Policy Brief
periodic analyses of issues before the Legislature

LAO

Bonds And The 1990 Ballots

How Should the Legislature Determine What Bonds to Put on the 1990 Ballots?

California faces large, unmet infrastructure needs which will require bond financing. Fortunately, the state can issue more bonds without being financially imprudent. However, there are several criteria which can assist the Legislature in deciding exactly which bonds to put on the 1990 ballots.

Introduction

One of the more significant issues facing the Legislature during the next several months will be to decide what bond measures it should place on the June and November statewide ballots for voter approval. This decision is important because bonds are the principal means by which the state's infrastructure needs are currently being financed, and a large and growing inventory of unmet infrastructure needs exists. How well the state's infrastructure needs are addressed will be a principal determinant of the future health of the state's economy and the quality of life for many Californians in the years to come.

What Are California's Capital Infrastructure Needs?

The state has developed neither a complete inventory of its capital infrastructure needs nor a comprehensive multi-year capital outlay plan for addressing them.

Figure 1

Projected Capital Needs for the State and K-12 1990-91 through 1994-95

(dollars in millions)

	Five-Year Total
Legislative/Judicial/Executive	$60
State/Consumer Affairs	680
Business/Transportation/Housing	4,830
Resources	470
Health/Welfare	160
Youth/Adult Corrections	3,710
Education	8,560
General Government	30
TOTAL	$18,500

Source: LAO estimates, based on latest available information from departments.

Nevertheless, it is widely agreed that, whatever their exact magnitude, these needs are both large and growing.

Billions of dollars will be required

One general indication of how sizeable the state's infrastructure needs are can be seen from the 1984 report of the Governor's Infrastructure Review Task Force. It concluded that, over the ensuing 10-year period, approximately $29 billion would be needed for deferred maintenance of existing infrastructure and another $49 billion for new infrastructure at the state and local levels in California. With few exceptions (most notably prisons and education), little has been done in the past five years to address the needs identified in this report.

Another general indication of the magnitude of infrastructure needs can be seen from Figure 1, which shows that--at the state level--there is $18.5 billion worth of needed projects over the next five years.

Estimates like these have many shortcomings, due to the incompleteness of the state's capital outlay planning process, the fact that not all listed projects may actually merit funding, and other factors, like the lack of systemic incorporation of earthquake-related capital improvements. However, one thing seems clear--the state's infrastructure needs are easily in the tens of billions of dollars.

Where Will the Money Come From?

There are three basic ways that the state's infrastructure projects can be financed:

- First, the state can pay "up front" for its capital infrastructure, through direct appropriations of state revenues.
- Second, the state can rent, lease, or lease-purchase capital facilities from private parties.

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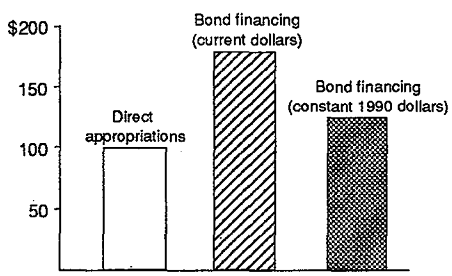
- Third, the state can borrow money in order to acquire capital facilities, by issuing state bonds that are repaid with interest over the years that the facilities are being used. As shown in Figure 2, financing a project with bonds is about 25 percent more costly than directly paying for it (after adjusting for the effects of inflation).

Figure 2

Relative Costs of Bond Financing for a $100 Million Project [a]

(dollars in millions)



[a] *Assumes a 20-year bond issue with level maturity structure, an average interest rate of 7.5 percent, and an average inflation rate of 5 percent.*

The state cannot realistically avoid using bonds

The state currently uses to varying degrees all of the above approaches to financing its capital outlay needs. However, it relies most heavily on bond financing, for several reasons:

- Given the large volume of infrastructure needs and the state's current tight budgetary situation, there simply is not enough money available to rely extensively on direct appropriations.
- Established and reliable renting and leasing markets do not exist for many of the types of infrastructure needs that the state has.
- Since capital infrastructure generates benefits to citizens over many years, it often makes sense to spread their costs out over time amongst these different beneficiaries.

Taken together, these reasons explain why bonds, despite the interest costs they impose, have been and will continue to be used to fund most of the state's capital outlay needs.

What Are the Bond-Related Issues Facing the Legislature?

Given the state's large capital infrastructure needs and the inevitability of reliance to a large degree on bonds to finance them, the Legislature faces two key bond-related issues regarding the 1990 ballots:

- First, what should the *total dollar volume* of requested bond authorizations be?
- Second, for what *purposes* and in what *amounts* should this total volume of requested authorizations be distributed?

How many new bond authorizations are appropriate?

Figure 3 shows that there are over $16 billion of general obligation bond measures which have qualified or are currently being considered for the ballot by the Legislature. There is no simple formula for pinpointing exactly what the "right" amount to place on the ballot actually is. One reason for this is that the mere act of authorizing bonds does not by itself directly affect the state financially. Rather, a financial impact only occurs after new bond authorizations have actually been sold, a process which generally does not begin immediately and is spread over a number of years.

This does not mean, however, that bonds should indiscriminately be placed on the ballot. Because most authorized bonds are ultimately sold, the amounts authorized will eventually help determine (along with the timing of the bond sales) the state's debt level and debt-servicing payments. *Therefore, the amount of requested bond authorizations on the ballot should take account not only of the state's capital outlay needs and the voters' willingness to approve debt, but also the state's ability to issue more bonds over time without jeopardizing its credit rating or having to devote an unacceptably high percentage of its total budget for debt-service payments.*

The state has considerable "room" to issue more debt

There is no evidence at present that California has "too much" debt, or that it cannot issue considerably more debt without damaging its credit rating or allocating an excessive share of the state budget for debt service. Rather, California currently devotes less than 2 percent of its General Fund budget

Figure 3

General Obligation Bonds Proposed for the 1990 Ballots[a]

(dollars in millions)

Bill	Author	Authorization	General Program Area
AB 67	Waters	$200	Auburn Dam: Public enhancements
AB 145	Costa	874	Wildlife, parklands, recreation resources
AB 236	Clute	1,000	K-12 school facilities
AB 256	Bader	800	K-12 school facilities
AB 348	Sher	300	Reforestation and urban forestry
AB 461	Hayden	1,000	Higher education: New campuses
AB 524	Murray	800	Youth/adult correctional facilities
AB 655	Jones	200	Agricultural land conservation
AB 824	Bader	100	School bus safety
AB 973	Costa	1,000[b]	Passenger rail facilities
AB 1312	Filante	200	Water treatment and reclamation
AB 1375	Costa	200	Water quality and conservation
AB 1416	Killea	150	Urban waterfront parks
AB 1572	Waters	500	Water conservation and development
AB 1598	Peace	150	Waste water and toxics cleanup
AB 1755	Friedman	100	Police facilities
AB 1771	Roos	50	Child care
AB 1811	Sher	256	Forestry and wildland fire protection
AB 1882	Bronzan	700	County health facilities
AB 2050	Areias	2,000	Mass transit
AB 2180	Brown	745	County courthouses
AB 2527	O'Connell	200	Water quality: Safe drinking water
SB 78	Watson	300	Child care facilities
SB 147	Hart	900	Higher education facilities
SB 173	Greene	1,000	K-12 school facilities
SB 484	Seymour	1,000	K-12 school facilities
SB 842	Presley	900	Youth/adult correctional facilities
SB 1053	Alquist	100	Urban waterfront parks
SB 1094	Presley	750	County correctional facilities
SB 1145	Nielsen	150	Flood control
SB 1250	Torres	300	Earthquake safety: Public buildings
SB 1618	Lockyer	30	Voting system uniformity
SB 1621	Lockyer	745	County courts
SB 1693	Roberti	150[c]	Housing and homeless needs
SB 1710	Torres	100	Fire protection for state high-rise buildings
SB 1712	Ayala	1,200	Auburn Dam construction and operation
SB 1717	Presley	740	State/local correctional facilities
SB 8X	Roberti	300	Housing rehabilitation: Seismic support
SB 13X	Torres	950	Earthquake safety: Public buildings
Voter Initiative:		1,990	Passenger rail facilities
Total, all proposals		$23,130	
Total, without double-counting		$16,395[d]	

[a] Source: California State Treasurer and Legislative Analyst's Office. Data are as of early January 1990.
[b] This bill, which was enacted as Chapter 108/89, also provides for a $1 billion bond act in both 1992 and 1994.
[c] Enacted as Chapter 48/88.
[d] Excludes authorizations for which another measure exists that calls for a nearly identical program.

"Bonds . . . will . . . be necessary to fund most of the state's capital outlay needs."

for debt-service payments, has a debt-service ratio which is low relative to other states, and has the highest credit rating possible from each of the nation's top bond rating agencies. In our view, California currently has considerable room to authorize and issue more bonds without being financially imprudent, and thus can focus on the state's long-term capital outlay needs in making its bond decisions.

But won't the debt burden eventually become excessive?

Figure 4 shows that California's debt-service payments, as a percent of the state's budget, have steadily increased since 1980, and that this ratio can be expected to rise further as additional bonds are sold in the future. However, the figure also indicates that, even if several billions of dollars of new bonds are authorized each election year throughout the next decade and subsequently sold, the state's debt-service burden will remain relatively modest for many years and remain near, if not below, the current average of other states (around 4.5 to 5 percent of expenditures), even into the next century. In fact, even larger bond volumes than those shown in Figure 4 could be marketed in the early 1990s without causing an excessive debt burden, if the state wanted to move quickly to address certain infrastructure needs and follow this with fewer bond sales later in the decade.

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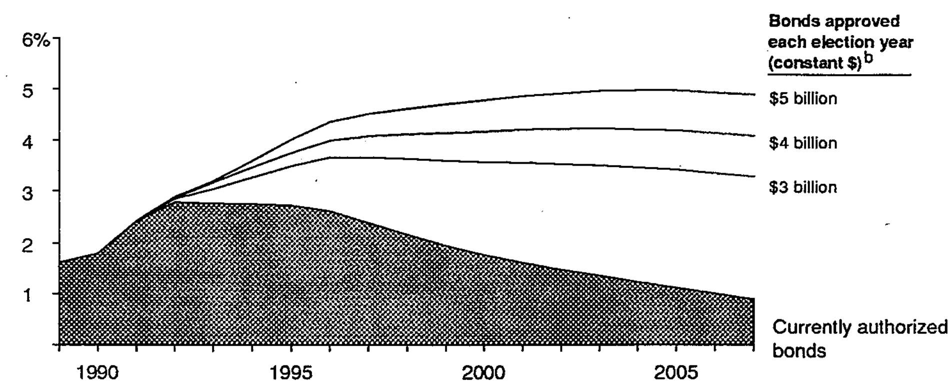
Figure 4

Projected Trends in the General Fund Debt-Service Ratio Under Alternative Assumptions[a]



[a] *Data shown are for fiscal years ending in years shown. The "debt-service ratio" represents General Fund costs for paying off nonself-liquidating general obligation bonds and lease-purchase revenue bonds, plus net cost of loans prior to bond sales, as a percent of total General Fund expenditures. Projections assume that new and existing-but-unissued bond authorizations are fully marketed within five years and paid off over 20 years at an average interest rate of about 7.5 percent.*

[b] *Constant 1990 dollars. In current dollars, the dollar amounts shown would grow by about 10 percent for each election year after 1990.*

How should the 1990 authorizations be allocated?

Ideally, the total amount of bond authorizations placed on the 1990 ballots should be distributed amongst different purposes according to the priorities contained in a comprehensive multi-year state capital outlay plan. However, California currently lacks such a tool. Nevertheless, the Legislature must still make this allocation in accordance with its priorities, and there are several key criteria to consider in arriving at this decision. These criteria are shown in Figure 5.

Figure 5

Key Criteria in Allocating Bond Authorizations

- ✔ Is a capital need urgently required for health and/or safety purposes?
- ✔ Would there be significant negative consequences of failing to immediately fund a capital need?
- ✔ Are there economically feasible alternatives to bond financing for funding a capital need, such as conventional leasing?
- ✔ Are there authorized but as-yet-unissued bonds that could be used to fund the need?
- ✔ How quickly will the expenditure of bond funds need to begin, and how will this spending be spread over time?

The answers to the questions shown in the figure will determine the relative importance of allocating bond authorizations to any particular capital need.

Conclusion

California currently has infrastructure needs that range in the tens of billions of dollars. The only realistic way for the state to meet these needs in the coming years is to rely to a large extent on bond financing.

With regard to the *total amount* of bonds to be placed on the 1990 ballots, there is no simple formula for pinpointing the "right" amount. The state, however, can issue a great many bonds while still being financially prudent. This is because California is currently a relatively "low debt" state, and it would remain so even if it continues to authorize several billions of dollars of bonds each election year.

With regard to *allocating* the total bond authority on the ballots, the state does not currently have a comprehensive capital outlay plan, which ideally is needed for this purpose. There are, however, several key criteria which can assist the Legislature in making this decision. ❖

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