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Ratings

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Summary:

State of Ohio; Gas Tax; General Obligation

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US$188.795 mil GO hwy cap imp bnds ser V dtd 12/18/2018 due 05/01/2034		
Long Term Rating	AAA/Stable	New
Ohio gas tax		
Long Term Rating	AAA/Stable	Affirmed
Ohio GO		
Long Term Rating	AAA/Stable	Affirmed
Ohio GO		
Long Term Rating	AAA/Stable	Affirmed
Ohio State Treasurer, Ohio		
State of Ohio, Ohio		
Ohio State Treasurer (Ohio) GaxTax		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' long-term rating, and stable outlook, to Ohio's series V general obligation (GO) highway capital improvement bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating, and stable outlook, on the state's parity debt outstanding.

The bonds are secured by the state's highway user receipts (HURs) which Ohio's constitution defines as any fees, excises, and license taxes relating to the registration, operation, or use of vehicles on public highways or to fuels used for propelling those vehicles. In addition to the pledge of HURs, the bonds also have a full faith and credit pledge of Ohio (GO rating: AA+/Stable), excluding net state lottery proceeds. In our view, the highway user receipts represent the stronger of the two security pledges, mainly due to the very strong coverage levels. In addition, the Ohio Constitution restricts highway user receipts to highway uses and they cannot be used for non-highway obligations or uses.

We rate the bonds under our priority-lien tax revenue debt criteria, which factor in both the strength and stability of the pledged revenues, as well as the general credit quality of the municipality where taxes are distributed and/or collected (the obligor's creditworthiness or "OC"). The priority-lien rating for the highway capital improvement bonds is tied to the OC for the state of Ohio.

Other key credit considerations include:

- A very strong statewide economic base with a population of over 11.7 million in 2017;
- Relatively consistent performance of Ohio's pledged revenues over time in line with our view that nationwide gas taxes have historically demonstrated low volatility;

- Very strong debt service coverage levels, in our view, combined with rapid amortization of all bonds in the next 15 years; and
- Constitutional limitations on the amount of debt that can be outstanding at any one time.

Revenue volatility: Low

The HURs pledged to the bonds consist mainly of motor fuel and use taxes (66% of total revenues) and registration and license fees (34% of total revenues). Ohio's motor vehicle fuel tax is 28 cents per gallon, which is in line with the average rate for all states but below that of most contiguous states.

HURs have expanded by an average of 1.9% per year in the 21-year period from 1998 through 2018. While these pledged revenues have exhibited some declines during recession periods, we believe they have been relatively stable overall. Since 2000, HURs have declined five times: by 3.7% in fiscal 2001, 3.5% in fiscal 2007, 4.7% in fiscal 2009, 1.8% in fiscal 2012, and 0.09% in fiscal 2016. The state attributes part of the declines in fiscal years 2007, 2009, 2012, and 2016 to a delay in recording receipts, which was partially offset by expanded collections in the next year (growth of 4.9% in fiscal 2008, 0.35% in fiscal 2010, 5.1% in fiscal 2013, and 1.6% in fiscal 2016).

On a macro level, we consider gas tax revenues to have a low historical volatility assessment given the critical nature of gasoline for automobiles and other transportation. Nationwide gasoline sales have historically fluctuated less than total consumption of goods and services, even through severe economic downturns and price fluctuations, given the relative inelasticity of demand for motor fuel. We do not expect oil price variations in the medium term will affect our view of the volatility of gas tax revenue in aggregate; however, affordable electric substitutes to gas-powered vehicles could occasion a shift in market dynamics over the longer term.

Coverage and liquidity: Very strong

Coverage has been very strong historically. In the 19-year period since 2000, coverage has averaged 18.0x maximum annual debt service (MADS). Currently, total fiscal 2018 pledged revenues of $2.9 billion provide more than 19.2x coverage of MADS, which is estimated to be $152.9 million in fiscal 2020.

Pursuant to the state's constitution, revenues cannot be diverted for nonhighway purposes, which we view as a credit strength for the bonds. The constitutional provisions were enacted in 1948. Management reports that there has never been an attempt to divert the HURs for other purposes.

While there is no additional bonds test (ABT) for these obligations, we believe the lack of an ABT is mitigated by other legal protections. The state's constitution limits total issuance to $1.2 billion. It also prohibits annual issuance of more than $220 million in principal (plus the principal amount of highway obligations that in any prior fiscal years could have been but were not issued within the $220 million fiscal year limit). Currently, there is $925.7 million of highway bonds outstanding.

While maximum maturity on the bonds cannot exceed 30 years, typically the state has amortized its bonds more rapidly. Currently, the bonds' debt service schedule retires 82.0% of principal within 10 years and 100% of principal within 15 years.

Economic fundamentals: Very strong

The U.S. Census Bureau's population estimate for Ohio is 11.7 million as of 2017, making Ohio the seventh-most populous state in the nation. More than half of the state's residents reside in the Cleveland, Cincinnati, and Columbus metropolitan statistical areas. Ohio's population over the past decade was relatively weak, averaging only 0.14% growth annually, well below the U.S average of 0.78%. The state is made up of a larger dependent population than the nation at 63.1% for the state versus 61.3% for the nation, according to data from the U.S. Census Bureau's American Community Survey for 2014. Outmigration is consistent, particularly among young professionals aged 20-34, and is most prevalent in communities with a strong manufacturing presence such as Cleveland, Dayton, and Toledo. However, Ohio's economy continues to expand, and although the expansion has been slow compared with previous post-recession phases, the state's unemployment rate significantly improved in 2015 to 4.9% (from 5.8% in 2014) and held constant in 2016 and 2017 at 5.0%.As of September 2018, Ohio's unemployment rate is 4.6%, well above the U.S. rate of 3.9% for the same time period.

While Ohio's economic growth is expected to remain steady, IHS Markit projects the state's economy will generally grow more slowly than the nation's. Overall employment growth is expected to rise 1.4% for Ohio in 2018 compared with U.S. growth of 1.6%. For 2018, projected gross state product growth is at 2.5%, below the U.S. GDP growth forecast of 2.9%.

Ohio has a population of 11.7 million. The state's per capita personal income is 91% of the national level.

Obligor linkage: Close

We view the highway capital improvement bonds as linked to Ohio's creditworthiness. While we consider the constitutional dedication of HURs for transportation purposes as providing some uplift, in our view, the collection and distribution of pledged revenues by the state itself expose the revenues to operating risk. For this reason, under our priority-lien criteria, we consider the linkage between the priority-lien pledge and Ohio to be close.

Management reports HURs are never co-mingled with the state's general revenue fund (GRF); the state collects the pledged revenues and deposits them into dedicated funds. In addition, debt service for highway capital improvement bonds is included in the state's transportation budget rather than its GRF budget. While the constitution requires annual appropriation of HURs to pay for debt service, state statute allows for continuous appropriation of HURs to the highway capital improvement bond service fund pledged to the bonds.

Ratings linkage to Ohio

We assess Ohio's general operations because we view overall creditworthiness as a key determinant of an obligor's ability to pay all of its obligations, including bonds secured by a special tax. Ohio has a long track record of proactive financial and budget management, including its implementation of frequent and timely budget adjustments over time to mitigate lower revenue. The state ended its 2018 fiscal year with a GRF balance of $849.9 million (2.6% of total fiscal year sources), exceeding its statutory target of a 0.5% ending GRF balance. The majority of this surplus was used to make a $657.5 million deposit into the budget stabilization fund, bringing its balance up by 32.5% to $2.69 billion, or 8.3% of fiscal 2018 sources (4.0% of total biennium sources), which we consider strong. We consider the state's debt levels to be moderate with rapid amortization and a conservatively managed capital and debt program. Ohio's pension liabilities are average, in our view, and the state has implemented significant pension reform changes in recent years and made steady progress in funding other postemployment benefits (OPEB).

For more information on the State of Ohio's creditworthiness, please refer to our last GO analysis published Oct. 12, 2018 on RatingsDirect.

Ohio's gas tax bonds are eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, and the institutional framework in the U.S. is predictable with significant state autonomy and flexibility.

Outlook

The stable outlook on these bonds mirrors the outlook on the state of Ohio. Although unexpected, given the linkage between these bonds and the state, a negative rating action or outlook revision on the state could also lead to a negative rating action or outlook revision on these bonds.

In addition, the stable outlook reflects S&P Global Ratings' view that coverage will remain very strong over the two-year outlook horizon. We believe the broad pledge of statewide HURs supporting the bond program has been stable over time and this history of stability in combination with constitutional limitations for debt issuance will ensure that extremely strong debt service coverage levels will continue. Given these factors, we do not expect to lower the rating within the two-year outlook horizon. Although unexpected, downward pressure on the rating could result from materially weakened pledged revenue collections that affect debt service coverage or alterations to bond provisions that we believe weaken established legal protections.