State of Indiana

General Government
Full Rating Report

Ratings

State of Indiana

Issuer Default Rating	AAA
Indiana Finance Authority	
Lease Revenue Bonds	AA+
Lease Appropriation Bonds	AA+
Lease Appropriation Refunding Bonds	AA+
Facilities Revenue Refunding Bonds	AA+
Highway Revenue Refunding Bonds	
Revenue Bonds	AA+
Revenue Refunding Bonds – State Appropriation	AA+
East End Crossing Project Federal Transportation Infrastructure Finance and Innovation Act Loan	AA+

Rating Outlook
Stable

Related Research

Fitch Rates Indiana Finance Authority's $134MM State Appropriation Bonds 'AA+'; Outlook Stable (May 2016)

2016 Outlook: U.S. States (Credit Stability but Budgeting Remains a Challenge) (December 2015)

2015 State Pension Update (October 2015)

U.S. States: The Rising Cost of Care (How Medicaid Costs Affect State Budgets and Credit Ratings) (July 2015)

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The 'AAA' Issuer Default Rating (IDR) reflects Indiana's low long-term liability burden and strong operating profile including a commitment to structural budget balance and rapid restoration of fiscal flexibility during economic expansions. Cyclical declines can be challenging, with an above-average susceptibility of state revenues to weakness during recessions.

Key Rating Drivers

Economic Resource Base: Despite ongoing diversification, Indiana's economy remains highly dependent on manufacturing. The state is prone to large swings in conjunction with national business cycles and is also likely to see slower overall growth than the nation. Despite the manufacturing concentration, Indiana's overall economic profile is solid, with jobs growth slightly ahead of the national trend since the Great Recession and education and health services becoming nearly as important as manufacturing.

Revenue Framework ('aa' factor assessment): Fitch Ratings expects Indiana's revenues — primarily income and sales taxes — will continue to reflect the depth and breadth of the economy, but also its slower pace of growth. The state has complete legal control over its revenues.

Expenditure Framework ('aaa' factor assessment): The state maintains ample expenditure flexibility with a low burden of carrying costs for liabilities and the broad expense-cutting ability common to most U.S. states. Also, as with most states, Medicaid remains a key expense driver but one that Fitch expects to remain manageable.

Long-Term Liability Burden ('aaa' factor assessment): Indiana's long-term liability burden is just below the median for states and is well managed. Since establishment of the Indiana Finance Authority in 2005, debt issuance and management have been centralized. The state issues debt infrequently, has been active in the public-private partnership (PPP) market, and also relies on pay-as-you-go capital funding. The burden of unfunded pensions is higher than the debt burden, but manageable. The closed Teacher's pre-1996 account utilizes a dedicated Pension Stabilization Fund to manage growth of annual contributions for the plan.

Operating Performance ('aaa' factor assessment): Indiana remains extremely well-positioned to deal with economic downturns, with very strong gap-closing capacity in the form of ample budgetary reserves, the state's control over revenues and spending and a demonstrated willingness to take timely budgetary action. The state tends to rely on its significant expenditure control to deal with budgetary stress. As revenues recover, Indiana restores many of those cuts and focuses on reserve restoration.

Rating Sensitivities

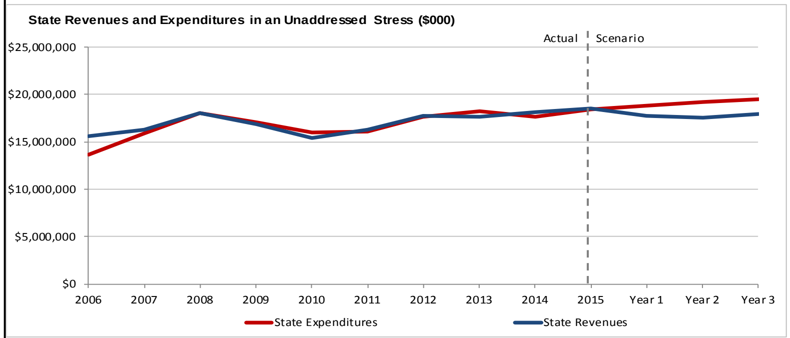
Fundamental Credit Characteristics: The state's ratings are sensitive to shifts in fundamental credit characteristics, including Indiana's manufacturing-centered economic profile, proactive and conservative financial management, and very manageable long-term liabilities.

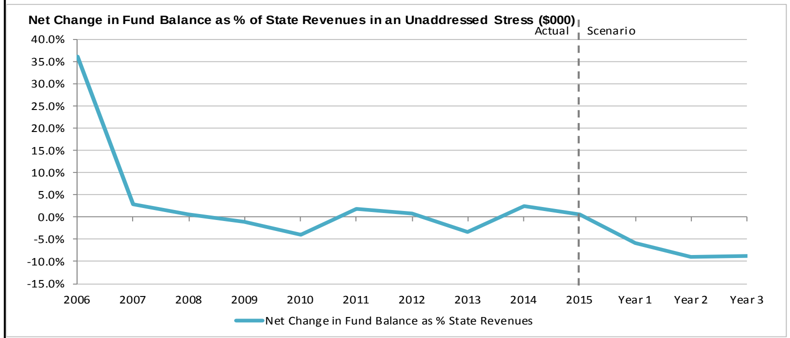
Appropriation-Backed Bonds; TIFIA Loan: Ratings for Indiana's appropriation-backed debt, including a loan with the federal Transportation Infrastructure Finance and Innovation Act (TIFIA) program, are sensitive to changes in the state's 'AAA' IDR, to which they are linked.

Indiana, State of (IN)

Scenario Analysis

v. 1.02 2016/05/17





Analyst Interpretation of Scenario Results:

Indiana's ability to respond to cyclical downturns rests with its superior budget flexibility. Conservative fiscal practices and a somewhat concentrated, but still diverse, economy provide sufficient resources to the state to gradually restore fiscal flexibility once utilized. Indiana typically responds to budgetary stress with spending restraint and use of budgetary reserves. After a budget is enacted, the budget agency has significant statutory authority to administer the budget and scale back spending as needed, allowing the state to be responsive to changing conditions.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(4.2%)	(1.0%)	2.2%

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Year 1	Year 2	Year 3
Expenditures													
Total Expenditures	20,868,301	23,693,587	26,078,274	26,557,904	26,466,207	26,812,510	28,494,102	29,497,921	29,011,823	30,256,472	30,861,601	31,478,833	32,108,410
% Change in Total Expenditures	(3.3%)	13.5%	10.1%	1.8%	(0.3%)	1.3%	6.3%	3.5%	(1.6%)	4.3%	2.0%	2.0%	2.0%
State Expenditures	13,645,367	15,899,930	17,991,105	17,098,564	15,996,364	16,028,703	17,666,922	18,237,491	17,681,857	18,405,724	18,773,838	19,149,315	19,532,302
% Change in State Expenditures	(6.7%)	16.5%	13.2%	(5.0%)	(6.4%)	0.2%	10.2%	3.2%	(3.0%)	4.1%	2.0%	2.0%	2.0%
Revenues													
Total Revenues	22,830,000	24,114,215	26,150,819	26,353,047	25,840,108	27,095,752	28,575,479	28,877,170	29,425,065	30,347,309	29,808,711	29,877,205	30,516,487
% Change in Total Revenues	6.0%	5.6%	8.4%	0.8%	(1.9%)	4.9%	5.5%	1.1%	1.9%	3.1%	(1.8%)	0.2%	2.1%
Federal Revenues	7,222,934	7,793,657	8,087,169	9,459,340	10,469,843	10,783,807	10,827,180	11,260,430	11,329,966	11,850,748	12,087,763	12,329,518	12,576,109
% Change in Federal Revenues	3.6%	7.9%	3.8%	17.0%	10.7%	3.0%	0.4%	4.0%	0.6%	4.6%	2.0%	2.0%	2.0%
State Revenues	15,607,066	16,320,558	18,063,650	16,893,707	15,370,265	16,311,945	17,748,299	17,616,740	18,095,099	18,496,561	17,720,948	17,547,687	17,940,378
% Change in State Revenues	7.1%	4.6%	10.7%	(6.5%)	(9.0%)	6.1%	8.8%	(0.7%)	2.7%	2.2%	(4.2%)	(1.0%)	2.2%
Excess of Revenues Over Expenditures	1,961,699	420,628	72,545	(204,857)	(626,099)	283,242	81,377	(620,751)	413,242	90,837	(1,052,890)	(1,601,628)	(1,591,923)
Total Other Financing Sources	70,994	63,935	34,271	12,146	20,986	5,613	73,368	15,224	15,424	11,159	24,158	27,867	18,766
Net Change in Fund Balance	5,651,220	484,563	106,816	-192,711	-605,113	288,855	154,745	-605,527	428,666	101,996	-1,028,732	-1,573,762	-1,573,157
% Total Expenditures	27.1%	2.0%	0.4%	(0.7%)	(2.3%)	1.1%	0.5%	(2.1%)	1.5%	0.3%	(3.3%)	(5.0%)	(4.9%)
% State Expenditures	41.4%	3.0%	0.6%	(1.1%)	(3.8%)	1.8%	0.9%	(3.3%)	2.4%	0.6%	(5.5%)	(8.2%)	(8.1%)
% Total Revenues	24.8%	2.0%	0.4%	(0.7%)	(2.3%)	1.1%	0.5%	(2.1%)	1.5%	0.3%	(3.5%)	(5.3%)	(5.2%)
% State Revenues	36.2%	3.0%	0.6%	(1.1%)	(3.9%)	1.8%	0.9%	(3.4%)	2.4%	0.6%	(5.8%)	(9.0%)	(8.8%)

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. For further details, please see Fitch's US Tax-Supported Rating Criteria.

Rating History — IDR

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	5/20/16
AAA	Assigned	Stable	10/15/14

Rating History — State Appropriation

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	5/20/16
AA+	Revised	Stable	4/5/10
AA	Affirmed	Stable	8/16/06
AA	Upgraded	—	5/31/00
AA-	Assigned	—	1/12/98

Rating History — East End Crossing Loan Obligations

Rating	Action	Outlook/ Watch	Date
AA+	Affirmed	Stable	5/20/16
AA+	Assigned	Stable	4/8/15

Related Criteria
U.S. Tax-Supported Rating Criteria (April 2016)

Credit Profile

Revenue Framework

Indiana primarily relies on its sales and use tax and individual income tax for general operating revenues. Together, they account for 80%–90% of general fund revenues. The sales and use tax has gradually become more important and this trend will likely continue given personal income tax reductions enacted into law several years ago that are being phased in.

Historical revenue growth, adjusted for the estimated impact of policy changes, has been essentially flat on a real basis over the last 10 years. Sharp declines during the recession offset strong gains in the years leading into it. Since then, revenue growth has generally been slow. Fitch anticipates the long-term trend for revenue growth will be in line with historical performance. Indiana has no legal limitations on its independent ability to raise revenues through base broadenings, rate increases, or the assessment of new taxes or fees.

Expenditure Framework

Education is the dominant spending item for Indiana given that the state essentially fully funds basic education costs for grades K–12. Local education aid consumes roughly one-half of general fund expenditures annually. Medicaid is the next largest area of spending for the state and the most rapidly growing one. Between 2009 and 2015, Medicaid spending grew between 8% and 9% on an average annual basis while overall general fund expenditures increased at a 2.6% average annual rate.

Spending growth, absent policy actions, will likely be slightly ahead of revenue growth driven primarily by Medicaid, requiring regular budget measures to ensure ongoing balance. The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program as well as federal government rules limit the states' options in managing the pace of spending growth. In other major areas of spending such as education, Indiana is more able to adjust the trajectory of growth since it does not retain responsibility for direct service delivery. This is true even for education spending as the state appropriates money to local school districts rather than operating any schools itself.

Indiana retains ample expenditure flexibility. While Medicaid costs are somewhat beyond the state's ability to materially change given federal requirements for the program, the state's carrying costs for liabilities are minimal. Like most states, Indiana's operating budget (outside of Medicaid) goes largely towards funding of services rather than direct service delivery allowing the state to shift costs to lower levels of government in times of fiscal stress.

Long-Term Liability Burden

Indiana maintains a modest long-term liability burden that should remain very manageable. Per Fitch's October 2015 state pension update report, the state's total net tax-supported debt and unfunded pension liabilities of $15 billion made up just 5.71% of 2014 personal income compared to the 50-state median of 5.8%.

Debt is limited to capital needs and the state is not a regular issuer. GO bonds are prohibited under state law, so Indiana has a long history of using appropriation-backed bonds to meet its capital borrowing demands. The state has been a leader in utilizing PPPs, particularly for transportation needs. The largest of these projects use an availability-payment structure with payments derived from state appropriations. Fitch incorporates estimates for the outstanding related project debt on these PPPs in its assessment of long-term liabilities. While the total amounts are substantial and account for approximately one-third of total net tax-supported debt, overall debt levels remain very modest.

The state maintains close control over its pension system, with all but one small system under the oversight of the Indiana Public Retirement System (INPRS). The Public Employees' Retirement Fund (PERF) and the Indiana Teachers' Retirement Funds (TRF) are the state's primary retirement systems. The TRF includes a pay-as-you-go pre-1996 account (closed to new members) that is supported by a substantial reserve fund (Pension Stabilization Fund) meant to smooth annual growth in state contributions to support benefits.

Operating Performance

Indiana's ability to respond to cyclical downturns rests with its superior budget flexibility. Conservative fiscal practices and a somewhat concentrated, but still diverse, economy provide sufficient resources to the state to gradually restore fiscal flexibility once utilized. Indiana typically responds to budgetary stress with spending restraint and use of budgetary reserves. After a budget is enacted, the budget agency has significant statutory authority to administer the budget and scale back spending as needed, allowing the state to be responsive to changing conditions.

As revenues recover in economic expansions, the state works toward restoring prior year cuts and rebuilding reserves. By fiscal 2012, the state had essentially reached its statutory cap for budgetary reserves (12.5% of operating revenues in the final year of each biennium); since then, excess funds have been refunded to taxpayers, directed towards pay-as-you-go capital needs, or used to defease debt. The bulk of the reserves is in the form of unrestricted general fund balance with smaller portions in a Medicaid reserve, the rainy day fund, and a tuition reserve for grades K–12 education. Education funding has also been increased in recent budgets, particularly in the current fiscal 2015–2017 biennial budget, after recessionary cutbacks.

Current Developments

Indiana ended fiscal 2015 with another reported operating surplus (a modest $210.4 million, or 1.4% of operating revenues), even as general fund revenues fell just short of the forecast. The state, as it regularly does, utilized spending reversions to bring down expenditures midyear as revenue collections showed signs of modest weakness relative to the forecast.

Based on the December 2015 revenue forecast technical committee projection, the state forecasts fiscal 2016 operating revenues will be essentially flat versus the prior year ($68 million, or 0.4%, increase). Earlier in the fiscal year, the governor implemented a 3% executive agency spending reversion (excluding higher education) to ensure budgetary balance in light of the tepid growth expectations. Given its continued prudent budget management Fitch expects the state will end the current year in structural balance with stable reserves. Revenue through April is in line with the December forecast, with slight overperformance in individual and corporate income tax collections offsetting sales and use tax weakness.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.