EVALUATING STATE AND LOCAL BONDS

Tax & Fiscal Facts

AT ISSUE:

Bonds can be an appropriate mechanism to finance capital projects at the state and local levels of government. However, expenditures funded by a bond should be thoroughly evaluated.

BOND POLICY CRITERIA

- **Capital Expenditures.** The project to be financed is a capital facility or infrastructure project, and the bond funding will pay for land acquisition and capital costs, not for maintenance, operations, non-construction salaries or wages, or ongoing costs, or for equipment, computers, or similar items that will not be useful for at least as long as the debt is outstanding.

- **Consider Interest Rates.** Interest rates for indebtedness are not abnormally high, and the overall debt level will not be excessive. Local governments should avoid using capital appreciation bonds.

- **Short-Term vs. Long-Term Benefits.** The project costs are appropriately shared by future taxpayers because the project will have a useful life at least as long as the term of the bonds, and future taxpayers will benefit from the facility that is built with the bond proceeds.

- **State Bonds for State Concerns.** For state bonds, projects funded are of state-level concern and importance. State bonds should not pay for local projects that do not have significant extra-territorial impact.

- **All Other Options Have Been Explored.** Non-bond financing is not a reasonable option.

TYPES OF BONDS:

- **State General-Obligation Bonds.** Bond principal and interest are secured by the full faith and credit of California and supported by tax and fee revenue. Bonds are paid out of the General Fund and must be approved by a majority of the voters.

- **Local General-Obligation Bonds.** Bond principal and interest are secured by the full faith and credit of a local government. Bonds are paid for by higher property taxes. Under Proposition 13, locally assessed properties are taxed at an average rate ranging from 0.952% to 1.214% of the property's base-year value, plus inflation. When a local government issues bonds, the property tax rate increases. Bonds must be approved by a two-thirds vote of the electorate, except school district bonds, which must be approved by 55 percent of voters.

- **State and Local Revenue Bonds.** Bond principal and interest are secured by revenue obtained from tolls, charges, or other capital projects. These bonds generally pay for revenue-generating projects, and may be issued without voter approval.

- **Local Capital Appreciation Bonds.** Bond principal and interest payments are deferred until the bond matures. Delayed repayment allows local governments to issue bonds when issuance otherwise would not be possible. CABs typically are repaid with a higher interest rate and a long repayment schedule.

- **Other Local Bonds.** Some local governments issue bonds for a Community Facilities District (CFD) or an Infrastructure Financing District (IFD). Bonds issued within a CFD are repaid using revenue from parcel taxes, and bonds issued through IFDs are repaid through tax-increment financing.

CALIFORNIA TAX FOUNDATION

The California Tax Foundation is a nonprofit, nonpartisan think tank affiliated with the California Taxpayers Association. The foundation is dedicated to promoting sound tax policy and government efficiency.

1215 K Street, Suite 1250 • Sacramento, CA 95814 • (916) 441-0490 • www.caltaxfoundation.org