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Ratings

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Summary:
Cuyahoga County, Ohio; Sales Tax

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Summary:

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Credit Profile		
US$70.53 mil sales tax rev bnds (federally taxable) (Quicken Loans Arena Proj) ser 2017C due 01/01/2035		
Long Term Rating	AAA/Stable	New
US$35.265 mil sales tax rev bnds (federally taxable) (Quicken Loans Arena Proj) ser 2017B due 01/01/2035		
Long Term Rating	AAA/Stable	New
US$35.0 mil sales tax rev bnds (tax-exempt) (Quicken Loans Arena Proj) ser 2017A due 01/01/2035		
Long Term Rating	AAA/Stable	New

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Cuyahoga County, Ohio's series 2017A, 2017B, and 2017C sales tax revenue bonds (Quicken Loans Arena Project). At the same time, we affirmed our 'AAA' long-term rating on the county's series 2014 and 2015 sales tax revenue bonds. The outlook is stable.

Securing the 2017 bonds are proceeds from a 1.25% tax on all retail sales in the county and on the storage, use, or consumption in the county of tangible personal property, including automobiles. The 2017 bonds are on parity with the county's series 2014, 2015, and 2016 sales tax bonds. There are no subordinate liens. Proceeds of the 2017 bonds will be used to fund renovations at Quicken Loans Arena, home of the Cavaliers, Monsters (minor league hockey), and Gladiators (arena football). The renovation will expand the public areas of the arena, adding a larger concourse as well as more space for related entertainment.

While the bonds are legally secured only by the county's sales tax, officials plan to use other sources of revenue to repay the majority of debt service on the bonds. Our rating reflects only the pledge of the county's 1.25% sales tax.

The 2017A bonds are expected to be repaid from a portion of the county's sales tax and from a countywide 1.5% hotel occupancy tax. In 2007, the county approved a 20-year 0.25% increase to its sales tax with the intention to finance a new convention center. Officials plan to use excess revenue from this portion of the sales tax to support debt service on the 2017A bonds. The 1.5% hotel tax is collected by the county and shared with the local Convention and Visitor's Bureau (Destination Cleveland).

The 2017B bonds are expected to be repaid largely from incremental revenue and admissions taxes from the Arena that the City of Cleveland will collect. The county and the city have agreed to extend a 1992 cooperative agreement that directs a portion of the admissions tax to cover debt service on the bonds. Reserve funds will also be created to capture excess cash flow from the series A and B bonds. Lastly, through an amendment of the lease between the Cavaliers and the Gateway Economic Development Corp. (a nonprofit that serves as the arena's lessor), the Cavaliers will agree to make contingent rental payments to cover debt service to the extent that the admissions tax and reserve funds are insufficient.

The 2017C bonds are expected to be repaid completely by rental payments from the Cavaliers. The Cavaliers have agreed to extend their lease of the arena through 2035, which is the final maturity of the 2017 bonds.

The county is also pledging tax increment revenue to its series 2015 sales tax revenue bonds, but we rate the bonds based on the pledge of sales tax revenue, which we view as the stronger pledge.

The county has also covenanted that it will fulfill any debt service shortfall on its series 2014 sales tax bonds with any legally available funds no less than two business days prior to the debt service. However, we rate the bonds based on the pledge of sales tax revenue, which we view as the stronger pledge. For more information on the county's general creditworthiness, please see our report published May 15, 2017 on RatingsDirect.

The county's sales tax bonds are eligible to be rated above the sovereign because we believe the county can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings--Methodology And Assumptions," published Nov. 19, 2013, the county has predominantly locally derived revenue sources, independent taxing authority, and independent treasury management from the federal government.

The 'AAA' rating reflects our view of the county's:

- Stable sales tax revenue stream since 2009;
- Very strong maximum annual debt service (MADS) coverage of 10.5x, which could drop in 2017 and 2018 given the statewide exemption of Medicaid managed care organizations from the sales tax but which should remain very strong;
- Good legal provisions, including the direct transfer of pledged revenue from the state tax commissioner to the bond trustee and a 3x MADS historical additional bonds test (ABT);
- Deep and diverse regional economy; and
- Remote possibility that it will issue bonds to the extent allowed under its ABT, owing to its reliance on sales tax revenue for general fund operations.

The bonds' lien on the 1.25% sales tax is on parity with the county's other sales-tax-secured bonds. One percent of the county sales tax is continuous, while the remaining 0.25% is in effect until 2027. Neither is subject to repeal. All sales tax revenue is pledged to the bonds and the debt service coverage remains very strong, in our opinion, assuming the revenue generated from the 0.25% sales tax rate is not renewed after calendar 2027.

Pursuant to resolutions and the trust agreement, the state tax commissioner deposits sales tax revenue monthly into the trustee-held sales tax revenue fund. We consider this is a strength, as it isolates the sales tax revenue to ensure timely bondholder payments. The trustee will deposit 25% of the amount that will be sufficient to pay interest on the bonds due in the next interest payment date and 10% of the amount sufficient to pay principal due on the next principal date. As a result, sufficient money will be on hand in the sales tax bond fund two months prior to debt service due dates for payment on the bonds. To the extent that the aforementioned intended repayment sources for the 2017 bonds are sufficient for debt service, then the excess sales tax revenue will be remitted to the county. If the intended repayment sources are not deposited with the trustee in a timely manner, then the county will be reimbursed with the project revenue at a later date. The series 2017 bonds will not have a debt service reserve.

The bonds are covered by an ABT on the county's other parity sales tax debt, which is defined as one-half of the aggregate continuing county sales tax receipts (1%) during the prior 24 consecutive months prior to the sale of additional bonds, which is greater than 300% of the debt service charges on all bonds payable during any bond year. Based on calendar years 2015 and 2016, the continuing sales tax amount calculated for the past 24 months is $219.2 million and the coverage for all series of bonds is more than 8x in any debt service payment year.

Sales tax revenue for the county since calendar 2009 has grown by an annual average of 5.1%. Management reported 6.4% sales tax growth for 2016, which likely benefited in part from the Republican National Convention as well as the Cleveland Cavaliers and Indians' championship runs. The county's sales tax revenue grew to $272.2 million for fiscal 2016, eclipsing prerecession levels prior to 2009, when sales tax revenues fell 10% to $193.3 million. While county sales taxes were somewhat volatile during the recession, we believe that sales tax coverage ratios are sufficiently strong to withstand potential future volatility.

Using 1.25% sales tax revenue of $272.2 million in 2016, MADS of $25.9 million (including all sales tax bonds) occurring in 2033 resulted in coverage of 10.5x. Annual debt service gradually ramps up through 2026, is relatively level through 2034, and then drops off until final maturity in 2038. Assuming just the 1% sales tax revenue ($233 million) is used after 2027, MADS coverage drops to 9.04x, which we still consider very strong. These coverage levels are on par with the medians for other 'AAA' rated sales tax bonds (see "Special Tax Bonds: U.S. Recovery Underpins the Sector's Stability," published Sept. 14, 2015).

As a result of a federal mandate, starting June 30, 2017, the State of Ohio as well as counties and transit authorities across the state will no longer be able to apply sales and use taxes to services provided by Medicaid managed care organizations. Officials report that the county collects $27.4 million, or about 10% of its total collections, from these services. Excluding this amount from 2016 collections, we estimate that coverage would fall to 9.5x for the full 1.25% tax and 8.0x for the 1.0% tax. We still consider this coverage very strong.

The county will no longer collect Medicaid sales tax starting in October 2017, so estimates for the county's total sales tax collections in 2017 show a 2.2% drop. Current projections for 2018 reflect a 3.8% drop in total sales tax collections, reflecting the full impact of the loss in Medicaid sales taxes. This projection assumes that growth in other sales will somewhat offset the loss of the Medicaid tax revenue. We believe this assumption is reasonable given the county's recent growth and because our local government credit conditions forecasts retail sales to grow at an annual average of 2.3% in the East North Central region over the next three years. (See "For U.S. State and Local Governments, the Resilient but Shallow Expansion Complicates Budget Management," published July 24, 2017.)

Officials report a potential issuance of $20 million of new sales tax bonds over the next few years, but we believe coverage ratios will remain very strong and well in excess of the ABT. In our view, the county's reliance on sales tax revenue to fund general operations also reduces the risk that it would issue bonds to the extent allowed under its ABT. In fiscal 2016, sales tax revenue accounted for about 60% of total general fund revenue.

Cuyahoga County serves an estimated 2016 population of 1.3 million in northeastern Ohio, on Lake Erie and anchored by Cleveland, which we consider a broad and diverse economy. The city is a regional financial, health care, and services center that provides a wide variety of jobs to county residents. The county's average weighted population decline is 5.2% based on the past 10 years and projected 10-year change, with the largest decline in Cleveland. In our view, the stability of Northeast Ohio's regional population at over 4.3 million somewhat mitigates historical and potential population loss at the county level.

The county's 2016 median household and per capita effective buying income were 88% and 102%, respectively, of the national level. County per capita retail sales were 82% of the U.S. level in 2016. Leading sales taxpayer information is not available, but given the size of the county we do not view concentration as an issue. The average unemployment rate for the county was 5.4% in 2016, which was a slight increase from the 5.2% average in 2015. Cuyahoga County has codified economic development as a priority and has supported various projects to add and retain jobs and support housing in Cleveland and throughout the county in recent years. Various large hotel, retail, and residential projects have been completed and more projects are underway. Officials report over $13 billion in economic development activity throughout the county. Cuyahoga County's economy has exhibited relatively strong recovery since the recession, in our view, and continued economic development should further strengthen its tax base.

Outlook

The stable outlook reflects our expectation that the county will not issue bonds to the extent allowed under its ABT because of its reliance on sales tax revenue for operations as well as our belief that sales tax revenue will continue to generate very strong debt service coverage. As such, we do not expect to change the rating during the two-year outlook period. The rating further reflects our view of the broad and diverse economic base.

Downside scenario

We could lower the rating if sales tax revenue declines and coverage falls to a level we believe is not commensurate with that of similarly rated peers or if the county weakens its ABT requirement. We could also lower the rating if coverage were to drop significantly following the issuance of additional debt.

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 24, 2017
- Special Tax Bonds: U.S. Recovery Underpins The Sector's Stability, Sept. 14, 2015

Ratings Detail (As Of September 26, 2017)		
Cuyahoga Cnty sales tax rev bnds (pub square proj) ser 2015A due 12/01/2033		
Long Term Rating	AAA/Stable	Affirmed
Cuyahoga Cnty SALESTAX		
Long Term Rating	AAA/Stable	Affirmed

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.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.