CAFR

INTRODUCTORY SECTION

2012

VINCENT C. GRAY • MAYOR

NATWAR M. GANDHI • CHIEF FINANCIAL OFFICER

GOVERNMENT OF THE DISTRICT OF COLUMBIA

OFFICE OF THE CHIEF FINANCIAL OFFICER

Government of the District of Columbia

★★★

Office of the Chief Financial Officer
Office of Financial Operations and Systems
1100 4th Street, S.W. (East Building), 8th Floor
Washington, D.C. 20024
(202) 442-8200
(Fax) (202) 442-8201

January 28, 2013

Dr. Natwar M. Gandhi
Chief Financial Officer

The Comprehensive Annual Financial Report (CAFR) of the Government of the District of Columbia (District) for the fiscal year ended September 30, 2012, is herewith submitted. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with District management and the Office of the Chief Financial Officer (OCFO). To the best of my knowledge and belief, the enclosed financial statements and schedules are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and component units of the District.

This report has been prepared in accordance with generally accepted accounting principles (GAAP) for state and local governments as promulgated by the Governmental Accounting Standards Board (GASB) and includes all disclosures necessary for readers to gain an understanding of the District's financial activities.

The ability to produce a timely and accurate CAFR depends upon the adequacy of the District's internal controls. Internal control is defined as a process, effected by an entity's governing board, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) efficiency and effectiveness of operations; (b) reliability of financial reporting; and (c) compliance with applicable laws and regulations. Reasonable assurance is defined as a high, but not absolute, level of assurance about whether the financial statements are free of material misstatement. The District's management is responsible for establishing and maintaining adequate internal controls. The greatest challenge in establishing and maintaining adequate internal controls is ensuring that the control framework developed by management is comprehensive—that is, broad enough to achieve its intended purpose.

Due to certain inherent limitations, such as prohibitive costs, judgment errors, or potential for management override and collusion, internal control can only provide reasonable assurance that management's objectives will be achieved. However, routine, periodic audits help management assess, on an on-going basis, the adequacy of the District's internal controls. In accordance with D.C. Code Section 47-119, an independent auditor audited the District's financial statements for the year ended September 30, 2012. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards, issued by the Comptroller General of the United States. In addition to issuing an opinion on the District's financial statements, the independent auditor, KPMG LLP, prepared a report, which was issued in conjunction with the CAFR, that discussed the auditor's consideration of the District's internal control over financial reporting and the outcome of the auditor's tests of the District's compliance with certain provisions of laws, regulations, contracts, grant agreements, and other related requirements. This report is commonly referred to as the Yellow Book Report.

Moreover, an audit of compliance with the Federal Single Audit Act Amendments of 1996 and the related OMB Circular A-133 is also performed annually and a separate report, often referred to as the Single Audit Report, is issued by the independent auditors. The District's fiscal year 2012 Single Audit Report will be issued at a later date.

GASB Statement No. 34 requires management to provide a narrative introductory overview and analysis (termed management's discussion and analysis (MD&A)) to accompany the basic financial statements. This letter of transmittal is designed to complement the MD&A and, therefore, does not discuss the District's financial operations and results. For that reason, this letter should be read in conjunction with the MD&A in order to gain a better understanding of the District's financial condition.

PROFILE OF THE GOVERNMENT

Overview: Historical Background of the District

President George Washington established Washington, D.C. (herein after referred to as D.C., the District of Columbia, or the District) in 1791 from territory ceded by the State of Maryland and the Commonwealth of Virginia. The United States Congress assumed jurisdiction over the District of Columbia, but citizens residing in the District of Columbia did not have voting representation in Congress.

Significant dates in the history of the District of Columbia are presented in the timeline shown in **Table T1**.

Table T1 – Timeline: Key Dates in the History of the District of Columbia

February 1801	Congress enacted the Organic Act of 1801, thereby dividing the capital district into Washington County (former Maryland area) and Alexandria County (former Virginia area).
1846	Congress passed a law allowing the City of Alexandria and Alexandria County to be returned to the Commonwealth of Virginia.
1871	Congress consolidated Georgetown, Washington City, and Washington County into one territorial government. The President appointed a territorial governor and council and an elected House of Delegates. A non-voting delegate to Congress was also established.
1874	The territorial government of the District of Columbia was abolished and the non-voting delegate to Congress was eliminated.
1878	The power to elect a territorial governor and council was eliminated. Congress established a three-member Board of Commissioners to govern the District of Columbia. This form of governance lasted for almost 100 years.
1961	The 23rd Amendment to the U.S. Constitution was ratified. Citizens of the District of Columbia were granted the right to vote in a presidential election.
1967	President Lyndon B. Johnson appointed Walter E. Washington Mayor of the District of Columbia.
1970	Congress passed the District of Columbia Delegate Act.
1971	Walter Fauntroy became the first Congressional Delegate to represent the District of Columbia.
1973	Congress passed the District of Columbia Home Rule Act, which provides for a popularly elected mayor and a 13-member Council.

Although Congress passed the Home Rule Act in 1973, Congress retained and continues to retain the right to review and overturn the legislative acts of the Council if both houses of Congress vote within 30 legislative days to do so. In addition, the budget for the District of Columbia government must be approved by Congress and the President of the United States.

The Home Rule Act prohibits the taxing of federal property, other tax-exempt property and the income of non-District residents who work in the District.

In 1983, it was determined that the District could legally issue its own debt. On October 15, 1984, the District issued municipal debt for the first time, in the form of Tax Revenue Anticipation Notes (TRANs), which totaled $150 million.

Although progress has been made on many fronts throughout the city's history, District of Columbia residents still do not have voting representation in Congress. However, in accordance with the District of Columbia Delegate Act of 1970, U.S. Public Law 91-405, the citizens of the District of Columbia are represented in the House of Representatives by a Delegate, who is elected by the voters of the District of Columbia. Consistent with the Act:

> *The Delegate shall have a seat in the House of Representatives, with the right of debate, but not of voting, shall have all the privileges granted a Representative by § 6 of Article I of the Constitution, and shall be subject to the same restrictions and regulations as are imposed by law or rules on Representatives. The Delegate shall be elected to serve during each Congress.*

The current D.C. Delegate, Congresswoman Eleanor Holmes Norton, has no voting power. However, despite her limitations over the years, she has been able to accomplish much on behalf of the District of Columbia. Some of her recent major accomplishments include the following:

- Worked with the U.S. Department of Housing and Urban Development (HUD) to expand job opportunities for low-income people and public housing residents by creating a registry of eligible Section 3 businesses and job opportunities.

  The District is a participant in the Section 3 Business Registry, a HUD pilot program, which offers a searchable online database that housing authorities, local government agencies, and contractors can use to identify firms that have self-certified their status as Section 3 businesses that hire low-income individuals.

- Worked jointly with Democratic Whip Steny Hoyer to secure funding for the Frederick Douglass/South Capitol Street Bridge project. In November 2011, the U.S. Department of Transportation awarded $68 million to the District for construction of a new Frederick Douglass/South Capitol Street Bridge, which is the cornerstone of the South Capitol Street revitalization project.

  Hoyer and Norton have worked for years to obtain incremental funding for this bridge project, successfully securing $123 million in the transportation reauthorization bill, and approximately $20 million since 2002 for the rehabilitation of South Capitol Street and the Frederick Douglass/South Capitol Street Bridge through the appropriations process. The funding announced in November 2011 will be used for right-of-way acquisition.

- Succeeded in fighting back an amendment to allow people with "concealed carry" permits issued by other states to carry concealed guns in the District of Columbia. The amendment was offered to the National Right-to-Carry Reciprocity Act of 2011 (H.R. 822), which would allow people with concealed carry permits to carry concealed guns in any jurisdiction that allows "concealed carry", but not in those jurisdictions that prohibit concealed carry. The amendment, if adopted, would have created a unique exception.

For more information on the initiatives, activities and accomplishments of the D.C. Delegate, visit Congresswoman Eleanor Holmes Norton's website at www.norton.house.gov.

Financial Reporting Entity

For financial reporting purposes, the District's reporting entity consists of: (1) the primary government; (2) five discretely presented component units (Housing Finance Agency, University of the District of Columbia, Washington Convention and Sports Authority, Water and Sewer Authority, and the Not-For-Profit Hospital Corporation (d/b/a the United Medical Center); and (3) one blended component unit (the Tobacco Settlement Financing Corporation). The District of Columbia Housing Authority and the District of Columbia Courts are considered related organizations because the District is not financially accountable for their operations. The funds and accounts of all agencies, boards, commissions, foundations, and authorities that have been identified as part of the primary government or the component units have been included in the reporting entity. Further information on the reporting entity can be found in Note 1B, page 58 of the Notes to the Basic Financial Statements.

The District and its component units provide a wide range of services to residents, including elementary, secondary, and postsecondary education; health and human services; economic development and regulation; public safety; transportation; and other general government services.

Budgetary Information

During the first quarter of each fiscal year, agencies begin the budget formulation process for the upcoming fiscal year. On or about March 20 of each year, consistent with Section 442 of the Home Rule Act, the Mayor submits a balanced operating budget for the upcoming fiscal year to the Council for review and approval. The Council holds public hearings and adopts the budget (including a multi-year capital improvement plan by project for all District agencies) through passage of a Budget Request Act. The Mayor may not submit and the Council may not adopt any budget which presents expenditures and other financing uses that exceed revenues and other financing sources. After the Mayor approves the adopted budget, it is forwarded to the President and then to Congress for approval. Congress enacts the District's budget through passage of an appropriations bill, which is signed into law by the President of the United States.

The legally adopted budget is the annual Appropriations Act passed by Congress and signed by the President. The Appropriations Act authorizes expenditures at the agency level and by appropriation title (function), such as Public Safety and Justice; Human Support Services; or Public Education. To revise planned expenditures for any function, Congress must enact the appropriate legislation. However, the District may reallocate budgeted amounts using the District's reprogramming process in accordance with applicable legal requirements.

The District utilizes budgetary controls designed to monitor compliance with expenditure limitations contained in the annual Appropriations Act. Both automation and sound governance provide strong budgetary controls. The annual budget is assigned specific accounting attributes and is uploaded into the District's accounting system of record, thereby establishing the budget authority for each entity within the District government. The budget authority established in the system of record is then reconciled to the levels of funding authorized by the Appropriations Act. In addition, on an annual basis, independent auditors review the budgetary comparison statement to ensure compliance with federally approved amounts and to determine whether budget adjustments are properly documented and approved.

The "*District Anti-Deficiency Act of 2002*" (the Act), which became effective on April 4, 2003, introduced additional budgetary control requirements. This Act requires District managers to develop spending projections, by source of funds, on a monthly basis, which show year-to-date spending, approved budget, year-end projected spending, explanations of variances greater than 5% or $1 million, and planned corrective actions for instances of overspending. Spending projections are required to be submitted to the agency head and the Agency Fiscal Officer. Summarized spending projections must be submitted to the District's Chief Financial Officer (CFO) no later than 30 days after the end of each month.

Other reporting requirements have also been established to enhance the District's budgetary control policies and practices. Consistent with D.C. Code § 47-355.04, agency heads and Agency Fiscal Officers are to submit jointly a monthly spending plan for the fiscal year to the District's CFO by October 1 of each fiscal year. In addition, pursuant to D.C. Code § 47-355.05, the District's CFO is to submit quarterly reports to the Council and the Mayor that present each agency's actual expenditures, encumbrances, and commitments, each by source of funds, compared to each agency's approved spending plan. This report is required to be accompanied by the District CFO's observations regarding spending patterns and steps being taken to ensure that spending remains within the approved budget. These reports are used by the District's Anti-Deficiency Review Board to assess cases of overspending.

In addition, the District uses encumbrance accounting as a means of strengthening budgetary controls and financial reporting. Under this method of accounting, purchase orders, contracts, and other commitments for the expenditure of funds are recorded in the financial system of record in order to reserve the portion of the related appropriation that will be needed for the expenditure. Therefore, the recording of encumbrances is a valuable tool used by the District to ensure that expenditures are within budgeted amounts. Generally, encumbered amounts lapse at year-end in the General Fund but not in the Capital Projects Fund, Special Revenue Fund, or the fund for Federal Payments.

Cash Reserves

Through Congressional mandate, the District is required to maintain cash reserves totaling 6% of the previous fiscal year's general fund expenditures less debt service cost. The 6% is comprised of a contingency cash reserve of 4% and an emergency cash reserve of 2%. The contingency cash reserve may be used to provide for nonrecurring or unforeseen needs (*e.g.,* severe weather or other natural disasters, and unexpected obligations created by federal law) that arise during the fiscal year or to cover revenue shortfalls experienced by the District for three consecutive months. The emergency cash reserve may be used to provide for unanticipated and nonrecurring extraordinary needs of an emergency nature (*e.g.,* natural disaster or calamity) and may be used in the event that the Mayor declares a State of Emergency in the District.

Other Fund Balance Reserves

Fiscal Stabilization Reserve

The fiscal stabilization reserve may be used by the Mayor for the same purposes for which the contingency reserve was established. However, this reserve may not be used for cash flow management purposes. At full funding, the fiscal stabilization reserve must equal 2.34% of the District's General Fund operating expenditures for each fiscal year.

Cash Flow Reserve

The cash flow reserve may be used by the District's CFO as needed to manage the District's cash flow. When a portion of the reserve is used to meet cash flow needs, this reserve must be replenished in the same fiscal year the amounts were used. At full funding, the cash flow reserve must equal 8.33% of the General Fund operating budget for each fiscal year.

District Accounting and Financial System

Accounting System

The District's accounting system is organized and maintained on a fund basis. A fund is a separate, distinct accounting entity that has its own assets, liabilities, equity, revenues, and expenditures/expenses. The District uses generally accepted accounting principles (GAAP) when determining the types of funds to be established and is guided by the "minimum number of funds principle" and sound financial management practices when determining the number of funds within each fund type.

Measurement Focus and Basis of Accounting

The District's financial statements are prepared in accordance with GAAP. Accordingly, the measurement focus and basis of accounting applied in the preparation of government-wide financial statements and fund financial statements are as follows:

- The government-wide financial statements focus on all of the District's economic resources and use the full accrual basis of accounting.

- Fund financial statements focus primarily on the sources, uses, and balances of current financial resources and use the modified accrual basis of accounting.

- Specialized accounting and reporting principles and practices apply to governmental funds. Proprietary funds, component units and pension trust funds are accounted for in the same manner as business enterprises.

- The budgetary basis of accounting is used to prepare the budgetary comparison statement presented in Exhibit 2-d found on page 49. This basis of accounting differs from the GAAP basis as described below:

  - ***Basis Differences*** - The District uses the purchase method for budgetary purposes and the consumption method for GAAP basis accounting for inventories. Under the purchase method, purchases of inventories are recognized as expenditures when the goods are received and the transaction is vouchered. Under the consumption method, an expenditure is recognized only when the inventory items are used rather than purchased.

  - ***Entity Differences*** - This basis relates to inclusion or exclusion of certain activities for budgetary purposes as opposed to those included or excluded on a GAAP basis for reporting purposes. Such activities primarily include the following as reported in Exhibit 2-d found on page 49:

    1. Fund balance released from restrictions
    2. Proceeds from debt restructuring
    3. Accounts receivable allowance
    4. Operating surplus from enterprise funds

  - ***Perspective Differences*** – Perspective differences exist when the structure of financial information for budgetary purposes differs from the fund structure that is used to construct the basic financial statements. The District does not have any significant budgetary perspective differences that limit its ability to present budgetary comparisons of its general fund. The District's *Budgetary Comparison Statement* is presented as part of the basic financial statements in Exhibit 2-d on page 49.

  - ***Timing Differences*** – Timing differences can exist when there are significant variances between budgetary practices and GAAP, which may include continuing appropriations, project appropriations, automatic re-appropriations, and biennial budgeting. The District has no significant timing differences between its budgetary practices and its GAAP presentation of its financial statements.

Transparency in Financial Reporting

The OCFO continues to promote openness in government and transparency in financial reporting. Over the last decade, the District has opened its books to the public by posting online the annual operating budget and capital plan, the comprehensive annual financial report, and the popular annual financial report. In addition, the OCFO's website provides information that allows taxpayers to review and assess the District's financial status, programs, activities and services, and determine how their tax dollars are being used. This information includes: monthly cash collection reports; debt management policy and data regarding bond issuances; monthly reviews of economic trends; other economic indicators and reports; CFO News (including press releases and Council Hearing written testimonies); and links to other useful information, such as the Taxpayer Service Center, the D.C. College Savings Plan, Unclaimed Property Division, and the Office of Contracting and Procurement.

In addition, CFOInfo, a District government OCFO financial web portal, presents data on actual expenditures for at least the two most recent fiscal years, the current fiscal year's approved budget, and the budget for the upcoming fiscal year. Users can view data in graphical or tabular format and may create comparisons and cross tabs for more detailed analyses. CFOInfo may also be used to access data regarding operating budgets, special purpose revenue, capital budgets, and the current year financial status.

In recent years, the District broadened its efforts to be transparent in financial reporting by creating the website, www.recovery.dc.gov, which offers a wealth of information regarding the District's receipt and use of federal Stimulus funds. This website allows the general public to track the District's receipt and use of such funds (by project category and District agency) and provides information on how District residents may access the benefits associated with Stimulus funds.

ECONOMIC CONDITION AND OUTLOOK

The District's job market gained strength between FY 2011 and FY 2012 and the city realized stronger than expected revenue in both years. Despite a brightening of the District's economic and fiscal outlook, certain risks continue to "cloud" the District's future economic and financial outlook. Federal cutbacks continue to pose the most serious threat to the District's economy and finances. Significant federal cutbacks would most likely tip the national economy into another recession, the effects of which would trickle down to the local economy. Although the federal government cushioned the District and the metropolitan area from the worst effects of the national recession over the past four years, it can no longer be considered a source of real growth as we look to the future.

The possibility of federal government cutbacks is not the only threat to the District's economy. Key issues in the European debt crisis remain unresolved. Moreover, the District's economy may potentially be negatively impacted by disruptions to oil supplies stemming from current Middle East instability and a downturn in the still fragile national economy.

Highlights: The District's Economy

Highlights regarding the District's economy in FY 2012 are presented below:

- Since January 2012, growth in wage and salary jobs located in the District has slowed; however, resident employment has been on the rise in recent months.
- In July 2012 (the start of the third quarter), there were 8,033 (1.1%) more wages and salary jobs located in the District than a year earlier, all in the private sector, as measured by a three-month moving average. There were 3,500 (1.6%) fewer federal government jobs in July 2012 than there were a year earlier. Health services accounted for almost half of the District's net job growth over the past year.
- District resident employment was 15,729 in July 2012 which was 5.1% more than a year earlier. The unemployment rate declined to 8.8%, down from 10.5% a year earlier.
- Housing slowed in recent months. Single family sales for the three-month period ending August 2012 were down 0.5% from a year ago, and there was a 0.1% decrease in the average selling price.
- Condominium sales over the three-month period ending August 2012 were up 17.9% and the average price was 1.6% higher. The value of all home sale contracts for the three-month period was 5.7% more than a year ago.
- Tax collections for FY 2012 have been quite strong, with individual income, sales, and business taxes all showing significant growth.

Key Factors in the District's Economy

Population

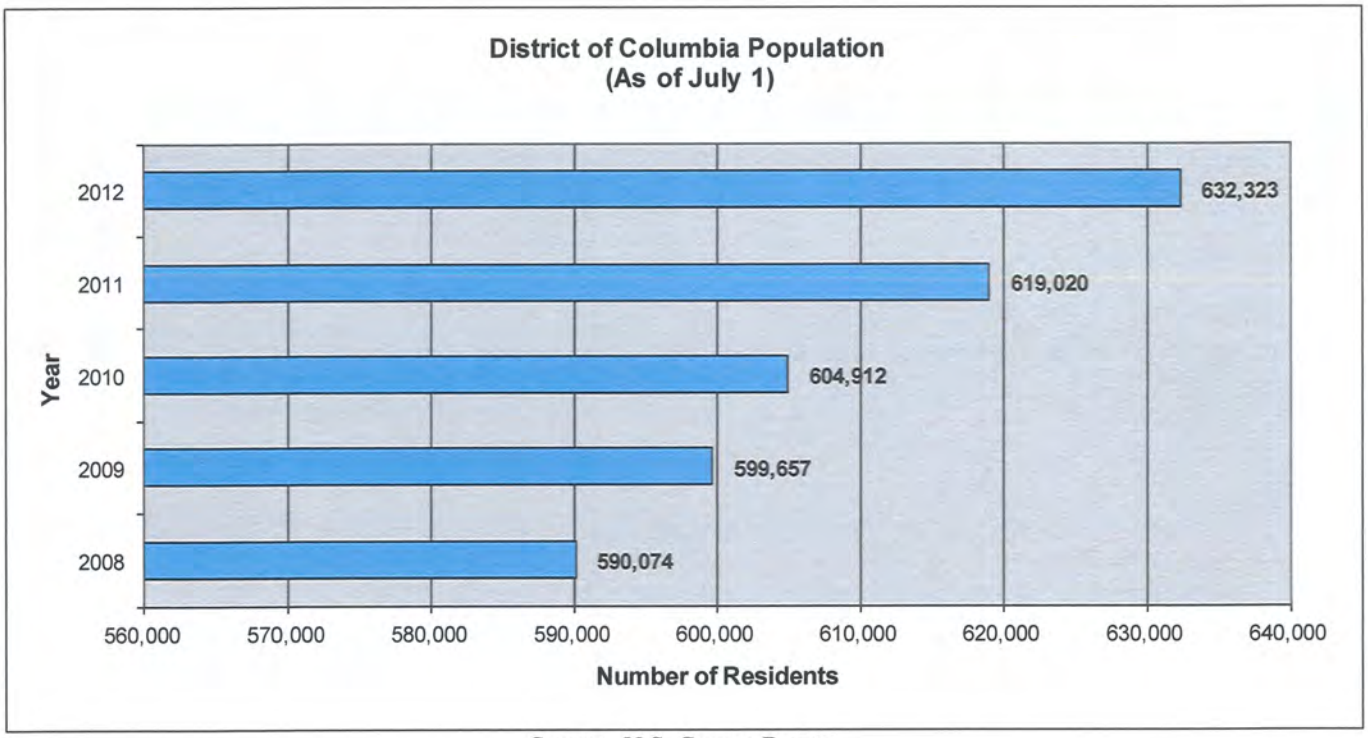
The U.S. Census Bureau estimated that there were 632,323 residents in the District of Columbia, as of July 1, 2012. This represents an increase of 13,303, or 2.1%, from the revised July 1, 2011 estimate of 619,020. Annual census estimates are based on birth and death records, changes in tax return filings, and estimates of the number of immigrants who move into the District each year. **Chart T1** presents the District's population trends for calendar years 2008 through 2012.

Income Trends

Income has grown considerably in the District in recent years. From the third quarter of 2008 to the third quarter of 2012, personal income grew approximately 13.9% in the District as compared to 7.2% nationally.

The distribution of income in the District differs from that of the nation as a whole, with higher proportions at the higher and lower ends and a smaller proportion in the middle. Median household income data is not yet available for 2012; however, for the two-year period 2010 and 2011, the District's median household income of $56,988 was 13.0% above the U.S. average. The Census Bureau estimates that 18.7% of the District's population was below the poverty line in 2011 as compared to 15.9% for all of the U.S.

Chart T1 – Population Trends (2008 – 2012)



Source: U.S. Census Bureau

Employment Trends

Total wage and salary employment in the Washington metropolitan area increased to approximately 3,023,900 in fiscal year 2012 from the revised 2,988,200 for fiscal year 2011, representing a 1.2% increase. These numbers exclude the self-employed, domestic workers, military and foreign government personnel, which represent a significant portion of the total workforce of the region. Some of the references to the 2011 employment numbers may differ from those presented in the fiscal year 2011 CAFR because of updates and revisions. **Table T2** presents 2012 labor market data for the District and the metropolitan region.

Total wage and salary employment within the District increased slightly to 24.4% of the metropolitan area's total wage and salary employment. The seasonally adjusted September 2012 unemployment rate in the District was 8.7%, compared to the September 2011 seasonally adjusted rate of 11.1%.

Total employment within the District increased to 736,600 as of September 2012 from the revised 728,400 as of September 2011. As the nation's capital, Washington, D.C. is the seat of the federal government and headquarters for most federal departments and agencies. The total September 2012 federal workforce in the Washington metropolitan area was 382,900; with approximately 209,700 federal employees located in Washington, D.C. and 173,200 additional federal employees who worked elsewhere in the Washington metropolitan area.

Minimum Wage Rate

District law requires that the minimum wage rate for District employees be at least $1.00 per hour more than the Federal minimum wage. Beginning on July 24, 2009, the Federal minimum wage rate was increased to $7.25 per hour and has not been revised since that time. Therefore, effective July 24, 2009, the District's minimum wage rate increased to $8.25 per hour and has remained unchanged through calendar year 2012.

Table T2– 2012 Labor Market Data for the District and Surrounding Metropolitan Area

Labor Market (000s): FY 2012

Item	District of Columbia Level	District of Columbia 1 yr. change (number)	District of Columbia 1 yr. change (%)	Metropolitan Area Level	Metropolitan Area 1 yr. change (number)	Metropolitan Area 1 yr. change (%)
Employed residents	330.2	22.1	7.2	3,058.3	64.2	2.1
Labor force	361.8	17.6	5.1	3,229.2	46.8	1.5
Total wage and salary employment	736.6	8.2	1.1	3,023.9	38.2	1.3
Federal government	209.7	-2.6	-1.2	382.9	-1.5	-0.4
Local government	34.3	0.2	0.6	292.6	4.4	1.5
Leisure & hospitality	63.5	1.7	2.8	284.7	8.0	2.9
Trade	23.5	0.9	4.0	283.6	-36.9	-11.5
Education and health	123.7	6.9	5.9	374.8	11.6	3.2
Prof., bus., and other services	217.9	0.2	0.1	883.2	9.4	1.1
Other private	64.0	0.9	1.4	522.1	43.2	9.0
Unemployed	31.7	-4.6	-12.6	170.8	-17.4	-9.3
New Unemployment Claims **(a)**	1.9	-0.1	-6.9			

Sources: U.S. Bureau of Labor Statistics (BLS) & D.C. Dept. of Employment Services (DOES)

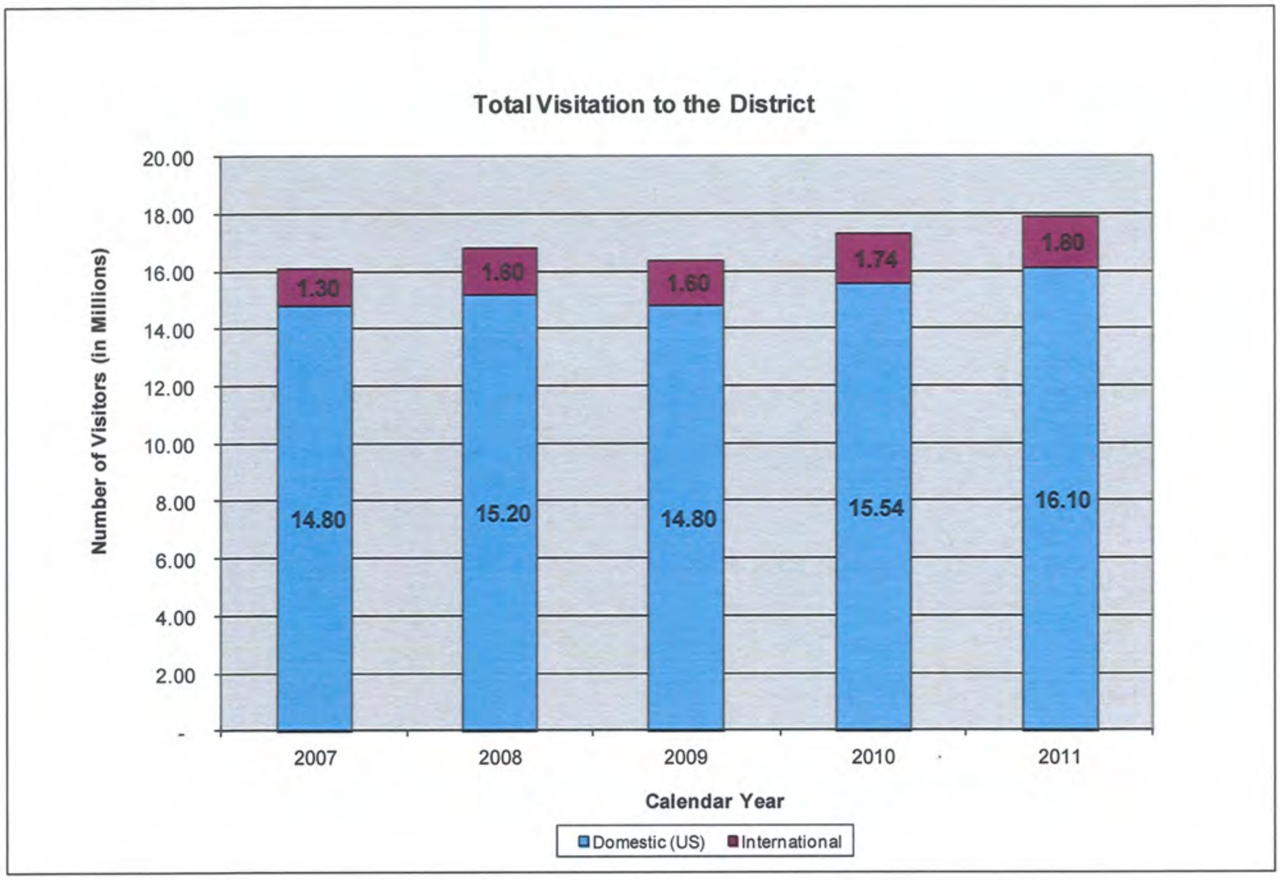
All data are monthly averages for the fiscal year and are preliminary, not seasonally adjusted.

Tourism and Hospitality

Millions of U.S. citizens and international tourists visit the District's more than 400 museums and other historical landmarks each year. Popular attractions include sites along the National Mall, numerous monuments to U.S. presidents, war memorials, and other museums. The presence of a large number of foreign embassies, recognized diplomatic missions, and other international organizations in the District helps to boost tourism. In calendar year 2011, approximately 16.1 million domestic visitors and 1.8 million international visitors traveled to the District. During calendar year 2011, the District maintained its position as the seventh most visited destination in the U.S. for international travelers. **Chart T2** presents the trends in tourism for calendar years 2007 through 2011. Tourism data for calendar year 2012 is not yet available.

Visitor spending, which totaled approximately $6.03 billion in 2011, generated additional business activity in related industries (*e.g.,* hotel, restaurant, and retail) and continues to help sustain the local and regional economies. The distribution of visitor spending in 2011 (by category) was as follows: $2.13 billion for Lodging; $1.63 billion for Food and Beverage; $994 million for Entertainment; $698 million for Shopping/Retail; $103 million for Air Transportation; and $473 million for Other Transportation. Total visitor spending increased by 34 million, or 6.0%, over the prior year. Hotel occupancy was approximately 75.3% at September 30, 2012. Travel and tourism supported more than 76,256 jobs in the District, generating approximately $3.06 billion in wages.

Chart T2 – Trends in District Tourism (2007 – 2011)



Source: Data compiled by Destination DC (formerly the Washington Convention and Tourism Corporation)

Construction - Commercial Real Estate

Construction of commercial real estate continued to show signs of recovery during calendar year 2012. At the end of 2012, commercial space under construction was up 13.5% over the prior year. Nonetheless, during the year, leased space decreased by 210,000 square feet and, the vacancy rate (including sublet) within the District increased from 8.7% at the end of 2011 to 9.3% at the end of 2012.

Construction – Housing Units

For the 12-month period ending September 2012, 4,091 housing unit building permits were issued. This represents a 66.4% increase over the prior 12-month period. **Table T3** presents the number of apartment units located in the District in 2008 through 2012.

Table T3 - District Apartment Units (2008 – 2012)

	2008	2009	2010	2011	2012
Inventory	85,427	87,090	87,970	88,710	89,464
Occupied Units	81,521	81,964	82,965	84,125	85,551

In calendar year 2012, there were 89,464 apartment units in the District, of which 85,551, or 95.6%, were occupied. It is anticipated that approximately 3,980 new apartment units will be added to the inventory between calendar years 2012 and 2013, and occupancy will grow by 4,438 units.

AMERICAN RECOVERY AND REINVESTMENT ACT (STIMULUS ACT)

On February 17, 2009, the American Recovery and Reinvestment Act (ARRA), or federal "Stimulus Bill" was signed into law. The Stimulus Bill was created to jump start the economy, preserve existing jobs, create new employment opportunities, and promote economic recovery throughout the country. Stimulus funding was made available for investments in infrastructure, energy efficiency, science, and state and local fiscal stabilization.

The District received stimulus funding for a variety of activities, including: road and bridge construction; public transportation improvements; energy efficiency and environmental projects; health care and health research; education; and public safety. Total stimulus operating expenditures were approximately $48.7 million in fiscal year 2012, which was approximately $157 million, or 76.3% less than the amount of such expenditures in the prior year. Although this reduction was significant, it was anticipated given the defined period during which stimulus funding was available. For that reason, this reduction did not significantly impact the District's ability to provide programs and services. In many instances, new sources of funding were identified to cover specific programs and activities or portions of costs associated with programs/services were assumed by the general fund. Approximately $39.1 million, or 80.2%, of the stimulus operating expenditures was made by the following agencies: Department of Health (10.7%), Office of the State Superintendent for Education (41.5%), Department of Housing and Community Development (15.1%), and District Department of the Environment (12.9%).

In fiscal year 2012, total stimulus capital expenditures were approximately $38.4 million, of which approximately $20.6 million, or 53.7%, was made by the District Department of Transportation.

THE DISTRICT'S BOND RATINGS

Rating agencies assess the credit quality of municipal issuers and assign a credit rating to the issuer based on the outcome of their assessments. Consequently, rating agencies provide vital information to investors regarding the relative risks associated with rated bond issues. Attaining an acceptable credit rating is important to an issuer because it allows the issuer to more easily access the market.

The three primary agencies that rate municipal debt are: (1) Fitch Ratings; (2) Moody's Investors Service; and (3) Standard & Poor's Rating Service. **Table T4** presents the District's bond ratings from these rating agencies for the past five years. The District's ratings for its general obligation bonds have remained high over the last several years. As a result, the District has been able to access the market and issue bonds more cost effectively.

During fiscal year 2009, the District issued its first Income Tax Secured Revenue Bonds. These bonds are special obligations of the District, payable solely from the Trust Estate pledged under the indenture. The bonds are without recourse to the District, and are not a pledge of, and do not involve, the faith and credit or the taxing power of the District (other than the pledge of the available tax revenues made by the indenture and the Act). The bonds do not constitute a debt of the District, or lending of the public credit for private undertakings. As presented in **Table T4**, the District's ratings for its Income Tax Secured Revenue Bonds continued to be high in fiscal year 2012.

Table T4 – Bond Rating History (Last Five Fiscal Years)

	General Obligation Bonds				
	2008	2009	2010	2011	2012
Fitch Ratings	A+	A+	AA-	AA-	AA-
Moody's Investors Service	A1	A1	Aa2	Aa2	Aa2
Standard & Poor's Rating Service	A+	A+	A+	A+	A+

	Income Tax Secured Revenue Bonds			
	2009	2010	2011	2012
Fitch Ratings	AA	AA+	AA+	AA+
Moody's Investors Service	Aa2	Aa1	Aa1	Aa1
Standard & Poor's Rating Service	AAA	AAA	AAA	AAA

Note: The District issued its first series of Income Tax Secured Revenue Bonds in 2009.

OTHER FACTORS AFFECTING THE DISTRICT'S FINANCIAL POSITION

The District, as the central urban location of a large metropolitan area, houses a disproportionately large share of the area's poor and needy population. The District's overall poverty rate of 18.7% and child poverty rate of 30.4% are significantly higher than the U.S average and that of neighboring counties in Maryland and Virginia. Unlike other urban jurisdictions, the District cannot pool resources across suburban areas to serve its urban poor. Yet, it must provide state-level services such as healthcare, housing and welfare, largely through its own resources.

Moreover, the costs of delivering services to District residents are high. Labor costs in the District are 21% above the national average for public services, and the costs associated with acquiring capital goods and services are 55% above the national average. The high cost of delivering services to a large population in need of healthcare, housing, welfare and other similar services or assistance severely strains the District's financial resources. It has been estimated that if the District were to offer a basket of public services that prevail as "average" among all the state and local governments, it would have to spend 31% more than the national average to deliver it.

The District's ability to pay the high costs of service delivery is limited by several federally mandated restrictions. The federal government has restricted the District's tax base by prohibiting the taxation of federal real property. However, the federal government does not provide a Payment in Lieu of Taxes to compensate for this lost tax revenue. In addition, the Home Rule Act prohibits the District from taxing nonresident income. This prohibition significantly reduces the District's income tax base because approximately 55% of the amounts earned in the District of Columbia cannot be taxed.

As a result of these restrictions on the District's tax revenue collections, District residents must bear a disproportionate share of the costs of public services, while the benefits generated by the District are shared by a much larger community. Under slower revenue growth scenarios, District services could become severely impaired.

The U.S. Government Accountability Office (GAO), in its report entitled, "District of Columbia – Structural Imbalance and Management Issues," described the impact of the high cost of living, high poverty and crime rates, and limited tax base on the District's financial operations and estimated the range of the District's structural deficit to be between $470 million to $1.1 billion annually. Although the GAO's report, which was issued in May 2003, discusses conditions that existed at that time, the District's financial operations continue to be negatively impacted by the conditions reported.

LONG-TERM FINANCIAL PLANNING

As a result of improved financial management practices over the years, the District has been able to develop and operate within more disciplined budgets and address issues faced during challenging economic times. Across the nation, economic recovery has been slow and the District has not been immune to the lingering effects of the national recession.

District officials have developed and implemented a plan for maintaining a strong, stable financial environment, which includes:

- Monitoring and analyzing the District's quarterly revenue estimates and making spending adjustments throughout the year, as necessary;
- Identifying sound measures to enhance revenue streams; and
- Developing and implementing plans to minimize costs without sacrificing essential programs or services.

MAJOR INITIATIVES

Many initiatives and projects have been completed, in progress, or planned to help sustain the District's economy and produce strong financial results. Several of the District's major initiatives and projects are discussed briefly below:

- **Pennsylvania Avenue Great Streets Project:**

  The Pennsylvania Avenue Great Streets Project, which began in November 2009, was substantially completed during fiscal year 2012, with only seasonal planting and other "punch list" items remaining.

  The Pennsylvania Avenue Great Streets Project covers two miles, from 200 feet west of 27th Street, S.E. to Southern Avenue, S.E. on the Maryland border. It runs through the historic neighborhoods of Fairlawn, Randle Highlands, Hillcrest, and Fairfax Village. A portion of the corridor was reduced from five lanes to four. In its place, the District Department of Transportation (DDOT) added a landscaped median and turn pockets that protect pedestrians and neighborhood vehicles. Special streetscape treatments were designed to highlight and enhance the retail nodes along the corridor, and DDOT completed the sidewalk network on both sides of the street for the full length of the corridor. This project also includes multiple Low Impact Development (LID) features, including three environmentally friendly rain gardens. Rain gardens are a method of treating storm runoff by utilizing a mixture of soil and plants to filter out pollutants prior to the runoff entering storm-sewer systems, and local waterways.

This $35.8 million project has dramatically improved this corridor, making it safer for pedestrian and vehicular traffic and much more visually appealing. The District's Great Streets Initiative provided approximately $11 million for the project, and $19.5 million was provided by the American Recovery and Reinvestment Act (ARRA) of 2009. The remainder came from other local and federal sources. The Great Streets Program is a partnership between DDOT, the Office of the Deputy Mayor for Planning and Economic Development, and the Office of Planning.

- **U.S. Department of Homeland Security Headquarters (St. Elizabeth's West Campus)**:

In September 2009, the U.S. Department of Homeland Security (DHS) and the U.S. General Services Administration broke ground for the $3.4 billion consolidated DHS headquarters. DHS is building its headquarters on the west campus of the old St. Elizabeth's Hospital located in Southeast Washington, D.C. The first phase of this project is the new energy-efficient, 1.18 million square foot Coast Guard headquarters facility. Occupancy of the new Coast Guard headquarters facility is slated to begin in 2013.

When completed, the DHS headquarters will house approximately 14,000 employees working in the following DHS components: Transportation Security Administration, Customs and Border Protection, Immigration and Customs Enforcement, and the Federal Emergency Management Administration.

- **CityCenter DC**

Construction began in March 2011 on CityCenter DC, a $700 million complex with 2.5 million square feet of office, residential, and retail space as well as a public plaza and park. Completion of most of the planned project is slated for late 2013.

The principal owner of the CityCenter DC project is the Qatari Diar Real Estate Investment Company. This real estate arm of the Persian Gulf state of Qatar made a $620 million equity investment in the project.

CityCenter DC will include six buildings (two for apartments, two for condominiums, and two for offices), each 10 or 11 stories in height, in keeping with the District's 130-foot height restriction. The six buildings will be connected by a public courtyard. There will be 458 apartments, 216 condominiums, 185,000 square feet of retail space, 515,000 square feet of office space and four levels of underground parking. A luxury hotel is also planned for the project's second phase.

- **Convention Center Hotel**

On November 10, 2010, the District broke ground on the 14-story Washington Convention Center Marriott Marquis Hotel. One of only four Marriott Marquis properties in the country, the hotel will have 1,175 rooms (including 46 suites) and more than 53,000 square feet of meeting space. The hotel will feature an elegant lobby and five separate retail and restaurant outlets on the ground floor; a 30,000-square foot grand ballroom; two 10,800-square foot junior ballrooms; an 18,800-sqaure foot indoor event terrace; and a 5,200 square foot rooftop terrace.

The estimated cost of this project is $520 million. District officials approved $206 million in funding for the hotel during the summer of 2010 and the developer secured financing from private investors. The four-star boutique-style hotel, a mix of glass and steel, is scheduled to open in the spring of 2014.

The project will create about 1,600 construction jobs and more than 1,000 jobs at the hotel when completed.

- **D.C. Streetcar**

The District plans to build a $1.5 billion network of eight streetcar lines throughout the city by 2020, providing transit links in areas currently lacking Metrorail access. Construction on the project began in 2008. The first two lines, H Street/Benning Road in Northeast and Martin Luther King Boulevard in Anacostia, are scheduled to begin ferrying riders during 2013.

Approximately 80% of the construction for the H Street/Benning Road line was completed in 2011 as part of the Great Street project. The remaining 20% of the work began in December 2012.

Construction activities along the Anacostia Corridor are also progressing. The Anacostia Initial Line Segment is a 1.1 mile planned streetcar line connecting the Anacostia Metro Station with the Joint Base Anacostia-Bolling. This line will include a storage yard and maintenance facility. This segment will be used as a testing and commissioning track for streetcar vehicles prior to being put into service.

The District purchased its first "modern streetcars" in late 2009. These cars are approximately eight feet wide and approximately 66 feet long, about 10 inches narrower than and one-third the length of a light rail double car train. The modern streetcars are able to operate in mixed traffic and can easily accommodate existing curbside parking and loading.

The District's existing vehicles will be stored at the Anacostia facility with vehicle testing and commissioning slated to begin in mid-to-late February 2013.

Several District projects and initiatives have been implemented with a focus on protecting the environment. Two of these initiatives are described more fully below:

- **Capital Bikeshare:** In September 2010, the District launched Capital Bikeshare, a regional bike sharing network of 1,100 bicycles throughout the District, and Arlington, Virginia. Bikes are docked at bike stations in the District and Arlington, where they remain locked to racks until a Capital Bikeshare member releases one for use. Anyone can become a Bikeshare member by paying the following fees: for 24 hours, $5; for 30 days, $25; or for a full year, $75.

  Members who sign up for longer than a day receive palm-size bar-coded cards. These cards are slipped into a slot to release a bike. The first 30 minutes of each ride are free, after which the charges are: $1.50 for the next 30 minutes; $3 for the third half-hour; and $6 for each 30-minute period after that.

  Amounts owed are billed to the member's credit card and $1,000 is charged if a bike is not returned within 24 hours. The billing system is activated with the insertion of the bar-coded membership card at the bike station, and another insertion when the bike is returned, both of which are transmitted to Bikeshare headquarters through a wireless, solar-powered communications network.

  Each station begins the day with about 10 bikes and five empty docking spaces. On the Capital Bikeshare Website, a click of the mouse on each station reveals the number of bikes which are available at any given moment, and the number of docking stations which are open for those who want to return a bike. Capital Bikeshare is the nation's largest program of its type. Members of Congress are encouraging the National Park Service to allow Capital Bikeshare stations on the National Mall to offer an innovative, cost-effective and environment-friendly transportation service for the millions of people who visit the National Mall annually.

- **Anacostia River Clean Up and Protection Fund/ Carryout Bag Fees:** During fiscal year 2010, the District established the Anacostia River Clean Up and Protection Fund, which is to be used solely to fund efforts to clean and protect the Anacostia River and the other impaired waterways.

  In January 2010, to help fund such efforts, the District began levying a five-cent "bag tax" on District consumers. A consumer making a purchase from a retail establishment within the District must pay, at the time of purchase, a fee of five cents for each disposable carryout bag he or she receives. During fiscal year 2012, the District collected approximately $2.0 million in bag taxes. Since the inception of the tax in 2010, the District has collected more than $5.3million in such taxes.

The District also makes every effort to implement initiatives that will enhance service to District residents and the general public. Over the last several years, the District has introduced numerous innovative initiatives to improve service delivery, some of which included the following:

- **Pay-By-Phone Parking.** The Pay-By-Phone Parking initiative, designed to make parking in the District more convenient, was implemented in fiscal year 2011.

  The District Department of Transportation rolled out the pay-by-phone parking program on a District-wide basis to enable residents, workers, and visitors to use their mobile telephones to pay for parking at all of the District's approximately 17,000 on-street metered spaces. Pay-by-phone parking gives drivers another convenient payment option. Instead of feeding cash or a credit card into a meter, transactions may be completed by telephone, on the Internet, or by using a mobile application ("app") (available for the iPhone, Android, and Blackberry).

- **<u>DC311 Smartphone App:</u>** In April 2012, the District launched the DC311 free smartphone app, which may be used by residents to report up to 80 different common, non-emergency quality-of-life issues, such as potholes, graffiti, downed trees, and streetlight outages. The DC311 app may also be used to upload pictures and track the status of requests made. In addition, a mapping function may be used to determine where requests have been made.

  The DC311 Smartphone App, together with the Citywide Call Center and 311 Online, offer ways by which the community can report non-emergency problems that need to be rectified. Information from each of these sources is funneled into one centralized database for monitoring and resolution.

Additional information about these and other initiatives within the District may be obtained from the following:

- **Office of the Deputy Mayor for Planning & Economic Development**
  John A. Wilson Building
  1350 Pennsylvania Avenue, N.W., Suite 317
  Washington, D.C. 20004
  Telephone: (202) 727-6365
  Website: http://dcbiz.dc.gov

- **District Department of Transportation**
  55 M Street, S.E., Suite 400
  Washington, D.C. 20003
  Telephone: (202) 673-6813
  Website: http://ddot.dc.gov

- **Office of Planning**
  1100 Fourth Street, S.W., Suite E650
  Washington, D.C. 20024
  Telephone: (202) 442-7600
  Website: http://planning.dc.gov

- **Department of Parks and Recreation**
  3149 16th Street, N.W.
  Washington, D.C. 20010
  Telephone: (202) 673-7647
  Website: http://dpr.dc.gov

- **Department of General Services**
  2000 14th Street, N.W., 8th Floor
  Washington, D.C. 20009
  Telephone: (202) 727-2800
  Website: http://dgs.dc.gov

- **U.S. General Services Administration**
  1800 F Street, N.W.
  Washington, D.C. 20405
  Telephone: (202) 501-0705
  Website: http://www.gsa.gov

AWARDS AND ACKNOWLEDGMENTS

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the District of Columbia for its comprehensive annual financial report (CAFR) for the fiscal year ended September 30, 2011. The District has received this award for twenty-eight of the last thirty years. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that the fiscal year 2012 CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The District also earned an award from GFOA for Outstanding Achievement in Popular Annual Financial Reporting (PAFR) for the fiscal year ended September 30, 2011, for the ninth consecutive year. The PAFR presents the District's financial results in a format and language that allows information to be more easily understood by the general public. The PAFR is not required to present the same level of detail as the CAFR. It contains very few financial statements, less technical language, and more graphics and photographs.

Like the Certificate of Achievement, the Award for Popular Annual Financial Reporting is valid for one year only. The District expects that the fiscal year 2012 PAFR, which will be issued within 30 days after the CAFR is completed, will conform to the Award for Popular Annual Financial Reporting Program requirements. It will also be submitted to the GFOA to determine its eligibility for another award.

Acknowledgments

I would like to thank the District's accounting and financial management personnel who worked collaboratively with the Office of Financial Operations and Systems throughout the year. I greatly appreciate their efforts, which contribute significantly to the timely preparation of the CAFR. I want to thank my immediate staff, *Bill Slack, Diji Omisore, Tonja Lowe, Wilma Matthias, Vanessa Jackson,* and their respective teams. I am grateful for their dedicated efforts. I would also like to thank the Office of the Inspector General, and the District's independent auditors, KPMG LLP, assisted by Bert Smith & Company, for their efforts throughout the audit engagement.

Respectfully submitted,

Anthony F. Pompa
Deputy Chief Financial Officer
Financial Operations and Systems