Los Angeles County, California

New Issue Report

Ratings

Issuer Default Rating	AA

New Issues

Los Angeles County 2017–18 Tax and Revenue Anticipation Notes	F1+
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds, 2017 Series A (LAC–CAL Equipment Program)	AA–

Outstanding Debt

Los Angeles County Certificates of Participation	AA–
Los Angeles County Public Works Financing Authority Lease Revenue Bonds	AA–
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds	AA–
Sonnenblick-Del Rio El Monte Asset Leasing Corporation Certificates of Participation	AA–
Sonnenblick-Del Rio West Los Angeles Leasing Corporation Certificates of Participation	AA–

Rating Outlook

Stable

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New Issue Summary

Sale Date: Notes: Week of June 5 (negotiated sale). Lease revenue bonds: June 20 (competitive sale).

Series: $800,000,000 2017–18 Tax and Revenue Anticipation Notes. $37,845,000 Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds, 2017 Series A (LAC–CAL Equipment Program).

Purpose: Notes: to smooth cash flow management for general fund operations during fiscal 2018. Lease revenue bonds: to redeem bond anticipation notes that funded the acquisition of almost 1,700 pieces of equipment to be leased to Los Angeles County (the county) and to fund a reserve fund.

Security: Notes: General obligations of the county payable from a first lien on unrestricted general fund revenues attributable to fiscal 2017, including requirements to set aside the first such bonds received during specified time periods for note repayment. Lease revenue bonds: Payable from county departments' equipment lease rental payments to the Los Angeles County Capital Asset Leasing Corporation (the corporation), subject to abatement.

Key Rating Drivers

Economic Resource Base: The county covers over 4,000 square miles and includes 88 incorporated cities and 100 school districts. With a population exceeding 10 million, it is more populous than most U.S. states. The county's huge, diversified economy represents approximately one-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 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. Fitch Ratings expects expenditure growth to be roughly in line with revenue growth. The portion allocated to carrying costs will increase as the county pays down its unfunded pension liability and significant OPEB obligations.

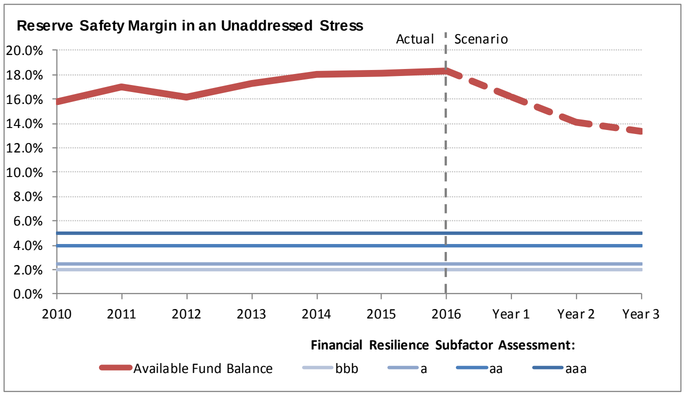
Long-Term Liability Burden: 'aa' factor assessment. The county's combined long-term liability is moderate relative to total personal income. Debt issued by overlapping jurisdictions makes up almost two-thirds of the total liability.

Operating Performance: 'aaa' factor assessment. The county has demonstrated an ongoing commitment to bolster its financial cushion during the economic recovery, aided in part by the county's Department of Health Services' (DHS) improved financial position. The county is very well positioned to address cyclical downturns.

Los Angeles County (CA)

Scenario Analysis

v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

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. Despite state-imposed constraints on its revenue-raising ability, the county demonstrated notable gap-closing ability during the recession. It generated additional revenue, primarily through federal stimulus funds and health care reform (e.g. client enrollment in managed health care under the Affordable Care Act). On the expenditure side, the county relied on employee attrition, unfilled vacancies, departmental curtailments, efficiency initiatives, 0% COLAs for four to five years (depending on the bargaining unit), and use of reserves and capital funds. The county maintains a notable amount of expenditure control due to moderate carrying costs and labor contracts with considerable flexibility.

Scenario Parameters:	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%)	2.0%	3.4%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2010	2011	2012	2013	2014	2015	2016	Year 1	Year 2	Year 3
Total Revenues	13,485,442	13,568,254	13,825,979	14,606,938	15,208,018	15,454,733	16,190,186	16,028,284	16,355,101	16,909,375
% Change in Revenues	-	0.6%	1.9%	5.6%	4.1%	1.6%	4.8%	(1.0%)	2.0%	3.4%
Total Expenditures	13,239,768	13,554,044	13,619,386	14,013,588	14,790,147	15,237,807	15,863,407	16,180,675	16,504,289	16,834,374
% Change in Expenditures	-	2.4%	0.5%	2.9%	5.5%	3.0%	4.1%	2.0%	2.0%	2.0%
Transfers In and Other Sources	363,487	475,230	484,995	508,087	468,614	393,023	374,195	370,453	378,007	390,817
Transfers Out and Other Uses	780,168	762,808	772,080	863,738	663,327	522,934	506,555	516,686	527,020	537,560
Net Transfers	(416,681)	(287,578)	(287,085)	(355,651)	(194,713)	(129,911)	(132,360)	(146,233)	(149,013)	(146,743)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(171,007)	(273,368)	(80,492)	237,699	223,158	87,015	194,419	(298,624)	(298,201)	(71,742)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(1.2%)	(1.9%)	(0.6%)	1.6%	1.4%	0.6%	1.2%	(1.8%)	(1.8%)	(0.4%)
Unrestricted/Unreserved Fund Balance (General Fund)	2,211,383	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745	2,991,807	2,693,183	2,394,982	2,323,240
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	2,211,383	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745	2,991,807	2,693,183	2,394,982	2,323,240
Combined Available Fund Bal. (% of Expend. and Transfers Out)	15.8%	17.0%	16.2%	17.2%	18.1%	18.2%	18.3%	16.1%	14.1%	13.4%

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 — IDR

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	6/2/17
AA	Upgraded	Stable	2/23/16
AA–	Affirmed	Positive	12/24/14
AA–	Assigned	Stable	6/9/11

Rating History — Certificates of Participation and Lease Revenue Bonds

Rating	Action	Outlook/ Watch	Date
AA–	Affirmed	Stable	6/2/17
AA–	Upgraded	Stable	2/23/16
A+	Affirmed	Positive	12/24/14
A+	Revised	Stable	4/30/10
A	Affirmed	Positive	11/5/01
A	Upgraded	—	5/23/00
A–	Downgraded	—	6/21/95
A+	Assigned	—	9/11/92

Related Research

Fitch Rates LA County, CA's 2018 Notes 'F1+' & Lease Revs 'AA-'; Outlook Stable (June 2017)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (May 2017)

Rating Sensitivities

Solid Financial Profile: The rating is sensitive to fundamental changes in the county's financial operations and strong budget management, which Fitch does not expect.

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

Analytical Conclusion

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 state and local economic cyclicality, DHS operations, and 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 of 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.

Credit Profile

The county is a major economic and manufacturing center, and incorporates two ports and an airport that are among the busiest in the world. Taxable assessed valuation (AV) has grown strongly in the past six years after very small recessionary declines, reflecting the county's highly developed and mature nature and large Proposition 13 cushion. Taxable AV will increase by a further 6% in fiscal 2018 to an all-time high exceeding $1.4 trillion. House prices continue to rise, the value of building permits has stabilized, and commercial vacancy rates, notices of default and assessment appeals have all declined.

Despite these strong economic and tax base characteristics, the unemployment rate has historically been higher than the nation's, although the gap has been narrowing progressively since the recession. Wealth indicators are below the state and mixed relative to the nation, reflecting some highly urbanized and low income areas.

Revenue Framework

The majority of general fund revenues come from federal and state funding for social services (55% of total general fund revenues in fiscal 2016), although this amount fluctuates significantly throughout the economic cycle due to caseloads, reimbursement timing and state budget issues. Two other key revenue sources are locally generated taxes (31%) and charges for services (10%).

Over the past decade, total general fund revenue growth has been slightly below national GDP but has outpaced inflation. However, excluding intergovernmental revenues, locally controlled revenues outperformed national GDP growth. Fitch expects locally controlled revenues to mirror future economic trends at the county level. The fiscal 2018 budget assumes around 6% property tax revenue growth and 4% sales tax revenue growth. This includes $355 million generated by a sales tax measure approved by voters in March 2017 for new homeless services and housing assistance. Meanwhile, Fitch expects future intergovernmental revenues will be determined by federal and state policy decisions and economic performance.

The county has satisfactory independent revenue-raising capacity relative to modest historical cyclical revenue declines. However, the county’s ability to raise revenues is constrained by state laws (in particular, Propositions 13 and 218) requiring voter approval for tax increases. Independent revenue-raising ability is largely limited to licenses, permits, fines and charges for service.

Expenditure Framework

Over one-half of fiscal 2016 general fund expenditures were on public safety (34%) and health and social services (20%), which is typical for county governments. Personnel costs remain the largest driver of expenditure increases. The fiscal 2018 budget had to absorb over $189 million in salary and benefit cost increases compared to $108 million in programmatic increases and fiscal policy changes. However, these combined cost increases represented just over 1% of the combined general fund and hospital enterprise fund budgets.

The pace of spending growth absent policy actions is likely to be in line with to marginally above 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. The county’s fixed cost burden is moderate, with fiscal 2016 carrying costs for debt, pensions and OPEB comprising a moderate 14% of governmental spending. Fitch expects that carrying costs will grow as a percentage of general fund spending, in large part due to rising pension contribution costs, but remain moderate.

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. All current three-year labor agreements provide for a 10% cost of living increase over the term of the agreements (expiring from Dec. 31, 2017 to Sept. 30, 2018). Non-represented employees are receiving a comparable increase. The next round of labor negotiations will commence in the second half of fiscal 2018.

Long-Term Liability Burden

The county's debt and pension liabilities represent a moderate burden at just over 10% of personal income.

The county's overall debt of approximately $37 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 $1.5 billion of direct debt represents only 3% of the total liability burden. There are no new county bond issuances planned for the next three to four years. The county plans to cash fund its significant information technology upgrade, deferred maintenance and capital replacement needs on a phased basis, over a number of years.

The majority of the total debt burden is debt issued by overlapping jurisdictions outside of the county's control. This portion could grow significantly. By themselves, school and community college districts located within the county have over $17 billion in unissued bond authorizations.

The Los Angeles County Employees Retirement Association (LACERA) reports a $7.4 billion net pension liability, a 7% increase over the previous year despite the county’s consistent funding of LACERA's actuarially required contributions. Further increases are expected due to recent changes to economic and mortality assumptions and a lowered discount rate (to 7.25% from 7.50%), which will drive increased employer contributions. Related cost increases will be phased in over fiscal years 2018 to 2020, with further cost increases expected over the following three years. Fitch estimates the current net pension liability at a much higher $19.4 billion using the agency’s more conservative 6% investment return assumption.

Although the county's unfunded actuarial accrued OPEB liability is sizable ($27.9 billion in fiscal 2016), the county does have the ability to reduce it. The county enacted OPEB reforms in 2015 and is increasing its annual contributions, funded in part by maximizing subvention revenues from other governments. The county is contributing $61 million and $121 million towards OPEB prefunding in fiscal years 2017 and 2018, respectively, the second and third years of a multiyear plan to incrementally increase the prefunding of retiree healthcare benefits by approximately $60 million per year. The county is projecting that it will be able to reach full actuarially required OPEB contributions by fiscal 2028. In addition to the county's $664 million irrevocable OPEB trust, LACERA has an almost $88 million reserve for annual healthcare premium fluctuations.

Operating Performance

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. For details, see Scenario Analysis, page 2.

The county ended fiscal 2016 with a strong general fund balance of almost $3 billion, or approximately 18% of spending. The county expects to end fiscal 2017 slightly higher, with a further increase projected for fiscal 2018. The fiscal 2017 unrestricted general fund balance will include a rainy day fund of just under 7% of ongoing discretionary revenues (excluding federal and state pass-through funding). The goal is to reach 10% of ongoing discretionary revenues, which the county expects to achieve in the next five to six years. The county has also budgeted 10% of new discretionary revenues for contingency appropriations in both fiscal years 2017 and 2018.

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 has stabilized at around 13% of DHS's total budget, as DHS operations have 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 ($756 million budgeted in fiscal 2018, 13% of the total DHS budget, down from a peak of $828 million in fiscal 2008, 18% of the total DHS budget). Given the county’s high general fund balances, it clearly has the financial capacity to return to a higher level of NCC if necessary. The general fund also provides DHS with working capital loans ($134 million projected for 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 approximately $535 million at fiscal 2017 year end, compared to a surplus of only $13 million in fiscal 2011. DHS is benefitting from a number of external and internal reforms, most notably the Affordable Care Act, an improved payor mix and the Medi-Cal 2020 extension for California public hospitals (through Dec. 31, 2020), a focus on primary rather than hospital-based healthcare, infrastructure investments, electronic system integration and departmental reorganization.

Given uncertainties related to federal and state funding, the county is prepared to make fiscal 2018 expenditure adjustments in later budget phases if necessary.

Notes Finance Cash Flow Needs

Note proceeds will be used to smooth cash flow management for general fund operations during fiscal 2018. The county expects all three note set-asides to occur in months with positive net ending balances, thereby allowing sufficient coverage of between 2.4x to 5.0x solely based on each month's net ending balance, without drawing on $4.3 billion to $6.4 billion in borrowable funds at those set-aside dates. The inclusion of borrowable funds increases coverage to between 17.9x and 39.0x. The repayment deposit structure sets aside 100% of principal and interest almost three months in advance of note maturity.

Sound Equipment Lease Program

The 2017 LAC-CAL lease revenue bonds are the latest installment in a strong 34-year program of lease revenue bonds issued to refund bond anticipation notes issued for equipment purchases. The bonds' lease features are typical of California lease transactions. Bondholder protections include the county's covenant to budget and appropriate the equipment lease payments, and the corporation's assignment of its right to receive the equipment lease rental payments to a trustee who is responsible for enforcing payment when due each year. There is no acceleration upon default.

Other bondholder protections include a bond-funded reserve of the lesser of $1 million or total remaining unpaid principal and interest, an additional reserve of excess county payments, and mandatory insurance coverage, including two years of rental interruption insurance to address abatement concerns. All pieces of equipment are in current use, their aggregate average useful life exceeds the weighted average bond maturity, and their cumulative value is greater than the bond amount. Any equipment substitution must be of comparable useful life and value. The trustee does not have the right to retake possession of the equipment or force its sale or return.

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