Howard Jarvis Taxpayers Association

California Commentary

Volume 4, Issue 42 Week of October 16, 2006

Caution: Bonds Have a Hidden Cost

By Jon Coupal

There was a popular song a few years ago called, "Money for Nothing." While the tune was a satire on the vast amounts paid to successful rock stars, the title could just as easily apply to many voters' attitudes toward bonds.

As we approach the November election with over $41 Billion in bonds on the statewide ballot, and additional billions being considered for local jurisdictions, now is a good time to brush up on the significance of bonds, their true costs, and how they are repaid.

The California Constitution gives the electorate the right to vote on state and local general obligation bonds. However, the rules for passage are *different* for each category.

State bonds, commonly used for infrastructure improvements like highways and to provide additional funding for school construction, require a simple majority vote of the statewide electorate for approval. These bonds do *not* trigger a tax increase, but are repaid from the state's general fund into which virtually everyone pays through sales and income taxes.

Although there is at least the appearance of fairness to a system that allows a majority vote to approve bonds that are repaid by everyone, these bonds are hardly a perfect means to finance long-term capital improvements.

First, these bonds are more expensive than many voters imagine. Most are aware that bonds mean debt that must be repaid, but just like when we see that must-have item that we charge to a credit card, it is easy to overlook the impact of compounding interest.

Since most government bonds are issued with a 30 year payback, a good estimate of the *actual* cost to taxpayers is to *double* the face amount of the bond. Additionally, when the state takes on a lot of debt, bond buyers demand higher interest rates to compensate themselves for the perceived additional risk. This makes the bonds even more expensive.

Second, since bond repayment has first call on the general fund, less money is left behind to pay for transportation, education, health care, and other programs Californians consider important. In other words, the amount of debt we must pay from the general fund means *less* money to finance other government programs or for infrastructure on a "pay-as-you-go" basis where taxpayers get, by far, more bang for their buck.

The second category of bonds on which we vote is local general obligation bonds used for local infrastructure projects, libraries, and schools. Although everyone can vote on these bonds, *property owners* are singled out as solely responsible for the repayment of principal and interest. Both commercial and residential property owners see a *tax increase* when these bonds are approved, but the hardest hit are the *single-family homeowners* who, unlike businesses that

For more information, contact: Kris Vosburgh, Executive Director
Howard Jarvis Taxpayers Association ● 621 S. Westmoreland Ave., Suite 202 ● Los Angeles, CA 90005 ● (213) 384-9656

can pass additional costs on to customers, must pay the entire amount.

Wisely, the drafters of the California Constitution of 1879 recognized the inherent unfairness of letting everyone vote on a tax that would be placed on a minority of the community. To level the playing field, they required a *two-thirds* vote for passage of these local general obligation bonds under the belief that if passed with a higher vote threshold, it would be a reflection of a strong community consensus, including the support of those who would be paying the principal and interest bills.

This system served California well for over a century. Then, in 2000, Netflix CEO, Reed Hastings — author of the Proposition 88 property tax increase on the November ballot — and his merry band of billionaires bankrolled the misleading campaign that passed Proposition 39, which *lowered* the vote for local school bonds to 55 percent. The measure has virtually *guaranteed* that all school bonds pass, regardless of merit, and has saddled property owners with *tens of billions* of dollars in bond debt.

So, for the upcoming election, a large percentage of Californians will confront bond proposals that require a majority vote, a 55 percent vote, and a two-thirds vote.

Although this may seem complex, there is a simpler way to classify bonds. Those that are a necessary evil and those that are an unnecessary evil.

The "necessary evil" bonds are those that build something like a bridge or a sewage treatment plant that would be very difficult to fund immediately out of existing revenue. Although paying for the infrastructure improvement means going into debt, the debt may be justified in that it allows government to continue to provide vital services that would be curtailed if an immediate cash outlay were required.

"Unnecessary evil" bonds are those like some we have seen in recent years marketed as measures to help the environment. However, closer examination has shown that some of the backers of these bonds benefit, because when the bonds are passed, the state becomes obligated to buy property they own at inflated prices.

Unfortunately, some bonds contain both flimflam and worthwhile projects, which makes it even more difficult for voters to weigh their merits.

Ultimately, Californians would be wise to approach all bonds with extreme caution. The debt bonds create is an *irreversible* obligation that continues for *decades*. *Don't* buy into voting "yes" unless the need for a bond is proven beyond a reasonable doubt.

* * *

JON COUPAL is an attorney and president of the Howard Jarvis Taxpayers Association — California's largest taxpayer organization which is dedicated to the protection of Proposition 13 and promoting taxpayer rights. He can be reached through the Association's website: http://www.hjta.org.