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INVESTORS SERVICE

CREDIT OPINION
12 July 2017

New Issue

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City of Oakland, CA

New Issue - Moody's Assigns Aa2 to Oakland, CA's GO Bonds Series 2017A-1 & 2017 A-2; Outlook is Stable

Summary Rating Rationale

Moody's Investors Service has assigned an Aa2 rating to the City of Oakland's (CA) $63 million General Obligation Bonds (Measure KK, Series 2017A-1) (Tax-Exempt) and $55 million General Obligation Bonds (Measure KK, Series 2017A-2) (Taxable). The city's outstanding parity debt which totals approximately $216.7 million is also rated Aa2. The outlook is stable.

The Aa2 rating reflects the city's large and diverse tax base, strong and growing economy as well as an average socioeconomic profile. The city's strong financial position is supported by healthy reserve and cash levels that we expect to remain stable over the near term. The rating also incorporates the city's above average debt burden, as well as above average pension and OPEB obligations. The city has long term budgetary and fiscal challenges, including pension and health care costs and sustaining grant funded programs in spite of reduced state or federal funding. We expect management to successfully address these issues over time.

Credit Strengths

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

» Strong and expanding Bay Area economy

» Healthy financial profile that we expect to remain stable

Credit Challenges

» Long term budgetary challenges including pension and health care costs

» Above average debt, pension, and OPEB obligations

Rating Outlook

The stable outlook reflects the city's large and diverse tax base which we expect to experience ongoing, moderate growth, and the city's likely continued strong operating performance despite long-term challenges.

Factors that Could Lead to an Upgrade

» Material and sustained improvement in the city's socioeconomic indicators

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

» Sizeable increase and sustained reserve levels

Factors that Could Lead to a Downgrade

» Significant increase in the city's debt burden, particularly debt supported by the city's general fund

» Further pension and OPEB burden on the city's general fund

» Erosion of the city's fiscal health

» Prolonged economic decline

Key Indicators

Exhibit 1

Oakland (City of) CA	2012	2013	2014	2015	2016
Economy/Tax Base					
Total Full Value ($000)	$ 41,940,552	$ 42,838,031	$ 45,042,336	$ 47,676,125	$ 51,286,226
Full Value Per Capita	$ 106,748.84	$ 107,904	$ 111,951	$ 116,832	$ 125,679
Median Family Income (% of US Median)	92.1%	92.1%	92.4%	92.7%	92.7%
Finances					
Operating Revenue ($000)	$ 597,903	$ 590,046	$ 600,637	$ 659,214	$ 706,581
Fund Balance as a % of Revenues	24.3%	16.4%	18.6%	20.5%	20.9%
Cash Balance as a % of Revenues	48.3%	50.9%	47.3%	45.8%	51.6%
Debt/Pensions					
Net Direct Debt ($000)	$ 794,297	$ 1,119,645	$ 1,052,038	$ 923,653	$ 879,898
Net Direct Debt / Operating Revenues (x)	1.3x	1.9x	1.8x	1.4x	1.2x
Net Direct Debt / Full Value (%)	1.9%	2.6%	2.3%	1.9%	1.7%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	N/A	N/A	N/A	4.1x	4.2x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	N/A	N/A	N/A	8.2%	8.4%

Source: City of Oakland, Moody's Investors Service

Detailed Rating Considerations

Economy and Tax Base: Large and Growing Tax Base; Sustained Economic Improvement Expected

The City of Oakland's strong and diverse economy will continue to expand over the next few years. The city enjoys spillover growth from the greater Bay Area's technology expansion and Oakland is also undergoing its own organic tech expansion which will sustain economic growth. Job and income growth will surpass national averages over the next few years and the proximity to the world's tech capitol supports long term strength in the economy and tax base.

The city's assessed value (AV) increased to $55.1 billion in fiscal 2017, a 7.5% increase from the previous year and the city currently projects close to 6% AV growth in 2018. Helping to fuel the city's AV growth are single-family home sale prices that remain well above the median assessed value. We expect that the city's AV will continue to experience moderate growth given the large number of homes assessed below market value as well as new residential and commercial development underway. The 10 largest taxpayers comprise a low 4.1% of total fiscal 2017 AV, reflecting the city's large and diverse assessed value.

The city's unemployment rate continues to trend downward and fell to 4.2% as of May 2017, which is in-line with the state (4.2%) and nation (4.3%) for the same period. The city has an economically diverse residential population resulting in a median family income of 92.7% of the US average.

Financial Operations and Reserves: Healthy Financial Position Though Long Term Budgetary Challenges Remain

We expect the city's financial position to remain stable given the city's strong reserve and cash levels and management's prudent fiscal practices. Based on unaudited fiscal 2017 figures, the city will generate its fourth consecutive operating surplus and reserves will remain in-line with the previous year. The city began with a $32.5 million budget gap for its 2017-2019 biennial budget, but through various cost saving measures and revenue enhancements such as revised fees, the city was able to balance the adopted budget. Long term budgetary challenges remain, including managing overall expenditure growth and addressing pension and health care cost increases. The city is also looking for ways to sustain grant funded programs in the face of reduced or eliminated state and federal funding.

The city's total revenues have increased year over year since fiscal 2011, and property tax revenues are strong and increased 13.0% in fiscal 2016. Property tax delinquency rates continue to decline (the city is not on the county's Teeter Plan). The city also underwent healthy revenue growth in its real estate transfer tax, transient occupancy tax, and sales and use tax in fiscal 2016 and remained strong in fiscal 2017. Public Safety expenditures increased noticeably in fiscal 2016 with the hiring of additional police and fire workers. Public Safety expenditures will likely increase only modestly moving forward, given the city has nearly reached its program targets.

Available reserves (unassigned, assigned, committed general fund and restricted debt service fund) were strong in fiscal 2016 totaling $148.0 million (20.9% of revenues). This was up from $135.2 million in fiscal 2015, reflecting overall revenue growth outpacing the increase in public safety expenditures mentioned above.

LIQUIDITY

The city's liquidity continues to improve. Net cash and investments were strong in fiscal 2016 at $364.7 million (51.6% of revenues). Based on projected fiscal 2017 results, the city's liquidity position will remain strong.

Debt and Pensions: Debt Burden Will Remain Above- Average; Pension and OPEB Costs Remain a Challenge

Including the current offering, the city's direct debt burden is an above-average 1.52% of AV and its overall debt burden is high at 5.3% of AV. The current offering is the first issuance under the city's recently approved $600 million bond Measure KK, which received strong voter support with 82% approval. The city plans to issue debt every two years until the bond measure is exhausted. AV growth should help to keep debt as a percentage of AV stable in the medium term.

DEBT STRUCTURE

The city has only fixed-rate obligations outstanding.

DEBT-RELATED DERIVATIVES

The city has one stand-alone swap that is not associated with any outstanding bonds. 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 most recent mark to market valuation was negative $3.7 million as of July 10, 2017, which is not burdensome given the city's available unrestricted cash and reserves. 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%). The city's payments to the counterparty are insured.

PENSIONS AND OPEB

Pension-driven budgetary pressures for the City of Oakland are significant and will be a long term fiscal challenge. Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is $3.6 billion, or a notably above-average 4.2 times operating revenues.

Rate increases will increase the funded ratio to 75% for each the city's California Public Employees' Retirement System (PERS) plans, which are currently at 67.2% for the Safety Plan and 70.2% of the Miscellaneous Plan. The city makes 100% of its required annual contribution to CalPERS. These combined annual costs in fiscal 2016 were $111.7 million (15.8% of operating revenues), which is an above average burden on the general fund relative to other California cities.

The city also maintains its Police and Fire Retirement System (PFRS) plan, which should be fully funded by 2026 and has a current funded ratio of 54.0%. The city issued its Pension Obligation Bonds to prepay PFRS contributions in July 2012 and reduced the unfunded liability by $210.0 million.

Oakland has a large unfunded OPEB liability of $860.0 million, an exceptionally high 238.3% of covered payroll, as of the July 1, 2015 actuarial valuation date. The city historically funds its OPEB on a pay-as-you-go basis with some additional, modest contributions. It is working on being in a position to fully fund its annual required contribution (ARC). As of June 9, 2017 the city had deposited a total of $4.3 million into its OPEB Trust.

Fixed costs for the city, including its pension contributions, OPEB ARC, and general fund-supported debt service are elevated at 33% of revenues. The large fixed costs are largely attributable to the city's pension costs and OPEB ARC.

Management and Governance

The city has an exceptionally strong management team, which we feel will carefully guide the city through its long term fiscal challenges.

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 revenues 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 5-10% annually.

Legal Security

The general obligation offering is secured by an unlimited property tax pledge of all taxable property within the city boundaries. Debt service on the rated debt is secured by the city's voter-approved unlimited property tax pledge.

Use of Proceeds

Proceeds from Series 2017 A-1 will be used to finance public capital improvements and the proceeds from Series 2017 A-2 will finance affordable housing.

Obligor Profile

The City of Oakland is located in the County of Alameda on the eastern shore of the San Francisco Bay, approximately seven miles from downtown San Francisco via the San Francisco-Oakland Bay Bridge. Occupying approximately 53.8 square miles, the city is the largest and most established of the "East Bay" cities. Population for the city is 422,856.

Methodology

The principal methodology used in these ratings was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Oakland (City of) CA

Issue	Rating
General Obligation Bonds (Measure KK, Series 2017A-1) (Tax-Exempt)	Aa2
Rating Type	Underlying LT
Sale Amount	$63,000,000
Expected Sale Date	08/01/2017
Rating Description	General Obligation
General Obligation Bonds (Measure KK, Series 2017A-2) (Taxable)	Aa2
Rating Type	Underlying LT
Sale Amount	$55,000,000
Expected Sale Date	08/01/2017
Rating Description	General Obligation

Source: Moody's Investors Service

REPORT NUMBER 1079108

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