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INVESTORS SERVICE

Rating Action: Moody's assigns Aa2 to Ohio's certificates of participation; outlook stable

20 Jan 2021

New York, January 20, 2021 -- Moody's Investors Service has assigned Aa2 ratings to the State of Ohio's \$20.5 million Certificates of Participation, Series 2021 (Voting System Acquisition Project) (Tax-Exempt), \$11.8 million Refunding Certificates of Participation, Series 2021 (Bureau of Criminal Investigation System Project) (Federally Taxable), \$43.8 million Refunding Certificates of Participation, Series 2021 (Multi-Agency Radio Communications System Project) (Federally Taxable) and \$12.5 million Refunding Certificates of Participation, Series 2021 (State Taxation Accounting and Revenue System Project) (Federally Taxable). The outlook is stable.

RATINGS RATIONALE

The Aa2 rating is a notch below the state's Aa1 general obligation (GO) rating, reflecting the need for biennial legislative appropriation of lease payments backing the bonds, the essential nature of the projects being financed, and the strong legal structure for payment of debt service. There are limited bondholder remedies in the event of non-appropriation, but the state has very strong incentive to appropriate, given the importance of maintaining continued market access for subject-to-appropriation lease debt.

The Aa1 general obligation rating is based on the state's strong budget and financial management, sound reserve levels, and affordable fixed costs associated with below-average long-term debt, pension and retiree healthcare (OPEB) liabilities. These strengths are offset by below-average economic growth, compounded by weak demographic trends.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The coronavirus crisis is not a key driver for this rating action. We do not see any material immediate credit risks for the State of Ohio. However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the State of Ohio changes, we will update the rating and/or outlook at that time.

RATING OUTLOOK

The stable outlook is based on our expectation that the state's proactive financial management, low fixed costs, fully-funded rainy day fund and substantial available liquidity will continue to support satisfactory budget flexibility during the severe economic disruption and revenue declines related to the coronavirus outbreak.

In fiscal 2020, the state fully balanced the 1.3% (\$425 million) revenue shortfall with spending reductions during the prior fiscal year. In fiscal 2021, the state released updated tax revenue estimates that projected \$2.4 billion (9%) less than previously expected. This revenue gap will be partially balanced with the extension of budget cuts implemented in fiscal 2020, the increase in Federal Medical Assistance Percentages (FMAP) through March 2021, and salary freezes and reductions across all state departments.

Actual fiscal 2021 revenue performance through December has been above forecast; total taxes are \$458 million (3.7%) above estimate, mostly due to strong collections in sales taxes (6.3% above estimate) and personal income taxes (1.5%). In addition, continued spending holdbacks have kept expenditures \$699 million (3.6%) below budget through December. This solid year-to-date performance provides some budget flexibility as the state manages a surge of coronavirus cases through the winter. Ohio has a \$2.7 billion rainy day fund available to stabilize any remaining budget gap or any future increase in the forecasted revenue gap.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

For the GO rating:

- Improved demographic trends, particularly in working age population growth, net migration, and age distribution, that contribute to stronger economic growth relative to peers

- Maintenance of a budget in structural surplus, together with an increase in pension contributions sufficient to "tread water"

- Development of governance tools such as consensus revenue forecasting or publicly available long-term forecasts that institutionalize current best practices, increase transparency, and ensure consistency across administrations

For the appropriation bonds:

- An upgrade of the state

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

For the GO rating:

- Further weakening of employment, personal income or demographic trends

- Financial deterioration, including a return to budgetary structural imbalance and/or materially lower reserve levels

- Unanticipated rise in long-term liabilities and an increase in fixed-costs

For the appropriation bonds:

- A downgrade of the state

LEGAL SECURITY

The certificates are secured by separate lease-purchase agreements with the State of Ohio Leasing Corporation, an Ohio non-profit, as lessor, and the Department of Administrative Services (DAS), as lessee. The leases are subject to biennial renewal, with final terminations that correspond to the final payment date on the COPs. Debt service is payable from base DAS rental payments, which are assigned and remitted directly to the trustee 15 days prior to the debt service payment dates.

The lease stipulates that the obligation to make lease payments is absolute and unconditional, contingent only upon the appropriation of funds by the legislature, and not on whether the financed projects are in use. Debt service payment dates (September 1 and March 1) are far enough removed from the July 1 start of the state's fiscal biennium to limit risk of an event of non-appropriation due to late budget adoption. In the most recent case of a late budget (2010-2011 biennium) the state quickly passed a continuing resolution to appropriate for all outstanding lease obligations.

Pursuant to the leases, the director of DAS is required to include the lease payments in biennial budget requests to the Office of Budget and Management. There are no debt service reserve funds associated with these certificates, and there are limited bondholder remedies in case of default. In the event of non-appropriation, the leases would terminate and project assets would be surrendered to the trustee, but the assets provide limited recovery value. The importance of maintaining continued market access for subject-to-appropriation lease debt, in general, provides a strong incentive to continue making timely appropriations. Approximately 20% of Ohio's net tax-supported debt requires appropriation for payments.

USE OF PROCEEDS

Proceeds of the Voting System Acquisition certificates will finance acquisition and installation of equipment to support voting systems for Ohio counties.

Proceeds of the other certificates will refund outstanding certificates for net present value savings.

PROFILE

The State of Ohio has a population of 11.7 million, located in the Midwest region of the US with 312 miles of shoreline along Lake Erie, according to NOAA. The state is the seventh-largest US state by population, and has a large, diverse economy reflected in its GDP of \$676 billion (also seventh among the states).

METHODOLOGY

The principal methodology used in these ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBM_1102364 . Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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