Los Angeles County Public Works Financing Authority, California

Lease Revenue Bonds
New Issue Report

Ratings

New Issue

Lease Revenue Bonds, 2016 Series D	AA–
Outstanding Debt	
Implied County Unlimited Tax General Obligation Bond Rating[a]	AA
Certificates of Participation	AA–
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds (LAC-CAL Equipment Program)[b]	AA–
Los Angeles County Public Works Financing Authority Lease Revenue Bonds[b]	AA–
Sonnenblick-Del Rio El Monte Asset Leasing Corporation Senior Certificates of Participation[c]	A+
Sonnenblick-Del Rio West Los Angeles Leasing Corporation, Senior Certificates of Participation[c]	A+
Implied County Unlimited Tax General Obligation Bonds[a]	AA
Certificates of Participation[b]	AA–
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds (LAC-CAL Equipment Program)[b]	AA–
Los Angeles County Public Works Financing Authority Lease Revenue Bonds[b]	AA–
Sonnenblick-Del Rio El Monte Asset Leasing Corporation Senior Certificates of Participation[c]	A+

[a]Upgraded from ‘AA–’ to ‘AA’ on Feb. 23.
[b]Upgraded from ‘A+’ to ‘AA–’ on Feb. 23.
[c]Upgraded from ‘A’ to ‘A+’ on Feb. 23.

Rating Outlook
Stable

Related Research
Los Angeles County, California (January 2015)
Los Angeles County, California (June 2014)

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New Issue Details

Sale Information: $246,255,000 Lease Revenue Bonds, 2016 Series D, via negotiation the week of Feb 29.

Security: Los Angeles County’s (the county) 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 an appropriate, subject to abatement.

Purpose: To finance and refinance certain capital improvement projects at Martin Luther King, Jr. Community Hospital, including commercial paper repayment.

Final Maturity: Serially, Dec. 30, 2017–2045. Subject to optional, mandatory sinking fund and extraordinary redemption prior to final maturity.

Key Rating Drivers

Solid Financial Management: The ratings upgrade 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 DHS: The performance of the county’s Department of Health Services’ (DHS) continues to benefit from wider health sector reform, a five-year extension of the federal hospital financing waiver, and internal changes. Fitch Ratings expects that DHS will continue to need general fund support at a significant but stable and sustainable level.

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). A new OPEB funding policy is a credit positive.

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 somewhat mixed, but the tax base and revenue streams continue to grow.

Lease Debt Rating Distinction: The one-notch rating distinction between the county’s implied unlimited tax GO (ULTGO) rating of ‘AA’ and the ‘AA–’ rating on the majority of its 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 (‘A+’) for non-standard leases for Department of Social Services buildings that the county leases but does not purchase, resulting in an increased non-appropriation risk.

Rating Sensitivities

Stable Rating Outlook: The ratings are sensitive to fundamental changes in financial operations, general fund balances, reserves, liabilities, and the level of general fund support for DHS. The Stable Rating Outlook reflects Fitch’s expectation that the county will maintain its current solid financial profile.

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 successfully maintain 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 surplus for the third consecutive year, increasing the unrestricted general fund balance to $2.862 billion (18.2 % of spending) from the prior year's $2.790 billion (18.1%). These results follow a pattern of notably stable county financial operations throughout the most recent economic downturn.

The county is currently projecting another general fund surplus in fiscal 2016 (year ending June 30). Consequently, the total general fund balance is projected to improve from $3.190 billion in fiscal 2015. In fiscal 2016 to date, both general fund revenues and expenditures reportedly are coming in as budgeted.

The county is expecting to benefit from further revenue growth in fiscal 2017, particularly related to property and sales tax revenues. However, these gains will be at least partially offset by personnel cost increases. The county has agreed to 10% salary increases for most classifications which will be implemented incrementally between October 2015 to April 2018 (at an annual cost of approximately $150 million); fringe benefit increases for certain classifications will cost an additional $35 million–$40 million annually through fiscal 2019. The county notes that its expenditure flexibility is protected by a steady employee vacancy rate.

The county's rainy day reserve fund is now $337.7 million. The county remains committed to achieving its reserve goal of 10% of ongoing locally generated revenues (currently equivalent to approximately $539 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 to a contingency reserve, with any unused monies at the end of the year transferred to the rainy day reserve fund and/or the OPEB trust. As part of the county's fiscal 2016 adopted budget, $15.9 million was set aside in the contingency reserve (5% of discretionary revenues) and a further $5.0 million was allocated for deferred maintenance needs. The county's general fund liquidity has been gradually improving in recent years and it has sizable funds available for intrafund borrowing, if needed (a projected $3.955 billion in January 2016).

DHS Financials Improving but General Fund Support Still Required

The county projects that DHS will end fiscal 2016 with a fund balance at least comparable to its fiscal 2015 ending balance of $350 million, representing its seventh 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 2016, the net county contribution is $635.5 million, or 15.5% 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 increases in fiscal 2016 compared to fiscal 2015 ($561 million) because board policy allows DHS to retain savings generated from the state's

Rating History — GOs

Rating	Action	Outlook/ Watch	Date
AA	Upgraded	Stable	2/23/16
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
AA–	Upgraded	Stable	2/23/16
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

Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015 and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings, dated Feb. 2, 2016). The drafts include a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published in the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

Related Criteria

Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings (February 2016)

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

Tax-Supported Rating Criteria (August 2012)

Exposure Draft: U.S. Tax-Supported Rating Criteria (September 2015)

Rating History — Nonstandard Certificates of Participation

Rating	Action	Outlook/ Watch	Date
A+	Upgraded	Stable	2/23/16
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

redirection of less realignment revenues to social services under Assembly Bill (AB) 85. Regarding AB 85, $100 million is being redirected by the state to social services programs in fiscal 2016, much less than the $238.3 million redirected in fiscal 2015. (Both amounts could be adjusted under a two-year reconciliation process.) The county has successfully negotiated with the state not to redirect further monies in fiscal 2017, which will be a boost to DHS funding.

The county expects general fund cash flow loans to DHS to decline to between $500 million and $600 million outstanding per year. Fiscal 2015 ended with an unusually low $419.6 million in outstanding general fund loans, down from $870.7 million a year prior and a fiscal 2011 peak of $1.049 billion; the reduction was due to improved DHS cash flows and fund balance. To date, each month in fiscal 2016 has required considerably smaller loans year over year; however, the county is expecting to end the year with around $550 million in outstanding general fund loans, more in line with its projections.

DHS pressures continue to be partially alleviated by the extension of a federal section 1115 waiver through Dec. 31, 2020 (renamed Medi-Cal 2020). The county does not expect that DHS's budget will be materially affected by lower funding levels under Medi-Cal 2020 as the maximum reduction is projected to be approximately $55 million in any one year from fiscal 2016 onward.

Significant Long-Term Liability Exposure

The county's overall debt burden is a moderate $3,528 per capita, or 2.7% of market valuation. Principal amortization is above average at an estimated 64% in 10 years. No long-term debt issuances are currently planned until fiscal years 2019 and 2020.

The county faces sizeable long-term unfunded pension and OPEB liabilities. As of June 30, 2015, the county's net pension liability was $6.957 billion. On an actuarial basis, the June 30, 2015 funded ratio is 83.3% using the county's 7.5% assumed rate of return. This does not recognize $980 million of deferred investment gains still to be smoothed in. Fitch estimates the funded ratio at 81.2% 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), are budgeted at $1.376 billion in fiscal 2016, after years of steady growth. The county's fiscal 2017 pension contributions are projected to decrease by $74 million due to smoothing in investment gains.

The county also has a $27.3 billion UAAL for OPEB (July 1, 2014), which it has begun to address by establishing an OPEB trust. At its current balance of $530 million, the trust funds approximately 1.9% 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 $24 million contribution to the OPEB trust. Additionally, in January 2016 $50 million was transferred from excess in the pension system's retiree health premium reserve. The county has enacted a new policy to increase its annual OPEB contributions to $60 million annually until the actuarially required annual contribution is fully funded from fiscal 2028 onwards. The $60 million will consist of $25 million general fund monies plus $35 million from federal and state subventions.

The combined carrying costs for debt service, pension ARC, and OPEB pay-as-you-go in fiscal 2015 were manageable at 14.3% of total governmental spending.

General Fund Financial Summary

($000, Audited Fiscal Years Ended June 30)

	2009	2010	2011	2012	2013	2014	2015
Taxes	3,970,566	3,864,654	3,843,366	3,980,409	4,267,858	4,520,755	4,772,762
Licenses and Permits	54,877	49,079	56,656	57,144	61,412	59,886	61,561
Fines and Forfeits	264,375	258,842	244,787	217,972	222,226	207,094	207,684
Charges for Services	1,654,173	1,659,224	1,641,399	1,700,540	1,565,937	1,743,447	1,491,656
Intergovernmental	7,211,150	7,337,716	7,506,492	7,632,814	8,182,687	8,395,672	8,574,288
Other Revenue	382,609	315,927	275,554	237,100	306,818	281,164	346,782
Total Revenues	**13,537,750**	**13,485,442**	**13,568,254**	**13,825,979**	**14,606,938**	**15,208,018**	**15,454,733**
General Government	946,008	859,319	883,854	983,077	979,989	998,438	1,155,070
Public Safety	4,420,786	4,412,935	4,401,985	4,538,075	4,694,982	4,843,148	5,136,461
Health and Social Services	0	2,421,615	0	2,689,192	2,779,870	3,204,177	2,931,257
Culture and Recreation	242,999	247,094	263,046	255,818	272,835	282,660	304,895
Capital Outlay	772	2,115	32,598	20,106	8,065	2,398	866
Debt Service	247,248	271,378	278,477	24,602	30,816	28,928	27,060
Other	7,276,712	5,025,312	7,694,084	5,108,516	5,247,031	5,430,398	5,682,198
Total Expenditures	**13,134,525**	**13,239,768**	**13,554,044**	**13,619,386**	**14,013,588**	**14,790,147**	**15,237,807**
Operating Surplus/(Deficit)	**403,225**	**245,674**	**14,210**	**206,593**	**593,350**	**417,871**	**216,926**
Extraordinary and Special Items	0	0	0	0	0	0	870
Transfers In	299,247	360,412	422,680	466,078	504,567	466,108	391,287
Other Sources	1,658	3,075	52,550	18,917	3,520	2,506	866
Transfers Out	911,752	780,168	762,808	772,080	863,738	663,327	522,934
Net Transfers and Other	**(610,847)**	**(416,681)**	**(287,578)**	**(287,085)**	**(355,651)**	**(194,713)**	**(129,911)**
Net Op. Surplus/(Deficit) After Transfers	**(207,622)**	**(171,007)**	**(273,368)**	**(80,492)**	**237,699**	**223,158**	**87,015**
Total Fund Balance	3,166,818	2,995,811	2,722,443	2,641,951	2,879,650	3,102,808	3,189,823
% Total Expenditures, Transfers Out, and Other Uses	22.5	21.4	19.0	18.4	19.4	20.1	20.2
Unreserved Fund Balance	2,626,967	2,211,383	0	0	0	0	0
% Total Expenditures, Transfers Out, and Other Uses	18.7	15.8	0	0	0	0	0
Unrestricted Fund Balance	0	0	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745
% Total Expenditures, Transfers Out, and Other Uses	0	0	17.0	16.2	17.2	18.1	18.2

Note: Numbers may not add due to rounding.

Local Economy Continues to Improve

The county's unemployment rate (5.8% in December 2015) is in line with the state's (5.8%) and remains somewhat higher than the nation's (4.8%). Growth in both employment opportunities and the labor force has brought the unemployment rate down from 7.5% 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 small at 0.5% and 1.9% 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, with further 5% growth projected for fiscal 2017. This strong TAV growth is supported by a combination of rising house prices, increased construction, decreasing defaults and foreclosures, Proposition 8 TAV restorations, ownership changes, and healthier commercial and industrial real estate markets.

Essential Assets

The 2016 series D bonds are on parity with 2015 series A, B, and C bonds (rated 'AA–' by Fitch); they have the same bondholder protections and share a pool of leased assets. All 13 leased facilities provide essential county services and include courthouses, a sheriff station, a library, county department buildings, the civic center heating and refrigeration plant, and various components of the Martin Luther King Jr. Community Hospital. Their combined value of an estimated $860.2 million comfortably exceeds the outstanding cumulative par amount of the parity bonds ($605.3 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.