# Overview of State Bond Debt

This section describes the state's bond debt. It also discusses how Proposition 51—the $9 billion school bond proposal—would affect state bond costs.

## Background

***What Are Bonds?*** Bonds are a way that governments and companies borrow money. The state government uses bonds primarily to pay for the planning, construction, and renovation of infrastructure projects such as bridges, dams, prisons, parks, schools, and office buildings. The state sells bonds to investors to receive "up-front" funding for these projects and then repays the investors, with interest, over a period of time.

***Why Are Bonds Used?*** One reason for issuing bonds is that the large costs of infrastructure projects can be difficult to pay for all at once. Additionally, infrastructure typically provides services over many years. Thus, it is reasonable for people, both currently and in the future, to help pay for these projects.

***What Are the Main Types of Bonds?*** The two main types of bonds used by the state are general obligation bonds and revenue bonds. The state repays general obligation bonds using the state 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. Under the California Constitution, state general obligation bonds must be approved by voters.

In contrast, the state repays revenue bonds typically using revenue from the fees or other charges paid by the users of the project (such as from bridge tolls). In other cases, certain revenue bonds are paid using the state General Fund. Under current law, state revenue bonds do not require voter approval. (We note that Proposition 53, described earlier in this voter guide, would require state revenue bonds totaling more than $2 billion for a single state project to receive statewide voter approval.)

***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 many 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 much less—about $1.30 for each $1 borrowed.

## Infrastructure Bonds and the State Budget

***Amount of General Fund Debt.*** The state has about $85 billion of General Fund-supported infrastructure bonds outstanding—that is, bonds on which it is making principal and interest payments. In addition, the voters and the Legislature have approved about $31 billion of General Fund-supported 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. In 2015-16, the General Fund's infrastructure bond repayments totaled close to $6 billion.

***This Election's Impact on Debt Payments.*** The school bond proposal on this ballot (Proposition 51) would allow the state to borrow an additional $9 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 specific details of the bond sales. We assume an interest rate of 5 percent, that the bonds would be issued over a five-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 $500 million, about 8 percent more than the state currently spends from the General Fund for debt service. We estimate that the measure would require total debt-service payments of about $17.6 billion over the 35-year period during which the bonds would be paid off.

***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 school bond on this ballot, we project that the state's debt service on already authorized bonds will likely remain at about 5 percent over the next several years, and decline thereafter. If voters approve the proposed school bond on this ballot, we project it would increase the DSR by about 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 the state and voters approve additional bonds in the future.

Figure 1

**General Fund Debt-Service Ratio**

*Percent of General Fund Revenues Spent on Debt Service*