



August 21, 2014

To: CSAC Board of Directors

From: Jean Kinney Hurst, CSAC Legislative Representative

Re: **Fiscal Analysis: State Debt – INFORMATIONAL ITEM**

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As the CSAC Board of Directors considers a position on Proposition 1, the state water bond, staff has prepared this memo to provide additional information on the state's current debt portfolio and practices.

California is one of the largest issuers in the \$3 trillion U.S. municipal bond market. The state largely relies on borrowing to finance public infrastructure projects such as roads, educational facilities, prisons, parks, water projects, and office buildings. Bonds are generally preferable for these types of projects for two reasons: first, because infrastructure typically provides services over many years, it makes sense to have both current and future taxpayers help pay for them; and second, in a state as large as California, these types of projects are difficult to pay for all at once (i.e. "pay as you go," or essentially saving up money for a project).

Types of Municipal Debt

General obligation bonds are those bonds that are backed by the "full faith and credit" of the issuer with no specified source of funding for payment; the issuer can make its debt payments from taxes, fees, and other sources of revenue or raise a new source of revenue to meet its payment obligations. General obligation bonds are generally viewed as very safe investments and defaults are rare. In California, state general obligation bonds must be approved by a 2/3 vote of the Legislature, signed by the Governor, and achieve a simple majority voter approval.

Revenue bonds are bonds that are backed by a specific source of revenue generated by the specific project financed by the bonds. Revenue bonds are higher risk than general obligation bonds and therefore generate higher yield for investors. In California, state revenue bonds must be approved by a simple majority vote of the Legislature and signed by the Governor.

Debt-Service Ratio (DSR)

One important measure of the state's debt situation is its debt-service ratio (DSR). The DSR indicates the portion of the state's annual General Fund revenues that must be set aside for debt-service payments on bonds and, therefore, are unavailable for other state programs. The current DSR is about 5 percent of annual General Fund revenues. Without a new water bond, the LAO is projecting that the state's debt service on already authorized bonds will peak at under 6 percent of General Fund revenues in 2018-19 and decline thereafter. Considering the previous water bond (Proposition 43), the LAO projected that the DSR would increase by less than a half a percentage point. Since Proposition 1 would authorize a significantly smaller water bond, we assume that the impact to the DSR would be much less than a half a percentage point.

The 2014-15 State Budget

The 2014-15 state budget plan includes a significant investment in managing the state's debt. Governor Brown's efforts to pay down the now-infamous "Wall of Debt" have resulted in a dramatic change in the state's debt portfolio, particularly with the projected retirement of the Economic Recovery Bonds (ERBs). The ERBs are funded with a dedicated 0.25% of the state sales tax rate; the mechanism known as the Triple Flip offsets a reduction to local agencies' Bradley-Burns sales tax rates. The 2014-15 state budget includes a supplemental payment of about \$1.3 billion to finally pay off the ERBs.

According to the State Treasurer's Office, the state's debt management practices have also improved. The Brown Administration has focused on first spending unused proceeds from prior bond sales to fund infrastructure projects, thereby reducing the need for additional borrowing. The state's general obligation bonds have become more competitive in the market, with higher ratings and reduced interest-rate premiums. At the same time, the state refinanced billions of dollars of bonds at lower interest rates and reduced debt service payments by hundreds of millions of dollars.

A Snapshot of California's Current Debt Service Requirements

	Total Debt		
	Interest	Principal	Total
General Obligation Bonds			
General Fund Non-Self Liquidating			
Fixed Rate	\$61,371,619,142.70	\$72,068,780,000.00	\$133,440,399,142.70
Variable Rate	290,444,664.59	3,421,790,000.00	3,712,234,664.59
Enterprise Fund Self Liquidating			
Fixed Rate	345,136,486.24	669,080,000.00	1,008,216,486.24
Special Revenue Fund Self Liquidating			
Fixed Rate	818,942,175.00	3,306,745,000.00	4,125,687,175.00
Variable Rate	175,014.67	110,370,000.00	110,545,014.67
Revenue Bonds			
General Fund Lease Revenue	6,699,555,261.73	11,266,240,000.00	17,965,795,261.73
General Fund and Lease-Revenue Total	\$69,525,872,744.93	\$90,837,005,000.00	\$160,362,877,744.93

Source: State Treasurer's Office, as of August 2014

In 2013-14, the General Fund's bond repayments totaled over \$5 billion. LAO projects that outstanding bond debt costs will rise, likely peaking at over \$7 billion in 2019-20, as bonds that were previously authorized but not sold are marketed. Note that voters and the Legislature have approved about \$29 billion in general obligation and lease revenue bonds that have not yet been sold.

California's Current Credit Ratings

Type of Debt	Fitch Ratings	Moody's Investors Service	Standard and Poor's
General Obligation	A	Aa3	A
Lease Revenue Bonds	A-	A1	A-
Economic Recovery Bonds	AA	Aa2	AA

Source: State Treasurer's Office

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