CITY OF OAKLAND

AGENDA REPORT

TO: Office of the City Administrator
ATTN: Dan Lindheim
FROM: Finance and Management Agency
DATE: July 14, 2009

RE: **An Informational Report Providing Status on the City's Bond Rating**

SUMMARY

This report is to provide to the City Council a status update on the City's recently received bond ratings. This report is presented for City Council's information and review only and requires no City Council action.

FISCAL IMPACT

This is an informational report. There is no fiscal impact.

BACKGROUND

A credit rating is a value assigned by one or more of the recognized rating agencies that "grade" a jurisdiction's credit, or financial trustworthiness. The higher the grade the City receives, the stronger the credit. Rating agencies generally focus on four major areas when assigning credit ratings: finances, management, economy and outstanding debt.

The three primary rating agencies are Moody's Investors Service ("Moody's"), Standard & Poor's Rating Services ("S&P"), and Fitch Ratings ("Fitch"). These rating agencies serve as independent assessors of municipal and corporate credit strength. Investors rely on their opinions to make investment decisions. Also, receiving a favorable credit rating will result in lower interest rates.

The table below presents the categories for long-term and short-term credit ratings for the three rating agencies:

Long-term Credit Rating		
Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa	BBB	BBB
Baa3	BBB-	BBB-

Short-term Credit Rating		
Moody's	S&P	Fitch
MIG-1	SP-1+	F1+
MIG-2	SP-1	F1
MIG-3	SP-2	F2
SG	SP-3	F3
		B
		C
		D
		NR

KEY ISSUES AND IMPACTS

Recent Rating Review

In June 2009, the City met with all three rating agencies to review and update ratings for the upcoming GO Bond and Tax and Revenue Anticipation Note issuances. Treasury staff worked with City management and the City's Financial Advisor to prepare a rating agency presentation for meetings with the rating agencies on June 4, 2009 and June 9, 2009. After their intensive research and interviews with the City, the rating agencies have assigned the City's ratings as follows:

	Moody's	S&P	Fitch
Underlying Rating	A1/Stable	AA-/Negative Outlook	A+/Negative Outlook
GO Bonds (Measure DD)	A1/Stable	AA-/Negative Outlook	A+/Negative Outlook
Pension Obligation Bonds	A2	A+	A
TRAN	MIG-1	SP-1+	F1+

All three rating agencies have kept the City's bond ratings the same, with a stable outlook from Moody's and a negative outlook from S&P and Fitch. Moody's kept the general obligation bond rated at A1, the fifth highest out of the ten in the investment grade category. S&P kept the rating on those bonds at AA-, the fourth highest in the investment grade category with a negative outlook. Fitch kept the rating at A+, the fifth highest in the investment grade category with a negative outlook.

A negative outlook means that the City's rating may be lowered if certain conditions do not improve or are not met. According to the rating agencies, the City received a negative outlook because of the City's constrained financial flexibility, with significant budgetary pressure due to declines in revenues and rising expenditures. It is prudent that the City demonstrate the ability to control expenditures, spend within its means, have a strong financial planning, with the ability to react quickly to changes due to economic downturn and address long-term structural budget issues. If the City is unsuccessful in addressing these issues and it becomes a credit concern, then the City may face a possible rating downgrade. For reference, the rating agency reports from Moody's, S&P and Fitch are attached.

Importance of credit ratings to the City

A credit rating is important to the City for the following reasons:

- Ensures low interest cost to the City
- Demonstrates strong financial management and condition to potential investors
- Yields savings on debt service
- Ability to attract potential investors
- Ability to sell bonds

The financial credit squeeze that began with the subprime mortgage market collapse has caused the financial market to be volatile. Under the current market conditions, investors are now concerned about liquidity and the credit ratings of the bonds. Potential investors look to these rating agencies for credit ratings for indication of good investments or not. If the City receives high credit ratings, this signals that the City is in good financial health.

It is critical that the City adopt a balanced budget and executes all measures proposed in the budget to maintain a financially sound city in order for the City to preserve these ratings. Failure to retain fiscal balance in light of a slowing economy, increasing personnel costs, inability to diversify revenue streams, and an inability to build the general fund reserve will result in a possible downgrade.

SUSTAINABLE OPPORTUNITIES

There is no impact to economic, environmental or social equity opportunities following actions under this report.

DISABILITY AND SENIOR CITIZEN ACCESS

There is no impact to disability or senior citizen access following actions under this report.

RECOMMENDATION(S) AND RATIONALE

Staff recommends Council's acceptance of this informational report.

ACTION REQUESTED OF THE CITY COUNCIL

Staff requests that Council accept this informational report.

Respectfully submitted,

JOSEPH T. YEW, JR
Finance Director/ Treasurer

Prepared by:
Katano Kasaine, Treasury Manager
Treasury Department

APPROVED AND FORWARDED TO THE
FINANCE AND MANAGEMENT COMMITTEE:

Office of the City Administrator

Moody's Investors Service

New Issue: MOODY'S ASSIGNS MIG 1 RATING TO CITY OF OAKLAND'S TRAN

Global Credit Research - 24 Jun 2009

APPROXIMATELY $180 MILLION IN DEBT AFFECTED

Municipality
CA

Moody's Rating

ISSUE	RATING
2009-10 Tax and Revenue Anticipation Notes, Series A	MIG 1
Sale Amount $100,000,000	
Expected Sale Date 07/08/09	
Rating Description Tax and Revenue Anticipation Notes	
2009-10 Tax and Revenue Anticipation Notes, Series B	MIG 1
Sale Amount $80,000,000	
Expected Sale Date 07/08/09	
Rating Description Tax and Revenue Anticipation Notes	

Opinion

NEW YORK, Jun 24, 2009 -- Moody's Investors Service has assigned a MIG 1 rating to the City of Oakland's 2009-10 Tax and Revenue Anticipation Notes (TRAN) Series A and B. The rating action is a result of the city's satisfactory projected ending cash balance that is supplemented by a sound level of alternate liquidity. Our analysis also considers the city's continued efforts to reduce costs and its recent history of outperforming ending cash balance projections. The large size of the borrowing and the city's typically late set-aside for note repayment is also reflected in the rating assignment. The notes are secured by the city's fiscal 2009-10 unrestricted receipts.

SATISFACTORY ENDING CASH BALANCE BASED ON SIGNIFICANT BUDGET CUTS STILL TO COME

The city's projected 2010 ending cash balance is a satisfactory 8.3% of total projected receipts. This represents a $2.5 million decline from fiscal 2009, but is still largely comparable to that year's 8.5% ending cash balance. In order to meet these projections, the city will have to reduce its disbursements by a total of 8.2% from fiscal 2009. The most significant of these reductions is nearly $47 million in reductions to salaries and benefits. The city's budget calls for significant layoffs in addition to an increase in the retirement rate and a 12-day shut-down of non-essential city services. The city's proposed budget includes the necessary cutbacks in service and staff, but has not yet been adopted by the city council. However, council has given indication that it will adopt a balanced budget, monitor disbursements throughout the year, and make any necessary mid-year reductions as needed. Moody's assignment of the MIG 1 presumes that the city will, in fact, make any necessary adjustments to produce an adequate operating result. The city has demonstrated an ability to make significant mid-year budget adjustments. In fiscal 2009, the city cut disbursements twice in order to reduce the impact of receipts that fell faster than anticipated due mostly to the rapid deterioration of the economy.

The city is prudently projecting nearly all of its receipts to decline to some extent. Precluding the expected borrowing, total receipts are forecast to fall by 3% from fiscal 2009, which was down 2% from fiscal 2008. The most significant of these declines is a 53% drop in miscellaneous receipts. In 2009, the city captured receipts as a result of one-time actions such as the sale of city property. The city does anticipate the availability of such options in 2010. The city also projects the recession to continue to have negative impacts on real estate transfer receipts, sales tax, and property tax, all of which are expected to decline in 2010. Oakland is not unique given the fact that virtually all California cities are experiencing negative impacts from the weak economy resulting in soft revenue streams. However, based on Oakland's ability to make mid-year budget adjustments, its reasonable cash flow projections, and satisfactory anticipated ending cash balance, Moody's expects the city's finances to be sufficient for the rating designation.

FISCAL 2010 BUDGET NOT YET FINAL; ADDITIONAL CUTS IN DISBURSEMENTS IS POSSIBLE

From fiscal 2005 to fiscal 2008, the city ended with actual cash balances that were better than the projected level. The city was able to accomplish this by taking a conservative approach to its forecast of receipts and disbursements. This string was broken in 2009 when receipts fell at a rate faster than anticipated and in a manner that outpaced the city's ability to make reductions. In fiscal 2010, the city could potentially outperform its expected ending cash level due to some cost saving possibilities that are not included in the projections. The first among these possibilities are potential concessions from the city's labor unions that would further drop the cost of salaries and benefits. The city is also pursuing a federal grant for the funding of 140 city police officers who are currently paid for out of the city's general fund. Receipt of the grant could potentially free $23 million in fiscal 2010 disbursements. Oakland's city council is scheduled to adopt a budget by June 30 and is exploring other options for receipt enhancement or disbursement reduction that could further strengthen the city's projected cash flow.

SOUND LEVEL OF ALTERNATE LIQUIDITY

The city's cash flows are supplemented by a sound level of alternate liquidity found across a range of funds. These funds could be used as a source of note repayment and include money that can be utilized by the city without having to be repaid in the same fiscal year in which it was borrowed. If these funds are included, the city's total ending cash balance rises to a healthy 20% of total receipts. The largest source of alternate liquidity is approximately $40 million in city's pooled cash fund.

LARGE BUT MANAGEABLE BORROWING SIZE; TYPICALLY LATE SET ASIDE SCHEDULE

The city's TRAN will be issued in an amount not to exceed $185 million. This size issue represents 30% of the city's projected fiscal 2010 receipts. This is a very large size borrowing relative to expected receipts. However, the borrowing should be manageable for the city, in part, because Series B will be used to prepay the city's annual CALPERS obligation for fiscal 2010. The city prepays its CALPERS obligation for the benefit of getting a 3% discount on the total amount owed. The city is setting aside 50% of its note repayment funds in March and May to result in a typically late dollar weighted- average set aside of 1.8 months prior to the fiscal year end. Such late set-asides have been a regular practice of the city and are a credit weakness relative to other California cities with set-asides that are generally 1.5 months sooner. As it has in years past, the city will be placing the note repayment funds with a third-party trustee.

KEY STATISTICS

City GO Rating: A1/STABLE

Projected amount borrowed as % of receipts, FY 2010: 30.4%

Projected ending cash as % of receipts, FY 2010: 8.3%

Alternate Liquidity, Projected FY 2009: $69 million

Pledged set-aside timing (months before June): 1.8 months

The last rating action was on June 23, 2008 when a MIG 1 rating was assigned to the City of Oakland's 2008 TRAN.

The principal methodology used in rating this issue was Short-Term Cash Flow Notes which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

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Moody's Investors Service

New Issue: Oakland (City of) CA

MOODY'S ASSIGNS A1 RATING TO CITY OF OAKLAND'S 2009B GO BONDS; RATING OUTLOOK AND RELATED RATINGS AFFIRMED, DESPITE BUDGET PRESSURES

APPROXIMATELY $983 MILLION IN DEBT AFFECTED, INCLUDING CURRENT ISSUE

Municipality
CA

Moody's Rating

ISSUE	RATING
General Obligation Bonds Series 2009 B, Measure DD	A1

Sale Amount	$62,897,622
Expected Sale Date	07/15/09
Rating Description	General Obligation Bonds

Opinion

NEW YORK, Jun 17, 2009 -- Moody's Investors Service has assigned an A1 rating to the City of Oakland's General Obligation Bonds Series 2009B, Measure DD. Moody's has also affirmed the existing ratings on the city's outstanding general obligation bonds and general fund lease debt. While the city is experiencing significant budget pressures, these are generally common to the majority of California municipalities. We believe the city is well positioned to address these challenges, and we expect the city will rebalance its budget without significantly weakening its balance sheet. The city's stable, long-term rating outlook has, therefore, also been affirmed. The rating action positively reflects the city's mid-year budget adjustments in fiscal 2009, its projection of sound fiscal 2009 year-end General Fund balances, both total and unreserved, and the city's reasonable revenue and expenditure projections for fiscal 2010. Effectively implementing the 2010 budget proposal, and closing the significant, projected budget gap, will, however, be critical for maintaining the city's fiscal stability going forward. Failure to bring on-going revenues and expenditures back into balance would put negative pressure on the rating. The rating also includes our recognition that the city's large and diverse East Bay Area economy is being negatively impacted by the recession, but in the long-run it should perform well compared to other, similarly-rated, mid-sized cities across the country. Our rating also incorporates Oakland's high but still manageable debt levels.

NEAR-TERM BUDGETARY STRESS POSES MANAGEABLE CHALLENGE

The city is facing significant near-term budget stress that will require large spending cuts in order to balance operations and maintain fiscal stability. Our rating presumes that the city will, in fact, effectively execute a balanced budget thereby producing operating results consistent with its rating. Moody's recognizes that this year's budget shortfall is appreciably larger than those faced by the city in other economic downturns. However, it appears that the city has identified a viable course of action that will enable it to successfully manage the shortfall while largely preserving its general fund reserves.

The city is going into fiscal 2010 with a healthy total general fund reserve that is approximately 40% of total fiscal 2009 revenues. This amounts to $217 million and is the result of the city enacting approximately $75 million in budget balancing measures during the course of the 2009 fiscal year. The measures include staff and service reductions across city departments, fee increases, property sales, and a reduction in fund balance. These actions reflected continued weakness in the city's revenue streams. The real estate transfer tax revenue in particular fell by $11 million as a result of the sluggish housing market. In addition, the city expenditures for police were once again over budget, this time by $11 million. The fact that the city was able to make such significant mid-year budget reductions is a credit positive in that it shows an ability to quickly respond to threats to the city's fiscal health.

The fiscal 2010 budget identifies an $83 million budget shortfall. This shortfall is projected based on the city's initial calculation of a $51 million decline in revenues and a $32 million increase in expenditures. The city has proposed a balanced budget that will close the shortfall primarily through $79 million in cuts and service reductions. As per the original budget proposal, approximately 40% of these cuts will be the result of eliminating or reclassifying staff along with other department spending reductions. The city is also considering significant increases in parking meters and citations and entertainment ticket surcharges. About 30% of the cost savings in the original budget are the result of the city's plan to delay repayment of internal service funds. However, the city is now reconsidering this option and is exploring other means of making additional cuts or fee increases that would preclude a delay in repayment the internal funds. The final portion of the city's budget cutting measures is in finding alternative funding for 140 existing city police officers. Management is working to win a federal grant that would award the city with $23 million annually for three years to pay the cost of the officers. Receipt of this federal grant would free the city's general fund of this cost during that period. If the city does not win the grant, or receives only a portion thereof, it plans to seek concessions from its police union. If the city cannot win concessions in these negotiations, it will have to either layoff the officers, make deeper cuts among the civilian staff and departments, or draw upon its reserves. The current budget proposal does not call for draw on reserves. It should be noted that Oakland has at times had a contentious relationship with its police union and does not have a history of effectively controlling public safety costs. Thus, it is conceivable that the city will have to make some draw on fund balance on 2010. However, our rating and rating outlook presume that any such draws will not significantly reduce the city's reserve position. The city plans to adopt a balanced budget by June 30.

PROPOSED POLICIES MAY STRENGTHEN FISCAL OPERATIONS GOING FORWARD

The city is considering several fiscal policy proposals that could serve to strengthen the city's financial operations going forward. Among these considerations are measures to use real estate transfer revenues above a specified baseline to build reserves, pay back negative balances, and establish set-asides for other post-employment benefits. The city is also considering policies affecting the use of one-time revenues, reserve levels, and a retirement incentive program. If implemented and adhered to, these actions could serve to bolster the city's finances and introduce a larger measure of year-to-year budget stability.

LARGE AND DIVERSE EAST BAY AREA TAX BASE BEING IMPACTED BY THE RECESSION

Oakland is a mid-sized city located in the heart of the expansive San Francisco Bay Area. City residents have access to a wealth of diverse economic opportunities owing to region's significant concerns in education, technology, hospitality, finance, and a wide range of other industries. Oakland's 2009 assessed valuation is very large at $43.8 billion and has grown by an average annual rate of 9.7% since 2004. However, despite its economic size and integration into the generally wealthy regional economy, Oakland has been hampered by appreciable pockets of socioeconomic disadvantage. As a result, the city has typically recorded unemployment and wealth levels that are on average comparable to or slightly weaker than the state. These disparities are being exacerbated as the Oakland economy is being impacted by the national recession. In March 2009, the city's Unemployment rate had risen to a woeful 15.9%, which is even higher than the rates the city suffered when the dot-com bubble burst. Housing prices in the city are down significantly while both residential and commercial development has also slowed greatly. The city currently expects its 2010 assessed valuation to decline by 3.2%. If this comes to pass, it would mark the first time the city's tax base has actually declined. However, the overall size of the tax base is such that even if it undergoes some modest contraction, it will still be very sizeable for the rating.

HIGHER THAN AVERAGE BUT MANAGEABLE DIRECT DEBT

Oakland's direct debt level of 2.2% is high compared to other Moody's-rated cities but is still manageable for the city. The burden of the direct debt obligations is underscored by the city's direct debt per capita level of $2,300, which is well above the median for a U.S. city. The overall debt level of 4.8% is similarly high. While these debt levels are substantial in comparison to the universe of Moody's-rated U.S cities, Oakland is not an outlier when compared to other cities of similar size and service provision. In addition, the city has a robust 10-year principal payout of 70%. This is healthy payout even by national standards, which are generally well above than those of California municipalities. The city's debt levels as a percentage of the tax base may increase slightly in 2010 even though the Oakland does not plan on issuing any additional long-term debt. This is due to the possible contraction of the city's assessed valuation. However, given the tax base size, rapid payout and absence of additional borrowing plans, the city's debt obligations should remain manageable over the long-term.

MODEST VARIABLE RATE DEBT EXPOSURE

The city has a modest exposure to variable rate debt as a result of $136 million in Coliseum/Arena revenue bonds. This obligation represents only 14% of the city total debt outstanding and is largely self-supporting. The city's exposure is further reduced by its obligation to only pay half of any remaining debt service after the application of the Coliseum/Arena revenues. The other half of any potential debt service is paid by Alameda County (Aa3/Stable). However, in the event that the county cannot pay its share, the city must cover that cost as well. Since the city's exposure to variable rate debt is fairly low, Moody's does not consider the debt to be a significant credit risk.

Outlook

The stable outlook is based upon Moody's expectation that the city will effectively execute a fiscal 2010 budget that will prevent significant deterioration of the city's fiscal resources.

KEY STATISTICS

Net direct debt as % of A.V.: 2.2%

Overall debt as a % of A.V.: 4.8%

Average annual assessed valuation growth, FYs 2002-2007: 9.7%

Assessed value per capita: $103,179

Median family income (2000 Census): $44,384 (83.7% of the state)

Per capita income (2000 Census): $21,936 (96.6% of the state)

The last rating action was on April 8, 2008 when the ratings of Oakland were affirmed.

The principal methodology used in rating this issue was Local Government General Obligation and Related Ratings which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

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MOODY'S IN ANY FORM OR MANNER WHATSOEVER. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

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STANDARD
&POOR'S

RATINGSDIRECT®

June 22, 2009

Summary:

Oakland, California; Note

Primary Credit Analyst:
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Summary:

Oakland, California; Note

Credit Profile		
US$185. mil 2009-2010 TRANs ser A&B due 06/30/2010		
Short Term Rating	SP-1+	New

Rationale

Standard & Poor's assigned its 'SP-1+' short-term rating to Oakland, Calif.'s 2009-2010 tax and revenue anticipation notes (TRANs) series A and B.

The rating reflects our opinion of the city's:

- Good coverage of note principal based on projected ending fiscal 2010 cash position; and
- Alternate liquidity sources available for inter-fund loans.

The notes are general obligations (GO) of the city, according to the note ordinance, and are secured by a first lien and charge against the first moneys received by the city from pledged revenues. Pledged revenues include unrestricted moneys in an amount equal to 50% of principal from unrestricted moneys on deposit with the city in the months ending March 31, 2010, and May 31, 2010, plus an amount sufficient to pay interest on the notes at maturity from the first unrestricted moneys on deposit in the month ending May 31, 2010. Unrestricted moneys means taxes, revenues, income, cash receipts, and other moneys which are received by the city for the general fund for fiscal year 2009-2010, and are available for payment of current expenses and other obligations of the city. To the extent unrestricted moneys are insufficient for payments on the notes, the notes may be paid from any legally available moneys. The notes are being issued to meet the county's anticipated cash flow needs during fiscal years 2009-2010. The notes mature on June 30, 2010.

Although we recently revised the outlook on our long-term ratings on the city's GO debt (AA-) and its appropriation-backed debt (A+) to negative, we believe the city is likely to retain at least a strong capacity to repay its debt obligations. Based on the city's pro-forma cash flows, the city projects coverage at final maturity, June 30, 2010, to be good at 1.26x by pledged revenues. The city projects debt service coverage for the March and May set-aside dates to be 1.62x and 1.0x, respectively. The city projects ending cash balances in other non-general fund sources to be $122.6 million, which would grow coverage to 1.91x at June 30, 2010.

The cash flows are based on the current budget assumptions, including negative growth in property, sales, and business license tax. Additionally, changes from prior-year actual annual results (based on year-to-date actuals through April 2009), include 4.8% growth to franchise fees, 4.1% in licenses and permits, and an increase in fines and penalties. Expenditures are forecasted to decline by $53 million, or 8%, for fiscal 2010 over the prior year, based on annualized actuals through April 2009. Reduction assumptions include layoffs, closure of non-essential service for a total of 12 days, and an increase in employees' contribution rates. Not included in the budget proposal is an $11.8 million estimated impact if the state takes Proposition 1A funds. It is our understanding from the administration that debt financing is being considered as an offset because it is not being considered as a permanent loss, with the state repaying it in the following year. If the end-of-year cash balance is reduced by this amount, coverage by general fund ending cash and combined general fund and alternative liquidity at June 30, 2010, would be 1.20x and 1.85x, respectively.

The city issued TRANs for fiscal year ending 2009. At the time the 2008-2009 TRANs were issued, the city projected year-end receipts and disbursements would be 9% and 5% higher, respectively, than they are currently estimating for the year end. By applying this variance to the current pro-forma cash flows, coverage at maturity would be adequate at 1.10x.

Related Research

USPF Criteria: "Short-Term Debt," June 15, 2007

Complete ratings information is available to RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Ratings in the left navigation bar, select Find a Rating.

June 16, 2009

Oakland, California; General Obligation

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Oakland, California; General Obligation

Credit Profile		
US$61.97 mil GO bnds (Measure DD) ser 2009B due 01/15/2039		
Long Term Rating	AA-/Negative	New
Oakland GO		
Long Term Rating	AA-/Negative	Outlook Revised

Rationale

Standard & Poor's Ratings Services revised the outlook to negative on its ratings and underlying ratings (SPURs) on Oakland, Calif.'s general obligation (GO) bonds and pension obligation bonds, and Oakland Joint Powers Financing Authority's revenue bonds. Standard & Poor's affirmed its 'AA-' rating and SPUR on the GO bonds, 'AA-' SPUR on the revenue bonds, and 'A+' SPUR on the pension obligation bonds. Finally, Standard & Poor's assigned its 'AA-' rating to the city's series 2009B GO bonds.

The outlook change reflects our view that despite what we consider to be strong actions by the city to resolve successive budget gaps and rapid changes in revenue trends, we believe the recessionary impact on the city's revenues may continue to be a strain on the city's ability to balance its budget. Although we understand that the city may adopt a balanced budget on June 30, given the level of job losses in the city -- with estimated monthly unemployment rates reaching above 14% between January and April -- we believe the full impact of the downturn on the city's local revenues, including consumption-based taxes and property taxes, may be deeper than assumed in the current proposed budget.

The ratings continue to be 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;
- Strong financial management practices, many of which are enshrined in council-adopted policy;
- Cash flows and liquidity levels that are closely monitored and managed throughout the fiscal year and an emphasis on maintaining healthy general fund reserves;
- Given the limited ability of municipalities in California to raise revenue and the city's vibrant political environment and context (including strong labor union representation), the city's well-embedded management practices and the maintenance of consistently strong general fund balances that have provided the foundation and financial flexibility needed to address structural budget issues over a multi-year period; and
- A property tax override of 0.1575% of assessed value (AV) that supports the city's Police and Firemen's Retirement System obligations.

The rating strengths are tempered by what we consider to be a moderate overall debt burden at 5% of AV and $5,271 per capita, including the proceeds of these bonds, as well as our view of the budget pressures resulting from declining tax revenues and management's ongoing challenge of constraining expenditure growth.

The GO bonds are secured by the city's unlimited ad valorem property tax pledge. The city has indicated that it may elect to treat some or all of the series 2009B bonds as Build America Bonds (BABs) as authorized by the American Recovery and Reinvestment Act (ARRA) of 2009. However, the amount, if any, designated as BABs will depend on market conditions. Under ARRA, the city expects that the bonds would qualify for a cash subsidy from the U.S. Treasury equivalent to 35% of the amount of each interest payment. It is our understanding from the city that it would mitigate timing issues between the receipt of the subsidy and the semi-annual debt service payment due dates by levying a tax sufficient to fund the full amount of the first annual debt service payment, and use the current-year actual subsidy receipts to offset the subsequent year's levy rate.

The rating on the city's pension obligation bonds 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.

Despite grappling with a volatile revenue environment during the current fiscal year, the city is projecting closing fiscal 2009 with a 1% general fund deficit, or a shortfall of about $4.7 million, down from a total of about a $75 million cumulative shortfall realized throughout the year. Including the spend-down of prior-year carry-overs of about $10.6 million, the fund balance will decline about $15.3 million, or 3% of expenditures. Fiscal 2008 general fund results included a $121.1 million unreserved balance, equal to 25% of expenditures. We estimate that, based on a $15.3 million drawdown for fiscal 2009, the ending unreserved general fund balance would be what we consider a still strong 23% of expenditures.

The mayor's proposed policy budget, based on the October 2008 forecast, is balanced, with $83 million of gap-closing measures. The general fund budget gap for fiscal 2010, driven by continued contraction in tax revenues and expenditure growth, is balanced primarily by $79 million of expenditure reductions and $3.9 million of revenue enhancements. Expenditure measures require elimination of 193 positions, potentially resulting in actual layoffs of nearly 180 full-time-equivalent employees (FTEs). Layoffs include 140 police positions if the city is not awarded a federal grant for $23 million annually. We understand the mayor's proposed budget solutions included the deferral of a $24 million contribution to restore deficit balances in the facilities and equipment fund. The city council finance committee's recommended budget, released on June 12, is balanced and rejects delaying the general fund payment to the facilities and equipment funds and added additional budget solutions of about $31,792 for the general fund and $3.6 million in all funds. The recommended budget also left intact the elimination of 140 police positions if the federal grant is not awarded. In addition, recent technical budget adjustments included in the current balanced budget that will be presented to the council includes further downward revisions to property taxes and sales tax revenue. We understand that the mayor's proposed budget was based on a 1.5% reduction in AV, which was revised downward to reflect recent estimate of a 3.2% AV decline. The 1.5% decline in AV generates about a 4% reduction in property tax revenue. Sales tax revenue has been reduced by another 5%. The city council's first round of budget hearings starts June 16, with final adoption scheduled for June 30.

We understand that the mayor's proposed budget also includes several enhancements to financial policies, including a requirement to set aside one-time revenue in reserves and for capital projects. Not included in the budget proposal is an $11.8 million estimated impact if the state takes Proposition 1A funds. It is our understanding from the administration that debt financing is being considered as offset because it is not being considered as a permanent loss, with the state repaying it in the following year.

Oakland (population 425,068), benefits from its location, just seven miles from downtown San Francisco and the center of the East Bay economy; thus it enjoys a diverse local economy and plentiful employment opportunities. The city's location at the hub of a broad transportation network -- including highway, rail, port, and airport facilities -- also provide good access to other parts of the Bay Area, including San Francisco and the Silicon Valley. With these inherent advantages, we believe the city's economy is well positioned over the long term for continued expansion and job growth, particularly in the computer, chemical manufacturing, and leisure and hospitality industries. It is our understanding from the city that it expects to receive $77 million in federal stimulus funds for the completion of the Bay Area Rapid Transit-Oakland Airport Connector project. However, the city is not immune to the broader slumping housing market, which is translating into what we consider an acute downturn in construction employment, which declined 13% year-over-year through April 2009 according to IHS Global Insight's economic report. Another notable decline in the report is an 8.5% contraction in the financial sector during the same period, which contributes more than 25% of total output.

Mirroring national economic conditions, the city's unemployment rate has been climbing. However, employment contraction has been, in our view, deep, with the Bureau of Labor Statistics reporting a preliminary unemployment rate of 15.5% for April 2009, compared with approximately 7.8% for the same month in 2008 and exceeding peak rates of about 11% during the last downturn in 2003. Rates are not seasonally adjusted. According to IHS Global Insight, Oakland has experienced job losses in nine out of 10 sectors, on a year-over-year comparison. The tangible result is a projected 2.2% loss in per capita personal income, adjusted for inflation, in 2009 and stagnation in 2010, as reported by IHS Global Insight. The 2008 household and per capita effective buying income indicators are on par with national levels, although they are, in our view, low compared with the median for the Bay Area as a whole, at 74% and 83%, respectively.

Taxable property value increased through fiscal 2009, with a year-over-year increase of 5% to $43.9 billion. Although certified AV has not yet been released by the county, the city anticipates about a 3.2% decline due to property reassessments for fiscal 2010. Management has also budgeted for an increase in property tax delinquencies, which management reports grew by about 1.4 percentage points between fiscals 2007 and 2008. Per capita market value, at $103,179 per capita, is above average on a national basis, although it is average as compared to the Bay Area as whole.

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.

The proceeds of these bonds will be used to fund recreational and aquatic facilities. After this issuance, the city will have about $64 million of authorization remaining under the measure DD approved by voters in 2002. It is our understanding that the city also intends to issue tax and revenue anticipation notes for seasonal cash flow needs for fiscal 2010. The overall net debt of Oakland is what we consider moderate at 5% of AV and $5,271 per capita, including the proceeds of these bonds, and debt service carrying charge as a percentage of total governmental expenditures is, in our view, elevated at 16% for fiscal 2008. Including annual retirement benefit expense, the carrying charge grows to 30%. These debt levels include pension obligation-related debt from 1997, 2001, and a recent 2008 financing, and are secured by a pledge of a voter-authorized pension override tax of 0.1575% of AV.

Outlook

The negative outlook reflects our view of the city's very constrained financial flexibility, with continued pressure from declining revenues and rising expenditures, including employee benefit costs. The outlook reflects possible downward pressure on the rating if the city is not able to navigate a cyclically slower economy as it has previously, or liquidity weakens to a level that severely diminishes its financial flexibility. Additionally, notwithstanding incremental budget-balancing efforts, the rating may also be lowered if the city is unsuccessful in addressing long-term structural budget issues such that the length and amount of recurring deficits becomes a credit concern.

Financial Management Assessment: 'Strong'

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. Practices and policies are well established in almost all areas. Revenue and expenditure forecasts are based on historical performance and are aided by input from outside consultant reviews. Long-range financial forecasting is performed for the budget years and five pro forma years. The city maintains a rolling five-year capital plan with identified funding sources for all anticipated projects. The city adheres to a formal investment management policy as described above. The city adheres to a formal 7.5% fund balance reserve level.

Finances

To address recurring volatility in general fund revenues and expenditures, the city amended its budget three times during fiscal 2009. The total fiscal 2009 budget gap -- including shortfalls estimated prior to the July 2008 budget adoption through the last budget revision in May 2009 -- was $75 million (about 16% of expenditures), of which the city adopted budget solutions for all but $4.7 million. Additionally, the fiscal 2009 budget includes a spend-down of $10.6 million of carry-forward of funds accumulated in prior years that were designated for specific purposes. According to the city, the estimated deficit and carry-forward spend-down would total $15.3 million, or 3% of estimated expenditures. Management attributed the shortfalls to both downward revisions to revenue forecasts and an $8 million overspending in police mainly resulting from citizen protests following a shooting incident. Gap-closing measures included the elimination or freezing of 174 positions in the general fund, including 70 layoffs; a 13-day shutdown of citywide services; use of one-time funds; transfers of costs to external funds; and deferral of capital project costs into the next year.

Approximately 10 years ago, the city implemented a two-year budget process in an effort to support a longer-term financial perspective. The city is in the midst of its two-year budget (spanning fiscals 2010 and 2011). Driven by continued contraction in tax revenues and expenditure growth, the city-estimated budget gaps for the biennial budget is $83 million and $85.3 million, respectively, for fiscals 2010 and 2011. The mayor's proposed balancing measures are primarily driven by expenditure reductions of $79 million for fiscal 2010 and $83.3 million for fiscal 2011. We understand that solutions also include revenue enhancements for fiscals 2010 and 2011 of $3.9 million and $2 million, respectively. The $83 million gap for fiscal 2010 would have be about 17% of originally forecasted expenditures (i.e. assuming no cuts). Expenditure measures require elimination of 193 positions -- potentially resulting in actual layoffs of nearly 180 FTE employees, including 140 police officer positions -- if the city is not awarded a federal grant for $23 million annually. We understand that permanent cuts are composed primarily of personnel reductions, compensation concessions, furloughs, savings from anticipated golden-handshake incentives, and transfers out of the general fund. Proposed revenue enhancements are, in our view, minimal in relation to the overall size of the shortfall at $3.9 million. About $835,000 would be generated from taxes requiring voter approval, which would be proposed at a special election on July 21, 2009, according to the proposed budget. The council finance committee's recommendations include additional revenue enhancements, which will be offset by add-backs of several of the mayor's proposed budget cuts, for a net positive adjustment to the general fund budget of $31,792. Among the committee's recommended revenue enhancements, the largest sources would include $5.7 million from parking fees and $9 million from a surcharge on tickets at the Coliseum and Arena.

The mayor's proposed budget recommends several policy changes, including a requirement that 50% of one-time revenues be used to repay negative fund balances and another 50% for future capital projects. Similarly, the budget proposes to establish a real estate transfer tax baseline, with revenue in excess of the baseline being set aside for reserves or capital funding, so that years with unusually strong collections are used for one-time purposes. An amendment to the reserve policy is also included and would require annual review and certification of the general fund reserve; the reserve amount would exclude reservations, designations, and obligation by the director of finance and prohibit carry-forwards.

Not included in the budget proposal is an approximately $11.8 million impact if the state takes Prop. 1A funds. State budget impacts may also reduce gas tax revenue for roads and street improvements by $6 million and grant-funded social service programs by $2 million, both of which are outside the general fund, according to the administrators.

Related Research

- USPF Criteria: "GO Debt," Oct. 12, 2006
- USPF Criteria: "Appropriation-Backed Obligations," June 13, 2007

Ratings Detail (As Of June 16, 2009)		
Oakland taxable pension oblig bnds ser 1997 sub-ser A dtd 02/01/1997 due 12/15/1999-2009 & capital apprec bnd dtd 02/25/1997 due 12/15/2010		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Oakland POB (wrap of insured) (MBIA, National & Assured Gty) (SEC MKT)		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Oakland GO		
Unenhanced Rating	AA-(SPUR)/Negative	Outlook Revised
Oakland POB		
Unenhanced Rating	A+(SPUR)/Negative	Outlook Revised
Oakland Jt Pwrs Fing Auth , California		
Oakland, California		
Oakland Jt Pwrs Fing Auth (Oakland) (wrap of insured) (AMBAC & BHAC) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Outlook Revised
Oakland Jt Pwrs Fing Auth (Oakland) (City Of Oakland Go Bnd Pgrm) (wrap of insured) (AMBAC & ASSURED GTY) (SEC MKT)		
Unenhanced Rating	AA-(SPUR)/Negative	Outlook Revised

Ratings Detail (As Of June 16, 2009) **(cont.)**

Oakland Jt Pwrs Fing Auth (Oakland) (City Go Bnd Pgrm)

Unenhanced Rating	AA-(SPUR)/Negative	Outlook Revised

Many issues are enhanced by bond insurance.

Tax Supported
New Issue

Oakland, California

Ratings

New Issues	
General Obligation Bonds, Series 2009B (Measure DD)	A+
2009–2010 Tax and Revenue Anticipation Notes, Series A and B (Federally Taxable)	F1+[a]
Outstanding Debt	
City of Oakland	
General Obligation Bonds	A+
Pension Obligation Bonds	A
Oakland Joint Powers Financing Authority	
(City of Oakland General Obligation Bond Program) Refunding Revenue Bonds, Series 2005	A+
Lease Revenue Refunding Bonds (Oakland Administration Buildings), 2008 Series A-1, A-2, and B	A

[a]On June 18, 2009, the 2009–2010 TRANs, Series A and B, were rated 'F1' by Fitch Ratings based on the city's initial projected fiscal 2010 cash flow. Based on the city's subsequent revision of its projected fiscal 2010 cash flow, Fitch upgraded the 2009–2010 TRANs, Series A and B, to 'F1+' on June 22, 2009.

Rating Outlook

Negative[a]

[a]Revised from Stable on June 18, 2009.

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New Issue Details

Sale Information: $61,970,000 General Obligation Bonds, Series 2009B (Measure DD), at or about July 16 via negotiation. Not exceeding $185,000,000 2009–2010 Tax and Revenue Anticipation Notes, Series A and B (Federally Taxable), on July 8 via negotiation.

Rating Rationale

- The city of Oakland benefits from a diverse economic base; a variety of revenue streams that have the potential to be diversified further; good financial management policies and procedures, which are being further enhanced; and strong general fund balances.
- Oakland faces significant near-term budgetary pressure due to declines in its economically sensitive tax revenues and property values and the doubling of its unemployment rate.
- During the course of fiscal 2009, the city adjusted its budget downward three times, cutting costs and increasing revenues where possible, while relying heavily on one-time budget solutions to maintain structural balance.
- Revenue pressure is projected to persist into fiscal years 2010 and 2011 due to ongoing revenue declines, growing retirement and other post-employment benefit (OPEB) liabilities, increasing property tax collection delinquencies related to taxable assessed valuation (TAV) declines, and unmet infrastructure and maintenance needs.
- Balancing structural shortfalls within the general purposes fund is complicated by the fact that less than one-quarter of the fund is truly discretionary. In addition, budget adjustments during fiscal years 2008 and 2009 have greatly reduced the city's flexibility to cut further, and some fiscal 2010 balancing measures require voter approval.
- Coverage of note principal and interest by the city's revised fiscal 2010 cash flow projections is improved and the city now projects that it can set aside 50% of note principal and interest in each of March and May 2010 without drawing upon borrowable funds.

What Could Trigger a Downgrade?

- Failure to retain fiscal balance in light of a slowing economy, increasing personnel costs, and likely state funding reductions.
- Inability to diversify revenue streams, build general fund financial reserves, reduce the city's work force size, and set new staffing and service baselines.

Credit Summary

The 'A+' long-term rating reflects the city's diverse economic base, variety of revenue streams, good financial management policies and procedures, and strong general fund balances. The Rating Outlook revision to Negative is based on Oakland's significant near-term budgetary pressure due to declines in its economically sensitive tax revenues and property values, coupled with rising fixed costs. Revenue pressure began building in fiscal 2009 and is projected to persist into fiscal years 2010 and 2011 due to ongoing economic pressures that impact property tax and other revenues, growing retirement and OPEB annual costs, labor pressures, and unmet infrastructure and maintenance needs. The city's continued ability to balance structural shortfalls will likely be negatively affected by adverse state funding actions and the fact that many of the fiscal solutions to date have been nonrecurring in nature.

New Issue Details (continued)

Security: GO bonds: Payable from ad valorem property tax revenues. TRANs: Payable from unrestricted general fund taxes, income, revenue, cash receipts, and other moneys received by the city for the general fund during fiscal 2010.
Purpose: GO bonds: to fund water quality improvements; educational and recreational facilities for children; and acquisition, preservation, and/or renovation of open space.
TRANs: for general fund cash flow needs (tax-exempt portion) and to prepay the fiscal 2010 CalPERS obligation for the city's safety plan (taxable portion).
Final Maturity: GO bonds: fiscal 2039. Subject to optional and mandatory redemption prior to maturity.
TRANs: June 30, 2010. Not subject to redemption prior to maturity.

Related Research

- *Fitch Rates Oakland, CA $62 Million General Obligation Bonds 'A+' and $185 Million TRANs 'F1'; Outlook Negative, June 18, 2009*
- *Oakland, California, June 20, 2008*
- *Oakland Joint Powers Financing Authority, California, March 27, 2008*

Rating History — GO Bonds

Rating	Action	Outlook/ Watch	Date
A+	Affirmed	Negative	6/18/09
A+	Affirmed	Stable	4/2/08
A+	Assigned	Stable	4/8/97

Rating History — TRANs

Rating	Action	Outlook/ Watch	Date
F1+	Upgraded	—	6/22/09
F1	Assigned	—	6/18/09

The 'F1+' short-term rating reflects improved coverage of note principal and interest by the city's revised fiscal 2010 cash flow projections. The city prudently sets aside 50% of note principal and interest each March and May, which it can now do without drawing upon its $122.6 million in borrowable funds. In the base case scenario, the May set-aside coverage without borrowables is a slim 1.00 times (x); however, when borrowables are included, May set-aside coverage increases to 2.28x. The projected cash flow, supported by borrowable funds, holds up sufficiently to stress scenarios that envision the state borrowing funds from the city, as well as several types of general fund revenue underperformance relative to budget.

Oakland is a major commercial and trade center in the San Francisco Bay area. The city's economy is diverse, but growth has slowed considerably. While the economy had expanded in the high-technology, medical, government, construction, and service sectors, since 2008, Oakland has experienced contraction in most of its employment sectors. The unemployment rate doubled between April 2008 and April 2009, rising to 15.5%, somewhat reflecting a strong 5.5% increase in the labor force. Oakland is home to Kaiser Permanente's headquarters, several large hospitals, Oakland International Airport, the Port of Oakland, and a regional federal government center.

While Oakland was the beneficiary of TAV growth averaging 8.5% per year between fiscal years 2002 and 2009, it now faces up to a 3.2% TAV decline in fiscal 2010, which will negatively affect the city's property tax revenues. Property tax delinquencies have been rising. Although the local property market is expected to remain soft over the next one to two years, significant residential, office, and retail developments recently opened or are under construction.

The city is currently in contract negotiations with the majority of its unions for agreements that expired at the end of fiscal 2008. The city is seeking labor concessions, which will help close the general fund structural imbalance in fiscal 2010. The city faces considerable financial pressure going forward in terms of funding fully its growing pension and OPEB liabilities. Fitch views the ability to achieve labor savings as an uncertainty that requires positive resolution to retain fiscal balance, a key element to the ratings remaining at their current levels.

In the third consecutive year of operating deficits, the fiscal 2008 unreserved general fund balance fell to a still strong 20.8% of spending, down from 25.5% in fiscal 2007. This was the lowest level in five fiscal years and reflects three consecutive fiscal years of operating deficits, including the highest Oakland has experienced to date. In fiscal 2009, the city revised its budget three times to offset general fund revenues underperforming optimistic assumptions. The city projects ending fiscal 2009 with a moderate operating loss after revising its budget three times to offset underperforming general fund revenues. The city council is currently refining the proposed fiscal 2010 budget, which closes a baseline shortfall of $83 million created by the city's ongoing revenue declines and rising personnel and other costs.

Debt

The city's net direct debt totals $975.3 billion, or a moderately low $2,321 per capita and 2.2% of TAV. Overall net debt is much higher at $2.5 billion, or $5,987 per capita and 5.7% of TAV. Principal amortization of the city's long-term, fixed-rate debt is above average at 71.3% retiring within 10 years. The city's only outstanding variable-rate debt exposure relates to its $135.1 million share of the Oakland-Alameda County Coliseum Authority lease revenue bonds. The city has one remaining swap, which currently has a value of negative $20.4 million.

General Obligation Bonds, Series 2009B (Measure DD)

On Nov. 5, 2002, more than two-thirds of voters approved the $198.3 million Measure DD for the funding of recreational and aquatic facilities. To date, $71.5 million has been issued (general obligation bonds, series 2003A). The series 2009B bonds represent the second issuance against Measure DD and may include taxable Build America Bonds. Repayment of the bonds is secured by ad valorem property tax revenues.

2009–2010 Tax and Revenue Anticipation Notes, Series A and B (Federally Taxable)

In line with many California municipalities, Oakland issues notes to assist its annual cash flow by mitigating timing differences among property, state, and local tax receipts and expenditures. The city receives 43% of its property taxes, which make up slightly more than 30% of projected general fund receipts, in December and 35% in April and May combined. However, the city's diverse revenue stream, including utility user, real estate, hotel, and parking taxes, assists the cash flow by leveling the revenue stream. The city's cash flow projections are based on the proposed fiscal 2010 budget, which realistically assumes ongoing declines in Oakland's economically sensitive revenue streams. The notes are secured by unrestricted general fund revenues to be received during fiscal 2010.

The tax-exempt portion (series A) will offset the uneven nature of property and other tax revenues during the year, while the taxable portion (series B) will prepay the fiscal 2010 pension obligation for the city's safety and miscellaneous employee plans, with the city receiving a discount on the payments. The city does not expect to issue any other notes or warrants for cashflow borrowing purposes in fiscal 2010.

To further ensure noteholder payment, the city covenants to deposit 50% of the principal due by March 31, 2010; the remaining 50% of principal, as well as accrued interest, will be deposited by May 31, 2010. The set-aside payments are restricted solely for note repayment. The March set-aside is covered 1.62x by cash available during that period. While the May set-aside is covered a slim 1.00x by May's ending balance; taking into account June's ending balance, the coverage increases to a stronger 1.52x.

The city's borrowable funds add a strong cushion against unanticipated revenue or expenditure variances. The borrowable funds are substantial, estimated at roughly $122.6 million for fiscal year-end 2010, about the same as in fiscal 2009 ($122.5 million). These funds include city revenue received but not yet credited to the general fund and separate revenue that belongs to other city funds but legally available for lending to the general fund, if necessary. Additional flexibility is achieved in that the funds are unrestricted and do not require City Council approval for use. Under the baseline case, the general fund balance plus borrowables provides 2.95x coverage for the March set-aside and 2.28x coverage for the May 2010 set-aside (which rises to 2.80x coverage after taking into account the June 2010 ending balance).