FITCH AFFIRMS OAKLAND, CA'S GOS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-San Francisco-28 July 2014: Fitch Ratings has affirmed the following Oakland, California (the city) ratings:

--$77.5 million outstanding city of Oakland general obligation (GO) bonds, series 2006 (Measure G), and 2009B (Measure DD) at 'A+';
--$66.3 million Oakland Joint Powers Financing Authority (City of Oakland General Obligation Bond Program) refunding revenue bonds, series 2005 at 'A+';
--$136 million outstanding city of Oakland pension obligation refunding bonds, series 2001 at 'A';
--$127.9 million Oakland Joint Powers Financing Authority (Oakland Administration Buildings) refunding revenue bonds, 2008 series A-1 and B at 'A'.

The Rating Outlook is Stable.

SECURITY

The GO bonds and the Oakland Joint Powers Financing Authority (City of Oakland General Obligation Bond Program) refunding revenue bonds, series 2005 are secured by the city's full faith and credit and unlimited taxing power.

The pension obligation bonds are secured by the city's pledge to make annual payments from dedicated tax override revenues and any other legally available source of city revenues; the city's obligation is imposed by law.

The Oakland Joint Powers Financing Authority (Oakland Administration Buildings) refunding revenue bonds, 2008 series A-1 and B are secured by lease payments for use and occupancy of certain administrative buildings, subject to abatement.

KEY RATING DRIVERS

MIXED SOCIOECONOMIC CHARACTERISTICS: The city benefits from being part of the large San Francisco Bay Area economy and its property market is rebounding well. However, the city remains challenged by an above-average unemployment rate and some below-average socioeconomic characteristics.

SIGNIFICANT LONG-TERM LIABILITIES: Debt levels are high but amortize swiftly. Pension and other post-employment benefit (OPEB) liabilities are significant. Anticipated growth in annually required CalPERS contributions should be moderated by the implementation of new pension tiers and full employee share contributions from all city personnel.

ONGOING GENERAL FUND STRUCTURAL IMBALANCE: The general fund continues to experience net operating deficits after transfers, with ongoing structural imbalances projected in the future largely due to escalating benefits liabilities and deferred capital costs.

HIGH EXECUTIVE MANAGEMENT TURNOVER: Lack of executive management stability could hinder the city's ability to take advantage of the improving economy and interfere with the implementation of redevelopment projects.

RATING SENSITIVITIES

MATERIAL CHANGES TO FINANCES AND DEBT: The rating is sensitive to shifts in fundamental credit characteristics, including the city's current level of general fund balances and debt profile. The Stable Outlook reflects Fitch's expectation that such shifts are unlikely.

CREDIT PROFILE

Oakland is the largest and most established of the San Francisco Bay Area's East Bay cities, an economic center of its own, and a central transportation and transit hub with one of the largest container-ship ports in the nation and an international airport. The economy continues to diversify from a historically industrial city to a commercial, service, and governmental center, with a number of large hospitals and a restaurant and entertainment sector that continues to grow in importance.

MIXED SOCIOECONOMIC CHARACTERISTICS

While the Oakland economy is large and diverse with strong ties to the broader Bay Area employment market, the city's economy is weaker than many of its San Francisco Bay Area neighbors. The unemployment rate tends to run above regional, state, and national averages, and it remained quite elevated at 8.9% in April 2014 compared to the state (7.3%) and the nation (5.9%). Nevertheless, the city's unemployment rate has declined significantly from its 16.9% peak in 2010. This decline has been noticeably sharper than the declines experienced by the state and the nation over the same period, albeit from a much higher peak.

Socioeconomic characteristics are below-average when compared to regional data but are more mixed in relation to state and national data. While the city's median household income is only 83% of the state and 97% of the nation, its per capita income fares better at 107% and 114% respectively. While the city has a higher individual poverty rate (20%) than the nation (14%), it significantly outperforms the nation in terms of educational attainment (16% have advanced degrees compared to 11% nationally).

REBOUNDING TAX BASE

After taxable assessed valuation (TAV) declines in fiscal years 2010 and 2011, the tax base resumed growth which has gradually accelerated during fiscal years 2012-2015. TAV should continue to grow due to the gradual rollout of significant residential and commercial developments.

SIGNIFICANT LONG-TERM LIABILITIES

Overall net debt is high at $6,597 per capita or 5.9% of market valuation. However, amortization is above average at 75.4% in 10 years and, despite more than $1.5 billion in capital improvement needs, the city has limited GO debt issuance plans ($62.3 million in Measure DD GO bonds in 2015 and annual TRANs issuances).

The city's unfunded pension and OPEB liabilities remain very high. The unfunded actuarial accrued liabilities (UAAL) for the city's pensions - PFRS and CalPERS - are currently estimated to be $203.7 million and $742.2 million, respectively. Anticipated future growth in CalPERS liabilities should be somewhat moderated by the implementation of new pension tiers and full employee share contributions from all city personnel.

The OPEB UAAL is also significant at $553.5 million. The city established a California Employer's Retiree Benefit Trust to start reducing its OPEB liability. This trust is currently funded at $2.2 million.

ONGOING GENERAL FUND STRUCTURAL IMBALANCE

After six consecutive years of general fund net operating deficits after transfers, the city ended fiscal 2012 with surplus operations of $30.6 million. However, the general fund returned to deficit operations in fiscal years 2013 ($10.3 million) and 2014 (projected $10.6 million). The city's multiyear projections indicate an ongoing structural imbalance largely due to unfunded and deferred capital costs as well as escalating benefit liabilities. In fiscal 2015, the general fund could require up to $19.9 million of one-time monies to fund ongoing operating expenditures, depending on possible policy changes about how excess real estate transfer taxes can be used.

The city reported a fiscal 2013 unrestricted general fund balance of $80.2 million, or 13.9% of spending, down from $145.2 million, or 25.5% of spending, in fiscal 2012. This decline was due to the city reclassifying the pension override balance to its restricted general fund in fiscal 2013 from its committed general fund in fiscal 2012. However, when pension override set-asides are excluded from the fiscal 2011 and 2012 unrestricted general fund balances, there is a positive upward trend in the unrestricted general fund balance in fiscal 2013.

Improving general fund revenues, final transfer of former redevelopment agency monies and bond proceeds to the city, and ongoing good general fund liquidity are all credit positives. Cumulatively, the city is facilitating increased investment in public safety, economic development, service restorations, and critical deferred infrastructure needs. However, significant budget balancing challenges remain in a political and taxpayer environment which will undoubtedly seek further service restorations and capital reinvestment. Such challenges are complicated by the large proportion of expenses that are non-discretionary.

Annually required CalPERS pension contributions are anticipated to grow and annual PFRS contributions resume in fiscal 2018 with the potential to resume stressing the general fund. The city's currently moderately high carrying costs related to annual debt service, annually required pension contributions, and OPEB pay-as-you-go payments will likely become a higher proportion of city spending going forward.

HIGH EXECUTIVE MANAGEMENT TURNOVER

Over the past three years, the city has experienced significant executive management turnover, particularly with regard to its city administrator's office and police department. This turnover, in combination with a highly contested mayoral election in November 2014, could hinder the city's ability to take advantage of the improving economy, interfere with the implementation of redevelopment projects, and make it more difficult to manage the city's frequently contentious political, taxpayer, and labor environments. Fitch notes, however, that the risk of the police department being placed into federal receivership is now greatly diminished under the new Police Chief. The police department is expected to fully comply with all court mandates by December 2014.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, and National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314