



Office of Budget and Management

John R. Kasich
Governor

Timothy S. Keen
Director

Ohio Constitutional Modernization Commission Committee on Finance, Taxation and Economic Development

October 8, 2015

Testimony of Timothy S. Keen Director, Office of Budget and Management

Introduction

Chairman Cole, Vice Chair Bell and members of the Finance, Taxation and Economic Development Committee, good morning and thank you for the opportunity to provide this testimony based on my experience with the debt provisions of Article VIII of the Ohio Constitution. As Director of the Office of Budget and Management (OBM), I work regularly with the Constitutional provisions subject to the jurisdiction of this Committee and certainly appreciate the work you are doing to review these important provisions.

History

I would like to start with a brief history of Article VIII as that history provides a helpful backdrop and context for my remarks. The State's earliest debt was issued by the Ohio Canal Commission back in 1825 to finance the Ohio and Erie and Miami and Erie canals. In 1837, the Ohio General Assembly passed 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 businesses within the State provided those businesses were able to raise the remaining costs. In practice, however, most of the loans went to railroad companies

and spurred significant railroad growth in the State which ironically competed with the canal business. While the canal debt and railroad loans certainly improved the State's transportation infrastructure, they over-extended the State's treasury and the State had to borrow money to meet its expenses. By 1839, Ohio had a deficit of more than one-quarter of a million dollars and the Ohio Loan Law was repealed the next year. Following necessary reforms of the State's taxation and tax collection system in 1846, the State was able to refinance its debt and began making its debt service payments.

Given that context, it is easy to understand why the incurrence of debt and the State's ability to afford repayment of its debt were of great concern to the Constitutional Convention of 1850-1851. As you are undoubtedly aware, Section 1 of Article VIII limits debt not expressly authorized by the voters to \$750,000. Section 2 (and selected other sections of Article VIII) expressly authorize the purposes and amounts for which debt of the State may be issued, while Section 3 prohibits any other debt except that which has been expressly authorized. 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. The State's challenging financial history at the time of enactment of Article VIII explains our State's conservative approach to debt, debt authorization, and debt repayment.

Ohio Debt Overview - Present Day

At this time, I would direct your attention to Exhibit 1 – a summary of debt authorization provisions of Article VIII and 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). By 22 constitutional amendments approved from 1921 to 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 our war veterans. Currently, general obligation debt of the State 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. 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.

The below table summarizes 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). 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. Fiscal year 2015 GRF debt service represents approximately 3.9% of fiscal year 2015 GRF revenue plus lottery profits.

\$ in Billions	GRF Debt	GRF Debt Service	GRF Debt Service % of GRF Revenue & Lottery
	\$9.35	\$1.28	3.9%

With respect to the issuance of debt backed by State revenues, 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. 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. As you are aware from prior testimony of the Treasurer of State’s office, 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 Treasurer. However, the Sinking Fund Commission still technically exists and periodically must approve the reporting work done on its behalf by the Treasurer's office.

Other bond issuers in the State you may be familiar with, such as 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.

Possible Modifications to Article VIII

Prior to discussing potential modifications to Article VIII, I want to emphasize that Article VIII and its framework for authorizing debt of the State has served the State exceptionally well for more than 150 years. 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. 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. The voters have proven themselves to be worthy arbiters, having approved 26 and rejected 17 Article VIII debt related ballot issues since 1900. Thus, I would propose to the Committee that Article VIII works as intended and that wholesale reform is not warranted. One compelling piece of evidence of the State's favorable debt position under Article VIII is the credit agencies ratings which emphasize Ohio's conservative debt practices and that

existing debt of the State is both 'moderate' and 'affordable.' Ohio's credit rating is in the second highest possible category of 'AA+', which keeps the interest rates paid on State bonds very low.

In terms of specific opportunities to update Article VIII, I'd like to address the suggestion that Ohio needs to modernize the \$750,000 debt limitation of Section 1 because the 5.0% annual debt service limitation set forth in Section 17 of Article VIII is insufficient. This suggestion pre-supposes that our existing 5.0% debt service limitation could be thwarted by back-loading debt or substantially extending its amortization period (e.g., issuing 100-year debt). With respect to extremely long amortization periods, a review of Exhibit 1 shows that Ohio's debt authorizations include maximum terms that range from 10 to 30 years, and in practice our bond issuances have consistently been amortized over periods shorter than those maximums. In addition, Section 17 itself requires that the numerator of the 5.0% 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. For these reasons, the 5.0% debt service limitation has been and remains an effective limitation on both the amount of State debt and debt service. In fact, the 5.0% threshold is a key factor in why the credit rating agencies and investors take comfort that Ohio's debt burden is and will remain 'moderate' and 'affordable.' Moreover, Section 1 of Article VIII is critical because the \$750,000 limit, when considered in conjunction with other key Constitutional provisions, forms the basis of Ohio's balanced budget requirement.

There are, however, opportunities for improving the administrative efficiency and cost-effectiveness of State debt. As you are aware, the security backing the State's debt

affects its credit quality and thus the level of interest rates the State pays to investors. The State's general obligation debt carries our highest credit rating, currently 'AA+', and prices extremely well in terms of achieving low interest rates in the municipal bond market. Since 1973, Constitutional amendments authorizing new State debt have generally provided for general obligation security. However, the State still issues several categories of lease-appropriation debt under Section 2i which was approved by the voters in 1968. 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% to 0.3%, versus its general obligation counterpart. Thus, I would suggest 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. For each \$100 million of debt issued over 20 years, this change to general obligation security would save State taxpayers \$1.5 to 4.0 million over the life of the debt.

Another opportunity to reflect modern practice and to improve efficiency involves the Commissioners of the Sinking Fund provided for in Sections 7 through 11 of Article VIII. The Commissioners of the Sinking Fund -- originally consisting of the Attorney General, Auditor and Secretary of State -- were established in 1851 to administer the 'sinking fund' to 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 of the Sinking Fund expanded to include administering and issuing many types of State debt, and in 1947 the Governor and Treasurer were added as members. Beginning in the late 1950's, new State bond programs utilized dedicated

bond service funds separate from the sinking fund with debt service payments effectuated by the Treasurer and OBM. In 2001, the General Assembly transferred bond issuance authority from the Commissioners of the Sinking Fund 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. Thus, the Sinking Fund provisions of Article VIII are viable candidates for repeal. If this committee recommends their repeal, it should consider replacing them with a provision that assigns necessary ongoing debt reporting functions to the Treasurer of State.

Finally, I understand there has been some discussion in this committee regarding the repeal or removal of inactive bond issuance sections. While I have no concern with these sections remaining in the Constitution, I understand that some view elimination of inactive sections as helpful cleanup and there is precedent for such repeal as Section 2a authorizing compensation payments to World War I veterans was repealed in 1953. Moreover, the Ohio Constitutional Revision Commission (OCRC) in 1972 recommended the repeal or modification of additional sections within Article VIII, though only Section 12 providing for a Superintendent of Public Works was later repealed. Current sections that are candidates for repeal include 2b, 2c, 2d, 2e, 2f, 2g, 2h, 2j, and 2k (see Exhibit 1 for a summary of these provisions). Repeal of these sections would shorten the length Article VIII by 40%, though there would need to be new language added confirming the continuing validity of obligations issued under those sections.

Closing

In summary, the central concepts of Article VIII have served our state well for more than

150 years. While some work can and should be done to modernize it, I believe there should be a high threshold for amendments to the debt provisions of Article VIII and that voters should continue to be the final arbiters of the purposes and amounts for which long-term debt of the State may be issued.

To facilitate your review and consideration of the observations offered in this testimony, I have included as Exhibit 2 draft language that would effectuate the potential changes noted in this testimony. Thank you for the opportunity to present to you today. As you develop specific proposals with respect to the modernization of Article VIII, OBM will be sure to review those proposals and provide feedback. Thank you again. I would be happy to answer any questions at this time.