MOODY'S
INVESTORS SERVICE

New Issue: Moody's Assigns A1 Rating to Lease Supported Obligations of Los Angeles County, CA

Global Credit Research - 03 Oct 2012

Approximately $335 Million of Debt Affected

LOS ANGELES COUNTY PUBLIC WORKS FINANCE AUTHORITY, CA
Counties
CA

Moody's Rating

ISSUE	RATING
Lease Revenue Bonds (Multiple Capital Projects II), Series 2012	A1

Sale Amount	$335,000,000
Expected Sale Date	10/18/12
Rating Description	Lease Rental: Abatement

Moody's Outlook

Opinion

NEW YORK, October 03, 2012 --Moody's Investors Service has assigned an A1 rating to Los Angeles County's Lease Revenue Bonds, Series 2012 (Multiple Capital Projects II).

RATINGS RATIONALE

The ratings reflect the county's large and diverse economy. Although it remains currently weak, robust annual growth in the regional economy of 2.6% or more is expected this year. The rating also reflects the county's generally strong financial operations with still sufficient reserves, and its easily manageable debt position. The sizable burden of the county's health care system on its financial operations also weighs on the rating.

The underlying security for the current issue is a lease between the County of Los Angeles and the Los Angeles County Public Works Financing Authority. The lease is a typical, abatable general fund lease secured by the county's pledge to budget and appropriate lease payments so long as it has use and possession of the leased assets. The leased assets will be Los Angeles County USC Medical center and High Desert Multi-Service Ambulatory Care Center. . . The assigned rating also reflects the strength of the county's general fund pledge, the specific terms of the lease, and the county's other fundamental credit strengths stated above.

The two notch rating distinction between the A1 on the current offering and the county's Aa2 Issuer Rating represents Moody's standard notching differential for essential asset leases relative to a California issuer's general obligation rating. Broadly speaking the typical two notches reflect the risk of abatement, the narrower, general fund security pledge for leases compared to the very strong, voter-approved unlimited property pledge securing general obligation bonds.

Proceeds of this issue will be used to fund major upgrades to the county's health care system and other core assets.

KEY CREDIT STRENGTHS

Large and diverse economy.

Strong financial management.

Low lease burden.

KEY CREDIT CHALLENGES

Large health care burden.

Four consecutive general fund deficits though 2011.

DETAILED CREDIT DISCUSSION

FINANCIAL OPERATIONS ARE STRONG WITH AMPLE RESERVES

The county's ability to preserve its above average financial strength, even through the current climate of sluggish economic conditions and the state's budgetary challenges, is notable. During periods of strong economic expansion and revenue growth the county has balanced its budgets with tight controls on expenditures, and with the embedded conservatism of these budgets, the general fund yielded notable surpluses adding to the county's sizable reserves. Key to the county's fiscal discipline has been its ability to maintain a significant number of positions unfilled during the recent period of financial uncertainty, particularly related to the financial difficulties of the state. The county has also been decisive in eliminating positions, which has at times resulted in actual lay-offs, but the budgets from 2010 through 2013 were free of lay-offs and furloughs.

As of June 30, 2011, the end of the most recent fiscal year for which there are audited financial results, the county's general fund enjoyed a total balance of $2.7 billion and Unrestricted, Spendable Fund Balance of $2.4 billion equaling 20.1% and 17.9% of general fund revenues respectively. These figures approximate the figures for similarly rated counties in California, although are somewhat less than the figures for similarly rated counties nationwide. The 2011 balance reflects a decrease of $273 million for the year, which was the third consecutive decrease after twelve consecutive surpluses since 1996, during which time the general fund balance increased from $160 million to $3.4 billion in 2008. The 2011 general fund deficit was largely the result of expenditure reductions not keeping pace with flat revenues. Despite the decrease in reserves, 2011 saw a modest 1.4% increase in revenues while expenditures increased by 2.1%.

While the county's commitment to strong financial operations is evident, we believe that the key pressure on the county's expenditures remains its enormous health care system. In 2011, the county spent $2.5 billion in health related expenses from the general fund, which represented 17.5% of expenditures before transfers. In addition, the county's five major health care facilities had combined operating expenses of $3.1 billion, and received $672 million in inter-fund transfers from the general fund. For many years, the health care system has operated with structural deficits, relying on its reserves, general fund transfers and other one- time measures. The latter include state and federal waivers which, in return for operating improvements, allow the county to seek reimbursements for certain normally ineligible expenditures.

Unaudited results for 2012 indicate yet another GF operating deficit, though much smaller than the previous ones. The estimated GF decrease is $80 million, reducing it to $2.6 billion or 18.8% of 2011 GF revenues.

The county's 2013 budget indicates no dramatic changes from 2012. The budget relies less on cancellation of reserves and designations of fund balance than in 2012, which may reflect incrementally closer structural balance. The hiring freeze and reducing headcount is still the county's primary tool for controlling expenditures. Some labor concessions, including 0% COLA in 2010, 2011, 2012, and 2013 also result in measurable savings. Based on the county's assessment, the state budget impact on its 2013 budget is minimal. Overall, we expect a 2013 general fund balance that is not significantly different than in 2012. An unchanged or increasing fund balance would reverse a the four year trend of declining reserves. If these deficits resume beyond 2012, the county's reserve levels may begin to fall short of reserves consistent with the current rating, and downward pressure may mount on the rating.

LARGE, DIVERSE AND AGAIN GROWING ECONOMY WITH SLIGHTLY BELOW AVERAGE WEALTH AND INCOME LEVELS

Los Angeles is by far the largest county in the state. The economy remains diverse with higher education, manufacturing, healthcare and biotech firms, trade, tourism and perhaps most importantly, the TV/motion picture industry prominent among the county's largest private sector employers. The county's population and employment recovered strongly through the 1990's following the severe contraction of the defense industry in the early 1990's. However, since 2000 population growth has moderated with out-migration outpacing in- migration.

Through 2008 total employment remained between 4.4 and 4.7 million and the unemployment rate in mid single digits approximated the rates of the state as a whole. During the most recent recession the county seems to have lost approximately 400,000 jobs with over two thirds of the losses occurring in 2009, when the metro area gross product contracted by 3.9%.

Between June, 2011 and June, 2012 approximately 50,000 jobs seem to have been gained, with the unemployment rate decreasing to a still high 11.1% from 12.4%. The county's recovery is still weighed down by its stalled labor market, but the gross metro area product is expected to increase by 2.6 % in 2012. Entertainment and tourism are among the few industries to add to payrolls in recent months. We don't expect the unemployment rate to be in single digits until 2013.

The county's trillion dollar tax base has fared somewhat better than other counties' in the state. After decreasing by 0.6% and 1.9% respectively in 2010 and 2011, the county's assessed value (AV) increased by a small but notable 1.4% in 2012. The AV grew by another 2.2% in 2013. This relative stability is due to the more built out and aged nature of the county's residential base. The county's 2012 full value per capita of $102,000 remains notably lower than the California county median of $177,000 but higher than the national median of $75,780. The 2010 census estimate indicates that the average resident's socio-economic profile strengthened in real terms and relative to state and national averages. For example, as of the 2000 census, per capita income in Los Angeles County was only 91.1% of the state average and 95.8% of the national average, compared to 94.5% and 100.2% respectively, according to the 2010 estimate. Going forward, although the county's economy, wealth and income levels may not grow as rapidly as in the recent past, we believe the county will continue to enjoy one of the most diverse and steadily growing economies in the state.

MANAGEABLE DEBT POSITION

Proceeds of this issue will be used to refund outstanding Commercial Paper and fund improvements throughout the county, most notably improvements to medical facilities. These lease revenue bonds and approximately $790 million of outstanding similarly secured bonds are secured by the county's lease payments for the use of its new 600 bed hospital, which is valued at over $1.05 billion and a Multi-Service Ambulatory Care Center valued at $142 million. The new hospital has no outstanding debt because it was funded with large grants, mostly from the federal government. The total amount of debt secured by the lease payments is $1.123 billion.

Including the current offering the county will have approximately $1.9 billion in outstanding direct debt., The county's direct debt burden is 0.2% and overall debt 3.1% of assessed value. While the county's direct debt equals the state average of 0.2% for counties, overall debt is above the median of 2.1% due to the significant debt of overlying entities, most notably the Los Angeles Unified School District. Moody's nonetheless believes that the county's debt levels remain very easily manageable. It is noted that the county's lease ratios - perhaps the best measure of the budget burden of county debt - compare better with medians. The typical median net lease burden for a California county is 1.7% of general fund revenues while the total burden of lease and General Fund obligations (e.g. pension obligation bonds) is 1.9%. With the current offering the county's peak lease payment, as a percent of general fund revenue, will be about 1.2%. The county's POBs were retired in 2011.

The county's annual actuarially required contribution for its Other Post Employment Benefits (OPEB) is $1.72 billion but the county's practice is to fund its OPEB on a pay-as-you-go basis, which in 2013 is approximately $440 million. The OPEB liability is likely to continue to grow each year. The county recognizes the importance of better managing its OPEB liability, and established an OPEB Trust in May, 2012, which should be funded with a $400 million contribution in 2013. In the meantime, the retirement of the pension obligations will afford the county some relief in the short term. The county's pension systems are in healthier positions. The Los Angeles County Employee Retirement Association's Retirement plan had a funding ratio of 80.6% as of June 30, 2011.

LEGAL PROVISIONS FOR THE CURRENT OFFERING ARE SATISFACTORY FOR THIS TYPE OF TRANSACTION

The county pledges to budget and appropriate for lease payments; as such, the Bonds represent an obligation of its general fund subject only to abatement. Security provisions provide protection against abatement risk, primarily through the county's commitment to obtain rental interruption insurance in an amount equal to two years' rental payments. The debt service reserve fund for the Series 2012 bonds will be maintained at the reserve requirement of approximately $22.4 million.

Outlook

Moody's outlook on Los Angeles County's long-term ratings is stable. The stable outlook reflects the county's demonstrated ability to preserve its financial position through challenging economic and financial cycles. The financial health with which the county emerges from the expected fiscal challenges in the current and coming years will be an important contributor to future rating considerations.

WHAT COULD MAKE THE RATING GO UP

Long term financial stability of the county's health system with structural budgetary balance

Significant improvement in the area economy with fundamental improvement in area income levels

WHAT COULD MAKE THE RATING GO DOWN

Significant deterioration of the county's financial position

KEY STATISTICS

2010 estimated population: 10 million.

20 per capita income (est), $26,988 (94.5% of state)

2013 full valuation: $1.08 trillion

Overall debt burden: 3.1%

Net direct debt burden: 0.2%

FY 2011 General Fund balance: $2.7 billion (20.1% of 2011 General Fund revenues)

FY 2011 , Spendable Fund Balance of $2.4 billion (17.9% of 2011General Fund revenues)

Net lease burden, est. 1.2%

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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