Issue 4
November 2014 bond and levy proposal

October 1, 2014

On July 15, 2014, the Board of Education of the Cleveland Municipal School District voted unanimously to place before voters on the Nov. 4, 2014, ballot its proposal to issue $200 million in school-improvement bonds and to levy a half-mill continuing levy for permanent improvements.

The two measures will be presented as a single, yes-or-no question as Issue 4 on the ballot. The bond debt would be retired over a maximum of 37 years; the half-mill levy for permanent improvements would continue until it is repealed.

Using the parameters of a principal amount of $200 million, a presumed bond interest rate of 4.75 percent and a maximum debt-retirement period of 37 years, applied to the current District tax valuation, the Cuyahoga County Fiscal Office calculated that the average millage rate required to retire the debt would be 2.0 mills per year, assuming that all $200 million of the bonds will be issued in one series bearing interest and maturing in equal principal amounts in each year over the 37 years.

The District Administration describes the question generally as a "no new millage" request for the purposes of school construction and renovation (the bonds) and for maintenance (the half-mill levy).

A thorough understanding of what is involved requires some explanation, so the following may help in that regard:

Does the District need additional bond money?

Yes, if it is to complete the comprehensive school replacement/full-renovation program begun in 2002 and co-funded by the state at $2 for every District dollar spent.

The BAC calculated last year that about $167 million in additional money would be needed to execute the construction Master Plan in place at the time but that as much as $222 million would be needed if the District also continued to finance repairs and improvements of its other buildings (those already deleted from the Master Plan) with bond money.

The Master Plan is being reduced again due to declining enrollment, but the District Chief Executive has pledged that in addition to building Master Plan schools, some 23 schools not part of the Master Plan will each receive $2.5 million to $4 million in "refresh/update" improvements not matched by the state, which would total $57.5 million to $92 million of the requested $200 million.

But didn't voters already fund the program with the 2001 approval of Issue 14?

The $335 million in bonds authorized by voters in May 2001 as ballot Issue 14 was not nearly enough to finance the entire program as envisioned at the time. According to Plain Dealer articles in early 2001, the District Chief Executive at the time characterized the $335 million as "a good start" toward financing the program.

The District's share of the original state-subsidized construction plan for approximately 111 schools would have been $482 million *plus* the cost of land acquisition and items that the state will not co-fund, such as auditoriums and various architectural amenities (sloped roofs, ornamental fencing, upgraded brick veneers, etc.)

Most importantly the $482 million figure was in *2002 dollars.* According to the national Turner Building Cost Index, construction costs have risen 43 percent since then.

Although a number of schools have been removed from the co-funded program because of declining enrollment, the District still has schools that state assessments back in 2001 deemed to merit replacement or full renovation. In addition, schools that have been deleted from the construction plan but remain open have continued to need substantial repairs, which the District has financed from the original $335 million in bond proceeds.

What about the additional half-mill levy, is that needed too?

Yes; in fact, even if approved it will not provide the District with enough money to maintain its schools to the standard in the District's official Maintenance Plan, a plan required by the state as a condition of construction co-funding. The state-approved consultant hired by the District to devise that Plan previously found that currently available funds, part of which come from a half-mill continuing levy approved as part of Issue 14, were more than 71 percent short of the optimum amount.

The previously approved half-mill levy, a state "equalization" subsidy, and the proposed half-mill levy would produce a combined total of about $7 million a year for maintenance and capital repairs. In some past years, the District has appropriated an additional $5 million in operating funds, which, if continued, would yield a grand total of $12 million for maintenance and capital repairs.

The total number of District schools will change, but let's say the District ends up with 80; $12 million would be enough for only $150,000 in repairs annually at each school. The District's Maintenance Plan consultant once estimated the ideal funding level – which includes saving money for major longer-term repairs such as roof and boiler replacements -- at more than $390,000 per school.

Lack of proper maintenance eventually ends up costing taxpayers more, because it results in preventable catastrophic failures or severe deterioration.

The District's Chief Executive recently acknowledged that the additional half-mill would not provide all the money that is needed for maintenance, but he said that was all that the District could request while sticking to its "no new millage" pledge.

Please note that the half-mill request approved by the Board of Education reads: "an Additional Tax of 0.5 Mills to Provide Funds for the Acquisition, Construction, Enlargement, Renovation, and Financing of General Permanent Improvements." So although the District has portrayed this as being for "maintenance," the language legally would permit more uses than what might be considered maintenance.

What does "no new millage" mean?

The phrase is not any kind of legal requirement but rather a promise made by CMSD leaders to the public. They are saying that the current collection rate to retire Issue 14 bond debt is 6.1 mills and that they will not collect above that rate for the new 0.5-mill levy and to retire remaining Issue 14 bonds and any new Issue 4 bonds

It should be noted that even if the annual millage rate does not increase, approval of the additional bonds would mean that taxes for construction and improvement debt could be collected until as late as 2052, rather than 2027, when Issue 14 debt is to be fully retired.

If voters decline to approve any more bond issuance, the collection rate to retire existing Issue 14 debt will range, according to the District, from about 2.2 to 3.0 mills each year until 2026, and a little less (1.3 mills) in 2027.

How do millage rates translate into dollars and cents on my tax bill?

That depends on how much your property is worth. Every three years, the county fiscal officer must reassess the market valuation of every property. In Ohio, property taxes are assessed on 35 percent of this official market valuation. Collection of a one-mill tax means collection of $1 per every $1,000 of 35 percent of the official market valuation.

For example, if your home and property are valued at $100,000 and the District is collecting construction-bond property taxes at its maximum target rate of 6.1 mills, your tax bill would be calculated on a value of $35,000 (35 percent of $100,000). The tax would be $6.10 (the millage rate) times 35 (the number of thousands in the assessed valuation), or $213.50 a year. If your home is valued at $50,000, the annual tax bill at the 6.1-mill pledged maximum would be $106.75.

For Issue 14, actual tax bills for residential property owners have been and will be reduced by 12.5 percent from the nominal millage rates by a state subsidy known as the property tax rollback, which cut the amount collected to about $187 for a $100,000 home and $93 for a $50,000 home. The Ohio General Assembly ended the rollback subsidy last year for future tax measures, so any taxes for Issue 4 debt will be collected at the full millage rate while taxes for remaining Issue 14 debt will continue to be rolled back.

Where did they come up with the 6.1-mill maximum millage rate?

That is the approximate rate at which the District has collected property taxes to pay off its bond debt since 2001.

The District tells the county each year how much money it needs to retire the bonds maturing each year, and the county sets the millage rate necessary to collect that amount of money.

It is important to note that under Ohio law, municipal school districts are responsible for issuing and servicing bond debt of municipal library systems. From 1991 through 2011, CMSD bond-debt tax collections included payments on $90 million in Cleveland Public Library debt issued in part to finance construction and renovation of the downtown Main library. Those collections were part of the 6.1 mills levied for payment of CMSD bond debt. Since retirement of the Library bonds, the District has continued to collect 6.1 mills, allowing early retirement and refinancing of Issue 14 debt at a substantial long-term savings to taxpayers.

Now the District promises not to exceed the 6.1-mill target in servicing remaining Issue 14 debt and new, Issue 4 bond debt if voters approve, although it legally could do so.

If 6.1 mills is the maximum collection rate, why are they talking about 2.0 mills for the current request?

It is unlikely that the District will collect 2.0 mills every year over the next 37 years to service Issue 4 debt.

Ohio law requires that a ballot request for bond authorization contain language specifying the maximum term over which the requested debt will be retired – 37 years in this case – and the average annual millage that would be required to retire the debt over that term, which the county's fiscal office has calculated at 2.0 mills.

However, this calculation *assumes* that all of the bonds are issued at once and that the individual bonds each bear the same interest rate and mature in equal principal amounts in each of the 37 years. It also *assumes* that the total property valuation in the District remains constant at the current $5.087 billion over the 37 years, that the on-time tax-collection rate remains constant at the current rate (89 percent), and that bond interest rates remain steady at a nominal 4.75 percent (currently about 4.4 percent for the District's credit rating) over that time.

But the assumptions are just that. The reality is that as time passes the total property valuation of the District is likely to change, the on-time tax collection rate has changed over time and may continue to do so, bond interest rates can vary markedly, and, due to federal tax rules on spending of standard municipal bonds, the District is likely to issue bonds only as needed according to its construction/repair timetable, not all at once.

Also, retiring Issue 4 debt faster than 2.0 mills per year would allow would quite likely save taxpayers a considerable amount of interest costs.

So, in pledging to keep the tax rate at a maximum of 6.1 mills, the District essentially has promised to take all of these variables into account as they change and to set its bond issuance and retirement strategy accordingly.

So if the 2.0-mill rate is just an average based on assumptions, what is likely to be the District's actual bond strategy?

The short answer, from the District, is "to be determined." We asked for a copy of any debt-strategy memos from the District's financial advisors since 2010, and the CMSD controller said he didn't have any.

With that in mind, we have no reason to believe that the District's strategy will be any different than it has been in the past: generally, to issue bonds as needed to fund its construction/repair timetable and to retire those bonds as quickly as possible within the declared 6.1-mill maximum rate, thereby minimizing interest payments and maintaining flexibility for future bond issuance.

After this year, the District says, it needs annually to collect only about 2.2 to 3.0 mills to retire remaining Issue 14 debt. Counting the additional half-mill continuing levy in the current request, the total would be 2.7 mills to 3.5 mills, meaning that the District could collect 2.6 to 3.4 additional mills through 2027 to retire new bond debt while staying within its 6.1-mill target, and it could collect the full 6.1 mills from 2028 onward.

Matters could be slightly complicated if the Cleveland Public Library decided to issue more bonds.

The BAC asked what would happen to the District's "no new millage" promise if the Library should decide to engage in a new, bond-funded construction project. The District's answer: "If taxpayers were to approve a bond issue for the Library then millage would increase by whatever millage it would take to pay debt payment."

That doesn't necessarily mean that the 6.1-mill target would be exceeded, but otherwise it would mean that the District would have less flexibility in servicing its school-construction debt.

How was Issue 14 debt handled?

It might help to look at that:

Issue 14 in 2001 contained similar language to the current bond request, estimating that average annual tax collections to retire the $335 million would be 3.7 mills over a maximum term of 25 years. At the time, the District was already collecting about 2.4 mills to service previous District bond issues and the Cleveland Public Library debt. Adding 3.7 mills to those collections yielded the nominal target rate of 6.1 mills.

As the previous debt was paid off, the District continued to collect around 6.1 mills, allowing faster retirement of Issue 14 debt, which generally has saved taxpayer money by reducing interest payments and has opened the window now for additional bond issues without raising individual annual property tax bills.

When the District tells the County Fiscal Office each year how much money it will need to make bond-debt payments due that year, the tax is then levied at the millage rate needed to yield that amount at the current on-time collection rate. But eventually some of the past-due taxes are collected as well, and those collections are forwarded to the District, resulting in excess cash in its Bond Retirement Fund. The District occasionally has used excess cash in that Fund for what amounts to early retirement of some outstanding bonds, which also has reduced the future tax burden and further opened the window for additional bond issuance that does not require raising annual tax bills.

For a more-detailed explanation of the District's past strategy, see Pages 85-92 and 104-113 of "Issue 14 Bond Issues," a consultant report commissioned in 2010 by the BAC, at

http://www.clevelandmetroschools.org/cms/lib05/OH01915844/Centricity/Domain/278/Issue%2014%20Bond%20Issues%20REPORT51410%201.pdf

Can the District issue any more of those "stimulus" bonds on which the federal government pays the interest?

Probably yes.

In 2010, the District issued $55 million in Qualified School Construction Bonds, often referred to as QSCBs, which were made possible as part of economic stimulus legislation approved by Congress during the Great Recession.

That $55 million was the last of the $335 million in bonds authorized under Issue 14, but an unused QSCB allocation of $49.2 million remains, which the District can issue if the state approves.

Interest earnings on ordinary municipal bonds, such as those normally issued by the District, are tax-free for the bondholder. But QSCBs are taxable, and therefore bring a higher interest rate. The advantage for the District is that the federal government rebates almost all of the interest costs to the District.

The District could use federal rebates on any additional issue of QSCBs to pay the interest due, making those bonds a virtually free loan for taxpayers, or it could deposit the rebates in its construction fund, where they could draw matching state funds at $2 for $1 and give the District more flexibility in meeting its "no new millage" promise.

However, the District legally can do about anything it desires with the rebates. The District funneled past QSCB rebates to its operating funds.