Cincinnati City School District, OH

Rating Update - Moody's Affirms Cincinnati School District, OH's Aa2 GO and Aa3 COP Ratings; Outlook Revised to Stable

Summary Rating Rationale
Moody's Investors Service has affirmed the Cincinnati City School District, OH's Aa2 general obligation ratings and Aa3 rating on the district's certificates of participation (COPs). The district has $335 million in general obligation unlimited tax (GOULT) debt, $196 million in general obligation limited tax (GOLT) debt and $103 million in COPs. The outlook has been revised from negative to stable.

The Aa2 GOULT rating reflects the district's very large tax base, sound financial position and trend of favorable operating results. The rating incorporates the district's comparatively weak demographic profile and its elevated debt and pension burdens. The lack of distinction between the GOULT and GOLT ratings reflects the full faith and credit pledge of the district on both securities, in which it pledges to use all available revenues to pay debt service prior to any other use.

The Aa3 rating on the district's outstanding COPs is notched once from the GO rating, reflecting the risk of non-appropriation of lease payments and the more essential nature of the pledged facilities.

Credit Strengths
- Diverse regional economic center anchored by corporate headquarters, healthcare organizations and higher education institutions
- Sound financial position supported by a trend of favorable operating results

Credit Challenges
- Comparatively weak demographic profile evidenced by a negative population trend and low resident income levels
- Elevated direct and overall debt burdens
- Exposure to two underfunded cost-sharing retirement plans that raises long-term operating risks tied to potential increases in contributions
Rating Outlook
The stable outlook reflects our expectation that the district’s healthy financial position will support the current credit rating despite challenges arising from a weak socioeconomic profile and high leverage.

Factors that Could Lead to an Upgrade
» Strengthening of the district’s economic and demographic profile as indicated by improved labor market characteristics, population trends and resident income
» Continuation of solid fiscal management that results in improved financial metrics

Factors that Could Lead to a Downgrade
» Weakening of the tax base or socioeconomic profile
» Narrowing of the district’s reserves
» Increased debt or pension burdens

Key Indicators

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<tbody>
<tr>
<td>Economy/Tax Base</td>
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<tr>
<td>Total Full Value ($000)</td>
<td>$18,782,820</td>
<td>$17,096,213</td>
<td>$17,012,049</td>
<td>$16,906,454</td>
<td>$17,187,449</td>
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<td>Full Value Per Capita</td>
<td>$56,736</td>
<td>$51,800</td>
<td>$51,447</td>
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<td>$51,922</td>
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<td>Median Family Income (% of US Median)</td>
<td>76.7%</td>
<td>75.4%</td>
<td>73.0%</td>
<td>71.9%</td>
<td>71.9%</td>
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<tr>
<td>Finances</td>
<td></td>
<td></td>
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<td>Operating Revenue ($000)</td>
<td>$498,347</td>
<td>$500,339</td>
<td>$511,744</td>
<td>$522,568</td>
<td>$546,146</td>
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<td>Fund Balance as a % of Revenues</td>
<td>29.6%</td>
<td>32.0%</td>
<td>37.3%</td>
<td>37.8%</td>
<td>37.7%</td>
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<td>Cash Balance as a % of Revenues</td>
<td>26.5%</td>
<td>32.2%</td>
<td>35.1%</td>
<td>25.5%</td>
<td>28.7%</td>
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<td>Debt/Pensions</td>
<td></td>
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<td>Net Direct Debt ($000)</td>
<td>$714,255</td>
<td>$720,790</td>
<td>$693,540</td>
<td>$664,965</td>
<td>$635,670</td>
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<td>Net Direct Debt / Operating Revenues (x)</td>
<td>1.4x</td>
<td>1.4x</td>
<td>1.4x</td>
<td>1.3x</td>
<td>1.2x</td>
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<td>Net Direct Debt / Full Value (%)</td>
<td>3.8%</td>
<td>4.2%</td>
<td>4.1%</td>
<td>3.9%</td>
<td>3.7%</td>
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<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Revenues (x)</td>
<td>N/A</td>
<td>3.4x</td>
<td>3.4x</td>
<td>3.2x</td>
<td>2.6x</td>
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<td>Moody’s - adjusted Net Pension Liability (3-yr average) to Full Value (%)</td>
<td>N/A</td>
<td>10.0%</td>
<td>10.2%</td>
<td>10.0%</td>
<td>8.1%</td>
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Source: Audited Financial Statements, US Census Bureau, Moody’s Investors Service

Detailed Rating Considerations
Economy and Tax Base: Recovering Tax Base with Strong Institutional Presence
We expect the district’s tax base to improve in the near to medium term. Current full valuation of $17.3 billion remains 16% below the 2006 peak. Most recently, the district’s tax base grew by 1.7% in 2015 and by an additional 0.6% in 2016, indicating overall stabilization. The City of Cincinnati (Aa2 stable) remains a hub of economic activity in southwest Ohio and is home to multiple corporate headquarters including Kroger Co. (Baa1 stable) and Procter & Gamble Company (Aa3 stable). The second largest employer is the University of Cincinnati (A1 stable), which enrolls over 40,000 undergraduate and graduate students. The city’s institutional base is rounded out by various hospitals, including the university’s health system and Cincinnati Children’s Hospital.
The district's population declined to approximately 330,000 residents in 2010 from approximately 400,000 residents in 1990. Most recent census estimates show that the declining population trend stabilized from 2010 through 2014. As of November 2016, the City of Cincinnati’s unemployment rate (4.4%) was on par with the state’s rate (4.4%) and the national rate (4.4%). The city's labor force is growing. Between 2007 and 2012, the labor force declined to 141,100 from 164,300, a 14% decrease. However, the trend reversed, and labor force grew slowly to 142,309 in 2015. The district’s median family income is estimated at 71.9% of the national figure.

District enrollment declined steadily to approximately 31,000 students in 2012 from 41,000 students in 2002. The declining enrollment trend reversed in 2012 and total enrollment grew to more than 35,000 students during the 2017 school year. Additionally, the district adopted open enrollment in fiscal 2014, which had a positive enrollment impact.

Financial Operations and Reserves: Strong Operating Results and Recent Voter Approval of New Tax Revenue Point to Maintenance of Healthy Reserves

The district's sound financial position, having improved over the last few years with strong operating results, will benefit from recent voter approval of a new local levy. The district closed fiscal 2015 with an audited, GAAP-basis available operating fund balance of $206 million across its general and debt service funds, equal to a healthy 38% of operating revenues. This follows eight consecutive operating surpluses.

On an internal cash basis, the district recorded a fiscal 2015 year-end reserve balance of $59 million, equivalent to a narrower 12% of revenues. Although audited financials are not yet available for fiscal 2016, the district estimates closing the fiscal year with another surplus and cash-basis reserve balance of $66 million, equivalent to 13% of revenues.

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

Notably, in November 2016 voters approved a new money levy that will raise $48 million annually. The additional revenue is expected to support stable operations in the near to medium term.

LIQUIDITY

On a GAAP-basis, the district closed fiscal 2015 with a cash balance of $157 million across its major operating funds. This was equivalent to 29% of fiscal 2015 operating revenues. As with fund balance, the audited cash balance exceeds the district’s internal figures due to the advancement of property taxes from Hamilton County.

Debt and Pensions: Elevated Debt and Pension Burdens

The district’s direct debt burden exceeds state and national medians at 3.7% of full valuation and 1.2 times operating revenue. The high debt burden arises from a plan initiated over ten years ago to renovate or replace all facilities. With no plans to issue additional debt, we expect the district’s direct debt burden to moderate slowly over time. The district’s overall debt burden is elevated at 7% of full valuation, with the City of Cincinnati accounting for a majority of the overlapping debt.

Moody’s adjusted net pension liability (ANPL) for the district, our measure of a local government’s pension burden, is $1.4 billion, equal to an elevated 8% of full value and 2.6 times operating revenue. Fixed costs, inclusive of debt service and retirement contributions, equal 18% of fiscal 2015 operating revenues.

DEBT STRUCTURE

All debt is fixed rate and amortizes over the long term, with 57% of outstanding principal retired in 10 years.

The district’s Series 2015 COPs are secured by rental payments made by the school district, subject to annual appropriation, per a lease-purchase agreement. Failure to renew the lease in any year prior to maturity is an event of default under the agreement and may be remedied by the trustee’s eviction of the district from the pledged facilities. As the pledged facilities consist of four of the district’s high schools, we expect the incentive to annually renew the lease and appropriate payment to remain high. The district’s 2014 and 2015 COPs are further supported by outstanding agreements with Hamilton County and the City of Cincinnati for direct payment of annual lease rental costs via payments to the district in lieu of property taxes. The Series 2012 COPs are similarly secured by annually-
appropriated lease rental payments and are further backed by a pledge of certain elementary school facilities. However, repayment of the Series 2012 COPs is not directly supported by agreements with the City of Cincinnati and Hamilton County.

DEBT-RELATED DERIVATIVES
The district is not a party to any derivative agreements.

PENSIONS AND OPEB
District employees are members of the Ohio State Teachers Retirement System (STRS) and the Ohio School Employees Retirement System (SERS). Ohio statutes establish local government retirement contributions as a share of annual payroll. While the district has routinely made its full statutorily required payment to the cost-sharing plans, statutory contributions to STRS were set well below actuarially based standards for a number of years, resulting in steady growth in that plan’s unfunded liability. In fiscal 2015, the district paid $34 million, or 6% of revenue, to the two plans.

Fiscal 2015 total employer contributions to SERS and STRS were 92% of the plans’ combined “tread water” indicator. The “tread water indicator measures the employer contributions required to prevent reported net pension liabilities from growing, under plans assumptions. After accounting for employee contributions, government contributions that tread water are equal to the sum of current year service cost and interest on reported net pension liabilities at the start of the year. Contributions above the “tread water” level are stronger, from a credit perspective, than contributions below that level because, assuming other plan assumptions are realized, they pay down some net pension liability principal.

Ohio statute establishes a 30-year target for amortizing unfunded liabilities of all statewide cost-sharing plans. If plan actuaries determine that current contribution rates and actuarial assumptions result in an amortization period exceeding 30 years, the pension fund must submit a plan for adjusting contributions or benefits to meet the 30-year requirements. The state legislature adopted benefit reforms for all Ohio cost-sharing plans in 2012 to control annual cost-of-living adjustments for retirees, resulting in a considerable decline in reported unfunded pension plan liabilities in 2013. However, reported net pension liabilities of all Ohio cost-sharing plans grew in 2015, in part due to weak investment returns relative to plan assumptions.

Management and Governance: Moderate Institutional Framework
Ohio school districts have an institutional framework score of “A,” or moderate. Operating revenues consist of local property taxes and state aid, with some districts also levying voter-approved income taxes. Revenues are moderately predictable as property values are improving and state fiscal health supports stability of state aid. Districts have moderate flexibility to raise revenues as they can increase local tax rates with the approval of voters. Expenditures predominantly consist of personnel costs, which are highly predictable. However, these costs tend to be dictated by labor agreements, resulting in a moderate ability to reduce expenditures.

The district has a strong history of renewing existing operating levies and passing new money levies. Approximately 52% of the district’s operating revenues are generated from property taxes, with state aid comprising another 40%. Management also has a strong history of very conservative budgeting practices and financial forecasting, which has resulted in a stable operating trend.

Legal Security
The district’s GOULT debt is by the pledge and authority to levy a dedicated property tax levy that is unlimited as to both rate and amount, to pay debt service. The district’s GOLT bonds are secured by the statutory 10 mill levy apportioned to all overlapping governments to first pay debt service.

The district’s COPs are secured by the district’s annual appropriation pledge to make rental payments.

Use of Proceeds
Not applicable.

Obligor Profile
The Cincinnati City School District is located in southwestern Ohio and includes all of the City of Cincinnati as well as portions of 14 surrounding cities and villages. The district covers approximately 90 square miles. The district operates 43 elementary schools, 17 secondary schools and four satellite schools.
Methodology
The principal methodology used in the general obligation rating was US Local Government General Obligation Debt published in December 2016. The principal methodology used in the lease rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.
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