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Findlay City School District, OH

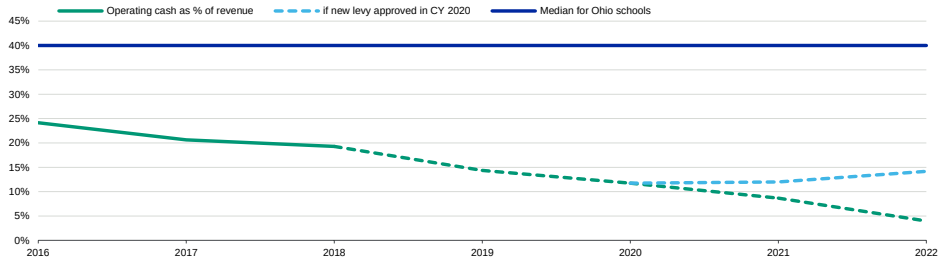
Update to credit analysis following downgrade

Summary

Findlay City School District, OH (A1 negative) has materially reduced its reserve position over the past two fiscal years. Additional operating shortfalls for fiscal years 2019 and 2020 are expected to further reduce reserves to a level well below the sector median. Like all Ohio school districts, the pension burden is also elevated. These challenges are balanced by several strengths, including a healthy tax base and moderate debt burden.

On September 27, we downgraded the district's outstanding general obligation unlimited tax rating to A1 from Aa2 and assigned a negative outlook.

Exhibit 1
District's cash balance is expected to drift further from sector median
Available operating cash as a % of revenue



Dashed blue line represents scenario where voters approve a new $5 million operating levy, with a half-year collection beginning in fiscal 2021. See text below for details.
Source: Audited financial statements, Moody's projections based on district forecast and updates

Credit strengths

» Healthy tax base exhibits recent growth

» Debt burden is moderate

Credit challenges

» Pressured financial position following voter rejection of operating levy

» Elevated pension burden

Rating outlook

The negative outlook reflects the risk that reserves could further diminish to narrow levels in fiscal 2021, absent new revenue or significant expenditure cuts. Management currently

intends to stabilize reserves in fiscal 2021 by seeking a new property tax levy, which would require voter approval in calendar year 2020.

Factors that could lead to an upgrade

» Significant increases in reserves and liquidity

» Expansion of the tax base coupled with strengthening resident income levels

Factors that could lead to a downgrade

» Further declines in reserves or liquidity

» Growth in the debt burden

» Inability to maintain structural balance without the use of reserves

Key indicators

Exhibit 2

Findlay City School District, OH	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$2,201,996	$2,196,763	$2,209,091	$2,238,219	$2,333,128
Population	41,868	41,911	42,061	42,004	41,863
Full Value Per Capita	$52,594	$52,415	$52,521	$53,286	$55,732
Median Family Income (% of US Median)	95.6%	91.8%	94.2%	92.9%	91.5%
Finances					
Operating Revenue ($000)	$63,001	$63,349	$64,869	$67,816	$64,999
Fund Balance ($000)	$13,355	$14,072	$13,999	$12,201	$7,855
Cash Balance ($000)	$14,266	$15,743	$15,659	$13,988	$12,529
Fund Balance as a % of Revenues	21.2%	22.2%	21.6%	18.0%	12.1%
Cash Balance as a % of Revenues	22.6%	24.9%	24.1%	20.6%	19.3%
Debt/Pensions					
Net Direct Debt ($000)	$50,387	$49,271	$48,151	$46,908	$45,560
3-Year Average of Moody's ANPL ($000)	$241,345	$204,688	$202,750	$227,167	$232,723
Net Direct Debt / Full Value (%)	2.3%	2.2%	2.2%	2.1%	2.0%
Net Direct Debt / Operating Revenues (x)	0.8x	0.8x	0.7x	0.7x	0.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	11.0%	9.3%	9.2%	10.1%	10.0%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	3.8x	3.2x	3.1x	3.3x	3.6x

Source: Audited financial statements, US Census, Moody's Investors Service

Profile

Findlay City School District is located in Hancock County (Aa2) in northwestern Ohio (Aa1 stable), approximately 45 miles south of Toledo (A2 stable). The district encompasses the City of Findlay (Aa2) and serves a population of approximately 42,000. Enrollment in the district is roughly 5,500.

Detailed credit considerations

Economy and tax base: manufacturing base in Ohio

We expect the district's tax base will remain relatively large given the diversity of top taxpayers, though the local economy's concentration in manufacturing could expose it to future economic swings. The $2.4 billion property tax base has grown at an average

annual rate of 1.4% over the past five years, nearing full recovery to its pre-recession peak. Management anticipates significant growth of nearly 8% in the next assessment. The top ten taxpayers account for only 5.9% of the total.

Two of the district's largest employers, Cooper Tire and Marathon Oil, have expanded their operations in recent years. Employment in the city continues to grow, with the unemployment rate at a very low 3.4% as of June 2019. Resident income levels slightly trail the nation, with median family income equal to 92% of the national median.

Financial operations and reserves: district seeks voter approval to restore reserves from low level

We expect the district's financial reserves will decline to a level significantly below sector medians for Ohio school districts over the next year. The district closed fiscal 2018 with a shortfall of $4.3 million across its operating funds (General Fund, Debt Service Fund), reducing the available operating fund balance to $7.9 million or 12% of operating revenue. The operating shortfall was generally due to rising expenses in the General Fund, but the decline in fiscal 2018 fund balance was exacerbated by a $2.4 million decline in revenue due to the timing of property tax distributions from the county. On a cash basis, the General Fund declined by $1.5 million in fiscal 2018.

While audited results are not yet available for fiscal 2019, which closed on June 30, management estimates closing the year with a $3.2 million shortfall. On a budgetary cash basis, this would reduce the General Fund cash position to $7.7 million or 13% of revenue. Notably, voters rejected the district's request for a new 1.5 mill levy in November 2018. While the levy was primarily intended for public safety, approval would have mitigated the shortfall in fiscal 2019.

For the current fiscal year 2020, management expects another $1.7 million shortfall, which would reduce the General Fund cash position to $6 million or 10% of revenue. The district intends to seek voter approval of a new operating levy as early as March 2020 in order to reverse this trend. While the exact millage request is yet to be determined, an initial estimate of 5.9 mills would generate nearly $5 million in new annual revenue - enough to stabilize reserves with a half-year collection in fiscal 2021. Should voters reject the new levy, the district has sufficient time to return to the ballot in August or November 2020. Failure to pass a new levy could reduce the General Fund cash position to as low as $4 million or 6% of revenue in fiscal 2021, absent expenditure cuts.

LIQUIDITY

The district's General Fund cash position totaled $11.5 million at the close of fiscal 2018. Inclusive of the Debt Service Fund, the operating cash position was $12.5 million or 19% of operating revenue. The district's cash position is expected to decline in fiscal years 2019 and 2020, as discussed above.

Debt and pensions: moderate debt burden; elevated unfunded pension liabilities

We expect the district's debt burden to remain moderate given limited plans for future borrowing. At the close of fiscal 2018, net direct debt is moderate at 0.7x operating revenue and 2.0% of full value. The district currently does not anticipate any additional borrowing over the next two to three years.

The Moody's adjusted net pension liability (ANPL) for the district totals $233 million, or an elevated 10% of full value and 3.6x operating revenue in fiscal 2018. Overall fixed costs for fiscal 2018, inclusive of debt service, pension and OPEB contributions, were moderate at 14% of operating revenue.

DEBT STRUCTURE

All of the district's debt is fixed-rate and long-term. Debt amortization is below average with 44% of principal scheduled for repayment within 10 years.

DEBT-RELATED DERIVATIVES

The district is not party to any derivative agreements.

PENSIONS AND OPEB

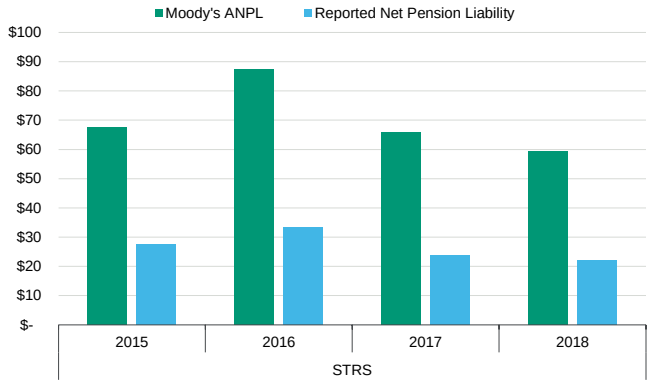
District employees are members of the Ohio State Teacher Retirement System (STRS) and the Ohio School Employees Retirement System (SERS). There is broad legal flexibility in Ohio to amend pension benefits, and statute establishes a 30-year target for amortizing the unfunded liabilities of all cost-sharing plans. In 2012 and 2017, the 30-year target was breached for STRS and the state legislature acted by reducing benefits and increasing employee contributions. The 2012 and 2017 reforms did not increase employer

contributions from participating governments. As of fiscal 2018, the amortization periods for STRS and SERS were 17.8 and 26 years, respectively.

The combined Moody's adjusted net pension liability (ANPL) for STRS and SERS fell by a considerable 23% between 2016 and 2017—primarily the result of the suspended cost-of-living-adjustments implemented in 2017, but also because of strong investment returns. On a reported basis, combined net liability of the two plans fell by 27.1% between 2016 and 2017. The combined ANPL for the plans declined by 9% in fiscal 2018, benefiting from an increase in the market-based interest rate and continuation of the COLA suspension.

Exhibit 3

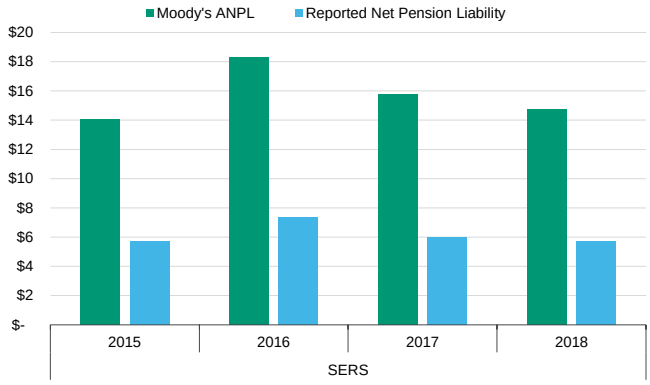
COLA suspension decreases STRS unfunded liabilities ($ billions)



Source: STRS, Moody's Investors Service

Exhibit 4

COLA suspension decreases SERS unfunded liabilities ($ billions)



Source: SERS, Moody's Investors Service

STRS unfunded liabilities may decline over the short-term because statewide contributions were 129% of the amount necessary to tread water[1] in fiscal 2018. Contributions to SERS were only 88% of tread water, indicating that unfunded liabilities in the plan are likely to grow. The tread water indicator is however sensitive to assumed rates of return, which in the case of STRS and SERS are above average at 7.45% and 7.5%, respectively. The use of higher discount rates has the effect of reducing the tread water payment.

Management and governance: moderate institutional framework

Ohio school districts have an Institutional Framework score of "A", which is moderate. The sector's major revenue sources are property taxes and state aid, with wealthier districts relying more heavily on property tax. Local property tax do not have a rate cap, but can be increased with voter approval only. Some school districts also levy a local income tax, which requires voter approval. Revenues and expenditures tend to be predictable. Ohio has public sector unions, which can limit the ability to cut expenditures.

Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 5

Findlay City School District, OH

Rating Factors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$2,336,873	Aa
Full Value Per Capita	$55,822	A
Median Family Income (% of US Median)	91.5%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	12.1%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	-4.1%	Baa
Cash Balance as a % of Revenues	19.3%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	0.1%	A
Notching Factors:[2]		
Other Analyst Adjustment to Finances Factor: Expected draws in fiscal 2019 and 2020		Down
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.9%	A
Net Direct Debt / Operating Revenues (x)	0.7x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	10.0%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	3.6x	A
	Scorecard-Indicated Outcome	A2
	Assigned Rating	A1

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology dated December 16, 2016
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs Updated for 2019 publication.
Source: Audited financial statements, US Census Bureau, Moody's Investors Service

Endnotes

1 Our "tread water" indicator measures the annual contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year,

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