S&P Global Ratings

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Summary:

Ohio Enterprise Bond Fund State of Ohio; State Revolving Funds/Pools

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Ohio (Ohio Enterprise Bnd Fd)		
Long Term Rating	AA+/Stable	Affirmed

Rationale

S&P Global Ratings affirmed its 'AA+' rating on the State of Ohio's revenue bonds issued for the Ohio Enterprise Bond Fund (OEBF). As of June 30, 2019, the fund had $90.5 million in bonds outstanding. The outlook is stable.

The ratings reflect our assessment of the following characteristics:

- A very strong enterprise risk profile, given that the pool is managed by a nonprofit, nonstock public corporation and the loan program has no geographic concentration; and
- An extremely strong financial risk profile, reflecting its loss coverage score (LCS), operating performance, and financial policies.

Security for bonds issued under the OEBF is provided by the following sources, in the following order:

- Loan payments received from loans under the OEBF program;
- Funds deposited into the collateral fund due primarily to prepayments and proceeds from asset sales by a defaulting OEBF borrower causing the draw on this reserve fund to occur;
- Funds deposited into the primary reserve by an OEBF borrower causing the draw on this reserve fund to occur (typically, 10% of the original loan amount);
- Principal and interest payments collected from direct loans under the Chapter 166 program, and the indenture requires them to be held as pledged revenues for at least six months after collection, but they can then be released from the security pledge for OEBF bonds;
- Program reserve funds, currently totaling $10.7 million;
- Remaining funds in the primary reserve, drawn on a pro rata basis from the remaining borrower account balances; and
- Remaining funds in the collateral fund, drawn on a pro rata basis from the remaining borrower account balances.

We view the program's enterprise risk profile as very strong due to a combination of the low industry risk profile for municipal pools, and our view of the program's market position, which we consider strong. The OEBF serves as an economic development program to aid businesses in the state and was authorized in 1980 under Chapter 166 of the Ohio Revised Code. The Ohio director of development manages OEBF and direct loans under the same chapter. However, excess loan revenues collected under the Chapter 166 program are eventually released from the security pledge (provided all debt service payments are current).

We view the program's financial risk profile as extremely strong based on a combination of the LCS, historical operating performance, and our view of management policies.

We consider the program's LCS extremely strong. Over-collateralization available to cure loan defaults arises from Chapter 166 loan revenues ($144.3 million in outstanding principal and interest as of June 30, 2019) and pledged reserves totaling $28.7 million in the primary and program reserve funds (excluding additional project reserves only available to cure defaults on a particular series). If, after accounting for defaults, we project an excess of Chapter 166 loan revenues in any given year, we consider them available to pay debt service in the next year only. The reason for this is that the indenture only requires these revenues to be held for six months, and they can then be released from the indenture. The reserves are composed of money market funds, cash reserves, and letters of credit (LOCs). Our default modeling also includes a weighted average recovery of defaulted loan revenues.

We consider the program's operating performance score low, given that one of the OEBF loans was either delinquent or in default in the last year. According to management, as of June 30, 2019, there was approximately $135,000 outstanding on this loan, which was paid off as scheduled in September 2019. Given the nature of the Chapter 166 loan portfolios, there are typically at least several delinquent or defaulted loans in existence at any time.

Averaging all of the financial policies and practices, we view the corpus as adequate.

We based our assessment on the following factors:

- Under the authorizing legislation, the director must consider various underwriting criteria, including economic development effects, project costs, and the needs of the company seeking financing. However, there is also wide latitude as to which projects are ultimately approved, what the security granted will be, and how creditworthiness is to be assessed.
- There is a dedicated staff that monitors financial statements and compliance with loan terms, but the financial disclosure requirements vary depending on the project type and loan size. Management reports ongoing efforts to improve monitoring, enhance standards for financial statement submissions, and assess the risk posed by outstanding loans.
- Loan payments are made monthly, and the flow of funds directs the trustee to draw or replenish various funds in a specific order. Because all of the OEBF borrowers are corporate, defaults and delinquencies are handled differently depending on the circumstance.
- Management prioritizes projects as loan demand develops.
- The general indenture allows for funds to be invested in several investments in compliance with state statutes, although actual investment practices have been generally limited to cash, money market funds, U.S. Treasury obligations, and LOCs.

Based on these enterprise and financial risk profiles, the indicative rating is 'AA+'. The final 'AA+' rating is equal to the indicative rating because we have not made any overriding adjustments.

Program characteristics and bond provisions

Although most pledged loans consist of those made to unrated corporate borrowers, most often the trustee holds a first mortgage and security interest in land, buildings, or equipment, depending on the asset financed with the loan. This feature, in our view, presents a further level of security to bondholders; any cash generated from these asset sales are pledged revenues and available to restore reserve balances or cure any loan defaults.

As of June 30, 2019, total bonds outstanding under the OEBF program were $90.5 million for 28 projects. Pledged OEBF loans total $90.5 million, while Chapter 166 pledged loans total another $144.4 million. Bond fund management expects to issue bonds on an ongoing basis to finance economic development projects. Cash flows are structured for loan repayments to borrowers under the OEBF program to be equal to debt service on OEBF bonds issued to finance the loans. Chapter 166 loan repayments provide excess annual cash flow, creating a greater financial cushion, in our view. Loans repaid under the Chapter 166 program accrue to pledged funds for at least six-to-12 months and then are released to make new loans. Combining OEBF and Chapter 166 loan revenues, coverage of annual debt service exceeds 1.7x in all years, except from 2031-2033, when Chapter 166 revenues are significantly lower compared to previous years. Despite this, we still view the currently available program reserve as sufficient to cure defaults during this time.

As of June 30, 2019, the primary and program reserve funds had a total balance of about $28.7 million ($18.0 million in the primary reserve and $10.7 million in the program reserve, which equaled 32% of bonds outstanding). In addition, accrued Chapter 166 loan revenues in the first- and second-half accounts totaled $17.0 million.

Outlook

The stable outlook reflects our expectation that the level of over-collateralization will remain consistent with the rating level and the other program features will not deviate from historical trends and practices. Within the two-year outlook horizon, we could lower the rating if reserves become insufficient for the rating level, in our view, or any other program factors weaken the enterprise or financial risk profiles (such as loan delinquencies, over-collateralization levels, or financial policies and practices).

Downward scenario

We believe that the most immediate factors that could cause downward pressure on the rating or outlook are the amount of reserves held as LOCs and the amount of OEBF bonds relative to the amount of Chapter 166 loans outstanding. There could also be downward pressure on the rating or outlook if the amount of OEBF bonds issued outpaces the new issue of Chapter 166 bonds or if prepayments in both programs outpace new loan generation, since annual debt service coverage would erode compared to historical trends.

Upward scenario

Conversely, we could raise the rating if our view on enterprise risk profile becomes more positive, although we view this as unlikely absent statutory changes to the program that would improve the market position score.