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Bonds and the November 1994 Ballot

OVERVIEW

Two bond measures totaling $1.2 billion will be considered by California voters in November. The Legislature soon must decide which, if any, additional general obligation bond measures to place on the November 1994 ballot. The following factors must be considered as the Legislature makes these decisions.

- **Tens of billions of dollars** will be needed over the next five years to meet the state's identified capital outlay needs.
- **Only $1.3 billion** of previously authorized general obligation bonds are available to address these needs.
- **How well the state addresses** its capital outlay needs will influence the state's future competitiveness and economic growth, and Californians' quality of life.
- **The state's annual debt burden** has risen sharply in recent years. These debt costs are a direct trade-off to using General Fund monies for support of other state programs.

Without additional general obligation bond authorizations, either few capital outlay needs will be addressed or more costly debt financing—such as lease-payment bonds—will have to be used.

WHAT ARE THE STATE'S CAPITAL OUTLAY NEEDS?

The five-year capital outlay plans submitted annually by state agencies provide a project-specific inventory of needs. Figure 1 provides a summary of these five-year plans, which total $47 billion for state agencies and K-12 education from 1994-95 through 1998-99. This amount includes $13 billion from special and federal funds for transportation capital outlay and $34 billion in other state agency and K-12 education needs. These estimates should be viewed with caution because the plans are incomplete and also may include proposals that, upon examination, do not merit funding. While recognizing these shortcomings, we believe the plans provide a reasonable assessment of the overall magnitude of need in those areas included in the plans. Overall funding needs will be even higher, however, if the state continues to provide funds for nonstate facilities such as local jails, parks, libraries, and water quality/treatment plants.

Figure 1

Projected Capital Outlay Needs For the State and K-12 Education 1994-95 Through 1999-00

(In Billions)

	Five-Year Total
State/Consumer Services	$1.5
Transportation	14.9[a]
Resources	0.6[b]
Health/Welfare	0.3
Youth/Adult Corrections	7.8
K-12 Education	15.0[c]
Postsecondary Education	6.3
General Government	0.3
Total	**$46.7**

[a] Includes $13 billion in funding from state and federal gasoline tax revenues, state truck weight fees, and state toll bridge revenues for the Department of Transportation.

[b] Does not include amounts for the Coastal Conservancy, the Santa Monica Mountains Conservancy, the Tahoe Conservancy, or the Wildlife Conservation Board, which do not prepare five-year plans.

[c] No statewide five-year plan. General estimate only.

Source: Legislative Analyst's estimates, based on information from state departments.

Most Authorized Bonds Are Allocated

Figure 2 summarizes the existing general obligation bonds which are unallocated to specific capital projects. For all of these capital outlay programs, only $1.3 billion remains available. Over two-thirds of this total is in transportation, and these unallocated funds are authorized by Proposition 116 for rail projects in specific transit corridors. Clearly, there are insufficient authorized bonds remaining to finance the multi-billion dollar capital outlay programs identified by those state and local entities that have relied on state bonds to finance these programs.

THE STATE'S USE OF BONDS

Financing with direct appropriations is less costly than using bonds. However, just as most families cannot pay "up front" the cost of a house, the

Figure 2

Unallocated General Obligation Bonds

(In Millions)

Program	
Transportation	$900
Parks/resources	—
Safe drinking water/clean water/ water conservation	—
County correctional facilities	—
State prisons/youth authority	11
K-12	145
Higher education	24
Libraries	—
Public buildings—seismic upgrading	223
Totals	**$1,303**

state cannot afford to finance many of its capital assets in such a way. The use of bond financing allows the state to acquire these assets sooner than it otherwise would. In addition, since capital investments provide benefits to citizens over many years, it often makes sense to spread the costs to taxpayers over time.

It is also important to note, however, that whenever the state chooses to fund its needs using bonds, the state is making a long-term committment of General Fund monies. For instance, for every $1 billion in general obligation bonds sold (at 6 percent interest), the state is committing to pay an average of $70 million in annual debt service costs for the next 25 years. Consequently, there is a trade-off between using bonds to fund the state's capital outlay needs and funding the state's ongoing General Fund-supported programs. It is, therefore, critical for the Legislature to consider the costs and benefits of the long-term capital investments it chooses to fund with bonds versus the costs and benefits of other state programs.

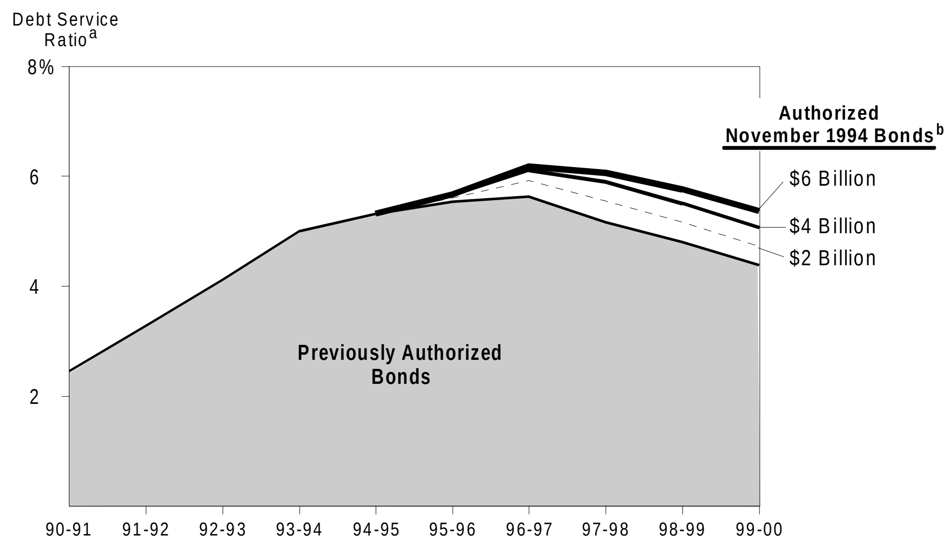
The State's Debt Burden

In 1994-95, the state will pay an estimated $2.2 billion in debt service on general obligation and lease-payment bonds. The state's "debt ratio" (debt payments as a percentage of General Fund revenues) for 1994-95 will be about 5.3 percent, which is relatively high compared to other states. In 1990-91, debt payments were about $1 billion and the debt ratio was 2.5 percent. The increase in the debt ratio is primarily due to the issuance of more bonds in recent years, but it has also risen because of the impact of the recession on General Fund revenues.

Figure 3 (next page) shows what would happen to the debt ratio in the future under several scenarios. For example, if all previously authorized bonds are sold (but no others are authorized), the debt ratio would reach a peak of about 5.6 percent in 1996-97 (debt payments would be $2.5 billion) and slowly decline thereafter. If an additional $2 billion is approved in November and then sold over a several-year period, the debt ratio would peak at 5.9 percent in 1996-97. For $4 billion and $6 billion of additional bonds, the debt ratios peak at 6.1 percent and 6.2 percent, respectively, in 1996-97. Actual future debt ratios will, of course,

Figure 3

Potential Impact of November 1994 Bonds



[a] Assumed interest rates on general obligation bonds: 6 percent through 1996 and 6.5 percent thereafter. Assumed interest rates on lease-payment bonds are 0.3 percent higher than interest rates on general obligation bonds.
[b] Assumes additional general obligation bond authorizations and subsequent sales over a three-to-six-year period.

depend on the timing, volume, and actual interest rates on bond sales, and on actual General Fund revenues.

What Level of Debt Should the State Assume?

We do not believe there is a "right" ratio of debt-service costs to General Fund revenue. As a result, the Legislature should not use an arbitrary debt-service ratio as the sole or driving factor in determining the level of bond financing. The key thing for the Legislature to focus on should be the trade-off between using state revenues to pay debt service on bonds to address the state's capital needs versus using these revenues to support or enhance other state programs. Given the state's relatively high debt burden and multi-billion dollar capital needs, it is critical that the Legislature establish its capital outlay spending priorities and target state bonds to these priorities.

Short-Term Budget Impacts of New Bonds

Given the state's continuing tight budget situation and the potential for "trigger" cuts in 1994-95 and 1995-96, a natural concern is the impact of new bond authorizations on short-term debt service spending. Because any bonds approved in November are unlikely to be sold immediately, there would not be *any* effect on state spending for 1994-95. For 1995-96, we estimate that $2 billion to $6 billion in new November general obligation bond authorizations would increase General Fund spending by about $30 million to $60 million. The exact impact would depend on the actual level of bond sales, which would in part be determined by the particular capital programs funded and the ability of projects in those programs to proceed with construction.

Impact of Changes in the State's Credit Rating

On July 15, 1994, the three major credit rating agencies (Fitch, Moody's, and Standard and Poor's) reduced the state's credit rating. This action is likely to have the effect of increasing slightly the interest rate the state pays on future bond issues. For every 0.1 percent increase in the interest rate, the state's debt service costs would increase by about $500,000 per year for each $1 billion in bonds sold.

Bond Measures Before the Legislature

General Obligation Bonds. As of July 7, 1994, there were 19 separate general obligation bond measures before the Legislature. Figure 4 (next page) summarizes these measures, which total $10 billion. The total without double-counting those measures that fund nearly identical programs is $6.9 billion. Programmatically, the $6.9 billion is comprised of $2.7 billion for education, $1.5 billion for criminal justice, $1.4 billion for resources, and $1.3 billion for other programs.

Lease-Payment Bonds. In addition to general obligation bonds, the state has issued several billion dollars in lease-payment bonds (commonly referred to as lease-revenue bonds or Public Works Board bonds). The debt service on most of these bonds (which are typically authorized for specific projects) is paid through annual lease payments made by the state agency using the facility, but, unlike general obligation bonds, is not backed by the full faith and credit of the state. For this and other reasons, lease-payment bonds cost the state more than general obligation bonds and, therefore, use up more of the state's debt capacity without providing any additional program benefits.

Figure 5 lists the pending legislation that would authorize lease-payment bonds. There are ten measures totaling $2 billion, the largest of which ($1.2 billion) is to develop four new state prisons. The authorization and sale of these bonds would add to the state's debt burden. If all of these measures are authorized, debt payments would be about $170 million per year. In some cases, however, the debt payments would not require entirely new state spending. For example, debt payments for new state office buildings would be offset in part by avoiding the current costs to occupy existing state-leased office space.

Figure 4

General Obligation Bonds Proposed for the November 1994 Ballot[a]

Bill	Author	Authorization (In Millions)	General Program Area
Criminal Justice			
ABX1 121	Speier	$25	Firearms buyback
SB 132	Roberti	425	Department of Forestry; Office of Emergency Services; local law enforcement facilities
SB 379	Lockyer	50	Courthouse security
SB 1963	Presley	1,000	Youth and adult corrections
Education			
AB 163	Areias	$900	Higher education
AB 1261	Eastin	200	School technology/safety
AB 1700	Eastin/Murray	1,800	K-12 facilities and technology
AB 2914	Snyder	100	Schoolbus safety
SB 189	Greene	1,000	K-12 facilities
Resources			
AB 1128	Cortese	$877	Parks, natural resources
AB 1637	O'Connell/Cortese	495	Clean water; safe drinking water; flood control
SB 158	Thompson	885	Parks, natural resources
SB 2103	Leslie	Unspecified	Auburn Dam
Other			
AB 61	Alpert	$100	Libraries
AB 638	Brown, W.	200	Local infrastructure
AB 2833	Baca/Bates/Moore/Solis	900	Military facilities reuse
ABX1 5	Baca	900	Military facilities reuse
SB 174	Marks	150	Libraries
SB 710	Watson	Unspecified	Child care
Total, all proposals		**$10,007**	
Total, without double-counting		**$6,930[b]**	

[a] Status of proposals as of July 7, 1994.

[b] Excludes authorizations for which another measure exists that calls for a nearly identical program. In these cases, the highest proposed authorization was used.

Source: Legislative Analyst's Office.

Figure 5

Proposed Authorizations of Lease-Payment Bonds[a]

Bill	Author	Authorization (In Millions)	Project
State Offices			
AB 3334	Conroy	$137[b]	Caltrans, Los Angeles
AB 3630	Karnette	75	Long Beach
SB 1410	Rogers	12	Caltrans, Inyo County
SB 1674	Johnston	189	Franchise Tax Board, Sacramento
SB 1854	Killea	140	San Diego
SB 1926	Johnston	105	Department of Corrections, Sacramento
Subtotal		**($658)**	
Other Projects			
AB 2458	Connolly	$33	Three additional veterans' homes in Southern California
AB 2496	Knight/Connolly	24[c]	Two additional veterans' homes in Southern California
AB 3182	Bates	90	Department of Health Services—Phase 2 laboratory, Richmond
SB 1688	Presley/Wyman	1,170	Four new state prisons
Total		**$1,951**	

[a] As of July 7, 1994.
[b] Bill does not specify amount. Estimated cost per DGS Los Angeles facilities plan.
[c] Not included in total.

How Many and Which Bonds for November?

In deciding how many and which general obligation bonds to place on the November ballot, the Legislature should be guided by (1) the state's capital outlay needs and (2) the Legislature's priorities for addressing these needs. It is important to remember that *certain capital outlay needs can be postponed but they cannot be avoided indefinitely*. Regardless of whether new bonds are approved, K-12 enrollments and prison inmate populations are projected to continue growing. Though higher education enrollments have recently declined, future growth is predicted. Furthermore, aging facilities and infrastructure (such as sewer and water systems)—whether on a college campus, a state hospital, or a firefighting base—will not function indefinitely.

We believe that the Legislature should consider the following factors in making decisions about which bonds to place on the November ballot.

- Is the capital outlay program clearly a state responsibility?

- If the program is a local responsibility, why should the state assist with funding?
- Are there ways to reduce capital outlay needs?
- Is the capital outlay program urgently required for health and/or safety purposes?
- Will funding be available to operate and maintain the capital investments?

Bond Measures Already on the Ballot

Two general obligation bond measures have already been placed on the November ballot through previous legislation. These measures are (1) $1 billion for rail projects and (2) $185 million for a first-time homebuyers assistance program. We believe the Legislature should review these measures—taking into consideration the above factors and the priority of these measures compared to other state capital outlay needs—when deciding which measures to place on the November ballot.

CONCLUSION

The state will have to rely, to a great extent, on bond financing to meet its capital outlay needs, which total tens of billions of dollars over the next five years. In deciding whether to place additional bond measures on the November ballot, it is important to consider that the use of bond financing requires a long-term committment of General Fund monies, and, thus a trade-off between expenditures for long-term capital investments and ongoing General Fund-supported programs. It is therefore essential that bond authorizations be directed to the state's highest priority capital outlay needs. This paper identifies several factors which can help the Legislature in making these decisions.

This Policy Brief was prepared by Charles Nicol, under the supervision of Gerald Beavers. For additional copies contact the Legislative Analyst's Office, State of California, 925 L Street, Suite 1000, Sacramento, CA 95814, (916) 322-8402.