S&P Global
Ratings

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Summary:

Los Angeles County, California; Appropriations; General Obligation

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Credit Profile		
US$226.545 mil lse rev bnds ser 2019 E-1 due 12/01/2049		
Long Term Rating	AA+/Stable	New
US$33.285 mil lse rev bnds ser 2019 E-2 due 12/01/2049		
Long Term Rating	AA+/Stable	New
Los Angeles Cnty lse rev bnds (Lac-cal Equipment Program)		
Long Term Rating	AA+/Stable	Upgraded
Los Angeles Cnty ICR		
Long Term Rating	AAA/Stable	Upgraded
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+/Stable	Upgraded

Rationale

S&P Global Ratings raised its rating to 'AAA' from 'AA+' on Los Angeles County, Calif.'s issuer credit rating (ICR). At the same time, S&P Global Ratings raised its long-term and underlying rating (SPUR) to 'AA+' from 'AA' on the Los Angeles County Capital Asset Leasing Corp.'s (LACCAL) and the county's appropriation debt outstanding. In addition, S&P Global Ratings assigned its 'AA+' long-term rating to the Los Angeles County Public Works Financing Authority's (LACPWFA) 2019 series E-1 and 2019 series E-2 lease revenue bonds (LRBs), issued for the county. The outlook on all ratings is stable.

The upgrades reflect our view of the county's long-term trend of robust local economic performance from an already strong and very diverse tax base and an associated strengthening in revenue and tax base that have improved its capacity to meet capital and service priorities. The county has grown and maintained very strong reserves in both the general fund and the Department of Health Services (DHS) fund. Historically, the DHS fund has not maintained any of its own fund balances and has been a large general fund budgetary expense. The county expects to end 2019 with a $1.1 billion fund balance or more than 25% of revenues in the DHS fund, up from nothing in it seven years ago. The general fund continues to support the department, stabilizing at around $346.3 million in recent years, which the county considers manageable. In addition, while the trade war with China is a concern--with the county being home to the largest port system in the U.S. (Los Angeles/Long Beach)--the diverse economic base limits the downside potential. The rating also reflects our view that effective budgetary discipline with very strong management policies and practices since the end of the Great Recession have played a significant role in putting the county on a much stronger financial footing. Finally, while the county has a large pension and other postemployment benefits (OPEB) liability, we believe that the county will continue to manage its pension and OPEB obligations and maintain balanced operations.

The 2019 series E-1 and E-2 LRBs are secured by semiannual lease payments made by the county to the LACPWFA, a California joint powers authority. The leased assets are sufficient to support the issuance of the 2019 series E-1 and E-2 bonds and the previously issued bonds under the same master lease. 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 payments are well after the beginning of the county's fiscal year, mitigating the risk of nonappropriation 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 rental 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 (FMA) 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 2018;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2018 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash at 42.8% of total governmental fund expenditures and 43.7x governmental debt service, and access to external liquidity that we consider exceptional;
- Strong debt and contingent liability profile, with debt service carrying charges at less than 1.0% of expenditures and net direct debt that is 9.3% 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 OPEB obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Strong economy

We consider the county's economy strong. With an estimated population of 10.2 million, Los Angeles County is 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 96.5% of the national level and per capita market value of $150,245. Overall, the county's market value grew 6.6% over the past year to $1.5 trillion in 2019. The county unemployment rate was 4.7% in 2018.

Los Angeles is the largest county in the U.S., by population. Assessed value (AV) has grown since fiscal 2011, with a 6.3% increase projected for fiscal 2020. The county experienced only a relatively minor dip in AV during the most recent recession: a reflection of its large and mature property tax base coupled with Proposition 13 limitations on AV growth.

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 of more than 10.0% in fiscal 2012. The county benefits from two major ports--Los Angeles and Long Beach, with a broad and diverse employment base and an estimated 2017 GDP of $670 billion. This represents 28.2% of California's GDP and is larger than that of 45 states and all but 17 countries.

Similar to other large coastal areas of California, the county's housing prices and lack of affordable housing is a continuous concern. There are some indications that the housing market, while not retracting, growth is slowing. Management indicates that some slowdown may be beneficial to the county as more residents are able to purchase homes, additionally, a large number of homes are assessed under 1975 valuations due to Prop 13; any turnover will be beneficial to county revenue.

The county has a large and growing technology sector known as the Silicon Beach, with more than 500 technology startup companies and major employers such as 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 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 revenue 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 and a written investment policy and prepares monthly investment performance reports that it submits to the county board. While it has set a goal of building 10% of locally generated revenues 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. Management has a policy to set aside 5%-10% of its discretionary revenue for contingencies, and has set aside about 10% for the past several years.

Strong budgetary performance

Los Angeles County's budgetary performance is strong, in our opinion. The county had slight surplus operating results in the general fund of 1.3% of expenditures, and surplus results across all governmental funds of 2.6% in fiscal 2018. General fund operating results of the county have been stable over the past three years, with a result of 1.5% in 2017 and of 1.2% in 2016.

Management reports fiscal 2019 was operationally balanced, with another increase to its rainy day fund. The fund grew to $525 million from $448 million--the fifth-consecutive year of growth. Management budgets tend to be conservative, underestimating tax growth and overestimating expenditures. The fiscal 2020 budget is also structurally balanced. The budget includes a $586 million or 1.5% increase over the 2019 adopted budget. The fiscal 2020 budget projects 5.7% AV growth, less than the actual 6.3% growth. In addition, the budget includes a 2.0% growth in sales tax revenue. The county has also settled with 58 of its 62 unions and salary and benefit increases are included in the balanced 2020 budget.

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 tax has experienced strong growth, with taxable AV growth of 6.3% in 2019, compared with 5.7% budgeted growth. Sales-tax-related revenue continues to improve as well, Prop 172 sales taxes are budgeted to increase 2.0%. County officials focus on balancing ongoing revenue with ongoing expenditures, and in 2017 received voter approval for a 10-year, 25-cent dedicated sales tax to fund homelessness initiatives. The county expects this tax to bring in approximately $424 million in fiscal 2020.

The fiscal 2020 budget is balanced from a structural standpoint, however, changes to federal health care spending could negatively pressure operations, given the size of the county's health services department. The 2020 budget does not anticipate an increase in net county cost to subsidize the DHS fund, however, a significant federal overhaul in the next few years of the Affordable Care Act (ACA) could result in a cut to state and federal support for health services, which would be a challenge for the county. Since the advent of ACA, uninsured inpatient visitors fell to 7%, in 2018, from 25% prior to the implementation of ACA. This risk is somewhat mitigated, however, by the county's buildup of reserves in the DHS fund. Fiscal 2019 health department reserves are projected to reach $1.1 billion, up from no reserves in fiscal 2012. The county is budgeting to maintain those reserves in fiscal 2020. In recent years, management has restructured DHS from a hospital-based to an integrated ambulatory care system, which we believe could position the county better than many to minimize the cost of adapting to changes in health care funding. Management reports that these changes have resulted in 30 fewer inpatient visits, 30 fewer emergency visits, and 220 more outpatient visits per 1,000 cases managed, which significantly reduces costs per case.

General fund and governmental fund revenue and expenditures were adjusted to account for recurring transfers to and from the county's hospital funds. In addition, the general fund expenditures were adjusted to account for recurring transfers to the library and various debt service funds. Taxes (primarily property taxes) represent 32% of the audited fiscal 2018 general fund revenue. The county's other major revenue streams were intergovernmental revenue from the federal government (22%) and state government (33%). Charges for services represented another 10%. Other smaller revenue sources included 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 2018 of 17% of operating expenditures, or $3.1 billion. Over the past three years, the total available fund balance has remained at a consistent level overall, totaling 18% of expenditures in 2017 and 16% in 2016.

In fiscal 2018, reserve levels exceeded $3 billion. For fiscal year-end 2019, county officials project that ending available balances will exceed that level. Management continues to improve its reserve position and add to its rainy day fund (included with the unassigned fund balance).

Furthermore, the county has implemented an additional 5%-10% of new ongoing discretionary revenue to be set aside annually for contingencies. Should any of these setasides 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 42.8% of total governmental fund expenditures and 43.7x governmental debt service in 2018. In our view, the county has exceptional access to external liquidity if necessary.

Supporting our view of the county's exceptional access to liquidity, is the fact that 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 2019, the county restructured the LACCAL Lease Revenue Note Program, which consists of four separate bank letter of credit and reimbursement agreements authorizing the issuance of separate series of notes by each bank up to a maximum aggregate principal amount of $600 million.. The county also has $562.3million of CP 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 that we consider low risk, such as U.S. Agency securities, certificates of deposit, and CP 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 less than 1.0% of total governmental fund expenditures, and net direct debt is 9.3% 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 $2 billion in additional debt to finance capital projects including a new consolidated correctional treatment facility for its jail system, a new Harbor-UCLA Medical Center tower and the Los Angeles County Museum. Given the county's large size and rapid amortization, we do not expect that this will weaken its debt metrics.

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 10.1% of total governmental fund expenditures in 2018. Of that amount, 7.1% represented required contributions to pension obligations, and 3.0% represented OPEB payments. The county made its full annual required pension contribution in 2018. The funded ratio of the largest pension plan is 80.6%.

County employees participate in the Los Angeles County Employees Retirement Association, a cost-sharing multiple-employer plan that includes six employers, including the county and the Los Angeles Superior Court. The Governmental Accounting Standards Board funded ratio is 80.6%, which we consider adequate, and is based on a discount rate of 7.38%, which is higher than the 7.25% national average.

We expect retirement liabilities to be a growing cost pressure due largely to a high discount rate, which puts pressure on investment returns to reduce annual contributions and could add volatility and budgetary strain. The county's actuarially determined contribution (ADC) is based on a 30-year, layered, level 3.25% of payroll amortization method, which we consider very aggressive. This method creates negative amortization, which means unfunded liabilities will likely grow in the near-to-medium term before large deferred contributions begin to pay it down.

We believe management is addressing the rising cost of retiree benefits. The county has been prefunding an OPEB trust for the past five years, but not at full ADC levels. The plan is under 5% funded and the county expects to fully fund its OPEB ADC by 2027-28, which should increase funding over time. Until the ADC is funded, costs will continue to be deferred. Management has a multiyear plan to address the county's OPEB unfunded liability, including nominal ad hoc contributions in the past as well as liability management. After negotiations regarding new employees in 2018, dependents will no longer be included in retiree health benefits, which should reduce costs significantly, although affordability is still questionable given the continuing rapid increase to health care costs.

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 rating in the next two years, given, in part, the county's improving hospital performance and fund balances. We believe the county's broad and diverse economy enhances stability.

Downside scenario

Should the county's operations deteriorate, with a weakening of both budgetary performance and flexibility, we could lower the rating. We could also lower the rating if the county's hospital and medical center operations deteriorate, weakening general fund performance. Pension and OPEB increases without corresponding increases in revenues or expenditure reductions could also pressure the rating.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 24, 2018
- 213. SeismiCat Earthquake Model, May 4, 2018
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria
- 2018 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of July 31, 2019)		
Los Angeles Cnty lease rev bnds (Multiple Capital Projects Ii)		
Long Term Rating	AA+/Stable	Upgraded
Los Angeles Cnty lse rev bnds (Mlk Hospital Project)		
Long Term Rating	AA+/Stable	Upgraded

Ratings Detail (As Of July 31, 2019) (cont.)		
Los Angeles Cnty rfdg COPs (Disney Concert Hall Parking Garage)		
Long Term Rating	AA+/Stable	Upgraded
Los Angeles Cnty APPROP		
Long Term Rating	AA+/Stable	Upgraded
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)/Stable	Upgraded
Los Angeles Cnty Facs Inc, California		
Los Angeles Cnty, California		
Los Angeles Cnty Facs Inc (Los Angeles Cnty) lse rev bnds		
Long Term Rating	AA+/Stable	Upgraded
Los Angeles Cnty Facs Inc (Los Angeles Cnty) lse rev bnds (Los Angeles Cnty) ser 2018A due 06/30/2052		
Long Term Rating	AA+/Stable	Upgraded
Los Angeles Cnty Pub Wks Fing Auth, California		
Los Angeles Cnty, California		
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) (Multi Cap Proj I)		
Long Term Rating	AA+/Stable	Upgraded
Los Angeles Cnty Pub Wks Fing Auth (Los Angeles Cnty) (Multi Cap Proj I)		
Long Term Rating	AA+/Stable	Upgraded
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)/Stable	Upgraded

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.