SELECTED ISSUES: THE 1998-99 BUDGET PROPOSAL FOR: INFRASTRUCTURE BONDS

The Department of Finance estimates that the state must finance over $80 billion in new capital by 2006-07.

Table 1

DOF Estimates of New Capital Need
1997-98 through 2006-07
(Dollars in Billions)

	Amount	Percent
Caltrans	$27.8	34.7
K-12 Education	22.0	27.5
Higher Education	10.5	13.0
Youth & Adult Corrections	9.2	11.5
Resources & Environmental Protection	7.5	9.4
Other	3.2	4.0
TOTAL	**$80.0**	**100.0**

*Totals do not add, due to rounding.

To address a portion of this capital need, the Governor proposes spending $961 million during the budget year from the General Fund, special funds, new lease revenue bonds and new General Obligation (GO) bond revenues. He also proposes authorization for additional GO bonds to be spent in future years.

MAJOR PROPOSALS

To address the state's infrastructure needs, the Governor proposes the following are part of his 1998-99 spending plan:

- Budget-year expenditures from the General Fund of $149 million, special funds of $176 million and lease revenue bond proceeds of $186 million. According to the Department of Finance, the Governor also proposes to spend $450 million for higher education capital needs in 1998-99, financed from the proceeds of a $1 billion General Obligation bond proposed for approval in the 1998 elections;

- General Obligation (GO) bond measures to be placed before the voters in 1998 totaling $7 billion. Nearly one-third of this amount would be allocated to resources projects. Another 29 percent would be allocated to projects for K-12 schools. Corrections and higher education facilities would receive 14 and ten percent, respectively; and

➢ In addition, the Governor proposes to put $8 billion worth of General Obligation bonds on the next four election cycles. The first $2 billion would provide $850 million for new construction, $450 million for school renovation, up to $500 million for class-size reduction, and $200 million for hardship cases. The Governor proposes a 50 percent local match for districts to qualify for these funds.

These proposals are summarized in Table 2.

Table 2

Governor's Capital Outlay Proposal
Sorted by General Fund Expenditure, Special Fund Expenditure
Lease-Revenue and General Obligation Bond
(Dollars in millions)

	General Fund	Special Fund	Lease Revenue	GO Bonds
K-12	$0	$0	$0	$2,000
Higher Education	0	21	0	1,000
Corrections	55	0	0	1,400
Health & Welfare	9	8	149	0
Resources	68	75	0	2,100
Other	18	72	37	500
Total	**$ 149**	**$ 176**	**$ 186**	**$ 7,000**

The Legislature also proposes a series of measures to place bonds on the 1998 ballot including nine education-related measures, four correctional facilities, six resource measures, and a handful of other bond proposals.

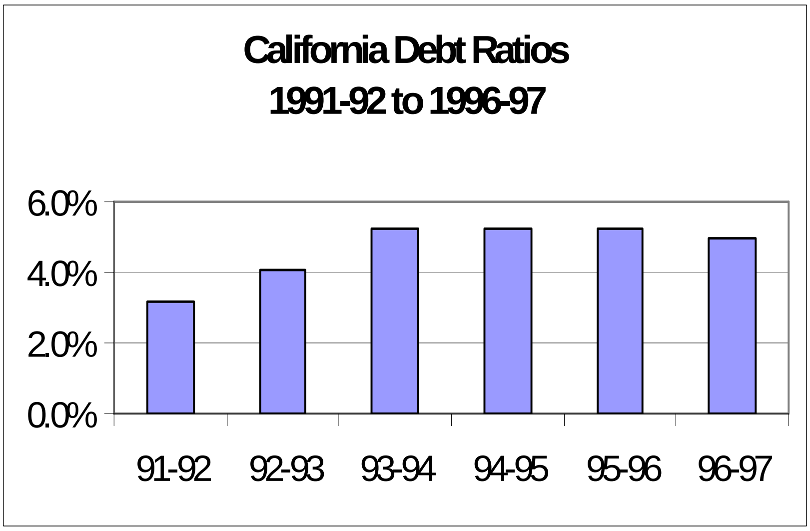
Debt Load and Rating: The Department of Finance reports that California "ranks between second and fifth places in terms of overall debt" among the most populous states. That is, California has a high level of outstanding debt. Levels of debt, however, may not give the most accurate picture of the state's indebtedness. Because California has a larger and wealthier population than most other states, it can afford greater debt loads. After accounting for population and wealth, the state appears to have "moderate" debt levels compared to its peer states. As displayed in Table 3, five of the most populous states have higher per-capita debt and higher ratios of public debt to personal income: New York, New Jersey, Illinois, Florida and Georgia. California's relative debt load is higher than that of Ohio, Pennsylvania, Michigan and Texas. By this relative measure, California has a "middle of the pack" debt load.

Table 3

Relative Measures of California's Debt Burden Compared to the Nine Most Populous States 1997		
State	**Debt Per Capita**	**Debt to Income**
New York	$1,840	6.7%
New Jersey	1,136	3.8
Illinois	741	2.9
Florida	690	3.0
Georgia	669	3.1
California	**612**	**2.6**
Ohio	559	2.5
Pennsylvania	529	2.2
Michigan	360	1.5
Texas	312	1.5

Debt Affordability: When evaluating how much capital to finance over time, the Legislature often considers state's "debt ratio" -- the ratio of debt payments to revenue base. In 1996-97, for example, the General Fund spent $2.4 billion on interest and principal. In that year, the General Fund had a revenue base of $49.7 billion. Accordingly, the debt ratio was 4.8 percent for 1996-97. As a percentage of the budget, the state's debt ratio has increased from 3.2 percent to 4.8 percent, a 56 percent increase in the share of the budget dedicated to financing debt. Chart 1 below shows the rise in debt loads since 1991.

Chart 1



By increasing its debt payments, the Legislature reduces funding available for discretionary spending. To preserve its fiscal flexibility, the Legislature has an interest in minimizing its debt payments. In years past, it has been suggested that a 5.5 percent debt ratio is prudent. By assuming a cap on debt, the Legislature limits how much debt it can sell. For example, by assuming a 5.5 percent cap on debt for the next ten years, the state could authorize no more than $26 billion of new debt. In contrast, if the state assumed a 6.5 percent cap, it could sell $34 billion of bonds 2008.

The debt ratio is a measure of debt load and capacity because it evaluates debt relative to the General Fund revenue stream. It is a measure rating agencies consider when determining the state's debt rating. These ratings help determine the interest the state must pay on its bonded indebtedness. Because a higher rating reduces interest payments, the Legislature has an interest in keeping the rating as high as possible.

Rating Affected by Many Factors: Rating agencies consider many measures of a state's credit worthiness in addition to the debt ratio. Indeed, several states have higher debt ratios but more favorable bond ratings.

The state's rating, as a measure of the state's "credit worthiness," reflects not only the debt ratio, but the private sector's view of the state's general fiscal health and fiscal management. Consequently, rating agencies evaluate the state's overall fiscal condition when rating the state's bonds. Agencies consider not only the debt ratio, but factors such as the General Fund rainy day reserve, fiscal constraints imposed by initiative, and forecasts of the state's economy.

KEY ISSUES

In evaluating the Governor's proposals for the 1998 ballot, the Legislature may wish to consider:

- **What Is the "Right" Size of the Bond Package?** The Governor proposes a $7 billion bond package for the 1998 elections. That is a much larger package than the Legislature has placed on the ballot in previous election cycles. There is a concern that voters will tend to reject all bond proposals if their total rises above a certain threshold. The Legislature will have to consider this threshold, and account for bond initiatives in circulation for signatures.

- **Which Bonds Should Be Placed on the June and November Ballots?** Some of the Governor's proposals are designed to match federal appropriations or subvention programs. To the extent the match requirements must be met in the federal 1997-98 fiscal year, those proposals must be placed on the June ballots. Moreover, some bond proposals may benefit from being placed either on a primary or general ballot.

- **What Is the Long-Term Plan for Capital?** The state relies on bond proceeds to meet much of its capital needs. To ensure that it has a steady stream of bond funds, the Legislature should consider multi-election plan for placing bonds on the ballot and projects to be financed.

- **How Specific Should Each Bond Proposal Be**? There is a tension between providing significant detail on the bond proposals to solicit electoral support, and providing future Legislatures with sufficient discretion so that they may allocate the bond funds to their highest and best use. The Legislature will need to determine how much detail is enough.

- **Does the Legislature Agree with the Governor's Priorities?** The Governor would allocate nearly three-quarters of the proceeds of the bond proposal to education, resources and water. It is not clear that this allocation—and the specific uses of the funds within each broad spending category—is consistent with the Legislature's goals.

- **Lease revenue bonds are more expensive.** The Governor proposes issuing $185.8 million in new lease-revenue bonds.

  Because GO bonds have the State's full faith and credit to their repayment, interest rates and maturities are set in advance. The California Constitution requires GO bonds to be approved by a majority vote of the public and makes the repayment of GO debt a priority over all other State obligations except those for K-14 education.

  Lease-Revenue bonds on the other hand, are secured by a revenue stream produced by the project being built. Because revenue bonds are not backed by the full faith and credit of the State, they may be enacted in statute without voter approval. However, interest rates are higher than GO bonds and are not fixed.

  The total projected outstanding lease-revenue bonds as of June 30, 1996 was $5.8 billion. This excludes the numerous lease-revenue proposals included in the Governor's Budget for 1997-98.

  A cost comparison analysis between GO bonds and Lease-Revenue bonds completed by the Legislative Analyst's Office (reflected in the May 3, 1995 "Uses and Costs of Lease-Payment Bonds") indicates that total debt service for Lease-Payment (Revenue) bonds is 15 to 20 percent higher than for GO bonds. The analysis concluded that for every $1 billion of Lease-Revenue bonds used in lieu of GO bonds (25-year maturity), $275 million to $370 million more is spent in General Fund debt service costs over the life of the bonds.