STATE HIGHWAY CAPITAL IMPROVEMENT BOND AND GRANT ANTICIPATION REVENUE VEHICLES (GARVEE) BOND POLICY

POLICY STATEMENT:

State Highway Capital Improvement bonds are general obligations of the State of Ohio (State) and are issued by the Treasurer of Ohio for the purpose of funding highway capital improvements for which financing is not practical through proceeds from the State Highway Operating Fund.

GARVEE bonds are state authorized debt instruments issued to advance construction of certain capital highway projects. They are an option to traditional federal grant reimbursement pay-as-you-go state transportation projects, and allow for direct reimbursement of debt service costs from the federal government. They too are issued by the Treasurer of Ohio for the purpose of funding highway capital improvements for which financing is not practical through proceeds from the State Highway Operating Fund. GARVEES are special obligations of the State. They are not general obligations of the State or of the federal government. The primary security for these debt instruments are Federal-aid Highway Obligations for State projects.

The bonds are also secured by certain pledged receipts which are specified under the bond trust agreement. Depending on the blend of GARVEE projects, annual GARVEE debt service requires a 10% to 20% state matching contribution from State revenue sources or is waived through the use of Toll Revenue Credits.

AUTHORIZATION:

State Highway bonds are authorized and issued on behalf of the State by the Treasurer pursuant to constitutional and statutory authorizations. Section 2m of Article VIII of the Ohio Constitution, adopted by the electors of Ohio on November 7, 1995, Title I and Title 55 of the Ohio Revised Code (ORC) and acts of the Ohio General Assembly authorize the issuance of State Highway bonds.

GARVEE bonds are authorized and issued on behalf of the State by the Treasurer pursuant to constitutional and statutory authorizations, in particular, Section 13 of Article VIII of the Ohio Constitution and Section 5531.10 of the ORC. Direct payment of principal and interest on the bonds is authorized under U.S. Code Title 23, Sections 115 and 122.
SCOPE:

This policy is Department-wide and applies most specifically to the Division of Finance. This policy does NOT apply to obligations issued in connection with any bond funds associated with the State Infrastructure Bank Loan and Bond Programs, or any Capital Facilities Bonds.

BACKGROUND AND PURPOSE:

The purpose of this policy is to provide instruction and background information needed to issue State Highway and GARVEE bonds, to help determine under what circumstances to issue State Highway and GARVEE bonds, the nature of projects to fund with State Highway and GARVEE bonds, and to inform of certain risks and requirements, including federal internal revenue code (IRC) requirements, concerning the use of State Highway and GARVEE bonds. This policy supersedes Policy Number 18-008(P) issued December 28, 2010.

ODOT’s executive management recommends capital program funding levels based on forecasts of revenue and capital program needs as well as from various sources within the Department. Program levels include projects that will be funded entirely from a single revenue source or from a combination of state and federal highway revenue, proceeds from the issuance of State Highway bonds and or proceeds from the issuance of Federal Highway GARVEE bonds.

The use of a decision model is recommended to determine if it is less costly to currently undertake projects funded by bonds or to defer projects until a later date when the project may cost more due to inflation. By adjusting to present values, the model compares the interest cost on bonds needed to finance the project with the projected inflation cost that results from delaying the project.

APPROPRIATIONS FOR BOND PROCEEDS AND DEBT SERVICE PAYMENTS:

The only time ODOT is able to request appropriations or budget authorization for bond proceeds in the Highway Capital Improvement Fund (State Highway Bonds) or the Infrastructure Bank Obligation Fund (GARVEE Bonds) is during the legislative budget process. ODOT does not have the authority to seek additional bond appropriations through the state controlling board. For State Highway Bonds, ODOT must seek general assembly issuance authority as well as appropriation authority. GARVEE Bond issuance requires only appropriation authority and not general assembly issuance authority.

All encumbering and payment activity in the bond proceeds funds requires appropriations. In regard to ODOT debt service payments for State Highway Bonds, ODOT does not need appropriations to make the payments. ODOT satisfies its State Highway Bond debt service payments through a series of equal monthly cash revenue withholding by the Department of Taxation from its motor fuel tax revenue distributions. The tax withheld is provided to the
Treasurer of State for deposit into the State Highway Bonds debt service fund for payment to the trustee. ODOT must obtain appropriations for the payment of GARVEE bond debt service. ODOT estimates the amount of appropriations needed during the biennial budget process. If the estimated appropriations are insufficient to make the debt service payment, OBM has the authority to increase appropriations in the related budget line items. If the appropriations requested are in excess of the amount needed to satisfy the GARVEE debt service requirements, ODOT has legal authority to transfer the excess appropriations to be utilized elsewhere in its capital or operating programs.

**FISCAL LIMITATIONS FOR ISSUING STATE HIGHWAY BONDS:**

State Highway Bonds will be issued in a manner to ensure the outstanding principal balances from bonds issued by authority of section 2m, article VIII of the Ohio Constitution do not exceed $1.2 billion at any one time (Paragraph B, Section 2m, Article VIII, Ohio Constitution). In addition, not more than $220 million can be issued in any one year, plus the carryover of any prior fiscal years in which $220 million could have been issued but were not. (Paragraph B, Section 2m, Article VIII, Ohio Constitution). An amount issued to redeem a prior issue will not be counted against the fiscal year or the total year limit.

State Highway bonds shall mature in not more than thirty years from the date of issuance (Paragraph D, Section 2m, Article VIII, Ohio Constitution). ODOT’s practice is to use a maturity period between 10 and 15 years based on an analysis performed by the Treasurer’s Office. The expected life of the projects funded should be considered when determining the term for highway bonds.

Fiscal forecasts must indicate that annual debt service will not exceed 20% (ODOT Policy) of ODOT’s share of annual state revenue dedicated to highways. Fiscal forecasts must also ensure ODOT state highway revenues will adequately cover annual state highway bond debt service and operating expenses, and still have a sufficient amount remaining to meet the required 10% to 20% state match for use of Federal-aid Highway Funds (U.S. Code, Title 23 Section 120).

**FISCAL LIMITATIONS FOR ISSUING GARVEE BONDS:**

The State first issued GARVEE bonds in 1998. The Department stipulated in the Certificate and Agreement that the total amount of bond service charges would not exceed the lesser of (a) 25% of the lowest amount of pledged federal highway receipts received by the Department in any of the three immediately previous state fiscal years or (b) one hundred million dollars ($100,000,000). Later this stipulation was changed so that subsequent to the maturity of the Series 1998-1 bonds and Series 1999-1 bonds, the annual debt service charges could not exceed one-fifth (20%) of the average amount of federal highway receipts received by the Department in the three immediately previous state fiscal years. This stipulation was further changed with the Series 2012-1 bonds such that additional debt service charges could not exceed twenty percent (20%) of the highest annual amount of Obligation Authority distributed during any of the three most recently completed FFY immediately previous to the date of such issuance and delivery.
Due to the relative difficulty in forecasting future Federal-aid receipts from year to year, the forecasts prepared by the Division of Finance will base the calculation on ODOT’s estimated total annual Federal-aid Highway Obligation Authority. Regardless, ODOT’s policy will be to keep both calculations below 20%.

The expected life of the projects funded should be considered when determining the term of GARVEE bonds. Rating agencies prefer that the bond term not exceed two Federal authorization periods (twelve years).

**FACTORS INFLUENCING SIZE, TIMING AND USE OF STATE HIGHWAY CAPITAL IMPROVEMENT BONDS AND GARVEE BONDS:**

The size of a bond issue, be it either State Highway or GARVEE, should be consistent with the programming and funding of projects, so that forecasted expenditures of bond proceeds will occur within the spend down timetable set by USC Title 26, Section 148 (Internal Revenue Code (IRC) sec. 148) and being 10% within 6 months, 45% within 12 months, 75% within 18 months and 100% within 24 months of issue. The spend-down provisions of Section 148 of the IRC relate only to the question of whether any rebate of investment earnings to the Internal Revenue Service (IRS) is required.

State Highway bonds and GARVEE bonds are usually issued as tax exempt. Bond proceeds may be invested; however, if the bond investment yield of the bond proceeds exceeds the borrowing rate, a condition referred to as “arbitrage” exists. Arbitrage is governed by IRC sec. 148.

*IRC sec. 148* requires that the amount of interest earned resulting from an investment yield that is greater than the yield paid to the bond investors be remitted to the IRS by means of a tax filing every 5 years from the date of issue until the time the bonds are retired. If bond proceeds are disbursed according to the IRC timetable, an arbitrage filing is still required, but no payment is due regardless of the amount of excess interest earned. Sufficient lead time for the bond issuance process, usually two to three months, is necessary for proceeds from the issuance to be deposited in ODOT’s construction bond fund account at or near the time the proceeds from the previous issue are totally expended, and thereby assuring uninterrupted, timely payments to contractors. Use of bond proceeds for the funding of Highway Construction Projects will be in accordance with ODOT’s Capital Finance Plan. Bond proceeds used on capital transportation projects should be used for the construction phase. Bond proceeds should not fund right of way and design phases unless planned expenditures can reasonably be expected to meet IRC spend down requirements. As noted above, failure to meet the spend-down schedule means that a rebate may be due. It does not mean that the bonds automatically become taxable.

Because of the interest and issuance costs associated with State Highway and GARVEE Bonds, ODOT will fund its capital program, to the extent funds are available, from state and federal highway revenue before choosing to fund with bonds. The amount of a bond issue may be determined in conjunction with analysis using ODOT’s inflation vs. borrowing decision model to determine if it is less costly to either presently issue additional debt and complete projects now, or to defer projects and incur inflation costs until such time as the projects are sold.
ODOT may request the Office of Budget and Management (OBM) to transfer cash from the Highway Operating Fund to the Highway Capital Improvement Fund or to the Infrastructure Bank Obligation Fund if market conditions or other concerns prevent bonds from being issued in a timely manner. Upon receipt of the bond proceeds, any amount transferred from the Highway Operating Fund to either the Highway Capital Improvement Fund or the Infrastructure Bank Obligation Fund will be transferred back from the respective fund to the Highway Operating Fund. ODOT’s authority to transfer cash between the Highway Capital Improvement Fund and the Highway Operating Fund lies in temporary law and must be requested in each biennial budget.

In addition to monitoring by its own staff, ODOT relies on the Treasurer’s office and on OBM to monitor and recommend the desirability of refunding outstanding State Highway and GARVEE bond issues.

**ANNUAL DEBT SERVICE FOR STATE HIGHWAY BONDS:**

Interest on State Highway bonds is payable each May 1 and November 1, whereas annual principal payments are payable each May 1. ODOT’S share of State Motor Fuel Tax Revenue Derived from [ORC Section 5735.05](https://ohr.oag.ohio.gov/ohrweb/ohrweb_display_document.aspx?dc=5735.05&d=14155) is deposited to the Highway Improvement Bond Service Fund in 6 equal monthly payments beginning in September ([ORC Section 5735.23 Paragraph D](https://ohr.oag.ohio.gov/ohrweb/ohrweb_display_document.aspx?dc=5735.23&d=14165)) of each year. Scheduling annual principal payments for the following May helps to ensure that sufficient funds are available in the Highway Capital Improvement Bond Service Fund.

As general obligations of the state, the full faith and credit, revenue and taxing power of the State shall be pledged to the payment of debt service; all fees, excises, or license taxes relating to the registration, operation or use of vehicles on the public highways or to fuels used to propel those vehicles, the highway user receipts, and money deposited in the State Highway Capital Improvement Bond Service Fund may be pledged to the timely payment of bond service charges ([Paragraph D, Section 2m, Article VIII, Ohio Constitution](https://ohr.oag.ohio.gov/ohrweb/ohrweb_display_document.aspx?dc=5735.23&d=14165)).

**ANNUAL DEBT SERVICE FOR GARVEE BONDS:**

With respect to any federal fiscal year for which moneys constituting pledged federal highway receipts, toll revenue credits, or state highway operating revenues are available, the Department will cause to be deposited in the State Infrastructure Bank Revenue Bond Service Fund by October 15th of each year, an amount equal to all bond service charges payable on the bonds and parity obligations for the federal year prior to any other payment to be made from such moneys during that federal fiscal year.

Payment of bond service charges is dependent on biennial appropriations made to the Department by the General Assembly. If the funds are not appropriated, the obligation of the Department to cause moneys to be deposited with the Treasurer sufficient for the payment of bond service charges will terminate. The bonds are special obligations of the State secured solely
by the pledged federal highway receipts. The bonds are not a debt of the State and bondholders have no right to moneys raised by taxation by the State.

**GENERAL OBLIGATION STATE HIGHWAY CAPITAL IMPROVEMENT BOND REFERENCES:**

- Ohio Constitution, Article VIII, Section 2m
- ORC, Title LV, Section 5528
- ORC, Title I, Section 151.06
- ORC, Title LVII, Section 5735.05 and 5735.23
- IRC, Section 148

**FEDERAL-AID HIGHWAY GARVEE BOND REFERENCES:**

- US Code Title 23, Sections 122 and 120
- Ohio Constitution, Article VIII, Section 13
- IRC, Section 148
- ORC, Title LV, Sections 5531.09 and 5531.10

Certificate of Agreement between the Treasurer of State and Director of Transportation

**TRAINING:**

At this time, no additional training of Division of Finance employees is contemplated. Future training may be required from time to time as laws, policies and accepted practices change or are modified.

**FISCAL ANALYSIS:**

Continued use of State Highway and GARVEE bonds will provide ODOT timely funding of capital projects and at the same time reduce the current funding required from state and federal highway revenue.