70 YEARS OF SERVICE

April 25, 2013

Overview of Infrastructure Planning, Budgeting, and Financing

LEGISLATIVE ANALYST'S OFFICE

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Infrastructure Planning and Budgeting

☑ Infrastructure Priorities

- University infrastructure priorities often are driven by enrollment increases and programmatic expansions.
- Infrastructure priorities also depend upon existing building conditions. For example, (1) buildings may require modifications to make them seismically safe or (2) their subsystems (such as roofs or electrical systems) may need replacement after many years in service.

☑ Infrastructure Planning Process

- The governing boards of the University of California (UC), the California State University (CSU), and Hastings College of the Law (Hastings) adopt long-range infrastructure plans. These plans include both "state-supportable" projects (mostly limited to instruction and research space) and "non-state" projects (such as for student housing or parking).
- In the past, the state has adopted a five-year infrastructure plan for all state programs, including its own plan for the public universities' state-supportable programs. Though the administration is required to submit such a plan to the Legislature annually, the last plan submitted was in 2008.

☑ State Budget Authorizes Infrastructure Projects

- Like other state agencies, the universities submit their requests for state-supportable projects to the Department of Finance (DOF). The DOF reviews these projects and includes ones it approves in the Governor's budget.
- As part of the budget process, the Legislature's budget committees review each project, including the project's scope, schedule, and cost. Approved projects are included in the annual budget act.
- Projects are approved in four phases: preliminary plans, working drawings, construction, and equipment.

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Two Ways to Finance Infrastructure

☑ Bond Financing

- The state typically borrows to pay for infrastructure, as the upfront costs of constructing a facility or undertaking major renovations are substantial and the facilities provide services over many years.
- Typically, this borrowing comes in the form of bond financing, with the state selling bonds to investors, and investors being repaid, with interest, according to specified schedules.

☑ Pay-As-You-Go Financing

- Smaller infrastructure projects (such as a heating and air conditioning system replacement) are sometimes financed on a “pay-as-you-go” basis. This means the projects are funded using available revenues. No borrowing is involved.

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State Bond Financing

Types of State Bonds

	General Obligation	Lease-Revenue
Approval-Related Characteristics		
Legislative vote threshold	Two-thirds vote in each house	Majority vote in each house
Requires voter approval?	Yes (majority vote)	No
Allowable projects	Specified in voter measure	A facility that can be leased
Repayment Characteristics		
Repayment guarantee	State's general taxing power	Annual debt-service appropriations, plus available bond reserve funds
Typical repayment fund source	General Fund	General Fund
Maximum repayment period	Constitutional limit: 50 years	Statutory limit: 35 years
Typical repayment period	30 years	20 to 25 years
Debt-service appropriations	Continuously appropriated in one state budget item	Reflected within department budgets but restricted to repay debt service
Other		
State agency selling bonds	State Treasurer	State Public Works Board

☑ Spending by Type of Bonds

- The state has funded most university projects in the recent past with general obligation bonds. For example, over the last ten years, about 80 percent of state bond spending for CSU projects and slightly more than half of bond spending for UC projects has come from general obligation bonds.
- Currently, most general obligation bond authority for the universities has been depleted, leaving lease-revenue bonds as the main financing option at this time.

State Bond Financing *(Continued)*

☑ Interest Rates

- Most state bonds have fixed interest rates and level debt-service payments. About 5 percent of the state's general obligation bond debt currently has a variable interest rate. None of the state's lease-revenue debt has a variable rate.
- For its variable-rate bonds, the state has not entered into any interest rate swaps.
- Interest rates depend in part on the state's credit rating. Because they are backed by the state's taxing power, general obligation bonds typically have a higher credit rating than lease-revenue bonds and a lower interest rate.

☑ Bond Refinancing and Restructuring

- Depending on market conditions, the state sometimes refinances bonds to obtain lower interest rates, while keeping the same repayment period. This saves on interest costs.
- The state does not "restructure" its debt by selling new bonds with longer repayment periods to pay off existing bonds. Restructuring typically results in reduced payments in the near term but higher costs in the long term.

☑ Debt Service

- In 2012-13, state debt service is $401 million for UC projects, $261 million for CSU projects, and $1.4 million for Hastings projects. By 2016-17, these costs are expected to increase by 11 percent, 24 percent, and 29 percent, respectively. (These estimates do not include any new bonds that may be authorized.)
- Debt service for these university projects makes up about 8 percent of total state infrastructure debt service.

University Bond Financing

Types of University Bonds[a]

University	Types of Bonds	Repayment Fund Sources
University of California (UC)		
	General Revenue	Unrestricted university revenues[b]
	Limited Project Revenue	Revenues raised by project built
	Pooled Medical Center	Medical center revenues
California State University (CSU)	Systemwide Revenue Bonds	Revenues raised by project built
Hastings College of the Law (Hastings)	General Revenue	Unrestricted university revenues[b]

[a] The UC's authority to issue bonds comes from its constitutional autonomy. State law authorizes CSU and Hastings to issue bonds. Figure does not include lease-revenue bonds since they are issued by the state and the state appropriates funding to pay the debt service. However, credit-rating agencies count these bonds as university debt.

[b] Includes most funds legally available to repay debt service, such as revenues from sales and services, overhead on federal grants, nonresident tuition, and investment income. Excludes state General Fund. The UC pledges student tuition as collateral but does not use tuition revenues to repay bonds.

Repayment Periods

- State law limits CSU to issuing bonds with a maximum repayment period of 50 years. There are no similar limitations on bonds issued by UC or Hastings.
- Bonds issued by the universities generally have similar repayment periods as those issued by the state (20 to 30 years), with exceptions. For example, UC recently issued a "century" bond with a 100-year maturity.

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University Bond Financing *(Continued)*

Interest Rates

- Bonds issued by CSU and Hastings all carry a fixed rate. Most of UC's debt also is fixed rate, though about 7 percent was issued at a variable rate.
- For most of its variable rate bonds, UC has entered into interest rate swap contracts.
- The credit ratings on university bonds currently are higher than the ratings on state general obligation bonds—which means a university bond would typically have a lower interest rate than a similar state bond. However, state lease-revenue bonds for university projects currently are rated the same as most types of university bonds.

Bond Refinancing and Restructuring

- Like the state, the universities often refinance bonds to take advantage of lower interest rates.
- Restructuring university bonds is uncommon but has occurred. For example, UC recently restructured some of its debt for one of its housing projects.

Debt Service

- In 2012-13, debt service for existing university bonds is $827 million at UC, $253 million at CSU, and $1.6 million at Hastings. By 2016-17, existing debt service is projected to decrease by about 3 percent at UC, increase by 7 percent at CSU, and remain level at Hastings. (These estimates do not include any new bonds that may be authorized.)