

State of Ohio; Appropriations

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US\$20.7 mil certs of part (Ohio Attorney General Claims Fd Proj) ser 2021 due 09/01/2036

Long Term Rating

AA/Stable

New

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Ohio Attorney General's (OAG) approximately \$20.7 million certificates of participation (COPs), series 2021 (Ohio Attorney General Claims Fund project). The outlook is stable.

Lease-rental payments payable solely from amounts collected and deposited to the Attorney General Claims Fund--pursuant to the master lease-purchase agreement and supplemental lease agreement between the State of Ohio Leasing Corp. Inc. (the lessor) and the OAG (the lessee)--secures the series 2021 COPs. Pursuant to the trust agreement, Ohio Leasing Corp. Inc. assigned the OAG to make COPs payments directly from the Attorney General Claims Fund to The Bank of New York Mellon Trust Company, N.A. (the trustee). The obligation of the OAG to make lease-rental payments from the Attorney General Claims Fund is subject to and dependent on biennial appropriations by the Ohio General Assembly.

The Attorney General Claims Fund receives up to 11% of total collections by the OAG (or agents of the Attorney General or by special counsel) that are paid into the state treasury and are credited to the Attorney General Claims Fund for administering the law and other certified claims for the State of Ohio and political subdivisions in accordance with section 131.02 of the Ohio Revised Code. The OAG, in consultation with the Director of the Office of Budget and Management (OBM), determines the exact percentage (with administrative authority to raise the rate up to 11%) of those collected amounts that shall be paid into the state treasury to the credit of the Attorney General Claims Fund.

Proceeds from the series 2021 COPs will finance the acquisition, installation, and implementation of hardware and software that will replace the OAG existing computerized debt-collection systems to be used in connection with the Attorney General Claims Fund.

Credit overview

We rate the series 2021 COPs one notch lower than Ohio's general creditworthiness, as reflected in the state general obligation (GO) rating (AA+/Stable). The one-notch differential reflects our view of biennial appropriation risk associated with the series 2021 COPs. We rate the obligation based on the application S&P Global Ratings' "Issue Credit Ratings Linked to U.S. Public Finance Obligors' Creditworthiness" criteria, published Nov. 20, 2019, which reflects our assessment of the state's (including its agencies or departments) involvement relative to the obligation, as well as its degree of significance and essentiality to the state's basic functions. It also reflects our assessment of the depth and reliability of resources provided within the state's Attorney General Claims Fund as the intended payment source for the obligation, subject to biennial appropriation, and the fund's exposure to contingent liquidity and timing risks. Finally, our assessment incorporates other credit risk components, including potential political or administrative

risks.

We view the state's relationship to the projects being financed to be strong, which reflects the essentiality and direct importance of the project to the OAG's core operations, and more broadly, the state's legal administration and debt collection function. Furthermore, the OAG is subject to annual audit and other reporting requirements and the series 2021 COPs will be recognized in the state's audited financial statements, which supports our view of strong state involvement in the project.

Furthermore, we view the intended payment source and timing risks associated with the obligation as posing a moderate credit risk given the that pledged lease-rental payments are derived from appropriations from a significantly narrower revenue stream--the Attorney General Claims Fund--relative to the total operating funds of the state. However, partially offsetting this view is our understanding that the OAG has administrative authority, and it maintains additional capacity to raise the rate up to the 11% statutory maximum collection rate level to provide additional liquidity to the Attorney General Claims Fund should it be necessary. We understand that ending cash balances in the Attorney General Claims Fund grew significantly over the past five fiscal years, to approximately \$19.5 million at the end of fiscal 2021 from \$3.07 million in fiscal 2017. The accumulation of these cash balances before the onset of the project provides significant liquidity in the fund to support expected level debt service requirements of approximately \$1.94 million through final maturity in 2036. However, we could weaken our view if available liquidity within the fund becomes less reliable and introduces potential timing or liquidity risks for appropriations from the Attorney General Claims Fund.

We view the presence of contractual provisions of the lease agreement that prioritize lease-rental payments ahead of all other expenses, claims, and payments from the Attorney General Claims Fund and an absolute and unconditional payment provision to make lease-rental payments once funds are appropriated to be strong. In addition, we believe that state's long-standing and demonstrated commitment to appropriate for similar obligations represent strong mitigation of potential political and administrative risks. Currently, we are unaware of any political or administrative resistance to the projects, and we believe the OAG, in consultation with the OBM, developed administrative procedures for setting the exact percentage of the amounts collected that are to be credited to the Attorney General Claims Fund. OBM certifies that the budget request and biennial appropriations are sufficient to make lease-rental payments from the fund, which in our view, provides an additional administrative check.

The stable outlook reflects the outlook on the State of Ohio.

In our view, Ohio's stable outlook is underpinned by embedded financial discipline within its government framework and active budgetary management that stabilized the state's strong operating performance and reserve profile during a period of unprecedented economic and public health uncertainty brought on by the COVID-19 pandemic. Ohio's constitutional framework effectively precludes the state from ending a fiscal year or biennium in a deficit position, and as a result, the state's executive agencies used revenue and expenditure forecasting to develop structural budgetary solutions in response to the pandemic-induced challenges of the fiscal 2020-2021 biennium. The carryover effects of proactive expenditure management and better-than-forecasted revenue performance, in our view, coupled with the state's expectation to receive nearly \$5.6 billion in direct federal aid under the American Rescue Plan (ARP) over two years to support its economic recovery, position Ohio well financially as it begins the fiscal 2022-2023 biennium. In

addition, we anticipate Ohio's long-term funding discipline related to pension and other postemployment benefits (OPEB) liabilities profile will remain adequate, albeit manageable relative to its budgetary and economic metrics, and Ohio's long-standing 5% constitutional debt limit positions the state well to manage its fixed-cost profile, lending to our view of the state's long-term credit stability.

For further information on the state's general credit characteristics, refer to the most recent analysis on Ohio, published Aug. 5, 2021, on RatingsDirect.

Environmental, social, and governance (ESG) factors

S&P Global Ratings views 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, strong cyber-security risk management 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 long-term social risks could 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 economic diversification efforts help manage this risk.

Stable Outlook

Upside scenario

A positive rating action would be predicated on Ohio's income levels strengthening to a level that more closely aligns with the broader U.S. economy and those of higher-rated peers, and its economy diversifies and is sustained in a way that we believe better insulates the state from cyclicity. This would be in conjunction with the state preserving financial stability--including maintaining strong Budget Stabilization Fund 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.

Downside scenario

Although unlikely based on the state's recent operating trends and a strong 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 an exogenous economic shock or international trade conditions that significantly weaken the state's core economic metrics relative to the U.S. level.

Credit Opinion

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.

Bond provisions and structure

In our opinion, the bond provisions and structure provide a strong incentive to appropriate. Under the lease agreement, the obligation to make lease-rental payments from the Attorney General Claims Fund is absolute and unconditional once appropriated. Under the provisions of the master lease-purchase agreements, the OAG is required to discontinue lease payments on all obligations if it discontinues payments with respect to any leases. No debt service reserve fund is required under the trust indenture, which is acceptable under our criteria for leases and COPs.

On or before Aug. 15 of the fiscal year immediately following the previous lease term, OBM provides a certified copy of the appropriation legislation by the Ohio General Assembly and a statement by the OBM director certifying that the general assembly has appropriated sufficient funds to make all payments during the lease term. The OAG is required to have on deposit with the trustee the aggregate amount of base lease-rental payments due on each lease payment date. Lease-rental payment dates occur on Sept. 1 for principal and interest, and March 1 for interest only. Ohio operates on a fiscal biennium cycle that ends on June 30 of each odd year, and appropriations are made for a two-year lease term. In our view, the timing difference between the beginning of the fiscal year and when debt service payments are due mitigates late budget adoption risk.

The first-year certificate payment will be managed by the OAG through its existing budget process. As the state has no additional parity debt outstanding prior to the series 2021 issuance, funds within the Attorney General Claims Fund are not restricted for debt service on obligations currently. However, the state anticipates that, beginning July 1, 2022, a separate fund, dedicated solely for lease rental payments, will be created in the state treasury, and given appropriation necessary to make all debt service payments, with monthly transfers made from the Attorney General Claims Fund.

Upon the incidence of non-appropriation, OAG could terminate the lease and return possession of the project to the Ohio State Leasing Corp. Inc. by no later than Aug. 15 of the fiscal year immediately following the termination date. However, if by Aug. 15, the Ohio General Assembly appropriates sufficient funds to enable the lease-rental payment, then the lease shall be reinstated and renewed as of the first day following the termination date. OAG will not withhold any lease payments or assert any right of set-off or counterclaim, and no provision for the abatement of lease payments exist. Based on our assessment of bond documents, however, we do not believe these include unusual structural features that impair the OAG's ability to make timely debt service payments from the Attorney General Claims Fund, or permissive events of default that increase the risk of non-appropriation.

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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