CLEVELAND METROPOLITAN SCHOOL DISTRICT
BOND ACCOUNTABILITY COMMISSION 2

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PREPARED BY

AMERICAN GOVERNMENTAL FINANCIAL SERVICES COMPANY

in conjunction with

GOVERNMENT FINANCIAL STRATEGIES INC.

DELPHIS-HANOVER CORPORATION

LAW OFFICE OF PERRY ISRAEL

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EXECUTIVE SUMMARY

Based upon our review as directed by Bond Accountability Commission 2 ("BAC"), we found that, overall, the Issue 14 Bond and Note offerings of the Cleveland Metropolitan School District ("CMSD" or the "District") were well-conducted and that CMSD and the taxpayers received the benefit of interest costs at prevailing market levels or, in the case of the 2002 Bonds, somewhat better. In addition, transaction costs were reasonable.

We are able to report to BAC and CMSD's taxpayers that CMSD is conducting its securities offerings in a reasonable manner meeting CMSD's responsibilities to the taxpayers.

Within that overall positive context, we are making a number of recommendations for CMSD's consideration, in consultation with its Financial Advisors and Bond Counsel, in order to determine whether CMSD may benefit from additional enhancements relating to its securities offerings and market activities.

BAC assigned specific tasks to the AGFS Team. Those respective tasks are to review and discuss the following:

- History, advantages and disadvantages of CMSD's strategy in execution of bond and note sales authorized by Issue 14, including its practices for selecting Financial Advisors, Bond Counsel and underwriters
- History, advantages and disadvantages of CMSD's timing and comparative results of sales
- Recommendations, if needed, for improvements

- The state of the overall credit market
- The financial condition and credit impact of CMSD's property tax base, including declining collection rates and property valuations, and of CMSD's forecast of significant operational deficits
- Identification of credible debt insurance options and analysis of their impact on the CMSD credit rating and on interest rates on CMSD debt
- Cash-flow requirements based on the construction Master Plan and associated cost estimates approved by CMSD and the Ohio School Facilities Commission ("OSFC")*

  *Analysis of construction costs beyond consideration of cash-flow requirements identified by CMSD and OSFC is not required

- A quantitative comparison of and opinion on future financing options that are permitted under federal law, including recently authorized tax-credit bonds and stimulus-legislation grants, as well as under Ohio law and any regulations of the OSFC

In our discussion of certain issues, we cite Best Practices of the Government Finance Officers Association (GFOA"). GFOA has issued a number of its Best Practices (formerly called "Recommended Practices") over the past several years to set forth accepted sound practices for the benefit of GFOA's governmental members.[1]

[1] GFOA's website at *http://www.gfoa.org* contains the following explanation of GFOA's Best Practices, as well as certain "Advisories"—

GFOA Best Practices and Advisories

In 1993, the Government Finance Officers Association (GFOA) Executive Board directed the association's staff to work with the GFOA standing committees to develop a body of recommended practices in the functional areas of public finance to give GFOA members and other state and local governments more guidance on sound financial management practices. This effort represented a fundamental new direction for GFOA and one that is still evolving.

In 2009, the GFOA's Executive Board determined that GFOA's Recommended Practices should be reclassified as Best Practices and Advisories. A GFOA Best Practice identifies specific policies and procedures as contributing to improved government management. It aims to promote and facilitate positive change rather than merely to codify current

The GFOA Best Practices promote sound governmental financial practices that benefit governmental issuers and their taxpayers.

NOTE: This Report is current as of its date, April 6, 2010. The AGFS Team does not undertake to revise the Report with respect to developments after its date.

accepted practice. Partial implementation is encouraged as progress toward a recognized goal. A GFOA Advisory identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is not to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure. The ongoing and future work of the standing committees will be the development of Best Practices and Advisories.

This resulting collection of Best Practices and Advisories have been approved by the GFOA Executive Board after careful development by the standing committees. Each practice and advisory was developed drawing on the collective wisdom of more than 50 persons with extensive and diverse experience in public finance. The best practices are intended to identify enhanced techniques and provide information about effective strategies for state and local government practitioners.

INTRODUCTION

The Bond Accountability Commission 2 ("BAC") contracted with American Governmental Financial Services ("AGFS"), a private firm in Sacramento, California, to review the following CMSD bond and note offerings relating to CMSD's 2001 Issue 14 and to make recommendations regarding improvements in practices for future CMSD financing transactions—

- $35,000,000 School Improvement Notes, Series 2001 dated November 7, 2001
- $124,920,000 Various Purpose Improvement and Refunding Bonds, Series 2002 dated as of October 1, 2002
- $125,000,000 School Improvement Bonds, Series 2004 dated as of July 8, 2004
- $30,000,000 School Improvement Notes, Series 2005 dated December 22, 2005
- $30,000,000 School Improvement Notes, Series 2007 dated March 6, 2007
- $20,000,000 School Improvement Notes, Series 2007A dated December 5, 2007
- $15,000,000 School Improvement Notes, Series 2008 dated December 30, 2008

This Report is based upon review and analysis of information and documents that BAC, CMSD and CMSD's Finance Team made available to us and upon discussions with CMSD's Finance Team members (including CMSD finance officials) and with BAC's Commissioners and Administrator.

With the consent of BAC, AGFS brought together a Team consisting of the following nationally recognized municipal securities market firms and professionals to participate in the review and analysis—

- **Government Financial Strategies** ("GFS"), Lori Raineri, President, Keith Weaver, Senior Project Manager, and Michael Terry, Senior Financial Analyst; GFS is a specialist in school district financing transactions

- **Delphis-Hanover Corp.**, Austin Tobin, CEO, a specialist in pricing municipal securities issues

- **Law Office of Perry Israel**, a specialist in federal tax law application to municipal securities transactions

Each of these firms and professionals has decades of experience working in its respective specialty in the municipal securities market. Brief information regarding the backgrounds and qualifications of the AGFS Team members is set forth in Appendix I.

The AGFS Team members are independent with respect to transactions conducted by CMSD and relationships with CMSD and members of CMSD's financing team.[2]

[2] Robert W. Doty of AGFS was a partner in Squire, Sanders & Dempsey from 1979 to 1984.

Transactional Execution

Financial Advisors' Employment & Services

CMSD receives financial advice from two firms—Fifth Third Securities, Inc. and Blaylock Robert Van, LLC (succeeding to SBK-Brooks Investment Corp.)—and experienced individuals within those firms. CMSD also receives Bond Counsel advice from Squire, Sanders & Dempsey, LLP and experienced personnel within that firm. CMSD's Financial Advisors appear to have served independently of CMSD's underwriters in the Issue 14 transactions. Independent financial advice is an important asset of which some issuers fail to avail themselves. We endorse it as an important way to protect the interests of the District and its taxpayers.

Underwriters are adversaries to the interests of issuers in the issuance and sale of municipal securities, even when the underwriters are well-intentioned. Among other things, CMSD wants to receive the lowest borrowing cost and most flexible terms, while underwriters, representing their own interests and the interests of investors, want the highest investment returns and the strictest terms.[3] CMSD needs to continue to have the full benefit of qualified independent financial advice that focuses *solely* upon CMSD's best interests.

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[3] See Rule 2320(a)(1) of the Financial Industry Regulatory Authority ("FINRA"), which states that dealers (including underwriters) must act for the benefit of "customers" (*i.e.*, investors), as follows—

> In any transaction for or with a customer … [the dealer] shall use reasonable diligence to ascertain the best market for the subject security and buy or sell in such market so that the resultant *price to the customer is as favorable as possible* under prevailing market conditions. [Emphasis added.]

Therefore, the identities of the Financial Advisors selected by CMSD, and the process for that selection, are especially important to CMSD and the taxpayers. It is important that any municipal securities issuer, such as CMSD, follow a competitive selection process to ensure that it is selecting a highly qualified Financial Advisor at a reasonable cost.[4] That protects the interests of the District and its taxpayers. We are informed, however, that the current CMSD administration cannot document how firms that competed for the position of Financial Advisor were evaluated or scored by a prior District Administration in 2001. Contracts with the firms selected at that time have been renewed since, without solicitation of competing bids.

While CMSD could work successfully with one Financial Advisor, it has chosen to employ two. Presumably, CMSD perceives value from having two Advisors. Therefore, CMSD should receive the full benefits of the professional perspectives of each Advisor. In general, however, we have seen only formal memoranda provided on key issues by one Advisor. In this Report, we recommend utilizing a process by which CMSD receives the full benefits of both professional perspectives for which CMSD is paying.

The Financial Advisors' *independent* professional perspectives are important to CMSD. In support of CMSD's utilization of its Financial Advisors, we note that the Government Finance Officers Association ("GFOA") states in a Best Practice entitled

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[4] We emphasize that cost is not the sole consideration. Quality is particularly important and must also be taken into account.

"Selecting and Managing the Method of Sale of State and Local Government Bonds," as follows[5]—

> There is … a lack of understanding among many debt issuers about the appropriate roles of underwriters and financial advisors and the fiduciary relationship that each has or does not have with respect to state and local government issuers. The relationship between issuer and financial advisor is one of "trust and confidence" which is in the "nature of a fiduciary relationship". This is in contrast to the relationship between the issuer and underwriter where the relationship is one of some common purposes but also some competing objectives, especially at the time of bond pricing.

In a Best Practice entitled "Selecting Underwriters for Negotiated Bond Sales," GFOA also states its view as to the contrasting roles of financial advisors and underwriters, as follows—

> Issuers must keep in mind that the roles of the underwriter and the financial advisor are separate, adversarial roles and cannot be provided by the same party. Underwriters do not have a fiduciary responsibility to the issuer. A financial advisor represents only the issuer and has a fiduciary responsibility to the issuer.

Appropriately in recognition of such principles, CMSD's Memorandum to Potential Proposers dated November 1, 2001, directed to firms interested in serving as Financial

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[5] GFOA's Best Practices may be found at *http://www.gfoa.org*/.

Advisor to CMSD states that in negotiated securities offerings "the District will prohibit a firm from serving as both financial advisor and underwriter."[6] It makes no statement about whether CMSD's Financial Advisors could change their role and bid as an underwriter in competitive sales.

The Agreements between CMSD and its respective Financial Advisors (the "Financial Advisor Agreements"), however, are silent on the question of whether the Advisors could be permitted to underwrite CMSD's securities.

In addition, the Financial Advisor Agreements contemplate that the Financial Advisors are to perform services focused entirely upon securities offerings, including development of Plans of Finance. With that sole transactional focus, and with the fee schedule stated in the Financial Advisor Agreements as discussed below, CMSD is depriving itself of the continuing service of experienced Financial Advisors with respect to a range of other significant financial planning and financial management issues, some of which are discussed in this Report. Recognizing that CMSD has its own internal finance personnel, financial advisory services nevertheless can extend beneficially well beyond the conduct of specific securities issues.

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[6] Under Municipal Securities Rulemaking Board Rule G-23, a dealer is permitted to resign from a financial advisory role in order to serve as underwriter to a municipal securities issuer in a negotiated sale. In that event, Rule G-23 permits financial advisors to resign by informing issuers that a conflict of interest "may" exist, and on that basis to obtain the issuers' consents to the change in roles. Dealer firms may follow the practice of asking issuer employees to sign the consents, rather than seeking governing board approval of such a fundamental change from a fiduciary to an adversarial role. The Rule is controversial due to the inherent conflicts of interest between the fiduciary duties of financial advisors and the adverse interests that underwriters have with issuers.

CMSD's stated preference in its Memorandum to Potential Proposers is consistent with Best Practices of the Government Finance Officers Association (GFOA). GFOA states that it intends "to set a higher standard than is required under MSRB Rule G-23, because disclosure and consent are not sufficient to cure the inherent conflict of interest."

Financial Advisory Fee Structure

CMSD's Financial Advisors are paid on a transactional basis according to the following contingent fee schedule (in addition to reimbursement of out-of-pocket expenses) set forth in each of the Financial Advisor Agreements between CMSD and the Advisors—

$.50 per $1,000 financed, plus

$25,000 per bond issue (excluding refunding issues), or

$35,000 per bond issue for refunding issues, or

$7,500 per note (one-year or shorter) issue

We are informed that the Financial Advisors divide that fee equally between themselves.

GFOA's Best Practice entitled "Selecting Financial Advisors" states on the subject of financial advisory fees, as follows—

> **Basis of Compensation.** Fees paid to financial advisors should be on an hourly or retainer basis, reflecting the nature of the services to the issuer. Generally, financial advisory fees should not be paid on a contingent basis to remove the potential incentive for the financial advisor to provide advice that might unnecessarily lead to the issuance of bonds.

While GFOA recognizes that a noncontingent fee structure may be difficult for certain issuers, in CMSD's case the District is sufficiently large, and has sufficient funds, that it would benefit from continuing financial advice from its Advisors directed, among other things, to the goal of assisting the District with respect to specific financial planning and financial management issues and the long-term goal of improving further the pricing of CMSD's securities.[7] On a "net" basis, removing the potential for conflicts of interest from the fee structure would be of benefit to CMSD and the taxpayers.

CMSD's financial advisory fee schedule contains at least two significant disadvantages for both CMSD and its Financial Advisors—

- First, the Advisors must complete transactions in order to be paid.

> No matter how much work the Advisors expend, if there are no securities sales, there is no compensation. That is unfair to CMSD, the taxpayers and the Financial Advisors. The Financial Advisors deserve to be paid for their respective time and effort in providing continuing professional advice to CMSD. CMSD should not be in the position that its Advisors must cause a closing to occur in order to receive compensation for their professional work. While we have not found evidence of biased advice, that potential should not be in the picture.

[7] To the extent that the continuing services of Financial Advisors and Bond Counsel, as recommended herein, are related to CMSD's securities, it may be appropriate in terms of timing for CMSD to advance those fees from its other funds as costs are incurred and then to obtain reimbursement to those other funds from proceeds of sale of securities. CMSD may wish to discuss this with the Financial Advisors and Bond Counsel.

The potential for an appearance of impropriety should be avoided.

- Second, the fee schedule pays the Advisors additional compensation if the transactions are larger.

    Again, that is unfair to all parties. The Advisors should be paid according to their respective time and effort, not by the size of a transaction. Although we have seen no evidence of biased advice, the Advisors are exposed to the potential criticism that specific transactions should not have occurred or that transactions may be larger than necessary for CMSD's purposes.

It is unfair to CMSD and all members of its Finance Team to place the Team members in a position of losing months of diligent professional work if a transaction, even if through no fault of the Financial Advisors, were to become marginal or inadvisable near its end. That set of facts is an extreme illustration of the conflicts created by contingent fee structures.

Competitive Bids vs. Negotiated Sales

Municipal securities are sold typically through two methods of sale.[8] One, competitive bids, offers the securities for sale after the securities are structured by the

[8] Another method of sale, not relevant to this review of CMSD's practices, involves direct private placements with sophisticated investors.

issuer, its Financial Advisors and its Bond Counsel. The sale occurs through a bidding process that advertises the sale, provides an official statement (prospectus) and other information, and solicits bids by underwriting firms. The firm proposing the lowest overall interest cost in a competitive bid wins the bid.

The other method is known as a “negotiated sale.” In a negotiated sale, the underwriting team is selected before the securities are structured, and the underwriters participate in the structuring efforts. In negotiated sales, underwriters are able to engage in more extensive pre-marketing efforts because they have confidence that they will be able to purchase and resell the municipal securities. In competitive bids, such pre-marketing efforts are not needed due to the standardization and high quality of the securities.

There is considerable debate in the municipal securities market regarding the methods of sale, but in most facts and circumstances, one or the other method can be identified as preferable.

CMSD stated in its Memorandum to Potential Proposers for Financial Advisor to CMSD that “The District is hopeful that the majority of District securities will be issued and sold through competitive bid. Therefore, the District anticipates that any negotiated underwritings will be minimal.”

GFOA's Best Practice entitled "Selecting and Managing the Method of Sale of State and Local Government Bonds," states in part as follows[9]—

> **Background.** State and local government bond issuers should sell their debt using the method of sale that is *most likely to achieve the lowest cost of borrowing* while taking into account both short-range and long-range implications for taxpayers and ratepayers. Differing views exist among issuers and other bond market participants with respect to the relative merits of the competitive and negotiated methods of sale. Moreover, research into the subject has not led to universally accepted findings as to which method of sale is preferable when taking into account differences in bond structure, security, size, and credit ratings for the wide array of bonds issued by state and local governments.
>
> * * *
>
> **Recommendation.** When state and local laws do not prescribe the method of sale of municipal bonds, the Government Finance Officers Association (GFOA) recommends that issuers select a method of sale based on a thorough analysis of the relevant rating, security, structure and other factors pertaining to the proposed bond issue. …

[9] See also Johansen, "Ensuring a Successful Bond Sale" Government Fin. Rev. at 16 (Feb. 2010).

> The GFOA believes that the presence of the following factors may favor the use of a competitive sale:
>
> - The rating of the bonds, either credit-enhanced or unenhanced, is at least in the single-A category.
> - The bonds are general obligation bonds or full faith and credit obligations of the issuer or are secured by a strong, known and long-standing revenue stream.
> - The structure of the bonds does not include innovative or new financing features that require extensive explanation to the bond market.

GFOA also states that when the "issuer, in consultation with its financial advisor, determines *that a negotiated sale is more likely to result in the lowest cost of borrowing*," then a negotiated sale could be appropriate by following enumerated steps involving an open and competitive selection process for underwriters. [Emphasis added.]

GFOA adds, as follows—

> GFOA believes that the presence of the following factors may favor the use of a negotiated sale:
>
> - The rating of the bonds, either credit-enhanced or unenhanced, is lower than single-A category.

- Bond insurance or other credit enhancement is unavailable or not cost-effective.

- The structure of the bonds has features such as a pooled bond program, variable rate debt, deferred interest bonds, or other bonds that may be better suited to negotiation.

- The issuer desires to target underwriting participation to include disadvantaged business enterprises (DBEs) or local firms.

- Other factors that the issuer, in consultation with its financial advisor, believes favor the use of a negotiated sale process.

One of the ironies of the municipal securities market is that large numbers of issuers that otherwise are frugal and that carefully evaluate costs and money-saving alternatives in making even relatively small purchases, nevertheless choose to ignore strong evidence that competitive bidding produces better pricing in certain securities financings of significant size. That is especially true in connection with the issuance of what might be described as "commoditized" securities. In general, commoditized securities, discussed further below, are those that have strong easily recognizable credit support, that incorporate standardized terms, and that carry satisfactory ratings. Commoditized securities do not require special premarketing sales efforts or extensive explanations by underwriter sales personnel to potential investors because the securities are readily recognizable to investors.

While it is true that a high percentage of municipal securities are sold through negotiated sales, in general for commoditized securities that is not the preferable course. That view applies to CMSD's 2002 and 2004 Bond issues, which were negotiated sales. We do not have information as to why CMSD chose to conduct those specific sales as negotiated transactions.

It is true that, as GFOA observes, in some facts and circumstances, negotiation may be a better choice. Such facts and circumstances may include, for example, certain (but not all) bonds with ratings below "A," complex or novel financing structures, issuers unknown in the market, questionable credits, or especially volatile market conditions.[10]

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[10] We note that, at the end of 2008, one of CMSD's Financial Advisors provided the following rationale for selecting underwriters for an expected negotiated sale of CMSD Bonds in 2009 (which ultimately did not occur)—

> **<u>Negotiated vs. Competitive Underwriting</u>**:
>
> As with the District's proposed issuance of bonds in 2007 to refinance previously issued bonds, the District's Financial Advisors recommended using a group of firms to negotiate the upcoming $55,000,000 bond issue in 2009. Supporting this recommendation is the ratio of negotiated-to-competitive debt issues nationally, which has increased from about 70% negotiated in 2007, to almost 85% negotiated year-to-date in 2008. The market turmoil described above has convinced more issuers to access the markets through a negotiated underwriting process. The benefits of the negotiated process include:
>
> - Based upon market volume, economic announcements, actions by the Federal Reserve, etc., the underwriters can more easily adjust when to bring the issue to market,
> - Small structural changes can be made the day of the bond sale to respond to specific demand by investors, which result in lower net borrowing rates,
> - The marketing period for the bonds can start several weeks in advance of the sale date, rather than the typical two or three days for competitively bid issues,
> - Negotiating underwriters have agreed to buy the issuer's debt, even if it cannot all be immediately sold to investors, and
> - An issuer can be certain that any interested investors within the issuer's district will have access to the issuer's bonds.

Those considerations do not apply in general to CMSD's tax-exempt securities offerings. In general, CMSD issues double-A-rated securities that have an unlimited general obligation property tax (provided though Issue 14) as security and that incorporate standardized terms.

Although CMSD has its own ratings of "BBB+" from Standard and Poor's and "Baa2" from Moody's Investor Service,[11] themselves respectable ratings, the credit of CMSD's Bonds is backed further by the Ohio Department of Education's Credit Enhancement Program, giving CMSD's Bonds a "AA-" rating by Fitch Ratings, a "Aa3" rating by Moody's Investors Service, and a "AA" rating by Standard and Poor's. All of those enhanced ratings are excellent.

In general, CMSD's bonds are not complex or novel, they are not variable-rate bonds, and they do not otherwise incorporate features that make them difficult to market. Given those conditions, study after study has concluded that competitive bids produce the best results.

At those rating levels and given CMSD's unlimited general obligation tax pledge backing its securities, CMSD's securities are a true commodity. Under those facts and circumstances, and with market conditions having improved significantly during 2009, the benefits of competitive bidding are optimal, and CMSD should capture those benefits.

The potential drawback to the negotiated bond process is the concern that the interest rates received from the negotiating underwriter(s) are not on-the-market. For Cleveland MSD, this risk is mitigated by having independent Financial Advisors in place to review the rates proposed by the underwriters. The Financial Advisors receive the same compensation whether the District's debt is negotiated or bid, so the only motivation is obtaining the lowest all-in costs of borrowing for the District.

[11] Fitch Ratings does not rate CMSD's securities on their own merit, but rather only on an enhanced basis.

It is true that many issuers use negotiated sales, and that in the turbulent 2008 market more did so. Many of those securities offerings, however, do not involve commoditized securities.[12] With CMSD's own credit level, the enhanced ratings provided through CMSD's participation in the Department of Education's enhancement program, and standardized terms of unlimited tax general obligation Bonds, a competitive bid is preferable in terms of producing optimized yields for CMSD and the taxpayers.

Moreover, experience during the past two years demonstrates that regional underwriting firms have emerged successfully as larger underwriting firms withdrew from or decreased their activity in the market. The regional firms may not be recognized for purposes of invitations to submit proposals to participate in negotiated bond issues. Competitive bidding would give CMSD greater access to such firms in widely advertised bid transactions.

Qualified School Construction Bonds ("QSCBs") present a different set of facts, although recent federal legislation will probably result in a wider use of QSCBs in a different, newly authorized form with issuers electing to receive a direct subsidy from the federal government ("direct subsidy QSCBs") rather than selling QSCBs in the form described in the next paragraph.[13]

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[12] CMSD's Financial Advisors should manage CMSD's Bond structuring process. We see little if any value from underwriter participation in that process given the experience and capabilities of CMSD's Financial Advisors and the standardized terms of unlimited tax general obligation Bonds, whether tax-exempt or taxable.

[13] See "Financing Options under Federal Law" beginning at page 114 herein for a discussion of QSCBs, Build America Bonds ("BABs"), and other new federally-subsidized forms of taxable or tax credit municipal securities. As discussed in that section, recent federal legislation has given issuers of QSCBs the option of receiving a direct subsidy from the federal government rather than selling bonds that allow

QSCBs, in the form originally authorized under federal law for the first time in early 2009, provide tax credits and taxable interest to investors, rather than tax-exempt interest ("credit QSCBs"). The goal of the federal legislation was to provide sufficient levels of income tax credits to investors that school districts would not be required to pay any interest at all—a goal that largely failed, as discussed below in conjunction with the recent experience of the City of Milwaukee. Credit QSCBs were a relatively new form of municipal securities and had a more limited investor appeal than traditional bonds,[14] requiring an investor educational effort in order to build the market. As a result, many underwriting firms were reticent to commit to large purchases without significant premarketing efforts. Underwriters had concerns about the possibility of having to hold credit QSCBs in inventory for extended periods, thereby tying up dealer capital, before the bonds could be sold to investors. That created a risk that the underwriters might lose money if prices were to change in the market before resales of the securities could be completed. In turn, that impacted competitive bids because dealers are reluctant to bid without a full opportunity to pre-sell the bonds.

This was reflected in December 2009, when the City of Milwaukee offered, in two attempted competitive bid sales, $50 million of general obligation credit QSCBs for the Milwaukee Public Schools. The ratings were "AA+" by Fitch, "Aa2" by Moody's, and "AA" by S&P. In other words, the Milwaukee Schools offerings were similar in a number

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investors to receive credits. We expect very few "credit" QSCBs will be issued in the future as the "direct subsidy" QSCBs result in a cheaper net borrowing cost to the issuer.

[14] The prior market for QSCBs was sufficiently limited that one institutional investor, Guggenheim Partners LLC, was reported to have "bought roughly 50% of the roughly $2.4 billion [of QSCBs] that [had been] sold as of Dec. 11, and [to have] participated in nearly every of the 144 transactions completed" through Dec. 31, 2009. Devitt, "Guggenheim Likes the Taste of QSCBs, Even Ones from Detroit" (Bond Buyer Online Dec. 31, 2009).

of respects to a potential $55 million credit QSCB offering contemplated by CMSD in 2010. Milwaukee's experience illustrated the difficulty of marketing credit QSCBs through competitive bid procedures when the tax credits were payable to investors.[15] Now that CMSD is able to opt for direct receipt of federal subsidy payments, competitive bidding, as with BABs, is the preferable course.[16]

Build America Bonds ("BABs") are a form of bonds that, again at the option of the issuers, can pay taxable interest to investors (with or without tax credits) and in connection with which issuers may opt to receive direct federal subsidies (in which case, no tax credits would be available to the investors). BABs in that format have been sold successfully in competitive bids in several geographic regions with positive results.[17] The

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[15] See the more detailed discussion at n. 124 regarding Milwaukee's experience.

[16] The AGFS Team acknowledges, however, that, due to the structure of the federal QSCB direct-pay subsidy program, so long as the interest rate is at or below the federally-prescribed tax-credit rate, the federal government has removed the incentive for CMSD to be cost conscious on matters on which costs normally would be an issue, such as to whether competitive bidding or a negotiated sale is used.

The federal government will pay all of CMSD's interest costs, so there is no incentive to CMSD to pursue further reductions in those costs. Moreover, CMSD would be able to utilize a single long-term Bond maturity and to invest the amounts that otherwise would be paid for principal in a sinking fund to be used to pay principal at maturity. Such a sinking fund may be invested at up to the permitted sinking fund yield (as of April 6, 2010, about 4.3%), so that CMSD would be able to receive positive arbitrage earnings for application to pay debt service and reduce CMSD's costs further. This is known as an "invested sinking fund."

See Devitt, "Ohio Sees Negotiated Direct-Pay QSCBs" (Bond Buyer Online Apr. 5, 2010) ("In what might be the first direct-pay QSCB sale, Boston on March 25 competitively sold $17.425 million of taxable direct-pay QSCBs to UBS Financial Services with a TIC [true interest cost] of 5.179%, according to tm3.com. Those bonds mature through 2026 and are callable at par in 2020. … Last Wednesday, the Bloom-Carroll district priced $26.5 million of bonds, comprising $15 million of taxable, direct-pay QSCBs and $11.5 million of taxable, direct-pay BABs. The QSCBs captured an interest rate of 5.8%, just under the day's tax-credit rate of 5.82%. The government will cover 100% of the district's interest costs. … Estimating a return of roughly 3% on the sinking fund, the finance team expects the all-in total interest cost for the QSCBs to total negative 2.342%. The all-in TIC for the full $26.4 million financing is expected to total 1.957%.")

[17] As a result of the improving market, competitive bids are now being used for BABs. See Kaske, "Milestone BAB Sale On Tap—Pennsylvania Readies Biggest Competitive Deal" (Bond Buyer Online Jan. 11, 2010); Scarchilli, "Pennsylvania's BAB-Heavy Deal Leads the Way" (Bond Buyer Online Jan.

opportunity for competitive bidding of direct subsidy QSCBs emerged with the change in federal law to allow school districts, such as CMSD, to receive direct subsidy payments as with BABs (although at a much higher subsidy level "equal to the lesser of the actual interest rate of the bonds or the tax-credit rate for muni tax-credit bonds, which the Treasury sets daily," while the subsidy for BABs is equal to only 35% of interest.[18] The history and success of competitive bidding for BABs should translate readily to direct subsidy QSCBs.

14, 2010) ("a $900 million Pennsylvania competitive sale that included more than $600 million of taxable Build America Bonds"); Cooke, "Pennsylvania Obtains Record Low Rate on $900 Million Bond Sale" (Bloomberg.com Jan. 13, 2010) ("The debt sale included the largest competitively bid series of Build America Bonds since such sales began nine months ago. … 'That's just a tremendous rate from our perspective,' said Rick Dreher, who oversees Pennsylvania's general obligation bond auctions.")

Municipal Market Advisors—EDGE (April 6, 2010) ("Illinois competitively sold BABs today in its first offering since Fitch Ratings raised the rating based on its new re-calibrate rating scale. Illinois sold $300 million general obligation Build America Bonds to JPMorgan Securities Inc.; A2/A+/A+; institutions only. Max yield: BABs in 2035 are spread +210 basis points to 30-year UST, which yields 6.94%.")

Bond counsel to the State of Delaware informed us that Delaware successfully sold at competitive sale $179,315,000 General Obligation Bonds, Series 2009D (Federally Taxable-Build America Bonds). In South Carolina, bond counsel to several local issuers informed us that competitive bids are used for BABs by those local issuers.

BABs are now widely used and are better recognized in the investor community, although there is still some room for improvement, especially in terms of marketing to pension funds and foreign investors. According to the Municipal Securities Rulemaking Board ("MSRB"), "Nearly $64 billion of Build America Bonds were issued in 2009 as state and local governments took advantage of the federal program for financing public projects. … [There were] 680 Build America Bonds issued in 2009 … . MSRB Press Release, "Municipal Securities Rulemaking Board Publishes Report on 2009 Build America Bond Activity" (Feb. 12, 2010).

See also n. 24.

[18] Schroeder, "Obama Signs BABified Jobs Bill" (Bond Buyer Online March 17, 2010) ("The Hiring Incentives to Restore Employment Act allows issuers of qualified school construction bonds, qualified zone academy bonds, new clean energy bonds and qualified energy conservation bonds to opt to receive direct subsidy payments from the federal government instead of offering investors a tax credit. … Issuers of the school bonds that opt for the direct-pay mode will receive payments equal to the lesser of the actual interest rate of the bonds or the tax-credit rate for muni tax-credit bonds, which the Treasury sets daily.")

Underwriter Selection

Underwriters selected for negotiated municipal securities offerings should be selected based on their capabilities to sell the proposed securities at optimal prices yields (*i.e.*, the lowest overall cost of borrowing).

GFOA's Best Practice entitled "Selecting and Managing the Method of Sale of State and Local Government Bonds," states in part as follows—

> Concerns have been raised about the lack of a competitive Request for Proposals (RFP) process in the selection of underwriters in a negotiated sale and *the possibility of higher borrowing costs when underwriters are appointed based on factors other than merit*. As a result, issuers have been forced to defend their selection of underwriters for negotiated sales in the absence of a documented, open selection process.
>
> * * *
>
> If an issuer, in consultation with its financial advisor, determines that a negotiated sale is more likely to result in *the lowest cost of borrowing*, the issuer should undertake the following steps and policies to increase the likelihood of a successful and fully documented negotiated sale process:
>
> - Select the underwriter(s) through a formal request for proposals process. The issuer should document and make publicly available the criteria and process for underwriter selection so that the decision can be explained, if necessary.

- Enter into a written contractual relationship with a financial advisor (a firm unrelated to the underwriter(s)), to advise the issuer on all aspects of the sale, including selection of the underwriter, structuring, disclosure preparation and bond pricing.[19]

* * *

- Remain actively involved in each step of the negotiation and sale processes in accordance with the GFOA's *Best Practice, Pricing Bonds in a Negotiated Sale*.

- Require that financial professionals disclose the name(s) of any person or firm compensated to promote the selection of the underwriter; any existing or planned arrangements between outside professionals to share tasks, responsibilities and fees; the name(s) of any person or firm with whom the sharing is proposed; and the method used to calculate the fees to be earned.[20]

- Review the "Agreement Among Underwriters" and ensure that it governs all transactions during the underwriting period.

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[19] GFOA also notes in its Best Practice entitled "Selecting Underwriters for Negotiated Bond Sales" that "The financial advisor can lend objective knowledge and expertise in the selection of underwriters for negotiated sales."

[20] As a part of the investigation, CMSD also should ask about relationships with other professionals in the market.

- Openly disclose public-policy issues such as the desire for DBEs and regional firm participation in the syndicate and the allocation of bonds to such firms as reason for negotiated sale; measure and record results at the conclusion of the sale.[21]

- Prepare a post-sale summary and analysis that documents the pricing of the bonds relative to other similar transactions priced at or near the time of the issuer's bond sale,[22] and record the true interest cost of the sale and the date and hour of the verbal award. [Emphasis added.]

GFOA adds in its Best Practice, as follows—

> *The issuer's goal in a negotiated bond sale is to obtain the highest possible price (lowest interest cost) for the bonds*. To maximize the potential of this occurring, the issuer's goal in the underwriter selection process is to *select the underwriter(s) that has the best potential for providing that price*. Those underwriters are typically the ones that have demonstrated both

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[21] We have not seen evidence of this type of analysis by CMSD of underwriter performance by firm.

[22] The analyses should examine information from independent sources regarding the sale results for all maturities in a securities issue, not merely selected examples.

The Municipal Securities Rulemaking Board ("MSRB") has created a website that provides real time trading data for all sales of municipal securities, including secondary market trading activity. The website, known as "EMMA" ("Electronic Municipal Market Access System") is a valuable independent source for issuers of up-to-date pricing information.

A review of EMMA data regarding post-sale trading of the issued securities is another source of significant information regarding the quality of pricing of the securities.

> experience underwriting the type of bonds being proposed and the *best marketing/distribution capabilities*. [Emphasis added.]

GFOA continues that "No firm should be given an unfair advantage in the selection process."

We do not have information on the process or criteria by which the prior CMSD Administration selected underwriting teams for the 2002 and 2004 Bond issues. The current Administration is unable to locate documentation regarding the selection process used at the time. We are informed, however, that CMSD's Financial Advisors were not involved in that process, so CMSD made the underwriter selection without the benefit of independent professional advice.

More recently, in late 2008 at a time when market conditions were adverse and volatile in the midst of the worst part of the financial crisis, CMSD's current Administration, this time with the active participation of its Financial Advisors, selected an underwriting team expecting to complete a negotiated bond sale in 2009. That bond sale did not take place because CMSD made a policy decision first to undertake a new facilities assessment in order to determine how it might most effectively spend the taxpayers' money.

We understand that CMSD is seriously considering revisiting the underwriter selection for future Bond issues. We fully endorse that reconsideration. Given all that has transpired in the market, and with the emergence of new types of federally-subsidized securities made available to CMSD, CMSD should not feel bound to continue with the

former underwriting team under new market conditions and with respect to a new type of taxable municipal securities (QSCBs) that did not even exist at the time the team was selected.

Moreover, the criteria and weighting factors used by CMSD in evaluating underwriters involved criteria that tilted the selection process heavily in a particular direction. The emphasis was not upon what GFOA termed “merit,” with a specific focus upon “obtain[ing] the highest possible price (and lowest interest cost) for the bonds.”

The criteria and weighting utilized by CMSD were as follows—

Fees and expenses—25%

Ability to distribute tax-exempt debt—20%

Commitment to and/or ownership by minority groups—20%

Corporate presence in the District—20%

Performance on previous District bond or note issues—15%

That is, CMSD gave a 20% credit for local firms and another 15% credit for firms that performed satisfactorily in prior CMSD transactions. The reference to “Fees and expenses—25%” does not relate to interest costs, but rather to the underwriters’ compensation and expenses for selling the securities. Although CMSD awarded the highest credit to “Fees and expenses,” in relation to interest costs, as discussed further

below, such fees and expenses normally are a significantly less important element in overall issuer costs.[23]

In the recent selection process, members of prior CMSD underwriting teams, at least two of which teams were selected without professional financial advice, had a significant 35% head start that could not be overcome easily by other, potentially more qualified firms. Meanwhile, the ability to sell tax-exempt debt at optimal yields for CMSD and the taxpayers—the most important component to be considered—rated only 20%. It would have been more meaningful to place a significantly heavier emphasis upon "Ability to distribute."

Because at the time QSCBs were unknown in the municipal securities market, the capability of selling QSCBs at attractive yields was not a criterion. CMSD did not know at the time the underwriting team was selected, and likely does not know today, the capabilities of the members of that underwriting team to market bonds bearing taxable interest, such as direct subsidy QSCBs or BABs.[24]

With the 35% aggregate local and prior service weighting, it would have been very difficult, if not impossible, for other firms to have been selected. That would have

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[23] With the federal direct-pay QSCB subsidy program pursuant to which the federal government will pay 100% of CMSD's interest costs so long as CMSD's interest yield is below a prescribed federal level, the incentive for CMSD to save further on interest costs has been removed from the subsidy program, interest costs become irrelevant, and underwriting and other costs of issuance assume a greater significance than under normal circumstances. See n. 16.

[24] See "Financing Options under Federal Law" beginning at page 114 regarding Build America Bonds ("BABs"). Pursuant to federal legislation recently signed by the President, QSCBs now can be sold with taxable interest, such as is payable on BABs and with the subsidy payable directly to CMSD, rather than in the form of tax credits to investors.

See also n. 70.

discouraged some other well-qualified firms even from submitting proposals. Such a result, especially in combination with the criteria weighting, would have denied CMSD an effective process for selecting the optimal underwriting team.

As does GFOA, we believe that the ability to provide issuers, such as CMSD, with the lowest overall costs is the key factor to consider for CMSD and the taxpayers.[25] As noted, we also believe that, in general, low Bond yields are significantly more important to CMSD than the level of underwriting fees and expenses.[26] That is because the Bond yields represent, by far, the largest cost for the District and the taxpayers. A "true interest cost" ("TIC") analysis, taking into account both the present value of bond yields (interest payments) and costs of issuance, is used customarily in the market to demonstrate the lowest overall cost to the issuer. A firm that may charge a little more compensation for its work in order to motivate its sales staff to a greater extent, but which overall produces the lowest yields, is almost invariably the firm that will benefit the District and the taxpayers the most. The weighting criteria should be changed to reflect what is most important to the taxpayers, namely the lowest *overall* cost.

Bond Counsel Information & Relationship

The District has been unable to locate documentation regarding the initial process of employment of CMSD's Bond Counsel or a final executed contract with Bond Counsel. The District has continued to use the same Bond Counsel since the initial selection.

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[25] GFOA recognizes that issuers may wish to employ regional firms and minority firms, but in the context of an overall emphasis on obtaining the best price for issuers' securities.

[26] CMSD's Financial Advisors can assist CMSD in a total true interest cost evaluation taking into account all costs, including Bond yields, underwriting fees and expenses, and other costs of issuance.

We understand that Bond Counsel's fees are contingent upon transactional completion and vary according to the size of transactions. Bond Counsel's fees for Issue 14 Note proceedings have been $0.75 per $1,000 of Note principal amount, and solely for Issue 14 Bond proceedings, $0.90 per $1,000 of Bond principal amount, except for issues in excess of $100 million, for which fees have been $0.825 per $1,000.

We also have been informed that CMSD's Bond Counsel is not employed for certain post-issuance matters or otherwise on a continuing basis between securities issues. That is a practice likely carried over from past Administrations at a time when life for municipal securities issuers was much simpler. Municipal finance today is becoming increasingly complex. There is rapidly increasing federal regulatory interest in matters such as post-issuance tax compliance and disclosure to the market on a continuing basis (*i.e.*, annual reporting of financial and operating information and the occurrence of certain events, not only disclosure at the time municipal securities are offered for sale). In addition, CMSD is subject to certain compliance requirements as a result of covenants and other provisions contained in its Bond documentation, and has a need for continuing communications with the Ohio School Facilities Commission ("OSFC").

CMSD would benefit from continuing access to and consultation with Bond Counsel, just as it would be beneficial for CMSD to have continuing access to and consultation on financial matters with CMSD's Financial Advisors.

Investor Relations Program

The municipal securities market has changed substantially in recent years and continues to change rapidly.[27] Issuers that seize the initiative to be competitive are the issuers most likely to be more successful in their securities sales.[28] Investor populations are changing due in part to changes in the tax treatment of municipal securities through authorizations for tax credit and taxable bonds.[29] CMSD should be aware of and respond

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[27] In response to new market conditions and changing bond products, new investors are coming into the market. See the discussion beginning at n. 60 and accompanying text.

See also Seymour, "Muni Market Witnessing the Changing Face of Ownership—BAB Program Bringing in New Kinds of Bondholders" (Bond Buyer Online Dec. 11, 2009), stating that according to a Federal Reserve report—

> Foreign investors—one of the primary target audiences for the BAB program—owned $53.5 billion of municipal bonds at the end of the third quarter, a leap of more than a third since the BAB program launched.
>
> * * *
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> "This should help put to rest the question about whether or not BABs are being purchased by international institutions," said Phil Fischer, head of municipal strategy at Bank of America Merrill Lynch. "They obviously are doing so at an accelerating rate. … The initial holders of BABs were primarily domestic, but over time we would expect that most of the BAB issuance would migrate to foreign institutions."
>
> Another illustration of the shifting winds in public finance was a new line item in the Fed's municipal securities table: exchange-traded funds.
>
> * * *
>
> This is not to say the retail investor has vanished from the municipal market. Far from it: households remain the single largest category of muni bond holders. They owned $979.5 billion in municipals at the end of the third quarter, the most households have ever owned.
>
> * * *
>
> The categories showing lower market share than a year ago are broker-dealers, government-sponsored enterprises, and commercial banks.

[28] GFOA states in its Best Practice entitled "Maintaining an Investor Relations Program" that "The municipal marketplace is changing, and the need to provide additional information with greater frequency is significant."

[29] See "Financing Options under Federal Law" beginning at page 114 herein for a discussion of QSCBs, BABs and other new federally-subsidized forms of taxable or tax credit municipal securities.

to those changing demographics in the market, which may require reaching out to new investors, especially in the case of taxable bonds, such as BABs, foreign investors,[30] life insurance companies and pension funds.[31] Since issuers now have the option to elect direct payments from the federal government (rather than selling instruments that give investors a federal income tax credit), foreign investors, life insurance companies and pension funds will be similarly important to CMSD. Those new investors to municipal securities need education.[32]

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[30] Illustrating the emerging importance of foreign investors for U.S. taxable municipal securities, a recent article cited a prospectus for a BABs investment fund offered in French and English to Canadian investors. According to the article, Canadian funds are able to convert to some extent taxable U.S. municipal securities payments into tax-exempt income in Canada. The article states—

> [T]he launch was the most concrete illustration yet of the foreign investors who reportedly have emerged to buy BABs.
>
> "It makes perfect sense for a Canadian investor," said Darren Cabral, vice president at Connor, Clark & Lunn, citing U.S. municipal default rates well below those on comparably rated corporate bonds and a "fairly attractive yield."
>
> Because of the legal structure of mutual fund trusts in Canada, the monthly dividends paid on the fund will mostly be tax-exempt, according to the Canadian law firm McCarthy Tetrault LLP, which was counsel on the initial public offering.

Seymour, "Build America Bonds—Parlez-Vous BABs? A Fund Wants to Know" (Bond Buyer Online Feb. 24, 2010).

See also McGrail, "International Buyers Boost Muni Holdings 50% on Build America" (Bloomberg.com March 13, 2010) ("Foreign investors boosted their holdings of U.S. municipal debt by about 50 percent in 2009, to $60.6 billion, in the first year of Build America Bonds, according to data from the Federal Reserve. The overall market for muni debt increased 4.8 percent … . 'The vast majority of that is BABs,' said Guy LeBas, chief fixed-income strategist at Janney Montgomery Scott LLC … .")

[31] See, *e.g.*, McDonald, "New York to Sell Build America Bonds as Taxable Paper Rallies" (Bloomberg.com Jan. 26, 2010) ("The New York City Municipal Water Finance Authority … plans to sell $400 million of Build America Bonds. … Alan Anders, New York City's debt manager and chief executive officer of the city's water finance authority, said 35 life insurance companies bought the Build America Bonds the authority sold in October. He said in comments after the sale at a meeting of the Securities Industry and Financial Markets Association that banks need to do a better job of broadening the market for the taxable securities to investors such as pension funds.")

[32] See Albano, "Teaching Investors the ABC's of BABs" (Bond Buyer Online March 29, 2010) ("Even as the market for Build America Bonds has evolved over the past 12 months, underwriters, bankers, and analysts are still schooling investors and issuers about the taxable securities using various approaches. … Large or small, participants say the three main classes of buyers of the economic stimulus credit—

Currently, CMSD does not have a formal investor relations program. While CMSD has fared well in the pricing of its Bond issues, in order for CMSD to obtain the optimal prices for its securities going forward, especially in the changing market, it is important that CMSD become proactive in reaching out to the investment community to educate investors about CMSD and to learn how to enhance CMSD's appeals to investors. CMSD has a strong credit to offer. Given especially negative news stories regarding the community, CMSD in particular could benefit from a proactive approach providing accurate information that would likely improve CMSD's image with investors, as well as investor receptivity to CMSD's Bond offerings. CMSD's Financial Advisors and Bond Counsel can be invaluable in providing assistance in the establishment, development and continuing operation of an effective program.

In that regard, GFOA states in a Best Practice entitled "Maintaining an Investor Relations Program, in part as follows—

> The Government Finance Officers Association (GFOA) recommends that governmental issuers consider developing an investor relations program. The centerpiece of such a program is a commitment to provide full and comprehensive disclosure of annual financial, operating, and other significant information in a timely manner consistent with federal, state and

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domestic taxable investors; non-traditional domestic taxable buyers, such as hedge funds,; and overseas investors—are still doing their homework when it comes to the one-year old security class. … [Bankers at JP Morgan] said besides their own staff instructing investors on the ABC's of BABs, many investors gain a certain comfort level from speaking directly with issuers.")

Further, the inefficiencies in the municipal securities market associated with bond insurance demonstrate a failure by many investors to understand the default risks of traditional governmental securities, such as CMSD's unlimited tax Bonds, versus the corporate default risks of bond insurers. See "Debt Enhancement Options" beginning at page 67 regarding bond insurance.

local laws. Issuers may consider providing additional information to investors beyond that provided for in their contractual commitments.

GFOA then discusses numerous steps and issues relating to ongoing investor relations programs, including among them the following—

- Identify the individual(s) who is (are) responsible for speaking on behalf of the issuer. Establish steps to ensure that all external communication regarding disclosure is approved by this (these) person(s).
- Consider creating a "Disclosure Board" or other appropriate group, to establish the events to be disclosed and periodicity of disclosure items.[33]
- Identification of ways to stay abreast of issues that are likely to be of concern to investors.
- Identification and maintenance of a database of investors and analysts who review the purchase of the issuer's debt instruments.[34]
- Responding to investor questions.
- Ensuring the majority of investors have access to the information.

[33] CMSD recently updated its continuing disclosure filings.

In following GFOA's recommendation, it is important not to do so in a merely formal manner. The substantive process and its results are what matter. Those involved should be CMSD personnel familiar with information, together with key legal and financial professionals.

[34] The purposes of such a database include facilitation of investor contacts and analysis of characteristics of the investor population interested in CMSD's securities.

- Maintaining a good relationship with the rating agencies and fund analysts.

- Engaging in marketing activities to alert investors of a pending bond sale.

As can be seen, GFOA's emphasis is upon becoming proactive in creating and maintaining good investor relations. We agree. Once again, CMSD's Financial Advisors and Bond Counsel can be especially valuable in assisting CMSD in undertaking those efforts. Over time, CMSD may find it advisable to re-evaluate its disclosure practices, since historically investors in taxable securities have been accustomed to receiving more information on a more timely basis than is customary in the municipal securities market.

Investor Meetings

In their proposals to CMSD in 2001, both of CMSD's Financial Advisors spoke to the desirability of CMSD's conducting meetings with the investment community in order to stimulate interest in CMSD's securities.[35] For an issuer the size of CMSD that issues

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[35] Fifth Third Securities stated at pages 11-12 of its proposal to CMSD—

> In order to make certain that Cleveland Schools' bonds and notes are attractive to … institutional portfolio managers, we recommend that the District make direct contact with some of the major institutional buyers. This contact could be via conference call or in group meetings. All of these contacts would be coordinated by Fifth Third Securities as Financial Advisor.
>
> As with any presentations to the credit rating agencies and bond insurance companies, Fifth Third would prepare the District representatives making the presentations, and prepare the presentation materials. These presentation materials could be as simple as flip-books, or more sophisticated power-point presentations.
>
> * * *
>
> *Making contact with the institutional buyers should be viewed as a process rather than a one time event*. There are too many potential institutional buyers to be able to contact each one, but by contacting the most active buyers first, and then subsequently contacting other potential buyers, the District can develop much more consistent demand for its note

Bonds and Notes in sizable amounts and as frequently as does CMSD, that is a concept that should be implemented and evaluated, at the very least as a pilot program. Such meetings are especially desirable in view of issues relating to CMSD's property tax base[36] and associated questions that investors naturally would have. The meetings could become an integral facet of an investor relations program.

Investor meetings may occur directly in person or in larger conference-type settings, by telephone conferences, or given technological developments, in "webinars." The

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> and bond issues. This is a strategy that is frequently used by issuers of corporate debt, and a strategy that would help Cleveland Schools to more quickly reap the benefits of the management improvements that have taken place. [Emphasis added.]

SBK-Brooks stated at page 7 of its proposal—

> A successful negotiated sale will require a multi-faceted marketing strategy focused on Ohio institutional and retail buyers. To enhance institutional interest, the lead manager should coordinate with the financial advisor and hold information meetings with targeted institutional investors around the country.
>
> While Ohio participation will be important, the District's issue will attract major buyers from many other states. If the timing of the issue permits, we recommend holding meetings with key institutional investors in Cleveland, New York, Chicago and Boston.
>
> The District may want to consider utilizing a "video conference" presentation for analysts and portfolio managers across the country. Major buyers of Ohio issues would meet at a video conference center in their State and participate in a presentation and "question-answer" session.
>
> At these meetings (in person or video conference), representatives from the District, the Financial Advisor and the financing team will discuss credit and other topics as well as explain the proposed issue structure to major bond funds, money managers and other institutional buyers and respond to any questions. This outreach is then followed up by institutional salespeople to further explain the District's credit in detail.
>
> Retail buyers are typically less interest rate sensitive than institutional investors. This can result in interest cost savings for the District. With an effective pre-marketing program, SBK-Brooks can generate this critical retail demand, aggressively price the bonds and produce a lower interest rate.

[36] See the discussion of CMSD's tax base in "CMSD Financial Considerations" beginning at page 85 and "Cash Flow Considerations" beginning at page 104 herein.

emerging market for direct subsidy QSCBs—with new types of investors—highlights both the importance and feasibility of investor meetings for such Bond offerings.

The meetings would signify that CMSD values investor perspectives, would allow CMSD to inform investors about CMSD[37] and to respond to investor questions, and would afford CMSD an opportunity to identify investor concerns to which CMSD could respond.

MSRB Financial Disclosure Incentives

The Municipal Securities Rulemaking Board ("MSRB") recently proposed to offer to municipal securities issuers, such as CMSD, a number of voluntary financial disclosure incentives. If accepted by CMSD, those financial disclosure incentives would lead to special recognition by the MSRB on its new EMMA website[38] of those issuers, such as CMSD, accepting one or more of the incentives. The EMMA website clearly is well on its way to becoming the central information vehicle in the municipal securities market. While one of the incentives is controversial—commitments to deliver audited financial statements within 120 days following the end of fiscal years (with an option for 150 days on a temporary basis to December 31, 2013)—the others have not drawn widespread issuer objections. Especially when attempting to attract new investors, as would be the case with taxable bonds, CMSD should be aware that many investors in taxable securities

[37] Any "material" information, however, should be made available to all investors and the market simultaneously. The MSRB's new EMMA disclosure platform will accept supplemental filings, and provides an important vehicle for communications with investors.

This is another area within which CMSD would benefit from continuing advice of its Bond Counsel and Financial Advisors.

[38] The EMMA website is located at *http://www.emma.msrb.org/*.

are accustomed to receiving financial and other information on a more detailed and timely basis than is customary in the municipal securities market.

The MSRB described its incentives in its initial proposing release,[39] as follows—

> Such additional continuing disclosures and related indexing information would be displayed on the EMMA web portal and also would be included in EMMA's continuing disclosure subscription service. Such additional items would include:
>
> - an issuer's or obligated person's undertaking to prepare audited financial statements pursuant to generally accepted accounting principles ("GAAP") as established by the Governmental Accounting Standards Board ("GASB"), as described below (the "GASB-GAAP undertaking");
> - an issuer's or obligated person's undertaking to submit annual financial information to EMMA within 120 calendar days after the

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[39] The MSRB's revised incentives are described in MSRB Notice 2009-63, "MSRB Amends Pending Proposal on Additional Voluntary Submissions by Issuers and Obligated Persons to the MSRB's Electronic Municipal Market Access System (EMMA") (Dec. 21, 2009). See MSRB Press Release, "Municipal Securities Rulemaking Board Amends Proposal on Voluntary Timeframe for Submission of Annual Financial Information from Issuers and Other Related Proposals" (Dec. 21, 2009).

Regarding the MSRB's initial proposal, see MSRB Notice 2009-44, "MSRB Files Proposals to Provide for Additional Primary Market and Continuing Disclosure Information To Be Made Available Through the MSRB's Electronic Municipal Market Access System ('EMMA')" (July 15, 2009). See also MSRB Press Release, "Municipal Securities Rulemaking Board Seeks to Provide Investors with Additional Disclosure Information—Proposal Would Allow Pre-Sale Disclosures and Shed Light on Timing of Annual Financial Disclosures" (July 15, 2009). As with other MSRB actions, Notice 2009-44 is filed with the SEC and subject to SEC approval. See SEC Rel. No. 34-60315 (July 15, 2009) (giving notice of the MSRB's filing of the proposed rule with the Commission).

The MSRB documents are available at *http://www.msrb.org/msrb1/whatsnew/2009-63.asp*.

end of the fiscal year, as described below (the "annual filing undertaking");[40] [and]

* * *

- uniform resource locator (URL) of the issuer's or obligated person's Internet-based investor relations or other repository of financial/operating information.

Website

One of the MSRB's offered incentives would grant special recognition to an issuer, such as CMSD, for posting on the EMMA website the issuer's uniform resource locater ("URL"). That would direct investors to the issuer's website, where additional issuer information would be available for investors and the market.[41]

Currently, CMSD's website does not contain a special page or section devoted to providing information about CMSD to the investment community or to the market. That information might include financial and operating information that is provided more frequently than annually, as well as information regarding specific developments.

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[40] In revising its proposal in Notice 2009-63, the MSRB added a temporary incentive for issuers willing to commit to submit annual financial information within 150 days after the end of fiscal year-ends. That incentive would expire on December 31, 2013.

The MSRB also dropped a proposed incentive for recognition of issuers that receive a GFOA Certificate of Achievement for Excellence in Financial Reporting. We note that CMSD has received such an award. The MSRB would permit issuers to indicate in the submission process that their financial statements are Comprehensive Annual Financial Reports ("CAFRs").

[41] Issuers, such as CMSD, may also choose on a voluntary basis to file additional information with EMMA.

In connection with consideration of the MSRB's incentives, we recommend that CMSD discuss with its Bond Counsel and Financial Advisors how CMSD might be able to make a low-cost effort on its website to attract investor interest and to provide certain updated information as a way of responding to investor questions and interests. There are a number of important considerations in that regard that require close consultation with CMSD's Bond Counsel and Financial Advisors.

Factors for consideration are discussed in two GFOA Best Practices. One is entitled "Using a Website for Disclosure," which states that GFOA "recommends that governmental issuers use their Web sites to disseminate information to the municipal securities market regarding their debt, financial condition and other related information."

GFOA's Best Practice entitled "Web Site Presentation of Official Financial Documents" lists and discusses numerous perceived benefits of such an avenue of communication and related considerations.

Recommendations:

The recommendations in this Report are made in the context of what, based upon our review, are good overall Bond and Note sale results for CMSD's Issue 14 program. We believe our recommendations should be understood to be efforts constructively to assist CMSD and its Finance Team of Financial Advisors and Bond Counsel in making improvements. We also believe that CMSD's taxpayers should understand that CMSD is seeking in good faith to honor its responsibilities to the taxpayers regarding the tax burdens of Issue 14, and that CMSD is achieving that goal in a reasonable manner.

Given that overall context, we make the following recommendations—

We recommend that, so long as CMSD chooses to employ multiple Financial Advisors, each Financial Advisor be consulted on all financial issues of significance to CMSD, and that each make its own explicit recommendations in writing on each of those significant issues.

We recommend that CMSD consider the potential for broader utilization of its Financial Advisors outside the narrow confines of planning for and conducting securities offerings, such as, for example, assisting with continuing financial issues, continuing disclosure to investors and the market, establishment of an investor relations program, use of CMSD's website as an integral element in an investor relations program, and potentially accepting one or more of the incentives offered by the MSRB.

How CMSD might benefit from such broader utilization of the Financial Advisors would be best defined by CMSD itself, after due consideration with its Financial Advisors. We note, for example, that SBK Brooks Investment Corp.'s proposal dated November 30, 2001, offered at page 13 to provide "on-going support and to assist in developing and implementing certain financial and investment policies …," and refers at page 14 to "[d]evelopment of a debt Policy Statement," "[r]eview and/or development of an Investment Policy" and "investment strategies that maximize return." In addition, both Financial Advisors recommended that CMSD establish a continuing investor communications program. As with separation of the financial advisory and underwriting functions, we recommend that the investment advisory function be separated from sales of investments.

We recommend that CMSD's Financial Advisor Agreements be modified to clarify that the Financial Advisors cannot underwrite CMSD securities on which they have advised CMSD.

We recommend that CMSD investigate periodically the market for financial advisory services to ensure that its financial advisory fees remain in line with the market. In such an evaluation, it is appropriate for CMSD to consider the quality of services, and not merely the levels of fees.

We recommend that CMSD enter into a contract with Bond Counsel that clarifies for CMSD the roles and responsibilities of Bond Counsel,[42] as well as CMSD's roles and responsibilities. We have found that sometimes municipal issuers do not fully understand Bond Counsel's precise roles, potential limitations on Bond Counsel roles and responsibilities, or the full potential range of services Bond Counsel might provide. Such a contract should also provide for a range of continuing Bond Counsel services for CMSD, not merely services at the time of, or with fees dependent upon the completion of, Bond or Note issues.

We recommend that CMSD investigate periodically the market for Bond Counsel services to ensure that its Bond Counsel fees remain in line with the market. In such an

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[42] This was encouraged in the National Association of Bond Lawyers' **MODEL ENGAGEMENT LETTERS** (1998 ed.) According to the publication—

> The Committee [on Professional Responsibility] believes that consistent use of written engagement letters will (a) minimize disagreements or misunderstandings; (b) focus attention on the conditions and guidelines that will govern the proposed attorney-client relationship; and (c) lead to more productive relationships.

Although in the past, relationships in the municipal securities market were often created informally, as transactions have become increasingly complex under federal tax and securities law regulatory pressures, carefully negotiated written contracts are now advisable.

evaluation, it is appropriate for CMSD to consider the quality of services, and not merely the levels of fees.

We recommend that CMSD consider the potential for broader utilization of its Bond Counsel outside the narrow confines of planning for and conducting securities offerings, especially regarding post-issuance tax and securities law compliance (such as filings with the MSRB's EMMA website of continuing disclosure notices and supplementary information), compliance with Bond and Note documentary requirements, working with State agencies, establishment of an investor relations program, use of CMSD's website as an integral element in an investor relations program, and potentially accepting one or more of the incentives offered by the MSRB.

We recommend that CMSD's Financial Advisors and Bond Counsel not be compensated on the basis of contingent fees that are payable only at the closing of a transaction or on the basis of fees that vary according to the size of a transaction.[43] Rather, we recommend that each of the Financial Advisors and Bond Counsel be paid according to the time and effort involved in their respective work. In addition to removing potential conflicts of interest, a different fee structure would allow CMSD to seek advice on a continuing basis on a wider range of issues, not merely securities offerings.

In addition, municipal securities market regulation may affect the roles and responsibilities assigned to CMSD's Financial Advisors and Bond Counsel. We recommend that CMSD monitor regulatory developments with that in mind.

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[43] We recognize that securities transactions carry liability risks. Accordingly, there may be fee differentials according to the nature of services provided.

We recommend that at least CMSD's tax-exempt general obligation Bonds, and any CMSD direct subsidy QSCBs[44] and BABs,[45] rated at AA- or better levels be sold through competitive bids under current market conditions.[46]

In all negotiated Bond and Note sales, we recommend that CMSD conduct a new underwriter selection process focused on overall underwriter sales performance capabilities, taking into account experience relating to successful offerings of Bonds and Notes of the type expected to be offered. That process should obviate an emphasis on local, or Ohio, offices and on participation in past CMSD transactions. We recommend that the focus be placed on the ability of the underwriters to sell the proposed CMSD Bonds at the optimally lowest overall cost for CMSD and the taxpayers taking into account both yields and transactional costs.

The following factors lead us to recommend that any underwriting team for a negotiated bond sale be identified through a new selection process—

- Emergence of QSCBs for the first time in the market during 2009 and recent changes to the QSCB subsidy program

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[44] See n. 18 and accompanying text.

[45] Again, see "Financing Options under Federal Law" beginning at page 114 herein for a discussion of QSCBs, BABs, and other federally-subsidized forms of taxable or tax credit municipal securities.

[46] See, however, n. 16.

- Criteria used in the prior selection process that were based on considerations other than strictly upon the overall cost to CMSD and the taxpayers

- Stabilization of the municipal securities market since the selection of the prior team

We recommend that the criteria weighting used in the selection process for underwriters for any negotiated CMSD Bond or Note offerings focus *solely* upon what is most important to CMSD's taxpayers—the capability to sell the Bonds and Notes at the lowest overall costs taking all costs and interest yields into account.

We recommend that CMSD develop, with its Financial Advisors and Bond Counsel, a program directed toward stimulating enhanced investor interest through meetings and other communications with institutional investors, and potentially individual, investors and in addition, for direct subsidy QSCBs and BABs, foreign investors, life insurance companies and pension funds.

Once the MSRB's issuer financial disclosure incentives become final, we recommend that CMSD discuss with its Financial Advisors and Bond Counsel the potential for taking advantage of the MSRB's offer in order to attract investor interest.

We recommend that CMSD discuss with its Financial Advisors and Bond Counsel how CMSD might be able to make a low-cost effort on its website to attract investor interest.

Results of Sales

Credit Levels

CMSD's 2002 and 2004 Bonds were sold with three levels of credit support, as follows—

- First, CMSD provided its own unlimited tax (Issue 14) credit support that was rated by Standard and Poor's at a "BBB+" level and by Moody's at a "Baa1" level (Moody's now rates CMSD's Bonds at "Baa2;" Fitch did not rate the Bonds at unenhanced levels). Those are good ratings regarded by many investors as indicating a suitable credit level, known in the market as "investment grade."

- Second, the credit of the 2002 and 2004 Bonds was enhanced by the Ohio Department of Education's Credit Enhancement Program, resulting in enhanced ratings of "AA-" by Fitch Ratings, "Aa3" by Moody's Investors Service, and "AA" by Standard and Poor's. All of those enhanced ratings are excellent.

- Third, the 2002 and 2004 Bonds received additional credit support as a result of the purchase of bond insurance, resulting in triple-A ratings by each of the three major rating agencies. Those triple-A ratings, however, are on a

corporate rating scale, which is considerably different from a municipal rating scale.[47]

In the context of those three layers of credit support, Delphis-Hanover Corporation provided a technical analysis of the yields in CMSD's Bond and Note sales. That technical analysis by Delphis-Hanover Corporation appears in Appendix B hereto.

Bond & Note Yields

Delphis Hanover reached the following conclusions, which are quite favorable regarding the results of CMSD's Bond and Note sales—

- CMSD's 2002 Bonds were sold "with a notably strong scale," or in other words, with interest yields on each maturity that were lower than prevailing rates in the market for securities of similar maturities and a similar credit level
- That strong scale (yield for each maturity) applies to all maturities of the 2002 Bonds
- In fact, the prices were so strong that they "were better than triple-A uninsured bonds in the overall general market," while insured bonds of other issuers were being sold in the market "at yields equivalent to those of a double-A rated bond"

[47] As discussed in "Debt Enhancement Options" beginning at page 67, bond insurance actually has a default risk profile that is less favorable than CMSD's own unenhanced unlimited tax (Issue 14) support.

- CMSD's 2004 Bonds were sold "at a strong price in all maturities… slightly better than" Moody's Aa1-rated uninsured bonds

- Meanwhile, other insured bonds were being sold in the market "at yields equivalent to those of a" Moody's Aa3-rated bond

- CMSD's Notes "attracted major financial bidders," meaning that the competitive bidding processes were effective in attracting strong buyers[48]

- The "Notes sold at fair market value"

Those are very positive conclusions. In effect, CMSD's Bonds sold better than other comparable bonds in the market at the time, and CMSD's Notes were sold at fair market values. CMSD and the taxpayers could not expect better results.

Upfront Costs

Introduction

In addition to interest yields, the other component of financing costs is upfront costs. For purposes of a comparative analysis, upfront costs are separated into two categories—

- Underwriter's discount. This is the fee the underwriter receives for purchasing Bonds from the District and reselling to investors. This is typically expressed as a percentage of the principal amount issued.

[48] The 2008 Note sale, which occurred in volatile market conditions, attracted only one bidder, but Delphis-Hanover found that the Note yield was at a market level.

- Costs of issuance including bond insurance. Other than costs for bond insurance, costs of issuance primarily consist of bond counsel fees, financial advisor fees, rating agency fees, and other miscellaneous expenses. These costs generally do not increase with the size of the principal,[49] as there is not much difference in the amount of work involved, the amount of documents prepared, and the amount of time spent between a small and a large bond issuance. The costs for bond insurance are included in this category as well, consistent with how costs are typically reported in Official Statements of comparison districts we examined.

To analyze the upfront costs, four comparisons were undertaken: (1) a comparison of bond costs based on timing, (2) a comparison of bond costs based on size, (3) a comparison of note costs versus bond costs, and (4) a comparison of note costs.

Cost of Bonds Based on Timing

For this analysis, comparison districts were chosen based on being located in Ohio, having issued the same type of financing as CMSD, having issued within approximately a month of CMSD, having issued at least $5 million, and having Official Statements available on the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access ("EMMA"). The upfront cost information was obtained from the Official Statements of the comparison districts. If a particular category of upfront cost

[49] CMSD, however, pays to its Financial Advisors and Bond Counsel fees that vary according to the size of the transaction.

was not provided in the Official Statement, it is noted as "unavailable." All of the comparison districts obtained bond insurance except for one, Beachwood City School District.

As shown in the table below, "Upfront Cost Comparison Analysis Based on Timing of Bonds," several conclusions can be reached—

- CMSD did exceptionally well in obtaining low costs from underwriters. The underwriter's discounts obtained by CMSD were approximately one-third to one-half of what the comparison districts obtained on a percentage basis.

- CMSD's costs of issuance including bond insurance were low to mid-range on a percentage basis. It appears there is some room for improvement in this category, as some other districts achieved lower costs, but certainly the costs do not appear unreasonably high.

- On an overall basis, CMSD's upfront costs were low. The exceptional underwriter's discounts helped CMSD achieve better results than the comparison districts.

Upfront Cost Comparison Analysis Based on Timing of Bonds

	District	Principal Amount	Underwriter's Discount	Discount as a %	Costs of Issuance Incl. Bond Ins.	Costs as a %	Total Upfront Costs	Costs as a %
2002 General Obligation Bonds								
1	**Cleveland Municipal School District**	**$124,920,000**	**$312,410**	**0.25%**	**$747,084**	**0.60%**	**$1,059,493**	**0.85%**
2	Olentangy Local School District	$39,635,000	$208,084	0.53%	$150,147	0.38%	$358,231	0.90%
3	Beachwood City School District	$18,814,982	$94,075	0.50%	$91,138	0.48%	$185,213	0.98%
4	Jonathan Alder Local School District	$24,999,958	$162,500	0.65%	$117,646	0.47%	$280,146	1.12%
5	Northwest Local School District	$22,999,986	$180,500	0.78%	$127,000	0.55%	$307,500	1.34%
6	West Clermont Local School District	$11,075,000	unavailable	n/a	unavailable	n/a	$154,566	1.40%
7	Tuslaw Local School District	$14,999,990	$112,500	0.75%	$101,288	0.68%	$213,788	1.43%
8	Ottawa-Glandorf Local School District	$13,485,000	$114,623	0.85%	$110,063	0.82%	$224,685	1.67%
9	Edgerton Local School District	$9,374,988	$72,656	0.78%	$89,067	0.95%	$161,723	1.73%
10	Kenston Local School District	$6,725,000	$40,014	0.60%	$76,496	1.14%	$116,510	1.73%
11	Copley-Fairlawn City School District	$5,934,990	unavailable	n/a	unavailable	n/a	$120,033	2.02%
2004 General Obligation Bonds								
1	**Cleveland Municipal School District**	**$125,000,000**	**$342,500**	**0.27%**	**$559,901**	**0.45%**	**$902,401**	**0.72%**
2	Lakewood City School District	$64,999,987	unavailable	n/a	unavailable	n/a	$555,203	0.85%
3	Columbus City School District	$164,000,000	$700,870	0.43%	$722,304	0.44%	$1,423,174	0.87%
4	Olentangy Local School District	$70,684,994	$353,425	0.50%	$362,464	0.51%	$715,889	1.01%
5	Otsego Local School District	$18,399,999	$119,600	0.65%	$126,039	0.68%	$245,639	1.33%
6	Madeira City School District	$28,000,000	$196,000	0.70%	$224,740	0.80%	$420,740	1.50%
7	Springboro Community City School District	$61,500,000	unavailable	n/a	unavailable	n/a	$994,866	1.62%
8	Chillicothe City School Disdtrict	$34,000,000	$234,600	0.69%	$326,654	0.96%	$561,254	1.65%
9	Archbold Area Local School District	$7,364,997	$51,555	0.70%	$75,485	1.02%	$127,040	1.72%
10	Allen East Local School District	$8,499,992	$53,315	0.63%	$95,926	1.13%	$149,240	1.76%

Cost of Bonds Based on Size

Given that CMSD issued Bonds of relatively large principal amounts relative to the comparison districts, and to ensure that scale was not unduly influencing the cost comparison analysis, we undertook an additional analysis of large bond issuances. Comparisons were chosen based on being a large school district located in Ohio, having issued within a few years of CMSD, having issued approximately $100 million or more, and having Official Statements available on the MSRB's EMMA website. The upfront cost information was obtained from the Official Statements of the comparison districts. If a particular category of upfront cost was not provided in the Official Statement, it is noted as "unavailable." All of the comparison districts obtained bond insurance.

As shown in the table below, "Upfront Cost Comparison Analysis Based on Size of Bonds," largely the same conclusions can be reached—

- CMSD did well in obtaining low costs from underwriters. The underwriter's discounts obtained by CMSD typically were slightly

more than one-half of what the comparison districts obtained on a percentage basis.

- CMSD's costs of issuance including bond insurance were low to mid-range on a percentage basis. It appears there is some room for improvement in this category, as some other districts achieved lower costs, but certainly the costs do not appear unreasonably high.

- On an overall basis, CMSD's upfront costs were low. The exceptional underwriter's discounts helped CMSD achieve great results relative to the comparison districts.

Upfront Cost Comparison Analysis Based on Size of Bonds

	Date	District	Principal Amount	Underwriter's Discount	Discount as a %	Costs of Issuance Incl. Bond Ins.	Costs as a %	Total Upfront Costs	Costs as a %
1	**Jul. 2004**	**Cleveland Municipal School District**	**$125,000,000**	**$342,500**	**0.27%**	**$559,901**	**0.45%**	**$902,401**	**0.72%**
2	Dec. 2003	Toledo City School District	$103,600,000	unavailable	n/a	unavailable	n/a	$758,352	0.73%
3	Oct. 2006	Columbus City School District	$282,864,897	$1,357,522	0.48%	$1,038,574	0.37%	$2,396,095	0.85%
4	**Oct. 2002**	**Cleveland Municipal School District**	**$124,920,000**	**$312,410**	**0.25%**	**$747,084**	**0.60%**	**$1,059,493**	**0.85%**
5	Sep. 2006	City of Cincinnati School District	$380,945,000	$1,619,016	0.43%	$1,640,668	0.43%	$3,259,684	0.86%
6	Jul. 2003	Dayton City School District	$151,555,000	$681,998	0.45%	$676,454	0.45%	$1,358,451	0.90%
7	Jun. 2001	City of Cincinnati School District	$123,945,000	$565,189	0.46%	$606,483	0.49%	$1,171,672	0.95%
8	Oct. 2003	City of Cincinnati School District	$480,000,000	$2,040,000	0.43%	$2,714,316	0.57%	$4,754,316	0.99%
9	Jun. 2003	Dayton City School District	$99,500,000	$472,625	0.48%	$677,047	0.68%	$1,149,672	1.16%
10	Jan. 2004	Akron Public Schools	$215,000,000	$1,542,078	0.72%	$2,098,716	0.98%	$3,640,794	1.69%

Cost of Notes versus Bonds

CMSD issued notes as a strategy to achieve several goals, including to reduce financing costs. As shown in the table below, "Upfront Costs for CMSD's Notes," the Notes in general were significantly less expensive than the Bonds.

For comparative purposes, issuance costs are often expressed as a percentage of the amount issued. For CMSD's 2001, 2005, 2007 and 2007A Note issuances, the underwriter's discount ranged from 0.02% to 0.06%. This is approximately 10% to 25%

of the underwriter's discount for the 2002 and 2004 Bonds, which were 0.25% and 0.27% respectively. The sole exception to this is the 2008 Notes' underwriter's discount, of 0.31%, that was comparable to the bond issuances. For CMSD's 2005, 2007, 2007A and 2008 Note issuances, costs of issuance ranged from 0.17% to 0.19%. This is approximately 30% to 40% of the costs of issuance for the 2002 and 2004 Bonds, which were 0.60% and 0.45% respectively. (Costs of issuance for the 2001 Notes was not available.)

Total upfront cost is equal to the sum of the underwriter's discount and the costs of issuance. Upfront costs for CMSD's 2001, 2005, 2007 and 2007A Note issuances were approximately 25% of the upfront costs for the 2002 and 2004 Bonds, while the upfront costs for the 2008 Notes was approximately 60% of the upfront cost of the 2002 and 2004 Bonds.

Upfront Costs for CMSD's Notes

Series	District	Principal Amount	Underwriter's Discount	Discount as a %	Costs of Issuance	Costs as a %	Total Upfront Costs	Costs as a %
2001	Cleveland Municipal School District	$35,000,000	$22,155	0.06%	unavailable	n/a	unavailable	n/a
2005	Cleveland Municipal School District	$30,000,000	$11,000	0.04%	$50,500	0.17%	$61,500.00	0.21%
2007	Cleveland Municipal School District	$30,000,000	$7,000	0.02%	$53,600	0.18%	$60,600.00	0.20%
2007A	Cleveland Municipal School District	$20,000,000	$3,900	0.02%	$38,100	0.19%	$42,000.00	0.21%
2008	Cleveland Municipal School District	$15,000,000	$46,450	0.31%	$27,200	0.18%	$73,650.00	0.49%

Because the Notes were significantly less expensive than the Bonds, the strategy of issuing Notes to reduce upfront costs was successful to the extent that the Notes replaced the Bonds. For example, this strategy did not work for the 2001 Notes, because CMSD later issued Bonds to refinance the Notes. Therefore, the cost of the 2001 Notes became an extra expense in addition to the cost of the Bonds. If CMSD had instead issued Bonds

initially, it would have saved the cost of issuing the Notes (plus the additional interest cost of the Notes).

The cost savings strategy was very successful for CMSD's 2005, 2007, 2007A, and 2008 Notes. The 2005, 2007A, 2008, and half of the 2007 Notes were repaid with property taxes, and so CMSD did not need to issue Bonds and therefore achieved significant savings. The other half of the 2007 Notes was refinanced by the 2007A Notes, but because the cost of the Notes is relatively minimal, even the combined costs of both Notes are a substantial savings over issuing Bonds. Therefore, with respect to the goal of reducing upfront costs, the strategy of issuing Notes appears to have been very successful overall.

Cost of Notes Comparison

The last analysis undertaken on upfront costs was a comparison against Note issuances of other school districts. Comparisons were chosen based on being a school district located in Ohio, having issued between 2001 and 2008, having issued between $15 million to $30 million, and having Official Statements available on the MSRB's EMMA website. Neither CMSD nor any of the comparison districts obtained bond insurance for the Notes.

As shown in the table below, "Upfront Cost Comparison for Notes," several conclusions can be reached—

- CMSD did exceptionally well in obtaining low costs from underwriters, with the exception of the 2008 Notes, for which costs

were relatively high. While some of the increased 2008 cost may be attributable to seriously disrupted market conditions during the financial crisis, costs were still high relative to other $15 million note offerings from Ohio districts within the same time frame. Specifically, total upfront costs for Beavercreek City School District were $38,200, or 0.25% of the issuance, while Buckeye Valley Local School District's total upfront costs were $46,800, or 0.31% of the issuance; CMSD's total upfront cost was $73,850, or 0.49% of the issuance. The notes for both Beavercreek and Buckeye Valley were dated December 23, 2008, whereas CMSD's notes were dated December 30, 2008.

- CMSD's costs of Note issuance were in the mid- to high-range on a percentage basis. It appears there is some room for improvement in this category, as some other districts achieved lower costs, but certainly the costs do not appear unreasonably high.

- On an overall basis, CMSD's upfront costs were low for the 2005, 2007, and 2007A Notes. Based on the underwriter's discount for the 2001 Notes, the upfront costs for these Notes may have been low as well, but the costs of issuance information was unavailable. CMSD's upfront costs were high for the 2008 Notes.

Upfront Cost Comparison Analysis for Notes

	Series	*District*	*Principal Amount*	*Underwriter's Discount*	*Discount as a %*	*Costs of Issuance*	*Costs as a %*	*Total Upfront Costs*	*Costs as a %*
1	2001	Olentangy Local School District	$30,000,000	$30,000	0.10%	$20,066	0.07%	$50,066.25	0.17%
2	**2007**	**Cleveland Municipal School District**	**$30,000,000**	**$7,000**	**0.02%**	**$53,600**	**0.18%**	**$60,600.00**	**0.20%**
3	**2005**	**Cleveland Municipal School District**	**$30,000,000**	**$11,000**	**0.04%**	**$50,500**	**0.17%**	**$61,500.00**	**0.21%**
4	2002B	Dublin City School District	$22,000,000	$27,575	0.13%	$17,745	0.08%	$45,320.00	0.21%
5	**2007A**	**Cleveland Municipal School District**	**$20,000,000**	**$3,900**	**0.02%**	**$38,100**	**0.19%**	**$42,000.00**	**0.21%**
6	2001	Dublin City School District	$27,000,000	$34,360	0.13%	$23,690	0.09%	$58,050.00	0.22%
7	2002	Dublin City School District	$15,000,000	$19,180	0.13%	$17,420	0.12%	$36,600.00	0.24%
8	2003	Plain Local School District	$18,496,850	$27,745	0.15%	$18,450	0.10%	$46,195.28	0.25%
9	2008	Beavercreek City School District	$15,000,000	unavailable	n/a	unavailable	n/a	$38,200.00	0.25%
10	2002	Zanesville City School District	$19,414,581	$19,415	0.10%	$35,140	0.18%	$54,554.97	0.28%
11	2008	Buckeye Valley Local School District	$15,000,000	$30,000	0.20%	$16,800	0.11%	$46,800.00	0.31%
12	2001	City of Cincinnati School District	$25,000,000	unavailable	n/a	unavailable	n/a	$87,500.00	0.35%
13	2004	City of Cincinnati School District	$29,600,000	unavailable	n/a	unavailable	n/a	$104,805.30	0.35%
14	2003	City of Cincinnati School District	$19,400,000	unavailable	n/a	unavailable	n/a	$74,806.64	0.39%
15	**2008**	**Cleveland Municipal School District**	**$15,000,000**	**$46,450**	**0.31%**	**$27,200**	**0.18%**	**$73,650.00**	**0.49%**
16	2005	South-Western City School District	$21,390,000	$80,213	0.38%	$56,802	0.27%	$137,014.50	0.64%
	2001	**Cleveland Municipal School District**	**$35,000,000**	**$22,155**	**0.06%**	**unavailable**	**n/a**	**unavailable**	**n/a**

Recommendations:

In general, we recommend CMSD's continuation of its practice of timing sales of securities to correspond with CMSD's need for funds.

We believe that CMSD has achieved good overall sales results with low costs for the taxpayers, but as explained in the Recommendations beginning at page 40 following the prior section on "Transactional Execution," we recommend that CMSD cease its reliance on negotiated sales of commoditized Bonds. Instead, we recommend that CMSD take advantage in those sales of the benefits of competitive bids.

We recommend that, when CMSD uses negotiated sales for Bond issues, it alter its weighting criteria for the selection of underwriters to focus solely on the lowest overall cost for CMSD and the taxpayers.

Market Conditions

Recovery

The municipal securities market is continuing to adjust to the credit crisis. Current conditions, however, are considerably more favorable than at the end of 2008, when the market was extraordinarily volatile and when many institutional investors had abandoned the market for what was perceived to be safer ground, primarily U.S. Treasury securities. Individual investors supported the higher quality credits in the market at that time.

During 2009, market conditions improved significantly, and in Fall 2009 re-adjusted as a number of institutional investors took profits from a rally in prices. Individual investors, both directly and through mutual funds, again provided important support.

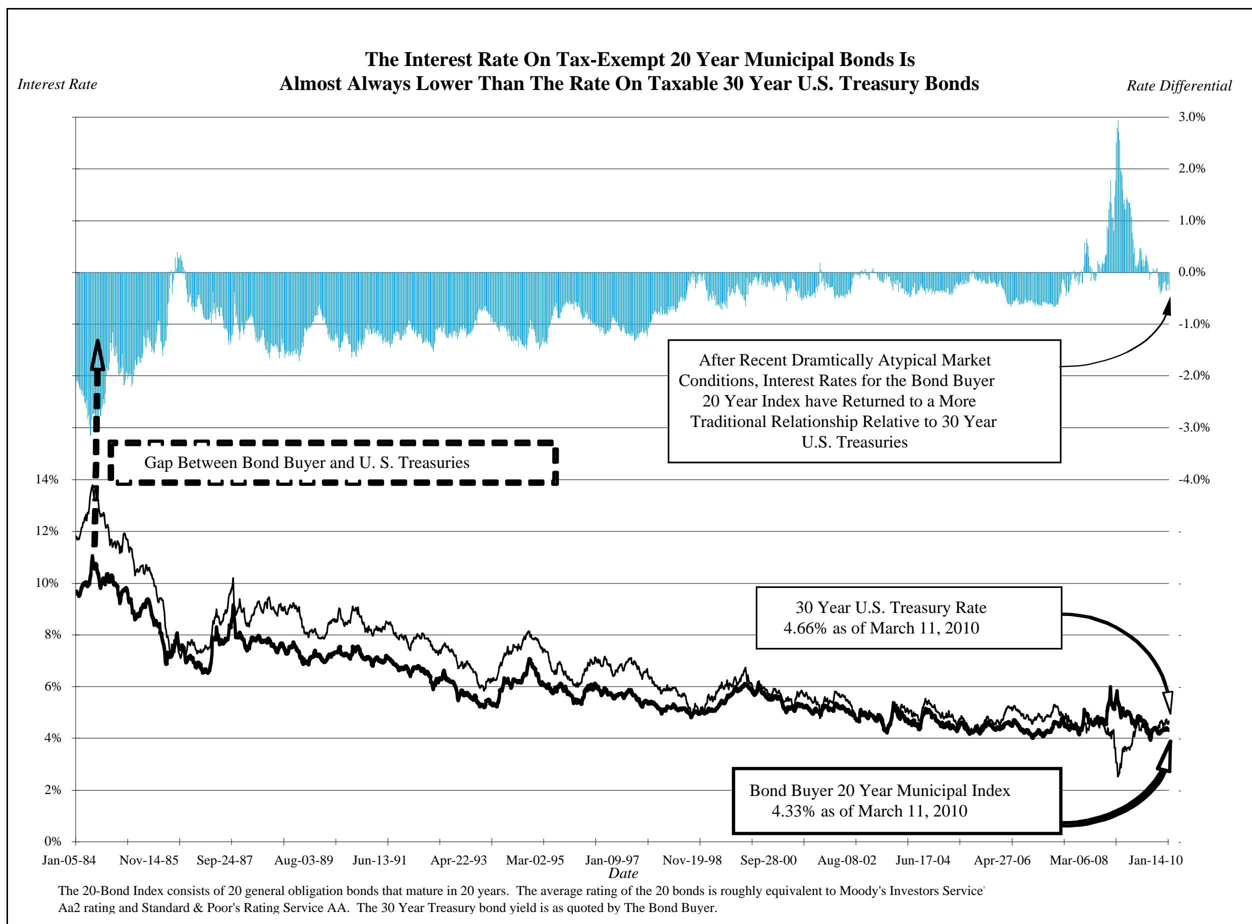
Much of the market activity into mid-2009 stemmed from the declining economy and associated market disruptions. Then, in later 2009, the market experienced a slow recovery, and returned to life, with low tax-exempt yields fed by a diminished tax-exempt securities supply and issuer use of Build America Bonds ("BABs") and other taxable and tax credit bonds.

Interest Rates

To review the history of the market during the financial crisis, in Fall 2008 tax-exempt interest rates rose sharply, and for the first time since the New York City default in the 1970s, the market came very close to a cessation of activity. The Bond Buyer 40-Bond Average, which had been 4.59% on January 10, 2008, climbed to 7.82% on October

16, 2008. Yields on tax-exempt securities rose sharply in relation to yields on U.S. Treasury securities.

Those impacts are illustrated in the following long-term graph of tax-exempt and U.S. Treasury yields—



A "flight" to the safety of U.S. Treasuries, together with investors' loss of confidence in bond insurers and rating agencies, led to facts and circumstances in which 10-year triple-A municipal securities yielded at one point as much as 186.1% of the

corresponding Treasuries. That contrasts with more typical ratios of between 72% and 91%.[50]

During 2009, the Bond-Buyer 40-Bond Average had declined to 5.19% on April 23, before rising again to 5.65% on June 11 and then declining again as "[m]unicipal bonds … headed for their best July performance in seven years," followed by the "best August performance in five years."[51] By October 1, the 40-Bond average had declined to 4.47%, as the supply of tax-exempt securities dropped sharply, partly in response to the growth in issuance of BABs and other taxable municipal securities.[52] On October 1, the Bond Buyer's 20-Bond index was at its lowest point in more than 40 years.[53] The decreased rates then discouraged investors and drew more issuer volume into the market.

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[50] Seymour, "With the Muni-Treasury Ratio Back to 'Normal," What Comes Next?" (Bond Buyer Online June 22, 2009).

[51] Cooke, "Municipal Bonds Headed for Best Performance in July Since 2002" (Bloomberg.com July 30, 2009); Cooke, "Municipal Bonds Headed for Best August Performance Since 2004" (Bloomberg.com Aug. 28, 2009) ("State and local government bonds headed for their best August performance in five years as sales of Build America Bonds damped tax-exempt issuance and municipal mutual funds extended their unbroken streak of inflows in 2009.")

[52] See also Cooke, "Muni Yields Plummet to 42-Year Low as Issues Slow, Funds Grow" (Bloomberg.com Sept. 25, 2009) ("Even with the record fund flows, this year's rally in municipal bonds has an 'artificial or manufactured feel' because of the creation of Build America Bonds, [Tom Dalpiaz of Advisors Asset Management] said.")

See also Seymour, "Munis Surge as Buyers Clamor for Supply" (Bond Buyer Online Sept. 17, 2009) ("Municipals surged to match record-high prices yesterday as many traders doubted whether the latest wave of new bonds can satiate a market still starved for paper. … Municipal bonds have been on a practically unbroken winning streak for more than a month. … Demand has been bolstered by the prospect of higher taxes and almost $54 billion in investments in muni bond mutual funds this year. Supply has been eviscerated by the unavailability of letters of credit for variable-rate debt obligations, as well as the transference on bond sales from the tax-exempt market to the taxable market through the Build America Bonds Program. … Some market participants have said a flurry of new supply is the most likely threat to this rally."); Saskal, "Lower-Rated Credits Getting More Access to Market, Panelists Say" (Bloomberg.com Sept. 17, 2009) ("As more time passes from last year's credit crisis, market access for lower-rated credits is beginning to increase, according to some panelists at [a Bond Buyer conference].")

[53] Scarchilli, "Indexes: 40-Year Lows" (Bond Buyer Online Oct. 2, 2009) ("The Bond Buyer 20-Bond index of 20-year general obligation bond yields dropped 10 basis points this week to 3.94%. This is the lowest level for the index since Aug. 10, 1967, when it was also 3.94%.")

The resulting decrease in demand and increase in supply was accompanied by a rise in rates.[54]

In other words, the market was gradually returning to somewhat more normal supply and demand pressures, even if still a bit tenuous (especially for lower-rated or nonrated credits). By year end, fixed rate municipal securities sales volume was strong.[55]

Summary of Market Conditions

Taking such experiences into account, we are cautiously optimistic about market conditions. Interest rates are low, although they still remain a bit unstable.[56] In addition, regulatory policies and proposed legislation relating to rating agencies are leading to greater formality in connection with obtaining ratings.

It is important, however, to remain flexible and watchful. Clearly, the financial markets in general are not fully out of the woods. Consumers are not spending at the same levels as in the past. Debt, especially governmental debt, is increasing at substantial rates.[57] According to reports, financial institutions are not lending or investing at past

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[54] Cooke, "Muni Market Faces $11.3 Billion in New Issues, Most Since June" (Bloomberg.com Oct. 19, 2009); Seymour, "Sell-Off Finally Staunches Municipal Fund Inflows" (Bond Buyer Online Oct. 19, 2009); Cooke, "Municipal Bond Market Absorbs Third $10 Billion Week Since June" (Bloomberg.com Oct. 23, 2009).

[55] Cooke, "Muni Market Headed for Record Fixed-Rate Bond Sales This Year" (Bloomberg.com Dec. 23, 2009) ("after U.S. state and local governments shunned variable-rate issues and employed new federal subsidies to broaden demand for their debt"); Braun, "Build America Bonds Rush Propels Muni Debt Sales to $374 Billion" (Bloomberg.com Dec. 28, 2009).

[56] See, e.g., McGrail and Marois, "Municipal Bond Yields Reach Four-Month High Amid Wave of Supply" (Bloomberg.com March 26, 2010) ("climbed to a four-month high amid the biggest weekly issuance of state and local debt since Dec. 11").

[57] Some sovereign debt has been subject to special concerns, notably in Dubai and Greece, with perceived weakness in Italy, Spain and Portugal also contributing to uncertainty.

levels,[58] although lending activity appears to be growing very gradually. Some additional companies still are experiencing financial difficulties.[59] Some believe a second market downturn could emerge as a result of the bursting of a credit bubble caused by the injection of excessive liquidity into the financial sector or inflation or for other reasons.

Those are some of the "bad news" considerations, and they do indicate a need to remain aware. Having said that, overall, most indicators appear to be in a more positive vein, even if not dramatically so.

Retail & Foreign Investors

Retail investors (consisting primarily of individuals and smaller companies) are the single largest category of investors in municipal securities.

The high interest rates in 2008, as many institutional investors abandoned the municipal market, prompted recommendations to retail investors such as "The 'Panic' Turns Into a Rout, Not Rebound; If You Can Buy, Then Buy!"[60] Retail investors provided

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Several U.S. states and many local governments are reporting significant budgetary issues as tax receipts decline due to falling property values and decreased economic activity.

[58] See van Duyn, "Supply shocks in store after switch to bonds" (ft.com Dec. 24, 2009) ("As the bank capital depleted by hundreds of billions of dollars of losses on subprime mortgage exposure and other losses from the credit bubble is rebuilt, lending continues to be difficult. One of the big clashes between governments and banks has been around this very issue: even as banks are rebuilding profits due to government help, they are still hoarding funds.")

[59] See Keogh, "Company Defaults Rise to Highest Since 1981, S&P Says (Update1)" (Bloomberg.com. Dec. 14, 2009) ("The number of global corporate defaults rose to the highest since at least 1981, with 260 issuers failing to pay their debt year-to-date for a rate of 9.77 percent, according to Standard and Poor's.")

[60] California Municipal Bond Advisor, vol. 24, issue 12b, at 1 (Oct. 17, 2008). The article states, "As our headline says, … it isn't time to say 'good-bye' to munis. It's time to say 'good buy' if you have any liquid resources to spare." A subsequent California Municipal Bond Advisor article on Nov. 1, 2008 (vol. 25, issue 1), was headed "Smaller Investors Rush to Buy Bargains; The Fire Sale Isn't Over Yet," stating at 1-2 the following analysis—

key support, but in the absence of bond insurance, only at the high credit end of the market, as lesser rated issuers found barricaded doors.[61]

The importance of retail investors was re-emphasized in Fall 2009. Some large institutional investors abandoned the market or reduced their holdings in the face of concerns about financial strength of state and other issuers stemming from the financial crisis or in order to take profits from the earlier market rally.[62]

Retail investors, then, are significant to the municipal securities market, and are becoming more important.[63] It was reported in Fall 2009 that "households" own almost $1

> We stand by what we said in recent issues—the recent market decline didn't reflect a sudden deterioration in municipal credit quality, regardless of the growing budget pressure facing states and localities. Rather, investor redemptions forced big municipal funds to dump bonds in a market already struggling with liquidity issues. In addition, funds that used leverage as part of their investing strategy were sellers as well, and the decline turned into a rout. All the other factors we have discussed recently, such as the downgrading of triple-A bond insurers, contributed to the free fall. …
>
> Just as a sudden decline in the usually "stable" municipal market can be difficult to predict or understand, a gigantic rally can be as perplexing to explain. There is no doubt that smaller "retail" investors jumped into the market with a vengeance when they realized that tax-exempt yields were providing Taxable Equivalent Yields of 9% to 11% on longer-term bonds (depending on your tax bracket). …

[61] Municipal Market Advisors, "Advisor" (Nov. 2008), reiterates at 1 that, "During the month it became more evident that issuers, having less than a AA rating, were penalized by higher interest rates or prohibited from access to capital."

[62] See, *e.g.*, Mysak, "Loews, Guardian Join Allstate Selling Munis as Individuals Buy" (Bloomberg.com Nov. 12, 2009) ("Institutions were selling as individual investors put a record amount of more than $2 billion a week in August and September into municipal-bond funds, according to the Investment Company Institute … ."); McGee, "Allstate Favors Corporate Debt Over Munis, Real Estate Holdings" (Bloomberg.com Nov. 24, 2009).

[63] Municipal Market Advisors, "Advisor" (Nov. 2008), states at 1, "Individuals provided the support for a calendar of $23.5B of primary issuance in November … . Institutional demand remained absent for most of the month as the remaining leveraged accounts sold selectively, mutual funds maintained outflows and property & casualty companies remained sidelined by economic adversity."

trillion of municipal securities “or about 36% of the debt.”[64] Mary Schapiro, the SEC’s Chairman, agreed: [65]

> Municipal securities represent an important market, and one with a sizable level of retail investor participation. At the end of 2008, individual investors held approximately 36 percent of outstanding municipal securities directly and up to another 36 percent indirectly through mutual funds and closed end funds.

As the retail sector’s influence grew, arrangements between market participants reflected a desire to tap into the retail sector as an important market resource.[66] Further regulatory action reflected the growing importance of the retail sector, as in MSRB actions to enhance protections for retail investors and issuer desires for distribution to that sector.[67]

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[64] California Municipal Bond Advisor, “Households Near $1 Trillion Muni Mark;” vol. 25, issue 12 at A (Oct. 1, 2009) (“[W]e always cited this statistic as proof of the influence the smaller ‘retail’ player had in the market, even if they didn’t always get much respect. … We have noted in recent months that the funds are raking in the dough. Since many in the “household” sector also purchase bond fund shares, this is another number showing the role of the ‘retail’ buyer in the market. The household sector and mutual funds own slightly more than half of all outstanding muni debt.”)

[65] Schapiro, “Speech by SEC Chairman: Address before the New York Financial Writers’ Association Annual Awards Dinner” (June 18, 2009).

[66] See Shields, “Loop Partners Up with UBS on Retail Side” (Bond Buyer Online Oct. 2, 2009) (“Chicago-based Loop Capital Markets LLC has cemented a partnership with UBS Wealth Management US to provide primary municipal securities to UBS’ retail clients in a move Loop is hoping will bolster its appeal with borrowers looking to capitalize on retail’s heightened prominence in the market.”)

[67] MSRB Notice 2009-59, “Rule Amendments and Interpretive Notice Filed Regarding Priority of Orders in Primary Offerings” (Nov. 18, 2009). See MSRB Press Release, “Municipal Securities Rulemaking Board Files with SEC to Change Rule on Allocation of New Issues of Municipal Bonds—Changes Affect Priority of Orders and Distribution to the Marketplace” (Nov. 18, 2009).

See also Ackerman, “MSRB Files Controversial Priority Of Orders Rule Changes With SEC” (Bond Buyer Online Nov. 19, 2009) (“Some market participants were convinced the proposed rule changes

With the emergence of Build America Bonds ("BABs"), foreign investors and potentially pension funds also are becoming important to the municipal securities market.[68] Those investors do not benefit from the tax-exemption on municipal securities or from tax credits, but reflecting globalization of the financial markets, foreigners are active buyers of U.S. taxable debt, including taxable municipal securities. Given the recent enactment of legislation to convert QSCBs into an optional BABS-style direct pay taxable bond format, CMSD, is able to receive direct subsidies from the federal government, rather than the investors receiving tax credits. Foreign investors and pension funds, as investors in taxable securities, will become much more significant to CMSD. Additionally, as expected tax law extensions for direct subsidy QSCBs and BABs take effect and market conditions evolve, we believe that this development should be kept in mind. A CMSD investor relations program will need to reach this investor population and to educate it regarding CMSD.

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were an attempt to curtail flipping, but board officials said they were meant to clarify that dealers must respect the priority of orders for bonds outlined by issuers, as many issuers have come to rely more on retail order periods to sell their bonds.")

[68] See Seymour, "Muni Market Witnessing the Changing Face of Ownership—BAB Program Bringing in New Kinds of Bondholders" (Bond Buyer Online Dec. 11, 2009), quoted at n. 27.

See also McDonald, "Illinois Seeks Foreign Buyers for Pension Debt as Deficit Looms" (Bloomberg.com Jan. 7, 2010) ("The state also will sell $750 million of taxable Build America Bonds this month for its capital projects. Illinois needs to expand its buying base abroad because it is selling more taxable debt and so is less dependent on traditional buyers of tax-exempt securities in the U.S., [John] Sinsheimer [the state's director of capital markets] said.")

Indeed, even while we were preparing this Report, a new private investor— Cohen & Company Securities, LLC—contacted us on its own initiative seeking direct pay taxable municipal securities (as opposed to tax credit securities) to buy. We gave the firm the name of a CMSD Financial Advisor. This indicates that investors are there, and that CMSD can benefit by reaching out in ways designed to identify them.

See also n. 31 and accompanying text.

Recommendations:

There is little need, given current facts and circumstances, for CMSD to be excessively concerned about the conditions in the municipal securities market. We suggest that planning assume a continuation of the gradual improvements of recent months.

We recommend that CMSD examine closely with its Financial Advisors and Bond Counsel how CMSD will present itself to and seek to attract investors in direct subsidy QSCBs.

The specific market for credit QSCBs is relatively thin and novel.[69] The market conditions for credit QSCBs may evolve, but how fast and in what direction that will occur cannot be predicted. Accordingly, also CMSD should continue to monitor the market for credit QSCBs, it is unlikely that they will provide a better overall borrowing cost than, for example, direct subsidy QSCBs.

Generally, given the increased importance of the retail market, in negotiated sales, we recommend that CMSD reach out actively to retail investors in order to broaden the market for CMSD's securities. In credit QSCB offerings, however, retail investors are unlikely to be a significant factor because the tax credits incorporated into credit QSCBs are complex and uncertain for many individual investors.[70] In sharp contrast, it is

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[69] See Devitt, "Guggenheim Likes the Taste of QSCBs, Even Ones from Detroit" (Bond Buyer Online Dec. 31, 2009), regarding a single investor reported to have purchased roughly half of the QSCBs issued. See also n. 14.

[70] Further, although the credits are to be amenable to "stripping" (separation) from the municipal securities with which the credits are sold initially, federal tax rules governing stripping are yet in

expected that the market for direct subsidy QSCBS will quickly develop. Accordingly, we recommend that CMSD consider with its Financial Advisors means of reaching out actively to foreign investors, as well.

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formative stages. Moreover, a proposal in Congress would prohibit stripping. If that were to be enacted, then tax credit bonds would become even more difficult to sell. See also n. 24.

Debt Enhancement Options

There are several types of credit enhancement used in municipal securities issues. Only two are relevant for CMSD—the Ohio Department of Education's credit enhancement program and bond insurance.[71]

CMSD is able to receive credit enhancement through the Credit Enhancement Program of the Ohio Department of Education.[72] Apart from any "recalibrations" by rating agencies as discussed in this Report,[73] obligations backed by that Program have been rated "AA-" by Fitch Ratings, "Aa3" by Moody's Investors Service and "AA" by Standard and Poor's. Standing alone, CMSD's Bonds have been rated "Baa2" by Moody's and "BBB+" by S&P.

Therefore, CMSD's obligations, particularly with credit enhancement by the Ohio Department of Education, already have excellent ratings. Although CMSD may benefit to some degree from a Bond yield reduction associated with the purchase of bond insurance from a private bond insurer, we recommend that CMSD exercise caution, and consult

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[71] Two others, both costly, include letters of credit, which are used principally for short-term obligations, and collateralization, which would not add significant value to CMSD's own unlimited tax credit. In addition to their costs, letters of credit have been difficult to obtain since the financial crisis led banks to tighten their credit requirements. Collateralization would tie up CMSD funds.

[72] Pursuant to the Credit Enhancement Program of the Ohio Department of Education, a school district essentially pledges its future state operating subsidy against a default on the district's debt obligations. Therefore, if the property tax base or delinquencies were to result in CMSD being unable to make the required payments of principal of and interest on its securities, the Department of Education would make the payments and would reduce CMSD's operating subsidy in the same amount. Rating agencies look to the Department of Education's program as the credit support in the case of enhanced Bond issues.

[73] See the discussion of rating "recalibrations" beginning at page 96.

carefully with its Financial Advisors, in spending taxpayer dollars for private credit enhancement for at least the following reasons—

- Although the number of highly-rated bond insurers was as many as seven in recent years, a substantial number of those companies have experienced significant financial adversity due to poor management and disputed risk evaluation practices that were exacerbated by the financial crisis.[74]

- The number of bond insurers essentially has decreased to one company (which owns two insurers), and after rating downgrades by some rating agencies, that one company's insurers now are rated triple-A by only one major rating agency, S&P.

- Bond insurance prices are rising in the monopolistic environment[75]

- Investors do not have the same confidence in bond insurance as in the past, so that the value of bond insurance is reduced

- While rating agency "recalibrations" of municipal securities ratings are not sufficient, as described by the respective rating agencies, to place

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[74] Some insurers are suing investment banking firms claiming, among other things, that the banking firms misrepresented, and did not disclose to the insurers, material information relating to mortgage-backed securities the insurers insured.

[75] See McGee, "Assured Unrivaled in 2009—Insurer Takes 98% of Market" (Bond Buyer Online Jan. 19, 2010) ("Through its two subsidiaries, Assured Guaranty Ltd. Insured $34.8 billion of municipal debt last year, or 98.2% of the insured market, according to Thomson Reuters. Competition was virtually absent … .")

municipal securities ratings on a fully comparable default risk basis with corporate securities ratings, the "global" ratings for CMSD on a stand-alone basis and as enhanced by the Ohio Department of Education's credit enhancement program can be expected to be at higher levels than their municipal scale ratings, thus decreasing further any value that bond insurance might provide[76]

- Given the 100% subsidy now available to CMSD under the federal direct-pay QSCB program, there would not appear to be value to CMSD from reductions in interest costs once CMSD's interest yields already are below the federally-prescribed subsidy rate published by the Treasury Department

- CMSD would pay for bond insurance a premium that would take into account CMSD's debt service over a long-term, but in connection with a refinancing of the insured securities, CMSD may lose much of any "net" benefit from the original purchase of insurance[77]

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[76] Municipal Market Advisors—Weekly Outlook (March 22, 2010) opined that—

> This [rating recalibration] is not exactly good news for the bond insurers as it will eliminate many safe sector rating scale arbitrage opportunities or, at a minimum, reduce the potential premium issuers will pay to receive the insured rating while not alleviating the capital the insurers must book against the insured risk.

[77] In some cases, bond insurers may agree to insure the refinancing at a lower insurance cost than required for the original bonds, but that lower cost, if any, still would add additional cost above the original cost of insuring the same debt.

- The value of additional enhancement through bond insurance is questionable, particularly if municipal and corporate ratings and associated default risks are disclosed appropriately to investors

- CMSD's utilization of an aggressive investor education program could assist in educating investors about CMSD's stronger credit strength in relation to the higher default risk, discussed below, of corporate triple-A or double-A ratings received by bond insurers

- Bond insurers have been reluctant to stand fully behind the disclosure information they provide for use in official statements in the same manner the insurers demand that municipal issuers stand behind the issuers' disclosure information

- Bond insurers have resisted due diligence investigations by underwriters and others

- Bond insurers are evidencing a more aggressive willingness to sue issuers and other parties with whom the insurers conduct business, which raises the question of whether perceived value otherwise resulting from the insurance, if any, may be offset by the potential risks

- In the event of insurer rating downgrades, CMSD would incur costs associated with filing continuing disclosure notices under its continuing disclosure undertakings as contemplated in SEC regulatory actions

Certain of those issues are discussed further below.

Recent Experience

As a result of events connected both with bond insurer practices and the financial crisis, bond insurance does not have the same value that it once had to investors or to municipal securities issuers, such as CMSD.[78]Today, there is essentially only one active bond insurance company, and as one would expect, the new bond insurance monopoly is raising premiums to issuers.[79]

It has become apparent that there also are hidden potential costs associated with bond insurance. Although the only value of bond insurance to a fixed-rate securities issuer, such as CMSD, is at the time of the securities sale, after their securities issues were completed, tens of thousands of municipal securities issuers incurred unexpected costs associated with bond insurance.[80]

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[78] During the financial crisis, bond investors began to avoid insured municipal securities, which was demonstrated, for example, in the collapse of the auction-rate securities market and by significant difficulties in the variable-rate securities market. Many investors lost significant value and liquidity in those investments.

Although it is not reported widely, investors in fixed rate obligations, even "buy and hold investors" (who do not trade their bonds), also lost enormous market value as a result of bond insurers' financial difficulties and rating downgrades.

[79] See Seymour, "Beefed-Up Assured Is Ready to Rule the Roost" (Bond Buyer Online July 24, 2009) ("Assured Guaranty Ltd.'s business is poised to enjoy a two-pronged benefit—capturing fatter portions of fatter spreads, according to the credit research firm CreditSights. After buying Financial Security Assurance this month, Assured controls the only companies writing any measurable new business in the bond insurance industry. Assured and FSA together captured 83% of the market share during the first half of 2009, according to Thomson Reuters, with nearly $21 billion in insured deals."); Seymour, "Assured's Dominance Peaks As It Nabs 100% of July's Market" (Bond Buyer Online Aug. 7, 2009) ; Seymour, "Assured, the Only Game in Town, Hikes Prices" (Bond Buyer Online Dec. 18, 2009) ("Now that Assured Guaranty Ltd. has cemented a monopoly in bond insurance, it has done what any other monopolist would do: raised prices").

[80] For example, many issuers, including CMSD, found it necessary under continuing disclosure agreements contemplated in SEC regulations to file repeated continuing disclosure reports regarding

Hidden costs to issuers, such as CMSD, associated with bond insurance have become apparent only in the recent past.[81] Some bond insurers asserted that they conducted rigorous due diligence in the transactions they insured. If a transaction truly needed insurance, the general view in the market was that a bond insurer would not insure it, so the insurers were perceived widely as entailing little risk.[82]

Many bond insurers, almost as a group, stepped out of their traditional, limited municipal securities insurance roles and began insuring billions of dollars of mortgage-

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rating downgrades of their securities that occurred solely due to bond insurer downgrades, not through any fault of or loss of credit by the municipal issuers.

Large numbers of other issuers incurred even greater costs as interest rates rose sharply on many auction rate and variable rate securities as a result of bond insurers' rating downgrades. Municipal issuers commonly found it necessary to refinance those securities issues at higher interest rates and to pay substantial additional costs of issuance in the refinancing transactions.

[81] See, *e.g.*, Norris, "A Lack of Rigor Costs MBIA" (nytimes.com Nov. 13, 2009), which states—

> MBIA, the financial insurance company, used to hold itself out as a paragon of hard work and number crunching. 'Each transaction guaranteed by MBIA needs to pass a rigorous underwriting process proving no losses will arise under the worst probable case scenario,' the company said in a typical investor presentation just three years ago. It added that its payouts for claims over 32 years came to less than $10,000 per year for every $100 million of insurance it wrote. 'We expect,' the company added, 'to remain at that level or better.' That expectation was wrong. MBIA's once pristine AAA-rating has now turned into junk and no one wants to buy insurance from the company. … In [a] suit, filed in state court in New York, MBIA details its underwriting process, which does not sound very rigorous.

One Appellate Court described the practices of one insurer in an insured municipal securities issue as an "abject failure to satisfy its due diligence burden." *Financial Security Assurance, Inc. v. Stephens, Inc., et al.*, 500 F.3rd 1276, 1290 (11th Cir. 2007), reversing on rehearing an earlier decision at 450 F.3d 1257 (11th Cir. 2006).

[82] With such a business model and triple-A ratings, it was widely believed by issuers and investors that the bond insurers' potential for financial difficulty was extremely remote. That assumed, of course, that the bond insurers conducted appropriate investigations of the risks of transactions they insured (or later, upon which they wrote credit default swaps). If a bond insurer failed (which few considered possible, given the image projected by some insurers and information various insurers provided to issuers and investors), investors could continue, of course, to look to the underlying issuers for payment of the securities.

backed securities and engaging in credit default swaps.[83] The financial crisis impacted many municipal securities issuers, including CMSD,[84] especially as bond insurers lost their triple-A ratings and, for some insurers, even investment grade credit ratings.

"Net" Value of Bond Insurance

As noted, at one time, there were as many as seven bond insurers rated at the highest rating levels.[85] As of this writing, the supply side of the bond insurance market has almost

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[83] Jim Lebenthal stated in his excellent recently-published book, "Lebenthal on Munis—Straight Talk About Tax-Free Municipal Bonds for the Troubled Investor Deciding 'Yea …' or 'No!'" at 61-64 (Morgan James Publishing, LLC New York 2009), that—

> municipal bond insurers underwrite to a zero loss standard. They have little incentive to go looking for trouble. That's because the rating agencies compel them to reserve capital for each insured issue in an amount depending on how risky it is. The riskier the issue, the more capital that has to be set aside and taken out of play. So, the insurers only guarantee municipal bonds that don't really need it. If a bond really did need insurance, other than to get that triple-A rating and bring down the cost of borrowing, believe me, the insurers would turn it thumbs down. And I ought to know. I was a director of MBIA, the premier municipal bond insurer.
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> After many profitable years of growth carrying coals to Newcastle by insuring bonds that don't need it, we began to get fidgety about our business. The saturation of triple-A bonds was affecting their market value. At some point, the cost of the insurance was going to wipe out the shrinking economic value of having it. We had to look elsewhere for future earnings and our growth.
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> * * *
>
> We forgot that it wasn't our insurance that made municipal bonds safe. Insurance simply made municipal bonds more marketable. Just the way insuring collateralized debt obligations and credit default swaps—and rating them triple-A—would make these enigmatic inventions marketable. …
>
> As we go to press, not only the municipal bond insurance companies but the whole world is unwinding, unleveraging, and writing down those "complicated, risky financial instruments." Nations are crawling out of the attendant wreckage. There's got to be a lesson in what the financial geniuses have brought down on the heads of innocent, risk-averse bystanders. Maybe it's to listen to your inner voice. It's not all that inner. If you can't explain an investment to yourself, it's the security's way of declaring, "I'm not for you:" …

[84] CMSD has been required to make continuing disclosure event filings reflecting that its bond ratings have been downgraded due to the ratings downgrades of both of the bond insurers on CMSD's bonds.

[85] Herman, "Bond Insurers: We Still Have a Future" (Bond Buyer Online June 9, 2009).

disappeared.[86] No bond insurer has the highest rating from each of the three major services.[87]

The proportion of insured bonds issued in the municipal securities market decreased sharply in 2009.[88] Still, bond insurers believe they may have a role to play especially for lesser known and lower rated credits, although some detractors express skepticism.[89]

In retrospect, disparities in the rating process were a key component in those disruptions. As experience and rating agency data demonstrate, the bond insurers' corporate rating categories entail greater default risks than do rating categories of most of the investment grade municipal securities the insurers insure, even likely after proposed

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[86] Seymour, "Assured Wraps Up FSA Purchase, Cements Hold on Industry" (Bond Buyer Online July 2, 2009) ("After closing the deal [acquiring FSA] … Assured is essentially the only insurer writing significant new business.")

[87] "Insurer Ratings at a Glance" (Bond Buyer Online as of Feb. 17, 2010). One rating service, Standard & Poor's, maintained a "AAA" rating on two insurers, but Moody's Investor Service and Fitch Ratings had assigned lower ratings to those companies.

[88] Herman, "Bond Insurers: We Still Have a Future" (Bond Buyer Online June 9, 2009), states, "Bond insurance penetration has plummeted as most of the industry's legacy insurers have seen their formerly triple-A ratings downgraded. Just 12.5% of new issues came to the market with insurance through May 31, compared to a peak of 57.1% of new issues in 2005, according to Thomson Reuters."

Efforts to date to form new highly-rated insurers that would limit their business to insuring municipal securities have not been successful. See, *e.g.*, Herman, "Ambac Postpones Everspan Kick-Off—Capital Raising Talks Not 'Satisfactory'" (Bond Buyer Online June 22, 2009), regarding efforts to create a double-A insurer.

Another insurer, MBIA, split into two companies. One company, intended to be a new municipal bond insurer, is named National Public Finance Guarantee Corp. Herman, "MBIA Public Finance Arm Renamed" (Bond Buyer Online March 27, 2009). To date, the effort has not been successful in achieving triple-A status, as it has drawn litigation.

[89] Herman, "Bond Insurers: We Still Have a Future" (Bond Buyer Online June 9, 2009).

rating "recalibrations" to "global" rating scales. The following table contains data drawn from rating agency default risk statistics based upon rating categories[90]—

	Default Risk	
Rating Categories	**Moody's (10-yr.)**	**S&P (15-yr.)**
Muni Baa/BBB	**0.13%**	**0.37%**
Corporate Baa/BBB	**4.64%**	**7.70%**
Muni Aa/AA	**0.06%**	**0.07%**
Corporate Aa/AA	**0.52%**	**1.20%**
Muni Aaa/AAA	**0.00%**	**0.00%**
Corporate Aaa/AAA	**0.52%**	**0.65%**

An irony, then, as actual experience has demonstrated, is that rating agency practices, together with federal and state regulatory mandates that certain investment companies, insurance companies and other institutional investors invest with an emphasis upon rating categories, rather than upon credit risk, pressured municipal securities issuers to spend large sums to purchase triple-A bond insurance from private companies with

[90] Moody's Investors Service, "The U.S. Municipal Bond Rating Scale: Mapping to the Global Rating Scale And Assigning Global Scale Ratings to Municipal Obligations" at 6-7 (March 2007) (ten-year "Time Horizons") ("the global scale [is] used to rate all bonds outside of the U.S. public finance market"); Standard & Poor's, "Default, Transition, and Recovery: 2008 Annual Global Corporate Default Study And Rating Transitions" at 43-44 (Apr. 2, 2009) (15-year time horizons); Standard & Poor's, "U.S. Municipal Rating Transitions And Defaults, 1986-2009" at 28 (March 11, 2009) (15-year time horizons).

See also Municipal Market Advisors (MMA), "Corporate Ratings for Munis" (Jan. 17, 2008) (citing Moody's and S&P historical default rates by rating category for municipal and corporate securities).

See also beginning at page 96 regarding recent rating agency actions to "recalibrate" municipal securities ratings on "global" scales.

greater default risk profiles than the default risk profiles of the municipal issuers themselves.[91]

In other words, when a "BBB" or "Baa" municipal issuer, such as CMSD (which is actually a "BBB+" and Baa2" issuer), with a Moody's municipal rating default risk of

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[91] Moreover, much of the default risk among municipal obligations relates to obligations significantly different from general obligation bonds (such as CMSD's Issue 14 bonds) or revenue obligations of traditional governmental enterprises (*e.g.*, established water and wastewater systems). Therefore, for an issuer such as CMSD, the default risk is even lower than the category average.

As stated in UBS Wealth Management Research, "Education Note—Municipal bond defaults and bankruptcy: an overview" at 1-2 (Apr. 2, 2009)—

> Recent rating agency studies show that default rates for municipal bonds remain low, with much of the risk concentrated in the housing project and health care sectors. Within each rating category, default rates are far lower for municipals than for corporate bonds or any other sector of the fixed-income markets.
>
> * * *
>
> Statistics compiled over the past 38 years show that municipal bonds with investment-grade ratings (at least BBB- or Baa3) have a record of very low default rates in comparison with virtually every other sector of the fixed income markets. Rating agency default studies show that, during this period, investment-grade municipals as a group have a lower default rate than 'AAA' rated corporate bonds. …
>
> * * *
>
> S&P also finds that default rates vary significantly by sector. Of the 39 non-housing-related public finance defaults between 1986 and 2008 listed in the study, over half are for non-profit healthcare borrowers. S&P recorded 60 housing issue defaults during this period. Most of these defaults were bonds issued to finance multi-family rental housing projects, and of these, 19 were caused by the failure of Executive Life Insurance in 1991 when bond proceeds deposited in Executive Life investment contracts and used as collateral were lost.
>
> * * *
>
> Moody's published similar studies evaluating the default rates of the municipal securities they rate. The most recent was released in March 2007 and covers the period from 1970 to 2006. Their findings are consistent with those of the S&P studies. The 10-year average cumulative default rate for 'A' rated municipal borrowers is 0.03% versus 1.29% for 'A' rated corporate obligations. … Moody's notes that "over 80% of the 41 Moody's-rated municipal defaults since 1970 are concentrated in the not-for-profit healthcare and housing sectors." [Footnote omitted.]

0.13% and an S&P default risk of 0.37%[92] (and in the case of CMSD, with its "AA-" enhanced rating from the Ohio Department of Education, a Moody's default risk of only 0.06% and an S&P default risk of 0.07%) purchased bond insurance from a bond insurer with a double-A Moody's corporate default risk of 0.52% and an S&P triple-A default risk of 0.65%, investors did not receive an upgraded or "enhanced" credit rating, despite the common terminology of the market.

Instead, the investors received only another obligation issuer—the bond insurer—in a corporate rating category with an inferior default risk. A Moody's double-A insurer had a default risk almost nine times the default risk of a double-A municipal issuer, such as CMSD with State credit enhancement. Although the bond insurance companies that are rated at triple-A or double-A levels are determined by the rating agencies to have good credits, the default risk of the bond insurers' triple-A ratings on a corporate rating scale therefore was greater even than the unenhanced default risk of "BBB+"/"Baa2"-rated securities issuers, such as CMSD, on a municipal rating scale (and likely even after "recalibrations"). On a municipal rating scale, the triple-A default risk on a "global" (*i.e.*, corporate) scale appears to be below that of a "BBB/Baa" rating level for an issuer of

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[92] Standard & Poor's presents a more detailed breakdown of default risk by rating category and modifier within rating categories (such as "BBB+", "BBB" and "BBB-" within the "BBB" rating category). Those data show the following 15-year default risks for those rating subcategories, as so modified—

BBB+: 0.24%

BBB: 0.28%

BBB-: 1.09%

Standard & Poor's, "U.S. Municipal Rating Transitions And Defaults, 1986-2009" at 29 (March 11, 2009) (15-year time horizons).

municipal securities backed by governmental credits, but perhaps above a "BBB-"/"Baa3" level.

As stated by Municipal Market Advisors prior to rating "recalibrations"[93]—

> Most municipal bonds are rated on a different, more conservative rating scale than corporate bonds. Triple-A US corporate bonds have up to 10x the historical default rate of single-A munis … . *Neither municipal issuers, nor the individual investors who own the large majority of outstanding paper or fund shares, understand this point.* As a result of the "muni rating scale,"

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[93] Municipal Market Advisors, "Corporate Ratings for Munis" (Jan. 17, 2008).

See also UBS Wealth Management Research, "Education Note—Municipal bond defaults and bankruptcy: an overview" at 1-2 (Apr. 2, 2009), quoted in n. 91.

Municipal Market Advisors—Weekly Outlook (March 22, 2010) stated at 4 that—

> Moody's is emphatic that these changes are not upgrades but re-ratings along a new rating scale. Yet higher ratings WILL broaden the universe of investors willing or able to buy the affected bonds, boosting prices and lowering yields accordingly. First among these investors are individuals, who, besides already holding nearly $1T of munis directly, strongly favor bonds rated at or above Aa3 along the front half of the yield curve. Importantly, the prices and evaluations for current high grade paper may fall somewhat as MMD-eligible trades proliferate across the curve.
>
> * * *
>
> At the same time, these rating changes should facilitate BAB issuance as that product has, so far at least, most benefitted the highest rated issuers … .
>
> * * *
>
> There are also implications for the short-term market.

MMA added—

> there are already arguments being made that, because it doesn't move ratings up as far as the original rating map from several years ago, the new Moody's plan is still not a full reconciliation of municipal and corporate scale ratings. We believe there is something to that argument; however, we also believe that, from this point, it is US corporate ratings which more pressingly need adjustment lower.

> taxpayers likely pay a large premium to access the capital markets (via insurance and rating fees and higher interest rates). [Emphasis added.]

Given default risks of corporate credits, it is little wonder, in retrospect, that so many bond insurers have experienced so much credit difficulty, with five of the former seven triple-A insurers no longer writing insurance and some even unable to pay claims, while municipal issuers (with the usual minimal proportions of defaults by municipalities) are continuing to pay their bills. The vast majority of municipal securities issuers for governmental purposes, like CMSD, continue to perform largely as expected, even with inferior ratings from the faulty rating system, but in actuality a superior default risk.[94] Meanwhile the bond insurers have a very poor record, underscoring the greater risks they present as corporate credits.[95]

Bond Insurers' Emerging Litigiousness

Another cost associated with bond insurance that CMSD should consider is an increased litigiousness by bond insurers.

When they purchase bond insurance, municipal securities issuers, such as CMSD, should understand that they generally not only are *not actually enhancing* the credit of

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[94] See Preston, "Investors Sue Wisconsin City After Steam-Bond Default (Update2)" (Bloomberg.com Sept. 25, 2009) (referring to "Menasha, Wisconsin, the first U.S. city to default since Vallejo, California, filed for bankruptcy in 2008 … ." and adding "No more than one city a year defaults on municipal bonds, according to Richard Lehmann, president of Miami Lakes, Florida-based Income Securities Advisers, Inc., which tracks such events.")

[95] See Keogh, "Company Defaults Rise to Highest Since 1981, S&P Says (Update1)" (Bloomberg.com Dec. 14, 2009) (reflecting the higher risks of corporate debt in contrast with municipal debt defaults in the 1-2% range or less, "[t]he number of global corporate defaults rose to the highest since at least 1981, with 260 issuers failing to pay their debt year-to-date for a rate of 9.77 percent, according to Standard & Poor's.")

their securities by doing so, but they are entering into long-term business arrangements with parties that have a strong financial interest in bringing litigation against the issuers in the event that the insurers must make payments on the insured municipal securities. In addition, insurers have the financial capacity, aggressiveness and sophistication to prosecute complex, hard-fought and lengthy legal actions. Recent experience demonstrates an increasing willingness to do so.[96]

For the first time in the history of the municipal securities market, several pending legal actions involve litigation between bond insurance companies, either as insurers or as swap counterparties, and local governments.

[96] The following legal actions have been brought in recent years by bond insurers in their capacities as bond or swap insurers or as swap counterparties, or in one case, by a private obligor for a declaratory judgment in response to a bond insurer's claims asserted against the obligor for continued premium payments when the obligor did not utilize the bond insurer (which had been downgraded) in connection with a refinancing: *AMBAC Assurance Corp. v. Adelanto Public Utility Authority*, Case No. 09-5087 (SDNY); *NPS LLC v. Ambac Assurance Corp.*, Case No. 08-11281 (D MA) (held for the insurer on a motion for summary judgment); *Ambac Financial Services, LLC v. Bay Area Toll Authority*, Case No. 09-7062 (SDNY); *Bank of New York Mellon, as Trustee, Financial Guaranty Insurance Corp., and Syncora Guarantee Inc. v. Jefferson County, Alabama, et al.*, Case No 08-1703, Complaint filed Sept. 16, 2008 (ND AL); and *In re River Park Square Project Bond Litigation*, Case No. CS-01-0127-EFS (ED Wash.)

See also *Financial Security Assurance, Inc. v. Stephens, Inc., et al.*, 500 F.3rd 1276 (11th Cir. 2007), an action by a bond insurer against an underwriter.

Unwillingness to Stand Fully Behind Disclosure Information or To Cooperate with Investigatory Efforts

Bond insurers expect municipal securities issuers, such as CMSD, to certify both the material accuracy and material completeness of the issuers' disclosure information.[97]

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[97] In 2004, CMSD provided the following certification—

> Except as to the information in the Preliminary Official Statement and the Official Statement under the headings Underwriting, Summary of Certain Terms of the Bonds—Book Entry Method, Security and Sources of Payment—Bond Insurance and in Exhibit A [Text of Legal Opinion], Exhibit B [Book-Entry Method], and Exhibit D [Bond Insurance Policy Specimen] and information on the cover of the Official Statement as to the offering prices for the Bonds, as to all of which no representation is made, on the respective dates of the Preliminary Official Statement and the Official Statement and on the date of delivery of the Bonds to the Original Purchaser (being the date of this certificate), *the Preliminary Official Statement and the Official Statement did not and do not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading.* [Emphasis added.]

It is appropriate for CMSD to certify the material accuracy and completeness of information that CMSD knows or controls. In an era of increasing municipal securities litigation, however, CMSD should consider carefully what information contained in official statements and continuing disclosure documents CMSD actually knows and what it does not know. In that connection, CMSD should consult with personnel within CMSD's organization who have specific knowledge (*e.g.*, CMSD's insurance managers regarding CMSD's insurance programs, CMSD's pension administrators regarding pension programs, and CMSD's human relations managers regarding numbers and classifications of employees, unions, and labor conditions).

In the event that CMSD does not have sound assurance of its knowledge regarding particular information, CMSD should consider with its Financial Advisors and Bond Counsel what CMSD is able to do to gain the necessary assurance. In some instances, that may require investigative steps by CMSD and, in others, may involve investigative steps by CMSD's Financial Advisors and Bond Counsel with information that is communicated by them to CMSD and others in certifications or opinions or other written forms.

Some bond insurers, however, are unwilling to enter into the same certification of their own disclosure information.[98]

In addition to declining to certify their disclosure information fully, many bond insurers were resistant to due diligence investigations of their information.[99]

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[98] For example, in 2004, the following was the substance of the disclosure certification by Financial Security Assurance, Inc. ("FSA")—

> [T]he information contained in Exhibit D set forth under the caption "BOND INSURANCE AND SPECIMEN POLICY—Financial Security Assurance Inc."· in the official statement dated June 24, 2004, relating to the Bonds is true and correct.

Notice that FSA's certification omitted to state that FSA's information did not "omit to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading."

In 2002, the certification of Financial Guaranty Insurance Company ("FGIC") provided—

> The statements described above in the Official Statement relating to Financial Guaranty (with the exception of Financial Guaranty's total capital and surplus which as of June 30, 2002 was approximately $1.01 billion) and the Policy accurately and fairly present the summary information set forth therein and do not omit any material fact with respect to the description of Financial Guaranty relative to the material terms of the Policy or the ability of Financial Guaranty to meet its obligations under the Policy.

The foregoing certification refers to FGIC's certification to "the statements in the Official Statement dated October 15, 2002 relating to the Bonds … under the caption "EXHIBIT D—BOND INSURANCE AND SPECIMEN POLICY."

Notice that FGIC's certification spoke only as to "the material terms of the Policy or the ability of Financial Guaranty to meet its obligations under the Policy," not more generally to financial or other information provided by FGIC for use in conjunction with CMSD's Official Statement.

[99] This is described in a joint publication by the American Bar Association and the National Association of Bond Lawyers, as follows—

> Although a more complete due diligence investigation of the financial condition of credit enhancers is theoretically advisable, such an investigation is typically impractical and often precluded by the credit enhancer's unwillingness to devote sufficient management time and resources to facilitate the investigation.

American Bar Association Section of State and Local Government Law, ABA Section of Business Law Committee on Federal Regulation of Securities, and National Association of Bond Lawyers, **DISCLOSURE ROLES OF COUNSEL IN STATE AND LOCAL GOVERNMENT SECURITIES OFFERINGS** at 190 (3rd ed. 2009).

Recommendations:

We recommend that CMSD exercise significant care in determining whether to purchase bond insurance, taking into consideration not only price and securities yield factors, but all relevant facts and circumstances.

We also recommend that CMSD investigate with its Financial Advisors the potential for an aggressive investor education program to inform investors about the actual credit strength of CMSD's municipal rating scale rating category and the strength of CMSD's unlimited tax general obligation credit. Even after "recalibration" of ratings on "global" scales, CMSD may not be given full recognition by rating agencies with respect to CMSD's true relative credit strength based on default risk. Investors that fully understand CMSD's default risk—both unenhanced and enhanced by the Department of Education—should be less likely to assign significant value to bond insurance.

We also recommend that, if CMSD determines that there is value in purchasing bond insurance on top of CMSD's own credit and the credit of the Ohio Department of Education's Credit Enhancement Program, CMSD obtain satisfactory *full* certification as to both the material accuracy and the material *completeness* (in typical language based

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Regarding the ability of issuers to investigate bond insurers' information, **ROLES OF COUNSEL** adds—

> Furthermore, both municipal issuers and conduit borrowers lack both the expertise and the opportunity to investigate credit enhancers, and there is no evidence that investors believe that such issuers or borrowers should assume such responsibility. Accordingly, the most common approach for such issuers and borrowers is to rely upon the information supplied by the credit enhancer without independent investigation of its accuracy and completeness, while noting in the Official Statement that the credit enhancer is in fact the source of such information.

upon governing antifraud provisions) of *all* of the bond insurer's disclosure information provided (or incorporated from other sources by reference) for use in a CMSD offering. We further recommend that CMSD obtain assurance that the underwriters of CMSD's securities are able to conduct appropriate due diligence investigations of bond insurer information. In addition, we recommend that CMSD negotiate a liquidated damages agreement with any bond insurer that causes CMSD to incur additional costs as a result of a failure to make materially accurate and complete disclosure to CMSD and its investors.

We further recommend that, if CMSD determines to purchase bond insurance, CMSD disclose to potential investors material information regarding the default risk significance of the relative ratings of CMSD and the bond insurer to avoid misleading investors into believing that a double-A (or triple-A) rating for a bond insurer equates with or is superior to the rating resulting from enhancement by the Ohio Department of Education's Credit Enhancement Program, or for that matter, that bond insurance somehow provides a default risk profile that is superior to CMSD's own unenhanced default risk profiles.

CMSD Financial Considerations

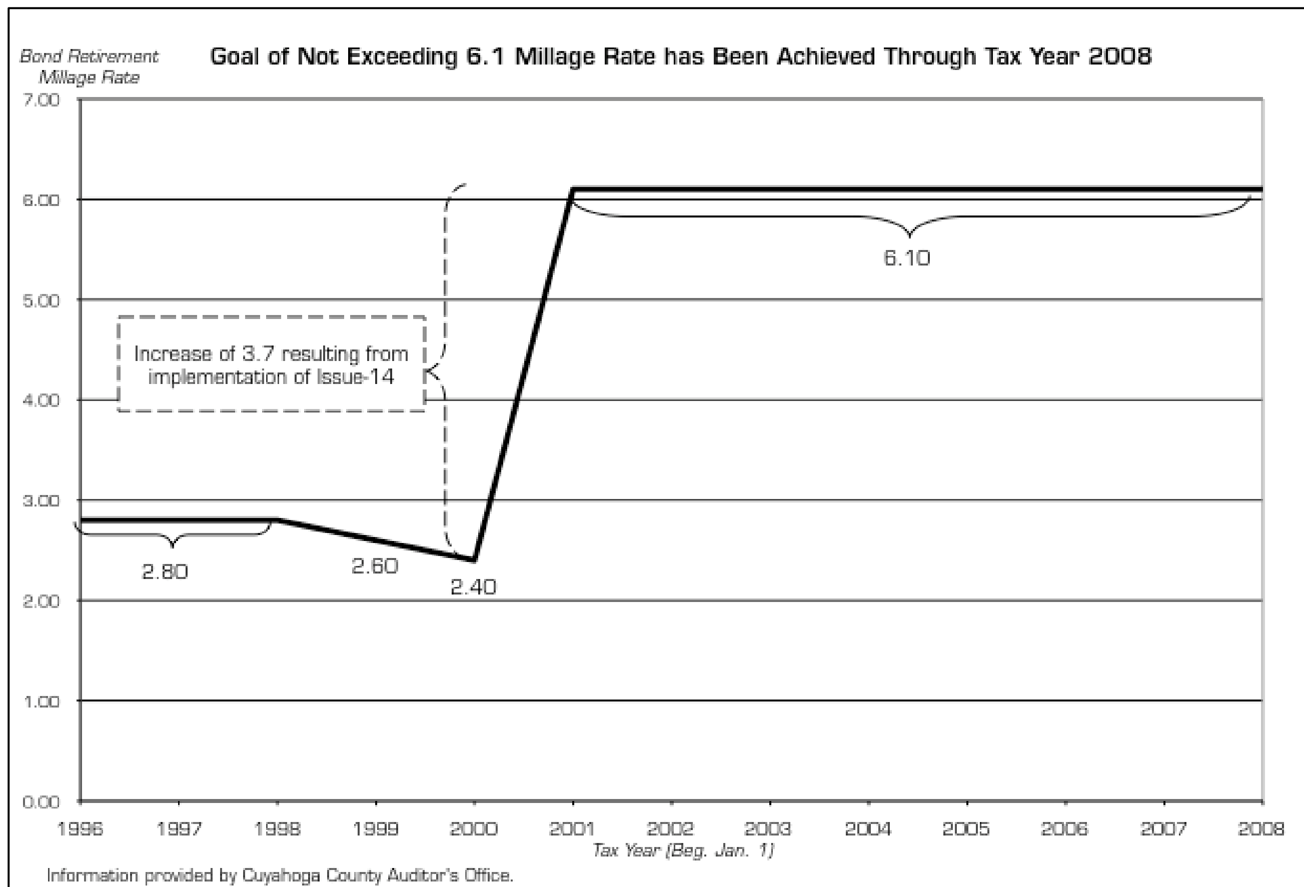
On May 8, 2001, with 60.1% of votes cast, voters approved Issue 14, authorizing the Cleveland Municipal School District to issue $335,000,000 in bonds, and implement a tax levy, projected to average 3.7 mills ($3.70 per $1000 of assessed value, as one mill generates $1.00 per $1,000 of assessed value) over 25 years, to be used to pay debt service on the authorized borrowing. In addition to the 3.7 Issue 14 millage rate approved by voters, the District had an existing 2.4 bond retirement millage rate in place, making the aggregate bond retirement millage rate 6.1. Beyond that, the District receives General Fund revenue from ad valorem property taxes, with a millage rate in place approaching 59.0.

To analyze financial considerations inherent in the District's approach, we need to consider the goals under which the District operates. Beyond that conveyed to voters, according to the District, the overall strategy includes maintaining the aggregate Bond retirement millage rate at the 6.1 target ($6.10 per $1,000 of assessed value) for the District's total Bond retirement tax collection.[100]

[100] The ballot language for Issue 14 was as follows—

> Shall the Cleveland Municipal School District be authorized to do the following:
> (1) Issue bonds for the purpose of renovating, rehabilitating, constructing, furnishing, equipping and otherwise improving school facilities and acquiring and improving their sites, in the principal amount of $335,000,000, to be repaid annually over a maximum period of twenty-five years, and levy a property tax outside the ten-mill limitation, estimated by the County Auditor to average over the bond repayment period 3.7 mills for each one dollar of tax valuation, which amounts to 37 cents for each one hundred dollars of tax valuation, beginning in 2001, first due in calendar year 2002, to pay the annual debt charges on the bonds, and to pay debt charges on any notes issued in anticipation of those bonds? (2) Levy an additional property tax for general on-going permanent

The initial consideration is whether the District has been successful at achieving millage rates within the stated goal. The following chart details historic millage rates for District indebtedness from Tax Years 1996 through 2008. It can be seen that the Bond retirement millage rate increased from 2.40 in 2000 to 6.10 in 2001, the first year of Issue 14 taxation, an increase of 3.70—in agreement with that conveyed to voters, consistent with the District's goal.



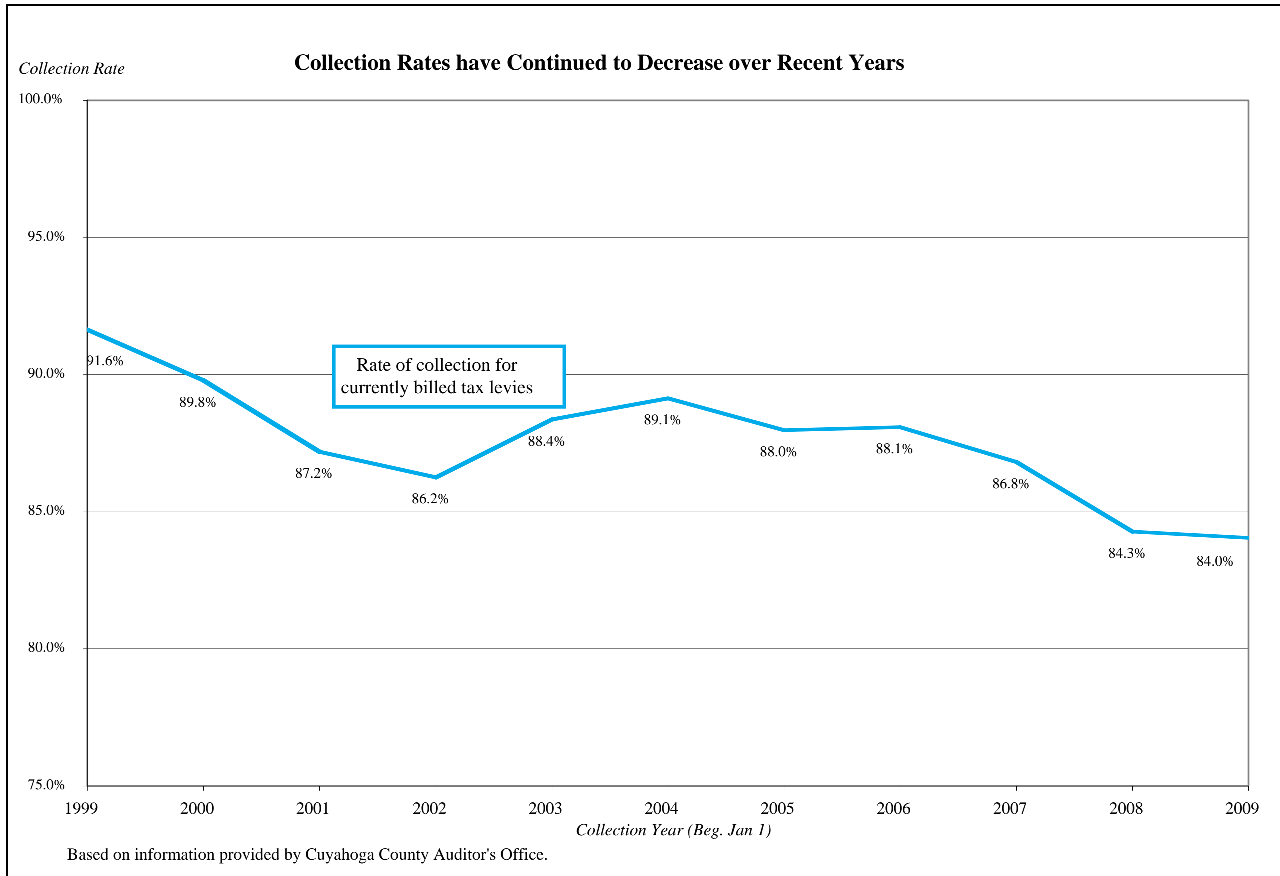
improvements at a rate not exceeding .5 mills for each one dollar of tax valuation, which amounts to 5 cents for each one hundred dollars of tax valuation, for a continuing period of time, commencing in 2001, first due in calendar year 2002?

This note is not intended to present a thorough list of information provided to voters.

Annually, the District determines a budget for the millage rate and provides this information to the Cuyahoga County Budget Commission so that the necessary rate is included in the tax roll. Minimally, the millage rate necessary to repay debt service is calculated by dividing the debt service by the total assessed value. This allows the District to determine, based on assumptions of assessed value growth, how much revenue will be available for debt service payments in future years. Thus, by determining potential tax revenue, the District is able to structure borrowings in such a manner as to over-amortize principal,[101] thus accelerating principal repayment, and to optimize the target millage rate.

Not all property taxes are paid on time. As can be seen in the following chart, collection rates have continued to decrease in recent years. As of collection year 2009, the collection rate was 84.0%.

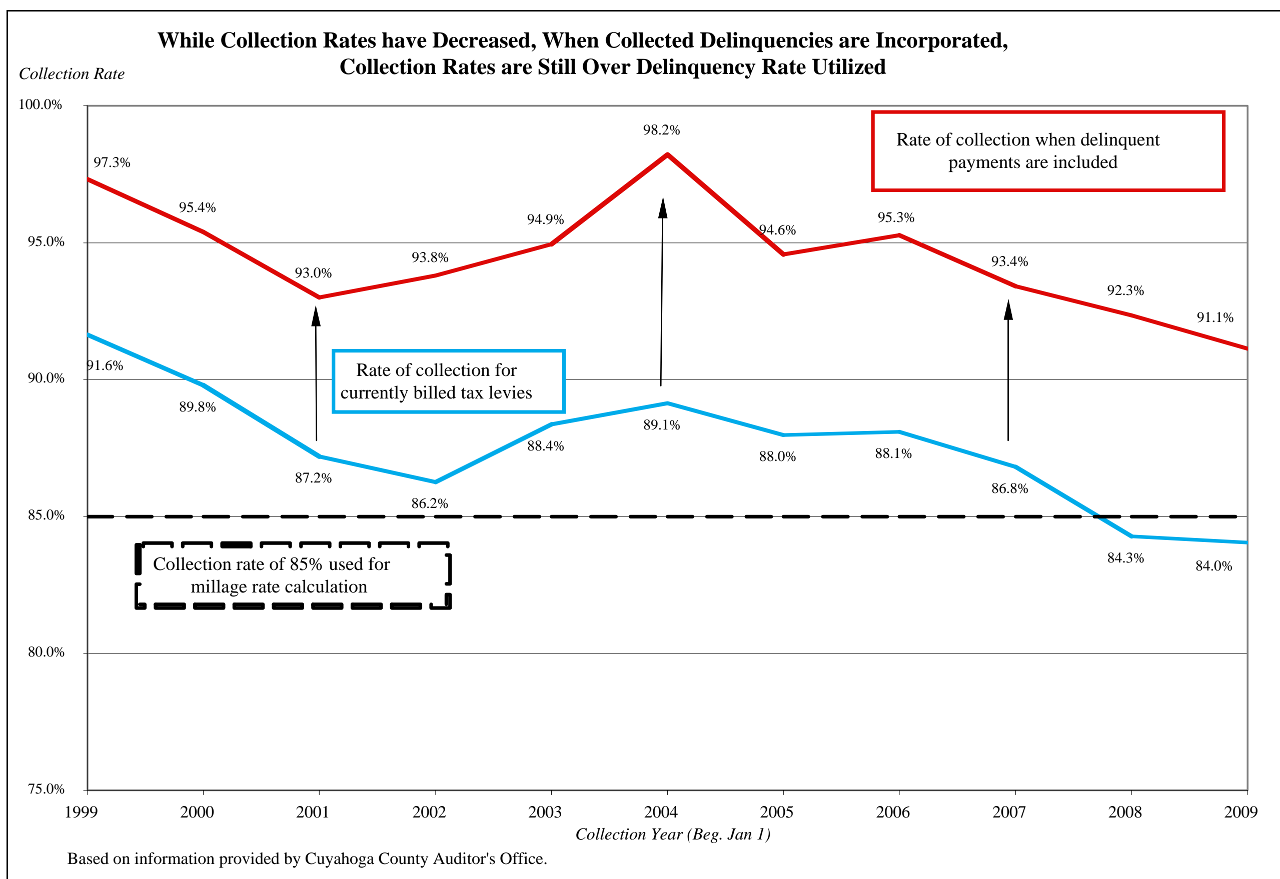
[101] By "over-amortizing," we mean to pay principal earlier than otherwise could be expected under typical conditions, as a homeowner might do by partially prepaying principal on a mortgage. Those payments reduce total principal and interest payable in later years.



To account for delinquencies, according to the District's Finance Department, the District has long opted to incorporate a *de facto* delinquency rate in its millage rate calculation by reducing assumed assessed value by 15%. Therefore, in a modified millage rate calculation, debt service is divided by 85% of the assessed value, thereby ensuring sufficient tax collection even in the event that 15% of taxpayers do not pay their taxes as scheduled.

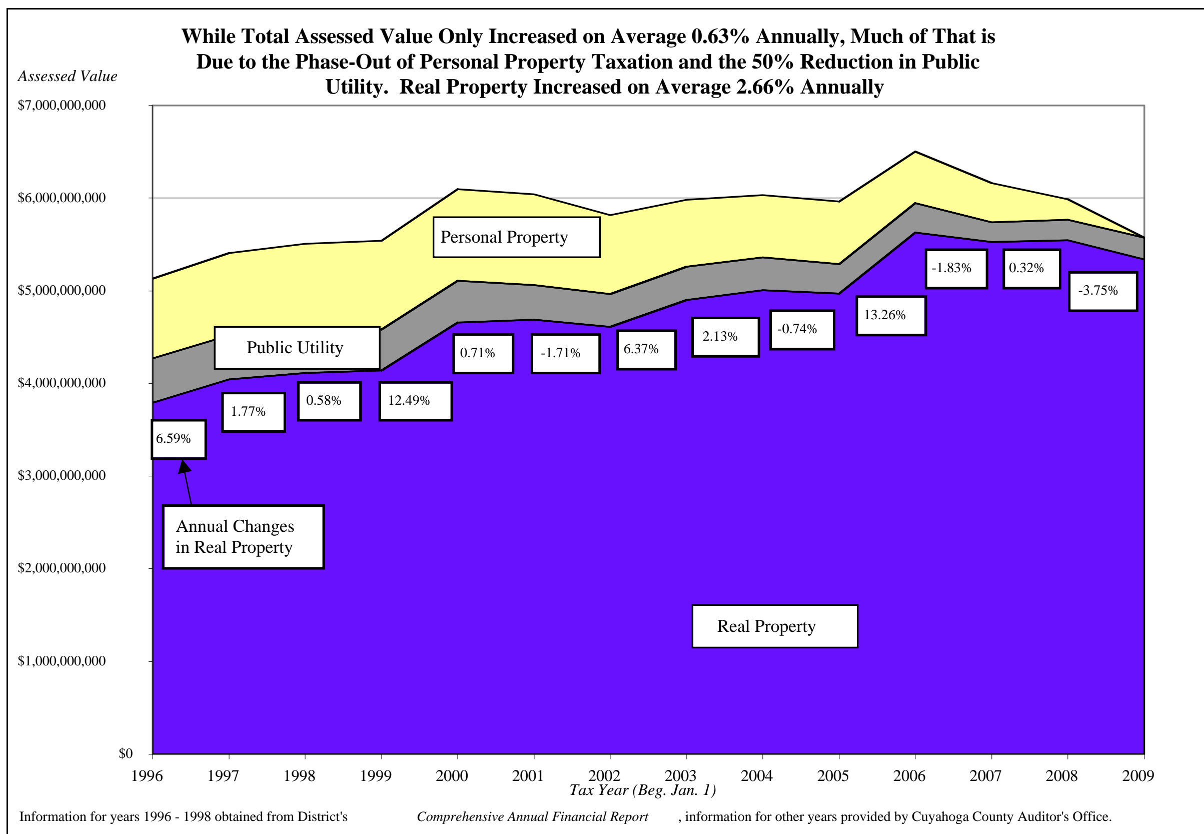
While this practice has worked well in years past, it may seem insufficiently conservative with a current collection rate of 84.0%. However, in addition to current year tax collections, prior years' delinquencies often are repaid. When payments on delinquencies are made, coupled with the actual collections, the total collection amount is

still well above the 85.0% collection threshold. The current total collection rate is 91.1%. This is reflected in the following chart, detailing collection rates since 1999 (represented by the blue line), as well as actual total collections, as represented by the red line. It can be seen that, despite declining collection rates, total collections are well above the assumed 85.0% level shown by the dashed line. Despite ongoing economic hardships, this practice seems prudent.

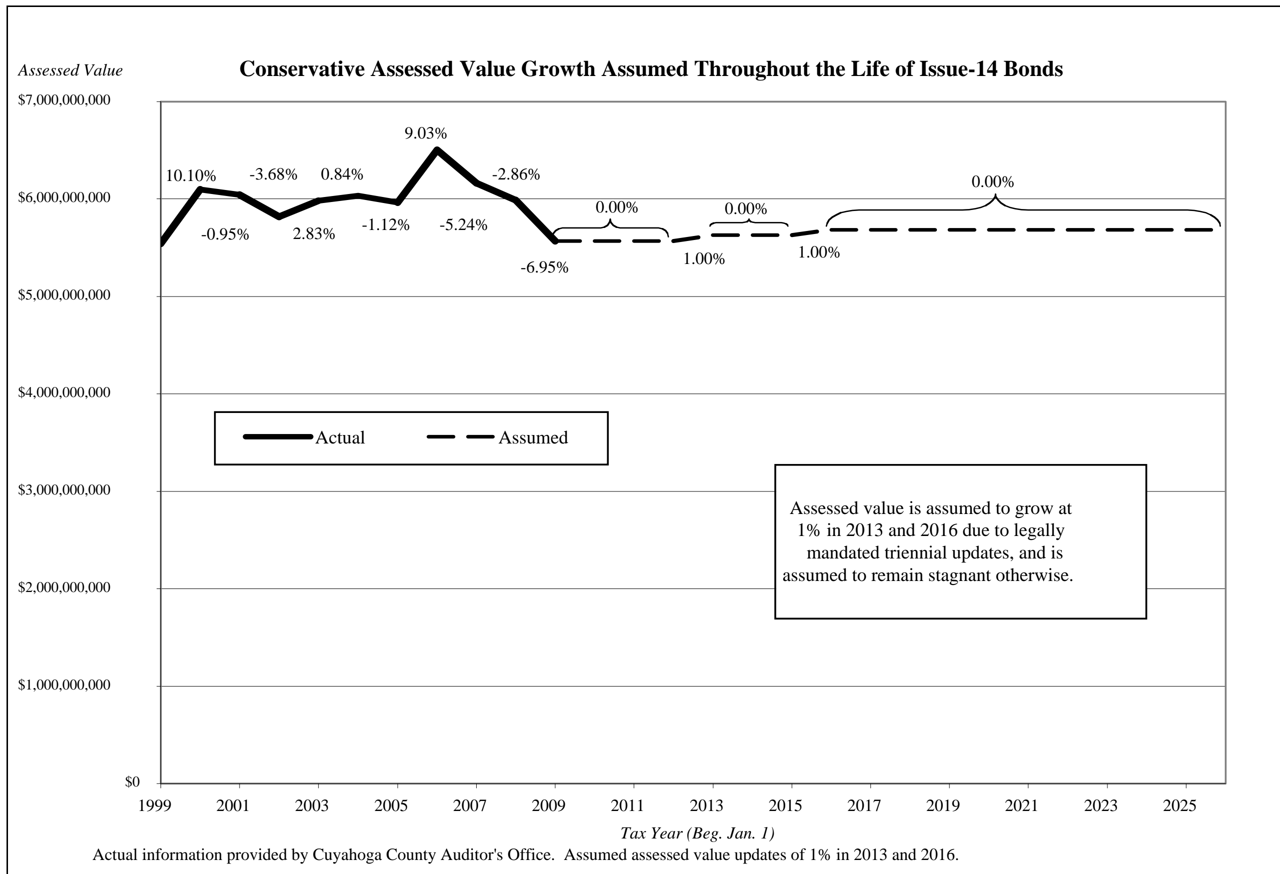


The District is able to determine projected tax revenue by multiplying the desired millage rate by 85% of the projected assessed value. In turn, this allows for the judicious use of tax revenue to maximize low-cost short-term borrowings, thus allowing for the expeditious repayment of principal.

CMSD utilizes additional important planning tools. Optimizing the 6.1 Bond retirement millage rate to support the $335,000,000 authorization requires assumptions regarding the pace of principal amortization and assessed value growth. Current and historic assessed values since 1997 are shown in the following chart, with the purple area representing real property, the gray area representing public utility and the yellow area representing personal property. Total assessed value has increased, on average, 0.75% annually since 1997. This, however, is distorted as tangible personal property taxation has been phased-out in accordance with State law during this time, and public utility assessed value has been cut in half. Despite recent declines, on average, real property has increased at a rate equivalent to an annual steady change of 2.66% during the same period.



According to a *pro forma* projection from the District's Finance Department, for future assessed value projections, the Department assumed an assessed value increase of 1% in 2013 and 2016 during legally required triennial County Auditor updates. These growth assumptions are shown in the following chart, in which the solid line reflects actual assessed value, whereas the dashed line reflects the assumed assessed value.



Despite the downturn in the housing market over the last two years, given the 2.66% average annual growth in real property since 1996, as documented in the chart pertaining to assessed value on the previous page, these assumptions do not appear to be overly optimistic. We acknowledge that the future may not resemble the past, and that it is

important to monitor economic developments carefully, but absent other data, these recent general historical trends are what we can review.

In conclusion, the District's goal of maintaining Bond retirement taxation at the target millage of 6.1 and assumptions regarding tax base growth and tax delinquencies establish constraints on the District's issuance of the debt authorized by Issue 14. The District is seeking at an explicit level to avoid undue taxpayer burdens, and to date, the District has been able to achieve its 6.1 target. How the cash flow needs of the Issue 14 school construction segments are met through borrowing, given these constraints, is addressed in "Cash Flow Considerations" beginning at page 104.

Recommendation:

We recommend that CMSD revisit periodically its assumptions to determine whether they are sufficiently conservative (or overly so) with regard to tax base changes and delinquency rates as the District pursues the issuance of the remaining $55,000,000 in authorized debt, or a potential new bond issue.

Potential Impacts from Credit Rating Changes

Rating agency actions are in a state of flux. Recent data relating to CMSD and its property tax base commonly are indicative of potentially adverse rating actions. On the other hand, due to market pressures from issuers and federal legislative proposals potentially affecting the rating agencies, Moody's (as well as Fitch) are "recalibrating" municipal securities ratings on "global" rating scales. Standard and Poor's states that it has always rated municipal securities on a "global" scale, but has recently been upgrading a substantial number of municipal securities issues.

Potential Consequences of Rating Downgrades

CMSD's recent declines in assessed value and declines in property tax collection rates demonstrate a weakening property tax base. CMSD's forecast of significant operational deficits demonstrates a worsening financial condition. Both of these factors are viewed negatively by the Standard & Poor's and Moody's. Fitch does not rate CMSD's Bonds.

CMSD's 2002 and 2004 bond issuances were assigned credit ratings at 3 levels: (1) CMSD's own credit, (2) credit enhancement by the Ohio Department of Education, and (3) credit enhancement from bond insurance.

In late March 2010, Moody's downgraded CMSD's stand-alone Bond rating from "Baa1" to "Baa2."[102]

Standard & Poor's assigned the following ratings for each level, respectively: (1) BBB+, (2) AA, and (3) AAA. Standard & Poor's has since maintained the credit ratings at these levels, although its most recent action on September 24, 2009 was to change the credit watch outlook on all three levels to "negative," which means the credit rating may be lowered.[103]

It is possible that the deteriorating property tax base and financial condition of CMSD are significant enough to result in a credit rating downgrade, which S&P has of course indicated may happen. The Ohio Department of Education may also be experiencing similar deteriorating conditions as CMSD, and so its credit rating could also be downgraded. Firms offering bond insurance are under severe financial pressure from the more general economic conditions, and may be downgraded further, as well.[104]

A credit rating downgrade may result in higher interest rates on future bond issuances than otherwise would be the case.[105] There would be no effect on the interest rates of CMSD's existing Bonds because the rates were fixed at the time the Bonds were issued. Currently, a one-notch change in an un-enhanced BBB credit rating range results

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[102] Devitt, "Cleveland Schools Cut" (Bond Buyer Online March 31, 2010) ("affects roughly $161 million of debt").

[103] As discussed below, however, S&P takes the position that all of its ratings are made on a single scale, but is systematically upgrading its municipal securities ratings on S&P's "global" scale.

[104] With respect to credit ratings associated with bond insurance, see "Debt Enhancement Options" beginning at page 67.

[105] See, however, n. 16.

in an interest rate change of approximately 20 to 30 basis points (0.20% - 0.30%). A one-notch change in an enhanced AA credit rating range results in an interest rate change of approximately 10 to 25 basis points (0.10% - 0.25%).

We would expect CMSD's future bond issuances to be enhanced by the Ohio Department of Education into the AA range. At this time, we would not expect CMSD's future bond issuances to be enhanced by bond insurance. This is because, among other things, enhancing a credit rating that is in the AA range with bond insurance is generally not cost effective, given the current cost of bond insurance premiums as compared to the interest savings resulting from having bond insurance.

Therefore, we would expect the most likely scenario, if a downgrade were to occur, would be for CMSD's own credit rating to fall only from BBB+ to BBB, and its credit rating as enhanced by the Ohio Department of Education to fall only from AA to AA-. In that event, we estimate that CMSD would incur higher interest rates of approximately 10 to 25 basis points on its future bond issuances.

CMSD's Issue 14 bond and note issuances have totaled $280 million, which leaves $55 million remaining of the $335 million authorization from the 2001 election. As a simple example, assuming a $55 million bond issuance with level debt service repaid over 25 years, the consequence of a 10 basis point increase in interest rates, from 5.00% to 5.10%, would result in a higher total interest cost over the 25-year period of approximately $1 million (from $42.5 million to $43.5 million). On an annual basis, the debt service payments would increase by approximately $40,000 (from $3.90 million to $3.94 million). The consequence of a 25 basis point increase in interest rates, from 5.00%

to 5.25%, would result in a higher total interest cost over the 25-year period of approximately $2.5 million (from $42.5 million to $45.0 million). On an annual basis, the debt service payments would increase by approximately $100,000 (from $3.9 million to $4.0 million).

The simple example above reflects one possible scenario. In actuality, were CMSD to over-amortize its debt repayment, as it has done in the past, the effect of the change in interest rates would be less, due to the more rapid repayment of principal. Conversely, were CMSD to under-amortize and defer some principal repayment, the effect of the change in interest rates would be greater. Were CMSD to issue a smaller amount of Bonds than discussed above, the effect on the interest rates would be less. Similarly, were CMSD to issue more Bonds (as a result of a future successful election), the impact would be greater. If CMSD were to issue Notes instead of Bonds, the impact would be significantly less, since Notes are repaid in one year instead of the assumed term of 25 years in the above example.

Rating "Recalibrations"

In contrast to the potential for rating downgrades, Moody's and S&P are in the process of "recalibrating" ratings on municipal obligations to a "global scale,"[106] which may result in higher CMSD ratings by one or both of those rating agencies.[107]

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[106] Actually, S&P takes the position that it has only one scale, although it has been upgrading large numbers of municipal credit ratings recently.

[107] Due to market pressures and pressures resulting from federal legislative and regulatory proposals, Fitch may also make similar changes.

In March 2010, Moody's announced and that it "will move to a global rating scale for its municipal bond issue ratings so that they are more in line with the ratings it issues for corporate debt, beginning in April" 2010.[108] Municipal Market Advisors opined that "A better retail bid may emerge as there will be an upward migration to double-A ratings from Moody's."[109] The firm also predicted that there would be benefits for BABs "with more double-A ratings."

Moody's announcement reads, as follows[110]—

> Moody's Investors Service will recalibrate its ratings of U.S. municipal bond issues and issuers to its global rating scale beginning in mid-April, the rating agency announced today. The purpose of the recalibration is to enhance the comparability of credit ratings across Moody's-rated universe.
>
> All municipal scale ratings will be recalibrated to the global scale according to a methodology being issued today. The global scale ratings will replace all outstanding municipal scale ratings. Approximately 70,000 sale-level ratings will be subject to the recalibration.
>
> "We are responding to the evolving needs of the market for greater comparability between the ratings of these obligations and those issued by

[108] Hume, "Moody's to Recalibrate Muni Ratings in Mid-April" (Bond Buyer Online March 16, 2010) ("As a result, Moody's will replace all of its 70,000 'sale-level' ratings for outstanding muni bond issues of 18,000 issuers.")

[109] Municipal Market Advisors—Edge (March 16, 2010).

[110] Moody's Investors Service, "Announcement: Moody's US Municipal Ratings to Move to Global Scale Beginning April" (March 16, 2010).

other entities, such as corporations," said Moody's Group Managing Director Gail Sussman. "The recalibration of the ratings represents a move from their expression on one scale to another and does not represent a change in our opinion of the credit quality of the affected issuers," she added. Moody's has used a distinct rating scale for U.S. municipal bonds since 1918.

For new sales during the recalibration period, securities will be rated on the municipal rating scale if the sector (e.g. states, transportation authorities, higher education, healthcare, etc.) has not been recalibrated, and on the global rating scale if that sector has already been recalibrated. This is designed to maintain comparability among like securities during the transition. For local governments, the sector is defined as all local governments in the same state.

During the recalibration process, bond issues and issuers that have been recalibrated to the global scale will carry a (GSR) notation on moodys.com. Moody's other data products will likewise clearly identify which municipal ratings have been recalibrated to the global scale.

A schedule outlining the projected timing of the recalibration for each sector, Moody's global scale rating methodology, and other information

about the recalibration is available on the rating agency's website at www.moodys.com/gsr.[111]

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[111] Contemporaneously, Moody's released a description of its rating methodology entitled "Recalibration of Moody's U.S. Municipal Ratings to its Global Rating Scale" (March 16, 2010), which states among other things—

> Our benchmarking analysis of municipal credits against global scale ratings across the Moody's rated universe will result in an upward shift for most state and local government long-term municipal ratings by up to three notches. The degree of movement will be less for some sectors, most notably in the enterprise sectors which are largely already aligned with ratings on the global scale.
>
> ***Market participants should not view the recalibration of municipal ratings as rating upgrades, but rather as a recalibration of the ratings to a different rating scale.***
>
> This recalibration does not reflect an improvement in credit quality or a change in our credit opinion for rated municipal debt issuers. Instead, the recalibration will align municipal ratings with their global scale equivalent. A key driver for the recalibration is the market's increasing desire for rating comparability between municipal and non-municipal sectors given the growing number of "cross-over" investors active in both tax-exempt and taxable markets.
>
> The following summarizes our conclusions by broad municipal sector:
>
> » State and local government general obligation (GO) ratings: will change by an average of about two notches higher than their current ratings on the municipal scale, with a range of zero to three notches. Ratings at or above Aa3 on the municipal scale will receive less upward movement than those rated below Aa3.
>
> » State and local government sales and special tax obligations: generally will move up by one notch. These obligations are typically secured by broad-based general sales taxes, and narrower restricted-use taxes such as hotel taxes and gas taxes. Special tax pledged revenues are generally more volatile than other broad-based tax revenues and the issuer often has less control in setting the tax rate associated with the pledged revenues. Therefore, debt ratings secured by these revenues will receive less lift in the recalibration than general obligation ratings.
>
> » Housing, healthcare and other enterprise sectors: most will not change because they are already well-calibrated with the global scale. Those enterprise credits that do change will move up by one notch.
>
> Once Moody's U.S. municipal ratings have been recalibrated, they will represent our credit opinion on the global scale for all rated municipal issues and issuers. Any subsequent changes in credit quality will be reflected through upgrades or downgrades on the global scale. [Footnotes omitted; emphasis in original.]

Moody's Rating Methodology then discusses the recalibration in greater detail, including among other things, its anticipated impacts on particular issuer sectors.

See also Moody's Investors Service, "Frequently Asked Questions About The Recalibration Of U.S. Municipal Ratings To The Global Rating Scale" (March 16, 2010)

Fitch Ratings also has announced a "recalibration" of ratings. Although Fitch does not rate CMSD's Bonds on an unenhanced basis, Fitch's action may impact its rating for CMSD's Bonds as enhanced by the Department of Education.[112]

Illustrating the political pressures that have been placed upon the rating agencies, members of Congress expressed positive reactions to Moody's action.[113] Representative Barney Frank (D-MA), Chairman of the House Financial Services Committee was quoted as stating that "'This represents a transfer of money from wealthy investors back to municipalities. This recognizes what we have been saying all along." Two other senior Committee members, Representatives Michael Capuano (D-MA) and Emanuel Cleaver (D-MO), praised the action.[114]

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[112] Fitch Ratings, "Fitch Recalibrates Its U.S. Public Finance State Ratings" (Apr. 5, 2010).

See Seymour, "Fitch Recalibrates 38,000 Ratings" (Bloomberg.com Apr. 6, 2010) ("Fitch Ratings lifted its rating on more than 38,000 municipal bond issues yesterday under a systematic overhaul of the way it assigns grades to the credit quality of state and local governments. The New York-based rating agency hoisted ratings on debt secured by 40 states, the District of Columbia, the Virgin Islands, and Puerto Rico. … Fitch is careful not to call these upgrades. … About 3,750 Cusips not previously rated AAA by Fitch now enjoy the top rating. More than 7,500 Cusips not previously rated AA-plus are now.")

See also Fitch Ratings, "Special Report—Recalibration of U.S. Public Finance Ratings" (March 25, 2010).

[113] Preston, "Moody's Muni Bond Ratings Will Move to Global Scale (Update2)" (Bloomberg.com March 16, 2010) ("The Moody's announcement came a day after Senator Christopher Dodd proposed, as part of the biggest Wall Street regulatory overhaul since the 1930s, that municipalities be assed in the same manner as companies. The same requirement was included in Frank's financial-services legislation last year.")

[114] House Committee on Financial Services, Press Release—"Capuano and Cleaver: Municipal Bonds to be Rated with fairness" (March 17, 2010).

Not everyone was thrilled, however. The California Bond Advisor, a publication directed to retail municipal bond investors, stated on its website[115]—

> According to a Moody's statement, "Our benchmarking analysis of municipal credits against global scale ratings across the Moody's rated universe will result in an upward shift for most state and local government long-term municipal ratings by up to three notches." … The Bond Advisor has commented on this before and lamented losing a century of special guidance for municipal bonds (with "relative" strength being an important factor). We always have noted that muni bonds faced lower default risk than their ratings indicated. The new global scale will reflect this fact, but we believe smaller investors in particular will lose out in evaluating new deals when the change is made. Moody's says the change isn't an "upgrade" for existing issues, but rather a move to a new scale.

In contrast to Moody's (and Fitch), Standard & Poor's (S&P) did not represent, in response to governmental complaints, that it would change its rating approach, asserting instead that it "uses that same rating scale across the structured finance, corporate, and

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[115] California Municipal Bond Investor online, "Moody's to Recalibrate Municipal Bond Ratings to higher levels" (March 16, 2010 ("Fitch ratings will probably follow suit. Standard and Poor's already is raising its ratings right and left as we noted the other day.")

government sectors."[116] S&P then continued a pattern in which it upgraded numerous municipal credits.[117]

This was reflected in November 2009 S&P release stating, as follows[118]—

> Despite tough economic times, the number of U.S. municipalities with 'AAA' ratings has more than doubled since early 2008, to 169. A total of 86 communities joined this group in the 18 months through August 2009. The large increase reflects ongoing modifications to Standard & Poor's Ratings Services' criteria …, and our view of the economic, financial, and managerial strength of these municipalities.
>
> Of the new entrants, 65 were upgraded from our 'AA' rating category, while the debt of 21 communities was initially rated 'AAA'.

At the end of 2009, "[r]esponding to calls from various regulators for rating agencies to be more transparent in their practices," Fitch Ratings published "new rating

[116] Standard & Poor's Public Finance, "Standard & Poor's Reaffirms Its Commitment To The Goal Of Comparable Ratings Across Sectors And Outlines Related Actions" (May 6, 2008).

[117] Preston and Richard, "Municipal Upgrades by S&P Show Inappropriate Scale (Update1)" (Bloomberg.com Dec. 4, 2008) (quoting Matt Fabian, managing director at Municipal Market Advisors, as stating "They're conceding that they've been rating these municipalities inappropriately… . The whole thing is very curious."); Shields, "S&P Boosts Water, Sewer Issuers, Thanks to New Criteria" (Bond Buyer Online Dec. 31. 2008).

[118] Standard & Poor's, "RatingsDirect—Sector Review: The Ranks Of 'AAA" Municipalities Swell Despite Hard Times" (Nov. 3, 2009).

criteria" that Douglas J. Kilcommons, a Fitch representative characterized as not "blazing new trails or earth-shattering … just tweaking certain items and variables."[119]

[119] McGee, "Fitch Releasing New Public Finance Rating Criteria" (Bond Buyer Online Dec. 20, 2009) ("Fitch began releasing the updates last week and all of them—about a dozen in public finance—should be published by the end of this week, spokespeople at the agency said. Two kinds of reports are being updated—master criteria reports, which deal with broad categories such as revenue-supported credits and sector-specific reports, such as those released yesterday on higher education or nonprofit credits. The criteria are based on all the factors one would expect to find.") See, *e.g.*, Fitch Ratings, "Revenue-Supported Rating Criteria" (Dec. 29, 2009).

Cash Flow Considerations

CMSD issues debt as needed to meet the expenditure requirements of a series of facilities projects organized as Segments 1-10. In meeting the expenditure cash flow requirements, the District's overall strategy involves retiring principal as rapidly as possible within the Bond retirement millage target. This is done with the intent to facilitate potential rating upgrades, as well as to allow for capacity within the Bond retirement millage rate target at the time the District might bring another Bond issue before voters. A further consideration is to utilize a phased-in debt issuance approach so as to adhere to IRS spend-down regulations. (While we analyze the phased-in issuance approach herein, whether the District is subject to arbitrage rebate is outside the purview of this analysis.)

Toward the aforementioned goals, the District has implemented a strategy of issuing Bonds and Notes as necessary to fund authorized building projects. With a 68% State match available, in order to initiate each segment, the District needs to demonstrate that it has funds on hand to cover its 32% share, so that the State will release its portion. Further, the District must address "Locally Funded Initiatives" ("LIFs") (additional projects not eligible for the State match). (The LIFs do not benefit from a State-funding match.) Therefore, the District needs to provide funding, adequate to cover its share, and in time, both to begin projects and, as applicable, to receive State matching funds. Thus far, the District has issued $280,000,000 of the $335,000,000 Issue 14 authorization via Bond and Note issuances, leaving $55,000,000 to be issued.

While Bonds are long-term borrowings, Notes are typically no more than one year. Bond issues lock in long-term interest rates, thus facilitating long-term financial planning while minimizing risks of future market fluctuations. With short maturities, Notes carry lower borrowing rates.[120] Issuing Notes gives the District flexibility to reduce or increase the pace of long-term borrowings in response to current conditions. Notes can be refinanced in a cost-effective manner should the need arise.

The following chart shows the Issue 14 Bonds and Notes issuance schedule. As mentioned, $35,000,000 in Notes was issued in 2001 and refinanced along with the 1992 Library Bonds via the 2002 Bond issue that also included $40,000,000 in new money for Issue 14 projects. Further $125,000,000 in new money Bonds was issued in 2004. Notes in the amount of $30,000,000 were issued in both 2005 and 2007, with $15,000,000 of the latter being refinanced in conjunction with an additional $5,000,000 in new money Notes in late 2007. Lastly, Notes in the amount of $15,000,000 were issued in 2008.

The 2005 Notes matured on July 27, 2006; $15,000,000 of the 2007 Notes matured on December 6, 2007; the 2007A Notes matured on July 30, 2008; and the 2008 Notes matured on September 30, 2009. These maturing notes were repaid with property tax revenue.

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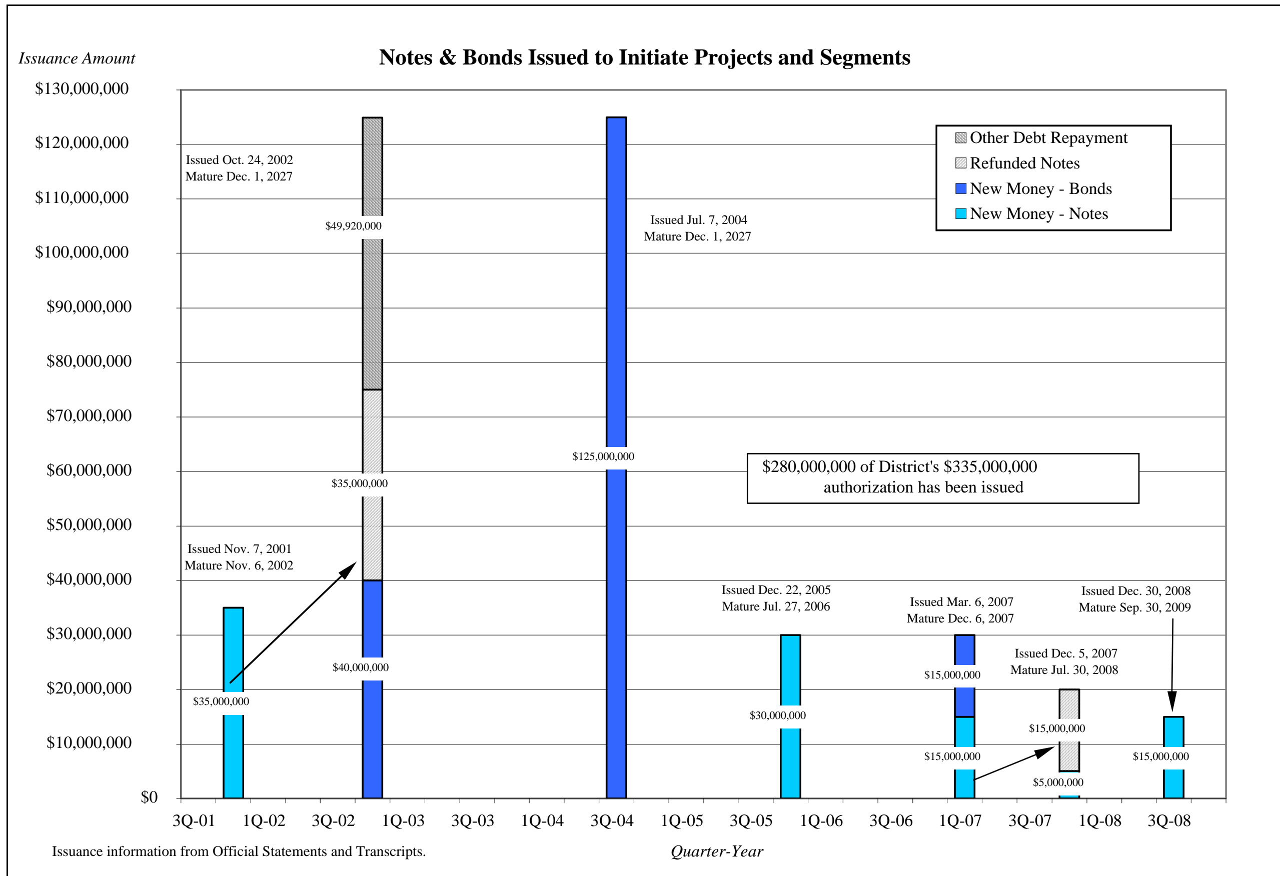
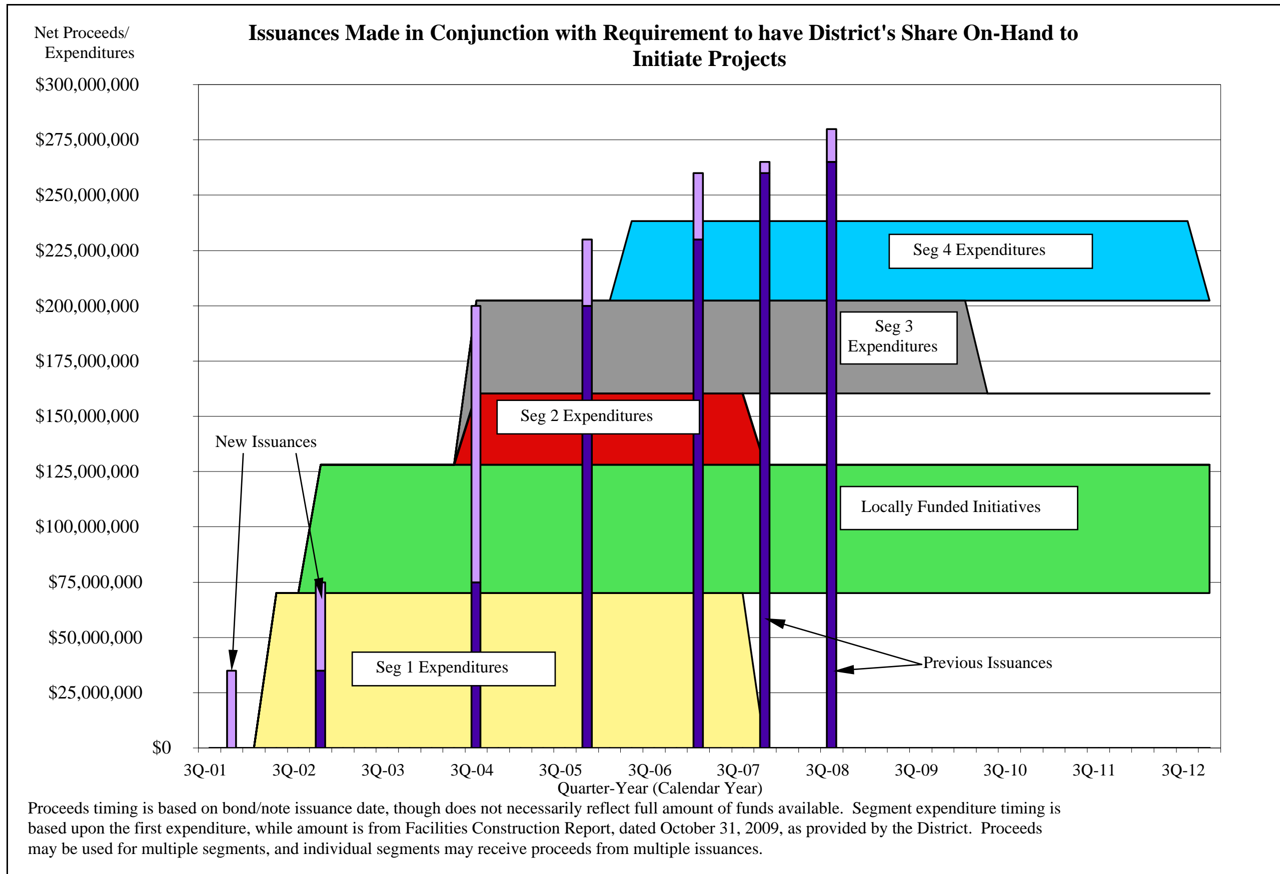
[120] See Seymour, "Despite Success of BABs, Muni Curve Stays Steep" (Bond Buyer Online Jan. 13, 2010) ("At the beginning of 2009, 30-year triple-A municipals yielded 315 basis points more than two-year triple-A munis, based on the Municipal Market Data scale. A year and $64.1 billion of BABs issuance later, the 30-year-over-two-year curve had steepened 40 basis points.") A basis point is 1/100th of a percentage point.



As mentioned, CMSD times its debt issuances to allow facilities projects, or segments thereof, to proceed when needed. Looking at the issuances relative to the initiation of expenditures for Segments –1-4, there is obvious coordination by CMSD, as reflected in the following chart. The columns reflect Bond/Note issuances, with the light portion representing new issuances, and the dark portion representing cumulative prior issuances. The remaining colored areas represent District expenditures and encumbrances (according to the District's Facilities Construction Report dated October 31, 2009), the duration of which reflects the actual or projected completion date for each segment. Certainly, the issuances through the 2005 Notes dovetail with the commencement of segment expenditures. Additional issuances provided additional funds for segments under construction. (The 2008 Notes issuance is in concert with preliminary costs associated

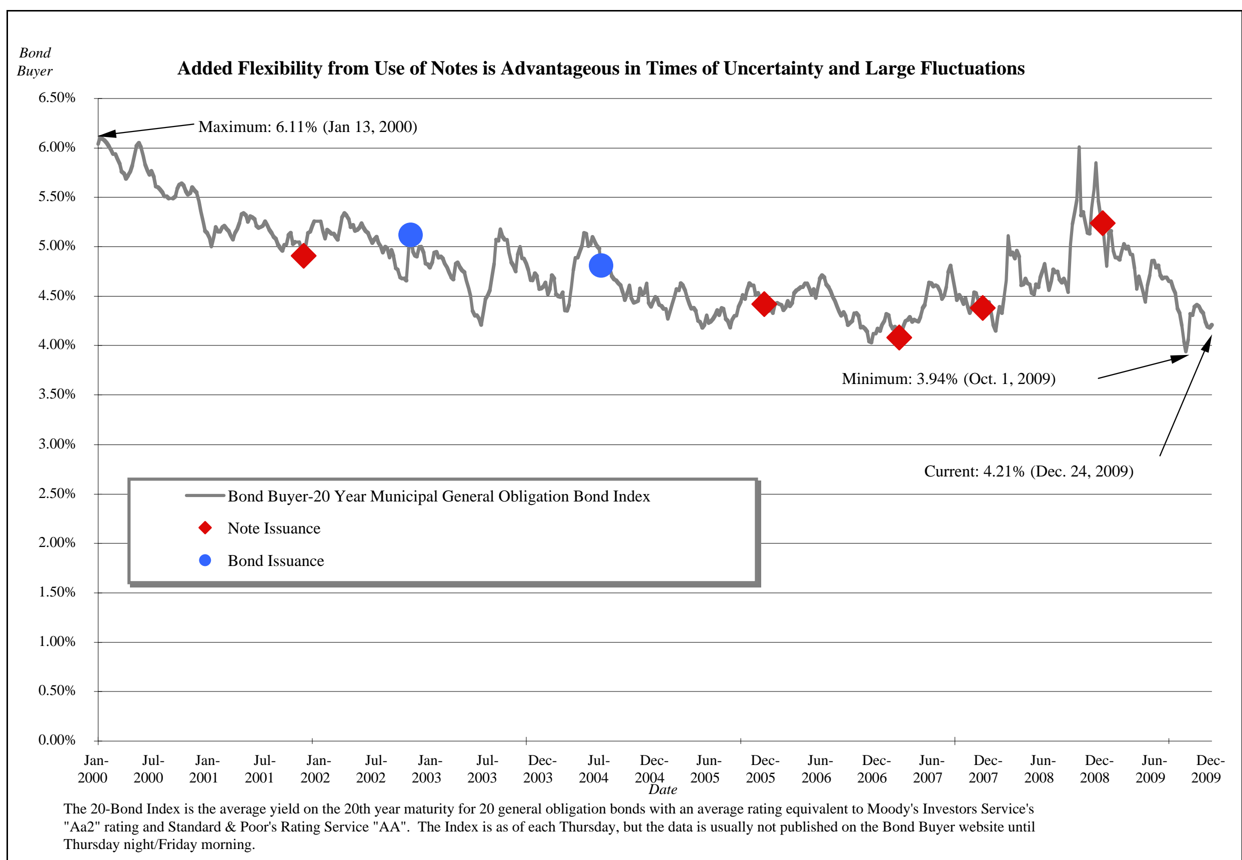
with the commencement of the Segment 5 expenditures that is not reflected on the chart due to insufficient data.) Clearly, CMSD times the issuance of Bonds and Notes to occur in concert with expenditure need.



While we never recommend trying to "time the market," and second-guessing in hindsight is an exercise in futility, there is value in looking at market conditions over the course of Issue 14 to determine whether the issuance strategy has benefited the District.

In that connection, the following chart details market conditions, as represented by the Bond Buyer's 20-Bond Index, consisting of 20 general obligation bonds that mature in 20 years. The average rating of the 20 bonds in the Index is roughly equivalent to Moody's Investors Service's "Aa2" rating and Standard & Poor's Corp.'s "AA." Those

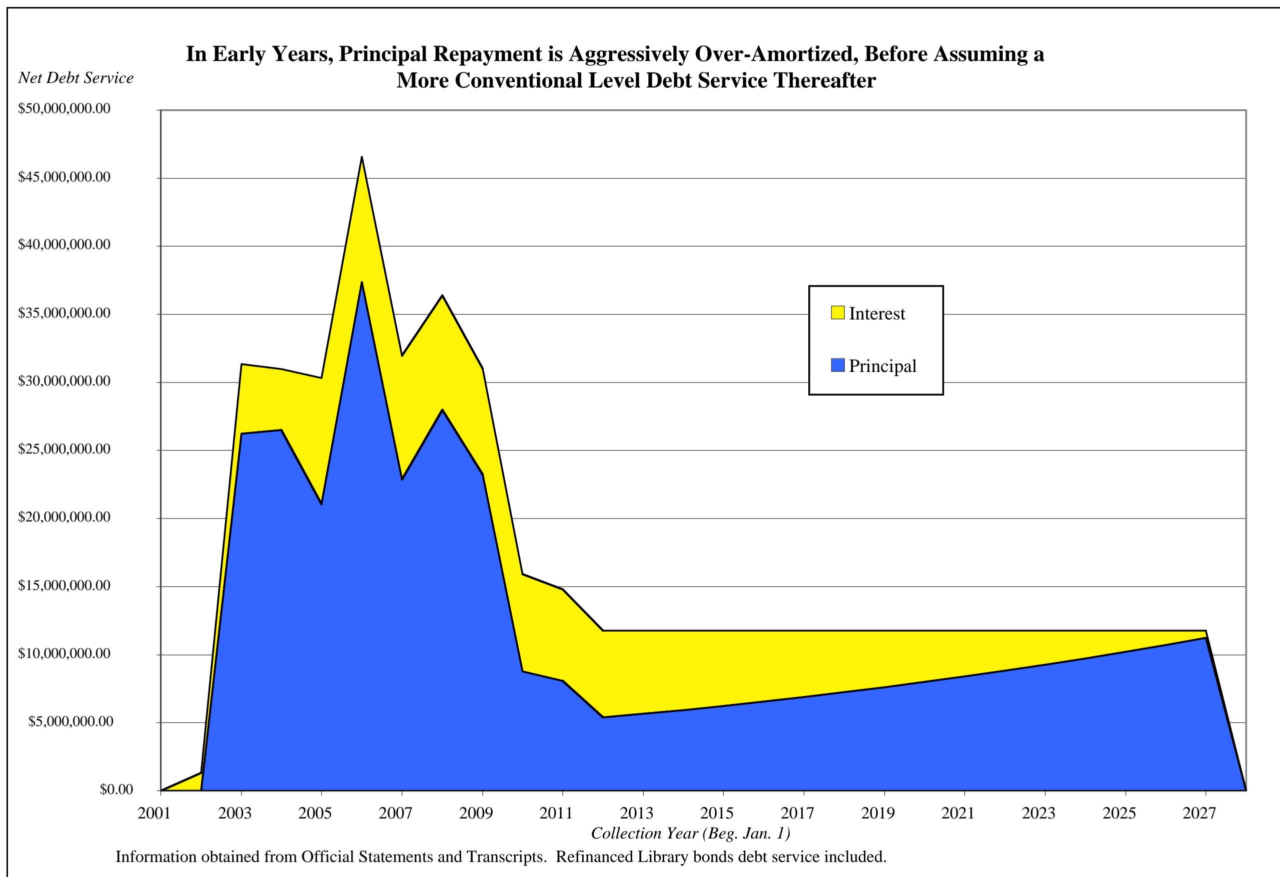
ratings correspond with CMSD's Bond ratings, as enhanced by the Ohio Department of Education enhancement program. The chart shows that yields in the municipal securities market have fluctuated, often considerably. The gray line represents the Bond Buyer 20-Bond Index, whereas the red diamonds reflect the timing of CMSD's Note issuances, and the blue circles reflect the timing of CMSD's Bond issuances. The use of Notes adds a level of flexibility to the District's financing options. Particularly in times of uncertainty, any additional flexibility can only be viewed positively.



The 20-Bond Index is the average yield on the 20th year maturity for 20 general obligation bonds with an average rating equivalent to Moody's Investors Service's "Aa2" rating and Standard & Poor's Rating Service "AA". The Index is as of each Thursday, but the data is usually not published on the Bond Buyer website until Thursday night/Friday morning.

Delving into the structure of the Bonds shows an unconventional repayment structure that is entirely consistent with the District's stated goals. The following chart reflects net debt service on the Issue 14 Bonds and Notes, with the blue area representing the principal component and the yellow area representing interest. (The refinanced

Library component of the 2002 Bonds is included, as it could not be extracted easily.) It should be noted that $55,000,000 in remaining Issue 14 authorization is outstanding and is not taken into account in this analysis. Net debt service is the total debt service of all Issue 14 borrowings, less any refinanced component, less any premium paid for the issuance (which is assumed to be applied at the first opportunity). It can be seen that debt service in general, and principal in specific, is pushed forward ("over-amortized"). This is due primarily to repayment of the Notes, yet a portion is undoubtedly from the Library Bond component of the 2002 Bonds.



This over-amortized structure permits the District to utilize the full millage rate over the first part of the borrowing. After the Notes are repaid, debt service drops dramatically

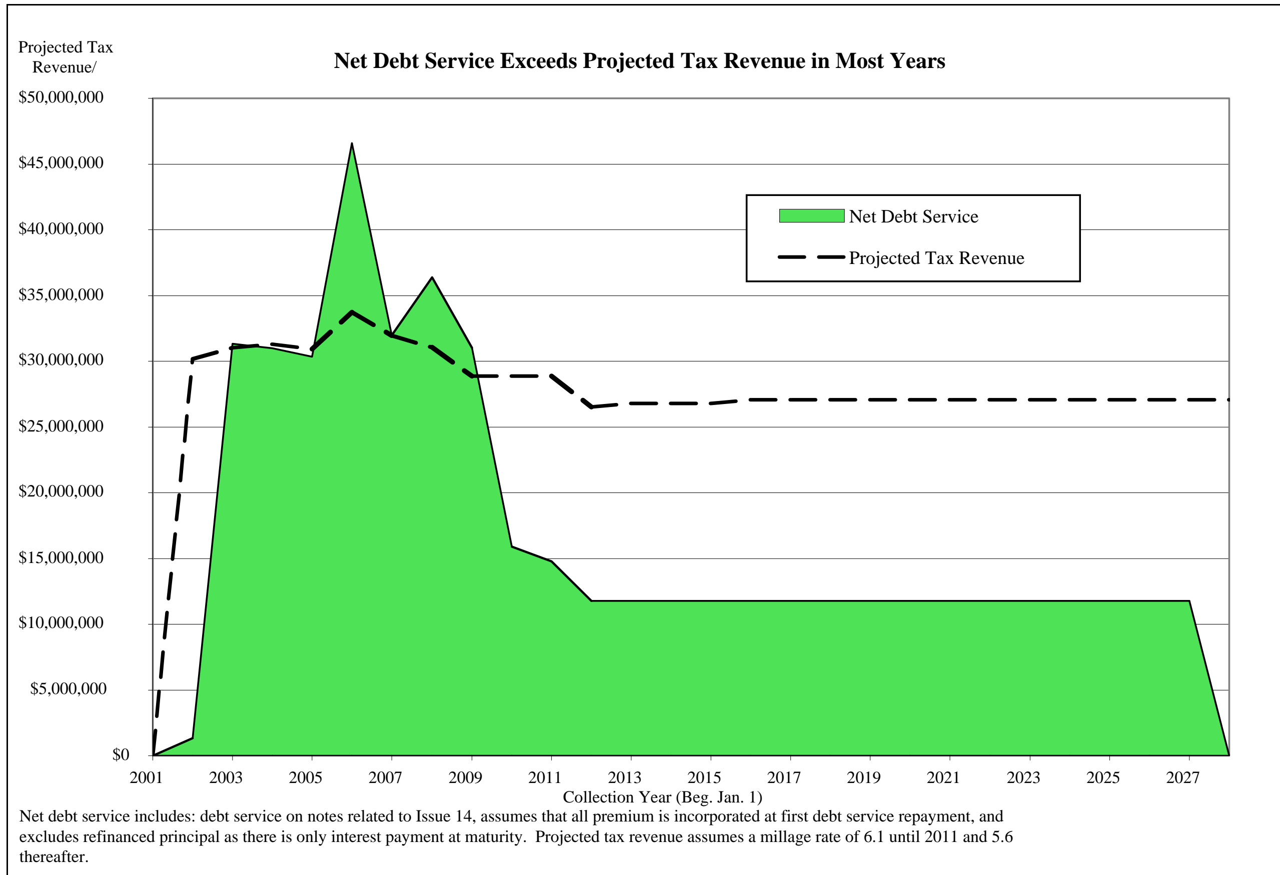
and is smooth thereafter, retaining a more conventional structure. As we discuss further below, assuming there is no precipitous drop in expected tax revenue, this reduced debt service will not require the full 6.1 target millage rate. In turn, this differential between the target millage rate and CMSD's need for project funds will be in effect if and when the District opts to put another Bond proposal on the ballot to complete the projects associated with Issue 14 in accordance with the District's goals.

Of course, the above structure will be viable only if CMSD receives sufficient revenue to repay the debt service. We are able to project potential tax revenue by applying the desired millage rate to the assumed assessed value. The currently desired millage rate of 6.1 is assumed to decrease by 0.5, beginning with collection year 2012, as a result of the repayment of the Library bonds. When the desired millage rate is applied to the assumed assessed value (which we assume to grow 1% in 2013 and 2016 during the mandated triennial assessed value adjustment, with all other years assumed to be stagnant), we are able to project potential tax revenue. To be conservative, we assumed that the revenue stream will experience delinquencies of 15%, and we did not include payments on delinquent taxes. We also maintained the millage rate at the target rate of 6.1%.

The results of our projections are reflected in the following chart, which is a theoretical exercise to determine the viability of CMSD's strategy throughout the life of Issue 14. As such, we are looking at revenue versus debt service from the onset.

As shown in the chart, in most years there is ample tax revenue at the 6.1 millage rate to repay CMSD's debt service. In collection years 2003 and 2006 through 2009,

CMSD's debt service exceeds its projected tax revenue. We assumed that accumulated tax revenue is used to address annual net debt service in the years in which net debt service exceeds tax revenue. After collection year 2009, CMSD's revenue at the 6.1 millage rate far exceeds debt service.

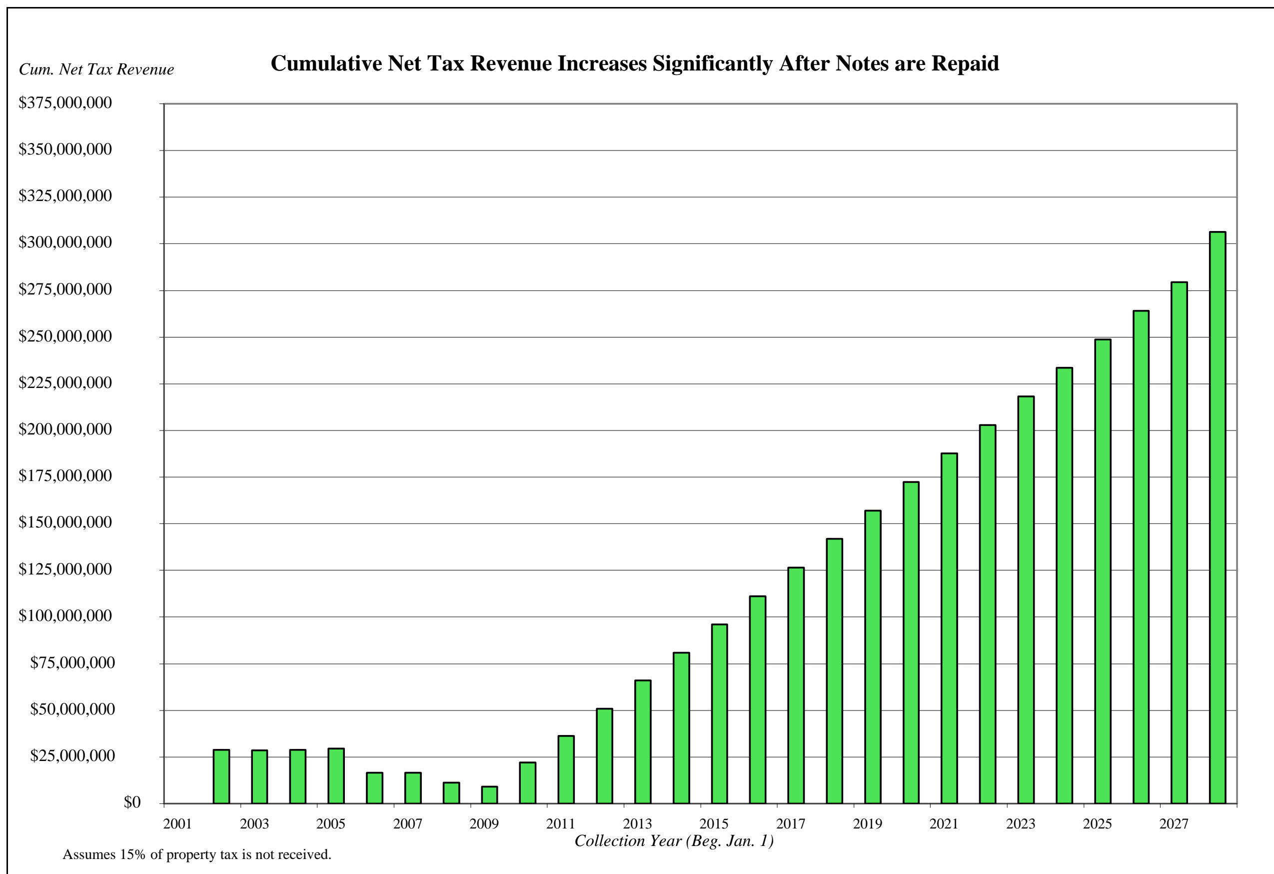


Net debt service includes: debt service on notes related to Issue 14, assumes that all premium is incorporated at first debt service repayment, and excludes refinanced principal as there is only interest payment at maturity. Projected tax revenue assumes a millage rate of 6.1 until 2011 and 5.6 thereafter.

In CMSD's approach, by applying CMSD's tax revenue not needed for current CMSD debt service to pay the next debt service payment, CMSD has been able to avert shortfalls in tax revenue, while adhering to the District's goals. The District thereby has been able to maintain the 6.1 millage rate and to over-amortize principal to accelerate the repayment (and thereby to reduce future principal and interest payments). The District is

able to utilize all tax collections and to apply excess balances to debt service in succeeding years in which annual revenue is insufficient to pay annual debt service.

As shown in the following chart, after the spikes in debt service, cumulative net revenue would increase significantly. This is available to support the issuance of the remaining $55,000,000 authorization, and/or can permit a reduction in the millage rate necessary to repay the outstanding 2002 and 2004 Bonds. Additionally, the millage rate could be maintained at the targeted level to support the repayment of any subsequently approved Bond.



The only obvious flaw in the structure is that while the Issue 14 ballot language stated that principal would be repaid "over a maximum period of twenty-five years,"

principal is scheduled for repayment over 26 years. Refinancing the bonds with a final maturity no later than 2026 would rectify this. Alternatively, debt service may be discharged by repaying the Bonds with excess tax revenue after the prepayment restrictions have lapsed.[121]

In summary, the District's borrowing structure strategy seems to have worked well from a cash flow perspective, while adhering to the District's goals of rapid repayment of the Bonds within the targeted millage rates.

[121] CMSD's Bonds are permitted to be prepaid beginning ten years after issuance.

Financing Options Under Federal Law

The following discussion of federal tax-credit and taxable bond options is provided by the Law Office of Perry Israel—

This section outlines the federal tax requirements for five financing alternatives for the Cleveland Metropolitan School District that provide subsidies through the Internal Revenue Code.

A. Tax-Exempt Governmental Bonds

The historic subsidy provided by the Internal Revenue Code for public school purposes is tax-exempt bonds. The benefit of this vehicle is lower borrowing costs provided through the mechanism of allowing the bondholders to exclude from federal gross income the interest paid on the bonds. Tax-exempt bonds issued for the purposes of schools are issued as "governmental" bonds (as opposed to "private activity bonds"). To qualify the bonds as tax-exempt, the issuer must not use more than 5% of the proceeds of the bonds for private business use purposes (so, for example, the ability of the school district to lease after-school or summer use of financed facilities to private entities is limited). In addition, the proceeds must generally be spent on items treated as "capital expenditures" for federal tax purposes, although there is limited ability to spend proceeds on related working capital or to issue short-term tax-exempt debt to provide cashflow financing. Tax-exempt bonds can be issued for new money purposes or to refund previously issued debt. The investment of the proceeds is constrained by the "arbitrage" rules, which generally provide that proceeds can only be invested temporarily (typically,

no more than three years) pending their expenditures and "arbitrage profits" earned by investing at above the yield on the bonds must be remitted (or "rebated") to the federal government unless the proceeds are spent on an expedited basis. There are no volume restrictions on the ability of a state or local government to issue tax-exempt governmental bonds.

B. Qualified School Construction Bonds

A relatively new type of bond that can be used by school districts is qualified school construction bonds ("QSCBs"). Under federal tax law, depending upon an election by the issuing school district, a holder of QSCBs may receive a periodic tax credit to reduce federal income tax liability rather than tax-exempt interest (a "credit QSCB"). The amount of the credit is set at the time the credit QSCBs are issued and based upon a percentage periodically published rate by the Internal Revenue Service and designed to allow the credit QSCBs to marketed at par with no current interest payments. (In practice, for bonds paying the tax credit to investors, issuers usually have to add an additional amount of interest to successfully market the credit QSCBs at par.)

Alternatively, pursuant to legislation recently signed by the President, the issuer may elect to receive the subsidy payment directly, as is the pattern set for Build America Bonds ("BABs"), discussed further below.[122] Based upon the market's experience with

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[122] Schroeder, "Obama Signs BABified Jobs Bill" (Bond Buyer Online March 17, 2010) ("The Hiring Incentives to Restore Employment Act allows issuers of qualified school construction bonds, qualified zone academy bonds, new clean energy bonds and qualified energy conservation bonds to opt to receive direct subsidy payments from the federal government instead of offering investors a tax credit. … Issuers of the school bonds that opt for the direct-pay mode will receive payments equal to the lesser of the actual interest rate of the bonds or the tax-credit rate for muni tax-credit bonds, which the Treasury sets daily.")

BABs, we feel sure that the "direct subsidy QSCB" will be a more cost efficient option for CMSD. The amount of the subsidy paid by the federal government is the lesser of the otherwise applicable credit rate and the actual interest rate on the direct subsidy QSCB.

The Internal Revenue Service also sets maximum maturities for both types of QSCBs. The maximum credit rate and maturity as of March 26, 2010, are 4.39% and 16 years.

There is a volume limitation on the amount of QSCBs of either type that can be issued. The Cleveland Municipal School Board received a direct allocation of $53,145,000 in QSCBs for 2009 and, if desired, could have sought more volume allocation from the State. In addition, CMSD received an allocation of $51,058,000 in 2010.[123] It should be noted that any allocation for 2009 not used in 2009 could have expired, and CMSD apparently did not have the ability itself to carry the allocation forward to 2010. By contrast, ARRA specifically allowed the State to carry allocation for 2009 forward to next year. CMSD transferred that allocation to the State of Ohio, and the State carried it forward (with the understanding that the allocation would be reallocated back to CMSD in 2010) as a way of preserving CMSD's 2009 volume cap.

See also the text accompanying n. 18.

[123] CMSD currently plans to use its 2009 QSCB allocation for all or most of a CMSD bond issue in 2010 in the approximate principal amount of $55 million.

The allocation to the States with respect to volume cap available in 2010 also resulted in an award to the State of Ohio of a $293,763,000 allocation. Hume, "Treasury, Education Departments Release QSCB Allocations" (Bond Buyer Online March 17, 2010), with tables of "2010 Allocations to States of Volume Cap for Qualified School Construction Bonds" and "2010 Allocations to Large Local Educational Agencies of Volume Cap for Qualified School Construction Bonds."

As mentioned, pursuant to the alternative in which the tax credit is paid to investors at the election of the school district, the holder of credit QSCBS gets periodic tax credits and the only cost to the issuer is repayment of the principal and possibly a small supplemental coupon.[124] In the alternative, the issuer may elect to receive a direct subsidy

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[124] The recent experience of the City of Milwaukee illustrates the necessity for a supplemental coupon in selling QSCBs prior to the enactment of federal legislation offering CMSD the option to receive federal subsidy payments directly, as with BABs. The following description is based upon interviews conducted by AGFS with the City of Milwaukee finance officials who were intimately familiar with the details of the transactions.

The offering was required by Wisconsin law to be competitively bid, although if the City rejected all bids, as ultimately occurred, the law permits negotiation. Milwaukee received only one bid in Milwaukee's first effort. The sole bid was submitted by JP Morgan at a total return of 7.71%, taking into account a federal QSCB tax credit subsidy that would have been payable to the investor, a "slight" discount (*i.e.*, a price less than the full principal amount) and a supplemental coupon providing additional interest to the investors beyond the benefits represented by the federal tax credits. As noted, the Treasury Department publishes subsidy data that is subject to change on a daily basis.

The City considered that bid to be unsatisfactory, and counterproposed to JP Morgan for a lower return. JP Morgan rejected the City's counterproposal. In the City's view, a key reason for the failure of the competitive bid was inventory concerns of a number of underwriting firms relating to QSCBs.

The City of Milwaukee attempted another competitive bid for the Milwaukee Schools' QSCBs on December 15, 2009, allowing underwriters to submit partial bids. Based upon a second conversation with staff of the Comptroller's Office (confirming a news report), Milwaukee received aggregate bids for $27 million of the QSCBs, and accepted $12 million of the bids. See Shields, "Milwaukee Delays Most of QSCB Deal" (Bond Buyer Online Dec. 16, 2009). Although the yields accepted were a bit higher than the 7.71% yield bid by JP Morgan a week earlier, the Treasury Department's QSCB subsidy on the date of the second bid process was also several basis points higher. As a result of the higher federal subsidy, the supplemental coupon of 1.48% (providing supplemental interest to investors beyond the tax credit benefits under federal law) was lower than JP Morgan had bid earlier and was within the range that the City had sought.

The City of Milwaukee staff remained of the view that negotiation was better for QSCBs until the market for QSCBs became better established and sales forces became better educated as to how to sell QSCBs. We note, however, that the Milwaukee Comptroller's Office, however, strongly favors competitive bids for commoditized highly-rated tax-exempt general obligation bonds, which by their inherent characteristics are easy to sell in the market. Milwaukee did negotiate one sale during the market crisis due to uncertain market conditions, and would also do so for refundings to allow for last minute adjustments in cash flows.

Milwaukee was hopeful that there would be a smaller supply of QSCBs in January (since many school districts were rushing QSCB offerings into a limited market in December 2009 in order to preserve their federal QSCB allocations before the allocations expired at the end of the year). An environment with a smaller supply in the market might have been more favorable for an offering.

In a subsequent conversation with the Milwaukee Deputy Comptroller, we learned that the City had delayed further in offering the remaining balance of the bonds due to legislation pending in Congress to alter the subsidy structure for QSCBs to a Build America structure involving payment of direct

from the federal government equal to the lesser of the otherwise applicable credit rate and the actual interest rate on the QSCBs, with the investor in the QSCB receiving only taxable interest and no tax credit. In addition, arbitrage rules apply to both types of QSCBs that limit the ability to invest the proceeds of the QSCBs at yields in excess of the yield on the bonds. In practice, most proceeds of QSCBs will qualify for exceptions to the arbitrage rules.

The programmatic requirements for both types of QSCBs are fairly easy to meet. No more than 2% of the proceeds may be used to pay costs of issuance, and the rest of the proceeds must be used to construct, rehabilitate, or repair a public school facility or used to acquire land on which a public school facility will be built using additional proceeds of the QSCBs. Unlike QZABs,[125] proceeds of QSCBs cannot be used to pay for equipment or for training; however, the proceeds may be spent with respect to any public school facility, and there is no requirement of a special program or participation of local businesses. One special requirement for QSCBs does apply, but this seems fairly easy to meet: The issuer must certify that any applicable conflicts of interest requirements provided by state or local law have been met with respect to the bonds and the projects.

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subsidies to the School District. See n. 24. A new sale will be offered once the outcome of that legislative effort becomes known. Under Wisconsin State law, due to the passage of more than 30 days since the attempted competitive bid sales in December 2009, there would be a need for another attempt to conduct a competitive bid. The Comptroller's Office expects a competitive bid for bonds without tax credits to offer greater opportunity for success.

Now that federal legislation allows CMSD to receive direct federal subsidy payments for QSCBs, as with BABs, competitive bidding is a preferable course. BABs have been sold successfully in competitive bids in several states.

[125] QZABs are discussed below.

Because the tax benefit to be derived from QSCBs (either in the form of the credit for holders or the direct subsidy for issuers) depends upon the principal amount of the bonds outstanding (that is, the credit or the subsidy is a percentage of the outstanding principal), issuers have an incentive to keep either type of QSCBs outstanding as long as possible, subject to the maximum maturity allowed by the Code and current Treasury Department pronouncements. As a result, QSCBs are generally issued with a single, "bullet" maturity. To provide comfort to the holders of the QSCBs that the issuer will have enough cash on hand to pay the bullet maturity and to provide for a more level payment to the issuer over the life of the QSCBs, QSCBs generally are structured with annual "sinking fund" installments that are deposited in a reserve against the maturity payment. Under federal tax law, this sinking fund may be invested at up to a rate established on a regular basis by the Treasury Department. The tax rule generally allows for permitted "arbitrage" (*i.e.*, the earnings may be kept and applied to the payment of the QSCBs) so long as the annual deposit into the sinking fund is no more than a pro rata amount of the ultimate principal payment. For example, if the QSCBs have a maturity of 15 years, the issuer will deposit $1/15^{th}$ of the principal amount into the sinking fund each year.

As a result of the tax rules, an issuer using either type of QSCBs may finance a wide variety of public educational facilities at an extremely low cost—the annual cost of the supplemental coupon (if any) and a pro rata deposit of the principal amount into the sinking fund. However, as mentioned above, the proceeds may not be used for equipment or training costs.

C. Build America Bonds

Another new type of bond available to finance municipal school facilities is the Build America Bond (or "BAB"). BABs (which can only be issued at present through 2010)[126] are bonds that would otherwise qualify as tax-exempt governmental bonds but for the issuer making an election to have them treated as taxable debt. Rather than in the form of tax-exemption, the federal tax is provided in the form of a tax credit to the bondholder in the amount of 35% of the interest rate. More attractively, for certain types of BABs, the issuer may elect to have the federal government pay a direct subsidy to the issuer equal to 35% of the interest payable on the BABs (so-called "Direct Pay BABs").[127] Very few of the tax credit BABs have been issued; most states and local governments taking advantage of the BAB program have elected to issue Direct Pay BABs.

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[126] Various Treasury and legislative staffers have suggested that the BABs program may be extended by future legislation.

[127] One disadvantage of BABs, and presumably QSCBs, under a direct subsidy format, is that the federal government will offset automatically any federal government claims against the issuer regardless of whether the claims are related to the bond issue or subsidy. That has led at least one prominent issuer—the State of Florida—to delay further issuances of BABs until it receives clarification regarding federal policies.

See McGee and Sigo, "Issuer Put Off by BAB Offsets—Treasury 'Aware' Continuity Is Key" (Bond Buyer Online March 19, 2010) ("Alan B. Krueger, assistant secretary for economic policy, … [said] 'My understanding is that IRS and Treasury have relatively little discretion in this area … . But I would assure you that Treasury is acutely aware of the importance of continuity and payments in this area. … Krueger's remarks came just hours after Ben Watkins, director of Florida's Division of Bond Finance, said he postponed a new-money competitive deal scheduled for next week—$265 million of new-money turnpike revenue bonds—until there is clarification from the federal government regarding the offsetting of subsidy payments. Watkins said the deal was expected to be a mix of BABs and tax-exempts. He also said BABs have been a 'great tool' for state financings, but he decided to stop selling them for now because of the risk that the Internal Revenue Service could intercept subsidy payments if issuers have payments due to the federal government under any federal program, including Medicaid and unemployment compensation. 'From a risk-management standpoint, we've made the internal decision to step away from BABs and not use them any longer until we get clarity around this issue and this new risk,' Watkins said.")

To qualify for Direct Pay BABs, the issuer can spend no more than 2% of the proceeds of the bonds on costs of issuance and must spend all remaining proceeds either on capital expenditures (*i.e.*, no working capital and no refunding) or to fund a reasonably required reserve for the BABs. The arbitrage rules relating to tax-exempt governmental bonds apply to both types of BABs, although the yield is calculated differently (for Direct Pay BABs yield is reduced by the amount of the federal subsidy). There is no volume limitation on either type of BABs, but the bonds must be issued no later than December 31, 2010. Direct Pay BABs have proven very attractive to issuers, and several tens of billions of dollars of Direct Pay BABs have been issued since March, with some being spent on school facilities. [128]

D. Qualified Zone Academy Bonds

Several years ago, Congress made available an alternative to tax-exempt governmental bonds for certain types of financings called qualified zone academy bonds (or "QZABs").[129] Congress has tinkered with the structure of and requirements for QZABs from time to time. Under the current rules, QZABs may be issued to finance certain qualified purposes with respect to a "qualified zone academy." Pursuant to prior federal law, if the bonds met the QZAB requirements, rather than receiving tax-exempt interest on the bonds, bondholders received a periodic tax credit that could reduce their federal tax liability. Alternatively, pursuant to legislation recently signed by the President,

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[128] Because of the success of Direct Pay BABs, a legislative proposal has been made to create a type of QZABs and a type of QSCBs that would also work on the direct pay basis rather than providing a tax credit to the holder. It will be important to watch developments with respect to this proposal.

[129] CMSD has issued two QZAB Bond issues for projects unrelated to Issue 14.

the issuer may elect to receive the credit subsidy payment directly, as is the pattern set for BABs and credit QSCBs.

When the credit is paid to bondholders, the amount of the credit is set at the time the bonds are issued based upon publication by the Internal Revenue Service and is designed to allow the QZABs to be marketed for par (in practice, issuers often must add a small supplemental coupon to keep from having to sell discount bonds). The amount of the credit is equal to the credit rate times the outstanding principal amount of the QZAB. The Internal Revenue Service also sets the maximum term for which the QZAB can be issued from time to time. The credit rate and the maximum maturity are the same as those available for QSCBs. As with QSCBs, it is not uncommon for the market to require a small supplemental coupon in addition to the tax credit on the QZABs. Where the issuer elects to receive the direct subsidy from the federal government, it receives a subsidy equal to the lesser of the otherwise applicable credit rate or the interest rate on the QZABs, and the investor merely gets taxable interest with no tax credit.

There is a volume limitation to the amount of QZABs that can be issued in each State, and an issuer must receive an allocation of part of the limitation to issue QZABs.[130] To qualify as a QZAB, no more than 2% of the proceeds of the bonds may be used to pay costs of issuing the bonds and all of the rest of the proceeds must be used to rehabilitate or repair a public school within a qualified zone academy, to equip the academy, develop course materials, or train teachers or other school personnel about the academy. A

[130] In Ohio, the State's share of the national QZAB limitation is administered by the Ohio Department of Education, and application must be made to the Department before CMSD can issue any QZABs.

"qualified zone academy" is a school or a program established by a school board that meets the following requirements:

1. It must be designed for education at the primary or secondary level.

2. It must have a program that is designed in cooperation with local businesses to enhance the curriculum, increase graduation and employment rates, and better prepare students for college and the workforce.

3. It must have the same academic standards and assessments as are otherwise applied in the school district.

4. It must have a comprehensive educational plan that is approved by the school board.

It must be located either (a) in an empowerment zone or an enterprise zone or (b) in an area where it is reasonably expected that at least 35% of the students attending the academy will be eligible for free or reduced-cost lunches under the National School Lunch Act.

In addition, the bonds are subject to the arbitrage limits applicable to tax-exempt governmental bonds, with two exceptions: the proceeds to be used to pay for the qualified purposes can be invested at above bond yield without regard to yield and not subject to rebate for up to three years and the issuer can establish an invested sinking fund (called a

"reserve fund" in the Code) in which it deposits moneys no faster than at a level principal amortization rate that can be invested at a rate set by the IRS (and not subject to rebate).

Finally, the school board must obtain commitments from local businesses to provide money or other in-kind contributions with a value of at least 10% of the proceeds of the QZABs. This requirement has proven difficult in many jurisdictions.

As with QSCBs, the Code permits the creation of an invested sinking fund, with annual deposits equal to a pro rata amount of the par amount of the QZABs. As a result, the economic benefit of QZABs is that the issuer will have little or no annual outlay for interest and will only be making annual deposits equal to a fraction of the principal amount due on maturity. Despite this benefit, although QZABs are regularly issued, because of the requirements imposed (especially the local business contribution requirement), they have been of somewhat limited use.

E. Recovery Zone Economic Development Bonds

Yet another new type of bond is recovery zone economic development bonds (or "RZEDBs"). The economic benefit of RZEDBs is similar to that of Direct Pay BABs, but, rather than receiving a 35% interest subsidy, the issuer receives a 45% interest subsidy from the federal government. Because of the deeper subsidy, there are statewide volume limits on RZEDBs, although many large municipalities have also received their own volume limit.[131]

[131] We note that the City of Cleveland separately received an RZEDB allocation of $16,590,000.

The proceeds of RZEDBs must be spent in designated "recovery zones," which are designated by the issuer of the bonds and must be an area determined to meet certain very broad criteria. No more than 2% of the proceeds can be spent for costs of issuance, and the remainder (less any reasonably required reserve fund) must be spent for "qualified economic development purposes." Qualified economic development purposes include expenditures for the purposes of promoting development or other economic activity, including capital expenditures paid or incurred with respect to property in the recovery zone, public infrastructure and construction of public facilities (wherever located so long as it is a benefit to the recovery zone), and job training and educational purposes. RZEDBs are subject to the normal arbitrage requirements.

RZEDBs can be issued for school purposes, if the City is willing to commit some of its volume cap for that purpose. However, we are not aware of any RZEDBs that have been issued for that purpose.

F. General Considerations

Given the subsidies provided, QSCBs and QZABs are the most cost-effective of these tax-subsidized financing methods available to CMSD. Based upon the market's experience with BABs, the most cost efficient option for either of these types of "credit bonds" would be for CMSD to choose to receive direct payments of the federal subsidy rather than giving the investor the tax credit.

If CMSD were to opt to issue QSCBs or QZABs with tax credits to investors, CMSD would be likely to have to pay only a supplemental coupon that would be substantially less than the interest rate that would be required by a purchaser of tax-exempt bonds and

less than the net interest cost to CMSD of either BABs or even RZEDBs even after the federal subsidy payments.

In addition, regardless of whether the direct subsidy or credit option is chosen, CMSD would have the opportunity to make annual sinking fund deposits for the QSCBs or QZABs that could be invested at a rate that may be higher than any borrowing cost actually incurred by CMSD. Of course, the amounts of those bonds that can be issued are limited and the uses for which the proceeds can be spent are more limited than the uses available for the other types of bonds.

In addition, it should be noted that ARRA specifically requires that the Davis-Bacon labor standards apply to projects financed with QSCBs, QZABs, and RZEDBs. Therefore, according to the Labor Department, any contract for construction, alteration, or repair using proceeds from any of these types of bonds must incorporate the Davis-Bacon contract clauses stated in 29 CFR 5.5(a)(1) through (10). These standards include, among others, a prevailing wage requirement that may result in a higher cost of facilities that could be obtained using financing vehicles that did not implicate the Davis-Bacon rules.

The federal tax law imposes "arbitrage" restrictions on all these types of bonds. In general, the arbitrage rules limit the ability of CMSD to invest amounts that are proceeds of the bonds or that are expected to be used to repay or secure the bonds at yields in excess of the yield on the bonds. There are many exceptions to these rules that allow, for example, the construction fund and a reasonably required reserve fund to be invested without regard to yield. However, as a general matter, even if the construction fund can be invested at a yield in excess of the yield on the bonds, any "arbitrage profits" must be

"rebated" to the federal government to preserve the tax-benefited status of the bonds. The arbitrage rebate rules can be avoided by actually meeting certain "investment milestones." With respect to tax-exempt bonds, BABs, and RZEDBs, rebate can be avoided if all of the proceeds are spent within either an 18-month or 2-year period (the longer period is allowed for projects where at least 75% of the proceeds are spent for construction expenditures) and interim milestones are met every six months. With respect to QSCBs and QZABs, rebate is avoided if all of the proceeds of the issue are actually spent within three years. Also, to the extent that not all of the proceeds are actually spent within three years, CMSD would be required to use any unspent proceeds to redeem QSCBs or QZABs within 90 days after the third anniversary of the issue date.

G. Quantitative Considerations

Quantitatively, QSCBs are particularly attractive for school districts, such as CMSD, although prior to the recent change in federal law permitting direct subsidy payments to issuers, such as CMSD, the QSCB market remained somewhat novel, difficult and uncertain. The federal tax subsidy for QSCBs proved inadequate to attract bond buyers without a supplemental yield coupon, but when all facts and circumstances were taken into account, QSCBs were sold by school district issuers at net yields that were far below the yields of both tax-exempt securities and BABs. In addition, QSCBs are limited in terms of the maximum maturities permitted, although in terms of CMSD's current Issue 14 needs, those maturity restrictions would not hamper CMSD. As discussed, the direct subsidy form of QSCBs will in most cases provide an economic benefit to CMSD greater than the credit form of QSCBs.

The following is a comparison of yields as of March 15, 2010, for representative AA-rated municipal debt, which reflects comparable yields under the QSCB program prior to the enactment of the federal legislation changing the subsidy payment approach[132]—

	15 Year Maturity Net Yield to Issuer	*30 Year Maturity Net Yield to Issuer*
Tax-Exempt	3.90%	4.75%
BABs	3.75%	4.20%
QSCBs	1.85%	n/a

In the absence of QSCBs, many municipal securities issuers have found BABs attractive and a means of reducing yields for their securities on a net basis, taking federal subsidies into account. BABs offer CMSD a lower subsidy than do QSCBs.[133] The lower subsidy restricts BABs' functionality for CMSD, but many issuers find a combined BABs/tax-exempt bond offering viable and attractive.

Now that school districts, such as CMSD, have the option to elect to receive direct subsidy payments, given the higher subsidy rate for QSCBs in relation to BABs, barring

[132] As we have noted, both market conditions and federal tax and subsidy policies have been in a significant state of flux. In addition, the heavy reliance pursuant to the prior structure of the QSCB program upon a single investor in QSCB securities, was somewhat tenuous, as that investor had made it known the investor had a limited appetite for the securities.

Since federal legislation has altered the subsidy structure to one modeled more closely on direct subsidy payments to bond issuers, as with BABs (but at a higher subsidy level), then the market reception for QSCBs can be expected to become even more favorable than it is at present. See n. 18 and accompanying text.

The illustration as of a specific date does not indicate what decision CMSD should make in terms of which federal tax and subsidy program to utilize.

[133] See n. 18 and accompanying text.

an unexpected change in law or market conditions, that will prove the most cost-effective option for CMSD.

Recommendations:

Federal law provides CMSD with a number of options that offer benefits, in appropriate facts and circumstances, beyond the benefits of tax-exempt securities.

We recommend that CMSD consider each of those options in detail with CMSD's Financial Advisors and legal counsel. In particular, given present market conditions and federal tax and subsidy policies, direct subsidy QSCBs clearly offer to CMSD the preferable option for Bond issuance. Both federal tax and subsidy policies and market conditions may change suddenly and drastically, however. Therefore, a definitive decision as to which approach is best must be made under then prevailing conditions.

APPENDIX A—AGFS Team

The following is a brief background on each of the firms and professionals on the AGFS Team—

AGFS and Robert Doty

Robert Doty is President of AGFS, a private firm in Sacramento, California. Mr. Doty has been involved in several financial and legal roles in the finance industry for more than 35 years. Mr. Doty has participated in the successful completion of billions of dollars of municipal finance and corporate finance transactions, including representations benefiting more than 150 governmental entities in approximately two dozen states. He has worked with a substantial diversity of credit types in the market for municipal bonds and other municipal securities, as well as numerous corporate credits.

Mr. Doty's extensive municipal bonds market experience includes roles as financial advisor, investment banker (underwriter), bond counsel, underwriter counsel, issuer disclosure counsel, trustee counsel, developer counsel, investor counsel, and special consultant. He has served as corporate and securities law counsel to private corporations and has taught corporate law, municipal finance and securities law courses at the University of Houston and Creighton Law Schools.

Mr. Doty has participated in a wide variety of activities related to municipal securities transactions, including the issuance of municipal bonds, notes, leases, certificates of participation and other municipal securities for many types of governmental securities issuers; workouts of and consulting regarding numerous

defaulted municipal bonds and other troubled municipal securities issues; tender offers; and federal and state enforcement investigations. The governmental securities issuers benefited by Mr. Doty include cities, multi-state interlocal agencies, water and wastewater agencies, counties, schools, assessment districts, special taxing districts, authorities, colleges, public utilities, state agencies, joint powers or joint action agencies, power authorities, and recreation and park, community service and other forms of special agencies and districts. He has been instrumental in the development of sophisticated pooled and other financing structures.

In addition, Mr. Doty has served as a principal drafter of market guidance publications on disclosure and conducting municipal securities transactions for the Government Finance Officers Association, International Municipal Lawyers Association, National Association of Bond Lawyers/American Bar Association, National Federation of Municipal Analysts and California Debt and Investment Advisory Commission. Mr. Doty was selected as one of a five-member United States delegation formed by the Smithsonian Institution's Woodrow Wilson International Center for Scholars and by the National Committee on United States-China Relations to consult with officials of the Peoples Republic of China and of the Cities of Beijing, Shanghai and Hangzhou. Mr. Doty has written numerous books and articles and has chaired and spoken at numerous conferences relating to municipal finance.

Mr. Doty received his law degree from Harvard Law School.

Additional information regarding AGFS is available at *www.agfs.com*.

Government Financial Strategies and Lori Raineri

Government Financial Strategies ("GFS") is an independent public finance consulting firm based in Sacramento, California, specializing in financial advisory services to school districts, including long-term financial planning and assistance in financing transactions.

GFS and Lori Raineri have served public entities for two decades, prior to which Ms. Raineri worked in the governmental finance arena as an investment banker. GFS and Ms. Raineri have structured many hundreds of school financings from K-6 through Community College.

Since GFS' founding in 1988, the firm has put together hundreds of long-range financial plans and helped finance billions of dollars of public projects for 300 California public agencies in every sector of government. GFS also serves County Boards of Education in discharging the Boards' responsibilities to preview financing transactions proposed by school districts.

Ms. Raineri is a Certified Independent Public Finance Advisor and serves on the Board of the National Association of Independent Public Finance Advisors. During the past year, Ms. Raineri has been a keynote speaker for the California Treasurer-Tax Collectors Annual Education Conference, the California Auditor-Controllers' Annual Conference, the California County School Superintendents Annual Business and Administration Conference, and the California School Business Officials Association CBO Mentor Program, among others. The focus of each of these presentations has been the principles of debt financing, including numerous case studies which demonstrate the

value of best practices, and ethics. Ms. Raineri graduated from the University of California, Berkeley.

In addition to Ms. Raineri, GFS personnel working on this Report include Keith Weaver, Senior Project Manager, and Michael Terry, Senior Financial Analyst.

Mr. Weaver focuses on financial modeling, financial research, and technical writing. He specializes in long-range financial planning and complex financial analysis. Mr. Weaver received his B.A. in Economics (High Honors) from the University of California, Berkeley, and is pursuing his Master's Degree in Accounting from California State University, Sacramento.

Mr. Terry provides analysis, research and technical writing. He has extensive experience in tax base analysis and general obligation bond ballot measure planning. Prior to joining GFS, he was the Property Tax Supervisor for Circle K Stores and the Fixed Asset Supervisor for ConocoPhillips. He holds a B.A. in Organizational Studies/Sociology from the University of California, Davis.

Additional information regarding Government Financial Strategies is available at *www.gfsi.com*.

Delphis-Hanover Corp. and Austin Tobin

Delphis-Hanover Corporation and Austin Tobin have their fingers on the pulse of the municipal securities market. They have maintained detailed daily close-of-market yield data for several decades. The data are used by governmental issuers and many market professionals across the nation. The data are subdivided by credit (rating) strength

and maturity, giving strong accurate national pricing averages for the purposes of analyzing municipal securities transactions.

In addition, Delphis-Hanover and Mr. Tobin consult actively with significant issuers in connection with evaluating bond pricing at the time of sale.

Mr. Tobin, a former bond lawyer, received his law degree from Columbia Law School.

Additional information regarding Delphis-Hanover and Austin Tobin may be obtained at *www.delphishanover.com*.

Law Office of Perry Israel

Perry Israel concentrates his practice in tax-exempt financing, Indian tribal financing, low-income housing credits, and mortgage credit certificates. He has acted as tax counsel, Bond Counsel, and underwriter's counsel on a variety of financings for a wide range of projects.

Mr. Israel acts as a consultant or special tax counsel to various Bond Counsel firms across the country. He also advises issuers and conduit borrowers on post-issuance compliance matters and represents issuers and borrowers in audit examinations by the Internal Revenue Service.

Prior to starting his own practice in 2007, Mr. Israel was a partner at Orrick, Herrington & Sutcliffe LLP in San Francisco and Sacramento for 20 years.

Mr. Israel was a member of the inaugural Tax Exempt Advisory Committee, for which he acted as an advisor to the Internal Revenue Service's Tax Exempt/Governmental Entities Group, focusing on tax-exempt bonds. He has been active as a chair and panelist for the Bond Attorney's Workshop and the Arbitrage Seminars of the National Association of Bond Lawyers. Mr. Israel has written many papers on federal tax law application to municipal finance.

Mr. Israel received both his initial law degree and his Master of Laws degree in Taxation from Boston University.

Additional information regarding Perry Israel is available at *www.103law.com*.

APPENDIX B—Delphis-Hanover Technical Analysis

The following is the complete analysis prepared by Delphis-Hanover Corporation of the results of CMSD Issue 14 Bond and Note sales—

CLEVELAND MUNICIPAL SCHOOL DISTRICT
Bond Sale Pricing Results

1. Various Purpose Improvement and Refunding Bonds
   Series 2002 (General Obligation Unlimited Tax):

   These FGIC insured bonds were re-offered with a notably strong scale. This strength applies to the non-callable bonds due through ten-years; the premium callable bonds due in 11 to 20-years, and both discount term bonds due in 22 and 25-years.

   All maturities were re-offered at yields that were better than triple-A uninsured bonds in the overall general-market. During the period in which these bonds were sold, average insured bonds were being re-offered at yields equivalent to those of a double-A rated bond.

2. School Improvement Bonds, Series 2004 (General Obligation Unlimited Tax)

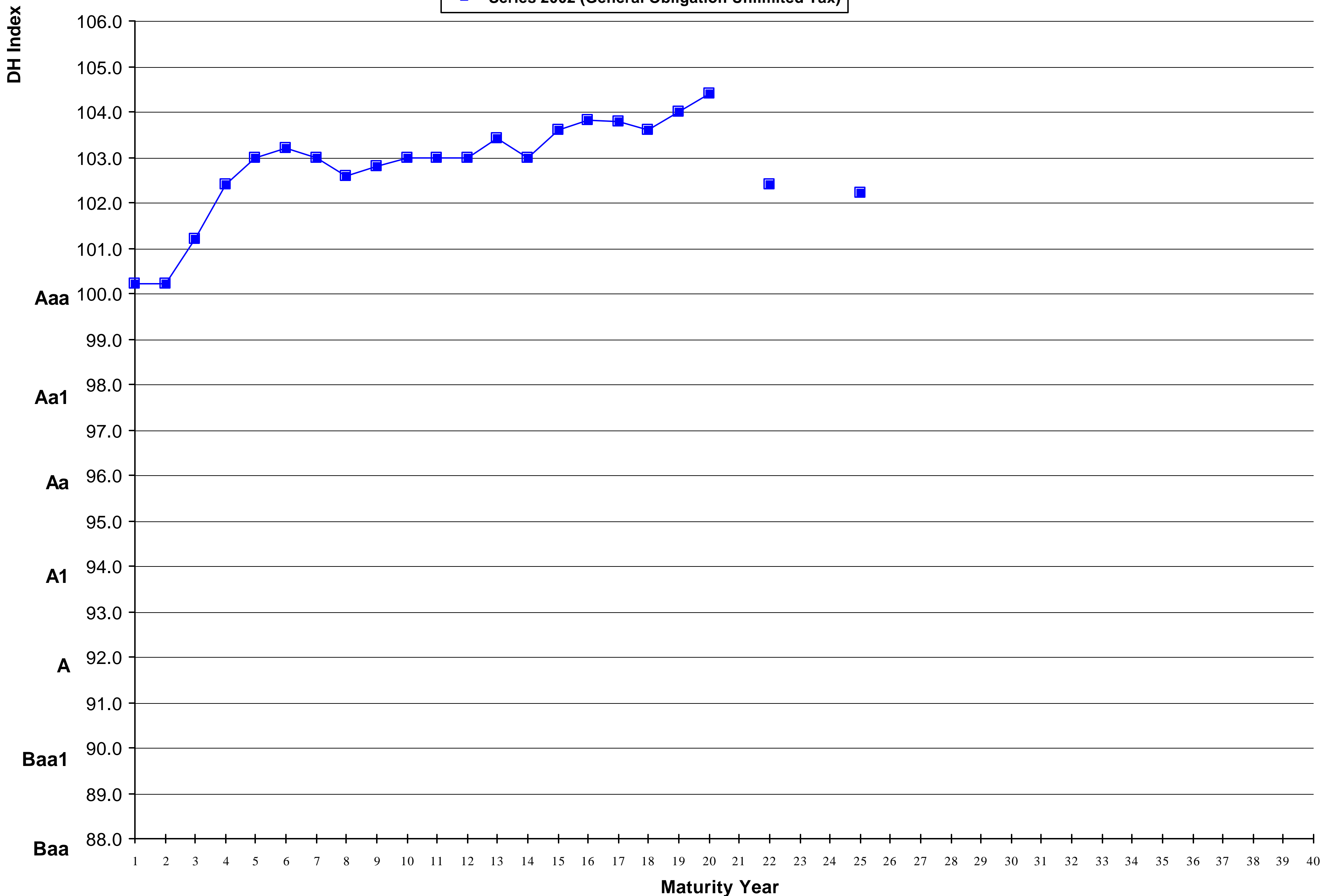
   These FSA insured bonds, while slightly below the extraordinary level of the Series 2002 bond sale, were nevertheless reoffered at a strong price in all maturities—slightly better than double-A-one rated uninsured bonds. During the period in which these bonds were sold, average insured bonds were being re-offered at yields equivalent to those of a double-A-three rated bond.

Range of Yield Curve Scales

Both bond and note issues of the Cleveland Municipal School District have been measured and evaluated against the Range of Yield Curve Scales matrix that was promulgated on the date of verbal award.

This matrix of tax-exempt municipal bonds is prepared daily after the close of trading and reflects the bid or acceptance price for general-market (widely recognized) names sold in primary and secondary.

Note: Municipal market bond and note sales are transacted over-the-counter. Price evaluation within the same time frame can vary among diverse participants. The Range of Yield Curve Scales relative value yield analysis is based on preparation consistency in assessing data in volume as available.



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DH Graph
st_5713.xls

Cleveland Municipal School District
Pricing Analysis Presentation

1. Relative Market Price Pattern

Graph compares re-offering yields on bonds with market credit ratings and evaluation index.

2. Verbal Award – Negotiated Sale Analysis

Based on re-offering yields by maturity.

Index
Evaluation of yields against current national market.
Aaa = 100, Aa1 = 98, Aa = 96.

Versus Aaa/100
Based on Index for Aaa/100 bonds.
e.g. minus -15 equals basis points better than Aaa;
20 equals basis points weaker than Aaa.

Year
Reflects sale date versus maturity date.

3. DH Index, Coupon and Insurance Comparison
Graphs juxtaposing Index for the purpose of highlighting any anomalies in reoffering scale that are based on coupon differential or insurance/non-insurance by maturity.

Delphis Hanover Corporation

10/15/02 **Verbal Award** **Negotiated Sale**

Issuer: Cleveland Municipal School District
Bond Name: Various Purpose Improvement and Refunding Bonds
Series: Series 2002 (General Obligation Unlimited Tax)
State: Ohio
Amount: $124,920,000
Due: 12/01/02 - 22, 24 & 27 *13
Dated: 10/1/2002 -
Purchaser: NatCity Investments
Neg/Comp: Negotiated Sale
Bid: - -
Bond Form: Book Entry
Bank Qual?: No
Base Cusip:

MATURES	(000) $ AMOUNT	COUPON	YIELD	INDEX	VERSUS Aaa/100	Call	Note	Mdy/S&P/Fit RATING	INSURER	YEAR
12/1/2002	5	1.450	1.450	-	-			Aaa/AAA/AAA	FGIC	0.13
12/1/2003	26,220	2.500	1.600	100.2	-1			Aaa/AAA/AAA	FGIC	1.13
12/1/2004	19,135	3.000	1.770	100.2	-1			Aaa/AAA/AAA	FGIC	2.13
12/1/2005	4,355	5.000	1.980	101.2	-6			Aaa/AAA/AAA	FGIC	3.13
12/1/2006	4,575	5.000	2.260	102.4	-12			Aaa/AAA/AAA	FGIC	4.13
12/1/2007	5,000	5.000	2.540	103.0	-15			Aaa/AAA/AAA	FGIC	5.13
12/1/2008	5,000	5.000	2.820	103.2	-16			Aaa/AAA/AAA	FGIC	6.13
12/1/2009	5,155	5.000	3.040	103.0	-15			Aaa/AAA/AAA	FGIC	7.13
12/1/2010	5,560	5.000	3.250	102.6	-13			Aaa/AAA/AAA	FGIC	8.13
12/1/2011	4,725	4.500	3.350	102.8	-14			Aaa/AAA/AAA	FGIC	9.13
12/1/2012	1,915	5.000	3.450	103.0	-15			Aaa/AAA/AAA	FGIC	10.13
12/1/2013	2,010	5.000	3.600	103.0	-15	*		Aaa/AAA/AAA	FGIC	11.13
12/1/2014	2,115	5.250	3.740	103.0	-15	*		Aaa/AAA/AAA	FGIC	12.13
12/1/2015	2,220	5.000	3.840	103.4	-17	*		Aaa/AAA/AAA	FGIC	13.13
12/1/2016	2,330	5.000	3.970	103.0	-15	*		Aaa/AAA/AAA	FGIC	14.13
12/1/2017	2,445	5.000	4.050	103.6	-18	*		Aaa/AAA/AAA	FGIC	15.13
12/1/2018	2,570	5.000	4.140	103.8	-19	*		Aaa/AAA/AAA	FGIC	16.13
12/1/2019	2,700	5.000	4.240	103.8	-19	*		Aaa/AAA/AAA	FGIC	17.13
12/1/2020	2,835	5.000	4.340	103.6	-18	*		Aaa/AAA/AAA	FGIC	18.13
12/1/2021	2,975	5.000	4.420	104.0	-20	*		Aaa/AAA/AAA	FGIC	19.13
12/1/2022	3,125	5.000	4.490	104.4	-22	*		Aaa/AAA/AAA	FGIC	20.13
12/1/2023									-	21.13
12/1/2024	6,705	4.500	4.670	102.4	-12	*		Aaa/AAA/AAA	FGIC	22.13
12/1/2025									-	23.13
12/1/2026									-	24.13
12/1/2027	11,245	4.625	4.720	102.2	-11	*		Aaa/AAA/AAA	FGIC	25.13
12/1/2032									-	30.13
12/1/2037									-	35.13
12/1/2042									-	40.13

* Call Feature: 12/01/12 @ 100 Bonds due 2024 & 2027 subject to MSFR
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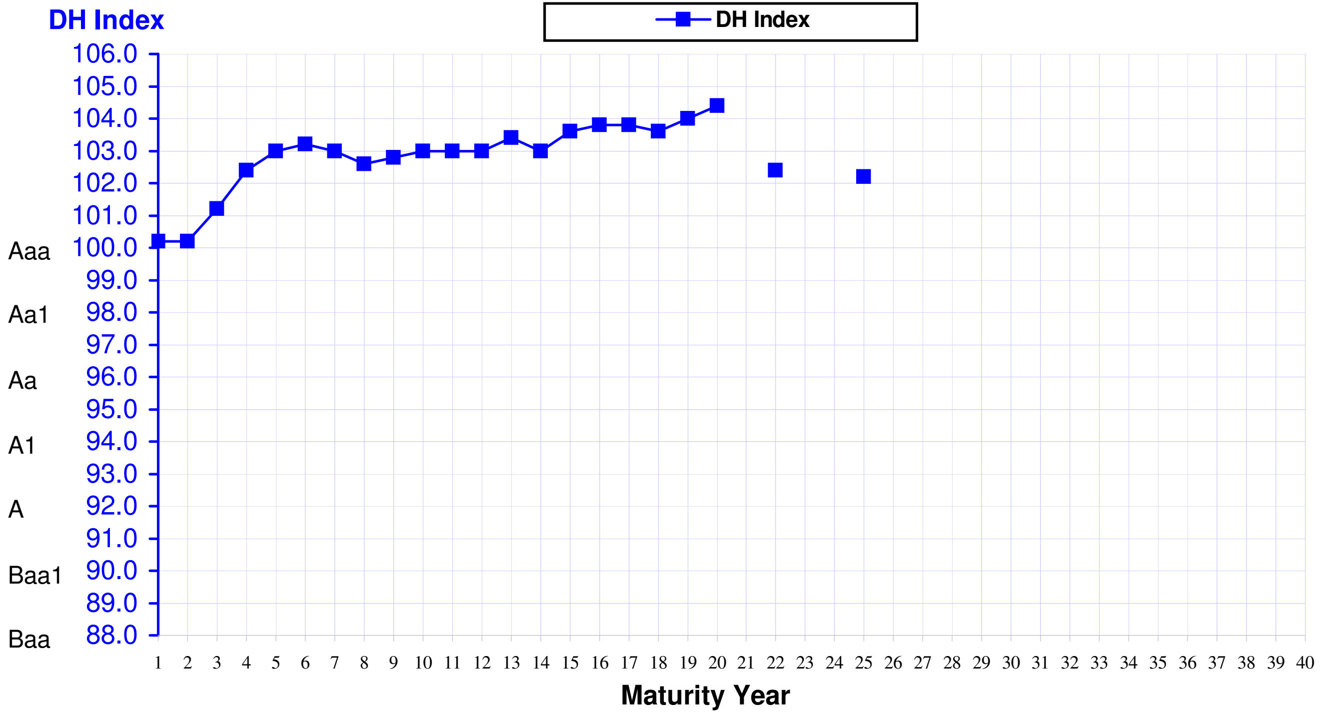
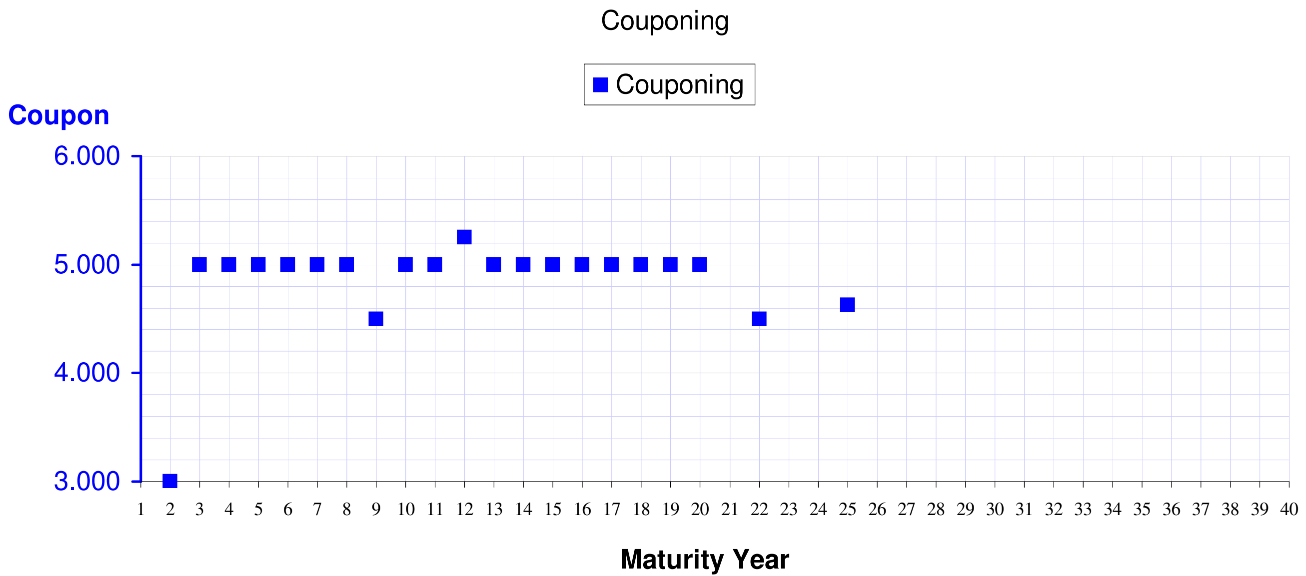
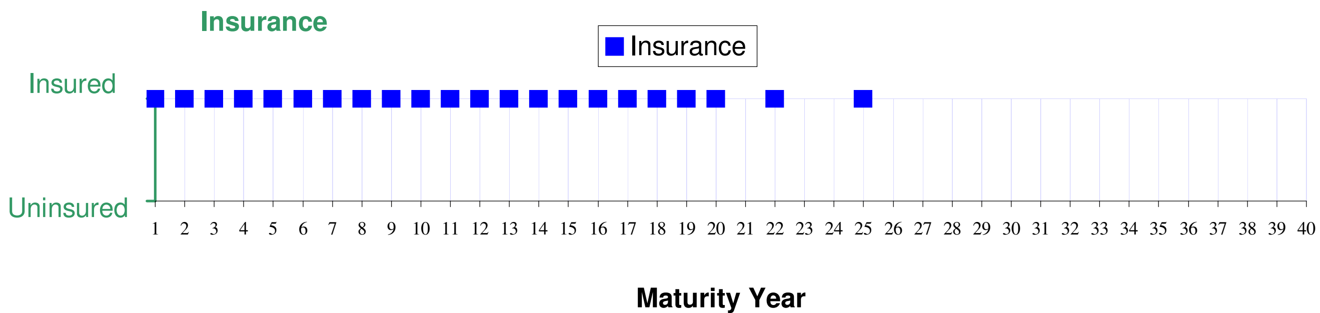
DH Index, Coupon and Insurance Comparison







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Comp Graph
st_5713.xls

Range of Yield Curve Scales

Market Close: 10/15/02

DELPHIS HANOVER CORPORATION

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INDEX	100 Aaa	98	96 Aa	94	92 A	90	88 Baa	86
2003	1.59	1.64	1.69	1.77	1.87	1.99	2.14	2.29
2004	1.75	1.81	1.86	1.94	2.09	2.20	2.32	2.47
2005	2.00	2.06	2.14	2.22	2.36	2.47	2.59	2.74
2006	2.34	2.40	2.48	2.56	2.71	2.82	2.94	3.09
2007	2.65	2.71	2.78	2.86	3.01	3.12	3.24	3.39
2008	2.95	3.01	3.08	3.16	3.31	3.43	3.55	3.70
2009	3.16	3.23	3.30	3.38	3.53	3.64	3.76	3.91
2010	3.37	3.43	3.50	3.58	3.73	3.84	3.96	4.11
2011	3.48	3.54	3.61	3.69	3.83	3.94	4.06	4.21
2012	3.58	3.64	3.71	3.79	3.93	4.04	4.16	4.31
2013	3.73	3.79	3.85	3.93	4.08	4.19	4.31	4.47
2014	3.87	3.93	3.99	4.07	4.22	4.33	4.45	4.61
2015	4.00	4.06	4.12	4.20	4.34	4.45	4.57	4.71
2016	4.11	4.17	4.24	4.32	4.46	4.57	4.69	4.83
2017	4.22	4.28	4.35	4.43	4.57	4.68	4.80	4.94
2018	4.32	4.38	4.45	4.53	4.65	4.76	4.88	5.03
2019	4.42	4.48	4.55	4.63	4.75	4.86	4.98	5.13
2020	4.51	4.57	4.64	4.72	4.85	4.96	5.08	5.23
2021	4.61	4.67	4.74	4.82	4.95	5.06	5.18	5.33
2022	4.70	4.76	4.83	4.91	5.04	5.15	5.27	5.42
2023	4.76	4.82	4.89	4.97	5.09	5.20	5.32	5.47
2024	4.79	4.85	4.92	5.00	5.12	5.23	5.35	5.50
2025	4.81	4.87	4.94	5.02	5.15	5.26	5.38	5.54
2026	4.82	4.88	4.95	5.03	5.16	5.27	5.39	5.55
2027	4.83	4.89	4.96	5.04	5.17	5.28	5.40	5.56
2032	4.86	4.92	4.99	5.07	5.20	5.32	5.44	5.60
2037	4.89	4.95	5.02	5.10	5.23	5.35	5.47	5.63
2042	4.92	4.98	5.05	5.13	5.26	5.38	5.50	5.66

High grades were down .08 to .09; slightly more selectively. Secondary market activity was light to moderate; new issue pricing adjusted to reflect rising yields.

Dollar bonds closed down one point. The market opened quoted down 1/2 to 3/4; was down 3/4 to one point by mid-morning; down one point at Noon EDT and quoted in range through the afternoon.

On The Run Treasury Issues

Maturity	Coupon	Yield	Aaa/100	Aaa/Trs Ratio	High Ratio	Low Ratio	High Date	Low Date
09/30/04	1 7/8	2.063	1.743	84.5%	97.0%	65.6%	08/13/02	03/08/02
05/15/05	6 3/4	2.313	1.896	82.0%	95.1%	68.6%	08/05/02	03/08/02
08/15/07	3 1/4	3.051	2.598	85.2%	96.1%	72.3%	09/30/02	03/08/02
05/15/09	5 1/2	3.571	3.072	86.0%	95.1%	74.4%	10/09/02	03/08/02
08/15/12	4 3/8	4.051	3.563	88.0%	96.0%	79.5%	10/09/02	11/16/01
02/15/31	5 3/8	4.989	4.850	97.2%	103.1%	90.4%	11/01/01	03/20/02

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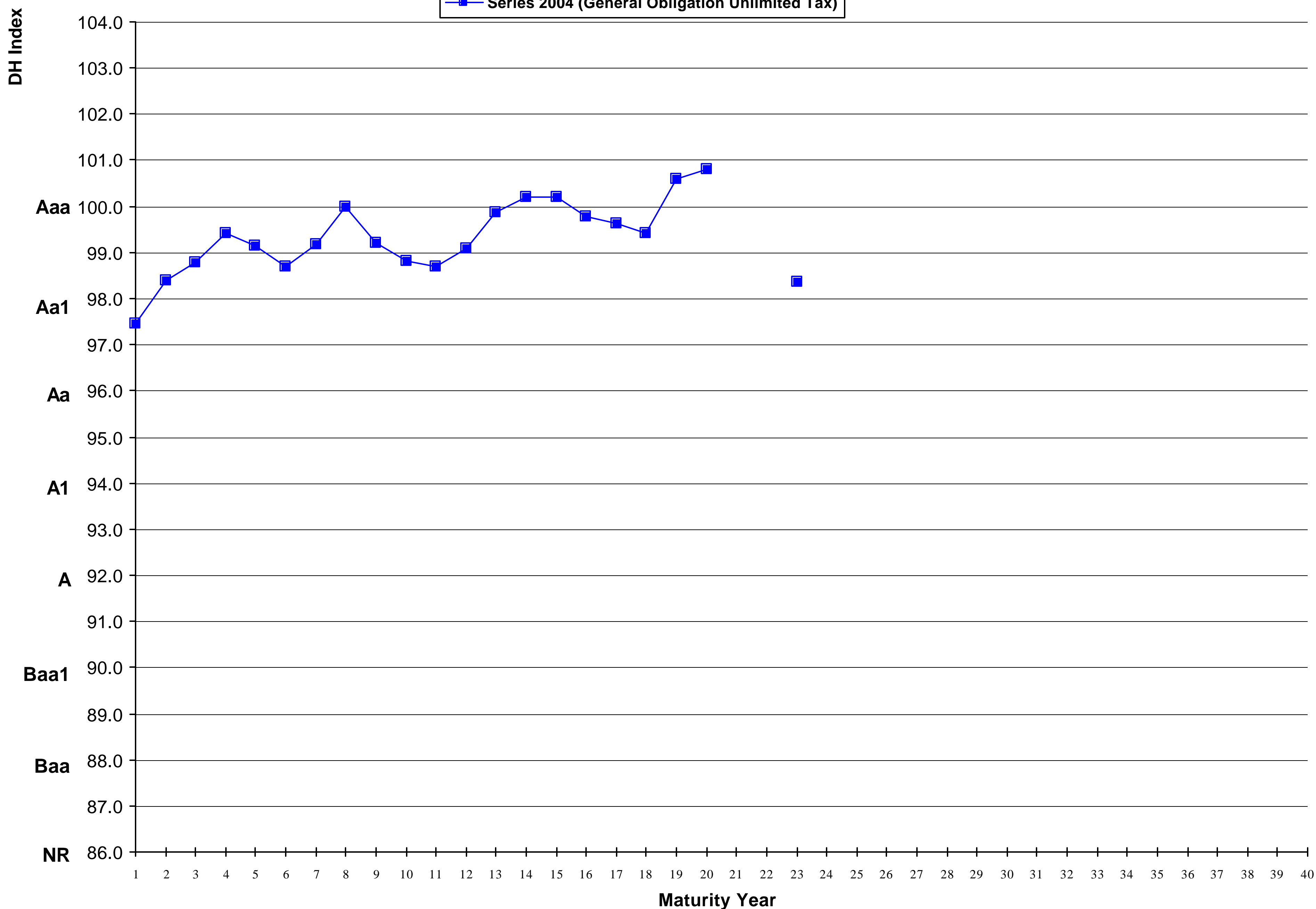

DH Graph
st_5714.xls

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Delphis Hanover Corporation

06/24/04 **Verbal Award** **Negotiated Sale**

Issuer: Cleveland Municipal School District
Bond Name: School Improvement Bonds
Series: Series 2004 (General Obligation Unlimited Tax)
State: Ohio
Amount: $125,000,000
Due: 12/01/04-24 & 27 *14
Dated: 7/8/2004 -
Purchaser: NatCity Investments
Neg/Comp: Negotiated Sale
Bid: - -
Bond Form: Book Entry
Bank Qual?: No
Base Cusip:

MATURES	(000) $ AMOUNT	COUPON	YIELD	INDEX	VERSUS Aaa/100	Call	Note	Mdy/S&P/Fit RATING	INSURER	YEAR
12/1/2004	7,360	2.000	1.390	-	-			Aaa/AAA/AAA	FSA	0.44
12/1/2005	16,715	3.000	1.900	97.5	10			Aaa/AAA/AAA	FSA	1.44
12/1/2006	2,790	3.000	2.360	98.4	6			Aaa/AAA/AAA	FSA	2.44
12/1/2007	2,875	3.500	2.760	98.8	5			Aaa/AAA/AAA	FSA	3.44
12/1/2008	2,975	3.750	3.070	99.4	2			Aaa/AAA/AAA	FSA	4.44
12/1/2009	3,090	4.000	3.340	99.1	3			Aaa/AAA/AAA	FSA	5.44
12/1/2010	3,210	4.250	3.570	98.7	5			Aaa/AAA/AAA	FSA	6.44
12/1/2011	3,345	3.750	3.750	99.2	3			Aaa/AAA/AAA	FSA	7.44
12/1/2012	3,475	5.000	3.890	100.0	0			Aaa/AAA/AAA	FSA	8.44
12/1/2013	3,645	5.000	4.050	99.2	3			Aaa/AAA/AAA	FSA	9.44
12/1/2014	3,830	5.000	4.180	98.8	5	*		Aaa/AAA/AAA	FSA	10.44
12/1/2015	4,020	5.000	4.300	98.7	5	*		Aaa/AAA/AAA	FSA	11.44
12/1/2016	4,220	5.000	4.390	99.1	4	*		Aaa/AAA/AAA	FSA	12.44
12/1/2017	4,430	5.250	4.450	99.9	1	*		Aaa/AAA/AAA	FSA	13.44
12/1/2018	4,665	5.250	4.510	100.2	-1	*		Aaa/AAA/AAA	FSA	14.44
12/1/2019	4,910	5.250	4.580	100.2	-1	*		Aaa/AAA/AAA	FSA	15.44
12/1/2020	5,165	5.000	4.680	99.8	1	*		Aaa/AAA/AAA	FSA	16.44
12/1/2021	5,425	5.000	4.760	99.6	2	*		Aaa/AAA/AAA	FSA	17.44
12/1/2022	5,695	5.000	4.840	99.4	2	*		Aaa/AAA/AAA	FSA	18.44
12/1/2023	5,980	5.250	4.850	100.6	-3	*		Aaa/AAA/AAA	FSA	19.44
12/1/2024	6,295	5.250	4.910	100.8	-4	*		Aaa/AAA/AAA	FSA	20.44
12/1/2025									-	21.44
12/1/2026									-	22.44
12/1/2027	20,885	5.000	5.110	98.4	7	*		Aaa/AAA/AAA	FSA	23.44
12/1/2028									-	24.44
12/1/2029									-	25.44
12/1/2034									-	30.44
12/1/2039									-	35.44
12/1/2044									-	40.44

* Call Feature: 06/01/14 @ 100 Bonds due 2027 subject to MSFR
-

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DH Index, Coupon and Insurance Comparison

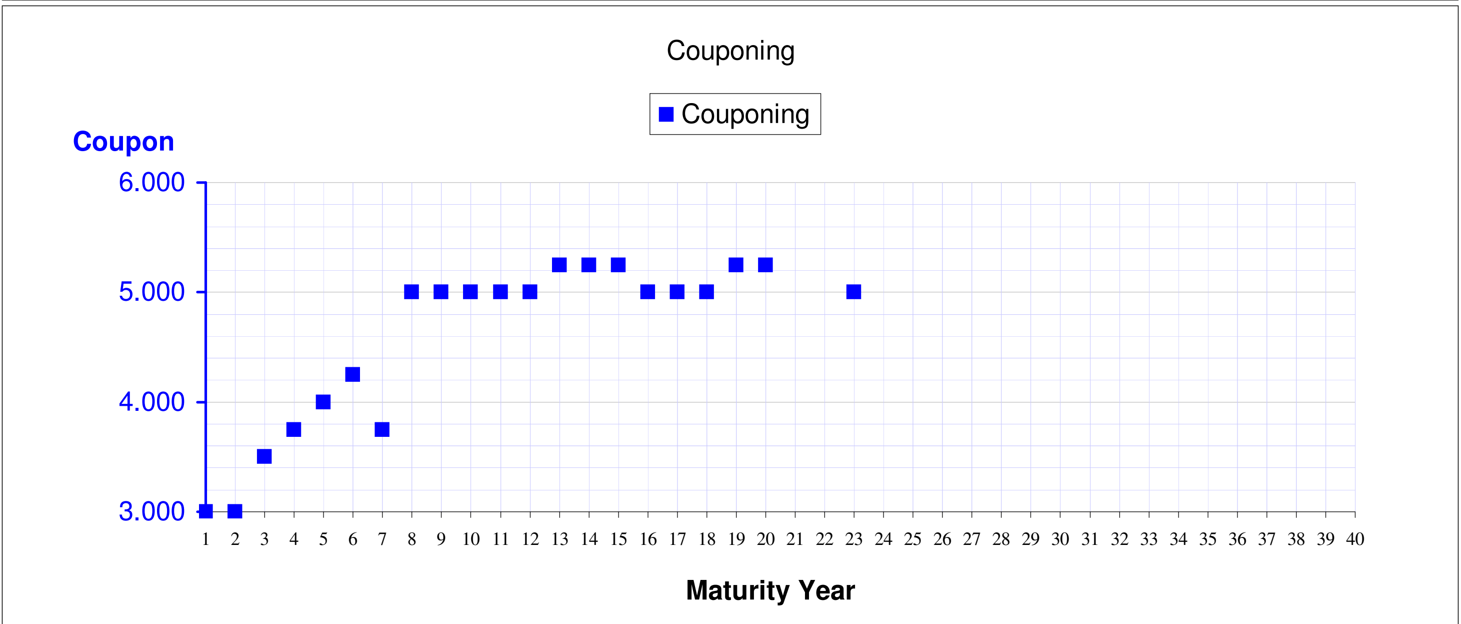
Cleveland Municipal School District, School Improvement Bonds, Series 2004 (General Obligation Unlimited Tax)

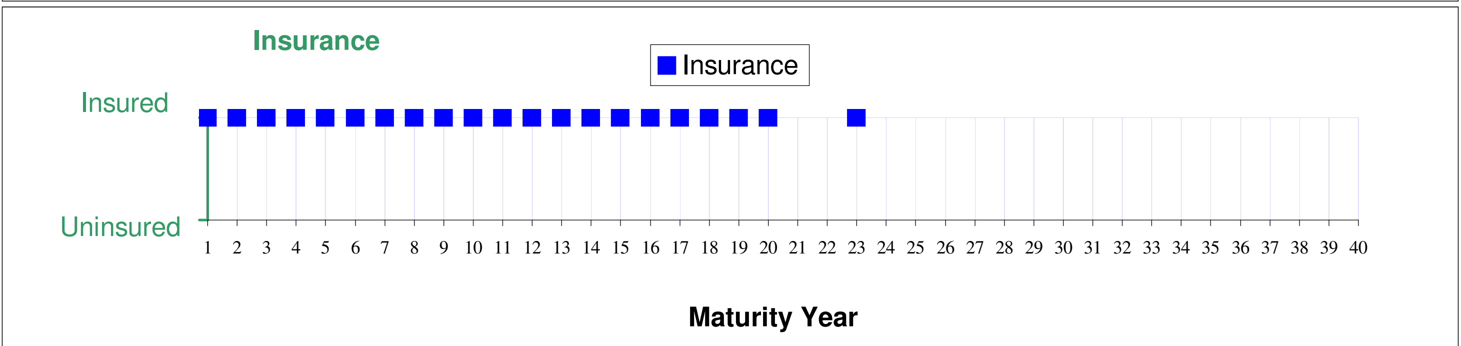
DH Index

104.0
103.0
102.0
101.0
Aaa 100.0
99.0
Aa1 98.0
97.0
Aa 96.0
95.0
A1 94.0
93.0
A 92.0
91.0
Baa1 90.0
89.0
Baa 88.0
87.0
N/R 86.0

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40

Maturity Year





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Comp Graph
st_5714.xls

Range of Yield Curve Scales

Market Close: 06/24/04

DELPHIS HANOVER CORPORATION

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INDEX	100 Aaa	98	96 Aa	94	92 A	90	88 Baa	86
2005	1.57	1.64	1.73	1.83	1.95	2.08	2.26	2.41
2006	2.10	2.18	2.27	2.37	2.51	2.67	2.82	2.97
2007	2.55	2.63	2.72	2.82	2.93	3.07	3.22	3.37
2008	2.92	3.00	3.09	3.20	3.30	3.44	3.58	3.73
2009	3.21	3.29	3.38	3.50	3.62	3.77	3.91	4.06
2010	3.43	3.51	3.59	3.71	3.83	3.99	4.14	4.29
2011	3.63	3.71	3.80	3.93	4.06	4.20	4.35	4.50
2012	3.83	3.91	4.00	4.14	4.27	4.42	4.57	4.72
2013	3.97	4.05	4.15	4.28	4.41	4.56	4.71	4.86
2014	4.08	4.16	4.26	4.38	4.51	4.66	4.81	4.96
2015	4.20	4.28	4.37	4.49	4.63	4.78	4.93	5.09
2016	4.31	4.39	4.48	4.60	4.74	4.89	5.04	5.20
2017	4.41	4.49	4.58	4.70	4.83	4.99	5.14	5.28
2018	4.49	4.57	4.67	4.79	4.92	5.08	5.23	5.37
2019	4.56	4.64	4.74	4.86	4.99	5.15	5.30	5.44
2020	4.64	4.73	4.82	4.95	5.06	5.21	5.36	5.51
2021	4.71	4.79	4.88	5.01	5.13	5.28	5.43	5.58
2022	4.79	4.87	4.96	5.08	5.20	5.35	5.50	5.65
2023	4.85	4.93	5.03	5.15	5.28	5.42	5.57	5.72
2024	4.92	5.00	5.10	5.22	5.34	5.48	5.63	5.78
2025	4.98	5.06	5.15	5.29	5.40	5.54	5.68	5.83
2026	5.02	5.10	5.19	5.33	5.45	5.61	5.75	5.90
2027	5.04	5.12	5.21	5.35	5.48	5.64	5.78	5.94
2028	5.05	5.13	5.22	5.35	5.48	5.64	5.78	5.94
2029	5.06	5.14	5.23	5.36	5.49	5.65	5.79	5.95
2034	5.10	5.18	5.28	5.41	5.54	5.69	5.82	5.98
2039	5.14	5.22	5.32	5.45	5.58	5.74	5.86	6.02
2044	5.18	5.26	5.36	5.49	5.62	5.78	5.91	6.07

High grades improved by about .02. Secondary market activity was moderate; new issue pricing firm to strong.

Dollar bonds closed up 1/4 to 3/8. The market opened plus 1/8; was up 3/8 to 1/2 at Noon EDT and gave back 1/8 in the afternoon.

On The Run Treasury Issues

Maturity	Coupon	Yield	Aaa/100	Aaa/Trs Ratio	High Ratio	Low Ratio	High Date	Low Date
06/30/06	2 3/4	2.754	2.107	76.5%	100.2%	65.1%	07/11/03	12/01/03
05/15/07	3 1/8	3.164	2.501	79.0%	94.8%	63.9%	07/11/03	12/01/03
06/15/09	4.000	3.843	3.203	83.3%	91.4%	70.0%	06/25/03	12/01/03
02/15/11	5.000	4.470	3.558	79.6%	93.9%	73.2%	06/25/03	01/02/04
05/15/14	4 3/4	4.648	4.068	87.5%	94.5%	81.3%	06/25/03	01/02/04
02/15/31	5 3/8	5.335	5.073	95.1%	99.9%	91.0%	06/25/03	01/02/04

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CLEVELAND MUNICIPAL SCHOOL DISTRICT
Note Sale Pricing Results

The days from issuance to maturity of these Notes was not consistent. This is not unusual among municipal Note issuers but tends to distort sequential re-offering comparisons.

Of immediate positive observation: the School District has attracted major financial bidders for its Notes.

We used both the Delphis Hanover Aaa-100 one-year bond yield and the weekly Bond Buyer one-year MIGI index for evaluation comparisons. Both measures indicate that within the periods of issuance these Notes sold at fair market value.

MIG1 rated Notes cover a wide spectrum of credit assessment all of which obtain investment qualification status. The 101 basis point spread from MIG1 for the Notes sold on 12/16/08 was a reflection of the financial crisis occurring at that time.

Cleveland Municipal School District

No.	Purchaser	Coupon	Sale Date	Issuance	Maturity	Days
1	PNC Capital Markets LLC	2.500	12/16/08	12/30/08	09/30/09	**270**
2	JP Morgan Securities Inc.	4.000	11/20/07	12/05/07	07/30/08	**235**
3	A.G.Edwards & Sons Inc.	4.000	02/20/07	03/06/07	12/06/07	**270**
4	Unknown	3.750	12/14/05	12/22/05	07/27/06	**215**
5	Banc One Capital Markets Inc.	3.000	10/24/01	11/07/01	11/06/02	**359**

No.	Rating	CUSIP	Price	Amount	Premium	Price	TIC
1	MIG1	186392-CC8	NRO	15,000,000	31,950	15,031,950	**2.2052**
2	MIG1	186392-CB0	NRO	20,000,000	43,600	20,043,600	**3.6479**
3	MIG1	186392-CA2	100.292	30,000,000	27,000	30,027,000	**3.8580**
4	MIG1	186392-BZ8	NRO	30,000,000	87,300	30,087,300	**3.2482**
5	MIG1	186360-UT8	NRO	35,000,000	285,495	35,285,495	**2.1529**

	Delphis Hanover Aaa-100			Spread
No.	Curve Date	1-Year	TIC	(Basis Pts)
1	12/16/08	**1.850**	**2.2052**	**36**
2	11/20/07	**3.360**	**3.6479**	**29**
3	02/20/07	**3.570**	**3.8580**	**29**
4	12/14/05	**3.190**	**3.2482**	**6**
5	10/24/01	**2.070**	**2.1529**	**8**

	Bond Buyer 1-Year MIG1 Index				Spread
No.	Wk Before	Wk After	Average	TIC	(Basis Pts)
1	1.120	1.270	**1.195**	**2.2052**	**101**
2	3.320	3.330	**3.325**	**3.6479**	**32**
3	3.620	3.620	**3.620**	**3.8580**	**24**
4	3.260	3.300	**3.280**	**3.2482**	**(3)**
5	2.110	2.060	**2.085**	**2.1529**	**7**