Overview of State Bond Debt

This section describes the state's bond debt. It also discusses how Proposition 1—the $7.5 billion water bond proposal—would affect state bond costs.

Background

What Are Bonds? Bonds are a way that governments and companies borrow money. The state government, for example, uses bonds primarily to pay for the planning, construction, and renovation of infrastructure projects. The state sells bonds to investors to provide "up-front" funding for these projects and then commits to repay the investors, with interest, over a period of time. The two main types of bonds used by the state to fund infrastructure are general obligation bonds (which must be approved by voters) and lease revenue bonds (which do not have to be approved by voters). Most of the state's general obligation and lease revenue bonds are repaid from the General Fund. The General Fund is the state's main operating account, which it uses to pay for education, prisons, health care, and other services. The General Fund is supported primarily by income and sales tax revenues.

What Do Bonds Fund and Why Are They Used? The state typically uses bonds to fund public infrastructure projects such as roads, educational facilities, prisons, parks, water projects, and office buildings. State bonds have also been used to help finance certain types of private infrastructure, such as hospitals and housing for veterans. A main reason for issuing bonds is that infrastructure typically provides services over many years. Thus, it is reasonable for both current and future taxpayers to help pay for them. Additionally, the large costs of these projects can be difficult to pay for all at once.

What Are the Costs of Bond Financing? After selling bonds, the state makes annual payments until the bonds are paid off. The annual cost of repaying bonds depends primarily on the interest rate and the time period over which the bonds have to be repaid. The state often makes bond payments over a 30-year period (similar to homeowners making payments on their mortgages). Assuming an interest rate of 5 percent, for each $1 borrowed, the state would pay close to $2 over a typical 30-year repayment period. Of that $2 amount, $1 would go toward repaying the amount borrowed (the principal) and close to $1 for interest. However, because the repayment for each bond is spread over the entire 30-year period, the cost after adjusting for inflation is less—about $1.30 for each $1 borrowed.

Infrastructure Bonds and the State Budget

Amount of General Fund Debt. The state has about $87 billion of General Fund-supported infrastructure bonds outstanding—that is, bonds on which it is making principal and interest payments. This consists of about $76 billion of general obligation bonds and $11 billion of lease revenue bonds. In addition, the voters and the Legislature have approved about $29 billion of general obligation and lease revenue infrastructure bonds that have not yet been sold. Most of these bonds are expected to be sold in the coming years as additional projects need funding.

General Fund Debt Payments. In 2013-14, the General Fund's infrastructure bond repayments totaled over $5 billion. As bonds that were previously authorized but not yet sold are marketed, outstanding bond debt costs will rise, likely peaking at over $7 billion in 2019-20.

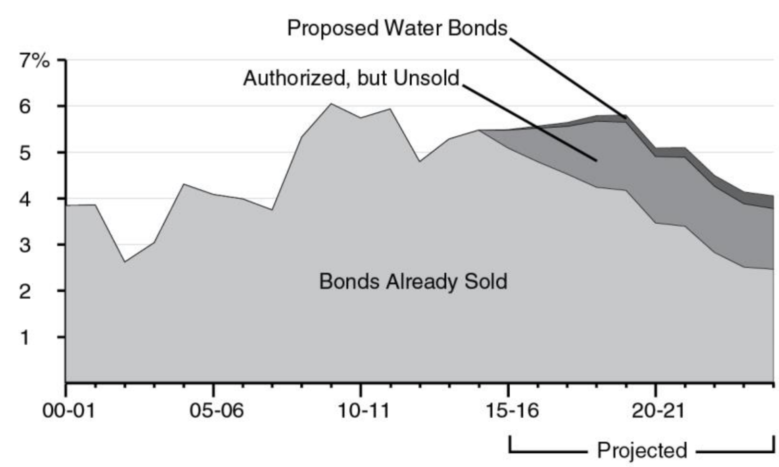
This Election's Impact on Debt Payments. The water bond proposal on this ballot (Proposition 1) would allow the state to borrow an additional $7.1 billion by selling general obligation bonds to investors. The amount needed to pay the principal and interest on these bonds, also known as the debt service, would depend on the timing and conditions of their sales. We assume an interest rate of just over 5 percent, that the bonds would be issued over a ten-year period, and that the bonds would be repaid over 30 years. Based on these assumptions, the estimated average annual General Fund cost would be about $360 million. We estimate that the measure would require total debt-service payments of $14.4 billion over the 40-year period during which the bonds would be paid off. Proposition 1 would also allow the state to redirect $425 million in unsold bonds that voters approved in previous elections. We assume that, without this measure, these bonds would eventually have been sold to fund other resource-related projects. As a result, redirecting the use of these bond funds would not have any additional fiscal effect on the state.

This Election’s Impact on the Debt-Service Ratio (DSR). One indicator of the state’s debt situation is its DSR. This ratio indicates the portion of the state’s annual General Fund revenues that must be set aside for debt-service payments on infrastructure bonds and, therefore, are not available for other state programs. As shown in Figure 1, the DSR is now about 5 percent of annual General Fund revenues. If voters do not approve the proposed water bond on this

Figure 1

General Fund Debt-Service Ratio

Percent of General Fund Revenues Spent on Debt Service



ballot, we project that the state's debt service on already authorized bonds will peak at under 6 percent of General Fund revenues in 2018-19, and decline thereafter. If voters approve the proposed water bond on this ballot, we project it would increase the DSR by less than one-third of a percentage point compared to what it would otherwise have been. The state's future DSR would be higher than those shown in the figure if additional bonds were authorized in subsequent years.