FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Riverside County, CA's $87.4MM 2021 Teeter Notes 'F1+'; Affirms IDR at 'AA-'

Wed 29 Sep, 2021 - 1:40 PM ET

Fitch Ratings - San Francisco - 29 Sep 2021: Fitch Ratings has assigned an 'F1+' rating to the following obligation of Riverside County (the county):

--$87.4 million Riverside County's 2021 teeter obligation notes.

In addition, Fitch has affirmed the following ratings on county obligations:

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

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

--Riverside County certificates of participation, series 2009 at 'A+';

--Riverside County Asset Leasing Corporation (CORAL) lease revenue bonds (LRBs), series 1997A and 2013A at 'A+';

--Riverside County Public Financing Authority, LRBs, series 2012 and 2015 at 'A+';

--Riverside County 2021 tax and revenue anticipation note at 'F1+';

--Teeter obligation notes, series 2020A at 'F1+'.

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

The teeter obligation notes are expected to sell via negotiation the week of Oct. 5. Proceeds will be used to refinance a portion of the county's 2020 teeter obligation notes and fund an advance of unpaid property taxes for participating agencies in the county's teeter plan.

SECURITY

The 2021 series A teeter obligation notes are payable from delinquent property taxes payable through fiscal 2020. The notes are additionally payable from any lawfully available moneys from the county's general fund.

ANALYTICAL CONCLUSION

The 'F1+' short-term ratings on the 2021 teeter obligations corresponds to the county's 'AA-' IDR. The combination of the pledged delinquent tax revenues, general fund resources and borrowable resources provides very strong coverage of debt service.

The 'AA-' IDR is based on the county's solid revenue growth and expenditure flexibility, moderate liabilities and very strong gap closing capacity. Prior to the pandemic, the county had been challenged to balance ongoing revenue and expenditures. Better than expected revenue performance during the pandemic and sizable federal stimulus have helped the county's financial performance in fiscal 2021 and will help balance fiscal 2022. Once the stimulus funds have been utilized, the county will need to continue to be proactive in its budget management in order to maintain fiscal balance.

The 'F1+' rating on the 2021 tax and revenue anticipation notes, series 2021 also corresponds to the county's IDR and the notes' sound security structure.

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 is 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 County and Los Angeles, and a location along major distribution routes. The county experienced considerable housing market and tax base volatility as one of the worst-affected regions in the country during the Great Recession; however, both the housing market and assessed values improved significantly through fiscal 2021, 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. The state constitution limits the county's independent ability to raise revenues as tax rate increases require voter approval.

Expenditure Framework: 'aa'

Carrying costs for debt and retiree benefits are in the moderate range but likely to rise given the funding status of the state pension plans in which the county participates. The county has demonstrated its solid flexibility to make 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'

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 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

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

--Successfully managing expenditure pressures to align expenditure growth with revenue growth;

--Sustained maintenance of available fund balance which results in a stronger cushion relative to typical revenue volatility.

Factors that could, individually or collectively, lead to a 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 discretionary 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

Near-Term Budget Relief

The county's allocation from the ARPA is $480 million equal to a significant 14% of fiscal 2020 general fund revenues and transfers in, with half received in May 2021 and the other half expected in May 2022. The ARPA funds are not included in the county's fiscal 2021 budget. Although the county has not yet appropriated the ARPA funds, it expects they will be used primarily to promote economic recovery and other largely one-time expenditures.

The impact of the coronavirus pandemic and mitigation efforts on the county were moderate given that its discretionary revenue are primarily property taxes, which have continued to increase. The county's discretionary revenues (unincorporated sales taxes and other revenues driven by economic activity such as permits and charges for services) did slow at the end of fiscal 2020 with the onset of the pandemic, and the county acted to slow discretionary spending. It ended fiscal 2020 with a modest $9 million deficit, reducing unrestricted reserves by about $22 million to $286.5 million, or 8.3% of fiscal 2020 spending. This is down from $308 million (9.7%) at the end of fiscal year 2019.

The county expects to have ended fiscal 2021 with a roughly $19 million addition to fund balance rather than the budgeted $62 million use of reserves, driven by better than budgeted revenues. Almost all discretionary revenue categories have modestly outperformed budget. The largest positive variance ($23 million) is due to a permanent change in the allocation of former redevelopment agency residual funds pursuant to an appellate court decision. In addition to improved revenues, about $21 million in general fund budgeted spending was eligible for CARES Act funding, freeing up those funds for other purposes. Given these improvements, the county expects to end fiscal 2021 without using reserves and with an unrestricted fund balance modestly higher than at fiscal year-end 2020.

The county's adopted fiscal 2022 budget includes discretionary spending above discretionary revenues by about $52 million, with the difference budgeted to be covered by reserves. However, the county now expects its fiscal 2021 ending balance/2022 starting fund balance to be higher than budget. In addition, the actual fiscal 2022 AV increase was 5.6% rather than the budgeted 4.5% providing an estimated $37 million in additional fiscal 2022 revenues. Finally, although not included in the proposed fiscal 2022 budget, the county expects to be able to use up to $18 million from ARPA to backfill revenue. As a result, the county is likely to end fiscal 2023 with no or a smaller draw on reserves than budgeted.

Even prior to the coronavirus pandemic downturn, the county was facing budget gaps due to expenditure growth exceeding revenue growth. The county is continuing its efforts to better match ongoing expenditures and revenues through strict position control, limited travel, and the combination of departmental efficiencies and attrition. The county's hospital (Riverside University Health System) has stabilized its reliance on county subsidies.

Ongoing close management of general fund spending will be required given expectations for spending growth to be above revenue growth. Spending pressure includes the new Benoit detention center and MOUs with 4% merit increases. Fitch believes the county has sufficient spending flexibility to manage this pressure and to withstand typical revenue volatility. If the county uses reserves to balance its budget during economic expansions, reducing financial resilience, there could be downward rating pressure.

CREDIT PROFILE

The county is the fourth largest in the state, covering about 7,300 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. 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 six years, with secured assessed value increasing between 5.1% and 5.6% between fiscal 2016 and fiscal 2022.

The county has only 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 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 somewhat higher than that of revenues in the absence of policy action. Even 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 has had a hiring freeze in effect for most general fund employees since January 2018 and continues to eliminate vacant positions.

While the county has been quite disciplined in its labor negotiations, imposing its last best and final offer on the Riverside Sheriff's Association (RSA) and SEIU, the parties eventually came to agreements for 4% annual salary increases though fiscal 2024, roughly matching expected AV and property tax revenue growth, the primary driver of discretionary revenues.

The county's fixed cost burden is moderate, with carrying costs for debt, pensions and retiree healthcare accounting for 12% of fiscal 2020 governmental spending.

Labor relations with some employee groups have been pressured in recent years. 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., the county settled with LIUNA after contracts had expired in June 2016 with terms generally favorable to the county. The county has the authority to ultimately impose terms and contracts if an agreement is not reached, as occurred with RSA and SEIU.

The vast majority of the county's labor contracts are settled through the next two or three years. Most contracts have annual merit increases of 4% while annual pension costs may rise at a faster rate depending on actual investment returns. The county is forecasting 4.5% AV growth over the next few 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 on the high end of the moderate range, estimated at 17% of personal income. Debt is primarily overlapping ($12 billion), with net direct debt of about $2.7 billion. In fiscal 2020, the county issued $720 million in pension obligation bonds to refinance its obligation with CalPERS. This will reduce the unfunded actuarial liability by a similar amount in the next pension audit and will result in an increase in direct debt, with essentially no impact on its total.

The county has three pension tiers through CalPERS and the aggregate adjusted net pension liability (adjusted to use a 6% rate of return assumption and offset by the deposit to CalPERS from the 2020 POBs) totals about $2.8 billion. The unfunded pension liability represents about 30% of the total long-term liability burden. The county's net OPEB liability is modest at just $46 million, up from $28 million due to a change in return assumption on assets.

Operating Performance

The county has had some challenges 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. Nonetheless, the county maintains solid reserve levels, which, coupled with spending flexibility, should allow it to manage through typical economic cycles. The unrestricted general fund balance at year-end fiscal 2020 was $286.5 million, or 8.3% of total general fund spending, including all pass-through revenues.

Fitch expects issuers 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 put negative pressure on the county's overall operating performance and therefore the rating.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR

ENTITY/DEBT	RATING			PRIOR
Riverside County (CA) [General Government]	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
• Riverside County (CA) /General Fund Contractual Obligations - Pension/1 LT	LT	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable
• Riverside	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating

VIEW ADDITIONAL RATING DETAILS

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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)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Riverside County (CA)	EU Endorsed, UK Endorsed

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