



## California Initiative Review (CIR)

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Volume 2008 *November 2008*

Article 12

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11-1-2008

### Proposition 12: Veterans' Bond Act of 2008

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#### Recommended Citation

Marchiano, David M. and Weissman, David (2008) "Proposition 12: Veterans' Bond Act of 2008," *California Initiative Review (CIR)*: Vol. 2008 , Article 12.

Available at: <https://scholarlycommons.pacific.edu/california-initiative-review/vol2008/iss2/12>

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# **CALIFORNIA INITIATIVE REVIEW**

## **Proposition 12: VETERANS' BOND ACT OF 2008**

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## Executive Summary

Proposition 12, the Veterans' Bond Act of 2008, authorizes the state to sell \$900 million in general obligation bonds to replenish funding for the existing Cal-Vet Home Loan Program, which provides low-interest loans to California veterans who buy homes and farms in the state. These bonds, if authorized, would provide sufficient funds for at least 3,600 additional veterans to receive loans under the program. *Proposition 12 Analysis – Voter Information Guide 2008*, <http://www.voterguide.sos.ca.gov/analysis/prop12-analysis.htm> (accessed Sept. 29, 2008). Proposition 12 would also give veterans who entered the military after 1977 the opportunity obtain these low-interest home loans.

The California Department of Veterans Affairs (DVA) oversees the program. DVA uses the revenue generated from the sale of these bonds to purchase farms, homes, and mobile homes, which are resold to California veterans under a purchase contract. Each participating veteran makes monthly payments to DVA. The payments from the veterans are sufficient to (1) "reimburse DVA for its costs in purchasing the farm, home, or mobile home; (2) cover all costs resulting from the sale of the bonds, including interest on the bonds; (3) cover the costs of operating the program." *Legislative Analyst's Office – Proposition 12*, [http://www.lao.ca.gov/ballot/2008/12\\_11\\_2008.aspx](http://www.lao.ca.gov/ballot/2008/12_11_2008.aspx) (accessed Sept. 29, 2008). Thus, the veterans holding the loans pay all the costs of the program, including administrative costs.

Both houses of the legislature unanimously passed the bill in July. The home-loan program is backed by general obligation bonds; all general obligation bonds must be approved by the voters. *An Overview of State Bond Debt*, [http://www.lao.ca.gov/ballot/2008/bond\\_11\\_2008.aspx](http://www.lao.ca.gov/ballot/2008/bond_11_2008.aspx) (accessed Sept. 29, 2008). Therefore, the legislature placed Proposition 12 on the November ballot for voter approval.

## II. The Law

### A. Background

The Veterans' Bond Act is a time-honored tradition of thanking our veterans for their brave service to our country. At the end of World War I, all states gave their returning soldiers some sort of compensation. *SB 1572 Senate Committee Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080325\\_105136\\_sen\\_comm.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080325_105136_sen_comm.html) (accessed Sept. 29, 2008). Compensation took several forms, including cash bonuses and educational assistance. *Id.* California, along with four other states, chose to provide low-interest home loans to its veterans. *Id.*

Established in 1921, the Cal-Vet Home Loan Program has provided approximately 420,000 loans to California veterans, enabling them to purchase homes and farms they might not have otherwise been able to afford. *2008 Ballot Watch: Proposition 12: Veterans Bond Act of 2008*, <http://www.sacbee.com/elections/v-print/story/1242641.html> (accessed Oct. 12, 2008). California voters have approved all 26 Cal-Vet bond measures presented to them since 1922. *Id.* The closest margin came in November 1962, when 50.3 percent of voters supported the \$250

million bond that year. *Id.* The last bond measure approved for the Cal-Vet Program was Proposition 32 in November 2000, in the amount of \$500 million. *Id.*

Historically, the Tax Reform Act of 1984 limited the use of Qualified Veterans Mortgage Bonds (QVMBs) to wartime veterans with active military duty prior to 1977, who applied for the loan within 30 years. *SB 1572 Senate Bill Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080703\\_140131\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080703_140131_sen_floor.html) (accessed Oct. 10, 2008). This effectively limited the program to Vietnam era veterans, and the 30-year time limit resulted in a rapidly declining pool of eligible applicants. *Id.*

President Bush recently signed into law the “Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008,” which ameliorated this harsh time restriction. *More Vets Eligible for Cal-Vet Low Interest Home Loans*, <http://www.vandenberg.af.mil/news/story.asp?id=123103496> (accessed Oct. 10, 2008). The vast majority of California veterans from recent conflicts were not eligible before the HEART Act. *Id.*

## **B. Existing Law**

The Cal-Vet Program is financed through the sale of voter-approved general obligation bonds pursuant to a federal law, Section 143(l) of the Internal Revenue Code. These bonds are generally tax exempt at both the state and federal levels, and are referred to as Qualified Veterans Mortgage Bonds (QVMBs) in the Internal Revenue Code. As of July 2008, there was approximately \$102 million of these authorized bonds remaining unsold. *Senate Rules Committee Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080703\\_140131\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080703_140131_sen_floor.html) (accessed Oct. 12, 2008). The California Department of Veterans Affairs projects that these bond proceeds will be depleted in 2008. *Id.*

As mentioned above, the current law in California changed because of the recent passage of the HEART Act by the federal government. Every eligible veteran can now use QVMB funds regardless of service date. Before the changes, qualified veterans mortgage bonds could only be used to help veterans who served on active duty before 1977 and applied for the financing within 30 years of leaving active service. The recent changes in federal law removed the time restrictions, making the qualified veterans bond program available to all veterans who have served within the last 25 years and have not been dishonorably discharged. *TECHNICAL EXPLANATION OF H.R. 6081, THE “HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008,”* <<http://www.house.gov/jct/x-44-08.pdf>> (accessed Oct. 12, 2008).

Veterans eligible for the Cal-Vet Program are now those who have served 1.) on active duty a minimum of 90 days; and 2.) under honorable conditions. *Cal Vet Home Loans*, <http://www.cdva.ca.gov/CalVetLoans/Eligibility.aspx> (accessed Oct. 10, 2008). It is irrelevant whether the veteran served in a time of war or peace. *Id.* Importantly, there are no prior residency requirements – a veteran may have entered service from outside California. *Id.* National Guard or reservists who have been ordered to active duty, including Active Guard/Reserve duty are also eligible. *Id.* Veterans wishing to use the loan proceeds must provide a copy of their DD 214 (Release from Active Duty) to confirm that they have qualifying service.

The Cal-Vet Program uses a Contract of Sale as the financing instrument for veterans' loans. Specifically, the California Department of Veterans Affairs (DVA) purchases the home, takes legal title to the property at close of escrow, and then sells the property to the veteran. The DVA holds the papers on the homes and does not transfer legal title to the veteran until the loan is paid in full. <http://www.cdva.ca.gov/CalVetLoans/FAQs2.aspx#pb1> (accessed Oct. 1, 2008). Thus, if there is a foreclosure, DVA then can sell the home to recoup the loan proceeds. *SB 1572 Senate Bill Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080707\\_102502\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080707_102502_sen_floor.html) (accessed Oct 12, 2008).

The maximum loan to participating veterans is \$521,250. *Cal-Vet Current Loan Terms, Fees, and Rates*, <http://www.cdva.ca.gov/CalVetLoans/Interest.pdf> (accessed Oct. 12, 2008). No down payment is required. *Id.* The current interest rate for a Cal-Vet home loan is 5.50% for a 30-year, fixed-rate loan. *Id.*

### **C. Changes in the Law**

Proposition 12 adds Article 5x (commencing with Section 998.400) to Chapter 6 of Division 4 of the Military and Veterans Code, relating to the financing of the Cal-Vet Program in accordance with the Veterans' Farm and Home Purchase Act of 1974. *Senate Bill No. 1572, Chapter 122*, <http://www.voterguide.sos.ca.gov/text-proposed-laws/text-of-proposed-laws.pdf#prop12> (accessed Oct. 13, 2008). In practical effect, Proposition 12 authorizes the state to sell more Qualified Veterans Mortgage Bonds to allow the Cal-Vet Program to continue to operate into the future. At \$900 million, Proposition 12 would be the largest Cal-Vet bond ever approved. *Id.*

### **D. Fiscal Impact**

According to the Legislative Analyst's Office, the total cost of this year's initiative would be about \$1.8 billion, with interest. *Legislative Analyst's Office, Proposition 12*, [http://www.lao.ca.gov/ballot/2008/12\\_11\\_2008.aspx](http://www.lao.ca.gov/ballot/2008/12_11_2008.aspx) (accessed Oct. 12, 2008). However, if the repayments are made properly, the program can be sustained at no cost to the taxpayers. *Id.*

The tax-free bonds authorized by Proposition 12 would be paid off over a period of approximately 30 years. *Id.* If the \$900 million in bonds were sold at an interest rate of 5 percent, the cost would be about \$1.8 billion to pay off both the principal (\$900 million) and the interest (\$856 million). *Id.* Thus, the average payment for principal and interest would be about \$59 million per year. *Id.*

In theory, the tax-payers are on the hook since the veterans' bonds are backed by the state. *An Overview of State Bond Debt*, [http://www.lao.ca.gov/ballot/2008/bond\\_11\\_2008.aspx](http://www.lao.ca.gov/ballot/2008/bond_11_2008.aspx) (accessed Oct. 12, 2008). In practice, however, the fiscal impact on the state would be very little, if any, since the principal and interest on the bonds would be covered entirely by the program participants (borrowers). *Legislative Analyst's Office – Proposition 12*, [http://www.lao.ca.gov/ballot/2008/12\\_11\\_2008.aspx](http://www.lao.ca.gov/ballot/2008/12_11_2008.aspx) (accessed Sept. 29, 2008). In addition, the Cal-Vet Program has back-up measures and "loan-loss reserves" in case participants default on

their loans. *SB 1572 Senate Bill Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080707\\_102502\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080707_102502_sen_floor.html) (accessed Oct 12, 2008). The reserve funds prevent costs to the general fund.

There are ancillary costs, however, that warrant discussion. Ballot costs to the Secretary of State (printing and mailing expenses) average between \$64,000 and \$98,000 per page depending on the total size of the ballot. *Senate Rules Committee Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080703\\_140131\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080703_140131_sen_floor.html) (accessed Oct. 12, 2008). Additional costs include paying for the title, summary, arguments, and text of the proposition to be placed on the November ballot. These costs range from \$192,000 to \$294,000. *Id.*

Proposition 12 could positively impact the state's housing market and faltering economy as a whole. Ostensibly, Cal-Vet home loans generate thousands of industry-related jobs with millions in annual payrolls. *Proposition 12 Analysis – Voter Information Guide 2008*, <http://www.voterguide.sos.ca.gov/analysis/prop12-analysis.htm> (accessed Sept. 29, 2008).

Proposition 12 could also have an impact on potential investors who purchase the Qualified Veterans Mortgage Bonds (QVMBs). The HEART Act of 2008 provides that the income earned on the interest of the QVMBs is tax exempt at both the state and federal levels. *TECHNICAL EXPLANATION OF H.R. 6081, THE “HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008,”* <<http://www.house.gov/jct/x-44-08.pdf>> (accessed Oct. 12, 2008). This tax reduction makes buying the QVMBs even more attractive to investors seeking a more stable alternative to Wall Street.

### **III. Drafting Issues**

There are no apparent drafting issues.

### **IV. Constitutional Issues**

The California Constitution has certain requirements for Bond Acts since they are backed by the state's General Fund. The California Constitution Article XVI, Section 1 provides in relevant part: “[N]o such law [which creates a debt of over \$300,00] shall take effect unless it has been passed by a two-thirds vote of all the members elected to each house of the Legislature and until, at a general election or at a direct primary, it shall have been submitted to the people and shall have received a majority of all the votes cast for and against it at such election.” Cal. Const. art. XVI, § 1, [http://www.leginfo.ca.gov/const/article\\_16](http://www.leginfo.ca.gov/const/article_16) (accessed Oct. 13, 2008).

Here, both the Senate and Assembly unanimously passed the law, Senate Bill 1572, in July. The Governor subsequently signed the bill. This law is now being submitted to the people in accordance with the provisions of Article XVI, Section 1 of the California Constitution. Thus, the state Constitutional requirements have been satisfied.

### **V. Public Policy Considerations**

## A. Proponents

The proponents support Proposition 12 for three main reasons. First, the money would replenish funding for the current Cal-Vet Home Loan Program. Second, based on history, there is no direct cost to the state taxpayer. Finally, the HEART Act of 2008 will expand the pool of potential participants that will further exhaust the remaining funds in the program.

The proponents first argue that replenishing the existing Cal-Vet Program is a fiscally responsible way to thank our veterans for their service to our country. Written by Senator Mark Wyland (R-Escondido), the bill passed both chambers of the legislature unanimously and was signed by Governor Arnold Schwarzenegger in July. Wyland states, "California has a proud history of supporting our veterans and the Cal-Vet Home Loan program is a simple, significant way we can show our thanks. Keeping this program alive is the least California can do for the people who have fought so heroically to protect our state, our country and our freedoms." *CA State Senator Mark Wyland website*, <http://cssrc.us/web/38/publications.aspx?id=4414> (Accessed Saturday September 13, 2008).

Governor Schwarzenegger echoed this sentiment, saying, "I'm asking voters to say Yes in November so that veterans who risked their lives in places like Kuwait, Iraq, and Afghanistan will be eligible to join the more than 420,000 others who have bought a home with a Cal-Vet loan." *Prop. 12 would extend veteran home loan program*, [http://www.mercurynews.com/breakingnews/ci\\_10550453](http://www.mercurynews.com/breakingnews/ci_10550453) (accessed Oct. 12, 2008).

Second, the proponents put forth a historical, pragmatic argument relying on more than 80 years of success. Since 1922, California voters have approved all 26 bond measures to replenish the pot. One major reason for the continuing approval of the funding is that the tax payer faces little chance of incurring any direct cost. *Yes on California bonds*, [www.latimes.com/business/la-ed-endorsements2-2008oct20\\_537298.story](http://www.latimes.com/business/la-ed-endorsements2-2008oct20_537298.story) (accessed Oct. 12, 2008). Furthermore, the Cal-Vet Program is self-supporting; the veterans faithfully pay down the debt they owe. To illustrate, in over 80 years, the program has never needed aid from the general public to cover the cost of a defaulted loan. This is important because legally, the state is ultimately responsible for paying back the bond money. *Prop. 12 would extend veteran home loan program*, [http://www.mercurynews.com/breakingnews/ci\\_10550453](http://www.mercurynews.com/breakingnews/ci_10550453) (accessed Oct. 12, 2008). Moreover, the state is in no financial position to bailout defaulting veterans should the need arise.

The Cal-Vet Program has proven to be fiscally sound because the DVA has installed safeguards in case of foreclosures. Specifically, the DVA holds the papers on the homes; they do not transfer legal title to the veteran until the loan is paid in full. <http://www.cdva.ca.gov/CalVetLoans/FAQs2.aspx#pb1> (accessed Oct. 1, 2008). Thus, if there is a foreclosure, DVA then can sell the home to recoup the loan proceeds. *SB 1572 Senate Bill Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080707\\_102502\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080707_102502_sen_floor.html) (accessed Oct 12, 2008). In addition, in the event that there is a short sale, the DVA has a mechanism in place referred to as "loan loss reserves," which is a set-aside that is required by their independent auditors and can be used to further prevent costs to the General Fund. *Senate Rules Committee Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-)



[1600/sb\\_1572\\_cfa\\_20080703\\_140131\\_sen\\_floor.html](http://www.cdva.ca.gov/CalVetLoans/Interest.pdf) (accessed Oct. 12, 2008). The maximum loan extended to veterans is \$521,250. *Cal-Vet Current Loan Terms, Fees, and Rates*, <http://www.cdva.ca.gov/CalVetLoans/Interest.pdf> (accessed Oct. 12, 2008). Finally, to ensure responsible lending, participants must pass a credit check to qualify for a Cal-Vet loan. *Prop. 12 would extend veteran home loan program*, [http://www.mercurynews.com/breakingnews/ci\\_10550453](http://www.mercurynews.com/breakingnews/ci_10550453) (accessed Oct. 12, 2008). The numbers do not detract from this conclusion, as there were only five reported defaults in all of last year. *Senate Rules Committee Analysis*, [http://info.sen.ca.gov/pub/07-08/bill/sen/sb\\_1551-1600/sb\\_1572\\_cfa\\_20080703\\_140131\\_sen\\_floor.html](http://info.sen.ca.gov/pub/07-08/bill/sen/sb_1551-1600/sb_1572_cfa_20080703_140131_sen_floor.html) (accessed on Oct. 12, 2008).

Finally, fairness dictates that Proposition 12 be approved. In June, the United States Congress finally passed legislation, the “HEART Act of 2008,” that affords new veterans in California the opportunity to obtain low-interest home loans. This new federal law enables veterans who served after 1977 to apply for a loan through the Cal-Vet Program. This, in turn, means the approximately \$102 million of authorized funds remaining will soon be depleted as the Cal-Vet Program is anticipating a surge in the number of applicants. This compels the need for fresh funding to extend this worthy program into the future. Without continued funding, many returning soldiers from Iraq and Afghanistan will never have the opportunity to purchase a home in high-cost California.

For these three compelling reasons, the supporters of Proposition 12 recommend that voters approve the Veterans’ Bond Act of 2008, so that the Cal-Vet Program may continue to assist men and women as they return to civilian life.

## **B. Opponents**

The opponents of Proposition 12 focus on three pragmatic arguments. First, authorizing further borrowing by our bankrupt state is irresponsible. Second, opponents argue that there are already too many general obligation bonds on the November ballot. Finally, opponents say voters can reasonably insist that the Cal-Vet Home Loan Program be limited to only veterans who have served in time of war

Opponents first contend that since the bonds are backed by the state, a financial risk to taxpayers always exists. Moreover, this risk is substantial in light of the statewide housing crisis and economic downturn. While foreclosures may have been an anomaly in years past, they are now occurring at a record clip. In fact, the state leads the foreclosure market. *California foreclosures surge*, <http://latimesblogs.latimes.com/laland/2008/04/california-fo-1.html> (accessed Oct. 13, 2008). The number of California homes lost to foreclosure in the first quarter of 2008 surged 327% from year-ago levels -- reaching an average of more than 500 foreclosures per day. *Id.* With the state wallowing in the red, now is not the time to impose additional burdens on the taxpayers. If the defaults occurred in large numbers, which is seemingly possible based on recent statistics, the state does not have the reserves to service this newly-created debt. Excessive debt with high interest rates could cripple the economy for years to come. The state government would be forced to raise taxes. Raising taxes to support more borrowing is a terrible idea for the state’s ailing economy.

Proposition 12 is the third general obligation bond act on the November ballot. *Directory of California State Propositions*, <http://www.smartvoter.org/2008/11/04/ca/state/prop/> (accessed Oct. 13, 2008). If all three measures pass, this could impose an unreasonable burden on our state's General Fund. Proposition 12 also removes capital from the state's tax base, since the income earned on the bond-returns is tax free. *TECHNICAL EXPLANATION OF H.R. 6081, THE "HEROES EARNINGS ASSISTANCE AND RELIEF TAX ACT OF 2008,"* <<http://www.house.gov/jct/x-44-08.pdf>> (accessed Oct. 12, 2008). In effect, it could sway investors from making tax-contributing investments in a state already in dire need of tax revenue.

Finally, opponents argue that voters can reasonably insist that the Cal-Vet Program be limited to veterans who served during a time of war. The program has limited funds and these funds will soon be depleted if the predicted rise in applicants occurs because of the recent passage of the HEART Act. Thus, voters should not approve more funding for a program that could be prioritized to include only veterans who have served in or during a time of war. In addition, there are no prior residency requirements – a veteran may have entered service from outside California and be entitled to the benefits of these low-interest loans. *Cal Vet Home Loans*, <http://www.cdva.ca.gov/CalVetLoans/Eligibility.aspx> (accessed Oct. 10, 2008). This, in turn, forces state taxpayers to subsidize out-of-state veterans who elect to relocate after serving our country.

Opponents of Proposition 12 contend that nothing is certain. California faces enormous challenges and voters should be reluctant to approve another bond measure backed by the state. A large number of defaults would further debilitate our treasury. As an alternative, if voters support the veterans' program, they should at least limit the benefits to veterans of war, thereby conserving the state's overall fisc.

## **VI. Financial Supporters**

No campaign committees have been formed to support or oppose Proposition 12. *California Secretary of State – Cal-Access*, <http://cal-access.ss.ca.gov/Campaign/Measures/Detail.aspx?id=1308397&session=2007> (accessed Oct. 13, 2008). Proposition 12 is a non-partisan, uncontroversial measure.

## **VII. Conclusion**

In the high-profile November election, there are many hot-ticket items that will surely garner more attention than Proposition 12. This fact, however, should not detract from the importance of this measure. Proposition 12 authorizes the state to sell nine hundred million dollars (\$900,000,000) of general obligation bonds to provide loans to California veterans who purchase farms and homes. The measure would allow thousands of new veterans, including younger ones returning from Iraq and Afghanistan, to buy homes and farms in California with low-interest rate mortgages. Proposition 12 would appropriate money from the state General Fund to pay off the bonds, if loan payments from participating veterans are insufficient for that purpose.

Since 1922, California voters have approved all 26 bond sales to help finance the Cal-Vet Program. Thus, it does not appear that Proposition 12 is susceptible to a successful challenge under either the California or Federal Constitution. Proponents argue that Proposition 12 will

continue the Cal-Vet Loan program for needy and deserving veterans who have served our country in the armed forces. It will also help stimulate the state's housing market and faltering economy as a whole. Opponents argue that voters could reasonably insist that the Cal-Vet Loan Program be limited to veterans who served in combat or a combat zone before they approve more borrowing to fund the Program. The California voting public must decide for themselves if continuing the Cal-Vet Program best serves the interests of the state.