FitchRatings

RATING ACTION COMMENTARY

Correction: Fitch Rates Ohio's $49MM Lease Appropriation Bonds 'AA'; Outlook Stable

Thu 03 Sep, 2020 - 2:02 PM ET

Fitch Ratings - New York - 03 Sep 2020: This is a correction of a press release issued earlier today. It includes the name of the issuer in the headline, which was omitted from the original release.

Fitch Ratings has assigned 'AA' ratings to the following state of Ohio (Treasurer of State) Capital Facilities Lease Appropriation bonds:

--$44 million series 2020A (Cultural and Sports Facilities Building Fund Projects);

--$5.5 million refunding series 2020A (Juvenile Correctional Building Fund Projects).

The bonds are expected to be sold via negotiation on or about Sept. 15, 2020.

The Rating Outlook is Stable.

SECURITY

The lease revenue bonds are special obligations of the state, payable from payments under separate lease agreements between the Ohio Public Facilities Commission (OPFC) and each of the Ohio Facilities Construction Commission (OFCC) and the Department of Youth Services (DYS). The lease agreements are subject to biennial appropriation from the state's general revenue fund (GRF).

ANALYTICAL CONCLUSION

Appropriation Mechanism:: The 'AA' rating on the bonds backed by Ohio's lease appropriation is one notch below the state's Issuer Default Rating (IDR), reflecting the slightly higher degree of optionality associated with payment of appropriation debt. The state's 'AA+' IDR is based on its careful financial management, which is reflected in maintenance of fiscal balance, the rebuilding of reserves and low liabilities. Ohio's economy had demonstrated slow but steady growth leading into the downturn from the coronavirus, with performance in recent years more in line with national levels, though still slightly lagging. Ohio's very slowly growing population may be limiting sustained growth.

ECONOMIC RESOURCE BASE

Ohio's economy is large and diverse, with distinct economic regions centered on several large urban centers. Manufacturing remains a disproportionally large sector with a concentration in more cyclically sensitive durable goods industries. Transportation equipment and related suppliers also have a strong presence.

On March 9, 2020, in an effort to mitigate coronavirus' spread, Governor Mike DeWine declared a state of emergency and closed all nonessential businesses in the state, beginning March 23. As expected, economic activity fell significantly with GDP declining 5.5% in the first quarter of 2020 as compared with the fourth quarter of 2019, a slightly steeper decline than the 5% U.S. rate. Employment also fell sharply. The state began a phased reopening of business on May 1 and economic activity has picked up, although it is noted that COVID-19 case counts have also ticked up and future economic growth may be tempered by additional measures to limit the spread of the virus. The state's insured unemployment rate, (IU; not seasonally adjusted, the ratio of continuing claims for unemployment insurance [UI] to total employment covered by the UI program), was 6.5% for the week ended August 15, versus 9.5% nationally. The weekly IU rate is different from the more commonly used monthly unemployment rate, but it provides a useful forward look given its timeliness.

KEY RATING DRIVERS

Revenue Framework: 'aa'

Like most states, Ohio has an unlimited legal ability to raise operating revenues. Its revenue base is diverse and relies on broad-based income and sales taxes. Tax cuts implemented over the past several biennia have been manageable, aided by favorable economic and fiscal trends.

Expenditure Framework: 'aaa'

Ohio retains ample flexibility to cut spending throughout the economic cycle. As in most states, the natural pace of spending growth is likely to be somewhat above revenue growth, requiring ongoing budget management. Carrying costs for debt and retiree benefits are below the median for states. Spending pressure in Medicaid and education appears to be well controlled.

Long-Term Liability Burden: 'aaa'

Debt is typically conservatively managed and debt issuance primarily consists of general obligation bonds (GOs). On a combined basis, outstanding debt and net pension obligations are low and a below average burden relative to other states.

Operating Performance: 'aaa'

The state generally has a careful approach to financial operations and has consistently managed to achieve budgetary balance. In recent years, the state has relied more on budget reductions than revenue enhancements to balance the budget and also used several one-time sources during the Great Recession. The state's budget stabilization fund has been restored after being drawn down during the recession and now totals $2.7 billion - more than 11% of state-source GRF revenues.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Sustained economic growth at a level that improves expectations for revenue growth over time.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An inability to address the fiscal challenges triggered by the expected short-term, but severe, economic contraction, as evidenced by an inability to make sufficient budget adjustments, leaving the state less financially resilient at the end of the recovery period;

--Economic contraction extending well into the second half of the year or beyond, consistent with Fitch's coronavirus downside scenario, that triggers sustained and deep revenue declines and materially erodes the state's historically strong gap-closing capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CURRENT DEVELOPMENTS

Sector-Wide Coronavirus Implications

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. Material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Recovery begins from 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP remains below its 4Q19 level until mid-2022. A severe but plausible downside scenario includes a prolonged health crisis and negative economic shock. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases" and the May 2020 report "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers", both available on www.fitchratings.com.

Federal Aid Provides Some Support for State Budgets

Federal aid measures enacted in recent weeks will benefit state budgets, although details remain fluid. The Families First Coronavirus Response included a 6.2% increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for every quarter of the national emergency declared by the president on March 13. FMAP is the rate at which the federal government reimburses states for Medicaid spending. The state expects to receive approximately $300 million each quarter and is assuming the enhanced FMAP rate will continue through December 2020. The ultimate value of the FMAP rate increase will depend on states' actual Medicaid spending, among other factors.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act enacted on March 27, the U.S. Treasury department distributed $150 billion to state and local governments. The statute limits the use of funds to coronavirus expense reimbursement rather than to offset anticipated state tax revenue losses. The U.S. Treasury allocated $4.5 billion to Ohio, of which $3.7 billion was received directly by the state, with the balance allocated to local governments in the state with a population of 500,000 or more.

Ohio Liquidity Update

Fitch considers Ohio well positioned to address liquidity pressure emanating from the coronavirus pandemic and related economic downturn with no interruption in timely payments for key operating expenses, including debt service. Fitch believes Ohio's very strong financial resilience, as evidenced by its significant reserves and conservative budgeting, positions it well to manage through potential revenue losses and additional expenditures due to the coronavirus. In addition to budget measures that have already been taken and the receipt of federal aid, the state has $2.7 billion in its budget stabilization fund, equal to more than 11% of state-source general revenue fund revenues. This healthy balance has allowed the state to bridge liquidity concerns over the extension of the income tax filing deadline to July 15. The state has indicated that it does not intend to access the Federal Reserve's Municipal Lending Facility.

Budget Update

As is the expectation for most U.S. states, Fitch anticipates Ohio's revenue collections, particularly for employment-based income and sales tax, to experience weakness through this period of reduced activity. Revenue collections through the first part of fiscal 2020 were strong and ahead of forecast, which provided a buffer against the sharp curtailment of tax collections that began in April. This cushion contributed to overall GRF revenues being only 1.6% ($559 million) below estimate and down approximately 1% as compared with fiscal 2019. GRF tax receipts were 4.6% ($1.1 billion) below estimate for the fiscal year, with personal income tax collections 9.7% ($845 million) below estimate, largely attributed by the state to the deferred tax filing deadline, and non-auto sales tax 3% ($283 million) below estimate. The underperformance in tax collections was partially offset by an increase in federal receipts and slightly better than forecast auto-sales tax collections.

Ohio has strong financial resilience that should allow it to absorb the immediate budgetary effects of the economic downturn. Ohio put in place spending controls to address revenue shortfalls, including a hiring freeze, a freeze on pay increases, promotions and new contracts, and a request to state agencies to reduce spending up to 20% for the balance of fiscal 2020 and for fiscal 2021, the second year of the biennial budget. The governor subsequently, by executive order, reduced the fiscal 2020 budget by $775 million, with an anticipated revenue gap of $2.43 billion in fiscal 2021, and is making additional adjustments to the fiscal 2021 budget. Reductions in place for fiscal 2021 include a 10-day furlough for exempt employees and continued hiring and pay increase freezes, among other personnel actions. The state has also reduced Medicaid reimbursement rates, reducing state spending that will be replaced in part by the enhanced federal match.

Though the state currently expects that the measures taken to date and access to the enhanced Medicaid FMAP will close a significant portion of the gap, other budget reductions will also be considered as the economic and revenue outlook evolves. The state did not draw upon the rainy day fund to address revenue loss in fiscal 2020 and is not currently planning to do so in fiscal 2021, although it is available with legislative action to address a shortfall whether in this fiscal year or the subsequent biennium.

These reductions and access to the state's $2.7 billion rainy day fund provide the state with sufficient flexibility to address the magnitude of revenue loss associated with Fitch's base case scenario, which indicates a first-year decline in Ohio's revenues of 13%, followed by a 5.9% increase and cumulative result over the three-year scenario of a 5.3% decline. This compares with the state median decline of 16.6% in the first year and negative 5.7% over the three-year scenario.

CREDIT PROFILE

The bonds currently offered are secured by rental payments that are appropriated biennially under separate lease agreements between the OPFC and each of the OFCC and the DYS. The debt is authorized by the state's constitution and secured by the state's pledge of legislative appropriation, with the leases renewable biennially until the bonds are repaid. The treasurer of state is required to submit an estimate of the debt service requirements to each department as well as the director of budget and management prior to the start of each fiscal year. The trustee does not have the ability to take possession of or operate leased projects.

For more information on Ohio's IDR, see "Fitch Rates Ohio's $96MM GO Bonds 'AA+'; Outlook Stable," dated Feb. 3, 2020.

DATE OF RELEVANT COMMITTEE

24 July 2020

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of Environmental, Social and Governance (ESG) credit relevance, if present, is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entities, either due to their nature or to the way in which they are being managed by the entities. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Ohio, State of (OH) [General Government]			
• Ohio, State of (OH) /Lease Obligations - State Appropriation/1 LT	LT	AA Rating Outlook Stable	Affirmed

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

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