



OHIO CONSTITUTIONAL MODERNIZATION COMMISSION

MINUTES OF THE FINANCE, TAXATION, AND ECONOMIC DEVELOPMENT COMMITTEE

FOR THE MEETING HELD THURSDAY, OCTOBER 8, 2015

Call to Order:

Chair Douglas Cole called the meeting of the Finance, Taxation, and Economic Development Committee to order at 11:06 a.m.

Members Present:

A quorum was present with Chair Cole and committee members Amstutz, Clyde, Davidson, Mills, Peterson, Tavares, and Trafford in attendance.

Approval of Minutes:

The minutes of the June 4, 2015 meeting of the committee were approved.

Presentation:

“Remarks Regarding Article VIII”

*Tim Keen
Director
Office of Budget and Management*

Mr. Keen began by providing a brief history of Article VIII, indicating Ohio’s earliest debt was issued by the Ohio Canal Commission in 1825 to finance the canal system, with the General Assembly in 1837 passing the Ohio Loan Law intended to assist in the building of additional canals by loaning up to one-third of the cost of construction to Ohio businesses that were able to raise the remaining costs. Mr. Keen continued that, in practice, however, most of the loans went to railroad companies, spurring railroad growth in the state that competed with the canal business. Mr. Keen indicated that the end result of the debt issuance was an improved transportation system, but the debt also over-extended the treasury and the state had to borrow money to meet its expenses. Mr. Keen noted that, by 1839, Ohio had a deficit of more than one quarter of a million dollars and the Ohio Loan Law was repealed the next year. After reforms of the state’s taxation and tax collection system in 1846, the debt was refinanced and Ohio was able

to service the debt, but the concern over debt was a subject of discussion at the Constitutional Convention of 1850-1851. Mr. Keen pointed out that, as a result of this concern, Article VIII, Section 1 of the 1851 Constitution limits debt not expressly authorized by the voters to \$750,000.00.

Mr. Keen continued that Section 2, as well as select other sections of Article VIII, expressly authorize the purposes and amounts for which state debt may be issued, while Section 3 prohibits any other debt except that which has been expressly authorized. Further, he said, Section 4 prohibits the state from lending its aid and credit, and Section 5 prohibits the state from assuming the debts of any subdivision or corporation. Mr. Keen concluded that the state's challenging financial history at the time of enactment of Article VIII explains Ohio's conservative approach to debt, debt authorization, and debt repayment.

Turning to the present-day approach to state debt, Mr. Keen provided the committee with a summary of debt authorization provisions of Article VIII, as well as the amounts issued and outstanding under those provisions for debt that is backed by State of Ohio revenue (i.e., payable from the state treasury). He noted that, by 22 constitutional amendments approved from 1921 to the present, Ohio voters have expressly authorized the incurrence of state debt for specific categories of capital facilities, to support research and development activities, and provide bonuses for Ohio's war veterans. He said, currently, general obligation debt is authorized to be incurred for highways, K-12 and higher education facilities, local public works infrastructure, natural resources, parks and conservation, and third frontier and coal research and development.

He said non-general obligation lease-appropriation debt is authorized to provide facilities for housing branches and agencies of state government and their functions, including state office buildings, correctional and juvenile detention facilities, and cultural, historical and sports facilities; mental health and developmental disability facilities; and parks and recreational facilities.

Mr. Keen then directed the committee's attention to a table summarizing the state's outstanding debt and debt service paid from the General Revenue Fund ("GRF") as of the end of fiscal year 2015 (June 30, 2015). He noted that the state currently has \$9.35 billion in outstanding GRF debt and paid \$1.28 billion in debt service from the GRF in fiscal year 2015. He observed that fiscal year 2015 GRF debt service represents approximately 3.9 percent of fiscal year 2015 GRF revenue plus lottery profits.

With respect to the issuance of debt backed by state revenues, Mr. Keen described that two entities carry out the issuance functions as directed by the Ohio General Assembly under law – the Ohio Public Facilities Commission and the Treasurer of State. He said management and certain reporting of the state's debt are housed in the Office of Budget and Management, while payment functions and other reporting requirements are housed in the treasurer's office. He commented that the Sinking Fund Commission has not been an active issuer of state debt since 2001, and its constitutional reporting duties set forth in Sections 7 through 11 of Article VIII are performed by the state treasurer. He continued that the Sinking Fund Commission still technically exists and periodically must approve the reporting work done on its behalf by the treasurer's office.

Describing the bond issuing system, Mr. Keen noted that the Ohio Water Development Authority (OWDA), the Ohio Turnpike and Infrastructure Commission (OTIC), the Ohio Housing Finance Authority (OHFA), and the Ohio Air Quality Development Authority (OAQDA), issue bonds backed by or payable from dedicated revenue streams with no recourse to revenue of the state.

Prior to discussing potential modifications to Article VIII, Mr. Keen emphasized that Article VIII's framework for authorizing debt has served the state exceptionally well for more than 150 years. He said the process of asking voters to review and approve bond authorizations sets an appropriately high bar for committing the tax resources of the state over the long term, adding that Ohio's long tradition of requiring voter approval ensures that debt is proposed only for essential needs, and those needs must be explained and presented to voters for their careful consideration. He complimented voters, calling them "worthy arbiters," based on their having approved 26 and rejected 17 Article VIII debt-related ballot issues since 1900.

As a result of these considerations, Mr. Keen said he would propose to the committee that Article VIII works as intended, indicating he would not recommend wholesale reform. As support for this position, he noted the credit agencies' ratings that emphasize Ohio's conservative debt practice, and that those agencies refer to Ohio's debt burden as being both "moderate" and "affordable". He said Ohio's credit rating is in the second highest possible category, known as "AA+", which keeps the interest rates paid on state bonds very low.

Mr. Keen also addressed the suggestion that Ohio needs to modernize the \$750,000.00 debt limitation of Section 1 because the 5.0 percent annual debt service limitation set forth in Section 17 of Article VIII is insufficient. He said this suggestion pre-supposes that the state's existing 5.0 percent debt service limitation could be thwarted by back-loading debt or substantially extending its amortization period, for example issuing 100-year debt. Mr. Keen directed the committee to Exhibit 1 of his printed materials, noting that, with respect to extremely long amortization periods, Ohio's debt authorizations include maximum terms that range from 10 to 30 years, and in practice Ohio's bond issuances have consistently been amortized over periods shorter than those maximums. He added that Section 17 itself requires that the numerator of the 5.0 percent annual debt service limitation be the highest debt service in any future fiscal year, thus capturing any debt service peaks that may occur due to back-loading. He said for these reasons, the 5.0 percent debt service limitation has been and remains an effective limitation on both the amount of debt and debt service. He added that, in fact, the 5.0 percent threshold is a key factor in the state's favorable credit rating. As an additional factor, Mr. Keen observed that Section 1 of Article VIII is critical because the \$750,000.00 limit, when considered in conjunction with other key constitutional provisions, forms the basis of Ohio's balanced budget requirement.

Mr. Keen acknowledged opportunities for improving the administrative efficiency and cost effectiveness of state debt.

First, he noted the security backing the state's debt affects its credit quality and thus the level of interest rates the state pays to investors. He said the state's general obligation debt carries its highest credit rating, currently "AA+", allowing Ohio to perform well in achieving low interest

rates in the municipal bond market. He said, since 1973, constitutional amendments authorizing new state debt have generally provided for general obligation security, but that the state still issues several categories of lease-appropriation debt under Section 2i, a section approved by the voters in 1968. He said that while this debt is functionally no different from the state's perspective, the subject-to-appropriation requirement lowers its credit rating to "AA" and, as a result, the state pays a higher rate of interest, typically ranging from 0.1 percent to 0.3 percent, versus its general obligation counterpart. Because of this, Mr. Keen suggested that the lease-appropriation debt authorization provisions of Section 2i for housing branches and agencies of state government, and for mental health, developmental disabilities, and parks and recreation facilities, be replaced with a general obligation authorization for those purposes. He estimated that, for each \$100 million of debt issued over 20 years, this change to general obligation security would save state taxpayers \$1.5 to 4 million over the life of the debt.

Mr. Keen suggested another opportunity to modernize and improve efficiency involves the administration of the Sinking Fund as provided for in Sections 7 through 11 of Article VIII. Mr. Keen noted that the Commissioners of the Sinking Fund – originally consisting of the attorney general, auditor and secretary of state – were established in 1851 to administer a fund that would pay-off, or "sink", the state's then-existing canal and railroad debt, and to report their activities and progress to the governor and General Assembly. He said that over the years, the duties of the commissioners expanded to include administering and issuing many types of state debt, and in 1947 the governor and treasurer were added as members. Mr. Keen then described how, in the late 1950's, new state bond programs began to use dedicated bond service funds separate from the sinking fund, with debt service payments effectuated by the treasurer and the Office of Budget and Management. Then, in 2001, the General Assembly transferred bond issuance authority from the commissioners to the Ohio Public Facilities Commission. Mr. Keen said, as a result of these changes, all of the functions historically performed by the Commissioners of the Sinking Fund are now performed by other state entities, indicating that the sinking fund provisions of Article VIII are viable candidates for repeal. Mr. Keen noted, however, that if the committee recommends the repeal of the sinking fund provisions, it should consider replacing them with a provision that assigns necessary, ongoing debt-reporting functions to the treasurer of state.

Mr. Keen also addressed the committee's consideration of whether to recommend repeal or removal of inactive bond issuance sections. He said while he has no concern with allowing those provisions to remain, he recognized that some committee members view elimination of inactive sections as helpful cleanup, noting there is precedent for such repeal because Section 2a, authorizing compensation payments to World War I veterans, was repealed in 1953. He further observed that the Ohio Constitutional Revision Commission in 1972 recommended the repeal or modification of additional sections within Article VIII, although only Section 12, providing for a superintendent of public works, was later repealed. Mr. Keen suggested current sections that would be candidates for repeal as including 2b, 2c, 2d, 2e, 2f, 2g, 2h, 2j, and 2k. He said repeal of these sections would shorten the length of Article VIII by 40 percent, but added there would need to be new language confirming the continuing validity of obligations issued under those sections.

Concluding his remarks, Mr. Keen said while some modernization could be effected, voters should continue to be the final arbiters of the purposes and amounts for which long-term debt of the state may be issued. Mr. Keen also provided the committee with draft language that would effectuate the potential changes noted in his testimony. He then invited questions from the committee.

Senator Charleta Tavares commented that the state is doing very well with its bond rating, but asked how it can do better. Mr. Keen answered that the next level up, the triple-A rating, is challenging to attain, and only a handful of states have it. He said the biggest challenge for Ohio will be the controls over how state debt is issued. He continued, noting that the economy of Ohio over the last 40 years has performed below the economy of the nation as a whole, and that this, combined with the fact that Ohio is a manufacturing-based economy, affects the state's performance. He said Ohio might be rated at double-A, rather than double-A plus, were it not for the long-time tradition of the state in effectively managing and controlling debt. He said if Ohio could attain a triple-A rating, it would reduce costs, but the realities of state economic performance over the last four years preclude that for the time being.

Sen. Tavares followed up, asking whether there are any Midwest states with a triple-A bond rating. Mr. Keen answered that Minnesota may have such a rating, but he doesn't know for sure.

Sen. Tavares then asked about Mr. Keen's remarks (on page five of his presentation) on debt amortizations, wondering if he was suggesting that Ohio should be reducing the number of years over which debt is amortized. Mr. Keen said the constitutional provisions offer a range, and that the general rule of public finance is that the cost of the asset is spread over a reasonable period, balanced against the cost the borrower pays. He said 20 years is a reasonable place to be.

Chair Cole asked for clarification, wondering whether Mr. Keen's position is that there is not much the committee could do regarding the language of Article VIII that would affect or improve the bond rating, meaning that the forces causing that are independent of the constitution. Mr. Keen answered that the limitations and parameters in the constitution support Ohio's current status, but there is not much that could be done in the constitution that would result in an upgrade.

Representative Ron Amstutz asked what types of expenditures would be outside the five percent debt limit. Mr. Keen said the five percent limit is for debt service paid from the GRF, measured against the GRF and the net lottery profits. He said this is most of the debt and most of the purposes he outlined. He said it doesn't include highway funds paid from the gas tax, the Third Frontier issue, or the Persian Gulf Conflict bond issue, for example. He said bonds subject to this limit are issued by the Ohio Public Facilities Commission or by the treasurer, but other bonds are from separate revenue streams and have no recourse to the GRF.

Rep. Amstutz commented he is not sure Ohio has a high bar, but, rather, may have a forest of bars and many mechanical hurdles because there are so many pieces and parts through the article. He asked whether, setting aside the "deadwood" in Article VIII, it would be possible or worthwhile in the remainder of the article to fashion something to modernize and clarify, but to keep checks and balances in place. Mr. Keen said he imagines that is possible, but that he comes

at it from the perspective that these provisions have served us well and that it is generally understood what is required and what they permit. As a result, he said, perhaps a modification is not necessary. He asked, if the provisions are generally working, why change them? He said his view is that they work and that a strict borrowing limitation without specific action by the people would deprive the state of an avenue to explore the issuance of new debt. He added there is also a value in having to follow specific steps before additional resources of the state are committed. He said he is generally comfortable with what Ohio currently has.

Following up, Rep. Amstutz asked whether it would work to keep the exact process and put it in the constitution but, for example, have the process presented to the voters on a schedule. Mr. Keen answered that if Rep. Amstutz is proposing a method or construction that would achieve the same end, he doesn't necessarily object to that. Rather, he said, his thought is that the very strict limitation on action without approval of the people has served Ohio well and he would want that reality or those parameters to stay in the constitution.

Chair Cole said the committee is considering two potential structures. One would be to take the \$750,000.00 limit and modernize it to a corresponding number based on inflation and other indicators, arriving at a new number that would be consistent with the amount of debt that Ohio currently carries. He continued that the other construct would be a constitutional amendment that would strip the debt limit from the constitution and make the debt limit more of a statutory process, with a requirement of a supermajority in legislature to authorize new spending, followed by a voter referendum. He said that approach would not amend the constitution, but, because the provision requires voter approval, would still have a mechanism for voter authorization.

In response, Mr. Keen commented that the latter plan seems to be a substantial change to get us to the same place we already are, wondering why go through the process to change the constitution to arrive at the same place. Regarding the former plan, to increase the \$750,000.00 debt limit, he said he likes that limitation, particularly as it has been amended, because that method acknowledges there is a wide range of public purposes for which it is appropriate to issue debt. He said Ohio has the ability under the existing framework to issue debt for things we need, and he likes the fact that we are limited. He noted the \$750,000.00 limit, in conjunction with other provisions in the constitution, also provides for a balanced operating budget and precludes the borrowing of money for the operation of state government. He observed that the lack of limitation in other governments, particularly the federal government, has created problems, and that a strict limit on debt is essential. He noted that the debt limitation "is the bedrock of what keeps our finances sound and strong in this state; we don't borrow for any reason for operating purposes. Some states do that, we don't and we shouldn't." He said for these reasons there is a very high bar to make changes in this space.

Chair Cole said one of the advantages that was discussed when that second approach was raised was that it would declutter the constitution; the structure that requires a supermajority in the legislature and voter approval becomes a real-time decluttering process, ensuring the next constitutional commission doesn't need to consider whether to have a new decluttering process. Mr. Keen said he is not particularly motivated by a need to remove the old provisions, so he hasn't contemplated this. But, he said, there may be other ways to do this. For example, could there be a "self-repealer" in place, like a sunset clause? He said it doesn't bother him to have

constitutional provisions referencing older issues; it provides a sense of what has gone before so we don't forget.

Committee member Kathleen Trafford asked Mr. Keen to provide some background on the "revenue stream bonds"—wondering if the number provided is the sum total of what Ohio has out there. She asked whether Mr. Keen has a sense of how big that pot is, noting that the revenue stream bonds are a commitment of revenue that is under the control of the state. Mr. Keen answered that revenue bonds mean that the taxes of the state are not pledged for that particular purpose. Noting that he didn't have that information at hand, he gave an example that, with regard to the turnpike, the revenues pledged are the tolls on the turnpike. He also noted that the Air Quality Development Authority issues bonds for pollution control projects at a private facility that wants to avail itself of tax benefits of that type of financing. He said the revenues are payments, with the state having a contractual arrangement associated with a particular project, on a project-by-project basis.

Regarding the Water Development Authority, he said that authority makes loans to political subdivisions of the state to improve water, sewage treatment or other facilities, and that local subdivision agrees to pay back the loan, with the stream of those loan repayments as well as assets on hand being used to pay back those bonds. He said these are loans the state makes to political subdivisions that are then paid back to the state, after which the state pays back the bond issuer. He said, in those cases, there is no recourse to the tax dollars of the state of Ohio.

Chair Cole asked whether these revenue stream bonds are different from the lease appropriation bonds that are paid with GRF resources. Mr. Keen said under Section 2i, essentially, the revenue stream bonds are not general obligation bonds and had no reference to state tax revenues per se. He said, for instance, in the case of bonds issued for developmental disability or mental health facilities the idea is that, practically, the state makes GRF appropriations to the agencies that benefit. He said these are called lease appropriation because the state pledges the bonds will be paid out of lease appropriations, but under another provision of the constitution they are only for two years at a time, so the bond issuers know it is subject to appropriation of these debt service payments. Mr. Keen said if the debt is not paid, there is recourse to other revenue streams that might be generated by those facilities. He then explained that conduit issuance bonds are those that are issued on behalf of another entity.

Ms. Trafford asked whether there is a source list of all revenue stream bonds. State Debt Manager Kurt Kauffman, who also was attending the meeting, answered that the Office of Budget and Management website has debt and debt service information for all of the state-backed debt, particularly data regarding both state debt and bond authority debt.

Chair Cole asked whether the revenue stream bond debt is part of the Article VIII, Section 17 debt. Mr. Keen answered that the five percent figure is exclusively tied to debt from the GRF. Also, the lease appropriation is included in the 5 percent limit.

Sen. Tavares asked about the current debt ceiling, to which Mr. Keen replied that the ceiling was 3.9 percent at end of the last fiscal year, with 3.2 percent being the last certification that the office made. He explained that every time there is a bond issuance, his office has to make a

certification pursuant to the constitution. He said the numerator is the debt service, the denominator is the GRF. The GRF grows over time; this last time it grew a little more than usual because of the Medicaid expansion, so the denominator grew.

Rep. Amstutz followed up on his earlier question by explaining that one goal of revising Article VIII would be to achieve efficiency. Mr. Keen answered that he has not contemplated the goal of making the article more efficient, but would be happy to consider it and engage in the discussion.

Chair Cole referenced Mr. Keen's comments regarding the sinking fund, asking whether he would give an example of his point about assigning the necessary, ongoing debt-reporting functions to the treasurer of state. Mr. Keen said that the sinking fund commission's duty is to meet two times a year and to issue an annual report on outstanding debt. He said this is the one remaining function of commissioners of the sinking fund that still occurs, and that the treasurer of state carries out this function. Mr. Keen said that function is important, and that his view is that the function should carry on, and should remain in the constitution. He said it might be possible to have the constitution reassign the function to the treasurer of state, who is doing it now, but that otherwise the provisions regarding the commissioner of the sinking fund should be retained.

There being no further questions for Mr. Keen, Chair Cole thanked him for his presentation.

Committee Discussion:

Chair Cole then turned the committee's attention to a discussion regarding Article VIII. He said his plan for moving forward would be to present a memo he is finalizing that summarizes what the committee's course has been, with some updates. He said the current status of the possible courses of action focuses on four different approaches: 1.) do nothing; 2.) repeal obsolete provisions; 3.) revamp the \$750,000.00 limit; and, 4.) create a process where legislative and voter approval would still be necessary for new forms of debt issuance, but legislative and voter approval wouldn't be enshrined in the constitution to prevent future clutter. He said that approach would provide just the framework in the constitution, and the approval once obtained would not be part of the constitution. He said he would like to move into a phase where the committee provides a sense of how it wants to proceed. He said it makes sense to have a general agreement as to which approach makes the most sense, and then pursue the constitutional language associated with that. Chair Cole then invited comments from committee members.

Committee member Fred Mills commented that, based upon information provided by Deputy Treasurer Seth Metcalf at a previous meeting, there may be some outstanding and unreported bonds or coupons associated with some expired provisions. Chair Cole said the suggestion from everyone has been that some provision should be made in the constitution for the ongoing validity of issued, but not yet paid off, bonds.

Committee member Jo Ann Davidson said it would make sense to have some language prepared that could accomplish that. She further remarked that, as regards the sinking fund, it is a redundancy to have that provision there, as well as a provision requiring an ongoing reporting

duty. She said removing or revising those provisions appear to be the less complicated things to address. Chair Cole said that statement is both true and not true, explaining that if there are structural changes, there may be a purpose for a reinvigorated sinking fund, but if the goal is to return to the original plan with updated numbers, it may be important to retain the sinking fund. He said it depends on what the committee changes to and that it would be helpful to first have a sense of the general direction the committee wants to pursue first.

Ms. Davidson continued that she is “a minimalist” on this exercise, saying she thinks the committee is searching for an answer to a question that doesn’t exist. She said, “when you have something functioning extremely well for the state, anything that we do can have an unknown impact on that bond rating.” She said she would like to see the committee begin the drafting process and move on. Chair Cole said he agrees wholeheartedly, but feels that the approach of repealing obsolete provisions is good.

Chair Cole asked the committee if it had heard enough that additional summaries are not needed in order for the committee to vote. Rep. Amstutz said the four options described by Chair Cole aren’t mutually exclusive. He said the committee could easily get a consensus on getting two, and that he personally favors all three of the recommendations from the Office of Budget and Management, but that option precludes reinvigorating the sinking fund. Rep. Amstutz said he would like to pursue the four options that Chair Cole outlined, or some combination of these, and that his goal would be to keep all the concerns in place, including checks and balances. But, he added, the statement in the constitution could be a different mechanism.

Chair Cole asked if it would be worthwhile for the committee to vote, at least regarding the sinking fund question. Rep. Amstutz said if the committee takes Mr. Keen’s recommendation, it would be transferring the duties of the sinking fund to the treasurer.

Mr. Mills commented that he would like to see the memorandum being prepared by Chair Cole before taking further steps. Chair Cole agreed that he would be providing the memorandum soon after finalizing it.

Chair Cole asked the committee whether there is consensus regarding the sinking fund, and whether it may be worthwhile for staff to prepare constitutional language that would repeal those provisions and create a new section authorizing the treasurer to perform those functions. Mr. Mills noted that Mr. Keen had given the committee proposed language of this nature that he would ask staff to review that language.

Mr. Cole also asked about lease appropriation versus general appropriation bonds, asking whether there is a generalized sense of whether the committee would be comfortable with changing lease appropriation bonds into general appropriation bonds, as suggested by Mr. Keen. There being no objection, Chair Cole asked staff to work with language Mr. Keen provided with regard to the sinking fund and the reporting requirements for the treasurer, as well as Mr. Keen’s suggestions regarding changing lease appropriation bonds into general appropriation bonds. He requested that staff begin to work on proposed language that could be introduced at the committee’s next meeting. He added that the committee seemed to have a shared sense that it would be helpful to repeal unused sections, and that language would be needed on that. He said

it would be important to review Mr. Keen's proposed language, and that staff should highlight any legal concerns raised by the various possible courses of action for the next meeting.

Public Comment:

Chair Cole opened the floor to public comment, of which there was none.

Adjournment:

With no further business to come before the committee, the meeting was adjourned at 12:16 p.m.

Approval:

The minutes of the October 8, 2015 meeting of the Finance, Taxation, and Economic Development Committee were approved at the December 10, 2015 meeting of the committee.

/s/ Douglas Cole _____
Douglas R. Cole, Chair

/s/ Excused _____
Karla L. Bell, Vice-chair