GENERAL OBLIGATION (GO) BONDS **6871**

(New 5/98)

Definition: GO bonds are a form of long-term borrowing in which the state issues municipal securities and pledges its full faith and credit to their repayment. Bonds are repaid over many years through semi-annual debt service payments. The California Constitution requires that GO bonds be approved by a majority vote of the public and sets repayment of GO debt before all other obligations of the state except those for K-14 education.

Key statutory authorities: Article XVI, Section 1, of the California Constitution prohibits the Legislature from creating debt or liability which exceeds $300,000 without a majority vote by the people, except in case of war.

Government Code, Title 2, Division 4, Part 3 (Section 16650 et seq.) sets out the statutory framework for GO bonds. Statutory authorization for individual GO bond measures is placed programmatically in the codes (e.g., prison authorizations are located in the Penal Code).

Fiscal highlights:

1. GO debt is a key component considered in the overall debt load of the state. The most commonly used measure of debt is annual debt service (for non self-liquidating bonds) as a percentage of General Fund revenues or receipts.

2. Self-liquidating GO bonds are backed by project-generated revenue streams and therefore the bond market does not include them when calculating debt service ratios. An example is the veterans' home loan program where expenditures are reimbursed through mortgage payments.

3. There is no California statutory or constitutional limit on the absolute level (or any other measurement) of state debt, other than that specified in Article XVI referred to in the preceding text.

4. GO debt repayment is continuously appropriated and therefore not included as a separate appropriation in the annual Budget Act.

5. GO issues have the highest credit quality in the state and therefore the lowest tax-exempt rates.

6. Debt service consists of both principal and interest payments.

7. GO debt repayment is frequently structured as level principal payments, i.e., the initial payments are the highest, decreasing as principal balances and therefore interest decline.

8. The California Constitution authorizes GO bonds with up to 50-year maturities, but the economics of the bond market usually dictate that bonds be issued on a 20- to 30-year basis. Some bond acts also limit the maximum maturity to 20 years. To meet cash needs before bonds are issued, GO programs may require interim financing through loans from the Pooled Money Investment Account or the General Fund, or through the issuance of tax-exempt commercial paper or other short-term negotiable instruments. See Section 6878.

9. Various GO finance committees must approve the use of interim financing and authorize the sale of bonds.

10. STO is the agent for sale and the registrar and/or paying agent for state GO bonds. GO bonds are normally sold using a competitive rather than negotiated process.

11. DOF provides fund condition statements and participates in sales preparation, due diligence, rating agency presentations and continuing disclosure.

12. Client departments are responsible for informing STO of program cash flow needs so that bond sales can be scheduled or interim financing arranged.