FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Riverside County, CA's $360MM 2023 TRANs 'F1+'; Affirms IDR at 'AA-'; Outlook Positive

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Fitch Ratings - San Francisco - 23 May 2023: Fitch Ratings has assigned an 'F1+' rating to the following obligation of Riverside County, CA:

--$360,000,000 Riverside County 2023 tax and revenue anticipation notes (TRANs).

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 2022 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	Affirmed	AA- Rating Outlook Positive
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	Affirmed	AA- Rating Outlook Positive
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+

VIEW ADDITIONAL RATING DETAILS

The notes are expected to sell via negotiated sale around June 1. TRANs proceeds will be used to provide moneys to meet the county fiscal 2024 general fund expenditures, including current expenses, and the discharge of other obligations or indebtedness of the county.

SECURITY

The 2023 TRANs are general obligations of the county payable from unrestricted revenues consisting of taxes, income, revenue (including but not limited to revenue from state and federal governments), cash receipts, and other moneys of the county attributable to fiscal 2024 and legally available.

ANALYTICAL CONCLUSION

The 'F1+' short-term rating on the 2023 TRANs corresponds to the county's 'AA-' IDR. The combination of the pledged fiscal 2024 cash receipts and borrowable resources provides very strong coverage of debt service (borrowables projected at almost $2.3 billion, estimated to cover note principal and interest 7.8x). Full note principal and interest set-asides occurs one month in advance of the TRANs' maturity on June 28, 2024.

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. Prior to the pandemic, the county had been challenged to balance recurring revenue and expenditures. Stabilized spending needs in correctional health litigation and the jail expansion along with better than expected revenue performance and sizable federal stimulus supported strong financial performance and accumulation of reserves. Fitch expects the county to remain proactive in its budget management in order to maintain fiscal balance

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 distribution routes. Top taxpayers include Duke Realty and Costco, 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 sales tax increase 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 2023, and sizable state and federal revenue in the budget tends to moderate 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, 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, but could rise given the funding status of the state pension plans in which the county participates. The county has demonstrated its solid flexibility to make spending cuts, including by trimming personnel costs when needed through layoffs and 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:

--Maintain 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.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

Fiscal 2022 Operations

The county has emerged from the Covid recession in an improved financial position, aided by direct and indirect pandemic aid. Total general fund revenues increased 6% 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 the 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, benefitting from fiscal stimulus and the Wayfair decision.

The fiscal 2022 surplus was 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 $487 million in CARES Act funding and $480 million under the American Rescue Plan Act (ARPA), equal to a significant 14% of fiscal 2020 general fund revenues. 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 totals $4.3 billion, up about 8.8% from the fiscal 2022 budget due to increases in state and federal funds as well as property and sales taxes. Discretionary revenue, such as taxes, permits charges for services and interest earning, are budgeted at about 10% higher than fiscal 2022, at about $1.013 billion. This increase is driven by an assessed value gain of 9% and expected strong sales taxes and interest earnings. On the expense side, the increase is driven by salaries and benefit cost increases due to 4% salary increases, increased pension contributions as well as additional staff.

The county's fiscal 2023 mid-year budget update indicates that its financial position continues to improve from the adopted budget. Discretionary revenues are roughly $89 million above adopted budget projections, totaling about $1.1 billion. In particular, property tax revenue, motor vehicle in-lieu and interest earnings are ahead by $21.5 million, $13.2 million and $34 million, respectively compared to the adopted budget.

In addition, the county anticipates about $73 million in operational savings, partially offset by a $16 million appropriation for some capital projects. As a result, the county expects to finish fiscal 2023 with an unassigned general fund balance of about $537 million, equal to about 49% of discretionary revenue, well above (about $261 million) its policy level of 25%.

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. In fiscal 2022, this would equal about $624 million, $88 million above the current level. The current policy of 25% of discretionary revenues is equal to about 7%-9% of total revenues.

Fiscal 2024 Budget

In fiscal 2024, the county is projecting a structurally balanced budget with about $4.3 billion in unrestricted general fund revenues. Sales taxes are expected to be equivalent with fiscal 2023 levels, and property taxes are expected to increase by 5.5%. Discretionary revenues are estimated at $1.1 billion, about $18 million in excess of recommended discretionary spending. The county executive recommends setting this aside in reserves and a deferred maintenance fund.

Fitch expects the county's strong revenue growth to gradually taper. As such, continued close 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. If the county maintains structural balance while maintaining reserves at or above historical levels as federal stimulus expires, there could be upward rating pressure.

2023-24 TRANS TO FINANCE CASH FLOW NEEDS

Note proceeds will be used to smooth cash flow management for general fund operations during fiscal 2024. The county expects the note set-asides to occur in months with positive net ending balances (January 2024 and May 2024), thereby allowing sufficient coverage of 1.43x and 1.07x solely on the basis of the January and May projected net ending balance, respectively without drawing upon over $2.0 billion in projected borrowable funds in June. Coverage increases to around 10.9x when projected borrowable funds are included. The repayment deposit structure sets aside 100% of principal and interest one month in advance of note maturity.

CREDIT PROFILE

The county is the fourth largest in California, covering about 7,300 square miles with a population of approximately 2.4 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 5.6% and 8.7% between fiscal 2018 and fiscal 2023. 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 employees since January 2018 and continues to eliminate vacant positions. Since fiscal 2020, revenue performance has been strong and county operations have been further supported by direct and indirect federal stimulus.

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 due to 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 Pension Advisory Review Committee. As of June 30, 2022, the balance in the pension Section 115 trust was $62.4 million (the annual pension contribution in fiscal 2022 was about $470 million) and provides potential budgetary flexibility in the event of increased 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%. TAV increased 8.7% in fiscal 2023, and the county is forecasting 5% increases in subsequent years, supporting similar rates of discretionary revenue increases. 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 pass-through 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.

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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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Dodd-Frank Rating Information Disclosure Form

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