HEARING
ON
THE MAYOR'S FY 2007
PROPOSED BUDGET AND FINANCIAL PLAN

Before the
Subcommittee on Transportation, Treasury, and Housing and Urban Development, the Judiciary, District of Columbia
Committee on Appropriations
U.S. House of Representatives

The Honorable Joe Knollenberg, Chairman

April 6, 2006, 10:00 a.m.
2358 Rayburn House Office Building

Testimony of
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Good morning, Chairman Knollenberg and members of the subcommittee. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia, and I am here to offer brief remarks about the fiscal year 2007 proposed budget and financial plan for the District.

First, I will summarize the fiscal recovery over the past decade and discuss some of the highlights of the FY 2007 budget request and the five-year plan. I will also address our capital spending needs and the continuing structural imbalance – which is the mismatch between capital spending needs and the ability to raise local revenues sufficient to fund those needs. Finally, I will address our ongoing commitment to remain fiscally balanced in the future.

Fiscal Recovery 1996 – 2005

The chart that appears as Attachment A to my testimony is a history of the remarkable fiscal comeback achieved by the District over the past decade. Our fiscal low point occurred in FY 1996, when the general fund balance hit a negative $518 million. Through the efforts of Mayor Williams, the District Council and the congressionally-mandated control board, we were able to balance the District's fiscal operations, and the control board was de-activated in 2001. Between FY 1996 and the end of FY 2001, there was a $1.1 billion increase in the fund balance, to a positive $562 million by the end of FY 2001.

But the real test for the District was the challenge of sustaining fiscal stability in the post-control period. As you can see, at the end of FY 2005, the general fund balance had risen another $1 billion – to $1.6 billion total. I believe that it is significant that, of the $2.1 billion increase in the general fund balance between FY 1996 and FY 2005, the amount of gain since the control period ended was about equal to the gain during the control period.

The measure of this success is reflected in the District's bond ratings. All three rating agencies – Fitch Ratings, Moody's Investors Service and Standard & Poor's – recognized the improved creditworthiness of our bonds by raising the District's bond ratings from "junk" status during the control period to "A" category ratings, which is the highest level ever achieved by this municipality. It is notable that compared to other major cities that experienced periods of financial stress, including New York, Philadelphia, Cleveland, and Detroit, this turnaround is the fastest both in terms of the time it took to return to investment grade and in the time to achieve their highest ratings (helped in part by our strong local economy, which added tax revenues that were used to provide essential services to our population).

A great deal of the increase in our fund balance was driven by the growth in local revenues, specifically by real estate, income and sales taxes resulting from the strong regional economy. Table 1 below shows a comparison of tax revenues, general fund balance and reserve funds in FY 1996 and FY 2005 that reflects the revenue growth and prudent financial management that contributed to the increased general fund balance.

Table 1 **Comparison of Key Financial Measures** *($ in thousands)*		
	FY 1996	**FY 2005**
Tax Revenues	$2,517,044	$4,179,078
Operating Surplus/(Deficit)	($33,688)	$369,668
General Fund Balance	($518,249)	$1,584,683
Reserves Available for Operations**	($332,357)	$428,900
Operating Reserves as % of Expenditures	--	8.5%

***Includes congressionally-mandated Emergency and Contingency Reserves plus unreserved undesignated General Fund balance.*

Revenue Outlook

Underlying the current revenue forecast is an economic outlook for the District similar to that projected for the nation as a whole – steady growth in employment, wages, and income. Continued high levels of federal spending mean an extra “kick” locally because so many of these dollars will be spent here. Retail activity will continue to improve, as the number of retail outlets in the District continues to grow and as shoppers increase their spending.

In FY 2007, District general fund resources are forecasted to be $5.497 billion, an increase of $99.7 million above the FY 2006 approved budget. These amounts include local fund revenue, special purpose fund revenue, as well as proposed revenue enhancements and appropriated fund balance.

The direction of the market for real property is a key question for the District in FY 2006 and on into FY 2007. Rising real estate assessments and transactions were major sources of revenue gains in fiscal years 2003 through 2005. The fundamentals affecting the District’s real estate markets remain strong. The District’s economy is growing, individuals and businesses both continue to demonstrate a desire to locate in the District, and the supply of housing and land for commercial development cannot increase very rapidly. Accordingly, the contributions of the real estate sector are expected to be significant in FY 2006 and in FY 2007, as well, but they will be more moderated, especially as regards the number of transactions.

Highlights of FY 2007 Proposed Budget and FY 2007 - 2010 Financial Plan

The FY 2007 – 2010 financial plan appears as Attachment B. Each of the four years is balanced. Tax revenues are projected to increase an average 6 percent per year, total local fund recurring revenues an average 5.6 percent, and recurring local operating expenditures an average 5.4 percent. Incorporated in the plan is the final phase of "tax parity" that the Mayor and Council initiated in 1999 to lower income tax rates and achieve better balance between D.C. and its neighbors. The plan also accommodates a major new expenditure starting in FY 2008, namely, the required actuarial payment for post employment retirement benefits (OPEB), thereby complying with the GASB requirement.

The Mayor's FY 2007 proposed budget includes $4.95 billion in spending supported by $4.952 billion of revenues, with an operating margin of $1.8 million.

Table 2
Budget Summary – Local Funds
($ in thousands)

	Approved FY 2006	Proposed FY 2007	% Change
Total Taxes	$ 4,101,533	$ 4,341,981	5.9%
Non Tax Revenue	413,622	395,675	-4.3%
Gross Sales Tax to School Modernization	-0-	($100,000)	--
Miscellaneous Revenues	48,078	46,144	-4.0%
Appropriated Fund Balance	466,930	219,792	-52.9%
Transfers to Special Purpose & Capital	-84,395	-0-	--
Revenue Enhancements – Compliance Initiatives	4,976	49,000	984.7%
Total Local Fund Resources	**$ 4,950,744**	**$ 4,952,592**	**0.0%**
Recurring Operating Expenditures	$ 4,474,358	$ 4,826,268	7.9%
Non Recurring Operating Expenditures	76,230	38,305	-49.8%
Subtotal Operating Expenditures	$ 4,550,833	$ 4,864,573	6.9%
Paygo Capital and Transfer to OPEB for FY 2007 costs	398,883	86,187	-78.4%
Total Expenditures	**$ 4,949,471**	**$ 4,950,760**	**0.0%**
Projected Operating Margin	**$ 1,273**	**$ 1,832**	

The Mayor’s proposed total local fund operating expenditures for FY 2007, not including paygo capital or transfers to OPEB, is $4,864.6 million, an increase of $314.0 million or 6.9% over FY 2006 revised expenditures of $4,550.6 million.

Gross Funds Budget

The proposed FY 2007 gross funds operating budget is $7.503 billion, an increase of $150.9 million, or 2.1 percent, over the approved FY 2006 gross funds budget of $7.352 billion. This expenditure increase is primarily due to higher funding levels for federal grants ($ 90.1 million) including Medicaid, and in programs supported by user fees, fines, the dedicated portion of deed recordation and transfer taxes (for housing production), and other special purpose revenues ($ 68.9 million). The local and non-local funding components of the proposed FY 2007 gross funds budget and the changes from FY 2006 are summarized in Table 3 below.

Table 3 **FY 2007 Gross Funds Budget By Fund Type** *($ in millions)*				
Fund Type	**FY 2006**	**FY 2007**	**Change**	**% Change**
Local	$ 4,949.5	$ 4,950.8	$ 1.3	0.03%
Federal	1,939.0	2,029.1	90.1	4.6%
Private Grants	16.2	6.8	(9.4)	(58.0)%
Special Purpose	447.1	516.0	68.9	15.4%
Total Gross Funds	**$ 7,351.8**	**$ 7,502.7**	**$ 150.9**	**2.1%**

General Fund Balance Use

It is not the function of government to "hoard" public funds, but to provide badly needed services. With this in mind, the FY 2006 budget included provisions for spending a portion of the funds that had accumulated over the years as a result of unprecedented growth in local revenues. This drawdown of fund balance was largely driven by one-time spending on capital needs and programs. As approved, the FY 2006 budget uses $467 million of local fund balance, and we currently estimate a net reduction by September 30, 2006, of roughly $450 million in the general fund balance.

The FY 2007 proposed local funds operating budget includes a proposal to use another $219.8 million of fund balance. The use of these monies is for non-recurring expenditures:

- $100 million for school modernization in FY 2007,
- $81.5 million for paygo capital to fund various capital projects,
- $4.7 million for transfer to the trust fund for other post employment benefits for FY 2007 costs, and
- $32.6 million for various one-time operating program enhancements.

Local Funds Budget and Fund Balance

As recently noted in the FY 2005 Comprehensive Annual Financial Report (CAFR), the District concluded FY 2005 operations with a $1.585 billion fund balance (i.e., accumulated surplus). For the FY 2006 approved budget, $591.6 million of the fund balance ($466.9 million in local funds and $124.7 million in special purpose funds) was appropriated for use.

The local fund is expected to end FY 2006 with an operating surplus of $52.7 million. This is based on current revenue and expenditure estimates for local funds in FY 2006 and the Mayor's proposal to convert special purpose balance to unreserved and undesignated fund balance, not considering the potential impact from congressional supplemental appropriations or end-of-year CAFR audit adjustments. This will increase the local fund balance.

Table 4
Local Fund Balance Analysis
($ in thousands)

	FY 2006	FY 2007
Beginning Fund Balance (October 1)	$ 1,277,000	$879,228
Local Appropriated Funds	(466,930)	(219,792)
Projected Local Operating Margin	52,709	1,832
Conversion of Special Purpose to Local	16,449	--
Projected Ending Fund Balance (September 30)	$ 879,228	$661,268

As exhibited in Table 4, the use of fund balance and the operating margin in FY 2006 would produce a fund balance for local funds of $879 million at the end of FY 2006. Roughly 60 percent would represent on-going, required commitments such as congressional and bond covenant reserves. The remainder is available for appropriation and represents a substantial asset to the District. As always with fund balance, because it must be considered non-recurring, it should be used in a careful, judicious and strategic manner and not to fund on-going program commitments. The District must invest part of the general fund balance in one-time infrastructure spending in order to address critical needs created by the ongoing structural imbalance, which I will discuss in detail later. The Mayor's proposed budget for FY 2007 utilizes $219.8 million from the accumulated fund balance. Table 3 also demonstrates that the planned drawdown of fund balance will reduce the accumulated surplus for local funds to a projected $661.3 million by the end of FY 2007. The degree of reduction in the fund balance is a reflection of the considerable and growing need to improve the District's infrastructure, which I will now address in detail.

Capital Spending

The District continues to face a wide variety of infrastructure needs, placing great demands on its Capital Improvements Plan (CIP). The total proposed appropriation request for the FY 2007-2012 CIP is $1.995 billion for all sources (excluding the Highway Trust Fund). This six-year plan includes a net increase in budget authority of $1.637 billion.

The FY 2007 capital program includes $581.5 million in planned capital expenditures financed by $400 million in newly issued G.O. bonds and $181.5 million of pay-as-you-go (paygo) transfers from the general fund balance.

Despite this effort to fund the District's considerable capital needs, I must again point out to the committee that this government continues to struggle to function under a structural imbalance, as confirmed by the GAO in its 2003 study of the District's finances.

Two consequences of the structural imbalance between the District's revenue base and its spending requirements are: 1) a high per capita tax burden with some of the highest tax burdens in the region and the country; and 2) the highest per capita borrowing. D.C.'s tax burden on households ranks in the upper-one third when compared to the largest cities in the U.S. (for total state and local burden of sales, income, property, and automobile taxes).

The burden is greater on businesses. D.C.'s tax rate on net business income is 9.975 percent**;** the gross receipts tax on public utilities used by businesses is 11 percent; and the real property tax on commercial property is $1.85 per $100 of value as compared to a range of $0.92 to $1.16 in neighboring suburbs.

The GAO ranks D.C.'s tax burden among the very highest in the country. "The District's tax burden (actual revenue collected from local resources relative to their own-source revenue capacity) is among the highest of all fiscal systems, . . . The District's actual tax burden exceeded that of the average state fiscal system by 33 percent, based on our lower estimate of its own-source revenue capacity, and by 18 percent, based on our higher estimate of that capacity."[1]

The District's very high per capita borrowing reflects the city's effort to sustain infrastructure generally provided by multiple jurisdictions. The District's per capita tax-supported debt burden exceeds $8,000, the highest of any major city in the nation. Clearly, we cannot borrow our way out of the structural imbalance.

Challenges may arise, however, adding to D.C.'s structural imbalance in coming years. First, all state and local revenue systems are stressed by the changing nature

[1] GAO-03-666, District of Columbia, Structural Imbalance and Management Issues, May 2003, page 41.

of the economy, as it evolves more into a service oriented economy. Because state and local tax systems were developed around the manufacturing and sale of goods, the old ways of gathering tax revenue are increasingly inadequate to the newer economy. The revenue challenge is made even greater in the District by federal prohibitions against taxing incomes earned by non-resident workers and incomes earned by certain professional services.

Second, the District has a large urban population that needs help. Census data for 2004 estimate the D.C. poverty rate at about 19 percent, the fourth highest in the nation when compared to states, after Mississippi, Louisiana, and New Mexico. Of D.C.'s 248,563 households, 18 percent have income of less than $15,000.[2] Median household income is about $46,600 – in a metropolitan area with median household income of $70,900. Only about a third of D.C.'s households are at or above the metropolitan median. Like other cities, D.C. is accountable for greater efforts to help the less advantaged in the city's population. The proposed FY 2007 budget works hard to manage the expenditure needs and fiscal requirements of the District's lower income population.

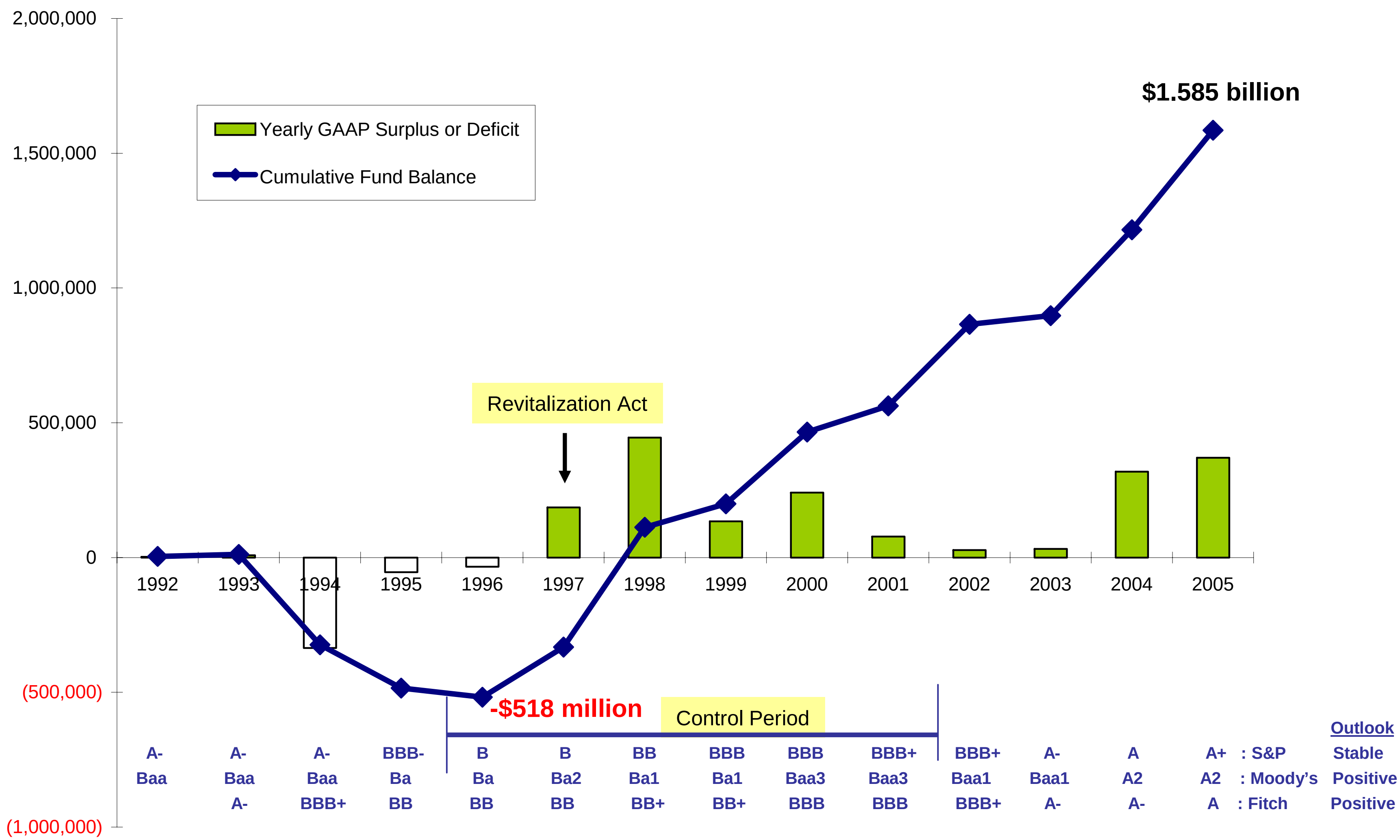
Conclusion

The leadership provided by the Mayor and the Council, along with the hard work of the Office of the Chief Financial Officer, allowed us to produce this balanced budget for FY 2007. As a result, we are certifying that the FY 2007 budget and financial plan, as proposed, is balanced for FY 2007 and beyond. I would like to thank this committee for its diligent and continuous oversight work on the District's finances during this sustained recovery period. We look forward to

[2] American Community Survey, 2004.

continuing to work with you and the subcommittee during the forthcoming budget deliberations.

Surplus and Bond Rating History



ATTACHMENT A

ATTACHMENT B

District of Columbia
FY 2007 - 2010 Proposed Budget and Financial Plan
GENERAL FUND
(Dollars in Thousands)

Revenues	FY 2005 Actual	FY 2006 Approved	FY 2006 Adjusted	FY 2007 Proposed	FY 2008 Projected	FY 2009 Projected	FY 2010 Projected
Taxes	4,052,087	4,101,533	4,110,172	4,341,981	4,613,778	4,892,984	5,179,039
General Purpose Non-Tax Revenues	352,427	340,522	319,847	323,575	318,077	320,958	317,518
Special Purpose (O-type) Revenues	311,789	264,254	347,538	372,841	373,534	372,954	386,829
Transfer from Lottery	71,450	73,100	72,000	72,100	72,100	72,100	72,100
General Fund Revenues	**4,787,753**	**4,779,409**	**4,849,557**	**5,110,497**	**5,377,489**	**5,658,996**	**5,955,486**
Gross Sales Tax Dedicated for School Modernization	0	0	0	(100,000)	(106,000)	(112,360)	(119,102)
Adjusted General Fund Revenues	**4,787,753**	**4,779,409**	**4,849,557**	**5,010,497**	**5,271,489**	**5,546,636**	**5,836,384**
Bond Proceeds for Issuance Costs	4,935	40,000	40,000	30,000	30,000	20,000	20,000
Payment-in-Lieu-of-Taxes from WASA	0	1,576	1,576	1,551	0	0	0
Transfer from Federal and Private Resources	0	6,502	6,502	6,502	6,646	6,807	6,979
Transfer from Special Purpose Funds for Debt Service	0	0	0	8,091	14,526	15,097	15,465
Fund Balance Use	80,781	591,642	607,615	326,189	19,968	0	0
Transfer to Special Purpose Revenues	0	0	0	0	0	0	0
Transfer to Capital	0	(30,000)	0	0	0	0	0
Revenue Proposals/One-time Revenue	0	8,729	0	114,700	246,405	215,344	169,286
Total General Fund Resources	**4,873,469**	**5,397,858**	**5,505,250**	**5,497,530**	**5,589,034**	**5,803,884**	**6,048,114**
Expenditures (by Appropriation Title)							
Governmental Direction and Support	294,778	340,859	341,858	380,492	366,995	377,019	388,915
Economic Development and Regulation	193,456	328,156	347,556	339,524	313,718	320,934	335,286
Public Safety and Justice	805,471	827,037	829,687	940,976	957,159	986,518	1,018,881
Public Education System	1,082,177	1,189,302	1,179,939	1,224,534	1,247,351	1,279,254	1,312,659
Human Support Services	1,258,537	1,307,530	1,340,581	1,419,912	1,471,831	1,544,764	1,624,269
Public Works	328,997	366,101	366,101	408,107	407,465	422,309	439,338
Financing and Other	421,070	561,276	532,857	573,032	645,695	685,065	733,145
Cash Reserve (Budgeted Contingency)	0	50,000	48,400	50,000	50,000	50,000	50,000
Lease Purchase Costs	22,058	27,441	27,441	43,955	46,320	49,320	51,320
Subtotal, Operating Expenditures	**4,406,544**	**4,997,702**	**5,014,420**	**5,380,532**	**5,506,534**	**5,715,183**	**5,953,813**
Paygo Capital	20,550	207,083	208,523	81,487	0	0	0
Transfer to Trust Fund for Post-Employment Benefits	0	138,000	138,000	4,700	81,000	86,200	91,800
General Fund Contribution to Capital Fund Balance	0	53,800	53,800	0	0	0	0
Total General Fund Expenditures	**4,427,094**	**5,396,585**	**5,414,743**	**5,466,719**	**5,587,534**	**5,801,383**	**6,045,613**
Operating Margin, Budget Basis	**446,375**	**1,273**	**90,507**	**30,811**	**1,500**	**2,500**	**2,500**
Beginning General Fund Balance	**1,215,015**	**1,584,683**	**1,584,683**	**1,047,575**	**732,197**	**693,729**	**676,230**
Operating Margin, Budget Basis	446,375	1,273	90,507	30,811	1,500	2,500	2,500
Projected GAAP Adjustments (Net)	4,074	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)
Deposits into Reserve Funds (From Fund Balance)					(31,150)		
Deposits into Reserve Funds (To Cash Reserves)					31,150		
Tax Increment Financing (TIF) Reserve (From Fund Balance)							
Unspent TIF Reserve							
Fund Balance Use	(80,781)	(591,642)	(607,615)	(326,189)	(19,968)	0	0
Ending General Fund Balance	**1,584,683**	**974,314**	**1,047,575**	**732,197**	**693,729**	**676,230**	**658,730**
Composition of Fund Balance							
Emergency Cash Reserve Balance (2%, formerly 4%)	70,532	84,622	70,532	73,001	100,879	101,142	102,294
Contingency Cash Reserve Balance (4%, formerly 3%)	182,905	169,244	182,905	189,307	201,759	202,284	204,588
Fund Balance not in Emergency & Contingency Reserves	1,331,246	720,448	794,138	469,890	391,091	372,803	351,847
Ending General Fund Balance (Line 37)	**1,584,683**	**974,314**	**1,047,575**	**732,197**	**693,729**	**676,230**	**658,730**