

## Fitch Rates Ohio's \$400MM GO Bonds 'AA+'; Outlook Stable

Written by Australian Business

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NEW YORK--( [BUSINESS WIRE](#) )--Fitch Ratings has assigned an 'AA+' rating to the following state of Ohio general obligation (GO) bonds:

--\$300 million common schools GO bonds, series 2013B (Tax-Exempt);

--\$100 million third-frontier research and development GO bonds, series 2013B (Federally Taxable).

The bonds are expected to sell via competitive bid on Sept. 17, 2013.

In addition, Fitch affirms the following ratings:

--\$8 billion outstanding state GO bonds at 'AA+';

--\$2 billion outstanding appropriations-backed bonds of the state at 'AA', including those issued by the Treasurer of State and previously by the Ohio Building Authority and the Ohio Public Facilities Commission.

The Rating Outlook is Stable.

SECURITY: General obligation, full faith and credit of the State of Ohio, excluding net lottery proceeds and highway user receipts.

KEY RATING DRIVERS

**BROAD ECONOMY WITH LARGE MANUFACTURING SECTOR:** The state's economy is broad and diverse, although the manufacturing sector continues to represent a disproportionately large segment of the economy. The state's economy is modestly expanding but at a slower pace than immediately following the recession.

**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 a manageable and 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, inclusive of surplus operating results in fiscal 2013, which provided for full funding of the state's budget stabilization fund (BSF). The budget enacted for the 2014-2015 biennium applies surplus revenues to pay for a large personal income tax rate cut while incorporating sizable growth in appropriations.

### RATING SENSITIVITY

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 generally careful financial management, ongoing record of maintaining fiscal balance, and a moderate, rapidly amortizing debt burden. Debt is supported by an economy that is steadily, albeit 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. However, the state has recorded consecutive months of year-over-year (y-o-y) job gains since July 2010, largely incorporating gains in the manufacturing sector as well as in the services sectors, offset by continued losses in government employment.

In the biennium that ended on June 30, broad budget balancing actions, notable growth in tax revenues, and the lease of the state's liquor distribution system to JobsOhio, a newly created not-for-profit economic development entity, enabled the state to record sizable operating surpluses and deposits to its rainy day fund. At the close of fiscal 2013, the state reports that its BSF was fully funded at 5% of general revenue fund (GRF) revenues.

### STEADY ECONOMIC GROWTH

The state steadily added jobs in 2011, evidenced by y-o-y growth in every month from July 2010, and 2012 evidenced a continuation of this positive trend with 1.5% annual growth recorded. Beginning in July 2012, monthly y-o-y growth slowed as compared to national averages, and the 1% growth reported in July 2013, when compared to 1.7% growth for the nation, continued this trend. The slow growth reflects a deceleration in manufacturing employment growth aided by more substantial growth in education and health services and leisure and hospitality, tempered by continuing losses in the government and construction sectors; down 1.5% respectively, y-o-y in July 2013.

Y-o-y through July 2013 state employment has increased by 51,700 jobs, yet employment remains well below its pre-recession peak that was set in 2006. Employment figures for 2012 show Ohio's annual employment growth in 2012 just below the national average: 1.5% as compared to 1.7% for the nation. The annual unemployment rate for 2012 was 7.2%; better than the 8.1% rate for the U.S. For July 2013, the differential in rates was slimmer; state unemployment measured 7.2% compared to a national rate of 7.4%.

Ohio's current unemployment rate is a notable improvement from rates that ranged above the national average in the recession, with an annual peak of 12.2% of the U.S. average in 2007. An increase in state personal income per capita to \$39,289 in 2012 (92% of the U.S.) from \$37,836 in 2011 reflects the economic improvements in the state.

### DEMONSTRATED ABILITY TO MANAGE BUDGET CHALLENGES

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Fiscal management practices in Ohio are sound and the state has consistently maintained budgetary balance, including during the recession. The state's fiscal position is substantially improved from the downturn, when the state employed one-time measures for fiscal relief.

The enacted budget for the 2012-2013 biennium that ended on June 30 cut spending and instituted Medicaid reforms. The budget directed the refunding of outstanding debt for current-year debt service savings in the first year of the biennium, the sale of state prisons for operational savings, the leasing of the state's liquor enterprise system, and the redirection of revenue to the state GRF by accelerating the phase-out of certain tax reimbursements to school districts and other local governments. One-time measures in fiscal 2012 were budgeted at \$1 billion with a drop to \$30 million in fiscal 2013.

GRF revenues in fiscal 2012 grew 3.1% from fiscal 2011, in contrast to a forecast 2.2% decline that was partly driven by a steep drop-off in federal stimulus funds. These results produced a \$129 million net increase in the GRF's cash balance, to \$973.4 million, after a \$235.1 million transfer to the BSF, increasing the BSF to \$482 million (about 1.8% of fiscal 2012 GRF revenue).

GRF actual revenues in fiscal 2013 were boosted by \$500 million in unbudgeted proceeds from the lease of the state's liquor distribution system to JobsOhio as well as robust PIT revenue that incorporated the acceleration of income into tax year 2012 due to anticipated federal tax law changes. The state reports revenue growth of 8.7% from actual receipts in fiscal 2012, including a 10.6% increase in tax receipts. Included in the growth are a 12.7% increase in PIT revenue and a 4.5% increase in non-auto sales tax revenue.

These results brought the state's fiscal 2013 ending cash balance to \$2.6 billion, \$995.9 million of which was transferred to the BSF, bringing its balance to \$1.478 billion, its statutory maximum of 5% of GRF revenues. The unencumbered GRF fund balance increased to \$1.11 billion, well above the statutorily required minimum fund balance of \$147.8 million. The difference between the actual ending unencumbered fund balance and the minimum required amount, \$963.1 million, has been reserved and is expected to be applied as an offset to the state's enactment of a three-year PIT rate reduction as part of the 2014-2015 biennial budget, adopted in the 2013 legislative session.

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The enacted budget for the 2014-2015 biennium authorizes GRF expenditures of \$30.26 billion in fiscal 2014 and \$31.7 billion in fiscal 2015. The fiscal 2014 budget is a 10.3% increase from estimated disbursements in fiscal 2013, incorporating 16.8% expected growth in the Medicaid program related to increased participation of currently eligible residents, although the state is not currently expanding its optional coverage as provided under the federal Affordable Care Act. While federal matching funds will increase in line with the increased participation, the state's baseline costs for the program are estimated to increase by \$186.3 million in fiscal 2014 (contributing to 12.2% state-share program growth) and \$334.8 million in fiscal 2015 (contributing to 6.5% state-share program growth). The legislature continues to review an expansion proposal and is expected to address this issue in the upcoming fall session.

As noted earlier, the budget also included a change to the PIT that will lower rates by 10% over three tax years beginning in 2013, increased the sales tax rate by 0.25% as an offset, reduced income taxes on small business owners, modified the K-12 education funding formula to provide additional state funding to lower-wealth districts, implemented new Medicaid cost-containment initiatives, redesigned the higher education funding formula to incorporate performance-based outcomes, and authorized a leveraging of the Ohio Turnpike system's revenues to fund key northern Ohio road projects.

The PIT rate reductions and tax modifications for small business owners are expected to result in a sizable amount of foregone revenue over the biennium and are only partly offset by the sales tax rate increase (revenue increased by \$319.1 million in fiscal 2014 and \$452.8 million in fiscal 2015, above the baseline forecast), some PIT index and exemption freezes, and other tax reform measures. Increasing sales tax revenue is also expected from the anticipated growth of medical health insurance corporations as health care coverage expands in the state. The PIT rate reductions are expected to reduce revenue compared to baseline by \$1.56 billion in fiscal 2014 and \$1.35 billion in fiscal 2015; the larger reduction in fiscal 2014 includes the retroactivity of the 8.5% rate change on withholding payments to Jan. 1, 2013. Included in these amounts is the income tax modification for small business owners that will result in \$515.8 million in foregone revenue in fiscal 2014 and \$537.8 million in fiscal 2015.

Based on the state's forecast of key economic variables, combined tax law changes are expected to result in GRF tax revenues declining by 4.9% in fiscal 2014 rather than a modest increase of 0.3% expected from baseline revenue growth from fiscal 2013. For fiscal 2015 the state projects GRF tax revenue growth of 8% which includes 11% expected growth in the PIT and a total of 7.8% growth in sales tax receipts. Fitch believes there is downside risk to the state's expectation of PIT growth given that employment growth in the state has slowed over the past 12 months. In the event of economic and revenue

under-performance, the application of fiscal 2013 surplus monies to the fiscal 2014-2015 operating budget could lead to structural imbalances beyond the 2014-2015 biennium.

### 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 \$11.4 billion is equivalent to a manageable 2.5% of 2012 personal income.

A \$1.78 billion capital improvement plan for FYs 2013 and 2014 was enacted in the 2012 legislative session and will be largely funded by \$1.4 billion of GRF-backed debt. The largest beneficiaries of the plan are higher education, primary and secondary education, and local infrastructure projects. Debt ratios are expected to approximate current averages as GRF principal continues to roll off. Personal income is also expected to continue to grow.

Funding for Ohio's pension systems has declined significantly, with the largest system, PERS, declining from a strong 96% funded ratio as of Dec. 31, 2007 to 77.4% funded as of Dec. 31, 2011, the most recent valuation date. Using Fitch's more conservative 7% discount rate assumption, PERS would have a 71.2% funded ratio. In September 2012, the governor signed several pieces of pension reform legislation targeted to improve the financial condition of all five Ohio pension systems. Reform measures affected employee contributions, number of years of service credit, minimum retirement age, cost of living calculations, and final average salary calculation.

On a combined basis, the burden of the state's net tax-supported debt and adjusted unfunded pension (UAAL) obligations equals 3.9% of 2012 personal income; well below the median of 7% for U.S. states rated by Fitch. The calculations include 45% of the liability of PERS that Fitch estimates to be attributable to the state and a small share of the teachers' retirement system (TRS) UAAL for which the state is responsible.

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

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](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](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033)

Additional Disclosure

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