FitchRatings

FITCH RATES OHIO'S $345MM GO BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-24 April 2015: Fitch Ratings has assigned an 'AA+' rating to the following general obligation (GO) refunding bonds of the state of Ohio:

--$300 million common schools GO bonds, series 2015B (tax-exempt);
--$35 million natural resources GO bonds, series T (tax-exempt);
--$10 million higher education GO bonds, series 2015B (federally taxable).

The bonds are expected to be sold via competitive bid on May 5, 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 disproportionally 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 March, non-farm employment had reached only 95.6% of its pre-recession peak, well below the U.S. median of 100.7%. Job growth has lagged the U.S., most recently recording 1.4% year-over-year growth in March 2015 versus the U.S. rate of 2.3%.

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. In the fiscal 2014-2015 biennium budget (that ends June 30, 2015), tax policy changes have been manageable, aided by favorable fiscal trends and a sizable ending balance from fiscal 2013 helping to cover originally forecast structural imbalances in the current biennium. Although the fiscal 2016-2017 budget proposal makes considerable structural progress and the fully rebuilt BSF provides an important source of flexibility, Fitch cautions that structural challenges could reemerge if recent favorable fiscal trends shift.

The enacted budget for the 2014-2015 biennium included several tax rate changes offset in part by applying the remaining fiscal 2013 fund balance. Rate changes included lowering personal income tax (PIT) rates by 10% over three tax years beginning in 2013, increasing the sales tax rate by 0.25%, to 5.75%, as an offset, and reducing income taxes on small business owners, among other provisions. The PIT rate reductions and tax modifications for small business owners were forecast to result in a sizable amount of foregone revenue over the biennium and were only partly offset by the sales tax rate increase, some PIT index and exemption freezes, and other tax reform measures. As of its mid-biennium review, the state accelerated the final 1% PIT rate reduction into tax year 2014 and made other adjustments to revenues. As a result, the enacted tax reforms are fully phased in and assumed in the base going into the next biennium.

The executive budget for the 2016-2017 biennium proposes further wide-ranging tax policy changes. PIT rates would be lowered further across all brackets, with additional reductions for certain small businesses. These reductions would be partially offset with a 0.5% sales tax rate increase, to 6.25%, expanding the sales tax base to certain services, and other targeted increases affecting commercial activity, oil and gas, and tobacco products. The tax policy changes are currently under consideration by the legislature.

CURRENT BIENNIUM ENDING 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 2014 PIT revenues were $215 million (2.7%) above estimate, although this represented a $1.4 billion (15.2%) reduction compared to fiscal 2013. The reduction reflects tax policy changes, some timing differences between the two fiscal years, as well as the effect of taxpayers having accelerated income into fiscal 2013 in response to federal tax law changes. The reduced income taxes were partially offset by sales tax revenues that were just below estimate but rose $721 million (8.5%) year-over-year, likewise due to tax policy changes. As a result, the budget was essentially balanced in fiscal 2014, significantly better than forecast at the start of the budget year.

FISCAL 2015 OUTLOOK SOLID

Fiscal 2015 performance has been 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 is driving the improved outlook. As of the governor's executive budget for fiscal 2016-2017, the state is forecasting a fiscal 2015 GRF ending fund balance of $970.4 million, well above the $631.6 million assumed at mid-biennium. The proposed budget would transfer $612.7 million of this balance specific uses, including $374 million to the BSF to fully prefund the fiscal 2017 forecast BSF maximum, two fiscal years early. Including the planned fiscal 2015 transfers, the BSF balance would rise to $1.85 billion (5.9% of fiscal 2015 GRF revenue).

FISCAL 2016-2017 BIENNIUM UNDER CONSIDERATION

The governor's executive budget for the fiscal 2016-2017 biennium, released on Feb. 2, includes a range of proposed tax cuts in the next biennium noted earlier; proposed tax law changes would trim a net $367 million from baseline revenues in fiscal 2016 and $444 million in fiscal 2017. Including tax law changes, GRF tax revenues are forecast to grow 5.3% in fiscal 2016, to $22.3 billion, and another 4.1% in fiscal 2017, to $23.3 billion. Overall GRF revenues grow faster, at 13.1% in fiscal 2016 and 4.9% in fiscal 2017, driven by federal revenues for Medicaid expansion being shifted to the GRF as of fiscal 2016. The executive budget proposes continued reforms to Medicaid for cost-containment and other savings; state spending on Medicaid rises 4.4% in fiscal 2016 and 6.1% in fiscal 2017. The proposal forecasts a GRF ending balance of $190 million in fiscal 2016 (0.5% of GRF revenues) and $213 million in fiscal 2017 (0.6% of GRF revenues).

CONSERVATIVE DEBT MANAGEMENT

The state's debt management is generally conservative. Debt amortization is rapid, with all debt fully retired in 20 years and 78% of GRF-backed debt amortized in 10 years. Total tax-supported debt of $11.1 billion is equivalent to a manageable 2.3% of 2013 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, 2013, showed the benefit of the reform measures as the reported funded ratio increased to 82.4%. 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 of 6.1% for U.S. states.

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Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033