California *at the* Fiscal Crossroads

Cutting Our Debt and Building Our Future

The State of California's Debt Affordability Report

Phil Angelides
California State Treasurer
November 2003

PHILIP ANGELIDES
Treasurer
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The Honorable Gray Davis, Governor

The Honorable Arnold Schwarzenegger, Governor-elect

The Honorable John Burton, Senate President pro Tempore

The Honorable Herb Wesson, Speaker of the Assembly

I am hereby transmitting to you, with a very sobering message, California's statutorily required Debt Affordability Report for 2003. Whereas, in the past, this annual report has served to advise the Governor and the Legislature regarding the amount of bonds that the State can prudently issue to make smart investments in our public fabric –schools, water, transportation and other infrastructure – this year, this report must address a more pressing topic.

It is my strong belief, based on the information provided in this report, that the State has authorized bonds for the purpose of closing its budget gap at a level beyond what is fiscally prudent. Accordingly, I urge the Governor-elect to propose, for the consideration of the Legislature in the soon-to-be-convened special session, budget-balancing measures to reduce to the greatest extent possible the amount of deficit borrowing included in the current year budget package. A deficit bond reduction plan should be enacted even if the currently proposed bonds clear all remaining legal challenges. This plan should be in place before the State issues any such bonds and before any such bonds are put before the voters for approval. In no event should the State expand – in this current fiscal year or in future fiscal years – the amount of deficit borrowing to balance the budget.

There have been indications recently that the incoming administration might seek voter approval of the deficit financings utilized to balance the budget – such as the proposed $11 billion in Fiscal Recovery Bonds – to resolve legal questions regarding these borrowings. While going to the voters may resolve legal uncertainties, it will not address the fundamental fiscal issues presented by such significant deficit financings. Before asking voters to approve a measure that will require future generations to pay for today's debt, good fiscal practice and common sense dictate that every effort be made to reduce, by as much as possible, the amount of deficit bonds used to balance this year's budget. The anticipated special legislative session presents an extraordinary opportunity to make the progress toward achieving a structurally balanced budget that was not accomplished with the enactment of the 2003-04 budget.

The nearly $18 billion in borrowings – internal loans and bonds – used to balance the 2003-04 budget and close the fiscal year 2002-03 operating deficit constitutes the largest borrowing package of its kind in state history, and seriously threatens our ability to restore the fiscal integrity so vital to our State's sustained economic success in the 21st Century.

These borrowings equate to approximately 24 percent of the $71.1 billion General Fund budget for 2003-04, and represent nearly 44 percent of the "solutions" enacted this year to close the approximately $39 billion, two-year budget gap. As a public entity, California is now second only to the federal government in terms of the amount that it is borrowing to balance its budget.

From the time that deficit borrowing was first proposed by the Republican legislative leadership during the deliberations on the State's 2003-04 budget, I consistently expressed my view that relying on massive borrowing to balance the budget – in lieu of working to achieve structural balance – was neither feasible nor fiscally prudent. Clearly, the path chosen – to authorize an unprecedented amount of bonds to close the budget deficit – is not one that I view as fiscally responsible.

The decision to engage in significant deficit borrowing has serious negative ramifications. Among the most substantial are the following:

- These borrowings come with great costs to California taxpayers. This office estimates that the cumulative costs of these borrowings add up to $1,076 per California household. Unfortunately, rather than borrowing to invest in our future – in schools, parks, and transportation – and to create jobs, the State is running up the equivalent of a huge credit card debt.

- When the proposed issuance of the approximately $11 billion in Fiscal Recovery Bonds is considered as part of the State's total bonded indebtedness, the resulting $2.1 billion in annual debt service would increase the State's overall ratio of debt service to General Fund revenues by over 2.9 percent, from its current moderate level of approximately 3.6 percent projected for fiscal year 2003-04, to nearly 6.5 percent – well beyond the 6.0 percent that is widely considered within the bounds of fiscal prudence. It should be noted that this ratio does not even include the normal general obligation and lease revenue bonds anticipated to be issued in fiscal year 2004-05 and beyond.

- If all the bonds in the 2003-04 budget package ultimately were to be issued this year, the total of over $14 billion would be more than double the highest amount of general obligation and lease revenue bonds ever issued by the State in a single year ($6.6 billion in fiscal year 2002-03) to invest in schools, water, transportation and other capital projects vital to California's future economic success. In fiscal year 2003-04, the State is scheduled to issue approximately $5.5 billion in general obligation and lease revenue bonds. The combined total of these bonds and the $14 billion in deficit borrowings means California will be trying to issue an unprecedented $19.5 billion in state bonds in fiscal year 2003-04, severely testing the market capacity for our bonds. This massive deficit borrowing also will reduce funding in future years for critical services and programs such as education and public safety, while also threatening to crowd out cost-effective borrowing for infrastructure projects of lasting public and economic value.

- All three credit rating agencies have cited the continued structural budget imbalance as the most significant negative factor currently contributing to California's position as the State with the lowest credit ratings in the nation. Continued deficit borrowing does nothing to correct this imbalance and to put the State back on the path to restoring its credit ratings. Indeed, reliance on these bonds puts in jeopardy the State's delicate fiscal balance and cash position for fiscal year 2003-04 and prolongs fiscal uncertainty, which has a negative impact on the State's ability to effectively maintain access to the capital markets for both its cash management needs and long-term infrastructure investments. Unless we reverse our course, California could find itself in a situation akin to that of New York City in the 1970s when financial institutions and investors retreated to the sidelines, refusing to extend credit and financing to the City.

It is clear that real solutions are needed to restore California's reputation and credibility in the national and global economy. In order to re-establish our State's international reputation as the dynamic, sixth-largest economy in the world, comprehensive structural resolution to the State's fiscal crisis must be achieved.

The underlying foundation of California's economy, with a gross state product of $1.4 trillion, remains as strong or stronger than that of the rest of the country at a time when the struggling national economy hopefully is moving toward recovery. A serious threat to our future economic strength is the political crisis that has postponed the structural balancing of our State's budget and has kept California from facing its fiscal future. Political paralysis must not be allowed to exacerbate the State's financial and economic challenges.

Looking forward, each day that we do not address the structural imbalance of our budget is another day that we are not facing our future. The time has come now to suture up our fiscal wounds, move forward and make the tough choices necessary to put this fiscal crisis behind us so we can turn our attention to investing in the future – educating our children, rebuilding our infrastructure and strengthening our economy.

As I indicated in a letter to the Governor and legislative leadership earlier this year (May 20, 2003), once a structurally balanced budget is in place, I look forward to offering an opinion regarding our State's capacity to issue additional general obligation bonds for the purpose of making the capital investments necessary for sustained economic progress.

In conclusion, I again urge you to take the following actions:

- Reduce, to the greatest extent possible, the amount of deficit bonds that are utilized to balance this year's budget;
- Achieve structural balance in the 2004-05 budget, without deficit borrowing, to stabilize and improve our State's fiscal health and credit ratings; and
- Embark upon an investment strategy for our State that will sustain the quality of life and long-term economic prosperity for all Californians.

Thank you for your consideration of this report and the recommendations contained herein.

Sincerely,

Phil Angelides
State Treasurer

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PREFACE

The Treasurer must submit an annual debt affordability report to the Governor and Legislature in accordance with the requirements of the Government Code. The following list identifies the information to be included in the report:

- A listing of authorized but unissued debt that the Treasurer intends to sell during the current year and the budget year and the projected increase in debt service as a result of those sales.
- A description of the market for state bonds.
- An analysis of the ratings of state bonds.
- A listing of outstanding debt supported by the General Fund and a schedule of debt service requirements for this debt.
- A listing of authorized but unissued debt that would be supported by the General Fund.
- Identification of pertinent debt ratios, such as debt service to General Fund revenues, debt to personal income, debt to estimated full-value of property, and debt per capita.
- A comparison of these debt ratios with the comparable debt ratios for the 10 most populous states.

The rating agencies and the investor community evaluate the State's debt position based on "net tax-supported bonds." Net tax-supported bonds are those that must be repaid by the General Fund. Net tax-supported bonds *exclude*: 1) commercial paper and short-term obligations, such as revenue anticipation notes and warrants; 2) "self-supporting" state bonds, which are repaid from specific revenues outside the General Fund; and 3) bonds of federal, state and local governments and their agencies that are not obligations of the State's General Fund. It also excludes all types of "conduit" bonds, such as those issued by financing authorities on behalf of other governmental or private entities whose obligations secure the bonds.

This report frequently uses the words "bonds" and "debt" interchangeably, even when the underlying obligation behind the bonds does not constitute debt under California's constitution. This conforms with market convention for the general use of the term "debt" and "debt service" as applied to a broad variety of instruments in the municipal market, regardless of their precise legal status.

CHAPTER A: POLICY STATEMENT

INTRODUCTION

State law requires the State Treasurer to report annually on certain factors regarding the State of California's "debt affordability" – including the market for state bonds, the State's credit ratings, its General Fund supported bonds, and various ratios designed to measure the financial impact of the State's outstanding bonds.

Normally, this office also has used the opportunity of this annual report to provide long-range estimates of the State's capacity to issue new bonds to finance strategic public investments in infrastructure – such as schools, transportation and water projects – that support sustainable economic progress in California. Regrettably, the current fiscal condition of the State precludes any meaningful estimates of such future capacity. As stated in the May 20, 2003 letter from this office to the Governor and the Legislature calling for a balanced budget plan before approval of any new bonding legislation, this office can perform such estimates of long-term bonding capacity only in the context of a long-term, structurally balanced budget plan. Unfortunately, the deep divisions and political turmoil over the course of the year contributed to the inability of the State to enact such structural reforms.

Therefore, rather than presenting the foundation for a discussion about how best to utilize our future capacity for financing much-needed infrastructure, this report must deliver a more sobering message about the negative ramifications of the State's recent pattern of using valuable bonding capacity to close budget deficits.

The enacted 2003-04 State Budget relied on an unprecedented level of nearly $18 billion in internal loans and bonds to balance the current year and plug past year deficits. This included, among others, $2.6 billion of internal borrowing and fund shifts from other state funds and $14.6 billion in net proceeds to the State from over $15 billion in bonds assumed to be issued between fall 2003 and spring 2004 to cover budget deficits.

From the time that deficit borrowing was first proposed by the Republican legislative leadership during the deliberations on the State's 2003-04 budget, the State Treasurer consistently expressed the view that relying on massive borrowing – in lieu of working to achieve structural balance –was neither feasible nor fiscally prudent. It is worth noting that in January 2003 the Governor's Budget contained very modest external borrowing – $2 billion in Pension Obligation Bonds but no Fiscal Recovery Bonds (or "Deficit Bonds") – to close the projected 2002-03 budget deficit. Subsequently, the idea of issuing bonds to close the State's accumulated budget deficit gained bi-partisan support and a proposal for these bonds was included in the May Revision.

Based on the information in this report, the State Treasurer's Office concludes that the State has authorized bonds for the purpose of closing its budget gap at a level beyond what is fiscally prudent. Accordingly, this office urges action to reduce, to the greatest extent possible, the amount of deficit borrowing included in the current year budget package through the enactment of alternative budget balancing measures. A deficit bond reduction plan should be enacted even if the currently proposed bonds clear all remaining legal challenges. This plan should be in place before the State issues any such bonds and before any such bonds are put before the voters for approval. In no event should the State expand – in this current fiscal year or in future fiscal years – the amount of deficit borrowing to balance the budget.

For the many reasons set forth below, massive borrowing for the purpose of financing deficits should not be pursued and cannot be sustained.

- Current Bonding Plans are Unprecedented and Prolong Fiscal Uncertainty
- Deterioration of the State's Credit Ratings is Driven by Lack of Structural Balance
- California Taxpayers are Paying the Price of Deferring Key Fiscal Decisions
- Bonds Issued for Closing Deficits "Crowd Out" Other Critical Investments
- Real Solutions are Needed to Restore California's Reputation and Credibility in the National and Global Economy
- Failure to Confront Past Problems Distracts from Focusing on the Future
- Political Paralysis Must Not be Allowed to Create Financial and Economic Crises

Current Bonding Plans are Unprecedented and Prolong Fiscal Uncertainty

The scale of the borrowing being used to balance the budget is unprecedented. As shown in Figure A-1, these internal and external borrowings represent nearly 44 percent of the "solutions" enacted to close the two-year, approximately $39 billion budget gap. If compared to the total $71.1 billion of expenditures in the State's General Fund budget for fiscal year 2003-04, the proceeds of these various borrowings would reach over 24 percent of the total budget (although nearly $10.7 billion of these proceeds, or 15 percent of the total budget, is being applied to make up the 2002-03 budget deficit, not for 2003-04 expenditures).

Figure A-1

2003-04 State of California General Fund Budget Package

	Amounts [1] ($ Millions)	Percent of Budget Gap Solutions [2]	Percent of Total Spending [3]
Budget Gap / Total Spending	**n.a.**	**$39,415**	**$71,100**
Internal Borrowing	$445	1.13%	0.63%
Fund Shifts	$2,155	5.47%	3.03%
Total Internal Borrowing and Fund Shifts	**$2,600**	**6.60%**	**3.66%**
Tobacco Securitization Bonds	$2,000	5.07%	2.81%
Pension Obligation Bonds	$1,900	4.82%	2.67%
Fiscal Recovery Bonds	$10,700	27.15%	15.05%
Total External Borrowing	**$14,600**	**37.04%**	**20.53%**
Total – All Borrowing and Fund Shifts	**$17,200**	**43.64%**	**24.19%**

[1] Amounts represent approximate net proceeds to the General Fund, at the time of budget enactment. In the case of external borrowing, the par amount of bonds issued will be higher, to account for costs of issuance, reserves and related expenses. The estimated total par amount of bonds for the $14.6 billion of net proceeds shown above is approximately $15.2 billion. This would put the total amount of borrowing and fund shifts at $17.8 billion, as estimated at the time of budget enactment. Subsequent events have and will affect the actual par amount of bonds issued.

[2] Budget gap solutions are those identified to close the two-year budget gap and increase reserves; $39.415 billion figure was calculated by the Department of Finance as of enactment of the fiscal year 2003-04 budget.

[3] Total spending is utilized for comparison, rather than total revenues, to avoid any distortion created by funding of reserves; $71.1 billion figure was calculated by the Department of Finance as of enactment of the fiscal year 2003-04 budget.

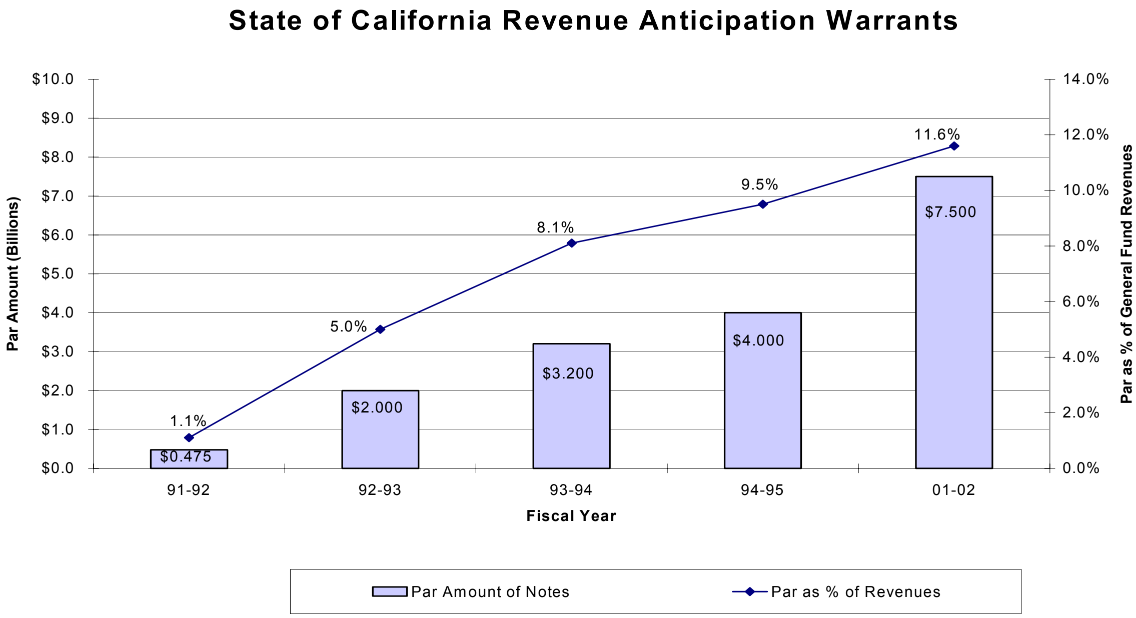
Of particular concern is the impact that this unprecedented level of deficit borrowing will have on the State's overall debt burden. The State has enjoyed the credit strength of moderate debt levels for its size. However, when the proposed issuance of the approximately $11 billion in Fiscal Recovery Bonds is considered as part of the State's total bonded indebtedness, the resulting $2.1 billion in annual debt service would increase the State's overall ratio of debt service to General Fund revenues by over 2.9 percent, from its current moderate level of approximately 3.6 percent projected for fiscal year 2003-04, to nearly 6.5 percent – well beyond the 6.0 percent that is widely considered within the bounds of fiscal prudence. It should be noted that this ratio does not even include the normal general obligation and lease revenue bonds anticipated to be issued in fiscal year 2004-05 and beyond.

The enacted package of deficit borrowing for the current fiscal year dramatically eclipses the State's past use of such tools, both as to magnitude and term to maturity. Certainly, past fiscal stress has caused California to borrow across multiple fiscal years on several occasions, using Revenue Anticipation Warrants (RAWs). These transactions primarily provided time for budget solutions, including new revenues, to take effect. RAWs had been used six times between fiscal year 1982-83 and fiscal year 2001-02, as shown in Figure A-2 and Figure A-3, below.

Figure A-2

State of California Revenue Anticipation Warrants				
Fiscal Year	**Par Amount ($Billions)**	**Term**	**General Fund Revenues ($ Billions)**	**Par as % of General Fund Revenues**
1982-83	$0.200 $0.200	3 months 7 months	$20.49	1.95%
1991-92	$0.475	1 month	$41.34	1.10%
1992-93	$2.00	6 months	$40.25	5.00%
1993-94	$1.20 $2.00	10 months 5 months	$39.60	8.10%
1994-95	$4.00	9 months	$42.22	9.50%
2001-02	$1.50 $3.00 $3.00	4 months 5 months 7 months	$64.58	11.60%

Figure A-3



The only other governmental agency in this country borrowing more than California to finance its budget deficits is the federal government, as the sluggish national economy, President Bush's tax relief plan, and the continuing war effort are expected to push the federal budget from balanced (in 1999 under then-President Clinton) to a deficit projected by the Congressional Budget Office at over $400 billion in each of fiscal year 2003 and fiscal year 2004. California can take no comfort in this comparison, however, because – unlike the federal government – California cannot print its own money.

As the State Treasurer's Office has indicated previously, including in past briefings to the media and the public, it will be a formidable task to implement the bond issues authorized in the 2003-04 budget package. A risk remains – due to the existence of legal challenges still pending – that not all of the bonds contemplated by the budget can be issued, at least in the period remaining in the fiscal year. The continued reliance on these bonds, which deferred implementation of long-term solutions for structural balance, puts at risk the State's delicate fiscal balance and cash position for fiscal year 2003-04. This prolonged fiscal uncertainty has a negative impact on the ability of the State to plan for the future and to maintain cost-effective access to the capital markets for both its cash management needs and long-term infrastructure investments.

DETERIORATION OF THE STATE'S CREDIT RATINGS IS DRIVEN BY LACK OF STRUCTURAL BALANCE

Since April 2001, the State has experienced several rating downgrades from the three municipal bond rating agencies. These downgrades were the result of fiscal challenges driven as much by the divisiveness and political turmoil that deferred decisions as by the underlying economic downturn and resulting revenue losses. As shown in the table below, these fiscal and political challenges brought California's general obligation bond ratings down from "double-A" in September 2000 – our highest ratings in over 10 years – to the current ratings, the lowest of any state currently rated.

Figure A-4

State of California
Recent General Obligation Bond Ratings *

Timing	Moody's	Standard & Poor's	Fitch
September 2000	Aa2	AA	AA
April - May 2001	***Aa3***	***A+***	AA
November 2001	***A1***	A+	AA
December 2002	A1	***A***	***A***
February 2003	***A2***	A	A
July 2003	A2	***BBB***	A
August 2003 - present	***A3***	BBB	A

** Ratings in bold italics indicate a change from the respective firm's rating during the previous period shown.*

All three rating agencies have cited the continued structural budget gap as one of the most significant negative factors affecting current ratings and, where applicable, the future outlook for these ratings. Both Moody's and Fitch retain a negative outlook on the State's ratings, although Moody's has removed the rating from its "Watch List" recently. The State's ratings can be restored only if there is real progress toward structural balance.

The State's reliance on access to the capital markets to meet its cash flow needs also has been of repeated concern, with the risk of restricted market access cited as a potential source of cash flow stress and illiquidity that could further diminish the State's creditworthiness. The risk of restricted market access is real – and costly. One need only look to the experience of New

York City in the 1970s to understand the ramifications if financial institutions and investors withdraw to the sidelines.

Already, California's lower ratings have required the State to obtain credit enhancement – the equivalent of co-signers on our loans – in order to issue the $3 billion of 2003 Revenue Anticipation Notes (RANs) for normal cash flow purposes. The letters of credit obtained from commercial banks will ensure potential investors in the RANs that they will receive timely repayment in June 2004 even if the State's fiscal condition worsens unexpectedly. However, such assurances have come at a price to the State. Bank fees on enhanced RANs sold to investors, together with the premium on interest rates for RANs held directly by banks, were approximately $30 million, in addition to normal market-rate interest costs.

Similar arrangements were required when the State Controller issued approximately $11 billion of Revenue Anticipation Warrants (RAWs) in June 2003 to provide financial liquidity before the 2003-04 State Budget was enacted. The subsequent downgrade of the State's long-term rating to BBB by Standard & Poor's in July triggered a cost increase of over $33 million on the enhancement for the RAWs, on top of $84 million in fees already paid at closing of the RAWs.

If California is to meet its promises and expectations to repay these $14 billion of RAWs and RANs on a timely basis in June 2004, the Governor and the Legislature must act responsibly in the months ahead to maintain the delicate balance of the 2003-04 State Budget and be prepared to enact a truly balanced 2004-05 State Budget. They also must take any necessary steps to ensure the State's cash flow needs are met, to prevent a liquidity crisis and protect the State's unbroken track record of meeting its obligations to its investors.

California cannot risk further eroding its already tenuous standing with the markets by neglecting the responsible path in ensuring the fiscal integrity of both the current year budget and the upcoming 2004-05 budget. At some point the risk goes beyond higher costs and to the very feasibility of accessing the market at any price. The State must not engage in any high stakes games of "chicken" with the capital markets, as the cost of failed market access is too high and the duration of the penalty too long. California is a growing state with a continued need for market access to finance the public investments that will sustain our economy and our society for years to come. We must not risk our future with short-sighted decisions today.

California Taxpayers are Paying the Price of Deferring Key Fiscal Decisions

There are both short-term and long-term costs to California taxpayers from the erosion of credit ratings and market confidence resulting from the State's continued structural imbalance. These costs reduce the available funds for health care, classrooms, textbooks, public safety, and other vital services. Among the short-term and long-term costs as a direct result of the State's current fiscal and political challenges are:

- An approximate total of $147 million in combined fees for credit support on 2003 RANs and RAWs;
- An estimated $500 million to $1 billion of increased interest costs over the 30-year lives of the State's upcoming general obligation bonds, assuming that higher interest rates associated with the rating downgrades were to exist during the issuance of the $23.25 billion in general obligation bonds already authorized by the voters but not yet issued as of July 1, 2003; and
- An estimated $2.7 billion in combined annual debt service – or $18.8 billion through maturity – for all the bonds included in the 2003-04 budget package to close the past and projected budget deficits. The cumulative debt service costs of these deficit borrowings (including the recently sold Tobacco Securitization Bonds) add up to more than $1,600 per California household (excluding the Tobacco Securitization Bonds, the costs are $1,076 per household).

The use of approximately $14 billion in bonds to cover past and projected budget deficits has perhaps the most direct and long-lasting impact on taxpayers. Although only the Pension Obligation Bonds have the State's General Fund as their pledged source of repayment, the total costs of these bonds ultimately are being borne by California taxpayers because the revenues used to repay the bonds either derive from taxpayers or, in the case of tobacco settlement revenues, could have been used for other programs that are supported by taxpayers. In the case of the Fiscal Recovery Bonds, the State has agreed to provide a "back-fill" to local governments from the General Fund to offset the loss of certain local sales tax revenues, which were reduced when recent legislation established a new state sales tax in connection with authorizing the Fiscal Recovery Bonds.

The expected total debt service cost for each of the bond issues enacted in connection with the 2003-04 State Budget package appears in Figure A-5 below.

Figure A-5

Summary of 2003-04 Bonds for Deficit Borrowing
($ Millions)

Transaction Description	Par Amount [1]	Term to Maturity [1, 2]	Annual Debt Service [1, 3]	Debt Service to Maturity [1, 4]	Debt Service Cost per Household [5]
Tobacco Securitization Bonds	$2,300	19-40 years	$160	$6,410	$557
Pension Obligation Bonds [6]	808	5 years	202	926	81
Fiscal Recovery Bonds	10,900	5-8 years	2,300	11,443	995
TOTAL [7]	**$14,008**	**n.a.**	**$2,662**	**$18,836**	**$1,633**

[1] Preliminary estimate only, subject to change. Par amounts are as reflected in the enacted 2003-04 State Budget, except for Pension Obligation Bonds. It is likely that the Pension Obligation Bonds will be reduced by nearly $1.2 billion, due to a delay in completion of validation proceedings, which may not be resolved until after the January 2004 payment to PERS.

[2] Term to Maturity ranges depend on levels of revenues actually received, which may permit prepayment prior to final nominal maturity.

[3] Annual debt service cost estimates based on current market conditions. Actual costs will differ based on pricing results. Costs include payments from all applicable sources, not just the State's General Fund.

[4] Estimates based on annual cost for full term to nominal maturity, except Fiscal Recovery Bonds, which are based on possible 5-year average life with anticipated prepayments from available sales tax revenues. If maturity on these bonds extends to a full eight years, the estimated cost could exceed $12.25 billion. Actual costs will differ based on pricing results.

[5] Total number of California households reported at 11.5 million by the 2000 U.S. Census.

[6] Original par amount of approximately $2 billion will be reduced by nearly $1.2 billion if bonds are not sold prior to January 2004 payment to PERS.

[7] Totals may not reconcile due to rounding.

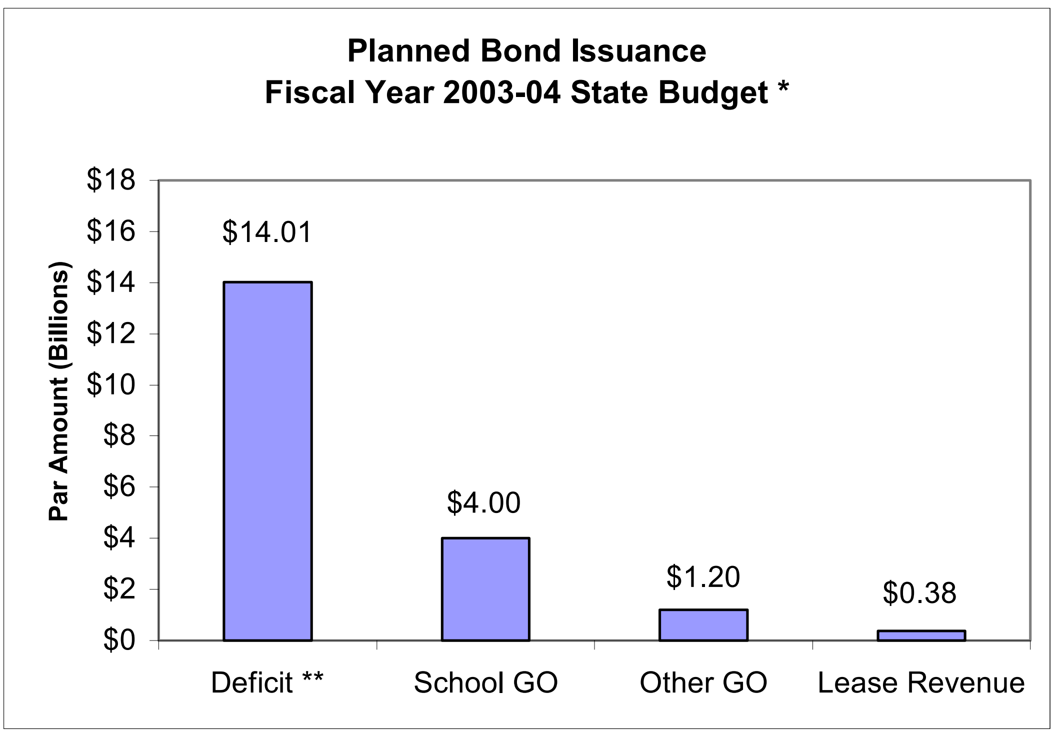
BONDS ISSUED FOR CLOSING DEFICITS "CROWD OUT" OTHER CRITICAL INVESTMENTS

The use of bonds to close past or projected budget deficits serves to limit the State's capacity to fund other critical needs in several ways. The first impact is directly on state and local programs and operations. Because the revenues used to repay the above-referenced bonds are not available for other state and local programs, the effect of issuing these bonds for closing budget deficits is that programs and services for other critical needs – such as schools, health care, and public safety – must be reduced, absent any new governmental revenues, during the term of the bonds.

Another impact is on the debt burden and resulting future bonding capacity of the State. Currently, the State's debt levels are viewed as moderate in proportion to its population, revenues, and income levels. However, as mentioned previously, the use of valuable state bonding capacity to close budget deficits increases these debt burden ratios, which has a limiting effect on the ability of the State to issue bonds for its normal long-term capital projects (such as schools, transportation, water quality, etc.). These are projects that are vital to the State's long-term economic health.

The unprecedented volume of bonds slated for issuance during the 2003-04 fiscal year in order to close past and projected budget deficits is more than double the volume of bonds slated for issuance during the same period to fund critical infrastructure projects, as shown in Figure A-6.

Figure A-6

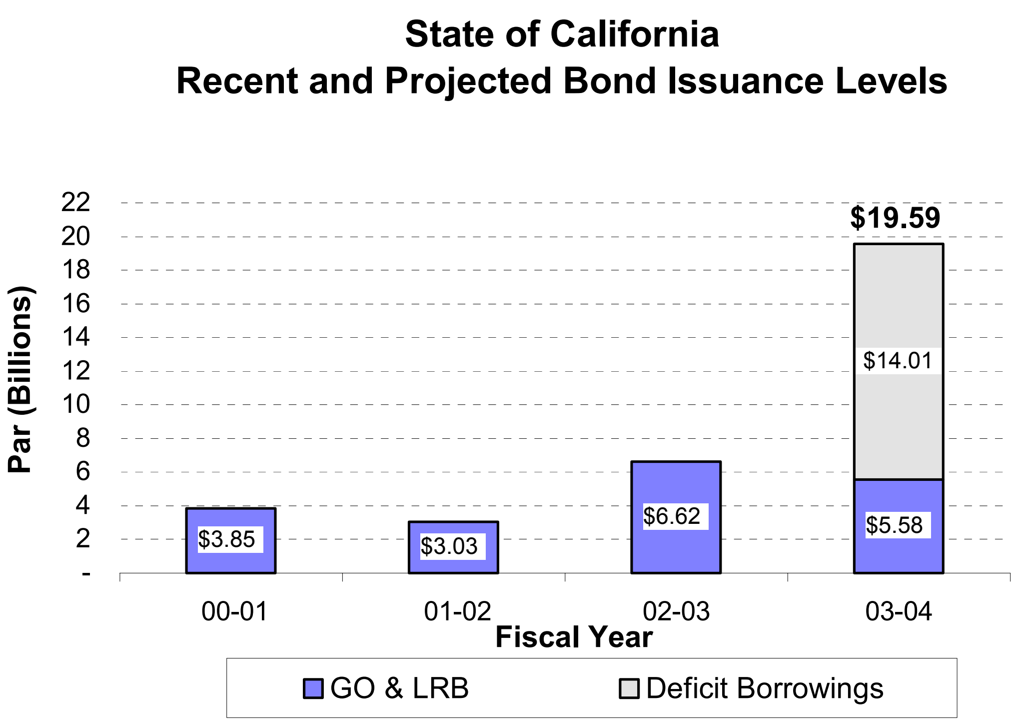


* As enacted, except for anticipated reduction in Pension Obligation Bonds by nearly $1.2 billion due to continuing delays in completion of validation proceedings.
** Includes Tobacco Securitization Bonds, Pension Obligation Bonds, and Fiscal Recovery Bonds.

Furthermore, the market's ability to absorb the projected cumulative volume of state bonds during such a short period remains untested. The State's successful experience with issuing bonds of historical proportion, the $11.3 billion Department of Water Resources Power Supply Revenue Bonds, does not provide a direct comparison because the revenue source for repayment of those bonds – a pledge of sufficient revenues from more than 10 million electric power customers – was entirely distinct from the state revenues behind the current package of bonds enacted to close the State's budget deficits.

If all the bonds in the 2003-04 budget package ultimately were to be issued this fiscal year, the total of over $14 billion would be more than double the highest amount of general obligation and lease revenue bonds ever issued by the State in a single year ($6.6 billion in fiscal year 2002-03) to invest in schools, water, transportation and other capital projects vital to California's future economic success. In fiscal year 2003-04, the State is scheduled to issue approximately $5.5 billion in general obligation and lease revenue bonds. The combined total of these bonds and the $14 billion in deficit borrowings means California will be trying to issue an unprecedented $19.5 billion in state bonds in fiscal year 2003-04, severely testing the market capacity for our bonds. This massive deficit borrowing also will reduce funding in future years for critical services and programs such as education and public safety, while also threatening to crowd out cost-effective borrowing for infrastructure projects of lasting public and economic value.

Figure A-7



** Par amounts above are exclusive of refunding bonds.*

If the supply pressure created by these proposed deficit bonds also drives up the cost of borrowing on the State's traditional general obligation bonds and lease revenue bonds, it will reduce the capacity to issue these traditional bonds in the future due to the increase in the State's debt burden levels that would result.

Supply pressures also limit the State's flexibility in structuring its financing programs to achieve the most cost-effective rates. For instance, the State already faces capacity constraints on its access to letters of credit due to the level of uncertainty about its future fiscal condition. This has required the State to curtail somewhat its commercial paper and variable rate general obligation bond programs in order to structure the 2003 Revenue Anticipation Notes with the level of credit enhancement necessary to bring $3 billion to market.

The potential for continued fiscal uncertainty, or even the need for credit enhancement for at least a portion of the deficit bonds, is likely to continue to constrain the State's ability to use these credit facilities to take advantage of the lowest available cost of funds for the general obligation bonds scheduled for issuance over the next year. If these constraints cause the State's average debt service costs to rise, future capacity for these bonds will be further limited due to the increase in the State's debt burden levels that would result.

REAL SOLUTIONS ARE NEEDED TO RESTORE CALIFORNIA'S REPUTATION AND CREDIBILITY IN THE NATIONAL AND GLOBAL ECONOMY

The pattern of deferring the hard choices already has harmed California's reputation – on Wall Street and Main Street – as an inability to make key fiscal decisions has eroded confidence in our creditworthiness and has spilled over to create a negative perception about the State as a whole, both at home and abroad.

Even those who enacted the tenuously balanced 2003-04 State Budget admitted its weaknesses. It is critical that we rectify this year's budget, if possible, and prevent similar weaknesses in future budgets if California is to begin to restore its reputation and the confidence lost during our period of deepest fiscal challenges yet. California would be well served to reduce the amount of deficit borrowing being used in connection with the enacted 2003-04 budget by identifying the budget balancing measures that would reduce the need for these bonds. And, as California looks to the future, it is vital that the projected budget gap for fiscal year 2004-05 be solved with long-term, structural solutions, not further borrowing.

California's leaders need to acknowledge that all the "easy fixes" and "one-time" measures have not only been used, but in some cases are creating out-year challenges that must be squarely addressed in the development of the fiscal year 2004-05 State Budget.

As noted in recent correspondence from this office to the Governor-elect, the State needs to be in a position to move decisively with alternative plans in the event any of the components of the 2003-04 State Budget cannot be achieved as planned, so that contingency solutions can be put in place promptly, and confidence in the State's ability to manage its fiscal house can be restored. This report calls for California to go a step further, and to take action to reduce the use of deficit borrowing in the current fiscal year even if the planned deficit bonds clear all remaining legal challenges.

Failure to Confront Past Problems Distracts from Focusing on the Future

Another important downside of using bonds to close budget deficits is the negative impact such strategies have on the State's ability to focus on the solutions needed to achieve its long-term goals.

The tremendous time and effort required to implement these bonding programs is only one of the ways in which valuable state resources are directed to solving the State's past problems instead of focusing on the future. Every day that we defer our attention from the important issues confronting our State's economic and fiscal future is a day that we are not bringing about the investments that count – those that can contribute to our economic vitality for many years to come. Deferring the necessary fiscal decisions prevents us from reaching much-needed public consensus on the direction of our State – just when we need it most.

Political Paralysis Must Not be Allowed to Create Financial and Economic Crises

Some have advanced a mistaken impression that California's economy is in a shambles. The facts demonstrate otherwise. California remains the sixth largest economy in the world, with an underlying economy that remains as strong or stronger than that of the rest of the nation at a time when the nation's economy continues to struggle, hopefully moving toward recovery.

California's trends for jobs and unemployment throughout the national recession were approximately the same as the rest of the nation. Recent California trends in industry employment have been even better than the rest of the nation. California's economy today is much stronger than in the recession of the early 1990s, when the state reported a peak unemployment rate of 9.7 percent amid a much less diversified economy. In addition, our gross state product has expanded in real terms over the past three years, albeit at a slower pace, which contrasts with real declines in the earlier recession.

The national economic downturn clearly has had a significant impact on the State's finances. However, California's financial crisis has been exacerbated by the political divisiveness among decision-makers and the resulting logjams such divisiveness has created. California's leadership must overcome political gridlock – to restore the State's fiscal condition to health and to ensure the State's financial challenges do not spill over in a way that damages California's economic recovery.

This requires elected representatives to take responsibility for representing all of California, without drawing artificial limits that prevent rational, fair discussion of the prudent options at hand. A balanced budget will require a balanced combination of solutions, and the sooner we begin the task in earnest, the sooner we will finish, and the stronger the outcome will be.

CONCLUSION

As California hopefully moves toward economic recovery, it is up to the State's elected leadership to take the actions necessary to turn the corner on its fiscal recovery, as well. To do so will require discipline and cooperation – both in amounts far beyond that which has been exhibited in recent years. No one can responsibly refuse to put on the table for a full and fair hearing before the public all fiscally prudent options that move toward a structurally balanced budget. These options must include reducing the amount of bonds used for financing budget deficits, below the level already authorized with the enacted 2003-04 State budget. The one option that should not be considered is to repeat the failures of the past by using more bonds to close projected budget deficits. To do so would undermine our State's fiscal health and economic recovery.

The State of California
2003 Debt Affordability Report

CHAPTER - B

STATUTORILY REQUIRED PROVISIONS

PHILIP ANGELIDES
CALIFORNIA STATE TREASURER

THE MARKET FOR STATE BONDS

Municipal Bond Market

The United States' municipal bond market has expanded considerably over the last five years from $148.4 billion of new money issuance in 1998 to $221.2 billion of new money issuance in 2002, an increase of 49.1 percent. Total new money issuance over this period was over $850.0 billion. Despite this increased supply of bonds, the demand for municipal bonds has also increased over this period, keeping borrowing costs low in relation to other investments. The State of California's tax supported bonds are a subset of this market.

Investors in this overall market include insurance companies, mutual funds, hedge and investment funds, investment banks, trust departments, corporations, individual investors, and money market funds. Each of these buying groups exhibit differing preferences for the structure and maturities of the bonds they purchase. As one of the largest issuers of municipal bonds in the country, the State is able to draw significant attention from all of these buying groups.

The borrowing cost that issuers of municipal bonds must pay is a factor of overall market for the municipal bonds and the investment community's view of, and demand for, each issuer's credit. Investors require rates of return on their investments consistent with their perceptions of the likelihood of an issuer's ability and willingness to repay its obligations as compared to the likelihood of full repayment by other possible issuers and investments. The investment community historically has viewed California's bonds as high quality investments due to the State's large economy, taxing authority, and solid bond payment history.

Traditionally, the large numbers of investors residing in California and the State's progressive income tax system have created increased demand for the State's General Fund backed bonds. Recently, however, investor demand for California debt has experienced weakness due to the State's credit deterioration and investor concerns over the magnitude of the State's budget shortfall. The State's borrowing costs have risen accordingly.

Cost of California's Fixed Rate Debt

Between late January 2000 and late September 2002 the State's cost of borrowing decreased to historically low levels. During this period, the State's absolute 20-year borrowing cost fell from a five-year high of 6.00 percent on January 20, 2000 to a low of 4.47 percent on September 24, 2002, a decrease of 1.53 percentage points. During this period the State's borrowing costs relative to the national 20-year AAA-rated average varied between 0.13 percent lower than the average to 0.26 percent higher than the average. As of July 1, 2003 the State's absolute borrowing costs were 4.95 percent, 0.65 percentage points above the 20-year AAA-rated average.

Since Fall 2002, the State's cost of borrowing increased as the market's perception of the State's deteriorating credit began to put pressure on the demand for the State's bonds. The State's borrowing costs relative to the AAA-rated index rose from 0.03 percent above the AAA-rated average on September 24, 2002 to an all-time high of 0.74 percent above the average on July 25, 2003. In addition, the State's absolute borrowing costs increased from their low of 4.47 percent in late September 2002 to a near-term high of 5.56 percent as of July 31, 2003, an increase of 1.09 percentage points. This increase resulted from both a general increase in market rates and the State's deteriorating credit.

THE STATE'S CREDIT RATINGS

The State's General Obligation Bond Credit Ratings

In the past year, each of the three major credit rating agencies downgraded its rating of the State's creditworthiness. Fitch Ratings, Moody's Investors Service, and Standard & Poor's, respectively, rate the State as A (CreditWatch, negative[1]), A3 (negative outlook[1]), and BBB (stable outlook). The downward movement of the State's credit ratings in part reflects trends in the State's economy, but more so the political logjams and resulting uncertainty surrounding the fiscal condition of the State's General Fund. Figure B-1 provides a detailed description of the rating agencies' opinions of the State's credit strengths and credit weaknesses and risks.

Figure B-1

State of California General Obligation Credit Ratings and Agency Commentary

	Fitch Ratings	**Moody's Investors Service**	**Standard & Poor's**
As of July 1, 2002	AA	A1	A+
As of July 1, 2003	A	A2	A
Current (As of Sept. 30, 2003)	A (CreditWatch, Negative[1])	A3 (Negative outlook[1])	BBB (Stable outlook)
Ratings Strengths	• Fundamental strength of State's economy • Moderate burden of long-term debt	• State's broad-based economy • Moderate burden of long-term debt	• State's very deep and diverse economy • State's large, diverse, and growing population • A rising, but still moderately low, debt burden • A progressive income tax structure
Ratings Weaknesses And Risks	• Recessionary conditions • Unprecedented drop in personal income tax receipts as a result of decline in capital gains, bonuses, options, etc. • Structural budget gap • State's reliance on financial markets • Political instability of recall effort and budget process • Potential for further deterioration of State's financial position	• State's volatile tax revenue performance • Significant near-term budgetary and cash flows stress • State budget that will not be structurally balanced until after fiscal year 2003-04 • Politically polarized nature of legislative debate and recall effort • State's ability to access the capital markets • Assumption of $10.7 billion deficit bond	• Lack of meaningful structural budget reform from an enacted budget • Recall process and political uncertainty • State's dependence on accessing the private debt markets to maintain liquidity • Structural impediments, such as Proposition 98's mandatory funding requirements for schools, and a two-thirds legislative vote requirement for state budget passage

[1] Each of the three rating agencies employs a system for identifying the probability of a rating change and the likely direction of such a change. Designations such as "Positive" indicate a potential upgrade, "Negative" indicate a potential downgrade, and "Evolving" or "Developing" indicate ratings that may be raised, lowered or maintained.

GENERAL FUND DEBT

Outstanding Bonds and Authorized But Unissued Bonds

As of July 1, 2003, the State had a total of $27.607 billion in outstanding voter authorized general obligation bonds and a total of $23.254 billion in such authorized but unissued bonds. In addition, the State had $6.704 billion in outstanding legislatively authorized General Fund supported lease revenue bonds and $4.072 billion in such authorized but unissued bonds. A detailed listing of these outstanding bonds and authorized but unissued bonds, as of July 1, 2003, may be found in Appendix 1. A schedule of the State's debt service requirements for outstanding bonds, as of July 1, 2003, may be found in Appendix 2.

Intended Issuances of Net Tax-Supported Bonds

Intended issuances of general fund net tax-supported bonds for the next two fiscal years are shown in Figure 2. Net tax-supported bonds are those that must be repaid by the General Fund. Net tax-supported bonds *exclude*: 1) commercial paper and short-term obligations, such as revenue anticipation notes and warrants; 2) "self-supporting" state bonds, which are repaid from specific revenues outside the General Fund; and 3) bonds of federal, state and local governments and their agencies that are not obligations of the State's General Fund. It also excludes all types of "conduit" bonds, such as those issued by financing authorities on behalf of other governmental or private entities whose obligations secure the bonds.

The State's intended issuances of general obligation bonds and lease revenue bonds listed in Figure B-2 include only currently authorized but unissued bonds. The intended issuances may increase should voters approve proposed bond programs on the March 2004 and November 2004 ballots.

Figure B-2

Intended Issuances ($ Millions)		
	2003-2004	**2004-2005**
General Obligation	$5,200	$5,946
Lease Revenue	$375	$1,435
Pension Obligation Bonds	$808	N/A
Total General Fund Supported Bonds	$6,383	$7,381
Fiscal Recovery Bonds[2]	$10,700	N/A
Total Bonds	$17,083	$7,381

The State's intended issuance of a combined total of over $13 billion of General Fund net-tax supported bonds during fiscal years 2003-04 and 2004-05 is expected to increase General Fund

[2] The enacted 2003-04 budget authorizes the issuance of Fiscal Recovery Bonds to close the $10.7 billion accumulated budget deficit as of June 30, 2003. The Bonds are expected to be sold prior to June 2004 and be repaid from a new half-cent state sales tax that will be deposited in the Fiscal Recovery Fund. These bonds will have an impact on the General Fund's debt capacity because of the General Fund's commitment to backfill the loss in local government tax revenue created by the repeal of the local half-cent sales tax.

supported debt service by $90 million in fiscal year 2003-04 and $537 million in fiscal year 2004-05. A detailed schedule of the projected annual payments on these obligations can be found in Appendix 3.

The estimated annual debt service on Fiscal Recovery Bonds is approximately $2.137 billion, based on estimates of the sales tax revenues to be available for repayment.

DEBT RATIOS

Use of Debt Ratios

Measuring California's debt level through the use of debt ratios provides a convenient way to compare California's circumstances to those of other borrowers. The most common debt ratios applied to state issuers are: (1) debt service as a percentage of general fund revenues, (2) debt as a percentage of personal income, and (3) debt per capita.

Debt Service as a Percentage of General Fund Revenues: Credit analysts use the ratio comparing a state's general fund supported debt service to general fund revenues to examine a state's fiscal flexibility given that its debt service is considered a fixed part of its budget. The State's ratio of debt service to General Fund revenues was 3.37 percent for fiscal year 2002-03, based on $2.386 billion in debt service payments versus $70.852 billion in General Fund revenues (including transfers). This figure is 1.18 percentage points lower than the State's fiscal year 2001-02 ratio of 4.55 percent. The fiscal year 2001-02 ratio was calculated at 3.66 percent in the 2002 Debt Affordability Report based on General Fund revenues as reported by the Department of Finance at that time. These revenues subsequently were reduced by the Department of Finance to reflect updated actual receipts. The ratio of debt service to General Fund revenues for fiscal year 2003-04 is projected to be 3.57 percent, based on $2.616 billion in estimated debt service payments versus $73.353 billion in estimated General Fund revenues (including transfers and certain bond proceeds) as such revenues have been projected by the Department of Finance.

This projected ratio only reflects a portion of the bond sales listed in Figure B-2. For example, $3 billion of the $5.2 billion in general obligation bonds planned for fiscal year 2003-04 will be sold during the first half of the fiscal year. These bonds will have an interest payment in the second half of the fiscal year. The remaining $2.2 billion in general obligation bonds will not have a debt service payment during the 2003-04 fiscal year and will therefore not affect the ratio until the subsequent fiscal year.

The Fiscal Recovery Bonds are not expected to have a debt service payment until fiscal year 2004-05. At that time, the estimated annual debt service of approximately $2.137 billion would equate to an increase in the State's overall ratio of debt service to General Fund Revenues of over 2.9 percent, based on fiscal year 2003-04 General Fund revenue levels, which are the most current available revenue figures. (Although the bonds are to be payable from the new state sales tax deposited in the Fiscal Recovery Fund, the General Fund will have a new annual obligation to local governments, also in excess of $2 billion a year, due to the reduction in the local sales tax.) If the ratio associated with the Fiscal Recovery Bonds were added to the fiscal year 2003-04 ratio for other state bonds, the result would be a ratio of nearly 6.5 percent. This exceeds the 6.0 percent level that traditionally is considered prudent.

Debt as a Percentage of Personal Income: Comparing a state's level of debt to the total personal income of its residents measures a borrower's ability to repay its obligations because it indicates the potential ability of a state to generate revenues. As of December 31, 2002 the State's ratio of General Fund net tax-supported debt to personal income was 2.5 percent. Since that time this ratio has increased to 3.0 percent as of July 1, 2003, an increase of 0.50 percentage points. This change reflects the continued increase in issuances of voter-approved general obligation bonds.

At approximately $10.7 billion, issuance of the Fiscal Recovery Bonds would equate to an increase in the State's ratio of debt to personal income of 0.94 percent, based on current personal income levels. If this figure were added to the July 1, 2003 ratio for other state bonds, the result would be a ratio of 3.94 percent. Based on the data in Figure B-3, that would put California below only two of the 10 largest states.

Debt Per Capita: Debt per capita measures state residents' average share of the state's total debt outstanding. It does not account for the employment status, income or financial resources of the residents. As a result, debt per capita does not reflect a state's ability to repay its obligations as well as the other two ratios and is generally considered the least informative of the three debt ratios. As of December 31, 2002 the State's General Fund net tax-supported debt per capita was $802. Since that time this ratio has increased to $977 as of July 1, 2003, an increase of $175 per person. This change reflects the continued increase in issuances of voter-approved general obligation bonds.

At approximately $10.7 billion, issuance of the Fiscal Recovery Bonds would equate to an increase in the State's ratio of debt per capita of $305, based on current population levels. If this figure were added to the July 1, 2003 ratio for other state bonds, the result would be a ratio of $1,282 per capita. Based on the data in Figure B-3, that would put California below only two of the 10 largest states.

California's Debt Levels Compared to Other Large States

The State's debt levels are consistent with those of other large states. The comparison of California's debt position to other states is made possible primarily through the use of benchmark debt ratios published by Moody's. Moody's calculates the ratios of debt to personal income and debt per capita for each state and publishes an annual report containing the median ratios. In addition to comparing California's debt ratios to the Moody's state medians, it is useful to compare California to its "peer group" of the 10 most populous states. As shown in Figure B-3, the debt ratios of these 10 states are, on average, higher than the Moody's median for all states combined. Comparatively, California's ratio of General Fund net tax-supported debt to personal income and debt per capita rank just above the medians for the 10 most populous states.

Figure B-3

Debt Ratios of 10 Most Populous States
Ranked by Ratio of Debt to Personal Income

State	Moody's/S&P/Fitch[(1)]	Debt to Personal Income[(2)]	Debt per Capita[(3)]
Texas	Aa1/AA/AA+	0.9%	$246
Michigan	Aaa/AAA/AA+	1.8%	$542
Pennsylvania	Aa2/AA/AA	2.2%	$693
California [(4)]	A3/BBB/A	2.5%	$812
Ohio	Aa1/AA+/AA+	2.6%	$750
Georgia	Aaa/AAA/AAA	2.8%	$802
Illinois	Aa3/AA/AA	3.1%	$1,040
Florida	Aa2/AA+/AA	3.3%	$985
New Jersey	Aa2/AA/AA	5.5%	$2,110
New York	A2/AA/AA-	5.8%	$2,095
Moody's Median all States		2.2%	$606
Median for the 10 Most Populous States [(5)]		2.7%	$890

[(1)] *Moody's Investors Service, Standard & Poor's, and Fitch Ratings, as of October 1, 2003.*

[(2)]*Moody's July 2003 State Debt Medians are based on 2001 personal income figures released by the U.S. Bureau of Economic Analysis. Other figures used in the ratios are based on information available as of December 31, 2002.*

[(3)] *Moody's July 2003 State Debt Medians are based on 2000 population figures from the U.S. Census Bureau. Other figures used in the ratios are based on information available as of December 31, 2002.*

[(4)] *As of July 1, 2003, California's ratio of Debt to Personal Income was 3.0% and its ratio of Debt per Capita was $977.*

[(5)] *Calculated as the average of the ratios reported for each measure for the fifth- and sixth-ranked states.*

APPENDIX 1

State of California Outstanding and Authorized but Unissued Bonds
General Obligation Bonds
as of July 1, 2003 ($ Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a) (b)	Authorized but Unissued (c)
GENERAL FUND BONDS (Non-Self Liquidating)				
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	3/5/02	$ 2,600,000	$ 41,830	$ 2,558,170
California Library Construction and Renovation Bond Act of 1988	11/8/88	75,000	47,375	2,595
California Library Construction and Renovation Bond Act of 2000	3/7/00	350,000	4,530	345,450
California Park and Recreational Facilities Act of 1984	6/5/84	370,000	131,490	1,100
California Parklands Act of 1980	11/4/80	285,000	29,565	0
California Safe Drinking Water Bond Law of 1976	6/8/76	175,000	40,310	2,500
California Safe Drinking Water Bond Law of 1984	11/6/84	75,000	25,800	0
California Safe Drinking Water Bond Law of 1986	11/4/86	100,000	59,995	0
California Safe Drinking Water Bond Law of 1988	11/8/88	75,000	49,030	7,100
California Wildlife, Coastal, and Park Land Conservation Act of 1988	6/7/88	776,000	419,270	7,330
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed)	11/3/98	2,500,000	1,790,920	675,755
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12)	11/3/98	6,700,000	5,941,760	505,445
Clean Air and Transportation Improvement Bond Act of 1990	6/5/90	1,990,000	1,307,010	283,415
Clean Water and Water Conservation Bond Law of 1978	6/6/78	375,000	35,765	0
Clean Water and Water Reclamation Bond Law of 1988	11/8/88	65,000	46,010	0
Clean Water Bond Law of 1970	11/3/70	250,000	4,000	0
Clean Water Bond Law of 1974	6/4/74	250,000	8,695	0
Clean Water Bond Law of 1984	11/6/84	325,000	81,855	0
Community Parklands Act of 1986	6/3/86	100,000	42,180	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/8/88	500,000	298,965	0
County Correctional Facility Capital Expenditure Bond Act of 1986	6/3/86	495,000	218,255	0
County Jail Capital Expenditure Bond Act of 1981	11/2/82	280,000	58,725	0
County Jail Capital Expenditure Bond Act of 1984	6/5/84	250,000	51,150	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	6/5/90	300,000	205,740	59,450
Fish and Wildlife Habitat Enhancement Act of 1984	6/5/84	85,000	26,115	3,000
Hazardous Substance Cleanup Bond Act of 1984	11/6/84	100,000	7,500	0
Higher Education Facilities Bond Act of 1986	11/4/86	400,000	131,900	0
Higher Education Facilities Bond Act of 1988	11/8/88	600,000	293,585	10,440
Higher Education Facilities Bond Act of June 1990	6/5/90	450,000	251,530	2,130
Higher Education Facilities Bond Act of June 1992	6/2/92	900,000	649,830	8,280
Housing and Emergency Shelter Trust Fund Act of 2002	11/5/02	2,100,000	0	2,100,000
Housing and Homeless Bond Act of 1990	6/5/90	150,000	6,415	0
Kindergarten - University Public Education Facilities Bond Act of 2002 (K-12)	11/5/02	11,400,000	2,545,990	7,454,010
Kindergarten - University Public Education Facilities Bond Act of 2002 (Hi-Ed)	11/5/02	1,650,000	15,320	1,634,680
Lake Tahoe Acquisitions Bond Act	8/2/82	85,000	27,995	0
New Prison Construction Bond Act of 1981	6/8/82	495,000	49,250	0
New Prison Construction Bond Act of 1984	6/5/84	300,000	37,500	0
New Prison Construction Bond Act of 1986	11/4/86	500,000	177,430	1,500
New Prison Construction Bond Act of 1988	11/8/88	817,000	401,135	12,260
New Prison Construction Bond Act of 1990	6/5/90	450,000	234,515	6,125
Passenger Rail and Clean Air Bond Act of 1990	6/5/90	1,000,000	585,210	10,565
Public Education Facilities Bond Act of 1996 (K-12)	3/26/96	2,025,000	1,704,135	46,790
Public Education Facilities Bond Act of 1996 (Hi-Ed)	3/26/96	975,000	868,745	38,330
1988 School Facilities Bond Act	11/8/88	800,000	417,535	2,665
1990 School Facilities Bond Act	6/5/90	800,000	440,015	2,990
1992 School Facilities Bond Act	11/3/92	900,000	586,557	6,614
Safe, Clean Reliable Water Supply Act of 1996	11/5/96	995,000	462,435	507,165
Safe Drinking Water Bond Act of 2000	3/7/00	1,970,000	329,600	1,636,445
Safe Neighborhood Parks Bond Act of 2000	3/7/00	2,100,000	711,005	1,376,100
School Building and Earthquake Bond Act of 1974	11/5/74	40,000	30,655	0

APPENDIX 1 (Continued)

State of California Outstanding and Authorized but Unissued Bonds
General Obligation Bonds (continued)
as of July 1, 2003 ($ Thousands)

	Voter Authorization Date	Voter Authorization Amount	Bonds Outstanding (a) (b)	Authorized but Unissued (c)
GENERAL FUND BONDS (Non-Self Liquidating) (Continued)				
School Facilities Bond Act of 1988	6/7/88	$ 800,000	$ 370,480	$ 0
School Facilities Bond Act of 1990	11/6/90	800,000	475,745	2,550
School Facilities Bond Act of 1992	6/2/92	1,900,000	1,188,875	17,290
Seismic Retrofit Bond Act of 1996	3/26/96	2,000,000	1,604,595	269,645
Senior Center Bond Act of 1984	11/6/84	50,000	7,500	0
State Beach, Park, Recreational and Historical Facilities Bonds	6/4/74	250,000	495	0
State School Building Lease-Purchase Bond Law of 1982	11/2/82	500,000	29,685	0
State School Building Lease-Purchase Bond Law of 1984	11/6/84	450,000	113,750	0
State School Building Lease-Purchase Bond Law of 1986	11/4/86	800,000	288,650	0
State, Urban, and Coastal Park Bond Act of 1976	11/2/76	280,000	14,655	0
Veterans' Homes Bond Act of 2000	3/7/00	50,000	0	50,000
Voting Modernization Bond Act of 2002	3/5/02	200,000	0	200,000
Water Conservation and Water Quality Bond Law of 1986	6/3/86	150,000	70,210	27,600
Water Conservation Bond Law of 1988	11/8/88	60,000	37,290	11,500
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	11/5/02	3,440,000	72,670	3,367,330
Total General Obligation Bonds		$63,078,000	$ 26,206,727	$ 23,254,314

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Does not include $1,400,000,000 of outstanding variable rate bonds.
(c) Includes authorized commercial paper.
SOURCE: State of California, Office of the Treasurer.

APPENDIX 1 (Continued)

State of California Outstanding and Authorized but Unissued Bonds
Lease Revenue Bonds
as of July 1, 2003 ($ Thousands)

LEASE REVENUE BONDS		Authorized but Unissued
University of California	$	1,235,817
California State University		191,309
California Community Colleges		170,468
Department of Corrections		352,825
Department of Youth Authority		21,155
Department of Forestry and Fire Protections		95,704
State Buildings		1,740,620
Energy Efficiency Revenue Bonds		264,085
Total Lease Revenue Bonds	$	4,071,983

SOURCE: State of California, Office of the Treasurer.

APPENDIX 2

State of California Outstanding Debt Service Requirements
General Obligation Bonds (Fixed Rate and Variable Rate)
as of July 1, 2003

Fiscal Year Ending June 30	Current Debt (a) Interest (b)	Principal (c)	Total
2004	$ 1,395,701,283	$ 460,320,000	$ 1,856,021,283
2005	1,413,591,058	1,244,789,389	2,658,380,446
2006	1,339,636,860	1,173,910,000	2,513,546,860
2007	1,270,666,426	1,204,445,000	2,475,111,426
2008	1,205,031,803	1,331,543,078	2,536,574,881
2009	1,131,729,154	1,344,375,000	2,476,104,154
2010	1,056,681,073	1,395,720,000	2,452,401,073
2011	981,998,656	1,358,369,045	2,340,367,701
2012	904,660,463	1,000,470,000	1,905,130,463
2013	852,713,064	862,130,000	1,714,843,064
2014	810,204,683	739,730,000	1,549,934,683
2015	773,751,867	750,140,000	1,523,891,867
2016	734,328,795	733,770,000	1,468,098,795
2017	695,431,233	768,560,000	1,463,991,233
2018	656,181,907	794,850,000	1,451,031,907
2019	615,228,957	843,895,000	1,459,123,957
2020	572,047,581	873,530,000	1,445,577,581
2021	528,453,032	825,225,000	1,353,678,032
2022	486,564,569	964,020,000	1,450,584,569
2023	436,561,363	977,220,000	1,413,781,363
2024	388,468,635	851,305,000	1,239,773,635
2025	346,214,439	914,360,000	1,260,574,439
2026	300,310,176	889,170,000	1,189,480,176
2027	256,195,683	893,390,000	1,149,585,683
2028	211,447,649	935,495,000	1,146,942,649
2029	165,285,340	880,180,000	1,045,465,340
2030	121,813,896	935,595,000	1,057,408,896
2031	76,058,055	648,510,000	724,568,055
2032	46,365,295	576,195,000	622,560,295
2033	19,365,638	435,515,000	454,880,638
Total	$ 19,792,688,632	$ 27,606,726,512	$ 47,399,415,144

(a) Does not include commercial paper outstanding.
(b) Assumes 4.00% all-in rate for Variable Rate General Obligation Bonds.
(c) Includes scheduled mandatory sinking fund payments as well as serial maturities.
SOURCE: State of California, Office of the Treasurer.

APPENDIX 2 (Continued)

State of California Outstanding Debt Service Requirements
Lease Revenue Bonds
as of July 1, 2003

Fiscal Year Ending June 30	Current Debt Interest	Principal (a)	Total
2004	$ 343,386,044	$ 326,516,386	$ 669,902,431
2005	339,130,734	352,219,507	691,350,241
2006	319,233,880	371,892,555	691,126,434
2007	305,550,391	324,818,920	630,369,312
2008	286,328,149	333,166,788	619,494,937
2009	273,545,421	355,107,732	628,653,153
2010	249,949,348	343,676,634	593,625,982
2011	221,063,615	356,310,000	577,373,615
2012	202,396,701	339,700,000	542,096,701
2013	184,531,290	348,540,000	533,071,290
2014	166,276,852	351,520,000	517,796,852
2015	147,363,466	370,130,000	517,493,466
2016	127,649,752	351,330,000	478,979,752
2017	108,490,297	356,280,000	464,770,297
2018	89,600,585	370,835,000	460,435,585
2019	70,421,629	329,065,000	399,486,629
2020	53,156,841	299,060,000	352,216,841
2021	38,862,540	232,480,000	271,342,540
2022	26,705,617	202,390,000	229,095,617
2023	17,810,594	147,340,000	165,150,594
2024	11,258,071	56,175,000	67,433,071
2025	8,244,483	59,185,000	67,429,483
2026	5,574,756	45,215,000	50,789,756
2027	3,273,799	47,475,000	50,748,799
2028	922,863	34,170,000	35,092,863
Total	$ 3,600,727,717	$ 6,704,598,523	$ 10,305,326,239

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.
SOURCE: State of California, Office of the Treasurer.

APPENDIX 3

State of California Debt Service Requirements on Intended Sales of Authorized but Unissued Bonds during Fiscal Years 2003-04 and 2004-05[1]

Fiscal Year Ending June 30,	Intended Debt Issuances: FY 2003-04 GO Sales Debt Service	FY 2004-05 GO Sales Debt Service	FY 2003-04 POB Sales Debt Service	FY 2003-04 LRB Sales Debt Service	FY 2004-05 LRB Sales Debt Service	Total Debt Service All Intended FY 2003-04 & FY 2004-05 Sales
2004	$ 90,000,000	$ 0	$ 0	$ 0	$ 0	$ 90,000,000
2005	312,000,000	89,184,600	135,755,951	0	0	536,940,551
2006	312,000,000	356,738,400	198,825,513	0	0	867,563,913
2007	312,000,000	356,738,400	198,170,352	0	0	866,908,752
2008	312,000,000	356,738,400	197,351,644	37,532,600	17,813,700	921,436,344
2009	397,049,800	356,738,400	196,728,588	37,532,700	142,724,300	1,130,773,788
2010	397,046,500	454,411,700	0	37,535,300	142,724,400	1,031,717,900
2011	397,055,550	454,427,400	0	37,533,000	142,724,300	1,031,740,250
2012	397,047,000	454,414,400	0	37,533,700	142,725,300	1,031,720,400
2013	397,050,300	454,416,700	0	37,534,700	142,717,800	1,031,719,500
2014	397,053,100	454,414,700	0	37,533,300	142,727,350	1,031,728,450
2015	397,041,850	454,413,500	0	37,531,800	142,717,700	1,031,704,850
2016	397,051,950	454,420,800	0	37,532,200	142,723,500	1,031,728,450
2017	397,056,100	454,413,400	0	37,531,200	142,722,300	1,031,723,000
2018	397,046,400	454,416,600	0	37,535,500	142,721,950	1,031,720,450
2019	397,048,600	454,412,700	0	37,531,200	142,718,950	1,031,711,450
2020	397,050,600	454,418,400	0	37,535,000	142,719,350	1,031,723,350
2021	397,043,650	454,417,100	0	37,532,400	142,723,150	1,031,716,300
2022	397,042,650	454,420,700	0	37,534,500	142,724,150	1,031,722,000
2023	397,044,350	454,419,000	0	37,531,500	142,725,550	1,031,720,400
2024	397,053,400	454,418,800	0	37,533,900	142,719,800	1,031,725,900
2025	397,052,050	454,424,500	0	37,531,300	142,723,150	1,031,731,000
2026	397,045,300	454,417,500	0	37,533,600	142,724,900	1,031,721,300
2027	397,045,750	454,417,100	0	37,534,800	142,724,050	1,031,721,700
2028	397,046,950	454,418,400	0	37,533,900	142,727,950	1,031,727,200
2029	397,044,900	454,423,500	0	37,534,600	142,717,600	1,031,720,600
2030	397,052,300	454,411,200	0	0	142,723,100	994,186,600
2031	397,043,100	454,416,700	0	0	0	851,459,800
2032	397,053,400	454,420,400	0	0	0	851,473,800
2033	397,048,750	454,419,400	0	0	0	851,468,150
2034	397,027,600	454,415,700	0	0	0	851,443,300
2035	0	454,417,400	0	0	0	454,417,400
Totals:>>	$ 11,661,241,900	$ 13,330,995,900	$ 926,832,048	$ 825,732,700	$ 3,157,714,300	$ 29,902,516,848

Source: State of California, Office of the Treasurer.

[1] Debt service estimates for the Fiscal Recovery Bonds have not been included in this table because of the uncertainty surrounding the structure of the bonds.