

**JOINT RESPONSE TO PROPOSED ELIMINATION OF INSIDE MILLAGE PER H.B. 335
FROM OHIO BOND COUNSEL FIRMS**

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Via Electronic Mail

The Honorable Bill Roemer, Chair
Ways and Means Committee
Ohio House of Representatives
77 South High Street, 11th Floor
Columbus, OH 43215
Email: rep31@ohiohouse.gov

Members of the Ways and Means Committee

The Honorable David Thomas, Vice Chair
E-mail: rep65@ohiohouse.gov

The Honorable Daniel Troy, Ranking Member
E-mail: rep23@ohiohouse.gov

The Honorable Gary Click
E-mail: rep88@ohiohouse.gov

The Honorable Jack Daniels
E-mail: rep32@ohiohouse.gov

The Honorable Steve Demetriou
E-mail: rep35@ohiohouse.gov

The Honorable Derrick Hall
E-mail: rep34@ohiohouse.gov

The Honorable Beth Lear
E-mail: rep61@ohiohouse.gov

The Honorable Tracy Richardson
E-mail: rep86@ohiohouse.gov

The Honorable Elgin Rogers, Jr.
E-mail: rep42@ohiohouse.gov

The Honorable Nick Santucci
E-mail: rep64@ohiohouse.gov

The Honorable Mark Sigrist
E-mail: rep10@ohiohouse.gov

The Honorable Jim Thomas
E-mail: rep49@ohiohouse.gov

Re: Impact of the proposed prohibition against the levying and collection of taxes within the ten-mill limitation per House Bill 335, as introduced in the Ohio General Assembly on June 4, 2025, and generally, as such matter may become part of other legislation (“**H.B. 335**”)

Dear Chair Roemer and Committee Members:

We are writing to address certain legal issues, as well as other concerns and challenges presented by the proposed prohibition against the levying and collection of taxes within the ten-mill limitation, not the least of which are concerns regarding the constitutionality and legality of such a provision.

Background regarding Inside Millage

Ohio Constitution Article XII, Section 2 prohibits the taxation of property in excess of one percent of its true value without voter approval (the “**Unvoted Tax Limitation**”). Ohio Revised Code (ORC) Section 5705.02 further limits the constitutional standard to ten mills of property tax valuation as it pertains to a particular parcel (the “**Ten-Mill Limitation**” and together with the Unvoted Tax Limitation, the “**Inside Millage**”), and requires that such taxation be “by uniform rule according to value.” “Inside Millage” refers to this one percent of assessed value that serves as an unvoted tax limitation, as well as an indirect limit on the amount of unvoted debt that may be incurred, and is allocated among overlapping political subdivisions.

Ohio Constitution Article XII, Section 11, requires a pledge of taxes to secure unvoted general obligation debt¹, and statutes provide that the first use of Inside Millage is to pay debt service².

As drafted, H.B. 335 would, among other things, prohibit all political subdivisions, except for townships³, from levying Inside Millage. The provisions of H.B. 335, particularly the elimination of the Inside Millage, present a number of issues, concerns, and challenges with respect to unvoted general obligation debt of Ohio political subdivisions, as outlined herein.

Issues for Consideration

The undersigned law firms, each of which routinely serve as bond counsel for Ohio political subdivisions, request reconsideration of the elimination of Inside Millage as presented in H.B. 335 for the following reasons:

- **Constitutional and Statutory Prohibitions on Impairment of Contract:** Article II, Section 28 of the Ohio Constitution prohibits the passage of laws that impair contract provisions. In addition, ORC Section 133.25(D) states that laws may not be passed that reduce, rescind or impair responsibilities or covenants affecting “Chapter 133 securities,” such as unvoted general obligation bonds. Article XII, Section 11 of the Ohio Constitution requires political subdivisions to levy and collect sufficient taxes in order to pay debt service on bonded indebtedness, such as unvoted general obligation bonds, which is typically accomplished through bond legislation of a political subdivision⁴. This legislation, together with the bonds themselves and other related documentation, represents a contractual relationship between a political subdivision and the holders of the bonds. With respect to unvoted general obligation bonds that are currently outstanding, Article II, Section 28 of the Ohio Constitution and ORC Section 133.25(D) prohibit the elimination of Inside Millage, as it would eliminate the security provided to the holders of those bonds under the bond contract and represent a breach of contract by the political subdivision (see “*Challenges from Bondholders*” below); moreover, the elimination of the security for such unvoted general obligation bonds would immediately put those bonds in technical default. The covenant to levy and collect taxes, inclusive of Inside Millage is a fundamental component of the security expected by the capital markets and investors in bonds of Ohio political subdivisions. Further, the elimination of Inside Millage will remove the most commonly used tool for Ohio political subdivisions in financing necessary public improvements.
- **Enforceability Concerns:** Since Inside Millage has its origins in the Ohio Constitution, the elimination of Inside Millage pursuant to H.B. 335, as a statutory provision, presents enforceability issues. That is, constitutional provisions generally take priority over statutory provisions. Article XII, Section 11 of the Ohio Constitution requires a tax to be levied and

¹ Article XII, Section 11 of the Ohio Constitution states, “No bonded indebtedness of the state, or any political subdivisions thereof, shall be incurred or renewed unless, in the legislation under which such indebtedness is incurred or renewed, provision is made for levying and collecting annually by taxation an amount sufficient to pay the interest on said bonds, and to provide a sinking fund for their final redemption at maturity.” By virtue of the Ohio Constitution and the Ohio Revised Code, Inside Millage is used to satisfy this requirement and has already been pledged to bondholders of billions of dollars of bonds.

² See ORC Section 5705.51.

³ Townships would be permitted to levy only up to the amount of Inside Millage levied in tax year 2024.

⁴ See also ORC Section 133.23(C), which states, “[i]f the bonds are general obligations of the subdivision or a property tax is otherwise required to be levied for the purpose, the legislation shall provide for the levying of a property tax sufficient in amount to pay the debt charges on the bonds issued under the legislation...”

collected when unvoted general obligation bonds are issued and thus the elimination of this security raises enforceability concerns in connection with such bonded indebtedness. In addition, certain political subdivisions, namely municipal corporations also have powers derived from the Ohio Constitution, such as home rule powers⁵, which when coupled with the ability to levy taxes within the Unvoted Tax Limitation, make the enforceability of H.B. 335, as applied to the elimination of Inside Millage, questionable at best. Closely related to this issue is the question of what would prevent a municipal corporation from exercising its constitutional rights (specifically, a right to levy taxes not in excess of the Unvoted Tax Limitation in combination with home rule powers) to levy and collect 100% of Inside Millage (or perhaps more precisely, 100% of the Unvoted Tax Limitation).

- **What Happens to Outstanding Unvoted General Obligation Bonds?:** Without Inside Millage, what happens to currently outstanding unvoted general obligation bonds? Such bonds when validly issued, are contractually enforceable (typically through a bond purchase agreement), and suddenly the pledged Inside Millage security would be eliminated by virtue of H.B. 335. There is no substitute security for Inside Millage. While different sources of funds may be utilized to support the repayment of bonds (such as sales taxes for counties and income taxes for municipal corporations), the elimination of Inside Millage not only necessarily impairs the very nature of unvoted general obligation bonds, but results in an immediate technical default because the security for such bonds has been eliminated. In issuing unvoted general obligation bonds, a political subdivision has promised its full faith, credit and taxing power (in practical terms, its Inside Millage) to repay such bonds, and with H.B. 335, that pledge is no longer available, thus placing such bonds in immediate default. This is a fundamental change in security without a substitute source of repayment. This would force Ohio political subdivisions to either (a) pay off outstanding unvoted general obligation bonds, which raises the question of what funds would be used to do so or (b) refund outstanding unvoted general obligation bonds with voted general obligation bonds or bonds secured by another lawful revenue stream, neither of which may be an option for some political subdivisions. Any such efforts take significant amounts of time to accomplish and could not immediately cure the default, nor can they be accomplished unilaterally by political subdivisions, but would require all or some combination of redeeming bonds, issuing new bonds, identifying and engaging underwriters or purchasers, obtaining new credit ratings, and/or marketing and sales efforts, all of which would result in increased costs to taxpayers. In addition, any alternate statutory issuing authority will likely require a close examination and recalibration of permissible debt limits.
- **Challenges from Bondholders:** The elimination of Inside Millage will almost certainly be challenged by bondholders (and bond insurers and/or others deemed to have standing) as a breach of the existing contractual covenants and security made by political subdivisions that have issued unvoted general obligation bonds and holders of certificates of participation. These challenges will be based upon a number of Ohio Constitutional provisions and Ohio Revised Code provisions (as referenced within this correspondence), as well as legislative and contractual covenants within the bond documents.
- **Transition Period:** Even if the elimination of Inside Millage is limited to future unvoted general obligation bonds (which type of bond may not even exist if Inside Millage is eliminated), arguably, it will not be possible to eliminate Inside Millage as it applies to currently outstanding unvoted general obligation bonds. Thus, consideration would need to be

⁵ See generally, Article XVIII, Ohio Constitution.

given to a “transition period” that would need to last until all outstanding unvoted general obligation bonds in Ohio are paid off or such bonds mature, which, easily, could be 50 years, as permitted for some types of public improvements pursuant to ORC Section 133.20.

- **Weakening of Unvoted General Obligation Bonds; Risk of Defaults:** Unvoted general obligation bonds in Ohio are secured by a pledge of the “full faith, credit and taxing power” of a political subdivision, which primarily consists of a pledge of its Inside Millage. Without Inside Millage, political subdivisions could no longer effectively issue unvoted general obligation bonds. Additionally, to ensure that bondholders are paid, ORC Sections 5705.31 and 5705.312 require political subdivisions in Ohio to reprioritize the use of Inside Millage toward debt service if there is non-payment on unvoted general obligation bonds and notes. The elimination of Inside Millage as security for unvoted general obligation bonds would therefore weaken, if not effectively eliminate, one of Ohio’s most frequently used and market-accepted forms of debt. In addition, the inability to reprioritize the use of Inside Millage to cover any shortfalls in debt service may lead to an increase in bond defaults or the likelihood of bond defaults. As a result, the financing of critical public improvements by political subdivisions would be severely impacted by the proposed legislation as investors are likely to lose confidence in Ohio unvoted general obligation bonds.
- **Certificates of Participation (COPs):** There are many school districts throughout Ohio who utilize Inside Millage (or a portion thereof) as the primary source of payment for COPs (an appropriation-based type of lease not subject to debt limitations). The elimination of Inside Millage will strain general fund budgets, causing cuts to essential curriculum and/or services and/or lead to payment and non-payment defaults on COPs. Similarly, investors will lose confidence in COPs and similar lease-purchase obligations.
- **Rating Agency Considerations and the Cost of Capital to Taxpayers:** Many political subdivisions have different credit ratings, depending on the strength of a particular form of security. Credit rating agencies (such as Moody’s and S&P) typically view a political subdivision’s unvoted and voted general obligation bonds as the strongest type of security, which type of security will receive the strongest relative rating (often referred to as an issuer’s “underlying credit rating”). A political subdivision’s full faith and credit pledge, which consists primarily of Inside Millage, is the foundation of its underlying credit rating from credit rating agencies. In Ohio, usually, there is no distinction between a political subdivision’s unvoted underlying credit rating and its voted underlying credit rating (these credit ratings are usually one in the same). However, with the elimination of Inside Millage, it is likely that rating agencies will distinguish between unvoted and voted general obligation bonds. Political subdivisions will be confronted with rating downgrades as a result of the elimination of Inside Millage, thus increasing future borrowing costs (all else being equal, higher credit ratings generally lead to lower borrowing costs). The cost of replacement debt will be higher. That is, alternate forms of security (such as sales tax or income tax) are often viewed as weaker forms of security, causing replacement debt to be more expensive, which will ultimately cost taxpayers more in debt service.
- **Maintenance Tax Considerations for Co-Funded School Construction Projects:** When school districts enter into project agreements with the Ohio Facilities Construction Commission (OFCC) for certain types of co-funded school construction projects, school districts are required by the Ohio Revised Code to commit to a 23-year half-mill maintenance tax or equivalent for purposes of maintaining co-funded classroom facilities. According to the Ohio Association of School Business Officials, 122 school districts in Ohio have reallocated Inside

Millage for permanent improvement uses, which Inside Millage, in many cases, is used to finance a school district's 23-year maintenance tax commitment. Without Inside Millage, school districts may be in default of their agreements with OFCC because they are not able to fulfill the statutorily mandated half-mill maintenance tax requirement.

- **Disruption of Tax Incentive Agreements; Revenue Bond Defaults:** For those political subdivisions who enter into tax incentive agreements utilizing Ohio's tax incentives for economic development, such as tax increment financing (TIF) and community reinvestment areas (CRA) to name a couple of such tax incentives, the elimination of Inside Millage will reduce the overall tax base upon which these transactions were structured. Inevitably, the expected revenues supporting revenue bonds that fund Ohio's critical infrastructure projects will fall short of expectations, as Inside Millage is typically an important part of the tax base. Since many, if not most, of these transactions operate on very thin margins, bond defaults are likely, which will impact the sustainability of existing and future public infrastructure projects, and indirectly weaken Ohio tax incentives for economic development.

These are just a few of the issues, concerns, and challenges that are likely to result from the proposed elimination of Inside Millage. The elimination of Inside Millage is not the same as eradicating "siloed" provisions in the Ohio Revised Code that are limited in scope. Inside Millage is the chief source of security for a significant part of Ohio's capital infrastructure. The sudden elimination of Inside Millage will have far-reaching unforeseen and unintended consequences, most of which will have a severely negative impact on Ohio political subdivisions, and Ohio taxpayers.

The undersigned firms appreciate the opportunity to present this broad summary of some of the unintended consequences that are likely to accompany the elimination of Inside Millage. Each firm is ready to discuss these matters in greater detail and to work with the General Assembly to provide solutions that, while accomplishing the desired policy goals of the General Assembly, ultimately maintain the integrity of Ohio capital markets as it pertains to providing critical financing mechanisms for various public improvements, for the benefit of Ohio taxpayers.

Very truly yours,

Bricker Graydon LLP
Rebecca C. Princehorn, Esq.
E-mail: rprincehorn@brickergraydon.com

Calfee, Halter & Griswold LLP
Blake C. Beachler, Esq.
E-mail: bbeachler@calfee.com

Dinsmore & Shohl LLP
Bradley N. Ruwe, Esq.
E-mail: bradley.ruwe@dinsmore.com

Frost Brown Todd LLP
Patrick M. Woodside, Esq.
E-mail: pwoodside@fbtlaw.com

Squire Patton Boggs (US) LLP
Catherine Z. Romancheck, Esq.
E-mail: catie.romancheck@squirepb.com

cc: Office of the Governor
Giles Allen, Director of Legislative Affairs, E-mail: giles.allen@governor.ohio.gov
Matt Donahue, Chief Legal Counsel, E-mail: matthew.donahue@governor.ohio.gov
Christine Morrison, Chief of Staff, E-mail: christine.morrison@governor.ohio.gov