FITCH AFFIRMS TOLEDO CITY SCHOOL DISTRICT, OH'S IDR AND ULTGO BONDS AT 'A-'; OUTLOOK STABLE

Fitch Ratings-New York-17 August 2017: Fitch Ratings has affirmed the following Toledo City School District, Ohio bond ratings at 'A-':

--$23.6 million unlimited tax general obligation ULTGO bonds, series 2009;
--Issuer Default Rating.

The Rating Outlook is Stable.

SECURITY
The bonds are a general obligation of the district, payable from an ad valorem tax on all taxable property within the district, unlimited as to rate or amount.

The bonds qualify for the Ohio School District Credit Enhancement Program which is rated 'AA' by Fitch.

ANALYTICAL CONCLUSION

The affirmation of the 'A-' rating reflects the district's limited revenue raising flexibility, adequate ability to cut expenditures, moderate long-term liability burden and limited gap-closing ability during times of economic downturn.

Economic Resource Base
Toledo City School District covers 72 square miles in Lucas County in northwestern Ohio, approximately 75 miles east of the Indiana border and within 5 miles of the Michigan border. The district's territory adjoins Lake Erie and encompasses approximately 70% of the city of Toledo, 66% of Spencer Township, with the remainder comprised of Harding Township and the Village of Ottawa Hills. The city of Toledo's population decreased about 10% since 2007 to 279,789 in 2016, affected by the decline of a large manufacturing presence. School district enrollment has followed this trend, and is down approximately 25% in the past 10 years, but saw modest increases in 2015 (0.25%) and 2016 (1.5%). Fitch expects to continue to see modest positive gains in the near term due to new pre-school programs and declining charter school enrollment.

KEY RATING DRIVERS

Revenue Framework: 'bbb'
Revenue growth is expected to remain stagnant. Changes to the state aid formula, along with some gains in enrollment may drive modest future revenue gains. The district's independent ability to raise revenues is highly constrained.

Expenditure Framework: 'a'
Flexibility of main expenditure items is adequate and may result in manageable cuts to core services during an economic downturn. Fitch believes the natural pace of spending growth will remain above that of revenues.

Long-Term Liability Burden: 'aa'
The combined liability burden of overall debt and net pension liabilities is moderate in relation to the district's resource base.

Operating Performance: 'bbb'
The district has limited gap-closing ability. Voter support for new and renewal levies has been inconsistent which could contribute to stressed operations in an economic downturn as it has in the past.

RATING SENSITIVITIES
ENROLLMENT CHANGES: Enrollment declines and increases in charter school competition may decrease state aid available for district operations and put negative pressure on the rating.

VOTER SUPPORT: Continued voter support for new and renewal levies is key to financial stability. Changes in patterns of voter support could affect credit quality.

CREDIT PROFILE

The local economy is driven mostly by manufacturing with a concentration in the automotive industry complemented by the healthcare and university sectors. The unemployment rates in the district are about twice the state and the nation, with income levels below. In addition, 2015 poverty rates were nearly double those of the state and nation.

Taxable assessed value (AV) suffers from sustained downward trends, declining 33% since the 2007 peak. AV for 2016 declined modestly from the prior year, despite the triennial update of values. Leading taxpayers are diverse and include a casino, several utilities and large real estate holdings.

Revenue Framework
Ohio school districts operate within a restrictive revenue environment. Revenue growth prospects are stagnant and the legal ability to raise revenues is limited. State aid comprises about 70% of general fund revenues. Outside mills, levied on a fixed rate and fixed dollar basis, account for approximately 27% of general fund revenues.

The district expects state aid to increase at the state maximum cap of 3% in 2017 and 2018. The district is competing with both charter schools and other districts (through open enrollment) for per-pupil funding. Nevertheless, enrollment increased modestly last year due to headstart programs that transition children into the elementary public school system without the option to transfer to charters. In addition, management expects to attract and retain students due to several charter school closings and anticipates modest increases to enrollment in the near term.

Ad-valorem tax revenues are projected to remain flat, a projection Fitch believes is reasonable, given AV trends and the limited ability for the property tax millages to capture economic growth.

Fixed-rate levies can capture economic growth from new construction. However, fixed-rate levies on existing property are subject to rate roll-back provisions during times of revaluation that prevent the district from receiving revenues in excess of the prior year. Fixed-rate levies comprise approximately 18% of general fund revenues.

Fixed-dollar levies do not capture AV growth and account for about 4% of general fund revenues.

State law limits school districts' ability to raise revenues without going to voters to fees, charges, and other locally controlled revenues. However, districts like Toledo that have a high percentage of economically disadvantaged students in attendance are prevented from raising these charges.

Income and property tax "outside millage" levies require voter approval. The district's outside millage consists of both continuing and renewal levies. Renewal levies are exposed to voter-renewal risk every 5 to 10 years. Outside mill renewal risk accounts for about 8% of general fund revenues.

Expenditure Framework

General instruction, which includes teachers' salaries, is the district's largest expenditure item, accounting for approximately 66% of general fund spending.

Fitch expects the pace of spending growth to be above the expected pace of revenue growth without consideration of expenditure controls.

Fiscal 2016 carrying costs for debt and pension, and other-post employment benefits (OPEB) are low at about 8% of governmental expenditures. Carrying costs declined modestly from prior years, due to reductions in OPEB actuarially required contributions and increased governmental expenditures. Fitch's supplemental pension metric, which estimates the annual pension cost based on a level dollar payment for 20 years with a 5% interest rate, indicates that carrying costs are vulnerable to significant future increases. For more information, see "Revised Pension Risk Measurements (Enhancing Pension Analysis in U.S. Public Finance Tax-Supported Rating Criteria)" dated May 31, 2017.

Charter school spending currently comprises a high 30% of general fund expenditures. However, several charter schools are closing in the area and management projects a reduction in charter school expenses. In addition, the district may be able to limit the impact of charter school spending on its budget if it is able to attract new students. Discretionary spending was reduced by 25% for the district's 2016 cash budget, which limits future opportunities for cost savings.

Union negotiations have recently been settled and labor contracts include manageable step increases over a three-year term.

Long-Term Liability Burden

The district has a moderate long-term liability burden, with overall debt and net pension liability at 13% of personal income. Direct debt levels, equal to about 14% of total long-term liabilities, are expected to decline as the district does not plan to issue new debt in the near term and about half of the debt is scheduled to be retired within the next 10 years. Fitch-adjusted net pension liability comprises approximately 72% of long-term liabilities.

Pension and OPEB are provided through two state sponsored defined benefit pension plans, the Ohio School Employees Retirement System (OSERS) and the Ohio State Teachers Retirement System (OSTRS). When combined, the plans' reported assets to liabilities ratio is 71.5% assuming a 7.75% rate of return, as of Dec. 31, 2015. Using Fitch's more conservative 6% rate of return the estimated assets to liabilities ratio is a weaker 59.4%.

Operating Performance

Financial resilience is limited, given the district's history of reserve maintenance, limited inherent budget flexibility and moderate expected revenue volatility. Financial resilience through economic downturns has been pressured by poor support for new voter-approved levies. For example, the district passed new operating levies in 2014 which were the first new levies to receive voter approval since 2008, with three failed attempts in between. During this same period fund balances fell to a deficit position and did not regain positive balances until the passage of the 2014 levy. Operations could experience additional stress if future levies do not receive voter approval, causing a delay in gap-closing measures and further reduction of fund balance. Current unrestricted general fund reserves total 15.2% of spending.

Management adheres to the common Ohio school district budgeting practice of exhausting reserves before a new tax levy is submitted for voter approval or other policy action is taken to replenish fund balances. The district plans to ask voters for a 10 year renewal levy in 2018, which if passed will address a cash-basis general fund deficit in 2019. Renewal levies have historically received voter support. While the district follows this budgeting cycle, management has proactively built in some additional cushion in preparation for times of economic downturn. This includes the authorization of a formal debt policy and the option to divert budgeted pay-go capital expenditures for general fund operations. In addition, management has restricted $6.6 million of operating surplus to a general fund reserve account and expects to add an additional $6 million-$8 million by 2018, equal to approximately 4% of general fund expenditures and transfers out.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
https://www.fitchratings.com/site/re/898466

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