

CPIM

CENTER FOR PUBLIC INVESTMENT MANAGEMENT



A PROGRAM BROUGHT TO YOU BY:

ROBERT SPRAGUE

OHIO TREASURER

General Session: Current Trends in Public Finance

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Presenters

Eileen Stanic, CTP

Sr. Public Funds Advisor

Meeder Investment Management

3125 Memorial Drive

Dublin, OH 43017

440-662-8268

estanic@meederinvestment.com

Andrew Laskey

Vice President

RBC Capital Markets

255 E 5th St.

Cincinnati, OH 45202

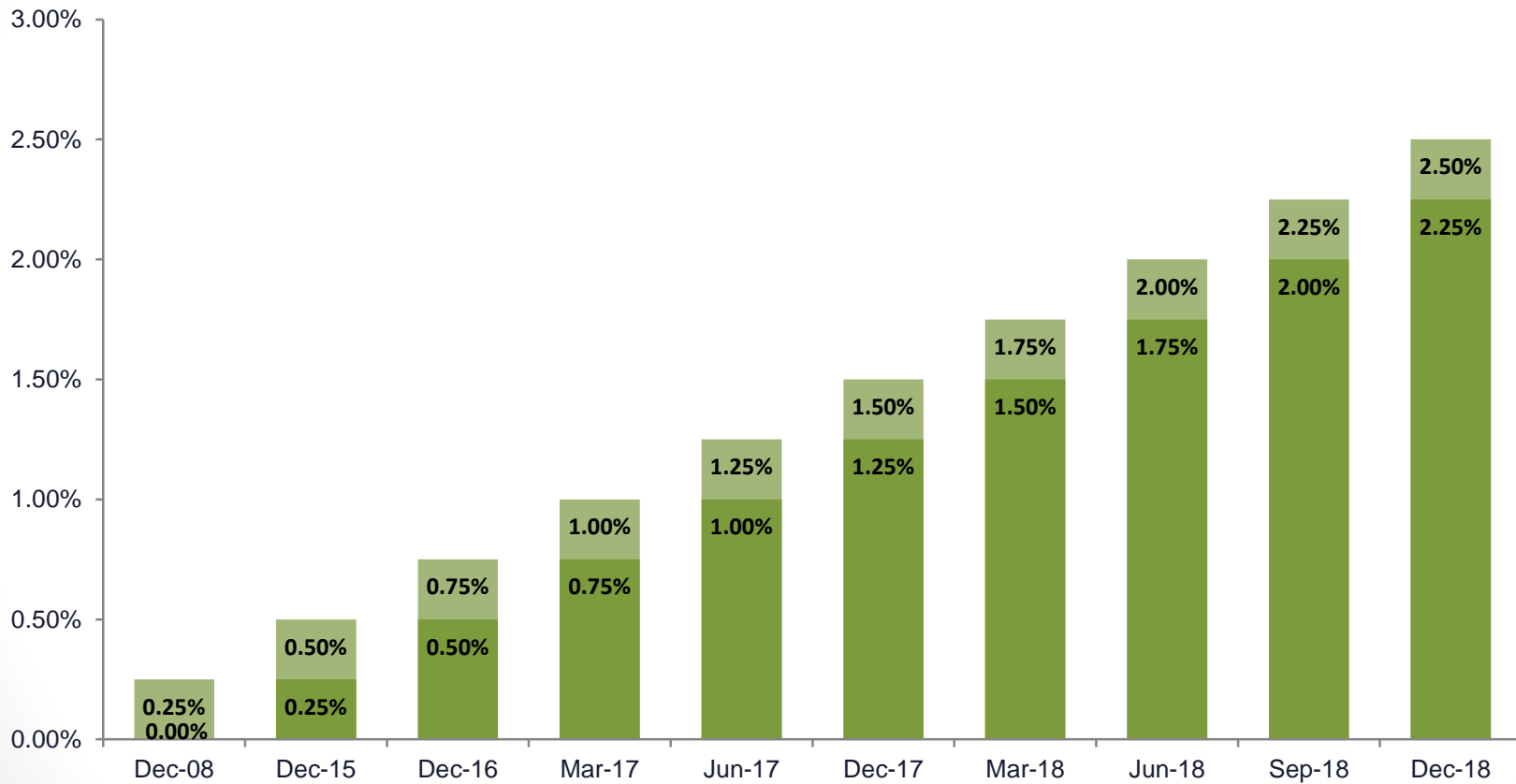
513-826-0582

andrew.laskey@rbccm.com

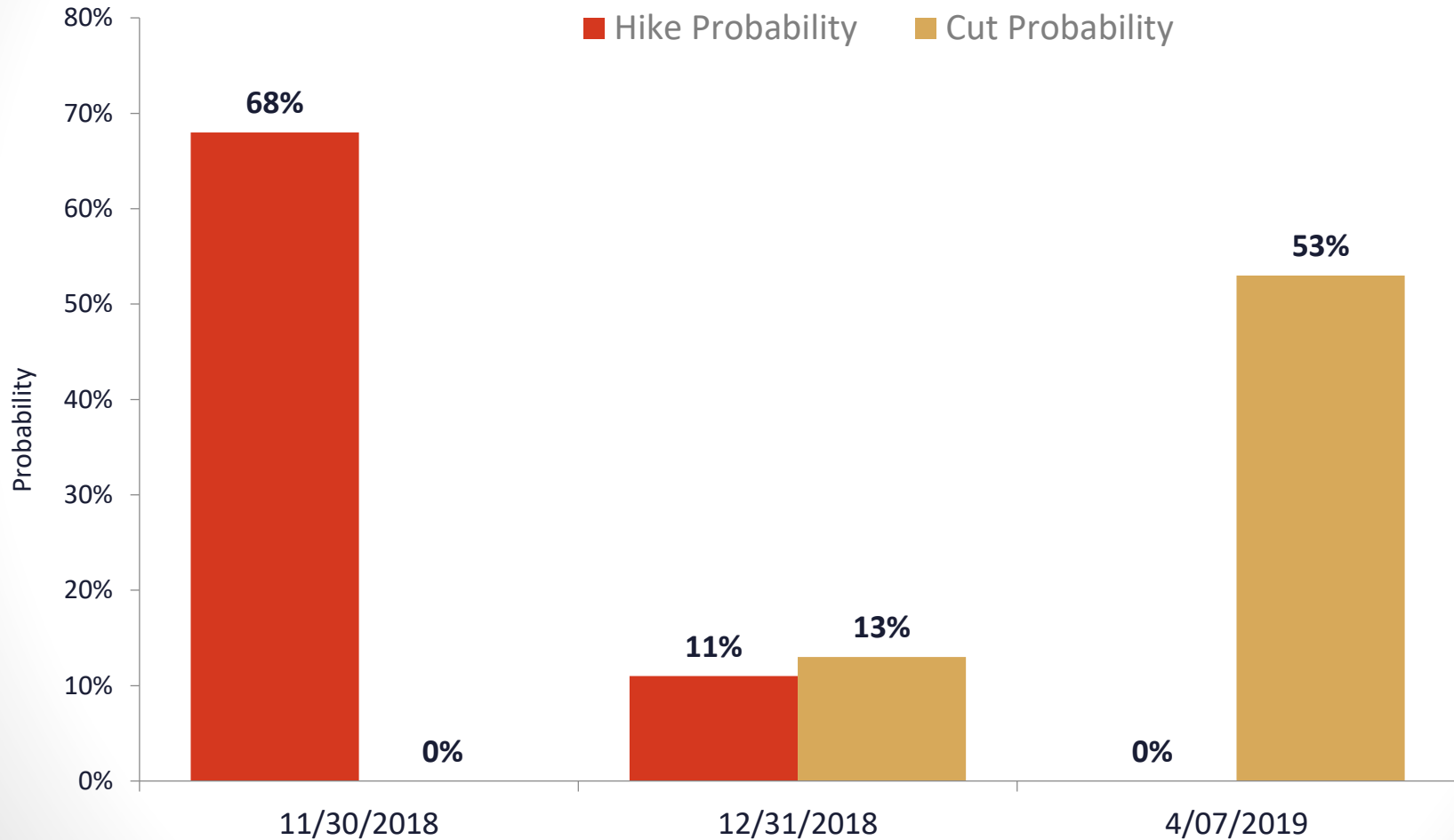
Current Issues Impacting Investments



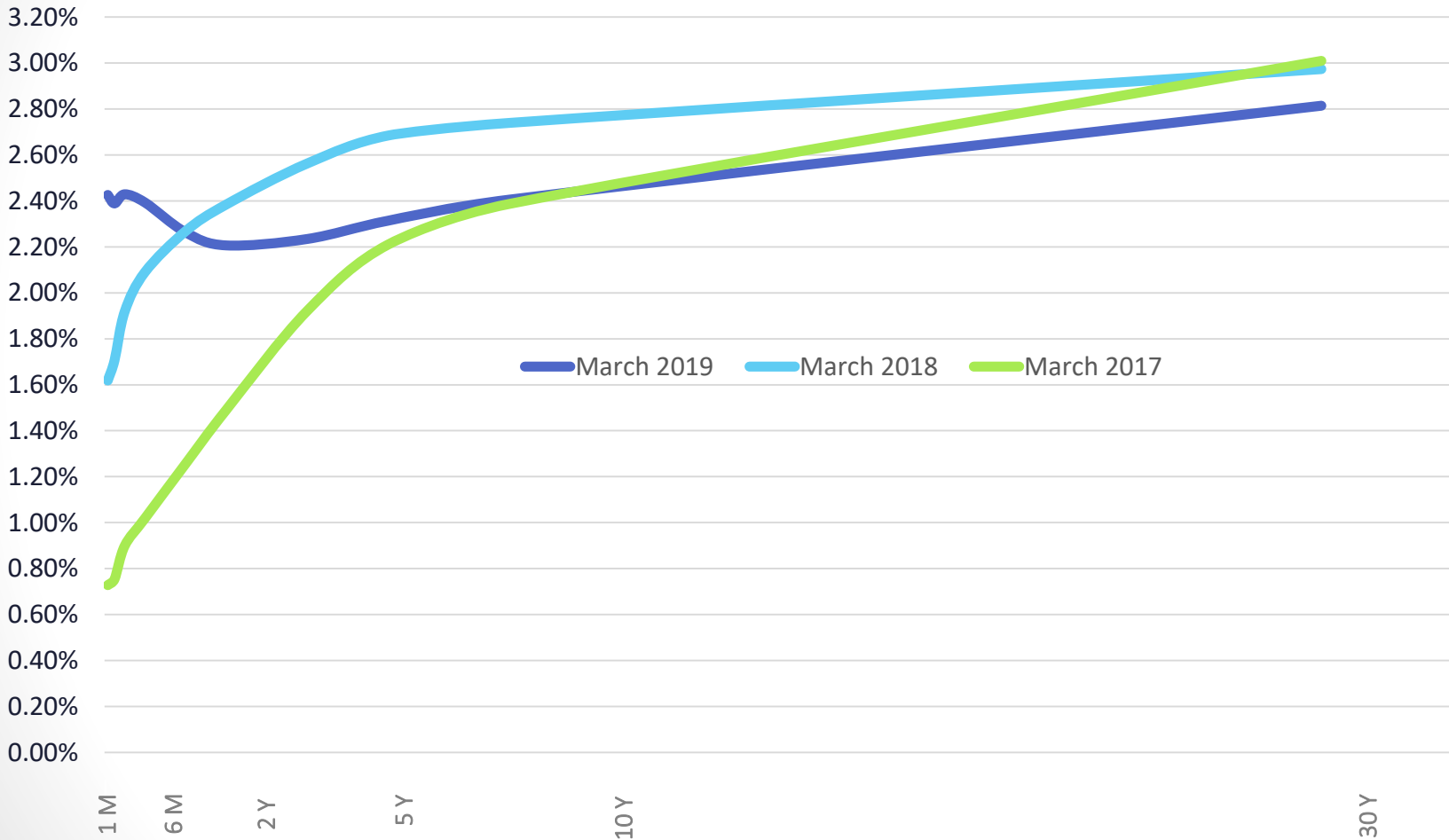
Historical Fed Funds Target Range



Hike or Cut?



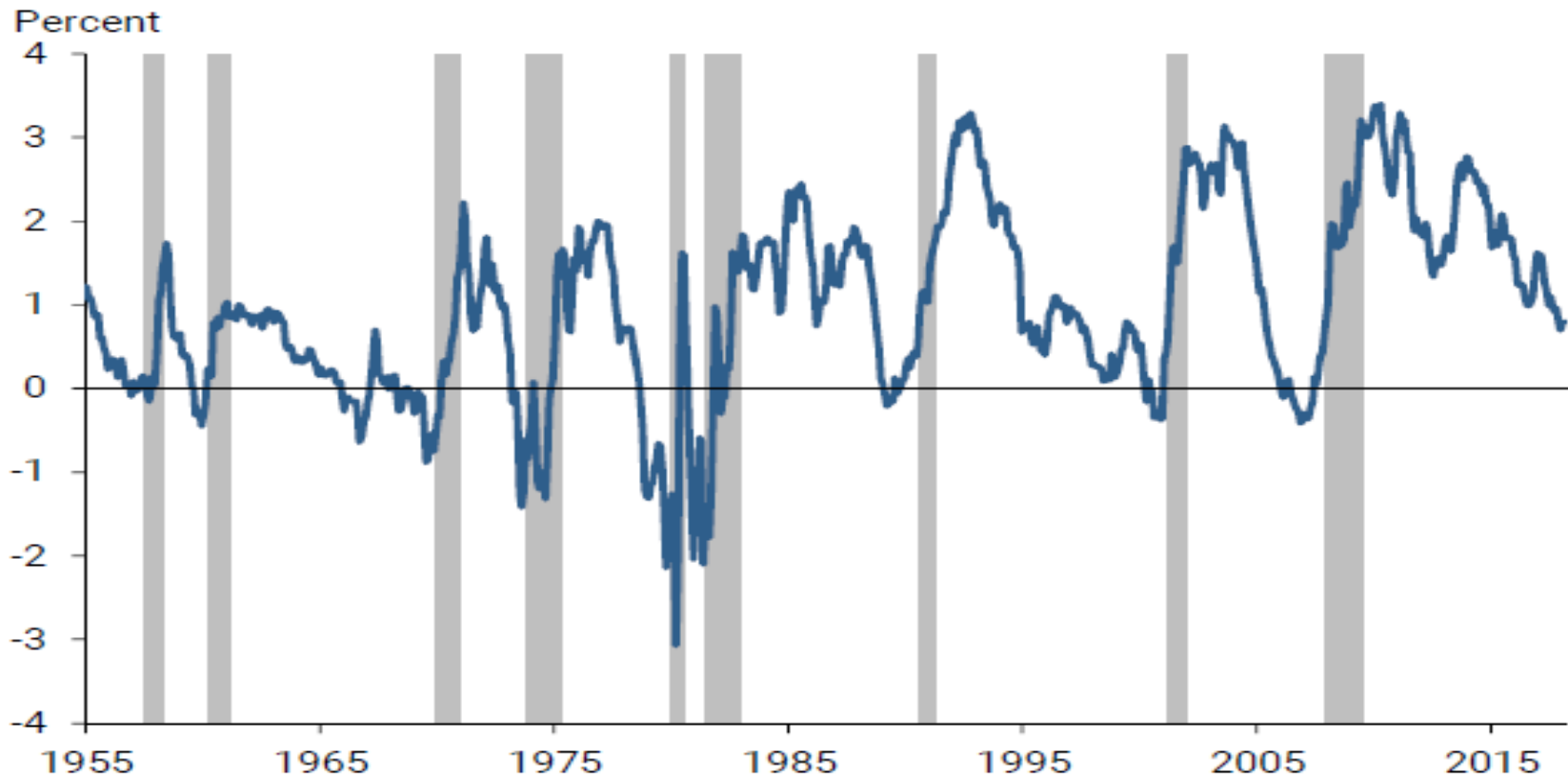
Yield Curve Comparison



Source: Bloomberg

Recession Indicator

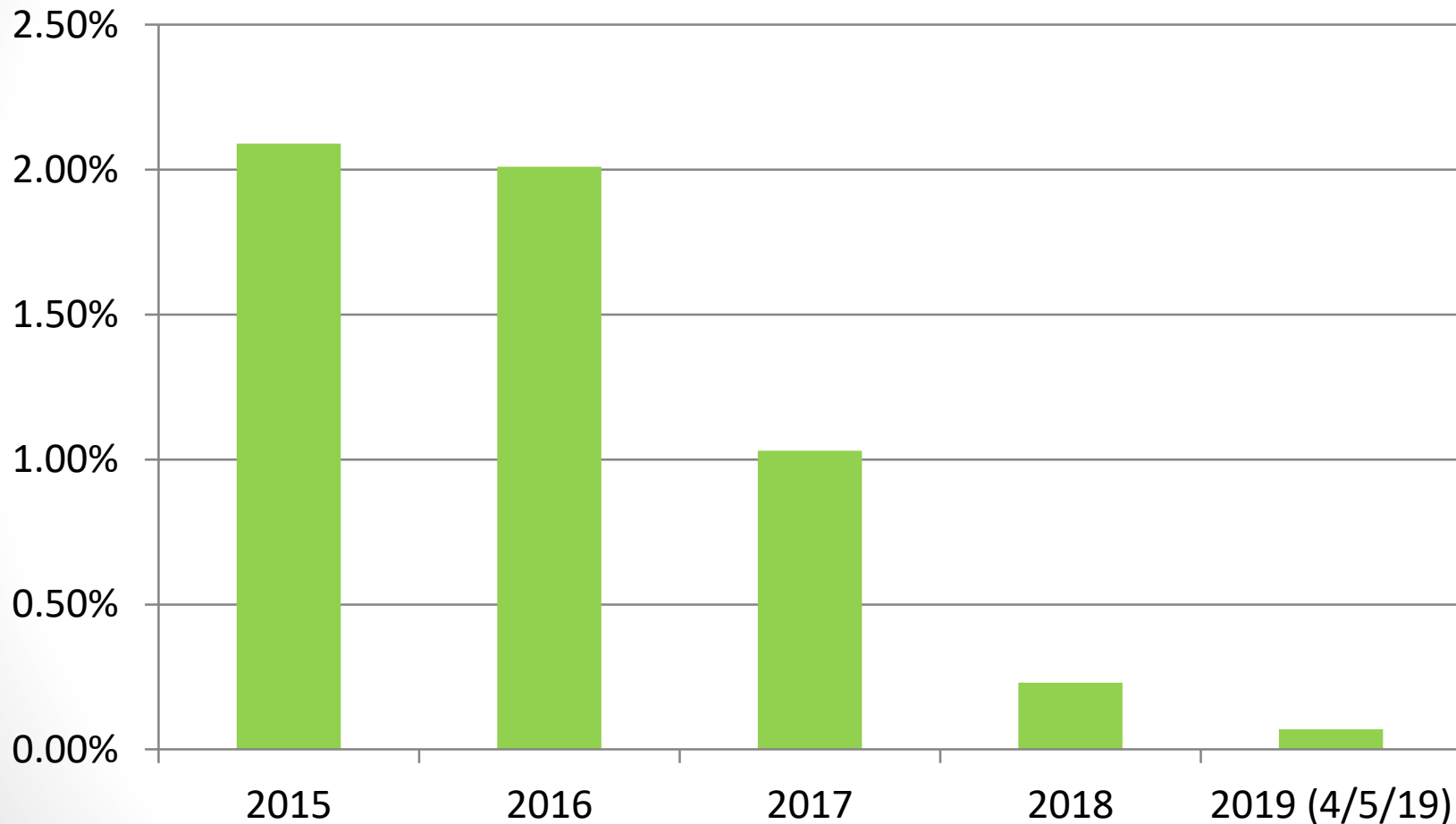
The term spread and recessions



Note: Gray bars indicate NBER recession dates.

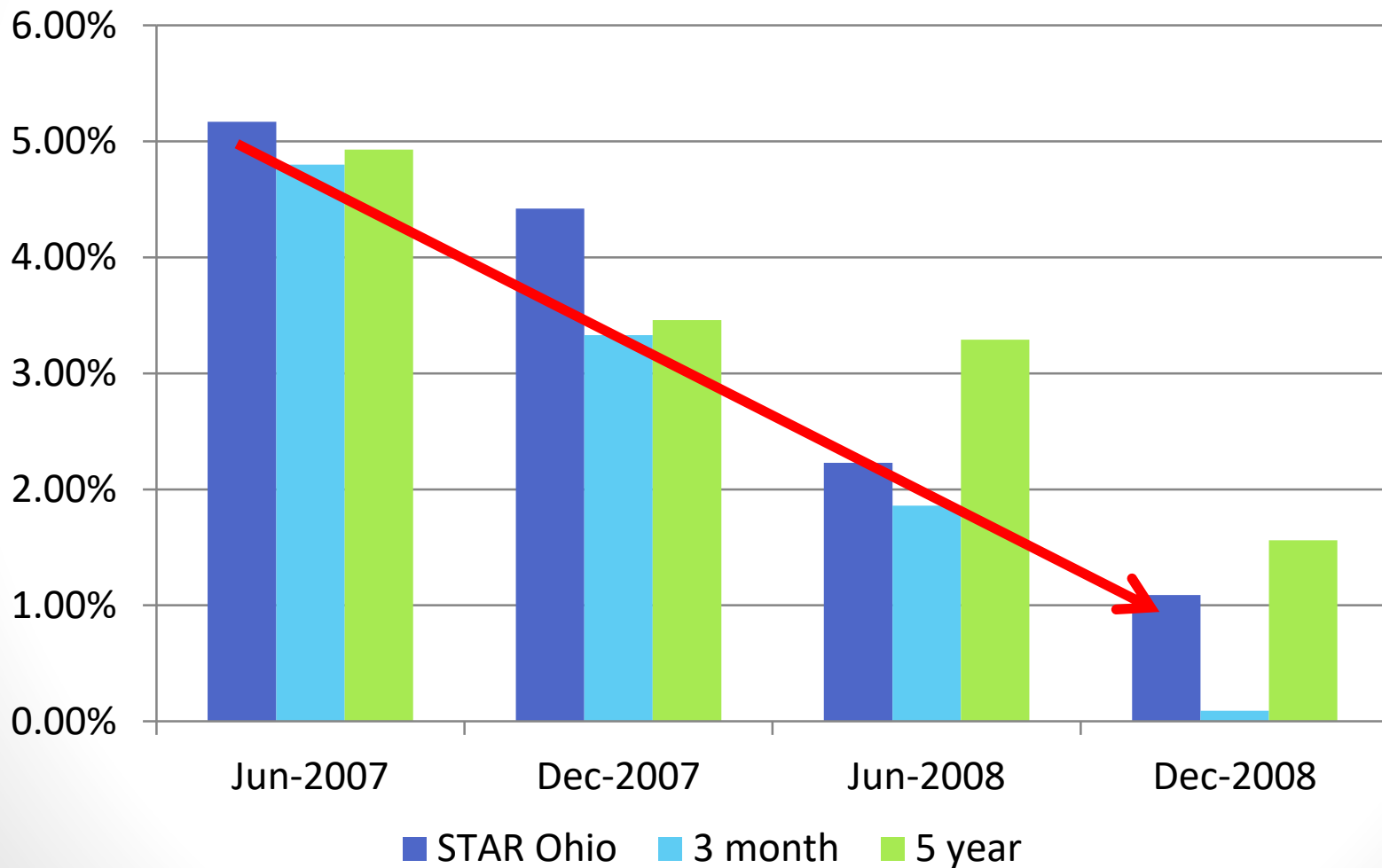
Term Spreads

3 month versus 10 year



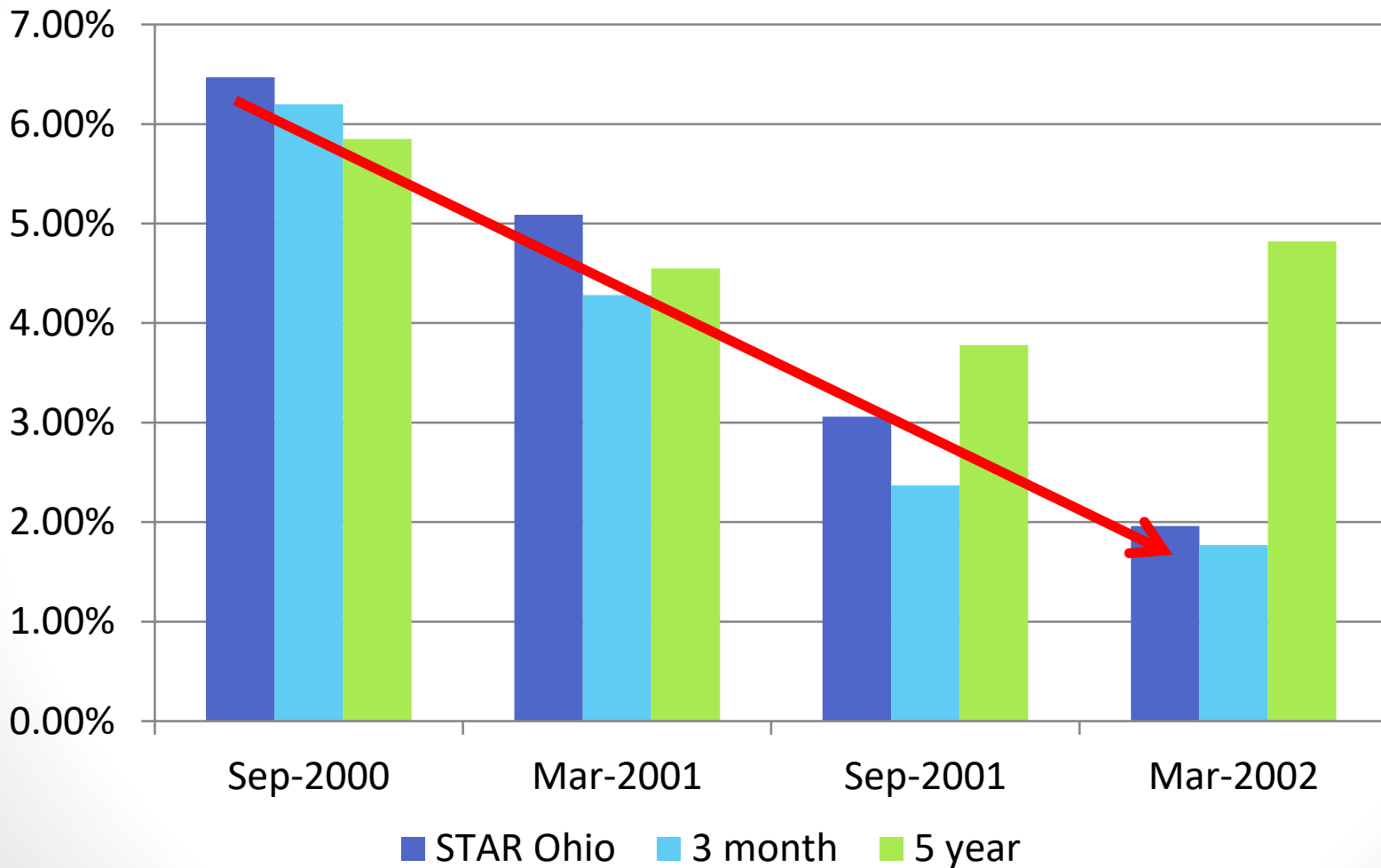
Past Recessions

Great Recession December 2007



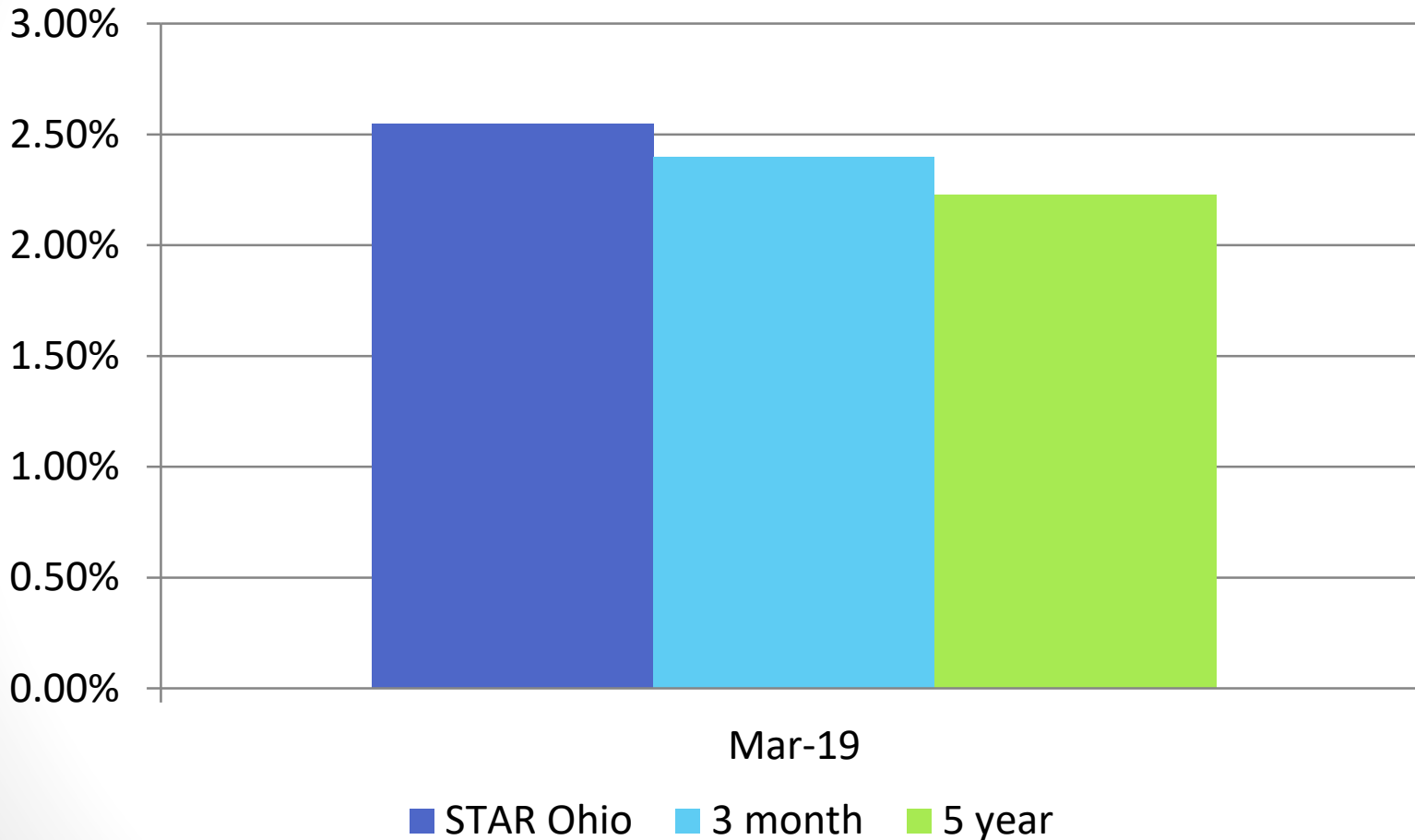
Past Recessions

March 2001

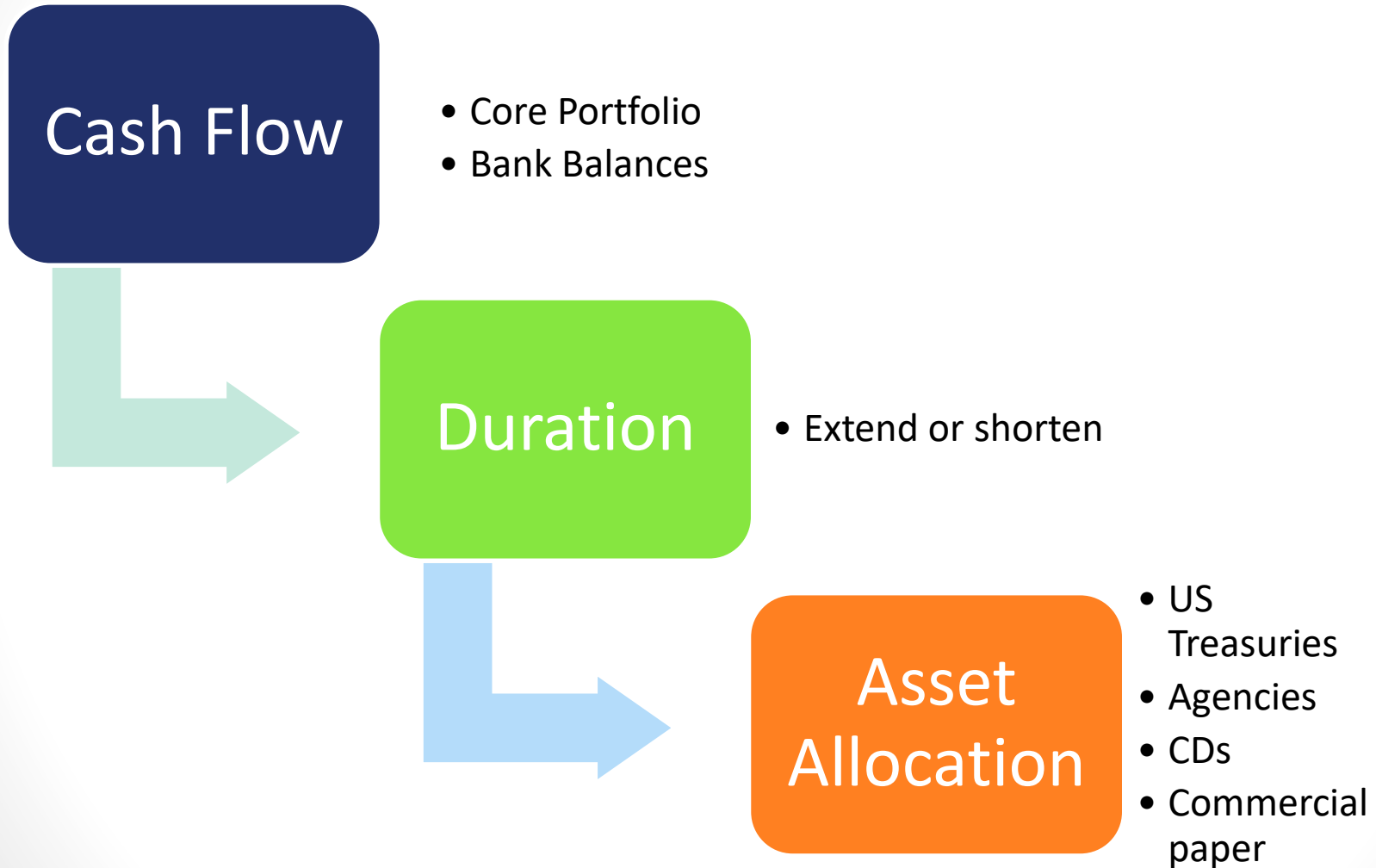


Preserving Your Interest Income

March 2019



Comprehensive Strategy



THANK YOU.....

DO YOU HAVE ANY QUESTIONS ?



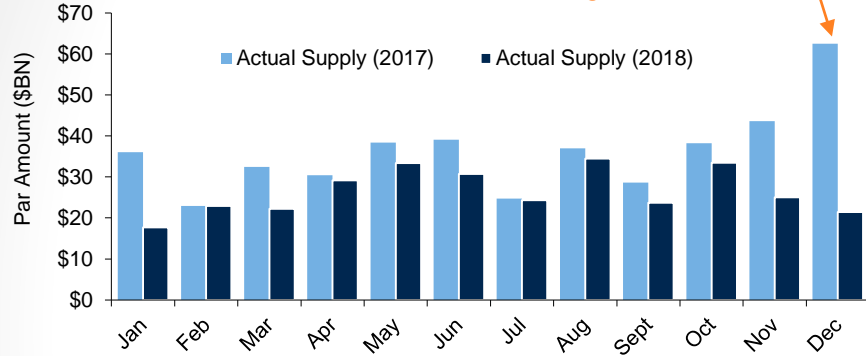
2018 Year in Review | Municipal Bond Market Characterized by Consistent Buyer Demand

Strong demand in municipal market coupled with modest supply created favorable conditions for issuers

Municipal Bond Issuance

Issuance decreased dramatically in 2018, primarily due to tax law changes that eliminated advanced refunding

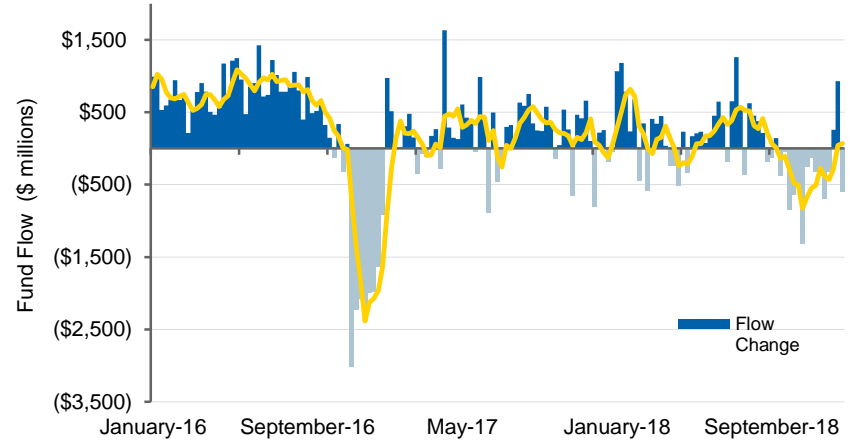
\$62.5bn of volume in Dec 2017;
Largest month of all-time



Source: Thomson Reuters SDC Platinum

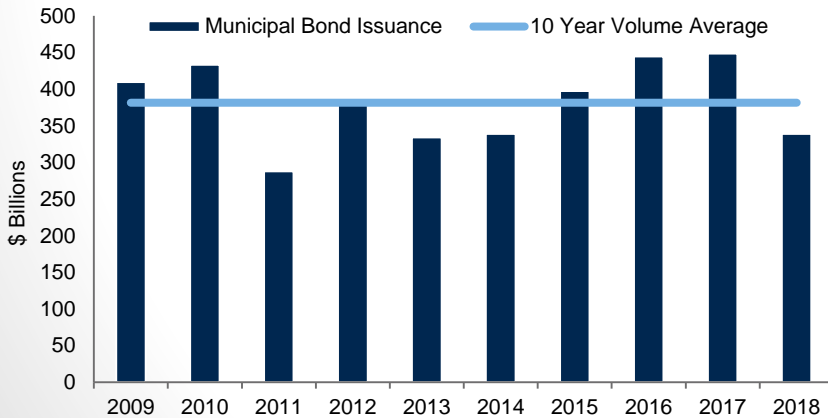
Municipal Bond Fund Flows

Bond funds experienced net inflows in 29 weeks during 2018



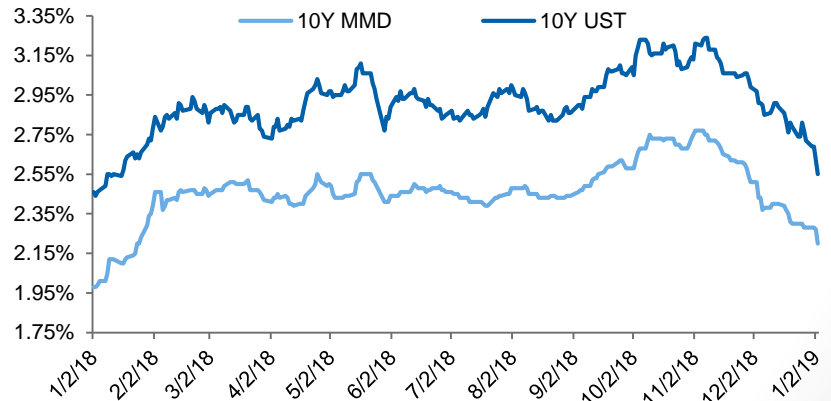
Source: Lipper

Municipal Volume over Last 10 Years



Source: Bond Buyer Decade of Municipal Bond Finance

10 Year MMD and 10 Year UST

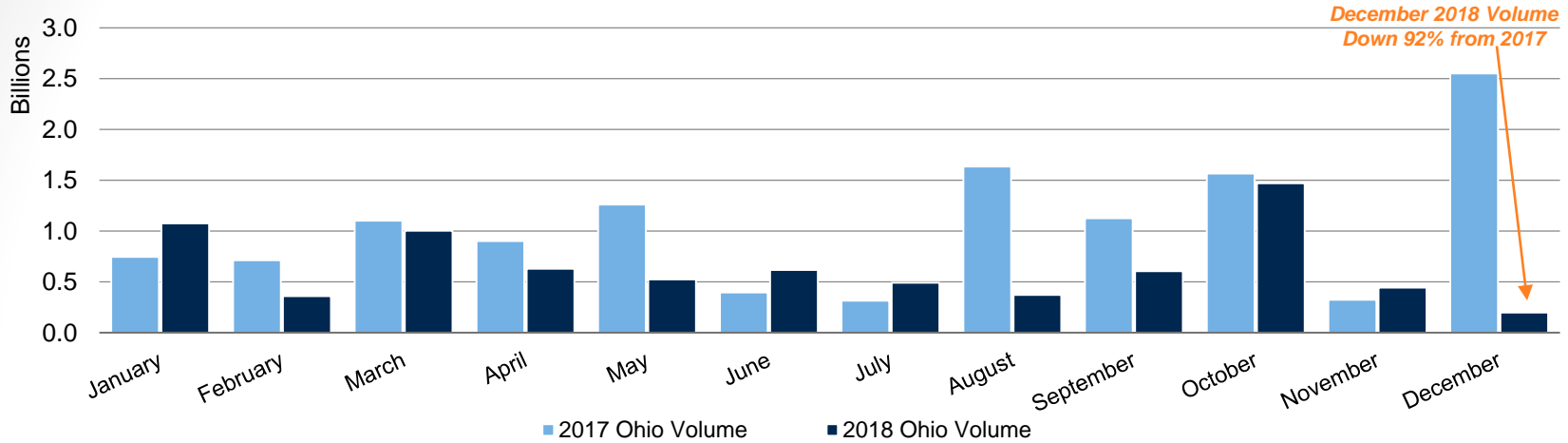


Source: Thomson Reuters – The Municipal Market Monitor (TM3), as of January 4, 2019

2018 Ohio Volume

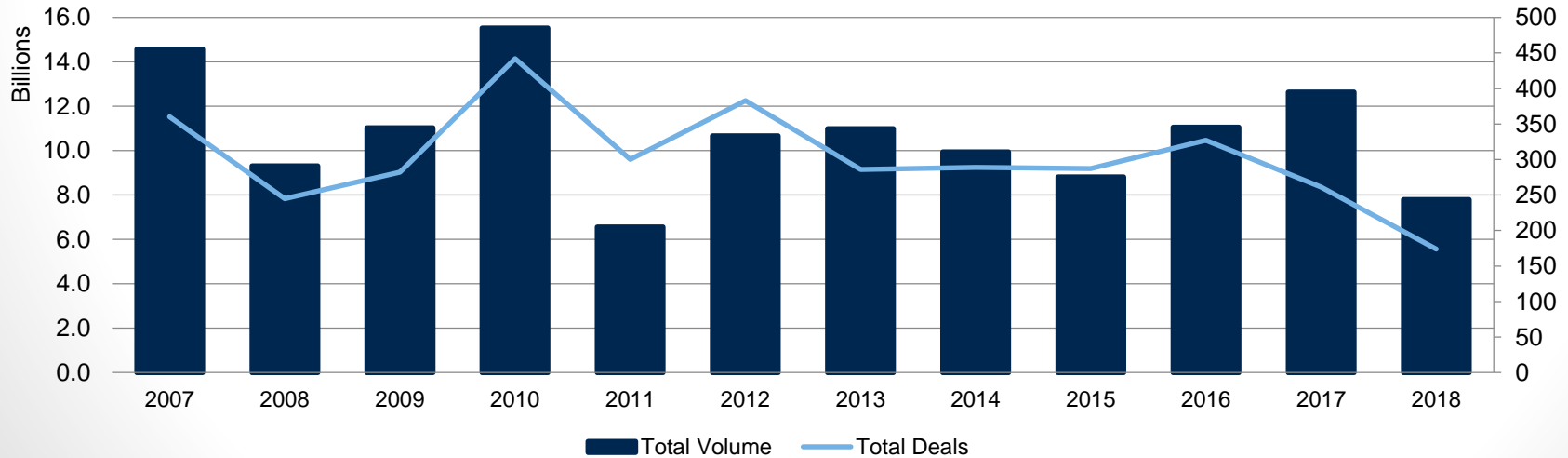
In 2018 Ohio Volume Was Down over 38% Primarily Due to Accelerated 2017 and Reduced 2018 Refunding Volume

Ohio Municipal Bond Issuance by Month 2017 & 2018



Source: Bloomberg

Municipal Volume over Last 12 Years



Source: Bloomberg

Tax Cuts and Jobs Act of 2017

- The Tax Cuts and Job Act of 2017 eliminated the use of tax-exempt bonds for the purposes of advance refunding outstanding tax-exempt bonds
 - The elimination of advance refundings was a major factor that contributed to a 22.4% reduction in municipal issuance in 2018
 - Private Activity Bonds (PABs) were preserved under the Act but survived. They could potentially be a target again as revenue raising may be a priority in future budget discussions.
- December 2017 issuance set an all-time monthly record with over \$60 billion of tax-exempt issuance brought to market
 - Much of December issuance was advance refunding transactions to close by the December 31 deadline
- Wall Street forecasts for 2019 call for a moderate increase in municipal issuance, with RBC projecting \$340 to \$350 billion in debt issuance in 2019 (other Wall Street bank estimates range from \$358-\$385 billion)
- The reduction in the corporate tax rate to 21% impacted certain key investors (primarily banks and insurance companies) appetite for holding tax-exempt debt
 - Through the third quarter of 2018 banks reduced their municipal holdings by approximately \$40 billion compared to end of year 2017 holdings
 - On the positive side, the minor reduction in the maximum individual tax rate to 37% did not appear to lessen demand from individual investors for tax-exempt debt
- **While the full impact of the Tax Cuts and Job Act of 2017 on the municipal market is yet to be determined, the combination of significantly lower debt issuance combined with the expected strong demand from individual investors should allow the municipal market to perform well in the new environment**
- The Federal Reserve interest rate tightening program that began in December 2015 has resulted in nine hikes to date but relatively little change in long-term interest rates
 - In December, 2018 Fed policymakers forecast two rate hikes in 2019, down from its previous estimate of three, but fed fund futures markets were pricing in just one move. There have been a great deal of revisions and volatility among forecasts from Wall Street banks.
 - Additionally the Fed is still in the early stages of the reversal of its quantitative easing program that resulted in the huge build up of its balance sheet
 - The unwind that began in 2017 increased from \$10 billion to \$20 billion a month in 2018. Currently the Fed is allowing up to \$30 billion of US Treasury securities and up to \$20 billion of Agency MBS to mature each month
 - The Tax Cuts and Job Act of 2017 was a stimulus for the economy with average US GDP growth of 3.27% through the first 3 quarters of 2018

Summary of Major Tax Reform Provisions and Effect on Municipal Buyers

Issue/Affected Party	2018 Tax Plan	Issue/Affected Party	2018 Tax Plan
Individuals	<ul style="list-style-type: none"> Adjusts individual income tax rates and thresholds, creating six rates of 10%, 12%, 24%, 32%, 35% and 37% Increases the standard deduction to \$12,000 / \$18,000 / \$24,000 \$10,000 cap on property tax and state and local income taxes (SALT) paid deduction 	Private Activity Bonds	<ul style="list-style-type: none"> Permitted
Corporations	<ul style="list-style-type: none"> Lowers the corporate income tax rate to 21% 	Advance Refundings	<ul style="list-style-type: none"> Prohibits tax-exempt advance refundings
Property and Casualty Insurance Companies	<ul style="list-style-type: none"> Replaces the fixed 15% <i>reduction in the reserves</i> deduction with a fixed 26.25% <i>reduction in the reserves</i> deduction <ul style="list-style-type: none"> Keeps it consistent with current law by adjusting the rate proportionately to the decrease in the corporate tax rate The proration rule imposes a partial tax on tax-exempt interest earned by P&Cs, and the change in the bill would increase that tax relative to P&Cs general tax rate 	Alternative Minimum Tax	<ul style="list-style-type: none"> Corporate AMT is eliminated Individual AMT exemption amount is raised from \$84,500 to \$109,400 (married filing jointly) The exemption amount phase-out will be increased to \$1,000,000
		Tax Credit Bonds	<ul style="list-style-type: none"> All rules for issuance of tax credit bonds repealed
		Professional Sports Facilities Bonds	<ul style="list-style-type: none"> Permitted

Source: taxfoundation.org, *KPMG Tax News Flash Report*, *Sullivan & Cromwell LLP U.S. Tax Reform: Insurance Company Provisions Report*, and *Forbes*.

Economic Conditions and Market Update

Economic Update

Bond Buyer 20 GO Bond Index Since 1961

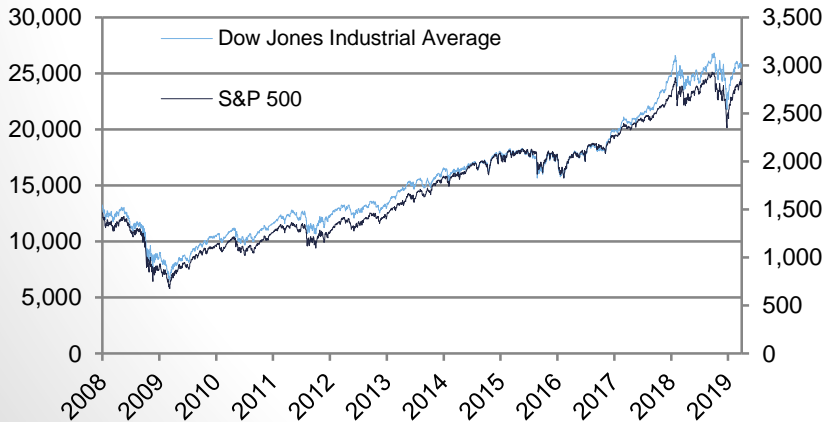


% of Time in Each Range Since 1961

Yield Range	% of Time
Less than 3.50%	9.97%
3.50% - 4.00%	10.69%
4.01% - 4.50%	11.55%
4.51% - 5.00%	9.94%
5.01% - 5.50%	13.85%
5.51% - 6.00%	9.64%
6.01% - 6.50%	7.47%
6.51% - 7.00%	6.81%
7.01% - 7.50%	6.15%
7.51% - 8.00%	3.62%
Greater than 8.00%	10.30%
Total	100.00%

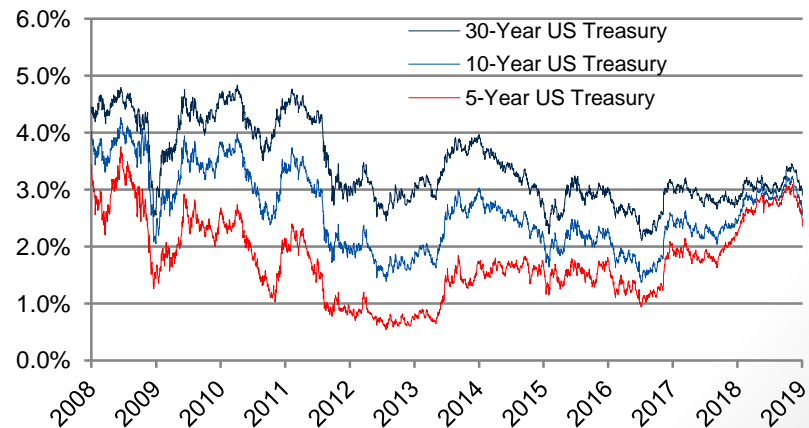
Source: Bloomberg as of March 28, 2019. Weekly yields and indexes released by the Bond Buyer. Updated every Thursday at approximately 6:00pm EST. 20 Bond General Obligation Yield with 20 year maturity, rated Aa2 by Moody's Arithmetic Average of 20 bonds' yield to maturity

U.S. Equity Market



Source: Bloomberg

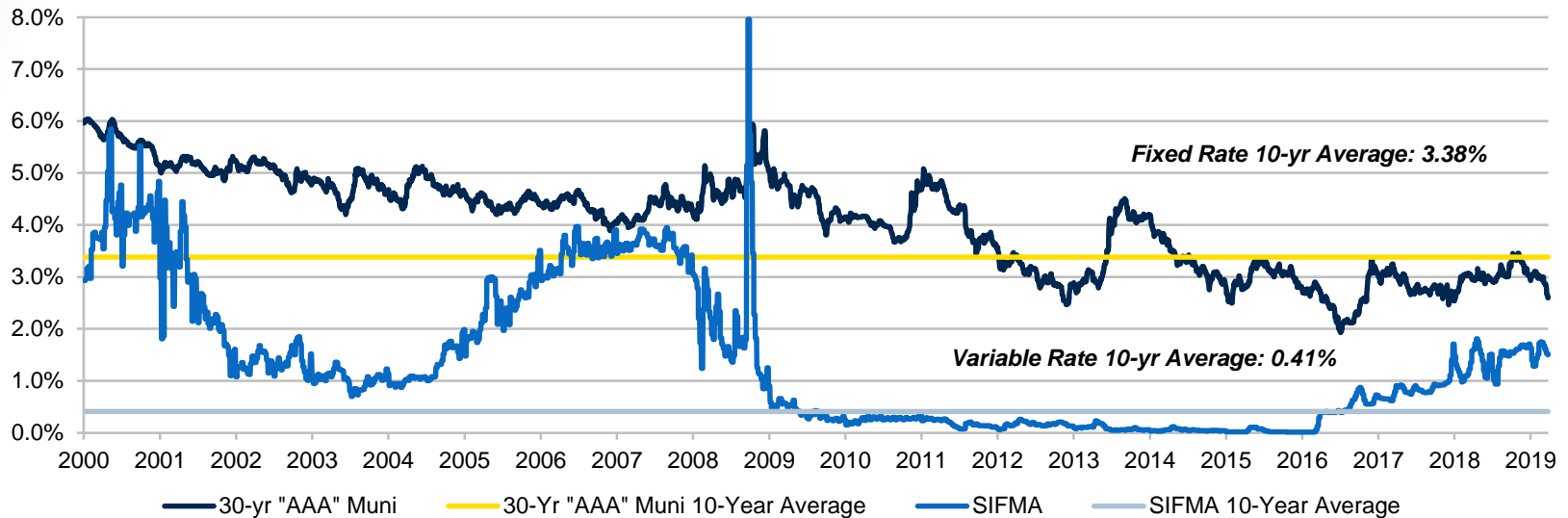
U.S. Treasury Rates



Source: Thomson Reuters

Current Capital Market Conditions | Tax-Exempt Marketplace

Long-Term View: Short-Term and 30-Year Tax-Exempt Yields Since 2000...

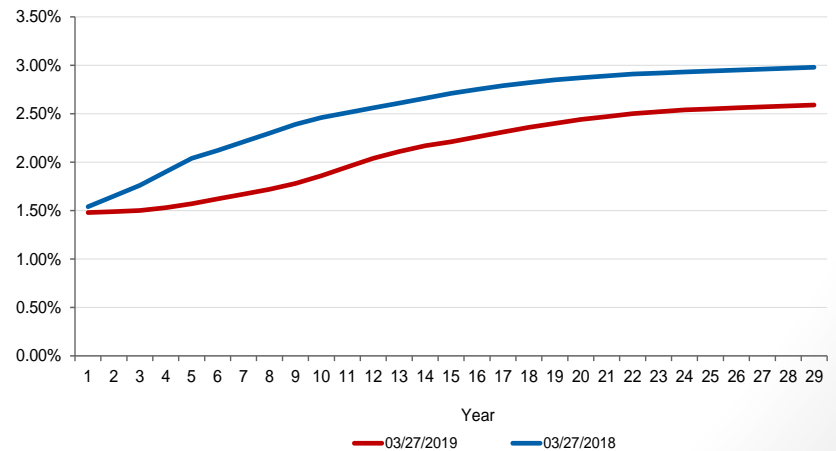


Source: Thomson Reuters – The Municipal Market Monitor (TM3), Bloomberg

Long Term Yields Below 10-year Average

- 30-year “AAA” MMD currently **2.60%**
 - 67bps off all-time low of 1.93%
 - 78bps below 10-year average of 3.38%
 - 30-year Tsy Yield currently 2.82%
 - Muni-to-Tsy ratio at 92.20%
- SIFMA Index currently **150bps**
 - 10-year average is 0.41%

Municipal GO “AAA” MMD Yield Curve YOY



Source: Thomson Reuters – The Municipal Market Monitor (TM3)

Source: Thomson Reuters – The Municipal Market Monitor (TM3), Bloomberg
Current yields as of March 29, 2018

Industry-Wide Estimates Projecting Municipal Issuance Will Increase Modestly In 2019

Recent market developments should make tax-exempt bonds attractive to investors

- The Tax and Job Cut's elimination of Advance Refunding Bonds diminished supply of new tax-exempt bonds
- Decreased supply could cause bonds trade at lower ratios to taxable bonds
- Increased economic activity and the Fed's policies may guide rates higher; municipal bonds tend to price at lower ratios in rising rate environments

2019 Municipal Issuance

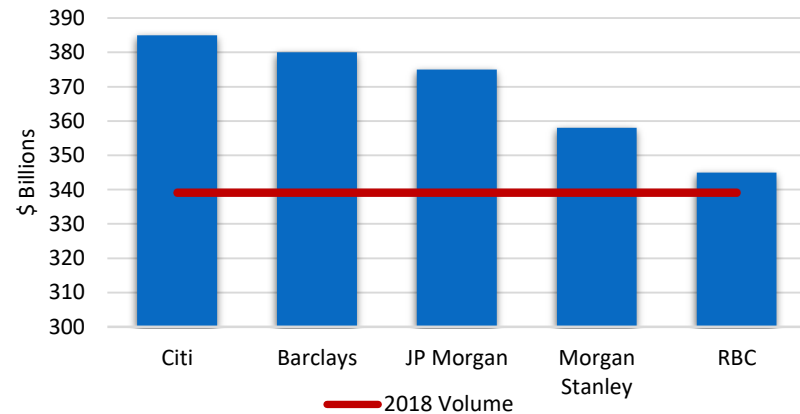
- 2019 YTD Volume: \$82.52bn, up 16% year over year from 2018
- 2018 Volume: \$339bn, down 22.4% from 2017
- 2017 Volume: \$449bn, up 0.9% from 2016

Average Weekly Supply:

- 2019: \$5.89bn
- 2018: \$6.52bn
- 2017: \$8.63bn

Sources: *The Bond Buyer* and *RBCCM*.

2019 Projected Municipal Issuance



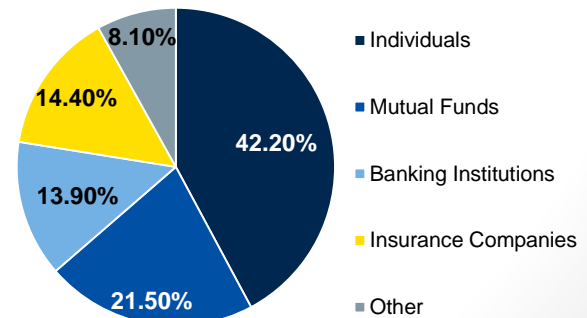
Source: *Bloomberg*, "Wall Street's Municipal-Bond Bankers Expect Brighter Year Ahead," December 4, 2018

With the passage of tax reform, new issue purchases by the major asset classes were impacted as follows:

- Individual and Professional Retail – **increased** demand
- Mutual Funds – **increased** demand
- Banking institutions – a general **reduction** in overall demand with highest impact at the shorter-end and among the highest credit grades
- Property and casualty insurers- a general **reduction** in overall demand with the highest impact at the shorter end among the highest credit grades

Source: *RBC Capital Markets*

Q3 2018 Holders of U.S. Municipal Securities



Source: *Thompson Reuters SDC*

Current Capital Market Conditions | Week of April 1, 2019

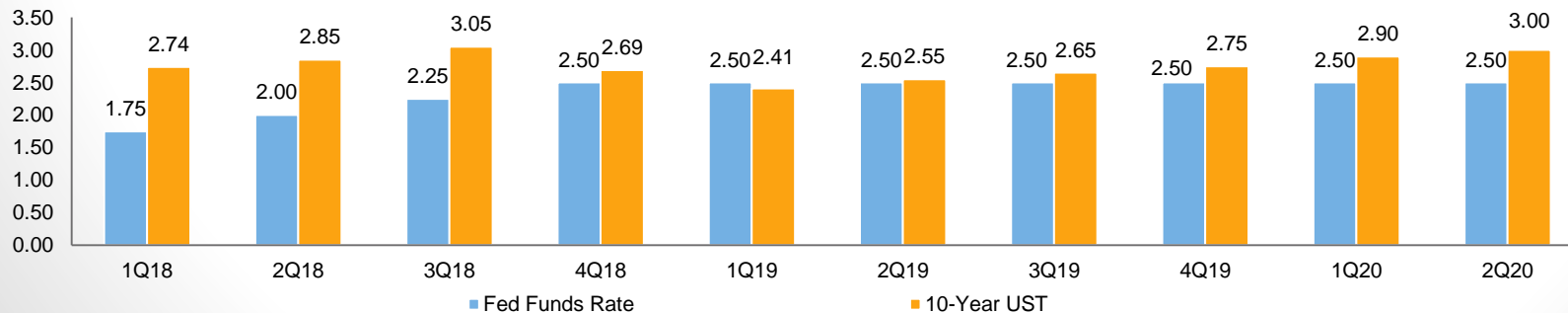
Market Commentary

- Equities advanced last week, with the DJIA, S&P, and Nasdaq climbing 1.7%, 1.2%, and 1.1% respectively.
- Stronger-than-expected Chinese manufacturing data is driving continued strength in risk markets on Monday.
- Treasuries and equities traded in tandem last week on continued accommodative central-bank policies.
- Fed funds futures are pricing in one cut for both 2019 and 2020; Fed officials have pushed back on the notion of cuts at this point.
- Markets continue to focus on developments relating to Brexit, central-bank policies, and global growth.
- Economic highlights this week include March payrolls, ISM mfg/non-mfg, durable goods, retail sales, and ADP.
- Consensus calls for non-farm payroll gains of 175k for March; the unemployment rate is seen holding at 3.8%.
- Municipal supply totaled \$9.7bn last week, and \$2.3bn of the volume was taxable.
- This week's primary calendar is expected to total \$6.1bn, and 30-day visible supply has dropped to \$7.4bn.
- Municipal bond funds reported \$1.53bn of net inflows last week, marking the 12th consecutive week of positive flows.
- Cumulative inflows have totaled nearly \$16bn this year; the technicals of positive flows and light supply continue to drive activity.

Source: RBC Capital Markets

RBCCM Interest Rate Forecast

Period	Actual					Forecast				
	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20
Fed Funds Rate	1.75	2.00	2.25	2.50	2.50	2.50	2.50	2.50	2.50	2.50
2-Year UST	2.27	2.52	2.81	2.48	2.27	2.40	2.45	2.50	2.55	2.55
5-Year UST	2.56	2.73	2.94	2.51	2.23	2.40	2.50	2.60	2.70	2.75
10-Year UST	2.74	2.85	3.05	2.69	2.41	2.55	2.65	2.75	2.90	3.00
30-Year UST	2.97	2.98	3.19	3.02	2.81	2.95	3.00	3.10	3.20	3.40
Spread (30-yr to 2-yr)	70	46	38	54	54	55	55	60	65	85



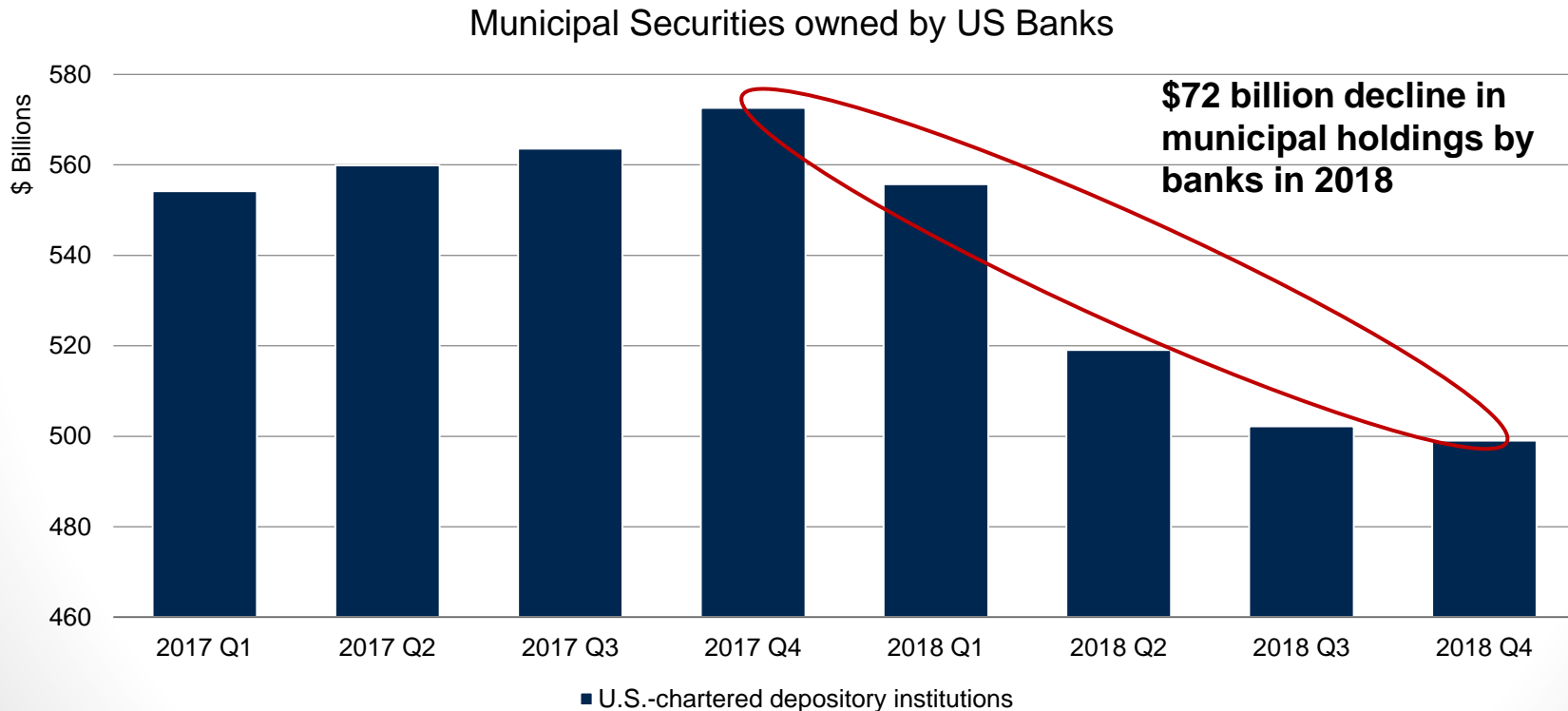
Source: RBC on April 4, 2019 <http://www.rbc.com/economics/economic-reports/pdf/financial-markets/rates.pdf>

Bank Qualification Definition & Updates

- Prior to 1986, banks were a major purchaser of all sizes of municipal bonds
- In 1986, with the passage of the Tax Reform Act of 1986, banks could no longer deduct the carrying cost of tax-exempt bonds
- An exception in the Code allowed banks to deduct 80% of the carrying cost of a “qualified tax-exempt obligation” also commonly referred to as “bank qualified bonds”
- In order for a bond issue to be a “qualified tax-exempt obligation” the bonds must be (i) issued by a “qualified small issuer,” (ii) issued for public purposes, and (iii) designated as “qualified tax-exempt obligations.”
- For the District’s proposed financing, any issue (or combination of issues) that are not reasonably expected to exceed \$10 million in a calendar year would qualify as bank qualified (subject to review and approval by Bond Counsel)
 - Current refundings of existing debt do not count toward the \$10 million limit
 - If BANs are issued in 2018, they could be currently refunded in 2019 and not count toward the BQ limit
- Bank qualified bonds have historically carried a substantial pricing benefit in the municipal market due to the increased demand for these bonds from banks
- The Tax Cuts and Jobs Act of 2017 reduced the corporate tax rate from 35% to 21%, which reduces the benefit of tax exemption for banks and all other corporations
 - Because of this and other factors, the pricing benefits of bank qualified bonds compared to non-bank qualified bonds have decreased in 2018 for the majority of the yield curve

US Banks Have Been One of The Largest Sellers of Municipal Securities

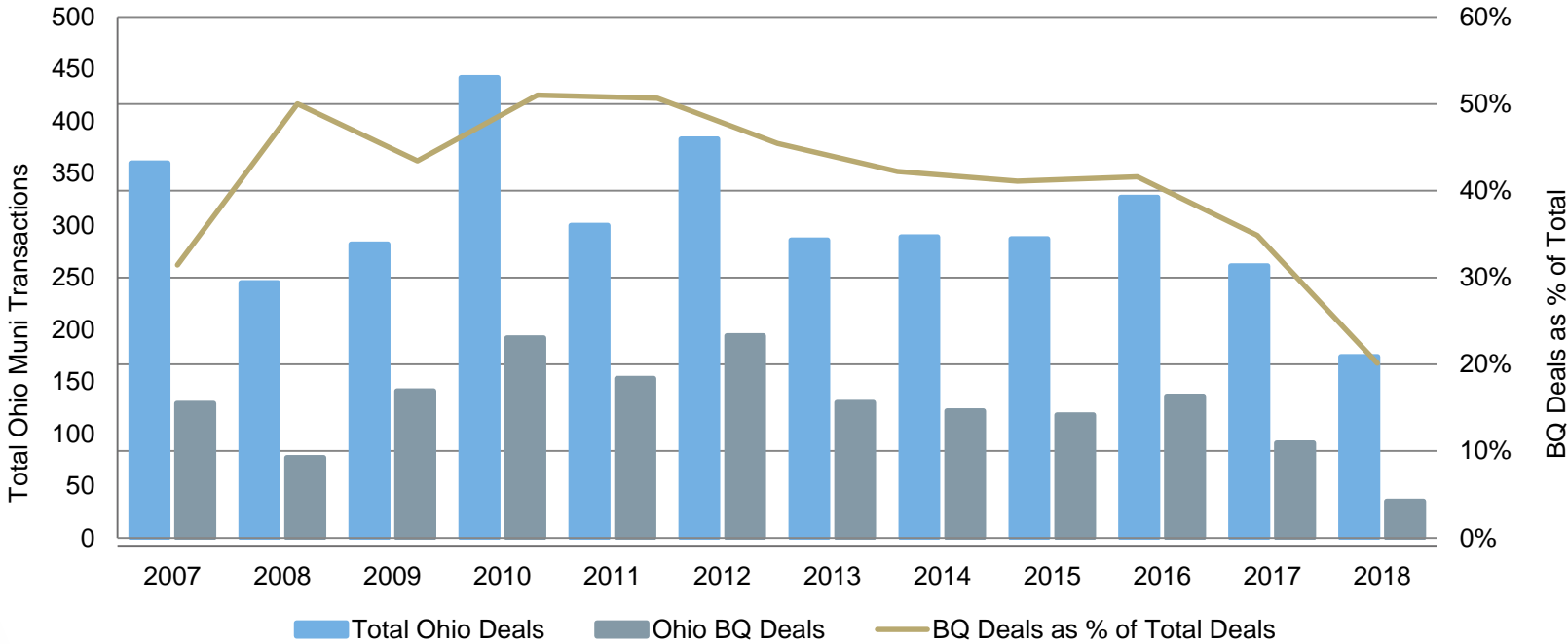
- In March 2019 the Federal Reserve released the fourth quarter 2018 table of municipal holdings
- Within this report, US banks showed the largest decline in municipal holdings across all investor classes, reducing holdings by \$72 billion since the end of 2017
- This selling combined with a lower corporate tax rate has played a role in the decreasing benefit of bank qualified issuance



Source: Federal Reserve (updated quarterly); <https://www.federalreserve.gov/apps/fof/DisplayTable.aspx?t=l.212>

Bank Qualified Issuance as Percentage of The Ohio Market Reached an All Time Low in 2018

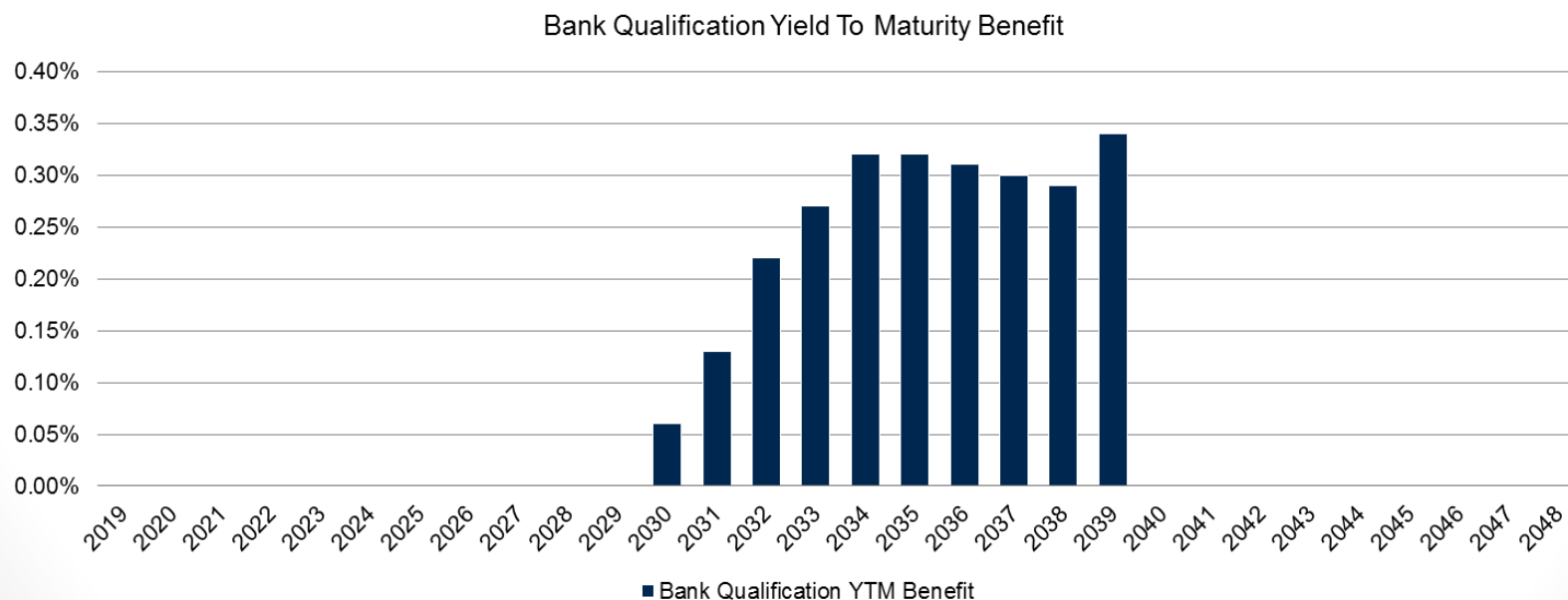
Ohio Bank Qualified Percentage of Deals over the Past 12 Years



Source: Bloomberg

Bank Qualification Benefits & Example

- In order to maximize the benefit of bank qualification, we typically recommend issuing bank qualified (BQ) debt primarily in the years where the BQ benefit is greatest when compared to non-bank qualified debt
- The exact maturities that produce the greatest relative savings varies over time, but currently the greatest benefit is 2033-39
- If the District does delay a BQ portion of the voter authorized issuance until 2020 the 2019 bonds maturing in 2030 through 2039 would currently produce substantial savings
- The following sample table shows the currently estimated yield to maturity benefit attributable to bank qualification by maturity date. As you can see, bank qualification currently only provides a yield to maturity pricing benefit in years 2030-39, with the majority of that benefit concentrated in years 2033-39.



Source: RBCCM preliminary pricing information as of April 3, 2019 for an example Aa2 rated Ohio school district. Subject to change based on market conditions

Advance Refunding Alternatives

Cash Market Alternatives

Taxable Bonds

- Taxable bonds may be used to advance refund tax-exempt bonds with an escrow to the call date
- Negative arbitrage in the escrow is a factor just like tax-exempt advance refundings
- Issue taxable bonds with a call to allow for future tax-exempt refundings

Forward Delivery Bonds

- Bonds are sold today with a delayed delivery period
- Forward premium estimated at 7 to 8 basis points per month
- May work best for bonds with call dates within a year but could go as long as 2 years

Other Alternatives

- Cinderella Bonds
- Swap-Based Alternatives

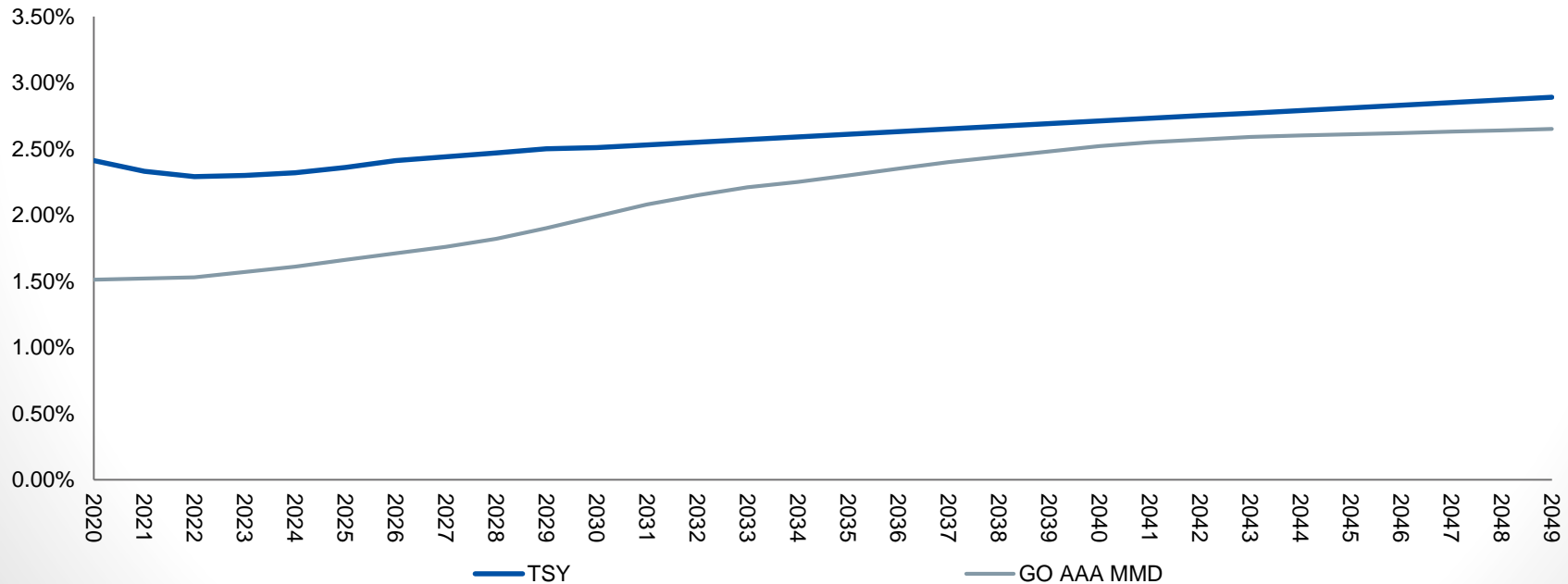
Advance Refundings with Taxable Bonds

Taxable bonds can be used to advance refund bonds with an escrow to the call date

Mechanics

- Long-term taxable bonds can be issued which are not subject to the yield restriction and arbitrage rebate rules accompanying tax-exempt bonds
 - Negative arbitrage in the escrow would still be a factor, just like in tax-exempt advance refundings
- Short-term taxable bonds can be issued which mature or are callable not earlier than 90 days before the call date of the refunded bonds
 - Once these bonds are callable or mature, they can be refunded (or remarketed) at market tax-exempt interest rates
- Shape of the US Treasury yield curve is a factor in determining the economic viability of this structure
 - The current yield curve is relatively flat, providing a potential for substantial PV debt service savings
- Taxable yields are almost always higher than tax-exempt yields, especially on the short and intermediate parts of the yield curve, potentially reducing the savings compared to those realized in a tax-exempt advance refunding

US Treasury and MMD Yield Curves



Source: Thomson Reuters – The Municipal Market Monitor (TM3), as of April 1, 2019

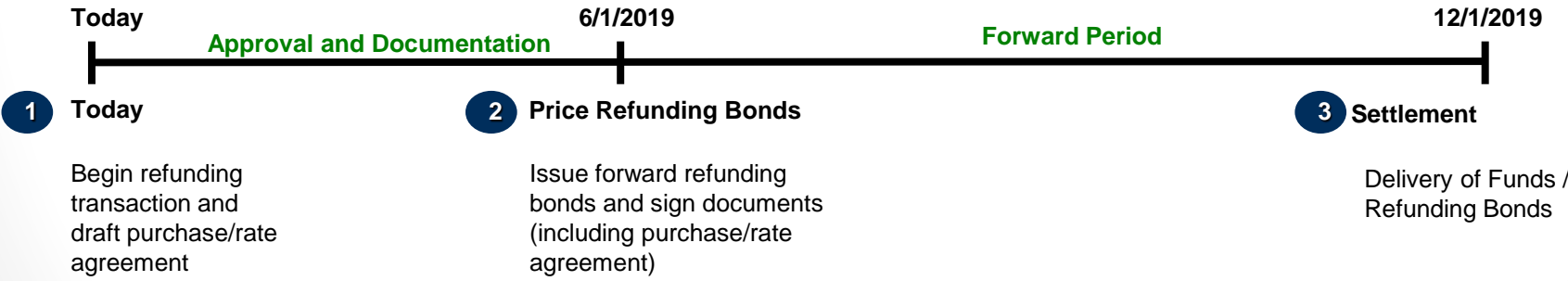
Forward Delivery Bonds

Bonds are sold today with a long delivery period in the future

Mechanics

- Forward refunding is accomplished by entering into a bond purchase agreement or rate lock agreement with a bond purchaser for the purchase of tax exempt bonds to be issued not earlier than 90 days before the refunded bonds' call date
 - Due to credit and settlement risk, 12-18 months is typically the maximum forward period
- Forward premium is estimated at 5 to 7 basis points per month, but this eliminates future market risk on the refunding bonds
 - This forward premium, however, is an additional cost over current market yields for current delivery bonds
- This structure is best suited for bonds that have a call date within one year of entering into the rate lock agreement

Forward Delivery Timeline



Source: RBC Capital Markets

Taxable Build America Bonds Refunding Update

- The American Recovery and Reinvestment Act allowed state and local governments to issue taxable Build America Bonds (“BAB”) that would receive federal subsidies to offset a portion (35%) of their interest cost
 - However, the subsidy is subject to sequestration reduction, i.e. the FY 2019 sequestration rate of 6.2% reduces the effective BAB interest rate subsidy to 32.83%
- Issuers can execute a tax-exempt advance refunding of the outstanding BABs to generate savings and eliminate exposure to federal sequestration
 - While the Tax Cut and Jobs Act eliminates the advance refunding of outstanding tax-exempt bonds, it does not eliminate the ability to advance refund a taxable bond (when the original purpose of the bonds would qualify for tax-exempt financing)
 - As long as the subsidy is “turned off,” Treasury Department Associate Tax Legislative Counsel, John Cross, does not believe that this will trigger any tax issues; guidance from the Treasury is expected soon

Refunding Considerations:

- **Base Case – Future Current Refunding:** The District can wait until the call date to refund the BABs
 - This is the baseline scenario to use in the evaluation of alternative scenarios
- **Alternative I – Advance Refunding Today:** Assuming the preliminary conclusion on advance refunding BABs, the District could execute a tax-exempt advance refunding
 - The BAB subsidy payments *are not expected* to remain in effect once the BABs are legally defeased

Short Call Option Considerations

- The passage of the Tax Cuts and Jobs Act eliminated the ability to advance refund tax exempt bonds
 - An advance refunding is defined as a refunding issue that closes greater than 90 days in advance of the stated call date of a bond issue
 - Tax exempt municipal issuers were permitted one advance refunding over the life of a bond issue
- A logical market adaptation could be the use of call options shorter than the typical 10 year call option
- RBC served on a number of Ohio local government transactions with shorter than typical call options in 2018
- Four of these transactions that would be of note are:
 - 5 Year Call Option - \$36,700,000 Series 2018A & \$9,825,000 Series 2018B Brunswick CSD UTGO School Construction Bonds (Priced 3/28/18 and 4/12/18)
 - 5 Year Call Option - \$57,100,000 Series 2018A & \$5,900,000 Series 2018B Highland LSD (Medina County) (Priced 4/10/18 and 5/1/18)
 - 5 Year Call Option - \$6,750,000 Series 2018 Refunding bonds Richfield Joint Recreation District (Priced 8/28/18)
 - 8 Year Call Option - \$22,000,000 Series 2018 COPS Cincinnati Public Schools (Priced 9/6/18)
- These transactions received substantial interest from investors and at yields lower than comparable 10 year call option bonds
- Some examples of major investors of long dated bonds with short call options have included:
 - Vanguard
 - Boston Company
 - Eaton Vance TABS
 - Franklin Funds
 - State Farm

Ohio Ratings Update

- **Moody's:** Maintains 577 underlying ratings on counties, cities and school districts in Ohio
 - Approximately 66% of those Ohio local governments pass tax increases in May 2017
 - Ohio county sales tax grow revenue but at a slowing rate compared to 2015 and 2016 rates
 - School districts continue to rely on levy elections to grow revenue in September 2017 due to a decade of declining state aid for 75% of districts statewide
- **S&P :** Maintains 239 underlying ratings on counties, cities and school districts in Ohio
 - “stable in recent years” with “moderate tax revenue growth and good financial management” allowing “governments to build and maintain strong budgetary reserves”
 - “Despite cuts to state-shared revenue in recent years, most local governments in Ohio have addressed these cuts without credit deterioration. Overall, S&P Global Ratings has taken more positive than negative rating actions during the past few years.”
 - The loss of sales tax revenue from Medicaid managed care services is the biggest risk for Ohio counties in the next few years.
 - Cities with weaker economies remain most vulnerable to credit pressure in light of lower state-shared revenue.
 - The recently approved state biennium budget holds funding relatively flat for most school districts.

Moody's Rating Agency Methodology

Moody's develops a scorecard comprised of 4 factors:

This indicative score can be further “notched” upward or downward based on qualitative factors, other pertinent statistics, or extreme results in any single statistic

Factor 1: Economy/Tax Base

Why it Matters

The ultimate basis for repaying debt is the strength and resilience of the local economy. The size, diversity, and strength of a local government's tax base and economy drive its ability to generate financial resources. The taxable properties within a tax base generate the property tax levy. The retail sales activity dictates sales tax receipts. The income earners living or working in the jurisdiction shape income tax receipts. The size, composition, and value of the tax base, the magnitude of its economic activity, and the income levels of its residents are therefore all crucial indicators of the entity's capacity to generate revenues.

Factor 2: Finances

Why it Matters

A local government's fiscal position determines its cushion against the unexpected, its ability to meet existing financial obligations, and its flexibility to adjust to new ones. Financial structure reflects how well a local government's ability to extract predictable revenues adequate for its operational needs are matched to its economic base.

Factor 3: Management

Why it Matters

Both the legal structure of a local government and the practical environment in which it operates influence the government's ability to maintain a balanced budget, fund services, and continue tapping resources from the local economy. The legal and practical framework surrounding a local government shapes its ability and flexibility to meet its responsibilities.

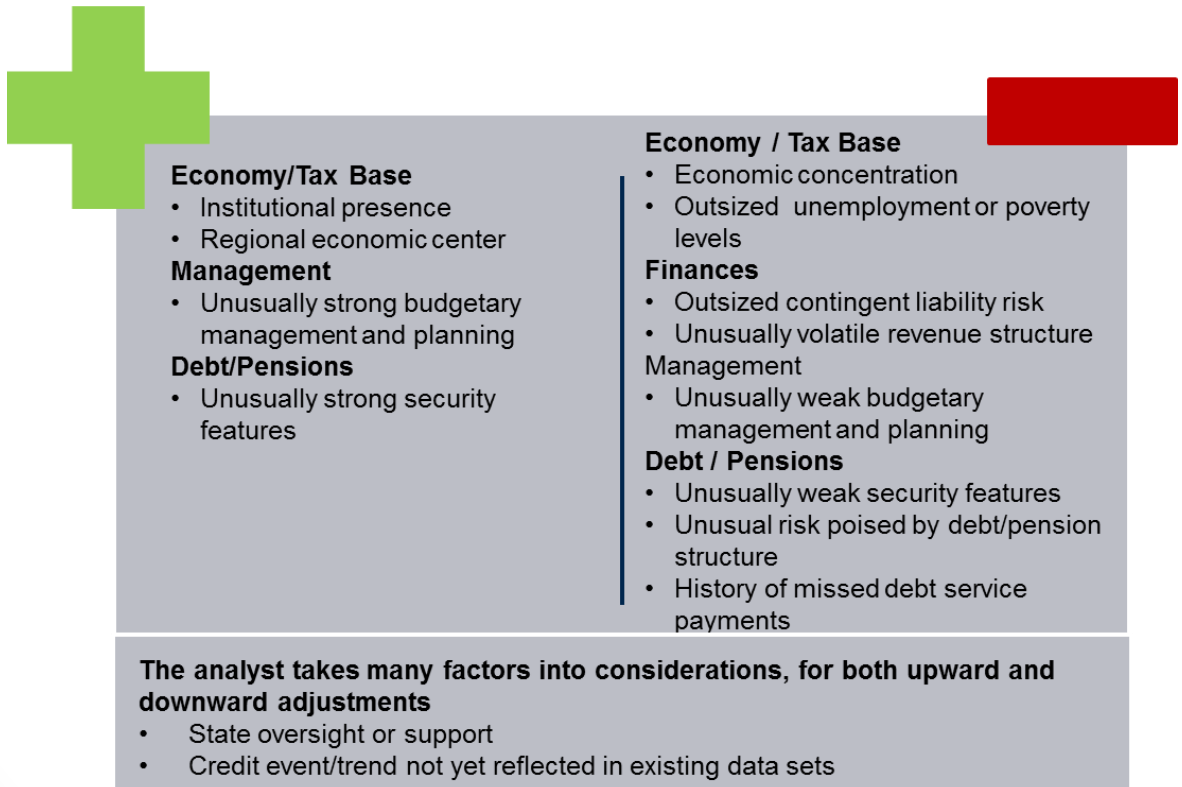
Factor 4: Debt/Pensions

Why it Matters

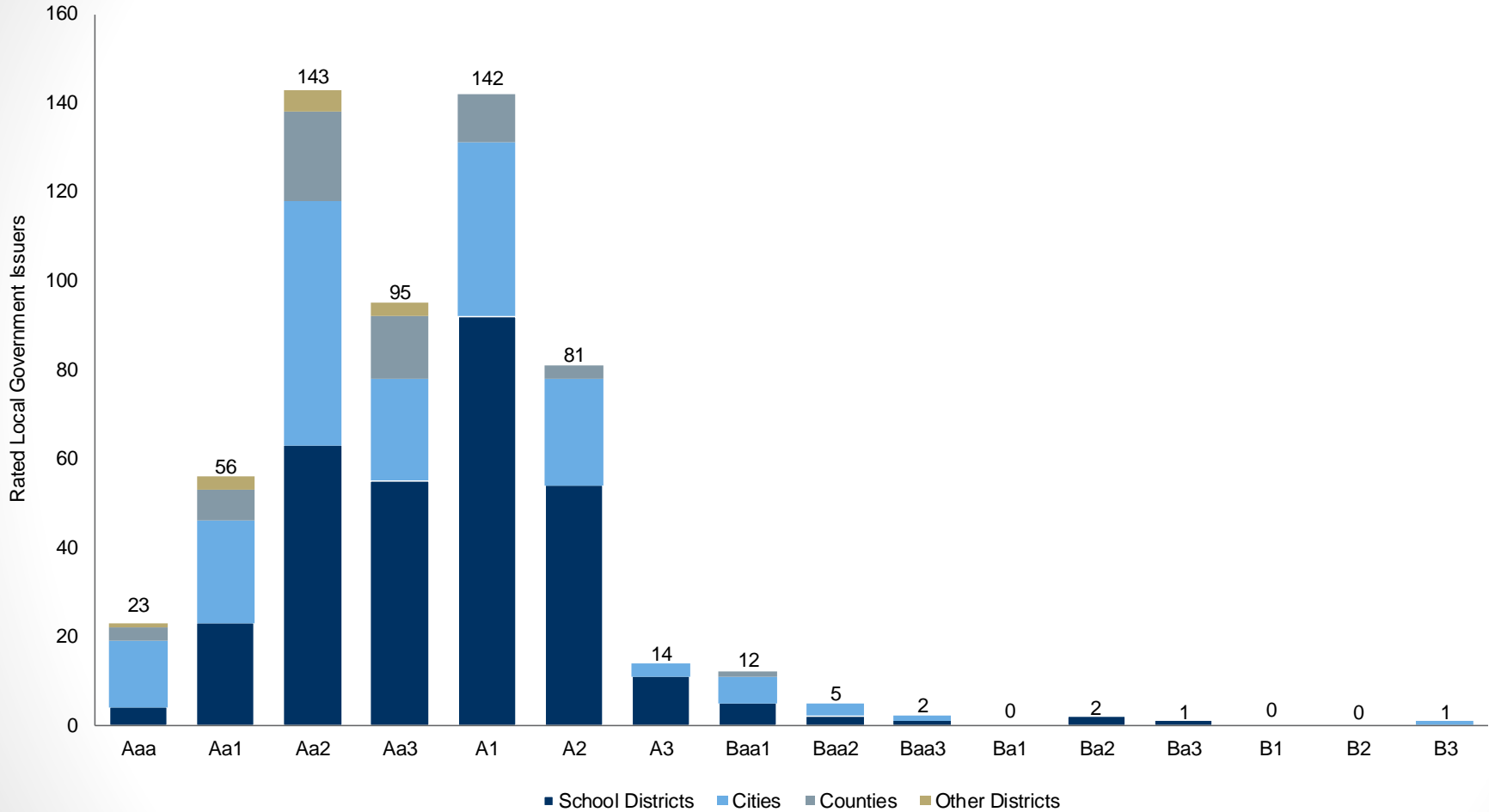
Debt and pension burdens are measures of the financial leverage of a community. Ultimately, the more leveraged a tax base is, the more difficult it is to service existing debt and to afford additional debt, and the greater the likelihood that tax base or financial deterioration will result in difficulties funding fixed debt service expenditures.

Adjustments or Mitigating Factors

- The scorecard provides a grounds for discussion on certain quantifiable metrics used in the rating process, but the process still involves a significant degree of judgment
 - It is not a calculator. There are many qualitative factors that cannot be measured and overriding factors that are very important when making the final rating decision.
 - Below are some examples of adjustments that may be made to the rating:

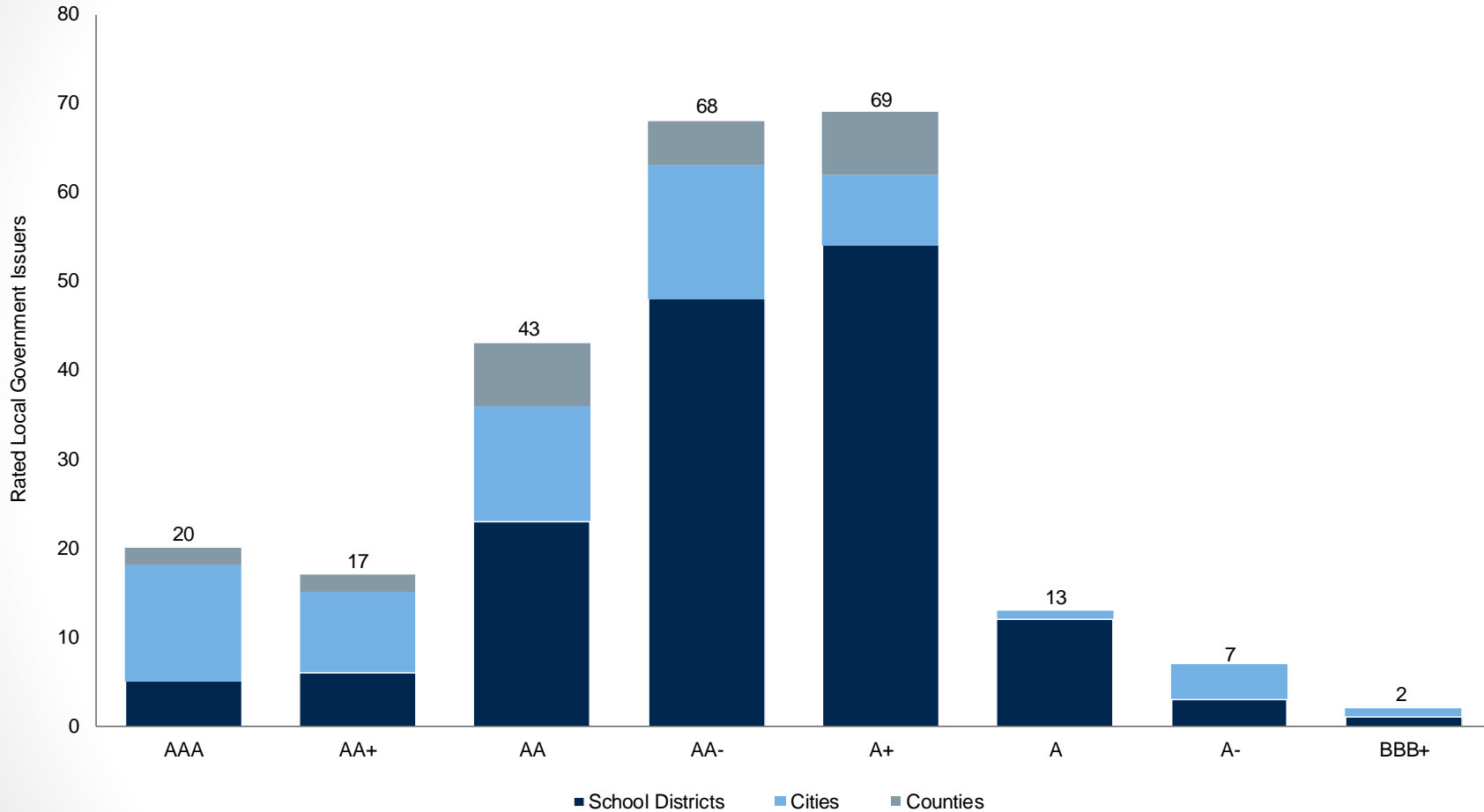


Moody's Ohio Local Government Credit Rating Distribution



- Moody's currently rates 577 local governments in the state of Ohio, with the majority of local government issuers (50%) receiving either a Aa2 (25%) or A1 (25%) rating

S&P's Ohio Local Government Credit Rating Distribution



- S&P currently rates 239 local governments in the state of Ohio, with the majority of local government issuers (29%) receiving an A+ rating

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