

Fitch Rates Riverside County (CA) Teeter Notes 'F1+'

Written by Australian Business

SAN FRANCISCO--([BUSINESS WIRE](#))--Fitch Ratings has assigned an 'F1+' rating to the following Riverside County California (the county) Teeter obligation notes (TONs):

--\$118.4 million TONs series D (tax-exempt);

--\$1.6 million TONs series E (taxable).

The TONs will sell via negotiated sale on Oct. 2. Proceeds will refund a portion of the county's outstanding 2012 TONs and fund an advance of delinquent property taxes to local taxing agencies.

SECURITY

The notes are secured by delinquent property taxes and proceeds of sales of tax-defaulted properties, and have been legally validated as a binding obligation of the county. They are additionally secured by any lawfully available moneys from the county's general fund.

KEY RATING DRIVERS

SOUND NOTE STRUCTURE: The 'F1+' short-term rating reflects the county's long-term general credit quality correlating to the pension obligation bond (POB) rating and the notes' sound security structure. The notes are supported both by pledged property tax delinquencies and the county's general fund. In addition, the county retains the option of refinancing the notes through the county investment pool if necessary.

OPERATIONS BALANCED BUT VULNERABLE: The county's financial operations are estimated to produce a small surplus in fiscal 2013 and the recommended budget for fiscal

2014 is structurally balanced. However, out-year operations will be pressured by a multi-year negotiated wage hike, recent public safety service enhancements, and a correctional facility opening scheduled in fiscal 2017.

COUNTY HOSPITAL CONCERNS: The county's hospital enterprise is facing a significant structural deficit that may drain the enterprise's limited cash resources and necessitate internal cash flow borrowing. However, management is working to reduce the deficit and a recent consultant report suggests the enterprise may turn cash flow positive in 12 to 18 months if recommended reforms are implemented.

DIVERSE ECONOMY IN RECOVERY: The county's economy is large, diverse, and well-situated for growth given its proximity to the Los Angeles and Orange County employment regions with competitive home prices and ample developable land. The housing-led recession severely affected the region, but recent data concerning housing, employment, and sales tax revenues suggest the economy is continuing to recover at a moderate pace.

SATISFACTORY DEBT PROFILE: The county's pension plans are adequately funded, the other post-employment benefit (OPEB) obligation is minimal, debt amortization is moderate, and carrying costs are low. However, debt levels are moderate to high and adequate pension levels are the result of recent years' POB issuances.

RATING SENSITIVITIES

STRUCTURAL BALANCE: The ratings reflect Fitch's expectation that the county will structurally balance out-year general fund operations despite numerous expenditure challenges noted below. However, an inability to maintain fiscal balance, leading to an actual or likely drawdown of fund balance to low levels, would result in a downgrade. Fitch specifically will focus on the county's ability to deal with rising labor and service provision costs, as well as the hospital enterprise's challenged financial operations.

CREDIT PROFILE

SOUND NOTE STRUCTURE

The Teeter plan is an alternate procedure for collection of property taxes authorized under state code and practiced by most California counties. Under the Teeter plan counties advance the full property tax levy to taxing jurisdictions, while retaining penalties and interest for themselves as taxes are paid, either by property owners or through sales of tax-defaulted properties. Substantial interest and penalty rates on delinquent taxes ensure that counties benefit from this program. The county reported that the Teeter program provided 6% of discretionary general fund revenues in fiscal 2013.

The 'F1+' short-term rating is based on Fitch's view of the county's general credit quality, as reflected in its outstanding 'A+' POB and standard lease backed ratings.

The notes are supported both by pledged delinquent property taxes and the county's general fund. Note proceeds will finance \$44.3 million in current year tax delinquencies and \$75.2 million in outstanding Teeter obligations. The notes are expected to be repaid from delinquent tax collections, with any balance remaining after the October 2014 maturity financed from the issuance of notes in fiscal 2015. In addition, the county retains the option of refinancing the notes through the county treasurer's investment pool (Fitch rating of 'AAA/V1'), if necessary.

MIXED ECONOMIC CONDITIONS; LONG-TERM GROWTH POTENTIAL

The populous western portion of the county is within commuting distance to the large economic centers of Los Angeles and Orange counties. Prior to the housing-led recession, population growth was very high, growing from 1.5 million in 2000 to 2.1 million in 2007 and slowing considerably thereafter.

The county's economy is large, diversified, and well-situated for long-term growth. However, the county continues to report below-average income levels, a distressed housing market that has only recently shown signs of recovery leaving a tax base that has contracted significantly since its peak.

County per capita income levels lag the state and nation at 83% and 88% of their averages, respectively. Household income levels are higher, reflective of larger household sizes, and poverty rates are moderate.

The county's housing market was one of the worst-affected in the nation, with average home values falling 55% from their \$433,000 peak in 2006 to a trough value of \$196,600 in 2012, according to Zillow. These severe price declines caused a cumulative multi-year property tax base contraction of 15.7% from fiscal years 2009-2013. Recently the housing market has posted solid price gains and 2014 assessed value (AV) increased 3.95%.

Pre-recession growth was spurred by the area's housing affordability, ample developable land, proximity to other employment centers, and location along a major distribution route. As the economy and housing market continue to recover, Fitch believes these attributes will continue to drive population growth going forward, though not to the extent of pre-recession years.

EMPLOYMENT CONTINUING TO RECOVER FROM HOUSING-LED RECESSION

The local economy is in its fourth year of employment recovery following severe jobs losses in 2008 and 2009. A substantial amount of job losses occurred in the construction industry, which continued to contract year-over-year through July 2013 despite an uptick in the state's construction industry. Gains in other employment sectors lowered unemployment to a still high 11.1% from 13.3% over the same period. Total employment increased 1.4% to 829,602, a level nearly equal to the county's 2006 employment base.

Sales tax revenues derive from a large and diverse base and are in their third year of improvement. The recession caused a severe cumulative decline of roughly 25% from 2006-2009, but revenues have increased in each year since hitting bottom. The recovering economy and recently positive trends in the housing market, if sustained, could bode well for sales tax revenues moving forward. The county conservatively budgeted for \$21 million of sales tax revenues in fiscal 2013, but the county is now estimating receipts at a much higher \$29.7 million, representing 1.3% of audited fiscal 2012 general fund revenues.

FINANCIAL OPERATIONS RETURN TO BALANCE

The county's revenue base suffered over the recession, with fiscal 2012 audited revenues about 6% below their fiscal 2008 peak, and while spending was cut the county ran sizeable operating deficits (after transfers) for several years. Nonetheless, the county expects general fund operations for fiscal 2013 to produce a small surplus, raising the total balance to an adequate level of \$347 million (13.8 % of estimated disbursements). Positive fiscal 2013 performance appears reasonable given years of cost-cutting, including hiring freezes, furlough days, early retirements, attrition, and layoffs.

The fiscal 2014 recommended budget is structurally balanced, but includes a manageable \$14 million draw-down of unrestricted fund balance for a one-time expense. Fitch notes, however, that the county has tended to budget conservatively and, based on historical experience, may outperform its budgeted draw-down.

BUDGETARY VULNERABILITIES REMAIN DESPITE RECENT BALANCE

Fitch believes the county's structural balance is vulnerable to four main challenges moving forward. First, the county agreed to a multi-year cumulative 8% wage increase as part of a broader pension reform measure that requires employees to pay their portion of pension contributions, formerly funded by the county, and implemented a two-tier pension system. The pension savings are projected to be significant but will accrue over a longer time horizon, whereas the wage increases will be acute and will phase in over four to five years.

Second, the board of supervisors recently enhanced public safety programs by \$40 million. Fitch is concerned that several years of cut-backs could lead to similar pressures for further service provision enhancements moving forward. Fitch acknowledges, however, the difficult cuts made to date to eliminate the county's structural deficit and the intent of management and policymakers to maintain its fragile fiscal balance. As a result, Fitch believes that the county will find offsetting departmental and other expenditure reductions, as necessary, to offset the costs of future potential service enhancements and wage increases.

Third, the county's exposure to underperforming hospital operations is growing. In May the county estimated its hospital enterprise fund would begin fiscal 2014 with a \$52 million structural deficit and management estimates the hospital ended fiscal 2013 with negative \$21 million of operating cash. The system's total cash position is positive with consideration of non-operating cash resources. The board authorized up to \$80 million of cash flow borrowing from the worker's compensation fund, if needed. The fiscal 2014 recommended budget includes a \$15 million hospital subsidy (0.7% of fiscal 2012 audited general fund spending) from the general fund, unchanged from the year prior.

Management recently received a report from a hospital consultancy that recommends numerous steps to improve financial operations. If implemented as proposed, the consultants expect the hospital to return to structural surplus within 12 to 18 months. Fitch views the existence of such a plan as a positive, but will not factor positive effects into the credit rating until evidence of a sustained operational recovery. Nevertheless, the enterprise has enjoyed significant historical success in closing prior year deficits, which Fitch believes bodes well for future financial improvements.

The hospital is ultimately back-stopped by the county's general fund, so a hypothetical inability or unwillingness to close the hospital's operational deficits could directly impact the general fund and could lead to a rating downgrade. To the extent that the hospital requires sizeable internal cash flow loans to fund operations, Fitch may view such loans as an offset to general fund balances if repayment of such loans is unlikely over the near term. The financial implications of the Affordable Healthcare Act are currently unknown.

Fitch's fourth concern regarding potential operating pressure relates to the new correctional facility to open in 2017. Management anticipates that related operating costs of \$40 million to \$50 million will be fully paid by increased Prop 172 sales tax revenues, which the county has begun prudently setting aside in anticipation of the opening of the facility.

The county uses sales tax projections from Beacon Economics and CSU Fullerton, who project Prop 172 sales tax growth ranging from 5.7% to 8% annually through fiscal 2018. Fitch believes these growth rates may be less than conservative with consideration of average annual sales tax growth of 6.1% over the past 17 years. To the extent that rising sales tax revenues would not cover increased operational costs, the general fund likely would be affected. Fitch believes the county would cut costs as necessary under such a scenario, based on the county's historical approach to achieving fiscal balance under challenged circumstances.

SATISFACTORY DEBT PROFILE

The county's debt profile is sound overall. Carrying costs (pension, OPEB, debt service costs over non-capital total governmental expenditures) are low at 10%, though the county's debt burden is moderate to high at \$3,578 per capita (5.4% of AV), reflective of high overlapping debt levels and recent years' AV losses. Debt amortization is below average, with 19% and 42% of principal maturing within five and 10 years, respectively.

The county's capital improvement plan consists largely of the correctional facility, to be paid from roughly \$235 million to \$250 million of lease debt and a \$100 million state grant. Related debt costs are expected to be offset by an equivalent amount of debt maturing in fiscal 2015.

The county offers five pension plans through CalPERS. The two largest plans, offered to safety and miscellaneous employees, are adequately funded at 86% and 88% (or a still adequate 81% and 83% based on Fitch's more conservative 7% investment return assumption), respectively. However, the funded ratios reflect substantial POB issuances. Management prudently has established two-tier pension systems, and has negotiated for labor groups to pay the employee portion of pension contributions, as noted above. The county's unfunded OPEB obligation is small.

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 14, 2012);

--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

Applicable Criteria and Related Research:

Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015

U.S. Local Government Tax-Supported Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

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