Los Angeles County, California
Tax and Revenue Anticipation Notes
New Issue Report

New Issue Details

Sale Information: $900,000,000 2014–15 Tax and Revenue Anticipation Notes, via negotiation on June 4 and $29,500,000 Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds, 2014 Series A (LAC-CAL Equipment Program), competitively on June 17.

Security: Notes: unrestricted general fund revenue attributable to fiscal 2015, including requirements to set aside the first such funds received during specified time periods for note repayment. Lease revenue bonds: county departments’ equipment lease rental payments to the Los Angeles County Capital Asset Leasing Corporation (corporation).

Purpose: Notes: to provide monies to smooth out lumpy fiscal 2014 general fund receipts that support ongoing county operations. Lease revenue bonds: redeem bond anticipation notes that funded the acquisition of 465 pieces of essential equipment to be leased to the county.

Final Maturity: Notes: June 30, 2015; lease revenue bonds: June 1, 2018.

Key Rating Drivers

Solid Financial Management: Financial operations are well managed with strong general fund balances. The general fund returned to positive operations in fiscal 2013.

Support for Health System: The county is working hard to take advantage of healthcare reform to strengthen its Department of Health Services’ (DHS) financial position. However, DHS’s finances remain vulnerable to state and federal funding changes and heavy social service expenditures and will continue to need significant general fund support.

Significant Long-Term Liability Exposure: While the county has a moderate overall debt burden, it also has increased pension contribution costs in fiscal 2015, a costly retiree medical program, and a large other post-employment benefits (OPEB) unfunded accrued actuarial liability (UAAL).

Local Economy Improving: The diversity and maturity of the county’s vast economy and tax base help offset its evident cyclical vulnerability. Improving economic indicators, particularly related to the county’s tax base and revenue streams, counterbalance the relatively high unemployment rate.

Strong Short-term Debt Coverage: The notes’ short-term rating corresponds to the county’s implied unlimited tax GO (ULTGO) bond rating. The combination of pledged revenues and court-verified borrowable resources provide very strong debt service coverage for the notes. Full note principal and interest set-asides occur well in advance of note maturity.

Sound Equipment Lease Program: The equipment lease financing program has a strong 31-year history, the bonds’ lease features are typical of California lease transactions, and the debt matures rapidly since it is matched to the leased equipment’s useful life. All of the leased equipment is essential to county departments’ service delivery and is in current use.

Related Research
Los Angeles County, California (June 2013)
Los Angeles County, California (October 2012)

Analysts
Alan Gibson
+1 415 732-7577
alan.gibson@fitchratings.com
Amy Laskey
+1 212 908-0568
amy.laskey@fitchratings.com

June 3, 2014
Cash flow projections.

units within the county. The general fund itself ultimately receives about one-third of all
trust by the county prior to being distributed to the various taxing agencies and governmental
$3.3 billion and $5.8 billion on a monthly basis in December 2014 and January and April 2015).

The 2014 lease revenue bonds are the latest installment in a 31-year program of lease revenue
bonds issued to refund bond anticipation notes (BANs) that funded the purchase of essential
equipment which the corporation leases to county departments. 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 and their average useful life exceeds the weighted average
bond maturity.

Rating History — GOs

Credit Profile

Strong Short-term Debt Coverage

Fitch’s ‘F1+’ notes rating reflects the sound note repayment structure, strong coverage of all
note repayment set-asides, particularly when borrowable funds are included, and the large size
of the borrowable resources relative to the set-aside amounts. The repayment deposit structure
sets aside 100% of principal and interest well in advance of note maturity.

Notes Set-asides and Coverage

As shown in the above table, the notes are secured by a first lien on unrestricted revenue
received in December 2014 and January and April 2015 (projected $3.7 billion), which is
estimated to cover note principal and interest 4.1x. Funds for repayment will be set aside
based on an aggressive schedule beginning in December 2014 at which time 35% of the
principal will be set aside. By January 2015, 70% of the estimated principal will be set aside.
The full amount will be set aside by April 2015 plus the estimated interest ($18 million).

Fitch notes that projected cash flow in fiscal 2015 shows two of the three note set-asides
occurring in months with negative net ending balances. During those two months, note set-
aside coverage falls below 1.0x based solely on the monthly net ending balances. However,
factoring in available borrowable resources, coverage during all three set-aside months is very
strong at 12.8x – 19.5x.

The county’s projected pool of resources available for interfund loans remains ample (between
$3.3 billion and $5.8 billion on a monthly basis in December 2014 and January and April 2015). Borrowable resources consist primarily of property tax collections and monies in transit, held in
trust by the county prior to being distributed to the various taxing agencies and governmental
units within the county. The general fund itself ultimately receives about one-third of all
borrowable resources. Fitch notes that the county has a long history of outperforming its initial
cash flow projections.

Sound Equipment Lease Program

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...
Solid Financial Management

The 'F1+' notes rating also incorporates the county’s long-term credit quality. The implied long-term ULTGO rating of ‘AA−’ reflects the county’s diverse and mature economy, low direct debt burden, sound financial reserves, and prudent management efforts to achieve fiscal balance amid ongoing and sizable financial pressures. These pressures stem from a heavy social service spending burden, state funding changes, the historic fiscal imbalance in the county’s DHS, a large unfunded pension liability, and a costly retiree medical program.

General Fund Financial Summary
($000, Audited Fiscal Years Ended June 30)

<table>
<thead>
<tr>
<th>Revenues</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Taxes</td>
<td>3,970,566</td>
<td>3,864,654</td>
<td>3,843,366</td>
<td>3,980,409</td>
<td>4,267,858</td>
</tr>
<tr>
<td>Licenses and Permits</td>
<td>54,877</td>
<td>49,079</td>
<td>56,656</td>
<td>57,144</td>
<td>61,412</td>
</tr>
<tr>
<td>Fines and Forfeits</td>
<td>264,375</td>
<td>258,842</td>
<td>244,787</td>
<td>217,972</td>
<td>222,226</td>
</tr>
<tr>
<td>Charges For Services</td>
<td>1,654,173</td>
<td>1,659,224</td>
<td>1,641,399</td>
<td>1,700,540</td>
<td>1,565,937</td>
</tr>
<tr>
<td>Intergovernmental</td>
<td>7,211,150</td>
<td>7,337,716</td>
<td>7,506,492</td>
<td>7,632,814</td>
<td>8,182,687</td>
</tr>
<tr>
<td>Other Revenue</td>
<td>382,609</td>
<td>315,927</td>
<td>275,554</td>
<td>237,100</td>
<td>306,818</td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td><strong>13,537,750</strong></td>
<td><strong>13,485,442</strong></td>
<td><strong>13,568,254</strong></td>
<td><strong>13,825,979</strong></td>
<td><strong>14,606,938</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenditures</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>General Government</td>
<td>946,008</td>
<td>859,319</td>
<td>883,854</td>
<td>983,077</td>
<td>979,989</td>
</tr>
<tr>
<td>Public Safety</td>
<td>4,420,786</td>
<td>4,412,935</td>
<td>4,401,985</td>
<td>4,538,075</td>
<td>4,694,982</td>
</tr>
<tr>
<td>Health and Social Services</td>
<td>—</td>
<td>2,421,615</td>
<td>—</td>
<td>2,689,192</td>
<td>2,779,870</td>
</tr>
<tr>
<td>Culture and Recreation</td>
<td>242,999</td>
<td>247,094</td>
<td>263,046</td>
<td>255,818</td>
<td>272,835</td>
</tr>
<tr>
<td>Capital Outlay</td>
<td>772</td>
<td>2,115</td>
<td>32,598</td>
<td>20,106</td>
<td>8,065</td>
</tr>
<tr>
<td>Debt Service</td>
<td>247,248</td>
<td>271,378</td>
<td>278,477</td>
<td>24,602</td>
<td>30,816</td>
</tr>
<tr>
<td>Other</td>
<td>7,276,712</td>
<td>5,025,312</td>
<td>7,694,084</td>
<td>5,108,516</td>
<td>5,247,031</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td><strong>13,134,525</strong></td>
<td><strong>13,239,768</strong></td>
<td><strong>13,554,044</strong></td>
<td><strong>13,619,386</strong></td>
<td><strong>14,013,588</strong></td>
</tr>
</tbody>
</table>

| Operating Surplus/(Deficit)            | 403,225  | 245,674  | 14,210   | 206,593  | 593,350  |
| Transfers In                           | 299,247  | 360,412  | 422,680  | 466,078  | 504,567  |
| Other Sources                          | 1,658    | 3,075    | 52,550   | 18,917   | 3,520    |
| Transfers Out                          | 911,752  | 780,168  | 762,808  | 772,080  | 863,738  |
| Net Transfers and Other                | (610,847)| (416,681)| (287,578)| (287,085)| (355,651)|
| Net Operating Surplus/(Deficit) After Transfers | (207,622) | (171,007) | (273,368) | (80,492) | 237,699  |

| Total Fund Balance                     | 3,166,818| 2,995,811| 2,722,443| 2,641,951| 2,879,650|
| As % of Expenditures, Transfers Out, and Other Uses | 22.5 | 21.4 | 19.0 | 18.4 | 19.4 |
| Unreserved Fund Balance                | 2,626,967| 2,211,383| — | — | — |
| As % of Expenditures, Transfers Out, and Other Uses | 18.7 | 15.8 | — | — | — |
| Undesignated/Unreserved Fund Balance   | 1,655,388| 1,592,484| — | — | — |
| As % of Expenditures, Transfers Out, and Other Uses | 11.8 | 11.4 | — | — | — |
| Unrestricted Fund Balance              | — | — | 2,427,939 | 2,327,239 | 2,566,028|
| As % of Expenditures, Transfers Out, and Other Uses | — | — | 17.0 | 16.2 | 17.2 |

Note: Numbers may not add due to rounding.

General fund support for DHS contributed significantly to net operating deficits after transfers during fiscal years 2009–2012. As shown in the general fund financial summary table, fiscal 2013 saw a return to positive general fund operations and ended with a total general fund balance of $2.9 billion (19.4% of spending) and an unrestricted general fund balance of $2.6 billion (17.2% of spending). This unrestricted general fund result represented a 10.3% increase from the prior year’s balance of $2.3 billion (16.2% of spending).
The county is projecting that it will end fiscal 2014 with a modest surplus, increasing the total general fund balance to between $2.9 billion and $3 billion. For the second time in six years, the county did not have to close a budget gap for its fiscal 2015 recommended budget and is not planning major spending cuts. The county is projecting increases in its property tax (4.1%) and sales tax (3.9%) revenues. However, these increases will be offset to some degree by agreed employee remuneration increases.

The county’s rainy day reserve fund is now $232 million, a $35 million increase since year-end fiscal 2013. The reserve equates to 4.6% of its ongoing locally generated revenue. Its policy goal is 10.0%. A recently enacted policy will require the county to allocate at least 10.0% of surplus revenues to either building up the rainy day reserve and/or its recently established OPEB trust.

**DHS Financials Improving, General Fund Support Still Required**

DHS ended fiscal 2013 with a $120.6 million operating surplus and is projecting to maintain its current financial balance through fiscal 2014. DHS’s fiscal 2015 budget was balanced with no revenue or appropriation placeholders. As DHS’s financial position has improved, county hospital cash flow loan balances declined from $1 billion in fiscal 2011 to $770 million in fiscal 2013. They are spiking back up in fiscal 2014 to a projected $971 million as Affordable Care Act provisions settle in. However, the county is anticipating that hospital loans will return to around $704 million in fiscal 2015 and stay at approximately that level for the following 2–3 years.

Favorably, DHS pressures continue being partially alleviated by the extension of a federal section 1115 waiver through Oct. 31, 2015. The waiver facilitated increased enrolment of newly eligible Medi-Cal patients under health care reform which is improving DHS’s payor mix. Negotiations with the federal government have commenced over furthering extending the waiver to cover the future costs of uninsured patients.

**Significant Long-Term Liability Exposure**

As shown in the debt statistics table, the county’s overall debt burden is a moderate $3,802 per capita, or 3.2% of market valuation. Principal and interest amortization is slow at approximately 33% in 10 years.

The county faces sizable long-term liabilities in terms of its unfunded pension and OPEB liabilities. As of June 30, 2013, the pension system’s UAAL was $13.3 billion and its funded ratio was 75% using the county’s 7.5% assumed rate of return. Fitch estimates the funded ratio at 71.1% when adjusted to reflect a more conservative 7% rate of return. There has been significant deterioration since fiscal 2007 when the UAAL was $2.5 billion with a 93.8% funded ratio (using an assumed 7.75% rate of return).
The county's cash contributions to the pension system, which are equal to the annually required contribution (ARC), continue to grow, to a projected $1.4 billion in fiscal 2015 from $676.7 million in fiscal 2006. Fitch considers the ongoing increase to be manageable and notes that a recently implemented pension tier with lower benefits for new hires should slightly decrease costs over time.

The county also has a $25.7 billion UAAL for OPEB, which it has begun to address by recently establishing an OPEB trust which, at its current balance of $466 million, funds approximately 1.8% of the liability. The county aims to increase its OPEB trust funding from future surplus revenues. Fitch views the OPEB funding effort as important for the county's long-term fiscal stability but recognizes the county has a funding challenge as the county's recent pay-as-you-go contributions have been only 20%–22% of its actuarially required contributions. A new OPEB tier with lower benefits for new hires is currently working its way through the county's legislative process. The combined carrying costs for debt service, pension ARC, and OPEB pay-as-you-go in fiscal 2013 were very manageable at 11.2% of total governmental spending.

**Continued High Unemployment, But Tax Base Rebounding Strongly**

The county's unemployment rate (8.7% in March 2014) remains higher than the state's (8.4%) and the nation's (6.8%). However, there has been growth in both employment opportunities and the labor force that has brought the unemployment rate down from 9.9% a year prior. The county's socioeconomic characteristics are below average relative to the state and largely on par with the nation.

Due to the county's highly developed and mature nature, taxable assessed valuation (TAV) losses were relatively low at 0.5% and 1.9% decreases in fiscal years 2010 and 2011 respectively, indicating a significant Proposition 13 cushion. Since then, the property market has rebounded with 1.4%, 2.2%, and 4.7% TAV increases in fiscal years 2012–2014 respectively, and an estimated 5.1% TAV increase in fiscal 2015.

**Lease Ratings Reflect Abatement Risks**

The one-notch rating distinction between the county's implied unlimited tax GO rating and the majority of its certificates of participation and lease revenue bonds represents the county's covenant to budget and appropriate for lease payments, subject to abatement. There is a further one-notch distinction for non-standard leases for the California Department of Social Services buildings that the county leases but does not purchase, due to increased non-appropriation risk since the county will not own the facilities upon lease maturity.
The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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