



What are the Fiscal Impacts of an \$11 Billion Water Bond?

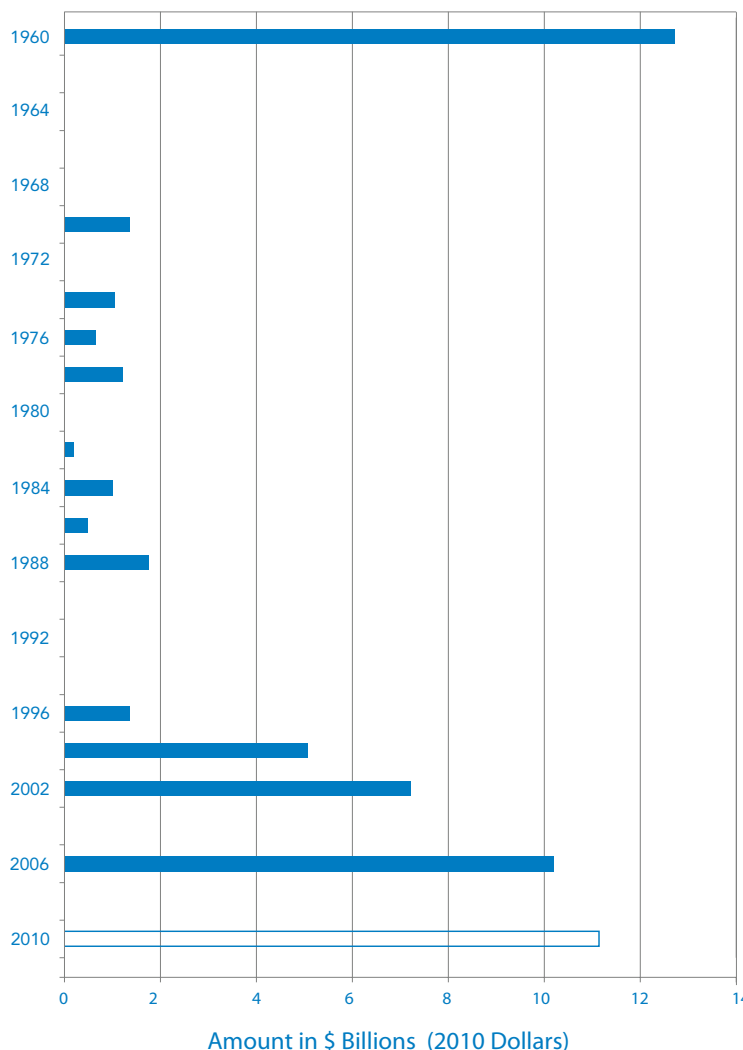
WATER BONDS ARE INCREASING IN SIZE AND FREQUENCY

General obligation (GO) bonds must be approved by voters, and their repayment, with interest, is guaranteed by a government's general taxing power. Between 1970 and 1999, several small water-related GO bonds were passed in California, ranging from \$188 million to \$1.8 billion (all in 2010 dollars), and totaling \$9.1 billion over the time period. However, since 2000, the frequency and size of water-related bonds has increased markedly (Figure 1). Between 2000 and 2006, six water-related GO bonds were passed, ranging from \$2.5 billion to \$5.8 billion, and totaling \$22.5 billion. The state legislature recently passed an additional \$11.1 billion water bond to be put before voters in November 2010, Proposition 18. Debt service payments for the proposed bond would be made out of the General Fund, forcing the state to either raise revenue or decrease spending on other General Fund programs, e.g., healthcare, higher education, and California Highway Patrol.

PROPOSED WATER BOND AMOUNT RIVALS THE STATE WATER PROJECT

The only previous California water bond as large as the one proposed was a \$1.8 billion GO bond passed in 1960 (equal to \$12.7 billion in 2010 dollars), which authorized the state to finance the State Water Project – one of the largest water infrastructure projects in the nation. This bond required that State Water Project users repay the vast majority of project costs, rather than relying on the General Fund. In comparison, the proposed bond authorizes a similar amount of spending with less defined outcomes and no revenue stream specified for repayment.

Figure 1. Amount authorized by water-related bonds in billions of (2010) dollars, 1970-2006.¹



■ CALIFORNIA'S CURRENT FINANCIAL CRISIS MEANS WE PAY MORE FOR BONDS

Currently, California has some of the lowest bond ratings in the nation. Moody's Investors Services gave California bonds a Baa1 rating, which is only one tier above speculative grade, otherwise known as "junk" bonds. The state's bond rating is important because it affects the interest rate at which the state must repay bonds. According to the Legislative Analyst's Office, annual payment for an \$11.1 billion bond would peak at \$725 million (at a 5% interest rate) to \$809 million (at 6% interest). Thus, the peak payment on a bond of this size is roughly equivalent to the annual cost of educating up to 70,000 students in California (assuming the average per-pupil spending in 2008-2009)² or to the annual cost of all regular positions in the California Highway Patrol (assuming actual expenditures from 2007-2008)³. Over the 30-year repayment period, the bond would end up costing taxpayers around \$22 billion with interest included.

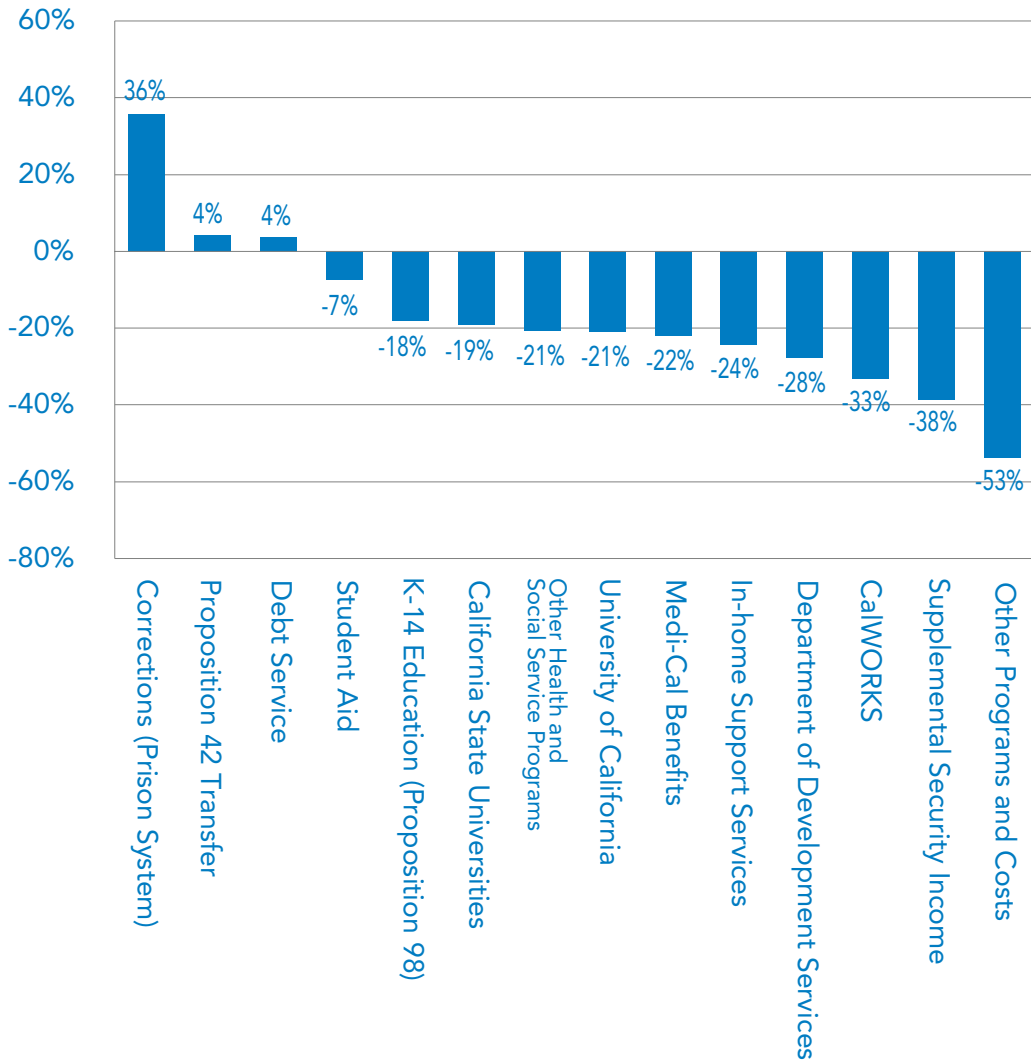
"[General Obligation] bond repayments are essentially the first funding priority of the General Fund (after K-12 education) and, for this reason, bonded debt service takes precedence over other spending priorities, be they education, health, social services, prisons, etc."

—Office of Senate Floor Analyses

■ LARGE BONDS MAY FORCE DEEPER CUTS TO PUBLIC SERVICES

The annual cost of water bond debt payments would constrain the availability of state funds for essential public services. If past trends continue, cuts are most likely in the education, health, and social services sectors. At the end of 2004, the Legislative Analyst's Office projected future state spending needs (to maintain legally required levels of service, given population and inflation changes). Figure 2 shows the percent difference between those projections for the 2009-2010 budget and estimated spending during 2009-2010. These data show that while spending increased for prisons and debt service (to pay off existing bonds), spending on most other programs supported by the General Fund fell below projections. Spending on some programs fell by more than one-third, e.g. support to needy families and elderly, disabled, or blind California residents.

Figure 2. Difference between projected baseline spending on General Fund programs and estimated 2009-2010 spending (see preceding paragraph for details).⁴



ENDNOTES

1 Legislative Analyst's Office. 2009. "Financing Water Infrastructure."

2 Legislative Analyst's Office. 2010. "Analysis of the 2008-09 Budget Bill: Education, Per-pupil Spending."

3 State of California. 2009. "2009-10 Salaries & Wages." Business, Transportation and Housing: Organization Codes 2100-2740.

4 California Budget Project. 2010. "Searching for Balance: The Social and Economic Context of the Governor's Proposed 2010-11 Budget."