Tobacco Securitization

Edward Millane, Budget Analyst
Phil Cummins, Economist
Jason Phillips, Budget Analyst

- Net proceeds from the securitization estimated to be $5.04 billion
- Proceeds will be used to finance school construction; GRF debt service savings to be used to expand property tax relief
- Nonschool facilities related tobacco budget programs have two fiscal years to secure new funding sources or phase down their activities

INTRODUCTION

In November 1998, as part of the Tobacco Master Settlement Agreement (MSA), the state of Ohio, along with more than 40 other states, the District of Columbia, and several territories ended litigation against leading domestic tobacco manufacturers to obtain relief for state health care costs related to smoking. In exchange for the settlement, Ohio received annual payments that, at the time the settlement was announced, were estimated to total $10.1 billion over 26 years (from FY 2000 to FY 2025). Under the MSA, payments were to continue in perpetuity. Once received by the state, MSA dollars were deposited into the Tobacco MSA Fund (Fund 087). The dollars collected interest while in Fund 087 and then were distributed to various trust funds pursuant to the allocations established in former Revised Code section 183.02 shortly after the end of the fiscal year in which the dollars were received.

The budget authorizes the securitization of Ohio's payments to be received over the next 40 or more years under the MSA and specifies that the proceeds be used for spending on the construction of school buildings and higher education facilities throughout the state. Since these capital costs will not be financed with bonds serviced by GRF, the required GRF debt service payments for the School Facilities Commission (SFC) and higher education will be lower in the next three years. Under the budget, GRF moneys that would otherwise be used to finance bonds issued for SFC and higher education projects in the next three years will be used to expand the Homestead Exemption Program.

ANALYSIS OF THE BUDGET

K-12 School and Higher Education Facilities Construction

The budget creates the Buckeye Tobacco Settlement Financing Authority for the securitization of up to 100% of Ohio payments to be received over the next 40 or more years under the Tobacco Master Settlement Agreement. The budget requires that at least 75.0% of the aggregate net proceeds of the obligations issued with tobacco securitization moneys must be paid to the School Building Program Assistance Fund (Fund 032) and limits the use of net proceeds to SFC and other capital facilities projects. It also provides that any net proceeds in excess of $5.0 billion must be deposited into that fund to assist SFC with additional support for school facilities projects.

When the tobacco payment securitization plan was initially proposed last March, the Office of Budget and Management (OBM) estimated that it would raise about $5 billion; however, the heightened risk aversion recently evident in financial markets, if it continues, could result in issuance of this debt on less favorable terms than anticipated earlier. The sale is expected to take place this fall. The obligations will not be general obligations of the state and will not be secured by the full faith and credit of the state.

According to OBM's original estimates, $2.20 billion would fully fund all of the tobacco funding allocated by former section 183.02 of the Revised Code to the Education Facilities Trust Fund (Fund N87) and the Education Facilities Endowment Fund (Fund P87) for FY 2008 through FY 2025. The remaining $2.84 billion would be used to pay for the capital costs of SFC ($1.92 billion) and higher education ($0.92 billion) over the next three years. In May 2007, SFC offered funding to 44 districts. Anticipating the additional funding from the tobacco securitization, SFC offered funding to another 57 districts in July 2007. SFC has now offered assistance to over half of the school districts in the state.

Since these capital costs will not be financed with bonds serviced by GRF, the required GRF debt service payments for SFC and higher education will be lower in the next three years. Under the budget, GRF moneys that would otherwise be used to finance bonds issued for primary and secondary school construction and higher education projects in the next three years will be used to expand the Homestead Exemption Program.

The Homestead Exemption

The Homestead Exemption is a property tax reduction granted to homeowners who are at least 65 years of age or are permanently and totally disabled and to their surviving spouses meeting certain conditions. The operating budget act expands the homestead exemption to $25,000 of market value and eliminates an income ceiling for eligibility along with two additional tiers of increasing exemptions at lower incomes. Tax relief will be at the effective millage rate for the real property rather than at the gross rate under the previous program. Participants in the prior homestead exemption program are to receive the greater of the tax relief under that program or the new program. The state will reimburse school districts and other local governments for forgone tax receipts. The change is effective for tax year 2007 for real property, paid one year in arrears, and tax year 2008 for homeowners whose primary residences are taxed as manufactured or mobile homes, paid concurrently.

The initial application deadline for the expanded homestead exemption is October 1, 2007. For homesteads in housing cooperatives, the nonprofit corporation that owns and operates the housing cooperative was required to obtain applications from the auditor and provide them to occupants by August 1. Applications were due to be returned to the corporation by September 1, and the corporation is to file them with the auditor by October 1. For an applicant whose request for a homestead exemption is denied, the auditor's deadline in CY 2007 to notify the applicant of the reason for the denial is extended to November 1.

The additional cost to the state for reimbursing school districts and other units of local government for forgone tax revenues is estimated at $128.5 million in FY 2008, $257 million in FY 2009, and growing amounts in future years.

County auditors will be compensated for the additional costs of administering the expanded homestead exemption, in an amount equal to 1% of property tax relief reimbursement paid to counties for the homestead exemption and the 2.5% rollback. The reimbursement to the county auditor for expenses relating to the homestead exemption is to be paid on the first day of August of each year. The estimated cost to the state for compensation to county auditors is $3 million in FY 2009. However, budget language leaves in place compensation provided in current law (R.C. 323.156), of 2% of the amount of these reductions, which appears to imply total compensation to county treasurers and auditors equaling 3% of these costs.

The expected cost of the expanded homestead exemption to the state in FYs 2008 and 2009 about equals the savings on GRF interest associated with the securitization of future tobacco settlement payments, according to the estimates in the executive budget proposal. The securitization is a borrowing to be repaid with future tobacco settlement payments. Anticipated homestead exemption costs of $128.5 million in FY 2008 and $257 million in FY 2009 approximate the sum of (1) interest savings to the GRF from use of proceeds from the tobacco securitization in lieu of funds from issuance of GRF-backed bonds for capital needs of primary, secondary, and higher education facilities, plus (2) interest earnings to the GRF from investment of proceeds from the tobacco securitization that have not yet been spent for educational facilities. Specific amounts are not appropriated for these purposes in the budget. Instead, Section 518.03 of the main operating budget act requires the Director of Budget and Management to determine appropriate amounts, following issuance of the bonds, and to transfer or increase appropriations with Controlling Board approval to the line items from which the reimbursements to school districts and other local governments are paid. Interest charges on the securitization would initially accrue at an annual rate of $252 million to $265 million per year for borrowing $5.04 billion at the interest rates of 5% to 5.25% estimated in the executive budget proposal, but these interest charges would be non-GRF.

Tobacco Budget Programs

As a result of the securitization and the repeal of the Tobacco Master Settlement Agreement Fund and the schedule for transferring moneys in that fund to various other trust funds, the following funds will no longer receive scheduled MSA payments: the Tobacco Use Prevention and Cessation Trust Fund (Fund H87), the Southern Ohio Agricultural and Community Development Trust Fund (Fund K87), Ohio's Public Health Priorities Trust Fund (Fund L87), the Biomedical Research and Technology Transfer Trust Fund (Fund M87), the Education Facilities Trust Fund (Fund N87), the Education Facilities Endowment Fund (Fund P87, which was repealed), and the Education Technology Trust Fund (Fund S87). Additionally, the Attorney General and Tax Commissioner will no longer receive transferred funds from the Tobacco Master Settlement Agreement Fund to their respective tobacco settlement enforcement funds (Funds U87 and T87) to cover enforcement costs.

Transfers from MSA Funds

While the above funds will no longer receive scheduled MSA payments, the budget includes three provisions for transferring moneys out of some of them. First, the budget continues to direct interest earnings of the Education Facilities Trust Fund (Fund N87) to the School Facilities Commission Fund (Fund 5E3), which pays for the operating expenses of the Commission. Next, the budget directs $40 million to be transferred from the Education Facilities Endowment Fund (Fund P87) to the GRF in FY 2008, presumably before Fund P87 is abolished. Finally, the budget requires $9.98 million be transferred from the Tobacco MSA Fund (Fund 087) to the GRF on July 1, 2007, or as soon as possible thereafter and before any other transfers from Fund 087 are made.

FY 2009 Funding Allocations

For selected programs, the budget replaces MSA funding with other resources in FY 2009, in many instances, the GRF. Altogether, the budget shifts over $16.3 million from MSA funds to the GRF for FY 2009. The table below summarizes the FY 2009 funding allocations for the selected tobacco budget programs by agency and line item and compares them to the FY 2008 funding provided for those programs by Sub. S.B. 321 of the 126th General Assembly, the most recent tobacco budget act. Under the executive budget proposal, programs not related to school facilities will have two fiscal years to secure new funding sources or continue their phase down of activities.

Tobacco Budget Program Funding Crosswalk, FYs 2008-2009				
	Sub. S.B. 321/126th General Assembly (MSA) appropriations		Am. Sub. H.B. 119/127th General Assembly appropriations	
Agency	**Old Line Item**	**FY 2008**	**New Line Item**	**FY 2009**
Department of Alcohol and Drug Addiction Services (ADA)	L87 038-403, Urban Minority Alcoholism & Drug Abuse Outreach Programs	**$500,000**	GRF 038-404, Prevention Services[26]	**$500,000**
	L87 038-405, Juvenile Offender Aftercare Program	**$3,000,000**	GRF 038-401, Treatment Services[1]	**$3,000,000**
Attorney General (AGO)	J87 055-635, Law Enforcement Tech., Training & Facility Enhancements	**$3,350,000**[27]	N/A	**$0**
	U87 055-402, Tobacco Settlement Oversight, Admin. & Enforcement	**$723,797**	N/A[28]	**$0**
Department of Development (DEV)	M87 195-435, Biomedical Research & Technology Transfer Trust Fund	**$21,416,437**	5AD 195-677, Economic Development Contingency[1] (transfer from Unclaimed Funds)	**$19,400,000**
eTech Ohio Commission (ETC)	S87 935-602, Education Technology Trust Fund	**$4,350,000**	N/A	**$0**
Department of Health (DOH)	L87 440-414, Uncompensated Care	**$3,855,050**	GRF 440-511, Uncompensated Care & Emergency Medical Assistance	**$3,500,000**
Commission on Minority Health (MIH)	L87 149-402, Minority Health & Academic Partnership Grants	**$1,090,000**	GRF 149-501, Minority Health Grants[1]	**$1,000,000**
Dept. of Public Safety (DHS)	L87 767-406, Under-Age Tobacco Use Enforcement	**$610,560**	L87 767-406, Under-Age Tobacco Use Enforcement[29]	**$375,000**
Southern Ohio Agricultural and Comm. Development Foundation (SOA)	5M9 945-601, Operating Expenses	**$475,220**	GRF 945-321, Operating Expenses	**$475,220**
	K87 945-602, S OH Agr. Comm. Dev. Fndtn.	**$7,513,251**	GRF 945-501, S OH Agr. Comm. Dev. Fndtn.	**$7,513,251**
Department of Taxation (TAX)	T87 110-402, Tobacco Settlement Enforcement	**$328,034**	GRF 110-404, Tobacco Settlement Enforcement	**$328,034**
Tobacco Prevention Foundation (TUP)	5M8 940-601, Operating Expenses	**$1,717,159**	N/A[30]	**$0**

[26] Other programs are also funded out of this line item.

[27] Am. Sub. H.B. 119 amended Sub. S.B. 321, the most recent tobacco budget, to increase the appropriation in this line item in FY 2008 from $0 to $3,350,000.

[28] The executive budget proposal included $723,797 in GRF funding for Tobacco Settlement Enforcement in line item 055-404 in FY 2009. However, the budget does not provide this appropriation.

[29] Am. Sub. H.B. 119 appropriated funding for FY 2009 out of Fund L87 using the same line item that is used for the program in the Tobacco Budget.

[30] The budget provided no appropriation in FY 2009 for the Tobacco Prevention Foundation, but allowed the Foundation to form a nonprofit corporation to raise money to aid it in carrying out its duties.