HEARING

ON THE

BUDGET REQUEST OF THE

DISTRICT OF COLUMBIA

FOR FISCAL YEAR 2006

Before the

Subcommittee on the District of Columbia
Committee on Appropriations
United States Senate

The Honorable Sam Brownback, Chairman

June 15, 2005; 10:00 a.m.
Room 138, Dirksen Senate Office Building

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

Good morning, Mr. Chairman, Senator Landrieu, and members of the subcommittee. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia, and I am here today to testify on the District's FY 2006 budget request to the Congress. My remarks will briefly touch on the FY 2005 financial outlook, the FY 2006 request, and the overall health of the District's finances.

Continuing Financial Strength

The Congress created the Office of the Chief Financial Officer to preserve, protect and enhance the District's financial viability and credibility at all times. I am pleased to report that the District has again made substantial progress in the past year, marking the eighth consecutive year of fiscal recovery. We again achieved a balanced budget and received a clean audit opinion from our external auditors and improved the District's financial infrastructure. The graph on Attachment 1 illustrates the turnaround in our general fund balance from a negative $518 million in fiscal year 1996 to a positive $1.2 billion fund balance at the end of fiscal year 2004. Roughly half of that fund balance is reserved as a result of congressional mandate or is legally reserved for bond escrows or other purposes. The fund balance is likely to climb in the current fiscal year to reach an unprecedented level of approximately $1.3 billion.

Our emergency and contingency reserves totaled $285.4 million, among the highest such reserves as a percentage of budget of all major cities or states in the nation. Last year, recognizing that the District's reserves were strong, Congress enacted legislation lowering the total reserves required to 6 percent from 7 percent. This fiscal year, we estimate that the emergency and contingency reserves will be about $249 million, an amount which we expect will still remain among the highest in the country.

We have again received favorable reviews from the bond rating agencies. Standard & Poor's raised the rating on the District's general obligation bonds to A from A- last November, and, at the same time, Fitch Ratings placed the District's A- rating on positive outlook for possible upgrade. The graph in Attachment 1 also shows the history of the District's ratings by all three major bond rating agencies.

We continue to strive to improve on this record of accomplishment. Our standardized spending plans for all agencies allow us to monitor results against those plans, and we continue to control agency spending using our online financial management tools. Spending plans are one component of the District's own Anti-Deficiency Act, designed to hold financial and program managers accountable for achieving program results within approved budgets. We have built performance budgets across all agencies that set specific targets which are benchmarked against best practices in local government.

Again this year, I must stress that it is time to grant the District of Columbia local budget autonomy. We have accomplished financial stability by institutionalizing changes that have been recognized by rating agencies and investors in the District's bonds and notes. We have established systems to monitor our budget on a constant basis and have enabled decision makers to receive timely and accurate information on which to make informed judgments. Without autonomy we must prepare specific spending plans and revenue estimates at least nine months in advance of the beginning of the actual budget year, a constraint under which no other state or municipal government must function. This issue of timing has added far greater uncertainty in budget planning and formulation and has posed more difficulty in executing the budget as well. We have been fortunate in recent years that our revenues have far exceeded our forecasts, but such time constraints have forced us to be overly conservative in our estimates, and have prevented us from providing tax relief or larger service benefits to our taxpayers as a result of those excess revenue collections. Congressman Tom Davis has introduced the District of Columbia Budget Autonomy Act of 2005, H.R. 1629, and Senator Collins introduced an equivalent bill, S.800, which would allow the Mayor and Council to enact the locally funded portion of the District's annual budget. We appreciate the interest of this subcommittee on the matter of budget autonomy and urge the Congress to consider the bills favorably.

Beginning Fund Balance, General Fund

As noted in the FY 2004 Comprehensive Annual Financial Report (CAFR), the District concluded FY 2004 operations with a $1.215 billion general fund balance (i.e., net accumulated surplus).

Based on current revenue and expenditure estimates, the General Fund is expected to end FY 2005 with an operating surplus of $320.6 million. The general fund balance is likely to reach $1.35 billion at the end of FY 2005.

FY 2006 Revenues

In FY 2006, District's certified general fund revenue is forecasted to be $4.81 billion, an increase of 13.8 percent over the FY 2005 approved budget after tax policy changes. Underlying the District's robust revenue growth is continued strength in the District's real estate market and strong growth in personal income. Substantial increases in prices and the number of transactions in both residential and commercial real estate markets were major sources of revenue gains in FY 2003 and FY 2004, and are expected to contribute significantly to FY 2005 and FY 2006 revenues. Going forward, our revenue projections assume District personal income will grow between 5 and 6 percent annually and the financial markets will continue their recovery.

The FY 2006 proposed budget includes tax policy reductions of $35 million and revenue shifts to capital of $30 million. The tax policy reductions include an increase in the homestead deduction, an increase in the local Earned Income Tax Credit, increases in both the standard deduction and the personal exemption, and a property tax deferral for low-income homeowners. The revenue shift to capital is to provide a dedicated stream of revenues to finance major investments in bridges and roads.

FY 2006 Proposed Expenditures

As Chief Financial Officer, I believe that it is not the role of government to amass large amounts of cash when needs for infrastructure improvements and other prudent investments in the future must be met. The magnitude of resources available for budgeting, both from the improved level of current revenues and the sizable accumulated surplus in the fund balance, provides an opportunity to address critical needs of the District.

Accordingly, this proposed budget would result in a reduction in the general fund balance of $610 million, to a balance of $740.2 million, from the projected year-end FY 2005 fund balance. This amount is composed almost entirely of one-time spending or transfers for future and retroactive pay-as-you-go capital funding, a reduction of a large pension benefit liability, policy shifts to special purpose and capital funds and operating budget programs to address critical social needs. I believe the spending levels and the uses of fund balance contained in this budget proposal are fiscally prudent and will not endanger the District's sound financial position or our strong credit standing. As shown in the table below, the Mayor and Council have weighed these financial opportunities in formulating policy goals for FY 2006, as incorporated into this proposed budget.

Table 2 **General Fund**

Proposed FY 2006 Budget Summary

($ in millions)

Total Revenues	$	4,871.2
Less Recurring Budget Expenses		(4,804.9)
Excess Revenues	$	66.3
Less Tax Policy Reductions and Revenues Shift to O type and Capital		(65.0)
Add Appropriated Fund Balance		591.6
Sources for Program and Fiscal Policy Initiatives	$	592.9
Less Non-recurring Budget Expenses		(399.8)
Less Fiscal Policy Initiatives		(191.8)
Projected FY 2006 Operating Margin	$	1.3

The FY 2006 general fund budget spending proposal of $5.40 billion is 19.8 percent higher than FY 2005 approved spending of $4.5 billion. This represents increases in both recurring expenses and the one-time uses of fund balance that I discussed previously. Recurring budget expenses of $4.80 billion are a net increase of $467 million, or 10.8 percent, over the FY 2005 approved budget.

Table 3 **General Fund**

FY 2006 Budget Submission

($ in millions)

	FY 2005	*FY 2006*	*Change*	% Change
Recurring Budget Expenses	**$4,337.8**	**$4,804.9**	**$467.1**	**10.8%**
Program Policy Initiatives:				
Nonrecurring Budget Expenses	165.0	192.8	27.8	16.8%
PayGo Capital (Nonrecurring)	-	207.1	207.1	n/a
Net Change: Recurring Expenses and Program Policy Initiatives			$702.0	
Non-recurring Fiscal Policy Initiatives:				
Post Employment Health Benefits	-	138.0	138.0	n/a
Contribution to Capital Fund Balance	-	53.8	53.8	n/a
Total General Fund Request	**$4,502.8**	**$5,396.6**	**$893.8**	**19.8%**

Financing the Budget Request

To finance both the program and fiscal policy initiatives, the District utilizes $591.6 million from the accumulated fund balance. The planned drawdown of fund balance will reduce the accumulated general fund balance to a projected $740.2 million by the end of FY 2006.

Table 4

FY 2006 General Fund Balance Analysis

($ in millions)

Projected Beginning Fund Balance (October 1, 2005)	$ 1,350.6
Appropriated for FY 2006	(591.6)
Projected FY 2006 Operating Margin	1.3
Projected GAAP Adjustments	(20.0)
Projected Ending Fund Balance (September 30, 2006)	$ 740.2

Proposed FY 2006 Gross Funds Budget

The proposed FY 2006 gross funds operating budget is $7.35 billion, an increase of $1.07 billion, or 17.0 percent, over the approved FY 2005 gross funds budget of $6.29 billion. The $1.07 billion expenditure increase is comprised largely of an $893.7 million increase in the General Fund budget, which reflects the program policy initiatives and fiscal policy initiatives discussed above. The other

$171.9 million increase in non-local funds reflects projected expenditures in federally funded programs ($169.0 million), including Medicaid; and private grants ($2.9 million).

Table 5

FY 2006 Gross Funds Budget By Fund Type

($ in millions)

Fund Type	FY 2005	FY 2006	Change	% Change
Local	$4,170.1	$4,949.5	$779.4	18.7%
Special Purpose (O Type)	$332.8	$447.1	$114.4	34.4%
Subtotal, General Fund	**$4,502.8**	**$5,396.6**	$893.7	19.8%
Federal	$806.3	$931.4	$125.1	15.5%
Federal Medicaid Payment	$963.8	$1,007.6	$43.9	4.6%
Private Grants	$13.3	$16.2	$2.9	21.8%
Total Gross Funds	**$6,286.2**	**$7,351.8**	$1,065.6	17.0%

Capital Improvements Plan

The District faces a wide variety of infrastructure needs, placing great demands on its Capital Improvements Plan (CIP). The total proposed appropriation request for the FY 2006 - FY 2011 CIP is $2.176 billion for all sources (including the Highway Trust Fund). This six-year plan includes a net increase in local budget authority of $778 million ($1.073 billion of new budget authority offset by $295 million of rescissions). The increased budget authority will be financed by General Obligation (G.O.) bonds, the Master Equipment Lease Program, asset sales, and PayGo financing. The FY 2006 capital program consists of $737 million in planned local non-streets capital expenditures (financed by up to $495 million in new G.O. bond issuance, $199 million of PayGo transfers from the General Fund balance, and $43 million from other sources), as well as $60 million of expenditures from the Local Streets Maintenance fund.

Performance Budgeting

This budget also reflects our continued progress implementing performance-based budgeting (PBB). In fiscal year 2005, we transitioned 11 new agencies to PBB, for a grand total of 67 agencies now fully enrolled in PBB for FY 2006. These 67 agencies account for nearly 63 percent of the District's annual gross operating budget. Transition to PBB is a key accomplishment because it establishes a clear relationship between the funding that agencies receive, the programs they operate, and the results that they must achieve. A critical component of PBB is development of programmatic benchmarks to assist policy makers, District executives and the public in assessing the value of the District's programs and determining opportunities for improvement. The current set of benchmarks for District programs has grown from 39 benchmarks for 18 agencies in FY 2005 to 71 benchmarks for 26 agencies in the FY 2006 proposed budget.

Structural Imbalance in the District's Budget

Mr. Chairman, despite this record of balanced budgets, there remains an ongoing, long-term financial problem, and that is the issue of the structural imbalance. This serious situation has been documented a number of times by sources outside the District, including most notably by the General Accounting Office in report GAO-03-666 in May 2003. This report defines a financial structural imbalance as the inability to provide a representative array of public services by taxing at representative rates. The District is the only city in the nation that has no state to share costs or underwrite expenditures in whole or part. The District bears about $500 million annually in costs of mental health, human services, child and family services, a university, motor vehicles licensing, taxation, insurance regulation, public service commission, and other services performed at the state level.

The District's primary employer – the federal government – has exempted itself from taxation on its property and its income. Furthermore, the preponderance of workers in the District of Columbia are exempt from D.C. income tax because they reside in the neighboring states of Maryland and Virginia. Finally, the District is the only municipality in the nation that must exercise the responsibilities of a city, a county, a state and a school district. Although the District has the authority for all types of taxes typically levied by states and municipal governments, it does not have the corresponding tax base sufficient to pay for the services it must provide.

Again this year, I must ask the subcommittee to consider the necessity of providing some additional federal consideration of the District's infrastructure needs. The District has pressing infrastructure needs – mostly in our schools, streets and transportation – that we cannot possibly fund locally. D.C. already has the highest per capita general obligation debt in the nation and, according to the GAO report, a tax burden that is 18 to 33 percent higher than average for the states. Our only options for addressing these infrastructure needs locally are:

- Adding even more debt per capita;
- Increasing the tax burden per capita – an action that is likely to discourage potential residents and employers and possibly drive current residents out of the city; or
- Reducing the delivery of other services – a very difficult choice in a city with a large population of people in need.

The GAO report stressed the unique financial challenges the District faces in generating the funds to finance usual and necessary services, and identified an annual structural imbalance of $470 million to $1.14 billion, based on FY 2000 budget and data, between the costs of delivering typical services and the revenue available from typical tax burdens. Over the years, the District dealt with this gap by neglecting infrastructure needs and assessing very high taxes.

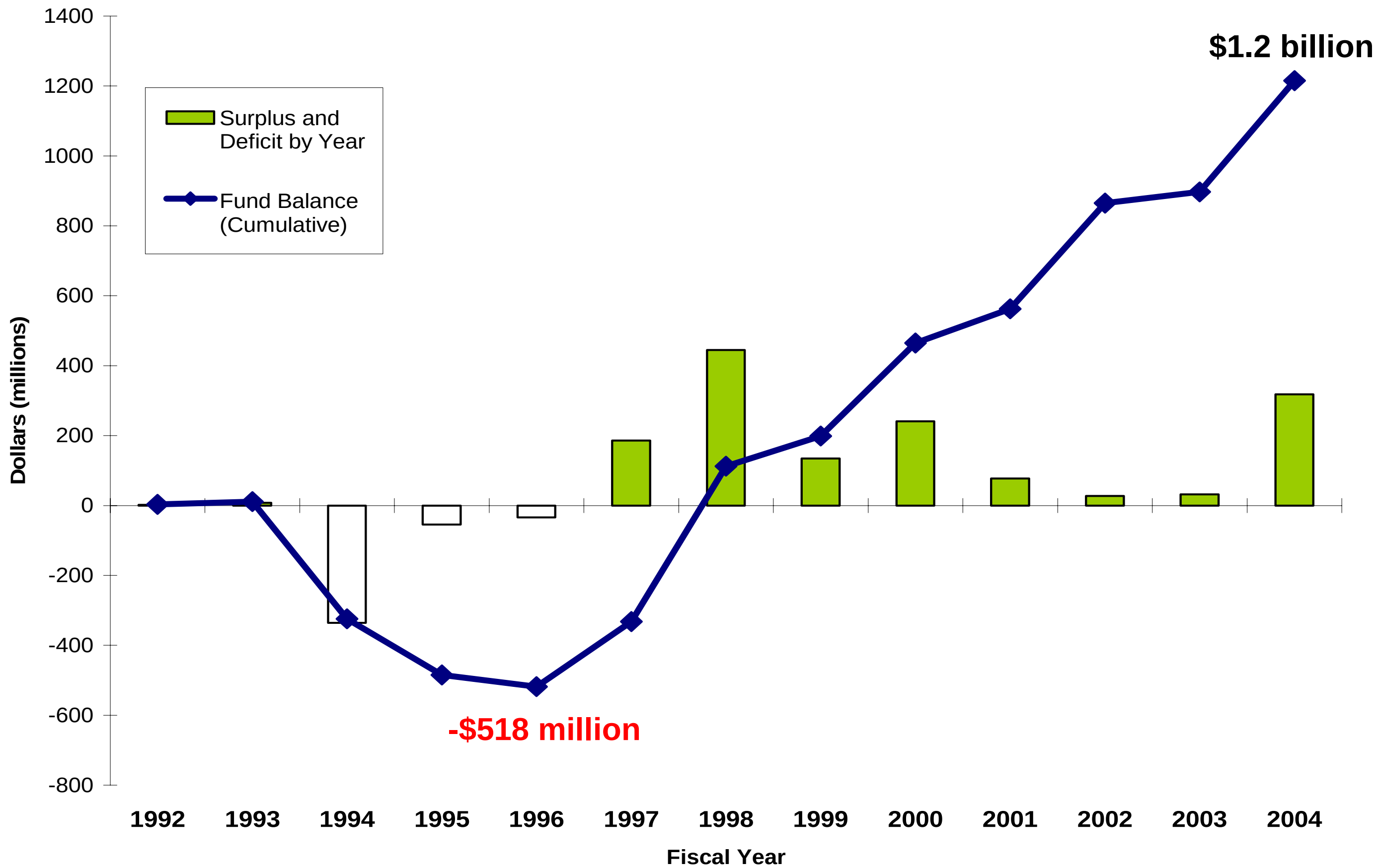
For example, our capital program is constrained by limited operating revenues to support debt service, as well as by the impact of prudent debt ratios and debt affordability determinations. The District's capital needs are now estimated to be about $7 billion, but our capital spending plan in FY 2006- FY 2011, for which we have identified funding sources, is only about $2 billion, leaving a gap of about $5 billion. If borrowing occurs as planned, our tax-supported debt per capita will rise to over $11,000 by FY 2009.

Again this year, Congresswoman Norton has introduced a bill, the Fair Federal Compensation Act of 2005 (H.R. 1586), to address the structural imbalance, to relieve some of the unsustainable burden on the D.C. government and residents and businesses, and to prevent another fiscal crisis for the capital city. We urge Congress to take action to enact this important legislation.

Conclusion

Mr. Chairman, this concludes my remarks. I will be pleased to answer any questions you or the other members may have.

General Fund Balance History



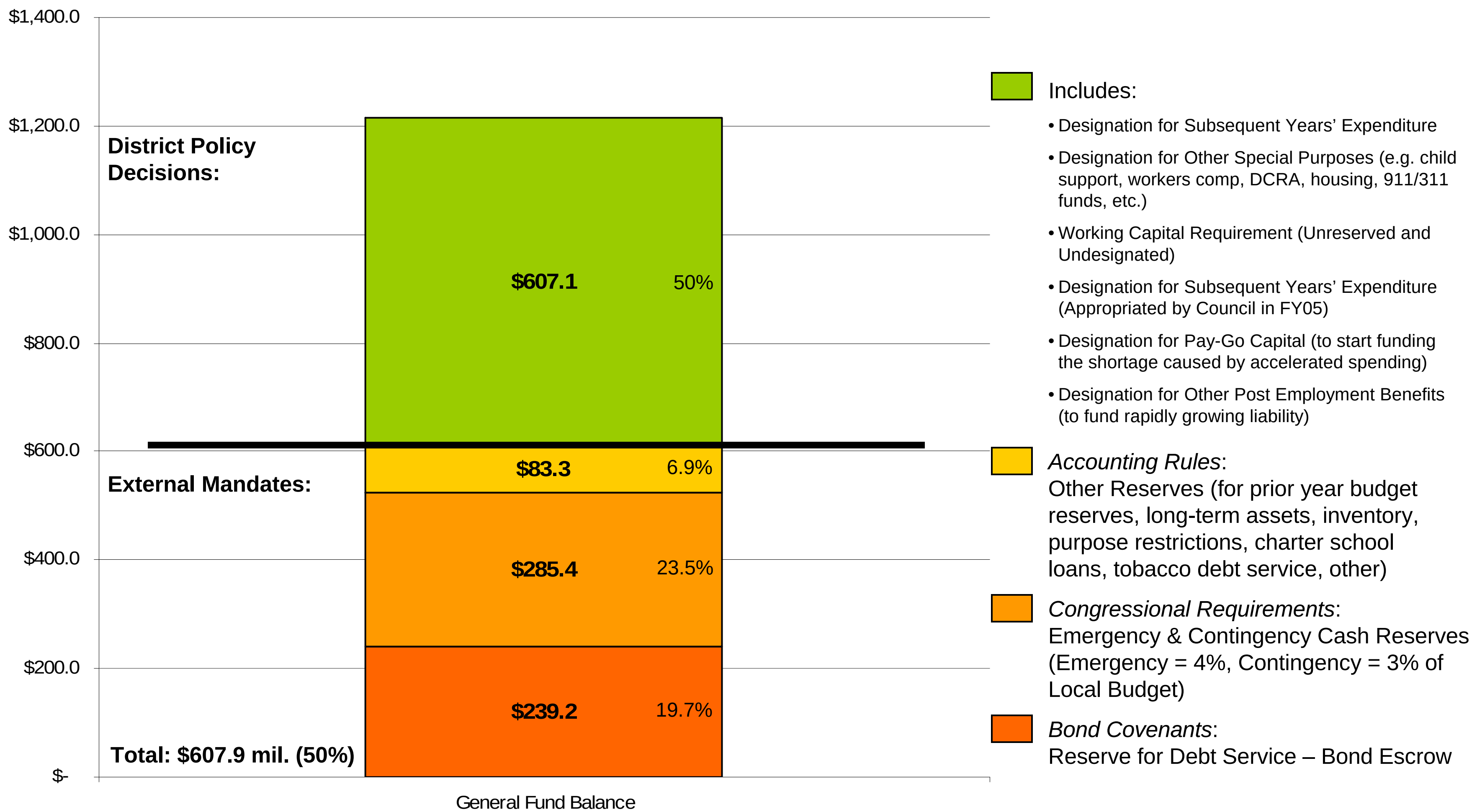
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
S&P:	A-	A-	A-	BBB-	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-

Control Period

Revitalization Act

FY 2004 General Fund Balance

($ in millions)



Total as of September 30, 2004: **$1,215.0 million**

Reserve Requirements

($ in millions)

Fund Type	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Emergency & Contingency Cash	$285	$249	$254	$258	$302	$307
Budgeted	$50	$50	$50	$50	$50	$50
Total	**$335**	**$299**	**$304**	**$308**	**$352**	**$357**

Cash Reserve Requirements Reduced from 7% to 6%:

- Emergency Reserve changed from 4% to 2%.
- Contingency Reserve changed from 3% to 4%.

District of Columbia
FY 2006 - 2009 Proposed Budget and Financial Plan
GENERAL FUND
(Dollars in Thousands)

	Revenues	**FY 2004 Actual**	**FY 2005 Approved**	**FY 2005 Revised**	**FY 2006 Proposed**	**FY 2007 Projected**	**FY 2008 Projected**	**FY 2009 Projected**
1	Taxes	3,665,195	3,628,730	3,875,218	4,101,533	4,330,091	4,610,561	4,890,072
2	General Purpose Non-Tax Revenues	324,493	292,447	330,973	340,522	342,896	338,513	346,573
3	Special Purpose (O-type) Revenues	240,253	208,624	236,026	264,254	273,603	280,326	287,789
4	Transfer from Lottery	73,500	71,100	70,000	73,100	73,100	73,100	73,100
5	**General Fund Revenues**	**4,303,441**	**4,200,901**	**4,512,217**	**4,779,409**	**5,019,690**	**5,302,500**	**5,597,534**
6	Bond Issuance Costs	0	0	15,400	40,000	16,000	16,000	15,615
7	Payment-in-Lieu-of-Taxes from WASA	0	0	1,500	1,576	1,622	1,669	1,717
8	Transfer from Federal and Private Resources	0	6,361	6,361	6,502	6,646	6,807	6,979
9	Fund Balance Use	129,128	165,015	165,015	591,642	0	0	0
10	Transfer to Special Purpose Revenues	0	0	0	0	0	0	0
11	Transfer to Capital	0	0	0	(30,000)	(30,300)	(30,603)	(30,909)
12	Revenue Proposals/One-time Revenue	0	128,107	76,600	8,729	7,607	9,367	11,137
13	**Total General Fund Resources**	**4,432,569**	**4,500,384**	**4,777,093**	**5,397,858**	**5,021,265**	**5,305,740**	**5,602,073**
	Expenditures (by Appropriation Title)							
14	Governmental Direction and Support	231,364	315,813	327,899	340,859	326,649	336,654	346,999
15	Economic Development and Regulation	148,949	241,570	216,715	328,156	246,557	252,885	259,394
16	Public Safety and Justice	746,066	790,815	799,194	827,037	864,258	884,495	917,173
17	Public Education System	1,029,193	1,067,666	1,055,821	1,189,302	1,194,175	1,228,423	1,263,822
18	Human Support Services	1,117,035	1,192,755	1,244,598	1,307,530	1,345,993	1,401,101	1,458,860
19	Public Works	314,620	327,936	328,334	366,101	373,427	388,605	404,451
20	Financing and Other	400,963	511,692	468,917	588,717	607,655	642,994	678,362
21	Cash Reserve (Budgeted Contingency)	0	50,000	15,000	50,000	50,000	50,000	50,000
22	Lease Purchase Costs	0	0	0	0	0	20,000	25,000
23	**Subtotal, Operating Expenditures**	**3,988,190**	**4,498,247**	**4,456,478**	**4,997,702**	**5,008,714**	**5,205,156**	**5,404,062**
24	Paygo Capital	0	0	0	207,083	10,000	0	0
25	Transfer to Trust Fund for Post-Employment Benefits	0	0	0	138,000	0	81,000	86,200
26	General Fund Contribution to Capital Fund Balance	0	0	0	53,800	0	0	0
27	**Total General Fund Expenditures**	**3,988,190**	**4,498,247**	**4,456,478**	**5,396,585**	**5,018,714**	**5,286,156**	**5,490,262**
28	**Operating Margin, Budget Basis**	**444,379**	**2,137**	**320,615**	**1,273**	**2,551**	**19,583**	**111,810**
29	**Beginning General Fund Balance**	**897,357**	**1,215,015**	**1,215,015**	**1,350,615**	**740,246**	**722,798**	**722,380**
30	Operating Margin, Budget Basis	444,379	2,137	320,615	1,273	2,551	19,583	111,810
31	Projected GAAP Adjustments (Net)	2,407	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)
32	Deposits into Reserve Funds (From Fund Balance)	(31,609)	(19,041)	36,032	(4,489)	(4,570)	(43,113)	(5,428)
33	Deposits into Reserve Funds (To Cash Reserves)	31,609	19,041	(36,032)	4,489	4,570	43,113	5,428
34	Tax Increment Financing (TIF) Reserve (From Fund Balance)	0	(9,710)	(9,710)	(9,710)	(9,710)	(9,710)	(9,710)
35	Unspent TIF Reserve	0	9,710	9,710	9,710	9,710	9,710	9,710
36	Fund Balance Use	(129,128)	(165,015)	(165,015)	(591,642)	0	0	0
37	**Ending General Fund Balance**	**1,215,015**	**1,032,137**	**1,350,615**	**740,246**	**722,798**	**722,380**	**814,190**
	Composition of Fund Balance							
38	Emergency Cash Reserve Balance (2%, formerly 4%)	163,091	179,930	83,126	84,622	86,145	100,516	102,325
39	Contingency Cash Reserve Balance (4%, formerly 3%)	122,318	124,520	166,251	169,244	172,290	201,032	204,651
40	Fund Balance not in Emergency & Contingency Reserves	929,606	727,687	1,101,238	486,381	464,363	420,832	507,214
41	**Ending General Fund Balance (Line 37)**	**1,215,015**	**1,032,137**	**1,350,615**	**740,246**	**722,798**	**722,380**	**814,190**