Orange County, California
Pension Obligation Bonds
New Issue Report

New Issue Details


Security: The bonds are absolute and unconditional obligations of Orange County imposed by law and are payable from all lawfully available funds.

Purpose: To prepay pension expenses.

Final Maturity: June 30, 2017.

Key Rating Drivers

Wealthy and Diverse Economy: The county benefits from a large, diverse and wealthy economic base.

Healthy Financial Position: The county’s financial position remains strong, bolstered by solid fund balance levels and proactive efforts to control expenditure growth.

Low Debt Levels: Direct debt levels are very low, and amortization is rapid.

Substantial Pension Liability: The county’s pension system retains a substantial unfunded liability despite recent pension reforms.

Rating Sensitivities

Strong Fundamentals: The ‘AA+’ implied GO rating reflects the county’s robust economy, favorable debt position and record of strong operating results. The Stable Rating Outlook reflects Fitch Ratings’ expectation that the county’s strong fundamentals will be maintained over the next several years.

Related Research

Fitch Rates Orange County, CA's $334.5MM Pension Obligation Bonds 'AA/F1+' (December 2015)

Analysts

Stephen Walsh
+1 415 732-7573
stephen.walsh@fitchratings.com

Shannon Groff
+1 415 732-5628
shannon.groff@fitchratings.com
Credit Profile

Orange County is the third most populous county in California and the sixth most populous in the nation. Located on the Pacific coast between San Diego and Los Angeles, the county is largely suburban, with major population centers in the cities of Anaheim, Santa Ana and Irvine.

Diverse and Wealthy Economy

Orange County’s credit strength relies primarily on its large, diverse and wealthy economic base. Its proximity to Los Angeles, San Diego and the Inland Empire of Riverside and San Bernardino Counties provides ready access to the substantial Southern California economy. Major business sectors include tourism, healthcare, biotechnology, and computer software and hardware.

Property values in Orange County fared relatively well during the most recent recession and have increased in its aftermath. Taxable assessed value (TAV) declined just 1.4% in fiscal 2010 and 0.4% in fiscal 2011 before returning to modest growth in fiscal years 2012 and 2013. TAV growth accelerated between fiscal years 2014 and 2016, resulting in cumulative growth of 19.9% since fiscal 2011. Home values reported by Zillow.com were up 5.3% year over year as of November 2015, pointing to continued TAV gains in fiscal 2017.

Unemployment was low at 4.3% as of October 2015, as compared with rates of 5.5%, 5.7% and 4.8% for the MSA, state and nation, respectively. Employment levels remain about 2% below prerecession peaks despite the county’s low unemployment rate.

Income and wealth indicators for county residents are substantially higher than state and national averages, and per capita TAV is also high at approximately $145,000. The county’s population growth has been considerably slower than that of its peers and is projected to remain below average, reflecting the relative maturity of the county’s development.

Healthy Financial Position

The county’s financial position remains sound, and reserves have increased steadily since fiscal 2010. Available fund balance was equal to 16.7% of general fund expenditures and transfers out at the end of fiscal 2014. Management reports further additions to fund balance for fiscal 2015, which Fitch considers reasonable based on recent strong revenue growth.

The county’s fiscal 2014 fund balance includes approximately $332 million categorized as nonspendable under GASB 54 due to the county’s prepayment of pension expenses for the following fiscal year. Fitch includes such amounts in its measure of available fund balance since the county’s pension obligation is unaffected by the timing of its payment. In addition to fund balance, the county retains access to $112 million in an investment account with its pension plan that is available only for payment of pension expenses at the county’s discretion.

Management efforts to maintain and increase reserves could be challenged by the recent resolution of a dispute with the state of California over vehicle license fee revenues. The county expects to return $145 million to the state over the next five years from funds previously set aside for this purpose. Current plans call for the county to make the repayments from future budget surpluses, but any shortfalls would be funded from reserves instead.

General fund revenue gains have exceeded expenditure growth for the past several years, and the county’s conservative financial projections for the next five years report modest annual surpluses before consideration of augmentation requests. Fitch assumes the county will implement sufficient recurring solutions to any gaps that might arise, based on its success in addressing sizable budget gaps during the most recent recession.
Low Debt, Large Pension Liabilities

Overall debt levels are moderate at 1.9% of market value and $2,973 per capita. Direct debt levels are very low, primarily as a result of limited new debt issuance since the county’s 1994 bankruptcy. All outstanding general fund-supported debt will be repaid by 2019. The county has relied on state grants and internal resources for recent capital projects and is considering approximately $80 million in new debt issuances for capital projects in fiscal 2016.

The county’s pension liabilities remain substantial despite recent reforms. At the end of fiscal 2014, the county’s multi-employer pension plan faced an unfunded actuarial accrued liability of $5.0 billion. Of this amount, $3.9 billion (approximately 0.8% of fiscal 2016 TAV)
was attributable to the county, with a reported funded ratio of 70%. Fitch estimates the county’s funded ratio would fall to 68% under an assumption of 7% investment returns.

The county has made recent progress in shifting pension costs to employees and has conservatively reduced both its pension amortization period and assumed rate of return. Management expects pension expenses to stabilize over the next several years if investment returns meet current assumptions. The county also restructured other post-employment benefits (OPEB) for most employees and retirees in 2007 and 2008, resulting in a significant reduction to OPEB liabilities. The county has fully funded its annual contribution requirements for OPEB in subsequent years. Carrying costs for debt service and retiree benefits were moderate at 15.6% of governmental expenditures in fiscal 2014.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

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