

# Los Angeles County, California

## Lease Revenue Bonds New Issue Report

### Ratings

#### New Issue

Public Works Financing Authority  
Lease Revenue Bonds (Multiple  
Capital Projects), 2015 Series A A+

#### Outstanding Debt

Implied County 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 Senior  
Certificates of Participation A  
Sonnenblick-Del Rio West Los  
Angeles Leasing Corporation,  
Senior Certificates of Participation A

### Rating Outlook<sup>a</sup>

Positive

<sup>a</sup>Revised from Stable on Dec. 24, 2014.

### Related Research

[Los Angeles County, California \(June 2014\)](#)

[Los Angeles County, California \(June 2013\)](#)

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### New Issue Details

**Sale Information:** \$167,495,000 Los Angeles County Public Works Financing Authority Lease Revenue Bonds (Multiple Capital Projects), 2015 Series A, to be sold via negotiation on Jan. 14.

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

**Purpose:** Finance and refinance capital improvement projects.

**Final Maturity:** Serially, June 30, 2017–2045.

### 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.

**Ongoing Support for Health System:** The county Department of Health Services' (DHS) reforms continue to improve DHS' financial position. However, DHS' 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 and a large other post-employment benefits (OPEBs) unfunded accrued actuarial liability (UAAL).

**Local Economy Improving:** 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 high 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 reflects 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 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.

**Essential Assets:** Proceeds from the series 2015 bonds will fund construction of a new family support center and a new public library. The leased assets include the new public library and essential county office and utility buildings.

### 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 — GOs**

Rating	Action	Outlook/ Watch	Date
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	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	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

**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-’ 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.

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 expects ongoing revenue increases in fiscal 2015, which will be partially offset by agreed employee remuneration increases and targeted service enhancements.

The county’s rainy day reserve fund is now \$256 million, a \$24 million increase since January. The county remains committed to achieving its goal of \$500 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 budget policy requiring the annual appropriation of 5%–10% of new ongoing discretionary revenues for 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 the next economic downturn.

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

DHS ended fiscal 2014 with a \$192 million surplus, representing its fifth consecutive year of improved year-end financial results. This is the result of more stable revenue streams, stable contributions from the general fund and improved patient demographics under healthcare reform and significant operational changes. DHS is currently projecting a much smaller \$20.4 million surplus at year-end fiscal 2015 given its cash funding of a new electronic health record system (\$105 million) and the redirecting of \$155.4 million in realignment revenues to social services as required under State Assembly Bill (AB) 85.

In fiscal 2014, the net county contribution was \$665.3 million, or 14% of the total DHS budget, and 4.3% of general fund spending. 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 decline in fiscal 2015 to \$561 million, or 12.6% of the total DHS budget.

However, while the net county contribution is declining, general fund loans to DHS to assist with cash flow issues are increasing due to realignment program funding reconciliations and state billing reimbursement delays. At year-end fiscal 2014, there was \$870 million in outstanding general fund loans, counteracting the downward trajectory that had occurred between year-end fiscal years 2011 (\$1 billion outstanding) and 2013 (\$770 million outstanding). The county expects the higher fiscal 2014 loan level to persist while healthcare reform provisions settle in.

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' payor mix. Negotiations with the federal government have commenced 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.

### Financial Summary

(\$000, Audited Fiscal Years Ended June 30)

	2009	2010	2011	2012	2013	2014
Total Tax Revenues	3,970,566	3,864,654	3,843,366	3,980,409	4,267,858	4,520,755
Licenses and Permits	54,877	49,079	56,656	57,144	61,412	59,886
Fines and Forfeits	264,375	258,842	244,787	217,972	222,226	207,094
Charges For Services	1,654,173	1,659,224	1,641,399	1,700,540	1,565,937	1,743,447
Intergovernmental	7,211,150	7,337,716	7,506,492	7,632,814	8,182,687	8,395,672
Other Revenue	382,609	315,927	275,554	237,100	306,818	281,164
<b>Total Revenues</b>	<b>13,537,750</b>	<b>13,485,442</b>	<b>13,568,254</b>	<b>13,825,979</b>	<b>14,606,938</b>	<b>15,208,018</b>
General Government	946,008	859,319	883,854	983,077	979,989	998,438
Public Safety	4,420,786	4,412,935	4,401,985	4,538,075	4,694,982	4,843,148
Health and Social Services	0	2,421,615	0	2,689,192	2,779,870	3,204,177
Culture and Recreation	242,999	247,094	263,046	255,818	272,835	282,660
Capital Outlay	772	2,115	32,598	20,106	8,065	2,398
Debt Service	247,248	271,378	278,477	24,602	30,816	28,928
Other	7,276,712	5,025,312	7,694,084	5,108,516	5,247,031	5,430,398
<b>Total Expenditures</b>	<b>13,134,525</b>	<b>13,239,768</b>	<b>13,554,044</b>	<b>13,619,386</b>	<b>14,013,588</b>	<b>14,790,147</b>
<b>Operating Surplus</b>	<b>403,225</b>	<b>245,674</b>	<b>14,210</b>	<b>206,593</b>	<b>593,350</b>	<b>417,871</b>
Transfers In	299,247	360,412	422,680	466,078	504,567	466,108
Other Sources	1,658	3,075	52,550	18,917	3,520	2,506
Transfers Out	911,752	780,168	762,808	772,080	863,738	663,327
<b>Net Transfers and Other</b>	<b>(610,847)</b>	<b>(416,681)</b>	<b>(287,578)</b>	<b>(287,085)</b>	<b>(355,651)</b>	<b>(194,713)</b>
<b>Net Operating Surplus/(Deficit) After Transfers</b>	<b>(207,622)</b>	<b>(171,007)</b>	<b>(273,368)</b>	<b>(80,492)</b>	<b>237,699</b>	<b>223,158</b>
Total Fund Balance	3,166,818	2,995,811	2,722,443	2,641,951	2,879,650	3,102,808
% Total Expenditures, Transfers Out and Other Uses	22.5	21.4	19.0	18.4	19.4	20.1
Unreserved Fund Balance <sup>a</sup>	2,626,967	2,211,383	—	—	—	—
% Total Expenditures, Transfers Out and Other Uses	18.7	15.8	—	—	—	—
Undesignated/Unreserved Fund Balance <sup>a</sup>	1,655,388	1,592,484	—	—	—	—
% Total Expenditures, Transfers Out and Other Uses	11.8	11.4	—	—	—	—
Unrestricted Fund Balance <sup>b</sup>	—	—	2,427,939	2,327,239	2,566,028	2,790,224
% Total Expenditures, Transfers Out and Other Uses	—	—	17.0	16.2	17.2	18.1

<sup>a</sup>Pre-GASB54. <sup>b</sup>Reflects GASB 54 classifications: sum of committed, assigned and unassigned. Note: Numbers may not add due to rounding.

### Significant Long-Term Liability Exposure

The county's overall debt burden is a moderate \$3,631 per capita, or 3.0% 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, 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. The county's cash contributions to the pension system, which are equal to the annually required contribution (ARC), will continue to grow to a projected \$1.4 billion in fiscal 2015 from \$676.7 million in fiscal 2006. Fitch considers the expected future increase to be manageable, and notes that the most recently implemented pension tier with lower benefits for new hires should decrease costs slightly over time.

**Debt Statistics**

(\$000)	
This Issue	167,495
Outstanding Direct Debt — Net of Refunding	1,643,199
Overlapping Debt	34,557,637
<b>Total Overall Debt</b>	<b>36,368,331</b>
Debt Ratios	
Net Direct Debt Per Capita (\$) <sup>a</sup>	181
As % of Market Value <sup>b</sup>	0.2
Overall Debt Per Capita (\$) <sup>a</sup>	3,631
As % of Market Value <sup>b</sup>	3.0

<sup>a</sup>Population: 10,017,068 (2013). <sup>b</sup>Market value: \$1,198,108,113,000 (fiscal 2014 estimate). Note: Numbers may not add due to rounding.

The county also has a \$25.7 billion UAAL for OPEB, which it has begun to address by recently establishing an OPEB trust. At its current balance of \$473 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 been only 20%–43% of ARCs.

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 Improving**

The county's unemployment rate (7.8% in September 2014) remains higher than the state's (6.9%) and the nation's (5.7%) rates. However, there has been growth in both employment opportunities and the labor force, which brought the unemployment rate down from 9.6% a year prior. The county's socioeconomic characteristics are below average relative to the state and somewhat mixed relative to the nation.

Due to the county's highly developed and mature nature, taxable assessed valuation (TAV) losses were relatively low at 0.5% and 1.8% decreases in fiscal years 2010 and 2011, respectively, indicating a significant Proposition 13 cushion. In the subsequent four years, the property market has rebounded increasingly strongly with 1.4%, 2.2%, 4.7%, and 5.5% TAV increases over fiscal years 2012–2015, respectively. The county projects further TAV growth over fiscal years 2016–2020.

**Essential Assets**

Proceeds from the series 2015 bonds will fund construction of the new Zev Yaroslavsky Family Support Center and the new Manhattan Beach Public Library. Both buildings are located on

county-owned property and will provide core governmental services. The leased assets will include the new public library, for which the county will have beneficial occupancy before the series 2015 bonds are issued. The other two leased assets support core governmental services: the county's Internal Services Department headquarters and the county civic center heating and refrigeration plant. The value of the leased assets exceeds the series 2015 bond par amount.

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