S&P Global
Ratings

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Summary:

Oakland, California; Appropriations; General Obligation

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US$139.245 mil GO bnds (Measure KK) ser 2020B-1 due 01/15/2050		
Long Term Rating	AA/Positive	New
US$64.505 mil GO rfdg bnds ser 2020 due 01/15/2033		
Long Term Rating	AA/Positive	New
US$44.88 mil GO bnds (Measure KK) ser 2020B-2 due 01/15/2030		
Long Term Rating	AA/Positive	New
Oakland GO		
Long Term Rating	AA/Positive	Outlook Revised

Rationale

S&P Global Ratings revised the outlook to positive from stable and affirmed its 'AA' long-term rating and underlying rating (SPUR) on Oakland, Calif.'s previously issued general obligation (GO) bonds and non-ad valorem obligations, and its 'AA-' long-term rating on the city's previously issued appropriation obligations. At the same time, S&P Global Ratings assigned its 'AA' long-term rating, with a stable outlook, to the city's:

- $139.2 million Measure KK series 2020B-1 GO bonds (tax-exempt),
- $44.9 million Measure KK series 2020B-2 GO bonds (taxable), and
- $64.5 million series 2020 GO refunding bonds (taxable).

The city will have about $1.2 billion in governmental debt, including tax increment obligations associated with its successor agency, outstanding at the end of fiscal 2020.

The outlook revision reflects our view of Oakland's economic-growth-fueled strong financial performance and budgetary approach that we think is helping the city manage recessionary risks. These include formally distinguishing between one-time and ongoing revenue growth and the use of a portion of economically sensitive real estate transfer taxes to fund a "vital services" reserve. We think that there is at least a one-in-three chance that its current practices and a strong development pipeline will help the city continue to build reserves as it manages the long-term challenges of escalating pension contribution requirements and a large deferred maintenance backlog.

Security and use of proceeds

Revenue from unlimited ad valorem taxes levied on taxable property within the city secures the series 2020B-1, 2020B-2, 2020 refunding GO bonds and previously issued GO bonds. The city's non-ad valorem obligations, which were issued for funding the city's pension liabilities, are payable from any legally available revenue of the city and are rated on par with the city's GO obligations given a lack of legal limitations on fungibility of resources within the

organization. The city's appropriation obligations are secured by or represent an interest in lease rental payments by the city, as lessee. We rate these obligations one notch lower than the city's general creditworthiness (as reflected in the GO rating) to account for the appropriation risk associated with lease payments. Under the agreements, the city can abate lease payments in the event the leased property is damaged or destroyed, but the city has agreed to maintain at least two years of rental interruption insurance as well as casualty insurance equal to the full replacement cost of the damages.

The city will use the proceeds of the series 2020B-1 for a variety of capital improvements in the city, with an emphasis on street paving and improvements and the construction of or improvements to civic facilities such as fire stations, libraries, or recreation facilities. The city will use proceeds of the 2020B-2 to finance anti-displacement and affordable housing preservation programs. The series 2020 will refund the city's previously issued GO debt with a similarly structured payment schedule and interest cost savings estimated at 9% of refunded principal.

Credit overview

Oakland is experiencing strong economic growth that is fueling tax revenue growth that is in turn helping the city build up its reserves, while focusing service spending growth on services that address the key community concerns of homelessness and homelessness. We think a rainy day funding mechanism adopted since the Great Recession and a new policy to start to fund long-term other postemployment benefit (OPEB) costs are positioning the city to manage recession risks by both building up a financial cushion and moderating growth in ongoing spending. The city's main long-term challenges, in our view, are managing pension and OPEB costs and a large deferred maintenance backlog, but we think that its budgetary approach and long-term financial forecasting practice is helping it make tradeoffs. The city also is emerging as a national leader in integrating environmental, social, and governance concepts into service provision and capital investments.

The ratings reflect our view of the city's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area;
- Strong management, with good financial policies and practices under our financial management assessment methodology;
- Strong budgetary performance, with operating surpluses in the general fund and at the total governmental fund level in fiscal 2019;
- Very strong budgetary flexibility, with an adjusted available fund balance in fiscal 2019 of 23% of adjusted operating expenditures;
- Very strong liquidity, with total government available cash at 70% of total governmental fund expenditures and 7.3x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 10% of expenditures and net direct debt that is 102% of total governmental fund revenue, and a large pension and OPEB obligation that likely will require higher contributions in the coming years; and
- Strong institutional framework score.

Very strong economy

The 432,900-resident city is one the main political, cultural, and economic centers of the West Coast and a cornerstone of the broad and diverse San Francisco Bay Area regional economy, which is undergoing strong economic growth related to high-human capital industries in information technology and life sciences. With employment growth during the current economic expansion focused as much in urban centers as Silicon Valley office parks, Oakland has been positioned to accommodate job growth given its substantial transportation assets that include stations on the region's main commuter rail network, a deepwater port, and an international airport. And as development and infrastructure challenges constrain growth across the bay in San Francisco, Oakland is realizing the vision of many of its major land use plans, with intensive development around rail stations, downtown core, and waterfront. We see a substantial development pipeline--including a $900 million headquarters project for health care provider Kaiser Permanente--as likely to contribute to strong medium-term tax revenue growth.

Concurrently, the city has been struggling to mitigate the negative effects of regional economic growth, including displacement of existing residents and rising homelessness, which recently replaced crime as the main citizen concern in the city's annual resident survey. Management reports that the city has 9,277 residential units under construction and 10,097 in the pipeline and expects that the series 2020B-2 will play a role in retaining affordable housing and facilitating the development of new affordable units.

The city has a projected per capita effective buying income of 126% of the national level in 2023 and its 2020 per capita market value stands $158,200. Overall, the city's market value grew by 8% over the past year to $68.5 billion in 2020 and, based on our expectation of real GDP growth in the Pacific U.S. states through 2021 and a substantial list of housing, commercial, and industrial projects yet to come on the tax rolls, we think that the city's assessed value growth will proceed at a similar pace in the medium term. Hotel development is as important to the city's revenue given its tax-generating properties, and is also unusually active, with two properties that just came on line and 627 rooms across three sites slated to open in 2021.

Strong management

We view the city's management as strong, with good financial policies and practices under our financial management assessment 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.

The city's financial policies and practices include:

- Biennial budget-building process that incorporates a robust analysis of economic conditions and analyses of cost trends that endeavor to distinguish between one-time and ongoing revenue and cost trends to inform spending choices;
- Intrayear budget-to-actual reporting that starts midyear and can be used to amend the budget;
- Maintenance of a five-year operating forecast that is integrated with the biennial budget and includes an extensive analysis of assumptions and the implications of current decisions relative to city policies;
- Lack of annually updated comprehensive multiyear capital planning, although the city reports on the five-year horizon for individual projects in its biennial capital plan;
- Investing based on a formal comprehensive policy that details allowable investment types and quarterly reporting to

council on holdings and performance;

- Formal debt management policy that focuses on governance principles – but lacks what we consider material quantitative constraints – and a practice of making detailed disclosures in the city's annual financial report; and
- Two-prong reserve policy that addresses emergencies such as natural disasters with a 7.5%-of-expenditures general purpose fund (a subset of the general fund as reported in its audited financial statements) and a "vital services" rainy day reserve that is funded with revenue from economically volatile real estate transfer taxes up to 15% of expenditures.

We understand that the city has attracted interest from other municipalities in the state regarding policies regarding in environment, social, and governance topics. Most prominent has been an equity-based analysis that has helped it direct road maintenance and improvement resources to economically vulnerable neighborhoods to facilitate economic resilience and recovery from a natural disaster, and a formal equity-based climate action plan that addresses service and capital investment choices. The city has an officer with formal responsibility for resiliency policy and has developed a "soft story" plan to address seismic vulnerability for this common type of residential and commercial architecture. The city has a full-time cybersecurity risk officer and brings in external auditors to identify and mitigate such risks.

At the same time, the city also has what we find are unusual governance risks in the form of an often contentious political culture and long-term tensions between the city's police department and residents of impoverished neighborhoods. The former has manifested itself in often raucous city council meetings that can make policy discussions more difficult and/or delay addressing long-term challenges. Moreover, the city often serves as the venue for public protests regarding regional and national issues, which can add to the city's police overtime costs. We think long-term police-community tensions and ongoing judicial oversight of the police function after past malfeasance means that the city has less flexibility to find efficiencies and improve service effectiveness than do its peers.

Strong budgetary performance

Oakland's budgetary performance is strong, in our opinion. The city had operating surpluses of 5.2% of adjusted expenditures in the general fund and of 1.7% across all governmental funds in fiscal 2019. (These calculations include adjustments that add recurring transfers out to expenditures for national comparability.) Fiscal 2019's general fund performance follows similarly strong 4.6%-of-expenditures net results in both fiscal years 2017 and 2018 and, notwithstanding available budget and forecast documents pointing to slightly negative net results during fiscal years 2020 to 2022 for the city's general purpose fund (which makes up the bulk of the city's general fund on a generally accepted accounting principles reporting basis), we think that local economic growth and regional real GDP growth will translate into continued positive general fund net results in the medium term.

The city's general fund structure is weighted toward property tax revenue, which made up 37% of general fund revenue in fiscal 2019, followed by real estate transfer taxes (12%) and charges for services (also 12%). Relative to its state peers, Oakland has a small share of its general fund revenue coming from business license taxes (12%) and sales taxes (7%), but based on commercial growth we think the former might grow in the coming years. The city's sales tax revenue is unlikely to benefit from a shift in market share to internet retailers for the time being because the state's distribution system reinforces the existing retail sales tax revenue structure by using each city's brick-and-mortar share

of retail sales within a given county.

The city has a record of securing voter support for tax revenue targeted at specific services, which we think is a modest credit positive insofar as it allows the city to operate core services within statutory and constitutional revenue constraints while providing a policy basis for reducing service levels for specific voter-approved services in the event that an economic downturn weakens funding or funding is not renewed. Oakland voters in March 2020 will consider ballot measures that propose to extend current taxes and fees for a variety of specific programs through fiscal 2024 and a new parcel tax that would pay for homelessness services, parks maintenance, and stormwater trash collections.

Very strong budgetary flexibility

Oakland's budgetary flexibility is very strong, in our view, with an adjusted available fund balance in fiscal 2019 of 23% of adjusted operating expenditures, or $186.8 million. The numerator of this calculation includes the city's vital services reserve, which the city reports as "committed," because we see it as practically available and the denominator reflects an adjustment to treat recurring general fund transfers out as expenditures to make expenditures nationally comparable. Consistent with our view of the city's strong financial performance and the likelihood that an active real estate market will contribute to real estate transfer tax revenue that contribute to the city's vital services reserve, we anticipate that the city's reserves will continue to grow in some form in the medium term.

Very strong liquidity

In our opinion, Oakland's liquidity is very strong, with total government available cash at 70% of total governmental fund expenditures and 7x governmental debt service in 2019. In our view, the city has strong access to external liquidity if necessary, given its issuance of GO, non-ad valorem, and revenue bonds during the past 20 years. We don't consider its investment portfolio, which is weighted toward federal agencies (82% of assets as of December 2019) and money market holdings (11%), to be aggressive.

The city has no alternative financing other than an annual tax and revenue note issuance. The current incarnation includes what we consider nonremote events of default and an acceleration remedy for $97.3 million in principal, but given its short horizon and the availability of generally more than $600 million in governmental cash and investments we do not consider this a material contingent liquidity risk.

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 10% of total governmental fund expenditures, and net direct debt is 102% of total governmental fund revenue. Approximately 67% of the direct debt is scheduled to be repaid within 10 years, which is, in our view, a positive credit factor. After this issuance, the city will have roughly $334 million in authorized but unissued GO debt, and management reports that the city is not actively considering proposing an additional authorization to voters.

With the departure of previously Oakland-based professional sports teams the Raiders to Las Vegas and the Warriors to San Francisco, the city's coliseum and arena complex will soon be underutilized and the county, which shares a joint and several obligation with the city, is seeking to retire its exposure to the property. We think that the city may pursue financing for redevelopment of the site in the future, but for now the key question is whether the remaining team, the Athletics, will be able to realize a proposal to relocate to a waterfront location near the Oakland Harbor and downtown. Based on public statements by public leaders and the team, we think that the city is unlikely to borrow to

finance direct improvements to facilitate a move.

Pension and OPEB highlights:

- In our view, the city's pension and OPEB liability is a material credit weakness, even after taking into account the presence of a dedicated property tax that it can use to fund its smaller closed single-employer plan.
- The city's two largest pension plans' funded status, combined with recent changes to assumed discount rate and amortization methods, will likely lead to accelerating costs in the medium term, but we believe this approach will help the city make timely progress reducing pension liabilities.
- While the city is not making full actuarially determined contributions toward its OPEB liability, the city's recent negotiated changes to the benefit and the adoption of an ongoing funding policy will moderate long-term cost growth.

The city participated in the following plans funded as of June 30, 2018:

- California Public Employees' Retirement System (CalPERS) agent multiple-employer plan for miscellaneous employees: $839 million in net liability, and 69% funded;
- CalPERS agent multiple-employer plan for safety employees: $741 million in net liability, and 65% funded;
- Single-employer Police and Fire Retirement System (PFRS) plan: $280 million in net liability, and 57% funded; and
- Single-employer OPEB plan: $841 million in net liability, and 2% funded.

Oakland's required pension and actual OPEB contributions totaled 18.7% of total governmental fund expenditures in fiscal 2019, with 15.5% representing required contributions to pension obligations. The bulk of this went toward the city's actuarially determined contributions for both CalPERS plans, which fell short of both static funding and minimum funding progress, indicating no funding progress and increased liabilities. We see CalPERS' recent adoption of a 20-year, level dollar amortization approach for new gains and losses as a turning point in that contribution increases from a shorter amortization period will provide a faster recovery to plan funding following years of poor investment performance or upward revisions to the pension liability. However, we believe costs will continue to increase for the next several years to retire existing unfunded liability, much of which is amortized over 30-year periods using a level-percent-of-payroll approach. In our view, the discount rate of 7.15% could lead to contribution volatility. Oakland has planned for higher contribution rates in its multiyear projections but has no plans, such as a substantial funding of a side fund, that we think would give it more flexibility in managing upcoming contribution increases.

A small but material portion of the city's pension contributions (3.8% of total governmental fund expenditures) went toward the city's single-employer PFRS plan, which was closed to new members in 1976, and the city's contributions are structured to amortize the liability by fiscal 2026. The city's approach to funding this liability has been unusual, with pension obligation bonds issues in 1997, 2001, and 2012 and associated agreements enabling the city to forgo annual required contributions during most of the past two decades. We understand that this approach was partly a function of a desire to fund the liability solely with a dedicated property tax that is available to a small number of cities in the state, and the city was able to build up a restricted reserve that now holds about $182 million after making debt service payments on the pension obligation bonds. We consider a credit weakness the city's past willingness to debt

finance what is typically an annual expense and to postpone making contributions that would have enabled it to fully fund the liability earlier, but we note that the city resumed making contributions to PFRS in fiscal 2018 and don't expect it to set up a similar financing mechanism during the final ramp-up to full funding. Moreover, although the dedicated tax is subject to assessed value performance and complex case law, we anticipate that tax and the reserve will substantially or fully cover both debt service and actuarially determined contributions through fiscal 2026. Should the plan's assets experience major investment losses after fiscal 2026, the city would need to make contributions from the general fund or other legally available sources.

The city recently formalized a plan to address its OPEB liability, the pay-as-you-go contributions that represented 3.3% of total governmental fund expenditures. The city set up an irrevocable trust in 2014 that is managed on an agent, multiple-employer basis by CalPERS, that had a fiduciary net position of $16 million against a total liability of $857 million and as of the June 2018 measurement date, and whose current holdings we understand are about $29 million. As part of a policy adopted in February 2019, the city has set up a practice to steadily add to the plan's assets with above-pay-as-you-go annual contributions of 2.5% of payroll, which translate into about $10 million per year currently. Equally important, in our view, the city and its safety employee bargaining groups agreed to cap the benefit for existing employees and add a new tier with lower benefits for employees hired after Jan. 1, 2019, which, in combination, could cut the city's actuarial liability by $175 million. We anticipate that these changes will enable the city to make more rapid progress in funding its OPEB liability, although we note that the new policy does not require the city's contributions to align with the actuarially determined annual contribution.

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit, which triggers enhanced reporting requirements, is strong.

Outlook

The positive outlook reflects what we see as at least a one-in-three chance that we will raise the rating during the next two years. We anticipate that economic growth and a cautious approach to budgeting will enable the city to continue to add to reserves while managing the challenges of addressing community service priorities amid higher pension and OPEB contribution requirements and catching up on deferred maintenance. Making a higher rating more likely would be enhancements to institutionalized financial management policies and practices as inventoried in our financial management assessment and/or an acceleration in assessed valuation growth. The outlook incorporates our view that the city may further exercise its existing GO authorization but that new debt is unlikely to significantly add to the city's debt profile.

Downside scenario

We see a deviation from the recent pattern of strong financial performance or a reversal in the trend towards stronger reserves as the most likely reason we would revise the outlook to stable. We see this potentially occurring either as a result of a recession scenario that substantially slowed revenue growth or difficulty in managing cost growth from sources such as pension contributions. However, should a recession scenario materialize, we expect to examine closely the city's efforts to make adjustments to maintain at least balanced results on a sustainable basis.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 29, 2019
- 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
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Medians and Credit Factors: California Municipalities, Jan. 22, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments

Ratings Detail (As Of February 6, 2020)		
Oakland taxable POB		
Long Term Rating	AA/Positive	Outlook Revised
Oakland GO GO (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised
Oakland GO (BAM) (SECMKT)		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised
Oakland POB (wrap of insured) (MBIA) (National) (AGM)		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised
Oakland POB (wrap of insured) (MBIA, National & Assured Gty) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised
Oakland POB		
Unenhanced Rating	AA(SPUR)/Positive	Outlook Revised
Oakland Jt Pwrs Fing Auth, California		
Oakland, California		
Oakland Jt Pwrs Fing Auth (Oakland) lse rev rfdg bnds		
Long Term Rating	AA-/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

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