RatingsDirect®

Summary:

Oakland, California; Appropriations; General Obligation

Primary Credit Analyst:
Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@standardandpoors.com

Secondary Contact:
Misty L Newland, San Francisco (1) 415-371-5073; misty.newland@standardandpoors.com

Table Of Contents

Rationale

Outlook

Related Criteria And Research

Summary:

Oakland, California; Appropriations; General Obligation

Credit Profile		
US$124.615 mil GO rfdg bnds ser 2015A due 01/15/2039		
Long Term Rating	AA-/Stable	New
Oakland GO		
Long Term Rating	AA-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA-' long-term rating to Oakland, Calif.'s series 2015A general obligation (GO) refunding bonds. At the same time, Standard & Poor's affirmed its 'AA-' long-term rating and underlying rating (SPUR) on the city's GO bonds and on GO bonds issued by the Oakland Joint Powers Financing Authority on behalf of the city, as well as its 'A+' SPUR on pension obligation bonds (POBs) and 'A+' SPUR on lease revenue bonds for which the city is the obligor. The outlook is stable.

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 tax override revenue that the city may levy through 2026 to fund the city's Police and Fire Retirement System (PFRS) obligations; revenue from these special ad valorem taxes at the fiscal 2014 level was equal to 0.9x maximum annual debt service, which occurs in fiscal 2023. The city's lease revenue bonds are secured by lease payments made by the city, as lessee, to the authority, as lessor.

The rating reflects our assessment of the following factors for the city:

- Very strong economy, with participation in a broad and diverse metropolitan statistical area (MSA);
- Strong management, with "good" financial policies;
- Weak budgetary performance, with slightly positive general fund operating results in fiscal 2014 that we anticipate could deteriorate in the near term;
- Strong budgetary flexibility, with an available fiscal 2014 general fund balance in fiscal 2014 of 17% of operating expenditures;
- Very strong liquidity, with total government available cash of 33.6% of total governmental fund expenditures and 2.3x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with a debt service carrying charge of 14.6% and net direct debt of 118.1% of total governmental fund revenue in fiscal 2014, as well as a large pension and other postemployment benefit (OPEB) liability and the lack of a plan to sufficiently address the obligation, but rapid amortization with 69% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Very strong economy

We consider Oakland's economy very strong. Oakland, with an estimated population of 404,400, is located in Alameda County in the San Francisco-Oakland-Hayward MSA, which we consider broad and diverse. The county unemployment rate was 7.4% in 2013 and preliminary 2014 data suggest that it edged down to 5.9% for 2014. The city has a projected 2018 per capita effective buying income of 120% of the U.S. level and per capita market value of $117,900. The city is experiencing a surge in economic activity, with a 5.8% assessed value increase to $47.7 billion in 2015 after a 5.1% increase in fiscal 2014. Although we understand that much of this growth represents spillover activity from the robust information technology clusters in Silicon Valley and San Francisco, we believe that the city is well placed geographically to absorb growth as an increasing number of real estate projects become economically viable. Significant projects slated to enter major construction phases in 2016 are a 360-acre trade and logistics center adjacent to the city's maritime port and a 3,100-unit housing development on the city's waterfront.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our financial management assessment (FMA) methodology, indicating our view 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%-of-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. In the past year, the city also adopted and started to fund a "rainy day" reserve designation as a hedge against the revenue effects of economic cycles, but we understand that the city has not formally set a numerical target for this reserve. Management provides quarterly budget-to-actual results and investments updates to the council, and the city annually updates its five-year capital plan, which identifies funding sources.

Weak budgetary performance

Oakland's budgetary performance is weak, in our opinion, with adjusted general fund results showing a slight surplus of 0.8% of expenditures in fiscal 2014 after net deficits in fiscal years 2012 and 2013 and we think that the city's general fund could show a deficit in fiscal 2015. All governmental funds showed a 5.3% operating deficit in fiscal 2014, following deficits in the prior two years.

Although the city's budgetary basis operating estimates and projections are not directly comparable with GAAP-basis accounting because of a slightly narrower definition of the city's main operating fund and because of different treatments of revenue and expenditures, the city's February 2015 financial estimate for fiscal 2015 and April 2015 budget proposal for fiscal years 2016 and 2017 suggest that the city's net general fund results will weaken from fiscal 2014. The city's main operating fund is slated to show what we calculate would be an approximately 6%-of-expenditures operating deficit, which is comparable to the deficit that we calculated in summer 2014 based on city figures at that time. We understand that police overtime expenses related to the city's role as a focal point for civic protests in the region in the past year have weighed on expenditures. At the same time, the city's latest data show that the city's two largest tax revenue streams – property taxes and business license taxes -- are trending strongly positive over fiscal 2014 and, based on our prior experience and discussions with management, we believe that this deficit is likely to narrow substantially as a result of conservative assumptions.

Similarly, the city's fiscal years 2016 and 2017 biennial budget proposal suggests that the city's main operating fund will show negative operations of about 1% to 2% of expenditures and all governmental funds at about negative 3% to 4% of expenditures. We believe, based on prior experience of conservative assumptions, that the city's performance is likely to materialize with stronger ratios.

Strong budgetary flexibility

Oakland's budgetary flexibility is strong, in our view, with an available adjusted general fund balance in fiscal 2014 of 17.0% of expenditures, or $97.4 million, which is up from an adjusted 13.9% of expenditures at the end of fiscal 2013. The city's February 2015 estimates for its main operating fund and fiscal years 2016 and 2017 budget proposal suggest operating losses that we believe would likely pull the general fund ending balance below 15% of expenditures by fiscal 2016 if they materialize. However, based on the city's record of conservative expenditure assumptions, positive tax revenue performance in the current fiscal year, and our discussions with management, we believe that any draws on reserves are likely to be substantially narrower in scope.

Very strong liquidity

In our opinion, Oakland's liquidity is very strong, with total government available cash of 33.6% of total governmental fund expenditures and 2.3x governmental debt service in 2014. 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.

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 14.6% of total governmental fund expenditures, and net direct debt is 118.1% of total governmental fund revenue. Approximately 72% of the city's direct debt, which includes sewer revenue bonds, tax increment debt associated with its redevelopment successor agency, and the city's share of contingent debt on which it is paying, is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor. Management reports that the city is considering issuing all or a portion of its $62 million in authorized but unissued "Measure DD" GO debt in 2016.

The city has approximately $41 million in alternative financing that does not represent a significant source of contingent liquidity risk at the current rating. However, we have included in our ratios contingent debt associated with a joint powers authority created by the city and its overlapping county to fund a professional football and baseball arena because the bonds, which are a joint and several obligation of the city and county, have not been self-supporting. We have excluded the authority's debt with a similar security associated with the financing of a professional basketball arena because the facility's operations have been sufficient to cover debt service. Based on our review of draft financing documents, we do consider the city's exposure to this obligation following the authority's refinancing of existing basketball arena debt in April 2015 to have materially changed.

In our opinion, a credit weakness is Oakland's large pension and OPEB liability, without a plan in place that we think will sufficiently address the budgetary implications of costs under these obligations. Oakland's combined pension and OPEB contributions totaled 14.6% of total governmental fund expenditures in 2014, with 12.4% representing contributions to pension obligations and 2.2% OPEB payments. The city made its annual required pension contribution to state-managed California Public Employees Retirement System's (CalPERS) multi-employer pooled plans in 2014 and, following voter approval, annuitized a closed pension plan. However, concurrent to its issuance of

POBs in 2012, the city decided to suspend through fiscal 2017 its annually required contributions to its closed public safety plan, whose latest funded ratio stood at 67% after the debt contribution to the plan's assets. Aiding the city's effort to support debt payments associated with or direct contributions to its closed public safety plan is a special ad valorem property tax that represents about 1% of total governmental fund expenditures. We believe that this revenue will likely support all or virtually all of the city's POB debt service through the end of the decade.

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 view that, although the city's revenue is benefiting from positive economic momentum, its estimates and forecasts suggest that a parallel upward cost trend will likely challenge the city to achieve balanced operations in the medium term. We could raise the rating during our two-year outlook horizon if economic trends remain robust, the city posts balanced-to-positive adjusted general fund net results for fiscal 2015, and available reserves stabilize or continue to grow. We do not anticipate lowering the rating in the next two years unless the city experiences deterioration among multiple factors that we view as important to credit quality, such as an operating deficit that substantially erodes the city's available reserves and liquidity position.

Related Criteria And Research

#3, 6, 10, 11, 202, 214, 216

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Non Ad Valorem Bonds, Oct. 20, 2006

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 2, 2015
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Institutional Framework Overview: California Local Governments

Ratings Detail (As Of May 5, 2015)		
Oakland taxable POB		
Long Term Rating	A+/Stable	Affirmed
Oakland POB (wrap of insured) (MBIA) (National) (AGM)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Oakland POB (wrap of insured) (MBIA, National & Assured Gty) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Oakland GO		

Ratings Detail (As Of May 5, 2015) (cont.)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Oakland POB		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Oakland Jt Pwrs Fing Auth , California		
Oakland, California		
Oakland Jt Pwrs Fing Auth (Oakland GO Bnd Prgrm) (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Oakland Jt Pwrs Fing Auth (Oakland) (City Of Oakland Go Bnd Pgrm) (wrap of insured) (AMBAC & ASSURED GTY) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Oakland Jt Pwrs Fing Auth (Oakland) lse rev bnds (Oakland Admin Buildings) 2008B (ASSURED GTY)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Oakland Jt Pwrs Fing Auth (Oakland) POB (ASSURED GTY)		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
Oakland Jt Pwrs Fing Auth (Oakland) (City Go Bnd Pgrm)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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.