CALIFORNIA'S DEBT AFFORDABILITY REPORT

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State Treasurer

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Executive Summary

With much of the State's operating budget crisis resolved, Legislators and the Governor must renew their focus on the long-term capital needs of the State. The Department of Finance has identified $80 billion in infrastructure needs over the next ten years. Some of these needs will be funded by the federal government and some by special funds of state government. The remainder however must be paid out of the General Fund. With the budget constraints in place today, all of these needs cannot be funded on a "pay as you go" basis. The State will need to stretch the funding out over time, through the sale of bonds with principal and interest payments (debt service) paid by the General Fund. The question, of course, is *"How much debt can the State afford?"* That is the subject of this report.

The concept of debt affordability is that a ceiling exists for the amount of debt that can be authorized and issued without impairing the State's other spending obligations and priorities. Determining the amount of debt the State can afford must be answered in the context of these competing obligations. The result represents a judgment about those relative priorities and implies trade-offs between competing priorities. These priorities can change over time, and for that reason, the report focuses on the amount of debt that the State Treasurer believes can be authorized and issued in the current fiscal year (1997-98) and the budget year (1998-99).

State Treasurer's Perspective

To preserve the quality of life that we enjoy as Californians and to achieve the economic growth we need to continue to provide jobs for our citizens, we must make significant infrastructure investments over the next few years. Studies show a direct and positive correlation between economic growth and the quality of infrastructure. Without these investments our State cannot remain competitive in the global economy in which we sell our products and services.

We must plan the financing of these investments, so as not to exceed a debt service ratio that will overburden the State budget. Careful planning will allow the State to finance a large portion of our capital outlay needs, while demonstrating the financial discipline necessary to achieve an increase in our credit rating.

The Cautionary Zone of Borrowing

The report introduces the concept of a "Cautionary Zone of Borrowing" as a policy guideline for managing the State's ongoing debt load. This concept is important for several reasons with significant fiscal implications for the State.

Executive Summary-continued

The cautionary zone of borrowing establishes a ceiling (not a target), for the maximum amount of debt service as a percentage of General Fund revenues. This cautionary zone should warn policymakers of reaching an impending danger zone if borrowing is not kept in check. The establishment of a prudent ceiling compels policy choices in terms of project prioritization and project timing. This concept is important for the following reasons:

Accelerated debt and declining economic conditions can create an imbalance in our debt load. As witnessed in the period 1991-1994, the State accelerated the issuance of debt during a time of economic recession. This in turn exceeded the historical debt ratios for the State which, along with the State's budget crisis, lead to a rapid decline in the State's bond rating, reduced investor confidence and increased costs to California taxpayers. The additional cost in terms of higher interest payments forced on California taxpayers during this period will potentially total more than $750 million.

Failure to return the State to its higher credit status leads to higher debt costs and robs Californians in the form of a "hidden tax" of higher interest costs. If the State cannot increase its bond rating level to at least the "AA"-"Aa" level (it was AAA prior to 1992), the additional cost to the taxpayers for the currently projected debt requirements will exceed $1 billion over the term of the projected bonds. This is enough to build approximately 100 new elementary schools.

Maintaining debt within the cautionary zone preserves the flexibility for the Governor and the Legislature to address shifting policy priorities. Currently, only 10% of the State's budget is left to the discretion of the Legislature. Increasing debt service requirements will further shrink the 10% discretionary spending and inhibit the ability of the Legislature to respond to changing priorities and pressing social issues. For example, increasing the percentage of debt service to 7% from 5% of General Fund revenues will reduce the budget amount available of discretionary spending by 20% (from 10% of the budget to 8%).

Effective management of debt within the cautionary zone requires the use of best public finance practices to eliminate unnecessary costs. The 1996 introduction of the State's commercial paper program has reduced costs more than $21 million over the less efficient approach of using the State's Pooled Money Investment Account (PMIA), to fund projects during the construction period. The utilization of short notice sale strategies for bond refundings, the recent introduction of a competitive sale for the State's revenue anticipation notes and the recently implemented investor relations program are further examples of using financial innovation to reduce costs to the taxpayers. The introduction of a comprehensive Capital Outlay Plan for the State is another example of improved management practices, which should be incorporated into our policymaking. We should continue to employ sound, innovative financial strategies to reduce unnecessary costs (and thus increase our debt affordability).

Current Debt Picture

Since 1991, the total outstanding debt and the corresponding debt service requirement for the General Fund has increased dramatically. Over $13 billion of bonds were aggressively sold during 1991 through 1994. Debt per capita increased to $518 from $467, debt service as a percent of General Fund revenue increased to 5% from just over 3%, and debt service as a percentage of personal income increased to 2.9% from 2.2%. As of June 30, 1997, the State has $14.2 billion in general obligation (GO) bonds outstanding and $6.2 billion in lease revenue bonds (LRB) outstanding. The backlog of authorized but unissued GO bonds is $7.4 billion and is $1.7 billion for LRB.

As a result of the deceleration in the amount of new State debt, and the improved economic situation in the State, the debt balances and ratios are currently considered in the "moderate" range by credit analysts who rate the State's bonds. Nevertheless, the State is approaching a level of indebtedness that could hamper efforts to return the State's credit rating to a higher level. With the $80 billion capital outlay needs identified by the Department of Finance Capital Outlay and Infrastructure Report 1997, the State could cross the line into a high debt category. Maintaining a moderate level of debt service (i.e. below 6 percent of General Fund revenue), the State will be unable to fund $15 billion of the $80 billion capital outlay needs identifies in the Department of Finance report.

Capacity for Additional Debt

Maintaining the goal of a moderate level of debt and considering the State's current backlog of unissued bonds and the current level of debt service payments, the State Treasurer estimates that a total of $11.4 billion in bonds can be issued between now and the end of the 1999-00 fiscal year. Depending on market conditions, and assuming further authorization, sales will be scheduled to issue approximately $3.8 billion in each of the three years.

Some of the $11.4 billion will be issued from bonds already authorized. A total of $5.4 billion in general obligation bonds and $1.1 billion in lease revenue bonds will be issued to fund projects already authorized. Should the Legislature and the Governor choose to authorize additional bonds in 1998 and, to the extent that the associated projects were ready for funding, another $4.9 billion in issuance could be accomplished within the moderate cautionary zone of borrowing. The use of this $4.9 billion in capacity is dependent upon prioritization and formal authorization by the Legislature and/or the voters.

Chapter 1: Introduction

In 1996, State Treasurer Matt Fong sponsored SB 2009 (Killea) to focus State attention on the issue of debt affordability. The unmet infrastructure needs of the State total in the billions of dollars. The State's ability to issue debt, however, is limited due to internal constraints, such as limited General Fund revenues, and external constraints, most notably the municipal bond market. Before the State can prudently plan for additional bond-funded infrastructure programs, policymakers need information on the State's current and future capacity for debt. This report is designed to meet these important information needs.

SB 2009 was signed into law in 1996 and requires the State Treasurer to submit a debt affordability report to the Governor and Legislature by October 1 of each year. This is the first such report.

As mandated by SB 2009, this report provides a framework for the Legislature and the Governor to establish priorities for legislation that propose the authorization of additional debt to be supported by the General Fund. To accomplish this, the report includes the following:

- A discussion of debt affordability and its importance to the State
- A background on the State's GO and LRB debt programs
- An analysis of the State's current and future levels of indebtedness
- A discussion of the State's ability to afford additional debt
- A review of the State Treasurer's role in debt affordability

As Legislators and the Governor consider the many competing requests for financing capital outlay projects, they face the practical constraint of limited resources. As this report confirms, the needs of the State and its local agencies for infrastructure, as identified by the Department of Finance, exceed the State's ability to fund them with debt. The critical question for these decision-makers is, "*What portion of these needs can we afford to fund?*" For the upcoming legislative budget deliberations, this question translates to, "*How much debt should we authorize in the coming year?*" Answering this question is the principal objective of this report.

Chapter 2: Debt Affordability

The concept of debt affordability, simply stated, is a ceiling on the amount of debt that can be authorized and issued without impairing the State's other spending obligations and priorities. Thus, those other obligations and priorities must be considered, and their claims on the State's resources identified, in determining the extent to which we can fund our capital outlay needs. At the same time, sufficient consideration must be given to the *relative* priorities of our capital outlay needs and those other competing demands for resources. As a result, any determination of debt affordability represents a *judgment* about those relative priorities, and may imply trade-offs between competing priorities.

Certainly, those judgments are subject to change over time, and for that reason the Legislature's focus on the amount that can be authorized in the coming year is appropriate. Economic conditions, responsibilities for programs and public preferences may change over time, and those changes can affect both the magnitude of the State's capital outlay needs and their affordability. This report, this year and in future years, should provide a starting point for debate on the State's capital outlay program.

This chapter describes the factors that must be considered in the determination of debt affordability, and concludes with the State Treasurer's perspective on the determination of the amount of affordable debt for 1998.

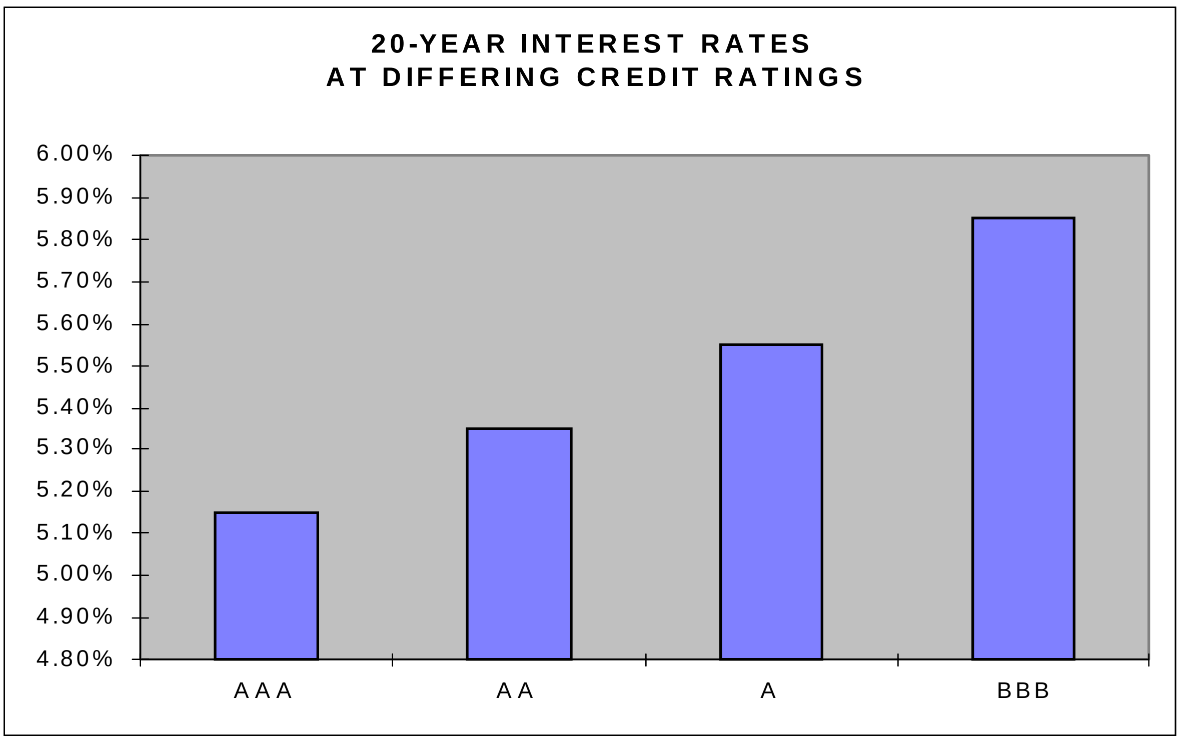
Factor 1 - *Credit Ratings and the Cost of Debt*

To assist investors in determining the relative creditworthiness of a state bond, private sector "rating agencies" provide issuers of tax-exempt bonds with a credit review and analysis. They summarize their written opinion of creditworthiness by assigning a letter grade, called a rating, on those bonds. The municipal bond rating designations of the three major ratings agencies differ somewhat but generally range from a "AAA" rating which is considered the highest credit quality, to a "C" rating which is considered below investment grade.

The determination of credit ratings is based upon an analysis of the interrelationship of a number of financial factors. Through this process, credit analysts attempt to assess the willingness and ability of an issuer to repay debt. On the revenue side, positive credit factors for states include the existence of stable and broad-based revenues on which to operate and the ability to increase those revenues when needed. A state with a strong, diverse economy and which obtains revenues from many differing sources would have a more stable revenue base to rely upon in a changing economic environment and would be less affected in its ability to repay its obligations over time. Conversely, states with chronic deficit situations, with substantial constraints on the specific use of funds, or which are in need of a substantial amount of additional debt, are viewed by the rating agencies as having limitations on their ability to repay their debt.

Because a relatively higher bond rating relates to a stronger credit perception and security for a particular bond, investors are willing to accept a lower interest rate on that bond. Conversely, a lower rating implies a relatively higher risk security, and investors' demand a higher interest rate to be compensated for this risk. Thus, issuers of municipal bonds with the highest credit ratings are able to borrow at the lowest costs of funds available in the bond market. The following chart shows the current market averages for bonds of differing credit ratings. Issuers of AA bonds can expect, on average, to obtain interest rates that are 20 basis points (i.e., 0.2%) less than issuers of A rated bonds.

Figure 1-1



Source: Delphis Hanover Corporation

Clearly, over the long run, a credit upgrade will result in significant savings in borrowing costs. With those savings, debt financing becomes more affordable. For example, improving the rating to the AA level from single A would, on a $1 billion bond issue, amount to $30 million in interest savings over the life of the bonds. If the State issues, as we estimate that it can, approximately $34 billion in bonds over the next 10 years, this translates into a total savings of almost $1 billion over the life of these bonds – enough to build over 100 new elementary schools at today's cost.

California's credit rating is now at the highest single A rating for each of the three major rating agencies (i.e., A1 for Moody's and A+ for both Standard & Poor's and Fitch). Once at the highest AAA level, our rating is now restrained by several factors. Rating agencies dislike the California voter initiatives that restrict the Legislature's ability to make budget decisions. According to credit analysts, these restraints inhibit the State's ability to react quickly to financial problems such as the revenue shortfalls the State experienced a few years ago.

These concerns, however do not eliminate the possibility of a credit upgrade. The State did enjoy higher ratings with these initiatives in place before the last financial crisis. Improving the State's credit rating, therefore, is an important and achievable goal that will result in substantial savings in borrowing costs.

Factor 2 – *Competing Demands for Resources*

As in other states, California decision-makers face difficult choices in the budget process concerning the allocation of scarce resources. Unlike other states, however, California's budget choices have been dictated largely by passage of voter-approved tax and spending measures. At the same time, decision-makers are confronted with demands for tax reductions and increased spending for popular items like public safety. Because of these factors, it is difficult to consider the question of debt affordability without recognizing and considering the fact that some of the State's other resource commitments have been and will continue to increase as a share of the State budget.

This leaves a shrinking share available for the State's remaining priorities. In fact, only 10% of the State's budget is left as a practical matter to the discretion of the Legislature. Increasing debt service requirements will further shrink this level of discretionary spending. For example, a 2% increase in debt service up to 7% of General Fund revenues would not only jeopardize our credit status by exceeding the caution zone for borrowing, but would also reduce the Legislature's discretionary spending by 20% (from 10% of the budget to 8%). Of course, the Legislature may feel the reduction is justified if the bonds that are supported by the additional debt service are issued for high priority projects, such as additional schools and infrastructure upgrades that are needed for commuters and for businesses that move goods around the State.

Chapter 2: Debt Affordability-continued

The Legislature and the Governor have the difficult task of balancing the competing spending priorities to arrive at a balanced State budget. Further, new demands for State resources will always be present, such as fiscal relief for local governments and relief for State taxpayers.

Preserving some of the State's remaining budgetary flexibility for the accommodation of unanticipated events also is important. The funding of the State's Reserve for Economic Uncertainties should receive a higher priority than it does today, and consideration must be given to the likelihood of natural disasters and the State's responsibilities that result from them. Credit analysts who rate the State's bonds are concerned that the State's "rainy day fund" is insufficient to cover unexpected additional expenses and revenue shortfalls that would occur in an unexpected economic downturn. These analysts point to other states such as Virginia and Maryland with AAA ratings and fund balances of 4.5% and 8.0%, respectively, of fiscal year 1996-97 expenditures. An example of an AA state with a strong reserve is Michigan with a fund balance of 14.4%.

Rating agencies judge the adequacy of the level of reserves on the basis of the State's ability to react in a timely way to fiscal problems arising during the budget year. California's current budget process prevents us from reacting quickly to financial problems. For example, even when revenues declined dramatically during the 1990-91 and 1991-92 budget years, budget corrections were not enacted until the summer debate on the subsequent budget year. Under this scenario, a larger reserve is necessary to cushion the State from the date a problem is identified to the passage of the next year's budget. Rating agencies have indicated that a budget reserve of 3% to 5% is needed for an adequate cushion.

Of course, a reserve of 5% in California is not practical. Such a reserve would amount to over $2.5 billion in the current fiscal year. Fortunately, there is an alternative to a large reserve. If we shorten the time between the indication of a problem with the budget and the beginning of debate on the solution to the problem, rating agencies have indicated that a smaller reserve would be acceptable. A corrective mechanism could be installed in the budget process to bring the Governor and the Legislature together to discuss problems with the current year's budget. The result of a special midyear budget session would be to make modest changes in the current year budget and to begin earlier talks on how to correct the problem in the next budget year.

Chapter 2: Debt Affordability-continued

Factor 3 – *The Economic and Revenue Outlook*

Expectations about the State's fiscal outlook also have an impact on debt affordability. A robust economy tends to produce revenue growth that exceeds the State's program spending requirements, and allows the State to address a larger portion of its unmet capital needs and to grow its Reserve for Economic Uncertainties. Conversely, a contracting economy will make it more difficult to maintain the State's commitments, and may require that the State scale back on its commitment to its capital outlay program. Current expectations are that the State's economic prospects are quite good, and will remain that way for the foreseeable future.

The State's past experience with economic and revenue forecasting, however, makes it clear that accuracy in long-term forecasts is difficult to achieve. Even the sort of short-run forecasting used in the budgeting process can be very inaccurate at turning points in the business cycle. This lack of reliability can be mitigated to some extent by continued monitoring of revenue and expenditure trends and timely corrective measures. In the context of the debt affordability determination, this holds true as well – planning and budgeting decisions based upon long-term trends and forecasts must be subject to adjustments based on current conditions. Plans and strategies must be developed to manage the process of adjusting to changing conditions.

This report relies upon a fairly simple but reasonable projection of State revenues as the basis for its findings. This projection assumes that State's General Fund revenues will grow at an average rate of 5.5% percent annually over the long run, consistent with the expectations of other State economic forecasters, and has been adjusted for the effects of the recent State tax cuts. We have also tested our results for sensitivity using a range of revenue growth assumptions which confirm the general findings.

Factor 4 – *Outstanding and Unissued Debt*

Finally, consideration must be given to the level of resources already committed to the payment of debt service through prior action. Currently outstanding debt – that is, debt already authorized and issued – will consume a declining portion of General Fund resources over time as bonds are paid off and retired. However, there are backlogs of authorized, but as yet, unissued debt that will require commitments of General Fund resources in the future. Our projections of the debt service associated with outstanding and unissued debt indicate that the cost of paying off all these bonds, expressed as a percent of General Fund revenues, will decline in the future. This frees up resources that can be used to pay for new authorizations of debt upon their enactment by the Legislature and the Governor.

Chapter 2: Debt Affordability-continued

The State Treasurer's Perspective

Until a few years ago, California was a low debt state with many projects financed on a "pay as you go basis." This is the ideal financial position for the State. Nevertheless, an enormous number of high priority infrastructure needs face the State in the coming years. The quality of life of our citizens, and our ability to provide jobs to those citizens with a business environment that encourages economic growth, is critically dependent on addressing these needs. Studies have shown a positive and direct link between infrastructure quality and economic growth.

Cautionary Zone of Borrowing: During 1991 to 1994, the State issued a large amount of debt, bringing us from being a low debt state to being a moderate debt state. Moving from a low to moderate debt state requires decision-makers to exercise caution in this zone of borrowing.

At this higher level of borrowing, the State must guard against substantial increases in the issuance of bonds. Substantially higher debt service takes away discretionary spending decisions from the Legislature, risks overburdening the budget and also risks the ability to return to a higher credit rating. So long as the State remains in this cautionary zone, investment in high priority capital projects will provide the State with much needed upgrades in infrastructure without overburdening the State budget. Under the present budget conditions, a reasonable case can be made that to remain in the cautionary zone of borrowing, debt service as a percent of the General Fund revenues should remain below 6 percent.

As this report will show in detail, the State, unfortunately, cannot remain in this cautionary zone of borrowing and invest in all the capital outlay needs that have been identified. Therefore, the Legislature and the Governor will need to prioritize projects and decide which projects must be delayed. To accomplish prioritization, a formal multi-year capital outlay plan must be adopted. Of course, priorities and financial conditions may change and the plan may be amended from time to time. Without a formal debate and capital-spending plan, however, prioritization will be very difficult.

The importance of minimizing our cost of credit. The magnitude of our unmet capital needs argues strongly that we achieve the biggest "bang for the buck" that we possibly can. It is clear that an improved credit rating can save State taxpayers considerably in terms of the cost of financing these capital projects and that a modest improvement is achievable if the

State can demonstrate a commitment to financial discipline.

To provide further savings, the State Treasurer has implemented several programs that take advantage of market conditions and financial techniques often used in the world of corporate finance. These programs are more fully discussed in Chapter 6 of this report.

First, in 1996 the State Treasurer began a commercial paper program to provide interim financing for capital projects at lower borrowing costs. Since its inception this program has saved taxpayers over $21 million. The State Treasurer has also aggressively refinanced higher interest bonds. With a plan that allowed State Treasurer's Office staff to sell lower cost replacement bonds on short notice, over $100 million in interest cost savings over the remaining life of the bonds was achieved. Finally, to generate new interest in the purchase of California bonds and to make sure that existing bondholders maintain a continued interest in California bonds, the State Treasurer has implemented an ongoing investor relations program. These ongoing programs will continue to provide interest cost savings.

To demonstrate a commitment to fiscal discipline, the State Treasurer believes the Legislature should formally adopt a capital outlay plan and a debt authorization policy that keeps the State in the cautionary zone of borrowing with a ceiling of no more than 6 percent of General Fund revenues devoted to debt service.

Chapter 3: Background on California Bonds

Basic Concepts

The State Treasurer's Office generally sells two types of bonds where the principal and interest payments (debt service) are paid by the State General Fund — GO and LRB. GO bonds pledge the full faith and credit of the General Fund without regard to any specific capital project. Payment of GO bond debt service is payable from any moneys in the General Fund after funding of public education. LRB are project-specific and are secured by a lease entered into by a state agency. The principal and interest payments are structured to resemble lease payments and are paid out of the General Fund.

The Life Cycle of a GO Bond

The State Constitution requires voter approval of GO bond acts in a statewide election. As a result, the first step in creating a GO bond measure is to place a proposition on the ballot either by a legislative enactment or by the initiative process. Once the voters have approved a bond act, the Legislature must approve the use of the bond moneys for specific projects. Some voter approved bond acts, however, automatically appropriate the use of the money and do not require further legislative action.

Because of the magnitude of some GO bond projects, the appropriations are made in stages so that it may take several years to exhaust the authorized amount. For example, the Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990 was approved by the voters seven years ago yet only $50 million of the original $300 million authorization has been sold. The remainder of the projects is in progress and funded with PMIA loans or the projects have not yet been approved.

The Life Cycle of a LRB

The first step in the creation of a LRB is for a State agency (including the University of California and the California State University) to develop a general justification for a capital project (e.g., construction of a new prison or State building). The Department of Finance reviews and approves the project for inclusion in the Governor's Budget. The Legislature then approves the use of LRB as a mean of financing the project either through the budget act or through separate legislation. Once all necessary approvals are given, the State Treasurer can arrange financing.

Most of the LRB issued to date have funded projects for institutions of higher education, correctional facilities, and certain State office buildings and are issued through the State Public Works Board (SPWB) or a joint powers authority (JPA).

A Historical Perspective

The use of GO bonds dates back to the mid 1800s when the State issued bonds to fund governmental expenditures, such as paying California Civil War veterans. The first GO bonds authorized in the 20th Century were for development and improvement of the San Francisco Harbor and to provide for the acquisition, construction and maintenance of a State highway system.

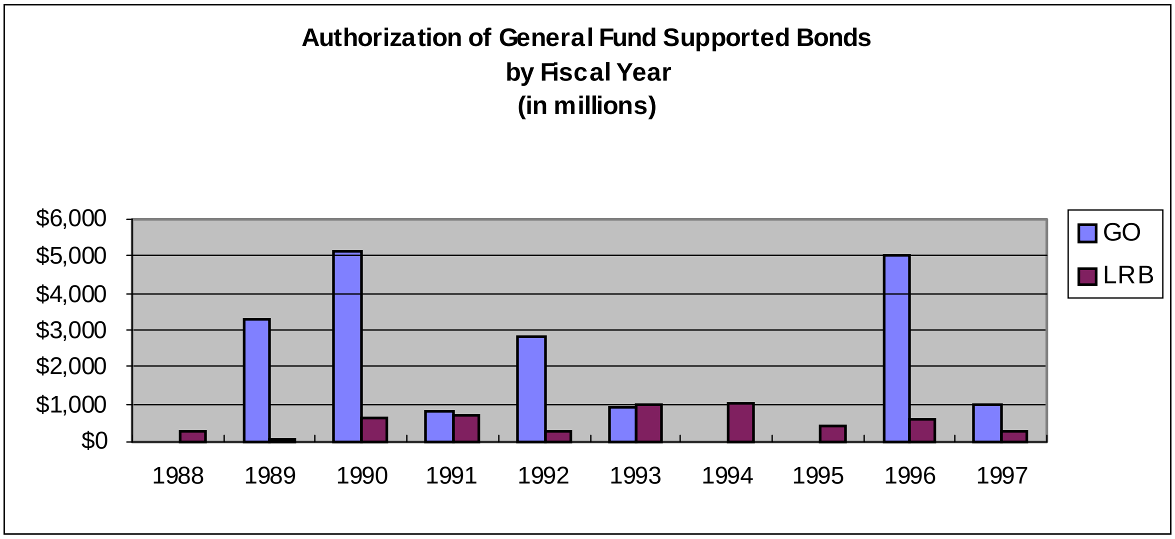
GO bonds for public education were first approved in 1913 to fund construction of buildings for the University of California. In the mid to late 1950s, GO bonds authorization saw a dramatic jump in the number and authorization size, culminating with the mammoth $1.75 billion Water Resources Development Act of 1959. Since then, voters have selectively approved GO bond acts to fund transportation, clean water, schools and prison construction projects.

In an effort to reduce the GO bond backlog, the State Treasurer's Office issued a large number of GO bonds from 1991-1994. As a result, the amount of outstanding GO bonds has seen a dramatic increase. On June 30, 1997, the State had $14.2 billion in outstanding GO bonds, compared to $3.4 billion in 1987, a 318% increase.

Although the legislative authorization for the use of LRB existed since 1955, the State did not issue LRB in a significant fashion until the mid-1980s when the GO authorization was not sufficient to meet the State's infrastructure needs. On June 30, 1997, the State had $6.2 billion in outstanding LRB compared to $1.3 billion in 1987, a 377% increase.

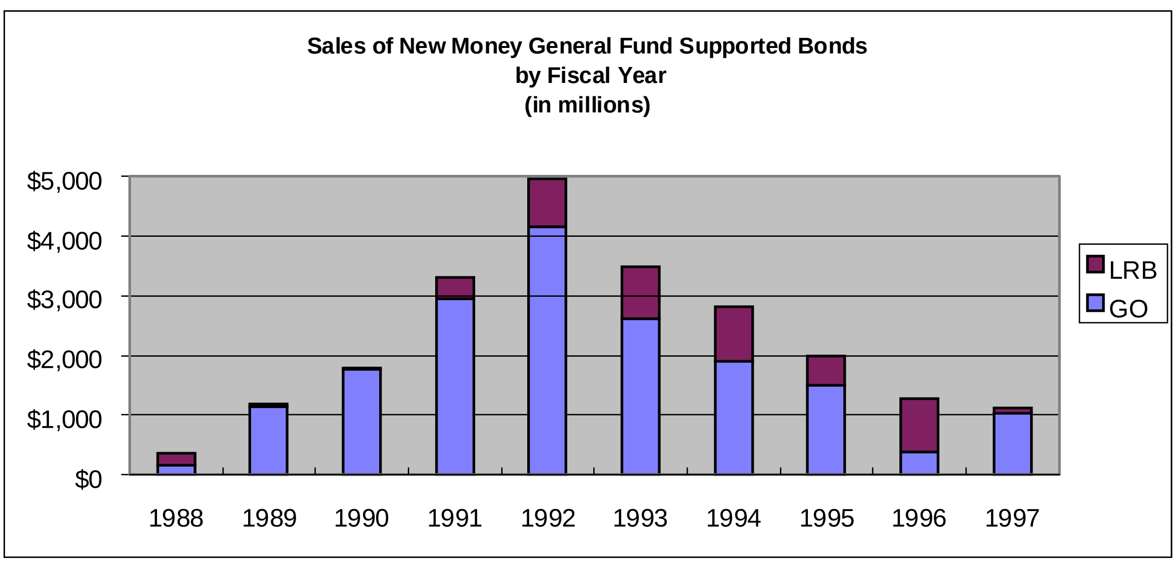
Chapter 3: Background on California Bonds-continued

Figure 1-2



Source: Office of the State Treasurer

Figure 1-3



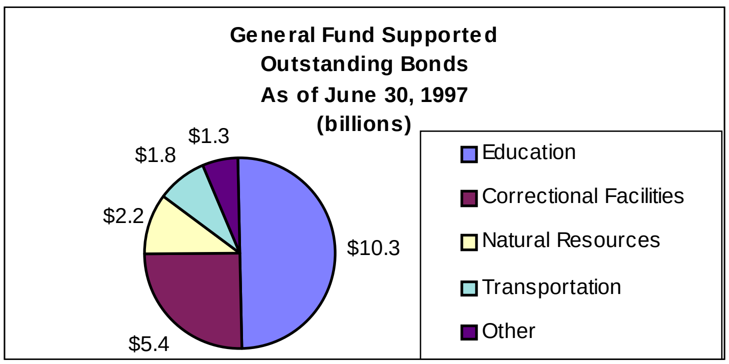
Source: Office of the State Treasurer

Chapter 4: California's Current Debt Picture

Bonds Outstanding

As of June 30, 1997, the State had $20.4 billion in outstanding General Fund supported long-term debt. Of that amount, $14.2 billion was GO bonds and $6.2 billion was LRB. Most of these bonds were issued to fund K-12 schools and higher education facilities. The two other major categories for bond financed projects are correctional facilities, transportation and natural resources.

Figure 1-4

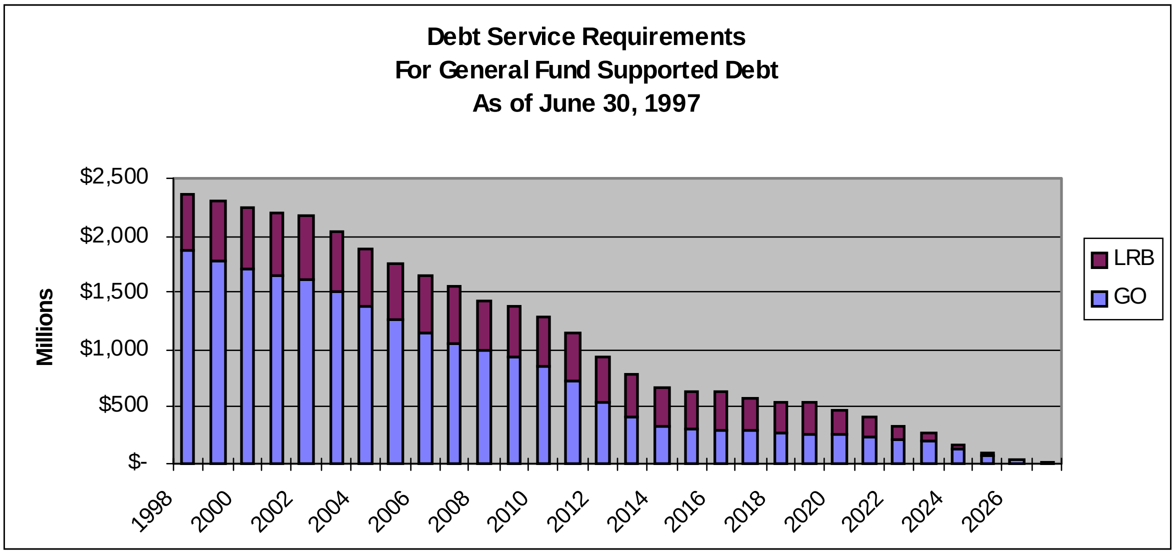


Source: Office of the State Treasurer

Over the remaining life of the GO bonds currently outstanding, principal and interest payments will total $22 billion. For LRB currently outstanding, debt service payments will total $10 billion. Without the issuance of additional bonds, these payments decline over time much the same as a balance on a home mortgage. The debt service payments for the bonds currently outstanding are shown in Figure 1-5.

Chapter 4: California's Current Debt Picture-continued

Figure 1-5



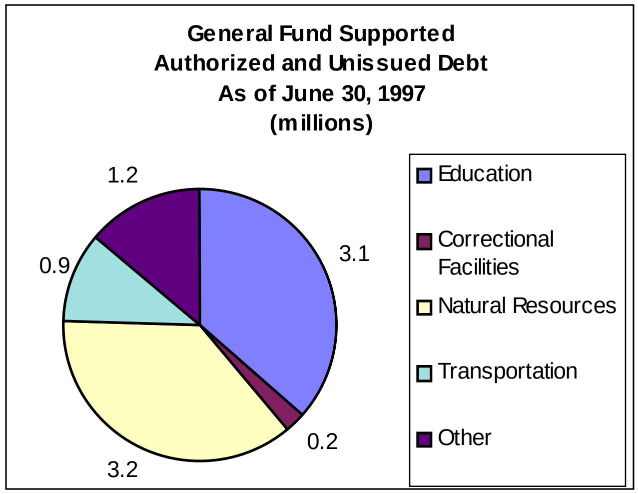
Again, with the issuance of additional bonds, these payments would increase and extend over time.

Authorized But Unissued Bonds

In addition to the currently outstanding GO and LRB, the State has a total of $9.1 billion of authorized and unissued General Fund supported debt. Of that total, GO bonds represent $7.4 billion and LRB represent $1.7 billion. Most of the GO bond backlog represents voter approved bond measures from 1996. A significant portion of these GO bonds is scheduled to be sold over the next two years. Figure 1-6 shows that a large portion of these bonds is for natural resource projects, including bonds approved in 1996 for water projects. In addition, a large number of bonds were approved in 1996 for schools. Although these bonds have not been sold, all projects that have received appropriate legislative and agency approval are being funded either with loans from the Pooled Money Investment Account (PMIA) or with commercial paper.

Chapter 4: California's Current Debt Picture-continued

Figure 1-6



Source: Office of the State Treasurer

Figure 1-7 shows how these bonds are divided between GO bonds and LRB approved by the Legislature. Until the passage of over $8 billion in GO bonds on the March and November, 1996 ballots, most of the backlog consisted of LRB. The majority of the backlog now consists of GO bonds.

Figure 1-7

Status of General Fund Supported Debt
(dollars in billions)

	Outstanding			**Authorized but Unissued**		
	GO	**LRB**	**Total**	**GO**	**LRB**	**Total**
Education	$7.7	$2.3	$10.0	$3.0	$0.3	$3.3
Correctional Facilities	2.6	2.8	5.4	0.1	0.1	0.2
Natural Resources	2.0	-	2.0	3.4	-	3.4
Transportation	1.7	-	1.7	0.9	-	0.9
Other	0.2	1.1	1.3	-	1.3	1.3
Total	$14.2	$6.2	$20.4	$7.4	$1.7	$9.1

Chapter 4: California's Current Debt Picture-continued

The Market for State Bonds

State and local governments have essentially two budgets — an operations budget and a capital budget. Much of the capital budget is borrowed money and the municipal bond market is where state and local governments go to borrow that money. In calendar year 1996, state and local governments borrowed over $184 billion in the municipal bond market to fund a laundry list of governmental programs. Eighty-four percent or $154 billion was borrowed on a tax-exempt basis (i.e. the interest earned by the bondholders is not subject to federal income tax).

The State of California issued more bonds during 1996 than any other issuer in the country. During 1996, $11.8 billion of new money and refunding bonds and notes were sold, with $7.2 billion or 61% representing General Fund supported debt. The remaining $4.6 billion funded a number of programs such as low-income housing, pollution control projects and Central Valley water projects.

California competes for investors with other borrowers in a very competitive market. Traditionally, California has fared well relative to other issuers. Investors regard California debt as a high-quality investment (refer to Figure 1-9 for a list of the buyers of California debt). During the State's recent financial crisis, however, the price of California bonds and notes suffered in the municipal markets. At the depth of the recession, investors demanded slightly over 10 basis points or one tenth of one percent in additional interest than the prevailing market rate for similarly rated bonds. That translates to $7.5 million in additional interest over the life of a typical $500 million GO bond issue.

With the economic recovery and more solid financial position for the State, the market price for our bonds has improved dramatically. Some of this improvement is the result of the State Treasurer's efforts to reach and inform investors through an active investor relations program. As Figure 1-8 shows, California bonds have in recent months been trading steadily better when compared to the bonds of other issuers that have a similar credit rating. In fact, as recent as July 1997, California's debt traded significantly lower than similarly rated states. In other words, investors are willing to accept less in interest than they would from other single A rated states. The savings associated with this improvement are dramatic. On the same $500 million GO issue, California now pays $3.7 million less in interest than other A-rated states. Furthermore, we are now paying $11.3 million less in interest than what we were paying during our low point in 1995.

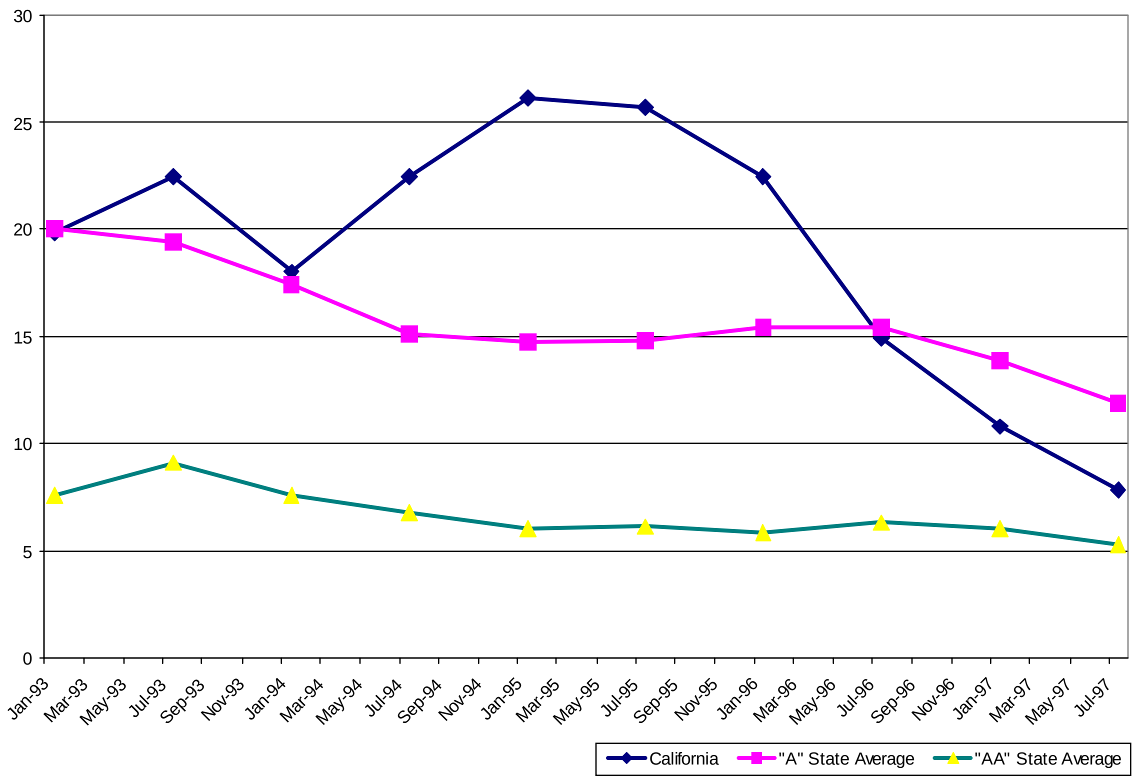
The steady improvement in the relative trading value and the associated capital gains earned by investors who have held these bonds during this improvement period enhances the

Chapter 4: California's Current Debt Picture-continued

market demand for our bonds. A sustained economic expansion, fiscal discipline, and our continuing efforts to reach investors will encourage the demand for California bonds and enable us to continue borrowing money at relatively lower interest rates.

Figure 1-8

Relative Trading Values
Comparison of California with "A" and "AA" Rated State Averages



Source: The CHUBB Corporation

Chapter 4: California's Current Debt Picture-continued

Figure 1-9

California General Obligation Bonds

Ten Largest Institutional Holders

Firm/Management Company	Par Amount Held
Franklin Advisors, Inc.	$480,285
AIG Global Investors	$436,775
State Farm Mutual Automobile Insurance	$311,280
Putnam Investments	$279,560
Vanguard Group Incorporated	$201,915
The Dreyfus Corporation	$148,205
St. Paul Companies, Inc.	$117,255
Fidelity Management Trust Company	$109,825
John Nuveen and Company	$101,470
ITT Hartford Insurance Group	$97,660

Source: Municipal Bondwatch for Windows, CDA Spectrum – CDA Investment Technologies, Inc. as of July 16, 1997.

Measures of Debt Affordability

There are a number of debt ratios that are widely used to measure the debt affordability of the State. California's ratios for debt per capita, debt as a percent of personal income, and debt as a percent of General Fund revenues are considered "moderate" by credit analysts. Figure 1-10 shows how these ratios have been impacted by bond sales over the last ten years.

Figure 1-10

CALIFORNIA'S RATIOS
FISCAL YEARS 1991-92 THROUGH 1996-97

	Debt Outstanding Per Capita	Debt as a Percentage of Personal Income	Debt Service as a Percentage of General Fund Receipts
1991-92	$467.33	2.25%	3.19%
1992-93	$555.82	2.59%	4.09%
1993-94	$617.61	2.85%	5.21%
1994-95	$643.87	2.91%	5.23%
1995-96	$628.99	2.54%	5.23%
1996-97	$630.75	2.36%	4.98%

Source: Office of the State Treasurer

Chapter 4: California's Current Debt Picture-continued

As mandated by SB 2009, the Figure 1-11 shows a number of debt ratios for the 10 most populous States in the nation. However, California does not keep data on debt to estimated full-value of property.

At the present time, the State has a moderate debt burden with a manageable backlog of unissued bonds. Significant increases to this debt burden have the potential of pushing the State into the high debt category. With the enormous infrastructure needs that are identified in the following chapter, it appears at this time the State will not be able to finance all identified projects without moving into the high debt category. A strategy that would undoubtedly result in significantly higher borrowing costs overall.

Figure 1-11

TEN MOST POPULOUS STATES

State	Debt Per Capita	Debt to Personal Income	Debt to General Fund Revenue	Bond Ratings
New York	$ 1,840	6.70%	6.60%	A-/A2/A+
New Jersey	1,136	3.80%	4.90%	AA+/Aa1/AA+
Illinois	741	2.90%	4.30%	AA/Aa3/AA
Florida	690	3.00%	4.90%	AA/Aa2/AA
Georgia	669	3.10%	4.00%	AAA/Aaa/AAA
California	612	2.60%	5.60%	A+/A1/A+
Ohio	559	2.50%	3.90%	AA+/Aa1/AA+
Pennsylvania	529	2.20%	4.60%	AA-/A1/AA-
Michigan	360	1.50%	1.40%	AA/Aa2/AA
Texas	312	1.50%	2.60%	AA/Aa/AA+
1997 National Median	422	2.10%	n/a	n/a
1996 National Median	n/a	n/a	3.50%	

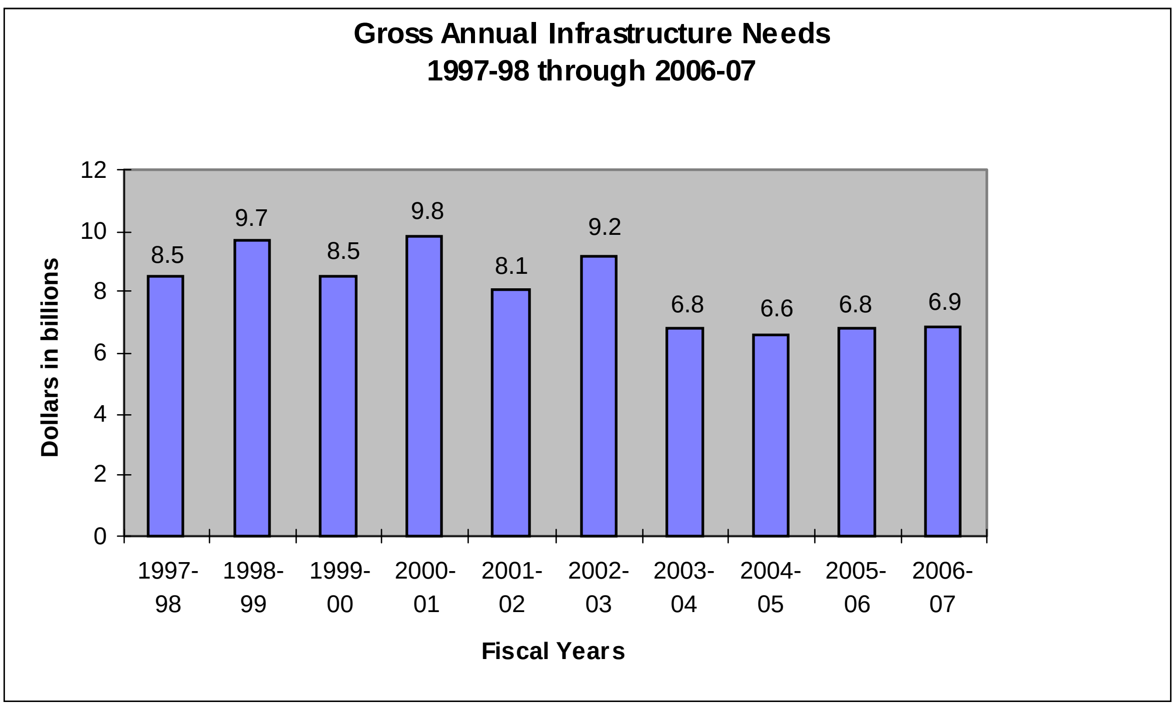
Source: Moody's Investors Service

Chapter 5: State Infrastructure Needs

Annually, the Department of Finance prepares a report that projects the State's infrastructure needs and funding sources for the next ten years. In August 1996, the Department of Finance surveyed State departments to identify infrastructure needs in total, by fiscal year and by fund source. Departments were also requested to report capital outlay separately from State-funded local infrastructure. The report identifies the capital outlay and local infrastructure needs for the State's schools, highways, bridges, water systems, public facilities and natural resources as reported by the various State departments.

The 1997 report projects gross annual infrastructure needs for all agencies to be $80.9 billion as shown in Figures 1-12 and 1-13:

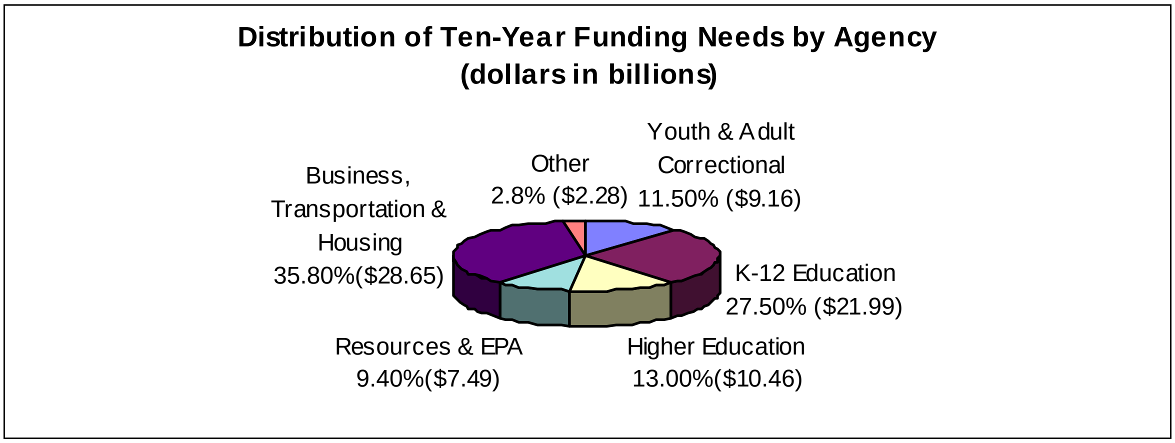
Figure 1-12



Source: Department of Finance, Capital Outlay & Infrastructure Report 1997

Chapter 5: State Infrastructure Needs-continued

Figure 1-13



Source: Department of Finance, Capital Outlay & Infrastructure Report 1997

Of the $80.9 billion identified by the departments, approximately $0.9 billion represents future projects, which have existing bond authorizations, and $30.9 billion, which can be financed through federal, special and other non-General Fund monies. This leaves a balance of $49.2 billion over the next ten years which requires new General Fund support.

If the State were to finance the entire $49.2 billion with bond authorizations and sales over the next ten years, the effect on the State's debt burden would be dramatic. As Figure 1-14 shows, debt as a percent of General Fund revenue would increase to almost 7.5%, well outside a prudent amount of debt for the State budget to support.

Figure 1-14

IMPACT ON DEBT RATIO
(dollars in billions)

Fiscal Year	GF Revenue	Debt Service*	Debt Ratio	Amount to Sell
1997-98	$52.3	$2.3	4.40%	$5.2
1998-99	54.5	3.4	6.24%	5.9
1999-00	57.3	3.8	6.63%	5.2
2000-01	60.5	4.3	7.11%	6.0
2001-02	63.9	4.7	7.36%	4.9
2002-03	67.4	5.0	7.42%	5.6
2003-04	71.0	5.2	7.32%	4.1
2004-05	75.0	5.5	7.33%	4.0
2005-06	79.1	5.7	7.21%	4.1
2006-07	83.5	5.8	6.95%	4.2
				$49.2

***Assumes bonds will be sold at a true interest cost of 6.5% and includes debt service outstanding as of September 1, 1997.**

Chapter 5: State Infrastructure Needs-continued

To remain in the cautionary zone of borrowing, keeping the debt service ratio at a maximum of 6%, the State can afford to issue $34 billion bonds over the next ten years as shown in Figure 1-15.

Figure 1-15

DEBT SERVICE ANALYSIS WITH A 6% DEBT RATIO
(dollars in billions)

Fiscal Year	GF Revenue	Debt Service*	Debt Ratio	Amount Sold
1997-98	$52.3	$2.1	4.0%	$3.64
1998-99	54.5	3.0	5.5%	4.13
1999-00	57.3	3.3	5.7%	3.64
2000-01	60.5	3.6	5.9%	4.20
2001-02	63.9	3.9	6.0%	3.43
2002-03	67.4	4.1	6.0%	3.92
2003-04	71.0	4.2	5.9%	2.87
2004-05	75.0	4.3	5.7%	2.80
2005-06	79.1	4.4	5.5%	2.87
2006-07	83.5	4.5	5.3%	2.94
				$34.44

***Assumes bonds will be sold at a true interest cost of 6.5% and includes debt service outstanding as of September 1, 1997.**

With the $9 billion existing backlog of authorized but unissued bonds, the remaining $25 billion must be authorized by the Legislature or by the voters.

To the extent the State experiences better than projected economic growth, or actual interest rates are significantly lower than those used in this projection (current rates are approximately one percentage point lower in today's market), additional debt may be afforded within the cautionary zone. The State Treasurer *does not* recommend that the State adopt a strategy of maximizing debt at the 6% level every year for the ten-year period. Such a strategy creates future vulnerability for economic downturns and may diminish the potential for a ratings upgrade.

By the same token, it is appropriate that the upper range of the cautionary zone be reached on a short-term basis to accommodate needed capital investment, consistent with construction schedules and the ability to effectively spend the proceeds. This is consistent with the belief that the 6% limitation is a ceiling on debt, not an annual target level.

Chapter 5: State Infrastructure Needs-continued

To summarize, most of the $80 billion in capital outlay and infrastructure needs identified by the Department of Finance can be financed with federal funds, “pay as you go” State funds, and State GO or LRB. Of the $49.2 billion that must be financed with State Bonds, currently only $34 billion is affordable within the cautionary zone of borrowing. Approximately $15 billion in capital outlay and infrastructure needs are currently unmet.

Prioritizing Capital Outlay Needs

Faced with capital outlay needs far in excess of its capacity to fund, how should the State approach the task of deciding which of those needs are addressed and which are not? Are there alternative means of addressing those needs that do not rely on State sources of funding? These difficult questions should be approached in a considered rather than piecemeal fashion, because the risk inherent in making piecemeal decisions is that the State will fail to allocate its resources in the most cost-effective manner. But perhaps more importantly, by approaching these decisions in a reasoned way, the State is much more likely to receive the voter support that will be needed to achieve its capital outlay goals.

As this report has described earlier, there are both practical constraints on the amount of bonds that can be issued at any one time, and policy reasons, based upon debt affordability, to restrain that issuance. However, even under the circumstance of limitations on *issuance*, the Legislature and the Governor are still free to *authorize* any amount of debt that they see fit. At the extreme, the Legislature and the Governor could *authorize* issuance of debt for the entire $49 billion of identified but unfunded capital outlay needs, and allow the issuance constraints to determine which needs receive funding. This would result in a huge backlog of authorized but unissued debt and a chaotic situation where projects compete for the available issuance. This approach is unlikely to be regarded as demonstrating the fiscal discipline necessary to achieve higher credit ratings, or to generate widespread voter support.

Alternatively, those unmet capital outlay needs can be prioritized up front, so that the authorization of funding ensures that the available resources are used in the most cost-effective manner, and bears some relationship to what can be realistically issued. Because this approach also results in the identification of the lowest-priority projects, it allows the proponents of those projects and other participants to focus their efforts on finding alternative means to achieve those goals. As discussed earlier, a large portion of the identified capital outlay need is for State-supported local infrastructure.

Chapter 5: State Infrastructure Needs-continued

A "Just in Time" Process

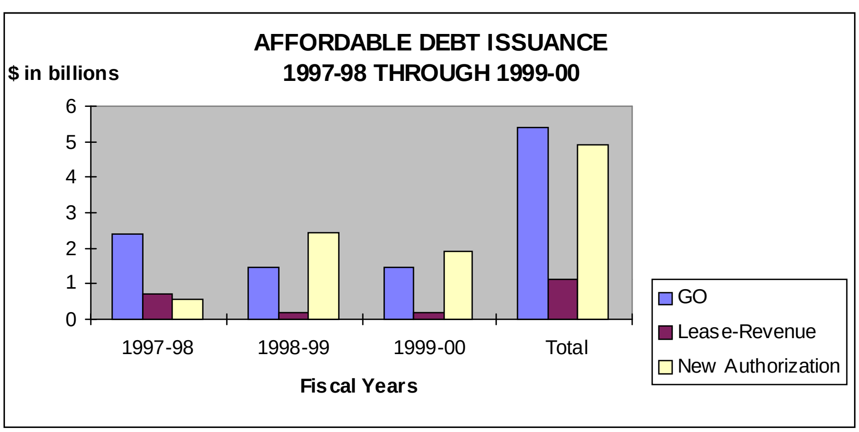
In prioritizing the $49 billion of capital outlay needs, the Legislature must recognize that some of those needs exist *today*, while others are *projected* to exist at some point in the future. Further, the economic and demographic conditions of this State will undoubtedly vary from the estimates of future conditions that we rely upon today. For these reasons, it makes sense for the Legislature to adopt a prioritization process that is adaptable to changing conditions.

While it is appropriate to set overall *priorities* for the State's full menu of capital outlay needs, it makes little sense to make *commitments* for future capital outlays long in advance of the time that they are actually needed. A more flexible approach is to authorize funding only for those high-priority projects likely to spend the funds in the *near future* – probably no more than two or three years. This approach preserves the State's abilities to react to changing conditions, and would enhance its reputation for fiscal discipline.

Based upon our conclusions about debt affordability, we estimate that the State has the capacity to issue approximately $11.4 billion in new money debt over the 3-year period from 1997-98 through 1999-00. The State Treasurer is planning to issue about half of this amount pursuant to existing bond authorizations for projects already under way.

As shown in the Figure 1-16, the State Treasurer plans to issue about $5.4 billion of already authorized GO bonds and $1.1 billion of already authorized LRB during this period. Should the Legislature choose to authorize additional bonds in 1998, and to the extent that the associated projects were ready, another $4.9 billion in issuance could be accomplished within our capacity constraints.

Figure 1-16



Source: Office of the State Treasurer

Chapter 5: State Infrastructure Needs-continued

Again, this figure should be regarded as a "target" rather than an absolute limit, because it is based upon estimates and expectations that are subject to revision. Also, the actual levels of issuance that are consistent with the capacity constraints will be continually reviewed as part of the State Treasurer's debt management program, as described in Chapter 6.

In summary, the State Treasurer recommends that the Legislature and the Governor review all of the State's identified capital outlay needs and set general priorities on a program basis. These priorities should identify how the $25 billion of new authorization available within the State's debt affordability constraints should be allocated, given current conditions.

After these overall priorities are established, the Legislature and the Governor should proceed to make authorizations for those projects that are "ready to go" in the near term, consistent with the overall priorities and issuance constraints described above. In 1999, the Legislature can again review its overall priorities given conditions at that time, and begin the process of authorizing the debt that will be needed for the priority projects that are then expected to be ready to use the funds.

Chapter 6: State Treasurer's Plan for the Sale of State Bonds

As agent for sale on all state bonds, the State Treasurer is responsible for managing the sale of bonds authorized by the voters and by the Legislature. The goal in managing these sales is to sell the right amount of bonds at the right time for the lowest possible borrowing cost that is achievable under the circumstances.

As trustee for State bonds, the State Treasurer also is responsible for making principal and interest payments to current bondholders and for keeping those bondholders informed about the State's financial situation. Finally, the State Treasurer is the primary contact between the State and the municipal bond community including mutual funds and individuals who buy the bonds, credit rating agencies who rate the State's creditworthiness, and investment banking firms who help the State sell bonds.

Components of an Effective Debt Management Plan

"What's the Right Amount to be Sold?" To start the process of determining the right amount of bonds to be sold, various State agencies report to the State Treasurer their cash needs for capital projects they have in progress. Federal tax laws also constrain the timing of tax-exempt bonds that may be issued. Finally, the total amount of tax-exempt securities being sold in the market may influence the size of the bond sale. For example, if a large number of state and local government bonds are being sold, buyers may be less interested in buying bonds and may charge a higher interest rate for the bonds. By selling fewer bonds, the State Treasurer can avoid this extra cost.

"When's the Right Time to Sell Bonds?" The primary goal is to provide funds to agencies when needed but at the lowest possible cost the market will provide. With this goal in mind, State agencies provide a range of cash needs that allows the State Treasurer flexibility in issuing bonds in the most advantageous market (i.e., at the lowest rates possible). Second, the State Treasurer times the sale of bonds to coincide with favorable information about the State's economy and finances, and the national economy. Finally, federal tax law dictates the sale of bonds within certain time periods for capital projects.

The State Treasurer also observes two "blackout periods" for the sale of most State bonds. Because information about the State's budget is crucial to buyers, bonds usually are not sold in January due to the release of the Governor's proposed budget. Another blackout period occurs between the time the Governor's May Revision is published and the passage of the budget later in the summer.

Chapter 6: State Treasurer's Plan for the Sale of State Bonds-continued

Tax-Exempt Commercial Paper Program: Capital projects usually are not funded with bond proceeds at the beginning of the project. To have the entire amount of financing outstanding at long-term interest rates from the first day of the project would result in unnecessary borrowing costs and could violate federal tax law. As with most private sector capital projects, "interim financing" is obtained during the construction phase of the project. Bond proceeds then are used as permanent financing to retire the amount borrowed during construction.

Until recently, capital outlay projects for State agencies were financed on an interim basis with loans from the Pooled Money Investment Account (PMIA), a $28 billion short-term money market fund managed by the State Treasurer. Borrowers from the PMIA are charged an "opportunity cost." That is, the amount of interest that would have been earned by PMIA during the time of the loan. Currently, PMIA charges approximately 5.7% on all loans.

In 1995, however, State Treasurer Fong sponsored legislation to authorize the State to use commercial paper (CP) for interim borrowing. Commercial paper is a short-term debt instrument that carries lower interest rates than long-term bonds and lower rates than are charged by PMIA. Also, CP provides a low cost way to maintain flexibility in timing the sale of long-term bonds. If conditions do not appear to be advantageous for the sale of long-term bonds, the State Treasurer can delay the sale by issuing commercial paper instead. Since the program was started in May 1996 the *State has saved $21 million* in interest costs using CP. As more bond acts provide for the use of CP, these savings will grow rapidly.

Bond Refinancings: A prudent debt management plan means looking for opportunities to refinance bonds already issued and outstanding. As with a home mortage, when interest rates fall it makes sense for the State to refinance bonds that were issued at higher interest rates. Since 1995, the State Treasurer has refinanced almost $1 billion in outstanding bonds and has generated almost $100 million in savings over the life of the bonds. As part of this refinancing effort, the Public Finance Division of the State Treasurer's Office devised a way to immediately enter the market and refinance bonds when interest rates moved in the State's favor. On one occasion, using this method, savings of $15 million was achieved in only two hours.

Investor Relations Program: With $20.4 billion in outstanding bonds, the State has a large number of investors that follow news about the State's finances and economy and make major investment decisions on State of California bonds and commercial paper. Figure 1-9 contains a list of the top institutional investors and the amount of California bonds they hold.

Chapter 6: State Treasurer's Plan for the Sale of State Bonds-continued

The State has a vested interest in keeping existing bondholders informed on State finances and in convincing potential new investors to buy California bonds and commercial paper. Simply stated, the more buyers that are interested in purchasing State bonds, the better price the State will receive for its bonds.

In 1995, State Treasurer Fong created an active State investor relations program. This program includes frequent, written communication with current investors of state bonds as well as direct meetings with investor groups to keep current investors informed and to encourage new investors to purchase California's bonds. The State Treasurer's investor relations program has been recognized as one of the nation's best programs. The program has increased the demand for State bonds, which, in turn, reduces the cost of borrowing to the State.

Two Year Debt Issuance Plan

Based on state departments' reported needs for funding and considering the current and predicted conditions in the municipal bond marketplace, the State Treasurer plans to sell approximately $3.10 billion in bonds in 1997-98 and approximately $1.70 billion in 1998-99. Programmatic areas may be subject to change depending on the status of projects and priorities. Figure 1-17 describes the type of bonds that may be sold. These bond sales will increase the State's debt service ratio as a percent of General Fund revenue to 3.6% in 1997-98 and 5.0% in 1998-99.

Figure 1-17

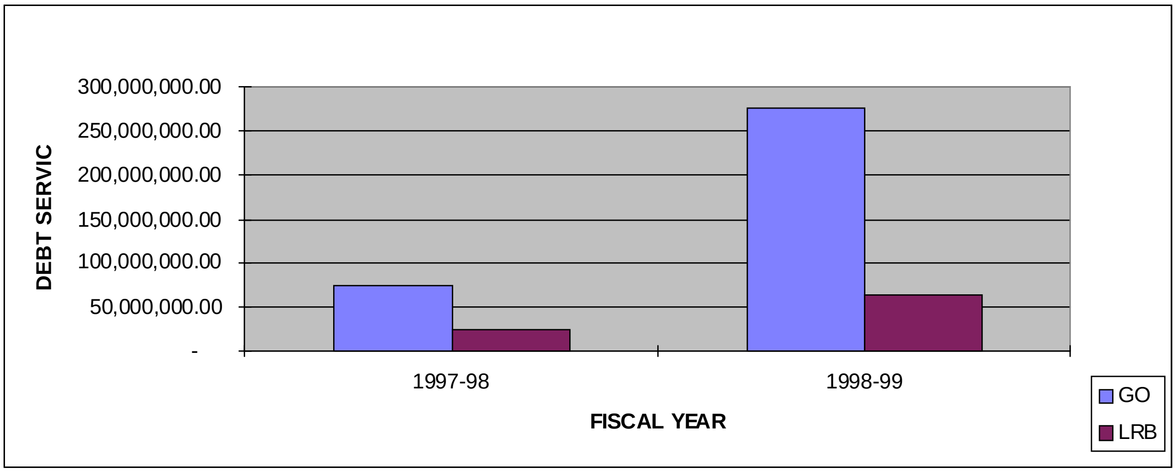
General Fund Supported Debt to be Sold in 1997-98 and 1998-99 (dollars in billions)

	1997-98	1998-99
Education	$1.12	$0.62
Correctional Facilities	0.07	0.04
Natural Resources	1.16	0.64
Transportation	0.31	0.17
Other	0.44	0.24
Total	$3.10	$1.70

Chapter 6: State Treasurer's Plan for the Sale of State Bonds-continued

The State Treasurer believes these sales will maintain a level of debt affordability that is acceptable to taxpayers, the market, and the rating agencies. After the sale of these bonds, debt ratios will remain in the moderate range. The increase to debt service as a result of these sales is shown in Figure 1-18:

Figure 1-18



The sale of these bonds will reduce the amount of authorized but unissued bonds to $4.3 billion from the current $9.1 billion. Of course, changes in funding needs and changes in market conditions could alter the planned amounts and timing of these sales.

Conclusion

In the next ten years, California must make significant investments in capital outlay and infrastructure to maintain the quality of life and business environment that keeps our state competitive in the global economy. Total needs of $80 billion have been identified. Most of this $80 billion can be funded with federal funds, special funds of the State, and bond financing. Unfortunately, given the current level of State borrowing, we will not be able to fund approximately $15 billion of those projects.

With the rapid increase in bond issuance in the early 1990s, California moved from a low debt state into a much higher, cautionary zone of borrowing. Exceeding this cautionary amount of borrowing will have two affects; 1) it will risk the State's credit standing in the municipal markets, resulting in higher interest costs; and 2) the higher interest costs will reduce the already minimal discretionary spending authority of the Legislature.

To maximize the investment in quality capital outlay and infrastructure projects and to minimize the cost of borrowing, the Legislature and the Governor must undertake a capital outlay spending priority plan. In addition, the State can continue to look for ways to lower the cost of these capital outlay needs and explore the possibility of public-private partnerships to provide for infrastructure needs.

Clearly, the State's infrastructure needs are a paramount concern for all Californians. We need to increase our efforts to address these needs, and we need to examine all of the available options. Our efforts, however, must be guided by our fiscal realities. The State budget has limited flexibility, and our taxpayers have limited resources. Our economic potential, in the final analysis, is limited or enhanced by our ability to make the right choices today.

Appendices

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of June 30, 1997
(Thousands)

	Voter Authorization		Bonds	
	Date	Amount	Outstanding	Unissued
GENERAL FUND BONDS (Non-Self Liquidating)				
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988	6/7/88	$ 150,000	$ 95,525	$ -
California Library Construction and Renovation Bond Act of 1988	11/8/88	75,000	55,965	8,625
California Park and Recreational Facilities Act of 1984	6/5/84	370,000	231,680	7,500
California Parklands Act of 1980	11/4/80	285,000	84,250	-
California Safe Drinking Water Bond Law of 1976	6/8/76	175,000	76,265	5,000
California Safe Drinking Water Bond Law of 1984	11/6/84	75,000	46,010	1,500
California Safe Drinking Water Bond Law of 1986	11/4/86	100,000	76,600	8,000
California Safe Drinking Water Bond Law of 1988	11/8/88	75,000	49,450	18,265
California Wildlife, Coastal, and Park Land Conservation Act of 1988	6/7/88	776,000	588,905	39,980
Clean Air and Transportation Improvement Bond Act of 1990	6/5/90	1,990,000	978,690	862,720
Clean Water and Water Conservation Bond Law of 1978	6/6/78	375,000	101,925	4,150
Clean Water and Water Reclamation Bond Law of 1988	11/8/88	65,000	44,200	12,505
Clean Water Bond Law of 1970	11/3/70	250,000	7,000	-
Clean Water Bond Law of 1974	6/4/74	250,000	16,850	-
Clean Water Bond Law of 1984	11/6/84	325,000	142,490	-
Community Parklands Act of 1986	6/3/86	100,000	71,220	-
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/8/88	500,000	386,845	25,000
County Correctional Facility Capital Expenditure Bond Act of 1986	6/3/86	495,000	357,245	2,000
County Jail Capital Expenditure Bond Act of 1981	11/2/82	280,000	141,025	-
County Jail Capital Expenditure Bond Act of 1984	6/5/84	250,000	126,150	-
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	6/5/90	300,000	43,400	250,000
Fish and Wildlife Habitat Enhancement Act of 1984	6/5/84	85,000	49,670	3,500
Hazardous Substance Cleanup Bond Act of 1984	11/6/84	100,000	47,105	-
Higher Education Facilities Bond Act of 1986	11/4/86	400,000	251,900	-
Higher Education Facilities Bond Act of 1988	11/8/88	600,000	427,055	11,705
Higher Education Facilities Bond Act of June 1990	6/5/90	450,000	334,215	21,500
Higher Education Facilities Bond Act of June 1992	6/2/92	900,000	723,320	106,120
Housing and Homeless Bond Act of 1988	11/8/88	300,000	120,925	-
Housing and Homeless Bond Act of 1990	6/5/90	150,000	86,295	-
Lake Tahoe Acquisitions Bond Act	8/2/82	85,000	52,325	1,000

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
(Continued)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding	Unissued
New Prison Construction Bond Act of 1981	6/8/82	$ 495,000	$ 185,250	-
New Prison Construction Bond Act of 1984	6/5/84	300,000	127,500	-
New Prison Construction Bond Act of 1986	11/4/86	500,000	333,435	3,000
New Prison Construction Bond Act of 1988	11/8/88	817,000	590,765	16,000
New Prison Construction Bond Act of 1990	6/5/90	450,000	319,470	40,100
Passenger Rail and Clean Air Bond Act of 1990	6/5/90	1,000,000	724,265	107,900
Public Education Facilities Bond Act of 1996	3/26/96	3,000,000	407,825	2,587,605
1988 School Facilities Bond Act	11/8/88	800,000	545,940	45,000
1990 School Facilities Bond Act	6/5/90	800,000	577,250	34,745
1992 School Facilities Bond Act	11/3/92	900,000	741,506	65,094
Safe, Clean Reliable Water Supply Act of 1996	11/5/96	995,000	0	995,000
Seismic Retrofit Bond Act of 1996	3/26/96	2,000,000	50,005	1,949,995
School Building and Earthquake Bond Act of 1974	11/5/74 (a)	40,000	38,665	-
School Facilities Bond Act of 1988	6/7/88	800,000	550,765	-
School Facilities Bond Act of 1990	11/6/90	800,000	584,470	55,000
School Facilities Bond Act of 1992	6/2/92	1,900,000	1,567,805	65,000
Senior Center Bond Act of 1984	11/6/84	50,000	22,500	-
State Beach, Park, Recreational and Historical Facilities Bonds	(b)	250,000	4,850	-
State School Building Lease-Purchase Bond Law of 1982	11/2/82	500,000	155,925	-
State School Building Lease-Purchase Bond Law of 1984	11/6/84	450,000	248,750	-
State School Building Lease-Purchase Bond Law of 1986	11/4/86	800,000	528,650	-
State, Urban, and Coastal Park Bond Act of 1976	11/2/76	280,000	27,785	2,450
Water Conservation and Water Quality Bond Law of 1986	6/3/86	150,000	70,710	57,000
Water Conservation Bond Law of 1988	11/8/88	60,000	31,950	23,935
Total General Fund Bonds		$ 28,468,000	$ 14,250,536	$ 7,436,894

(a) Pursuant to Prop 203, passed by the voters in the March 26, 1996 primary election, $40 million in bonds unissued at that time became general fund supported, while all previously issued bonds will remain under "State School Building Aid Bonds" as self-liquidating Enterprise Bonds.

(b) Various dates.

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF OUTSTANDING AND UNISSUED LEASE REVENUE DEBT
As of June 30, 1997

	Outstanding	Unissued
Community Colleges	$ 668,230	$ 40,433
Department of Corrections	2,813,468	132,582
Energy Efficiency	155,050	279,220
Regents of the University of California	1,033,156	156,572
Trustees of the California State Universit	625,910	147,835
Various State Office Buildings	879,230	924,372
Total Lease-Debt	$ 6,175,044	$ 1,681,014

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND GENERAL OBLIGATION BONDS
(Non-Self Liquidating)
As of June 30, 1997

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal	Total
1998	$ 873,193,042.50	$ 985,590,000.00	$ 1,858,783,042.50
1999	810,234,879.98	964,485,000.00	1,774,719,879.98
2000	753,466,633.75	950,345,000.00	1,703,811,633.75
2001	699,567,456.75	944,058,068.25	1,643,625,525.00
2002	633,185,393.82	987,850,000.00	1,621,035,393.82
2003	572,966,411.39	936,991,391.80	1,509,957,803.19
2004	511,917,361.25	862,850,000.00	1,374,767,361.25
2005	460,475,807.59	799,584,388.71	1,260,060,196.30
2006	407,076,800.00	736,120,000.00	1,143,196,800.00
2007	359,420,428.27	691,355,000.00	1,050,775,428.27
2008	317,545,182.94	674,678,078.31	992,223,261.25
2009	272,609,968.75	671,245,000.00	943,854,968.75
2010	229,073,333.75	614,605,000.00	843,678,333.75
2011	192,075,597.34	539,629,045.16	731,704,642.50
2012	155,409,373.80	396,085,000.00	551,494,373.80
2013	133,381,254.60	285,320,000.00	418,701,254.60
2014	118,663,209.64	212,665,000.00	331,328,209.64
2015	107,049,610.94	201,140,000.00	308,189,610.94
2016	95,919,642.24	199,450,000.00	295,369,642.24
2017	84,985,480.93	199,175,000.00	284,160,480.93
2018	74,211,161.85	198,740,000.00	272,951,161.85
2019	63,495,143.75	198,290,000.00	261,785,143.75
2020	52,800,875.00	197,825,000.00	250,625,875.00
2021	41,823,888.75	197,955,000.00	239,778,888.75
2022	31,074,846.25	182,635,000.00	213,709,846.25
2023	20,740,959.20	184,665,000.00	205,405,959.20
2024	11,708,668.09	112,420,000.00	124,128,668.09
2025	5,791,045.74	73,145,000.00	78,936,045.74
2026	2,370,980.00	34,140,000.00	36,510,980.00
2027	492,205.00	17,500,000.00	17,992,205.00
Total	$ 8,092,726,643.86	$ 14,250,535,972.23	$ 22,343,262,616.09

SOURCE: State of California, Office of the Treasurer.

SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of June 30, 1997

Fiscal Year Ending June 30	Current Debt Interest	Current Debt Principal (a)	Total
1998	$ 332,645,744.82	$ 224,633,822.20	$ 557,279,567.02 (b)
1999	327,135,441.89	244,125,400.38	571,260,842.27
2000	314,883,840.96	264,839,962.79	579,723,803.75
2001	301,897,421.05	284,604,019.75	586,501,440.80
2002	288,273,277.95	262,580,773.02	550,854,050.97
2003	277,742,869.15	262,146,118.58	539,888,987.73
2004	262,357,766.49	272,746,386.24	535,104,152.73
2005	248,054,778.60	285,019,507.20	533,074,285.80
2006	230,259,386.58	302,697,554.60	532,956,941.18
2007	218,924,071.36	253,863,920.44	472,787,991.80
2008	202,146,297.95	259,226,787.98	461,373,085.93
2009	191,926,952.89	278,742,732.44	470,669,685.33
2010	171,248,055.27	264,491,633.76	435,739,689.03
2011	145,659,209.57	273,860,000.00	419,519,209.57
2012	130,523,498.51	254,080,000.00	384,603,498.51
2013	116,353,811.21	258,865,000.00	375,218,811.21
2014	102,042,118.31	257,875,000.00	359,917,118.31
2015	87,462,780.06	272,670,000.00	360,132,780.06
2016	72,457,462.43	248,670,000.00	321,127,462.43
2017	58,528,644.85	248,460,000.00	306,988,644.85
2018	45,101,701.51	257,585,000.00	302,686,701.51
2019	31,728,936.52	210,210,000.00	241,938,936.52
2020	20,435,303.84	183,740,000.00	204,175,303.84
2021	11,847,998.75	120,570,000.00	132,417,998.75
2022	5,147,568.13	92,150,000.00	97,297,568.13
2023	1,884,767.51	31,345,000.00	33,229,767.51
2024	271,065.63	2,515,000.00	2,786,065.63
2025	93,267.50	2,730,000.00	2,823,267.50
Total	$ 4,197,034,039.29	$ 6,175,043,619.38	$ 10,372,077,658.67

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(b) Total represents the remaining debt service requirements from July 1, 1997 through June 30, 1998.

SOURCE: State of California, Office of the Treasurer.