

March 30, 2011

Summary:
Oakland, California;
Appropriations; General Obligation

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Summary:

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Credit Profile

Oakland GO

Long Term Rating

AA-/Stable

Outlook Revised

Rationale

Standard & Poor's Ratings Services revised the outlook to stable from negative on its ratings and underlying ratings (SPURs) on Oakland, Calif.'s general obligation (GO) bonds and pension obligation bonds (POBs) and Oakland Joint Powers Financing Authority's revenue bonds. The rating action reflects our view of management's budgetary actions that have allowed the city to maintain what we consider to be still very strong reserve levels despite the recession's impact on local revenue and resulting successive budget gaps. At the same time, Standard & Poor's affirmed its 'AA-' rating and SPUR on the GO bonds, its 'AA-' SPUR on the revenue bonds, and its 'A+' SPUR on the POBs.

The ratings are supported by our view of the following credit strengths:

- A very deep and diversified economic base that contributes to and participates in the Bay Area regional economy;
- The city's strong financial management practices, many of which are enshrined in council-adopted policy;
- City cash flows and liquidity levels that are closely monitored and managed throughout the fiscal year and management's emphasis on maintaining healthy general fund reserves;
- The city's very strong reserves; and
- A property tax override of 0.1575% of assessed value (AV) that supports the city's Police and Firemen's Retirement System (PFRS) obligations.

The rating strengths are partially tempered by what we consider to be a moderately high overall debt burden as well as our view of continued budget pressures resulting from declining tax revenues and management's ongoing challenge to contain expenditure growth.

The GO bonds are secured by the city's unlimited ad valorem property tax pledge.

The rating on the city's POBs is one notch lower than the GO rating to reflect our view of the appropriation risk associated with appropriation-backed obligations.

The authority's revenue bonds are secured by revenues consisting of payments on city GO bonds issued concurrently with the revenue bonds and purchased in their entirety by the Oakland Joint Powers Financing Authority. The authority-owned GO debt is secured by unlimited ad valorem property taxes of the city, which serve as the security for the revenue bonds issued by the authority.

The city has a population of about 414,678. Its job market continues to struggle, as demonstrated by a 16.5% preliminary unemployment rate reported for January 2011 by the Bureau of Labor Statistics. Although the monthly

unemployment rate has improved from 17.7% in July 2010, monthly employment figures have been negative since 2008. IHS Global Insight forecasts one more year of weak employment, except for very modest growth (0.5%) in services industries payrolls. However, over the long term, Oakland will benefit from the high-technology research and venture capital investment targeting the Bay Area, according to IHS Global Insight. In addition, IHS Global Insight believes San Francisco's limited land development prospects will push business expansion into the Oakland area. The city's median household effective buying income for 2009 was 98% of the nation's.

Revenue losses in governmental funds were primarily experienced in the area of the real estate transfer tax, which has remained 50% below the peak received in fiscal 2007. Sales taxes revenue was also hit hard, declining by 30% between fiscals 2008 and 2010. Utility consumption taxes, transient occupancy taxes, and parking revenue experienced modest losses. Although property tax delinquency rates rose during the recession, with the exception of fiscal 2010, continued AV growth offset those losses. Growth of 3.4% in fiscal 2011 reversed losses experienced in fiscal 2010. Total AV for fiscal 2011 was \$41.3 billion.

Management expects the fiscal 2011 general fund will be balanced. The city's fiscal 2011 midyear forecast includes an additional revenue loss of almost \$11 million due primarily to lower-than-budgeted parking meter citations, interest income, and billboard revenue. However, this shortfall was partially offset by lower-than-expected expenditures of \$6 million. We understand that the remaining imbalance will be offset by a limited amount of one-time revenue and additional projected underspent expenditures, pending approval by the city council in late April or early May. We expect that with these budget revisions, reserves will remain consistent with prior-year levels, which we consider very strong. Fiscal 2010 closed with an unreserved general fund balance of 29.7% of expenditures.

The city's ballot measures BB and V revenue enhancements were approved by voters in November 2010. We understand that Measure BB eliminated minimum staffing mandates that were required under Measure Y, a parcel tax approved by voters to fund violence prevention and public safety. In response to budget pressures, the city reduced police staffing below Measure Y requirements, thus resulting in a loss of the parcel tax revenue. With the passage of Measure BB, the city may maintain reduced staffing levels while regaining the parcel tax revenue. Measure V approves increases to business taxes on marijuana and took effect on Jan, 1, 2011. The tax was increased to \$50 from \$18 per \$1,000 gross receipts.

For fiscal 2012, management reported that the annual general fund shortfall is reduced compared to prior years and is projected to be about \$46 million. Management attributes these results to its projections of continued declines in property and real property transfer taxes and increased fringe benefit retirement rates, discontinuation of prior-year furloughs, and step and column increases. In addition, management's forecast eliminates \$19 million of land sale proceeds as the sale may not be realized during fiscal 2012. We understand that the first city council budget hearing will begin in April. Currently, the mayor is reviewing the feasibility and impact of a 15% reduction to all departments, potential furloughs, eliminating step and merit increases, reorganizations, and a parcel tax ballot measure. Although the parcel tax measure failed during the November 2010 ballot, management informed us that polling results have been positive, which may be attributable to the reduced size of the parcel tax (\$80 per single-family residence).

Oakland's management practices are considered "strong" under Standard & Poor's Financial Management Assessment (FMA). An FMA of "strong" indicates our view that practices are strong, well embedded, and likely sustainable.

We understand that the city expects to issue tax and revenue anticipation notes for fiscal 2012 in the spring. It expects the issue amount to be consistent with prior years to meet seasonal cash flow needs. Oakland's overall net debt is what we consider moderately high at 6.8% of fiscal 2010 market value and \$6,499 per capita. The overall debt includes debt of overlapping entities and about \$497 million of tax increment and special assessment debt. It also includes POBs, which were issued to fund a portion of the PFRS obligation and are secured by a pledge of a voter-authorized pension override tax of 0.1575% of AV. We understand the city is contemplating issuing POBs to fund its PFRS obligation, to be backed by an ad valorem property tax approved by voters for the purpose of funding PFRS and PFRS-related debt. PFRS unfunded actuarial accrued liability is about 38% funded. We understand that the plan is closed and the liability must be funded by June 30, 2026. Management reported that the PFRS property tax generated about \$5 million in excess of its currently outstanding PFRS POBs, which had an annual debt service payment of \$40.3 million for fiscal 2011. In addition to the PFRS property tax, management stated that additional general fund appropriation-backed debt will mature in the next three to five years, making additional budget capacity available for the liability. We understand that the city has accumulated about \$74 million of surplus PFRS surplus revenue, which it may use to terminate a swap associated with PFRS related POBs. A swap related to the variable-rate series 1998 A1/A2 remains outstanding although the bonds were defeased in 2005. Although the refunding bonds were issued at a fixed rate, the city chose not to terminate the swap, for which it pays about \$5,000 annually, due to the high termination payment, which at the time was about \$20 million. According to management, the cost of the swap is also funded from the PFRS property tax and the city now has sufficient surplus revenue accumulated to pay the swap termination payment. We understand that the city also participates in California Public Employees' Retirement System for which it funds its actuarially determined annual required contributions, and the miscellaneous and safety plans are 80% and 78% funded, respectively.

Outlook

The stable outlook reflects our view of recent budget actions that have allowed the city to retain a very strong general fund balance, although the budget remains structurally imbalanced. We do not expect to raise the rating during the two-year outlook period due the city's projection that revenues will remain constrained for fiscal 2012 and our view that a structurally balanced budget would likely require revenue growth to keep pace with inflation and pension contribution costs, not just stemming losses.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008

Ratings Detail (As Of March 30, 2011)

Oakland POB (wrap of insured) (MBIA, National & Assured Gty) (SEC MKT)

Unenhanced Rating

A+(SPUR)/Stable

Outlook Revised

Oakland GO

Unenhanced Rating

AA-(SPUR)/Stable

Outlook Revised

Oakland POB

Ratings Detail (As Of March 30, 2011) (cont.)

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Outlook Revised
Oakland Jt Pwrs Fing Auth , California		
Oakland, California		
Oakland Jt Pwrs Fing Auth (Oakland) (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised
Oakland Jt Pwrs Fing Auth (Oakland) (City Of Oakland Go Bnd Pgrm) (wrap of insured) (AMBAC & ASSURED GTY) (SEC MKT)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised
Oakland Jt Pwrs Fing Auth (Oakland) lse rev bnds (Oakland Admin Buildings) 2008B (ASSURED GTY)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Outlook Revised
Oakland Jt Pwrs Fing Auth (Oakland) GO (ASSURED GTY)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Outlook Revised
Oakland Jt Pwrs Fing Auth (Oakland) (City Go Bnd Pgrm)		
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Outlook Revised
Many issues are enhanced by bond insurance.		

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