MOODY'S INVESTORS SERVICE

CREDIT OPINION
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City of Oakland, CA

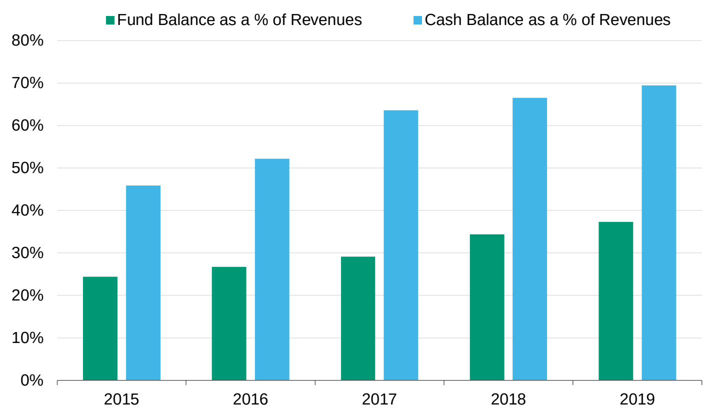
Update to credit analysis following upgrade of GOs to Aa1, lease revenue and pension obligation bonds to Aa2

Summary

The City of Oakland's (Aa1 stable) strong credit fundamentals are supported by the city's long-term fiscal improvement, further integration into the robust Bay Area economy and generally positive long-term socioeconomic trends. The city's current, very strong fiscal position, combined with strengthened fiscal policies and an experienced, prudent management, have positioned the city well for its clear fiscal and social challenges, including increasing pension costs, sharply increased homelessness and declining housing affordability.

On February 3, 2020, we upgraded the ratings on the city's outstanding general obligation bonds to Aa1, lease revenue bonds to Aa2, and pension obligation bonds to Aa2.

Exhibit 1
Healthy Financial Position Supported by Strong Reserves and Liquidity



Source: City of Oakland's Audits and Moody's Investors Service

Credit strengths

» Very large and diverse tax base poised for continued moderate growth

» Stable and diverse economy

» Healthy financial position supported by strong reserves and liquidity

» Strong management team

Credit challenges

» Declining housing affordability

» Rise in homelessness

» Rising pension and OPEB costs

Rating outlook

The stable outlook incorporates the city's large and diverse tax base that is poised for continued healthy growth and our expectation that the city's financial position will remain strong given management's prudent fiscal practices.

Factors that could lead to an upgrade

» Sizable and sustained increase in reserves and liquidity

» Significant reduction in the city's pension and OPEB obligations

» Improvement in socioeconomic indicators

Factors that could lead to a downgrade

» Erosion of the city's fiscal health

» Prolonged economic decline

Key indicators

Exhibit 2

Oakland (City of) CA	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$47,676,125	$51,286,225	$55,120,060	$59,086,693	$63,395,378
Population	408,073	412,040	417,442	430,482	431,373
Full Value Per Capita	$116,832	$124,469	$132,042	$137,257	$146,962
Median Family Income (% of US Median)	92.7%	95.1%	100.1%	100.1%	100.1%
Finances					
Operating Revenue ($000)	$783,716	$861,058	$925,712	$1,008,437	$1,074,580
Fund Balance ($000)	$191,341	$230,283	$269,277	$346,548	$400,702
Cash Balance ($000)	$359,216	$449,312	$588,526	$670,486	$745,994
Fund Balance as a % of Revenues	24.4%	26.7%	29.1%	34.4%	37.3%
Cash Balance as a % of Revenues	45.8%	52.2%	63.6%	66.5%	69.4%
Debt/Pensions					
Net Direct Debt ($000)	$427,930	$407,199	$401,768	$488,006	$459,507
3-Year Average of Moody's ANPL ($000)	$2,682,637	$2,766,461	$3,233,747	$3,614,301	$3,798,168
Net Direct Debt / Full Value (%)	0.9%	0.8%	0.7%	0.8%	0.7%
Net Direct Debt / Operating Revenues (x)	0.5x	0.5x	0.4x	0.5x	0.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	5.6%	5.4%	5.9%	6.1%	6.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.4x	3.2x	3.5x	3.6x	3.5x

Source: City of Oakland's Audits and Moody's Investors Service

Profile

The City of Oakland is in the County of Alameda (Aaa, stable) on the eastern shore of the San Francisco Bay, approximately seven miles from downtown San Francisco via the San Francisco-Oakland Bay Bridge. It has a diverse economic base and some of the major industries include retail trade, transportation/logistics, hi-tech, scientific research and healthcare. The city's population is 431,373.

Detailed credit considerations

Tax Base and Economy: Large and diverse tax base poised for continued solid growth; benefits from greater Bay Area economy

The city's significantly large and diverse tax base will continue to experience healthy growth given the sizable amount of residential and commercial developments currently underway coupled with the mechanics of Prop 13. Some of the new developments include three new hotels scheduled to open in 2021 and 9,277 residential units under construction. The city's assessed value (AV) increased to $68.5 billion in fiscal 2020, which is a strong 8.0% increase from the previous year. The average annual AV growth has been 7.5% over the past five years, which is significantly higher than the Aa1 national median (2.7%) and materially above the state median (5.5%) as well. The 10 largest taxpayers comprise a low 3.2% of total fiscal 2020 AV.

The city's robust local economy is supported by ongoing capital investments from employers such as those in the healthcare and tech sectors. Kaiser Permanente is building a new headquarters, a $900 million investment, which will provide 1.5 million of new office space. This development is likely to be completed in 2023. Square, Inc. and Blue Shield recently relocated to Oakland from San Francisco and are leasing 356,000 square feet and 600,000 square feet of office space respectively. The city and local economy benefit from being a transportation hub. All Bay Area Rapid Transit (BART) (Aaa stable) lines go through Oakland; the Port of Oakland (A1 stable) is the third largest port in California and the 8th largest in the US by container volume; and Oakland International Airport is the third largest in the San Francisco Bay Area by passenger volume.

The city's unemployment rate continues to trend downward and fell to 3.0% as of November 2019, which was below with the state (3.7%) and national (3.3%) averages. The city has an economically diverse residential population resulting in a median family income (MFI) of 100.1% of the US average, which has slowly been improving over the years (MFI was 90.4% in 2010).

Financial Operations and Reserves: Healthy financial position supported by management's prudent fiscal practices

The city's economic and tax base growth are continuing to drive the city's extremely strong financial position which we expect to remain healthy given management's prudent fiscal practices. The city has recorded five operating surpluses over the past six years and ended fiscal 2019 with available operating fund balance at $400.7 million or an ample 37.3% of operating revenue. The city's adopted fiscal 2020 budget is balanced with a $4.1 million appropriation of general fund balance. Based on year-to-date projections, management expects to end the year at least within budget, however given management's conservative budgeting practices it is likely that the city will outperform budget. We expect reserves to remain healthy and in-line with the previous year.

Long term budgetary challenges remain, including managing overall expenditure growth and addressing pension and healthcare cost increases. The city also faces challenges similar to many large urban cities such as an increase in homelessness and declining housing affordability. The city's management team has various strategies to address these challenges such as partnering with Alameda County on programs and funding, and issuing GO bonds under Measure KK for affordable housing developments.

We expect that the city will maintain its strong financial position given management's commitment to strategic, long-term financial planning that is supported by prudent fiscal policies.

LIQUIDITY

Similar to its reserve position, the city's liquidity will remain very strong. Operating net cash and investments reached close to $746.0 million in fiscal 2019, or an exceptionally healthy 69.4% of revenue. Based on projected fiscal 2020 results, the city's liquidity position will remain in-line with prior year's level.

Debt, Pension and OPEB

The city's direct debt burden is low at 1.4% of AV, and its overall debt burden is higher at 3.8% of AV and above the Aa1 national median at 1.9%. We expect that AV will continue to grow at a moderate rate and keep debt as a percentage of AV stable in the medium term. The city will have $297.3 million in authorized unissued general obligation bonds after its upcoming debt issuance (GO bonds Series 2020B-1 and Series 2020B-2).

DEBT STRUCTURE

The city's debt structure includes $486.5 million in general obligation bonds (including its upcoming bond sale), $222.6 million in pension obligation bonds and $49.2 million in lease revenue bonds. The final maturity is 2050. The city's annual debt service payments materially decline after 2026 when the pension obligation bonds mature. Nearly 80% of all outstanding debt will retire within the next 10 years.

DEBT-RELATED DERIVATIVES

The city has one swap and it is not associated with any debt. 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 termination risk for the city is low and the most recent mark to market valuation is negative $1.3 million (June 30, 2019), which the city could easily afford given its strong unrestricted cash position. 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%).

PENSIONS AND OPEB

The city provides defined benefit pensions to both safety and miscellaneous employees through the California Public Employees' Retirement System (PERS). The city also maintains a closed Police and Fire Retirement System (PFRS) plan.

Pension-driven budgetary pressures for the City of Oakland will be a long term fiscal challenge. Positively, Oakland is one of the few cities in California that is authorized to levy a “property tax override” to fund pension obligations. The revenue generated by this 0.1575% of AV levy are currently used to pay the debt service on the city's outstanding pension obligation bonds (POBs) which mature in 2026. Because of the strong growth in assessed value, the revenues generated from the property tax override have been growing and the revenues (net of debt service payments for the POBs) are held in the city's restricted general fund. At fiscal 2019 year-end, the total for these funds was $182.8 million (16.8% of operating revenues), all of which are available to fund pension obligations.These funds are not included in the available operating fund balance of $400.7 million reported in the above finance section.

In fiscal 2019, the city's reported net pension liability using a 6.9% discount rate was $1.6 billion, which is significantly lower than the Moody's adjusted net pension liability calculation of $3.3 billion using a 4.14% discount. This $3.3 billion liability equates to an above average 3.3 times operating revenue.

The combined, annual pension costs for fiscal 2019 were $164.1 million or 15.3% of operating revenue and in fiscal 2018 the city's contribution was at our tread water indicator measure. In prior years, the city's pension contribution had been below our tread water indicator. However the city would have still generated operating surpluses in fiscal 2016 and 2017 if it had funded up to this higher measure.

The city's adjusted net OPEB liability is high at 79% of operating revenue when compared to the Aa1 national median for cities at 25% of operating revenue. Management has taken steps to address this unfunded liability by adopting a policy that includes ongoing prefunding of 2.5% of payroll, approximately $10 million per year, in addition to the city's pay-as-you-go requirements. In addition, management implemented cost containment measures such as capping benefits for existing public safety employees and retirees and establishing lower cost-tiers for employees hired after January 1, 2019.

Inclusive of debt service, OPEB and pension contributions, the city's fixed costs amounted to 29.5% in fiscal 2019, compared to 24.6% in fiscal 2016. The increase is attributable to continued growth in pension and OPEB costs.

Management and Governance

California cities have an Institutional Framework score of A, which is moderate compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenue and decrease expenditures. California cities major revenue sources can only be raised with voter approval, or, in the case of ad valorem property taxes, cannot be raised except to meet GO bond payments. Ad valorem property tax rates cannot be increased above 1% except to meet GO bond payments, and assessed valuation growth is also generally limited to 2% annually unless a property changes ownership. Unpredictable revenue fluctuations tend to be moderate, or between 5-10% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, California has strong public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be moderate, between 5% and 10% annually.

The city uses a five-year financial forecast, which allows management to anticipate and plan for necessary cost cutting or new revenue. Management is conservative in its forecasting and robust reserves will enable the city to curb expenditures in the event of an economic downturn. Management has proved that expenditure adjustments will be made annually to these long-term plans to address any unanticipated economic or financial changes. The city's financial policies include maintaining a minimum 7.5% general purpose fund emergency reserve and a “Vital Services Stabilization Fund” reserve, which the city is working on funding up to the 15% minimum. These policies and practices will help to keep the city's financial profile stable in the long term and comparable to the median for cities rated Aa1.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 3

Oakland (City of) CA

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$68,482,649	Aaa
Full Value Per Capita	$158,755	Aaa
Median Family Income (% of US Median)	100.1%	Aa
Notching Factors:[2]		
Other Analyst Adjustment to Economy/Taxbase Factor: Large and diverse Bay Area economy, major transportation hub, and benefits from spillover growth from SF and Silicon Valley tech industry		Up
Finances (30%)		
Fund Balance as a % of Revenues	37.3%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	22.4%	Aa
Cash Balance as a % of Revenues	69.4%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	38.2%	Aaa
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	Aa
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.9%	Aa
Net Direct Debt / Operating Revenues (x)	0.6x	Aa
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	5.5%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.5x	A
Notching Factors:[2]		
Other Analyst Adjustment to Debt and Pensions Factor (specify): Rising pension and OPEB costs coupled with expected slow down in revenue growth		Down
Standardized Adjustments [3]: Unusually strong or weak security features: Secured by statute		Up
	Scorecard-Indicated Outcome	Aa1
	Assigned Rating	Aa1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.
Source: US Census Bureau, Moody's Investors Service

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