MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Aa1 to Ohio's Highway G.O. Bonds, Ser. V; outlook stable

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New York, November 15, 2018 -- Moody's Investors Service has assigned Aa1 ratings to the State of Ohio's $188.8 million General Obligation Highway Capital Improvements Bonds, Series V. The bonds are expected to price the week of November 26. The outlook on the bonds is stable.

RATINGS RATIONALE

The Aa1 rating is based on the state's GO credit quality, including its strong, proactive budget and financial management, sound reserve levels, and affordable fixed costs associated with below-average long-term debt, pension and other post-employment benefit (OPEB) liabilities. These strengths are somewhat balanced by moderate, but below-average economic growth that will be challenged by weak demographic trends.

Ohio's highway bonds are also secured by a pledge of state highway user revenues, including gasoline taxes and motor vehicle license and registration fees. Although the bonds have substantial (18 times) debt service coverage by a constitutionally dedicated revenue stream, the special tax credit quality is no higher than the state's Aa1 GO rating due to a relatively weak legal structure compared to other highly-rated special tax bonds. In addition, the bonds have insufficient legal revenue separation and economic characteristics to pierce the GO rating.

RATING OUTLOOK

Ohio's stable outlook is based on our expectation that the state's proactive financial management and low fixed costs will continue to support satisfactory budget flexibility even as weak demographic trends may lead to revenue growth below the national average over the medium term.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Improved demographic trends, particularly in working age population growth, net migration, and age distribution, that contribute to stronger economic growth relative to peers

- Maintenance of a budget in structural surplus, including pension contributions sufficient to "tread water"

- Development of governance tools such as consensus revenue forecasting or publically available long-term forecasts that institutionalize current best practices, increase transparency, and ensure consistency across administrations

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Lower-than-expected economic growth, reflected in worsening employment, personal income or demographic trends

- Evidence of financial deterioration, including a return to budgetary structural imbalance and/or weakening reserve levels

- Unanticipated rise in long-term liabilities and an increase in fixed-costs

LEGAL SECURITY

Ohio's general obligation highway bonds are secured by the state's full faith and credit as well as a pledge of state highway user receipts, which includes gasoline taxes and motor vehicle license and registration fees. Pledged revenues are constitutionally dedicated to state highway purposes, including debt repayment, and provide substantial (18 times) coverage of maximum debt service. Bonds have been historically paid entirely from highway user receipts, and the GO backstop has not been tapped.

The highway user receipts pledge provides very strong security for the bonds, but does not surpass the state's Aa1 GO rating. The special tax pledge has a relatively weak legal structure compared to other highly-rated special tax bonds, as well as insufficient legal separation of revenues and economic characteristics to pierce the GO rating. The special tax legal structure is primarily established through constitutional and statutory provisions, which do not provide the same clarity and framework as a typical special tax indenture. Somewhat unclear are provisions regarding the prioritization of debt service over other transportation spending, and detail surrounding the flow of funds and the leverage constraint. In addition, these bonds do not have sufficiently strong legal and economic characteristics to exceed the GO rating, such as a constitutional dedication that is specifically tied to debt service, and an economic base that is stronger than suggested by the GO rating.

Despite the bonds' strong coverage, future coverage could be reduced by revenue declines, a short debt service schedule, or a change in transportation funding policy, which are not considered by a constitutional cap on issuance of GO debt for highways. GO highway bond issuance is constitutionally capped at $1.2 billion of total debt outstanding and a $220 million per-year issuance limit, under which unused portions may be added to the annual cap amount in subsequent years. Excluding the current borrowing, the state has approximately $274 million of remaining borrowing capacity. If the state issued all remaining capacity as 15-year bonds (matching the current structure), MADS coverage would decline slightly, to 19 times. Additional flexibility is available due to the state's 15-year amortization policy, which is well below the constitutional authorization to amortize debt over a 30-year span.

Constitutional amendments in Ohio must be approved by a super-majority (3/5) in each legislative chamber, and then by a simple majority in a public vote. While the state has covenanted to levy and collect taxes at levels sufficient to pay debt service on the bonds, it is not prohibited from repealing or reducing the pledged revenues to sum-sufficient coverage.

Highway user receipts also pay the debt service on $158.7 million of state appropriation debt issued for a DOT building (Transportation Building Fund Capital Facilities Bonds, Series 2015A). In addition, in the event of an interruption in Title 23 funding, the DOT Director has covenanted to pay debt service on the state's $991 million of Major New State Infrastructure Project Revenue Bonds (GARVEEs) using other funds lawfully available. The other funds would consist of appropriations of DOT revenues from sources including state gasoline tax receipts, which would become lawfully available after GO Highway debt service is paid.

USE OF PROCEEDS

Series V proceeds will finance highway capital improvements.

PROFILE

Ohio is the seventh-largest US state by population. Its gross domestic product per capita also ranks seventh among the states.

METHODOLOGY

The principal methodology used in this rating was US States and Territories published in April 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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