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

Fitch Ratings-New York-01 September 2015: Fitch Ratings has assigned 'AA+' ratings to the following general obligation (GO) bonds of the state of Ohio:

--$150 million infrastructure improvement GO bonds series 2015B;
--$50 million conservation projects GO bonds series 2015B;
--$34.91 million infrastructure improvement GO refunding bonds series 2015C.

The bonds are expected to be sold via competitive bid on Sept. 15, 2015.

The Rating Outlook is Stable.

SECURITY

General obligation, full faith and credit of the State of Ohio, excluding net lottery proceeds.

KEY RATING DRIVERS

BROAD ECONOMY WITH LARGE MANUFACTURING SECTOR: The state's economy is broad and diverse, although manufacturing remains a disproportionately large sector. The state's economy is expanding but at a slower pace than immediately following the recession. The unemployment rate is under the national average.

MODERATE LIABILITY BURDEN: The state's debt burden is moderate and rapidly amortized. 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.

DEMONSTRATED ABILITY TO MANAGE BUDGET CHALLENGES: The state generally has a careful approach to financial operations and has consistently managed to achieve budgetary balance. The state's budget stabilization fund (BSF) is fully funded.

RATING SENSITIVITIES

The rating is sensitive to shifts in the state's fundamental credit characteristics, particularly its economic and financial profiles.

CREDIT PROFILE

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

The recession had a widespread impact on the Ohio economy, accelerating a longstanding slump in manufacturing and weighing on the slowly growing service sector. While there has been steady year-over-year job growth since July 2010, the state has yet to fully recover the jobs lost prior to and during the recession. As of July, non-farm employment had reached only 95.8% of its pre-recession peak, well below the U.S. state median of 102.7%. Job growth has lagged the U.S., most recently recording 1.6% year-over-year growth in July 2015 versus the U.S. rate of 2.1%.

TAX POLICY CHANGES MANAGEABLE TO DATE

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. The fiscal 2016 - 2017 enacted biennial budget appears to be structurally balanced and the rebuilt budget stabilization fund (BSF) provides an important source of flexibility; nonetheless, structural challenges could reemerge if recent favorable fiscal trends shift.

LAST BIENNIUM ENDED STRONGLY

Although the fiscal 2014 - 2015 biennium enacted budget anticipated a sizeable operating deficit in fiscal 2014, leading to some concern over future ability to achieve balance, actual performance was better than anticipated primarily due to lower Medicaid spending. Tax revenues were just above forecast but 4.2% lower as compared to fiscal 2013, given tax policy changes noted above.

Fiscal 2015 performance was solid, with the state lifting its expectations for the ending GRF balance accordingly. As with fiscal 2014, higher than forecast revenues and lower than forecast state spending on Medicaid drove the improved performance. Strong growth in both personal income tax revenues (up 5.5% on a year-over-year basis) and sales tax revenues (up 8.7%) contributed to stronger performance relative to the July 2014 (mid-biennium) estimate.

The state made a deposit to the BSF from the FY 2015 ending balance, raising it to $2 billion, or 6.4% of GRF revenue, while maintaining a stable GRF ending balance. The enacted budget for the current 2016 - 2017 biennium includes raising the statutory target for the budget stabilization fund from 5% of prior year GRF revenues to 8.5%.

FISCAL 2016 - 2017 BUDGET BALANCED

The budget for the 2016 - 2017 biennium is balanced as enacted while incorporating further tax policy changes. PIT rates have been lowered further across all brackets, with additional reductions for certain small businesses. Some offset to the reductions is provided by an increase in cigarette taxes, although the governor's proposed increase and expansion of the sales tax was not enacted. The net impact of tax policy changes is expected to reduce biennial revenues by $869 million in fiscal 2016 and $952 million in fiscal 2017, moderating what would otherwise have been strong revenue growth.

Including tax law changes, GRF tax revenues are forecast to grow 3.3% in fiscal 2016, to $22.1 billion, and another 4.1% in fiscal 2017, to $23 billion. Overall GRF revenues including transfers grow faster, at 10.8% in fiscal 2016 and 4.6% in fiscal 2017, driven by federal revenues for Medicaid expansion being shifted to the GRF as of fiscal 2016. The budget incorporates continued reforms to Medicaid for cost-containment and other savings.

CONSERVATIVE DEBT MANAGEMENT

The state's debt management is generally conservative. Debt amortization is rapid, with all debt fully retired in 20 years and 79% of GRF-backed debt amortized in 10 years. Total tax-supported debt of $11.1 billion is equivalent to a manageable 2.2% of 2014 personal income. Debt ratios are expected to approximate current averages as GRF principal continues to roll off and personal income grows.

Funding for Ohio's five pension systems declined significantly with recessionary market losses; the largest system, PERS, declined from a strong 96% funded ratio as of Dec. 31, 2007 to 77.4% as of Dec. 31, 2011. Reform measures enacted in September 2012 have contributed to the improved financial sustainability of PERS and the state's other major systems. The most recent PERS valuation, from Dec. 31, 2014, showed the benefit of the reform measures as the reported funded ratio increased to 83.8%. Using Fitch's more conservative 7% discount rate assumption, PERS would have an estimated 72.9% funded ratio. On a combined basis, the burden of the state's net tax-supported debt and the adjusted unfunded pension (UAAL) obligations attributable to the state (including about 45% of the unfunded liability of the state division of PERS, the state highway patrol system and a small share of the teachers retirement system) was approximately 3.3% of personal income in 2014, well below the median for U.S. states.

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Applicable Criteria
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033