S&P Global Ratings

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Summary:

Ohio; Appropriations

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Credit Profile		
US$33.0 mil cap facs lse-approp bnds (Juvenile Correctional Building Fund Projs) ser 2019A due 04/01/2039		
Long Term Rating	AA/Stable	New
US$22.045 mil cap facs lse-approp rfdg bnds (Administrative Building Fund Projs) ser 2019B due 10/01/2029		
Long Term Rating	AA/Stable	New
US$13.17 mil cap facs lse-approp bnds (Juvenile Correctional Building Fund Projs) ser 2019B due 10/01/2024		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to Ohio's $33 million series 2019A capital facilities lease-appropriation bonds (juvenile correctional building fund projects), $13.17 million series 2019B capital facilities lease-appropriation refunding bonds (juvenile correction building fund projects), and $22.05 million series 2019B capital facilities lease-appropriation refunding bonds (administrative building fund projects), issued by the State Treasurer of Ohio. The outlook is stable.

We assigned the long-term rating based on the application of our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria, published Jan. 22, 2018.

Securities and use of proceeds

Lease-rental payments and other pledged receipts (subject to biennial appropriation) received by the Ohio Public Facilities Commission (OPFC) and the Ohio Department of Youth Services (DYS), in accordance with a master lease indenture and a separate supplemental lease agreement between DYS (the lessee) and OPFC (the lessor), secure the series 2019A and series 2019B refunding bonds (juvenile correctional building fund projects).

In addition, lease-rental payments and other pledged receipts (subject to biennial appropriation) received by the OPFC and the Ohio Department of Administrative Services (DAS), in accordance with a master lease indenture and a separate supplemental lease agreement between DAS (the lessee) and OPFC (the lessor), secure the series 2019B refunding bonds (administrative building fund projects).

We rate each of 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 payment. We view these bonds as having a strong relationship to the obligor. Ohio pledges to annually appropriate sufficient funds to the DYS and DAS from their respective operating revenues to make lease-rental payments, and the state 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.

We understand that proceeds from the series 2019A juvenile correctional bonds will be used to finance construction and improvements to capital facilities leased to the DYS, while the series 2019B juvenile correction refunding bonds will be used to legally defease and refund previously issued project bonds. We understand that proceeds from the series 2019B administrative refunding bonds will be used to legally defease and refund previously issued project bonds.

Credit Overview

The 'AA' long-term rating on lease-appropriation reflects our view of:

- The strong contractual provisions of the master lease structure securing the 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.

2020 - 2021 fiscal biennium budget (enacted)

Ohio was late in enacting a balanced budget for the fiscal 2020-2021 biennium by the June 30 constitutional deadline, which, in our view, was uncharacteristic for the state. The legislature and governor agreed upon a provisional spending plan that funded state agencies and operations at fiscal biennium 2018-2019 levels through July 17, 2019. We recognize that Ohio's budget impasse stemmed from contending legislative proposals related to personal and business income tax measures, education aid spending, and reforms to Ohio's Medicaid prescription drug program. Nevertheless, we believe that the brief budget impasse had minimal effect on the state's day-to-day operations. In addition, the temporary budget included necessary debt service and authority to make lease rental payment appropriations for the entire biennium, which, in our view, mitigated potential risks associated with late budget adoption. This was the first temporary budget for Ohio since 2009 and only the third temporary extension since 1991; both prior extensions occurred during substantial economic downturns.

On July 18, 2019, Ohio's governor signed the nearly $70 billion biennial appropriations act for 2020-2021. The GRF spending plan is nearly $34 billion (or 4% over the prior fiscal year) in the first year of the biennium, and a $36 billion expenditure appropriation (or 6% year-over-year increase) in the second year. The enacted budget does not impose new taxes or draw on the Budget Stabilization Fund (BSF). Excluding carryover balances from the prior fiscal year's GRF surplus, Ohio's budget is nearly structurally aligned under what we believe to be a conservative baseline forecast, as recurring revenues and transfers-in to the GRF are within 1% of total spending over the biennium.

The final budget enacted several tax policy and allocation changes that are estimated to reduce net GRF revenue by approximately $410 million for fiscal 2020 and $177 million for fiscal 2021. These modifications included a 4% reduction in Ohio's personal income tax rates, expansion of the earned income tax credit, the elimination of the lowest two income tax brackets effective in the 2019 tax year, and a two-year pause on the indexing of the income tax brackets through the 2020 tax year. Ohio partially offset these revenue reductions by narrowing the scope of eligible businesses that claim the small business income tax deduction and modernizing the state sales tax to align statutes with remote sales tax collection definitions under the South Dakota v. Wayfair court ruling.

The state's biennial spending plan prioritizes additional funding for health and social services, education, and environmental (particularly clean water) programs through the newly established H2Ohio Fund. Although Ohio has observed lower Medicaid enrollment and costs due to an improving economy, it appropriated for a projected increase in state-only GRF Medicaid expenditures to meet its share of federal matching requirements over the biennium, coupled with a 1.4% net increase in mental health and developmental disability funding. In addition, Ohio increased its combined GRF and Lottery Fund appropriations in support of elementary and secondary education (approximately 4.1%) and primary operating funding for higher education (approximately 7.2%) over the next two years.

Through the first two months of the fiscal year, state officials report general revenue fund (tax and non-tax) receipts are $53.8 million, or nearly 0.9% above the budgeted estimate. However, federal revenue has experienced weaker-than-expected performance--with federal grants coming in $43.2 million (or 2.2%) below estimate--which the state attributes to GRF Medicaid spending remaining below budget. Concurrently, year-to-date expenditures are $92.03 million below budget estimate, due primarily to Medicaid savings and lower property tax reimbursements.

While revenue and expenditure estimates are currently outperforming budgeted estimates, we believe Ohio could potentially experience narrowing fiscal operating margins through the 2020-2021 biennium compared to the previous biennium due to our expectation that the state's economic indicators may soften, resulting in more-subdued sales and income tax receipts and rising social service spending in excess of inflation and GDP growth.

2018 - 2019 fiscal biennium (actual)

Actual year-end 2019 results show that Ohio's total tax receipts and revenues for the GRF exceeded budgeted estimates by $651.1 million (2.9%) and $207.6 million (0.6%), respectively. In addition, total fund uses from the state's GRF are $619.6 million (1.8%) less than anticipated, driven largely by lower-than-estimated Medicaid enrollment and spending. Officials expected a moderate one-time reduction in personal income tax revenue due to a 3.3% cut to the employer withholding tax rate, but this was offset by growth in net personal income tax receipts, which were $313 million above budgeted projections. Ohio's sales tax revenue performance also remained strong as receipts (auto and non-auto sales) were $234.2 million (2.3%) above estimates. As a result, Ohio closed fiscal 2019 with a GRF fund balance of $1.15 billion, or approximately 3.4% of total fiscal year sources. The state will carry forward about $665.7 million of this ending balance, of which $168.8 million meets its statutory reserve target of 0.5% of fiscal 2019 GRF revenue.

The state ended the 2018 fiscal year with a GRF cash balance of $849.9 million (2.6% of total fiscal year sources), exceeding the state's 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 BSF, raising the balance by 32.5% to $2.69 billion, or by 8.3% of fiscal 2018 sources and 4.0% of total biennium sources, which we consider strong. The statutory ceiling for the BSF was increased to 8.5% of revenues in fiscal 2017, from a previous maximum of 5.0%, which we view as a credit positive for Ohio's fiscal flexibility since it aids the state in addressing budget volatility. This is especially significant for Ohio, which has to maintain budget balance throughout the year.

We have assigned a total score of '1.57' to Ohio under our state ratings methodology, in which '1.00' is the strongest score and '4.00' the weakest. This score corresponds to a 'AA+' rating. For additional information, see the analysis on Ohio's general creditworthiness published Jan. 31, 2019, on RatingsDirect, and our analysis, published Aug. 20, 2019.

Outlook

The stable outlook on Ohio's general creditworthiness reflects our view of the state's demonstrated commitment to proactive budget management and continuing focus on economic development initiatives and incentives to support growth, which contributed to improved structural budget alignment and an increasing reserve position over the recent biennia. The outlook also reflects our expectation that employer contributions to the state's pension plans will continue to meet or exceed actuarially determined levels. We note that meaningful postretirement liability reform efforts in previous biennia and statutory debt limits somewhat alleviate fixed-cost pressures over the long-term.

If Ohio's economy were to strengthen in a way that we believe would better insulate the state from substantial fluctuations to its economic metrics and financial position across business cycles (for example, a more diversified economy and population growth trends that are more in line with the nation), we could take positive rating action. Although unlikely based on current operating trends and fiscal policy decisions, sustained structural budget misalignment and a sharp decline in Ohio's reserve position could pressure the rating. The state's concentration in the manufacturing sector could intensify this downside risk if national economic or international trade conditions were to materially weaken the sector.