Los Angeles County, California

New Issue Report

Ratings

Issuer Default Rating	AA
New Issue	
2018-19 Tax and Revenue Anticipation Notes	F1+
Outstanding Debt	
Los Angeles County Certificates of Participation	AA–
Los Angeles County Public Works Financing Authority Lease Revenue Bonds	AA–
Los Angeles County Capital Asset Leasing Corporation Lease Revenue Bonds	AA–
Sonnenblick-Del Rio El Monte Asset Leasing Corporation Certificates of Participation	AA–
Sonnenblick-Del Rio West Los Angeles Leasing Corporation Certificates of Participation	AA–

Rating Outlook

Stable

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New Issue Summary

Sale Date: Negotiated sale during the week of June 4.

Series: $700 Million 2018-19 Tax and Revenue Anticipation Notes.

Purpose: To smooth cash flow management for general fund operations during fiscal 2019.

Security: General obligations of the county, payable from a first lien on unrestricted general fund revenues attributable to fiscal 2019, including requirements to set aside the first such funds received during specified periods for note repayment.

Analytical Conclusion

The 'AA' IDR reflects the county's strong economic underpinnings with solid revenue growth prospects, exceptionally strong gap-closing capacity and moderately low long-term liability burden. A demonstrated ability to cut spending, a sound financial cushion and limited revenue cyclicality offset the county's exposure to federal and state funding decisions, Department of Health Services (DHS) operations and state law constraints on the county's independent ability to raise revenues.

The 'F1+' short-term rating on the notes corresponds to the county's IDR. The combination of pledged revenues and court-verified borrowable resources provides very strong debt service coverage for the notes. Full note principal and interest set-asides occur well in advance of note maturity.

Key Rating Drivers

Revenue Framework: 'a'
The county's independent legal ability to raise revenues is limited by state law. The county's revenues have demonstrated limited volatility, reflecting the size and maturity of the economy and tax base (which has a large Proposition 13 cushion). Growth prospects for revenues are solid.

Expenditure Framework: 'aa'
The county demonstrated strong expenditure control during the Great Recession and continues to enjoy solid expenditure flexibility. Fitch Ratings expects expenditure growth to be in line with, to marginally above, future revenue growth in the absence of policy action. The portion of the budget allocated to carrying costs will increase as the county pays down its unfunded pension liability and significant other post-employment benefits (OPEB) obligations but is expected to remain moderate.

Long-Term Liability Burden: 'aa'
The county's combined long-term liability burden is moderately low relative to total personal income. The majority of debt is issued by overlapping jurisdictions.

Operating Performance: 'aaa'
The county has demonstrated an ongoing commitment to bolster its financial cushion during the economic recovery, aided in part by DHS' improved financial position. The county is very well positioned to address cyclical downturns.

Rating History — IDR

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	5/31/18
AA	Upgraded	Stable	2/23/16
AA–	Affirmed	Positive	12/24/14
AA–	Assigned	Stable	6/9/11

Rating History — Certificates of Participation and Lease Revenue Bonds

Rating	Action	Outlook/ Watch	Date
AA–	Affirmed	Stable	5/31/18
AA–	Upgraded	Stable	2/23/16
A+	Affirmed	Positive	12/24/14
A+	Revised	Stable	4/30/10
A	Affirmed	Positive	11/5/01
A	Upgraded	—	5/23/00
A–	Downgraded	—	6/21/95
A+	Assigned	—	9/11/92

Related Research

Fitch Rates $700MM Los Angeles County, CA Notes 'F1+' (May 2018)

Related Criteria

U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Rating Sensitivities

Solid Financial Profile: The ratings are sensitive to fundamental changes in the county's financial operations and strong budget management, which Fitch does not expect.

Revenue Growth Prospects: Sustained revenue growth that improves Fitch's evaluation of the county's revenue growth prospects, combined with the county's other credit strengths, could support a rating upgrade.

Credit Profile

Los Angeles County covers over 4,000 square miles and includes 88 incorporated cities and 100 school and community college districts. With a population exceeding 10 million, it is more populous than most U.S. states. The county's huge, diversified economy represents approximately one quarter of California's total economy.

The county is a major economic and manufacturing center and incorporates a port and an airport that are among the busiest in the world. Taxable assessed valuation (TAV) has grown strongly in the past seven years after very small recessionary declines, reflecting the county's highly developed and mature nature and large Proposition 13 cushion. The county is projecting a further strong TAV increase in fiscal 2019.

Despite strong economic and tax base characteristics, the county’s unemployment rate has historically been higher than the nation's, although recently the gap has been largely eliminated. Wealth indicators are below the state but generally above or in line with the nation, incorporating some highly urbanized and low income areas.

Revenue Framework

The majority of general fund revenues comes from federal and state funding for social services (55% of total general fund revenues in fiscal 2017), although this amount can fluctuate significantly through the economic cycle due to caseloads, reimbursement timing and state budget issues. Two other key revenue sources are locally generated taxes (31%) and charges for services (11%).

Over the past decade, total general fund revenue growth has been slightly below national GDP but has outpaced inflation. Excluding intergovernmental revenues shows locally controlled revenues outperforming national GDP growth until fiscal 2017, when they dipped slightly below. Fitch expects future intergovernmental revenues will be determined by federal and state policy decisions and economic performance, while locally controlled revenues will mirror future economic trends at the county level. In terms of two key locally controlled revenues, the fiscal 2019 budget assumes almost 6% property tax revenue growth and 2% sales tax revenue growth.

The county has satisfactory independent revenue-raising capacity relative to its modest historical cyclical revenue declines. However, its ability to raise revenues is constrained by state laws (in particular, Propositions 13 and 218) requiring voter approval for tax increases. Independent revenue-raising ability is largely limited to licenses, permits, fines and charges for service.

Consideration is being given to a potential ballot measure for a stormwater parcel tax estimated to generate up to $400 million per year to improve regional compliance with stormwater and urban runoff regulations. Meanwhile, the state legislature is considering funding stormwater programs through a rate-setting process that could provide a valuable funding stream for the county's growing stormwater regulatory compliance costs.

Expenditure Framework

Over half of fiscal 2017 general fund expenditures were for public safety (33%) and health and sanitation services (21%), which is typical for county governments in California. Personnel costs remain the largest driver of expenditure increases. The fiscal 2019 budget absorbs over $265 million in salary and benefit cost increases, compared to $49 million in programmatic increases and fiscal policy changes. However, these combined cost increases represent only just over 1% of the combined general fund and hospital enterprise fund budgets.

The pace of spending growth absent policy actions is likely to be in line with, to marginally above, revenue growth patterns given high-needs communities within the county. Fitch expects the county will continue to control expenditures aggressively.

The county retains solid expenditure flexibility despite its ongoing support of DHS operations. Its fixed-cost burden is moderate. Fitch expects that carrying costs will grow as a percentage of general fund spending, due to future debt issuance plans and rising pension contribution costs, but expenditure flexibility will remain solid.

The county operates within a strong labor environment, and labor has the ability to strike. Nevertheless, labor relations are productive and multiyear labor contracts have considerable flexibility, although they do not typically include reopeners. The county is currently in labor negotiations and will begin negotiating its fringe benefit memoranda of understanding soon.

Long-Term Liability Burden

Overall debt of approximately $38 billion is a moderately low burden on county taxpayers' resources. The majority is debt issued by overlapping jurisdictions outside of the county's control (61% of the total long-term liability burden). This portion could grow significantly. By themselves, school and community college districts located within the county have $19 billion in unissued bond authorizations

By contrast, net direct county debt of about $1.3 billion represents only 2% of the total long-term liability burden. The county plans to cash fund its significant information technology upgrade, deferred maintenance and capital replacement needs on a phased basis over a number of years. However, in August the county is planning $305 million in lease revenue bonds to construct a new Department of Mental Health headquarters (the Vermont Corridor Project, development site 1). The bonds will be issued through a not-for-profit special purpose entity, Los Angeles County Facilities, Inc., which will also serve as the construction and facility manager for the project. The county will lease the facility for 30 years, after which it will take possession.

In 2019, the Los Angeles County Capital Asset Leasing Corporation (LAC-CAL) expects to issue approximately $50 million in lease revenue bonds for its LAC-CAL Equipment Program. The Los Angeles County Public Works Financing Authority (the authority) could issue approximately $300 million in lease revenue bonds to refund commercial paper previously issued for capital improvement projects. The county is considering future issuance of lease revenue bonds to construct a new consolidated correctional treatment facility. Even if all proposed debt was issued immediately, the county's long-term liability burden would remain moderate.

Adjusted pension liabilities represent 37% of the total long-term liability burden. The Los Angeles County Employees Retirement Association (LACERA) reported a $10.3 billion net pension liability at June 30, 2016 (a funded ratio of approximately 79%, assuming a 7.25% discount rate). This net pension liability represented a 38% increase over the previous year despite the county consistently funding LACERA's actuarially required contributions. Further increases are expected that will drive increased employer contributions through fiscal 2023. Using a 6% discount rate results in a Fitch-adjusted increase in the county's net pension liability to an estimated $22.6 billion, reducing the asset-to-liabilities ratio to 67%.

The county's share of LACERA's unfunded actuarial accrued OPEB liability is sizable at $24.8 billion in fiscal 2017 (almost 5% of personal income). However, it is 9% lower than the previous fiscal 2015 valuation and the county does have the ability to reduce it further. The county enacted OPEB reforms in 2015, which are reflected in the fiscal 2017 reported liability number, and is increasing its annual contributions, funded in part by maximizing subvention revenues from other governments.

The county is budgeting $183 million in prefunding contributions to its OPEB trust fund in fiscal 2019. This is the fourth year of a multiyear plan to incrementally increase the prefunding of retiree healthcare benefits. The county is projecting that it will be able to reach full actuarially required OPEB contributions by fiscal 2028. In addition to the county's irrevocable OPEB trust (with a current balance of $856 million), LACERA has a $107 million reserve for annual healthcare premium fluctuations.

Operating Performance

The county has prioritized maintenance of strong general fund balances and continued strengthening of its reserves during the economic recovery, even while increasing employee remuneration costs. For details, see Scenario Analysis, page 6.

The county ended fiscal 2017 with a strong unrestricted general fund balance of nearly $3.4 billion, or almost 20% of spending. The county expects to end fiscal 2018 slightly higher at around $3.7 billion. The fiscal 2017 unrestricted general fund balance included a rainy day fund equivalent to 7% of ongoing discretionary revenues (i.e. excluding federal and state pass-through funding). The goal is to reach 10%, which the county expects to achieve in the next four years. The county has also budgeted 10% of new discretionary revenues for contingency appropriations in fiscal 2019 as well as additional funding for deferred maintenance needs.

The county operates the second-largest public health system in the nation. The general fund is responsible for DHS administration, online medical records and the managed care program. In recent years, DHS' more stable revenue streams, improved patient demographics and operational changes made it possible for the general fund net county contributions (NCC) to DHS to decline from a fiscal 2008 peak of $828 million (18% of the total DHS budget). In fiscal 2019, however, the NCC is budgeted to increase to $991 million (approximately 16% of the total DHS budget) due to DHS' absorption of correctional health services ($315 million) and strategic board initiatives ($20 million). Consequently, the NCC increase is being driven by policy decisions rather than DHS budgetary pressures.

The general fund also provides DHS with cash advances and working capital loans ($170 million balance projected for June 2018, down from a high of $1.05 billion in June 2011).

DHS' year-end financial results continue to improve. The county is projecting a DHS ending fund balance of approximately $700 million for fiscal 2018, compared with $661 million at the end of fiscal 2017. DHS continues to benefit from a number of external and internal reforms, most notably the Affordable Care Act and an improved payor mix, the “Medi-Cal 2020” extension for California public hospitals through Dec. 31, 2020, a focus on primary rather than hospital-based healthcare, infrastructure investments, electronic system integration and departmental reorganization. While recent federal tax reform included a repeal of the Affordable Care Act's individual mandate starting in 2019, the county does not expect a significant revenue impact given its proven ability to assist uninsured patients in accessing health insurance coverage.

Notes Finance Cash Flow Needs

Note proceeds will be used to smooth cash flow management for general fund operations during fiscal 2019. The county expects all three note set-asides to occur in months with positive net ending balances, thereby allowing sufficient coverage of between 2.0x-7.8x solely on the basis of each month's net ending balance, without drawing upon $5.2 billion–$7.0 billion in borrowable funds at those set-aside dates. Including borrowable funds increases coverage to 21.0x–66.0x. The repayment deposit structure sets aside 100% of principal and interest two months in advance of note maturity.

Related Ratings

As noted above, Fitch has affirmed the following outstanding ratings, each of which is linked to the county's IDR:

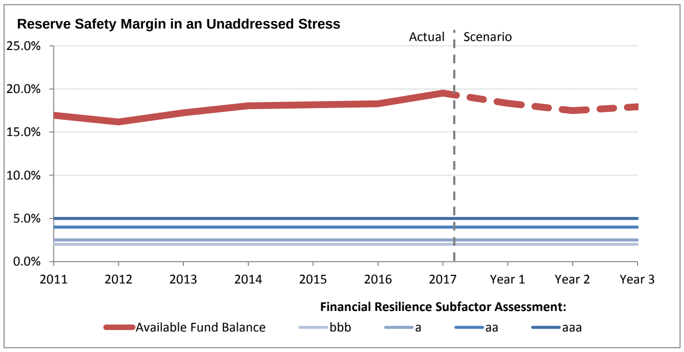
- $1.6 billion Los Angeles County Public Works Financing Authority lease revenue bonds (multiple capital projects), 2010 series A (tax-exempt) and series B (Build America Bonds), lease revenue bonds (multiple capital projects II), series 2012, lease revenue bonds (multiple capital projects), series 2015A, lease revenue bonds (master refunding project), series 2015B (tax-exempt) and 2015C (federally taxable), and lease revenue bonds, 2016 series D at 'AA–';
- $58 million county COPs, series 1993 Disney Parking Project and 2012 refunding COPs (Disney Concert Hall Parking Garage) at 'AA–';
- $61 million Sonnenblick-Del Rio El Monte Asset Leasing Corporation senior COPs, series 1999 (Department of Public Social Services Facility) and series 2001 (Department of Public Social Services Facility - Phase II) at 'AA–';
- $29 million Sonnenblick-Del Rio West Los Angeles Leasing Corporation senior COPs, series 2000 (Department of Public Social Services Facility) at 'AA–';
- $30 million Los Angeles County Capital Asset Leasing Corporation lease revenue bonds (LAC-CAL Equipment Program), series 2014A and 2017A at 'AA–'.

The authority's outstanding lease revenue bonds are payable from the county's facility lease rental payments to the authority. The county's outstanding COPs are payable from the county's facility lease rental payments to the Parking Authority of the County of Los Angeles, the Sonnenblick-Del Rio El Monte Asset Leasing Corporation and the Sonnenblick-Del Rio West Los Angeles Leasing Corporation. The county covenants to budget and appropriate annually sufficient COP and lease rental payments from any source of legally available funds, subject to abatement.

LAC-CAL’s lease revenue bonds are payable from county departments' equipment lease rental payments to LAC-CAL.

Los Angeles County (CA)

Scenario Analysis v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

The county has prioritized maintenance of strong general fund balances and continued strengthening of its reserves during the economic recovery, even while increasing employee remuneration costs. During the great recession, the county demonstrated notable gap-closing ability during the recession despite state-imposed constraints on its revenue-raising ability. It received additional revenue through federal stimulus funds and health care reform (e.g. client enrollment in managed health care under the Affordable Care Act). On the expenditure side, the county relied on employee attrition, unfilled vacancies, departmental curtailments, efficiency initiatives, 0% COLAs for four to five years (depending on the bargaining unit), and use of reserves and capital funds. The county maintains a notable amount of expenditure control due to moderate carrying costs and labor contracts with considerable flexibility.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.0%)	2.1%	3.5%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	13,568,254	13,825,979	14,606,938	15,208,018	15,454,733	16,190,186	17,081,934	16,911,115	17,269,969	17,875,454
% Change in Revenues	-	1.9%	5.6%	4.1%	1.6%	4.8%	5.5%	(1.0%)	2.1%	3.5%
Total Expenditures	13,554,044	13,619,386	14,013,588	14,790,147	15,237,807	15,863,407	16,573,050	16,904,511	17,242,601	17,587,453
% Change in Expenditures	-	0.5%	2.9%	5.5%	3.0%	4.1%	4.5%	2.0%	2.0%	2.0%
Transfers In and Other Sources	475,230	484,995	508,087	468,614	393,023	374,195	438,769	370,453	378,314	391,578
Transfers Out and Other Uses	762,808	772,080	863,738	663,327	522,934	506,555	680,922	516,686	527,020	537,560
Net Transfers	(287,578)	(287,085)	(355,651)	(194,713)	(129,911)	(132,360)	(242,153)	(146,233)	(148,706)	(145,982)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(273,368)	(80,492)	237,699	223,158	87,015	194,419	266,731	(139,629)	(121,338)	142,018
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(1.9%)	(0.6%)	1.6%	1.4%	0.6%	1.2%	1.5%	(0.8%)	(0.7%)	0.8%
Unrestricted/Unreserved Fund Balance (General Fund)	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745	2,991,807	3,368,535	3,228,906	3,107,567	3,249,585
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	2,427,939	2,327,239	2,566,028	2,790,224	2,861,745	2,991,807	3,368,535	3,228,906	3,107,567	3,249,585
Combined Available Fund Bal. (% of Expend. and Transfers Out)	17.0%	16.2%	17.2%	18.1%	18.2%	18.3%	19.5%	18.3%	17.5%	17.9%

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	16.0%	8.0%	5.0%	3.0%	2.0%
Reserve Safety Margin (aa)	12.0%	6.0%	4.0%	2.5%	2.0%
Reserve Safety Margin (a)	8.0%	4.0%	2.5%	2.0%	2.0%
Reserve Safety Margin (bbb)	3.0%	2.0%	2.0%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

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