



RATING ACTION COMMENTARY

Fitch Upgrades Ohio's IDR to 'AAA' from 'AA+'; Assigns Stable Outlook

Thu 08 Sep, 2022 - 1:28 PM ET

Fitch Ratings - New York - 08 Sep 2022: Fitch Ratings has upgraded the following debt obligations of the state of Ohio:

--The state's Long-Term Issuer Default Rating (IDR) to 'AAA' from 'AA+';

--\$4.5 billion of outstanding GO bonds to 'AAA' from 'AA+';

--\$1.5 billion of outstanding appropriation-backed bonds to 'AA+' from 'AA';

--The programmatic rating of the Ohio School District Credit Enhancement Program to 'AA+' from 'AA';

--The PPP Grantor Counterparty rating assigned to the Ohio Department of Transportation's Portsmouth Bypass project payment obligation to 'AA-' from 'A+'.

In addition, Fitch has also affirmed the following rating:

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

The Rating Outlook is Stable.

SECURITY

GO bonds are full faith and credit obligations of the state of Ohio, excluding lottery proceeds. Highway user receipts are also pledged to payment of GO highway improvement bonds. Ohio's annual appropriation debt consists mainly of lease revenue bonds, which are special obligations of the state payable from payments made under a lease agreement between the Ohio Public Facilities Commission (OPFC) and the Ohio Facilities Construction Commission (OFCC). Lease payments are subject to biennial appropriation from the state's general revenue fund (GRF).

ANALYTICAL CONCLUSION

The upgrade of Ohio's Long-Term IDR and GO ratings to 'AAA' from 'AA+' reflects material strengthening of the state's financial resilience and budget management, particularly over the past two biennia. Ohio has achieved a sustained trend of balanced finances over the past decade coupled with more recent growth in fiscal reserves and cash balances. These have materially strengthened Ohio's gap-closing capacity. Reserve policy changes that raised the targeted balance of Ohio's rainy-day fund to 8.5% of prior-year general fund revenues from 5% have also helped to improve fiscal resilience.

The upgrade also factors in the state's proven ability to absorb the effects of economic cyclicalities and tax policy changes. State officials budgeted a 4% tax revenue decline for fiscal 2022 to reflect the latest round of income tax cuts, but Ohio achieved 6.4% yoy growth. In Fitch's view, these results indicate increased resilience of the state's revenue system.

Ohio's 'AAA' IDR and GO ratings are supported by a long track record of conservative revenue forecasting and cautious budgetary management, which have supported fiscal balance and gradual expansion of liquidity. The ratings also reflect a low long-term liability burden. The 'AA+' rating on Ohio's annual appropriation bonds is one notch below the state's IDR, reflecting the slightly higher degree of optionality associated with payment of annual appropriation debt.

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

Economic Resource Base

Ohio's economy is large and diverse and features six distinct economic regions, three of which are grouped around the state's largest urban centers (i.e. Cleveland, Cincinnati, and Columbus). Ohio's economy has continued to become more diversified, with expansion in its finance, health care, insurance and real estate sectors, but the state's manufacturing sector remains large compared to national averages.

Manufacturing is concentrated in the more cyclically sensitive durable goods industries. Transportation equipment and related suppliers also have a strong presence. Fitch expects Ohio's economy to achieve steady growth 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 growth has historically been slow, with state-source revenues expanding in line with, or slightly above, inflation when factoring in the effect of tax policy changes. Direct revenue effects of the tax cuts that Ohio has implemented over the past several biennia have so far 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 levels are conservatively managed and debt primarily consists of GO bonds. On a combined basis, outstanding debt and net pension obligations are below the U.S. states' 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, equal to about 10% of fiscal 2022 state-source GRF revenues.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not relevant for a 'AAA' rating.

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

--Failure to maintain fiscal balance and robust reserves when addressing future financial challenges, including absorbing the potential effects of major tax policy revisions;

--State revenue growth that falls below Fitch's expectations for the long-term level of U.S. inflation for 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

Ohio Economic Update

The pandemic initially had a sharply negative effect on Ohio's economy. Nonfarm payrolls declined by 16% from February to April 2020 compared to a U.S. median decline of 15%. Ohio's job market has since seen a strong recovery, with 85% of lost jobs regained through July 2022. However, this is well below the national median (100% regained) and US states' median (95% regained). Ohio's slower-than-average labor market recovery is affected by a combination of factors, including early retirements, weaker relative growth in information

technology, finance and services jobs in Ohio since 2020, and less robust labor recoveries among lower-wage workers.

Fitch also considers the employment to population ratio (EPOP) when evaluating the health of state and local labor markets as EPOP helps gauge what proportion of the labor force is actively employed. Ohio's EPOP indicates a much improved, but not fully recovered, labor market. Ohio's EPOP of 59.6% in July was below the 60.6% states' median and also below Ohio's 60.7% reported EPOP in February 2020, just prior to the pandemic. Ohio's official unemployment rate was 3.9% in July versus the U.S. rate (3.5%).

Fiscal 2022 Concluded with a More Than \$2 Billion Operating Surplus

Fiscal 2022 revenue performance finished well above budgeted estimates. Tax revenues exceeded estimates by \$2.7 billion, or 10.8%, and were \$1.7 billion (6.4%) above prior-year actuals. Fiscal 2022's tax revenue growth was unanticipated, as the state had budgeted for a \$1 billion (4%) drop in collections when incorporating the effect of personal income tax (PIT) reductions that took effect on July 1, 2021.

PIT receipts beat forecasts by the broadest margin, coming in \$1.9 billion (21%) above budget despite the tax cuts. Ohio revised its biennial budget in 2022, appropriating a portion of the surplus to fund new capital projects and finance infrastructure upgrades related to Intel and other developments.

State policymakers and the Ohio legislature are focused on directing one-time revenues, including federal funding, toward nonrecurring expenditures. The budget stabilization fund (BSF) balance currently totals \$2.7 billion, equal to 6.7% of fiscal 2022 general revenue fund (GRF) revenues and 9.4% of state-source GRF revenues. No draws were made on the BSF in fiscal years 2020 and 2021, and none are expected in the current biennium.

Fiscal 2022-23 Biennial Budget Focuses on Tax Cuts and Education Spending

Ohio's biennial budget for fiscal years 2022-2023 assumes 3% annual tax revenue growth, adjusting for the effect of 2020's delayed income tax payments. Factoring in policy-driven tax reductions, revenues were projected to decline by 4% in fiscal 2022 followed by 3.4% growth in fiscal 2023. As mentioned above, the budget included various tax revisions, including PIT rate cuts and bracket changes, that were estimated to reduce revenues by \$1.6 billion (3%) for the biennium. However, based on fiscal 2022 unaudited results, state officials now expect fiscal 2022-23 state source revenues to exceed the prior biennium by approximately \$7 billion (14.3%).

The biennial budget includes increased spending for K-12 education and a revised funding formula that takes resident income levels into account along with local property values. Along with expanded funding for K-12 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 using a portion of federal funding made available to Ohio through the American Rescue Plan Act (ARPA).

Ohio's ARPA Plans Focus on Infrastructure and a Replenished Unemployment Trust Fund

The ARPA allocates \$11 billion in federal funding to the state of Ohio and its local governments. Approximately \$5.4 billion has been allocated directly to the state, with another \$274 million directed to state capital projects. In addition to infrastructure spending and local government recovery programs, the state has appropriated \$1.5 billion of ARPA funds to fully repay an equally-size federal borrowing that supported Ohio's Unemployment Trust Fund (UTF) in 2020.

Aside from the UTF deposit, Ohio has appropriated \$3.4 billion of ARPA moneys in the 2022-23 biennial budget with the largest allocations targeting water and sewer system upgrades (\$696 million), economic improvement projects in Ohio's southeastern 'Appalachia' region (\$500 million), public safety and violence prevention (\$250 million) and natural resources (mostly water) conservation efforts (\$202 million). Another \$1.9 billion of ARPA moneys remains to be allocated; these funds will likely be included in Ohio's fiscal 2024-25 biennial budget. Ohio has not used its ARPA allocation to supplant state revenue or to finance recurring expenditures.

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.

For additional information on Ohio's IDR, see "Fitch Affirms OH IDR at 'AA+'; Rates Lease Appropriation Bonds 'AA'; Outlook Revised to Positive," dated Aug. 5, 2021, available at www.fitchratings.com.

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.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕		PRIOR ↕
Ohio, State of (OH) [General Government]	LT IDR	AAA Rating Outlook Stable	AA+ Rating Outlook Positive
	Upgrade		
Ohio School District Credit Enhancement Program (OH) /State School Bond Program Rating/1 LT	LT	AA+ Rating Outlook Stable	Upgrade AA Rating Outlook Positive

Ohio State Department of Transportation (OH) /Contract Obligation - Portsmouth Bypass DBFOM Project/1 LT	LT	AA-	Rating Outlook Stable	Upgrade	A+ Rating Outlook Positive
Ohio, State of (OH) /General Obligation - Unlimited Tax/1 LT	LT	AAA	Rating Outlook Stable	Upgrade	AA+ Rating Outlook Positive
Ohio, State of (OH) /Lease Obligations - State Appropriation/1 LT	LT	AA+	Rating Outlook Stable	Upgrade	AA Rating Outlook Positive
Ohio, State of (OH) /Self-Liquidity/1 ST	ST	F1+	Affirmed		F1+

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[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)

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