



## RATING ACTION COMMENTARY

# Fitch Rates Riverside County, CA's \$360MM 2022 TRANS 'F1+'; Affirms IDR at 'AA-'; Outlook to Positive

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Fitch Ratings - San Francisco - 03 Jun 2022: Fitch Ratings has assigned an 'F1+' rating to the following obligation of Riverside County, CA (the county):

--\$360 million Riverside County's 2022 tax and revenue anticipation notes (TRANS).

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

--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 and 2013A at 'A+';

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

--Riverside County 2021 TRANS at 'F1+';

--Teeter obligation notes, series 2021A at 'F1+'.

The Rating Outlook on the long-term bonds is revised to Positive from Stable.

The notes are expected to sell via negotiated sale the week of June 14. TRAN proceeds will be used to provide moneys to meet the county fiscal 2023 general fund expenditures, including current expenses, and the discharge of other obligations or indebtedness of the county.

## **SECURITY**

The 2022 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 2023 and legally available.

## **ANALYTICAL CONCLUSION**

The 'F1+' short-term ratings on the 2022 TRANs correspond to the county's 'AA-' IDR. The combination of the pledged fiscal 2023 revenues and internal borrowable resources provides very strong debt service coverage (projected to be in excess of \$2.2 billion, estimated to cover note principal and interest 7.6x). Full note principal and interest set-asides occur well in advance of the TRANs' maturity on June 30, 2023.

The revision of the Outlook to Positive from Stable reflects the improved fiscal outlook given recent strong gains in revenues along with leveling off of previously increasing costs for an inmate healthcare settlement and the Riverside University Health System operations. 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 recurring revenue and expenditures. Better than expected revenue performance during the pandemic, and sizeable federal stimulus supported solid financial performance in fiscal 2021 and 2022. 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 Amazon, Nordstrom, and United Parcel Service, 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 as well as due to development 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 Recession; however, both the housing market and assessed values (AVs) improved significantly through fiscal 2022, and sizable state and federal revenue in the budget tends to moderate the effect of this cyclical volatility 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. Nevertheless, the county's revenue raising from fees and charges is satisfactory.

### **Expenditure Framework: 'aa'**

Carrying costs for debt and retiree benefits are in the moderate range but may 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 equal to or 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 very strong financial resilience.

## **RATING SENSITIVITIES**

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

- Maintain structural balance as recent revenue surge and federal relief funds subsidies;
- Maintenance of unrestricted fund balance around historical level.

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**

### **COVID and Fiscal Stimulus**

The impact of the coronavirus pandemic and mitigation efforts on the county were moderate given that its discretionary revenue is primarily property taxes, which have continued to increase. The county's other locally generated 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. The county 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 2019.

The county was allocated \$488 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. Half was received in May 2021 and the other half is still pending receipt. As of April 2022, the county had allocated \$194 million for infrastructure, housing and homelessness, county departments response, non-profit assistance, and child-care. In addition, the county budgeted \$10 million in revenue backfill in fiscal 2022.

### Fiscal 2021 Operations

Total general fund revenues increased 6% in fiscal 2021, driven by tax increases - primarily property taxes - while spending only increased 3%. After budgeting a \$62 million use of fund balance, the county ended fiscal 2021 with a \$165 million surplus, and added \$135 million to the unrestricted fund balance, bringing the total to almost \$422 million, or 11.7% of spending. The 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.

### Fiscal 2022

The county's fiscal 2022 third quarter report indicates discretionary revenues about \$50 million above budget, reducing the planned use of unassigned fund balance to \$3 million. The improved revenues include sales and use taxes, motor vehicle in lieu, distribution from the former redevelopment agencies, and real property transfer taxes. In addition, the county anticipates ending the year with budgeted contingency of about \$14.5 million, which will be available for appropriation in fiscal 2023.

Ongoing close management of general fund spending will be required given expectations for spending growth to be above revenue growth. Spending pressure includes 4% employee 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 2.4 million. It is a higher-growth region with less maturity than its coastal neighbors; as such, the county 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 6.3% between fiscal 2018 and fiscal 2022.

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 modestly 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 15% of fiscal 2021 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. 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 March 2022, the balance in the pension Section 115 trust was \$62.4 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 the next two to three years. Most contracts have annual merit increases of 4%. The county is forecasting a 6% AV increase in fiscal 2023 and a 5% increase over the medium term, 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 about 17% of personal income. Debt is primarily overlapping (\$12 billion), with net direct debt of about \$3.6 billion. In fiscal 2020, the county issued \$720 million in POBs to refinance a portion of its obligation with CalPERS. This had the effect of reducing the unfunded actuarial liability by a similar amount.

The county has three pension tiers through CalPERS and the county reports the aggregate net pension liability of \$3 billion and an asset to liabilities ratio of 77% as of June 30, 2020 (as reported in the fiscal 2021 audit), assuming 7.15% discount rate). The Fitch-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 \$5.2 billion. The county's net other post-employment benefits (OPEB) liability is modest at just \$187 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 YE fiscal 2021 was \$421 million, or 11.7% 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 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.

## 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](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT ◆	RATING ◆	PRIOR ◆
Riverside County (CA) [General Government]	LT IDR    AA- Rating Outlook Positive  Affirmed	AA- Rating Outlook Stable



Riverside County (CA) /General Fund Contractual Obligations - Pension/1 LT	LT	A+ Rating Outlook Positive	Affirmed	A+ Rating Outlook Stable
Riverside County (CA) /Issuer Default Rating - General Government/1 LT	LT	AA- Rating Outlook Positive	Affirmed	AA- Rating Outlook Stable
Riverside County (CA) /Lease Obligations - Standard/1 LT	LT	A+ Rating Outlook Positive	Affirmed	A+ Rating Outlook Stable
Riverside County (CA) /Operating Cashflow/1 ST	ST	F1+	Affirmed	F1+

[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**

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Riverside County (CA)

EU Endorsed, UK Endorsed

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