STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:
Oakland, California; Water/Sewer

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Summary:

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Credit Profile		
US$42.01 mil swr rev rfdg bnds ser 2014 dtd 03/18/2014 due 06/15/2029		
Long Term Rating	AA/Stable	New
Oakland wtr/swr		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Many issues are enhanced by bond insurance.		

Rationale

Standard & Poor's Ratings Services has raised its rating on Oakland, Calif.'s series 2004A sewer revenue bonds to 'AA' from 'AA-'. At the same time, Standard & Poor's assigned its 'AA' rating to Oakland's pro forma $42 million series 2014A revenue bonds. The outlook is stable.

The upgrade reflects our view strong financial metrics that we expect to continue.

The 2014A bond proceeds are to refund series 2004A debt in its entirety. After issuance, it will represent the system's only parity debt outstanding.

The rating reflects our view of the following credit strengths:

- Very strong debt service coverage (DSC), including revenue bond debt and a subordinate state-revolving fund loan;
- Recent significant rate increases, coupled with an intent to continue increasing rates at inflation;
- Limited system operational risks, given that it only entails sewer collection with the regional East Bay Municipal Utility District (EBMUD) providing treatment services; and
- A large, mostly built-out service area and system with sufficient system capacity.

In our opinion, credit weaknesses include:

- A high unemployment rate relative to the state and nation, albeit declining; and
- Uncertainty regarding the full extent of environmental compliance-related capital costs.

The sewer system's net revenues secure the bonds. Except for the lack of a debt service reserve, we believe remaining bond provisions are fairly typical for this type of debt. A two-tiered rate covenant is in effect, whereby net revenues must cover parity debt by least 1.2x and all debt by 1.0x. In either case, transfers from a rate-stabilization fund are permissible. An additional bonds test calls for net revenues to provide 1.2x maximum annual pro forma DSC.

Although it benefits from a deep and diversified economy that contributes to and participates in the Bay Area regional economy, Oakland has had high unemployment -- 10.4% based on November 2013 figures, compared with 8.5% for the state and 6.6% for the nation. Meanwhile, median household effective buying income is 97% of the nation, which we consider good, although below much of the region.

Coterminous with the City of Oakland, the sewer system's service area encompasses 56 square miles. Oakland's sewer system collects wastewater, which EBMUD transports and treats. Because it does not provide treatment services, the system's operating complexity and regulatory risk are limited. Although there is infill development throughout the city, the service area is not undergoing significant growth and its boundaries are stable. The system is primarily residential, and the 10 largest sewer customers by revenue only account for 1.7% of total revenues, making for what we believe is a very diverse system.

Residential sewer customers are billed a flat monthly rate, currently $34.72 per month for single-family accounts; adding EBMUD's costs brings the total residential bill to $55.25. Meanwhile, commercial, industrial, and other customer types pay a volume-based rate. EBMUD provides billing and collection services on a staggered bimonthly basis (cash collections are essentially flat throughout the year). At the beginning of 2011, 2012, and 2014, the city implemented 16% rate increases, which are to offset increased maintenance costs from aging infrastructure. Oakland has adopted a rate schedule that is based on CPI. It may hold rates steady in any particular year, but unless it raises rates under a method that departs from this inflation-based index, it need not seek further approval through the state's legislative process.

We believe coverage of total system debt service has been very strong in recent years, at no lower than 3.90x over the past five years, and reaching 5.84x in fiscal 2013 (year ended June 30). Including subordinate state revolving fund loans, DSC only dips modestly to a still-strong low of 3.24x over the past five years, and this debt has now been retired. Including the 16% rate increase that took effect Jan. 1, 2014, and indexed to inflation annually thereafter, the system is calling for DSC in fiscal 2014 of about 4.4x, immediately jumping to about 5.8x the following year and remaining at that level through the 2018 forecast period.

The rate increases have resulted in higher cash reserves, to about $37.8 million at June 30, 2013, or 517 days' cash on hand. Despite annual capital spending of $16 million-$17 million projected over the next five years, management expects its unrestricted cash position to remain fairly stable, due to projects financed from ongoing revenues. Although there is no formal liquidity policy, we believe the system's financial condition benefits from stable revenues and expenditures due to the lack of complexity in system operations and the flat fee rate structure.

The system's capital plan has focused on corrective action related to infiltration-inflow and discharge issues. Although a major portion of the program is nearing completion, resulting in significant reduction of infiltration-inflow levels, management is uncertain to what extent additional requirements will be necessary. The annual spending, therefore, is management's attempt to quantify additional needs with respect to environmental compliance. Officials indicate that based on this assumed spending, which they can meet through ongoing revenues, there are no additional debt plans.

Outlook

The stable outlook reflects our expectation that the stable nature of the system's revenue and expense base will continue to support very strong DSC. We further expect that, in the next two years, the system will maintain a strong liquidity position. We do not expect to lower the rating in that period. At the same time, we do not expect to raise the rating, given the city's overall economy and uncertain additional compliance needs.

Related Criteria And Research

Related Criteria

- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
- USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Dec. 17, 2013

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.