FitchRatings

FITCH RATES LOS ANGELES COUNTY, CA NOTES 'F1+'; AFFIRMS OUTSTANDING RATINGS & STABLE OUTLOOK

Fitch Ratings-San Francisco-31 May 2013: Fitch Ratings has assigned the following rating to Los Angeles County, California tax and revenue anticipation notes (TRANs):

--$1 billion 2013-14 TRANs, series A and B at 'F1+'.

The notes will be sold via negotiation on June 4, 2013. There are two tranches of notes due on Feb. 28, 2014 ($300 million) and June 30, 2014 ($700 million) respectively.

Fitch has also affirmed the following outstanding ratings:

--Implied unlimited tax general obligation (ULTGO) bond rating at 'AA-';

--$74.5 million county certificates of participation (COPs), series 1993 Disney Parking Project and 2012 refunding COPs (Disney Concert Hall Parking Garage) at 'A+';

--$40.9 million Los Angeles County Capital Asset Leasing Corporation lease revenue bonds (LAC-CAL Equipment Program), series 2009A and 2011A at 'A+';

--$1.158 billion Los Angeles County Public Works Financing Authority lease revenue bonds, series 2005 (Calabasas Landfill Project), lease revenue bonds (multiple capital projects), 2010 series A (tax-exempt) and series B (Build America Bonds), and lease revenue bonds (multiple capital projects II), series 2012 at 'A+'.

The Rating Outlook is Stable.

SECURITY

The notes are general obligations of the county, secured by unrestricted general fund revenue attributable to fiscal 2014, including requirements to set aside the first such funds received during specified time periods for note repayment.

The county's outstanding lease revenue bonds and COPs are secured by the county's lease payments, payable from legally available funds, subject to annual appropriation and abatement.

KEY RATING DRIVERS

IMPLIED ULTGO RATING: The 'AA-' rating reflects the county's diverse and mature economy, sound financial reserves, prudent management efforts to achieve fiscal balance, and moderate debt burden balanced by ongoing and sizable financial pressures.

STRONG SHORT-TERM DEBT COVERAGE: The combination of pledged revenues and court-verified borrowable resources provide very strong note principal and interest coverage. Full note principal and interest set-asides occur well in advance of note maturity.

LOCAL ECONOMIC STRENGTH: The diversity and maturity of the county's vast economy and tax base help offset its evident cyclical vulnerability. Improving economic indicators, particularly related to the county's tax base and revenue streams, help offset the persistently high unemployment rate.

SOLID FINANCIAL MANAGEMENT: Financial operations are well managed with strong general fund balances and significant reserves. The county is working hard to take advantage of health care reform to strengthen the Department of Health Services' (DHS) financial position. However, finances remain vulnerable to state funding changes and heavy social service expenditures.

SIGNIFICANT PENSION AND BENEFITS OBLIGATIONS: While the county has a moderate overall debt burden, it also has heavy investment losses to absorb in its pension system, a costly retiree medical program, and a large other-post employment benefits (OPEB) unfunded accrued actuarial liability (UAAL).

LEASE RATINGS: The one-notch rating distinction between the county's implied ULTGO rating and the majority of its COPs and lease revenue bonds represents the county's covenant to budget and appropriate for lease payments.

RATING SENSITIVITIES

The rating is sensitive to shifts in fundamental credit characteristics including the county's strong financial management practices. The Stable Outlook reflects Fitch's expectation that such shifts are unlikely.

CREDIT PROFILE

STRONG NOTE REPAYMENT STRUCTURE
Fitch's 'F1+' rating reflects the sound note repayment structure, strong coverage of all note repayment set-asides when borrowable funds are included, and the large size of the borrowable resources relative to the set-aside amounts. The repayment deposit structure sets aside 100% of principal and interest well in advance of both note maturities.

The notes are secured by a first lien on unrestricted revenue received between December 2013 and April 2014 (projected $4.3 billion), which is estimated to cover note principal and interest 4.3x. Funds for repayment will be set aside based on an aggressive schedule beginning in December 2013 at which time 100% of the estimated interest ($20 million) will also be set-aside. By February 2014, 75% of the estimated principal will be set aside; the full amount will be set aside by April 2014. The projected cash flow covers all five set-asides well when the county's vast borrowable resources are included.

Fitch notes that fiscal 2014's projected cash flow shows four of the five note set-asides occurring in months with negative net ending balances, compared to only one in fiscal 2013. During those four months, note set-aside coverage falls below 1.0x based solely on the monthly net ending balances. However, factoring in available borrowable resources, coverage during the five months is very strong at 11.8x-32.2x. Coverage holds up well to severe stress scenarios of 10% reductions in revenues without offsetting expenditure reductions (7.4x-15.4x coverage including borrowables) and 10% increased expenditures without compensatory revenue increases (5x-14.9x coverage including borrowables).

The county's pool of resources available for interfund loans remains ample (between $2 billion and $5.3 billion on a monthly basis during December 2013 to April 2014). Fitch notes that the county has a long history of outperforming its initial cash flow projections, and that about one-third of the borrowable cash is later allocated to the general fund.

STRONG GENERAL FUND RESULTS DESPITE BUDGETARY PRESSURES
The 'F1+' rating also incorporates the county's long-term credit quality. The implied long-term ULTGO rating of 'AA-' reflects the county's diverse and mature economy, low direct debt burden, sound financial reserves, and prudent management efforts to achieve fiscal balance amid ongoing and sizable financial pressures. These pressures stem from a heavy social service spending burden, ongoing state funding uncertainty, the historic fiscal imbalance in the county's DHS, a large unfunded pension liability, and a costly retiree medical program.

Nonetheless, the county's reserve levels remain above average, providing a needed financial cushion. Key general fund revenues are improving, as are overall financial results. Favorably, DHS pressures are being partially alleviated by the extension of the federal section 1115 waiver through

Oct. 31, 2015. The waiver has facilitated increased enrolment of newly eligible Medi-Cal patients under health care reform which is improving DHS's payor mix.

DHS ended fiscal 2012 with a $27.6 million surplus and is projecting to end fiscal 2013 with a $21.5 million surplus. DHS' fiscal 2014 budget was balanced with no revenue or appropriation placeholders. As DHS's financial position has improved, county hospital loan balances have been declining, from $1 billion in fiscal 2011 to $770 million in fiscal 2013 and a projected $670 million in fiscal 2014.

General fund operations are generally balanced, but significant transfers out for DHS support have contributed significantly to net operating deficits after transfers in each of the last four fiscal years. The fiscal 2012 unrestricted general fund balance decreased slightly to $2.33 billion (a still high 16.2% of spending) from $2.43 billion (17% of spending) the year prior. Fiscal 2013 is expected to end with a comparable unrestricted general fund balance.

For the first time in five years, the county did not have to close a budget gap for its fiscal 2014 recommended budget and is not planning major spending cuts. The county is projecting increases in its property tax (2.9%) and sales tax (4.1%) revenues. However, these increases will be offset to some degree by increasing wage and benefit cost pressures.

The county increased its two main reserves by $10 million each in fiscal 2013. The rainy day reserve fund is now $103.3 million and the provisional financing uses economic reserve fund is now $94 million. Fitch expects the county to meet its plan to increase these formal reserves as the economy and budget situation improves.

SIGNIFICANT LONG-TERM LIABILITY EXPOSURE

The county's overall debt burden is a moderate $3,729 per capita and 3.4% of market valuation. Principal and interest amortization is average at approximately 46% in 10 years.

The county faces sizeable long-term liabilities in terms of its unfunded pension and OPEB liabilities. As of June 30, 2012, the county's pension UAAL was $11.8 billion (31% of market value), up a sharp 25.2% from the year prior as heavy investment losses were smoothed in and actuarial assumptions were changed. A further $1.6 billion of net deferred investment losses are being smoothed in over fiscal years 2013-2016. Despite the size of the fiscal 2012 UAAL, the funded ratio remained good at 76.8% (using the county's 7.6% assumed rate of return). Fitch estimates the funded ratio at 71.3% when adjusted to reflect a more conservative 7% rate of return. There has been significant deterioration since fiscal 2007 when the UAAL was $2.5 billion with a 93.8% funded ratio (using an assumed 7.75% rate of return).

The county's cash contributions to the pension system, which are equal to the annually required contribution (ARC), continue to grow, to a projected $1.3 billion in fiscal 2014 from $863.6 million in fiscal 2007. Fitch considers the ongoing increase to be manageable. No new cost containment initiatives are being discussed for the county's pension system as the county considers the pension benefits currently offered to be conservative.

The county also has a $27 billion UAAL for OPEB, which it has begun to address by establishing an OPEB trust which funds approximately 1.7% of the liability. The county aims to increase its OPEB trust funding from future surplus revenues. Fitch views the OPEB funding effort as important for the county's long-term fiscal stability but recognizes the county has a funding challenge as the county's annually required OPEB contribution of $2.1 billion in fiscal 2013 was 4.8 times its budgeted pay-as-you-go expense that year ($440.6 million). The board of supervisors is currently considering OPEB reform measures to constrain future OPEB liability growth.

The combined carrying costs for debt service, pension ARC, and OPEB pay-go in fiscal 2012 were manageable at 8.7% of total governmental funds spending less capital.

CONTINUED HIGH UNEMPLOYMENT, BUT TAX BASE STABILIZING

Economic indicators show the recession's impact on the county, particularly the still high unemployment rate of 10.3% in February 2013 (down from 11.6% a year prior). The county's socioeconomic characteristics are below-average relative to the state and on par with the nation.

Due to the county's highly developed and mature nature, taxable assessed valuation (TAV) losses were relatively low at 0.5% and 1.9% decreases in fiscal years 2010 and 2011 respectively, indicating a significant Proposition 13 cushion. Since then, the property market has rebounded with 1.4% and 2.2% TAV increases in fiscal years 2012 and 2013, and an estimated 4.2% TAV increase in fiscal 2014.

In a statement issued on May 28, 2013 ("US Residential Recovery Too Fast in Some Local Economies"), Fitch noted that housing prices in the Los Angeles MSA rose more than 10% in the past year despite the stubbornly high unemployment rate and real income declines over the past two years. While Fitch considers this level of growth to be unsustainable, it also notes that housing prices' impact on TAV is affected by many variables including the number of houses sold and their prior Proposition 13 and 8 valuations. Further, there is typically at least a year's lag between price increases and their impact on the tax rolls.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, and National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
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