

CREDIT OPINION

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Cincinnati City School District, OH

Update to credit analysis

Summary

The Cincinnati City School District (Aa2 stable) benefits from a large and growing tax base and a sound financial position. These attributes are balanced against challenges including weak resident income indices and high leverage from debt and pensions.

Credit strengths

- » Large tax base and diverse economy anchored by corporate headquarters, health care organizations and higher education institutions
- » Sound financial position supported by a long trend of favorable operating results

Credit challenges

- » Comparatively weak demographic profile
- » Elevated debt burden; exposure to two underfunded state cost-sharing retirement plans

Rating outlook

The stable outlook reflects our expectation that the district's healthy financial position will continue to offset challenges arising from a weak socioeconomic profile and high leverage.

Factors that could lead to an upgrade

- » Strengthening of resident income levels
- » Improved operating reserves
- » Substantial reduction in debt and pension leverage

Factors that could lead to a downgrade

- » Weakening of the tax base or socioeconomic profile
- » Narrowing of the district's reserves
- » Increased debt or pension burdens

Key indicators

Exhibit 1

Cincinnati City School District, OH	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value (\$000)	\$17,012,049	\$16,931,306	\$17,187,149	\$17,298,475	\$17,475,020
Population	330,671	331,025	331,499	332,113	332,113
Full Value Per Capita	\$51,447	\$51,148	\$51,847	\$52,086	\$52,618
Median Family Income (% of US Median)	73.1%	71.9%	70.8%	71.5%	71.5%
Finances					
Operating Revenue (\$000)	\$511,744	\$522,568	\$546,146	\$571,950	\$613,189
Fund Balance (\$000)	\$190,696	\$197,723	\$205,776	\$225,570	\$247,097
Cash Balance (\$000)	\$179,754	\$133,076	\$156,602	\$114,580	\$139,971
Fund Balance as a % of Revenues	37.3%	37.8%	37.7%	39.4%	40.3%
Cash Balance as a % of Revenues	35.1%	25.5%	28.7%	20.0%	22.8%
Debt/Pensions					
Net Direct Debt (\$000)	\$693,540	\$664,965	\$635,670	\$609,365	\$576,945
3-Year Average of Moody's ANPL (\$000)	\$1,731,522	\$1,688,743	\$1,396,162	\$1,384,378	\$1,610,476
Net Direct Debt / Operating Revenues (x)	1.4x	1.3x	1.2x	1.1x	0.9x
Net Direct Debt / Full Value (%)	4.1%	3.9%	3.7%	3.5%	3.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.4x	3.2x	2.6x	2.4x	2.6x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	10.2%	10.0%	8.1%	8.0%	9.2%

Source: Moody's Investors Service, US Census Bureau, district's audited financial statements

Profile

The Cincinnati City School District is located in southwestern Ohio (Aa1 stable) and includes all of the City of Cincinnati (Aa2 stable) as well as portions of 14 surrounding cities and villages. The district covers approximately 90 square miles. The district operates 4 preschools, 42 elementary schools, 11 high schools and 4 combination schools.

Detailed credit considerations

Economy and tax base: recovering tax base with strong institutional presence

We expect the district's economy to continue improving in the near to medium term. Current full valuation of \$18.5 billion has increased annually since 2015 but remains 10% below the 2006 peak. The City of Cincinnati ([Aa2 stable](#)) remains a hub of economic activity in southwest Ohio and is home to multiple corporate headquarters including Kroger Co. ([Baa1 stable](#)) and Procter & Gamble Company ([Aa3 stable](#)). The University of Cincinnati ([A1 stable](#)) is a large employer in the area, with an enrollment exceeding 36,000 students. The city's institutional base is rounded out by various hospitals, including the university's health system and Cincinnati Children's Hospital ([Aa2 stable](#)).

The district's population declined to approximately 330,000 residents in 2010 from approximately 400,000 residents in 1990. Most recent census estimates show that the population trend is stabilizing at approximately 332,000 residents. District enrollment declined steadily to approximately 31,000 students in 2012 from 41,000 students in 2002. The declining enrollment trend reversed in 2012 and total enrollment grew to more than 35,000 students during the 2017 and 2018 school years. As of December 2017, the City of Cincinnati's unemployment rate (4.0%) was on par with the state's rate (4.5%) and the national rate (3.9%). Median family income is low at just 72% of the US.

Financial operations and reserves: recent voter approval of new tax point to maintenance of healthy reserves

The district's sound financial position, having improved over the last few years with strong operating results, benefits from the recent voter approval of a new local levy. In November 2016 voters approved a new money levy that generates \$48 million annually. The

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district closed fiscal 2017 with an audited, GAAP-basis available operating fund balance of \$247 million across its general and debt service funds, equal to a healthy 40% of operating revenue. These results follow a decade of consecutive operating surpluses.

On an internal cash basis, the district recorded a fiscal 2017 year-end reserve balance of \$89 million, equivalent to a narrower 16% of revenue. Although audited financials are not yet available for fiscal 2018, the district's projection shows a \$9 million deficit. However, enrollment trends and conservative budgeting are expected to yield positive budget variances that will close the budgeted gap.

The difference in GAAP and cash-basis reserves reflects the annual advancement from Hamilton County ([Aa2 stable](#)) of property tax revenue already collected but not due to the district until the following fiscal year. The district receives the advance in June so that the revenue is available to support operations at the start of the next fiscal year on July 1. Separate action by the School Board is necessary to appropriate the advance in the fiscal year it is received and, while the advanced revenue is held in a separate fund, that fund is combined with the district's general fund for auditing purposes.

LIQUIDITY

On a GAAP-basis, the district closed fiscal 2017 with a cash balance of \$140 million across its major operating funds, equal to 23% of fiscal 2017 operating revenue. As with fund balance, the audited cash balance exceeds the district's internal figures due to the advancement of property tax revenue from Hamilton County.

Debt and pensions: elevated debt and pension burdens

The district's net direct debt burden exceeds state and national medians at 3% of full valuation, though compared to operating revenue, debt is more moderate at 0.9x fiscal 2017 revenue. The high debt burden reflects the district's capital plan, implemented ten years ago, to renovate or replace all facilities. We expect the district's direct debt burden to moderate slowly over time. The district's overall debt burden is elevated at 6% of full valuation, with the City of Cincinnati accounting for a majority of the overlapping debt.

The three-year average Moody's adjusted net pension liability (ANPL) for the district, our measure of a local government's pension burden, is \$1.6 billion, equal to an elevated 9% of full value and 2.6x fiscal 2017 operating revenue. The single year ANPL totals \$1.9 billion, equal to 3.2x revenue and 9.2% of full value. Fixed costs, inclusive of debt service and retirement contributions, equaled 16% of fiscal 2017 operating revenues.

DEBT STRUCTURE

All debt is fixed rate and amortizes over the long term, with approximately 68% of outstanding principal retired in 10 years.

The district's debt profile includes GOULT ([Aa2 stable](#)), GOLT ([Aa2 stable](#)) and Certificates of Participation (COPs; [Aa3 stable](#)). The GOULT debt is secured by the district's GOULT pledge to levy a dedicated property tax levy that is unlimited as to rate or amount. The GOLT debt, including the current bonds, is secured by the district's pledge of the 10 mill levy to first pay debt service. The COPs are secured by the district's pledge to consider appropriating for lease payments.

The [Aa2](#) rating on the district's GOLT debt, including the Series 2018 bonds, is rated on parity with the district's GOULT debt due to the full faith and credit pledge of the district, in which it pledges to use all available revenue to pay debt service.

The [Aa3](#) rating on the district's COPs is notched once from the GOULT rating due to the risk of non-appropriation and the more essential nature of the financed project, various school buildings. The district's Series 2015 COPs are secured by rental payments made by the school district, subject to annual appropriation, per a lease-purchase agreement. Failure to renew the lease in any year prior to maturity is an event of default under the agreement and may be remedied by the trustee's eviction of the district from the pledged facilities. As the pledged facilities consist of four of the district's high schools, we expect the incentive to annually renew the lease and appropriate payment to remain high. The district's 2014 and 2015 COPs are further supported by outstanding agreements with Hamilton County and the City of Cincinnati for direct payment of annual lease rental costs via payments to the district in lieu of property taxes. The Series 2012 COPs are similarly secured by annually-appropriated lease rental payments and are further backed by a pledge of certain elementary school facilities. However, repayment of the Series 2012 COPs is not directly supported by agreements with the City of Cincinnati and Hamilton County.

DEBT-RELATED DERIVATIVES

The district is not a party to any derivative agreements.

PENSIONS AND OPEB

District employees are members of the Ohio State Teachers Retirement System (STRS) and School Employees Retirement System (SERS). As measured by Moody's ANPL, unfunded liabilities of the two plans are elevated relative to school district's tax base and operating revenue. Ohio benefits from a flexible legal framework surrounding public pension benefits. State statute establishes a 30-year target for amortizing unfunded liabilities of all statewide cost-sharing plans. If plan actuaries determine current contribution rates and actuarial assumptions result in an amortization period exceeding 30 years, the pension fund must submit a plan for adjusting benefits or contributions. STRS breached this threshold in both 2012 and 2017. The state legislature reduced benefits and increased employee contributions in 2012. The STRS board suspended cost-of-living adjustments for all participants in 2017.

State statute sets public employer contributions as a share of annual payroll. In recent years, statewide employer contributions fell below amounts needed to forestall growth in reported net pension liabilities assuming other plan assumptions are realized, that is, to tread water. We calculate that fiscal 2017 statewide contributions to SERS and STRS were 85% and 75%, respectively, of the amounts needed for the plans to tread water.¹A sustained tread water gap could cause unfunded liabilities to grow and trigger further reforms. Given the state's recent focus on improving plan funding through employee concessions, political limitations may impede similar reforms in the future. This could raise the possibility of state-mandated increases in statewide school district contributions.

Management and governance: moderate institutional framework

Ohio school districts have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector's major revenue sources are property taxes and state aid. Local property tax rates can be increased with voter approval only. Some school districts also levy a local income tax, if approved by voters. Revenues and expenditures tend to be predictable. Ohio has public sector unions, which can limit the ability to cut expenditures.

The district has a strong history of renewing existing operating levies and passing new money levies. Approximately 51% of the district's operating revenue is generated from property taxes, with state aid comprising another 39%. Management has a history of conservative budgeting practices and financial forecasting, which has resulted in a stable operating trend.

Endnotes

¹ Our "tread water" indicator measures the annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will either reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than with lower contributions.

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MOODY'S

INVESTORS SERVICE

Rating Action: Moody's assigns Aa2 to Cincinnati City School District, OH's GO bonds; outlook stable

Global Credit Research - 20 Mar 2018

New York, March 20, 2018 -- Moody's Investors Service has assigned an Aa2 rating to the Cincinnati City School District, OH's \$72 million School Improvement Refunding Bonds, Series 2018 (Limited Tax General Obligation). Moody's maintains the Aa2 rating on outstanding general obligation unlimited tax (GOULT) debt, the Aa2 rating on outstanding general obligation limited tax (GOLT) debt, and the Aa3 rating on outstanding certificates of participation (COPs). Following the sale, the district will have \$294 million in outstanding GOULT debt, \$133 million in outstanding GOLT debt, and \$127 million in outstanding COPs. The outlook is stable.

RATINGS RATIONALE

The Aa2 rating on the district's GOULT debt reflects a very large tax base, sound financial position and trend of favorable operating results. The rating also incorporates the district's comparatively weak demographic profile and its elevated debt and pension burdens.

The Aa2 rating on the district's GOLT debt, including the current bonds, is rated on parity with the district's GOULT debt due to the full faith and credit pledge of the district, in which it pledges to use all available revenue to pay debt service.

The Aa3 rating on the district's COPs is notched once from the GOULT rating due to the risk of non-appropriation and the more essential nature of the financed project, a school building.

RATING OUTLOOK

The stable outlook reflects our expectation that the district's healthy financial position will continue to offset challenges arising from a weak socioeconomic profile and high leverage.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Strengthening of the district's resident income levels
- Improved operating reserves
- Substantial reduction in debt and pension leverage

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Weakening of the tax base or socioeconomic profile
- Narrowing of the district's reserves
- Increased debt or pension burdens

LEGAL SECURITY

The GOULT debt is secured by the district's GOULT pledge to levy a dedicated property tax levy that is unlimited as to rate or amount.

The GOLT debt, including the current bonds, is secured by the district's pledge of the 10 mill levy to first pay debt service.

The COPs are secured by the district's pledge to consider appropriating for lease payments.

USE OF PROCEEDS

Proceeds will be used to refund existing debt for anticipated interest cost savings.

PROFILE

The Cincinnati City School District is located in southwestern Ohio (Aa1 stable) and includes all of the City of Cincinnati (Aa2 stable) as well as portions of 14 surrounding cities and villages. The district covers approximately 90 square miles. The district operates 4 preschools, 42 elementary schools, 11 high schools and 4 combination schools.

METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

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