MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Oakland's (CA) G.O. Refunding Bonds

Global Credit Research - 29 Apr 2015

$125.0M refunding debt affected

OAKLAND (CITY OF) CA
Cities (including Towns, Villages and Townships)
CA

Moody's Rating

ISSUE	RATING
General Obligation Refunding Bonds, Series 2015A	Aa2

Sale Amount	$124,615,000
Expected Sale Date	05/04/15
Rating Description	General Obligation

Moody's Outlook STA

NEW YORK, April 29, 2015 --Moody's Investors Service has assigned an Aa2 rating to the City of Oakland's (CA) General Obligation Refunding Bonds, Series 2015A totaling approximately $125.0 million. Moody's maintains ratings on $219.7 million outstanding general obligation bonds; $81.9 million outstanding lease-backed securities; and $358.5 million of Pension Obligation Bonds.

SUMMARY RATING RATIONALE

Oakland's Aa2 general obligation rating is supported by the city's very large Bay Area economy that is successfully emerging from the economic downtown. The rating is supported by the city's healthy operating reserves and improving revenues. The city's ability to maintain a stable financial position will be challenged by increased demand for city services and rising pension and medical costs. The city has an above-average net direct debt burden and an elevated lease burden on the general fund that has been incorporated into the current review, as well as above-average pension and OPEB obligations.

OUTLOOK

The outlook is stable and reflects the positive trends of the city's economic and financial position that are offset by the city's elevated debt position.

WHAT COULD MAKE THE RATING GO UP

- Material and sustained improvement to the city's assessed value and socioeconomic indicators

- Significant improvement to the city's financial position

WHAT COULD MAKE THE RATING GO DOWN

- Erosion of the city's financial position

- Prolonged economic decline

STRENGTHS

- Positive economic growth

- Improving general fund revenues

CHALLENGES

- Budgetary pressures for increased pension and medical costs

- Elevated debt and retirement obligations

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ECONOMY AND TAX BASE: SUSTAINED ECONOMIC IMPROVEMENT EXPECTED

The City of Oakland has a strong Bay Area economy that should continue to expand in the near-term. The city's economy is currently undergoing strong growth fueled by increased building permits, increase in taxable sales, and rising residential home values. Planned commercial and housing developments continue to fuel economic activity and help to create the city as a Bay Area destination for commercial and residential activity. There are as many as 11,000 new housing units in the development pipeline (under construction, have received, or applied for entitlements) throughout the City, with additional retail space planned with the developments.

The city remains a transportation hub for the Bay Area economy and the city's port remains the 5th largest container port in the nation. Supporting the city's economy are high-income sectors, such as technology, research, and digital arts.

The city's assessed value (AV) increased by 5.8% in fiscal 2015 to $47.7 billion, the city's highest AV ever. The city has low taxpayer concentration at 3.4% of total fiscal 2015 AV. The city's unemployment rate continues to trend downward to 7.8% as of December 2014, though remains higher than the state (6.7%) and nation (5.4%) for the same period. Resident wealth levels are slightly lower than national averages with median family income at 92.1% of the US.

FINANCIAL OPERATIONS AND RESERVES: STABLE RESERVES AND INCREASED REVENUES EXPECTED; BUDGETARY CHALLENGES REMAIN

The city should maintain a stable financial profile in the near-term as general fund revenues continue to support the city's budgetary pressures. The city's economically sensitive revenues continue to increase, with strong growth in fiscal 2015 in the city's property tax, sales tax, business license tax, and transient occupancy tax revenues. Property tax revenues increased by 7.7% in fiscal 2015, largely fueled by growth in real property values and property transfers. Sales Tax revenues grew by 3.1% in fiscal 2015, supported by the city's Measure BB, which is a ½ cent sales tax increase to be used for transportation projects. Measure BB was extended for three years and will expire in March 2045; the measure also increased by ½ cents to collect a full 1 cent sales tax in January 2015. The city's Business License Tax revenues increased by 9.1% in fiscal 2015, reflecting a decline in office vacancy rates to 8.4% as of June 30, 2014. Transient Occupancy Tax revenues grew by 11.7% in fiscal 2015, fueled by a 78% hotel occupancy rate. These economically-sensitive revenues should continue to increase in fiscal 2016 and fiscal 2017.

The city will likely have an $8.0 million operating surplus by fiscal 2015 yearend, which is largely attributable to strong revenue growth. This should result in a slight increase in total reserves in fiscal 2015. The city had an available fund balance of $97.4 million (16.8% of revenues) in fiscal 2014.

By June 30, 2015, the city will adopt a two-year budget for fiscal 2016 and fiscal 2017. The preliminary budgets for these fiscal years are structurally balanced and reflect no reductions in workforce or service levels. The budget assumptions reflect continued growth in the city's ongoing revenues fueled by an improving economy, improved collections, and some fee increases. The budgets also reflect the restoration of some key services, including public safety, economic development, and housing projects.

The city still faces budgetary challenges, including rising pension and medical costs, upcoming collective bargaining agreements, and increased demand for city services. Negotiations with bargaining units should be completed by June 30, 2015, in time for the adoption of the two-year budget. We feel the city's positive economic trend will provide some revenue growth to address these challenges while management maintains stable reserves in the near-term. The city is also preparing for long-term economic cycles, by setting aside revenues into a Vital Service Stabilization Reserve. Annual set asides are based on formula. The fund will be used in times of economic downturn to maintain city services and limit long-term expenditure pressures. The current reserve total is $2.0

million as of February 28, 2015.

Liquidity

The City of Oakland maintains ample general fund liquidity. General fund cash was $270.9 million (46.8% of revenues) at the end of fiscal 2014.

DEBT AND PENSIONS: ELEVATED DEBT AND PENSION OBLIGATIONS; STABILITY EXPECTED; NO VARIABLE-RATE DEBT

Oakland has an above-average net direct debt burden for a California city that should remain stable. The city has $219.7 million of general obligation bonds outstanding, supported by an unlimited property tax pledge. Debt supported by the city's general fund include the city's $81.9 million Lease Obligations and $89.3 million authority debt attributed to the city. The city's $358.5 million Pension Obligation Bonds are supported by a property tax override. The totals for all of these bonds outstanding are as of March 1, 2015. The city has an elevated 2.0% of AV net direct debt burden and an above-average 6.0% lease burden as a percentage of general fund expenditures.

The city has $62.3 million in general obligation bond authorization outstanding under Measure DD. The city will likely issue additional general obligation bonds in 2016, but AV growth should help to keep the debt as a percentage of AV stable.

Debt Structure

After the refunding of the city's outstanding variable-rate Lease Revenue Bonds, Series 1996 A-1 and A-2 to fixed-rate bonds-scheduled for April 29, 2015-the city will have only fixed-rate obligations outstanding.

Debt-Related Derivatives

The city has one stand-alone swap that is not associated with any outstanding bonds. The rating termination triggers for the swap are a function of the city's and the swap provider's (Goldman Sachs Mitsui Marine Derivative Products) ratings, with the city's option to terminate if the counterparty's rating falls below A3 and the counterparty's option to terminate if the city's rating falls below Baa3. The most recent mark to market valuation was -$7.6 million as of March 31, 2015, which is not burdensome given the city's available unrestricted cash and reserves. Under the swap, the city pays the counterparty a fixed payment of 5.6775% and receives a variable payment computed at 65% of LIBOR rate (total rate not to exceed 12%). The city's payments to the counterparty are insured.

Pensions and OPEB

Pension-driven budgetary pressures for Oakland City could prove to be a budgetary burden.

Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $3.2 billion, or an above-average 4.4 times operating revenues. Rate increases will increase the funded ratio to 75% for each the city's California Public Employees' Retirement System (PERS) plans, which are currently at 67.9% for the Safety Plan and 69.5% for the Miscellaneous Plan. The city makes 100% of its annual pension costs for each of the PERS plans. These annual costs in fiscal 2014 were $98.6 million (16.4% of operating revenues), which is slightly above-average relative to other California cities. The city also maintains its Police and Fire Retirement System (PFRS) plan, which should be fully funded by 2026. The city issued its Pension Obligation Bonds to prepay PFRS contributions in July 2012 and reduced the unfunded liability by $210.0 million.

Oakland has a large unfunded OPEB liability of $463.8 million, and is currently making approximately half of its annual required contribution (ARC) of $40.5 million (6.7% of 2014 revenues). The city's goal is to fully-fund its ARC. The city has budgeted $8.0 million one-time and $5.0 million ongoing in its fiscal 2016 budget and $3.0 million ongoing in its fiscal 2017 toward its OPEB liability. Additionally, the city paid $2.9 million in fiscal 2014 toward the unfunded liability and has budgeted to pay $665,000 annually until June 30, 2022.

MANAGEMENT AND GOVERNANCE

California cities have an institutional framework score of "A" or moderate. Primary sources of unrestricted revenues come from property tax, sales tax, and utility users tax. Service charges and state aid make up significant sources of city revenues as well, however are usually restricted to specific purposes. Property taxes are fairly predictable, given the state's constitutional formula, known as "Prop. 13," while sales taxes are extremely sensitive, either to the local economy or the state's financial position. Expenditure flexibility is similarly limited, although somewhat less so than revenues. For full service cities police and fire expenditures makeup nearly 2/3 of discretionary spending and California cities operate in an environment with collective bargaining and pressures associated with growing pension and OPEB burdens.

KEY STATISTICS

- Assessed Value, Fiscal 2015: $47.7 billion

- Assessed Value Per Capita, Fiscal 2015: $117,907

- Median Family Income as % of US Median: 92.1%

- Fund Balance as % of Revenues, Fiscal 2014: 16.8%

- 5-Year Dollar Change in Fund Balance as % of Revenues: -3.83%

- Cash Balance as % of Revenues, Fiscal 2014: 46.8%

- 5-Year dollar Change in Cash Balance as % of Revenues: 4.95%

- Institutional Framework: A

- 5-Year Average Operating Revenues/Operating Expenditures: 0.99x

- Net Direct Debt as % of Assessed Value: 1.85%

- Net Direct Debt / Operating Revenues: 1.5x

- 3-Year Average ANPL as % of Assessed Value: 5.48%

- 3-Year Average ANPL / Operating Revenues: 4.4x

OBLIGOR PROFILE

The City of Oakland is located in the County of Alameda on the eastern shore of the San Francisco Bay, approximately seven miles from downtown San Francisco via the San Francisco-Oakland Bay Bridge. Occupying approximately 53.8 square miles, the city is the largest and most established of the "East Bay" cities.

LEGAL SECURITY

The general obligation offering is secured by an unlimited property tax pledge of all taxable property within the city boundaries. Debt service on the rated debt is secured by the city's voter-approved unlimited property tax pledge. The county rather than the city will levy and collect the property taxes constitutionally restricted to pay debt service on general obligation bonds to the city. The city will transfer the debt service payment to the trustee.

USE OF PROCEEDS

The General Obligation Refunding Bonds, Series 2015A will be used to refund all of the city's outstanding General Obligation Refunding Bonds, Series 2005 and advance refund all of the outstanding General Obligation Bonds, Series 2006 and Series 2009B.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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