

RatingsDirect®

Summary:

Oakland, California; Water/Sewer

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Credit Highlights

Summary:

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Credit Profile

Oakland WTRSWR

Long Term Rating

AA+/Watch Neg

On CreditWatch Negative

Credit Highlights

- S&P Global Ratings placed its 'AA+' rating on Oakland, Calif.'s sewer revenue bonds on CreditWatch with negative implications.
- The CreditWatch placement reflects our view that there is at least a one-in-two chance we could lower the rating, potentially by multiple notches, within the next 90 days due to the material and rapid deterioration of the general fund and, what we view as, potential governance weaknesses that could complicate fiscal decision-making under challenging circumstances. We think intensified general fund distress could lead to the city transferring cash into the general fund from the sewer fund, which would negatively affect the sewer system's liquidity assessment. Moreover, under our criteria, "U.S. Municipal Water, Sewer, And Solid Waste Utilities: Methodology And Assumptions," published April 14, 2022, on RatingsDirect, negative extraordinary intervention would generally cap the sewer rating at the general obligation (GO) rating of the related government.

Security

The sewer system's net revenue secures the bonds. We consider bond provisions standard. A two-tiered rate covenant is in effect, where net revenue must cover parity debt by at least 1.2x and all debt by 1x. In either case, transfers from a rate-stabilization fund are permissible. An additional bonds test calls for net revenue to provide 1.2x maximum annual pro forma debt service coverage. As of June 30, 2023, the city had \$18.5 million of sewer system debt outstanding.

Credit overview

The CreditWatch action follows our opinion of the city's recently published fiscal 2025 first-quarter report, dated Nov. 15, 2024, that revealed significant estimated deviations from the city's adjusted fiscal 2025 general-purpose-fund budget and preliminary net results for fiscal year-end 2024. We think that the city will likely face challenges to make midyear budget adjustments that set it on a course of fiscal sustainability and that there is elevated potential for political gridlock and turnover in key management positions following the yet-to-be certified recall of the city's mayor; in our opinion, this environment is likely to complicate decision-making concerning budget solutions that could play a role in avoiding credit deterioration. (For more information on our general obligation (GO) rating, see the analysis, published Nov. 20, 2024.)

We recognize that the sewer enterprise is a restricted fund that can only be used for the purpose outlined in the city's charter, and Proposition 218 (Article XIII C and D of the California Constitution) restricts municipalities from imposing overhead costs or franchise fees on utility enterprises to increase general fund revenue. However, in our view, the city council could take steps to circumvent such protections in times of severe financial distress. We consider a discussion

with the city's management regarding the separation of sewer-system and general-government funds, including the allocation of city overhead costs, critical to maintain our credit rating.

CreditWatch

The CreditWatch placement reflects a greater than one-in-two chance we could lower the rating within the next 90 days with a key consideration being any extraordinary transfers between the sewer and general fund, coupled with our view of any ongoing governance or management challenges that influence utility budgeting, rate-setting, and staffing. While the CreditWatch period extends for 90 days, we expect to complete a review of our ratings as soon as the city provides the necessary information we deem sufficient to resolve the CreditWatch.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.

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