PUBLIC HEARING

ON

BILL 17-741, THE "INCOME TAX SECURED BOND AUTHORIZATION ACT OF 2008"

Before the
Committee on Finance & Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

June 12, 2008; 10:00 a.m.
Room 412, John A. Wilson Building

Testimony of
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Treasurer and Deputy Chief Financial Officer
Government of the District of Columbia

Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Lasana K. Mack, Treasurer and Deputy Chief Financial Officer of the District of Columbia government. I am here to testify today on the proposed legislation to create a new vehicle for issuing District of Columbia debt that will enable the city to continue its practice of borrowing at the lowest possible interest rate, within prudent risk levels. Efficient use of available market tools has saved the District more than $100 million already, and this legislation would provide us with another tool, without increasing our risk.

These bonds would be secured by and paid solely from the Individual Income Tax and the Business Franchise Tax. As such, these bonds would be considered revenue bonds, and can also be considered a securitization of income tax revenues. We expect that this type of bond issue will provide a lower cost of borrowing and greater flexibility for the District.

The objectives of the proposed income tax bond program are, first and foremost, to achieve a lower cost of borrowing for the District; and second, closely tied to the first, to attain bond ratings on the Income Tax bonds that are higher than those of the District's General Obligation (G.O.) bonds. A third objective is to structure a flexible program that may be used instead of, or in addition to, the G.O. bond program, depending upon market conditions and other considerations.

Background

In Fiscal Year 2007, the District received $1.7 billion in combined individual income tax and business franchise tax revenue. These are the only major sources of revenue that have no claims against them. Conversely, our other major sources of revenue are pledged. The real property tax, which accounted for $1.4 billion in FY 2007, is pledged, first, to pay general obligation bonds, and it also backs outstanding tax increment financing bonds (TIFs). The sales tax ($1.1 billion in FY 2007) has various claims against it, including transfers to the Convention Center Authority, TIFs, and the schools modernization pay-as-you-go capital funds (Paygo). Gross receipts taxes are transferred to the Ballpark Fund. Thus, in contrast to these sources of revenue, with no claims against the income taxes, the District may offer investors a first claim on this flow of revenues.

Higher Bond Ratings Possible

Income tax bonds are relatively rare because income taxes are not generally a source of revenue available to local governments. In contrast, based on their broad ability to tax, nearly all states enjoy ratings in the double-A or triple-A category on their general obligation pledges, thereby negating or mitigating any reason for them to issue income tax bonds. In issuing such bonds, they would achieve little or no bond rating advantage, and little or no interest rate advantage. (See Attachment 2—Schedule of Bond Ratings.) Therefore, there are only a handful of examples on which we can base a comparison of what we might expect. The City of New York has issued income tax bonds through a separate authority, the Transitional Finance Authority, and the ratings assigned are AA+ by Fitch Ratings (Fitch), two notches above the city's G.O. rating, Aa2 from Moody's Investors Service (Moody's), one notch above the G.O. rating, and AAA by Standard & Poor's (S&P), two notches above the G.O. rating. (A notch is one rating increment, e.g., the difference between A and A+, or between A+ and AA-.) The Nassau County (New York) Interim Finance Authority achieved ratings of AA+, Aa2 and AAA from Fitch, Moody's and S&P, respectively. This was an improvement over the county's G.O. rating of three notches by Fitch and Moody's and five notches by S&P.

Mr. Chairman, we cannot be certain about what bond ratings are achievable on a District income tax bond program. Rating agencies will not issue a rating until bonds are ready to go to market. Therefore, we are seeking authorization to move forward with this program in order to propose an income tax bond issue to provide funding for the FY 2009 capital improvements program. That said, we believe that ratings in the double-A or even triple-A category, as compared to our current GO bond ratings in the A category, may be achievable for an income tax bond program.

Description of the Program

Let me be very clear at this point about what the income tax bond program is – and what it is not. It is a financing tool by which we hope to achieve a lower cost of borrowing. If lower costs are not available by using these bonds, we will not use them. As is currently the case with G.O. bonds, the program will continue to make available funding for any Council authorized District capital needs, including schools, libraries, recreation centers, roads, government buildings or any other item in the District's capital plan. The $2.9 billion level of authorization in the proposed legislation ties exactly to the amount of G.O. borrowing anticipated in the 6-year FY 2009 – FY 2014 Proposed Capital Improvements Plan that is a component of the Proposed FY 2009 Budget and Financial Plan. In short, this borrowing will be instead of – not in addition to – the District's General Obligation bonds.

This program will not eliminate or replace the District's ability to issue G.O. bonds. Those G.O. bonds already issued will continue to be paid from property taxes and G.O. bonds can be issued again in the future. The intent is as follows: each time the District needs to issue debt for its capital program, the Chief Financial Officer (CFO) will review market conditions, investor demand, potential savings and the ratings the District can expect for either G.O. bonds or Income Tax bonds and determine the best debt instrument – G.O. bonds or Income Tax bonds – to use to the District's benefit. I mention "investor demand" because as substantial amounts of bonds are issued against income tax revenues, fewer bonds will be outstanding against property tax revenues. At some point, the District's traditional property-tax-secured G.O. bonds could become more desirable to some investors. We will also continue to make prudent use of variable-rate bonds, either in the form of G.O. bonds or income tax bonds, which has been a tool through which we have achieved substantial debt service savings over the years.

This program will not increase taxes. The program will not delay income tax refunds. The program will not prevent the Council from reducing individual income and business franchise tax rates, with some limitation. The limitation is that the taxes will not be able to be reduced below a certain level of coverage for the debt service on the bonds. However, with a total revenue stream of $1.7 billion from income taxes, there is wide margin of protection to investors, even if the entire $2.9 billion authorization is issued. Therefore, if the Mayor and Council wish to provide income tax relief for individuals or businesses, they may do so within the customary budget constraints, which would be well within any limitations provided by this proposed bond program.

The recommended constraints on overall borrowing are not changed by this program. The proposed bill specifically requires that the CFO consider the income tax bonds as if they were G.O. bonds for purposes of the District's debt ceiling. Furthermore, the OCFO will include income tax bonds in the calculation of debt ratios that are the basis of the debt caps that have been recommended by the CFO to the Mayor and the Council. All debt issued pursuant to this proposed new borrowing vehicle will be considered District tax-supported debt, and the debt service on it will be included in the calculation of the debt service-to-expenditures ratio for which we have recommended a target of ten percent and a firm cap of no more than twelve percent.

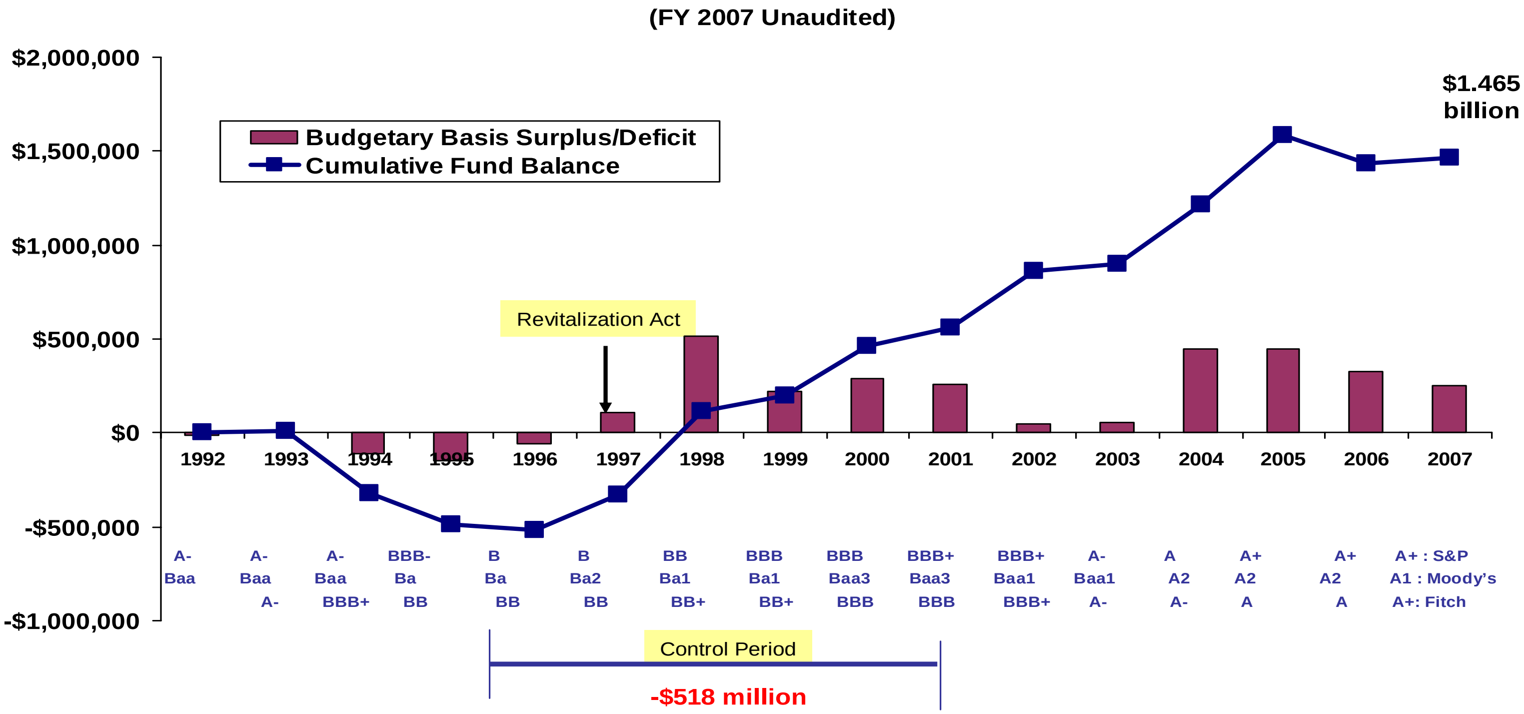
Projected Savings

It is expected that there would be no effect on the FY 2009 Budget. The debt service on income tax bonds would take the place of budgeted debt service on G.O. bonds. With higher bond ratings, we conservatively project that the result of an income tax bond program could be annual debt service savings of $1 million or greater, based on $1 billion of bond issuance. If all $2.9 billion were issued, annual savings could be $3 million or greater, with gross savings over the life of the bonds in excess of $70 million, compared to issuing G.O. bonds.

Conclusion

Mr. Chairman, you, the Mayor, the Council Chairman and others have put a great deal of effort into improving the District's G.O. bond ratings. We have much to be proud of in that regard, having achieved rating upgrades or improved rating outlooks every year for the past ten years. The Office of the Chief Financial Officer believes that the proposed income tax bond program can help us achieve even higher ratings on District bonds. In brief, the income tax bonds could be a valuable tool available to the District to achieve debt service savings, and we strongly recommend that the Council approve the legislation. This concludes my remarks. I would be pleased to answer any questions you may have.

Surplus and Bond Rating History



Schedule of Bond Ratings

	Fitch Ratings	Moody's Investors Service	Standard & Poor's
Highest Quality	AAA	Aaa	AAA
High Quality	AA+	Aa1	AA+
	AA	Aa2	AA
	AA-	Aa3	AA-
Good Quality	**A+**	**A1**	**A+**
	A	A2	A
	A-	A3	A-
Adequate Quality	BBB+	Baa1	BBB+
	BBB	Baa2	BBB
	BBB-	Baa3	BBB-
Below Investment Grade -- "junk" or "speculative"	BB+	Ba1	BB+
	BB	Ba2	BB
	BB-	Ba3	BB-
	B+	B1	B+
	B	B2	B
	B-	B3	B-
	CCC	Caa	CCC
	CC	Ca	CC
	C	C	C
	D	D	D

Current District of Columbia General Obligation Bond Ratings are in Bold type