

RatingsDirect®

Cleveland Municipal School District, Ohio; School State Program

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Cleveland Municipal School District, Ohio; School State Program

Credit Profile

US\$150.797 mil sch imp bnds (tax-exempt bnds) ser 2015A due 12/01/2052		
<i>Long Term Rating</i>	AA/Stable	New
<i>Underlying Rating for Credit Program</i>	A-/Stable	New
US\$49.203 mil sch imp bnds (federally taxable - QSCB - Direct Payment) ser 2015B due 12/01/2038		
<i>Long Term Rating</i>	AA/Stable	New
<i>Underlying Rating for Credit Program</i>	A-/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'A-' school underlying rating to Cleveland Municipal School District, Ohio's series 2015A and B unlimited-tax general obligation (GO) school improvement bonds. Standard & Poor's also affirmed its 'A-' underlying ratings on the district's existing debt. In addition, we assigned our 'AA' long-term rating to the series 2015 bonds and affirmed our 'AA' long-term rating and underlying rating (SPUR) on the district's existing GO debt, reflecting the district's eligibility for and participation in, the Ohio Credit Enhancement program. The outlook on all ratings is stable.

The 'AA' program rating reflects our opinion of the strength of the Ohio State Aid Intercept program, which provides liquidity and credit support on the bonds; therefore, our long-term rating on the bonds is linked to the intercept program rating. The intercept program rating is 'AA' for districts that meet certain criteria, including Cleveland Municipal School District. (For additional information, see the summary analysis on the Ohio State Aid Intercept program, published Nov. 19, 2004, on RatingsDirect.)

The underlying rating reflects our view of the district's:

- Willingness and ability to make necessary adjustments to offset enrollment declines and other financial pressures to maintain at least adequate cash reserves;
- Total projected unencumbered operating cash balances which officials project will be a good 9.6% of expenditures to end fiscal 2015;
- Moderate overall net debt burden; and
- Participation in Cleveland's deep and diverse economic base.

In our view, the following characteristics constrain the rating:

- A lack of sustained historical support for new operating levies, in part due to infrequent levy referenda;
- Declining enrollment and assessed value (AV); and
- Low per capita effective buying income (EBI).

Cleveland Municipal School District's unlimited-tax GO pledge secures the bonds pursuant to an election held Nov. 4, 2014. It will use bond proceeds to finance the construction, renovation, remodeling, and other improvements to school

district buildings.

The district has been undergoing a financial and academic transition since 2012, when it passed a four-year 15-mill operating levy and adopted the Cleveland Plan. Since then, the district's financial position and academic metrics have improved while enrollment and AV, which are tied to district finances, have stabilized. However, the district's operating levy expires at the end of 2017, and academic reforms and competition from charter and other schools remain challenges.

On Nov. 6, 2012, Cleveland Municipal School District passed a four-year 15-mill operating levy. This was its first operating levy increase since 1996; two other new operating levy referenda failed in 2004 and 2005. Of the levy increase, one mill was designated for partnering charter schools while the remaining 14 mills are for general district operating purposes. The levy increase has enabled the district to restore programs, lengthen the school day, and maintain at least adequate cash reserves over four years. We believe the maintenance of adequate reserves without significant program cuts represents a stabilization of district finances. Prior to the levy passage, the district had to make significant budget cuts annually, including school closures and large layoffs, to maintain a positive cash position because of eroding per-pupil revenue, stagnant operating levies, and a weakened tax base. Management plans to return to voters on a four-year cycle for levy renewal or increases and expects that implementation of The Cleveland Plan will create a culture of support for investment in the district in future levy referenda. The district plans to return to voters in 2016 for a levy renewal.

Recent growth in audited reserves is largely due to the passage of the operating levy in 2012. Measured on a generally accepted accounting principle (GAAP) basis, the district reported an audited \$27.8 million surplus in fiscal 2014, increasing available reserves to \$58.1 million, or a strong 8.5% of expenditures. For fiscal 2013, it reported an audited \$28.4 million surplus and an available fund balance at \$27.8 million, or a good 4.4% of expenditures. Available GAAP basis reserves were only 0.39% of expenditures to end fiscal 2012.

On a cash basis, Cleveland Municipal School District has forecasted that the new levy will enable it to maintain at least adequate reserves through fiscal 2016 without a levy renewal. Its October 2014 forecast projected a \$27.3 million operating deficit, but currently, management expects to have reduced the budget gap to \$17.3 million. Updated fiscal 2015 projections indicate an unencumbered balance of \$69.2 million, or a good 9.6% of expenditures. Management currently projects a \$30.3 million budget gap for fiscal 2016, which would reduce the district's unencumbered cash position to \$38.9 million, or an adequate 5.3% of expenditures. Should the levy fail in 2016, the district would need to close a \$14.4 million gap to maintain positive cash.

The district has been taking aggressive budget-reduction actions for several years. It plans to continue to work to decrease district expenses through labor negotiations, evaluation of facilities for maximum space utilization, and workforce reductions to align with enrollment declines. It reduced staff by 23.6% over fiscal years 2008-2013 and negotiated significant concessions, including salary reductions. Other cuts included reduced programs and school closures. Effective January 2013, the district brought back 193 teaching positions and restored 50 minutes to the school day.

Enrollment losses have been significant over the past 15 years, but partly due to recent reforms, management expects

relatively flat enrollment over the next few years. From fiscal 2001 to fiscal 2015, enrollment has declined 48.7% to 37,771 students. Over the same period, students attending charter schools have increased 453%. District enrollment declined 1.9% in fiscal 2014 and 0.5% in fiscal 2015, indicating a degree of stabilization, and management is projecting a 1.5% increase for fiscal 2016. An external enrollment study indicates a projected enrollment loss of 8,000 students from fiscal 2014 to fiscal 2024, but management is taking actions to retain students. In recent years, district state aid has been guaranteed, meaning that enrollment losses have not significantly reduced district revenue. However, students leaving for charter schools cost the district about \$143.9 million in fiscal 2015. State aid accounts for 60.2% of projected fiscal 2015 revenues. The district stands to benefit from the upcoming biennial budget as currently proposed, although some increase in revenues will be passed through to charter schools and other non-district schools.

Since declining 13.5% to \$4.9 billion in 2013, reflecting a sexennial reappraisal, district AV has increased, reflecting new construction and economic revitalization. AV grew 0.6% in 2013 and 1.0% in 2014. Collections have been poor in recent years, but management has built lower collection rates into its forecast, and poor collections have had no detrimental effects on debt service. Its five-year financial forecast assumes a collection year 2013 collection rate of 89%. Local taxes account for 29.6% of projected fiscal 2015 revenues.

We consider Cleveland Municipal School District's overall net debt burden moderate at 4.9% of market value and low at \$1,801 per capita. Debt service carrying charges have typically been low, and were 2.6% of total government expenditures in fiscal 2014. With the issuance of the new debt, debt service will increase for the first 10 years before dropping back to 2014 levels; however, we expect that carrying charges will remain low. The district has no immediate plans to issue additional debt, but may layer in additional debt with no millage increase over the longer term.

Outlook

The stable outlook on the underlying rating reflects our expectation that the district will continue to make sufficient budget adjustments, supported by the recent levy passage, to sufficiently offset enrollment declines and other financial pressures and maintain at least adequate reserves over the two-year outlook horizon.

While we do not expect the district's credit profile to change substantially over the next two years, sustained voter support, improved student retention, and economic growth over a longer period could strengthen the rating. Reduced community support, more rapid declines in enrollment, and a return to dramatic budget cuts to maintain positive cash could weaken the rating.

The stable outlook on the program rating reflects the outlook on the Ohio GO bond rating.

The Cleveland Plan

On July 7, 2012, Ohio signed House Bill 525, also known as "The Cleveland Plan," into law. Currently, the law is specific to Cleveland Municipal School District. Primarily intended to improve the quality of Cleveland schools, management believes it will improve community support and reduce district expenditures. House Bill 525 transforms the district from a traditional, single-source school district to a new partnership system of district and charter schools. As part of the 15-mill levy, Cleveland Municipal School District will share one mill of the levy with high-performing district and partnering charter schools. Officials anticipate that the partnership between the district and charter schools

will lead to increased school accountability and that the tie between district levies and charter school revenues could improve voter support for future levy referenda. Another provision permits the district to keep high-performing and specialized teachers during layoffs by making tenure and seniority only secondary factors in those decisions. House Bill 525 builds on Ohio's Senate Bill 5, signed March 31, 2011, which included merit-based pay for teachers as well as eliminating salary schedules and step increases for public school teachers in Ohio. Management has incorporated merit-based hiring and incentives in its fiscal 2014-2016 contracts.

Cleveland Municipal School District set out with a four-year implementation strategy, with goals including increasing the number of high-performing schools, the elimination of failing schools, and higher graduation rates. It has achieved many measurable improvements since implementing this plan, which it believes are necessary to win the support of voters for future school levy renewals and increases. The district believes that the passage of the \$200 million bond levy and the 0.5-mill permanent improvement levy in November 2014 (63% approval rate) is a sign of community support.

General economic profile

Cleveland Municipal School District serves a population of 386,662 and serves nearly the entire city of Cleveland, along with the villages of Newburgh Heights, Linndale, and Bratenahl and a small portion of Garfield Heights, entirely within Cuyahoga County. Approximately 99% of the district is within Cleveland, northeastern Ohio, on the shores of Lake Erie. We consider median household and per capita effective buying incomes low at 58% and 61% of their respective national averages. Cleveland's unemployment rate averaged 9.1% in 2013 and was 8.3% as of February 2015, above comparable state averages of 7.5% and 5.6%, respectively. We consider 2014 per capita market value adequate at \$36,998.

While Cleveland had notable population declines over the past decades and decreasing property values in recent years, it has taken measures to revitalize the economy, and new construction has led to economic improvements. Completion of the Cleveland Flats East Development project, the Global Center for Health Innovation and Convention Center, and the Horseshoe Casino are such examples. It is also seeing notable hotel development and a pick-up in activity related to the 2016 Republican National Convention (to be held in Cleveland).

Financial management assessment

We consider the district's management practices "good" under Standard & Poor's Financial Management Assessment methodology, indicating practices exist in most areas, although not all might be formalized or regularly monitored by governance officials. The district reports to the board on budget performance monthly and on investment holdings quarterly. The district does not have a fund balance or debt management policy, but has a formal, five-year financial forecast for the general fund. In addition, the district, in conjunction with the Ohio School Facilities Commission and related to the 2001 bond authorization, formed a master facilities plan.

Pension and other postemployment benefits

District pension and retiree other postemployment liabilities are limited to participation in the School Employees Retirement System and the State Teachers Retirement System of Ohio, cost-sharing, multiemployer retirement plans. Members have a choice among defined-benefit, defined-contribution, and combined plans. District employer required contributions totaled \$51.3 million in fiscal 2014, or 5.6% of total governmental expenditures. The district has

historically contributed 100% of required contributions.

Related Criteria And Research

Related Criteria

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: State Credit Enhancement Programs, Nov. 13, 2008

Ratings Detail (As Of April 20, 2015)		
Cleveland Mun Sch Dist GO State Enhancement		
<i>Long Term Rating</i>	AA/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	A-/Stable	Affirmed
Cleveland Mun Sch Dist GO		
<i>Underlying Rating for Credit Program</i>	A-/Stable	Affirmed
<i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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