STANDARD & POOR'S

RATINGSDIRECT®

June 16, 2009

Oakland, California; General Obligation

Primary Credit Analyst:
Misty Newland, San Francisco (1) 415-371-5073; misty_newland@standardandpoors.com

Secondary Credit Analyst:
Gabriel Petek, CFA, San Francisco (1) 415-371-5042; gabriel_petek@standardandpoors.com

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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.