Summary:
Toledo City School District, Ohio; School State Program

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Rating Action

S&P Global Ratings assigned its ‘AA’ long-term rating and ‘A+’ underlying rating to Toledo City School District, Ohio's 2020 general obligation (GO) taxable school facilities improvement refunding bonds. At the same time, S&P Global affirmed its ‘AA’ long-term rating and ‘A+’ underlying rating on the district's GO debt outstanding. The outlook is stable.

Security and use of proceeds

The district's full faith and credit, including its ability to levy ad valorem property taxes without limitation as to rate or amount, secures the 2020 GO bonds and its GO bonds outstanding.

The 2020 bond proceeds will be used to partially advance refund the district's 2014 and 2012B GO bonds for debt service savings with no extension of maturity.

The ‘AA’ enhanced long-term rating on some of the district's debt outstanding is one notch below our GO rating on Ohio (AA+/Stable), reflecting our view of the following:

- State aid appropriation risks are partially mitigated by strong state support for the program and consistent and well-established state aid funding.
- Maximum annual debt service coverage provided by state aid payments will continue to exceed approximately 8x on a semiannual basis.
- The flow of state aid distributions and debt service payment dates result in a moderate assessment of timing and administrative risks, given the timing mechanisms that allow for notification to the state and an intercept before debt service payment.

Credit overview

Toledo City School District, the fourth-largest in the state by enrollment, carries a recent track record of financial and operational resilience following decades of enrollment and population decline across the Toledo metro area. Following
a Transformation Plan, initiated in 2011, and new leadership in 2015, the district has managed to successfully compete with charter schools, recapture student market, and improve educational outcomes, all while generating positive operating results and carrying a manageable amount of debt. Its consistent performance has allowed the district to accumulate a very strong general fund reserve position. Given the nuances of the levy cycle among Ohio school districts, the district's ability to maintain its financial position will depend on continued strong voter support, maintenance of state aid levels, and stable property values. The economic turmoil initiated by the COVID-19 pandemic may challenge these factors. However, given the district's revenue composition--with a reliance on state aid and property taxes--we believe that the district is comparatively insulated from the immediate impacts of the economic environment, and that its credit quality should remain stable. An extended economic downturn would have negative secondary impacts to the districts, including potential declines in state aid funding levels, assessed value (AV), or enrollment. If this scenario were to occur, our view of the district's credit quality could deteriorate. We view this situation as fluid, and will continue to monitor economic conditions and their impact on the district's budgetary performance.

The stable outlook on the enhanced rating reflects our views of the state's creditworthiness and that Ohio's support for the program will remain strong. We expect that coverage will remain strong over the two-year outlook horizon given the program's structural features and recent state aid trends.

The 'A+' underlying rating further reflects our view of Toledo City School District's:

- Very strong reserves, supported by a track record of positive financial performance and supportive financial management practices;
- Manageable debt burden with no additional debt plans;
- Financial projections indicating dependence on maintenance of strong state and voter support; and
- Relatively heightened economic sensitivity and history of demographic challenges given its location in the Toledo metro area.

**Stable Two-Year Outlook**

**Downside scenario**
All else equal, we could consider a lower rating if the district is unable to align recurring revenue or expenditures, leading to sustained draws on its reserve position without a plan in place to restore balances, or if voter support for property tax levies declines.

**Upside scenario**
All else equal, we could consider a higher rating if the district is able to maintain its reserve position through the economic downturn, if state and voter support remain strong, and if the district's enrollment and population show long-term stability.
Credit Opinion

Challenged economy that has historically depended on manufacturing, though recent diversification provides support

Toledo City School District serves an estimated population of 221,631 and encompasses an area of 72 miles, including approximately 70% of the City of Toledo and components of Spencer and Harding townships and the Village of Ottawa Hills with Lucas County. In our opinion, median household and per capita effective buying income are relatively low at 64% and 65%, respectively, of national averages. We also consider the district's estimated per capita market value low at $30,672 per capita. Taxable AV and market value remain below their 2007-2008 pre-recession peaks, and this partly reflects reappraisals. However, values have risen 5.4% over the past five years. We consider the district's property tax base diverse, with residential property accounting for 67% of values and the top 10 taxpayers for 13.4% of taxable value.

Toledo's local economy has historically been concentrated in manufacturing, including major employers in automobile and auto parts manufacturing, glass, and furniture. The city's labor market has diversified to include major employers in health care, education, and logistics and distribution industries, and also includes several large oil refining centers. The metro economy is supported by several universities, including the University of Toledo and Bowling Green State University. Nonetheless, the Toledo metro economy remains 72% more concentrated in manufacturing than the U.S. average, with this relative concentration forecasted to grow according to projections from IHS Markit. The metro area's top employers include ProMedica Health System, Mercy Health, Fiat Chrysler, The University of Toledo, UPS, Sauder Woodworking Co., and General Motors. Ongoing economic development efforts are largely focused on reinvigorating the city's downtown core and continued growth in the city's Overland Industrial Park.

As the economic fallout from the COVID-19 pandemic intensifies throughout U.S. state, the state, and county, unemployment filings, which have already spiked in the county and throughout Ohio, will likely increase, at least in the short term. S&P Global Ratings' most recent forecast, published March 17, 2020 on RatingsDirect, points to a 1% annualized decline in GDP in first-quarter 2020 and at least a 6% annualized decline in the second quarter. The county's unemployment rate peaked at 14.0% during the 2007-2008 financial crisis and has declined year over year to 4.7% in 2019. Partly as a result of the manufacturing sector's economic sensitivity, the unemployment rate within Lucas County tends to trend above state and national figures. Several of the city's large manufacturing employers, including Fiat Chrysler and General Motors, have temporarily halted operations to protect employees from the spread of COVID-19.

Given that the district's revenue consists primarily of state aid and, to a lesser extent, property taxes, the immediate impacts to the district are limited in our view. The ultimate economic impact to the district remains to be seen and depends on the length and depth of the downturn. If the situation is extended, longer-term implications, including manufacturing and supply chain disruptions, may exacerbate the area's demographic challenges, including decades of population stagnation and decline, and aging residents, leading to enrollment and AV declines. If the downturn is short-lived, we anticipate that the district will remain relatively insulated.
Stable financial performance
School districts in Ohio generally rely on a combination of property tax and state-shared revenue. The formula for state-shared revenue has undergone changes in recent years, but in general is based on per-pupil enrollment. Therefore, as enrollment has a direct impact on revenue, we view it as an important credit factor when assessing school districts in the state. Property taxes within the district and property tax relief payments from the state accounted for 29.4% of 2019 general fund revenue, while state distributions under the education funding formula accounted for 68.6%.

Over the past six years, the district's financial, operational, and educational achievements have pointed to a successful turnaround story. In fiscal years 2009 to 2014, enrollment declined nearly 18%, reflecting the impact of population decline in Toledo, local economic conditions, and pressure from community (charter) schools. Since 2015, enrollment figures have stabilized, with growth realized in several years, countering several decades of decline. Overall, enrollment for the 2020 school year is up 4.7% over the low point in 2014. Projected enrollment of 22,985 for the 2021 school year is up from 22,905 in 2020. We note that the district's market share of students within its boundaries is up to 68.8% in 2020 from 60.2% in 2017. This partly reflects the district's expansion of pre-K programs, but also reflects success at higher grade levels partly as a result of positive enrollment at its magnet schools, which are considered Schools of Choice. The district's growth in market share includes students recaptured from charter schools or students who never previously attended district schools. Charter attendance in the district of 7,517 is down from a high of 9,829 in 2014.

The district does remain pressured from competition with private schools, and growth under the state's EdChoice program, which requires districts to provide funds to a certain number of students attending private schools, has exacerbated this. However, these costs remain minor relative to the district's forecast 2020 general fund expenditures, at only 4.7%, though nominal distributions have grown 87% since 2015. Measures within the Ohio General Assembly seek to modify the program and alleviate pressure on local districts, and a bill in each chamber has been proposed, though a reconciliation of bills and details has stalled. The district also loses a small net number of students under its open enrollment policy. However, the district has realized some of the most robust educational achievement improvements among large Ohio districts in recent years. We understand the district continues to make efforts to strategically evaluate and enhance its programming, building upon the success since 2015. As a result, we anticipate that its market share of students will at least remain stable.

The district has seen positive results in its general fund since 2011. This follows increases in enrollment since 2015, declines in charter enrollment, AV growth since 2015, and changes to the state aid formula providing more resources for economically challenged districts. The district's operating results and successful property tax measures have allowed it to accumulate a 2019 general fund reserve position equal to 22.3% of expenditures on a generally accepted accounting principles basis. This includes a committed balance for budget stabilization equal to $6.6 million. The district increased its budget stabilization reserve to $8.5 million in 2020 to provide an amount approximately equal to one month of payroll.

A large portion of school property tax levies in Ohio are based on a revenue level, rather than a rate that fluctuates with AV. This creates what is known as the levy cycle in Ohio, in which districts must often seek voter approval for new levies as revenue becomes insufficient to match rising costs. Thus, voter support is usually a key factor in the
maintenance of strong district finances. We note the district's voter base has passed every measure since 2013.

School districts in Ohio are required to submit five-year financial forecasts to the state. Toledo's forecast shows drawdowns in 2020 through 2024, largely reflecting its position within the levy cycle. Estimates for 2020 highlight a drawdown of $10.0 million on a budgetary basis, though this is positive relative to the originally forecast drawdown of $11.4 million. The district's financial strategy involves extending its levy cycle as far as possible before asking for replacement levies or additional taxes, as well as incorporating updates from the state on education funding. Additionally, we note that the district has realized positive results compared with those projected in previous five-year forecasts.

The COVID-19 pandemic has contributed to uncertainty across Ohio school districts. Schools across the state are closed for a three-week period, with plans to reopen or plans to extend instruction into the summer yet to be determined. We will continue to monitor the impacts from the economic environment for Toledo City School District as well as school districts across Ohio, though we anticipate no significant changes to overall credit quality.

Our view of the district's financial health and overall credit quality largely depends on its ability to manage its budget and ultimately maintain a healthy reserve position. Given its strong financial management practices, we anticipate that it will be able to balance revenue and expenditures over the long term. However, if projections under the five-year forecast materialize without plans to adjust revenue or expenditures, our view of the district's credit quality could deteriorate.

**Supportive financial management practices and policies**

S&P Global Ratings considers the district's financial management practices good under its financial management assessment methodology, indicating our view that practices exist in most areas although not all may be formalized or regularly monitored by governance officials.

The district's budget process is comprehensive and dovetails with its five-year forecast. With the majority of the district's revenue coming from the state, enrollment figures and state aid are budgeted conservatively, allowing the district to outperform its budget in recent years. For expenditures, the district requires budget justification for line items, utilizes historical information, and incorporates fixed and contractual costs where present. Monthly financial updates are provided to the board and include comments on budgetary performance to date, an analysis of performance against forecast results, budget-to-actual analysis, a summary of budgetary amendments, and information on investment performance. The district maintains a formal five-year forecast that is updated at least twice per year per state statutes. In terms of capital planning, the district carries a regularly updated maintenance plan financed with a 0.5-mill classroom maintenance levy, and holds periodic buildings and grounds meetings. The district carries comprehensive and formally adopted debt and investment management policies. The district carries a budget stabilization policy, including a budget stabilization reserve that shall not exceed 15% of general fund appropriations. Each fiscal year, 50% of the increase in the general fund unencumbered fund balance will be set aside into the stabilization reserve. Should the operating fund balance decrease, the budget stabilization reserve will be reduced.

**Manageable debt position with retirement benefit costs likely to increase**

In our opinion, the district's overall net debt is moderate at 3% of market value, and very low at $933 per capita. Amortization is fairly rapid, with 60% of the district's direct debt scheduled to be retired within 10 years. The debt
service carrying charge was 4.3% of total governmental fund expenditures excluding capital outlay, which we consider low, in fiscal 2019. We understand the district has no debt plans.

Pension and other postemployment benefit (OPEB) liabilities:

- Pension and OPEB costs are manageable for the district, though pension cost escalation is likely given plan assumptions.
- OPEB cost pressures are relatively minimal given that one of the district's plans is fully funded while the other plan has a low funded ratio, though progress is being made to build an asset position.

Toledo City School District participated in the following plans as of June 30, 2019:

- Ohio State Teachers' Retirement System (STRS): 77.4% funded, with a proportionate share of the plan's net pension liability of $279.9 million
- Ohio State Employees Retirement System (SERS): 70.9% funded, with a proportionate share of the plan's net pension liability of $98.3 million
- OPEB (STRS): 175% funded, with a proportionate share of the plan's net OPEB asset of $20.3 million
- OPEB (SERS): 16% funded, with a proportionate share of the plan's net OPEB liability of $41.1 million

The district met our calculations for static funding across both pension plans, meaning the district's total pension liability is declining. However, our calculations for minimum funding progress were missed, meaning progress toward fully funding may be extended and that contributions will escalate over time. This scenario is common under plans that utilize a level-percent-of-pay amortization basis. STERS and SERS utilize a closed amortization period, which we view positively, though we consider amortization periods extended at 26 years. In our view, both plans carry comparatively high discount rates with STERS at 7.45% and SERS at 7.5%, introducing risks associated with contribution volatility under scenarios in which investment experience deviates from the discount rate.

Required pension contributions are determined on a statutory basis and currently follow an actuarially determined amount. The district paid its fully required contribution of $27.2 million, or 5.8% of total governmental expenditures in fiscal 2019. OPEB contributions for 2019 amounted to 0.2% of total governmental expenditure.

**Related Research**

Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.