Paying Down Debt

The revised Governor's Budget continues to address two of the Governor's top priorities, paying down state debt and restoring the state's fiscal condition. Paying down state debt ensures the additional one-time revenues are used for one-time purposes and also reduces the projected 2007-08 operating deficit.

The Administration addresses these priorities by proposing to: (1) pre-pay and repay state debt including reducing the amount of outstanding Economic Recovery Bonds (ERBs) debt by $1.0 billion, (2) create the Transportation Debt Service Fund to fund transportation bond debt, and (3) build the General Fund reserve.

Debt Pre-payments and Repayments

The May Revision continues to pre-pay or repay outstanding state debt. The Administration proposes to pre-pay or repay a total of $3.2 billion of state debt, which is an increase of $1.6 billion from the Governor's Budget.

The Governor's Budget proposed a total of $1.627 billion in pre-payments or repayments of state debt as follows:

- Proposition 42 Prepayment of $920 million—The May Revision continues to propose repaying $920 million in 2006-07 on the 2004-05 Proposition 42 loan, which will allow local government to receive $254 million in funding for local streets and roads repairs. This is even more critical now due to the damage suffered in the winter of 2005-06 and the fact that the regular Proposition 42 allocation for 2006-07 contains no funds for local streets and roads.

- Transfer $460 million to the Budget Stabilization Account to retire ERBs—
The May Revision proposes to increase the transfer to $472 million pursuant to Proposition 58.

- Various Special Fund Loan Repayments totaling $149 million—The Governor's Budget proposed to repay 14 special fund loans in 2006-07. The May Revision proposes to pre-pay additional special fund loans (see below).

- Repayment of Reimbursements to Local Government (not including school districts)—$98 million. Proposition 1A and current statute specify that the payable claims for mandated costs incurred prior to the 2004-05 fiscal year that have not been paid prior to the 2005-06 fiscal year may be paid over a period of not more than 15 years commencing with the 2006-07 fiscal year. The $98 million is adjusted to $83 million at May Revision.

The May Revision proposes an additional $1.572 billion in pre-payments or repayments of state debt as follows:

- Economic Recovery Bonds Pre-payment totaling $1.0 billion—See Reduce Outstanding Economic Recovery Bonds Debt section below.

- Various Additional Special Fund Loan Pre-payments totaling $198 million—
The May Revision proposes to pre-pay 13 special fund loans in 2006-07 that are currently scheduled to be repaid in 2007-08. This pre-payment of $198 million is in addition to the $149 million of repayments proposed at Governor's Budget.

- Proposition 98 Settle-up Pre-payment totaling $150 million—For Proposition 98 settle-up prior to 2003-04.

- Flood Control Subvention totaling $100 million -The May Revision proposes $100 million for the state's share of funding for local flood control projects from prior years. In some cases, the funds will allow local agencies to proceed with additional flood projects.

- Pre-payment of the second year of Reimbursements to Local Government (not including school districts) totaling $87 million—This will increase payments for mandates to $170 million.

- General Obligation Bond Debt Pre-payment totaling $40 million—The May Revision proposes to make the final payment on various general obligation bonds issued under 27 different bond acts. These bonds would normally be retired in 2007-08. An interest savings of $1 million will be realized in 2007-08 by accelerating the pay-off of these bonds in 2006-07.

Reduce Outstanding Economic Recovery Bonds Debt by $1.0 Billion

On March 2, 2004, voters approved Proposition 57 (the Economic Recovery Bond Act) and Proposition 58 (the California Balanced Budget Act). Proposition 57 authorized the issuance of Economic Recovery Bonds (ERBs) to achieve up to $15 billion in net bond proceeds to retire the accumulated state budget deficit. To date, a total of $10.9 billion in ERBs have been issued ($11.3 billion in net proceeds), with $3.7 billion of net proceeds available. To ensure the repayment of the ERBs, the Legislature authorized the "Triple Flip," which consists of three major provisions regarding the distribution of sales and use taxes and other revenues to schools and local governments as follows:

- The ¼ percent local sales tax rate was replaced with a new ¼ percent statewide sales tax rate to fund ERB repayment.
- Property tax previously allocated to local schools was shifted to cities and counties to backfill revenues now used to repay ERBs.
- The General Fund now repays the local schools to backfill the property tax previously allocated to them.

Proposition 58 requires a special reserve to be established, the Budget Stabilization Account (BSA), part of which is to repay the ERBs authorized by Proposition 57. The amount of BSA funds used to repay ERBs is capped at $5 billion.

As a result of aggressive repayment efforts, the Governor's Budget proposed to significantly shorten the originally scheduled ERB retirement date from July 2023 to June 2010.
The May Revision proposes an additional $1 billion General Fund to further accelerate the repayment of the ERBs. As a result of these additional revenues, refinements to the ERB repayment model, and increases in revenues dedicated to the repayment of the ERBs, it is now estimated that the ERBs will be effectively paid off by June 30, 2009, one full year ahead of the previous projection. In addition, it is estimated that the pre-payment of the ERBs will

result in more than $147.9 million in simple interest savings, an increase of $266.3 million to the BSA reserves in 2008-09, and make available $1.679 billion General Fund in 2009-10 that otherwise would have been used to reimburse local governments for the Triple Flip.

Transportation Debt Service Fund

The May Revision revenue forecast indicates substantial sales tax will be derived from the increase in gasoline prices. Under the "spillover" formula in existing law, this money does not go into Proposition 42. Over the last two decades, the bulk of the spillover funds have been redirected to the General Fund. The Administration proposes to shift these special revenues to a new fund that will be dedicated to paying a portion of the debt service on existing and new transportation bonds. The General Fund will pay the remaining debt service. Based on current forecasts, this could provide over $4.1 billion through 2015-16 toward transportation debt service costs, with initial resources of $355 million in 2006-07 and $336 million in 2007-08 (See Revenue Estimates section).

Build the 2006-07 General Fund Reserve

The May Revision proposes to use part of the additional $7.5 billion in revenue to increase the General Fund reserve from $613 million to $2.2 billion, an increase of $1.6 billion. This amount includes $472 million from the Budget Stabilization Account for rainy day purposes.