S&P Global
Ratings

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Summary:
Ohio State Treasurer
State of Ohio; Appropriations

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Table Of Contents

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Credit Profile		
US$57.0 mil cap facs lse-approp var rate bnds (State of Ohio) (Adult Correctional Bldg Fd Proj) ser 2021B due 10/01/2040		
Long Term Rating	AA/A-1+/Stable	New
US$57.0 mil cap facs lse-approp bnds (Ohio) (Adult Correctional Bldg Fd Proj) ser 2021A due 10/01/2030		
Long Term Rating	AA/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA' long-term rating to the Ohio State Treasurer's $57 million capital facilities lease-appropriation bonds (adult correctional building fund projects), series 2021A, issued on behalf of the State of Ohio. At the same time, we assigned our 'AA/A-1+' dual rating to the Ohio State Treasurer's $57 million capital facilities lease-appropriation variable rate bonds (adult correctional building fund projects). The outlook on the long-term ratings is stable.

Lease-rental payments and other pledged receipts received by the Ohio Public Facilities Commission (OPFC) from the state's Department of Rehabilitation and Correction (DRC), in accordance with the supplemental trust agreements and lease agreements between DRC (the lessee) and OPFC (the lessor), secure the series 2021A (fixed-rate) and series 2021B (variable-rate) bonds. Lease-rental payments and other pledged receipts are subject to biennial appropriation by the Ohio General Assembly.

Our 'A-1+' short-term rating on the state's series 2021B variable-rate demand obligations (VRDOs) reflects the short-term self-liquidity facility component provided by the Treasurer's liquidity fund.

Proceeds from the series 2021A and series 2021B bonds will be used to pay the costs of capital facilities to be leased to the DRC by the OPFC, and to pay costs of issuing of the bonds.

Credit overview

We rate these obligations one notch lower than Ohio's general creditworthiness, as reflected in the state GO rating (AA+/Stable). The one-notch differential for the state's capital facilities lease-appropriation debt reflects appropriation risk associated with annual debt service payments on the series 2021A and series 2021B bonds. We view these bonds as having a strong relationship to the obligor. Ohio pledges to biennially appropriate sufficient funds to the DRC from its operating revenues to make lease-rental payments, and it has a long track record of appropriating for similar obligations. In our opinion, there is no unusual political, timing, or administrative risk related to the debt payment.

The series 2021B variable-rate bonds mature Oct. 1, 2040, and the state will enter into a remarketing agreement with KeyBank Capital Market, Inc., as the initial remarketing agent. Debt service payments for the series 2021B variable-rate bonds are due on Oct. 1 for principal and interest, and April 1 for interest only. With at least 25 days' written notice to bondholders prior to the purchase date, these bonds are subject to mandatory tender upon conversion from the current weekly interest rate period to another period, or upon the provision of a substitute liquidity facility. In the event of a failed remarketing of the bonds, the maximum interest rate cannot exceed the lower of 9% or the maximum interest rate permitted by Ohio law.

The short-term rating on the state's VRDO bonds reflects S&P Global Ratings view of the ample self-liquidity and sufficient assets pledged by the State Treasurer of Ohio to cover the $457.4 million of VRDOs (or approximately 4.2% of direct debt outstanding). In our view, the risk of higher interest costs under the maximum interest rate is mitigated by the relatively small amount of variable-rate debt compared with both Ohio's overall debt profile and the state's sufficient liquidity to absorb higher interest rate costs on the bonds for the duration of the interest rate period. In addition, Ohio's clear and detailed liquidation procedures indicate a strong likelihood to guarantee full and timely purchase price of the bonds tendered when due, as the portfolio's duration is maintained at less than one year and is typically managed to a weighted-average maturity of 90 days or less.

The treasurer's liquidity fund alone had nearly $6.29 billion (discounted market value) of short-term assets with same-day liquidity as of Feb. 28, 2021 and total assets of approximately $9.22 billion. The liquidity fund is invested in a diversified portfolio of cash and high-quality, short-term, fixed-income securities ('A' or better long-term ratings, and 'A-1/P-1' short-term ratings), primarily consisting of U.S. treasury and agency securities, high-grade U.S. corporate notes and commercial paper, and money market funds rated 'AA' or better. S&P Global Ratings Fund Ratings And Evaluations Group regularly monitors the credit quality, liquidity, and sufficiency of the treasurer-pledged assets.

The 'AA' long-term rating on both the fixed- and variable-rate capital facilities lease-appropriation bonds reflects our view of:

- The strong contractual provisions of the lease structure securing the capital facilities lease appropriation bonds, including an absolute and unconditional payment provision once funds are appropriated;
- The state's longstanding and demonstrated commitment, within both the administrative and legislative branches, to allocate sufficient funds biennially to support appropriation-backed obligations; and
- The importance of appropriation debt to Ohio's overall capital bonding structure.

S&P Global Ratings believes Ohio's credit stability is underpinned by its disciplined government framework, active budget management, and very strong reserve profile as the state continues to navigate economic uncertainty and budgetary challenges brought on by public health and safety risks stemming from the federal and state response to the COVID-19 pandemic. Ohio entered the fiscal 2020-2021 biennium well positioned financially, having demonstrated proactive expenditure management and conservative financial forecasting during a strong period of economic growth over the last biennium, and the state set aside surpluses in its budget stabilization fund (BSF) to achieve the highest rainy day fund savings in state history at the end of the fiscal 2018-2019 biennium. At the end of fiscal 2020, the state maintains a current BSF balance of nearly $2.7 billion (or approximately 8% of general revenue fund expenditures) will in our view, afford it a degree of flexibility to manage budgetary challenges as they arise.

The state ended the first year of the fiscal 2020-2021 biennium reporting a $645.9 million (or 8.4%) net increase in general revenue fund balances, measured on a GAAP basis. Based on audited results for June 30, 2020, general revenue funds experienced a historical decline of nearly $1.1 billion, or 4.6% below the enacted budget estimate, of which approximately $719 million was attributable to the deferral of the income tax filing deadline to the ensuing fiscal year. However, total general revenue fund receipts in federal grant revenue for Medicaid and COVID-19 related expenditures (totaling approximately $659.4 million), partially offset the decline in state-generated revenue. In response to the estimated revenue shortfall at fiscal year-end, the administration also announced $781.9 million in general revenue fund reductions for the remainder of fiscal 2020. These cost measures were sufficient to close the fiscal 2020 structural budget gap and did not rely on BSF reserves or other one-time measures.

On Feb. 1, 2021, the state published its preliminary 2020-2021 biennium revenue and fiscal 2022-2023 budget forecast concurrent with the governor's budget proposal. February revenue and economic baseline forecast estimates were considerably improved from OBM's June 2020 forecast. The June 2020 forecast estimated general revenue fund receipts and balances of approximately $2.43 billion, or nearly 7% below budgeted general revenue fund revenue (and transfers in) estimates for fiscal 2021. However, the February revenue estimate forecasted general fund tax receipts for fiscal 2021 to be $1.67 billion, or 7.4% above fiscal 2020-levels. Over the fiscal 2022-2023 biennium, the forecast estimates general fund tax revenue to increase by $495 million (or 2%) and $838 million (3.4%) year-over-year, respectively. The forecasted revenue estimates over the biennium will be aided largely a robust recovery in individual income tax (2.3% growth in 2022 and 4.3% growth in 2023) and sales tax (5.6% growth in 2022 and 3.4% growth in 2023).

Through the first eight months of fiscal 2021, Ohio's general revenue fund receipts are outperforming the states' June 2020 revenue forecast, supporting the state's view of an improving revenue picture in the second half of the current fiscal year. Fiscal year-to-date (through Feb. 28, 2021) general revenue fund tax receipts were approximately $722 million (or 4.5%) ahead of the state's biennial budget estimate and $1.3 billion (or 8.3%) ahead of the previous fiscal year revenue. Ohio partly attributes positive revenue performance to a return to growth in withholding tax payments, but a substantial portion has been due to a shift in the income tax deadline from the previous fiscal year to the current year. Reopening of the state's economy over the third and fourth quarters of 2020 also contributed to a rebound in economic activity and consumer spending that was likely boosted by pent-up demand and federally enhanced assistance payments to individuals. Among its three leading sources, income tax receipts are approximately 3.8% above the fiscal year-to-date budget estimate, while auto sales tax (13.9%) and non-auto sales tax (4.8%) also performed well-ahead of the budget estimate.

Ohio's governor released a balanced executive budget recommendation for the fiscal 2022-2023 biennium, including a general fund agency appropriations plan totaling $35.38 billion for fiscal 2022 and $39.27 billion for fiscal 2023. In our view, the general fund recommendation calls for a substantial year-over-year expenditure increase of $1.1 billion (or 3.5% above the fiscal 2021 estimate) for fiscal 2022 to restore funding to previously cuts to state operations and local aid during the pandemic and provide one-time program investments to aid the state's recovery. A substantial $3.9 billion spending increase (or 11% above the proposed fiscal 2022 budget) is partly the product of an expected increases in the state's share of Medicaid and other agency programmatic currently being supplemented by federal grants and transfer payments in the current biennium.

We anticipate that there will likely be some legislative changes to the governor's proposal, particular as the state determines how it will use nearly $5.9 billion in direct federal aid under the American Rescue Plan (ARP), signed into law as on March 11, 2020, before the beginning of fiscal 2022-2023 biennium on July 1, 2021. However, the governor's budget proposal does not include any federal aid to fund recurring or new programmatic expenditures that would come with the recently passed $1.9 trillion coronavirus relief package. We also expect that there will be negotiations between the governor on revenue adjustments, and one-time versus ongoing agency expenditure requests for the next biennium.

During periods of economic stress, Ohio has demonstrated a willingness to make necessary adjustments to correct structural imbalances, which we anticipate will continue as the current economic cycle evolves. We expect the state will continue to approach the remainder of the fiscal 2020-2021 biennium with an emphasis on proactive and structural solutions, and we consider this continuance integral to maintaining Ohio's credit quality. Based on its constitutional framework, Ohio is effectively precluded from ending a fiscal year or biennium in a deficit position. Reflecting the state's responsive financial oversight and management, in March and May 2020, by executive order of the governor, Office of Budget and Management (OBM) and the Ohio Department of Administrative Services (DAS) developed an expenditure reduction plan for state agencies, boards, and commissions, including hiring and spending freezes, state agency holdbacks, and other discretionary spending reductions. The plans were implemented over the final three months of fiscal 2020, and the state has eased released some state agency holdbacks in fiscal 2021 due to the better-than-expected budgetary projections.

Although optimism of a nascent economic recovery in the U.S. has been spurred on by the approval of vaccines and the stabilizing of certain revenues, we believe near-term public health and safety risks stemming from the federal and state policy response to combat the pandemic could curtail economic momentum and bear down on states' credit stability in 2021. While the longer-term impacts of the pandemic remain uncertain for Ohio, we will continue to monitor the developments and the second-order effects to credit fundamentals across the sector. Should vaccinations progress smoothly and economic growth match expectations, some potential credit pressures could wane by mid-year. For more on our view of the U.S. state credit sector in 2021, see "Outlook For U.S. States: Symptoms Persist, But A Shot In The Arm Could Lead To Growth," published Jan. 5, 2021, on RatingsDirect.

In our view, a key credit consideration for the state's economic outlook will be the path its manufacturing sector follows through this contractionary period. At this juncture, a swifter recovery in statewide manufacturing conditions in Ohio has insulated near-term employment and cyclical economic losses in public and service-based sectors that have been more disproportionately affected by public health and social risks. Beyond the near-term direct effects of the COVID-19 pandemic, we believe Ohio's path out of the recession could be slower and weaken its overall credit metrics including employment, gross state product, and personal income gains relative to the nation. At the same time, the state has realized gains in education and health services, which could steady wealth and personal income metrics in the state during an economic recovery.

Our view of Ohio's general creditworthiness reflects what we view as the state's:

- Long track record of proactive financial and budget management, including the state's implementation of frequent and timely budget adjustments over time to mitigate revenue shortfalls;

- Commitment to funding budget reserves that have been, and are expected to remain, instrumental in managing budget gaps through the current and future economic cycles;
- Improved revenue and budget performance and the restoration of the BSF, which was increased to a statutory target of 8.5% of revenue as part of the enacted 2016-2017 budget;
- Vast, broad, and diverse economy that had benefitted from steady expansion following weak performance during the past two recessions, although there is some concentration in manufacturing relative to the U.S., which anchors the employment base and is sensitive to exogenous demand shocks;
- Low-to-moderate debt levels, with rapid amortization and a conservatively managed capital and debt program, with very strong self-liquidity to withstand temporary volatility to its existing VRDO and interest rate swaps; and
- Significant pension reform changes and steady progress in funding OPEB, although we continue to monitor the state's funding policy to assess the sustainability of this progress trend under more subdued investment return conditions.

Environmental, social, and governance (ESG) factors

S&P Global Ratings views the state's environmental risks as being in line with the sector, and Ohio has historically maintained a strong management and regulatory framework to respond to developing risks. 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 and transparency of its policies, reporting, and disclosures. Absent the implications of COVID-19, which we consider a health and safety social risk that could weaken the state's economy, liquidity, and budgetary performance if sustained, 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 longer-term social risks may 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 recent economic diversification efforts help manage this risk.

Stable Outlook

Downside scenario

Although unlikely based on recent operating trends and a strong budgetary 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 this exogenous economic shock or international trade conditions that significantly weaken the state's core economic metrics relative to the U.S. level. We recognize that state governments across the nation will continue to face unprecedented public health and economic challenges in the near term to contain ongoing public health and social risk due to the COVID-19 pandemic. The duration and severity of these events affecting the state's fiscal profile may result in deterioration of its credit quality should economic conditions change.

Upside scenario

While unlikely to occur over the outlook period, positive rating action would be predicated on Ohio's economic conditions strengthening and diversifying to a level that more closely aligns with that of the broader U.S. economy and higher-rated peers, and in a way that we believe better insulates the state from cyclicality. This would be in conjunction with the state preserving financial stability – including maintaining strong BSF 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.

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.

For more information, see our full analysis for the State of Ohio, published Feb. 23, 2021.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020