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RATING ACTION COMMENTARY

Fitch Affirms Oakland Unified School District, CA's IDR at 'BBB+'; Outlook to Negative; Removes UCO

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Fitch Ratings - San Francisco - 19 Sep 2024: Fitch Ratings has affirmed Oakland Unified School District, CA's Issuer Default Rating (IDR) at 'BBB+' and General Obligation (GO) bonds at 'AA.'

The Rating Outlook has been revised to Negative from Stable. The ratings have been removed from Under Criteria Observation.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Oakland Unified School District (CA)	LT IDR	BBB+ Rating Outlook Negative Affirmed	BBB+ Rating Outlook Stable
Oakland Unified School District (CA) /General Obligation	LT	AA Rating Outlook Negative Affirmed	AA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The affirmation of the IDR and GO bonds reflects implementation of Fitch's new "U.S. Public Finance Local Government Rating Criteria". The 'BBB+' IDR incorporates the district's 'bb' assessment for financial resilience, given the district's minimal budgetary flexibility due to low revenue and expenditure control. The district's fiscal 2025 draft budget projects that the district will end fiscal 2024 with an approximately $59 million deficit and $80.4 million unrestricted fund balance, or roughly 8% of spending.

While projected deficits are likely to increase in subsequent years as a result of the recently enacted labor agreements, the rescission of the school closure and consolidation plan, and expiration of one-time pandemic funds, the district is in the process of implementing a budget stabilization plan to help close outyear budget gaps. Initial projections indicate that the plan will result in about $16.4 million in savings for fiscal 2025; however, details of the plan, its longer-term impact and the feasibility of implementation remain unclear.

Nevertheless, Fitch expects the district will take the necessary steps to achieve budgetary balance and maintain reserves at the state required 2% minimum for districts its size. The Outlook revision to Negative reflects the scale of the challenge and the risks of implementation of any plan that involves revisiting closing and consolidating local schools.

The rating also incorporates the district's weak population trend (28th percentile of Fitch's rated local governments portfolio.) It further incorporates the district's midrange economic and demographic strength level metrics (57th percentile), which include a slightly elevated unemployment rate and strong educational attainment.

The district's long-term liability burden is assessed as weak (36th percentile), and includes a midrange long-term liability burden as a share of personal income and high carrying costs.

In January 2022, the school board approved a plan to close or consolidate several under enrolled schools in order to better align resources with declining enrollment and forestall future budget shortfalls when pandemic aid expired. After significant backlash from teachers and parents, a new board voted to halt and rescind the school closure and such non-recurring support in the near term given the expiration of one-time pandemic aid and the district's underlying cost structure. This includes a larger facilities footprint than it receives state funding for, given the changes in enrollment levels over the last two decades.

The 'AA' GO bond rating is based on a dedicated tax analysis and an analysis of legal opinions presented to Fitch by district counsel that provide a reasonable basis for concluding that the tax revenues levied to repay the bonds would be considered "pledged special revenues" in the event of a district bankruptcy. This would allow the bonds to be rated up to five notches above the district's 'BBB+' IDR. The rating also reflects the large, growing and diverse tax base supporting bond repayment.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

IDR

--An inability to reach consensus among stakeholders in order to identify and implement expenditure cuts that close sizable outyear deficits, in turn causing actual or expectations for reserves to fall below the state-mandated 2% minimum requirement;

-A sustained approximate 20% increase in long-term liabilities and carrying costs assuming current levels of income, governmental revenue and expenditures.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

DTBs

--A downgrade of the district's IDR below 'A';

--A significant and long-lasting decline in the district's economy and tax base.

--Ability to successfully implement the budget stabilization plan, eliminating the use of non-recurring sources while maintaining budgetary balance;

--A sustained approximate 30% decrease in long-term liabilities and carrying costs assuming current levels of income, governmental revenue and expenditures;

--Sustained improvements in enrollment that enhances the district's revenue profile.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

DTBs

--An upgrade of the district's IDR.

SECURITY

The GO bonds are secured by unlimited ad valorem taxes levied on all taxable property in the district.

FITCH’S LOCAL GOVERNMENT RATING MODEL

The Local Government Rating Model generates Model Implied Ratings, which communicate the issuer's credit quality relative to Fitch's local government rating portfolio. (The Model Implied Rating will be the Issuer Default Rating except in certain circumstances explained in the applicable criteria.) The Model Implied Rating is expressed via a numerical value calibrated to Fitch's long-term rating scale that ranges from 10.0 or higher (AAA), 9.0 (AA+), 8.0 (AA), and so forth down to 1.0 (BBB- and below).

Model Implied Ratings reflect the combination of issuer-specific metrics and assessments to generate a Metric Profile and a structured framework to account for Additional Analytical Factors not captured in the Metric Profile that can either mitigate or exacerbate credit risks. Additional Analytical Factors are reflected in notching from the Metric Profile and are capped at +/-3 notches.

Individual Additional Analytical Notching Factors:

-- Non-Recurring Support or Spending Deferrals: -1.0

-- Management Practices: -1.0

Oakland Unified School District's Model Implied Rating is 'BBB+'. The associated numerical value of 3.16 is at the lower end of the 3.0 to 4.0 range for its current 'BBB+' rating.

KEY RATING DRIVERS

FINANCIAL PROFILE

Financial Resilience - 'bb'

Oakland Unified School District's financial resilience is driven by the combination of its 'Low' revenue control assessment and 'Low' expenditure control assessment, culminating in a 'Minimal' budgetary flexibility assessment.

-- Revenue control assessment: Low

-- Expenditure control assessment: Low

-- Budgetary flexibility assessment: Minimal

-- Minimum fund balance for current financial resilience assessment: <10.0%

-- Current year fund balance to expenditure ratio: 15.6% (2023)

-- Five-year low fund balance to expenditure ratio: 5.6% (2023)

Revenue Volatility - 'Weak'

Oakland Unified School District's weakest historic three-year revenue performance has a have to be addressed through revenue raising, cost controls or utilization of reserves through economic cycles.

-- Lowest three-year revenue performance (based on revenues dating back to 2005): 9.9% decrease for the three-year period ending fiscal 2012

-- Median issuer decline: -4.5% (2023)

Financial Profile Additional Analytical Factors and Notching: -2.0 notch (for Management Practices and Non-Recurring Support or Spending Deferrals)

The application of a -1.0 notch Additional Analytical Factor for Management Practices reflects Fitch's view that the rescission of the school closure and consolidation plan constitutes irresolute decision-making.

In addition, the application of a -1.0 notch Additional Analytical Factor for Non-Recurring Support or Spending Deferrals reflects the district's history of reliance on non-recurring support for operations. In addition, it reflects Fitch's view that the district is likely to rely on such non-recurring support in the future given the expiration of one-time pandemic aid and the district's underlying cost structure which it has experienced challenges adjusting in the recent past.

DEMOGRAPHIC AND ECONOMIC STRENGTH

Population Trend - 'Weak'

Based on the median of 10-year annual percentage change in population, Oakland Unified School District's population trend is assessed as 'Weak'.

Population trend: 0.5% 2022 median of 10-year annual percentage change in population (28th percentile)

Unemployment, Educational Attainment and MHI Level - 'Midrange'

levels and midrange median-issuer indexed adjusted MHI offsetting elevated unemployment rate.

-- Unemployment rate as a percentage of national rate: 116.7% Analyst Input (30th percentile) (vs. 2023), relative to the national rate of 3.6%

-- Percent of population with a bachelor's degree or higher: 48.4% (2022) (86th percentile)

-- MHI as a percent of the portfolio median: 104.9% (2022) (56th percentile)

Economic Concentration and Population Size - 'Strongest'

Oakland Unified School District's population in 2022 was of sufficient size and the economy was sufficiently diversified to qualify for Fitch's highest overall size/diversification category.

The composite metric acts asymmetrically, with most issuers (above the 15th percentile for each metric) sufficiently diversified to minimize risks associated with small population and economic concentration. Downward effects of the metric on the Metric Profile are most pronounced for the least economically diverse issuers (in the 5th percentile for the metric or lower). The economic concentration percentage shown below is defined as the sum of the absolute deviation of the percentage of personal income by major economic sectors relative to the U.S. distribution.

-- Population size: 425,586 (2022) (above the 15th percentile)

-- Economic concentration: 22.4% (2023) (above the 15th percentile)

The application of a -1.0 notch Additional Analytical Factor for School District Resources reflects Fitch's view that, taken together, the weak population trend and midrange economic and demographic level metrics do not fully capture the negative revenue implications of Fitch's expectations for continued significant enrollment declines that may not be fully captured in the district's enrollment projections.

Analyst carried over the district's 2022 unemployment rate, which is the most recent data available.

LONG-TERM LIABILITY BURDEN

Long-Term Liability Burden - 'Weak'

Oakland Unified School District's carrying costs to governmental expenditures remain weak while liabilities to personal income and liabilities to governmental revenue remain midrange. The long-term liability composite metric in 2023 is at the 36th percentile, indicating a somewhat elevated liability burden relative to the Fitch's local government rating portfolio.

-- Liabilities to personal income: 5.1% Analyst Input (53rd percentile) (vs. 4.7% 2023 Actual)

-- Liabilities to governmental revenue: 189.6% Analyst Input (44th percentile) (vs. 177.6% 2023 Actual)

-- Carrying costs to governmental expenditures: 20.7% Analyst Input (16th percentile) (vs. 19.6% 2023 Actual)

Analyst Inputs to the Model

Analyst inputs to the model reflect metric adjustments to account for historical data anomalies, forward-looking performance shifts, or nonrecurring events that may otherwise skew the time series.

Fitch adjusted the district's direct debt to reflect the addition of $185 million in Series 2023A and 2023B General Obligation bonds and scheduled principal amortization on outstanding debt in fiscal 2024. Carrying costs were adjusted to include the additional annual debt service costs and governmental expenditures associated with the new issuance.

DEDICATED TAX SECURITY

notches above the IDR allowed under Fitch's "U.S. Public Finance Local Government Rating Criteria."

DEDICATED TAX KEY RATING DRIVERS

Fitch expects solid growth in the property tax base supporting the bonds, which drives the amount of revenue available for bondholders. Increases in taxable assessed value (TAV) are expected to exceed U.S. GDP growth, resulting in a 'aaa' assessment for growth prospects for revenue. TAV increased at a 10-year CAGR of 7.7% in the decade ended in fiscal 2024. Fitch expects the district's access to major employment markets to yield solid growth over time.

California's Proposition 13 limits growth of existing property values to the lesser of inflation or 2%, but the tax base benefits from new construction and increases in values of existing properties when parcels change hands. Many properties are listed on the tax rolls at well below market value due to Proposition 13, providing both a cushion against downturns and additional growth potential when properties turn over.

Resilience of the pledged revenue to economic downturns is extremely strong, reflecting the unlimited nature of the tax supporting the bonds and a reasonably diverse tax base and supporting the 'aaa' assessment for resilience. Tax rates are low and unlikely to climb to a level that would pressure the rating even under relatively severe stress scenarios. The general tax rate of 1% of TAV is capped by Proposition 13 tax limitations. Top 10 taxpayers provide just over 4% of assessed value, and a majority of the top taxpayers are office buildings and apartment complexes. As such, Fitch believes the tax base is highly unlikely to suffer losses that would meaningfully erode repayment capacity.

The specific features of the GO bonds meet Fitch's criteria for rating special revenue obligation debt. Fitch believes bonds that receive "pledged special revenue" opinions provide bondholders additional protections from the operating risk of the district as expressed in its IDR.

Fitch sets a high bar for considering local government tax-supported debt to be secured by

Fitch has identified a number of elements it considers sufficient to reduce the incentive to challenge the special revenue status, given the definitions outlined in the bankruptcy code. These include clear restrictions on the use of pledged revenue for identified projects and clear separation from the entity's operations. Fitch has undertaken an extensive review of the statutory provisions that govern the use of the pledged property tax revenue. These provisions, along with the legal documents governing the bond issuance, provide sufficient strength for Fitch to rate the district's GO bonds up to five notches above the district's IDR.

As a result, Fitch analyzes these bonds as dedicated tax bonds. This analysis focuses on the district's economy, tax base and debt burden. Fitch typically calculates the ratio of available revenue to debt service for dedicated tax bonds, but the unlimited nature of the tax-rate pledge on the district's bonds eliminates the need for such calculations.

PROFILE

The district is almost coterminous with the city of Oakland, located on the eastern shore of the San Francisco Bay. The district's boundaries also include small portions of the neighboring city of Emeryville. The district encompasses approximately 54 square miles, and operates forty-seven elementary schools, three elementary/middle schools, eleven middle schools, three middle/high schools, seven comprehensive high schools, six alternative high school programs and one continuation school program. The district's tax base growth has been strong and steady except for two small declines during the Great Recession.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Oakland Unified School District (CA) has an ESG Relevance Score of '4' for Rule of Law, Institutional & Regulatory Quality, Control of Corruption, due to district's history of budget observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Finance Local Government Rating Criteria (pub. 02 Apr 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

U.S. Local Government Rating Model, v1.2.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Oakland Unified School District (CA)	EU Endorsed, UK Endorsed

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