Los Angeles County Public Works Financing Authority, California

Lease Revenue Bonds
New Issue Report

Ratings

New Issues

Lease Revenue Refunding Bonds (Master Refunding Project), 2015 Series B (Tax-Exempt)	A+
Lease Revenue Refunding Bonds (Master Refunding Project), 2015 Series C (Federally Taxable)	A+
Outstanding Debt	
Implied County Unlimited Tax General Obligation Bonds	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 Senior Certificates of Participation	A

Rating Outlook
Positive

Related Research
Los Angeles County, California (June 2015)

Los Angeles County, California (January 2015)

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: $120,350,000 Lease Revenue Refunding Bonds (Master Refunding Project), 2015 Series B (Tax-Exempt), and $85,380,000 Lease Revenue Refunding Bonds (Master Refunding Project), 2015 Series C (Federally Taxable), scheduled to be sold via negotiation during the week of Aug. 10.

Security: Los Angeles County's (the county) annual lease rental payments to the Los Angeles Public Works Financing Authority (the authority), payable from legally available funds, under a covenant to budget and appropriate, subject to abatement.

Purpose: To refinance various lease revenue bonds for savings.

Final Maturity: 2015 Series B bonds: serially June 30, 2016–2034; 2015 Series C bonds: serially June 30, 2016–2023. The bonds are subject to optional and mandatory sinking fund redemption.

Key Rating Drivers

Solid Financial Management: The Positive Rating Outlook reflects the county's well-managed financial operations, with strong general fund balances throughout the economic cycle and strengthened reserve policies.

General Fund Support for Health System: The performance of the county's Department of Health Services (DHS) continues to benefit from both wider health sector reform and changes implemented internally. However, DHS's finances remain vulnerable to state and federal funding changes and heavy social service expenditures, and Fitch Ratings expects that DHS will continue to need significant general fund support.

Significant Long-Term Liability Exposure: While the county has a moderate overall debt burden, it faces large unfunded accrued actuarial liabilities (UAAL) for its pensions and other post-employment benefits (OPEB).

Local Economy Continues to Improve: The county's vast economy and tax base is vulnerable to economic cycles, despite its diversity and maturity. Economic indicators are mixed, with improving tax base and revenue streams, but a persistently above-average unemployment rate.

Lease Debt Rating Distinction: The one-notch rating distinction between the county's implied ULTGO rating of 'AA–' and the 2015 Series B and C bonds represents the county's covenant to budget and appropriate for lease payments, subject to abatement.

Rating Sensitivities

Positive Rating Outlook: A sustained trend of positive operations, strong general fund balances, improved reserves, reduced liabilities and manageable general fund support for DHS could result in a ratings upgrade.

Rating History —Lease Revenue Bonds

Rating	Action	Outlook/ Watch	Date
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

Related Criteria

Tax-Supported Rating Criteria (August 2012)

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

Credit Profile

Solid Financial Management

The implied long-term ULTGO rating of 'AA–'/Positive reflects the county's diverse and mature economy, moderate 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, DHS cash flow issues, a large unfunded pension liability and a costly retiree medical program.

The county ended fiscal 2014 with a solid surplus for the second consecutive year, increasing the unrestricted general fund balance to $2.790 billion (18.1% of spending) from the prior year's $2.566 billion (17.2%). These results follow a pattern of notably stable county financial operations throughout the challenging recent economic downturn.

The county is currently projecting a $237.8 million general fund drawdown in fiscal 2015. However, the county expects to outperform this projection based on previous years' experience of benefiting from revenues at the year-end reconciliation. In the unlikely event that there was a drawdown of that magnitude, the total general fund balance would remain a very strong $2.865 billion.

The county's rainy day reserve fund is now $256 million. The county remains committed to achieving its goal of 10% of ongoing locally generated revenues (currently equivalent to approximately $543 million) through the annual allocation of at least 10% of surplus revenues to either the rainy day reserve fund and/or the county's OPEB trust. In September 2014, the county added a further budget policy requiring the annual appropriation of 5%–10% of new ongoing discretionary revenues to a contingency reserve, with any unused moneys at the end of the year transferred to the rainy day reserve fund and/or the OPEB trust. Fitch views the strengthening of the county's reserve policies as a credit positive because of the extra insulation provided against future economic downturns.

DHS Financials Improving, But General Fund Support Still Required

The county projects that DHS will end fiscal 2015 with a $107.4 million surplus, representing its sixth consecutive year of improved year-end financial results. This is the result of more stable revenue streams, stable contributions from the general fund, improved patient demographics under healthcare reform and significant operational changes.

In fiscal 2015, the net county contribution is projected to be $561 million, or 12.6% of the total DHS budget. By contrast, the net county contribution peaked in fiscal 2008 at $827.7 million, or 18.2% of the total DHS budget. The net county contribution is budgeted to increase slightly in fiscal 2016 to $633.2 million, or 13.1% of the total DHS budget as board policy allows DHS to retain savings generated from the state's redirection of fewer realignment revenues to social services under Assembly Bill (AB) 85. In addition, there will be increased costs related to higher staffing.

The county expects general fund loans to DHS to assist with cash flow issues to decline to between $500 and $600 million outstanding per year. At year-end fiscal 2015, there will be a projected $419.6 million in outstanding general fund loans, down from $871 million a year prior and a fiscal 2011 peak of $1 billion.

DHS pressures continue to be partially alleviated by the extension of a federal section 1115 waiver through Oct. 31, 2015 and the negotiation of a unique formula for the county under AB 85. The waiver facilitated increased enrollment of newly eligible Medi-Cal patients under healthcare reform, which improved DHS's payor mix. Negotiations with the federal government are currently under way over further extending the waiver to cover the future costs of uninsured patients. The negotiation of a unique formula under AB 85 has allowed the county to maintain a fairly stable source of funding for DHS.

Significant Long-Term Liability Exposure

The county's overall debt burden is a moderate $3,602 per capita, or 2.9% of market valuation. Principal amortization is average at an estimated 54.3% in 10 years. During first-quarter 2016, the county expects to issue $275 million in bonds to take out commercial paper used to fund the Martin Luther King Jr. Hospital inpatient tower. After that, no further debt issuances are planned for the next couple of years.

The county faces sizable long-term unfunded pension and OPEB liabilities. As of June 30, 2014, the county pension system's UAAL was $11.3 billion and its funded ratio was 79.5% using the county's 7.5% assumed rate of return. Fitch estimates the funded ratio at 75.3% when adjusted to reflect a more conservative 7.0% rate of return. The county's cash contributions to the pension system, which are equal to the annually required contribution (ARC), grew to $1.4 billion in fiscal 2015 from $676.7 million in fiscal 2006. The most recently implemented pension tier with lower benefits for new hires should decrease costs slightly over time.

The county also has a $27.3 billion UAAL for OPEB, which it has begun to address by recently establishing an OPEB trust. At its current balance of $497 million, the trust funds approximately 1.8% of the outstanding OPEB liability. The county aims to increase its OPEB trust funding from future surplus revenues. The fiscal 2016 adopted budget includes a $22 million contribution to the OPEB trust. Thereafter, the county plans to increase its annual OPEB contributions to $60 million annually until the actuarially required contribution is fully funded.

A new OPEB tier has been created for employees hired on or after July 1, 2014. It eliminates spousal and dependent coverage and requires mandatory enrollment in Medicare at age 65. This new tier is projected to save $840 million over 30 years.

The combined carrying costs for debt service, pension ARC and OPEB pay-as-you-go in fiscal 2014 were very manageable at 12.8% of total governmental spending.

Local Economy Continues to Improve

The county's unemployment rate (7.1% in April 2015) remains higher than the state (6.1%) and national (5.1%) levels. However, there has been growth in both employment opportunities and the labor force, which has brought the unemployment rate down from 7.8% a year prior. The county's socioeconomic characteristics are below average relative to the state and somewhat mixed relative to the nation. Educational attainment is similarly mixed relative to national averages.

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. In the subsequent five years, the property market has rebounded by 21.4% through fiscal 2016. This rebound is supported by rising house prices, a strong rebound in the number of residential construction permits, decreasing defaults and foreclosures, more Proposition 8 TAV restorations and healthier commercial and industrial real estate markets.

Essential Assets

The 2015 Series B and C bonds are on parity with 2015 Series A bonds (rated A+/Positive by Fitch) and have the same bondholder protections and share a pool of leased assets. All eight leased facilities provide essential county services. They include courthouses, a sheriff station, a library, county department buildings and the civic center heating and refrigeration plant. Their combined value of an estimated $622 million well exceeds the outstanding cumulative par amount of the parity bonds ($359 million).

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

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK HTTPS://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2015 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004.Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at anytime for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.