S&P Global
Ratings

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Summary:

Oakland, California; Appropriations; General Obligation

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Credit Profile		
US$63.33 mil lse rev rfdg bnds ser 2018 due 11/01/2026		
Long Term Rating	AA-/Stable	New
Oakland GO		
Long Term Rating	AA/Stable	Affirmed
Oakland taxable POB		
Long Term Rating	AA/Stable	Affirmed
Oakland Jt Pwrs Fing Auth, California		
Oakland, California		
Oakland Jt Pwrs Fing Auth (Oakland) lse rev bnds (Oakland Admin Buildings) 2008B (ASSURED GTY)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AA-' long-term rating to Oakland, Calif.'s series 2018 lease revenue refunding bonds. At the same time, S&P Global Ratings affirmed its 'AA' long-term rating and underlying rating (SPUR) on the city's existing general obligation (GO) bonds and pension obligation bonds (POBs), and its 'AA-' SPUR on the city's existing lease revenue bonds. The outlook on all ratings is stable.

The lease revenue bonds are secured by lease rental payments made by the city, as lessee, to the Oakland Joint Powers Financing Authority, as lessor. We rate these obligations one notch lower than the city's general creditworthiness (as reflected in the GO rating) to account for the appropriation risk associated with the lease payment. The city has covenanted to budget and appropriate funds for the bonds' repayment, and has considered the affordability of the lease payment in its long-term plans. We considered the affordability and likelihood of the lease payment, which is reflected in the appropriation rating and in our view of the city's general creditworthiness. In our view, the lease features and terms are standard, with no unusual risks regarding timely payment of debt. Under the agreements, the city can abate lease payments in the event the leased property is damaged or destroyed. To mitigate the risk of abatement in such a case, the city has agreed to maintain at least two years of lease interruption insurance as well as casualty insurance equal to the full replacement cost of the damages. We understand that the series 2018 lease revenue refunding bonds will refund the entirety of the city's outstanding 2008 series B lease revenue refunding bonds for savings.

Revenue from unlimited ad valorem taxes levied on taxable property within the city secures the city's GO bonds. The Alameda County Board of Supervisors has the power and obligation to levy these taxes at the city's request for the bonds' repayment. The POBs are payable from any legally available revenue of the city, including special ad valorem property tax override revenue that the city levies to fund the city's Police and Fire Retirement System (PFRS) obligations.

The ratings reflect our view of the city's:

- Very strong economy, with access to the broad and diverse San Francisco-Oakland-Hayward metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could deteriorate in the near term relative to fiscal 2017, which closed with operating surpluses in the general fund and at the total governmental fund level;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2017 of 15.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 59.7% of total governmental fund expenditures and 5.5x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability profile, with debt service carrying charges at 10.9% of expenditures and net direct debt that is 128.0% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation, but rapid amortization, with 74.4% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Very strong economy

We consider Oakland's economy very strong. The city, with an estimated population of about 426,000, is located in Alameda County in the San Francisco-Oakland-Hayward, Calif., MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 120% of the national level and per capita market value of $129,900. Overall, the city's market value grew by 7.2% over the past year to $54.6 billion in fiscal 2018.

The city of Oakland is one of the main political, cultural, and economic centers of the West Coast and a cornerstone of the San Francisco Bay Area regional economy. The city is the county seat of Alameda County, the seventh-most populous county in the state. As the city is deeply embedded within the regional economy, its economic trends mirror that of the region.

After declining by a cumulative 6.8% during the recession (fiscals 2009 to 2011), the city's assessed value (AV) has grown by 5.1% annually (through fiscal 2018). The city continues to see major residential projects under construction, driven by strong demand for single- and multifamily dwellings. These include the Brooklyn Basin Project ($1.5 billion for all phases) and the Broadway-Valdez projects ($1 billion for all phases). Additionally, we understand that commercial development has accelerated recently, with a trade and logistics center on track for completion in June 2020 and two new offices towers breaking ground since March 2017. The city has also benefitted from strong economic growth across the San Francisco Bay Area, which is reflected in a county-level unemployment rate of 3.7% for calendar 2017--lower than the state and national rates.

Looking forward, we are forecasting stable to positive growth for the urban centers in California as continued home price appreciation has helped boost local government tax receipts throughout much of the region, including the city of

Oakland. As a result, we expect the broader macroeconomic forces to support our view and expectation of a local economy that we consider to be very strong. For additional information, please refer to our U.S. State And Local Government Credit Conditions Forecast (published Nov. 1, 2017, on RatingsDirect).

Strong management

We view the city's management as strong. We revised our view of the city's financial policies and practices to good from strong under our FMA methodology, indicating that financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Elements include a robust analysis of economic conditions and cost trends to build budget assumptions, as well as a formal 7.5% expenditures minimum reserve policy for emergencies in the city's "general purpose fund," which is its main operating fund on a budgetary basis and which, we understand, constitutes the bulk of its general fund on a generally accepted accounting principles (GAAP) basis. More recently, the city adopted a "rainy day" reserve designation as a hedge against the revenue effects of economic cycles, and has begun to fund this reserve with real estate transfer tax revenues above a specified benchmark. Management provides quarterly budget-to-actual results and investments updates to the council, and the city updates its five-year capital plan, which identifies funding sources, with each biennial budget. The city also maintains a five-year financial forecast that is integrated into decision making and is updated with each budget. Finally, while the city has a formal debt management policy, we note that the city's 2012 POBs were effectively used to finance ongoing operations (see below for more information).

Adequate budgetary performance

Oakland's budgetary performance is adequate in our opinion. The city had operating surpluses of 4.6% of expenditures in the general fund and of 5.8% across all governmental funds in fiscal 2017. Our assessment accounts for the fact that we expect budgetary results could deteriorate somewhat from 2017 results in the near term.

Buoyed by rising tax revenues, the city achieved a fourth straight year of general fund surplus in fiscal 2017. Property taxes, which account for 38% of general fund revenues, have grown by an annual average of 6.5% since fiscal 2012. Other significant tax revenues include a real estate transfer tax (11.2% of revenues) growing by 20.7% annually since 2012, a business license tax (10.7% of revenues) growing by 5.0% annually, a sales tax (7.6% of revenues) growing by 3.7% annually, a utility consumption tax (7.4% of revenues) that has not grown significantly, and a transient occupancy tax (3.3% of revenues) growing by 16.4% annually.

Although the city's budgets are not directly comparable with its GAAP-basis audits because of a slightly narrower definition of the city's main operating fund and different treatments of revenue and expenditures, its two-year budget for fiscals 2018 and 2019 shows expenditures exceeding revenues by about $6.4 million in fiscal 2018. Further, we note that the city has a history of one-time general fund expenditures, including overtime expenditures related to the city's role as a focal point for civic protests in the region and the potential demand for one-time investments due to the high growth within the region. Finally, we believe that the city's large debt and pension liabilities could have a negative effect on its future budgetary performance, particularly since the city deferred annual contributions to its single-employer pension plan from fiscal 2013 to fiscal 2017, and will resume these payments in fiscal 2018. Accordingly, we still believe that the city's budgetary performance is adequate due to the potential for deterioration from fiscal 2017 results.

Very strong budgetary flexibility

Oakland's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2017 of 15.4% of operating expenditures, or $104.3 million. We have included the city's committed reserve stabilization balance in our assessment of its available balance. Despite a positive general fund net result in fiscal 2017, the city's available fund balance declined by $19.0 million due to a write-down of part of its assigned balance associated with multiyear capital projects. Looking forward, we believe that the city's roughly $516 million in approved but unissued GO bonding authority will support the city's ability to meet its capital needs without significant balance drawdowns.

Very strong liquidity

In our opinion, Oakland's liquidity remains very strong, with total government cash at 59.7% of total governmental fund expenditures and 5.5x governmental debt service in fiscal 2017. We believe the city has strong access to external liquidity, given its issuances of POBs, lease revenue bonds, and GO bonds in the past 20 years. We expect that the current liquidity levels will not likely fall below the threshold levels in the coming years. The city manages its cash in accordance with its investment policy, which we do not consider aggressive, and it invests primarily in U.S. government agencies, money market funds, and the state's Local Agency Investment Fund. Finally, we note that the city did not issue a tax and revenue anticipation note (TRAN) in fiscal 2017 for cash flow purposes, and does not expect to do so in fiscals 2018 or 2019, although it does regularly issue TRANs early each fiscal year to pre-fund its pension contributions and generate a positive carry.

Very weak debt and contingent liability profile

In our view, Oakland's debt and contingent liability profile is very weak. Total governmental fund debt service is 10.9% of total governmental fund expenditures, and net direct debt is 128.0% of total governmental fund revenue. Approximately 74.4% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city is responsible for 50% of the Oakland-Alameda County Coliseum Authority's (OACCA) operating costs and debt service requirements, pursuant to an agreement that originated in 1995 to manage a complex consisting of professional baseball/football (Oakland Coliseum) and basketball (Oracle Arena) venues. As a result of the uncertainty surrounding the coliseum and the arena (given that the Golden State Warriors are planning to relocate to San Francisco next year), the city identified a contingent liability of $68.2 million on its balance sheet, which represents its share of OACCA's outstanding debt; we have included this amount in our calculation of the city's debt burden. The city contributed $12 million for debt service and operations in fiscal 2017 because the OACCA is running at an operating deficit, and expects to make similar contributions in future years.

We anticipate future GO debt issuances by the city, as the city still has roughly $480 million in unissued authorization under Measure KK (which was approved by voters in November 2016) as well as about $36 million under Measure DD (approved in November 2002). All components of Measure KK are managed under the city's capital improvement plan, and we expect the city to continue to issue under Measure KK in multiple series, rather than fulfilling the remaining authorization in one final series. Although the city's debt and contingent liability profile is very weak currently, we do not expect that the issuance of the remainder Measure KK authorization over time will significantly constrain the city's balance sheet.

In our opinion, a credit weakness is Oakland's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Oakland's combined required pension and actual OPEB contributions totaled 15.3% of total governmental fund expenditures in 2017. Of that amount, 13.3% represented required contributions to pension obligations, and 2.0% represented OPEB payments. The city made its full annual required pension contribution in 2017. The funded ratio of the largest pension plan is 67.4%. The city participates in three defined benefit retirement plans: the PFRS, the California Public Employees' Retirement System (CalPERS) Safety Plan, and the CalPERS Miscellaneous Plan.

PFRS is a closed, single-employer plan for uniformed city employees hired prior to 1976. As of July 1, 2017, the city's net pension liability for its PFRS plan was $340 million, and the plan's funded ratio was 50%, which we view as very low. The city's funding plan is to amortize the unfunded PFRS liability by fiscal 2026 (at a level percentage of payroll). The city has a dedicated ad valorem property tax override that it uses to fund the PFRS plan, but we understand that these revenues may not be sufficient to cover the annual actuarially determined cost of the plan plus debt service on POBs the city has issued to support the plan in the coming years. In fiscal 2013, the city issued a POB to pay down its unfunded PFRS liability by $210 million. As part of this POB issuance, the city deferred its annual PFRS contributions through fiscal 2017, and is resuming annual contributions this year. We view this practice as equivalent to using debt to finance ongoing operations, which we believe is a credit risk. City management expects that accumulated funds from its property tax override (from the years during which the city deferred its PFRS contributions) will be able to cover annual PFRS costs through fiscal 2021, after which the plan may require general fund support.

The city's CalPERS Miscellaneous plan is its largest by the size of the city's net pension liability, which was $801 million as of the end of fiscal 2017, when the plan's funded ratio was 67%. At that time, the city's CalPERS Safety plan had a net pension liability of $637 million and a funded ratio of 65%.

The city's OPEBs consist of health care benefits that it has historically funded on a pay-as-you-go basis. These costs amounted to $20.4 million, or 2.0% of total governmental funds expenditures, in fiscal 2017, which was equivalent to 27% of the plan's actuarially determined contribution. In 2014, the city established an irrevocable trust to begin pre-funding its OPEB liability, and contributed $13.7 million to this trust in fiscal 2017. As of March 2018, the trust contained a total of about $16 million, or 1.8% of the city's unfunded OPEB liability of $860 million. We understand that the city plans to contribute an additional $20 million to the trust through fiscal 2019.

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit is strong.

Outlook

The stable outlook reflects our expectation that the city's economy will continue to expand, but that its large debt and pension liabilities, as well as the ongoing possibility of unplanned one-time expenses, will keep its budgetary performance at roughly current levels. Accordingly, we do not expect to change the ratings within the next two years.

Upside scenario

We could raise the ratings if our view of the city's debt profile were to improve, which would likely require the city to develop specific plans to accommodate rising pension and OPEB costs without stressing its budgetary performance or flexibility. We could also raise the ratings if the city were to maintain budgetary performance at a level we consider strong.

Downside scenario

We could lower the ratings if the city's debt and pension liabilities, or one-time spending, were to further pressure its budgetary performance and flexibility, particularly if the city's available fund balance were to fall to a level we no longer consider strong.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Nov. 1, 2017
- Standard & Poor's Earthquake Model, Oct. 25, 2012
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of April 20, 2018)		
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) (AGM)		
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		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.