

RatingsDirect®

Summary:

Oakland, California; Water/Sewer

Primary Credit Analyst:

Chloe S Weil, San Francisco + 1 (415) 371 5026; chloe.weil@spglobal.com

Secondary Contact:

Edward R McGlade, New York + 1 (212) 438 2061; edward.mcglade@spglobal.com

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Credit Profile

Oakland WTRSWR

Long Term Rating

AA/Negative

Downgraded, Removed from CreditWatch

Credit Highlights

- S&P Global Ratings lowered its long-term rating to 'AA' from 'AA+' on Oakland, Calif.'s outstanding sewer revenue bonds and removed it from CreditWatch with negative implications, where it was placed on Nov. 20, 2024.
- The outlook is negative.
- The rating action reflects our view of the sewer system's operational and financial policies, which are weaker than those of similarly rated peers in an environment where sector risks are rising. Moreover, weakened general fund metrics expose the enterprise to a greater risk of liquidity impairment.
- The negative outlook indicates there is at least a one-in-three chance we could lower the rating over during the outlook period should accelerating capital spending pressure margins as the utility addresses aging infrastructure and asset hardening while complying with a consent decree. Heightened general fund distress could also pressure the sewer rating.

Security

The sewer system's net revenue secure the bonds. We consider the bond provisions standard. A two-tiered rate covenant is in effect, whereby net revenue must cover parity debt by least 1.2x and all debt by 1.0x. 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 (DSC). As of June 30, 2024, the city had \$15.8 million of sewer debt outstanding.

Credit overview

While financial results remain strong at the enterprise level, sector—and city-specific risks—heighten the overall credit vulnerability. Management weaknesses related to asset management and capital budgeting policies coupled with demonstrated weakness in organizational effectiveness (cyber), increase event risk and liquidity depletion. Further, the economy is pressured, as evidenced by the announced downsizing of a major employer and demographic and social trends that portend a weakened service area outlook.

Oakland manages an extensive sanitary sewer collection system, with more than 929 miles of sewer main line, 28,000 sewer structures, and seven pump stations. Like many older cities, Oakland is grappling with aging infrastructure and regulatory challenges related to sewage overflows caused by leaky pipes and excessive root intrusion. Sewage is collected and transferred to the East Bay Municipal Utility District (EBMUD) interceptor for sewage treatment. We understand that the city is in the process of completing an update to its sewer master plan to identify additional areas

for capital repairs and upgrades; the absence of a completed plan, in our view, increases uncertainty regarding near-term capital spending.

Oakland has experienced a significant general fund structural imbalance for fiscal years 2024 and 2025; while city leadership has taken action to bridge the budget gap in the current year, we view the fiscal impact of such actions as either uncertain or one-time in nature. The city indicates that its substantial overspending is primarily driven by ballooning public safety costs from overtime in the police and fire departments. In our view, absent additional structural budgetary adjustments, the city will likely continue to face a large outyear budget gap that could strain the sewer rating should this gap widen over time. (For more information on our general obligation (GO) rating, see our analysis published Feb. 19, 2025.)

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, we believe the city council could take steps to circumvent such protections in times of severe financial distress.

The rating further reflects our view of the sewer system's:

- Strong billing mechanism as EBMUD collects Oakland sewer collection system rates on EBMUD customer bills within Oakland and remits those to the city; customers are incentivized to pay their sewer bill to avoid having EBMUD (which provides water service) shut off water. While EBMUD indicates that it has experienced a year-over-year increase in delinquencies from customers in Oakland, we understand that the uptick is consistent with the districtwide rise in delinquencies.
- Average residential sewer rate of \$79.10 a month (including EMBUD's treatment charge), which we consider generally affordable at 1.2% of median household income in Oakland, which is about 123% of the national average. Meanwhile, commercial, industrial, and other customer types pay a volume-based rate. EBMUD provides billing and collection services on a staggered bimonthly basis.
- The current rate structure adopted by city council allows the system to annually increase rates by the Bay Area consumer price index. It may hold rates steady in any particular year, but it does not require additional approvals through the Prop. 218 process unless it raises rates under a method that departs from this inflation-based index.
- Standard financial policies and practices, including formal debt management and investment policies, but lacking long-range financial and capital plans.

Environmental, social, and governance

We view environmental factors as relevant to our credit analysis, given that the sewer system operates under a consent decree to reduce peak weather flows, finalized in September 2014 between the city, the regional water control board, and other authorities. Under the consent decree, the city must inspect 10% of its total linear footage annually and rehabilitate 13 miles of sewer mains. The city also faces moderately elevated risk factors associated with catastrophic wildfire, as there are about 22,000 structures within a designated "very high fire hazard severity zone" in the Oakland hills, per CalFire. The city works with EBMUD and other regional partners on wildfire prevention and mitigation. Measured MM was approved by voters in November 2024, which creates a 20-year dedicated funding source to address wildfire risk through vegetation management, enhanced fire patrols, and evacuation route

protections, among other actions within the city's Wildfire Prevention Zone; the measure would fund the implementation of a 10-year vegetation management plan and the special tax is estimated to yield \$2.67 million in its first year for wildfire resilience efforts.

Social and governance risk are neutral factors in our sewer system analysis. However, we recognize that rate affordability could be pressured if sewer bills (including EBMUD's costs) rise faster than household incomes over time.

Outlook

The negative outlook reflects our view that Oakland is experiencing institutional stress and weakness in its operational management practices, which could present challenges over the outlook period. As such, there is at least a one-in-three chance we could lower the sewer system rating.

Downside scenario

We could lower the rating if the sewer system's liquidity deteriorates to a level no longer comparable to those of its 'AA' rated peers due to accelerated capital spending or heightened general fund transfers, or if we believe protracted economic challenges are likely to limit management's rate-setting flexibility or financial capacity.

Upside scenario

We could revise the outlook to stable if the city demonstrates economic and financial stability and develops more formalized planning practices, and we believe the sewer system will likely maintain reserves roughly in line with current levels.

Oakland, California--economic and financial data					
		Fiscal year-end			
	Most recent	2024	2023	2022	Median (AA)
Economic data					
MHHEBI of the service area as % of the U.S.	122.0				110.0
Unemployment rate (%)	5.6				3.6
Poverty rate (%)	10.1				10.0
Water rate (6,000 gallons or actual) (\$)	0.0				36.5
Sewer rate (6,000 gallons or actual) (\$)	79.1				41.0
Annual utility bill as % of MHHEBI	1.2				1.1
Operational management assessment	Standard				Good
Financial data					
Total operating revenues (\$000s)		76,390	73,620	71,232	24,286
Total operating expenses less depreciation (\$000s)		59,843	58,454	39,978	17,090
Net revenues available for debt service (\$000s)		21,558	18,085	30,322	--
Debt service (\$000s)		3,647	3,643	3,650	--
S&P Global Ratings-adjusted all-in DSC (x)		5.9	5.0	8.3	2.2
Unrestricted cash (\$000s)		99,327	87,198	85,591	24,667
Days' cash of operating expenses		606	544	781	631
Total on-balance-sheet debt (\$000s)		15,795	18,515	21,126	39,844

Oakland, California--economic and financial data (cont.)

	Most recent	Fiscal year-end			Median (AA)
		2024	2023	2022	
Debt-to-capitalization ratio (%)		5.0	6.0	7.1	27.0
Financial management assessment	Standard	--	--	--	Good

Note: Most recent economic data available from our vendors. MHHEBI--Median household effective buying income. DSC--Debt service coverage.

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