JOINT LEGISLATIVE HEARING

SENATE COMMITTEE ON GOVERNANCE & FINANCE

ASSEMBLY COMMITTEE ON APPROPRIATIONS

March 2, 2016

Committee Background

This background paper prepares the members of the Assembly Appropriations Committee and the Senate Governance and Finance Committee for the March 2, 2016, hearing on Initiative No. 15-0003, titled by its proponents as "The No Blank Checks Initiative." The measure proposes to amend the California Constitution to require voter approval for the state to issue revenue bonds to finance certain projects. This paper:

- Provides background regarding the state's issuance of bonds, specifically revenue bonds.
- Summarizes the pending initiative.
- Includes arguments from the initiative proponent and opponents.

New Initiative Review Process

The committees are hearing the initiative to satisfy the new requirements of Elections Code 9034, as amended by SB 1253 (Steinberg, 2014):

- Proponents of a proposed initiative who have gathered 25% of required signatures must certify under penalty of perjury to the Secretary of State they have done so.
- The Secretary of State then transmits the certification, along with the Attorney General's title and summary, to the Senate and the Assembly.
- The two houses then refer the measure to appropriate policy committees for joint hearings, to be held not later than 131 days before the election at which voters will consider the measure -- June 30th this year.
- The Legislature can neither amend the initiative, nor prevent it from appearing on the ballot.
- Secretary of State Alex Padilla determined on November 2, 2015 that Initiative No. 15-0003 has received sufficient signatures to be eligible for the November 2016 ballot.

- Should proponents not withdraw the measure before June 30th, the measure officially qualifies for the November ballot on July 1st.

Types of California Bonds

Bonds Generally. When public agencies issue bonds, they essentially borrow money from investors. Investors provide cash in exchange for an agency's commitment to repay the bond, plus interest. Bonds are usually either revenue bonds or general obligation bonds.

- Revenue bonds repay investors out of revenue generated from the project the agency builds with bond proceeds, such as fees and charges for a utility service (water, sewer, or electricity), parking garage revenues or bridge tolls.

- General obligation bonds, usually designated as supported by the issuing agency's full faith and credit, are repaid with the state's general revenues, or in the case of local agencies, from a dedicated tax above the Proposition 13 limit.

- Revenue bonds are explicitly **not** guaranteed by the issuing agency's full faith and credit; bondholders can only be repaid out of revenues pledged for the purpose.

Approval Process for Bonds. Because revenue bonds and general obligation bonds are distinct, the process for authorizing and approving each is different.

- Section One of Article XVI of the California Constitution requires a two-thirds vote of the Assembly and Senate and majority voter approval to issue state **general obligation bonds**, as was recently done with the Water Quality, Supply, and Infrastructure Improvement Act of 2014 (AB 1471, Rendon).
    - Voters can also place general obligation bonds on the ballot by initiative, as they have in recent years for children's hospitals, water projects, and stem cell research, among others.
    - Either way, general obligation bonds issued by the state must be ratified by majority vote of the state's electorate, which differs from local general obligation bonds. (Local general obligation bonds require approval of two-thirds of voters residing within the local agency's boundaries, except for school districts, which require only 55% voter approval.)

- Alternatively, to issue state **revenue bonds**, the Legislature enacts a bill authorizing the issuance of the bonds, and pledges the specific revenues necessary to repay investors. Revenue bonds issued by the state are **not** subject to the Constitution's voter approval requirements that apply to general obligation bonds.

Revenue Bonds. In recent years, revenue bonds have been a valuable tool for the state to finance capital improvements, such as the State Water Project, improvements at the University of California and California State University, California Department of Corrections and Rehabilitation facilities, and state office buildings, among others. Additionally:

- California issued Power Supply Revenue Bonds to finance the Department of Water Resources' purchase of electricity on behalf of utility customers as a result of the energy crisis.

- The California Infrastructure and Economic Development Bank, housed in the Governor's Office of Business and Economic Development, can issue conduit bonds on behalf of non-profit organizations and certain types of private companies. Financing authorities in the Treasurer's Office, including the California Pollution Control Financing Authority, California Educational Facilities Authority, California School Finance Authority, and the California Health Facilities Financing Authority, issue similar bonds.

- The California Earthquake Authority issues revenue bonds backed by insurance premiums to pay claims.

Currently, the Constitution does not require voter approval to issue revenue bonds, or refund or refinance existing ones.

The state repays each revenue bond from the distinct source of funds authorized by the Legislature, which vary according to the purpose of that bond issue.

- For State Public Works Board lease revenue bonds, state agencies lease facilities from the Board, and the Legislature appropriates funds to state agencies to pay the leases. These bonds are not general obligations because the Legislature is not obligated to pay the lease rentals if the building is not available for use and occupancy.

- State Water Project bonds are repaid out of water delivery charges to 29 contractors.

- Ratepayers within the service territories of the state's three investor-owned utilities and other electricity users pay a charge on their electricity bills imposed by the California Public Utilities Commission to repay the Power Supply Revenue Bonds.

Under no circumstance is the State's General Fund at risk for repaying these bonds if the pledged revenue source turns out to be insufficient.

Proposed Initiative

On March 13, 2015, Attorney General Kamala Harris prepared the title and summary for Initiative No. 15-0003, as follows:

REVENUE BONDS. STATEWIDE VOTER APPROVAL. INITIATIVE CONSTITUTIONAL AMENDMENT.

Requires statewide voter approval before any revenue bonds can be issued or sold by the state for projects that are financed, owned, operated, or managed by the state or any joint agency created by or including the state, if the bond amount exceeds $2 billion. Prohibits dividing projects into multiple separate projects to avoid statewide voter approval requirement.

Included with the title and summary is an estimate of the fiscal impact on state and local government prepared by the Legislative Analyst's Office (LAO) and the Director of Finance (DOF):

The fiscal effect on state and local governments is unknown and would vary by project. It would depend on (1) the outcome of projects brought before voters, (2) the extent to which the state relied on alternative approaches to the projects or alternative financing methods for affected projects, and (3) whether those methods have higher or lower costs than revenue bonds.

Voter approval requirements. Specifically, the initiative, titled by the proponents as the "No Blank Checks Initiative," adds Section 1.6 to Article XVI of the California Constitution. It would require majority voter approval before issuing or selling any state revenue bonds in an amount over two billion dollars for any single project financed, owned, operated, or managed by the state. The measure applies the two billion dollar threshold to bonds issued either singly or in aggregate, and applies notwithstanding any other law. The initiative also directs the Treasurer's Office to adjust the two billion dollar threshold annually for inflation.

While the measure does not define either "revenue bonds" or "single project," the initiative precludes the state from avoiding its voter approval requirements by dividing or deeming a single project as multiple separate projects. The initiative states that "multiple allegedly separate projects shall be deemed to constitute a single project" under certain circumstances. The measure sets forth three examples of such projects which must be considered a single project for its purposes, *including, but not limited to*:

- Where the allegedly separate projects will be physically or geographically proximate to each other,
- Where the allegedly separate projects will be physically joined or connected with each other, or
- Where one allegedly separate project cannot accomplish its stated purpose without the completion of another allegedly separate project.

The measure also defines the term “state” to mean the State of California, any agency or department thereof, and any joint powers agency or similar body created by the State, or in which the state is a member. The measure excludes from the definition of “state” any city, county, city and county, school district, community college district, or “special district,” a term the initiative states refers only to public entities formed for the performance of local government functions within limited boundaries.

Other Provisions.

- The initiative states that it should be liberally construed to effectuate its purposes.

- In the event that this initiative and any other measure or measures relating to voter approval requirements for state bonds appear on the same statewide election ballot, the measure deems the other measure or measures to be in conflict with this one. In such a case, if voters approve all the measures, this one becomes effective in its entirety if it receives more votes that the others, but if the others do, this one is nullified.

- Additionally, the initiative provides that in the event its provisions are superseded by another conflicting initiative, but the other initiative is subsequently held invalid, then this initiative is self-executing and given full force and effect.

- The measure also contains a severability clause, which in the event some part of it is held invalid for any reason, provides that the invalidity of one part does not affect any of its remaining provisions.

- In the event the voters approve the measure, but it is then subjected to a legal challenge in which the Governor and Attorney General refuse to provide a defense, then the Attorney General must:

    - Appoint independent counsel to faithfully and vigorously defend the initiative, and

    - Prior to appointing or substituting independent counsel, exercise due diligence in determining the qualification of independent counsel, including written affirmation from the independent counsel that he or she will faithfully and vigorously defend the act. This affirmation must be made available to the public upon request.

    - The initiative provides a continuous appropriation from the General Fund without regard to fiscal year in an amount necessary to cover the cost of independent counsel.

- The measure states that its purpose is to bring the state’s public debt crisis under control and contains various additional findings and declarations.

Arguments from the Proponent. According to the proponent, the initiative would require statewide voter approval for state revenue bond projects costing more than $2 billion, but exempts cities, counties, special districts, school districts and community college districts. The proponent also assert that the University of California is exempted under Article IX, § 9 of the California Constitution although this is not specified in the initiative.

The proponent believes that voters should have a say in the state's largest, most consequential revenue bond projects, asserting that they, and future generations, will be expected to pay for the bonds over many years to come. He asserts that the measure does not veto or stop any revenue bond project, but rather simply puts the bonds up for a vote of the people, just as general obligation bonds are already required to do. The proponent also argues that the initiative closes a loophole that allows state agencies to issue massive new debt for multi-billion dollar projects, without giving Californians the right to vote.

In summary, the proponent asserts that his measure will protect the right to vote on major bond debt, close a loophole that allows massive new debt to be issued without a vote, hold politicians accountable, give voters a say in new state debt, and ensure that voters understand the full cost of future projects.

The proponent argues that California is saddled with historic levels of debt that puts the state's long-term fiscal health in danger. Citing LAO, the proponent believes that California's outstanding liabilities, totaling over $330 billion[1], are unsustainable. Further he states that California has the third worst credit rating of any state in the nation and that, as a share of personal income, population, and gross domestic product, California's debt load is the third worst among the ten largest states[2]. He believes that new major bond debt affects all Californians and they deserve the right to vote on these bonds.

The proponent cites projects under discussion in Sacramento, indicating costs estimated at nearly $100 billion, and believes that voters should have an opportunity to stop such spending. He believes that the pending projects have been structured to avoid "the public review and accountability that comes with getting voter approval," and characterizes this as "a loophole that will allow them to borrow billions in new revenue bond debt without giving voters a voice."

Arguments from Opponents. According to opponents, the measure would delay or stop much needed repairs to roads, bridges, water supply and delivery systems, hospitals and universities all over the state, at a time when there is a significant infrastructure backlog. Opponents also believe that the measure is deceptive and assert that the proponent's real goal is to try to disrupt one specific project – the California Water Fix, but will have far more sweeping consequences.

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[1] Legislative Analyst's Office, "Addressing California's Key Liabilities," Mar. 7, 2014.

[2] John Chiang, California State Treasurer, "California Debt Affordability Report," Oct. 2015.

Opponents argue that the initiative is misleading in that private investors bear the financial risk for revenue bonds, not the state or its general fund, with revenue bonds repaid by users of a project who directly benefit, not taxpayers. For instance, repairs to a bridge would be paid by tolls on the bridge, not taxpayers. Opponents believe that it does not make sense to have a statewide election on projects not financed by taxpayers for which the state and local governments bear none of the financial risk.

Additionally, opponents assert that the measure erodes local control. Under this measure, cities and towns that want to come together with the state and form a JPA to issue revenue bonds to upgrade local water systems, roads, bridges, ports and energy systems would have to put their project on a statewide ballot, which to opponents means that voters in faraway regions would be empowered to deny funding for local projects outside of their community. Opponents cite as two examples the Bay Area Toll Authority and the Orange County Transportation Corridor Agencies, two local JPAs formed in partnership with the state to finance local infrastructure. They also believe that numerous other JPAs have been created by special statewide legislation and would be covered by the initiative.

Finally, opponents express concern that the measure would create "vast uncertainty, lawsuits and red tape" that could delay or stop a large number of infrastructure projects because the initiative fails to define the key term "project." The opponents cite a part of the LAO/DOF fiscal analysis:

"The measure does not provide a definition for a project. For example, a project could be limited to what is built on a given site at a specific time (such as an individual medical building) or could include larger systems of improvements constructed over time (such as a medical center with multiple buildings). A broader definition of a project would result in more instances in which the $2 billion threshold is reached, thus triggering the measure's voting requirements. Accordingly, there is uncertainty regarding which projects government agencies and the courts would determine are subject to the requirements of this measure."

Opponents believe that the uncertainty of this provision makes it ripe for abuse and will be used by project opponents to call for statewide votes or to engage in litigation that could tie up projects or make projects far more expensive to finance.