



## RATING ACTION COMMENTARY

# Fitch Rates Riverside County, CA's \$103MM 2023 Teeter Notes 'F1+'; Affirms IDR; Outlook Positive

Thu 28 Sep, 2023 - 10:43 AM ET

Fitch Ratings - San Francisco - 28 Sep 2023: Fitch Ratings has assigned an 'F1+' rating to the following obligation of Riverside County, CA:

--\$103,170,000 Riverside County Teeter Plan Obligation Notes, 2023 series A.

In addition, Fitch has affirmed the following ratings:

--Issuer Default Rating (IDR) at 'AA-';

--Riverside County pension obligation bonds (POBs), series 2005A at 'A+';

--Riverside County Asset Leasing Corporation (CORAL) lease revenue bonds (LRBs), series 1997A at 'A+';

--Riverside County Public Financing Authority, LRBs, series 2015 at 'A+';

--Riverside County 2023 TRANs at 'F1+';

--Teeter obligation notes, series 2022A at 'F1+'.

The Rating Outlook on the long-term bonds is Positive.

## RATING ACTIONS

ENTITY / DEBT ⇄

RATING ⇄

PRIOR ⇄

Riverside County (CA) [General Government]	LT IDR	AA- Rating Outlook Positive		AA- Rating Outlook Positive
		Affirmed		
Riverside County (CA) /General Fund Contractual Obligations - Pension/1 LT	LT	A+ Rating Outlook Positive	Affirmed	A+ Rating Outlook Positive
Riverside County (CA) /Issuer Default Rating - General Government/1 LT	LT	AA- Rating Outlook Positive		AA- Rating Outlook Positive
		Affirmed		
Riverside County (CA) /Lease Obligations - Standard/1 LT	LT	A+ Rating Outlook Positive	Affirmed	A+ Rating Outlook Positive
Riverside County (CA) /Operating Cashflow/1 ST	ST	F1+	Affirmed	F1+

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The notes are expected to sell via negotiated sale Oct. 4. Proceeds will be used to refinance a portion of the county's 2022 teeter obligation notes and fund an advance of unpaid property taxes for participating agencies in the county's teeter plan.

#### **SECURITY**

The teeter obligation notes are payable from any delinquent property taxes payable through fiscal 2023 as well as any lawfully available moneys from the county's general fund.

#### **ANALYTICAL CONCLUSION**

The 'F1+' short-term rating on the Teeter Plan Obligation Notes 2023 Series corresponds to the county's 'AA-' IDR. In addition, the pledge of the general fund and defaulted property taxes received in the current year and any subsequent year is very strong as well as substantial internal borrowable resources.

The 'AA-' IDR reflects the county's positive financial operations and very strong gap closing capacity supported by strong reserves and solid budgetary balance. The 'AA-' rating also reflects solid revenue growth and expenditure flexibility and moderate liabilities. Spending needs have stabilized since the correctional health litigation and the opening of a new and expanded jail, along with better than expected revenue performance and sizable federal stimulus, supported strong financial performance and accumulation of reserves in recent years. Fitch expects the county to remain proactive in its budget management in order to maintain fiscal balance as general fund revenue growth is likely to slow to more sustainable levels.

The 'A+' rating on the POBs and lease obligations reflects the slightly higher optionality associated with payment of these obligations.

### **Economic Resource Base**

Riverside County's economy remains well-situated for continued population and economic growth over the long term, owing to its relative affordability, capacity for additional development, proximity to employment centers including San Bernardino, Orange and Los Angeles Counties, and a location along major transportation and distribution routes. Top taxpayers include Amazon, Costco, and Duke Realty, an industrial REIT, reflecting the growth of distribution facilities in the county, which support the increase in online purchases. The county benefits from this trend both as a recipient of increased sales taxes due to the Wayfair decision allowing online sales taxes to be collected and distributed in the destination state, as well as the property tax revenues of these distribution centers.

The county experienced considerable housing market and tax base volatility as one of the worst-affected regions in the country during the Great Financial Crisis; however, both the housing market and taxable assessed values (TAVs) improved significantly through fiscal 2024, and sizable state and federal revenue in the budget serve to moderate the effect of this cyclicity on overall revenues.

### **KEY RATING DRIVERS**

#### **Revenue Framework: 'a'**

Growth in total general fund revenues has been above inflation but below that of the U.S. economy, a trend that Fitch expects to continue given the county's mix of operating revenues. The state constitution limits the county's independent ability to raise revenues as

tax rate increases require voter approval. Nevertheless, the county's revenue raising ability from fees and charges is satisfactory.

### **Expenditure Framework: 'aa'**

Carrying costs for debt and retiree benefits are in the moderate range. The county has demonstrated its solid flexibility to make spending cuts, including by trimming personnel costs when needed through furloughs. Fitch expects the pace of spending growth in the absence of policy action to be marginally above growth in revenues, driven primarily by salary and benefits.

### **Long-Term Liability Burden: 'aa'**

Fitch expects the county's overall debt and pension burden, the bulk of which comes from overlapping debt, to remain moderate relative to personal income.

### **Operating Performance: 'aa'**

The county maintains very strong gap-closing capacity as evidenced by sound reserve levels relative to solid spending flexibility and moderate expected revenue volatility. Given only satisfactory ability to raise revenues relative to expected volatility, the county's ability to manage its expenditure growth and maintain solid reserves is critical to maintaining its superior financial resilience.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Maintenance of structural balance beyond the recent surge in local revenues and federal relief funds;
- Maintenance of unrestricted fund balance near historical levels;
- Expectations for sustained strong revenue growth above the U.S. GDP.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- An inability to address fiscal pressure, as evidenced by draws on unrestricted fund balance reducing the county's financial resiliency;

--Slower revenue growth around the pace of inflation.

## **CURRENT DEVELOPMENTS**

### Fiscal 2022 Operations

The county has emerged from the pandemic-related downturn in an improved financial position, aided by direct and indirect pandemic aid, helping to boost reserves. Total general fund revenues increased 6% yoy in fiscal 2022 due to increased tax receipts, primarily from property taxes. Spending only increased 5%. The county ended fiscal 2022 with a \$116 million surplus and added \$70.6 million to the unrestricted fund balance, bringing its total to \$492 million, or 13.2% of spending, up from \$286 million (8.3% of spending) in fiscal 2020. Taxes (primarily property taxes but also local sales tax receipts) increased 30.6% between fiscal 2020 and fiscal 2022, including increased sales tax revenues driven by federal stimulus and the Wayfair decision.

The fiscal 2022 surplus was also driven by better than budgeted revenues as almost all discretionary revenue categories outperformed budget. Improved revenues were aided by an appellate court ruling changing the ongoing allocation of former redevelopment agency property tax fund distribution in the county's favor.

The county was allocated \$488 million in CARES Act funding and \$480 million under the American Rescue Plan Act (ARPA), relative to its roughly \$3.8 billion fiscal 2021 general fund budget. To date, the county has focused these funds on infrastructure; housing and homelessness, and neighborhood revitalization; economic recovery; county departments response; non-profit assistance; and childcare. The county recognized just \$10 million in revenue backfill from ARPA in fiscal 2022, which was used to fund government services.

### Fiscal 2023 Budget and Estimates

The fiscal 2023 general fund budget totaled \$4.3 billion, up about 8.8% from the fiscal 2022 budget with much of the increase due to increases in state and federal funding. Of that total, discretionary revenues, including property and sales taxes, and interest earnings, other revenues not associated with state and federal programs, was budgeted at about \$1.0 billion. Such revenues outperformed budgeted by an estimated \$89 million which, in addition to estimated operational savings of about \$57 million, results in an expected fiscal 2023 unassigned general fund balance of about \$537 million, equal to roughly 14% of total general fund spending and about 50% of discretionary revenue.

## Fiscal 2024 Budget

The county's adopted fiscal 2024 general fund budget of \$5.0 billion is up 13% over the fiscal 2023 budget, with the largest increases in state and federal funding, property taxes, sales taxes and interest earnings. Property tax increases are driven by a 9.4% gain in TAV over fiscal 2023 levels, reflecting both continuing development in commercial and residential properties as well as property appreciation captured in the TAV when properties are sold. Discretionary revenues are estimated at \$1.14 billion, led by \$863 million in property taxes and motor vehicle in lieu revenue which are pegged to TAV increases. The budget is structurally balanced and includes a \$20 million contingency that can be allocated throughout the year if needed, as well as about \$18 million to be set aside for reserves or deferred maintenance. Ending unassigned fund balance (reserves) is projected at about \$555 million.

Management is focused on building reserves and the county is contemplating updating its reserve policy to comply with GFOA's recommended two month's expenditures (about 16.7% of total general fund spending), which Fitch would view favorably. The current policy of 25% of discretionary revenues is equal to about 7%-9% of total revenues.

Fitch expects the county's strong revenue growth to gradually taper. As such, continued careful management of general fund spending will be required to maintain fiscal balance. Fitch believes the county has sufficient spending flexibility to manage this pressure and to withstand typical revenue volatility. Maintenance of structural balance while maintaining reserves at or above historical levels as federal stimulus expires, could lead to an upgrade. Fitch views the county's substantial liquidity as mitigating risks associated with a short-term federal government shut-down should it occur.

## 2023 TEETER PLAN OBLIGATION NOTES

The county utilizes its teeter note program to manage the cash flows associated with its property tax collection and distribution program. Note proceeds will be used to refund the outstanding teeter plan obligation notes, and to fund the advance of unpaid property taxes for agencies participating in the county's Teeter Plan. The notes are payable from any legally available general fund resources as well as defaulted property taxes collected in the current year and any subsequent year. In addition, as of June 30, 2024, the county projects \$2.3 billion in borrowable resources, including special revenue, capital project, enterprise and internal service fund balances.

## CREDIT PROFILE

The county is the fourth largest in California, covering about 7,300 square miles with a population of approximately 2.5 million. It is a higher-growth region with less maturity than its coastal neighbors and so may experience higher-than-average economic volatility in its tax base.

## **Revenue Framework**

State and federal health, social services and criminal justice pass-through funds comprise a substantial portion of the county's budget, as is typical for California counties. State and federal funds typically account for over two-thirds of the general fund revenues.

Discretionary revenues comprise about one quarter of the county's total general fund revenues and are primarily generated by property taxes.

Growth in total general fund revenues has been generally above inflation but below U.S. economic performance. Excluding state and federal pass-through funds, growth in general fund revenues is also above inflation but below U.S. economic performance. Property tax revenues have increased in each of the last seven years, with secured AVs increasing between 5.4% in fiscal 2022, 9.5% in fiscal 2023 and 9.4% in fiscal 2024. Fitch expects revenue growth to slow after the impact of federal stimulus on resident spending tapers off.

The county has only satisfactory capacity to independently raise revenues relative to its expected revenue volatility. Proposition 13 fixes the countywide property tax rate at 1% and limits AV growth on a property to no more than 2% per year absent a change in ownership. Proposition 218 requires voter approval for new or increased general taxes, essentially limiting the county's ability to raise revenue to fees and charges for services.

## **Expenditure Framework**

Spending is focused on public safety and health and social services, which account for about 45% and 50% of general fund spending, respectively. Strong support for public safety spending, in combination with its large role in the county's budget, can challenge expenditure flexibility in periods of revenue shortfalls.

The pace of spending growth is likely to be marginally higher than that of revenues in the absence of policy action. Prior to the pandemic, the county had a modest structural deficit due to rising salary and pension costs, increased correctional operating costs arising from the opening of a new jail and the settlement of class action litigation regarding inmate health care. In an effort to control expenditure growth, the county instituted a hiring freeze in effect for most general fund positions since January 2018 and continues to eliminate

some of the vacant positions. In an effort to manage expenditure pressure, the county has only opened a portion of the new jail.

The county's fixed cost burden is moderate, with carrying costs for debt, pensions and retiree healthcare accounting for about 15% of fiscal 2022 governmental spending. This amount is somewhat overstated as it includes pension obligation bond debt service without the anticipated lower pension contributions resulting from the issuance of POBs in fiscal 2020. The county maintains a Section 115 trust account funded with savings from the issuance of POBs as determined by its Board of Supervisors. As of June 30, 2023, the balance in the Section 115 pension trust was \$98.9 million (the annual pension contribution in fiscal 2023 was about \$421 million) and provides potential budgetary flexibility in the event of increased required pension contributions.

The vast majority of the county's labor contracts are settled through January 2024 and December 2024. Most contracts have annual merit increases of 4%, affordable compared to recent revenue growth. The county has demonstrated its capacity to implement layoffs and furloughs in times of revenue decline; however, an inability to continue to control labor costs in light of other cost demands could put negative pressure on the rating.

### **Long-Term Liability Burden**

The county's overall debt and pension liabilities are estimated at about 14% of personal income. The largest component of the metric is estimated overlapping debt at \$13.7 billion, with net direct debt of about \$2.0 billion. The county has three pension tiers through CalPERS and the county reports the aggregate net pension liability of \$1.3 billion and an asset to liabilities ratio of 90.5% as of June 30, 2022 (as reported in the fiscal 2022 audit), assuming a 7.15% discount rate. The Fitch-adjusted net pension liability (adjusted to use a 6% rate of return assumption) totals about \$3.6 billion, resulting in an estimated asset to liabilities ratio of 77%. The county's net other post-employment benefits (OPEB) liability is modest at just \$192 million, or 0.2% of personal income.

### **Operating Performance**

The county had been challenged in balancing its discretionary budget in recent years as costs of salaries, pensions and a new jail facility were consuming most, if not all of each year's revenue growth. Given recent revenue gains and the leveling off of these previously increasing costs, the improvements should allow the county to maintain or add to its unassigned fund balance and continue to improve its expenditure flexibility. The unrestricted general fund balance at fiscal year-end 2022 was \$492 million, or 13.2% of total general fund spending, including all state and federal revenues.



Fitch expects the county to use fund balance during economic downturns and replenish reserves during economic expansions. The county has a proven track record of managing spending to offset revenue weakness, while limiting its use of reserves. Reserves maintained below the county's own reserve policy (25% of discretionary revenue) during an economic expansion, or an inability to manage expenditures could result in a revision of the Outlook to Stable from Positive.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **ESG CONSIDERATIONS**

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**APPLICABLE CRITERIA**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

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Riverside County (CA)

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