S&P Global Ratings

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State of Ohio; Gas Tax; General Obligation

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Credit Profile		
US$205.08 mil GO highway cap imp bnds ser T due 5/1/2033		
Long Term Rating	AAA/Stable	New
US$136.79 mil GO highway cap imp rfdg bnds ser U due 05/01/2028		
Long Term Rating	AAA/Stable	New
Ohio GO hwy cap imp bnds		
Long Term Rating	AAA/Stable	Affirmed
Ohio State Treasurer, Ohio		
State of Ohio, Ohio		
Ohio State Treasurer (Ohio) GO hwy cap imp bnds		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating, and stable outlook, to Ohio's series T general obligation (GO) highway capital improvement bonds and series U GO highway capital improvement refunding bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating, and stable outlook, on the state's parity debt outstanding.

The rating reflects our view of:

- The pledge of statewide highway user receipts, which are restricted for transportation purposes pursuant to the state constitution;
- Relatively consistent performance of pledged revenues over time, due in part to tax increases;
- Taxes and charges that are levied statewide with a population estimate of 11.6 million in Ohio in 2016;
- Very strong debt service coverage levels, in our view, combined with rapid amortization of all bonds in the next 15 years; and
- Constitutional limitations on the amount of debt that can be outstanding at any one time.

In addition to the pledge of highway user receipts, the bonds also have a full faith and credit pledge of Ohio (GO rating: AA+/Stable; see the summary analysis published March 27, 2017, on RatingsDirect). In our view, the highway user receipts represent the stronger of the two security pledges, mainly due to the very strong coverage levels. Ohio Constitution restricts highway user receipts to highway uses and they cannot be used for nonhighway obligations or uses. We understand that proceeds from the series T bonds will be used to fund highway capital projects and proceeds from the series U bonds will be used to refund previously issued debt.

The highway user receipts pledged to the bonds consist of motor fuel and use tax (66% of total revenues) and registration and license fees (34% of total revenues). Total fiscal 2017 pledged revenues were $2.9 billion, providing more than 21.8x coverage of maximum annual debt service, which is estimated to be $133.3 million in fiscal 2019.

Pledged revenues have expanded by an average of 1% per year from 2008 through 2017, with some cyclicality during recession periods. Highway user receipts have declined five times since 2000: 3.8% in fiscal 2001, 3.6% in fiscal 2007, 4.9% in fiscal 2009, 1.9% in fiscal 2012 and 0.09% in fiscal 2016. The state attributes part of the declines in fiscal years 2007, 2009, 2012, and 2016 to a delay in recording receipts, which was partially offset by expanded collections in the next year (growth of 4.9% in fiscal 2008, 0.35% in fiscal 2010, 5.1% in fiscal 2013, and 1.6% in fiscal 2016). Despite the recorded declines, coverage has remained extremely strong, in our opinion. Pursuant to the state's constitution, revenues cannot be diverted for nonhighway purposes, which we view as a credit strength for the bonds. Ohio's motor vehicle fuel tax is 28 cents per gallon, which is in line with the average rate for all states. Ohio's tax rate is below that of most contiguous states.

The series T and series U bonds are being issued pursuant to Section 2m Article VIII of the Ohio Constitution, and are payable from all excises and taxes levied by the state relating to registration, operation, or use of vehicles and fuel taxes. The series T and series U bonds are the 20th and 21st series of bonds issued under Article VIII, respectively. This constitutional amendment was approved by the electorate in November 1995 and authorizes the issuance of highway capital improvement bonds of up to $220 million per fiscal year, plus any previous fiscal year's unused authorization. No more than $1.2 billion of highway capital improvement bonds may be outstanding at any one time, and there is $815.35 million outstanding at present. Maximum maturity on the bonds cannot exceed 30 years but typically the state has amortized its bonds more rapidly. All debt (including the series T and series U bonds) is amortized by fiscal 2033.

Ohio's gas tax bonds are eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, and the institutional framework in the U.S. is predictable with significant state autonomy and flexibility.

Outlook

The stable outlook reflects S&P Global Ratings' view that the broad pledge of statewide highway user receipts supporting the bond program has been stable over time. We believe that the bond provisions governing the issuance of additional debt will ensure that extremely strong debt service coverage levels will continue. Given both of these factors, we do not expect to lower the rating within the two-year outlook horizon. Although unexpected, downward pressure on the rating could result from materially weakened pledged revenue collections that impact debt service coverage or alterations to bond provisions that we believe weaken established legal protections.

Economy

The U.S. Census Bureau's July 2016 population estimate for Ohio is 11.6 million, making Ohio the seventh-most populous state in the nation. More than half of the state's residents reside in the Cleveland, Cincinnati, and Columbus metropolitan statistical areas. Ohio's population over the past decade was relatively weak, averaging only 0.12% growth annually, well below the U.S average of 0.8%. The state is made up of a larger dependent population than the nation at 62.6% for the state versus 60.7% for the nation, according to data from the U.S. Census Bureau's American Community Survey for 2014. Outmigration is consistent, particularly among young professionals aged 20-34, and is most prevalent in communities with a strong manufacturing presence such as Cleveland, Dayton, and Toledo. However, Ohio's economy continues to expand, and although the expansion has been slow compared with previous post-recession phases, the state's unemployment rate significantly improved in 2015 and held constant in 2016 before rising slightly so far in 2017. Ohio's 2013 unemployment rate was 7.5%, just above the U.S. rate, but dropped to 4.9% in 2015 and 2016. As of July 2017, the state's unemployment rate is 5.2%, which is above the 4.3% U.S. rate for the same time period.

Ohio's manufacturing sector remains a strength to the state's economy, chiefly due to Ohio's heavy presence in the auto industry, after suffering significantly in the Great Recession, and IHS Markit projects average annual growth of 1.1% from 2017 to 2020. It also projects overall average annual job growth to be 0.73% from 2017 to 2019, which would be below the projected national level. In our view, Ohio's manufacturing sector will remain a significant component in the state's economy, but in our view the sector's long-term performance is still not clear.

State wealth and income levels lag national averages. At $44,876 per capita, the 2016 personal income was 91% of the national level. Ohio's employment composition has become more balanced over time because of continued loss of manufacturing jobs and growth in other sectors. The largest sectors in the state's economy, as of 2016 data, were trade, transportation, and public utilities (18.6% of nonfarm payrolls); education and health services (16.9%); government (14.2%); and professional and business services (13.2%). Ohio's manufacturing employment (12.5%) remains significantly higher than that of the U.S. as a whole (8.5%). Major industries for this sector continue to be transportation equipment (vehicles) and fabricated metals and machinery industries. The transportation equipment sector is the state's largest export product category and its civilian aircraft, engines, and parts components make up the largest portion of transportation equipment exports with demand pouring in from foreign markets.

Ohio's major metropolitan centers are home to significant employers, including being headquarters for major corporations. The state's leading employers reflect the transition to a service-based economy, with a strong emphasis on health services. As of 2017 data, the eight largest employers in the state are in either the retail, health care, or financial services sectors: Wal-Mart Stores Inc. (50,500 employees), Cleveland Clinic Health System (49,050), Kroger Co. (43,850), Mercy Health (32,035), University Hospitals Health System (26,000), Ohio Health (22,340), JP Morgan Chase & Co. (21,000) and Giant Eagle, Inc. (19,000). The largest employers outside of these sectors are General Electric Corp. and Honda Motor Company, which each employ14,500. In addition to a significant health care industry and major corporate employers, Ohio has a well-developed higher education system that, in our view, should continue to generate economic development opportunities for the state over time. Furthermore, there are possibly significant economic gains for the state in the long term given development of the Utica shale formation, but the short-term forecast is for a weaker and more gradual recovery than the rest of the country.

State Enacted 2018-19 Biennium Budget

The enacted 2018-2019 biennium budget is balanced with what we view as minimal reliance on one-time revenue sources. The total biennium appropriations are approximately $65.5 billion and are based on expected total general revenue fund (GRF) biennial revenues of $65.6 billion. The GRF ending balance is budgeted to close at $196.8 million in fiscal 2018 and $168.1 million in fiscal 2019 which meets the state's statutory target of 0.5% ending GRF balance. Over the biennium, Medicaid and education represent the two largest spending categories at $30.5 billion (46.6% of GRF expenditures) and $22.2 billion (34.0% of GRF appropriations), respectively. The proposal maintains the state's BSF at $2 billion (about 6% of GRF revenues) through the biennium. In the previous budget cycle, the statutory ceiling for the BSF was raised to 8.5% of revenue, from the previous maximum of 5.0%, which we view as a credit positive for Ohio's fiscal flexibility and believe will aid the state in addressing future budget volatility. This is especially significant for Ohio, which has to maintain budget balance throughout the year.

Appropriations in fiscal 2018 are budgeted at $32.2 billion or a 6.7% decrease from fiscal 2017, with Medicaid being the largest driver of the decrease. GRF Medicaid spending as enacted for fiscal 2018 falls 15.0% from fiscal 2017 levels following a change in federal policy that excludes federally matched funds from the state's sales tax on Medicaid managed care plan premiums. The enacted 2018-2019 biennium budget establishes a Health Insurance Corp. provider assessment to offset the impending net negative impact to the state of approximately $597 million in fiscal 2018. The assessment is expected to generate a net fiscal benefit of $615 million annually, with revenues and federal reimbursements to be deposited and expended from a non-GRF dedicated purpose fund. Local governments that received state support stemming from the previous sales tax will not receive such revenues from the provider assessment; the state has developed a support plan to help local entities manage the change. The governor vetoed a provision that would have required the state to explore with the Centers for Medicare and Medicaid Services the option of increasing the assessment in a manner that provides an additional $207 million each fiscal year in an effort to distribute these funds to affected local governments. In Ohio, the legislature could override the governor's veto with a three-fifths majority vote of each house of the general assembly. So far, the house has voted to override the veto while the senate has yet to vote on the matter. We note that the legislature could still reconvene to override any of the governor's outstanding vetoes, including the veto to freeze the state's participation in Medicaid expansion. In our view, the potential impact of additional veto overrides is indeterminate at this time.