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CREDIT OPINION
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Cuyahoga (County of) OH

Update to credit analysis

Summary

Cuyahoga County, OH's (Aa2) strong credit profile benefits from a large revenue base and sound fiscal management. Healthy operating reserves and very strong coverage on revenue debt provide a strong buffer against anticipated revenue loss in 2020. Key credit challenges include high leverage both from its direct debt and contingent liability debt of MetroHealth System (Baa3 stable), a component unit of the county.

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and financial market declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Cuyahoga County. The county currently projects that the coronavirus and associated stay-at-home order will result in material sales tax revenue losses in the current fiscal year, although management intends to fully offset these losses through furloughs and other expenditure reductions. MetroHealth also maintains substantial liquidity to address challenges associated with the coronavirus pandemic. However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Cuyahoga County changes, we will update the rating and/or outlook at that time.

This report reflects recent updates from the county related to the coronavirus outbreak, primarily related to finances. The rest of the report remains largely unchanged from our prior report dated March 16, 2020. On April 23, we affirmed the county's issuer rating, all notched ratings, and the sales tax revenue rating.

Credit strengths

» Very large tax base encompassing the City of Cleveland (A1 stable) and many surrounding suburbs

» Healthy financial position supported by recent revenue growth and strong fiscal management

Credit challenges

» Debt burden exceeds sector medians and pension burden is high due to participation in underfunded cost-sharing retirement plans

- Contingent liability risk associated with the MetroHealth System and financial commitments to economic development initiatives
- Economically-sensitive sales taxes comprise the bulk of the county's general operating revenue

Rating outlook

The stable outlook reflects Moody's expectation that reserves will stabilize at a healthy level despite projected sales tax revenue losses in fiscal 2020 given management's plan to reduce expenses. The county plans to implement furloughs and make other expenditure cuts to offset revenue losses. Management is also seeking voter approval of new revenue to support growing health and human services costs. The outlook also considers the county's extensive tax and revenue base and sound fiscal management practices that include adoption of a two-year budget and quarterly adopted five-year financial forecasts.

The county has some exposure to contingent liability risk from MetroHealth, but we expect management would make budgetary adjustments to mitigate any impact on general operations should the system require additional support.

Factors that could lead to an upgrade

- Strengthening of the county's demographic and economic profile
- Moderation of the county's debt and pension burden

Factors that could lead to a downgrade

- Weakened financial position of MetroHealth that raises the risk of increased county operating support
- Narrowing of the county's financial position
- Increased debt or pension burden
- Substantial decline in sales tax revenue and debt service coverage (special tax rating)

Key indicators

Exhibit 1

Cuyahoga (County of) OH	2014	2015	2016	2017	2018
Economy/Tax Base					
Total Full Value ($000)	$79,128,118	$79,238,437	$78,646,146	$78,924,984	$79,652,199
Population	1,272,533	1,267,513	1,263,189	1,257,401	1,253,783
Full Value Per Capita	$62,182	$62,515	$62,260	$62,768	$63,529
Median Family Income (% of US Median)	92.3%	91.9%	91.7%	90.0%	89.5%
Finances					
Operating Revenue ($000)	$1,040,901	$1,052,917	$1,094,429	$1,063,735	$1,083,422
Fund Balance ($000)	$524,987	$494,021	$469,324	$469,173	$441,217
Cash Balance ($000)	$506,030	$451,535	$373,619	$434,618	$389,393
Fund Balance as a % of Revenues	50.4%	46.9%	42.9%	44.1%	40.7%
Cash Balance as a % of Revenues	48.6%	42.9%	34.1%	40.9%	35.9%
Debt/Pensions					
Net Direct Debt ($000)	$1,197,121	$1,205,187	$1,170,181	$1,254,509	$1,185,174
3-Year Average of Moody's ANPL ($000)	$1,919,432	$1,887,354	$1,807,200	$1,869,379	$1,955,175
Net Direct Debt / Full Value (%)	1.5%	1.5%	1.5%	1.6%	1.5%
Net Direct Debt / Operating Revenues (x)	1.2x	1.1x	1.1x	1.2x	1.1x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.4%	2.4%	2.3%	2.4%	2.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.8x	1.8x	1.7x	1.8x	1.8x

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

Profile

Cuyahoga County is one of the two largest counties in Ohio with a population of 1.3 million as of 2018. Approximately 30% of the county's population resides within the City of Cleveland (A1 stable), the county seat. County operations include economic development, health and human services, public safety, judicial and general governmental functions.

Detailed credit considerations

Economy and tax base: very large base will contract over the near-term

The regional Cleveland economy will contract over the near term due to the coronavirus outbreak and associated closure of many businesses. We expect growth to resume over the next 1-2 years, but the recovery is likely to lag the state and nation as it has in the past. Cuyahoga County's full valuation is a very large $87 billion and has grown at an average annual rate of 1.9% over the past five years, including nearly 10% growth in 2019 with the sexennial reappraisal. The City of Cleveland's urban core has revitalized in recent years with substantial new residential and commercial development. Despite economic development in Cleveland, the county's population dropped 8.2% between 2000 and 2010. Annual estimates indicate that the population continues to decline, though at a less rapid pace of under half a percent per year. Median family income is estimated 90% of the US median, with a number of wealthy suburbs offsetting the low socioeconomic profile of Cleveland.

Financial operations and reserves: strong reserves and proactive management provide a buffer against revenue loss; MetroHealth remains source of moderate enterprise risk

We expect the county's strong financial reserves will continue to provide a buffer against expected revenue loss, especially as management seeks to cut expenses to limit the use of fund balance in 2020. The county initially budgeted for continued revenue growth and a modest draw on reserves in fiscal 2020, but management now projects revenue will decline by $76 million. The projected loss is largely due to an estimated 20% decline in sales tax revenue for the year. Notably, data on county sales tax collections from March, when the state's stay-at-home order took effect, is not yet available. Sales tax revenue is collected by the state and distributed to counties with a two month lag. Management's projections conservatively assume very little recovery in the region's travel and visitor industry for the remainder of the year. The county intends to fully offset the revenue loss by reducing department costs by 15%, implementing a 10 day furlough for all employees, and deferring capital projects.

The county's healthy fund balance provides an additional backstop in the case of budgetary imbalance. While audited results are not yet available for fiscal 2019, the county reports utilizing $47 million of reserves both for capital projects and to address rising costs for health and human services. Adjusting the most recent audited figures from 2018 for these draws conservatively yields a projected operating fund [1] balance of $394 million at the close of fiscal 2019, or a still very strong 35% of revenue. Notably, an upcoming referendum on April 28 to replace an existing 3.9 mill levy with a new 4.7 mill levy would generate an additional $35 million for the county to fund a variety of social services in 2021.

The county closed fiscal 2018 with an available operating fund balance of $441 million, which consisted of $202 million in the general fund, $73 million in the debt service fund and the remainder in various health and human services funds. The operating fund balance declined by $28 million during fiscal 2018, largely due to planned draws for capital projects.

Sales taxes are the county's largest revenue source, accounting for 55% of general fund revenue in fiscal 2018. Coverage provided by sales tax revenue on annual debt service has been exceptionally strong in recent years, and so we expect the county can weather a substantial loss in sales tax revenue while maintaining ample coverage. Sales tax collections provided very strong 9.7x coverage on maximum annual debt service (MADS) during 2018, and collections reportedly increased by 4% in 2019. Even with a 20% loss in fiscal 2020, coverage would remain more than adequate at roughly 8.0x coverage. While the county's current sales tax is 1.25% and all associated revenue is pledged to repayment of the bonds, the 0.25% tax expires in 2027 while the county's sales tax bonds do not mature until 2038. The continuing 1.0% sales tax alone provided 7.8x coverage on MADS during 2018.

Non-tax revenue accounts for a modest 15% of operating revenue but is notable because it secures several of the county's bond issuances. Non-tax revenue provided strong coverage of 3.8x maximum annual debt service in fiscal 2018. Non-tax revenue consists primarily of charges for services, investment earnings, intergovernmental grants and reimbursements, fines and forfeitures and license and permit fees. These revenues are projected to decline slightly in 2020 but coverage will likely remain strong.

MetroHealth System is a component unit of the county that serves as the safety net hospital for the greater Cleveland area. The system has just over $1 billion in outstanding revenue debt most of which was issued in April 2017 to construct a new campus. With $1.2 billion in operating revenue in fiscal 2018, the system's operations are about as large as the county's operating funds. MetroHealth received an appropriation from the county of $33 million in fiscal 2018, which was consistent with recent years and comprised a modest 4% of county operating revenue. While the county has no legal requirement to fund the system, in our view the important public safety net function of the system may compel the county to increase support should the system contend with sustained operating challenges. To date, the system maintains substantial liquidity, and the county has no plans to provide additional support in 2020. We perceive the contingent liability risk to be moderate given the system's large size relative to county operations, a high amount of revenue debt, and significant cash flow requirements to sustain adequate debt service coverage.

LIQUIDITY

The county's liquidity is healthy with a net operating fund cash position of $389 million, or 36% of revenue at the close of fiscal 2018. The general fund had $175 million, or a solid 39% of revenue. The general fund cash position is expected to decline but remain strong in fiscal 2019, as described above.

Debt and pensions: growing debt burden with earmarked revenue sources for repayment

The county's debt burden has grown over the past five years, with most debt financing economic development projects consistent with the county's charter mission. We consider all of the county's debt, with the exception of MetroHealth debt, in our debt and fixed cost ratios. The county has approximately $1.2 billion in debt, or 1.4% of full value and 1.1x operating revenue. Cuyahoga County's debt burden is above the medians for rated counties (0.5% of full value and 0.6x operating revenue). The county does not currently have any plans to issue additional debt within the next year, but may seek additional refunding opportunities for interest savings.

The county has indentified specific revenue to support debt service on all recent issuances. This reduces the burden on the property tax base, but exacerbates exposure to economically sensitive revenue. For example, the county intends to repay its Series 2014 COPs, in part, with sales taxes, hotel taxes, and net revenue generated by the financed hotel that is being run by Hilton. Similarly, the county's 2014A bonds are expected to be paid with net revenue of a local development project.

In the three years through 2018, Moody's adjusted net pension liability (ANPL) for the county averaged $2.0 billion, which is above average compared with the tax base at 2.5% of full value though more moderate compared with operations at 1.8x operating fund revenue. Debt service in fiscal 2018 totaled $110 million or 10% of revenue. Inclusive of pension and OPEB contributions, the county's fixed costs were moderate at 15% of revenue in fiscal 2018.

DEBT STRUCTURE

All of the county's debt is fixed-rate. While the county is scheduled to pay down over $300 million over the next five years, we consider total scheduled payout to be comparatively slow given that only 53% of total debt is retired within ten years. Debt service on general fund supported debt is scheduled to rise modestly from $101 million in fiscal 2018 to $106 million in 2020, and descend thereafter.

The county's outstanding debt includes $245 million of GOLT debt, $201 million of certificates of participation, $310 million of non-tax revenue bonds, $301 million of sales tax revenue bonds, $97 million of capital leases and $17 million of appropriation guarantee debt.

The county's GOLT bonds are secured by its full faith and credit and pledge to levy ad valorem property taxes under the state's 10-mill limitation, and the non-tax revenue bonds are secured by its pledge of non-tax revenue.

The COPs are secured by lease payments that are subject to annual appropriation. The Series 2013 COPS were issued for an administration building. The Series 2014 COPS were issued for a hotel project, which we consider to be less essential to county operations. Management has already appropriated the $21 million debt service payment on these bonds for fiscal 2020, which is equivalent to a modest 2% of operating revenue. The hotel is operated by Hilton and currently remains open, though occupancy is down substantially. Hotel operations typically contribute about $11 million toward the annual debt service payment, of which $4 million has been collected year-to-date. The county's revised budget plan incorporates projected loss of hotel revenue and provides for full payment from county sources.

The sales tax revenue bonds are secured by a senior lien on revenue collected pursuant to the county's current 1.25% sales tax. The additional bonds test (ABT) is strong. It requires that, on average, the most recent 24 months of collections from the county's 1% permanent sales tax provide 3.0x coverage of maximum annual debt service on existing and proposed bonds. There is no debt service reserve requirement. The sales tax bonds have a strong flow of funds with favorable bondholder protections, as the county has covenanted in the trust indenture to direct the state Tax Commissioner, or another appropriate state official, to transfer the county's locally generated sales taxes directly to the trustee for deposit in a designated bond retirement fund.

The appropriation guarantee bonds are secured by revenues received by the county from a developer (Flats East Development LLC) pursuant to a loan agreement between the two parties. The county and developer have also entered into a guaranty agreement, pursuant to which the county provides an annually renewable guaranty of debt service payments, which is subject to appropriation by the county.

The county assisted MetroHealth with its 2017 financing by entering into a $63.6 million standby letter of credit. If there is a draw on the system's debt service reserve, the county may reduce its annual subsidy to MetroHealth and could establish a 10-year repayment term for any amount above the subsidy. The county could choose to limit its maximum exposure to the initial notional amount by terminating the letter if the full notional amount is drawn. The initial term of the LOC expires on May 22, 2020. The county is in the process of replacing the LOC with a similar credit facility prior to expiration.

DEBT-RELATED DERIVATIVES

The county is not a party to any derivative agreements.

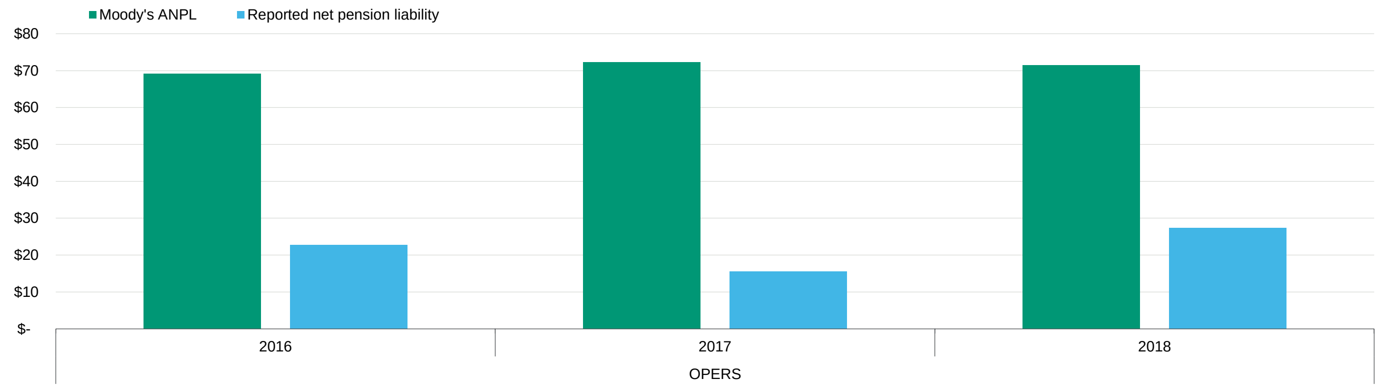
PENSIONS AND OPEB

County employees are members of the Ohio Public Employees Retirement System (OPERS), though a very small share participate in the State Teachers Retirement System. 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, the 30-year target was breached and the state legislature acted by reducing benefits and increasing employee contributions. The 2012 reforms did not increase employer contributions from participating governments. As of fiscal 2018, the OPERS amortization period increased to 27 years.

The Moody’s adjusted net pension liability (ANPL) for OPERS declined by 1% in 2018 due to an increase in the market-based interest rate from the prior year, although the decline would have been larger had the plan not experienced negative investment returns. On a reported basis, the net pension liability increased by 75% due primarily to OPERS lowering the discount rate to 7.2% from 7.5% and weak investment performance.

Contributions to OPERS were 113% of tread water[2] in fiscal 2018. While payments in excess of tread water would typically indicate future decline in the ANPL, the tread water payment in fiscal 2018 relied upon the plan's above average 7.5% discount rate (as calculated prior to the discount rate reduction). Higher discount rates have the effect of lowering tread water payments, which can understate the payment needed to reduce ANPL growth. OPERS contributions, which are set by the state based on a percentage of payroll, have historically been below tread water.

Exhibit 2
Slight decline in 2018 OPERS ANPL
($ billions)



Source: OPERS

ESG considerations

Environmental considerations are not a material driver of the county's credit profile. According to data of Moody's affiliate, Four Twenty Seven, Cuyahoga County is at relatively high risk for extreme rainfall events relative to counties nationally. While the county has had flooding events, they have been constrained and have had little financial impact on the county. The regional sewer district is currently undertaking a massive capital plan to increase storm sewer capacity.

Social issues are a material consideration. The county has a significant population living under the poverty level and faces rising costs to provide social services. Drug overdose rates in Cuyahoga County are significantly higher than the nation, and officials are currently weighing long-term solutions to crowding at the county jail. In October, four drug companies announced settlements with Cuyahoga County totaling nearly $179 million that will fund addiction prevention and treatment services to curb the social and economic costs of opioids. The money will be held in a dedicated opioid mitigation fund.

Governance is also a material consideration. The county implemented a new charter in 2010 that eliminated a number of elected positions. The County Executive and prosecuting attorney are elected at large with the county council members elected by district. The MetroHealth System is operated by a board of county hospital trustees appointed by the County Executive together with the senior judges of the Probate and Common Please Courts of the County, subject to confirmation by the County Council.

Cuyahoga County has the authority to increase its local sales tax another 0.25% up to the state cap of 1.5%. However, any increase would be subject to repeal by voter referendum. The county has two health and human services property tax levies subject to periodic voter approval. The county is seeking voter approval of a replacement and increase to an existing levy in April to support health and human services and prevent additional draws on reserves. Voters have historically renewed the levies by comfortable margins, with the last renewal garnering 72% approval in May 2018.

Ohio counties have an institutional framework score of "A," or moderate. County revenues are moderately predictable as sales taxes tend to dominate general fund revenue, but more diversified streams fund overall operations. Local sales tax rates are capped at 1.5% and raising property tax rates requires voter approval. Revenues and expenditures tend to be predictable.

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 3

Cuyahoga (County of) OH		
Scorecard Factors	**Measure**	**Score**
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$87,037,004	Aaa
Full Value Per Capita	$69,420	Aa
Median Family Income (% of US Median)	89.5%	A
Notching Factors:[2]		
Regional Economic Center		Up
Finances (30%)		
Fund Balance as a % of Revenues	40.7%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	-1.6%	Baa
Cash Balance as a % of Revenues	35.9%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	-6.3%	Baa
Notching Factors:[2]		
Outsized Enterprise or Contingent Liabliity Risk		Down
Other Analyst Adjustment to Finances Factor: Adjustment to operating trend given maintenance of very strong reserves despite draws for capital		Up
Management (20%)		
Institutional Framework	A	A
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	Baa
Notching Factors:[2]		
Other Analyst Adjustment to Management Factor (specify): Flexibility to levy additional 0.25% income tax, implement bed tax		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	1.4%	Aa
Net Direct Debt / Operating Revenues (x)	1.1x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	2.2%	A
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.8x	A
	Scorecard-Indicated Outcome	Aa2
	Assigned Rating	Aa2

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.
[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication
Source: US Census Bureau, Moody's Investors Service, audited financial statements

Endnotes

1 We include the following in our calculation of operating funds: General, Debt Service, Board of Developmental Disabilities, Human Services, Health and Human Services Levy, Mental Health Board, and Children Services funds.

2 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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