FITCH RATES STATE OF OHIO GO REFUNDING BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-17 May 2016: Fitch Ratings has assigned 'AA+' ratings to the following general obligation (GO) bonds of the state of Ohio:

--$39.495 million Higher Education GO Refunding Bonds, series 2016A;
--$15.79 million Natural Resources GO Refunding Bonds, series U;
--$22.355 million Third Frontier Research and Development GO Refunding Bonds, series 2016B.

The bonds are expected to be sold via competitive bid on May 19, 2016.

In addition, Fitch affirms the following ratings:
--Issuer Default Rating (IDR) at 'AA+';
--$8.6 billion outstanding state GO bonds at 'AA+' (including highway capital improvement bonds);
--$1.6 billion outstanding appropriation-backed bonds of the state at 'AA', including those issued by the Treasurer of State and the Ohio Building Authority.

The Rating Outlook is Stable.

SECURITY
General obligation, full faith and credit of the state of Ohio, excluding lottery proceeds.

KEY RATING DRIVERS

The state's 'AA+' GO rating and IDR is based on its careful financial management, ongoing record of maintaining fiscal balance, and a moderate, rapidly amortizing debt burden. Liabilities are supported by an economy that is slowly adding jobs lost in the recession.

Economic Resource Base
Ohio's economy is large and diverse, with distinct economic regions centered on several large urban centers. Manufacturing remains a disproportionally large sector with a concentration in more cyclically sensitive durable goods industries. Transportation equipment and related suppliers have had a strong presence. The state's economy is expanding but at a slower pace than immediately following the recession. Shale gas development along the Utica Shale formation is a potential stimulus in the eastern part of the state.

Revenue Framework: 'aa' factor assessment
Like most states, Ohio maintains nearly unlimited ability to raise operating revenues. Its revenue base is diverse and relies on broad based income and sales taxes. Tax policy changes pursued over the past several biennia have been manageable, aided by favorable economic and fiscal trends

Expenditure Framework: 'aaa' factor assessment
Ohio retains ample flexibility to cut spending throughout the economic cycle. Spending pressure in Medicaid and education appears to be well controlled.

Long-Term Liability Burden: 'aaa' factor assessment

Debt is typically conservatively managed and primarily consists of GOs. On a combined basis, outstanding debt and pension obligations are manageable and a well below-average burden on the state.

Operating Performance: 'aaa' factor assessment
The state generally has a careful approach to financial operations and has consistently managed to achieve budgetary balance. In recent years, the state has relied more on budget reductions than revenue enhancements to balance the budget and also utilized several one-time sources during the recession. The state's budget stabilization fund (BSF) is fully funded, having been drawn down during the recession.

RATING SENSITIVITIES
Ohio's rating is sensitive to shifts in its fundamental credit characteristics and to continued successful maintenance of fiscal balance in light of ongoing efforts to reduce the tax burden.

CREDIT PROFILE

The recession had a widespread impact on the Ohio economy, accelerating a longstanding slump in manufacturing and weighing on the slowly growing service sector. Important employment sectors include transportation, distribution, and warehousing of manufactured goods, which is facilitated by an extensive system of ports on Lake Erie, barge service on the Ohio River, and advanced air-cargo and rail infrastructure. Health care and education are growing as employment and economic sectors and relatively low non-manufacturing wages in the state have been a magnet for back-office, banking, personnel and trade operations. However, while there has been steady year-over-year job growth since July 2010, the state has yet to fully achieve the peak employment reached prior to the recession.

Revenue Framework
Ohio relies on a diverse set of broad based taxes to support operations, including income and sales and use taxes. These major tax revenues are collected in the general revenue fund (GRF) with constitutional exceptions for highway-related revenues that are directed to highway purposes and lottery proceeds that are directed to education.

In recent biennia the state has pursued wide-ranging tax policy changes, shifting the source of GRF tax receipts and lowering overall receipts relative to baseline. To date, these tax policy changes have been manageable, aided by favorable economic and fiscal trends.

Ohio's historical revenue growth, adjusted for the estimated impact of policy changes, has lagged economic growth and has even declined on a real basis, with growth slightly below the inflation rate. Absent tax policy changes, recent performance has been a good deal stronger than is reflected in the historical trend. Fitch anticipates the long-term trend for revenue growth will be in line with historical performance.

Ohio has no legal limitations on its ability to raise revenues through base broadening, rate increases, or the assessment of new taxes or fees.

Expenditure Framework
Ohio has ample flexibility within its expenditure framework. The natural pace of spending growth is likely to be in line with or marginally above its somewhat slowly growing revenue stream. Carrying costs for debt and pensions are well below the median for states.

As with most states, Ohio's spending growth is expected track future revenue growth. Primary cost drivers include Medicaid and education spending. With a shift to managed care, Medicaid spending growth is contained and with only modest population growth, education spending pressures should be manageable.

Ohio has solid expenditure flexibility. The state has had a budget cutting bias rather than relying on revenue increases when necessary to maintain budgetary balance, even in core spending areas. During the last recession, Ohio reduced distributions and phased out certain tax reimbursements to both local governments and school districts. The state's carrying cost for debt and pension obligations are well below the state median and is expected to remain low given the state's well-funded pensions and conservative debt management.

Long-Term Liability Burden
Ohio's liability position and structure are conservative and well below the median for U.S. states. The state carries a moderate amount of rapidly amortized net tax supported debt and debt ratios are expected to approximate current averages as GRF principal continues to roll off and personal income grows.

Funding of retirement benefits, both for pensions and health care, have historically been considered a credit strength, with pension systems generally well-funded and a history of state full funding of annual contributions. Plans are cost-sharing, multi-employer with limited liabilities attributed to the state. However, funding for Ohio's five pension systems declined significantly with recessionary market losses and has only just begun to recover. Reform measures enacted in September 2012 have contributed to the improved financial sustainability of PERS and the state's other major systems.

The state has $472 million in outstanding GO variable rate debt with liquidity provided by the state (rated 'F1+'). Of that, $397.4 million is synthetically fixed through swap agreements. State policy is that all swap counterparties must be rated at least 'AA-/AA3' with progressive collateral requirements if the rating falls below this threshold.

Operating Performance
Ohio's ability to respond to cyclical downturns reflects its ample budget flexibility and availability of reserves. During the most recent recession, Ohio's revenues suffered significant declines, exacerbated by ongoing tax reductions. The state closed the resulting budgetary gaps with both ongoing and one-time measures. Some of these measures include use of the rainy day fund, refunding debt for current year savings, asset sales including the liquor enterprise, changes in the education funding formula, and eliminating tax reimbursements for schools and local governments. It is Fitch's expectation that Ohio will continue to rely primarily on expense reductions to address a future downturn and would again draw upon its now restored rainy day fund.

During times of economic recovery, Ohio rebuilds its financial flexibility including restoring draws on its rainy day fund and reducing the use of one-time budget items. In recent biennia, natural revenue growth has been met with tax reductions, which have, to some extent, absorbed tax revenue increases related to overall economic expansion. While it has been a concern that ongoing tax reductions could limit future flexibility, a statutory increase in the rainy day funding requirement from 5% to 8.5% of prior year revenue, provides additional capacity to address future downturns and is emblematic of the state's approach during this period of expansion.

The state's cash position is sound. It does not borrow for cash flow purposes and has ample liquidity to provide liquidity for its own variable rate debt.

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478