions is likely to generally track revenue growth patterns given high-needs communities within the county. Fitch expects the county will continue to control expenditures aggressively.

The county retains a notable amount of expenditure flexibility despite its ongoing support of DHS operations. Its fixed cost burden is moderate, with fiscal 2015 carrying costs (for debt, pensions and OPEB) comprising a moderate 14% of governmental spending.

The county operates within a strong labor environment, and labor has the ability to strike. Nevertheless, labor relations are productive, and multiyear labor contracts have considerable flexibility. The labor contracts contain layoff and furlough options, and there are no salary or “me too” reopeners, no binding arbitration constraints on the compensation negotiation process and no mandatory requirements to consider regional compensation. All but two of the county’s 61 labor agreements are now settled through fiscal years 2018 or 2019.

Long-Term Liability Burden

The county’s overall debt of approximately $36.9 billion is a moderate burden on resources. Amortization of direct debt principal is average, and all direct debt is fixed rate, although the county’s $1.8 billion of direct debt represents less than 5% of the total liability burden. There are no new county bond issuances planned until fiscal 2018 at the earliest (a possible $250 million in lease revenue bonds). In the medium term, the county’s identification of $1 billon in deferred maintenance needs might spur the need for new debt, particularly since that figure does not include replacement or refurbishment costs associated with buildings that exceed their useful lives.

The almost $7 billion net pension liability reported for the Los Angeles County Employees Retirement Association (LACERA) should reduce as recent investment gains are smoothed in. Fitch estimates that net pension liability at $10.6 billion using its more conservative 7% investment return assumption. The county consistently funds LACERA at actuarially sustainable levels.

Although OPEB liability is sizable ($27.7 billion in fiscal 2015), the county does have the ability to reduce it. OPEB reforms enacted in 2015 are projected to reduce the unfunded actuarial accrued liability by about 21%. Further, the county is increasing its annual contributions, funded in part by maximizing subvention revenues from other governments. The county is contributing $23 million and $61 million toward OPEB prefunding in fiscal years 2016 and 2017, respectively. In addition to the county’s $540 million irrevocable OPEB trust, LACERA has a $50 million reserve for annual healthcare premium fluctuations.

Operating Performance

Despite state-imposed constraints on its revenue-raising ability, the county has demonstrated notable gap-closing ability on the expenditure side during economic downturns. For details, see "Scenario Analysis," page 2.

The county has prioritized maintenance of strong general fund balances and continued strengthening of its reserves during the economic recovery, despite increased staffing and salary outlays. After significant position cuts during the recession, the county has staffed board priorities with new positions each year from fiscal 2014 onward. Strong upward salary and benefits pressure has been addressed through multiyear contracts that spread 10% personnel cost increases over three years.

The county expects to end fiscal 2016 with a total general fund balance in excess of $3.2 billion, in line with its fiscal 2015 result. Fiscal 2016 is expected to end with a Rainy Day Fund of $338 million, 6% of ongoing discretionary revenues (that is, excluding federal and state pass-through funding), with an additional $26 million budgeted for fiscal 2017. The ultimate goal is to reach 10% of ongoing discretionary revenues. The county is also budgeting $26 million (10% of new discretionary revenues) for its contingency appropriation in fiscal 2017.

The county operates the second largest public health system in the nation. The general fund is responsible for DHS administration, online medical records and the managed care program. The level of general fund support is stabilizing around 13% of DHS's total budget as DHS operations become financially more viable. The general fund net county contribution (NCC) to DHS has declined significantly due to DHS's more stable revenue streams, improved patient demographics and operational changes ($653 million budgeted in fiscal 2017, 13% of total DHS budget, down from a peak of $828 million in fiscal 2008, 18% of total DHS budget). Given its high general fund balances, the county clearly has the financial capacity to return to a higher level of NCC if necessary. NCC funding is from a mix of general fund (49% budgeted in fiscal 2017), state vehicle licensing fee (42%) and tobacco settlement (9%) revenues. The general fund also provides DHS with working capital loans ($580 million budgeted in June 2017, down from a high of $1.05 billion in June 2011).

DHS's year-end financial results are improving. The county is projecting a surplus of at least $330 million at fiscal 2016 year end, compared to a surplus of only $13 million in fiscal 2011. DHS is benefiting from the recent extension of the former Section 1115 Hospital Financing Waiver for California public hospitals through Dec. 31, 2020. This extension, "Medi-Cal 2020," removes significant financial uncertainty as Affordable Care Act implementation settles down. From fiscal 2017 onward, DHS also expects the state to either cease redirecting under AB 85 post-ADA realignment revenues from health to social service programs (compared to the $100 million redirection in fiscal 2016) or for prior year reconciliations to offset future redirections.

The county is currently focused on how best to utilize the approximately $1 billion federal and state funding it receives for single homeless adults, particularly in terms of increased preventive services and service coordination. A number of funding strategies are under consideration for fiscal 2018 onward to increase funding for homeless services. These include a local personal income tax on high earners (would require state legislative approval), a sales tax increase (within the board's jurisdiction but requiring state legislative exemption for three cities already at the sales tax rate cap), a medical marijuana tax (within the board's jurisdiction) or a parcel tax (also within the board's jurisdiction).

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.