S&P Global Ratings

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Summary:

Ohio State Treasurer State of Ohio; Appropriations

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Credit Profile		
US$150.0 mil cap facs lse-approp bnds (Ohio) (Mental Health Facilities Improvement Fund Projs) ser 2021A due 02/01/2031		
Long Term Rating	AA/Stable	New
US$78.66 mil cap facs lse-approp bnds (State of Ohio) (Administration Building Fund Projs) ser 2021A due 04/01/2041		
Long Term Rating	AA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Ohio State Treasurer's $150 million capital facilities lease-appropriation bonds (mental health facilities improvement fund projects), series 2021A, and its $78.66 million capital facilities lease-appropriation bonds (administrative building fund projects), series 2021A, issued on behalf of the State of Ohio. The outlook is stable.

Lease-rental payments and other pledged receipts received by the Ohio Public Facilities Commission (OPFC) from the state's Department of Mental Health and Addiction Services and Department of Developmental Disabilities, in accordance with the supplemental trust agreements and lease agreements between the mental health departments (the lessees) and OPFC (the lessor), secure the series 2021A (mental health facilities improvement fund projects) bonds.

In addition, lease-rental payments and other pledged receipts received by the Ohio Public Facilities Commission (OPFC) from the state's Department of Administrative Services (DAS), in accordance with in accordance with the supplemental trust agreements and lease agreements between the DAS (the lessee) and OPFC (the lessor), secure the series 2021A (administrative building fund projects) bonds. The obligations and other pledged receipts of the mental health departments and DAS to make their respective lease-rental payments are subject to separate biennial appropriations by the Ohio General Assembly.

Proceeds from the series 2021A (mental health facilities improvement fund projects) bonds will be used to pay the costs of capital facilities to be leased to the Department of Mental Health and Addiction Services and Department of Developmental Disabilities by the OPFC, and to pay costs of issuing of the bonds. Proceeds from the series 2021A (administrative building fund projects) bonds will be used to pay the costs of capital facilities to be leased to the DAS by the OPFC, and to pay costs of issuing of the bonds.

Credit overview

We rate these obligations one notch lower than Ohio's general creditworthiness, as reflected in the state GO rating (AA+/Stable). The one-notch differential for the state's capital facilities lease-appropriation debt reflects appropriation risk associated with annual debt service payments on the series 2021A (mental health facilities improvement fund projects) and series 2021A (administrative building fund projects) bonds. We view the bonds and the projects being financed as having a strong relationship to the obligor. Ohio pledges to biennially appropriate sufficient funds to the Department of Mental Health and Addiction Services and Department of Developmental Disabilities, and the DAS from its operating revenues to make lease-rental payments, and it has a long track record of appropriating for similar obligations. In our opinion, there is no unusual political, timing, or administrative risk related to the debt payment.

The 'AA' long-term rating on the capital facilities lease-appropriation bonds reflects our view of:

- The strong contractual provisions of the lease structure securing the capital facilities lease appropriation bonds, including an absolute and unconditional payment provision once funds are appropriated;
- The state's longstanding and demonstrated commitment, within both the administrative and legislative branches, to allocate sufficient funds biennially to support appropriation-backed obligations; and
- The importance of appropriation debt to Ohio's overall capital bonding structure.

S&P Global Ratings believes Ohio's credit stability is underpinned by its disciplined government framework, active budget management, and very strong reserve profile as the state continues to navigate an economic recovery and budgetary challenges brought on by public health and safety risks stemming from the federal and state response to the COVID-19 pandemic. Ohio entered the fiscal 2020-2021 biennium well positioned financially, having demonstrated proactive expenditure management and conservative financial forecasting during a strong period of economic growth over the last biennium, and the state had set aside surpluses in its budget stabilization fund (BSF) to achieve the highest rainy day fund savings in state history at the end of the fiscal 2018-2019 biennium. At the end of fiscal 2020, the state maintains a current BSF balance of nearly $2.7 billion (or approximately 8% of general revenue fund expenditures), which will in our view, afford it a degree of flexibility to manage budgetary challenges as they arise.

During periods of economic stress, Ohio has demonstrated a willingness to make necessary adjustments to correct structural imbalances, which we anticipate will continue as the current economic cycle evolves. We expect the state will continue to approach the remainder of the fiscal 2020-2021 biennium with an emphasis on proactive and structural solutions, and we consider this continuance integral to maintaining Ohio's credit quality. Based on its constitutional framework, Ohio is effectively precluded from ending a fiscal year or biennium in a deficit position. Illustrating the state's responsive financial oversight and management, the Office of Budget and Management (OBM) and the DAS--by executive order of the governor--developed an expenditure reduction plan for state agencies, boards, and commissions, including hiring and spending freezes, state agency holdbacks, and other discretionary spending reductions. The plans were implemented over the final three months of fiscal 2020, and the state has since released state agency holdbacks and unfrozen all exempt employee pay rate and step increases in fiscal 2021 due to the better-than-expected budgetary projections.

Ohio ended the first year of the fiscal 2020-2021 biennium reporting a $645.9 million (or 8.4%) net increase in general revenue fund balances, measured on a GAAP basis. Based on audited results for June 30, 2020, general revenue funds experienced a historical decline of nearly $1.1 billion, or 4.6% below the enacted budget estimate, of which approximately $719 million was attributable to the deferral of the income tax filing deadline to the ensuing fiscal year. However, total general revenue fund receipts in federal grant revenue for Medicaid and COVID-19 related expenditures (totaling approximately $659.4 million), partially offset the decline in state-generated revenue. In response to the estimated revenue shortfall at fiscal year-end, the administration also announced $781.9 million in general revenue fund reductions for the remainder of fiscal 2020. These cost measures were sufficient to close the fiscal 2020 structural budget gap and did not rely on BSF reserves or other one-time measures.

Through the first three quarters of fiscal 2021, general revenue fund receipts have outperformed the states' fiscal year-to-date budget estimate, supporting the state's view of an improving revenue picture in the second half of the current fiscal year. As of March 31, 2021, general revenue fund tax receipts are approximately $763.4 million (or 4.3%) ahead of the state's biennial budget estimate and $1.57 billion (or 9.3%) above the previous fiscal year revenue. Ohio partly attributes year-to-date revenue performance to growth in withholding tax payments, but a substantial portion is due to a shift in the income tax deadline that shifted two filing deadlines into the current fiscal year. Although Ohio incorporated recent Internal Revenue Service (IRS) changes into its tax code and extended its tax filing deadline to May 17, 2021 from April 15, 2021, it does not anticipate a substantial shift in its revenue or cash flows. In addition, easing social and public health restrictions, federally enhanced assistance payments to individuals, and pent-up demand have likely boosted the state's economic activity and consumer spending. Among its three leading sources, income tax receipts are 2.9% above the fiscal year-to-date budget estimate, while auto sales tax (15%) and non-auto sales tax (4.3%) also performed well-ahead of the budget estimate.

On Feb. 1, 2021, the state published its preliminary 2020-2021 biennium revenue and fiscal 2022-2023 budget forecast concurrent with the governor's budget proposal. February 2021 revenue and economic baseline forecast estimates were considerably improved from OBM's June 2020 forecast, which anticipated general revenue fund receipts and balances to be approximately $2.43 billion, or nearly 7% below budgeted revenue (and transfers in) estimates for fiscal 2021. The state's forecast estimates year-end general revenue tax receipts for fiscal 2021 to be $1.67 billion, or 7.4% above fiscal 2020-levels. Over the fiscal 2022-2023 biennium, the forecast estimates general fund tax revenue to increase by $495 million (or 2%) and $838 million (3.4%) year-over-year, respectively. These estimates over the biennium will be aided largely by a robust recovery in individual income tax (2.3% growth in 2022 and 4.3% growth in 2023) and sales tax (5.6% growth in 2022 and 3.4% growth in 2023).

Ohio's governor's executive budget recommendation for the fiscal 2022-2023 biennium includes a general fund agency appropriations plan totaling $35.38 billion for fiscal 2022 and $39.27 billion for fiscal 2023. In our view, the general fund recommendation calls for a substantial year-over-year expenditure increase of $1.1 billion (or 3.5% above the fiscal 2021 estimate) for fiscal 2022 to restore funding to previously cuts to state operations and local aid during the pandemic and provide one-time program investments to aid the state's recovery. A substantial $3.9 billion spending increase (or 11% above the proposed fiscal 2022 budget) is partly the product of an expected increases in the state's share of Medicaid and other agency programmatic expenditures currently being supplemented by federal grants and reimbursements.

On March 31, 2021, Ohio's governor signed the state's $8.3 billion fiscal 2022-2023 biennial transportation budget into law. The transportation plan includes $2.6 billion for state-maintained roadway improvements, $2.4 billion for local roadway improvements, and $318 million for highway safety projects. It also includes investments of $116 million for the Public Works Commission, $74 million in public transit, and $8 million for electric vehicle charging station grants administered through the Ohio Environmental Protection Agency.

We anticipate that there will likely be some legislative changes to the governor's biennial budget proposal, particularly as the state determines how it will use nearly $5.6 billion in direct federal aid under the American Rescue Plan (ARP) and an additional $274 million allocated for state capital projects before the beginning of fiscal 2022-2023 biennium on July 1, 2021. However, the governor's budget proposal does not include any federal aid to fund recurring or new programmatic expenditures that would come with the recently passed $1.9 trillion coronavirus relief package. We also expect that there will be negotiations between the governor on revenue adjustments, and one-time versus ongoing agency expenditure requests for the next biennium.

Optimism for an accelerating economic recovery for the U.S. in 2021 has been spurred on by faster-than-expected vaccination implementation and quickening reopening schedule, and the injection of additional federal stimulus from the recently approved ARP to states and individuals. As a result, S&P Global Economics revised its most recent base case to reflect this improved optimism, forecasting 6.5% growth in national GDP in 2021 compared with 4.2% from our December forecast. While we believe this will benefit state governments, the effects of an uneven health recovery and the pandemic-induced crisis on employment could be a lingering weakness for Ohio (see "Economic Outlook U.S. Q2 2021: Let The Good Times Roll" and "State, Local Government, School District, And Charter School Sector Views Revised Back To Stable", both of which were published March 24, 2021, on RatingsDirect).

In our view, a key credit consideration for the state's economic outlook will be the path its manufacturing sector follows through this contractionary period. At this juncture, a swifter recovery in statewide manufacturing conditions in Ohio has insulated near-term employment and cyclical economic losses in public and service-based sectors that have been more disproportionately affected by public health and social risks. At the same time, the state has realized gains in education and health services, which could steady wealth and personal income metrics in the state during an economic recovery. Ohio's preliminary unemployment rate fell to 4.7% in March 2021, below the U.S. average unemployment rate of 6.0%. Beyond the near-term direct effects of the COVID-19 pandemic, however, we believe Ohio's path out of the recession could be slower and weaken its overall credit metrics including employment, gross state product, and personal income gains relative to the nation.

Our view of Ohio's general creditworthiness reflects what we view as the state's:

- Long track record of proactive financial and budget management, including the state's implementation of frequent and timely budget adjustments over time to mitigate revenue shortfalls;
- Commitment to funding budget reserves that have been, and are expected to remain, instrumental in managing budget gaps through the current and future economic cycles;
- Improved revenue and budget performance and the restoration of the BSF, which was increased to a statutory target of 8.5% of revenue as part of the enacted 2016-2017 biennium budget;
- Vast, broad, and diverse economy that had benefitted from steady expansion following weak performance during the past two recessions, although there is some concentration in manufacturing relative to the U.S., which anchors the employment base and is sensitive to exogenous demand shocks;
- Low-to-moderate debt levels, with rapid amortization and a conservatively managed capital and debt program, with very strong self-liquidity to withstand temporary volatility to its existing VRDO and interest rate swaps; and
- Significant pension reform changes and steady progress in funding OPEB, although we continue to monitor the

state's funding policy to assess the sustainability of this progress trend under more subdued investment return conditions.

Environmental, social, and governance (ESG) factors

S&P Global Ratings views the Ohio's environmental risks as being in line with the sector. In our view, the state's efforts to address legacy environmental risks related to water quality, land management, and natural resource conservation through its policy and legal framework as supportive of its credit profile. At the same time, we view Ohio's long-term governance risks as aligned with the sector due to the relative strength of the state's government framework and transparency of its policies, reporting, and disclosures. We consider Ohio to have social risks that are generally in line with the sector, although it exhibits some demographic pressures due to its aging prime working-age population and low replacement rates statewide. While these longer-term social risks may slow statewide economic growth forecasts and alter current service demands that could weigh on the state's financial position, Ohio's historically strong policies (including economic and financial forecasting) and recent economic diversification efforts help manage this risk.

Stable Outlook

Downside scenario

Although unlikely based on recent operating trends and a strong budgetary framework for making fiscal policy decisions, sustained structural budget misalignment and a sharp decline in Ohio's reserve or liquidity position could pressure the rating. The state's concentration in the manufacturing sector could intensify this downside risk due to this exogenous economic shock or international trade conditions that significantly weaken the state's core economic metrics relative to the U.S. level. We recognize that state governments across the nation will continue to face unprecedented public health and economic challenges in the near term to contain ongoing public health and social risk due to the COVID-19 pandemic. The duration and severity of these events affecting the state's fiscal profile may result in deterioration of its credit quality should economic conditions change.

Upside scenario

While unlikely to occur over the outlook period, positive rating action would be predicated on Ohio's economic conditions strengthening and diversifying to a level that more closely aligns with that of the broader U.S. economy and higher-rated peers, and in a way that we believe better insulates the state from cyclicality. This would be in conjunction with the state preserving financial stability--including maintaining strong BSF balances and very strong liquidity--and managing around potential tail-end revenue and expenditure cliffs that occur through the fiscal recovery and as the state's share of enhanced federal transfer payments and stimulus wanes over time.

Based on the analytic factors we evaluate for states, we have assigned a total score of '1.6' to Ohio under our state ratings methodology, in which '1.0' is the strongest score and '4.0' the weakest. This score corresponds to a 'AA+' GO rating.

For more information, see our full analysis for the State of Ohio, published Feb. 23, 2021.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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