

02 DEC 2024

Fitch Downgrades Oakland, CA's Sewer Revs to 'AA'; Outlook Negative

Fitch Ratings - Austin - 02 Dec 2024: Fitch Ratings has downgraded the following Oakland, CA (the city) obligations to 'AA' from 'AAA':

--\$15.8 million sewer revenue refunding bonds, 2014 series A.

Fitch has also assessed the Standalone Credit Profile (SCP) of the city's sewer system (the system) at 'aaa'. The SCP represents the credit profile of the system on a standalone basis irrespective of its relationship with and the credit quality of the city (Issuer Default Rating A/Negative).

The Rating Outlook is Negative.

The downgrade of the sewer revenue bonds to 'AA' from 'AAA' and the Negative Outlook are driven by the recent downgrade of the city's Issuer Default Rating (IDR) to 'A'/Negative from 'AA-/Stable'. Per Fitch's criteria, the sewer revenue bond rating is capped at three notches higher than the city's IDR.

On Nov. 19 Oakland's financial management team released a report on the city's general purpose fund (GPF) that stated immediate action is necessary to avoid beginning the Chapter 9 process. The report was subsequently replaced with another report that still calls for immediate action to maintain solvency in the GPF but does not reference bankruptcy or Chapter 9. The city is enacting contingency measures, but leadership challenges signal potential risks about timely and effective budget alignment. For more information, see [Fitch Downgrades Oakland, CA's IDR to 'A'; Outlook Revised to Negative](#).

Fitch continues to assess the system's SCP at 'aaa'. This reflects its 'Exceptionally Strong' financial profile within the framework of 'Very Strong' revenue defensibility and a 'Very Strong' operating risk profile, both assessed at 'aa'. The system's leverage of -0.1x in fiscal 2023, measured as net adjusted debt to adjusted funds available for debt service (FADS), indicates cash and investments available for debt service that are greater than net adjusted debt. Leverage is projected to increase to 1.9x over the next five years in Fitch's Analytical Stress Test (FAST) rating case, but the metric should retain ample headroom within the rating category. There has been no publicly reported information or disclosure from management that the sewer enterprise fund faces any fiscal challenges. A change in this expectation would likely weaken the SCP assessment.

SECURITY

The bonds are secured by the system's net revenues after payment of operations and maintenance expenses.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Favorable Service Area, Affordable Rates for a Significant Majority of the Population: The city retains the legal authority to adjust rates as needed without external oversight. Fitch considers the monthly residential sewer bill affordable for about 79% of the service area population based on standard monthly usage of 6,000 gallons. The favorable service area is characterized by stronger income levels, a volatile unemployment rate relative to the nation and midrange customer growth.

Customer growth registered a five-year compound annual growth rate of 0.7% as of fiscal 2023. Income levels are about 26% higher than the national median as of 2022. The unemployment rate has decreased to 4.6% since 2020 and was 28% more than the national average in 2023.

Operating Risk - 'aa'

Very Low Operating Cost Burden, Moderate Investment Needs: In fiscal 2023, the system's operating cost burden was very low at \$2,825 per million gallons (mg), consistent with the operating risk assessment. The life cycle ratio was low at 39% in fiscal 2023. Annual capital spending relative to depreciation has been strong, averaging 150% over the last five fiscal years from 2019 to 2023. Planned capital spending for the next five years should generally outpace historical depreciation, supporting a continued low life cycle ratio.

The CIP for fiscals 2024-2028 totals \$169 million and continues to be entirely pay-go funded. No additional debt is expected since the current plan continues to focus on rehabilitating about 13 miles of sewer mains per year as part of the system's consent decree. In fiscal 2023, the system rehabilitated a total of 15.1 miles.

Financial Profile - 'aaa'

Leverage to Increase: The system had leverage of -0.1x as of fiscal 2023 since available cash exceeds adjusted debt. The liquidity profile is neutral to the overall assessment with current days cash on hand of 562 and coverage of full obligations (COFO) of 4.5x. Fitch-calculated total debt service coverage for fiscal 2023 was 5.0x.

The FAST considers the potential trend of key ratios in a base case and stress scenario over a five-year period. The stress scenario is designed to impose capital costs 10% above expected base-case levels and evaluate potential variability in projected key ratios. The FAST reflects Fitch's view of a reasonable scenario, which is generally informed by publicly available and/or management provided information with respect to capex, user charges and rate of revenue and expenditure growth.

In the base case scenario, the leverage ratio is expected to increase to 1.4x through fiscal 2028. In the stress scenario, which is considered the rating case, the leverage ratio is projected to increase to 1.9x over the five-year horizon. Both scenarios factor capital spending in line with CIP and sufficient to address the system's current consent decree. The liquidity profile is expected to remain neutral to the assessment over the five-year horizon.

Asymmetric Additional Risk Considerations

No asymmetric additive risk considerations currently affect this rating determination. Future asymmetric risk could include significant political pressure that delays or prevents rate increases; a failure to adopt budgets in a timely manner due to absence of consensus in the governing body; or the siphoning of funds to the GPF that weakens the sewer fund's margins.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Deterioration in the city's credit quality would lead to further negative rating action in light of the rating constraints applicable to enterprises related to a host government.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Improvement in the city's credit quality would lead to an improvement in the bond rating.

PROFILE

The system provides collection-only sewer service with treatment provided by the East Bay Municipal Utility District (EBMUD; sewer revenue bonds AA+/Stable). EBMUD bills all of the system's customers directly, so the city has no costs associated with EBMUD treatment reflected on the system's income statement. Oakland is the San Francisco Bay Area's third-largest city with a population of about 420,000 people and nearly 119,000 service accounts. The city's large downtown is a regional employment hub with significant commercial, industrial and governmental ratepayers.

The sewer system operates under a consent decree to undertake significant, but manageable, capital upgrades to reduce sewer discharges into the San Francisco Bay. The utility has committed to funding these needs with cash flow from operations. This has resulted in healthy financial margins and should allow for sustained exceptionally low leverage.

Fitch considers the system a related entity to the city for rating purposes given the city's oversight of the system, including the authority to establish rates and operations. Pursuant to Fitch's criteria, the rating on the sewer revenue bonds is limited by the credit quality of the city and constrained to only three notches higher than the city's IDR.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by data from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Fitch Ratings Analysts

Victor Valdez

Senior Analyst

Primary Rating Analyst

+1 512 813 5650

Fitch Ratings, Inc. 2600 Via Fortuna, Suite 330 Austin, TX 78746

Graham Schnaars

Director

Secondary Rating Analyst

+1 415 732 7578

Audra Dickinson

Senior Director

Committee Chairperson

+1 512 813 5701

Media Contacts



Sandro Scenga

New York

+1 212 908 0278

sandro.scenga@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Oakland (CA) [Sewer]			
• Oakland (CA) LT /Sewer	AA 	Downgrade	AAA 

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Revenues/ 1 LT			

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	◐	

Applicable Criteria

[U.S. Public Sector, Revenue-Supported Entities Rating Criteria \(pub.12 Jan 2024\) \(including rating assumption sensitivity\)](#)

[U.S. Water and Sewer Rating Criteria \(pub.29 Feb 2024\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Oakland (CA) EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: <https://www.fitchratings.com/understandingcreditratings>. In addition, the following <https://www.fitchratings.com/rating-definitions-document> details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European

Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at <https://www.fitchratings.com/site/regulatory>. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed. Fitch Ratings makes routine, commonly-accepted adjustments to reported financial data in accordance with the relevant criteria and/or industry standards to provide financial metric consistency for entities in the same sector or asset class.

The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across

asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see [Best- and Worst-Case Measures](#) under the Rating Performance page on Fitch's website.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001. Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

dv01, a Fitch Solutions company, and an affiliate of Fitch Ratings, may from time to time serve as loan data agent on certain structured finance transactions rated by Fitch Ratings.

Copyright © 2024 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved.

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.