Before the economy went bust, California voters authorized multibillion-dollar charges on the state's infrastructure credit card.

They approved generational investments in roads, schools and levees, as well as hospitals and stem-cell research. At the time, fiscal experts projected that California at most would have to spend roughly 6 percent of its annual budget on payments.

But after an economic collapse, estimates now show that debt service could consume as much as 10 percent of the annual general fund budget by 2014-15 – an "unprecedented" ratio, according to the Legislative Analyst's Office.

The latest debt warning comes weeks after lawmakers and Schwarzenegger placed a new $11.1 billion water bond on next November's ballot. Backers of the measure say the state desperately needs a water system overhaul.

Until this year, the state had not spent more than 5.7 percent of its general fund on debt, according to Department of Finance records dating back to 1976. The ratio now stands at 6.7 percent.

Treasurer Bill Lockyer warned in a report last month that a 10 percent debt ratio "would require cutting even deeper into crucial services already reeling from billions of dollars in reductions." Fiscal conservatives warn that it also increases pressure on lawmakers to raise taxes.

"It's a zero-sum game," added Lockyer spokesman Tom Dresslar. "Every additional dollar you spend on debt service is a dollar you cannot spend to educate your kids, provide health care, protect the environment or fight fires."

A combination of voter bond approvals and plummeting state revenues have led to the situation.

Voters approved a flurry of bonds in recent years, none greater than the $37.3 billion package for roads, schools and levees in 2006 that was championed by Gov. Arnold Schwarzenegger. In 2004, they authorized $3 billion in stem-cell research bonds and $15 billion in deficit bonds.

Even as the state sank into recession last year, voters approved $10 billion in bonds for high-speed rail in California. Most bonds originated in the Legislature.
"I think ultimately you can blame the voters for approving them and electing people who put these on the ballot," said Jon Coupal of the Howard Jarvis Taxpayers Association.

When voters approved the public works bond package in 2006, the Department of Finance projected that California's debt ratio in 2014-15 would be 6.35 percent. Finance now projects that ratio to be 9.54 percent in 2014-15. Lockyer has pegged it at 10.16 percent, using different assumptions.

While the projected dollar amount of annual debt service has stayed roughly the same, the 2006 projection optimistically showed California would take in $151 billion in general fund revenues in 2014-15.

The Finance Department now projects the state will instead receive only $104.8 billion that year.

Jason Dickerson, director of state administration with the Legislative Analyst's Office, said there is no rule of thumb for how much the state should devote to debt payments.

"If the Legislature and voters believe 9 to 10 percent is the right amount to devote to the water bond and other debt service, that's fine," Dickerson said. "But it will mean they will have somewhat less to spend on other general fund programs."

Debt as a percentage of general fund revenues is only one measurement of a state's debt load. Others are debt as a percentage of total personal income in California and debt per capita. In both cases, California has a higher debt ratio than the median for the 10 most populous states, but not as high as New York or New Jersey, according to Lockyer's Debt Affordability Report.

Proponents of infrastructure bonds say California would suffer greater consequences without such investments.

Schwarzenegger's chief of staff, Susan Kennedy, called it a "false argument" to suggest the state has to choose between pursuing a water bond and preserving core state services. She said California must do both and should view water infrastructure as a necessity. Without it, she said, residents and businesses would suffer economically as water deliveries shrink.

The governor in recent weeks has defended the bond's impact on debt load by saying California would stagger its water borrowing. Because the state would sell only half its water bonds before 2014-15, he argues that the borrowing would add only "a little bump" to debt load before then.

"There is a big difference between spending and investing," Schwarzenegger said in San Jose this month. "This is the greatest investment that the people of California can make into the future of California, and this is why it is so important."

Investors remain concerned because of the debt's potential impact on California's budget situation. The LAO last week projected that the state will have roughly $20 billion annual deficits through 2014-15. While California prioritizes its payments on debt above most other
expenditures and has never defaulted, investors remain nervous. California already has the lowest bond rating in the nation.

"California has a lot more risk than we'd like right now," said Alex Anderson, portfolio manager of Los Angeles municipal-bond firm Envision Capital Management. "Not as many people are working, home values are deteriorating. … It's just really ugly out there in terms of revenues coming into the state."

Both Lockyer and the LAO have suggested that policymakers re-evaluate the state's debt situation and prioritize projects if they believe the state cannot spend 10 percent of its budget in that manner. Lockyer has advocated for a "master plan" to direct investments through 2050.

One way for the state to reduce its debt service ratio is for lawmakers and the governor to slow bond spending that has been authorized by voters. At the beginning of October, the state had $53 billion of bond debt that had been authorized but not issued, according to the LAO.

"When a budgetary category grows to 8, 9 and 10 percent of revenues, it's getting to be the equivalent of a fairly good-sized program in the general fund," Dickerson said. "One option is slowing down the rate of issuance."

Coupal suggested evaluating projects based on how many jobs they create.

While conservatives have long been cautious about bond spending, the issue has begun to worry more liberal interests, including labor unions who want to protect their workers.

Willie Pelote, California political director for the American Federation of State, County and Municipal Employees, said the state should look more toward bonds that rely on user fees.

"The general fund can't continue to sustain it," Pelote said. "You would think there would have been more thought into the future of debt. The impact has been to create more pressure on programs already cut beyond the bone."
RISING DEBT PAYMENTS

Principal and interest payments on debt are consuming a larger percentage of California’s general fund.

Note: Figures for FY 2009-10 and beyond assume voters approve $11.1 billion in water bonds the Legislature placed on the November 2010 ballot.

Source: Legislative Analyst’s Office

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