

Oakland, California

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Credit Profile

US\$21. mil GO bonds (Measure G) ser 2006 due 01/15/2026 A+
Sale date: 14-JUN-2006

AFFIRMED

\$122.170 mil. Oakland GO	A+
\$0,000 Oakland GO (AMBAC)	AAA/A+(SPUR)
\$37.215 mil. Oakland GO (FGIC)	AAA/A+(SPUR)
\$371.841 mil. Oakland GO (MBIA)	AAA/A(SPUR)
\$62.525 mil. Oakland GO bonds (Measure DD) ser 2003A dtd 08/06/2003 due 01/15/2004-2026 2028 2033	AAA/A+(SPUR)

OUTLOOK: STABLE

Rationale

Standard & Poor's Ratings Services assigned its 'A+' rating to the City of Oakland, Calif.'s series 2006 (Measure G) GO bonds and affirmed its ratings on the city's outstanding debt, reflecting:

- A stable and diversified economic base that is rebounding from a marked downturn in employment and retail sales activity;
- Continued strong growth in taxable assessed value (AV);
- Strong financial management, demonstrated by the city's ability to maintain adequate financial reserves and close projected budget gaps in fiscals 2005-2007; and
- A property tax override that supports the city's Police and Fire Retirement System (PFRS) obligations.

These strengths are tempered by average income levels compared to the nation, though below average regionally, and high overlapping debt.

Oakland (population 412,300), located seven miles from downtown San Francisco, enjoys a diverse local economy and employment opportunities. The city's location at the hub of a broad transportation network—including highway, rail, port, and airport facilities—also provides good

access to other parts of the Bay Area, including San Francisco and Silicon Valley. The city economy is improving with accelerating job growth, falling office and industrial vacancy rates (which were already lower than regional averages), as well as strong residential and commercial construction trends. Residential construction in particular has been healthy in in-fill areas, as well as several newly developable hillside tracks with increasingly expensive condominiums and single-family homes.

Household and per capita income indicators are on par with national levels, though low as compared to the median for the Bay Area as a whole, at 72% and 79%, respectively. Mirroring generally improving economic trends, unemployment has decreased from above 10% in 2002 and 2003, to 7.9% in 2005. Taxable property values have continued to increase at a solid pace, up 10% to \$32.6 billion from fiscal 2005 to 2006, driven by turnover of existing homes with increasing home prices and accelerated construction and redevelopment activity. Per capita AV, at \$79,100 per capita, is average on a national basis, though below average as compared to the Bay Area as whole. Lower taxable property values also reflect higher affordability, however, compared to dramatically increasing housing prices statewide, as well as older housing stock.

The city continues to demonstrate strong financial management with a commitment to prudent financial policies and multiyear planning. The unreserved and undesignated general fund balance at the end of fiscal 2005 was \$46.3 million, or 9.0% of expenditures after transfers, up from \$39.8 million in the previous year, due primarily to higher-than-budgeted property and real estate transfer taxes. The city is completing the first year of its fiscal 2005-2007 two-year budget cycle with the current anticipation of an \$8 million general fund surplus for fiscal 2006 and projection of at least balanced performance in the fiscal 2007. The city's policy is to maintain an unreserved undesignated reserve balance equal to at least 7.5% of expenditures, a level it has exceeded despite budget pressures. The city does not currently anticipate a budget gap in the 2007-2009 budget cycle.

The overall net debt of Oakland is high at \$4,750 and 6.0% of AV, and debt service carrying costs as a percentage of total governmental expenditures are high and have been rising, at 18% in fiscal 2005. These debt levels include \$366 million and series 1997 and 2001 pension obligation bonds (POBs) secured by a pledge of a voter-authorized pension override tax. Current GO issuance will be used to fund projects at the Oakland Zoo and Museum. After the current issuance, the city will have \$126.8 million in additional GO debt authorization remaining, authorized in 2002 for recreation and aquatic/estuary improvements.

Outlook

The stable outlook reflects Standard & Poor's expectation of continued strong management of city finances and continued adherence to its financial reserve policies. The outlook also reflects the expectation of a continued recovery, evidenced by good employment growth and development activity, after the recent economic decline. High debt is a factor currently limiting upward rating mobility.

Economy

Oakland, with an approximate population of 412,200, encompasses 54 square miles on the eastern side of the San Francisco Bay and is the seat of Alameda County. While residents of the city have access to the greater Bay Area for employment, the city has developed into a financial, commercial, and government center. Although Oakland tends to have lower wealth and income indicators than other cities in the Bay Area, its relatively diverse economic base has made it among the more economically stable communities in recent years. Leading employers in the city include local, county, state (including the Office of the President of the University of California), and federal governments, and public transportation entities. Health service organizations and air

transportation firms are also major employers. The Port of Oakland is also well positioned to compete with the Port of Los Angeles and will benefit from a weakening dollar, particularly if China allows its currency value to rise.

Oakland's economic base, which has historically been largely industrial, has diversified into commercial and service sectors. The focus of the city's economic development strategy is in biotechnology/healthcare, telecommunications, software/multimedia, food processing, and transportation. Projects currently under development or in planning include an Oakland Airport expansion, Oakland Army Base auto mall development, various smaller commercial projects, and a variety of housing developments, aided by the explicit mayoral goal of bringing 10,000 new residents to the downtown area. Known as the "10k Initiative," the program is multiphased with the goal to develop housing for 10,000 new residents, or approximately 6,000 new units, in downtown Oakland by 2006. Through aggressive marketing and utilization of economic redevelopment, the city has brought 1,663 units online, with 2,268 under construction, 2,705 with planning approval, and 2,991 in the planning phase. The pace of development and permitting has increased pace markedly over the past two years.

Finances

In fiscal 2005, the city's financial performance was buoyed by very strong property tax collections and real estate transfer taxes, driven by a very strong real estate market with significant turnover, new and redevelopment activity, and rising sale prices. Actual general fund revenues exceeded projections by \$40.0 million. The city's unreserved undesignated fund balance increased by \$6.5 million, or 1.3% of expenditures include transfers, to \$46.3 million from \$39.8 million in fiscal 2005. The total fund balance increased by a more sizable \$58.5 million due to an increased carryover in designations and reserves.

Importantly, the city continues to adhere to its policy of maintaining an unreserved fund balance in its general fund of at least 7.5% of expenditures, with 6% in its capital reserve fund, and its commitment to funding recurring expenses with recurring revenues. In recent years the city has been forced to contend with projected budget shortfalls, similar to other local governments, nearly all of which have been resolved in a structurally sound manner.

Debt And Other Long-Term Obligations

In fiscal 1998, Oakland restructured a portion of outstanding debt previously issued to reduce its pension liability. Although the issuance did not increase the debt burden, it increased the city's exposure to variable-rate debt. Almost 66% of the variable-rate debt, however, is currently hedged, leaving a more manageable 10% of the city's total debt with unhedged variable-rate exposure.

The city has two floating-to-fixed rate swaps outstanding; one was entered in 1998 and two were entered in 2004 to hedge against interest rate risk associated with the city's variable-rate debt, which totals \$426 million, or 38% of outstanding debt. The city has been assigned a debt derivative profile (DDP) overall score of '2' on a 4-point scale, with '1' representing the lowest risk. The overall score of '2' reflects Standard & Poor's Ratings Services' view that the county's general fund-related swap portfolio reflects low credit risk.

Between the PFRS and the PERS retirement systems, the most recent estimated unfunded pension liability after issuance of POBs totaled \$663 million between three retirements funds. The issuance of POBs has limited the required contribution to the closed PFRS system until fiscal 2011, and the city contributes the full PERS-provided actuarial cost as a percentage of payroll for current employees. The city raised benefits for public safety employees in fiscals 2002 and 2004, increasing the long-term liability, which are included in the

current estimated liability and are being absorbed into current contribution rates. A pension override tax alleviates some of the burden born by the general fund to support this city's long-term pension liability for PFRS, supporting the cost of POB debt service plus an annual surplus that is set aside annually for future contributions.

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