OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: October 23, 2006 **IBA Report Number:** 06-49

City Council Agenda Date: October 24, 2006

Item Number: 330

Subject: Support for Proposition 1A-1E, the Infrastructure Bond Package, on the November 2006 Statewide Ballot

OVERVIEW

At the October 11, 2006 meeting of the Rules, Open Government and Intergovernmental Affairs Committee, the committee members voted to forward Propositions 1A, 1B, 1C, 1D and 1E to the City Council for support. These Propositions, representing various infrastructure measures, will appear on the ballot of November 7, 2006. Report to the City Council 06-146 provides information on the measures' impacts to the City of San Diego.

FISCAL/POLICY DISCUSSION

The total bond package proposed to the voters is $37.3 billion for Propositions 1B through 1E (1A does not authorize the sale of bonds, see below for more information), the largest state bond proposal in history. Proposition 84 is another infrastructure measure, proposing $5.4 billion in bonds for "Water Quality, Safety and Supply. Flood Control. Natural Resource Protection. Park Improvements." This measure was placed on the ballot through the initiative process, as opposed to the legislature, and is not before the City Council to consider for support as part of this item.

While this report focuses on the impact of these measures to the City of San Diego, it is valuable to briefly note the anticipated fiscal impact to the State of California through this increase in bonded indebtedness. Attachment 1 is "An Overview of State Bond Debt" published by the California Legislative Analyst's Office (LAO). The LAO has stated that approval of the five measures (including Proposition 84) would increase the state's debt-service ratio, a measurement of the portion of annual revenues that must be allocated for debt-service. The ratio is estimated to peak at 5.9 percent in 2010-11 and decline thereafter. MBIA MuniServices Company, the City of San Diego's tax revenue consultants, have identified that a 6 percent debt service ratio is generally considered prudent (Attachment 2). The LAO has estimated that the annual debt service on these bonds could average $2 billion if sold over a 10 year period. Actual costs would depend on the timing of the sales.

Below are comments on each Proposition:

Proposition 1A
The IBA supports the analysis by the Mayor's Office in Report 06-146.

In addition, the LAO reminds us that:

> *"Since 2002, the state has suspended the Proposition 42 transfer twice because of the state's fiscal condition. In 2003-04, the transfer was suspended partially, and in 2004-05, the full amount of the transfer was suspended. Existing law requires that these suspended amounts, with interest, be repaid to transportation by 2008-09 and 2007-08, respectively."*

The City's FY 2007 Budget includes $5 million in funding from Proposition 42. The allocation of the funds is to be used only for public street and highway maintenance, rehabilitation, reconstruction and storm damage repairs. The $5 million is allocated to CIP #59-001.0 for Resurfacing/Slurry Seal. As of October 2006, the City has received Proposition 42 payback of $5.2 million for 2004-2005 and $4.3 million for 2003-2004 for a total of $9.5 million.

This measure also has some similarity to a previously approved measure. In November 2004, California voters approved Proposition 1A, which amended the State Constitution to provide greater protection of local revenues. Specifically, Proposition 1A prohibits the state from:

1) Reducing the local Bradley-Burns Sales & Use tax rate or altering its method of allocation;
2) Decreasing Vehicle License Fee revenue from the 0.65% rate without providing replacement funding to cities and counties;
3) Shifting property taxes from cities, counties or special districts.

Under certain conditions, Proposition 1A allows the state to suspend the property tax revenue protection provision. Beginning in Fiscal Year 2009, the State Legislature may "borrow" a fixed portion of total property tax revenues for a declared "severe fiscal hardship." Proposition 1A requires that any borrowed fund be repaid with interest within three years, that the state cannot enact such a suspension more than twice in any 10 year period, and that no funds may be borrowed until all previous borrowings have been repaid. The current Proposition 1A, slated for the November 7, 2006 ballot, would amend the Constitution to provide similar restrictions on the "borrowing" of Proposition 42 gasoline sales tax funds.

Proposition 1B
The IBA supports the analysis by the Mayor's Office in Report 06-146.

However, the LAO cautions that:

> *"The state and local governments that construct or improve transportation infrastructure with these bond funds (by, for example, building roads and bridges or purchasing buses or railcars) will incur unknown additional costs to operate and maintain them. A portion of these costs would be offset by revenues generated by the improvements, such as transit fares and tolls."*

Therefore we would note that, should the City support this measure and should it be passed by the voters, the City of San Diego must be vigilant in planning for the funds required to operate and maintain additional and improved infrastructure. These costs will be an additional financial burden to the City, as we face the looming challenge of funding maintenance on current infrastructure that has already been deferred for many years. Therefore, strategies for maintenance funding required through Proposition 1B efforts should be folded into the City's long-term financial forecast. This plan should include a strategy to tackle the City's current deferred maintenance as well as fund all current and future maintenance requirements in order to prevent the further accumulation of deferred maintenance within the City.

Proposition 1C
The IBA supports the analysis by the Mayor's Office in Report 06-146.

Proposition 1D
The IBA supports the analysis by the Mayor's Office in Report 06-146.

Proposition 1E
The IBA supports the analysis by the Mayor's Office in Report 06-146.

As with Proposition 1B, however, the LAO notes that:

> *"To the extent that bond funds are used by state and local governments to purchase property or develop a new flood control project, these governments would incur unknown additional costs to operate or maintain the properties or projects."*

Therefore, the IBA again recommends that the City be vigilant in planning for these potential costs well in advance.

Additionally, this measure may have an effect on City revenues. The LAO states that:

> *"The measure provides funds for land acquisition by the state for flood management, including the development of bypasses and setback levees. Under state law, property owned by government entities is exempt from property taxation. To the extent that this measure results in property being exempted from taxation due to acquisitions by governments, local governments would receive reduced property tax revenues."*

The extent of the potential revenue impact for the City of San Diego is unknown at this time.

Supporters

Finally, we note that Propositions 1A through 1E are supported by the League of California Cities, California State Association of Counties, the California Chamber of Commerce, the San Diego Regional Chamber of Commerce and the City's tax revenue consultants, MBIA MuniServices Company. Propositions 1B through 1E are supported by the League of Women Voters, while the organization is neutral on Proposition 1A. Propositions 1A, 1B, 1D and 1E are supported by the San Diego Taxpayer's Association, while no position was taken on Proposition 1C.

CONCLUSION

In general, these ballot measures represent significant investment in infrastructure that will benefit the City of San Diego, as well as the entire state. The IBA recommends support for these measures with the caveat that, if passed, the City must carefully plan for related operations and maintenance costs associated with Propositions 1B and 1E.

[SIGNED]

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Attachments