Moody's
INVESTORS SERVICE

# New Issue: Moody's assigns A1 to LA County's (CA) Lease Revenue Bonds and affirms outstanding GOULT and other lease revenue bond ratings

Global Credit Research - 24 Dec 2014

**Approximately $1.7 billion affected, including the current issue**

LOS ANGELES (COUNTY OF) CA
Counties
CA

**Moody's Rating**

| ISSUE | RATING |
|---|---|
| Lease Revenue Bonds (Multiple Capital Projects), 2015 Series A | A1 |
| **Sale Amount** $168,000,000 | |
| **Expected Sale Date** 01/15/15 | |
| **Rating Description** Lease Rental: Abatement | |

**Moody's Outlook** STA

**Opinion**

NEW YORK, December 24, 2014 --Moody's Investors Service has assigned an A1 rating to Los Angeles County Public Works Financing Authority Lease Revenue Bonds, 2015 Series A in an estimated amount of $168 million. We have affirmed the county's Aa2 general obligation unlimited-tax (GOULT) rating, which is equivalent to the county's "issuer" rating, and the A1 and A2 ratings on the county's outstanding lease revenue bonds. The outlook is stable.

RATING RATIONALE

The county's GOULT Aa2 rating reflects the county's emergence from the economic downturn with key credit factors intact. The county's assessed value (AV) stands at an all time high following a relatively small declines in 2010 and 2011. The labor market is recovering, though the unemployment rate remains higher than state and US levels. Financial operations are well managed and large surpluses in 2013 and 2014 will further enhance the county's operational flexibility. Reserve levels are generally in line with similarly rated counties, although slightly below their medians. The debt position remains strong. Low direct debt and lease burden remain key positive credit factors. Additional expected long term debt within two to three years should not weigh on the rating. The county's unfunded pension and Other Post Retirement Benefits (OPEB) liability represent long term risks for the county's rating but are currently manageable.

The county's lease ratings are at A1 and A2. The two and three-notch distinction with the county's GOULT/"issuer" rating represents the weaker security pledge for lease-backed obligations and the additional risk to bondholders from the county's financial, operational, and economic conditions over the more secure assumed general obligation pledge of the issuer rating. Security for the lease payments is a contractual pledge of the county of all of its available financial resources, subject to abatement of the leased property, effectively on parity with other unsecured obligations. This promise is notably in contrast to the stronger, voter approved general obligation pledge that provides a baseline for our estimate of the credit quality of lease pledges. Under California law, a county's GO pledge is an unlimited ad valorem property tax pledge. The county must raise property taxes by whatever amount necessary to repay the obligation, irrespective of the city's general financial position.

KEY CREDIT STRENGTHS

-Large and diverse economy with steady recovery

-Strong financial management with steady reserves

-Strong debt position and low lease burden

KEY CREDIT CHALLENGES

-Large health care burden

-Potentially oversized OPEB burden

DETAILED CREDIT DISCUSSION

LARGE AND DIVERSE ECONOMY IS GROWING AND FUELING REVENUE GROWTH

The county's extremely large AV is relatively stable and provides a steady source of discretionary revenues for the county. Following small declines in 2010 and 2011, AV levels began recovering in 2012 and now stand at an all time high. At $1.15 trillion, the county's AV is by far the largest of any county in the nation. The property taxes generated from this base represent the county's largest source of discretionary revenues (at approximately 25%), and its recent growth is a key credit positive.

The county's AV has remained relatively stable over a long period of time, which serves to moderate revenue swings. During the run-up of housing values, the AV breached 10% annual growth only once, in 2007, while elsewhere in the state double digit annual increases were commonplace. This relative stability is rooted in the generally older, and more mature nature of the housing stock within the county. A significant number of properties have AV's well below the market price. Because of CA law, downward fluctuations in market prices do not affect the AV of this category of properties.

Benefiting from its diversity and the national recovery, the countywide economy resumed growth in 2010, accompanied by large job gains starting in 2011. As of September, 2014, the county's labor force exceeded its prerecession levels, far earlier than what we projected.

The economic downturn took a large toll on the county's employment base. During the recession, the county lost 369,000 jobs or 7.9% of the 2007 peak employment level. The peak unemployment rate was 12.6%. The economic recovery has restored approximately half of the lost jobs. However, barring another recession, job creation should continue at a steady rate, with a corresponding locally generated revenue growth for the county.

The county's improving wealth levels continue to approximate nationwide medians. Estimated 2012 Median Family Income is 97.0% of the US, while in 2000 it stood at 92.8%. Compared to Aa rated large counties, these levels are relatively low, but satisfactory for the rating given the county's other credit strengths.

HISTORICALLY WELL MANAGED FINANCIAL OPERATIONS WITH GROWING RESERVES AFFORD THE COUNTY OPERATING FLEXIBILITY

The county is well managed and its financial operations are stabilizing. In 2014 the county achieved a sizeable second annual surplus ($223 million), following a four year stretch of declines. Going forward, we expect balanced operating results, which would be consistent with its financial performance before the recession.

The county faces financial challenges, however. Rising retiree health care costs will become a growing burden on the county's finances and may have a future impact on the rating. Another burden is the county's general fund subsidy of its large health care services. However, the county projects the subsidy to decline and does not present an outsized risk to the county's overall financial health.

The county has a history of conservative budgeting of expenditures, enabling it to realize sizable surpluses as revenues have outpaced expenditure growth. Between 1998 and 2008 the county recorded 11 consecutive years of general fund (GF) operating surpluses. This was accomplished with carefully balanced operations, where expenditures generally tracked revenues but remained sufficiently low to generate surplus and improve the county's reserve position. The county's GF balance of 19.8% of revenues, however, is well below the median for similarly rated counties nationwide, but compares well with similarly rated counties in California.

COUNTY'S DEBT POSITION IS STRONG WITH LOW DIRECT DEBT AND LEASE BURDEN

The debt position remains strong, with a net direct debt burden of 0.1% and a low net lease burden of 1.0%; which are key credit positives. Additional long term debt of up to $600 million within two to three years would raise the direct debt to just 0.3% of AV and should not weigh on the rating. The above-average overall debt burden of 2.8%,

compared to the nationwide median of 1.9% for Aa2 counties, reflects the large amount of debt of the overlapping jurisdictions, mainly Los Angeles Unified School district. The direct debt burden, which only considers the county's debt on the tax base, remains in line the median for Aa2 rated counties, with populations above one million, nationwide. All of the county's long term debt is fixed rate and lease supported.

The county is currently relying on its commercial paper program to fund ongoing capital projects. Approximately $418 million of total capacity of $600 million is currently outstanding, as of June 30, 2014.

COUNTY'S PENSION POSITION CAN POSE A LONG TERM CREDIT RISK

The Los Angeles County Employees Retirement Association (LACERA) manages the county's nine benefit tiers on behalf of the county and at the end of fiscal year 2013 (June 30, 2014) had a reported unfunded liability of $13.3 billion. We calculate LACERA's 2013 adjusted net pension liability (ANPL) at $38.8 billion, or 2.7 times fiscal 2013 revenues, which is high for the rating category-and represents a long-term credit risk if not addressed. However, the county's three-year average of ANPL-to-revenue is 1.6 times. This compares favorably to other Moody's-rated local governments and is consistent with its rating category. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported liability information, but to improve comparability with other rated entities.

OTHER POST EMPLOYMENT BENEFITS ARE A LONG TERM CREDIT NEGATIVE

The county's unfunded OPEB liability remains a challenge, however. As of July 1, 2012, LAC's unfunded OPEB liability was $25.7 billion or 1.6 times fiscal 2014 revenues. Together, the county's pension and OPEB liabilities equal 5.6% of the county's AV, dwarfing the county's 0.1% direct debt burden and double the overall debt burden. In an effort to stem the looming burden of OPEB liabilities, the county established an irrevocable OPEB trust in 2012. As of June 30, 2014, the trust had a net position of $483.82 million.

Outlook

Moody's outlook on Los Angeles County's long-term ratings is stable. The stable outlook reflects the county's demonstrated ability to preserve its financial position through challenging economic and financial cycles. How the county manages its fiscal challenges in the coming years will be an important contributor to future rating considerations.

WHAT COULD MAKE THE RATING GO UP

-Long term financial stability of the county's health system with continuing trend of operating surpluses

-Significant improvement in the area economy with fundamental improvement in area income levels

WHAT COULD MAKE THE RATING GO DOWN

-Significant deterioration of the county's financial position

-Potential weight of pension and OPEB benefits

KEY STATISTICS

Assessed Value, Fiscal 2015: $1.15 trillion

Assessed Value Per Capita, Fiscal 2015: $115,119

Median Family Income as % of US Median: 97.00%

Fund Balance as % of Revenues, Fiscal 2014: 19.79%

5-Year Dollar Change in Fund Balance as % of Revenues: -0.41%

Cash Balance as % of Revenues, Fiscal 2014: 12.34%

5-Year Dollar Change in Cash Balance as % of Revenues: 0.58%

Institutional Framework: "A"

5-Year Average Operating Revenues / Operating Expenditures: 1.00x

Net Direct Debt as % of Assessed Value: 0.13%

Net Direct Debt / Operating Revenues: 0.10x

3-Year Average ANPL as % of Assessed Value: 2.24%

3-Year Average ANPL / Operating Revenues: 1.64x

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. The additional methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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**Analysts**

Gregory W. Lipitz
Lead Analyst
Public Finance Group
Moody's Investors Service

Michael Wertz
Additional Contact
Public Finance Group
Moody's Investors Service

Robert Azrin
Additional Contact
Public Finance Group
Moody's Investors Service

**Contacts**

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007

USA

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