FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Ohio's $228.7 MM Lease Appropriation Bonds 'AA'; Outlook Stable

Fri 23 Apr, 2021 - 11:47 AM ET

Fitch Ratings - New York - 23 Apr 2021: Fitch Ratings has assigned 'AA' ratings to the following state of Ohio lease appropriation bonds:

--$150 million State of Ohio (Treasurer of State) Capital Facilities Lease-Appropriation Bonds, Series 2021A (Mental Health Facilities Improvement Fund Projects);

--$78.7 million State of Ohio (Treasurer of State) Capital Facilities Lease-Appropriation Bonds, Series 2021A (Administrative Building Fund Projects).

The bonds are expected to be sold via negotiation on or about May 5, 2021. Bond proceeds will fund capital facilities for the Department of Mental Health and Addiction Services (DMH), the Department of Developmental Disabilities (DDA) and the Department of Administrative Services (DAS).

The Rating Outlook is Stable.

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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 DMH and DDA and between OPFC and DAS. The lease agreements are subject to biennial appropriation from the state's general revenue fund (GRF).

ANALYTICAL CONCLUSION

The 'AA' rating on the bonds 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.

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. Fitch anticipates slow but steady growth in Ohio's economy, limited by very 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 during the last economic expansion. The fund now totals a strong $2.7 billion, over 11% of fiscal 2020 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;

--Demonstrated ability to address economic and financial volatility through cycles, including the current pandemic-driven uncertainty, while achieving superior financial flexibility, including maintenance of strong reserve balances.

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

--Failure to maintain fiscal balance, particularly if the state returns to its pre-pandemic trajectory of tax reductions;

--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

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. The state 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.

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. The ultimate value of the FMAP rate increase will depend primarily on Ohio's actual Medicaid spending and enrollment.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act, the U.S. Treasury department distributed $150 billion to state and local governments. The statute limited the use of funds to coronavirus expense reimbursement rather than to offset anticipated state

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tax revenue losses. The U.S. Treasury allocated $4.5 billion 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 (ARP) allocates about $11.2 billion in federal funding to the state of Ohio and its local governments. About $5.6 billion is allocated directly to the state, with an additional $274 million allocation for state capital projects. In addition to potentially addressing certain capital spending needs, the governor has discussed using ARP moneys for repayment of borrowing from the federal government that supported the state's Unemployment Trust Fund, currently totaling about $1.5 billion. Additional details on the effect of ARP on state and local governments can be found in the report "Fitch Rtgs: American Rescue Plan Boosts State and Local Government Budgets," published on March 11, 2021 at www.fitchratings.com.

Budget Update

Ohio has very strong financial resilience that allowed it to absorb the immediate budgetary effects of the economic downturn. Ohio 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 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 its rainy day fund balance 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 fiscal year estimate, 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.

Based on spending measures taken to date, federal pandemic-related aid and current revenue performance trends, Ohio currently projects a balanced 2021 budget with no draw upon the rainy day fund. Fiscal 2021 YTD tax revenue performance remains stronger than original budget estimates. Collections through March 2021 show tax receipts exceeding original projections by about $763 million (4.3%). Both personal income tax and sales tax YTD collections exceed these estimates (2.9% and 5.8% ahead, respectively). Total YTD revenues are below estimates by about 1.6%. This reflects federal revenue performance chiefly related to lower than expected required Medicaid disbursements, which are also resulting in overall YTD GRF disbursements coming in under budget. The state expects that, through year end, these collections should exceed estimates, as the federal government's likely continuation of enhanced FMAP through the end of the calendar year is not assumed in the estimates.

The executive biennial budget proposal for fiscal years 2022 and 2023 forecasts general GRF tax revenues growth of 2.0% for fiscal 2022 and 3.4% for fiscal 2023. In addition to expanded funding for ongoing education and health needs, 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. State budget planning has focused on directing one-time revenue sources, including federal funding, toward nonrecurring expenditures.

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. Following significant labor declines, the state's recovery has outpaced the nation. Nonfarm payrolls declined by about 16% at the pandemic's start (from February to April) compared to the national decline of about 15%. Since April, Ohio's recovery in jobs (about 67% of jobs regained through March) exceeds the nation (about 62%). State unemployment has decreased and is currently lower than the national rate.

Ohio's official monthly unemployment rate was 4.7% in March as compared to 6.0% for the nation. Ohio's higher 7.1% Fitch-adjusted unemployment rate, which adds back declines in labor force since February 2020, indicates the continuing labor market challenges. Additional detail on state employment losses and recovery can be found in "U.S. States Labor Markets Tracker," published on April 15, 2021 on www.fitchratings.com.

CREDIT PROFILE

The bonds currently offered are secured by rental payments that are appropriated biennially under the respective lease agreements. The debt is authorized by the state's constitution, with the leases renewable biennially until the bonds are repaid. The state treasurer must 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 additional information on Ohio's IDR, see "Fitch Affirms Ohio IDR at 'AA+'; Rates $566 MM GO Bonds 'AA+'; Outlook Stable," dated Feb. 22, 2021 at www.fitchratings.com.

DATE OF RELEVANT COMMITTEE

19 February 2021

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

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RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR

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

VIEW ADDITIONAL RATING DETAILS

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Additional information is available on www.fitchratings.com

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 Econometric API - Fitch Analytical Stress Test Model, v2.4.0 (1)

ADDITIONAL DISCLOSURES

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