Government of the District of Columbia
Office of the Chief Financial Officer

Natwar M. Gandhi
Chief Financial Officer

December 29, 2010

The Honorable Adrian M. Fenty
Mayor of the District of Columbia
1350 Pennsylvania Avenue, NW – 6th Floor
Washington, DC 20004

The Honorable Vincent C. Gray
Chairman
Council of the District of Columbia
1350 Pennsylvania Avenue, NW – Suite 504
Washington, DC 20004

Dear Mr. Mayor and Chairman Gray:

I would like to inform you that the revenue estimate for FY 2011-FY 2015 remains unchanged from the September 2010 certification.[1] Table 1 below presents the revenue estimate from the September certification.

Table 1: September 2010 revenue estimate compared to previous estimate

Local Source, General Fund Revenue Estimate ($ millions)	Actual FY 2009	Estimate FY 2010	FY 2011	FY 2012	Projected FY 2013	FY 2014	FY 2015
February 2010 Revenue Estimate	**5,050.6**	**5,164.4**	**5,029.1**	**5,120.8**	**5,257.5**	**5,398.3**	
Legislative and administrative changes to revenues		24.6	101.4	81.3	81.4	93.2	
February 2010 estimate TOTAL	**5,050.6**	**5,189.1**	**5,130.5**	**5,202.1**	**5,338.9**	**5,491.6**	
Percent growth over previous year	*-5.2%*	*2.7%*	*-1.1%*	*1.4%*	*2.6%*	*2.9%*	
Change from prior		-45.4	-99.8	-38.3	-33.7	-89.7	
September 2010 Revenue Estimate	**5,050.6**	**5,143.7**	**5,030.7**	**5,163.8**	**5,305.2**	**5,401.8**	**5,539.3**
Percent growth over previous year		*1.8%*	*-2.2%*	*2.6%*	*2.7%*	*1.8%*	*2.5%*

Since the September revenue certification, most economic indicators, including the latest cash collections report, show that the national and local economies are in recovery. However, these indicators also show that the pace of the recovery remains slow and a great deal of uncertainty still clouds forecasts of both the national and local economies. In addition to the uncertainty of the current economic environment, there are several reasons to wait until next quarter to reassess the revenue forecast.

[1] Note that the September revenue estimate includes an estimated $22 million in additional corporate franchise tax revenue in FY 2012 and beyond from the implementation of combined reporting requirements for District corporations. The FY 2010 Budget Support Act of 2009 requires that legislation necessary to implement combined reporting be enacted. Since no such legislation has been enacted in the 18th Legislative Session, the revenue projections for Fiscal Year 2012 will immediately be reduced by $22 million.

First, the latest cash collections report does not reflect the performance of the real property tax, which has surpassed the individual income tax as the single largest source of revenue for the District in recent years. This is because first half real property tax payments for the fiscal year are not due until March 2011. In January, there will be information on the real property tax bills that will be sent out for FY 2011 and we will have a first look at real property assessments that will be the basis for FY 2012 real property tax revenue.

Second, the latest report of cash collections reflects only the first two months of the new fiscal year. The report shows that year-to-date tax revenue is growing once more; in particular, the taxes that are paid monthly—the withholding, sales and use, and deed taxes—show a lot of strength. However, the fragility of the economic recovery requires that we remain cautious. Also, next quarter there will be at least a full quarter of revenue collections to review, and we will be better able to assess the sustainability of the recovery.

Finally, next quarter the Comprehensive Annual Financial Report (CAFR) will be completed and we will have accurate results of how each revenue source performed in FY 2010, the base year, from which growth will be projected for FY 2011 and beyond.

Overview

Although U.S. economic indicators since the September 2010 revenue estimate show an economy in recovery, the results have been mixed. Growth in the national economy, though positive, has picked up only slightly, and there has been little net change in U.S. employment. In the past three months, by contrast, the stock market gained almost 10% in value. The District economy has shown gains in recent months, as federal government employment has increased, the unemployment rate has fallen, and the commercial office building vacancy rate has declined. Still, the District's unemployment rate remains close to 10%, and most of the private sector remains weak. The mixed economic news for both the national and District economies are accompanied by considerable uncertainty, which clouds the outlook for FY 2011.

Revenue Highlights

Sales and Excise Taxes
Sales tax revenue collections have had several months of solid performance, mostly making up for the shortfall in the winter caused by the snowstorms. A pickup in hotel and restaurant portion of the sales tax revenue particularly contributed to what is expected to be slightly positive growth in the overall sales and use tax revenues in FY 2010.

Individual and Corporate Income Taxes
Preliminary data on FY 2010 show that the non-withheld portion of the individual income tax was the lowest since 1980, representing the impact of the recession, and in particular the stock market collapse, on capital gains. Similarly, corporate franchise tax revenue is below last year's level by approximately 6%.

Deed Recordation and Deed Transfer Taxes

Deed taxes as early as May were about 12% behind FY 2009 but a strong summer in commercial property sales reversed the trend and now revenue from deed taxes is expected to finish FY 2010 at least 10% higher than the previous year. There were several significant sales that contributed to this reversal, showing that the District is still seen as one of the strongest commercial office markets in the country.

National and Regional Economies

While the longest and deepest U.S. recession since the 1930's has officially ended, the recovery has been remarkably slow. Real GDP has now registered five quarters of positive growth, but growth in the most recent quarter ending in September was only 2.5%. Because growth to this point has been strongly influenced by the national stimulus program and by inventory replenishment, the outlook for sustained recovery in the future remains uncertain.

- U.S. employment (seasonally adjusted) gained only 187,000 jobs (0.1%) from August 2010 to November 2010. The number of U.S. wage and salary jobs in November was 7.4 million (5.4%) less than at the start of the recession in December 2007. The U.S. unemployment rate (seasonally adjusted) was 9.8% in November, up from 9.6% in August.
- Wages and salaries earned in the U.S. in the September quarter were 2.8% above those of a year ago, and personal income was 3.6% higher. However, wages and salaries earned in the U.S. in the September 2010 quarter were 1.9% lower than they were two years earlier.
- The S & P 500 stock market index in November was 10.3% above its level in August, a rebound that brought the market back to a level almost exactly equal to where it was this past April. The market in November was 10.2% higher than a year earlier, but was still 22.1% below its October 2007 peak.

The District's economy is strongly influenced by its position as the central city of one of the best performing metropolitan areas in the country (D.C. accounted for 23.8% of the Washington metropolitan area's wage and salary employment and 10.5% of its resident employment in the September quarter). During the U.S. recession, the entire region has benefitted greatly from the presence of the federal government, which is the source of jobs from both direct federal hiring and contracts. Metropolitan area employment has rebounded over the past few months and is now above last year's level, though still below the comparable period of 2008.

- In the 3-month period ending October 2010, the region gained 38,200 (1.3%) wage and salary jobs compared to a year earlier; about three-quarters of the gain was in the private sector. Total employment was, however, still 26,500 (-0.9%) below the level of October 2008.
- In the 3-month period ending October 2010, resident employment in the region was 19,400 (0.7%) above a year earlier.
- Regional unemployment was 5.8% in July, down from 6.3% a year earlier. The October unemployment rate in the D.C. area was the lowest among the nation's major metropolitan areas.

The District's Economy

D. C. economic indicators are showing some signs of improvement.

- In the 3-month period ending October 2010, there were about 14,600 (2.1%) more wage and salary jobs located in D.C. than a year earlier. The federal government gained 9,700 (4.8%) over the past year, while local government lost 6,700 (a 15.2% decline that reflects the impact of the summer jobs program). The private sector gained 11,500 (2.5%), but the increases were concentrated in the relatively low wage miscellaneous business services category.
- D.C. resident employment in the 3-month period ending in October was 4,300 (1.5%) more than a year earlier. The labor force decreased over the year, but only by 0.2%. On a seasonally adjusted basis, D.C.'s unemployment rate fell from 11.4% in October of last year to 9.7% in October 2010.
- Wages earned in D.C. grew 2.4% in the June 2010 quarter compared to the same quarter a year ago. This was considerably better than the 0.8% growth nationally in that quarter. The federal government was the major factor in recent wage growth. In the June quarter, federal wages and salaries were $1.15 billon (5.9%) higher than a year earlier, more than twice the $0.53 billion (1.6%) increase in D.C.'s private sector wages.
- During the summer, the number of housing sales declined compared with the prior year, while average selling prices moved higher. Single family sales for the 3-month period ending in October were down 22.0% from a year ago, and the average selling prices were 6.2% higher. Condominium sales in that 3-month period were down 26.0%, with average prices 8.3% higher. The value of all home sale contracts for the 3-month period ending in October was 18.2% less than a year ago.
- In the quarter ending in September, occupied office space rose by 1.5% from the prior quarter and 4.8% from the prior year. At the same time, the commercial office vacancy rate fell from 10.0% (including sublet) in June to 9.1% in September. The September vacancy rate was well below the metropolitan area average of 12.2%. An additional 2.4 million square feet are expected to be added to inventory over the next 2 years, with the District's vacancy rate decreasing slightly to 9.0%.
- For the 3-month period ending in October, the average room-rate for hotels was 8.2% higher than for the same period a year earlier, while the number of hotel room-days sold was up 5.3%. Revenues from room sales were up 13.9%.
- For the 3-month period ending in October, employment in retail was up 0.6%, employment in accommodations was up 1.1%, and restaurant employment was up 2.9%.

Economic Outlook

Over the summer, hopes that had been building about the pace of the national recovery gave way to rising uncertainty and scaled back expectations for FY 2011 and FY 2012. In the past few months, a little bit more optimism has returned to the forecasts.

- In December, the consensus of 50 economists contributing to the Blue Chip Economic Indicators forecast was that the slow, U-shaped recovery that has been occurring would pick up its pace in the coming year. The previous peak of Real GDP in the U.S. is now expected to be reached in the first quarter of 2011 (which would be the 7th consecutive quarter of growth); in September, the Blue Chip estimate was that the previous peak would not be reached until the second quarter of 2011.

- The December Blue Chip forecast for Real GDP growth in FY 2011 is 2.5%, and nominal growth is 3.9%. (A recent Blue Chip forecast for FY 2012 is not available.)
- Global Insight's November forecasts for Real GDP for FY 2011 and FY 2012 are 2.3% and 2.8%, respectively. This forecast is unchanged from August, but is an improvement over the FY 2011 outlook in their September and October estimates.

In brief, the outlook for the District of Columbia for FY 2011 and FY 2012 includes:

- Employment gains of 1,400 (0.2%) in FY 2011 and 7,100 (1.0%) in FY 2012.
- Unemployment rate of 10.1% in FY 2011 and 9.1% in FY 2012.
- Wages and salaries earned in D.C. grow 3.3% in FY 2011 and 4.0% in FY 2012.
- Wages and salaries of D.C. residents grow 4.8% in FY 2011 and 3.9% in FY 2012.
- Personal income growth of 2.7% in FY 2010 and 2.0% in FY 2012.
- The Standard and Poor's 500 stock index is forecast to decline 0.8% from the fourth quarter of 2009 to the fourth quarter of 2010, then increase 6.0% to the fourth quarter of 2011.

Risks and Uncertainties

There are still many uncertainties that could unravel the fragile state of the national economy with effects that spill over to the District of Columbia. At this point, there are more positive signals than negative, but the economy is still tenuous. Downside risks and uncertainties to this forecast include the possibility of a slowing down or reversal of national economic growth, and further financial market problems. The District would also be adversely affected by cut-backs in federal spending that affect the federal presence in the District, and national security considerations. However, the continued desire of persons to locate to D.C. appears not to have been much changed by the recession to this point and represents an up-side risk for District revenue. The National Conference of State Legislatures published a survey of state revenue forecasts recently and most of the states are now reporting positive growth and a more optimistic outlook. Growth in District revenue will still be restrained by growth in real property tax revenue, which is expected to decline next year, but revenue closely associated with real time economic trends like sales taxes and withholding of income tax appears to be recovering.

If you have any questions regarding this matter, please contact me on (202) 727-0064.

Sincerely,

Natwar M. Gandhi

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