S&P Global Ratings

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Summary:

Los Angeles County Facilities, Inc., California
Los Angeles County; Appropriations; General Obligation

Primary Credit Analyst:
Jennifer Hansen, San Francisco (1) 415-371-5035; jen.hansen@spglobal.com

Secondary Contact:
Alyssa B Farrell, Centennial (1) 303-721-4184; alyssa.farrell@spglobal.com

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Credit Profile		
US$297.015 mil lse rev bnds (Los Angeles Cnty) ser 2018A due 06/30/2052		
Long Term Rating	AA/Positive	New
US$5.195 mil lse rev bnds (Los Angeles Cnty) ser 2018B due 06/30/2024		
Long Term Rating	AA/Positive	New
Los Angeles Cnty lease rev bnds (Multiple Capital Projects Ii)		
Long Term Rating	AA/Positive	Outlook Revised
Los Angeles Cnty ICR		
Long Term Rating	AA+/Positive	Outlook Revised

Rationale

S&P Global Ratings revised its outlook to positive from stable on Los Angeles County, Calif.'s issuer credit rating (ICR) and appropriation debt. At the same time, S&P Global Ratings assigned its 'AA' long-term rating to the Los Angeles County Facilities Inc.'s (LACF) lease revenue bonds (LRBs), tax exempt series 2018A (Vermont Corridor County Administration Building), and taxable series 2018B (Vermont Corridor County Administration Building) bonds issued for the county. Finally, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the Los Angeles County Capital Asset Leasing Corp's (LAC-CAL) and the county's appropriation debt outstanding, and its 'AA+' issuer credit rating (ICR).

The outlook revision reflects our view of the county's long-term trend of robust local economic performance from an already strong and very diverse base and an associated strengthening in revenue and tax base that have improved its capacity to meet capital and service priorities. The outlook also reflects our view that effective budgetary discipline since the end of the Great Recession have played a significant role in putting the county on a much stronger financial footing than a decade ago with very strong reserves in the general fund and the Department of Health Services fund. The series 2018A and 2018B LRBs are secured by semiannual lease payments made by the county to the LACF, a California nonprofit public benefit corporation and single-purpose entity. The leased assets are a new office building with approximately 468,000 gross square feet of Class A office with ground floor retail space and public serving uses, with approximately 936 structured parking spaces and a separate 10-story garage structure containing approximately 800 parking spaces. These buildings will serve as the headquarters and office space for the county's Department of Mental Health; office space for the county's Department of Workforce Development, Aging and Community Services; and office space for other county departments, divisions or staff. To mitigate the risk of late completion and abatement of payments, the county has included the following:

- The bonds are structured to include six months of capitalized interested past the expected date of completion.
- The county has contracted with an experienced developer with a history of completing large-scale projects in Southern California.
- The builder will maintain builders risk insurance equal to the full replacement cost of the building, which includes 24 months of "lost income", which would cover debt service in the event casualty delays completion past when county would have started paying rent.

Lease payment are payable from all available funds of the county and are subject to annual appropriation. The county is not funding a debt service reserve for the bonds, however the debt service payment are well after the beginning of the county's fiscal year, mitigating the risk of non-appropriation due to late budget adoption. 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.

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 methodology;
- Strong budgetary performance, with a slight operating surplus in the general fund and an operating surplus at the total governmental fund level in fiscal 2017;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 42.1% of total governmental fund expenditures and 36.0x governmental debt service, and access to external liquidity that we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 1.2% of expenditures and net direct debt that is 7.4% of total governmental fund revenue, as well as low overall net debt at less than 3.0% 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 10.3 million, is located in the Los Angeles-Long Beach-Anaheim, CA MSA, which we consider broad and diverse. The county has a projected per capita effective buying income of 95.3% of the national level and per capita market value of $137,115. Overall, the county's assessed value grew by 6% over the past year to $1.4 trillion in 2018. The county's unemployment rate was 4.7% in 2017.

Los Angeles is the largest county in the nation, by population. Assessed value (AV) has grown since fiscal 2011, with a 6% increase projected for fiscal 2019. The county experienced only a relatively minor dip in AV during the Great Recession, which we consider 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 4.7% after falling from a peak above 10.0% in fiscal 2012. The county's broad and diverse employment base and an estimated

2017 gross domestic product of $670 billion represents nearly one third (28.2%) of the state of California's GDP and is larger than the GDPs of 44 states and all but 21 countries. The county benefits from two major ports: the ports of Los Angeles and Long Beach, which combined are the largest port system in the US. Of concern is the current administration's threat of tariffs and trade wars which could reduce port activity and in turn slow or even reverse the economic growth in the county. The county has a large and growing technology sector known as the Silicon Beach with over 500 tech start-up companies and major employers that include: Google, Yahoo!, YouTube, BuzzFeed, Facebook, Salesforce, AOL, and Electronic Arts. The county also has a very large entertainment industry with major movie studios, television networks, recording studios, video game developers, publishers, and artists.

Very strong management

We view the county's management as very strong, with "strong" financial policies and practices under our Financial Management Assessment 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. It prepares a five-year revenue and expenditure forecast, as well as a seven-year long-term capital plan. The county has adopted a debt management plan, has a written investment policy, and prepares and submits monthly investment performance reports to the county board. While it has set a goal of building 10% of locally generated revenue in a rainy day and economic reserve, officials report that the county is not currently meeting the goal, but continues to transfer a portion of surplus revenue either to the rainy day fund or to pay down its OPEB liability. The county recently passed a new policy to set aside 5%-10% of its discretionary revenue for contingencies.

Strong budgetary performance

Los Angeles County's budgetary performance is strong in our opinion. The county had a slight surplus operating results in the general fund of 0.7% of expenditures, and surplus results across all governmental funds of 3.1% in fiscal 2017. The county's general fund operating results have been stable over the past three years, with a result of 1.2% in 2016 and a result of 1.4% in 2015.

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 revenue supporting the county's expenditure goals mostly growing year over year. Property taxes have experienced strong growth with estimated taxable assessed value (AV) growth of 6.0% in 2019, compared to a budgeted 5.7% budgeted growth. Sales tax-related revenue continues to grow as well, as Proposition 172 sales taxes are budgeted to rise by 2.0%. 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). The fiscal 2019 budget is balanced from a structural standpoint; however, changes to federal healthcare spending could put pressure on operations, given the size of the county's health services department. The 2019 budget does not anticipate a significant increase in net county cost to subsidize the Department of Health Services (DHS), additionally, we believe the likelihood of a significant federal overhaul in the next few years of the Affordable Care Act (ACA) is greatly diminished. While there may be changes which could result in a cut to state and federal support for health services, we believe the changes will likely be smaller and incremental with would give the county time to adjust its budget. This risk is also somewhat mitigated by the county's build-up of reserves in the county health department. Fiscal 2017 reserves totaled $661 million, up from $0 reserves in fiscal 2012. The county is also budgeting to increase those reserves to about $700 million in fiscal 2018. In recent years, the county has taken steps to restructure its health services department from a hospital-based to an integrated ambulatory care system, which we believe could position it better than many to minimize the cost of adapting to changes in health care funding.

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 2017 general fund revenue. The other major revenue stream for the county came from intergovernmental revenue from the federal and state government and 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 available fund balance in fiscal 2017 of 18% of operating expenditures, or $3.0 billion.

For fiscal 2018 year end, county officials project that ending available balances will meet or exceed 2017 levels.. Management continues to work to improve its reserve position and add to its rainy day fund (included with the unassigned fund balance). Further, the county has implemented a policy that an additional 5%-10% of new ongoing discretionary revenue to be set aside annually for contingencies. Should any of these set-asides remain at the end of the year, they will be transferred to the reserves or OPEB trust. 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 42.1% of total governmental fund expenditures and 36.0x governmental debt service in 2017. 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 lease revenue bonds, commercial paper (CP), assessment debt, and tax and revenue anticipation notes. The county is authorized to issue up to $500 million of lease revenue notes to fund it capital plan and currently has has $324.6f million of commercial paper outstanding. 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 commercial paper with an 'A-1' rating.

Strong debt and contingent liability profile

In our view, Los Angeles County's debt and contingent liability profile is strong. Total governmental fund debt service is 1.2% of total governmental fund expenditures, and net direct debt is 7.4% of total governmental fund revenue. Overall net debt is low at 2.5% of market value, which is in our view a positive credit factor.

While the timing and amount is somewhat uncertain, the county plans to issue up to $1 billion in additional debt to finance capital projects for its jail system. Given the county's large size and rapid amortization, we do not expect that this will weaken the debt.

In our opinion, a credit weakness is Los Angeles County's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Los Angeles County's combined required pension and actual OPEB contributions totaled 9.9% of total governmental fund expenditures in 2017. Of that amount, 6.7% represented required contributions to pension obligations, and 3.2% represented OPEB payments. The county made its full annual required pension contribution in 2017. The funded ratio of the largest pension plan is 82.4%. County employees participate in the Los Angeles County Employees Retirement Association, a cost-sharing multi-employer plan that includes six employers, including the county and the Los Angeles Superior Court. 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 percent 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. After recent negotiations about new employees, dependents will no longer be included in retiree health benefits. The county's required pension contribution is its Actuarially Determined Contribution (ADC), 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 positive outlook reflects our view that Los Angeles County's budgetary performance and flexibility will likely remain strong and very strong as a result of economic stabilization and conservative budgeting. We believe there is a one in three chance we could raise the county's rating over the two-year outlook timeframe. The outlook also reflects our view of the stabilization of the county hospital system, which has built up strong reserves and continues to benefit from strong management and the ACA. The county's broad and diverse economy enhances stability.

Although an economic slowdown or downturn could make it more difficult to sustain recent trends that have been positive for credit quality, we anticipate the decisive factor whether to raise the ICR rating to 'AAA' will be our view of the likelihood that the county can sustain long-term structural balance, despite challenges such as rising pension and OPEB costs.

We could revise the outlook to stable if the county's financial performance falters, which could result from a sharp downturn in tax revenues without effective budget-balancing actions.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 26, 2018
- 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
- Local Government Pension And Other Postemployment Benefits Analysis: A Closer Look, Nov.8, 2017

Ratings Detail (As Of July 3, 2018)		
Los Angeles Cnty lse rev bnds (Lac-cal Equipment Program)		
Long Term Rating	AA/Positive	Outlook Revised
Los Angeles Cnty lse rev bnds (Mlk Hospital Project)		
Long Term Rating	AA/Positive	Outlook Revised
Los Angeles Cnty rfdg COPs (Disney Concert Hall Parking Garage)		
Long Term Rating	AA/Positive	Outlook Revised
Los Angeles Cnty APPROP		
Long Term Rating	AA/Positive	Outlook Revised
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		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised
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		
Long Term Rating	AA/Positive	Outlook Revised
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) (Multi Cap Proj I)		
Long Term Rating	AA/Positive	Outlook Revised
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) (Multi Cap Proj I)		
Long Term Rating	AA/Positive	Outlook Revised
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		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.