

RatingsDirect®

Summary:

Los Angeles County, California; Appropriations; General Obligation

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Credit Profile

US\$37.845 mil lse rev bnds (Lac-cal Equipment Program) ser 2017A due 12/01/2020

<i>Long Term Rating</i>	AA/Stable	New
Los Angeles Cnty ICR		
<i>Long Term Rating</i>	AA+/Stable	Affirmed
Los Angeles Cnty APPROP		
<i>Long Term Rating</i>	AA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to the County of Los Angeles Capital Asset Leasing Corp.'s (LAC-CAL) lease revenue bonds (LRBs), 2017 series A, issued for Los Angeles County, Calif. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the LAC-CAL's and the county's appropriation debt outstanding, and its 'AA+' issuer credit rating on the county. The outlook is stable.

The 2017 series A LRBs are secured by semiannual lease payments made by the county to the LAC-CAL for use of the leased assets, which include \$69.9 million of equipment (vehicles, medical equipment, and technology infrastructure). Lease payments, in turn, are payable from all available funds of the county and are subject to annual appropriation. The underlying equipment leases are structured to mature within the useful life of the pledged equipment, which ranges from three to five years, and the final maturity of the LRBs will be in December 2020. The county is funding a debt service reserve for the bonds. Lease payments are subject to abatement in the event of loss of, damage to, destruction of, or theft of the leased equipment, and the county covenants to maintain 24 months of business interruption insurance to offset abatement risk.

Proceeds of the 2017 series A LRBs, together with other sources of funds including excess cash collected from departmental leases and unused bond anticipation note (BAN) proceeds, will be used to redeem \$70 million of currently outstanding BANs, initially issued to fund capital equipment purchases for county departments.

The rating on the LRBs reflects our view of the risk of nonappropriation of lease payments. The ratings further reflect our view of the county's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong management, with strong financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with slight operating surpluses in the general fund and at the total governmental fund level in fiscal 2016;
- Very strong budgetary flexibility, with an adjusted available general fund balance in fiscal 2016 of 16% of adjusted

operating expenditures;

- Very strong liquidity, with total government available cash at 37.8% of total governmental fund expenditures and 13.4x governmental debt service, and access to external liquidity we consider exceptional;
- Very strong debt and contingent liability position, with debt service carrying charges at 2.8% of expenditures and net direct debt that is 7.6% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation; and
- Strong institutional framework score.

Strong economy

We consider the county's economy strong. Los Angeles County, with an estimated population of 10.2 million, is located in the Los Angeles-Long Beach-Anaheim, Calif. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 93.7% of the national level and per capita market value of \$138,217. Overall, the county's market value grew by 5.58% over the past year to \$1.336 trillion in 2017. The county unemployment rate was 5.1% in 2016.

Los Angeles is the largest county in the U.S., by population. Assessed value (AV) has grown since fiscal 2011, with a 6% increase projected for fiscal 2018. The county experienced only a relatively minor dip in AV during the Great Recession, a reflection of its large and mature property tax base.

Meanwhile, population, income, and consumer spending continue to rise, while the county's unemployment rate has flattened out at just about 5% after falling from a peak of 12.6% in fiscal 2012. The county benefits from two major ports, Los Angeles and Long Beach, and has a broad and diverse employment base and a gross domestic product that represents 28% of the state of California's.

Very strong management

We view the county's management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

The county uses state economic data and actual historical trends in revenue forecasting and reviews expenditures and revenues monthly against budget. The county has adopted a debt management plan and a written investment policy and submits investment performance reports to the county board monthly. While it has set a goal of building 10% of locally generated revenues in a "rainy day" fund, officials report that the county is not currently meeting the goal, but continues to transfer a portion of surplus revenue to the rainy day fund. The county recently passed a new policy of setting aside 10% of its discretionary revenues to the rainy day fund.

Strong budgetary performance

Los Angeles County's budgetary performance is strong in our opinion. The county had slight operating surpluses of 1.2% of expenditures in the general fund and of 1.0% across all governmental funds in fiscal 2016. General fund operating results of the county have been stable over the last three years, with a result of 1.4% in 2015 and a result of 2.3% in 2014.

The county's highest general fund expenditures are for its public assistance and public protection. We do not anticipate a significant deviation from balanced operations over the next two years, with major revenues supporting the county's expenditure goals mostly growing year over year. Property tax has experienced strong assessed value (AV) growth,

and the county estimates a 6.02% AV increase in 2018 compared with the budget projection of 5.8%, excluding residual tax increment associated with redevelopment dissolution. Sales tax-related revenues continue to grow as well, and Proposition 172 sales tax are budgeted to be up by 3.5% in 2018. County officials have emphasized a focus on balancing ongoing revenue with ongoing expenditures, and in 2017 received voter approval for a dedicated sales tax to fund homelessness initiatives (\$355 million annually). The fiscal 2018 budget is balanced from a structural standpoint; however, changes to federal health care spending could put pressure on operations, given the size of the county's health services department.

The county's support for its hospital operations has fallen to 12.8% of the Department of Health Services (DHS) budget in 2017 from 14.4% in 2013 due in large part to state Medicaid expansion through the Affordable Care Act (ACA). Although the 2018 budget does not anticipate an increase in net county cost to subsidize the DHS, a significant federal overhaul of the ACA could result in a cut to state and federal support for health services, which would be a challenge for the county. In recent years, the county has taken steps to restructure its health services department to an integrated ambulatory care system from a hospital-based system, which we believe could position it better than many to minimize the cost of adapting to changes in health care funding. County working capital loan balances to the hospital system declined to a projected \$134 million in June 2017 from over \$1 billion in fiscal 2011.

General fund and governmental fund revenue and expenditures were adjusted to account for recurring transfers to and from the county's hospital funds. Additionally, the general fund expenditures were adjusted to account for recurring transfers to the library and various debt service funds. Taxes represent 30% of the audited fiscal 2016 general fund revenues. The other major revenue stream for the county came from intergovernmental revenues from the federal and state government, which represent about 55% of revenues. Charges for services are another 10% of revenues. Other revenue sources are relatively small and include fines and forfeitures.

Very strong budgetary flexibility

Los Angeles County's budgetary flexibility is very strong, in our view, with an adjusted available fund balance in fiscal 2016 of 16% of adjusted operating expenditures, or \$2.7 billion.

For fiscal 2017 year-end, county officials project that ending available balances will exceed that level. Management continues to work to improve its reserve position and add to its rainy day fund (included with the unassigned fund balance), with 10% of new ongoing discretionary revenue set aside for deposit into the rainy day fund annually.

We expect reserves will remain close to or slightly higher than current levels, given management's commitment to reserves; however, a significant reduction in federal and state support for medical and health services, should it materialize, could reduce flexibility in the short term as the county adjusts.

Very strong liquidity

In our opinion, Los Angeles County's liquidity is very strong, with total government available cash at 37.8% of adjusted total governmental fund expenditures and 13.4x governmental debt service in 2016. In our view, the county has exceptional access to external liquidity if necessary.

Supporting our view of the county's exceptional access to liquidity, the county has issued various types of debt in the past 15 years, including LRBs, commercial paper (CP), assessment debt, and tax and revenue anticipation notes. In

April 2016, the county entered into a direct-purchase revolving credit agreement with Wells Fargo and Los Angeles County Capital Asset Leasing Corp. The county could draw up to \$200 million under the terms of the agreement. There are no acceleration provisions in the agreement, beyond the annual lease payment. The county also has \$181 million of CP outstanding (\$49.7 million for governmental type activities). While the state allows for what we consider permissive investments, the county's own adopted investment policy is more conservative, and its current portfolio consists primarily of investments we consider low risk, such as U.S. Agency securities, certificates of deposit, and CP with an 'A-1' rating.

Very strong debt and contingent liability profile

In our view, Los Angeles County's debt and contingent liability profile is very strong. Total governmental fund debt service is 2.8% of total governmental fund expenditures, and net direct debt is 7.6% of total governmental fund revenue. Overall net debt is low at 2.6% of market value, which is in our view a positive credit factor.

In our opinion, a credit weakness is Los Angeles County's large pension and OPEB obligation. Los Angeles County's combined required pension and actual OPEB contributions totaled \$1.96 billion (including \$72 million beyond the required pay-as-you-go amount to prefund OPEB liabilities), equivalent to 10.4% of adjusted total governmental fund expenditures in 2016. Of that amount, 70% represented required contributions to pension obligations, and 30% represented OPEB payments. The county made its full annual required pension contribution in 2016. The funded ratio of the LACERA is 79.4%.

County employees participate in the Los Angeles County Employees Retirement Assn., a cost-sharing multiemployer plan that includes the county and five other participating agencies, of which the county is by far the largest plan sponsor. We expect retirement liabilities to be a growing cost pressure over the medium term due in large part to low investment returns and more conservative actuarial assumptions; however, we view the current funded ratio, which is calculated as the plan fiduciary net position as a percentage of the total pension liability, as good. Furthermore, we believe management has taken some steps to address the rising cost of retiree benefits, including a multiyear plan addressing the county's OPEB liability, and a 2013 transfer of \$449 million into an irrevocable OPEB trust fund to help pay for future OPEB obligations, which we expect will offset some of the cost pressure associated with funding retiree health care obligations. The current balance of the OPEB trust fund as of March 31, 2017, is \$664 million. As a result of previous negotiations, dependents will no longer be included in retiree health benefits, effective Jan. 1, 2013. The county's required pension contribution is its actuarially determined contribution, based on an actuary study.

Strong institutional framework

The institutional framework score for California counties required to submit a federal single audit is strong.

Outlook

The stable outlook reflects our view that Los Angeles County's budgetary performance and flexibility will likely remain strong as a result of economic stabilization and conservative budgeting. We do not expect to change the ratings in the next two years, given, in part, the county's relationship with the hospital system. Although the hospital system's stability has substantially improved, there remains some uncertainty because we believe hospitals are facing some challenges over the next few years. The county's broad and diverse economy enhances stability.

Upside scenario

Should the county demonstrate sustained strong budgetary performance and greatly increased flexibility, along with substantially improved funded levels for its liabilities, we could raise the ratings.

Downside scenario

Should Los Angeles County's hospital and medical center operations deteriorate or other expenditures rise unexpectedly, such that they weaken the county's budgetary performance and flexibility profiles, we could consider lowering the ratings.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2016 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of June 7, 2017)		
Los Angeles Cnty lease rev bnds (Multiple Capital Projects Ii)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Los Angeles Cnty lse rev bnds (Mlk Hospital Project)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Los Angeles Cnty rfdg COPs (Disney Concert Hall Parking Garage)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Los Angeles Cnty APPROP		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Los Angeles (Los Angeles Cnty) certs of part (Dept of Pub Social Svcs Fac) ser 1999A dtd 08/01/1999 due 08/01/2002-2011 2019 2024 2031		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Los Angeles Cnty Pub Wks Fing Auth, California		
Los Angeles Cnty, California		
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) lse rev rfdg bnds (Master Rfdg Proj) ser 2015C due 06/30/2034		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) (Multi Cap Proj I)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) (Multi Cap Proj I)		
<i>Long Term Rating</i>	AA/Stable	Affirmed
Sonnenblick-Del Rio El Monte Asset Lse Corp, California		
Los Angeles Cnty, California		
Sonnenblick-Del Rio El Monte Asset Lse Corp certs of part (Dept Of Pub Soc Svc Fac) ser 1999 dtd 01/15/1999 due 06/01/2001-2014 2019 2030		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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