S&P Global
Ratings

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Summary:

Oakland, California; Appropriations; General Obligation

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Table Of Contents

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Credit Profile		
US$194.37 mil GO bnds (Measure KK) ser 2022C-1 due 07/15/2052		
Long Term Rating	AA/Stable	New
US$17.945 mil GO bnds (Measure KK) ser 2022C-2 due 07/15/2022		
Long Term Rating	AA/Stable	New
Oakland GO		
Long Term Rating	AA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to Oakland, Calif.'s anticipated $194.4 million series 2022C-1 and expected $17.9 million series 2022C-2 general obligation (GO) bonds. S&P Global also affirmed its 'AA' long-term rating on the city's previously-issued GO bonds, its 'AA' long-term rating and underlying rating (SPUR) on the city's previously-issued and non-ad valorem obligations, and its 'AA-' long-term rating on the city's previously-issued appropriation obligations. The outlook is stable.

The city will have about $1.2 billion in governmental debt, including tax-increment obligations associated with its successor agency, outstanding at the end of fiscal 2022.

Revenue from unlimited ad valorem taxes levied on taxable property within the city secures the series 2022C-1 and 2022C-2 GO and previously issued GO bonds. The city's non-ad valorem obligations, which were issued for funding its pension liabilities, are payable from any legally available revenue of the city and are rated on par with the city's GO obligations given a lack of legal limitations on fungibility of resources within the organization. Oakland's appropriation obligations are secured by or represent an interest in lease-rental payments by the city, as lessee. We rate these obligations one notch lower than the city's general creditworthiness (as reflected in our GO rating) to account for the appropriation risk associated with lease payments. Under the agreements, the city can abate lease payments if the leased property is damaged or destroyed, but it has agreed to maintain at least two years of rental interruption insurance as well as casualty insurance equal to the full replacement cost of the damages.

The city will use the proceeds of the series 2022C-1 and 2022C-2 bonds for a variety of capital improvements, with an emphasis on street paving and improvements and the construction of or improvements to civic facilities such as fire stations, libraries, or recreation facilities.

Credit overview

The COVID-19 pandemic and associated recession have buffeted Oakland's economy and strained its finances but we see federal grant support under the American Rescue Plan Act and a strong real estate development pipeline as helping the city to address a baseline operating imbalance. Although the city mostly exhausted its rainy day fund early in the pandemic and suspended its policy of other postemployment benefit (OPEB) trust contributions, it maintained compliance with its well-defined reserve policy and is increasingly confident in its financial outlook. For fiscal 2022, it expects to partially restore its rainy day fund due to robust economic activity underlying the fund's contribution source and also has budgeted to catch up on its suspended OPEB trust contributions by fiscal 2023.

We continue to view pension and OPEB costs and a large deferred maintenance backlog as weighing down credit quality, plus a recent surge in crime has brought the public safety function to the fore in budget discussions, but we also think a history of voter support for services and capital projects has made budgeting easier than it otherwise would be. Moreover, a now-institutionalized long-term financial forecasting practice is helping it put near-term budgeting decisions in context and the city has become a national leader in integrating environmental, social, and governance (ESG) concepts into service provision and capital investments. We see potential for credit quality to strengthen in the coming years if property value growth continues at a similar pace, which would make it easier for the city to sustainably bolster its financial position and secure voter support for infrastructure needs.

The ratings additionally reflect our view of the city's:

- Economic base in the center of the large and diverse San Francisco Bay Area, with substantial infrastructure assets including a container seaport, airport, and nodes of the region's freeway and commuter rail network;
- Very strong budgetary flexibility and liquidity, with a substantial rebound in performance in fiscal 2021 and a phased use of federal grants amid budget adjustments to position the city to balance its budget without such support by fiscal 2024; and
- Large pension and OPEB liability and what are likely to be rising carrying charges this decade, even with the advantage of a special ad valorem tax restricted to pension costs.

Environmental, social, and governance

We believe that environmental risks are elevated relative to those of its peers, with a major earthquake fault running through the city, a history of wildfire within its boundaries, and an extensive shoreline exposing its infrastructure and economy to sea-level rise. However, Oakland has been active in inventorying its natural hazards and planning mitigation efforts, including hiring an officer with formal responsibility for resiliency policy, and has developed a "soft story" plan to address seismic vulnerability for this common type of residential and commercial architecture. The city uses an equity-based scoring system that helps it deploy road maintenance and improvement resources to economically vulnerable neighborhoods to facilitate economic resilience and recovery from a natural disaster and employs a similar framework for its climate action plan.

Social risk is also above average, in our view, with a long-standing significant population of unhoused people and high housing costs that put more people at risk of homelessness, especially during economic downturns. We expect housing and homelessness services to figure prominently in budget decisions and expect affordable housing to be a common use of debt proceeds for the foreseeable future.

We see governance risks stemming from a contentious political culture and long-term tensions between the city's police department and residents of impoverished neighborhoods. The former has manifested itself in often raucous city council meetings that can make policy discussions more difficult and/or delay addressing long-term challenges. Moreover, the city often serves as the venue for public protests regarding regional and national issues, which can add to the city's police overtime costs. We think long-term police-community tensions and ongoing judicial oversight of the police function after past malfeasance means that the city has less flexibility to find efficiencies and improve service effectiveness than do its peers.

Stable Outlook

Upside scenario

We could raise the ratings during the next two years if we see the city as effectively addressing its baseline budgetary challenges, particularly if property tax base growth continues to add breathing room and if the city develops effective contingency plans if voter-approved taxes that support ongoing services are not renewed. Important indicators of a strengthening financial profile likely would include adherence to the city's OPEB trust funding plan, restoration of its rainy day reserve, and overall growth in its general fund position that approaches state peers. Enhancements to the city's institutionalized financial management policies and practices also could materially strengthen credit quality, in our view, but would be unlikely, in and of themselves, to lead to a higher rating.

Downside scenario

We could lower the ratings if we saw evidence that the city was having trouble balancing its operations, particularly if strong property tax revenue growth built into financial projections does not materialize, especially if this caused the city to draw on its reserve intended for emergencies.

Credit Opinion

The pandemic has disrupted the local economy but not real estate demand

Oakland is one of the political, cultural, and economic centers of the West Coast and a cornerstone of the broad and diverse San Francisco Bay Area regional economy, which went into the pandemic with an economy increasingly focused on high-human capital industries in IT and life sciences. The pandemic at least temporarily damaged service industry employment and a short-term drop in residential rents, but Oakland has long been positioned to accommodate job growth given its substantial transportation assets that include stations on the region's main commuter rail network, a deepwater port, and an international airport and affordability relative to San Francisco. This helped the city realize the vision of many of its major land-use plans, with intensive development around rail stations, the site of a former medical center, in the downtown core, and on its waterfront. These have included hotel projects, which are prized by cities for their tax-generating potential, and management reports that at least two major office tower projects, which tend to have long development timelines, are poised to move forward if tenants materialize. More complex in its contingencies but potentially transformative for its neighborhood is a proposed relocation of the city's Major League Baseball stadium to the waterfront near the city's downtown. As currently conceived the project would include 3,000 housing units and 1.8 million square feet of commercial space.

Strong institutionalized policies and practices, with formal forecasting and a two-prong reserve policy

Our assessment of the city's institutionalized policies and practices reflects its:

- Biennial budget-building process that incorporates a robust analysis of economic conditions and analyses of cost trends that endeavor to distinguish between one-time and ongoing revenue and cost trends to inform spending choices;
- Intrayear budget-to-actual reporting that starts midyear and can be used to amend the budget;
- Maintenance of a five-year operating forecast that is integrated with the biennial budget and includes an extensive analysis of assumptions and the implications of current decisions relative to city policies;
- Lack of annually updated comprehensive multiyear capital planning, although the city reports on the five-year horizon for individual projects in its biennial capital plan;
- Investing based on a formal comprehensive policy that details allowable investment types and quarterly reporting to council on holdings and performance;
- Formal debt management policy that focuses on governance principles--but lacking what we consider material quantitative constraints--and a practice of making detailed disclosures in the city's annual financial report; and
- Two-prong reserve policy that addresses emergencies such as natural disasters with a 7.5%-of-expenditures general purpose fund (a subset of the general fund as reported in its audited financial statements) and a "vital services" rainy day reserve that is funded with revenue from economically volatile real estate transfer taxes up to 15% of expenditures.

The city has budgeted for a full-time cybersecurity risk officer and brings in external auditors to identify and mitigate such risks.

City faces baseline operating gap but robust property tax growth is making budgeting easier

Prior to the pandemic, the city was enjoying growth in its primary revenue source, property taxes (43% of fiscal 2021 general fund revenues), and more than five consecutive years of positive general fund net results. We think that additions to reserves during this period, including the institutionalization of the funding of rainy day reserve (which it fills with proceeds from a tax on property sales), gave the city time to formulate budget adjustments in response to the 2020 recession and pandemic. These ultimately came in the form of cuts equivalent to 3% of general fund expenditures (adjusted to include recurring transfers out) in mid-fiscal 2021.

Subsequently, new federal support for local governments, including American Rescue Plan Act grants totaling approximately 11% of adjusted expenditures in fiscal years 2021 and 2022, boosted net results for fiscal 2021 and likely will lead to approximately balanced or positive operations in fiscal 2022, according to the city's most recent estimates. Management indicates that, for budgetary purposes, Oakland has spread these grants in a tapering form for revenue recovery through fiscal 2023 with the goal of phasing in budgetary adjustments to achieve balance in their absence by fiscal 2024. We think this could prove difficult, as the city's most recent five-year baseline forecast drawn up in March 2021 (when the economic outlook was weaker) points to an ongoing budgetary imbalance even after taking into account the likelihood that real estate development and rising property values will lead to strong property tax revenue growth. We think that a local and regional surge in crime during the pandemic is likely to raise the stakes of budgetary debates regarding the city's violence prevention approach. Also emerging as a budgetary challenge are recruiting challenges in a region with a high cost of housing and a national rise in inflation. In this environment, we think that the renewal of the city's contracts with most of its nonpublic safety employees for fiscal 2023 could lead to larger cost-of-living adjustments than in prior years.

Relative to its state peers, Oakland has a small share of its general fund revenue coming from business license taxes (12% on a budgetary basis) and sales taxes (7%). Its lodging and parking taxes are suppressed due to pandemic-related health measures, but we think the city's housing development pipeline will support such revenues in the long run indirectly via demand growth. Its sales tax revenue is unlikely to benefit from the shift in market share to internet retailers because the state's distribution system reinforces the existing retail sales tax revenue structure by using each city's brick-and-mortar share of retail sales within a given county.

Oakland has a record of securing voter support for tax revenue targeted at specific services, which we think is a modest credit positive insofar as it allows the city to operate core services within statutory and constitutional revenue constraints while providing a policy basis for reducing service levels for specific voter-approved services if an economic downturn weakens funding or funding is not renewed. Such sources, some of which are accounted for in special revenue funds, total the equivalent of approximately 11% of general fund revenues. Most recently, voters approved a parcel tax for parks maintenance and homelessness services in March 2020 and we anticipate that the city will request renewal of the two voter-approved revenue streams representing approximately the equivalent of 5% of expenditures that expire in 2024.

The city's government-wide cash position has increased during each of the past five fiscal years through fiscal 2021 and we anticipate its liquidity profile will remain very strong for the foreseeable future. The city has no alternative financing other than an annual tax and revenue note issuance. The current incarnation includes what we consider nonremote events of default and an acceleration remedy for $124 million in principal, but given its short horizon and the availability of approximately $1 billion in governmental cash and investments, we do not consider this a material contingent liquidity risk.

Debt burden is shifting toward GO as city exercises voter authorizations

After the series 2022C-1 and 2022C-2 bonds, the city will retain about $121 million in authorized but unissued GO debt. As this is less than the principal scheduled to be retired in fiscal 2023, we anticipate that the city's debt burden will ease in the intermediate term. However, given identified infrastructure needs for transportation alone exceeding multiples of the city's most recent GO authorization of $600 million in 2016, management anticipates that the city will put a ballot measure to voters by mid-decade if tax base growth continues at a pace similar to the past five years.

With the departure of two of Oakland's three professional sports teams, the city's coliseum and arena complex is now underutilized. Alameda County, which shares a joint and several obligation with the city that runs through fiscal 2026, is seeking to retire its exposure to the property, which likely would simplify negotiations over the future of the site. We understand that the city is in negotiations with a consortium regarding reworking the site's land uses and a key question is whether the remaining team, the Athletics, will be able to realize a proposal to relocate to a waterfront location. We understand that current negotiations regarding infrastructure improvements to support the relocation would involve financing coming in the form of a tightly-drawn district mostly consisting of the development site and we see it as unlikely that the city will choose to make a major contribution from its unrestricted resources.

Significant pension and other postemployment benefit (OPEB) liability even after considering a dedicated property tax

The city's pension plans' funded status will likely lead to accelerating costs in the medium term, but a dedicated property tax (unusual in the state) that also supports pension obligation payments, provides some budgetary relief. Although Oakland is not making full actuarially determined contributions (ADCs) toward its OPEB liability, we think the city's formal funding policy to contribute to a trust, which was suspended for fiscal years 2020 and 2021 due to budget stress, will moderate long-term cost growth.

The city participated in the following plans funded as of June 30, 2021:

- California Public Employees' Retirement System (CalPERS) agent multiple-employer plan for miscellaneous employees: $936 million in net liability, and 68% funded;
- CalPERS agent multiple-employer plan for safety employees: $860 million in net liability, and 64% funded;
- Single-employer Police and Fire Retirement System (PFRS) plan: $225 million in net liability, and 63% funded; and
- Single-employer OPEB plan: $843 million in net liability, and 3% funded.

We view recent funding discipline changes for CalPERS plans positively from a credit perspective, as the pension manager recently adopted a 20-year, level dollar amortization approach for new gains and losses, which are in line with our baseline pension assumptions. While this will lead to more immediate contribution increases, a shorter amortization period that no longer defers costs will provide a faster funding recovery following years of poor investment performance and upward revisions to the liability. We understand CalPERS plans to reduce its discount rate to 6.8% or less in fiscal 2022 from the current 7.0%, with the idea of reducing market risk. We believe a discount rate above our pension guideline of 6% could lead to contribution volatility.

A small but material portion of the city's pension contributions went toward its single-employer PFRS plan, which was closed to new members in 1976, and its contributions are structured to amortize the liability by fiscal 2026. Its approach to funding this liability has been unusual, with POBs issued in 1997, 2001, and 2012 and associated agreements enabling the city to forgo annual required contributions during most of the past two decades. We understand that this approach was partly a function of a desire to fund the liability solely with a dedicated property tax available to a small number of cities in the state. Although the dedicated tax is subject to assessed value performance and complex case law, we anticipate that tax and a dedicated reserve will substantially or fully cover both debt service and ADCs through fiscal 2026. Should the plan's assets experience major investment losses after fiscal 2026, the city would need to make contributions from the general fund or other legally available sources.

The city set up an irrevocable trust in 2014 for its OPEB liability that is managed on an agent, multiple-employer basis by CalPERS, that had a fiduciary net position of $28 million against a total liability of $871 million as of the end of fiscal 2021. Just before the pandemic, it formally set out to steadily add to the plan's assets with above-pay-as-you-go annual contributions of 2.5% of payroll, which translate into about $10 million per year, but suspended contributions in fiscal years 2020 and 2021. For fiscal 2022, the city has made a $15 million contribution and would catch up to its baseline plan in fiscal 2023 under its biennial budget. Coupled with a negotiated cap for existing employees and a new tier with lower benefits for hires after Jan. 1, 2019, we think it has started on a path toward funding its OPEB liability, although we note that the new policy does not require the city's contributions to align with the actuarially determined annual contribution.

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit, which triggers enhanced reporting requirements, is strong.

Oakland, CA -- Key Credit Metrics

	Most recent	Historical information		
		2021	2020	2019
Very strong economy				
Projected per capita EBI % of U.S.	132			
Market value per capita ($)	181,923			
Population		435,514	427,089	430,266
County unemployment rate(%)			8.8	3.0
Market value ($000)	79,229,853	74,804,641	68,482,652	63,401,378
Ten largest taxpayers % of taxable value	3.6			
Strong budgetary performance				
Operating fund result % of expenditures		7.1	(2.6)	5.2
Total governmental fund result % of expenditures		1.7	(0.5)	1.7
Very strong budgetary flexibility				
Available reserves % of operating expenditures		16.6	13.5	23.2
Total available reserves ($000)		138,980	117,441	186,848
Very strong liquidity				
Total government cash % of governmental fund expenditures		83	73	70
Total government cash % of governmental fund debt service		940	734	728
Strong management				
Financial Management Assessment	Good			
Very weak debt & long-term liabilities				
Debt service % of governmental fund expenditures		8.8	9.9	9.6
Net direct debt % of governmental fund revenue	87			
Overall net debt % of market value	3.9			
Direct debt 10-year amortization (%)	59			
Required pension contribution % of governmental fund expenditures		16.1		
OPEB actual contribution % of governmental fund expenditures		3.2		
Strong institutional framework				

EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Outlook for U.S. Local Governments, Jan. 5, 2022
- Pension Spotlight: California, July 13, 2021
- 2021 Update Of Institutional Framework For U.S. Local Governments
- U.S. Local Governments Credit Brief: California Counties And Municipalities, Oct. 15, 2021
- How Inflation Has Mixed Effects On U.S. State And Local Government Credit Quality, Feb. 3, 2022
- Five Public Pension And OPEB Credit Considerations To Watch In 2022, Feb. 1, 2022

Ratings Detail (As Of February 11, 2022)		
Oakland taxable POB		
Long Term Rating	AA/Stable	Affirmed
Oakland GO GO (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Oakland GO (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Oakland POB (wrap of insured) (MBIA, National & Assured Gty) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Oakland POB (MBIA) (National)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Oakland Jt Pwrs Fing Auth, California		
Oakland, California		
Oakland Jt Pwrs Fing Auth (Oakland) lse rev rfdg bnds		
Long Term Rating	AA-/Stable	Affirmed

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.