

AGENDA
SENATE COMMITTEE
ON BUDGET AND FISCAL REVIEW

April 26, 2007
State Capitol, Room 4203
9:30 a.m. or upon adjournment of session

Fiscal Overview of State Bonds

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TESTIFYING

- Legislative Analyst's Office
- Department of Finance

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I. Background and General Understanding of 2006 Bonds

A. Recent History and Allowable Uses of the Bond Funds.

In November 2006, California voters approved five propositions which authorize \$42.7 billion in general obligation (GO) bonds. The bonds cover a range of purposes, including transportation, education, resources, and housing. The bond package represents a major commitment by the Legislature, Governor, and the voters to improve the state's infrastructure. The bonds provide funding to many new programs for which goals and allocation criteria have yet to be established.

Within the five bond measures, there are many specified allocations of funds. In total, there are 67 pots of money included in the five bonds. The smallest such pot of money is in the housing bond and provides \$10 million for self-help construction grants to organizations which assist households in building or renovating their own homes. In contrast, the largest pot of money is in the transportation bond and provides \$4.5 billion for corridor mobility to reduce congestion on state highways and major access routes. Each pot of money has its own purpose, administering department, and restrictions (if any) on its use.

The five propositions and allowable uses are indicated below:

1. **Proposition 1B** – The Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006. Every category of funding in Proposition 1B is funded “upon appropriation by the Legislature.” It is anticipated that the legislative action will occur in the context of the budget, meaning funds will likely be available to projects in the budget year beginning in July 2007.

Proposition 1B	
The Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	
(in millions)	
Congestion Reduction, Highway and Local Road Improvements	\$11,250
Corridor mobility: reduce congestion on state highways and major access routes.	\$ 4,500
State Transportation Improvement Program: increase capacity on highways, roads, and transit.	2,000
Local roads: enhance capacity, safety, and operations.	2,000
Highway 99: enhance capacity, safety, and operations.	1,000
State-Local Partnership: grants to match locally funded transportation projects.	1,000
State Highway Operations and Protection Program: rehabilitate and improve operation of highways and roads.	750

Transit	\$ 4,000
Local transit: purchase vehicles and right of way.	\$3,600
Intercity rail: purchase railcars and locomotives for state system.	400
Goods Movement and Air Quality	\$3,200
Trade corridors: improve movement of goods on highways and rail, and in ports.	\$2,000
Air quality: reduce emissions from goods movement activities.	1,000
School bus retrofit: retrofit and replace polluting vehicles.	200
Safety and Security	\$1,475
Transit security: improve security and facilitate disaster response.	\$1,000
Grade separation: grants to improve railroad crossing safety.	250
Local bridges: grants to seismically retrofit local bridges and overpasses.	125
Port security: grants to improve security and disaster planning in publicly owned ports, harbors, and ferry facilities.	100
TOTAL	\$19,925

2. **Proposition 1C** – The Housing and Emergency Shelter Trust Fund Act of 2006. Unlike the transportation bond, much of the housing bond is continuously appropriated to existing programs that were created in the prior housing bond (Proposition 46, 2002). Therefore, about one-half of the housing bonds will be able to flow as early as Spring 2007, to continue funding existing affordable housing programs.

Proposition 1C	
The Housing and Emergency Shelter Trust Fund Act of 2006 Bond Funds	
(in millions)	
Development Programs	\$1,350
Regional Planning, Housing and Infill Incentive. Grants for projects, including parks, water, sewer, transportation, and environmental cleanup – to facilitate urban infill development.	\$ 850
Transit Orientated Development -- Grants and loans to encourage more dense development near transit.	300
Housing Urban-Suburban-and-Rural Parks. Grants for parks throughout the state.	200
Homeownership Programs	\$ 625
CalHome -- Homeownership programs for low-income households, such as loans for site development.	\$ 290
Homebuyer's Down payment Assistance. Deferred low-interest loans for up to 6 percent of home purchase price for first-time low-or moderate-income homebuyers.	200
Building Equity and Growth in Neighborhoods (BEGIN). Grants to local governments for homebuyer assistance.	125

Self-Help Construction Management. Grants to organizations which assist low- or moderate-income households in building or renovating their own homes.	10
Multi-Family Housing Programs	\$ 590
Multi-family Housing. Low-interest loans for housing developments for low-income renters.	345
Supportive Housing. Low-interest loans for housing projects which also provide social services to low-income renters.	195
Homeless Youth. Low-interest loans for projects that provide housing for young homeless people.	50
Other Housing Programs	\$ 285
Farmworker Housing. Low-interest loans and grants to develop housing for farm workers.	135
Affordable Housing Innovation. Grants and loans for pilot projects that create or preserve affordable housing.	100
Emergency Housing Assistance. Grants to develop homeless shelters.	50
TOTAL	\$2,850

3. **Proposition 1D** – The Kindergarten-University Public Education Facilities Bond Act of 2006. Proposition 1D provided a total of \$10.4 billion in bonds; of this total, \$7.3 billion for K-12 school facilities is designated for seven types of projects. The underlying requirements and funding formulas for four of these project types (modernization, new construction, charter school facilities, and joint-use projects) would be based on the existing School Facilities Program (SFP) criteria. The three other types of projects (overcrowded schools, career technical facilities, and environment-friendly projects) would be new components of the SFP.

Through the SFP, K-12 school districts apply for funding to buy land, construct new buildings, and modernize (renovate) existing buildings. A school district's allocation is based on a formula. The formula considers the number of students a district is expected to enroll that cannot be served in existing facility space. The SFP requires state and school districts to share in the cost of facilities.

Proposition 1D	
The Kindergarten-University Public Education Bond Act of 2006	
(in millions)	
Kindergarten through 12th Grade	\$ 7,329
New school construction pursuant to State Allocation Board regulation.	
School districts would be required to pay 50 percent of new construction and earthquake-safety projects (unless they qualify for state hardship funding).	\$ 1,900
Charter School Facilities. For new construction or modernization; a 50 percent local match is required.	500

Modernization of School Facilities. School districts are required to pay 40 percent of project costs (unless they qualify for state hardship funding).	3,300
Career Technical Education Programs. Grants would be provided to high schools and local agencies that have career technical programs.	500
Joint Use Projects. Can be used for constructing new facilities and reconfiguring existing facilities for a joint-use purpose.	29
Severely Overcrowded Schools. Under the program definition of overcrowded, roughly 1,800 schools (or 20 percent of all schools) would be eligible for funding.	1,000
Environment-Friendly Facilities. Incentive grants to promote the use of designs and materials in new construction and modernization projects – such as maximizing the use of natural lighting, the use of recycled materials, or the use of acoustics conducive to teaching and learning.	100
California Community Colleges	\$ 1,507
The Governor and Legislature would select the specific projects to be funded with the bond monies.	
California State University	\$ 690
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University of California	\$ 890
The Governor and Legislature would select the specific projects to be funded with the bond monies. Of the amount available for UC, \$199 million is for telemedicine / medical school projects.	
TOTAL	\$10,416

4. **Proposition 1E** – the Disaster Preparedness and Flood Prevention Bond Act of 2006. Every category of funding in Proposition 1E is funded upon appropriation by the Legislature. This legislative action will likely occur in the context of the budget, with funding likely available for projects beginning with the 2007-08 budget year.

Proposition 1E	
The Disaster Preparedness and Flood Prevention Bond Act of 2006	
(in millions)	
State Central Valley flood control system repairs and improvements; Delta levee repairs and maintenance.	\$3,000
Flood Control subventions (local projects outside the Central Valley).	500
Stormwater flood management (grants for projects outside the Central Valley).	300
Flood protection corridors and bypasses; floodplain mapping.	290
TOTAL	\$ 4,090

5. **Proposition 84** – The Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006. Most categories of funding in Proposition 84 are funded upon appropriation by the Legislature. This legislative action is likely to occur in the context of the budget, with funding likely available for projects beginning with the 2007-08 budget year.

Proposition 84	
The Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	
(in millions)	
Water Quality	\$1,525
Integrated regional water management.	1,000
Safe drinking water.	380
Delta and agriculture water quality.	145
Protection of Rivers, Lakes, and Streams	\$ 928
Regional conservancies.	279
Other projects – public access, river parkways, urban stream restoration, California Conservation Corps.	189
Delta and coastal fisheries restoration.	180
Restoration of the San Joaquin River.	100
Restoration projects related to the Colorado River.	90
Stormwater pollution prevention.	90
Flood Control	\$ 800
State flood control projects – evaluation, system improvements, flood corridor program.	315
Flood control projects in the Delta.	275
Local flood control subventions (outside the Central Valley flood control system).	180
Floodplain mapping and assistance for local land use planning.	30
Sustainable Communities and Climate Change Reduction	\$ 580
Local and regional parks.	400
Urban water and energy conservation projects.	90
Incentives for conservation in local planning.	90
Protection of Beaches, Bays, and Coastal Waters	\$ 540
Protection of various coastal areas and watersheds.	360
Clean Beaches Program.	90
California Ocean Protection Trust Fund – marine resources, sustainable fisheries, and marine wildlife conservation.	90
Parks and Natural Education Facilities	\$ 500
State park system – acquisition, development, and restoration.	400
Nature education and research facilities.	100
Forest and Wildlife Conservation	\$ 450
Wildlife habitat protection.	225
Forest conservation.	180
Protection of ranches, farms, and oak woodlands.	45
Statewide Water Planning	\$ 65
Planning for future water needs, water conveyance systems, and flood control projects.	65
TOTAL	\$5,388

B. Administration's Proposals

Proposed Budget-Year Expenditures. According to the Legislative Analyst, the Governor proposes spending \$8.7 billion in 2007-08. In some cases, the administration proposes new staffing and statutory language to help implement the programs. In other cases, however, the Governor's budget does not include any such requests despite a program being funded for the first time. While this proposed spending covers most of the programs authorized by the bond package, the Governor's plan does not include spending for seven pots of funding, primarily for new programs.

Proposed Current-Year Expenditures. Of the Governor's proposed expenditures, the LAO notes that \$2.8 billion would be spent in the current year. In the case of the \$1.1 billion for higher education, the Legislature appropriated these amounts in the *2006-07 Budget Act*, with the assumption that Proposition 1D would be passed by the voters. In other cases, such as the \$985 million for K-12 education facilities, \$160 million for existing housing programs, and \$60 million from Proposition 84, the funding is continuously appropriated and became available for spending upon the passage of the bonds. Regarding the \$523 million in proposed transportation spending for the current year, however, the Legislature would need to enact urgency legislation to appropriate the funds if it wished to adopt the administration's planned timing.

Governor's Executive Order. On January 24, 2007, the Governor signed an executive order with the intent of increasing governmental accountability and public information about the use of the November 2006 bonds. The Governor's executive order focuses on three main areas.

- Prior to spending. For each bond funded program, a department is required to delineate the criteria or processes for spending the funds. The criteria and processes would be based on one or more of the following: existing law and regulations, strategic plans, capital outlay programs, and performance standards or outcome measures.
- While spending. Departments would report semiannually to the Department of Finance (DOF) on what actions they are taking to ensure that costs are controlled and funds are spent as allocated.
- Post spending. Expenditures would be subject to audits by DOF staff (unless alternative audit measures are approved by DOF).
- Plans Due March 1, 2007. Each department has until March 1, 2007 to develop its accountability structure consistent with the executive order. Departmental plans must be approved by DOF prior to the expenditure of bond funds, unless DOF provides an exception.

II. Policy Frameworks to Consider When Dealing with the 2006 Bonds (Discussion)

There Are Existing and New Programs. Some pots of bond funding provide state programs with additional resources. Many of these existing programs also have funds remaining from prior bond authorizations. The LAO, at the time of their *Analysis of the 2007 Budget Bill*, estimated that almost \$5 billion in prior bond funds have not yet been spent on these programs. In other cases, a pot provides dollars for a purpose never previously funded. In these cases, the program purpose at this point may be defined only by a few sentences. The bond package funds 21 new programs, representing more than 40 percent of total funding. Many of these new programs will need further implementing legislation in order to begin operating.

Most of the programs will need future legislative action to appropriate funding--either through the annual budget bill or separate legislation--before state departments can begin spending the funds. In some cases, the funds are continuously appropriated--meaning that funding obligations can be made by departments without additional legislative action. These continuous appropriations cover \$9.4 billion of the bond funding. They apply to all K-12 education programs, a number of housing programs, and several pots within Proposition 84.

Since the bonds commit \$18.2 billion to new programs, one of the most important responsibilities for the Legislature will be to effectively design the frameworks for these new programs.

Four standing committees of the State Senate: Environmental Quality, Education, Transportation and Housing, and Natural Resources and Water, are responsible for the various bond subject matters and have held one or more informational hearings on implementation of the recently passed bonds. Consistent with these hearings, the Chair of the Budget Committee has invited Senator Joseph Simitian (Chairman, Environmental Quality Committee), Senator Jack Scott (Chairman, Education Committee), Senator Alan Lowenthal (Chairman, Transportation and Housing Committee), and Senator Darrell Steinberg (Chairman, Natural Resources and Water) to discuss policy frameworks that should be considered when appropriating bond funds.

**New Programs Funded
In the 2006 Bond Package
(in millions)**

PROGRAM	Amount
Proposition 1B -- Transportation	
Corridor Mobility	\$4,500
Local transit	3,600
Trade Corridors	2,000
Highway 99	1,000
State-Local Partnership grants	1,000
Air Quality	1,000
Transit Security	1,000
School bus retrofit	200
Port Security	100
Proposition 1C -- Housing	
Development in urban areas	\$ 850
Development near transportation	300
Parks	200
Pilot programs	100
Proposition 1D -- Education	
Severely overcrowded schools	\$1,000
Career Technical facilities	500
Environment-friendly projects	100
Proposition 84 -- Resources	
Local and regional parks	\$ 400
San Joaquin River restoration	100
Urban water and energy conservation	90
Incentives for conservation planning	90
TOTAL	\$18,180

III. Guiding Fiscal Principles for Appropriating Bonds in the Budget (Discussion).

Below are some general fiscal principles for appropriating bonds that should be discussed by the full Committee:

1. No multi-year bond appropriations. Any appropriation should be for what is considered project-ready to be encumbered in the budget year. For example, Item 9350-104-6065 provides for a \$1.05 billion appropriation available to the California Transportation Commission over three years (\$600 million in 2007-08; \$300 million in 2008-09; and \$150 million in 2009-10.)
2. No blanket bond authorization without a plan, particularly where traditionally a plan (or categories) of expenditure have been provided.
3. Priority should be given for essential fire / life safety projects. However, #1 and #2 should be adhered to.
4. No inference shall be made about future Legislative commitment on bond appropriations; if the Legislature is funding position authority for bond purposes. For example, in the California Conservation Corps' budget, the administration has proposed personnel for grant guideline development; however, DOF had informed staff that by approving the personnel for 2007-08, the Legislature is considered having made a policy decision to approve the entire \$45 million in Proposition 84 expenditure program.
5. Do not appropriate bond funding for any project that does not provide long-term infrastructure benefits, unless the bond allows for such exceptions.
6. Insure appropriate reporting and oversight of bond appropriations throughout the budget year.
7. Do not allow for any additional continuous appropriations beyond those indicated in the bonds.
8. Avoid project earmarking of bond funds.
9. Projects funded with bonds should focus, to the extent possible, on statewide needs.
10. Maintain reasonable controls on administrative costs.
11. Use existing bonds, where available, prior to appropriating November 2006 bonds.

12. Consider other sources of funds in order to maximize available resources for projects. To the extent possible, match state bond funds with available federal, local, and/or private.

Debt Service Considerations. Finally, it is critical that in determining how much bond funding to appropriate in the budget year, consideration must be given on the debt service costs and the implications on out-year budgets.

The LAO has provided information that illustrates the level of debt service costs that the State might incur under the following assumptions: cost projections are generally based on the administration’s assumptions about the timing of bond sales. In addition, the LAO projections also assume:

- Maximum maturity lengths for GO bonds and lease-revenue bonds of 30 years and 25 years, respectively.
- GO bond interest rates of 4.5 percent currently, trending up over time to 5.7 percent, with lease-revenue bonds slightly higher.

Projected Infrastructure Debt-Service Ratios (DSRs)					
<i>(Dollars in Millions)</i>					
	General Fund Revenues ^a	Authorized Debt		With Governor’s Corrections Plan	
		Debt Service	DSR	Debt Service	DSR
2005-06	\$93,427	\$3,878	4.15%	\$3,878	4.15%
2006-07	94,052	4,077	4.33	4,077	4.33
2007-08	101,593	4,691	4.62	4,691	4.62
2008-09	106,932	5,130	4.80	5,133	4.80
2009-10	113,727	5,971	5.25	6,000	5.28
2010-11	120,745	6,790	5.62	6,897	5.71
2011-12	127,689	7,146	5.60	7,330	5.74
2012-13	135,350	7,262	5.37	7,524	5.56
2013-14	143,471	7,394	5.15	7,733	5.39
2014-15	152,080	7,490	4.93	7,922	5.21
2015-16	161,204	7,437	4.61	8,008	4.97
2016-17	170,877	7,705	4.51	8,346	4.88
2017-18	181,129	7,713	4.26	8,397	4.64
2018-19	191,997	7,404	3.86	8,122	4.23
2019-20	203,517	7,418	3.64	8,152	4.01
2020-21	215,728	7,173	3.33	7,908	3.67
2021-22	228,672	7,187	3.14	7,922	3.46
2022-23	242,392	7,124	2.94	7,859	3.24
2023-24	256,935	7,065	2.75	7,800	3.04
2024-25	272,351	7,075	2.60	7,809	2.87

^a LAO projections through 2011-12, with 6 percent annual growth thereafter.

Debt-Service Ratio (DSR). The ratio of annual debt-service costs to yearly revenues is often used as a general indicator of a state's debt burden. The DSR helps to look at debt from the perspective of affordability, as it takes into account the amount of revenues the state has available or is projected to have available to fund its programs (including debt payments).

Although concerns have sometimes been voiced in the past about DSRs in excess of 5 percent or 6 percent, there is no "right" level for the DSR. Rather, this depends on such things as a state's preferences for infrastructure versus other priorities, and its overall budgetary condition. According to LAO, some states, for example, have comparatively high DSRs and/or related measures (such as debt as a percent of personal income) that are higher than California's, but still experience more favorable bond ratings. Examples include Maryland, New York, New Jersey, and Illinois.

From an affordability perspective, however, each additional dollar of debt service out of a given amount of revenues comes at the expense of a dollar that could be allocated to some other program area. Thus, the "affordability" of more bonds has to be considered not just in terms of their marketability and the DSR, but also whether their dollar amount of debt service can be accommodated on both a near- and long-term basis within the state budget. (As a rule of thumb, each \$1 billion of new bonds sold at 5 percent interest adds close to \$65 million annually to state debt-service costs for as long as 30 years.)

IV. Public Comment