



MENDOCINO COUNTY EXECUTIVE OFFICE

NEWS RELEASE

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TO: MENDOCINO COUNTY NEWS MEDIA
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Ukiah, California...November 29, 2016

***FITCH RATINGS AFFIRMS COUNTY OF MENDOCINO'S "A+"
CREDIT RATING – OUTLOOK STABLE***

Fitch Ratings recently conducted a customary review of Mendocino County's credit rating and stability. Today, November 29, 2016, the County received the attached Press Release from Fitch outlining their findings.

In summary, Fitch Ratings has affirmed an "A+" rating on the County's general obligation debt and an "A" rating on its pension obligation bonds. The ratings reflect the "...county's solid spending flexibility and moderate long-term liability burden in the face of a limited revenue framework." Fitch assesses the local economic environment as, "The county continues to face challenges associated with a long-term economic contraction. Wealth and income levels remain well below state and national averages." However, "Total general fund revenues have performed in line with to slightly above inflation and modestly below U.S. economic growth."

According to Fitch's assessment, reserve levels are the primary factor in the County's credit rating sensitivity and resilience in the event of an economic downturn. While Fitch acknowledges the County's progress in incrementally increasing reserve levels they state, "...the county's gap-closing capacity as only adequate. Future revenue volatility can be mitigated by the accumulation of larger reserves."

Fitch acknowledges that, "Based on historical performance Fitch believes that the county, although challenged due to prior spending reductions, would make the necessary budgetary changes to maintain an adequate safety margin in a moderate economic decline scenario."

For more information, please contact the Mendocino County Executive Office at (707) 463-4441.

Released by: *Carmel J. Angelo*
Carmel J. Angelo
Chief Executive Officer

FITCH AFFIRMS MENDOCINO COUNTY, CA'S POBS AT 'A'; OUTLOOK STABLE

Fitch Ratings-San Francisco-29 November 2016: Fitch Ratings has affirmed the following Mendocino County, CA (the county) ratings:

--\$64.15 million pension obligation refunding bonds (POBs) series 2002 at 'A';
--Issuer Default Rating (IDR) at 'A+'.

The Rating Outlook is Stable.

SECURITY

The POBs are an absolute and unconditional obligation of the county imposed by law, the payment of which is not limited to any special source of funds.

KEY RATING DRIVERS

The 'A+' IDR reflects the county's solid spending flexibility and moderate long-term liability burden in the face of a limited revenue framework. The county's reserve levels support adequate financial resilience relative to its somewhat limited budgetary flexibility.

Economic Resource Base

Mendocino County is located in northern California, along the Pacific coast, approximately 115 miles north of San Francisco. The county's estimated population of 90,000 is little changed from the 1990s and is dispersed across 3,500 square miles - a land area larger than several states. The county continues to face challenges associated with a long-term economic contraction. Wealth and income levels remain well below state and national averages. The unemployment rate has historically mirrored that of the state and been above the national average.

Revenue Framework: 'a' factor assessment

Total general fund revenues have performed in line with to slightly above inflation and modestly below U.S. economic growth. The county's legal ability to raise revenues is constrained by state constitutional provisions that require voter approval for tax increases.

Expenditure Framework: 'aa' factor assessment

The pace of spending is expected to be in line with to moderately above revenue growth. Carrying costs, including debt and pension contributions, are moderate.

Long-Term Liability Burden: 'aa' factor assessment

The county's liability burden is moderate relative to its resource base.

Operating Performance: 'a' factor assessment

Reserves have increased over the past few years, relieving some pressure on a moderately constrained expenditure profile. Fitch expects the county to exercise sufficient spending control to maintain satisfactory resilience in the event of a moderate economic downturn.

RATING SENSITIVITIES

Maintenance of Reserves: The rating is sensitive to material changes in reserve levels, which along with adequate spending flexibility serve as a buffer to potential revenue contraction.

CREDIT PROFILE

The county continues to face challenges associated with a long-term economic contraction that dates from the late 1990s. Population growth has been very slow over this period and employment levels dropped steadily before modest growth over the past few years. Tourism and wine production have provided some opportunities for growth, but overall employment and labor force levels have not recovered to pre-recession levels. Wealth and income levels remain well below state and national averages. The unemployment rate has historically mirrored that of the state and been above the national average.

Taxable assessed valuation (TAV) was relatively unaffected by the national housing boom and has been insulated from subsequent declines. TAV dropped by just 2.2% between 2010 and 2013 after many years of steady increases, and resumed modest growth in fiscal 2014.

Revenue Framework

The county's largest source of revenues is state and federal funding at nearly half of total general fund revenues. Taxes make up about 40% of the revenue total.

Total general fund revenues, with a 10-year CAGR of 2.4% through fiscal 2014, have performed in line with inflation and below U.S. economic growth. Excluding intergovernmental revenues, the general fund recorded a faster rate of revenue growth over this period at 3.3%.

Similar to other California local governments, the county's independent legal ability to raise revenues is limited by state constitutional provisions which require voter approval for tax increases. The county may increase fees and charges for services, but is generally limited to the cost of services provided.

Expenditure Framework

Approximately 42% of spending is for public assistance and 38% is for public safety.

Spending over the near term is expected to be in line with to moderately above revenue growth.

Carrying costs are moderate at about 12% of fiscal 2015 governmental expenditures. The county implemented substantial expenditure reductions during and after the last economic downturn, primarily through workforce and payroll reductions; these cuts limit the county's near-term spending flexibility to a degree. Workforce reductions eliminated approximately one-fourth of the county's full-time employees after the recession, while remaining employees experienced permanent wage cuts of 10% to 12.5%. Most of the most recent two-year labor contracts through fiscal 2017 have 2%-3% annual compensation increases. In addition, the county eliminated other post-employment benefits (OPEB) for current and retired employees.

Voters recently approved two cannabis-related measures. Measure AI authorizes the county to tax cannabis cultivation sites in unincorporated areas of the county at 2.5%, which the Board of Supervisors will be allowed to incrementally increase starting in 2020 up to a maximum 10% rate. Measure AJ advises the board to spend the majority of revenue on enforcing marijuana regulations, providing mental-health services, repairing county roads, and providing fire and medical services. The county has not finalized its plans for allocation of the tax revenue, but management indicated a portion of the revenues generated by the tax would likely be spent on roads.

Long-Term Liability Burden

The long-term liability burden is moderate, with overall debt and pensions at approximately 13% of personal income. The county participates in the Mendocino County Employees' Retirement Association, which has an estimated ratio of assets to liabilities of 73.7% adjusted by Fitch to a 7%

rate of return. The county began a phased elimination of OPEBs in 2010, which was completed Dec. 31, 2013.

The county recently adopted and last updated in May 2014 a five-year capital plan (fiscals 2014 - 2018), after having been without a plan since 2006. The total budgeted capital improvements for fiscal 2017 equal \$6.45 million, of which \$4 million is funded through the general fund, including about \$2.4 million in carryover projects.

The largest long-term cost facing the county is a remodeling or replacement of the county jail, estimated at \$21 million. The county's application for a \$20 million state grant for the project was denied, and the county is currently applying again. Management estimates the current facility has sufficient capacity for the next five to 10 years, and estimates the annual operating costs of a new facility at \$1.5 million - \$2 million (similar to the current cost).

Operating Performance

The county's finances could become stressed in an economic downturn. Given Fitch Analytical Sensitivity Tool (FAST) estimated county total general fund revenue declines of more than 5% in a typical recession, or 3.8% less intergovernmental revenues, and the somewhat constrained ability to make expenditure adjustments, Fitch assesses the county's gap-closing capacity as only adequate. Future revenue volatility can be mitigated by the accumulation of larger reserves and retention of expenditure flexibility. Based on historical performance Fitch believes that the county, although challenged due to prior spending reductions, would make the necessary budgetary changes to maintain an adequate safety margin in a moderate economic decline scenario.

The county adopted a general fund reserve policy in 2012 that increased targets for its stabilization, counter-cyclical and emergency reserves from a cumulative 2% to 6.35% of general fund expenditures, or a minimum of \$10 million. The policy also provided a mechanism for incremental additions to reserves until targeted levels are reached, which occurred in fiscal 2015. In addition, the county created a pension gap reserve with a balance of \$3.65 million for the last few years. The county posted four years of surpluses through fiscal 2015, each between 5% and 6% of spending.

The county continues to make notable progress in addressing weaknesses previously cited by Fitch. Management recently met increased fund balance targets, updated treasury practices, and updated the capital improvement plan.

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Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)

<https://www.fitchratings.com/site/re/879478>

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