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The Great GASB – Fuller Disclosure on Public Bond Issues

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By: David G. Barnes, JD

Heber Fuger Wendin, Investment Advisors.

Remember the large, faded eyes of Dr. T.J. Eckleburg on a billboard in F. Scott Fitzgerald's classic *The Great Gatsby*? Dr. Eckleburg's huge, bespectacled, painted eyes stare disapprovingly down from the billboard at the novel's characters, including Jay Gatsby, as they engage in some disreputable behavior. Although the Governmental Accounting Standards Board ("GASB" pronounced Gasby) may not immediately bring to mind Fitzgerald's novel, GASB's new recommended accounting rules for state and local governments, under which governments should, but are not required, to report starting in June 2015, may widen the eyes of bond issuers who are public employers that sponsor pension plans. Why? Application of the new rules, like Dr. Eckleburg's big round reading glasses, may show that some, but certainly not all, unfunded public pension obligations are larger than they currently appear.

The GASB accounting rules governing public pensions and the government employers that sponsor the pension plans have been roundly criticized for years by government watchdogs because the rules, they claim, can mask the true depth of a pension's financial hole, thereby making a public pension appear more affordable to states, municipalities and school districts than it really is. Critics of the rules also allege they can motivate government entities to take imprudent risks with taxpayer money in an effort to close the unfunded gaps. So, GASB established new rules. The new rules became effective for the pension plans themselves in fiscal years starting June 15, 2013 and they began reporting pursuant to them in June 2014. The new rules became effective for governments that sponsor pension plans in June 2014 and they will begin reporting under these new rules – if they subscribe to GASB's recommendations - in June 2015.

A large part of the issue here comes down to how states, municipalities and school districts discount future pension payments to retirees in today's dollars. The new rules require a new method; if the pension plan is expected to run dry, it may no longer use a discount rate based on the expected rate of return (which has been unrealistically high at some plans). It must instead use a discount rate, starting for the time when it runs out of assets, using "...a tax-exempt, high-quality municipal bond rate." So, the new discount rate for severely unfunded state and local pension funds will be a weighted mix of the expected rate of return and the muni bond rate, which will be much lower. Governments with fiscally healthier pension plans will be allowed to continue discounting future payments to their plans without using the muni bond rate.

A number of other changes are also required by the new rules, including the following:

- Transparency. Historically state and local governments have been allowed to disclose unfunded pension amounts only in footnotes on their financial reports. But under the new rules, starting in June 2015 unfunded pension

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liabilities will be required to endure the harsh light of day next to other obligations on the balance sheets of state and local government pension plan sponsors.

- **Reporting of Pooled Pension Obligations.** Many states manage pooled pension systems for themselves and on behalf of their local governments. The current accounting rules don't require each municipality to report its share of the aggregate pension obligation. Only the amount the municipalities contributed to the pool must be reported. The new rules will require each municipality to disclose their respective obligations in the pool.
- **Cost Recognition.** Current rules allow states and local governments to spread pension costs over 30 years. Some re-start the 30 year clock every year, in effect kicking the can down the road according to critics. The new rules require state and local governments to recognize some costs immediately, in addition to limiting the spread on other costs to five years.
- **"Smoothing."** The current rules allow states and municipalities to spread the recognition of pension investment gains and losses over many years. The new rules will curtail this "smoothing" practice, which will make it more difficult for them to "manage" the investment returns.

Many critics of the current rules claim the new rules don't go far enough in forcing states and local governments to play by the same or similar accounting rules as the private sector. They claim governments will still be allowed to conceal significant portions of their pension obligations with accounting moves. In addition, they complain that municipalities are not required to comply with the GASB rules, although about two-thirds of the largest muni issuers do, in fact, incorporate GASB's recommended practices. Conversely, state and local executives are worried that as a result of the new rules, their newly exposed pension shortfalls will cause taxpayers to demand cuts to public employee benefits, causing credit rating downgrades of municipalities and increasing their costs to float new bond issues. Further, they may contend that the majority of issuers already accurately and honestly report the financial condition of their pension plans, so this is a case of relatively few alleged bad apples spoiling the whole bunch. Regardless, the new rules are designed to at least partially achieve GASB's goals of making the financial statements of state and municipal governments generally more representative of their financial position and in GASB's words, enhance their "value for assessing accountability and interperiod equity" and increase "consistency and transparency."

The full text of the rules along with a summary and an implementation guide with Q & A on this matter can be found at gasb.org.

So, thanks to the new spectacles GASB is suggesting in the form of new accounting rules for issuers of state, municipal and school district debt, buyers of muni bonds should soon have the vision to better confirm whether a given issuer of public debt has really been living up to its pension obligations (as most issuers likely do), or whether, like some of the behavior witnessed by the ominous eyes of Dr. T.J. Eckleburg, the issuer has been somewhat mischievous.

Heber Fuger Wendin, established in 1934, is a fee-only, independent SEC-registered investment advisory firm (not a broker) to insurance companies and depository institutions. Mr. Barnes leads the Heber team in helping to manage \$4.6 billion. Mr. Barnes can be reached at dbarnes@hfw1.com or HeberInvestments.com or [linkedin.com/in/davidgbarnes](https://www.linkedin.com/in/davidgbarnes).

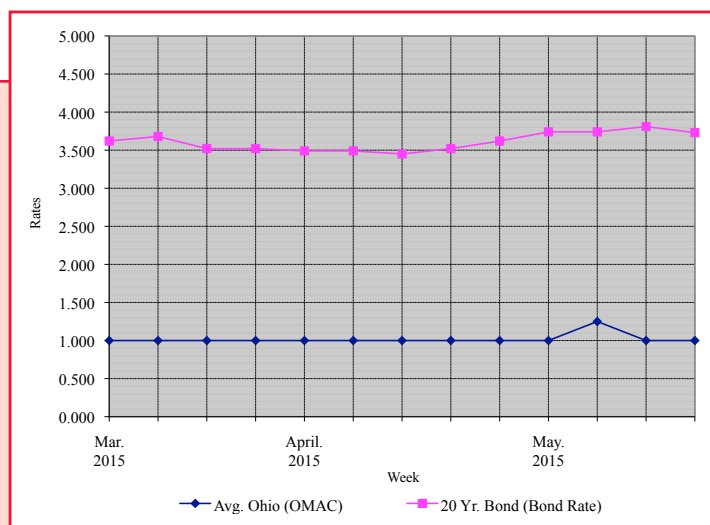
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MARKET UPDATE

GENERAL OBLIGATION

Note and Bond Interest Rates for March thru May

The following graph compares Ohio short-term note rates with the Bond Buyer's 20 year bond index. The short-term rates represent actual rates reported to OMAC by Ohio purchasers and reported on OMAC's weekly calendar.



Ohio Voters Approve New Taxes in Some School Districts

From U.S. Public Finance Weekly Credit Outlook

On May 5, Ohio (Aa1 stable) residents voted in a number of local referenda on new tax revenue for school districts. Thirteen rated districts sought voter approval of new levies to either enhance current financial operations or address forecasted budget gaps. Preliminary results indicate that voters in eight of these districts approved the requested levies, which is a credit positive for those districts.

The new revenue will significantly strengthen the financial operations of all of these districts, but particularly Genoa Area Local School District (A1), Keystone Local School District (Aa3), Monroeville Local School District (A3) and Springfield Local School District (Lucas County) (A2 negative).

Alternatively, results are credit negative for the five districts that did not gain approval for new levies and particularly negative for Walnut Township Local School District (Baa2 negative) and Woodmore Local School District (A2 negative). Both of those districts face growing fiscal pressure and defeat of the levies could exacerbate current operating and credit stress.

The Exhibit below details the preliminary election results, the size of the levy requested and each district's projected fiscal 2015 General Fund cash reserves as a share of revenue.

Voters Approve New Taxes in Eight of 13 Rated School Districts

District	Rating	Tax Request - millage or income tax %	Result	Proj. 2015 Cash / Rev
Avon Local School District	Aa2	2.90	Passed	33.9%
Genoa Area Local School District	A1	6.38	Passed	12.4%
Kenston Local School District	Aa1	4.00	Passed	30.3%
Keystone Local School District	Aa3	7.95	Passed	12.5%
Monroeville Local School District	A3	4.95	Passed	4.7%
Northeastern Local School District	A1	1.0%	Passed	17.9%
Springfield Local School District	A2 negative	5.98	Passed	-2.4%
Tipp City Exempted Village School District	Aa3	4.95	Passed	17.1%
Cleveland Heights-University Heights City School District	Aa2	5.90	Defeated	27.1%
Fairless Local School District	Aa3	8.90	Defeated	17.7%
Northwest Local School District	Aa2	1.18	Defeated	46.3%
Walnut Township Local School District	Baa2 negative	7.00	Defeated	2.6%
Woodmore Local School District	A2 negative	0.75%	Defeated	3.0%

Ratings listed without outlooks do not have outlooks assigned

Sources: Ohio Secretary of State, respective county Board of Elections, School district five-year financial forecasts submitted to the Ohio Department of Education in October 2014

The results are particularly positive for Genoa Area Local School District, Keystone Local School District, and Monroeville Local School District. All three districts faced narrowing liquidity without additional revenue and the new taxes will help stabilize financial operations. The results also mark a shift in voter sentiment in all three districts. Voters in both Monroeville and Genoa defeated similar levy requests in 2014. Voters in Keystone had defeated ten consecutive requests for a new operating levy since 1995.

Despite the approval of its new levy, Springfield still faces significant fiscal strain indicated by its projected deficit cash balance for fiscal 2015. We downgraded the district in 2014 given its negative financial trend and weak voter history. Prior to the May 5 election, voters in Springfield had defeated three consecutive requests for new operating revenue since November 2013. The new levy will generate approximately \$3.9 million annually but collections will not begin until fiscal 2016. If the district fails to adjust its current year expenses, it could face significant near term credit pressure.

We expect the remaining four rated districts where voters approved new taxes to utilize the new revenue to reinforce fiscal stability. Each of these districts project to close fiscal 2015 with cash reserves in excess of 15% of revenue.

Walnut Township and Woodmore will face further fiscal and credit stress as a result of the voter defeat of their levy requests. Both districts project closing the current year with very narrow cash balances and will likely face continued



operating pressure in fiscal 2016. The districts have the option of seeking voter approval in subsequent special elections this year, but the May 5 margins of defeat may be difficult to overcome. Voters in Walnut Township defeated that district's request by a margin of 55% to 45%. The gap was significantly higher in Woodmore where an estimated 65% of votes went against the district's request.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

We anticipate much more moderate credit pressure in the other three districts with defeated levies. All three project closing fiscal 2015 with cash reserves in excess of 17% of revenue and, like all districts in Ohio, retain the option to seek voter approval in later elections.

Many Ohio school districts rely on periodic voter approval of new levies in order to address inflationary growth in operating costs and maintain fiscal stability. New local tax revenue also frees Ohio school districts from total reliance on the state to fund operations.

Analyst Contacts: CHICAGO +1.312.706.9950
 Matthew Butler +1.312.706.9970 *Assistant Vice President - Analyst* matthew.butler@moodys.com
 Henrietta Chang +1.312.706.9960 *Vice President - Senior Credit Officer* henrietta.change@moodys.com

Authors: Matthew Butler, Henrietta Chang
 Production Associate: Aykash Prasad

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CALENDAR

Calendar of Issuer Conferences & Outings for 2015

NAME	EVENT	DATE	LOCATION
CAAO	Winter Conference	Nov. 18 – 20	Embassy Suites- Dublin, Ohio
CTAO	Fall Meeting	November 16 - 18	Columbus Marriott NW at Tuttle Crossing – Dublin, Ohio
GFOA	Annual Golf Outing	July 27	Worthington Hills Country Club- Worthington, Ohio
	Annual Fall Conference	September 23 - 25	Hilton Netherland Plaza - Cincinnati, Ohio
	Advanced Accounting Seminar	August 6	Put-In-Bay, Ohio
MFOA (OML)	OML Annual Conference	October 21 - 23	Renaissance Hotel – Columbus, Ohio
	MFOA Annual Conference	October 29 - 30	Marriott Northwest - Dublin, Ohio
	Northeast Ohio Golf Outing	July 22	Lost Nation Municipal Golf Course - Willoughby, Ohio
	North-Central Ohio Golf Outing	September 9	Woussickett Golf Course – Sandusky, Ohio
NACO	National Conference	July 10 – 13	Charlotte Convention Center – Charlotte, NC
OAPT	Annual Conference	Sept. 30 – Oct. 2	The McKinley Grand Hotel – Canton, Ohio
	National Conference	August 16 - 18	Hilton Chicago - Chicago, Ill.
OMCA	Annual Conference	July 20 - 23	Marriott Northwest – Dublin, Ohio
OSBA	Capital Conference	November 8 – 11	Columbus Convention Center – Columbus, Ohio

(T) - means date or place is tentative.

Red lettering means revised or updated events.

CAAO – County Auditor's Association of Ohio ----- (614) 228-2226 ----- www.caaao.org
 CTAO – County Treasures Association of Ohio ----- (614) 517-5072 ----- www.ohiocountytreasurers.org
 GFOA – Government Finance Officers Association ----- (614) 221-1900 ----- www.ohgfoa.com
 MFOA – Municipal Finance Officers Association of Ohio ---- (614) 221-4349 ----- www.omloho.org
 NACO – National Association of Counties ----- (614) 221-5627 ----- www.naco.org
 OAPT – Ohio Association of Public Treasurers ----- (440) 576-3944 ----- www.ohioapt.org
 OASBO – Ohio Association of School Business Officials ---- (614) 431-9116 ----- www.oasbo-ohio.org
 OMCA – Ohio Municipal Clerks Association ----- (614) 221-4349 ----- www.omca.us
 OSBA – Ohio School Boards Association ----- (614) 540-4000 ----- www.ohioschoolboards.org

If your organization has other events scheduled that you would like to see listed here, please contact OMAC at 800-969-6622 or email us at chris@ohiomac.com.