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Mayfield City School District, OH

Update to credit analysis

Summary

Mayfield City School District (Aa1) benefits from extremely strong reserves that are expected to remain high given conservative budgeting and an absence of renewal risk as all levies are continuing levies. The debt burden is moderate consisting almost entirely of certificates of participation (COPs), which are paid from a permanent improvement levy that generates significantly more revenue than annual debt service. The tax base, located in the Cleveland metro, has solid resident income levels though they trail the medians for the rating category. The rating also considers the district's exposure to underfunded state cost-sharing pension liabilities, which remains high though was materially lowered due to recent reforms.

Credit strengths

» Very strong reserves supported by lack of levy renewal risk

» Permanent improvement levy provides for ongoing capital investments, revenue generated significantly exceeds COPs debt service

Credit challenges

» Exposure to underfunded state cost-sharing pension liabilities

Rating outlook

Outlooks are usually not assigned to ratings of local governments with this amount of debt.

Factors that could lead to an upgrade

» Major expansion of tax base and increases in resident income levels

» Moderation of pension burden

Factors that could lead to a downgrade

» Material tax base contraction and/or weakening of wealth indices

» Substantial draws on reserves

» Large increases in debt or pension burdens

Key indicators

Exhibit 1

Mayfield City School District, OH	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$3,653,742	$3,640,956	$3,658,582	$3,690,661	$3,715,666
Population	33,006	32,882	32,889	32,952	32,952
Full Value Per Capita	$110,699	$110,728	$111,240	$112,001	$112,760
Median Family Income (% of US Median)	124.2%	120.4%	120.4%	120.4%	120.4%
Finances					
Operating Revenue ($000)	$71,234	$68,252	$70,554	$69,873	$76,965
Fund Balance ($000)	$37,393	$36,259	$43,189	$46,352	$53,956
Cash Balance ($000)	$31,716	$33,620	$35,539	$42,285	$52,355
Fund Balance as a % of Revenues	52.5%	53.1%	61.2%	66.3%	70.1%
Cash Balance as a % of Revenues	44.5%	49.3%	50.4%	60.5%	68.0%
Debt/Pensions					
Net Direct Debt ($000)	$45,521	$44,804	$43,163	$58,230	$56,084
3-Year Average of Moody's ANPL ($000)	$301,219	$257,281	$252,566	$271,988	$269,756
Net Direct Debt / Full Value (%)	1.2%	1.2%	1.2%	1.6%	1.5%
Net Direct Debt / Operating Revenues (x)	0.6x	0.7x	0.6x	0.8x	0.7x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	8.2%	7.1%	6.9%	7.4%	7.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	4.2x	3.8x	3.6x	3.9x	3.5x

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

Profile

Mayfield City School District is located in suburban Cleveland (A1 stable) serving the cities of Highland Heights (Aa2) and Mayfield Heights, and the villages of Mayfield and Gates Mills. The district provides kindergarten through 12th grade education for roughly 4,000 students in a community of an estimated 32,914 residents.

Detailed credit considerations

Economy and tax base: large district in suburban Cleveland

We expect the district's tax base and economy will continue to benefit from its location within the greater Cleveland metropolitan area. Currently valued at a sizable $3.97 billion in its 2019-2020 sexennial reappraisal, the district's tax base has experienced modest increases over the past several years but remains approximately 4% below pre-recession highs.

The tax base is relatively diverse with residential real estate comprising 70% assessed value followed by commercial/industrial property at 29%. While residents benefit from access to a variety of employment opportunities throughout the metro area, notable local employment sectors include insurance and health care. The district is home to the headquarters for Progressive Casualty Insurance Co (Aa2 stable) which serves as the district's largest employer and taxpayer (4.5% of assessed valuation). In December 2018, the county's unemployment rate of 5.0% was slightly elevated as compared to the state and nation, which had rates of 4.8% and 3.7%, respectively, for the same month. Overall, the district's estimated median family income is a healthy 120.4% of US figures though it trails medians for the rating category. Enrollment is stable at roughly 4,000, although enrollment does not contribute much to revenue generation as the district is currently at the state's funding floor.

Financial operations and reserves: very strong reserves expected to remain high

Mayfield City School District will likely maintain very high reserves for at least the next five years, benefitting largely from continuing property tax levies. At $54.0 million in available fund balance at the end of fiscal 2018, the district's reserves were equal to a very high

70.1% of operating revenue (including general fund and debt service fund). Reserves grew from ten years of consecutive operating surpluses, aided by proactive new levy requests in 2012 and 2016. The district is projecting an additional $4.7 million in operating surplus for fiscal 2019, and it is expecting to continue surpluses through 2020, which will keep it well above its fund balance policy of maintaining at least 25% of general fund expenditures in reserves.

LIQUIDITY

Liquidity is similarly very strong as the district had $52.4 million in net cash at the end of fiscal 2018, equal to 68.0% of revenue.

Debt and pensions: moderate fixed costs despite above average pension burden

The district's debt burden will likely remain moderate given no borrowing plans, and its pension burden will remain elevated despite a decline following state pension plan cuts. At $56.1 million, the district's debt burden at the end of fiscal 2018 was a moderate 1.5% of full value or 0.7x operating revenue. The Moody's adjusted net pension liability (ANPL) declined 21% to $242 million from $308 million, bringing the three year average to $270 million or a still high 3.5x revenue. Compared with the tax base it is more elevated at 7.3% of full value. Fixed costs, inclusive of debt service and retirement contributions, was a moderate 14% of fiscal 2018 operating revenue.

The district has no future borrowing plans and is able to make ongoing capital investments given the presence of a permanent improvement levy, which generated $2 million in excess of COPs debt service in fiscal 2018.

DEBT STRUCTURE

All of the district's debt outstanding is fixed rate and amortizes somewhat slowly with roughly 45% of principal paid in ten years. As of the end of fiscal 2019, the district will have $52.5 million in certificates of participation (COPs) outstanding with no GO debt. The district's COPs are secured by a ground lease and a lease agreement subject to annual renewal by action of the district board of education's appropriation of lease payments. School facilities are the pledged assets on the COPs. The district generates $6.1 million annually through its continuing permanent improvement levies, providing substantial coverage for COPs debt service of roughly $4 million annually through the life of the bonds.

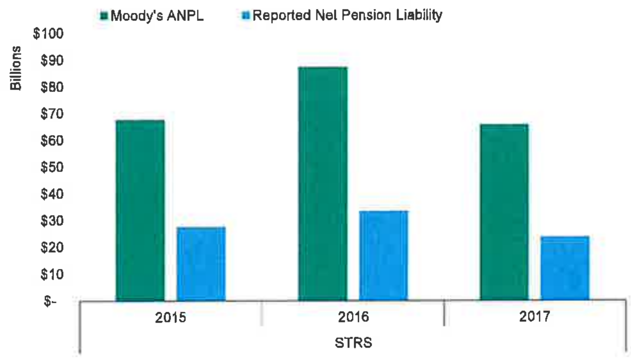
DEBT-RELATED DERIVATIVES

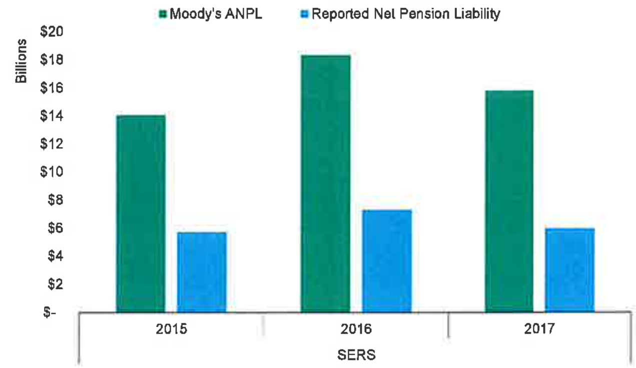
The district is not party to any derivatives or interest rate swap agreements.

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.

Moodys adjusted net pension liability (ANPL) is our measure of a local governments pension burden that uses a market-based interest rate to value accrued liabilities. The combined Moodys ANPL of 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.





Going forward, we expect unfunded liabilities to grow because statewide contributions remain below the amount necessary for the two plans to tread water[1]. Fiscal 2017 employer contributions, which are set by the state as a share of annual payroll, were 75% and 85% of the amounts needed to tread water in STRS and SERS, respectively.

Management and governance: moderate institutional framework; strong levy election history

Ohio school districts have an Institutional Framework score of A, which is moderate. Institutional Framework scores measure a sectors legal ability to increase revenues and decrease expenditures. The sector's major revenue sources are property taxes and state aid. Local property tax rates can be increased with voter approval only. The district benefits from continuing property tax levies, which produce 85% of operating revenue. Because all levies are continuing, the district will not require levy renewals. Management does not currently have plans for additional levy proposals. The district's practice is to consider additional levies in the first year of draws on reserves. Some school districts also levy a vote approved local income tax, although Mayfield City School District does not levy an income tax. Additionally, the district has a strong election track record, passing 3 of 4 levy requests in the past ten years.

Revenues and expenditures tend to be predictable. Ohio has public sector unions, which can limit the ability to cut expenditures. Mayfield City School District is in its first of four years in its new union contracts, and contractual salary increases are included in its financial forecasts.

Endnotes

1 Our "tread water" indicator measures the annual government 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. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.