PUBLIC OVERSIGHT HEARING

on:

OFFICE OF THE CHIEF FINANCIAL OFFICER

and the

DC LOTTERY AND CHARITABLE GAMES CONTROL BOARD

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

The Honorable Jack Evans, Chairman

December 13, 2012
John A. Wilson Building
Council Chambers

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

Good Morning Chairman Evans and members of the Committee on Finance and Revenue. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia. I am pleased to appear before you today for this oversight hearing. With me today are Stephen Cordi, the District's tax commissioner; Robert Farr, Director of the Real Property Tax Administration, Buddy Roogow, Executive Director of the DC Lottery and David Tseng, our General Counsel. Mr. Cordi and Mr. Roogow will also present testimony today.

Update of District Financial Condition

First, let me assure you that the District's financial condition continues to be strong, despite the slow recovery of the national economy. Our fiscal year 2012 ended September 30th and appears on track to show another budgetary surplus, although it is still too early to say with certainty how much that will be. We expect to produce our Comprehensive Annual Financial Report, or CAFR, on time. This will be the sixteenth consecutive CAFR showing a balanced budget. (See Attachment A.) Since the beginning of Fiscal Year 2013, we have sold $675 million one-year Tax Revenue Anticipation Notes (TRANs) at a record low rate of 0.19 percent. Last month, we sold $776 million of 25-year Income Tax Secured Revenue Bonds to fund the FY 2013

Capital Improvement Plan, which achieved an interest cost of 3.16 percent, again a record low rate. Part of the reason for this is, of course, extraordinarily strong municipal bond market conditions, but it also results from our continued excellent bond ratings – AAA from Standard & Poor's, Aa1 from Moody's Investors Service and AA+ from Fitch Ratings on the income tax bonds, all with stable outlooks. Furthermore, the District's general obligation bond ratings were affirmed by S & P (A+) and Fitch Ratings (AA-) also with stable outlooks (See Attachment B). Last month, District residents demonstrated their confidence in the City's financial stability by purchasing more than $130 million of the income tax bonds.

All of this is the result of the fiscally responsible decisions made by the city's elected leadership, including the passage of balanced budgets, the establishment of the 12 percent debt cap, and the commitment to rebuild our fund balance. These achievements have been noticed by investors in our debt offerings, and the result is a lower debt service burden and marginally more room for additional borrowing under the debt cap, as shown in Attachment C.

Update on OTR/Real Property Tax Assessment Improvements

Mr. Chairman, we welcome and appreciate this opportunity to update the Committee on the issues raised at the last oversight hearing in October.

Mr. Cordi will address the specific steps taken to improve the transparency and efficiency of the real property tax assessment process, and to increase the public's confidence in these assessments and the related appeals process. This includes how changes are made to the assessed valuation on residential and commercial properties, requiring an auditable trail for all changes made to the assessment rolls, providing multiple levels of approval before significant changes can be made to the assessed real property values, and other modernization and enhancements.

As the District's taxing agency, OTR must not only be aggressive, but also fair and equitable, for both commercial and residential taxpayers. This means providing all taxpayers with a clear and open process for appealing their property tax assessments.

Real property assessment is a responsibility that the leadership within OTR and I take seriously, and it is the reason that we remain emphatic in disputing the erroneous allegations that the OTR failed to collect millions of dollars in tax revenue in 2012. The allegations are, quite simply, false and were made without any understanding of the real estate tax assessment and appeals process. We stand behind the assessment methods used by the Real Property Tax Administration, which is the same method employed by governments in Maryland and Virginia, and by the majority of governments throughout the nation.

These allegations are based on the flawed reasoning that the initial assessment is always correct. As I stated in October, real property assessment notices by law must be mailed by March 1st, which is well before critical income and expense information becomes available. As a result, initial assessments are often imperfect and require revision; further, it is alleged that any downward revision in the assessed value represents a loss of revenue to the District. The right of property owners to appeal is codified in law as recognition of the fact that property assessment is not an exact science, but rather a function of judgment and access to relevant information.

We do believe that by changing the law to allow for the mailing of real property assessment notices for commercial income producing properties to

June 15, rather than the current statutory deadline of March 1, the process for commercial assessments can be improved. This would allow OTR to receive important expense/income statements prior to the release of the initial assessment. We have submitted draft legislation for your review which, if implemented, would significantly improve the quality and accuracy initial assessments, and the overall efficiency of the assessment and appeals process.

OCFO Internal Controls

As stated in my testimony before this committee in October, I formally established the Office of Integrity and Oversight (OIO) in 2002 to support our on-going efforts to continually improve our operations by providing me with reviews and appraisals of our programs. The role of OIO, and the executive director in particular, is to assist agency management in maintaining the integrity, accountability and efficiency of the District's financial management and tax administration systems through its audit and investigative programs. Simply put, OIO's job is to identify and report potential problems and work closely and collaboratively with management so that it can effectively address them.

OIO serves as one of the OCFO's principal internal controls. The reports that it produces are evidence that we are doing our work and living up to our commitment and responsibility to be constantly vigilant in safeguarding the District's financial resources.

Another important improvement in our internal controls was the establishment of an Office of the Chief Risk Officer (CRO) in 2008. Our CRO, Kathy Crader, reviews and evaluates the inherent risk in our processes and collaborates with management to develop and implement risk mitigation plans. Equally important, the CRO evaluates the recommendations included in OIO audits and assigns them a level of urgency for implementation purposes. As you know, some OIO findings are high priority and resources must be directed to immediately remediating those problems. Other findings are less urgent, and include relatively routine suggestions for improvements. As you are aware, OCFO has undergone a reduction in FTE of 18 percent since 2009, and it is essential that we prioritize work according to the degree of risk in order to safeguard District assets and meet our goal of a more secure OTR.

Since October, we have posted 24 OIO reports on the OCFO web site and they are available for review. We have provided Executive Summaries of each report which include its current status, a risk assessment, and an overview of the recommendations to provide greater explanation and context to the reader.

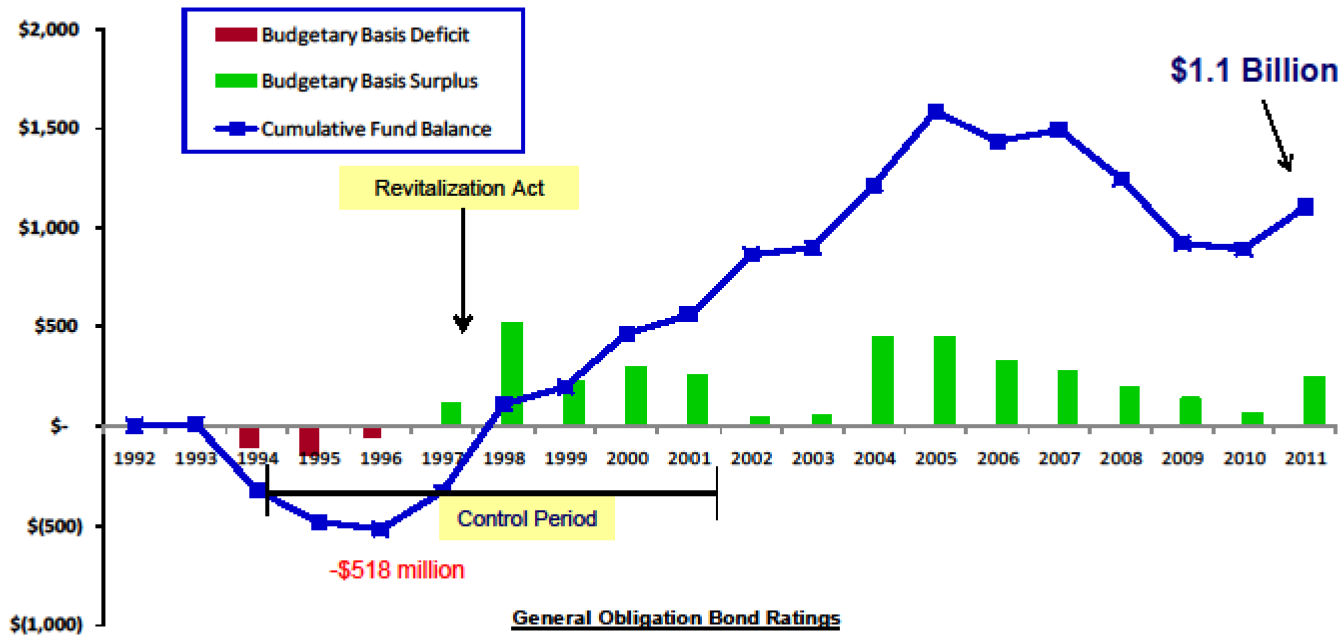
Again, let me emphasize that I created OIO with the intention of improving all OCFO internal operations and controls. I believe OIO's function is a "best practice" that increases our efficiency and the security of public resources. Like all financial enterprises, public or private, we are targets of fraud. Unfortunately, that is our reality. While we continue our efforts to prevent theft before it occurs, no financial institution can fully eradicate attempts at theft. Since 2007, our efforts have resulted in significant improvements in the OCFO's internal control structure. The preventive and detective controls implemented have allowed us to identify anomalous transactions and uncover fraudulent activity. Most recently, this resulted in the arrest and conviction of two employees who were using their positions to steal from the government for which they worked. We appreciate your leadership in these efforts, Mr. Chairman, and your support of funding both critical staff like the CRO and improving technology for catching fraud and theft before it occurs.

Conclusion

Thank you for the opportunity to address these issues today. I would be happy to address any questions you may have at this time.

District of Columbia

District of Columbia
Surplus and Bond Rating History



General Obligation Bond Ratings

S&P:	A-	A-	A-	B	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A-	A	A+	A+	A+	A+	A+	A+
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Baa3	Baa3	Baa1	Baa1	Baa1	A2	A2	A2	A1	A1	A1	Aa2	Aa2
Fitch:		A-	A-	BB	BB	BB	BB+	BBB	BBB	BBB+	BBB+	A-	A-	A	A	A+	A+	A+	AA-	AA-

Income Tax Secured Revenue Bonds: S&P: AAA Moody's: Aa1 Fitch: AA+

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER

Attachment B

Natwar M. Gandhi
Chief Financial Officer

December 7, 2012

The Honorable Vincent C. Gray
Mayor of the District of Columbia
1350 Pennsylvania Ave., NW – 6th Floor
Washington, DC 20004

The Honorable Phil Mendelson
Chairman
Council of the District of Columbia
1350 Pennsylvania Ave., NW – Suite 504
Washington, DC 20004

The Honorable Jack Evans
Chairman, Committee on Finance and Revenue
Council of the District of Columbia
1350 Pennsylvania Ave., NW – Suite 114
Washington, DC 20004

Dear Mayor Gray, Chairman Mendelson and Chairman Evans:

I am writing to inform you that both Standard & Poor's and Fitch Ratings have recently affirmed their ratings on the District's General Obligation (GO) bonds and Certificates of Participation (COPs), as well as the "Stable" outlooks. The ratings reflect continued confidence in the District's financial management, and the GO ratings assure investors that the full faith and credit of the District is sound. Copies of both rating agency reports are attached.

Standard & Poor's affirmed the District's GO rating of "A+" and the COPs rating of "A", both with a Stable Outlook. (See Attachment for explanation of ratings.) The ratings were issued in connection with the refunding of variable rate bonds.

Fitch affirmed the District's GO rating of "AA-" with a Stable Outlook, and the ratings on District Certificates of Participation (COPs) at "A+", also with a Stable Outlook. The Fitch review was conducted as part of the firm's regular surveillance process.

In their report, Standard & Poor's refers to the District's "role as the nation's capital and as a regional employment center that is anchored by the federal government, military contractors, services, and tourism sectors; sizable real estate and income tax bases… and strong financial policies and practices." The report also notes that the stable outlook is based on their expectation that the District will maintain structurally balanced operations despite uncertainty in the revenue

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base. Furthermore, the report states, "…an upgrade is dependent on the District's ability to adjust to possible federal fiscal consolidation while maintaining good reserves, strong liquidity, and a manageable debt profile."

The Fitch report states, "The District's financial management practices are sound." The report adds, "Prudently, the District's current-year budget assumes revenues losses due to possible federal sequestration." The report repeats the firm's previous statement that "The District's debt levels are high and expected to remain so, partially due to its unique position in serving as both sole funder and provider of government services for its residents." Other highlights of the report include reference to pension and OPEB obligations as "limited and well managed". The report notes the possible effect of sequestration and the District's reliance on the federal government, stating that although this has been a source of stability, the District's economy could weaken should sequestration and other federal deficit reduction measures go into effect.

The rating affirmations affect approximately $2.8 billion outstanding General Obligation bonds; $7.7 million COPS Series 2002, which funded 441 Fourth Street building; $48.9 million COPs Series 2003, which funded the Public Safety and Emergency Communications Center and related technology; and $170.1 million COPs Series 2006, which funded Saint Elizabeths and DMV building renovations. (The Series 2002 COPs will be fully repaid January 1, 2013.)

I should also note that the ratings on the District's Income Tax Revenue Bonds (AAA from S&P, Aa1 from Moody's and AA+ from Fitch) were recently affirmed in connection with the sale of $776 million bonds.

I want to commend you all for showing continued support for and adherence to sound financial policies, including in particular the debt cap and the restoration of the General Fund balance. It is clearly important to maintaining and possibly improving our bond ratings, which as you know, will allow the District to achieve the lowest possible costs of borrowing.

Please give me a call at (202) 727-2476 if you have any questions or would like to discuss these issues.

Sincerely,

Natwar M. Gandhi

Attachments

cc: Members of the Council of the District of Columbia
Allen Lew, City Administrator
Chris Murphy, Chief of Staff to the Mayor
Eric Goulet, Deputy Chief of Staff and Budget Director
Jennifer Budoff, Budget Director, Council of the District of Columbia

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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

District of Columbia Income Tax Secured Revenue Bond Ratings

District of Columbia General Obligation Bond Ratings

STANDARD & POOR'S
RATINGS SERVICES

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RatingsDirect®

District of Columbia; Appropriations; General Obligation

Primary Credit Analyst:
Le T Quach, New York (1) 212-438-5544; le_quach@standardandpoors.com

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Karl Jacob, Boston (1) 617-530-8134; karl_jacob@standardandpoors.com
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District of Columbia; Appropriations; General Obligation

Credit Profile		
US$114.205 mil multimodal GO rfdg bnds var rate dem oblig ser 2008D due 06/01/2034		
Long Term Rating	A+/Stable	New
District of Columbia multimodal GO rfdg bnds var rate dem oblig ser 2008A		
Long Term Rating	A+/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its rating to 'A+' with a stable outlook on the District of Columbia's general obligation (GO) series 2008A bonds to reflect the creditworthiness of the district. The previous rating was based on the short- and long-term ratings on the bank facility. At the same time, Standard & Poor's assigned its 'A+' rating to the district's series 2008D GO bonds and affirmed its 'A+' rating and underlying rating (SPUR) on the district's existing GO debt and its 'A' rating and SPUR on the district's existing certificates of participation (COPs).

The 'A+' rating reflects our assessment of:

- The district's role as the nation's capital and as a regional employment center that is anchored by the federal government, military contractors, services, and tourism sectors;
- Sizable real estate and income tax bases that are beginning to experience modest growth; and
- Strong financial policies and practices.

Factors constraining the rating include our view of the district's:

- Limited revenue-raising flexibility, resulting from the district's lack of authorization to tax commuters or federal tax-exempt property, which account for 70% of the district's workforce and 68% of the district's taxable value, respectively.;
- Uncertainty regarding the direct impact of federal sequestration reductions under the Budget Control Act (BCA) of 2011, which could hamper the district's future growth;
- Very high debt ratios, which are expected to remain high, based on ongoing capital improvement needs that will be debt funded; and
- Increased liquidity risk due to certain provisions in its direct purchase agreements that could limit the district's financial flexibility if an event of default were triggered.

The rating is based on the district's full faith and credit pledge.

Outlook

The stable outlook is based on our expectation that the district will maintain structurally balanced operations and contend with ongoing uncertainty in its revenue base in a timely manner. The stable outlook also reflects the district's current sufficient liquidity levels to meet its contingent liabilities. Should cash reserves deteriorate, causing coverage of

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its contingent liabilities to fall below 1x, we could lower the rating over the two-year outlook period. In addition, if the district's financial performance weakens as a result of softening revenues, ongoing significant hospital operational support, or general economic decline, we could lower the rating. Although the district increased available reserves for fiscal 2011 and economic indicators have largely improved, an upgrade is dependent on the district's ability to adjust to possible federal fiscal consolidation while maintaining good reserves, strong liquidity, and a manageable debt profile.

Improvement In Reserves After Five Consecutive Years Of Reductions

After five consecutive years of reductions to its general fund balance, the district reported in fiscal 2011 general fund revenues exceeding expenditures by $135 million before transfers, and $174 million after net transfers in part due to growth in income tax and real property tax revenues. This increased the district's total fund balance to $1.1 billion, with about $330 million available within its committed and unassigned balances (equal to 5.6% of general fund expenditures). In addition, the district holds $756.6 million as a restricted general fund balance, which includes its $338.6 million emergency and contingency cash reserve balances that are restricted by legislation to be used only for unanticipated and nonrecurring, extraordinary needs.

The district's governmental fund revenues are diverse with property taxes making up 34%, income and franchise taxes 31%, and sales taxes 21% of total governmental fund revenues. The composition of total personal income taxes is concentrated, with incomes of $100,001 and higher (15.5% of total filers) making up about 71% of total income taxes.

For fiscal 2012 (ended Sept. 30, 2012), finance officials have indicated that the district ended the fiscal year with general fund revenues exceeding general fund expenditures, although unaudited financials will not be ready until early calendar year 2013. The district issues quarterly revenue projections and based on its September 2012 revenue estimate, general fund revenues were adjusted upward by about 3% to $5.86 billion to reflect higher-than-initially projected estate, withholding, and sales tax collections. In addition, automatic traffic enforcement revenues have contributed to an increase to the district's previous quarterly estimate. Based on the district's cash projections, total available unrestricted cash totaled $386.7 million as of Sept. 28, 2012, equal to about 24 days' cash on hand.

The district's multiyear projections through fiscal 2016 assume federal sequestration cuts will occur as detailed in the Budget Control Act of 2011, and that real property and sales tax growth could be negatively affected by these reductions in as early as fiscal 2013. The district has built into its revenue forecasts a reduction in revenue due to sequestration of $47 million in fiscal 2013, $86 million in fiscal 2014, and $93 million in fiscal 2015. The district assumes that reductions in federal employment will hurt withholding and sales taxes immediately, and that cuts in procurements will hamper corporate income and deed taxes as early as fiscal 2014. The district's approved budget for fiscal 2013 shows a 2.7% reduction in total fund balance or a $19.7 million drawdown.

The district recently mandated the creation of two additional reserves that would allow it to fund reserves equivalent to two months of operations. In addition to the 6% Congressionally-mandated fund balance, the district would fund a fiscal stabilization reserve at 2.34% and a cash flow reserve at 8.33%; however, there is currently no clear plan on how to fund these. From a credit standpoint, the district re-establishing structural balance and demonstrating its ability to

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manage both its service and capital needs are important to rating stability.

In addition, we understand that the district received on Oct. 22, 2012 an informal inquiry request letter from the SEC requesting copies of audits, inspections, and other documents for the period Jan 1, 2010 through Oct. 19, 2012. District management has indicated that it is providing the requested information to the SEC, and Standard & Poor's will continue to assess the credit impacts, if any, of this ongoing inquiry as updates occur.

High Debt Levels And Sizable Capital Needs

The district has approximately $8 billion in total tax-supported debt outstanding (10% of general fund expenditures). The district's debt ceiling act limits all debt service on all tax-supported debt to 12% of general fund expenditures. Approximately 11% of the district's tax-supported debt consists of variable rate debt, with 4% hedged with liquidity or credit support. Overall debt levels are high on a per capita basis at $12,750 or moderate as a ratio of market value at 3.5%. The district's capital plan of about $5.2 billion through fiscal 2018 will be financed by a mix of debt, grants, and pay-as-you-go funding. The district anticipates issuing additional income tax bonds over the next month.

In October 2012, the district entered into a $173.6 million direct purchase agreement with Citibank with respect to its series 2008A and D multimodal GO refunding bonds. At the same time, it entered into a $224 million direct purchase agreement with Wells Fargo with respect to its series 2008C multimodal GO bonds. These bonds constitute the only parity variable rate GO debt currently outstanding. Under the respective direct purchase agreements, the events of default and remedies include language that allows for cross-default should an event of default occur under any of the district's parity GO bond documents, including these direct purchase agreements.

We believe the direct purchase agreement provisions increase the risk profile of the district's outstanding debt, given the compressed seven-day tender period following certain expansive events of default and the inclusion of most favored nation language within the Citibank direct purchase agreement. Based on our analysis of the district's cash flows, we believe the district could have sufficient cash on hand within its various reserves to handle this potential draw on liquidity. Management has indicated that should payment be required, the district would use its federally required emergency reserve (2% of operating expenditures) and contingency reserve (4% of operating expenditures) restricted funds to pay the obligations, and then refund the debt to reimburse itself for the draw. Based on cash flow statements provided by the district, emergency and contingency reserves at its fiscal year low point (February 2012) totaled $281.5 million, providing coverage of the total outstanding principal of the series 2008A,C, and D GO bonds of $397.6 million of 0.71x. In addition, the district has access to additional unrestricted cash of $270 million (during its fiscal year cash low point), which provides total coverage of 1.39x. In our view, as these direct purchase provisions present potential liquidity risks and could limit the district's financial flexibility, we will continue to monitor and assess the district's ability to fund these contingent liabilities from its cash reserves.

Manageable Pension And OPEB Liabilities

The district has two single-employer defined benefit pension plans for police/fire and teachers. The district has contributed its full actuarial amounts, and for fiscal 2011 paid $127 million, equal to 2% of total governmental

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expenditures. Based on its Oct. 1, 2010 actuarial study, the two plans were 111% funded. In addition, the district sponsors a defined contribution pension plan for permanent full-time employees. For fiscal 2011, the district contributed $46,955.

In addition, the district offers postemployment health benefits to eligible employees. For fiscal 2011, the district contributed $94 million to the plan, equal to 1.6% of total governmental expenditures. As of Sept. 30, 2010, the plan was 54% funded.

United Medical Center

On July 9, 2010, the district foreclosed on United Medical Center (UMC) and created the not-for-profit Hospital Corporation to own and operate the hospital. UMC is the only hospital east of the Anacostia River and the district took it over to ensure that its residents would continue to have access to medical facilities. At the time of the takeover, the hospital could not meet its operating expenditures. In fiscal 2011, the hospital drew $3.9 million from its district-provided cash reserve, leaving approximately $900,000. In addition, management has indicated that in fiscal 2012, the district provided an additional $7.7 million in support to the hospital in part due to some one-time payments. Although the hospital has made some reductions and restructured operations, there is no certainty that UMC can operate without the district's subsidy, particularly because of the need for additional capital improvements. We understand that district management plans to sell the hospital; however, it has not been able to identify buyers or set a timetable for the sale or transfer of UMC. To the extent that UMC requires ongoing subsidies from the district or creates additional liabilities for them, this could have a negative impact on the district's credit profile.

Recent Growth Has Benefited Revenue Performance

On many fronts, the district's underlying economy has shown signs of modest improvement, although many challenges remain. Unemployment levels have fallen since a year ago, with a seasonally unadjusted unemployment rate of 8.8% for August 2012. Total wage and salary employment for the district is up slightly with a 1% increase for June 2012. In addition, district population is up with a 2.2% increase year over year to 618 million residents in 2011.

In our view, federal sequestration, if it should be implemented in its current form, will have negative effects on the district's operating revenue base, as there are about 210,000 federal civilian employees in the district, which account for 29% of all wage and salary employment and 35% of the wages and salaries paid in the city. In addition, the federal government employs an estimated 45,000 district residents, equal to 15% of all employed district residents. More importantly, federal government spending is a critical component of gross product, with $62 billion of federal spending across the district's salaries/wages, grants, retirement and other benefits, and other direct payments, equal to a sizable 60% of fiscal 2010 district gross product.

The district's assessed value has declined over the last two audited fiscal years. The district's total market value fell by 7% to $139 billion in 2011, of which about 37% is tax exempt due to the large government and non-profit presence in the district. Taxable value also fell by 4.8% to $220.8 billion, or, in our view, a still extremely strong $365,751 per capita. Yet, recent reports indicate some positive improvements. District economic reports show condo sales are up

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from a year ago by about 22% but single-family home sales are still weak with a 9.7% reduction year over year for June 2012. However, median single family prices are up about 15% year over year.

Financial Management Assessment: 'Strong'

The District of Columbia's financial management practices are considered "strong" under Standard & Poor's FMA. The district's financial management practices include conservative budgeting; close monitoring of revenues and expenditures; long-term financial forecasting; and capital planning, liquidity, and reserve policies. For each fiscal year, the mayor is required by the Home Rule Act to submit a budget to the council. Once approved by the council, the budget is subject to additional approval by the U.S. Congress. The district's budget is prepared using baseline revenue and expenditures provided by the office of the chief financial officer (CFO), taking into account recurring spending pressures and policy initiatives as well as national and local economic trends. The district's revenue estimates reflect a combination of statistical models, historical factors, local information, and experience with the regional economy. The budget must include a multiyear financial forecast as well as a multiyear CIP. The financial forecast includes the most recent year, the current year's budget, and four additional years. The financial plan must be balanced on a budgetary basis, which does not preclude the district from submitting a budget that is balanced with the use of reserves. Although management has historically generated structurally balanced budgets, it has done so by budgeting its use of reserves. The CIP is a rolling six-year plan, with all funding sources identified.

Key policies include the local anti-deficiency law, which requires district agencies to plan and manage expenditures according to spending plans without generating deficits. The office of the district's CFO monitors compliance for the district through a quarterly financial review process that compares actual revenues and expenditures against budgeted amounts. The CFO submits quarterly reports to the DC council and mayor, indicating each agency's actual expenditures and funding sources compared with the approved spending plan. If overspending occurs or is expected, the CFO is authorized to take actions that are intended to ensure the spending reductions.

The district's liquidity and reserves policy clearly states that the general fund balance must include a unique cash reserve equal to 6% of local annual operating expenditures, made up of a 4% contingency reserve and a 2% emergency reserve. In 2010, the district enacted the Sustainable Capital Investment and Fund Balance Restoration Act, which created two new reserves: the fiscal stability reserve and the cash flow reserve. When coupled with the Congressionally mandated reserves, the district's reserves would amount to 16.67%, or two months of operations. Unlike most states with cash reserves, which have no replenishment requirement, the district's emergency and contingency cash reserves must be replenished over a two-year period, if used. The act requires the mayor, starting in fiscal 2012, to include a pay-as-you-go capital account and to fund that account with an amount equal to 25% of the incremental revenue from fiscal 2011. The district's Home Rule Act limits debt service on any given year to 17% of expenditures. In 2009, the district enacted the Debt Ceiling Act, which statutorily limits debt service on all tax-supported debt to 12% of general fund expenditures.

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Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Bond Anticipation Note Rating Methodology, Aug. 31, 2011
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

Temporary contact information

Le T. Quach: (347) 529-5076

Ratings Detail (As Of November 15, 2012)		
District of Columbia COPs		
Long Term Rating	A/Stable	Affirmed
District of Columbia GO		
Unenhanced Rating	A+(SPUR)/Stable	Affirmed
District of Colu certs of part ser 2002		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
District of Colu certs of part ser 2003		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
District of Colu COPs		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

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FitchRatings

FITCH AFFIRMS DISTRICT OF COLUMBIA'S GOS AT 'AA-'; OUTLOOK STABLE

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Fitch Ratings-New York-05 December 2012: Fitch Ratings has affirmed the 'AA-' rating on approximately $2.8 billion in general obligation bonds of the District of Columbia (DC, or the District).

Fitch has also affirmed the 'A+' rating on the following certificates of participation (COPs) of the District:

--$7.7 million COPS series 2002;
--$48.9 million COPs series 2003;
--$170.1 million COP s series 2006.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the District, with its full faith and credit pledged. Also pledged is revenue from a special real property tax, unlimited as to rate or amount and levied in an amount to pay debt service on GO and parity bonds.
The certificates evidence proportionate interests in lease payments from the District to the trustee as lessor for various essential facilities. The payments, equal to annual debt service, are subject to inclusion in the District's annual budget and annual appropriation by the United States Congress.

KEY RATING DRIVERS

SOUND FINANCIAL MANAGEMENT: The District's financial management practices are sound. Recession-driven revenue weakness led to drawdowns of the sizable general fund balance, but the District has begun to restore those losses and reserve levels remain solid. Prudently, the District's current-year budget assumes revenues losses due to possible federal sequestration.

ELEVATED DEBT BURDEN: The District's debt levels are high and expected to remain so, partially due to its unique position in serving as both sole funder and provider of government services for its residents. Pension and OPEB obligations are limited and well managed.

RELIANCE ON FEDERAL GOVERNMENT: Government employees comprise a very high approximately one-third of the District's total employment and an even higher percentage of personal income, with the vast majority from the federal government. While historically this has been an important source of stability, potential sequestration and other expected federal deficit reduction in the coming years could weaken the District's economy.

CREDIT PROFILE

The 'AA-' GO rating reflects the District's strong financial management practices, including consistently sound reserves levels and timely actions to maintain budgetary balance, a broad and diverse array of tax revenues, and high resident wealth levels. The District regularly delivers below budget expenditures, which allowed it to restore general fund reserves in recent years after several years of drawdowns. The recent gains in operating performance are especially impressive in light of the District's continued full funding of its actuarially required contributions (ARC) for pensions and other post-employment benefits (OPEB) obligations. The rating also incorporates the District's high debt ratios, which are expected to remain high, as well as possible economic and revenue weakness due to reliance on the federal government at a time of federal deficit reduction.

Attachment B

FINANCES

District financial operations have begun rebounding from recession-driven pressures. The general fund total balance declined for three consecutive years between fiscal 2008 to fiscal 2010 (years ending Sept. 30). In fiscal 2011, tax revenue growth of 2.8% on a GAAP basis and tight expenditure control (1% growth) resulted in an increase in fund balance. The general fund balance at fiscal year-end 2011 totaled $1.1 billion, or 18.9% of general fund expenditures.

Budgeted general fund expenditures and transfers out, and general fund resources for fiscal 2012 were both 3.6% below the prior year's revised budget. Tax revenues were budgeted to decline 5.9% (including dedicated and non-dedicated). The District's June 2012 revenue estimate substantially improved the forecast, projecting a 6.2% increase in general fund local revenues, and the September 2012 monthly cash report showed a robust 10% gain in general fund taxes (gross basis) from fiscal 2011.

For the current fiscal year (2013), the District's balanced budget conservatively forecasts a 1.2% decline in general expenditures and transfers out versus the revised fiscal 2012 budget estimate, and a 0.4% decline in general fund resources (including a modest $31.2 million use of fund balance). The long-range financial plan through fiscal 2016 projects balanced operations in fiscal years 2014 through 2016, with no use of the fund balance. Pay-go capital contributions, mainly for school modernization are contemplated later in the plan while additional OPEB trust contributions remain budgeted.

ECONOMY

District economic indicators, which grew strongly earlier this decade and significantly outperformed the U.S. in the recession, moderated more recently with just 0.6% year-over-year employment growth in October 2012 versus 1.4% nationally. As the nation's capital, government employment constitutes a substantial nearly one-third of District employment, with the majority made up of federal employees. Federal employment contracted year over year for 13 consecutive months. In October, federal employment declined 1.1% from the prior year. Fitch expects the trend to continue, whether or not federal sequestration is implemented as federal deficit reduction is likely in the coming year. Growth in the services sector, namely education and health, helped offset the government employment contraction. The District's unemployment rate in October reached 8.5%, down substantially from 10.3% in the prior year but still above the national rate of 7.9%.

Income levels remain very high for the district, but growth is slowing relative to the national rate, and an income inequity gap remains. Personal income per capita (PIPC) is by far the strongest in the nation at nearly $74,000 (178% of the U.S. average) in 2011. But the poverty rate was a high 18.7% versus a national 13.2% for the same year. PIPC grew 3.6% in 2011, but that was slower than the national growth rate of 4.4%. That was the first time since 1999 that the District's annual PIPC growth rate fell below the national rate. Federal budget cuts would likely accelerate this trend, though continued growth in the services sectors could provide a partial offset.

DEBT AND OTHER LONG-TERM LIABILITIES

Debt levels are high and are projected to increase moderately given the backlog of deferred capital needs (most importantly for school modernization) and other borrowing plans. Direct tax-supported debt represents a high 18.7% of personal income, 6.1% of 2011 market value, and is $13,826 on a per capita basis. The District's locally funded six-year capital improvement plan (CIP) for fiscal years 2013-2018 totals $5.0 billion (excluding the Local Highway Trust Fund) and is expected to be primarily debt financed, though the District plans to maintain compliance with the Debt Ceiling Act that statutorily limits tax-supported debt service to 12% of expenditures. District debt amortization, when considering GO and income tax secured revenue bonds, is below average, with approximately one-third amortized in 10 years, which Fitch attributes to adherence to the Debt Ceiling Act cap. The 'A+' rating on the District's COPs reflects the District's long-term credit characteristics, satisfactory legal provisions, and the essentiality of the assets financed.

The District's pension and other post-employment benefits (OPEB) obligations are well-managed, partially due to significant support from the federal government. The District's Retirement Board estimates its pension plans for teachers and police/fire employees were over 100% since fiscal 2007. Regarding OPEB, the District makes full ARC payments and reduced its unfunded liability to $784 million at the end of fiscal 2011, or a low 1.7% of the District's personal income.

Attachment B

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. State Government Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

Applicable Criteria and Related Research:
Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686033
U.S. Local Government Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314

Attachment C

District of Columbia

Summary of Debt Cap Position as of December 6, 2012

($ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revised Budget Scenario										
Total Debt Service on Existing & Planned Tax-Supported Debt	$ 683.83	$ 729.00	$ 759.27	$ 801.94	$ 820.86	$ 872.23	$ 896.76	$ 953.12	$ 983.90	$ 1,025.19
General Fund Expenditures	$ 6,639.37	$ 6,787.82	$ 6,931.08	$ 7,112.87	$ 7,290.69	$ 7,472.96	$ 7,659.79	$ 7,851.28	$ 8,047.56	$ 8,248.75
Ratio of Debt Service to Expenditures	**10.30%**	**10.74%**	**10.95%**	**11.27%**	**11.26%**	**11.67%**	**11.71%**	**12.14%**	**12.23%**	**12.43%**