Los Angeles County, California

Tax and Revenue Anticipation Notes

New Issue Report

Ratings

New Issue

Los Angeles County 2015-16 Tax and Revenue Anticipation Notes	F1+
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 (January 2015)
Los Angeles County, California (June 2014)

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: $900,000,000 Los Angeles County 2015–16 Tax and Revenue Anticipation Notes, scheduled to sell via negotiation during the week of June 1.

Security: Unrestricted general fund revenue attributable to fiscal 2016, including requirements to set aside the first such funds received during specified time periods for note repayment.

Purpose: To provide moneys to smooth out lumpy fiscal 2016 general fund receipts that support ongoing Los Angeles County (the county) operations.

Final Maturity: June 30, 2016.

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.

Strong Short-Term Debt Coverage: The notes' short-term rating reflects the county's implied 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.

Ongoing 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 (OPEBs).

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 Ratings Reflect Abatement Risks: The one-notch rating distinction between the county's implied ULTGO 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 nonstandard leases for Department of Social Services buildings, which the county leases but does not purchase. There is increased non-appropriation risk since the county will not own those facilities upon lease maturity.

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 — Implied GOs

Rating	Action	Outlook/ Watch	Date
AA–	Affirmed	Positive	6/1/15
AA–	Affirmed	Positive	12/24/14
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	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

Rating History — Nonstandard Certificates of Participation

Rating	Action	Outlook/ Watch	Date
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	Stable	1/16/04
BBB+	Assigned	—	6/14/99

Rating History — Notes

Rating	Action	Outlook/ Watch	Date
F1+	Assigned	—	6/1/15

Related Criteria

Tax-Supported Rating Criteria (August 2012)

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

Rating U.S. Public Finance Short-Term Debt (January 2015)

Credit Profile

Solid Financial Management

The implied long-term ULTGO rating of 'AA–' 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 locally generated revenues (currently equivalent to approximately $675 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.

Strong Short-Term 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.

The notes are secured by a first lien on unrestricted revenues received by April 2016 (projected $4 billion), which are estimated to cover note principal and interest 4.5x. Funds for repayment will be set aside based on an aggressive schedule beginning in December 2015, 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 ($13.5 million). The notes are scheduled to be repaid on June 30, 2016.

All three note set-asides occur in months with positive net ending balances, thereby allowing sufficient coverage of between 1.3x and 2.9x solely on the basis of each month's net ending balance. However, factoring in available borrowable resources, coverage during all three set-aside months is very strong at 15.5x–22.7x.

The county's projected pool of resources available for interfund loans remains ample (between $4.0 billion and $6.1 billion on a monthly basis in December 2015 and in January and April 2016). Borrowable resources consist primarily of property tax collections and moneys 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.

DHS Financials Improving, But General Fund Support Still Required

The county projects that DHS will end fiscal 2015 with a $102 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 $634.1 million, or 13.2% 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.

General fund loans to DHS to assist with cash flow issues are also projected to decline. At fiscal 2015 year end, there will be a projected $748 million in outstanding general fund loans, down from $870 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 $3,647 per capita, or 3.1% of market valuation. Principal and interest amortization is average at an estimated 64% retiring in 10 years.

The county faces sizable long-term unfunded pension and OPEB liabilities. As of June 30, 2014, the 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% rate of return. The county's cash contributions to the pension system, which are equal to the annual 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 billion UAAL for OPEB, which it has begun to address by recently establishing an OPEB trust. At its current balance of $485.9 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. Fitch views the OPEB funding effort as positive but modest and recognizes the county has a funding challenge as recent pay-as-you-go contributions have only been approximately 20% of ARC.

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 (7.7% in February 2015) remains higher than the state (6.8%) and national (5.8%) rates. However, there has been growth in both employment opportunities and the labor force, which has brought the unemployment rate down from 8.7% 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 1.8% decreases in fiscal years 2010 and 2011, respectively, indicating a significant Proposition 13 cushion. In the subsequent four years, the property market's rebound became progressively stronger, with 1.4%, 2.2%, 4.7% and 5.5% TAV increases over fiscal years 2012–2015, respectively. The county is projecting a further 5.9% TAV growth in fiscal 2016, supported by rising house prices, a strong rebound in the number of residential construction permits, decreasing defaults and foreclosures and the likelihood of numerous Proposition 8 revaluations.

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