FitchRatings

05 AUG 2021

Fitch Affirms OH IDR at 'AA+'; Rates Lease Appropriation Bonds 'AA'; Outlook Revised to Positive

Fitch Ratings - New York - 05 Aug 2021: Fitch Ratings has assigned an 'AA' rating to the following state of Ohio lease appropriation bonds:

--$56.5 million State of Ohio (Treasurer of State) Series 2021A Capital Facilities Lease-Appropriation Bonds (Cultural and Sports Facilities Building Fund Projects).

The bonds are expected to be sold via negotiation on or about Aug. 17, 2021. Bond proceeds will fund capital facilities for the Ohio Facilities Construction Commission (OFCC).

Fitch has also affirmed the following:

---Ohio's Issuer Default Rating (IDR) at 'AA+';

---Ohio's GO bond rating at 'AA+';

---Outstanding appropriation-backed bonds of the state at 'AA';

---'F1+' Short-Term rating on adjustable GO bonds and lease-appropriation bonds for which the state provides liquidity upon a failed remarketing.

Fitch has also affirmed the ratings on other debt linked to the IDR as listed at the end of this release.

The Rating Outlook is revised to Positive from Stable.

SECURITY

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

ANALYTICAL CONCLUSION

The revised Outlook to Positive from Stable reflects Ohio's sustained trend of balanced finances and growth in reserves that strengthens the state's financial resilience as it confronts cyclical economic and revenue trends. Although the state has prioritized tax cuts over time, revenue actions to date have not limited its ability to absorb economic and fiscal cyclicality while maintaining structural balance and ample reserve balances. Further action on the rating will look to the state's fiscal and economic position beyond the pandemic, as federal aid expires, including the longer-term direction of economic growth and the state's continued ability to maintain structural balance and high resilience.

The state's 'AA+' IDR is based on its careful financial management, which has supported financial stability and the rebuilding of reserves over time, and low liabilities. The 'AA' rating on the bonds to be issued is one notch below the state's IDR, reflecting the slightly higher degree of optionality associated with payment of appropriation debt.

The 'F1+' Short-Term rating reflects the ample liquidity provided by investments in the state treasurer's liquidity account, the strength of the state's IDR, and the procedures in place to ensure timely payment of optional tenders of bonds that have not been remarketed.

Economic Resource Base

The state economy is large and diverse, featuring distinct economic regions centered on several large urban areas. While the economy has experienced continued economic diversification, including expansion in finance, insurance and real estate sectors, manufacturing remains a disproportionally large sector, relative to national averages, with a concentration in more cyclically sensitive durable goods industries. Transportation equipment and related suppliers also have a strong presence. Fitch anticipates slow but steady growth in Ohio's economy, limited by slow population gains.

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. Revenue implications of 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.

Long-Term Liability Burden: 'aaa'

Debt is typically conservatively managed and debt issuance primarily consists of GO bonds. On a combined basis, outstanding debt and net pension obligations are below the state median.

Operating Performance: 'aaa'

The state generally has a careful approach to financial operations, consistently achieving budgetary balance and restoring its Budget Stabilization Fund (BSF) during the last economic expansion. The fund now totals a strong $2.7 billion, about 10% of fiscal 2021 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 Fitch's expectations for Ohio's revenue growth over time to be maintained above inflation and closer to national GDP growth;

--Ability to maintain structural balance while emerging from pandemic-related uncertainty, given state tax policy actions, particularly as federal stimulus support is removed from the general economy.

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

--Failure to maintain fiscal balance in addressing potential financial challenges, including related to continued pandemic-driven uncertainty or absorbing the impact of tax policy revisions;

--Fiscal stress leading to sustained budget actions that significantly diminish expenditure flexibility;

--State revenue growth that falls below the level of U.S. inflation over an extended period of time.

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

Budget Update

Ohio has superior financial resilience that allowed it to absorb the immediate budgetary effects of the economic downturn. In response to the pandemic, Ohio quickly put in place spending controls 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 years 2020 and 2021, the second year of the biennial budget. The governor subsequently, by executive order, reduced the fiscal 2020 budget by $775 million, including cuts to education and Medicaid spending. A portion of these carried over to the fiscal 2021 budget. The state did not rely on any use of the BSF, the state's 'rainy day fund' to address revenue loss in fiscal 2020.

Ohio's revenue collections, particularly for employment-based income and sales tax, experienced weakness through the period of reduced activity brought on by the pandemic but have since recovered. Fiscal 2020 GRF tax receipts were 4.6% ($1.1 billion) below the original budget estimate for the fiscal year, with personal income tax collections 9.7% ($845 million) below estimate, due largely 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. Overall GRF revenues were only 1.6% ($559 million) below estimate and down approximately 1.0% as compared with fiscal 2019.

The state's fiscal 2021 actual tax revenue performance was stronger than original budget estimates. Tax receipts exceeded projections by about $1.5 billion (6.2%), with both personal income tax and sales tax collections ahead by 4.5% and 9.0%, respectively. Total fiscal 2021 revenues exceeded estimates by about 4.2% and exceeded the prior year by about 18%, or about 13% accounting for deferred tax filing deadline. Growth was driven by growth in sales and income tax collections (even net of the deferred filing impact) and also increased federal receipts.

Ohio's biennial budget for fiscal years 2022-2023 assumes about 3% base annual revenue growth, adjusting for the impact of the delayed 2020 income tax payment date. Factoring in policy changes, including tax revisions, revenues decline by about 4.0% in fiscal 2022, with about 3.4% growth in fiscal 2023. The budget included various tax revisions, with the most significant in terms of fiscal impact related to personal income tax rate reductions and bracket changes. These changes are estimated to decrease tax revenues by about $1.6 billion for the biennium, or about 3% of tax revenues. The estimated revenue decrease associated with all enacted tax revenue revisions is about $2.0 billion for the biennium, or about 3.9% of tax revenues.

The budget also includes increased spending for K-12 education and a revised funding formula for the biennium that considers resident income levels in addition to property tax values. In addition to expanded funding for education, health, and Medicaid, the budget includes a $1 billion Investing in Ohio Initiative that provides one-time funding for business sectors and communities negatively affected by the pandemic, largely from funding made available by federal pandemic-related stimulus moneys.

The state's budget planning has focused on directing one-time revenue sources, including federal funding, toward nonrecurring expenditures. The BSF balance currently totals $2.7 billion or about 6.8% of fiscal 2021 revenues. No draws were made on the fund in fiscal years 2020 and 2021, and none are expected in the current biennium.

Federal Aid Provides Some Support for State Budgets

Federal aid measures enacted since the pandemic's onset are benefiting state budgets and economies. The Families First Coronavirus Response Act included a 6.2% increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for every quarter of the national public health emergency. FMAP is the rate at which the federal government reimburses states for Medicaid spending. Ohio expects to receive approximately $300 million each quarter and is assuming the enhanced FMAP rate will continue through the end of calendar year 2021, as indicated by the current federal administration.

The U.S. Treasury allocated $4.5 billion in Coronavirus Aid, Relief and Economic Security (CARES) Act funds to Ohio, of which about $3.8 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. Of the $3.8 billion received by the state, Ohio shared about $1.2 billion with local governments. State CARES funds have been used for relief programs for small businesses and communities affected by the pandemic, support of health and long-term care facilities and personal protective equipment.

The recently enacted American Rescue Plan ACT (ARPA) allocates about $11 billion in federal funding to the state of Ohio and its local governments. About $5.4 billion is allocated directly to the state, with an additional $274 million allocation for state capital projects. In addition to infrastructure spending needs and local government recovery programs, ARPA moneys have also been appropriated for the repayment of a $1.5 billion borrowing from the federal government that supported the state's Unemployment Trust Fund. Additional details on the FMAP extension are found in the report "Medicaid Enhanced Funding Extension Benefits State Budgets," published on Feb. 1, 2021 at www.fitchratings.com.

Economic Update

Mandated shutdowns of nonessential businesses at the pandemic's start resulted in a sharp decline in economic activity, but with a phased reopening starting in May 2020, activity picked up. Nonfarm payrolls declined by about 15.8% at the pandemic's start (from February to April 2020) compared to the national decline of about 14.7% and a national median decline of about 13.7%. Since then, Ohio has seen a recovery in employment, with about 67.5% of lost jobs regained through June 2021. This is lower than nation (about 69.8% regained).

State unemployment has decreased from the high levels at the onset of the pandemic and is currently lower than the national rate. Ohio's official monthly unemployment rate was 5.2% in June, an increase from the two prior months (4.7% and 5.0%, respectively), but still below the comparable national rate (5.9%). Ohio's much higher 10.3% Fitch-adjusted unemployment rate, which adds back declines in labor force since February 2020, however, indicates continuing labor market challenges. Additional detail on state employment losses and recovery can be found in "U.S. States Labor Markets Tracker," published on July 21, 2021 on www.fitchratings.com.

CREDIT PROFILE

Ohio's economy had demonstrated slow but steady growth leading into the pandemic, with performance in recent years more in line with national levels, though still slightly lagging. The state's key employment sectors include transportation, distribution and warehousing of manufactured goods, which is facilitated by an extensive system of ports on Lake Erie, barge service on the Ohio River and advanced air-cargo and rail infrastructure. The state experienced a sharp drop in economic activity due to the onset of the pandemic and related shutdown measures. As these were eased, and with the benefit of the federal stimulus, activity rebounded. Going forward, economic performance will likely return to a trend of steady growth that trails the nation.

Revenue Framework

Ohio relies on a diverse set of broad-based taxes to support operations, including income and sales and use taxes. These major tax revenues are collected in the GRF with constitutional exceptions for highway-related revenues, which are directed to highway purposes, and lottery proceeds, which are directed to education.

In recent biennia, the state has pursued wide-ranging tax policy changes including revisions that lowered overall receipts relative to baseline. The fiscal 2022-2023 biennial budget includes tax revenue changes totaling about $2.0 billion for the biennium, or about 3.9% of tax revenues. The most significant revisions ($1.6 billion for the biennium) relate to personal income tax rate reductions and bracket changes. To date, tax policy changes have been manageable, aided by solid state fiscal management and favorable economic and fiscal trends.

The state's 10-year historical average revenue growth rate in recent years, adjusted for the estimated effect of policy changes, has generally lagged U.S. GDP growth but has been just above the inflation rate. Fitch anticipates the state's revenues will continue to experience a trend of steady growth in line with inflation.

Ohio has no legal limitations on its ability to raise revenues through base broadening, rate increases or the assessment of new taxes or fees.

Expenditure Framework

Ohio has ample flexibility within its expenditure framework. The natural pace of spending growth is expected to be marginally above its somewhat slowly growing revenue stream. The state's carrying costs for debt and retirement liabilities are below the median for states.

Ohio's primary cost drivers include Medicaid and education spending. The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program as well as federal government rules limit the states' options in managing the pace of spending growth. Federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or Congressional leadership. As with all federal programs, Medicaid remains subject to regulatory changes that could affect various aspects of the program.

Ohio is seeing an increase in Medicaid caseloads due to the impact of the pandemic and federal relief funding provisions mandating continued eligibility. The state will continue to benefit from enhanced FMAP funding at least through the end of the calendar year, with ARPA providing some additional enhancement for home and community-based services through March 21, 2022. In addition, the fiscal 2022-2023 biennial budget sets aside reserves (about $1.2 billion) to be used over the biennium as enhanced federal aid is expected to end. The state expects Medicaid enrollment to decline post-pandemic, since current growth is seen as driven by the coverage provision, rather than increases due to economic eligibility.

The state has ample expenditure flexibility, with a tendency to rely on budget-cutting rather than revenue increases when necessary to maintain budgetary balance. During the Great Recession, Ohio reduced distributions and phased out certain tax reimbursements to both local governments and school districts. The state responded to current pandemic-related revenue weakening with spending reductions, including cuts to education and Medicaid spending. The state's carrying costs for debt and retiree obligations are below the state median and are expected to remain low given the state's well-funded pensions and conservative debt management.

Long-Term Liability Burden

On a combined basis, debt and net pension liabilities attributable to the state as of Fitch's 2020 state liability report are about 4.7% of personal income, falling below the 5.0% median for U.S. States. Reflecting more recent debt data as of June 2021, Fitch estimates the combined burden of long-term debt and net pension obligations remains low at about 4.2% of 2020 personal income.

Funding of defined benefit retirement systems, which provide both for pensions and health care, has historically been considered a credit strength, with a history of annual contributions sufficient to support full actuarial funding. Plans are largely cost-sharing, multiemployer with limited liabilities attributed to the state. As of their fiscal 2020 financial statements, system assets covered about 81% of liabilities. Using Fitch's more conservative 6% discount rate would lower the ratio of assets to liabilities to about 71%.

Operating Performance

Ohio's superior ability to respond to downturns reflects its ample budget flexibility and availability of reserves. During the Great Recession, revenues suffered significant declines, exacerbated by ongoing tax reductions. Resulting budget gaps were addressed with both ongoing and one-time measures. These included use of the BSF, refunding debt for current year savings, unpaid employee leave, and accelerating the phase-out of tax reimbursements for schools and local governments.

In response to the current pandemic-related stress on its finances, the state acted to reduce spending, relying also on increased federal aid, but not on draws from the BSF. It is Fitch's expectation that Ohio would continue to rely primarily on expense reductions to address a future downturn, but could again draw upon its now restored BSF.

FAST Analysis

The Fitch Analytical Stress Test (FAST) scenario analysis tool relates historical tax revenue volatility to GDP to support the assessment of operating performance under Fitch's criteria. FAST is not a forecast, but represents Fitch's estimate of possible revenue behavior in a downturn based on historical revenue performance. Actual revenue declines will vary from FAST results, which provide a relative sense of the risk exposure of a particular state compared to other states. The current FAST analysis indicates the potential for state revenue declines and reductions to state ending balances. Ohio's history of actions to contain expenditures and its access to the $2.7 billion BSF balance provide the state with sufficient flexibility to address the magnitude of revenue loss associated with Fitch's scenarios.

Ohio has rebuilt its financial flexibility during times of economic recovery, including restoring its BSF and moving away from a reliance on one-time budget items. A statutory increase in the BSF maximum funding requirement to 8.5% of GRF revenues from 5.0% of prior year revenue provided additional capacity to address future downturns and is indicative of the state's approach to bolstering its financial position during the period of economic expansion that followed the Great Recession. The current balance totals about $2.7 billion, representing about 6.8% of GRF revenues and about 10% of state-source GRF revenues.

Ample Liquidity

The state's Liquidity Fund has ample liquidity to meet tenders on variable rate debt that has not been remarketed. The fund is conservatively invested in U.S. Treasury and agency securities, domestic commercial paper, and money market funds. The liquidity portfolio has consistently provided strong variable rate debt coverage. The month-end balance of as of June 30, 2021 discounted to reflect the immediate availability of funds, provided over ten times coverage of outstanding debt backed by the state's internal liquidity.

RELATED RATING AFFIRMATIONS

In conjunction with the affirmation of the state's IDR, Fitch has affirmed the ratings as noted below on various credits linked to the IDR, and revised the Outlook to Positive:

Ohio School District Credit Enhancement Program Rating

The 'AA' rating assigned to the Ohio School District Enhancement Program reflects the state's overall credit quality as well as strong program features supporting sufficient coverage of school district debt service payments, if needed. These include a timely intercept mechanism and stringent participation requirements that support adequacy of intercepted revenues.

PPP Grantor Counterparty Rating

The 'A+' PPP Grantor Counterparty rating assigned to the Ohio Department of Transportation's (ODOT) Portsmouth Bypass project payment obligations, three notches below Ohio's 'AA+' IDR, reflects the midrange financial and legal attributes of the financing. ODOT receives large statutorily-determined allocations of motor fuel tax revenues. Its capacity to make payments for this financing from its annual resources is solid.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Fitch Ratings Analysts

Maria Coritsidis
Director
Primary Rating Analyst
+1 212 908 0514
Fitch Ratings, Inc. Hearst Tower 300 W. 57th Street New York, NY 10019

Karen Krop
Senior Director

Secondary Rating Analyst
+1 212 908 0661

Douglas Offerman
Senior Director
Committee Chairperson
+1 212 908 0889

Media Contacts

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Ohio, State of (OH) [General Government]	LT IDR	AA+	Affirmed		AA+
• Ohio School District Credit Enhancement Program (OH) /State School Bond Program Rating/ 1 LT	LT	AA	Affirmed		AA
• Ohio	LT	A+	Affirmed		A+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
State Department of Transportation (OH) /Contract Obligation - Portsmouth Bypass DBFOM Project/ 1 LT					
• Ohio, State of (OH) /General Obligation - Unlimited Tax/ 1 LT	LT	AA+	Affirmed		AA+
• Ohio, State of (OH) /Lease Obligations - State Appropriation/ 1 LT	LT	AA	Affirmed		AA

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• Ohio, State of (OH) /Self-Liquidity/1 ST	ST	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊡	

Applicable Criteria

Public-Sector Counterparty Obligations in PPP Transactions Rating Criteria (pub.04 May 2021)

U.S. Public Finance Tax-Supported Rating Criteria (pub.04 May 2021) (including rating assumption sensitivity)

Applicable Models

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

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Ohio, State of (OH) EU Endorsed, UK Endorsed

Disclaimer

Copyright

behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Endorsement policy

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s Regulatory Affairs page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.