S&P Global
Ratings

# RatingsDirect®

# Indiana
# Indiana Finance Authority; Appropriations; General Obligation; Moral Obligation

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# Indiana
# Indiana Finance Authority; Appropriations; General Obligation; Moral Obligation

| Credit Profile | | |
|---|---|---|
| Indiana ICR | | |
| *Long Term Rating* | AAA/Stable | Affirmed |
| **Indiana Bond Bank, Indiana** | | |
| Indiana | | |
| Indiana Bnd Bank (Indiana) MORALOB | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Indiana Bnd Bank (Indiana) (AGM) | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| **Indiana Finance Authority, Indiana** | | |
| Indiana | | |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |

## Credit Highlights

- S&P Global Ratings affirmed its 'AAA' issuer credit rating (ICR) on Indiana, its 'AA+' rating on the state's appropriation debt, and its 'AA' rating on the Indiana Bond Bank's moral obligation debt.
- S&P Global Ratings also affirmed its 'AA' long-term ratings on the Indiana Finance Authority (IFA)'s Railroad and Rehabilitation and Improvement Financing (RRIF) program loans (supporting the Double Track [DT] and West Lake Corridor commuter Rail Project [WLC Project]).
- The outlook on all ratings is stable.

### Security

We rate Indiana's appropriation debt one notch lower than the state's general creditworthiness to reflect the appropriation risk associated with the annual payment. Our rating on the state's moral obligation debt is two notches lower than the state's general creditworthiness, reflecting our view of the preponderance of factors associated with the state's moral obligation.

The Rail Rehabilitation and Improvement Financing (RRIF) loans are secured and payable solely from a pledge of the trustee of the trust estate in accordance with each of the trust indentures between the IFA and its trustee (Bank of New York Mellon [BNY]). The trust estates include revenues on deposit in the IFA Regional Development Authority (Northwest Indiana RDA) in respective accounts for each project, established pursuant to a revenue trust agreement among the IFA, the RDA, the Northern Indiana Commuter Transportation District (NICTD), and BNY (as deposit trustee and bond trustee under the indentures). Revenues in the IFA RDA's respective accounts are derived from annual member dues (statutorily defined) from five entities ($3.5 million each).


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WLC is further secured by a pledge of local income taxes from 16 local units of government (statutorily authorized) owed to RDA. Member dues and local income tax contributions are collected by the state treasurer and state comptroller, respectively, and will be subsequently remitted to the deposit trustee before being released into the IFA RDA's respective accounts under the trust fund agreement based on rental payments owed by the RDA to the IFA (pursuant to separate master leases). Funds are subsequently transferred to the debt service fund under the indentures to satisfy debt service when due. Income tax contributions from the local units of government are, by statute, withheld according to a prescribed schedule before being released to the entity. In the event a member's dues are not paid in full, the state treasurer is authorized to intercept any revenue, excluding local property taxes, payable to the entity as prescribed in statute.

We rate the bonds under our "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Nov. 20, 2019). While we link the obligation to the State of Indiana (AAA/Stable), it has not pledged, committed, or appropriated state resources to the RRIF loan agreements. We rate these bonds two notches below the state's rating, reflective of the state's moderate involvement in the projects being financed, strong coverage over the last two years, our expectation that it will remain at least adequate in the near term, and no timing and administrative risks given the collection cycle of pledged revenues and the state's ability to intercept certain revenues.

## Credit overview

In our view, Indiana's credit profile is strengthened by its strong budgetary reserves and its financial oversight and management. A key credit consideration for the state has been the path its manufacturing sector follows, which currently represents the second-largest portion of its employment base, and the state's economy has followed the steady U.S. economic expansion in recent years. Finally, the state's low overall debt profile, with manageable pension liabilities, is another factor supporting its credit profile.

The state is nearly halfway through the 2023-25 biennium budget enacted last year. It included an 8% increase in kindergarten-through-grade 12 (K-12) education funding, notable economic development investments, and provided funding increases to starting salaries for law enforcement. The budget also included strategic one-time investments, such as $1.25 billion in fiscal 2023 to finish remaining capital projects funded in the 2021-23 biennium budget, and an additional one-time payment of $700 million for the pre-1996 teachers' retirement fund. In addition, the budget expedited previously enacted income tax cuts to reach its final rate by 2027, rather than 2029, and removed trigger mechanisms. Overall, the state's as-passed budget is balanced and left sizable surpluses in both fiscal years over the course of the biennium.

About halfway through fiscal 2024, the state announced it could miss its Medicaid expenditure forecast by about $984 million by the end of fiscal 2025, primarily driven by increasing costs related to long-term services and supports, particularly home and community-based services. Budget reversions and somewhat lagging data used in the budget-setting process led to a different expenditure figure at the time the budget was enacted. Upon discovering the budget issue, the state resolved it using a balanced approach of fund reversions, cost-containment strategies, and usage of its Medicaid reserve. At the same time, the state is evaluating operational improvements, such as how to incorporate more up-to-date data in the budget process, to avoid facing this in the future. We believe the state's management of this cost escalation not included in the budget displays its consistent oversight mechanisms, and that its focus on replenishing reserves in positive budgetary times allowed it to have a stabilizing tool to navigate the



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pressure.

The state is forecasting maintaining strong reserves over the course of the biennium. The state's rainy day fund, state tuition, and Medicaid reserves are estimated to total 8.2% of fiscal 2024 expenditures and increase to 9.2% of expenditures in fiscal 2025. The growth over the biennium reflects increases to both the rainy day fund and the school tuition account. Including the state's ending general fund balance, there are an estimated combined total 10.4% and 10.3% of appropriations in 2024 and 2025, respectively. We view the state's buildup of reserves in strong budgetary periods as a strength, given the cushion it provides the state to navigate potential pressures.

Currently, S&P Global Ratings' economists are forecasting steady U.S. real GDP growth of 2.5% in 2024, based on a sturdy labor market, and still expects the economy to transition to slightly below potential growth in the next couple of years. Overall, we expect inflation will remain above the Fed's 2% target through 2024, primarily reflecting persistently higher service price inflation. We expect real GDP growth to be 1.5% in 2025 and 1.7% in 2026. For more information, see "Economic Outlook U.S. Q2 2024: Heading For An Encore," published March 26, 2024, on RatingsDirect. We anticipate that Indiana will follow similar trends to that of the national economy over the near term.

The ICR reflects our opinion of the state's:

- Maintenance of strong budgetary reserves, with a combined amount totaling 10.4% of appropriations in fiscal 2024 and 10.3% in fiscal 2025;
- Active budget management, with practices that have been consistently applied to maintain sound reserve levels, including the administration's willingness to use its power to align appropriations with conservative revenue estimates and implement a lower cost structure;
- Historically modest economic growth across sectors, albeit at a slower pace than the nation as a whole, but benefiting in recent years from enhanced economic development investments; and
- Low overall debt levels, but with significant contingent liabilities tied to infrastructure investment projects that could result in higher debt levels if toll revenues fall short of expectations.

Indiana's ICR is eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013), U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, and the institutional framework in the U.S. is predictable, with significant state autonomy and flexibility.

Based on the analytic factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a composite score of '1.5' to Indiana, which equates to an indicative rating score of 'AAA'.

### Environmental, social, and governance

We consider the state's social factors to be credit neutral, although its aging population and limited population growth historically could weigh on its demographic profile in the longer term, absent an improvement. We view the state's governance and environmental factors as being neutral within our credit rating analysis. Indiana has historically maintained a strong management and policy framework to respond to developing risks.



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## Outlook

The stable outlook reflects our view that management will continue its historical trend of strong oversight and aligning revenues with expenditures to ensure balance. It also reflects our expectation that the state will continue to monitor any unexpected budgetary challenges should they arise, and will respond in a timely manner.

### Downside scenario

Should the state experience sustained budgetary stress that results in management being unable to align revenues and expenditures, leading to material decreases in its reserves, we could lower the rating. While we anticipate the state's economic metrics will remain below national levels, should the gap materially widen, we could also lower the rating.

## Credit Opinion

## Governmental Framework

In 2018, the state's electorate supported a constitutional amendment requiring a balanced biennial budget. A suspension of the requirement is only feasible with a supermajority (two-thirds) approval from both legislative chambers, respectively. Embedding this requirement into the state's constitution strengthened the state's governmental framework, in our view. We continue to view the state's proactive mechanisms in place, which provide it with the flexibility to adjust both revenues and expenditures if it believes it is necessary, as a credit strength. For example, only a simple majority of the legislature is required to raise taxes, and there is no constitutional constraint on the amount of the increase. Additionally, state statute provides that the state budget director, with the approval of the governor, can withhold allotments of appropriations to agencies if revenues are less than anticipated to prevent revenue and appropriation misalignments. Indiana has historically used its allotment authority to avoid deficits when revenues are falling short of targets. The state provides a limited level of assistance to local governments, but fully funds local school general operations as a result of the property tax reform passed in 2008. In fiscal 2010, the administration used its allotment power and withheld funds from schools, displaying some flexibility within its expenditure authority. Indiana also used its allotment power between 2013-2015. It is not a voter initiative state, which we believe provides some stability.

Indiana's constitution does not allow new debt, except to meet casual deficits in revenue, pay interest on state debt, or provide funds for public defense. As a result, the state has no general obligation (GO) or tax-supported debt, but does have appropriation-backed debt, which is required to be authorized by the legislature. This requirement for legislative approval does not apply to availability payment agreements, which are approved under the state's Public-Private Partnership Agreement (Indiana Code 8-15.5) and only require approval from the budget committee, which, while including legislators, does not include the fully legislative body and the governor. In 2014, Indiana adopted a debt policy that limits total appropriation debt, including availability payments, to 15% of the previous year's revenues. Given that the state's debt is appropriation-backed, there is no legal priority for debt payments.

On a four-point scale, in which '1.0' is the strongest and '4.0' is the weakest, we assigned a score of '1.1' to Indiana's



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governmental framework.

## Financial Management

We consider Indiana's financial management practices good under our Financial Management Assessment (FMA) methodology. An FMA of good indicates that practices exist in most areas, although not all might be formalized or regularly monitored by governance officials. In terms of revenue assumptions and forecasts, the state convenes every December with the Revenue Forecast Technical Committee, consisting of members from the executive branch, House, and Senate, along with economists, to prepare the upcoming revenue forecast. The same group updates the revenue forecast in April of odd-numbered years and compares the budget with the April forecast. The forecast is presented every December and in April of odd-numbered years to the state budget committee. The state has a biennium budget process, and standard practice is to not amend the budget. However, the budget director has the power to forego allotting appropriations. While the state performs some longer-term forecasts internally, they are not produced on a consistent basis and no formal long-term forecasts are maintained. In terms of long-term capital planning, state agencies and universities provide formal long-term plans for five years and 10 years, respectively, and the IFA requires long-term capital plans for lease transactions.

The state maintains its own investment policy that requires regular reporting. The state's debt management policies are comprehensive and include a well-defined swap management policy. In addition, the state has a policy that limits appropriation debt to 15% of the previous year's revenues. In terms of liquidity and reserves, the state has an informal goal of maintaining 10%-12% of annual operating revenues in the general fund.

### Budget management

Once the budget is approved, the state monitors revenue and expenditure performance monthly. With the approval of the governor, the state budget director can withhold allotments of appropriations to agencies if revenues are less than anticipated, toward preventing a deficit. Budget adjustments have historically been implemented on a regular and timely basis.

On a four-point scale, in which '1.0' is the strongest and '4.0' is the weakest, we assigned a score of '1.5' to Indiana's financial management.

## Economy

Indiana's economic performance has tended to follow national trends, although, with its large manufacturing presence, it has been sensitive to industry cycles. However, the state's concentration in manufacturing has slightly decreased over time, from 19% in 2006 to 16.5% in 2023. According to S&P Global Market Intelligence, the state's top manufacturing sectors include transportation equipment, fabricated metals, primary metals, machinery, and food. The largest sector in the state is trade (19.6%), followed by manufacturing (16.5%), and education and health services (14.7%). Indiana's concentrated level of manufacturing is 8.3% above national levels.

Although key economic and demographic indicators have improved in the last five years, they continue to lag national



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averages. While population growth exceeded or was in line with the nation in four out of the last 10 years, the state's population compound annual growth rate (CAGR) was 0.42%, compared with the nation's 0.56%. Indiana's age dependency is 66.4, slightly above the nation's of 64.4. In our view, weak population growth could somewhat limit employment growth in the long term. Indiana's real gross state product (GSP) growth of 1.4% in 2023 was below the nation's GDP growth of 2.5%; however, the state's overall GSP has remained stable, at 87%-89% of the nation's GDP historically, and 89% of the U.S. in 2023 on a per capita basis.

We believe Indiana's relatively low cost of living and business-friendly legislation and regulatory practices continue to make it an attractive target for firms looking to expand and relocate their operations when economic conditions improve. The Indiana Economic Development Corp. (IEDC) leads the state's job creation efforts by trying to attract increased investment in several key areas, including advanced manufacturing, agriculture, life sciences, and defense and national security. The 2023-25 biennium budget included a new $500 million deal closing fund, provided additional resources for large economic development deals over $5 billion, and created a new site acquisition fund for shovel-ready development projects, as well as investing an additional $500 million in the state's Regional Economic Acceleration and Development Initiative (READI) program. The state's enhanced investments into its economic development strategy have resulted in positive gains, with the first quarter of 2024 posting the state's largest committed capital investment in its history, driven by numerous companies locating or expanding in the state, and ultimately leading to new jobs. We expect recent investments will continue to support IEDC's efforts over the course of the biennium, likely leading to further economic development.

On a four-point scale, in which '1.0' is the strongest and '4.0' is the weakest, we assigned a score of '2.4' to Indiana's economy.

## Budgetary Performance

Indiana's financial management and oversight led it to finish the 2021-23 biennium on solid footing, with strong budgetary reserves heading into the new biennium. The state enacted its 2023-25 biennial budget last year, which recognized a roughly 20% general fund expenditure increase from the previous biennium. Appropriations for public education (K-12 and higher education) and Medicaid account for 71% of the biennium's general fund appropriations. The state's primary sources of general fund revenue are personal income tax and sales tax, at 36.5% and 49.5% of forecast general fund revenues, respectively, for the 2023-25 biennium.

In the 2023 legislative session, the state expedited its planned personal income tax cuts, with decreases from 3.15% in 2023 to 2.9% by 2029, subject to certain revenue triggers. The personal income tax rate will now reach 2.9% by 2027, and trigger mechanisms were removed. In addition, the state passed further tax relief, including military exemptions, earned income tax credit updates, and additional tax deductions for adoptive parents. While we believe revenue triggers are prudent measures to include in tax legislation to ensure strong revenue performance before tax cuts, we believe the state's cautious planning, specifically budgeting for larger-than-typical surpluses, is a helpful mechanism to adjust to the phased-in lower rates over the course of the biennium.

The state has a statutory reserve cap of 12.5% of revenues as a percentage of the following year's appropriation. Any


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amounts in excess of that cap are equally divided among payments to pension funds and to an automatic taxpayer refund, except in 2016, in which any balance in excess of 11.5% at the end of fiscal 2016 was used to fund transportation improvements. The reserves must exceed the cap by $50 million to trigger the transfer, which only occurs in budget years. In fiscal year 2021, given the state's strong budgetary performance, $545.3 million was allocated for taxpayer refunds and another $545.3 million to the state's pension funds. In fiscal 2022, the state distributed $2.5 billion toward the state's pensions, and several hundred million for taxpayer refunds, was triggered as a result of the reserve cap. As adopted, the current biennial budget maintains its combined reserves at 8.2% of fiscal 2024 appropriations and 9.2% of fiscal 2025 appropriations.

Indiana has maintained sufficient liquidity to avoid cash flow borrowing. It does not have a history of issuing short-term debt for cash flow purposes.

### Fiscal 2023 audited results

On a generally accepted accounting principles (GAAP) basis, Indiana's assigned and unassigned general fund balance was $8.0 billion, or 39.4% of general fund expenditures. The state recognized a 2.7% deficit in the general fund after transfers, driven by large transfers out of the general fund, primarily to the public welfare Medicaid assistance fund ($3.1 billion), with an additional $451.5 million to another fund to match federal grants. The total general fund balance decreased from $9.7 billion, as restated, to $9.2 billion.

On a four-point scale, in which '1.0' is the strongest and '4.0' is the weakest, we assigned a score of '1.3' to Indiana's budgetary performance.

## Debt And Liabilities

We view Indiana's debt burden as low. Given that Indiana's constitution does not allow for new debt (see Governmental Framework section), the state has no GO or tax-supported revenue debt, but it does have appropriation-backed debt. For fiscal 2023, debt levels were $186 per capita and 0.3% of personal income, both of which we consider low. Debt service accounted for about 0.7% of general governmental spending and 0.3% of GSP, both of which we also consider low. Debt amortization is rapid, in our view, with approximately 75% of principal amortized over 10 years. We currently do not include bond bank debt that is secured by the state's moral obligation pledge, which totaled approximately $73 million (as of June 30, 2023). While Indiana has appropriated fee-replacement debt for the university in the past, there is no appropriation pledge supporting the bonds and the state is not obligated to appropriate for it in the future. Therefore, we do not include the university fee-replacement debt in Indiana's debt calculation.

### Pension liabilities

Indiana maintains a variety of pension plans, of which the Teachers Retirement Fund (TRF Pre-1996) and the Public Employees Retirement Fund (PERF) represent the largest proportionate shares of the state's unfunded pension liability. The Indiana State Teachers' Retirement Fund consists of the closed pre-1996 account and the new 1996 account. In 1996, Indiana closed the plan and moved new hires to actuarially sound plans. The new plan, which is the responsibility of school districts, includes transferred teachers from the state plan.



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The state funds the closed pre-1996 account on a pay-as-you-go basis, and the fund was approximately 62% funded in 2023; the total pension liability was $13.7 billion with the state's proportionate share at $5.2 billion. The PERF's pension-funded ratio was 81%, with a total pension liability of $4.8 billion, in 2023, of which the state's proportionate share was approximately $915 million. In order to address the significant unfunded liability in the TRF Pre-1996 plan, Indiana established a pension stabilization fund, which should limit the annual growth rate for the TRF Pre-1996 to less than historical revenue growth rates. The pension stabilization fund is a dedicated fund in the TRF Pre-1996 plan, designed to accumulate balance during a 12-year period. The fund is allowed to smooth out yearly general fund contribution growth to less than 3%; the original statute allowed use of the fund to start in 2007.

We calculate the combined pension-funded ratio over the previous three years at 74%, which we view as relatively low, although an improvement from 67% in 2021. In our opinion, while our calculated pension funding ratio is relatively low, our holistic assessment captures the relative weight and risk associated with the state's pre-1996 plan. Given that the pre-1996 plan is structured as a pay-as-you-go plan, appropriations will fund actuarially determined contributions (ADC) in their entirety when they equal the expected benefit payment. Peak appropriations are expected to occur within the next couple of years. To the extent that the state will continue to support all its plans, the relative risk within the short-to-medium term is manageable, in our view. Our assessment also captures the relatively well-funded status of the state's other plans, which in aggregate are weighted down by the pre-1996 plan. The state exceeded its aggregate service costs, interest costs and amortization component for PERF in 2023, and the five-year average rate of return is 6.26%, slightly above the assumed rate of return at 6.25%. For each of the last three fiscal years, our calculation of plan contributions exceeds the total costs, which we expect will continue, reflective of the state's strong funding discipline.

PERF assumes a closed amortization schedule with 20-year amortization based on level dollar. The system ratio of active members to beneficiaries is 1:2, and has been on a declining trend in recent years. PERF incorporates experience trends and industry standards through experience studies produced every five years.

The pension relief fund, a holding account administered by the Indiana Public Retirement System, was created to support local governments with their legacy police and firefighter retirement plans. These pay-as-you-go plans include the 1925 Police Pension Fund, 1937 Police Pension Fund, and 1953 Pension Fund. While the liabilities belong to the local entities, the state has assumed 100% of the cost. Funding is provided through general fund appropriations, lottery proceeds, cigarette taxes, alcohol taxes, and investment income. Benefits are paid on a pay-as-you-go basis.

In terms of other postemployment benefits (OPEB), we view the net liability as manageable at roughly $85 million, or slightly less than $12 per capita. The state is currently funding the OPEB liability on a pay-as-you-go basis.

On a four-point scale, in which '1.0' is strongest and '4.0' is the weakest, we assigned a score of '1.4' to Indiana's debt and liability profile.

## Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022



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| Ratings Detail (As Of April 16, 2024) | | |
|---|---|---|
| **Indiana Bond Bank, Indiana** | | |
| Indiana | | |
| Indiana Bnd Bank (Indiana) MORALOB | | |
| *Long Term Rating* | AA/Stable | Affirmed |
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| *Long Term Rating* | AA/Stable | Affirmed |
| Indiana Bnd Bank (Indiana) MORALOB | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Indiana Bnd Bank (Indiana) MORALOB (AGM) | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| Indiana Bnd Bank (Indiana) MORALOB (AGM) | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| Indiana Bnd Bank (Indiana) MORALOB (AMBAC) | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| Indiana Bnd Bank (Indiana) MORALOB (MBIA) (National) | | |
| *Unenhanced Rating* | AA(SPUR)/Stable | Affirmed |
| **Indiana Finance Authority, Indiana** | | |
| Indiana | | |
| Indiana Fin Auth (Indiana) corridor-commuter rail (Double Trk Proj) ser 2022 due 11/01/2054 | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| *Unenhanced Rating* | NR(SPUR) | |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| *Unenhanced Rating* | NR(SPUR) | |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
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| *Long Term Rating* | AA+/Stable | Affirmed |



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| Ratings Detail (As Of April 16, 2024) (cont.) | | |
|---|---|---|
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA+/Stable | Affirmed |
| Indiana Fin Auth (Indiana) APPROP | | |
| *Long Term Rating* | AA/Stable | Affirmed |
| **Indiana State Office Building Commission, Indiana** | | |
| Indiana | | |
| Indiana St Office Bldg Comm (Indiana) APPROP | | |
| *Unenhanced Rating* | AA+(SPUR)/Stable | Affirmed |
| Indiana St Office Bldg Comm (Indiana) APPROP | | |
| *Unenhanced Rating* | AA+(SPUR)/Stable | Affirmed |
| **Indiana Transportation Finance Authority, Indiana** | | |
| Indiana | | |
| Indiana Transp Fin Auth (Indiana) APPROP (wrap of insured) (FGIC & AGM) (SECMKT) | | |
| *Unenhanced Rating* | AA+(SPUR)/Stable | Affirmed |
| Indiana Transp Fin Auth (Indiana) APPROP (FGIC) (MBIA) (National) | | |
| *Unenhanced Rating* | AA+(SPUR)/Stable | Affirmed |

Many issues are enhanced by bond insurance.



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