Moody's Investors Service

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

Global Credit Research - 17 Jun 2009

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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