MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa1 to Ohio's $300M Higher Ed G.O. Bonds, Series 2015C, outlook stable

Global Credit Research - 09 Oct 2015

$7.4 billion in G.O. debt outstanding

OHIO (STATE OF)
State Governments (including Puerto Rico and US Territories)
OH

Moody's Rating

ISSUE	RATING
Higher Education General Obligation Bonds, Series 2015C	Aa1

Sale Amount	$300,000,000
Expected Sale Date	10/20/15
Rating Description	General Obligation

Moody's Outlook

NEW YORK, October 09, 2015 --Moody's Investors Service has assigned a Aa1 rating to Ohio's planned issuance of $300 million Higher Education General Obligation Bonds, Series 2015C, issued through the Ohio Public Facilities Commission. The bonds are scheduled to price on October 20th, 2015. The outlook is stable.

SUMMARY RATING RATIONALE

The state's Aa1 GO rating is supported by strong and proactive financial management, including timely response to budget shortfalls and moderate, affordable debt, pension and other post-employment benefit (OPEB) liabilities. Recent revenue growth has helped improve the state's financial position, mitigating exposure to an economy that is expected to lag the nation. Newly enacted tax reforms are expected to reduce general fund revenues, but are largely offset by baseline revenue growth.

OUTLOOK

The stable outlook for Ohio is based on our expectation that its recently enacted budget and proactive financial management will support a satisfactory financial position for the current budget year amid enacted tax reforms. It also reflects our view that the state's economy will continue to improve, despite relatively weak demographic trends.

WHAT COULD MAKE THE RATING GO UP

- Sustained increase in reserves and fund balance position significantly above historic levels

- Economic performance that exceeds national averages over an extended period

WHAT COULD MAKE THE RATING GO DOWN

- Evidence of financial deterioration, including a return to budgetary structural imbalance

- Weakening of GAAP-basis general fund balances and liquidity position below current expectations

- Persistent economic weakness, reflected in below-average employment, personal income or demographic trends

STRENGTHS

- Conservative fiscal management including sound budgeting and proactive responses to budgetary shortfalls

- High levels of internal liquidity including available balances outside the general revenue fund

- Relatively moderate long-term liabilities that are affordable compared to the state's budget

- Statutory requirement to deposit surplus year-end revenues in the state's Budget Stabilization Fund

CHALLENGES

- Economy that remains vulnerable to manufacturing industry exposure

- Potential revenue reductions from tax reform that could threaten the state's balanced financial operations

- Lack of certain best financial management practices

RECENT DEVELOPMENTS

Ohio enacted its FY 2016-2017 biennial budget in late June 2015, with projected increases in general revenue fund appropriations of 13.1% and 4.2%, respectively, over the next two fiscal years. Expenditure growth is concentrated in key spending areas of Primary and Secondary Education (5.3% and 4.1% increases, respectively, in 2016 and 2017) and Medicaid (21.8% and 5.1%). The projected increase in fiscal 2016 Medicaid spending is largely driven by an accounting shift that will move certain expenditures, and the associated federal funding, into the general revenue fund. The plan includes a 6.3% across-the-board personal income tax cut and small business tax reforms. The legislature also increased the state's rainy day fund statutory target to 8.5% of general revenue fund revenues (of the preceding year) from 5%.

DETAILED RATING RATIONALE

ECONOMY: STATE ECONOMY REMAINS STABLE OVERALL, DESPITE SLOWER JOB GROWTH

After a strong initial post-recession recovery, Ohio's job growth remains below the national average. Through August 2015, Ohio's non-farm employment grew only 1.1% on an annualized basis, down from approximately 2.3% in mid-2012, and below the nation's 2.05% level. Nonfarm jobs continue to slowly improve, but remain 43,000 short of the 2006 peak. At 5.41 million in August 2015, Ohio's employment has fallen back to 1997 levels. The state's unemployment rate has been below the US rate since February 2014 and was 4.7% in August (preliminary), compared to 5.1% for the US. The state's personal income growth has been at or above the nation's since mid-2011. Ohio's 2014 per-capita personal income ($42,588) improved to 92% of the nation's, from 89% in 2008.

Overall, manufacturing, healthcare and professional services have been key components of Ohio's stabilized economy. According to Moody's Analytics, Ohio's recovery will lag the nation due to weaker demographics, but growth is expected accelerate in 2016 as the state diversifies its industrial base.

FINANCES AND LIQUIDITY: ADDITIONAL TAX REFORM ENACTED IN GOVERNOR'S FY16-FY17 BUDGET; STATE WILL USE PRIOR YEAR BALANCES AND TAX OFFSETS

The 6.3% across-the-board income tax rate cut effective this fiscal year, when added to income tax rate reductions in the past two fiscal years, brings the top marginal tax rate down to 4.99% from 5.93% in 2011. Ohio also adjusted its taxes on cigarettes and small businesses. Per-pack cigarette taxes increased to $1.60 from $1.25 and beginning in 2016 small businesses can now deduct 100% of their first $250,000 in income each year, with excess income subject to a 3% flat rate. However, post-reform tax receipts are budgeted to increase 3.3% and 4.1% in the two fiscal years due to assumed base revenue growth and an increased allocation of certain taxes to the general revenue fund.

The combined net revenue decrease of tax reforms adopted to date for fiscal 2014 through fiscal 2017 is a significant $4.3 billion, or 20% of fiscal 2015 combined state tax receipts. Fiscal 2015 General Revenue Fund ending unencumbered fund balance was $1.287 billion (6% of state-source revenues), down from a high of $2.3 billion (11% of state-source revenues) in fiscal 2013, but above an initial projection of $632 million for the fiscal year. With the excess funds, the state made several designated transfers, including a $425.5 million transfer to the Budget Stabilization Fund. The resulting unencumbered and unobligated balance was $550.4 million, which is $393 million above the statutory 0.5% ending general revenue fund balance ($157.4 million). The excess will counter-balance costs of the income tax rate reduction in fiscal 2016. Combined, the fund balance carryover, baseline revenue growth, the cigarette tax hike and increased revenue allocation of existing taxes are expected to fully offset the cost of this latest round of tax reforms.

While solid financial performance so far has limited declines in fund balance, we view these tax reform budgets as vulnerable to slower-than-expected baseline revenue growth, particularly in view of recent fluctuations in Ohio's job growth trends.

Ohio's conservative budget management and continued economic growth have maintained solid and favorable financial performance, allowing for gradual absorption of last biennium's tax reform impacts. Fiscal 2015 personal income taxes (39.7% of state source revenues) surpassed estimates by 3.4%, demonstrating a stable job market within the state. Total fiscal 2015 tax receipts exceeded budget by 1.9% ($390.2 million). In addition, actual fiscal 2015 disbursements were -0.3% ($80.9 billion), virtually matching budget. Fiscal 2016 preliminary year-to-date tax revenues through September totaled $5.35 billion, -0.4% below estimate, but 6.1% above prior year levels. September 2016 results are currently not available, but August 2016 disbursements were $6.7 billion, 20.5% above the same period last year and 1.1% above that month's estimate. The higher growth was largely driven by Medicaid expenditures.

Liquidity

The state increased the Budget Stabilization Fund statutory target to 8.5% (from 5%) of general revenue fund revenues, followed by a $526.6 million deposit in early fiscal 2016, its fourth consecutive deposit into the Budget Stabilization Fund (BSF). The current BSF balance of $2 billion is 6.4% of prior year general revenue fund revenues. Of the deposit amount, $425.5 million was from general revenue fund surpluses, while the remaining amount was transferred from Medicaid Reserve Fund balances. The state made a $996 million deposit in early fiscal 2014, the first year the BSF reached its statutory maximum since fiscal 2000. The statutory requirement to deposit surpluses in excess of 0.5% of general revenue fund revenues into the Budget Stabilization Fund generally accelerates reserve restoration, although the legislature has diverted surpluses for other uses in past years.

The state's financial position continues to improve on a GAAP basis. Fiscal 2014 audited results reflect an increase in available general fund balance (unassigned fund balance, including the BSF, plus assigned fund balance) to $3.6 billion (14.8% of state-source GRF revenues) from $3.3 billion (13.2% of state-source revenues) in fiscal 2013. As discussed earlier, we expect these balances to decline during the next two years as the state implements tax reform.

The long-term lease of the state liquor enterprise to JobsOhio, through January 2038, provided a non-recurring $500 million GRF contribution in fiscal year 2013. In addition to the up-front payment, the state will receive 75% of excess net profits above an agreed-upon threshold under the lease.

DEBT AND PENSIONS

Ohio has maintained a moderate debt burden relative to other states. The state's debt burden is slightly higher than the 50-state median, at 2.7% of personal income. Ohio ranks 24th among states based on net tax-supported debt as a percentage of personal income, down from 20th in 2005.

In December 2014, the state, through its Department of Transportation, entered into a public-private partnership (PPP) to construct the Southern Ohio Veterans Memorial Highway (State Route 823), a four-lane limited access highway around the City of Portsmouth, Ohio. The project is expected to alleviate traffic congestion and reduce travel time for commuters. The Portsmouth Gateway Group, LLC's $227.4 million senior Tax Exempt Private Activity Bonds, Series 2015 and its $208 million subordinate TIFIA loan were both assigned a Baa2 rating. Ohio's termination payment as of June 30th, 2015 for its PPP is $30.9 million. Given the long-term, debt-like obligation of the state to make availability payments through the life of the concession agreement, we include this obligation in the state's net tax supported debt.

Debt Structure

Interest payments on the Higher Education G.O. Bonds are paid semi- annually (May 1 and November 1 for these issues).

The state has about $492 million of variable-rate demand debt outstanding (or 4.6% of its total debt), for which it has maintained an internal liquidity program for tendered bonds that are not remarketed. The ratings on these bonds are VMIG 1, reflecting the state's strong management of available liquid resources. Ohio had $4.77 billion of same-day liquid assets available to support the bonds as of August 2015, on a discounted basis, and has access to an additional $1.72 billion of weekly liquidity (discounted).

Debt-Related Derivatives

The state is a party to five swap agreements with a combined notional principal of $407.5 million that hedge interest rate risk on its variable-rate obligations. Collateral posting requirements are pegged to rating levels starting at A3 and lower, and termination provisions are triggered if the state's rating falls below Baa3 (Moody's) or BBB- (S&P). Triggers at these low rating levels introduce minimal risk to the state. As of June 30, 2015, the combined mark-to-market value of the swaps was negative $45.9 million.

Pensions and OPEB

Ohio's pension liability and annual contributions remain affordable despite the growth in liability and declines in the reported funded ratio since 2008. After several consecutive years of declines in funded ratio, the reported funded ratio for the state's largest pension fund improved to 82% in 2013 from 77%. This reflects both improved investment returns and the impact of pension reform.

Based on the state's fiscal 2013 pension data, we have calculated that its adjusted net pension liability (ANPL) was 33% of revenues. The 50-state median ANPL to revenues is 60.3%, and Ohio ranks 41st in this ratio. Our adjustments to reported state pension data include the common 20-year amortization period, as well as an assumed 13-year duration of plan liabilities and a market-based discount rate to value the liabilities, rather than the long-term investment return used in reported figures. Our adjusted liability amounts include the three major state plans, the Ohio Public Employees Retirement System, the State Teachers Retirement System, and the Highway Patrol Retirement System.

In September 2012, Ohio approved pension reform legislation that ensures state plans comply with a 30-year amortization period, assuming level employer contributions at 14% of payroll. Benefits are not guaranteed by the state and are not subject to collective bargaining. The reform took effect in January 2013 and reduces benefits in OPERS (members only) and STRS (members and retirees), and also increases contributions for STRS. The state estimates the reform reduced the OPERS and STRS liabilities by $3.2 billion and $15.7 billion, respectively, although the state's share of the STRS liability is minimal.

Unlike most states, which fund other post-employment benefit (OPEB) obligations on a pay-as-you-go basis, Ohio's OPEB programs have substantial assets ($12 billion) pledged to cover liabilities. After the 2012 reforms, OPEB liabilities dropped substantially, and the state's aggregate funded ratio as of the most recent valuation is 62%. Pension and OPEB benefits are not guaranteed under state law, and contribution requirements and benefit levels can be changed for future and current employees. The state's pay-go portion in fiscal 2014 for OPEB declined to $64.6 million, a minimal portion of its budget.

MANAGEMENT AND GOVERNANCE

Ohio operates on a biennial budget. The state constitution has no revenue raising caps or mandated spending levels, providing flexibility to increase revenues and cut expenditures when needed. The governor also has the ability to reduce appropriations through executive orders. The state rainy day fund has a statutory target pegged at 8.5% of the prior year's general revenue fund revenues. The state is also required to retain funding equal to 0.5% of fiscal year revenues in the general revenue fund that could be carried over to the following fiscal year.

KEY STATISTICS

- Per-capita income relative to U.S. average: 92.4%

- Industrial diversity (1=most diverse): 0.85

- Employment volatility (U.S.=100): 108

- Available balances as % of operating revenue (5-yr. avg.): 4.9%

- NTSD/total governmental revenue: 25.1%

- 3-year avg. adjusted net pension liability/total governmental revenue: 27.6%

OBLIGOR PROFILE

Ohio is the 7th largest US state by population. Its gross domestic product per capita also ranks 7th among the states (in current dollars).

The issuer, the Ohio Public Facilities Commission (which acts on behalf of the state), is a state agency composed of six state officials: the governor, the attorney general, state auditor, the secretary of state, the treasurer, and the budget director.

LEGAL SECURITY

The general obligation bonds are secured by a pledge of the full faith and credit, revenue and taxing power of the State of Ohio and are on parity with other general obligation bonds issued by the state. Debt service payment of the bonds are not dependent on the progress, completion, or operation of the facilities or projects financed by the G.O. bonds.

USE OF PROCEEDS

Proceeds from the Higher Education GO Bonds will finance capital facility costs for state-supported and state assisted higher education institutions within Ohio.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. 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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