MOODY'S
INVESTORS SERVICE

CREDIT OPINION
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Update

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South Dakota

Update: Moody's Upgrades South Dakota's Lease-revenue Bond Ratings to Aa1; Outlook Stable

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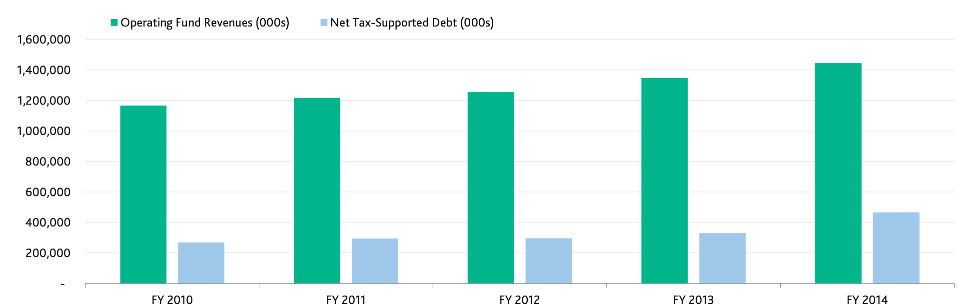
Summary Rating Rationale

Moody's Investors Service has upgraded to Aa1 the ratings on South Dakota's lease-revenue bonds issued through the South Dakota Building Authority and the South Dakota Health and Education Facilities Authority.

The upgrade reflects governance improvements the state implemented recently combined with very strong credit fundamentals. South Dakota's credit benefits from conservative fiscal practice, low fixed costs and a stable and healthy economy. The Aa1 rating reflects the subject-to-appropriation nature of the lease-revenue bonds. South Dakota has no issuer or general obligation debt rating.

Exhibit 1
South Dakota Revenues Improving



Source: Moody's Investor Service

Credit Strengths

» Conservative fiscal policy including several years of structural budget balance and high reserve levels

» Low fixed costs including low debt and no liability for other post-employment benefits (OPEB)

» Stable and growing underlying economy

Credit Challenges

- » Constitutional constraints that include supermajority to raise taxes and requirement for legislative approval of mid-year budget adjustments may constrain future fiscal flexibility

Rating Outlook

The stable outlook reflects our expectation of continued economic stability and that, in the event of a downturn in revenues, expenditures will be adjusted to maintain a high level of reserves.

Factors that Could Lead to an Upgrade

- » An upgrade is unlikely given the Aa1 ratings and the subject-to-appropriation nature of the lease-revenue bonds

Factors that Could Lead to a Downgrade

- » Economic deterioration
- » Sharp reduction in fund balance
- » Return to use of one-time revenues to resolve budget gaps
- » Inability to surmount constitutional constraints on fiscal flexibility

Key Indicators

Exhibit 2

South Dakota	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Operating Fund Revenues (000s)	1,166,547	1,218,059	1,255,949	1,347,606	1,445,272
Balances as % of Operating Fund Revenues	11.5%	11.2%	11.7%	13.8%	11.0%
Net Tax-Supported Debt (000s)	269,369	295,107	296,081	330,199	466,291
Net Tax-Supported Debt/Personal Income	0.9%	0.9%	0.9%	0.9%	1.2%
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.8%	2.8%	2.6%	2.5%
Debt/All Governmental Funds Revenue	7.8%	8.4%	8.8%	9.4%	12.5%
Debt/All Governmental Funds Revenue 50 State Median	23.4%	22.7%	24.3%	23.8%	23.0%
Adjusted Net Pension Liability/All Govt Funds Revenue	34.8%	20.7%	50.7%	29.5%	46.5%
Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median	57.1%	48.7%	63.9%	60.3%	59.2%
Total Non-Farm Employment Change (CY)	-0.1%	1.1%	1.7%	0.8%	1.4%
Per Capita Income as a % of US (CY)	101.2%	105.0%	103.3%	102.8%	100.5%

Source: Moody's Investors Service

Recent Developments

In December, the governor released the recommended fiscal 2017 budget which includes a half-cent increase in the state sales tax to 4.5%. The additional tax revenues, estimated to be about $107 million per year when fully implemented, would primarily fund a salary increase for teachers.

In February, the state projected 3.5% growth in revenues in fiscal 2017, excluding one-time receipts in fiscal 2016.

Detailed Rating Considerations

Economy

South Dakota's economy ended 2015 in very good health. The state unemployment rate was 2.9% in December, well below the national average of 5.0%. South Dakota's total nonfarm employment increased 2% overall in calendar 2015 with no major sectors in decline. The state's per-capita personal income is close to the national average, but will be pressured in 2016 by declining farm incomes as global agricultural supply outstrips demand. South Dakota's economy is the most dependent on agriculture of all states.

Sioux Falls has a niche credit card processing industry located there to take advantage of state interest rate laws. Financial services accounts for a quarter of the state's economy, which is larger relative to its size than in most other states. Employment in financial services has been relatively stable for the past ten years at around 30,000 jobs.

Finances and Liquidity

State revenues are growing at a faster-than-expected pace. Through December, general fund receipts grew 5.1% over last year, compared to budgeted growth of 3.7%. Low unemployment and low gas prices fueled a strong 4.2% growth in sales taxes, the state's largest revenue source at 61% of general fund revenues. Exemptions on agricultural inputs and a lack of exemptions on food sales enhance the stability of South Dakota's sales tax.

South Dakota has ample reserves that were kept intact through the recession. The state ended fiscal 2015 with an available fund balance of $184 million, or 15% of revenues, which is above the Aaa-median for states. Although the state has indicated it would like to use some of its reserves to repay outstanding debt in the coming years, we expect South Dakota to maintain a strong level of reserves going forward. The state has had structurally balanced budgets since 2011 and five consecutive years with a budget surplus.

LIQUIDITY

Liquidity is strong. South Dakota has not resorted to external or internal cash flow borrowing.

Debt and Pensions

DEBT STRUCTURE

South Dakota's low fixed costs are a key credit strength. The state constitution effectively prohibits general obligation debt and the state relies solely on limited use of lease-revenue bonds for access to the capital markets. The state's net tax-supported debt was 1.2% of personal income or just 1.0% of the economy as a whole, which ranks 41st among states. The governor has recommended applying a portion of reserves to pay down existing debt in fiscal 2016, which the state has done in recent years. That, and the lack of borrowing in its capital plans, indicates that debt levels will be continue to be low in coming years.

DEBT-RELATED DERIVATIVES

The state has no variable rate debt or debt-related derivatives.

PENSIONS AND OPEB

South Dakota's pensions are well-funded with a $1.7 billion Moody's adjusted net pension liability that, at 29.5% of state governmental revenues, ranks 42nd according to fiscal 2014 data and is well below the 50-state average of 79.5%.

South Dakota is ahead of most other states in addressing other post-employment benefits (OPEB). It eliminated the implicit rate subsidy for retirees and as of January has zero liability for OPEB (unaudited).

Governance

South Dakota made significant governance improvements last year, legislating that the state will issue a debt affordability report, a long-term financial plan and a capital expenditure plan annually. These solidified best practices enhance the state's fiscal awareness. The state also improved the timeliness of its financial reporting, which had been delayed in recent years. Taken together, these measures make the state's governance equal to that of its peers.

Financial flexibility remains below average. The governor does not have the ability to make significant mid-year spending adjustments without consent of the legislature and tax increases require a super-majority in the legislature. These restrictions may lead to financial stress should revenues significantly underperform the budget. South Dakota also has an active ballot initiative process.

Legal Security

South Dakota's lease revenue bonds are secured by lease payments from state agencies or departments to the authorities, subject to appropriation. Rents paid to the authorities are fixed at a rate sufficient to pay debt service. The authorities covenant that they will seek an appropriation from the state legislature to the department or agency sufficient to pay debt service.

Moody's views the risk of non-appropriation as slight, given the state's reliance on subject-to-appropriation lease debt to finance a broad range of projects, both through the South Dakota Building Authority and the Health and Educational Facilities Authority. South Dakota's constitution prohibits significant amounts of general-obligation borrowing. The underlying leases stipulate that should the agency or department fail to pay rent, the authority will exclude the agency or department from all leased facilities, providing an additional incentive for the agency or department to pay the amount due. All lessee payments flow through a single state fund so that default on any one bond would translate to a default on all lease-appropriation bonds of either authority, providing additional incentive for the state to appropriate funds for debt service.

Use of Proceeds

This rating action was not the result of a sale.

Obligor Profile

South Dakota is the 47th-largest state with a population of 845 thousand. It had a gross domestic product of $46 billion in 2014, which ranks 47th in the US and a per-capita personal income of $46,345 in 2014.

Methodology

The principal methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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