PUBLIC OVERSIGHT HEARING ON

THE FISCAL YEAR 2002 AND 2003 SPENDING AND PERFORMANCE BY THE OFFICE OF BUDGET AND PLANNING, INCLUDING DEBT SERVICE, CERTIFICATES OF PARTICIPATION, TOBACCO TRANSFER, AND RESERVES

Before the

Committee of the Whole
Council of the District of Columbia

The Honorable Linda Cropp, Chairman

February 12, 2003, 10:00 a.m.
Council Chambers

Testimony of
N. Anthony Calhoun
Treasurer and Deputy Chief Financial Officer
Office of Finance and Treasury

Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good morning Chairman Cropp and members of the committee. My name is N. Anthony Calhoun, and I am the District's treasurer and deputy chief financial officer for finance and treasury. I am here to present testimony regarding the District's debt service, certificates of participation, tobacco transfer, and cash reserves for fiscal years 2002 and 2003. I am accompanied by Lasana Mack, associate treasurer, who is here to assist me in answering any questions that the committee might have at the conclusion of my testimony.

Long-term Debt Service – FY 2002 and FY 2003

The District's FY 2002 debt service expenditures on its outstanding long-term debt totaled approximately $272 million, with $38.9 million of that being for principal and interest on the deficit bonds that were issued in 1991. Total FY 2002 debt service expenditures were approximately $14 million below the original budget and $6.7 million below the revised budget, primarily due to lower-than-budgeted interest rates on both the new fixed-rate bonds and the outstanding variable-rate bonds. FY 2002 debt service expenditures were approximately $14 million higher than they were in FY 2001 (in which they totaled $258 million), as a result of the additional debt service associated with new borrowing.

FY 2003 total long-term debt service is projected to be approximately $284 million, with approximately $39 million of that being debt service on the 1991 deficit bonds, which will be completely paid off in FY 2003. This projected result is approximately $13 million below the revised FY 2003 budget, due to the savings obtained on our refunding (refinancing) bonds and the low interest rates obtained on our new-money bond issuance in the first quarter of FY 2003.

Certificates of Participation – FY 2002 and FY 2003

In FY 2002, principal and interest on the District's certificates of participation (COPs), issued to finance the One Judiciary Square facility, totaled \$7.9 million, in accordance with the budget for this category. In FY 2003, the budget is \$7.9 million, as it has been in the past. However, in the first quarter of FY 2003, the District refunded these COPs, replacing them with new COPs at lower interest rates. This produced significant debt service savings, and the transaction was structured such that the bulk of these savings are to be realized in FY 2003. Therefore, the projected debt service in this budget category for FY 2003 is approximately \$2.1 million, which is approximately \$5.8 million lower than budgeted.

Tobacco Transfer – FY 2002 and FY 2003

As you are aware, in FY 2001 the District of Columbia Tobacco Settlement Financing Corporation (the "Corporation") was established, and it issued \$521 million of revenue bonds backed by future tobacco settlement payments to the District from tobacco manufacturers. The FY 2002 budget included \$33.2 million as an expenditure line item for tobacco-related debt service savings that were to be transferred to the cash reserves (until filled) or to the Tobacco Trust Fund. However, as one of the FY 2002 gap-closing measures that accompanied the realization of a reduction in the FY 2002 revenue projection, these funds were not transferred but were made available to the general fund budget, thereby contributing to the FY 2002 result of a balanced budget. In addition, in FY 2002 there was \$9.75 million in tobacco "residuals," amounts received by the Tobacco Corporation from the tobacco manufacturers in excess of what was needed for debt service on the tobacco settlement bonds, which represents revenue to the District in

FY 2002. In FY 2003, the amount of tobacco-related debt service savings and expected residuals total approximately $56 million, all of which is budgeted to fund Medicaid-related costs in the FY 2003 budget.

Short-term Debt Service – FY 2002 and FY 2003

In FY 2002, the District did not do any short-term borrowing, and therefore there were no expenditures for interest on short-term debt. The budget for interest on short-term borrowing in FY 2002 was $500,000, a small amount established as a contingency in the event of an unforeseen short-term cash need. At the time of FY 2003 budget preparation, it was not clear what the FY 2003 short-term cash impact would be of the District's revenue picture and the full funding of the cash reserves in FY 2002. The amount budgeted for short-term interest for FY 2003 was doubled to $1 million from the FY 2002 contingency amount, still a relatively small amount. For a clearer picture of our FY 2003 short-term cash flow needs, in the first quarter of FY 2003 the District borrowed $150 million by issuing short-term Tax Revenue Anticipation Notes. These notes must be repaid by the end of the fiscal year. If they are paid off at the end of the fiscal year, the interest cost will be approximately $3.3 million, $2.3 million higher than budgeted. However, depending on how the revenue and cash picture develops in the coming months, there is the possibility of repaying the notes prior to the end of the fiscal year, producing a lower interest cost. In any event, the plan is to reprogram funds from the long-term debt service budget to cover the variance between the budgeted and actual debt service expense on the FY 2003 short-term borrowing.

Reserve Funds – FY 2002 and FY 2003

In FY 2002, the District deposited approximately $146 million into the cash reserve funds (Emergency and Contingency Reserves). This brought the cash reserves to their required level of a combined seven percent of local general fund expenditures (at $248.7 million), five years ahead of the original congressional requirement for full funding. These cash reserves are viewed very favorably by the bond rating agencies and investors in the District's bonds, and are a positive factor in the District's overall financial health and in the equation that determines the interest rates that the District pays on its outstanding debt. From this point forward, the requirement is that cash reserves be maintained at the level of seven percent of local expenditures. For FY 2003, based on the current budget, this means an increase of $5 million to the level of $253.7 million by the end of FY 2003.

Chairman Cropp, members of the committee, that concludes my testimony. We are prepared to answer any questions that you may have.

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