FITCH RATES RIVERSIDE COUNTY (CA) $340MM TRANS 'F1+'; AFFIRMS 'AA-' IDR

Fitch Ratings-San Francisco-30 May 2019: Fitch Ratings has assigned a 'F1+' to the following Riverside County, California obligations:

--$340 million 2019 Tax and Revenue Anticipation Notes (TRANs).

In addition, Fitch has affirmed the 'AA-' Issuer Default Rating (IDR) as well as various related ratings detailed at the end of this release.

The Rating Outlook on the IDR is Stable.

The 2019 notes will sell via negotiation on or around June 11. Proceeds will be used to meet the county's fiscal 2020 expenditure needs.

SECURITY
The TRANs are payable from taxes, income, revenue cash receipts and other moneys of the county attributable to the 2020 fiscal year. They are additionally payable from any lawfully available moneys from the county's general fund.

ANALYTICAL CONCLUSION

The 'F1+' note rating reflects the county's long-term general credit quality correlating to the county's IDR of 'AA-' and the notes' sound security structure.

The 'AA-' IDR is based on the county's healthy financial performance, moderate liabilities and very strong gap closing capacity. However, the county is still struggling to balance ongoing revenue with ongoing expenditures several years into the economic expansion and Fitch expects the county to continue to demonstrate proactive spending restraint as it manages budget pressure over the next several years.

Economic Resource Base
Riverside County's economy is large, diversified and well-situated for long-term growth. It has an affordable housing stock relative to the region, capacity for additional development, proximity to employment centers, including San Bernardino, Orange County, and Los Angeles, and a location along a major distribution route. The county experienced considerable housing market and tax base volatility as one of the worst-affected regions in the country during the economic downturn. However, both the housing market and assessed values have improved significantly over the past several years, and a large amount of state and federal revenue in the budget moderates the effect of this cyclicality 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, and Fitch expects that trend to continue. State law limits the county's independent ability to raise revenues to permits, fines and charges for services.

Expenditure Framework: 'aa'

Carrying costs for debt and retiree benefits are in the moderate range, but likely to rise given the funded status and funding assumptions associated with the state pension plans the county participates in. The county has demonstrated its solid flexibility to make significant staffing cuts when needed through layoffs and furloughs. Fitch expects the pace of spending growth in the absence of policy action to be above growth in revenues, driven primarily by salary and benefits, a new jail facility, and costs associated with an inmate healthcare settlement.

Long-Term Liability Burden: 'aa'
The county's overall debt and pension burden, the bulk of which comes from overlapping debt, is moderate relative to personal income and Fitch expects it to remain in this range.

Operating Performance: 'aa'
The county maintains very strong gap-closing capacity as evidenced by robust reserve levels relative to solid spending flexibility and moderate expected revenue volatility. Given moderate 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 very strong financial resilience.

RATING SENSITIVITIES
Ability to Control Spending: Continued ability to control rising costs in relation to expected revenue growth and in light of restricted revenue raising flexibility is key to maintaining the rating at the current level.

CREDIT PROFILE

The county is the fourth largest in the state, covering 7,303 square miles with a population of approximately 2.45 million. It is a high-growth region with less maturity than its coastal neighbors; as such, the county is likely to experience higher-than-average economic volatility over the foreseeable future.

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. The county's non-discretionary general fund revenues are primarily provided by state and federal funds, which account for an estimated 65% of the fiscal 2019 budget. Discretionary revenues comprise about 24% of the county's fiscal 2019 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. However, excluding state and federal funds, growth in general fund revenues is just in line with U.S. economic performance. Property tax revenues have increased in each of the last six years, with assessed value increasing 6.3% in fiscal 2019. The county's fiscal 2019 budget includes general fund discretionary revenues of $781 million, a roughly 4% increase over the fiscal 2018 budget.

The county has moderate capacity to independently raise revenues relative to its expected revenue volatility. Proposition 13 fixes the countywide property tax rate at 1% and limits assessed value growth to no more than 2% per year absent a change in ownership. Furthermore, Proposition 218 requires voter approval for new or increased general taxes, limiting the county's ability to raise revenue to fees and charges for services. The county expects to update its fee schedule in the fiscal 2020 budget.

Expenditure Framework

Discretionary spending is focused on public safety, which accounts for about 78% of the discretionary fiscal 2019 budget, followed by public assistance at 5.5% and health and sanitation at 3%. Strong support for public safety spending, in combination with its large role in the county's discretionary budget, can challenge expenditure flexibility in periods of revenue shortfalls.

The pace of spending growth is likely to be somewhat higher than that of revenues in the absence of policy action. The county projects deficit spending through fiscal 2021, in declining amounts each year, due to rising salary and pension costs and 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 has had a hiring freeze in effect for most general fund employees since January 2018 and is seeking to eliminate vacant positions.

The county's fixed cost burden is moderate, with carrying costs for debt, pensions and retiree healthcare accounting for 12% of fiscal 2018 governmental spending. However, Fitch's supplemental pension metric, which estimates the annual pension cost based on a level dollar payment for 20 years with a 5% interest rate, indicates that carrying costs are vulnerable to significant future increases that could constrain the county's overall expenditure profile. For more information, see Fitch's special report "Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)" dated May 31, 2017.

Labor relations with some employee groups continue to be pressured. The county's employees are represented by six labor organizations; the largest two: SEIU and Laborers' International Union of North America (LIUNA), represent about 74% of all county employees. Contracts with SEIU and the Riverside Sheriff's Association (RSA) expired in 2016 and the county reached an impasse and imposed contract terms on RSA in October 2017. The county is in fact finding with SEIU, which implemented a two-day strike in early September 2017. In March 2019, the county settled with LIUNA after contracts had expired in June 2016 with terms generally favorable to the county, reducing the number of step increases to one from two and for a lower total compensation increase than requested. According to the county, the primary negotiation issues relate to merit increases.

The county has the authority to ultimately impose terms and contracts if an agreement is not reached, as occurred with RSA. In addition, 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.

The county estimates the ongoing cost of an inmate class action lawsuit settlement at about $40 million per year. This amount compares with fiscal 2019 general fund discretionary revenues of $781 million and an overall budget of $5.6 billion. Management has identified offsets to this additional outlay, including adjusting and delaying staffing for the new John J. Benoit Detention Center and establishing a requirement for county departments to absorb any staffing cost increases. In addition, the county continues to implement recommendations from a Strategic Plan for Criminal Justice produced by KPMG Consulting for the county and a preliminary jail utilization report provided by California Forward, a bipartisan governance reform organization. The county expects implementation of both to result in considerable costs savings, as well as revenue recovery.

Long-Term Liability Burden
The county's overall debt and pension liabilities are on the high end of the moderate range, estimated at 18% of personal income. Debt is primarily in the form of overlapping debt ($10.7 billion), with net direct debt of about $1.6 billion.

The county offers five pension plans through CalPERS and the adjusted pension liabilities represent about 30% of the total long-term liability burden. The county reported a net pension liability of $3.3 billion at June 30, 2017 (a funded ratio of about 70%, assuming a 7.15% discount rate). Using a 6% discount rate results in a Fitch-adjusted net pension liability of $5.3 billion (5.5% of personal income) with assets-to-liabilities ratio of 59%. The county's net OPEB liability is negligible at just $15 million.

Operating Performance

The county's very strong gap-closing capacity is derived from its ability to manage spending, relatively low expected revenue volatility and available reserves. The unrestricted (committed, assigned and unassigned) general fund balance at year-end fiscal 2018 was $270 million, or 8.8% of total general fund spending and the county expects fiscal 2019 results to show a draw of about $22 million from unrestricted balance. Fitch expects that the county would maintain reserves at solid levels throughout a moderate economic downturn, primarily by adjusting spending.

To balance the fiscal 2019 budget, most departments were directed to make 4% cuts to their allocation of discretionary county revenue by using departmental reserves and eliminating unfilled positions. Due to unexpected costs associated with general assistance and some health center clinics within the Riverside University Health System, the county expects to use about $22 million in fund balance to offset these cost over runs, compared with $18.5 million in budgeted use of fund balance. Nonetheless, on a budget basis, the county expects to end the year with about $212 million in reserves, which is above its board policy reserve target of 25% of discretionary revenue.

Ongoing spending restraint will be required given budget pressures, including rising pension contributions, costs associated with opening a new jail facility later in the year and the unexpected costs noted above. However, after several years into the economic expansion, the county is still struggling to balance ongoing revenue with ongoing expenditures; Fitch believes the county will need to use its expenditure flexibility to maintain financial flexibility.

Notes Finance Cash Flow Needs

Note proceeds will be used to smooth cash flow management for general fund operations during fiscal 2020. Note set asides occur in months with positive net ending balances, resulting in expected coverage of 1.1x with 60% principal and interest set aside in January 2020 and 1.2x 40% of principal and interest to be set aside in May 2020. This does not include about $1.75 billion in projected borrowable resources. The repayment deposit structure sets aside 100% of principal and interest one month in advance of note maturity.

In conjunction with the affirmation of the county's IDR, Fitch has also affirmed the following ratings, which are linked to the county's general credit quality:

--Riverside County pension obligation bonds (POBs), taxable series 2005A at 'A+';
--Riverside County certificates of participation (COPs), 2009 at 'A+';
--Riverside County Asset Leasing Corporation (CORAL) lease revenue bonds (LRBs), series 1997A, 1997B, 1997C, 2013A at 'A+';
--Riverside County Public Financing Authority LRBs series 2012 and 2015 at 'A+';
--Riverside County 2018-2019 TRANs at 'F1+';
--Riverside County teeter obligation notes, series 2018A at 'F1+.

The Rating Outlook on the above bonds is Stable.

Contact:

Primary Analyst
Karen Ribble
Senior Director
+1-415-732-5611
Fitch Ratings, Inc.

One Post Street,
San Francisco, CA 94104

Secondary Analyst
Graham Schnaars
Analyst
+1-415-732-7578

Committee Chairperson
Michael Rinaldi
Senior Director
+1-212-908-0833

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

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Short-Term Debt Rating Criteria (pub. 01 Nov 2017)
https://www.fitchratings.com/site/re/905637
U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)
https://www.fitchratings.com/site/re/10024656