OHIO CONSTITUTIONAL MODERNIZATION COMMISSION

REPORT AND RECOMMENDATION

OHIO CONSTITUTION
ARTICLE VIII
SECTIONS 7, 8, 9, 10, AND 11

THE SINKING FUND AND THE SINKING FUND COMMISSION

The Ohio Constitutional Modernization Commission adopts this report and recommendation regarding Article VIII, Sections 7, 8, 9, 10, and 11 of the Ohio Constitution concerning the Sinking Fund and the Sinking Fund Commission. It is issued pursuant to Rule 10.3 of the Ohio Constitutional Modernization Commission's Rules of Procedure and Conduct.

Recommendation

The Commission recommends that Sections 7 through 11 of Article VIII dealing with the Sinking Fund and the duties of the Sinking Fund Commission be repealed for the reason that the state no longer utilizes a fund identified as "the Sinking Fund," and the duties of the Sinking Fund Commission are being performed by other state officers and agencies. These provisions include Section 7, creating the Sinking Fund; Section 8, listing the members of the Sinking Fund Commission; and Sections 9, 10, and 11, outlining the duties of the Sinking Fund Commission.

Background

Article VIII deals with public debt and public works, and was adopted as part of the 1851 constitution.

In addition to placing a limitation on the actions of the General Assembly in incurring debt, through the adoption of Article VIII, Sections 1, 2, and 3, delegates to the 1851 Constitutional Convention also adopted five sections designed to assure that any debt that was incurred by the state would be paid off responsibly through the creation and operation of a Sinking Fund. The use of such a fund was a popular method of paying off debt by the states in the 19th century.[1] The five sections that directly relate to the Sinking Fund include Sections 7, 8, 9, 10, and 11.

Section 7 creates the "Sinking Fund" for the purpose of paying accruing interest on public debt. This section provides that the fund will annually reduce the principal by a sum of not less than $100,000, increased yearly by compounding at six percent per year. The source of the fund is described as the net annual income of the public works and stocks owned by the state, any other funds or resources provided by law, and further sums to be raised by taxation as may be required. Section 7 provides as follows:

> The faith of the state being pledged for the payment of its public debt, in order to provide therefor, there shall be created a sinking fund, which shall be sufficient to pay the accruing interest on such debt, and, annually, to reduce the principal thereof, by a sum not less than one hundred thousand dollars, increased yearly, and each and every year, by compounding, at the rate of six per cent per annum. The said sinking fund shall consist, of the net annual income of the public works and stocks owned by the state, of any other funds or resources that are, or may be, provided by law, and of such further sum, to be raised by taxation, as may be required for the purposes aforesaid.

Section 8 creates a supervisory body known as "The Commissioners of the Sinking Fund," consisting of the governor, the treasurer of state, the auditor of state, the secretary of state, and the attorney general. Although originally part of the 1851 constitution, the provision was amended in 1947 to add the governor and state treasurer to the board.[2] Section 8 reads:

> The governor, treasurer of state, auditor of state, secretary of state, and attorney general, are hereby created a board of commissioners, to be styled, "The Commissioners of the Sinking Fund".

Section 9 prescribes that a biennial report shall be issued by the commissioners before each session of the General Assembly. The report, which is to include information about the amount in the fund from all sources except taxation, is to be provided to the governor, who then transmits the information to the General Assembly. Relying on this information, the General Assembly is directed to make all necessary provision for raising and disbursing the fund in pursuance of the provisions of Article VIII. Section 9 states:

> The commissioners of the sinking fund shall, immediately preceding each regular session of the general assembly, make an estimate of the probable amount of the fund, provided for in the seventh section of this article, from all sources except from taxation, and report the same, together with all their proceedings relative to said fund and the public debt, to the governor, who shall transmit the same with his regular message, to the general assembly; and the general assembly shall make all necessary provision for raising and disbursing said sinking fund, in pursuance of the provisions of this article.

Section 10 states that the commissioners shall apply the fund, along with other moneys appropriated by the General Assembly, to the payment of interest as due, as well as to the redemption of the principal of the public debt. Section 10 excludes state school and trust funds from this directive. Section 10 provides:

> It shall be the duty of the said commissioners faithfully to apply said fund, together with all moneys that may be, by the general assembly, appropriated to

> that object, to the payment of the interest, as it becomes due, and the redemption of the principal of the public debt of the state, excepting only, the school and trust funds held by the state.

Section 11 provides that the commissioners shall issue a semi-annual report describing the proceedings of the Sinking Fund Commission, to be published by the governor and communicated to the General Assembly. This report is in addition to the biennial report required by Section 9. Pursuant to Section 11:

> The said commissioners shall, semi-annually, make a full and detailed report of their proceedings to the governor, who shall, immediately, cause the same to be published, and shall also communicate the same to the general assembly, forthwith, if it be in session, and if not, then at its first session after such report shall be made.

Amendments, Proposed Amendments, and Other Review

The five provisions concerning the Sinking Fund Commission were adopted in 1851, with their only amendment occurring in 1947, when Article VIII, Section 8, was adopted to add the governor and the state treasurer to the commission.[3] Therefore, the commission now includes all five statewide officeholders.

The Ohio Constitutional Revision Commission (1970s Commission) studied Article VIII in depth and made extensive recommendations concerning how the state incurs debt.[4] The 1970s Commission recommended the repeal of unnecessary provisions concerning the Sinking Fund and the Commissioners of the Sinking Fund, explaining:

> The Commission proposes the repeal of Sections 7 through 11 of Article VIII, which deal with the Commissioners of the Sinking Fund and their duties, and the Sinking Fund itself. Whatever justification these sections might have had at one time, in the Commission's view they no longer serve a useful constitutional purpose. The very concept of the sinking fund, in which large sums of money are accumulated until they are needed to pay bonds at maturity, has fallen into disfavor. Today, the bond which is the norm for public financing is the serial bond: "State and local debt nowadays is almost always in serial form, that is, when the debt is incurred, provision is made for annual retirement of the principal, so that the annual carrying charge for a twenty-year issue includes a sum sufficient to redeem, say, one-twentieth of the principal, as well as a sum of interest." [citing James A. Maxwell, *Financing State and Local Governments,* rev. ed. (Washington, The Brookings Institution, 1969) p. 185.] However, in suggesting the deletion of sections relating to the Sinking Fund, the Commission is not suggesting that the General Assembly should not have the power to establish either a sinking fund or a sinking fund commission, should it desire to do so, and hence Section 1 of the proposed Article VIII would provide ample authority to do so. The deletion of these sections is recommended only because the Commission believes that these sections are not needed in the Constitution.[5]

In November 1977, the General Assembly submitted a ballot issue to the voters that, among other changes, proposed repealing Sections 7, 9, and 10 dealing with the Sinking Fund. However, voters rejected Issue 4 by a margin of 72.5 percent to 27.5 percent, with an over one million vote difference.[6]

Litigation Involving the Provisions

There has been no litigation directly related to Sections 7, 8, 9, 10, and 11.

Presentations and Resources Considered

Metcalf Presentations

Seth Metcalf, deputy treasurer and executive counsel for the Ohio Treasurer of State, presented to the Finance, Taxation, and Economic Development Committee on May 8, 2014, March 12, 2015, and March 10, 2016. In addition to reviewing the history of Article VIII, including the $750,000 debt limitation in Section 1, Mr. Metcalf addressed the role of the Sinking Fund Commission. Originally adopted as a safeguard, he said the commission is no longer playing an active role in managing the payment of the debt. In fact, Mr. Metcalf noted that the commission has not been an active issuer of state debt since 2001. Mr. Metcalf suggested the state should continue to involve the five statewide executive officeholders in the debt issuance process, further opining that the constitutional references to the Sinking Fund should be replaced with references to the state treasurer, or to the Ohio Public Facilities Commission, which currently issues most of the state's general obligation debt and is comprised of those five statewide officeholders and the director of the Office of Budget and Management (OBM).[7]

Keen Presentation

On October 8, 2015, Timothy S. Keen, director of OBM, provided an in-depth analysis of the history and purpose of Article VIII, as well as suggestions for modernizing its debt provisions.

For the purpose of improving efficiency, Mr. Keen advocated eliminating Sections 7 through 11. He 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. Over the years, the duties of the commissioners expanded to include administering and issuing many types of state debt, with the governor and treasurer being added to the commission in 1947. In the 1950s, 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 OBM. Then, in 2001, the General Assembly transferred bond issuance authority from the commissioners to the Ohio Public Facilities Commission. 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.

Azoff Presentation

Jonathan Azoff, director of the Office of Debt Management and senior counsel to the Ohio Treasurer of State, presented to the committee on April 14, 2016 regarding the role of his office in relation to state debt.

Among the changes recommended for Article VIII, Mr. Azoff proposed the reference to the sinking fund in Section 2 should be changed to the word "state." He said this recommendation is based on the fact that a true "sinking fund" no longer exists. Mr. Azoff further indicated his office supports the repeal of Sections 7 through 11 of Article VIII for the reason that the state no longer utilizes a sinking fund, with the duties of the Sinking Fund Commission now being performed by the treasurer's office. However, Mr. Azoff expressed the concern that removal of Sections 7 through 11 without replacement language clarifying who should perform those same duties would be detrimental to the interests of public accountability. He expressed that the committee's review provides the opportunity to recommend constitutional amendments that would reflect current statutory procedures.

In this regard, Mr. Azoff described that his office performs the ongoing roles and responsibilities of the Sinking Fund Commission, including paying debt service on the state's general obligation debt from the Commissioners of the Sinking Fund's designated bond service funds, and fulfilling the treasurer's reporting role as a member of the Commission of the Sinking Fund. He noted that the Office of Debt Management's operating expenses are funded through the Commissioners of the Sinking Fund GRF line item in the Treasurer of State's operating budget. As a result, Mr. Azoff urged the committee to recommend the retention of constitutional authorization for the performance of the Sinking Fund Commissioners' duties.

Kauffman Presentation

On April 14, 2016, Kurt Kauffman, acting assistant director of the Office of Budget and Management (OBM), appeared before the committee to provide comment related to Article VIII.

Mr. Kauffman said OBM supports the repeal of Sections 7 through 11 of Article VIII, because all of the functions historically performed by the Commissioners of the Sinking Fund are now defunct or, in the case of the Sinking Fund report required under Section 11, performed by other state entities. Mr. Kauffman reiterated Mr. Keen's suggestion that the debt reporting requirement be replaced by a new provision that would assign necessary debt reporting functions to the state treasurer.

Addressing a suggestion by Seth Metcalf, deputy treasurer, that removing the Sinking Fund would compromise public accountability in the debt issuance process, Mr. Kauffman said OBM does not share that concern, instead acknowledging that the interests of the public are protected by the fact that citizens always must approve debt authorization by voting for constitutional amendments. He noted multiple steps that protect public participation, among them that voters must approve a ballot issue, that the General Assembly's legislative process welcomes public comment, and that the PFC holds open meetings for the purpose of passing bond issuance resolutions.

Mr. Kauffman said these multiple opportunities for consideration of public comment protect the interests of public accountability, adding that unnecessary changes would risk creating uncertainty and confusion in the municipal bond market.

Finally, Mr. Kauffman said OBM supports the proposal to retain Article VIII, Sections 1 and 3 in their current form, and to revise Section 2 only to eliminate what would be an outdated reference to the Commissioners of the Sinking Fund.

Discussion and Consideration

In reviewing the provisions relating to the Sinking Fund and the Commissioners of the Sinking Fund, the Finance, Taxation, and Economic Development Committee considered whether the provisions are obsolete for the reason that the widespread use of bonds for the purpose of raising funds, and the transfer of the duties of the commissioners to other state agencies, has left the Sinking Fund Commission with little to do. In considering this concern, the committee found it persuasive that the commissioners have not met since 2008, and that many of the duties assigned to the commissioners are now performed by other state officers and agencies.

The committee concluded that Sections 7 through 11 are obsolete for the reason that the purpose of the Sinking Fund and duties of the Sinking Fund Commission have been replaced by other state entities primarily through (i) authorizations contained in constitutional amendments approved by the electors of the state; and (ii) by statutory enactment made pursuant to the authorizations contained in these subsequent constitutional amendments.[8]

Action by the Finance, Taxation, and Economic Development Committee

After formal consideration by the Finance, Taxation, and Economic Development Committee on April 14, 2016 and May 12, 2016, the committee voted on May 12, 2016 to issue a report and recommendation recommending that Article VIII, Sections 7, 8, 9, 10, and 11 be repealed.

Presentation to the Commission

On June 9, 2016, on behalf of the Finance, Taxation, and Economic Development Committee, committee Chair Doug Cole appeared before the Commission to present the committee's report and recommendation, by which it recommended repeal of Article VIII, Sections 7, 8, 9, 10, and 11. Chair Cole explained the history and purpose of the provisions, emphasizing the Sinking Fund and the Sinking Fund Commission are no longer utilized to manage state debt, and indicating that the committee determined it would be appropriate to repeal Article VIII, Sections 7 through 11 as obsolete provisions.

On September 8, 2016, on behalf of the Finance, Taxation, and Economic Development Committee, Executive Director Steven C. Hollon appeared before the Commission to provide a second presentation of the committee's report and recommendation. Mr. Hollon described that the Sinking Fund was no longer being used as a method for the state to pay down state debt, and that the Sinking Fund Commission's duties had been undertaken by other state officers and agencies. Thus, Mr. Hollon indicated the report and recommendation recommends the repeal of Sections 7 through 11.

Action by the Commission

At the Commission meeting held September 8, 2016, Commission member Dennis Mulvihill moved to adopt the report and recommendation for Article VIII, Sections 7, 8, 9, 10, and 11, a motion that was seconded by Commission member Patrick F. Fischer.

A roll call vote was taken, and the motion passed unanimously by a vote of 26 to zero.

Conclusion

The Ohio Constitutional Modernization Commission concludes that Article VIII, Sections 7, 8, 9, 10, and 11 should be repealed.

Date Adopted

After formal consideration by the Ohio Constitutional Modernization Commission on June 9, 2016, and September 8, 2016, the Commission voted to adopt the report and recommendation on September 8, 2016.

/s/ Charleta B. Tavares
Senator Charleta B. Tavares, Co-Chair

/s/ Ron Amstutz
Representative Ron Amstutz, Co-Chair

Endnotes

[1] *See, e.g.,* Henry C. Adams, *Public Debts: An Essay in the Science of Finance* 384 (New York: D. Appleton 1890). For a discussion of the history of the use of the sinking fund, *see* Donald F. Swanson and Andrew P. Trout, *Alexander Hamilton's Hidden Sinking Fund,* 49 William and Mary Quarterly 108 (1992).

[2] Steven H. Steinglass & Gino J. Scarselli, *The Ohio State Constitution* 275 (2nd prtg. 2011).

[3] *Id.* at 275, app. B.

[4] Ohio Constitutional Revision Commission Recommendations for Amendments to the Ohio Constitution, Part 2, State Debt (Dec. 31, 1972), http://www.lsc.ohio.gov/ocrc/recommendations%20pt2%20state%20debt.pdf (last visited Feb. 5, 2016).

[5] *Id.* at 39-40.

[6] Steinglass & Scarselli, *supra* at app. B.

On the November 8, 1977 ballot, Issue 4 stated:

"PROPOSED CONSTITUTIONAL AMENDMENT

To adopt Section 1 of Article VIII and repeal Sections 1, 2, 2b, 2c, 2d, 2e, 2f, 2g, 2h, 3, 7, 9, and 10 of Article VIII and Section 6 of Article XII of the Constitution of Ohio

1. To repeal the general state constitutional debt limit of $750,000 and replace it with authority to incur debt for capital improvements by a two-thirds majority vote of each house of the general assembly within specified limitations directly related to state revenues.

2. To permit the state to contract debt without limitation on amount of purpose, in addition to the authority specified above, if that debt is submitted to a vote of the electors by a three-fifths majority vote of each house of the general assembly and approved by a majority of the electors voting on the question.

3. To require the general assembly to retire at least 4% of the state's indebtedness each year.

4. To permit the state to borrow funds to meet a current year's appropriations if any such loan is repaid out of that year's revenues.

5. To repeal part of the constitutional requirements relating to a sinking fund and to require that the general assembly provide for the repayment of state debt.

6. To enumerate purposes and amounts for which the first $640 million of capital improvement debt would have to be appropriated.

(Proposed by Resolution of the General Assembly of Ohio)"

Source: Youngstown *Vindicator*, Nov. 6, 1977. Available at: https://news.google.com/newspapers?id=zfRJAAAAIBAJ&sjid=sYQMAAAAIBAJ&pg=2945,1851669&hl=en (last visited March 28, 2016).

[7] R.C. 151.02. *See also*, http://obm.ohio.gov/BondsInvestors/publicfacilities.aspx (last visited Feb. 8, 2016).

[8] Based on its recommendation to eliminate the Sinking Fund and related provisions, the committee concluded it is appropriate to remove reference to the Sinking Fund in Section 2, replacing it with a generic phrase allowing the state to pay state indebtedness. A description of that review and conclusion is set forth in a separate report and recommendation relating to Article VIII, Sections 1, 2, and 3, titled "State Debt."

The committee further recommended that, if the General Assembly should place a ballot issue before the voters to repeal Sections 7, 8, 9, 10, and 11 of Article VIII, the ballot issue should also contain a proposal to revise Section 2 to delete reference to the Sinking Fund.