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California's Long-Term Capital Outlay and Infrastructure Needs

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Joint Legislative Budget Committee
and the
Senate Appropriations Subcommittee on
Bonded Indebtedness and Methods of Financing

Senators Mike Thompson and Lucy Killea, Chairs

Capital Outlay Funded From Many Sources

Fund	Capital Outlay Programs Funded
Bonds	Proceeds from sales of general obligation bonds and lease-payment bonds have been the main funding sources for most capital outlays excluding transportation.
State Highway Account/ Transportation Planning and Development Account	Used for highway and mass transit capital outlay programs.
General Fund	Direct appropriations from the General Fund have been very limited in recent years.
Tidelands Oil Revenue	Generally a portion of tidelands oil revenues goes to the Special Account for Capital Outlay (SAFCO). The SAFCO funds can be appropriated for any purpose.
Outer Continental Shelf Lands Act Section 8(g) Revenue Fund	Can be appropriated for any purpose. Have been used mainly by resources agency departments and conservances for property acquisition.
Public Resources Account, Cigarette and Tobacco Products Surtax Fund	Established in 1988 by Proposition 99. Can be used for state and local parks projects and land acquisitions.
Motor Vehicle Account	Funds projects for the California Highway Patrol and the Department of Motor Vehicles.
Habitat Conservation Fund	Established in 1990 by Proposition 117. Funds several resource agency departments and conservancies for land acquisition to protect/ enhance wildlife.
Off-Highway Vehicle (OHV) Fund	Projects at state OHV areas administered by the Department of Parks and Recreation.
Harbors and Watercraft Revolving Fund	Projects developed by the Department of Boating and Waterways at state parks and recreation areas.
Fish and Game Preservation Fund	Projects developed by the Department of Fish and Game.
Federal Funds	Funds for specific capital outlay programs, mainly for transportation.

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Recent Capital Outlay Spending 1990-91 Through 1994-95

(In Millions)

For State Agencies	Expenditures
Legislative, Executive, and Judicial	$1
State and consumer services	273
Transportation (buildings only)	95
Resources	577
Health and welfare	67
Youth and adult correctional facilities	2,045
UC and CSU	1,942
General government	49
Total	**$5,049**
For Local Governments:	
K-12 education	$4,020
Community colleges	952
County jails and juvenile detention facilities	754
Water treatment/conservation facilities	535
Parks	232
Boating facilities	82
Libraries	74
Seismic safety (local public buildings)	45
Total	**$6,694**

- ☑ **91 percent of spending for state agencies was from bond funds.**
- ☑ **98 percent of spending for local governments was from bond funds.**
- ☑ **75 percent of total capital outlay spending was for K-12 schools, higher education, and youth and adult corrections.**

Projected Five-Year Capital Outlay Needs For the State and K-12 Education 1995-96 Through 1999-00

(In Millions)

	Five-Year Total
Executive	$50
State and Consumer Services	1,050
Transportation	14,721[a]
Resources	719
Health and Welfare	403
Youth and Adult Corrections	7,036
K-12 Education	11,000[b]
Higher Education	6,563
General Government	273
Total	**$41,815**

[a] Includes $14.5 billion to be funded from state and federal gasoline tax revenues, state truck weight fees, and state toll bridge revenues for the Department of Transportation (1992 STIP and seismic retrofit).

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

- ☑ **$42 billion in project-specific needs have been identified over the next five years.**
- ☑ **Amounts listed above do not include programs for the state land conservancies and local governments for projects (such as jails and parks).**

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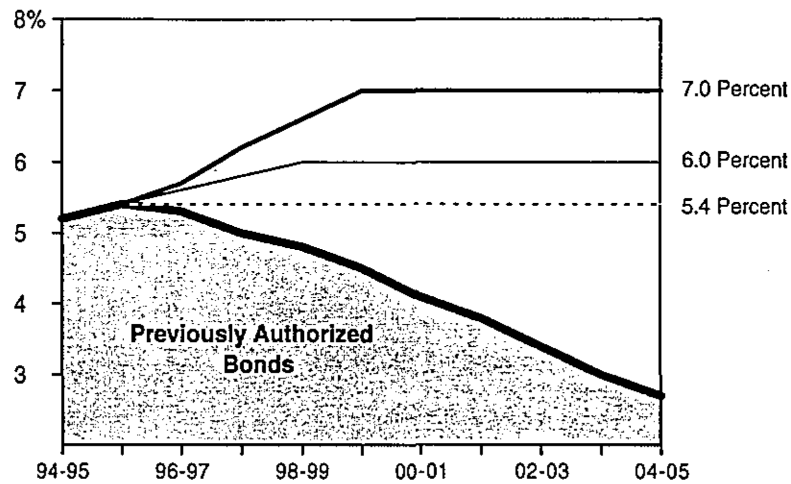
Unallocated General Obligation Bonds As of January 1995

(In Millions)

Program	
Transportation (rail programs)	$787
Parks/resources	15
Safe drinking water/clean water/water conservation	92
County correctional facilities	—
State prisons/youth authority	32
K-12 education	70
Higher education	46
Libraries	—
Public buildings—seismic upgrading	222
Total	**$1,264**

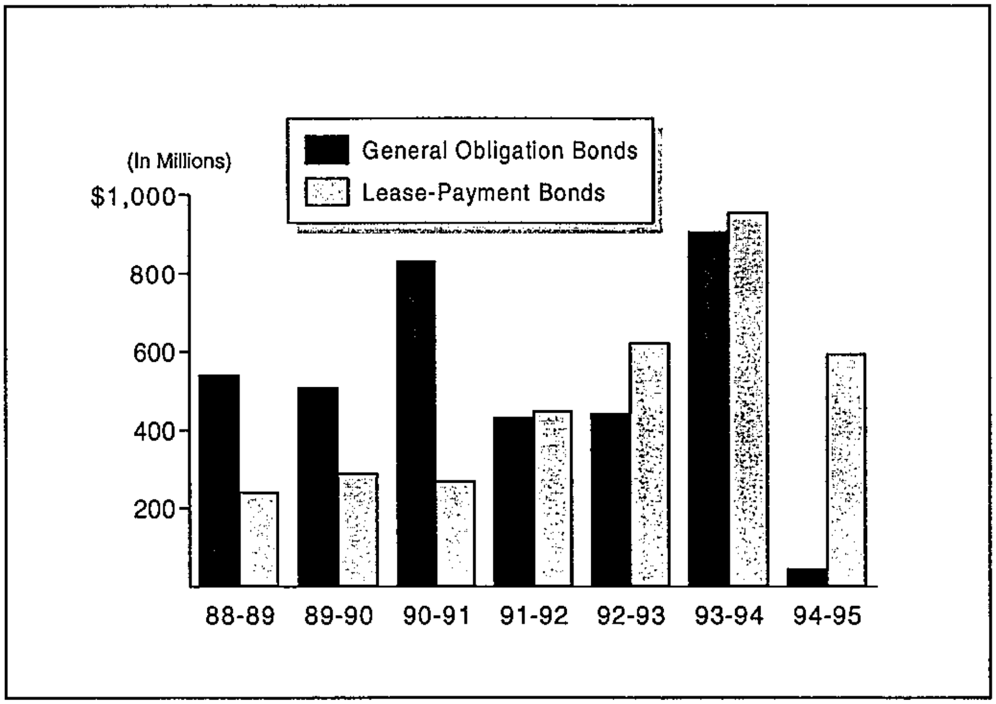
- ✔ **Transportation bonds are from Proposition 116 for specific transit corridors. The funds are not to be allocated by the Legislature.**
- ✔ **Limited general obligation bond funds available to address indicated five-year needs.**

Can the State Issue More Debt?



- In the last ten years, General Fund debt service costs have increased from 1.5 percent to 5.2 percent of total General Fund revenues and will peak at 5.4 percent in 1995-96.
- If the Legislature sustained a 5.4 percent debt-service ratio, a total of $5 billion in new bonds could be sold over the next five years and another $15 billion the following five years.
- If the debt-service ratio is increased to 7 percent, a total of $14 billion in new bonds could be sold over the next five years and another $19 billion the following five years.
- If more costly lease-payment bonds are used in lieu of general obligation bonds, fewer needs will be funded within these debt levels.

Use of Lease-Payment Bonds Has Increased



- For 1988-89 through 1990-91, lease payment bonds represented about 30 percent of total bond expenditures for state capital outlay programs.

- For 1991-92 through 1994-95, lease-payment bonds represented about 60 percent of bond expenditures for state capital outlay.

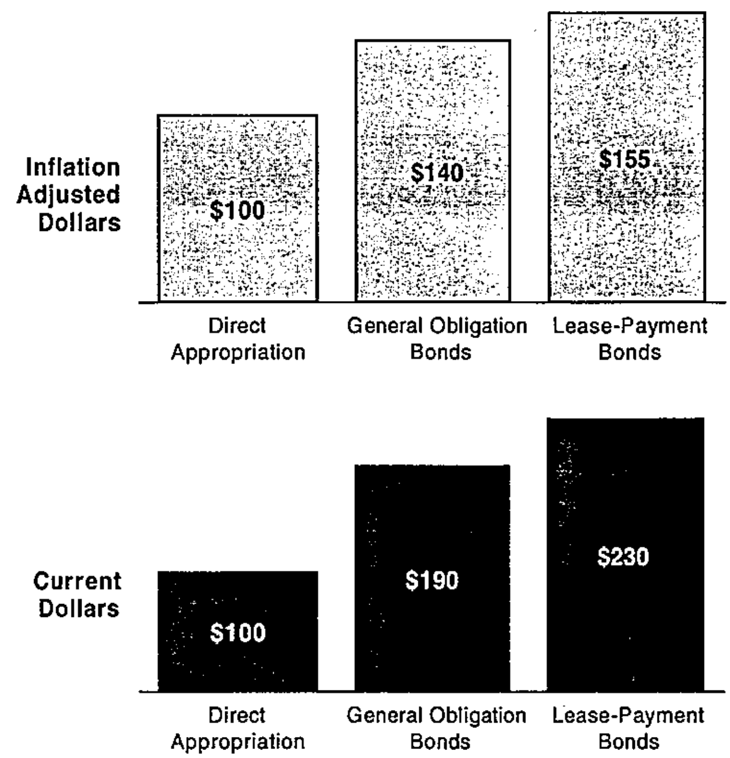
- The low level of spending from general obligation bonds for 1994-95 reflects the depletion of previously approved bonds and the lack of new general obligation bonds in 1994.

Lease-Payment Bonds Are Costlier to Issue

	General Obligation Bond	Lease-Payment Bond
Approval needed	Two-thirds of Legislature and Governor (except initiatives) *and* majority voter approval	Majority vote of Legislature and Governor
Amount authorized 1990-94	$10 billion	$4.1 billion
Limits on spending	Amount approved by voters (administrative augmentations and other costs must be within this amount)	Amount authorized by Legislature (plus any administrative augmentations and bond upsizing)
Pledged security to bondholders	Full faith and credit of the state (entire taxing power)	Annual debt-service appropriations required for "lease" payments
Interest rate on bonds	Lowest possible (actual sales at 4.8 percent to 7 percent between 1990-94)	Up to 0.5 percentage points above general obligation bond rate; average about 0.4 percent (actual sales at 5.1 percent to 7.3 percent between 1990-94)
Underwriting process	Competitive bidding required	Competitive bidding not required; sales to date have been negotiated
Need for reserve fund to effectively market bonds?	No	Yes
Need to purchase property and liability insurance?	No	Yes
Amount of bonds required	Based on project costs, plus less than 1 percent for issuance costs	Bond volume upsized to cover project costs *plus* such costs as underwriting fees, debt-service during construction period, issuance costs, insurance, and reserve fund
Additional debt service costs	—	15 to 20 percent higher than general obligation bonds over life of the bonds

Relative Costs of Financing A Capital Outlay Project

(In Millions)



Note: Assumes 25-year bonds with average interest of 7.0 percent for general obligation bonds and 7.4 percent for lease-payment bonds and average annual inflation of 3 percent.

- ✔ **Lease-payment bonds are more costly, mainly because they must be upsized (more bonds must be sold for a given project) and they sell for somewhat higher interest rates (about 0.4 percent on average).**

Department of Finance February 1994 Report

- Estimates ten-year capital outlay need of $78 billion.
- Estimates $67.6 billion in state funds will be available to meet the highest priority needs.
  - $35.5 billion in general obligation bonds (including $31.1 billion to be authorized)
  - $8.9 billion in lease-payment bonds
  - $11.5 billion in special funds
  - $10.4 billion in federal funds
  - $1.3 billion from the General Fund
- Allocates funding to the following programs:
  - State office buildings ($2.3 billion)
  - Transportation ($22.8 billion)
  - Resources/environmental quality ($3.7 billion)
  - Public safety ($12 billion)
  - K-12 education ($15 billion)
  - Higher education ($10.4 billion)
  - Other ($1.4 billion)
- Projects that debt service ratio will be around 6 percent of General Fund revenues but arbitrarily restricts sale of bonds to stay close to this level.

Department of Finance Report
Examples of Information Not Included

- It is unclear how needs are determined.
- There is no discussion on how funding priorities are established either within or between programs.
- Except for "caseload" driven programs, such as K-12 education and corrections, report lacks programmatic basis for proposed ten-year funding levels.
- It is unclear as to what needs will be foregone if proposed funding levels are not available.
- There is no discussion as to how priorities should be determined for funding projects within each program.
- There is no schedule indicating when and at what level bonds would be needed for each program.

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Legislative Process for Approving Capital Outlay

☑ The legislative process for reviewing and approving capital outlays:

- Budget proposals are considered by the various budget subcommittees.
- Other capital outlay proposals submitted in a number of separate bills considered by different policy committees and the appropriations committees.

☑ Problems with the current legislative process:

- The state does not have a comprehensive statewide multi-year plan to make its capital outlay planning and budgeting decisions.
- Capital outlay needs have not been reviewed and funded in the context of a statewide program.
- Programs are reviewed and funded separately within the limited parameters of the individual programs—both in the budget process and through separate legislation.
- Some programs may receive funding for projects that, in the context of other statewide needs, may be a lower priority than projects that do not get funded.
- State does not get the "biggest-bang-for-the-buck" for what it spends on capital outlay.

What Should the Legislature Do?

☑ **Undertake a more proactive and comprehensive approach to capital outlay planning and financing. This would include considering the following:**

- Assessment of the state's capital outlay needs in the various program areas.
- Extent to which state revenues should be used for capital outlay needs over a multi-year period, versus providing other state services.
- Appropriate levels of state funding support for each infrastructure program.
- Appropriate levels of state capital outlay funding assistance for local governments.
- Preferred financing methods for each infrastructure program.
- Legislative priorities for funding projects within each program.

☑ **Require that all capital outlay proposals be reviewed and approved through the annual budget process.**

- This would give the Legislature a complete picture of statewide capital outlay proposals and allow the Legislature the opportunity to review them in the context of statewide funding priorities for both capital outlay and other state programs.