FitchRatings

RATING ACTION COMMENTARY

Fitch Rates State of Ohio's $55MM Lease-Appropriation Bonds 'AA+'; Outlook Stable

Tue 31 Jan, 2023 - 4:07 PM ET

Fitch Ratings - New York - 31 Jan 2023: Fitch Ratings has assigned a 'AA+' rating to the following State of Ohio (Treasurer of State) capital facilities lease-appropriation bonds:

--$55 million series 2023A (Transportation Building Fund Projects).

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Ohio, State of (OH) [General Government]				
Ohio, State of (OH) /Lease Obligations - State Appropriation/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	AA+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The bonds are expected to be sold via negotiation on or about Feb. 14, 2023. Proceeds will be used to finance the costs of various capital facilities projects of the Department of Transportation of the State of Ohio (ODOT), as provided for in the Ohio General Assembly's appropriation acts. The projects consist of renovations and other capital improvements to facilities and roadways owned by the ODOT.

SECURITY

The bonds are special obligations of the state of Ohio issued by the Treasurer of State under the trust agreement. The bonds are payable from lease rental payments made under a lease agreement between the Ohio Public Facilities Commission (OPFC) and the ODOT. Payments under the lease agreement are subject to biennial appropriation by the Ohio General Assembly using lawfully available funds. Funds used to pay the bonds are expected to originate from the state's highway operating fund.

ANALYTICAL CONCLUSION

The 'AA+' rating on the bonds backed by Ohio's lease-appropriation pledge is set one notch below the state's Long-Term Issue Default Rating (IDR), reflecting the slightly higher degree of optionality associated with the payment of appropriation debt. Ohio's 'AAA' IDR is based on the state's sustained trend of balanced budgets, growing fiscal reserves and robust gap-closing capacity. The rating also factors in the state's proven ability to absorb the effects of economic cyclicality and tax policy changes, a long track record of cautious revenue forecasting, and a low long-term liability burden.

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.

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. Non-farm 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 modest recovery, with 88% of jobs lost due to the pandemic regained through December 2022. This is well below the national median (107% regained) and U.S. states' median (100% regained). Ohio's slow labor market recovery is affected by several factors, including early retirements, weaker relative growth in information technology, finance and service sector jobs since 2020 compared to peers, and a less robust labor recovery among lower-wage workers.

Fitch also considers the employment to population ratio (EPOP) when evaluating the health of state 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 58.6% in December was below the 60.1% states' median and Ohio's 60.7% reported EPOP in February 2020, just prior to the pandemic. Ohio's official unemployment rate was 4.2% in December 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 factoring in 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. Following a $727 million deposit on Jan. 17, 2023, the BSF balance totals $3.5 billion, equal to 8.5% of fiscal 2022 general revenue fund (GRF) revenues and 12.4% of state-source GRF revenues. Incorporating this deposit, the BSF has reached Ohio's statutory target of 8.5% of prior-year GRF revenues. No draws were made on the BSF in fiscal years 2020 and 2021, and none are expected in either the current or the next biennium.

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

Ohio's biennial budget for fiscal years 2022-2023 assumed 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 PIT rate cuts and bracket changes estimated to reduce revenues by $1.6 billion (3%) for the biennium. However, based on fiscal 2022 results, state officials now expect fiscal 2022-2023 state source revenues to exceed the prior biennium by approximately $7 billion (14.3%).

The biennial budget included 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 included a $1 billion 'Investing in Ohio Initiative' that provides one-time funding for business sectors and communities negatively affected by the pandemic using a portion of Ohio's American Rescue Plan Act (ARPA) allocation.

Ohio's governor is expected to release his executive budget proposal for the fiscal 2024-2025 biennium during the week of January 30.

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 appropriated $3.4 billion of ARPA moneys in the 2022-2023 biennial budget with the largest allocations for water and sewer upgrades ($696 million), economic improvement projects in southeast Ohio ($500 million), public safety and violence prevention ($250 million) and natural resources 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 2024-2025 biennial budget.

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.

DATE OF RELEVANT COMMITTEE

07 September 2022

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.

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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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