Moody's
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to Ohio's $219M Ser. 2014 FHWA Grant-Backed Bonds

Global Credit Research - 18 Nov 2014

$759 million of parity debt outstanding

OHIO DEPARTMENT OF TRANSPORTATION FEDERAL GRANT ANTICIPATION PROGRAM
State Governments (including Puerto Rico and US Territories)
OH

Moody's Rating

ISSUE		RATING
Major New State Infrastructure Project Revenue Bonds, Series 2014-1A		Aa2
Sale Amount	$156,390,000	
Expected Sale Date	12/03/14	
Rating Description	Special Tax: Transportation-Related	
Major New State Infrastructure Project Revenue Refunding Bonds, Series 2014-1B		Aa2
Sale Amount	$62,175,000	
Expected Sale Date	12/03/14	
Rating Description	Special Tax: Transportation-Related	

Moody's Outlook

Opinion

NOTE: On November 18, 2014, following initial publication, the press release was corrected as follows: In the last sentence of the first paragraph, changed “stable to negative” to “negative to stable.” Revised release follows.

NEW YORK, November 18, 2014 --Moody's Investors Service has assigned ratings of Aa2 to Ohio's planned issuance of $156.4 million in Major New State Infrastructure Project Revenue Bonds Series 2014-1A and $62.2 million in Major New State Infrastructure Project Revenue Refunding Bonds Series 2014-1B. Moody's is also correcting the outlook on the Ohio Department of Transportation's Federal Grant Anticipation Bond to stable from negative. Due to an internal administrative error, Moody's did not change the outlook from negative to stable as part of a June 16, 2014, rating action on GARVEEs.

SUMMARY RATING RATIONALE

Ohio's Major New State Infrastructure Project bonds are secured by a lien on Federal Highway Administration (FHWA) reimbursements to the Ohio Department of Transportation (ODOT) for construction projects. The rating is supported by strict limits on additional parity debt issuance, which have maintained strong coverage of annual debt service by pledged federal grant revenues, as well as the availability of other funds for payment of debt service.

STRENGTHS

- Additional bonds test (ABT) requiring five times debt service coverage

- Requirement that FHWA reimbursements be used for debt service prior to other ODOT purposes

- Federal Aid Highway Program's history of national support

- Short (12-year) maturity that limits exposure to FHWA reauthorization risk

CHALLENGES

- Stagnant gasoline consumption and insufficient Federal Highway Trust Fund (HTF) tax receipts

- Federal government's failure to enact comprehensive, multi-year reauthorization and Federal Highway Trust Fund solvency uncertainty

- Requirement for Ohio legislature to pass biennial appropriations of state's FHWA funds

DETAILED CREDIT DISCUSSION

RATING RECOGNIZES CONSTRAINTS ON PROGRAM LEVERAGE

The Aa2 rating on these grant-anticipation bonds (or GARVEES) recognizes strong legal constraints on the extent to which the state can leverage anticipated reimbursements under Title 23 of the United States Code, which provides for the Federal Aid Highway Program (FAHP). Under the bond documents, new bonds may only be issued as long as federal revenue will cover resulting maximum annual debt service by a 5-1 ratio. The measure of revenue specified in the additional bonds test is the average of actual FHWA reimbursements to the state in the most recent three state fiscal years. The average of Ohio's reimbursements during the past three years ($1.5 billion) provides 8.2 times coverage of projected maximum annual debt service (MADS) after issuance of the 2014-1 bonds. The state also plans two subsequent issues, of $150 million each, in 2016 and 2018, which would not increase MADS.

The coverage ratios do not include federal debt service subsidies (of 35%) received on Ohio's 2010-2 and 2010-4 BABs, which are pledged to bondholders. Using the state's 2014 obligation authority (the amount of FHWA funds that a state may commit to spend), MADS coverage is 7.4 times. This coverage provides protection against federal funding reductions that may occur over time.

STATE IS MODIFYING ADDITIONAL BONDS TEST PROVISIONS

Ohio is revising the terms of its additional bonds test so that obligation authority, rather than actual receipts, is the basis for demonstrating compliance with the debt service coverage requirement . Obligation authority is the amount of federal program funding that a state may commit to spend under the FAHP in a given year. Under the current ABT, compliance has been demonstrated using a three-year average of actual federal reimbursements received, as previously noted. The change, which is intended to limit possible future impacts from low-reimbursement years, is expected to take effect after June 15, 2021, when debt issued under the existing covenant matures. The state previously altered terms of its additional bonds test. In connection with the issuance of the Series 2007-1 bonds, Ohio eliminated an absolute cap on annual program debt service ($100 million) and increased coverage required under the additional bonds test to 5 times MADS from 4 times. While this change allowed for additional program leverage, it maintained coverage at a high level relative to other GARVEE programs.

PROGRAM GIVES DEBT SERVICE PRIORITY OVER OTHER TITLE 23 FUND EXPENDITURES

The rating assigned to these bonds recognizes structural features that enhance bondholder security. ODOT, under an agreement between the state treasurer and the director of ODOT, cannot use federal highway aid for other purposes in the course of a federal fiscal year until it has first provided for payment on outstanding GARVEEs. This requirement should ensure that sufficient funds are set aside to make principal and interest payments. ODOT has already provided for debt service through the current federal fiscal year, which began October 1, using funds available in the prior federal fiscal year. Payment of Title 23 funds is subject to biennial appropriation by the state legislature, a feature that is not common among GARVEE programs. Ohio state law broadly prohibits agencies from spending federal funds without legislative appropriation. Moody's views the risk of non-appropriation of funds for debt service as remote in view of the requirement that debt service on the securities be provided for prior to any other uses. In addition, ODOT and the state have a long history of timely budget adoption, and the interest and principal payment dates on the bonds, June 15 and December 15, are far removed from the July 1 start of the state's fiscal biennium, offsetting risk of default caused by late budget adoption. While no other state resources are pledged as a back-up to the federal reimbursements, the DOT director has covenanted to pay using other funds lawfully available in the event of an interruption in Title 23 funding. The other funds would consist of cumulative unused prior year appropriations of ODOT revenues from sources such as state gasoline tax collections. Such other funds in fiscal 2014 consisted of approximately $331 million on an available-cash basis. In practice, ODOT pays for GARVEE debt service using motor-fuel tax receipts, setting aside these funds in the federal fiscal year before debt service is due.

GARVEE SECTOR DOWNGRADED IN JUNE 2014, BUT OHIO BONDS WERE EXCLUDED

In June 2014, Moody's Investors Service downgraded 26 stand-alone GARVEEs by one notch and revised their outlooks to stable. The downgrade reflected a growing structural imbalance in the HTF, uncertain timing and magnitude of US general fund support, and increased risk of payment interruption or reduction. The HTF structural imbalance is the result of political unwillingness to provide a sustainable source of long-term funding for federal transportation investments. The downgrades affected GARVEE bonds that are secured solely by anticipated federal aid grants, with no additional state-source revenues (also known as standalone GARVEEs). GARVEE bonds that, like Ohio's, are backed by additional revenues were not downgraded. Ohio has covenanted that it will use of lawfully available prior-year appropriations in the event that Title 23 funds are interrupted.

OUTLOOK

The rating for Ohio's Major New State Infrastructure Project Revenue Bonds is stable, reflecting the high additional bonds test, sufficient prior-year appropriations to pay debt service if Title 23 funds are insufficient, and our expectation the state will continue to maintain debt service coverage.

WHAT COULD MOVE THE RATING UP

- Structural enhancements, such as closing the lien on pledged revenues

WHAT COULD MOVE THE RATING DOWN

- Increased political risk to federal highway program

- Reduction of federal apportionments to levels significantly below forecast

- Issuance of debt with significantly longer maturities than in the past

- State budget delays

The principal methodology used in this rating was US Public Finance Special Tax Methodology published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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