FitchRatings

RATING ACTION COMMENTARY

Fitch Rates Ohio's $729MM GO Bonds 'AA+'; Outlook Stable

Wed 10 Jun, 2020 - 10:30 AM ET

Fitch Ratings - New York - 10 Jun 2020: Fitch Ratings has assigned 'AA+' ratings to the following state of Ohio general obligation (GO) refunding bonds:

--$194.695 million Higher Education GO Refunding Bonds, Series 2020A (Federally Taxable);

--$115.27 million Common Schools GO Refunding Bonds, Series 2020A (Federally Taxable);

--$141.02 million Infrastructure Improvement GO Refunding Bonds, Series 2020A (Federally Taxable);

--$93.44 million Higher Education GO Refunding Bonds, Series 2020B (Tax-Exempt);

--$111.725 million Common Schools GO Refunding Bonds, Series 2020B (Tax-Exempt);

--$73.075 million Infrastructure Improvement GO Refunding Bonds, Series 2020B (Tax Exempt).

The bonds are expected to be sold via negotiation on June 17, 2020.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligation, full faith and credit of the state of Ohio, excluding lottery proceeds.

ANALYTICAL CONCLUSION

Ohio's 'AA+' Issuer Default Rating (IDR) and GO rating is based on its careful financial management, which is reflected in maintenance of fiscal balance, the rebuilding of reserves and low liabilities. Ohio's economy had demonstrated slow but steady growth leading into the downturn from the coronavirus, with performance in recent years more in line with national levels, though still slightly lagging. Ohio's very slowly growing population may be limiting sustained growth.

ECONOMIC RESOURCE BASE

Ohio's economy is large and diverse, with distinct economic regions centered on several large urban centers. Manufacturing remains a disproportionally large sector with a concentration in more cyclically sensitive durable-goods industries. Transportation equipment and related suppliers also have a strong presence.

On March 9, 2020, in efforts to mitigate coronavirus' spread, Governor Mike DeWine declared a state of emergency and closed all nonessential businesses in the state, beginning March 23. The state has been working with business leaders to develop industry specific health and safety guidelines and has begun the process of gradually re-opening. Using continuing claims data through May 23, 9.6% of the labor force was unemployed, below the 11.6% median for states; the number of initial claims filed in the latest week fell sharply.

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. Tax cuts implemented over the past several biennia have 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. Spending pressure in Medicaid and education appears to be well-controlled.

Long-Term Liability Burden: 'aaa'

Debt is typically conservatively managed and debt issuance primarily consists of GOs. On a combined basis, outstanding debt and net-pension obligations are low and a below average burden relative to other states.

Operating Performance: 'aaa'

The state generally has a careful approach to financial operations and has consistently managed to achieve budgetary balance. In recent years, the state has relied more on budget reductions than revenue enhancements to balance the budget and also used several one-time sources during the Great Recession. The state's budget stabilization fund has been restored after being drawn down during the recession and now totals $2.7 billion-more than 11% of state-source general revenue fund (GRF) revenues.

RATING SENSITIVITIES

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

--Sustained economic growth at a level that improves expectations for revenue growth over time.

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

--An inability to address the fiscal challenges triggered by the expected short term, but severe, economic contraction, as evidenced by an inability to make sufficient budget adjustments, leaving the state less financial resilient at the end of the recovery period;

--Economic contraction extending well into the second half of the year or beyond, consistent with Fitch's coronavirus downside scenario, that triggers sustained and deep revenue declines and materially erodes the state's historically strong gap-closing capacity.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance 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

Sector-Wide Coronavirus Implications:

The recent outbreak of coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. Material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in 1H20 at a speed and depth that is unprecedented since World War II. Recovery begins from the 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP remains below its 4Q19 level until mid-2022. A severe but plausible downside scenario includes a prolonged health crisis and negative economic shock. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" on www. Fitchratings.com.

Federal Aid Provides Some Support for State Budgets

Federal aid measures enacted in recent weeks will benefit state budgets, although details remain fluid. The Families First Coronavirus Response included a 6.2% increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for every quarter of the national emergency declared by the president on March 13. FMAP is the rate at which the federal government reimburses states for Medicaid spending. The state expects to receive approximately $300 million each quarter and is assuming the enhanced FMAP rate will continue through December 2020. The ultimate value of the FMAP rate increase will depend on states' actual Medicaid spending, among other factors.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act enacted on March 27, the U.S. Treasury department will distribute $150 billion to state and local governments within 30 days of enactment, essentially on a per-capita basis. The statute limits the use of funds to coronavirus expense reimbursement rather than to offset anticipated state tax revenue losses. The U.S. Treasury allocated $4.5 billion to Ohio, of which $3.7 billion was received directly by the state, with the balance allocated to local governments in the state with a population of 500,000 or more.

The Federal Reserve's recent announcement of a Municipal Lending Facility (MLF) to set up a special purpose vehicle (SPV) that will directly purchase up to $500 billion in short-term debt issued by states, the District of Columbia and the largest counties and cities provides a potentially valuable source of short-term liquidity. Under terms of the program, Ohio could borrow up to $8.9 billion to address the state's own cash flow needs.

Ohio Liquidity Update

Fitch considers Ohio well positioned to address liquidity pressure emanating from the coronavirus pandemic and related economic downturn with no interruption in timely payments for key operating expenses, including debt service. Fitch believes Ohio's very strong financial resilience, as evidenced by its significant reserves and conservative budgeting, positions it well to manage through potential revenue losses and additional expenditures due to the coronavirus. In addition to budget measures that have already been taken and the receipt of federal aid, the state has $2.7 billion in its budget stabilization fund, equal to more than 11% of state-source general revenue fund revenues. This healthy balance should also allow the state to bridge liquidity concerns over the extension of the income tax filing deadline to July 15.

Budget Update

As is the expectation for most U.S. states, Fitch anticipates Ohio's revenue collections, particularly for employment-based income and sales tax, to experience weakness through this period of reduced activity. Revenue collections through the first part of fiscal 2020, as of February, were strong and ahead of forecast. The revenue reports for April and May, however, show the sharp curtailment of both sales taxes and personal income taxes, the later primarily attributed by the state to the delay in the filing date. YTD GRF tax receipts through May are 4.9% ($1 billion) below estimate, with personal income tax collections 9.7% ($767 million) below estimate and sales tax 3.3% ($327 million) below estimate.

Ohio has strong financial resilience that should allow it to absorb the immediate budgetary effects of the economic downturn. Ohio put in place spending controls to address revenue shortfalls, including a hiring freeze, a freeze on pay increases, promotions and new contracts, and requested state agencies reduce spending up to 20% for the balance of fiscal 2020 and for fiscal 2021, the second year of the biennial budget. The governor subsequently, by executive order, reduced the fiscal

2020 budget by $775 million and, with an anticipated revenue gap of $2.5 billion in fiscal 2021, is making additional adjustments to the fiscal 2021 budget. Reductions in place for fiscal 2021 include a 10 day furlough for exempt employees and continued hiring and pay increase freezes, among other personnel actions.

Though the state currently expects that the measures taken to date and access to the enhanced Medicaid FMAP will close a significant portion of the gap, other budget reductions will also be considered as the economic and revenue outlook evolves. The state has indicated that it does not intend to draw upon the rainy day fund to address revenue loss in fiscal 2020 but may do so in fiscal 2021 and into the next biennium if necessary.

These reductions and access to the state's $2.7 billion rainy day fund provide the state with sufficient flexibility to address the magnitude of revenue loss associated with Fitch's base case scenario, which indicates a first-year decline in Ohio's revenues of 13%, followed by a 5.9% increase and cumulative result over the three-year scenario of a 5.3% decline. This compares to the state median decline of 16.6% in the first year and negative 5.7% over the three-year scenario.

CREDIT PROFILE

The current offerings will refund outstanding general obligation bonds for budgetary relief in fiscal 2021. The state is restructuring principal due in August and September and may take a similar approach to bond principal coming due later in the fiscal year. Fitch views this type of "scoop and toss" restructuring as a reasonable budget balancing measure to address the severe and rapid decline in revenues associated with the pandemic. It is not expected to increase Ohio's overall liabilities or negatively affect the state's overall debt structure.

For more information on Ohio's IDR, see "Fitch Rates Ohio's $96MM GO Bonds 'AA+'; Outlook Stable," dated Feb. 3, 2020.

CRITERIA VARIATION

No criteria variations.

DATE OF RELEVANT COMMITTEE

03 April 2020

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.

RATING ACTIONS

ENTITY/DEBT	RATING			F
Ohio, State of (OH) [General Government]				
• Ohio, State of (OH) /General Obligation - Unlimited Tax/1 LT	LT	AA+ Rating Outlook Stable	Affirmed	A C S

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

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