MOODY'S INVESTORS SERVICE

CREDIT OPINION
31 July 2019

Contacts

Alexandra J. Cimmiyotti +1.415.274.1754
VP-Sr Credit Officer
alexandra.cimmiyotti@moodys.com

Michael Wertz +1.212.553.3830
VP-Senior Analyst
michael.wertz@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Los Angeles County, CA

Update to credit analysis

Summary

Los Angeles County (Aa1, stable) has a massive assessed value that stands at an all-time high at $1.6 trillion in fiscal 2020 as well as a large and diverse economy. The county's sound financial operations are well managed and supported by healthy reserve levels that will continue to be stable given management's prudent fiscal practices. The county's debt burden is modest. Rising pension and OPEB costs will remain budgetary challenges, however county management has taken progressive actions to increase funding for these long-term liabilities.

Credit strengths

» Exceptionally large tax base poised for additional growth

» Large and diverse economy

» Sound financial position supported by healthy reserves and cash

» Strong management team

Credit challenges

» Unfunded pension and Other Post Retirement Benefits (OPEB) liabilities representing long term, but manageable, risks for the county

» Department of Health Services' (DHS) reliance on the county's support for operations, while considerably manageable, could fluctuate given the volatility of the health care industry

» Growing costs for homeless services; recognizing Measure H provides a growing funding source to address this challenge

Rating outlook

The stable outlook reflects the county's large and diverse tax base, which is expected to experience ongoing moderate growth. The outlook is also inclusive of the county's sound financial position with reserves expected to be maintained within current levels.

Factors that could lead to an upgrade

» Strong financial performance that contributes to sustained growth in reserves and cash

» Significantly improved wealth indicators of county residents

» Sizeable decrease in pension and OPEB liabilities

Factors that could lead to a downgrade

» Significant deterioration in the county's financial position

» Inability to effectively manage retirement costs

» Weakened hospital operations that materially increase reliance on the county's general fund

Key indicators

Exhibit

Los Angeles (County of) CA	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$1,085,743,686	$1,146,946,428	$1,218,549,286	$1,287,688,313	$1,366,276,412
Population	10,069,000	10,192,000	10,240,000	10,278,000	10,328,000
Full Value Per Capita	$107,830	$112,534	$118,999	$125,286	$132,289
Median Family Income (% of US Median)	95.2%	95.0%	95.5%	96.4%	96.4%
Finances					
Operating Revenue ($000)	$15,210,968	$15,457,073	$16,192,098	$17,083,590	$17,871,298
Fund Balance ($000)	$2,872,559	$2,948,546	$3,060,999	$3,398,212	$3,706,202
Cash Balance ($000)	$2,020,888	$2,770,039	$3,255,581	$4,208,725	$4,446,230
Fund Balance as a % of Revenues	18.9%	19.1%	18.9%	19.9%	20.7%
Cash Balance as a % of Revenues	13.3%	17.9%	20.1%	24.6%	24.9%
Debt/Pensions					
Net Direct Debt ($000)	$1,585,747	$1,668,075	$1,875,593	$1,802,056	$1,746,547
3-Year Average of Moody's ANPL ($000)	$25,351,862	$27,658,863	$25,984,797	$30,354,366	$34,151,562
Net Direct Debt / Full Value (%)	0.1%	0.1%	0.2%	0.1%	0.1%
Net Direct Debt / Operating Revenues (x)	0.1x	0.1x	0.1x	0.1x	0.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.3%	2.4%	2.1%	2.4%	2.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.7x	1.8x	1.6x	1.8x	1.9x

Source: Moody's Investors Service and Los Angeles County's Audits

Profile

Los Angeles County is the largest county in the nation both by tax base ($1.6 trillion assessed value) and population (10.3 million). The county has a large and diverse economy and the unemployment rate is 4.9%, which is slightly above the state (4.8%) and US (4.4%).

Detailed credit considerations

Taxbase and Economy: massive tax base benefits from large and diverse economy

The county's extremely large assessed value (AV) continues to exhibit strong growth and reached an all-time high of $1.6 trillion in fiscal 2020, which is by far the largest of any county in the nation. We expect healthy AV growth to continue given ongoing residential and commercial development coupled with the mechanics of Prop 13. The county's five year average annual AV growth is strong at 7.1% which significantly exceeds the national median at 1.5%. AV per capita is healthy at $148,132, and as expected with the county's diverse tax base, the 20 largest taxpayers comprise an extremely low 3.0% of total fiscal AV.

The county's growing economy is not only a catalyst for regional economic expansion and job creation but remains an economic engine for the state. The county's economy is larger than 45 states and all but 17 countries. Los Angeles County's Gross Domestic Product (GDP) grew to $807 billion in 2018 from $629 billion in 2016, and represents 27.3% of the state's GDP and 3.9% of the United States' GDP. Los Angeles County's unemployment rate at 4.9% is slightly above the state (4.8%) and U.S. (4.4%) rates and is significantly down from its peak of 12.6% in 2010.

The county's wealth levels continue to approximate nationwide medians. Estimated 2017 median family income is 96.4% of the US and compared to Aa-rated large counties, these levels are relatively low, but satisfactory for the rating given the county's other credit strengths.

Financial Operations and Reserves: healthy financial position will remain stable

We expect the county's trend of strong financial operations to continue, given management's prudent fiscal practices and commitment to maintaining reserves within current levels. In fiscal 2018, the county generated its sixth consecutive general fund surplus, increasing the available general fund balance to $3.7 billion or a strong 19.9% of general fund revenues. Available operating fund balance, which includes the general and debt service funds was also strong at 20.7% of operating revenues. The county's surplus was primarily due to expenditures coming in below budget across several departments. Based on estimated financial results for fiscal 2019, the county's management team expects to generate a surplus and reserves will remain in-line with the prior year. Given management's standing track record of outperforming budget projections, the current estimates are reasonable.

The adopted fiscal 2020 budget includes a modest increase of 1.5% over the prior year's adopted budget and is based on reasonable revenue assumptions. The fiscal 2020 contribution to the county's rainy day fund is $39 million which will bring the balance to $601.9 million (9.4% of ongoing discretionary revenue). The county is on track to reach its 10% target for this reserve in fiscal 2022. In addition, management is committed under its budget policies to fund ongoing costs with ongoing revenues, to not backfill cuts for programs funded by the State or Federal government and to continue its practice of funding reserves for its unfunded liabilities. These practices support our expectation of continued stable financial operations.

One of the county's major expense items involves healthcare for the county's indigent population, provided through its Department of Health Services (DHS). DHS is heavily reliant on its operating subsidy, which comprises roughly one- third of total DHS revenues. Positively, DHS has recently become less reliant on county general fund support for operations. The county's general fund fiscal 2020 contribution is $346.3 million, which is slightly up from the prior year at $342.9 million yet just 1.3% of 2020 county general fund revenues. The DHS working capital loan balance owed to the county increased to $456.3 million in fiscal 2019 from $109.6 million, which is largely due to an advance caused by a two-year delay in the Centers for Medicaid and Medicare Services approval for key components of new revenue programs. Operations remain stable at DHS and management projects fund balance to be $1.1 billion of which $527.0 million is booked as a receivable expected to be received in September 2020. DHS has benefited from the Affordable Care Act as well as management's strong internal controls and commitment to maximize efficiencies.

LIQUIDITY

Similar to the county's reserve position, we expect liquidity to remain healthy. The county's fiscal 2018 operating cash balance was $4.4 billion or a strong 24.9% of operating revenues.

Debt and Pensions: low debt burden; moderate pension burden

Including the county's upcoming bond offering (Lease Revenue Bonds 2019 Series E-1&E-2), the county's net direct burden remains low at 0.2% of AV. The above-average overall debt burden of 2.7% of AV, compared to the nationwide median of 1.9% AV for Aa1 counties, reflects the large amount of debt of the overlapping jurisdictions, mainly Los Angeles Unified School district. We expect that the county's debt burden will remain modest given our expectation that the county's AV will continue to moderately grow in the medium term.

DEBT STRUCTURE

The county's outstanding long-term debt consists of approximately $1.7 billion in lease revenue bonds and certificates of participation.

DEBT-RELTED DERIVATIVES

The county does not have any debt-related derivatives.

PENSIONS AND OPEB

The county provides pension benefits for employees that is administered by the Los Angeles County Employees Retirement Association. Its adjusted net pension liability, based on a 3.87% discount rate, was $37.5 billion in fiscal 2018. In comparison, the county reported a GASB net pension liability of $8.9 billion, based on a 7.38% discount rate. While pension costs will continue to increase and remain a budgetary pressure, the county is well positioned to address this challenge given its sound financial position.

Management created an OPEB trust in 2012, and the fair market value of assets is approximately $1.1 billion (as of March 31,2019). The county's adjusted net OPEB liability is $24.4 billion in fiscal 2018 or an elevated 1.36 times operating revenues. The Board of Supervisors adopted a funding plan commencing in fiscal 2016 that would enable the county to fully fund its annual contribution

($2.7 billion) by fiscal 2028. The county remains on target in meeting this goal and the fiscal 2020 budget includes a $246.2 million appropriation in addition to its pay-go contribution for OPEB.

The county's fixed costs, including debt service, pension and OPEB contributions, amounted to 11% of total operating revenues, which is manageable in relation to the county's overall operations.

Management and Governance

INSTITUTIONAL FRAMEWORK

California counties have an Institutional Framework score of “A”, or moderate. California counties' major revenue sources are determined by the state government or, for the most part, can only be raised with voter approval. Ad valorem property tax rates cannot be increased above 1% except to meet GO bond payments, and assessed valuation growth is also generally limited to 2% annually unless a property changes ownership. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5% and 10% annually.

OPERATING HISTORY

The county's five-year operating ratio is 1.0 times, indicative of management's conservative budgeting practices and strong financial policies.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

Los Angeles (County of) CA

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$1,456,853,756	Aaa
Full Value Per Capita	$141,059	Aa
Median Family Income (% of US Median)	96.4%	Aa
Notching Factors:[2]		
Institutional Presence		Up
Other Analyst Adjustment to Economy/Taxbase Factor: Large and diverse economy; 27.3% of CA's GDP		Up
Finances (30%)		
Fund Balance as a % of Revenues	20.7%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	5.9%	A
Cash Balance as a % of Revenues	24.9%	Aa
5-Year Dollar Change in Cash Balance as % of Revenues	15.2%	Aa
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.2%	Aaa
Net Direct Debt / Operating Revenues (x)	0.1x	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.3%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.9x	A
Notching Factors:[2]		
Standardized Adjustments [3]: Unusually strong or weak security features: Secured by statute		Up
Other		
Credit Event/Trend Not Yet Reflected in Existing Data Sets: Elevated unfunded OPEB liability		Down
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[1] Economy measures are based on data from the most recent year available
[2] Notching factors are specifically defined in the US Local Government General Obligation Debt methodology dated December 16, 2016
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2019 publication
Source: US Census Bureau and Moody's Investors Service

REPORT NUMBER 1187977

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Asia Pacific	852-3551-3077
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