Los Angeles County, California

Tax and Revenue Anticipation Notes

New Issue Report

Ratings

New Issues

Los Angeles County 2014-15 Tax and Revenue Anticipation Notes	F1+
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds, 2014 Series A (LAC-CAL Equipment Program)	A+

Outstanding Debt

Los Angeles County Implied Unlimited Tax General Obligation Bond Rating	AA–
Certificates of Participation	A+
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds (LAC-CAL Equipment Program)	A+
Los Angeles County Public Works Financing Authority Lease Revenue Bonds	A+
Sonnenblick-Del Rio El Monte Asset Leasing Corporation	A
Sonnenblick-Del Rio West Los Angeles Leasing Corporation	A

Rating Outlook

Stable

Related Research

Los Angeles County, California (June 2013)

Los Angeles County, California (October 2012)

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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.

Rating History — GOs

Rating	Action	Outlook/ Watch	Date
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
A+	Affirmed	Stable	6/2/14
A+	Affirmed	Stable	5/31/13
A+	Affirmed	Stable	9/27/12
A+	Affirmed	Stable	6/6/12
A+	Affirmed	Stable	2/22/12
A+	Revised	Stable	4/30/10
A	Affirmed	Stable	7/29/04
A	Upgraded	—	5/23/00
A–	Downgraded	—	6/21/95
A+	Assigned	—	1/14/93

Rating History — Non-Standard Lease Obligations

Rating	Action	Outlook/ Watch	Date
A+	Affirmed	Stable	6/2/14
A+	Affirmed	Stable	5/31/13
A+	Affirmed	Stable	9/27/12
A+	Affirmed	Stable	6/6/12
A+	Affirmed	Stable	2/22/12
A+	Revised	Stable	4/30/10
A	Affirmed	Stable	7/29/04
A	Upgraded	—	5/23/00
A–	Downgraded	—	6/21/95
A+	Assigned	—	1/14/93

Related Criteria

Tax-Supported Rating Criteria (August 2012)

U.S. State Government Tax-Supported Rating Criteria (August 2012)

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

($000)

Date (m/yy)	Set-Aside Payment	Total Unrestricted GF Receipts	Coverage (x)	Borrowable Resources	Total Available Resources	Coverage (x)
12/14	315,000	1,296,715	4.1	5,778,791	7,075,506	22.5
1/15	315,000	1,328,099	4.2	3,333,695	4,661,794	14.8
4/15	270,000	1,057,683	3.9	5,063,401	6,121,084	22.7
Total	900,000	3,682,497	4.1	—	—	—

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

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.

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)

	2009	2010	2011	2012	2013
Revenues					
Total Taxes	3,970,566	3,864,654	3,843,366	3,980,409	4,267,858
Licenses and Permits	54,877	49,079	56,656	57,144	61,412
Fines and Forfeits	264,375	258,842	244,787	217,972	222,226
Charges For Services	1,654,173	1,659,224	1,641,399	1,700,540	1,565,937
Intergovernmental	7,211,150	7,337,716	7,506,492	7,632,814	8,182,687
Other Revenue	382,609	315,927	275,554	237,100	306,818
Total Revenues	**13,537,750**	**13,485,442**	**13,568,254**	**13,825,979**	**14,606,938**
Expenditures					
General Government	946,008	859,319	883,854	983,077	979,989
Public Safety	4,420,786	4,412,935	4,401,985	4,538,075	4,694,982
Health and Social Services	—	2,421,615	—	2,689,192	2,779,870
Culture and Recreation	242,999	247,094	263,046	255,818	272,835
Capital Outlay	772	2,115	32,598	20,106	8,065
Debt Service	247,248	271,378	278,477	24,602	30,816
Other	7,276,712	5,025,312	7,694,084	5,108,516	5,247,031
Total Expenditures	**13,134,525**	**13,239,768**	**13,554,044**	**13,619,386**	**14,013,588**
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).

Debt Statistics

($000)

Lease Revenue Bonds, 2014 series A	29,500
Outstanding Debt Net of Refunding	2,798,302
Direct Debt	**2,827,802**
Overlapping Debt	35,252,658
Total Overall Debt	**38,080,460**
Debt Ratios	
Net Direct Debt Per Capita ($)[a]	282
As % of Market Value[b]	0.2
Overall Debt Per Capita ($)[a]	3,802
As % of Market Value[b]	3.2

[a]Population: 1,0017,068 (2013). [b]Market value: $1,198,108,113,000 (est. 2011). Note: Numbers may not add due to rounding.

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.