FITCH RATES OHIO GO HIGHWAY IMPROVEMENT BONDS 'AA+'; OUTLOOK STABLE

Fitch Ratings-New York-31 March 2016: Fitch Ratings has assigned an 'AA+' rating to the following general obligation (GO) bonds of the state of Ohio:

--$250 million GO highway capital improvement bonds, series S (full faith and credit/highway user receipts).

The bonds are expected to be sold via negotiation on April 12, 2016.

The Rating Outlook is Stable.

SECURITY:
General obligation, full faith and credit of the state of Ohio, excluding net lottery proceeds. The bonds are additionally secured by state highway user receipts.

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 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 of Ohio'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 February 2016, non-farm employment had reached only 97.2% of its pre-recession peak, below the U.S. state median of 103.7%. Job growth has lagged the U.S., most recently recording 1.6% year-over-year growth in February 2016 versus the U.S. rate of 1.9%.

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 BSF provides an important source of flexibility.

FISCAL 2016-2017 BUDGET BALANCED

The budget for the 2016-2017 biennium is balanced as enacted while incorporating further tax policy changes. Personal income tax (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. Through February 2016, tax revenues are meeting expectation overall, although personal income tax collections are slightly underperforming. Through the first half of the year, this had been offset by strong sales and use tax performance. These fell off fairly sharply in February, although they are still slightly exceeding the year-to-date forecast. Overall, the enacted budget was based on an assumption of GRF revenues, including transfers, increasing 10.8% in fiscal 2016 and 4.6% in fiscal 2017. This includes the impact of federal revenues for Medicaid expansion being shifted to the GRF as of fiscal 2016.

CONSERVATIVE DEBT MANAGEMENT

The state's debt management is generally conservative. Debt amortization is rapid, with all debt fully retired in 20 years and 82% of GRF-backed debt amortized in 10 years. Total tax-supported debt of $11.1 billion is equivalent to a manageable 2.3% 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.

As of Fitch's 2015 pension report, the combined 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 3.2% of personal income, well below the 5.8% median for U.S. states and the ninth lowest overall. Under GASB 68, the state is reporting a lower proportionate share of the PERS obligation than has been assumed in Fitch's prior reporting, 20.7% rather than the 45% noted above.

HIGHWAY BONDS PAYABLE FROM USER FEES

The current offering will finance highway capital improvements and while ultimately secured by the state's full faith and credit, the bonds are expected to be paid from state highway user receipts. These include fees, excises, and license taxes levied by the state relating to registration, operation, or use of vehicles on public highways as well as fuel taxes. Highway user receipts available for debt service have been a generally stable source of funding and provide ample coverage of debt service requirements.

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Date of Relevant Rating Committee: February 1, 2016.

Additional information is available at 'www.fitchratings.com'.

Fitch recently published an exposure draft of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015). The draft includes a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published the beginning of the second quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

Applicable Criteria
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
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