Riverside County, California

New Issue Report

Ratings

Issuer Default Rating	AA–
New Issue	
2018 Tax and Revenue Anticipation Note	F1+
Outstanding Debt	
Certificates of Participation and Lease Revenue Bonds	A+
Pension Obligation Bonds	A+
Teeter Obligation Notes, 2017 Series A (Tax-Exempt)	F1+

Rating Outlook

Stable

New Issue Summary

Sale Date: June 6, 2018.

Series: $340 million 2018 Tax and Revenue Anticipation Note.

Purpose: To provide moneys to meet Riverside County's (the county) fiscal year 2019 (year end June 30) general fund expenditures and the discharge of other obligations of the county.

Security: Fiscal 2019 general fund unrestricted revenues.

Analytical Conclusion

The 'F1+' tax and revenue anticipation note rating reflects the county's long-term general credit quality correlating to the county's Issuer Default Rating (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. Fitch Ratings believes the county will continue to demonstrate proactive spending restraint as it manages projected modest deficits 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 is located along a major distribution route.

The county experienced considerable housing market and tax base volatility as one of the worst hit regions in the country during the economic downturn. However, both the housing market and assessed values have improved significantly over the past several years. Also, a large amount of state revenue in the budget moderates the effect of this cyclicality on overall revenues.

Key Rating Drivers

Revenue Framework: 'a'
Growth in discretionary general fund revenues has been above inflation but below that of the U.S. economy, and Fitch expects this trend to continue. State law requires a popular vote to raise taxes; the county may increase its revenues by raising charges for permits, fines and charges for services.

Expenditure Framework: 'aa'
Carrying costs for debt and retiree benefits are relatively low but likely to rise given the trajectory of pension contributions. The county has demonstrated its solid expenditure 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 salaries and benefit costs.

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.

Rating History

Rating	Action	Outlook/ Watch	Date
AA–	Affirmed	Stable	9/13/17
AA–	Affirmed	Stable	5/5/15
AA–	Affirmed	Negative	5/21/14
AA–	Downgraded	Stable	9/28/11
AA	Revised	Negative	4/30/10
AA–	Downgraded	Negative	10/14/09
AA	Affirmed	Negative	8/27/08
AA	Assigned	Stable	3/27/06

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 its limited ability to raise revenues, the county's ability to manage its expenditure growth and to maintain solid reserves is critical to maintaining its strong financial resilience.

Rating Sensitivities

Ability to Control Spending: Continued ability to control rising costs — in light of very limited revenue flexibility and solid expected revenue growth — is key to maintaining the rating at the current level.

Credit Profile

The county is the fourth largest in the state, covering 7,177 square miles with a population of approximately 2.39 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 sources, which together account for an estimated 65% of the county's fiscal 2018 budget. Discretionary revenues (i.e. excluding state and federal funds) comprise about 24% of the county's fiscal 2018 total general fund revenues and are primarily generated by property taxes, which account for almost one-half of fiscal 2018 budgeted discretionary revenues.

Growth in total general fund revenues has generally outpaced U.S. economic performance. However, excluding state and federal funds, growth in general fund revenues is just in line with inflation. Property tax revenues have increased in each of the past five years, with assessed value increasing 5.5% in fiscal 2018. The county estimates fiscal 2018 general fund discretionary revenues will increase approximately 3% over the prior year.

The county has limited capacity to independently raise revenues under state law; Proposition 13 generally allows for a maximum increase of 2% annually in property tax assessments other than resale taxes, while Proposition 218 requires voter approval for new or increased general tax levies.

Expenditure Framework

Public safety accounts for 76% of the discretionary fiscal 2018 budget, whereas health and sanitation represent 6% and public assistance 4%.

The pace of spending growth is likely to be somewhat higher than that of revenues in the absence of policy action. The county projects deficits over the next three years given rising pension costs, operating costs of a new correctional facility and ongoing costs related to an inmate lawsuit settlement.

The county's fixed cost burden is relatively low, with carrying costs for debt, pensions and retiree healthcare accounting for 10% of fiscal 2017 government 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

Related Criteria

U.S. Public Finance Short-Term Debt Rating Criteria (November 2017)

U.S. Public Finance Tax-Supported Rating Criteria (April 2018) significant future increases. 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 have recently become somewhat contentious. The county's employees are represented by six labor organizations, the largest two of which — SEIU and Laborers' International Union of North America (LIUNA) — represent about 72% of all county employees. Contracts with SEIU, LIUNA and the Riverside Sheriff's Association (RSA) expired in June 2016. The county and labor reached impasse, and the county is currently in the fact finding phase with SEIU and LIUNA. SEIU implemented a two-day strike in early September 2017. Members of the Riverside Sheriff's Association (RSA) unit rejected a tentative agreement with the county in October, after which the county imposed its last, best and final offer. According to the county, the primary negotiation issues relate to merit increases. The county is also in negotiations with two smaller bargaining units whose contracts have also expired.

The county has the authority to ultimately impose terms and contracts if agreement is not reached, as occurred with RSA. Contracts are not subject to binding arbitration. In addition, the county has demonstrated its capacity to implement layoffs and furloughs in times of revenue decline; however, an inability to maintain its control over 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 compares to a fiscal 2018 total discretionary budget of $756 million and overall budget of $5.45 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 is in the process of implementing 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 cost savings, as well as revenue recovery.

Long-Term Liability Burden

The county's overall debt and pension liabilities are moderate, estimated at 18% of personal income. Debt is primarily in the form of overlapping debt ($10 billion), with net direct debt of $1.2 billion.

The county offers five pension plans through CalPERS. The county's ratio of assets to pension liabilities based on a Fitch adjustment to a 6% return assumption is 58%, for an adjusted net pension liability of $5 billion (5.6% of personal income). The county's OPEB liability is negligible at just $9 million.

Operating Performance

The county's very strong gap-closing capacity derives from its ability to manage spending, relatively low expected revenue volatility and available reserves. For details, see Scenario Analysis, page 5.

Departments were directed to absorb 6.5% across the board cuts for fiscal 2018 in response to the governor's budget proposal to shift a significant share of the cost of the In-Home Supportive Services (IHSS) program from the state to counties. The county estimated a $42 million impact on the fiscal 2018 general fund budget. The state later determined that the IHSS cost shift will occur over a longer time period but the impact of future cost shifts is still unknown. As such, the county kept the 6.5% cuts in place in order to absorb the costs associated with the opening and operation of the new detention center. Departments have been instructed to absorb a 4% cut for fiscal 2019 while also absorbing higher pension costs.

The county is currently in the process of analyzing its service delivery in several departments as part of a KPMG Consulting engagement and expects to reduce headcount, particularly vacant positions, in the public safety and other departments through attrition as the plan is rolled out. The county estimates that 24% of full-time positions are vacant and may be a source of cost reductions.

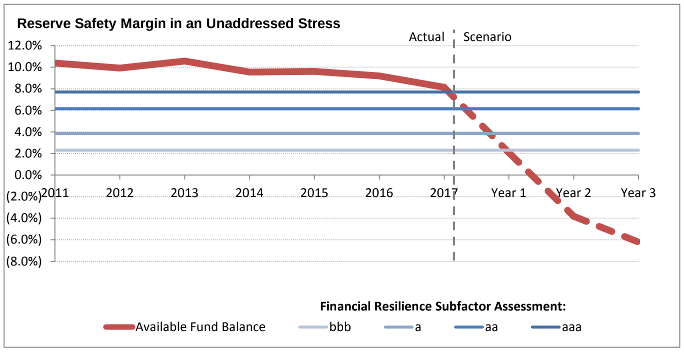
Fitch is concerned that several years into the economic expansion, the county is still forecasting deficits, albeit modest ones, through fiscal 2021. Notably, the five-year forecast does include remediation strategies. The county will need to use its expenditure flexibility to maintain its financial flexibility.

The unassigned general fund balance reserve was budgeted at $173.4 million (or nearly 23% of discretionary revenues) for fiscal 2017, down from $221 million in fiscal 2016. The county expects to begin adding to reserves to meet its board policy reserve target of 25% of discretionary revenue starting in fiscal 2022. Spending restraint will be required in order to meet that target, given expected increased costs for salaries and benefits, uncertainty about future IHSS costs and operating costs related to the new correctional facility. In addition, the county will face the challenges of absorbing settlement costs associated with the inmate class action lawsuit mentioned earlier, additional health and mental health professional staffing, and managing exposure to its hospital operations (particularly in the evolving healthcare environment).

In recent years, the county took swift action to address large deficits in its Riverside University Medical Center. It initiated a rapid turnaround plan, resulting in prompt improvement and a reduction in the county's financial exposure.

Riverside County (CA)

Scenario Analysis v. 2.0 2017/03/24



Analyst Interpretation of Scenario Results:

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 general fund balance at year-end fiscal 2017 was $251 million, or 8.1% of total general fund spending. Fitch expects that the county would maintain reserves at solid levels throughout a moderate economic downturn.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(1.5%)	2.1%	5.7%
Inherent Budget Flexibility	Midrange		

Revenues, Expenditures, and Fund Balance	Actuals							Scenario Output		
	2011	2012	2013	2014	2015	2016	2017	Year 1	Year 2	Year 3
Total Revenues	2,181,383	2,214,419	2,315,681	2,462,759	2,702,857	2,783,311	2,881,016	2,836,677	2,895,198	3,059,182
% Change in Revenues	-	1.5%	4.6%	6.4%	9.7%	3.0%	3.5%	(1.5%)	2.1%	5.7%
Total Expenditures	2,245,458	2,252,029	2,292,501	2,453,293	2,711,043	2,791,357	2,943,055	3,001,916	3,061,954	3,123,194
% Change in Expenditures	-	0.3%	1.8%	7.0%	10.5%	3.0%	5.4%	2.0%	2.0%	2.0%
Transfers In and Other Sources	114,368	126,258	94,018	97,982	142,453	126,014	177,803	124,087	126,647	133,820
Transfers Out and Other Uses	93,217	98,045	96,547	101,021	103,554	141,847	139,043	144,684	147,578	150,529
Net Transfers	21,151	28,213	(2,529)	(3,039)	38,899	(15,833)	38,760	(20,597)	(20,930)	(16,709)
Bond Proceeds and Other One-Time Uses	-	-	-	-	-	-	-	-	-	-
Net Operating Surplus(+)/Deficit(-) After Transfers	(42,924)	(9,397)	20,651	6,427	30,713	(23,879)	(23,279)	(185,836)	(187,687)	(80,720)
Net Operating Surplus(+)/Deficit(-) (% of Expend. and Transfers Out)	(1.8%)	(0.4%)	0.9%	0.3%	1.1%	(0.8%)	(0.8%)	(5.9%)	(5.8%)	(2.5%)
Unrestricted/Unreserved Fund Balance (General Fund)	242,796	233,113	252,562	244,036	270,421	269,502	250,787	64,951	(122,736)	(203,456)
Other Available Funds (Analyst Input)	-	-	-	-	-	-	-	-	-	-
Combined Available Funds Balance (GF + Analyst Input)	242,796	233,113	252,562	244,036	270,421	269,502	250,787	64,951	(122,736)	(203,456)
Combined Available Fund Bal. (% of Expend. and Transfers Out)	10.4%	9.9%	10.6%	9.6%	9.6%	9.2%	8.1%	2.1%	(3.8%)	(6.2%)

Reserve Safety Margins	Inherent Budget Flexibility				
	Minimal	Limited	Midrange	High	Superior
Reserve Safety Margin (aaa)	24.6%	12.3%	7.7%	4.6%	3.1%
Reserve Safety Margin (aa)	18.5%	9.2%	6.2%	3.8%	2.3%
Reserve Safety Margin (a)	12.3%	6.2%	3.8%	2.3%	2.0%
Reserve Safety Margin (bbb)	4.6%	3.1%	2.3%	2.0%	2.0%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. Inherent budget flexibility is the analyst's assessment of the issuer's ability to deal with fiscal stress through tax and spending policy choices, and determines the multiples used to calculate the reserve safety margin. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.