MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns A2 underlying/Aa2 enhanced to Cleveland Municipal School District's (OH) $200M GOULT Bonds, Ser. 2015A-B; Outlook stable

Global Credit Research - 20 Apr 2015

A2 underlying rating affirmed on $89.5M of outstanding GOULT debt

CLEVELAND MUNICIPAL SCHOOL DISTRICT, OH
Public K-12 School Districts
OH

Moody's Rating

ISSUE		UNDERLYING RATING	RATING
General Obligation Unlimited Tax School Improvement Bonds, Series 2015A (Tax-Exempt Bonds)		A2	Aa2
Sale Amount	$150,797,000		
Expected Sale Date	04/30/15		
Rating Description	General Obligation		
General Obligation Unlimited Tax School Improvement Bonds, Series 2015B (Federally Taxable -Qualified School Construction Bonds - Direct Payment)		A2	Aa2
Sale Amount	$49,203,000		
Expected Sale Date	04/30/15		
Rating Description	General Obligation		

Moody's Outlook STA

NEW YORK, April 20, 2015 --Moody's Investors Service has assigned an A2 underlying rating to Cleveland Municipal School District, OH's $150.8 million General Obligation Unlimited Tax School Improvement Bonds, Series 2015A and $49.2 million General Obligation Unlimited Tax School Improvement Bonds, Series 2015B (Federally Taxable-Qualified School Construction Bonds - Direct Payment). Concurrently, we have affirmed the A2 rating on $89.5 million of outstanding GO debt. We have also assigned an Aa2 enhanced rating to both series of bonds and affirmed the Aa2 enhanced rating on previously issued bonds.

SUMMARY RATING RATIONALE

The A2 underlying rating is based on the district's financial operations that have benefited from new operating revenue and recent expenditure restructuring; pressures related to steadily declining enrollment, population loss and elevated tax delinquencies; declining socio-economic profile; moderate debt burden; and a high pension liability.

The Aa2 enhanced rating assigned to the Series 2015 bonds is based on the Ohio School District Credit Enhancement (OSDCE) programmatic rating, which is notched one time below the State of Ohio's Aa1 general obligation (GO) rating and is also assigned a stable outlook. The programmatic rating is based on the strength of the program structure, including timing of debt service payments and debt service coverage requirements. The enhanced rating assigned to these bonds is also based on satisfactory coverage of maximum annual debt service provided by the district's interceptable state aid revenue, which the Ohio Office of Budget and Management estimates at 7.8 times.

OUTLOOK

The stable outlook reflects the significant changes undertaken by management to reduce expenditures and create operational flexibility as well as the structurally balanced operations generated, in part, by the passage of a new operating levy in 2012.

WHAT COULD MAKE THE RATING GO UP

- Budgetary operations and financial policies that provide for the long term maintenance of satisfactory reserves

- Improved socioeconomic profile of tax base

- Tax base stabilization and/or growth coupled with improved tax collection rates

- Stabilization of enrollment trends

- Upward movement in the state of Ohio's general obligation rating (Enhanced Rating)

WHAT COULD MAKE THE RATING GO DOWN

- Significant changes to long-term management of the district's cash balances to narrower levels that could be insufficient to address unexpected budget variances

- Failure to generate sufficient voter support to renew or pass new levies as needed

- Narrowing of liquidity and material declines in fund balance

- Enrollment declines due to increased charter school attendance matched by an inability to make corresponding expenditure reductions

- Further declines in property tax collections either due to loss in valuation or increases in delinquencies

- Downward movement in the State of Ohio's general obligation rating (Enhanced Rating)

- Weakening of Ohio School District Credit Enhancement program mechanics (Enhanced Rating)

STRENGTHS

-Large and diverse local economy with a strong health care and higher education presence

-Willingness to enact substantial expenditure reductions to close budget gaps and restore balanced operations

-Recent operating surpluses and developed financial reserves following passage of 15 mill operating levy in 2012

-Provisions of the Cleveland Plan which provides management with significant financial and operational flexibility

-Improvements in financial and educational operations that help to increase likelihood of voter support

CHALLENGES

-Economic and demographic profiles of the city and wider metro area remain in weakened condition following the recession with only modest recovery to date

-Declining enrollment trends expected to continue

-Below average total property tax collection rate of approximately 87%

-Exposure to underfunded pension liabilities of two cost-sharing retirement plans

RECENT DEVELOPMENTS

Recent developments are incorporated in the Detailed Rating Rationale.

DETAILED RATING RATIONALE

ENHANCEMENT PROGRAM MECHANICS: OHIO SCHOOL DISTRICT CREDIT ENHANCEMENT PROGRAM CHARACTERIZED BY STRONG PROGRAM MECHANICS

The OSDCE programmatic rating is based on Moody's assessment of the overall mechanics of the program, as defined in the statute as of July 16, 2008, and rated one notch below the State of Ohio's GO rating. The OSDCE program, which is established in the Ohio Revised Code and implemented in accordance with Ohio Administrative Code, demonstrates strong state commitment and program history. Available funds for the intercept include the remaining aid appropriated for the district for the remainder of the state's fiscal year and the state may continue to intercept aid in future years, if necessary, until any debt service shortfall is fully paid.

State oversight of the program includes review by the state's Office of Budget and Management (OBM) and Department of Education (ODE). The legislation and approval applications specify the agreement is irrevocable once executed, as long as enhanced bonds are outstanding. While the program has never been utilized, the state has demonstrated its commitment to school capital financings and the oversight criteria ensure availability of adequate education aid to repay bondholders, if necessary. The State of Ohio has historically adopted timely budgets or has made provisions for continuation resolutions. Based on these provisions, Moody's believes the OSDCE program exhibits strong state commitment.

The timing mechanisms of the program are also strong and require a third party fiscal agent to notify the state to intercept education aid if debt service is not received at least fifteen days prior to the date debt service is due. Once the ODE confirms that the district will be unable to meet debt service payments within three days prior to the debt service payment date, it must deposit the intercepted aid by 2 PM the day before debt service is due. These characteristics support our opinion that program mechanics are strong and the program is expected to continue to be rated one notch lower than the State of Ohio's GO rating.

The Aa2 rating and stable outlook also incorporate Moody's analysis of the sufficiency of interceptable revenues for all enhanced debt issued by the Cleveland Municipal School District and the role of the independent fiduciary. Debt service coverage is strong with estimated fiscal 2015 state foundation aid providing approximately 7.8 times coverage of maximum annual debt service. The paying agent is Huntington National Bank (A3 rating under review) and the paying agent agreement will be signed in accordance with the administrative code requirements. The administrative code also specifies that any solvency loans required by districts under fiscal emergency are not to be included in the coverage calculation and that any state aid payments required for enhancement debt shall be made before any reduction in state aid is made for reimbursement of a solvency assistance advance.

ECONOMY AND TAX BASE: ECONOMIC PROFILE STABILIZING BUT RECOVERY LIKELY TO REMAIN SLOW

Cleveland's (A1 stable) economic profile has stabilized in the aftermath of the 2008-09 recession but recovery will likely continue at a slow pace. The annualized 2014 unemployment rate in the city was 8.9% following steady improvement since a high of 11.7% in 2010, though the labor force contracted by nearly 3% over this same time period. Employment in the city grew 1% during 2014, the first year of growth in over a decade. Economic development efforts of both the city and Cuyahoga County (Aa1 stable) are focused on downtown revitalization. Officials report the downtown residential occupancy rate at 98%, indicating these efforts have been successful in drawing residents to the city center. Notwithstanding these positive developments, the city continues to contend with population loss. The 2010 US Census population of 399,046 was down 17% from 2000. Additionally, The City of Cleveland had a 19% housing vacancy rate during the 2010 census, which is partly attributed to increased foreclosure activity in recent years. The district had a very weak 80.3% current property tax collection rate (87% total collection) in 2014,

After peaking at $18.5 billion in 2007, the district's full valuation declined by a cumulative 28.5% through 2015 to $14.3 billion. The district recorded tax base growth of 0.6% and 1% in the two most recent years and continued downtown redevelopment could drive further tax base expansion.

FINANCIAL OPERATIONS AND RESERVES: IMPROVED FINANCIAL POSITION; LONG TERM FISCAL HEALTH DEPENDENT ON CONTINUED VOTER SUPPORT

We expect that the district's financial operations will remain stable, as a result of continued efforts to cut expenditures to correspond with recent declining enrollment, though future fiscal stability will rely on the renewal of existing operating levies, or the successful passage of new levies.

The passage of a significant operating levy and large expenditure reductions in recent years has stabilized financial operations despite declining state aid, elevated property tax delinquencies, and declining enrollment. The district's financial operations have historically been pressured due in part to inconsistent voter support for operating rate increases. The district had largely relied on substantial expenditure decreases and state aid increases to maintain balanced operations. These operational pressures, exacerbated during the national recession, drove the district's GAAP-basis General Fund balance to a deficit reserve position of -$21.1 million in fiscal 2010.

A new management team initiated a comprehensive restructuring of operations in 2012. The plan included $111 million of expenditure reductions, which included the closure of 23 schools, the lay-off of 594 teaching staff and 565 staff non-teaching staff, wage concessions, and administrative reorganization. The district partnered with local businesses and the state in passing legislation known as the Cleveland Plan to give the district greater flexibility in managing its operations and finances. In November 2012, district voters approved a four-year 15 mill operating levy in support of the plan. The levy generates approximately $62 million of additional operating revenue for the district annually. One out of the 15 mills, or an additional $4.3 million, is directed to partner charter schools. The district used some of the new revenue to recall 193 teachers and restore fifty minutes of instructional time that had been previously eliminated. The substantial expenditure adjustments and new operating revenue restored GAAP-basis General Fund reserves to $43.5 million, or a satisfactory 6.6% of revenues in fiscal 2013. An additional $9.8 million operating surplus in fiscal 2014 increased General Fund reserves to $71.3 million, or 10.2% of revenues.

The district's largest revenue source is state aid, which comprises approximately 65% of fiscal 2014 operating revenues. Basic state aid had been stagnant over the past several years, however, based on the recent budget proposal outlined in the Governor's biennium budget, the district could gain as much $5.3 million and $4.4 million in fiscals 2016 and 2017, respectively, net of continued enrollment declines, including diversions to charter schools. The district has lost approximately 50% of its student enrollment since 1991. Enrollment loss to charter schools results in a direct transfer of the district's state aid to those schools. Over 18,000 district students attended charter schools in fiscal 2015, resulting in a $142 million transfer of state aid. Under the Cleveland Plan, the district has begun to partner with charter schools to insure the quality of education and to further support the operations of those schools with property taxes.

Liquidity

The district's liquidity position is currently healthy but may face pressure in future years. On an audited GAAP-basis, the district's General Fund cash reserves stood at $13 million, or a very limited 2% of revenues, at the close of fiscal 2010. As of fiscal 2014, the General Fund audited net cash balance increased to $83.6 million, or 12% of receipts. On a cash basis, the General Fund carry over was $98.5 million or a similarly healthy 14.1% of General Fund receipts. The district reports actual and forecasted cash operations as required by the Ohio Department of Education twice a year in May and October.

DEBT AND PENSIONS: ABOVE AVERAGE DEBT BURDEN; MORE MANAGEABLE DIRECT DEBT POSITION

The district's overall debt burden is a high 5.2% of estimated full value, largely due to debt issued by overlapping governments. The district's direct debt burden is more manageable at 2.1% of estimated full value. The district does not have any plans to issue additional debt.

Debt Structure

All of the district's outstanding debt is fixed rate.

Debt-Related Derivatives

The district is not party to any swap agreements.

Pensions and OPEB

The district's fiscal 2014 adjusted net pension liability (ANPL) is $2.1 billion, equivalent to a very high 15.3% of full valuation and 2.9 times operating revenue, and indicative of potential long-term operating risks. The ANPL is based upon an allocation of the unfunded liabilities of two multi-employer cost-sharing pension plans to which the district contributes, as well as our methodology for adjusting reported pension information. District employees are members of the State Teachers Retirement System of Ohio (STRS) and School Employees Retirement System of Ohio (SERS), and the district's fiscal 2014 contribution to the two plans was $47.8 million, or 6.6% of operating revenue. We allocated the reported unfunded liabilities of the plans to the district based on its share of total public employer contributions.

Ohio statutes dictate that school districts annually contribute a specified percentage of payroll to both STRS and SERS. While the district has routinely complied with the statutory requirement, those statutory payments have been set well below actuarially sound contributions for a number of years, resulting in steady growth in the plans' reported unfunded liabilities. Ohio law mandates adjustments to plan provisions if projected amortization of unfunded liabilities does not meet certain thresholds. The state legislature adopted reforms for the plans in 2012 to control annual cost-of-living adjustments for retirees and increase employee contributions. While the reforms were effective in reducing the liabilities of STRS and SERS as reflected in fiscal 2013 actuarial valuations, the unfunded liabilities of both plans remain elevated and additional reforms may be necessary. The underfunded status of the plans raises potential operating risks as the state could increase required contributions from school districts in the future.

MANAGEMENT AND GOVERNANCE: MODERATELY STRONG INSTITUTIONAL FRAMEWORK

Ohio school districts have an institutional framework score of 'A' or moderate. Operations are supported by a variable mix of state aid and local property tax revenue, with a minority of school districts also levying local income taxes. State aid has remained stable or grown in recent years and districts have the ability to increase local tax rates with voter approval. While costs tend to be predictable, school districts have limited flexibility to reduce expenditures, if needed, given that costs are heavily influenced by staff levels and compensation is governed by collectively bargained contracts.

The district's declining enrollment trends, charter school competition, reliance on state aid and a reliance on voter support for operating levies will continue to present challenges for the district over the long term. District management has set the groundwork for stabilizing operations over the long-term with a new plan for its levy cycle and operating flexibility granted under the Cleveland Plan as authorized by new state law. The Cleveland Plan provides the superintendent the ability to restructure employment contracts in low performing schools, provides for a performance based compensation structure, allows for staff layoffs and recalls to be determined by performance and not seniority, and the creation of a charter school review process to ensure they are meeting academic standards. The Cleveland Plan has also generated improvements to overall school performance measured by such factors as graduation rates and student satisfaction. This progress is likely to factor favorably into voter support for renewal of the 15 mill levy; current polls suggest adequate support for renewal. Failure to renew the levy would pose significant operating pressure that could result in a negative rating action.

KEY STATISTICS

- Estimated full valuation: $14.3 billion

- Estimated full valuation per capita: $35,850

- Estimated median family income as % of the US: 50.7%

- Fiscal 2013 available General Fund balance / operating revenue: 9.7%

- 5-year change in available General Fund balance / operating revenue: 10.6%

- Fiscal 2013 General Fund net cash / operating revenue: 11.5%

- 5-year change in General Fund net cash / operating revenue: 4.7%

- Institutional framework score: A

- 5-year average operating revenue / operating expenditures: 1.02x

- Net direct debt burden: 2.1% of full valuation; 0.4 times operating revenue

- 3-year average Moody's adjusted net pension liability: 18.2% of full valuation; 3.6 times operating revenue

OBLIGOR PROFILE

The district is located in Cuyahoga County (Aa1 stable) and covers an area of 82 square miles that is essentially coterminous with the City of Cleveland. District enrollment as of 2014-15 is nearly 38,000.

LEGAL SECURITY

The Series 2015A-B General Obligation Bonds are secured by the district's general obligation unlimited tax pledge, which benefits from a dedicated property tax levy that is unlimited as to rate or amount.

USE OF PROCEEDS

The bonds are being issued to finance the costs of constructing, renovating, remodeling, equipping and otherwise improving school district buildings and facilities.

PRINCIPAL METHODOLOGY

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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