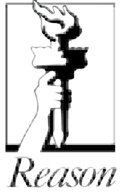
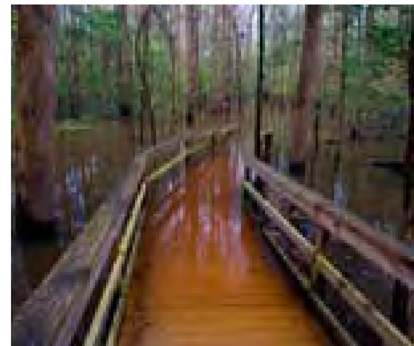


CALIFORNIA GENERAL ELECTION

September 2006

Undermining the Future: Problems with November's Bond Initiatives, and Alternatives

By Adrian T. Moore, Ph.D., George Passantino, and Adam B. Summers



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Undermining the Future: Problems with November's Bond Initiatives, and Alternatives

By Adrian T. Moore, Ph.D., George Passantino, and Adam Summers

Executive Summary

California needs to invest in infrastructure, but the five bond initiatives on the November ballot would authorize $42.65 billion in new debt, with annual debt service payments of $2.8 billion, and a total cost to taxpayers of approximately $84 billion, while delivering a lot of pork and little new infrastructure.

The state budget is once again in the red as spending growth outstrips even our healthy revenue growth. At the same time the state is already sitting on a record-breaking mountain of debt that is making borrowing money more expensive and raising debt payment amounts to levels far beyond what is fiscally responsible. The vast new debt we will vote on in November would create tremendous pressure for new taxes. There is no sign that the state's leaders will reverse course and begin managing spending as debt payments rise.

Forty-five years ago nearly 60 percent of the budget for capital projects came from general and special funds. Currently, almost all state capital improvements are financed with debt.

We do not have to put up with this trend. Californians need to take a hard look at the details of the bond proposals provided here before they vote, and consider the many and realistic alternative means of meeting our infrastructure needs.

For more information on this issue and others on California's November Ballot, go to reason.org/californiaballot/

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Part I

Introduction

Most people agree that California faces a critical need to invest in infrastructure. From roads to schools to levees, maintenance of existing facilities has been poor and construction of new facilities has lagged way behind growth. A brief look at the American Society of Civil Engineer's report card for California's infrastructure tells the grim tale.[1]

In response to this growing problem, California's leaders have done almost nothing to change spending priorities and give infrastructure its due. Instead, they have placed on the ballot four bond initiatives that if passed would authorize $42.65 billion in new debt, with annual debt service payments of $2.8 billion, and a total cost to taxpayers of approximately $84 billion.

1. Proposition 1B, the *Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006* would authorize more than $19.9 billion in general obligation debt, with an annual debt service of $1.3 billion and a total cost to taxpayers of approximately $38.9 billion.
2. Proposition 1C, the *Housing and Emergency Shelter Trust Fund Act of 2006,* would authorize $2.85 billion in general obligation debt with an annual debt service of $204 million and a total cost to taxpayers of about $6.1 billion.
3. Proposition 1D, the *Kindergarten-University Public Education Facilities Bond Act of 2006*, would authorize $7.3 billion in general obligation debt for primary education (K-12) and $3.1 billion for higher education facilities with an annual debt service of about $680 million per year and a total cost to taxpayers of about $20.3 billion.
4. Proposition 1E, the *Disaster Preparedness and Flood Prevention Bond Act of 2006,* would authorize $4.1 billion in new general obligation debt with annual debt service payments of $266 million and a total cost to taxpayers of $8 billion.
5. Proposition 84, the *Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006,* would authorize $5.4 billion in general obligation debt with annual debt service costs of $350 million and a total cost to taxpayers of about $10.5 billion.

This suite of debt will impose a crushing burden on future state budgets and taxpayers for too little gain. More than half the money in these bonds is for ongoing programs, not new infrastructure.

They represent a new pinnacle of fiscal irresponsibility and lack of policy imagination. Rather than taking on record-breaking debt to fund a pork-barrel spending spree, we should be demanding that state leaders change the way things are done in Sacramento so that infrastructure funding begins with prioritization, with adequate support from the general fund, and with leveraging private investment and other innovative financing sources.

A. More Bonds In a River of Red Ink?

For the past several years, California has suffered a severe structural deficit, a veritable "river of red ink." Despite impressive growth in state revenues over the past several years, spending continues to outpace revenue. And this deficit is projected to continue on into future years.

In fact, taxpayers should be alarmed at the prospect of increasing general fund debt service by nearly $3 billion when the budget is already billions in the red. Perhaps many of them are. An August survey by the Public Policy Institute of California found that 59 percent of likely voters think that the total amount of bonds on the ballot in November is too much.[2]

While lawmakers were quick to applaud the approval of the 2006-2007 state budget before the constitutional deadline, the reality of the deal leaves little to applaud. In its 2005-2006 Budget, the state of California spent $92.7 billion (general fund) and $117 billion (when combined with other special funds). The budget approved this year authorized spending of $101.3 billion (general fund) and $127.9 billion (when combined with other special funds). This reflects a general fund spending increase of 9 percent. At the same time, general fund revenues increased by a much more modest 1.7 percent or $1.9 billion. Thus the trend of spending growing faster than revenue continues.

Major drivers in state spending include:

- A 10.3 percent or $5.2 billion increase in K-14 education spending, which now totals $55.1 billion
- An additional increase of $2.5 billion in one-time education spending
- A 10.0 percent or $1.8 billion increase in state health spending
- A 12 percent or $1.2 billion increase in spending on judicial and criminal justice programs (note: $945 million of this increase is reserved for adult corrections)
- Repayment of approximately $1.4 billion for Proposition 42 (gasoline sales tax) monies borrowed in 2003-2004 and 2004-2005
- $361 million general fund increase in salaries for state employees (representing 6 of 21 state bargaining units and less than 44 percent of the state workforce)

While the current budget substantially increased spending this year, it also failed to account for numerous budgetary uncertainties, which could dramatically alter the financial picture of the state in future years for the worse, including:

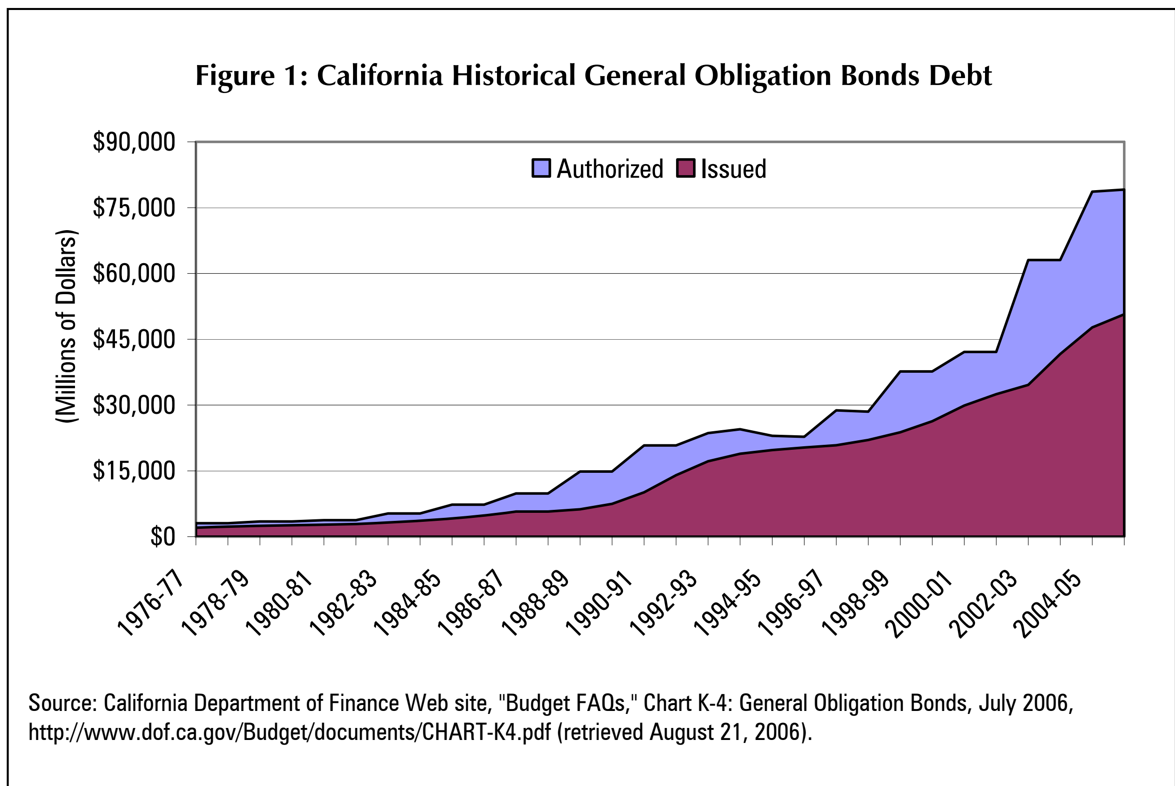
- Pending and future collective bargaining agreements with more than 56 percent of state employee unions are unaccounted for in the current budget. Any increases will be funded out of budget reserves; though, in reality, will reflect additional spending in this budget year.
- New public accounting rules will require full reporting of unfunded liabilities in retiree health benefits in 2007-2008. This new requirement under Government Accounting Standards Board Rule 45 may require an additional $5 billion annual payment from the general fund. According to the Legislative Analyst's Office, the total unfunded liability for retiree health benefits may be $40 billion to $70 billion or more.
- Despite positive economic growth, California has a history of dramatic peaks and troughs in state revenues. As such, when revenues do begin to decline (as they inevitably will) the shortfall may be quite dramatic.

All of this puts the lie to assertions that the proposed new bonds will not require new taxes. At what point will the state's leaders suddenly reverse course and begin holding spending in check, even making some cuts, in order to pay for the bonds?

B. Already Astonishing Debt

California has been on a rapidly increasing borrowing binge for over a decade. The state issued 2.5 times as much debt in FY 2005-06 as it did in FY 1995-96, and over 10.5 times as much as in FY 1985-86 (see Figure 1).

Figure 1: California Historical General Obligation Bonds Debt

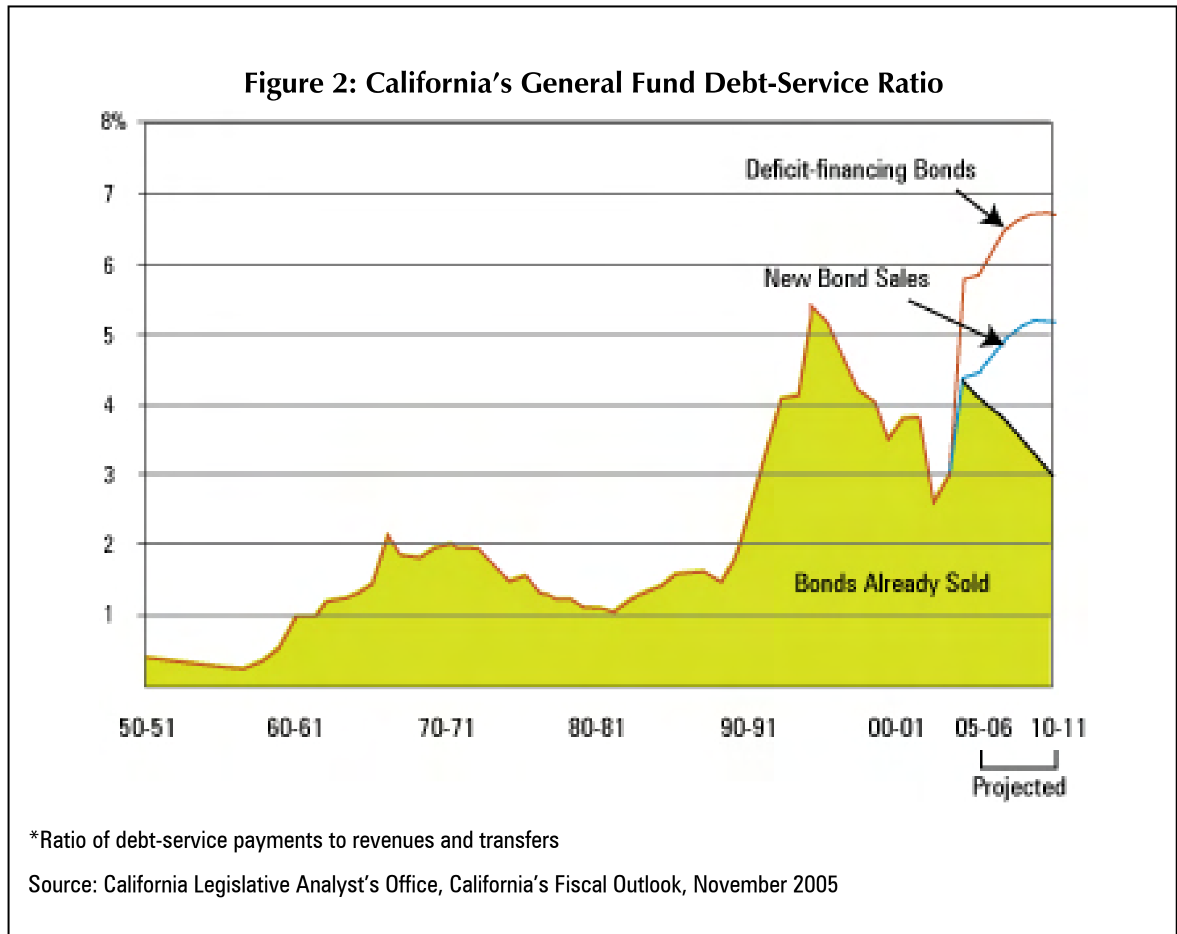


Source: California Department of Finance Web site, "Budget FAQs," Chart K-4: General Obligation Bonds, July 2006, http://www.dof.ca.gov/Budget/documents/CHART-K4.pdf (retrieved August 21, 2006).

California's credit rating, as determined by the three major rating agencies (Standard & Poor's, Moody's, and Fitch), is already the lowest of all the states, mainly because of our ongoing structural deficit. As such, we already pay a premium of 0.22 percent above the AAA interest rate on our bonds. That translates into debt payments eating up even more of the budget, and California has blown past all fiscally responsible levels of debt payment as a share of the budget (the debt service ratio). According to the Legislative Analyst "In past years . . . some concerns have been voiced [in the investment community] when a state's DSR [debt service ratio] began to exceed 5 percent or 6 percent."[3]

Yet California's estimated debt service ratio for FY 2006-07 is already 5.9 percent for infrastructure-type bonds alone, or 6.3 percent when the 2004 deficit-financing bonds are included (see Figure 2).[4] These rates would balloon dramatically if the bond package is approved.

Figure 2: California's General Fund Debt-Service Ratio



*Ratio of debt-service payments to revenues and transfers

Source: California Legislative Analyst's Office, California's Fiscal Outlook, November 2005

C. California's Shift to a Debt-Driven Approach to Infrastructure

Table 1 shows that on a per-capita basis California state government spends the same on infrastructure today, in constant dollars, as it did thirty-seven years ago—$299 in 2002-03 compared to $307 in 1965.[5] Given the rising costs, it is no surprise that California has failed to

improve and expand its infrastructure to keep up with growth. From 1957 through 1969 California state and local governments outpaced the national average of public infrastructure spending.[6] Over the last thirty years, however, California's spending mirrored the national average. But forty-five years ago infrastructure was financed using current tax dollars, especially from special fund sources. Table 1 depicts the changes since 1960, especially the shift from using current tax dollars (General and Special Funds) to debt (Bond Funds). In 1960 – 1961, for example, nearly 60 percent of the Governor's Budget for capital projects came from general and special funds.[7] This reflects spending on higher education and flood control projects. Currently, almost all state capital improvements are financed over time using proceeds from the sale of bonds.[8]

Table 1: State Revenue Sources for Infrastructure Financing

	1960-61	1965-66	2002-03
General Fund	13.5%	1.8%	0.9%
Special Funds	44.2%	27.9%	7.5%
Bond Funds	15.8%	42.2%	77.5%
Federal Funds	26.6%	28.0%	14.1%
Total Amount	$4,104	$5,789	$10,607
Amount per capita*	$259	$307	$299

*2003 dollars

Reprinted from Shelly de Alth and Kim Rueben, Understanding Infrastructure Financing for California, p. 8,

In 1998 the Legislative Analyst recommended the legislature commit 6 percent of the general fund for infrastructure spending. Chapter 606, Statutes of 1999 (AB 1473, Hertzberg), requires the governor to submit a five-year infrastructure plan annually in conjunction with submission of the governor's budget. This plan has not been produced since 2003.

Part 2

Proposition 1B: Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006

California's population is projected to reach 48 million by 2030, an increase of 11 million people. The majority of this growth will occur in the state's three major urban regions (Los Angeles, San Francisco, and San Diego). Vehicle miles traveled by individuals will increase by 30 to 50 percent in these regions, with truck traffic growing even faster, especially in greater Los Angeles. Yet California's urban freeway systems are already nearing capacity, with pervasive congestion during ever-lengthening peak periods.

By 2030, even if current long-range transportation plans are implemented, congestion in the three largest urban areas will be much worse than today's already intolerable levels. The Los Angeles metro area already leads the nation in congestion, with the Bay Area ranking fourth. To eliminate the most severe congestion requires adding enough highway capacity to more than keep pace with projected growth in vehicle travel. A recent Reason Foundation study projects that between now and 2030, California would need to add 13,132 new lane-miles to do this. That amount of new capacity would cost $122 billion, or about $5 billion per year over 25 years.

While these are not small numbers in any sense, they are reasonable in the grand scheme of transportation spending. In response to this growing crisis, California's leaders have offered a dismal response.

Proposition 1B would authorize more than $19.9 billion in general obligation debt, with an annual debt service of $1.3 billion and a total cost to taxpayers of approximately $38.9 billion. The funds would be spent as follows:

- $4.5 billion to congestion-reducing highway capacity projects
- $2 billion to highways, local roads and public transit systems
- $2 billion to local roads

- $1 billion to State Route 99 through the Central Valley
- $1.75 billion to local transportation projects and to state highways
- $4 billion to capital projects for local transit systems and intercity rail systems
- $2 billion to goods movement via ports, highways and rail
- $1.2 billion to reduce air emissions and replace/retrofit old school buses
- $1.1 billion to security and disaster response on transit systems and in publicly owned ports and harbors
- $325 million to railroad crossings and to retrofit local bridges and overpasses

While that is an impressive looking list and it would seem that $19.9 billion could make a substantial improvement to the state's transportation system, only a limited portion of this money will be used for new infrastructure, and an even smaller portion for new roads and highways. Most funds may go to ongoing maintenance and rehabilitation and to other non-infrastructure uses such as retrofitting buses or improving security on local transit systems. And since most of the money will be apportioned by the legislature if Proposition 1B is approved, we should expect plenty of it to go to local pork barrel projects.

This attention to California's transportation infrastructure is overdue, but good intentions and recognition of the problem alone do not make good public policy. In reality, this bond proposal is an easy way for California's leaders to look as if they're addressing the congestion problem while passing the buck to future generations and making very little in the way of real long-term improvement.

Californians recognize these doubts. In spite of the overwhelming support for the bond among state leaders and groups like AAA and the Chamber of Commerce, the latest Public Policy Institute of California survey shows only 50 percent of likely voters say they would vote yes on Proposition 1B if the election were held today.

Even more damning is an innovative survey conducted by researchers from San Jose State University and Portland State University as a project for the Mineta Transportation Institute at San Jose State University. They surveyed Californians on different ways to fund transportation projects, and their question about using general obligation bonds like Proposition 1B explained that "paying off the bonds from the state's general fund over 30 years would use money that otherwise might be spent for other state programs and services." With that reality included, only 29.9 percent of those surveyed said they would support using general obligation bonds like Proposition 1B.

Fundamental problems with the approach of Proposition 1B include:

- **Roads should be funded by user fees**. General obligation bonds paid out of general tax revenues require many Californians to pay for roads they will never use and don't need. Gasoline taxes at least come close to relating how much you pay to how much you use the

system. The use of direct fees—tolls—to pay for new roads is increasingly popular with drivers and makes the most economic sense. Gas tax funds could then be focused on roads that cannot be toll funded.

- **Proposition 1B is a drop in the bucket that would decrease momentum for long-term solutions**. Many argue that something is better than nothing, but based on impact, 1B would be very close to doing nothing. The bond will not provide congestion relief on interstate freeways. A portion of the funds would be unavailable to most of the state—$1 billion is devoted specifically to State Route 99. An unknown portion of a $2 billion component of the bond devoted to traffic safety and congestion relief may be spent on pubic transit. But conventional transit is unlikely to offer much in the way of congestion relief and Proposition 1B's passage would not change that reality. If the bond passes many will be satisfied that "something" has been done about transportation when what we really need is a radical overhaul of California's approach to transportation infrastructure.

- **Essential infrastructure ought to be a priority for general revenue funding**. By allowing the legislature to bond for essential infrastructure, taxpayers remove the pressure on the legislature to prioritize the general budget. In 1960-1961 bonds accounted for only 16 percent of infrastructure funding, but by 2002-2003 the figure had grown to 76 percent. Voters have approved bond after bond, and yet here we are again. An expert panel assembled by USC's Keston Institute "believes that the Department of Finance is singling out transportation to pay a disproportionate share of the general fund deficit." This bond would allow our leaders to lean on the crutch of borrowing yet again and continue their habit of shortchanging transportation in the general fund.

- **Proposition 1B allows poor prioritization to continue**. State leaders and local MPOs have refused to make cutting congestion a priority. Officials hope to slow congestion's rate of growth, but they fully expect conditions to grow much worse in the future. Policymakers claim they simply do not have the money to actually make conditions better, but that is not the case. The MPOs for our state's three largest regions (Los Angeles, San Francisco, and San Diego) plan to spend $265 billion over the next couple of decades, but the majority will go toward transit, not toward reducing congestion on our roads. Our MPOs do have the money necessary to actually reduce congestion by 2030.
    - Los Angeles plans to spend 58 percent of transportation funds on transit. Devoting the same percentage to expanding capacity would eliminate gridlock by 2030.
    - San Francisco plans to spend 64 percent of transportation funds on transit. Devoting just 25 percent of planned funds to expanding capacity would eliminate gridlock by 2030.
    - San Diego plans to spend 49 percent of transportation funds on transit. Devoting just 24 percent of planned funds to expanding capacity would eliminate gridlock by 2030.

- **California's bonded indebtedness is already at record levels**. The state issued 2.5 times as much debt in FY 2005-06 as it did in FY 1995-96, and over 10.5 times as much as in FY 1985-86. We have already authorized the state to go nearly $80 billion in debt. It is fiscally risky to increase the state's level of debt by the amount proposed in this and the other bond measures on the November ballot.

There are three main parts to the way California *ought* to be approaching our transportation infrastructure needs.

First, make better use of current funds. Proposition 1B is a pork-laden mess and much less than half the money will go to projects that will relieve congestion. That is typical of our transportation spending. While transit is important and needs appropriate funding, current spending plans allocate a disproportionate share of funds to transit. The three largest metro areas plan to spend about $154 billion on transit over the next 25 years, versus $109 billion on roads, and most of the road money will go to maintenance and upgrades, not new capacity. If even one-third of the money going to transit was shifted to roads we could get three to five times more congestion relief than Proposition 1B will accomplish.

Second, the state should give transportation its share of the budget. We used to devote a reasonable share of the general fund to transportation infrastructure. Now, even though the state budget has grown considerably, we don't devote the same share of general fund revenue to infrastructure that we used to. If Proposition 1B passes, we will pay $38.9 billion to get less than $20 billion in current funds for projects, and we'll be paying for that with about $1.33 billion each year out of the general fund. It makes more sense to take a responsible look at our bloated budget and cut less essential spending so that we could allocate $4-5 billion per year out of the general fund for what is surely one of the most core functions of the state. Some bonding for large infrastructure investments might still be good policy, but prioritizing spending of the revenue we have should come first. We have plenty of good examples of such an approach. Nineteen counties in California have put in place local sales taxes for local transportation funding and used them to combine pay-as-you-go financing with bonding.

Third, California is falling far short of making full use of public-private partnerships for transportation projects. We are far behind states like Virginia, Massachusetts, and Florida in outsourcing highway maintenance, which would free up gas tax funds to help fund new road projects. More importantly, the private sector would happily invest their own capital in providing major new highway projects. If we aggressively pursued PPPs and tolled some of the new facilities and lanes added, private capital could fund at least 25 percent of what the bond could if all the bond funds were spent on roads.

We recommend improving the existing flawed public-private partnership law to incorporate state-of-the-art learning on this issue. The legislation should authorize both Caltrans and other levels of government (cities, counties, joint powers authorities, etc.) to initiate toll-funded transportation infrastructure projects, and permit them to partner with the private sector to carry out such projects,

using both RFPs and procedures for dealing with unsolicited proposals. The appropriate approval process should occur within the responsible government entity (the MPO, or Caltrans, for example). This would enable California to enter the global capital markets, as well as tap world-class expertise for modernizing its vitally important highway system. With the private sector to provide investment for these large-scale projects, scarce public money can be spent on things only the public sector can do.

Part 3

Proposition 1C: Housing and Emergency Shelter Trust Fund Act of 2006

The severe shortage of affordable housing in California threatens the state's economic health and has placed the American Dream of homeownership out of reach for hundreds of thousands of families. Declining federal support for housing programs over the last several decades has prompted calls for increased state funding for affordable housing in California. Rather than establishing a fiscally responsible ongoing revenue stream to fund the state's affordable housing programs, California policymakers have repeatedly asked voters to approve one-time influxes of bond funding, violating a basic principle of public finance: long-term debt should be used to fund long-term investments, not the operating expenditures of state programs.

If approved by voters this November, Proposition 1C would become the latest in a string of housing bond measures that have failed to substantively address the state's housing affordability crisis. It would authorize $2.85 billion in general obligation debt with an annual debt service of $204 million (and a total cost to taxpayers of about $6.1 billion) for the following purposes:

- $1.35 billion to fund housing projects predominantly in urban areas and near public transportation systems. Funds could be used for a myriad of purposes, including parks, water systems, transportation, and housing.
- $625 million to fund taxpayer-subsidized loans and grants to encourage home ownership by low- and moderate-income homebuyers.
- $590 million to fund taxpayer-subsidized loans for high-density multi-family housing that reserves units for low-income residents, with priority given to projects located in urban cores and near existing public services.
- $185 million in taxpayer-subsidized grants and loans to fund homeless shelters and housing for farm workers, and to those that develop, own, lend to, or invest in affordable housing.

- $100 million to the newly created Affordable Housing Innovation Fund to pay for grants and loans for affordable housing pilot projects.

Like most of the political remedies aimed at increasing the affordable housing stock, Proposition 1C fails to reflect the real-world functioning of housing markets and could exacerbate the affordability problem. Specifically, Proposition 1C:

- Fails to address the root cause of California's housing affordability crisis: the severe, ongoing shortage of new housing, which is largely attributable to the myriad of state and local land-use regulations that make it difficult for new housing to be approved and built. The severe mismatch between supply and demand has helped to drive up the cost of housing statewide and has produced a shortage estimated between 600,000 and 1 million housing units.
- Directs very little of the bond money to infrastructure. Almost half of Proposition 1C—$1.35 billion—would fund new programs to promote urban infill and transit-oriented developments (TODs) and to acquire parkland. An additional 22 percent ($625 million) would be targeted to existing homeownership assistance programs via down payment assistance to homebuyers through low-interest loans or grants.
- Perpetuates the misconception that the poor need high-quality *new* housing made artificially cheap through legislation and regulation. This practice contradicts the well-established concept of the "housing ladder"—affordable housing is created when existing homeowners upgrade to newer, higher-quality units, placing older, lower-quality units on the market for young and first-time homeowners.
- Subsidizes housing, creating new demand in a market that is already experiencing a dearth in supply and potentially *increasing* the housing shortage.
- Places an overwhelming focus on promoting transit-oriented development, which has little to do with addressing the housing affordability crisis and more to do with reengineering society with the aim of getting citizens to make the "right" transportation, housing, and land-use choices.

Alternative policies that do not require significant new spending and have a much greater likelihood of succeeding include: deregulating the land market to allow more market-driven densities and development, eliminating costly and wasteful building codes that do not measurably improve public health and safety, repealing prevailing wage laws that dramatically increase the cost of building new affordable housing, and avoiding new subsidies for high-income housing projects, such as transit-oriented development. Further, policymakers should separate the larger issue of housing affordability from efforts to provide a housing "safety net" for the needy through the construction of new shelters for homeless persons, foster children, domestic violence victims, and others. Safety net programs are best addressed through the regular budgeting process, as bond funding is a fiscally irresponsible method of financing ongoing government programs.

Like the numerous affordable housing bonds and programs before it, Proposition 1C would do little to address the problem of low-income homeownership and would likely worsen the situation. California's affordable housing problem is largely a creature of government's own making. Increasing the costs of housing, and then throwing an additional $2.85 billion of taxpayers' money at the problems government has exacerbated in the first place, simply does not make any sense.

Part 4

Proposition 1D: Kindergarten-University Public Education Facilities Bond Act of 2006

Proposition 1D would authorize $7.3 billion in general obligation debt for primary education (K-12) and $3.1 billion for higher education facilities. Together, this debt package would have annual debt service costs of $680 million per year and a total cost to taxpayers of $20.3 billion. This money would be available to fund construction for modernization projects, new construction, and vocational education facilities, among other uses.

Over the past ten years, state voters have authorized $28.1 billion in general obligation debt for K-12 school facilities. Approximately $3 billion of those funds remain unused at this time. Additionally, local school district voters have authorized an additional $41 billion in local bonds to fund school construction. School construction is also supported by developer fees paid when new homes are built. Overall, California has made a $95 billion investment in K-12 and higher education facilities over the past decade.

Yet state general obligation bond funding is a poor way to finance school construction. It is expensive (interest payments make it nearly twice the cost of the principal), places an unfair debt burden on future generations, and represents a cop-out by legislators unwilling to make difficult decisions to provide funding through the normal budgeting process. This gives politicians greater incentives to spend money irresponsibly on pet projects and programs and then rely upon desperate voters to fund "critical" programs. Local bonds tend to be more accountable and more closely tied to real local needs and are a better way to use debt where appropriate for building new schools.

In addition, Proposition 1D leaves the current school facility program in place and does not address the inherent problems with the school facility process in California.

The complex regulatory process in California forces long delays in school construction while other factors, such as prevailing wage rules, increase the cost of school projects. Local school districts also play a significant role in the inefficient use of school construction funding. Districts vary

drastically in their construction approaches, accounting methods, contracts and budgets, so it's difficult for the public to know when money is wasted or lost. There is no single state watchdog agency that ensures that districts spend bond money efficiently.

Proposition 1D also does not earmark any money for districts facing growing enrollment. Instead it creates a free-for-all atmosphere where the savviest districts may win more of the bond money. Yet there are clear shifts in enrollment patterns from one district to another.

It also fails to place the primary responsibility for school construction funding at the local level which would offer school districts the financial incentive to better manage their school facilities programs. In California both the school construction financing mechanism and the actual school building process need to be reformed with incentives for school districts to utilize innovative school building strategies such as lease-leaseback and developer-built schools.

Rather than a series of large-scale state-level general obligation bonds to fund school construction in California, the state should fund schools at the local level. Growing areas should be able to cover the majority of their new school costs through developer fees—especially if they utilize developer-built schools. In rapidly growing areas, districts should rely heavily on developer-built and lease-leaseback arrangements to build new capacity quickly. In addition, a state-level per-pupil component that is financed out of the general fund should give local districts a stable funding source that can be bonded against or aggregated over time to fund schools.

Public-private partnerships should play an important role in the development of new schools in California. Because the private builder who assumes the risk of building a new school has real money to lose from construction delays, he has an incentive to build schools quickly and at or under budget. Since the developer finances the school up-front, school districts or the state can redirect school construction bond money to more efficiently modernize and build new schools.

The state level per-pupil facility grants should offer districts an incentive to use innovative private delivery mechanisms to build schools quickly for a lower cost. The state level financing from the general fund should include performance incentives for those districts that build schools on time and on budget. A 10 percent reward above the state’s per-pupil allocation would be appropriate for those districts that leverage state construction funds to build schools in a timely manner. The public-private partnership is one mechanism for achieving that goal. A school district could offer builders financial rewards for on-time performance. However, any school district that can build schools on budget within a pre-set time frame should be eligible for performance bonuses above the minimum level of state funding.

Many California children continue to languish in deteriorating and overcrowded classrooms in spite of the fact that in the past decade California has made a massive $95 billion investment in K-12 and higher education infrastructure. Proposition 1D would continue this trend with another $10.1 billion education bond. Yet, the proposition offers no help for the school children who are stuck with deteriorating schools, not because of a lack of funding, but because of the highly-

regulated school construction process and the ineptitude of school district facility programs. It is time to revamp the school construction process in California. Regulations should be streamlined, local districts should take the primary responsibility for their school facilities needs, the districts should utilize the cost saving benefits of public-private partnerships, and the work should be performance-based to ensure that school districts build schools on time and on budget.

Part 5

Proposition 1E: The Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006

While both Propositions 1E and 84 are being sold as necessary to improve vital infrastructure, there is actually very little infrastructure support included. Rather, the bonds offer token funds for real infrastructure projects and represent a grab-bag of funding for environmental programs, parks and recreation facilities, and non-infrastructure-related water programs.

Proposition 1E authorizes $4.1 billion in new general obligation debt with annual debt service payments of $266 million and a total cost to taxpayers of $8 billion. This money would be used for California's aging system of levees, overflow weirs, and channels. Approximately $3 billion of this total would be dedicated to the state Central Valley Flood Control System. Of the funds in the bond measure, 73 percent or more of the fund is for as-yet unidentified projects in the Sacramento-San Joaquin Delta, and 93 percent of the fund is available for projects without any requirement for federal and/or local matching funds. Since 1996, California voters have authorized $11 billion in general obligation bonds for water and resource-related purposes. Approximately $1.4 billion of this funding remains available.

Proposition 84 would authorize another $5.4 billion in general obligation debt with annual debt service costs of $350 million and a total cost to taxpayers of $10.5 billion over the life of the bond. While the title of the measure suggests that water quality, safety and supply (as in drinking water) are the primary aims of the bond, this is quite misleading. The funds from the bond would go to a range of purposes, including:

- $1.5 billion for water quality projects (mostly through grants to local agencies)
- $928 million for projects to protect of rivers, lakes, and streams
- $800 million in additional funding beyond Proposition 1E for flood control projects

- $580 million to fund "sustainable communities" and "climate change reduction"
- $1.5 billion for planning and feasibility studies concerning water supply and flood control

While there is a clear state interest in preserving the water supply which flows through the Delta, general obligation debt is a poor and indirect method of funding these improvements. There is no guarantee that the funds will be used to address priority flood control and levee projects that increase the state's long-term water infrastructure and financial security. In fact, the opposite is likely as the system does a poor job of prioritizing needs and pork barrel projects vie for a share of the funds. Why should California taxpayers take on another $10.5 billion in costs to fund more of the same system that hasn't fixed our water and resource issues in the past? In recent years we have approved $11 billion in bonds for these purposes and little went to actual infrastructure. Instead, it is mostly comprised of funding for unrelated purposes, such as land conservancy purchases, protection of water quality for non-potable uses, funding for parks and nature education facilities like museums and aquariums, and programs for "sustainable communities" and "climate change reduction."

Policymakers should adopt appropriate user-fees both within drinking water rates, upon land-users that are protected by flood-control facilities, and upon users of recreational facilities. Adopting this "user pays" system would not only fund needed infrastructure improvements but would also encourage sensible land use in and around flood plains. Asking taxpayers to shoulder this obligation encourages inappropriate land-use within flood plains, worsening the potential impact of future flooding, and allows the legislature to avoid responsible budgeting for ongoing water and resource needs and instead rely on future generations to pay for their commitments through debt.

Part 6

Conclusion

The bond Propositions on the November ballot will deliver too little infrastructure at too high a cost, at a time when the state is in no fiscal or management shape to take on the burden of spending the funds wisely and paying the debt costs.

Californians should demand that state leaders change the way things are done in Sacramento so that infrastructure funding begins with prioritization, with adequate support from the general fund, and with leveraging private investment and other innovative financing sources.

About the Authors

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Endnotes

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[1] See http://www.asce.org/reportcard/2005/page.cfm?id=44

[2] Public Policy Institute of California, *Survey on Californians and the Future*, (San Francisco: PPIC, August 30, 2006).

[3] California Legislative Analyst's Office, "A Primer: The State's Infrastructure and the Use of Bonds," p.13, http://www.lao.ca.gov/2006/infrastructure/infrastructure_010306.pdf.

[4] California Legislative Analyst's Office, *California's Fiscal Outlook*, November 2005, p. 14.

[5] This and the following information on infrastructure funding trends from Michael Semler, *Financing California's Infrastructure,* Sacramento State University, December 2005, http://www.csus.edu/calst/government_affairs/reports/financing_california.pdf.

[6] Shelly de Alth and Kim Rueben, *Understanding Infrastructure Financing for California*, p. 5, cited in Semler, *Financing California's Infrastructure*.

[7] From 1960-61 through 1965-66 (the last six years of Pat Brown's administration), general and special fund spending on capital projects accounted on average for 13 percent of all state expenditures.

[8] The legislature placed on the October 2003 ballot a proposal to finance infrastructure improvements on a "pay-as-you-go" basis. The measure received only 36.2 percent of the votes cast. Proposition 53 (ACA 11) would have set aside a specific percentage of the general fund for state and local infrastructure purposes. Beginning with the upcoming fiscal year (2006-07), the measure would have set aside 1 percent of the general fund and grow to 3 percent by 2013-14. Opponents argued successfully that earmarking a specific share of the state's general fund would have further limited the legislature's and governor's policy options, especially during a major downturn in the state's economy, as was the case at the time. California Secretary of State, Official Voter Information Guide, October 2003, p. 34–39.

CALIFORNIA GENERAL ELECTION

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