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Why Ohio Wants a Bond Bank.

DALLAS – Smaller Ohio governments would enjoy easier bond market access at lower costs through a state bond bank, say supporters of legislation to create one.

House Bill 435 passed the House on May 18 on a 95-1 vote and has strong bipartisan support from legislators and Gov. John Kasich's administration, said its sponsor, Rep. Jeff McClain, R-Upper Sandusky.

"The rules, laws and everything about issuance of bonds under the bond bank legislation is exactly the same as what we already have for bond issuance in the state of Ohio," McClain said. "The hope is that we will be able to pool some of the smaller entities like townships and villages and they can take advantage of a bigger pool and better rates."

McClain worked in conjunction with the state treasurer's office on the bill.

"The goal of the bond bank is to allow local governments to borrow at a lower cost than they could achieve on their own," said Amanda Merritt, press secretary for Treasurer Josh Mandel. "The bond bank can potentially provide significant cost savings to local government issuers with reduced interest rates and reduced costs of issuance."

The governing rules for the proposed bond bank would allow it to issue bonds and use the proceeds to make loans to local governments throughout the state at their request.

The entity could consolidate local bond issues to create a single, pooled issue, allowing smaller local governments the advantage of accessing the state's investment grade ratings.

Under HB 435, the Treasurer's office would administer the bond bank. Like the existing Ohio Market Access Program (which received the 2014 Bond Buyer Small Issuer Deal of the Year Award) and the State Treasury Asset Reserve of Ohio Program, the bond bank would be another treasurer's office program designed to benefit local governments.

As with those programs, the bond bank would be entirely voluntary, with the goal of giving local governments additional low-cost financing options. In terms of savings, ratings and the number of issuances per year, it's too early to say.

Supporters say a bond bank structure spreads risk, netting better interest rates and lower issuing costs.

Market participants say the benefits are clear.

"The bond bank recognizes that the implicit credit of the state is valuable in reducing the cost to its cities of capital financing for that infrastructure so essential not just to health; drinking water, police & fire stations, etc.; but also to public infrastructure investment from wastewater to bridges, etc. — investments which are fundamental to the overall state economy," said Frank Shafroth, director at the Center for State and Local Government Leadership at George Mason University.

Progress on the bond bank comes in a state funding environment that has been hostile to local governments.

“The state really hammered local governments with three blows: they cut the local government fund in half, they phased out property tax and eliminated the estate tax,” said Wendy Patton, the Senior Project Director at Policy Matters Ohio. “All of those funds could be used for operation by localities and that is where the real loss and injury has been.”

Municipalities saw the Local Government Fund, critical to the survival of many local services, cut in half five years ago.

Under the LGF, established in the 1930s, local governments receive a set percentage of all taxes collected by the state.

“In some cases these funds are essential to the very survival of some local governments,” said Shafroth.

The state legislature also eliminated the estate tax in Ohio in the 2012-2013 budget. Local governments received 80% of the revenue; in the last year of existence it contributed between $220 and $300 million, according to Patton.

“Local governments looked to that source as a capital fund for replacing vehicles or capital goods that was eliminated and it was a major source of funding for capital infrastructure,” said Patton. “To the extent that communities are facing needs for capital goods and are lacking the estate tax to build up a fund … the state bank would be helpful as a source of funding for capital needs.”

The bond bank, while making lower cost capital funding available, won’t substitute for the loss of unrestricted funds such as those lost from the LGF, which typically funded operations.

“The state bond bank won’t address that loss,” said Patton.

Cuts to local government are evident in East Cleveland; on April 27, Mayor Gary Norton Jr. formally petitioned State Tax Commissioner Joseph Testa for permission to file for Chapter 9 bankruptcy because is struggling to meet payroll and benefit obligations because of a revenue crunch that is not likely to ease.

The city’s major sources of revenue come from income taxes, local government revenues distributed by the state, property taxes, and trash collection fees, as well as a street lighting assessment. The city has seen steep reductions in the past few years. It has no bond debt.

“Because of disparities between communities, those with the greatest needs for infrastructure investment — think East Cleveland — confront the greatest borrowing costs; so the state has significant incentives to help not just level the playing field, but also to leveraging capital investment in ways that will help the underlying state economy,” said Shafroth.

If the Senate passes the legislation, Ohio would join other states that use bond banks to pool borrowing capacity for smaller local governments and projects.

“The structure of a number of other states’ bond banks were considered in the creation of HB435, though the proposed bond bank is set up to best meets the needs of Ohio’s local governments,” said Merritt.

McDaniel said that in the development of the Ohio legislation there were some “conversations” about how Indiana modeled its bond bank.

The Indiana State Bond Bank was established as a self-supporting quasi-government entity by the Legislature in 1984. A seven-member board oversees the Bond Bank, with the Treasurer as the chair of the board. The Public Finance Director of the Indiana Finance Authority is statutorily appointed, with the remaining five members being appointed by the Governor.

As with Indiana's bond bank, Ohio's local governments would be on the hook for repaying bondholders, not the state.

"Ohio's current legislation does not provide for any state backing of the bonds, but does contemplate an intercept mechanism," said Merritt. Intercept mechanisms on revenues, such as state aid, give potential investors some comfort that borrowers will be forced to make good on their obligations.

The state is rated AA-plus by S&P Global Ratings and Fitch Ratings and Aa1 by Moody's Investors Service.

The Bond Buyer

By Nora Colomer

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