Policy Brief

Bond Debt Update

In the March 26 statewide election, the voters approved two general obligation bond measures totaling $5 billion—$3 billion for K-12 schools ($2.025 billion) and higher education facilities ($975 million) and $2 billion to retrofit state highway bridges and toll bridges. This was the highest level of bonds approved since the June 1990 primary election when six measures totaling $5.1 billion received a majority vote. Between the June 1990 and March 1996 elections, the voters had approved only five of twenty statewide bond measures ($4.9 billion of $15.5 billion proposed bonds).

This policy brief discusses the General Fund cost that will be incurred from sales of these March 1996 bonds, as well as other previously authorized bonds, and how these costs affect the state's ability to issue additional debt to finance the state's capital outlay program.

Current and Projected Debt Levels

The state's debt service costs in the current fiscal year are about $2.3 billion, or about 5.1 percent of estimated General Fund revenues for 1995-96. This percentage is referred to as the state's debt ratio. By this measure, California's debt level is the twelfth highest among the states. There are currently about $9 billion in authorized but unsold general obligation and lease-payment bonds. We estimate that as these bonds are sold over the next several years, the state's debt payments will increase to $2.9 billion in 1999-2000. We estimate that the state's debt ratio will peak at 5.4 percent in 1998-99 and decline thereafter to 3.3 percent by the end of the period. (Actual debt ratios will, of course, depend on the timing, volume, and actual interest rates on bond sales, and on actual General Fund revenues.)

Future Bond Authorizations

Figure 1 shows the amount of additional general obligation bonds that the state could sell through 2004-05 and remain within various debt service levels. The various scenarios are illustrated in Figure 2. As the figures show, a higher level of bonds can be sold in the second half of the period. This is because, as debt is retired and debt payments decline for previously authorized bonds, there is more "room" to sell newly authorized bonds. Figure 1 is based on current law. If the Governor's tax cut proposal is enacted, the range of bond sales over the period shown in Figure 1 would be reduced by about $5 billion under each debt level.

The data in Figure 1 are intended to illustrate the state's debt capacity under different assumptions. We do not intend to imply that there is a "right" level of debt which the Legislature should use as a control on future authorizations. Instead, the Legislature should assess the state's needs for all capital outlay programs, determine which programs are priorities for bond funding over a multiyear period, and consider the trade-off of using General Fund revenues to pay debt service for improvement of capital assets versus funding other state programs.

Figure 1

Potential Additional Bond Sales for Various Debt Service Ratios[a]

(Dollars in Billions)

	5.4 Percent[b]	6 Percent	7 Percent
1996-97 through 2000-01	$6	$10	$16
2001-02 through 2004-05	15	16	19
Totals	**$21**	**$26**	**$35**

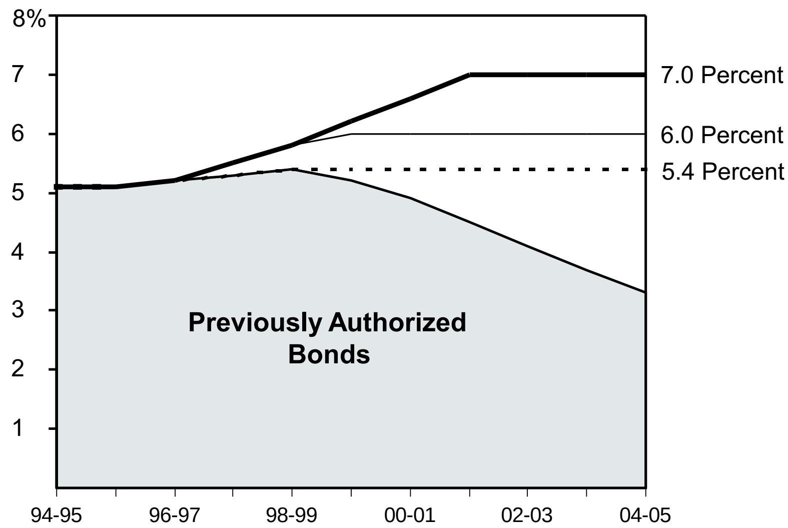
[a] Assumes sales of general obligation bonds with 25-year maturity at 5.5 percent interest.
[b] Estimated peak debt service ratio with sales of previously authorized bonds.

Capital Outlay Needs

As summarized in Figure 3, state agencies and K-12 education have identified the need for about $25 billion over the next five years to meet their capital outlay needs. (This total does not include transportation programs, such as highways and rail.) The $25 billion should be viewed with caution because some of the agency plans are incomplete and also may

Figure 2

Alternative Debt Ratio Scenarios
1994-95 Through 2004-05



include proposals that upon examination would not merit funding. In addition, Figure 3 does not include some local government capital outlay needs (such as jails and water treatment facilities) for which the state has provided funds in past years. In general, however, the $25 billion provides a reasonable assessment of the overall magnitude of five-year capital outlay needs.

Limits on Meeting Capital Outlay Needs. As shown in Figure 2, even if the state had a relatively high debt ratio of 7 percent, it could sell only $16 billion in bonds over the next five years. This level of funding would fall far short of the capital needs during that period identified in Figure 3. Furthermore, our debt ratio estimates

Figure 3

Projected Five-Year Capital Outlay Needs For the State and K-12 Education 1996-97 Through 2000-2001

(Dollars in Millions)

	Five-Year Total
Executive	$50
State and Consumer Services	1,325
Department of Motor Vehicles/ California Highway Patrol	243
Resources	840
Health and Welfare	420
Youth and Adult Corrections	4,604
K-12 Education	10,500[a]
Higher Education	6,610
General Government	228
Total	**$24,820**

[a] Estimate only. No statewide five-year plan.

are based on the use of general obligation bonds. To the extent that more costly lease-payment bonds are used, fewer needs could be funded.

CONCLUSION

The state clearly has limitations on the level of future bonds that can be authorized and sold to address its significant capital outlay needs. It is therefore imperative that future authorizations be targeted to the highest priority programs and projects.

We continue to stress that the Legislature must develop a comprehensive plan in order to address the state's capital outlay program needs in the context of limited fiscal resources. To develop such a plan, the Legislature should undertake a comprehensive review of the state's capital outlay needs, set priorities, and establish a financing plan to meet these priorities over a multiyear period.

This Policy Brief was prepared by Chuck Nicol, under the supervision of Gerald Beavers. This report and others are available on the LAO's World Wide Web page at http://www.lao.ca.gov. The Legislative Analyst's Office is located at 925 L Street, Suite 1000, Sacramento, California, 95814. To request publications call (916) 445-2375.