

RatingsDirect®

Summary:

Orange County, California; Appropriations; General Obligation

Primary Credit Analyst:

Misty L Newland, San Francisco (1) 415-371-5073; misty.newland@standardandpoors.com

Secondary Contact:

Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@standardandpoors.com

Table Of Contents

Rationale

Outlook

Related Criteria And Research

Summary:

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Credit Profile

US\$334.305 mil taxable pension oblig bnds ser 2016A due 06/30/2017		
<i>Long Term Rating</i>	AA/Stable	New
Orange Cnty taxable pension oblig bnds		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Orange Cnty ICR		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Orange Cnty Pub Fincg Auth, California		
Orange Cnty, California		
Orange Cnty Pub Fincg Auth (Orange Cnty) lease rev bds ser 2006		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its issuer credit rating (ICR) on Orange County, Calif. to 'AA+' from 'AA' and its long-term rating and underlying rating (SPUR) on the county's lease revenue bonds, recovery bonds, and pension obligation bonds (POBs) outstanding to 'AA' from 'AA-', based on the county's improved budgetary flexibility. At the same time, we assigned our 'AA' long-term rating to the county's 2016 series A taxable POBs. The outlook on all ratings is stable.

The POBs are payable from any lawfully available funds, generally consisting of the county's general purpose revenue, but without an unlimited ad valorem pledge or a pledge of any specific form of taxation. We understand that the 2016 series A POB proceeds will be used to prepay the county's projected unfunded actuarial accrued liability and normal contribution to the Orange County Employees Retirement System (OCERS) for fiscal year ending June 30, 2017. OCERS provides the county with a discount for prepayment of its employer contribution, which the county expects will be 5.8%.

The lease revenue bonds are secured by lease payments, subject to appropriation, from the county.

The ratings reflect our view of the county's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with "good" financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Strong budgetary performance, with an operating surplus in the general fund and a slight operating surplus at the total governmental fund level in fiscal 2014;
- Strong budgetary flexibility, with an available fund balance that we expect will improve in the near term from its

fiscal 2014 level of 5.6% of operating expenditures;

- Very strong liquidity, with total government available cash at 69.0% of total governmental fund expenditures and 16.5x governmental debt service, and access to external liquidity we consider exceptional;
- Strong debt and contingent liability position, with debt service carrying charges at 4.2% of expenditures and net direct debt that is 17.2% of total governmental fund revenue, as well as low overall net debt at less than 3% of market value, but a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation; and
- Strong institutional framework score.

Very strong economy

We consider the county's economy very strong. Orange County, with an estimated population of 3.1 million, is located in the Los Angeles-Long Beach-Anaheim, Calif. MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 120% of the national level and per capita market value of \$160,326. Overall, the county's market value grew by 6.0% over the past year to \$504.7 billion in 2016. The county unemployment rate was 5.5% in 2014.

The county, the third-most populous in the state, is located on the southern boundaries of Los Angeles and San Bernardino counties, with Riverside County to the east, San Diego County to the southeast, and the Pacific Ocean to the west. Tourism and recreation are prominent economic activities, including Disney Resort, Knott's Berry Farm, and coastal communities including Newport Beach, Laguna Beach, and Dana Point. The life science industry also has a presence, with companies such as Allergan, Edwards Lifesciences, and Abbot Medical Optics. The county also reports a growing high tech sector with software companies, chipmakers, TV manufacturers, and computer product developers.

Strong management

We view the county's management as strong, with "good" financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Formal policies support many of these activities, adding to the likelihood that these practices will be continued into the future and transcend changes in the operating environment or personnel. The county projects revenues and expenditures for five years, using external forecasters to provide economic assumptions, and maintains a five-year capital plan. The five-year financial forecast and capital plan are updated annually. Elected officials receive quarterly financial updates against budget and have historically made midyear adjustments. The county has a written investment policy, which it reviews annually, and presents a report on holdings to elected officials monthly. Reserve policies include setting a targeted reserve for contingencies during the annual strategic financial plan process. The current reserve target is two months of general operating revenues. We understand the county expects to create a debt management policy by the end of the fiscal year.

Strong budgetary performance

Orange County's budgetary performance is strong in our opinion. The county had surplus operating results in the general fund of 2.6% of expenditures, and slight surplus results across all governmental funds of 0.8% in fiscal 2014. General fund operating results of the county have been stable over the last three years, with a result of 4.5% in 2013

and a result of 2.9% in 2012.

General fund revenue and expenditures have been adjusted upward for recurring transfers for debt service. General fund results are projected to be positive for fiscal 2015 and are balanced for fiscal 2016.

Strong budgetary flexibility

Orange County's budgetary flexibility is strong, in our view, with an available fund balance that we expect could improve in the near term from its fiscal 2014 level of 5.6% of operating expenditures, or \$153.3 million.

Available general fund reserves include combined unassigned and assigned general fund balance. Management estimates these reserves will increase to about \$298 million for fiscal 2015; however, adjusted downward for the \$15 million set aside for motor vehicle license fees (MVLFF) settlement payment to the state, available reserves equal 10% of estimated fiscal 2015 general fund expenditures. Management informed us that, in its settlement with the state, it must repay \$150 million over five years for incorrectly withholding from property tax collections property taxes in lieu of MVLFF that were supposed to be distributed to other local governments during fiscal 2011 and fiscal 2012.

Repayment of the \$150 million is scheduled to start in fiscal 2015 at \$5 million and rise to \$55 million by fiscal 2019. We understand the county included the annual payments as part of its base budget starting in fiscal 2017, eliminating the need to draw down on reserves for settlement payment.

Very strong liquidity

In our opinion, Orange County's liquidity is very strong, with total government available cash at 69.0% of total governmental fund expenditures and 16.5x governmental debt service in 2014. In our view, the county has exceptional access to external liquidity if necessary.

Due to the frequency of debt issuances and diverse types of debt, we believe the county has exceptional access to external liquidity. We expect the current liquidity levels will not likely fall below very strong threshold levels in coming years. The county has an unhedged variable-rate line of credit with Wells Fargo that it uses to support its Teeter Plan. The Teeter Plan note (which expires Jan. 29, 2016) has an authorization of up to \$100 million, about \$40 million of which is outstanding. We understand the county plans to extend the note to July 31, 2018. We do not believe the county is currently exposed to significant liquidity risk stemming from the Teeter Plan note, based on the county's general fund cash and investments of \$425 million at fiscal year ended June 30, 2014. The county also reported \$513 million of reserves and other funds available for temporary general fund borrowing.

Strong debt and contingent liability profile

In our view, Orange County's debt and contingent liability profile is strong. Total governmental fund debt service is 4.2% of total governmental fund expenditures, and net direct debt is 17.2% of total governmental fund revenue. Overall net debt is low at 1.8% of market value, which is in our view a positive credit factor.

The county's direct debt includes \$30 million of Orange County Development Agency tax allocation bonds. We understand the county may issue an additional \$79 million of lease revenue obligations during fiscal 2016 to fund safety communication system and central utility facility upgrades. We anticipate that this additional debt would have a minimal impact on the direct debt ratios, as its recovery bonds (bankruptcy obligation) matured June 1, 2015, and the county's other bankruptcy obligation (lease revenue refunding bonds, series 2005) matures in July 2017. The remaining

general fund-backed obligations (lease revenue bonds, certificates of participation, and POBs) mature during the next 10 years.

In our opinion, a credit weakness is Orange County's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Orange County's combined required pension and actual OPEB contributions totaled 11.7% of total governmental fund expenditures in 2014. Of that amount, 10.3% represented required contributions to pension obligations, and 1.4% represented OPEB payments. The county made its full annual required pension contribution in 2014. The funded ratio of the largest pension plan is 69.7%.

The majority of county employees participate in the OCERS, a cost-sharing multiple-employer public employee retirement system established by the voters of Orange County. The county also administers four single-employer retirement funds that represented less than 1% of the county's total 2014 combined pension contributions. The county also maintains the Retiree Medical Plan, a single employer defined benefit OPEB plan, and contributed 114% and 116% of annual OPEB cost in fiscal 2013 and fiscal 2014, respectively. The OPEB plan was 27% funded as of June 30, 2013, the most recent valuation.

Strong institutional framework

The institutional framework score for California counties required to submit a federal single audit is strong.

The institutional framework score is based on the state legislative and functional environment under which these local governments operate, including a framework that encourages transparency by requiring these local governments to perform annual financial statement audits of their entire operations if it is subject to the federal single-audit requirement due to federal awards in multiple programs exceeding \$500,000 per year.

Outlook

The stable outlook reflects our view that positive economic momentum will likely translate into at least stable revenue during our two-year outlook horizon and that its budget flexibility will remain at least strong. For these reasons we do not expect to change the ratings during the current two-year outlook period.

Upside scenario

If budgetary flexibility and performance were to be consistently maintained at levels we consider very strong, we could potentially raise the ratings.

Downside scenario

Lower ratings are possible if budgetary flexibility and performance were to weaken to levels we consider only adequate.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006

- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Non Ad Valorem Bonds, Oct. 20, 2006

Related Research

Institutional Framework Overview: California Local Governments

Ratings Detail (As Of December 28, 2015)		
Orange Cnty Pub Fincg Auth, California		
Orange Cnty, California		
Orange Cnty Pub Fincg Auth (Orange Cnty) lse rev ser 2005		
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Upgraded
South Orange Cnty Pub Fin Auth, California		
Orange Cnty, California		
South Orange Cnty Pub Fin Auth (Orange Cnty) lse rev rfdg bnds (Orange Cnty) (Juvenile Justice Ctr)		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Many issues are enhanced by bond insurance.		

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